The Value of Experience

HASKELL & WHITE LLP

SEC Roundtable Series

DETERMINING FAIR VALUE IS EASIER THAN YOU THINK!

September 26, 2012

Our Agenda

I. Welcome and Introductions

II. Determining Fair Value is Easier Than you Think!
- Why this is an important topic
- The different valuation methodologies and when it is most appropriate to use each one
- The various assumptions needed to determine fair value and the most critical drivers of value
- The "make or buy" assessment – when do you need third-party expertise
- Common pitfalls frequently made by public companies

III. Closing and Questions

Introduction to Haskell & White LLP

- ✓ We are a **middle-market focused** firm powered by 65 client-centered professionals and 9 entrepreneurial partners
- ✓ We practice with the **technical competencies and experience** of larger accounting firms and the **attentiveness and responsiveness** of smaller accounting firms
- ✓ Our primary focus areas include **SEC, Real Estate and M&A**
- ✓ Our SEC clients include both **accelerated and non-accelerated filers**; we serve pre-revenue companies, as well as businesses with revenues in the hundreds of millions
- ✓ In January 2011, we received our second consecutive **"clean" PCAOB inspection report**

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Introduction to Globalview Advisors LLC

Globalview Advisors

- ✓ An international firm with offices in Irvine, Boston and London
- ✓ Provider of financial valuations and related advisory services for publicly listed and privately owned companies in the US and around the world
- ✓ Provider of Fairness and Solvency Opinions for a variety of transactions
- ✓ Comprised of experienced, senior level valuation professionals who work hands-on with clients to provide best results
- ✓ Expertise in high technology, and life science industries, as well as consumer and industrial products and services industries

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First – Why You Need to Know This Stuff

There is a growing prevalence of fair value in US GAAP – just look at where we've been…and where we may be going

- 1990s - stock options – fair value disclosure
- 2000s - asset impairments; stock options – mandatory fair value expensing; comprehensive fair value measurements disclosures; business combinations
- 2010 and beyond – complex financial instruments/derivatives; investment property entities

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First – Why You Need to Know This Stuff

✓ Impairment testing :

(i) **Amortizing assets** – when there is evidence of impairment, compare carry value with undiscounted cash flows; if the asset is not recoverable, then fair value is needed to determine impairment

(ii) **Non-amortizing assets** – perform annual test and test more frequently when there is evidence of impairment; compare carry value with fair value

(iii) **Goodwill** – perform annual test and test more frequently when there is evidence of impairment; Step #1 - compare carry value with the fair value (reporting unit level); Step #2 – calculate implied fair value of goodwill

(iv) **ASUs 2012-02 and 2011-08** – new "qualitative" assessments

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First – Why You Need to Know This Stuff

(v) Duff and Phelps Goodwill Impairment Studies

- Impairments totaled $30B in 2010, up from $26B in 2009, but down from $188B in 2008 (financial services companies made up almost half the total in 2010)
- Approximately 4% of public cos recognized impairments in 2010; down from 5% in 2009 and 10% in 2008
- 15% of public cos perform annual impairment testing in December versus 48% of private cos; 21% of public cos perform in October
- What was the triggering event for interim impairment testing – operating issues/changes (43%); reduced stock price (35%); industry/market conditions (17%)

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First – Why You Need to Know This Stuff

✓ Business combinations (i.e., acquisitions):

(i) Determination of purchase price – what is the fair value paid in the transaction

(ii) Allocation of purchase price – once the purchase price is determined, it must be allocated to the assets acquired and liabilities assumed based on their relative fair values

✓ Stock-based compensation (principally private companies):

(i) Determination of fair value of common stock – determination of enterprise value; allocation of enterprise value to various classes of equity instruments; discounts for lack of marketability

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First – Why You Need to Know This Stuff

✓ Derivative financial instruments:

(i) **Determination of fair value of the embedded or stand-alone derivative instrument** – when a company issues a debt or equity instrument that is convertible, or when a company issues a warrant, it is required to assess whether or not the conversion right and/or warrant is required to be separately accounted for at fair value at inception and at each reporting date

