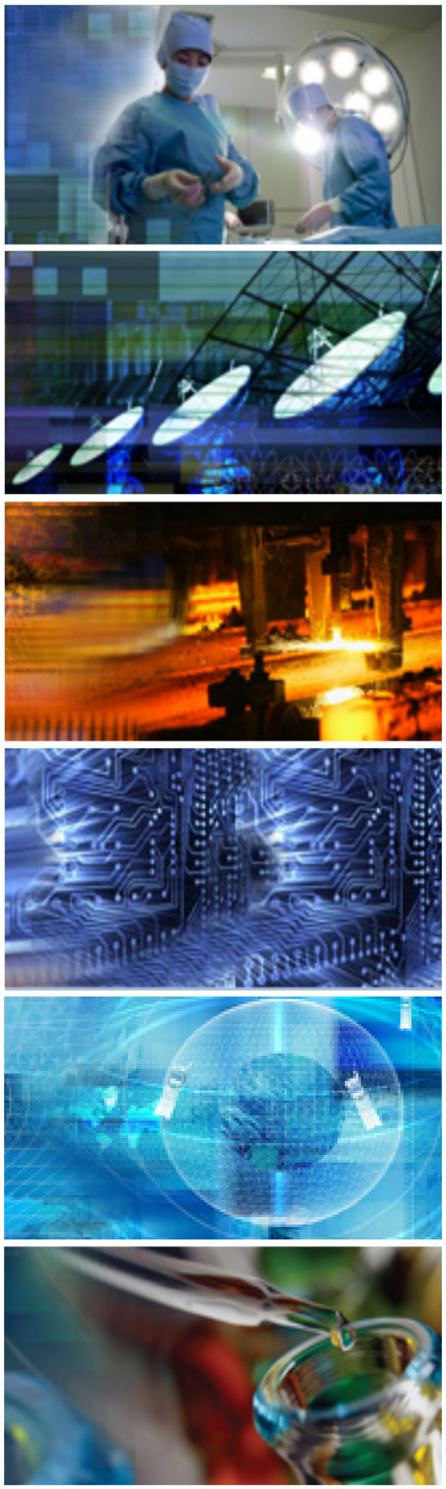

Globalview Advisors

Financial Valuation and Advisory Services

Valuation Update

FEI Orange County Chapter
September 17, 2014

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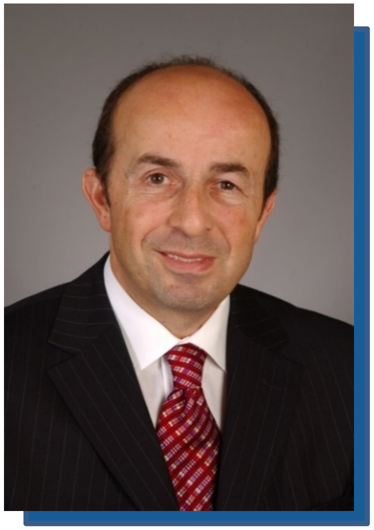
Presenter's Contact Information



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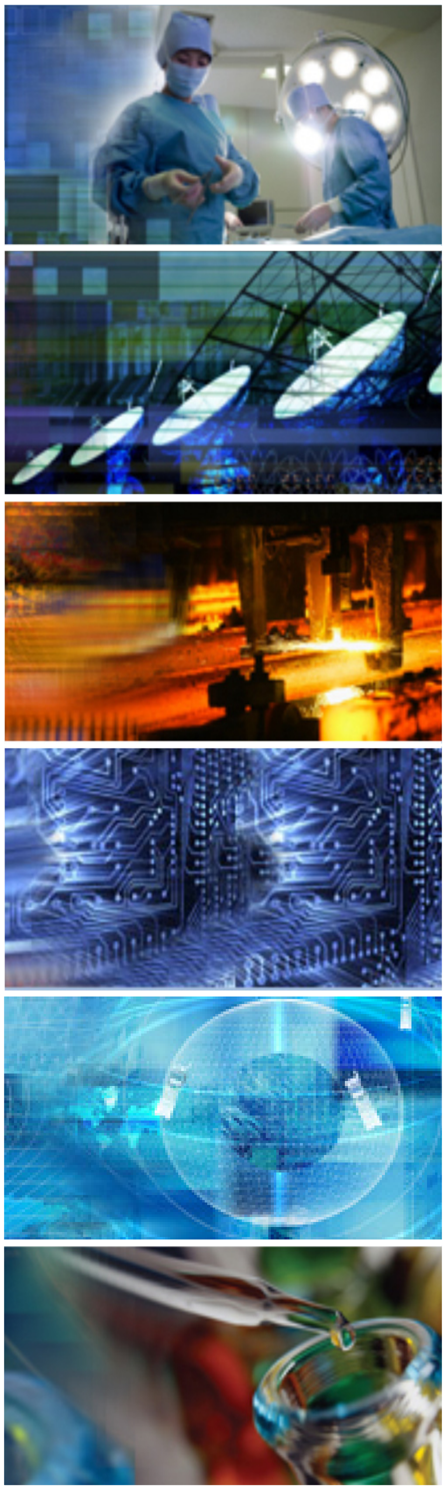
Presentation Overview

