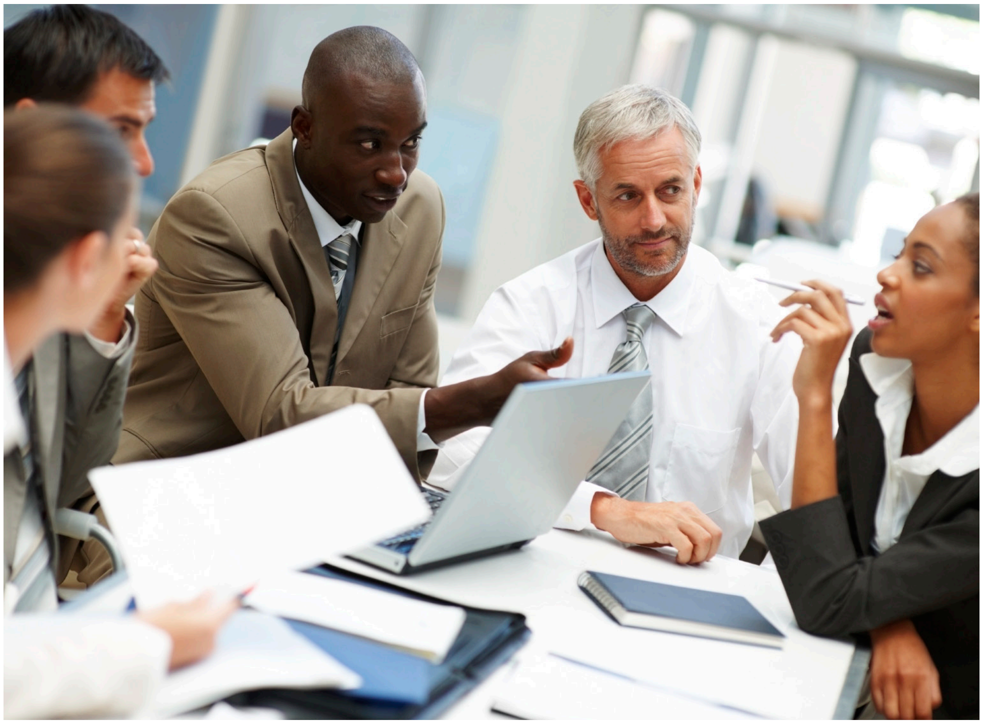
Duff & Phelps

First Quarter 2012

Valuation Insights

Inside

Contact us at:
www.duffandphelps.com



In this edition of Valuation Insights we discuss the SEC's increased focus on management's use of pricing services to estimate the fair value of assets. In recent public forums the SEC has underscored management's responsibility to understand and assess the reasonableness of inputs, models, and judgments made by pricing services in estimating the fair values of assets.

In our Technical Notes section we discuss two new draft guides issued by the AICPA on in-process research and development and goodwill impairment. These practice aids serve as a comprehensive source of guidance on best practices in connection with key implementation issues on these topics.

Our International in Focus section discusses observations on the European size premium and calculating cost of capital in the current market environment. Finally, our in Focus article discusses Duff & Phelps' recent acquisitions of two restructuring practices.

In every issue you will find Industry market multiples which are useful for benchmark valuation purposes. We hope that you will find this and future issues of this newsletter informative and reliable resources.

Read this issue to find out more.

Increased Scrutiny on the Use of Pricing Services

Recent news headlines have highlighted the U.S. Securities and Exchange Commission's (SEC) renewed emphasis that companies have the responsibility for the complex and often subjective task of estimating the fair value of assets – even when management uses pricing services for assistance. When using pricing services, companies often don't know what inputs, models and judgments are used. These concerns are even more pronounced in volatile markets and when valuing instruments such as thinly-traded bonds, asset-backed securities and other structured products.

Historical Background

Historically investors relied on market makers and their related back office pricing services to provide indications of value for various securities, including debt and equity securities. In 2008, as markets became less liquid, the SEC Division of Corporation Finance sent a "Dear CFO" letter to certain public companies identifying a number of disclosure issues they may wish to consider in preparing Management's Discussion and Analysis. This letter included the following request:

If you disclose that you use brokers or pricing services to assist you in determining fair values, consider explaining the extent to which, and how, the information is obtained and used in developing the fair value measurements in the consolidated financial statements. The nature and form of this information may vary depending on the facts and circumstances, but may include the following:

