MERCER CAPITAL

BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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Estate Tax Exemption Uncertainty

And Other Takeaways from the Heckerling Estate Planning Conference

Mercer Capital had the opportunity to attend the **57th Annual Heckerling Institute on Estate Planning,** one of the largest conferences for estate planning professionals. It was a great time to meet lots of new faces and run into some familiar ones. Our Chairman, **Chris Mercer**, and **Andy Frew,** from our Houston office, were also in attendance. As of this writing, I have not received the Yeti Cooler or nice bottle of bourbon I expected from the business cards I dropped off at the various booths.

This year's week-long conference was the first to be held in person in a few years, and the exhibit hall and education sessions were full of good information and details on the estate, gift, and tax planning fronts. Below we share a few topics of conversation and tidbits we picked up from the sessions and conference.

Estate Tax Exemption Uncertainty from Panel of Experts

Steve Akers with Bessemer Trust, **Samuel Donaldson** at Georgia State University College of Law, and **Beth Shapiro Kaufman** with Caplin & Drysdale delivered a "brief" three-hour, 285-page 'dissertation' on recent developments facing the estate planning community. Topics ranged from federal legislation, administrative and treasury guidance, transfer tax developments, valuation, and a bevy of other developments of interest. One interesting back-and-forth included the panelists' opinions on the current gift and estate tax exemption, set for **2023 at $12.92 million** for an individual but expected to halve on January 1, 2026. The panelists were split; Mr. Donaldson believed the exemption wouldn't drop that far, and historical trends point to a higher exemption. But Ms. Shapiro made an important caveat: the current legislation sunsets, i.e., it would require congressional action to keep the exemption as is (or change from its current course). With the current trend of Washington, the panel was less than optimistic about much of anything happening for at least the next few years.

Document and Design your Gifts Carefully

There were a few sessions on how to carefully design and document your gift transfers (including charitable ones) to meet the grantor's wishes and avoid a second look from the IRS. **Alan Rothschild** with Page, Scrantom, Sprouse, Tucker & Ford, P.C. provided some good pointers on crafting charitable gift agreements, highlighting that a well-drafted charitable gift agreement can protect both the donor and charity and ensure that a situation doesn't end up in litigation.

Stephanie Loomis-Price with Perkins Coie LLP and **Christine Wakeman** with Winstead PC wrote on recent developments in audits and case law related to privileges applicable to estate planning. The session covered strategy in audit responses related to transfer tax returns for privately held interests. To summarize at least part of their legal advice: understand the rules and protections around communication with your attorneys and document the reasons and goals for the transfer.

Valuation Practitioners See More Gift and Estate Planning Ahead

Mercer Capital and a number of valuation professionals and independent valuation shops attended the conference, and the ability to chat with other practitioners is always a plus. A non-scientific study of the professionals I spoke to saw gift and estate work plateauing from the flurry of activity experienced in 2021 (consternation from the changes proposed in the now-deceased "Build-Back-Better" bill). However, as the calendar turns to 2026, practitioners are seeing more and more gift and planning work fed into the hopper. As we've written previously, **current market volatility creates a good gift and planning opportunity** for the family business in it for the long haul, especially with gifts made now not subject to clawback in the future if the combined exemption is reduced.

Bonus: Sunshine State Update and Final Thoughts

Florida, with friendly tax and trust rules and regulations, punches above its weight at Heckerling (never mind it is held in Orlando in January). **Shane Kelley** with Kelley & Kelley, P.L., **Elaine Bucher** with Gunster, and **Sarah Butters** with Ausley McMullen, sat on a panel discussing the most important developments in Florida over the past two years that in-state and out-of-state practitioners should know. One highlight included an update on the Florida Uniform Directed Trust Act (FUDTA), signed in 2021. In layman's terms, FUDTA allows a directed trust officer to handle trust administration while your financial advisor or other professional handles asset allocation, investment, and administration. This brought Florida into an even more friendly trust regime and should allow everyone to lean into their core strengths: trust professionals work on the trust side, and investment managers focus on investment management.

Conclusion

Mercer was glad to be back at the Heckerling conference, meeting new friends and connecting with old ones. Our professionals aim to keep their ears to the ground on gift and estate tax issues and help our clients, both family and not, avoid any headaches with their estate plans. We've been providing objective valuations for tax compliance since 1982 and have seen a few things. Let us know if we can help with your gift and estate tax compliance needs.

