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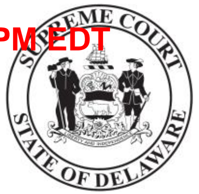

IN THE SUPREME COURT OF THE STATE OF DELAWARE

SOURCEHOV HOLDINGS, INC., Respondent Below, Appellant, vs. MANICHAEAN CAPITAL, LLC, CHARLES CASCARILLA, EMIL KHAN WOODS, LGC FOUNDATION, INC. and IMAGO DEI FOUNDATION INC., Petitioners Below, Appellees.	No. 215, 2020 Court Below: Court of Chancery of the State of Delaware, C.A. No. 2017-0673-JRS

APPELLANT SOURCEHOV HOLDINGS, INC.'S OPENING BRIEF

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TABLE OF DEFINED TERMS

Appellees	Manichaean Capital, LLC, Charles Cascarilla, Emil Khan Woods, LGC Foundation, Inc., and Imago Dei Foundation, Inc.
Apollo	Apollo Global Management
APV	Adjusted Present Value
BCA	Business Combination Agreement
Business Combination	Merger of SourceHOV, Novitex, and Quinpario
CAPM	Capital Asset Pricing Model
CCF	Capital Cash Flow
Mr. Chadha	HGM's Chief Executive Officer and Chief Investment Officer and Director of SourceHOV
Delos	Delos Investment Fund, LP
DCF	Discounted Cash Flow
Exela	Exela Technologies, Inc.
Ex-Sigma	Ex-Sigma LLC
First Lien	First Lien Credit Agreement dated as of October 31, 2014
GPTC	Guideline Publicly Traded Companies
HGM	HandsOn Global Management
Mr. Jonovic	Managing Director, HGM
KPMG	KPMG, LLP
Leverage Ratio	A measurement of SourceHOV's debt to equity ratio where the numerator represents SourceHOV's total net debt and the denominator is a measure of EBITDA

LOI	Letter of Intent
M&M	Modigliani & Miller
MDP	Madison Dearborn Partners
Millstein	Millco Advisors, LP
Novitex	Novitex Holdings, Inc.
Order	Final Order and Judgment dated March 26, 2020 (annexed as Exhibit C)
Opinion or Op.	Memorandum Opinion issued January 30, 2020 (annexed as Exhibit A)
PIPE	Private Investment in Public Equity
Proxy	Definitive Proxy Statement for Business Combination, Schedule 14A, filed with SEC on June 26, 2017
Quinpario	Quinpario Acquisition Corp. 2
RBC	Royal Bank of Canada
Mr. Reynolds	Director and former Chief Financial Officer of SourceHOV and HGM Partner
Rothschild	Rothschild, Inc.
Second Lien	Second Lien Credit Agreement dated as of October 31, 2014
SourceHOV	Respondent SourceHOV Holdings, Inc.
SPAC	Special Purpose Acquisition Company
TransCentra	TransCentra, Inc.
Valuation Date	July 12, 2017
WACC	Weighted Average Cost of Capital

NATURE OF THE PROCEEDINGS

Faced with near certain default on over $1 billion of debt and the immediate repayment obligations that would follow, in July 2017, SourceHOV entered into a Business Combination in an effort to transform, and save, its business. While most shareholders approved the transaction, Appellees sought appraisal. The trial court held a trial in June 2019 to determine the fair value of SourceHOV.

On January 30, 2020, the trial court issued its Opinion, acknowledging SourceHOV's dire operative reality as of the Valuation Date: severe "liquidity pressure" caused by bi-annual step-downs in a Leverage Ratio loan covenant, revenue stagnation, and increased loan expenses; several near misses on covenant defaults; and misses on *seven* consecutive sets of management projections. Op.13, 15, 24. Nonetheless, the Opinion does not take this acknowledged financial distress into account for the valuation, choosing instead to adopt the fundamentally flawed, methodologically jumbled valuation presented by Appellees' expert, Mr. Timothy Meinhart, that was untethered to, and inconsistent with, SourceHOV's operative reality. The Opinion calculates the fair value of SourceHOV at $4,591 per share ($722 million).

SourceHOV respectfully appeals from that ruling.

PRELIMINARY STATEMENT

Throughout, the Opinion acknowledges that SourceHOV was a highly-levered company drowning in expensive debt:

- SourceHOV faced severe "liquidity pressure" caused by bi-annual Leverage Ratio step-downs for its over $1 billion debt, "compounded" by stepped up amortization payments;
- Meeting those obligations was "particular[ly] challeng[ing]" given "revenue stagnation" since at least 2014 (it was undisputed that organic growth since that time was negative);
- SourceHOV had a series of near misses in breaching the Leverage Ratio covenant, and had to resort to raising equity from existing stockholders to cure one missed Leverage Ratio; and
- SourceHOV missed seven of eight sets of projections, each one lower than the prior.

The Opinion also acknowledges that, when SourceHOV sought in late 2016 to avoid a breach of the Leverage Ratio covenant through a capital raise from shareholders at a valuation of $1,547-$2,137 per share, Appellees chose not to invest and instead sought to *sell* their stake at that valuation.

Yet with one exception, the Opinion adopts Appellees' valuation that was untethered to, and inconsistent with, this acknowledged operative reality. An appraisal valuation must consider "all relevant factors," including the company's operative reality on the valuation date. By adopting Appellees' valuation, the Opinion commits legal error, affecting:

Cost of debt/capital structure. For his two DCF models, Mr. Meinhart employed three scenarios that included *hypothetical* cost of debt and capital structure assumptions not based on SourceHOV's *actual* cost of debt or capital structure. Mr. Meinhart even conceded the first scenario was "fundamentally different" from SourceHOV's operative reality. The hypothetical cost of debt in the other two scenarios was based on an index of bonds of other companies that Mr. Meinhart never confirmed were like SourceHOV, and the bonds' yields-to-maturity were widely dispersed (3%-160%). Professor Gregg Jarrell, SourceHOV's expert, estimated SourceHOV's *actual* cost of debt based on *SourceHOV-specific* evidence.

Equity Beta. Mr. Meinhart calculated an "indirect beta" based on the betas of 19 guideline companies that he concluded were *not* comparable enough to support a GPTC analysis. He also unlevered and re-levered his betas using the same three hypothetical capital structure scenarios, including the "fundamentally different" scenario discussed above. He then compounded the problem by taking a scattershot approach to valuation, calculating and using multiple, wide-ranging betas, and then using those betas to generate and average *seven* discount rates.

Meanwhile, the Opinion wrongly criticizes Professor Jarrell's straightforward approach to beta that started with SourceHOV's actual cost of debt estimated from SourceHOV-specific evidence; derived an implied debt beta of 1.4 using CAPM; and used the 1.4 implied debt beta as the equity beta based on the well-accepted

M&M Theorem, which dictates that debt beta must always be less than equity beta. The Opinion questions this approach as "methodologically novel," but each step was grounded in bedrock finance principles and generated a conservative estimate.

Projected Cash Flows. The Opinion further errs in rejecting the use of "Bank Case" projections that SourceHOV proffered, on the basis that Professor Jarrell supposedly disagreed with their use. In fact, Professor Jarrell presented valuations based on *both* the Bank Case and the Equity Case projections, and noted his "serious reservations" with the reasonableness of the Equity Case. The more conservative Bank Case more reliably projected future cash flows, although it too ultimately proved to be too optimistic.

The Opinion separately commits legal error in adopting Mr. Meinhart's valuation that rejected updated financial information that existed and was "knowable" as of the Valuation Date. Finally, the Opinion wrongly embraces Appellees' false tale of "backdating" an irrelevant document, which should not have colored review of the record.

Accordingly, this Court should vacate the Order and remand with instructions to calculate SourceHOV's fair value in a manner consistent with its operative reality.

SUMMARY OF ARGUMENT

1. By adopting Appellees' valuation that was untethered to, and inconsistent with, SourceHOV's operative reality, the Opinion fails to consider "all relevant factors" as required by the appraisal statute. This legal error infected the cost of debt and equity beta calculations, and selection of projected cash flows.

