IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

PATRICIA LAIDLER,	)	
	)	
Petitioner,	)	
	)	
v.	)	*Civil Action No. 7561-VCG*
	)	
HESCO BASTION ENVIRONMENTAL, INC.,	)	
	)	
Respondent.	)	

MEMORANDUM OPINION

Date Submitted: March 28, 2014
Date Decided: May 12, 2014

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Richard P. Rollo, of Richards, Layton & Finger, P.A., Wilmington, Delaware; OF COUNSEL: John N. Bolus, of Maynard Cooper & Gale, P.C., Birmingham, Alabama, Attorneys for the Respondent.

GLASSCOCK, Vice Chancellor

This case presents a demand for a statutory appraisal,[1] response to which should be a daunting task for a law-trained judge: the statute in question requires the Court—not either party through assignment of a burden of proof—to determine the fair value of a corporation. Here, the Plaintiff is entitled to the fair value of her interest in Hesco Bastion USA, Inc. ("Hesco," or the "Company"), which interest was lost when Hesco merged with an affiliate. The task is made more difficult, perhaps, by the facts that the merger was not the result of an auction process, and thus the market provides no guidance; that management produced no projections for the Company in the ordinary course of business; that the Company was about to lose the benefit of a license and patent covering its sole product; and that the sales of that product, in part, are driven by natural disasters, the frequency of which are of dubious predictability. The results of my analysis are below.

I. FACTS

A. The Hesco Merger

Hesco Bastion Ltd. ("HBL"), not a party to this action, is a United Kingdom corporation that designs and manufactures "Concertainer units."[2] These rapidly deployable barriers consist of multi-cellular wall systems built from steel wire mesh coated with zinc-aluminum and lined with polypropylene geotextile, which are designed to be filled with sand and rock to create mobile barriers for military,

[1] 8 *Del. C.* § 262.
[2] Pre-Trial Order at 2.

asset, and flood protection.[3] The Concertainer units are stored accordion-style (hence, presumably, the name); once deployed, they operate as giant sandbags. HBL designs and manufactures Concertainer units outside of North America. Prior to her termination in 2011, Petitioner Patricia Laidler acted as Company Secretary, General Manager, and Managing Director of HBL.

In 2003, Hesco Bastion USA, LLC was created for the purpose of licensing intellectual property from HBL in order to manufacture and market Concertainer products to non-military clients in North America.[4] In 2006, Stephanie Victory became head of management at the LLC. On February 24, 2009, Hesco, the corporation that is the subject of this appraisal proceeding, was incorporated in Delaware, and the Hesco Bastion USA, LLC business was merged into Hesco with little change to its ongoing management structure or business.[5] That business included the assembly of Concertainer units at the Company's Hammond, Louisiana facility, but not manufacture of the components—the wire mesh, pins, coils, or geotextile—required to assemble the Concertainer units.[6] At its incorporation, an affiliate of HBL, Respondent Hesco Bastion Environmental, Inc. ("Environmental"), held a majority interest in Hesco.

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[3] Resp't's Pre-Trial Answering Br. at 5.
[4] Pre-Trial Order at 2.
[5] Trial Tr. 338:14-17, 339:12-16; JX 75 at 23.
[6] Trial Tr. 324:1-4.

To reiterate, as of the first day of 2012, the relationships among the various corporate entities were as follows: HBL and Environmental were each wholly-owned by the same party, as described in more detail below; Environmental held a majority interest in Hesco; and HBL licensed to Hesco its intellectual property rights relating to the Concertainer units. The Petitioner was the Managing Director of HBL, and held a minority interest in Hesco.

On January 26, 2012 (the "Merger Date"), Hesco was merged into Respondent Environmental. Before and after the Merger Date, HBL, Hesco, Environmental, and several other entities bearing the Hesco name operated under common control. Prior to September 2010, British entrepreneur and inventor of the Concertainer units, James William Heselden, retained a controlling interest in these entities; in September 2010, Heselden passed away and his interests in the group of entities were held by his estate.[7] In order to value the businesses in which Heselden held an ownership interest, his estate hired Michael Hughes, who in turn commissioned BDO Seidman to evaluate the financial position of the individual entities as well as the Hesco group as a whole. The resulting reports included Project Green, which detailed HBL's business plan to acquire Hesco Military Products, an entity affiliated with the Hesco entities but owned by its director, Leo

[7] Pre-Trial Order at 3.

Clifford;[8] Project Red, which set out HBL's business plan to acquire the minority interests in Hesco; and Project Blue, which collected necessary information for use in the sale of the entire corporate group, once the minority interests in the individual entities were acquired.[9]

In 2011, HBL terminated Laidler's employment due to her alleged involvement in shipping fraud. At that time, pursuant to a shareholder agreement, Laidler retained a contractual right to compel Hesco to repurchase her shares. In preparation for her exercise of that right, Hesco sought an opinion from Willamette Management Association ("Willamette") valuing Laidler's stake in Hesco. On November 18, 2011, Willamette issued its first valuation opinion (the "Fair Market Value Opinion"), opining that the fair market value of Hesco's stock was $180 per share. Laidler chose not to exercise her put right at that time.

In January 2012, Victory, Clifford, and the Petitioner each held 10,000 shares of Hesco, a respective 10% interest. Shortly thereafter, Victory and Clifford tendered their shares in the Company to Environmental for $207.50 per share; Laidler did not. On January 26, 2012, pursuant to 8 *Del. C.* § 253, Hesco merged into Environmental. As of the Merger Date, Heselden's estate owned 100% of Environmental, which in turn owned 90% of Hesco, with the Petitioner retaining

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[8] Trial Tr. 334:17-22.
[9] *Id.* at 540:10-541:10.

her 10% interest.[10] Because Environmental held a 90% interest in Hesco, no stockholder vote was required to consummate the short-form merger. The Petitioner—the only remaining minority stockholder of Hesco—was offered $207.50 per share for her interest in the Company.[11] Declining that consideration, on May 23, 2013, the Petitioner filed her Verified Petition for Appraisal, pursuant to 8 *Del. C.* § 262.[12]

B. Floods and Other Disasters

Operating in the flood barrier industry, Hesco's customers primarily consist of architecture and civil engineering firms as well as governmental organizations providing storm and flood protection. Accordingly, Hesco's revenue is in large part determined by natural disasters and other weather-related events: the bigger the disaster, the more revenue Hesco generates, but revenue in any given year is difficult to predict. As a result of fluctuations in demand for Concertainer units, prior to the Merger, the Company typically retained fifteen permanent employees, who sometimes did not have enough work to keep them occupied; at other times the Company had so much work that it had to hire a significant number of short-term employees.[13] Hesco never generated forward-looking projections,[14] and the

[10] Pre-Trial Order at 2.
[11] *Id.* at 3.
[12] *Id.* at 4.
[13] *See* Trial Tr. 321:19-322:4 ("The number of employees would fluctuate depending on what the demand for the product was. So we would have—we in the beginning eventually basically built up to 15 core employees that we would, you know, have, so that if we did have to bring in more

parties dispute whether and to what extent weather-related events would have continued to create demand for the Hesco product had the Company continued as a going concern. At trial, the parties pointed to three events that significantly impacted revenues in 2009, 2010, and 2011.