Reprinted from Mercer Capital's Family Business Director Blog

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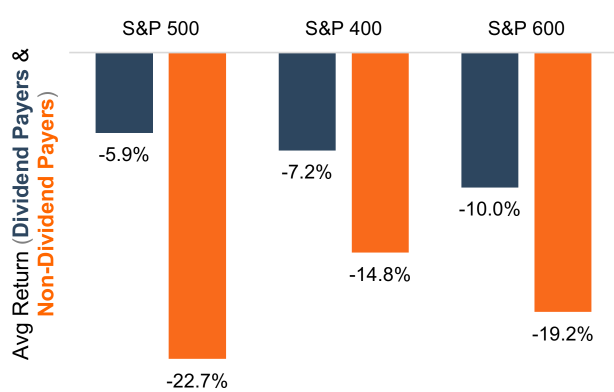
Dividends, Shareholder Signals & Present Value

As market and financial data for 2022 continue to roll in, we are beginning to prepare for our annual benchmarking study. One early finding is that investors clearly distinguished between companies that pay dividends and those that don't. Across the size spectrum, investors favored dividend-paying stocks in 2022, as illustrated in Figure 1.

Figure 1 :: Average Returns by Dividend Status



Source: S&P Capital IQ Pro

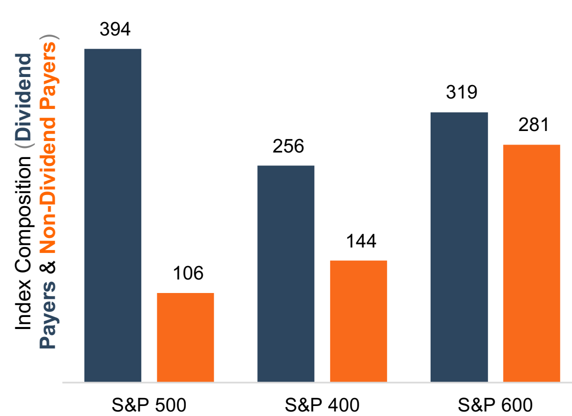
While it was a down year across the board, the average return for companies that paid dividends was less negative than those that did not. In this article, we explore two potential reasons for this outcome and the lessons for family business directors.

Lesson #1 – Dividends Are A Powerful Signal To Shareholders

Actions speak louder than words, and dividends speak louder than slide decks. Dividends tell shareholders what time it is and what the future looks like.

- Paying a dividend—or not—tells shareholders whether it is planting time or harvesting time. The implicit signal from non-dividend payers is that the company has more attractive investment alternatives than available capital (i.e., it's planting time).However, dividend payers are communicating to shareholders that they are generating more cash flow than can be responsibly reinvested (i.e., it's harvesting time).

Figure 2 :: Prevalence of Dividend Payers by Index



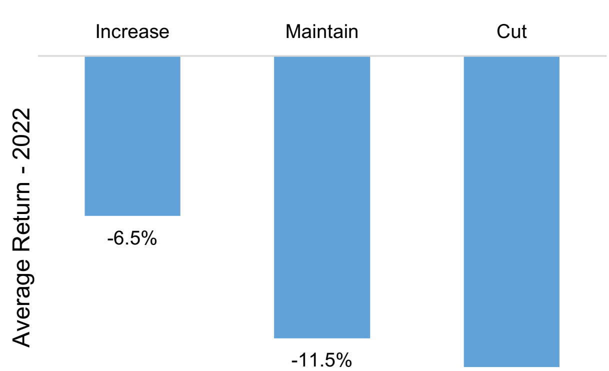
Source: S&P Capital IQ Pro

We can confirm this in general terms by looking at the prevalence of dividend payers among the small-cap (S&P 600), mid-cap (S&P 400), and large-cap (S&P 500) indices. As shown in Figure 2 (on the previous page), nearly 80% of the large-cap companies in the S&P 500 paid dividends in 2022, compared to just over half of the small-cap companies in the S&P 600.

As companies grow and mature, they often use dividend payments to signal to shareholders what time it is.

- Second, companies can use dividends to signal to shareholders what they believe the future holds. Stock prices are all about expectations for the future, not what has happened in the past. Companies tend to only change dividends when they believe the new level will be sustainable, so investors interpret dividend changes as powerful signals regarding management's confidence in the company's performance going forward.

Figure 3 :: 2022 Return by Dividend Change



Source: S&P Capital IQ Pro

As shown in Figure 3, those dividend payers that increased dividends during the year outperformed those that maintained or reduced their dividends during 2022.

So what is your family business's dividend policy telling your family shareholders about what time it is and what the future holds for your family business? As we have often remarked, shareholder letters may or may not get read, but dividend checks always get cashed. Are your dividend actions aligning with your words about the family business's circumstances and future prospects? If not, there is a good chance you are eroding credibility and trust with your family shareholders, and credibility and trust are the lifeblood of successful and sustainable family businesses.

