VALUE FOCUS

Auto Dealer Industry

Year-End 2014

Overview

The aptly named "Great Recession" hit the auto industry and its dealers harder than almost any other industry, save for construction and housing. As unemployment rose, consumer spending and home values plummeted. With little to no discretionary income and no means to finance car purchases, sales tumbled, margins were squeezed, and GM and Chrysler filed for Chapter 11 bankruptcy. Recovery began in 2009, confidence and disposable incomes rose allowing consumers to fund purchases of more durable goods, including cars. These trends are expected to continue through 2019. However, the auto dealer industry, though making a strong recovery from the most recent recession, is facing pressures from government regulation, shifting demand and supply, and new market entrants.

More stringent environmental standards are causing car prices to rise, the shift to the internet for information and purchasing is forcing margins down (but also increasing volume), and demand is shifting more toward hybrid, electric, and autonomous cars. The leading auto dealers are taking notice of these shifting trends. All things considered, revenue for new cars is expected to grow at 2.0% per year through 2019, though margins will unlikely keep pace.

SPECIAL SUPPLEMENT

Fairness Opinions: Evaluating a Buyer's Shares from the Seller's Perspective

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Inside

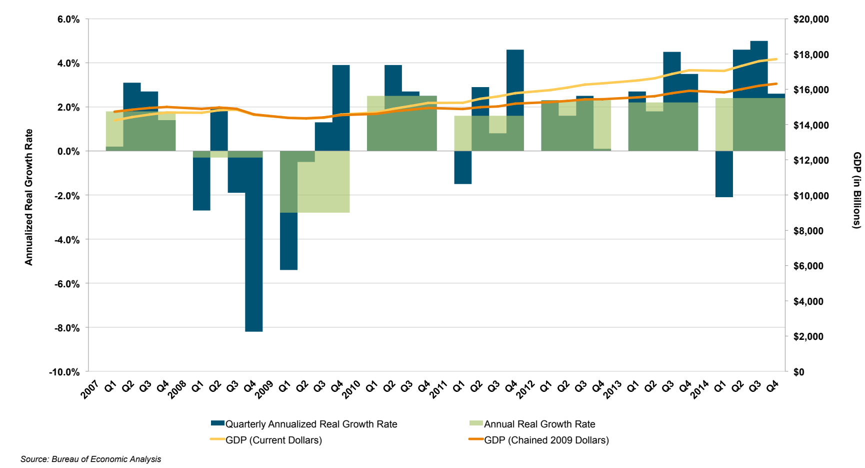
Macroeconomic Indicators // Productivity

Rising disposable income, a measure of consumers' ability to support debt-funded purchases, is dependent on an economy's productivity. While the "Great Recession" reached its official end in mid-2009, economic growth remains somewhat subdued. Although the housing market has strengthened, growth in the market remains weak. The unemployment rate reached pre-recession levels in December 2014, but labor force participation remains low and has continued to fall. Economic growth is expected to remain positive, though government spending cuts, political uncertainty, and rising interest rates are causes for concern. GDP growth expectations from private economists surveyed by *The Wall Street Journal* are on the order of 2.8% for the first quarter of 2015 and 2.8% for all of 2015. This compares to GDP growth of 2.3%, 2.2%, and 2.4% in 2012, 2013, and 2014, respectively. Although the Federal Reserve ended its asset purchases, a significant tightening of monetary policy (via an increase in the target federal funds rate) is unlikely in the short run until unemployment declines and inflation rises.

GDP

According to advance estimates released by the Department of Commerce's Bureau of Economic Analysis, Real Gross Domestic Product ("GDP"), the output of goods and services produced by labor and property located in the United States, increased at an annualized rate of 2.6% during the fourth quarter of 2014. The increase in real GDP during the fourth quarter was attributable to personal consumption expenditures, private inventory investment, exports, nonresidential fixed investment, state and local government spending, and residential fixed investment.

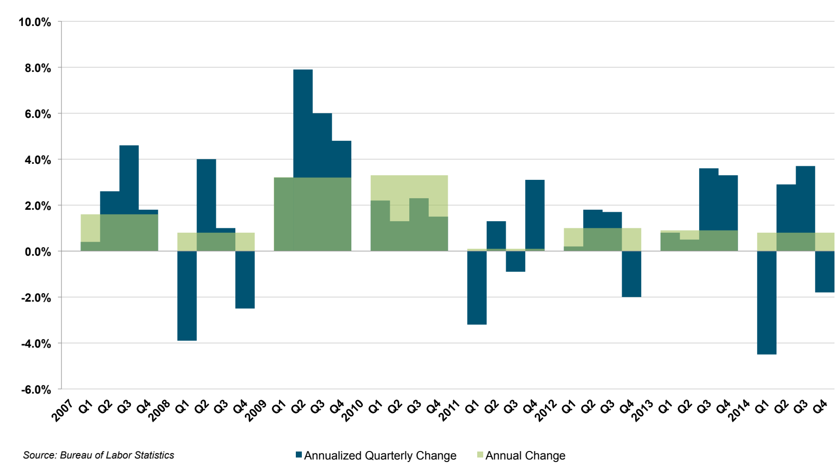
Gross Domestic Product



Nonfarm Business Productivity

According to the Bureau of Labor Statistics, seasonally adjusted nonfarm business productivity, as measured by the hourly output of all persons, decreased at an annual rate of 1.8% in the fourth quarter of 2014.

Change in Nonfarm Business Productivity

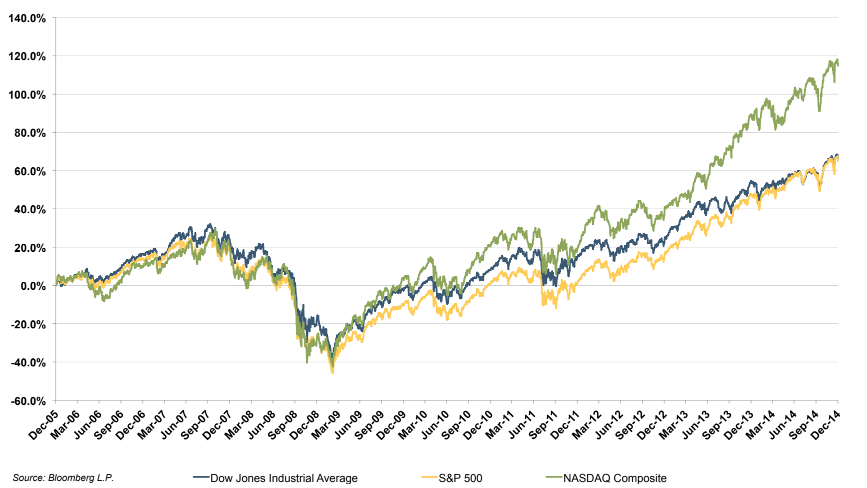


Macroeconomic Indicators // Productivity (cont.)

