Valuing Corporations

RECENT CASE LAW IN PERSPECTIVE
by Z. Christopher Mercer, ASA, CFA
and Travis W. Harms, CFA, CPA/ABV

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by B. Patrick Lynch

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New Look,  
Same Thought Leadership

Dear Reader,

We hope you have noticed a change in our newsletter, Value Added™. We’ve moved away from a traditional 4 page newsletter into more of a news magazine, if you will. Why? To provide more content that is helpful to you and your business.

Each issue of Value Added™ will contain articles from several of the service groups of Mercer Capital, which are financial reporting valuation, corporate valuation, transaction advisory, controversy services, and financial institutions valuation. Not every article will speak to every reader, yet each reader should find information that is useful.

In this issue, Patrick Lynch tackles the issue of SFAS 141R and provides a wonderful overview of the upcoming standard. Andy Gibbs and Jay Wilson have included an article discussing how to analyze a bank’s earnings quality as a precursor to understanding its earning power. Also included is an article from our controversy services team that lists at least 10 reasons why it’s important to hire your expert witness earlier, rather than later, in the process. The longest article was penned by me and Travis Harms, and puts recent S corporation valuation case law in perspective. There is much confusion surrounding S corporation valuation in the business appraisal profession. As usual, we’re seeking to help business appraisers as well as users of business appraisals understand the issues and solutions.

I’m also pleased to report that this issue begins the 20th year of publication of this newsletter. Twenty years ago, Mercer Capital was a much smaller firm yet one with big dreams. We have been fortunate to realize many of those dreams with the help of our clients, referral sources, and employees. Like any successful firm, we still have big dreams and we’re pressing forward to reach them.

Thank you for your interest in the content of this issue and, as always, if we can help you in any way, please do not hesitate to contact me or any of the professionals listed in this newsletter.

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FEATURED ARTICLES

2  An Overview of SFAS 141R
   by B. Patrick Lynch
   The Financial Accounting Standards Board released a revised version of Statement of Financial Accounting Standards No. 141, Business Combinations, (“SFAS 141R”) on December 7, 2007. While the standard will not be effective for most practitioners until early 2009, financial managers should familiarize themselves with the rule changes now, so that they can be adequately prepared when SFAS 141R becomes effective. The revised standard sharpens the accounting guidance for business combinations as well as the scope of situations applicable to these rules, and also provides a significantly larger body of implementation guidance than its predecessor.

6  Valuing S Corporations: Recent Case Law in Perspective
   by Z. Christopher Mercer, ASA, CFA and Travis W. Harms, CFA, CPA/ABV
   In this article, we will examine the limitations inherent in such fair value cases with respect to assessing the fair market value of enterprises organized as S corporations. Despite these limitations, we will review the economic analysis of the subject S corporation in the Kessler decision, highlighting the encouraging manner in which the Court distinguished between the enterprise and shareholder benefits of the S election. Finally, we will propose a technique allowing judges and appraisers to extend the analysis found in Kessler in a robust manner to different fact patterns.

18  Bank Valuation: A Focus on Earnings Quality
    by Andrew K. Gibbs, CFA, CPA/ABV and Jay D. Wilson, Jr.
    Given the earnings challenges facing numerous banks and the declining valuations of publicly traded banks during 2007, it is important to know how to analyze a bank’s earnings quality as a precursor to understanding its earning power. In this article, we examine the philosophy of earnings quality analysis and overarching earnings quality issues and focus on an analysis of the adequacy of the loan loss reserve, which is one critical earnings quality issue facing banks in the current environment. We also provide general recommendations of how to construct a reasonable estimate of earning power after assessing earnings quality.

22  Good Things Come to Those Who Don’t Wait
    Having been retained for a number of significant litigation engagements over the years, Mercer Capital has had the opportunity to observe a variety of theories on the best time for attorneys to retain experts for their lawsuits. In many lawsuits, the testimony of your business valuation, economic damages, or investment banking expert will be among the more important elements of your case, making it vital that the expert be involved early in the process.

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The Financial Accounting Standards Board released a revised version of Statement of Financial Accounting Standards No. 141, *Business Combinations*, (“SFAS 141R”) on December 7, 2007. While the standard will not be effective for most practitioners until early 2009, financial managers should familiarize themselves with the rule changes now, so that they can be adequately prepared when SFAS 141R becomes effective. The revised standard sharpens the accounting guidance for business combinations as well as the scope of situations applicable to these rules, and also provides a significantly larger body of implementation guidance than its predecessor.

**REPORTING REQUIREMENTS**

The increased timing sensitivity and lengthened list of disclosure requirements in the revised standard will likely prove to be the most immediate challenge for financial managers. While current rules prescribe only a vague timeline for the reporting of business combinations, SFAS 141R establishes a defined *measurement period* that governs the time period within which the business combination must be reported. If the accounting for a business combination is not completed by the end of the reporting period the transaction occurred, a company must report provisional amounts for the incomplete items. The measurement period is the period (of up to one year following the close of a transaction) during which the company gathers the necessary information to complete the accounting. During this period, changes to the provisional amounts can be made without reporting the changes as errors in accounting.

In addition, the revised standard significantly expands the scope of disclosure requirements. The full list of required disclosures can be found in paragraphs 67 – 73 of SFAS 141R. Of note, if the company does not complete the business combination accounting by the end of the reporting period when the business combination occurred, the company must disclose the reasons why the accounting is incomplete. This requirement may create significant pressure for companies to complete the business combination accounting during that reporting period, which would be a dramatic change of pace for the completion of business combination accounting for many reporting companies. Given the changes in reporting requirements, discussing the pertinent valuation issues with the valuation specialist early in the process will be helpful in minimizing the potential for unsavory surprises.

**PURCHASE CONSIDERATION**

SFAS 141R includes several important changes to the measurement of purchase consideration, the most significant of which is the inclusion of contingent consideration (i.e. earn-out consideration). When the revised standard becomes effective, consideration transferred in a business combination will be defined as the aggregate of the fair
values of assets transferred from, liabilities incurred, and equity interests issued by the acquirer to the target company and its previous owners.

This definition specifically includes contingent consideration, which must be recognized at its fair value as of the transaction date. Two significant implications of this rule change for financial managers are: 1) reported purchase consideration for transactions with the potential for significant earn-out payments will be reported greater under SFAS 141R compared to current rules, and 2) the need to measure the fair value of contingent consideration, which is by nature characterized by significant uncertainty, will inevitably increase the complexity of the purchase price allocation process.

Other notable changes in the definition of purchase consideration are the exclusion of acquisition costs and clarified treatment of share-based payments to existing employees of the target company. While current rules allow a company to capitalize deal costs into the purchase price, SFAS 141R requires that such costs be expensed as they occur. More detailed discussion of the appropriate treatment of share-based payments in this context can be found in paragraphs 43 – 46 of SFAS 141R.

