



*cutting through complexity*

# Valuations in a litigious world

**Valuation Matters**

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# Foreword

Given the unprecedented pace of change and deep-seated uncertainty blowing across global markets, it should come as no surprise that – now, more than ever – valuation matters.

Indeed, almost regardless of the reason for conducting a valuation – M&A activity, financing, asset sales or even dispute resolution – the reality is that robust, trusted and independent valuations is increasingly important in today's economy.

Providing expert witness services in a JV dispute

Valuing claimed damages

Shaking hands and saying goodbye

Building support for a share pledge

Valuing shares in an equity funded start-up

That is why we created Valuation Matters. We firmly believe that, by sharing our experiences, approaches and best practices, we can help the business community to better understand the challenges of developing accurate valuations and help create a communal body of knowledge.

Nowhere is the accuracy and independence of valuations more important than in commercial dispute or litigations situations. So in this, our first edition, KPMG's valuations professionals have focused on sharing their experience in providing valuations in a dispute context. To do so, we have included five case studies that, we believe, illustrate a number of key approaches and outcomes that should resonate with almost any business leader.

At KPMG member firms, our Global Valuations team combine an in-depth understanding of commercial disputes and litigation with extensive experience producing well-reasoned valuation analysis to help our firms' clients cut through the complexity of dispute resolution.

To learn more about these cases – or the services provided by KPMG's Global Valuations team – I encourage you to contact your local member firm or any of the authors listed in the back of this publication.

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# Valuations in a litigious world

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In today's fast-paced and complex business environment, commercial disputes and litigation are simply a fact of life.

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The rapid globalization of the world economy has created both opportunities and challenges for organizations. Operating in multiple legal jurisdictions, gaining access to economies at different stages of development, working in multiple languages and understanding cultural differences are all adding new complexities to the business agenda. At the same time, the business environment is becoming increasingly litigious; a trend that has become ever more apparent as the global financial crisis wears on.

It should come as no surprise, therefore, that we are experiencing a rapid increase in both the number and the complexity of commercial disputes. The reality is that the triggers of commercial disputes can be found in a wide variety of common business activities. Those that most frequently tend to spark litigation include:

- recent M&A activity, including acquisition/sale of businesses, assets or intellectual property
- the establishment or dissolution of a joint venture or strategic alliance
- financial and/or operational challenges, potentially leading to a breach of contract



- infringement of licenses on significant intellectual property (for example, patent or trademark claims)
- management transitions – both ‘good’ and ‘bad’ leavers
- succession contracts or disputes
- actual or potential breach of financing covenants
- provision of funding – institutional and private
- repayment of existing financing facilities
- disagreements between shareholders in a private company
- deviation from a protocol or a legally established framework
- fraudulent activity.

In almost every commercial dispute, it is the fair value of certain assets – or the value of the legal claim itself – that is often the greatest point of contention between parties. As a result, many organizations are now seeking robust and well-reasoned valuation analysis created by appropriately qualified and independent specialists, to help them better prepare for pending or potential disputes created or litigation.

Conducting a valuation analysis in the context of a dispute is a rather specialized process that often comes with unique complexities and challenges such as:

- the essential separation of facts from opinions in a valuation context
- ensuring a clearly defined valuation process is established and adhered to
- understanding the different bases of valuation – fair value, market value, intrinsic value – and how these may apply
- limitations on access to information – for example, as a result of minimal contact with key stakeholders or a retrospective valuation whereby the analysis is performed as at a date in the past
- collecting, collating and presenting underlying documentation to support legal submissions
- specialized forums for hearing disputes which requires appropriately qualified and experienced experts able to ‘hold their own’ in an adversarial setting
- presenting an effective and consistent rhetoric by aligning legal, strategic and valuation opinions for the best possible outcome.