Equity Indices

Broad market equity indices exhibited generally upward performance in the fourth quarter of 2014. Both the Dow Jones and the S&P reached records highs repeatedly throughout 2014. The Dow Jones has recorded six consecutive years of gains.

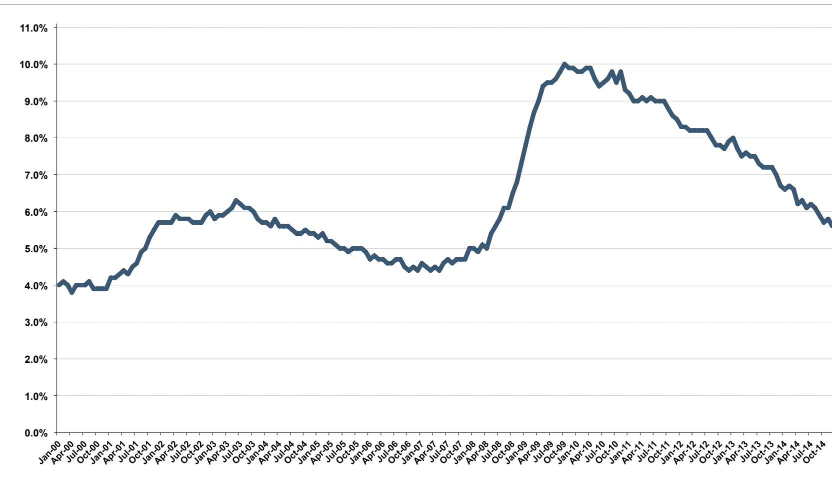
Equity Index Price Return



Unemployment

According to the Labor Department's Bureau of Labor Statistics ("BLS"), the unemployment rate was 5.6% in December 2014, down slightly from 5.7% and 5.8% in October and November, respectively. Unemployment rates increased steadily throughout 2008 and into 2009, peaking at a level of 10% in October 2009. The October 2009 unemployment rate represented the highest level since 1983. The December 2014 rate is the lowest rate since September 2008, although the labor force participation rate is also generally lower.

Civilian Unemployment Rate



Macroeconomic Indicators // Housing

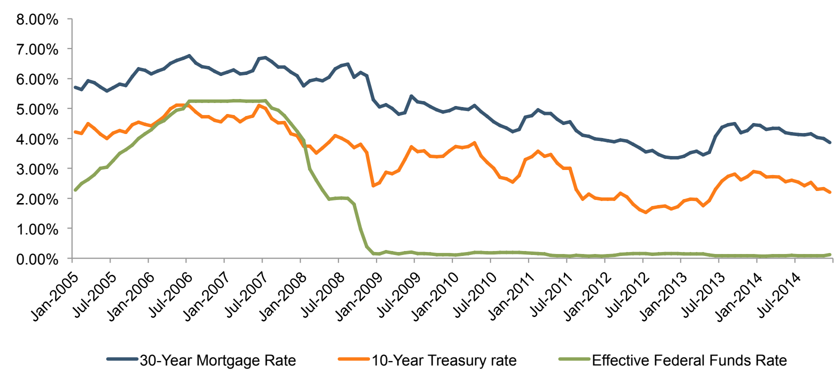
Traditionally, home owners have used home equity to purchase durable goods. When the housing market collapsed in late 2007, this method of financing was effectively cut off. The housing market improved considerably from the depths of the financial crisis due to sustained reductions in interest rates, though it remains well below highs seen in 2005 and 2006. Although the Federal Reserve has begun tapering the rate of asset purchases, a significant tightening of monetary policy (via an increase in the target federal funds rate) is unlikely in the short run until unemployment declines and inflation rises. Further, home building activity has traditionally been a primary driver of overall economic activity because new home construction stimulates a broad range of industrial, commercial, and consumer spending and investment.

> *"The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run."*
> -Federal Reserve FOMC statement December 17, 2014

Key Interest Rates

The Federal Reserve's Open Market Committee ("FOMC") lowered its target for the federal funds rate to a range of 0% to 0.25% during the fourth quarter of 2008, representing a total rate cut of 175 to 200 basis points during the quarter. Target rates were held steady during 2009 and have remained unchanged through the fourth quarter of 2014. This has kept interest rates low, increasing the ability of households to fund spending. The yield on the 10-year Treasury note is expected to increase during 2015, which could cause consumers to switch to used cars, as new car loans are less affordable.

Change in Key Interest Rates



Source: Federal Reserve Economic Data

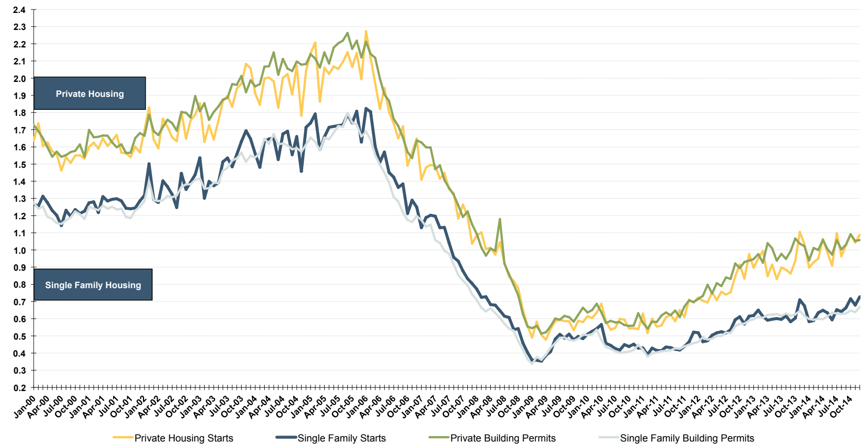
Macroeconomic Indicators // Housing (cont.)

Housing Starts

According to the U.S. Census Bureau, new privately owned housing starts were at a seasonally adjusted annualized rate of 1,089,000 units in December 2014, 4.4% above the revised November rate of 1,043,000 units, and 5.3% above the December 2013 level. The seasonally adjusted annual rate of private housing units authorized by building permits (considered the best indicator of future housing starts) was 1,032,000 units in December 2014, 1.9% below the revised November estimate of 1,052,000, but 1.0% above the December 2013 level.

