IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE No. FSD 32 of 2019 (NSJ)

IN THE MATTTER OF THE COMPANIES ACT (2018 REVISION)

AND IN THE MATTER OF IKANG HEALTHCARE GROUP, INC.

Appearances:	Ms Camilla Bingham KC, instructed by Mr Paul Madden and Ms Anya Allen of Harneys for the Petitioner
	Mr Barry Isaacs KC and Mr Simon Salzedo KC, instructed by Mr Andrew Jackson of Appleby and Mr Shaun Maloney and Ms Farrah Sbaiti of Ogier for the Dissenting Shareholders
Before:	The Hon. Justice Segal
Heard:	11 – 22 April 2022, closing 9 – 10 May 2022
Draft Judgment circulated:	23 May 2023
Judgment Delivered:	21 June 2023

TRIAL JUDGMENT

Introduction

1. This is my judgment following the trial of the petition presented by iKang Healthcare Group Inc (the ***Company***) pursuant to section 238 of the Companies Act (2018 Revision) (the ***Act***).

Background

2. The Company is a Cayman Islands exempted limited company which has carried on business at all material times as a provider of private preventative healthcare services in the People's Republic of China (I refer to both China and the PRC interchangeably).

3. The Company's share structure was dual class, consisting of Class A common shares (entitled to one vote per share) and Class C common shares (entitled to 15 votes per share). From 9 April 2014, the Company's American Depositary Shares (***ADS***), each representing one half of a Class A common share in the Company (so that two ADS represent one such share), were listed on the NASDAQ Global Select Market (***NASDAQ***). The ADS were evidenced by American depositary receipts (***ADRs***).

4. All the Class C shares were beneficially owned by the Company's founder, chairman and CEO, Mr Lee Ligang Zhang (***Mr Zhang***) such that his combined Class A and Class C shares carried 34% of the total voting power of the Company's outstanding ordinary shares.

5. In 2018 the Company was acquired by a group of investors (the ***Buyer Group***) which included Mr Zhang. Other members of the Buyer Group were Mr Boquan He (***Mr He***), the vice-chairman of the Company's board, and of its holding company; investment funds managed by Yunfeng Capital (***Yunfeng***); Taobao China Holding Ltd, an indirectly wholly-owned subsidiary of Alibaba Group Holding Ltd (***AGH***); and a Boyu Capital (***Boyu***) investment fund.

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6. The acquisition took place by means of a merger between the Company and IK Healthcare Investment Limited pursuant to Part XVI of the Act (the ***Merger***). The Merger was the means by which the Company was taken private, resulting in the holders of the publicly traded ADS being cashed out and the Company delisted.

7. The price agreed between the Company and the Buyer Group was US$41.20 per A share which was equivalent to US$20.60 per ADS (the ***Merger Price***).

8. The Merger was approved at an extraordinary general meeting on 20 August 2018 (the ***Valuation Date***).

9. Various shareholders considered that the Merger Price was below the fair value of their shares. They decided to exercise their rights under section 238 of the Act to dissent from the Merger and, absent agreement being reached with the Company as to the fair value of their shares, to seek the Court's determination of that fair value. The dissenting shareholders who have actively participated in these proceedings are Blackwell Partners LLC – Series A, Maso Capital Arbitrage Fund Limited, Maso Capital Investments Limited (***Maso***) and Star V Partners LLC (who were represented by Appleby (Cayman) Ltd) and Corbin Equity Fund, LP, Corbin Erisa Opportunity Fund, Ltd., Corbin Opportunity Fund, LP, FourWorld Event Opportunities, LP, FourWorld Special Opportunities Fund LLC, Lamma Fund, Lantau Fund and S2 Holdings (who were represented by Ogier) (together the ***Dissenting Shareholders***).

10. Following the failure to reach agreement, the Company presented a petition under section 238 on 26 February 2019 seeking the determination by the Court of the fair value of the Dissenting Shareholders' shares. The trial of the petition was held on 11-22 April 2022 with a further hearing for closing submissions on 9-10 May 2022.

11. The Company argued, based on the expert evidence of Mr Nicholas Good (***Mr Good***), a partner in KPMG LLP, that the fair value of the Dissenting Shareholders' shares on the Valuation Date was US$38.42 per share. This was a blended average of Mr Good's discounted cash flow valuation (***DCF***) of US$38.37 (weighted at 60%); Mr Good's guideline public company (***CoCo***) valuation of US$40.31 (weighted at 30%) and the Company's market trading price of US$33.04 per share (weighted at 10%). The Dissenting Shareholders, based on the expert evidence of Mr Neil Beaton, a Managing Director of Alvarez & Marsal (***Mr Beaton***), argued that the fair value of the Dissenting Shareholders' shares on the Valuation Date was US$64.43 per share. This was a blended average of Mr Beaton's DCF valuation of US$67.07 (weighted at 75%); Mr Beaton's

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CoCo valuation of US$63.54 (weighted at 15%) and Mr Beaton's guideline company transaction valuation (***CoTrans***) of US$45.93 (weighted at 10%).

12. The Dissenting Shareholders contend that the Merger Price, and the valuation at which Mr Good has subsequently arrived, significantly undervalue the Company to the benefit of the Buyer Group and the prejudice of the unaffiliated shareholders, including themselves. They submit that, for the reasons which Mr Beaton has given, the Court should adopt his approach on an issue-by-issue basis.

Summary of my decision

13. I have decided that (a) a 90% weighting should be attributed to a DCF valuation calculated based on the decisions I have made and methodologies I discuss below in relation to the five DCF valuation issues in dispute and that (b) a 10% weighting should be attributed to the CoCo valuation based on Mr Good's CoCo valuation but adjusted in the manner I discuss below (based on the four comparable companies identified and agreed upon by both experts but with the adjustments to the calculation of the multiples that I prescribe and consider to be required). I have decided that no weight should be given to Mr Beaton's CoTrans valuation or to Mr Good's market trading price valuation. I have also concluded that the Merger Price should not be used as a cross-check to determine the reasonableness or relative ranking of other valuation methodologies (for example to show that the fair value should be below the Merger Price). I shall invite the parties, with the assistance of their experts, to prepare and seek to agree the revised valuations and will deal with any disputes when considering consequential matters and the order to be made to give effect to this judgment.

The evidence and the witnesses

14. The Court received expert evidence from Mr Good and Mr Beaton. Expert reports dated 13 May 2021 were exchanged (I refer to Mr Good's first report as ***Good 1*** and Mr Beaton's first report as ***Beaton 1***) followed by supplemental expert reports dated 7 October 2021 (I refer to Mr Good's supplemental report as ***Good 2*** and Mr Beaton's supplemental report as ***Beaton 2***). The Experts also produced and agreed a joint memorandum dated 15 July 2021 (the ***JM***). Mr Beaton filed a further report dated 6 April 2022 in which he made corrections to Beaton 1 and Beaton 2 and his equity valuation (***Beaton CR***).

15. Following the directions order dated 29 June 2020, the parties gave disclosure, the Company responded to information requests from both experts and a management meeting took place on 29 January 2021 (attended *inter alia* by management and the experts) pursuant to [21] of the directions order. As is usual, the directions order provided for the Company to open a data room to which documents to be disclosed by the parties were to be uploaded. 86,616 documents were disclosed by the Company in its initial uploads and 5,495 documents were uploaded by the Dissenting Shareholders. A CMC was dispensed with in circumstances where the parties were able to agree outstanding directions for trial as embodied in a consent order dated 29 October 2021. However, as I discuss below, the Dissenting Shareholders criticised the Company for failing to produce the documents which J.P. Morgan Securities (Asia Pacific) Limited (***JPM***), the financial advisers to the special committee (the ***Special Committee***) of the Company's board (established to lead the negotiations relating to, to evaluate the options for and potential transactions to give effect to, and to make recommendations to the full board regarding, the take private offers received by the Company) which they say JPM must have generated during its engagement. The Dissenting Shareholders argued that the Company had failed to make proper arrangements with JPM to ensure the preservation of and access to JPM's working papers.

16. The Company also led evidence from Ms Yuting Dan (***Ms Dan***), the Company's former Group Associate Finance Director from August 2011 to October 2017 (she was subsequently retained by the Company as an external consultant to assist with the Merger from March to April 2018), and from Ms Rong Lu (***Ms Lu***), an independent director of the Company who chaired the Special Committee. Ms Lu filed a first affirmation originally dated 17 February 2022 (***Lu 1***) (she also filed a second affirmation dated 4 April 2022 in support of the Company's application that permission be given for Ms Lu to give her evidence remotely, which application was granted). Ms Dan filed a first affirmation which had been signed on 28 February 2022 (***Dan 1***).

17. Mr Good, Mr Beaton and Ms Lu were cross-examined. However, the Dissenting Shareholders elected not to challenge Ms Dan's evidence by cross examination.

18. The credibility and expertise of both expert witnesses was challenged.

19. The Company submitted that Mr Good was straight talking, solid and sensible and well appreciated his overriding duty to the Court. He was balanced in his presentation, highlighting points which favoured the Dissenting Shareholders where appropriate. He was quick to recognise where his conclusions entailed judgment calls rather than (or in conjunction with) doctrine (the estimation of an appropriate minority discount being an example of this) and where subjectivity was in play (the CAPEX figures being an example). At no stage did Mr Good seek to overplay

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his hand or exaggerate the strength of a given position. He was scrupulous in underscoring the shortcomings and limitations of the methodologies he deployed, where that was appropriate and had taken care where appropriate to alert the Court to counter-arguments to his own views. In testifying Mr Good had presented as an even-handed and straightforward professional witness who was intent on assisting the Court.

20. In contrast, the Company submitted that while Mr Beaton was plainly experienced in business valuations and an accomplished expert witness, his reports and testimony were altogether less compelling than Mr Good's. Despite (or perhaps as a consequence of) the involvement of a large team in the production of Mr Beaton's reports, a lack of care was discernible in his approach. He had been required to correct (see Beaton CR) significant elements of his work and simple errors littered his reports. Mr Beaton's account (see the transcript for day 5 at page 9) of which documents he had reviewed and which he had not was unsatisfactory and he had provided an equally unsatisfactory account of who had compiled his exhibits and on what basis. In his evidence at the trial, Mr Beaton had washed his hands of the whole process, claiming in cross-examination not to have been in charge of selecting what was presented (see the transcript for day 5 at page 100 and day 7 at page 195) and had given his team (and the lawyers) a free hand. It was regrettable, the Company said, that an important matter such as the choice of materials to be exhibited was delegated to others. Also troubling was Mr Beaton's evidence regarding the size premium document apparently extracted from an expert opinion submitted to this Court by FTI in another case (*Trina*). Mr Beaton had demonstrated an undue eagerness to advance the Dissenting Shareholders' cause and had been argumentative in cross-examination.

21. The Dissenting Shareholders rejected these criticisms of Mr Beaton and challenged Mr Good's expertise and evidence, as I describe when dealing the issues in dispute below.

22. The Company noted that Ms Lu was and is an independent director of the Company, a renowned venture capitalist and a trusted and experienced independent director. She had served as chairperson of the special committee in respect of four take-private transactions and was both financially astute and acutely aware of the duties owed to the shareholders of a company in the context of a change of control. Whilst resolute on issues such as the independence of the Special Committee and the quality of the work undertaken by JPM she did not have a perfect recall of the merger process which was unsurprising given that in excess of six years had passed since the privatisation process began, and in excess of three since the Merger was consummated. The Company noted that it had not been suggested to Ms Lu that she had acted otherwise than in good faith or that she had failed to do her best to achieve the highest price for shareholders against a difficult backdrop.

23. The Dissenting Shareholders argued that Ms Lu was an unsatisfactory witness who was partisan and evasive, who gave whatever evidence she believed would assist the Company's cause and did her best to avoid any questions which she appreciated to be difficult.

24. I discuss my views on the reliability of the evidence of each of the witnesses below in connection with each of the issues in dispute. At this point, I should just make some more general comments on the attacks made as to credibility and expertise of the experts.

25. In my view, the challenges to Mr Good's and Mr Beaton's expertise and credibility were overdone. I found both experts to be sufficiently and suitably experienced and qualified to give expert evidence on each of the issues they we asked to opine on although they exhibited different styles and modes of thought.

26. Mr Good is an accountant based in London who has specialised for the last 23 years in dispute advisory services, principally in calculating loss and business valuations in the context of a dispute. He has been instructed as an expert witness on these issues in cases in various jurisdictions and in international arbitrations. He has also worked on accountancy investigations, including those into fraud and corporate collapses. He has valued well over 100 businesses over the last 23 years in a range of industries, from small, owner-managed businesses, through to a global US$20 billion business. I found his evidence generally to be methodical and careful showing a good understanding of valuation methodologies and practice with a preference for following conventional methods. It is true, as I discuss further below, that he was not comfortable in adjudicating on many of the more arcane academic disputes in the literature that he cited and was questioned about. This did lead to weaknesses in some of his evidence which I have considered and taken into account where appropriate. Mr Good also found some of the cross-examination rather uncomfortable (and occasionally discombobulating). This did result in some hesitation, confusion, lack of clarity and changes of view. However, it seemed to me that Mr Good did, as the Company submitted, seek to be candid and acknowledge his limitations, and (with occasional exceptions) seek to grapple with difficult issues and questions so as to assist the Court. He was also on occasions driven to adopt some speculative and weakly supported analysis and once again I have considered and taken these into account where appropriate.

27. Mr Beaton is a certified public accountant based in Seattle, Washington USA. He also has qualifications as an appraiser and financial analyst. He has extensive experience in business valuation and acting as an expert witness, particularly in proceedings in the US. He is articulate and quick thinking and was clearly fully familiar with the underlying valuation methodologies,

valuation practice and debates within the valuation profession that arose in this case and were aired during his cross-examination. His fluency and experience in the expert witness box on occasions made some of his responses just a little cute and clever, but generally I found him to be a reliable witness who sought to explain his position fully and clearly and to assist the Court. It is clear though that he had been forced to make a number of corrections to important elements of his evidence, which indicated that his preparation and work had not been as thorough on occasions as it should have been. Furthermore, he undertook a number of studies and analyses which appeared to me to involve a material degree of subjectivity and speculation, which I found to raise reliability concerns, and I have considered and taken these into account where appropriate.

28. Both experts were accused on occasions of crossing the line into the territory of arguing for the party who had instructed them. This seems to me to be a problem with much expert evidence where it is clear that the opinion of the experts pointedly favours the party who appointed them. But it is in part a problem with the system we have adopted and while in my view experts in section 238 cases need to be vigilant and avoid crossing the line, neither expert did so in this case.

29. Ms Lu is clearly a very experienced and impressive corporate officer. She was energetic in her defence of the work of the Special Committee. She clearly considered that she and the Special Committee had done all they could in a difficult situation to secure the best available deal and that the Special Committee had acted properly and behaved reasonably. On occasions, her defence was a little too zealous and she was driven into taking some unrealistic positions, in particular in relation to Mr Zhang's likely willingness to cede control of the Company and to accede to pressure to accept a price and transaction that was not of his making or design, or otherwise what he wanted. This undermined her credibility in some respects and weakened the reliability of some of her evidence. She also failed to appreciate the significance of the JPM conflict issue. However, I reject the Dissenting Shareholders' assertion that Ms Lu was in all respects an unsatisfactory witness who was partisan and evasive.

The approach to determining fair value

30. There was no dispute as to the basic principles to be applied by the Court when assessing fair value under section 238 of the Act.

31. The meaning of fair value is now well-established. I set out the proper approach to its determination in *Re Trina Solar* at [91] (unreported. 23 Sep. 2020) (***Trina***) as follows:

> *"In ascertaining fair value, the Court must assess and determine a monetary amount which in the circumstances represents (its best estimate of) the worth, the true worth, of the dissenting shareholder's shares (true worth meaning the actual value to the shareholder of the financial benefits derived and available to him from his shares and by being a shareholder). The reference to fair requires… inter alia that the manner and method of that assessment and determination is fair to the dissenting shareholder by ensuring that all relevant facts and matters are considered and that the sum selected properly reflects the true monetary worth to the shareholder of what he has lost, undistorted by the limitations and flaws of particular valuation methodologies and fairly balancing, where appropriate, the competing, reasonably reliable alternative approaches to valuation relied on by the parties".*

32. As the Court of Appeal observed in *Re Shanda Games* [2018] 1 CILR 352 at [22] (***Shanda CICA***):

> *"…fair value is not necessarily the same as the merger price or the price at which the shares were trading before the market in them was affected by knowledge of the merger…"*

33. In *Re Qunar Cayman Islands Limited* [2019] 1 CILR 611 at [59]-[60] (***Qunar***), Parker J further explained that fair value *"…cannot only mean, or only be a proxy for, the market or traded price for the shares. The words used [in s.238] could have been "market or open market value" or "traded value" if that was what had been intended." "Fair value means something other than market price. It may mean more, the same, or less."*

34. The facts and matters relevant to determining fair value are therefore not only those which were available to market participants at the relevant time but as was said by Parker J in *Qunar* at [89] include everything needed to *"…give [the Court] a full picture of the commercial reality in which the Company was operating and would have continued to operate but for the merger*."

35. Where a company contends that the merger consideration is indicative of fair value sufficient evidence of "*market efficiency, fair play, low barriers to entry, outreach to all logical buyers and a well-designed sales process*" must be adduced (see *Trina* at [156]). Where relevant documentary or witness evidence is not available, the Company "*risks failing to satisfy the evidential burden" in respect of that aspect of its case on fair value*" (see *Trina* at [156]). Where a company contends that the market trading price is indicative of fair value, it needs to demonstrate both that there was no material non-public information and that the market for the relevant shares at the relevant time was semi-strong efficient (see *Trina* at [128]).

36. The Court will consider detailed expert valuation evidence in making its determination of fair value. In assessing such expert evidence, as I explained in *Re Shanda Games* at [84] (unrep. 25 April 2017) (***Shanda GC***) "*…the Court should approach the disputed issues on the basis that it*

is for [the Company] and the Dissenting Shareholders to establish, on the balance of probabilities, that the valuations their experts have presented on the issue in question are reasonable and reliable. If only one is reasonable and reliable then the Court should (absent some other reason for not doing so) follow and apply that approach. If both appear to be reasonable and reliable, the Court must decide which is to be preferred. If neither is reasonable and reliable, the Court must make its own determination. The Court, in a petition under section 238, is not able simply to treat fair value as not being established. It must make a determination of fair value and, if neither expert has presented a convincing (reasonable and reliable) opinion, the Court must form its own view."

37. There is no hierarchy with respect to the valuation approaches which may be applied to determine fair value. As I explained in *Trina* at [94] "*The selection of which valuation method to use – alone or in combination with others – is a fact sensitive issue so that in some cases it will be appropriate to give particular weight to market based indicia of value and use the DCF as a means of testing those other valuation methodologies*" and (at [103]) "*There are a number of recognised methods for attributing a monetary value to the particular rights and obligations which shareholders of particular companies possess and it is necessary in each case to consider, with the assistance of suitably qualified experts, which method is most suitable and appropriate*."

38. In many of the cases in this Court, Delaware authorities have been cited and relied on (on most albeit not all issues). They are often illuminating and helpful. But I have had a concern that the Delaware case law was being cited by counsel as if they were decisions of courts of this jurisdiction or of England and Wales without there being expert evidence from Delaware qualified attorneys. My issue is that, while on almost all issues, the Court does not need much, if any, assistance from Delaware qualified attorneys to understand and interpret the analysis and decisions in Delaware court opinions, the Court does, in my view, need to know that the Delaware case law that is being cited is up to date and not subject to qualification or contradiction in other cases which have not been cited. This Court needs to know that what is being presented as an authoritative, up-to-date and balanced statement of the applicable law in Delaware really is just that and it seems to me that an opinion from a Delaware attorney to that effect (it does not need to be lengthy but just refer to the cases which a party cites and relies on) is required. In this case, therefore, I gave pre-trial directions that if Delaware decisions were to be cited and relied on they must be supported by an expert opinion of Delaware counsel. However, while the Company wished to cite and rely extensively on the Delaware jurisprudence it had, unfortunately but for some unknown reason (perhaps an oversight in failing to remember that I made this direction), failed to obtain such an opinion and file the requisite expert evidence. When the Company at trial sought to make arguments based on the Delaware cases the Dissenting Shareholders objected on

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the basis that no expert evidence of Delaware law had been adduced as required and I upheld their objection.

The core issues in dispute

39. Both Mr Good and Mr Beaton adopted a weighted or blended approach and placed the greatest weight on their DCF valuations. They both then placed the next largest weight on their CoCo valuations. Mr Good then placed some reliance on the Company's market trading price (on which Mr Beaton placed no reliance). Mr Beaton however placed some reliance on his CoTrans valuation method (while Mr Good placed no reliance on this method). There is therefore a dispute as to the weighting to be given to the DCF valuation and the CoCo valuation and whether any weight is to be given to the market trading price or a CoTrans valuation, and if so, how much.

40. As regards the DCF valuation there are disagreements on five core features of the DCF valuation. These relate to (a) whether to apply a size premium; (b) the terminal period growth rate; (c) the terminal period growth model to be adopted; (d) foreign exchange and (e) the minority interest discount.

41. As regards the CoCo valuation method, both experts placed some weight on valuations based on multiples derived from the financial information of comparable companies and their market values. Mr Good ascribed a 30% weighting to his CoCo valuation and Mr Beaton ascribed 15% to his. Both experts agreed that four companies were properly comparable with the Company: China Resources Medical, Harmonicare, New Century Healthcare and Rici Healthcare. Mr Good, but not Mr Beaton, identified a further two comparable companies: Fleury SA and Guangdong Kanghua. Mr Beaton, but not Mr Good, identified a further three comparable companies: Aier Eye Hospital Group, Meinian, and Topchoice Medical Corp. The difference between the CoCo valuations was driven mainly by Mr Beaton's inclusion of mainland Chinese listed companies (which trade at significantly higher multiples) within his set of comparator companies. Mr Good considered that the valuation multiples of such companies were not relevant to the valuation of the Company since the Dissenting Shareholders' shares were not shares in such a company and they could not have required the Company to list its shares in mainland China in view of their minority holding.

42. Mr Beaton gave a 10% weighting to a valuation based upon comparable transactions in the shares of companies he considered to be sufficiently similar to the Company, while Mr Good gave no weight to this method. Mr Beaton searched for merger and acquisition transactions of companies with characteristics similar to the Company and identified twenty potential transactions. He then

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refined his list to five transactions (Fosham Chancheng Central Hospital, Guandong Zhongankang Logistics, Jiangsu Aoyang Health Industry, Ciming Health Checkup Group and Jiande Heyue Enterprises). He considered the acquisition of Ciming by Meinian in October 2017 as most indicative of the pricing that the Company would command in the open market. Mr Good, in contrast, considered that the difficulties in identifying suitable transactions which could provide a like-for like comparison for the valuation of the Dissenting Shareholders' shares were too great to allow a sufficiently reliable valuation to be done. Mr Good rejected the use of the acquisition of Ciming by Meinian as a comparator transaction because of the significant synergistic value which was probably available to Meinian in the transaction.

43. Mr Good gave a 10% weighting to a valuation (of $33.04 per share) based on an assessment of the Company's market trading price in the thirty days prior to 12 March 2018 (six months before the Valuation Date). He considered that, since there were various market indicators that suggested that the Company's ADS were trading in a liquid and efficient market before the Merger it was appropriate to place some weight on the Company's trading price. Mr Beaton however conducted an event study to assess the validity of using the Company's market trading price as an indicator of fair value and concluded from this that the market for the Company's shares (ADS) was inefficient because stock analysts effectively stopped covering the Company after the initial bid for the Company's shares was made in August 2015 and because the shares (ADS) were not reacting appropriately to a significant proportion of the twenty one statistically significant events that he identified.

44. Neither expert placed any weight on the Merger Price. However, Mr Good used the Merger Price as a cross-check. The Company submitted that, at a minimum, the Merger Price served as a useful cross-check when considering the fair value of the Company's shares. The Dissenting Shareholders countered that in truth Mr Good ultimately expressed no view on the Merger Price being indicative of fair value. They said that the cross-check that Mr Good had in mind was that his valuation was lower than Merger Price (that, he argued in his reports, was consistent with the expectation to be derived from the merger process) but in his oral evidence, after being taken through some of the factual evidence about the process, he conceded that he was not able to give any opinion as to whether the Merger Price could be expected to be above fair value (so that, the Dissenting Shareholders argued, he had conceded that the cross-check he previously had in mind was no longer tenable).

The ADS issued by the Company and the position of ADS holders

45. The voting and other rights (and treatment) of holders of ADS were summarised in the Company's SEC Filing Form 13E Transaction Statement and Proxy Statement dated 16 July 2018 (the ***Proxy Statement***) as follows (at pages iv and v) (underlining added):

> *"As the registered holder of the Shares represented by ADSs, JPMorgan Chase Bank, N.A., (the "ADS depositary") will endeavour to vote (or will endeavour to cause the vote of) the Shares it holds on deposit at the extraordinary general meeting in accordance with the voting instructions, the form of which is attached as Annex H to the accompanying proxy statement, timely received from holders of ADSs at the close of business in New York City on July 17, 2018, the ADS record date. … The ADS depositary has advised us that, pursuant to Section 12 of the American depositary receipt evidencing your ADSs, the form of which was attached to the deposit agreement, dated as of April 8, 2014, by and among the Company, the ADS depositary and all holders and beneficial owners from time to time of ADSs issued thereunder, as may be amended from time to time (the "Deposit Agreement"), it will not itself exercise any voting discretion in respect of any Shares represented by ADSs other than in accordance with signed voting instructions from the relevant ADS holder. Accordingly, Shares represented by ADSs, for which voting instructions fail to specify the manner in which the ADS depositary is to vote or no timely voting instructions are received by the ADS depositary, will not be voted…..*
>
> *Holders of ADSs will not be able to attend or vote directly at the extraordinary general meeting unless they cancel their ADSs and become registered in the Company's register of members as the holders of Shares prior to the close of business in the Cayman Islands on August 7, 2018, the Share record date. ADS holders who wish to cancel their ADSs need to make arrangements to deliver the ADSs to the ADS depositary for cancellation before 5:00 p.m. (New York City Time) on July 31, 2018 together with (a) delivery instructions for the corresponding Shares (name and address of the person who will be the registered holder of the Shares), (b) payment of the ADS cancellation fees ($0.05 per ADS to be cancelled pursuant to the terms of the Deposit Agreement), and any applicable taxes, and (c) a certification that the ADS holder either (i) held the ADSs as of the applicable ADS record date for the extraordinary general meeting and has not given, and will not give, voting instructions to the ADS depositary as to the ADSs being cancelled, or has given voting instructions to the ADS depositary as to the ADSs being cancelled but undertakes not to vote the corresponding Shares at the extraordinary general meeting, or (ii) did not hold the ADSs as of the applicable ADS record date for the extraordinary general meeting and undertakes not to vote the corresponding Shares at the extraordinary general meeting. If you hold your ADSs in a brokerage, bank or nominee account, please contact your broker, bank or nominee to find out what actions you need to take to instruct the broker, bank or nominee to cancel the ADSs on your behalf. Upon cancellation of the ADSs, the ADS depositary will arrange for JPMorgan Chase Bank, N.A., Hong Kong Branch, the custodian holding the Shares, to return the Shares to the Company's share registrar to transfer registration of the Shares to the former ADS holder (or a person designated by the former ADS holder). If after the registration of Shares in your name you wish to receive a certificate evidencing the Shares registered in your name, you will need to request the Company's Cayman registrar of the Shares to issue and mail a certificate to your attention. If the merger is not completed, the Company would continue to be a public company in the U.S. and the ADSs would continue to be listed on the Nasdaq Global Select Market. The Company's Shares are not listed and cannot be traded on any stock exchange other than the Nasdaq Global Select Market, and in such case only in the form of ADSs. As a result, if you have cancelled your ADSs to attend the extraordinary general meeting and the*

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merger is not completed and you wish to be able to sell your Shares on a stock exchange, you would need to deposit your Shares into the Company's ADS program for the issuance of the corresponding number of ADSs, subject to the terms and conditions of applicable law and the Deposit Agreement, including, among other things, payment of relevant fees of the ADS depositary for the issuance of ADSs ($0.05 per ADS issued) and any applicable stock transfer taxes (if any) and related charges pursuant to the Deposit Agreement.

Completing the proxy card in accordance with the instructions set forth on the proxy card will not deprive you of your right to attend the extraordinary general meeting and vote your Shares in person. Please note, however, that if your Shares are held of record by a broker, bank or other nominee and you wish to vote at the extraordinary general meeting in person, you must obtain from the registered holder a proxy issued in your name.

Shareholders who dissent from the merger will have the right to receive payment of the fair value of their Shares in accordance with Section 238 of the Cayman Islands Companies Law if the merger is completed, but only if they deliver to the Company, before the vote to authorize and approve the merger is taken at the extraordinary general meeting, a written objection to the merger and subsequently comply with all procedures and requirements of Section 238 of the Cayman Islands Companies Law for the exercise of dissenter rights, a copy of which is attached as Annex D to the accompanying proxy statement. The fair value of your Shares as determined under the Cayman Islands Companies Law could be more than, the same as, or less than the merger consideration you would receive pursuant to the merger agreement if you do not exercise dissenter rights with respect to your Shares.

ADS HOLDERS WILL NOT HAVE THE RIGHT TO EXERCISE DISSENTER RIGHTS AND RECEIVE PAYMENT OF THE FAIR VALUE OF THE SHARES UNDERLYING THEIR ADSs. THE ADS DEPOSITARY WILL NOT EXERCISE OR ATTEMPT TO EXERCISE ANY DISSENTER RIGHTS WITH RESPECT TO ANY OF THE SHARES THAT IT HOLDS, EVEN IF AN ADS HOLDER REQUESTS THE ADS DEPOSITARY TO DO SO. ADS HOLDERS WISHING TO EXERCISE DISSENTER RIGHTS MUST, BEFORE 5:00 P.M. (NEW YORK CITY TIME) ON JULY 31, 2018, SURRENDER THEIR ADSs TO THE ADS DEPOSITARY FOR CONVERSION INTO SHARES, PAY THE ADS DEPOSITARY'S FEES REQUIRED FOR THE CANCELLATION OF THEIR ADSs, AND PROVIDE INSTRUCTIONS FOR THE REGISTRATION OF THE CORRESPONDING SHARES IN THE COMPANY'S REGISTER OF MEMBERS, AND CERTIFY THAT THEY HELD THE ADSs AS OF THE ADS RECORD DATE AND HAVE NOT GIVEN, AND WILL NOT GIVE, VOTING INSTRUCTIONS AS TO THEIR ADSs, AND BECOME REGISTERED HOLDERS OF SHARES BY THE CLOSE OF BUSINESS IN THE CAYMAN ISLANDS ON THE SHARE RECORD DATE. THEREAFTER, SUCH FORMER ADS HOLDERS MUST ALSO COMPLY WITH THE PROCEDURES AND REQUIREMENTS FOR EXERCISING DISSENTER RIGHTS WITH RESPECT TO THE SHARES UNDER SECTION 238 OF THE CAYMAN ISLANDS COMPANIES LAW."

The Company's business

46. The Company provides medical examination, disease screening and other medical and dental related services through a network of medical examination centres across China, primarily for corporate customers. The vast majority of its revenues (approximately 80% in FY17) are derived from its medical examination services. Almost all of the Company's revenues (97% in FY17) are

derived from the Company's self-owned medical centres. The Company historically had expanded its operations by increasing the number of its medical centres through the acquisition of existing, and the construction of new medical centres. As at 31 March 2018, the Company owned and operated 110 medical centres across 33 cities in China. Historically, most of the Company's medical centres had been in China's four major cities (***Tier 1 Cities***) but, by the end of FY17, its expansion had meant that approximately 55% of its centres were in other, lower tier, cities (***Lower Tier Cities***). However, the Company's revenue was still predominantly derived from its centres in Tier 1 Cities.

47. Ms Dan provided an overview of the Company's business in her evidence as follows:

> *"26 iKang is one of China's largest providers of private preventative healthcare solutions. It has an integrated network of self-owned medical centres and third-party facilities across China, providing, amongst other things, routine medical examination and disease screening, as well as many value-added services. The Company's client base comprises both corporate clients (seeking medical examination services for their employees) and individuals.*
>
> *27. One of iKang's strengths is its large corporate client base, which accounts for over 80% if its net revenue. A small increase in the number of corporate clients significantly increases the number of individuals using iKang's medical services.*
>
> *28. A large corporate client base is, however, a double-edged sword. Corporate customers have increased bargaining power and can demand volume-based discounts and more favourable payment terms – with the threat of moving to a competitor if those demands are not met, and iKang losing a significant amount of revenue as a result. iKang is also more financially exposed, with each corporate client presenting a far greater credit risk than that of an individual.*
>
> *29. iKang enjoyed revenue growth in the years leading up to the merger, although it was anticipated that this would slow with (amongst other things) the growth of competitors, and increasing difficulty attracting new corporate clients and maintaining those clients. Further, a phenomenon of having a revenue base as large as iKang's is that it is difficult to maintain the same growth rate year after year, as it involves attracting exponentially more clients over time. Relatedly, the larger a network gets, the greater the risk of disparity in the level of service offered to consumers, and exposure of the brand to bad press.*
>
> *30. One of the more recent developments prior to the Merger was iKang's off-balance sheet approach to growth. Beginning in 2017-2018, iKang developed limited partnerships to fund the build-out and acquisition of new medical centres, committing to providing investors in these limited partnerships a 15% return on their investment. The fund was managed through a trust, with an investment committee deciding what existing or new medical centres to invest in directly versus through the fund, and iKang would be obliged to buy any fund-financed centres at the end of a three-year incubation period, including a 15% return on investment for fund investors."*

The go-private transaction

48. The take private process (codenamed Project Jaguar) is said to have been among the longest ever take-private processes for a US listed Chinese company. The process started in August 2015 and ended on the Valuation Date (the Merger became effective on 18 January 2019). A detailed account of the background to the transaction and the rival bids appears in Lu 1 and at pages 28-64 inclusive of the Company's Form 13E Transaction Statement filed on 16 July 2018 (the ***Transaction Statement*** which was exhibited as exhibit (a)-1 to the Company's Proxy Statement.

49. The history of the take private process can be summarised as follows (I base this summary on Ms Lu's evidence).

50. On 31 August 2015, the Company received a non-binding proposal from Mr Zhang and certain of his affiliated entities, together with FV Investment Holdings (this consortium together, and as subsequently reconstituted, being ***Buyer Group 1***). Buyer Group 1 offered US$17.80 per ADS or US$35.60 per share. The offer price was at a 10.8% premium on the closing price of the Company's ADS on 28 August 2015, and a premium of 18% and 9.7% against the volume-weighted average closing price of the Company's ADS during the previous 7 and 30 days of trading.

51. On 9 September 2015, the Company's board formed the Special Committee to consider the Buyer Group 1 proposal. The Special Committee consisted of Ms Lu, who was appointed as chairperson, Mr Gavin Zhengdong Ni (***Mr Ni***) and Professor Daqing Qi (***Professor Qi***). At the board meeting convened to consider whether to appoint such a committee, the board was advised by a representative from its external US counsel, Davis Polk & Wardwell, that a going private transaction was a related party transaction, which presented conflicts, and therefore that it was advisable for the board to consider forming a special committee consisting of independent and disinterested directors to ensure that unaffiliated shareholders of the Company were adequately protected. The board resolution deciding to appoint the Special Committee recited that the Special Committee was being appointed "*to consider, review and evaluate the [Buyer Group 1 Proposal], to negotiate and structure a transaction (if appropriate) under [that proposal], or consider such other responses as the Special Committee deems to be in the best interests of the Company and its shareholders and make recommendations to the Board*."

52. The Special Committee retained Simpson Thatcher & Bartlett LLP (***STB***) as its independent international legal adviser, Walkers as its Cayman counsel and Jun He Law Offices (***Jun He***) as its PRC legal adviser. The Special Committee considered three investment banks, JPM, UBS and

Duff & Phelps to act as its independent financial adviser and after discussions (including interviews and various communications) with the three firms and a review of their expertise and competence, JPM was selected.

53. On 29 November 2015, the Company received a separate, non-binding, privatisation proposal from another buyer group which included Meinian – a competitor of the Company providing preventative healthcare services in China – Cathay Capital Private Equity SAS, Shenzhen Ping An Decheng Investment Co., Ltd, Taiping Guofa (Suzhou) Capital Management Co. Ltd, Sequoia China Investment Management LLP, and Huatai Ruilian Fund Management Co., Ltd (the consortium together, and as subsequently reconstituted, ***Buyer Group 2***). The proposed merger price for the Buyer Group 2 transaction was originally $22 per ADS.

54. Ms Lu said that on 30 November 2015 she attended a telephone meeting of the Special Committee, JPM and STB to discuss the Buyer Group 2 proposal. During this meeting there was a discussion of the feasibility of the Buyer Group 2 proposal given that Meinian was the Company's biggest competitor, so that Mr Zhang, who held a blocking stake of the Company's shares, was unlikely to support it. As Meinian was a major competitor, and the intentions of Buyer Group 2 were yet to be determined, the Special Committee also discussed the necessity and legal implications of adopting a poison pill mechanism (through a rights agreement) to address the risk that the Company could lose control of the going-private process to a potentially hostile buyer in Buyer Group 2. The Special Committee decided that such action was unwarranted at that time but that the option might need to be revisited depending on Buyer Group 2's willingness to enter into a non-disclosure agreement.

55. Subsequently, through its legal counsel, Buyer Group 2 indicated that, unlike Buyer Group 1, it would not agree to the Special Committee's proposed standstill and related provisions as part of a non-disclosure agreement (***NDA***). The Special Committee, Ms Lu said, could not help but view this as a sign of hostility, and as raising a suspicion as to the true intentions of Buyer Group 2. As a result, with a view to ensuring that the Special Committee retained control of the go-private process, and to buy time for market checks to be conducted, on 2 December 2015 the Special Committee recommended and the Board resolved to adopt a poison pill rights agreement (the ***Rights Plan***), a draft of which the Special Committee had on 1 December 2015 requested be prepared by the Company's attorneys. The Company's press release on 2 December 2015 summarised the terms and effect of the Rights Plan as follows:

> *"Pursuant to the Rights Plan, until the earlier of (i) the Company's announcement that a person or group has acquired 10% or more of the Company's Class A Common Shares (an "Acquiring Person") or the date and time on which any Acquiring Person has*

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acquired more than 50% of the Company's Class A Common Shares (in either case, the "Flip-in Date") and (ii) the tenth business day, or such later date designated by the Board, after any person or group commences a tender or exchange offer that will result in such person or group owning 10% or more of the Company's Class A Common Shares, the Rights will be evidenced by the Common Share certificates, will automatically trade with the Common Shares and will not be exercisable. Thereafter, separate Rights certificates will be distributed and each Right will entitle its holder to purchase one Class A Common Share for an exercise price of $80.

Upon the occurrence of the Flip-in Date, each Right (other than Rights beneficially owned by any Acquiring Person or transferees thereof, which Rights become void) will entitle its holder to purchase, for the exercise price, a number of the Company's Class A Common Shares having a market value of twice the exercise price. Also, if after an Acquiring Person controls the Company's Board of Directors or is the owner of 50% or more of the Company's Class A Common Shares, the Company is involved in a merger or sells assets representing more than 50% of its assets, operating income or cash flow and, in the case of a merger, the Acquiring Person will receive different treatment than all other shareholders or the transaction is with the Acquiring Person, each Right will entitle its holder to purchase, for the exercise price, a number of shares of common shares of the Acquiring Person having a market value of twice the exercise price. If any person or group acquires between 10% and 50% of the Company's Class A Common Shares, the Board may, at its option, exchange one share of the Company's Class A Common Stock for each Right.

The record date to determine shareholders of the Company entitled to receive the Rights is December 13, 2015. The Rights Plan will expire no later than December 2, 2016, unless renewed by the Board.

The Rights may be redeemed exclusively by the Special Committee for $0.001 per Right prior to the Flip-in Date, and the Rights Plan may be amended by the Company (acting upon the recommendation or direction of the Special Committee)."

56. On 9 December 2015, at a meeting of the Special Committee JPM reported that Buyer Group 2 was still refusing to agree to customary standstill provisions and so the Special Committee decided to have direct discussions with Buyer Group 2. They did so but Buyer Group 2 refused to change its position.

57. However, on 14 December 2015, the Special Committee received a revised proposal letter from Buyer Group 2 which modified and clarified the Buyer Group 2 proposal, including increasing the offer price to US$23.50 per ADS or US$47 per share (the ***Second Buyer Group 2 Proposal***). While the Special Committee was dissatisfied with the lower offer price proposed by Buyer Group 1, it was equally concerned that Buyer Group 2 would not be able to propose a transaction structure reasonably capable of completion.

58. At the meeting of the Special Committee on 14 December 2015, consideration was given to, and JPM outlined the advantages and disadvantages of, conducting a pre-signing market check as a way of evaluating strategic alternatives available to the Company. Ms Lu said that by this time it

was apparent to the Special Committee that the history and relationship between Buyer Group 1 and Buyer Group 2 was so toxic and distrustful that the parties involved would probably never agree to work together. The Special Committee was therefore in favour of the proposed market check, and hoped that it would reveal a white knight buyer capable of matching Buyer Group 2 on pricing, but with greater certainty that a deal could be consummated. The Special Committee instructed JPM to prepare a list of potential buyers for consideration and instructed JPM and STB to continue to negotiate with the existing buyer groups (the ***First Market Check***).

59. JPM identified and contacted six potential buyers. The initial feedback was, Ms Lu said, negative, with parties contacted regarding a transaction as "*messy*" because of the parties' awareness that Mr Zhang and his affiliates were part of Buyer Group 1, and that Buyer Group 2 included the Company's biggest competitor. One of the potential buyers contacted, namely Alibaba Investment Limited (***AIL***), indicated that it had no interest in starting a competing bid to Mr Zhang, but would consider joining Mr Zhang's consortium. On 7 January 2016, JPM reported that AIL had joined Buyer Group 1. The remaining potential buyers contacted ultimately expressed no interest in pursuing a go-private or other strategic transaction involving the Company.

60. On 6 January 2016, the Company received a further revised proposal letter from Buyer Group 2 including an increased offer price of US$25.00 per ADS or US$50 per share, and proposing a two-step merger process (a tender offer directly to acquire shares to be followed by a back-end merger, depending on the percentage of the Company's voting power acquired in the tender offer) (***Third Buyer Group 2 Proposal***). The Third Buyer Group 2 Proposal identified additional members to be added to the Buyer Group 2 consortium.

61. In mid-December 2015, financial projections prepared by Ms Dan under the guidance of Luke Chen (the chief financial officer of the Company) and other members of the Company's management were provided to JPM for review. JPM organised due diligence calls with the Company's management and on 7 January 2016 they confirmed to the Special Committee that the Company had provided updated projections which responded to JPM's questions and indicated that they would be in a position to present to the Special Committee within two weeks.

62. At a meeting of the Special Committee on 25 January 2016 (also attended by JPM, STB and Mr Chen amongst others) Mr Chen reviewed the draft financial projections prepared by the Company's management, outlining in detail the key underlying assumptions, including the Company's acquisition plans and organic expansion, a summary of the outlook for the China healthcare market, and the interplay between the Company's various business segments. Mr Chen

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went on to discuss the differences between the Company's draft financial projections and third-party estimates. The Special Committee approved the financial projections and determined that JPM should use them as a basis of its valuation analysis of the Company.

63. At a meeting of the Special Committee on 2 February 2016, JPM reported that Buyer Group 1 had orally agreed to increase its offer to US$21.50 per ADS or US$43.00 per share and the Special Committee reviewed with STB the key issues affecting the Buyer Group 1 and Buyer Group 2 proposals. The Special Committee was concerned that Buyer Group l's latest offer was still significantly lower than Buyer Group 2's offer but continued to question the feasibility of Buyer Group 2 achieving 50 per cent of the votes of the Company’s shareholders through its proposed tender offer, or otherwise consummating a transaction. The Special Committee decided, Ms Lu said, that it should not rush the process and, in the interests of achieving the best deal possible for the Company and its shareholders, that it should give each buyer group sufficient time to maximise their proposed price and certainty of funds.

64. On 1 February 2016 Buyer Group 1 confirmed its increased offer of $21.50 per ADS. On 23 February 2016 Buyer Group 1 verbally agreed a further increase to US$24 per ADS.

65. Thereafter negotiations continued with both Buyer Group 1 and Buyer Group 2. On 20 May 2016 the Special Committee instructed JPM to send a process letter to each buyer group requiring them to submit a best and final offer by 10 June 2016.

66. At a meeting of the Special Committee on 4 June 2016, JPM provided an update on their discussions with certain key shareholders of the Company. GIC had said that it would support Buyer Group 1 if it matched or exceeded the price offered by Buyer Group 2, while Goldman Sachs had indicated that it would support Buyer Group 1 if its offer price came (at least) very close to that of Buyer Group 2. Mr He had indicated that he would make a decision based on price.

67. On 6 June 2016, shortly before a deadline of 10 June 2016, the Company received a non-binding proposal from Yunfeng and others (the ***Yunfeng Buyer Group***) offering US$20 to US$25 per ADS (the ***Yunfeng 2016 Offer***). The proposals from Buyer Group 1 and Buyer Group 2 were withdrawn in the days following the Yunfeng 2016 Offer. Then, on 10 June 2016 the Company received a binding proposal from China Life, a member of Buyer Group 1, which was made on behalf of a consortium of unidentified members offering US$20.50 per ADS (the ***China Life Offer***). However, Ms Lu explained that the absence of "*critical information necessary to complete a proper evaluation*" meant that it was impossible for the Special Committee

meaningfully to assess the China Life Offer. The China Life Offer expired without acceptance a few days later.

68. Thereafter, with only one offer remaining, there followed additional market checks by JPM in June 2016 (***the Second Market Check***). JPM contacted seven potential buyers, but the initial feedback was that business conditions had deteriorated so that no one was interested in being a competitor of the Yunfeng Buyer Group or committing their resources to launching a competing bid. On 10 August 2016, JPM reported to the Special Committee that none of the potential buyers contacted had ultimately showed any interest in submitting a proposal.

69. At a meeting of the Special Committee on 13 December 2016, conscious Ms Lu said that the Yunfeng Buyer Group had still not made a binding proposal, the Special Committee reviewed with JPM a potential list of buyers to be included in a further market check, to include foreign potential buyers from the United States, Europe and Southeast Asia. On 24 January 2017, JPM reported that a number of the prospective buyers contacted had indicated possible interest in potentially pursuing a transaction with the Company, with their further responses expected in the days that followed, but, on 24 February 2017 JPM reported that the majority of potential buyers contacted had declined to submit a proposal, with a small number still evaluating their options.

70. Throughout the summer of 2016, the Special Committee continued to engage with the Yunfeng Buyer Group, initially working to a deadline of the end of October 2016, to finalise the terms of the proposed transaction. On 12 October 2016 JPM reported that it had pressed the Yunfeng Buyer Group to provide an offer as soon as possible, to allow JPM to perform its valuation analysis and for the Special Committee then to carry out its evaluation. Discussions continued for many months without significant progress and by September 2017 the Yunfeng Buyer Group had completed its due diligence and was considering lowering its offer price to an unspecified amount on account of deteriorating business conditions.

71. On 28 February 2018, following a request to the Yunfeng Buyer Group from the Special Committee for a written and legally binding offer, a privatisation proposal was submitted by the Buyer Group proposing to acquire all of the outstanding shares and ADS of the Company for $20 per ADS or $40 per share (the ***Merger Proposal***).

72. On 21 March 2018, at a meeting of the Special Committee attended by Mr Chen, JPM, STB and others, Mr Chen outlined and explained the Company management's financial projections dated 20 March 2018 for the fiscal year ending 31 March 2018 up to the fiscal year ending 31 March 2027 (the ***Merger Projections***). Mr Chen explained the key assumptions underlying the

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management forecasts, including a projected annual growth rate of the private medical examination industry in the PRC of approximately 22% for the years 2017- 2021 and no material changes to the market affecting the Company's competitive position in 2016. Mr Chen also explained the basis for the forecasted slowing-down of annual net revenue growth thereafter, pointing to the expected increased size of the Company resulting from several years of high growth. The Special Committee authorised JPM to use and rely on the Merger Projections for the purpose of its financial analysis of the proposed transactions and approved the distribution of the Merger Projections to the Buyer Group to aid their due diligence investigation of the Company.

73. On 24 March 2018, the Buyer Group indicated that it would increase its offer to US$20.50 per ADS (US$41.00 per share), which it maintained was its best offer. At a meeting of the Special Committee that evening the Special Committee discussed whether US$20.50 per ADS was the best price available and considered strategic alternatives to the Buyer Group's proposal and the potential risks and benefits of consummating the Merger compared to the Company remaining a stand-alone entity, including the risks related to the Company's liquidity position and the challenges it would face executing its business plan if the Buyer Group's proposal was terminated. The Special Committee decided after much discussion, balancing the importance of maintaining the Buyer Group's proposal with the desire to achieve the best price for the Company and its shareholders, to push for a further price increase.

