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Valuation Report

Business Valuation Trends and Strategies

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Litigation Update

Delaware Supreme Court Supports Dell Deal Price

Founded in 1983 by Michael Dell, Dell, Inc. was a publicly traded company for 25 years. When Michael Dell led a management buyout (MBO) group in taking his namesake technology company private in 2013, the deal price was $13.75 per share. At the time, it was the largest technology buyout ever.

Although a majority of shareholders approved the deal, some petitioned the Delaware Chancery Court for a fair value determination, believing the buyout price was too low. Thus began a multi-year litigation process culminating in a highly controversial decision in 2016 by the Chancery Court, which agreed that the company was underpriced—by about 22 percent.

The case reached the Delaware Supreme Court on appeal, and in December 2017, the Supreme Court overruled the original decision, saying the Chancery Court should have given more weight to the deal price because it was a market-based indicator of fair value. The Supreme Court reversed and remanded the case back to the Chancery Court, and that's where the case stands today. Here's a look at how it unfolded:

The Deal

Dell enjoyed steady growth until 2004 when Michael Dell resigned as CEO. After several quarters of low earnings, he returned to his CEO position in 2007 and tried to diversify the business by expanding its focus from PC and hardware sales to a broader market position via $13 billion in acquisitions.

Unfortunately, the company continued to lose market share, and while it continued to expand, it was unable to convince the market of a bright future. Its share price dropped from the high $20s in the mid-2000s to the $13-14 range in 2012.

As Michael Dell considered his MBO, the market view of the company was pessimistic. The board's special committee, formed to assess the company's value, turned to JP Morgan Chase & Co. and then to Boston Consulting Group (BCG) as financial advisors.

JP Morgan suggested that there was a "low probability" that a strategic buyer would be interested in ac-

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Word to the Wise

The Ins and Outs of a Valuation Review

In the course of litigation, it is not uncommon for a valuation analyst to be asked to assess another analyst's valuation report, its analysis, and conclusions. This review process is designed to offer stakeholders, judges, or other triers of fact a neutral opinion about the credibility of the valuation report in question.

Both the National Association of Certified Valuation Analysts and the Appraisal Standards Board's Uniform Standards of Professional Appraisal Practice provide guidance for the valuation review process. In general, this guidance covers the following:

Appropriate Standards

Was the valuation conducted according to applicable professional standards?

The goal is to assess whether the valuation was conducted according to accepted standards covering the stated purpose of the valuation, the standard of value, the valuation date, and generally accepted valuation practices.

The report should identify which professional standards the valuation analyst applied, the type of engagement, and the type of report issued.

Credible Analysis

Was the valuation analysis complete, accurate, and adequate?

In this area, the reviewer assesses whether the valuation analyst considered all of the facts and circumstances known (or knowable) at the time of the valuation and whether his or her assumptions were logical.

The reviewer also considers the accuracy of the calculations. Does the conclusion reflect computational or math errors or faulty formulas?

Reasonable Conclusions

Was the analysis relevant and reasonable given the intended use of the opinion and report?

Here the reviewer assesses whether the valuation process resulted in a reasonable, reliable, and objective opinion of value. Were the valuation analyst's conclusions and opinions appropriate and credible? Did the report identify and include complete and accurate information, discussion, and disclosures to help users understand its conclusions?

A Closer Look

It's often necessary for the reviewing analyst to conduct his or her own research and analysis. For example, a reviewing analyst will likely dig into certain areas that are open to misinterpretation, such as:

Compensation: Business owners sometimes overpay or underpay themselves. For the purposes of a valuation, executive compensation must be adjusted to reflect market-driven salaries and benefits.

Subsequent events: A valuation report indicates the analyst's opinion of value at a certain date and should not include facts or knowledge that wouldn't have been known as of the valuation date. For example, an industry upheaval, market collapse, or natural disaster occurring after the valuation date shouldn't be reflected in the conclusion of value.

Discounts: When assessing a business interest in a privately held company, discounts for lack of marketability and lack of control should be reflected when appropriate. The valuation analyst must also appropriately interpret public company guideline values relative to the privately held business in question.

Review, Not Redo

Be aware that a valuation review does not include a recalculation of value. While a review can be a smart step in certain circumstances where the credibility of a valuation is in question, a review is not a substitute for a second opinion of value.

If you'd like to find out more about valuation review services, please contact our team.

Dell Litigation Update

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quiring the company and prepared a series of valuations based on a leveraged buyout (LBO). The resulting analysis indicated that a financial sponsor would likely be willing to pay in the range of $11.75 to $13 per share, or $13.25 to $14.25 per share if the buyer recapitalized the company.