Seasonally Adjusted Annualized Rates of New Housing Starts and Building Permits

(millions of units)

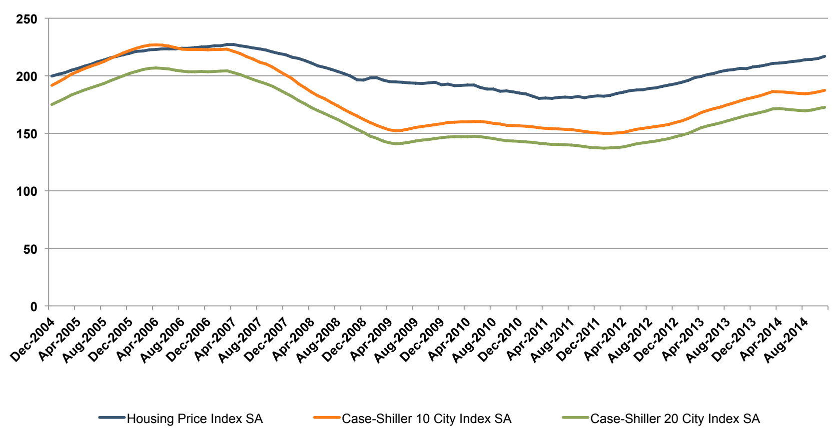


Source: U.S. Census Bureau

Housing Prices

Housing prices have not yet recovered to pre-recession levels but have increased year-over-year since January 2011.

Change in Housing Prices



Source: Federal Housing Finance Agency and Federal Reserve Economic Data

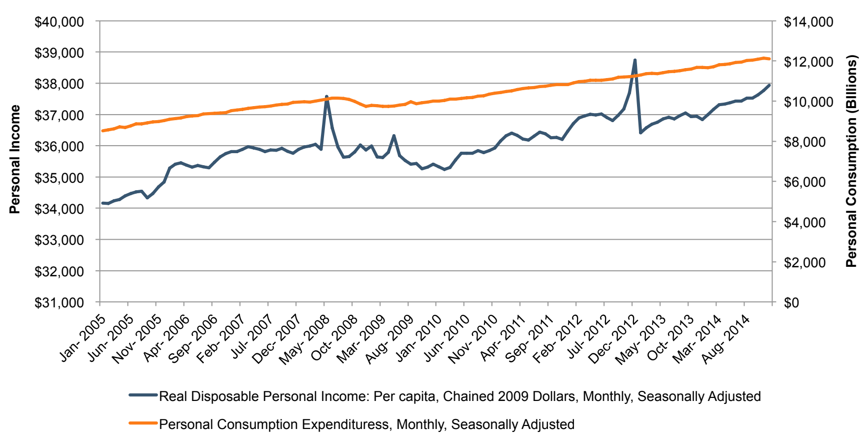
Macroeconomic Indicators // Personal Consumption & Confidence

Increases in disposable income allow for increases in personal consumption, especially debt-fund purchases like cars. However, these increases must keep pace with inflation. Further, increases in disposable income tend to increase confidence in consumers and business owners. Confident consumers have more optimistic expectations of the future: They expect a stronger economy, lower unemployment, higher future wages, and better ability to pay for debt-funded purchases. Similarly, confident businesses are a gauge of an economy's ability to employ labor productively in the future.

Disposable Income and Personal Consumption

Real personal income and personal consumption have both been steadily increasing year-over-year since 2010, partly due to growth and partly due to Federal Reserve policy keeping inflation near 0.0%. Further, disposable income is expected to continue rising through 2015.

Disposable Income and Personal Consumption

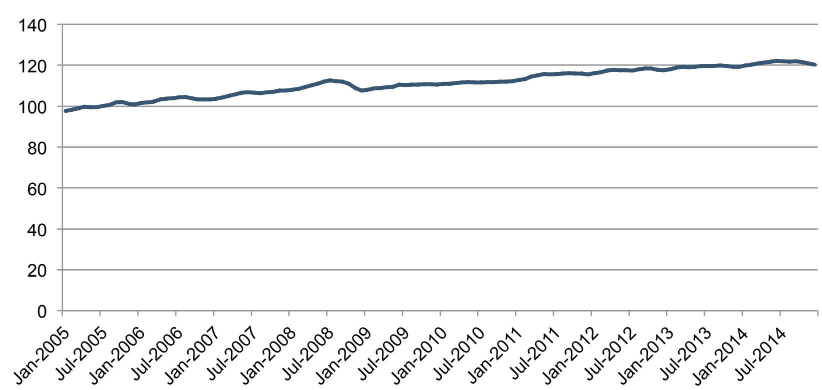


Source: Federal Reserve Economic Data

Consumer Price Index

The Consumer Price Index is a measure of inflation. While it has steadily increased since 2009, the Federal Reserve's monetary policy has kept inflation below its 2.0% target, keeping interest rates low and consumption high.

Consumer Price Index



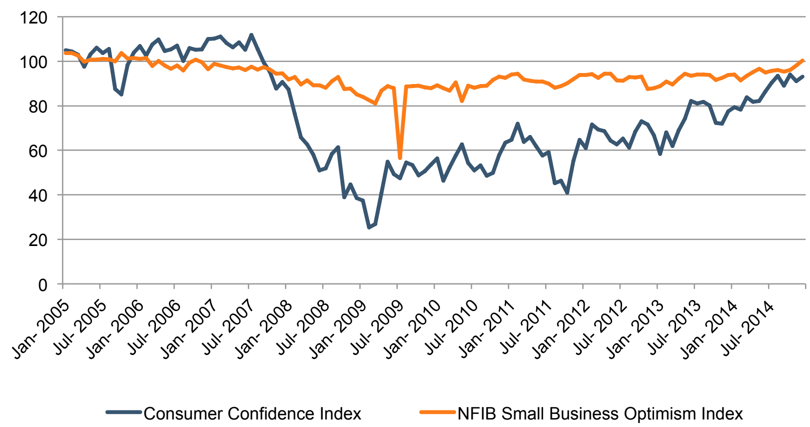
Source: The Conference Board

Macroeconomic Indicators // Personal Consumption & Confidence (cont.)

Confidence

Both consumer and small business confidence has been trending upward since the "Great Recession." This confidence will drive demand for cars.

Change in Confidence



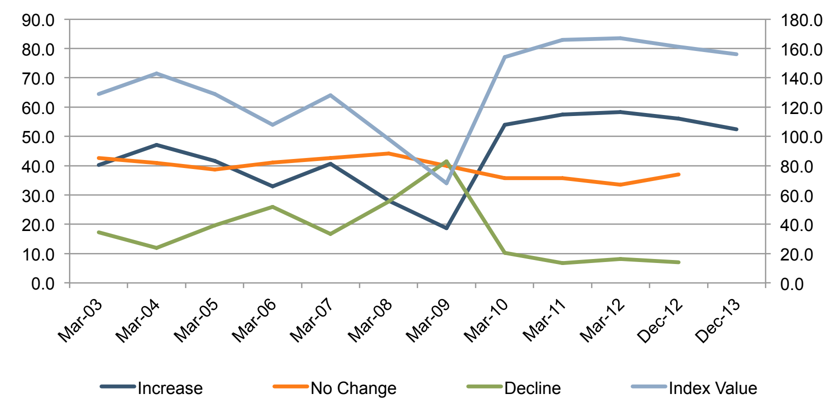
Source: Bloomberg, L.P.

