GALLAGHER IS BAD NEWS FOR THE SERVICE

PRE-PUBLICATION ARTICLE DRAFT

> *"... rather than adopting one of the experts' opinions or "splitting the baby," the Court, in effect, wrote its own valuation report."*

BY ESPEN ROBAK, CFA[1]

In *Gallagher v. Commissioner*[2], not only did the Internal Revenue Service lose badly, but it did so even with seemingly very good facts and past Tax Court opinions both on its side. It was not a great day in court for the government – in fact, it would have been better off not even picking the tax return up for audit. The Court's concluded value was lower than the value claimed on the estate tax return.

The case is a must-read for anyone interested in current Tax Court thinking on valuation issues, particularly on the applicability of the market approach and the minute details of how to apply the income approach to a business valuation. *Gallagher* also further solidifies the Court's position on the treatment of the tax obligations of investors in pass-through entities.

BACKGROUND

Louise Paxton Gallagher passed away on July 5, 2004, holding 15 percent of Paxton Media Group, LLC, (PMG) her family's media empire. PMG owned 28 local newspapers, 13 paid weekly publications, and a few specialty publications, plus one television station, mostly throughout the U.S. South and Midwest. The company was established in 1896 and had grown significantly from its roots as a single-newspaper holding company in Paducah, Kentucky. PMG's newspapers are local papers, report mostly local news, and had a dominant position as news providers in their communities. The company had grown historically through acquiring underperforming companies and improving their performance. PMG's revenues for the fiscal year ended 2004 were approximately $169.1 million and its balance sheet showed approximately $357.5 million of assets and approximately $73.8 million of equity. As a limited liability company, PMG was not taxed at the corporate level but instead passed the tax burden on to its unit holders.

Ms. Gallagher's units were valued for the estate tax return by PMG's president, David Michael Paxton, at approximately $34.9 million.[3] PMG had an option plan in place and, pursuant to the plan, provided internal valuations of its units on a regular basis. Initially, in audit, the Service proposed a $49.5 million value. By the time the case made its way to Judge Halpern's courtroom, the estate had lowered its valuation to $28.2 million[4] and the IRS had come down from its initial position to a value of approximately $40.9 million. These valuations were both backed by valuation reports from experts who testified at trial.

THE COURT'S OPINION

Gallagher is a pure business valuation case: the only question for the Court was the fair market value of the decedent's units. Also, while Gallagher involves valuation discounts, and discounts are discussed by the Court in its 53-page opinion, they were not a major point of contention between the parties. Further, rather than adopting one of the experts' opinions or "splitting the baby," the Court, in effect, wrote its own valuation report. In doing so, the Court reviewed the two appraisal reports and analyzed the methods and inputs of each expert. Based on this analysis, the Court then either chose among the inputs provided by the experts or rejected both appraisers' inputs and generated its own.

This methodology is unusual, and for good reasons. It is a valuation process that is fraught with risks, including the possibility that in making changes in one area, other areas of the analysis might no longer be quite as appropriate. Above all, when the finder of fact micro-manages the valuation process, what is often missed, in the end, is the reconciliation

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of the analysis – where the appraiser looks back and says "does this make sense?" The opinion provides a fascinating summary of Tax Court thinking on a series of vexing valuation problems.[5] Overall, the Court arrived at a value much closer to the taxpayer's position than the Service's, even though the Court rejected most of the analysis and inputs of the taxpayer's appraiser, including on major issues such as the discount rate, growth rates, and the tax treatment of earnings.[6]

The market approach. In the Court's analysis, as a first step, it rejected the market approach (the public guideline companies method[7]) used by both appraisers.[8] The Service's expert chose four guideline companies, with EBITDA multiples[9] ranging from 10.9 to 12.6, and a median of 11.8.[10] The Court noted that PMG was significantly smaller than (about one-third of) the median of the guideline companies and that many of them had a broader range of publications and more of an online presence. In addition, the Court noted that PMG had seen faster growth in the recent past than had the guideline companies. All things considered, the Court concluded that the only company "arguably of sufficient similarity to PMG" was McClatchy Co.[11]

