

ValueAdded@WBLI

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WBLI is pleased to present the Fall/Winter 2010 edition of our newsletter *ValueAdded@WBLI*, which provides information on current corporate finance, valuation, M&A and litigation support topics to the business, banking and legal communities of Atlantic Canada. If you have any questions, contact any member of our team or the editor Bill Vienneau, CA•CBV, TEP, CF at (902) 493-5466.

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Capital Markets Update

Canada's recovery has been the strongest of the G-7; however, it is being constrained by weakness in the United States.

Canada has shown the strongest recovery of the G-7 nations. Due to Canada's relationship with the United States, economic growth going forward is expected to closely mirror that of the U.S.

Due to the heavy trade and financial links between Canada and the U.S., any substantial weakness in the U.S. economy will greatly impact the Canadian economy and could potentially slow the recovery process.

Major economic indicators:

	Sep 30, 2010	Sep 30, 2009	Change
CDN\$/US\$	\$0.971	\$0.933	4.1%
S&P 500	1,141	1,057	8.0%
S&P/TSX	12,369	11,395	8.5%
Bank prime rate	3.00%	2.25%	0.75%
LIBOR (90-day)	0.29%	0.29%	0.0%
WTI Crude Oil	\$79.97	\$70.61	\$9.36

- The CDN\$ has remained strong compared to the US\$ mainly due to the weakness of the U.S. economy. In comparison to other currencies, the CDN\$ has been losing ground.
- The S&P 500 and the TSX, while being volatile through the year, have closed at 8% and 8.5% higher, respectively.
- Canadian commercial bank prime rates have increased by 75 basis points, as the Bank of Canada overnight lending rate grew to 1% – a move to keep inflation within its target levels.
- WTI Crude has increased by 13.3%, slowly creeping up to pre-recession levels. However, it still remains significantly lower than the September 30, 2008 level of \$103.90 per barrel.

Capital Markets Update (cont'd)

Atlantic Economy

The Atlantic economy is facing the same situation as the national economy. A full recovery will not occur until economic conditions in the U.S. improve, as the two are closely connected.

Atlantic Canada has shown an increase in non-residential construction investment and urban housing starts which is in contrast to other areas of the country where real estate markets have slowed.

Non-residential Building Construction Investment (\$MM)

	2nd Quarter 2010	2nd Quarter 2009	% Change
Canada	\$10,135	\$10,514	-3.6%
Atlantic Canada	454	431	5.2%
NL	67	83	-19.1%
PEI	21	34	-38.8%
NS	189	162	16.5%
NB	177	152	16.3%

Source: Statistics Canada

- Atlantic Canada has not followed the same trend as the rest of Canada with an increase in spending of 5.2%.
- This increase is led by spending increases in Nova Scotia and New Brunswick only to be offset by decreases in spending in Newfoundland and Prince Edward Island.

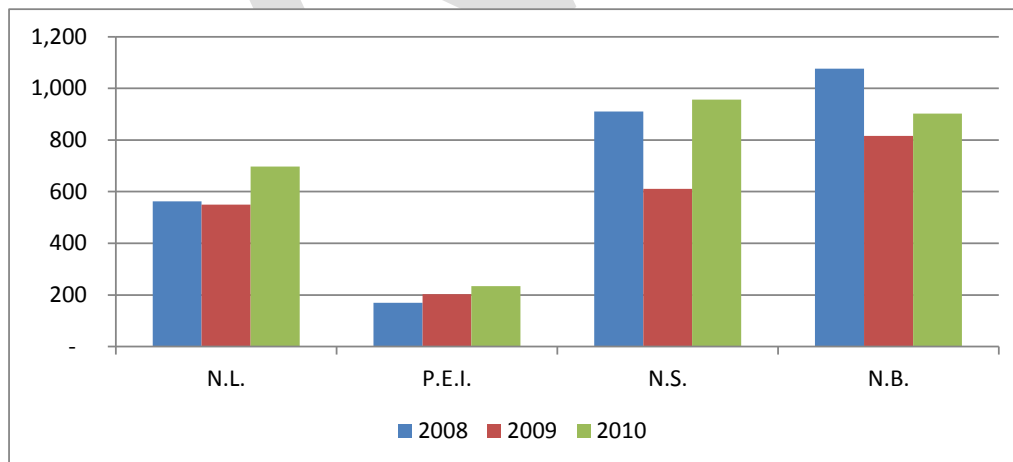
Housing Starts Atlantic Canada - Urban Starts; 2nd Quarter

	2008	2009	2010
Atlantic	2,718	2,180	2,789
NL	562	550	697
PEI	170	203	234
NS	910	611	956
NB	1,076	816	902

Source: CHMC



2nd quarter housing starts have increased in every province from 2009 to 2010.



- Newfoundland has increased above 2008 numbers and is expected to increase further with the emergence of new offshore projects.
- New Brunswick has improved from 2009 but is still lagging behind starts in 2008.

