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Valuation Case Law Update: Legal and Financial Perspectives - Plan Valuation Issues



Presented by
Andrew Silfen
Arent Fox LLP
Washington, DC | New York, NY | Los Angeles, CA

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***In re Granite Broadcasting Corp., et al.*, 369 B.R. 120 (Bankr. S.D.N.Y. May 18 2007)
(Gropper, J.)**

The debtors moved for confirmation of their plan of reorganization. Certain equity holders objected on the grounds that the plan overvalued the debtors and paid secured creditors more than the full amount of their claims, thereby depriving the equity holders of their due recovery. The bankruptcy court confirmed the plan, finding that the expert valuations provided by the parties in interest as well as the proposal to acquire the debtors made by the equity holders confirmed that there is no value beyond debt.

The bankruptcy court noted that each of the principal parties in interest submitted valuation reports that relied on the same three standard enterprise valuation methods: (1) discounted cash flow analysis, which calculates the enterprise's future cash flow and discounts it back to present value; (2) comparable company analysis, which estimates a company's future value based upon the market capitalization of comparable companies in the same industry; and (3) precedent transaction analysis, which attempts to ascertain the value of a company based upon the amounts paid for comparable companies in the same industry and in recent transactions.

The debtors and a secured creditor plan proponent both found that the debtors' value at confirmation was generally between \$450 and \$525 million, with a midpoint value of approximately \$490 million. Equity, however, arrived at a value of between \$626 and \$707 million with a midpoint of approximately \$667 million. The difference in valuations is accounted for by the fact that whereas the debtors and secured creditor used the projections in the debtors' current business plan to estimate its future cash flow and margins (which they did not reduce to account for the debtors' failure to meet such projections in the first quarter of 2007), whereas equity used projections of future enterprise performance that were far higher and were provided by a third party (who would be installed by equity as the new CEO if they were able to gain control).

With regard to the expert witness submissions, the bankruptcy court noted that equity provided no support for the third-party projections, that the third party was not qualified as an expert, that his work on the projections was never described in detail, and that it was established at deposition that he knew very little about the debtors. The bankruptcy court further noted that many of the assumptions upon which the third-party projections were based were unsupported, that the last broadcasting company run by the third party (the debtors were a broadcasting company as well) was overleveraged and frequently in default under its credit facility and had poor operating results, bringing into question the third party's qualifications to provide projections on the debtors' future performance. The projections provided by the debtors and secured creditor, however, were supported by evidence and were also the product of extensive due diligence. The bankruptcy court also found significant that the compensation for the expert witness relied upon by equity was contingent upon the results of his testimony. The bankruptcy court also noted that the best evidence of value is often what a third party is willing to pay in an arm's length transaction, and determined that the valuation based upon equity's offer to acquire the debtors also did not support the existence of any value over debt.

***In re Nellson Nutraceutical, Inc.*, 2007 WL 201134 (Bankr. D. Del. Jan. 18 2007)
(Sontchi, J.)**

Although not in the context of confirmation, the bankruptcy court issued a decision which calculated the debtors' enterprise value. The bankruptcy court determined that there was deliberately inaccurate information provided to the experts by the debtors and the experts relied upon this inaccurate information in issuing their opinions. The bankruptcy court wanted to rely on the expert opinions but to do so had to adjust the opinions to compensate for the manipulations in the debtors' long range plan and the poor performance of the debtors after the issuance of the long range plan.

To reach its final enterprise value amount, the bankruptcy court (i) accepted the opinions of the three experts as to enterprise value; (ii) adjusted the experts' opinions to correct for errors or inconsistencies; (iii) assigned weight to the experts' opinions based on the credibility of each expert's opinion and testimony; and (iv) further adjusted the weighted average of the experts' opinion to compensate for the debtors' long range plan and the poor performance of the debtors after that date.

The bankruptcy court found that all three of the experts' reports and testimony meet the criteria of admissibility of expert evidence: qualification, reliability, and fit. However, the bankruptcy examined the qualifications of each of the experts to determine the weight to give the admissible evidence.