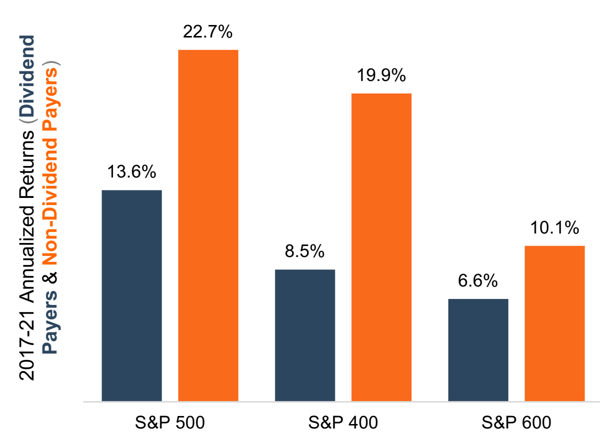
Lesson #2 – Dividends Reduce Shareholder Risk

Markets are complicated, and returns are influenced by many factors. However, at the risk of oversimplifying, stock prices fell in 2022 because higher interest rates increased the cost of capital for businesses. As the Wall Street adage says: "Don't fight the Fed."

Rising interest rates do not affect all investments equally, however. The longer investors have to wait to receive cash, the more sensitive an investment is to interest rates. A steady dividend stream shortens the "duration" of investments in dividend-paying shares relative to non-dividend-paying shares. So, in a rising rate environment like 2022, basic present value math suggests that dividend-paying stocks will outperform.

But one shouldn't expect that what worked in 2022 will not always work going forward. Figure 4 summarizes average annualized returns for the same group of companies for four years ending December 31, 2021. Over this period, during which the federal fund's effective rate fell from 1.42% to 0.08%, returns for dividend payers lagged those of their non-dividend paying peers.

Figure 4 :: Annualized 2017-2021 Returns by Dividend Status

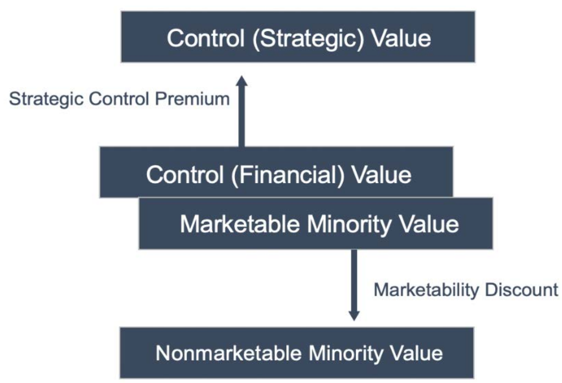


Source: S&P Capital IQ Pro

Dividends reduce risk (and upside potential) for public company investors. What about your family shareholders? What role do dividends play in managing the investment risk of your family shareholders?

We've written previously about how your family business has **more than one value.** Of the three "values" of your family business at any given time, the lowest is the value of a minority (non-controlling) position in shares that is not readily liquid, as depicted in Figure 5.

Figure 5 :: The Levels of Value



The "marketability discount" in Figure 5 measures the economic burden of illiquidity commonly borne by family shareholders. The magnitude of that discount is not the same for all family businesses. Rather, it is a function of several factors, prominent among which is the amount of expected future dividends. As markets demonstrated in 2022, dividend payments mean that investors don't have to wait as long to receive a return on their investment. For family shareholders facing an uncertain but potentially lengthy holding period, regular dividend payments ease the burden of illiquidity.

Conclusion

Your family business's dividend policy is sending a signal to and is affecting your family shareholders' risk (and potential return). Are you and your fellow directors being intentional about the signals sent by your dividend? Are you incorporating the risk-return tradeoff for your family shareholders in your dividend policy deliberations? Intentionally crafted or not, all family businesses have a dividend policy: is yours sending the right signals?

Mercer Capital has worked with family businesses in crafting their dividend policy. Let us know if you have questions about your dividend policy and the message it is sending your family shareholders.

Reprinted from Mercer Capital's Family Business Director Blog

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A Little Planning—A Lot of Tax Savings

Charitable Giving Prior to a Business Sale

Recently, I've had both professional and personal conversations with family business owners who utilized a business transaction to maximize their charitable giving and minimize their tax burden. While taxes are not generally the primary driver in making large gifts to charity, a little foresight and planning can create flexibility in your giving, yield more bang for your buck, and result in fewer taxes owed to Uncle Sam. In this article, we discuss the tax strategy that charitable family business owners should keep in mind when selling their business.

Charitable Gifts and Business Transaction

For many family businesses, the original cost basis of their business ownership interest is extremely low, if not zero. If you have inherited stock from prior generations, your stock's basis is "carried over" from the original donor (or was the stock's fair market value at the time of the gift). In short, for many family businesses, any sale likely has quite a large built-in capital gains tax, especially if your family business has generated solid returns over generations.

