The fair value of common stock in a dissenting shareholders’ rights case has often been examined within the Delaware Block framework since its creation by the Supreme Court of Delaware over 60 years ago. While the use of the Delaware Block framework is no longer commonly relied on in Delaware Chancery Court decisions, it has not disappeared in some other jurisdictions. The traditional Delaware Block framework, however, may need to be modified to incorporate the current generally accepted valuation methods.
1. Market value – based on a contemporaneous or recent market price
2. Asset value – based on the net asset value of the corporation (i.e., the fair value of the assets less the fair value of the liabilities)
3. Investment or earnings value – typically based on the five-year trailing average earnings multiplied by a capitalization multiple (generally, a price-to-earnings multiple derived from guideline publicly traded companies)

It is important to note that these three value measures are not the same as the three generally accepted valuation approaches (i.e., the market approach, the income approach, and the asset-based approach).

The three value measures considered in the traditional Delaware Block framework are not forward looking. Due to its preference for historical data points, the traditional Delaware Block framework does not incorporate the use of projections. Also, subject company and public market data on an invested capital basis (e.g., EBITDA, EBIT, debt-free net cash flow) are not generally used.

In 1983, the Delaware Supreme Court overturned the exclusive reliance on the Delaware Block framework in the decision of Weinberger v. UOP. That judicial decision was based on the following justification:

The standard “Delaware block” or weighted average method of valuation, formerly employed in appraisal and other stock valuation cases, shall no longer exclusively control such proceedings. We believe that a more liberal approach must include proof of value by any techniques or methods that are generally considered acceptable in the financial community and otherwise admissible in court. . . . Fair price obviously requires consideration of all relevant factors. . . . This is not only in accord with the realities of present day affairs, but it is thoroughly consonant with the purpose and intent of our statutory law.

The Supreme Court determined that the Delaware Block framework was “outmoded” to the extent it “excludes other generally accepted techniques used in the financial community and the courts.”

It is important to note that the Delaware Block factors are not abandoned by the Weinberger decision. Instead, the case stated that all relevant factors should be considered, and it allowed for the use of other valuation methods. In fact, Weinberger was ironically decided in favor of a valuation based on the Delaware Block framework.

Although the discounted cash flow (DCF) method is probably the most frequently used post-Weinberger valuation method, it has not been the exclusive valuation method employed by the Delaware courts. The Delaware courts (and other state courts) have continued to use a variety of valuation methods, depending on the facts and circumstances of each particular case.

There are post-Weinberger instances where the Delaware Block framework has been relied on (at least in part) by the Delaware courts and in other state courts:

- Rosenblatt v. Getty Oil Co., 493 A.2d 929, 940 (Del. 1985), noting that “Weinberger did not abolish the block formula, only its exclusivity.”
- Oakridge Energy, Inc. v. Clifton, 937 P.2d 130, 135 (Utah 1997), suggesting that the stock appraisal valuation should consider each of the three Delaware Block measures of value, but not employing a weighted average methodology, aff’d, 796 F.2d 803 (5th Cir. 1986).
- Hernando Bank v. Huff, 609 F. Supp. 1124, 1126-27 (N.D. Miss. 1985), considering each of the three Delaware Block measures of value, but not employing a weighted average methodology, aff’d, 796 F.2d 803 (5th Cir. 1986).
- In fact, at least one state, Tennessee, may still rely on the exclusive use of the Delaware Block framework in fair value cases even after Weinberger.
- Blasingame v. American Materials, Inc., 654 S.W.2d 659, 668 n.1 (Tenn. 1983) (opinion on petition to rehear), affirming the court’s pre-Weinberger decision based on the “weighted average method,” which is essentially the Delaware Block method, and noting that “[w]e do not find anything
in Weinberger that causes us to alter the adoption of the weighted average method.”

- Elk Yarn Mills v. 514 Shares of Common Stock of Elk Yarn Mills, 742 S.W.2d 638, 640-44 (Tenn. Ct. App. 1987), noting that “The parties all agree that the correct method for calculating the value of the shares in this case is the Delaware Block method adopted by our Supreme Court in [Blasingame].”

- Genesco, Inc. v. Scolaro, 871 S.W.2d 487, 490 (Tenn. Ct. App. 1993), concluding that the Delaware Block framework was appropriate.

Even if courts elect to accept the Delaware Block framework, it may be appropriate to make adjustments to the traditional Delaware Block analysis.

The following section presents an illustrative valuation example based on modifications to the traditional Delaware Block analysis.