74. As a result there were further negotiations and the Buyer Group offered a further increase of US$0.10, to US$20.60 per ADS (US$41.20 per share) (which was the Merger Price). The Special Committee reported the outcome of the negotiations to JPM and STB at a meeting on 25 March 2018 at which the Special Committee considered the new offer and the fact that there was no competing offer. Ms Lu said that the Special Committee "*knew that the Company did not have the luxury of walking away unscathed at this point. If the deal fell through, the Company would immediately need to seek secondary financing at an extremely low price. The share price of the Company was being propped up by the potential merger: seeking equity finance against the backdrop of a failed merger would have been catastrophic for the shareholders, and the price was likely to be significantly lower than US$20.60 per ADS*." At the close of the meeting the Special Committee asked JPM to prepare its opinion on the fairness of the offer price for presentation the following morning.

75. On the morning of 26 March 2018, the Special Committee met again and received advice from Walkers concerning the directors' fiduciary duties under Cayman law in connection with their evaluation of the Buyer Group's proposal. JPM presented a document dated 26 March 2018 entitled "*Discussion Materials*" containing JPM's opinion on the fairness from a financial point

of view of the proposed merger consideration (the ***JPM Discussion Materials***) and discussed their financial analysis with respect to the consideration to be paid, reviewed the valuation methodologies employed and answered the Special Committee's extensive questions. JPM's conclusion was that the offer price was fair from a financial point of view to the Company's shareholders. At the end of the meeting all members of the Special Committee voted to approve resolutions recommending to the Company's board that the Buyer Group's offer be accepted.

76. The Company's board met later that day and resolved that the proposed transactions to give effect to and implement the Buyer Group's proposal were fair to, and in the best interests of, the Company and its shareholders; that it was advisable to enter into those transactions (and waive the rights granted by the Rights Plan); that the relevant transaction documents be executed and submitted to shareholders for approval with a recommendation from the board that they be approved; and that US$41.20 in cash per share (or US$20.60 per ADS) without interest represented the fair value of the shares.

77. On 26 March 2018, the Company entered into the Merger Agreement with IK Healthcare Investment Limited and its subsidiary company IK Healthcare Merger Limited. The Company was to merge into IK Healthcare Merger Limited. On 16 July 2018 the Company published the Proxy Statement. The Merger was approved at the EGM on 20 August 2018. 62.91% of the Company's outstanding shares (representing approximately 71.92% voting rights) were voted at the EGM, and 99.17% of these voting rights were voted in favour.

78. The shares beneficially owned by Mr Zhang and Mr He were rolled over in the transaction such that, after the Merger, the Company (now merged into IK Healthcare Merger Limited) was beneficially owned by Mr Zhang, Mr He and the sponsors, being Yunfeng Fund III L.P, Yunfeng Fund III Parallel Fund LP, Taobao China Holding Limited and Boyu. Together they owned the shares in IK Healthcare Holdings Limited, a company that owned the entire share capital in IK Healthcare Investment Limited, which in turn owned the share capital in IK Healthcare Merger Limited. The sponsors committed equity of approximately US$1.15 billion in exchange for 74.7% of the share capital of IK Healthcare Holdings Limited.

79. The Merger ultimately became effective on 18 January 2019, whereupon the Company ceased to be a publicly traded company.

The Company's market position at the Valuation Date

80. In Dan 1, Ms Dan gave an overview of the private preventive healthcare services market in China based on her personal knowledge and experience and industry reports prepared by Frost & Sullivan (the ***Frost & Sullivan Reports***). She exhibited copies of the 2015 and 2017 Frost & Sullivan Reports. She said that she had used the Frost & Sullivan Reports for reference, in particular in relation to population and market share data, in order to check the reasonableness of particular forecasts when she prepared the Merger Projections. Her overview was as follows:

> *"21 Over the last decade, the Chinese government has increasingly looked to the private sector to ease the pressure on public hospitals caused by China's large and ageing population, loosening restrictions on market access by, amongst other things, removing minimum investment thresholds and allowing 100% foreign ownership of hospitals and clinics to encourage private capital investment. As a result, the private medical sector in China has enjoyed a period of growth.*
>
> *22 At the same time, across the population there has been increasing awareness of general health and well-being, and corresponding interest in preventative healthcare as a compliment to medical treatment. When I was employed by iKang, the industry was growing and expected to continue to do so with the expansion of commercial insurance and supportive government policy.*
>
> *23 That said, the private medical industry faces multiple obstacles to growth. Bureaucratic red tape has not been removed completely, and even where governmental reforms have been enacted, there is often a time-lag in implementation by local governments. For example, the loosening of restrictions on doctors working in multiple locations requires, in practice, the issue of a multisite license, which can be prohibitively burdensome on doctors to obtain and maintain. This has led to a shortage of doctors licensed to practice in private health centres.*
>
> *24 Other issues include:*
>
> *(a) Difficulties in recruiting active healthcare personnel in public hospitals - since most experienced healthcare personnel are still employed in public hospitals, private clinics are under pressure to recruit active healthcare personnel, and doctors who retired from public hospitals are more likely to join private clinics in order to increase their income;*
>
> *(b) Public perception of private medical centres – In tier one cities, people are more open to using private doctors. However, in lower-tier cities, people still perceive public hospitals as better, notwithstanding their high prices and often sub-standard service. Furthermore, non-compliant behaviours of some practitioners in the industry has led to negative press and undermined public trust in the industry; and*
>
> *(c) Increasing price competition – There are no unified charging standards for medical examination centres and price competition continues to keep down prices primarily through discounting (despite growing demand and increases in undiscounted average selling price), which negatively impacts the level of service given to consumers."*

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Merger Projections

81. Ms Dan (in Dan 1) explained the process by which the Merger Projections were prepared (and her role in their preparation). She said as follows (at [39] and [40]):

> "*39. I based the Merger Projections and underlying model on historic data, the annual budget and the outlook for the business. For example:*
>
> *(a) the assumptions relating to top-line revenue figures were based on the historic performance of the Company and cross-referenced against Frost & Sullivan Reports, which contained data about the market and iKang's competitors; and*
>
> *(b) the assumptions surrounding the future acquisition of medical centres were based on historic acquisition data and general targets for growth. As discussed above, iKang used an off-balance sheet limited partnership fund (Fund) as an 'incubator' to help acquire or build new centres. The targets would be held in the Fund ordinarily for three years, after which iKang could be contractually obliged to formally acquire them, regardless of how they were performing. The Fund also had the option of selling the medical centres to a third-party, which presumably the Fund would do if the sale would generate a return greater than 15%.*
>
> *40. The Merger Projections were subject to multiple internal revisions driven by discussions with JPM by telephone and over email. JPM would highlight formula and typographical errors, seek clarification of and test assumptions that we made. For smaller matters, such as formula and typographical errors, JPM would contact me directly by telephone. For more substantive changes, such as those arising from amendments to assumptions, JPM would contact both Mr Chen and I. We would discuss in detail any change of assumption resulting from JPM's input before I revised and updated the model for Mr Chen's consideration. Revisions were always made internally, and not by JPM.*
>
> *41 In December 2015, the Merger Projections were provided to JPM in draft for review. I exhibit a copy of the draft Merger Projections at [YD-1/165-196]. During subsequent telephone discussions and rounds of correspondence with JPM, at the request of JPM we updated the draft projections to cover a longer period of time (10 years), reflect the most recent actual data, and to correct some minor errors."*

82. As can be seen, the Merger Projections were prepared before the FY17 results were available and, as such, included FY17 estimates.

83. They provided growth estimates for specific lines of business, including medical examinations, disease screening, dental services, and other services up to FY 2021. The aggregate revenue growth rates were 29.5 percent, 24.6 percent, 24.9 percent, and 22.1 percent for the periods FY 2018 to FY 2021, respectively. The Merger Projections however did not provide specific revenue growth estimates for the separate lines of business for the periods FY 2022 to FY 2026. Instead,

revenue growth estimates were provided without explanation or support as 15 percent in FY 2022, 10 percent in FY 2023, 8 percent in FY 2024, 6 percent in FY 2025, and 5 percent in FY 2026. EBIT margins were forecast by management to increase steadily from 11.7 percent in FY 2018 to 12.9 percent, or from $19.3 million to $249.8 million, by the end of the forecast period in FY 2027. The increase in the forecast EBIT margin was said to be the result of the efficiencies gained by the Company as it built and acquired more medical centres.

84. Mr Good and Mr Beaton both used and relied on the Merger Projections (as adjusted by Mr Good) for their DCF valuations. Mr Good's adjustments reflected the latest results between March 2018 and the Valuation Date and a small number of relatively minor adjustments as a result of his review of the Merger Projections. In Beaton 2, Mr Beaton adopted Mr Good's adjustments. As he said at [2.2]:

> *"I adopted Mr Good's adjustments to management's forecast, which included [the Company's] actual results through the Valuation Date, and made a small number of relatively minor adjustments to the Final Merger Projections. My adoption of Mr Good's adjustments to management's projections increased [the Company's] cash flow by approximately $0.54 per ADS ($1.09 per share)."*

Issues relating to the DCF - size premium

The experts' opinions and the parties' position

85. A size premium is an adjustment to a company's estimated cost of capital to reflect risks stemming from the size of the company, following the general theory (based on empirical research) that smaller companies tend to be riskier than larger ones. Mr Good applied a size premium of 1.58% to capture what he sees as the additional risks that need to be captured in the Company's cost of capital by reason of its size, ascertained by reference to its market capitalisation. Mr Good derived this figure from the Duff & Phelps CRSP Deciles Size Study (the ***Deciles Study***) and his assessment of the Company's market capitalisation of approximately US$1.23 billion. Mr Beaton did not apply and considered that there was no proper justification for applying a size premium. The standalone impact of Mr Good's inclusion of a size premium would be to reduce Mr Beaton's DCF valuation by $16.94 per share.

86. The Company argued that a size premium was justified in principle having regard to proper valuation methodology and practice and that a size premium, and the premium applied by Mr Good, were justified on the facts of this case. A size premium had been consistently applied in

cases in the Cayman Islands, with only rare exceptions, including to valuations of public companies with a market capitalisation well in excess of US$500 million.

87. The Dissenting Shareholders relied on a primary and secondary case. Their primary case was that it was inappropriate to apply a size premium in estimating the Company's cost of equity capital, having regard to the unique facts and evidence of the present case. They said that they did not submit that it was always (or even often) inappropriate to apply a size premium in estimating a company's cost of equity capital (although it seemed to me that their arguments, both written and oral, often appeared to amount to a full-frontal attack on the justification for a size premium ever being applied). The Dissenting Shareholders relied on nine propositions to make good their primary case. First, Mr Good had accepted that there was no empirical or historical evidence of the relationship between size and returns of ADRs which are equivalent to the Company's ADS. Secondly, the Deciles Study on which Mr Good had relied should not be applied to the Company's ADS. Thirdly, Mr Good's oral evidence was that he was an expert only as to the alleged regular use in practice of a size premium. Fourthly, it followed that there was no expert before the Court who sought to justify the size premium on historical or empirical grounds. Fifthly, these points had not been canvassed or addressed in any previous case. Sixthly, the evidence undermined rather than supported the existence of a market practice of applying a size premium which extended to the Company's ADS. Seventhly, Mr Beaton had agreed to a very substantial upward adjustment to the Company's beta, which would double-count risk if a size premium were also added. Eighthly, the Company's ADS were well-traded and liquid. Ninthly, the Company had the characteristics of high-quality companies as explained in the literature on which Mr Good relied, which resurrected a size premium for junk companies. The Dissenting Shareholders' secondary case was that if, contrary to their primary case, it was appropriate to apply a size premium in relation to the Company's ADS, the premium should be based on Mr Beaton's analysis of the one hundred and ninety three Chinese companies which traded on a US stock exchange, as these would provide a more appropriate basis for comparison than the companies on which the Deciles Study was based (because those Chinese companies were of a similar risk profile, since they were all Chinese companies which were traded on a US stock exchange). Mr Beaton's analysis placed the Company between his second and third size deciles for such Chinese companies, so that by applying the third decile from the Deciles Study, the size premium would be 0.87%.

Mr Good's evidence

88. In Good 1, Mr Good appeared to base his decision to apply a size premium on the fact that such a premium was regularly applied in practice. He said at [13.2.20], citing and quoting an article from July 2018 by Professor Damodaran, that the size premium is recognised as being an empirically observed correction to the CAPM whereby the CAPM formula is considered historically to have underestimated the cost of capital for small companies. Then at [13.2.21] he said that "*In my experience and that of my colleagues, the size premium is applied regularly in practice. Therefore, I consider it is appropriate to include a size premium in [the Company's] costs of equity and I include a size premium of 1.58% derived from the Duff & Phelps CRSP Deciles Size Premium*." He challenged Mr Beaton's reliance on various surveys on the basis that they involved small sample sizes and showed large fluctuations between studies.

89. By the time of Good 2, he had added references to Company specific factors that he considered justified the application of a size premium and gave a fuller explanation of his analysis and opinion. He summarised his position as follows ([2.2.1(ii)]):

> *"I include a conservative size premium of 1.58% in my calculation of [the Company's] WACC. Size premia are regularly included when calculating a company's cost of equity and, in my view, it is appropriate to apply it for [the Company], based on the size of the Company (based on market capitalisation) shortly before the announcement of the Merger Proposal, and due to various risk factors which are present for [the Company] which are typically associated with smaller companies (for example, the key person management risk arising from the reliance on Mr Zhang)."*

90. Mr Good identified seven factors which he said were referred to in the literature as some of the key risk factors associated with smaller companies (key person management risk; lack of a dividend history, difficulty raising financing; lack of product, industry and geographic diversity; higher sensitivity to economic movement; lack of economies of scale or cost disadvantages and share illiquidity).

91. He noted that Mr Beaton had referred to critics of the size premium including Professor Damodaran and Clifford Ang, said that he was aware that there was criticism of and academic debate over the use of size premia but that there were two sides to the debate. He concluded that despite the criticisms and challenges it was still appropriate to use a size premium (Good 2 at [5.2.9]):

> *"Despite the use of size premia being subject to some academic debate, Grabowski explains that size premia in the cost of equity are "widely used by valuation professionals". In my experience and that of my colleagues, size premia are applied regularly in practice."*

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92. He referred to literature which he said addressed many of the criticisms and supported the existence of the size effect and supported the application of a size premium, including an extract from *Cost of Capital: Applications and Examples* (3rd ed. but no date was given for the date of publication of this edition) by Mr Shannon Pratt and Mr Roger Grabowski; an October 2018 article by Mr Grabowski; the Duff & Phelps 2018 *Valuation Handbook* and Mr James Hitchner's *Financial Valuation, Applications and Models* (the date of the book was not provided). Mr Hitchner had set out his views on the debate as follows:

> *"There is continuing debate over which size premia should be used. Some analysts even have argued against including a size premia adjustment for smaller companies altogether. Recent studies have been used to advance both sides of this argument, but most analysts agree that some adjustment should be made to account for the fact that, over time, smaller entities in the public markets have demanded higher rates of returns, generally speaking, than their larger counterparts."*

93. Mr Good also claimed that recent academic research had concluded that the challenges to the continued existence of the size effect (and therefore the need for a size premium) based on an analysis of the empirical data that was said to show that the effect could no longer be detected were rebutted when the data was adjusted to control for the quality of stocks (by using for example measures of profitability, growth and pay out so as to control for the impact of stocks which are small as a result of being unprofitable, low growth, or otherwise junk stocks). He quoted the following passage from the article by Clifford Asness and others entitled *Size Matters if You Control Your Junk* in the Journal For Financial Economics for 2018 (the ***JFE Article***):

> *"The size premium has been accused of having a weak historical record, being meagre relative to other factors, varying significantly over time, weakening after its discovery, being concentrated among microcap stocks, residing predominantly in January, relying on price-based measures, and being weak internationally. We find, however, that these challenges disappear when controlling for the quality, or its inverse, junk, of a firm. A significant size premium emerges, which is stable through time, robust to specification, not concentrated in microcaps, more consistent across seasons, and evident for non-price-based measures of size, and these results hold in 30 different industries and 24 international equity markets."*

94. Mr Good then considered the manner in which the size premium should be calculated. He noted that a common approach was to use the Deciles Study produced by Duff & Phelps. Duff & Phelps also published an alternative size premium study – the Risk Premium Report – which could also be used. The Duff & Phelps size premia reflected the excess returns for small stocks over and above those predicted by CAPM, and were therefore beta adjusted. This meant that the premia had been adjusted for systematic risk factors, other than size. For the Deciles Study, the size premia were calculated for ten portfolios of NYSE and NASDAQ listed securities, ranked by market capitalisation. The Risk Premium Report was based on a slightly different universe of

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companies, and instead ranked the companies into twenty five portfolios using eight measures of size (market capitalisation, book value of equity, five-year average net income, market value of invested capital, total assets, five-year average EBITDA, sales, and number of employees).

95. Mr Good decided to use the Deciles Study and that the Company should be treated as coming within decile 7 which covered companies with a market capitalisation of between US$1,175,369 million and US$1,814,568 million and gave a size premium of 1.58%. He said (at Good 2 [5.2.16]) that he had adopted this approach "*considering (i) the risk factors that are present for [the Company]; and the (ii) the regular use of size premia in practice.*"

96. The following were the risk factors that Mr Good relied on:

   (a). the key person management risk – Mr Zhang was the founder, CEO and chairman of the board of directors of the Company. The Company's reliance on the continued service of key officers and employees, and Mr Zhang specifically, had been identified as a business risk in the Company's FY17 annual report.

   (b). the lack of dividend history. The Company had not paid any dividends to its common shareholders since its listing in 2014 and its dividend policy in the Company's FY17 annual report was that it did not plan to do so in the near future.

   (c). capital constraints. While Mr Beaton was of the view that the Company was able to access capital markets as needed, the Company had explained that it had experienced liquidity issues and difficulties in securing financing and maintaining existing credit lines (although this was, in part, because of uncertainties surrounding the potential privatisation transactions).

   (d). lack of product, industry and geographic diversity. The Company had a nationwide network of medical examination centres across China, and was diversifying its service offering, for example, with its dental services segment. However, medical examinations still made up approximately 80% of its revenues and the Company had no major expansion plans outside of China.

97. The Company submitted that Mr Good had adopted a balanced view, which properly reflected the disputes in the literature and had acknowledged that there were arguments both for and against use of a size premium, and that in light of the inconclusive nature of the debates in the literature he was justified in deciding to apply a size premium based on his understanding and the evidence

available to him of the practice generally adopted by valuers. Mr Good's view that the Company's operations were on a small scale was also well supported by the Company's credit rating agency reports.

Mr Beaton's evidence

98. Mr Beaton said that although he agreed that a size premium was often included within the cost of equity in order to reflect the perceived higher risks associated with smaller companies, and that a size premium was applied by some practitioners, it was critical that a specific company assessment (and not a generic application of the size premium) be made as to whether a size premium was justified. A company's cost of capital should reflect that company's risk vis-à-vis the market it operated in and the companies it competed against and a size premium should not be added solely on the basis of market capitalisation. In Mr Beaton's opinion, since the Company was at the material time a public company and there were publicly traded counterparts from which return information was available, it was unnecessary, and less reliable, to utilise a generic set of public company data (in the Deciles Study) to determine whether to apply and the quantum of any size premium for the Company.

99. Mr Beaton's assessment of the risk profile of the Company was that it was one of the top non-governmental healthcare check-up providers in China and therefore its WACC should be assessed based on its specific risk characteristics as a leading company in China, and not as a relatively small company compared to other companies trading on the NASDAQ. A stock's relative risk was often measured as its beta (relative to the overall market) and the evidence showed that firm size was not a reliable predictor of a company's risk measured by beta. The indiscriminate addition of a size premium without a concomitant analysis of the underlying company's risk profile could lead to over risking a company's cost of capital, since there may be no additional risk to be captured associated with or because of the company's size or it would be duplicative of other risk factors already captured by market influences. Furthermore, Mr Beaton said, if a public company's beta was adjusted based on the betas of its competitor peers, as Mr Good and he had both done, a further adjustment to its cost of capital would be duplicative of specific risks that had already been addressed.

100. Mr Beaton considered that there was no need to add an additional size premium to the Company's cost of capital because both Mr Good and he had already adjusted the Company's beta to reflect market returns exhibited by its peer group in China. Mr Good and Mr Beaton had increased the Company's actual five-year monthly beta of 0.05 and actual five-year weekly beta of 0.39 to 1.00. As such, increasing the Company's beta to 1.00 was a twenty times increase in risk based

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on monthly returns and a 2.6 times increase in risk based on weekly returns. In Mr Beaton's opinion to add a further 1.53% of risk to the Company's cost of equity as Mr Good had done double counted the Company's true risk profile in relation to the market since the Company's beta was well below the average beta of the largest companies in the Deciles Study.

101. Mr Beaton also considered that the small company risk factors did not apply to the Company, since it was one of the largest companies of its kind operating in China. To support his analysis, Mr Beaton assessed all Chinese companies that were listed on a US stock exchange as of August 2020 and identified one hundred and ninety three Chinese companies that traded on a US exchange, which he ranked by market capitalisation into ten deciles, similar to the Duff & Phelps protocol. He then compared Mr Good's and his own values for the Company in light of these decile rankings and found that both valuations of the Company put it between the second and third of Mr Beaton's deciles for Chinese companies trading on US exchanges. He concluded that:

> *"If Mr Good had utilized the 3rd decile of the Duff & Phelps data for his selection of the size premium instead of the 7th decile, the size premium would have been 0.87% instead of 1.58% and his valuation would have increased from $38.37 per share to $43.12 per share, a 12.4 percent increase."*

102. In cross-examination, Mr Beaton made it clear that he was focussing, for the purpose of his risk assessment and deciding whether a separate size premium needed to be added, on the Company's position within the markets in which it operated in China:

> [Day 7, page 108]
>
> *"Q. Now, at any rate, your main point appears to be that even if the size premium does exist, [the Company] doesn't exhibit the characteristics of being a small company; is that it?*
>
> *A. In China, that's correct."*
>
> [Day 7, page 114]
>
> *"... the point I'm making is, when you are looking at a size premium and you have a company that has a dominant position in the private healthcare market in China, one needs to look specifically at its position in the Chinese market, not in relation to very large companies of every flavour and size in the United States. That's the point I'm making."*

103. In Mr Beaton's opinion, while small privately held companies did carry elements of risk that may not be properly captured when measuring discount rates through calculating beta or other elements of the CAPM, the size of the Company (which he initially considered had a market

capitalisation in excess of US$2.0 billion but which he accepted in cross-examination was an error and that US$1.3 billion or 1.4 billion "*would be [a] more balanced*" estimate - see the transcript for day 7 at page 110) combined with its position as a publicly traded market leader within its industry as of the Valuation Date, meant that it lacked the requisite elements to support a theoretical size premium. These elements included illiquidity, capital constraints, and probability of failure. His analysis, he argued, demonstrated that the Company's shares exhibited substantial liquidity, that the Company was able to access capital markets as needed, and that the Company was not subject to the risk of failure by any objective measure.

104. Mr Beaton said that, while each case required a risk assessment to be made by reference to the relevant facts and the company's position, he would generally not consider it appropriate to apply a size premium to a company with a market capitalisation of above US$1 billion. Therefore, the adjustment he had made to his market capitalisation figure for the Company, reducing it to US$1.3 billion or US$1.4 billion, did not cause him to change his mind as to whether a size premium was needed. During his cross-examination, Mr Beaton was asked whether he applied a cut-off point for a company's market capitalisation, above which a size premium would not be applied. He set out his position in the following exchange with Ms Bingham KC (underlining added):

[Day 7 pages 30-33]

Q. *No, but -- what, typically, you apply a size premium beneath 500 million or -- is that your evidence?*

A. *No, the evidence is that that's what McKinsey states in their book. And the studies that KPMG did show that it's about AUD 50 million. My evidence is I look at every individual case. And if I make adjustments to the discount rate that incorporates a measure of size, then I don't use a size premium. If I don't have data for a lot of my private companies, I might use a size premium on a big company, because I don't have a measure of what that market is saying that that company is in comparison to the other companies I'm using.*

Q. *So there's no bright line, you say, of cut-off. So, for instance, you might, in some circumstances, apply a size premium to a company with a market cap over – over 2 billion correct?*

A. *There's -- there's a possibility that that would happen, yes.*

……

Q. *So you're not actually batting for a cut-off point of, say, half a million or 250 to 500, because we'd sort of understood from your report that you might be going in that direction. But, no, it's -- there's no rule, and you could apply a premium to a company with a market cap of more than 2 billion; correct?*

> A. I would say, yes, the empirical evidence is anything over a billion would not have it. That's the empirical evidence that I've provided.
>
> Q. Well, we'll have to come to that.
>
> A. I'm saying there could be a situation, I'm not saying there is. It could be 0.001% of all the valuations done in the world, where a $4 billion company might need something because of some circumstances."
>
> …….
>
> Q. I'm trying to establish whether you accept – and I think you do accept - that it could be appropriate to apply a size premium even to a company with a market cap in excess of 4 billion; yes or no?
>
> A. No, not on a rote basis. There has to be very specific circumstances where a size premium would apply."

105. At the end of his re-examination, I asked Mr Beaton what he meant by "*specific circumstances.*" My question and his response were as follows (underlining added):

> *"Q. My question is: can you help me with what you say the special circumstances would be?*
>
> *A. Certainly. So the prime - at that level, at that size, when I'm valuing a privately held company that does not have market-based indications of weighted average cost of capital or equity capital, I have to use either CAPM, the build-up, the M - CAPM; I could use an APT, the arbitrage pricing theory, a number of different tools in the toolbox to measure what that is. Going back to what Mr Grabowski stated in some of the items that we went over in my examination yesterday, the point is we need to find companies that are of a similar stature and nature. So if it's a privately held company and I don't have market indications that I do with [the Company], I might provide a size premium because I can't - I can't measure the risk that the market is saying for that very large privately held company, but that would be a circumstance - an instance where I might incorporate a size premium. It would be small, of course, but I would go through that process, determine how close was I at? I would look at the betas of the comparable companies that I had and then compare that to that privately held company. And, again, I'm not negating that - that the size premium could not be determined, but it would have to be something after a lot of research is done and a lot of analysis has been done."*

106. Mr Beaton challenged Mr Good's assertion that the size premium was applied regularly in practice. He relied on a 2018 study by KPMG (the ***KPMG Cost of Capital Study***) which he said (Beaton 2 at [2.18]) showed that of two hundred and seventy six companies located in Germany, Austria and Switzerland only 6.8% of respondents applied a size premium in 2017 and 8.3% in 2018. He also relied on a 2017 survey by KPMG Australia (the ***KPMG Australia Study***) of participants "*from a variety of core valuation organizations across Australia, including Australia's Big 4 accounting firms, prominent boutique firms, second-tier accounting firms and*

smaller practitioners" which he said showed that for all companies with an equity value of AU$51,000,000 or more the majority of respondents did not add a size premium at all. He said that it was important to note that for entities with an equity value of AU$501 million or more the median and mode size premiums were nil or close to nil and that since both he and Mr Good had determined that the Company's equity value was well in excess of the largest category shown in the KPMG Australia Study, the range of size premiums that would be applied by reference to that study would be nil to 0.5%, with a nil median and a nil mode. Mr Beaton also relied on the study (the ***CFO Study***) by Professor Graham and Mr. Harvey ("*The theory and practice of corporate finance: evidence from the field*" Journal of Financial Economics 60 (2001), 198-243) in which they surveyed three hundred and ninety two chief financial officers about the cost of capital, capital budgeting, and capital structure. The authors set out to determine how firms calculate the cost of equity capital. Mr Beaton commented that (at [2.22] of Beaton 1) as follows:

> *"The authors set out to determine how firms calculate the cost of equity capital. Over 73% of the respondents utilised CAPM ... without extra 'risk' factors, including size. When specifically asked if 'size' was used to adjust their discount rates, only 14.6% [applied] of the respondents responded affirmatively ..."*

However, during his cross-examination Mr Beaton accepted that it would have been preferable and more balanced to say that 34% of respondents applied a size premium.

107. He also considered that the view that a size premium was only applied to companies that were much smaller than the Company was supported by three studies published by McKinsey, Ron Alquist, et al. and Professor John R. Graham and Campbell R. Harvey. For example, in the McKinsey study (Tim Koller, Marc Goedhart, David Wessels, *Valuation: Measuring and Managing the Value of Companies*, (6th edition), John Wiley & Sons, Inc., 2015, page 84) (the ***McKinsey Study***) it was asserted that once companies reach a certain cut-off point, size was no longer relevant for the purpose of determining the cost of capital:

> *"However, there is no evidence that size matters once companies have reached a certain size. The cut-off point probably lies in the range of a market capitalization of $250 million to $500 million. Only below that range is there some indication of higher cost of capital, for example. Whether a company has a market capitalization of $1 billion, $5 billion, or more does not matter for its relative valuation in the market."*

108. Mr Beaton also considered that the Duff & Phelps data relied upon by Mr Good (the Duff & Phelps Cost of Capital Navigator for March 2018) was unreliable in estimating a size premium for the Company. This was for a number of reasons. First, the Risk Premium Report did not include ADS, non-operating holding companies, and financial services companies. Since the Company's traded shares were ADS the Duff & Phelps study did not address the size

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characteristics of companies like the Company that trade as ADS. Mr Beaton quoted from a chapter in Pratt and Grabowski's *Cost of Capital: Applications and Examples* (5th ed., 2014) (***Cost of Capital 5***) in which it was said that (adding Mr Beaton's emphasis):

> *"Financial services companies are excluded from the analysis of the Risk Premium Report because it is difficult to apply to companies in the financial sector (for instance, 'sales' at a commercial bank). Because of this, valuation professionals should not use the Report to estimate cost of equity capital for a financial services company. Financial services companies include those companies in finance, insurance, or real estate (i.e., companies with an SIC code that begins with 6). American depositary receipts (ADRs) and non-operating holding companies are also excluded from the analysis of the Risk Premium Report, and valuation professionals should not use the Report to estimate cost of equity capital for these company types.*

109. Second, the size premium estimates presented by Duff & Phelps were based on data measured over the period from 1926 to 2016. If the measurement period was limited to 1982 and onwards, the date after the original article from Dr Banz highlighting the size premium, the size premium for decile 10 companies compared to decile 1 companies on average was 0.33%, down from averages of 4.89% and 7.19% measured from 1963 to 2018 and 1926 to 2018 respectively. Mr Beaton, in addition to calculating the size premium between the smallest and largest deciles as done by Duff & Phelps, calculated the size premium between the 7th decile and the largest decile from 1926 through 2018 to ascertain if the size premium would be different using the Company's market capitalization. The result was that the size premium for companies in the 7th decile compared to companies in the largest decile was negative 1.21% when measured from 1983 to 2018. Furthermore, the size premiums for 7th decile companies measured from 1926 to 2018 and 1963 to 2018 were 43.5% and 59.8% lower than the size premiums for 10th decile companies measured over the same time periods. This analysis, Mr Beaton argued, indicated clearly that the size premium for a company like the Company disappeared, and even became negative, after 1982.

110. Mr Beaton noted that there were analyst reports published by eight different investment banking or advisory groups in relation to the Company in the period from May 2014 to June 2018. Of the eight investment banking or advisory groups involved, six provided estimates of the Company's cost of capital in varying degrees of detail but only three of them (including JPM in the JPM Discussion Materials) included specific detail for each input into the Company's cost of capital. None of the analysts from these three investment banks added a size premium. Mr Beaton argued that this was inconsistent with Mr Good's claim that a size premium was regularly applied in practice.

The Dissenting Shareholders' submissions on Mr Good's evidence

111. The Dissenting Shareholders argued that Mr Beaton's opinion was reasonable and was to be preferred to Mr Good's opinion. They challenged Mr Good's evidence in a number of respects.

112. First, they argued that Mr Good had relied on the JFE article as supporting the use of a size premium and as confirming the importance of making an adjustment to control for quality (junk) but, in fact, the JFE article, as Mr Good had accepted in cross examination, had confirmed the main criticisms of the size effect and Mr Good had based his calculation of the size premium on the Deciles Study which did not, and was not subject to a, control for quality/junk. Mr Good had initially said in cross examination that the Deciles Study was subject to such a control because it excluded companies with five year profitable trading histories but during his re-examination he said that in fact during his cross-examination he had had in mind the Risk Premium Report (but in fact there was no suggestion in the literature that the CRSP Deciles Size Study adjusted for quality or junk). The Risk Premium Report stated that the companies used to perform the analysis presented in it excluded companies with any of the following characteristics: lacking 5 years of publicly traded price history; sales below US$1m in any of the five previous fiscal years; a negative 5-year average EBITDA for the previous five fiscal years and not being listed on one of the major US exchanges. However, Mr Good was unable to redeem his opinion because his estimated size premium had not been derived from the Risk Premium Report, so that these exclusions had no relevance to his valuation. Furthermore, the exclusion of certain companies from the Risk Premium Report was not sufficient to constitute adjusting for quality or junk in the relevant sense, in the manner done in the JFE Article, which had added a quality factor to the regression of size on standard factors, so that the relationship which was the subject of the report included the addition of a quality or junk factor. The Risk Premium Report examined the relationship between returns and size *simpliciter*. It treated every company in the study as if it had the same quality or junkiness, without regard to any other quality or junk factors, from the smallest company to the largest.

113. Secondly, Mr Good's evidence was that the size premia in the Deciles Study gave no consideration to the characteristics of ADS, because ADS are not used in arriving at the size premium. Only the historic returns of companies with comparable characteristics as those of the subject company should be used as evidence of the likely expected returns for the subject company. Thus the historic returns of companies with comparable characteristics as those of the subject company should be used as evidence of the likely expected returns for the subject company. The paper adduced by Mr Good as NG-117 (the Duff and Phelps Cost of Capital Navigator under the heading CRSP Deciles Size Study) had explained the data sources and

methodology used and made it clear that companies with ADRs were excluded. Pratt and Grabowski then made it clear in Cost of Capital 5, when discussing the Risk Premium Report, that *"valuation professionals should not use the Report to estimate cost of equity capital for these company types."* For the same reason, the Deciles Study should not be used to estimate the cost of equity capital in relation to ADS. Since the Company had failed to challenge Mr Beaton on his evidence that the Duff & Phelps data relied upon by Mr Good was unreliable in estimating a size premium for the Company (since the Company had failed to address the size characteristics of companies such as the Company which trade as ADS) and having regard to Mr Good's evidence, there was no proper basis on which to reject Mr Beaton's evidence that the Deciles Study should not be used to estimate a size premium in relation to the Company.

114. The Dissenting Shareholders noted that the Company had sought to avoid this consequence by correctly arguing (as I explain below) that holders of ADS did not have the right to exercise dissenter rights and that, in order to dissent, holders of ADS had to surrender them for shares. However, the Dissenting Shareholders argued, it did not follow from this need to convert ADS into shares that, as the Company submitted *"the application or otherwise of the Duff & Phelps tables to ADR [was] a red herring."* Section 238 of the Act provided that a member of a company had the right to payment of fair value of their shares upon dissenting. Holders of ADS are not members of the Company. Therefore it was necessary for them to surrender the ADS for conversion into Class A shares in order to exercise dissenter rights. But this process of surrender and conversion had nothing to do with the proper method of valuing the Dissenting Shareholders rights, either in respect of ADS or, when issued upon the surrender of the ADS, the Class A shares.

115. Thirdly, the Dissenting Shareholders argued that Mr Good's answers during his cross-examination, in particular his acceptance that his expertise in this area was limited, substantially reduced the scope and weight of the evidence relied on by the Company in support of the application of a size premium. The following exchanges, *inter alia*, were relied on by the Dissenting Shareholders:

[Day 2 transcript page 19 to 22]

Q. "….Schwert (2003) suggests that the small firm anomaly disappeared shortly after the initial publication of the papers that discovered it and coincided with an explosion of small-cap-based funds and indices." Now, that suggestion is a reasonable one, isn't it?

A. These -- I've not read each of these papers. This paper suggests that it's a reasonable criticism, yes.

Q. I'm asking you if it's a reasonable criticism. Sorry, not a reasonable criticism, I'm asking you about the suggestion by Schwert -- I'll read it out again quotation read

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again]. So I'm asking you about that suggestion by Schwert and I'm putting it to you that that's a sensible suggestion. Do you agree with that?

A. *I don't have a view on that.*

Q. *Well, I'm asking you to express a view. I'm putting to you that it's sensible; do you agree or disagree?*

A. *I neither agree nor disagree.*

.....

Q. *"Gompers and Metrick ... argue that institutional investors' continued demand for large stocks in the 1980s ... increased the prices of large companies relative to small companies, which accounts for a large part of the size premium's disappearance over this period." Now, that's a sensible argument, isn't it?*

A. *These are -- these are some of the many arguments that exist in relation to size premium.*

Q. *Yes, I know they are, but that's not an answer to my question. My question is: that's a sensible argument, isn't it? So do you agree with that, or do you think it's not a sensible argument?*

A. *Again, I -- I can't say whether it's a sensible argument or not.*

Q. *Well, of course you can. You're an expert in the field, aren't you? It's your job to say whether these sorts of arguments are sensible or not. Can you not express a view on the arguments about the existence of the size premium and its disappearance? Do you not consider yourself competent to do that?*

A. *There is a mass of literature - as I set out in my report, there is a mass of literature that goes one way and the other way in relation to size premium. I am aware that that exists, but I'm also aware that practitioners apply and I apply a size premium on a regular basis, whatever the academic argument.*

……

Q. *The question is: is the argument that I've just referred to here a sensible one, yes or no?*

A. *And I'm saying I -- I have seen the argument before and I can't comment on whether it's sensible or not.*

Q. *And is that because you're not competent to express a view on whether this argument is sensible or not?*

A. *I'm not fully informed of all the literature in relation to this specific argument.*

Q. *Are you fully informed of the literature that's referred to in the reports before the court on this case?*

A. *The direct literature, yes. The indirect references, no.*

[Day 2 transcript page 23 line to line 20]

Q. In what sense, if any, are you an expert in relation to the size premium?

A. Its regular use in practice.

116. The Dissenting Shareholders submitted that in light of Mr Good's answers, the Company's evidence in support of the application of the size premium rested on the following assertions: (a) Mr Good used a size premium "*on a regular basis*" and (b) Mr Good had been told in unidentified conversations with unidentified colleagues that it is used "*regularly*" in practice. However, Mr Good's assertion that he regularly applied a size premium could not support its application in every case. Nor could his assertion that an unidentified number of his colleagues had said that a size premium was applied regularly in practice. Mr Good's reports included no details of the colleagues to whom he referred, nor details of the circumstances in which, or the characteristics of the companies to which, a size premium was said to be regularly applied.

117. The Dissenting Shareholders said that in order to consider the relevance of the alleged market practice, it was necessary to identify the scope of the practice. The existence of a market practice which extended to all companies was inconsistent with, and unsupported by, the evidence before the Court. Since the Company relied on the existence of a market practice which extended to the Company's ADRs, it was for the Company to adduce evidence in support of such practice. It has failed to do so and relied on bare assertion. The evidence which would support the existence of a market practice was typically survey evidence. Evidence which showed practitioners applying the alleged practice would also tend to be probative. Mr Good did not rely on evidence of either kind. Mr Beaton, in contrast, had adduced survey evidence and evidence of practitioners which undermined the existence of a universal practice of the kind for which the Company must contend in order to establish that a size premium should be applied in this case. Mr Good had ignored the market practice as reflected by the leading investment banks and financial institutions, whose valuations he relied on in support of his estimates of other elements of the Company's cost of equity capital. Had he not done so, he would have been forced to acknowledge that there was no reference to a size premium in any of the fourteen reports produced by such institutions (by JPM, UBS, Bank of America Merrill Lynch, Citi, Oppenheimer and MCM Partners in relation to the Company and by Morgan Stanley, Nomura, Credit Suisse, ICBC, Southwest Securities and China United Assets Appraisal Group in relation to the Company's competitors). Furthermore, general descriptions and adjectives used in textbooks and articles were of no probative value in evidencing a practice which applied to the Company, because they were consistent with a practice which did not apply to the Company.

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118. The Dissenting Shareholders also argued that Mr Good's evidence in relation to the liquidity of the market for the Company's shares undermined his use of a size premium. Liquidity militated against the addition of a size premium. Mr Good said he had no basis to dispute the findings in the research papers referred to in evidence. The JFE Article had concluded, as Mr Good accepted, that their results were consistent with the size premium being an illiquidity premium. Mr Good also agreed that he had no reason to dispute the view expressed in that article that the size factor was highly correlated to factors that attempted to capture liquidity more directly. Mr Good had accepted that the Company's ADRs were liquid and well-traded. The Company's trading volume in 2018 had been around the median of the one hundred largest companies listed on NASDAQ and the bid-ask spread was below the median and the average of those companies. Mr Beaton's evidence was that the substantial liquidity of the Company's shares was a factor which led him not to include a size premium and this evidence had not been challenged in Mr Beaton's cross-examination.

119. The Dissenting Shareholders noted that Mr Good had agreed with my summary of his evidence as follows:

> *".... you've decided to apply the size premium because of what you take to be market practice. And you've done that because you think market practice is a determinant of what buyers will ultimately pay in the market for shares, because they will receive advice from market participants; and market participants, on the basis of your view and understanding, apply a size premium."*

120. The Dissenting Shareholders submitted that reliance on what buyers will pay for the Company's ADRs did not justify the application of a size premium. What buyers will pay may depend on what they are advised by market participants; and what they are advised by market participants is likely to depend on the existence of any market practice. If as the Dissenting Shareholders submitted there was no market practice which extended to the Company's ADRs it was unlikely that a buyer would be advised to apply a size premium. Insofar as it was appropriate to consider whether market participants would apply a size premium to the Company's cost of equity capital, the Dissenting Shareholders submitted that they would not, for the various reasons which had already been rehearsed including that there was no market practice which extended to the Company's ADRs; the Deciles Study should not be used to estimate the Company's cost of equity; the application of a market practice was undermined by the survey evidence and by the valuations produced by the numerous banks and institutions who valued the Company and its competitors; the Company's market capitalisation was US$1.23 billion which was much greater than the cut-off justified by the research literature and adjusting beta was a way of allowing for risk which would otherwise be allowed for by applying a size premium and both Mr Good and Mr Beaton had already made a very substantial addition to the Company's beta.

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121. Mr Good had placed great reliance on the studies that argued that the size effect was established when controlled for quality. But, the Dissenting Shareholders argued, it was clear and Mr Good had been forced to accept during his cross examination that the Deciles Study did not control for quality in the relevant sense. This had been confirmed by Mr Grabowski in his 2018 article "*Size Effect Continues to be Relevant When Considering the Cost of Capital*" in which he had noted that "*The CRSP Decile Size Premia include all companies with no exclusion of speculative (e.g., start-up) or distressed companies whose market cap is small because of being speculative or distressed*." In addition, it was noted in the *Duff & Phelps Cost of Capital Navigator* that "*The CRSP Deciles do not exclude "high-financial-risk" companies from the portfolios used to create its size premia.*"

The Company's submissions on Mr Beaton's evidence

122. The Company submitted that the evidence had established that a number of authoritative commentators and academics confirmed that that size premium was applied regularly in practice and Mr Beaton had accepted this. During his cross examination (Day 7, pages 65) he had recognised that the use of a size premium was "*widespread*" and "*established practice at many appraisal firms, investment banks and companies.*" But Mr Beaton's cross examination had established that the core issue was not whether small cap companies were more exposed to some risks than large cap companies but rather as to how that excess risk should be addressed.

123. Despite this, Mr Beaton had relied on and given inappropriate weight to the KPMG Cost of Capital Study to suggest that few practitioners applied a size premium. Out of two hundred and seventy six participants in that study, some two hundred and sixteen were from Germany where the application of a size premium was not common. Mr Beaton had also misrepresented the results of the CFO Survey. The survey in fact showed that while only 14.6% of respondents applied a size premium to their discount rates, 6% applied it by adjusting cash flows and 13.43% used both methods, so a total of 34% of respondents applied a size premium in one form or another. In cross-examination, Mr Beaton admitted it would have been more balanced to include both the 14.6% and the 13.43% (totalling approximately 27%) as size premium users but he resisted the suggestion that he should have also given weight to the 6% contingent of cash-flow adjusters since neither he nor Mr Good had "*changed the cash flows*" (Day 7, page 78). But, the Company said, it was precisely because neither Mr Beaton nor Mr Good had accounted for the size effect in the cash flows, that a size premium in calculating the Company's WACC was warranted. Furthermore, the KPMG Australian Study related to just forty five Australian

practitioners and was arguably too niche to guide the Court (as Mr Beaton accepted in his cross examination). In any event, the Company said, it did not support the proposition that practitioners do not apply any size premium to companies with a market capitalization above $500 million. Rather, respondents indicated that for entities with an equity value of AU$501 million or more (equivalent to approximately US$366 million as of the Valuation Date), the median and mode size premiums were very modest. And some 82% of participants declared that their practice was "*always*" or "*often*" to apply a company specific risk premium. In addition, Mr Beaton admitted that he had not reviewed the surveys in previous years. The KPMG Valuation Practices Survey in 2015 showed that 34.5% of participants reported that they applied a small stock premium and that a 1.9% size premium was applied where the subject company had a market value between AU$1 billion and AU$2 billion.

124. The Company argued that the statements made by the rating agencies supported Mr Good's conclusion that the Company was of a size that justified the use of the size premium. Once it was recognised that small companies were associated with higher risks, and it was accepted that the Company itself had, in the words of those ratings agencies, a "*small scale*" (S&P Global, 14 February 2018), "*relatively small business scale*" (Fitch, 14 February 2018) and "*limited scale*" (Moodys), it was clear that a size premium was needed and justified.

125. The Company also argued that the McKinsey Study provided no support for the suggestion that a size premium should not be applied to companies with a market capitalisation in excess of US$500 million. The source for the McKinsey Study was an article by McNish and Palys, which Mr Beaton had not read or considered. That article only made the point that whether a company's market capitalisation was US$2.3 billion in decile 5, or triple that (US$6.3 billion) in decile 3, returns to shareholders would be just 1% apart, so that size "*has no meaningful effect on the cost of equity*" because the differences in the size premium discernible are small.

126. The Company argued that Mr Beaton had been wrong to rely on the various analyst reports, published by eight investment banking or advisory groups in relation to the Company, to support his view that a size premium should not be applied. Not all of the analyst reports presented cost of capital estimates, and those that did do so did not include sufficient detail regarding the calculation of the cost of capital to enable the Court to deduce with confidence whether a size premium was in play. During his cross examination, Mr Beaton had accepted Bank of America's 8% risk premium might or might not include a size premium. In Mr Beaton's words "*No one can know, because it doesn't give you any detail on that.*"

127. Further, the Company argued that in reaching his conclusion that even if the size effect existed, the Company was not small, so that a size premium was unwarranted, Mr Beaton had made a number of errors and misjudgments. In particular, he had mischaracterised the Company by overstating its market capitalisation (at least initially) and its market share and by underestimating the risks faced by the Company (he failed to give proper weight to the risk factors to which the Company was subject that justified its treatment as a small company for the purposes of applying a size premium).

128. I have already explained Mr Beaton's change of heart during his cross examination as to the calculation of the Company's market capitalisation. Furthermore, the Company said that Mr Beaton had relied on an incorrect figure for the Company's market share when deciding that it did not have the characteristics of a small company. He had assumed (as he confirmed during his cross examination – see day 7 at page 112) that the Company's overall market share for the whole market in which it operated was 31% (as set out in Beaton 1) but in fact that percentage only related to the Company's market share of China private health check-up market revenues in Tier 1 cities. The Company only had a 13.4% market share of the private health check-up market and just 2.4% of the overall China health check-up market. These errors and misjudgments meant that Mr Beaton's conclusion was unsound and should not be relied on by the Court.

129. The Company submitted that Mr Beaton had failed to take into account that the Company operated in the private (rather than the large public market) in China which was fragmented. The Frost & Sullivan analysis of the China health check-up market in the period 2012-2021 showed that in 2016 the public hospital sectors represented 81.9% of the total China health check-up market and therefore the private health check-up market made up only 18.1% and the Company had only a 2.4% market share of the overall China health check-up market (i.e. 18.1% x 13.4% = 2.4%). The evidence showed that the Company had had difficulties in raising finance. In early 2018, the Company had been suffering a cash crunch which had not been caused by the go private transaction (a large convertible debt issue was about to mature). The Company was subject to product and industry diversification risk since it was highly reliant on limited core supplies, such as doctors and nurses, and while it had diversified into dental services with some success, this was of only limited effect. The Company was also significantly dependent on a small number of large customers. Its revenue from its top ten corporate customers accounted for between 14 and 15 per cent of net revenues in the relevant period. The Company was also wholly at the mercy of regulatory changes if the Chinese Government introduced new licensing rules and regulations or new accreditation rules. And the Company was subject to a serious geographic concentration risk because, as I have noted, it was critically reliant on doctors and nurses and they could not readily be sourced from countries outside China where there were few Mandarin speakers. The Company

was also subject, as its public disclosures had made plain, to key person management risk in the form of Mr Zhang and others. The Company's US registration statement had said that the Company "*[depends] on the continued service of [its] management team and other key employees, and [its]business, financial condition and results of operations will suffer greatly if [its lost] their services*."

