NAVIGANT

TRANSACTION ADVISORY SERVICES

# ENGAGEMENT CASE STUDY — WORTHLESS STOCK VALUATION

## CHALLENGE

In 2011, our client made a significant investment to acquire an online retailer (the company) of complementary products with a similar customer base in order to bolster its own online presence. The company was founded during the internet boom of the 1990s and operated as a stand-alone online-only business since its inception. At the time the company was acquired by our client, many industry observers believed online retail growth would occur within specialized websites with a specific product focus. Furthermore, to a great extent, online retailers were considered as a separate category from brick-and-mortar retailers. At the time of the investment, the acquisition was thought to be a good strategic fit for our client, as the acquisition of the company was expected to provide a pure-play online retail channel while streamlining our client's efforts to supplement and enhance its own website.

Subsequent to the transaction, the industry's evolution deviated radically from our client's original expectations. In addition to increasingly intense competition from online retailers such as Amazon, omnichannel retailers (those focusing on both web and brick-and-mortar sales) made significant strides in building effective online presences that hampered the market positioning of the company. Over time, customers gained comfort patronizing retail websites whose brick-and-mortar stores they already frequented, extending the advantages of specific store branding as compared to more generalized websites such as the target. These developments, coupled with other challenges, eroded any competitive advantage our client expected to achieve from operating the company.

As part of evaluating its strategic alternatives for the company, our client pursued a divestiture of the company in order to stem its losses. In the absence of any viable buyers for the business, our client ultimately determined a shutdown of the company and liquidation of its assets and liabilities was the most prudent course of action. In connection with the business dissolution, our client requested assistance with the valuation requirements to complete a worthless stock deduction under Internal Revenue Code Section 165 (IRC 165). Such a valuation requires careful analysis and thorough documentation to successfully defend the value conclusions, should the issue be litigated in Tax Court.

## SOLUTION

Our scope of work included a complex multistep engagement that was specifically designed to meet our client's needs.

The first step of our analysis was to make a determination of the business enterprise value of the company using the income and market approaches under a going concern premise of value. As part of this analysis, we assessed historical operating and financial results of the company in order to gain an understanding of the business, evaluated the industry in which the company operates, and developed long-term financial projections for the business in order to determine the viability of the business as a going concern given the expected outlook for the business and industry. Within the income approach, we considered a base case scenario reflecting the client's expectations for the business. In addition, we evaluated multiple supporting scenarios that considered potential performance based on historical and projected operating results for public companies within the industry. This multifaceted analysis provided further assurance that the valuation will withstand any future scrutiny. At the conclusion of the first step of our analysis, we determined the fair market value of our client's equity investment in the company was zero under a going concern premise of value.

Based on our conclusions from the first step of our analysis, it was necessary to proceed with the second step of our analysis, which was to make a determination of our client's equity investment in the company under an orderly liquidation scenario using the adjusted balance sheet method under the cost approach. In step two, we analyzed the balance sheet line items in order to determine the fair market value of relevant assets under an orderly liquidation scenario. Our scope of work was primarily focused on the valuation of the intangible assets inherent in the company. As part of our analysis, we assessed the value of the company's customer relationships, domain/trade names, and other intangible assets.

## CONTACTS


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### About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant's professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage, and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the firm primarily serves clients in the healthcare, energy, and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant's practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at navigant.com.

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IRC 165

| STEP 1: GOING CONCERN | STEP 2: ORDERLY LIQUIDATION | STEP 3: CONCLUSION |
|---|---|---|
| • Income approach<br>– Base case<br>– Supporting scenarios<br>• Market approach<br>– Guideline public companies<br>– Guideline transactions | • Analysis of fair market value of financial and intangible assets<br>• Adjusted balance sheet method under the cost approach | • Valuation conclusions for the business enterprise and relevant underlying assets<br>• Robust, thoroughly documented support for IRC 165 deduction<br>• **Significant income tax savings for our client** |

## IMPACT

After assessing the client's needs, Navigant developed a multistep engagement in order to provide a valuation solution for the client that resulted in a well-documented analysis and report designed to withstand scrutiny. Navigant's analysis relied on the specialized analytical skills of our team and a thorough evaluation of our client's business, including the industry and economic environment in which it operates. The work performed by Navigant enabled us to distill the company's complex strategic and operational history into a cohesive analysis, leading to well-reasoned and thoroughly supported conclusions of value. By employing a comprehensive solution that draws consistent conclusions from multiple valuation approaches, Navigant helped the client to be best positioned to avoid future tax uncertainty. With the support provided by Navigant's analysis, the client was able to achieve ordinary income tax savings.