The McLean Group
INVESTMENT BANKING

Valuation Vantage©

Insights and Perspectives on Leading Corporate Finance Valuation Issues© Spring 2009

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The McLean Group's Valuation Practice

As a core competency and complement to its mergers & acquisitions (M&A) practice, The McLean Group provides business valuation services, including intangible asset and financial security valuations for a variety of transaction, financial reporting and tax purposes.

"Pomeroy Bill" Puts Pressure on Discounts

Democrats Seek to Boost Tax Revenues by Eliminating Certain Valuation Discounts

On January 14, 2009, H.R. 11-436 (the "Pomeroy Bill") was introduced in the United States House of Representatives by Congressman Earl Pomeroy (D-ND). The bill seeks to eliminate the use of certain valuation discounts related to the transfer of fractional interests in family limited partnerships (FLPs), a common estate planning tool that is used for long-term wealth management planning and is often times used to reduce estate and gift taxes. The bill is currently at the House Ways and Means Committee.

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Use of Fairness Opinions is on the Rise

Recent Study Shows Increase Demand for Fairness Opinion

A recent Duff & Phelps fairness opinion survey of U.S. and European senior executives shows an increase in the use of fairness opinions as boards of directors' concern over shareholder lawsuits grow. For instance:

- **An overwhelming 86% of respondents believe a company should obtain a fairness opinion when making a significant acquisition.**
- **Roughly 52% of executives and board members are using fairness opinions, with 56% of those giving "insight into market transactions and value multiples" as being "by far the greatest benefit of fairness opinions."**

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FASB Provides More Guidance on Fair Value

On May 1, 2009 FASB released FASB Staff Position FAS 157-f, which addresses the measurement of liabilities within the framework of SFAS 157, Fair Value Measurements. More specifically, in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity shall measure fair value using one of the following approaches that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs:

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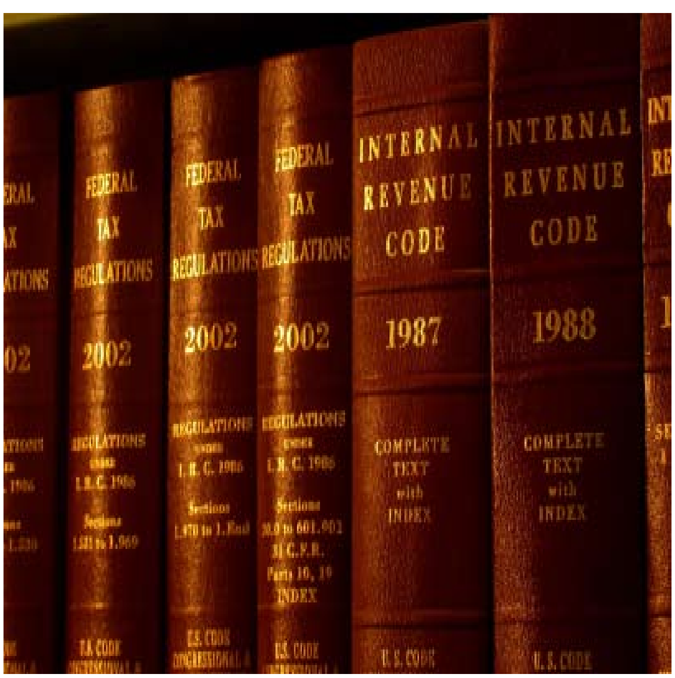
"'Pomeroy Bill' Puts..." continued from p. 1

The proponents of the bill point to the use of valuation discounts on the transfer of property as a way for the wealthy to avoid gift and estate taxes. At the core of the bill is the reestablishment of the "family attribution" doctrine. This concept has been widely discredited since 1981 (Estate of Mary Frances v. U.S.) and was formally abandoned by the IRS in 1993 with the publication of Revenue Ruling 93-12. Family attribution means that any and all fractional ownership interests in family controlled entities are deemed to be controlling interests. Under current law, the use of valuation discounts for lack of control and marketability is very prevalent in the valuation of transfers of interests in FLPs. The Pomeroy Bill argues that the true underlying nature of these transfers do not reflect a lack of control and therefore should not be discounted.