- *The nature and amount of assets you valued using broker quotes or prices you obtained from pricing services, along with the classification in the fair value hierarchy;*
- *The number of quotes or prices you generally obtained per instrument, and if you obtained multiple quotes or prices, how you determined the ultimate value you used in your financial statements;*
- *Whether, and if so, how and why, you adjusted quotes or prices you obtained from brokers and pricing services;*
- *The extent to which the brokers or pricing services are gathering observable market information as opposed to using unobservable inputs and/or proprietary models in making valuation judgments and determinations;*
- *Whether the broker quotes are binding or non-binding; and*
- *The procedures you performed to validate the prices you obtained to ensure the fair value determination is consistent with SFAS 157 (now known as FASB ASC 820), Fair Value Measurements, and to ensure that you properly classified your assets and liabilities in the fair value hierarchy.*

Because of the impact of the financial crisis and less and less transaction data, in 2009, the Financial Accounting Standards Board modified SFAS 157 (ASC 820) *Fair Value Measurements*, to provide guidance for situations where access to pricing data was limited or not available. FASB ASC 820 paragraph **820-10-35-54 L** states: *If there has been a significant decrease in the volume or level of activity for the asset or liability, a reporting entity shall evaluate whether the quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk).*

While market conditions have improved, in early 2011 the Public Company Accounting Oversight Board's (PCAOB) Standing Advisory Committee formed a taskforce to focus on the extent to which auditors were evaluating management's reliance on pricing services to determine fair value. On December 5, 2011, at the AICPA National Conference on Current SEC and PCAOB Developments, Jason K. Plourde, Professional Accounting Fellow, of the SEC Office of the Chief Accountant raised the following questions that management should be prepared to answer with respect to pricing services:

- Does management have sufficient information about the values provided by pricing services to know that they are complying with GAAP?
- Has management adequately considered the judgments that have been made by pricing services in order to be comfortable with management's responsibility for the reasonableness of such judgments?
- Does management have a sufficient understanding of a pricing service's sources of information and the processes used to develop it to identify risks to reliable financial reporting?
- Has management identified, documented, and tested controls to adequately address the risks to reliable financial reporting?

Management Options

Management should be prepared for increased scrutiny from both auditors and the SEC on fair value estimates obtained from pricing services. At a minimum, management must be able to explain the nature of inputs and calculation methodology used by their pricing services. Such understanding could be obtained through extensive due diligence and ongoing monitoring. However, because of the need for management to validate and document that their pricing services are using appropriate inputs and models, it may prove more cost-effective for management to establish their own models for securities that trade infrequently or not at all.

Management can enhance their internal control processes through the use of an independent valuation expert such as Duff & Phelps. Duff & Phelps provides technical skills and sound advice that can assist management in validating pricing service practices and inputs for more illiquid securities. Further, Duff & Phelps' Alternative Asset Advisory team can enhance a company's internal control system by contributing an independent assessment of the reasonableness of management's estimate of value and can also assist in the design and review of management's valuation procedures. In addition to providing market-based guidance on valuing complex and illiquid securities, the Duff & Phelps Portfolio Valuation team can help ensure that management's fair value procedures are compliant with standards set by GAAP, and that are expected by the SEC and auditors.

Remarks by Jason K. Plourde, *Professional Accounting Fellow, Office of the Chief Accountant, U.S. Securities and Exchange Commission* are available at: http://www.sec.gov/news/speech/2011/spch120511jkp.htm.

For further information contact David Larsen, Managing Director, at 415-693-5330.

Technical Notes
AICPA Issues Draft Guides on IPR&D and Goodwill Impairment

In November 2011, the AICPA's Financial Reporting Executive Committee (FinREC) issued two working drafts for public comment. These guides, when finalized, will serve as a comprehensive source of non-authoritative guidance on two important financial reporting valuation topics. The AICPA Accounting and Valuation Guide *Assets Acquired to Be Used in Research and Development Activities* ("IPR&D Guide") replaces the current practice aid and incorporates guidance on new accounting and valuation issues that have emerged since its publication in 2001. The AICPA Accounting and Valuation Guide *Testing Goodwill for Impairment* ("GWI Guide") is a new guide addressing goodwill impairment testing. The guides were developed by task forces and AICPA staff. The AICPA has requested comments (to be kept confidential) on both guides by March 15, 2012.

Paul Beswick, Deputy Chief Accountant at the SEC, recently shared his concerns on the current fragmented state of the valuation profession in the U.S. In his view, one potential solution was to consider "…whether there should be, similar to other professions, a single set of qualifications with respect to education level and work experience, a continuing education curriculum, standards of practice and ethics, and a code of conduct…" The AICPA guides will hopefully help assuage his concern.

