Fourth Quarter 2012

Valuation Insights

Inside

Contact us at:
www.duffandphelps.com

In this edition of Valuation Insights we discuss the recently released 2012 Duff & Phelps Goodwill Impairment Study that was done in conjunction with the Financial Executives Research Foundation. The study examines the general and industry trends of goodwill impairment of U.S. companies, analyzes the performance of companies that recorded a goodwill impairment relative to the market as a whole, and reports on the results of a survey of FEI members.

In our Technical Notes section we discuss a recent Delaware appraisal action in which a number of valuation issues were addressed in connection with the determination of the value per share of the common stock of Orchard Enterprises, Inc. The article summarizes the case and discusses the valuation implications for companies.

Our International Spotlight section discusses business incentives opportunities in Europe to induce corporate investments in facilities, machinery and equipment, as well as research and development. The article discusses the types of available incentives by region and how companies can secure public funding.

Finally, our Spotlight article discusses Duff & Phelps' acquisition of CETERIS®, a leading independent provider of transfer pricing and strategic economic consulting services.

In every issue you will find industry market multiples which are useful in benchmarking for 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.

2012 U.S. Goodwill Impairment Study

Duff & Phelps and the Financial Executives Research Foundation (FERF)[1] have released the results of the 2012 Goodwill Impairment Study (2012 Study). Initiated in 2009, these annual comprehensive studies:

- Examine the general and industry trends of goodwill and goodwill impairment of U.S. companies.
- Assess whether new goodwill impairment trends have emerged.
- Analyze the performance of companies that recorded goodwill impairment relative to the performance of the market as a whole.
- Report the results of the annual goodwill impairment survey of Financial Executives International (FEI)[1] members.

Highlights of the 2012 Study

The total amount of goodwill impaired by U.S. companies in calendar year 2011 of $29 billion tracked closely the $30 billion of aggregate goodwill impaired in 2010. For the third year in a row, financial services firms represented the greatest proportion of total impairments. However, since 2008 consumer staples companies have been steadily increasing their share of total goodwill impairments, nearly equaling that of financial services firms in aggregate amount of 2011 impairments.

New in the 2012 Study

In prior studies specific statistics were presented across industries. In the 2012 Study, Duff & Phelps introduced "Industry Spotlights" that highlight 10 industry sectors.[2] The Industry Spotlights allow readers to focus on relevant metrics and statistics for the particular industry of their interest. Each spotlight also displays the top three companies recognizing the highest amount of goodwill impairment for that industry in 2011.

The annual survey on goodwill impairments conducted from a sample of FEI members, representing both public and private companies, has been refined and updated. The survey continues to assess the reasons for goodwill impairments and the valuation techniques used in the impairment testing process. Notably, the 2012 survey captures FEI members' level of usage of the qualitative goodwill impairment test (a.k.a "Step 0") as well as preliminary views on the new qualitative assessment option for indefinite-lived intangible assets, recently finalized under ASU 2012-02 Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment ("ASU 2012-02").

The qualitative assessment option for goodwill had broad appeal among the respondents, with 52% of private companies and 43% of public companies applying it to some or all of their reporting units. The level of actual usage was lower than previously anticipated: in the 2011 survey 69% of private and 81% of public entities responded that they expected to apply Step 0 in some form. Primary reasons cited in 2012 for not applying Step 0 included:

- Specific financial circumstances led directly to Step 1;
- Traditional Step 1 test was considered more robust; and
- Documentation requirements were perceived to be too cumbersome and/or time consuming relative to the current Step 1 analyses.

The 2012 Study also added cross-tabulation analyses beyond the segregation of responses between public and private companies. These were included in an attempt to uncover inter-relationships between certain responses, such as those related to the qualitative impairment testing. For example, a cross-tabulation between company responses regarding the use of the qualitative assessment for goodwill and indefinite-lived intangible assets was performed to assess the respondent's expected use of ASU No. 2012-02. Recall that by issuing ASU No. 2012-02 in July 2012, the FASB aligned the impairment guidance for indefinite-lived intangibles with that for goodwill by providing:

- The option to perform a qualitative (more likely than not) test prior to the quantitative test;
- The ability to bypass or resume the quantitative test in any period; and
- Examples of factors to be considered in a qualitative impairment test of indefinite-lived intangibles that are similar to those used for goodwill.

The cross-tabulation analysis revealed that of the companies that applied Step 0 in the goodwill impairment test, the majority (86%) also expect to apply it to indefinite-lived intangibles testing. Further, half of the companies that did not apply Step 0 to goodwill impairment testing anticipate applying it for indefinite-lived intangibles.

