

# Value Highlights™



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## Highland Global News

September 2006

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➤ **Highland Global Announces its New Office Location in Myrtle Beach, South Carolina**

**Myrtle Beach, SC & Miami, FL, September 2, 2006**—Highland Global, LLC announced its new office address at the distinguished Founders Centre in Myrtle Beach today. Highland Global's new Myrtle Beach address is as follows:

Highland Global, LLC  
Founders Centre  
2411 North Oak Street  
Suite 305  
Myrtle Beach, SC 29577

Highland Global spokesman Sebastian G. Peréy made the following statement relating to the announcement:

Mr. Clinger is excited about Highland Global's new Myrtle Beach office location. We believe that this new office location at the prestigious Founders Centre will show our commitment to this area as Highland Global continues to build its presence in business valuation throughout the region. We look forward to continuing to create awareness of Highland Global's business valuation and financial analysis services among business owners, attorneys, accountants, and other professionals.

➤ **Highland Global announces Publication of Robert M. Clinger III's article "Direct Market Data Method: Value Disparity Issues Part II" in NACVA's *The Value Examiner***

**Myrtle Beach, SC & Miami, FL, September 2, 2006**—Highland Global, LLC is pleased to announce that Robert M. Clinger III, AVA has had the second part of his informative business valuation article, "Direct Market Data Method: Value Disparity Issues," published in the National Association of Certified Valuation Analysts' publication *The Value Examiner* (July/August 2006 issue). Though

simple in theory, there are some challenges to using the direct market data method effectively to provide a reliable indication of value. Part I of Mr. Clinger's article discussed value disparities between the direct market data method and the multi-period discounted earnings method. The significantly different value indications usually result from high growth expectations over the forecast period used in the multi-period discounted earnings method. In Part II of the article, Mr. Clinger examines how value disparities may arise between the direct market data method and the single period capitalization method. These disparities usually occur when the transaction data used in the direct market data method is not representative of fair market value but, rather, reflects strategic value to a specific investor, skewing the value indication higher. Mr. Clinger then discusses three options for addressing the value disparities.

Business appraisers, attorneys, business owners, professors, students, and accountants may find Mr. Clinger's "Direct Market Data Method: Value Disparity Issues" useful in understanding some of the more subtle valuation issues relating to the impact of estimated future growth on the value estimate arrived in valuing a business or business interest and insightful on options for dealing with the potential value disparities. Highland Global spokesman Sebastian G. Peréy stated the following about the publication of the article:

Once again, Highland Global is pleased that Mr. Clinger's article has been published in The Value Examiner. Publication of this article is part of our on-going commitment to fostering excellence in the valuation profession and to providing value-added research and analysis to both our clients and the general valuation body of knowledge. We look forward to continuing our tradition of leading the way on insightful articles and analysis of pertinent issues in the valuation field through publication of additional articles and books in the near future.

➤ **Highland Global Announces Departure of Managing Director**

**Myrtle Beach, SC & Miami, FL, September 2, 2006**—Highland Global, LLC announced today that Paul Morin has resigned from the firm effective immediately.

Highland Global founder and former candidate for the Horry County Council District #2 seat Robert M. Clinger III stated the following upon the announcement of Mr. Morin's resignation:

I am deeply saddened that Paul has decided to leave Highland Global to pursue other business interests. These last two years have been momentous for Highland Global as Paul and I have worked closely to build the firm into one of the leading business valuation firms in the region. His contribution to this organization will be greatly missed, but we wish him well in his other endeavours. We also look forward to the possibility of working with him again on select engagements in the future.

## Discount Statistics of Closed-End Funds

### 2<sup>nd</sup> Quarter 2006 Update

July 2006

The following is an excerpt from Highland Global's "Discount Statistics of Closed-End Funds" for the Second Quarter of 2006. The complete article and press release may be downloaded from Highland Global's website [www.HighlandGlobal.com](http://www.HighlandGlobal.com).