Private Company Transaction Multiples

Based on U.S. transactional information compiled by GF Data Resources LLC, the gap still exists between larger and smaller company transaction multiples. Larger companies (based on transaction size) are demanding higher prices in terms of Total Enterprise Value (“TEV”) as a multiple of earnings before interest, taxes, depreciation and amortization (“EBITDA”) due to the inherent risk differences related to financial strength and size. (TEV is equal to the sum of an entity’s invested capital which can be broken into Equity value plus Debt).

The average TEV / EBITDA multiple for all transactions is 5.5x in the first half of 2010, compared to the long-term average of 5.9x. For deals less than \$25M, this multiple is 4.8x in 2010, with a long-term average of 5.4x.

Transactions Multiples Based on Total Enterprise Value (TEV) / EBITDA

Total Enterprise Value (TEV)/EBITDA - All Industries

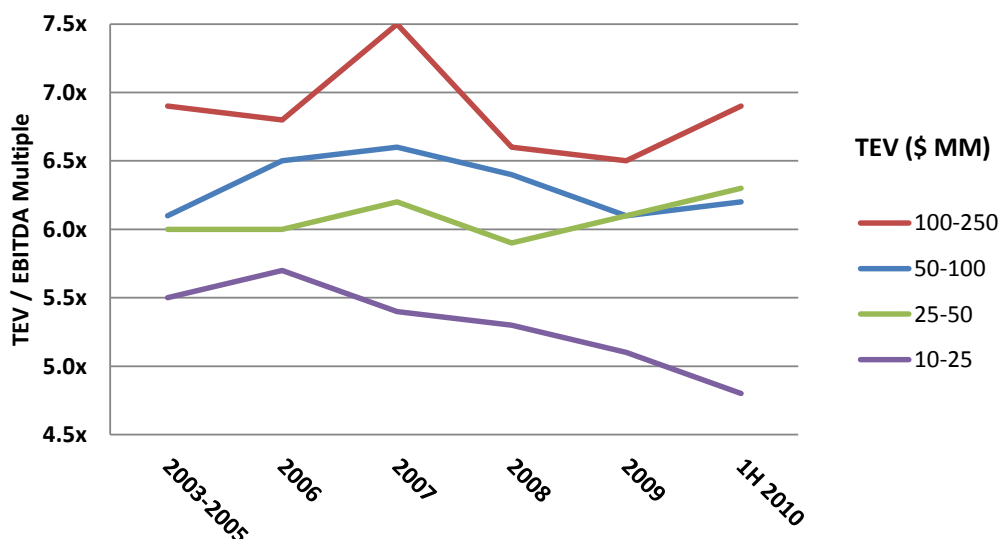
TEV (\$ M)	2003-2005	2006	2007	2008	2009	1H 2010	Total	# of Deals
10-25	5.5x	5.7x	5.4x	5.3x	5.1x	4.8x	5.4x	392
25-50	6.0x	6.0x	6.2x	5.9x	6.1x	6.3x	6.0x	295
50-100	6.1x	6.5x	6.6x	6.4x	6.1x	6.2x	6.3x	186
100-250	6.9x	6.8x	7.5x	6.6x	6.5x	6.9x	7.0x	69
Total	5.9x	6.0x	6.0x	5.8x	5.7x	5.5x	5.9x	
# of Deals	337	171	189	131	72	42	942	

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GF Data Resources provides data on private equity sponsored U.S. M&A transactions with TEV of \$10 to \$250 million.

Starting in 2008, transaction multiples started to decline due to lack of confidence in the economy. During the 1st half of 2010 transaction multiples have increased on deals above \$25M. However multiples for deals less than \$25M have continued to decrease. The gap between transactions greater than \$100M and deals under \$25M is widening as highlighted below:

Total Enterprise Value (TEV) / EBITDA - All Industries



Source: GF Data Resources LLC

The Importance of a Purchase Price Allocation

In a transaction involving numerous assets, the buyer and seller negotiate a price for the group of assets and must allocate the purchase price to the various tangible and intangible assets for tax and accounting purposes commonly referred to as the purchase price allocation or PPA.

In negotiating the transaction, both sides seek to obtain the most favourable tax treatment possible.

The goal of the buyer is to maximize the potential for future income tax deductions on the assets acquired, while the goal of the seller is to minimize income tax arising from the sale of those assets. Generally, it is more beneficial for the seller if a greater portion of the purchase price is allocated to assets that are treated as capital gains as opposed to business income.

Buyers may want to minimize amounts allocated to land or buildings which will be subject to land transfer tax. In addition, it is more beneficial for buyers to allocate a greater portion of the proceeds to assets that provide a faster tax write-off, such as high-rate depreciable property. For example, only 75% of the goodwill / intangible assets can be deducted at 7% per annum, whereas allocation to a fixed asset will provide depreciation on 100% of the purchase price which typically is at higher CCA deduction rates.

Buyers and sellers have different motivations. The risks and tax implications should be carefully considered in any transaction.