So, where's the beef? A donation of some portion of your family's business ownership in its business prior to a sale provides two benefits:

1. A charitable tax deduction for the fair market value of the interest at the time the gift is made.
2. Minimized capital gains exposure for the portion donated and sold by the charity rather than the family.

Below we provide an example and some thoughts on this strategy.

Utilizing a Donor Advised Fund

A **donor-advised fund**, or "DAF," is a flexible and tax-efficient way to give to charities. A DAF operates like a charitable investment account for the sole purpose of supporting charitable organizations. When taxpayers contribute assets, such as cash, stock, or other (read: private business stock) assets to a DAF, they can take an immediate tax deduction, avoid capital gains recognition, and grow the donation tax-free.

A primary benefit of using a DAF to implement this gifting strategy is a practical one. Many charities are not structured to take stock of privately held companies, whereas organizations that support DAFs are able to handle the complexities around private family-owned stock gifts.

Gift Timing

As the saying goes, "Pigs get fat, hogs get slaughtered." If you already have a legally-binding transaction agreement in place, this strategy is less useful, and the IRS is not likely to allow recognition of the gift. However, a non-binding letter of intent ("LOI"), where each side can leave the table, meets the bill. For the gift, a qualified appraisal would likely give significant weight to the pro rata offer on the table in measuring fair market value. The likelihood of a near-term transaction would also limit the typical discounts for lack of marketability or control. This would maximize the value of the ownership interest for gifting purposes.

This works for donating stock to charity broadly, not just in a business transaction context. However, if a path to liquidity is not on the horizon, discounts for lack of control and marketability are likely to be more significant. This lowers the total fair market value of your gift, reducing tax savings at the time of the gift. On the flip side, if the gift is made to a DAF, as discussed, the ownership interest may be held and grow as the business value grows. At a business exit, your DAF reaps the benefits of the sale and avoids the capital gains tax on that portion of ownership, maximizing future charitable gifts from the DAF.

Qualified Appraisal

You may have guessed this already; Gifts of private family ownership interests require qualified appraisals per the IRS. We talk about what amounts to a "qualified appraisal" and how to pick a qualified business appraiser **here**.

Tax Benefits of Planning

To illustrate the benefits of this strategy, consider two alternative scenarios: (1) the business owner contributes to charity using funds after a sale of the business ("post-sale"), or (2) the business owner contributes stock to charity prior to the deal closing ("prior-to-sale"). We briefly summarize Figure 1 below.

- In both scenarios, the value of the gift is assumed at $3.5 million. This represents the pro rata cash proceeds in the post-sale scenario and the value of the privately held stock based on a qualified appraisal (which referenced the non-binding LOI purchase price in developing the conclusion of fair market value) in the prior-to-sale scenario.
- In the post-sale scenario, the business owner pays a capital gains tax on the appreciation in the stock, or $700,000 (20% of $3.5 million, assuming a $0 basis). In the prior-to-sale scenario, the business owner avoids the capital gains tax because the stock was gifted to a DAF.
- Under both scenarios, the business owner is entitled to a charitable deduction of $1.295 million for income tax purposes.
- The total tax benefit in the post-sale scenario is $595,000 ($1.295 million less the capital gains tax paid of $700,000). The prior-to-sale scenario's total tax benefit is $1.295 million, or $700,000 higher.

Figure 1 :: Illustrative Gift Example

		Contribute Post-Sale	Contribute Prior-to-Sale
Gift		$3,500,000	$3,500,000
Basis in Stock		$0	$0
Taxable Amount (Capital Gains)		$3,500,000	na
Capital Gains Tax Paid	20%	($700,000)	0
Income Tax Savings on Gift	37%	$1,295,000	$1,295,000
Cost of Gift to Donor		$2,905,000	$2,205,000
Donor Tax Benefit		$595,000	$1,295,000
Prior to Gift Vs. Post Sale Gift		-	**$700,000**

Final Thoughts

As we said in the beginning, tax considerations are generally on the back burner when considering major gifts. While gifts of family business stock can be complex, the benefits of the strategy and the impact it can have are too significant to ignore. We've worked with business owners to provide qualified appraisals for gifting purposes in both a charitable and estate planning context. Give us a call if you want to discuss a gifting strategy you are contemplating in confidence.

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Note: The example here and tax ramifications are for illustration only. This article does not consider state, AMT, or other complex tax situations. The value of stock in your situation may not equal post-sale pro rata proceeds. Please consult your independent appraiser and tax advisor regarding your situation and potential tax consequences.

Should You Conduct a Shareholder Survey?