**Based on our firms’ deep experience conducting valuations in dispute situations, we have set out five real-life case studies on the following pages that – we believe – offer unique lessons and valuable insights for executives and managers involved in dispute resolution. We hope these provide you, the reader, with new insights and approaches to valuations within dispute situations.**

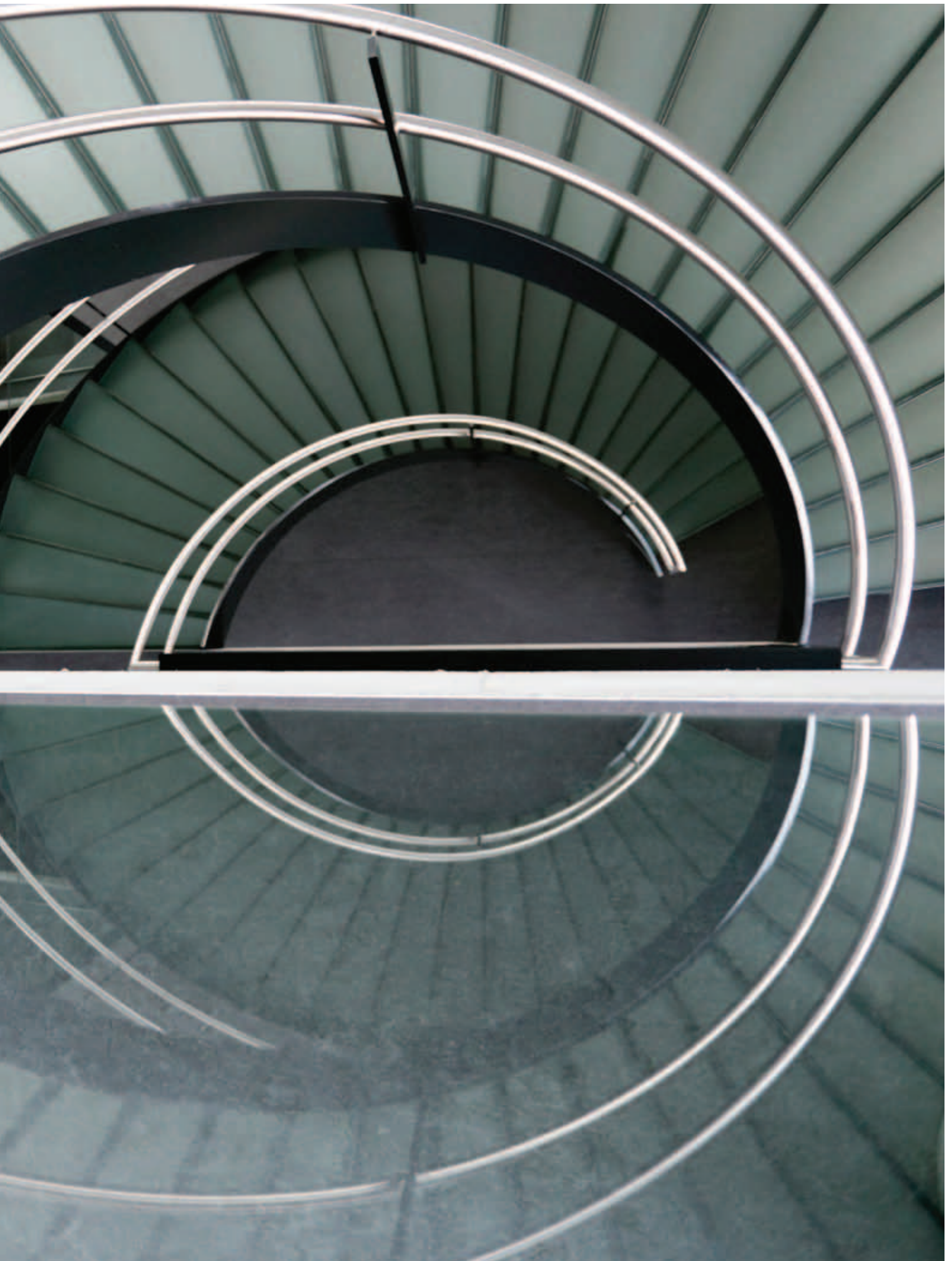
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# Case Studies