130. The Company submitted that Mr Beaton had been wrong to argue that because he and Mr Good had used a proxy beta based on comparable companies instead of the Company's beta, an adjustment to the WACC by way of adding a size premium would double count the Company's risks. The Duff & Phelps size premia were beta adjusted, so that they had been adjusted to remove the portion of excess returns attributable to beta, as Mr Beaton accepted during his cross examination. Therefore the size premium captured risk in excess of beta and the use of a beta (whether the Company's or a proxy beta) did not include the additional risk captured in the size premium.

131. The Company said that Mr Beaton's approach in arguing that the Deciles Study could and should not be applied to ADRs (and ADS) was "*purist*" and both inconsistent with the approach he had adopted in other court based valuations and unjustified since the results of the Deciles Study could be carried across to ADRs. Mr Beaton had used the Deciles Study to value private companies and had sought to persuade the Delaware Chancery Court in *Gesoff v IIC Industries Inc.* (18 May 2006) to use the Decile Study in valuing a company traded on Budapest Stock Exchange. In addition, the Company argued, as I understood the point, that it did not matter that the Deciles Study excluded data relating to companies who had issued ADS because the Dissenting Shareholders dissented and sought relief under section 238 as shareholders not holders of ADS. In her oral opening submissions, Ms Bingham QC had referred to the explanation in the Proxy Statement, which I have quoted above, of the rights of holders of ADS and to the need for them to surrender their ADS in order to be able to exercise rights as a dissenting shareholder under section 238 (which the Dissenting Shareholders have did). Accordingly, Ms Bingham QC submitted, "*such rights as [the Dissenting Shareholders] have under section 238 … are rights as members of the company entered on the register, and not as participants in the ADS programme. So the application or otherwise of the Duff & Phelps tables to ADS is, we say, a red herring*."

132. The Company argued that the Dissenting Shareholders' challenge to the use of a size premium based on the Deciles Study (because it did not control for quality) could easily be met by reliance on and use of the Risk Premium Report Study. It was clear that this report applied robust controls for quality, with the exclusion of high financial risk companies, companies lacking five years of publicly traded price history, or with negative earnings. If the Risk Premium Report Study was

used it would result in a much higher size premium being applied than the 1.58% proposed by Mr Good.

133. The Company also submitted that Mr Beaton's assessment of a suitable size premium by reference to the one hundred and ninety three companies that he identified was unreliable and flawed. Because the market capitalisation of the selected companies was notably lower than the market capitalisations within the Deciles Study for decile 2 onwards, Mr Beaton's conclusion that the Company fell within the second and third deciles was artificial. More fundamentally, the exercise was pointless since Duff & Phelps had not identified size premia for the grouping of companies that Mr Beaton identified. Most of these companies were listed on the Pink Open Market, which was for companies that do not qualify for listing on the New York Stock Exchange or the NASDAQ because of the size of their market capitalisation. It was the lowest and most speculative tier of the three marketplaces for the trading of OTC stocks. The Duff & Phelps data in the Deciles Size Study was not compiled using companies listed on the Pink Open Market. Mr Beaton had lined up the one hundred and ninety three companies in order of size and found that within that Chinese space, the Company was relatively large and would fall into either the second or third largest deciles. He then said that if the Duff & Phelps size premia were applied for those largest deciles, the size premium would in this case would be much smaller than the premium applied by Mr Good. But the Company was listed on the NASDAQ so that to ensure a proper comparison it should be lined up and compared with other NASDAQ stocks.

134. The Company argued that Mr Beaton had exhibited serious misconceptions as to the Company's size and market share which appeared to have led him to underestimate the risks faced by the Company. In Beaton 2 at [2.6], Mr Beaton had referred to the Company being a "*leading company in China*" but this was an unhelpful generalisation whose precise meaning was not specified. If, the Company said, Mr Beaton had meant that the Company was substantial relative to Chinese stocks as a whole, he was clearly wrong. China's big corporations were gigantic and alongside those stocks, the Company was plainly small. In any event, the Company submitted, it faced considerable risks of the sort traditionally associated with small companies. In cross-examination Mr Beaton had sought (a) to filibuster the question of whether the Company faced geographic concentration risk evading confronting the short point (which ought to have been uncontroversial) that the Company's ability to recruit doctors and nurses was limited to Mandarin-speakers – that was a facet of geographic risk and (b) to second-guess the Registration Statement insofar as it disclosed key person management risk and relied on an answer that he had received in the course of the management meeting but this answer responded to his question as to whether there were any shortages or key positions unfilled which raised a different issue from whether the Company faced key person management risk (which it plainly did, hence its inclusion

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in the Registration Statement). The Company submitted that in circumstances where the Dissenting Shareholders had not challenged Mr Good's evidence as to the risk factors identified in the literature on size premia as causing smaller companies to be subject to greater risk (Good 2 at 5.2.6]) and as to the risk factors applicable to the Company which justified the application of a size premium (Good 2 at [5.2.16]) the Court can (and should) proceed on the basis that a number of the risk factors associated with smaller companies were indeed present for the Company and all of them supported the inclusion of a size premium in calculating the Company's cost of equity.

135. The Company also argued that the fact that a large part of Beaton 2 used the same language as and was clearly based on the expert evidence filed on behalf of the dissenting shareholders in *Trina Solar*, which he had not openly and clearly acknowledged, undermined Mr Beaton's credibility as and cast real doubt on whether the Court could treat him as having given proper and independent expert evidence (it was to be inferred the Company said that Mr Beaton was giving evidence and using materials at the direction of the Dissenting Shareholders). In its written closing submissions the Company had set out side by side the relevant passages from Beaton 2 and the written evidence of Mr Edwards of FTI in *Trina Solar* and noted that Beaton 2 bore an "*uncanny resemblance*" to the FTI report. Mr Beaton's acceptance in response to a question put to him in cross examination by Ms Bingham QC that this was all happenstance was unconvincing and concerning. If, as Mr Beaton insisted, he was truly responsible for all of Beaton 2 and if as he insisted he never saw the FTI report (which had referred to the KPMG Australian Survey) and only found that Survey by conducting a through Google search, it was nothing short of extraordinary that the parallels that the Company had identified should exist.

Previous authority

136. The Company relied on the fact that the application of a size premium was upheld by the Grand Court in a number of previous cases, in particular in *Shanda Games* (both in my judgment - unreported, 25 April 2017 - and in the Court of Appeal, reported at [2018] 1 CILR 352), *Re Qunar* and *Trina*.

137. The Dissenting Shareholders noted that the appraisal decisions in this Court had not all gone the same way. No size premium was applied in *Nord Anglia Education Inc* (unreported, 17 March 2020) (***Nord Anglia***) and there was no suggestion that a size premium was applied in *Re Integra* [2016] 1 CILR 192 (***Integra***). However and crucially, each of the appraisal decisions in this Court was made on the basis of the evidence before the Court as it applied to each of the companies concerned. The Dissenting Shareholders relied on what I said in *Trina* at [300], namely that the

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conclusion in *Nord Anglia* that the case for a size premium had not been made out was based on the expert evidence adduced in that case. The Dissenting Shareholders submitted that the decision for this Court was whether the Company has made out its case that a size premium should be applied in relation to the Company's ADRs on the basis of the expert evidence which was adduced before this Court.

Discussion and decision

138. It seems to me that the core components of the Company's case can, fairly understood, be summarised as follows:

(a). there remains a sufficient and proper justification, when using the capital asset pricing model, for applying a size premium to adjust for the additional risk factors that are typically associated with smaller companies having regard to the empirical data on which the existence of a size effect was based.

(b). the challenges made by academic and other commentators to and criticism of the use of a size premium (though robust and serious) have not established that the use of a size premium is unjustifiable and without any proper foundation.

(c). it is necessary to consider the relevant company and make a judgment as to whether the relevant risk factors apply to it and, if they do, to what extent (in light of other elements of the CAPM as used by the relevant valuer) so as to decide whether the application of a size premium is justified.

(d). in this case there are a number of risk factors which affect and apply to the Company (see Mr Good's evidence in Good 2 at [5.2.16] where he listed the four risk factors he had relied on and the Company's oral closing submissions as recorded in the transcript for Day 9 at page 86 in which Ms Bingham QC referred to another three factors). They are (i) the existence of key-person management risk; (ii) a lack of dividend history; (iii) capital constraints because the Company found it difficult to access the capital markets as needed and raise financing; (iv) the Company's lack of product, industry and geographic diversification; (v) the Company's inability to expand into new markets; (vi) the Company's inability to control or influence regulatory and union activity; and (vii) a lack of economies of scale or cost disadvantages.

(e). these risk factors apply to a sufficient extent to require and to justify the application of a size premium.

(f). the quantum of the size premium can and is most appropriately calculated by reference to and by using the Deciles Study:

(i). it did not matter that (companies who have issued) ADS (evidenced by ADRs) are excluded from the Deciles Study. This was a matter of record but irrelevant. Ultimately what is being valued by the Court is the underlying shares (to which the ADS give rights) and not the ADS themselves (see the Company's Closing Submissions as recorded in the transcript for Day 9 at pages 77 and 79). The fact that the dissenting shareholders had initially held rights to shares by way of ADS had not prevented the Deciles Study being relied on in previous cases. On each occasion in the past when this Court had applied a size premium in a section 238 appraisal context, it had been dealing with ADS that had been swapped for shares for the purpose of dissenting and the Court had still proceeded to use and accept expert evidence based on and applying the Deciles Study. This was justifiable because in practice the premia suggested by the Deciles Study were regularly applied by valuers to companies not embraced by the study because the size effect was generally recognised and practitioners had no better means of estimating a premium. Ms Bingham QC had sufficiently challenged Mr Beaton during his cross-examination as to his approach on this issue to lay the ground for her submission in closing that the Deciles Study is regularly and justifiably applied outside of the context of public companies listed in New York.

(ii). the companies that are covered by the Deciles Study were appropriately and sufficiently comparable to the Company to justify using the Deciles Study. The Company's ADS were listed on NASDAQ and it made sense and was reasonable to line up the Company alongside other the NASDAQ stocks. Mr Beaton's approach, based on his own selection of comparable Chinese but US listed companies was a wholly artificial and unreliable exercise (based largely on the small and speculative companies listed on the Pink Open Market). The large and authoritative data collected and organised by Duff & Phelps for the purpose of the Deciles Study was more reliable.

(iii). the Deciles Study was reliable even if it did not adjust for quality (a quality adjusted size premium was not necessary) but even if a quality adjusted size premium was necessary or to be preferred, the size premia in the Risk Premium Report were

quality adjusted to a sufficient extent and showed that Mr Good's selection of his size premium was, as he had claimed in Good 2, conservative and reasonable.

(g). while none of the analysts and investment banks who had prepared relevant valuations of or reports on the Company had explicitly referred to applying a size premium, this did not mean that they had failed to account for the additional risk associated with the size effect. It was possible that they had applied a size premium without separately labelling it as such. Furthermore, the analysis of the rating agencies supported the Company's case that the valuation of the Company had to take into account and was affected by its small scale.

(h). Mr Good had sufficient expertise to support his expert evidence on this issue. He had not applied a size premium by rote, simply based on his own practice and that of other valuers of which he was aware. He had justified his use of a size premium by reference to the risk factors which factors were established as being relevant by the literature. His opinion was not dependent on establishing that the Deciles Study was adjusted for quality. The academic commentary had not established that the size effect was only discernible after such an adjustment had been made. In any event, even if the Deciles Study was not reliable for a failure to make such an adjustment, Mr Good's estimate of the Size Premium was supported by the Risk Premium Report Study. Furthermore, Mr Beaton had placed too much reliance on the KPMG studies which were based on a limited data set affected by local conditions from which generalisations as to the wider use and reliability of size premia could not properly be made.

139. The core components of the Dissenting Shareholders' case, when fairly understood, can in turn be summarised as follows:

(a). a company's cost of capital must properly reflect the relevant risks to which it was subject. The risk assessment should be based on the market in which the company operated and was best assessed by reference to the companies with whom it competed. Market capitalisation alone was an insufficient indicator of relevant risk.

(b). when properly assessed, the risks to which the Company was subject did not justify the application of a size premium in calculating the Company's cost of capital. The Company did not exhibit the characteristics of being a small company in China.

(c). the Company had a dominant position in the private healthcare market in China. It was one of the top non-governmental healthcare check-up providers in China. Its WACC should be

assessed based on its specific risk characteristics as a leading company in China and not as a relatively small company compared to other companies trading on the NASDA (to use Mr Beaton's phrase, a generic small company being traded on a foreign exchange). When assessing a size premium it was preferable to identify companies of similar size with similar risk profiles. In this case that meant looking at Chinese companies that are traded in the US. This is what Mr Beaton's analysis had done. His methodology was reasonable (only a small number of the companies included in his analysis were listed on the Pink Open Market). So was his conclusion that the Company could not be regarded as small by comparison with these other companies, which supported his opinion that no size premium should be applied.

(d). in addition, while there was empirical evidence that the simple size premium existed in relation to smaller stocks, this size premium was not applicable to the Company because the Company is larger than the cut-off supported by the empirical evidence.

(e). furthermore, Mr Good's evidence did not support the application of a size premium. Mr Good considered that he was applying a quality adjusted size premium to the Company but the size premium he used was not quality adjusted. It was therefore not applicable to the Company. In addition, Mr Good took his size premium from the Decile Study but the Decile Study was not applicable to ADRs (and ADS). So the size premium Mr Good applied was not applicable to the Company's ADS (or ADRs).

(f). the liquidity of the Company's ADRs was a strong factor supporting the conclusion that a size premium should not be applied. Mr Beaton's evidence on the relevance and impact of liquidity was not challenged in his cross-examination.

(g). applying a size premium would also result in double counting of risk. Mr Beaton was right to say that if a public company's beta was adjusted based on the betas of its competitive peers (as he and Mr Good had done) a further adjustment to its cost of capital is likely to be duplicative if specific risks have already been addressed.

(h). Mr Beaton's evidence was that he was not satisfied that the risk factors identified by Mr Good were material and sufficient to justify the application of a size premium. In his opinion, the main risk factors were illiquidity, capital constraints, and probability of failure. In his view, the Company's ADRs exhibited substantial liquidity, the Company was able to access capital markets as needed, and was not subject to the risk of failure by any objective measure. However, the Dissenting Shareholders chose not to challenge in

cross examination Mr Good's evidence that the Company exhibited the key risk factors that would justify an additional risk premium by reason of its size. They did not make this argument in their written or oral closing submissions.

(i). even if it was reasonable and appropriate to apply a size premium, rather than determine the Company's relative position (its decile number) as compared with other relevant companies based on the capitalisation figures used in the Deciles Study it was preferable to use the results from Mr Beaton's analysis of Chinese US listed companies which placed the Company between the second and third size deciles. By analogy with the third decile from the Deciles Study, the size premium would be 0.87%.

140. After having carefully considered all the evidence and submissions I am, on balance, persuaded (a) that Mr Good's opinion that a size premium should be applied is reasonable and to be preferred to Mr Beaton's opinion that no size premium is justifiable but (b) that Mr Good has failed to establish on the evidence that the Deciles Study can be relied on to quantify the proper size premium and that as a result Mr Beaton's evidence as to size premium is to be preferred. Therefore a size premium of 0.87% should be applied to the discount rate used in the DCF valuation in this case.

141. As regards the conclusion in (a) in the above paragraph, it seems to me that Mr Good had reasonable grounds, based on the professional and academic commentary and literature in evidence and his own experience of undertaking DCF valuations using the CAPM method, for including a size premium. In my view, that literature and evidence did not establish that it would be unreasonable and outside the boundaries of acceptable valuation methodology to apply a size premium in this case.

142. As Parker J had said in *Qunar*, the literature cited by the experts and reviewed in cross-examination and the parties' submissions, is not evidence. It is relevant to questions relating to the reasonableness of and the support for the expert evidence (the opinions of the experts on matters in dispute). It is not for this Court to form a view on which empirical study or theory is to be preferred. Rather the Court's role is to assess the evidence adduced in relation to the Company, to decide whether on each issue in dispute the expert evidence is reasonable and reliable and where the reasonable and reliable evidence of the experts is in conflict, which approach is ultimately to be preferred (or if none of the expert evidence is reasonable and reliable to form its own view as to what is reasonable and reliable). In this case, ultimately the detailed empirical studies and theoretical analyses demonstrated, as Mr Good had reasonably concluded, that there are within the professional valuation community continuing debates and disputes

regarding the use of a size premium but this Court is not, as I say, in a position to adjudicate on these controversies. The Court takes them into account when assessing what is a reasonable professional and expert opinion having regard to the views of the professional valuation community on controversial topics.

143. I accept that each case has to be considered on its own facts and that previous decisions of this Court on the application of size premia are only of limited assistance in this case having regard to the different facts applicable, expert evidence adduced and submissions made in those cases. But it is worthy of note that at least in some of those cases a full frontal attack on the justification for ever using a size premium had been made and failed so that, as the Dissenting Shareholders wisely accepted, the issue in this case is whether the justification for applying a size premium has been made out.

144. I prefer Mr Good's approach and evidence to that of Mr Beaton on the initial question of whether a size premium should be applied in this case. It seems to me that Mr Good's view that liquidity alone was not sufficient to make it inappropriate to apply a size premium was reasonable and to be preferred. All of the risk factors identified in the literature cited by Mr Good related to the size effect can be taken into account and liquidity was only one of them. Furthermore, as Mr Good noted in his cross-examination, there are respectable commentators who take the view that the size premium is a risk-based and not just an illiquidity premium. I found Mr Good's analysis of the risk factors as they applied to the Company in this case (often based on the Company's own concerns and data as expressed in the Registration Statement but supported by statements in analysts' reports highlighting the Company's small business scale and perceptions that it had limited scope for growth) to be reasonable and convincing. The Company's position on these issues was well rehearsed in Ms Bingham QC's cross-examination of Mr Beaton on day 7 (see the transcript for day 7, pages 116-126). In any event, the Dissenting Shareholders did not challenge Mr Good's evidence on this issue, which stands despite Mr Beaton's claim that what mattered was the Company's relative size compared to Chinese companies listed in the US (which in any event did not seem to me to outweigh the impact of the application of the risk factors by Mr Good in this case). I also am not persuaded that a size premium should not be applied because it will result in a double counting of risk. I have taken into account the fact that JPM (and the other investment banks referred to by Mr Beaton) did not refer to and may not have applied a size premium but I accept the Company's submissions that it has not been established that they failed to factor in a risk premium for size related risks.

145. It is true, as I have noted above when summarising Mr Good's evidence, that he did initially place a good deal of weight on what he regarded as the widespread practice among professional valuers

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of applying a size premium. But in Good 2 he made it clear that his decision to apply a size premium was heavily driven by an appreciation of the size-related factors that are understood to increase risk and of how the risk factors applied to the Company. He still relied on the practice which he himself had followed and observed in other valuers when preparing DCF valuations in various contexts including for parties who were intending to purchase a company but accepted that there was no universal practice that a size premium be applied and that applying one had to be justified having regard to the position of the Company in this case. The proposition I put to Mr Good at the end of his cross-examination (see [96] above), with which he agreed, was formulated in an attempt to clarify the relevant practice he had in mind. Mr Beaton's evidence regarding the KPMG surveys showed that in some markets and circumstances there was limited reliance on and use of size premia but, for the reasons given by the Company, these surveys were in my judgment of limited evidential value.

146. I reach the conclusion set out in (b) in paragraph 140 above reluctantly because, as I explain below, using Mr Beaton's size premium still involves substantial reliance on the Deciles Study and also because I consider that there is a strong argument for concluding that the fact that the vehicle for listing shares happens to be an ADS, which is merely a convenient method for establishing an indirect holding of an interest in shares, should not materially impact on the section 238 fair value determination whose purpose is to value the underlying shares (to which the Dissenting Shareholders were entitled by virtue of holding the listed ADS). But, as it seems to me, the Company relied merely on assertion in support of its case that the size premia derived from the Deciles Study could be applied by analogy to a company with listed ADS (or ADRs) and this is insufficient to support their case. Since the Dissenting Shareholders have succeeded in showing that the Company failed to make out its case on this issue, but have failed in making out their case that no size premium at all should be applied, it seems to me to be right, as I explain below, to use the size premium contended for by the Dissenting Shareholders in their secondary case.

147. The Deciles Study (and the Risk Premium Report) are data based analyses (using size premia that reflect the excess returns for small stocks over and above those predicted by CAPM, calculated for ten portfolios of the New York Stock Exchange and NASDAQ listed securities, ranked by market capitalisation while the Risk Premium Report includes a slightly different universe of companies and instead ranks the companies into 25 portfolios using eight measures of size being market capitalisation, book value of equity, five-year average net income, market value of invested capital, total assets, five-year average EBITDA, sales, and number of employees). Evidence and a proper justification is needed to show that the data relates to, and is a reliable reference point for a CAPM valuation of, the Company. It was established, and the

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Company accepted, that the Deciles Study excluded companies which had listed ADRs rather than shares. The evidence showed that authoritative commentary advised valuers not to use the Deciles Study when valuing companies which had only listed ADRs. While such advice need not necessarily preclude reliance on and reference being made to the Deciles Study if a proper justification could be and was provided by reference to suitable evidence, none was. The fact that reliance was placed on the Deciles Study (or the Risk Premium Report) despite the clear guidance not to do so needed a clear and convincing justification. Mr Good did not provide any analysis or evidence supporting his view (given during his cross examination) that it was justifiable to use the Deciles Study. Ms Bingham QC submitted during her closing submissions, as I have noted above, that the Deciles Study was regularly applied by valuers to companies not embraced by the study and that this was justifiable because practitioners had no better means of estimating a premium. But the Company's evidence did not deal with and establish that practice and in this case there is alternative evidence for estimating the size premium which in my view has to be preferred to an approach based on using the Deciles Study when no case has been made out to show a proper linkage and connection between the returns on ADS and shares. I do not consider that the fact that other cases in this Court have involved reliance on the Deciles Study to value shares that were derived from ADS (or ADRs) is of itself sufficient to justify the reliance on the Deciles Study in this case. Now that the justification for doing so has been put in issue, the Company needs to provide a proper basis, by reference to adequate evidence, on which use of the Deciles Study can be supported. In my view, the Company has failed to do so in this case.

148. I am satisfied that Mr Good was competent and had the requisite expertise to give and sustain an opinion on the size premium issue.

149. He was subjected to a rigorous and robust cross-examination by Mr Isaacs QC on the literature and the related empirical studies and technical analysis. Mr Isaacs QC took a deep dive into the literature in order to challenge Mr Good's evidence. Mr Good was obviously uncomfortable in engaging with some of the technical and theoretical aspects of the literature and the associated debates and he accepted that he was not an expert in relation to the academic theory on size premium. He ultimately felt unable and considered that it was unnecessary for him to form his own view on these debates. He relied on the still substantial body of literature and his own experience in practice to support his judgment that a size premium was appropriate in this case. In my view this was an acceptable and reasonable position to adopt (albeit that another valuer may have adopted a different approach, as Mr Beaton to some extent did). There is sufficient in the literature and commentary in evidence to justify and make reasonable the application of a size premium in a case where the risk factors identified in the literature can be shown to operate.

150. Mr Good's general approach when being asked questions regarding particular papers and studies which did not support his approach was to say that he could not engage directly with the theory or detail of the empirical analyses but that he relied on other papers and studies which did support his approach. There was some extensive discussion of the main arguments presented in some of the papers that Mr Good had cited in Good 2 and whether they supported or undermined his approach. Mr Good did explain how he had read these papers and demonstrated an understanding of the key issues. The JFE paper is an example in point. The Dissenting Shareholders argued that the central thesis of this paper was that the size premium could be resurrected by controlling for quality or junk. They referred to the sentence in which it was said that "*Controlling for quality or junk ... resurrects a strong size effects and helps distinguishing among the competing theories*." But Mr Good did not accept that this was the proper interpretation of the thrust of the paper or that if it was it should cause him to change his approach. As he noted in an answer to a question from Mr Isaacs QC (see the transcript for day 2 at page 17), in his view "*whatever the intention of the authors of that single sentence, the thrust of the article is to -- is to analyse, and in many cases rebut, the criticisms [of the use of a size premium]*."

151. The Dissenting Shareholders submitted that Mr Good had considered that he was applying a quality adjusted size premium to the Company but that in fact the size premium he had used was not quality adjusted so that his evidence should be rejected as unreliable. I do not accept that. The need for there to be a quality adjusted size premium and reliance on such an adjustment was not a central claim made by Mr Good in Good 2. Mr Good did make reference to the literature which argues that a size premium can (only) be justified where the data is controlled for quality, in particular the JFE paper, but he did not base his view that a size premium remained justifiable on that argument or substantially rely on that argument in the JFE paper in support of his approach. It was one of a number of articles which he understood to rebut some of the criticisms levelled at the use of size premia.

152. It is right to say that Mr Good's answers to Mr Isaacs QC's questions regarding whether the Deciles Study adjusted for quality were confused and on occasions wrong, as he admitted in re-examination. The following extract of exchanges with Mr Isaacs QC on day 2 is representative (see the transcript for day 2 at pages 48-50):

> "*Q.* *There is no statement in the Duff & Phelps' papers that says they control for quality or junk.*
>
> *A.* *Well, they don't -- they perhaps don't use those words "quality" or "junk", but they do control the companies that they put into the decile study.*
>
> ………

> *Q. Well, of course they control the companies they put in. That's not the point. The point is what companies are not in there. And what they're saying here is that they don't exclude speculative or distressed companies. Now –*
>
> *A. That seems -- that is what this says, yes.*
>
> *Q. And it can't be reconciled with what you said earlier, can it? That's the point you just made.*
>
> *A. I accept that.*
>
> *Q. So if this statement is true, what you said earlier is false; correct?*
>
> *A. I -- my understanding is still that they do control for five years of profitable trading history, but that doesn't seem to be what it's saying here. And if I have misunderstood and misled, then I apologise."*

153. In re-examination by Ms Bingham QC (see the transcript for day 4 at page 123-124) Mr Good had confirmed that he had been confused and had been thinking about and referring to the criteria for screening companies included in the Risk Premium Study and not the Deciles Study.

154. I accept that these answers did reveal a weakness in Mr Good's evidence in that he was not as on top of some of the materials he had referred to as he should have been. He should have been clear as to whether the Deciles Study controlled for quality. But his failure immediately and properly to recall whether it did was, in my view, at least in part the result of his not considering that controlling for quality was necessary in order to justify applying a size premium and that in any event there was a sufficient filtering of companies in the Risk Premium Study to constitute a suitable quality adjustment. When responding to Mr Issacs QC's questions Mr Good on my reading of his evidence did not for himself accept that it was necessary to adjust the underlying data for quality in order to justify reliance on it for the purpose of calculating a size premium. And in my view that was a reasonable position to adopt. I do not take the literature to have established beyond argument that such a control for quality is essential. The literature only shows that the argument for using a size premium may be stronger where there is such an adjustment. I also accept that to the extent that a quality adjusted size premium is to be treated as more reliable, the Risk Premium Study is to be treated as making adequate adjustments.

155. So I reject the Dissenting Shareholders' submission that Mr Good's use of a size premium was premised and depended on his using quality adjusted data. However, as I have explained, it seems to me that the Dissenting Shareholders' were right to submit that the Company had failed to adduce adequate evidence to show that the Decile Study (or the Risk Premium Study) could

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reasonably be used and relied on in this case for the purpose of determining the quantum of the size premium.

156. The Dissenting Shareholders established that there were real difficulties with using the data in the Deciles Study to calculate the quantum of the size premium in this case.

157. The Deciles Study, as I have noted, examines the relationship between returns for and the size of companies whose shares are listed on the New York Stock Exchange and the NASDAQ. It is based on a measure of size and the size premia are calculated by reference to the differences between historical portfolio excess returns (i.e. what actually happened) and the excess returns that the CAPM would have predicted. It is clear, and (as I have also noted) the Company accepted, that companies whose US listing was based on ADRs rather than shares were not included in the Deciles Study (or the Risk Premium Report).

158. Mr Pratt and Mr Grabowski in Cost of Capital 5 in the chapter relied on by Mr Beaton and the Dissenting Shareholders make their comments in relation to the Risk Premium Report rather than the Deciles Study but it seems that in this respect the data and approach in the Deciles Study is the same as that in the Risk Premium Report. The Duff and Phelps Cost of Capital Navigator paper adduced by Mr Good (exhibit NG 117) in the section headed "*CRSP Deciles Size Study*" confirmed that companies who have issued ADRs are excluded from the Deciles Study and that that "*The methodologies and data used to form the [Decile Study] portfolios are similar to the methodologies and data used to form the Risk Premium Report portfolios*" subject to certain "*significant differences*" which do not include or make reference to ADRs. I take the wording used by Mr Pratt and Mr Grabowski in Cost of Capital 5 ("*American depositary receipts (ADRs) and nonoperating holding companies are also excluded from the analysis of the Risk Premium Report, and valuation professionals should not use the Report to estimate cost of equity capital for these company types*") to mean "*American depositary receipts (ADRs) and nonoperating holding companies are also excluded from the analysis of the Risk Premium Report, and valuation professionals should not use the Report to estimate cost of equity capital for [nonoperating holding companies and companies that have issued ADRs].*"

159. In his cross-examination Mr Good denied that it was not justifiable to use and rely on the Deciles Study in this case even though companies with listed ADRs were excluded. But he confined himself to a denial and failed to offer any explanation of why this was so or to adduce evidence as to why this was justifiable or of a market practice supporting the use of and reliance on the Deciles Study in cases involving ADRs.

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160. The relevant part of Mr Good's cross examination is as follows (day 2 page 78-85) (underlining and bold added):

> Q. *[Quoting from the Duff and Phelps Cost of Capital Navigator under the heading CRSP Deciles Size Study – Mr Good's exhibit NG-117]*
>
> *"CRSP has refined the methodology of creating size-based portfolios and has applied this methodology to the entire universe of [New York Stock Exchange market and] NASDAQ-listed securities going back to 1926." That's correct, isn't it?*
>
> A. *Yes.*
>
> Q. *"All companies on the [New York Stock Exchange] are ranked ..." Do you have that?*
>
> A. *Yes.*
>
> Q. *"... are ranked by the combined market capitalisation of their eligible equity securities. The companies are then split into 10 equally populated groups, or deciles."*
>
> A. *Yes.*
>
> Q. *"Eligible companies traded on the [New York Stock Exchange market] ... and ... NASDAQ ... are then assigned to the appropriate deciles according to their capitalisation ..." You agree with all of that?*
>
> A. *Yes.*
>
> Q. *And in slightly shorter words, what that's saying is the decile study split the stocks on those three markets into ten groups by market cap?*
>
> A. *Correct.*
>
> Q. *And gave a size premium to each decile of those stocks; correct?*
>
> A. *Analysed a size premium for each of those deciles, rather than gave, but yes.*
>
> Q. *And that's why you say that the CRSP deciles derived empirically from portfolios of publicly-traded companies?*
>
> A. *Yes.*
>
> Q. *Now, this document explains that certain types of companies and securities are excluded, doesn't it?..... It says: "The New York Stock Exchange excludes: ...."American Depository Receipts." And you agree with that, don't you? So the rankings into deciles and the breakpoints are determined without reference to ADRs; correct?*
>
> A. *That's correct.*
>
> Q. *In other words, the size premia deciles are based on historic portfolio returns of companies on these three markets, from which ADRs have been excluded; correct?*

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A. *Yes.*

Q. *So there has been no observation of the historic relationship between size and excess returns in relation to ADRs as part of the decile size study; correct?*

A. *Correct.*

Q. *Your size premium of 1.58% is based on the CRSP decile size study; correct?*

A. *Yes.*

Q. *So your estimate was based on a study of historic returns, which excludes ADRs; correct?*

A. *Yes.*

Q. *You have referred to no empirical or historic data which - which establishes a relationship between the size and risk of ADRs, have you?*

A. *No.*

Q. *Nor have you referred to any empirical or historical data which establishes that there is a risk-adjusted size effect in relation to ADRs, have you?*

A. *No.*

…….

Q. *And you've agreed that the CRSP size premia give no consideration to the characteristics of ADRs because ADRs are not used in arriving at the size premium; Correct?*

A. *That is correct.* ***Although I do have a reason for doing so****.*

Q. *So the size premia from the decile study are not an appropriate basis to estimate a size premium for an ADR, are they?*

A. ***No, I disagree there.***

Q. *But nonetheless, you accept that the size premium gave no consideration to the characteristics of ADRs, because they're not used in arriving at the size premium. You do agree with that?*

A. *Yes. (Pause)*

Q. *And you agree that the studies exclude ADRs …….*

A. *Yes.*

Q. *[Quoting from Cost of Capital 5] "American depositary receipts ... and nonoperating holdings companies are also excluded from the analysis of the Risk Premium Report ..."*

A. *Yes.*

Q. "... and valuation professionals should not use the Report to estimate cost of equity capital for these company types."

…….

Q. That's also correct? You agree with that?

A. Yes. Well, I agree that's what it says.

Q. No, but do you agree it's correct? Can I just make it clear, when I read something to you, it's not to test your ability to read, I'm asking you whether you agree with the content. Do you agree that that's a true statement?

A. That - I agree that's a true statement of what Duff & Phelps is saying of course, ***because valuation professionals regularly use, all the time, the size premium study to -- or the -- sorry, the decile study to use cost of capital for private companies.***

……..

Q. Now, having regard to that, let's go back and read this again: "American depositary receipts ... and nonoperating holding companies are also excluded from the analysis of the Risk Premium Report ..." That's a true statement, isn't it?

A. Yes.

Q. And it's also true that "... valuation professionals should not use the Report to estimate cost of equity capital for these companies types." That's also correct, isn't it?

A. ***I disagree in respect of ADRs in this situation***.

Q. So you disagree with what the authors that you rely on, namely Harrington and Grabowski, say here; is that your position?

A. Yes."

161. The text that is underlined seems to me to highlight the key evidence given by Mr Good and the text in bold to represent Mr Good's position. This was that he considered that it remained appropriate to use the Deciles Study despite the statements in the Duff and Phelps Cost of Capital Navigator paper.

162. The Company's case, as I have noted, based on Mr Good's evidence, was that even though the Deciles Study and its size premia were not based on any observations of the historical relationship between size and returns in relation to companies which had issued ADRs, its deciles and size premia could still be used in cases where what was listed (on the New York Stock Exchange and NASDAQ) was ADRs (or ADS) rather the underlying shares by analogy and was so used by valuers in practice. This was justifiable, it was said, because the size effect expressed in and measured by the Deciles Study size premia in relation to the listed shares could reasonably be

treated as representative of and the same as the size effect that would apply with respect to the shares that the holder of an ADR was entitled to have issued to him/her.

163. I can see the logic of this assertion but I do not consider that the Court can accept it without more. The Court does not have a sufficient basis for *assuming* that the relationship between size and returns for companies with listed shares was broadly similar to that for companies with listed ADRs. I must say that I found Mr Good's evidence and responses to Mr Isaacs QC's questions on this issue (in particular those in bold in the extract from his cross examination above) to be enigmatic and evasive. He failed to provide any coherent let alone clear explanation or justification as to why it was justifiable to use the Deciles Study even though it was not based on data from companies like the Company which had issued ADS (and ADRs) and the even though there was a direction in the commentary from two recognised specialists on the use of the Deciles Study that valuation professionals should not use the Deciles Study to estimate cost of equity capital for companies whose shares are traded by way of ADRs. It seems to me that the clear direction from Mr Pratt and Mr Grabowski in Cost of Capital 5 required that a valuer who wished to use the Deciles Study in a DCF valuation of a company that had issued ADS at least to give a coherent explanation as to why it was appropriate and justified to do so.

164. Having concluded that (a) it is reasonable and justifiable to apply a size premium but that (b) the Company has failed to show that the size premium can properly be determined for a company whose ADS and not shares are listed by an unmodified application of the size premia in the Deciles Study or even the Risk Premium Report (which are calculated by reference to a ranking of all companies listed on the New York Stock Exchange and NASDAQ based on their capitalisation) the question arises as to whether it is permissible for the calculation of a size premium to be based on Mr Beaton's methodology. That methodology, as I have explained, still relies on the size premia in the Deciles Study. It still uses the Deciles Study size premia derived from a company's relative capitalisation and decile ranking but for the purpose of deciding the decile in which to place the Company it limits the data set to Chinese companies that were listed on a US stock exchange as of August 2020. The result was to move the Company's ranking from the seventh to the third decile in the Decile Study.

165. Accordingly, using Mr Beaton's size premium will involve reliance on the data and analysis in the Deciles Study. The difference between his approach and the approach adopted by the unmodified Deciles Study is that the Company's ranking and decile status is determined by reference to its position relative to other Chinese companies that were listed on a US stock exchange.

166. Since I have held that I have not been satisfied by the Company's submission and Mr Good's assertion that size premia in the Deciles Study can reasonably be treated as representative of and the same as the size effect that would apply with respect to the shares that the holder of an ADS was entitled to have issued to him/her, it would clearly be preferable to find a different source of data on which to base the size premium in this case. I have considered whether I should calculate my own size premium or whether, if I am driven to have recourse to the Deciles Study in the absence of a better alternative I should apply the deciles calculated in the usual way by reference to all companies listed on the New York Stock Exchange and NASDAQ. I have decided not to do so. It seems to me that using Mr Beaton's size premium is, on balance and in the circumstances, justifiable and preferable. This is the size premium for which the Dissenting Shareholders contended pursuant to their secondary case. Their secondary case was premised on the assumption that I decided, against their primary case, that a size premium was justified and should be applied. That is what has happened. While they successfully challenged reliance on the Deciles Study for the purpose of reliance being placed Mr Good's size premium, they must be taken to have accepted, for the purpose of their secondary case, that it be used in the manner proposed by Mr Beaton. The Company argued that the Deciles Study could and should be used to support Mr Good's valuation. In the face of my rejection of their case on that point, any objection to the use of a methodology based on the Deciles Study is unconvincing. The Company no doubt would prefer it if, despite this rejection, I reverted to an application of the unmodified Deciles Study. But I do not think that would be right in light of my rejection of the Company's case and furthermore it seems to me that there are merits in Mr Beaton's approach, for the purpose of quantum, that fixes the comparative position of the Company by reference to its relationship with other Chinese companies that were listed on a US stock exchange. This does not seem to me to be an unreasonable approach which cannot be relied on for this purpose (even though as I have said I do not regard the Company relative position as against other Chinese companies that were listed on a US stock exchange as justifying a refusal to apply any, or as undermining Mr Good's case for the application of a, size premium).

Issues relating to the DCF – the terminal growth model and the terminal growth rate

The differences between the experts

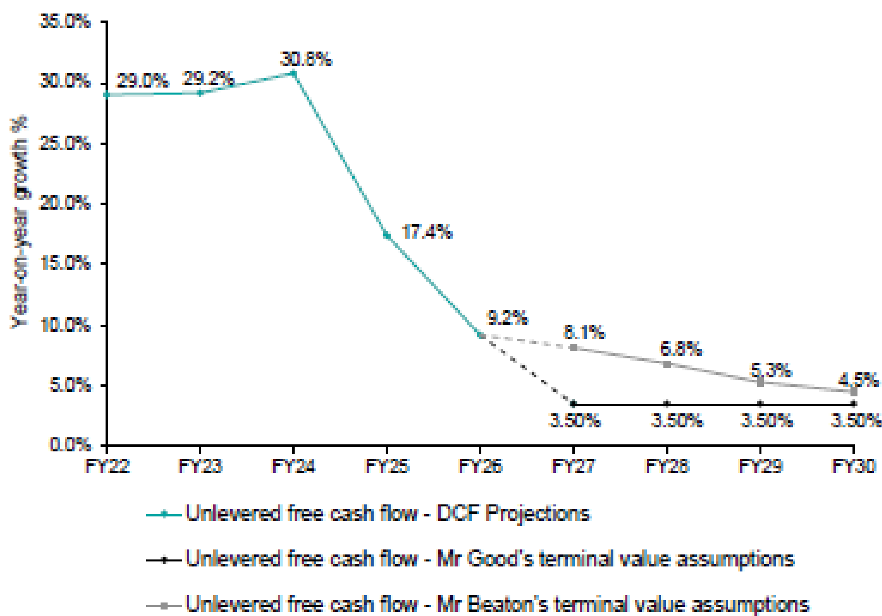
167. A DCF valuation typically contains an explicit forecast period, being the first stage of the DCF model, followed by a terminal value, which represents the value of the company that arises from the cash flows after the explicit forecast period. In this case the experts are not in agreement in respect of the terminal value calculation, specifically:

(a). the terminal value methodology: Mr Good used the Gordon Growth methodology involving a two stage DCF growth model whereas Mr Beaton used the H-model methodology which involved a three stage DCF model.

(b). the long-term terminal growth rate: Mr Good applied 3.5% whereas Mr Beaton applied 4.5%.

168. Mr Good's figure 6 in Good 2 helpfully set out and mapped the Merger Projection forecasts during the explicit period and Mr Good's and Mr Beaton's terminal value assumptions.

Figure 6: Forecast annual growth rates in unlevered free cash flows[21]



The Terminal Growth Model

169. Adopting Mr Good's terminal value growth model would bring Mr Beaton's per share value down by US$3.22. Adopting Mr Good's long term terminal growth rate would bring the per share value down by US$8.57. Adopting both Mr Good's terminal growth model and his terminal growth rate would bring the per share value down by US$11.87.

170. The Gordon Growth methodology assumes that a company's cash flow will grow at a constant rate into perpetuity immediately after the explicit forecast period. This results in a two-stage DCF model. It assumes that the growth in cash flows has essentially reached that long term rate at the end of the explicit forecast period. By contrast, the H Model is predicated on the assumption that the growth rate of a company's cash flows will more gradually decline after the explicit forecast period towards the long-term terminal growth rate. Which methodology is appropriate depends on an analysis of a company's cash flow forecasts.

171. Mr Good relied on Professor Damodaran's analysis in *Damodaran on Valuation: Security Analysis for Investment and Corporate Finance,* Second Edition, 2006 of the factors that are relevant to a decision as to whether to use a two or three stage model. In Professor Damodaran's view (at Good 2 at [4.2.7]):

> *"a two-stage DCF model is "more appropriate for firms with moderate growth rates, where the shift [between the growth rate at the end of the explicit forecast period and the terminal growth rate] will not be too dramatic". .... "as a rule of thumb, we consider any growth rate within 8 to 10 percent of the growth rate of the economy as a moderate growth rate."*
>
> *a three-stage DCF model is more appropriate "for firms with very high growth rates in operating income" – in particular, the H-model "may [be] a useful model for firms that are growing rapidly right now, but where the growth is expected to decline gradually over time as the firm gets larger and the differential advantage they have over their competitors declines". Further, a three-stage DCF model "allows for a gradual adjustment not just of growth rates but also of risk characteristics, returns on capital and reinvestment rates towards stable growth levels."*

172. Mr Good also relied on Dr Żelazowski's analysis (in his 2014 article "*Significance of Residual Value in Asset Valuation"*) in which he explained that the life cycle of a company is also a factor to consider when deciding between a two-, three- or even four-stage DCF model. Specifically, he suggested that three- or four-stage DCF models might be useful for companies that have a high rate of changes in cash flow (for example, those that are in their early stages of their product life cycle). Mr Good considered that it was therefore relevant when determining whether to apply a two- or three-stage DCF model to review the projected growth rates for the company both over time and as compared with the growth rate of the economy, metrics such as return on capital and the projected life cycle of the company.

173. In Mr Good's opinion, a two stage DCF model was more appropriate having regard in particular to the following factors:

    (a). as shown in Figure 6 in Good 2, the decline in the year-on-year growth in unlevered free cash flows in his terminal value calculation appeared to be a reasonable step down from FY26 and was broadly proportionate with the declining trend at the end of the explicit forecast period (FY24 to FY26).

    (b). the year-on-year growth in unlevered free cash flows in his adjusted DCF projections for FY26 of approximately 9% was within approximately two percentage points of the forecast nominal GDP growth rate for China in 2026 of approximately 7% The Company was therefore forecast to be growing at a "*moderate*" growth rate that was marginally higher

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than the Chinese economy. Following Professor Damodaran's approach, this suggested that a two-stage DCF model was appropriate.

(c). Dr Żelazowski had said that a DCF model in three or more stages may prove useful in instances where companies are expected to be in the early phases of their life cycle. On Mr Good's forecasts, revenue was forecast to slow towards the end of the explicit forecast period and this suggested, when set against the graph prepared by Dr Żelazowski which had revenue and profit on the Y axis and time on the X axis and plotted the movement in revenue and profit over time to show the different phases in the product life cycle, that the Company would be in its maturity phase by the end of the explicit forecast period.

(d). the fact that the forecast return on invested capital (***ROIC***) in Mr Good's two-stage model remained broadly stable in the final year of the explicit forecast period (FY26) and the year immediately after that (FY27) suggested that a stepped down adjustment need not be applied to reflect changes in ROIC towards more stable levels. ROIC is a return on capital measure that can be used to assess implicit excess returns. It is a measure of capital efficiency and provides an insight on the implied competitive advantages of a company (ROIC measures the tax-adjusted income achieved for a given amount of capital). Mr Good considered that the ROIC accorded with Professor Damodaran's ROIC estimates for the relevant healthcare industry sectors in China between 2016 and 2019.

(e). the explicit forecast period suggested that the Company would be in its maturity phase by the end of the explicit forecast period.

174. Mr Beaton summarised his approach at [9.15] of Beaton 1:

"I calculated an expected normalized cash flow growth rate based on an H-model given that the Company's cash flow growth in the last discrete year of the forecast was greater than its expected cash flows into perpetuity. The H-model uses a current growth rate from iKang's discrete cash flow forecast, a three-year time period until normalized, sustainable cash flow growth is expected, and a sustainable long-term cash flow growth rate. Because future cash flows are discounted by an ever-decreasing discount factor, the majority of a terminal value (which is the sum of all future cash flows after a discrete forecast period) occurs on a present value basis within the first few years beyond the discrete forecast period. In this case, management forecast a discrete cash flow period of 10 years with the final year cash flow growth still above a sustainable level in perpetuity. In order to capture these above-normal years of growth, the H-model addresses the annual percentage changes in the first three years beyond the terminal period before long-term stability is achieved."

175. Mr Beaton relied on a different volume written by Professor Damodaran (chapter 13 of *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset*, 3rd edition,

2012) and said that when a company's cash flow growth rate was expected to decline from a high, unsustainable, growth rate to a stable growth rate Professor Damodaran suggested using the three-stage H-model. This allowed for an initial period of high growth, a transitional period where growth declines, and a final stable growth phase. Mr Beaton considered that this was the pattern exhibited in two sets of forecasts other than the Merger Projections, namely the Project Jaguar and Project Thanksgiving projections (the former being a version of the Merger Projections and the latter were based on another long-term forecast prepared by the Company on the basis of an alternative strategy to raise debt capital and continue as a stand-alone, independent company in case the Merger failed to complete). Mr Beaton also put the point another way. He said that when a company's cash flow was expected to grow in excess of the steady state exhibited during the explicit forecast period, a three-stage growth model was generally employed as a more accurate way of capturing the expected high growth in the near term that was not addressed with a two-stage growth model (citing Mr Hitchner's *Financial Valuation, Applications and Models, Fourth Edition*, 2017, pages 148 and 1215). As he explained during his cross examination, a valuer was not required to use any particular model. The goal was properly to assess the company's growth rates and make a judgment as to how they were likely to step down.

176. In Beaton 2 (at [2.47]) (underlining added) (as corrected in [2.3] of Beaton CR) Mr Beaton reiterated that in his view the Company's ten year cashflow forecasts needed to be extended because the Company was continuing to experience rapid growth at the end of the explicit forecast period:

> *"Similarly, McKinsey outlines the best practice for determining a forecast's length and detail. As stated therein [the quotation below was substituted as the correct source document in Beaton CR, being an extract from Koller, Goedhart and Wessels "Valuation: Measuring and Managing the Value of Companies 6th edition]*
>
> *In general, we recommend using an explicit forecast period of 10 to 15 years—perhaps longer for cyclical companies or those experiencing very rapid growth. Using a short explicit forecast period, such as five years, typically results in a significant undervaluation of a company or requires heroic long term growth assumptions in the continuing value. Even so, a long forecast period raises its own issues—namely, the difficulty of forecasting individual line items 10 to 15 years into the future.*
>
> *To simplify the model and avoid the error of false precision, we often split the explicit forecast into two periods:*
>
> 1. *A detailed five-year to seven-year forecast, which develops complete balance sheets and income statements with as many links to real variables as possible (e.g., unit volumes, cost per unit)*
> 2. *A simplified forecast for the remaining years, focusing on a few important variables, such as revenue growth, margins, and capital turnover."*

> *<u>Based on McKinsey's recommendation, iKang's cash flow needed to be extended beyond the 10-year forecast period provided by iKang management since it was still experiencing rapid growth at the end of the explicit forecast period</u>."*

177. During his cross examination, Mr Beaton said that in his view it was unusual to see cash flow growth dropping from 9% immediately to 3.5%, particularly in a growing economy with a company like the Company which had stated that its steady state was 5% revenue growth. He could accept that it would be reasonable to use a two-stage model where the drop was from 9% to 5%. Mr Beaton said that the objective was to find a midpoint which did not involve too precipitous a drop and to capture some of the slowing transitional growth for a period – he had used three years – down to what he considered to be a more appropriate long-term growth rate of 4.5%. He said that the projected growth rate for 2026 was not very high but was still above the stable rate and that using an H-model was entirely appropriate when there is a terminal year cash flow that was greater than the ultimate stable rate.

