MERCER CAPITAL
Business Valuation & Financial Advisory Services

Value Matters™

Issue No. 2, 2020

Corporate Valuation and Estate Planning

COVID-19 and the Value of Your Business

An Estate Planning Opportunity Due to Lower Valuations

What do Black Monday, October 19, 1987, and the COVID-19 Crash of March 2020 have in common?

Black Monday was an event of uncertain cause, but the Dow Jones Industrial Average ("DJIA") dropped 508 points, or 22.6% on that one day in 1987. It was the largest single-day drop in history. In less than two years, however, the massive losses of Black Monday were recovered in the markets.

The COVID-19 Crash is a very recent event of certain cause. In mid-February 2020, the DJIA was flirting with the 30,000 level. Since February 20, 2020, when the Dow was at 29,220, the Index has dropped to 18,591 (close on March 23rd), or a drop of 36.4% – a larger percentage drop than Black Monday. In the days that followed, the Dow rebounded upon news of the fiscal package to combat the economic impact of COVID-19. As we move through uncertain days, it's difficult to envision a recovery, but we are convinced that our economy and our people will recover.

Black Monday provided a significant opportunity for intra-family ownership transfers. Why? Because with the substantial drop in public market values, there was an accompanying drop in private company values.

The COVID-19 Crash is severe. The triggering uncertainties are impacting all of us. The values of our client businesses are, at least for a time, lower than they were just a few short weeks ago.

As business owners and other business leaders continue to make hard decisions in real-time against the ever-changing backdrop of the coronavirus pandemic, their legal and tax advisors would do well to consider whether this is an opportune time for ownership transfers. For many businesses, the current economic uncertainty presents a unique, and perhaps fleeting, opportunity for more tax-efficient estate planning.

Wall Street vs. Main Street

Investors value the shares of public companies on a (nearly) continuous basis. It should not be too surprising that these "real-time" valuations are subject to a good bit of volatility.

Is the value of your business that volatile? Unlike public companies, private businesses are not subject to continuous public valuation. Reliable valuation data points for businesses exist only when a competent business valuation is prepared or when there is an arm's-length transaction with a third party. As a result, whatever day-to-day volatility exists in the value of private businesses is not visible. However, just because you can't see it doesn't mean it's not there. Instead, what is often assumed to be limited volatility in the value of a private business is more likely a function of the limited frequency with which value is observed.

The same fundamental factors that influence public stock prices – risk assessments, growth expectations, and cash flow projections – also influence the value of all private businesses.

We say all that to say this: unless you are a grocer or the like, the value of your business is likely lower today than it was two months ago, and maybe a good bit lower.

The Value of Your Business is Lower

At this point, you may be thinking that, even if the value of your business is currently depressed, you have no intention of selling today. But even for owners who have no intention of selling in the current environment, the fact that the value of your business has declined should not be ignored.

One of the cornerstones of estate planning is the concept of fair market value ("FMV"). Fair market value is the price at which shares in private businesses can be gifted or otherwise transferred when executing estate planning. In general, the lower FMV is, the more efficiently shares can be transferred in pursuit of estate planning goals.

IRS regulations (Revenue Ruling 59-60) define fair market value as:

> "The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property."

Fair market value does not depend on whether you are willing to sell your business today. What does matter is the price that would be received were a transaction to occur today. And if a transaction were to occur today, the price would reflect the same uncertainty that we see manifest in public markets. In case there was any doubt about this, Revenue Ruling 59-60 offers the following additional guidance, which seems almost prophetic with regard to where we find ourselves today:

> "The fair market value of specific shares of stock will vary as general economic conditions change from 'normal' to 'boom' to 'depression,' that is, according to the degree of optimism or pessimism with which the investing public regards the future at the required date of appraisal. Uncertainty as to the stability or continuity of the future income from a property decreases its value by increasing the risk of loss of earnings and value in the future."

As the number of confirmed coronavirus cases across the globe grows, we do not yet have a clear sense of what the long-term economic toll will be. Large-scale restrictions on social gatherings are having an immediate effect on the dining, entertainment and other service industries. Business and vacation travel have been sharply curtailed, so there is great impact on hospitality and any travel-related businesses.

