Federated Press

3RD ADVANCED VALUATION

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VALUATION OF GOODWILL

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COMPONENTS OF THE FAIR MARKET VALUE OF A BUSINESS

THE BUSINESS ENTERPRISE EQUATION

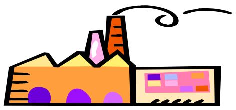
VALUE OF BUSINESS ENTERPRISE	=	VALUE OF NET MONETARY ASSETS + VALUE OF TANGIBLE ASSETS + VALUE OF INTANGIBLE ASSETS	=	VALUE OF EQUITY + VALUE OF LONG-TERM DEBT
		Value of Underlying Assets		Value of Invested Capital

GENERAL ALLOCATION FORMULA

Monetary and Current Assets + Fixed Assets + Intellectual Property + Other Identifiable Intangible Assets + Goodwill	=	Current Liabilities + Long-Term Debt + Shareholders' Equity

COMPOSITION OF A BUSINESS ENTERPRISE

Working Capital



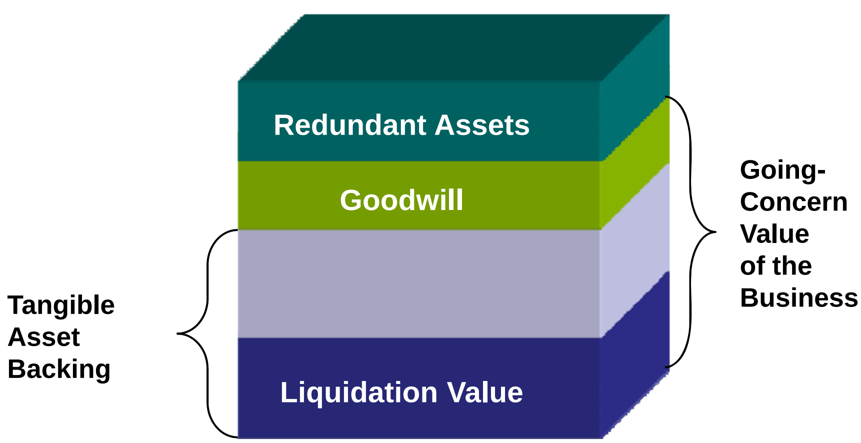
Other Tangible Assets

Intellectual Property

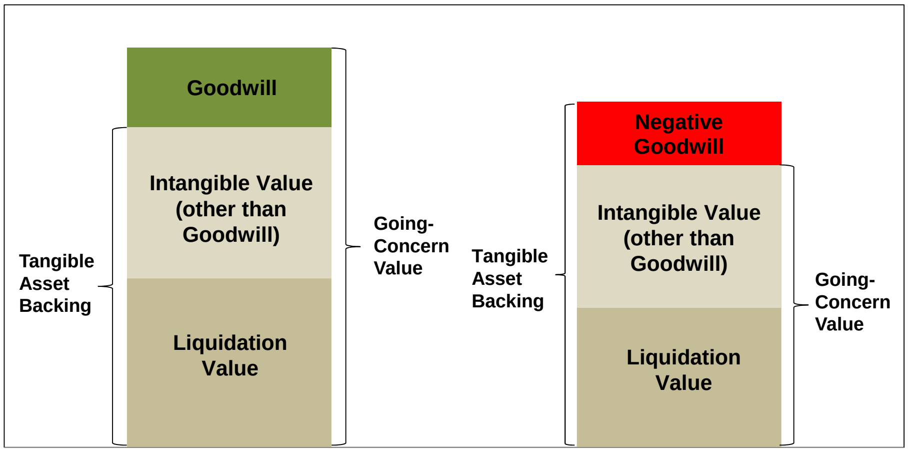
Other Intangible Assets including Goodwill

COMPONENTS OF CORPORATE WORTH

Total Value of Shares



COMPONENTS OF VALUE



GOODWILL

PERSONAL GOODWILL

Relates to unique advantage enjoyed by a given individual which arises from particular abilities, skills, experience, contacts and reputation. As it resides with individual and is *not transferable*, it has no commercial value.

PRACTICE GOODWILL

Pertains to favourable attitude of clients toward a professional practice. Practice goodwill follows the practice, is *transferable* and therefore can have material value.

PERSONAL GOODWILL vs. PRACTICE GOODWILL

- Is successor acquiring the *PRACTICE*?
- Are firm's CLIENTS being transferred to successor?
- Can firm carry on even if professional disappears from scene?
- Can professional's clients be serviced by purchaser?

