

# ESOP Sponsor Company Stock Valuation and Independent Financial Advisor Due Diligence Procedure Checklist

*Valuation analysts (“analysts”) and independent financial advisers (“advisers”) are often asked to opine on transactions involving an employee stock ownership plan (“ESOP”) and the ESOP sponsor company stock. These transactions may include the purchase, sale, contribution, or other transfer of the sponsor company stock. In the case of a proposed stock purchase transaction, the ESOP may request an opinion that the ESOP trust is not paying more than adequate consideration for the sponsor company stock. In the case of a proposed stock sale transaction, the ESOP may request an opinion that the ESOP trustee is not receiving less than adequate consideration for the sponsor company stock. Accordingly, before approving the sponsor company stock transaction, the ESOP trustee (or any other ESOP fiduciary) may request an independent valuation opinion or an independent financial adviser transaction fairness opinion. This discussion presents a checklist of procedures that analysts and advisers may consider in developing their transactional analyses and in reporting their transaction opinions. This checklist includes both business valuation procedures that analysts may consider in performing the stock valuation and due diligence procedures that advisers may consider in preparing the transaction fairness opinion.*

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## INTRODUCTION

The Employee Retirement Income Securities Act (hereinafter “ERISA”) provides that a sponsor company employee stock ownership plan (hereinafter “ESOP”) may pay no more than “adequate consideration” for the purchase of the sponsor company stock. Such sponsor company stock may include, for example, (1) common stock or (2) convertible preferred stock.

With regard to the ESOP purchase or sale of the sponsor company securities, the ERISA adequate consideration provisions have two general components:

1. A fair market value pricing determination component
2. A transactional good faith process component

The ERISA adequate consideration provisions require that the ESOP trustee (and other ESOP fiduciaries) should determine—in good faith—the fair market value of the sponsor company stock involved in the proposed purchase or sale transaction. This determination should be made in compliance with the applicable regulations issued by both (1) the Internal Revenue Service and (2) the United States Department of Labor.

This discussion presents a checklist that may be considered by valuation analysts (“analysts”) both in the development of a sponsor company stock valuation and in the reporting of the transaction-related sponsor company stock valuation.

In addition, this checklist may be considered by independent financial advisers (“advisers”) in the performance of a financial advisory due diligence analysis with regard to the pending stock purchase or stock sale transaction. Such a financial advisory analysis may be performed prior to the issuance of a transaction fairness opinion related to the sponsor company stock purchase or stock sale. The analyst and the adviser may be the same person.

This checklist may also be considered by an ESOP trustee or by any other ESOP fiduciary in the good faith assessment of an ESOP sponsor company stock valuation and/or of a financial advisory transaction fairness opinion. This checklist may also be considered by an ESOP administrator or by any other ESOP adviser (e.g., legal counsel, accountant, etc.) who may rely on ESOP sponsor company stock valuations.

As with any standardized procedure checklist, analysts, advisers, trustees, or other ESOP-related parties should exercise caution in the application of this checklist. This caution should be considered before this checklist (or any other procedure checklist) is applied in:

1. an ESOP-related sponsor company stock valuation or
2. an ESOP-related transaction financial advisory due diligence.

These application and reliance cautions are further discussed below.

## TRANSACTIONS INVOLVING AN OPINION OF ADEQUATE CONSIDERATION

The following list summarizes many of the typical forms of transactions involving an ESOP and the employer corporation securities. These types of ESOP sponsor company stock purchase or sale transactions often require the assessment of adequate consideration:

- A contribution of the sponsor company stock to the ESOP
- A purchase of the sponsor company stock by the ESOP



- The finalization of the ESOP sponsor company stock acquisition loan
- A contribution of cash to the ESOP, where the cash is then used to buy the sponsor company stock (either directly from the sponsor company or from other sponsor company shareholders)
- The assessment of an unsolicited purchase offer (from, say, a sponsor company acquirer) for the ESOP-owned sponsor company stock
- The purchase of the ESOP-owned sponsor company stock by a sponsor company acquirer
- The distribution of cash to the ESOP participants in place of a distribution of the sponsor company stock

In each of these types of sponsor company stock transactions, the ESOP trustee or other ESOP fiduciary should address the adequate consideration of the proposed transaction. The procedure checklist presented in this discussion is intended to be useful to analysts, advisers, trustees, and other ESOP-related parties in the assessment of adequate consideration related to the pending transaction.

