The Price is Right ... Or Maybe Not?

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"Price is what you pay. Value is what you get"

Warren Buffett

Agenda

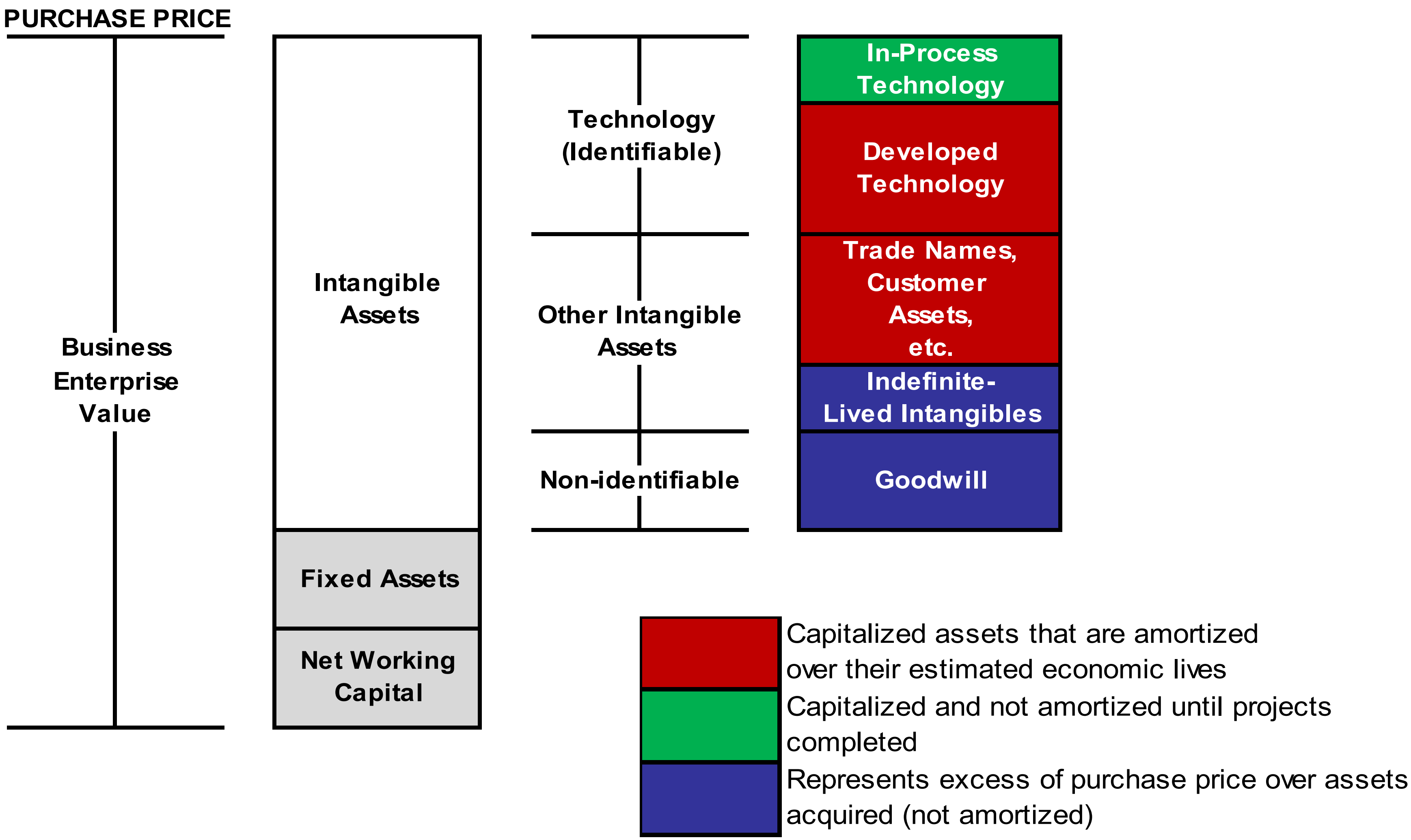
- **Our Perspective**
- **Case Study**
- **Impact of Bias**
- **Synergies**
- **Projections and Risks**
- **Valuation Multiples**
- **Models as a Valuation Tool**
- ***Appendices:***
  - *Speaker Background / Contact Information*
  - *Bibliography*

