

Deals, Dollars, and Disputes

**MAXIMIZING VALUE
MINIMIZING RISK**

*A Summary of Private Equity Transactions for the
Quarter Ended June 30, 2015*

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Introduction and Our Objective

We are pleased to present you with our *Deals, Dollars, and Disputes* report for the quarter ended June 30, 2015. Our quarterly report involves a study of the merger and acquisition transactions involving private equity firms (“PE firms”) during the recent quarter and over the past five quarters.

Our objective in preparing this report is to provide a general overview of the volume and value of transactions during the year, along with an analysis of trends when compared to prior periods.

As an independent consulting firm with financial and accounting expertise, we are committed to contributing thought leadership and relevant research regarding business and valuation matters to assist our clients in today’s fast-paced and demanding market. This report is just one example of how we intend to fulfill this commitment.

We appreciate your comments and feedback, and welcome requests for any additional analysis that you might find helpful.

Floyd Advisory
AUGUST 2015

Our Process and Methodology

We studied financial data for transactions involving PE firms, both as buyers and sellers, over the past five quarters for target companies headquartered in North America.

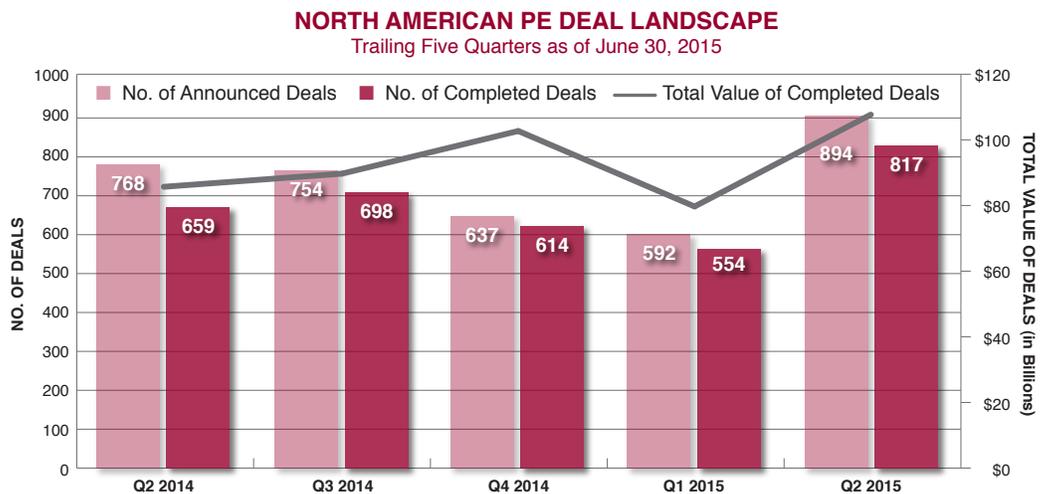
As part of our review, we gathered and analyzed relevant transaction information and data such as industry sector, equity interest, and deal structure, and created a database for our further analyses. From this information, we analyzed market trends by industry, common attributes, valuation premiums, and other characteristics. We have prepared this report applying our professional judgment to these observations.

For the purposes of this report, the transaction data we have analyzed is limited to publicly available information.

The second quarter of 2015 saw significant increases in both total deal value and overall deal activity in the North American PE markets.

Summary of Q2 2015 PE Firm Transaction Activity

Volume and Value of PE Deals Increased in Q2 of 2015



Source: Zephyr

Note: Includes data for which transaction details were reported and available.

The second quarter of 2015 saw significant increases in both total deal value and overall deal activity in the North American PE markets. Compared to the first quarter of 2015, the total value of completed deals increased 35% and the volume of all deals, both announced and completed, increased more than 47%. These increases correlated with an anticipated upsurge in mergers and acquisitions in the second quarter due to continued low interest rates and low-cost debt financing.¹

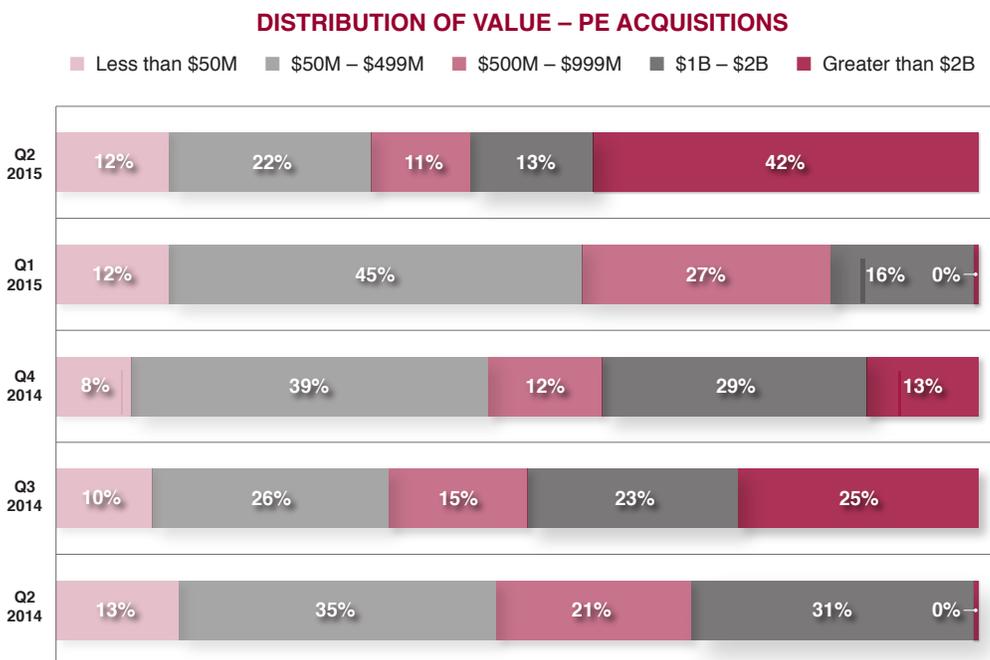
¹ "Mega-Mergers Are Back, but Will the Pace Last?" Knowledge@Wharton Web. 20 Jul. 2015.

The activity in the second quarter signals a clear rebound from both a quarterly decline in deal volume since the third quarter 2014 and fluctuating quarterly deal values throughout the prior four quarters. Total deal volume and value of deals in the second quarter surpassed previous highs reached at any point in the last twelve months. When comparing year-over-year results, the total value of completed deals increased 26%, and there were 158 more deals announced and 126 more completed deals than in the second quarter of 2014.

Over the last five quarters, an average of 9% more deals have been announced than completed. This disparity results from a range of potential factors that include break-ups, terminations, pending regulatory approval, and challenges confirming settlements of announced deals when transactions involve privately-held companies.

