MERGERS AND ACQUISITIONS

Management Projections in Delaware Appraisal Litigation: Anecdotal Evidence

Sell-side management projections play a significant role in Delaware appraisal litigation, from affecting the decision whether to accept the merger consideration or to seek appraisal, to informing the Court's ultimate fair value determination. However, when management projections of operating income are compared to companies' actual ex post performance, anecdotal evidence suggests that such projections are systematically optimistic relative to companies' actual performance. As such, there is good reason to reevaluate the role of management projections for Delaware appraisal litigation.

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Management projections historically have featured prominently in Delaware appraisal litigation. Sell-side management projections typically are disclosed in a merger proxy or a 14D-9 filing where a target company's financial advisor relies on those projections for purposes of its valuation and its fairness opinion. These projections—which generally provide estimates of the company's revenue, net income, EBITDA, and/or free cash flow over some discrete period—are, in Delaware at least, considered material to a stockholder's decision whether to accept the merger price in cash deals or to seek appraisal in appraisal-eligible deals. In determining fair value in a Delaware appraisal proceeding, the relevant management projections significantly impact the valuation performed by the Delaware Court of Chancery (Court). In particular, unless the Court gives exclusive weight to the deal price itself as a result of an open, arm's-length sale process, management's projections—unless specifically found to be unreliable—will often serve as the foundational inputs for a discounted cash flow (DCF) analysis[1] and, accordingly, as a key driver of the Court's ultimate fair-value determination.[2] As the Court has explained, "management ordinarily has the best first-hand knowledge of a company's operations," and "[w]hen management projections are made in the ordinary course of business, they are generally deemed reliable."[3] Clearly, in Delaware appraisal litigation, management projections can have a profound impact on litigation outcomes.

It is not entirely clear that this should be so; quite the contrary, in fact. Management projections are just that—projections. They are estimates, shaped by management's assumptions and biases, and their ultimate accuracy often depends on circumstances beyond management's control. Furthermore, there is evidence to suggest that management's projected earnings generally exceed, by a significant margin, the actual earnings eventually achieved by the company. There is good reason, therefore, to believe that management projections systematically paint an overly optimistic picture of a company's prospects, and, when used by appraisal litigants or the Court to prepare valuation calculations, distort outputs in an upward direction. Accordingly, it may be appropriate to reconsider the centrality of management projections in appraisal litigation, or at least to consider relying on such projections only upon application of an appropriate downward adjustment, to offset the observed upward bias.

The Rise of Appraisal Litigation and the Importance of Management Projections

In recent years, there has been a shift in Delaware public company M&A litigation from merger

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objection suits toward appraisal actions. The Court has recently taken steps to rein in the over-abundance of *Revlon* claims[4] and disclosure litigation[5] that had almost inevitably followed public company mergers.[6] Concomitantly—and in the wake of the Court's decision in *Transkaryotic* expanding the pool of potential appraisal petitioners[7]—appraisal litigation has burgeoned in recent years,[8] and should be expected to continue to expand. This is particularly the case because, by statute, the Court generally awards interest on its fair value determinations at a rate of five percent over and above the Federal Reserve discount rate.[9] This favorable interest rate makes appraisal proceedings a particularly appealing option for investors, especially where markets are otherwise weak.[10] Specifically, because of the high interest rate, respondents face significant pressure to prepay the merger consideration as quickly as possible. This allows appraisal arbitrageurs to infinitely (in theory, at least) lever their funds. Furthermore (and notwithstanding the recent *Clearwire* decision), significantly below-merger-price awards tend to be a rarity.[11] Thus, the risk of a negative return on appraisal is seen to be very low, especially when petitioners' lawyers are paid on a contingency-fee basis (which keeps funds' costs low). In view of the attractiveness of the strategy, certain plaintiffs' lawyers expressly market appraisal litigation as an investment strategy (oftentimes referred to as "appraisal arbitrage").[12]

Management projections inform the very decision to initiate appraisal proceedings.