1. Howard Hanson Dam

In 2009, Hesco's revenues totaled approximately $8.5 million, $1.7 million of which was derived from a single project, the Howard Hanson Dam project.[15] In January of that year, the Green River in Washington state flooded, exposing structural flaws in the Howard Hanson Dam. Though it worked to make repairs, "[t]he United States Army Corps of Engineers warned residents that there could be a one in four chance of a potential flood-level release of water in 2010 and suggested that barriers should be used as an interim precaution . . . ."[16] As a result, several companies with assets to protect, including Boeing,[17] contracted with Hesco to provide Concertainer units for use as barriers in the event the dam

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employees, that we would have a core team that knew how to assemble the product properly and could train. So it fluctuated anywhere from 15 to about 60 during the height of the 2011 production period."); *id.* at 323:11-13 ("[E]ven when there wasn't work, we would carry those employees, just to make sure if we needed to, we could do our best to respond.").

[14] *Id.* at 330:2-4; *see also id.* at 330:9-17 ("[I]t's very difficult to predict whether it's going to flood, and if it's going to be—what level of flooding would happen, if the hurricane—there's—you know, a hurricane prediction that comes out before hurricane season, always, and sometimes it happens the way they predict it and sometimes it doesn't. So it's almost impossible to predict when the floods are coming and if they're going to come, at what level.").

[15] Resp't's Pre-Trial Answering Br. at 20.

[16] *Id.*

[17] *See* Resp't's Post-Trial Op. Br. at 18-19 ("Hesco's biggest sales during this project came from the Boeing Company, which needed to protect a flight simulator and a complex that houses several national security defense programs as well as its critical data center.").

failed.[18] At trial, Hesco's former CEO, Stephanie Victory, explained that providing Concertainer units to Boeing escalated sales from other companies in the area, "just because people figure[d] that Boeing ha[d] done their due diligence."[19] As it turned out, those barriers proved to be unnecessary, since the Army Corps finished repairs to the dam before any leaks caused flooding. Once repairs were made, sales "essentially stopped"—"[t]he opportunity basically ceased as soon as the dam was shored up."[20]

2. BP Oil Spill

In 2010, the Deepwater Horizon oil rig exploded in the Gulf of Mexico in what resulted in one of the largest accidental marine oil spills in history. In that year, Hesco generated $7 million in revenues from experimental attempts to use Concertainer units in the clean-up effort. These included staking the Concertainer units' steel mesh baskets to shorelines and filling those baskets with hydrocarbon capture powder—chemicals designed to solidify oil in order to "capture" the spill—as well as deploying the Concertainer units along shorelines to create barriers in order to prevent the spilled oil from seeping onto the shore. While the latter effort represented a more traditional use for the units,[21] the former was largely unsuccessful, as the Concertainer units proved poor oil receptacles because

[18] Trial Tr. 345:5-15.
[19] *Id.* at 345:8-10.
[20] *Id.* at 347:20-21.
[21] *Id.* at 356:10-15.

it was difficult to secure the Concertainer baskets to the shoreline without weighting them with rocks. Victory explained:

> It was a very challenging project because our product is held in place because of the fill material that is inside of it and there wasn't any fill material in it. And it wouldn't rest on the beach appropriately, and the waves would come and it would get knocked over.
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> So they—the National Guard was assigned by the governor to come in and assist us in getting the units set up, and then they were taking pieces of rebar and sticking the rebar into the coils and hammering it down, trying to get something to hold those baskets in place.
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> So they would do that, and then the waves would come and the scour would happen around the rebar, and the rebar—so you would go sleep and wake up and the rebar's up out of the baskets. And so you'd have to go back and you'd have to hammer it back down, and sometimes the wall would fall over. And it's all connected. So when one section would fall, it would fall for—you know, for quite some period—it was a—it was a very high maintenance project to try and keep in place.[22]

Victory opined that the Company would not likely realize future sales based on that particular use of the units, explaining that "it was highly experimental, and I would argue that it's not—our product is not fit for purpose to be a fence cage to sit on the shoreline."[23]

3. 500-Year Flood

In 2011, Hesco generated approximately $22.5 million in revenues, largely due to a "500-year flood"—declared a federal disaster in three states—that occurred along the Red River and Mississippi River in the western United States

[22] *Id.* at 352:10-353:7.
[23] *Id.* at 354:15-18.

and Canada. To minimize the extensive damage caused by flooding, the Concertainer units were used as flood barriers throughout the flooded region, which included Manitoba and North Dakota.[24] For example, in some circumstances, Concertainer units were stacked in columns three units high, creating a twelve-foot wall that protected buildings located along the river, including a convention center, medical center, and hotel.[25] Many sales were made as "premitigation" efforts, "stocking [] or installing [the units] in advance of the flood, anticipating that a flood may occur."[26] At that time, the Company had trouble meeting the sudden demand for the product: the Company did not itself manufacture the component parts of the units, and Hesco was able to purchase enough raw material only because "the [HBL] requirements afforded [a manufacturer] to dedicate lines only for [Concertainer] geotextile because of their Department of Defense contract,"[27] and HBL permitted Hesco to draw textiles from those dedicated lines.[28] The Company did not, however, seek to obtain its own dedicated lines at that time, as it understood the demand generated by the impending 500-year flood to be only temporary.

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[24] Resp't's Pre-Trial Answering Br. at 21.
[25] Trial Tr. 358:7-15.
[26] *Id.* at 361:6-7.
[27] *Id.* at 363:11-13.
[28] *Id.* at 363:14-15, 19.

C. South Carolina Manufacturing Plant

The parties dispute whether plans to open a manufacturing facility in South Carolina as of the Merger Date reflected the "operative reality" of Hesco, or HBL. The Respondent contends that "the plan to open a production facility in South Carolina was for the purpose of serving the HBL [that is, non-Hesco] business and its military sales, which as of the Merger Date Hesco had no right to pursue."[29] In support of that position, the Respondent emphasizes that HBL—but not Hesco—maintained dedicated lines at unaffiliated production facilities from which Hesco was permitted to draw in very busy seasons—as with the 500-year flood in 2011—but that in usual circumstances Hesco did not manufacture enough Concertainer units to justify maintaining its own dedicated lines.[30] The Petitioner, on the other hand, contends that the South Carolina production facility was part of Hesco's, and not HBL's, business plan.

