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Webcast

Valuing Businesses: Working with Experts to Present Valuation Evidence in Business and Insolvency Contexts

Overview

- I. Valuation Contexts
 - a. Business Litigation Contexts
 - b. Bankruptcy Contexts
- II. Working with Experts
- III. Appendix on Data and Documents for Experts

I. Valuation Contexts

A. Business Litigation

- Statutory litigation related to fair value – public and private deals
 - In stock for stock deal, may also have to value consideration received
- Fiduciary litigation (relevance of “fair price”)
- Damages – change in value of business due to alleged tort or statutory wrong

I. Valuation Contexts

B. Bankruptcy Contexts

- Preference and fraudulent transfer claims
- 363 Sale
- Value of company in Chapter 11 plan
- Adequate protection for DIP financing

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IA. Business Litigation

Business Litigation

Definition of Value is Context Specific

- **Can be defined by contract**
 - Earn out clause
 - Liquidated damages provision
 - Limitation of damages
 - Preferred stock
- **Can be defined by statute**
 - Section 262 of Delaware General Corporation Law (appraisal statute)

Example: Delaware Statutory Approach to “Fair Value”

- 8 Del. Code Sec. 262 states that “the Court shall determine the fair value of the shares [subject to appraisal] exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation. . . .”
 - Fair value \neq fair market value
 - Stockholder entitled to pro rata value of going concern
- “In determining such fair value, the Court shall take into account all relevant factors.”
- Court comes up with own valuation, after analyzing expert valuation testimony presented by parties

Example Cont'd: Relevant Valuation Date for “Fair Value” Determination in Appraisal Proceeding

- Typically Date of Closing
- Can only take into consideration what was “known or knowable” as of that date
- DCF should be based on contemporaneous management projections
 - Even if turned out to be wrong, projections reliable if they were management’s (non-biased) best estimates at time they were prepared

Valuation Methodologies

- Discounted cash flow: key methodology (if reliable inputs)
- Comparable companies
- Comparable transactions
- Deal price
- Trading price
- Liquidation/net asset value
- Contractual Interpretation
- Weighting of different methodologies typical/Triangulation

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IB. Bankruptcy Contexts

Bankruptcy Valuation

“Much like a guess compounded by an estimate...”

- Judge Kevin J. Carey (Tribune Company, et al.)

Value of a Company in Chapter 11: *How is it Established?*

1. Schedules/Statements of Financial Affairs
2. Sale/Sale Process – Best Indication of Value?
3. Professional Valuation

Bankruptcy Adversary Proceedings

Valuation typically comes up in:

1. Determining solvency for preference and fraudulent transfer claims
2. Valuing property in fraudulent transfer claims

Insolvency Tests

- Although insolvency is a fact specific inquiry, bankruptcy courts generally use three tests used to determine whether an entity is insolvent
 1. Balance Sheet Test
 - a) The balance sheet test involves valuation issues more than the other tests
 2. Cash Flow Test
 3. Adequate Capital Test
- Rebuttable assumption of insolvency for preference claims but not fraudulent transfer claim
- Balance sheet valuation will differ depending on whether the company is a going concern or on its “deathbed”.

Other Bankruptcy Contexts

1. 363 Sale – Is the Sale Price Highest/Best?
2. Chapter 11 Plan – Does Value Properly Establish Interests of and Recoveries to Stakeholders?
3. Adequate Protection for cash collateral and DIP financing

II. Working With Experts

Use Expert to Help tell the Valuation Story

- Industry in flux?
- Competitive pressures?
- Changes in markets over time?
- Impact of globalization?

Selection of Expert

- Experience can be helpful but be sensitive to problem of “hired gun”
- Make sure no directly contradictory reports or testimony in prior cases (same analysis for articles, textbooks, etc.)
- Evaluate “real world” v. academic experience
- Check references carefully
- Advantages of individual v. firm of experts
- Level of engagement
- Industry familiarity can provide big edge

Working with Your Expert

- Ask the expert for periodic data and document requests
- Provide access to the discovery data base
- Provide legal instructions and directions
- Make sure the financial advisor understands the assignment
 - All solvency dates (and reasons)
 - Other types of analyses
 - Other types of opinions
- Provide reasonable deadlines

Working with Your Expert

- Provide all relevant documents and information
 - Deposition transcripts
 - Discovery documents
 - Other
- Don't expand the expert's role beyond his/her expertise
 - GAAP accounting expert
 - Tax accounting expert
 - Industry practices expert
 - Bankruptcy law expert

Discovery of Communications With Testifying Experts

- Different default rules in different jurisdictions, courts. Federal rules v. state rules
- Think about which rules will apply before communicating with potential experts
- Make sure expert, counsel and client understand at outset whether communications and draft reports will be discoverable
- Different rules apply for non-testifying experts, but may depend on facts.

Expert Communications With Management May or May Not Be Helpful

- Can provide useful context and inputs; BUT
- Discoverability issues
- Due diligence based on record may be more credible than unsworn conversations
- May lead to conclusion that expert analysis includes post-valuation date data
- Risk that inputs rejected as reflecting bias

Depositions of Experts:

Taking and Defending

- Think about trial cross-examination
- Think about experts' prior consistent/inconsistent analyses
- Explore everything the expert did/did not do in connection with analysis
- Explore bias
- Confirm that all opinions set forth in report
- Was analysis independent? Explore communications and relationships with lawyer and client
- Reveal and test assumptions

Cross-Examination of Opposing Expert

- Limit to high points
- Show that not familiar with industry
- Use concessions from deposition
- Show bias
- Show not familiar with how court has applied relevant valuation principles
- Show not familiar with record and facts pertinent to analysis
- Show assumptions were not reasonable

Role of Investment Banker Analysis

- General rule of thumb that should not use banker on deal as expert in deal litigation – discoverability, bias issues
- Also, fairness opinion involves different questions than does valuation analysis (but there may be overlap)
- Contemporaneous Investment banker analysis often helpful as valuation “fact” witness
- Fact that expert advised company in transaction affects weight given to testimony
- Bankruptcy courts may be more open to hearing expert testimony from persons who help manage the company

**III. Appendix:
Data And Documents
Valuation Expert May
Need**

Appendix: Data and Documents

- Data and documents about the company
- General Financial and Business Information
- Balance Sheet Information
- Cash Flow Data
- Income Valuation Information
- Cost of Capital Information
- Market Approach Information

Any Questions?

Contact Information



Christopher Harris

Partner (Latham & Watkins LLP - Washington, D.C.)

Email: john.manthei@lw.com

Telephone: +1.212.906.1880



Elena Norman

Partner (Young Conaway Stargatt & Taylor, LLP)

Email: enorman@ycst.com

Telephone: +1.302.571.5029

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