**GOODWILL MEASUREMENT**

Under the new standard, the measurement of goodwill is defined as the aggregate fair value of 1) purchase consideration, 2) any non-controlling interests in the target company, and 3) any equity interests in the target company already held by the acquirer on the transaction date less the net fair value of identifiable assets acquired and liabilities assumed in the business combination. Currently, goodwill is measured as the residual of the cost of the acquisition less the net fair value of identifiable assets acquired and liabilities assumed. This change will have the greatest effect in acquisitions of less than 100% of the target company and acquisitions completed in a series of transactions.

The underlying concept is that the fair values of the entire target company and its identifiable assets are measured, rather than just the component represented by the transaction. Note that this will generally increase reported total asset values, annual intangible asset amortization, as well as decrease the margin for error regarding future goodwill and long-lived intangible asset impairment.

**OTHER CHANGES**

Other notable rule changes in SFAS 141R from the current standard include:

- **Research & Development** – Under existing rules, an acquirer must measure the fair value of acquired in-process research and development and immediately charge off that amount. When the revised standard becomes effective, acquired IPR&D will be recognized as an identifiable intangible asset.

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Alert financial managers need to know that the effective date for SFAS 141R is around the corner, become aware of the changes that it will bring, and to adequately prepare for its arrival. With such preparation, the challenges presented by SFAS 141R need not be insurmountable.”

» **Acquisition Date** – SFAS 141R clarifies the definition of the acquisition date for a business combination. Under the revised standard, the acquisition date is always the date when the actual change of control occurs. Currently, the relevant measurement date for some components of a business combination can be different than the change of control date (e.g. the announcement date for a transaction).

» **Negative Goodwill** – SFAS 141R also eliminates the potential for the recognition of negative goodwill related to a bargain purchase. Under the revised standard, if the fair value of net identifiable assets acquired is greater than the sum of purchase consideration and the fair values of any non-controlling interests and existing equity interests, the excess must be recorded as a gain in earnings as of the transaction date.

» **Expanded Scope** – The scope of SFAS 141R was expanded to include business combinations that occur without the transfer of consideration (e.g. transfer of control through the lapse of minority veto rights).

**CONVERGENCE**

Financial managers that regularly wrestle with international accounting should be pleased with the significant progress in convergence with international accounting standards represented by the issuance of SFAS 141R and IASB’s revised IFRS 3, Business Combinations. Certain remaining differences include the treatment of non-controlling interests and contingent consideration. More information related to the status of convergence between the two standards can be found in Appendix G to SFAS 141R.

**AT THE END OF THE DAY**

SFAS 141R will create challenges for financial managers with the increased reporting requirements and significant number of rule changes. That being said, the revised standard includes more detailed practical implementation guidance, which should ease the accounting difficulties caused by ambiguity in the current standard. Alert financial managers need to know that the effective date for SFAS 141R is around the corner, become aware of the changes that it will bring, and to adequately prepare for its arrival. With such preparation, the challenges presented by SFAS 141R need not be insurmountable.

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Alternative Investments
Portfolio Valuation Services

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For more information, visit our website at www.mercercapital.com or contact Travis Harms (harmst@mercercapital.com) or Matt Crow (crowm@mercercapital.com). Both can also be reached at 901.685.2120.
Since 2001, with the issuance of the Gross decision by the U.S. Tax Court, there has been considerable judicial confusion regarding the theoretically correct manner in which to value S corporations and interests in them. Gross has been followed by four additional S corporation cases from the Tax Court in which the same theoretical misunderstandings were perpetuated.

We have previously written about the theoretical misunderstandings initiated by Gross. Unfortunately, many business appraisers have reacted to this line of faulty Tax Court decisions regarding S corporation valuation by simply mimicking the Court’s confusion rather than addressing the underlying economics in a consistent and appropriate fashion.

The body of S corporation valuation case law continues to expand. The two most recent additions, Kessler and Bernier, are unique, as they have been handed down by the Delaware Chancery Court and Massachusetts Supreme Court, respectively, rather than the U.S. Tax Court. Most importantly, in neither of the cases were the courts seeking to determine the fair market value of the subject shares, but rather were attempting to craft equitable resolutions to shareholder conflicts. Both courts were actually determining the fair value of shares.

In Kessler, the Delaware Chancery Court determined the fair value of shares held by a group of minority shareholders being “squeezed out” of a radiology practice. In Bernier, the Massachusetts Supreme Court established the fair value of the non-managing spouse’s share in a profitable grocery store as an element of divorce proceedings.

In this article, we will examine the limitations inherent in such fair value cases with respect to assessing the fair market value of enterprises organized as S corporations. Despite these limitations, we will review the economic analysis of the subject S corporation in the Kessler decision, highlighting the encouraging manner in which the Court distinguished between the enterprise and shareholder benefits of the S election. Finally, we will propose a technique allowing judges and appraisers to extend the analysis found in Kessler in a robust manner to different fact patterns.

KEY ISSUES

There is considerable literature on the subject of S corporation valuation. References to much of this literature can be found in our earlier articles cited above. Additional background can be found in a recent book by Nancy Fannon. In spite of plentiful literature, there remains confusion among business appraisers and confusion in courts regarding the valuation of S corporations and other tax pass-through entities and of interests in them.
Before addressing the topic of S corporation valuation directly, we focus the reader’s attention on several issues:

» The central issue of S corporation valuation is recognizing that the benefits of S corporation ownership are experienced at the shareholder level and not at the level of the enterprise. Some writers miss this critical point, and many appraisers apparently miss it as well.

» At least one court, Kessler, cited previous work by Mercer on the distinction between valuation at the enterprise level and the shareholder-level benefits conveyed by S corporation ownership. We recommend that readers examine not only this case but also the materials that are referenced in it.

» While there are several so-called “models” to value S corporations (or interests in them), with many of their names attributed to appraisers (including Mercer), there is only one model to successfully value S corporation interests— the shareholder level discounted cash flow model.

» It is important to note that while we are addressing S corporations, the methodology we are describing is generally applicable to all tax pass-through entities.

» We should also be clear that we are not attempting to address so-called “mom-and-pop” businesses or small professional practices that might be organized as S corporations. We are addressing the issues of larger, more developed companies, whose values ($2 to $3 million at the least) are beyond the purchasing ability of most individuals.

**FAIR VALUE VS. FAIR MARKET VALUE**

Fair market value is defined in the *ASA Business Valuation Standards* of the American Society of Appraisers as:

The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm’s length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. Fair market value is, as noted above, an arm’s length standard. Appraisers applying this standard of value are simulating the negotiations of hypothetical willing, able, and knowledgeable parties who negotiate in their own self-interests. All appraisals prepared for gift and estate taxes are rendered under the fair market value standard.