Valuation practitioners have pointed out that proponents of the bill are ignoring the fact that transferred interests in FLPs should be valued at "fair market value", which requires that the value be determined based on a hypothetical buyer and seller. They argue that the bill does not ensure that FLPs are properly valued, only that more taxes are raised. In addition, a departure from this principle contradicts the way that FLPs are valued for other purposes. For instance if an interest in an FLP is gifted to a charity, full valuation discounts could still be applied. If passed, the bill may eventually draw into question the way that valuation discounts are applied for other purposes. ◆



"'Use of Fairness..." continued from p. 1

- **Other reasons for fairness opinions included its insight into other valuation related issues, with 42% of respondents citing that reason.**

Over 68% believe that the Board of Director's have become more concerned with potential lawsuits over the past five years. Still, the most common reason for fairness opinions, cited by 78% of those polled, was to provide the board with independent analysis of a transaction. When asked about choosing a firm, the "firm's reputation" was cited as the most important criteria. Although not required by statue or regulation, fairness opinions have become commonplace in change of control transactions following the 1985 Delaware Supreme Court case of Smith v. Van Gorkom, in which a corporate board was held to have breached its fiduciary duty of care by approving a merger without adequate information on the transaction, including information on the value of the company and the fairness of the offering price.

In addition to providing a basis for the exercise of care by the board of directors, a fairness opinion is often provided to shareholders as a part of the proxy materials relating to a change of control transaction. Fairness opinions express a conclusion as to whether the consideration offered in a transaction is within the range of what would be considered "fair". However, such opinions generally do not offer an opinion as to whether the consideration offered is the best price, or other matters, such as solvency issues, that may arise from the transaction.

The Delaware Supreme Court has stated that "fairness" (in a transactions context) consists of two perspectives[1] :

- Fair price and
- Fair dealing.

As established by the courts, the issue of fairness should be looked at in its entirety, not necessarily bi-furcated between fair dealing and fair price. Fair price addresses all of the economic aspects of a transaction. Fair dealing focuses on the procedural matters relating to the timing and manner in which a transaction was initiated, structured, negotiated, and disclosed to the directors, and how approvals were obtained[2]. In all, an effective fairness opinion can enhance communication and analysis of a proposed transaction and provide additional comfort over its fairness. ◆

[1] Weinberger v. UOP, Inc., 426 A.2d 1333 del. Ch. 1981.
[2] Weinberger v. UOP, Inc., 457 A.2d at 711.

"'FASB Provides More Guidance on Fair Value…" continued from p. 1

a. The quoted price of the identical liability when traded as an asset in an active market;
b. The quoted price of the identical liability or the identical liability when traded as an asset in markets that are not active;
c. The quoted price for similar liabilities or similar liabilities when traded as assets in markets that are active; and
d. Another valuation technique that is consistent with the principles of Statement 157.

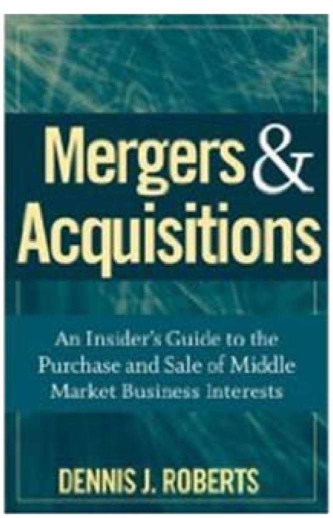
When measuring the fair value of a liability using the price of the liability when traded as an asset, the price shall be adjusted for factors specific to the asset that are not applicable to the fair value measurement of the liability. Some circumstances in which an entity should consider whether adjustments are required to the price of the asset include:

a. The quoted price for the asset relates to a similar (but not identical) liability traded as an asset;
b. The quoted price for the asset is not determinative of the fair value for the asset;
c. The quoted price of the asset includes the effect of a restriction preventing the transfer of the asset; and
d. The unit of account for the asset is not the same as for the liability (for example, the quoted price for the asset includes the effect of a third-party credit enhancement).

When estimating the fair value of a liability, an entity shall not include a separate input or adjustment to other inputs relating to the existence of a contractual restriction that prevents the transfer of the liability. The effect of a contractual restriction that prevents the transfer of a liability is either implicitly or explicitly included in the other inputs to the fair value measurement.

The proposed FSP, however, does not address the valuation of contingent consideration which is now required to be valued in a business combination under SFAS 141-R. The proposed FSP is open for public comments through June 1, 2009. ◆

Release of New Book:
Mergers & Acquisitions: An Insider's Guide to the Purchase and Sale of Middle Market Business Interests



The McLean Group's Chairman, Dennis Roberts, has authored a new book. The book was designed not only for owners and managers of middle market businesses but as a training text for middle market M&A investment bankers and advisors. It discusses the art and science of middle market M&A as well as the all-important psychology and behind-the-scenes negotiations pursued with a particular emphasis on obtaining the absolute highest value when selling a business. Subjects addressed include valuation, taxation, negotiations, M&A conventions, among many others from the buy-side and sell-side perspectives.