A Message to Clients and Friends During the COVID-19 Pandemic

Mercer Capital is open for business and will remain open for business. We have the secure technology and systems necessary to continue to serve our clients in a seamless fashion. Most of our employees are currently working from home yet are available as always via phone or email to meet your needs.

During these challenging times, it is our mission to ensure the safety of our employees and to continue to provide the same superior service to our clients. Feel free to reach out to us when you need us. And stay safe.

A video message from Mercer Capital's President, Matt Crow

The size of the economic ripples on other sectors is hard to forecast. However, the real-time impact of the uncertainty on public securities market can be measured. And that uncertainty translates into lower values for most private businesses.

Is There a Potential Silver Lining to the COVID-19 Crash?

Business owners and directors are currently facing many pressing issues. Amid all of the chaos, however, owners and directors should know that the estate planning opportunities triggered by lower valuations may not last. If your situation warrants, schedule a quick call with your estate planning advisors to see if there are steps you can take to help reduce the burden of future estate taxes on your business. Think in terms of the potential duration of the recovery from the COVID-19 Crash and engage in appropriate planning activities.

Conclusion

If you have measured the value of your business within the last year or so, that is good. However, that measure is likely not relevant in today's environment. Give us a call to talk about an appraisal or reappraisal of your business and to discuss, with your legal and tax advisers, the potential silver lining in the COVID-19 Crash.

We send our best wishes to our clients and friends. Be safe.

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AICPA Issues New Forensic Services Standard Effective January 1, 2020

Statements on Standards for Forensic Services ("SSFS No. 1") are issued by the AICPA's Forensic and Valuation Services Executive Committee. SSFS No. 1 provides guidance and establishes enforceable standards for members performing certain forensic and valuation services, specifically, for litigation and investigation engagements. These engagements are defined by SSFS No. 1 as follows:

- **Litigation**. An actual or potential legal or regulatory proceeding before a trier of fact or a regulatory body as an expert witness, consultant, neutral, mediator, or arbitrator in connection with the resolution of disputes between parties. The term litigation as used herein is not limited to formal litigation but is inclusive of disputes and all forms of alternative dispute resolution.

- **Investigation**. A matter conducted in response to specific concerns of wrongdoing in which the member is engaged to perform procedures to collect, analyze, evaluate, or interpret certain evidential matter to assist the stakeholders (for example, client, board of directors, independent auditor, or regulator) in reaching a conclusion on the merits of the concerns.

As the need for forensic services has grown and evolved, SSFS No. 1 serves to protect the public interest and increase the level of consistency across the profession. The issuance of SSFS No. 1 reflects a consolidation of relevant forensic services standards into one single standard. These forensic standards are effective for engagements accepted on or after January 1, 2020.

Ensure that your hired expert, if applicable, is aware of these new requirements and is aware of the applicable standards for the engagement. To download the Statement on Standards for Forensic Services, click **here**. To download information about Mercer Capital's litigation and forensic services, click **here**.

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Corporate Valuation

Looking Back to Look Forward

Five Observations Regarding How Businesses Persevered Through the Great Recession

Excerpted from Mercer Capital's *Family Business Director Blog*

We've made no secret of the fact that **Family Business Director** likes data. We are not economic forecasters, so we are not attempting to make any predictions about the coronavirus or its economic effects. However, in an effort to provide some context for ourselves, this week we decided to go back and examine some data from the Great Recession.

Specifically, we analyzed the performance of a group of small- and mid-cap public companies over the period from 2006 through 2011. This period allows us to see "normal" conditions prior to the crisis (2006 and 2007), two years of crisis performance (2008 and 2009), and two years of recovery (2010 and 2011).

The group we selected for analysis consisted of 554 companies having median revenues in 2006 of $853 million. We started with the current (March 2020) roster of companies in the S&P 1000 index (the sum of the S&P 400 Mid-Cap Index and the S&P 600 Small-Cap Index). We then removed financial institutions and real estate companies so that we were considering the performance of "operating" businesses. Finally, we removed companies that were not publicly traded through the entire period. There is a potential selection bias, as our sample includes only those companies that continue to be publicly traded 10+ years later. Nonetheless, it is the best we can do with our data resources, and we think the resulting data is still instructive.

