DUFF & PHELPS

Valuation Insights

Second Quarter 2017

In this edition of Valuation Insights, we discuss the results of a Duff & Phelps study which analyzed more than 3,000 fairness opinions filed with the SEC over a ten-year period ending in 2016. The study analyzed valuation ranges of fairness opinions to gauge their utility for Boards considering potential transactions.

In our Technical Notes section, we discuss the asset valuation process for funds and the trend towards higher quality valuations that are both consistent and transparent. While there have been no major revisions to the accounting rules defining fair value for financial reporting purposes, industry best practices with respect to fund valuation continue to evolve.

In our International in Focus article, we discuss highlights from the 2017 Duff & Phelps Global Regulatory Outlook report. The report included a survey of financial services professionals to understand how regulation is impacting cost of compliance, anticipated priorities of regulators and where firms are allocating their compliance budgets.

Finally, our Spotlight article discusses Duff & Phelps' recently announced acquisition of Quantera Global Asia Holding.

In every issue of Valuation Insights, you will find industry market multiples that are useful for benchmark valuation purposes. We hope that you will find this and future issues of this newsletter informative and reliable.

Read this issue to find out more.

Industry Market Multiples Online

Valuation Insights Industry Market Multiples are available online with data back to 2010. Visit **www.duffandphelps.com/multiples** to analyze market multiple trends over time across industries and geographies.

Inside

Cover Story:
In Defense of Fairness Opinions: An Empirical Review of Ten Years of Data

Most fairness opinions use a robust set of methodologies to produce a useful range of valuations, according to Duff & Phelps' study of more than 3,000 publicly disclosed fairness opinions.

Those conclusions address periodic criticisms that fairness opinions generally provide little utility for boards analyzing potential transactions. Specifically, some critics have asserted that fairness analyses produce valuation ranges too wide to provide meaningful information and that, because most fairness opinions are based in part on DCF analysis, the opinions are too reliant on financial projections that have been produced by management and left unscrutinized by the fairness advisor.

In an effort to assess the validity of periodic criticisms and determine the overall usefulness of fairness opinions, Duff & Phelps conducted a thorough analysis of more than 3,000 fairness opinions filed with the SEC during the ten-year period ending in 2016.

Our analysis confirms that on average, fairness opinions deliver a range of valuations that is sufficiently narrow to serve as a valuable tool in evaluating purchase offers. And the average range grows narrower as deal size grows larger. Among deals we analyzed that carried a value of $10 billion or more, DCF analyses produced average price ranges between 78 percent and 106 percent of the offer price.

DCF Analysis: Average Value Range By Deal Size Cohort

The average range widened only slightly for deals valued at less than $10 billion but more than $100 million. For deals valued at less than $100 million, DCF analyses produced average price ranges between 65 percent

and 105 percent of the offer prices. Our observation – wider and more disperse valuation ranges for smaller companies – is not all that surprising. This reflects the heightened complexity involved in valuing enterprises that are less mature, have less historical data to analyze and compare, or are growing at a rate that causes dramatic variances in expected cash flow.

Methodologies: Rigor and Sophistication Apparent

The findings present clear signs of an industry standard at work among fairness opinion advisors. Counter to the criticism that fairness opinions rely too heavily on DCF analysis, we find that fairness advisors have been using multiple methodologies for some time. Ninety-one percent of the fairness opinions we reviewed used more than one methodology to arrive at valuations. In 75 percent of the deals, advisors used three or more methodologies.

The common pairing of public-company comparables and/or precedent transactions with DCF analyses, often supplemented by one or more additional methodologies, demonstrates that, in the vast majority of cases, fairness opinion advisors diligently consider multiple perspectives and relevant analyses, when available, in assessing the fairness of transaction prices.

Further, the data we collected showed that overall the public-company comparables and DCF analyses produced relatively consistent ranges that were reasonably narrow, particularly for larger companies where more information was available. The consistency of the average valuation ranges across DCF and public-company comparables analyses confirms the rigor and validity of both methodologies.