Macroeconomic Indicators // NADA Dealer Optimism Index

NADA Dealer Optimism Index

According to the 2014 NADA Dealer Optimism Index, fewer dealers believed profits would continue to rise as of December 2013. However, the same survey showed dealer confidence has surpassed pre-recession highs, and current profits are expected increase.

NADA Dealer Optimism Index



Source: NADA Data

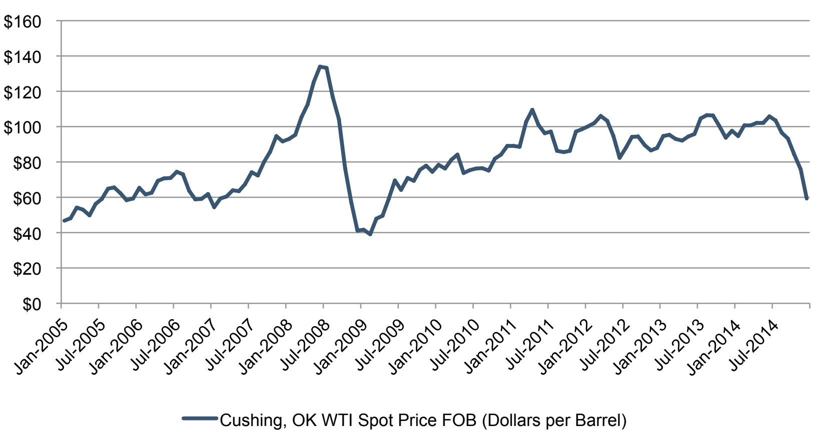
Macroeconomic Indicators // Energy

Energy prices not only impact the price of manufacturing a car, but also the running price of a car, as consumers must fill up on gas regularly. Increased environmental regulations have improved fuel economy of most cars but have also led to higher prices at the dealership. Consequently, consumer demand has shifted toward more fuel efficient, typically smaller, vehicles.

Spot Oil

Oil prices have steadily increased since 2009 to historically high levels through the first half of 2014, shifting consumer demand to hybrid and electric vehicles. World crude oil prices decreased sharply throughout the second half of 2014.

Spot Oil Prices

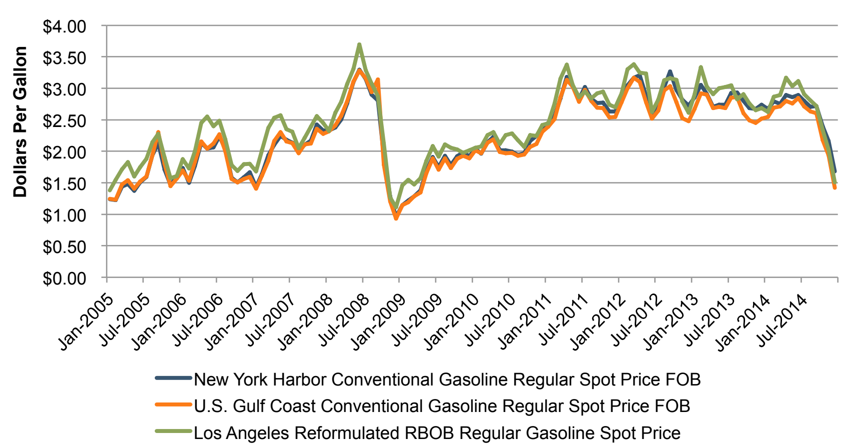


Source: Energy Information Administration

Gas

Gas prices have mimicked oil prices, rising to historical highs in the first half of 2014 before dropping sharply through December.

Gas Prices



Source: Energy Information Administration

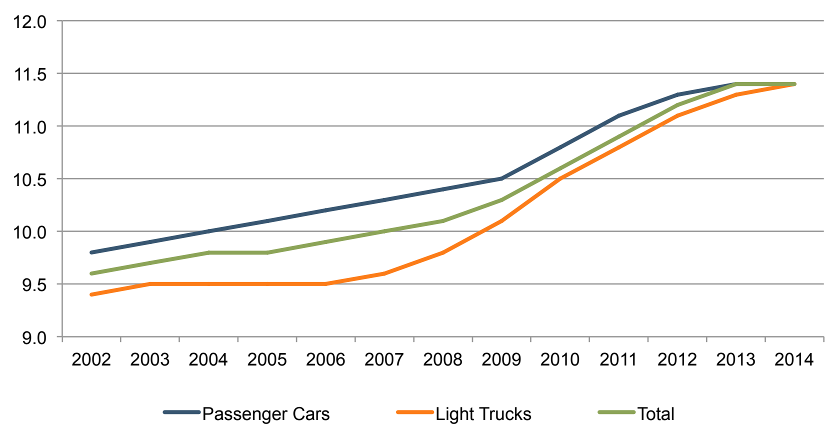
Auto Dealer Indicators // Average Dealer Profile

Macroeconomic measures including employment, productivity housing prices and starts, interest rates, and disposable income have provided an environment conducive to car purchases. However, rising prices, downward pressure on margins, and changes in demand have caused shifts in automobile demand.

Average Age of Vehicle Fleet

Polk, a global automotive market intelligence firm, found that the average age of all light vehicles hit a record high of 11.4 years in 2013 due to the recent recession and rising car quality. Further, they expect this trend to provide more opportunities for the automotive aftermarket.

Average Age of Vehicle Fleet



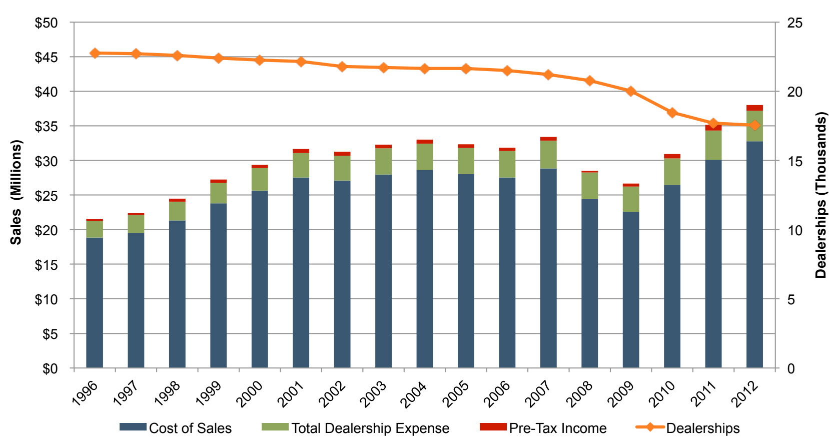
Source: IHS Automotive, driven by Polk

Dealership Sales

By the end of 2012, there was an increase of 95 franchised dealerships, the first annual increase since 1987.

Sales rose 9.2% in 2012, the second year in a row, above pre-recession highs. However, net profit before taxes gained only 6.2% as dealerships continued to experience margin compression. Current pressure on margins stems primarily from the fact that the asymmetric information that once favored dealers is balanced by internet sites such as Edmunds, cars.com, and autotrader.com.