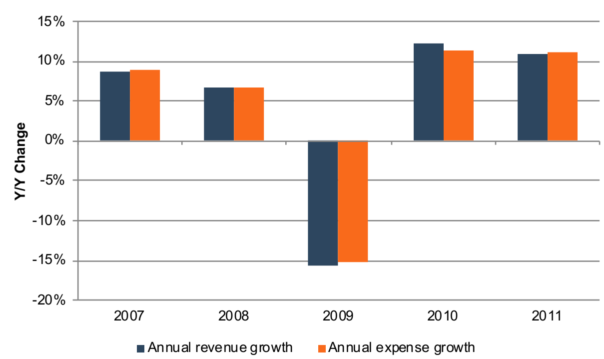
We constructed an aggregate income statement and statement of cash flows for the group. **You can see the detailed data here**. Sifting through the data, we make five observations regarding how businesses persevered through the Great Recession.

1. **Operating leverage can be managed**. The first thing that struck us is how effectively companies were able to manage operating expenses to maintain profit margins.

The textbooks tell us that, because some costs are fixed in the short-term, margins expand as revenues grow and shrink as revenues fall. While this is undoubtedly true, the data suggests that companies were able to manage costs more effectively than the theory would anticipate.

Exhibit 1 summarizes annual growth in revenue and expense for the years analyzed. In the face of a 15.6% drop in revenue during 2009, the companies in our sample trimmed expenses by 15.2%. As a result, EBITDA margin fell only modestly that year, from 12.0% in 2008 to 11.5% in 2009.

Exhibit 1
Annual Growth in Revenue and Operating Expenses

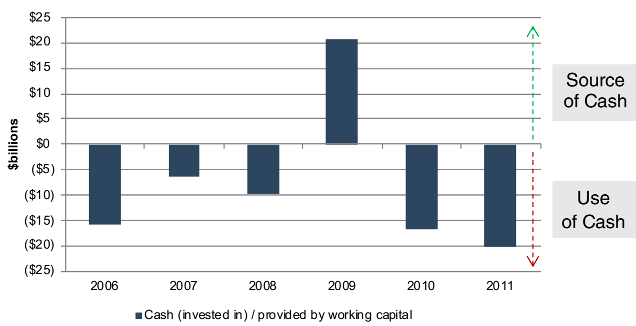


What steps can your family business take today to help preserve profit margins during a temporary revenue shortfall? How do you balance the near-term benefit of such steps against the long-term sustainability of your family business?

2. **Working capital really is a source of cash during a downturn**. Cash management takes on extra importance during a recession. However, the data shows us that companies focused on working capital manage-

ment can free up precious dollars by being intentional in inventory management and collections. As shown on Exhibit 2, the companies in our sample "found" $20.8 billion of cash by reducing working capital levels. For perspective, that's nearly 12% of the total lost revenue of $175 billion during 2009.

Exhibit 2
Cash (Invested in) / Provided by Working Capital

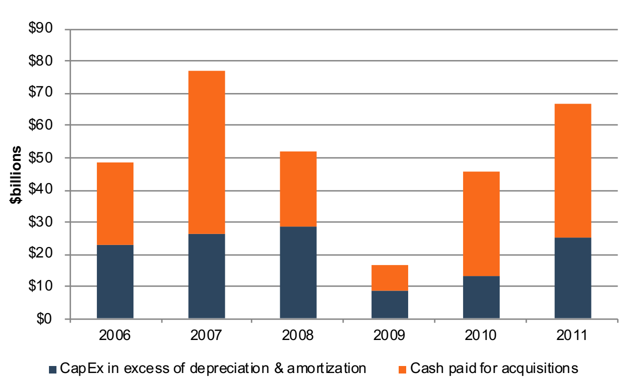


What strategies are available to your family business to help harvest cash from working capital during this cycle?

3. **Companies become more disciplined investors**. One of the first things companies did to conserve cash during the Great Recession was to curtail investment spending on M&A and capital expenditures.

   Exhibit 3 depicts investment spending over the period. Relative to the 2007 peak, total investment spending decreased nearly 80% to the 2007 trough.