Please visit the Duff & Phelps website to obtain a complete copy of the 2012 Study.

For more information contact **Gary Roland**, Managing Director, at 1 215 430 6042, **James Harrington**, Director, at 1 312 697 4938 or **Carla Nunes**, Director, at 1 215 430 6149.

1. Financial Executives Research Foundation (FERF) is the non-profit 501(c)(3) research affiliate of Financial Executives International (FEI).
2. Industries are defined throughout the 2012 Study in accordance with Global Industry Classification Standard (GICS) codes. The "Industry Spotlights" are for the ten 2-digit "sector-level" GICS codes.

Technical Notes

Valuation Implications of *Appraisal of The Orchard Enterprises, Inc.*

The old adage is that 90% of litigation matters settle. Therefore, anytime a case goes far enough that a decision is issued by a leading court, such as Delaware's Chancery Court, there is heightened interest in the outcome. One recent case in Delaware Chancery Court did not disappoint. In *Appraisal of The Orchard Enterprises, Inc.* ("Orchard") the court addressed at least four valuation-related topics:

(1) How to treat liquidation preference of preferred securities in valuing common stock;

(2) The preference of Discounted Cash Flow ("DCF") analyses over comparable companies and comparable transactions analyses;

(3) The use of hindsight to support management projections; and

(4) The continued trend of support for the use of the Capital Asset Pricing Model ("CAPM").

Background

The case involved Orchard which primarily sells licensed music, through online retailers such as iTunes and Amazon, for a variety of artists. In 2010 Orchard accepted an offer for all of its outstanding common shares at $2.05 per share, when the shares were trading at $1.34 per share. The common shareholders sought an appraisal by the Court, arguing that each common share was worth $5.42, not the $2.05 that was offered. Orchard countered that the merger price was generous and that the shares were worth $1.53 as of the merger date. The Court evaluated various issues including projections and cost of capital assumptions, to arrive at a value per common share of $4.67.

Liquidation Preference

The largest difference in value between the two parties in the case stemmed from how liquidation preference was treated. While Orchard argued that the company's preferred stockholders were entitled to the first $25 million of the company's equity value (and deducted $25 million from the equity value in their calculation) the Court rejected this approach, noting that the liquidation preference had not been triggered as of the merger date. Furthermore, the Court argued that the possibility that any of the triggering events would have occurred was speculative.

Valuation Approaches

As it relates to valuation approaches and methods, the Court found that the comparable companies and comparable transactions analyses could not reliably be used in this case, giving exclusive weight to the DCF method. The Court stated that "reliance on a comparable companies or comparable transactions approach is improper where the purported 'comparables' involve significantly different products or services than the company whose appraisal is at issue, or vastly different multiples." The Court also noted that one expert did not use the mean or median multiple, but rather picked a "multiple that has no logical relation to either" the mean or median, "inferring that [the comparable companies] are materially different from [the] sample."

While the Court rejected the comparable companies and comparable transactions analyses, the door was left open to use these methods in future valuation analyses, particularly in specific industries. For example, the Court singled out fast food restaurant chains, commercial banks, and automobile manufacturers as industries that might be seen as having, "a number of recognizable players who compete in the same markets."

Hindsight

The Court adopted an approach that weighted DCF projections based on 2 cases: a base case and an aggressive case. The Court weighted the base case 90% and the aggressive case 10%. The Court noted that the base case projections were supported by the actual financial results for the last twelve months as of the valuation date. While not technically hindsight, it is not clear whether these results were available as of the valuation date. That is, the Court specifically found that the weighting assumption of 90/10 in favor of the base case was appropriate in part because the actual financial results were *less* than the base case projections, albeit prior to the valuation date.

Cost of Capital

Finally, the Court addressed cost of capital issues. First, the Court adopted the CAPM method of estimating the cost of equity, citing that it "is generally accepted, involves less (but still more than comfortable) amounts of subjectivity, and should be used where it can be deployed responsibly." In terms of the components of the CAPM, the Court adopted the supply-side equity risk premium over the historical equity risk premium. The Court also rejected Orchard's use of a company-specific risk premium.