Fair value is not a defined term in the *ASA Business Valuation Standards* because it is variously defined in state statutes and in the judicial interpretations of the respective state. Fair market value may, but not necessarily will, equal fair value, depending upon judicial interpretations. It is therefore necessary for business appraisers to understand the valuation implications of judicial interpretations of fair value.

We mentioned the line of S corporation cases in the Tax Court above. Kessler and Bernier each cite this line of reasoning from fair market value cases in their fair value determinations. The confusion between differing standards of value in these cases has the potential to breed further confusion for appraisers attempting to render fair market value opinions.

It has been said that to quote wisely, one must read wisely and read well. This insight has broad application to many areas of valuation, not least in the interpretation and application of prior court decisions. Part of reading wisely and well is to understand an author’s motivation and intent. A brief review of the pertinent facts of the Bernier and Kessler cases reveals pronounced differences between the fair value standard under which the subject cases were decided and fair market value.

At this point, we should note one important caveat. We read cases, hopefully wisely and well, from our perspectives as businessmen and valuation experts. Any comments we provide should be considered in that light. We are not lawyers and offer no legal opinions. Nevertheless, it is necessary and appropriate for business appraisers to read cases and to make judgments regarding their implications for valuation.

**BERNIER**

In Bernier, a Massachusetts divorce matter, the subject shareholder interests were 50% ownership interests in two S corporations that...
Business Valuation: An Integrated Theory, Second Edition
by Z. Christopher Mercer, ASA, CFA
and Travis W. Harms, CFA, CPA/ABV

Whether you are an accountant, auditor, financial planner, or attorney, Business Valuation: An Integrated Theory, Second Edition enables you to understand and correctly apply fundamental valuation concepts. Thoroughly revised and expanded, the Second Edition demystifies modern valuation theory, bringing together various valuation concepts to reveal a comprehensive picture of business valuation.

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by Z. Christopher Mercer, ASA, CFA

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HIGHLIGHT SECTIONS/CHAPTERS INCLUDE:
» Categories & Types of Buy-Sell Agreements
» Process & Single Appraiser Buy-Sell Agreements
» Process Timetables - Why it takes more time than you think
» The Six Defining Elements of Buy-Sell Agreements - Agreements must have all six but most do not!
» War Stories from our experience
» The Buy-Sell Audit Checklist - This alone is worth the price of the book
» In addition, the ASA BV Standards and USPAP Standards 3, 9 & 10 are reprinted in full for your convenience

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operate grocery stores on Martha’s Vineyard. The grocery stores were managed by the husband. In the years leading up to the valuation date, the company had regularly distributed a portion of taxable corporate earnings to the shareholders. The decision does not provide an estimate of the magnitude of distributions, but seems to infer that they were substantial.

At trial, the judge heard valuation evidence regarding the fair value of the subject interests from experts on behalf of both parties. The valuation experts treated the potential benefit of the S election quite differently. The expert retained by the husband (the purchasing party in the divorce) valued the enterprises as if they were C corporations, deducting taxes on corporate income from the pro forma enterprise cash flows. The expert retained by the wife, in contrast, made no adjustment to the pro forma enterprise cash flows for taxes on corporate income. Purporting to rely on the infamous Gross decision, the trial judge essentially adopted the valuation of the husband’s expert, effectively treating the company for valuation purposes as if it were a C corporation.

On appeal, the Supreme Judicial Court of Massachusetts criticized the valuation conclusions of the trial judge, remanding the case for rehearing in light of the valuation methodology adopted by the Delaware Chancery Court in Kessler. We now focus on the economic analysis presented in the Kessler decision.

**KESSLER**

In Kessler, the question before the Delaware Chancery Court was whether the minority shareholders of a growing operator of MRI imaging centers received fair value in a squeeze-out merger. The case addressed three distinct valuation issues: (1) consideration of expansion plans in the determination of fair value, (2) normalization of related-party fees and expenses, and (3) appropriate treatment of S corporation tax benefits. We limit our focus to the third issue related to S corporation benefits.

As with the valuation evidence presented at trial in Bernier, the valuation expert for the majority shareholders (the purchasing party) treated the company as if it were a C corporation. In other words, in determining the net cash flows of the company, he deducted pro forma corporate taxes equal to 40% of pre-tax corporate earnings. Taking the opposite approach, the valuation expert for the minority shareholders (those being squeezed out) did not apply any pro forma corporate income taxes to derive the net cash flows of the company.

Criticizing the analysis of both experts, Vice Chancellor Strine prepared his own valuation analysis, applying a pro forma tax rate to the pre-tax earnings of the company that is adjusted to account for the shareholder tax benefits of the S corporation election. We will describe the derivation and implications of this adjustment in a separate section of this article.

**THE OBJECTIVE OF FAIR VALUE**

The Delaware Code Annotated states that the Chancery Court:

> shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.

Delaware courts have interpreted this statute for many years in a long series of cases. In Bernier, the relevant definition of value is not so explicitly defined. However, the court’s preliminary comments are clear:

> ...As a preliminary matter, where valuation of assets occurs in the context of divorce, and where one of the parties will maintain, and the other will be entirely divested of, ownership of a marital asset after divorce, the judge must take particular care to treat the parties not as arm’s length hypothetical buyers and sellers in a theoretical open market but as fiduciaries entitled to equitable distribution of their marital assets.

The court’s preliminary comments and endorsement of the economic analysis in Kessler suggest that that the objective was to provide a similarly equitable resolution to the shareholder controversy, or fair value. The court makes a clear distinction between fair market value – “price hypothetical willing buyer would pay hypothetical willing seller, both having reasonable knowledge of all relevant facts and neither being under compulsion to buy or sell” – and fair value.
Significantly, in both Kessler and Bernier, the courts focused on the benefits lost by selling shareholders rather than the fair market value of the subject enterprises. This is a subtle but critical difference that must be recognized when analyzing the valuation approach adopted by both courts.

In Kessler for example, the minority shareholders were squeezed out of a profitable, cash-flowing S corporation. The putative intent of the fair value statute is to ensure that the economic interests of such shareholders are not impaired as a result of being squeezed out. Careful analysis demonstrates that the present value of the shareholder benefits of an S corporation is not identical to the fair market value of the enterprise. As a result, the Court’s analysis is not directly relevant to determining the fair market value of S corporations at the enterprise level. In short, the Court is answering a different question.

Vice Chancellor Strine summarized this distinction in his opinion:

In other words, I am not trying to quantify the value at which Delaware Radiology would sell to a C corporation; I am trying to quantify the value of Delaware Radiology as a going concern with an S corporation structure and award the Kessler Group their pro rata share of that value.