Distribution of PE Deal Values for the Trailing Five Quarters

Looking at PE acquisitions and PE divestitures separately, the following two graphs provide percentages of quarterly deal totals in incremental ranges of value. The transaction data behind the percentages depicted in these graphs does not encompass secondary PE buyouts, wherein both the buyer and seller groups included PE firms.



Source: Zephyr

Note: Includes data for which transaction details were reported and available.

The aggregate value of acquisitions greater than \$2 billion in the second quarter marks a significant increase in total deal value compared with all quarters since this time last year. This subset equals 42% of the total value of PE acquisitions during the second quarter of 2015 and is driven by two large acquisitions. The first was closed in May 2015 for \$11.73 billion (including assumed debt) wherein IFM Investors acquired ITR Concession Company which operates the Indiana Toll Road, a divided highway spanning 157 miles across northern Indiana. Also, in June 2015, Leonard Green & Partners, LNK Partners, TPG Capital Management formed LTF Holdings, acquired Life Time Fitness, a company with 155 fitness and recreational sports centers across the U.S., for \$4 billion.

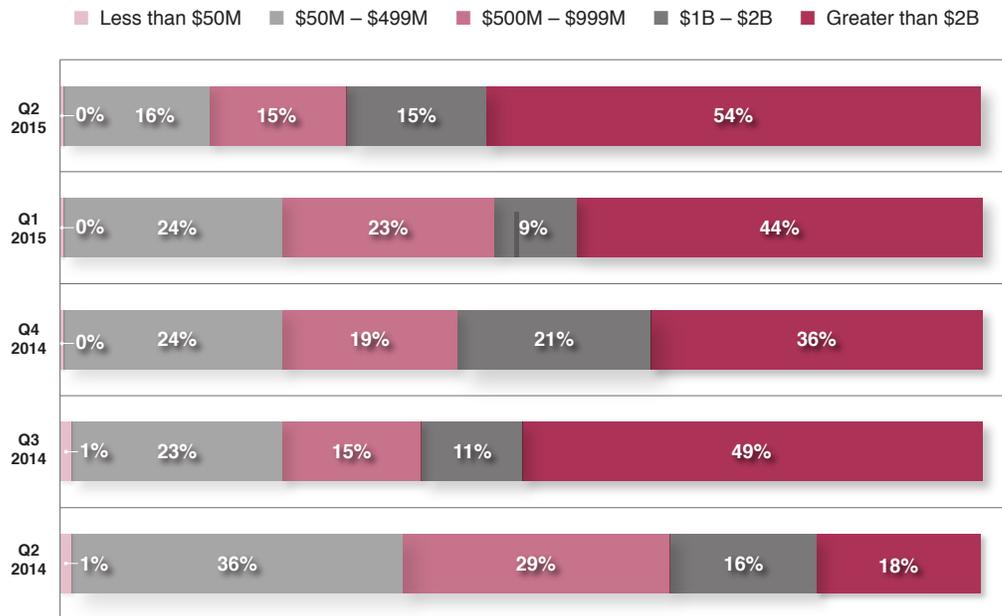
“According to professional services firm PricewaterhouseCoopers, 54% of CEOs in the U.S. plan to complete an acquisition in 2015.”

“Why 2015 Could Be The Best Year For M&A Since The Financial Crisis”, *Forbes*, 06/17/15

“2015 seems to be shaping up as the year of the mega-merger. Indeed, for many corporations, mergers and acquisitions are in the multibillion-dollar range. And increasingly, the flavor of M&A is cross-border – companies buying firms in other countries.”

“Mega-mergers Are Back, but Will the Pace Last?”, Knowledge @ Wharton, 07/20/15

DISTRIBUTION OF VALUE – PE DIVESTITURES



Source: Zephyr

Note: Includes data for which transaction details were reported and available.

For PE divestitures, the seller’s market remains robust. Divestitures greater than \$2 billion have seen a continual quarterly climb in the percentage of overall deal values for three quarters in a row. The growing proportion of these significant divestitures seems buoyed by buyers who remain confident during this period of sustained low interest rates and strengthened equity markets.

The second quarter of 2015 included seven PE divestitures with individual values greater than \$2 billion. The largest sale of PE interests driving this subset was a \$13.35 billion divestiture for a consortium of PE firms including KKR, Goldman Sachs Capital Partners, Blackstone Group, and TPG Capital Management, after exiting its holding company, LVB Acquisition, with its subsidiary Biomet, a manufacturer and distributor of surgical equipment, to Zimmer Holdings in June of this year.