As the market outlook became even more negative, BCG prepared new, independent projections for the company's performance, concluding that the company would realistically meet only 25 percent of its desired cost savings. In the meantime, one of two potential financial sponsors dropped out, and the other one proposed $12.70 per share. Both JP Morgan and BCG believed this offer reflected investor concerns about the company's outlook.

In early 2013, the committee conducted a 45-day "go shop," which allows a public company to seek competing offers, with an asking price of $13.65 per share. There were two offers of promise—neither worked out—which bumped the deal to $13.75 per share with dividends, for a total value of $13.96 per share. The buyout group bought Dell at that $13.75 price.

The Ruling

In its original ruling, the Chancery Court praised the sales process but noted a "valuation gap" between the company's intrinsic value and its market value due to investors being too focused on short-term profit. The court also suggested that using the LBO model for valuation resulted in a deal price below fair value.

At trial, both sides presented valuations using discounted cash flow (DCF) analysis to determine fair value, but they diverged by $28 million. The court conducted its own DCF and arrived at a value of $17.62 per share, substantially ignoring the deal price.

The Appeal

The company appealed, saying that the Chancery Court should have given weight to the deal price. The company pointed out that the law didn't require the deal price to be the "most reliable" or "best" evidence of fair value, but the company contended that the deal price shouldn't have been disregarded entirely.

The Supreme Court acknowledged that the Chancery Court looked at all factors relevant to the case but found that its decision not to assign any weight to the deal price—an indicator of market-based fair value—was problematic for several reasons:

Reliable assessment: The Supreme Court said the lower court ignored the "efficient market" hypothesis that the price produced by an efficient market, which is generally a more reliable indicator of fair value than the view of a single valuation analyst with a "well-heeled client" like Dell. (Ouch!)

Sponsor distortion: The Chancery Court suggested that the deal price was distorted by the fact that the bidders were financial sponsors whose analysis reflected their own desire for a specific rate of return. The Supreme Court took issue with this reasoning, pointing out that the lower court ignored an "important reality," namely that if no one else bid on the company, "… it does not suggest a higher value but a lower one."

MBO issues: The Chancery Court named a number of problems often associated with MBOs that contribute to a lower deal price, including the idea that some potential buyers might not want to outbid the existing management because management would have an inside view and therefore would "right price" their bid.

The Supreme Court said that none of the problems associated with MBOs were problems in this case and that the Chancery Court's willingness to believe that all potential bidders failed to see a significantly underpriced stock was "an abuse of discretion."

Competing DCFs: The Supreme Court said the Chancery Court erred by assuming it could reconcile the $28 million difference in the original valuations by doing its own analysis rather than relying on market data for indication of fair value.

In an interesting conclusion as it remanded the case, the Supreme Court told the Chancery Court that the lower court didn't have to use the deal price as the fair value, but if they did, there would be "no further proceedings." Conversely, if the Chancery Court chose to "go another route," it would have to provide to the Supreme Court an explanation "consistent with the record and with relevant accepted financial principles."

The case is now back at the Chancery Court, with the Supreme Court indicating that, while useful, DCF analysis doesn't trump the market when it comes to fair value.

We'd be happy to talk with you about these and other valuation concepts.

Source: Business Valuation Update

AICPA Extends ABV Credential to Non-CPAs

In May, the American Institution of Certified Public Accountants (AICPA) voted unanimously to offer its Accredited in Business Valuation (ABV) credential to non-CPAs. Previously, the credential was available only to CPAs, although non-CPAs had valuation certification options from other well-known credentialing organizations such as the National Association of Certified Valuators and Analysts and the American Society of Appraisers.

To earn the ABV credential, CPAs are required to obtain 75 hours of valuation-related education, complete 150 hours of business valuation work experience, and pass the ABV examination.

While these requirements haven't changed for CPAs, the eligibility requirements for non-CPAs require financial professionals to hold a college degree, complete 75 hours of valuation-related education, complete 1,500 hours of business valuation work experience, and pass the ABV examination.

All ABV credential holders must also complete 20 hours of continuing professional development annually and comply with the AICPA Code of Professional Conduct and Statements on Standards for Valuation Services.

According to the AICPA, expanding ABV eligibility to qualified finance professionals "helps to promote consistency, quality, and transparency in the valuation marketplace." The organization said, "Clients and potential clients can trust that ABV credential holders have the competencies to provide premier valuation services."

The move sparked a strong reaction by the CPA community, which claimed that AICPA members and stakeholders were not consulted in advance about the change and that the change represents a "seismic shift in the AICPA's goals for the credential."

Nonetheless, the change was approved, and it is likely that more valuation analysts will join the ranks of the more than 3,200 CPA/ABVs.

For those seeking valuation services, it is important to work with a credentialed valuation professional to ensure that he or she has the training and experience to conduct an appropriate valuation of a financial interest, security, or intangible asset.