2. The Opinion errs by refusing to consider financial information that was "knowable" as of the Valuation Date, which constitutes legal error.

3. The Opinion's witness credibility determination, based on Appellees' false tale of backdating, was erroneous and should not have colored the trial court's view of the record.

STATEMENT OF FACTS

I. BACKGROUND

A. SourceHOV

SourceHOV, an information management and transaction processing company, was formed in April 2011. Op.4, 6-7. It pursued a strategy of growth by acquisition, acquiring BancTec Group in November 2014, and TransCentra in September 2016. Op.6-7, 16, 24.

B. SourceHOV Takes On Massive Debt

SourceHOV funded these acquisitions almost exclusively with debt. Op.8-9. In connection with the 2014 BancTec acquisition, SourceHOV entered into the First Lien and Second Lien credit agreements. Op.8; A1215; A1389. The First Lien consisted of a $780 million term loan and $75 million revolving credit facility, carried a coupon rate of 7.75%, and was due in 2019. Op.9; A1215. The Second Lien included a $250 million term loan with a coupon rate of 11.5%, and was due in 2020. Op.9; A1389. Both were issued at discounts to par (3% and 4%), and their weighted average yield-to-maturity at issuance was 9.5%. Op.9; A0693.

The First and Second Liens contained covenants that required SourceHOV to maintain a defined Leverage Ratio. Op.9. Initially, the Leverage Ratio was 6.375x, with scheduled step-downs every six months requiring the Leverage Ratio to be cut to 4.75x by end of 2016 and 4.25x by mid-2017. Op.9-10. Failure to satisfy the

Leverage Ratio covenant would result in default and, absent cure, permitted a demand for immediate repayment of over $1 billion in loans. Op.10.

From the beginning, the market exhibited concerns over SourceHOV's ability to meet its debt obligations. At inception, Moody's gave SourceHOV a corporate family rating of B2, and rated the First and Second Liens at B1 and Caa1, based in part on "SourceHOV's high initial financial leverage," and warned that downgrades could result if revenue growth faltered. Op.15; A1210.

C. Ratings Downgrades And Liquidity Pressure

The downgrades came:

November 2015	Moody's	SourceHOV - B3 First Lien - B2 Second Lien - Caa2
May 2016	Moody's	SourceHOV – Caa1 First Lien – B3 Second Lien – Caa3
August 2016	S&P	SourceHOV – CCC+ First Lien – CCC+ Second Lien – CCC-

Op.15-16; A1516; A1521; A1536. In July 2016, the First and Second Liens were priced at approximately 20% and 30% yields-to-maturity. A1527. Appellee Cascarilla observed: "This debt pricing is a really bad sign. It[] suggests no real equity value." *Id.*

Meanwhile, in 2015 and 2016, SourceHOV's revenue stagnated and the Leverage Ratio step-downs posed "particular challenges." Op.13. Worse, the

"liquidity pressure" of SourceHOV's nine-figure interest payments due each year, Op.15; A2315, was "compound[ed]" as mandatory amortization payments increased from 2.5% in 2015 to 5% in 2016, Op.15; A1290-91. During that time, principal payments increased from $33.5 million to $47.9 million. A2315; A0721. By October 2016, SourceHOV had only $7 million in liquidity. A1589.

The severe "liquidity pressure" and related difficulties, Op.13-19, were reflected in SourceHOV's inability to meet revenue projections. While the Opinion observes that SourceHOV "had a strong record of meeting or exceeding its revenue projections," Op.14, the table included demonstrates that of the eight sets of projections SourceHOV created since 2013, it only met one, in 2013, Op.24. SourceHOV missed the remaining seven—despite each set being lower—and it did so almost immediately, starting in 2014. *Id.*

Revenue growth was also a challenge. While the Opinion notes that SourceHOV had a cumulative annual growth rate of 10.1% between 2014 and March 31, 2017, Op.14, 55, that growth came from acquisitions funded by debt, as the Opinion acknowledges, Op.7, 16, 24. Organic growth between 2014 and 2016 was negative, averaging -2.4% per year. A4020; A3611-12; A3685-86; A3918; A0297.

All the while, the Leverage Ratio covenant continued to loom. SourceHOV's Leverage Ratio went from 5.341x at the end of the second quarter of 2016, to 5.235x at the end of the third quarter, but that was a result of the Transcentra acquisition.

Op.16. SourceHOV "still had more work to do," Op.16, because it needed to bring its Leverage Ratio down to 4.75x by end of 2016. By that point, SourceHOV was "[l]iterally drowning" in its debt. A0219.

D. SourceHOV's Continued Debt Problem

As the likelihood of defaulting on over $1 billion in debt grew, SourceHOV explored several options to improve its capital structure, with help from Goldman Sachs, Millstein, Rothschild, and Morgan Stanley. None proved viable:

- SourceHOV sought an equity investment, but only MDP expressed interest. *See* Op.50 n.244. MDP's offer to invest at a valuation of $257-355 million did not progress into anything meaningful. *Id.*; A1569.
- SoureHOV hired Millstein to help (i) obtain additional financing and/or amend obligations under the First and Second Liens, A4132; and (ii) obtain incremental financing that "results in reasonable cushions under the financial covenants in the existing credit agreements" and in connection with a transaction with Novitex, owned by Apollo, A1621. Lenders were unwilling to amend, and any incremental lending would have been at yields-to-maturity higher than 12%. *See* A0772; A0533; A0535; A0541-42; *see also* A4114; A4043; A1576 ("In a normal situation pushing out the covenants is not an issue[.] But this isn't a normal situation").

E. SourceHOV's Stop-Gap Equity Issuance

Toward the end of 2016, management determined that it needed a $23 million investment from existing equity stockholders to meet the year-end Leverage Ratio. Op.16-17. The offer was for approximately $1,600 per share, valuing SourceHOV's equity at $231 million. Op.17; A1565. Appellees refused to invest at that valuation, instead seeking to sell their stake to stockholder Delos at that price. Op.18; A1566; A1635; A1634; A1632.[1]

SourceHOV failed to meet its projected performance for the fourth quarter of 2016 and was short of the Leverage Ratio covenant. SourceHOV "cured" the shortfall by using most of the new equity, reporting a Leverage Ratio of 4.749x, just below the required 4.75x ratio. Op.18; A2364; A0638-39.

F. The LOI

Having narrowly avoided a breach, SourceHOV sought a more enduring solution to its liquidity crisis: a transformative transaction. Rothschild, SourceHOV's lead financial advisor, Op.11; A1641, began searching for potential transaction parties, including SPACs, entities that provide a ready-made vehicle for accessing public markets, Op.11-12. As the Opinion acknowledges, while SourceHOV negotiated and structured what became the Business Combination and

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[1] The Opinion excuses Appellees' unwillingness to invest at $1,600 based on claimed insufficient information. Op.18-19. But separately, the evidence showed that Appellees were enthusiastic *sellers* at that price. A1639; A1634.

related transactions, it was "required . . . to juggle [its] liquidity issues," and "cash generation became a key priority." Op.13, 15.

In late-December 2016, it was suggested that Quinpario, a SPAC, might provide the equity for a combination of SourceHOV and Novitex. Op.11-12. Quinpario had $350 million in cash but was set to expire on January 22, 2017, and without an extension would return that cash to its investors and wind-up. Op.12.

On January 13, 2017, the parties signed an LOI for Quinpario's "acquisition" of Novitex and SourceHOV for approximately $2.7 billion. Op.12-13; A1656; A1673. The LOI contemplated (a) Quinpario providing $225-350 million, through a combination of cash and amounts raised through a PIPE, Op.12-13; A0731, and (b) new debt financing of $1.4 billion, A1657; A1676. The LOI also contemplated that SourceHOV and Novitex stockholders would rollover all their equity into the resulting company, Exela, with SourceHOV stockholders receiving 80.6 million shares, and Novitex stockholders receiving 30.6 million shares, of Exela stock. Op.13; A1658; A1677.

