SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF KINGS

IN THE MATTER OF THE APPLICATION OF LMEG WIRELESS LLC, Petitioner, -against- MENACHEM FARRO, Respondent. For a Determination of the Fair Value of Respondent's Interest in LMEG Wireless LLC under Article 4 of the Civil Practice Law and Rules, Section 1005 of the New York Limited Liability Company Law, and Section 623 of the New York Business Corporation Law.	Index No. 501508/2021 Hon. Reginald A. Boddie Motion Sequence No.: 006 Return Date: November 13, 2023

MEMORANDUM OF LAW IN SUPPORT OF PETITIONER'S MOTION IN LIMINE TO EXCLUDE THE TESTIMONY OF MARK L. ZYLA REGARDING HIS DISCOUNTED CASH FLOW VALUATION

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Petitioner LMEG Wireless, LLC ("LMEG" or the "Company") respectfully submits this Memorandum of Law in support of its motion in limine to exclude the testimony of Mark L. Zyla, CPA/ABV, CFA, ASA ("Zyla") concerning his discounted cash flow calculation for the value of LMEG as of November 16, 2016 (the "Valuation Date").

PRELIMINARY STATEMENT

Zyla calculates the value of Farro's interest in the Company in several ways, and this motion concerns only his Discounted Cash Flow ("DCF") analysis. That valuation approach involves essentially two steps: (i) forecasting the Company's future cash flows, then (ii) discounting those future cash flows to present value. Zyla fumbles step one.

Zyla did not prepare his own forecast of LMEG's future cash flows as of the Valuation Date. Instead, he adopted, hook, line, and sinker, a forecast prepared by Ridgemont Equity Partners ("Ridgemont") in connection with Ridgemont's potential—but ultimately abandoned prior to the Valuation Date—acquisition of the Company, set forth in a Ridgemont-created document titled, "Refreshed TUC." His wholesale adoption of Ridgemont's projections requires exclusion for three main reasons:

- ***First***, Zyla's use of Ridgemont's projections violates his fundamental charge under governing caselaw to value the Company as a "going concern"—*i.e.*, based on the assumption that it would continue to operate as it historically operated. That is because Ridgemont's rosy projections incorporate all of Ridgemont's plans to overhaul the Company with a major capital infusion, refinancing debt to a lower cost, revamping product lines and procurement channels, replacing the management team, streamlining operations, and developing a new operations hub. And as of the Valuation Date, all of those plans—and the rosy projections that incorporated them—had fallen through: Ridgemont abandoned the deal as LMEG's financial performance cratered.

- ***Second***, Ridgemont's out-of-court projections are inadmissible hearsay, and Zyla's DCF analysis therefore lacks foundation. Zyla cannot rely on the Ridgemont projections because (i) he cannot

establish that untested third-party projections are the type of out-of-court material typically relied upon by valuation experts, and (ii) neither Zyla nor Farro can introduce any evidence establishing that Ridgemont's projections are reliable. The entirety of the evidence is to the contrary: as of the Valuation Date, everyone knew that Ridgemont's projections—because they contemplated a strategic investment in the Company that would never happen and they did not account for LMEG's trending, steep decline that began in the second half of 2016—were fatally flawed.

- ***Third***, even setting aside the issue of admissibility of Ridgemont's projections, Zyla's wholesale adoption of those projections without any adjustments or documented reasonableness testing is a fatal flaw in Zyla's methodology requiring exclusion. It is appraisal gospel that a valuation expert cannot blindly rely on third-party projections without testing them for reasonableness. Had Zyla done *any* testing of Ridgemont's projections before copy-and-pasting them into his DCF analysis, he would have seen that those projections were grossly inflated. For FY (full year) 2016, Ridgemont projected unburdened Company reported earnings (EBITDA[1]) of $13.17 million; actual FY 2016 earnings were $8.07 million. For 2017, Ridgemont projected FY $14.28 million in unburdened earnings; LMEG *lost* $1.67 million in 2017.

In short, the starting point for Zyla's DCF analysis was his assumption, *without any factual basis or documented testing*, that Ridgemont's hearsay projections of the Company's earnings, based on Ridgemont's assumed and abandoned overhaul of the Company, were reasonable. Zyla's failure to test and verify the reasonableness of that assumption fundamentally departs from the mandatory generally accepted appraisal standards and requires exclusion of his DCF analysis.

In 2011, a Federal Court for the Northern District of Georgia excluded Zyla's expert calculation because he failed to evaluate the financial projections that he adopted into those calculations (*see Contr. Packaging, Inc. v Cent. Garden & Pet Co.*, 2011 WL 13162306, at *6

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[1] EBITDA stands for earnings before interest, taxes, depreciation and amortization. EBITDA is the standard input used by private equity companies and business appraisers using an income-based valuation methodology.

[ND Ga Mar. 31, 2011]). For the reasons set forth below, Zyla made the same mistake here, and the same result is required.

STATEMENT OF FACTS

LMEG will demonstrate at the hearing that the fair value of Farro's interest in the Company as of the Valuation Date is no more than $3,465,300, which LMEG's highly-qualified expert Harold Deiters, CPA/ABV/CFF/CGMA, CFA, MAFF/CVA calculated with widely-accepted valuation methodologies, historical Company data, and reasonable assumptions grounded in the nature and reality of the Company and its industry.

Farro's testifying expert, Zyla, by contrast, presents a pie-in-the-sky valuation of LMEG at a staggering $96 million. From there, after subtracting LMEG's debt and applying an arbitrary, absurdly small discount for LMEG's lack of marketability, he computes Farro's former one-third interest at $24.6 million. To reach that wildly inflated valuation, Zyla ignores, as he must, (i) the trending, steeply downward trajectory of the Company, (ii) the existential threat to LMEG and its entire industry posed by electronics titans Apple, Samsung, and Amazon, (iii) the fact that Ridgemont *abandoned* its plans to purchase LMEG prior to the Valuation Date when it saw where the Company was headed, and (iv) that a month before the Valuation Date, Farro made the Company completely toxic—unable to obtain loans or investment—by commencing a now-dismissed lawsuit (Index No. 518007/2016) alleging that Zalman Schochet had committed fraud, was not a member, and other criminal acts.