The first of the three experts was found to be extremely well qualified despite his lack of formal valuation training. He has received recognition as a valuation expert and his qualifications have been accepted by every court in which he has been offered as an expert on enterprise value. However, he was trained as a lawyer and has no formal business valuation credentials or training. The bankruptcy court found him to be a credible witness, but he made some errors in reaching his conclusion which indicated to the court a predisposition to reach a low valuation conclusion and the bankruptcy court determined that this fact affected his credibility.

The second of the three experts was an accredited valuation professional, a member of the American Society of Appraisers, and held a master's degree in business administration from Harvard University. He did make a few errors, in his DCF analysis, but the bankruptcy court found him to be the most credible of the three experts.

The third of the three experts was also found to be extremely well qualified despite his lack of formal valuation training. He is recognized as a valuation expert and his qualifications have been accepted by every court in which he has been offered as an expert on enterprise value. However, he was trained as a lawyer and has no formal business valuation credentials or training. Just like with the first expert, the bankruptcy court found him to be a credible witness, but he made some errors in reaching his conclusion which indicated to the court a predisposition to reach a low valuation conclusion and the bankruptcy court determined that this fact affected his credibility.

Thus, based upon the above, the bankruptcy court weighted the experts' opinions at 30%, 40%, and 30%, respectively.

***In re Nelson Nutraceutical, Inc.*, 356 B.R. 364 (Bankr. D. Del. Dec. 4 2006) (Sontchi, J.)**

The bankruptcy court held a trial to determine the debtors' enterprise value during which experts retained by the debtors, the creditors' committee and the informal first-lien creditors' committee actively participated. Each of the experts agreed, and as confirmed by the bankruptcy court, that there are three valuation methodologies that are used under standard valuation practice: (1) a discounted cash flow analysis, or "DCF Method", which derives the value of a company by calculating the company's future cash flows multiplied by a discount factor to determine a present value for those cash flows; (2) a precedent transaction or "Comparable Transaction Method", which derives the value of a company by examining recent control transactions of comparable companies; and (3) a publicly traded company or "Comparable Company Method", which derives the value of a company by examining the trading values of the equity of comparable publicly traded companies. The court recognized that any valuation methodology requires an expert to determine an appropriate metric of value and apply a multiple to that metric to determine a company's enterprise value and that different methodologies use different sources of material to determine both the appropriate metric of value and the multiple. Experts will also perform an analysis under each of the valuation methodologies and reach a conclusion by assigning an appropriate weight to each methodology.

Subsequent to the valuation trial, an issue arose with respect to the admissibility of the expert testimony offered by the debtors' expert in support of their particularized valuation approach. The debtors' expert valued the company solely under the DCF Method and calculated the debtors' terminal value by subtracting the debtors' capital expenditures from their earnings before interest, tax, depreciation and amortization ("EBITDA"). The bankruptcy court held this valuation approach was not sufficiently reliable and thus was inadmissible as it was not generally accepted by the experts in the field of valuation, was never used by any expert before any federal court to determine a company's terminal value under the DCF Method, was never tested and was in fact invented by the debtors' expert for use in this case.

***Chartwell Litig. Trust v. Addus Healthcare, Inc. (In re Med Diversified)*, 346 B.R. 621 (Bankr. E.D.N.Y. 2006)**

The bankruptcy court resolved the defendants' cross-motion *in limine* to exclude the testimony of the plaintiff's expert.

The plaintiff's claimed that a pre-petition payment of \$7.5 million from the debtor to the defendants was recoverable by the estate because it did not receive reasonably equivalent value. The defendants' filed a motion *in limine* seeking to deny admission of the expert

report and testimony of the plaintiff's expert on the grounds that the expert's methodologies for an enterprise valuation exhibited a deliberate, manifest, pervasive, and systematic bias. The defendants argued that report and testimony were fundamentally unreliable.

The Court granted the defendants motion *in limine* and excluded the expert's testimony and report. The Court held that the bias on Cimas's party in applying the standard methodologies for estimating the total enterprise value of Addus warranted disqualifying him and his report on the principal ground of unreliability.