178. Mr Beaton said this his approach was supported by the fact that five of the six analyst reports (including MCM Partners) cited by Mr Good in Good 1 that provided information on cash flow growth rates utilised a three-stage growth model.

179. The Company argued that Mr Beaton's fundamental thesis was that the Company would not have reached steady state growth by 2027. His view was that it would take another three years, but he had not demonstrated a proper and reasonable basis for, and had agreed during his cross examination that there was no science behind, that three year transitional growth period. Rather it was simply his judgment that the slowdown in growth would have changed down a gear in 2026 and proceeded more slowly than management had projected in the explicit period. The Company submitted that he had also accepted during cross examination that he was not better placed than management to predict the rate of the Company's growth and that the further out forecasts were projected the more speculative they became.

180. During Mr Beaton's cross examination, Ms Bingham QC put to him the following two passages from Professor Damodaran's *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset:*

> *"Since the two-stage dividend discount model is based on two clearly delineated growth stages – high growth and stable growth -- it is best suited for firms that are in high growth and expect to maintain that growth ... for a specific time period, after which the sources of the high growth are expected to disappear."*
>
> *"The assumption that the growth rate drops precipitously from its level in the initial phase to a stable rate also implies that this model is more appropriate for firms with modest*

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growth rates in the initial phase. For instance, it is more reasonable to assume that a firm growing at 7 per cent in the high growth period will see its growth rate drop to 2 per cent afterward than it is for a firm growing at 40 per cent in the high-growth period."

181. Ms Bingham QC put to Mr Beaton that since management was forecasting 9.2% growth in the final year of the explicit period, with EBITDA coming down to 5.1% growth in that year (2026), it was right to assume that Professor Damodaran would be comfortable with a two-stage growth model being used to value the Company with single-digit growth as these projections showed. Mr Beaton agreed. Mr Beaton had also accepted that the Company's growth rate was already in decline at the start of the explicit forecast period.

182. Ms Bingham QC also put the following passage from *Damodaran on Valuation* to Mr Beaton*:*

"Moderate-growth firms report earnings and revenues growing at a rate moderately higher than the nominal growth rate in the economy --as a rule of thumb, we would consider any growth rate within 8 to 10 per cent of the growth rate of the economy as a moderate growth rate."

183. Ms Bingham QC noted, and Mr Beaton accepted, that the OECD was projecting nominal GDP growth of 6.9% or 7% for China in 2026. Mr Beaton said that applying Professor Damodaran's rule of thumb would mean that a moderate growth rate would be in the range of 7.56 to 7.7. Ms Bingham QC noted that Mr Good considered that this interpretation of Professor Damodaran's rule of thumb was wrong. Professor Damodaran was to be understood as meaning that to calculate the range the valuer added between 8% and 10% so that if the economy was growing at 10%, a growth rate of 18-20% p.a. would be considered moderate.

184. The Dissenting Shareholders argued that Mr Beaton's evidence on this point was to be preferred. It was a natural reading of *"[A] is within 8 to 10 per cent of [B]"* that B is not less than 90% or more than 110% of A. It was not a natural reading of the words to say that a company is growing at a moderate growth rate when the company's growth rate is eleven times that of the economy.

185. The Company submitted that while in Beaton 2 Mr Beaton had relied on the available analysts' reports to support his adoption a three-stage model and had told the Court that "*five of the six analyst reports … cited in [Good 1] … utilised a three-stage growth model*" in cross-examination he had been forced to accept that his claim was unjustified. As he ultimately accepted, it would have been more accurate to say that four out of the six analysts appeared to have used two-stage models.

186. Mr Good also challenged Mr Beaton's use of an H model on the basis that Mr Beaton's projected cash flow growth in the three-year transitional period was not consistent with the trend in capital expenditure at the end of the explicit forecast period. This was because further growth in unlevered free cash flow growth would need to be driven by capital expenditure and because capital expenditure was forecast to grow at a slower rate than EBITDA from FY22 and decline year-on-year in FY23 to FY26 224. Mr Good made these points by reference to a graph of forecast growth rates in cash flow, EBITDA and capital expenditure. In appendix 5 to Good 2 he said this:

> *"A5.4.1 In the context of the terminal value calculation for iKang, Mr Beaton's unlevered free cash flow growth would seem to be driven by EBITDA and / or capital expenditure.*
>
> *A5.4.2 It appears that Mr Beaton assumes that EBITDA will grow by 4.5% on average per year. Therefore, given that unlevered free cash flow growth in his three-year extraordinary growth phase exceeds that rate, further growth would need to be driven by the amounts of capital expenditure.*
>
> *A5.4.3 However, Mr Beaton's projected cash flow growth in his three-year extraordinary growth phase is not consistent with the trend in capital expenditure at the end of the explicit forecast period. Specifically, his assumptions imply that capital expenditure as a % of revenue would need to continue to decline in his three-year extraordinary growth phase. This is inconsistent with the DCF Projections which already forecast a decline to a relatively stable rate by the end of the explicit forecast period."*

187. The Dissenting Shareholders submitted that there were three principal reasons why a three-stage rather than a two-stage model was more appropriate. First, the company was not growing at a stable rate or a steady rate at the end of the explicit forecast period. Secondly, the evidence did not suggest that the Company would become stable abruptly. Rather, it suggested that the Company would maintain high growth for a period and then have a transitional period where its characteristics change gradually as it became larger and the differential advantages over its competitors declined. Thirdly, the Company did not have a moderate growth rate at the end of the explicit forecast period.

188. The Dissenting Shareholders argued that Mr Good's figure 6 showed that his constant growth model proceeded on the assumption that the Company's cash flow growth would drop precipitously from 30.8% in FY24 to 3.5% in FY27 (a drop of over 88% in three years and the drop at the end of the explicit forecast was 63% from 9.2% to 3.5% in a single year). It was not reasonable to assume that the Company's growth rate will drop from 30.8% in FY24 to 3.5% in FY 27 in the absence of good reason to explain such a precipitous or drastic drop. There was, the Dissenting Shareholders submitted, no good reason to suppose that the Company's cash flow

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growth would drop precipitously or that the Company would maintain a high growth rate for a specific time period after which the sources of the high growth would be expected to disappear. Nor was there a good reason to suppose that the sources of the Company's cash flow growth might disappear for reasons akin to the expiry of a patent or elimination of barriers to entry or that the Company had two clearly delineated growth stages. In fact, the Dissenting Shareholders submitted, Mr Good's analysis suggested the contrary, namely a gradual decrease in growth rates as the Company became larger and the differential advantage it had over its competitors declined. This, they said, was clear from the three qualitative factors on which Mr Good had relied as tending to reduce his estimate of the Company's terminal growth rate: that the market would attract competition as the Company grew and as the Chinese health check-up market matured; increased bargaining power from corporate customers and price competition within the industry and difficulty recruiting experienced medical staff and less credibility among potential clients compared to its public sector competitors

189. The Dissenting Shareholders also challenged Mr Good's assertion, applying the approach set out in Dr Żelazowski s article, that the fact that revenue growth was forecast to slow toward the end of the explicit forecast when compared against Dr Żelazowski s product life-cycle graph suggested that the Company would be in the maturity phase by the end of the forecast period. The Dissenting Shareholders argued that (as Mr Good had accepted in his oral testimony) the growth stage of the product life cycle included a period of flattening revenue (the point on Dr Żelazowski s graph just before the dotted line between growth and maturity) so that the slightly flattening revenue of the Company towards the end of the explicit forecast period suggested that the Company was in the growth stage of the product life cycle, which in turn suggested that the H model was the more appropriate model to apply to the Company.

190. The Dissenting Shareholders argued that Mr Good had been wrong to claim that Mr Beaton's projected cash flow growth in the three-year transitional period was not consistent with the trend in capital expenditure at the end of the explicit forecast period. Mr Good's graph and his analysis failed to include a key element of the projected cash flow growth, namely depreciation. Mr Beaton's analysis of depreciation (in Beaton 1 Table 13) showed the trend in depreciation as a percentage of capital expenditure and in particular, showed that depreciation as a percentage of capex in FY20 was 48%, and that this percentage increased every year through the explicit forecast period and in the 3-year transitional period, reaching over 93% by FY27. Mr Good had repeatedly stated in his supplemental report that unlevered cash flow would be driven by higher EBITDA and/or lower capital expenditure, however, and as he accepted in cross-examination, cash flow could also be driven by higher depreciation. If other things remained the same, an increase of $1m of depreciation would have the same effect in generating cash flow as a reduction

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of $1m in capital expenditure Mr Good had relied on a formula for free cash flow which did not identify depreciation as a separate item.

191. I have carefully reviewed the evidence and the parties' arguments and have concluded that, on balance, Mr Good's approach is to be preferred and is reasonable. The decision as to the most appropriate DCF model to adopt in this case is finely balanced. But a two-stage model seems to me to be most appropriate, largely for the reasons given by Mr Good.

192. It seems to me that the Company's growth rate at the end of the explicit period can properly be characterised as moderate or at least close to moderate (and not high). I prefer Mr Beaton's interpretation of Professor Damodaran's rule of thumb guidance that "*any growth rate within 8 to 10 per cent of the growth rate of the economy as a moderate growth rate."* Professor Damodaran talks about a growth rate which is a percentage ***of*** the growth rate for the economy. He does not talk about a growth rate ***above*** (or below) the growth rate for the economy. It seems to me to be unlikely that where the economy is not growing (and has a zero rate of growth), a company's growth rate of 10% would be said to be moderate. In any event, in this case, where the OECD was projecting nominal GDP growth of 6.9% or 7% for China in 2026, a moderate growth rate would be in the range of 7.56% to 7.7%. I do not see that it is right to treat the Company's projected growth rate of 9.2% growth in the final year of the explicit period, with EBITDA coming down to 5.1% growth in that year, as outside the range of what can be said to be moderate and certainly not so high as to justify an additional transitional stage (or a transitional stage of three years).

193. I find convincing Mr Good's conclusion that using a two-stage DCF model is appropriate considering in particular the moderate levels of growth in unlevered free cash flows at the end of the explicit forecast period and the broadly stable forecast for ROIC in the final year of the explicit forecast period (FY26) and the year immediately after (i.e. FY27). As McKinsey noted in a passage relied on by Mr Beaton and quoted above, one of the characteristics of a steady state is that the company earns a constant return on its base level of invested capital. Mr Good's analysis suggests that the Company was moving close to a steady state by the end of the explicit forecast period. Mr Good's view also appears to have been consistent with the approach taken by the majority of the analysts.

194. It is necessary to consider which of the experts appears to have properly assessed the Company's rates of growth in its cash flows and made the most reasonable and reliable judgment in the circumstances as to how they are likely to step down after the end of the explicit period. It seems to me that Mr Good's opinion reasonably reflects the forecasts and the recent history of the

decline in growth rates. As the Company submitted, his terminal value calculation appeared to be a reasonable step down from FY26 and was broadly proportionate with the declining trend at the end of the explicit forecast period (FY24 to FY26). I do not accept there is a sufficient justification for adding the three year transitional period argued for by Mr Beaton.

Terminal growth rate

195. The terminal growth rate is the rate at which a company's cash flow is estimated to grow in the final stage of a DCF model and which can be sustained in perpetuity. Once the company's free cash flow reaches a steady growth state, the final or terminal year cash flow can be capitalised with an appropriate capitalisation rate. A capitalisation rate is equal to a company's WACC minus the company's long-term sustainable growth rate. Both quantitative and qualitative factors are considered when estimating a terminal growth rate.

196. The experts agreed that inflation and the nominal GDP growth rates mark the boundaries of the debate regarding the proper terminal growth rate given that (a) the cash flows of a company neither gaining nor losing ground will rise over time at a rate equal to inflation, and (b) no firm can forever outstrip the growth rate of the economy. However they disagreed as to where within these limits to fix the terminal growth rate in this case.

197. The experts' different conclusions can be summarised as follows:

    (a). Mr Good assumed that the Company's cash flows will grow in perpetuity at the end of the explicit forecast period at a rate of 3.5%. That rate is slightly below the mid-point between inflation of 2.75% and the forecast nominal GDP growth rate of 5.1%.

    (b). Mr Beaton argues for a rate of 4.5% having regard the PRC's average GDP growth of 9.2% p.a. over 20 years and 9.4% p.a. over 30 years. This estimate, in his opinion, reflects the Company's growth prospects and a favourable environment for continued growth in China's healthcare check-up sector. Over the five years to 2021, per capita GDP was expected to increase by 7.1% p.a. This increased wealth had, Mr Beaton said, translated into increasing disposable income for the PRC's urban residents, which in turn had increased their purchasing power, including for preventative healthcare.

198. As regards the quantitative factors, Mr Good estimated the terminal growth rate with reference to forecast long-term inflation rates and nominal GDP growth between 2027 and 2060. He provided figures and graphs showing the forecasts for inflation rates and nominal GDP growth

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prepared by the OECD, the Economist Group's Economic Intelligence Unit and the IMF. He noted, based on these various forecasts, that the forecast inflation rates were expected to converge towards an inflation rate of 2.5%-3.0% in 2022 and onwards (or a mid-point inflation estimate of 2.75%). He also said that the nominal GDP growth rate for the PRC was expected to decline over time to a rate of approximately 5.1% from the end of the explicit forecast period in 2027 through to 2060. This (as was confirmed in footnote 302 to [12.3.6] of Good 1, which cross referred to Appendix 17 of Good 1) 5.1% figure was calculated by taking the average nominal GDP growth rate from 2027 to 2060 as forecasted (only) by the OECD. Mr Good concluded that therefore the Company's terminal growth rate should be between 2.75% and 5.1%.

199. As regards the qualitative factors, Mr Good identified various factors which in his view were relevant to the assessment of the Company's terminal growth rate. He said that (a) on the upside there was an expectation of significant growth potential for private medical examination providers and the Company had a competitive advantage as a result of having centres nationwide and of providing consistent and quality services but (b) on the downside the Company was exposed to increased bargaining power from corporate customers and price competition within the industry; compared to its public sector competitors, it had competitive disadvantages such as difficulties in recruiting experienced medical staff and less credibility among potential clients and the market would inevitably attract competition as the Company grew and the Chinese health check-up market matured. He considered that since the revenue forecasts in the Merger Projections suggested that the Company was forecast to be in its maturity phase by the end of the explicit forecast period adopting a terminal growth rate that was lower than the nominal GDP growth rate of the economy would be consistent with the approach recommended by Professor Damodaran (in chapter 4 of *Damodaran on Valuation*).

200. Mr Good also undertook a cross-check of his results against various terminal growth rates from analysts. In Good 1 he reviewed the terminal growth rate estimates from analyst reports and the JPM Discussion Materials for (a) the Company as assessed at dates between the Company's IPO and the Valuation Date and (b) certain comparable companies, assessed in the year prior to the Valuation Date. In Good 2 he identified two further terminal growth rate estimates, namely an analyst report for Meinian in the year prior to the Valuation Date and in a publicly available valuation report which was conducted in respect of Meinian's planned acquisition of Ciming in 2017. Mr Good noted that the analysts' estimates ranged between 0% and 5%, with an average and median across all estimates of 3.4% and 3.0%, respectively, so that his terminal growth rate estimate of 3.5% was above both the median and average. He considered that while the analysts' estimates were not directly comparable, his terminal growth rate was broadly aligned with their

estimates of the terminal growth rate for the Company and his comparable companies, Meinian and Ciming.

201. Mr Good concluded that on balance, considering these quantitative and qualitative factors, a terminal growth rate of 3.5%, which was slightly below the mid-point between the inflation rate for the PRC of 2.75% and nominal growth rate for the PRC of 5.1%, was reasonable. He noted that his terminal value assumptions implied a ROIC in the Terminal Period (i.e. FY27) that was broadly similar to the ROIC in the final year of the explicit forecast period (FY26). In particular, ROIC in the Terminal Period was above the Company WACC of 11.0% by 11.1% and so the Merger Projections and his terminal value assumptions implied that the forecasts were predicated on the Company being able to sustain its competitive advantages in the long term (which he considered was probably a somewhat optimistic assumption).

202. Mr Beaton said that in addition to the macroeconomic factors relied on by Mr Good he also relied on factors specific to the Company including trends in the PRC's healthcare industry, aging demographics, the PRC Government's HC 2030 initiative, and the greater health awareness among the Chinese. He supported his estimate of the Company's terminal growth rate by what he described as a comprehensive analysis of the PRC healthcare industry (set out in section 4 of Beaton 1).

203. This analysis revealed that the PRC health check-up market, which was specific to the Company, was expected to grow at 22.0% annually up to and including 2022, which was well in excess of the PRC's expected inflation or GDP. Based on Frost & Sullivan's October 2017 report commissioned by the Company the PRC's aging population was expected to be a driver of increased preventative healthcare services. Furthermore, healthcare expenditures per capita were also expected to increase as a result of increased urbanisation. The National Bureau Statistics China had projected that the PRC's urban population would increase to 900 million people by 2019 following a new urbanisation plan, leniency of the one-child policy, and other reform. In addition, the Chinese government had pushed to implement changes that focused on the privatisation of medical facilities in place of the government-run healthcare system. The encouragement and support for privately operated medical institutions is part of legislation and the Government's HC 2030 policy introduced in 2016. These deregulation efforts granted privately run medical care institutions similar rights to those enjoyed by public institutions. In Mr Beaton's view, the healthcare industry in the PRC had significant opportunity for growth, robust demand, and was experiencing major transformation toward the private sector. In addition to the positive drivers of the Company's growth there were significant barriers to entry for new entrants, including licensing requirements, physician and nurse resources, and investment.

204. Mr Beaton considered that taken together these micro and macroeconomic factors, and the Company's management forecast growth to the end of 2026, supported a long-term growth rate in excess of Mr Good's 3.5% growth rate. The growth in the Company's cash flow over and above the growth rates in the Merger Projections was also supported by the Project Thanksgiving forecast, which had been prepared by the Company's management (and adjusted by the Company's financial advisers). The cash flow in the Project Thanksgiving forecast had resulted in a 28% increase in the Company's value based on substantially higher expected growth.

205. The Dissenting Shareholders did not dispute that a terminal growth rate is typically between the inflation rate and the nominal GDP growth rate. But they challenged Mr Good's estimates of inflation and nominal GDP. The Dissenting Shareholders argued that Mr Good's estimate that the nominal GDP growth rate for the PRC would decline to approximately 5.1% per annum and that forecast inflation rates would converge towards 2.5%-3.0% per annum (with a mid-point of 2.75% per annum) was based on a flawed methodology. Mr Good had improperly mixed data from different sources. Mr Good had taken his figures from OECD, EIU and IMF estimates. The 5.1% estimate of nominal GDP growth was an OECD estimate. Yet Mr Good had included estimates of the EIU (2.5%) and IMF (3.0%) for inflation to obtain a figure of 2.75%. Had he only used the OECD estimates, and not mixed his data sources, he would have used an inflation estimate of 3% rather than 2.75% (so the midpoint between inflation (3%) and nominal GDP growth (5.1%) would be 4.05%). Furthermore, the nominal GDP estimates from the EIU and IMF were higher than those of the OECD for the last year of the EIU and IMF estimates – the IMF's estimate for 2023 was 8.7%, compared to the OECD's estimate of 7.5%. Yet Mr Good had taken no account of the fact that the nominal GDP estimates from the EIU and IMF were higher than those of the OECD – he used the OECD figures without adjustment.

206. The Dissenting Shareholders also criticised Mr Good's approach to applying his cross-checks. They said that Mr Good's cross-checks were misleading and showed that he was partisan, since he had resorted to and relied on cross-checks when he thought that they supported his case but failed to cross-check when do so would undermine his case. The Dissenting Shareholders noted that of the fourteen cross-checks made by Mr Good, only six related to the Company, and four of those were published more than four years before the Valuation Date. The two reports published in 2018 were the JPM Discussion Materials and a report by MCM Partners. MCM Partners had estimated the Company's cash flow in 2022 to be $232 million and had estimated a terminal growth rate of 3% p.a., corresponding to free cash flow in 2027 of $262 million (RMB 1.92 B). This figure was 55% higher than the figure of RMB 1.27 B which Mr Good had used in his DCF. Mr Good had failed to point this out in his reports and failed to point out that his cross-

checks gave no support to his estimate of the Company's long-term growth rate. Rather he had said that his terminal growth rate was more optimistic, i.e. tending to generate a higher DCF than that of MCM Partners. Mr Good had compared his estimate of the WACC favourably against the estimate of MCM Partners but had failed to point out that MCM Partners' DCF estimate of $50/share was more than 30% higher than his DCF estimate of $38.37/share, so that the MCM Partners' DCF valuation undermined rather than supported Mr Good's estimate. And Mr Good had failed to apply cross-checks in relation to the size premium and minority discount, which undermined his views. Nor did he include a cross-check against the WACCs estimated by analysts whose reports he cross-checked against in relation to terminal growth rate. Yet, as he had accepted in cross-examination, those analysts' estimates were lower than his.

207. The Company challenged Mr Beaton's evidence. The Company noted that (a) in cross-examination, Mr Beaton had confirmed that he had relied on the PRC's historic GDP growth and historic inflation rates as relevant metrics when calculating terminal growth rate but had gone on to concede that when selecting a terminal growth rate, it was appropriate to look forward into the future and consider future GDP growth rates and future inflation rates, and that (b) it was not obvious that the 22% growth projected for the Company annually to the end of 2022 should have fed into Mr Beaton's terminal growth rate, nor that the PRC's HC 2030 initiative was relevant – in selecting a terminal growth rate, the focus should not have been on the near term but on the period beyond 2027 and into perpetuity. Mr Beaton had agreed that there was no evidence before the Court that Frost & Sullivan or anyone else was projecting industry growth in excess of 5% after 2026 and he had accepted that Frost & Sullivan were anticipating a slowing in growth rates as compared with historical market growth. Mr Beaton, the Company argued, had agreed in cross-examination that the PRC health check-up industry was subject to intense competitive pressure and that large sums of capital expenditure were needed by the Company to maintain its position and achieve real growth through expanding its medical centres - but had then, without justification, refused to align himself with Dr Pratt's reasoning that the rate of inflation might prove an appropriate growth rate for the Company. Pratt and Shannon's *Valuing a Business* had said that "*If the company is in an industry subject to vigorous competitive pressure, with little prospect for real growth without large capital expenditures, then perpetual growth at the rate of expected long-term inflation may be reasonable (i.e., zero real growth).*"

208. The Company submitted that the growth rates estimated by analysts of the Company both in the year of the Merger and previously all suggested that Mr Good's rate was reasonable. Mr Good's rate was higher than the 3% rate predicted by MCM Partners just two months before the Valuation Date (on the basis of a forecast period of just four years) and at the very top end of the range of 2.5% - 3.5% favoured by JPM in March of 2018 (in the context of a ten year forecast). If it was

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appropriate to supplement (a) the 2018 analyst estimates of the Company's prospects with estimates prepared as long ago as 2014, Mr Good's rate again exceeded the median and (b) the estimates of the Company's terminal growth rate with estimates of the terminal growth rates of its comparators companies (China Resources Medical, Rici and Harmonicare) again Mr Good's estimate hovered around the median.

209. The Company noted that during his cross-examination Mr Beaton acknowledged that he had not conducted a cross-check of his 4.5% terminal growth rate by reference to the available analyst reports and that he had accepted that Citi Research favoured a terminal growth rate of 3% and that UBS used a terminal growth rate of 3.5%. Mr Beaton had been unable to take issue with Mr Good's observation that his chosen terminal growth rate of 3.5% stood above the median and the mean of all rates used by the analyst reports. Mr Beaton had also accepted that while Oppenheimer's chosen growth rate of 5% was higher than both Mr Good's and his own, their model disclosed an assumption that 5% growth would be arrived at in FY2020 which was inconsistent with the assumption made by the Company's management in the Merger Projections that this level of growth would only be reached in 2026 or 2027.

210. Once again, this is an issue which is finely balanced, involving the exercise of professional judgment and substantial scope for differing reasonable views. Despite noting that there were some grounds for adopting a higher rate and the challenges to the basis and impact of Mr Good's cross-checks, I have concluded that on balance, and for the reasons given by the Company as summarised above, Mr Good's approach is generally reasonable and to be preferred. But I am not completely satisfied with Mr Good's calculations. I have a concern that, as the Dissenting Shareholders pointed out, Mr Good on occasion failed adequately to factor in and take into account some of more positive data and adopted a selective and rounding down approach to settling on his estimate.

211. Mr Good's terminal growth rate analysis was, as I have already noted, set out at [12.3] (and note the graphs at [12.5] and [12.6] and Appendix 17 of Good 1. It is clear that data for the inflation rate and real and nominal GDP growth was only available from EIU for 2018-2022 and from the IMF for 2018-2023. However, data from the OECD for these items was available from 2017-2060.

212. Mr Good's 5.1% figure for GDP growth was calculated by taking the average nominal GDP growth rate from 2027 to 2060 as forecasted *only* by the OECD. As the Dissenting Shareholders pointed out, the nominal GDP estimates from the EIU and IMF were higher than those of the OECD for the last year of the EIU (2022) and the IMF (2023) estimates. The IMF's estimate for

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2023 was 8.7% compared to the OECD's estimate of 7.5% (in 2022 the EIU's estimate was 7.9% compared to the OECD's estimate of 7.8%). Mr Good took no account of these higher nominal GDP estimates.

213. In relation to the inflation rate, Mr Good took into account the estimates made by EIU and the IMF for 2022. The EIU estimate was 2.5% while the IMF estimate was 3% (it remained at 3% for 2023). On this basis Mr Good concluded (at [12.3.6] of Good 1) that "*Forecast inflation rates, meanwhile, were expected to converge towards an inflation rate of 2.5%-3.0% in 2022 onwards (or a mid-point inflation estimate of 2.75%).*"

214. The EIU and IMF data was only available for a limited period. The OECD estimates went right through to 2060. Various different approaches could reasonably be adopted in these circumstances. But whatever approach was adopted needed to be consistent, balanced and reasonable. It might have been reasonable, since what was being done was to find a long term rate, to ignore or discount the short-term EIU and the IMF data (and thereby give greater weight to the OECD estimates). But Mr Good gave them equal weight when determining his inflation rate (by producing an average of the 2022 figures). I do not find that to be unreasonable. Taking into account the data from sources other than the OECD where available makes the estimation process more robust. But if that is done, I do not see that it is then justifiable to ignore the EIU and the IMF data for the purpose of estimating GDP growth. I am not persuaded that Mr Good had a proper justification for doing so.

215. Mr Good, having settled on a range of 2.75%-5.1%, concluded that 3.5% was the proper terminal growth rate to adopt. He acknowledged that this figure was "slightly below the mid-point" in his range ([12.3.8] of Good 1). But as the Dissenting Shareholders noted, 3.5% is approximately 11% lower than the mid-point of 2.75% and 5.1% (which is 3.925%). Now Mr Good made a judgment in selecting the point within the range to use having regard to the various matters he referred to including the qualitative factors. I consider that he is generally entitled to do this without relating with mathematical precision the discount he has applied to each factor to settle on his 3.5% final number. But the fact that he has chosen to pick a figure below the mid-point by a not insubstantial margin reinforces the concern that, all in all, his choice of 3.5% as the reasonable terminal growth rate, is on the low side.

216. The Dissenting Shareholders noted that had Mr Good only used the OECD estimates for the inflation rate he would have applied an estimate of 3% rather than 2.75% and the midpoint between inflation (3%) and nominal GDP growth rates (5.1%) would then be 4.05%. Had he

instead taken into account the higher EIU and IMF estimates for growth, he would have had to increase his 5.1% figure.

217. In all the circumstances, it seems to me that a reasonable terminal growth rate should be above, but only slightly above, Mr Good's 3.5% estimate. I consider that 3.75% is a reasonable and fair estimate.

Issues relating to the DCF – foreign exchange

218. The Company's operations are in RMB as are the Merger Projections on which both experts have (subject to adjustments) based their DCF valuations. Both experts used a USD risk free rate to build their discount rate. But there was a dispute as to the best way of making an adjustment for currency risk.

219. Both experts cited practitioner textbooks and academic literature which suggested that the currency of the cash flow projections should be consistent with the currency of the discount rate. Because expected inflation is built into both the cash flows and the discount rate, a mismatch in currency between the two would mean different expected inflation rates built into the cash flows and the discount rate which would in turn yield an incorrect value.

220. The point was explained as follows in McKinsey's *Valuation – measuring and managing the value of companies* (5th ed.) at 621-626:

> *"To value a company with international operations, first forecast the components of cash flow in their most relevant currency. This means forecasting the British- pound cash flows in British pounds, the Swiss-franc cash flows in Swiss francs, and so on, before combining them into a set of financials for the entire company.*
>
> *A company valuation should always result in the same intrinsic value regardless of the currency or mix of currencies in which cash flows are projected. To achieve this consistent outcome, you need to use consistent monetary assumptions and one of the following two methods for forecasting and discounting foreign-currency cash flows:*
>
> 1. *Spot rate method: Project foreign cash flows in the foreign currency, and discount them at the foreign cost of capital. Then convert the present value of the cash flows into domestic currency, using the spot exchange rate.*
>
> 2. *Forward rate method: Project foreign cash flows in the foreign currency, and convert these into the domestic currency using the relevant forward exchange rates. Then discount the converted cash flows at the cost of capital in domestic currency.*
>
> ....

In other words, when you project and discount cash flows in different currencies, you cannot make independent assumptions for inflation, interest rates, and forward exchange rates across currencies. To ensure that your valuation results do not change with the choice of currency of denomination for a business's cash flows, you need to ensure that your monetary assumptions for all the currencies involved are consistent as follows:

- *Inflation assumptions underlying cash flow projections in a specific currency need to be consistent with inflation assumptions underlying interest rates in that currency.*

- *Forward exchange rates between two currencies need to be consistent with inflation and interest rate differences between those currencies.*

- *Cash flow projections need to be converted from one currency into another at forward exchange rates."*

221. The experts did not agree on the appropriate approach to address the issue of a mismatch between the currency of projections and the currency of the discount rate:

(a). Mr Good used the forward rate method. He converted RMB cash flows to USD at forward exchange rates for each explicit year from FY18 to FY26, and the FY26 forward rate for his terminal value, then discounted the converted cash flows applying a USD-denominated discount rate.

(b). Mr Beaton did not make an adjustment to the RMB cash flows by applying the spot rate method or the forward rate method. He considered this to be unnecessary since he had included a country risk premium (***CRP***) is his calculation. As a result, he considered (see Beaton 1 at [9.40]) that when deciding on the equity risk premium (***ERP***) to be applied, it was appropriate to use the RMB cash flows and a discount rate calculated by reference to US based data "*adjusted based on a country risk premium specific to the country wherein the majority of the subject company's operations are conducted*." He then converted the discounted RMB cash flows so calculated to USD by applying a spot exchange rate as at the Valuation Date.

(c). the difference in approach has a significant impact on the experts' valuations. Had Mr Beaton used Mr Good's forward rate method his DCF valuation would have been $4.13 per share lower.

222. Mr Good provided extracts from various practitioner textbooks including Duff & Phelps International Cost of Capital: Understanding and Quantifying Country Risk (at page 30):

"A common error in estimating international cost of capital is mixing currencies. According to corporate finance theory, the currency of the projections should always be

consistent with the currency of the discount rate. In practice, this means that the inputs used to derive a discount rate (the discount rate is included in the denominator in a discounted cash flow (DCF) model) should be in the same currency used to project cash flows (the numerator in a DCF model). For example, if cash flow projections are denominated in Canadian Dollars, then the risk-free rate, equity risk premium, and other discount rate inputs should also be denominated in Canadian Dollar terms."

223. Mr Good, in reliance on the approach set out in these textbooks, said that in this case, in order for the forecast cash flows and the discount rate applied to those cash flows to be consistent, it was necessary either to (a) discount RMB cash flows with a RMB discount rate, and then convert the DCF valuation from RMB to USD using the spot exchange rate at the relevant date (the ***RMB Approach***) or (b) convert RMB cash flows into USD cash flows using forward exchange rates, then discount the USD cash flows with a USD discount rate (the ***USD Approach***). Mr Good concluded that having calculated the discount rate using a USD risk-free rate and a US and US ERP, he should, for consistency, apply the USD Approach, converting RMB unlevered free cash flows into USD using the latest forward exchange rates as at the Valuation Date, and then applying the discount rate.

224. Mr Good reviewed and questioned Mr Beaton's approach. He noted that Mr Beaton had performed his DCF entirely in RMB (applying his discount rate to RMB unlevered free cash flows) and then converted his valuation to USD using the spot exchange rate as at the Valuation Date. It appeared to him that Mr Beaton's discount rate was not in RMB. For example, in his cost of equity calculation, Mr Beaton had used a risk-free rate derived from 20-year US treasury securities and a US ERP. This, Mr Good, suggested, showed that Mr Beaton's approach was flawed as it failed to ensure the requisite consistency between the currency of the projections and the currency of the discount rate.

225. Mr Beaton considered that Mr Good had been wrong to make an adjustment for currency risk in the manner he had adopted. Mr Beaton had included a CRP of 1% in his estimate of the Company's cost of equity capital. This, he said, included an element of differential inflation between China and the US which would otherwise be taken into account by making an adjustment for currency risk.

226. Mr Beaton accepted that a valuer needed to make adjustments when cash flows are in one currency and the valuer is using a discount rate based on a different currency but said that (a) he had made an adequate and appropriate adjustment by accounting for country risk (see the transcript for day 7, page 220, 11-22) so that he had in fact a Chinese-based discount rate (see the transcript for day 7, page 211) and (b) he considered that Mr Good's approach of using ten-year forward rates, rather than a single spot rate, was unjustified and introduced an unnecessary

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speculative element which resulted in too low a valuation in a case where the Company's operations were conducted completely and totally in RMB and the ADSs were settled completely in USD so that there was no exchange rate exposure (see the transcript for day 7, page 219).

227. The Dissenting Shareholders submitted that Mr Beaton was right that Mr Good's approach introduced complexity, because it required synthetic forward exchange rates to be estimated using interest rate parity theory. As was confirmed in the practitioner literature, they said, forward exchange rates are not available for most currencies beyond 18 months. Mr Good used estimated forward exchange rates for ten years which had introduced an element of speculation. Furthermore, Mr Good had accepted during his cross-examination that differential inflation between two countries could be taken into account by making an adjustment for currency risk or in a CRP, provided that there was no double-counting of the risk. Mr Good had also accepted that the CRP can be estimated by the International Fisher Effect, which represented the relative inflation rates between the two countries Mr Beaton had included a CRP of 1% in his estimate of the Company's cost of equity capital which included an element of differential inflation between the PRC and the US which could otherwise be taken into account by making an adjustment for currency risk. It also avoided the need to speculate on 10-year forward exchange rates.

228. The Company challenged Mr Beaton's evidence and argued that Mr Good's approach was to be preferred. The Company disputed the proposition, and said that there was no suggestion in Mr Beaton's reports or the literature, that the country risk premium was a proxy for the differential currency risk and Mr Beaton had agreed ((see the transcript for day 7, pages 223-224). The Company also argued that Mr Beaton had been wrong to suggest that the Company was effectively immune to foreign exchange risk. He had accepted in cross-examination that if the renminbi were to fall dramatically the Company's US dollar share price would also fall. Accordingly, the Company invited the Court to adopt the forward rate method, using a USD discount rate and applying forward exchange rates to RMB cash flows for each explicit year from FY18 to FY26.

229. I prefer Mr Good's approach on this issue. It seems to me to be more conventional and reliable, closely following the guidance in the textbooks (see the extract from McKinsey's *Valuation* I have quoted above) and clearly meeting the need to achieve consistent monetary assumptions in the valuation process. Even if it is right that differential inflation between two countries could be taken into account by applying a CRP, I consider the methodology referred to by McKinsey and followed by Mr Good (involving the discounting of the foreign-currency cash flows) to be a more direct and reliable method of dealing with the problem of foreign currency cash flows.

Minority Discount

The experts' opinions

230. Both experts applied a minority discount, but in different ways:

(a). Mr Good applied a 5% minority discount to his DCF model to reflect Mr Zhang's blocking vote and the presence of anti-takeover provisions in the Company's memorandum and articles of association.

(b). Mr Beaton applied a minority discount to his CoTrans methodology (of 10.6%) but declined to apply a discount to his DCF valuation on the basis that the projections underlying the DCF cash flows already reflected cash flows that would flow to a minority shareholder. It followed, according to Mr Beaton, that no value attached to control with the corollary that no minority discount was appropriate.

(c). both experts agreed that the Co-Co method yielded a minority value so that no question of a discount arose when this valuation methodology was used.

(d). the standalone impact of Mr Good's 5% minority discount would be to reduce Mr Beaton's DCF valuation by $3.35 per share.

Mr Good's opinion

231. Mr Good understood that the advice of the Privy Council in *Shanda Games Ltd v Maso Capital Investments Ltd and Others* [2020] UKPC 2 (***Shanda Games***) had established that section 238 required fair value to be attributed to what the dissenting shareholder possesses, so that if the dissenting shareholder possessed only a minority shareholding then it was to be valued as such and a minority discount should be applied where appropriate.

232. Mr Good's starting point was that a minority shareholder did not possess, and therefore could not sell or be paid for the value associated with, control of the company. He quoted from *Business Valuations: Discounts and Premiums* (2nd edition) by Shannon Pratt (page 38) as follows:

> *"Virtually no one questions the reality that a minority position in a company lacks valuable prerogatives of control and potential economic benefits that a control owner enjoys. However, the differential in share value between minority and control shares to reflect the presence or absence of these prerogatives and attendant benefits is difficult to measure."*

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233. It was necessary, he said, to consider whether the particular valuation methodology used produced a value that reflected control rights or only the rights of a minority shareholding. If the former, it would be necessary to remove the value attributable to or reflecting control rights by applying a minority discount. If the latter, no adjustment was needed.

234. Valuation methodologies based on the historical trading price and the CoCo methodology utilised data based on the price of shares transacted on public exchanges, typically being small parcels of shares. Consequently, these two valuation methodologies already reflected the value of a minority shareholding. But this was not the case in relation to the DCF methodology.

235. Mr Good noted that whether a minority discount should be applied to a DCF was dependent on how the DCF was prepared. He cited the following passage from Dr Pratt's book *Business valuation discounts and premiums* (Wiley, 2009) (at page 26):

> *"the income approach can produce either a control value or a minority value. Therefore, it is necessary to understand the assumptions used in the income approach implementation to determine whether a minority discount or a control premium is warranted."*

236. Mr Good said that it was generally accepted that it was the cash flows in a DCF which determine whether a DCF generates a control value (in which case a minority discount should be applied) or a minority value (in which case a minority discount need not be applied). He cited the following passage from Mr Hitchner's book *Financial Valuation, Applications and Models* at page 89:

> *"if the numerator [i.e. the cash flows] includes adjustments related to control, the value conclusion will be a control value. By excluding adjustments related to control, the value conclusion is a minority value. If control adjustments are included in the normalization and the resulting value is a control value, a minority interest discount may be used to adjust from control to minority value."*

237. Mr Good said that control adjustments were adjustments to the cash flows for matters such as related- party transactions and excess compensation.

238. Mr Good further noted that, as Mr Hitchner had said in his book (also at page 89), where a control owner is considered to be running a company for the benefit of all shareholders, minority discounts may still be applied to reflect the potential for changes in the future:

> *"There are often situations where no control adjustments are necessary and the company's control owners run the company to the benefit of the [sic] all the owners. In this situation, the value would be same for minority and control. However, some analysts still apply a minority discount to reflect the risk of a potential change in the control owner or his or her management philosophy."*

239. Mr Good assumed that the Merger Projections were prepared on a controlling basis but that there were no specific control adjustments included within the cash flows. This was on the basis of a response given by the Company's management to a question raised by Mr Beaton in the Management Meeting when management had confirmed that the Merger Projections were "*management's best hope for long-term sustainable growth*" and that expenses in the Merger Projections were "*at market*." Mr Beaton made the same assumption and the point was not disputed by the Dissenting Shareholders.

240. In Table 12 of Good 2, Mr Good extracted a chart from *Guide to Business Valuations* by Fishman Pratt and Griffith labelled *Levels of Value* which identified the different elements that made up the total value of a share and the relevant discounts or premiums applied to move between these levels of value. The table identified the separate values to be attributed to different features. The table stared with the market price of freely traded shares without control rights (the publicly traded equivalent value):

(a). to which was added a premium of 25% where the shares give control rights (the control premium) and a further 20% where there was added value flowing from synergies and strategic benefits to a purchaser of the shares, and

(b). from which was deducted, where the shares represent restricted stock of a public company, a discount of 25% to reflect the shares' lack of marketability, and a further 20% discount where the shares were in a private company and did not have control rights.

241. Mr Good gave an example of a share with a publicly traded minority value of $8.00 per share. Further levels of value could be added to reflect the additional value associated with control. A control premium (25% or a $2.00 premium) could be added to calculate the value of control shares (giving a total value of $10.00 per control share). In these circumstances, a minority discount of 20% would be applied to move from a control value back to a minority value. And a further $2.00 premium (an additional 20%) could be added over and above control value, resulting in a synergistic (strategic) value or acquisition value of $12.00 per share where a buyer was able to achieve strategic or synergistic benefits by an acquisition.

242. When deciding whether to apply a minority discount where the DCF methodology is used, Mr Good considered that there were two key factors to be taken into account. First, the spread of the other shareholdings and other shareholders' voting rights, to see whether there were other

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shareholders who had control rights and secondly the level of protection available to minority shareholders, and the presence in the company's constitution of anti-takeover measures.

243. In this case, Mr Good took into account the following matters. The Dissenting Shareholders' shares represented (in aggregate) approximately 9.7% of all common shares outstanding at the Valuation Date (and only 7.4% of the voting rights), while there was a single shareholder – Mr Zhang, the founder, CEO and chairman of the board of directors of the Company – who held approximately 34.3% of the voting rights in the Company and, as such, had the ability to block special resolutions. He also had significant influence on appointments to the board and therefore also matters such as operational policy, strategy, and dividend policy (the Company's policy being that it did not plan to pay any dividends in the near future). The Dissenting Shareholders' minority shares did not hold such influence. In addition, minority protection provisions were included in the Company's memorandum and articles which could be considered to be anti-takeover terms, such as the board having the authority (without approval by shareholders) to issue any unissued shares and to determine the terms and conditions of such shares. The Company had explained (see page 37 of the FY17 Annual Report) that "*these provisions could deprive our shareholders of opportunities to sell their shares at a premium over prevailing market prices by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transaction*." While Mr Good had disregarded the effect of the Rights Agreement on the Valuation Date for the purpose of his determination of fair value, he took into account the ability of the Company to enter into similar arrangements in the future and that the Dissenting Shareholders' minority shareholding would be unable to control the adoption or removal of such measures.

244. Mr Good noted that takeover premiums of 20%-30% (which implied minority discounts of approximately 17%-23%) were supported by various academic research and market studies (to which he made reference) but in his view a control premium in isolation (where there was no additional synergistic or strategic benefits which would justify an additional premium) would be below this range. He also noted that certain other academics considered that the premium to be paid purely for control was minimal. Furthermore, the minority discount to be applied to publicly listed shares would typically be lower than the discount to be applied to shares in a private company (all other things being equal) since shareholders in public companies generally had greater minority protections.

245. In these circumstances he considered that the proper minority discount in this case would be between nil and 23%. He decided that 5% was the appropriate figure taking into account the fact that the Dissenting Shareholders' shares were in a public company, the inferior voting rights of

the Class A shares compared to Class C shares, the control concentrated in the hands of Mr Zhang as a result of his beneficial ownership of all the super-voting Class C shares and the presence of anti-takeover measures in the Company's memorandum and articles.

Mr Beaton's opinion

246. Mr Beaton did not consider that the factors that Mr Good had relied on justified the application of a minority discount. In his view they did not impact the DCF valuation of the Company since the Company's projected cash flows were prepared by management with Mr Zhang's shareholdings in place. He noted that Professor Damodaran considered that "*The value of control in a firm should lie in being able to run that firm differently and better*" and that "*The value of changing management will be zero in a firm that is already optimally managed and substantial for a firm that is badly managed … If the likelihood of management change happening is low, the expected value of control will also be low … The control premium should be the function of the ease of making management changes*." Mr Beaton considered that in this case management was entrenched and the Company was optimally managed based on the Project Jaguar and Project Thanksgiving projections so that there was no room for such improvements and the value of control would be minimal. Mr Beaton said that in a DCF valuation the cash flow anticipated by the company is discounted at a rate of return that reflected the risk of achieving that cash flow. Both Mr Good and he had determined a WACC that reflected all of the Company's risk related to the cash flow that the Company's management had projected with full knowledge of Mr Zhang's ownership position and the Company's various takeover provisions. As a result, to apply an additional 5% discount for the minority nature of the Dissenting Shares was double counting the impact of the two factors outlined by Mr Good and therefore was not appropriate.

The Company's submissions

247. The Company submitted that the Court should accept Mr Good's minority discount. In his evidence he had confirmed that his opinion as to the need to apply and the quantum of a minority discount was a professional judgment based on his experience. He said that his approach was consistent with studies Mr Beaton had referred to. He did not accept that it was speculative. When it had been put to Mr Good that various analysts had not applied a minority discount to their DCF in respect of the Company he explained that the principal valuation tool deployed by analysts in the available reports appeared to have been price earnings, which already incorporated a minority discount.

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248. The Company noted that in response to questions from me at the end of his cross-examination, Mr Good had agreed that the first question to be explored when considering a minority discount was whether the minority had fair access to the cash flows proportionate to their interest or whether the control owners were exercising their rights in a way which prevented the minority from getting fair access to those cash flows or might do so in the future. There were two limbs to the question. First, whether at the company level the funds were being diverted out of the company and secondly whether even if the company was receiving the full benefit of the cashflows, whether those cashflows were available to benefit all shareholders including the minority shareholders or may not be so available in the future.

249. The Company noted that during his cross-examination Mr Beaton had agreed that the Dissenting Shareholders' inability to influence big decisions was "*a very real disadvantage to which the [Dissenting Shareholders] as minority shareholders were subject*" (see the transcript for day 7 at page 137) and that the power that the substantial shareholders wielded to cash out the public and push through mergers was nicely illustrated by the Company's merger process (also see the transcript for day 7 at page 137). He had also recognised that an email to the Special Committee from one of the Dissenting Shareholders, Maso Capital, dated 21 December 2015 had suggested that for its part Maso Capital considered that it was disadvantaged by reason of the voting power held by Mr Zhang and by reason of the Rights Agreement. The Company submitted that against this backdrop the case for a minority discount was clear. As a matter of principle, a company's beta could never capture risks specific to a given constituency of its shareholders because the Company's beta applied to the Company as a whole. Nor did the proxy beta adopted by the experts in this case capture risks specific to the Company. Mr Beaton was therefore plainly wrong, the Company argued, when he stated that the WACC calculated by the experts reflected all of the Company's risk. The experts' betas did not capture the risks pinpointed by Mr Good as warranting a minority discount. Furthermore, Mr Beaton had been unable during his cross examination and when questioned by me to provide a satisfactory justification for his approach.

The Dissenting Shareholders' submissions

250. The Dissenting Shareholders submitted that Mr Beaton's approach was to be preferred. Mr Good's approach was flawed. His suggestion that some analysts applied a minority discount when no control adjustment was necessary was not a good reason for adopting a minority discount in this case. Mr Good had been unable to point to any reasoned support for this approach in the literature nor to adduce any evidence that analysts applied a minority discount to DCF valuations. His approach was based on mere assertion as to his own practice.

251. The Dissenting Shareholders said that Mr Good had based his opinion that a minority discount should be applied on the risk of private benefits being taken by controlling shareholders but had improperly assumed the existence of such a risk in this case. Professor Damodaran had said (in his paper "*The Value of Control: Implications for Control Premia, Minority Discounts and Voting Share Differentials*") that "*the control premium should be zero for firms where management is already making the right decisions*." Kevin Kreitzman had argued in his article *The Value of Control: Control Premiums, Minority Interest Discounts, and the Fair Market Value Standard* (with which Mr Good had agreed during his cross examination) that "*Control premiums (or minority interest discounts) based on the assumed ability of the controlling shareholders to benefit at the expense of the minority shareholders are zero if the directors are assumed to comply with their fiduciary responsibilities*" and said that "*In effect, control premiums assume that, despite rules and laws to the contrary, controlling shareholders are able to divert value to themselves at the expense of the minority interest shareholders.... If no value is placed on the psychological benefit of being in control, an analysis to support a non-zero control premium could consist of making an estimate of the degree to which the controlling agents would likely violate their fiduciary responsibility and favour one group of shareholders over another*." Mr Good had given weight to the risk that in this case the Company's policy of running its business to the equal benefit of all investors could change in the future but had identified no particular way in which this was likely to happen which would impact the Company's cash flows.

