IN THE UPPER TRIBUNAL (LANDS CHAMBER)

Neutral Citation Number: [2017] UKUT 91 (LC)
Case No: ACQ/50/2015

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

COMPENSATION - Compulsory Purchase – leasehold franchise restaurant at Farringdon – extinguishment of business owing to Crossrail Scheme – agreed assumed maintainable earnings figure – dispute as to appropriate multiplier – comparable transactions of franchises – extinguishment value determined at £1,498,000

IN THE MATTER OF A NOTICE OF REFERENCE

BETWEEN:

SME (HAMMERSMITH) LIMITED	**Claimant**
- and -	
TRANSPORT FOR LONDON	**Acquiring Authority**

Re: 48 Cowcross Street,
London EC1

9-11 January 2017

Her Honour Judge Alice Robinson and Mr Peter McCrea FRICS

Royal Courts of Justice, London WC2A 2LL
- -

Alexander Booth QC and *Rebecca Clutten*, instructed by Bircham Dyson Bell LLP, for the claimant
Robert Walton, instructed by Pinsent Masons LLP, for the acquiring authority

DECISION

Introduction

1. This is a reference by SME (Hammersmith) Limited ("the claimant") to determine the compensation payable upon the extinguishment of its Kentucky Fried Chicken ("KFC") franchise at 48 Cowcross Street, London EC1 ("the premises") owing to a compulsory purchase to facilitate the Crossrail scheme. The premises were compulsorily acquired under the Crossrail Act 2008 which received Royal Assent on 22 July 2008. The Secretary of State for Transport executed a general vesting declaration in relation to the leasehold interest in the premises on 27 April 2009 and the lease vested in the Secretary of State on 28 May 2009 which is the valuation date for the purposes of this reference. Possession was taken on 1 June 2009.

2. By virtue of the Crossrail (Devolution of Functions) Order 2010, anything done by the Secretary of State before the devolution date of 21 April 2010 has effect after the devolution date as if done by Transport for London ("TfL") which is therefore the acquiring authority.

3. Mr Alexander Booth QC and Ms Rebecca Clutten of counsel appeared for the claimant, and called Mr David Epstein, a forensic accountant; Mr Mark Henderson, a Chartered Surveyor; and Mr Aly Esmail who is Chief Executive of SME Group plc, the ultimate parent company of the claimant.

4. Mr Robert Walton of counsel appeared for the acquiring authority and called Mr James Stanbury, a forensic accountant, and Mr Martin Willis who is a Chartered Surveyor.

5. We are grateful to counsel for their assistance in this matter and their helpful written closing submissions.

Facts

6. From the evidence and statements of agreed facts we find the following facts.

7. SME Group plc is a family company that operates KFC, Pizza Hut and Costa Coffee franchises, franchised hotels, and has other property interests. It owns a subsidiary company, SME Holdings Ltd, which in turn owns ten further subsidiaries including the claimant company, SME (Hammersmith) Ltd. At the valuation date SME (Hammersmith) Ltd operated five KFC franchises, including that at the premises.

8. The premises were located at the corner of Cowcross Street and Farringdon Road, EC1, a short distance from Farringdon rail and underground station. It comprised part of the ground floor of a multi-occupied 1960's development. The area was synonymous with Smithfield Market, but at the valuation date comprised a variety of land uses, including residential, office, retail and

leisure. Farringdon had become an established destination for food, drink, and evening entertainment, with a concentration of bars and restaurants extending along the full length of Cowcross Street, with a high level of footfall during the week, both at day and night.

9. The other four KFC franchises operated by the claimant comprised: unit 3, Royale Leisure Park, Acton, W3 (a retail park outlet); 161 Kilburn High Road, Kilburn, NW6 and 47 Chase Side, Southgate, N14 (both high street outlets); and unit 4, Pegasus Court, Kettering, Northants (a drive-thru outlet). The Southgate unit was held on a virtual freehold basis; the others were held on leases.

10. The claimant held a leasehold interest in the premises under a lease dated 4 October 1984 made between Eagle Star Insurance Company Ltd and Rumana Catering Limited. The term of the lease was 25 years commencing on 14 September 1984, thus expiring contractually on 13 September 2009. At the valuation date the rent passing was £155,000 pa. The freehold interest was owned by Cardinal Tower Limited ("Cardinal") whose interest was also compulsorily acquired.