D. Expiration of Patents and Termination of Licensing Rights

Lending to the uncertainty of future Hesco cash flows, in 2011, one Canadian and two US Concertainer unit patents expired. Prior to the patents' expiration, Hesco and affiliated entities were required to actively enforce the patent,[31] as the simple structure of the Concertainer units was easily replicable.

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[29] Resp't's Pre-Trial Answering Br. at 8.
[30] Trial Tr. 370:5-8.
[31] *Id.* at 534:22-535:3.

The Respondents contend that, not only were those units replicable—and in fact, in late 2011, Leggett & Platt introduced their "Barricage,"[32] essentially a replica of the Concertainer units[33]—but there also existed several competing flood barrier products in the market, which competition would likely drive down future Hesco sales.

In addition to the expiration of certain patents, in late 2011, HBL terminated Hesco's license to use the trademark "Hesco" in its name beyond 2012, as well as know-how rights associated with the expired patents beyond 2020.[34] When asked at trial why he made the decision to terminate Hesco's license, Michael Hughes testified:

> . . . Because I had the contractual right to do so, it was the best thing I could do for my business. And I was the director of Hesco Bastion Limited—or one of the directors of Hesco Bastion Limited, so what I was doing was in the best commercial interests of Hesco Bastion Limited.
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> I accepted and realized that the impact of that is anyone looking at Hesco Bastion USA would probably look at it in a slightly different light in terms of what its value may or may not be. So, yes, there was going to be a collateral damage impact in the value, but from my perspective as the director working—and, in fact, the only independent director—working at Hesco Bastion Limited, that was in the best commercial interests of Hesco Bastion Limited.[35]

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[32] The urge to pun seems to be irresistible in the flood-barrier industry.
[33] Trial Tr. 377:5-15.
[34] Resp't's Pre-Trial Answering Br. at 10.
[35] Trial Tr. 533:4-19.

After Environmental's acquisition of Hesco, the surviving entity continued to use the Hesco trademark, despite cancellation of the license in 2011. Hughes testified that the new entity was operating under a new "verbal" agreement:

> Well, you—the verbal is I allowed them to continue to use the name. It continued, anyway, because it had a year through to—it had a year through to probably October. When did we terminate? So it had a year through October 2012, and since then I have been conscious we need to put a full set of new agreements in place; but all the IP and know-how and trademark agreements are there. And I have withdrawn, because I don't need to do it in any other way, the need to remove the name because I have effectively taken that company and incorporated into a company that I have that had the name, anyway. So I didn't necessarily have to go and give another agreement. If you own the company and you own all the companies a hundred percent, as we do within the group now, then I can call them what I want and change the names as I wish.[36]

The Petitioner contends that the value of the trademark and know-how rights should be included in the value of the Company as a going concern because the licenses were terminated for the sole purpose of depressing the value of Hesco, as evidenced by the fact that the surviving entity has continued to use the licenses despite their purported cancellation.

E. Expert Valuations

As noted above, the price offered to the Petitioner in the Merger was $207.50 per share. Upon seeking appraisal, the Petitioner obtained an expert valuation from Thomas Frazee of Frazee Valuation & Forensic Consulting LLC,

[36] *Id.* at 632:16-633:8.

who, relying exclusively on a direct capitalization of cash flow method of valuation, opined that the fair value of the Petitioner's shares as of December 31, 2011 was $515 per share.

Prior to the Merger, Curtis Kimball of Willamette produced for the Respondent the Fair Market Value Opinion, opining that the Petitioner's interest in Hesco could be valued at $180 per share; that valuation was meant to produce a price if the Petitioner exercised her contractual right to put her shares to the Company, included a minority discount, and was intended to reflect the *fair market value*—but not the *going-concern value*—of the Petitioner's interest in the Company. After the Petitioner filed her Verified Petition for Appraisal, the Respondent sought a going-concern valuation from Willamette (the "Fair Value Opinion"), which relied heavily on a capitalization of cash flow analysis but also implemented guideline companies and guideline transactions analyses, which, taken together, estimated the fair value of the Petitioner's shares at $322. Michael Hughes, unsatisfied with that Opinion's conclusion, then contacted Kimball because he "felt that the report that [Kimball] produced did not adequately reflect particular issues around normalized earnings that [Hughes] felt were pertinent to the case and pertinent to his valuation."[37] To address those concerns, Hughes and

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[37] *Id.* at 578:7-10.

Victory met with Kimball on October 8, 2013. At trial, Hughes explained that at that meeting:

> I indicated to him that I didn't think that it was appropriate just to assume—or use the earnings as they were within the business as a basis for determining what was maintainable going forward. What I did say was there were a number of what I perceived to be extraordinary events which ought to be taken into account and factored into his valuation in some shape or form, but I gave no direction on how that should be. I just felt it was omitted. I thought it was a manifest error in what he had done, and I felt it should be reflected in that report.[38]

The October 8 meeting resulted in Kimball backing out certain revenues that former Hesco management indicated were "non-recurring," including revenues generated by the Howard Hanson Dam project, the BP oil spill, and the 500-year flood. Taking into account the newly "normalized" revenues, Willamette issued a third opinion (the "Revised Fair Value Opinion") on October 31, 2013, which resulted in a decreased estimation of per share value from $322 to $250.30.[39] That Opinion was the subject of the Petitioner's Motion in Limine, which I denied in a bench ruling at the start of a three-day trial held on January 14, 15, and 16, 2014. Accordingly, my analysis focuses primarily on Frazee's September 11, 2013 valuation opinion and Kimball's October 31, 2013 Revised Fair Value Opinion.

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[38] *Id.* at 578:20-579:6.

[39] After making minor corrections to account for Hesco Bastion USA, LLC's cash flows in 2009, the Respondent submits that the fair value of the Petitioner's shares is $256.20 per share. Resp't's Post-Trial Op. Br. at 1.

II. ANALYSIS

Where a stockholder has been frozen out of a company by virtue of a short-form merger, she may petition this Court for a statutory appraisal pursuant to 8 *Del. C.* § 262, in accordance with which:

> the Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.[40]

In undertaking the statutory responsibility to consider "all relevant factors," this Court often relies on market and income approaches to valuation, including comparable companies analyses, comparable transactions analyses, and discounted cash flow analyses;[41] the Court has also considered the merger price generated from an arm's length transaction as indicative of fair value, at least where alternative methods of valuation are unreliable.[42] Still, the Court may consider "proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."[43]

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[40] 8 *Del. C.* § 262(h).
[41] *Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 WL 3793896, at *4 (Del. Ch. July 8, 2013).
[42] *See Huff Fund Inv. P'ship v. CKx, Inc.*, 2013 WL 5878807, at *1 (Del. Ch. Nov. 1, 2013); *Union Ill.1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 357 (Del. Ch. 2004).
[43] *Doft & Co. v. Travelocity.com Inc.*, 2004 WL 1152338, at *5 (Del. Ch. May 21, 2004) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983)).

