STATE OF MICHIGAN

IN THE CIRCUIT COURT FOR THE COUNTY OF INGHAM

TECHSMITH CORPORATION,

Plaintiff,

vs.

WILLIAM EMERICK and
JOHN HAUCK,

Defendant.
________________________________/

Case No. 14-294-CB

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

At a session of said Court held in the City of Lansing,
Ingham County, Michigan, on: July 8, 2016

PRESENT: Hon. Joyce Draganchuk
Circuit Judge

This matter is before the Court following a bench trial held on November 3, 5, and 6, 2015. At the request of counsel, closing argument was delayed so that a transcript could be prepared and post-trial briefing could occur. Closing arguments were heard on February 19, 2016.

This is a stock valuation dispute brought under the Michigan Business Corporation Act, MCL 450.1761, et seq. In November 2013, Plaintiff TechSmith completed a merger in which Defendants shares of stock were purchased. Defendants dissented on the basis that they did not receive fair value for their shares. In accordance with § 773 of the Business Corporation Act, TechSmith brought this action for a judicial determination of the fair value of Defendants’ shares.

The Court has considered the testimony of all witnesses, the exhibits admitted into evidence, and the briefing and oral argument of counsel. All parties acknowledge that the Business Corporation Act places the burden on the Court to determine fair value. Therefore, stock valuations disputes do not lend themselves to the traditional burden-of-proof analysis where the Court would accept a competing valuation by default if the opposing party fails to meet its burden. While the Court acknowledges its responsibility under the Act, it has relied on the experts who testified in this case to reach its conclusions by weighing and evaluating their opinions.

TechSmith is a software developer located in Okemos, Michigan. Bill Hamilton, TechSmith's President, founded the corporation in 1987. When TechSmith started out in business, it was a contract programming and consulting business. TechSmith managed ups and downs through the 1990's and stayed in business only by transitioning from consulting to software development.

Since 1996, TechSmith has focused on selling two software products that account for 90% of its sales. SnagIt is a screen capture utility and Camtasia Studio is a video editor. Both products are made for installation on a desktop and run on Windows or Mac systems. The products are purchased by a one-time license purchase as opposed to a yearly subscription service.

TechSmith is not publicly traded and has never paid dividends to shareholders. The shareholder agreement in effect in 2013 restricted shareholders from selling any of their shares without the prior written consent of all other shareholders (Plaintiff's Confidential Ex. 13). TechSmith's President, William Hamilton, holds a right of first refusal on the transfer of any shares. If he does not exercise his right, all other shareholders hold a subsequent right of first refusal. In the event that shares were sold to someone other than the right of first refusal holders, the new shareholder had to agree to be bound by the same restrictions as the original shareholder.

The shareholder agreement further provides that involuntary transfers of stock, such as those occurring upon a shareholder's death, divorce, or bankruptcy, constitute offers to sell the stock to TechSmith at book value. Shareholders acknowledge that book value is the "fair cash value" of the shares.

In 2013, Mr. Hamilton was 66 years old. He was concerned that he was still leading the company at his age and believed there was a need for the company to make a transition before it got to the point where he was either incapacitated or gone.

There were 74,232 shares of TechSmith outstanding in 2013. Shareholders included CompuServ, a company that had previously been actively involved with TechSmith but had since separated from TechSmith. Nevertheless, CompuServe still owned 3,201 shares of TechSmith. Other shareholders, such as Defendants, had previously worked for TechSmith but had long since separated from the company. Defendants each owned 797 shares of stock, which gave them each a 1.074% minority interest in the company.

Mr. Hamilton viewed the stock ownership situation as "a mess." In 2012, he had considered an employee stock option purchase (ESOP). An ESOP committee had a preliminary valuation analysis done, but that is as far as the ESOP plan went. One year later, as Mr. Hamilton contemplated some sort of TechSmith transition, he knew that the stock ownership situation would have to be corrected regardless of whether TechSmith became public or transitioned to an ESOP.