> *"... the discount rate is almost the exact inverse of a valuation multiple"*

As support for dismissing the market approach, the Court cites *Hall*,[12] where the Court had earlier (in 1989) found that an expert reasonably selected six comparable companies that "were involved in similar businesses as, and occupied similar positions within those industries as, the subject company."[13] However, the guideline companies selected by the petitioner's appraiser in *Hall* were much more divergent from the subject company than the ones relied on by the IRS appraiser in *Gallagher*. The "similar positions in the industry" criterion was added to justify the use of a much wider range of guideline companies.[14] The Court also cites *Zaiger*, where the Court previously (in 1975) held that differences in product mix and size of operations doomed the use of a proffered set of guideline companies.[15] The Court does not cite any of the many more recent business valuation cases where the guideline companies method has been successfully used, for example *Kohler*[16] and *Hess*,[17] both from the current century. Considering the significant overlap between the operations of the subject company and the guideline companies used in *Gallagher*, the Court's more exacting test for comparability would tend to preclude the market approach from being used in most business valuations. After all, in competitive markets, where the survival of any company hinges, to a considerable extent, on its ability to differentiate itself from its competitors, it is rare to find guideline companies for any valuation that can be applied without further analysis and adjustments. Applying such analysis and making such adjustments is an important and integral part of the process under the market approach. These adjustments and the additional analysis they require are part of what makes the approach so powerful. Not surprisingly, the Court's dismissal of the market approach is already under attack.[18]

In defaulting to the income approach, the Court ended up performing its own valuation under the discounted cash flow (DCF) method.[19] This method lends a scientific look and feel to the analysis because it reduces the valuation, after determination of the inputs, to a math problem. The main weaknesses of the method are its sensitivity to minute changes in valuation inputs and, most importantly, the risk that the valuation may lose contact with market realities.[20] We will return to this issue again in the discussion below.

After selecting the income approach, the Court proceeds to project PMG's future revenues and expenses before discounting the resulting cash flows back to the present. Projecting cash flows requires the Court to again opine on the issue of tax affecting earnings.

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Tax affecting. Haven't we seen this movie before? The taxpayer goes to court with a simple plea: pass-through entity status doesn't make us immune from paying taxes – it just means we pay taxes at a different level! Should it really matter whether the same amount of income taxes are paid by the company or by its owners? Then the taxpayer slams face-first into *Gross*[21] barrier. As paraphrased in *Gallagher*, *Gross* held that "the principal benefit enjoyed by S corporation shareholders is the reduction in their total tax burden, a benefit that should be considered when valuing" pass-through entities.[22] Primarily, owners of pass-through entities benefit by avoiding double taxation of distributions. In *Gallagher*, the taxpayer's appraiser had explicitly considered and accounted for these tax savings benefits.[23] And yet, the Court found that he "failed to explain his reasons for tax affecting PMG's earnings and discount rate" and that he had "advanced no reason" to deviate from the *Gross* analysis.

Based on a string of opinions,[24] it appears the Tax Court considers the pass-through earnings technique used in *Gross* as something akin to "settled law."[25] It is clear that appraisers who want to tax affect earnings in court need a very thoughtful critique of the *Gross* method – certainly a much better one than anything the Court has seen until now.[26] In addition, a "plan B" might be recommended, for example by providing two separate DCF analyses applying two different methods for considering the additional benefits of pass-through tax status.[27]