Each quarter, Barron's Online ([www.barrons.com](http://www.barrons.com)) reports statistics on publicly-traded closed-end funds. The statistics reported include the discount (or premium) of the market price from the fund's net asset value (NAV), the 52-week average discount or premium, the fund's objective, and various return measurements, etc. For the second quarter ending June 30, 2006, Barron's reported that 490 closed-end funds traded at discounts to their NAV for the quarter. This is slightly higher than the 467 closed-end funds trading at discounts for the first quarter ending March 31, 2006. For the third and fourth quarters of 2005, there were approximately 450 and 479 closed-end funds, respectively, trading at discounts to their NAV.

The average discount to NAV for the second quarter was 8.3% with a median of 7.9% and a standard deviation of 4.4%. For the first quarter, the average discount to NAV was 7.4% with a median of 6.9% and a standard deviation of 4.6%. For the fourth quarter of 2005, the average discount to NAV was 9.2% with a median of 9.8% and a standard deviation of 4.3%. In the third quarter of 2005, the average discount was 7.7% with a median discount of 7.5% and standard deviation of 4.6%.

Of the total closed-end funds, 459 funds traded at a 52-week average discount to NAV as of June 30, 2006 as compared to 463 trading at a 52-week average discount to NAV for the period ending March 31, 2006. Approximately 459 and 457 of the closed-end funds traded at a 52-week average discount to NAV for the periods ending December 31, 2005, and September 30, 2005, respectively. For the second quarter, the average 52-week discount to NAV was 7.7% with a median of 7.5% and a standard deviation of 4.3% as compared to an average 52-week discount to NAV of 7.5%, a median of 7.1% and a standard deviation of 4.4% for the period ending March 31, 2006. For the fourth quarter 2005, the average 52-week discount to NAV was 7.3% as compared to 7.0% for the 52-week period ending September 30, 2005. The median 52-

Highland Global article appears in the  
NACVA's *The Value Examiner*

"The Direct Market Data Method: Value Disparity Issues Part II" by Highland Global founder Robert M. Clinger III, AVA appeared in the July/August issue of *The Value Examiner*, the bimonthly publication of the National Association of Certified Valuation Analysts. Mr. Clinger's article discusses how to best address the disparity between value indications produced under the direct market data method and the single period capitalization method. More details follow later in this newsletter...

week discount to NAV was 6.9% as of December 31, 2005 as compared to 7.0% for the period ending September 30, 2005. The standard deviation as of December 31, 2005 was 4.4% as compared to 4.5% for the period ending September 30, 2005.

For the second quarter, the discounts to NAV ranged from 0.1% to 27.3% with the 52-week average discount ranging from 0.1% to 24.8%. For the first quarter of 2006, the discounts ranged from 0.1% to 24.3% with the 52-week average discount ranging from 0.1% to 25.8% as of March 31, 2006. The discounts ranged from 0.1% to 27.5% based on the collective fourth quarter data and from 0.1% to 29.4% for the third quarter data. A table containing information on all of the funds is included at the end of this article.

Morningstar ([www.morningstar.com](http://www.morningstar.com)) reported betas for approximately 373 of the closed-end funds with discounts to NAV for the second quarter as compared to 362 of the closed-end funds with discounts to NAV at the end of the first quarter 2006. For the fourth quarter, roughly 380 of the closed-end funds with discounts to NAV had reported betas as compared to 364 based on the third quarter data. The betas at the end of the second quarter of 2006 ranged from -0.06 to 2.35 as compared to a range of -0.4 to 2.36 for the first quarter. The betas at the end of the fourth quarter ranged from -0.03 to 2.41 as compared -0.33 to 2.43 for the third quarter data.