Dealership Sales



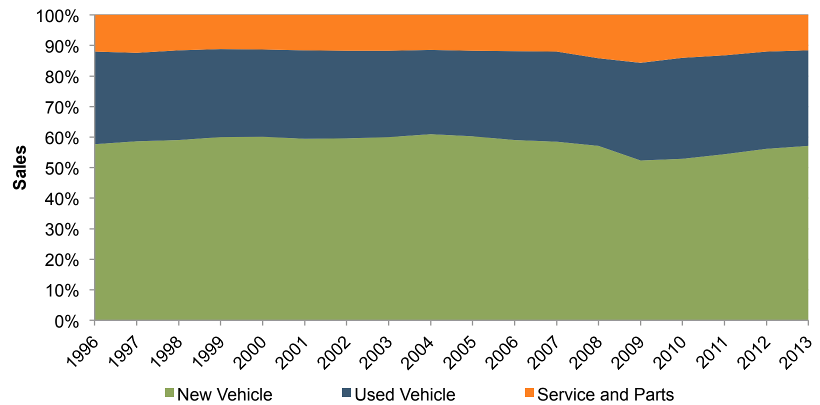
Source: NADA Data

Auto Dealer Indicators // Average Dealer Profile (cont.)

Products and Services Segmentation

From 2005 to 2010, the percentage of sales from used vehicles and service and parts segments of the industry rose, as financing new vehicle purchases became more difficult. Since then, new vehicles' share of sales has gone up, but has not recovered to pre-recession levels.

Products and Services Segmentation



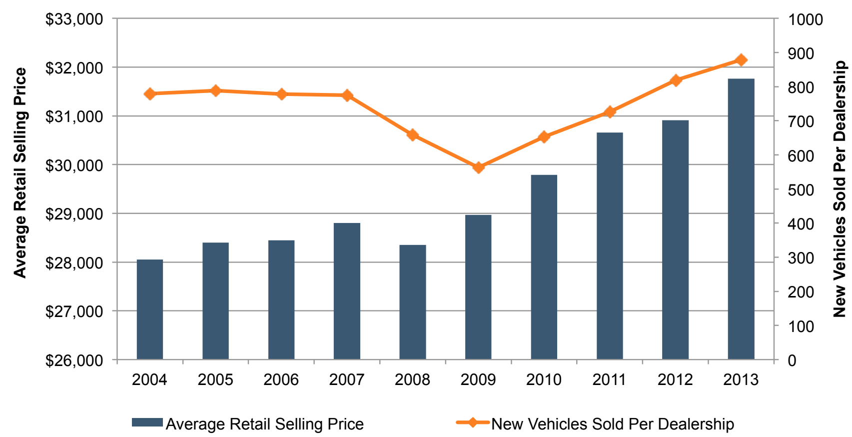
Source: NADA Data

Auto Dealer Indicators // Vehicles and Price

Vehicles and Price

Through the end of 2013, prices were forced up by rising oil prices and increased environmental regulations. Average vehicles sold per dealership continued to rise even as the number of franchised dealerships increased.

Vehicles and Price



Source: NADA Data

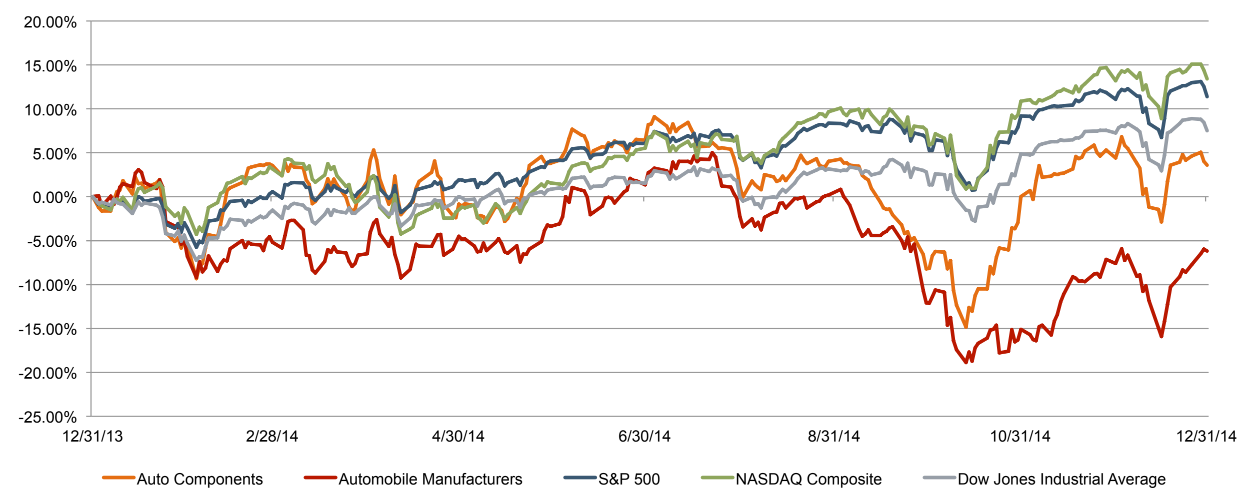
Valuation Trends

OEMs and Indices

Auto components have continued to outpace auto manufacturers reflecting continued increases in consumer spending on maintenance compared to pre-recession levels.

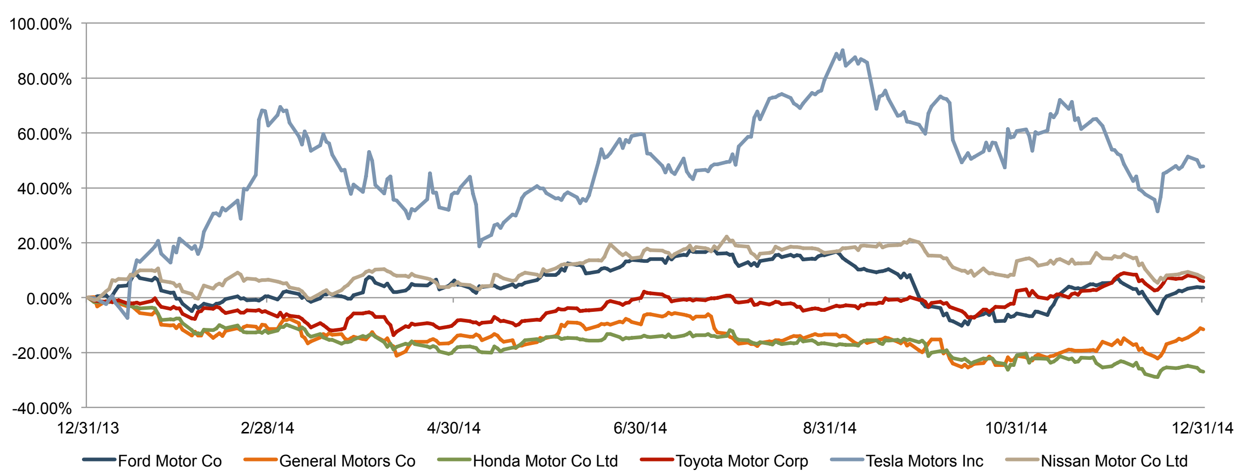
Tesla is outperforming all other auto dealers. They are on the forefront of electric vehicle and autonomous driving system technology. Their recent adoption of an open source mentality in regard to their patents provided a boost in public perception. Lastly, despite their trouble with certain trade restrictions placed on them by particular states, they are increasing margins by removing the need for a physical dealership. AutoNation, following suit, launched AutoNation Direct, an online selling platform in December 2014.