Financial projections. The choice of a starting point for the financial projections appears to be either operating income during the trailing five months ended May 30, 2004, (presumably annualized) or revenue for the trailing 12 months ended June 27, 2004. Thereafter, the Court clearly thought the Service's appraiser had better support for his inputs. When projecting revenues, for example, the low growth rates he used were found to be more reasonable because they were based on an analysis of PMG's historical growth.[28] Also, the Court adopted the operating margins estimated by the Service's appraiser. Similarly, the Court adopted the Service's appraiser's analysis of management fees, capital expenditures, and working capital needs. In contrast, the estate's appraiser pointed out that by 2004, newsprint costs were increasing dramatically, which in retrospect was proven a major detriment to newspaper profits and valuations.[29] Unfortunately, the estate's appraiser did not supply enough evidence to persuade the Court to consider this in its projections. Unfortunately, there is little discussion in the opinion of how and why PMG's future might be different from its past although, as discussed below, it's apparent that the Court believes the future is likely to be more stable than its past.

As a result of the foregoing analysis and the chosen inputs, the Court arrived at a set of financial projections for the five years following the valuation date. Operating profits were expected to grow from $63.0 million in year one to $65.8 million in year five. It is interesting to note that these earnings figures seem to indicate significantly stronger profitability in PMG's future than in its past.[30]

Discount rate. The Court rejected the capital asset pricing model (CAPM) in favor of the "build-up" method for calculating the cost of equity capital.[31] The Court ultimately arrived at a weighted average cost of capital (WACC) of 10 percent, which was identical to the Service's appraiser's estimate.[32] Tax affecting earnings and the difference in capital structure estimates (discussed below) made up most of the difference between the two parties.

The Court devoted considerable attention to developing the proper capital structure for PMG, which was a critical input to the WACC calculation due to the significant difference between

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the cost of equity capital and the cost of debt.[33] Again, the Court adopted the opinion of the Service's appraiser and applied a 75-25 debt-equity ratio for the WACC calculation. The ratio was based on the book value, rather than market value, of debt and equity, even though the Court agreed with the taxpayer that market values were more appropriate.[34] The taxpayer's appraiser had argued for a 15-85 debt-equity split.[35] Unfortunately, according to the Court, he "provided no analysis as to how he arrived at those percentages, other than to state that the 15 percent is 'based on analysis guideline companies' capital structure'."[36] Adopting market value based debt-equity ratios for this valuation – but leaving everything else in the Court's analysis constant – would have resulted in a significantly different value, due to the sensitivity of the DCF method to variations in the WACC. Using market value based debt-equity ratios, the value of the estate's interest would have dropped dramatically, perhaps to as low as $11 million, or one-third of the Court's conclusion (and well below one-half of the taxpayer's own valuation at trial).[37] The Court also rejected certain valuation adjustments proposed by the taxpayer's appraiser, most importantly the addition to value of the amount of overfunding of a defined benefits pension plan.

At the end of Judge Halpern's analysis, with inputs based mostly on those supplied by the Service's appraiser, the Court arrives at a market value of invested capital (MVIC) of approximately $667.5 million, a total equity value before discounts of $408.7 million, and a final value of the estate's 15 percent of $32,601,640, which was about $2.3 million *below* the 706 valuation, $8.3 million less than the government's appraisal but $4.4 million higher than the appraised value argued by the taxpayer.[38]

"Using market value based debt-equity ratios, the value of the estate's interest would have dropped dramatically"

Other issues. The two appraisers had, as a starting point, used financial statements for different periods. The Service's appraiser had used financial statements for the period ending June 27, 2004, i.e., just days before the valuation date. The taxpayer's appraiser stated that the June statements would have been unavailable as of the valuation date due to the lag time in compiling and reporting such numbers. Therefore, he used PMG's statements for the period ending May 30, 2004 (and guideline company statements for the period ending March 28, 2004, the latest quarterly statements available as of the valuation date). The Court held that the financial statements for the accounting period ending nearest the valuation date should be used, whether or not those statements would have been available at the time. This is a highly useful clarification by the Court and will hopefully result in more uniformity of practice going forward.

"...the most disappointing aspect of Gallagher is the rejection of the market approach."