We specifically modified the Delaware Block analysis to incorporate the following variables:

- Invested capital (debt plus equity) pricing multiples and invested capital present value discount rates (e.g., weighted average cost of capital)
- Multiple time periods, in addition to a five-year average time period
- Projected guideline publicly traded company method pricing multiples
- A discounted cash flow method analysis
- An analysis of transaction data of guideline publicly traded companies
- Net cash flow instead of net income in the direct capitalization method

While the foregoing descriptions follow the traditional Delaware Block framework, these analyses were based on generally accepted valuation approaches and methods. That is, the traditional Delaware Block analysis was modified to be more consistent with generally accepted valuation approaches and methods.

Our modified Delaware Block analysis is summarized in Exhibit 1 and discussed in the following sections.

**Investment or Earnings Value Analysis**

As part of the of the investment or earnings value analysis, we considered the following generally accepted valuation approaches and methods:

1. The income approach and, specifically, the direct capitalization method
2. The income approach and, specifically, the discounted cash flow method
3. The market approach and, specifically, the guideline publicly traded company method
4. The market approach and, specifically, the guideline merged and acquired company method.

These valuation approaches and methods are summarized in the following sections.

**Direct Capitalization Method**

The direct capitalization method is presented in Exhibit 2. This method has two variables:

1. The capitalization rate (which is the present value discount rate minus an expected long-term growth rate)
2. The normalized and sustainable economic income to be capitalized

As presented in Exhibit 2, we conducted the direct capitalization method analysis on an after-tax, invested capital (i.e., debt plus equity) basis. We selected net cash flow to invested capital as the appropriate measure of economic income to use in our direct capitalization method.

Net cash flow to invested capital represents the maximum amount of cash that could be distributed to company stakeholders without affecting normal operational cash requirements. We calculated net cash flow on an invested capital basis by:
## Exhibit 1
The Generic Co. and Subsidiaries
Fair Value Summary
As of December 31, 2010

<table>
<thead>
<tr>
<th>Valuation Approach and Method</th>
<th>Indicated Fair Value of Total Equity (in 000s)</th>
<th>Weight</th>
<th>Indicated Fair Value of Equity (in 000s)</th>
<th>Fair Value Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment or Earnings Value Analysis</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income Approach - Direct Capitalization Method</td>
<td>$161,000 [a]</td>
<td>20%</td>
<td>$32,200</td>
<td></td>
</tr>
<tr>
<td>Income Approach - Discounted Cash Flow Method</td>
<td>$169,000 [b]</td>
<td>50%</td>
<td>$84,500</td>
<td></td>
</tr>
<tr>
<td>Market Approach - Guideline Publicly Traded Company Method</td>
<td>$141,000 [c]</td>
<td>30%</td>
<td>$42,300</td>
<td></td>
</tr>
<tr>
<td>Market Approach - Guideline Merged &amp; Acquired Company Method</td>
<td>NA</td>
<td>0%</td>
<td>$</td>
<td>-</td>
</tr>
<tr>
<td><strong>Indicated Investment or Earnings Value</strong></td>
<td>100%</td>
<td>$159,000</td>
<td>80%</td>
<td></td>
</tr>
<tr>
<td><strong>Asset Value Analysis</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asset Approach - Asset Accumulation Method</td>
<td>155,000 [d]</td>
<td>100%</td>
<td>$155,000</td>
<td></td>
</tr>
<tr>
<td><strong>Indicated Asset Value</strong></td>
<td>100%</td>
<td>$155,000</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td><strong>Market Value Analysis</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Past/Recent Transactions in Subject Stock (Backsolve Method)</td>
<td>NA</td>
<td>100%</td>
<td>$</td>
<td>-</td>
</tr>
<tr>
<td><strong>Indicated Market Value</strong></td>
<td>100%</td>
<td>-</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td><strong>Indicated Fair Value of Total Equity Based on a Modified Delaware Block Analysis (rounded)</strong></td>
<td>$158,000</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

[a] See Exhibit 2  
[b] See Exhibit 3  
[c] See Exhibit 4  
[d] See Exhibit 5

1. adding noncash charges to debt-free net income, and  
2. subtracting expected capital expenditures and increases in working capital from debt-free net income.

In order to arrive at the fair value of equity, it is necessary to subtract the interest-bearing debt from the fair value of invested capital as of the valuation date.