Exhibit 3
Aggregate Investment Spending

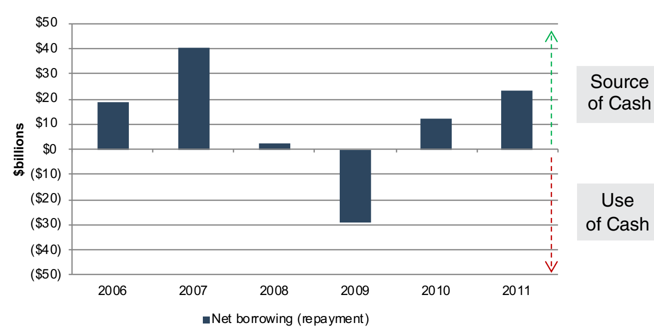


The data doesn't reveal the answer to the most relevant question: what was the long-term impact of the dramatic reduction in investment spending in 2009? Revenue growth accelerated in 2010 and 2011 to rates higher than those experienced in 2007 and 2008. Part of that is likely attributable to pent-up demand from the weak results in 2009, but it does at least give us pause to wonder what portion of "ordinary" investment spending is effectively squandered by companies.

How will your family business prioritize investment opportunities during the Coronavirus downturn?

4. **Borrowers reduced debt levels**. Whether by choice or by lender demand, companies repaid debt during 2009, in contrast to other years in which incremental borrowing is the norm. Exhibit 4 illustrates the net change in debt in each year over the period. After effectively eliminating incremental borrowing in 2008, the companies used $29 billion of available cash flow to pay back debt during 2009. For context, that represents about 83% of the $35 billion reduction in investment spending that year compared to 2008.

Exhibit 4
Net Incremental Borrowing (Repayment of Debt)

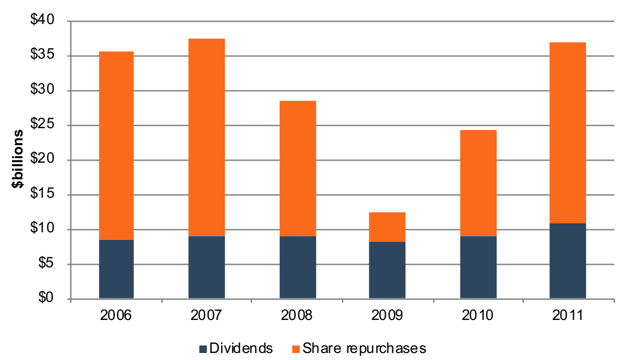


What is the status of loan covenants, credit line availability, and other factors that can influence your decision (or need) to borrow or repay debt in a downturn?

5. **Dividends were much less affected than share buybacks**. Of the 274 dividend payers in our sample, only 57 reduced per share dividends during 2009, reflecting the powerful signaling property of dividend payments.

Reducing the annual dividend is likely the last resort for public companies seeking to conserve cash. However, as shown on Exhibit 5, public companies tend to use more cash in share repurchases than dividend payments. From more than $28 billion in 2007, share repurchases fell to $19 billion in 2008, and bottomed out at $4 billion in 2009. The irony, of course, is that due to the depressed share prices, 2009 is precisely when repurchasing shares would have had the highest prospective return for public companies.

Exhibit 5: Aggregate Shareholder Distributions



Most family businesses don't redeem shares as aggressively as public companies. As a result, suspending redemptions won't conserve as much cash as it will for their public brethren. How have you prepared your family shareholders for a potential reduction in dividends? For shareholders deriving a significant portion of their annual income from family business dividends, any reduction can be unpleasant. How will you prioritize dividend payments against investment spending and debt reduction? Do your family shareholders know what your dividend policy is?

Conclusion

As we said at the outset, we are not professional economic forecasters. There are certainly many elements of our current situation that are far different than what we encountered over a decade ago. That said, the Great Recession was no walk in the park, either. Yet, companies of all shapes and sizes survived. As we have noted in previous weeks, it is our firm conviction that family businesses are better-suited to handling the type of adversity we are currently facing than non-family businesses.

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Mercer Capital In The News

Matt Crow, President of Mercer Capital, was interviewed by Mindy Diamond on the podcast, *Mindy Diamond on Independence - A Podcast for Financial Advisors Considering Changes*. The topic of the session was "**The Real Impact of the Crisis on Valuations and the Independent Space as a Whole**."

