

# Valuation

# Vantage<sup>®</sup>

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Insights and perspectives on leading corporate finance valuation issues.

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## PCC Approves Private Company Alternative to Value Intangible Assets

On September 16, 2014, the Private Company Council ("PCC"), which helps set accounting standards for private companies under the FASB, reached a final consensus to approve an alternative approach for private companies to value certain intangible assets.

Under this proposal, when a private company makes an acquisition, the company does not have to recognize the following as intangible assets:

1. Non-competition agreements ("NCAs").
2. Customer-related intangible assets ("CRIs") that are not capable of being sold or licensed independently from the other assets of a business.

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## “PCC Approves Private Company Alternative for Intangible Assets” continued

The PCC states that mortgage servicing rights, commodity supply contracts, and core deposits are recognizable CRIs.

One of the PCC’s roles is to make recommendations on accounting changes to FASB. With this recommended change to accounting, FASB is considering the change and has indicated that it may accept the proposal. A decision from FASB to change GAAP may come as soon as year end, stay tuned... ♦

The PCC states that mortgage servicing rights, commodity supply contracts, and core deposits are recognizable CRIs.



# Implications of GreatBanc Trust's Settlement with the Department of Labor

As part of GreatBanc Trust's ("GreatBanc" or the "Trustee") recent settlement with the Department of Labor ("DOL") regarding its oversight of the June 20, 2006 purchase of Sierra Aluminum Company ("Sierra") stock by the employee stock ownership plan sponsored by Sierra (the "Sierra ESOP"), ESOPs that purchase or sell, contemplate purchasing or selling, or receive an offer to purchase or sell employer securities that are not publicly-traded ("proposed transaction" or "ESOP transaction"), must abide by specific guidelines, including:

1. **Selection and Use of Valuation Advisor – General** – The DOL asked the Trustee to prudently investigate the valuation advisor's qualifications. In addition, the DOL advised the Trustee to make sure that the valuation advisor had access to complete, accurate and current information in order to perform the ESOP valuation. In all, the Trustee should determine whether the valuation advisor's advice can be relied upon.
2. **Selection of Valuation Advisor – Conflicts of Interest** – The Trustee's valuation advisor is not allowed to accept an appraisal engagement for an ESOP transaction if the valuation advisor previously worked for the ESOP sponsor, a counterparty of the ESOP, or an entity that is putting together the ESOP transaction for a party other than the ESOP or the ESOP trustee. Also, the Trustee is not allowed to hire a valuation advisor if there is a familial or corporate relationship (such as a parent-subsidary relationship) with any party to the ESOP transaction.
3. **Selection of Valuation Advisor – Process** – The DOL gave a list of steps that the Trustee should take when selecting a valuation advisor.
  - a. The reason for selecting the particular valuation advisor,
  - b. A list of all the valuation advisors that the Trustee considered,
  - c. A discussion of the qualifications of the valuation advisors that the Trustee considered,
  - d. A list of references checked and discussion of the references' views on the valuation advisors,
  - e. Whether the valuation advisor was the subject of prior criminal or civil proceedings, and
  - f. A full explanation of the basis for concluding that the Trustee's selection of the valuation advisor was prudent.

The DOL provided an exception if the valuation advisor was previously used by the Trustee, subject to certain conditions.

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**“Implications of GreatBanc Trust’s Settlement...”** *continued*

- 4. **Oversight of Valuation Advisor – Required Analysis** – The DOL asked the Trustee to document the assumptions used in the projections for the ESOP and identify the individuals who prepare the projections including any potential conflicts of interest.
  - h. Reliability and timeliness of historical financial data considered
  - i. Material assumptions
  - j. Documenting why the averages, median or other multiples are selected in the market-based approach
- 5. **Financial Statements** – The Trustee must request five years of audited financial statements or the available audited financial statements be provided to the Trustee and financial advisor. If audited financial statements are unavailable, the Trustee must document why the unaudited financial statements are suitable.
  - k. How corporate debt is considered
- 6. **Fiduciary Review Process – General** – The Trustee must determine the reasonableness of the financial statements provided by the ESOP sponsor as it pertains to “the purchase or sale of employer securities that are not publicly-traded.”
  - l. Determining if the methodologies employed were standard and accepted methodologies
  - m. ESOP sponsor’s ability to service any debt or liabilities to be taken on in connection with the proposed transaction
  - n. Foreseeable risks of the proposed transaction
  - o. Disclosure of any other material considerations or variables that could significantly affect the price of the employer securities
- 7. **Fiduciary Review Process – Documentation of Valuation Analysis** – The Trustee must document its conclusions regarding various parts of the report including:
  - a. Marketability and minority discounts
  - b. Control premiums
  - c. The reasonableness of the company’s projections
  - d. Value drivers of the company
  - e. Discount rate(s) applied
  - f. Financial statement adjustments
  - g. Relevant economic and industry narrative

**“Implications of GreatBanc Trust’s Settlement...”** continued

**8. Fiduciary Review Process – Reliance on Valuation Report**

– The Trustee must document and understand the valuation report with regards to the consistency of the report and its conclusions, assumptions and analyses. The Trustee must document the individuals who participated in the proposed transaction, who and why certain individuals disagreed with the transaction, and whether the disagreement occurred before the Trustee approved the transaction.