**Discounted Cash Flow Method**  
The discounted cash flow method is presented in Exhibit 3. The discounted cash flow (DCF) method is a commonly used business valuation method. This is because it reflects the trade-off between investment risk and expected return that is integral to the common stock valuation process.

Expectations of investment return are normally based on an assumption that the entity generating the return is a going concern. In general, common stocks are purchased with expectation of stock price appreciation. Expected stock price appreciation is strongly influenced by expectations about a company’s cash flow potential.

A DCF analysis estimates value on the basis of future economic income over an investment time horizon. Using empirical market data, macroeconomic and industry evidence, and the underlying
fundamental trends for the subject company, the DCF analysis applies a present value discount rate to expected future cash flow. This present value procedure results in an estimation of the net present value of the cash flow projection.

We conducted the DCF analysis on an invested capital basis. We used net cash flow on an invested capital basis as the appropriate measure of economic income.

The resulting value estimate derived by using net cash flow on an invested capital basis in the DCF analysis is the market value of invested capital. In order to arrive at the fair value of equity, the interest-bearing debt was subtracted.

**Guideline Publicly Traded Company Method**

The guideline publicly traded company method is presented in Exhibit 4. This analysis was derived from the capitalization of earnings measures based on guideline publicly traded company pricing multiples.

In order to be internally consistent with our DCF analysis, we performed the guideline public company method analysis on a debt-free basis. Debt-free valuation methods are often used in the valuation of closely held companies in order to minimize capital structure differences between the subject company and the guideline companies.
In general, the greater the differences between the companies’ capital structures, the more useful it is to use debt-free valuation methods.

Methods using invested capital benefit streams are based on economic cash flows that accrue to both debt and equity holders. In other words, valuations using invested capital result in indications of value for a subject company’s total capital.

We derived guideline publicly traded company market pricing multiples based on the following four time periods:

1. The projected fiscal year 2012
2. The projected fiscal year 2011
3. The latest 12 months
4. An average of the last five years

The market-derived pricing multiples that we applied to the Generic Co. financial fundamentals were based on our analysis of the differences in growth, size, risk, and profitability between the guideline companies and Generic Co.
Exhibit 4 presents a summary of:
1. the Generic Co. financial fundamentals,
2. the range of market-derived pricing multiples calculated for the guideline companies,
3. the selected guideline public company pricing multiples applied to Generic Co.'s financial fundamentals,
4. the resulting value indications, and
5. the overall value indication resulting from the guideline publicly traded company method.

In order to arrive at the fair value of equity, it was necessary to subtract the interest-bearing debt as of the valuation date.

### Guideline Merged and Acquired Company Method
The guideline merged and acquired company method is similar to the guideline publicly traded company method in that pricing multiples are calculated and applied to the subject company financial fundamentals.
The merged and acquired company method, however, is based on the analysis of similar companies (either publicly traded or closely held) that were recently acquired in a merger or acquisition transaction (as opposed to similar companies that are traded on an organized exchange).

Due to a lack of available information regarding guideline company merger and acquisition transactions, we did not rely on the guideline merged and acquired company method in this illustrative analysis.

Weights Assigned to Each Valuation Method

In estimating the investment or earnings value of Generic Co., we assigned the highest weight (50 percent) to the results of the DCF method. We assigned the next highest weighting (30 percent) to the results of the guideline publicly traded company method.

We assigned a 20 percent weighting to the results of the direct capitalization method. We did not assign any weighting to the guideline merged & acquired company method.

Asset Value Analysis

As part of the asset value analysis, we relied on the asset accumulation method. In the asset accumulation method, the company’s assets and liabilities are separately analyzed and valued.

In the asset accumulation method, the total fair value of equity is estimated based on the difference between the fair value of total assets less the fair value of total liabilities. The asset accumulation method is summarized in Exhibit 5.

We valued the assets and liabilities of Generic Co. on a going-concern basis. With the exception of inventory, the best indications of value of the largest category of assets and liabilities—current assets and liabilities—are the values used for financial reporting purposes. The Generic Co. inventory is reported on a last-in first-out (LIFO) accounting basis for financial reporting purposes. We adjusted the inventory for the higher fair value that would be observed under the first-in first-out (FIFO) accounting method, and we adjusted the balance sheet for the built-in gain tax reserve liability that is associated with the Company’s LIFO financial and tax position.

We relied on recent fair value appraisals of the Company’s fixed assets.

Market Value Analysis

As part of the fair value analysis, we considered any recent or historical transactions involving Generic Co. stock. Based on our analysis, we determined that there was not sufficient trading history of Generic Co. stock as of the subject valuation date to provide an indication of fair value.