Multiple DCF Scenarios Indicate Additional Scrutiny

In 43 percent of the filings we analyzed, fairness opinion advisors used multiple cases of DCF analyses. The frequent use of multiple DCF scenarios indicates that advisors are considering every potentially pertinent projection, rather than simply accepting a single set of forecasts. In addition, the presentation of two (or more) DCF scenarios is likely the result of a growing judicial emphasis – via suggestion and mandate – on disclosure. Companies today are less likely to pick and choose which projections to disclose than they were a decade ago. Those who counsel boards of directors may conclude that erroring on the side of complete disclosure – even if a certain forecast included in regulatory filings was prepared for a much different purpose than assessing fairness – is generally prudent for the filer.

Choice of Advisor Matters

Finally, our study reveals that valuation ranges vary by provider. Among the most active advisors, the tightest average range, at 23 percentage points, is nearly twice as narrow as the broadest range of 41 percentage points. This demonstrates that the choice of an advisor does impact the precision and usefulness of a given fairness opinion and illustrates the importance of following the best practices described above – calibrating public-company comparables and scrutinizing management's projections.

Conclusion

The vast majority of fairness opinions offer valuation indications that fall within 15 percentage points on either side of a midpoint. Our analysis indicates that fairness opinion advisors use robust, sophisticated methods to reach those valuations. From this we can only conclude that, broadly speaking, fairness opinions represent a reliable way for corporate boards and executives to evaluate purchase offers.

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Technical Notes:
Valuing fund interests of increasing concern?

Asset valuation processes for funds continue to be a prominent topic of discussion despite no major revisions in the past five years to Financial Accounting Standards Board (FASB) ASC 820 or International Financial Reporting Standards (IFRS) 13, the two accounting rules defining fair value for fund financial reporting purposes. Governmental Accounting Standards Board (GASB) Statement 72, issued in early 2015, mirrors the definition of fair value used by the FASB and the International Accounting Standards Board (IASB) and highlighted that investors in funds cannot blindly accept net asset value as the fair value estimate. In addition, investors' focus on fair value includes obtaining transparency, evolving industry best practices and the evolving regulatory landscape.

Fair value measurements are no longer considered by investors as a compliance box to tick on a monthly or quarterly basis. Investors continue to become increasingly sophisticated and the NAV reported by GPs has evolved into an input into multiple processes: the investor's own financial reporting; asset allocation calculations; and risk considerations, incentive compensation, etc.

While not news, investors that report under GASB have to report their assets on the same fair value basis as other funds that report under U.S. GAAP or IFRS. From experience, it is clear that many general partners are aware of this fact and that a weak valuation process on the GP end has operational impacts at the Limited Partner (LP) level.

LPs often lack the resources (human or funding) to have a robust valuation process. As such, these investors increasingly look to GPs or lead investors to leverage the GPs' valuation work for their own reporting purposes. To be able to leverage valuation work done at the GP/lead investor level, LPs must be able to show the GP/lead investor has a robust and well-documented valuation process – starting with an up-to-date valuation policy and ending with robust documentation for the fair value determination of each asset, increasingly using the best practice of validating underlying investment valuations through the use of a qualified experienced third-party valuation expert. Absent the ability to show that, LPs must have their own robust process at the asset level.

Related to fair values for financial reporting is the fact that LPs are becoming more sophisticated in the criteria used to manage their investment portfolios – both existing and new investments. Fair value is the only objective measure to compare dissimilar investments on each measurement date. Robust fair values enable LPs to make well-informed decisions around performance and asset allocation. Advancements in technology are making it increasingly easy for even smaller, resource constrained LPs to look at their portfolio's makeup and performance in ways they couldn't even a few years ago. When an LP sees a fund's NAV or the fair value of an underlying investment remain constant for a number of periods, it is increasingly being seen as a reason to reach out to the GP for a greater understanding of the valuations in question.