In contrast to the fair market value emphasis on a transaction between hypothetical willing parties, the Delaware Chancery Court’s task was to make the minority shareholders whole, recognizing that the shareholders enjoyed material cash flow benefits owing to the company’s status as a qualifying S corporation. As the decision clarifies further:

Under Delaware law, an appraisal petitioner is “entitled to be paid for that which has been taken from him...” In this case, the Kessler Group was involuntarily deprived of the benefits of continuing as stockholders in a profitable S corporation – benefits that were comprised materially of the favorable tax treatment that accompanies S corporation status. As a matter of fairness, the merger price had to take into account these benefits and provide fair compensation for the Kessler Group’s loss.

The courts in Kessler and Bernier could not be clearer – they are determining fair value, which includes equitable considerations, and not fair market value, which is an objective, arm’s-length standard. It would therefore be incorrect and unreasonable to cite or to rely on either case for judicial guidance for fair market value determinations.

ENTERPRISE VS. SHAREHOLDER BENEFITS

In estimating the fair value to be awarded the minority shareholder, Vice Chancellor Strine’s economic analysis is noteworthy for unambiguously distinguishing the shareholder and enterprise level tax benefits of the S election. Addressing the approach taken by the valuation expert for the minority shareholders, the opinion notes that “[t]he value of the S corporation structure is one that is experienced at the stockholder level and that is easy to overstate.”

The failure to properly situate the S corporation tax benefit with the shareholder rather than the subject enterprise has been the source of much of the confusion regarding the appropriate valuation treatment of S corporations. Recognition of this distinction by the court in Kessler marks a significant step forward, and should, given the prominence attributed to the Delaware Chancery Court, signal the beginning of the end of the current valuation impasse regarding S corporation valuation in the courts.

The relevant mechanics of S corporations and other tax pass-through entities are familiar. The S corporation election replaces the corporate income tax with a personal shareholder tax on S corporation income “passed through” to the individual shareholders. Of critical importance, the S corporation income is “passed through” to the individual shareholders for tax purposes irrespective of whether the S corporation makes any cash distributions. The elimination of the corporate income tax leads some observers to the erroneous conclusion that the benefit of the election accrues to the enterprise. However, the S corporation’s income continues to be fully taxable. While the legal obligation to pay “corporate” income taxes shifts to S corporation shareholders, the economic obligation remains with the corporation.

The distinction between shareholder and enterprise S corporation tax benefits can be illustrated with a simple example. In the following table, we consider otherwise identical C and S corporations under three different distribution scenarios.
We make the following observations with respect to Table One:

» Taxes are paid on the pre-tax corporate income of both the C and S corporation in each scenario, regardless of distribution policy. However, while corporate earnings are fully taxed in each scenario, economic distributions to S corporation shareholders are not. We use the term “economic distributions” to refer to all shareholder distributions beyond the level needed to fund the personal taxes due on corporate earnings.

» Economic distributions to C corporation shareholders are taxed at the current (federal) dividend income rate of 15%, while the same distributions to S corporation shareholders are not. For simplicity, we will not treat state taxation of dividends in this article and will assume that personal marginal income tax rate and corporate income tax rates are identical.

» The fact that taxes are paid on pre-tax corporate income suggests that, for any given level of economic distribution, the retained earnings available to the S and C corporations for reinvestment are identical. Therefore, the S corporation election does not confer any benefit on the enterprise.11

» The absence of taxes on economic distributions to S corporation shareholders gives rise to a potential S corporation tax benefit at the shareholder level. The magnitude of the cash flow benefit increases with the portion of available earnings distributed to shareholders. In the case of no economic distributions, there is no cash flow benefit related to the S corporation election. The valuation impact of the cash flow tax benefit is contingent upon the accompanying shareholder risks, an S corporation’s distribution policy, the expected duration of the shareholder tax benefits, and the prevailing dividend tax rate.

» In addition, retained earnings in an S corporation add pro rata to the tax bases of its shareholders. Unlike a C corporation, where a shareholder’s tax basis is fixed at its historical cost, the S corporation shareholder can experience an increase in basis which will offset capital gains taxes at the time of a future sale. The magnitude of this basis increase is a function

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<td>Economic Distribution to Shareholders (After-tax)</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$25.50</td>
</tr>
<tr>
<td>Shareholder Level Benefit of S Corporation Election</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$4.50</td>
</tr>
<tr>
<td>Retained Corporate Earnings</td>
<td>$60.00</td>
<td>$60.00</td>
<td>$30.00</td>
</tr>
<tr>
<td>Enterprise Level Benefit of S Corporation Election</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.00</td>
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</table>

TABLE ONE: Comparison of Enterprise Cash Flows (S versus C Corporation)
of the distribution policy. If all economic earnings (after shareholder-level taxes) are distributed, there will be no basis build-up, and shareholders will experience the maximum available cash flow tax benefit. Alternatively, if there are no economic distributions beyond the pass-through shareholder-level taxes, basis build-up will be maximized, and the shareholders will receive no cash flow tax benefit.

Distribution policies between 0% of economic earnings and 100% of economic earnings provide for varying degrees of cash flow tax benefit and basis buildup benefit.

As noted above, the magnitude of the shareholder level cash flow benefit is also directly related to the prevailing dividend income tax rate avoided by the S corporation election. The shareholder level tax benefit is greater under a tax regime in which dividends are taxed at the higher ordinary income tax rates, as was the case prior to 2003.17

To summarize these observations, recall that value is a function of expected cash flow, risk, and growth. The relevant cash flow expectations, risk profile, and growth prospects correlate to the familiar levels of value chart. As Vice Chancellor Strine noted, the benefits of the S corporation election are experienced at the shareholder level. In other words, the relevant cash flow expectations, risk profile, and growth prospects at the enterprise levels of value are unaffected by the S election – so the value of the enterprise is unaffected by the S election, as illustrated in Table Two.

S corporation models that ascribe all or a portion of the shareholder benefits of the S corporation election to the enterprise are flawed at a conceptual level. The benefit, or, as we will see below, the potential detriment in value of an S corporation interest relative to an otherwise identical C corporation interest, is properly assessed at the shareholder level. That benefit (or detriment) is properly determined, as shown at the bottom right of Table Two, at the shareholder level. In other words, the nonmarketable minority value of an S corporation (relative to an otherwise identical C corporation), would be adjusted upwards (or downwards) based on the expected distribution policy that gives rise to the shareholder-level tax benefit, the risks associated with receiving those benefits, and the duration of the expected holding period for the investment.
Vice Chancellor Strine rejected the S corporation valuation techniques of both experts in Kessler. Homing in on the distinction between enterprise and shareholder tax benefits of the S corporation election, the Vice Chancellor prepared an analysis to objectively quantify “the primary tax benefit associated with an S Corporation, which is the avoidance of a dividend tax in addition to a tax on corporate earnings.”

The Court’s analysis is straightforward. Assuming full distribution of earnings, what pro forma corporate tax rate applicable to S corporation earnings, followed by application of the personal income tax on dividends yields the after-tax distribution available to the S corporation shareholder? Table Three, reproduced from the Kessler opinion, illustrates the question and answer.