Index Performance



Source: Bloomberg L.P.

OEM Stock Performance



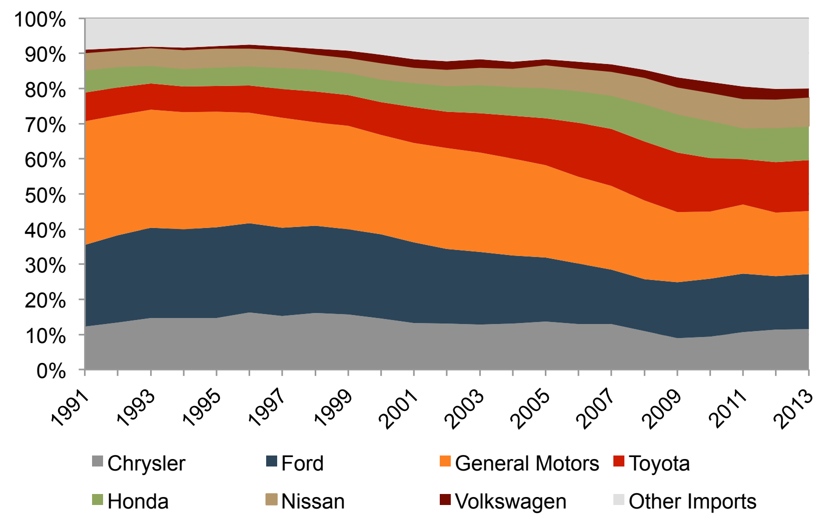
Source: Bloomberg, L.P.

Valuation Trends (cont.)

Brand Market Share By Unit Sales

In 2012, Chrysler was the only member of the Detroit Three whose market share rose. Of the three major Japanese brands, Nissan's fell while Honda and Japanese brands gained market share. Other imports have been gaining market share.

Brand Market Share By Unit Sales



Source: NADA Data

Valuation Trends (cont.)

Publicly Traded Auto Dealerships

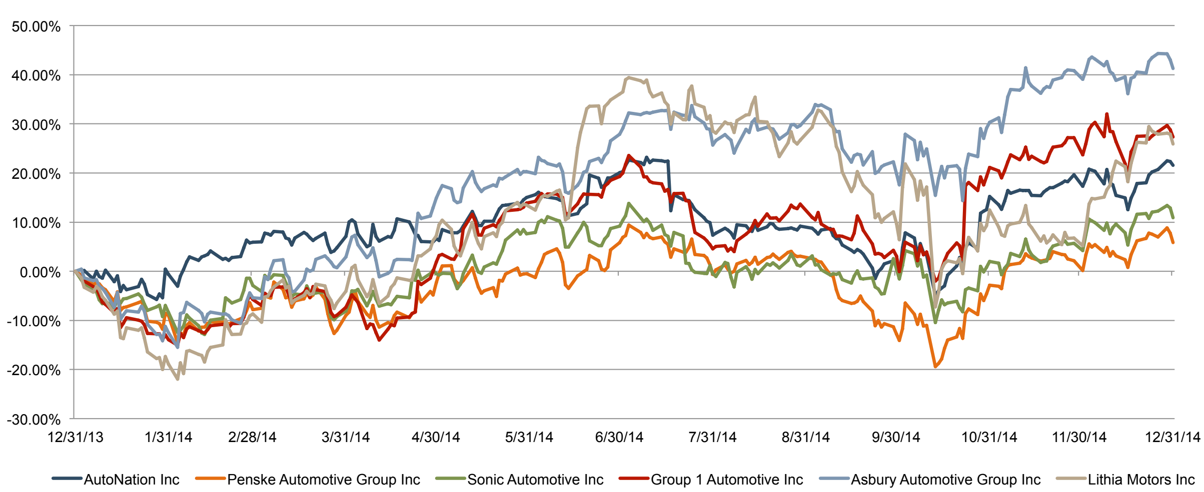
"We are very pleased with our strong year-over-year growth across all areas of our business, as well as our 17th consecutive quarter of double-digit year-over-year growth in EPS. This quarter and year we set another record for the highest ever quarterly and annual EPS from continuing operations." Mr. Jackson added, "We are expecting U.S. industry new vehicle unit sales above 17 million in 2015." *Mike Jackson, Charmain and CEO of AutoNation.* "AutoNation Reports All-Time Record Quarter and All-Time Record Full Year Results." 3 February 2015.

"Our retail automotive dealership business produced another strong quarter across both the U.S. and the U.K. Same-store retail revenue increased 8.3% and we had a 90-basis-point increase in our service and parts gross margin to 59.7%, which helped drive another record quarter for our business. Strong results across the retail automotive dealership business and our U.S.-based commercial vehicle dealership business were partially offset by our Australian operations which were impacted by challenging economic conditions and post-acquisition restructuring costs within the Power Systems business." *Roger S. Penske, Chairman of Penske Automotive Group.* "Penske Automotive Reports Record Results." 11 February 2015.

"We are delighted to announce all-time record adjusted earnings for this quarter and the full year. For the quarter, the results reflect double-digit revenue growth, improved margins, and impressive cost control. Each of our geographic markets delivered significant improvements, with continued strong growth in the U.S. and U.K. and the benefits of cost reductions in Brazil driving higher earnings in all three countries. For the full year, revenue increased more than $1 billion, which in combination with improvements in our cost and capital structure, translated into record adjusted full year earnings of $5.87." *Earl J. Hesterberg, President and CEO of Group 1 Automotive.* "Group 1 Automotive Reports Record Adjusted Financial Results for Quarter and Year." 5 February 2015.