252. Mr Good had agreed during his cross examination with the statement made in the paper entitled "*Value of Corporate Control: Some International Evidence*" by Paul Hanouna and others that "*The value of control is derived in at least two ways. First, control can generate shared benefits for all shareholders by improving the economic performance of the firm. Second, a controlling shareholder can generate private benefits that accrue to itself, possibly even to the detriment of other shareholders*" and that the first way of deriving value from control did not, while the second way might, give rise to a minority discount. But there was no basis in this case, the Dissenting Shareholders argued, for attributing any weight to the risk of the controlling shareholders acting so as to generate such private benefits where Mr Good had agreed that the Company's directors had a common law duty of loyalty to act in good faith in their dealings with or on behalf of the Company and to exercise their powers and fulfil the duties of their office honestly, and a duty to exercise the care, diligence and skills that a reasonably prudent person would exercise in comparable circumstances.

253. The Dissenting Shareholders criticised Mr Good for failing to undertake a cross-check against the approach taken by other analysts' DCF valuations. Had he done so he would have found that no minority discount was applied to the DCF valuations in any of the fourteen reports on which

Mr Good had relied as a cross-check against other aspects of his DCF valuation. This demonstrated the Dissenting Shareholders said a partisan approach. Furthermore, as Mr Good had been compelled to accept in cross-examination, it was an industry practice not to apply a minority discount to a DCF for a public company, which industry practice appeared to have been followed by JP Morgan, Bank of America, Nomura, Credit Suisse, Citi, Morgan Stanley, ICBC, Oppenheimer and, MCM Partners.

254. The Dissenting Shareholders also challenged Mr Good's decision to adopt a 5% minority discount. This, they said, corresponded to a value of more than $73 million. The Dissenting Shareholders submitted that the figures of 5% and $73 million were speculative and arbitrary. Mr Good had given no reason or justification for choosing 5% as opposed to say 1% or 0.5%, and he had accepted that there was nothing in the studies on control premiums to which he had referred in Good 1 which supported a figure of 5% rather than 1% or 0.5%. Furthermore, Mr Good had not identified any particular impact that Mr Zhang's control or the Rights Agreement could have on the Company's cash flows in the DCF or model any way in which Mr Zhang could obtain private benefits, *a fortiori* private benefits valued at $73 million.

255. The Dissenting Shareholders raised a further challenge to Mr Good's approach. They submitted that to the extent that Mr Good had at applied a minority discount to his DCF valuation because Mr Zhang's control or the Rights Agreement might have an impact *on the price at which minority shareholders might be able to sell their shares* he had been wrong to do so. The Dissenting Shareholders said that this approach was unsupported by the textbooks and articles on which Mr Good had relied or by market practice. Mr Beaton had said during his cross examination that "*if the merger did not take place and the company continued to operate in accordance with its forecasted cash flows, and the [Dissenting Shareholders] and even the majority shareholders continued to receive the free cash flow benefits going forward, then … there's no reason to have a discount*." This was consistent with the fact that a DCF valuation allows for the determination of intrinsic value. The financial worth of a share can be assessed for the purposes of section 238 of the Act on the assumption that the dissenting shareholder retains that share and obtains the financial benefits of so doing so. The Court was not required to assume a hypothetical sale, which is what Mr Good must be taken to have assumed on this approach. As Justice Parker had said in *Qunar* (at [84]) the problem with applying the hypothetical sale analogy was that the sellers (dissenting shareholders) might be unwilling and the buyers (the majority) somewhat eager in the context of the merger, and moreover, for the purpose of section 238 there was no sale, simply an extinguishment of rights and the cancellation of shares in return for the entitlement to the fair value payment. Mr Beaton's DCF valuation assumed that a dissenting shareholder retained its shares and obtained the financial benefits of so doing and was an estimate of the value of a

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dissenting shareholder's rights by reference to the financial benefits flowing from the right to participate in the Company's profits and obtain distributions in a winding up, on the assumption that the shareholder retained that share and obtained the financial benefits of so doing.

Discussion and decision

256. There are two issues that arise. First, should a minority discount be applied and secondly, if it is appropriate to apply one, what is the proper quantum?

257. In my view, Mr Good's opinion on the first issue that a minority discount was justifiable and should be applied was reasonable and is to be preferred to Mr Beaton's opinion that no such discount should be applied. But on the second issue I regard, having regard to the challenges made by the Dissenting Shareholders in reliance on Mr Beaton's evidence, Mr Good's selection of a 5% discount as unjustifiably high. I would reduce it by half to 2.5%.

258. On the first issue, Mr Good considered that a minority discount should be applied because (a) the Merger Projections were assumed to be prepared on a controlling basis (as Mr Beaton agreed) and because (b) there were other shareholders who had control rights and the protections available to minority shareholders did not completely remove the risk in the future of those control rights being exercised to the detriment of minority shareholders such as the Dissenting Shareholders. While there was no evidence of current mismanagement benefitting or the diversion of value to Mr Zhang and those in control, nonetheless the Dissenting Shareholders remained in this case subject to a material risk that in future Mr Zhang and those in control may use their superior rights to mismanage the Company or divert value in this way. Mr Good had said, this risk was derived from the inferior voting rights of the Class A shares compared to Class C shares, the control concentrated in the hands of Mr Zhang and the presence of anti-takeover measures in the Company's memorandum and articles. In reliance on Mr Hitchner's view (that even where a control owner is considered to be running a company for the benefit of all shareholders a minority discount may still be applied to reflect the potential for changes in the future) Mr Good considered that a minority discount was justified in these circumstances. This seems to me to be a reasonable conclusion. I was not persuaded by Mr Beaton's evidence to the contrary. It does not seem to me that the fact that the Company's projected cash flows were prepared by management with Mr Zhang's shareholdings in place is an answer to the risks identified and relied on by Mr Good.

259. Furthermore, as I understood the Company's submissions and Mr Good's evidence, they claim that such a risk of detriment justified a minority discount even where no account was to be taken of the impact of the Dissenting Shareholders' weaker position and lesser rights on the price they

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would receive on a sale of their shares. The Privy Council in *Shanda Games* had confirmed the principle that fair value was to be attributed only to what the dissenting shareholder possessed, so that where he/she possessed only a minority shareholding, his/her shares were to be valued taking that into account. The detriment that could be suffered by a shareholder who did not have control and only held a minority interest could be suffered without there being a sale (and without having regard to the reduced share price which he/she could obtain on a sale). This was because the exercise of control powers, which the minority shareholder could not prevent, could impact on the enjoyment and value of the minority shareholder's rights before a sale by reducing or eliminating the payment of dividends or reducing the value of the company and thereby of entitlements to distributions in a winding-up. The quantification of that detriment could be calculated by reference to its impact on the share price. This was not because a sale of the shares was assumed but because the reduction in the share price could be taken to be a proxy for the and another way of measuring and quantifying the effect of the minority shareholder limited rights, and prejudice by way of a reduced access, to the company's cashflows (see the conclusion of my discussion with Mr Good on day 4 of the trial at pages 133–143 of the transcript for day 4). This seems to me to right and to deal with the Dissenting Shareholders' objections to an approach based on the impact of control on the share price.

260. On the second issue, Mr Good selected 5% from within the range of nil - 23%. That range represented in his view the lower and upper limit of the value to be attributed to control (as supported by various academic research and market studies). The determination of the discount had to take into account the fact that where no additional synergistic or strategic benefits were to be taken into account the discount would be below this range and the premium to be paid purely for control was minimal. It appears that Mr Good did not consider that such benefits were relevant in this case and that this was a case of pure control. He considered that a relatively low figure was justified because although the Dissenting Shareholders were subject to material risks they were relatively modest in view of the absence of any history of mismanagement or diversion of cashflows and the fact that the Company was a public company (so that the Dissenting Shareholders had the benefit of a listing and heightened regulation and governance and disclosure obligations to which public company were subject).

261. But Mr Good's 5% discount was not based on any further analysis or an attempt to relate the risk to a monetary sum. As the Dissenting Shareholders pointed out, his discount corresponded to a value of more than $73 million. Mr Beaton considered that no discount, let alone a discount of such a large amount, could be justified. While I have rejected his opinion that no minority discount could be justified I find persuasive his view that in the circumstances of this case the risk derived from the absence of control should be taken only to have a relatively low monetary

value. Once again, I accept that the selection of the 5% figure involves an exercise of professional judgment by Mr Good but even taking that into account choosing 5% (and $73 million) seems to me substantially to overstate the value to be attributed to the risks he has identified and to be unreasonable. I would reduce his minority discount by half and apply such a discount of 2.5%. While I do not consider that a nominal discount (of say 1%) is sufficient in this case, and that a figure above such a nominal discount is justified, I would only apply a small multiple to such a nominal discount. I regard 2.5% as suitably above a nominal sum, to still be related to Mr Good's evidence and to be fair in the circumstances. It seems to me that most if not all of the Dissenting Shareholders submissions (and Mr Beaton's evidence) can be understood as an objection to the high figure selected by Mr Good in the circumstances of this case and I am satisfied that such objections have considerable force.

Co-Co valuation

The experts' views

262. The CoCo valuation is based on multiples derived from the financial information of comparable companies and their market values. Mr Good's CoCo valuation, as I have noted, was US$40.31 to which he ascribed a 30% weighting while Mr Beaton's was US$63.54 to which he ascribed a 15% weighting (Mr Beaton referred to his Co-Co valuation as being based on a Guideline Public Company methodology (***GPC***)).

263. The essential methodology is (a) to identify a set of market listed companies with a business that is similar to the Company's; (ii) to identify from their market values on the Valuation Date and published financial information, multiples of earnings or revenue which their market valuation represents; (iii) to apply the multiples thus derived to the Company's financial information in order; and (iv) to arrive at a valuation of the Company. In any comparison of this sort a key question is the extent to which the multiples being compared are truly comparable.

264. The experts agreed that four companies were properly comparable with the Company, namely China Resources Medical, Harmonicare, New Century Healthcare and Rici Healthcare. Mr Good, but not Mr Beaton, identified a further two, namely Fleury SA and Guangdong Kanghua. Mr Beaton, but not Mr Good, identified a further three companies: Aier Eye Hospital Group, Meinian and Topchoice Medical Corp.

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265. The Company was listed in the US, operated private medical examinations centres for health check-ups and operated in the PRC. Further, the Company was forecast in the Merger Projections to grow its revenue by approximately 25% year-on-year from FY17 to FY20.

Mr Good's analysis and opinion

266. In order to establish which companies might be comparable as at the Valuation Date, Mr Good initially performed a screening process. This identified eighty-eight companies. In order to assess the relevance of these companies as comparators he considered the industry segment in which the companies operated, their geography of operations, certain financial metrics of growth and profitability and the location of the comparator company's listing. He excluded companies in industry sectors which were not comparable to the Company (for example, in the pharmaceuticals and biotechnology sectors). This left companies operating in the healthcare industry. In order to identify separately companies with similar operations Mr Good categorised the companies as health care services – examination (i.e. including companies which operate networks of centres providing medical examination, diagnostic testing, or dental services) and other health care services and facilities. Companies in the former category would in his view be the most closely comparable to the Company in terms of the nature of their operations but companies operating other healthcare facilities and services could also be appropriate comparators, for example where they displayed similar growth prospects.

267. Since market dynamics vary from country to country and influence the performance and prospects of companies operating in different geographies, and healthcare systems vary from country to country (the PRC's healthcare system is distinctive being traditionally hospital based with few primary care physicians and with lower penetration rates for health check-ups than in developed countries such as the US), Mr Good separately identified the geography of operations for each company so as to distinguish between companies operating primarily in the PRC or other major emerging economies and those operating elsewhere. He excluded companies where the data necessary to calculate forward multiples (that is EBITDA estimates for the financial years following the Valuation Date (LFY+1 and LFY+2) was not available; which had, on average, exhibited negative revenue growth over the financial years preceding the Valuation Date or were forecast to experience negative future revenue growth (in contrast to the Company) or which had exhibited negative EBITDA margins historically or were forecast to do so (also in contrast to the Company). This produced a list of thirty-one companies.

268. Mr Good calculated both trailing and forward-looking multiples for each of these companies and focused on the EV/EBITDA multiple as this could more readily be compared between companies

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with different capital structures. He established that companies listed in mainland PRC had consistently some of the highest multiples across his dataset. PRC-listed companies could he concluded exhibit disproportionately higher multiples as a result of their listing being in mainland PRC and of capital restrictions specific to the PRC market. Since the Dissenting Shareholders' shares were not shares in a PRC listed company and since the could not, as minority shareholders, bring about a listing of the Company in the PRC, Mr Good removed those companies (including Meinian) whose listing location was in mainland PRC.

269. Focusing specifically on companies operating either in the PRC or in other major emerging economies, Mr Good considered that Fleury SA and Rici Healthcare and companies in his Health Care Services – Examination category were the most comparable to the Company in terms of their industry segment and operations. He provided summaries of their trailing and forward-looking multiples and noted that (a) Rici Healthcare was another medical examination provider based in the PRC, although its revenue was forecast to grow at a substantially higher rate than the Company's (starting from a lower base, Rici Healthcare held a smaller market share of the PRC private health check-up market than the Company in 2016) and (b) Fleury SA operated patient service centres for medical diagnostic services although in a different geography to that of the Company (but in another major emerging economy) and that its forecast revenue growth was lower than that of the Company.

270. Since this dataset was small Mr Good considered that it was appropriate also consider the multiples for those comparable companies he had identified as operating in his Other Health Care Services and Facilities segment, again focusing specifically on companies operating either in the PRC or in other major emerging economies. There were eleven such companies. Mr Good identified EV/EBITDA multiples for LFY, LFY+1 and LFY +2. The mean was 16.4x for LFY, 14.4x for LFY+1 and 12.4x for LFY+2 while the median was 15.3x for LFY, 13.5x for LFY+1 and 12.4x for LFY+2. Mr Good selected four of these companies as the more appropriate comparators being Guangdong Kanghua, China Resources Medical, New Century Healthcare and Harmonicare which were each operating in the PRC, albeit with forecasts for annual revenue growth which were lower than the Company's (although only slightly lower for New Century and Harmonicare, in particular).

271. Mr Good then combined and compared the multiples for these six companies (Fleury SA and Rici Healthcare plus Guangdong Kanghua, China Resources Medical, New Century Healthcare and Harmonicare). He said that he had not identified any company with the same combination of listing location, business segment, geography, and growth projections as the Company (which in his view was not uncommon with a CoCo analysis), however, he considered that his short-listed

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companies to be suitable comparators because they either operated a network of centres providing medical examination or diagnostic testing or operated hospitals in the PRC and provided a more diverse range of healthcare services.

272. The mean was 27.1x for LFY, 11.7x for LFY+1 and 7.8x for LFY+2 while the median was 11.2x for LFY, 10.2x for LFY+1 and 7.7x for LFY+2. Mr Good noted that the LFY multiple for Rici Healthcare (107.1x) appeared to be a clear outlier (indeed its LFY-1 and LFY-2 multiples were 15.2x and 18.3x respectively).

273. He concluded that he should apply the following EV/EBITDA multiples to the Company's earnings: LFY (FY17): 15.0x; LFY+1 (FY 18): 12.5x and LFY+2 (FY19): 10.0x. Mr Good's calculation, applying these multiples, was summarised in Appendix 16 to Good 1. He considered these multiples to be suitable taking account of (a) the multiples for Guangdong Kanghua, China Resources Medical, New Century Healthcare and Harmonicare which operated hospitals in the PRC and provided a more diverse range of healthcare services, such that they may be less closely comparable to the Company and have lower growth forecasts to the Company such that their multiples could be expected to be comparatively lower and (b) the higher multiples for Rici Healthcare and Fleury SA (albeit that Fleury SA operated and was listed in Brazil with lower growth forecasts, and Rici Healthcare operated in the PRC but with a significantly higher growth forecast).

274. Mr Good applied this multiple range to the Company's EBITDA (see Appendix 16 to Good 1) and calculated an equity value per share for his CoCo valuation as follows: LFY (FY17): $36.87 LFY+1 (FY 18): $41.18 and LFY+2 (FY19): $42.88.

275. Mr Good said that he did not treat Aier Eye, Meinian and Topchoice as comparator companies since those companies were listed in mainland PRC. Mr Good noted, based on the relevant literature, that the PRC stock market had been referred to as being a "*casino*" dominated by retail investors and subject to erratic movements detached from economic conditions. The market was segmented. The PRC's A-share market consisted of shares in mainland PRC companies trading in RMB on the PRC's domestic Shanghai or Shenzhen Stock Exchanges; the B-share market consisted of domestically listed shares in PRC companies traded in USD or HKD and the offshore H-share market of PRC companies traded in HKD on the Hong Kong Stock Exchange. Historically, the PRC's A-shares had only been available to PRC domestic investors and B shares to foreign investors. Discounts of approximately 60-80% were observed for B-shares compared to their A-share counterparts. Certain measures had since been passed which had opened up the PRC's stock market somewhat however the PRC stock market remained subject to government interventions.

276. In Mr Good's view therefore the PRC stock market should be considered as at best only weak-form efficient. Despite the measures implemented to improve access for foreign and institutional investors, PRC listed companies could exhibit disproportionately higher valuation multiples as a result of their listing being in mainland PRC. Mr Good cited the research by Carpenter, Whitelaw and Zou in 2020 (*The A-H Premium and Implications for Global Investing in Chinese Stocks*) on the A-H premium (whereby shares listed in mainland PRC - A-shares - in dual-listed companies have traded at a premium to shares listed in Hong Kong - H-shares - for the same companies) which explained that "*the prices of the A shares have historically exceeded those of H shares by 60% or more on average*" and observed that "*H-share returns are much more highly correlated with the global stock market than A shares*." Mr Good said that this research made reference to a historical average of 60% or more for the A-H premium and noted that, while the premium had fluctuated significantly over time, the data presented in this research paper suggested that the median figure was in that approximate range (or higher) during 2015 and 2016.

277. It was this data and these issues relating to the PRC stock market that in Mr Good's view justified his decision to exclude all mainland PRC listed companies from his list of potential comparator companies. He also noted that JPM had not included any mainland PRC listed companies in its CoCo valuation analysis for the Fairness Opinion.

Mr Beaton's analysis and opinion

278. Mr Beaton searched the public markets in the PRC and surrounding geographies to identify reasonably comparable public companies by using the Capital IQ database. He was also of the view that it was generally difficult to identify public companies that were an exact fit but considered that many public companies had operating and economic characteristics that were similar to the company being valued and that was the case with the Company. He considered both economic and operational characteristics as part of the process in determining sufficient comparability and ultimately the selection of a valuation multiple or multiples. He reviewed the guideline companies for their product/service mix, geographic location and reach, and primary and secondary market offerings and selected guideline public companies based on operations in the PRC or closely surrounding geographies and operations focused on full-service or specialty care hospitals, health check-up and medical treatment facilities. His initial screening identified thirty-four potential guideline companies based on these criteria. He then rejected twenty seven companies primarily due to their focus on specific healthcare or other services unrelated to preventative healthcare including, but not limited to, rehabilitation services, real estate development, maternal health, genetics testing, construction, pharmaceutical manufacturing,

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radiotherapy, cosmetic medicine, skin care and edible mushrooms. This resulted in his list of seven comparable companies.

279. Mr Beaton set out a high-level summary of these companies' operating statistics and highlighted the Company, Meinian and Rici Healthcare since they were direct competitors and offered very similar services. However, the other companies were also useful comparators because they could provide insights into how investors viewed these companies in comparison to the Company because they operated primarily in the PRC healthcare market and were therefore exposed to similar economic, regulatory and demographic influences to the Company.

280. The seven guideline public companies indicated a wide dispersion of valuation multiples. Mr Beaton considered multiples of cash-adjusted enterprise value-to-revenue as well as cash-adjusted enterprise value-to-EBITDA to develop estimates of the enterprise value for the Company. The revenue multiples were derived by dividing each company's market capitalisation by its revenue while the EBITDA multiples were derived by dividing each company's market capitalisation by its EBITDA. The formulation and use of valuation multiples from the public market stock price provided the proxy for which to value the Company.

281. Mr Beaton considered growth and other financial characteristics of the Company as compared with the guideline public companies. Mr Beaton noted that the Company had experienced strong revenue growth when compared to the guideline public companies, with revenue growth between the median and maximum growth rates of the guideline public companies. This strong revenue performance indicated that multiples greater than the median may be appropriate. However, the Company's EBITDA margins had historically been between the 25th percentile and the 75th percentile of the guideline public companies, indicating that a valuation multiple at or slightly below the median may be appropriate (Mr Beaton referred to the FYE whereas Mr Good has referred to the LFY). Notwithstanding the fact that the Company's historical performance in FYE-2, FYE-1 and FYE had been negatively impacted by the protracted go-private activity, given management's forecast for FYE+1, a return to above average profitability compared to the guideline companies was indicated. Based on his analysis of the Company's historical revenue growth rates as well as its anticipated EBITDA growth rates and improved margins, Mr Beaton selected multiples based on his analysis of specific company attributes and their applicability to the Company. When determining the range of multiples applicable to the Company he excluded Topchoice's multiples (in Beaton CR at [2.2], Mr Beaton noted that he had first deemphasised Topchoice's multiples by using median rather than average multiples for his seven guideline companies) as they were considerably higher and considered outliers compared to the other guideline public companies, because Meinian and Rici Healthcare had operations that were most

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similar to the Company and also because Meinian was a direct competitor which had provided a third, and highest, acquisition bid of $25.00 per ADS to acquire the Company. Accordingly, in selecting appropriate revenue and EBITDA multiples to apply Mr Beaton had focused on Meinian's and Rici Healthcare's implied multiples.

282. Meinian and Rici Healthcare's had similar FYE+1 EBITDA multiples, but since Rici Healthcare reported an operating loss in the TTM period, an EBITDA multiple could not be calculated. However, the companies' revenue multiples were materially different. Meinian's TTM (trailing twelve months) and FYE+1 revenue multiples were 6.4 and 5.2 respectively, while Rici Healthcare's TTM and FYE+1 revenue multiples were 2.4 and 1.9 respectively. Furthermore, Rici Healthcare's revenue and EBITDA multiples for the FYE+2 and FYE+3 periods diverged considerably from Meinian's revenue and EBITDA multiples (in addition to all the other guideline companies) signalling that Rici Healthcare was not expected to grow and improve compared to other PRC healthcare providers, including the Company. Mr Beaton focused on his perception of how the market would view the Company in light of Meinian's strategy execution. Although Meinian focused on lower tier cities and charged a lower average selling price (ASP) compared to the Company, Meinian was more profitable. However, the Company's management anticipated that the Company would be more profitable than Meinian in the future upon stabilisation of growth due to enhanced pricing of its services available to the Company from the Tier 1 markets that it serves. Accordingly, Mr Beaton assumed that the Company's revenue and EBITDA multiples would move towards Meinian's multiples, thereby capturing the similarities of the two companies' operations. However he tempered these multiples because of the Company's inferior performance during the go-private period of FY16, FY17 and into FY18. In order to do this he assessed the average multiples for Meinian and Rici Healthcare, which were 4.38x based on TTM revenue, 3.53x revenue based on FYE+1 forecast revenue, 35.21x based on TTM EBITDA and 26.96x based on FYE+1 EBITDA. He then assessed the median revenue and EBITDA multiples for the seven guideline companies to ascertain their comparability to the average multiples for Meinian and Rici Healthcare. Since there were only modest differences between the Meinian/Rici Healthcare averages and the median GPC multiples he chose the median GPC multiples as a more conservative representation of the Company's value.

283. Mr Beaton selected a median revenue multiple from the guideline public companies of 4.02x based on TTM revenue and 3.54x revenue based on FYE+1 forecast revenue. This selected median revenue multiple was the calculated midpoint based on the indicated range of the guideline public companies (the median was not affected by outliers like Topchoice). By comparison, Meinian's TTM revenue multiple was 6.38x and its FYE+1 revenue multiple was 5.19x.

284. When comparing his approach to that of Mr Good, Mr Beaton noted that he had utilised seven guideline companies, all of which operated in China and included two of the Company's direct competitors (Meinian and Rici Healthcare). Mr Good had selected six companies five of which operated in China and one of which, namely Fleury SA, operated in Brazil.

285. Mr Beaton considered that the inclusion of Meinian was justified. It was the Company's largest competitor and had made an offer to acquire the Company before ultimately pulling out of the bidding. Excluding all companies listed in mainland PRC was unjustified. In his opinion, while A shares had typically traded at a premium to H shares, the fact that Meinian was listed on a different stock exchange was not a valid reason for rejecting and excluding it (or indeed all other PRC listed comparator companies) from the dataset. Appropriate adjustments could be made to account for the potential premium differential between A-Shares and H-Shares. In addition, the exclusion of Meinian was difficult to justify since it was the Company's largest and most direct competitor and because Mr Good had included Rici Healthcare, which although it was the Company's other direct competitor, was smaller and less profitable albeit that it was anticipating higher growth due to its small size. These factors made Rici Healthcare a less suitable comparator company than Meinian, which was closer in size and growing at a similar rate to the Company. It appeared that the only reason why Mr Good had included Rici Healthcare and excluded Meinian was their respective stock market listing locations.

286. Mr Beaton had made what he considered to be suitable adjustments based on studies of companies trading in the PRC. He analysed Meinian and Rici Healthcare as direct competitors and then other healthcare companies that provided specific health services that the Company did not provide. He then selected the median multiples for revenue and EBITDA to avoid the influence of unusually low or high multiples. The selected TTM and FYE+1 revenue multiples were 37.2% and 31.9% lower respectively than the actual multiples for Meinian. The selected TTM and FYE+1 EBITDA multiples were 35.2% and 11.5% lower respectively than the actual multiples for Meinian but the FYE+1 EBITDA multiple was identical to Rici's FYE+1 multiple. As a result, Mr Beaton used the multiple from Rici Healthcare as a relevant guideline company. Mr Good had been wrong to discount Rici Healthcare's FYE+1 EBITDA multiple by 46.1% even though the Company was larger and more profitable (these being factors which normally indicated that a higher multiple should be selected). Mr Beaton noted that his implied discounts of the selected multiples to Meinian's revenue and EBITDA multiples were in line with observed premiums for A-Shares over H-Shares. Mr Beaton referred to the study published by Professors Jennifer N. Carpenter, Robert F. Whitelaw, and Zou Dongchen which outlined the size of the Chinese A-Share and H-Share markets ($7.5 trillion and $700 billion, respectively) and

concluded that "*there are apparent investment opportunities for global investors in both the A share and H share markets*." Mr Beaton argued that accordingly the mere fact that a company trades on a PRC exchange was not a valid reason for excluding it from use as a guideline company as long as the premium was recognised and appropriately addressed, as he had done based on the discounts he had applied to the Meinian multiples. Furthermore, a China-based company such as the Company and its shareholders could, in his view, benefit from the higher multiples achieved by A-Share traded companies like Meinian, since the pool of potential acquirers (such as Meinian) could be factored into the investment decision of minority shareholders. Mr Good had been wrong to discount the Rici Healthcare EBITDA multiples as he had done, since Rici Healthcare traded in the H-Share market and was a direct competitor to the Company.

287. Mr Beaton also considered that Mr Good had been wrong to include Fleury SA. It had been in operation for over 90 years and therefore operated in a mature market. In addition, Brazil's GDP had contracted by over 8% per annum from 2014 to 2020 compared to the PRCs positive GDP growth of over 8%. Furthermore, Fleury traded on the Brazilian stock exchange so that if Mr Good was right about his justifications for excluding Meinian, Fleury should have been rejected as well.

288. Furthermore, Mr Beaton considered that Mr Good had been wrong to include Guangdong Kanghua. According to Guangdong Kanghua's 2017 annual report, only 5.1% of its revenue was generated by healthcare check-ups in the form of physical examinations and the vast majority of that revenue was generated by its two hospital locations, not numerous clinics throughout the PRC as was the case for the Company, Meinian, or Rici Healthcare. Given that the economics of Guangdong Kanghua's operations were materially different from the Company's, it was an inappropriate guideline company with low EV/EBITDA multiples due to the focus on its two hospitals as the primary source of its revenue.

289. Mr Beaton said that in contrast, Topchoice, Aier Eye, and Meinian were suitable comparator companies in view of their multiple PRC – located business models, in spite of their trading on PRC stock exchanges. He had adjusted (the word he used was "*de-emphasised*") the multiples generated by Aier Eye, Topchoice, and Meinian by utilising the median multiples, which were not impacted by outliers, either high or low. Nonetheless, these three companies were exposed to the same competitive pressures in the PRC as the Company and therefore represented reliable and relevant comparators.

290. Mr Beaton considered that he had captured the appropriate market multiples from the guideline public companies that operated in the PRC and competed either directly or indirectly with the

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Company while Mr Good had ignored the Company's largest public competitor and substituted a company operating in Brazil with little to no comparative economic attributes to the Company, a company operating in China.

The Company's submissions

291. The Company invited the Court to give a 30% weighting to Mr Good's CoCo valuation.

292. The Company submitted that there were problems with Mr Beaton's approach for adjusting the A-H premium and the mismatch between the pricing of A-listed companies and others. The Company noted that, as I have explained, by adjustment Mr Beaton meant taking an arithmetical average of the multiples of two companies (Rici Healthcare and Meinian – one A-listed and the other H-listed) and comparing that with the median multiple among seven companies (three of them A-listed and four of them not). Mr Beaton had made no attempt to grapple with the actual A-H premium or to quantify it and the mere inclusion of A-listed companies within the average and in the line-up of companies from which the median was derived would distort the outcome. This approach weakened the case that Mr Beaton's analysis was based on comparability or at least close comparability.

293. The Company submitted that Mr Good had been right to exclude A-listed companies from his list of comparators. There was no reliable way of quantifying the A-H premium (Mr Beaton had recognised in his cross examination that doing so was "*tough*") and there was more than sufficient support for Mr Good's view that the stark divide between the pricing of A-shares and H-shares was likely to result in serious valuation distortions. ISS's proxy recommendation had referred to PRC-listed comparators as potentially having "*a distorted valuation given capital restrictions*" and as at December 2017. BAML took the view, when writing to Maso, that "*A-share listed and US-listed Chinese healthcare companies are trading at totally different multiples. The gap can be huge, even when the market does not suspect a pending privatisation. It may not work, if one uses the A-share valuation to justify the valuation for a US-listed stock.*"

294. In its written Closing Submissions, the Company noted that the Court was not bound to adopt the entire population of comparables from either expert and was at liberty to decide on its own set of comparable companies for the purpose of a CoCo analysis. The Company suggested that in this case, where neither expert had suggested that four companies were too few to form the basis of a Co-Co valuation, and where neither expert had relied on his CoCo analysis for more than 30% of his overall valuation, it would be appropriate to use the four companies which both experts had accepted were true comparables, taking into account the necessary adjustments to the

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multiples for Rici Healthcare (where it was common ground that its multiples were "*aberrational*") and for China Resources (which was agreed to have been going through turbulent times). The Company submitted that the Court adopted this approach.

295. The Company noted that both experts had derived assistance from EV/EBITDA multiples and that Mr Beaton had afforded equal weight to EV/Revenue multiples. However, the Company submitted that it was hard to see that revenue multiples could contribute meaningfully to the Court's investigation of fair value. This was because where a company has no operating profits, revenue multiples can form useful data points, but where companies are generating and trading on earnings, revenue multiples are typically less relevant since implicit in the use of a revenue multiple is the proposition that the subject company will earn the same or similar margin as the comparable company from which the revenue multiple is derived. The figures in Mr Beaton's Appendix 7 to Beaton 1 showed that the EBITDA margins of the comparable companies selected by the experts were widely divergent, ranging in LFY from 35% down to 2%.

The Dissenting Shareholders' submissions

296. The Dissenting Shareholders submitted that the key question was the extent to which the multiples being compared with each other were truly comparable and they noted that the parameters of comparability discussed by the experts included:

    (a). the degree of similarity of the business of each company compared to that of the Company. This was an issue that arose whenever the CoCo methodology was applied and was a reason why CoCo comparisons cannot be given undue weight.

    (b). the future prospects of each comparator relative to the Company. A company which was expected to grow quickly would have higher multiples than one which was not. This was also an important issue because the selection of the most appropriate multiples from among the comparators was a matter of judgment. Indeed, the experts' view was that this was the most important issue in comparability.

    (c). the most appropriate types of multiple to use, such as whether they were calculated from profit or revenue.

    (d). the reliability of the market trading prices of the comparator companies' shares.

297. The Dissenting Shareholders noted that Mr Beaton considered that the closest comparators were Meinian and Rici Healthcare, albeit that the Company had lower growth prospects than the first

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and higher than the second. He had found that the mean average of these two companies matched the median of his wider group of comparators so that he had used that median as a more conservative approach. Mr Beaton had then cross checked that result with the various features of the Company as compared to those of the comparator companies to check its reasonableness.

298. The Dissenting Shareholders submitted that Mr Beaton had been right to exclude Fleury SA and Guangdong Kanghua for the reasons he had given. Mr Good had accepted that he had no basis for his assumption that a Brazilian listing was comparable to a US listing, other than the bare fact that MSCI included Brazil in its emerging markets index but he had no reason to suggest that this indicated anything about prices on that exchange. Mr Good had accepted the differences in Fleury SA's business to that of the Company and had given no reasons as to why these should be overlooked. He also had no answer to the point that a report he relied on, from MCM, clearly stated with reasons that the Company should be compared to other businesses operating in the PRC which Fleury SA was not. Guangdong Kanghua was a very different business because its revenue was generated mainly by two large hospitals not by numerous large clinics like the Company. Mr Good had accepted that it was sufficiently different such that care was needed in using its multiples and also that it was a markedly worse company than iKang. Aier, Meinian and Topchoice were similar businesses to the Company and based in the PRC. On their face, they were the most apt comparators and Meinian in particular was clearly the closest comparator.

299. Mr Good has been wrong to exclude all three of them for only one reason, namely that their shares were listed in mainland PRC. This was a wholly insufficient reason to exclude the most apposite comparators. As at the Valuation Date, the PRC stock market was operating in a mature way and was not valued substantially differently from other markets, the A-H premium at that date being only 17.5%. The more rational approach was to consider the relevant comparators and treat with caution any multiples from other markets that looked out of line, which is the approach that Mr Beaton adopted.

300. The Dissenting Shareholders submitted that none of the material relied on by Mr Good supported any proposition that PRC markets were over-valued by the time of the Valuation Date, save for the (undisputed) existence of an A-H premium, which was only 17.5% at that date. In cross-examination, Mr Good was taken carefully through each piece of such evidence as to the operation of the Chinese market and it became clear that (a) most of the material pre-dated the Valuation Date and thus gave no real evidence as at that date; (b) the MSCI document evidenced that important reforms had taken place by the Valuation Date, upon which overwhelmingly positive feedback had been received and Mr Good had accepted that he had failed to take those reforms into account in forming his views; (c) Mr Good continued to rely on the fact that other

reforms were still anticipated in the future but had accepted that he could not express any view that those reforms were relevant to whether the PRC markets would be overvalued (he simply could not express a view either way); and (d) the one up to date academic article that Mr Good had claimed showed that the PRC market was at best weak form efficient, in fact showed that it was at least weak form efficient, meaning, in Mr Good's words, that it was "*more or less properly operating*." On all the evidence, it was entirely possible that A Shares were not overvalued at all at the Valuation Date, which Mr Good had accepted. As Mr Good had also accepted, a 17.5% A-H premium at the Valuation Date was not sufficient for anybody to conclude that a given A share was overvalued.

301. The Dissenting Shareholders also submitted that it was important to bear in mind that an unknown part of that premium related to enhanced growth prospects on Mr Good's own evidence and a further part of the premium related to under-pricing in the H-market, a point made in one of the articles that Mr Good had relied upon, but which he had not considered.

302. When Mr Beaton came to give evidence, none of the numerous materials that Mr Good had relied upon were put to Mr Beaton. Instead, voluminous additional documents were added to the Company's cross-examination bundle shortly before the start of the trial and these were put to him. The Dissenting Shareholders submitted that the Court should not take these new materials into account. Mr Beaton said that he was unable to say anything about the opinions expressed in such documents since he had not had time to study them.

303. The Dissenting Shareholders submitted that an important issue bearing on the selection of multiples from among the comparator companies was the Company's superior growth prospects. That was important because the market values of the comparators were, for this purpose, assumed to represent the net present value of their future cash flows to equity. If company A was expected to grow its EBITDA faster than company B, then A was expected to have higher multiples than B. Accordingly, it was not necessarily the case that the subject company, the Company, must sit in the middle of the best available set of comparators. Instead, the judgment required on selection involved comparing the Company's growth prospects with those of the comparators and determining where in that group (or above or below that group) the Company should be positioned. This issue was critical to the assessment of Mr Good's proposed CoCo analysis because the multiples he had used were numerically approximate to those of Fleury SA, which had markedly lower growth prospects than the Company. Mr Good had agreed during his cross examination that if Fleury SA was the only comparator then his selected multiples should have been higher. He had also accepted that a valuer should have considered whether it was appropriate to use for the Company's multiples, multiples that were so close to Fleury SA's multiples, though

he had failed to do so. When it was put to Mr Good that it was important to consider whether the Company's multiples should be higher since it had twice the growth prospects of Fleury SA he had accepted that this was so but had sought to rely on a claim that the Company had half the growth prospects of Rici Healthcare. But, numerically, that was an exaggeration – Rici Healthcare's revenue growth CAGR at 42.7% was only 1.7 times that of the Company at 25%. The more fundamental problem with Mr Good's defence of his final selected multiples was that his approach to Rici Healthcare incoherently adjusted its multiples downwards while leaving its growth prospects as per their actual revenue growth CAGR. That was incoherent because, as he accepted, there was a direct relationship between the growth prospects and the multiples.

304. The Dissenting Shareholders argued that Mr Good had not only ignored Rici Healthcare's multiple of 107.1 for LFY, but for LFY+1 he had treated its multiple of 23.2 as being "*abnormally high*" and had therefore treated it as being "*too high*" but without making any assessment of how much "*too high*" it was. At the same time, he had continued to treat Rici Healthcare's growth prospects as being represented by the figure of 42.7 and then used that as the justification for ending up with much lower multiples for the Company. This approach made no sense since (a) it was fallacious to conduct an analysis on the basis of Rici Healthcare's actual growth prospects (which were very high), but then use at the same time its heavily adjusted multiples (which had been adjusted downwards on the basis that the growth prospects were anomalous) - the proper approach was either to adjust neither variable, or to adjust both in a consistent way and (b) Mr Good had given full effect to his (fallacious) view of the relationship between Rici Healthcare and the Company by halving the Company's multiples compared to those of Rici Healthcare's but zero effect to the equivalent relationship between Fleury and the Company - to give equal effect to both, he would have had to conclude on multiples that were at least half way between Fleury SA's and Rici Healthcare's, rather than down at the level of Fleury SA and adopting this approach (since according to Mr Good there was no relevant Rici Healthcare multiple for LFY) would not assist in arriving at a multiple, save that the Company's should be significantly higher than Fleury's. For LFY+1, splitting the difference between Fleury SA and Rici Healthcare, Mr Good's multiple ought to have been in the region of 17.8 (which would imply a valuation of $58.64 per share, which was very close to Mr Beaton's valuations); for LFY+2, Mr Good accepted that Rici Healthcare's figure of 7.1 made no sense in the context of the other multiples, so again, the key data point was that the Company's multiples should be significantly higher than Fleury SA's 10.9, whereas Mr Good had concluded on only 10 and since there was no relevant Rici Healthcare multiple for LFY according to Mr Good, this approach would not assist in arriving at a multiple, save that the Company's multiple should be significantly higher than that for Fleury SA.

305. Accordingly, the Dissenting Shareholders submitted that even if PRC listed companies were ignored, Mr Good's own comparators on proper analysis demonstrated that the Company's valuation should be closer to Mr Beaton's figures than his own. This was consistent with Mr Beaton's evidence that if he had excluded PRC listed comparators, he would have ended up with materially the same multiples in any event by virtue of his comparison of the Company's characteristics with those of the comparators. The Court should therefore adopt and apply Mr Beaton's multiples and weighting for the CoCo valuation.

306. On the question of whether it was appropriate to use both revenue and EBITDA multiples, the Dissenting Shareholders argued that Mr Beaton's approach was to be preferred. He had, as I have noted, used both. The Dissenting Shareholders said that this was an obviously sensible approach where the Company's EBITDA was rising very quickly year on year, whereas its revenue was far steadier and where its actual EBITDA had been depressed by non-recurring factors such as the distraction of management as a result of the drawn-out privatisation process. As Mr Good had accepted, there was a close relationship between revenue growth and EBITDA growth over the medium or longer term. Mr Good's evidence that revenue multiples should not be used consisted of quotations from Dr Pratt and Prof Damodaran, but on inspection, it transpired that both authors supported much wider use of revenue multiples than Mr Good had allowed.

Discussion and analysis

307. As the parties pointed out, the only section 238 case to date in which the Court had relied on a CoCo analysis was *Integra* where it had been given a 25% weighting alongside a 75% weighting for a DCF valuation.

308. The core question for the Court is whether the evidence establishes that the comparator companies are sufficiently comparable to justify the CoCo analysis being relied on for the purposes of the section 238 valuation. The comparator companies will never be identical – no two companies ever are – so it becomes necessary to assess whether the similarities are sufficient or whether the differences are so material as to make it unsafe to rely on the comparison. Both parties accepted that the CoCo analysis involved a substantial element of judgment because ultimately, having decided which set of comparator companies to use, and then having decided which multiples to use for those comparators, it was necessary to decide how the Company related to the comparator companies. Both parties also accepted that the selection of the relevant comparables, multiples and the determination of the proper CoCo valuation were ultimately for the Court based on the evidence, with the Court obtaining such assistance from the experts as the Court considered to be helpful and useful. The Court was entitled to arrive at its own view on these matters.

309. As can be seen from my summary of their evidence, and as I summarised at [238] above, both experts undertook a detailed and extensive analysis following a similar process of carefully identifying a pool of comparable companies and then filtering the initial results to remove the least and insufficiently comparable companies to produce a final list whose multiples were calculated so as to allow the expert to judge what multiples should be applied to the Company.

310. In this case, there is a substantial difference between the experts' CoCo valuations. Mr Good's was US$40.31 while Mr Beaton's was US$63.54. They also adopted very different approaches to weighting (which I discuss separately below).

311. The first question is which (if any) comparator companies are to be treated as sufficiently comparable.

312. It seems to me that the four companies which both experts had relied on can be treated as sufficiently comparable. These were China Resources Medical, Harmonicare, New Century Healthcare and Rici Healthcare. The fact that the experts were in agreement on these companies is in my view to be given substantial weight and their joint view should only be displaced if there was some clear and sound reason for doing so. In my view there is not. I note that these four companies were also selected and treated as comparable by other analysts/valuers including JPM (see Beaton 2 table 13).

313. But there was a dispute, as I have noted, regarding the multiples to be used for two of these companies, namely Rici Healthcare and China Resources.

314. As regards Rici Healthcare, Mr Good was closely cross-examined on and challenged at length about his approach (see the transcript for day 5, in particular pages 36-49). I have to say that I found the cross-examination confusing because Mr Good was less than clear in many of his responses although this was in part because he was on occasions interrupted before he could complete his answer, and the questioning then went off down a different path. The following extract is representative (underlining added):

> *"Q. So what are you saying? You're saying that because the LFY-1 and -2 multiples for Rici were different, you've downgraded the LFY+1 and +2 multiples for iKang, is that what you're saying, from what they would otherwise have been?*
>
> *A. Well, I would -- I have two choices with that LFY and LFY+1 for Rici. I either ignore them completely, or I look for other data. And you -- I set out in my first report in the footnotes why those numbers are so high, because Rici is -- spends a lot of money*

on new centres which are partially operating. And they -- Rici produce their own adjusted EBITDA.

Q. *You have not conducted a proper CoCo looking at LFY-1 and LFY-2, have you?*

A. *I only put that number out for Rici, that's correct.*

Q. *Yes. So -- and you have derived your CoCo valuation from the figures in table 9, haven't you?*

A. *When taken with Rici.*

Q. *Well, I don't understand that. You've derived – surely your concluding multiples on this table, they are the ones that feed into your valuation, aren't they?*

A. *Well, I set out what I've done at 7.5.2, which is simply –*

Q. *Surely you can answer the question on that? That the 2 multiples that you conclude on in table 9 are the ones that feed into your valuation, aren't they?*

A. *Oh, sorry. The concluded numbers are, yes.*

Q. *The 15, 12.5 and 10, they are the ones that –*

A. *Correct.*

Q. *- feed into your valuation?*

A. *Correct.*

Q. *And I think you're telling my Lord -- I don't know why you weren't able to give a yes/no answer to this before, but I think you're telling my Lord that those numbers are lower than you would have allocated because of your view of Rici's LFY-1 and -2 figures?*

A. *No.*

Q. *All right.*

A. *Because I would not take into account the LFY, and be cautious about the LFY+1, just for the reasons I've already explained.*

Q. *Right. I'm not sure you have explained. What I would like to know is what you did; okay? Not what you would do, Mr Good. I need to understand what you did and then we can -- then we can discuss it.*

A. *Right. I –*

Q. *What did you do to get to your concluded numbers from this table?*

A. *I dis--- in respect of Rici, I disregarded 107.1.*

Q. *Right.*

A. *As a clear outlier.*

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Q. Okay.

A. I understand the reasons why that was there, and saw that partly that fed into LFY - well, was expected to feed into LFY+1. I then looked at the Rici LFY-1 and -2, to say, okay, so what does a normal Rici look like, which you can also derive other ways from the data in - that's in evidence. And then taking Rici and Fleury as the healthcare exam, thought, okay, well, the LFY is 15, the LFY-2 is 18, LFY+2 is 7. And then I looked at those. I looked at Fleury and I thought that's in Brazil, but it's bigger, has lower growth. And then I looked at the other healthcare ones, which have a range of growths. And I didn't particularly disregard China Resources, because that growth is a one-off problem.

Q. I have to suggest to you that - that - well, first of all, what you've said is incredibly impressionistic, isn't it? You're not explaining how anyone else could actually do the same thing, are you?

A. Agreed that it is - it ends up being looking at the data, and somebody else might look at that data and come to a different number.

Q. And what you've done in relation to Rici -- I mean, I still don't actually understand it; let me make sure I do. I did understand you to say that you discarded the 107 LFY ratio. And I understand that you say that's an aberration, or whatever -- well, you refused it was an aberration. So what? You say it's an outlier? If it wasn't an aberration, why do you discard [it]?

A. Well, I call it a "clear outlier".

Q. Right. So it's an outlier but not an aberration?

A. Sorry, I'm saying it's not an aberration because it's explainable by the underlying business fundamentals, as opposed to some - you know, sort of something's gone wrong with the company.

Q. Right, okay. So –

A. So that's why I perhaps refuse the word "aberration".
Q. Right. So you discard the 107 as an outlier. What do you do with the 23.2?

A. I note it, I think about it, but I also know that the issues that caused the 107.1 to be too high would spill into LFY+1.
Q. And then you say that you somehow took into account the LFY+1 and +2 numbers for Rici alone, but nobody else. How do you take them into account? I don't understand.

A. Well, because I know that the Rici for LFY-1 is 15.2, which is just obviously the year before LFY. So I know that it was trading on about that for the year before. I don't know -- well, I do know actually what the LFY number would be on the adjusted EBITDA. It would be 16.9, but I appreciate that's not in this report. So knowing that about the LFY-1 and the LFY+2, I form a view that, well, Rici, although it's displaying high growth, is not displaying - is not displaying a particularly high multiples that I need to adjust down further.

Q. Is there a relationship between the high growth prospect and the high multiples that you discard as outliers?

> A. *Only very indirectly, in that the high growth comes from investing in centres, and the very depressed profits for LFY for Rici which leads to a very small - sorry, a larger valuation being divided by a very small profit to give a very high multiple.*
>
> ……
>
> A. *Well, I'm not making specific adjustments. I'm saying -- I'm looking at all -- all of them. And I'm saying, well, I don't think it's appropriate to use Rici, which is too high at 23.2, for example, when concluding on LFY, but nevertheless looking at the other data and concluding at 12.5, taking account of Rici."*

315. Mr Good was, in my view, to be understood as confirming that he had ultimately made a judgment as to the proper and reasonable multiples to apply to the Company and that in doing so he had ignored Rici's multiple for LFY (107.1x) but gave limited weight to the multiple for LFY+1 and substantial weight to the multiple for LFY+2. He had concluded that because the issues that in his view had caused the multiple for LFY to be too high (and unreliable or at least the result of one-off and unsustainable factors) would continue to affect and carry over to ("*spill into*") LFY+1 it was necessary to be cautious about the multiple for LFY+1 but LFY+2 could safely be incorporated into his assessment of the Company's multiples because he was able to conclude that Rici Healthcare's growth at that point was likely to be high but not very high.