Zyla's primary method for valuing LMEG is his DCF calculation. The DCF method, as Zyla explains, entails forecasting the Company's future cash flows, then discounting those future cash flows back to present value (Mahler Aff. Ex. 1 at ¶ 73). Thus, the reliability of the method turns on the reliability of the forecast: even a slightly inflated forecast of future cash flows will

produce a heavily inflated valuation. Based on his DCF method, Zyla concludes that the enterprise value of the Company as of the Valuation Date is $96 million, or $78.6 million after subtracting the Company's then-outstanding debt.

Zyla's own treatise, published in 2020, *Fair Value Measurement: Practical Guidance and Implementation*,[2] correctly observes that "the reliability of the value derived from an income [including a DCF] approach method is dependent on the quality of prospective financial information used in its development." In plain English, "Garbage in; garbage out."[3]

Zyla did not prepare his own forecast of LMEG's future cash flows as of the Valuation Date, nor did there exist any LMEG-prepared projections for him to reply upon. Instead, he adopted, without any modification whatsoever, a forecast prepared by Ridgemont in connection with Ridgemont's potential—but ultimately abandoned—acquisition of the Company, set forth in a confidential, Ridgemont-created document titled, "Refreshed TUC." Those projections—which LMEG did not prepare or endorse—were extremely optimistic; they projected where LMEG's cash flows could be ***after Ridgemont made a major investment into the Company, took over management, obtained significantly lower debt financing, and completely overhauled operations and product offerings***. Specifically, Ridgemont planned to spend millions on hiring a new management team, designing a new operations center and hub, overhauling and leaning out operations, and standardizing the refurbishment process. By Mid-2017, Ridgemont contemplated that LMEG would be a completely different company, and their projections reflect those major plans.

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[2] Wiley; 2nd edition (November 13, 2012) (excerpted at Mahler Aff. Ex. 2).

[3] *Ramcell, Inc. v Alltel Corp.*, 2019-0601-PAF, 2022 WL 16549259, at *11 (Del Ch Oct. 31, 2022) ("**Without a reliable estimate of cash flows, a DCF analysis is simply a guess**" [emphasis added]).

The projections in the Ridgemont TUC also were utterly stale; they were prepared when Ridgemont only had the Company's financial performance as of June 2016. Later in 2016—but before the Valuation Date—when Ridgemont received updated financials revealing that the Company had entered a potential death spiral, Ridgemont terminated further discussions about a potential purchase of the Company.

LEGAL STANDARD

This Court serves an important "gatekeeping function" to prevent unreliable expert testimony (*People v Powell*, 37 NY3d 476, 495 n.15 (2021). A motion in limine to exclude expert testimony is proper even where the fact-finder is the Court, rather than a jury (*see, e.g.*, *Line Design LLC v Pro Design, LLC*, 2022 NY Misc LEXIS 303 [Sup Ct NY Co. Jan. 20, 2022] [granting motion in limine in case that proceeded to bench trial]). The Court has the inherent discretion to grant a motion in limine permitting "a party to obtain a preliminary order before or during trial excluding the introduction of anticipated inadmissible, immaterial, or prejudicial evidence" (*State v Metz*, 241 AD2d 192, 198 [1st Dept 1998]).

In exercising its gatekeeping function, New York courts follow well-settled guidelines. First, New York courts have adopted the *Frye* standard, pursuant to which an expert's testimony is not admissible unless "the thing from which the deduction is made [is] sufficiently established to have gained general acceptance in the particular field in which it belongs" (*see Frye v US*, 293 F. 1013, 1014 [DC Cir. 1923]; *see also Fraser v 301 52 Townhouse Corp.*, 57 AD3d 416, 417-18 [1st Dept 2008]). Second, expert evidence will not be admissible in the absence of a proper foundation. An expert opinion will not have an appropriate foundation unless the "**accepted methods were appropriately employed in a particular case**" (*Parker v Mobil Oil Corp.*, 7 NY3d 434, 447 [2006] [emphasis added]). Thus, the Court must assess the "specific reliability of the

procedures followed to generate the evidence proffered and whether they establish a foundation for the reception of the evidence at trial," and exclude any unreliable or speculative methodologies used by the expert (*id.*).

ARGUMENT

"The first key to a reliable DCF analysis is the availability of reliable projections of future accepted cash flows" (*In re PetSmart, Inc.*, CV 10782-VCS, 2017 WL 2303599, at *32 [Del Ch May 26, 2017]).[4] But "***without reliable five-year projections, any values generated by a DCF analysis are meaningless***" (*Huff Fund Inv. Partnership v CKx, Inc.*, CV 6844-VCG, 2013 WL 5878807, at *9 [Del Ch Nov. 1, 2013] [emphasis added]).

Here, Zyla acknowledges that his DCF analysis utilizes—without any adjustment or modification whatsoever—the projections prepared by Ridgemont in connection with their potential but ultimately abandoned acquisition of the Company (Mahler Aff. Ex. 3 [Zyla Tr. 283:11-284:14]) set forth in Ridgemont's Refreshed TUC.

I. Zyla's Adoption of Ridgemont's Projections is a Fatal Methodological Flaw Requiring Exclusion Because Ridgemont's Projections Assumed a Dramatically Different Company Than LMEG as a Going Concern.

Zyla acknowledges that he was required to value LMEG as a "going concern,"[5] which assumes, according to Zyla, that "the business will continue operating as it has been operating" (Mahler Aff Ex. 3 [Zyla Tr. 79:2-21]). But despite paying lip service to the proper premise of value, Zyla—because he adopted wholesale the projections of Ridgemont—actually valued

[4] The Delaware Chancery Court is the foremost authority on business valuation litigation, including a proper DCF analysis. Accordingly, this memorandum respectfully cites Delaware cases as persuasive authority on the principles discussed herein. New York courts routinely look to Delaware caselaw in interpreting matters of corporate law (*See*, *e.g.*, *In re 1545 Ocean Ave., LLC*, 72 AD3d 121, 131-132 [2d Dept 2010]).

[5] *See Matter of Seagroatt Floral Co., Inc.*, 78 NY2d 439, 444 (1991) ("In that the valuation proceeding avoids dissolution and allows the continuation of an operating business, the value to be ascertained is that of an interest in a going concern").

LMEG based on the assumption that Ridgemont would completely overhaul the Company and take it to unprecedented levels of profitability.