Our Perspective

- **We are not investment bankers … but have unique insight working with buyers on accounting-related valuations associated with acquisitions**
  - We see the initial deal stages (from due diligence and negotiations) to post-deal results (integration and beyond) … ***both good and bad***
  - Bad = impairment (goodwill and long-lived assets)
  - Experience on hundreds of deals

Our Perspective (continued)

Overview of Purchase Price Allocation Principles (ASC 805)



Our Perspective (continued)
Impairment Testing Overview

	Long-Lived Assets Tangibles & Intangibles	Indefinite-Lived Intangibles	Goodwill
Primary Guidance	**ASC 360** Accounting for the Impairment or Disposal of Long-Lived Assets Formerly SFAS 144 ASC 350-30 (primarily -35)	**ASC 350** Goodwill and Other Intangible Assets Formerly SFAS 142 **ASU 2012-02 (issued 7/12) Qualitative Testing**	**ASC 350** Goodwill and Other Intangible Assets Formerly SFAS 142 **ASU 2011-08 (issued 9/11) Qualitative Testing**
Focus	Test **recoverability** of long-lived assets; determine impairment if needed	**Fair value test** Indefinite-lived intangibles carried at lower of fair value or carrying value	**Fair value test** Goodwill carried at lower of fair value or carrying value
Testing	Event based	At least annually; event based if triggered	At least annually; event based if triggered

Case Study

- Client: Publicly traded, Fortune 500 company with significant international operations

- Assisted with over 15 acquisition-related valuations (purchase price allocations) and on-going work associated with impairments

- **Reporting Unit #1**
  - Majority of operations -- established through acquisitions
  - Over $700 million in goodwill and intangible assets – ***majority ultimately impaired***

- **Acquisition A**
  - Acquisition led by a division in Reporting Unit #2
  - Entry into a related but new market
  - ***Examining potential impairment now***

Impact of Bias

- Motivations of deal players – CEOs, bankers, etc.
- Bias can often be seen in valuation models and considerations:
  - Speculative, hard-to-achieve synergies priced into acquisition price
  - Overly optimistic projections
  - Discount rates which fail to consider risks
  - Selection of market peers with high multiples which may not be comparable; multiples not adjusted to reflect target company characteristics

☞ ***Case study example***

Impact of Bias (continued)

- The CFO as the **voice of reason**

- Example – HP CFO Cathie Lesjak's opposition to the Autonomy acquisition
  - *"In the summer of 2011, Lesjak earned the wrath of then CEO Leo Apotheker when she forcibly opposed the Autonomy takeover – not because she suspected fraud, but because she believed the valuation absurd. Unable to get Apotheker to see her way, she took the case to the boardroom in a highly unusual and dramatic plea to scotch the deal."*

    CNN Money, November 2012

  - *"[Apotheker] knew that … Lesjak opposed the deal.* ***She had told him the price, around 11 times revenue, was too rich. Comparable companies were selling for three times revenue, according to investment bank Software Equity Group.*** *He'd countered that Autonomy's profitability more than justified the price. The two had discussed it privately.*
  - *"But then, with no warning to Apotheker, Lesjak made an impassioned case against the acquisition before the board. "I can't support it," she told the directors, according to a person who was present. "I don't think it's a good idea. I don't think we're ready. I think it's too expensive. I'm putting a line down. This is not in the best interests of the company." Directors were shaken. Lesjak was considered a voice of sobriety, and here she was on the verge of insubordination, directly resisting a key element of her boss' strategy."*