11. On 20 March 2009, the claimant served a request under section 26 of Part II of the Landlord and Tenant Act 1954 ("the 1954 Act") seeking the grant of a new lease. Since Cardinal did not serve a counter-notice within two months of the s.26 request, it could not subsequently have opposed the grant of a new lease. The parties agree that compensation should be assessed on the assumption that the claimant would have secured a new 15-year lease at a rent of £163,000 pa, benefitting from the protection of Part II of the 1954 Act.

12. In May 2009, upon the joint instruction of the parties, Davis Coffer Lyons, specialist leisure property valuers, produced a valuation report ("the DCL report") which valued the claimant's interest in the premises, as at 7 January 2009 on a market value basis as an operational entity having regard to trading potential, at £950,000. That report did not lead to a settlement of the claim.

Agreed matters

13. The parties agree that the leasehold interest had no premium or capital value and accordingly the claimant is not entitled to any compensation under rule (2) of s.5 of the Land Compensation Act 1961. However, the claimant is entitled to compensation under rule (6) in relation to the following matters:

(a) The extinguishment of its business at the premises;

(b) Costs incurred pursuant to the closure of the business at the premises;

(c) Reasonable professional fees incurred in formulating the claim.

14. In respect of paragraphs (b) and (c) above the parties have agreed the following sums, from which VAT is excluded since the claimant is VAT registered.

Item	Agreed amount
Legal fees	£54,081.98
Surveyor's fees	£82,297.55
Accountant's fees	£24,310.26
Management time	£7,500.00
Staff redundancy costs	£14,282.00
Planning Consultant's fees	£13,205.00
Equipment and removals	£8,643.00
Electrics	£470.00
Total:	**£204,789.79**

15. It is also agreed that the claimant is entitled to an Occupier's Loss payment under the Land Compensation Act 1973 in the sum of £5,179.25. Advance payments totalling £398,643.23 have been paid to the claimant.

16. It is common ground that in valuing the extinguishment of the claimant's business at the premises at the valuation date, the annual maintainable earnings can be assumed to be £107,000.

Issue in dispute

17. The remaining issue between the parties is in respect of the multiplier that should be applied to the assumed maintainable earnings of £107,000 in order to calculate the claimant's loss. The joint approach of the parties, in assessing the appropriate multiplier, is to rely upon transactions involving other "clutches" of KFC franchises.

18. The claimant contends that the correct multiplier to be applied is 17, which would result in compensation payable for the extinguishment of the business of £1,819,000. TfL contends that the correct multiplier should be 7.5, which would result in compensation payable of £802,500.

Evidence

19. On any view, the available comparable evidence is limited. By the end of the hearing, there were four comparable transactions which might assist in the determination of the value of the extinguished business. These were as follows:

"Marz/Marsden"

20. Mr David Epstein FCA CTA MAE MEWI is a chartered accountant and consultant at Kingston Smith LLP. He was instructed by the claimant to provide an expert opinion on the loss suffered as a result of the extinguishment.

21. Mr Epstein explained that he had searched a number of databases covering transactions of the acquisition of businesses and companies and had found only one independent comparable transaction not involving franchisor to other franchisees. This was the acquisition of Marsden Caterers of Sheffield Ltd ("Marsden") by Marz Limited ("Marz") on 3 March 2008. Marsden was an existing KFC franchisee with 14 outlets across the North of England comprising eight "drive-thru" outlets and six "high street" outlets. Of the 14, five were owned by Marsdens on a freehold[1] basis, the remainder were held leasehold.

22. The total consideration that Marz paid to the shareholders of Marsden was £19,825,191, plus an obligation to repay third-party loans and overdrafts totalling £1,614,791 but this included £389,782 of cash. The net amount paid was therefore £21,050,200. Marsden's accounts for the calendar year 2007 showed a net profit, before tax, of £1,240,915.

23. Mr Epstein calculated that the price paid equated to a multiple of 16.96 on the net profit.

24. In order to ascertain whether the value of the five freehold outlets had any effect on the multiple, Mr Epstein noted that these had been independently valued, as part of the transaction, at £1,698,493. He then made two adjustments. First, he deducted the freehold value from the purchase price to arrive at a net figure of £19,351,707. Secondly, in order to reflect the notional rent that should be attributed to the five outlets had they been held leasehold, he deducted a figure of £102,000 (based upon the freehold value of £1,698,493 at a yield in perpetuity of 6%) to arrive at a net earnings figure of £1,138,915. This again produced a multiple of around 17, which led Mr Epstein to conclude that the presence of freehold outlets made very little difference to the multiple achieved on the sale of the company. He accepted that this was one transaction but it did indicate what a purchaser would pay for a clutch of KFC franchises.