INDIVIDUAL GOODWILL

Represents the economic benefits that accrue to business by virtue of its employment of one or more persons who have technical abilities, contacts and good reputation. loss of such individual could have negative impact if he/she were to compete with business. Unlike personal goodwill, individual goodwill does not expire upon retirement or death. Business may have capacity to substitute another individual to fill role. In an open market context, non-competition agreements result in individual goodwill having commercial value.

VALUATION APPROACHES

- Income-Based
- Market-Based
- Asset-Based

INCOME-BASED APPROACH

Income Approach — a general way of determining a value indication of a business (or its underlying assets) using one or more methods wherein a value is determined by converting anticipated benefits at a rate of return. Contemplates continuation of business operations. More common methodologies under Income Approach are:

- Capitalizing operating earnings or cash flow, applying Earnings Method or Cash Flow Method respectively;
- Discounting future stream of benefits, applying Discounted Cash Flow Method ("DCF Method") or Discounted Future Earnings Method ("DFE Method"); and
- Capitalizing gross revenues, applying Multiple-of-Revenues Method.

CAPITALIZATION RATE OR DISCOUNT RATE (RATE OF RETURN) INCLUDES FOLLOWING COMPONENTS

a. **Risk-free rate**

Risk Components

b. **Equity risk**

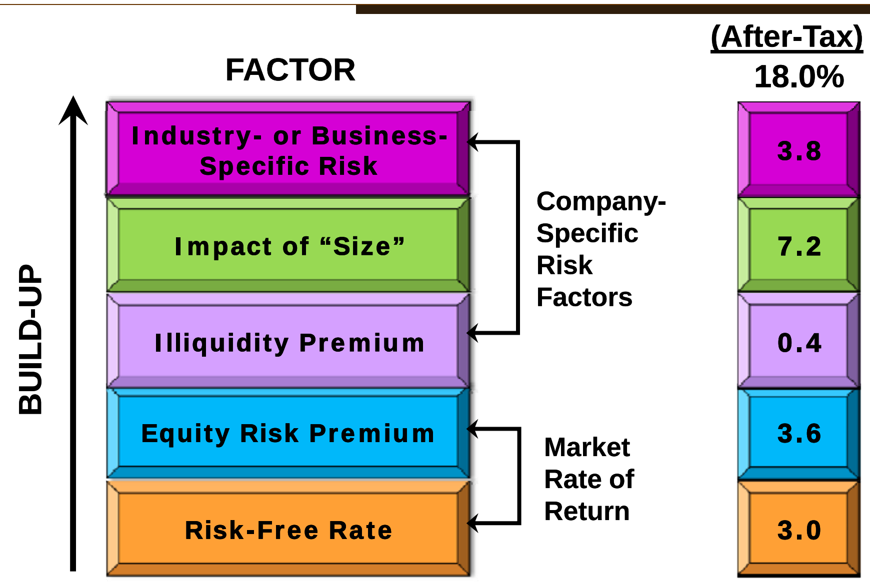
c. **Illiquidity**

d. **Size**

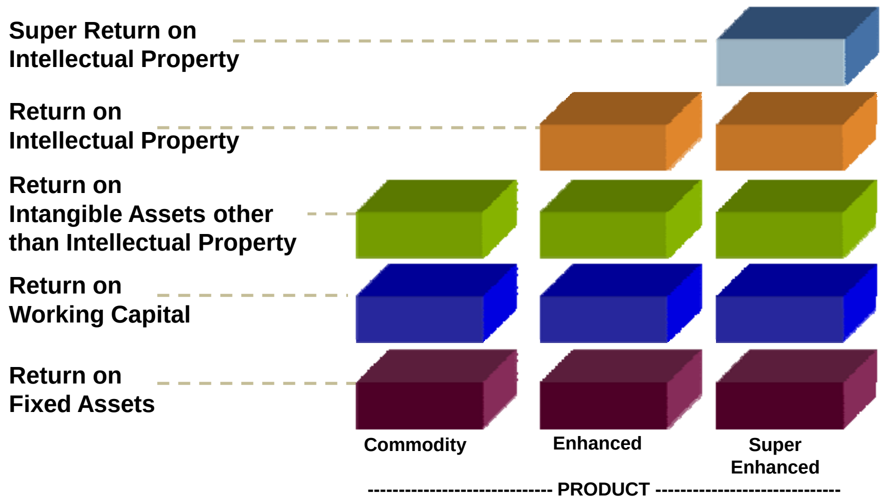
e. **Company-specific risk**

DEVELOPING RATE OF RETURN (DISCOUNT RATE OR CAPITALIZATION RATE)