Conclusion

In summary, in Orchard the Court rejected the values of both parties (the petitioner and Orchard), and arrived at a value per common share of $4.67, more than twice the value of the publicly-traded price prior to the merger. In doing so the Court chose not to apply a liquidation preference, continued its support of DCF analyses, introduced hindsight as support for certain assumptions, and continued its support for CAPM and other cost of capital assumptions. While the Court left the door open for other interpretations on some of these issues in the future, any valuation analysis that could become subject to litigation in Delaware's Chancery Court should be cognizant of the issues in this case.

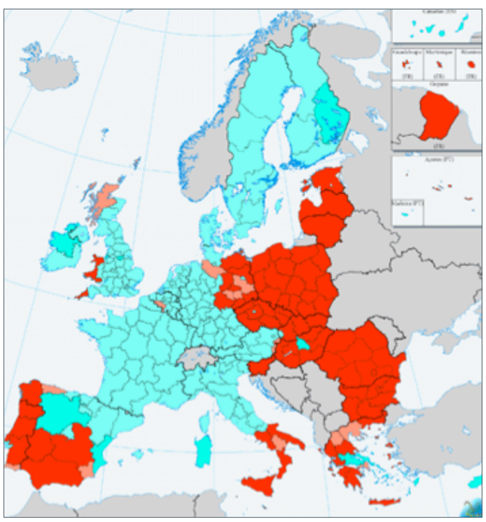
For more information contact
Jaime d'Almeida at 617-378-9445 or
Rebecca Levy at 617-378-9461

International in Focus
Business Incentive Opportunities in Europe

In Europe, local authorities, Regional or National Governments and the European Union offer state aid (cash grants and tax incentives) to induce corporate investments in facilities, machinery and equipment as well as to support research and development. The amount of the aid varies from country to country and region to region according to their level of development.

Every seven years, the European Union and Member States enter an agreement that defines a new framework for state aid. In each region, the state aid is concentrated in three or four main priorities and each priority, in turn, includes three or four sub-priorities.

Below is a map of Europe with the defined priorities.



The regions in red (called "Convergence") are the areas where economic development is below the EU average. In these regions, companies could receive the highest level of aid (direct support for capital investment). The areas in blue (called "Competitiveness and Employment") are the ones where the level of direct aid is limited.

Convergence Regions
In the Convergence Regions, the governments are permitted to give up to 50% of the eligible costs to induce a project. "Eligible Costs" could include the following items:

- Construction of new facilities
- Construction of expanded facilities
- Machinery and equipment

Competitiveness and Employment Regions
The state aid in "Competitiveness and Employment Regions is restrained by a de minimis rule (e.g. 200,000€ per company every three years). Unlike the Convergence Regions where the governments support capital investment, in the Competitiveness and Employment Regions, the governments support companies in their operational activities:

- Research and development expenses including salaries and lab costs.
- Hiring of new employees and training.
- Costs attributed to the development of products that improve health, safety and the environment.

In addition to the national sources of state aid, the European Commission finances R&D and environmental projects that have a continental dimension. The main EC programs are the seventh framework programme for RTD (FP7) and the LIFE+ program.

How to benefit from these funds?
Before investing in a new or expanded facility, hiring and training personnel or developing new products and processes, it is worth checking whether the business activities are eligible to receive a grant under any number of funding programs. Duff & Phelps professionals can assist you in optimizing the procedures related to the request of public funding while guaranteeing a minimum financial and human involvement from your side. Our team, along with our alliance partner in Europe, has in-depth knowledge of local and national programs and maintains close relations with the authorities and agencies that manage the European Union funds.

Our team could provide you with the following services:

- Assistance throughout the whole process of obtaining and securing the public funding.
- Proven reporting methods and negotiation skills to optimize the relationships with the funding authorities.
- Monitoring of the project's compliance with administrative funding requirements.

Duff & Phelps' expertise and rich network of relationships help secure value from business incentives, reduce above-the-line operating costs, enhance cash flow and raise return on investment. We understand the importance of approaching governments well in advance of a project's announcement, with a strong rationale for granting an incentive. Specific services include:

- Negotiation strategy
- Representation and expert testimony in public forums
- Economic and fiscal impact analyses
- Site selection support and comparative location cost modeling
- Application writing and form preparation
- Administrative compliance, computer-assisted monitoring and tracking of tax and non-tax benefits secured.

For more information contact **Greg Burkart**, Managing Director, at +1 248 675 6959.

Spotlight
Duff & Phelps Acquires CETERIS®

Duff & Phelps recently announced that it acquired CETERIS®, a leading independent provider of transfer pricing and strategic economic consulting services. This acquisition better positions Duff & Phelps to support our clients as they face increased scrutiny from tax authorities around the world.