Five Reasons Why It's a Good Idea

Of the many well-worn clichés in the financial world that should be retired, "maximizing shareholder value" is surely toward the top of the list. While private companies aren't provided the constant, real-time feedback in terms of shareholder value afforded to public companies, ensuring that board, management, and shareholder incentives and preferences in privately held businesses are aligned is one step towards potentially maximizing shareholder value. A shareholder survey can provide feedback to boards and management teams to avoid situations like the one **Salesforce is currently facing**, which finds itself amidst a potential shareholder-driven board takeover. Since private company managers know precisely who their shareholders are, shouldn't the characteristics and preferences of these shareholders be considered in the corporate decision-making process? Absent these considerations, any attempts to "maximize shareholder value" are almost always destined to fail.

This article outlines a few reasons why boards and management teams should consider a shareholder survey as part of their strategy to keep the incentives of all a company's stakeholders aligned.

1) A Survey Will Help You Learn About Your Shareholders

A well-crafted shareholder survey will go beyond mere demographic data (age and family relationships) to uncover the deeper characteristics that owners share and which characteristics distinguish owners from one another. We recently completed a survey for a multi-generational family company; unsurprisingly, one of the findings was that the shareholder base included a number of distinct "clienteles" or groups of shareholders with common needs and risk preferences. What we found surprising was that these "clienteles" were largely not defined by age or family tree branch but rather by the degree to which (a) the shareholder's household income was concentrated in distributions from company stock and (b) the shareholder's personal wealth was concentrated in company stock. The boundary lines for the resulting clienteles did not fall where management naturally assumed.

2) A Survey Will Help You Gauge Shareholder Preferences

The results from a shareholder survey will help directors and managers move away from flimsy abstracts like "maximizing shareholder value" toward concrete objectives that consider tangible shareholder preferences. For example, what are shareholder preferences for near-term liquidity, current distributions, and capital appreciation? Identifying these preferences will enable directors and shareholders to craft a coherent strategy that addresses actual shareholder needs. Conducting a survey does not mean that the board is offloading its fiduciary responsibility to make these decisions to the shareholders: a survey is not a vote. Rather, it is a systematic means for the board to solicit shareholder preferences as an essential component of decision deliberation.

3) A Survey Will Help Educate The Shareholders About The Strategic Decisions Facing The Company

While a survey provides information about the shareholders to the company, it also inevitably provides company information to shareholders, creating a beneficial two-way flow of information in the process. In our experience, the survey is most effective if preceded by a brief education session that reviews the types of questions asked in the survey. Shareholders do not need finance degrees to be able to understand the three basic decisions that every company faces: (1) how should we finance operations and growth investments (capital structure), (2) what investments should we be making (capital budgeting), and (3) what form should shareholder returns take (distribution policy). Educated shareholders can provide valuable input to directors and managers and will be more engaged in management's long-term strategy.

4) A Survey Will Help Establish A Roadmap For Communicating Operating Results To Shareholders.

Public companies are required by law to communicate operating results to the markets on a timely basis. Many public companies invest significant resources in the investor relations function because they recognize the markets must understand not only the bare "what happened" of financial reporting but also the "how and why" provided by a strategy discussion. Oddly, most private companies have no parallel roadmap for communicating results. Private company investor relations are either ignored or consist of reluctantly answering potentially-loaded questions from disgruntled owners (who may, frankly, enjoy being a nuisance).

A shareholder survey can be a great jumping-off point for a more structured process to proactively communicate operating results to shareholders. An informed shareholder base that understands not only the "what happened" but also the "how and why" is more likely to take a long-term perspective in evaluating performance.

5) A Survey Gives A Voice To The "Un Squeaky" Wheels

A shareholder's input should not be proportionate to the input volume. While the squeaky wheel often gets the grease, it is prudent for directors and managers to solicit feedback regarding the needs and preferences of quieter shareholders. Asking for input from all shareholders through a systematic survey process helps ensure the directors and managers receive a balanced picture of the shareholder needs and preferences. A confidential survey administered by an independent third party can increase the likelihood of receiving frank (and therefore valuable and decision-useful) responses.

An engaged and informed shareholder base is essential for any private company's long-term health and success, and a periodic shareholder survey is a great tool for achieving that result. Give one of our senior professionals a call to discuss how a shareholder survey or ongoing investor relations program might benefit your company.

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Did Spirit Airlines' Board Ask the Ultimate Fairness Question?

As participants and observers in transactions, the possible acquisition of Spirit Airlines, Inc. (NYSE: SAVE) by JetBlue Airways Corporation (NASDAQGS: JBLU) offers a lot of fodder for us to comment on. In this article, we look at the fairness opinions delivered by Morgan Stanley and Barclays to the Spirit board before approving the deal and then ask a key transaction-related question.