LPs are now looking past the fund level performance and have a greater understanding of the performance of the underlying investments. Be it allocations to industries or asset classes, robust fair values give LPs the information they need to make informed allocation decisions. GPs that do not have robust valuation processes might find interests in their funds being sold in the secondary market and/or not receiving future allocations. Looking forward, LPs are examining how GPs create value (alpha) in their investments and fair value is an important piece of the analysis that is an input to the capital allocation decision. Gone are the days when a GP got meaningful credit for increases in value because the market went up.

Harvard University recently announced significant changes to how it manages its endowment. These changes include a move away from asset-class-based investing to allocating resources based on risk. For all assets, movements in fair values are an important input into the true assessment of risk. For illiquid assets, market prices are not observable, therefore, robustly determined fair values are the basis for investors' assessments of risk for an individual investment or illiquid asset class. If fair values are not robustly determined, one's risk assessments will be misinformed, potentially having significant impacts on investment decisions.

The regulatory world continues to affect the world of fair value determination as well. From the European Union's Alternative Investment Fund Managers Directive making a clear push for independence in the valuation process to Brazil's enacting fair value rules for the first time (and requiring public disclosure of fair values by investment), regulators have taken notice of the importance of fair value to all constituents. 2016 saw the Securities and Exchange Commission and European regulators fine several funds for poor valuation practices despite valuation not being at the top of the published list of examination priorities.

The American Institute of Certified Public Accountants (AICPA) is working on a new guide for the valuation of private equity investments that is due out in draft form in early 2018. The AICPA guide is expected to be rich in examples that demonstrate proper valuation methodologies as well as the need for judgment in the valuation process. Weighing in at an expected 700-plus pages, the AICPA guide hopefully will provide more consistent guidance across the industry and, as it will be considered by auditors, it is likely to be pushed globally across the audit firms, enhancing global consistency.

There is also a push in the U.S. to add consistency to the valuation profession through regulation and requirement of a professional certification or designation. The requirements for the Certified in Entity and Intangibles Valuations (CEIV) designation are now being developed, as is the certification process. Auditors will be the "regulator" and will have the ability to accept/place more emphasis on valuations performed by a professional holding the CEIV designation and less emphasis on valuations not performed by a CEIV holder. This is developing in real time and is expected to be rolled out later this year.

In conclusion, while the definition of fair value remains unchanged, robust fair value measurement remains an evolving global topic and the trend continues to move toward higher quality, greater consistency and better transparency.

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This article was originally published in the March 2017 issue of Pensions & Investments.

International in Focus: Old challenges for financial services compliance are going to have a new relevance in our changing world.

The Duff & Phelps 2017 Global Regulatory Outlook (GRO) survey of 181 financial services professionals shows they continue to contend with well-established challenges around competitiveness, international coordination and costs. Almost nine out of ten (89%) believe regulations are increasing costs, for instance, and compliance spending at a typical firm is expected to double in the next five years.

Today, the most common spend on compliance among asset managers, brokers, banks and others is up to 4% of revenue. By 2022, it's expected to rise to up to 10%. The proportion putting their compliance spending at less than 1%, meanwhile, is expected to halve.

Technology trials

Spending on cybersecurity will account for at least some of this hike, and this has been a key development in the past year. After attacks on the Swift payment system,[1] the "unprecedented" theft from a UK retail bank's online accounts[2] and a huge increase in reported attacks on financial services groups generally,[3] regulators are widely expected to focus on firms' cyber defences and – perhaps most crucially – their detection and response plans.

So far, regulators such as the U.S. Securities and Exchange Commission (SEC) have held off mandating precise requirements around cybersecurity. Nevertheless, about two-thirds of professionals in our survey expect it to be among the regulators' top three priorities in 2017. Anti-Money Laundering (AML) and Know Your Customer (KYC) seem to be among the regulators' top priorities.[4]

In any case, firms are taking this seriously; 86% say their company intends to put more resources and time into cybersecurity in the coming year. Other areas likely to see attention, meanwhile, are MiFID II, where more than half (54%) of those to whom it applies say they are still unsure if they're on track to comply by 3 January 2018; and the SEC's proposed rules to enhance information reported by investment advisors in 2017, which 62% of regulated firms say will impact them.

