



The Relevance of Discounts in Business Valuation for Litigation Support Cases

6 Shenton Way,
#38-01 OUE Downtown 1,
Singapore 068809

PKF-CAP Advisory Partners Pte. Ltd. is a member of PKF Global, the network of member firms of PKF International Limited, each of which is a separate and independent legal entity and does not accept any responsibility or liability for the actions or inactions of any individual member or correspondent firm(s).

Introduction

In the world of litigation support, accurate business valuation is often a pivotal factor in determining the outcome of legal disputes. Valuation experts play a crucial role in estimating the value of a business, and consequently the business interest of a company.

One of the critical considerations in the valuation process is the application of discounts, which can significantly impact the final conclusion of valuation. In this article, we will explore the types of discounts commonly applied in business valuations, and its relevance in business valuations for litigation support cases by looking at several landmark Court cases and judgments in Singapore.

Types of Discounts

Discounts are reductions applied to the value of a business interest to account for various factors that could affect its value. These reductions are typically classified into two primary categories, namely:

1. Discount for lack of control (DLOC); and
2. Discount for lack of marketability (DLOM).

DLOC

Discount for lack of control (or sometimes referred to as minority discount) are applied when the subject business interest does not hold a controlling position within the business. This lack of control can lead to reduced decision-making power and a decreased ability to influence company operations.

Consequently, the value of a non-controlling interest may be discounted to reflect this limitation. DLOC may be relevant in cases when assessing the value of a minority interest in a business.

DLOM

Discount for lack of marketability (or sometime referred to as illiquidity discount), are used to account for the difficulty of selling an ownership interest. An interest in a closely held or privately held business can be less marketable than shares of a publicly traded company, as finding a buyer can be more challenging.

Hence, DLOM are especially pertinent in litigation cases when an ownership interest in private companies is being valued. Understanding when such a discount should be applied is critical, as the resulting value of a business interest could be significantly lower.



Minority Oppression Situations

This is a case relating to Kiri Industries Ltd (“Kiri”) v Senda International Capital Ltd (“Senda”) relating to a minority oppression suit. In 2018, the Singapore International Commercial Court (“SICC”) found that Senda (who owns about 62% in DyStar Global Holdings (Singapore) Pte Ltd (“DyStar”)) was liable for oppressive conduct against Kiri (who owns about 38% in DyStar) and made a buyout order pursuant to Section 216(2) of the Companies Act (Chapter 50)¹.

Kiri’s 38% equity interest in DyStar was subsequently valued at US\$481.6 million in a judgment by the SICC in 2021. In particular, the SICC held that a DLOM of 19% should apply to the valuation of Kiri’s shareholding in DyStar. The SICC was of the opinion that a DLOM should apply as a starting point where a private company was being valued.

Kiri and Senda both appealed to the Singapore Court of Appeal against various aspects of the SICC’s valuation judgment. In this regard, Kiri appealed against, inter alia, the SICC’s finding that a DLOM should apply to the valuation of Kiri’s shares in DyStar.

On 6 July 2022, the Singapore Court of Appeal² allowed Kiri’s appeal that a DLOM should not apply to the valuation of Kiri’s shareholding in DyStar.

This is the first time the Singapore court has clarified and authoritatively decided the law on the applicability of a DLOM where a minority shareholder’s shares are valued pursuant to a buyout order made in a minority oppression.

It follows that such valuations are not done based on ‘a willing buyer and a willing seller’ basis. Hence, under such situations, market value is NOT the appropriate basis of value, which is defined by International Valuation Standards (“IVS”) as:

‘Market value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.’

In another case, which we were appointed as expert consultant, relating to Ayaz Ahmed and 5 others (“Plaintiffs”) v Mustaq Ahmad and 5 others (“Defendants”) relating to a minority oppression suit³.

Based on the Singapore High Court judgment made on 9 December 2021, it was determined by the Singapore High Court that certain Defendants acted in a manner that was oppressive. As such, the 1st and 2nd Defendants were ordered to buyout the Mustafa Estate’s 25.4% shareholding in Mohamed Mustafa & Samsuddin Co. Pte Ltd (“Mustafa Company”) at a price to be determined by an independent valuer.

