VALCON 2018

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Valuations: Art or Science? Where We've Been and Where We're Going

Ian Ratner, Moderator
GlassRatner Advisory & Capital Group LLC; Atlanta

Thomas S. Biemer
Dilworth Paxson LLP; Philadelphia

Thomas J. Hall
Norton Rose Fulbright US LLP; New York

Prof. Jack F. Williams
Baker Tilly Virchow Krause, LLP; Atlanta

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Our Mission

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This lively session is intended to trace the trends in the application of the technical approaches to business and securities valuations, and to examine the direction the valuation profession is heading in. Are we becoming more of a science or an art, and how will the direction of the profession affect our work and its reliability?

"It is often said that valuation is more art than science, but this aphorism reflects the need for professionals to make case-specific judgments."

- Vice Chancellor Laster, *In re El Paso Pipeline Partners, L.P. Derivative Litig.*, No. CV 7141-VCL, 2015 WL 1815846, at *22 (Del. Ch. Apr. 20, 2015).

Trends Within the Industry

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Available Data

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How has access to data and the sophisticated data tools developed in the last few years affected the profession?

Do you see trends in the valuation area that may relate to an over or under reliance on empirical data?

How do you determine what is reliable data in today's world?

Is it important to be consistent with the data that you use?

Sophisticated Analytics

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How has valuation analysis changed over the past few years?

Has reliance on sophisticated analysis impacted the industry?

How do you convey complex analysis to a Judge or Jury that may not be well versed in valuation?

The Discount Rate

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Is there controversy in applying a Company Specific Risk Premium (CSRP) to your Discount Rate?

What do the courts say?

Court Decisions on Company Specific Risk Premiums [1]	
Questioned the Concept	• Union Illinois v. Korte, 2001 WL 1526303 (Del. Ch. 2001) • Union Illinois 1995 Investment LP v. Union Financial Group Ltd., 847 A.2d 340 (Del. Ch. 2003) • Gotham Partners v. Hallwood Realty Partners LP, 855 A.2d 1059 (Del. Ch. 2003)
Accepted the concept, but rejected its use in the case	• Le Beau v. M.G. Bancorporation, 1998 WL 44993 (Del. Ch. 1998) • Hintmann v. Fred Weber Inc., 1998 WL 83052 (Del. Ch. 1998) • Gesoff v. IIC Industries, 902 A.2d 1130 (Del. Ch. 2006) • In re Sunbelt Beverage Corp., 2010 WL 26539 (Del. Ch. 2010)
Question possible bias in determining the CRSP	• Solar Cells v. True North Partners LLC, 2002 WL 749163 (Del. Ch. 2002) • In re Loral Space & Communications Consolidated Litigation, 2008 WL 4293781 (Del. Ch. 2008)
Employed a CRSP	• Wacht v. Continental Hosts Ltd., 1994 WL 52522 (Del. Ch. 1994) • Onti Inc. v. Integra Bank, 751 A.2d 904 (Del. Ch. 1999) • Delaware Open MRI Radiology Associates v. Kessler, 898 A.2d 290 (Del. Ch. 2006) • Reis v. Hazelett Strip-Casting Corp., 2011 WL 4346913 (Del. Ch. 2011)

[1] Analysis of Delaware Chancery Court Opinions on the Use of Company-Specific Risk Premiums in Valuation By Arthur H. Rosenbloom & Bala G. Dharan, Charles River Associates and Ihsan Dogramaci, Esq., Orrick, Herrington & Sutcliffe

Reliance on Court Cases

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Is there a trend in the valuation industry to over or under rely on court opinions?

Do you find that the courts are generally consistent in their opinions?

Do you see the court's shifting their opinions on any valuation subject in particular?

How would this shift in court opinion impact the valuation industry?

Explicit vs Implicit (embedded) Assumptions

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What are the differences between Explicit and Implicit assumptions?

How do these types of assumptions impact value?