Ultimately, it was decided that TechSmith would go forward with a merger to allow it to buy out the stock of certain shareholders. A Notice of Special Meeting of Stockholders to be held on November 26, 2013 was sent to all shareholders. The Notice stated that at the Special Meeting, the stockholders would elect directors and consider and take action upon a proposal for a merger. The Notice explained that "[t]he Merger is being proposed for several reasons, including to address concerns regarding unknown stockholders, to restructure the Corporation's ownership so that the Corporation is owned solely by employees who are actively engaged in the Corporation's business, and to provide a liquidity event for stockholders who are not actively-engaged employees of the Corporation. Upon completion of the Merger, all of the shares of the Corporation's common stock will be owned by actively-engaged employees of the Corporation."

The Notice provided that certain shareholders, including Defendants, would receive $409.90 per share. Defendants provided a notice of their intent to dissent. At the meeting, the shareholders owning a majority of the outstanding shares of TechSmith approved the merger. Defendants were the only shareholders to vote against the merger and exercise their dissenters' rights.

On December 20, 2013, TechSmith sent each Defendant a payment of $327,388.43. These payments represented TechSmith's estimate of the fair value of

$409.90 per share plus accrued interest of $698.13**.** Defendants had 30 days in which to notify TechSmith of their own demand for payment. On January 16, 2014, Defendants notified TechSmith that they were demanding $4,384.12 per share based on a valuation they said was performed by Stout Risius Ross (Defendants' Ex. R).

In a letter sent to Defendants on March 7, 2014, TechSmith advised Defendants that the Stout Risius Ross valuation was based on an incorrect number of outstanding shares. TechSmith's letter advised Defendants that if the correct number of shares was used, their demand amounted to $3,089.92 per share. On June 19, 2015, TechSmith provided an affidavit setting forth the correct number of outstanding shares at 74,232 (Plaintiff's Ex. 9). On August 27, 2015, long after the 30 day time frame and four months after Stout Risius Ross provided a complete written valuation for purposes of this litigation, Defendants made amended demands of $1,446 per share (Defendants' Ex. T and U).

A. Management projections

One year prior to the merger, TechSmith was exploring the feasibility of an employee stock option purchase (ESOP). Mr. Bradley Van Horn of Business Appraisal Services, LLC, prepared a preliminary analysis of value for use by the ESOP committee. Mr. Van Horn did not do the due diligence required for a valuation, such as talking with management and looking more in depth at industry data. His preliminary 2012 document (Defendants' Ex. A) was missing many of the elements of a finalized business valuation. He applied a small (5%) lack of marketability discount because he believed that Federal law provided for some liquidity of ESOP shares.

Donald Nourse is TechSmith's Vice President of Finance and Administration. Nourse prepared a valuation at the time of the merger in November 2013. He looked at a valuation of TechSmith prepared in 2009 by Maner-Costerisan, an independent CPA firm, and used that report for his methodology. He then prepared a spreadsheet forecasting earnings through 2018 (Plaintiff's Confidential Ex. 10). He used the forecast to come up with what he called a rough valuation of the company. He made his valuation a few weeks before the December 20, 2013 payment was made to Defendants.

Mr. Nourse's valuation came out to $394 per share, which was below book value. However, TechSmith determined that Defendants should be paid book value because the shareholder agreement said that book value would be paid if a shareholder died and the agreement further provided that book value was fair cash value. Therefore, TechSmith increased Mr. Nourse's valuation and paid Defendants $409.90 per share.

Mr. Nourse subsequently prepared new projections in May or June of 2014, just two or three months after TechSmith filed this lawsuit. Those projections made reductions in TechSmith's projected total sales through 2018 and cut income from operations in half.

B. The Experts

TechSmith's trial expert was Bradley Van Horn, a professional business appraiser and owner of Business Appraisal Services, LLC. Mr. Van Horn performs business appraisals for litigation and non-litigation purposes. He routinely performs valuations for estate and gift tax purposes, for business acquisitions, for employee stock ownership plans, and for financial reporting purposes. Mr. Van Horn prepared a Fair Value Appraisal Report, dated July 31, 2014, rendering an opinion that the fair value of 797 shares of stock as of November 26, 2013 was $434 per share, or $345,898 in the aggregate (Plaintiff's Confidential Ex. 15). The valuation was based on an equity value discounted for minority interest (20%) and lack of marketability (33%).