IPR&D Guide

In the late '90s the SEC expressed concerns regarding what appeared to be unreasonable valuations of acquired assets to be used in R&D activities. The AICPA responded by forming the IPR&D task force to develop the original IPR&D practice aid, published in 2001. The practice aid identified best practices related to the accounting, valuation and disclosure of assets acquired to be used in R&D activities, including IPR&D projects.

The 2001 practice aid has served as the foundation for performing and auditing IPR&D valuations. In addition, it has been subject to a variety of off-label uses. For example, the insights related to contributory asset charges and tax amortization benefits have been applied in the valuation of a wide array of other assets.

FASB's new fair value measurement and business combination standards, released in 2006-2007, dramatically changed the landscape of IPR&D accounting and valuation. Recognizing the impact of such changes, the AICPA formed a new task force to update the guidance in the 2001 practice aid.

The draft IPR&D Guide provides guidance and illustrations related to the initial and subsequent accounting for, disclosures, and valuation of acquired IPR&D assets, addressing issues that have evolved in valuation practice and that have resulted from changes in the accounting standards. The new issues addressed include:

- Defensive IPR&D assets
- Implications of the FASB ASC 820 fair value framework
- Subsequent issues related to capitalization of IPR&D and its testing for impairment
- IPR&D in an asset acquisition
- Aggregation or disaggregation of projects
- Implications of assets shared among projects
- Core technology
- Enabling technology and technology migration
- Use of the relief from royalty method in IPR&D valuation

The draft IPR&D Guide, when finalized, will continue to provide in-depth guidance on par with its 2001 predecessor. The added topics, as well as adjustments to tailor the guidance to current accounting standards, will make this an indispensible guide for the accounting and valuation of IPR&D.

GWI Guide

Goodwill impairments saw a dramatic increase at the end of 2008 with recorded impairments approaching $190 billion. The magnitude of the impairments coupled with a certain degree of diversity in practice magnified the need for best practice guidance in this area.

Greg Franceschi, Duff & Phelps Managing Director and Head of the Financial Reporting Valuation practice, is the Co-Chair of the AICPA Impairment task force that developed the GWI Guide. The draft GWI Guide discusses practice issues related to the first step of the two-step impairment test, such as identifying reporting units and assigning assets and liabilities to reporting units. It also discusses measuring the fair value of a reporting unit in accordance with the fair value measurement guidance in ASC 820 and provides illustrations of the valuation techniques generally used in this context. An illustration of the second step of the two-step goodwill impairment test is also included.

A future version of the GWI Guide may address the execution of *qualitative* goodwill impairment assessments, pursuant to recent FASB guidance (ASU 2011-08), which provides this option under specific circumstances. A second guide yet to be developed by the same Task Force will focus on impairment testing of intangible assets.

Summary

These guides are two examples of best practice documents that have been completed or are under development. While this approach is not as revolutionary as Mr. Beswick's suggested solution, it will clearly enhance the quality and comparability of fair value estimates and reduce diversity in practice.

For more information contact Gary Roland, Managing Director, at 215-430-6042 or Greg Franceschi, Managing Director, at 650-798-5570.

International in Focus

Observations on the European Size Premium and Calculating Cost of Capital in the Current Environment

On October 21, 2011, Duff & Phelps organized a conference at Rotterdam School of Management, Erasmus University entitled *"How to Price the Risk of Equity: Global Evidence from New Markets"*. The conference brought together a distinguished group of experts and academics for a comprehensive technical discussion about methodologies and approaches for estimating various components of the cost of capital in today's unsettled economic environment. Our aim for the program was to help our clients and contacts to better navigate the current market environment, as it relates to the risk premium and its components.

Our presenters and their respective subject matter included:

- Henk Oosterhout, Managing Director and Head of International Operations, Duff & Phelps: "Introduction to the Risk Premium"
- Professor Elroy Dimson, emeritus finance professor at the London Business School, on the topic of "Equity Premia Around the World: The Long-Run Perspective" (joint work by Elroy Dimson with Paul Marsh and Mike Staunton)
- Roger Grabowski, Managing Director of Duff & Phelps, on the subject of "Estimating the Components of Cost of Capital in Today's Unsettled Economic Environment"
- Pablo Fernández, corporate finance professor at the IESE Business School, University of Navarra, presented his research regarding "Market Risk Premium used in 56 Countries in 2011"
- Professor Erik Peek of the Rotterdam School of Management, Erasmus University, Netherlands, delivered an overview of his research regarding "The Size Premium: A European Perspective"

While the primary focus of the conference was the equity risk premium (i.e., "ERP", "market risk premium") through the lens of historical data, current capital market expectations and expert opinions, speakers also presented new evidence of a size premium effect in Europe, as well as a discussion on risk free rates and whether there may be periods during which "normalization" (averaging) of rates becomes necessary.