Most respondents (61%) concede that regulations will improve internal controls. More than half (54%) also say making executives and senior managers responsible for the actions of employees within the firm has a positive impact on the industry.

Bang for buck?

More widely, however, scepticism about the value financial regulation brings remains. More than half say financial services regulation has either had little effect (35%) or actually worsened market stability (17%) – presumably reducing liquidity in some markets – against only 43% who say it has increased stability. Similarly, half (51%) say it has done little to improve investor confidence, and 7% say it has eroded it.

Finally, just one in ten says regulatory changes over recent years have adequately created safeguards to prevent a future crash.

This comes as no surprise: the findings are not vastly different to previous years. But scepticism regarding the efficacy of financial regulations since the crisis has added import in light of the recent political upsets in the U.S. and, perhaps, the UK.

In the former, the new president has pledged to "dismantle" Dodd-Frank, a position his Democratic opponent on the campaign trail, Hillary Clinton described as "reckless." That disagreement foreshadows the opposition President Trump may face if he does push for any significant reduction in financial services regulation.

In this context, it's interesting to note that financial services professionals themselves remain far from convinced that regulation – despite the vast costs imposed on the industry – has made markets safer.

A new world

A similar observation may also apply in the UK if Brexit sees an end to EU passporting and enables the UK to determine its own, potentially lighter, regulation. In any case, most firms expect Brexit to have some impact on their compliance arrangements, whether in the long term, over 18 months (26%); nearer term, within seven to 18 months (22%); or, in some cases, sooner (12%).

Confidence in the UK's position as a financial centre is weak, however. Today it alone challenges New York as the pre-eminent global financial centre, with 36% naming it compared with 58% naming the U.S. city. Asked what location will dominate in five years' time, however, the proportion naming New York remains steady, while those naming London more than halves to just 16%.

It's a reminder, perhaps, of just how much uncertainty remains as we enter 2017; and it's a reminder, too, if one is needed after the past year, that we cannot take anything for granted.

For more information contact Julian Korek, Global Head of Compliance and Regulatory Consulting, at +1 44 2070 890800

1 http://www.reuters.com/article/us-cyber-heist-swift-specialreport-idUSKCN0YB0DD

2 According to FCA chairman Andrew Bailey http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/financial-conduct-authority-november-2016/oral/42882.html

3 https://www.ft.com/content/66c95bc0-71b8-3adc-9e35-bef3e67b9292

4 https://www.bloomberg.com/news/articles/2016-11-10/trump-s-transition-team-pledges-to-dismantle-dodd-frank-act

Spotlight: Duff & Phelps Acquires Leading Transfer Pricing Advisory Firm in Asia Pacific

Duff & Phelps recently announced that it acquired Quantera Global Asia Holding, a leading Asia-Pacific transfer pricing firm. The transaction adds more than 25 transfer pricing professionals to Duff & Phelps in Australia, Hong Kong, Singapore and Vietnam that can provide advice throughout the Asia-Pacific region.