## STOCK VALUATION OPINIONS AND TRANSACTION FAIRNESS OPINIONS

As part of the adequate consideration assessment process, the fair market value of the sponsor company stock should be estimated as of the date of the

ESOP purchase or sale of the employer corporation securities. This fair market value estimation is typically documented and reported in a sponsor company stock valuation opinion.

The procedure checklist presented in this discussion is intended to assist the analyst in the development and reporting of the sponsor company stock fair market value valuation.

Some transactions involving ESOP-owned securities also involve an assessment of the fairness—from a financial perspective—of the proposed stock purchase or sale transaction. This statement is particularly true in the case of multi-investor stock purchase or sale transactions. In these cases, an adviser will typically perform a financial advisory due diligence exercise—and issue a transaction fairness opinion.

The procedure checklist presented in this discussion is also intended to be useful in the assessment of transactional fairness.

## CONSIDERATIONS REGARDING THE PROCEDURE CHECKLIST

It is important for analysts, advisers, and other ESOP-related parties to consider the many limitations regarding the application of any standardized procedure checklist. This cautionary statement is true whether the procedure checklist applies to either (1) a sponsor company stock valuation or (2) a financial advisory transaction due diligence analysis.

First, the procedure checklist should never substitute for the analyst or the adviser (or the ESOP trustee) independent professional judgment.

Second, no procedure checklist can be comprehensive and all-inclusive. For example, the following procedure checklist does not discuss every generally accepted sponsor company stock valuation method—but only the more common sponsor company stock valuation methods.

Third, the terminology used in the procedure checklist may be subject to different interpretations. For example, the checklist refers to “valuation premiums and discounts”; the experienced analyst or adviser will understand that this term includes consideration of all related valuation factors, such as: the discount for lack of marketability, the effects of the ESOP sponsor stock repurchase liability, the discount for lack of ownership control/premium for ownership control, and the effects of financial leverage.

Fourth, this procedure checklist does not include a complete consideration of all of the possible aspects of:

1. an ESOP sponsor company leveraged stock transaction or
2. an ESOP sponsor company leveraged stock valuation.

Fifth, this procedure checklist assumes that the valuation subject is the stock of a private corporation sponsor company—that is, the indicated valuation procedures assume that there is no organized or efficient secondary market for the sponsor company securities.

Finally, this procedure checklist primarily relates to the business valuation process and the financial adviser due diligence process—and not to the content or format of the stock valuation report or the financial adviser fairness opinion. Therefore, this procedure checklist does not include a “table of contents” for:

1. an ESOP stock valuation report or
2. an ESOP transaction fairness opinion.

However, since this content is an important issue to parties who rely on the ESOP stock valuation report, any written ESOP sponsor company stock valuation report should include an assessment of the following factors:

1. The nature of the subject business and the history of the sponsor company
2. The economic outlook and the condition and outlook of the specific industry in which the sponsor company operates
3. The book value of the sponsor company stock and the financial condition of the sponsor company business
4. The earnings capacity of the sponsor company
5. The dividend-paying capacity of the sponsor company
6. Whether or not the sponsor company has goodwill or other identifiable intangible asset value
7. The market price of securities of corporations engaged in the same or a similar line of business that are actively traded on an organized stock market
8. The marketability, or lack thereof, of the sponsor company stock
9. Whether or not the seller would be able to obtain an ownership control price premium with regard to the sale of the sponsor company stock

## THE PROCEDURE CHECKLIST IS NOT A STOCK VALUATION OR FAIRNESS OPINION SCORE CARD

This procedure checklist should not be used to derive a quantitative score used to review or evaluate a sponsor company stock valuation or financial adviser transaction opinion.