25. Mr Booth submitted that the multiple derived from the Marz/Marsden transaction accurately reflected the market view of the value of KFC franchises at the valuation date. The transaction could be considered a reliable comparable because it related to the sale of KFC franchises, it was based upon price and earnings data obtained from audited accounts; derivation

[1] In this decision we have used "freehold" to describe both freehold and virtual freehold franchise outlets, as no distinction was drawn between them by the parties.

of the multiple only involved one adjustment to exclude the freehold premises; and the figure used to make that adjustment reflected an external valuation carried out at the time of the transaction.

26. Mr Walton submitted that the transaction was unreliable for several reasons: it took place 15 months before the valuation date, prior to the onset of the recession; and it related to a significantly different portfolio of properties both in terms of the proportion of freehold outlets and the proportion of drive-thru outlets. However, there was no dispute that the correct analysis of this transaction, using historic earnings figures, gives rise to a multiplier of 17.

Timing and the impact of the recession

27. Mr Aly Esmail is the Chief Executive of SME Group plc. His written evidence was that at the valuation date of May 2009, both the claimant company and the SME group as a whole, were performing extremely well with substantial sales and profit growth. He said that the KFC brand thrives during an economic downturn where people 'trade down' from fast casual dining to fast food. He accepted in cross examination that the claimant's profit and loss account for the years ended March 2008 and March 2009 showed the claimant's company was making a loss which increased, but said that was set against rising turnover and did not apply to the SME group as a whole. The directors' reports for the SME group were in evidence. These also showed that for the year to March 2009, profitability had been maintained in line with the previous year. However, for the year to 28 March 2010, whilst the group's gross profit margin was 67%, mirroring that for the previous year, the profit and loss account showed a profit after tax of £2.35 million, which in comparison with the previous year's figure of £1.63 million, was a substantial increase.

28. Mr Martin Willis FRICS is a chartered surveyor, and the chairman of Fleurets. In his written evidence he said that any review of the restaurant or franchise sector needed to be preceded by a review of the general economy and that following the government's intervention to prevent the collapse of Northern Rock in September 2007 and further intervention to assist other banks and building societies in 2008, the UK economy was generally regarded to be in a critical state throughout 2009. The downturn was exacerbated by the collapse of Lehman Brothers in September 2008. Mr Willis accepted that franchise restaurants were faring better than most traditional restaurants although transactions were largely restricted to new retail developments, mainly involving drive-thru outlets. He acknowledged that in 2009, fast-food businesses were trading well relative to most hospitality businesses as customers "traded down" from more expensive restaurants. However, he considered that the Marz/Marsden transaction, could not be considered a reliable comparable because it occurred when the market was very different, prior to the severe economic recession taking hold, which meant that funding was virtually unobtainable.

29. In his oral evidence, however, Mr Willis accepted that the UK was already suffering an economic downturn at the beginning of 2008 and indeed he had produced an Estates Gazette timeline that described January 2008 as "pretty bleak". In his rebuttal report he had stated that there was no evidence either of like for like growth or improvements in profitability. However, in cross examination he was constrained to accept that neither statement was correct as the evidence showed increases in both sales and profitability in the quick service restaurant ("QSR") sector. He then said that this was just a 'purple patch' i.e. short term, although that was not a point made in

either of his reports nor did he produce any figures to demonstrate a subsequent downturn in sales or profits in this sector.

30. Mr Mark Henderson BSc (Hons) MRICS IRRV is a chartered surveyor and a senior director of Cushman and Wakefield. He accepted Mr Willis's evidence regarding both the general economy and the effect of the recession on the restaurant sector, but maintained that the QSR sector was in fact a beneficiary of the downturn and he produced a number of press articles to support his evidence. These showed that fast food restaurants generally were doing well during the recession. KFC was specifically mentioned: "same store sales in the first two months of KFC's latest financial year are up 14%" (Telegraph 20 February 2009), and "KFC were among the traditional fast food sellers to have also grown store presence" (UK Economy 22 November 2009). The one exception was an article dated 23 February 2009 which stated that "KFC was underperforming with extremely poor sales in January 2009." However, as Mr Willis agreed, this article focussed on the sale of potato products worldwide. In the light of the other evidence we consider that this comment on the global market is not reflected by trading conditions in the UK.