At the left-most column, we see a fully-taxable C corporation that distributes 100% of its after-tax earnings. The assumed corporate tax rate is 40%. The $60 available for distribution yields $51 of shareholder cash flow after payment of taxes on the dividends at the current rate of 15%. The middle column provides a similar analysis for an otherwise identical S corporation, indicating that after-tax distributions are $60. The S corporation “multiplier” is 1.176x (i.e., $60/$51).

The court then asked, in effect: what corporate tax rate should be applied to an S corporation to provide an identical $60 benefit to the S corporation example in the middle? As the right-most column in Table Three indicates, a pro forma corporate tax rate of 29.4% yields pro forma corporate earnings available for distribution of $70.6. Assuming distribution of this amount, taxed at the dividend income tax rate of 15.0%, provides the S corporation shareholder with $60 of after-tax distributions, or precisely the same amount of benefit available to a fully-distributing S corporation shareholder (as indicated in the middle column of Table Three).

### TABLE THREE: Corporate Tax Rate Analysis from Kessler Opinion

<table>
<thead>
<tr>
<th>C CORP</th>
<th>S CORP</th>
<th>S CORP VALUATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Before Tax</td>
<td>$100</td>
<td>$100</td>
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<tr>
<td>Corporate Tax Rate</td>
<td>40.0%</td>
<td>0.0%</td>
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<tr>
<td>Available Earnings</td>
<td>$60</td>
<td>$100</td>
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<tr>
<td>Dividend or Personal Income Tax Rate</td>
<td>15.0%</td>
<td>40.0%</td>
</tr>
<tr>
<td>Available After Dividends</td>
<td>$51</td>
<td>$80</td>
</tr>
</tbody>
</table>

### S CORPORATION VALUATION TECHNIQUE IN KESSLER

Vice Chancellor Strine rejected the S corporation valuation techniques of both experts in Kessler. Homing in on the distinction between enterprise and shareholder tax benefits of the S corporation election, the Vice Chancellor prepared an analysis to objectively quantify “the primary tax benefit associated with an S Corporation, which is the avoidance of a dividend tax in addition to a tax on corporate earnings.”

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### TABLE FOUR: Kessler and the Levels of Value

**APPLICATION OF LEVELS OF VALUE TO KESSLER ANALYSIS (DELAWARE FAIR VALUE)**

**DELWARE RADIOLOGY**

- **Strategic Control Value**
- **Financial Control Value**
- **Marketable Minority Value**
- **Nonmarketable Minority Value**

Implied S corporation valuation “premium” is present value of capitalized shareholder tax benefits into perpetuity.

Factors traditionally giving rise to marketability discounts (incremental shareholder risks and agency costs) not relevant for determination of fair value under Delaware case law.
Assuming the same valuation multiple (10x) applies to both the C and S corporations, the Court’s analysis suggests that the fair value of the subject interest in an S corporation is $706, or approximately 17.6% higher than the corresponding interest in an otherwise identical C corporation. This premium is the present value of all expected future shareholder tax benefits from the S corporation election, discounted to the present at the enterprise discount rate.16

One cannot, however, translate this result to the fair market value of the respective enterprises – determining fair market value was not the Court’s task. Rather, the Court sought to compensate the minority shareholders for the specific economic benefits, as shareholders, that were taken from them.

The opinion describes this mandate thusly: “...when minority shareholders have been forcibly denied the future benefits of S corporation status, they should receive compensation for those expected benefits and not an artificially discounted value that disregards the favorable tax treatment available to them.”

The court’s analysis effectively capitalizes the shareholder cash flow tax benefit into perpetuity. In other words, the court made no decision about the likely holding period over which existing shareholders would enjoy S corporation benefits. And clearly, the court did not impose a marketability discount in Kessler, which would have been contrary to our understanding of prior Delaware fair value case law. Table Four adapts Table Two to the facts and circumstances of the Kessler case.

Table Four highlights the error of applying the economic analysis in Kessler directly to the determination of the fair market value of shareholder interests in S corporations. The adjustment of the pro forma corporate income tax rate to give effect to the shareholder tax benefits of the S corporation election was feasible in Kessler only because a marketability discount was not applicable. The better interpretation of the court’s analysis in Kessler is that the shareholder tax benefit was added to the shareholder (nonmarketable minority) level of value, which by judicial precedent was equal to the enterprise level of value.

There is no conceptual basis for “grossing up” the enterprise value for shareholder tax benefits, and then taking a marketability discount from that ill-defined base. This point is critical – there are no enterprise cash flow benefits from the S corporation election, so there is no effect on the value of the enterprise. There are, however, discrete and readily definable cash flow benefits (and risks) for the S corporation election for shareholders. Therefore, the appropriate means of incorporating the shareholder benefits and risks is to adjust the otherwise applicable marketability discount to derive the nonmarketable minority level of value. The most concise, straightforward and conceptually appealing method for valuing shareholder interests is a shareholder level discounted cash flow model.

Appraisers who add the shareholder level benefit of the S corporation to enterprise value are left with the problem of then determining the appropriate marketability discount in fair market value determinations of illiquid minority interests in S corporations. If discounted cash flow (or capitalization) methods are used to value the S corporation incremental benefit (relative to an otherwise identical C corporation), use of those same methods to derive the value of all of the shareholder benefits flowing to the minority shareholder of an S (or C) corporation is compelling.

It is for this reason that we have not developed an “S corporation valuation model.” On this point, we noted in Business Valuation (Second Edition):17

We are occasionally credited with developing a model to value the S corporation benefit. While we appreciate the credit, we have not done so. Rather, we advocate valuing nonmarketable minority interests in S corporations using the very same shareholder level discounted cash flow model we apply to such interests in C corporations. We find that the relevant shareholder tax benefits of the S corporation election can be reliably incorporated into the value of the subject interest using the Quantitative Marketability Discount Model.

Consulting the conceptual framework of the Integrated Theory (Exhibit 10.4), we observe that any difference in value between a subject minority interest in an S corporation and a similar interest in an otherwise comparable C corporation must be attributable to a difference in interim shareholder benefits (\(\text{CF}_{\text{sh}}\)), risks over the expected holding period (manifest in \(\text{Rh}_{\text{hp}}\)), or growth in value over the expected holding period (\(\text{G}_{\text{v}}\)).

The Court’s economic analysis and commentary in Kessler suggest that a shareholder level discounted cash flow model is needed to promote
equitable resolution of fair value cases involving S corporations. Such a model would incorporate the specific tax benefits reasonably anticipated by S corporation shareholders from owning an investment. Kessler meets this requirement for the facts and circumstances of that particular case. However, the Court’s approach would not necessarily be portable to cases with different fact patterns.