In an appraisal proceeding, the burden to establish fair value by a preponderance of the evidence rests on both the petitioner and the respondent.[44] After evaluating the parties' presentations, this Court may "select one of the parties' valuation models as its general framework, or fashion its own, to determine fair value in [an] appraisal proceeding."[45]

The parties dispute whether the merger price, market analyses, or an income approach to valuation are reliable indications of the fair value of Hesco. I consider each of those measures of fair value in turn.

A. Merger Price

As an initial matter, the Respondent suggests that this Court should consider the merger price set by Environmental as persuasive evidence of Hesco's fair value. The Respondent contends:

> Hughes provided evidence at trial about how the deal value was reached and about the arms-length negotiations that took place between the Estate and Hughes as an "independent director" acting for Hesco Holdings, Inc. at the time, as well as the acceptance of the price by Clifford. . . . It is significant that real negotiations occurred which affected the price in a positive way for Petitioner, as well as the other shareholders. . . . Hughes' suggested number, and ultimate revised number, reflects the relevant information available at the time and the revised number was accepted by those with an interest in receiving cash from the deal.[46]

[44] *M.G Bancorp., Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. 1999).
[45] *Cede & Co. v. Technicolor, Inc*., 684 A.2d 289, 299 (Del.1996).
[46] Resp't's Post-Trial Op. Br. at 40, 43.

The Respondent here implicitly draws from my recent decision in *Huff Fund Investment Partnership v. CKx*, in which I found that, in circumstances where no comparable companies or transactions were available to conduct a market analysis, and where "a one-time, unpredictable, irreversible, and immitigable" event rendered future cash flows indeterminable such that a discounted cash flow analysis would have been particularly unreliable, the merger price generated from an arm's length transaction where a full market check had been conducted was the best available evidence of the fair value of the shares at issue.[47] That circumstance, truly an arm's length transaction, bears no resemblance to the short-form merger at issue here. Here, Hesco's ninety-percent controlling stockholder itself determined the price it would pay for the Company's sole minority stockholder's shares, and, pursuant to 8 *Del. C.* § 253, consummated a merger transaction without that minority stockholder's consent. Under our case law, a statutory appraisal is the *sole* remedy to which the Petitioner is entitled,[48] and to defer to an interested controlling stockholder's determination of fair value in a transaction such as this would render that remedy illusory. I therefore decline to consider the merger price in determining the fair value of Hesco.

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[47] *Huff Fund Inv. P'ship v. CKx, Inc.*, 2013 WL 5878807, at *10 (Del. Ch. Nov. 1, 2013).
[48] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983).

B. Market Analyses

The Respondent also offers, as part of its expert's report, a comparable companies analysis, or "Guideline Publicly Traded Company Method," as well as a comparable transactions analysis, or "Guideline Merged and Acquired Companies Method." A comparable companies analysis "entails the review of publicly traded competitors in the same industry, then the generation of relevant multiples from public pricing data of the comparable companies and finally the application of those multiples to the subject company to arrive at a value,"[49] while a comparable transactions analysis involves "finding similar transactions, quantifying those transactions through financial metrics, and applying those metrics to the company at issue in order to arrive at a value."[50] The "true utility" of either approach "is dependent on 'the similarity between the company the court is valuing and the companies used for comparison,'"[51] and "when the 'comparables' involve companies that offer different products or services, are at a different stage in their growth cycle, or have vastly different multiples, a comparable companies or comparable transactions analysis is inappropriate."[52]

[49] *Doft & Co. v. Travelocity.com Inc*., 2004 WL 1152338, at *8 (Del. Ch. May 21, 2004).
[50] *In re U.S. Cellular Operating Co*., 2005 WL 43994, at *17 (Del. Ch. Jan. 6, 2005).
[51] *Doft & Co.*, 2004 WL 1152338, at *8 (citing *Gray v. Cytokine Pharmasciences, Inc*., 2002 WL 853549, at *9 (Del. Ch. Apr. 25, 2002)).
[52] *Merion Capital, L.P. v. 3M Cogent, Inc*., 2013 WL 3793896, at *6 (Del. Ch. July 8, 2013).

Kimball's comparable transactions analysis considered "six companies acquired from 2007 through the Valuation Date [that] collectively provide a reasonable benchmark for purposes of comparison to Hesco," which transactions "cover companies in the small and middle markets, both public and private."[53] From those transactions, Kimball derived a pricing multiple, based 80% on a weighting of market value of invested capital to EBITDA among the selected transactions, and 20% on a weighting of market value of invested capital to revenue among the selected transactions.[54] That weighting entailed qualitative adjustments based on "differences in size, scale, business similarities, and profitability of Hesco to the underlying comparable companies," as well as the difference in "size and volatility of Hesco's sales and earnings within its market niche versus those of the guideline companies in their lines of business."[55]

Kimball's comparable companies analysis selected four companies within Standard & Poor's "structural metal" industry classification, including Leggett & Platt, Inc., Moro Corporation, NCI Building Systems, Inc., and Gibraltar Industries, Inc. Kimball conceded that "the selected guideline public companies are not exactly like Hesco," and suggested that they provided a "relative basis for cross-check comparison" only after "making adjustments" based on differences in

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[53] JX 75 at 42.
[54] *Id.*
[55] *Id.*

expected future growth and considerations of variability due to "the Company's dependence on flood problems."[56] Ultimately, Kimball concluded in his report that "Hesco is not as similar to the guideline companies as we would prefer, therefore, this method was given relatively little weight in our final analysis," and further, that "the guideline merged and acquired company method was [also] given relatively little weight due to (1) the data points available and (2) the comparability of the transactions with Hesco's specific line of business, size, and other specific factors;"[57] he similarly testified at deposition that "[i]n my review of the companies, again, I could not find a public company that had the kind of weather-driven, event-related sales volatility that [the Company] had,"[58] and conceded that "[a]ll of [the proposed comparable companies] are diversified companies, so to that extent, they do have a much smoother and less volatile revenue structure [than Hesco]."[59]

Because I find that the Respondent has failed to demonstrate that the companies upon which its analyses are based are truly comparable to Hesco, I

