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The Court of Chancery Applies DCF to Determine the Fair Value of Trussway Holdings

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Kendall Hoyd and Silver Spur Capital Partners, LP v. Trussway Holdings, LLC, C.A. No. 2017-0260-VCG

In the Delaware Court of Chancery's decision on February 28, 2019, Vice Chancellor Sam Glasscock relies on the discounted cash-flow (DCF) methodology to find the fair value of the shares of Houston-based manufacturer Trussway Holdings LLC to be $236.52 per share, which lands between the $387.82 valuation offered by the petitioner and the $225.92 valuation offered by the respondent company.

Case Background

Trussway's board of directors approved a merger in December 2016, at which time Trussway and its subsidiaries were converted into limited-liability companies. The company's two minority stockholders sought appraisal pursuant to 8 Del. C. 262 in the Court of Chancery shortly thereafter, although one settled with Trussway prior to trial.

The remaining petitioner agreed with the respondent on the value of the company's assets and liabilities. The primary point of dispute was the value of Trussway's wholly owned subsidiary, Trussway Industries, Inc. ("TII"). The petitioner's expert valued TII through a DCF analysis based on a set of nine-year projections developed by TII management (the "management projections"), a comparable companies analysis, and a precedent transaction analysis, with 60% weight afforded to the DCF. Notably, the petitioner's expert added a "1% risk premium to WACC to allow for the reduced predictability of performance in the outer four years."

The respondent's expert used a variation of the Income Approach, applying 25% weight to a DCF analysis based on the management projections, but assigning 75% weight to an alternate DCF analysis based on a modified version of five-year projections. The respondent argued against wholesale reliance on the management projections given that they had been created for use in a TII sales process and were "based on strategic initiatives…which had not commenced as of the merger."

The Court of Chancery Decision

The Court of Chancery rejected market approaches for valuing TII, finding that the "supposed 'comparable companies' are too divergent from TII, in terms of size, public status, and products, to form meaningful analogs for valuation purposes." Turning to DCF, the court found the management projections to be management’s best estimate of TII’s future performance. The court was not troubled by the inclusion of the strategic initiatives on the ground that they formed part of TII’s operative reality at the time of the merger.

Of more concern to the Vice Chancellor was “management’s ability to accurately predict corporate performance nine years out.” The court declined to adopt the petitioner’s 1% risk premium and opted for the respondent’s blended approach, placing 50% weight on a DCF derived from the management projections and 50% weight on a second DCF derived from the same management forecasts with a terminal period beginning after a more standard five years.

Key Takeaways

The court’s analysis provides helpful insight into the meaning of “operative reality” as used in the Delaware appraisal statute and underscores the utility of the DCF methodology in the context of a private company valuation.