That is, the fact that an individual analysis does not receive a “score” of 100 does not indicate that the analysis is not in compliance with promulgated regulations or with generally accepted professional standards. Such an analysis may still be consistent with generally accepted professional standards and practices.

And, such an analysis may provide the appropriate basis upon which the ESOP trustee may assess adequate consideration within the context of a pending sponsor company stock purchase or sale transaction.

Likewise, the fact that an individual analysis may receive a high “score” does not necessarily indicate that the analysis is prepared in compliance with all promulgated regulations and generally accepted professional standards. Such an analysis may still be inconsistent with professional standards and practices. And, such an analysis may be an inadequate basis upon which the ESOP trustee may assess adequate consideration within the context of a pending sponsor company stock purchase or sale transaction.

The procedure checklist presented in this discussion is intended to provide a guide that analysts and advisers—and ESOP fiduciaries—can use as a reminder in the development of sponsor company stock valuations and/or transaction fairness opinion.

The procedure checklist may be used to document whether the appropriate analytical procedures were (or were not) performed. But this checklist will not evaluate the analytical quality and the professional judgment involved in the performance of the actual procedures.



## SUMMARY AND CONCLUSION

The procedure checklist that accompanies this discussion lists the generally accepted procedures that are performed during an analytical process. That process is involved in either a sponsor company stock valuation or a financial adviser transaction fairness opinion.

The procedure checklist is presented to provide practical guidance to analysts and advisers, to ESOP fiduciaries, and to other ESOP-related parties. The checklist may be useful in the conduct of the stock valuation or the financial adviser fairness opinion. The checklist may also be useful in the analyst’s or the adviser’s internal quality control review of:

1. the sponsor company stock valuation report or
2. the sponsor company stock purchase or sale transaction fairness opinion.

Of course, the procedure checklist presented in this discussion should not be used as a substitute for the professional experience and the reasoned judgment of the analyst or the adviser. In addition, the procedure checklist should not be used as a substitute for the good faith due diligence, prudence, and professional care of the ESOP trustee or other ESOP fiduciary.

## Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process

Item	Yes	No	NA	Work Paper Reference	Procedure
					I. <u>Engagement letter and/or engagement work product</u>
1.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. State the purpose and objective of the engagement
2.					1. Identify the purpose (fairness opinion, annual sponsor company stock valuation, etc.)
3.					2. Identify the objective (estimate the fair market value of the ESOP ownership interest, etc.)
4.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Define the business/security valuation or the financial adviser assignment
5.					1. Identify the retaining party
6.					2. Identify the entity subject to the analysis
7.					3. Identify any pending transaction that is the subject of the analysis
8.					4. Identify the current legal and income taxation form of the subject organization (C corporation, S corporation, limited partnership, etc.)
9.					a. List the state of incorporation
10.					b. List the date of incorporation
11.					5. Identify the specific ownership interest subject to the analysis
12.					6. Identify the valuation date or transaction fairness date (the "as of" date of the analysis)
13.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Document the standard of value and the premise of value to be applied
14.					1. Identify and define the appropriate standard of value (fair market value, fair value, investment value, etc.)
15.					2. Identify and define the appropriate premise of value—based on the assignment instruction or on the analyst's highest and best use consideration (value in use as a going-concern business, value in exchange as an orderly disposition of assets, etc.)
					II. <u>Due diligence collection of data</u>
16.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. Collect and review sponsor company documents and information
17.					1. Request financial information (typically for the prior 5 years and the latest 12-month interim financial statements)
18.					a. Request income statements
19.					b. Request balance sheets
20.					c. Request statements of cash flow
21.					d. Request capital statements
22.					e. Request explanatory financial statement footnotes, explanation of accounting principles, and supplemental disclosures to the financial statements
23.					2. Request a list of subsidiaries (consolidated or not) and/or financial ownership interests in other companies (including relevant historical financial information)
24.					3. Request other relevant financial information
25.					a. Request all financial budgets, plans, projections, or forecasts prepared as of the analysis date