Specifically, the Ridgemont projections that Zyla adopts contemplate, among other changes, infusing millions of capital into the Company (Mahler Aff. Ex. 3 [Zyla Tr. 82:2-17] ["Q: Did your valuation of the company assume a capital infusion after the valuation date? A: To the extent it was included in the Ridgemont Prospective financial information it did."]), refinancing debt at a significantly lower interest rate, retaining an entirely new management team, undertaking aggressive (and well-funded) efforts to streamline and grow the business, and designing and building a new operations center and shipping hub. Zyla utilized projections based on Ridgemont's planned overhaul of nearly every aspect of LMEG's business:

> Q: In valuing LMEG, did you assume that post-valuation date there would be changes to LMEG's procurement channels?
>
> A: Yeah, to the extent it was contemplated in the TUC.
>
> Q: Same question with respect to sales channels.
>
> A: Again as it was contemplated in the TUC.
>
> Q: Same question as to changes in the product mix.
>
> A: That was, yes, same answer, as it was contemplated in the TUC.
>
> Q: Changes to personnel.
>
> A: Yes, as contemplated in the TUC.
>
> Q: And changes to the geographic location of the business premises of LMEG.
>
> A: Yes, and the move to Texas is contemplated in that document.

(Mahler Aff. Ex. 3 [Zyla Tr. 84:6-24]). All of those changes are baked into Ridgemont's projections, and accordingly assumed in Zyla's DCF analysis and his subsequent valuation. In short, Zyla valued what Ridgemont thought it could turn LMEG into, not what LMEG actually was.

Zyla attempts to square all of the anticipated changes to the Company contemplated in Ridgemont's projections with the requirement that he value LMEG as a "going concern" with his *assumption* that those changes were "contemplated" as of the Valuation Date (Mahler Aff. Ex. 3 [Zyla Tr. 79:22-25]). But Zyla is plain wrong. Ridgemont abandoned its plans to purchase LMEG prior to the Valuation Date (*see* Mahler Aff. Ex. 4). Therefore, as of the Valuation Date, the Company's dramatic makeover contemplated in the projections adopted by Zyla definitively was not going to happen. Nonetheless, Zyla charged ahead with projections that assumed that makeover, ensuring that his DCF analysis would produce deeply flawed, unreliable results (*Finkelstein v Liberty Digital, Inc.*, 2005 WL 1074364, at *14 [Del Ch Apr. 2, 2005] [rejecting an expert's valuation because the expert's DCF analysis was based on "assumptions that b[ore] no relationship to [the operative] reality" of the company]; *Grimes v Vitalink Communications Corp.*, 1997 WL 538676, at *5 [Del Ch Aug. 28, 1997] [holding that an expert's valuation was an inaccurate projection of the company because it "assume[d] the existence and sale of products that [the company] did not then [i.e., as of the merger date] have the ability or right to provide"]; *Lane v Cancer Treatment Ctrs. of Am.*, 2004 WL 1752847, at *26 [Del Ch July 30, 2004] ["[T]he embryonic status of [an] expansion effort, as of the Merger Date, makes unreasonable any projection of capacity based on that project"]).

By utilizing projections that assume an overhaul of the Company that definitively was not going to happen as of the Valuation Date or foreseeably at any later date, Zyla's DCF analysis fails

to properly apply reliable methodologies to this case, and it therefore should be excluded. In *Deborah Int'l Beauty v Quality King Distributors*, NY LAW JOURNAL, Jan 14, 1993 at 21 (Mahler Aff. Ex. 5), the Nassau County Supreme Court granted a motion to strike an expert's valuation testimony where the expert rendered "a valuation of a corporation that did not exist." The Court stated that the expert "assumed a stand alone corporation, restructured in a mold of the expert's own creation, and projected earnings for four years beyond the statutory date for valuation envisioning a pie in the sky methodology that bore no relation to the real corporate identity of Deborah" (*id.*). By adopting Ridgemont's projections, that is exactly what Zyla's DCF analysis does; it should be excluded on that basis (*id.*; *see also Finkelstein*, 2005 WL 1074364, at *17 ["[R]ather than addressing the operative reality of [the company], as required by law, [the expert] imagines an ideal world for [the company] and values the [the company] on that basis…[The expert's] DCF valuation [is] unreliable and [provides] no rational insight into the company's value]").

II. Zyla's DCF Analysis Must Be Excluded Because it Lacks Foundation: Zyla Cannot Justify His Reliance on the Inadmissible Hearsay Within the Refreshed TUC.

The Refreshed TUC and the projections therein are inadmissible hearsay. "Out-of-court statements offered for the truth of the matters they assert are hearsay and may be received in evidence only if they fall within one of the recognized exceptions to the hearsay rule, and then only if the proponent demonstrates that the evidence is reliable" (*Hochhauser v Electric Ins. Co.*, 46 AD3d 174, 178 [2d Dept 2007]). The Refreshed TUC is an out-of-court statement by Ridgemont—not a party or witness to this proceeding—as to the anticipated future performance of the Company, which Zyla adopts for its truth: that the Company, because it would reasonably hit those projections, was worth upwards of $96 million as of the Valuation Date.

While an expert witness may provide an opinion based upon otherwise inadmissible out-of-court material, he or she can *only* do so where: (1) the out-of-court material is of a kind accepted in the profession as reliable as a basis in forming a professional opinion, and (2) there is evidence presented establishing the reliability of the out-of-court material referred to by the witness (*Hambsch v New York City Tr. Auth*., 63 NY2d 723 [1984]; Scanga v Family Practice Associates of Rockland, P.C., 27 AD3d 547, 548 [2d Dept 2006] judgment where defendants' pathology experts testified about out-of-evidence biopsy slides for which the defendants had failed to establish reliability]). Zyla's blind reliance on the Refreshed TUC fails both of these fundamental requirements.

A. Zyla Cannot Establish that Third-Party Projections Are Material Generally Accepted in the Appraisal Profession.

Zyla's reliance on the third-party Refreshed TUC is proper only if Zyla can establish that such evidence is of a kind generally accepted in the profession as reliable in forming a professional opinion (*Supple Mind Acupuncture, P.C. v State Farm Ins. Co*., 20 Misc3d 144(A) *1 [App Term 2d Dept 2008] [finding expert report and expert testimony inadmissible because "defendant did not elicit any testimony from its expert which could support a conclusion that the material he relied upon in forming his opinion was of a kind accepted in the profession as reliable in forming a professional opinion"]).