To apply to a broader range of fact patterns, a more supple model is needed. As its name implies, the Quantitative Marketability Discount Model (QMDM) is principally used to determine marketability discounts when developing the fair market value of minority interests in closely held companies. However, the QMDM is neither more nor less than a shareholder level discounted cash flow model. As such, it can also be used to determine the fair value of S corporation interests even if no marketability discount is applicable.

CONCLUSION

The economic analysis set forth by the Delaware Chancery Court in Kessler (and endorsed by the Massachusetts Supreme Judicial Court in Bernier) represents a significant step toward resolution of the S corporation valuation struggles that have bedeviled appraisers and courts far too long. In Kessler, Vice Chancellor Strine clearly and unequivocally identified the potential tax benefits of the S election as inuring to the shareholders.

Unfortunately, although achieving the intended result, the valuation technique advanced by the Court in Kessler (application of an adjusted pro forma tax rate to the pre-tax cash flows of the enterprise) obscures the important distinction between the value of an enterprise and the value of a particular shareholder interest in the enterprise. It is now the task of business appraisers to present credible valuation evidence to courts that builds upon the judicial insights of Kessler within an intellectually and theoretically coherent framework.

Using a shareholder-level discounted cash flow model (the QMDM in particular) to account for all the potential shareholder benefits of the S corporation election allows appraisers and courts to extend the analytical insights of the Kessler decision to a much broader range of relevant fact patterns. Use of this model, which provides a clear delineation of the degree to which the specific shareholder benefits of the S election contribute to the value of the subject shareholder interest, represents a significant improvement over the current practice of many appraisers.
Finally, business appraisers looking to either Kessler or Bernier for guidance must understand the relevant differences between fair value and fair market value. Appraisers must exercise due professional caution when attempting to translate the implication of decisions of courts seeking equitable resolution of shareholder disputes to assignments involving fair market value determinations. As with other disputed areas of valuation, a dogged focus on the relevant expected cash flows, growth and risk attributes of the subject enterprise and shareholder interest will allow our profession to exit the confusing maze of competing techniques and models.

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- Various Industry Associations
In the current environment, investors have often viewed banks as less volatile than non-financial companies due to several factors, including a high level of regulatory oversight, less variance in earnings from period to period, and favorable dividends. However, investors' traditional perception of the volatility of financial institutions may no longer be true in the current environment. The banking industry has been a casualty of the turmoil in the broader debt markets brought on by the unwinding of the housing bubble, which accelerated in mid-May 2007. Bank stocks, as reflected in the total return for the SNL Bank Index, were down 7.09% year-to-date through September 30, 2007 compared to an increase of 9.13% for the S&P 500.

The most significant factor weighing on bank stocks' performance in recent months has been credit quality. According to a recent review by the American Banker of third quarter financial statements for 16 of the nation’s largest banks, “rising loan delinquencies and their attendant costs constitute the most immediate threat to earnings.” Smaller, privately held banks have not been immune to this difficult operating environment either, as concerns have also developed regarding other lending areas that many smaller banks are dependent upon, such as construction and development lending. Due to increasing levels of impaired loans and concerns regarding other loans that may become but are not yet impaired, many banks have experienced earnings pressure in recent quarters and anticipate the difficult operating environment to continue in the near-term. The Federal Deposit Insurance Corporation’s Quarterly Banking Profile for the Second Quarter of 2007 provides a review of public and private banks and noted increased loan loss provisions (particularly at larger institutions), increased charge-offs, a faster pace of reserve growth, and a modest increase in the number of banks deemed “problem” institutions.

Given the earnings challenges facing numerous banks and the declining valuations of publicly traded banks during 2007, it is important to know how to analyze a bank's earnings quality as a precursor to understanding its earning power. In this article, we examine the philosophy of earnings quality analysis and overarching earnings quality issues and focus on an analysis of the adequacy of the loan loss reserve, which is one critical earnings quality issue facing banks in the current environment. We also provide general recommendations of how to construct a reasonable estimate of earning power after assessing earnings quality.

PHILOSOPHY OF EARNINGS QUALITY ANALYSIS FOR BANKS

By nature, valuation is forward looking. Value is a function of future cash flows, not historical cash flows. However, historical cash flows can help predict (or confirm other estimates of) future cash flows, as any prediction of the future depends on the quality of the inputs. Analyzing the quality of historical earnings, and making appropriate adjustments thereto, can aid in making better predictions of future earnings.

Adjusting earnings is a relative concept, and the analyst should view potential adjustments in relation to the subject bank’s history, the market for publicly traded banks, and the banking industry in general. Adjustments appropriate for one bank may not be applicable to another. However, it is always important to keep in mind that items deemed unusual, non-recurring, and/or discretionary do create or destroy shareholder value. Non-recurring items flow through the equity...
account just like recurring revenue and expense. The gain or loss to shareholders from the non-recurring items can be measured as the amount that the bank can use (if there is a gain) or could have used (if there is a loss) to pay dividends, repurchase stock, make an acquisition, or grow the balance sheet.

Additionally, it is important to remember the interaction between earnings quality analysis and risk assessment when valuing banks. Short term earnings can be enhanced by taking more risk (of the credit or interest rate variety), and the impact of accepting an inappropriate level of risk is usually not immediately evident in a bank. However, earning power can be viewed as a long-term concept and not necessarily a prediction of next quarter’s earnings.

Bank financial analysis is different from other industries in that the balance sheet drives the income statement. Thus, the key to a solid analysis of the earnings quality of a bank begins with a thorough review of the subject bank’s balance sheet. While a detailed discussion of all the elements of importance in the balance sheet is beyond the scope of this article, we focus on one issue of current importance, the loan loss reserve.

**FOCUS ON ADEQUACY OF THE LOAN LOSS RESERVE**

With credit concerns currently looming as the most pressing earnings issue for numerous banks, a determination of the adequacy of the loan loss reserve, which can serve to either mitigate or heighten these credit concerns, is vitally important. When analyzing asset quality, it is important to focus on two components of the financial statements: the loan loss provision - an income statement component, and the loan loss reserve - a balance sheet component. Analysts should ask the following questions regarding these accounts:

» Does the current period loan loss provision reflect a normalized provision?

» Is the loan loss reserve adequately funded?

**Loan Loss Provision.** When examining the loan loss provision, the analyst should attempt to determine whether the current period’s loan loss provision reflects a normalized provision. For instance, the analyst should look at trends in the ratio of the loan loss provision to loan charge-offs. Other than for short periods, loan charge-offs cannot exceed the loan loss provision, and charge-offs in excess of the provision are generally a sign of lower quality earnings. The loan loss provision can also be analyzed by examining trends in the composition of the bank’s loan portfolio and the risk of the portfolio. For example, an increase in consumer loans, which tend to generate higher losses, may require a higher loan loss provision going forward.