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General Valuation Methodologies

✓ Generally speaking, three basic approaches are commonly used to determine enterprise value

✓ **Income Approach** – primarily uses a discounted cash flow methodology because (i) a business is worth what it can generate in future cash flows, (ii) cash received today is worth more than an equal amount of cash received in the future, and (iii) future cash flows can be reasonably estimated

✓ **Market Approach** – primarily uses multiples derived from stock prices of public companies (GPCM) or acquisition transactions (GMAC) in similar industries and businesses and applies those multiples to the company's financial metrics to derive an estimate of fair value

✓ **Cost Approach** – based on the principle of substitution and that replacement cost is an indicator of value

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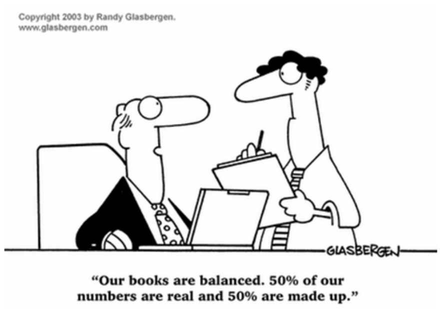
General Valuation Methodologies

- ✓ In the determination of which of the three valuation approaches is the most appropriate one to use, what should I be thinking about?
- ✓ When is it appropriate to "blend" valuation results and how do I determine the weightings of any blending?



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What Drives Value – The Most Critical Assumptions

Income Approach or "DCF"

- ✓ Revenue and expense forecasts
- ✓ Discount rate determination and WACC
- ✓ Discrete and terminal periods
- ✓ What to do with capex needs, working capital and debt payments

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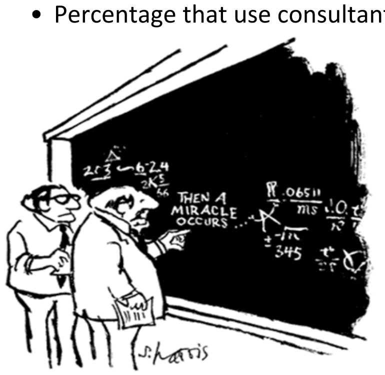
What Drives Value – The Most Critical Assumptions

Market Approach

- ✓ GPCM – what multiples are most appropriate: revenues, EBIT, EBITDA, net income, tangible book value
- ✓ GPCM – who are comparable public companies; should there be a premium or discount applied to the company's metrics – if so, how much
- ✓ GMAC - what multiples to actual prices paid in merger and acquisition transactions are most appropriate: revenues, EBIT, EBITDA, net income, tangible book value
- ✓ GMAC – are there enough comparable transactions

Your Make or Buy Assessment

- ✓ Most recent Duff & Phelps Goodwill Impairment Study:
    - Percentage that use consultants – public cos = 47%
    - Percentage that use consultants – private cos = 33%



"I think you should be more explicit here in step two."

Your Make or Buy Assessment

- ✓ How simple/complex is your company's business and industry characteristics?
- ✓ Does your company's human capital have the capabilities to perform this work?
- ✓ What are the expected results of your assessments?

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Common Pitfalls Made by Public Companies

Cannot provide support for material assumptions

- when forecasting revenues and expenses that differ significantly from past experience (sales growth rates; gross margins; expenses as a percent of revenues), be prepared to explain the reasons why
- support your discount rate and control premiums

Missing pieces

- commonly misapplied DCF items include terminal periods, working capital adjustments, capital expenditures and debt payments

Failure to reconcile with market capitalization

- Duff & Phelps: 55% of public cos did not consider!

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Determining Fair Value is Easier Than you Think!

- ✓ Please complete **evaluation** form
- ✓ Please suggest **future topics**
- ✓ Please use the sign-in sheet for **CPE credit**
- ✓ We'll see you again in **December 20, 2012** for our next SEC roundtable with former Assistant Chief Accountant for the US Securities and Exchange Commission, Ron Kiima

Thank You and Have a Great Day!

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