316. But I did find some aspects of Mr Good's reasoning to be questionable. It seems to me that caution about the multiples for LFY and LFY+1 was justifiable, so that the application of some discounting was reasonable, but I have doubts about Mr Good's decision to ignore completely rather than factor in and give some weight to Rici's multiple for LFY (even if he had concluded that the main reason for the high multiple was factors – such as the high investment in new centres to which he referred in cross-examination - that were short term and would not persist). It also seems to me that the Dissenting Shareholders' charge of inconsistency has some force. It is not consistent, I think, to say both that Rici Healthcare's high growth prospects (compared with the Company's growth prospects) are to be given full weight when deciding that the difference was a reason for not applying its high multiples to the Company, but then to question the reliability of the high growth prospects by saying that some of its high multiples were anomalous and unreliable.

317. In any event, I do accept that the thought process and reasoning revealed by the cross-examination was less than precise and resulted in multiples that must be seen to be somewhat soft and on the low-side, built on a not entirely rigorous analysis.

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318. As I have noted, Mr Beaton was satisfied that he could include and use Rici Healthcare's FYE+1 EBITDA multiple. He analysed the median multiples for revenue and EBITDA for Rici Healthcare, Meinian and the other healthcare companies that provided specific health services that the Company did not provide and showed that these multiples for TTM and FYE+1 revenue multiples were lower than the actual multiples for Meinian and for TTM and FYE+1 EBITDA were lower than the actual multiples for Meinian and that the FYE+1 EBITDA multiple was identical to Rici Healthcare's FYE+1 multiple. He had therefore concluded that it was reasonable to include and use the median multiples he had calculated for Rici Healthcare. He also considered that this was justifiable because the Company was larger and more profitable than Rici Healthcare, factors which normally indicated that a higher multiple should be selected.

319. But as I explain below, I have concluded that mainland Chinese listed companies should not be included in the CoCo valuation analysis because there is an insufficiently reliable basis in the evidence for doing so. This means that Mr Beaton's justification for including and taking into account the full median multiples that he had calculated for Rici Healthcare cannot be relied on.

320. I have noted Mr Beaton's grounds for challenging the inclusion of both China Resources and Fleury SA but on balance I have concluded that they do not justify ignoring these two companies which, for the reasons given by Mr Good, appear to me to have sufficiently strong connections with the Company to justify their multiples being taken into account. But I do accept the Dissenting Shareholders' challenge to the way in which Mr Good did so.

321. It seems to me that the Dissenting Shareholders were right to stress the importance for the CoCo valuation of the Company's superior growth prospects and to question Mr Good's final selection of multiples when they ended up being numerically approximate to those of Fleury SA which had markedly lower growth prospects than the Company. This appears to be a *prima facie* anomaly which required at least a rethink and reassessment which Mr Good admitted he did not undertake. I think that the Dissenting Shareholders were right to rely on the fact that Mr Good had accepted in cross-examination that if this issue had been focussed on and addressed it would have been necessary to consider whether the Company's multiples should be higher since it had twice the growth prospects of Fleury and to say that Mr Good should have accepted. As I have already concluded, Mr Good's approach to taking into account Rici Healthcare's multiples was subject to justifiable criticism and had resulted in multiples for the Company that were on the low side. I also accept that, as the Dissenting Shareholders submitted, Mr Good had overstated the difference between the Company's and Rici Healthcare's growth rates.

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322. I have already explained the adjustments to the Company's multiples that the Dissenting Shareholders proposed in order to deal with these issues and to give proper weight to the impact of Fleury SA's multiples and the Company's higher growth rate. The Dissenting Shareholders argued that the Company's FYE multiple should be significantly higher than Fleury's 14.5; that for LFY+1 taking the average of the multiples for Fleury (12.4x) and Rici Healthcare (23.2x) would be reasonable and result in a multiple of 17.8x and for LFY+2, the Company's multiple should be significantly higher than Fleury's (10.9x) instead of Mr Good's multiple of 10x.

323. It seems to me that Mr Good's approach of using only EBITDA multiples is reasonable, for the reasons he gave, and most appropriate in the circumstances.

324. It seems to me that in the circumstances and although somewhat rough and ready this approach is essentially reasonable, although the multiples proposed are on the high side. Following this basic approach and taking into account all of the factors I have discussed, I have concluded that the Company's EBITDA multiples should be as follows:

(a). LFY: 16

(b). LFY+1: 14

(c). LFY+2: 11

325. I have also concluded that the mainland Chinese companies should not be included in the CoCo valuation. Although I can see that this is some ways sub-optimal and creates a problem for the CoCo valuation because, as was common ground, Meinian was the Company's closest comparator company (and other mainland Chines companies had significant connections with the Company), I have been unable, despite carefully studying Mr Beaton's analysis and the Dissenting Shareholders' arguments, to conclude that Mr Beaton or the Dissenting Shareholders have been able to establish a sufficiently firm foundation for their case that reliable adjustments can be made and quantified to account for the acknowledged and substantial mismatch between the pricing of A-listed companies and others. I also have noted and taken into account the fact that other valuers had concluded that it was inappropriate to rely on and include mainland Chinese companies in a CoCo valuation. As Mr Good pointed out, for example, JPM did not include any mainland Chinese listed companies in its CoCo valuation analysis for the Fairness Opinion (in the Management Meeting the Company had indicated that Meinian had not been included as a comparator by JPM because of its listing location, and there being significant price gaps between the domestic equity market and the H-share international market.

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326. The weaknesses and limitations of Mr Beaton's methodology were highlighted by the Company. They can be seen in the following short extract from his cross-examination (see the transcript for day 5 at page 183-186) (highlighting added):

> *"Q. Well, I mean, I suppose the problem is you say we can adjust for it, but we've certainly got no scientific way of adjusting for it. We've just got this -- this median or an averaging approach. It's not -- you're not quantifying a size premium, are you?*
>
> *A. I'm not using that to quantify the A-H premium. I'm using my expertise and 30 years in the business to come up with what I believe is a reasonable multiple to apply to a company like iKang, that was second in its market; had huge growth prospects going forward according to management.*
>
> *…….*
>
> *Q. [You state that] "Furthermore, a China-based company like iKang and its shareholders could benefit from the higher multiples achieved by A-Share traded companies like Meinian, since the pool of potential acquirers (such as Meinian) can be factored into the investment decision of minority shareholders." So we're agreed that the dissenters can't bring about an A-listing. You've told the court that. What are you factoring in? Or what's the relevance of that sentence?*
>
> *A. That's a good question. So my thought process – when I'm looking at stock picking, stock analysts, investments, everyone -- including in the Carpenter report - looks to, you know, either increasing alpha, decreasing beta and looking at opportunities where there is a contrary movement, if you will, of the stock market; right? Because that is what is going to be driving the returns. And so if I'm an investor in the United States investing in ADSs and I see that companies like Meinian, Topchoice and Aier are trading at double those multiples, then I may have a concept, "Well, shoot, since we're in China, we are being exposed to the same economic factors as Aier Eye, Topchoice and Meinian and those multiples are higher, there's a chance, again, that the investors will be driven towards more buying which would increase the price." But that's my – that was my potential enquiry(?). Plus, the pool of potential acquirers - we saw that Meinian use stock to acquire Ciming -- or "Ciming" - and since their stock is valuable in the A market, they can use those valuable shares to buy a company like iKang, and therefore pay more because they have more valuable stock. And that's the other component of how a potential increase in the multiple could be had from those three companies.*
>
> *…….*
>
> *A. Because there are comparable companies that I believe are comparable that are A-Share traded companies in China with multiples higher than iKang's, there is an opportunity for investors looking at the Chinese market to say, "If iKang" -- and we saw that in emails that Mr Good cited from BAML. We saw it in the Carpenter analysis. We saw it in -- in some of the other investors -- that iKang was undervalued in relation to these H-Share traded companies, therefore the pressure would be to increase iKang's multiple and its value."*

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327. Mr Beaton had, to support his opinion, relied on and referred to the UBS analyst report dated 21 July 2015 in which, he said, the A-Share to H-Share premium was discussed and quantified. Mr Beaton noted that UBS had selected both A-Share and H-share traded companies even though the A-shares traded at premiums to the H-shares and considered UBS' methodology to be pragmatic and reliable. The reliance on the A-shares was, and could be, justified on the basis that returns on the Chinese mainland stocks were attractive due to relative price to equity differentials and not due to the fact that they traded on different exchanges. He also, as I have noted, referred to and relied on the study published by Professors Jennifer N. Carpenter, Robert F. Whitelaw, and Zou Dongchen which had outlined the size of the Chinese A-Share and H-Share markets ($7.5 trillion and $700 billion, respectively) and concluded that "*there are apparent investment opportunities for global investors in both the A share and H share markets*." I can see and accept that Mr Beaton is seeking to capture and find a way of taking into account this upside and added value even though as he accepted he is not seeking to quantify the A-H premium (he had accepted during his cross-examination that quantifying the premium was very tough). The difficulty I have is that it seems to me that the evidence does not establish that this upside and additional value in a reliable and sufficiently precise way.

328. While I accept, once again, that an expert opinion based on the exercise of professional judgment can be relied on (and indeed on many issues the Court will do so or exercise its own judgment which may not always be based on absolutely precise data and assessments), where the reliability of the expert's opinion and judgment and the methodology on which it is based is challenged and the challenge is credible (as it is in my view in this case) then the Court must be cautious and scrutinise the basis for the opinion with care. In this case, as the above extract from his cross-examination reveals, it seems to me that Mr Beaton's approach, while understandable, does not have a sufficiently firm foundation to justify its adoption by the Court in this case. I find that because of the acknowledged serious problems in quantifying (in a mathematically satisfactory or precise way) the A-H premium, Mr Beaton was driven to basing his judgments on generalised assumptions about investor attitudes and some speculation. I do not consider that to be sufficient to permit the Court safely to rely on his approach for the purpose of determining a CoCo valuation of the Company.

329. Indeed, I have found the basis for the CoCo valuation in this case, even though I am satisfied that a CoCo valuation can reasonably be based on the four comparator companies agreed on by the experts, subject to difficult comparisons and judgments and more than a little problematic. As I have noted, and both experts agreed, a CoCo valuation is always challenging but in this case it seems to me there were real problems in assessing both comparability and the relevant variables

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and for that reason, as I explain below, it seems to me that only a low weighting of 10% should be attributed to the CoCo valuation.

CoTrans valuation

The experts' opinions

330. Mr Beaton, as I have noted, gave a 10% weighting to a valuation based upon comparable transactions in the shares of similar companies, while Mr Good gave no weight to this method.

Mr Beaton's opinion and analysis

331. Mr Beaton searched for merger and acquisition transactions of companies with characteristics similar to the Company. He identified twenty potential transactions. These transactions were then individually screened based on the full business descriptions of the target companies. Mr Beaton then narrowed his list to five transactions (Foshan Chancheng Central Hospital Company Limited; Guandong Zhongankang Logistics Group Co., Ltd., Jiangsu Aoyang Health Industry Investment Holding, Ciming Health Checkup Group and Jiande Heyue Enterprise Management Co. Ltd.) involving companies that he considered to be the most closely comparable to the Company based on the underlying operating, financial and geographic characteristics of the target companies. Among these transactions was the acquisition of Ciming Health Checkup Group (***Ciming***) by Meinian, which closed in October 2017. The acquisition agreement was originally signed by the parties in May 2016. In Beaton 1, Mr Beaton said that the total consideration paid to Ciming's shareholders was RMB 2.8 billion for a 72.2 percent stake by Meinian and that the implied total enterprise value paid for Ciming was RMB 3.8 billion (see his table 9). According to information available on the Capital IQ database Ciming's reported total revenue of RMB 1.02 billion implied an enterprise value to revenue multiple of approximately 3.8x. Mr Beaton considered that this transaction was most indicative of the pricing that the Company would command in the open market, as Meinian was a direct competitor which had also attempted to acquire the Company in the same manner as it had acquired Ciming. Meinian's bid to acquire the Company for $25.00 per ADS implied a $1.8 billion value for the Company, a bid price that had increased throughout the negotiations.

332. Mr Beaton considered multiples of cash-adjusted enterprise value-to-revenue to develop an estimate of enterprise value for the Company. Cash-adjusted enterprise value-to-EBITDA was reviewed and considered but ultimately was not used as an indicator of value given the lack of detailed financial data for some of the guideline transactions, leaving a limited number of value

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indicators based on EBITDA. In selecting the appropriate multiple to apply to the Company's financial statistics, Mr Beaton considered the profitability, size, growth, and company-specific risk of the Company compared to the companies in the selected transactions. Given that the Company was larger than the companies acquired, occupied better locations in Tier-1 cities, and had better margins than the two transactions with earnings data, Mr Beaton considered that the Company would have commanded a revenue multiple at least in line with the Ciming transaction, if not higher, since Meinian was also interested in acquiring the Company. The revenue multiple of 3.8x was applied to the Company's TTM revenue of RMB 3,962 million or $578,002,000, resulting in an enterprise value of $2,168,648,000.

333. Mr Beaton had then added cash and equivalents of $44,794,000 and subtracted interest-bearing debt of $214,562,000 to derive the Company's cash-adjusted equity value of $1,998,880,000 on a control, marketable basis, as of 20 August 2018. He then calculated and applied a minority interest discount to equate the value derived to a minority, marketable level of value.

334. However, in Beaton CR, Mr Beaton amended his revenue multiple with respect to Meinian. He said as follows (at 2.6]):

> *"On Schedule 9 of my First Report, I utilized an enterprise value for Ciming of ¥3,811 million based on data provided by CapitalIQ as of the offered date of 15 June 2017, but I did not reduce this enterprise value by cash as I did not have a reasonably current indication of cash and CapitalIQ indicated that no additional consideration of any kind was exchanged. Upon receipt of [Good 2], I noted that the final transaction price was actually ¥4,266.53 million, not ¥3,811.03 million. Furthermore, Mr Good provided a Ciming 2016 Annual Report that contained cash balances as of 31 December 2016. Based on these new inputs, I recalculated the Ciming transaction's revenue multiple to be 3.23 rather than my original 3.75x (rounded to 3.8x in [Beaton 1])."*

335. At [2.7] of Beaton CR, Mr Beaton concluded that "*With the corrected revenue multiple, iKang's corrected implied value after subtracting net debt, adding non-operating assets and applying a 10.6% minority interest discount is ¥11,488 million*" and at [2.8] of Beaton CR he stated that "*Combining iKang's corrected value under the Guideline Company Transaction with iKang's prior values determined under the Discounted Debt-Free Cash Flow Method and the Guideline Public Company Method, results in a per share value of $64.43 and a per ADS value of $32.21, on a minority, marketable basis…."*

336. As regards the minority discount, Mr Beaton said that all empirical data that provided guidance for quantifying minority interest discounts and control premiums were derived from public markets (a control premium was the additional consideration that an investor would pay over a minority marketable equity value, i.e., publicly traded stock prices, in order to own a controlling

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interest the common stock of the company). This data fell into two main categories, first premiums paid for acquisitions of companies compared with public market minority trading prices prior to the acquisition announcement (sometimes called acquisition premiums) and secondly where net asset value was known or reasonably estimated, the percentage discount observed in minority interest transactions compared to the underlying net asset value. Mr Beaton said that his focus was on the first set of data since the Company was a public company and the inputs into his valuation methodologies all derived from the public markets. The main data source for control, or acquisition, premiums was the FactSet MergerStat Control Premium Study. Mr Beaton said that the data (as summarised in chart 40 in Beaton 1) revealed that median one-week deal premiums for global acquisitions averaged around 30.6 percent from 2000 to 2019 but were approximately 24.6 percent and 24.1 percent in 2017 and 2018, respectively. Mr Beaton considered, based on the views of Dr Pratt that because the control premium data exhibited "*tremendous dispersion*", that the use of the median was a more reliable measure of central tendency. Dr Pratt had also noted that a material number of transactions occurred at prices below their premerger public market trading prices constituting a negative premium. Mr Beaton said that since he had data on negative premiums, he had incorporated them into his control premium analysis since excluding them could result in a significant source of upward bias.

337. Furthermore, as Dr Pratt had also pointed out, premiums paid in such transactions (strategic or synergistic transactions) reflected more than just the prerogatives of control on a stand-alone basis. The result of a strategic or synergistic, acquisition was referred to as acquisition value rather than fair value since they reflected additional value beyond just the elements of control. Mr Beaton noted that Steven D. Garber had presented empirical research at an American Society of Appraiser's conference in 1998 in which he separated out the go private transactions in the period from 1988 to 1997 and compared those premiums to the premiums in all transactions. He found that the average premiums paid in the going private transactions were almost twenty percentage points less than the average for all transactions. He attributed this difference to the lack of a premium for synergies. Taking Mr. Garber's empirical evidence, coupled with the observations of Mr. Bradford Cornell in his paper "*Guideline Public Company Valuation and Control Premiums: An Economic Analysis*," 29 January 2013 ("*A major component of the acquisition premium is synergies which, according to the appraisal standard [fair value in Delaware] should not be included in a "going concern*" valuation") Mr Beaton estimated that the control premiums set out in his chart 40 contained above a 25 percent or more synergistic component that related more to the acquirer's individual perception of the transaction than it did to the differential between a controlling and minority interest.

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338. To account for the control attributes related to Meinian's purchase of the remaining 72.22 percent interest in Ciming it did not already own, Mr Beaton applied a minority interest discount of 10.6 percent (although he considered that this minority interest discount may overstate the implied control premium from the Ciming acquisition since Meinian already owned a material interest in Ciming). Mr Beaton used the FactSet MergerStat database which indicated a median control premium of 29.1 percent for sixty two international transactions for the TTM period ended June 30, 2018, excluding negative control premiums and 16.4 percent when negative control premiums were included. Since the control premiums ranged from negative 92.5 percent to positive 515.9 percent, indicating that some companies had been acquired at a significant discount while others had been acquired at a significant premium, Mr Beaton selected the 16.4 percent premium that included negative control premiums since including them produced in his view a more accurate estimate of the overall premiums in the market in 2018.

339. Mr Beaton then calculated a minority interest discount based on the following formula:

$$\text{Minority Discount} = 1 - \left(\frac{1}{1+\text{control premium}}\right)$$

This resulted on a minority discount of 14.1 percent (1 – [1/(1+164)]). However, in Mr Beaton's view the 14.1 percent minority interest discount still contained some synergistic value based on the studies presented by Mr Garber and Mr Cornell so that to account for the impact of synergies on the premiums paid he assumed ("*conservatively*" he said) that 25 percent of the minority interest discount was due to synergies which implied a 10.6 percent minority interest discount, or alternatively, an 11.3 percent control premium. After applying a 10.6 percent minority discount to the Company's cash-adjusted equity value of $1,998,880,000 under the GCT method, the Company's resulting cash-adjusted equity value on a minority, marketable basis amounted to $1,787,659,000, or $50.91 per share ($25.46 per ADS).

Mr Good's opinion and analysis

340. Mr Good placed no reliance on the Ciming–Meinian transaction, in particular given what he regarded as the clear synergies driving it. He explained the underlying principle as follows (Beaton 2 at [8.4.8]).

> *"In my view, it is not appropriate to calculate the fair value of the [Dissenting Shareholders'] shares in the Company based on a transaction where there is likely to have*

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been significant synergistic value included within the transaction price, unless the extent of those synergies can be quantified reliably and the valuation adjusted accordingly."

341. Mr Good considered that a like-for-like comparison of transactions can be particularly challenging where the amount paid included a premium or discount which was specific to that transaction. He explained that he would expect there to have been significant synergistic and strategic benefits available to Meinian from the acquisition of Ciming such that Meinian may have been prepared to pay in excess of intrinsic fair value. He noted that a contemporaneous industry article (in Blue Whale Health) had cited "*the synergies that exist between Meinian and Ciming in the medical examination field*" as a possible reason for the transaction, that MergerMarket had recorded the rationale for the Ciming acquisition as being "*in line with [Meinian's] strategy to increase synergy and improve profitability*" and that the 2017 Ciming Valuation Report, conducted by China United Assets Appraisal Group in connection with the Ciming acquisition, had acknowledged that "*[Meinian and Ciming] are both in the health check-up industry, so there is a certain synergy in the distribution of physical examination outlets and business operations."*

342. Mr Good considered that there were three problems with Mr Beaton's analysis:

(a). the type of multiple calculated by Mr Beaton, and so the amount of revenue for the Company to which it should be applied.

(b). his calculation of the EV/revenue multiple.

(c). the minority discount he applied in order to remove the control attributes associated with the Ciming acquisition.

343. Mr Good noted that Mr Beaton had calculated the revenue multiple of 3.8x for the Ciming acquisition based on information available to him from the CapitalIQ database. He had presented this as a TTM multiple, and applied it to the Company's TTM revenue. However, Mr Beaton's multiple had been calculated using (i) Ciming's equity value as implied by the deal terms revised in June 2017 and (ii) Ciming's revenue figure for the year ended 31 December 2015. As such, Mr Beaton's multiple was not a TTM multiple. Rather it was the Company's LFY-1 multiple. As the Company and Ciming were growing companies, Mr Beaton had therefore overstated his valuation by applying a LFY-1 revenue multiple to the Company's higher TTM revenue. For consistency and to avoid this overstatement, the multiple (subject to the further correction which Mr Good proposed, which I discuss shortly) should instead be applied to the Company's LFY-1 revenue, or alternatively, the revenue multiple for the Ciming acquisition could be calculated

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using Ciming's revenue figure for the year ended 31 December 2016 (LFY) and then applied to the Company's LFY revenue.

344. Mr Good noted that in their calculations of the Company's equity value, he and Mr Beaton had made net debt adjustments. However, Mr Beaton had calculated the revenue multiple of 3.8x for the Ciming acquisition without making any adjustment for the net debt position of Ciming. In order appropriately to calculate the EV/revenue multiple for the Ciming acquisition, Ciming's equity value implied by the transaction should be adjusted to calculate the EV by adding net debt, or deducting net cash. Based on the data available to him from Ciming's publicly available financial statements, Mr Good understood that Ciming was in a net cash position as at 31 December 2016. Mr Beaton's EV/revenue multiple for the Ciming acquisition was therefore overstated as a result of him not making any net cash adjustment. On this basis an adjustment was needed. Mr Good calculated the LFY-1 EV/Revenue multiple for the Ciming acquisition to be approximately 3.5x (lower than Mr Beaton's figure of 3.8x) once Ciming's net cash had been correctly deducted from the transaction's implied equity value and the LFY EV/Revenue multiple for the Ciming acquisition to be approximately 2.9x, using Ciming's revenue figure for the year ended 31 December 2016. Mr Good said that Mr Beaton's CoTrans valuation would be substantially lower if adjusted to reflect these amendments. The results were set out in Table 13 of Good 2. This showed:

	Mr Beaton's Valuation	**Corrected LFY**	**Corrected LFY-1**
Equity value – before minority discount ($m)	2,173.5	1,626.1	1,526.9
Less: 10.6% minority discount ($m)	(229.7)	(171.8)	(161.3)
Equity value – minority ($m)	1,943.8	1,454.3	1,365.5
Equity value per share: minority before synergies discount ($/share)	53.27	39.85	37.42

345. As a result of the control attributes associated with Meinian's acquisition of a 72.22% interest in Ciming, Mr Beaton had applied a minority discount of 10.6% in his CoTrans valuation. His discount of 10.6% was calculated as the median control premium of 16.4% observed in the Factset Mergerstat database for international transactions in the twelve month period ended 30 June 2018, converted to an implied minority discount of approximately 14.1% and reduced by a quarter (Mr Beaton assumed – in a manner which he described as conservative - that a quarter of

the minority discount of 14.1% was due to synergies). Mr Good noted that the median figure selected by Mr Beaton from the MergerStat database included negative control premiums (the median premium would have been 29.1% if the negative premiums were excluded). Mergerstat had presented both of these figures in its control premium study in order to show the impact on its results but ultimately did not include negative premiums in its average and median statistics. Mr Beaton's decision to use the figure of 16.4% was therefore inconsistent with Mergerstat, the effect of which was to reduce the size of his minority discount, and produce a higher valuation. Further, Mr Beaton had reduced his discount by a quarter for the impact of synergies (he had estimated this proportion based in particular on empirical research by Steven Garber in 1998) so that Mr Beaton had removed only the element of value in his CoTrans valuation which he estimated to be related to the value of control, while still including the proportion (3.5%) which he estimated to be attributable to synergies. His valuation therefore still included an element of synergistic value. Mr Good noted that in his view the proper valuation methodology should not include synergistic value (including the value of synergies attributable to one particular buyer) because the proper valuation methodology required that the buyer was a hypothetical arm's length willing buyer.

346. Mr Good concluded that Mr Beaton's CoTrans valuation had therefore been overstated as a result of improperly including synergies. He expected that there would have been significant synergistic benefits available to Meinian (as the largest private medical examination provider in the PRC) from acquiring Ciming (the third largest private medical examination provider in the PRC), such that the Ciming acquisition would probably have attracted a significant synergistic premium. Therefore, Mr Beaton's selection of the median control premium observed by Mergerstat in a twelve month period shortly before the Valuation Date (including negative premiums), and his estimate of 3.5% for the portion attributable to synergies (being a relatively arbitrary one quarter of the median control premium) may be underestimated.

The Company's submissions

347. The Company invited the Court either to give no weight to Mr Beaton's CoTrans valuation or only to take it into consideration after adjusting (a) for Mr Beaton's errors and (b) to remove the synergies driving the acquisition price. The Company argued that a Co-Trans valuation was often a complex and fragile exercise and a valuation based primarily or exclusively on the Ciming acquisition, as proposed by Mr Beaton, was unreliable and should not be used by the Court.

348. Mr Beaton had agreed in cross-examination that, as a matter of principle, synergies affected the price of a transaction, and in relation to the Ciming acquisition he agreed that analysts at the time

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viewed the transaction in terms of a strategic alliance so that synergies were a big part of Meinian's grand plan in taking over Ciming. He furthermore agreed that in order to arrive at a CoTrans valuation based on the Ciming transaction it was necessary to "*strip out something*" for synergies (see the transcript for day 5 at page 61) and that the task was "*not easy*" (see the transcript for day 5 at page 65) not least because there was no one generally accepted formula or textbook method for quantifying and stripping out synergies and calculating control premiums. Accordingly, the Company argued, it was better for the Court to avoid such an exercise that was accepted as being fraught with complexity and subjectivity.

349. Mr Good's analysis of Mr Beaton's errors was correct, as Mr Beaton had acknowledged in Beaton CR and during his cross examination (see the transcript for day 5 at page 61). Two of those errors were significant, namely his miscalculation of Ciming's revenue multiple and his failure to make a net debt adjustment. Applying these corrections had resulted in Mr Beaton's CoTrans valuation being reduced from US$53.27 to US$45.93 per share (see the transcript for day 5 at page 80). The Company criticised Mr Beaton for not making it clear in Beaton CR that he had accepted such a substantial reduction. The Company also noted during Mr Beaton's cross examination that his new valuation of approximately $46 per share was closer to Mr Good's DCF outcome of $38.37 per share than Mr Beaton's $67.07.

350. Furthermore, a separate and important deficiency in Beaton CR was that it presented as fact (at [2.6]) a highly contentious claim regarding the correct figure for the acquisition price. Mr Beaton had written that "*I noted that the final transaction price was actually Y4,266.53 million, not Y3,811.03million*" but in fact there was significant evidence to the contrary (and at the very least, considerable doubt, as to the correct figure). The Company challenged Mr Beaton's interpretation of the Cap IQ report on which he relied (which it said was unclear – Mr Beaton had been required to infer that the consideration had been increased during the course of negotiations – see Day 5, 94-95). But importantly, a MergerMarket report dated October 2017 (i.e. after completion of the transaction) clearly identified the price for the 75% acquisition as $2.7 billion. That report had been exhibited to Mr Good's evidence yet Mr Beaton had insisted that he did not need to review it because had used Cap IQ. Yet the MergerMarket figure was not uncorroborated. It chimed with Meinian's own accounts for the period to 31 December 2017 (which under the heading "*Investment in subsidiaries*" showed an increase in investment in subsidiaries amounting to Y2.702 billion, which was the figure that was assumed by Mr Good based on a value for 100% of Ciming being Y3.7 billion with 72.8% of that sum being Y2.7 billion). The Company noted that Mr Beaton had been forced to accept during his cross examination that Meinian was likely to know how much it paid to buy Ciming. Assuming that the figure in Meinian's accounts was correct, Mr Beaton's CoTrans valuation had to be reduced yet further to US$40.89/share (which

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the Company noted was close to the Merger Price) and that this figure was before any further deduction for synergies.

351. As regards the quantification of synergies, the Company claimed that not only was Mr Beaton's approach unreliable but it also failed properly to remove synergies to convert investment value to fair value. Mr Beaton had drawn on data taken from the 1998 study by Steven Garber and the paper by Bradford Cornell to assert that absent specific evidence as to the quantum of synergies, a round figure of 25% of any control premium could be used to account for synergies. In cross-examination Mr Beaton had described this as a "*generalised assessment based on the Garber analysis"* (see the transcript for day 5 at page 116) which he described as "*the best evidence that [he] [could] provide*" in circumstances in which specific synergistic data in relation to the subject transaction was unavailable. However, having recognised the need to strip out synergies and having purported to quantify them as 25% of the notional total control premium Mr Beaton had then failed to remove the value of those synergies in arriving at his Co-Trans valuation. Instead he had reduced his minority discount by 25%. The effect of that was not to remove synergies so as to convert investment value to fair value but rather to keep the synergistic value within his CoTrans valuation.

352. The Company submitted that Mr Beaton's credibility had been seriously damaged by the need for these corrections and was further damaged by what the Company claimed was a new position he had adopted when confronted by the cumulative effect of the necessary corrections to his CoTrans valuation. These corrections reduced Mr Beaton's CoTrans valuation to US$45.93 per share, leaving his Co-Trans number some 32% below of his DCF valuation. But Mr Beaton had not accepted that this called into question his DCF valuation. He had said during his cross examination that CoTrans valuations were typically expected to produce lower values than DCF valuations for a growth stock. Such a view was at least irrelevant in the circumstances of this case where both Ciming and the Company are high growth stocks, and in any event illogical.

The Dissenting Shareholders' submissions

353. The Dissenting Shareholders submitted that the Court should adopt Mr Beaton's CoTrans valuation. Both experts agreed that one comparable transaction was Meinian's acquisition of Ciming and Mr Beaton's opinion that this was the closest comparable transaction and his methodology were reasonable. The Dissenting Shareholders noted that Mr Beaton had given some (albeit a low) weight to this valuation methodology even though it had resulted in a lower valuation than his other methods (which he considered to be typical of the results of the CoTrans method).

354. The Dissenting Shareholders set out their case on this issue only briefly in their written closing submissions (and did not deal discuss or elaborate on the points made in writing during their oral closing submissions). The points made by the Dissenting Shareholders in their written submissions were as follows.

355. The Dissenting Shareholders argued that Mr Good's criticisms of Mr Beaton's approach did not survive examination.

356. Mr Good had been wrong to assert that Mr Beaton should have used an EBITDA multiple rather than a revenue multiple. As the Dissenting Shareholders had argued in relation to the CoCo valuation, it was entirely appropriate to use a revenue multiple in these circumstances.

357. Mr Good had alleged that an adjustment was required for Ciming's net cash. Mr Beaton had accepted this and agreed that the net cash figure as at 31 December 2016 could be used as the best available proxy for the position at the transaction date of 11 October 2017. But this adjustment was more than offset by correcting the transaction proceeds from the offer price originally used by Mr Beaton (RMB 3.811 B) to the actual proceeds that the figures identified by Mr Good had disclosed (RMB 4.266 B).

358. There was also no real evidence for Mr Good's view that the Ciming price included synergies. The Dissenting Shareholders argued that even if the Court was prepared to assume that there were some synergies, a standard quantity of synergies (25% of the control premium) was taken out from the transaction proceeds by Mr Beaton as part of his CoTrans exercise. There was no reason to suppose that this did not cover such synergies as there may have been.

359. Furthermore, the Company was wrong to suggest that the proceeds figure shown on the CapitalIQ data produced by Mr Good was incorrect. As Mr Beaton had explained, the CapitalIQ document made it clear that the deal terms had changed and this accounted for the existence of other materials referring to the earlier price.

Discussion and decision

360**.** I accept the Company's submissions on this issue. I do not consider that Mr Beaton's CoTrans valuation is sufficiently reliable to justifying applying it to the determination of the fair value of the Dissenting Shareholders' shares.

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361. Mr Beaton accepted the limited reliability of his CoTrans valuation by only attributing a 10% weighting to it and the Dissenting Shareholders did not mount a vigorous defence of his valuation. Furthermore, the reliability of Mr Beaton's conclusions was called into question and weakened by the corrections he was required to make to his valuation, which were material.

362. Nonetheless, I have carefully reviewed Mr Beaton's analysis and the evidence. However, in my view the criticisms and challenges made by the Company and Mr Good, which I have summarised above, are sound and support the conclusion that Mr Beaton's CoTrans valuation is insufficiently reliable to justify it being relied on for the purpose of the Court's section 238 valuation.

The Market Trading Price

The experts' position

363. Mr Good gave a 10% weighting to a valuation based on an assessment of the market trading price of the Company in the thirty days prior to 12 March 2018. That date is the date on which the Merger Proposal was announced and six months before the Valuation Date (Mr Good referred to it as the ***Announcement Date*** and so shall I). Mr Good's market trading price was $33.04 per share. Mr Beaton gave this approach no weight.

Mr Good's analysis and opinion

364. Mr Good said that an assessment of whether market trading price was an appropriate measure of fair value could not be made in isolation. It was necessary to consider alternative valuation techniques (such as the DCF and CoCo methodologies) alongside the market trading price and view the resulting valuations in the round. There were certain factors which he considered to be relevant when assessing the extent to which the market trading price itself should be relied upon, which included (a) historical share price movements (i.e. how the share price had responded historically to events in the market); (b) the liquidity of and volume of trading in the shares; and (c) the extent of contemporaneous analyst coverage (as well as providing a contemporaneous indication of the valuation opinions of market participants, such coverage can indicate the extent to which the share price was being scrutinised by the market).

365. Mr Good calculated that the 30-day trailing volume-weighted average trading price (***30-day VWAP***) before the Announcement Date was $16.52 per ADS. This price represented an average price at which the Company's ADS were being traded in the period shortly before the market became aware of the details of the proposed Merger. However, the proposal for the Merger was

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not the only privatisation proposal received by the Company in the preceding years. The non-binding Yunfeng 2016 offer had been submitted in June 2016 and the Merger Proposal was subsequently submitted by the Buyer Group on 28 February 2018, following a request from the Special Committee to Yunfeng for a written legally-binding offer. The Rights Agreement also remained in place (from its implementation on 2 December 2015 to immediately prior to the Merger on 18 January 2019). Therefore, in Mr Good's view, further analysis and comparison with other valuation techniques was required in order to consider whether the 30-day VWAP of $16.52 per ADS immediately before the Announcement Date could be said to represent fair value.

366. Mr Good examined the Company's ADS price movement over the period of the Company's listing, alongside the various privatisation proposals received prior to the Merger. The Company's share price over time, he said, appeared to have broadly been responding to announcements of the receipt of privatisation offers. He also compared the Company's historical ADS price movement against its announcements of financial results for FY14 to Q1 FY18, in particular comparing the historical ADS price trend with the movement of three key measures of profitability, being LTM EBITDA, LTM EBITDA Margin and LTM Net Income/(Loss), whereby each LTM metric was plotted at the date of public announcement of quarterly results. Based on this analysis, it appeared that the Company's ADS price movement was broadly consistent with the Company's financial results announcements, in particular in the period between the Yunfeng 2016 Offer in June 2016 and the Announcement Date in March 2018.

367. Mr Good noted that other general market factors may also affect a company's share price (and indeed the intrinsic fair value of the shares). His CoCo valuation had taken account of the relative valuation of the Company compared to comparator companies although he noted that the Company's beta (being a measure of systematic risk which is a function of the expected relationship between the return on an individual security and the return on the market) as at the Valuation Date was significantly lower than its beta prior to the Buyer Group 1 offer. He therefore did not place reliance on the Company's historical beta close to the Valuation Date and noted that this issue also suggested that lessened reliance should be placed on the Company's historical market trading price for the purpose of assessing fair value.

368. Mr Good considered that the volume of trading and the liquidity of the Company's shares were also relevant to an assessment of whether the historical trading price of the Company's shares could be indicative of fair value. The trading price of a share which was liquid and actively traded could provide a strong indication of fair value as it represented an accumulation of pricing from various market participants. Mr Good analysed the Company's 30-day trailing daily average number of shares traded from listing in 2014 until the Merger in 2019. Based on his analysis he

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concluded that the Company's share trading volumes were generally lower in late 2016 to early 2018 (i.e. in the period between the Yunfeng 2016 offer and the Announcement Date); its annual median bid-ask spread was consistently around $0.01 to $0.03 from 2015 onwards, which was broadly consistent with some of the largest US listed companies and that the Company's ADS appear to have been liquid over the period of the Company's listing, including in the build-up to the Announcement Date. Further, according to Bloomberg data there were 39,585 individual trades in the 30 days leading to 9 March 2018 (i.e. immediately prior to the Announcement Date), being an average of approximately 1,320 daily trades. The 30-day VWAP of $16.52 per ADS prior to the Announcement Date therefore represented an accumulation of various valuation opinions within the market.

369. Mr Good also considered the contemporaneous analyst coverage of the Company in order to understand the extent to which the trading price was being analysed by the market and analysts' views and commentary on the market trading price in the build-up to the Announcement Date, and the impact of the Rights Agreement. Mr Good noted that according to the Company's website the Company's analyst coverage encompassed Citi Research (***Citi***), Essence International (***Essence***) and UBS Securities Asia Limited (***UBS***). Using the ThomsonOne platform, he sought to identify reports by these analysts over the period from the Company's listing in April 2014 through to the Merger. Of these three analysts, only the UBS reports (from initiation in May 2014 through to cessation of coverage in April 2016) were available to him via ThomsonOne. However, he also identified analyst reports by Oppenheimer and Co. Inc. (***Oppenheimer***), and China Merchants Securities (HK) Co. Ltd. (***CMS***) in 2014, from ThomsonOne, analyst reports from Citi and Essence in 2014 and 2015 and Bank of America Merrill Lynch (***BAML***) in 2014, from his review of the Data Room. Following the receipt of the buyer group offers, assorted research and analysis was also published covering the Company's privatisation process. However, he did not identify any analyst reporting on the Company by Citi, Essence, UBS, BAML, Oppenheimer or CMS after April 2016. He understood from the Company that sell-side analyst reporting had ceased by then and through to the Valuation Date. Based on his review of these reports he noted that it appeared that there was an expectation in 2015 that the Company's share price would not be trading with reference to its financial results in the short-term following the receipt of privatisation proposals from Buyer Group 1 and Buyer Group 2 and the implementation of the Rights Agreement. Further, he noted that in its report dated 20 September 2017 MCM Partners had referred to public commentary from Heng Ren Investments (an activist investor in the Company) and attributed the "*abysmal*" performance of the Company's share price to factors such as (a) uncertainty arising as a result of the privatisation process; (b) corporate governance concerns from the presence of the Rights Agreement; as well as (c) the Company's financial performance (in particular, slowing revenue growth, lumpy margins and the financial

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impact of aggressive expansion. However, Mr Good considered that the absence of regular analyst coverage from 2016 onwards made it difficult to determine the extent to which these were views shared widely in the market and in the longer term through to the Announcement Date. However, he concluded that it seemed that certain market participants were of the view that the presence of the Rights Agreement and the privatisation uncertainty had, to some extent, depressed the Company's share price.

370. Mr Good also considered interactions with analysts on quarterly earnings calls. He noted that across the quarterly earnings calls in 2017 (i.e. before the Announcement Date) various external participants were in attendance (including, inter alia, from UBS and BAML) and that certain participants on the calls noted concerns regarding the impact on the share price from the implementation of the Rights Agreement and the progress of the privatisation process. However, the absence of regular analyst coverage over this period meant that it was once again difficult to determine the extent to which these were views shared widely by market participants in the immediate build-up to the Merger Proposal. But Mr Good did note that the Company's CEO had said in June 2017 that the Company's share price was "*not driven by the fundamentals*" while the results of the privatisation process were unknown.

371. Mr Good noted that the 30-day VWAP was $16.52 per ADS immediately prior to the Announcement Date but that between the Announcement Date and the Valuation Date:

(a) the Q3 FY17 results were announced showing a continuing trend of revenue growth and an improvement in the Company's profitability (although profitability had broadly levelled off in the FY17 results which were also announced prior to the Valuation Date), so that the price of $16.52 per ADS may understate the fair value of the Dissenting Shareholders' shares on the Valuation Date to the extent that it did not take account of the subsequent improvement in results announced prior to the Valuation Date.

(b). the share price of PRC companies listed in the US or Hong Kong declined by approximately 15% so that the price of $16.52 per ADS may overstate the fair value of the Dissenting Shareholders' shares on the Valuation Date, to the extent that the Company's ADS price would also have suffered a similar deterioration, but for the Merger.

372. Mr Good noted that if by means of an indicative adjustment he were to roll-forward the 30-day VWAP of $16.52 per ADS prior to the Announcement Date in March 2018 to the Valuation Date (a) at the Company's cost of equity of 11.31% this would equate to an implied price of approximately $17.34 per ADS on the Valuation Date or (b) by decreasing by 15% (in accordance

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with the share price movement of Chinese companies listed in the US or Hong Kong), this would equate to an implied price of approximately $14.04 per ADS on the Valuation Date. However, in his view the cost of equity was not a guaranteed return and ignored market movements so that given the subjectivity of making roll-forward adjustments of this nature, it was preferable to hold the price flat at $16.52 per ADS (or $33.04 per share) as an estimate of the unaffected market trading price on the Valuation Date but for the Merger.

373. Mr Good concluded that the Company's ADS appeared to have been liquid and well-traded and that the Company's share price movement in the period prior to the Announcement Date appeared to have been broadly consistent with movements in the Company's financial results. Accordingly, the combined valuation opinions in the market for minority shareholdings should not therefore be ignored in determining the fair value of the Dissenting Shareholders' shares. Mr Good noted that at any one point in time the market trading price may not have reflected intrinsic fair value since the absence of regular analyst coverage for the Company from 2016 onwards indicated that the stock was being less closely scrutinised by the market and from the limited market commentary which was available in the period prior to the Announcement Date, it appeared that there was some concern that the share price was not trading based on fundamentals while the outcome of the privatisation process remained unclear. On the basis of this analysis Mr Good considered that it was necessary also to make reference to other valuation methodologies in order to compare them with his market trading price estimate and to determine the appropriate weighting to be given to each valuation methodology.

374. Mr Good noted that Mr Beaton had decided to give no weight to the Company's market trading price and that the difference between their conclusions appeared to relate to two issues, namely (a) that Mr Beaton had concluded from an event study, which he conducted in order to test the relationship between news events and share price changes, that the Company's shares were not reacting properly to a significant proportion of the twenty one events he had identified and (b) Mr Beaton's overwhelming emphasis in his conclusion on the results of his event study. However, Mr Good considered that Mr Beaton's approach was unreliable. Empirical findings showed that, even for members of the S&P 500, many potentially material events are not associated with a significant impact on returns, demonstrating the difficulties surrounding conducting event studies. Further, Mr Beaton's event study methodology was highly reliant on his retrospective assessment of how the market should have reacted to events. Mr Good considered that his less subjective analysis indicated that the Company's shares were being traded in larger volumes and achieving larger absolute returns on the days of his twenty one events compared to other days in which the Company's shares were traded on the NASDAQ, and that he was justified in placing a modest weight of 10% on the market trading price, while acknowledging that there were certain factors which detracted from relying entirely on the market

trading price (such as the lack of analyst coverage from 2016 onwards and some concern that the ADS were not trading based on fundamentals while the privatisation process was continuing, and while the Rights Agreement was in place).

Mr Beaton's analysis and opinion

375. Mr Beaton considered the Company's historical share price movement and concluded that after the first take-private bid in August 2015 the Company's traded shares did not reflect the Company's fundamental operating characteristics and therefore could not be considered to be unaffected (contrary to Mr Good's assertion that the unaffected stock price could be identified as at the Valuation Date). Although he agreed with Mr Good that the Company's ADS appeared to have been liquid for the duration of the Company's listing, he disagreed that the 30-day VWAP of $16.52 per ADS prior the Announcement Date represented an accumulation of various valuation opinions within the market. His disagreement was based on his event study (set out in Section 14 of Beaton 1). Mr Beaton considered that he had conducted a robust event study to assess the validity of the Company's market trading price as an indication of fair value. In contrast, Mr Good did not conduct an event study but rather made observations utilising only limited data. In Mr Beaton's view, the market for the Company's ADS was inefficient because stock analysts effectively stopped covering the Company after the first take-private bid and the Company's ADSs did not react appropriately to statistically significant events. Mr Good's lack of a quantitative analysis in assessing the trading price of the Company's ADSs was a significant omission.

376. Mr Beaton noted that the Company's stock price had gyrated significantly over time but with no definitive correlation between a particular offer and the movement of the Company's stock price. For example, after the first offer of $17.80 per ADS on 31 August 2015 the Company's stock price decreased by 8.6 percent to $14.47 on 23 September 2015. Then after the June 2016 offer of $20.00 to $25.00 by Yunfeng, the Company's stock price had meandered downward over the next 12 months to a nadir of $11.73 on 31 July 2017. From that nadir, however, the stock price had improved consistently up to 26 March 2018 when Yunfeng made its final offer of $20.60 per share. The stock price never went above $20.90 per share after the March 2018 offer, representing less than a 2.0 percent increase. This implied, Mr Beaton said, that the Yunfeng offer in March 2018 may have contributed to a lack of any additional stock appreciation until the Merger was consummated in January 2019.

377. In order to assess the impact of various publicly announced events Mr Beaton reviewed the Company's average trading prices within various time periods to ascertain the impact of these

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external events on its stock price. He concluded, based on his assessment of events both internal and external to the Company that transpired between the August 2015 offer and the ultimate March 2018 offer impacting (or failing to impact) the Company's trading price, that the trading price could not be considered a fair indicator of value.

378. Mr Beaton noted that the semi-strong form of the efficient market hypothesis (***EMH***) holds that stock prices reflect all publicly available information while the strong form of the EMH states that stock prices reflect all public and private information. Mr Beaton focussed his analysis on the semi-strong form of the EMH which was in his view the most widely accepted characterisation of what is meant by an efficient market in the securities industry and in academia. Thus a showing that the market for a stock exhibits the characteristics of a semi-strong efficient market would demonstrate that company-specific information reached market professionals thereby affecting stock market prices. If a security's price fully reflected all public information an investor could rely on it as the market's consensus assessment of the security's fair value. Mr Beaton cited and relied on the approach set out in the opinion of Judge Alfred J. Lechner, Jr., in *Cammer v. Bloom* (United States District Court for the District of New Jersey, 1989) which he said was widely considered to be the definitive legal authority in the US on the issue of the efficiency of the market for a company's stock. Judge Lechner had developed standard tests to assess if the market for a stock was efficient and incorporated all publicly available information into the price. In particular, there were five factors which, if alleged, might give rise to an inference that a stock traded in an efficient market:

(a). the stock's average weekly trading volume.

(b). the number of analysts who follow and report on the stock.

(c). the presence of market makers, institutional investors, and arbitrageurs trading the stock.

(d). the company's eligibility to file a Form S-3 Registration Statement with the Securities and Exchange Commission (***SEC***).

(e). a cause-and-effect relationship, over time, between unexpected corporate events or financial news releases and an immediate response in stock price.

379. Mr Beaton said that he believed that the *Cammer* factors were consistent with the economics literature and provided insight into whether the market for a security was efficient. Factor five

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was in his view especially important because it related directly to the definition of an efficient market.

380. In addition to the *Cammer* factors, Mr Beaton identified three factors used to assess the efficiency of the market for a stock. These had been identified in *Krogman* v. *Sterritt* (a decision of the Federal Court for the Northern District of Texas, 2001) and provided three additional indirect criteria consistent with an efficient stock market:

(a). the company's market capitalisation.

(b). the stock's bid-ask spread.

(c). the stock's public float.

381 Mr Beaton examined each of the *Cammer* and *Krogman* factors for the Company's ADS to facilitate a thorough assessment of whether the market for the Company's ADS was efficient or inefficient.