**Loan Loss Reserve.** The loan loss reserve represents an amount necessary to cover the losses inherent in the loan portfolio. Under the current accounting methodology, the loan loss reserve contains the following components:

» Specific reserves against identified impaired loans (per SFAS 114); and,

» Reserves for non-impaired loans (per SFAS 5) based on the bank’s prior charge-off history, adjusted for “environmental” factors that could cause future losses to diverge from recent history, such as changes in portfolio delinquencies, local economic conditions, loan concentrations, etc.

Several factors can be used to analyze the bank’s loan loss reserve:

» **Loan Loss Reserve / Loan Ratio.** A declining ratio suggests that the bank’s loan loss provision is either not keeping up with loan growth or that current period loan charge-offs are more than the loan loss provision. Future income could be affected as provisions are recorded to increase the loan loss reserve / loan ratio.

» **Loan Loss Reserve / Non-Performing Loans Ratio.** Non-performing loans are usually defined as the sum of loans for which interest accrual has ceased and loans that are 90 days or more past due that are still accruing interest. An increasing level of non-performing assets suggests that credit risk in the portfolio may be increasing, while a lower ratio of reserves to non-performing loans may indicate that future increases in loan loss reserves (and provision) could occur.

» **Composition of the Loan Portfolio.** It is important to analyze the diversity of the bank’s loan portfolio, both in terms of type of borrower and type of loan product. Potentially, a more concentrated loan portfolio in terms of both borrower and/or loan type could be indicative of higher risk. It is important to remember though that each bank is unique,
and this diversification should be considered in light of other factors as well. For example, community banks often have less diversification in terms of types of loans and borrowers and are generally tied to the economic health of the local market served by the bank. This factor may be mitigated to some extent by a strong management team’s understanding of the their local market and the unique risk present better than their larger, more diversified counterparts who may have extended into unfamiliar product lines and/or markets.

» Other Factors. These factors include, for example, the analyst’s impression of management, the bank’s primary market area, types and quality of collateral, and the type of loans emphasized by the bank.

### HOW DOES THE EARNINGS QUALITY ANALYSIS AFFECT YOUR VALUATION ANALYSIS?

After the analyst’s assessment of the overall quality of the bank’s earnings, the analyst must then consider how this assessment affects the valuation analysis. We briefly describe three ways to handle this assessment in the valuation analysis either individually or in some combination with each other.

1. **Adjust the historical financial data.** Once the analyst has assessed the bank’s earnings quality, the analyst may identify adjustments to apply to the bank’s historical earnings. By

<table>
<thead>
<tr>
<th>Common Adjustments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income Statement</strong></td>
</tr>
<tr>
<td>» Eliminate non-recurring gains and losses</td>
</tr>
<tr>
<td>» Recognize a normalized loan loss provision</td>
</tr>
<tr>
<td>» Life insurance proceeds</td>
</tr>
<tr>
<td><strong>Balance Sheet</strong></td>
</tr>
<tr>
<td>» Adjust for unrealistic valuation of assets</td>
</tr>
<tr>
<td>» Investment in other companies carried at cost or equity</td>
</tr>
<tr>
<td>» Recognize estimated cost of settling contingent liabilities</td>
</tr>
<tr>
<td>» Normalize loan loss reserve</td>
</tr>
<tr>
<td>» Adjust intangible assets</td>
</tr>
</tbody>
</table>

**TABLE ONE:** Common Adjustments
adjusting historical earnings, the analyst seeks to derive a better depiction of the bank’s underlying earning capacity from which future growth may occur. Table One details several common adjustments, which may be deemed appropriate.

2. **Estimate earning power via a normalized return on assets ("ROA") or return on equity ("ROE"),** which are common measures of profitability in the banking industry. In some cases, a bank’s earnings may have so much “noise” that determining specific adjustments is difficult. In this instance, it may be beneficial to use historical returns to estimate earning power. For example, the analyst might take an average of the bank’s ROA and ROE measures for a five year period prior to the current year and apply this normalized ROA and ROE measure to the bank’s assets or equity in the current period. An important assumption in this approach is that the bank’s historical returns are reasonably indicative of its future returns.

3. **Carve out part of the business and value separately.** This type of analysis may be helpful when a significant component of the bank has a different risk/return profile than other parts of the bank. For example, consider a bank with a substantial mortgage subsidiary. Mortgage companies tend to have more volatile earnings than commercial banks, and publicly traded mortgage banks are often valued differently in the market than commercial banks. Rather than attempting to “smooth out” the volatility of a bank’s mortgage company, the mortgage company could be valued separately and added to the value of the other parts of the bank.

Once earning power has been specified using one of the preceding approaches, the analyst can proceed with valuation analyses commonly used in appraisals of financial institutions, such as a guideline public company analysis, guideline change of control transaction analysis, or discounted cash flow analysis.

For more information or to discuss a valuation matter in confidence, call us at 901.685.2120.

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Having been retained for a number of significant litigation engagements over the years, Mercer Capital has had the opportunity to observe a variety of theories on the best time for attorneys to retain experts for their lawsuits.

In many lawsuits, the testimony of your business valuation, economic damages, or investment banking expert will be among the more important elements of your case, making it vital that the expert be involved early in the process. However, some attorneys tend to wait until the last minute to hire their experts, ostensibly under the theory that hiring experts late in the game minimizes the overall expense of the case. After all, the thinking goes, if the experts are not hired until it is certain that their expert reports will be needed, then the looming deadline provides an automatic limit to the number of hours that can be billed.

This approach is flawed for a number of reasons. In our experience, it is far better to involve the experts early. The sooner your business valuation, economic damages, or investment banking expert is involved, the sooner the expert will be able to provide you with an economic perspective on the facts of your case or your theory of damages. The longer you wait, the later your expert will be able to provide economic insight, good or bad, and the less time you will have to address any issues raised by your expert.

As an example of the above, Mercer Capital was contacted by an attorney concerning a significant breach of contract case involving a warehouse and distribution business whose business had been damaged when a key supplier canceled a supply contract. The lawsuit was very well developed by the time we were contacted, and detailed pleadings existed concerning the mechanism by which the plaintiff’s business was damaged and the results of the defendant’s actions. The result of the case as presented to us was that, aside from some distraction and aggravation on the part of the plaintiff, a big piece of the case was essentially a wash, with very little economic damages. It would have been beneficial to the plaintiff’s lawyer to have known much earlier in the process that the damaged part of the operation was essentially breaking even (at best) prior to the breach of contract, and that there were few fixed costs that continued after the breach. The bottom line is that our estimate of damages was far lower than anticipated by either the plaintiff or his attorney.

In addition to the advantages associated with gaining perspective described above, hiring your expert early provides the following advantages:

1. Your expert can help you understand financial and economic concepts that are relevant to the dispute at hand. There are words and concepts that have particular meanings in a
In our experience, it is far better to involve the experts early. The sooner your business valuation, economic damages, or investment banking expert is involved, the sooner the expert will be able to provide you with an economic perspective on the facts of your case or your theory of damages.

legal context that are unfamiliar or even surprising to non-attorneys. Similarly, there are certain elements of finance, accounting, and economics that might surprise those who do not work in these areas.