31. Mr Henderson concluded that Mr Willis's criticism of the Marz/Marsden transaction on the basis that it took place in better market conditions that those prevailing at the valuation date was misplaced. In fact, as demonstrated by the press articles and the evidence of Mr Esmail, the recession had a positive impact on the fast food takeaway business and in particular KFC.

32. Mr James Stanbury FCA, MAE, ACIArb is a Chartered Accountant and a partner in RGL Forensics. He agreed with Mr Willis that the use of the Marz/Marsden transaction as a comparable was inappropriate, and sought to support his opinion by reference to the price-earnings (PE) ratios, a drop in share prices generally and a drop in the number of company acquisitions. In his rebuttal report he produced a table of PE ratios for Yum Brands and McDonalds to show that these too fell during 2008 and 2009.

33. In response, Mr Epstein criticised the use of PE ratios and Mr Stanbury's use of those for McDonalds and Yum Brands, on the basis that both were multinational companies whose UK businesses represented a small proportion of their global operations - 10% in Yum's case – and the PE ratios on which Mr Stanbury relied reported their worldwide operations. Further, they are franchisors rather than franchisees. In any event the evidence shows that over the period March 2008 to May 2009 which is relevant to the Marz/Marsdens transaction, although there were fluctuations in between, overall the share prices of both companies rose – which Mr Stanbury accepted. Mr Epstein explained that PE ratios are calculated by dividing the daily share price by the published earnings per share. Whereas the share price changes daily, the results (earnings) are only published quarterly and fluctuations do not necessarily reflect the value of the company. As the share price rises so does the PE ratio because the earnings figure – the denominator in the equation - remains static. Immediately after results are published, the share price may not change much but if the results improve, there is an immediate drop in the PE ratio as the earnings per share has increased. There was no cross-examination of any of Mr Epstein's evidence on this issue.

34. In oral evidence Mr Stanbury accepted Mr Epstein's analysis of his PE ratio evidence, agreeing that the market does not necessarily value shares in line with earnings and that a fall in a PE ratio might not necessarily have been caused by the recession, although he did note that the market sentiment, reflected in the share price, had not responded to the increase in earnings.

The effect of the proportion of freehold outlets on the multiple

35. Mr Willis's original criticism of the Marz/Marsden transaction was that it involved five[2] outlets (out of 14) held on a freehold basis, whereas the claimant's portfolio only contained one (out of five).

36. However, the acquiring authority subsequently accepted Mr Epstein's method of removing any such distortion by deducting the value of the freehold interests and allowing for notional rents in the earnings figure. The issue that remained was therefore, after an adjustment for freehold outlets had been made, whether there remained any further adjustment to reflect the additional security derived from trading from a portfolio that was more heavily weighted with freeholds.

37. Mr Willis maintained that the business profits generated from freehold sites are available to the operator in perpetuity, without the need to deal with a landlord, which he considered gave the operator more flexibility. A freehold owner did not have the cost of rent reviews, landlord's consent to alterations, lease renewals, etc. He also said that there would be an effect on how the profit would be viewed. If both a freehold and a leasehold franchise produced a net profit, after notional rent or rent had been deducted, of say £50,000, that £50,000 would be treated differently depending on the tenure in which the outlet is held. However, he accepted that there was no evidence to this effect in his reports.

38. Mr Epstein said that in the current reference, where the assessment of compensation is in respect of the loss on one, leasehold, outlet, no purpose can be served by looking at the balance of the claimant's wider portfolio, because what has been lost is the security from trading from the premises that were taken. Mr Booth submitted that, as such, the relevant consideration was whether there was any material difference in value in a trading business run from the premises with the benefit of the lease to be assumed – which we remind ourselves at this point was a new 15-year term with no landlord's break clauses, and falling within the security of tenure provisions of the 1954 Act – or a trading business run from the premises assuming they are in hand on a freehold basis.

39. Mr Esmail's evidence was that he wouldn't pay any more for a business that traded from a freehold business than for that trading from a leasehold property on the agreed assumed term. The value of the business was purely determined on the trade of the business. He went on to say that

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[2] Mr Willis accepted Mr Henderson's contention that there were five freehold outlets rather than six as he had indicated in his first report.

for some franchisees, like the SME group, who have a property portfolio which is a separate business, they might prefer a freehold property and in fact SME liked to have freeholds.