382. As regards *Cammer* factor 1, Mr Beaton concluded that the average weekly turnover for the Company's ADS was 2.90 percent and 2.66 percent for the period before and after the first take-private bid, so that this factor indicated that the market for the Company's ADS was efficient in both periods because the turnover was greater than 2.0 percent. As regards *Cammer* factor 2, since there was no longer consistent or frequent stock analyst coverage regarding fundamental news after the first take-private bid, this *Cammer* factor indicated that the market was not efficient after the first take-private bid and that consequently the Company's ADS may have been susceptible to mispricing (in particular as there was insufficient and less than complete analyst coverage from April 2016 to August 2018, the CEO's unwillingness to entertain other offers was not included in any analyst report and likely not incorporated into an efficient ADS price). As regards *Cammer* factor 3, the number of institutional investors, the number of ADS held by them and trading volume were consistently high both before and after the first take private bid (FountainVest's first offer to acquire iKang on 31 August 2015). At least fifty institutions invested in the Company with their ownership equating to at least 24 percent of the ADS outstanding over the entire review period and these institutions traded at least three million ADS per quarter. High levels of institutional ownership and the active trading by these holders was further evidence that was consistent with the market for the Company's ADS being efficient during both periods. As regards *Cammer* factor 4, this referred to SEC Form S-3 which is a simplified security registration form utilised by businesses that have already met other reporting

requirements. Since the Company is not a U.S. company, it was not eligible to file Form S-3. However, Mr Beaton considered that it otherwise met the financial requirements (voluntarily filing required materials with the SEC and meeting size criteria) to file a Form S-3 – it filed all materials required under the Securities Exchange Act of 1934 and its public float market capitalisation ranged from $800 million to $1.5 billion throughout its trading history) so that the Company's ADS far exceeded the size criteria for this *Cammer* factor, which was only $75 million. A larger market capitalisation for a stock implied it had an open and developed market, which in turn was efficient.

383. As regards *Cammer* factor 5, Mr Beaton relied on his event study. He explained that an event study is used to determine whether a stock's price reaction to a news announcement is statistically significant. It is, he said, consequently the standard analytical technique to assess the stock market's responsiveness to new information when testing for market efficiency. The new information is the "*event*," and the one-day change in the issuing company's stock price the day the information is released into the market indicates the stock market's assessment of the information's significance. The stock market's reaction was consistent with market efficiency when the actual reaction to the new information conformed to the reaction that was directionally expected by the market. Mr Beaton concluded that there were twenty one news announcements or events that were anticipated to have an effect on the Company's ADS price; however, only eight events (38 percent) had a statistically significant change in the ADS price in the direction that it was anticipated to move the ADS price. Therefore the Company's ADS did not react as anticipated for thirteen events (62 percent). Consequently, in Mr Beaton's view, the Company did not properly react to news announcements or events well over fifty percent of the time. This material lack of reaction to news announcements was evident both before and after the first take-private bid and indicated an inefficient market for the Company's ADS throughout the time the Company attempted to go private.

384. Mr Beaton also applied the three additional *Krogman v. Sterritt* indirect criteria and found that each were satisfied and indicated that the market for the Company's ADS was efficient.

The Company's submissions

385. The Company submitted that Mr Good's valuation represented a rational, reliable and balanced approach which should be preferred to Mr Beaton's approach.

386. Mr Good had confined his weighting on the market price to 10%, acknowledging that certain factors detracted from the reliability of the market trading price, such as the lack of analyst

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coverage from 2016 onwards and some concern that the Company was not trading on fundamentals while the privatisation process became clear and while the Rights Agreement was in place. As to the impact of the merger process, Mr Good distinguished between the period to early 2016, during which he considered that the Company's trading price was clearly influenced by the merger bids on the table, and the later period, when the Yunfeng offer was in place, with no apparent progress being made by Yunfeng for many months, when in his view the Company was trading on fundamentals and the Company's ADS price movement was broadly consistent with the Company's earnings announcements. There had been an average of approximately 1,320 daily trades in the 30 days leading up to 9 March 2018, meaning that the 30-day VWAP of US$16.52 per ADS prior to the Announcement Date represented an accumulation of various valuation opinions within the market. When cross-examined, Mr Good had maintained his position that there was a rational basis for affording the market trading price a 10% weighting, highlighting the stock's liquidity, modest bid-ask spread, and the fact the metric is anchored in reality.

387. The Company challenged Mr Beaton's approach in a number of fundamental respects. The Company noted that Mr Beaton's position was that from around the time the analyst coverage stopped in 2016 through to 2018, the Company's share price did not reflect fundamentals and that he had declined to accept that as time went on, and the Yunfeng offer was not accepted, investors' faith in a merger might have waned and their focus might have switched to fundamentals. The Company submitted that much of Mr Beaton's event study was irrelevant to the valuation issue before the Court. An analysis of the efficiency or otherwise of the market for the Company's shares as at 2014, 2015 and 2016 (and sixteen of the twenty one events analysed by Mr Beaton occurred in that period) were of no relevance since the only point in time that the Court was concerned with is the Valuation Date (or rather the last trading date before the Announcement). Insofar as the efficiency of the market price in 2017 and 2018 might suggest the efficiency of the market as at the Valuation Date, it was proper to take it into consideration. But any study of events prior to then could be of no more than academic interest. Only five of the events in the event study were within a relevant period and four out of those five events pointed squarely towards market efficiency, as Mr Beaton had accepted during his cross examination.

388. The Company noted that Mr Beaton had accepted that six of the eight *Cammer* and *Krogman* factors that he considered showed that the market for the Company's shares was semi-strong efficient but it was *Cammer* factor 5 that had ultimately driven his rejection of the market trading price. The Company submitted that Mr Beaton had been wrong to do so.

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389. There were, the Company said, a number of sub-optimal features of Mr Beaton's event study. First, it seemed to be more the work of Mr Beaton's colleague, Dr Wilner, than of Mr Beaton. It was Dr Wilner (see the transcript for day 6 at page 164) who had made the initial decision as to which events would be included in the event study and the figures in Schedule 20 of Beaton 1 (setting out a calculation of stock underperformance in relation to the events he identified as having an impact that did not match the anticipated impact) were prepared entirely by Dr Wilner and his team. Secondly, Mr Beaton had confirmed during his cross examination that he only classified an event as anticipated to be statistically significant if actual earnings or earnings per ADS varied from analyst expectations but this approach was somewhat arbitrary in circumstances where analyst expectations differed and where a limited number of reports had been consulted. As Mr Beaton accepted during his cross examination, he ought to have looked not only at the expectations of UBS but also at those of Citigroup. The Company submitted that it could also be said that Mr Beaton (or at least Dr Wilner) should have looked at all analyst reports, including the reports of Essence International. Thirdly, Mr Beaton's regression model entailed that only movements in excess of market moves could be considered in assessing whether a move was statistically significant. Yet, as Mr Beaton accepted, he could not be sure that the entirety of the Company's stock movement up or down on a given day was referable to the event under consideration. Fourthly and fundamentally, the study was fundamentally subjective. It was singularly reliant on Mr Beaton's (or Dr Wilner's) assessment *ex ante* of how the market ought to have reacted to events. Mr Beaton's instincts could not be treated as a reliable basis for such an analysis.

390. There were also serious shortcomings in relation to Mr Beaton's analysis of the twenty one announcements and events he had identified and relied on. His position was that there were twenty one news announcements or events that were anticipated to have an effect on the Company's ADS price but in fact only eight had a statistically significant change in the ADS price in the direction that he anticipated the ADS price would move. He had concluded that the Company did not react as anticipated for thirteen events and accordingly that the Company did not properly react to new announcements or events over 50 percent of the time. But Mr Beaton had accepted during his cross examination that the average trading volumes on the chosen twenty one event days were almost four times higher than the other days when the Company's shares were trading on the NASDAQ (see the transcript for day 6 at page 182) and that this indicated that the market was open and efficient and was absorbing information.

391. The Company said that it did not accept that there was any value to Mr Beaton's event study. It was sloppily conducted, fraught with subjectivity and largely aimed at an irrelevant time horizon. The indications were, the Company submitted, that at the material time the Company's trading

price could be treated as an index of the Company's value. In particular, the Company challenged Mr Beaton's analysis and treatment of various events as follows:

(a). event 30 was the launch of the Company's mobile medical examination app (9 April 2015). Mr Beaton had recorded in Beaton 1 that this occurred on 9 April 2015 and he anticipated that the impact on returns would be positive whereas the actual impact on returns was marked as neutral. Mr Beaton had classified this as "*Actual did not Match Anticipated Impact*." However, event 30 was examined through the prism of price moves on 9 April 2015, whereas the App itself had been launched on 27 March 2015 and its launch was announced by Citi on 31 March 2015. Mr Beaton, the Company submitted, had conceded during cross-examination that based on what he now knows about the date on which the Company in fact launched the App he would not have included event 30 in his event study, or he would have moved his analysis up to 31 March 2015.

(b). event 33 was the launch of the Company's doctor referral app (24 April 2015). Mr Beaton in Beaton 1 had described this as a significant new initiative and expected that its impact on returns would be positive whereas it was neutral and as such he classified the event as "*Actual did not Match Anticipated Impact*." However, the Company submitted, in his cross examination he accepted that he could not be confident that the Company had not been advertising this new app for weeks prior to the date of the announcement.

(c). event 17 was the Company's earnings announcements (25-28 August 2015) and Mr Beaton considered the impact of the Company's quarterly earnings announcement over a three-day period commencing on 25 August 2015 (although Mr Good considered that in an efficient market the impact of an earnings release would be seen on the first day of a window). In Beaton 1 Mr Beaton had said that the anticipated impact was negative whereas the actual impact was neutral. Accordingly, the event was classified as "*Actual did not Match Anticipated Impact*." The Company submitted that Mr Beaton had conceded in cross examination that he should have set out what happened on day one when the results were in fact announced. In fact the Company's share price fell on the first day by 13.6% (from \$22.65 to \$19.58) and then there was some share price recovery on the two subsequent days. Had Mr Beaton used a one-day event window, he would have found there to be a statistically significant negative excess return and concluded that the market was acting rationally and efficiently.

(d). as regards the events connected with the Merger, at [12.3] of Beaton 1, Mr Beaton had said that the Company's stock price moved in the opposite direction than expected after the

Merger announcement. However, there were in fact only four occasions in Mr Beaton's regression study (see Table 18 Good 2) where the market moved in the opposite direction from Mr Beaton's expectation and two of the events were faulty (in that Mr Beaton had examined share price movements on the wrong dates). The Company said ten out of the eleven Merger related events resulted in a move in the direction that Mr Beaton had anticipated and only three where the movement was deemed not statistically significant.

(e). event 53 was the Meinian group's non-binding bid of US$23.50 (14 December 2015). Mr Beaton considered the impact of the offer (a 20 percent premium above the share price) and anticipated that it would have been positive whereas it was in fact neutral. Mr Beaton classified this as "*Actual did not Match Anticipated Impact*." However, the Company argued, when the offer came in, Mr Zhang was in Buyer Group 1 with a blocking vote and the Meinian bid had been declared hostile. Since there was a poison pill in place only the wildest of optimists would have banked the bid as a development that was likely to yield fruit. Yet Mr Beaton had refused to concede that the fact the market did not react positively to this offer was not unexpected.

(f). event 55 was the Meinian group's non-binding bid of US$25.00 (6 January 2016). Mr Beaton considered the impact on the trading price of the increased Meinian bid but refused to concede that the fact the market did not react positively was not unexpected. The Company submitted that it was of note is that the Company's share trading volumes had increased from 365,000 to 2.450 million around the time of this announcement, before dropping back to 63,000. Clearer evidence of informational efficiency was, the Company said, hard to imagine. Mr Beaton had accepted that the market was absorbing information as it was released so that his quarrel lay only with how the market was responding to the news, namely not in the way that he would personally have anticipated.

(g). event 58 was the Company's announcement of the submission of the report of violation of Anti-Monopoly Law by Meinian Onehealth and its ultimate controlling shareholder Yu Rong (10 March 2016). The Company said that Mr Beaton appeared to have conceded that event 58 was parasitic on events 53 and 55, in that it relied on the fact that, had the market responded as he would have expected for event 55, it should have greeted with unhappiness the Company's move of challenging Meinian's merger with Ciming. If Mr Beaton's event study 55 was flawed, then so was his event 58.

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The Dissenting Shareholders' submissions

392. The Dissenting Shareholders submitted that the market trading price at the Announcement Date was not a reliable indicator of fair value and should not be used by the Court.

393. The Dissenting Shareholders, as I explain below, considered that the Merger Price was itself unrelated to and not a reliable indicator of fair value and noted that on the Announcement Date the Merger Price had been fixed at a 25% premium to Mr Good's for the market trading price. Although, they said, in general a premium to market may not be unusual, in this case there were no synergies as this was a simple take private transaction and on any view, at the date when the Merger Price was agreed, it had emerged from a process which was highly likely to produce a below fair value price because of the position of Mr Zhang and the other factors identified by the Dissenting Shareholders (the Dissenting Shareholders submitted that the Company's sale process was characterised by Mr Zhang wielding his over one-third voting power in the Company, fortified by the implementation of a poison pill pursuant to the Rights Agreement).

394. Those factors, they argued, meant that the market trading price could not be considered to reflect any element of fair value as it represented a 25% discount to a value (the Merger Price) which was known to have been likely to be too low at the same date. If one asked the question whether the market trading price was more likely to be too low or too high, the answer was obvious. Once that conclusion had been reached it must follow that the market trading price could not be treated as an unbiased indicator of fair value and could not be used.

395. In addition to relying on the impact of a comparison with the unreliable Merger Price, the Dissenting Shareholders argued that Mr Beaton's evidence showed that Mr Good's market trading price could not be relied on. Mr Beaton's event study demonstrated that the trading price of the Company's shares in 2015 and 2016 was not determined in a semi-strong efficient way. Furthermore, they noted that this point was of limited relevance since Mr Good had accepted that up to until June 2016 the trading price was not reacting to news but was instead based on the market's view of the likely outcome of the offers made and negotiations being conducted in relation to the proposed take-private transaction. Accordingly, the Court must proceed on the basis that both parties accepted that the market was not efficient at least up to June 2016. After that date, there was a market with no forward guidance from the Company and no analysts reporting so that there was no way properly to measure market expectations and hardly any events that could be expected to generate a price reaction that could be reliably measured. There was no information about what the market's expectations might be. Even if in that in the period shortly before the Announcement Date the market trading price had moved in some generally

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impressionistic way in a similar direction to some measure of profits that did not suggest or show that the trading price had become fundamentally efficient or an indicator of fair value. For that to happen, it would be necessary to assume that the effect and influence of the potential merger had disappeared and there was no proper basis for doing so.

396. The essential problem, the Dissenting Shareholders argued, was that the Company was known to be subject to going private and other proposals for the whole period from 31 August 2015 until the Valuation Date on 20 August 2018. Accordingly, for almost 3 years the market trading price for the Company was primarily determined by market participants' assessment of the likelihood of a deal being concluded and the likely price paid under such a deal. It followed that there is no relevant "*unaffected price*" (probably after the first take private announcement on 31 August 2015) and that the market trading price was not an indicator of fair value.

397. The Dissenting Shareholders submitted that the Company had failed to establish (and that there was no evidence) that the market trading price had shifted to being driven by fundamentals after June 2016. The Dissenting Shareholders relied on the evidence that the analysts had never returned to coverage of the stock (which Mr Good had agreed was an important factor); the impact of the poison pill Rights Agreement on the share price remained unclear (which Mr Good had agreed was a reason why it was not possible to be sure that the trading price was tracking intrinsic value at any given time); the market's interest in the Company's shares never picked up (annual trading volume was 84m, 122m and 102m in 2014, 2015 and 2016, in 2017 it had dropped to 54m, and in 2018 prior to the Announcement Date the annualised figure of only 44m); as noted above, the Company's own CEO had believed in June 2017 that the share price was not driven by fundamentals; Mr Good had identified market commentary from September 2017 stating that share price performance was "*abysmal*" and had not identified any commentary going the other way; the market was aware that the Special Committee was still functioning and regularly asked about the privatisation process in earnings calls so that any rational investor would have been influenced by the knowledge that Mr Zhang was still seeking to take the Company private and that there was at least a real chance that their investment would turn out to be a short-term play on the eventual merger price, rather than a long-term stake in the Company's cash flows and that Mr Beaton (but not Mr Good) had carried out an event study which confirmed that the market trading price of the Company did not react in expected ways to new information.

398. The Dissenting Shareholders also argued that Mr Good's roll forward of a price determined in the 30 days up to 11 March 2018 (from around 24 February 2018) all the way through to 20 August 2018 (almost exactly six months) introduced a massive subjective element, which was sufficient to undermine any possible use of this figure in the final calculation of fair value.

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399. As regards Mr Beaton's event study, the Dissenting Shareholders accepted that most of the events it considered were in the period in which Mr Good had agreed that the market for the Company's shares was not operating normally. To that extent, it (only) confirmed the common ground that the market could not be relied upon up to June 2016. However, the Dissenting Shareholders said that the Company had been wrong to claim that of the five events in the period after June 2016 four had reacted appropriately. That was a bad point because three of the four were after the period from which Mr Good had measured his market trading price.

400. The Dissenting Shareholders also relied on Mr Beaton's further analysis of earnings events after the first take-private offer on 31 August 2015. This showed that in that period when there were few other events to consider, the market had not reacted properly to earnings announcements (and this was an analysis which Mr Good had not sought to address). Mr Beaton had explained the analysis he had done in Beaton 1 at page 178 at fn 297:

> *"I performed another scenario that considered earnings events after the first privatization bid. My criteria for anticipating a statistically significant event was if the year-over-year change in non-GAAP earnings per ADS exceeded five percent. All earnings announcements changed by more than five percent except for iKang's earnings release relating to the quarter ended March 31, 2018, whose actual non-GAAP net income changed by three percent. Consequently, there were an additional nine statistically significant anticipated events, but only one of those events reacted as anticipated. Furthermore, four of the positive anticipated events underperformed by \$2.93, and four of the negative anticipated events overperformed by \$2.98. Therefore, the net effect was an additional underperformance of only \$0.05."*

401. The Dissenting Shareholders noted that if the Court accepted their argument that the distorting impact of the take-private and other proposals from August 2015 meant that a market trading price at the Valuation Date was bound to be unreliable together with their claim that Mr Good's attempt to show why and how this effect could be discounted and treated as immaterial in the period shortly before the Announcement Date and up to the Valuation Date was flawed, then the Court would not need, as Mr Salzedo QC put it in his oral closing submissions, "*to grapple with the eternal debate about market efficiency as a general concept or as the theory applies to this case*." Nonetheless, the Dissenting Shareholders argued that the evidence in this case was that the proposition that major stock markets are generally efficient has not been generally accepted for many years; Mr Good had relied on the article by Cornell & Rutten which made the valuable point that it could be rational to assume reliance on an open and developed market for the purpose of the fraud on the market theory of reliance but the same tests did not establish market efficiency for the purpose of quantification; the same article had made the point that the only two *Cammer* factors which directly addressed efficiency were analyst coverage and market reaction to events which were the two factors by reference to which the Company's share price had failed the test;

in forming his view of market efficiency, Mr Good had relied on a paper by a professional expert witness called Dr Tabak, which he ultimately accepted was of limited relevance; the paper was also flawed for reasons that Mr Good could not challenge; Mr Good had accepted that an event study was a commonly used technique to test market efficiency; Mr Good had relied on a paper by Bhole and others to attack event study methodology in general but he had to accept that the point made there was not applicable and Mr Good had conceded that he was not an expert in event studies but had asked colleagues about Mr Beaton's event study and they had raised no issues about the methodology.

Discussion and decision

402. Mr Good only gave a 10% weighting to his market trading price valuation. As the Company acknowledged, this low weighting was chosen because of the serious problems with the reliability of an analysis of value based on the market price. The question for the Court is whether despite these serious problems any reliance on the market trading price assessed by Mr Good is justifiable (and if some reliance is justified is a 10% or a lower weighting justifiable). In my view, the substantial problems that Mr Good accepted existed in reliably being able to determine whether the Company's market trading price reflected fundamentals during the relevant period, and the weaknesses identified by Mr Beaton and the Dissenting Shareholders in the grounds relied on by Mr Good for his limited reliance on the market price, were so significant that no reliance on his market trading price valuation is justified.

403. Mr Good was cross-examined on his reasons for concluding that the Company's trading price had reverted to being based on fundamentals in the period he measured up to the Announcement Date. The following are relevant and representative exchanges with Mr Salzedo QC (see the transcript day 4 at page 40-44) (underlining added):

> "*A.* *So I am saying that it seems to me on this evidence that the share price up till early '16 is clearly influenced by the offers, and then buyer group 1 and 2 cease, and then there's the Yunfeng offer. But after that, there's essentially radio silence. And after that it appears to be influenced by the fundamentals from the poor financial performance, and particularly in the year to March '17.*
>
> *Q.* *But as you mentioned, in the earnings calls, those participating asked about progress with the Yunfeng offer?*
>
> *A.* *They did.*
>
> *Q.* *So they were clearly interested in that?*
>
> *A.* *Yes.*

.....

A. *At least some participants were. I think the name Peter Halesworth of Heng Ren appears in the earnings calls on this particular point. But not him alone.*

Q. *And the company told him the truth about the continuing negotiations with Yunfeng and Mr Zhang?*

A. *I think that was the -- I think they predominantly simply referred it as a matter for the Special Committee.*

Q. *So I suggest that you - it cannot be right to put any weight on the market price immediately before the Announcement Date as being - because it is - it was influenced by the market's knowledge that the take-private process was still ongoing?*

A. *But at that point, all they have is the Yunfeng offer from -- I need to get the exact date up, but it's sometime in late spring 2016.*

Q. *Yes, June, I think, yes.*

A. *They know that. They know the number. But since then, they - it's not as if there is a -- say, a buyer group 2 number out there that the trading price is influenced by. There's knowledge that somebody might want to buy the business, and might that in fact be an upward price pressure, somebody's going to buy this, potentially - I don't know. I'm not saying that's a factor, I'm just saying - I'm not sure you can say that just because you know there is an ongoing process, at a - at a price which I think was announced in 2016, but since then, radio silence as to pricing, I'm not sure how you can say that that influences the – the market price of the share.*

Q. *Well, it would influence the market price of the share because if you were a rational buyer, you would no longer expect that you were going to end up sharing the long-term profits of the company, you would now expect that you would -- in the short-term, you would probably be able to sell your share for whatever final offer is agreed by Mr Zhang, wouldn't you? That's what you would expect?*

A. *Yes, but you would expect the Yunfeng offer of 20-25 is out there, and that ultimately it may or may not come to pass, because we've had -- there are two known buyer groups that have failed. Albeit I know there is, I think, elsewhere clear understanding that this will happen at some point. You've got a $20-25 price out there since June. To be precise, 6 June 2016. But you've also got a set of trading results from the company, which are not going to just affect fundamentals, they would, I imagine, I would expect, affect the final price that is going to be set in a deal.*

Q. *But I think that answer confirms that rational buyers would be taking account of what they think the deal price ultimately would be likely to be, rather than their long-term benefiting from dividends and so on as shareholders, and therefore that would influence the price?*

A. *But if the price is influenced by the fundamentals, then it's just another way of getting back to the price is influenced by the fundamentals of the company.*

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> Q. *Well, it's influenced by a number of things, but one of the things it's influenced by is the likelihood that there would be a take-private deal in the relatively short-term. Do you agree?*
>
> A. *I don't think they know it's in the relatively short-term. By the time of the VWAP period, which is 8 February/March '18, the 30 days I actually take for market price, there had been no information, as I understand it, apart from "it's ongoing", since 11 June 2016. So I'm not sure how to hypothesise that an investor would factor that into the market price.*
>
> Q. *But a rational investor is going to know, as you said, that the process is ongoing, Mr Zhang wants to take the company private; yes?*
>
> A. *Yes.*
>
> A. *A rational investor is therefore going to know that there is at least a high chance that this is not a long-term investment but ultimately a short-term play on what the deal turns out to be.*
>
> Q. *Well, I don't think I can add much to my previous answer.*
>
> A. *So that very strongly reduces the ability of the market price at that date to reflect fair value, doesn't it?*
>
> A. *No.*"

404. Mr Good relied on his analysis of trading volume (to show liquidity and market-based decision making as to value) and of price movements related to and compared with financial result announcements in his measurement period to show that it was likely that there was sufficient market-based activity based on financial fundamentals to justify some reliance on the market trading price. In his view, the results demonstrated an accumulation of valuation opinions within the market within that period that were based on the company's financial performance, business and prospects which should not be ignored. He countered Mr Beaton's opinion that buyers and sellers in the market were still aware of and must be taken to have been materially influenced when deciding on a sale price by the Merger Process by arguing that the impact of that process could be ignored (or at least treated as immaterial for these purposes) because during this period the process was stalled and uncertain so that buyers and sellers did not have sufficient information about a merger transaction (including the deal price) to use in their decision making instead of and to displace information about the Company's financial position. As he said during his cross examination, there was "*radio silence*" as to the deal price or progress in the Merger negotiations. He did not see how an investor could (or would) factor the Merger into his/her decision making on price. He also decided that no roll-forward adjustment should (or could reliably) be made.

405. It seems to me that while Mr Good identified some market-based indications of value (as did Mr Beaton), they are too limited, speculative and tenuous to be relied on for the purpose of the fair

value determination. I appreciate that Mr Good considered that the status of the Merger process meant that it was unlikely to have been a significant distorting factor in market decision making in his measurement period and that he had detected that the share price "*seemed to be*" (see his cross-examination on day recorded in the transcript for day 4 at page 93, line 22) reacting to the improved news in the results for the period to 31 March 2018 but his views remained, as it seems to me, tentative and I was not persuaded that these data points were sufficient to support his conclusion. It also seems to me that his inability to find and use a reliable methodology for rolling-forward his 30-day VWAP figure to the Valuation Date, when he accepted that an adjustment was necessary, further undermined its reliability.

406. I accept the Dissenting Shareholders' submissions regarding the "*essential problem*" that undermines the reliability of a market trading price valuation in the present case, the lack of adequate evidence to justify the conclusion that the impact of the (unprecedently) long running and uncertain take-private process would have ceased to be material in the period relied on by Mr Good in the run-up to the Announcement Date and as to the additional uncertainty introduced by Mr Good's failure to find a reliable basis for rolling forward his 30-day VWAP figure. I accept the submissions made by the Dissenting Shareholders summarised at [396] and [397] above and found Mr Salzedo QC's challenge to Mr Good's analysis in the extract from his cross-examination to be convincing.

407. Mr Good had accepted that there were major issues affecting the market trading price during 2015, 2016 and 2017. He acknowledged the expectation in 2015 that the Company's share price would not be trading with reference to its financial results in the short-term, had not found any analyst coverage after April 2016 and had noted that on all the quarterly earnings calls in 2017 concerns were expressed regarding the impact on the share price arising from the implementation of the Rights Agreement and the progress of the privatisation process and that in June the Company's CEO had admitted that the Company's share price was "*not driven by the fundamentals*" while the results of the privatisation process were unknown.

408. It seems to me that in these circumstances Mr Good needs to present convincing evidence to show that the information available to and conditions affecting buyers and sellers in the market had changed so as to make it likely that they would have made decisions as to price in the period up to the Valuation Date without the distorting influence of the Merger process and without giving material weight to the effect of a Merger on price and on value. I do not consider that he did so.

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409. He relied on trading volume but accepted that the Company's share trading volumes were generally lower in late 2016 to early 2018 (in the period between the Yunfeng 2016 Offer and the Announcement Date). Furthermore, as the Dissenting Shareholders pointed out, trading activity appears to have remained affected and reduced at least in the sense that the market's interest in the Company's shares never picked up to historic levels. And while trading volumes at a sufficient level demonstrate liquidity, which is an indicator of market efficiency, in this context liquidity alone does not show whether buyers and sellers entering the various trades were basing their decision on financial fundamentals or their view of the likely outcome of the proposed take-private transaction.

410. Mr Good sought to deal with that issue by undertaking a price movement analysis to test the reactions of the market in his measurement period to information regarding, and to link price movements to, the Company's financial performance. He reviewed ADS price movements as they responded to the Company's financial results. He considered the historical ADS price trend against the movement of three measures of profitability being LTM (last twelve months) EBITDA, LTM EBITDA margin and LTM net income/(loss) and plotted each LTM metric at the date of public announcement of quarterly results (see Beaton 1 at [7.2.10] – [7.2.16] and figure 9 and appendix 5). He concluded, as I have noted, that after the period in late 2015 and early 2016 coinciding with the various buyer group offers the ADS price trend was broadly consistent with that of the Company's financial results and in particular that the general downwards trend in LTM Net Income, LTM EBITDA and LTM EBITDA Margin from LTM 31 December 2015 (announced 14 March 2016) to LTM 31 March 2017 (announced 22 June 2017) was mirrored by a general downwards trend in ADS price and the subsequent general upwards trend in LTM Net Income, LTM EBITDA and LTM EBITDA Margin from LTM 31 March 2017 (announced 22 June 2017) to LTM 31 December 2017 (announced 22 March 2018) was similarly mirrored by a general upwards trend in ADS price. He said that based on this analysis, it appeared that the Company's ADS price movement was broadly consistent with the Company's financial results announcements, in particular in the period between the Yunfeng 2016 Offer in June 2016 and the Announcement Date in March 2018.

411. I accept that Mr Good's conclusion that the Company's ADS price movement was *broadly consistent* with the Company's financial results announcements is reasonable based on this data, at least in the period up to the Announcement Date in March 2018. But Mr Beaton's evidence challenges this conclusion and in my view it is, even leaving Mr Beaton's event study to one side, of limited weight where the data stops months short of the Valuation Date and derives from a market in which at the relevant time there was no forward guidance from the Company and no analysts reporting. This does mean, in my view, as the Dissenting Shareholders argued, that there

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was no way properly to measure market expectations and hardly any events that could be expected to generate a price reaction that could be reliably measured. Mr Good acknowledged that an adjustment to roll-forward his 30-day VWAP figure was necessary but was unable to make one. It is also necessary to take into account the impact of the level of and movements in the Company's beta up to the Valuation Date which Mr Good concluded meant that "*lessened reliance should be placed on the Company's historical market trading price for the purpose of assessing fair value*" (see Beaton 1 at [7.2.16]).

412. Some support for the challenge to Mr Good's reliance on his 30-day VWAP market trading price can be derived from Mr Beaton's event study but this in my view is to be given little weight. It was common ground that in the end Mr Beaton's event study was of limited scope and usefulness. The Dissenting Shareholders, as I have noted, accepted that most of the events it considered were in the period which Mr Good had accepted was a period in which the market for the Company's shares was not operating normally, so that it was unnecessary to rely on Mr Beaton's conclusions as they related to that period. They also accepted that three of the four events in the period after June 2016 which the Company said showed an appropriate reaction were irrelevant because they had occurred in the period after the period in which Mr Good had measured his market trading price. Furthermore, the Company demonstrated that a number of material corrections to Mr Beaton's event study were required.

413. However, the Dissenting Shareholders did place particular emphasis on the conclusions that Mr Beaton had reached regarding the market's responses to earnings events after 31 August 2015 (as set out in footnote 297 at page 178 of Beaton 1 which I have quoted above). In Mr Beaton's opinion he had identified an additional nine statistically significant anticipated events only one of which reacted as he had anticipated. The Dissenting Shareholders said that Mr Good had failed adequately to respond to or rebut Mr Beaton's opinion on this point. Mr Good was cross-examined on this (see the transcript for day 4 at page 92):

> *"Q. Am I right to think that you do not comment on that in your supplemental report?*
>
> *A. That's correct. It's only in a footnote.*
>
> *Q. That is a more direct measure, isn't it, of whether the stock price is responding to earnings announcements than your graph?*
>
> *A. But it's requiring, on the day after the announcement, a statistically significant move if the year-on-year change in non-GAAP earnings exceeded 5%. So that's a choice of 5% as your growth rate. There's no analysis really or justification of why a 5% change in earnings would be considered to lead to a statistically significant event. Although that's what he's testing for.*

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Q. If that's the view you take, then that shows the whole problem with trying to rely on the market price at this time, because you've got no way of knowing what the market expects, have you?

A. We have - you have the past history and showing, in particular, that iKang had turned a corner in terms of profitability, and the share price - it appears, and I don't put it any higher than that -- appears coming back, i.e. increasing, on the back of that.

.....”

414. It seems to me that this part of Mr Beaton’s analysis offers some evidence of an inefficient market, but Mr Good’s response shows that it is of limited weight because Mr Beaton’s criterion for identifying statistically significant events was open to challenge as being unreasonable and insufficiently explained or justified. This challenge and weakness in the analysis highlights the core difficulty affecting any event study and assessment of market responses which I have already mentioned, namely the fact that there was no forward guidance from the Company and no analysts reporting at the relevant time so that there was no way properly to measure market expectations against which to test price movements and hardly any events that could be expected to generate a price reaction that could be reliably measured.

415. Mr Beaton’s event study was one part of his overall analysis of the efficiency of the market in the Company’s shares. As I have explained, he analysed whether that market was semi-strong efficient by reference to the *Cammer* and *Krogman v Sterritt* factors. *Cammer* factor 2 is the number of analysts who follow and report on a stock. Mr Beaton concluded since there was no longer consistent or frequent stock analyst coverage regarding fundamental news after the first take-private bid the Company’s ADS may have been subject to mispricing and therefore *Cammer* factor 2 was not satisfied and this was a material reason, supported by the results of the event study, for concluding that the market for the Company’s ADS in the relevant period was not semi-strong efficient. The Company did not challenge the reliability or applicability in this case (or generally in section 238 cases in this jurisdiction) of the *Cammer* and *Krogman v Sterritt* factors (although of course the Company did vigorously challenge Mr Beaton’s application of the factors in this case and note that he had found that six of the eight factors supported the conclusion that the market for the Company’s shares was semi-strong efficient) and it seems to me that (as the Dissenting Shareholders submitted) it is unnecessary and inappropriate for me to express a considered view on whether those factors should be used and the weight to be given to them in this jurisdiction or on the wider disputes concerning whether major stock markets are generally efficient. But I do note that the *Cammer* factors do treat the level of analyst coverage as a separate and important factor and that this supports the view that the absence of adequate analyst coverage is a significant factor when considering whether the market is efficient.

Adequate analyst coverage is an important way of evidencing and establishing, and of allowing a reliable measurement of price movements against, market expectations.

416. Ultimately, the question for the Court on this issue is whether to give Mr Good's 30-day VWAP of US$16.52 per ADS a 10% or zero weighting. I have concluded that in view of all the problems with assessing the reliability of the market trading price in this case as discussed above a zero weighting is the only safe approach.

Merger Price

The position of the experts

417 Neither expert placed any weight on the Merger Price. However, Mr Good used the Merger Price as a cross-check. The Company submitted that, at a minimum, the Merger Price served as a useful cross-check when considering the fair value of the Company's shares.

Mr Good's opinion

418. Mr Good (as he explained in [10.2.7] – [10.2.14] of Good 2 when summarising his opinion and responding to Mr Beaton's views) said that he considered that the circumstances surrounding the agreement of the Merger Price supported his fair value conclusion of $38.42 per share.

419. He noted that three market checks had been conducted by JP Morgan between the end of 2015 and the end of 2016 and that Mr Lu's evidence was that Mr Zhang had "*stated publicly that he would be open to an offer from a friendly party.*" Although certain feedback from JPM's market checks had included concerns about how a third-party privatisation proposal would have been received by Mr Zhang other feedback listed different reasons as to why no competing bids were made, for example the deterioration of business conditions, regulatory uncertainty, limited growth potential and high valuation. He referred to Lu 1 at [75] where Ms Lu stated that "*JPM contacted seven potential buyers, but the initial feedback was that business conditions had deteriorated, and so no one was interested in being a competitor of the Yunfeng Buyer Group or committing their resources to launching a competing bid.*"

420. Mr Good also noted the following facts: that the recommendations given by proxy advisors were to vote for the Merger; that Goldman Sachs and Ora - two of the Company's major unaffiliated shareholders - both voted in favour of the Merger and that between the final offer of $41.20 per

share from the Yunfeng-Alibaba Buyer Group in March 2018 and the Valuation Date, market indices for (US or Hong Kong listed) Chinese companies had declined by approximately 13%-14%.

421 Mr Good concluded that his fair value opinion of $38.42 per share (being slightly below the Merger Price) "*would seem to be consistent with these facts*" but that if Mr Beaton's opinion as to fair value of $65.16 per share was correct "*then the three proxy advisors, Goldman Sachs and Ora were all incorrec*t" which he considered to be unlikely. Goldman Sachs and Ora were both sophisticated, longstanding and major unaffiliated investors in the Company and he considered it unlikely that they would have voted in favour of the Merger if the fair value of their minority shares was 58.2% higher than the Merger Price, as Mr Beaton's conclusion suggested.

422. Mr Good also noted that JPM had performed various analyses for its fairness opinion and had concluded that the Merger Price of $41.20 per share, or $20.60 per ADS, was fair from a financial point of view. While he did not place direct reliance on JPM's analysis for his own fair value assessment, he noted that his fair value assessment would seem to be consistent with JPM's conclusion while Mr Beaton's assessment would not. He challenged Mr Beaton's view that fairness opinions were generally considered to be rubber stamps to justify a deal to investors by referring to a 2021 document prepared by Alvarez & Marsal (who also prepare fairness opinions) in which they explained that their fairness opinions are based on careful analysis and due diligence. Alvarez & Marsal said that in preparing such opinions they worked directly with management and legal counsel to "*build a concise, transaction-specific statement regarding the fairness of a proposed corporate action to a particular stakeholder from a financial perspective. Combining analytics with [their] operational expertise, [they] provide transaction due diligence and frame a clear, industry-relevant valuation analysis that supports [their] opinions*."

423. In his evidence in cross-examination, Mr Good confirmed that his cross-check was based on his expectation that a merger price pursuant to a proper process should be above fair value (see the transcript for day 3 on page 178). Mr Good accepted that (a) Mr Zhang was not in substance a seller in the Merger since he ended up with approximately the same percentage interest in the Company after the Merger as he had before the Merger and (b) that all other things being equal it was likely that in a market where one buyer could veto and prevent a sale being made to any other buyer and had more information than any other buyer, the price that arose from a sale transaction would favour the buyer. He was pressed as to whether he also accepted that it would be likely that such a price would be below fair value. He said that this would not necessarily be so since other factors may have effect to neutralise or reduce the price impact of such a dominant seller/buyer. He mentioned other factors such as "*the strength of the purchaser, the attitude of*

other shareholders [and] in this case the Special Committee" (see the transcript for day 3 at pages 188-190). He also confirmed that he understood Mr Zhang only to have been saying that he was open to joining a buyer group and not that he was open just to being a seller (with no interest in the buyer group) and so he accepted as a result that the market checks were in reality about finding a partner for Mr Zhang rather than an arm's-length buyer.

424. Mr Good was taken during his cross-examination to the four documents (in addition to Ms Lu's evidence) that he had relied on to support his statement regarding other feedback that had listed reasons other than Mr Zhang's position and attitude as to why no competing bids were made.

425. The first document was an email dated 6 January 2016 from JPM to Ms Lu and others which stated as follows:

> *".....Pls also find below a summary of market check results for our further discussion.*
>
> - *New China Life: No interest in this opportunity*
> - *China Resources (Holdings) Co., Ltd: Not interested because this industry is facing regulatory uncertainty. From CR's perspective, if it wants to invest in this sector, forming partnership is preferred (instead of making large, risky investment like this one). Limited growth potential and high valuation are also issues to CR.*
> - *Fosun Pharma: Will consider joining an existing buyer group but no interest in making separate proposal*
> - *Sunshine Insurance: Not interest in investing by its own or leading/forming a separate buyer group. Interested in joining an existing buyer group or even a separate buyer group. But the key is Sunshine Insurance does not want to lead a complicated M&A transaction like this.*
> - *Wuxi AppTech: Will pass this opportunity*
> - *Alibaba: Already joined BG."*

426. The second document was an email dated 5 July 2016 from JPM to the Special Committee which stated that:

> *"..... Meanwhile, our Healthcare Coverage team has conducted market check by contacting the following investors.*
>
> *Here is a summary for your info. Thanks*
>
> - *China Resources*
>   - *Pass*

- *Don't view check-up business something they have to own. Plus given the current situation they think it is too complicated and do not want to get involved*

- *Fosun*
  - *Pending further response*
  - *Will discuss internally and revert*

- *Sunshine Insurance*
  - *Pass*
  - *Not interested in this opportunity*

- *Capital Healthcare (首都医疗集团)*
  - *Pass*
  - *Although they had discussions before with both Lee and Yu, they felt that this is not a strategic fit to take the whole business. They view the check-up platform as a complementary asset but do not want to pursue scale*

- *Hopu Capital*
  - *Pass*
  - *They have spent quite some time and resources studying the assets and talked to both Lee and Yu before. They passed before as they cannot take control in either consortium. They are aware of the current situation but don't feel that they want to emerge as an independent party. However, they indicated the desire to participate in YF for a very small stake but it probably has not initiated the discussion with YF yet*

- *Hony Capital*
  - *Pass*
  - *They have studied the case before and talked to both parties. At that time, they felt that they could only take a small stake in either consortium so didn't want to pursue. They recently looked at the case again but still not comfortable participating as an independent party (don't want to be perceived as a "hostile" bidder)."*

427. The third document was a Special Committee minute from January 2017 relating to the third market check. At that time the Yunfeng buyer group had not yet managed to make an agreement with Mr Zhang and had not made a binding offer (underlining added).

> *"…Ms. Lian updated the Special Committee and representatives of STB on conversations between JPM and Mr. Qi Fan, a representative of the Yunfeng Buyer Group, regarding the letter from the Yunfeng Buyer Group to the members of the Special Committee, dated January 23, 2017 (the "Yunfeng Letter"), during which Mr. Fan noted to representatives of JPM, among other things, that (i) the Yunfeng Buyer Group did not propose a price in the Yunfeng Letter because the members of the Yunfeng Buyer Group were still discussing the price internally and were concerned that the Company would use a proposed price in a market check to solicit other acquisition proposals, (ii) the Yunfeng Buyer Group has certain concerns about the business performance of the Company, and (iii) the Yunfeng Buyer Group is prepared to finance the Yunfeng Proposed Transaction solely with offshore funds to increase the certainty of consummating the Yunfeng Proposed Transaction.*
>
> *Mr. Jia presented to the Special Committee and representatives of STB certain materials that JPM had prepared as a response to the concerns raised in the Yunfeng Letter, noting*

certain issues with the arguments and valuation methodology set forth in the Yunfeng Letter and discussing, among other matters, the Company's forecasted EBITDA growth, and potential changes to the FX rate. Mr. Jia responded to questions from the Special Committee.

Ms. Sudol discussed with the Special Committee and representatives of JPM the status of the key outstanding issues in the merger agreement, including among other issues: (i) payment of the reverse termination fee related to regulatory risks, (ii) termination fee amounts, (iii) closing deliverables to be delivered by the Company, (iv) certain Company interim operating covenants and representations and warranties, (v) disclosures to the Company of certain agreements between members of the Yunfeng Buyer Group and (vi) conditions related to alternative financing. Ms. Sudol also provided the Special Committee with an update regarding amendments to the Company's outstanding convertible notes, noting that according to Mr. Luke Chen, the CFO of the Company, the Yunfeng Buyer Group is aware of, and has agreed to, the terms of the outstanding convertible notes. Ms. Sudol responded to questions from the Special Committee.

Ms. Lian and Mr. Jia updated the Special Committee regarding the market check conducted by JPM pursuant to the Special Committee's request, noting that (i) certain of the potential buyers contacted by JPM had indicated possible interest in pursuing a potential transaction with the Company and would provide a further response within the next few days, (ii) certain potential buyers had expressed concerns regarding the recent guidance from the China Insurance Regulatory Commission on acquisition activities by insurance companies, and (iii) JPM will continue to contact other potential buyers in the list approved by the Special Committee. Mr. Jia responded to questions from the Special Committee.

The Special Committee, representatives of JPM and representatives of STB discussed proposed next steps with respect to the Yunfeng Proposed Transaction, noting among other matters, the importance that (i) the Yunfeng Buyer Group and Mr. Ligang Zhang ("Mr. Zhang"), the CEO and founder of the Company, discuss and reach agreement on certain arrangements required by the Yunfeng Buyer Group and (ii) the Yunfeng Buyer Group provide a price offer soon and within the range previously proposed by the Yunfeng Buyer Group. Ms. Sudol responded to the Special Committee's questions regarding potential disclosure requirements. After discussion, the members of the Special Committee instructed JPM to (i) respond to the Yunfeng Letter and (ii) emphasize to the Yunfeng Buyer Group the Special Committee's expectation that the Yunfeng Buyer Group propose an offer price that is within the range previously proposed by the Yunfeng Buyer Group. Ms. Lu agreed to discuss with Mr. Zhang the status of the Yunfeng Proposed Transaction and the need to finalize the terms of the Yunfeng Buyer Group soon."

428. The fourth document was a Special Committee minute from 24 February 2017 which stated as follows (underlining added):

"…….Mr. Jia reported to the Special Committee the results of the market check conducted by JPM noting that most potential buyers contacted by JPM had declined the opportunity to submit a proposal while certain other potential buyers are still evaluating the opportunity. Mr. Jia noted, among other things, that certain potential buyers had expressed concerns regarding Mr. Zhang's potential reaction to a proposal from a third party and the need for such potential buyer to confirm Mr. Zhang's support for a potential transaction. Ms. Lian and Mr. Jia responded to questions from the Special Committee.

Mr. Jia updated the Special Committee regarding a meeting between Mr. He Boquan ("Mr. He"), a principal shareholder of the Company, and representatives of JPM, during which Mr. He stated that (i) he would not accept an offer price below the range initially proposed in the Yunfeng Buyer Group's non-binding offer letter dated June 6, 2016, and that (ii) he has received multiple inquiries regarding his shareholding in the Company but did not intend to engage with any third parties and, instead, would wait for the confirmation of Special Committee's process. Ms. Lian reported to the Special Committee that representatives of GIC, a principal shareholder of the Company, also stated that GIC would not sell its shares in the Company for a low offer price. Ms. Sudol responded to questions from the Special Committee."

429. It was suggested to Mr Good that his summary of the feedback was misleading. Mr Salzedo QC suggested that it was only one of these documents, namely the first, that provided any support for the summary Mr Good had given in [10.2.9] of Good 2 which had been issued 31 months before the valuation date and only mentioned one buyer who had raised the wider (non-Zhang related) issues but who had subsequently taken a different position a few months later. Mr Good accepted that he had not given a blow-by-blow account of the market check process and that all he was saying was that "some people were put off by Mr Zhang and some people had other reasons" (see the transcript for day 3 at page 205).

430. Mr Good accepted that he had no knowledge of the reasons why Goldman and Ora decided to vote in the favour of the Merger or why the proxy advisers recommended a vote.

431. Mr Good also accepted that he did not rely on the market checks as providing a reason for believing that the Merger Price would be above fair value and that he had omitted to identify as an issue in his reports Mr Zhang's ability to achieve (or arrange for) a lower price because of his position. Mr Good was asked whether he accepted that in light of this he should reconsider whether his use of the Merger Price as a cross-check. His response was that everything depended on whether account could properly be taken of the Merger process. He said this (see the transcript for day 4 at page 7-10):

"Q. I'm suggesting to you that these two matters we've just discussed now are two matters that point the other way. Well, one that points the other way, and one that neutralises a point you'd previously relied on. So I'm now asking you the simple question: in the light of those two points, would - do you agree that you should now reconsider your overall view of the merger price as a cross-check?

A. I should reconsider, yes.

Q. And have you done so?

A. I'm doing so. At the moment, you've got what remains - what -- the other factors I rely on are set out in my report in relation to Goldman Sachs, the fact that the market - Goldman Sachs and GIC - the fact that the market dropped the recommendations

> *of the proxy advisers. I - I still think whether the Merger Price is going to come out above fair value is going to depend on your view of what you can or cannot take into account of the conduct of that Merger process."*

432. Mr Good agreed that if the Merger process did not assist in the discovery of a good price for the sellers, then the Merger Price could not be used as a cross-check. He said that it was possible to conclude that the Merger process was completely flawed and still decide that there were other factors which nevertheless suggested that the Merger Price was consistent with fair value or to conclude that because the process was flawed that meant that the other factors should be given no weight and that no reliance could be placed on Merger Price. He agreed that he was not expressing a view as to which of these alternative conclusions were appropriate in this case.

Mr Beaton's opinion

433. Mr Beaton said that the price paid for a business in an arm's-length negotiation between informed parties may be considered a reliable indicator of fair value if that price resulted from an open, competitive sales process designed to attract multiple potential buyers who were given an equal opportunity to bid. Conversely, absent an open and competitive sales process, the resulting transaction price may not be a reliable indicator of fair value. In his opinion, in the present case, the Merger process was neither open nor competitive because of Mr Zhang's public refusal to support a bid from a competitor or to work with other investors besides Buyer Group 1, before he ultimately accepted the Yunfeng Buyer Group, and JPM's inability to conduct a robust market check because of Mr Zhang's position and the likely information asymmetries. Therefore, the Merger Price was not a reliable indicator of the fair value of the Dissenting Shareholders' shares (see Beaton 1 at [5.55]).