Travis Harms, Senior Vice President, was a panelist on the recent webcast "**FCG Member Roundtable on the Implications of the Coronavirus on Business Valuation**" sponsored by the *Financial Consulting Group* and held April 2, 2020.

Jeff Davis, Managing Director, was quoted in the article, "**COVID-19 Could Spark Community Bank Industry Reshuffle as Lenders Feel Strain of PPP Demand**" published by *Mergermarket*.

Tim Lee, Managing Director, through his participation on The ESOP Association's Advisory Committee on Valuation, contributed to The ESOP Association's "ESOP Report" newsletter with authoritative content aimed at benefitting ESOP Trustees and Plan Administrators concerning **the effects of COVID-19 on the valuation and administration of ESOPs**. Tim's contributions were included with content from numerous other contributors.

Financial Reporting Valuation

Goodwill Impairment Testing in Uncertain Times

The economic impact from the COVID-19 pandemic has been swift and unexpected. Just a few short weeks ago, the S&P 500 was at an all-time high and goodwill impairments were not a serious concern for most companies. However, between mid-February and the end of March, the S&P 500 declined by 25%. The Russell 2000 fell nearly 32% over the same period, and the negative shock to certain companies and sectors has been much worse.

Most financial professionals understand that goodwill impairment testing is typically performed annually, usually near the end of a company's fiscal year. In fact, many companies just completed an impairment test as of year-end 2019. But the unprecedented events precipitated by the COVID-19 pandemic now raise questions about whether an interim goodwill impairment test is warranted.

Do I Need an Impairment Test?

The accounting guidance in ASC 350 prescribes that interim goodwill impairment tests may be necessary in the case of certain "triggering" events. For public companies, perhaps the most easily observable triggering event is a decline in stock price, but other factors may constitute a triggering event. Further, these factors apply to both public and private companies, even those private companies that have previously elected to amortize goodwill under ASU 2017-04.

For interim goodwill impairment tests, ASC 350 notes that entities should assess relevant events and circumstances that might make it more likely than not that an impairment condition exists. The guidance provides several examples, including the following:

- Changes in the macroeconomic environment, such as a deterioration in general economic conditions
- Limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets
- Industry and market considerations such as a deterioration in the environment in which an entity operates or an increased competitive environment
- Declines in market-dependent multiples or metrics (consider in both absolute terms and relative to peers)
- Changes in the market for an entity's products or services, or a regulatory or political development
- Cost factor considerations such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows
- Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods
- Entity-specific events (changes in management or key customers, contemplation of bankruptcy, adverse litigation or regulatory events)
- Changes in the carrying amount of assets at the reporting unit including the expectation of selling or disposing certain assets
- If applicable, a sustained decrease in share price (considered both in absolute terms and relative to peers)

The examples above are not all-inclusive and entities should consider other relevant events and circumstances that might affect the fair value or carrying amount of a reporting unit. An entity should place more weight on the events and circumstances that most affect a reporting unit's fair value or the carrying amount of its net assets. The guidance notes that an entity should also consider positive and mitigating events and circumstances that may affect its conclusion. If a recent impairment test has been performed, the headroom between the recent fair value measurement and carrying amount could also be a factor to consider.

How an Impairment Test Works

Once an entity determines that an interim impairment test is appropriate, a quantitative "Step 1" impairment test is required. Under Step 1, the entity must measure the fair value of the relevant reporting units (or the entire company if the business is defined as a single reporting unit). The fair value of a reporting unit refers to "the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date."

For companies that have already adopted ASU 2017-04, the legacy "Step 2" analysis has been eliminated, and the impairment charge is calculated as simply the difference between fair value and carrying amount. Under the old framework, an additional "Step 2" analysis was performed and the impairment charge was based on the amount by which carrying amount exceeded the implied value of goodwill.

ASC 820 provides a framework for measuring fair value which recognizes the three traditional valuation approaches: the income approach, the market approach, and the cost approach. As with most valuation assignments, judgment is required to determine which approach or approaches are most appropriate given the facts and circumstances. In our experience, the income and market approaches are most commonly used in goodwill impairment testing. In the current environment, we offer the following thoughts on some areas that are likely to draw additional scrutiny from auditors and regulators.