2. Your expert can help you figure out the discovery and documentation requirements associated with your case. This can help you give your client a better understanding of the overall cost of the lawsuit in terms of time, legal fees, and possible accounting, forensic accounting, or other services that might be required.

3. Your expert can consult with you about economic and financial matters, helping you create a theory of damages that is relevant and calculable. In economic damages cases in particular, it is important that the facts and the law align in such a way that an economic damages expert can provide an opinion that is consistent with the remedies the law allows.

4. Time allows organization and familiarity with the underlying facts and documents of the case. The more organized your experts, the better able they will be to get command of all the information in the case relevant to their opinions, and the less likely they will be to be surprised by key documents that may appear to undermine their opinions.

5. Hiring experts early provides additional time to prepare for deposition and trial, which will allow for more effective testimony. Your experts can help you create more effective direct examinations and cross examinations of opposing experts if they have the time to do so.

6. Experts may be able to supply deposition questions for opposing experts and fact witnesses. In some cases, Mercer Capital has provided literally hundreds of questions for opposing expert and fact witnesses that greatly clarified the underlying economic and financial facts of the case. Better depositions of experts enhance the potential for settlement, and better depositions of your experts compared to the other side’s experts enhance your negotiating position. It has been our experience that many cases settle shortly after expert depositions, and we have seen at least a few where another expert completely torpedoed a case.

7. As the case progresses, your expert can vet the work of experts on the other side.

8. Hiring an expert early allows your reports to be prepared at lower effective billing rates. Reports prepared in the normal course of business benefit from data entry and basic analytical functions being performed by professionals with lower billing rates than your expert. If a report is prepared at the list minute, it must typically be prepared almost exclusively by (rather than under the supervision of) higher-rate personnel.

9. The sooner “the team” on the litigation is complete, the better they will work together. This is not to imply that your expert is anything but independent, but rather to point out that the familiarity that comes from working together over the course of an engagement will enhance the communication and rapport between attorney and expert.

10. If you hire your experts early, you generally get a better product. Being hired early allows your expert time to prepare a report, reflect on that report, and then issue a final report. It minimizes the potential for mistakes and last minute changes to the final report, and it also allows your expert to issue a more complete, more cohesive, and better written expert report.

As you can see, hiring your experts early in the process allows the experts to do a better job forming and documenting their opinions, and informing you and the court. While it may seem to be a greater financial commitment from your client, waiting until the last minute could prove to be much more costly. Simply put, the early dollars spent on your valuation, economic, or investment banking expert may be the best dollars. Good things come to those who don’t wait.
Mercer Capital is proud to announce that Laura J. Hoffmeister and B. Patrick Lynch have been promoted to the position of Senior Financial Analyst.

“Laura and Patrick have demonstrated technical proficiency, determination, and the ability to form strong relationships with clients, with exceptional results,” said Mercer Capital senior vice president Timothy R. Lee, ASA. “We thank them for their efforts and challenge them to higher achievements and responsibilities in the future.”

Mercer Capital’s professionals are actively engaged in thought leadership through various speaking engagements and published articles.

Z. Christopher Mercer, ASA, CFA, wrote an article titled “Wealth Management for Private Businesses - The One Percent Solution” that appeared in the February 2008 issue of Southeast Wealth Management magazine. Chris also recently spoke on the topic of buy-sell agreements at the ING International Forum in Miami, Florida.

Andrew K. Gibbs, CFA, CPA/ABV was quoted in the article titled “Eroding Goodwill Sparked a Slew of Charges for 4Q,” which appeared in the February 8, 2008 issue of American Banker.

Jay D. Wilson, Jr. recently participated in a panel discussion titled “How Much is an M&A Intermediary Really Worth?,” at the Alliance of Merger & Acquisition Advisors Winter Conference in Las Vegas, Nevada. Wilson’s presentation was based on his article, “Empirical Evidence Regarding the Importance of a Transaction Advisor,” which can be accessed at www.mercercapital.com.

Travis W. Harms, CFA, CPA/ABV and B. Patrick Lynch were recently quoted in an article published on CFO.com, titled “How Fair Value Could Affect Your Next Deal,” by Sarah Johnson. In the article, Harms and Lynch discuss the effect that the new fair-value accounting standard, FAS 157, may have on a financial executive’s approach to purchase price allocation reports, which determine the value of an acquired company’s intangible assets.

Travis Harms was also quoted in an article published on April 8, 2008 on ComplianceWeek.com, titled “When Bear Stearns Rammed Into Fair Value,” by Tammy Whitehouse.

Timothy R. Lee, ASA was quoted in an article titled “How to Value a Restaurant for Resale,” which appeared in the March 2008 issue of QSR Magazine.

Mercer Capital is proud to announce that vice presidents Andrew K. Gibbs, CFA, CPA/ABV and Travis W. Harms, CFA, CPA/ABV have been promoted to the position of Senior Vice President.

Andy joined Mercer Capital in 1999 and currently leads Mercer Capital’s Financial Institutions Group. Andy has extensive experience working with financial institutions in merger and acquisition advisory engagements. Andy has also taken a lead role in projects in a litigated context, including tax disputes, dissenting shareholder actions, and employee stock ownership plan related matters.

Travis also joined Mercer Capital in 1999, and currently leads Mercer Capital’s Corporate Valuation Group. He has broad industry experience providing corporate valuation services to hundreds of companies. Travis is also senior member of the Mercer Capital’s Financial Reporting Valuation Group, and is experienced in the valuation of various intangible assets, employee options, restricted stock, and assets subject to specific contractual restrictions. In addition, Travis recently co-authored the book, Business Valuation: An Integrated Theory, Second Edition, with Z. Christopher Mercer, ASA, CFA, published in 2007 by John Wiley and Sons, Inc.
Check out Mercer Capital’s new complimentary whitepaper series, “Understand the Value Of...”

Written for business owners, each article in this series focuses on a particular industry, providing an overview of that industry and the issues that affect the value of businesses within the industry. Each whitepaper also reviews the basic concepts of value. Business owners should not miss this valuable resource.

Current whitepapers in the series include:

- “Understand the Value of Your Local Exchange Carrier”
- “Understand the Value of Your Electrical Distributorship”
- “Understand the Value of Your Start-Up Business”
- “Understand the Value of Your Trust Company”
- “Understand the Value of Your Truck Dealership”
- “Understand the Value of Your Brick Business”
- “Understand the Value of Your Insurance Brokerage”
- “Understand the Value of Your Physician Practice”
- “Understand the Value of Your Auto Dealership”
- “Understand the Value of Your Distributorship of Malt Beverage Products”

Visit www.mercercapital.com to download these complimentary whitepapers. Check back often for new whitepapers in the series.
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