40. At the start of the hearing we asked the parties to consider, if we were minded to make any adjustment to reflect the differing proportions of freehold outlets within the claimant's estate in comparison with the comparables, what that adjustment should be. Mr Epstein's view, without prejudice to his view that there should be no adjustment, was a reduction of up to 5% in the multiple, assuming the purchaser of the franchise was one who also wished to own freehold property. Mr Willis said that it wasn't easy to carry out an empirical exercise, and whilst he didn't fundamentally disagree with Mr Epstein's 5% he thought the appropriate adjustment might be up to 10%. He arrived at his figure by considering the average proportion of freehold outlets in each portfolio.

The effect of the proportion of drive-thru outlets on the multiple

41. The acquiring authority mounted a similar challenge to the reliability of Marz/Marsden as a comparable owing to the higher proportion of drive-thru outlets included in that transaction – eight of the 14 outlets – in comparison with the single drive-thru outlet in the claimant's estate.

42. The basis of the acquiring authority's criticism was that drive-thru's were more attractive in the market, and were the main driver for growth in the sector, town centres having reached saturation point.

43. Mr Willis produced a presentation entitled "Green Shoots: No Parachute Required" ("the Green Shoots document") which had been given by the Business Development Director of KFC UK to the Accessible Retail Conference in October 2009. The points which Mr Willis took from the presentation were that whilst there were difficulties in the general consumer market, the QSR market had nevertheless been resilient as a result of people trading across from casual dining; that same stores sale growth ("SSSG") for drive-thru outlets was higher than for other outlet types; that new store openings were the key drivers of trade, particularly drive-thru outlets; and that the future needs of KFC UK was heavily dominated by drive-thru requirements - 243 drive-thru locations compared with 12 new high street locations.

44. Mr Willis said that the QSR market had evolved over the last 30 to 40 years, and as retail outlets moved out of the town centre to retail parks, so did the restaurant sector, of which the drive-thru outlet was the most modern format. He said that drive-thru's were incredibly successful and that there were a number of advantages to both the operator and the retail park owner. Drive-thru units were purpose built and designed, had greater seating, had parking, and had dual income from drive-thru and takeaway customers. When located on retail parks, they benefitted from the owner of the park managing the cluster of QSR operators to avoid direct competition.

45. Mr Willis said that the evidence and research he had carried out suggested that profitability of drive-thru outlets was high, with more modern outlets achieving turnover figures of £30-£40,000 per week. He clarified in cross examination that not *every* drive-thru outlet was

more profitable than *every* high street outlet, and that the reference premises were more profitable than some drive-thru franchises. In his rebuttal report he said that sales at drive-thru outlets could be achieved with a lower unit cost, thus improving overall return on investment, but he accepted that he had not adduced any evidence in support of this assertion, which he said was from his experience as a valuer.

46. Mr Esmail accepted that the main thrust of KFC's expansion was in the drive-thru format, but said that this was largely because town centre locations were saturated. As regards the profitability and lower unit cost of drive-thru outlets, Mr Esmail said that Mr Willis's contentions were wholly incorrect. He said that it was more expensive to build, fit-out and run drive-thru outlets, in comparison with most (but not all, including the reference premises) high street outlets. In London, particularly near transport hubs, Mr Esmail said that high street locations were more profitable.

47. He said that of the five outlets in the claimant's portfolio, only one, in Kettering, was a drive-thru and that made a loss, whereas the reference premises were the most profitable. He also commented that of the 53 KFC franchises in the wider SME group, only 11 were drive-thru outlets.

48. In response to our request for the parties' view of the appropriate adjustment, if we were minded to make one, to reflect the difference in the proportion of drive-thru outlets in the claimant's estate compared with the comparable evidence, Mr Epstein said that if a purchaser considered that drive-thru outlets had a greater growth than other types of outlets, the adjustment to be made should reflect the amount of that greater growth in comparison with a top class, city centre, railway hub location, this might be reflected by a 5% adjustment, but he maintained his position that no adjustment was warranted. The acquiring authority did not advance a figure or comment on this.

"Herbel/Kram"

49. The acquiring authority's primary comparable was the purchase on 1st September 2009 by Herbel Restaurants Ltd ("Herbel") of five KFC outlets from Kram Restaurants Ltd ("Kram"). Both Herbel and Kram were existing KFC franchisees. The five outlets comprised existing KFC franchises at two drive-thru's and three high street properties in the south west of England. Four of the outlets were leaseholds and one, the drive-thru outlet at Barnstaple, was held freehold.