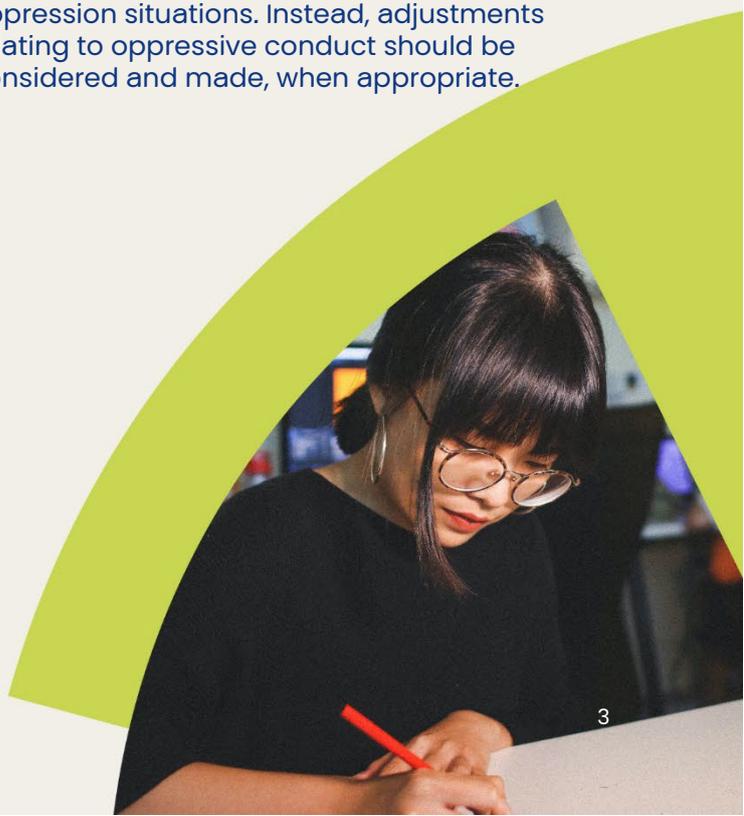
In determining the purchase price, the independent valuer was to appraise the value of the said interest without applying any minority discount (or DLOC). Appropriate adjustments to offset the effects of the oppressive and/or unjust conduct were to be made.

It is clear from these two Court judgments that both DLOM and DLOC should not be applied when valuing business interest in minority oppression situations. Instead, adjustments relating to oppressive conduct should be considered and made, when appropriate.

¹ Personal remedies in cases of oppression or injustice.

² [2022] SGCA (1) 5.

³ HC/ JUD 590/2021



No Finding of Minority Oppression Situations

On the other extreme end, should DLOM and/or DLOC be applied when a buy-out order is made where there is no finding of minority oppression? These are the questions faced by the Singapore Court of Appeal in *Liew Kit Fah (Appellants) and 5 others v Koh Keng Chew and 2 others (Respondents)*⁴.

The Appellants held a majority of the shares (about 72%) in a group of companies and the Respondents held a minority of those shares (about 28%). The Respondents commenced suit against the Appellants, alleging oppression, but this action was later dropped and parties consent not to determine liability for oppression.

Instead, an order was sought for one side to purchase the other side's shares, and for the Court to determine who should buy out whom, which they could not agree as each wanted to buy out the other. In the consent order, parties also agreed that the price should be determined by an independent valuer.

After the Singapore High Court ordered the Appellants to purchase the Respondent's shares, the valuer referred to the High Court the question whether DLOC and DLOM should be applied in determining the price of shares. These issues were not addressed in the consent order. The Singapore High Court held that both discounts should not be applied. Consequently, the Appellants appealed.

Subsequently, the Singapore Court of Appeal held that since the buy-out order was not made pursuant to Section 216(2) of the Companies Act (Chapter 50), the sale of the Respondents' shares (being a minority interest) to the Appellants was akin to a sale between a willing seller and a willing buyer respectively. Hence, the independent valuer was to apply a DLOC and DLOM, if deemed appropriate.

When valuations are to be done based on 'a willing buyer and a willing seller' basis, market value is the appropriate basis of value. Whether DLOM and/or DLOC should be applied needs to be considered on a case by case basis.

Application of DLOM

When shares of a private company is being valued, the application of DLOM depends on the valuation method applied and the key inputs used.

DLOM should be applied when the comparable companies are deemed to have superior marketability to the subject asset. For example, publicly-traded shares can be bought and sold nearly instantaneously, while shares in a private company may require a significant amount of time to identify potential buyers and complete a transaction. In which case, DLOM should be applied.

DLOM can be estimated based on either restricted stock studies or pre-Initial Public Offering (IPO) studies, which is summarised below. Such a discount can range between 10% and 50%⁵.

⁴ [2019] SGCA 78.

