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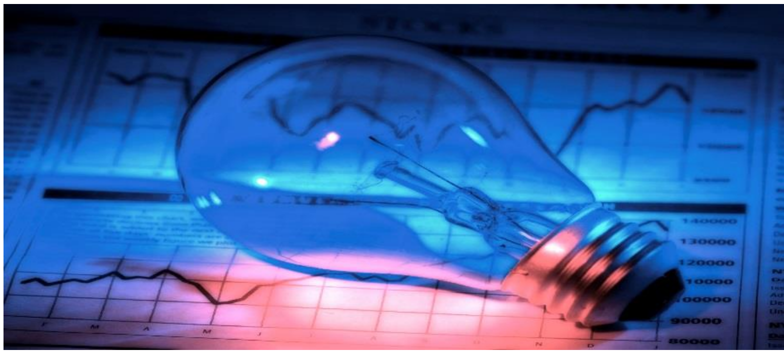

When Value Counts…

1st Quarter 2016

Happy New Year! We hope that you had a nice holiday season. In the 1st Quarter 2016 newsletter, you will find the following short articles:

- Trademark Values in Wireless Telecom Industry
- M&A Surge Fuels Fair Value Audit Deficiencies
- Tax Court's Judge Laro Discusses Hot Topics in Tax Valuation
- Healthcare Services Sector Multiples
- Court KOs Ownership Percentage as Rationale for DLOC
- Economic Update at a Glance

We hope that you enjoy the articles. Please feel free to call us if you need any assistance with valuation matters. Thank you, and we look forward to working with you in 2016.

Trademark Values in Wireless Telecom Industry

This month's brand value snapshot from Markables covers the wireless telecom sector. A comparison reveals brand valuations of 44 wireless telecom businesses between 2000 and 2014 in 24 countries. Some prominent brands in the peer group are Nextel, Leap, Cingular, Vivo Móvel, E-Plus, O2, Metro, Orange, Mobinil, and more.

Low brand multiples: Although perceived as an industry with high advertising spending, brand value multiples for the sector are rather low. The major reason is that assets other than brand are typically much more valuable (i.e., spectrum licenses, customer relations, and the network itself).

The interquartile range analysis shows a mean trademark royalty rate on revenues of 1%, and a mean trademark value of 5% of enterprise value, for sales multiples of 2x revenues. The multiples are consistent with the variation of factors such as territory (emerging versus developed), revenue size, or period (pre- or post-financial crisis). Not surprisingly, the multiples increase slightly with profitability. The reported brand values are in contrast to some publications that advocate higher brand values in the telecom sector, including the Brand Finance Telecoms 500 ranking.

M&A Surge Fuels Fair Value Audit Deficiencies

Fair value measurement audit deficiencies attributable to mergers and acquisitions activity increased to 49% in 2013, up from 45% in 2012 and an average of 9% from 2008 to 2011. This is according to a new analysis of recent Public Company Accounting Oversight Board inspections from Atlanta-based consulting firm Acuitas. These results suggest that auditors are still having trouble keeping up with the increase in M&A activity in the wake of the financial crisis. Big picture: Overall, the 2015 Survey of Fair

Value Audit Deficiencies finds that 43% of all audits inspected by the PCAOB in 2013 had deficiencies (compared with 16% in 2009), with fair value measurement (FVM) and impairment deficiencies representing 31% of the deficiencies. The number of deficiencies caused solely by failures to assess risk and test internal controls remained high in 2013, at 45% of all deficiencies for the top 25 firms. In comparison, such failures were present in 22% of fair value measurement deficiencies between 2008 and 2012. "We have seen a significant shift from the years where FVM deficiencies were largely the result of financial instruments to the current trend of business combinations and a failure to test or understand financial assumptions," Mark Zyla, managing director of Acuitas, says in a news release. "This shift has likely been caused by audit improvements for financial instruments that resulted from the PCAOB inspection process and by increased merger activity in recent years," he explained. "The auditing community should certainly be concerned about the continuing increase in deficiencies caused by a failure to assess risk and internal controls, and the PCAOB's assessment that they are caused by 'a lack of due professional care,'" says Zyla.

Tax Court's Judge Laro Discusses Hot Topics in Tax Valuation

A highlight at the 2015 AICPA conference in Las Vegas was the session in which David Laro, senior judge of the United States Tax Court, shared some of his thoughts on hot valuation topics.

Tax affecting: Practitioners must know the IRS's October 2014 job aid explaining the agency's thinking on valuing S corporations. The IRS's position of no tax affecting leans on Gross v. Commissioner and progeny but contradicts sound valuation practices, says Judge Laro. Keep in mind that Tax Court memos are not precedent, he reminds us. Therefore, "the final chapter on tax affecting has not yet been written."

