UPDATE

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Nord Anglia Education, Inc: Grand Court decides Cayman's most significant s.238 fair value appraisal case

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The Grand Court of the Cayman Islands has recently released its decision on the most significant s.238 fair value appraisal case of its kind in the jurisdiction, determining that fair value of the dissenting shareholder's shares represents a blended value derived from the transaction price and an adjusted discounted cash flow (**DCF**) valuation, applying them on a 60/40 split respectively. Mourant acted for 22 of the 32 dissenting shareholders and was successful in securing a fair value determination in excess of the transaction price.

Background to the case

Pursuant to s.238 of the Cayman Islands Companies Law (2020 Revision) (the **Law**), a shareholder in a Cayman Islands registered company who dissents from a merger of the company is entitled to seek determination of the *fair value* of their shares by the Grand Court (the **Court**).

Nord Anglia Education, Inc. (the **Company**) operates international schools in Europe, the Americas, the Middle East, China and South East Asia. Between March 2014 and 1 September 2017, the Company's ordinary shares (the **Shares**) were listed on the New York Stock Exchange (**NYSE**). In April 2017, a buyer consortium comprising funds affiliated with Baring Private Equity Asia Group, Inc (**BPEA**) and Canada Pension Plan Investment Board (**CPPIB**) (the **Buyer Consortium**) presented an offer to purchase the Shares at $32.50 per Share. Materially to the case, BPEA also had a significant interest on the sell side of the transaction, on the basis that its affiliated funds owned 96% of the Company's then majority shareholder, Premier Education Holdings Ltd (**Premier**).

Following an extraordinary general meeting of the Company's shareholders on 21 August 2017 (the **EGM** and the **Valuation Date**), the Buyer Consortium's proposal to purchase the Shares at $32.50 each (the **Transaction Price**) was approved and the merger became effective on 1 September 2017 (the **Merger**). The Company's position was that the Merger represented an arm's-length transaction (notwithstanding the presence of BPEA funds on the buy and sell sides of the transaction) which was overseen by a special committee tasked with negotiating the Transaction Price with the Buyer Consortium. A substantial number of shareholders dissented from the Merger (the **Dissenters**), and, accordingly, in November 2017 the Company petitioned the Court to determine the fair value of the Dissenters' shares pursuant to s.238 of the Law.

Issues considered by the Court

The Court was tasked with determining the fair value of the Dissenters' shares as at the Valuation Date, and was presented with competing views on fair value (and the means by which this should be arrived at) by each side's expert which, in summary, were as follows:

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The Company's position

The Company's position was that a historic market price, being the closing price of the Shares on the NYSE on 24 April 2017 (the day prior to the announcement of the Merger to the market) adjusted forwards to the Valuation Date (the **Adjusted Market Price**), would represent fair value. The Company's expert preferred the market price over any other alternative on the basis that *market transactions reflect what willing buyers paid willing sellers for that stock*. Although he conducted a DCF analysis, the Company's expert further opined that little to no weight should be afforded to a DCF analysis in determining fair value.

The fair value advanced by the Company based on the Adjusted Market Price was $30.45 per Share, over $2 per Share less than the Transaction Price itself. As to this, the Company's expert opined that the Transaction Price – whilst another form of market evidence – likely exceeded fair value since it *presumably reflects a sharing of the gains the parties anticipated would be created by the [Merger]*.

The Dissenters' position

The Dissenters' expert's opinion of fair value relied on an orthodox DCF analysis, based on relevant internal financial projections. In adopting this approach, the Dissenters' expert:

1. rejected market price as a reliable data-point for fair value, concluding that the market did not have access to all value-relevant, material, non-public information (**MNPI**) (such as material internal financial projections), with the consequence that market analysts could not be expected to generate a *fair value* estimation of the Shares. Additionally, he opined that there was insufficient evidence to conclude that the market for the Company's shares was semi-strong form efficient, meaning that it could not be definitively concluded that the market responded appropriately to new value-relevant public information released regarding the Company; and
2. opined that the Transaction Price was unreliable as a data-point on the basis that it could not be reliably said that the Merger was negotiated at arm's length as entities on the buy side and sell side of the Merger were under the same control (accordingly rendering the Merger a foregone conclusion), and the Merger process lacked meaningful price discovery.

The Decision

Market price

The Court noted that a DCF analysis should be given considerable weight in the Court's valuation process, but not to an extent which generates a value which is significantly at variance with the [market price], viewed together with the Transaction Price. With that said, it concluded that:

1. the evidence of efficiency within the market for the Shares was not sufficiently strong to justify appraising fair value based on the market price alone; and
2. there was MNPI (most significantly management projections) material to the intrinsic value of the Shares which key market actors involved in the Merger felt it desirable to take into account.

Transaction Price

The Court concluded that the Transaction Price carried evidential weight, and that it reflected an arm's length bargain, albeit *negotiated between loosely related parties through the agency of closely connected human actors*. Additionally, it was found to be significant that: (a) the Merger agreement was concluded in circumstances where at least some attempts were made to find other bidders and none came forward in a serious way; and (b) the Transaction Price offered a premium on the then current market price. Notwithstanding this, the Court held that the *robustness*[1] of the Merger process was diminished to a material extent by the existence of a controlling selling shareholder which had already agreed to sell to an affiliated bidder, but that *this did not deprive the Transaction of all commercial reality*.

The court concluded that, [...] *the Transaction Price appeared to [...] have much more credibility than the Market Price as an indicator of fair value, most importantly because it was informed by MNPI which was not available to the market. But the entire concatenation of circumstances surrounding the Transaction process*

[1] In the sense described by the Delaware Supreme Court in *Dell, Inc.-v-Magnetar Global Event Driven Master Fund Limited* 177A.3d 1 (2017).

still leaves room for anxious doubts about whether it can be relied upon (in part or in whole) without considering the more elaborate DCF analysis [...].

DCF analysis

The Court had in mind the various DCF analyses conducted by the Company's expert; the Dissenters' expert; and by Houlihan Lokey, the special committee's independent advisors, whose DCF analysis was prepared at the time of the Merger.

The Court rejected the Company's expert's view that little to no weight should be placed on a DCF analysis but nonetheless supported the use of the majority of inputs used by the Company's expert in his DCF. It also agreed with the Dissenters' expert as regards the approach to the Company's cost of debt, which necessitated an adjustment to the Company's proposed weighted average cost of capital figure (the effect of that adjustment must now be agreed between the parties' experts). Accordingly, the Court found that that the value derived from the DCF analysis prepared by the Company's expert should be increased, resulting in a *pro rata* DCF Share valuation in the region of $44. The Court noted that the DCF value reached by Houlihan Lokey was broadly consistent with its own findings, thus lending credibility to the Court's DCF value.

The Court went on find that s.238 of the Companies Law confers a jurisdiction on the Court which permits '*adapting or blending*' the approaches proposed by Expert Valuers. Having given the issue consideration, the Court concluded that that the fair value of the Dissenters' Shares was derived from a 60:40 weighting between the Transaction Price and accepted DCF value respectively. The final fair value figure is still subject to the experts' final determination, but is expected to be significantly in excess of the Transaction Price.

Key points to note

This is an important judgment in the field of fair value appraisal litigation. It follows the recent Privy Council decision in the *Shanda Games Ltd* appraisal (see here here for a link to our recent briefing on this), and illustrates the Court's approach to the weight, if any, to be attributed to the market price, transaction price and the DCF value of dissenters' shares, and what cross-checks the Court will seek to use to reinforce its decision. It underscores how the Court will blend methodologies to reach fair value if it considers appropriate.

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