In late January 2017, facing yet another step-down of its Leverage Ratio covenant in June, Op.10; A1353, SourceHOV sought to raise additional equity from its existing stockholders, again at approximately $1,600 per share, A1928. This time, aware the Business Combination was in the works, Appellees invested. *See* A1932 ("[R]isk is deal does not go through"); A0770-71; Op.18.

G. The Equity And Bank Case Projections, And Rothschild's Analysis

Around the same time, management prepared a set of projections covering 2017-2021 in connection with a potential transaction. A1984; *see* Op.24.[2] The projections contained two cases: the Equity Case and the Bank Case. A1984; *see* Op.25-26. The difference was "primarily the growth rate." A0644; *see* Op.25-26, 54-55. Trial testimony described the Equity Case as the "optimistic, or very hopeful scenario," in which SourceHOV would "fire on all cylinders, everything goes per the plan – there's no room for error" and "all the moons would have to align." A0644. The Equity Case projected annual growth rates of 2.4% for 2017, and 5% for 2018-2023. Op.25; A1984. The Bank Case was premised on more conservative assumptions, A0644, projecting annual growth rates of 1.4% for 2017, 2.1% for 2018, and 2.2% until 2023, Op.26; A1984. Both cases were off within months. Op.24.

On February 13, 2017, SourceHOV sent both cases to Rothschild in one spreadsheet, with a toggle between them, Op.24 n.119; A1984; A0644, as part of a "standard practice" to provide a "spectrum of numbers," A0644. While the Opinion notes that management "stood behind" the Equity Case, Op.25, management "stood

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[2] The Opinion identifies a January *2016* date for the Equity Case, Op.24, but the spreadsheet cited is dated January *2017*, A1699.

behind" both sets, authorizing both to be sent out in a spreadsheet with the toggle, A0620-21; A0644.

Two days later, Rothschild returned a deck that included a DCF analysis of SourceHOV, electing to base their analysis on the Equity Case projections. Op.26; A3466; A3482. Critically, Rothschild assumed a discount rate of 11%-13% based on a theoretical, optimized capital structure for SourceHOV, not its then-current capital structure. Op.26; A3482; A0167 (Rothschild's WACC "assumes an optimal capital structure" and "will tend to reflect a . . . less levered entity"). Rothschild estimated SourceHOV's implied equity value at $931 million. Op.52; A3482.

H. The BCA And The Lender Case Projections

On February 21, 2017, SourceHOV, Novitex, Quinpario, and others executed the BCA, committing to effectuate the Business Combination described in the LOI. Op.20; A2020. Closing was conditioned on Quinpario providing at least $275 million cash from its trust account or the PIPE. Op.20 n.101.

Quinpario entered into a commitment letter with several lenders, including RBC, to provide up to $1.35 billion in debt financing. Op.20-21; A2453; A2596; A2369. Thereafter, the parties undertook a road show to syndicate the debt. *See* Op.14.

In March 2017, RBC created a deck, including a set of projections referred to as the Lender Case, for the road show. A2227. The Lender Case reflected a "minor

'haircut'" to the Equity Case based on negative feedback from potential lenders, but still projected 5% annual revenue growth for 2018-2021. Op.25; A0277. By mid-2017, the Lender Case was already off. Op.24.

I. The Unanticipated Margin Loan And Revised BCA

Because redemption rights had already reduced (and could further reduce) the cash Quinpario would contribute to the Business Combination, the parties had to look to the PIPE to provide most funds to meet the $275 million closing condition. *See* Op.19-21; A1941. Unable to secure sufficient funds from outside investors, SourceHOV ultimately resorted to a margin loan to help close the gap, generating $57.5 million. Op.21.

To secure the margin loan, the parties amended the BCA to include an additional transaction that would precede the Business Combination: SourceHOV would be merged into a wholly-owned subsidiary of Ex-Sigma, and each share of SourceHOV stock would be converted into the right to receive one membership unit of Ex-Sigma. Op.21-22. Ex-Sigma would receive the 80.6 million shares of Quinpario stock that SourceHOV was to receive under the original BCA, and Ex-Sigma would pledge those shares, plus any additional shares it obtained through the PIPE, as security for the margin loan. *See* Op.22.[3]

[3] The margin loan terms required Ex-Sigma to hold its Exela stock as security until the loan was repaid within two years. Op.22; A3197; A3200.

J. Another Narrow Miss Of A Leverage Ratio Covenant Breach And The Revised BCA's Execution

Meanwhile, SourceHOV continued to struggle. In March 2017, SourceHOV's auditor, KPMG, expressed concern about SourceHOV's ability to continue as a going concern. A0053; A0641. SourceHOV provided KPMG a report prepared by Ernst & Young that concluded there was "not a substantial doubt about [SourceHOV's] ability to continue as a going concern within one year after the date the December 31, 2016 financial statements are expected to be issued." A2225. But the report's conclusion was dependent on SourceHOV achieving its projections. *See* A2208; A0641. Yet for the first six months of 2017, SourceHOV missed the Equity Case revenue projection by 7.0% and EBITDA projection by 23%. Op.24; A3387; A3410; A3413-14; A2000.

The Business Combination and related agreements closed on July 12, 2017. Op.23. To finance the Business Combination, Exela issued $1.0 billion in first priority senior secured notes due in 2023 at an interest rate of 10.0% and borrowed $350 million in a senior secured term loan due on July 12, 2023, at an interest rate of 9.06%. A3538; A3596-97.

On July 12, 2017, Exela's stock price closed at $8.61 per share, implying a value of $694 million for SourceHOV's portion of the merger consideration. Op.23; A4058. But Exela's stock price reflected a total reset of debt and anticipated synergies, estimated at $70.3 million. A2505. The Exela shares were also subject

to the margin loan's lockup. *Supra* n.3. And by August 10, 2017 (after disclosure of second quarter financial results), Exela's shares closed at $6.50 per share, implying a value of $524 million for SourceHOV's portion of the merger consideration. A3384; A3585; A4058.

II. THE PROCEEDINGS BELOW

On September 21, 2017, Appellees sought appraisal, and trial occurred June 3-5, 2019.

Appellees, through Mr. Meinhart, calculated SourceHOV's fair value at $5,079 per share. Op.2; A3815. Mr. Meinhart conducted DCF, CCF, and GPTC analyses, Op.32; A3815, but placed no weight on the GPTC analysis because "there is not a perfect guideline company" and because of "differences between SourceHOV and the guideline companies," A3852; A0839; A0400-01; *see* Op.37.

Mr. Meinhart's DCF employed a discount rate that was the *average* of three discount rates generated by three scenarios, each based on (i) different assumptions regarding SourceHOV's cost of debt and capital structure, A3836-38; A3872; A0827-28; A0830; A0842; *see* Op.34; and (ii) three equity betas, indirectly calculated based on betas of 19 companies from Mr. Meinhart's rejected GPTC analysis, A3872.[4] Mr. Meinhart's CCF employed a pre-tax discount rate that was

[4] Mr. Meinhart calculated his betas as follows: He gathered 228 betas for his 19 guideline companies (12 each), reflecting different lookback periods and trading intervals. A3835; A0826. He then selected one beta per company, based on two

the *average* of three pre-tax discount rates calculated based on the same three scenarios and same three indirect betas from his DCF, plus a fourth unlevered cost of equity capital, calculated based on a fourth indirect beta. A3873; *see* Op.36. He then based his ultimate valuation on the *further average* of his valuations under the DCF and CCF. Op.37; A3852; A3857.

SourceHOV, through Professor Jarrell, offered two fair value calculations. One, based on the Equity Case, estimated SourceHOV's fair value at $2,817 per share; the other, based on the Bank Case, estimated fair value at $1,633 per share. A3691-92; A3917-18; A4007-08; A4056; *see* Op.2.[5] Both valuations were calculated and presented by Professor Jarrell:

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years of daily trading, A3835; A0826-27; unlevered each of the 19 betas using 3 different formulas and selected from among that group of 57 betas the highest of 1.21, which corresponded to Cognizant, A3836-37; A0827; A0829; A0848; and relevered that beta using the Hamada method, using the three different capital structure assumptions from his three scenarios, generating betas of 1.37, 2.02, and 2.46, A3836-37; A0827-28; A0830; A0848.