Defendants' trial expert was Jesse Ultz, employed at Stout Risius Ross. Mr. Ultz is the managing director of the Valuation and Financial Opinions Group and he heads the valuation litigation practice across all 12 SRR offices in the United States. SRR has an opinion committee that has to approve every opinion that SRR issues. Mr. Ultz prepared a valuation report dated April 27, 2015, rendering an opinion that the fair value of Defendants' stock was $1,446 per share, or $1,153,000 in the aggregate (Defendants' Confidential Ex. C). Mr. Ultz's valuation did not apply any discounts for minority interest or lack of marketability.

C. Analysis of fair value

Under § 762 of the Michigan Business Corporation Act, Defendants are entitled to the fair value of their shares and accrued interest. Fair value is defined as the value of the shares immediately before the merger. MCL 450.1761(d).

The Court finds Mr. Van Horn's valuation to be substantially more credible and probative of the value of TechSmith shares than Mr. Ultz's valuation for the following reasons:

Mr. Ultz used only two methodologies to reach his conclusion. His valuation opinion is based on (1) capitalized cash flow, which takes historical earnings, adjusts for non-recurring items, and applies a market multiple to generate value, and (2) guideline company, which uses publicly traded stocks and applies multiples of earnings to determine the value of a private company. In contrast, Mr. Van Horn used capitalized cash flow and guideline company but he also used (3) discounted cash flow, which operates like capitalized cash flow but uses projected future earnings and cash flow instead of historical earnings, and (4) acquired company, which operates like guideline company, but uses multiples from the sale of privately held companies in the same broad industry category.

Mr. Van Horn testified that it is normal to use all four methods and that he gave all four methods equal weight in his analysis. He testified that using all four methodologies gives a more complete valuation. It is apparent to the Court that each of the four different methodologies uses a different perspective. Since no method, by itself, is an absolute perfect measure of value, the use of all four methods will provide a better measure of value than the use of only two methods.

Mr. Ultz did not interview management at TechSmith, although he acknowledged that it is better to do so. In contrast, Mr. Van Horn interviewed management and gained their insights into the future of the company. Mr. Van Horn learned from management interviews that SnagIt and Camtasia were products in decline. With that knowledge, the year 2013 was seen in a different light. Instead of an aberration, management and Mr. Van Horn concluded that 2013 reflected the downward trend in products that are not for use on mobile devices and are not sold as subscription services.

Mr. Ultz treated 2013 as an aberration that held no significance for the future. Mr. Van Horn treated 2013 as a watershed event that signaled a downturn for the future. Mr. Van Horn's conclusion comes from his management interviews. Although Defendants say that management is biased, the reasons management gave for the downturn in business comport with the other testimony and with common sense and general knowledge.

TechSmith's two products that represent 90% of its sales are not made for mobile applications and are purchased by one-time license purchases. Mr. Nourse testified that, in fact, 2013 saw new license sales numbers going down. Also, cloud computing and the shift from desktop computers to mobile devices was troubling for the future of their two main products, which were not suited to any of these trends. Management acknowledges, and everyday experience supports, that desktop computers are on the decline while mobile devices are taking their place. Furthermore, selling a license for a software program does not provide the same assurance of on-going sales that selling a yearly subscription does.

Because Mr. Ultz did not have the information Mr. Van Horn had regarding SnagIt and Camtasia, he made no adjustments for product concentration. He also treated 2013 the same as other years. Mr. Van Horn made a 10% adjustment in his capitalized cash flow method for product concentration risk. He also accounted for the importance of 2013 by giving it more weight than previous years. Because Mr. Ultz did not see 2013 for what it was, he did not apply a company specific risk premium. However, for the reasons stated above, a company specific risk premium was appropriate and it was applied by Mr. Van Horn. The failure to include a company specific risk adjustment alone increased Mr. Ultz's total equity valuation by over $8.5 million.

Defendants argue that Mr. Van Horn's opinion should be set aside because he did not have and thus did not consider the November 2013 projections made by Mr. Nourse contemporaneous with the merger. Instead, Mr. Van Horn used Mr. Nourse's 2014 projections, which he prepared after litigation had begun.