Considering the increase in appraisal arbitrage litigation and the economic incentives supporting that trend, it is worthwhile to reexamine the significant role that management projections have historically played in appraisal litigation. As a starting point, management projections inform the very decision to initiate appraisal proceedings. Guided by the Court's decisions in the disclosure litigation context, an acquisition target, to reduce the risk of a pre-closing claim based on inadequate disclosures, will generally disclose its management projections to shareholders in the deal proxy.[13] At the same time, the *Transkaryotic* decision held that an appraisal petitioner who beneficially owns shares acquired after the record date of a merger (which is typically set to occur after the release of the deal proxy) need not prove that the specific shares for which it seeks appraisal had not been voted in favor of the merger.[14] This dynamic allows appraisal arbitrageurs interested in using the appraisal remedy as an investment strategy to take a wait-and-see approach—once a deal is announced and the management projections are then released in the merger proxy, an arbitrageur can evaluate the projections and decide whether to acquire shares in the company for the purpose of seeking appraisal of those shares (which the arbitrageur will do if it determines that the projections support an argument for a valuation meaningfully above the deal price).[15]

Once appraisal proceedings are underway, management projections potentially significantly inform both the method of valuation the Court uses and the Court's ultimate appraisal award. Where management projections are not considered sufficiently reliable, the Court is unlikely to give significant weight to a DCF calculation, since the cash flow inputs required for that calculation are suspect.[16] On the other hand, if the management projections are considered reliable (and unless the Court gives exclusive weight to the deal price based on an open and arm's-length sale process[17]), the Court is likely to employ a DCF analysis, on the basis of those projections, to determine fair value.[18] Under the Court's jurisprudence, then, management projections have historically been critically important to appraisal litigation outcomes.

Testing the Reliability of Management Projections

A bedrock premise of Delaware appraisal jurisprudence is that, in the absence of indicators to the contrary, management's mid-to-long-range projections,

at least those prepared in the ordinary course of business, generally are treated as presumptively reliable and appropriate for use (with adjustments as appropriate) as the basis for DCF calculations.[19] Several considerations, however, cast doubt on the validity of this presumption. First, as others have confirmed, businesspersons tend to be naturally optimistic and to exhibit that optimism in their development of company projections. Second, because many company managers are themselves shareholders and are looking to maximize returns upon an eventual sale of the company, and because managers know that sale valuations will be driven in large part by ordinary-course projections, managers may be incentivized to develop incrementally optimistic projections, even if a specific sale transaction is not imminent. Third, company managers understand that, conversely, if a hostile bidder for the company emerges and management wishes to remain independent, resist the bid, and build a case for why the hostile bidder's offer is inadequate, rosy ordinary-course projections are a valuable arrow in their quiver.[20] Given the importance of management projections for appraisal litigation under the current jurisprudence, the rise in appraisal litigation, and the natural inclinations and incentives of managers to swell projections, we felt that the assumed reliability of management projections deserved some pressure-testing.

Managers may be incentivized to develop incrementally optimistic projections.

Existing literature suggests that management's financial forecasts often exhibit upward biases. Koo and Yeung, for example, concluded that management's "growth forecasts are on average exceedingly optimistic relative to ex post actual growth rates," calculating a mean growth forecast of 15 percent as compared to an actual growth rate of 3 percent.[21] Armstrong, Davila, Foster and Hand similarly found that management is optimistic when it comes to projecting profit.[22] These articles suggest that there is good reason to be skeptical of management projections. However, to reach their conclusions, neither set of authors compared management's *ex ante* projections against the actual *ex post* actual results. Rather, they extrapolated—based on a company's historical performance—what its actual results were likely to be. Further, neither article dealt with management projections in the context of M&A transactions.

We therefore set out to test how target companies actually perform in relation to management projections. The challenge, however, is that the universe of transactions in which it is possible to compare *ex ante* projections with the company's *ex post* results is necessarily quite limited. Strategic acquirers will generally integrate target companies into their operations and report consolidated financials. Additionally, many financial acquirers will take target companies private and thus ordinarily do not publicly report financial results post-closing. Our attempted solution to these circumstances was to focus on private equity-backed deals which involved either public debt or public stub equity in some form post-closing. Thus, we examined public-company transactions announced between 2008 and 2015[23] in which: (a) an acquirer purchased a public company and continued to run the company on a standalone basis;[24] (b) the target company publicly disclosed, in its deal proxy, management's projections for "operating earnings,"[25] revenue, and/or capital expenditures; and (c) the target company continued to report publicly its financial results (including operating earnings, revenue, and/or capital expenditures) following the acquisition.[26]