[5] Both valuations reflected increases after Professor Jarrell issued his report, based on certain suggestions from Mr. Meinhart. Op.38; A0323-25; A3912.

Jarrell DCF Fair Value Opinion

APV-Based DCF Model	Jarrell Opinion	Range
Equity Case:		
Aggregate Equity Value	$468.1M	$431.2M - $508.1M
Equity Value Per Share	$2,817.41	$2,595.51 - $3,058.34
Bank Case:		
Aggregate Equity Value	$271.4M	$240.9M - $304.6M
Equity Value Per Share	$1,633.85	$1,450.17 - $1,833.14

Source: Jarrell Report, Exhibit 8 (updated), Exhibit 9 (updated); Jarrell Dep., pp. 12-23.

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A4056; *see also* A4007-08; A4011; A3691-92; A3917-18. Professor Jarrell consistently presented analyses and a fair value opinion based on the Bank Case. A3605; A3655; A3692; A3918; A4007-08; A4011; A4021; A4023; A4056; A4060; A4100-01; A0858. Professor Jarrell expressed "serious reservations" about the reasonableness of the Equity Case, Op.39; A3608; A0863; A0865; A0888, and underscored that his valuation based on it "will likely overstate the actual (unknown) fair value given SourceHOV's operative reality as of July 12, 2017," A3611; *see also* A0888 ("I would just emphasize that, in my judgment, the [valuation based on the Equity Case] is a maximum value, because of the nature of those projections").

Professor Jarrell conducted an APV-based DCF, which was functionally equivalent to Mr. Meinhart's CCF. Op.39; A0784; A0870. To calculate his discount rate, and in particular the equity beta, Professor Jarrell observed that he could not use either of the two conventional methods to estimate beta: (i) no direct calculation

based on stock regressions, as SourceHOV's stock was not publicly traded; and (ii) no indirect calculation based on peer betas, because any guideline companies were too dissimilar from SourceHOV. A0873; A0882; A3627-28; A3757-64; A3784; Op.41. Professor Jarrell undertook three steps:

1. He used the record evidence about SourceHOV to estimate its minimum, reasonable cost of debt as of the Valuation Date (11%);
2. That yielded, by application of CAPM, an implied minimum reasonable debt beta (1.4); and
3. Based on M&M Theorem—which posits that "the risk (beta) of the firm's debt must always be less than the risk (beta) of the firm's equity"—he conservatively used the 1.4 implied debt beta as the "minimum possible estimate" of SourceHOV's unlevered equity beta.

Op.40-41; A0874-75; A0877-78; A3622-30; A3755-56. That "minimum possible estimate" for equity beta ensured that Professor Jarrell was *overestimating* SourceHOV's value, because a lower beta generates a lower discount rate and a higher valuation. A3756.

Professor Jarrell explained that each part of his analysis was based on bedrock finance theory. A0877 ("[T]aking the cost of debt, taking the implied beta, that, you can find everywhere"; "that the beta of the debt must be less than the beta of the asset unlevered can be found everywhere"). He acknowledged, however, that he had

never before taken an implied debt beta and used it as the minimum possible estimate of equity beta, A0877, and testified that he hoped this method "will become . . . one of things that people can do to get a reasonable estimate when they're out of luck with regard to statistical regression analysis . . . or the peer betas," A0877; Op.60.

On January 30, 2020, the trial court issued its Opinion setting fair value at $4,591 per share, adopting Mr. Meinhart's analysis "*in toto*, except for my adjustment to the applicable size premium." Op.75. The Opinion finds SourceHOV's presentation "lacked credibility" because of (i) Professor Jarrell's "bespoke approach" to equity beta; (ii) SourceHOV's two proffered fair value calculations, which were characterized as SourceHOV "disagree[ing] with its own expert"; and (iii) testimony by Mr. Chadha about a separate Rothschild deck, which the Opinion characterizes as "not at all forthright." Op.2, 53, 56-57; *see infra* Point III. On March 26, 2020, the trial court entered the Order with an appraisal award, plus compounded interest, of $57,684,471. Order at 2.

ARGUMENT

I. THE OPINION ERRS BY FAILING TO CONSIDER "ALL RELEVANT FACTORS," INCLUDING SOURCEHOV'S OPERATIVE REALITY

A. QUESTION PRESENTED

Does the Opinion err by failing to consider "all relevant factors"—including SourceHOV's operative reality—in determining SourceHOV's fair value? Op.53-55, 57-64; A0972; A0979-91; A1106-22.

B. SCOPE OF REVIEW

The interpretation and application of the mandates in Section 262 to appraisal proceedings present questions of law, which this Court reviews *de novo*. *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 524 (Del. 1999).

C. MERITS OF ARGUMENT

In determining the fair value of shares under the Delaware appraisal statute, "the Court shall take into account all relevant factors." 8 Del. C. § 262(h). "Fair value" is a jurisprudential concept that seeks to calculate "the value of the company to the stockholder as a going concern, rather than its value to a third party as an acquisition." *M.P.M. Enters., Inc. v. Gilbert*, 731 A.2d 790, 795 (Del. 1999). "Fair value" must be based upon, and reflect, the "operative reality" of the company at the time of a merger. *M.G. Bancorporation*, 737 A.2d at 525; *accord Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1, 20 (Del. 2017).

The Opinion repeatedly acknowledged SourceHOV's operative reality as a highly-levered company that was drowning in expensive debt, facing extreme "liquidity pressure" from and near misses on the Leverage Ratio covenant, and having missed the last seven sets of projections. Yet the Opinion adopts Mr. Meinhart's flawed valuation analysis that ignored, and was inconsistent with, this operative reality.

1. The Opinion Errs In Adopting Mr. Meinhart's Cost Of Debt And Capital Structure Assumptions

(a) Mr. Meinhart's Assumptions Were Untethered To SourceHOV

The Opinion nowhere addresses Mr. Meinhart's flawed cost of debt and capital structure assumptions underlying the three scenarios used in his DCF and CCF analyses.

Delaware courts require that the parties use or calculate a company's *actual* cost of debt and capital structure. *See Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, *7 (Del. Ch. Feb. 10, 2004); *Hintmann v. Fred Weber, Inc.*, 1998 WL 83052, *5 (Del. Ch. Feb. 17, 1998).[6]

Mr. Meinhart did not do so. He explained that cost of debt is a measure of the rate at which a company can borrow or refinance its existing debt. A0849-50. Yet

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[6] *Accord Gilbert v. M.P.M. Enters., Inc.*, 1998 WL 229439, *1-2 (Del. Ch. Apr. 24, 1998), *aff'd*, 731 A.2d 790 (Del. 1999); *In re Radiology Assocs. Inc. Litig.*, 611 A.2d 485, 493 (Del. Ch. 1991).

when the trial court inquired whether Mr. Meinhart based his cost of debt assumptions "at all [on] the information we have in the record . . . as to [SourceHOV's] ability to go out" and borrow or refinance, Mr. Meinhart conceded he did not. A0850. He based his cost of debt assumptions on generic bond indices, in turn based on yields-to-maturity of other company bonds. A3838; A0849.

The first of three scenarios used by Mr. Meinhart assumed that SourceHOV had a capital structure with 17% debt, and a cost of debt at 4.42%. A3838; A3872-73. Mr. Meinhart admitted both assumptions were "fundamentally different" from SourceHOV's operative reality. A0388-90; A0838; A0842; A0848-50. Indeed, they were fanciful. A0849 (4.42% cost of debt assumption was "less than half" of what Meinhart's valuation calculated as actual cost of debt); A0842 (acknowledging that debt was 57% of SourceHOV's capital structure on Valuation Date). This first scenario used in Mr. Meinhart's DCF and CCF analyses artificially decreased the discount rate and increased SourceHOV's value.