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
26.					b. Request all financial budgets, plans, projections, or forecasts prepared at any time during the five-year period prior to the analysis date
27.					c. Request other financial schedules (accumulated depreciation, inventory, accounts receivable, accounts payable, open purchase orders, production backlog, etc.)
28.					d. Request copies of any existing contracts/leases (employment agreements, noncompete agreements, labor agreements, customer contracts, supplier agreements, real estate leases, etc.)
29.					e. Request amounts and descriptions of any insurance in force (key person, property/casualty, etc.)
30.					f. Request a compensation schedule for senior management and for any employee/owners included in senior management (salary, stock options, etc.)
31.					g. Request prior business, stock, or property valuation reports (prepared for any purpose during the five-year period prior to the analysis date)
32.					h. Request a schedule of dividends paid during the prior five-year period
33.					4. Request copies of any sponsor company financing documents
34.					a. Request copies of all public debt indenture agreements
35.					b. Request copies of all private debt indenture agreements
36.					c. Request any schedule of weighted average debt interest rates
37.					d. Request any schedule of debt service payments during the prior five-year period
38.					e. Request any schedule of required debt service payments over the term of the longest term debt repayment period
39.					5. Request copies of any sponsor company legal documents
40.					a. Request articles of incorporation, bylaws, amendments to each, etc.
41.					b. Request any existing buy-sell agreements, options, rights of first refusal, etc.
42.					c. Request minutes from shareholders' meetings during the prior five-year period
43.					d. Request a list of all stockholders as of the analysis date
44.					1) Number of shares owned by each stockholder
45.					2) Number of shares owned by senior management and employee/owners involved in senior management
46.					e. Request descriptions of all recent prior transactions of the subject stock and any recent bona fide offers to purchase the sponsor company and/or any of the sponsor company securities
47.					f. Request any ESOP-related stock ownership transaction and any ESOP trust documents, including:
48.					1) ESOP-related employer stock acquisition loan agreements

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
49.					2) Sponsor company stock purchase agreements
50.					3) ESOP plan and ESOP trust documents (with all amendments) in place as of the analysis date
51.					4) Other documents that may impact the rights of the holder of the sponsor company securities
52.					6. Request other relevant operational information
53.					a. Request history and description of the sponsor company business
54.					b. Request copies of sales/marketing materials
55.					c. Request locations in which the sponsor company operates
56.					d. Request major customers by annual dollar volume
57.					e. Request major suppliers by annual dollar volume
58.					f. Request major competitors (and size and/or market share, if available)
59.					g. Request a breakdown of personnel (by department or function) and resumes of the senior management
60.					h. Request a description of all patents, trademarks, copyrights, and other owned/licensed intellectual property
61.					i. Request a description of any identifiable intangible assets not recorded on the sponsor company balance sheet
62.					j. Request a description of any other contingent and/or off-balance-sheet assets or liabilities
63.					k. Request a list of industry or trade associations, industry or trade publications, and corporate memberships of the subject sponsor company business
64.					l. Request a description and current property appraisal (if available) of all nonoperating assets of the subject sponsor company business
65.					m. Request operational (e.g., production) budgets, plans, projections, or forecasts
66.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Conduct sponsor company management interviews, if possible
67.					1. Speak with senior management in all relevant functional areas, regarding:
68.					a. Historical operations and results
69.					b. Prospective operations and results
70.					c. Responsibility for functional areas
71.					2. Discuss with senior management and/or outside legal counsel with regard to any pending or potential litigation or claims against the sponsor company, if possible, including:
72.					a. Commercial litigation
73.					b. Employment disputes
74.					c. Occupational and safety issues
75.					d. Environmental issues
76.					e. Tax audits or litigation
77.					f. Other controversy matters