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[56] *Id.* at 48.
[57] *Id.* at 50; *see also* Kimball Dep. 97:8-13 ("With the caveat that there is no ideally comparable company in this particular case in this particular set of facts and circumstances, I felt that the selection of the four were the best available in terms of their manufacturing business that they conducted."); *id.* at 99:3-4 ("None of these are great comps or even necessarily that good a comp . . . ."); *id.* at 98:17-20 (testifying that a subsidiary of Leggett & Platt involved in the same business as Hesco generated only a "very, very small percentage" of Leggett & Platt's overall revenue).
[58] *Id.* at 102:18-21.
[59] *Id.* at 103:4-6.

decline to rely on the Respondent's market approaches. Though the Respondent criticizes Frazee's decision to rely "exclusively on the DCCF method without performing any other analyses to confirm his results,"[60] it has not convincingly demonstrated that the companies and transactions used in its market analyses are truly comparable such that they could provide a reliable cross-check of the Company's value. Notably, in addition to the limitations the Respondent's own expert indicated as detailed above, the Petitioner correctly points out that in Willamette's original Fair Market Value Opinion, Kimball considered six comparable companies, but in his Fair Value Opinion, dropped three companies and added one, analyzing a total of only four comparable companies;[61] similarly, his Fair Value Opinion analyzed entirely different transactions than his earlier Fair Market Value Opinion.[62] Further, the Petitioner's expert confirmed with credible testimony that the companies and transactions in the Respondent's expert's analyses were not truly comparable to Hesco.[63]

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[60] Resp't's Post-Trial Op. Br. at 24.
[61] Trial Tr. 49:20-24.
[62] *Id.* at 50:8-12; Frazee Dep. 347:1-6 ("But in a nutshell, these companies are not comparable to HESCO in that they do not have exposure to the same revenue drivers that HESCO does. These companies, they make building products. They are not in the business of anything close to flood control barriers.").
[63] Trial Tr. 27:10-11 ("They were—in my view, they were not very close at all to being what I would term to be comparable."); *id.* at 51:4-8 ("Q: In your opinion, is [sic] there any comparables that have been identified that are appropriate to rely on?

A: Not that have publicly available information that I could rely on.").

Accordingly, although this Court recognizes that "it is preferable to take a more robust approach involving multiple techniques . . . to triangulate a value range,"[64] I find that the comparable companies and transactions analyses are not reliable indicators of fair value here, and decline to adopt those analyses in my valuation of Hesco.

C. Direct Capitalization of Cash Flow Analysis

Income approaches to valuation are premised on the idea that the value of a company is equal to the present value of its future cash flows. Both experts here rely primarily on an income approach, the direct capitalization of cash flow method of valuation ("DCCF"). The first step of this income approach is similar to that of a discounted cash flow analysis ("DCF"), but differs in that a DCF projects cash flows over a horizon period and estimates a terminal value at which cash flows can be valued in perpetuity, and then discounts to present value those cash flows over multiple periods; a DCCF, on the other hand, estimates a normalized level of cash flows in perpetuity and divides those cash flows by a capitalization rate to estimate the present value of the business.[65] A DCCF is employed in two steps, by (1) determining a normalized figure for annual cash flows in perpetuity, and (2) calculating a capitalization rate by which to divide cash flows.

[64] *See Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 WL 3793896, at *5 (Del. Ch. July 8, 2013) (citations omitted).
[65] Trial Tr. 695:12-15.

Though DCF is more prominently employed in Delaware appraisal litigation, both parties' experts opine that employing a DCF is not feasible here because Hesco's management never made cash flow projections in the ordinary course of its business. I assume, therefore, that use of the DCCF analysis is the appropriate method for determining the present value of the Company based on income. Due to the lack of comparable companies or transactions upon which to base an analysis, and the lack of management projections upon which to conduct a DCF, I find that the most reliable indicator of fair value here is a direct capitalization of cash flow analysis, and accordingly place 100% weight on the following DCCF calculation. Because I am unfamiliar with the methodology typically employed in a DCCF analysis (as opposed to the more-common DCF), and because both parties' experts are in agreement as to the inputs and calculation to be used, differing only as to the values for each, I have employed the methodology common to both experts in my analysis below, resolving the valuation disputes as appropriate.

1. Cash Flows

At trial, the bulk of both parties' presentations focused on the appropriate cash flows to consider in a DCCF. The parties' valuations differ[66] primarily

[66] *Id.* at 693:15-20 ("There's three big areas, essentially. The first area is what are the normative level of revenues and the associated cash flows that the company and investor can rely on going

because the Petitioner's expert constructs his cash flow figure by weighting Hesco's actual revenues in 2010 and 2011 40% and 60%, respectively, then multiplying that figure by a projected 55% profit margin and subtracting $1.5 million in estimated overhead expenses; the Respondent's expert, on the other hand, constructs a cash flow figure by weighting to varying degrees actual and "normalized" EBITDA figures for 2009,[67] 2010, and 2011, where "normalized" figures back out revenues earned from the Howard Hanson Dam project, BP oil spill, and 500-year flood, which earnings the Respondent characterizes as "non-recurring."[68] With this approach, the Respondent contends that "Willamette used the figures from 2009 to represent poor years, the figures from 2010 to represent typical years, and the figures from 2011 to represent active years."[69] Actual results accounted for 25% of the Respondent's cash flow estimation, while normalized results accounted for 75%.

The parties dispute (a) how future cash flows would be impacted by plans to build a plant in South Carolina, the expiration of patents, and the termination of

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forward in terms of looking at what the base level of earnings are that are sustainable in this company.").

[67] The Respondent's expert used a figure for 2009 that represented only the EBITDA generated by Hesco, and not its predecessor LLC, which generated revenues in the first three months of 2009.

[68] *See* Resp't's Post-Trial Op. Br. at 16 ("Willamette, taking the reality of the company's revenue history into consideration, used six data points to derive its basis for sustainable future cash flow: actual and adjusted results for 2009, actual and adjusted results for 2010, and actual and adjusted results for 2011.").

[69] *Id*. at 25.

licenses, and (b) whether certain past revenue-generating events should be considered non-recurring such that they are poor indicators of future cash flows. I consider those issues in turn, below.

a. South Carolina Plant, Expiration of Patents, and Termination of Trademarks

First, the parties dispute whether (1) the South Carolina plant was an opportunity that belonged to Hesco and would have increased future cash flows had Hesco continued as a going concern, (2) the impending expiration of certain patents and resulting increased competition in the market would have decreased Hesco's future cash flows, and (3) the value of certain trademark and know-how rights that HBL purported to terminate should be added back into the value of Hesco. In estimating future cash flows, neither party's expert quantified the value of the South Carolina plant, the effect of increased competition,[70] or the value of the trademark rights.[71] In other words, the Petitioner's expert did not adjust future cash flows upward to reflect the increased revenues the South Carolina plant would generate,[72] nor did he adjust the Company's income stream to account for the

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[70] I note that Kimball indicated that he accounted for increased competition in adopting a 3% unsystematic risk premium; however, the Petitioner agrees that a 3% unsystematic risk premium is appropriate without regard to increased competition. *See infra* note 103.