Founded in 2003, CETERIS® serves many of the largest multinational organizations, leading law firms and government agencies around the world. CETERIS® experts provide clients with transfer pricing, tax valuation, intellectual property and strategic economic analysis, as well as objective advice and viewpoints that are rooted in independence and free from conflict. CETERIS® professionals also provide support services in relation to CAP audits and audit defense, as well as expert witness services for complex disputes.

CETERIS® adds approximately 50 professionals to Duff & Phelps' existing team in North America, Europe and Asia, along with an alliance network of advisory partners throughout the world. The addition of CETERIS® elevates the transfer pricing capabilities provided by Duff & Phelps' Valuation Advisory Services business, which provides financial reporting and tax valuation and related services.

For more information contact **Michael Heimert**, Managing Director, at + 1 312 253 0925.

North American Industry Market Multiples
As of September 30, 2012

	Market Value of Equity to Net Income		MVIC to EBIT		MVIC to EBITDA	
Industry	U.S.	Canada	U.S.	Canada	U.S.	Canada
Energy	14.4	14.3	14.6	12.6	8.1	6.4
Energy Equipment & Services	17.1	8.1	13.2	7.7	8.8	4.9
Integrated Oil & Gas	11.6	—	8.3	11.7	5.5	7.4
Materials	15.6	11.7	11.7	12.3	8.1	7.9
Chemicals	15.8	12.9	11.6	11.6	8.3	6.9
Diversified Chemicals	14.3	—	12.2	—	8.9	—
Specialty Chemicals	16.5	—	11.4	—	8.4	—
Construction Materials	19.1	—	19.9	—	10.2	6.4
Metals & Mining	15.3	11.1	12.2	12.4	8.2	8.0
Paper & Forest Products	14.0	13.8	11.7	12.6	7.4	9.8
Industrials	15.3	14.0	11.9	12.9	8.7	9.2
Aerospace & Defense	13.5	10.6	10.6	11.2	7.7	7.7
Industrial Machinery	16.8	8.0	11.9	12.6	9.0	10.7
Commercial Services & Supplies	16.1	16.3	11.8	13.9	8.3	9.3
Road & Rail	15.1	13.8	10.7	13.5	7.3	11.2
Railroads	15.1	—	13.1	—	11.5	—
Consumer Discretionary	16.4	13.6	12.3	11.4	8.7	8.2
Auto Parts & Equipment	8.9	9.1	9.5	7.1	6.1	5.1
Automobile Manufacturers	5.9	—	7.8	—	4.6	—
Household Durables	11.3	—	11.4	—	9.0	—
Leisure Equipment & Products	15.9	—	12.4	—	8.9	—
Textiles, Apparel & Luxury Goods	18.4	13.1	13.1	9.8	10.5	6.8
Restaurants	19.9	17.7	14.3	10.4	9.5	9.2
Broadcasting	9.3	—	10.6	10.6	8.9	9.0
Cable & Satellite	19.7	8.2	15.9	9.8	7.7	4.9
Publishing	13.9	6.3	10.3	7.3	6.9	6.3
Multiline Retail	15.6	—	11.7	—	7.3	—

	Market Value of Equity to Net Income		MVIC to EBIT		MVIC to EBITDA	
Industry	U.S.	Canada	U.S.	Canada	U.S.	Canada
Consumer Staples	16.2	14.9	13.2	13.1	9.8	9.5
Beverages	16.7	10.6	16.8	12.6	13.0	8.0
Food Products	15.8	18.7	13.7	13.2	9.9	9.5
Household Products	17.8	—	13.3	—	9.4	—
Health Care	18.9	12.1	14.6	12.9	10.7	11.4
Health Care Equipment	21.5	—	14.8	—	12.9	12.9
Health Care Services	20.1	—	13.2	—	8.7	7.5
Biotechnology	24.4	—	23.1	—	20.3	13.8
Pharmaceuticals	12.2	11.8	11.8	12.3	8.8	15.3
Information Technology	18.6	13.0	15.8	13.2	11.9	9.6
Internet Software & Services	26.0	15.1	22.9	18.7	16.7	8.0
IT Services	17.7	14.3	13.1	13.2	10.2	8.9
Software	23.1	18.3	22.9	15.7	14.7	13.2
Technology Hardware & Equipment	15.7	8.0	13.1	9.9	10.0	6.2
Communications Equipment	19.2	8.4	16.2	10.2	11.9	6.8
Computers & Peripherals	15.6	—	11.9	—	10.1	—
Semiconductors	23.5	—	23.4	—	13.6	—
Telecommunication Services	16.8	13.5	14.6	12.4	6.3	6.8
Integrated Telecommunication Services	18.9	13.1	13.9	11.6	6.2	6.7
Wireless Telecommunication Services	17.4	—	14.6	—	6.3	—
Utilities	18.2	15.3	14.7	22.7	9.3	11.9
Electric Utilities	16.2	—	14.0	—	8.9	—
Gas Utilities	20.4	—	14.5	—	9.9	—