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
78.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Conduct sponsor company physical facility visit, if possible
79.					1. Inspect representative plants and facilities consider:
80.					a. Capacity adequacy of the existing plants, facilities, and equipment
81.					b. Functional and technological adequacy of the existing facilities
82.					2. Discuss plants and facilities with company management representatives; consider:
83.					a. Future plant and facility expansion and capital investment plans
84.					b. Competitive effects of planned plant and facility changes
					III. <u>Economic environment (as of the analysis date)</u>
85.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. Consider (research and analyze) the national/international economic environment
86.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Consider (research and analyze) the regional/local economic environment
87.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Consider any economic relationships relevant to the performance of the sponsor company—identify significant relationships of economic performance with the performance of the sponsor company
					IV. <u>Industry environment</u>
88.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. Consider (research and analyze) the industry in which the sponsor company operates
89.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Consider (research and analyze) the nature and history of the industry in which the sponsor company operates
90.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Consider (research and analyze) the current outlook for the industry in which the sponsor company operates
					V. <u>Fundamental position of the sponsor company</u>
91.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. Consider the sponsor company capitalization and ownership
92.					1. Analyze all classes of sponsor company stock, including rights, seniority, voting, etc. of each class
93.					2. Analyze the total outstanding shares and the distribution of ownership of each class
94.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Consider the sponsor company history and operations
95.					1. Review the sponsor company history
96.					2. Review and analyze current business operations, including:
97.					a. Locations and markets served
98.					b. Products, service lines, and customer base
99.					c. Competition, including:
100.					1) Current and projected total market size
101.					2) Current and projected market size growth rate
102.					3) Position of the sponsor company within the industry
103.					4) Relative position of the sponsor company among all existing market participants



**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
104.					5) Sponsor company competitive strengths and weaknesses
105.					6) Sponsor company competitive opportunities and threats
106.					d. Management personnel and assembled workforce
107.					e. Overall positive and negative aspects of the sponsor company operations
108.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Consider the outlook for the sponsor company—review strategic plans, financial and business projections, and current business outlook
					<b>VI. <u>Financial statement normalization adjustments and analysis</u></b>
109.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. Make appropriate financial statement normalization adjustments, including:
110.					1. Adjust inventory, as appropriate
111.					a. Consider LIFO vs. FIFO inventory accounting method
112.					b. Consider inventory write-offs and/or write-downs
113.					2. Adjust for excessive/insufficient management executive compensation, as appropriate
114.					3. Adjust for nonrecurring items, as appropriate (e.g., unusual gains/losses, nonrecurring tangible asset impairment charges, nonrecurring intangible asset impairment changes, insurance proceeds, nonrecurring revenue, and/or nonrecurring expenses, etc.)
115.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Perform historical financial statement analysis
116.					1. Calculate and analyze common size financial statements
117.					2. Compute and analyze financial ratios and operating ratios, including:
118.					a. Size
119.					b. Growth
120.					c. Liquidity
121.					d. Profitability
122.					e. Turnover/activity
123.					f. Leverage
124.					3. Identify and explain any significant financial statement trends
125.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Perform prospective financial statement analysis
126.					1. Identify important financial variables that drive the company financial performance (e.g., capacity constraints, cost/volume/profit relationships, etc.) for prospective results of operations
127.					2. Obtain (if available) and analyze financial projections of prospective results of operations
128.					3. Assess the reasonableness of all historical management-prepared financial projections relative to historical results of operations
129.					4. Assess the reasonableness of all historical management-prepared financial projections relative to historical industry data
130.					5. Assess the reasonableness of all current management-prepared financial projections relative to current industry data
131.					6. Obtain and explain alternative management-prepared financial projections covering the same time period

