

# FEDERATED PRESS

*11<sup>th</sup> M&A VALUATION FOR CFOs*

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## VALUING HIDDEN LIABILITIES

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# DUE DILIGENCE

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- Investigation
- Verification



# INVESTIGATION

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



# VERIFICATION

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



# EXAMPLES OF POTENTIAL LIABILITIES ARISING FROM FRAUD

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- 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**

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



## **ANALYSIS OF LITIGIOUS CLAIMS — FACTORS TO CONSIDER**

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- 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**

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- 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**

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- Employee bonuses
- Customer rebates



## **INFORMATION REQUIRED FOR VALUING EMBEDDED TAXES**

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### **❑ 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**

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- ❑ 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**

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### **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**

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### **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

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- 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

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(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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## **WISE, BLACKMAN LLP**

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