The expert Cimas used three different methods of valuation to support his conclusion that Addus was worth only \$21 million at the time the parties entered into the transaction for the sale of Addus to med Diversified for approximately \$119 million. The three methods were: (a) the discounted cash flow method; (b) the guideline company valuation or comparable company method; and (c) the direct market comparable transactions or comparable transaction method. Each of the three methods yielded different values for Addus: (a) the DCF method yielded a value of \$18,772,961; (b) the GCV method yielded a value of \$26,108,195; and (c) the DCT method yielded a value of \$20,830,171. After considering the limitations of each method, Cimas determined that the results reached using the DCF method should constitute 60% of the value determination, the GCV method results should represent 30%, and the DCT method results should make up only 10%. Then arrived at a weighted average value for Addus of \$21 million.

The Court noted that a benchmarking analysis compares the historical performance of the company to that of companies in the same industry and is used as a tool to measure the relative risk of the investment. Cimas performed a benchmarking analysis for Addus and used portions of this analysis in his DCF analysis. He also used results from his benchmarking analysis in his GCV analysis, upon which he determined that Addus's performance was comparable to companies who performed in the lower quartile performance range. The Court, however, found that Cimas's benchmarking analysis relied heavily on a small database of publicly held companies and was applied in a manner that was skewed to disfavor Addus, thereby rendering not only the benchmarking analysis unreliable, but also tainting his DCF and GCV analyses.

Using the DCF method, Cimas determined that the value of 100% of the shares of Addus was \$18,772,961. This figure constituted 60% of his final determination that Addus was only worth \$21 million at the time it entered into the sale transaction with Med D. Cimas offered no adequate explanation why this Court should not require equal weights to the results obtained by each of the three standardized methods. By reducing the weights of the results from the other methods, Cimas "shoved" the data to a lower value.

The future benefit Cimas chose to measure was Addus' net cash flow. The Court acknowledged that there are two components critical to the determination of the projected net cash flow: (1) projected revenue, and (2) projected costs and expenses. Cimas based his revenue projections on two variables: (1) the projected increase/decrease in reimbursement for services, and (2) the projected increase/decrease

for services measured by the combination of utilization demand for services and market share. While the actual increase in revenue for Addus was 34.76% from 1999 to 2000, and 11.24% from 2000 to 2001, his projected revenue increases for the prospective 5 year period were: 4.94% for years 1 & 2, 3.95% for year 3, and around 5% for years 4 & 5. H calculated projected revenue for Addus by applying these percentage increases to Addus's actual and projected revenue figures.

The record was devoid of any meaningful support for use of these variables to project future revenue. More importantly, it did not appear that Cimasi took any other variables into account in projecting Addus's revenue for post acquisition years 1-5, such as the revenue generating characteristics of each segment of Addus's business or any future plans for the business. The only characteristic of Addus's historical performance that he considered in projecting revenue was Addus's actual 2001 revenue, without any adjustments or qualifications, upon which he added his increase/decrease projection percentages. The figure Cimasi arrived at for the projected cost of sales and operating expenses for Addus consisted of the weighted average of Addus's historical cost of sales and operating expenses and the corresponding industry average cost of sales and operating expenses, which were obtained from the results of his benchmarking analysis. Cimasi testified that in calculating the operating cost figures for the benchmarking companies, he excluded extraordinary and nonrecurring expenses, but he did not do so when calculating the same figures for Addus. Cimasi provided no meaningful explanation for why he did not use Addus's normalized costs figures. To the contrary, he used an audited number which was decisively rejected by the plaintiffs' own accountant. The adjustments Cimasi failed to make exceeded \$13 million dollars for 2001. This failure effectively wiped out what would have been a \$13 million EBITDA. As a result, he did not properly apply the standard methodology in this case.

The Court then examined the discount rate. The rate that Cimasi used to determine the present value of the future stream of net cash flow from Addus was derived using a rate that reflected the weight and cost of both debt and equity of the company. In determining the cost of equity, Cimasi took a number of factors into consideration, including the results of his benchmarking analysis. After considering all of these factors, he concluded the cost of equity for Addus was 20.63%. Of this 20.63%, Cimasi attributed 10% of the risk associated with this particular company, which he called the subject entity specific risk premium. This premium was made up of five separate elements, three of which were wholly unjustified as either duplicative or based on his flawed benchmarking analysis.