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
162.					8. Select the appropriate market-derived valuation pricing multiples to apply to the sponsor company; consider:
163.					a. Invested capital to revenue
164.					b. Invested capital to EBITDA
165.					c. Invested capital to EBIT
166.					d. Invested capital to net operating income
167.					e. Invested capital to net income
168.					f. Invested capital to operating cash flow
169.					g. Invested capital to net cash flow
170.					9. Apply the selected valuation pricing multiples to the appropriate sponsor company financial fundamentals and operating fundamentals
171.					10. Synthesize an estimate of the sponsor company invested capital (i.e., long-term interest-bearing debt plus stockholders' equity) value—subtract the market value of the sponsor company debt in invested capital valuation analysis
172.					11. Identify any appropriate company-related or security-related valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
173.					12. Quantify any appropriate company-related or security-related valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
174.					13. Apply any appropriate company-related or security-related valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
175.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Perform a market approach business valuation—guideline merged and acquired company method (if appropriate)
176.					1. Identify guideline merged or acquired companies/precedent transactions, considering:
177.					a. Same or a similar line of business of the acquired companies
178.					b. Size of the acquired companies
179.					c. Financial condition of the acquired companies
180.					d. Relevant time frame of the transactions
181.					e. Availability of information regarding the transactions
182.					2. Normalize the historical financial statements of the selected guideline transaction companies (i.e., normalize guideline transactions to make them more comparative to the sponsor company, that is, "apples to apples")
183.					3. Identify appropriate financial fundamentals and operating fundamentals
184.					4. Calculate transaction pricing multiples for the guideline acquired companies; consider:
185.					a. Invested capital to revenue
186.					b. Invested capital to EBITDA
187.					c. Invested capital to EBIT
188.					d. Invested capital to net operating income

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
162.					8. Select the appropriate market-derived valuation pricing multiples to apply to the sponsor company; consider:
163.					a. Invested capital to revenue
164.					b. Invested capital to EBITDA
165.					c. Invested capital to EBIT
166.					d. Invested capital to net operating income
167.					e. Invested capital to net income
168.					f. Invested capital to operating cash flow
169.					g. Invested capital to net cash flow
170.					9. Apply the selected valuation pricing multiples to the appropriate sponsor company financial fundamentals and operating fundamentals
171.					10. Synthesize an estimate of the sponsor company invested capital (i.e., long-term interest-bearing debt plus stockholders' equity) value—subtract the market value of the sponsor company debt in invested capital valuation analysis
172.					11. Identify any appropriate company-related or security-related valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
173.					12. Quantify any appropriate company-related or security-related valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
174.					13. Apply any appropriate company-related or security-related valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
175.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Perform a market approach business valuation—guideline merged and acquired company method (if appropriate)
176.					1. Identify guideline merged or acquired companies/precedent transactions, considering:
177.					a. Same or a similar line of business of the acquired companies
178.					b. Size of the acquired companies
179.					c. Financial condition of the acquired companies
180.					d. Relevant time frame of the transactions
181.					e. Availability of information regarding the transactions
182.					2. Normalize the historical financial statements of the selected guideline transaction companies (i.e., normalize guideline transactions to make them more comparative to the sponsor company, that is, "apples to apples")
183.					3. Identify appropriate financial fundamentals and operating fundamentals
184.					4. Calculate transaction pricing multiples for the guideline acquired companies; consider:
185.					a. Invested capital to revenue
186.					b. Invested capital to EBITDA
187.					c. Invested capital to EBIT
188.					d. Invested capital to net operating income

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
189.					e. Invested capital to net income
190.					f. Invested capital to operating cash flow
191.					g. Invested capital to net cash flow
192.					5. Analyze range of guideline transaction pricing multiples
193.					a. Statistical analysis of the range of transaction pricing multiples
194.					b. Correlation with performance factors (e.g., growth rates, profit margins, returns on investment, etc.)
195.					6. Compute and analyze financial ratios and operating ratios for the guideline acquired companies, including:
196.					a. Size
197.					b. Growth
198.					c. Liquidity
199.					d. Profitability
200.					e. Turnover/activity
201.					f. Leverage
202.					7. Compare the sponsor company to the guideline acquired companies
203.					8. Select the appropriate transaction pricing multiples to apply to the sponsor company; consider:
204.					a. Invested capital to revenue
205.					b. Invested capital to EBITDA
206.					c. Invested capital to EBIT
207.					d. Invested capital to net operating income
208.					e. Invested capital to net income
209.					f. Invested capital to operating cash flow
210.					g. Invested capital to net cash flow
211.					9. Apply the selected transaction pricing multiples to the appropriate sponsor company financial fundamentals and operating fundamentals
212.					10. Synthesize an estimate of invested capital value—subtract the market value of the sponsor company debt in any invested capital valuation analyses
213.					11. Identify any appropriate company-specific or security-specific valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
214.					12. Quantify any appropriate company-specific or security-specific valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
215.					13. Apply any appropriate company-specific or security-specific valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
216.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	D. Perform an income approach business valuation—discounted cash flow method (i.e., either or both a yield capitalization method and a direct capitalization method), if appropriate