- FASB Developments Impacting Valuations
- ASC 718 and IRC 409A Valuation Issues
- Fairness and Solvency Opinions



Section One

FASB Developments Impacting Valuations

PCC Overview

- The Private Company Council (“PCC”) was formed by the Financial Accounting Foundation in 2012
- Purpose of PCC is to decide whether and when alternatives within U.S. GAAP are warranted for private companies
- PCC decisions affect only private companies and need to be “endorsed” by the FASB; however, the FASB has decided that any issues addressed by the PCC should be assessed for public companies and not-for-profits as well
- PCC has ten members—these include accountants (regional firms) and owners and finance officers of private companies

PCC Issues Addressed to Date

- **Issue 13-01A**: Accounting for Identifiable Intangible Assets in a Business Combination
- **Issue 13-01B**: Accounting for Goodwill Subsequent to a Business Combination
- Issue 13-02: Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements
- Issue 13-03: Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps

FASB Developments—PCC Issue 13-01B: Accounting for Goodwill Subsequent to a Business Combination

- PCC voted to finalize this accounting alternative on October 1, 2013—the proposal was endorsed by the FASB on November 25, 2013

CURRENT U.S. GAAP	PCC Accounting Alternative
Do not amortize goodwill	Amortize goodwill
— Test for impairment at least annually or more frequently	— Test for impairment upon occurrence of triggering event
— Goodwill impairment test	— Goodwill impairment test
— At reporting unit level	— At entity level or reporting unit level
— Two-step test	— One-step test
— Optional qualitative assessment	— Optional qualitative assessment

FASB Developments—PCC Issue 13-01B: What's Next?

- FASB voted to add a project to their agenda to address goodwill for public businesses and not-for-profit entities
- Staff is currently undergoing additional research, outreach and analysis, but presented four alternatives for consideration at the November 25 board meeting:
  - View A: Extension of the PCC alternative
  - View B: Amortization of goodwill over its useful life, not to exceed a specified number of years (an APB 17-like approach)
  - View C: Direct write-off
  - View D: Simplified (one-step) impairment test without amortization

Stay Tuned!

FASB Developments—PCC Issue 13-01A: Accounting for Identifiable Intangible Assets in a Business Combination

- Alternatives for intangible asset recognition presented at the January 2014 PCC meeting include:
  - View A—No intangible assets recognized separate from goodwill
  - View B—Only intangible assets capable of being sold or licensed independently from the other assets of the business
  - View C—Keep current GAAP
- In January 2014, the PCC instructed the staff to expand upon View B and develop additional alternatives similar to that view

FASB Developments—
PCC Issue 13-01A: FASB Consideration

- The Board is assessing whether Issue 13-01A should be considered for more than just private companies
- Discussions are ongoing with stakeholders of all types:
  - Private company preparers and users
  - Public company preparers and users
  - Accounting/auditing practitioners
  - Not-for-Profit preparers and users

FASB Developments—
Post Implementation Review ("PIR") on ASC 718

Post Implementation Review on ASC 718 Issued August 19, 2014

- Per FASB 8/19/2014 press release, "A 2004 accounting standard that addresses companies' share-based payment transactions achieves its purpose and provides useful information to users of financial statements."
- “”The post-implementation review report on Statement 123(R) identified many positive aspects of the share-based payment standard, including its usefulness to investors."
- "Private company stakeholders told the PIR team that the standard is sometimes difficult to understand and costly to apply."
- Input from investors, other financial statement users, preparers, auditors and academics.

FASB Developments—
Post Implementation Review ("PIR") on ASC 718

"For public companies, Statement 123(R) is generally understandable, can be applied as intended, and results in reliable information. However, the standard is often more difficult for private companies to understand and apply as intended, primarily because of the complexity of the financial instruments they use for share-based payments awards and the lack of internal expertise."