"I am very pleased with the performance of our team in the fourth quarter, especially considering the various initiatives we have tasked the team with during the year. In addition to our internal initiatives, during the fourth quarter we purchased Cherry Creek Chevrolet and Land Rover of Roaring Fork, both located in the Denver, Colorado market. We have also been awarded Mercedes Benz and Audi add points during the year. The Mercedes Benz add point is located in McKinney, Texas and we believe it will be operational by the second quarter of 2016. The Audi add point is located in the Pensacola, Florida area and we expect opening this point in late 2016. The additions of these premium luxury brands will prove to augment our existing luxury brand portfolio. We are dedicated to our EchoPark®, One Sonic–One Experience and growth through acquisitions initiatives and will continue to invest in these initiatives in 2015. We expect 2015 to continue to be favorable to dealers and anticipate new vehicle industry volume to be between 16.5 million and 17.0 million units. We project diluted earnings per share from continuing operations for 2015 to be between $1.85 and $1.95 per share. Excluding the effects of EchoPark on this range, adjusted diluted earnings per share from continuing operations from our historical franchised group of stores is expected to be between $2.01 and $2.11 per share." *B. Scott Smith, President of Sonic Automotive.* "Sonic Automotive, Inc. Reports Record Results and Launch of EchoPark® Automotive." 24 February 2015.

Auto Dealership Stock Performance

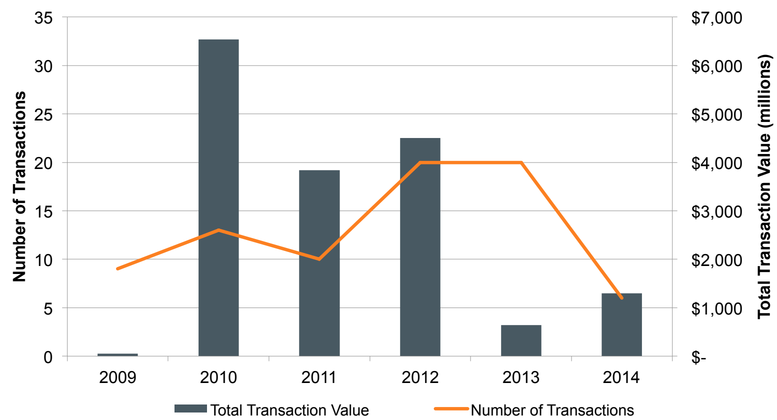


Source: Bloomberg L.P.

Mergers and Acquisitions

Deal activity in 2013 slowed somewhat in terms of aggregate deal value, but the number of transactions has increased. Though the number of transactions in 2014 slowed, total transaction value increased substantially.

M&A Activity



Source: Capital IQ

Guideline Company Pricing

Auto Manufacturing Pricing

Company Name	Ticker	31-Dec Price $	52 Week Perf. %	LTM Sales $ Mil	LTM EBITDA $ Mil	Ent. Value $ Mil	Debt / Equity %	EBITDA Margin %	EV / Sales Multiple x	EV / EBITDA Multiple x	EV / Nxt Yr EBITDA Multiple x	Price / Earnings x
Ford Motor Co	F	15.50	3.70%	145,243	9,247	178,848	456.05%	6.37%	1.23	19.34	16.24	10.20
General Motors Co	GM	34.91	-11.56%	156,797	10,116	100,070	103.04%	6.45%	0.64	9.89	6.55	23.65
Honda Motor Co Ltd	HMC	29.52	-27.34%	118,505	15,652	110,511	99.55%	13.21%	0.93	7.06	9.16	8.79
Hyundai Motor Co	005380.KS	169.00	-24.72%	83,733	9,801	83,085	89.26%	11.71%	0.99	8.48	8.20	6.20
Toyota Motor Corp	TM	125.48	5.94%	255,171	36,100	559,022	114.06%	14.15%	2.19	15.49	17.66	20.88
Tesla Motors Inc	TSLA	222.41	47.85%	2,857	76	30,289	235.89%	2.67%	10.60	396.78	39.10	nm
Nissan Motor Co Ltd	NSANY	17.47	7.29%	106,281	12,308	128,419	134.32%	11.58%	1.21	10.43	14.28	17.13
Peugeot SA	PEUGF	12.40	9.64%	73,265	5,050	53,127	329.91%	6.89%	0.73	10.52	11.37	nm
Average		**78.34**	**1.35%**	**117,731**	**12,294**	**155,421**	**195.26%**	**9.13%**	**2.32**	**59.75**	**15.32**	**14.47**
Median		**32.22**	**4.82%**	**112,393**	**9,958**	**105,290**	**124.19%**	**9.24%**	**1.10**	**10.48**	**12.82**	**13.66**

Source: Bloomberg L.P.

Dealer Pricing

Company Name	Ticker	31-Dec Price $	52 Week Perf. %	LTM Sales $ Mil	LTM EBITDA $ Mil	Ent. Value $ Mil	Debt / Equity %	EBITDA Margin %	EV / Sales Multiple x	EV / EBITDA Multiple x	EV / Nxt Yr EBITDA Multiple x	Price / Earnings x
Traditional Auto Dealers												
AutoNation Inc	AN	60.41	21.57%	18,585	901	11,626	233.98%	4.85%	0.63	12.90	12.36	17.72
Penske Automotive Group Inc	PAG	49.07	5.87%	16,728	559	8,161	227.92%	3.34%	0.49	14.60	12.76	15.58
Sonic Automotive Inc	SAH	27.04	10.90%	9,161	287	3,269	287.17%	3.14%	0.36	11.38	10.57	14.16
Group 1 Automotive Inc	GPI	89.62	27.33%	9,678	348	4,469	232.20%	3.59%	0.46	12.85	12.59	24.55
Asbury Automotive Group Inc	ABG	75.92	41.27%	5,739	286	3,423	221.93%	4.99%	0.60	11.96	10.74	18.16
Lithia Motors Inc	LAD	86.69	25.90%	4,622	234	3,275	162.20%	5.07%	0.71	13.99	10.00	18.76
Average		**64.79**	**22.14%**	**10,752**	**436**	**5,704**	**227.57%**	**4.16%**	**0.54**	**12.95**	**11.50**	**18.16**
Median		**68.17**	**23.73%**	**9,420**	**317**	**3,946**	**230.06%**	**4.22%**	**0.54**	**12.88**	**11.55**	**17.94**
Used Auto Dealers												
America's Car-Mart Inc/TX	CRMT	53.38	26.40%	450	(13)	570	48.41%	-2.92%	1.27	nm	10.51	21.70
CarMax Inc	KMX	66.58	41.60%	13,367	998	22,670	245.44%	7.47%	1.70	22.71	21.78	28.09
Average		**59.98**	**34.00%**	**6,909**	**493**	**11,620**	**146.93%**	**2.27%**	**1.48**	**22.71**	**16.14**	**24.90**
Median		**59.98**	**34.00%**	**6,909**	**493**	**11,620**	**146.93%**	**2.27%**	**1.48**	**22.71**	**16.14**	**24.90**

Source: Bloomberg L.P.

Sources

"IBISWorld Industry Report 44111: New Car Dealers in the US"

"IBISWorld Industry Report 44112: Used Car Dealers in the US"

"NADA Data" 2002-2014. http://www.nada.org/Publications/NADADATA/.

MERCER CAPITAL
BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

Mercer Capital

Auto Dealer Industry Services

Mercer Capital has expertise providing business valuation and financial advisory services to companies in the auto dealer industry.