The cost of debt assumption in Mr. Meinhart's second and third scenarios was also flawed. He chose 9.73% based on yields-to-maturity of other company bonds rated CCC in an S&P index. A3838; A3872-73; A0830-31; A0852. Before he relied on the index, Mr. Meinhart did nothing to determine whether the 468 indexed bonds reflected debt of companies similar to SourceHOV. A0852-53. Nor did he run a coefficient of variation to ensure that the yields-to-maturity were tightly packed

around the mean. A0853. Indeed, the yields-to-maturity in the index varied dramatically (3%-160%). A0852-53; A4087. Meanwhile, nearly one-third of the bonds had yields-to-maturity greater than 11%, and the average without any weighting was 11.3%. A0853; A0884; A4087. Had they been weighted based on face value, the resulting average would have been greater than 11%. A0853; A0884; A4087.

Mr. Meinhart also had no valid way to reconcile his 9.73% assumption with SourceHOV's operative reality. The assumed cost of debt was just .23% more than the 9.5% SourceHOV had to pay at issuance in 2014 for the First and Second Liens, and notwithstanding multiple subsequent ratings downgrades that Mr. Meinhart conceded only make debt riskier and more expensive. *Supra* at 6-7; A0852; A4086. The 9.73% assumption was also less than the 10% it cost Exela, with a better credit rating, to finance its debt on the Valuation Date. A3783; A4086; A4088.

(b) The Opinion Wrongly Criticizes Professor Jarrell's 11% Cost Of Debt Assumption

While silent on Mr. Meinhart's assumed cost of debt, the Opinion erroneously rejects Professor Jarrell's 11% cost of debt assumption used to calculate equity beta. Op.60-61 & n.297.

The trial court's primary concern was that Professor Jarrell grounded his 11% cost of debt assumption in "market-based yields for SourceHOV's *traded* debt," Op.41 (emphasis added), when the efficiency of the trading market was

questionable, Op.60-61.[7] Yet as the Opinion separately acknowledges, Op.57 & n.279, 60, Professor Jarrell's cost of debt assumption was not based on yields from trading, but on (i) the 9.5% weighted average yield-to-maturity of the First and Second Liens *upon issuance*; (ii) the fact that, after issuance, SourceHOV was repeatedly downgraded and had difficulties obtaining additional financing, *supra* at 7, 9; and (iii) the 10% stated interest rate on Exela's financing for the Business Combination, based on improved creditworthiness of combined Novitex and SourceHOV, A3588-97; A3629; A0875-78; A4039-45. Professor Jarrell considered the yields-to-maturity on the First and Second Liens from post-issuance trading only as *confirmatory* evidence, Op.61 n.297; A3630; A0878; A0885, and those were far north of 11%, A3589.

The trial court also expressed concern that yields-to-maturity may not accurately reflect "actual cost of debt, in an efficient market, full stop," citing a treatise warning that when a firm's debt is risky, "the debt yield will overestimate the debt cost of capital" because it ignores default risk. Op.61 n.297; A3993. This concern was likewise misplaced. Professor Jarrell considered only the weighted average yield-to-maturity *at issuance* of the First and Second Liens (followed by

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[7] Appellees, however, viewed the market pricing on SourceHOV's traded debt as accurate. A1527 (Cascarilla "doubt[ed]" "markets are wrong"); A1533 ("I doubt the market is more than 1 pt off of the bid or ask.").

downgrades and difficulties obtaining additional financing), and the stated interest rate for Exela's debt financing for the Business Combination. The initial pricing—including that the First and Second Liens were issued at a discount to par—would have factored in default risk. Indeed, the treatise cited in the Opinion does not warn against using yields-to-maturity *at issuance*, let alone in combination with other factors as Professor Jarrell did. *See* A3993.[8]

Consistent with Delaware law, Professor Jarrell correctly estimated SourceHOV's minimum actual cost of debt at 11%, based on SourceHOV-specific evidence.

2. The Opinion Errs In Adopting Mr. Meinhart's Beta Analysis

The Opinion adopts Mr. Meinhart's use of an indirect beta and multiple beta assumptions (ranging from 1.21-2.46) that, again, disregarded SourceHOV's operative reality by estimating beta through supposed guideline companies that were not sufficiently comparable to SourceHOV. The Opinion also rejects Professor

[8] The record was never developed regarding use of yields-to-maturity to calculate cost of debt, as Mr. Meinhart also based his debt cost assumption on them. A0849. Appellees first challenged such reliance in post-trial briefing. A1063; A1181; A1198-99. Moreover, even if Professor Jarrell's 11.0% assumption were overstated, any overstatement would have been counteracted by his conservative use of debt beta to set equity beta. *Infra* Point I.C.2.b. As a firm's leverage increases, its equity beta increases at a faster rate than its debt beta increases. *See* S. Pratt, R. Grabowski, COST OF CAPITAL at 550-51 (5th ed. 2014) (noting "nonlinear" relationship between leverage and firm's debt and equity betas); A3996 (as firm takes on more debt, equity holders bear increasingly higher risk of non-payment than debtholders).

Jarrell's beta (1.4) grounded in that operative reality and, specifically, SourceHOV's actual cost of debt. This was error.

(a) Mr. Meinhart's Indirect Beta Improperly Relied On Insufficiently Comparable Guideline Companies

Beta is "the measure of a given company's nondiversifiable risk relative to the market," *In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, *16 (Del. Ch. May 3, 2004), and should be *higher* for companies that are "more unstable and leveraged" and "less established and financially and competitively secure," *Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 WL 3793896, *16 (Del. Ch. July 8, 2013).

As the Opinion observes, an indirect beta is one of two "generally accepted," "traditional" methods for calculating beta, with the other, primary method being to directly calculate beta using statistical regressions of a company's own stock if it is publicly traded. Op.57-59, 61. But that same "generally accepted" and "traditional" method of calculating an indirect beta requires sufficiently comparable companies.[9]

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[9] *See* Ibbotson SBBI 2013 Valuation Yearbook at 81 (indirect beta measurement "includes only the 'pure play' companies in the calculation of beta. . . . Our rule of thumb is that a minimum of 75 percent of revenues must come from a single SIC code for a company to be considered a pure play company."); Koller et al., VALUATION: MEASURING AND MANAGING THE VALUATION OF COMPANIES at 253 (2010) ("if few direct comparables exist," one should use "the simple smoothing process used by Bloomberg"); *see also In re Appraisal of Jarden Corp.*, 2019 WL 3244085, *46 (Del. Ch. July 19, 2019) (while finance literature "supports the use of comparable companies" in beta analysis, "[t]his, of course, assumes that 'truly'

The burden was on Appellees and Mr. Meinhart to show comparability and justify his use of an indirect beta. The Opinion nowhere finds comparability, other than to observe that Mr. Meinhart's set of guideline companies included some of the companies identified as peers by SourceHOV, its accountants, and Rothschild. Op.35, 62. That partial overlap is not dispositive, and certainly not absent a qualitative showing of comparability.[10] Meanwhile, the Opinion acknowledges the "dearth of comparable companies" and that both experts agreed "there are no sufficiently comparable companies . . . with which to perform . . . a trading multiples analysis." Op.41, 51; *see also supra* at 16, 19. Delaware courts have eschewed use of an indirect beta where experts have rejected use of a GPTC analysis.[11]

At trial, Appellees could not demonstrate the requisite comparability because Mr. Meinhart's guideline companies were very different from SourceHOV: *none* had a lower market cap, a higher percentage of debt in capital structure, or the same

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comparable peers exist that can meaningfully be compared to the target company"), *aff'd*, 2020 WL 3885166 (Del. July 9, 2020).

[10] *See Jarden*, 2019 WL 3244085, *46 (where expert "failed convincingly to demonstrate" similarity of comparable companies, court was "disinclined to consider" beta based on comparables); *id.* at *33 ("finance literature advises against relying on peers provided by the target company's management").