# Providing expert witness services in a joint venture dispute

A breach of contract results in a forced sale

## The dispute

A listed Fortune 500 company and a joint venture (JV) partner were in dispute regarding the strategy employed for a joint investment. Among other challenges, the JV partner argued that the Fortune 500 company was restricting growth by blocking certain investments and, thus, was in breach of the Shareholder Agreement (SHA). Consequently, the JV partner claimed damages and triggered a 'breach of contract' procedure stated in the SHA.

The case was referred to the International Chamber of Commerce (ICC). Moreover, in the event that claims regarding a material breach were awarded to the JV partner, the Fortune 500 company would then be forced to sell its shareholding to the JV partner at a material discount to the market value.

Having been engaged by the Fortune 500 company, KPMG in the Netherlands acted as the financial advisor by analyzing certain investment proposals, assessing the validity of the valuation models used by both joint venture parties, evaluating the reasonableness of the key valuation parameters in these models and, ultimately, using that information to assess the reasonableness of the claimant's arguments regarding the calculation of the incurred damages. The report prepared by KPMG was submitted to the arbitral tribunal to support the Fortune 500 company's case.



## A deeper look at the valuation

### A specialized forum

Given that the case had been referred to the ICC in Paris, a renowned authority in the field of arbitration, the Fortune 500 company knew that the arbitral tribunal would include highly experienced judges from across Europe. Based on their extensive experience with M&A processes, it was understood that a robust and comprehensive analysis was required to support any arguments made before the tribunal.

### An integrated story

The Fortune 500 company had engaged legal advisors from various firms, a strategy advisor from a top tier strategy consulting firm and a valuation expert, each of which would prepare reports within their area of expertise. However, the company knew that – to create the most persuasive line of argument for the arbitral tribunal – these stories would need to be integrated. To achieve this, a headline summary storyline was composed prior to the drafting of the actual reports, thereby providing a basis for the actual report (the roadmap to persuasion) and a framework for the integrated approach.

### An experienced advisor

As the JV partner had based the damage claims on reports provided by a top tier management consultancy firm with years of experience in the relevant sector, it was essential that the analyses performed and the arguments made on behalf of the Fortune 500 company could be verified based on independent publications and sources.

### A retrospective valuation

In this case, the investment proposals being analyzed were originally prepared between 2006 and 2010. However, from a valuation perspective, it is commonly seen as best practice not to use hindsight to perform retrospective valuations. As a result, the analyses were to be based solely on information available at the time of the investment proposal.

### A robust approach to documentation

Given that the ICC requires that all supporting documentation and sources applied in the reports be provided to the tribunal along with the report, the Fortune 500 company needed to take a systematic approach to not only performing and reporting their analyses, but also filing each of the sources that had been applied from the start of the process.

## Why the valuation mattered

**The ICC ruled that the breach that occurred was immaterial and therefore no discount was to be applied to the market value. As a result, the JV partner was forced to purchase the Fortune 500 company's stake for more than EUR 574 million, almost double the initial investment.**

# Valuing claimed damages

A government deviates from a legally established auction process

## The dispute

When the Dutch Government issued a restricted radio frequency license to a competitor of a Dutch radio station, the Dutch court ruled that the license had been improperly awarded and that the license should have instead been awarded to the claimant. Subsequently, the disadvantaged radio station claimed damages regarding lost earnings from the Dutch Government.

In response, both the Dutch Government and the radio station requested a valuer to calculate the quantum of damages. KPMG in the Netherlands was appointed by the Dutch Court to provide an independent expert report regarding the level of the damage claim.



## A deeper look at the valuation

### Defining a clear process

At the start of the process, a meeting was planned during which the 'ground rules' for the valuation were determined. This process protocol included a description of the process principles, the approach to analysis and the valuation methodologies applied. The protocol ensured a transparent process for all parties at the beginning of the valuation.