Finally, the two appraisers mostly agreed on the appropriate marketability discount. The Court did not modify their analyses and ruled in favor of a 31 percent marketability discount. The Court nevertheless pointed out that data from restricted stock studies is inapplicable to privately held shares,[39] since restricted stock is subject to significantly shorter holding periods.[40] It is logical to conclude, in this reviewer's mind, therefore that discounts should be greater for closely held shares with longer holding periods than would be implied in the restricted stock studies.

DOES THIS MAKE SENSE?

To this reviewer, the most disappointing aspect of *Gallagher* is the rejection of the market approach. While in retrospect, more guideline companies probably should have been included, the ones selected by the taxpayer's appraiser were in truth fairly good comparables. The main appeal of the market approach is the *discipline* it can add to the analysis – a perspective perhaps lost in *Gallagher*. For example, the MVIC arrived at by the Court was over 4.0 times

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PMG's revenues, a multiple more often seen for high-flying technology stocks.[41] Clearly, the local newspaper business in PMG's markets had seen very good days during the recovery from the 2001 recession. However, the newspaper business is cyclical and was also subject to certain negative secular trends at the valuation date. The most important task of the appraiser when finalizing a conclusion based on as detailed and intricate an analysis as occurred in this case – is asking the question: Does this make sense? Would there have been any potential buyer as of mid-2004 ready to pay $667 million for PMG on a debt-free basis?

The outlook for newspaper stocks was already darkening as of mid-2004, which turned out to be the peak of the economic cycle. In addition, the newspaper business had been subject to durable trends that had eroded many of their best sources of income. Perhaps the closest competitor to PMG in its local markets at this time, Media General, Inc., was trading at a multiple of 2.4 times revenues as of the valuation date.[42] Furthermore, McClatchy Co., the closest of the guideline companies used,[43] traded at 2.4 times revenues.[44] And as we have seen above, a market-based adjustment to the capital structure assumed for PMG would have resulted in a very different analysis and a much lower valuation.

"The agent who picked up the Gallagher estate's return might look at the result and wish he had taken the day off instead."

The agent who picked up the Gallagher estate's return might look at the result and wish he had taken the day off instead. With the substantial drop in value and the significant expenses of audit and trial, the government certainly would have been better off leaving this one alone.

In retrospect, however, it would appear that both the taxpayer's appraisal, the Court's decision and the government's position were too high. Today, the media industry is a shadow of its former self. Revenues are down industry-wide and, in particular, the classified advertising revenue relied on by many newspapers has been decimated by competition from the Craigslists and eBays of the world.[45] As an example, The New York Times Company, which owns what is generally regarded as the premiere brand in the business, has lost more than 80 percent of its peak value and is currently trading at about 0.7 times revenues. More marginal competitors have fared much worse. Clearly, while a disappointment, the result for the Service in *Gallagher* could have been even worse.

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2 *Estate of Louise Paxton Gallagher v. Commissioner*, TCM 2011-148.

3 The nature of the family relationship between Mr. Paxton and either the decedent or the estate's beneficiaries, if any, is not explored in the Court's opinion, although, presumably he was not himself one of the beneficiaries.

4 The taxpayer had also secured another valuation at $26.6 million for the units, but this valuation was not presented at trial.

5 For example, Brealey & Myers, Principles of Corporate Finance (7th Ed. 2003) is cited – twice – in the opinion, which may be a first.

6 Terms like "fails to explain," "fails to convince," "fails to justify," etc, are common throughout the Court's discussion of the taxpayer's appraisal.

7 In the public guideline companies method, the subject entity is valued by multiplying representative levels of various measures of income or book value of the entity, with corresponding capitalization multiples derived from the market value and earnings or book value measures of publicly traded companies. The earnings measures are meant to be representative for expected future earnings, and therefore expense and income items in the past that are non-recurring in nature are eliminated.

8 The taxpayer's appraiser had used the market approach, but did not give it any weight in arriving at his final valuation. The Service's appraiser gave weight to both the market and income approaches in formulating his conclusion.