DLOM: Simply pulling the discount for lack of marketability rate from restricted stock studies and pre-IPO studies spells trouble, the judge cautions. Today's Tax Court judges know valuation in a way the prior generation did not. And they expect experts to tailor their DLOM to the facts of a particular case. Judge Laro recommends using his Mandelbaum decision, in which he provides a multifactor analysis, as guidance for your DLOM determination.

USPAP: Mere compliance with the profession's standards does not make you a reliable expert for Tax Court purposes, Judge Laro says. Conversely, failure to comply with the standards does not exclude your testimony from consideration.

Hot tubbing: This technique, also known as concurrent witness testimony, is Judge Laro's preferred technique for receiving expert testimony. It replaces the blood sport of cross-examination with a collegial discussion involving the judge and the experts on both sides but excluding the attorneys. According to Judge Laro, when experts need not fear attacks on their credibility, they are able to express their thoughts more freely and provide the judge with a more meaningful valuation than the adversarial system allows. Not everyone is on board, but it's a technique that is catching on. In fact, the AICPA is providing training in this technique.

Healthcare Services Sector Multiples

The S&P Healthcare Services Index has increased by 8.6% over the last three months, significantly outperforming the S&P 500 (a 6.4% increase over the same period), according to the September 2015 Healthcare Sector Update from Duff & Phelps. The best-performing sectors were healthcare staffing (up 26.4%), other services (up 19.1%), and emergency services (up 15.5%). The worst-performing sectors were assisted living (down 23%), psychiatric hospitals (down 17.2%), and diagnostic imaging (down 13.5%).

The current median LTM revenue and LTM EBITDA multiples for the healthcare services industry overall are 1.6x and 12.6x, respectively. The sectors with the highest valuation multiples include: HCIT (3.7x LTM revenue, 20.0x LTM EBITDA), healthcare REITs (12.8x LTM revenue, 16.4x LTM EBITDA), and emergency services (3.7x LTM revenue, 27.6x LTM EBITDA).

Court KOs Ownership Percentage as Rationale for DLOC

***Sieber v. Sieber*, 2015 Ohio App. LEXIS 2256 (June 15, 2015)**

Size does not matter, especially when it comes to applying a discount for lack of control (DLOC). A recent Ohio ruling examines the use of a DLOC where the owner spouse held a small interest in a business, but played a large role in running it.

Man in charge: For about 25 years, the husband worked for two closely held companies that shared common ownership and had an interdependent business relationship. He served as their principal sales person, president, and CEO and also owned a minority interest in both businesses: 1.73% in Company A and 1.37% in Company B.

Given the companies' interconnectedness, the husband's expert decided to value them as one entity using the capitalized earnings approach. He said that Company B's recent loss of a major account and the decline in revenue made him believe the companies might be out of business by 2015 or 2016. By his calculation, the husband's interest in both companies was worth under $11,400. It was appropriate to apply a 24.3% discount for lack of control and a 15% discount for lack of marketability because of the husband's minority interest and his limited control over decisions within the company, the expert claimed.

The wife's expert ultimately used a net asset approach to value both companies. He concluded that the interest in Company A was worth $63,000, including a 10% discount for lack of marketability (DLOM), and the interest in Company B was worth $20,000, again including a 10% DLOM. He said a 24.3% discount for lack of control was inappropriate because the husband was a top-ranking executive in both companies. "[W]e are not talking about a 2% investor in California who's outside the company and doesn't know what's going on … we're talking about an insider who is running the company, who's in control of that company from a day-to-day standpoint." The expert also pointed out that the companies had not compelled the husband to sign non-compete agreements.

The trial court agreed with this reasoning, as did the appeals court. According to the trial court, the husband, by his own testimony, was not only a "figurehead but the primary salesperson and key driving force behind the company's success." The majority shareholder had to take into account the husband's influence and control, and it did, as the lack of a non-compete showed.

The husband also raised a double dip claim in connection with the trial court's order of spousal support, despite the unfavorable view the Ohio Court of Appeals recently has taken on that issue. Here, the appeals court simply found the double dip theory inapplicable given that the prevailing valuation of the business was based on the asset approach.

Takeaway: Control is not simply a function of the size of the ownership interest. Here, the wife's expert was able to exploit the level of responsibility the husband had in the business to argue against the application of a discount for lack of control.

