

FEDERATED PRESS

11th M&A VALUATION FOR CFOs

DECEMBER 13, 14 & 15, 2010 — TORONTO



VALUING HIDDEN LIABILITIES

Richard M. Wise, FCA, CA•IFA, FCBV, FASA, MCBA, CVA

Member Firm



Wise, Blackman LLP
Business Valuators/Transaction Analysts
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DUE DILIGENCE

- Investigation
- Verification



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INVESTIGATION



- Gathering of information
- Understanding of acquiree's business operations
- Assessment of risks
- Pricing considerations



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VERIFICATION

- Are all assets bargained for included?
 - ▶ Quantity
 - ▶ Quality
- Are there liabilities *not* bargained for?



EXAMPLES OF POTENTIAL LIABILITIES ARISING FROM FRAUD

- Bribes;
- Kickbacks;
- Deceptive advertising;
- Falsification of customs invoices;
- Submission of misleading applications for lines of credit, government grants and subsidies;
- Conspiracy regarding employment insurance; etc.?



OPPRESSION REMEDY

- Shareholders**
- Former shareholders**
- Creditors**



ANALYSIS OF LITIGIOUS CLAIMS — FACTORS TO CONSIDER

- Settlement prospects**
- Prospect of arbitration or mediation**
- Extent and quality of documentary evidence available to respective parties, etc.**
- Availability and credibility of “fact” and “expert” witnesses to be called by parties at trial or in examinations-for-discovery**



ANALYSIS OF LITIGIOUS CLAIMS — FACTORS TO CONSIDER

(CONT'D)

- ❑ Controllable and uncontrollable costs of proceedings, to both defendant and plaintiff, including legal fees, expert fees, court costs, etc.
- ❑ Possibility/probability of appeal by either party to Court of Appeal (and Supreme Court, if appropriate)
- ❑ Interest costs included in award to plaintiff
- ❑ Length of trial and subsequent appeals, if any



HIDDEN LIABILITIES

“To warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.”

Huddleson v. Herman & MacLean,
650 F.2d 815 (U.S. 5th Cir. 1981)



FINANCIAL STATEMENT LIABILITY OMISSIONS **ACCRUED EXPENSES**

- Vacation pay
- Executive and other remuneration
- Taxes
- Insurance
- Professional fees
- Interest costs and GS&A
 - ▶ e.g., Interest costs capitalized (but should have been expensed), while selling, general and administrative costs expensed (but should have been capitalized).



ACCRUED LIABILITIES

- Employee bonuses
- Customer rebates



INFORMATION REQUIRED FOR VALUING EMBEDDED TAXES

❑ DEPRECIABLE ASSETS

- ▶ Fair market values
- ▶ Original capital costs
- ▶ Undepreciated capital cost (U.C.C. pools)

❑ NON-DEPRECIABLE CAPITAL PROPERTIES

- ▶ Fair market values
- ▶ Adjusted cost bases
 - » V-Day value for pre-1972 properly held continuously since 31/12/71



POSSIBLE UNRECORDED LIABILITIES

- ❑ Leases with non-arm's length parties
- ❑ Repayment obligations on government grants, loans, subventions
- ❑ Advertising commitments
- ❑ Unrecorded liabilities
 - ▶ Customs duties on foreign purchases



EXPOSURE TO PRODUCT LIABILITY

TYPES OF PRODUCTS

- Chemical & toxic products
- Consumer goods
- Office equipment
- Children's/juveniles' products
- Building supplies
- Recreational products
- Scaffolding & cranes
- Hand & power tools
- Automotive equipment



PRODUCT LIABILITY

HOW DO YOU VALUE

- Mitigation aspects?
- Economic loss?
- Psychiatric damage?
- Mental distress?
- Aggravated damages?
- Liability for punitive damages?

Does acquiree have product liability insurance?



VALUING LITIGIOUS CLAIMS

❑ FACTORS IMPACTING QUANTIFICATION OF DAMAGES

- ▶ Relative strengths of damage theories
- ▶ Relative qualities of trial lawyers
- ▶ Relative quality of discovery evidence
- ▶ Relative quality of trial evidence
- ▶ Relative quality of damage experts
- ▶ Relative quality of experts' reports
- ▶ Judge (or master)
- ▶ Appeal Court justices
- ▶ Cost to litigate



WHO MAY BE A "COMPLAINANT" UNDER CANADIAN OPPRESSION REMEDY LAWS

❑ Shareholders

❑ Creditors

- *Downtown Eatery (1993) Ltd. v. Ontario* (2002) 54 OR (3d) 161, CA

❑ Trustee-in-bankruptcy (as creditor's representative)

- *Re Margaritis* (1977), 23 CBR (NS) 150 (Ont. CA)



VISITS AND INTERVIEWS BY PURCHASER

- Gaining a better understanding of the acquiree's operations;
- Having a better understanding of information contained in acquiree's financial statements and other financial documents;



VISITS AND INTERVIEWS BY PURCHASER

(CONT'D)

- Identifying current and potential changes that might cause acquiree's future results to differ from those indicated by an extrapolation of historical data; and
- Providing additional insight as to the future prospects of acquiree's business, major risks, concerns, etc.



QUESTIONS?

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ÉVALUATION D'ENTREPRISES • JURICOMPTABILITÉ

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