Three percentage points of the 10% represented what Cimasi called an operational performance risk, or the added risk associated with Addus's poor performance when compared to the benchmarking companies. However, Cimasi's benchmarking analysis was fatally flawed. Another 3% was added for the risk associated with reimbursement, which was already accounted for in his computation of projected revenue, and was based in part on his calculated percentage projections for the increase/decrease in reimbursement for services. He added another 1% to account for market competition risk, which was also accounted for in his revenue projections that specifically accounted for the increase associated with the future demand for services and the expected increase

in market share. Thus, at least 7 percent points of the 20.63% calculated as the cost of equity for Addus was based on a flawed application of the methodology.

In addition, the actual cost of Addus' debt was 4.28%. Cimasi added 12% to that number to account for the fact that Addus' debt was personally guaranteed by its principal. Thus, the cost of debt used in his WACC calculation was 16.28%.

The Court found that there was simply no justification for the addition of 12% to the cost of Addus's debt simply because of the guarantee.

Using the GCV method, Cimasi measured the following ratios from a database of 13 publicly traded healthcare companies: (a) market Value of Invested Capital ("MVIC")/Revenue and (b) MVIC/EBITDA. The 13 publicly traded healthcare companies chosen by Cimasi were those he considered similar to Addus. He then assigned a weight to each ratio based on his determination of how similar the company was to Addus, as reflected in his benchmarking analysis. He then calculated a weighted mean, median, high & low, upper and lower quartile value for each of the ratios. The Court noted that the final determination of what ratio value to apply was chosen differently for each of the ratios.

The Court found that Cimasi did not explain why he used two different time periods of comparison in choosing the two different multiples. The low multiples Cimasi used in calculating the value of Addus under the GCV method were the result of a flawed analysis. There were obvious inconsistencies in calculating the multiples he used as the percentiles used in choosing each multiple were different, even though they were based on the same data. No doubt this was because these multiples were chosen based on a comparison of two different and inconsistent time periods. Further, Cimasi's failure to normalize the data for Addus was a fatal flaw in his methodology.

Using this method, Cimasi analyzed transactions he determined were comparable, calculated the ratios or multiples based on those transactions, and then applied those multiples to Addus.

The Court found several reasons why Cimasi's analysis under the DCT method were flawed. The transactions chosen by him were not comparable to Addus. Cimasi chose to exclude outliers under this method even though he did not choose to exclude outliers under the GCV method, notwithstanding the fact that the database he considered in this instance had only 11 transactions that he chose because they were comparable. If they were truly comparable, he would not have needed to exclude outliers from such a small sample size. Finally, Cimasi's application of a 10% discount for lack of marketability was completely unsupported.

***In re Oneida Ltd*, 351 B.R. 79 (Bankr. S.D.N.Y. 2006)**

On March 19, 2006, Oneida Ltd. and certain of its subsidiaries filed for Chapter 11 bankruptcy relief and filed their plan of reorganization. Thereafter, on July 7, 2006, the

Debtors, filed a first amended plan of reorganization (the "Plan") and moved for its confirmation.

A hearing was held at which the Court heard valuation testimony from experts called by the Debtors and an ad hoc committee, and testimony from members of the Debtors' board of directors and management, in order to determine whether or not the Debtors' Plan should be confirmed. In order to confirm the Plan, the Debtors had to establish that their Plan, under the absolute priority rule, did not deprive the equity of any recovery to which it was entitled.

During the hearing, the Court received four reports and heard testimony from four investment bankers on the value of the Debtors. Mehdi, from Credit Suisse, an expert called by the Debtors, concluded that total enterprise value ranged from \$190 million to \$230 million, with a midpoint value of \$210 million. Stogsdill of Alvarez & Marsal, the lenders' financial advisors, concluded that total enterprise value ranged from \$190 million to \$225 million with a midpoint value of \$207 million.

By contrast, Thompson of Imperial Capital, the Equity Committee's financial advisor, concluded that the total enterprise value of the company ranged from \$260 million to \$330 million, with a midpoint of \$295 million. King of Mesirow Financial Consulting, the financial advisor to the Creditors' Committee, did not perform a separate valuation but provided a critique of the Credit Suisse, Alvarez & Marsal and Imperial Capital reports. Mesirow concluded that (a) Credit Suisse's total enterprise value range should be adjusted to a range of \$196 million to \$227 million, with a midpoint of \$212 million; (b) Alvarez & Marsal's total enterprise value range should be adjusted to a range of \$205 million to \$243 million, with a midpoint of \$224 million; and (c) Imperial Capital's total enterprise value range should be adjusted to a range of \$228 million to \$254 million with a midpoint of \$241 million. Mesirow's total enterprise value for the Debtors ranged from \$196 million to \$254 million, with a midpoint range of \$212 million to \$214 million.