**9. Preservation of Documents –**

The Trustee must preserve for six years all notes and records that document any transactions that are completed in relation to the ESOP.

**10. Fair Market Value** – The Trustee must prevent the ESOP from purchasing employer securities for more than fair market value or sell employer securities for less than fair market value.

Also, the principal amount of debt financing the transaction cannot exceed the fair market value of the stock acquired with that debt.

**11. Consideration of Claw-Back –**

The Trustee must consider whether it makes sense to request a claw-back arrangement or other purchase price adjustment(s) to protect the ESOP against the possibility of adverse consequences in the event of significant corporate events or changed circumstances.

Trustee may use other professionals to carry out its fiduciary duties under ERISA as long as it is prudent to do so.

The areas covered by these guidelines do not necessarily represent all of the obligations that a Trustee needs to adhere and do not supersede any existing regulations. However, the GreatBanc case highlights areas the DOL will examine in an ESOP investigation and best practices Trustees should follow. ♦

**12. Other Professionals – The**



# Adelphia Recovery Trust Seeks Recovery from Former Venture Partner

*Adelphia Recovery Trust v. FPL Group, Inc., et al., U.S. Bankruptcy Court, Case No. 02-41729 (April 17, 2014)*

In this case, the Adelphia Recovery Trust (“Trust” or “Plaintiff”) sought to recover \$150 million related to Adelphia Communications Corp.’s (“Adelphia”) repurchase of Adelphia stock held by FPL Group, Inc. (“FPL” or “Defendant”). FPL originally purchased Adelphia stock as part of its joint venture with Adelphia.

## Background

The Defendant purchased Adelphia stock as part of its divestiture of a two-thirds economic interest and a 50% voting interest of its cable business, Telesat Cablevision Inc. These interests were divested into a joint venture between an Adelphia affiliate and FPL called Olympus Communications. This was a vehicle for FPL to divest itself of the management responsibilities of its cable business and to avoid antitrust review.

The Defendant had its Adelphia common stock repurchased in January 1999 to end the joint venture. The Plaintiff argued that the consideration given to the Defendant for the repurchase of the Adelphia stock was fraudulent because Adelphia was allegedly insolvent at the time of the repurchase.

In order to determine solvency, the Plaintiff’s expert used a discounted cash flow (“DCF”) analysis to determine the enterprise value of the business. The Defendant’s expert used comparable company and precedent transaction methodologies.

The Court was persuaded by the Defendant’s expert’s valuation methodology, which applied a value per subscriber multiple. This multiple is generally used to value companies in the cable industry. The Plaintiff relied on his own projections in the DCF analysis.

## The Court’s Conclusion

The Court ultimately ruled in favor of the Defendant’s valuation analysis. Based on the Defendant’s expert’s analysis, Adelphia was considered to be solvent at the time of the repurchase of Adelphia common shares. The Plaintiff could not prove that Adelphia was insolvent when it repurchased Adelphia stock from the Defendant. ♦

## Valuation Services Team

Andy Smith  
Principal  
McLean, VA  
asmith@mcleanllc.com  
703.827.0233

Ryan Berry  
Principal  
McLean, VA  
rberry@mcleanllc.com  
703.827.0091

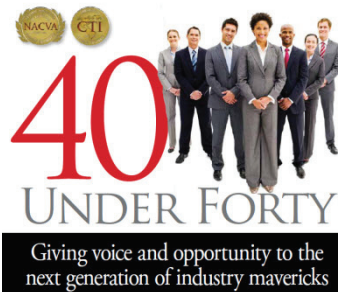
Shari Overstreet  
Managing Director  
Austin, TX  
soverstreet@mcleanllc.com  
512.751.7213

Brian Sullivan  
Managing Director  
Silicon Valley, CA  
bsullivan@mcleanllc.com  
650.638.2310

## The McLean Group

Headquartered in the Washington, DC metropolitan region, The McLean Group provides M&A, business valuation and strategic consulting services to middle market businesses.

# Practice Highlights



The National Association of Certified Valuators and Analysts (NACVA) and The Consultants' Training Institute (CTI) recognized McLean Group Principal Ryan Berry in its inaugural 40 Under 40 list of accounting and financial consulting professionals.

NACVA and CTI also honored McLean Group Founder and Chairman Emeritus, Dennis Roberts as the 2014 recipient of the prestigious Thomas R. Porter Lifetime Achievement Award.



## NASPP

On October 1, 2014 at the 22nd Annual National Association of Stock Plan

Professionals Conference, The McLean Group's Shari Overstreet presented on an expert panel, "Happy 30th Birthday 280G – The IRS Code Section That Has Not Aged Gracefully."

On June 17, 2014, The McLean Valuation Services Group Principal



**CFA Institute**

Andy Smith participated on a panel, "Issues With Private Equity Valuation - Top Performance or Inflated Valuations?" in association with the CFA Society of Washington, DC and with the US Securities and Exchange Commission's Jaime Eichen.

## The McLean Valuation Services Group

As a core competency and complement to our M&A practice, The McLean Valuation Services Group provides business valuation services, including intangible asset and financial security valuations for a variety of transaction, financial reporting and tax purposes. The McLean Valuation Services Group has the requisite experience and credentials to support litigation proceedings, including quantifying economic damages and valuing business interests.