This serious but occasionally irreverent book tells it like it is, including anecdotes to provide a "feel" for what really goes on in middle market transactions. The author, a former practicing CPA and a business valuation expert, is a veteran M&A investment banker with years of real life experience. He also is a widely-acclaimed instructor in the M&A field and a nationally-respected practitioner who has trained thousands of investment bankers. No comparable book on the market today provides this degree of comprehensive and invaluable insight. ◆

Available now at amazon.com.

Spotlight on Court Cases

Drumheller v. Drumheller
March 6, 2009

The major issues of the Drumheller's divorce focused on the valuation of the husband's 10% interest as a CEO of a large printing company and his one-third interest in the real estate partnership that owned the company's land and building.

Both parties hired qualified and experienced appraisers and each applied an asset, market, and income based approach. In addition to the income approach, the wife's expert considered a net asset valuation as well as a straight average of the comparables from a guideline public company approach. The husband's expert weighted the public company comparables by putting more weight on the smaller companies.

The trial court found the net asset value to be unreliable due to the assets not being at market value. In addition, the court found the set of public companies to be too limited and too much larger in size than the subject company. The court agreed with the income approach focus by the husband's expert and found him more credible since he had valued the subject company (for ESOP purposes) for 20 years.

Conversely, the trial court found the wife's expert more persuasive on the issue of the real estate interest. The husband's expert disregarded the current lease since it was not negotiated in an arm's length transaction, while the wife's expert relied on the current lease terms. The court agreed with the wife's expert despite an argument from the husband that the definition of fair market value requires the court to presume a sale or transfer of the property. The court also rejected the husband's proposed minority interest discounts. ◆

Estate of Majorie Litchfield, Deceased, George Snell and Peter Degreeff Jacobi, Coexectors v. IRS
January 29, 2009

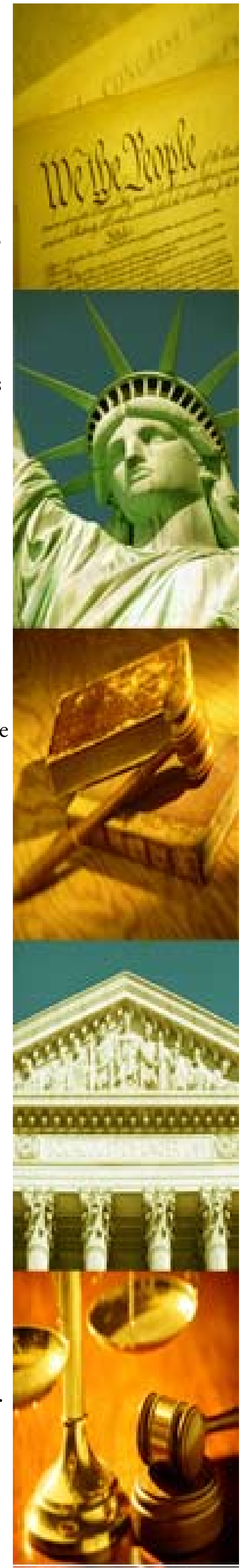
After the death of Litchfield's husband in 1984, Majorie Litchfield was given minority stock interests in two family-owned corporations, Litchfield Realty Co. (LRC) and Litchfield Securities Co. (LCS). Litchfield held approximately 43% of the shares in LRC and 23% in LCS.

An estate expert and IRS expert were brought in to assess the following:

- NAV;
- Discount for capital gains tax;
- Discount for lack of control;
- Marketability discount; and
- Ultimate fair market value.

The U.S. Tax Court found the estate expert more credible for the following reasons:

- The estate expert calculated the discount for capital gains by using historic asset sales and by predicting future sales by speaking with management, while the IRS expert only explored historic asset sales.
- The IRS expert did not account for the appreciation of the estate during its holding period, and
- The estate expert weighted his average discounts for lack of control accounting for Litchfield having substantially more invested in LRC as opposed to LCS. ◆



Recent Valuation Engagements

VISUALCV™
Business Valuation
Visual Resume & Professional Networking Services
As Business Valuators & Financial Advisors — The McLean Group

Green Mountain Energy
Business Valuation
Renewable Energy Marketers
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NETWITNESS
Business Valuation
Network Security Software
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CollabraSpace
Business Valuation
Web-Based Collaboration Software
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BELL
has acquired
Virginia Growers, Inc.
Purchase Price Allocation
Floral Wholesale Nurseries
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NISC National Interest Security Company
has acquired
MTI
Purchase Price Allocation
Government Contracting IT Services
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EIM
Business Valuation
Government Contracting IT Services
As Business Valuators & Financial Advisors — The McLean Group

CENTRIFUGE
(formerly Tildenwoods Corporation)
Business Valuation
Business Intelligence Software
As Business Valuators & Financial Advisors — The McLean Group

mpv Medical Present Value
has acquired
TeraHealth, Inc.
Purchase Price Allocation
Healthcare Related Software & Services
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