The court held that the valuations submitted by Credit Suisse, Alvarez & Marsal, and Mesirow were reliable; thus, there was no value for equity.

The Court noted that the three expert valuations all relied on a discounted cash flow analysis ("DCF analysis"), a comparable (or selected) company analysis, and a precedent transaction (or selected acquisition) analysis. The comparable company analyses and the precedent transaction analyses were not heavily disputed. The experts also generally agreed that the DCF analysis was the most probative as to value. All of the experts started with the projections provided by the Debtors. The experts agreed that in order to arrive at an appropriate discount rate, it was necessary to calculate a "weighted average cost of capital" and that the basic components of such a calculation were the projected costs of debt and equity and the split between the two. All of the experts used substantially the same cost of equity, with a range of 19.9% to 20.5%. All of the experts also agreed that the Debtors' cost of debt would be substantially lower than the cost of equity.

One of Thompson's principal disagreements with the other experts was in his use of a rate of 7.9% for the debt portion of the projected cost of capital and his assumption that debt could provide approximately 60% of the Debtors' future capital needs. The Court found that his conclusion that the Debtors could capitalize the company's future capital needs with debt at his low an interest rate lacked adequate support. The market showed that the Debtors had been able to obtain exit financing at a rate of 12-13% and there was no suggestion that management was overpaying for the Debtors' exit facility. Thompson argued that it was not proper to use the actual debt facilities of an enterprise in performing a WACC analysis, and that a valuation should be based only on the cost of debt for comparable companies. However, Thompson himself uses the exit facility as a comparable in his testimony. The Court found that while there was support in the literature to use the cost of debt of comparable companies in a WACC analysis, the comparables Thompson used to arrive at a 7.9% cost of debt were problematic at best. Additionally, the Court found that although the Debtors' exit facility appeared to have been priced by the market under circumstances favorable to them, the use of Credit Suisse and Alvarez & Marsal of the interest rate that would be charged on the Debtors' actual exit facility was more reasonable than Thompson's reliance on problematic comparables. The Court also found little support for Thompson's use of a 60/40 debt to equity split in his WACC calculation.

The Court clearly acknowledged that all of the experts used, for the most part, the same companies and the same transactions as comparables, and there was no real disagreement on the basic methodology. Thompson, however, made certain adjustments that the Court found to be unjustified in light of the fact that the Debtors' projections were already aggressive.

***In re Mirant Corp.*, 334 B.R. 800 (Bankr. N.D. Tex. Dec. 9, 2005) (Lynn, J.)**

In the context of the plan confirmation proceedings of this case, the court held a valuation hearing to determine the enterprise value of the debtors. Experts were retained by the debtors, the creditors' committee, the creditors' committee appointed in the debtors' second tier subsidiary, the equity committee and a subordinated creditor constituency, and each expert valued the company using the Comparable Company Method and the DCF Method. Although the court recognized the existence of other valuation methodologies, including the Comparable Transaction Method, it was generally agreed by the experts and confirmed by the court that the other methods were not suitable and that the Comparable Company Method and the DCF Method were most likely to ensure that the company would be valued based upon the worth of its future ability to produce income and that the appropriate variables necessary to be applied to these two valuation methodologies were present, i.e., estimates of future cash flow, choice of comparable companies and choice of a perpetual growth rate.

The court ultimately adopted as the basis for valuation the debtors' expert report and the debtors' business plan, subject to various adjustments which the court directed be made to recalculate the debtors' value to account for certain changes deemed necessary by the

court. In going through its own valuation analysis, the court accorded equal weight to the Comparable Method and the DCF Method to arrive at the company's total value. The court was unable to accept the values arrived by the creditors' committees as it found that they were flawed, contained errors and included inappropriate additions. Agreeing with the court in *Exide*, discussed below, the court also concluded that the market's pre-confirmation valuation of the debtors, for the purpose of equity investment in or loans to the debtors, was not a proper measure of the debtors' enterprise value as the "taint" of bankruptcy would cause the market to undervalue the securities and future earning capacity of the debtors.