Top 20 PE Firm Transactions by Deal Value Completed During Q2 2015

| | Deal Value USD (in Millions) | PE Role(s) | Target | Seller | Deal Type | Acquiring Entity (Advisors) | Target Primary US SIC Description |
|----|------------------------------|---------------|---|---|-----------|--|---|
| 1 | \$13,350 | Seller | LVB Acquisition Inc. | Kohlberg Kravis Roberts & Company LP, Goldman Sachs Capital Partners, Blackstone Group LP, The Bear Growth Capital Partners LP, Pamlico Capital LP, Ridgmont Equity Partners, TPG Capital Management LP | MAJ | Zimmer Holdings Inc. | Surgical products manufacturer holding company |
| 2 | \$11,725 | Buyer | The ITR Concession Company LLC | Receiver Statewide Mobility Partners LLC | MAJ | IFM Investors Pty Ltd | Toll road concession operator |
| 3 | \$4,000 | Buyer | Life Time Fitness Inc. | Shareholders, Mr. Bahram Akradi | MAJ | LTF Holdings Inc. (Leonard Green & Partners LP, LNK Partners, TPG Capital Management LP) | Sport and fitness centers operator |
| 4 | \$3,600 | Buyer | Riverbed Technology Inc. | Elliott Management Corporation | MAJ | Project Homestake Holdings LLC (Teachers' Private Capital, Thoma Bravo LLC) | Application performance infrastructure software developer, Online cloud-based application performance infrastructure software provider |
| 5 | \$3,450 | Seller | Equipower Resources Corporation, Brayton Point Holdings LLC | Energy Capital Partners LLC | MAJ | Dynegy Resource II LLC, Dynegy Resource III LLC | Gas, coal and oil-fired based electricity generation services, Gas, coal and oil-fired based electricity generation services |
| 6 | \$3,200 | Seller | Auspex Pharmaceuticals Inc. | CMEA Development Corporation, Shareholders, Deerfield Management Company LP, Thomas McNerney & Partners LLC, Panorama Capital LLC | MAJ | Teva Pharmaceutical Industries LTD | Orphan diseases treatment manufacturer, Orphan diseases treatment research and development services |
| 7 | \$3,000 | Seller | Aviv REIT Inc. | Lindsay Goldberg LLC, Shareholders | MAJ | Omega Healthcare Investors Inc. | Real estate investment trust |
| 8 | \$2,687 | Seller | Hilton Worldwide Holdings Inc. | The Blackstone Group LP | MIN | Shareholders | Hotel operator holding company |
| 9 | \$2,400 | Buyer, Seller | Blue Coat Systems Inc. | Teachers' Private Capital, Thoma Bravo LLC | MAJ | Bain Capital LLC | Mobile web security software developer, Online internet-delivered cloud-based security platform operator, Web security software developer |
| 10 | \$2,300 | Seller | Compound Holdings II Inc. | Compound Holdings I LLC | MAJ | Mallinckrodt Enterprises LLC | Critically ill patients biotechnology research and development services holding company, Critically ill patients equipment manufacturer holding company |
| 11 | \$2,090 | Buyer, Seller | Air Medical Group Holdings Inc. | Bain Capital LLC, Brockway Moran & Partners Inc. | MAJ | Kohlberg Kravis Roberts & Company LP | Emergency air ambulance services holding company |
| 12 | \$2,011 | Seller | TPG VI Envision BL LLC, Envision Topco Holdings LLC | Envision Pharmaceutical Holdings LLC, Shareholders | MAJ | Rite Aid Corporation | Mail-order services holding company, Medical insurance services holding company, Pharmacy benefit management services holding company, Specialty drug pharmacy services holding company |
| 13 | \$1,900 | Seller | Websense Inc. | Vista Equity Partners LLC | MAJ | Raytheon | Online cloud-based web, email and data security software developer |
| 14 | \$1,500 | Buyer | Walgreens Infusion Services Inc. | Walgreen Company | MAJ | Madison Dearborn Partners LLC | Home-infusion therapies provider |
| 15 | \$1,500 | Seller | Lynda.com Inc. | Spectrum Equity Investors, Accel Management Company LLC, Meritech Capital Partners, Shareholders, Ms. Lynda Weinman, Mr. Bruce Heavin | MAJ | LinkedIn Corporation | Online media, software, technology and business video-based education platform operator |
| 16 | \$1,400 | Seller | Amored Autogroup Parent Inc. | Avista Capital Holdings LP | MAJ | Spectrum Brands Holdings Inc. | Automotive cleaning products manufacturer holding company, Automotive cleaning sponges manufacturer holding company |
| 17 | \$1,350 | Buyer, Seller | Great Wolf Resorts Inc. | Apollo Global Management LLC | MAJ | Centerbridge Capital Partners LP | Indoor waterpark resorts operator, Resort hotel operator |
| 18 | \$1,343 | Buyer | Pyramid LLC | Shareholders | MAJ | Penn Products Terminals LLC (ArcLight Capital Holdings LLC) | Petrol, diesel fuel, heating oil and kerosene storage services, Petrol, diesel fuel, heating oil and kerosene terminal operator |
| 19 | \$1,250 | Seller | Fundtech Holdings LLC | GTCR LLC | MAJ | DH Corporation | Online financial technology Software-as-a-Service (SaaS) provider holding company |
| 20 | \$1,250 | Seller | Flexus Biosciences Inc. | Kleiner Perkins Caufield & Byers, Shareholders, Celgene Corporation, The Column Group LLC | MAJ | Bristol-Myers Squibb Company | Novel anti-cancer therapeutics developer services |

"In a stunning move, cross-town rivals Zimmer Holdings, Inc. and Biomet, Inc. have agreed to combine in a transaction which is valued at just over \$13 billion and will affect the work lives of more than 14,000 employees and create a company with combined annual revenues of about \$8 billion. This transaction further consolidates the orthopedic industry as it puts together the #2 player (Zimmer) with the #4 player (Biomet) and reduces the number of major, diversified orthopedic implant and instrument companies from 5 to 4."

"Young, R. "Zimmer Agrees to Buy Biomet for \$13.35 Billion", *Orthopedics This Week*, 04/22/2014

"Teva Pharmaceutical Industries Ltd. agreed to acquire Auspex Pharmaceuticals Inc. in a deal valued at roughly \$3.2 billion, increasing the Israel-based drug maker's presence in the market for treatments for central nervous system disorders. Teva is offering \$101 a share for Auspex, a 42% premium to its closing price on Friday. La Jolla, Calif.-based Auspex's lead investigational product is SD-809, which aims to treat chorea associated with Huntington's disease, tardive dyskinesia and Tourette syndrome."

Stynes, T. "Teva to Acquire Auspex in \$3.2 Billion Deal", *The Wall Street Journal*, 03/30/2015

"Rite Aid is squaring up to its drugstore rivals. The company said Wednesday it will pay nearly \$2 billion to add EnvisionRx, a pharmacy-benefits manager, to its business stable. EnvisionRx, which was owned by private-equity firm TPG, brings in sales of about \$5 billion a year with earnings before interest, tax, depreciation and amortization of as much as \$160 million. That will beef up Rite Aid's income and give it the third-largest benefits service in the U.S., trailing behind second-place CVS and industry heavyweight Express Scripts."

Lorenzetti, L. "Rite Aid takes aim at CVS with a \$2 billion purchase", *Fortune*, 02/11/2015

"Canadian financial technology firm D+H agreed to acquire global payment services provider Fundtech for \$1.25 billion in cash, in a bid to expand its service offerings aimed at global financial institutions and large U.S. banks. New York-based Fundtech provides a comprehensive line of transaction banking software that facilitates global and domestic payments, along with financial messaging, corporate cash management and merchant services. Toronto-based D+H said the Fundtech acquisition deepens its U.S. customer base and broadens its prospects in North America. It will now service eight of the top 10, and 32 of the world's top 50 banks, along with about 190 of the top 300 U.S. banks."