Mercer Capital provides business valuation and financial advisory services to auto dealerships throughout the nation. We provide valuation services for tax purposes, buy-sell agreements, partner buyouts, and other corporate planning purposes. Mercer Capital also works with owners who are considering the sale of their dealership or the acquisition of other dealership(s).

Services Provided

- Valuation of auto dealer industry companies
- Transaction advisory for mergers, acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

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Fairness Opinions

Evaluating a Buyer's Shares from the Seller's Perspective

M&A activity in the U.S. (and globally) has accelerated in 2014 after years of gradual improvement following the financial crisis. According to Dealogic, M&A volume where the target was a U.S. company totaled $1.4 trillion YTD through November 10, the highest YTD volume on record and up 43% from the same period last year. Excluding cross-border acquisitions, domestic-only M&A was $1.1 trillion, which represented the second highest YTD volume since 1999 and up 27% from last year. Healthcare and telecommunications were the first and second most targeted sectors.

The improvement has taken a long time even though corporate cash is high, financing costs are very low and organic revenue growth in most industries has been sluggish. Aside from improving confidence, another key foundation for increased M&A activity fell into place in 2013 when equity markets staged a strong rally as the S&P 500 rose 30% (32% with dividends) and the Russell 2000 increased 37% (39%). The absence of a meaningful pullback in 2014 and a 12% advance in the S&P 500 and 2% in the Russell 2000 have further supported activity.

The rally in equities, like low borrowing rates, has reduced the cost to finance acquisitions because the majority of stocks experienced multiple expansion rather than material growth in EPS. It is easier for a buyer to issue shares to finance an acquisition if the shares trade at rich valuation than issuing "cheap" shares. As of November 24, the S&P 500's P/E based upon trailing earnings (as reported) was 20.0x compared to 18.2x at year-end 2013, 17.0x at year-end 2012 and 14.9x at year-end 2011. The long-term average P/E since 1871 is 15.5x (Source: http://www.multpl.com).

High multiple stocks can be viewed as strong acquisition currencies for acquisitive companies because fewer shares have to be issued to achieve a targeted dollar value. As such, it is no surprise that the extended rally in equities has supported deal activity this year. However, high multiple stocks may represent an under-appreciated risk to sellers who receive the shares as consideration. Accepting the buyer's stock raises a number of questions, most which fall into the genre of: what are the investment merits of the buyer's shares? The answer may not be as obvious as it seems, even when the buyer's shares are actively traded.

Our experience is that some, if not most, members of a board weighing an acquisition proposal do not have the background to thoroughly evaluate the buyer's shares. Even when financial advisors are involved there still may not be a thorough vetting of the buyer's shares because there is too much focus on "price" instead of, or in addition to, "value."

A fairness opinion is more than a three or four page letter that opines as to the fairness from a financial point of a contemplated transaction; it should be backed by a robust analysis of all of the relevant factors considered in rendering the opinion, including an evaluation of the shares to be issued to the selling company's shareholders. The intent is not to express an opinion about where the shares may trade in the future, but rather to evaluate the investment merits of the shares before and after a transaction is consummated.

Key questions to ask about the buyer's shares include the following:

- **Liquidity of the Shares.** What is the capacity to sell the shares issued in the merger? SEC registration and even NASDAQ and NYSE listings do not guarantee that large blocks can be liquidated efficiently. Generally, the higher the institutional ownership, the better the liquidity. Also, liquidity may improve with an acquisition if the number of shares outstanding and shareholders increase sufficiently.

- **Profitability and Revenue Trends.** The analysis should consider the buyer's historical growth and projected growth in revenues, and operating earnings, (usually EBITDA or EBITDA less capital expenditures) in addition to EPS. Issues to be vetted include customer concentrations, the source of growth, the source of any margin pressure and the like. The quality of earnings and a comparison of core vs. reported earnings over a multi-year period should be evaluated.

- **Pro Forma Impact.** The analysis should consider the impact of a proposed transaction on revenues, EBITDA, margins, EPS and capital structure. The per share accretion and dilution analysis of such metrics as earnings, EBITDA and dividends should consider both the buyer's and seller's perspectives.

- **Dividends.** In a yield starved world, dividend paying stocks have greater attraction than in past years. Sellers should not be overly swayed by the pick-up in dividends from swapping into the buyer's shares; however, multiple studies have demonstrated that a sizable portion of an investor's return comes from dividends over long periods of time. If the dividend yield is notably above the peer average, the seller should ask why? Is it payout related, or are the shares depressed? Worse would be if the market expected a dividend cut. These same questions should also be asked in the context of the prospects for further increases.

- **Capital Structure.** Does the acquirer operate with an appropriate capital structure given industry norms, cyclicality of the business and investment needs to sustain operations? Will the proposed acquisition result in an over-leveraged company, which in turn may lead to pressure on the buyer's shares and/or a rating downgrade if the buyer has rated debt?

- **Balance Sheet Flexibility.** Related to the capital structure should be a detailed review of the buyer's balance sheet that examines such areas as liquidity, access to bank credit, and the carrying value of assets such as deferred tax assets.

- **Ability to Raise Cash to Close.** What is the source of funds for the buyer to fund the cash portion of consideration? If the buyer has to go to market to issue equity and/or debt, what is the contingency plan if unfavorable market conditions preclude floating an issue?

- **Consensus Analyst Estimates.** If the buyer is publicly traded and has analyst coverage, consideration should be given to Street expectations vs. what the diligence process determines. If Street expectations are too high, then the shares may be vulnerable once investors reassess their earnings and growth expectations.

- **Valuation.** Like profitability, valuation of the buyer's shares should be judged relative to its history and a peer group presently as well as relative to a peer group through time to examine how investors' views of the shares may have evolved through market and profit cycles.

- **Share Performance.** Sellers should understand the source of the buyer's shares performance over several multi-year holding periods. For example, if the shares have significantly outperformed an index over a given holding period, is it because earnings growth accelerated? Or, is it because the shares were depressed at the beginning of the measurement period? Likewise, underperformance may signal disappointing earnings, or it may reflect a starting point valuation that was unusually high.

- **Strategic Position.** Assuming an acquisition is material for the buyer, directors of the selling board should consider the strategic position of the buyer, asking such questions about the attractiveness of the pro forma company to other acquirers.

- **Contingent Liabilities.** Contingent liabilities are a standard item on the due diligence punch list for a buyer. Sellers should evaluate contingent liabilities too.

The list does not encompass every question that should be asked as part of the fairness analysis, but it does illustrate that a liquid market for a buyer's shares does not necessarily answer questions about value, growth potential and risk profile.

We at Mercer Capital have extensive experience in valuing and evaluating the shares (and debt) of financial and non-financial service companies garnered from over three decades of business. Feel free to contact us to discuss your situation in confidence.

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