The Court finds no reason to set aside Mr. Van Horn's opinion on the grounds argued by Defendants. Although Defendants say that he relied on the 2014 projections, in fact Mr. Van Horn only used Mr. Nourse's adjusted 2014 projections in his discounted cash flow method of valuation. Even for this one method, Mr. Van Horn used the same revenue numbers, but adjusted operating profit upward by a couple million dollars per year on average. He believed that Mr. Nourse's numbers were overly pessimistic. Had he used Mr. Nourse's numbers without adjustment, the value per share would have been only $39 lower and only for the discounted cash flow analysis.

Defendants make much of Mr. Hamilton's testimony that had Mr. Nourse not adjusted his projections downward, Mr. Hamilton would have fired him. In full context, what Mr. Hamilton was referring to were the projections made in 2012 when an ESOP was being explored and the projections made one year later in 2013 when management had confirmation of a downward trend in their products. Although Mr. Nourse lowered his projections even further in 2014, it was not under threat of being fired. The 2014 projections, relied upon in only small part by Mr. Van Horn, were further adjusted as it became more clear what the drop in 2013 sales meant for the future. The evidence supports managements concerns, but even if litigation played some role in management's projections, there is no evidence that any potential bias was carried over into Mr. Van Horn's analysis.

Many of the Defendants' criticisms of Mr. Van Horn's valuation are based on comparisons between the work he did for TechSmith's ESOP committee in November 2012 and the valuation made for this litigation. However, the preliminary analysis done in 2012 was not a final valuation. Mr. Van Horn did not interview management or do any in-depth analysis of the industry.

The 2012 analysis applied only a 5% lack of marketability discount , as opposed to the 33% discount applied for this case. However, Mr. Van Horn gave a credible explanation of the difference in terms of Federal law in relation to an ESOP. The marketability of shares in an ESOP is not comparable to the marketability of Defendants' shares and the difference in discounts is justifiable.

Mr. Ultz pointed out that Mr. Van Horn erred in his treatment of TechSmith's cash. TechSmith had a cash reserve because they never made any distributions to shareholders. After the payout to Defendants, the company's cash was depleted in the amount paid to Defendants. Mr. Van Horn used the lower amount of cash, after the buy-out, in his calculation of TechSmith's value. Doing so reduced the amount the Defendants were to receive by the amount that they had already received. It was, in effect, double counting.

The Court agrees that the method used results in double counting. Mr. Van Horn testified that the Defendants per-share fair value appraisal would increase from $434 to $440 if the situation were corrected as Defendants suggest. That small adjustment should be made to the per-share fair value.

D. Discounts

It is undeniable that Mr. Van Horn and Mr. Ultz's valuations are widely disparate because Mr. Van Horn applied minority and lack of marketability discounts and Mr. Ultz did not. This Court previously ruled in Defendants' motion for partial summary disposition that, in the absence of any authority in Michigan on applying discounts, the application of discounts is fact-specific and should be considered on a case-by-case basis. Having heard the testimony and having a fuller understanding of the facts of this case, the Court concludes that minority and lack of marketability discounts not only should but must be applied here.

The Business Corporation Act mandates that Defendants be paid fair value for their shares. While TechSmith has undoubtedly enjoyed success overall, the question to be answered is what would a willing buyer pay, not just for *a* share or *any* shares of TechSmith, but for *Defendants'* shares of TechSmith. Each Defendant owns 1% of TechSmith. As 1% shareholders, Defendants have no control over TechSmith. They make no decisions about any of the workings or policies of TechSmith. This lack of control necessitates a discount for a minority interest.

Any purchaser of Defendants' shares would be saddled with the significant restrictions that go along with those shares. The shareholder agreement does not allow any shareholder to sell shares without the unanimous consent of the other shareholders. Moreover, Mr. Hamilton has a right of first refusal, followed by the Company and then all other shareholders. The shareholder agreement applies to all subsequent purchasers of shares.

TechSmith is not publicly traded and Mr. Hamilton has received no offers to purchase TechSmith. There simply is no market for shares of TechSmith stock and a lack-of-marketability discount is necessitated.

The Defendants bemoan the discounts and point to the instantaneous wealth that could be created if their shares were purchased at a discount and then Mr. Hamilton sold his ownership interest. Defendants call this oppressive.