On July 28, 2022, Spirit agreed to be acquired by JetBlue for cash consideration of $33.50 per share, or $3.8 billion. Inclusive of net debt, the transaction at announcement had an enterprise value of $7.6 billion. Deal multiples included 25.5x analysts' consensus EPS for the next 12 months and 12.3x NTM EBITDA.

The deal value excluding ticking payments that could push the total consideration to $34.15 per share, represented a 38% premium to Spirit's closing price on July 27 of $24.30 per share; however, the announcement was not a surprise because Spirit had been in play since February 5 when the company agreed to be acquired by Frontier Group Holding, Inc. (NASDAQGS: ULCC) for 1.93 Frontier shares and $2.13 per share of cash, which was then valued at $25.83 per share.

JetBlue subsequently made an unsolicited cash offer on March 29 (disclosed on April 5) of $33.00 per share that was rejected on May 2. JetBlue then commenced a $30.00 per share tender on May 16, noting the price was less than the $33.00 per share offer because of the board's "unwillingness to negotiate in good faith with us."

Ultimately, the Frontier deal was terminated on July 27, and Spirit then entered into an agreement with JetBlue that provided for the following:

- $33.50 per share of cash, including $2.50 per share payable upon approval of the transaction by Spirit stockholders;
- Monthly ticking fee of $0.10 per share up to $0.65 per share commencing January 2023 through mid-July 2023 whether the transaction is consummated or terminated; and
- Downside protection via $70 million payable to Spirit and up to $400 million, or $4.30 per share payable to stockholders inclusive of the approval payment and ticking fees in the event the merger agreement is terminated for failure to obtain regulatory approval.

The Barclays and Morgan Stanley Fairness Opinions

The proxy statement dated September 12 enumerated the reasons the Spirit board approved the merger agreement, including the fairness opinions that opined the consideration to be received by shareholders was fair from a financial point of view to the shareholders. Interestingly, both banks were retained by Spirit in late 2019 to assist in a review of strategic options that was interrupted by COVID.

A fairness opinion provides an analysis of the financial aspects of a proposed transaction from the point of view of one or more parties to the transaction, usually expressing an opinion about the consideration though sometimes the transaction itself. Ideally, the opinion is provided by an independent advisor that does not stand to receive a success fee, especially when the transaction is a close call or involves real or perceived conflicts. In the case of the JetBlue-Spirit transaction, both Spirit advisors will receive much larger contingent fees if the transaction is consummated compared to the fixed fee fairness opinions.[1]

Let's look at a high-level comparison of each bank's analysis, some of which were explicitly included in the fairness analyses and some of which were presented for reference only. (A link to the proxy statement can be found **here**.)

Guideline Public Company ("GPC") Analysis

Barclays and Morgan Stanley reviewed and compared specific financial and operating data relating to Spirit with selected GPCs deemed comparable to Spirit. The following figure compares the selected GPCs, the then-current multiples, the relevant multiple range, and indicated range of value for Spirit as calculated by each bank.

Both banks relied upon management's forecast for net income and EBITDAR; however, Morgan Stanley also considered the Street's consensus forecast for 2023. Spirit is included in the comp group to develop the applicable multiples with both banks relying upon pricing in early February immediately before the Frontier deal was announced; however, Morgan Stanley included alternate multiples based upon Spirit's price as of July 26 and as of July 26 based upon the change in the industry ETF (JETS) from February 4. Nonetheless, the indicated values each developed based upon management's forecast were the same.

Guideline Transaction (M&A) Analysis

The opinions did not include guideline transactions, presumably because there is limited M&A data involving U.S. carriers. The most recent significant acquisitions include Northwest Airlines and Continental Airlines in 2008, AirTran Holdings in 2010, and Virgin America in 2016. Nonetheless, we find it odd that a GT analysis was not addressed in the proxy.

Figure 1 :: Guideline Public Company Analysis

Guideline Public Company	Barclays EV/2023 Est. EBITDAR	Morgan Stanley EV/2023 Est. EBITDAR	Barclays P/2023 Est. EPS	Morgan Stanley P/2023 Est. EPS	
Allegiant Travel Company	4.3x	4.3x	9.1x	9.1x	
Frontier Group Holdings, Inc.	3.9x	3.9x	7.9x	7.9x	
JetBlue Airways Corporation	3.3x	3.3x	7.9x	7.9x	
Southwest Airlines Co.	4.1x	4.1x	10.8x	10.8x	
Sun Country Airlines Holdings, Inc.	5.0x	5.0x	9.6x	9.6x	
Spirit Airlines, Inc. (2/4/22 Unaffected)	4.8x	4.8x	8.1x	8.1x	1
Spirit Airlines, Inc. (7/26/22 JETS Adjusted)	N/A	5.4x	N/A	12.5x	2
Spirit Airlines, Inc. (7/26/22)	N/A	6.0x	N/A	16.6x	
Reference Range	4.0x - 5.0x	4.0x - 5.0x	8.0x -10.0x	8.0x -10.0x	
Implied Value Per Share - Spirit Financial Forecasts	$7.00 - $17.00	$7.00 - $17.50	$16.00 - $20.00	$16.25 - $20.25	
Reference Range	N/A	4.0x - 5.0x	N/A	8.0x -10.0x	
Implied Value Per Share - Spirit Consensus Forecasts	N/A	$4.00 - $13.75	N/A	$11.25 - $14.00	