[71] The Respondent suggests that "[i]t was improper for Frazee to unilaterally decide that the termination of the licenses was not relevant, and instead he should have considered the effect of the termination of the licenses as well as the expiration of the patents in his Report." Resp't's Post-Trial Op. Br. at 34. However, neither party attempted to quantify the effect of terminating the licenses in order to accordingly adjust predicted future cash flows.

[72] Though he did not attempt to quantify the value of the South Carolina plant, Frazee did consider the cost of the South Carolina plant in his subtraction of $1.5 million in overhead

trademark and know-how rights;[73] nor did the Respondent's expert adjust cash flows downward to reflect the effect of increased competition due to the expiration of patents.[74] Instead, these factors were largely considered as "qualitative" factors in determining what predictive weight should be given to cash flows in certain prior years. Because the parties have not attempted to quantify the effects of the South Carolina plant, expiration of patents, or termination of licenses on future cash flows, I find that the parties have failed to demonstrate that those considerations materially impact my analysis of the fair value of Hesco, and decline to attempt such a quantification here. Further, to the extent I must consider

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expenses from his estimation of normalized cash flow. Frazee Dep. 53:3-6. *See also id.* at 131:16-15 ("Well, the disclosures as to what opportunities were going to be pursued through the South Carolina site were very minimal. . . . But I did look at a little bit of information there related to 2012 which contained some additional expense line items that showed that there was some expense associated with opening that site."); *id.* at 130:13-15 ("There was not a specific calculation for the revenue side of that equation. For the cost side of it, the number was $250,000 annually."); *id.* at 180:12-21 ("I am assuming a certain level of overhead expense is being incurred in South Carolina that causes . . . profits to drop by that amount on an annual basis. I don't have a specific dollar value to place on the revenue generated from that South Carolina business, but I think it is a relevant consideration when we are looking at whether that conclusion of revenue at $18 million is reasonable.").

[73] Frazee testified at deposition that his analysis "assumed that the license terminations, whether they are upheld or not, would have no significant negative impact on the ability of the company to generate revenue and profit." *Id.* at 64:16-19. Neither did Kimball adjust his cash flow estimate to account for gains Hesco would realize by no longer paying royalty fees associated with the licenses, since he assumed that "the company ex its termination of the agreements would have to devote sufficient funds to market its products that no longer benefited from an association with HESCO." Kimball Dep. 124:10-14.

[74] Frazee, on the other hand, "quantified" the effect of increased competition by assuming that any losses caused by increased competition would be offset by savings from no longer paying royalty expenses. Frazee Dep. 54:1-6, 15-19 ("It is reflective of my belief that the use of those dollars could be spent, expended, if you will, to your question, to address any competitive pressures that might materialize from the patent issue."). In the absence of any evidence quantifying the value of increased competition, I find Frazee's assumption here to be reasonable.

these issues in estimating a cash flow figure, I accept the parties' assumptions that (1) losses caused by increased competition due to the expiration of patents, if any, would be offset by the concomitant termination of the Company's obligation to make royalty payments,[75] and (2) royalty payments saved by the termination of licenses, if those terminations could be appropriately considered in the Company's going-concern value, would be equal to increased expenditures necessary to market its products after the licenses expired.[76]

b. Non-Recurring Events

The parties also dispute whether past cash flows are a reliable predictor of future cash flows, or whether future cash flows should take into account that certain revenues in previous years were generated by non-recurring or extraordinary events. The Petitioner challenges the Revised Fair Value Opinion's treatment of "non-recurring" revenues as litigation-driven and self-serving, contending that "after reviewing Willamette['s] [Fair Value Opinion], Hughes hailed Kimball from Atlanta to Washington, D.C. to change the revenue numbers expressed in this report."[77] The Petitioner underscores the fact that the Fair Market Value Opinion adjusted the growth rate downward for the year 2011 to account for

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[75] *See supra* note 74.
[76] *See supra* note 73.
[77] Pet'r's Post-Trial Op. Br. at 15.

revenue generated by the unusually large sales related to the 500-year flood,[78] but did not treat revenues generated by the Howard Hanson Dam project or the BP oil spill as extraordinary. In his Fair Value Opinion, however, Kimball, instead of adjusting the growth rate, placed less weight on revenues from 2011 due to the unusually large impact on revenues of the 500-year flood, but otherwise used actual revenue results from 2009 and 2011; revenue figures for 2010 were adjusted downward to back out roughly $4 million in sales generated by the BP oil spill.[79] Finally, in his Revised Fair Value Opinion, Kimball used the approach described above, weighting both actual and normalized revenues adjusted to back out revenues associated with the Howard Hanson Dam project, BP oil spill, and 500-year flood. The Petitioner suggests that these varying approaches represent an ill-disguised attempt to depress the results of Kimball's valuation, and that, if Hesco management truly believed revenues for the Howard Hanson Dam project, BP oil spill, and 500-year flood were "non-recurring" such that they were poor indicators of future revenue, management would have disclosed that fact in preparing materials for BDO Seidman.[80] Accordingly, the Petitioner argues that management

[78] Trial Tr. 651:12-18 ("Q: And why did you lower the growth rate?

A: Because in discussing the company's background and history and outlook with management, I came to the conclusion that the company was having an extraordinarily good year historically, and it was unlikely to be able to replicate that type of result in the future, over a reasonable time horizon.").

[79] *Id.* at 662:15-664:6.

[80] *Id.* at 439:7.

never considered revenues "non-recurring" until, for the purposes of this litigation, they realized that concept could be used to artificially depress the value of Hesco.

Rather than back out certain revenues as "non-recurring," the Petitioner's expert, Frazee, instead relies exclusively on actual revenues from 2010 and 2011, weighted 40% and 60%, respectively. At trial, however, Frazee presented no justification for that weighting, other than that he made a "qualitative assessment" based on certain considerations, including Hesco's plans to open a plant in South Carolina and attempts to reduce volatility by focusing on pre-mitigation sales. Putting aside the fact that these "qualitative" considerations were never translated into quantitative estimates of impact on future cash flow, I find it suspect that Frazee placed 60% weight on cash flows in 2011 despite the fact that 2011 was "Hesco's highest grossing year at more than *double* the revenue of any other year in Hesco's history."[81] Frazee provided no compelling explanation as to why 2011, the Company's highest grossing year, was a better indicator of future cash flows than 2009 or 2010.