Funds for which the beta statistic was available traded at 52-week average discounts ranging from 0.1% to 24.3% through the end of the second quarter as compared to a range of 0.1% to 25.2% through the end of the first quarter of 2006. The 52-week discount ranged from 0.1% to 25.3% through the end of the fourth quarter 2005 as compared to 0.1% to 25.4% through the end of the third quarter 2005. For the second quarter, the average 52-week discount was 7.3% with a median of 7.3% and a standard deviation of 4.1% as compare to an average as of the end of the first quarter of 7.1%, a median of 6.6%, and a standard deviation of 4.2%. The 52-week average discount was 7.2% with a median of 6.9% and a standard deviation of 4.1% for the fourth quarter 2005. For the third quarter, the 52-week average discount for the funds with betas was 6.9% with a median of 6.8% and a standard deviation of 4.1%. The range for the discounts as of December 31, 2005 for the fourth quarter was 0.1% to 27.2%. The range for the discounts as of September 30, 2005 for the third quarter was 0.1% to 24.5%.

For the second quarter of 2006, the average discount of funds with a reported beta was 8.0% with a median of 7.6% and a standard deviation of 4.1%. For the first quarter of 2006, the average discount of funds with a beta was 6.8% with a median of 6.5% and a standard deviation of 4.3%. For the third quarter of 2005, the average discount of funds with a beta was 7.1% with a median of 7.1% and a standard deviation of 4.3%. For the fourth quarter 2005, the average discount of funds with a beta was 8.7% with a median of 9.5% and a standard deviation of 4.2%.

The complete article and press release may be downloaded from Highland Global's website [www.HighlandGlobal.com](http://www.HighlandGlobal.com).

## Direct Market Data Method: Value Disparity Issues Part II

### July/August 2006

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The following is an excerpt from Robert M. Clinger III's "Direct Market Data Method: Value Disparity Issues Part II" that appeared in the July/August issue of the National Association of Certified Valuation Analysts' *The Value Examiner*. The complete article and press release may be downloaded from Highland Global's website [www.HighlandGlobal.com](http://www.HighlandGlobal.com).

#### More About Robert M. Clinger III

Mr. Clinger, founder of Highland Global, LLC, has strong experience in the fields of business valuation and financial analysis. Mr. Clinger has written numerous articles regarding economics, business valuation, and merger & acquisition issues. He earned a Bachelor of Science degree in Business Administration/Finance, summa cum laude, from Coastal Carolina University and received the distinguished President's award. Mr. Clinger has also earned the Accredited Valuation Analyst (AVA) designation from NACVA and is currently pursuing the Certified Business Appraiser (CBA) designation from the Institute of Business Appraisers. Mr. Clinger is also the author of two books, *The Seven Deadly Sins of Business Valuation* and *The Seven Deadly Sins of Business Valuation: Closely Held & Family Controlled Companies*.

As discussed in the Part I article on this subject, the direct market data method is an effective and intuitively logical approach to valuing a privately held business. The transaction data obtained from various databases represents actual transactions of similar privately held businesses in the selected industry and the multiples at which these transactions took place. It is relatively simple to apply the direct market data method to produce an indication of value. The appraiser analyzes the transaction data, selects an appropriate multiple based on the specific attributes

of the subject being valued relative to the transaction data, then multiplies the selected earnings stream (usually EBITDA or another measure of cash flow) or revenues by the selected multiple.

Though simple in theory, there are some challenges to using the direct market data method effectively to provide a reliable indication of value. In Part I, we discussed value disparities between the direct market data method and the multi-period discounted earnings method. The significantly different value indications usually result from high growth expectations over the forecast period used in the multi-period discounted earnings method. Value disparities are also possible between the direct market data method and the single period capitalization method...

...It is likely (but not totally certain) that the greater value estimate produced using the direct market data method is a result of transaction multiples that reflect strategic or investment value rather than fair market value. Most transaction providers merely report the data on the acquired company and do not indicate if the acquirer was a financial buyer or a strategic buyer within the company's industry. For certain businesses, such as restaurants or flower shops, the transaction data likely reflects an approximation of fair market value. The acquirers are likely individual buyers, seeking

either to “buy a job” or a lifestyle, or financial buyers in search of a return on their investment. For larger industries such as plastic injection molding, transactions are likely consummated between a strategic acquirer seeking synergies and the target company. In situations where the industry is undergoing rapid consolidation, such as the plastic injection molding industry, the transaction data likely is more representative of strategic value. This, in essence, skews the value estimate higher when using the direct market data method.