Notes:

(1): Spirit's unaffected stock as of Friday 2/4/22 before the Frontier announcement on 2/7/22

(2): Unaffeced Spirit share price adjusted for the percentage change in the Jets ETF between February 4 and July 26, 2022

[1] Morgan Stanley received a fee of $1.75 million for the fairness opinion and will be paid a success fee of $20.0 million if the deal closes. Barclay's opinion and success fees are $3.0 million and $14.0 million.

Discounted Cash Flow Analysis

Both banks included a DCF analysis, a valuation method that is standard in virtually all valuation analyses. The gist of the analysis reflects the discounting of unlevered cash flows over a discrete period (2H22-2026) and the projected debt-free value of the company at the end of the projection period to present values based upon the weighted average cost of capital. Net debt is then subtracted to derive the indicated equity value.

Figure 2 :: DCF Analysis

Description	Barclays	Morgan Stanley
Weighted Average Cost of Capital (WACC)	10.5% - 12.5%	10.6% - 12.2%
Terminal Value Multiple Range	5.5x - 7.5x	5.5x - 7.0x
Equity Value Per Share	$26.00 - $55.00	$26.00 - $48.25

Discounted Equity Analysis

Morgan Stanley but not Barclays derived indicated ranges of value per share by discounting management's forecasted 2025 EBITDAR and EPS to present values based upon a 12.9% equity discount rate. If Spirit paid common dividends, the present value of the dividends through 2025 presumably would have been included, too. The analysis is similar to the DCF method except that cash flows are viewed from the perspective of what is received by shareholders compared to enterprise-level cash flows in the DCF analysis. Morgan Stanley derived a range of $24 to $43 per share based upon 5.0x to 6.5x EBITDAR and $39 to $47 per share based upon 9.0x to 11.0x forecasted 2025 EPS.

Historical Share Price Analysis

Both banks reviewed the 52-week trading history for Spirit for the period ended July 26, 2022 ($16-$29 per share) and in the case of Morgan Stanley for the 52 week period ended February 4, 2022 ($20-$40 per share). Although seemingly an important consideration for the fairness analyses, neither bank's proxy write-up discussed the deal price premium relative to Spirit's recent trading on a stand-alone basis or compared to M&A involving publicly traded midcap companies. The proxy did note that the board considered the premium in approving the merger agreement, however.

Research Analyst's Price Targets

Both banks reviewed sell-side analysts' one-year price targets ($24-$36 per share). Morgan Stanley discounted the price targets to a present value range of $21 to $32 per share using a discount rate of 12.9%, though the analysis was presented only for reference.

Barclay's and Morgan Stanley's Conclusion

Both banks opined that, from a financial point of view, the consideration to be received by the stockholders of Spirit in the proposed transaction is fair to such stockholders. As can be seen in the figure below, the $33.50 share price falls within the range of values determined by both banks and decidedly above trading-based indications of value vs management's forecast as reflected in the DCF valuations.