Standard methods of estimating cost of capital that worked in periods of stability fell apart in late 2008 and early 2009. Even today, markets continue to experience heightened turbulence and uncertainty. Therefore, it is crucial for finance professionals and valuation practitioners to continually monitor and reassess their estimates of the building blocks of cost of capital (i.e. "discount rate", "expected return", or "required return").

The ERP is a forward-looking concept and represents the additional return that investors demand to compensate them for investing in a diversified portfolio of large common stocks rather than investing in risk-free securities. The ERP is used as a building block when estimating the cost of capital, and is an essential ingredient in any business valuation, project evaluation, and the overall pricing of risk. Because the ERP can have a larger impact on the concluded discount rate than other components, such as beta, estimating the ERP is one of the most important decisions one must make when developing a discount rate.

The Duff & Phelps Chair in Business Analysis and Valuation, Professor Erik Peek of the Rotterdam School of Management, Erasmus University, Netherlands, presented preliminary results of a Duff & Phelps study which investigates the existence of a size premium in European equity markets. Early findings suggest that there is indeed a size effect observed in European equity returns, particularly for very small firms (with market cap below EUR 14 million). Moreover, this size effect appears to follow a non-linear relationship. In other words, as the company size declines, the associated cost of equity (and size premium) rises more than proportionally. Professor Peek's preliminary results may suggest that the size effect in European equity markets mirror the size effect in U.S. equity markets, in that it seems to occur across the full size spectrum, but it is concentrated in the smallest of companies.

If you would like to learn more about Professor Peek's research regarding size premiums in Europe, please contact Lisa Gonzalez (lisam.gonzalez@duffandphelps.com). To learn more about cost of capital issues in today's turbulent economic environment, visit: www.duffandphelps.com/costofcapital

Contributors to this article include: James Harrington (Director, Office of Professional Practice), Carla Nunes (Director, Office of Professional Practice) and Michael Fischer (Senior Association, Valuation Advisory).

Spotlight
Duff & Phelps Expands Restructuring Practice in Key Markets

In the fourth quarter of 2011, Duff & Phelps added significant scale to its Global Restructuring Advisory practice with the acquisition of two specialty firms in North America and Europe.

On October 31, 2011, Duff & Phelps acquired MCR, a UK-based corporate restructuring and turnaround firm focused on insolvency administration and independent business reviews. This acquisition comprises approximately 150 staff across three offices in the UK, and significantly expands the firm's presence in Europe. This new team complements Duff & Phelps' existing team in London, which is focused on Valuation Advisory, Complex Asset Solutions and Mergers & Acquisitions. The MCR acquisition also expands the firm's European restructuring offering, and positions Duff & Phelps as a truly global advisor to assist clients with complex cross-border situations.

Duff & Phelps announced on December 12, 2011, that it had acquired RSM Richter's Financial Restructuring Practice in Toronto, Canada. This group is comprised of 17 professionals focused on restructuring and insolvency, and complements Duff & Phelps' existing team in Toronto that provide dispute consulting, valuation and corporate finance advisory services.

Read the full press releases for both of these acquisitions in our online press room at www.duffandphelps.com.