"BUILD-UP METHOD" — EXAMPLE



EXCESS RETURNS FROM INTELLECTUAL PROPERTY



TEN MOST VALUABLE GLOBAL BRANDS — 2012

($ U.S. Billions — SOURCES: INTERBRAND, S&P CAPITAL IQ)

Rank	Brand	Estimated Value	Book Value of Intangible Assets (Balance Sheet)	Market Capitalization (January 10/13)	Book Value of Shareholders' Equity (Balance Sheet)
10	TOYOTA	30.3	-	153.0	144.6
9	SAMSUNG	32.9	3.3	189.4	104.7
8	intel	39.4	15.8	108.2	49.3
7	M	40.1	2.7	91.8	13.9
6	GE	43.7	57.5	222.0	128.0

TEN MOST VALUABLE GLOBAL BRANDS — 2012

($ U.S. Billions — SOURCES: INTERBRAND, S&P CAPITAL IQ)

Rank	Brand	Estimated Value	Book Value of Intangible Assets (Balance Sheet)	Market Capitalization (January 10/13)	Book Value of Shareholders' Equity (Balance Sheet)
5	Microsoft	57.9	17.9	222.7	68.8
4	Google	69.7	18.2	242.5	68.0
3	IBM	75.5	31.8	217.3	21.7
2		76.6	5.4	485.6	118.2
1	Coca-Cola	77.8	27.8	166.1	33.6

SUPER RETURNS METHOD

- No-name bread is sold for $2.50
- Brand-name bread is sold for $3.25
- Differential of $0.75 x volume in units = additional revenues attributable to trade name
- Subtract additional advertising and promotion costs

VALUATION OF INTANGIBLE ASSET

EXAMPLE — EXCESS-EARNINGS METHOD

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues	$50,000	$52,500	$55,125	$57,881	$60,775
Earnings before depreciation, interest and taxes	10,000	10,500	11,025	11,576	12,155
Less: Depreciation	(2,000)	(2,200)	(2,200)	(2,100)	(1,900)
Earnings before interest and taxes	8,000	8,300	8,825	9,476	10,255
Less: Income taxes	(3,200)	(3,320)	(3,530)	(3,791)	(4,102)
Debt-free income	4,800	4,980	5,295	5,686	6,153
Depreciation	2,000	2,200	2,200	2,100	1,900
Capital expenditures	(2,500)	(2,200)	(2,200)	(1,800)	(1,800)
Changes in working capital	(682)	(716)	(752)	(789)	(829)
Reasonable after-tax return on fixed assets	(1,200)	(1,320)	(1,320)	(1,260)	(1,140)
Reasonable after-tax return on net working capital	(750)	(801)	(855)	(911)	(970)
Reasonable after-tax return on other intangible assets	(100)	(100)	(100)	(100)	(100)
Net cash flow (excess earnings) — subject asset	1,568	2,043	2,268	2,925	3,214
Present value factor	0.833	0.694	0.579	0.482	0.402
Present value	$ 1,307	$ 1,418	$ 1,313	$ 1,411	$ 1,291

VALUE OF INTANGIBLE ASSET = TOTAL OF PRESENT VALUES = $6,740

ABC CO.

VALUATION OF ACQUIRED GOODWILL — PURCHASE PRICE ALLOCATION

		FMV ($000's)
ABC Co.'s acquisition price of target		10,000
FMV of acquired assets		
Cash and marketable securities		300
Accounts receivable		1,500
Inventory		950
Total current assets	(A)	2,750
Property, plant and equipment		1,500
Land		1,000
Total fixed assets	(B)	2,500

ABC CO.

VALUATION OF ACQUIRED GOODWILL — PURCHASE PRICE ALLOCATION

		FMV ($000's)
Identifiable intangible assets		
Proprietary software		2,700
Trademarks		750
Patents		400
Know how		400
Total identifiable intangible assets	(C)	4,250
Total FMV of all identifiable assets	(A)+(B)+(C)	9,500
FMV of acquired Goodwill	($10,000 - $9,500)	450

LOTSA GOODWILL, INC.