In other words, we looked for, and then examined, all transactions within the selected timeframe where the target company disclosed both projections and actual results and for which any deviations between those figures could not be explained by integration or by synergies or other operational factors.[27] We identified 25 such deals in total, of which there were 13 with disclosed operating earnings data, 24 with disclosed revenue data, and 10 with disclosed capital expenditures data (with multi-year information available for most figures and most deals).[28]

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Having identified the qualifying transactions, we first engaged in a simple counting exercise, looking at how frequently a company's projections for a given figure for a given year exceeded (or fell short of) its actual results. We treated this exercise as binary—either the actuals met/exceeded the projections, or they did not. Thus, even if the actual result for a given company for a given figure for a given year was just shy of the corresponding projection, we coded the projection as optimistic. As detailed below, the projections often exceeded the actual results, sometimes dramatically,[29] sometimes by a margin of less than 1 percent;[30] in other cases, the actuals exceeded the projections.

We also assessed whether, on average, the observed projections were more optimistic than the actual results. Specifically, for each instance in which it was possible to compare a company projection for a given metric for a given year with actual results, we calculated the percentage by which the projection differed from the actual result (assigning a negative percentage if the actual exceeded the projection), and then calculated the mean of those discrepancies.

Our results tended to show that management projections were significantly optimistic relative to actual results.

Despite the differences in context and methodology, and our relatively limited observed data, our findings were generally consistent with those of Koo and Yeung as well as Armstrong, Davila and Foster.[31] Specifically, our results tended to show that management projections were significantly optimistic relative to actual results. From the 13 deals for which both projected and actual operating earnings were available, there were 39 instances in which it was possible to compare management's projections for a given year with the actual results for that year.[32] Out of those instances, the projections of operating earnings exceeded the actuals 30 times (i.e., 76.9 percent of the time) and, on average, the actual results fell short of the projections by approximately 21.4 percent**.** With respect to revenue, in 48 out of 77 observed instances (*i.e.*, 62.3 percent), projections exceeded reported actuals, with the actuals, on average, exceeding the projections by approximately 10.5 percent.[33]

In a fair coin toss, the coin has an equal chance of coming up heads or tails. Similarly, if management projections for operating earnings were unbiased estimates of actual earnings, one would expect that the likelihood of a projection exceeding the actual would be the same as that of the actual surpassing the projection. That, however, is not what we observed when we examined the deals. If one treats management projections of operating earnings as coin flips (with an equal chance, if unbiased, of being above or below the actual results), the odds of projections exceeding actuals 30 (or more) times out of 39 is microscopic—0.053 percent. In other words, it is extremely unlikely that the observed results would exist if management projections of operating earnings were truly fair and unbiased.[34]

Rethinking Management Projections in Appraisal Litigation

Several points follow from our finding that management projections of operating earnings issued in the context of merger transactions tend to skew upwards. Our finding suggests that the very decision to initiate appraisal proceedings may often rest, at least in part, on faulty assumptions: the projections disclosed in connection with a deal do not necessarily provide an accurate picture of a company's prospects and value. Further, our finding calls into question the presumed viability of using DCF calculations for valuation: If the free cash flow inputs for a DCF calculation are not reliable, the resulting valuation output is also subject to attack. At the very least, our finding suggests that, if a DCF calculation is used, the management projections upon which the analysis is based should be adjusted downwards in

order to counter the likely upward bias embedded in the projections.

Delaware courts are already rethinking the appropriateness of putting management projections front-and-center in appraisal litigation. In the Delaware Supreme Court's recent decision in *DFC Global Corp.*,[35] a unanimous court telegraphed a preference for a deal-price-less-synergies approach to valuation where a company is sold following an open, arm's-length process. The Court even stated that the very purpose of an appraisal proceeding is

> to make sure that [petitioners] receive fair compensation for their shares in the sense that it reflects what they deserve to receive based on what would fairly be given to them in an arm's-length transaction.[36]

The *DFC Global* decision is, in many ways, the culmination of a line of cases in which Delaware has given increased weight to the merger price and less weight to DCF analyses and other valuation methods, particularly in public company transactions.[37] Our finding represents an additional basis for management projections, at least unadjusted management projections, to play a diminished role in Delaware appraisal litigation going forward.