Rocha, E. "Canada's D+H Corp to buy payment services firm Fundtech", *Reuters*, 03/30/2015

Source: Zephyr

Deal types: MAJ = Majority Stake Acquisition, MIN = Minority Stake Acquisition, IPO = Initial Public Offering

Acquisitions, Divestitures, and Secondary Buyouts by PE Firms During the Trailing Five Quarters

Uptick in Private Equity Acquisitions

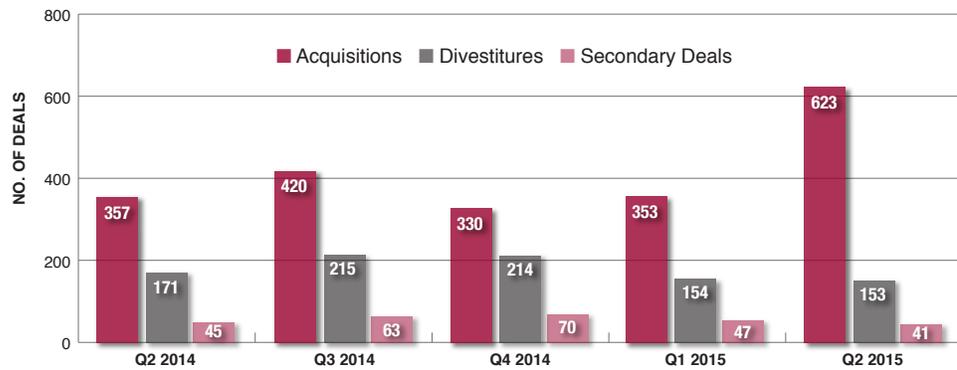
Acquisitions by PE firms increased significantly, both in overall activity and total value, during the second quarter of 2015. Totaling \$38 billion, the value of PE acquisitions more than doubled from the \$14 billion total achieved in the second quarter of 2014. Likewise, the volume of PE acquisitions increased significantly in this past quarter compared to the relatively even year-long period between the second quarter of 2014 and the first quarter of 2015.

Many analysts predict PE activity will remain robust through the rest of this year and into 2016. Some near-term events expected within the PE sector include larger-sized deals and buyouts, more exit activity through IPOs and strategic sales to trade buyers, and similarly, an eventual boom in the private equity secondary market.²

“Expectations are sky-high for increased divestments of portfolio companies, with about three-quarters of private equity respondents, up from two-thirds last year, anticipating an accelerated level of exits within the next 12 months. For private equity firms who still have investments in companies they made before the economy dipped in 2008, now might be a good time to consider selling some businesses and further focusing the portfolio.”

“M&A Trends Report 2015”,
Deloitte, 04/21/15

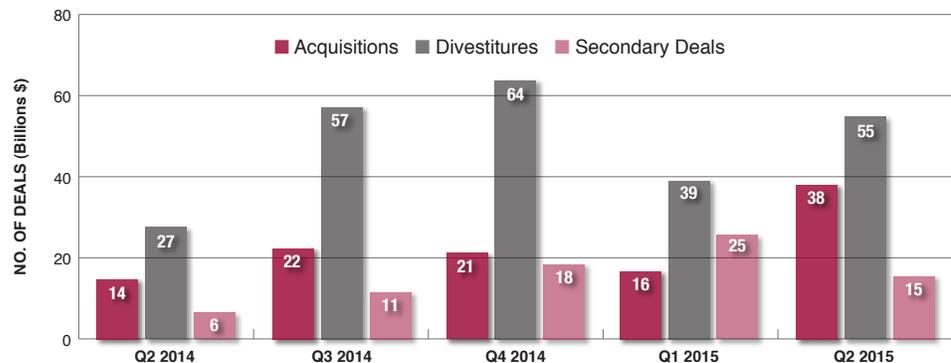
ACQUISITIONS VS. DIVESTITURES BY COUNT OF DEALS
Q2 2014 – Q2 2015



Source: Zephyr

Note: Includes data for which transaction details were reported and available.

ACQUISITIONS VS. DIVESTITURES BY VALUE OF DEALS
Q2 2014 – Q2 2015



Source: Zephyr

Note: Includes data for which transaction details were reported and available.

² “PwC M&A 2014 Review and 2015 Outlook.” PricewaterhouseCoopers. Web. 1 Jan. 2015.

Value of PE Divestitures Rises Significantly

The number of PE divestitures during the first two quarters of 2015 fell below the volume of the last two quarters of 2014 at just above 150 deals per quarter. However, the total value of divestitures increased 29% last quarter compared to the first quarter of 2015. Though total PE divestitures did not reach the \$64 billion mark seen during the last quarter of 2014, the average value per deal did increase almost 20% over that same period.

PE Transaction Analysis by Industry

VALUE AND NUMBER OF DEALS BY INDUSTRY For Q2 2015

| Industry* | Median Deal Value (In Millions) | Average Deal Value (In Millions) | Total Completed Deals** | |
|--|------------------------------------|-------------------------------------|-------------------------|--------|
| | | | Value (In Millions) | Count* |
| Agriculture, Forestry & Fishing | \$350 | \$350 | \$350 | 1 |
| Transportation, Communications & Utilities | \$40 | \$1,141 | \$19,400 | 17 |
| Mining | \$250 | \$239 | \$3,109 | 13 |
| Retail Trade | \$45 | \$221 | \$3,765 | 17 |
| Construction | \$30 | \$465 | \$930 | 2 |
| Finance, Insurance & Real Estate | \$16 | \$320 | \$8,970 | 28 |
| Manufacturing | \$18 | \$233 | \$21,938 | 94 |
| Public Administration | N/A | \$0 | \$0 | 0 |
| Services | \$17 | \$137 | \$45,910 | 335 |
| Wholesale Trade | \$4 | \$347 | \$3,466 | 10 |

* Industries are based on main divisions defined in the United States Department of Labor's Standard Identification Codes.

** Calculations are based on our Zephyr data and include only deals that list values.

As noted earlier in this report, the percentage of PE deals exceeding \$2 billion in value has increased this quarter. Two significant acquisitions and a handful of large divestitures together represented almost half the value of all transactions in the quarter. In the same manner, there is a marked disparity this quarter between median deal values and their averages for almost every target industry as shown in the table above. The most striking example of this divergence is in the Transportation, Communications and Utilities industry. Out of 17 transactions, this industry sector included the \$11.73 billion acquisition by IFM Investors of the ITR Concession Company which operates the Indiana Toll Road driving the average deal value for this industry sector well above the median.

"The strengthening U.S. economy gives bidders confidence their targets will continue to perform well post-acquisition. Foreign buyers such as Miraca Holdings in Japan and environmental services company ERM in the United Kingdom have grown more acquisitive in the United States. And, especially for financial buyers, the strong M&A and IPO markets provide the prospect of lucrative exits down the road."

David Toll. "Valuations Rebound to Near Pre-crisis Levels, Putting Pressure on Sponsors", *Duane Morris/Buyouts Insider*, Summer 2015

“The evolving healthcare industry offers increased opportunity for lucrative private equity investment in 2015, particularly in the subsector of retail health. Both exit and acquisition opportunities are likely to remain robust throughout 2015 as the industry continues to consolidate.”