### **Potential Solutions**

As in the case where the direct market data method produces a value estimate lower than the multi-period discounted earnings method due to the latter’s ability to capture rapid future growth, the appraiser is once again confronted with a difficult challenge as to how to best address the value disparity. As discussed in Part I, there are several options from which the appraiser may choose, including:

1. Do nothing, but explain the difference as discussed above and weight the methods equally;
2. Apply a lower weight to the value indication developed using the direct market data method; or
3. Adjust the price to sales multiple under the direct market data method.

The complete article and press release may be downloaded from Highland Global’s website [www.HighlandGlobal.com](http://www.HighlandGlobal.com).

## **State of the Economy 2<sup>nd</sup> Quarter Excerpt July 2006**

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The following is an excerpt from Highland Global’s State of the Economy for the Second Quarter of 2006 and provides our outlook for economic performance in 2006 and 2007. The complete article may be downloaded from Highland Global’s website [www.HighlandGlobal.com](http://www.HighlandGlobal.com).

Based on the current assessment of a number of economic factors, the previously solid foundation for economic growth finally appears to have been weakened by the adverse systemic impact of continued elevated energy prices. The continued high energy prices that have likely contributed to a rise in inflationary pressures coupled with rising interest rates as the Federal Reserve removes monetary policy accommodation and weaker real estate activity have apparently had an adverse impact on consumer spending, with personal consumption expenditures slowing markedly during the second quarter. Continued retrenchment in consumer spending could precipitate further cooling of economic activity, which could, in turn, prompt businesses to retrench slightly with respect to production and employment. As a result, economic activity could yet become more tempered in the coming quarters. These factors

suggest that the risks to the economy remain weighted heavily towards weaker economic activity in the coming quarters.

Previously, we did not believe that the preponderance of evidence pointed to a recession. Currently, we still believe that economic growth will likely be at a much more tempered pace in the second half of the year. However, we now believe that the probability of the economy slipping into recession in the first half of 2007 has increased moderately. For now, we contribute a higher probability that the U.S. economy will likely exhibit a period of low growth and higher inflationary pressures.

Our assessment of the current state of the economy indicates the following:

- The Federal Reserve's removal of accommodative monetary policy, along with already higher mortgage rates, have likely restrained real estate activity and contributed to the further removal of the speculative froth that had developed in many markets in the preceding two years.
- Oil prices are likely to remain at elevated levels throughout 2006 and into 2007, which could prompt further slowing of economic activity globally and in the U.S.
- Inflation has remained at levels above recent trends, and will likely remain above recent levels, which would be consistent with slower economic growth.

Our expectations for the economy include:

- Real GDP growth of 2¾% - 3¼% for 2006.
- The Federal Reserve is likely to end its removal of monetary policy accommodation in light of continued economic weakness. The federal funds rate, then, should end 2006 at 5¼% - 5½%.
- Inflation is likely to increase in 2006 with the core CPI increasing by roughly 2½% - 3¼%.
- As economic activity becomes more tempered, payroll employments are likely to increase at a lower rate. Unemployment is likely to range from roughly 4¾% - 5% for 2006.
- Continued geopolitical concerns will likely result in an additional risk premium in oil prices. It is unlikely that OPEC will increase production in the coming quarters of 2006. However, even if OPEC were to do so, these increases will not likely have a material impact on lowering the price of oil. Oil prices (WTI) are likely to average \$68-\$75 per barrel for 2006.

Economic activity slowed significantly in the second quarter following robust growth in the first quarter of 2006 with real GDP increasing at an annual rate of only

2.5%. Personal consumption expenditures, which had performed well during the first quarter, slowed markedly in the second quarter, perhaps as a result of a squeeze on personal finances caused by higher energy prices, a slowing housing market, and rising interest rates. These factors may create continued uncertainty regarding future economic growth in the coming quarters. Inflation remained largely contained but increased at levels not typically consistent with maximum sustainable economic growth. Based on our assessment of the state of the economy in the second quarter, conditions are likely to foster tepid economic activity during 2006. As such, the risks are weighted mainly towards growth at a more subdued rate and towards conditions that generate a higher level of inflation than in the previous year.