CAPITALIZED ECONOMIC INCOME METHOD
ESTIMATION OF EXCESS ECONOMIC INCOME

Net cash flow after-tax		$460,000
Fair market values of Tangible Capital Employed (net tangible assets and identifiable intangible assets) – "TCE"	$3,000,000	
Required after-tax rate of return on TCE	10%	
Required after-tax economic income to provide a normal commercial return on fair market value of TCE		300,000
Super Profits or Excess Earnings		$160,000

LOTSA GOODWILL, INC.

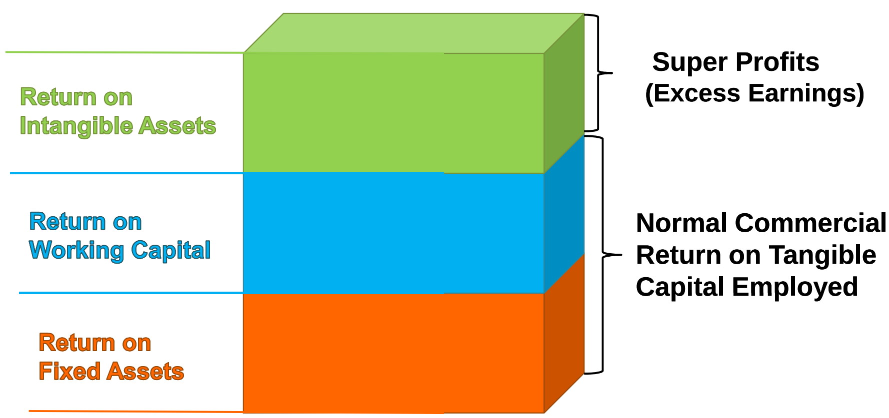
CAPITALIZED EXCESS ECONOMIC INCOME METHOD
INDICATED VALUE OF BUSINESS ENTERPRISE

ASSETS	
Current assets	$ 100,000
Tangible assets at fair market value	2,500,000
Identifiable individual intangible assets at fair market value	500,000
Intangible value, being goodwill	640,000
TOTAL ASSETS	$3,740,000
LIABILITIES & SHAREHOLDERS' EQUITY	
Current liabilities	$1,000,000
Long-term debt	1,000,000
Adjusted shareholders' equity	1,740,000
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$3,740,000

Indicated value of Shareholders' equity = $1,740,000:

	Value of total assets (above)	$3,740,000
Less:	Value of total liabilities	2,000,000
Equals:	Value of shareholders' equity	$1,740,000

DUAL CAPITALIZATION METHOD



DUAL CAPITALIZATION METHOD (EXCESS EARNINGS METHOD)

a) Determine business' earning power;

b) Determine fair market value of business' average tangible capital employed ("TCE");

c) Determine appropriate rate of return ("normal commercial return") on TCE;

d) Subtract return in c) from earnings in a), to arrive at excess earnings (super profits) of business;

e) Capitalize excess earnings (super profits) in d) by separate rate of return, to determine value of Goodwill; and

f) Add value of TCE at valuation date and Goodwill in e), to arrive at total fair market value of business.

DUAL CAPITALIZATION METHOD

	Range	
	Low	High
Indicated after-tax earnings of Company	$ 240,000	$ 310,000
Return on value of average TCE* (10%)	(150,000)	(150,000)
Excess earnings (super profits)	90,000	160,000
Capitalized at	22.5%	27.5%
Goodwill	400,000	500,000
ADD: Fair market value of TCE at Valuation Date plus fair market value of redundant assets	1,785,000	1,785,000
Fair market value of Company	$2,185,000	$2,285,000

Average TCE = $1,500,000.

DUAL CAPITALIZATION METHOD (EXCESS EARNINGS METHOD)

	Co. M	Co. N
Free cash flow of business	$100,000	$100,000
Return on Tangible Capital Employed:		
Co. M — $300,000 @ 12%	(36,000)	-
Co. N — $500,000 @ 12%	-	(60,000)
Therefore, free cash flow (super profits) related to Goodwill	$ 64,000	$ 40,000
SUMMARY OF VALUE		
Tangible Capital Employed at Valuation Date	$320,000	$560,000
Capitalization of free cash flow associated with Goodwill:		
40% (2.5x)	160,000	-
33-1/3% (3.0x)	-	120,000
Fair market value of business	$480,000	$680,000

CALCULATION OF GOODWILL AND GOING-CONCERN VALUE
AS AT SEPTEMBER 30, 2012
APPLYING DUAL CAPITALIZATION (EXCESS EARNINGS) METHOD OF VALUATION