“Momentum 2015—Middle Market Private Equity Outlook,”
CohnReznick, January 2015

The services industry continued as the most active sector with almost 200 more PE deals completed and almost \$20.5 billion more total value than the prior quarter. Deals in this sector were primarily in commercial physical and biological research, prepackaged software, and computer processing. Of the 335 completed deals in the services industry, six deals were above \$2 billion in value, accounting for 40% of the total services industry deal value.

Manufacturing also remained the industry sector with the second highest total value and total number of PE deals. Despite attracting less than one third the amount of PE deals and totaling less than half the value of transactions than the services industry, factors that point to a quietly thriving manufacturing industry include declining energy costs, falling oil and natural gas prices, and low interest rates with easy access to capital. Also, new technologies offer continued growth and further potential for manufacturing companies to work better, produce faster, and operate more cost efficiently. So despite valuations going up in other industry sectors, today’s pricing and the possibilities in manufacturing appear to keep the sector attractive for PE acquisitions.³

INDUSTRY FOCUS: THE HEALTHCARE INDUSTRY

Private equity participated in 78 transactions in the North American healthcare industry totaling almost \$15.6 billion during the second quarter of 2015. These numbers include deals in healthcare services as well as medical device and digital health device manufacturers, online health-related and medical imaging platform operators, and healthcare data analyses services. Of these transactions, 17 were divestitures amounting to almost 85% of the total value of completed deals in this industry. Five of these divestitures were for transactions that totaled more than \$1 billion and most were for several hundred million dollars. Of the 61 PE acquisitions in the healthcare industry, only one totaled more than \$1 billion and only two acquisitions surpassed \$100 million. The investment landscape spanning healthcare services and medical device manufacturing, including information technology, looks promising for private equity.

³ “Momentum 2015- Middle Market Private Equity Outlook.” CohnReznick LLP. Web. 1 Jan. 2015.

Featured Transactions and Insights

From the transaction activity and related events in the quarter, we select certain deals and market trends that present information we consider especially worthy of further review and analysis by those involved in structuring and negotiating business sales and acquisitions. Our goal is to feature topics that raise unique considerations from a valuation, deal-structure, or subsequent-dispute standpoint.

For our first feature, we consider a PE firm's acquisition of a target company that resulted in a valuation appraisal dispute. We explore this case as part of a growing trend and examine some of the fundamental valuation concepts often pivotal in these court proceedings.

Our second feature this quarter looks at a new securities law that makes it easier for private companies to raise capital from the general public. Regulation A+ peddles the promise to promote economic growth by allowing crowd-sourced equity funding thereby boosting capital raising by start-ups and small businesses.

"It is unclear how blending two unsupportable sets of projections gives a number on which this Court can rely."

In Re Appraisal of Ancestry.com, Inc., Civil Action No. 8173-VCG, *Memorandum Opinion*, January 30, 2015, page 41

Ancestry.com Acquisition—An Appraisal Dispute

Disputes over the value of companies are common, particularly in an acquisition setting. However, there has been a recent surge in the number of appraisal disputes brought forth in the Delaware Court of Chancery. Using the Ancestry.com appraisal dispute as an example, we will discuss this recent trend and explore some of the common valuation concepts and assumptions that are often central to these disputes.

An Upward Trend in Appraisal Disputes

Appraisal disputes brought forth recently in the Delaware Court of Chancery have more frequently involved shareholder activists or hedge funds that acquire shares of a company after a merger or acquisition is announced and then assert appraisal rights once the deal is finalized. The objective of this strategic investment tactic, often referred to as “*appraisal arbitrage*,” is to obtain a higher court-determined price, coupled with guaranteed accruing interest.⁴ Delaware is where more than half of U.S. publicly-traded companies are incorporated and its laws allow shareholders that dissent or abstain from voting on a cash transaction to pursue an appraisal claim that the fair value of the company is higher than the corporate buyout price.⁵ Equity laws in Delaware are set up to protect dissenting or minority shareholders from an undervalued deal price, which is more likely to occur in private equity buyouts, management buyouts, or controlling stockholder transactions.

The number of appraisal petitions filed in Delaware has increased significantly. In 2013, there were 28 appraisal petitions filed, representing 17% of all appraisal-eligible transactions, an increase from the 5% average from 2004 through 2010, and 10% in 2011.⁶ This increasing trend in appraisal petitions continues an upward curve with 33 appraisal cases filed in 2014, and almost 30 in the first half of 2015 alone.⁷ Also, the success rate for the petitioners in the Delaware Court of Chancery has been favorable for decades. Of appraisal disputes that have gone to trial since 1993, more than 80% have resulted in higher prices.⁸

“Ultimately, I am faced with an appraisal action where an open auction process has set a market price, where both parties’ experts agree that there are no comparable companies to use for purposes of valuation, and where management did not create projections in the normal course of business, thus giving reason to question management projections, which were done in light of the transaction and in the context of obtaining a fairness opinion.”

In Re Appraisal of Ancestry.com, Inc., Civil Action No. 8173-VCG, Memorandum Opinion, January 30, 2015, page 43

⁴ Interest accrues on the fair value amount determined by the court at five percent above the Federal Reserve discount rate, compounded quarterly. 8 Del. C. §262(h) (2015).

⁵ 8 Del. C. §262(h) (2015).

⁶ “New Activist Weapon - A Look At Appraisal Arbitrage Cases.” *Law360*, 8/7/2014.

⁷ Hoffman, Liz. “Wall Street Law Firms Challenge Hedge-Fund Deal Tactic.” *Wall Street Journal*, 4/6/2015.

⁸ Hoffman, Liz. “Judge Rules in Favor of Hedge Fund ‘Appraisal Arbitrage’ Strategy.” *Wall Street Journal*, 1/7/2015.

Ancestry.com Dispute

Ancestry.com (“Ancestry”) is one of the largest online resources for family history, with over two million subscribers.⁹ Established as a publishing company in 1983, Ancestry was a publicly traded company until it was acquired in December 2012 by the European private equity firm Permira, along with members of Ancestry’s management (including the CEO and CFO) and Spectrum Equity (Ancestry’s largest shareholder at the time). The acquisition purchase price was \$1.6 billion, or \$32 per share, which reflected a 41% premium over the market price prior to a June 6, 2012 Bloomberg announcement that Ancestry was shopping itself to potential buyers. Soon after this information became known to the public, nine potential bidders emerged. Non-binding bids from seven of the nine ranged from \$30 to \$38 per share.¹⁰ The auction process continued through October 2012 and ended when Permira submitted a bid of \$31 per share. After negotiations, the final price per share landed at \$32 and the deal closed on December 27, 2012.¹¹

After the auction was publicly announced, but before the deal was completed, certain hedge funds, including Merion Capital Group, Merlin Partners, and Ancora Merger Arbitrage Fund (collectively, the “Petitioners”), purchased 1.4 million shares of Ancestry’s stock. Following the deal’s finalization in December, the hedge funds petitioned the Delaware Chancery Court for an appraisal proceeding.