- Are the financial projections used in a discounted cash flow analysis reflective of recent market conditions? What are the model's sensitivities to changes in key inputs?
- Given developments in the market, do measures of risk (discount rates) need to be updated?
- If market multiples from comparable companies are used to support the valuation, are those multiples still applicable and meaningful in the current environment?
- If precedent M&A transactions are used to support the valuation, are those multiples still relevant in the current environment?
- If the subject company is public, how does its current market capitalization compare to the indicated fair value of the entity (or sum of the reporting units)? What is the implied control premium and is it reasonable in light of current market conditions?

At a minimum, we anticipate that additional analyses and support will be necessary to address these questions. The documentation from an impairment test at December 31, 2019 might provide a starting point, but the reality is that the economic landscape has changed significantly in the last three months.

Concluding Thoughts

Not all industries have been impacted in the same way and there will certainly be differences between companies. For public companies, it can be difficult to ignore the significant drop in stock prices and the implications that this might have on fair value. For private businesses, even if a triggering event has not arisen yet, the deteriorating economic environment may just push the triggering factors into the second or third quarter of the year.

At Mercer Capital, we have experience in implementing both the qualitative and quantitative aspects of interim goodwill impairment testing. To discuss the implications and timing of triggering events, please contact a professional in Mercer Capital's Financial Statement Reporting Group.

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Industry Spotlight: Private Equity

Always Cash Flow and Earning Power

Excerpted from Mercer Capital's *Private Equity Newsletter*

We recognize what matters today for many funds is helping portfolio companies survive a sharp drop in revenues rather than discerning how much first quarter marks may fall from the last valuation.

Scooter rental firm Lime reportedly is trying to raise capital at a valuation that is 80% below its last raise. Dilution and a valuation mark-down may be a bitter pill for existing investors, but for many money losing enterprises with dwindling cash such as Lime, it is unavoidable if the firm is to survive.

Marking to Models and Unhinged Markets

Our focus is on valuing illiquid securities, not sourcing capital. One of our colleagues once said that valuing private equity and credit portfolios is about marking as close to market as possible; it is not marking to a price target predicated on an investment thesis.

The accountants provide perspective and guidance, but not precision beyond the preference hierarchy of Level 1 vs. Level 2 vs. Level 3 valuation inputs. ASC 820-10-20 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." Fair value from the accountant's perspective represents the exit price of the subject asset for a market participant in the principal or most advantageous market.

Exit multiples are a theoretical concept today in which private equity and credit markets are frozen, but that will not always be the case. One never knows how much price dislocation is due to illiquidity vs. the market's reassessment of fundamentals. Time will tell, but the impact of the government's response to COVID-19 on the economy is unlikely to be transitory.

As it relates to marking private equity and credit to market or some semblance thereof, we offer these initial thoughts:

- Guideline M&A and capital raise transaction data observed prior to February 2020 are not as informative because markets and businesses are adjusting to an emerging recession that may be very deep.
- Guideline public company data provides a market assessment of how much value has been impacted but observed multiples convey less information because earnings do not yet reflect any post-COVID results.
- Analyst estimates are hypothesized guesses.
- Other than early-to-intermediate stage VC-type investments, there will be little tolerance or interest in portfolio companies that incinerate cash.
- Additional capital will be limited to growth opportunities that produce value rather than infusions to cover operating deficits or to just grow revenues.
- Investment horizons have extended because it likely will take time for the IPO and M&A market to reopen without distressed pricing.
- EBITDA add-backs for equity and credit investments will be limited to those that truly reflect non-recurring

items and will be more likely to exclude "what could be" adjustments based upon future actions to be taken.

Primacy of Cash Flow

So how does one value private equity and credit in a developing recession or depression that may be very deep and of an unknown duration? Our view is that investors will be more focused than ever on cash flow and earning power because the era of valuations on dubious pro-forma EBITDA is over.

Table 1 (on the next page) provides a sample overview of the template we use at Mercer Capital. The process is not intended to create an alternate reality; rather, it is designed to shed light on core trends about where the company has been and where it may be headed. Adjustments are intended to strip-out non-recurring items and items that are not related to the operations of the business.