			Sept. 30, 2012		Sept. 30, 2011
Shareholders' Equity as at September 30, 2012 — per balance sheet			$10,278,530		$ 9,210,630
ADD:	Fair market value of Property	$8,145,000		$ 8,145,000	
	LESS: Net book value	(68,500)	8,076,500	(68,500)	8,076,500
	Fair market value of Equipment	5,650,000		5,463,000	
	LESS: Net book value	(1,024,050)	4,625,950	(1,028,330)	4,434,670
LESS:	Loss of tax shield on total of Property, M&E and F&F	(2,217,000)		(2,214,800)	
LESS:	Redundant assets, gross	(4,932,000)	(7,149,000)	(3,932,000)	(6,146,800)
Tangible Capital Employed (rounded)		(A)	$15,830,000		$15,575,000
Average Tangible Capital Employed (ATCE), 2011-2012 (rounded)				$15,700,000	

PROFESSIONAL PRACTICE MULTIPLE-OF-GROSS-FEES METHOD

- Vendor's ability to transfer clients;
- Nature of fees/services;
- Recurrence of engagements;
- Loyalty and diversity of client base;
- Dependence on significant clients or client groups;
- Competition;
- Size of firm;
- Age and health of practitioner(s);
- Quality of personnel;

PROFESSIONAL PRACTICE MULTIPLE-OF-GROSS-FEES METHOD (CONT'D)

- Profitability of practice;
- Bad debt experience;
- Hourly billing rates and percentage of available time charged to, and collected from, clients (utilization rate) for practitioner/partners and employees;
- Location of firm and its clients;
- Extent and significance of personal contacts and relationships;
- Number of years clients have maintained relationship with practitioner(s); and
- History and reputation of firm.

CALCULATION OF GOODWILL AND GOING-CONCERN VALUE
AS AT DECEMBER 31, 2012
APPLYING DUAL CAPITALIZATION (EXCESS EARNINGS) METHOD OF VALUATION

Average Tangible Capital Employed (ATCE), 2011-2012 rounded			$15,700,000
Normal commercial return (pre-tax), say	10.00%		
Income tax rate	30.21%		
Normal commercial return (after-tax)			6.98%
Normal commercial return on ATCE (6.98% x $15,710,000)		(B)	1,096,000
Adjusted after-tax earnings		(C)	1,980,000
Super profits (Excess earnings) = After-tax return on intangibles		(D) = (C) – (B)	884,000
Rate of return on intangibles (37.5% pre-tax @ 1- 30.21%)		(E)	26.17%
Intangible value ($884,000 ÷ 26.17%) = Goodwill		(F) = (D)/(E)	$ 3,380,000
ADD: Tangible asset backing at Dec. 31, 2012			15,830,000
Going-concern value of the business (rounded)		(F) + (A)	$19,200,000

EXAMPLE OF DUAL CAPITALIZATION METHOD

Indicated net cash flow			$ 214,000
❒ Tangible capital employed — Jan. 31, 2012	(A)	$ 955,000	
❒ Tangible capital employed — Dec. 31, 2012	(B)	$1,084,000	
❒ Average tangible capital employed	[(A) + (B)] ÷ 2	$1,019,000	
LESS: 10% return on average Tangible Capital Employed ($1,019 x 10%)			(102,000)
Super profits			$ 112,000
Rate of return on super profits			30%
Capitalized super profits ($112,000 ÷ 30%) = Goodwill			$ 373,000
ADD: Tangible capital per December 31, 2012 balance sheet			1,084,000
Estimated Fair Market Value of Issued Shares			$1,457,000

AOL TIME WARNER INC.
YEAR ENDED DECEMBER 31, 2002

Reduction in Carrying Value of	Billions (U.S.)
Goodwill (AOL)	$33.5
Cable segment	10.6
Music segment	0.6
Brands and trademarks at Music segment	0.9
Impairment charge (to operating income)	$45.5

AOL MANAGEMENT EXPLANATION OF WRITE-DOWN IN 2002 FINANCIAL YEAR

"The $33.489 billion charge at the AOL segment reflects the AOL segment's lower than expected performance, including the continued decline in the online advertising market. The $10.550 billion charge at the Cable segment reflects current market conditions in the cable television industry, as evidenced by the decline in the stock prices of comparable cable television companies. The $1.499 billion charge at the Music segment reflects declining valuations in the music industry, primarily due to the negative effects of piracy.

"The impairment charges are non-cash in nature and do not affect the company's liquidity ... ".

QUESTIONS

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