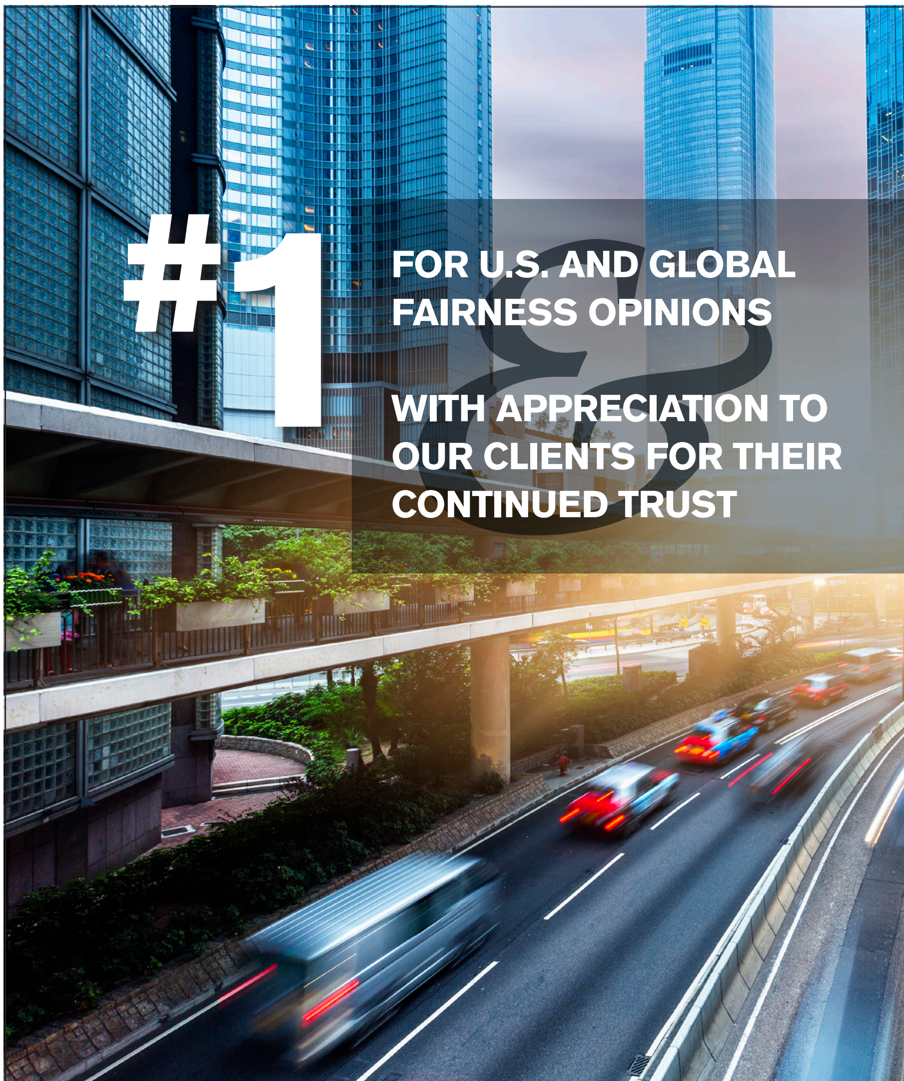
Tax authorities across Asia are expanding the transfer pricing reporting requirements of multinational companies and are increasingly auditing and challenging their transfer pricing practices. This transaction will enable Duff & Phelps to better serve its clients with operations in the Asia-Pacific region and augment the firm's transfer pricing capabilities.

"Duff & Phelps has been working closely with the Quantera Asia team over the past several years on numerous client engagements. This transaction is the culmination of a successful partnership and marks an important milestone in expanding our transfer pricing capability in the Asia-Pacific region," said Jacob Silverman, President of Duff & Phelps.

The transfer pricing practice of Duff & Phelps serves clients globally with transfer pricing compliance, planning and controversy support. This transaction follows Duff & Phelps' acquisition of Ceteris, a transfer pricing specialist, in 2012.

In conjunction with this transaction Quantera Global and Duff & Phelps have also entered into an alliance agreement which enables both firms to further strengthen their networks and bring increased opportunities to their respective clients on a global scale.

For more information contact Michael Heimert, Global Head of Duff & Phelps' Transfer Pricing practice, at +1 312 697 4560.



For the second year in a row, Duff & Phelps has ranked #1 provider of fairness opinions in the U.S. and globally, according to Thomson Reuters' "Mergers & Acquisitions Review - Full Year 2016".

Duff & Phelps is honored to be recognized as the undisputed market leader for fairness opinions. We thank our clients for trusting our independent financial advice. We look forward to continue helping companies make sound decisions in the year ahead.