"While the changes made to financial and operating practices as a result of Statements 123(R) could be considered significant, these changes were consistent with expectations. No unexpected significant changes to financial reporting or operating practices resulted from the standard."

"There were not any significant unanticipated consequences as a result of Statement 123(R)."

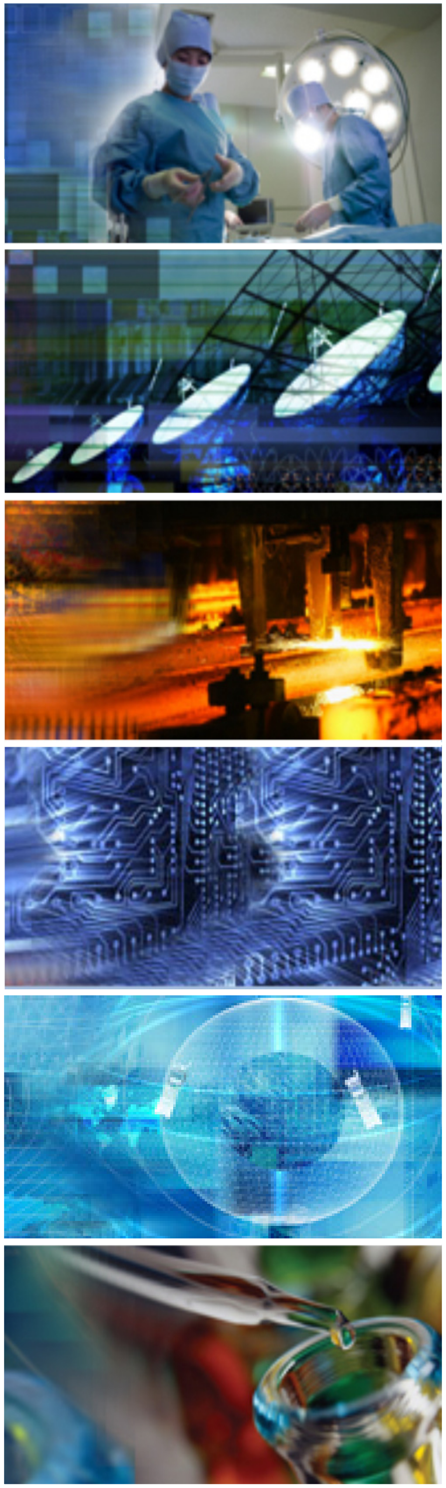
FASB Developments—
Post Implementation Review ("PIR") on ASC 718

- The FASB staff will continue to request shareholder feedback on potential improvements, including "identifying potential cost-effective solutions for areas that could be considered in potential narrow-scope projects," and plans to discuss the results of its outreach with the Board and the PCC later this year.

PCAOB - STAFF CONSULTATION PAPER *AUDITING ACCOUNTING ESTIMATES AND FAIR VALUE MEASUREMENTS*

- In a Staff Consultation Paper *Auditing Accounting Estimates And Fair Value Measurements* August 19, 2014, PCAOB requested public comment on standard setting efforts
- Public comment will assist PCAOB in its efforts to possibly consolidate several existing standards into a single new auditing standard
- Reflects challenges in auditing accounting estimates used in fair value measurements
- Comments requested by November 3, 2014

- The PCAOB staff is specifically seeking feedback on:
  - (i) the potential need for changes to the PCAOB’s existing auditing standards to **better address changes in the financial reporting frameworks related to accounting estimates and fair value measurements**,
  - (ii) current audit practices that have evolved to address issues relating to auditing accounting estimates and fair value measurements,
  - (iii) a **possible approach to changing existing auditing standards**, and the **requirements of a potential new standard**, and
  - (iv) **relevant economic data about potential economic impacts** to inform the PCAOB's economic analysis associated with standard setting in this area.