In addition, EBITDA is but one measure to be examined because EBITDA is a good base earnings measure, but it does not measure cash flow. Capex, working capital and debt service requirements are to be considered, too.

The adjusted earnings history should create a bridge to next year's budget, and the budget a bridge to multi-year projections. The basic question to be addressed: *Does the historical trend in adjusted earnings lead one to conclude that the budget and multi-year projections are reasonable with the underlying premise that the adjustments applied are reasonable?*

The analysis also is to be used to derive earning power. Earning power represents a base earning measure that is representative through the firm's (or industry's) business cycle and therefore requires examination of earnings over an entire business cycle. If the company has grown such that adjusted earnings several years ago are less relevant, then earning power can be derived from the product of a representative revenue measure such as the latest 12 months or even the budget and an average EBITDA margin over the business cycle.

Modest Terminal Values

Terminal values like cash flow will be subjected to more scrutiny, too. As noted previously, guideline transaction data is not as informative today given the change to the economy that has occurred. That is not to say guideline company and transaction data is not relevant, but probably requires a larger than normal haircut for fundamental adjustment.

Alternatively, the build-up method in which current earning power and the terminal value cash flow in a DCF model are capitalized may provide a better estimate of fair value than pre-COVID transaction data.

Table 2 (on page 12) presents a perspective on why market participants may often times conclude the multiple applicable to a given company should be lower in the post-COVID-19 world.

The process will lead to lower values than would have been derived prior to February 2020 because earning power and cash flow projections will be lower; risk premium applied to develop a weighted average cost of capital will be greater; and the expected long-term growth rate in earning power will be lower.

That may change over time as risk premia recede and business cash flows rebound, but that is not the world that exists today as it relates to marking-to-market.

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Table 1

Core Earnings Analysis	Budget 2020	LTM 03/30/20	For the Fiscal Years Ended December 31 2019	2018	2017	2016	2016
Units	1,474	1,414	1,390	1,321	1,223	1,267	1,221
x Average Price	$9.65	$9.55	$9.50	$9.35	$9.20	$9.25	$9.00
Reported Net Sales	$14,224	$13,500	$13,205	$12,351	$11,252	$11,720	$10,989
Adj (1) Acme Surcharge	0	(120)	(150)	(175)	0	0	0
Adjusted Net Sales	**$14,224**	**$13,680**	**$13,055**	**$12,176**	**$11,252**	**$11,720**	**$10,989**
Reported Cost of Sales	9,175	8,654	8,438	7,775	7,145	7,395	6,868
Adj (2) None	0	0	0	0	0	0	0
Adjusted Cost of Sales	9,175	8,654	8,438	7,775	7,145	7,395	6,868
Adjusted Gross Profit	**5,049**	**4,727**	**4,617**	**4,401**	**4,107**	**4,325**	**4,121**
Reported Operating Expense	2,550	2,425	2,448	2,295	2,225	2,115	2,025
Adj (3) Facility Closure	0	0	(90)	(15)	0	0	0
Adj (4) Litigation Expense	0	0	0	0	(35)	0	0
Adj (5) Rebate Settlement	0	35	0	0	0	0	0
Adjusted Operating Expense	**2,550**	**2,460**	**2,358**	**2,280**	**2,190**	**2,115**	**2,025**
Adjusted Operating Income	**2,499**	**2,267**	**2,259**	**2,121**	**1,917**	**2,210**	**2,096**
Reported Other Inc/(Exp)	(530)	(450)	(410)	(370)	(360)	(350)	(345)
Adj (6) Loss/(Gain) on Asset Sale	0	(95)	(75)	50	120	(20)	65
Adjusted Other Inc/(Exp)	(530)	(545)	(485)	(320)	(240)	(370)	(280)
Adjusted Pre-Tax Income	**$1,969**	**$1,722**	**$1,774**	**$1,801**	**$1,677**	**$1,840**	**$1,816**
EBIT, EBITDA & CapEx							
Adjusted Pre-Tax Income	$1,969	$1,722	$1,774	$1,801	$1,677	$1,840	$1,816
- Interest Income	(27)	(23)	(21)	(19)	(18)	(18)	(17)
+ Interest Expense	477	405	369	333	324	315	311
Adjusted EBIT	**2,420**	**2,104**	**2,123**	**2,116**	**1,983**	**2,137**	**2,109**
+ Depreciation & Amortization	710	680	660	620	560	590	550
Adjusted EBITDA	**$3,130**	**$2,784**	**$2,783**	**$2,736**	**$2,543**	**$2,727**	**$2,659**
Reported Capital Expenditures	780	740	730	680	620	640	600
Adjusted EBITDA less CapEx	**$2,350**	**$2,044**	**$2,053**	**$2,056**	**$1,923**	**$2,087**	**$2,059**
Incremental Working Capital	**127**	**49**	**132**	**139**	**(70)**	**110**	**50**
Adj EBITDA less CapEx & WC	**$2,223**	**$1,995**	**$1,921**	**$1,917**	**$1,993**	**$1,977**	**$2,009**
Adjusted Margins							
Adjusted EBIT	17.0%	15.7%	16.3%	17.4%	17.6%	18.2%	19.2%
Adjusted EBITDA	22.0%	20.8%	21.3%	22.5%	22.6%	23.3%	24.2%
Adjusted EBITDA less CapEx	16.5%	15.3%	15.7%	16.9%	17.1%	17.8%	18.7%
Adj EBITDA less CapEx & WC	15.6%	14.9%	14.7%	15.7%	17.7%	16.9%	18.3%
Period-to-Period Growth							
Adjusted EBIT	15.0%	-0.9%	0.3%	6.7%	-7.2%	1.3%	
Adjusted EBITDA	12.4%	0.1%	1.7%	7.6%	-6.8%	2.6%	
Adjusted EBITDA less CapEx	15.0%	-0.4%	-0.2%	6.9%	-7.9%	1.4%	
Adj EBITDA less CapEx & WC	11.4%	3.9%	0.2%	-3.8%	0.8%	-1.6%	