As part of appraisal actions in Delaware, both parties bear the burden of establishing fair value. Thus, each side engaged experts to submit a valuation report opining on Ancestry’s fair value as of the buyout date. Not surprisingly, the Petitioners’ expert valued the shares at approximately \$11 higher than the \$32 per share transaction price, while Ancestry’s expert valued the shares at approximately \$1.50 below the transaction price. In his ruling, Vice Chancellor Sam Glasscock III wrote that he found each expert’s approach “less than fully persuasive” and that the analyses appeared to be “result-oriented riffs.”¹² Ultimately, using all relevant factors, including his calculated fair value of \$31.79 per share, the Vice Chancellor ruled that the transaction price of \$32 was fair value.

Valuation Considerations

Valuation concepts are the fundamental drivers of mergers and acquisitions. At the same time, the application of these valuation concepts can vary greatly. In the Ancestry dispute, both experts utilized a discounted cash flow (“DCF”) income approach to value Ancestry, as opposed to a market approach such as a comparable company or comparable transaction analysis. Though the experts used the same approach, they parted ways on a number of valuation issues, especially the inputs that drive expected future cash flows.

“This Court has expressed skepticism in past cases as to management-prepared projections when those projections are not made in the ordinary course, and are instead made in contemplation of the sale of the company.”

In Re Appraisal of Ancestry.com, Inc., Civil Action No. 8173-VCG, Memorandum Opinion, January 30, 2015, page 45

⁹ Ancestry | About Ancestry. <<http://corporate.ancestry.com/about-ancestry/>>.

¹⁰ In Re Appraisal of Ancestry.com, Inc., Civil Action No. 8173-VCG, Memorandum Opinion, January 30, 2015, page 8.

¹¹ Id., page 12.

¹² Id., pages 42-43.

Some key valuation considerations at the heart of the Ancestry dispute include:

- **Projections**—What is the appropriate growth rate? What sensitive assumptions are included in projected cash flows?
- **Normalized Earnings**—Should the earnings margin for the last year’s projections be applied into perpetuity, or should an average be used? Do earnings need to be adjusted for any one-time expenses?
- **Projected Tax Rate**—Should the projected tax rate be based on historical outcomes or future expectations?

Setting Realistic Projections

Projections are typically the most important input in a DCF analysis. They are also the most sensitive, as they require significant judgment. Importantly, management is typically most suited to develop projections since they are most knowledgeable about the business and its future prospects. The risk becomes whether or not management’s projections are overly optimistic.

In the case of Ancestry, in the ordinary course of business, management did not prepare projections beyond one year, and they admittedly developed overly optimistic projections at the beginning of the auction process to tout their business. The projections were based on the key metrics of Ancestry’s subscription-based business: gross subscriber additions, churn (the number of cancelled subscriptions), and subscriber acquisition cost. During the bidding process, bidders provided candid feedback regarding the key metrics which led to a second set of more conservative projections.

Petitioners’ expert chose to weigh equally the original overly optimistic projections with the new conservative projections in his valuation. The Vice Chancellor best described the approach as follows: “[i]t is unclear how ‘blending’ two unsupportable sets of projections gives a number on which this court can rely.”¹³ As such, the Vice Chancellor ruled that the conservative projections, even with their limitations, best represented management’s view of Ancestry.

Sustainable Normalized Earnings Assumptions

Projected earnings (or cash flows) are a critical factor driving estimated value. The earnings margin in the final year (or the year immediately following the final year) of the projection period is a key component in calculating terminal value,¹⁴ which itself is a significant component of the DCF analysis. In determining the appropriate earnings margin to apply the perpetuity growth rate, one must consider whether to average multiple year’s earnings margins, normalize the earnings margin to account for certain expenses or situations not expected to occur in the future, or utilize the final year’s earnings margin. Because each situation is different, certain factors need

“In fact, this Court has held, where...the transaction giving rise to the appraisal resulted from an arm’s-length process between two independent parties, and no structural impediments existed that might materially distort ‘the crucible of objective market reality,’ a reviewing court should give substantial evidentiary weight to the merger price as an indicator of fair value.”

In Re Appraisal of Ancestry.com, Inc., Civil Action No. 8173-VCG, Memorandum Opinion, January 30, 2015, page 35

¹³ *Id.*, page 41.

¹⁴ Terminal value can be described as the prospective value as of the end of the discrete projection period.

to be examined when deciding whether to normalize, including: reasonableness of the projection period margins, long-term competitive forces, one-time events or expenses, and the company's business cycle. In the Ancestry matter, the Petitioners' expert chose to use the final year's earnings margin, citing Ancestry's trend of increasing margins and the conservative nature of the new projections. Ancestry's expert averaged four years of projected margins, claiming that margins for growth companies tend to erode over the long-term as competition enters. The Vice Chancellor agreed, again citing the fact that the new projections represented management's best view of Ancestry going forward.

Reasonable Projected Tax Rate

The projected future tax rate used in a DCF analysis often has a substantial impact on the valuation outcome. And, similar to sales projections, projecting a tax rate can require significant judgment and sometimes input from tax law expertise. The Petitioner's expert utilized a 35% tax rate, obtained by conservatively adding 1% to the current projected tax rate of 34% provided by Permira's tax consultant. Ancestry's expert used a marginal tax rate of 38%, which was based on the historical effective tax rates. In the end, Vice Chancellor Glasscock sided with Ancestry's expert, noting the transient nature of tax law and that it would be speculative to apply an anticipated current tax rate into perpetuity.

Supportable and Defensible Valuations Generally Prevail

Disputes can be challenging for the court as often each side presents a value that works in their favor. This is especially true for the mounting number of appraisal actions in the Delaware Court of Chancery, where the plaintiffs necessarily put forth a value above the transaction price. Vice Chancellor Glasscock's rulings in the Ancestry dispute illustrate how inputs and techniques are at the discretion of the appraiser and credibility becomes essential to building a defensible valuation. Seasoned judges, especially those in the Chancery Court, can often detect when inputs and judgments are results-oriented and distinguish them from those with sound and supportable conclusions. In disputes where both parties bear the burden of proving fair value, forming a supportable appraisal is essential to earning credibility in the courtroom and securing a favorable outcome.