Weights Assigned to Each Delaware Block Value Analysis

The weight accorded to the market value (backsolve) analysis is zero, which reflects the lack of trading of the subject shares. The implications here are that the Generic Co. shares do not trade regularly, and, if they did, they would have to be sold in the illiquid market for private company ownership interests.

Next, we address the weight to assign the investment or earnings value analysis. Typically, in an operating business valuation analysis, earnings-based valuation methods are given significant weight.

This is because the primary purpose of the business is to generate earnings rather than to hold assets that will appreciate in value over time.

Generic Co. is an income-producing operating company and not an asset holding company. Therefore, we applied the greatest weight (80 percent) to the investment or earnings value analysis indication. We applied the remaining weight (20 percent) to the asset value indication.

Summary and Conclusion

The traditional Delaware Block framework is no longer considered by many courts as the exclusive basis to estimate fair value in dissenters’ rights cases.

Therefore, in certain instances, a valuation analyst may need to modify the traditional Delaware Block framework to include the current generally accepted valuation methods.

This discussion provided an illustrative example of how a valuation analyst may modify the traditional Delaware Block framework to include such current generally accepted valuation methods.

Notes:
3. Feng Chen, Kenton K. Yee, and Yong Keun Yoo. “Did Adoption of Forward-Looking Valuation Methods Improve Valuation Accuracy in
### Exhibit 5
The Generic Co. and Subsidiaries
Asset Value Analysis
Asset Accumulation Method

<table>
<thead>
<tr>
<th></th>
<th>At Accounting Book Value</th>
<th>Valuation Adjustments</th>
<th>At Current Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$000</td>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>764</td>
<td>-</td>
<td>764</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>83,275</td>
<td>-</td>
<td>83,275</td>
</tr>
<tr>
<td>Inventory</td>
<td>119,881</td>
<td>53,913</td>
<td>[a] 173,794</td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>6,424</td>
<td>-</td>
<td>6,424</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td>210,344</td>
<td>53,913</td>
<td>264,257</td>
</tr>
<tr>
<td>Net Tangible Assets</td>
<td>66,833</td>
<td>13,100</td>
<td>[b] 79,933</td>
</tr>
<tr>
<td>Other Noncurrent Assets</td>
<td>3,950</td>
<td>-</td>
<td>3,950</td>
</tr>
<tr>
<td>Total Assets</td>
<td>281,127</td>
<td>67,013</td>
<td>348,140</td>
</tr>
<tr>
<td><strong>LIABILITIES &amp; EQUITY</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>55,237</td>
<td>-</td>
<td>55,237</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>8</td>
<td>-</td>
<td>8</td>
</tr>
<tr>
<td>Short-Term Notes Payable</td>
<td>96,020</td>
<td>-</td>
<td>96,020</td>
</tr>
<tr>
<td>Current Portion of LT Debt</td>
<td>97</td>
<td>-</td>
<td>97</td>
</tr>
<tr>
<td>Other Current Liabilities</td>
<td>14,572</td>
<td>20,487</td>
<td>[c] 35,059</td>
</tr>
<tr>
<td>Total Current Liabilities</td>
<td>165,934</td>
<td>20,487</td>
<td>186,421</td>
</tr>
<tr>
<td>Long-Term Debt</td>
<td>1,011</td>
<td>-</td>
<td>1,011</td>
</tr>
<tr>
<td>Other Noncurrent Liabilities</td>
<td>5,218</td>
<td>-</td>
<td>5,218</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>172,163</td>
<td>20,487</td>
<td>192,650</td>
</tr>
<tr>
<td>Total Equity</td>
<td>108,964</td>
<td>46,526</td>
<td>155,490</td>
</tr>
<tr>
<td>Total Liabilities &amp; Equity</td>
<td>281,127</td>
<td>67,013</td>
<td>348,140</td>
</tr>
</tbody>
</table>

**Indicated Fair Value of Total Equity, Rounded**: 155,000

Notes:
[a] Added the LIFO reserve to adjust inventory values to a FIFO basis.
[b] Valuation adjustment equal to the difference between (1) the appraised values as of the valuation date for the net tangible assets and (2) the book value of the net tangible assets as of the valuation date.
[c] Accrued income tax liability associated with the LIFO reserve adjustment. Equal to the LIFO reserve multiplied by the effective tax rate.


7. Ibid.: 628.
8. Ibid.

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