[11] *See Merion Capital*, 2013 WL 3793896, *18; *In re Appraisal of DFC Global Corp.*, 2016 WL 3753123, *9 (Del. Ch. July 8, 2016), *rev'd on other grounds*, 172 A.3d 346 (Del. 2017).

or lower credit rating. A3874; A4074. The companies were also very different from each other:

- Market caps ranged from $1.9B to $40.1B
- LTM revenue ranged from $513.7M to $13.8B
- LTM EBITDA ranged from $99.8M to $2.8B
- Debt to total market cap ranged from 0% to 52.2%
- Betas ranged from 0.565 to 1.663

A3874; A4074; A4077. Indeed, the range of their betas encompassed the betas of 89% of the S&P 500. A4077.

While the Opinion points to the unlevering and re-levering processes Mr. Meinhart undertook, Op.35, 63-64, that did not make up for the significant dissimilarity, and only introduced more error. After unlevering 19 betas using three different methods, Mr. Meinhart selected the highest (1.21)—but that corresponded to Cognizant, with a $40 billion market cap, capital structure with 2.9% debt, and credit rating of Aa. Op.35; A3836-37; A3874; A0407. It is fanciful to say that SourceHOV and Cognizant bear similar risk to the market. Mr. Meinhart then compounded the error by re-levering using the Hamada method, which assumes *zero* debt. A0848; A3837. And, he re-levered using the same three capital structure scenarios, including the 17% debt scenario that was "fundamentally different" from SourceHOV's operative reality. A3837; *supra* at 23. That re-levering generated one

beta (1.37) that served no valid purpose but artificially lowered the discount rate. A3837.

Perhaps to compensate for the non-comparability of his guideline companies, Mr. Meinhart engaged in a continuous exercise of averaging and "triangulating," *see* A0827-28, creating more issues. Mr. Meinhart's approach produced a beta stew: he started with 228 betas for 19 guideline companies, narrowed the set to 19 betas, unlevered those to create 57 betas, selected one (corresponding to Cognizant's beta), and re-levered under three scenarios to create three betas. *Supra* at n.4. He then took that beta stew and made WACC stew: his DCF used a discount rate that was the *average* of three discount rates based on the three betas, and his CCF used a discount rate that was the *average* of three pre-tax discount rates based on the three betas plus a fourth discount rate (Cognizant's beta). *Supra* at 16-17. Mr. Meinhart's ultimate valuation then *averaged* the results of his DCF and CCF. *Supra* at 17. This dizzying process—which continually recycled the 1.21 and 1.37 betas from dissimilar Cognizant and relied on a "fundamentally different" capital structure of 17% debt, A3872-74—is antithetical to the "point calculation" demanded by the appraisal statute.[12]

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[12] *See Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 2018 WL 922139, *49-50 (Del. Ch. Feb. 15, 2018) (criticizing expert's refusal to "calculat[e] a beta to generate a WACC as contemplated by CAPM" in favor of "unstructured approach[]," in which he used various beta candidates to generate numerous possible discount rates), *rev'd on other grounds*, 210 A.3d 128 (Del. 2019); *In re Orchard*

(b) <u>The Opinion Wrongly Rejects Professor Jarrell's Approach</u>

While the Opinion does not address the above-noted flaws, it rejects Professor Jarrell's beta analysis for three reasons.

First, while acknowledging "some imprecision associated with indirect beta estimates," the Opinion states that it is "generally accepted that when a company is privately held, a comparable companies analysis is the best tool available to derive beta, even if the comparable companies are larger or less levered." Op.62. The cited treatises, A3929; A3962, set forth no such hard-and-fast rule. Appellants are aware of no authority instructing that the two "traditional" methods to calculate beta are the *only* two methods, and the authority described *supra* at 27-28 & nn.9 & 11 makes clear that an indirect beta should *not* be used if guideline companies are not shown to be sufficiently comparable.[13]

Enters., Inc., 2012 WL 2923305, *18 (Del. Ch. July 18, 2012) ("Even if one were to conclude that there are multiple ways to come up with a discount rate, that does not mean that one should use them all at one time and then blend them together."), *aff'd* 2013 WL 1282001 (Del. Mar. 28. 2013); *see also In re Orchard Enters., Inc.*, 88 A.3d 1, 30 (Del. Ch. 2014) (noting "point calculation demanded by appraisal statute").

[13] For example, Professor Aswath Damodaran has discussed alternative approaches, including estimating risk parameters "using the financial characteristics of the firm – the volatility in earnings, their size, cash flow characteristics and financial leverage." Aswath Damodaran, THE DARK SIDE OF VALUATION at 28 (2000); *see also Merion Capital*, 2013 WL 3793896, *18 (noting recommended "smoothing" approach to beta for publicly-traded company).

Second, the Opinion finds Professor Jarrell's beta approach flawed because it was based on his 11% cost of debt assumption. Op.60-61. But the concerns with that assumption were misplaced. *Supra* at 24-26.

Third, the Opinion concludes that Professor Jarrell's "admittedly novel" approach to beta undermined the credibility of his presentation. Op.3, 57-58, 64. But Professor Jarrell emphasized that each step of his beta analysis was well-grounded in the record or bedrock finance theory:

1. He started with his conservative 11% cost of debt assumption, A3629-30, based on SourceHOV-specific evidence, *see supra* at 19, 25.

2. He then used CAPM to derive an implied debt beta of 1.4:

   11.0% = undisputed 2.65% risk free rate + 1.40 implied debt beta x undisputed 5.97% market risk premium

   Supra at 19; A3630. CAPM's application to debt, its formula, and Professor Jarrell's arithmetic all were unquestioned.[14]

3. He then turned to M&M Theorem, which dictates that debt beta must always be less than unlevered equity beta. *Supra* at 19; A3622-24.[15]

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[14] *See, e.g.*, R. Holthausen, M. Zmijewski, CORPORATE VALUATION: THEORY, EVIDENCE & PRACTICE at 453-54 (2d ed. 2020) (CAPM applies to debt); A0837 (Meinhart "not arguing with the arithmetic of the model").

[15] Under M&M Theorem, "the total risk of the company's assets, real and financial, must equal the total risk of the financial claims against those assets." A3979. Because "[t]he stockholders and debtholders both receive a share of the firm's cash flows and both bear part of the risk," "the firm's asset beta is equal to the beta of a portfolio of all the firm's debt and its equity. The beta of this hypothetical portfolio is just a weighted average of the debt and equity betas." A3996. This widely-accepted formula:

$$\beta_{\text{assets (unlevered)}} = (\beta_{\text{debt}} \text{ x Debt/Debt+Equity}) + (\beta_{\text{equity}} \text{ x Equity/Debt+Equity})$$

> M&M Theorem has been called the "foundation of modern finance,"[16] and Mr. Meinhart's rebuttal report acknowledged and applied its principles. *See* A3714-15.

Based on a direct application of M&M theorem, Professor Jarrell conservatively set SourceHOV's unlevered equity beta at 1.4, as it could be *no lower than* its 1.4 debt beta. *Supra* at 19; A3624-25; A3629-30; A3756; Op.40. That was the only "novel" aspect of his approach: using these well-accepted finance principles to solve for the beta issue in this case, where SourceHOV's stock was not publicly traded and there were no sufficiently comparable companies. A0877. He provided a straightforward approach—grounded in SourceHOV's operative reality (its actual cost of debt) and basic finance principles—that stood in stark contrast to Mr. Meinhart's beta stew based on other companies that no one believed were sufficiently comparable. Rather than being discounted for "novelty," Professor

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is the same formula on which Professor Jarrell relied. A3623; A4037. Because "[f]inancial leverage does not affect the risk or the expected return on the firm's *assets*," it necessarily increases the risk of the company's *equity* (since the equityholders have claims that are subordinate to those of debtholders). A3996. And because equity/(debt + equity) must be below 1 for a levered firm, then asset beta must be less than equity beta. A4000 ("[T]he equity beta will always be greater than the asset beta with financial leverage."). Accordingly, if the introduction of financial leverage increases the equity beta, and if the equity beta must be greater than the asset beta, and the asset beta remains constant, then the debt beta must always be less than the equity beta.

[16] Peter H. Huang & Michael S. Knoll, *Corporate Finance, Corporate Law and Finance Theory*, 74 S. CAL. L. REV. 175, 177 (2000).