Sample Court Cases

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Golden Telecom Inc. v. Glob. GT LP

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"Section 262(h) unambiguously calls upon the Court of Chancery to perform an independent evaluation of 'fair value' at the time of a transaction. It vests the Chancellor and Vice Chancellors with significant discretion to consider 'all relevant factors' and determine the going concern value of the underlying company. Requiring the Court of Chancery to defer—conclusively or presumptively—to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the statute and the reasoned holdings of our precedent. It would inappropriately shift the responsibility to determine 'fair value' from the court to the private parties. Also, while it is difficult for the Chancellor and Vice Chancellors to assess wildly divergent expert opinions regarding value, inflexible rules governing appraisal provide little additional benefit in determining 'fair value' because of the already high costs of appraisal actions."

-Chief Justice Steele, *Golden Telecom, Inc. v. Glob. GT LP*, 11 A.3d 214 (Del. 2010).

DFC Glob. Corp. v. Muirfield Value Partners, LP

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"Market prices are typically viewed superior to other valuation techniques because, unlike, e.g., a single person's discounted cash flow model, the market price should distill the collective judgment of the many based on all the publicly available information about a given company and the value of its shares. Indeed, the relationship between market valuation and fundamental valuation has been strong historically. As one textbook puts it, '[i]n an efficient market you can trust prices, for they impound all available information about the value of each security.' More pithily: 'For many purposes no formal theory of value is needed. We can take the market's word for it.' But, a single person's own estimates of the cash flows are just that, a good faith estimate by a single, reasonably informed person to predict the future. Thus, a singular discounted cash flow model is often most helpful when there isn't an observable market price."

-Chief Justice Strine, *DFC Glob. Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346, 369–70 (Del. 2017)

Discounted Cash Flow

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"The DCF analysis is a well-established method of determining the going concern value of a corporation. '[T]he DCF ... methodology has featured prominently in this Court because it is the approach that merits the greatest confidence within the financial community.'"

-Chanellor Bouchard, *Owen v. Cannon*, 2015 WL 3819204, at *16 (Del. Ch. June 17, 2015).

Projections

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"[M]anagement projections created in the 'ordinary course of business' are generally deemed reliable for valuation purposes. The Court also identified several circumstances that may warrant disregarding management projections, such as "where the company's use of such projections was unprecedented, where the projections were created in anticipation of litigation, or where the projections were created for the purpose of obtaining benefits outside the company's ordinary course of business."

*-Vice Chancellor Noble, In re Nine Sys. CorporationShareholders Litig., No. CIV.A. 3940-VCN, 2014 WL 4383127, at *41 (Del. Ch. Sept. 4, 2014).*

"This Court has a preference for the use of management forecasts because management is typically deemed most knowledgeable about the Company's prospects."

- Vice Chancellor Noble, *Cede & Co. v. MedPointe Healthcare, Inc.*, No. CIV.A. 19354-NC, 2004 WL 2093967, at *16 (Del. Ch. Sept. 10, 2004).

"This Court has consistently recognized the importance of management's contemporaneous projections because 'the outcome of a DCF analysis depends heavily on the projections used in the model.' Valuations that have ignored or altered management's contemporaneous projections are "sometimes completely discounted."

-Chancellor Chandler, S. Muoio & Co. LLC v. Hallmark Entm't Investments Co., No. CIV.A. 4729-CC, 2011 WL 863007, at *19 (Del. Ch. Mar. 9, 2011).

Post Valuation Adjustments

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"Generally speaking, our appraisal jurisprudence is skeptical of litigation-driven adjustments to management projections."

*Vice Chancellor Laster, In re Appraisal of Dell Inc., No. CV 9322-VCL, 2016 WL 3186538, at *46 (Del. Ch. May 31, 2016).*

"This Court has a preference for the use of management forecasts because management is typically deemed most knowledgeable about the Company's prospects. However, because post hoc litigation driven forecasts have a untenably high probability of containing hindsight bias and other cognitive distortions, this Court is skeptical of ex post adjustments to such predictions."

*-Vice Chancellor Noble, Cede & Co. v. MedPointe Healthcare, Inc., No. CIV.A. 19354-NC, 2004 WL 2093967, at *16 (Del. Ch. Sept. 10, 2004).*

"[T]his Court prefers valuations based on management projections available as of the date of the merger and holds a healthy skepticism for post-merger adjustments to management projections or the creation of new projections entirely. Expert valuations that disregard contemporaneous management projections are sometimes completely discounted."