"The party with the burden [of proof] must explain why its version of the facts is the more plausible in a way comprehensible and convincing to the trier of fact; if not, it has failed to carry its burden, and the judge's duty is accordingly clear. A judge in a bench trial relies, therefore, on the burden of proof; he holds on to it like a shipwreck victim grasps a floating deck-chair or an ex-smoker hoards his last piece of nicotine gum."

In Re Appraisal of Ancestry.com, Inc., Civil Action No. 8173-VCG, Memorandum Opinion, January 30, 2015, page 2

Regulation A+ Broadens the Landscape for US Capital Markets

Regulation A+ is the latest addition to the Jumpstart Our Business Startups Act (“JOBS Act”) and offers a new set of rules providing ordinary and unaccredited investors opportunities to venture into the pre-IPO investment market. Since its implementation by the SEC on June 19, 2015, commentators and industry analysts have hailed the new by-law extolling a potentially viable other avenue for small businesses and midsized companies to obtain vital funding. While this is good news for start-up businesses and small investors, some might guess the new policies invite competition for PE investors. As promising new enterprises are granted an alternative vehicle for raising capital, and mostly-unaccredited crowdfunders seek early entry into private placements with the potential for satisfying returns, will PE firms need to jockey for stakes in young companies promising long-term revenue growth?

The Job of The JOBS Act

Enacted on April 5, 2012, the JOBS Act provides smaller Emerging Growth Companies (“EGCs”)¹⁵ greater access to public capital markets by easing various securities regulations.¹⁶ In a departure from more rigorous rules, an EGC was allowed to file an IPO under lightened disclosure requirements, reduced risk, and lower costs than typically required for public companies. By its structuring, the legislation has provided the framework for crowdfunding¹⁷ in the equity market.

On September 23, 2013, Title II of the JOBS Act went into effect. This regulation permitted startups and small businesses to publicly advertise that they were looking for funding and generally solicit shares via social media and public websites. However, the new ruling left out any provision allowing companies to make offers to smaller non-accredited investors interested in investing in budding private businesses and startups. Only wealthy or “accredited”¹⁸ investors were authorized to participate in these pre-IPO securities offerings and accredited investors make up only one percent of all investors.¹⁹

Not long after rolling out Title II, the SEC put forth in December 2013 a proposal for Title III of the JOBS Act. Still awaiting enactment by Congress, anticipated in October 2015, these rules would ostensibly allow the participation of everyday non-accredited retail investors through crowdfunding.²⁰ Once passed, Title III will enable start-ups in their earliest stages to fundraise via offerings up to \$1 million annually through broker-dealers and funding portals from non-accredited investors and, depending on the final legislation, without any SEC or state review.²¹

“The extent to which Regulation A+ will result in issuers and other market participants actually using Regulation A to raise capital will depend on a number of factors—including how it compares to other methods for raising capital, how the SEC Staff will administer the offering process and the market’s acceptance of Regulation A-compliant offering materials.”

Thomas J. Kim, “Regulation A+ Takes Effect”, *Harvard Law School Forum on Corporate Governance and Financial Regulation*, June 20, 2015

¹⁵ Generally, an entity is considered an EGC if it has annual gross revenues of less than \$1 billion during its most recently completed fiscal year.

¹⁶ “Jumpstart Our Business Startups (JOBS) Act.” SEC.gov. <<https://www.sec.gov/spotlight/jobs-act.shtml>>.

¹⁷ Crowdfunding is the participation of people who network and pool their money and other resources, usually via the Internet, to support efforts initiated by other people or organizations. This funding is available for virtually any project. Kickstarter, Indiegogo, AngelList, RocketHub, SomoLend have led this developing fundraising sector.

¹⁸ Investors with a net worth of more than \$1 million or an annual income greater than \$200,000.

¹⁹ 19 Lion, J. “JOBS Act Title III and Crowdfunding: What We Know So Far,” *Onvest*, 3/19/2015.

²⁰ Nicastro, S. “What does regulation A+ do for small businesses?” *Chicago Tribune*, 7/22/2015.

²¹ Guzik, S. “Regulation A+ Day 1: A Look Past the Mainstream Media Headlines.” *Crowdfund Insider*, 6/22/2015.

Private Placements for the People

The rules under Regulation A+, mandated by Title IV of the JOBS Act, and left by Congress to be determined by the SEC, update and expand Regulation A of the Securities Act of 1933 which provided registration exemptions for smaller issuers of securities. Regulation A+ allows upstart businesses to raise up to \$50 million in new capital over a 12-month period, subject to eligibility, disclosure, and reporting requirements.²² Previously, under Regulation A, this ceiling was only \$5 million.

Regulation A+ provides for two tiers of offerings, each of which are subject to basic requirements regarding issuer eligibility and disclosure as established in Regulation A. Under Tier 1 offerings, companies can offer up to \$20 million of securities in a 12-month period, including no more than \$6 million on behalf of selling securityholders that are affiliates of the issuer.²³ Tier 2 offerings have an annual offering limit of \$50 million, including no more than \$15 million on behalf of selling securityholders that are affiliates of the issuer. In addition to the basic requirements, Tier 2 offerings have additional requirements, including stipulations that issuing companies (a) provide audited financial statements, (b) file annual, semiannual, and current-event reports, and (c) limit the amount of securities that a non-accredited investor can purchase to no greater than 10% of that investor's annual income or net worth. Tier 2 offerings would not, however, be subject to state securities law registration.

REGULATION A+ OFFERINGS EFFECTIVE JUNE 19, 2015

| | Prior Regulation A | Regulation A+: Tier 1 | Regulation A+: Tier 2 |
|--|--|---|---|
| Offering Limit | Up to \$5 million in a 12-month period | Up to \$20 million in a 12-month period | Up to \$50 million in a 12-month period |
| Type of Investors | Accredited ²⁴ only | Accredited & non-accredited | |
| Investor Limits | None | | Non-accredited investors limited to 10% of annual income or net worth, whichever is greater |
| Solicitation | May solicit from general public | | |
| Blue Sky / State Securities Laws Registration | Compliance with Blue Sky laws required | Not exempt, but eligible for NASAA ²⁵ Coordinated Review (state-related requirements and review) | Exempt (no requirement to register in each state securities are sold) |
| Audit / Ongoing Reporting Requirements | No audit or ongoing reporting requirements | | Audited financials, along with annual, semi-annual and current event reporting requirements |
| SEC Filing Requirement | Form 1-A (including Offering Circular) | | |

"At its core, the mandate of Regulation A+ is to help increase the access of smaller companies to capital. This is obviously a very important objective. Our rulemaking goal is to make Regulation A+ an effective, workable path to raising capital that—very importantly—also builds in the necessary investor protections."