Ultimately, I find it inappropriate to decrease my estimate of future cash flows based on the Respondent's contention that past revenue was generated by specific events unlikely to occur again. Although the parties dispute whether certain revenue should or should not be considered "non-recurring," such that

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[81] Respt't's Post-Trial Op. Br. at 3 (emphasis added).

those cash flows are or are not a good prediction of future revenues, neither party attempted to provide any statistical evidence explaining the likelihood that a particular weather-related event would occur in any given year, that Hesco would enjoy sales from such an event, and, if so, what size revenues would likely be realized. It may be that within the next several years another announcement of structural flaws in the Howard Hanson Dam, another 500-year flood in the upper Mississippi, or another oil spill in the Gulf of Mexico is unlikely, but the Respondent has not demonstrated that the Company would not, as a going concern, have generated future revenues caused by structural problems in a different dam, floods in a different geographic region, or experimental uses in another context. Nor has the Respondent indicated what percentage of the Company's overall revenue is generated by pre-mitigation sales where a natural disaster is anticipated but never eventualizes. The Company is primarily in the business of providing asset protection in anticipation of natural disasters, so the Respondent's suggestion that all natural disasters are non-recurring, and therefore a poor predictor of future revenue streams, seems to me misplaced.

Instead, I find that the best predictor of future cash flows is past cash flows in 2009,[82] 2010, and 2011, weighted equally. Based on the record before me, I do

[82] The 2009 cash flow figure I have used includes cash flows for the first three months of 2009 before the LLC was merged into Hesco. *See id.* at 11 n.38 ("The additional three months of

not find it unlikely that, if the Company continued as a going concern, some future revenue-generating events, in themselves "non-recurring," would occur; notably, events which the Respondent deems "non-recurring" occurred *every year* the entity was in existence. While it may be that in some years more weather-related events will occur than in other years, I find credible Kimball's account that 2009 and 2010 represented average to poor years, while 2011 represented a particularly profitable year for the Company. I therefore find that actual cash flows in those years, weighted equally, are the best available estimate of future cash flows. The Company's EBITDA was $5,886,000 in 2009; $5,258,000 in 2010; and $11,295,000 in 2011.[83] I therefore use as an estimation of future cash flows the average of those figures, $7,480,000.

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income earned at Hesco's predecessor company amounted to roughly $2.1 million that had been left out of both experts' reports.").

[83] I have calculated EBITDA figures by reference to the Company's historical income statements, JX 75, Ex. 3, but have added an additional $2.1 million to revenues for 2009, as explained in note 82 *supra*. I have not accepted the Respondent's additional adjustments to costs and expenses, as I have not found credible its expert's attempts at normalizing revenues.

	2011	2010	2009
Revenues, including an additional $2.1 million in 2009	$22,529,000	$10,541,000	$10,635,000
Costs and Expenses, other than interest, taxes, and depreciation and amortization	$11,234,000	$5,283,000	$4,749,000
EBITDA	$11,295,000	$5,258,000	$5,886,000

c. Tax Rate, Depreciation, and Capital Expenditures

The parties' experts face only minor disagreements over the applicable tax rate, depreciation figure, and capital expenditure figure.[84] With respect to the applicable tax rate, the Petitioner's expert used a "blended federal and state income tax rate" of 37.8%, while the Respondent's expert used a tax rate of 38.5%. At trial, in deposition, and in briefing, neither expert provided persuasive evidence bearing on which tax rate the Court should employ. Because I find it likely that the appropriate tax rate lies between these two similar estimates, I adopt a 38% tax rate.[85]

With respect to depreciation, the Petitioner's expert, Frazee, used a figure of $29,000, which represents 2011 levels for depreciation; the Respondent's expert used a figure of $30,000, which represents a "Willamette Management Associates estimate."[86] Again, neither party provided persuasive evidence or argument as to which figure I should employ; I therefore adopt Frazee's approach of using the

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[84] *See* JX 24 at 19 ("The capital expenditures, depreciation, and tax rate assumptions [employed by Frazee] generally match those set forth by Kimball.")

[85] *See Crescent/Mach I P'ship, L.P. v. Turner*, 2007 WL 1342263, at *11 (Del. Ch. May 2, 2007) ("In effect, neither side has proved an appropriate tax rate. The evidence supports an inference that the appropriate rate lies within a range of [the respondent's estimate] to [the petitioner's estimate]. Therefore, the Court finds, based on a weighing of the reasonable inferences from the evidence produced at trial, that the appropriate tax rate projection is [a figure between those estimates.]").

[86] JX 75, Ex. 7 n.[b].

2011 figure for depreciation,[87] as well as Kimball's assumption that "[d]epreciation and capital expenditures are assumed to be equal over the long-term."[88]

With respect to future capital expenditures, Kimball used an estimate of $31,000. Frazee employed a figure of $31,900, which represents 110% of the 2011 level. As I have adopted the 2011 figure for depreciation, I likewise adopt the 2011 figure for capital expenditures, which was $29,000.

2. Capitalization Rate

Both Kimball and Frazee use a capitalization rate determined by multiplying the Company's weighted average cost of capital ("WACC") by its long-term growth rate. They agree that the appropriate long-term growth rate here is 4%, but dispute the various inputs in calculating the Company's WACC. First, in calculating the Company's cost of equity, both experts employed a build-up model,[89] but dispute the context-appropriate Ibbotson deciles for both industry risk premium and size premium. Second, the parties' experts dispute the appropriate capital structure to employ.

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[87] JX 24, Ex. C.
[88] JX 75, Ex. 7 n.[d].
[89] In addition to a build-up model, Kimball employed a Modified Capital Asset Pricing Model ("CAPM") and Duff and Phelps Model. JX 75, Ex. 6b. However, Kimball did not testify at trial, nor did the Respondent make any argument, about the inputs to those models. Because the Respondent has not provided me with a sufficient evidentiary basis to adopt a CAPM or Duff and Phelps Model, I decline to adopt those models here.

a. Industry Risk Premium

Morningstar, a preeminent investment research company, publishes annually a "Bonds, Bills, and Inflation Valuation Yearbook," in which it compiles premia ("Ibbotson deciles") to reflect risks caused by certain factors shared among companies operating in the same or similar industries, or reflecting the same or similar characteristics, such as size.[90] The premium associated with a given decile is "calculated by subtracting the risk-free rate . . . from the total annual rates of return on common stocks" of companies categorized under the decile.[91] Industries in which companies operate are classified under the Standard Industrial Classification system, in accordance with which certain industries are identified by numbered codes ("SIC codes"), to which risk premia are assigned.