⁵ Measuring the Discount for Lack of Marketability for Noncontrolling, Nonmarketable Ownership Interests – Nathan P. Novak

Restricted Stock Study	Observation period of study	Observed average or median price discount
SEC Overall Average	1966 – 69	25.8%
SEC Nonreporting OTC Companies	1966 – 69	32.6%
Milton Gelman	1968 – 70	33.0%
Robert R. Trout	1968 – 72	33.5%
Robert E. Monroney	1969 – 72	35.6%
J. Michael Maher	1969 – 73	35.4%
Standard Research Consultants	1978 – 82	45.0%
Willamette Management Associates	1981 – 84	31.2%
Hertz and Smith [a]	1980 – 87	20.1%
William L. Silber	1981 – 88	33.8%
Bajaj, Denis Ferris and Sarin [b]	1990 – 95	22.2%
Johnson Study	1991 – 95	20.0%
Management Planning, Inc.	1980 – 96	27.0%
FMV Opinions, Inc. [c]	1980 – 14	19.3%
Greene and Murray	1980 – 12	24.9%
Columbia Financial Advisors Inc.	1996 – 97	21.0%
Columbia Financial Advisors Inc.	1997 – 98	13.0%
LiquiStat	2005 – 06	32.8%
Angrist, Curtis and Kerrigan	1980 – 09	15.9%
Stout Risius Ross	2005 – 10	10.9%

Pre-IPO Study	Observation period of study	Indicated Price Discount	
		Mean	Median
Emory	1997 – 2000	50%	52%
Valuation Advisors	2008 – 2012	N/A	16.8% - 47.0%
Willamette Management Associates	2000	22.9%	31.9%

Selection of the magnitude of DLOM may be affected by the following factors⁶, which are not exhaustive:

1. Size of subject business interest
2. Spread of shareholding
3. Accessibility and reliability of financial information
4. Number of potential buyers
5. Desirability of the business
6. Existence of restrictions on transfer of shares
7. Nature of underlying assets of the business

Application of DLOC

When a minority interest is being valued, the application of DLOC depends on the valuation method applied and the key inputs used.

Take the example of when the market approach is being adopted. As publicly-traded shares generally do not have the ability to make decisions related to the operations of the company (i.e. they lack control), and when maintainable earnings exclude controlling interest adjustments (e.g. above market salary paid to a director who controls the company is not adjusted for), the application of DLOC may NOT be appropriate because the application of publicly-traded valuation multiples to minority interest earnings results in a minority interest value.

It is also worth noting that the use of minority cash flows (which have not been adjusted for, say, excess compensation and non-arm's length transactions) in the income approach produces a minority interest value. It may be preferable to value a minority interest directly, rather than incur additional work and potential for error involved in adjusting a control value to a minority value by applying a DLOC.

Assuming a valuation warrants the application of DLOC, it can range between 10% and 30%⁷, which is computed as $DLOC = 1 - [1 / [1 + \text{Control Premium}]]$.

Conclusion

In litigation support cases, the relevance of discounts, namely DLOC and DLOM, in business valuation cannot be overstated. Valuation experts must carefully consider:

the specific circumstances of each case (e.g. whether minority oppression has been determined) the appropriate basis of value (e.g. market value)

the valuation method applied (e.g. guideline publicly-traded comparable method) and key valuation inputs used (e.g. minority earnings or cash flows) the appropriate discounts to apply (namely DLOM and DLOC) and its quantum

to arrive at a conclusion of value. When done correctly, valuation experts contribute to the resolution of disputes and the pursuit of justice in the legal system.

This article is written by Mr. Ong Woon Pheng (Partner), and co-authored by Spencer Teo (Manager), both of PKF-CAP Advisory Partners Pte. Ltd., and published on 16 October 2023. The author is contactable at woonpheng.ong@pkf.com and (+65) 9117 5457.

⁶ Refer to pages 481 to 484 relating to 'Factors Influencing Marketability' of publication entitled 'Financial Valuation, Application and Models' 4th edition by James R. Hitchner, Wiley.

⁷ FactSet Mergerstat/BVR Control Premium Study 2021



PKF CAP Advisory Partners Pte. Ltd.

6 Shenton Way,
#38-01 OUE Downtown 1,
Singapore 068809

Tel:+ 65 6500 9360
Fax:+65 6500 9366
contactsg@pkf.com
pkfsingapore.com

PKF CAP Advisory Partners Pte. Ltd. is a member of PKF Global, the network of member firms of PKF International Limited, each of which is a separate and independent legal entity and does not accept any responsibility or liability for the actions or inactions of any individual member or correspondent firm(s).