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
217.					1. Review and analyze management-prepared financial projections related to sponsor company prospective results of operations for a discrete projection period
218.					2. Develop the appropriate income fundamentals for the analysis—for example, typically net cash flow, which considers:
219.					a. Net income
220.					b. Noncash expenditures (depreciation expense, amortization expense, etc.)
221.					c. Capital expenditures
222.					d. Working capital requirements
223.					3. Develop the appropriate yield capitalization rate (or present value discount rate) and direct capitalization rate, with consideration of:
224.					a. The current capital market environment
225.					b. The current, long-term risk-free rate of return
226.					c. Historical equity rates of return (and/or general market equity risk premium)
227.					d. Any size-related equity risk premium
228.					e. Any company-specific risks/required rates of return, with consideration of:
229.					1) Expected attainability of the sponsor company financial projections
230.					2) Degree of financial/operating leverage
231.					3) Degree of diversification of the sponsor company business base
232.					4) Capital structure of the sponsor company
233.					5) Typical capital structure in the sponsor company industry
234.					f. Expected long-term growth rate in the income metric subject to capitalization (typically net cash flow); consider that the direct capitalization rate is typically quantified as: the yield capitalization rate minus the expected long-term growth rate
235.					4. Develop an estimate of the sponsor company terminal/residual value, with consideration of:
236.					a. Terminal/residual year financial fundamentals (e.g., net cash flow terminal period projection)
237.					b. Terminal/residual year direct capitalization rate (e.g., often derived from the Gordon growth model or a similar model)
238.					5. Apply the derived present value discount rate to the estimated income projection (e.g., net cash flow), including:
239.					a. The discrete projection period of periodic income
240.					b. The terminal/residual period income estimate
241.					6. Calculate an estimate of the sponsor company invested capital (long-term, interest-bearing debt plus total equity) value—subtract the market value of the sponsor company long-term debt in invested capital valuation analyses

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
242.					7. Identify any appropriate company-specific or security-specific valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
243.					8. Quantify any appropriate company-specific or security-specific valuation premiums/discounts (for the specific level of business interest subject to analysis)
244.					9. Apply any appropriate company-specific or security-specific valuation premiums/discounts (for the specific level of business interest subject to analysis)
245.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	E. Perform an asset-based approach business valuation—either (or both) adjusted net asset method or asset accumulation method (if appropriate)
246.					1. Adjust all on-balance-sheet recorded assets to a current value consistent with the business valuation assignment standard of value (e.g., current assets, real estate, tangible personal property, recorded intangible assets, and other assets); consider all generally accepted income approach, market approach, and cost approach property valuation methods
247.					2. Identify all off-balance-sheet identifiable intangible assets
248.					3. Estimate the current value of all off-balance-sheet identifiable intangible assets; consider the multiperiod excess earnings method ("MEEM") analysis for at least one identifiable intangible asset
249.					4. Estimate the current value of any intangible value in the nature of goodwill; consider a capitalized excess earnings method ("CEEM") analysis
250.					5. Adjust all recorded liabilities to a current value consistent with the business valuation assignment standard of value
251.					6. Adjust all off-balance-sheet and contingent liabilities to a current value consistent with the business valuation standard of value; consider any liabilities that will be created as a result of the asset revaluation process
252.					7. Calculate an estimate of the sponsor company total equity value (as the total analysis date value of all tangible and all intangible assets less the total analysis date value of all recorded and all contingent liabilities)
253.					8. Identify any appropriate company-specific and security-specific valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
254.					9. Quantify any appropriate company-specific and security-specific valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
255.					10. Apply any appropriate company-specific and security-specific valuation premiums/discounts (for the specific level of business ownership interest subject to analysis)
256.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	F. Consider any other generally accepted business or security valuation approaches
257.					1. Consider the application of any generally accepted business or security valuation approaches