Other Potential Factors

It is worth taking note of several factors that potentially complicate our findings. For example, one such factor is the degree to which leverage affects our analysis. Each of the companies whose financials we analyzed previously had operated as a standalone entity, with its own unique capital structure. After being acquired by private equity buyers, these companies likely became more leveraged on average, and increased leverage can, under certain circumstances, have a downward effect on profitability due to the burden of greater debt service. However, because the profitability metrics present in the deals we examined (EBITDA and adjusted EBITDA) ignore interest payments, it is unlikely that the acquired companies' increased leverage explains the observed discrepancy between projected earnings and actual earnings.

Management's overly optimistic sell-side projections are not a reliable indicator of a company's fair value.

A further significant complication is the context in which these management projections were generated. Some of them appear to have been prepared solely in connection with a sale, likely do not represent ordinary-course business plan projections, and thus could viewed as presumptively suspect and potentially unreliable for purposes of appraisal;[38] others, though, were prepared in the ordinary course.[39] In this sense, the mix of projections we tested (non-ordinary-course versus ordinary course) largely mirrors the mix of projections at issue in appraisal proceedings generally.[40]

Finally, it could be suggested that the discrepancies observed between actuals and the projections are attributable to unique factors concerning the deals themselves and do not establish any overall trend. However, the fact that we have considered a variety of transactions over a broad time period should offset any effect that deal-specific idiosyncrasies may have on our results. Moreover, while we observe that management projections reflect upward biases, the reasons for the discrepancies between projections and actuals matter less than the reality that these discrepancies exist. The fact that management projections tend historically to be overly optimistic—whatever the reasons for that may be—underscores the danger in affording significant weight in appraisal proceedings to management's projections or to valuation techniques (such as DCF calculations) based thereon, at least without a downward adjustment to correct for management's observed upward bias. In the

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end, it is clear that management's overly optimistic sell-side projections are not a reliable indicator of a company's fair value.

Conclusion

Our pressure-testing of management projections suggests that the information regarding projected operating earnings disclosed to shareholders generally reflects management's systematic upward bias. Thus, there is good reason to question whether management projections should continue to play an outsized role in appraisal litigation, at least without discounting them for management bias. And although Delaware courts are rethinking whether DCF-based valuations should continue to occupy pride-of-place in appraisal litigation, our findings suggest that more may be needed to counteract the effects of management's unduly optimistic forecasts. Indeed, the very decision to seek appraisal appears, in many cases, to rest on a significant misimpression about the company's prospects. As appraisal litigation continues to flourish in Delaware, it is imperative that litigants, courts, and lawmakers grapple with the upward biases and optimism inherent in management projections.

Notes

1. When employing a DCF analysis, the Court arrives at a company's value by discounting back to present value the company's anticipated free cash flow figures, typically using management's mid-to-long-range plan prepared in the ordinary course.
2. *See, e.g.*, *ACP Master, Ltd. v. Clearwire Corp.*, No. CV 9042-VCL, 2017 WL 3105858, at *31 (Del. Ch. July 21, 2017) ("The first key to a reliable DCF analysis is the availability of reliable projections of future expected cash flows, preferably derived from contemporaneous management projections prepared in the ordinary course of business.") (quoting *In re PetSmart, Inc.*, C.A. No. 10782-VCS, 2017 WL 2303599, at *32 (Del. Ch. May 26, 2017)).
3. *LongPath Capital, LLC v. Ramtron Int'l Corp.*, No. CV 8094-VCP, 2015 WL 4540443, at *10 (Del. Ch. June 30, 2015) (internal quotation marks omitted).
4. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court explained that, when the sale of a company becomes "inevitable," the fiduciary obligation of the company's directors switches from "preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit." 506 A.2d 173, 182 (Del. 1986). Since then, however, the Delaware Court of Chancery has explained that if a transaction is approved in "a fully-informed stockholder vote" the transaction is "insulate[d]"…from all attacks other than on the grounds of waste." *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 1001 (Del. Ch. 2014); *see also Singh v. Attenborough*, No. 645, 2015, 2016 WL 2765312 at *1 (Del. May 6, 2016) ("[A] fully informed, uncoerced vote of the disinterested stockholders invoked the business judgment rule standard of review.").
5. Disclosure litigation is often settled quickly with little or no economic remuneration to the shareholders, whose sole benefit "in exchange for releasing their claims is the dissemination of one or more disclosures to supplement the proxy materials." *In re Trulia, Inc. S'holder Litig.*, 129 A.3d 884, 891 n. 15 (Del. Ch. Jan. 22, 2016). Citing "the mounting evidence that supplemental disclosures rarely yield genuine benefits for stockholders," Chancellor Bouchard recently called upon the Delaware Court of Chancery to "reexamine[]" its "historical predisposition toward approving disclosure settlements." *Id.* at 896; *see also* Liz Hoffman, "The Judge Who Shoots Down Merger Lawsuits," Wall St. J. (Jan. 10, 2016), available at: *https://www.wsj.com/articles/the-judge-who-shoots-down-merger-lawsuits-1452076201*. Following the lead of the Delaware Court of Chancery, the Seventh Circuit has sharply critiqued disclosure litigation that "yields fees for class counsel and nothing for the class" as being "no better than a racket." *In re Walgreen Co., Stockholder Litig.*, 832 F.3d 718, 724 (7th Cir. 2016).
6. *See, e.g.*, *In re Topps Co. S'holders Litig.*, 924 A.2d 951, 957 (Del. Ch. 2007) ("The reality is that every merger involving Delaware public companies draws shareholder litigation within days of its announcement."); Olga Koumrian, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2014 M&A Litigation*, Cornerstone Res., Feb. 2015, at 2 (observing that ninety-three percent