While Zyla testified that appraisal experts commonly rely on projections (a/k/a Prospective Financial Information, "PFI") ***prepared by the Company***, he could offer no support for his reliance on projections like the Refreshed TUC, which were prepared by a third-party. Zyla acknowledged that Ridgemont was not "inside the company" (Mahler Aff. Ex. 3 [Zyla Tr. at 256:6-9]), and thus he was required to assume (without any basis) that Ridgemont has sufficient access to information to render reliable projections (Mahler Aff. Ex. 3 [Zyla Tr. 168:11-25]). Because a third-party

prepared them, Ridgemont's Refreshed TUC bears *none* of the indicia of reliability that generally accompany projections prepared within the Company (*see, e.g.*, *LongPath Capital, LLC v Ramtron Intl. Corp.*, CV 8094-VCP, 2015 WL 4540443, at *10 [Del Ch June 30, 2015] [explaining that management-prepared projections can be deemed reliable where they are regularly prepared in the ordinary course of business by those with first-hand knowledge of a corporation, but rejecting overly-optimistic projections prepared by management for the first time]).

Zyla attempted to justify his reliance on third-party prepared projections with the major assumption that LMEG participated in the preparation of the Refreshed TUC:

> Q: Is it generally appropriate for an appraiser like yourself to rely on third-party PFI to do your [DCF]?
>
> A: It can be, yes.
>
> Q: It can be?
>
> A: Yes.
>
> Q: When would it be inappropriate?
>
> A: It's – management – I'm assuming that the – Ridgemont based their PFI based on discussions with management and their own internal due diligence and where they expected the company to perform and, therefore, priced the company.

(Mahler Aff. Ex. 3 [Zyla Tr. 168:11-25]).

But neither Zyla nor Farro can prove the verity of that assumption because LMEG had *no role* in the preparation of the Refreshed TUC. And, as Zyla must concede, there is no evidence of "any management endorsement" of the projections in the Refreshed TUC (Mahler Aff. Ex. 3 [Zyla Tr. 255:9-13]).

Accordingly, because neither Zyla nor Farro can establish that third-party projections—particularly unverified, untested projections (as set forth more fully below)—are generally relied

upon by valuation experts, Zyla should be precluded from offering his DCF analysis based entirely on those projections.

B. Neither Zyla Nor Farro Can Satisfy the Additional Reliability Requirement Because the Ridgemont Projections Demonstrably Are Not Reliable.

Neither Farro nor Zyla can offer the required additional evidence establishing the reliability of Ridgemont's projections in the Refreshed TUC, which is central to an expert's reliance on out-of-court material (*Wagman v Bradshaw*, 292 AD2d 84, 89 [2d Dept 2002] ["[W]e also take this opportunity to reiterate the requirement that, "[i]n order to qualify for the 'professional reliability' exception, there must be evidence establishing the reliability of the out-of-court material"]).

Neither Zyla nor Farro can offer evidence supporting the reliability of the projections in the Refreshed TUC because the evidence uniformly supports the opposite conclusion: the projections in the Refreshed TUC are not reliable:

- ***First***, the Ridgemont projections themselves acknowledge that they are preliminary, and subject to extensive further diligence. Specifically, the Refreshed TUC contemplated another $700,000 worth of pre-deal due diligence—Ridgemont was going to take a much closer look under the hood after the Refreshed TUC. Indeed, the entire purpose of the Refreshed TUC was so that the Deal Team at Ridgemont could convince Ridgemont's management to proceed with that further diligence:

Confidential

Investment Opportunity Update

Company Overview

- Founded in 2005, LM Wireless ("LM" or the "Company") provides value-added distribution, refurbishment and reverse logistics services for returned, damaged and overstock consumer electronics ("CE") and CE accessories. Products include tablets, MP3 players (iPods), smartwatches, digital cameras, batteries, chargers, cases, cords, etc.
- The Company specializes in purchasing returned/damaged and wholesale CE products and accessories from OEMs, wireless carriers and large retailers/etailers in bulk and then selling them through etail (e.g., Amazon, eBay, proprietary LM website) and wholesale channels (e.g., CE insurance providers) after in-house refurbishing, reconditioning and/or testing
- In addition to its distribution/refurbishing/reselling activities (78% of sales), LM sources and sells third-party manufactured private label CE (tablets, speakers, etc.) (22% of sales)
- For the LTM period ended June 2016, LM generated $77.6mm in sales and $9.7mm in "Fully Burdened" EBITDA (i.e., EBITDA pro forma for significant cost additions related to building out a full management team and additional infrastructure to support future growth) (12.6% margin); "Status Quo" EBITDA (similar to Management Adjusted EBITDA) for the same period was $13.5 mm (17.4% margin)
- The Company is owned today by its two founders (only one of whom is active in managing the business) and LM's CEO (1/3 share each)

- REP received the opportunity through John LeClaire (Goodwin Proctor attorney and friend of an LM founder) in fall 2015
- For nearly 12 months, the deal team has been given significant access to management and key employees, completed significant business and industry diligence, completed nearly all of its third party confirmatory diligence (paid for by the Company), and has had the benefit of "living with"

- Given some highly unusual shareholder dynamics (to be further discussed), REP has negotiated to have up to $1 mm of confirmatory diligence & legal expenses covered by the Company in the event a transaction is not consummated; we have spent ~$700k to date and ~$700k remains to be spent, and so the purpose of this 'Refreshed TUC' meeting is to both (i) recommend that we continue to push towards a closing and (ii) to seek IC approval to incur up to $500k of Ridgemont-borne diligence expenses

- This 'future state' of the business would be an emblematic extension of REP's work in distribution, logistics, and supply chain efficiency

Valuation, Structure & Next Steps

- Given the inherent risk associated with the 'heavy lift' nature of this type of investment, we have negotiated a structured investment that we feel provides ample downside protection and an highly asymmetric risk-return profile
- Our going-in valuation of $73.5mm represents 7.5x Fully Burdened LTM June 2016 EBITDA or 5.4x Status Quo EBITDA; we believe this headline valuation multiple compares favorably to several transaction comps
- We intend to capitalize the business with (i) $17mm of debt capital (from either (a) an institutional lender at a market rate, if available, or (b) a combination of REP investment and a seller note at an ~15% rate, which we would intend to refi out with traditional debt capital as quickly as possible post-closing); (ii) a $35mm preferred equity investment from REP with a 10% PIK dividend (we would sit at 5.3x Fully Burdened EBITDA through this security; 62% nominal ownership of the Company); and (iii) $21.5mm of common equity rollover from the two owners who are active in the business today (38% nominal ownership)
- Given some highly unusual shareholder dynamics (to be further discussed), REP has negotiated to have up to $1 mm of confirmatory diligence & legal expenses covered by the Company in the event a transaction is not consummated; we have spent ~$700k to date and ~$700k remains to be spent, and so the purpose of this 'Refreshed TUC' meeting is to both (i) recommend that we continue to push towards a closing and (ii) to seek IC approval to incur up to $500k of Ridgemont-borne diligence expenses
- The deal team believes we have pushed the sellers to the limit on the negotiation and that there is unlikely to be any material optimization to the terms as outlined in this document