	Market Value of Equity to Net Income		Market Value of Equity to Book Value	
Industry	U.S.	Canada	U.S.	Canada
Financials	13.4	10.8	1.0	1.2
Commercial Banks	12.8	10.6	1.0	1.9
Investment Banking and Brokerage	19.4	—	1.1	0.6
Insurance	11.5	16.3	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 113 (U.S.), and 47 (Canada); the median number of companies in the calculation sample was 54 (U.S.), and 9 (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 September 30, 2012

Industry	Market Value of Equity to Net Income	MVIC to EBIT	MVIC to EBITDA
Energy	12.0	13.6	8.6
Energy Equipment & Services	16.5	15.2	9.6
Integrated Oil & Gas	8.7	7.8	4.8
Materials	13.1	11.5	7.2
Chemicals	16.4	12.9	9.0
Diversified Chemicals	17.6	13.9	8.1
Specialty Chemicals	17.9	13.0	10.3
Construction Materials	15.8	14.4	7.9
Metals & Mining	10.7	9.2	6.4
Paper & Forest Products	14.0	15.5	7.2
Industrials	13.0	12.1	8.5
Aerospace & Defense	13.3	12.5	8.4
Industrial Machinery	13.4	11.6	8.4
Commercial Services & Supplies	15.2	12.5	8.1
Road & Rail	13.5	12.5	6.4
Railroads	16.1	13.4	6.4
Consumer Discretionary	13.3	11.8	8.3
Auto Parts & Equipment	8.6	8.1	5.5
Automobile Manufacturers	6.6	12.2	6.8
Household Durables	14.0	11.0	7.8
Leisure Equipment & Products	13.0	12.6	8.7
Textiles, Apparel & Luxury Goods	14.8	12.4	9.3
Restaurants	17.0	12.9	9.7
Broadcasting	14.0	10.0	9.2
Cable & Satellite	—	19.2	9.2
Publishing	15.3	13.5	9.2
Multiline Retail	11.6	10.9	8.3

Industry	Market Value of Equity to Net Income	MVIC to EBIT	MVIC to EBITDA
Consumer Staples	15.5	13.9	9.4
Beverages	18.9	16.5	11.4
Food Products	12.8	13.5	9.1
Household Products	32.0	14.7	10.9
Health Care	18.1	15.0	10.7
Health Care Equipment	18.2	12.9	10.4
Health Care Services	12.8	11.0	9.5
Biotechnology	25.8	25.9	18.7
Pharmaceuticals	17.6	13.8	10.0
Information Technology	14.4	12.2	9.1
Internet Software & Services	17.9	17.0	11.6
IT Services	12.5	9.8	7.5
Software	16.8	12.8	9.9
Technology Hardware & Equipment	13.6	12.1	8.8
Communications Equipment	13.5	12.4	8.8
Computers & Peripherals	13.5	10.5	8.9
Semiconductors	15.8	16.5	11.6
Telecommunication Services	13.0	11.4	6.6
Integrated Telecommunication Services	13.0	10.5	5.7
Wireless Telecommunication Services	11.6	11.3	6.3
Utilities	15.9	14.9	8.8
Electric Utilities	13.2	12.8	8.0
Gas Utilities	13.1	11.9	6.5

Industry	Market Value of Equity to Net Income	Market Value of Equity to Book Value
Financials	11.9	0.8
Commercial Banks	10.3	0.5
Investment Banking and Brokerage	15.5	1.2
Insurance	10.1	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 105 and the median number of companies in the calculation sample was 47. 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.

Duff & Phelps

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 financial advisory and investment banking firm, 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; Pagemill Partners; and GCP Securities, LLC. Member FINRA/SIPC. M&A advisory 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. For more information, visit www.duffandphelps.com. (NYSE: DUF)

Valuation Insights Contributors

Greg Burkart
Jaime d'Almeida
James Harrington
Rebecca Levy
Carla Nunes
Gary Roland
Sherri Saltzman