Figure 3 :: Barclays Range of Implied Share Prices of Spirit Air

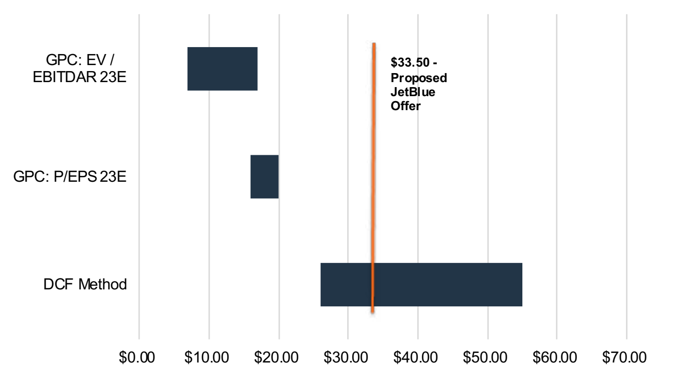


Figure 4 :: Morgan Stanley Range of Implied Share Prices of Spirit Air

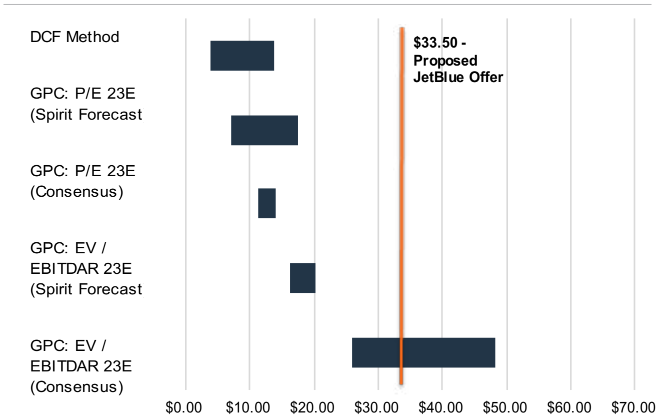
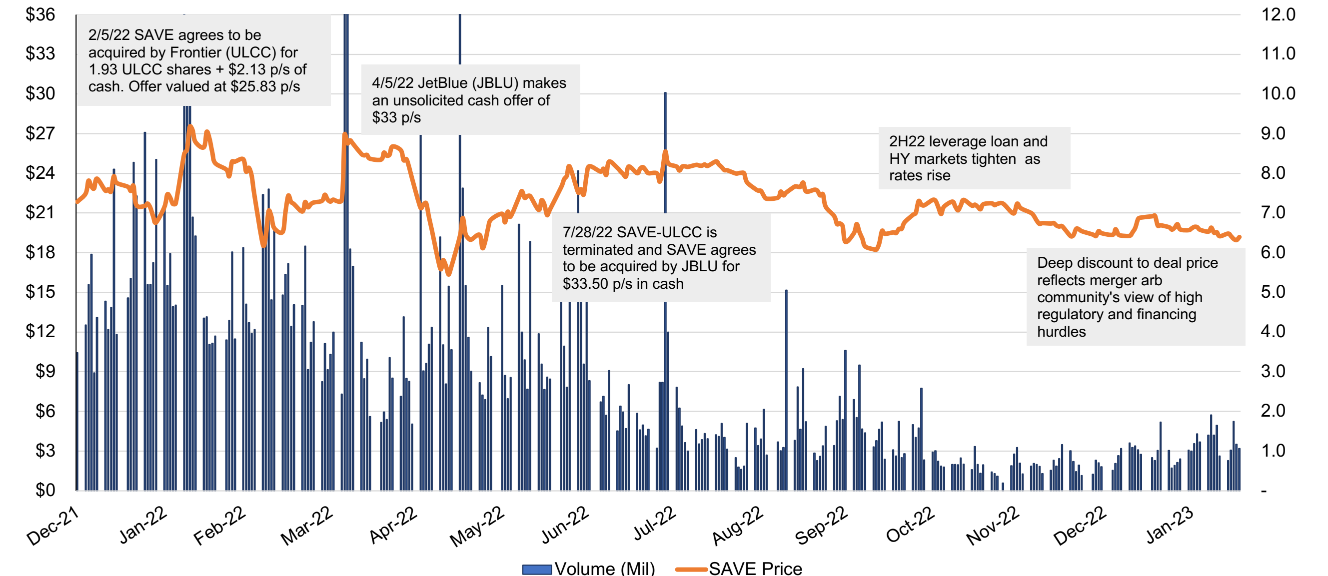


Figure 5 :: Spirit Airlines, Inc. (SAVE) Daily Closing Price and Volume



Source: S&P Global Market Intelligence

Current Status of the Transaction

Given the price and terms of the JetBlue deal, rendering the fairness opinions appears to have been a straightforward exercise; *however, one deal point a board must always consider is the ability of a buyer to close.* This begs the question: Can JetBlue close the deal?

The market's answer to the question is "no" given the deep discount Spirit trades to the acquisition price net of the approval payment. The deep discount reflects the likelihood that the U.S. Department of Justice would sue to block the deal because it would eliminate another low-cost carrier and position JetBlue-Spirit as the fifth-largest airline in the U.S. behind American Airlines, Delta Air Lines, Southwest Airlines, and United Airlines. On March 7, 2023 the DOJ did, in fact, sue to block the merger.

Among the factors the board considered that weighed against approving the deal was the risk that regulators would block the deal. These concerns were voiced by Frontier and some investors when JetBlue made its unsolicited offer nearly a year ago, but the board approved the transaction nonetheless, perhaps figuring JetBlue offered downside payments and that Frontier would still be an option if Washington nixes the JetBlue transaction.

And for what it is worth, the terminated Frontier deal would be valued around $23 per share, with its shares trading near $11 per share as of February 21.

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