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Ridgemont EQUITY PARTNERS < Highly Confidential – Not for Distribution > 2

- ***Second***, the Ridgemont projections are mooted by the reality that Ridgemont, prior to the valuation date, abandoned the deal. Ridgemont's abandonment of the transaction reveals two critical flaws in their projections: (i) the Company's massive financial and operational overhaul that the projections contemplated definitively would not happen, and (ii) even Ridgemont, when it decided to abandon the deal, recognized that LMEG was dramatically underperforming.

- ***Third***, and most importantly, as discussed further in Section III, *infra*, the actual performance of the Company demonstrates how shockingly inflated the projections in the Refreshed TUC are. Specifically, Ridgemont's projections describe a company with extraordinary growth—one that that will nearly double in earnings before interest, taxes, depreciation, and amortization ("EBITDA") between 2016 and 2019. Meanwhile—even at the time of the Valuation Date—LMEG was trending sharply downward, due to the effects of Amazon, Apple, and Samsung intruding on its business. Given that the Ridgemont projections were based, at best, on June 2016 financials, they could not possibly have contemplated the negative impact of Apple and Samsung or the further deterioration of proprietary sales due to Amazon, since that only happened after June. Because the Company's actual performance was magnitudes worse than the projections in the Refreshed TUC, neither Zyla nor Farro will be able to establish that Ridgemont's projections were reliable.

Accordingly, because neither Zyla nor Farro can point to any additional evidence supporting the reliability of the projections in the Refreshed TUC, Zyla's DCF analysis, which is based entirely on the Refreshed TUC, should be excluded (*see D'Andraia v Pesce*, 103 AD3d 770, 771-772 [2d Dept 2013] [error to allow expert to base in part his opinion on biopsy report as "there was no proof that the report was reliable"]; *A-Tech Concrete Co. v Tilcon NY, Inc*., 60 AD3d 603 [2d Dept 2009] [trial court did not err in excluding expert opinion based upon laboratory report of samples sent to an independent laboratory for testing by expert as expert did not conduct or observe the testing]); *Scanga* 27 AD3d at 548 ["[T]he defendants failed to establish the reliability of the recut biopsy slides as there was no evidence, except the expert's conjecture, that the slides were actually recut from the original biopsy sample. As such, the opinion testimony of the defendants' expert should have been stricken."]).

C. Allowing Zyla's Testimony Based on the Refreshed TUC is Irreparably Prejudicial Because LMEG Cannot Examine the Source of the Projections Zyla Utilizes.

Allowing Zyla to testify to his DCF analysis based on the hearsay projections within the Refreshed TUC would visit irreparable prejudice upon LMEG because it would deprive the Company of the ability to confront the source of those projections: Ridgemont.

Before the Ridgemont projections are admitted as evidence *or adopted by Zyla as fact*, LMEG is entitled to cross-examine Ridgemont on the reliability of those projections. That is the fundamental purpose of the rule against hearsay. That examination would reveal, *inter alia*:

- The purpose of the Refreshed TUC, thus explaining why Ridgemont had every reason to be unreasonably optimistic;
- All of the assumptions utilized in reaching those productions, showing that Ridgemont contemplated a complete Company redesign;

- The data available to the authors of the Refreshed TUC, revealing that the TUC was prepared with stale data;
- Ridgemont's awareness of the existential risks posed to LMEG's industry by Amazon, Apple, and Samsung, highlighting that Ridgemont's projections did not account for those threats; and
- Ultimately why Ridgemont abandoned the transaction—showing that they saw that their projections were unattainable.

Absent testimony from Ridgemont on all those items—Ridgemont and its personnel are outside of the Court's jurisdiction and cannot be subpoenaed for trial—the Court cannot evaluate (and LMEG cannot advocate upon) the reliability of the projections that sit at the heart of Zyla's analysis.

Admission of Zyla's DCF analysis based on the hearsay projections prepared by Ridgemont irreparably deprives LMEG of the ability to confront the author of those projections and test their accuracy. Out-of-court statements of fact are inadmissible precisely because the parties cannot test, and the Court cannot evaluate the reliability of those out-of-court statements. That principle is wholly applicable to the Ridgemont projections. Zyla cannot make his report unimpeachable simply by adopting Ridgemont's hearsay as his own (*Kovacev v Ferreira Bros. Contracting, Inc.*, 9 AD3d 253, 253 [1st Dept 2004] [holding that an expert's opinion was properly precluded at trial because his opinion "cannot be based on [hearsay evidence] by another health care professional who is not subject to cross-examination"]; *Jemmott v Lazofsky*, 5 AD3d 558, 559 [2d Dept 2004] [trial court erred in permitting the plaintiff's medical expert to offer testimony based upon evidence not admitted and was prepared by another health care professional who did not testify at the trial]).

III. Regardless of the Admissibility of the Refreshed TUC, Zyla's Failure to Test the Projections Therein is Another Methodological Flaw Requiring Exclusion of his DCF Analysis.

Even pretending the Refreshed TUC is admissible, which it is not, Zyla's DCF analysis should still be excluded because Zyla's blind reliance on the projections in the Refreshed TUC violate both appraisal doctrine and the *Frye* standard, both of which require an expert to independently test the assumptions provided to him or her. Zyla's failure to test the projections in the Refreshed TUC for reasonableness goes to the reliability of his methodology, which this Court must consider in the exercise of its gatekeeping function (*Kendall v Amica Mut. Ins. Co*, 135 AD3d 1202, 1205-1206 [3d Dept 2016] ["[E]ven if the reliability of the [hearsay] evidence [relied upon by an expert] is shown, it may not be the sole basis for the expert's opinion on an ultimate issue in the case"]).