Section Two

ASC 718 and IRC 409A Developments

ASC 718 and IRC 409A Developments—Introduction

- On May 29, 2013, the AICPA's Financial Reporting Executive Committee issued an Accounting and Valuation Guide entitled *Valuation of Privately-Held Company Equity Securities Issued as Compensation*
- The Guide (also known as the Cheap Stock Guide) provides non-authoritative valuation guidance and illustrations for preparers, auditors, and valuation specialists related to the issuance of privately-held company equity securities for compensation
- The Guide illustrates techniques used to determine the fair value of a company and the methods used to allocate the company's fair value to the components of its capital structure
- Guide discusses transactions in a company's securities and the consideration of private or secondary market transactions in those securities when determining their fair values

ASC 718 and IRC 409A Developments—Key Components of Guide

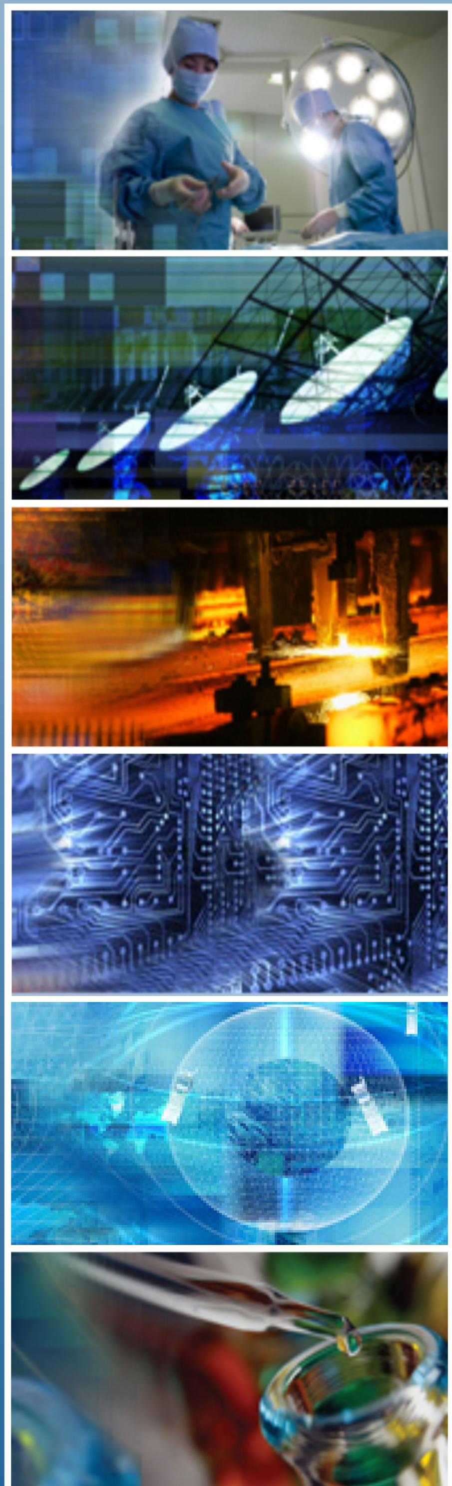
- Enterprise Valuation
  - Challenges with comparability
  - Use of expected cash flows
- Equity Allocation
  - Complex capital structures frequently observed
    - Multiple classes of securities
    - Unvested and vested options
  - "Auditability of Probability-Weighted Expected Return Method"
- Consideration of Transactions in the Stock of a Company
  - Prior capital raises
  - Third-party sales of stock
    - Orderly vs. disorderly transactions
- Valuation Discounts
  - Partially embedded in financing rounds
  - Quantitative Models

ASC 718 and IRC 409A Developments—Auditor Concerns from ASC 718 Reviews

- Valuations
  - Reliance on one approach when multiple approaches are possible
  - Need for better qualitative support on changes to business between valuation dates
  - Documentation on consideration of third-party transaction(s)
  - Ranges of value are too large
- Allocations
  - Breakpoint errors are still too frequent
- Discounts and Premiums
  - Use of multiple approaches (option models, studies, etc.) and a conclusion not supported by any of the approaches; improve justification
- Report
  - Quality is poor; key qualitative elements missing
- Mismatch of information in report and exhibits

ASC 718 and IRC 409A Developments—Comments from ASA SF Fair Value Conference in November 2012

- Market Approach
  - Reliance on means and medians without justification
  - No support for adjustments to multiple—Growth, profitability, and risk differences not considered and/or documented
- Income Approach
  - WACC—Lack of support for Company-Specific Risk Premium (“CSRP”) (also referred to as Alpha)
  - Growth—No support for terminal growth rate
  - NOLs inappropriately omitted from valuation
- Reconciliation of value indications from income and market approaches Reliance on significantly divergent value indications
- Technical timeliness—valuations that do not incorporate or contradict current guidance