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
258.					2. Perform all appropriate generally accepted business or security valuation approaches and methods or document the reasons why such other business valuation approaches and methods were not applicable
259.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	G. Prepare a sponsor company business valuation synthesis and conclusion
260.					1. Determine the relevance of the respective generally accepted business valuation approaches used in the analysis
261.					2. Weight the alternative estimates of value
262.					3. Identify the appropriate valuation premiums/discounts (for the specific sponsor company securities subject to analysis)
263.					4. Quantify the appropriate valuation premiums/discounts (for the specific sponsor company securities subject to analysis)
264.					5. Apply the appropriate valuation premiums/discounts (for the specific sponsor company securities subject to analysis)
265.					6. Synthesize an estimate of value for the analysis subject
266.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	H. Reach a conclusion of value—conclude the appropriate standard of value estimate for the analysis subject
VIII. <u>Documenting and reporting the results of the fairness opinion financial advisory due diligence</u>					
267.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. Prepare engagement work papers—prepare and maintain work papers and files that document the fairness opinion financial advisory due diligence procedures
268.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Prepare the transaction fairness opinion, as requested
269.					1. Describe the proposed sponsor company securities purchase or sale transaction
270.					2. Analyze the proposed sponsor company securities purchase or sale transaction in order to conclude whether: (a) the ESOP is paying no more to buy the sponsor company stock than any other typical willing buyer would pay or (b) the ESOP is receiving no less to sell the sponsor company stock than any other typical willing seller would receive
271.					3. Opine on the fairness of the essential components of the proposed sponsor company securities purchase or sale transaction from a financial point of view, with consideration of the concluded fair market value for the sponsor company stock
IX. <u>Documenting and reporting the results of the sponsor company valuation analysis</u>					
272.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	A. Prepare engagement work papers—prepare and maintain work papers and files that document the sponsor company valuation analysis
273.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	B. Prepare the value opinion and valuation report
274.					1. Opine on the adequate consideration with regard to the subject transaction; if requested
275.					2. Opine on the fair market value (or other appropriate standard of value) of the analysis subject
276.					3. Prepare a valuation report containing the following information:
277.					a. A summary of the professional qualifications of the analyst preparing the valuation

**Procedural Guidance for a Sponsor Company Stock Valuation and Financial Advisor Transaction Opinion Due Diligence Process (cont.)**

Item	Yes	No	NA	Work Paper Reference	Procedure
278.					b. A statement of the sponsor company stock value, a statement of the generally accepted valuation approaches and methods used to estimate that sponsor company value, and the reasons for the selection and rejection for valuation approaches
279.					c. A full description of the sponsor company security being valued
280.					d. The factors taken into account in developing the valuation, including any restrictions, understandings, agreements or obligations limiting the use or disposition of the sponsor company security
281.					e. The purpose and objective for which the valuation was developed
282.					f. The relevance or significance accorded to the generally accepted business valuation approaches applied—and the generally accepted business valuation approaches and methods considered but not applied
283.					g. The effective date of the valuation
284.					h. In the case where a written valuation report is prepared, the signature of the analyst developing the valuation and the date that the valuation report was signed
285.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____	C. Prepare a transactional fairness opinion
286.					1. Opine on the fairness of the proposed sponsor company stock purchase or sale transaction from a financial perspective
287.					2. Provide a complete description of the terms of the proposed sponsor company stock purchase or sale transaction
288.					3. Provide a complete description of the financial advisory due diligence procedures performed in the analysis
289.					4. In the case where a transactional fairness opinion is prepared, provide the signature of the financial advisory firm and the date that the transaction fairness opinion was signed