It is appraisal gospel that an appraiser should not blindly rely upon forecasts prepared by management (or, worse, a third-party) without substantively evaluating those forecasts. The American Society of Appraisers—in which Zyla chairs the Subcommittee on Standards—publishes business valuation standards, one of which, BVS VIII, expressly states:

> If projections of balance sheets or income statements are used in the valuation, key assumptions underlying those projections must be included and discussed.

Likewise, the appraiser must independently assess the projections to determine whether they are reasonable for use in their analysis.[6]

Zyla's own treatise, *Fair Value Measurement: Practical Guidance and Implementation*, sets forth an exhaustive checklist—based on the appraisal community's Mandatory Performance

[6] Pratt, Shannon, *Valuing a Business*, 6th Edition (2022) at 266. Dr. Shannon Pratt is the among the world's leading authorities in the Business Valuation Field.

Framework for appraisal assignments—setting forth all the perquisites to relying on projections (Mahler Aff. Ex. 2). Zyla's checklist requires the appraiser to "understand and document how the PFI was developed ***by management***." Zyla's treatise further states that "The Valuation Processional's Assessment of the PFI" must include "the identification of parties responsible for preparation of the PFI," an understanding of "the process used to develop the PFI," and "the explanation of key underlying assumptions used in the PFI" (Mahler Aff. Ex. 2).

Here, Zyla did none of those things. First of all, there was no PFI developed by LMEG's management. Second, he did not speak with anyone at Ridgemont concerning their calculations in the Refreshed TUC. As a consequence, Zyla has no idea what assumptions Ridgemont built into their analysis, and he has no way of knowing, for example, whether the Ridgemont projections accounted for the existential risk to the Company posed by Apple, Samsung, and Amazon.

Instead, Zyla masked his failure to follow his own checklist in evaluating Ridgemont's projections with assumptions and disclaimers. Zyla *assumed* that the Company provided Ridgemont with sufficient data to make its projections (Mahler Aff. Ex. 3 [Zyla Tr. 83:23-25]). Zyla *assumed* that Ridgemont's contemplated overhaul of the Company was "management's plan" (Mahler Aff. Ex. 3 [Zyla Tr. 56:8-11]). Zyla assumed the reliability of the projections in Ridgemont's TUC solely due to his view that Ridgemont's diligence was "pretty extensive" (Mahler Aff. Ex. 3 [Zyla Tr. 94:20-21]). All of those assumptions explain the critical caveat in Zyla's report that he does "not express an opinion or any other form of assurance on the forecasted data and related assumptions" (Mahler Aff. Ex. 1 at ¶ 19). That caveat swallows Zyla's DCF analysis. Garbage in; Garbage out.

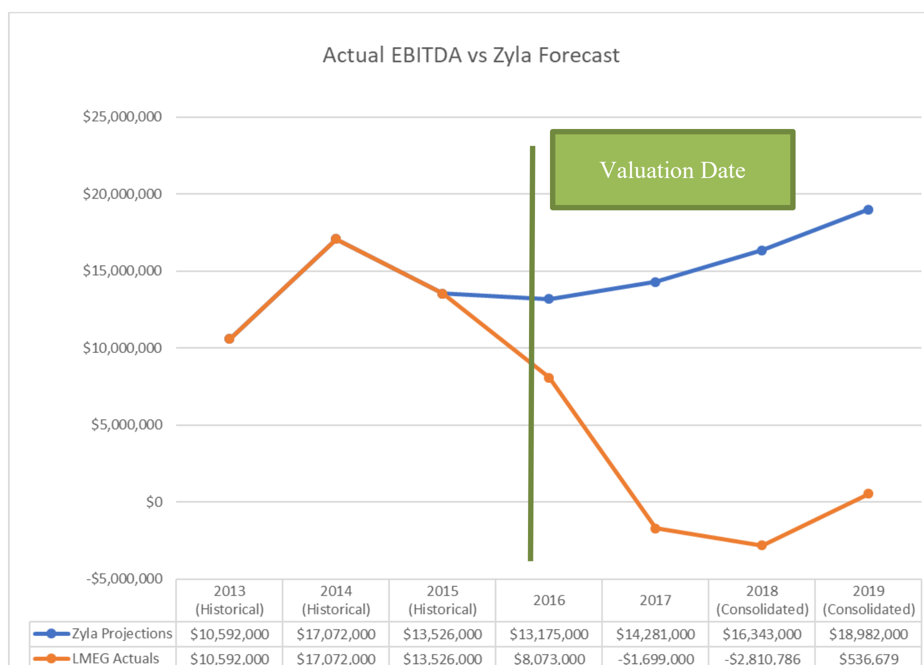
Most importantly, Courts have recognized that "**[b]ecause projections tend to be optimistic, their reasonableness must be tested by an objective standard anchored in the**

company's actual performance" (*Moody v Sec. Pac. Bus. Credit, Inc.*, 971 F2d 1056, 1073 [3d Cir 1992] [emphasis added]; *cited in In re Adelphia Communications Corp.*, 73 Collier Bankr Cas 2d 479 [SDNY Mar. 17, 2015], *aff'd sub nom. In re Adelphia Communications Corp.*, 652 Fed Appx 19 [2d Cir 2016]). Zyla's treatise acknowledges the same, stating that the PFI should be tested with "comparison of prior forecasts with actual results" (Mahler Aff. Ex. 2).

Despite that requirement, Zyla did not compare the projections he relied upon with LMEG's actual performance for the years 2016 - 2017:

> Q: I asked whether you compared the PFI in the Ridgemont TUC to the company's 2017 actuals.
>
> A: Not that I recall specifically compared to Ridgemont. We did that other analysis.