North American Industry Market Multiples

As of December 31, 2011

Industry	Market Value of Equity to Net Income		MVIC to EBIT		MVIC to EBITDA	
	U.S.	Canada	U.S.	Canada	U.S.	Canada
Energy	16.3	16.3	15.8	16.8	9.3	8.2
Energy Equipment & Services	18.9	12.3	15.4	10.1	8.7	6.6
Integrated Oil & Gas	9.9	—	7.8	9.7	6.1	8.2
Materials	13.0	11.5	11.1	12.9	7.7	8.1
Chemicals	12.2	9.9	10.8	9.4	7.6	7.5
Diversified Chemicals	10.7	—	11.0	—	7.4	—
Specialty Chemicals	13.4	8.2	11.0	6.5	8.4	4.4
Construction Materials	19.6	—	13.7	—	12.2	11.8
Metals & Mining	11.7	11.8	12.8	13.6	9.0	9.0
Paper & Forest Products	12.9	12.9	11.5	10.5	6.7	6.3
Industrials	15.2	11.0	12.1	11.1	8.7	8.4
Aerospace & Defense	14.4	8.0	12.1	9.5	8.6	7.7
Industrial Machinery	15.2	9.4	11.6	11.7	9.0	9.7
Commercial Services & Supplies	15.0	12.0	11.3	11.8	7.4	8.3
Road & Rail	19.1	14.5	12.2	13.3	8.0	10.5
Railroads	20.6	—	11.3	—	10.1	—
Consumer Discretionary	14.0	11.6	11.4	11.3	8.0	7.7
Auto Parts & Equipment	12.4	9.0	7.9	9.9	5.2	6.1
Automobile Manufacturers	7.2	—	7.7	—	4.4	—
Household Durables	10.8	—	12.0	—	9.0	—
Leisure Equipment & Products	14.8	—	11.8	—	9.4	—
Textiles, Apparel & Luxury Goods	13.1	21.4	11.2	9.3	9.2	5.8
Restaurants	18.6	6.3	14.3	11.1	8.1	10.2
Broadcasting	8.0	13.3	9.7	10.0	7.5	8.9
Cable & Satellite	22.6	—	15.3	9.2	7.6	5.5
Publishing	13.4	8.8	9.2	6.1	6.4	5.2
Multiline Retail	17.1	—	11.3	—	7.1	—

Industry	Market Value of Equity to Net Income		MVIC to EBIT		MVIC to EBITDA	
	U.S.	Canada	U.S.	Canada	U.S.	Canada
Consumer Staples	15.6	13.6	11.9	11.7	9.1	8.3
Beverages	14.1	10.9	14.2	11.6	11.0	10.0
Food Products	15.4	13.3	12.0	11.8	8.9	8.0
Household Products	18.4	—	12.5	—	10.6	—
Health Care	16.9	9.4	12.7	15.8	9.8	9.7
Health Care Equipment	20.9	4.1	14.7	—	11.5	5.9
Health Care Services	16.5	—	10.9	11.1	7.7	7.9
Biotechnology	15.0	6.5	13.0	15.7	13.0	7.9
Pharmaceuticals	18.4	17.5	12.6	20.5	9.0	9.9
Information Technology	16.0	9.9	14.2	11.4	10.6	9.1
Internet Software & Services	23.7	21.4	22.7	13.3	16.7	7.5
IT Services	16.9	9.4	12.8	8.7	9.4	10.3
Software	22.6	14.9	18.7	23.7	14.8	16.6
Technology Hardware & Equipment	13.8	8.3	13.1	9.0	10.3	6.6
Communications Equipment	15.3	8.4	16.2	9.0	12.8	6.8
Computers & Peripherals	16.0	—	13.9	—	10.6	—
Semiconductors	14.0	—	14.0	—	9.7	—
Telecommunication Services	15.7	13.3	13.8	11.4	6.1	6.7
Integrated Telecommunication Services	15.7	14.7	12.9	12.5	5.8	6.7
Wireless Telecommunication Services	13.0	—	12.7	—	5.6	—
Utilities	16.9	16.1	14.0	24.6	9.1	11.4
Electric Utilities	16.6	—	14.1	—	9.1	—
Gas Utilities	18.4	—	13.1	—	8.9	—

Industry	Market Value of Equity to Net Income		Market Value of Equity/ Book Value	
	U.S.	Canada	U.S.	Canada
Financials	13.8	10.7	0.9	1.6
Commercial Banks	12.7	10.8	0.8	1.8
Investment Banking and Brokerage	16.9	6.6	1.1	0.8
Insurance	11.8	10.8	0.8	1.0

An industry must have a minimum of 5 company participants to be calculated. For all reported multiples in the U.S. and Canada, the average number of companies in the calculation sample was 107 (U.S.), and 55 (Canada); the median number of companies in the calculation sample was 36 (U.S.), and 10 (Canada). Sample set includes publicly-traded companies (private companies are not included). Source: Data derived from Standard & Poor's Research Insight and Capital IQ databases. Reported multiples are median ratios (excluding negatives). MVIC = Market Value of Invested Capital = Market Value of Equity plus Book Value of Debt. EBIT = Earnings Before Interest and Taxes for latest fiscal year. EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization for latest 12 months.