Here, the parties dispute the appropriate Ibbotson decile to account for industry risk in calculating Hesco's cost of equity. While the Petitioner's expert "utilize[d] something that was roughly consistent with the average"[92] of three SIC codes—34 ("Fabricated Metal Products, Except Machinery and Transportation Equipment"), and two subsets of that category, 344 ("Fabricated Structural Metal Products") and 3499 ("Fabricated Metal Products, Not Elsewhere Classified")—over several years, the Respondent's expert employed only "the SIC code 344 for

[90] JX 75 at 39.
[91] *Id.*
[92] Frazee Dep. 277:21-22.

2011, the most relevant code number applied to the most recent year as is the usual industry standard."[93] The Respondent's expert testified at trial that he contacted Morningstar and was informed that "the appropriate use of their statistic is to use the latest available data," *not* to average codes over a period of years, because a code for the latest year already incorporates statistical data for previous years.[94] Further, Frazee conceded in his deposition testimony that he did not believe "SIC Code 34 or 3499 are very good," though he testified that SIC code 344 was not comparable to Hesco either.[95] Though concededly not a perfect fit,[96] based on Kimball's credible expert testimony, I find that the appropriate industry risk premium in this context is the premium corresponding to SIC code 344 for the year 2011, 5.91%.

b. Size Premium

To reflect size premium, the Respondent's expert employed Ibbotson decile 10, while the Petitioner's expert argues that a subset of that group, decile 10a, is more appropriate. The Respondent points out that decile 10a "includes companies with market capitalizations between 144 million and 236 million, despite the fact

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[93] Resp't's Post-Trial Op. Br. at 37.
[94] Trial Tr. 700:12-24.
[95] Frazee Dep. 295:12-16.
[96] I acknowledge the unreliability of selecting any industry risk premium having previously found that the parties have identified no companies sufficiently comparable to Hesco such that I could rely on a market approach to valuation; however, as the parties have presented no valuation alternatives that completely eschew inputs generated by the market, I accept the Respondent's industry risk premium as the better, albeit imperfect, input.

that Hesco is worth far less than that range."[97] On the other hand, the Petitioner contends that "the Court should utilize '10a' because using Decile 10 will result in the inclusion of premiums derived from companies that fall in 10b," and "10b includes a disproportionately large number of highly leveraged or poorly performing companies that have low equity values, not because their business operations are 'small,' but because their equity valuations are low."[98] In other words, the Respondent argues that decile 10a is inappropriate because it includes companies with market capitalizations that are too high, while the Petitioner argues that decile 10b is inappropriate because it includes companies with too much debt. Because the parties' respective experts provided credible testimony on both points, I find that the appropriate decile is 10, as it contains companies from both 10a, to account for companies with a more similar debt structure to Hesco, and 10b, to account for companies with more similar market capitalization. The risk premium associated with decile 10 is 6.10%.

Taking into account the foregoing analysis, the following represents my calculation of the Company's cost of equity under the build-up model:

[97] Resp't's Post-Trial Op. Br. at 38.
[98] Pet'r's Post-Trial Op. Br. at 9.

Risk free rate	2.74%[99]
Equity Premium	6.14%[100]
Size Premium	6.10%[101]
Industry Risk	5.91%[102]
Unsystematic Risk Premium	3.00%[103]
Cost of Equity	23.89%

c. Cost of Debt

The parties' experts also differ on the capital structure they assume. The Company's actual capital structure at the time of the Merger consisted of no debt, but the parties agree that as a going concern the Company would be expected to take on a certain amount of debt. The Respondent's expert employed a ratio of 90% equity to 10% debt; the Petitioner's expert, on the other hand, employed an 85% equity, 15% debt ratio. Because neither party has introduced any evidence bearing on the appropriate capital structure, I find that the appropriate capital structure here is the Respondent's more conservative estimate of 90% equity to 10% debt.

The cost of debt is taken from Moody's rating of a Baa company as of the Merger Date, here, 5.24%.[104] WACC is calculated with the following formula:

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[99] This figure represents the market rate yield-to-maturity on a twenty-year treasury bond as of the Merger Date. JX 75 at 38. I note that the Petitioner's expert inappropriately employed the risk-free rate as of December 31, 2011 rather than the Merger Date.

[100] This figure represents Ibbotson's equity risk premium for the years 1926 through 2011. JX 75 at 39. The parties agree on this figure except to the extent they round differently.

[101] This figure represents Ibbotson decile 10, as discussed in more detail above.

[102] This figure represents SIC code 344, as discussed in more detail above.

[103] The parties agree on this figure.

WACC = (Cost of Equity x Weight of Equity) + (Cost of debt x (1-Tax Rate) x Weight of Debt)[105]

Thus, the Company's WACC is 21.83%.

The capitalization rate is calculated by subtracting from the Company's WACC its long-term growth rate, which the parties here agree is 4%. Accordingly, the capitalization rate I employ in my analysis is 17.83%, with its inverse, 5.6, as the capitalization multiple.

3. Summary of DCCF Valuation

The following summarizes my calculation of the fair value of Hesco.

Normalized EBITDA	$7,480,000
Depreciation at 2011 level	($29,000)
	$7,451,000
Tax at 38%	($2,831,380)
	$4,619,620
Depreciation at 2011 level	$29,000
Capital Expenditures at 2011 level	($29,000)
	$4,619,620
Growth Rate	4%
Net Cash Flow to Invested Capital	$4,804,405
Capitalization multiple	5.6
	$26,904,668
Excess cash	$9,520,000[106]
Net value	$36,424,668

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[104] JX 75, Ex. 6a n.[b].

[105] *Lane v. Cancer Treatment Centers of Am., Inc.*, 2004 WL 1752847, at *30 (Del. Ch. July 30, 2004).

[106] This figure is derived by subtracting from the Company's $10,000,000 in excess cash $240,000 for unaccrued management bonuses and $240,000 for contingent unaccrued sales tax liability. The Petitioner used a $9,700,000 figure for excess cash as of December 31, 2011, because when he drafted his report he did not have access to the Company's financials as of the Merger Date. I use the more current figure, $10,000,000 in excess cash as of the Merger Date.

Accordingly, based on the direct capitalization of cash flow analysis described above, and dividing the Net Value by the number of shares outstanding, the fair value of one share of Hesco is $364.24. As explained in more detail above, I place 100% of my valuation of the fair value of Hesco on the results of this analysis.

III. CONCLUSION

For the reasons stated above, I find that the fair value of one share of Hesco is $364.24, and that the Petitioner is therefore entitled to $3,642,400 for her 10,000 shares, plus interest at the statutory rate.[107] With due regard to my arithmetic skill (or lack thereof), I will defer entry of a final order pending the parties' review of my calculations, with any suggested computational corrections to be submitted within two weeks of the date of this Memorandum Opinion.

[107] *See* 8 *Del. C.* § 262(h).