

SUPREME COURT - STATE OF NEW YORK

Present:

HON. VITO M. DESTEFANO,

Justice

**TRIAL/IAS, PART 11
NASSAU COUNTY**

**SERGIO MAGARIK, individually and derivatively
on behalf of KRAUS USA, INC.,**

Plaintiff,

-against-

INDEX NO.:606128-15

**KRAUS USA, INC., MICHAEL RUKHLIN and
RUSSELL LEVI,**

Defendant.

Decision and Order After Trial: Findings and Conclusions

Petitioner Sergio Magarik and Respondents Michael Rukhlin and Russell Levi, are the sole shareholders of Kraus USA, Inc. ("Kraus"), an internet-based business selling fine faucets, sinks and related plumbing fixtures, primarily through retailers. Kraus does no manufacturing of the products to which a Kraus label is affixed; all items sold by Kraus are manufactured in China. Kraus does not sell items from its own website but instead sells items through links on other websites. Petitioner owns 24% of the shares of Kraus, Rukhlin owns 25% and Levi owns 51%.

The petition initially sought dissolution of Kraus and damages from the individual respondents. Pursuant to BCL 1118(a), Levi and Rukhlin elected to purchase petitioner's shares. Subsequently, all claims and counterclaims were discontinued and the sole issue tried by the court, and which is the subject of the within decision and order, is the value of petitioner's 24% interest in Kraus on September 20, 2015, the day prior to when the petition was filed (BCL 1118(b)). This necessitates that the court determine the fair value of Kraus on that date.

On November 14 and 15 2018, March 5, April 3, 4, and May 15 and 16, 2019, the court conducted the trial at which Petitioner Magarik, Respondents Rukhlin and Levi, Kraus Chief Financial Officer Daniel Lusby, and experts Randall Paulikens and Paul Marquez testified. The parties submitted post-trial memoranda and proposed findings of fact and conclusions of law, all of which have been considered herein.

In view of all the testimony and evidence presented and other submissions, the court accepts the valuation of Respondents' expert Paul Marquez, which the court finds and determines to reflect a more accurate value of Kraus and the value of petitioner's interest therein. Marquez's valuation is supported by the credible evidence which demonstrated a successful and growing business that was not especially liquid. The court does not accept the valuations provided by petitioner's expert, Randall Paulikens, as they exceeded the true value of the business, were based on income projections that were unrealistic and optimistic and not based on appropriate comparable businesses. Moreover, the two valuations provided were vastly disparate from each other, underscoring mistaken premises and assumptions. The Petitioner's request that the court

average the two incredibly disparate valuations is rejected.

Kraus was formed in 2007. In 2009, petitioner became a 20% shareholder of Kraus and in 2010, he became a 24% shareholder. To be sure, petitioner contributed substantially to the value of the business of Kraus and to its success when he worked at Kraus. The court credits his testimony in this regard despite several other false assertions contained in the petition. However, the success of Kraus, which is evidenced by Kraus' early rapid growth in sales—the evidence demonstrating that in 2012 Kraus had \$21 million in sales which rose to \$36 million in 2015, was not as great as petitioner contended (especially considering Kraus' negative cash flow) nor was it accurately predictive of future success or of the true value of Kraus. In this regard, petitioner's valuations don't sufficiently account for the competitive nature of the internet business in which Kraus participated, Kraus' lack of cash flow and they otherwise over-estimated the value of any so-called Kraus brand—which, ironically, was not even owned by Kraus but by an entity over which Kraus had no direct control.

Much of the petitioner's valuation depended upon projected earnings prepared by Kraus Controller Daniel Lusby in connection with a loan application to Bank Hapoalim B.B. ("BHI"). These projections were, put mildly, ambitious, and, in fact, were overstated. In the loan application to BHI, the parties valued Kraus at more than \$30 million. In reality, the value of the business was never \$30 million and the projections contained in the loan application were never realized. The court need not comment further on representations made by the parties to BHI in order to secure a loan, or what reliance may have been placed on such representations by BHI,

except to note that, ultimately, the representations were not accurate.

The petitioner's expert and respondents' expert both utilized income and market approaches to value the fair value of Kraus and petitioner's interest therein. As noted, Paulikens' income approach was based on unrealistic projections, proven to be unrealized and wrong; his market approach was based on incorrect comparables, to wit, public companies, not reasonably relatable to Kraus either in terms of size, ownership or marketability. Under the income approach, Paulikens gave a value to Kraus of \$21,900,000; under the market approach, Paulikens arrived at a \$38,780,000 value. In contrast, Marquez's income approach provides a range of numbers derived from capitalization of earnings (\$6.16 million) and cash flow (\$6.1 million and 5.9 million). Under the market approach ("merged and acquired company method"), relying on Pratt's Stats for additional supporting data concerning comparables and which is credited by the court, Marquez provides a range from \$5.26 million to \$6.1 million.¹ Reconciling the numbers according greater weight to the income approach, Marquez values Kraus at \$6.05 million. The court concludes that this methodology is sound and provides a realistic assessment of Kraus' fair value consistent with the credible evidence presented regarding Kraus' successful business model as well as its debt and cash flow issues.

The court also accepts application of a discount for lack of marketability ("DLOM"), recognizing that the shares of Kraus, a close corporation, cannot be readily sold on a public market (eg, *Whalen v Whalen's Moving & Storage Co.*, 204 AD2d 468 [2d Dept 1994]). The

¹The numbers are rounded here as they were by the expert and the attorneys.

court concludes that a DLOM of 5% is warranted under the circumstances. In consideration of the \$6.05 million value of Kraus, petitioner's 24% interest with 5% DLOM is \$1,379,400.²

The court applies the pre-judgment interest of 9% from the date that the petition was filed there being no additional factors to warrant imposition of a different rate or date (see Business Corporation Law 1118[b]; *Ferolito v Arizona Beverages USA LLC*, 2014 NY Slip Op 32830 (U) [Supreme Court Nassau County 2014]) and orders that Kraus pay the judgment within two years (compare *Matter of Adelstein v Finest Food Distrib. Co. N.Y. Inc.*, 2011 NY Slip Op 33256(U) [Supreme Court Queens County 2011]). The two-year period is intended to balance the cash flow issues experienced by Kraus with the fact that he has not received the value of his interest during the pendency of the proceedings.

² The calculations are as follows: $6,050,000 - .05 \text{ DLOM } (\$302,500) = 5,747,500$ which is the fair value of Kraus. $5,747,500 \times 24\% = 1,379,400$.

Conclusion

Based on the foregoing, it is hereby determined that the value of Kraus is \$6,050,000 and that petitioner's 24% interest, accounting for DLOM of 5%, is \$1,379,400, which amount is awarded to the petitioner, together with interest of 9% from the date that the petition was filed.

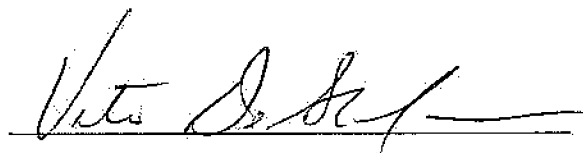
This constitutes the decision and order of the court.

DATE: April 10, 2020

ENTERED

Apr 28 2020

NASSAU COUNTY
COUNTY CLERK'S OFFICE



Hon. Vito M. DeStefano, J.S.C.