Table 2

Derivation of Capitalization Factor		Pre-Crisis Multiple		Post-Crisis Multiple	
Risk-Free Rate		2.00%	2.00%	1.00%	1.00%
Equity Premium (Beta = 1.0)		5.50%	5.50%	7.00%	7.00%
Size Premium		3.50%	3.50%	3.50%	3.50%
Specific Company Risk Premium		2.00%	3.00%	2.50%	3.50%
Equity Discount Rate		**13.00%**	**14.00%**	**14.00%**	**15.00%**
Cost of Debt Financing		5.50%	5.50%	5.00%	5.00%
After-Tax Cost of Debt	25.0%	**4.13%**	**4.13%**	**3.75%**	**3.75%**
WACC with Equity Financing	75%	**10.78%**	**11.53%**	**11.44%**	**12.19%**
- Earning Power Growth Rate		3.00%	5.00%	2.00%	4.00%
Capitalization Rate		7.78%	6.53%	9.44%	8.19%
Capitalization Factor (1/Cap Rate)		**12.9x**	**15.3x**	**10.6x**	**12.2x**

Determination of Value		Pre-Crisis Earning Power		Post-Crisis Earning Power	
Revenues		$150,000	$150,000	$135,000	$135,000
EBITDA		30,000	30,000	25,000	25,000
EBITDA Margin		20.0%	20.0%	18.5%	18.5%
Depreciation Expense		1,000	1,000	1,000	1,000
EBIT		29,000	29,000	24,000	24,000
Taxes / (Benefit)	25.0%		7,250	6,000	6,000
After-Tax Income		21,750	21,750	18,000	18,000
Add: Depreciation		1,000	1,000	1,000	1,000
Less: Capex		(1,000)	(1,000)	(1,000)	(1,000)
Incremental Working Capital		(1,500)	(1,500)	(1,350)	(1,350)
Net Op Profit After-Tax (NOPAT)		**$20,250**	**$20,250**	**$16,650**	**$16,650**
Capitalization Factor (1/Cap Rate)		12.9x	15.3x	10.6x	12.2x
Capitalized Enterprise Value		**$260,000**	**$310,000**	**$176,000**	**$203,000**
Ent Value / pre-crisis EBITDA	**$30,000**	**8.7x**	**10.3x**		
Ent Value / post-crisis EBITDA	**$25,000**			**7.0x**	**8.1x**

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