434. Mr Beaton noted that the Registration Statement had confirmed that "*This concentration of ownership [in Mr Zhang's hands] may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and may reduce the price of our ADSs. This concentrated control will limit your ability to influence corporate matters and could discourage others from pursuing any potential merger, takeover or other change of control transactions that holders of Class A common shares and ADSs may view as beneficial*." Mr Beaton said that this showed that Mr Zhang possessed the ability to discourage others from pursuing any potential merger, takeover, or other change of control transaction and when the Merger process was reviewed, which he did in Beaton 1, it could be seen that this was precisely what happened.

435. Mr Beaton summarised the take-private process as follows (at [5.44] of Beaton 2):

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"To summarize the take private process discussed in this Section as well as references in other Sections, the take private process began 17 months after iKang completed its IPO, the take private process took almost three years to consummate, it was public knowledge that Mr Zhang held a blocking stake in the Company and the Special Committee also understood his later unwillingness to consider supporting a bid from anyone other than Yunfeng, and the iKang Board had passed the Rights Agreement that would penalize certain attempts by potential third-party acquirers of the Company. The first two points speak to the take private process itself while the second three points speak to the deterrents to potential third party acquirers submitting a bid on iKang.

436. Mr Beaton went on to comment further on the thinking of the Company's board and the sale process and to set out his conclusions (underlining added):

> *"5.46. .....it appears that the Board is likely, in my opinion, to have perceived that iKang was undervalued in the public markets since iKang's stock price was specifically listed as a reason for the Board's decision to take iKang private.*
>
> *5.47. However ... the take private process dragged on for over two and a half years, distracting management from executing on iKang's business plan which resulted in poor operating performance. The poor operating performance resulted in liquidity problems with major lending banks who were placing pressure on the Company during the go private process. This prolonged process and resulting negative impact on operations presented a decidedly negative financial picture of iKang which, in my opinion, had an impact on the price potential acquirers were willing to pay. Mr Zhang himself was concerned about the negative impact of a prolonged take private process. Ultimately, the negative impact on operations and iKang's liquidity problems allowed the Yunfeng Buyer Group to offer a deal price that I believe was materially below the Dissenting Shareholdings' fair value. This pricing environment was exacerbated by Mr Zhang's initial refusal to give way to a bid from Meinian as well as the Board's adoption of the Poison Pill early in the bidding process.*
>
> *5.48. .... Mr Zhang owned or controlled approximately 34.5 percent of the aggregate voting power of the Company and therefore possessed the power to veto any potential merger. When coupled with Mr He, they controlled 44.4 percent of iKang's voting power. Mr Zhang had also stated, by way of the Founder Buyer Group's preliminary non-binding proposal letter of August 31, 2015, that he would not sell his shares to any third party. Then, once he had withdrawn from the Founder Buyer Group in June 2016, he had indicated in a public announcement that he was open to an offer from a friendly party, which clearly excluded any competitor. When asked if a transaction without Mr Zhang being involved was possible, management stated that "A deal without the chairman [Mr Zhang] was not on the table. So as such, was not considered by the special committee [sic]" Yet, the Meinian Buyer Group had offered $25.00 per ADS which was 20.2 per cent more for iKang than the ultimate deal price. Again, in my opinion, Mr Zhang's initial refusal to consider or accept any competing bid at all, and subsequently to consider supporting or accepting a bid from a competitor, which was known to the general public and potential investors, was likely to have narrowed the pool of potential purchasers and thereby very likely impacted the acquisition price that the Special Committee and JP Morgan were able to negotiate. Had Mr Zhang been willing to negotiate with Meinian, it is more likely that Meinian would have increased its offer above $25.00…*

5.49 Lastly, the Board's adoption of the Poison Pill provision in the Rights Agreement which was adopted early on in the bidding process (2 December 2015) led to the prolonged time period needed to close a transaction and, in my opinion, at least tempered, if not completely quashed, any prospect of potential hostile acquirers who faced a dilution of their investment if the Poison Pill provision was triggered. Poison Pills significantly raise the cost of acquisitions and create big disincentives to deter hostile takeovers through potential dilution of the company's shares when or if the Poison Pill is triggered. Again, the Poison Pill adopted by iKang, in my opinion, very likely reduced the willingness of hostile acquirers to take a run at acquiring iKang, which also contributed to an artificially low deal price.

5.50 Based on the foregoing overview, analysis and observations, it is my opinion that the deal process ultimately resulting in the Yunfeng Buyer Group's acquisition of iKang was hindered primarily by three things: 1) Mr Zhang's ability to block any special resolution with which he disagreed; 2) his refusal to support a bid from a competitor; and 3) the Board's adoption of the Poison Pill provision in the Rights Agreement; but also by various factors described more fully in the following paragraphs. Mr Zhang's refusal to support a bid from a competitor led to information asymmetries that advantaged the Yunfeng Buyer Group and most likely discouraged third parties from bidding on iKang. Research performed on management buyouts identified four factors, including information asymmetries, that, when present, may create an unlevel playing field for potential third-party bidders…"

437. Mr Beaton considered that JPM had been unable to conduct a robust market check process given the perceived hurdles that existed as a result of Mr Zhang's blocking vote, the Poison Pill as well as Mr Zhang's refusal to support a merger other than what he deemed amenable to his interest in keeping the Company from his competitors. The result of these actions in the market could, he considered, be seen in the Company's moribund stock price compared to other healthcare providers in the China healthcare market and the cessation of investment banking analyst coverage.

Ms Lu's evidence on the Merger Process

438. Lu 1 set out the Merger process in detail. Ms Lu summarised her views on the process in Lu 1 at [106] as follows:

"Overall, I believe that Professor Qi, Mr Ni and I fulfilled our duties to the Company's shareholders while serving on the Special Committee. In particular, I consider that we achieved the best price realistically possible for the shareholders through our extensive engagement with every buyer groups and lengthy negotiations with the Yunfeng and Alibaba Buyer Group during which several price increases were requested and secured. Further, we ensured the process stood up to scrutiny by undertaking multiple market checks. I believed at the Special Committee meeting on 26 March 2018 and I still believe now that the price agreed was fair to the Company's shareholders."

439. Ms Lu also discussed the role of the Special Committee (see Lu 1 at [20]) and the process for appointing its professional advisers. As regards the appointment of financial advisers she said that (at Lu 1 at [27] and [28]):

> *"27. The Special Committee considered three investment banks, J.P. Morgan Securities (Asia Pacific) Limited (JPM), UBS and Duff & Phelps, and after careful consideration and analysis of the materials submitted, as well as interviews and various communications, selected JPM to act as independent financial adviser of the Special Committee. I recall this was based on JPM's impressive pitch, my personal experience working alongside JPM on a previous going-private deal and STB's positive appraisal of the firm. The team at JPM, headed by Ms Lian, is well known in the market and held in high regard for their mergers and acquisitions work….*
>
> *28. The Special Committee, as advised by STB, assessed JPM's proposed remuneration by reference to market standards, personal experiences of similar transactions, and the quotations provided by other investment banks, determining that it was reasonable for the work anticipated."*

440. In addition, she discussed the impact of Mr Zhang's power to veto a transaction on the Special Committee's assessment of bids (see in particular [37], [42], [45] and [46]). The Special Committee immediately recognised after the initial approach from Buyer Group 2 that Mr Zhang's position was likely to inhibit a deal. Ms Lu says that "*the parties discussed the feasibility of the Buyer Group 2 Proposal given Meinian was the Company's biggest competitor, and Mr Lee, who held a blocking stake of the Company's shares, was therefore unlikely to support it*."

441. Further, Ms Lu discussed the market check process. The following paragraphs in Lu 1 are particularly relevant (underlining added):

> *"47. JPM identified and contacted six potential buyers. <u>The initial feedback was negative, with the deal viewed as too "messy": it was well known that Mr Lee, CEO of the Company and Chairman of the Board, and certain of his affiliates, were part of Buyer Group 1, and that Buyer Group 2 included the Company's biggest competitor. One of the potential buyers contacted, namely Alibaba Investment Limited (Alibaba) indicated that it had no interest in starting a competing bid to Mr Lee, but would consider joining Mr Lee's consortium</u>.*
>
> *48. Several weeks later, on 7 January 2016, I attended a telephone meeting of the Special Committee at which JPM reported that Alibaba had joined Buyer Group 1. The remaining potential buyers contacted ultimately expressed no interest in pursuing a going-private or other strategic transaction involving the Company. <u>This was disappointing but not entirely unexpected as, in my experience, institutional investors are far more interested in purchasing a controlling stake of a company than a minority one, as was on offer here. Further, four months had passed since the Buyer Group 1 offer was made, and no other interested party had come forward of its own volition in the. intervening period.</u>*

.....

75. [second market check] JPM contacted seven potential buyers, but the initial feedback was that business conditions had deteriorated, and so no one was interested in being a competitor of the Yunfeng Buyer Group or committing their resources to launching a competing bid.

76. On 10 August 2016, JPM reported to the Special Committee that none of the potential buyers contacted had ultimately showed interest in submitting a proposal.

.....

78. I attended a meeting of the Special Committee on 24 January 2017, at which JPM reported that a number of the prospective buyers contacted had indicated possible interest in potentially pursuing a transaction with the Company, with their further responses expected in the days that followed. The Special Committee discussed and agreed that JPM should continue to contact other potential buyers on the list…

79. A further update was provided by JPM to the Special Committee on 24 February 2017. JPM reported that the majority of potential buyers contacted had declined to submit a proposal, with a small number still evaluating their options. We discussed the fact that any potential buyer would be aware of the need for Mr Lee to be onboard with their proposal, owing to his voting power. Ultimately, however, no party put forward a competing bid."

442. Ms Lu was cross-examined extensively about these matters (see in particular the transcript for day 1 at pages 52-150). She was asked about Merger process, the market check process and the impact of Mr Zhang's position, as well as his willingness to sell his shares to an arm's length buyer without retaining an interest in the Company. Ms Lu appeared at times to try to qualify what she had said in Lu 1 but her answers were often rambling and unclear and suggested that she was attempting to downplay that impact. The following extract from her cross-examination on these issues is in my view representative (see the transcript for day 1 at pages 59-63 and then 98-99):

[59-63]

"Q. .. And then at paragraph 48, about four lines down you say:
"This was disappointing but not entirely unexpected because ... in [your] experience, institutional investors are far more interested in purchasing a controlling stake ... of a company than a minority one, as was on offer here."

So why was it that only a minority stake was on offer here?

A. I do not think that -- you know, I do not think that was -- I believe -- I believe when we do market check was to see whether people would buy it; right? And so I do not think it was - it was - I do not think it was - the company - okay, the reality is in the market check; it was actually the market check to acquire the company. And that is specific instruction that, you know, we had with JP Morgan that to do the market

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check to see whether people would - it's not a market check to buy, purchase the minority stake, but reality is Mr [Zhang] and if -- if the management team joins him or, like - you know, in the earlier paragraph, if he does have 50% of the - of the - over 50% of the shares, then -- then it would actually cause a problem in terms of purchasing, unless the other shareholders are willing to tender their shares, then you have a controlling stake. Otherwise, if they have over 50%, then for - for corporations to own, there's no point for corporations to own less than 50%; right? So in any event, what we - what we believe is if we could get people to come in and wanting to buy the company, we -- you know, like, if there are – our advisers advise us there are potential ways you could do it, you know, the price is high enough, Mr He would join into the consortium. The - you know, like, his [Mr Zhang's] affiliates in the shareholder line-up would join in the consortium. But - but, you know, reality is the – the extensive market check did not generate the result we want, but we -- it was a genuine, earnest effort to go out and talk to people, to see whether they will come in and buy it.

Q. *That was a long answer, Ms Lu, and I'm not sure at the end of it I actually know what your answer to my question was, so let me put it again. My question is –*

A. *Okay.*

Q. *Why was it that all that was on offer here was a minority stake?*

A. *It was -- I don't -- I don't think it was offered a minority. This could be in - you know, this could be unclear part about if they own, like, the 50%, I believe we ask some people to be acquirers if they're interested in buying the company. That's the -- that's the market check.*

Q. *A few moments ago you said on oath that your affirmation was true. Had you read it through before you said that?*

A. *Yes.*

Q. *Right. One of the things in your affirmation is the sentence I just read to you from paragraph 48 [see above]. Do you stand by that as being true or not true?*

A. *A bit - okay, I see whether - whether - this was Special Committee's internal discussion about speculating why people would not be interested. So true, in this - with that speculation why people would not come forward for it.*

Q. *And is that because the reality was that you knew and the market knew that Mr Lee would not sell his shares or suffer them to be diluted?*

A. *Oh, no, I do not think Mr Lee has such - you know, if it's the right price, he would sell. If it's – if it's - look, if it's a good enough price, I actually think Mr Lee would sell. And, you know, why not? Right? It's also a CEO's duty - CEO's duty, you - I mean, like, if it's the right price, why -- I mean, like, he can block it, but I do not - I do not think, you know, Mr Lee actually would, like - would be - it's in my - it's in my judgment call that if – if it's really good price, Mr Lee would sell.*

Q. *In 2015 and '16 you think he would have sold?*

A. *If -- yes, if the right price. And I believe that if it's the right price and if it's - if it's a good name, which we could - which we could build a very good preventive*

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healthcare practice sustainably in the long-term, then I actually - it's in my judgment call that Mr Lee would sell.

Q. And what do you base that on? Did you speak to Mr Lee about it?

A. I had been a board member by then since IPO for over a year. And it's my understanding that Mr Lee is a rational - he's a fairly rational business leader. And his ambition that - you know, he graduated from Harvard Medical School with the ambition to build a very reputable, respectful medical practice in China that focus on preventive care, you know? The – so I actually - I do believe Mr Lee's heart will be at the right place if it's good for the - for the company and for the shareholders. He - you know, he - I mean, like, I invested in quite a few medical practices in China, including the largest doctor community, the doctor-patient community, all that aim to alleviate - there are 1.4 billion people in China; there are only 2.8 million….”

[98-99]

Q. .. So if you had managed to generate competitive bids, then ultimately the competition would be decided by Mr Lee, not by the Special Committee, wouldn't it?

A. No, that is incorrect. That is incorrect, because - because reality is, if we could generate a real bid that - that would be actually, you know, like, what buyer group 2 had laid out, you could do tender offer. And Mr He is our wild card, because if we do tender offer, then if the price is high enough, then the price is high, that's why Mr He and us would go to whoever highest price. And then - then we can - Special Committee can instruct the - the management team to collaborate with - with the potential buyer group. If Mr Lee - if Mr Lee object to that, then there could be a tender - this is a tender offer, there could be litigation and fight in court to force him to do it; right? So that we - you know, like, you do need - you do need a large enough corporation that ability to do that. There is also possibility that Mr Lee would actually - would actually be - we did not rule out the possibility Mr Lee could respect and want to work with potential brand name, which I always believed that something that, you know, if it's a brand name that Mr Lee respects and want to, he would - he would go along with it. Then it's up to the negotiation; right?”

The role of and absence of documents from JPM

443. During her cross-examination, Ms Lu was asked about JPM’s role (including the terms on which they were engaged), JPM’s fairness opinion and why no documents from JPM’s files had been produced or why no-one from JPM had been tendered as a witness. These were matters which the Dissenting Shareholders complained about.

444. Mr Salzedo QC noted that the Company had been asked to identify or provide to the Dissenting Shareholders copies of the correspondence and other documents which JPM had provided to each potential buyer that it reached out to and all documents, including notes, memoranda and emails, recording the matters discussed between JPM and such potential buyers on the occasions when JPM made contact with each of them. He also noted that the Company’s attorneys Harneys had

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responded by saying that "*documents pertaining to the market checks (other than the emails for which Data Room references have been provided above) are not within the company's possession, custody or power. The Company wrote to JPM to request ... JPM has advised that they have no documents responsive to this request*."

445. Ms Lu said that she was aware of the request and had asked JPM to provide documents but could not further explain the reason why documents had not been available or provided. She agreed when asked that if the Court ordered that the Company make a further request to JPM for documents that this could be done and I subsequently directed that the Company do so. But no further documents were forthcoming.

446. Mr Salzedo QC discussed with Ms Lu JPM's remuneration terms. He noted that initially it was agreed that JPM would be paid US$1.5 million on the delivery of a fairness opinion (whatever it said) and US$500,000 on the closing of a transaction (so that initially three-quarters of their remuneration was payable even if their opinion was negative and no transaction took place). However, the terms of JPM's remuneration had been amended. There was a letter dated 7 March 2016 from JPM confirming the amended terms. This had not been referred to in Lu 1, as Ms Lu acknowledged (even though she had been involved in agreeing the amended terms). The amount of JPM's fairness opinion fee was increased to $2 million; the Company agreed to pay an additional fee of US$3 million payable upon the announcement of the signing a transaction and the fee payable and contingent on closing was increased to US$4 million. Accordingly, JPM stood to be paid US$2 million for delivering an opinion plus US$7 million in contingent fees, US$4 million of which would not be payable there was no transaction. There was on 25 March 2018 a subsequent reduction in the US$3 million fee to US$2 million and the US$4 million fee to US$3 million.

447. Mr Salzedo QC put it to Ms Lu that as a result (of the March 2016 amendments) JPM had a substantial incentive to ensure that their opinion on any potential transaction was positive and as a result a serious conflict of interest. Ms Lu's response was as follows (see the transcript on day 1 at pages 121-123):

> "A. *To be honest, I -- you know, like, when we were signing this, to be honest, like, I - you know, now you – you say it, reality is I contend with it. I don't – you know, like, I don't see how - how -- I don't see how JP Morgan as a firm would actually lower their standard, because investment bankers live and die by reputation, by integrity of their deal process, and the fact that - this team is, you know, like, held in high regard in the business community. So I actually do not think - I do not think they would - I do not think - because they also - they also have to go through the internal - internal - their internal committee for approval. So [the] reality is I do not think*

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simply because they get paid a certain way, they would lower the standard. So I think we - we negotiated it because we – we actually think it would incentivise them to work harder. But - but I do not think simply because of this format that they - if they don't think the deal is fair, they - I trust that JP Morgan will say it's not a fair deal. JP Morgan - it's a one deal, one - you know, like, it's over 100-year-old company lives and die by its integrity and reputation in the market. They would not because of one deal ruin their own standard and their own practice. I just don't think it's worth it for the firm. So - so reality is - reality is I see where you are getting at, but I do not think that's where we kind of - that's where we - that's where we signed the - you know, like, a deal that way.

Q. *Did you think about the conflict of interest at the time?*

A. *Did I think about the conflict of interest at the time? I did not see conflict of interest, to be honest. …I mean, I genuinely did not - and, you know, reality is we all vetted it, we all - you know, like, STB also advised, so we did not see the conflict…"*

448. Ms Lu denied that the Fairness Opinion was merely a rubber stamp.

The Company's submissions

449. The Company submitted that the merger price (US$41.20 per share, representing a premium of just under 25% over the trading price) was a vital metric and one which should guide the Court in assessing the several valuation outcomes before it.

450. The Company performed three rounds of pre-signing market checks:

(a). in around December 2015, at the time Buyer Group 1 (Mr Zhang) was blocking Buyer Group 2 (Meinian) but was unable to match the price (see Lu 1 at page 11).

(b). in around June 2016, after Buyer Group 1 and Buyer Group 2 withdrew their offer (see Ms Lu 1 at page 20).

(c). in around December 2016, when the Yunfeng Buyer Group had not put forward any binding proposal (see Lu 1 at page 20).

451. The Company accepted that the market checks were limited in the sense that Mr Zhang was unlikely to release his grip on the Company such that as a practical matter the hunt was not for an outright buyer but for institutions interested in partnering within a syndicate including Mr Zhang. The Company submitted that there was no principle of Cayman law to the effect that limited market checks of that nature rendered reliance on the Merger Price impermissible. The Company was at all times transparent about Mr Zhang's blocking position. The Registration

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Statement filed on the SEC website on 3 March 2014 clearly set out at page 50 that Mr Zhang had control of 36% of the voting power and that the concentration of ownership might discourage, delay or prevent a change in control of the Company, and might limit shareholders' ability to influence mergers and could discourage others from pursuing any potential merger. The Company says that this is the commercial and financial background and context which the Dissenting Shareholders had bought into and gave rise to risks which they could therefore not complain about.

452. As to other features of the merger process, the Merger Agreement contained an agreement not to shop with a superior proposal out and made provision for payment of a termination fee. The Company submitted that shop fees and termination clauses should not *per se* render the deal price an unreliable indicator of fair value. Rather, the Court should consider the deal process as a whole and whether the intention not to work with other bidders, any termination fee or information barrier would deter other (potential) bidders. Furthermore, the credibility of the Merger Projections relied on by JPM were unchallenged and JP Morgan had performed various analyses for its fairness opinion and concluded that the Merger Price of US$41.20 per share was fair from a financial point of view. In addition, the recommendations given by proxy advisors were to vote for the Merger and Goldman Sachs and Ora, who of the Company's major unaffiliated shareholders, both voted in favour.

453. As I have mentioned, during Ms Lu's cross-examination she was asked questions regarding the Dissenting Shareholders' allegation that the Company had failed properly to produce documents from JPM. The Company denied that it had failed to disclose documents and said that it had undertaken an honest and faithful discovery exercise. On 2 July 2020 it produced for inspection via an electronic data room all documents that it had identified as responsive to the categories outlined in the directions order dated 29 June 2020 and further discovery had been volunteered by the Company in accordance with its ongoing discovery obligations which had resulted in an aggregate production of approximately 87,000 documents. The Company had responded to five requests for information (***RFI***) from the experts (three from Mr Beaton and two from Mr Good), with well in excess of 100 questions and sub-questions having been raised by Mr Beaton with a view to eliciting information said to be needed by him to opine on the fair value of the Company's shares. In answering those RFI the Company had volunteered additional discovery with a view to responding as fully as possible to questions raised. Of the approximately 87,000 documents produced by the Company in the data room, no more than 96 had apparently been reviewed or considered by Mr Beaton. Before the commencement of the trial, the Dissenting Shareholders had not sought an order for specific disclosure of any particular categories of document.

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454. The Company argued that against this background it was not obvious that any of the alleged disclosure gaps were of particular import, far less that those gaps were sinister or such as to warrant any adverse inferences being drawn against the Company. The record showed that the Company had sought to have the relevant JPM materials preserved and that had requested written materials from JPM which had been met with the response that such documents did not exist. In the circumstances (i.e. the absence of working papers) it was not clear that seeking to call JPM to testify would have advanced the debate (even assuming that the individuals responsible for compiling the opinion continued to be employed by JMP). There was no reported decision of this Court in section 238 proceedings in which a fairness opinion provider had been called to defend the assumptions underlying its opinion. To do so, the Company submitted, would defeat the purpose of the parties engaging experts to prepare their own valuations from scratch. The Company accepted that in an ideal world models would be available for scrutiny. But the absence of models was not extraordinary – indeed in the experience of the Company's attorneys Harneys it was commonplace for investment banks to decline to share their working models and papers and the absence of those models did not render unreasonable reliance on the Fairness Opinion by the Special Committee.

The Dissenting Shareholders' submissions

455. The Dissenting Shareholders argued that it was significant that both experts had agreed that no weight should be placed on the Merger Price. This revealed that the merger process was deeply unsatisfactory at least as any method of discovering fair value.

456. The Dissenting Shareholders submitted that the Company's sale process was characterised by Mr Zhang wielding his over one-third voting power in the Company, fortified by the implementation of a poison pill so as (a) at all times to prevent any meaningful competition between bidders and/or any other prospective acquirers over the price at which the unaffiliated shares in the Company would ultimately be acquired; (b) materially to delay finalisation of the Yunfeng proposal while the Company became increasingly desperate for cash to pay its substantial debts which were falling due and consequently susceptible to greater opportunism, i.e. less able to negotiate properly for a fair price, or to resist an unfair one; and (c) to distract management from executing the Company's business plan, which resulted in poor operating performance.

457. In his reports, Mr Good had claimed that Merger Price was a useful "*cross-check*" which was consistent with his valuation but the cross-check he had in mind was that his valuation was lower than Merger Price and that was consistent with the expectation to be derived from the merger process. However in his oral evidence, after being taken through some of the factual evidence

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about the process, Mr Good had conceded that he was not able to give any opinion as to whether Merger Price would be expected to be above fair value. In other words, he conceded that the cross-check he previously had in mind was no longer tenable.

458. The Dissenting Shareholders submitted that the reasons why Mr Good made that concession were important because they indicated that the vital real-life metric actually pointed in exactly the opposite direction. Mr Good had accepted that there were factors consistent with either view, which was consistent with his final position that he expressed no view at all. His concession had been based on several matters that were inescapable on the evidence:

(a). Mr Zhang's blocking stake of over 1/3 meant that he alone could block any deal with which he did not agree.

(b). the combined stakes of Mr Zhang and his close associates was in the region of 50% and that meant that any third party could realistically obtain only a minority stake as Ms Lu made clear in her affirmation and Mr Good agreed that no buyer could obtain control other than in conjunction with Mr Zhang and on terms that he agreed.

(c). even Ms Lu had accepted that the only bidder who could complete a transaction would be one with whom Mr Zhang reached an agreement.

(d). reluctantly, but ultimately clearly, Mr Good had accepted that Mr Zhang's position of voting power and knowledge of the Company meant that all other things being equal he would be able to negotiate a lower price as a buyer than would otherwise be the case.

(e). Ms Lu had been forced to concede that the market checks were conducted only in the hope of finding a participant who could reach an agreement with Mr Zhang.

(f). Mr Good had accepted the same thing.

(g). the market checks revealed no significant evidence that any party was put off by price, and significant evidence that several parties were not and ultimately Mr Good had said that he did not rely on the market checks as providing any reason to suppose that the Merger Price would come out above fair value.

(h). the proxy adviser's advice added nothing because Mr Good did not cite any particular reasoning from them, as he accepted. Examination of the proxy advice adduced in evidence

confirmed that none of the proxy advisers had suggested that the Merger Price exceeded the long term value of the Company's returns to shareholders.

(i). the votes in favour also added nothing because, as Mr Good accepted, there were many reasons why an institutional shareholder might vote in favour of the Merger regardless of their view of intrinsic value.

(j). the fall in the market trading prices of other Chinese companies between March and August 2018 was also ultimately uninformative because unless it was permissible to assume that the price was fair in March it was not possible to say whether it had become fair by August, as Mr Good had accepted.

(k). the Fairness Opinion was undermined as evidence of fairness by their enormous contingent fee and by their, and the Company's, failure to disclose any of the materials underlying their opinion in especially unsatisfactory circumstances. In any event, their views could not be treated as more reliable than those of the experts in this case who had far greater access to information, time to work and scrutiny over their reports than JPM had. Mr Good's position was that he did not rely on it as a "factor" in any event.

459. Mr Good had ultimately expressed no view on the Merger Price being indicative of fair value. The reason that he repeated several times in his evidence at the start of day 4 was that it was a matter for the Court to assess the impact of the merger process and it was beyond his expertise to express any view on that. Without a positive assessment of that he could not express a view about the fairness of the price that resulted. Thus, if the assessment of the Merger process on the facts was that it was not a robust exercise in price discovery then Mr Good would not suggest that the resulting price was likely to be a fair one.

460. The Dissenting Shareholders said that the evidence showed that the Merger process was not such an exercise. They submitted that at all times after 31 August 2015, when the buyer group that Mr Zhang had formed submitted its preliminary non-binding proposal to the Company, and that proposal was publicly announced, the Company's traded share price had not reflected its fundamental operating characteristics. The overwhelming factor was that the position of Mr Zhang, which undermined any potential positive impact of the market checks, inevitably depressed the Merger Price, as Mr Good accepted. As Mr Beaton had opined, the deal process was not open or competitive and JPM was unable to conduct a robust market check because of Mr Zhang's position and the likely information asymmetries. Mr Beaton's conclusion (at Beaton

1 [55]) was entirely accurate and supported by the evidence (and Mr Beaton was not challenged on this).

461. The Dissenting Shareholders said that from the time in 2015 when Mr Zhang had made clear his desire to take the Company private, a desire which he never retracted, he clearly had no interest in the share price increasing whilst he pursued his plan to take the Company private, the Company's actual performance was depressed by distraction from the process and the market trading price of the Company's shares naturally was mainly determined by the market's view of what transaction was likely. In these circumstances, it is not at all surprising that an unaffiliated shareholder (or adviser) would vote in favour of any available exit at above market trading price. The only shareholders who might rationally refuse would be those with an appetite to litigate for a fair value which would not normally include substantial fund management firms, whose mandates and strategies would not usually involve litigation risks.

462. The Dissenting Shareholders submitted that the realistic position on the facts as established by the evidence was that it was inherently probable that the Merger Price was substantially lower than fair value (especially since this was a pure take private transaction without synergies). The only potential cross check for which that price could serve would be the opposite of the one applied by Mr Good, namely if the value arrived at was not substantially greater than Merger Price, then the valuation should be looked at carefully to justify why that was the case. This was a cross check which the Court was respectfully invited to perform in relation to its own final determination of fair value.

463. The Dissenting Shareholders considered, as I have noted, that the weight to be given to the Fairness Opinion was to be substantially reduced in circumstances where there was a dearth of documentary evidence regarding the work which JPM performed as the Special Committee's financial advisor throughout the sale process. The Dissenting Shareholders argued that the absence of such documents was surprising because (a) the Company was required by paragraphs 8 and 9 of the directions order dated 29 June 2020 to discover and produce all such documents in its possession, custody or power (and Appendix 3 to that order had particularly encompassed all documents relating to the Fairness Opinion and its preparation) and (b) Mr Beaton had specifically requested that the Company provide any documents which JPM would have created in connection with discussions regarding the Company's financial projections, discussions regarding major shareholders' views regarding the competing Buyer Group 1 and 2 proposals, its meeting with representatives of Meinian regarding its transaction proposals and each of the three market checks. Following the responses which Mr Beaton had received – which were generally to the effect that the Company neither held nor had the power to obtain documents from

JPM and understood from JPM that it had no relevant documents – the Dissenting Shareholders' attorneys requested a detailed account of the steps the Company had taken to require the preservation and provision of such documents by JPM and why it considered that it lacked the power to compel JPM to deliver up the relevant documents.

464. In response, the Company notified the Dissenting Shareholders that it had sent a document preservation letter to JPM on 27 February 2019 and affirmed its prior responses as to the non-existence of such JPM documents. The Dissenting Shareholders noted that no explanation as to what became of any relevant JPM documents was provided and the Company had failed to explain why it considered itself powerless to compel JPM to deliver up relevant documents.

465. The Dissenting Shareholders also noted that as regards the draft script which the Special Committee instructed JPM to produce for discussions with potential buyers in their market check Ms Lu had given evidence that she was sure that JPM had prepared it and that she had reviewed it but that she had not been asked to look for it (in any form) for the purpose of these proceedings. Despite my order made during the trial for disclosure of the script and any mark-ups made no version of that script could be found.

466. The Dissenting Shareholders submitted that:

(a). the Company ought to have ensured when engaging JPM that it would be entitled to have JPM deliver up all relevant documents, particularly given the reliance due to be placed on the market checks, valuation work and Fairness Opinion.

(b). JPM ought to have been instructed to preserve all of its potentially relevant documents from the outset of its engagement until all necessary disclosure was made in due course or until such time as it became clear that disclosure would be unnecessary.

(c). but there was no record of the JPM oral briefing without which the Fairness Opinion was incomplete and there was scant evidence as to what actually transpired in the market checks. There was no documentary evidence of what JPM told any prospective purchaser in any of the three market checks, nor any clear evidence regarding the time JPM devoted to each market check nor even as to the responses received from prospective purchasers contacted in the third market check. There was also scant evidence regarding the input that JPMorgan provided in respect of the Merger Projections and a complete absence of evidence regarding JPM's discussion with Meinian in February 2016.

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(d). the following observations of Arden LJ (as she then was) in *Re Mumtaz Properties Ltd* [2011] EWCA Civ. 610 443 were instructive:

> *"In my judgment, contemporaneous written documentation is of the very greatest importance in assessing credibility. Moreover, it can be significant not only where it is present and the oral evidence can then be checked against it. It can also be significant if written documentation is absent. For instance, if the judge is satisfied that certain contemporaneous documentation is likely to have existed were the oral evidence correct, and that the party adducing oral evidence is responsible for its nonproduction, then the documentation may be conspicuous by its absence and the judge may be able to draw inferences from its absence.*
>
> *[…] The approach of the judge in this case was to seek to test the evidence by reference to both the contemporary documentary evidence and its absence. In my judgment, this was an approach that he was entitled to take.*"

(e). the Court was entitled to, and should, draw adverse inferences from the Company's failure to secure and produce the vast quantities of documents which JPM must have generated throughout the course of its engagement as fairness advisor on this matter. The appropriate inference was that the documents would have demonstrated or at least evidenced that the fair value of the shares was greater than the Merger Price.

Discussion and decision

467. The only issue for the Court is whether the Merger Price should be used a cross-check. I take this to mean using the Merger Price as a reference point when assessing the results of and applying other valuation methodologies. Mr Good, as I understood his evidence, considered that while the Merger Price was insufficiently reliable to be used on its own as a measurement of fair value (and therefore was not to be given any weight when the Court determined fair value), nonetheless it was an indicator of value such that any valuation that was materially above the Merger Price should not be adopted. He took the view that a comparison of his blended valuation of US$38.42 per share with the Merger Price of US$41.20 per share) showed that his valuation was likely to be a reasonable estimate of fair value since the Merger Price was likely to be above fair value and because the price that emerged from a properly conducted merger process (even where the only transaction that realistically was available was one that involved Mr Zhang and new partners for him) could be treated as a guide to fair value particularly where it had been agreed to by major independent and sophisticated shareholders and was based on agreed financial projections.

468. I have concluded that the Merger Price does not assist in reaching a fair value determination in this case.

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469. I found Mr Good's (and the Company's) approach less than logical or convincing. On the one hand, the Merger Price is said to be insufficiently reliable to justify being given any independent weight in the calculation of fair value but, on the other hand, it is sufficiently reliable to be taken into account when deciding between other competing valuations and deciding on the fair value to be adopted by the Court. If the Merger Price is ultimately unreliable as a measure of fair value and is to be given no weight for that purpose, how can it then have sufficient weight to impact on the fair value determination at all? Mr Good's (and the Company's approach) did involve the Merger Price having an impact on and being taken into account on the fair value determination even if only indirectly (or secondarily) but I do not consider that they have shown that, having rejected the Merger Price as a direct (and primary) determinant of fair value it is reasonable or justifiable then to use it as an indirect (and secondary) determinant (or reference point that should affect the Court's decision as to fair value).

470. In any event, I prefer Mr Beaton's evidence (see in particular Beaton 2 at [5.44]-[5.40]), and accept the main submissions made by the Dissenting Shareholders, on this issue. Mr Zhang's position created a fundamental (and structural) difficulty for the Merger process. As the Company accepted, the market checks and the process as a whole were limited. Mr Zhang showed no signs at all and gave no indication that he was prepared, to use the Company's phrase in its Closing Submissions at [334]), to "*release his grip on [the Company]*" so that there was never a realistic prospect of an outright buyer being found and the exercise was confined to seeking out new partners for Mr Zhang (and his syndicate). The Rights Agreement reinforced management's and Mr Zhang's control over the Merger process and a transaction. There can be no doubt that these circumstances had a substantial chilling and complicating effect that reduced the pool of interested parties, gave ultimate control of the process to Mr Zhang and resulted in a price (paid by Mr Zhang's new partners) that was likely to be below what would be paid by an arm's length buyer in a competitive bidding process.

471. Mr Good accepted that the fact that Mr Zhang was able to veto any transaction with other parties and had a significant information advantage over them meant that it was likely that he would be able to negotiate a price favourable to him (and in other words lower than the price that could be expected to be negotiated with arms' length purchasers in a competitive process on a level playing field). He resisted the proposition that it was also at least likely that the price negotiated by Mr Zhang (or someone in his position) would be below fair value. He argued, in substance, that it was always possible that if the fair value was above the price that Mr Zhang negotiated he could be out-bid and a transaction at fair value achieved. It was possible, despite Mr Zhang's dominant position, that another bidder would appear who was prepared to take on Mr Zhang, seek with the support of other shareholders and the Special Committee to put pressure on Mr Zhang to accept

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their bid and who would look to buy at that higher price (fair value). But I found this to be unconvincing and rather detached from reality. Any such interested party would face high hurdles, which might be incapable of being overcome, and these difficulties in any event would be bound to chill interest by increasing costs and uncertainty and thereby have an adverse impact on price. I did not find the relatively few brief notes made by JPM of feedback from the parties with whom they had discussions which showed that some parties gave reasons for not being interested in a transaction unrelated to Mr Zhang's position as sufficient to rebut or undermine the case made by the Dissenting Shareholders or this conclusion. It was however clear that a significant number of interested parties were deterred from making their own bid independently of Mr Zhang because of Mr Zhang's position and that his position was an issue which from the beginning caused concerns to the Special Committee. I suspect that it would be very difficult to show that a sales or merger process conducted under conditions similar to that facing the Company with a dominant shareholder and director who wishes to retain control could be conducted in such a way as to produce a price reflecting fair value. Even if that were possible, much stronger evidence would in my view be needed (for example evidence from officers at interested parties setting out and demonstrating their position and views at the time).

472. I have already noted that it seemed to me that Ms Lu had in her evidence in cross-examination attempted, unconvincingly to my mind, to downplay the impact of Mr Zhang's dominant position. It further seems to me that her assessment of Mr Zhang's attitude and position in relation to competing bids that would leave him with no interest in the Company was inconsistent with the evidence of Mr Zhang's conduct and also unreal.

473. But I do accept, subject to the point I make below regarding the impact of the limited documentary record, Ms Lu's evidence that she and the Special Committee (plus advisers) sought in good faith to find other interested parties and to obtain the best price reasonably obtainable *in the circumstances*. However, the circumstances were difficult, as she said, and constrained and conditioned by Mr Zhang's position in the manner I have described.

474. It also seems to me that the Dissenting Shareholders are right to say that the absence of important documentary evidence from JPM regarding their work in relation the market check process (particularly the documents provided by JPM to and notes of discussions with interested parties, including the draft script which the Special Committee had instructed JPM to produce) justifies the Court giving reduced weight to and significantly weakens the Company's case as to the robustness and completeness of that the market check process. I also do not consider that the Company gave an adequate explanation as to why it was unable to require its financial adviser to produce additional documents or why JPM appeared not to have retained them. JPM was the

adviser to the Company and the Special Committee and should have been engaged on suitable terms that enabled the Company to obtain and have access to relevant documents which they might need. However, in my view, now is not the time and this is not the right case in which to undertake a detailed assessment of what the Company should have included in JPM's terms of engagement and whether JPM and the Special Committee's document retention policies and practices are acceptable. That will require a different case and more evidence. I am aware that these policies and practices are heavily influenced by applicable US law (particularly governing attorney-client privilege) and decisions of the US federal and state courts made in the context of M&A litigation and I do not consider that it would be appropriate to comment (adversely or otherwise) on how the Special Committee and JPM managed and dealt with documents without having a proper understanding of relevant US law, rules and practice (albeit that consideration needs to be given as to the extent to which US law and practice should govern every aspect of the market-check and merger process for Cayman companies). Having said that, it seems to me that in future cases companies in section 238 proceedings should be prepared to make available a proper documentary record relating to the work of financial advisers to a special committee and as to the conduct of a market-check and sales process and need properly to justify why documents have not been retained or are not available. I also do not consider that it is necessary for the Court to delve more deeply into the details of the market-check and Merger process in this case where the Company does not claim that the Merger Price is to be used (at least directly) in determining fair value.

475. I think that there was less of a concern regarding documents relating to the Fairness Opinion. While some further evidence of the oral briefing given by JPM would have been helpful and was relevant to an assessment of the advice given by JPM, the basis on which the Fairness Opinion was prepared was adequately explained and discernible from the documents disclosed by the Company. There may be cases in which evidence from the Company's financial adviser will be helpful and even necessary, particularly where direct reliance is placed on the Merger Price, but this is not one of those cases.

476. I also do not consider that this is the case in which to review the impact of contingent, success-based, fees on the weight to be given to fairness opinions, for the same reason. They clearly give rise to a risk of a conflict of interest and consequential issues and concerns. The substantial sums payable to JPM on success in this case clearly did give JPM an incentive to produce a positive fairness opinion and raise conflict concerns that affect the weight to be given to the Fairness Opinion but I am not prepared to criticise the Special Committee or JPM on the evidence before me for agreeing to or including such fee arrangements or to form a firm view that they substantially undermine the conclusions in the Fairness Opinion. Further evidence and a proper

consideration of the Delaware (and other jurisdictions') jurisprudence would be needed (for example as to why the success-fees were included, their reasonableness in the circumstances, the sufficiency of non-contingent fees and relevant market practice). I can see that, in this case, it was necessary and appropriate to adjust JPM's fees in view of the length and complexity of the take-private process and that it might be said that JPM's remuneration, taken together, was reasonable, consistent with market practice and not of a kind to jeopardise their independence.

Weighting

477. Both experts adopted a blended approach to assess fair value. They agreed that the principal weight should be given to their DCF valuations although they disagreed about the precise value of that weighting. Mr Good ascribed 60% and Mr Beaton ascribed 75%. The remaining percentage was allocated to market-based methodologies. Both experts gave the majority of the market-based weighting to their comparative multiples (30% for Mr Good; 15% for Mr Beaton). Each then had a further 10% which was ascribed to different market-based measures. Mr Good had used his estimated market trading price while Mr Beaton uses his CoTrans approach.

478. Mr Good summarised his approach to weighting as follows (see [2.6] of Good 1):

> "*2.6.1 I have weighted the results of each technique in order to make my fair value assessment.*
>
> *Income approach*
>
> *2.6.2 I have been able to benchmark and analyse my cash flow projections against various other cash flow projections for the Company, the Company's actual historical results and industry data, and, having made certain updates and corrections as a result of that review, my DCF Projections appear to be reasonable and reliable for the purpose of performing a DCF analysis. I have therefore placed most weight on this valuation technique for my fair value assessment.*
>
> *Market approach*
>
> *2.6.3 .... I do not consider it appropriate to place a significant weighting on the Company's own market trading price. Instead, I place more weight on my CoCo valuation, giving equal weighting to each of my LFY, LFY+1 and LFY+2 multiples.*
>
> *My conclusion*
>
> *2.6.4 I attach weightings to each of my valuations of:*
>
> *i. 60% to my DCF valuation;*
>
> *ii. 30% to my CoCo valuation;*
>
> *iii. 10% to the market trading price …"*

479. Mr Beaton set out his approach at [16] of Beaton 1 as follows:

> *"16.4 Once I determined that each of the indicators of value had been adjusted to the same level of value, i.e., a minority, marketable basis in line with the status of the Dissenting Shareholding, I assessed the relevance and reliability of each methodology and assigned an appropriate weighting.*
>
> *16.5 In my opinion, the income approach, specifically the discounted cash flow method, is the most relevant and reliable indicator of value because it is based on a conservative forecast prepared by iKang management as their best estimate of iKang's future cash flows which is the foundation of value. I gave this methodology a 75 percent weighting.*
>
> *16.6 After the income approach, it is my opinion that two of the three market approach methodologies are also relevant and reliable indicators of value, but because these value indicators rely on external value indicia derived from competitors and others in the healthcare industry, I only weighted this approach 25 percent overall. Within the market approach, I accorded 15 percent weight to the GPC method since I was able to obtain a substantial amount of financial and operating data on these seven selected companies. In contrast, I only accorded 10 percent weight to the GCT method as, although detailed data on the five selected transactions was adequate for determining valuation multiples, the transaction data was lacking in many of the qualitative aspects that were available for the GPC method. Nonetheless, the market approach provides a solid valuation basis to value iKang because of similar economics in a similar market.*
>
> *16.7 I did not apply any weighting to the Take-Private Price of $20.60 per ADS nor iKang's historical trading prices. In my opinion, the flawed process by which the Take-Private Price was determined did not account for the economic benefits the Dissenting Shareholders would have enjoyed in terms of increased cash flows or increased share value had their shares not been cancelled as of the Valuation Date. Furthermore, as discussed in Section 14 and other areas of my report, iKang's historical stock prices did not exhibit reactions to fundamental Company performance metrics. Accordingly, it is my opinion that neither the Take-Private Price nor iKang's historical trading prices are reliable indicators of iKang's value."*

480. During his cross-examination Mr Beaton said that in determining his weightings he had initially provided the smallest weighting to his CoTrans valuation because it was a historically based valuation. In his experience a CoTrans valuation typically resulted in a value that was much lower because it did not capture a company's growth as well as a CoCo or a DCF valuation. He also said that he did not consider that the corrections he had made and accepted in Beaton CR called into doubt or required an adjustment of his weightings (see the transcript for day 5 at page 85).

481. The Company invited the Court to adopt Mr Good's approach to weighting.

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482. The Dissenting Shareholders submitted that the decision on weighting would largely flow from the other issues in the case but suggested that the rational approach for the Court to adopt was as follows. First, the Court should determine whether Mr Good was right to ascribe 10% to his market trading price and whether Mr Beaton was right to ascribe 10% to his CoTrans valuation. Secondly, the only other market method that the experts proposed was comparable multiples and the question was whether to ascribe to them 30% or 15% or some other figure. Thirdly, the question arose as to whether the income method (the DCF) should have a weight of 75%, 60% or something else.

483. The Dissenting Shareholders explained that on the first question their position was that no weight should be ascribed to the market trading price and that Mr Beaton's CoTrans valuation should be accorded the 10% he had proposed. On the second question, Mr Beaton's approach of ascribing only 15% to a CoCo valuation was to be preferred to Mr Good's approach of 30%. The comparative multiples provided some market input but the uncertainties involved in assessing the proper comparisons to make were greater and less amenable to a robust evidence-based determination than the uncertainties of the DCF in this particular case.

484. The Dissenting Shareholders submitted that in this case the DCF was more secure than in many other cases since the two experts' DCF valuations were based on agreed cash flows for the explicit period. The fact that the cash flows were agreed meant that the Court was called upon to resolve disagreements only in relation to the discount rate. Even there, several of the parameters had been agreed. Reflecting the degree of agreement, the difference in the ultimate outturn of the experts' DCF valuations was not so great as in several recent section 238 petitions. This was important because it meant that the final DCF which will be arrived at after the Court had determined the five issues in dispute in relation to the WACC was a much more robust quantity than in other cases. Market-based measures will necessarily involve favouring the opinions of other market participants on the same issues, when those have not benefitted from either the agreement of the experts on so many aspects or the careful examination of the disputed matters in public adversarial proceedings. Mr Good had accepted that a 75% weighting for the DCF in this case was within the reasonable range and the Dissenting Shareholders submitted that it was indeed reasonable, and in all the circumstances of this case more reasonable, to award this weighting to the DCF rather than any lower figure.

485. I have decided that (a) a 90% weighting should be attributed to the DCF valuation based on the decisions I have made and methodologies I have discussed above in relation to the five DCF issues in dispute and that (b) a 10% weighting should be attributed to the CoCo valuation prepared

in the manner I have set out above (based on the four comparable companies identified and agreed upon by both experts but adjustments to the calculation of the multiples that I have prescribed).

486. I agree with the Dissenting Shareholders' submission, for the reasons they gave, that the case for complete or a very substantial reliance on a DCF valuation is very strong. The DCF valuation was based on agreed cash flows and, while the issues in dispute were on occasions finely balanced and not straightforward or capable of resolution without the application of judgment, they were limited and subject to analysis by reference to the valuation literature and practice. By contrast, as I have discussed above and found, the other valuation methodologies were subject to fundamental difficulties and much greater uncertainty. In my view, the DCF valuation is the most reliable methodology in this case and should be given very substantial weight.

487. It seems to me that, as I have explained above, an adjusted CoCo valuation is sufficiently reliable to justify a limited weighting and that it would be reasonable to include it as a modest market-based modification to the DCF valuation. As I have said, however, even though I am satisfied that a CoCo valuation can reasonably be based on the four comparator companies agreed on by the experts it remains subject to difficult comparisons and judgments and is more than a little problematic. Both experts agreed that a CoCo valuation is always challenging and in this case there were real problems in assessing both comparability and the relevant variables. When contrasted with the reliability and robustness of the DCF methodology in this case, and recognising that I have found the experts' CoCo valuations deficient and in need of adjustments in respects which they did not acknowledge, it seems to me that the adjusted CoCo valuation should be given a lower weighting than either Mr Good or Mr Beaton attributed to it and I have concluded that a weighting of 10% is in all the circumstances reasonable.

488. For the reasons I have given above, I do not consider that any weight should be given to Mr Beaton's CoTrans valuation or to Mr Good's 30-day VWAP market trading price valuation. I also do not consider that the Merger Price should be used as a cross-check to determine the reasonableness or relative ranking of other valuation methodologies (for example to show that the fair value should be below the Merger Price).

Delay

489. This judgment has taken much more time to complete than I would have wished or is usually justifiable. As I have explained to the parties when providing updates on progress, I found myself having a number of other trials and matters listed in the period shortly after the trial of this matter, many of which were urgent, and having to adjudicate and write judgments in those cases

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repeatedly and substantially delayed, despite my having made considerable progress with the drafting of this judgment, completion of the judgment. For this I must apologise to the parties and to counsel.

The Hon. Mr Justice Segal
Judge of the Grand Court, Cayman Islands
21 June 2023