Chair Mary Jo White, "Remarks at SEC Open Meeting", U.S. Securities and Exchange Commission, December 18, 2013

²² "SEC Adopts Rules to Facilitate Smaller Companies' Access to Capital." U.S. Securities and Exchange Commission, 5/25/2015 <<http://www.sec.gov/news/pressrelease/2015-49.html>>.

²³ For offerings of up to \$20 million, issuers can elect to offer securities under Tier 1 or Tier 2 requirements.

²⁴ Accredited investors are individuals who earn more than \$200,000 per year or have a net worth of over \$1,000,000, or entities with over \$5,000,000 in assets.

²⁵ North American Securities Administrators Association (NASAA).

Perhaps the most important element of Regulation A+ is that it allows eligible companies to solicit funding from the general public, as opposed to being limited to accredited investors only. Furthermore, advertising can take place online, enabling businesses to reach potential investors through varied social media outlets. Ultimately, the new regulation allows companies to benefit from an entire population of small investors and the easy access of crowdfunding outlets.²⁶ With Tier 2 offerings, for example, a venture capitalist can invest in a market that was previously available to only institutional and large investors. Importantly, while selling security holders and affiliates are subject to resale limitations, Regulation A+ allows for unrestricted secondary sales by non-affiliates, providing a liquidity benefit.

Reg A+ Has Its Minuses

The newly enacted Regulation A+ attempts to increase access to capital for small and growing companies by boosting the threshold amount for capital that can be raised via public venues and by streamlining filing and reporting requirements. However, many consider the process imperfect.

For example, the process can be cost prohibitive for small start-up companies with limited liquidity or if companies aim to limit their amounts of fundraising. To prepare the necessary documents and to comply with reporting obligations, small companies encounter attorney filing fees, accounting and audit costs, broker-dealer or other promotional costs, and depending on the size of the offering, these issuers will need to pay state regulatory fees. Total combined costs could range from \$40,000 to \$100,000.²⁷

It's also time consuming. According to the rules, the SEC must review a company's offering documents and financials (audited statements for Tier 2) before giving approval for that company to raise money. If the same degree of examination is applied as the SEC traditionally applies to more-established companies preparing for an IPO or Form S-1, the process could take longer than a small company in urgent need of capital can afford.

Additionally, no system for a secondary market is set up for small investors in this pre-IPO crowd-sourced market. The infrastructure for exchanging otherwise-liquid Regulation A+ securities does not exist.²⁸

“Small companies are essential to the livelihood of millions of Americans, fueling economic growth and creating jobs. As I have said in the past, it is critically important for the Commission to consider ways that our rules can facilitate capital-raising by smaller companies. Congress recognized the importance of providing new avenues for capital-raising when it adopted the JOBS Act, which provides for crowdfunding as well Regulation A+.”

Chair Mary Jo White, “Statement at Open Meeting on Rule 15b9-1 and Reg A+”, U.S. Securities and Exchange Commission, March 25, 2015

²⁶ Barnett, C. “SEC Democratizes Equity Crowdfunding With JOBS Act Title IV.” *Forbes*, 5/26/2015.

²⁷ Nead, N. “How Much Should Regulation A+ Cost?” *CrowdFund*. <<http://crowdfund.co/reg-a-cost/>>

²⁸ Nead, N. “Downsides of Reg A+” *CrowdFund*. <<http://crowdfund.co/downsides-of-reg-a/>>

Also, less stringent alternatives already exist for small companies to raise capital. While Regulation A+ offerings allow companies to solicit the throngs of small investors, it remains easier, more cost-effective, and quicker to raise capital from accredited investors through Regulation D offerings.²⁹ Even though, in 2013, the SEC in 2013 estimated 95% of registered offerings would be eligible to raise money under revised Regulation A rules, and Regulation A+ enables companies to sell securities to unaccredited investors, given the time, expense, and effort needed, the next logical question is why should they bother?³⁰ Regulation D offerings often do not require companies to register their securities with the SEC and on average cost small companies between \$7,000 and \$20,000.³¹

Enemy of the States

A consensus among lawmakers in 2012 concluded that a low offering limit together with arduous state registration requirements in effect discouraged companies from taking advantage of Regulation A, so an extension to the capital-raising rules allowed small companies to raise up to \$50 million from the public.³² The new rules also pre-empted states from reviewing deals over \$20 million. For deals smaller than this amount, companies could submit to state-level reviews, or opt out and accept the more rigorous North American Securities Administrators Association (NASAA) Coordinated Review Program's disclosure requirements instead.

With the new Federal law overstepping our states' Blue Sky registration laws, legal challenges to the SEC have been filed by both Massachusetts and Montana claiming the Regulation A+ rules unlawfully scale back their powers to police public offerings. Both states petitioned a U.S. Court of Appeals to review the SEC's rules.³³

Any Payoff for Private Equity?

The impact of Regulation A+ remains to be seen. By the SEC's own data,³⁴ since 2009, the original Regulation A was scarcely utilized by emerging companies as an offering method. If Regulation A+ offers a viable capital fundraising alternative, then an influx of average everyday Americans may be investing during the initial stages of private companies. With this investment, start-ups and small companies may thrive. If the economy prospers from these new freedoms offered to small businesses under Regulation A+, so too will grow the role of private equity firms.

“State regulators have a long and proud history of protecting investors, and their localized knowledge and resources have been instrumental in detecting and preventing fraud. Moreover, the Commission was also aware that NASAA was developing a coordinated review program intended to lessen the burden of multi-state review of Regulation A offerings.”

Commissioner Luis A. Aguilar, “Helping Small Businesses and Protecting Investors”, U.S. Securities and Exchange Commission, March 25, 2015

²⁹ Ivanov, I. and Banguess, S. “Capital Raising in the U.S.: The Significance of Unregistered Offerings Using the Regulation D Exemption.” Feb. 2012.

³⁰ “Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act.” U.S. Securities and Exchange Commission, 12/18/2013. <<http://www.sec.gov/rules/proposed/2013/33-9497.pdf>>.

³¹ Nicastro, S. “What does regulation A+ do for small businesses?” Chicago Tribune, 7/22/2015.

³² Lynch, S. N. “SEC refuses to stall ‘Regulation A’ rules on small offerings.” Reuters, 6/17/2015.

³³ Lynch, S. N. “Two states sue U.S. SEC over JOBS Act public offering rules.” Reuters, 5/26/2015.

³⁴ “Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A).” U.S. Securities and Exchange Commission, 5/25/2015. <<http://www.sec.gov/rules/final/2015/33-9741.pdf>>.

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