Economic Update at a Glance

The pace of U.S. economic growth slowed in the third quarter of 2015. GDP expanded at a rate of 1.5% in the third quarter, less than half of the previous quarter's rate of 3.9%, but in line with economists' expectations. A reduction in companies' inventory investments caused the sharp deceleration, with the inventory component of GDP experiencing its largest slowdown since the third quarter of 2011. With private inventory investment factored out of GDP, final sales grew at a rate of 3.0% in the third quarter after rising 3.9% in the second, a less dramatic deceleration. While consumer spending pulled back a little in the third quarter, it continued to be the main driver moving the economy forward. Residential investment, a proxy for the housing market, was also healthy. Business activity presented a mixed picture: Investment in equipment and intellectual property rose, but spending on structures fell. Government spending eased a bit but remained positive for the second consecutive month. There was little change in America's trade deficit, and net exports were only a slight drag on GDP.

After remaining unchanged in July and August, the Leading Economic Index fell in September, dropping to its lowest reading of the past seven months. A weaker stock market and manufacturing sector, along with declining housing permits, caused the drop. Despite the lower September reading, the Conference Board found that the data continue to indicate that the U.S. economy will expand at a moderate level during the next several quarters.

Measures of consumer confidence were mixed at the end of the third quarter. The Consumer Confidence Index rose for the second consecutive month in September as consumers assessed their present situations more positively. The improvement sent the Consumer Confidence Index to its second highest reading in eight years. The rise was unexpected, as economists had forecasted the index to decline. On the other hand, the Consumer Sentiment Index fell in September for the third consecutive month. A declining stock market and worsened finances brought the Consumer Sentiment Index to an 11-month low.

Business owner optimism was little changed in the third quarter, according to the Small Business Optimism Index, and confidence remained down from the levels seen at the end of 2014 and the beginning of 2015. The biggest mover in September was the component of the Small Business Optimism Index that measures whether business owners expect sales to be higher, which fell 6.0 points. The Wells Fargo/Gallup Small Business Index reading for the third quarter of 2015 lost ground, with the metric that measures how business owners regard their current revenue accounting for the majority of the downturn.

Job growth continued in the third quarter, though the pace continued to be slow. The combined job growth of September and August together were the worst two consecutive months for job growth since December 2013 and January 2014. The unemployment rate was unchanged at its lowest level since April 2008, though the labor-force participation rate dropped to its lowest figure since October 1977. Both wages and the workweek for private employees retreated slightly in September.

Both the manufacturing sector and services sector continued to expand in the third quarter, as measured by the Institute of Supply Management's respective indexes, though the pace of expansion in both sectors slowed. Regardless, both indexes remained at readings indicating that the U.S. economy continues to expand.

Industrial production fell in September and August after rising in July. July marked the only month thus far in 2015 that industrial production has risen. Regardless, industrial production was up from one year ago. The output of utilities rose, but it was not enough to offset a decline in manufacturing and mining.

The Federal Reserve maintained its decision to leave the target for the federal funds rate unchanged in the third quarter. It did, however, state that it would continue to assess labor market conditions and inflation expectations to determine whether raising the rate would be appropriate in the future. The Federal Reserve also continued its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities.

The third quarter was a turbulent time for the stock market, and the major indexes all declined. VIX surpassed a reading of 40.0 in the third quarter, an indication that there was a large amount of volatility as a result of investor uncertainty. The S&P 500 experienced its largest quarterly decline in four years as investors worried about a China-led global slowdown and a potential U.S. rate hike. The typically more volatile smaller-cap indexes fared even worse than mid- and large-cap benchmarks. The defensive utilities sector was the only S&P 500 sector to register a gain in the third quarter.

Consumer prices fell in September and August, while producer prices dropped sharply in September after remaining unchanged in August. Declining gas prices dragged down both the Consumer Price Index and Producer Price Index in September. At the end of the third quarter, both the three-month and 12-month averages for the Consumer Price Index and Producer Price Index were negative.

Housing starts rose in September, while building permits declined, though both remained well over their levels from a year ago. Builder confidence remained strong in the third quarter, with the Housing Market Index reaching its highest level since October 2005. Existing-home sales rebounded strongly in September after cooling off in August and have now increased year-over-year for 12 consecutive months. Pending home sales, on the other hand, slowed in both August and September, with the September reading being the second lowest in 2015. The national median existing-home price continued to rise in the third quarter, reaching year-over-year levels for the 43rd consecutive month. The Realtors Confidence Index report for current conditions showed that the market slowed for all three property types, but the report noted that this was seasonal and is normal for this time of year.

NOTE: *This newsletter does not constitute legal, valuation, tax or any other type of consulting advice. It is offered as an information service to our clients and friends. For specific legal and accounting issues, it is advisable to seek professional advice. We welcome the opportunity to discuss any specific valuation issues that you may have.*

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