In going through its analysis, the court commented that valuation issues could be quite complex and should not be expected to yield precise results. Based upon the specific circumstances before the court, it stated that it was constrained by the need to defer to the debtors' expert and management.

***In re Med Diversified, Inc.*, 334 B.R. 89 (Bankr. E.D.N.Y. Nov. 14 2005) (Bernstein, J.)**

Defendants' called a purported expert witness to value, *inter alia*, 100% of the shares of the defendant, a privately-held company. In support of his qualifications as an expert witness, the defendants stated that the witness had more than 20 years of experience as an accountant and liquidating agent/bankruptcy trustee.

In exercising the bankruptcy court's gatekeeper function under *Daubert*, the bankruptcy court held that Rule 702 requires the court to ensure that any and all scientific testimony or evidence admitted is not only relevant but reliable. *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 597, 113 S.Ct. 2786 (1993). Judge Bernstein ruled that the witness did not qualify as an expert witness because he lacked any formal education or training in business valuation, did not issue business valuation reports (although he relied on members of his staff who are certified business valuers for their input) and by his own admission was not a qualified business valuator. The bankruptcy court further noted that the defendants' witness testified that he had no peer-granted certifications as an expert on business valuations, that the expert report he had provided is not to be read as a certified business valuation report, and further that the report cannot be considered a certified business appraisal of value because it did not meet uniform standards for professional appraisal practices that are generally accepted by professional business appraisers.

In addition to his lack of qualifications, the bankruptcy court found that the witness failed to employ the level of "intellectual rigor" that characterizes the practice of an expert in the business valuation field where the methods he employed (the Company approach and the Transaction approach) did not consist of the preeminent valuation method (the Discounted Cash Flow method of valuation), were based on inadequate data, and where the report he submitted "thoroughly conflated the discreetly different concepts of gross cash flow and net cash flow from operations." *Med Diversified, Inc.*, 334 at 98.

Procedurally, the bankruptcy court also noted that it will not admit an expert report submitted by a corporate entity (a reference to the fact that the witness relied on his staff for the valuations), and that the person who signs the report must testify until the admission of the report is stipulated to for all evidentiary purposes, which did not happen. The bankruptcy court did find that the witness was sufficiently familiar with business valuation to testify as a rebuttal witness as to the methodology used by the Plaintiff's expert witness on valuation of the shares.

***In re Bush Industries, Inc.*, 315 B.R. 292 (Bankr. W.D.N.Y. Sept. 16, 2004) (Bucki, J.)**

In this Chapter 11 case, the equity committee objected to confirmation of the debtor's proposed plan and asserted that the debtor's value exceeded the amount of all outstanding claims and that such value should be distributed to equity. Thus, in the context of determining whether the debtor's plan violated Section 1129(b) of the Bankruptcy Code, the court was asked to consider the proposed valuations by the debtor, the equity committee and the secured creditors. Although each of the experts applied one or more of the three valuation methodologies designed to calculate enterprise value from expectations of future income, i.e., the Comparable Company Method, the Comparable Transaction Method, and the DCF Method, each expert reached different conclusions. The debtor estimated an enterprise value of \$104 million; the secured creditors estimated an enterprise value of between \$95 and \$130 million; and the equity committee estimated an enterprise value of \$200 million. With respect to the DCF analysis, the experts used different exit multiples, resulting in a disparity of terminal values.

The court ultimately disagreed with the equity committee's conclusions and found that they did not incorporate adjustments to reflect the special risks of the debtor's manufacturing segment. Applying the exit multiple arrived by the debtor to the valuation methods used by all three experts, the court arrived at an enterprise value of less than \$168,363,000, an amount less than the equity hurdle, and concluded that Section 1129(b) was not violated.

***In re Coram Healthcare Corp.*, 315 B.R. 321 (Bankr. D. Del. Oct. 5, 2004) (Walrath, C.J.)**

In the context of the confirmation proceedings of two competing plans proposed by the Chapter 11 trustee (the "Trustee") and the equity committee, the court was asked to determine the debtors' value, which issue directly impacted whether the Trustee's plan was fair and equitable within the meaning of Section 1129(b) of the Bankruptcy Code. Both the Trustee and the equity committee conducted their own valuations of the debtors by applying the three standard valuation methodologies discussed above: the Comparable Company Method, the Comparable Transaction Method, and the DCF Method. Despite using the same valuation methodologies, the end results were quite different, where both parties included different assets in reaching their valuation conclusions, attached different

weights to the three methodologies and took different positions with respect to the debtors' projections prepared by management.