The Court cannot agree with Defendants. All they ever owned was 1% of TechSmith. They are only entitled to fair value of what they own. What they own cannot be compared to what a majority shareholder owns. Furthermore, this is not an oppression action and a determination of fair value is based on the value of their stock right before the merger – not on what Mr. Hamilton could do in the future.

Along with their objections to discounts in general, Defendants also argue that the discounts should not be applied to cash on hand. The two experts did treat cash differently as follows:

Mr. Van Horn only considered cash in excess of what was needed for day-to-day operations in his valuation. Mr. Ultz was of the opinion that all cash should be considered and he pointed out that just taking the cash balance alone would result in a per share buyout amount quite close to what TechSmith paid Defendants.

Of the total amount of cash that TechSmith had at the end of December 2013, Mr. Van Horn determined that approximately $2 million was needed for day-to-day operations of the business. The remaining non-operating cash was used in his capitalized cash flow method.

The Court does not agree with Mr. Ultz's valuation insofar as it considers TechSmith's total cash. The cash needs for operating TechSmith on a day-to-day basis should not add to the valuation of the business. But the bigger impact on value is that Mr. Van Horn applied the discounts to cash. Defendants argue that as a result they received 47% less cash than what they generated.

The Court disagrees with Defendants' position. Mr. Emerick worked at TechSmith for 7 years from 1988 to 1995. Mr. Hauk worked there for 4 years from 1988 to 1992. While they each no doubt contributed to the company while they worked there, they are hardly responsible for generating the total amount of cash TechSmith had as of the end of 2013.

Furthermore, the discounts should be applied to TechSmith's cash. As 1% minority shareholders, the Defendants have no right to control the company's cash or make any decisions regarding the company's cash. To ignore that concept and treat *all* of TechSmith's cash as part of what Defendants own would fail to recognize their minority status. It would also fail to give them fair value for their shares. Instead, they would receive a windfall in value above and beyond the share of the company that they actually own.

E. Attorney fees and expert fees

Defendants have requested that they be awarded their attorney fees and expert fees under § 774 of the Business Corporation Act because TechSmith acted arbitrarily, vexatiously, and not in good faith. Defendants give three reasons for finding TechSmith's bad faith. The Court will address them briefly even though the Court's ultimate ruling in this case should make it evident that TechSmith did not act in bad faith.

First, Defendants say that TechSmith made a valuation that did not take into account the cash it had on hand. The Court has already addressed the cash on hand issue and concluded that only non-operating cash should be considered and discounts should be applied to cash.

Second, Defendants point to the difference between the 2012 ESOP analysis and the valuation done for this case. The Court has already addressed the 2012 ESOP analysis and, for the reasons stated, finds it is not probative of value in this case.

Third, Defendants point out that TechSmith acknowledged the value of Defendants' stock when it booked a $1,455,555 accrued liability for ex-shareholders, but then only offered to pay Defendants $653,380.60. This issue can be dealt with quite briefly in that the accrued liability does not represent what TechSmith believed was the value of Defendants' shares. TechSmith has amply demonstrated that the accrued liability was booked for 3,551 shares attributable to three other shareholders at $409.90 per share. Those shareholders did not dissent but are either unknown as to their whereabouts or, in the case of CompuServe, no longer in business. Their shares will escheat to the State and therefore represent a liability of $1,455,555.

F. Conclusion

For all of the foregoing reasons, the Court finds that the fair value of 797 shares of TechSmith stock as of the merger date is $440 per share. TechSmith must pay each Defendant the difference between the $409.90 per share payment already made and the $440 per share value, plus whatever amount of additional interest is due. Defendants' request for attorney fees and expert fees is denied.

Plaintiff shall submit a proposed final judgment within fourteen (14) days.

/S/

Hon. Joyce Draganchuk (P39417)
Circuit Judge

PROOF OF SERVICE

I hereby certify that I served a copy of the above Findings of Fact and Conclusions of Law upon the attorneys/parties of record by placing same in sealed envelopes addressed to each and depositing them for mailing with the United States Mail at Lansing, Michigan, on July 8, 2016.

/S/

Michael G. Lewycky
Law Clerk/Court Officer