Often, buyers and sellers do not record the allocation of the purchase price in the purchase and sale agreement. They will allocate it after the purchase of the business has closed. The Canada Revenue Agency (CRA) wants both the buyer and the seller to treat the transaction the same; i.e., they do not want the seller to record goodwill when the buyer has recorded the same amount as fixed assets. If the CRA audits the transaction and finds the buyer and seller did not treat the sale the same way, they can amend one or both tax returns and charge interest on any deficient tax payments.

Purchase price allocations

The company's financial statements, including the PPA, are management's responsibility. While the PPA can be performed by the company's management, many organizations do not have the required expertise or sufficient time to complete the PPA. The company's auditors may be qualified to perform the PPA but, for reasons of independence, may be prohibited from doing so.

The best option is often the use of outside experts, either another accounting firm or an independent firm of business valuers. This alternative provides more certainty with respect to the PPA process and, more importantly, allows management to focus on more strategic post-acquisition challenges.

The Importance of a Purchase Price Allocation (continued)

A valuator will seek to understand the components and circumstances of the transaction, including:

- identifying the seller (target company);
- identifying the buyer;
- the transaction date;
- quantifying the book value of the target company;
- quantifying the purchase price;
- understanding the overall rationale for the transaction; and
- identifying all tangible and intangible assets and their respective values.



Examples of identifiable intangible asset categories include:

- Marketing-related intangible assets
 - Trademarks, trade names, internet domain names, non-competition agreements.
- Customer-related intangible assets
 - Customer lists, order or production backlogs, customer contracts and customer relationships, including non-contractual relationships.
- Artistic-related intangible assets
 - Plays, operas, ballets, books, magazines, newspapers, pictures, photographs.
- Contract-based intangible assets
 - Licensing and royalty agreements, advertising, construction, service or supply agreements, lease agreements, franchise agreements, employment contracts.
- Technology-based intangible assets
 - Patented technology, computer software, databases, and trade secrets, such as formulas, processes and recipes.

In order to determine the appropriate value for the assets acquired, valuers examine the transaction to arrive at the value of the components of the purchase price. If the purchase price is greater than the net assets acquired, the remaining amount is recorded as goodwill which is tested annually for impairment.

Why are purchase price allocations important?

PPA's are intended to better reflect the investments made in a target company, improve the comparability of reported financial information and provide more complete financial information. PPA's also establish the basis for depreciation and amortization allowances for both accounting and tax purposes. In order to avoid tax problems with CRA, the buyer and seller should come to an agreement on the allocation of assets prior to the final transaction documentation (purchase and sale agreement).

The Importance of a Purchase Price Allocation (continued)

The CRA may challenge a transaction even if the parties consider that the total purchase price is reasonable. Section 68 of the Income Tax Act allows the CRA to reassess any allocation that does not appear commercially reasonable.

The following are two recent case examples in which CRA contested a PPA:

A&W Franchise sale

Date: December 12, 2009: 167849 CANADA INC., Appellant, and HER MAJESTY THE QUEEN, Respondent.

The appellant (seller) did business in the field of fast food and, during the 2001 taxation year, sold six A&W franchised restaurants for \$675,000.

Summary: There was no agreement between the seller and the purchaser as to the allocation of the purchase price and CRA did not agree with the appellant's allocation on the corporate income tax return. In the end, the judge decided to allocate the assets based on facts and reports supplied from both sides, summarized as follows:

	Seller's Position	CRA	Court
Leasehold improvements	114,775	183,000	180,000
Equipment	118,800	420,000	190,000
Franchise fees	-	51,668	30,000
Goodwill	441,425	20,332	275,000
	<u>675,000</u>	<u>675,000</u>	<u>675,000</u>

Transalta Corporation v. The Queen

Tax Court of Canada, July 13, 2010. Neutral Citation: 2010 TCC 375. Court File No. 2009-871(IT)G.

Transalta sold its electricity transmission business to AltaLink for \$800 million of which Transalta allocated \$190 million to goodwill.

Summary: Both parties agreed on a PPA. CRA disagreed with the allocated amounts and reassessed Transalta. The courts ruled that the taxpayer did not show that all the amounts allocated to goodwill were reasonable. The original allocation of \$190 million was reassessed to \$140 million.

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(CBV's) are
recognized by the
courts as experts in
their field.*

Having a PPA prepared by an independent CBV will provide you with the independent opinion parties are looking for when determining the reasonableness of a PPA.

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- Does your private, mid-market business require assistance in **placing & negotiating debt/equity financing** for working capital, growth or acquisition?
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We help entrepreneurs (and their advisors) buy or sell private and mid-market businesses, including assisting with targeting, valuation, negotiation, sourcing financing and due diligence. In addition, we assist entrepreneurs (and their legal advisors) by quantifying business losses for expert witness testimony in a variety of litigation disputes.

If we can help you or your clients, please contact any one of our Corporate Finance professionals for a complimentary consultation.

***“It's far better to buy a wonderful company at a fair price
– than a fair company at a wonderful price.”***
- Warren Buffet

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Through our membership in DFK Canada and DFK International, we are able to meet the needs of clients with interests across the Atlantic region, Canada and around the world.