Section Three

Fairness and Solvency Opinions

Fairness Opinion—Description

- A fairness opinion ("FO") is a communication from an FO provider to the commissioning party that contains the FO provider's opinion as to the fairness, from a financial point of view, of the consideration to be received or paid in a contemplated transaction—the work related to the provision of an FO considers the specified terms of a contemplated transaction regarding the consideration to be received or paid, and includes a comparison of the value of the interests given up to the value of the interests received
- FOs are often commissioned by the directors or other fiduciaries of an entity in order to demonstrate that they are acting in the interests of all shareholders

Fairness Opinions—Exclusions

- A fairness opinion is ***<u>not</u>***:
  - An opinion or any form of assurance that the highest and best possible price is being obtained or received for a given transaction
  - An assessment or evaluation of the sale or negotiation process leading to the pending transaction or consideration to be paid/received therein
  - An affirmation of the strategic merit of the contemplated transaction
  - A recommendation to security holders on how to vote
  - An analysis of, or opinion on, other aspects of a given transaction such as lockups, termination fees, severance agreements, and so on
  - A confirmation of, or any form of opinion or assurance (audit, review, or compilation) on, historic or, prospective financial or any other information provided by or on behalf of the client or obtained publicly

When is a Fairness Opinion Required?

(5) Examples of transactions for which fiduciaries would commission an FO include, but are not limited to, the following:

- Takeover bids;
- Compulsory acquisitions and buy-outs of minority security holders;
- Plans or schemes of arrangement;
- Capital reorganizations, including recapitalization transactions and debt-for-equity swaps;
- Going-private transactions;
- Related-party transactions;
- Transactions with persons in positions of influence;
- Buy-backs; and
- Tender offers, sale or merger transactions not involving an auction.

Source: March 2012 Exposure Draft, *Procedural Guidelines for Fairness Opinions*, International Valuation Standards Council. Project suspended March 2013.

Fairness Opinion—Purpose

(6) FOs can **assist fiduciaries in demonstrating their application of business judgment and duty** of care relating to a potentially important transaction or the use of an organization's resources. Fiduciary duties are ever-changing and are based on the continued guidance of law, courts, regulations, and regulators.

(7) A primary duty underpinning a fiduciary's approval of a contemplated transaction or of the consideration under a contemplated transaction, as appropriate, is the duty of care. It has been determined in some courts that **a fiduciary demonstrates a duty of care when the fiduciary acts in a diligent and reasonable fashion after due consideration of relevant facts, adequate information, and appropriate deliberation in arriving at a decision** that involves the organization.

Source: March 2012 Exposure Draft, *Procedural Guidelines for Fairness Opinions*, International Valuation Standards Council. Project suspended March 2013.

Fairness Opinion—Purpose *(cont'd)*

(8) Some courts have held that the application of business judgment protects a fiduciary from "after-the-fact" challenges regarding the manner in which the fiduciary conducted his or her activities in the contemplation of a proposed transaction. As a result, unless it is apparent that a fiduciary violated reasonable expectations of conduct, courts or regulators are less likely to review or question the fiduciary's activities and decisions or rule in such a fashion if required to review such activities.

(9) An FO typically opines on the fairness, from a financial point of view, of the consideration under a contemplated transaction, to any one of a range of stakeholders, all of the security holders or a certain group of security holders. The circumstances of the contemplated transaction and, if applicable, the relevance of any securities legislation or legal precedent may help define the stakeholder(s) to whom the fairness of the consideration under the contemplated transaction should be evaluated.

Source: March 2012 Exposure Draft, *Procedural Guidelines for Fairness Opinions*, International Valuation Standards Council. Project suspended March 2013.

Fairness Opinion—Objective and Unbiased

It is important that an FO is objective and unbiased and should **not be perceived as supporting the views of any interested party,** including the commissioning party.

An FO provider therefore needs to take all steps necessary to avoid threats to their independence. In particular, an FO provider should not accept an assignment where the commissioning party, or any other stakeholder in the transaction, seeks to unreasonably limit the investigations to be undertaken or to direct or otherwise influence the methods adopted or the conclusions reached.

Source: March 2012 Exposure Draft, *Procedural Guidelines for Fairness Opinions*, International Valuation Standards Council. Project suspended March 2013.

Fairness Opinion—Objective and Unbiased *(cont'd)*

(13) Before accepting an assignment to prepare an FO, the FO provider should consider any existing or proposed relationships that they or their firm or organization have that may impair, or create the appearance of impairing, their independence and evaluate the extent of that impairment. Examples include:

- Relationships with the commissioning party, including its non-independent directors, management, controlling security holder(s), other stakeholders; or
- Any relationship that creates, or may reasonably be perceived as creating, the FO provider with an interest in the outcome of a contemplated transaction.