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North American Industry Market Multiples
As of March 31, 2017

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Industry	Market Value of Equity to Net Income U.S.	Market Value of Equity to Net Income Canada	MVIC to EBIT U.S.	MVIC to EBIT Canada	MVIC to EBITDA U.S.	MVIC to EBITDA Canada
Energy	16.8	16.5	20.7	26.5	16.4	15.5
Energy Equipment & Services	50.4	27.8	22.9	20.9	15.8	16.2
Integrated Oil & Gas	—	—	—	—	—	—
Materials	20.3	15.4	17.2	17.6	10.9	10.9
Chemicals	20.9	—	17.2	17.6	11.9	12.8
Diversified Chemicals	17.9	—	16.9	—	11.5	—
Specialty Chemicals	22.1	—	17.1	—	13.4	—
Construction Materials	28.6	—	20.9	—	12.2	—
Metals & Mining	14.1	15.3	17.4	22.0	10.0	11.0
Paper & Forest Products	18.6	13.7	16.5	10.9	9.3	7.1
Industrials	22.4	20.7	16.7	17.1	11.7	12.0
Aerospace & Defense	19.0	20.5	16.3	15.8	12.4	10.5
Industrial Machinery	27.9	19.8	19.2	18.8	14.2	15.5
Commercial Services & Supplies	22.7	18.1	16.6	19.8	11.0	12.1
Road & Rail	20.3	18.1	16.0	17.2	8.5	11.9
Railroads	20.6	—	15.4	—	10.9	—
Consumer Discretionary	18.8	20.2	14.7	18.0	10.5	12.0
Auto Parts & Equipment	15.9	8.1	11.9	7.6	7.6	5.2
Automobile Manufacturers	—	—	—	—	14.2	—
Household Durables	15.0	—	12.8	—	11.5	—
Leisure Products	18.1	—	12.3	—	10.1	—
Textiles, Apparel & Luxury Goods	18.3	—	12.6	—	10.2	—
Restaurants	25.4	24.0	18.0	17.6	11.0	19.2
Broadcasting	16.6	—	13.2	20.0	10.2	9.8
Cable & Satellite	25.0	—	21.0	13.9	13.5	8.3
Publishing	30.5	—	14.8	15.9	10.7	9.5
Multiline Retail	14.6	—	10.5	—	7.3	—

Industry	Market Value of Equity to Net Income U.S.	Market Value of Equity to Net Income Canada	MVIC to EBIT U.S.	MVIC to EBIT Canada	MVIC to EBITDA U.S.	MVIC to EBITDA Canada
Consumer Staples	21.1	23.1	16.6	15.6	13.2	11.7
Beverages	18.9	—	21.0	18.1	19.3	13.4
Food Products	22.7	19.4	17.8	14.0	13.3	11.2
Household Products	25.6	—	17.7	—	13.6	—
Health Care	25.5	27.7	19.1	26.8	14.6	15.9
Health Care Equipment	35.1	—	24.1	—	17.2	—
Health Care Services	19.6	—	15.1	—	12.3	—
Biotechnology	20.9	—	21.2	28.7	21.5	13.9
Pharmaceuticals	17.9	21.1	16.7	44.0	12.7	19.1
Information Technology	26.7	25.5	22.2	23.9	16.2	17.9
Internet Software & Services	24.4	21.1	23.2	19.0	20.6	12.6
IT Services	26.7	29.8	20.2	21.9	13.4	17.0
Software	35.6	33.0	32.9	35.9	24.4	24.4
Technology Hardware & Equipment	24.9	22.4	18.5	18.1	14.0	14.7
Communications Equipment	25.6	30.9	22.0	19.6	16.6	17.2
Computers & Peripherals	20.7	—	15.2	—	12.7	—
Semiconductors	35.7	—	34.4	—	21.8	—
Telecommunication Services	24.7	—	19.6	15.2	8.5	8.2
Integrated Telecommunication Services	18.2	—	14.7	—	6.0	—
Wireless Telecommunication Services	36.6	—	27.5	—	9.2	—
Utilities	22.8	17.5	18.7	24.4	11.6	13.5
Electric Utilities	21.0	—	17.7	—	10.6	—
Gas Utilities	25.3	—	18.6	—	12.1	—