### Ensuring information symmetry

The process protocol mandated that all arguments presented by a party, either during a meeting, during a phone call or via email, had to be shared with all parties involved. Consequently, comprehensive meeting notes and summaries were composed and shared, and were then incorporated in the appendix of the report and provided to the Dutch court.

### Protecting the right to respond

As the valuation would be used in a court proceeding, it was essential that all parties could present their own views on issues impacting the valuation. Both parties were given the opportunity to comment on the meeting notes of the other party's interview, respond to the final draft report in writing, and provide comments on the other party's reaction to the final draft report.

### A retrospective valuation

The damage claim amounted to the earnings and value that the claimant did not realize because the radio license was not awarded to the correct radio station. Given that the claimant should have received the license two years prior to the damage claim, a retrospective valuation had to be conducted to assess the value of lost earnings.

### Separation of facts and opinions

While the radio station had prepared financial forecasts in the past, these did not represent the view of the Dutch Government and prevailing market circumstances at the time of the issuance of the license. The financial forecasts were therefore adjusted, which required the support of market analysis specialists who investigated the loss of market share and the loss of revenue, through quantitative research as well as interviews with relevant market players.

## Why the valuation mattered

**Once KPMG gave its independent view on the level of the damages, the Dutch Government was able to quickly agree to a settlement amount with the disadvantaged radio station.**

# Shaking hands and saying goodbye

KPMG in the UK act as advisors to a private company on the exit of the CEO

## The dispute

A mid-size UK group had hired a new CEO to lead and develop an existing subsidiary which, while considered non-core to the business, still relied on the core business to generate the vast majority of its leads and opportunities.

To incentivize the CEO, he was offered an opportunity to acquire 20 percent of the equity in the subsidiary for a nominal sum. The company also put into place a Shareholders Agreement (SHA) that covered several issues including:

- non-compete agreements
- guarantee of referring work from parent to subsidiary
- management fees from parent
- how the CEO's shares should be valued in the event that the CEO left (i.e. 'good' and 'bad' leaver clauses).

However, approximately two years into the appointment, the CEO was asked to leave. And while almost all of his leaving terms were agreed, the value of his 20 percent holding – which, under the SHA, he was required to sell on exit – was called into question.

## A deeper look at the valuation

### Setting the basis for valuation

While there was little difference between the views of the parent company and CEO on the prospects for the subsidiary, there was a major disagreement on the interpretation of the valuation rules from a practical perspective. The Articles of Association required an independent expert to value the entire company as if it were for sale between a willing vendor and a willing buyer. However, the SHA stated that the independent expert should take into account issues not evident in the financial information of the subsidiary (including non-compete agreements, assumptions about the trading relationship of parent and subsidiary and the level of management fees paid to the parent).

When taken together, the two documents created contradictions and a level of artificiality in the evaluation process. For example, the CEO initially argued that – in his view – the assumption should be made that the subsidiary was being sold to him, with the non-compete in place, but that the parent company would continue to refer work to a hypothetical independent company for no fee.

Eventually, an interpretation of the valuation rules was agreed upon based on discussions between the CEO, the parent company, their respective legal advisors and expert valuers. In this case, the parties agreed that:

- the basis for the valuation was a hypothetical sale of the parent company to a third party
- the assumption would be made that the parent company would continue to refer work to the subsidiary, but for a reasonable fee
- adjustments were made to the subsidiary's financials to reflect a stand-alone going concern business.

### Getting a qualified and experienced view

Having had the interpretation of the valuation settled, the two sides now had different views of what should be included in the above mentioned adjustments to the subsidiary's financials. To resolve these differences, both sides offered rational submissions on the subject.