European Industry Market Multiples
As of December 31, 2011

Industry	Market Value of Equity to Net Income	MVIC to EBIT	MVIC to EBITDA
Energy	12.1	17.6	9.4
Energy Equipment & Services	16.7	23.3	12.5
Integrated Oil & Gas	7.9	5.2	3.9
Materials	9.7	10.6	6.6
Chemicals	12.4	11.7	8.1
Diversified Chemicals	11.4	11.3	7.5
Specialty Chemicals	13.3	11.9	8.8
Construction Materials	16.3	14.3	7.8
Metals & Mining	6.9	8.0	5.9
Paper & Forest Products	7.0	12.2	6.3
Industrials	11.2	11.3	7.8
Aerospace & Defense	13.3	12.7	8.3
Industrial Machinery	12.2	10.6	7.6
Commercial Services & Supplies	12.6	11.4	7.8
Road & Rail	10.0	11.6	6.1
Railroads	11.8	16.9	6.5
Consumer Discretionary	11.4	11.0	7.5
Auto Parts & Equipment	6.9	7.9	5.2
Automobile Manufacturers	6.7	11.0	6.3
Household Durables	11.1	10.4	7.2
Leisure Equipment & Products	10.8	11.0	7.6
Textiles, Apparel & Luxury Goods	11.9	11.8	8.4
Restaurants	12.0	12.0	9.1
Broadcasting	11.9	9.8	7.0
Cable & Satellite	20.9	22.4	8.6
Publishing	12.4	12.3	8.1
Multiline Retail	10.9	11.6	7.1

Industry	Market Value of Equity to Net Income	MVIC to EBIT	MVIC to EBITDA
Consumer Staples	14.1	12.8	8.5
Beverages	16.1	14.9	9.1
Food Products	12.7	12.5	8.5
Household Products	—	—	10.4
Health Care	16.6	14.6	10.0
Health Care Equipment	14.3	16.4	12.1
Health Care Services	13.2	11.3	7.8
Biotechnology	21.5	17.9	16.1
Pharmaceuticals	16.7	11.4	9.3
Information Technology	12.5	10.9	8.3
Internet Software & Services	17.5	13.5	9.7
IT Services	11.5	9.3	7.5
Software	14.6	11.9	9.1
Technology Hardware & Equipment	12.0	10.3	8.0
Communications Equipment	11.9	9.7	7.1
Computers & Peripherals	13.8	14.7	8.0
Semiconductors	11.5	13.2	7.8
Telecommunication Services	12.1	10.6	5.9
Integrated Telecommunication Services	12.3	9.9	5.7
Wireless Telecommunication Services	11.0	10.8	6.1
Utilities	12.1	13.8	9.0
Electric Utilities	10.6	13.7	8.5
Gas Utilities	12.7	12.9	8.3

Industry	Market Value of Equity to Net Income	Market Value of Equity to Book Value
Financials	10.4	0.8
Commercial Banks	8.9	0.4
Investment Banking and Brokerage	13.8	1.2
Insurance	8.8	0.9

An industry must have a minimum of five company participants to be calculated. For all reported multiples in Europe, the average number of companies in the calculation sample was 90 and the median number of companies in the calculation sample was 37. Sample set includes publicly-traded companies (private companies are not included).
Source: Data derived from Standard & Poor's Research Insight and Capital IQ databases. Reported multiples are median ratios (excluding negatives). MVIC = Market Value of Invested Capital = Market Value of Equity plus Book Value of Debt. EBIT = Earnings Before Interest and Taxes for latest fiscal year. EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization for latest 12 months.

For more information about our global locations and expertise, or to subscribe to *Valuation Insights*, visit:

www.duffandphelps.com/subscribe

About Duff & Phelps

As a leading global provider of financial advisory and investment banking services, Duff & Phelps balances analytical skills, deep market insight and independence to help clients make sound decisions. The firm provides expertise in the areas of valuation, transactions, financial restructuring, alternative assets, disputes and taxation, with more than 1,000 employees serving clients from offices in North America, Europe and Asia. Investment banking services in the United States are provided by Duff & Phelps Securities, LLC. Member FINRA/SIPC. Investment banking services in the United Kingdom and Germany are provided by Duff & Phelps Securities Ltd. Duff & Phelps Securities Ltd. is authorized and regulated by the Financial Services Authority. Investment banking services in France are provided by Duff & Phelps SAS. For more information, visit www.duffandphelps.com (NYSE: DUF)

Valuation Insights Contributors

Michael Fischer
Greg Franceschi
Lisa Gonzalez
Roger Grabowski
James Harrington
David Larsen
Carla Nunes
Gary Roland
Sherri Saltzman
Marianna Todorova