## **Highland Global, LLC Announces Publication of *The Seven Deadly Sins of Business Valuation: Closely Held & Family Controlled Companies***

June 2006

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**Myrtle Beach, SC & Miami, FL June 1, 2006**—Highland Global, LLC is pleased to announce the release its second book, *The Seven Deadly Sins of Business Valuation: Closely Held & Family Controlled Companies*, by Highland Global principals Robert M. Clinger III, AVA and Paul Morin. *The Seven Deadly Sins of Business Valuation: Closely Held & Family Controlled Companies* is Messrs Clinger and Morin's second book in the *Seven Deadly Sins* series. Their first book, *The Seven Deadly Sins of Business Valuation*, was released in late 2005.

Frequent and thorough analysis of value creation in closely held or family controlled businesses is critical to effective ongoing management of the enterprise. Such monitoring will reveal the success or failure of the management in meeting the strategic goals and in creating value and wealth for the shareholders. Like their original book, *The Seven Deadly Sins of Business Valuation: Closely Held & Family Controlled Companies* identifies and discusses some of the challenges inherent in monitoring value creation and illustrates with examples and case studies several of the most common valuation errors that a financial analyst may make in analyzing a closely held or family controlled business. In addition, the authors discuss the seven characteristics of closely held or family controlled businesses that define a firm's ability to create transgenerational wealth: a clearly defined vision, professionalization of management, professionalization of ownership, effective communication, strong corporate governance, an established succession plan, and a comprehensive strategic plan.

Senior management of family controlled companies and their advisors, business appraisers, attorneys, professors, students, accountants, and other business and finance professionals may find this book useful in understanding some of the challenges involved in the preparation of a valuation of a closely held business.

Robert M. Clinger III, co-founder of Highland Global and former candidate for the Horry County Council District #2 (South Carolina), stated the following regarding publication of *The Seven Deadly Sins of Business Valuation: Closely Held & Family Controlled Companies*:

“Paul and I are very excited about the release of *The Seven Deadly Sins of Business Valuation: Closely Held & Family Controlled Companies*. This latest book is focused particularly on the unique challenges that confront senior management of family controlled businesses and the impact these challenges may have upon the valuation of the firm. We are confident that owners and the management team of closely held or family controlled businesses will find this book a very useful tool in understanding the importance of excelling in the seven characteristics associated with successful transgenerational wealth creation in order to create value for existing shareholders and subsequent generations of owners and managers.”

The book is available in hardback, paperback, and e-book format through Highland Global's website.

## **Estate Tax Repeal Update**

**June 2006**

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With the failure of the Senate to pass a total repeal of the estate tax in early June, the prospects for permanent estate tax relief seem to have diminished greatly. The 57-41 vote in the Senate to permanently repeal the death tax fell shy of the 60 votes needed to avoid a filibuster. Therefore, it appears that President Bush's 2001 tax relief plan, which has increased exemptions for estates to \$2 million currently for individuals and \$4 million for couples, will expire at the end of 2010 (the only year in which estate taxes are eliminated altogether). In 2011, then, the death tax will revert to its previous \$1 million exemption and 55% federal tax rate.

As a result, estate tax planning will remain crucial to wealthy individuals and family business owners for the foreseeable future. As always, valuations of family limited partnerships and businesses by qualified business valuation experts will remain an integral part of the estate planning process to ensure the successful transfer of transgenerational wealth.