## Why the valuation mattered

**Ultimately, the parent company and the CEO negotiated an exit price based on the valuation performed by the independent expert.**

# Building support for a share pledge

A bank prepares for court proceedings on defaulted loans

## The dispute

When a bank consortium providing financing to a large multinational real estate development and investment company, found the developer was in default on their loans, the consortium contemplated a share pledge. To support their position in the anticipated court proceedings, the consortium engaged an international KPMG team to perform a value analysis.



## A deeper look at the valuation

### Taking a practical approach to analysis

To serve as the basis for the share pledge in a court of the United Kingdom, the bank consortium required a comprehensive value analysis. However, the defaulted developer owned a portfolio of approximately 160 real estate businesses and investments across Europe, which demanded a practical approach to deriving the enterprise value for the company. By conducting a thorough value analysis of the most significant investments and a high-level value analysis of the smaller investments, a value range for the company was derived based on a sum-of-the-parts value analysis of all investments.

### Ensuring independence

Given that – at that time – the developer’s shareholders were unaware that the lenders were considering a share pledge, the advisors did not have access to these stakeholders. As such, all information used to perform the value analysis had to be provided by either the bank consortium or the management of the company. It was therefore essential to analyze and assess all information provided in order to retain an independent position. This was particularly true because the expert witness had been engaged as an independent valuer, which would allow the bank consortium to rely on the value analysis as support for their share pledge during a court proceeding.

### Engaging multinational support

While the head office of both the development company and the lenders were primarily based in the Netherlands, the lenders intended to execute the share pledge in the UK. As a result, the consortium required a team comprised of valuation experts from both the Netherlands and the UK who could help ensure that all methods applied were in line with UK standards and regulations.

## Why the valuation mattered

**The value analysis incorporated various scenarios, some of which illustrated that the value derived for the company would not warrant a share pledge. As a result, the bank consortium hesitated to enforce the share pledge and – ultimately – the shareholders and the lenders reached an agreement regarding a restructuring, thereby avoiding the court proceedings.**

# Valuing shares in an equity funded start-up

Valuer from KPMG in the UK appointed as independent expert

## The dispute

While the product of this start-up technology company in the UK was not yet commercially viable, the company had a number of shareholders that included a mixture of private investors with experience in the industry and a corporate investor. Typical of this type of company, there had been several rights issues to fund each stage of the product's research and development. As a result, there were now multiple classes of shares, thereby creating a complex interaction of rights to vote, dividends, capital and the right to participate in future rights issues.

The dispute arose when the corporate investor accidentally triggered the preemption rights over its shares, thereby unwillingly forcing itself to offer its shares for sale. No agreement could be reached between the shareholders on the price of the shares owned by the corporate investor, so it was referred to an independent expert to determine a value.





## A deeper look at the valuation

### Purchaser's view

The Articles of Association required an independent expert to deliver an opinion on the fair value of the two classes of shares owned by the corporate investor. The private shareholder group (the potential buyers) and their advisors suggested to the independent expert that each class of share should be valued separately. They produced a valuation based on that assumption, reflecting the rights attached to a hypothetical shareholder to participate in future rights issues (not available to all classes of share), limited voting powers and crucially any subsequent economic success of the company.

### Vendor's view

For its part, the corporate investor submitted that the two classes of shares should be valued together and that the collective rights of the two classes would produce an enhanced value as a 'package'. The corporate investor supported their view by noting the history of share ownership in the company, the circumstances by which their shares had become available for sale and the potential benefits to future buyers.

### Assessing fair value

The challenge for the independent expert therefore came down to the interpretation of 'fair value', which has a different meaning under English law than it does under IFRS or US GAAP (which are both effectively equitable to market value). Under English law, 'fair value' requires the independent expert to take into consideration all the circumstances leading up to the transaction, as well as the actual or potential parties to the transaction which, for example, would mean that the manner parcels of shares had been acquired in the past would be relevant.

## Why the valuation mattered

**The independent expert agreed with the corporate investor's interpretation of the valuation rules, however he did not agree with either party's conclusions on value.**

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