of all public company acquisitions announced in 2014 and valued at over $100 million resulted in stockholder litigation), available at: *https://www.cornerstone.com/GetAttachment/897c61ef-bfde-46e6-a2b8-5f94906c6ee2/Shareholder-Litigation-Involving-Acquisitions-2014-Review.pdf.*

7. *In re Appraisal of Transkaryotic Therapies, Inc.*, C.A. No. 1554-CC, 2007 WL 1378345 at *3 (Del. Ch. May 2, 2007) (holding that the appraisal statute did not preclude petitioners from seeking appraisal of the shares that they purchased after the shareholder vote approving the merger, because "a beneficial shareholder, who purchased shares *after* the record date but before the merger vote" need not "prove, by documentation, that each newly acquired share … is a share not voted in favor of the merger by the *previous* shareholder") (alterations in original).
8. *See* Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 Wash. U. L. Rev. 1551, 1553 (2015) ("The value of claims in appraisal in 2013 was nearly $1.5 billion, a tenfold increase from 2004 and nearly one percent of the equity value of all merger activity in 2013."); *see generally id.* at 1567-72 (discussing the recent rise in appraisal litigation).
9. 8 Del. C. § 262(h).
10. Delaware recently amended its appraisal statute to give appraisal respondents the unilateral right to prepay to petitioners—in advance of the Court's fair value determination—any amount, thereby cutting off the accrual of interest on the amount prepaid. *See id.*; Council of the Corporation Law Section of the Del. State Bar Ass'n, *Section 262 Appraisal Amendments* (Mar. 6, 2015) available at *https://www.lowenstein.com/files/upload/DGCL%20262%20Proposal%203-6-15%20Explanatory%20Paper.pdf.* In the absence of agreements with petitioners, however, respondents may still, despite the amendment, face significant practical barriers to effecting prepayments. *See, e.g.*, Respondent's Opening Br. in Support of its Mot. for a 262(g) and 262(h) Order, *Artic Investments LLC v. Medivation, Inc.*, C.A. No. 2017-0009-JRS (Del. Ch. Mar. 28, 2017). For this reason, the favorable interest rate remains a source of potential motivation for appraisal suits.
11. *See Clearwire Corp.*, 2017 WL 3105858 at *1 (finding that fair value of the company at the effective time of the merger was 42.6 percent of the deal price).
12. *See* Inst. Investor Educ. Found., *Appraisal as an M&A Investment Strategy: Breakfast Briefings Summary Report – Spring 2014*, available at *http://www.shareholderforum.com/appraisal/Library/20140520_Grant&Eisenhofer-IIEF.pdf.*
13. *See, e.g.*, *Maric Capital Master Fund, Ltd. v. Plato Learning, Inc.*, 11 A.3d 1175, 1178 (Del. Ch. 2010) ("[M]anagement's best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information.… Given the centrality of this issue … the proxy statement omits material information by, for reasons not adequately explained, selectively removing the free cash flow estimates from the projections provided to PLATO's shareholders. Until this information is disclosed, the merger will be enjoined."). Indeed, a confluence of Delaware decisions necessitates, as a practical matter, the disclosure of management's projections. When pursuing a strategic transaction, it is essential that a company's directors have "before them adequate information regarding the intrinsic value of the Company, upon which a proper exercise of business judgment could be made." *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009). And, although corporate directors are not strictly obligated to obtain a formal fairness opinion before entering into a strategic transaction, *see id; see* also Oberly v. Kirby, 592 A.2d 445, 472 (Del. 1991), it is nonetheless in their interests to do so. For example, a fairness opinion will often be "viewed as persuasive evidence that the minority stockholders were treated fairly." *Seagraves v. Urstact Prop. Co., Inc.*, No. 10307, 1996 WL 159626, at *4 (Del. Ch. Apr. 1, 1996). When a company's board does obtain a fairness opinion, Delaware courts have held that the valuation inputs undergirding that opinion—very often, management's projections—constitute material information. *See, e.g., In re Netsmart Techs., Inc., Shareholders Litig.*, 924 A.2d 171, 177 (Del. Ch. 2007) ("[T]he plaintiffs have also established a probability that the Proxy is materially incomplete because it fails to disclose the