## **M&A Update**

**June 2006**

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Global merger and acquisition activity, fueled by corporate deals and private equity investments, turned in a solid performance in the first half of 2006, reaching

\$1,930 billion worldwide—the highest volume for the first half in history according to Dealogic. Continued favourable borrowing costs, increased optimism by executives, shareholder activism, and strong balance sheets provided M&A activity with a solid foundation. Hostile bids, such as Mittal Steel's pursuit of Arcelor, increased during the first half of 2006 with 77 deals having a combined value in excess of \$381 billion. Private equity M&A represented 19% of all deals as compared to 18% for the full year 2005. Corporate bond issuance to help finance the acquisitions increased 15% to more than \$1,000 billion. Equity issuance increased 46% in the first half as compared to the first half of 2005 to \$361 billion.

Through early June, average deal multiples on U.S. targets increased as well according to The Deal.com's U.S. M&A Multiples from Dealogic. The average deal price to target's sales increased to 4.1x in the second quarter of 2006 as compared to 2.9x in the second quarter of 2005 and the first quarter 2006. The average deal price to target's EBITDA increased to 19.3x in the second quarter as compared to 14.9x in the same period a year ago and 14.7x in the previous quarter. The average deal price to target's net income was virtually unchanged at 24.9x in the second quarter as compared to 25.0x in the second quarter of 2005. This does, however, reflect an increase from the 22.7x multiple during the first quarter<sup>1</sup>.

Should executives' confidence remain strong, M&A activity is likely to remain robust throughout the second half of the year. It would be reasonable to conclude that a tempering of economic activity and increased uncertainties or geopolitical risks during the second half of the year may have an adverse impact upon the propensity of executives to consummate deals. However, those companies with strong balance sheets may find increased opportunities for M&A deals in the second half should targets become weakened by any economic slowdown and thereby prompt lower valuations.

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<sup>1</sup> Sources: "M&A activity surges to record," Lina Saigol and James Politi, The Financial Times, June 30, 2006.

## About Highland Global, LLC

### Overview

Highland Global, LLC is a leading strategic advisory and financial analysis firm for domestic and international privately held and family owned businesses. Our focus is on providing a variety of services from advising on transactions and corporate growth to business valuation. We specialize in small and middle market clients in industries ranging from manufacturing to technology. Our philosophy is to work closely with our clients to provide high value-added services that help them achieve their objectives. In addition to strong connections with other professional services providers, Highland Global has an extensive global network of clients, business leaders, and investors, which we leverage to benefit our clients domestically and internationally.

### Strategic Advisory Services

Highland Global offers our clients a wide range of strategic advisory and financial analysis services. With respect to corporate growth or exit strategies for privately held and family owned middle market companies, Highland Global may assist clients with mergers and acquisitions, sales and divestitures, recapitalizations, management buyouts, and privatizations. Our goal is to provide our clients with sound strategic guidance in order to facilitate the formulation and execution of successful growth and liquidity strategies.

Highland Global's team of seasoned professionals is actively involved in every phase of the transactions for which it provides advisory and analysis services. With respect to mergers and acquisitions, Highland Global assists the client in preparing the company for market, assesses the M&A markets, coordinates site visits with potential acquirers, coordinates the due diligence, and facilitates the closing process. In addition, Highland Global provides the client with post-transaction support and guidance as part of our commitment to building and maintaining a strong, high value-added relationship.

### Valuation and Financial Analysis Services

Highland Global also provides a variety of financial analysis services to its clients including market or industry research and business appraisals. Our industry research and financial analysis are usually provided in conjunction with our clients' corporate growth or exit strategies, but may be provided independently for consulting, business planning, forecasting or other purposes. Highland Global's full range of valuation services includes formal valuations, limited scope valuations, fairness opinions, and expert witness / consulting services. We focus on meeting our clients' objectives by providing the customized valuation service that best meets their needs. We perform independent business appraisals and valuations for a wide range of purposes including family limited partnerships, succession planning, gift taxes/planning, estates taxes/planning, mergers & acquisitions, employee stock ownership plans (ESOPs), financing/capital raising, divorce, shareholder issues, and litigation. Our goal is to provide accurate, objective, and reliable valuations and financial analysis based on widely-accepted, well-documented methodologies.