The equity committee believed the Trustee's experts undervalued the debtors to establish that equity was out of the money, by improperly relying on management's projections which the equity committee believed were too conservative, biased and incorrect as they (a) accepted improper reserves, (b) included cash flow projections that contained computational errors resulting in a low discounted cash flow, and (c) were not based on any independent analysis as to whether they were consistent with the market of the debtors' actual performance. The equity committee also contended that the Trustee's valuation varied from the traditional valuation methodology because the Trustee's experts rejected multiples that produced results that were not reasonable and were not consistent with the market. The equity committee's expert calculated the debtors' going concern as approximately \$279 million. In reaching this value, the equity committee's experts applied the debtors' projections, made adjustments to management's established reserves, cash flow projections, growth projections and EBITDA, and applied higher multiples because they believed the debtors had a specialty pharmaceutical component.


The Trustee, on the other hand, believed the equity committee overvalued the debtors by (a) making numerous and inappropriate adjustments to management's projections and the debtors' EBITDA, (b) using inflated multiples, (c) mischaracterizing the company as a specialty pharmaceutical company, (d) inappropriately substituting its own aggressive projections in the place of management's carefully prepared projections, and (e) failing to recognize the industry's price pressures. The Trustee maintained that the valuation reached by its own expert was more realistic than the valuation reached by the equity committee's expert, as it was based upon management's projections, financial models and experience in the purchase and sale of healthcare companies so that the assumptions and adjustments that were made were appropriate. The Trustee's expert calculated the debtors' going concern as approximately \$220 million.

In its analysis of the competing valuations, the court recognized, as did the courts above and below, that preparing valuations of companies is not an exact science and that experts often disagree on the appropriate value even when they apply the same methodologies.

The court ultimately accepted the going concern value reached by the Trustee's experts and confirmed the Trustee's plan. The court found the debtors' projections and valuation were credible, did not stray from generally accepted valuation methods and concluded the equity committee's numerous and subjective adjustments to management's projections, growth rate and EBITDA were too aggressive, unrealistic and not appropriate.

***In re Exide Technologies*, 303 B.R. 48 (Bankr. D. Del. Dec. 30, 2003) (Carey, J.)**

The court was faced with a situation similar to the case in *Coram Healthcare* and was asked to analyze two competing valuations of the debtors. As in *Coram Healthcare*, both experts used the three traditional valuation methodologies discussed above to calculate



the debtors' value but reached different conclusions. The debtors' expert used a "market-based approach" by analyzing the price that could be realized for the debtors' assets and made a number of subjective determinations that reduced the multiples prior to applying the valuation formula. The debtors' expert set a value in a range between \$950 million and \$1.050 billion.

The creditors' committee, on the other hand, maintained that the most accurate way to determine the value of the debtors was by a straightforward application of the three traditional valuation methodologies. The creditors' committee asserted the debtors undervalued the company and that the debtors' proposed plan would result in paying the debtors' lenders more than 100% of their claims. The creditors' committee set the debtors' value in a range between \$1.478 billion and \$1.711 billion.

The court ultimately agreed with the creditors' committee's expert, found that the proposed plan undervalued the debtors and determined the debtors' enterprise value to be in the range of \$1.4 billion to \$1.6 billion. The court concluded that the debtors' numerous downward adjustments were inappropriate, which included an adjustment for the "taint" of bankruptcy, which was not proper as it would cause the debtors to be undervalued. In determining the debtors' value for purposes of deciding whether the plan was fair and equitable, the court held that it was appropriate to include the benefits of the debtors' restructuring. The court denied confirmation of the debtors' proposed plan.

Andrew I. Silfen is a partner and chair of the Bankruptcy and Financial Restructuring group at Arent Fox LLP resident in the New York office. Sally R. Siconolfi is an associate in the Arent Fox's bankruptcy group resident in the New York office.