9 The multiples used were the MVIC-to-EBITDA multiples, which are calculated by dividing the market value of invested capital (MVIC) by the company's earnings before interest, taxes, depreciation, and amortization (EBITDA).

10 The guideline companies were Journal Register Co. (EBITDA multiple of 11.1); Lee Enterprises, Inc. (EBITDA multiple of 12.4); The McClatchy Co. (EBITDA multiple of 10.9); and Pulitzer, Inc. (EBITDA multiple of 12.6). These had earlier been selected as the most comparable from a list of 13 companies that all operated primarily as newspaper publishing companies.

11 *Gallagher*, supra, at p. 22.

12 *Estate of Hall v. Commissioner*, 92 TC 319 (1989).

13 *Gallagher*, supra, at p. 22. The emphasis is the *Gallagher* Court's own.

14 The valuation analyst whose analysis was adopted in *Hall* had selected the following guideline companies to value Hallmark Cards Incorporated (the greeting card company): A.T. Cross Company; Avon Products, Inc.; The Coca-Cola Company; Lenox, Incorporated; Papercraft Corporation; and American Greetings. Clearly, only the last of those is in the same business as the subject company.

15 *Estate of Louis Zaiger v. Commissioner*, 64 TC 927, where the respondent had used Electrolux, Sunbeam, and Scott-Fetzer to value two small, obscure Massachusetts corporations with combined earnings of less than $400,000 (making floor polishers, vacuum cleaners, etc).

16 *Herbert V. Kohler, Jr., et al. v. Commissioner*, TC Memo 2006-152. Two separate appraisals for the taxpayer were relied on where both had used public guideline companies for a highly diversified subject company (plumbing products, engines, hospitality service, real estate, etc.)

17 *Johann T. and Johanna Hess v. Commissioner*, TC Memo 2003-251, relying in part on a market approach that used a wide range of guideline companies to value Hess Industries, which produced metal processing machines and automation systems (products described as "one-of-a-kind") for the automotive markets and also had subsidiaries that did engineering and design. The guideline companies included Giddings & Lewis, Inc., Monarch Machine Tool Co., Cincinnati Milacron, Inc., and Gleason Corp. All of these had major differences in product mix, target markets, and/or size compared with Hess Industries.

18 See, for example, the analysis of Lance Hall, "A Battle of Experts," FMV Valuation Alert, at http://fmv.com/index.php?C=ValuationAlert_Archive_2011-07-01 (finding the Court's position on the guideline companies "untenable") or L. Paul Hood, "Estate 'Whips' IRS in Fair Market Value Determination," at http://lpaulhoodjr.wordpress.com ("There are some appraisers who disagree with the Tax Court's determination that the guideline companies offered were not similar enough to be considered in the market approach.")

19 In the DCF method, the appraiser projects future cash flows of the subject entity into the future over a set forecast horizon, often three to five years, and the terminal value of the entity at the end of the forecast horizon. The cash flows and the terminal value are thereafter discounted back to the present using a discount rate reflecting the time value of money and the risk inherent in the future cash flows and values projected.

20 The main market-based driver of the value from a DCF analysis is the discount rate. This rate is customarily derived, at least in part, from a review of published cost-of-capital data. This was also the case in *Gallagher* (supra, at pp. 34-41). Interestingly, these published sources (Ibbotson Associates, in *Gallagher*) get their data from public companies within the same (or a similar) industry as the subject company – in other words, the rough equivalent of guideline companies. And yet the discussion of comparability is rarely, if ever, given any prominence in DCF valuations. Nor was it considered in *Gallagher*. It is important to point out that, with a growth rate of only one percent (see below), the discount rate is almost the exact inverse of a valuation multiple. So, how comparable are the "Ibbotson comps" that were used here? We may never know.

21 *Gross v. Commissioner*, TCM 1999-254.