Industry	Market Value of Equity to Net Income U.S.	Market Value of Equity to Net Income Canada	Market Value of Equity to Book Value U.S.	Market Value of Equity to Book Value Canada
Financials	17.8	11.6	1.3	1.5
Commercial Banks	18.1	12.6	1.4	1.7
Investment Banking & Brokerage	18.6	—	1.6	1.3
Insurance	16.4	13.1	1.3	1.4

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 79 (U.S.), and 27 (Canada); the median number of companies in the calculation sample was 41 (U.S.), and 11 (Canada). Sample set includes publicly-traded companies (private companies are not included). Source: Data derived from Standard & Poor's 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 12 months. EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization for latest 12 months.

European Industry Market Multiples
As of March 31, 2017

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Industry	Market Value of Equity to Net Income	MVIC to EBIT	MVIC to EBITDA
	Europe	Europe	Europe
Energy	12.7	18.7	10.1
Energy Equipment & Services	15.1	15.2	10.2
Integrated Oil & Gas	20.0	52.4	10.1
Materials	17.6	16.1	10.1
Chemicals	19.9	17.4	10.6
Diversified Chemicals	19.4	16.2	9.4
Specialty Chemicals	24.5	18.1	12.5
Construction Materials	15.7	17.2	10.1
Metals & Mining	16.0	15.4	9.9
Paper & Forest Products	16.2	14.6	9.8
Industrials	19.8	17.1	11.7
Aerospace & Defense	23.6	19.9	13.7
Industrial Machinery	23.2	19.7	13.9
Commercial Services & Supplies	21.6	17.4	11.2
Road & Rail	14.9	14.0	8.0
Railroads	13.3	18.8	8.0
Consumer Discretionary	18.4	16.0	11.4
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Leisure Products	19.9	16.1	12.3
Textiles, Apparel & Luxury Goods	19.9	16.7	12.4
Restaurants	20.9	15.4	10.9
Broadcasting	20.9	18.7	13.0
Cable & Satellite	28.1	24.1	11.8
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Multiline Retail	21.5	14.8	12.0
Consumer Staples	20.2	17.0	12.1
Beverages	24.6	18.7	13.0
Food Products	18.0	16.2	10.8
Household Products	24.3	15.4	11.5

Industry	Market Value of Equity to Net Income	MVIC to EBIT	MVIC to EBITDA
	Europe	Europe	Europe
Health Care	28.5	23.4	17.3
Health Care Equipment	32.0	23.1	18.2
Health Care Services	18.1	18.7	13.6
Biotechnology	43.0	37.8	29.1
Pharmaceuticals	28.0	23.4	16.3
Information Technology	24.4	20.0	15.3
Internet Software & Services	26.4	24.3	21.0
IT Services	20.0	15.5	12.7
Software	29.1	23.2	18.1
Technology Hardware & Equipment	23.5	18.8	13.6
Communications Equipment	31.5	27.0	16.3
Computers & Peripherals	20.1	17.5	12.4
Semiconductors	29.1	30.0	15.9
Telecommunication Services	24.0	20.1	9.8
Integrated Telecommunication Services	22.8	18.2	8.8
Wireless Telecommunication Services	17.3	23.7	8.9
Utilities	15.4	18.4	10.4
Electric Utilities	13.6	16.4	10.2
Gas Utilities	15.4	16.0	11.4

Industry	Market Value of Equity to Net Income	Market Value of Equity to Book Value
	Europe	Europe
Financials	13.3	1.1
Commercial Banks	10.9	0.8
Investment Banking & Brokerage	19.8	1.8
Insurance	13.5	1.2

"An industry must have a minimum of 5 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 38. Sample set includes publicly-traded companies (private companies are not included). Source: Data derived from Standard & Poor's 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 12 months. EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization for latest 12 months.

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Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in complex valuation, dispute and legal management consulting, M&A, real estate, restructuring, and compliance and regulatory consulting. The firm's more than 2,000 employees serve a diverse range of clients from offices around the world.

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