Source: March 2012 Exposure Draft, *Procedural Guidelines for Fairness Opinions*, International Valuation Standards Council. Project suspended March 2013.

Solvency Opinion—Introduction

- Financial opinion to address the solvency of a specific entity, generally in connection with a corporate or financing transaction
- Solvency is generally defined in a manner consistent with the U.S. Bankruptcy Code—may also incorporate language from relevant state law
- Purpose—protect parties against insolvency claims involving a claimed fraudulent conveyance

Solvency Opinion—Elements

- Solvency opinion assesses the ability to meet claims when they come due—includes valuation and cash flow tests that determine if, after giving effect to a proposed transaction
  - Assets exceed liabilities
  - Ability to pay debts (current and anticipated)
  - Adequate capital to operate the business
- Opinion addresses solvency
  - At the time of the contemplated transaction
  - Giving effect to the contemplated transaction

Solvency Opinion—Benefits

- Protects against lenders possible loss of preferential payment status subsequent to providing capital in a leveraged transaction

Solvency Opinion—Transactions

Transactions that might require a solvency opinion

- Corporate spinoffs or split-offs
- Stock redemptions
- Leveraged recapitalizations
- Leveraged buyouts
- Dividend distributions

Solvency Opinion—Areas of Concern

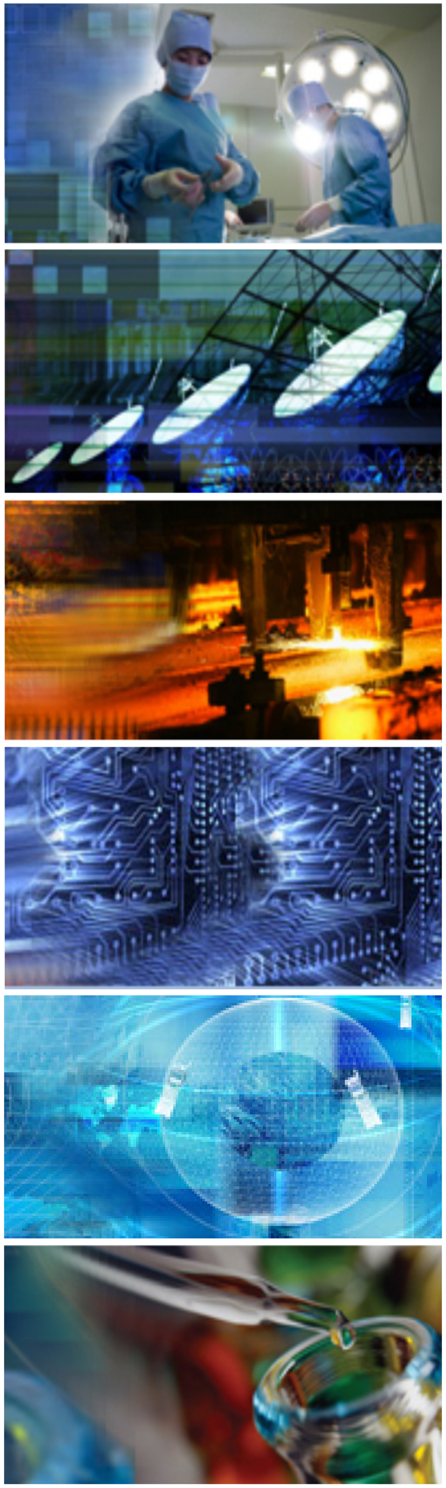
Critical elements of valuation process

- Understand financial projections and outlook
  - Confirmation of management projections
    - Industry
    - Consistency with other projections (Board, lenders, Wall Street presentations, auditors
    - Management willingness to reflect downside scenarios
- Depth of knowledge of industry and subject relative to competitors

Solvency opinions also involve cash flow analysis procedures as well

References

- *Valuation of Privately-Held Company Equity Securities Issued as Compensation*, AICPA May 28, 2013.
- FASB Update, Adam Smith, FASB Valuation Fellow, Presentation at ASA / USC 9th Annual Fair Value Conference, June 4, 2014.
- *Procedural Guidelines For Fairness Opinions*, March 2012, International Valuation Standards Council, March 2012.



Any Questions?