Jarrell's approach provides a tool for cases where the company's stock is not publicly traded and there are no sufficiently comparable companies. A0877.

Professor Jarrell's approach was also conservative for a respondent's expert, as using debt beta must provide the "absolute theoretical floor value for the unlevered equity beta." A3756; A0878. When Mr. Meinhart re-levered his betas using hypothetical capital structure assumptions of 62.1% and 51.5% debt—far closer to SourceHOV's actual 57% debt than his first scenario's 17% assumption—he generated betas of ***2.46*** and ***2.02***, A3872-73, underscoring how conservative Professor Jarrell's ***1.4*** beta was. Such a conservative approach bolstered Professor Jarrell's credibility, along with his other conservative assumptions. *See* Op.39 (Jarrell calculated fair value based on Equity Case, despite "serious reservations" with its reasonableness); Op.38 n.189 (Jarrell increased his initial fair value calculations by 63% based on certain "Meinhart[] suggestions").[17]

3. The Opinion Errs By Failing To Consider The Bank Case

The Opinion adopts Mr. Meinhart's use of the Lender Case and refuses to employ the Bank Case, finding that SourceHOV's proffer of the latter projections put SourceHOV "at odds" with Professor Jarrell and cloaking the rejection in terms of credibility. Op.2-3, 53–55. While a trial court's factual findings are typically

[17] Professor Jarrell's use of a conservative approach, grounded in well-accepted finance principles, cannot be squared with a finding that he was "out on a limb." Op.58.

awarded significant deference, "[t]his does not mean that the trial judge may insulate his or her factual findings from appellate review by denominating them as credibility determinations." *Cede & Co. v. Technicolor, Inc.*, 758 A.2d 485, 492 (Del. 2000); *see also id.* at n.36 ("the court of appeals may well find clear error even in a finding purportedly based on a credibility determination").

The Opinion begins by observing that both experts "agree[d]" that the Equity or Lender Cases were "the best revenue projections" to use. Op.53. But Professor Jarrell conducted a valuation analysis using the Equity Case to be "conservative." Op.39; A3611; A0860. He underscored that the valuation based on it would "likely overstate" the actual fair value and constitute a "maximum" fair value, and he highlighted his "serious reservations" with the Equity Case's reasonableness. *Supra* at 18-19.

For good reason. While SourceHOV selected the Equity or Lender Case to use with auditors and ratings agencies, and while Rothschild selected the Equity Case for its February 2017 analysis, Op.54, they did so against a backdrop of management having missed seven of the prior eight sets of projections, and both the Equity and Lender Cases were quickly missed, *see supra* at 8, 12, 14.[18] While the

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[18] *See LongPath Capital, LLC v. Ramtron Int'l Corp.*, 2015 WL 4540443, *18 (Del. Ch. June 30, 2015) (declining to use management projections where "management's track record at forecasting was questionable even under their standard method of forecasting").

Lender Case was the "most up-to-date," Op.54, it was also the one fastest proven wrong, Op.24.[19] And while the Opinion references SourceHOV's compound annual revenue growth of 10% since 2014, Op.55, that growth was due to acquisitions; SourceHOV experienced negative organic growth since at least 2014, *supra* at 8.

Moreover, the Equity Case was "optimistic" and "very hopeful," *supra* at 12, and the Lender Case was created as part of an effort to syndicate more than $1 billion in debt financing and find some path out of SourceHOV's unsolvable debt situation, *supra* 13-14. Both undermine the reliability of those projections.[20]

Meanwhile, the Bank Case was not an "afterthought." Op.55. Management created both the Equity and Bank Cases for a Novitex transaction, placing them in one spreadsheet with a toggle between the two. *Supra* at 12. While the Opinion observes that management "stood behind" the Equity Case, Op.25, the testimony

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[19] *See In re Nine Sys. Corp. S'holders Litig.*, 2014 WL 4383127, *42 (Del. Ch. Sept. 4, 2014) (rejecting projections where management had "overestimated the [c]ompany's revenues, even two to three months away . . . ."), *aff'd sub nom. Fuchs v. Wren Holdings, LLC*, 129 A.3d 882 (Del. 2015); *see generally DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346, 382 (Del. 2017) (rejecting reliance on projections where targets missed in under three months).

[20] *See DFC Global*, 172 A.3d at 350-51 (criticizing trial court for relying on "aggressive" projections that were "optimistic and designed to encourage bidders to pay a high price"); *In re PetSmart, Inc.*, 2017 WL 2303599, *32 (Del. Ch. May 26, 2017) ("[M]anagement's projections should reflect the 'expected cash flows' of the company, not merely results that are 'hoped for.'"); *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, *8 (Del. Ch. Apr. 30, 2015) (rejecting reliance on "optimistic" projections prepared "to maximize the effort to market the [c]ompany").

was that management "stood behind" both sets, *supra* at 13. With its "more conservative" 2.2% annual revenue growth rate from 2018-2021, the Bank Case was the one that best reflected SourceHOV's operative reality and thus was "more balanced in terms of its considerations of the [C]ompany's vulnerability." *DFC Global*, 172 A.3d at 382.

SourceHOV's advocacy for use of the Bank Case was not in "disagree[ment]" or "at odds" with Professor Jarrell's analysis, and he did not "reject" the Bank Case. Op.2-3, 53-55. Professor Jarrell performed calculations and provided valuations using both the Equity Case and Bank Case. *Supra* at 18. SourceHOV's proposed valuation of $1,633.85 per share was not a "recently minted litigation position," Op.55, but came directly from Professor Jarrell's valuations, *supra* at 18.

Nor was Professor Jarrell engaged to opine on the most accurate revenue projections for SourceHOV, Op.55, but "to opine on the fair value of SourceHOV as a going-concern as of July 12, 2017, the valuation date." A3562; *see also* A0862; A0866. When asked at trial if he had "a view as to which set of projections [Equity or Bank Case] is more consistent with the actual results," he testified: "Well, you know, I'm complaining about how aggressive the projections are. So, you know, that would imply that the . . . lower projections are more reliable than the higher projections." A0865. The Opinion's valuation should not have been colored by

concern over "disagreement" between SourceHOV and its expert regarding projections.

*   *   *

By adopting Mr. Meinhart's flawed analyses, the Opinion's valuation does not take into account SourceHOV's operative reality and thus "all relevant factors." This Court should remand the case to do so. *See DFC Global*, 172 A.3d at 351; *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 301 (Del. 1996).

II. THE OPINION ERRS IN REFUSING TO CONSIDER KNOWN OR KNOWABLE FINANCIAL RECORDS

A. QUESTION PRESENTED

Does the Opinion err by ignoring SourceHOV's second quarter financial records, which were known or knowable as of the appraisal date? Op.70-71; A0994; A0995; A1131-32.

B. STANDARD OF REVIEW

The interpretation and application of the mandates in Section 262 present questions of law reviewed *de novo*. *M.G. Bancorporation*, 737 A.2d at 524.

C. MERITS OF THE ARGUMENT

The Opinion accepts Mr. Meinhart's financial analysis based on SourceHOV's financial records as of March 31, 2017—rather than as of July 12, 2017, as Professor Jarrell used—because "[w]hile second quarter data may have *existed* before July 12," it was not "available" until after the Business Combination closed. Op.71.

Delaware law requires information to be "known *or knowable*" as of the appraisal date for the purpose of excluding speculative future events, and does not impose a date cutoff simply because a document first became "available" after the merger. *See Petsmart*, 2017 WL 2303599, *34; *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, *7 (Del. Ch. Dec. 31, 2003) (permitting use of projections that management began developing two months before merger date but did not finalize

until after that date, as information was "knowable" as of merger date), *aff'd in part, rev'd on other grounds*, 884 A.2d 26 (Del. 2005); *see also Gholl v. eMachines, Inc.*, 2004 WL 2847865, *8 (Del. Ch. Nov. 24, 2004) (information from 2002 budget that was finalized after merger date was "known or knowable," where testimony confirmed that underlying assumptions were developed before merger date and budget numbers were arrived at in 2001), *aff'd*, 875 A.2d 632 (Del. 2005).