*-Chancellor Chandler, Cede & Co. v. JRC Acquisition Corp., 2004 WL 286963, at *2 (Del.Ch. Feb.10, 2004).*

Panel Biographies

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Thomas S. Biemer

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Thomas S. Biemer represents his clients in complex commercial cases, handling matters in state and federal courts involving RICO, corporate governance, construction, ERISA, CERCLA, commercial real estate, patents, healthcare, class actions, trusts and estates, and contract disputes. He also represents both plaintiffs and defendants in a variety of alternative forums designed to expedite resolution and minimalize costs.

As Chair of Dilworth Paxson's Litigation Department, Mr. Biemer is responsible for over 50 attorneys in five offices practicing in state and federal courts in numerous jurisdictions.

Licensed in Pennsylvania and New Jersey, Mr. Biemer is also admitted in the State Courts of Pennsylvania, State Courts of New Jersey, United States Supreme Court, U.S. Court of Appeals for the Second Circuit, United States Court of Appeals for the Third Circuit, United States Court of Appeals for the Fourth Circuit, United States Court of Appeals for the Federal Circuit, United States District Court for the Eastern District of Pennsylvania, United States District Court for the District of New Jersey, United States District Court for the Southern District of New York, and the United States Tax Court.

Thomas J. Hall

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Thomas Hall is Co-Head of Litigation, New York and a leading trial lawyer who has led over 40 trials to verdict and arbitrations to award. Mr. Hall has extensive experience in a broad range of complex commercial litigation matters, including environmental, banking, securities, intellectual property, energy, project finance, construction, real estate, insurance, corporate governance, partnership and contract disputes. He has handled all aspects of litigation and alternative dispute resolution throughout the United States and abroad.

Benchmark's *Guide to America's Leading Litigators* recognizes Mr. Hall as among the leading litigators in the country. *The Legal 500* states that he "stands out in his approachability, frankness and sound judgment" and is "exceptionally user-friendly."

Jack F. Williams

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Jack Williams has over twenty-five years of experience in bankruptcy and financial distress-related matters and forensics and fraud investigations, providing consultation and expert witness services in the areas of business restructuring, bankruptcy and insolvency taxation (federal, state, and local), public finance, fiduciary duties and governance issues, D&O liability matters, related-party transactions, intercompany transfers, international asset concealments, fraud investigations and fraudulent transfers, remedies, forensic accounting and investigatory services, and commercial and IP damages modeling.

As a tenured Professor at Georgia State University College of Law and the Center for Middle East Studies in Atlanta, Georgia, Jack teaches and/or conducts research in the areas of business reorganizations, forensic accounting and financial investigations, mergers and acquisitions, corporate finance, taxation, and law and statistics. He is presently the Association of Insolvency & Restructuring Advisors' Resident Scholar and has served two terms as the American Bankruptcy Institute (ABI) Resident Scholar. In these roles, he has researched a range of forensic investigation issues, fiduciary duties and governance issues, solvency and distressed business valuations, profit and profitability assessments, and international asset concealment schemes.

Ian Ratner

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Ian Ratner is a CPA with approximately 30 years' experience in Public Accounting, Forensic Accounting, Business Valuations, Due Diligence Services, Corporate Finance and Bankruptcy Consulting. Mr. Ratner specializes in helping clients resolve distinctive and non-typical business challenges.

He co-founded GlassRatner in 2001 with Ron Glass. Ian has a diverse practice that includes assignments such as creditor committee representations, due diligence engagements, monitoring borrowers on behalf of lenders, serving as liquidating agent, Special Master, Receiver and other fiduciary roles, leading complex multi-bank restructuring assignments on behalf of borrowers and lenders. Mr. Ratner is better known as a national expert witness and has testified at trial and deposition on more than 140 occasions, and has worked on matters throughout the United States and Caribbean for law firms and Fortune 500 companies. He is a well-respected valuation expert and has valued hundreds of companies for a variety of purposes. In 2009 Ian co-authored the Wiley text book called Business Valuation and Bankruptcy and is a frequent speaker at valuation and restructuring conferences. In 2010 Ian became a Fellow of the American College of Bankruptcy.