22 *Gallagher*, supra, p. 32.

23 The taxpayer's appraiser had added three adjustments to his value conclusion to reflect the economic benefits of pass-through status: (1) $12.9 million for expected future distributions in excess of tax distributions; (2) $44.3 million for the future value of deductible goodwill, discounted to the present; and (3) $6.7 million for the extra marginal debt tax shield.

24 See, for example, *Robert Dallas v. Commissioner*, TC Memo 2006-212, where the petitioner argued the case was distinguished from Gross because the subject company only distributed enough to cover individual income taxes for its shareholders. This argument did not win the day.

25 To say that the appraisal community views the *Gross* method as conflicting with basic valuation principles would be an understatement. The decision has, however, spurred significant additional research into the magnitude of the additional economic benefits of pass-through status. Pre-*Gross*, the benefits were often simply ignored. However, very few appraisers today regard the benefits of pass-through status equivalent to nearly a 40 percent increase in enterprise value (which is about what you would get in most cases, ignoring leverage, using the Gross analysis). For all but the most profitable and liquid companies with sky-high dividend rates, the economic benefits are probably more modest. For example, consider an S-corporation (with significant capital requirements) that cannot afford to distribute more than just enough to cover shareholder-level taxes on its income. In that case, the additional benefits could arguably be zero (although of course, the benefits for this hypothetical company might go up in the future). The taxpayer made this argument in Dallas, infra, but not persuasively.

26 The decision in *Gross* was long viewed as an anomaly, or perhaps a special case applying only to pass-through entities that are able to distribute to their shareholders all or almost all of their net income. For such entities (e.g., the entity valued in *Gross*), it might indeed be preferable not to tax affect earnings. In its opinion, the Court does not directly address PMG's history of paying such distributions, its current ability to pay distributions, or its intent to pay such distributions in the future. However, reading between the lines, it appears that the taxpayer (in *Gallagher*, as in *Dallas*) made arguments along these lines. Alas, to no avail.

27 One approach might be to provide separate DCF analyses using both non-tax affected financials and a properly adjusted discount rate (adjusted for the added risk associated with maintaining the tax advantages of the S-corp status) blended with several alternative approaches, for example those advocated by Nancy Fannon (see, *S Corporations and Value: Simplifying the Debate*, 2006, available at www.fannonval.com) or Daniel Van Vleet (see *What's an S Corp Really Worth?* Trusts & Estates, December 1, 2007).

28 The Court applies a one percent growth rate for most years in the forecast horizon.

29 Annual Report to Stockholders for the Fiscal Year Ended December 26, 2004, Media General, Inc., Filed March 10, 2005.

30 Extrapolating from PMG's total long-term debt of $243.6 million (*Gallagher*, supra, p. 42), and its weighted average cost of debt of 3.5 percent (*Gallagher*, supra, p. 38), both as of the date of death, implies interest expense of around $8.5 million per year. This implies future net income for PMG in excess of 31 percent of revenue for the projection period. Compare this with net income margins for PMG for the prior three years increasing from 22.2 percent in 2002 to 28.5 percent in 2004 and with net income margins for the four-year period before 2002 fluctuating between a low of 1.0 percent and a high of 13.0 percent (*Gallagher*, supra, at p. 7). It appears the Court assumed the operating environment for PMG going forward would be very benign.

31 The Court found that the "special characteristics of closely held corporate stock make CAPM an inappropriate formula to use in this case." Also, citing Hoffman v. Commissioner, TC Memo 2001-109, "The use of CAPM is questionable when valuing small, closely held companies."

32 The Court notes that in *Hendrickson v. Commissioner*, TCM 1999-278, it had "previously held that WACC is an improper analytical tool to value a 'small, closely held corporation with little possibility of going public.'" Still, since both appraisers had used WACC in their analysis, the Court also adopted it here.