Here, the financial data for the second quarter of 2017 was a matter of the fixed historical record as of July 12, 2017. The second quarter ended on June 30, 2017, 12 days before the Valuation Date. A3384. Mr. Reynolds confirmed in his testimony that at the end of a quarter, "[a]ll the data exists. It just takes time to generate the financial statements." A0776. That testimony was not disputed, nor could it be. *See* Op.71 (noting second-quarter information "*existed*" before Valuation Date). Mr. Meinhart agreed that any cash flows and changes to net debt would have been accounted for by the Valuation Date. A0840.

The Opinion suggests that second quarter financial information was appropriately not considered because on July 11, 2017, SourceHOV "told its auditor that it only had 'best estimates' for May and June income statements." Op.70. These "estimates" underscore that the second quarter information was "knowable" as of the Valuation Date: The cited July 11 email attached a spreadsheet containing SourceHOV income statements and balance sheet information for May, June, and

the first 11 days of July 2017. A3924. The income statements were described as "estimates" only because they had not yet been finalized. No new information—first existing, known or "knowable" after July 12, 2017—was needed.

This Court should remand with instructions to use the "knowable" second quarter financial results. *See M.G. Bancorporation*, 737 A.2d at 525 (affirming corroborative use of valuation "updated . . . to reflect value data as of" merger date).

III. THE OPINION'S CREDIBILITY DETERMINATION REGARDING THE "AS OF JULY 2017" ROTHSCHILD DECK SHOULD NOT HAVE FACTORED INTO THE FAIR VALUE DETERMINATION

A. QUESTION PRESENTED

Does the Opinion err in adopting Appellees' tale of a backdated valuation? Op.2, 53, 56-57; A1095-96.

B. STANDARD OF REVIEW

In the absence of legal error, this Court reviews appraisal valuations for abuse of discretion. The trial court abuses its discretion when, *inter alia*, its factual findings do not have record support. *M.G. Bancorporation*, 737 A.2d at 526.

C. MERITS OF THE ARGUMENT

In discovery, SourceHOV produced a second Rothschild deck that showed an implied equity value for SourceHOV at $675 million. A3454; *see* Op.52. From this document and in trial briefing, Appellees spun a tale of alleged backdating and supposed cover-up. A0592-95; A1046-48; A1171-72. Appellee's narrative was based on mischaracterizations of, and selective excerpting from, the record and should not have colored the Opinion's valuation. *See* Op.56-57.

First, the second Rothschild deck is irrelevant to this "battle of the experts." Op.51. Determining the valuation of SourceHOV is an objective exercise. SourceHOV did not offer the second deck in support of its valuation, and neither expert considered it.

Second, Appellees' story was inconsistent with the record. The deck does not have a "'July 2017' date," as Appellees contended below. A0592; A0594; A1046; Op.30. At no point does the deck purport to have been created contemporaneously with closing of the Business Combination. Rather, the deck is titled "Komodo Final Structure *as of* July 2017," and states on its first page that it was done on a "retrospective basis." A3444-45 (emphasis added). The deck's first page also makes clear that the February 2017 analysis had been "further updated" to reflect new information that became available between February 2017 and the Business Combination, including that 2018-2021 projections were updated based on "the long-term financial guidance ranges provided in the 8K filed on April 3, 2017 (i.e., YOY revenue growth of ~3-4%)." A3445; A3448.[21]

Contemporaneous emails surrounding creation of this deck likewise evidence no backdating scheme, but rather demonstrate that Messrs. Chadha and Jonovic each recalled that Rothschild had updated its February 2017 valuation shortly before the Business Combination closed, given updated projections and information. On January 3, 2018, Mr. Jonovic forwarded to Mr. Chadha a Rothschild analysis that Rothschild had sent in May 2017. A3462. Mr. Chadha's response reflects his memory that there was a further updated analysis: "We should ask them for the

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[21] A2300 ("Long-term Financial Objectives/Organic Revenue Growth ~3-4%").

revised – because we did the deal at $8 etc.," and then he asked Mr. Jonovic to "look for valuation being fair or something like that. I thought they provided us with that as well." A3462. Mr. Jonovic responded the next morning, "I thought so too but have not been able to find it. Will look further." A3462. Mr. Jonovic then emailed Rothschild, seeking a post-May 2017 further updated analysis that he and Mr. Chadha remembered: "Ken, I was looking for the valuation fairness document (it was in the form of a deck) that Rothschild produced some time ago but have not been able to locate it. Could you please send it to me? Believe it was shared not long before closing, reflecting the revised share price." A4145.

The contemporaneous emails also show that once Rothschild indicated its files contained no post-February 2017 valuation deck, Mr. Jonovic's request was merely to memorialize, on an "as of" and "retrospective" basis, a post-February 2017 analysis that both Messrs. Chadha and Jonovic thought had been done. On January 4, when Rothschild forwarded the February 2017 deck, Mr. Jonovic responded, "Robin, thanks. Would it be possible to get this reissued *as of,* or close to, the Proxy date? Some of the numbers moved." A3491 (emphasis added). Similarly, on January 19 and after Rothschild sent the new deck—dated "January 2018" and with a cover note describing it as a "retrospective valuation update as of July 2017"—Mr. Jonovic confirmed that the attached deck contained the post-February 2017 analysis he had remembered: "Ken, thanks, this is it." A3493. Mr. Jonovic asked to make

the file date "in line with closing so it does not confuse people in the future." A3493. Rothschild's response highlighted that "it's better to show the analysis as of the closing date." A3492. Mr. Jonovic agreed, reiterating that he only wanted to avoid confusing people: "we are on the same page. All I'm saying is the cover page says Jan 2018, which implies it is still being worked on. Happy for it to simply say July 2017, without specific date." A3492. There is nothing nefarious in these exchanges. Mr. Jonovic does not pressure Rothschild; he does not tell them what valuation to reach or data to use; there is no attempt to edit the expressly "retrospective" nature of the deck. The "as of" nature of analysis is acknowledged and agreed by all, up front.

Appellees' backdating account is further contradicted by the testimony of Rothschild's Kenneth Surjadinata, who testified that the intent all along was to indicate that the "as of July 2017" analysis was retrospective. A0146. He testified that Rothschild used data publicly available by July 2017 to update their February 2017 analysis, further negating any attempt to cook up new data. A0147; A0155; A0161. He also confirmed the absence of any pressure or editorial input from SourceHOV. A0153; A0155.

As there was no backdating, the Opinion should not have faulted Mr. Chadha for failing to acknowledge that backdating had taken place. Op.57. The trial court appears to have been under the mistaken impression that Mr. Chadha testified at

deposition that the "as of July 2017" deck was given to SourceHOV prior to closing. Op.31 & n.152. Mr. Chadha testified to the contrary, that Rothschild "did not make a presentation like you see in [A3492]" in July 2017, and indicated that Rothschild may have made a different presentation during that period. A0503.[22]

In sum, Appellees' cherry-picking of the record led the trial court down a rabbit hole of erroneous inferences about an irrelevant document that should not have colored its valuation.

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[22] Nor was SourceHOV's June 25, 2018 interrogatory response part of some scheme to hide backdating. A0594; A1048; A1172; Op.30-31. The interrogatory response described that Rothschild "made presentations" in February and July 2017, *not* that Rothschild had presented the "as of July 2017" deck. A3550-51. In its revised interrogatory response, SourceHOV objected to the interrogatory's undefined term "presentation," and stated that SourceHOV would "interpret 'presentation' to mean PowerPoint decks" prepared by Rothschild and provided to SourceHOV. A3920. The revised response then listed various decks so provided. A3920-23.

CONCLUSION

For the above-stated reasons, SourceHOV respectfully requests that this Court vacate the Order and remand with instructions that the trial court's valuation consider SourceHOV's operative reality.

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CERTIFICATE OF SERVICE

I hereby certify that on August 26, 2020, the foregoing document was served in hard copy via messenger, and electronically via *File & Serve*Xpress, upon the following counsel of record:

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