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projections [the investment bank] used to perform the discounted cash flow valuation supporting its fairness opinion. This omission is important because Netsmart's stockholders are being asked to accept a one-time payment of cash and forsake any future interest in the firm. If the Merger is approved, dissenters will also face the related option of seeking appraisal. A reasonable stockholder deciding how to make these important choices would find it material to know what the best estimate was of the company's expected future cash flows."); *see also David P. Simonetti Rollover IRA v. Margolis*, No. 3694-VCN, 2008 WL 5048692, at *10 (Del. Ch. June 27, 2008) ("The key assumptions made by a banker in formulating his opinion are of paramount importance to the stockholders because any valuation analysis is heavily dependent upon the projections utilized.").

14. *Transkaryotic Therapies, Inc.*, 2007 WL 1378345 at *3.
15. Appraisal arbitrage is not without its defenders. Professors Korsmo and Myers, for example, argue that, in contrast to other forms of shareholder litigation, "appraisal cases stand out as something unusually valuable—a form of shareholder suit where the merits actually matter." Charles Korsmo & Minor Myers, *Shareholder Litigation That Works*, N.Y. Times (Apr. 16, 2015), *https://www.nytimes.com/2015/04/17/business/dealbook/shareholder-litigation-that-works.html.* They assert that appraisal suits tend to be "significantly associated with buyouts with an unusually low deal price and where insiders are part of the acquiring group." *Id.* They similarly argue that the rise of appraisal specialists (*i.e.*, arbitrageurs) is beneficial, insofar as the specialists "predominantly take aim at suspicious deals, providing genuine deterrence against lowball buyouts by insiders," and thereby discouraging "transactions that ought to be deterred." *Id.* This analysis, of course, presumes that appraisal proceedings are a reliable proxy for fair value. If not, appraisal becomes a form of rent-seeking, much like merger objection litigation.
16. *See, e.g.*, *PetSmart*, 2017 WL 2303599, at *35 ("[T]he Management Projections are not reliable statements of PetSmart's expected cash flows. Any DCF analysis that relies upon the Management Projections, therefore, would produce 'meaningless' results.").
17. *See, e.g., Merion Capital LP v. Lender Processing Services, Inc.*, C.A. No. 9320-VCL, 2016 WL 7324170 at *30-33 (Del. Ch. Dec. 16, 2016) (holding, where transaction resulted from robust process, that no weight should be given to a DCF calculation based on reliable management projections, and instead that exclusive weight should be given to the deal price); *see also DFC Glob. Corp. v. Muirfield Value Partners, L.P.*, No. 518, 2016, 2017 WL 3261190, at *18 (Del. Aug. 1, 2017) ("The purpose of an appraisal … is to make sure that [stockholders] receive fair compensation for their shares in the sense that it reflects what they deserve to receive *based on what would fairly be given to them in an arm's-length transaction.*") (emphasis added).
18. *See Clearwire*, 2017 WL 3105858, at *31.
19. *See, e.g.*, *Huff Fund Inv. P'ship v. CKx, Inc.*, No. CV 6844-VCG, 2013 WL 5878807, at *9 (Del. Ch. Nov. 1, 2013) ("Under Delaware appraisal law, '[w]hen management projections are made in the ordinary course of business, they are generally deemed reliable.'") (quoting *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at *7 (Del. Ch. Dec. 31, 2003)); *cf. PetSmart*, 2017 WL 2303599, at *34 ("[T]he projections were created to be aggressive and extra-optimistic about the future of the Company. … This makes perfect sense when projections are being prepared not in the ordinary course but to facilitate a sale of the Company.").
20. One potentially countervailing incentive of managers is their desire to meet projection targets that are used to measure company success (especially from the standpoint of outside analysts, as well as company boards), to gauge the strength of managers' performance, and to determine managers' eligibility for stock awards and bonuses. From this perspective, company managers may have an incentive to maintain downward pressure on their projections, in the interest of protecting their jobs and maximizing their compensation. Because many publicly disclosed company targets and internal executive compensation benchmarks are set just one or two years into the future, however, this incentive is immaterial as to most of the components of mid-to-long-range projections, which typically forecast out for at least five years and often beyond.