(Mahler Aff. Ex. 3 [Zyla Tr. 171:22-172:3]). That failure was deliberate: doing so exposes how wildly inflated the projections adopted by Zyla are (Mahler Aff. Ex. 1, 6):



	2013 (Historical)	2014 (Historical)	2015 (Historical)	2016	2017	2018 (Consolidated)	2019 (Consolidated)
Zyla Projections	$10,592,000	$17,072,000	$13,526,000	$13,175,000	$14,281,000	$16,343,000	$18,982,000
LMEG Actuals	$10,592,000	$17,072,000	$13,526,000	$8,073,000	-$1,699,000	-$2,810,786	$536,679

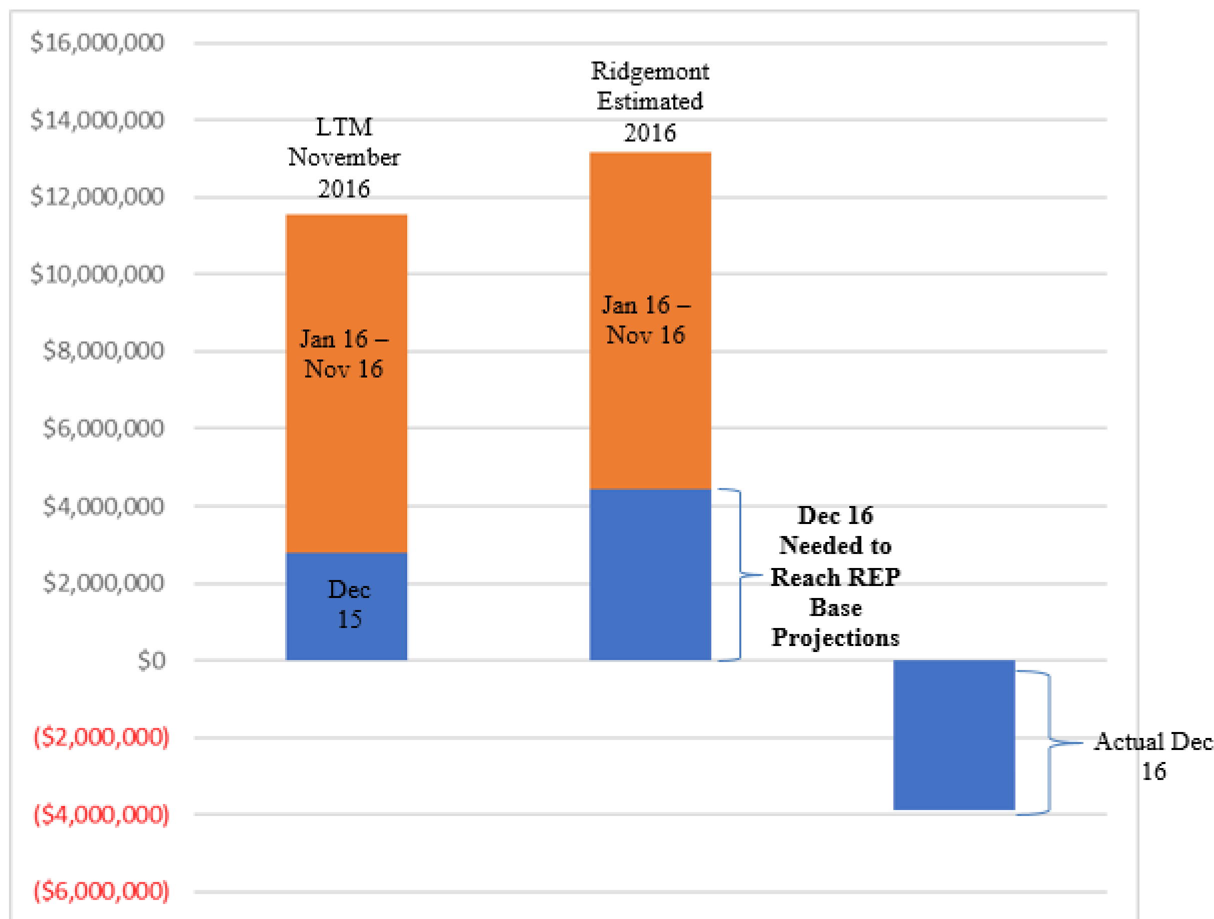
Even as of the Valuation Date—and most certainly based on the data at Zyla's fingertips—had Zyla tested the Ridgemont projections, he would have seen that the Company would never hit the pie-in-the-sky numbers he adopts. In 2016—the *first year of Zyla's projections, off of which all other years are based*—Zyla's projections predict $13.17 million in unburdened EBITDA; in reality, the Company's unburdened EBITDA was only 60% of that: $8.07 million.

That reality is evident from Zyla's own report. In a later analysis, Zyla recognizes that the Company is trending downward, citing:

- 2014 FY EBITDA of $14.501 million;
- 2015 FY EBITDA of $12.816 million; and
- last-twelve-months EBITDA as of 11/16/2016 of $11.544 million (after a $1.519 million addback)

(*see* Mahler Aff. Ex. 1). Zyla also is aware that a majority of the Company's sales occur during the November and December holiday season (Mahler Aff. Ex. 3 [Zyla Tr. 175:10-15]). Zyla's calculation of LTM EBITDA as of 11/16/2016 as $11.544 million means that in order to hit the $13.17 million year-end EBITDA projection that Zyla adopted from Ridgemont, LMEG would have needed to have an unprecedented and unreachable $4.475 million EBITDA from November 16, 2016 to December 31, 2016. With the downward trend of the Company, that was utterly impossible.

The below chart demonstrates the absurdity of Zyla's reliance on Ridgemont's projections. In order to hit the EBITDA projections (represented in the center column), LMEG needed to have a historic December 2016—much better than December 2015, despite the downward trend of the Company. In reality, LMEG lost money in December 2016.



And because all of the subsequent years are based on the 2016 projections, this fatal miscalculation compounds many times over, which accounts for the wildly inflated valuation that Zyla's DCF calculation reaches.

Any proper testing of Ridgemont's projections against the actual performance of the Company shows that the Ridgemont projections were grossly overstated to reach Farro's desired fair-value conclusion, and Zyla's failure to do that testing is fatal to his DCF analysis (*see Magarik v Kraus*, No. 606128/2015 [Sup Ct Nassau Co 2020] [rejecting the valuation calculation offered by petitioner's expert because they "were based on income projections that were unrealistic."]; *Shalor Designs, Inc. v NBA Props, Inc.*, 264 AD2d 686, 688–89 [1st Dept 1999] ["[P]laintiff's expert's inflated valuation of $1.9 million was speculative and unreliable. While his methods may

have been sound, *his starting data* was based on one financial projection by Shalor's CFO, who had previously predicted profits of $1.7 million for a year in which Shalor ended up losing $2.5 million"]).