    Fortune, May 2012

Synergies

- Be cautious when including synergies in a target's valuation; benefits attributed to the SELLER
- Differences between tangible vs. more "conceptual" synergies
  - Cost savings from elimination of management team or lower COGS associated with materials costs because of acquirer size (tangible synergies)
  - Pull-through revenue related to new markets (more conceptual synergies)
- If paying for synergies – consider probabilities and risks associated with achieving them
- Costs and time required to extract synergies

☞ *Case study examples*

Projections and Risks

- Develop and evaluate sales, margin, and other projections vs. history, competitors, trends, market size (e.g., implied penetration based on forecasts), etc.
  - "Story" behind assumptions?

- Discount rates – too low (not fully considering risks?)

☞ *Case study example*

- Consideration of multiple cash flow scenarios – most-likely, upside, downside
  - Expected cash flows = probability-weighted average of possible outcomes

Valuation Multiples

- *Multiple x target financial data = value*

- **Public Company Market Multiples**
  - How comparable are selected guideline companies?
  - Does the selection of multiples for valuation purposes consider characteristics of target company vs. guideline companies?
  - Often, private targets are smaller, less diversified, and less profitable vs. public comps – which would likely warrant multiples **lower** than guideline company indications.

- **Private Transaction Multiples**
  - Similar questions as above; often challenges with this approach due to lack of information disclosed on guideline transactions.

- **Target Financial Data (which multiples are applied to)**
  - Target will often recast / normalize financials for presentation to buyers
    - Nature and size of adjustments (e.g., "non-recurring" items)?

Models as a Valuation Tool

- **Does the model accurately incorporate and reflect key elements and drivers of deal value?**
- Important tool – *but be aware of limitations*
- Models important for fact finding, identifying and prioritizing areas of focus for due diligence, planning related to integration and execution, and for negotiations planning.
- Common pitfalls – "black box"; over-engineering; impact of changes (individual changes can't be made in a vacuum); bias and manipulation
- Fundamental model considerations:
  - Model structure; ease of use and running sensitivities / scenarios
  - Tracking impact of changes from version to version
  - Appropriate valuation methodologies and theory
  - Checking source data linkage (e.g., historical target information)
  - "Big picture" gut checks

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Q & A

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Current Responsibilities

Josette Ferrer is the founder and a Managing Director of Clairent Advisors. Since 1993, Josette has been assisting clients with the valuation of closely held businesses and business interests, intangible assets, intellectual property, stock options, debt instruments, capital equipment / fixed assets, and other assets.

Experience

Prior to founding Clairent Advisors in 2010, Josette was the U.S. Practice Leader of Marsh's Valuation Services Group (formerly Kroll's Valuation Services Practice). Her career includes serving as the Managing Director in charge of the San Francisco Valuation Services Group of WTAS, Inc. ("WTAS"), a former subsidiary of HSBC Group. At WTAS, Josette's responsibilities included developing and overseeing all technical, operational, marketing functions for the SF valuation team. Prior to WTAS, Josette was a director with Huron Consulting Group and a senior manager at Arthur Andersen LLP.

While Josette has extensive experience serving clients in many industries, areas of specialty include telecommunications, high technology, service companies, consumer products, manufacturing, and financial services. Her clients have ranged from small, emerging businesses to Fortune 500 companies. Josette has been a guest speaker for a wide variety of forums, including Financial Executives International ("FEI"), the Institute of Management Accountants ("IMA"), the Practicing Law Institute ("PLI"), the San Francisco Bar Association, Santa Clara University, BIOCOM, and various venture capital roundtables, and has also published an article related to the valuation of intellectual property for the PLI.

Education and Affiliations

- B.S. in Business Administration, University of California, Berkeley
- Member, Fair Value Forum
- Board Member, SF Chapter, Financial Executives International
- Corporate Affiliate, Finance Scholars Group
- Strategic Partner, Strategic Alliances Resources Network
- Member, ProVisors

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