21. David S. Koo & P. Eric Yeung. *Managers' Forecasts of Long-Term Growth in Earnings: New Information or Cheap Talk?* at 3 (Working Paper) available at *http://www.stern.nyu.edu/sites/default/files/assets/documents/Eric%20Yeung.pdf.*
22. Christopher S. Armstrong, et. al., *Biases in multi-year management financial forecasts: Evidence from private venture-backed U.S. companies*, 12 Rev. of Accounting Studies 183 (2007).
23. We analyzed and ruled out thousands of deals in order to arrive at our operative set of examined transactions. Our sources included the deal tombstones in annual issues of Corporate Control Alert, as well as deals reported by Intelligize.
24. As noted, to isolate deals in which the target company was operated on a standalone basis after acquisition, we examined exclusively private equity acquisitions. As the Court has observed, deals involving financial buyers do not tend to involve significant synergies. *See, e.g.*, *In re Appraisal of Ancestry.com*, C.A. No. 8173-VCG, 2015 WL 399726 at *16 (Jan. 30, 2015) ("[A]s is typical in a non-strategic acquisition, I find no synergies that are likely to have pushed the purchase price above fair value."). However, even assuming that the relevant deals resulted in some synergies, this would, in fact, strengthen the integrity of our conclusions. That is, if synergies were realized as part of a deal, presumably those synergies should boost the surviving company's operating earnings, thereby making it more likely that they would align with (or exceed) management's projections. Nevertheless, as discussed below, management projections were systematically more optimistic than the companies' actual performance. Thus, to the extent that our data accounts for post-merger synergies, our findings actually *understate* the upward bias embedded in management's projections.
25. We defined operating earnings as metrics of profitability such as EBITDA, adjusted EBITDA, free cash flow, and earnings. We had comparable projections and actuals data only for EBITDA and adjusted EBITDA metrics.
26. As noted, this was most often the case because, following the acquisition, a stub portion of the acquired company's equity remained public or the acquired company carried publicly traded debt.
27. As discussed in some more detail below, one potential difference between the pre- and post-acquisition companies that we examined is the increased leverage post-acquisition that is typically deployed in private equity-sponsored deals. For the reasons noted below, any such increase in leverage should not undermine the validity of our findings.
28. In compiling our evidence, we excluded certain data where a divergence between projections and actual results was likely attributable to exceptional circumstances. For example, with respect to Carl Icahn's attempted but unconsummated acquisition of Dynegy, Inc. in 2010, although management projections and actual results for years beyond 2011 were available, we opted to exclude these figures from our findings because the company went into bankruptcy in 2012 and, in subsequent filings, expressly noted that the financial results post-bankruptcy (which were much lower than the projected figures) could not be compared to financials from the pre-bankruptcy period.
29. Bankrate Inc.'s actual EBITDA figures, for example, consistently fell short of the corresponding projections for the entire four-year period for which projections were disclosed: the actuals fell short of the projections, respectively, by 24.1 percent, 46.6 percent, 6.9 percent, and 48.5 percent.
30. For example, Great Wolf Resorts, Inc. predicted that its 2012 EBITDA would be $89,000,000. In reality, its EBITDA for that year came in at $88,733,000.
31. *See* Koo, *supra* n.21; Armstrong, *supra* n.22.
32. Because many of the deals we examined reflected projected and actual operating earnings for multiple years, we were able to compare a data point of projected operating earnings against an analogous data point of actual operating earnings on thirty-five occasions.
33. For capital expenditures, out of the thirty-one instances where projections and actuals could be compared, projections were greater than actuals thirteen times (41.9 percent), with actuals, on average, coming in 16.5 percent higher than projections. It seems striking that the discrepancy between projected earnings and actual earnings was significantly larger than the discrepancies observed for revenue and capital expenditures. These findings, however, align with work done by other