33 The cost of equity capital was held to be 18 percent (versus 20 in the taxpayer's appraisal). The average cost of debt for PMG was held to be 2.9 percent and 3.5 percent, respectively, as of the end of 2003 and 2004, yet the Court (and the taxpayer's appraiser) held that 6.6 percent, based on the average for Baa corporate bonds, was more appropriate here.

34 See pp. 39-41 and note that the difference between the two is NOT trivial. According to the Court's own valuation, the undiscounted market value of PMG's equity was $424 million, versus $244 million of debt, which is a 36-64 debt-equity split, rather than 75-25.

35 It is also worth noting that the Service's appraiser presented research showing that the guideline companies had very similar (market value based) debt-equity ratios, or around 16-84 at the median.

36 sic, although whether the misprint is the Court's or the appraiser's is unclear.

37 Keeping all of the Court's inputs constant, and only varying the capital structure assumption, the WACC and resulting value change dramatically. For example, applying a 36-64 debt-equity ratio (as shown above, this is the market value based ratio implicit in the Court's own valuation), the WACC would be 14.0 percent (rounded), and the value of the estate's units would drop to $15.9 million. Further, if we applied a 15-85 debt-equity ratio (based on the guideline companies per the data used by both the taxpayer's and the Service's appraisers), the WACC would be 16.0 percent (rounded) and the value of the estate's equity would drop further, to $11.0 million.

38 Due to the low, stable growth rate during both the forecast horizon and thereafter, the DCF method is almost entirely unnecessary for this valuation. A simple single-period capitalization (Gordon growth) model would be almost as accurate for this purpose. Using a 9 percent capitalization rate (10 percent WACC minus 1 percent growth rate) and applying it to the next year's projected operating cash flow of $63.7 million would have resulted in an MVIC of approximately $700 million, which is well within a reasonable range of the Court's valuation. Also note that this 9 percent capitalization rate is just the inverse of a market multiple, in this case an operating cash flow multiple of approximately 11.0 [1 / 0.09]. ($63.7 million times 11.0 similarly equates to an approximate $700 million value.)

39 Citing *Furman v. Commissioner*, TC Memo 1998-157, to the effect that "owners of closely held stock held long term do not share the same marketability concerns as restricted stock owners with a holding period of 2 years". Needless to say, the cases that have applied restricted stock data for the marketability discount determination are numerous.

40 *Gallagher*, supra, p. 52. "We have previously disregarded experts' conclusions as to marketability discounts for stock with holding periods of more than 2 years when based upon the above-referenced studies."

41 Revenue multiples are rarely, by themselves, adequate for valuing a business, but they do provide interesting insights, and can further inform the appraiser's analysis. Certainly, higher than normal revenue multiples can be justified for unusually profitable companies. But that begs the question of what a representative earnings level was in this case. Had PMG by 2004 reached a permanently higher plateau in profitability after its weaker performance earlier in the decade? This is a highly cyclical industry and representative earnings levels based on multi-period averages should almost always be considered. It is not clear whether they were considered here.

42 Source: Bloomberg.

43 Note that Media General, Inc., is not discussed as a possible guideline company in the Court's opinion.

44 Source: Bloomberg. Also, based on the projected EBITDA number for PMG in the Court's valuation, the "forward-looking" EBITDA multiple implied by the Court's opinion is only about 10x. Note, however, the question of representativeness posed above._This EBITDA estimate seems a highly optimistic one. Conversely, an EBITDA multiple based on historical earnings would be significantly greater, perhaps higher than McClatchy's, which the Court points out is larger and has a more diversified business. For a private company like PMG to sell at multiples at or higher than larger, public competitors is unusual absent truly unique circumstances.

45 See Ryan Chittum, "Newspaper Industry Ad Revenue at 1965 Levels" Columbia Journalism Review, August 19, 2009. Citing Newspaper Association of America data on newspaper-industry revenue, which goes back to 1950. "It's ugly: You have to go back to 1965 to find a year with revenue lower in 2009 dollars than what this year is projected to be."

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