Zyla should know better. In *Contr. Packaging, Inc. v Cent. Garden & Pet Co.*, a Federal Court for the Northern District of Georgia excluded Zyla's damages calculation based on his failure to evaluate the financial projections that he adopted into his calculations. Zyla attempted to justify his reliance on those projections in the same manner that he justifies his reliance on Ridgemont projections here: based on his armchair observations that the "projections contain a high level of detail and are supported by a large amount of underlying data" (*see* Mahler Aff. Ex. 7 [Zyla Decl. ¶ 8]). The Court rejected that attempt, holding:

> The starting point of Zyla's analysis was the assumption that the projections created by Gulfstream were accurate and attainable, and although an expert may rely on assumptions, he must premise his opinion on reliable assumptions. Instead, Zyla has merely accepted the Gulfstream projections as true based on the opinions of others and on Gulfstream's alleged marketing expertise without any independent examination.

(2011 WL 13162306, at *6 [ND Ga Mar. 31, 2011]). So too here. Zyla's failure to independently analyze the projections upon requires exclusion of his (*see also, e.g.*, *ZF Meritor LLC v Eaton Corp.*, 646 F Supp 2d 663, 667 [D Del 2009], *aff'd*, 696 F3d 254 [3d Cir 2012] [excluding testimony of expert who relied "on the 2000 estimates without knowing either the qualifications of those who actually prepared them or the validity of the underlying data and assumptions upon which the 2000 estimates were based"]).

In *Contract Packaging*, Zyla tried to whitewash his wholesale adoption of third-party projections with a declaration detailing all of the vague things he allegedly did to "test" the

projections relied upon (Mahler Aff. Ex. 7). He tries the same maneuver here. At his deposition, Zyla testified that before adopting the Ridgemont projections, he:

> Looked at historical performance of the company. I looked at historical growth in debt free cash flows and the growth in the prospective financial statements debt free cash flows and compared it to. I looked at industry information and growth rates that were expected in various industry sectors. I looked at some guideline companies, guideline transactions . . . So there was a number of things I tested for reasonableness.

(Mahler Aff. Ex. 3 [Zyla Tr. 167:21-168:10]). Of course, none of the items that Zyla vaguely testified that he "looked at" is expressed (even in the most general terms) in his report, nor are they isolated in his work file. Nor could Zyla explain the specifics of how his "looking" at any of the data he cites allowed him to conclude that the Ridgemont projections were reasonable. Zyla's reference to undocumented, unspecified "reasonableness testing" does not save his deeply flawed methodology—particularly where, as discussed at length above, the most obvious test (comparing the projections to the actuals) reveals that Ridgemont's projections were horrendously over-optimistic.

IV. Zyla's Blind Reliance on the Unreliable Ridgemont Projections Underscores and Explains His Inability to Certify His Report in Accordance with the Business Valuation Standards of the American Society of Appraisers and the Uniform Standards of Professional Appraisal Practice.

As an ASA Certified Appraiser, Zyla ***must*** prepare his reports in conformity with the Business Valuation Standards of the American Society of Appraisers (Mahler Aff. Ex. 8 [the "ASA Standards"]). The ASA Standards contain all approved valuation standards, and they incorporate and require compliance with the Universal Standards of Professional Appraisal Practice (Mahler Aff. Ex. 9 [the "USPAP"]).

Pursuant to ASA business valuation standard BVS-VIII, a valuation report *must* contain two certifications relevant here: First, a written appraisal report must contain a concise statement of assumptions and limiting conditions:

> A. Pertaining to bias. A report must contain a statement that the appraiser has no interest in the asset appraised, or other conflict that could cause a question as to the appraiser's independence or objectivity; or, if such an interest or conflict exists, it must be disclosed.
>
> **B. Pertaining to data used. Where appropriate, a report must indicate that an appraiser relied on data supplied by others, without further verification by the appraiser, as well as the sources that were relied on.**
>
> C. Pertaining to validity of the valuation. A report must contain a statement that a valuation is valid only for the valuation date indicated and for the purpose stated.

(Mahler Aff. Ex. 8 [emphasis added]). Second, a written appraisal report must contain a certification as required by Standard 10 of USPAP. (Mahler Aff. Ex. 9) Standard 10 of USPAP, in turn, requires that an appraiser certify that the report was prepared in compliance with USPAP. The comments to the USPAP Standards Rule 10-3 insist that "A signed certification is *an integral*

part of the appraisal report. An appraiser who signs any part of the appraisal report, including a letter of transmittal, must also sign this [Rule 10-3] certification."

Zyla's report does not comply with the ASA or USPAP's certification requirements. It does not include a concise statement of "assumptions and limiting conditions," nor does it contain a certification that the report was prepared in accordance with USPAP.

That failure is not a mere oversight. Zyla's report does not contain the required certifications because Zyla cannot make those certifications without fatally undermining his conclusions. Based on his wholesale adoption of the Ridgemont projections, the ASA *requires* Zyla to state in his report that he "relied on data supplied by others, without further verification by the appraiser, as well as the sources that were relied on." But that certification would expose Zyla's reliance, lock, stock, and barrel, on the Refreshed TUC. Likewise, Zyla does not certify that his report was prepared in compliance with USPAP because USPAP Standards, Rule 1-4 states that "an appraiser must . . . base projections of future . . . income potential and expenses on reasonably clear and appropriate evidence." Zyla's adoption of the Refreshed TUC, without even speaking with Ridgemont or understanding the inputs to those projections, violates this core tenet.

Zyla's failure to make the required certifications speaks volumes about the seriousness of the methodological flaws discussed in this memorandum and, ultimately, the unreliability of Zyla's DCF calculation. His failure to follow applicable appraisal requirements requires exclusion (*Cooper v Meritor, Inc.,* 16-CV-52, 2019 WL 545169, at *4 [ND Miss Feb 11, 2019] [material non-compliance with USPAP results in exclusion]; *see also In re Methyl Tertiary Butyl Ether (MTBE) Prod. Liab. Litig.*, 2008 WL 2324112, at *5 [SD NY June 5, 2008] [excluding expert's testimony in part because analysis failed to comply with USPAP]).

CONCLUSION

For the foregoing reasons, the Court should exclude the testimony of Mark L. Zyla concerning his DCF analysis.

Dated: October 27, 2023
New York, New York

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CERTIFICATION OF COUNSEL

The foregoing Memorandum of Law in Support of Petitioner's Motion in Limine to Exclude the Testimony of Mark L. Zyla Regarding his Discounted Cash Flow Valuation as prepared by computer using Microsoft Word. The total number of words in the document, excluding the caption, Table of Contents, Table of Authorities, and signature block is 6,641. This certification complies Rule 17 of the Commercial Division Rules.

s/ *Peter A. Mahler*
Peter A. Mahler

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