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researchers, which indicates that management tends to be overly optimistic with respect to profitability forecasts, whereas management understates revenue and expense forecasts. *See* Armstrong, *supra* n.xxii, at 185 ("[M]anagers' profitability forecasts are significantly and increasingly optimistic as the forecasting horizon rises from one- to five-years-ahead.…However, we do not find that optimism is invariably present in the revenue and expense components of managers' profit forecasts. Specifically, we show that one year-ahead revenue forecasts are, on average, reliably understated (pessimistic) by 11%, and three- through five-year-ahead expense forecasts are reliably overstated (pessimistic) by 25%, 41% and 80%, respectively.").

34. It is important to stress that our findings in no way suggest that this upward bias is the result of any wrongdoing—intentionally or otherwise. That projections paint a rosy picture of a company's prospects may, as noted above, be a result of natural and non-fraudulent biases. Furthermore, it bears emphasizing that an optimistic bias can serve the interests of a company's shareholders (as acknowledged by Congress's enshrinement of certain safe harbors under federal securities laws for management's forward-looking statements about a company's prospects, *see* 15 U.S.C. 77z-2). For instance, bullish projections may make the company appear healthier and more appealing to would-be acquirers, and—if a deal is pursued—eventually allow management to secure a more favorable deal for their shareholders. Meanwhile, managers also have an incentive to temper their projections to ensure that their financial advisors are basing their opinions on reliable inputs.
35. *DFC Glob.*, 2017 WL 3261190.
36. *Id.* at *18.
37. *See, e.g.*, *PetSmart*, 2017 WL 2303599; *Lender Processing Servs.*, 2016 WL 7324170; *Merion Capital LP v. BMC Software, Inc.*, No. CV 8900-VCG, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015); *Merlin Partners LP v. AutoInfo, Inc.*, No. CV 8509-VCN, 2015 WL 206941 (Del. Ch. Apr. 30, 2015); *In re Appraisal of Ancestry.com, Inc.*, No. CV 8173-VCG, 2015 WL 399726 (Del. Ch. Jan. 30, 2015); *Huff Fund Inv. P'ship v. CKx, Inc.*, No. CV 6844-VCG, 2013 WL 5878807, at *1 (Del. Ch. Nov. 1, 2013) *aff'd,* No. 348, 2014, 2015 WL 631586 (Del. Feb. 12, 2015). *See generally DFC Global*, 2017 WL 3261190, at *13, n.84 (collecting cases); *PetSmart*, 2017 WL 2303599, at *27, n.333 (same).
38. *See, e.g.*, *CKx, Inc.*, 2013 WL 5878807 at *9 ("[T]his Court has disregarded management projections…where the projections were created for the purpose of obtaining benefits outside the ordinary course of business."). Of course, this is not to say the Court of Chancery will never rely on projections prepared outside the ordinary course of business. *See Merion Capital, L.P. v. 3M Cogent, Inc.*, No. CV 6247-VCP, 2013 WL 3793896, at *11 & n.103 (Del. Ch. July 8, 2013) (collecting cases in which the Court relied on projections prepared outside the ordinary course of business).
39. For example, in its Schedule 14D-9, PLX Tech. Inc. stated that its projections were prepared in the ordinary course of business. Other companies, such as Emdeon, Inc. or J. Crew Group, Inc., expressly noted that the projections were prepared in connection with consideration of strategic alternatives or that they were not prepared in the ordinary course of business. Still other companies did not specifically address this one way or another in their proxy disclosures. Of the 25 companies whose financials are reflected in our findings, no fewer than 10 (40 percent) expressly noted that the projections were not prepared in the ordinary course of business and/or were prepared in connection with a potential strategic alternative.
40. *see supra* n.38, supporting the appropriateness of drawing inferences from the projections we tested