50. There was no dispute that no adjustment is necessary to reflect the date of the transaction, the number of drive-thru's or the balance of freehold/leasehold interests, when comparing the assets with those of the claimant.

51. Herbel's accounts for the year ended 31 December 2009 refer to "acquired operations", namely the five KFC franchises acquired from Kram, and indicate that £3,198,108 was paid for goodwill and £1,411,031 for fixed assets and franchise licences. Accordingly, the total purchase

price was £4,609,139. The transaction included a put and call option on the remaining shares in Kram, to be exercised after five years, whereby Herbel could be required to purchase or Kram could be required to sell the shares in Kram.

52. In his written evidence, Mr Stanbury made three deductions. The first was transactional costs of 5%. The second was the sum of £156,100 which was, post-sale, repaid by Kram to Herbel to reflect the failure of one of the stores to reach its sales target. Thirdly, he deducted 12% from the purchase price to reflect the value of the 'put and call' option. After these deductions, he calculated a net purchase price of £3,669,485.

53. As there were no historic accounts available in respect of Kram's trading in the outlets, Mr Stanbury used evidence of profit made in the first four months of trading in the five outlets by Herbel and grossed that up to represent 12 months trading in order to arrive at a net maintainable earnings figure on an EBIT basis of £487,224.

54. He therefore arrived at a multiplier of 7.53 (£3,669.485/£487,224).

55. Mr Stanbury made several amendments to his analysis during the hearing. The first was to adjust the transactional costs to 4.8% (to reflect 5% on the net amount rather than the gross); the second was an abandonment of the deduction of £156,100; the third were deductions to reflect the value and notional rent of the freehold property that was included in the transaction. This resulted in an amended multiple of between 6.8 and 7, between which Mr Stanbury expressed no preference.

56. The claimant's case was that no deductions are possible to reflect the value of the freehold property or the 'put and call' option because of the lack of information as to the value of both. Further, criticism was made of the use of the post-acquisition trading figures on a number of grounds. As a result, the claimant's case was that the transaction is wholly unreliable and no weight should be placed upon it.

57. The issues are therefore as to the reliability of the transaction as a comparable having regard to:

- The existence of the freehold property
- The 'put and call' option
- The trading figures used to derive the earnings figure.

Freehold property

58. In his rebuttal report, Mr Epstein noted that Herbel's accounts showed freehold additions of £2,827,226, some of which would have been for Kram's single freehold, but said that no analysis or breakdown had been provided. Adopting a rough analysis, he said, of say half of the figure, and using the upper end of Mr Willis's range of yields - 8% - Mr Epstein arrived at a notional rent for the freehold property of £113,089. However, he stressed that in his view no weight could be put on this owing to lack of information.

59. Mr Willis noted in his first report that the Barnstaple drive-thru freehold was transferred from Herbel to Scotco (Eastern) Ltd, an associated company, at £1.5 million in October 2010. In his amended calculations, Mr Stanbury used this as the value of that property at the transaction date, and, using Mr Willis's range of 7-8%, arrived at a notional rent to be deducted of between £105,000 and £120,000 per annum.

'Put and call' option

60. The only evidence about the put and call option was contained in promotional material from the agent acting for Kram, Smith Cooper LLP, and paragraph 3.59 of Mr Stanbury's report which states that he had spoken to Mr John Farnsworth, the partner in Smith Cooper that dealt with the transaction:

> "I understand that there was no separate value ascribed to the option but there was an implicit and intrinsic value included in the transaction."

61. Mr Stanbury nevertheless sought to ascribe a financial value to it of 12% of the purchase price by assuming the value of Kram remained the same and calculating the return on a risk free investment rate. He said that because it was not possible to arrive at an exact value of the option, his approach assessed its minimum value by looking at the opportunity cost of investment. He said Herbel would not have entered into the option if it could make money elsewhere and the proxy to a risk free rate of investment was fair. In his initial calculation the value was £553,097 and after deducting the value of the freehold property the value of the option was £373,097.

62. Mr Epstein's evidence was that, in the absence of evidence as to the sale price of the shares, it is not possible to value the option. Further, the liability of the put option had to be taken into account. He concluded that at the date of the transaction there would have been no value to either option.

Post-acquisition accounts

63. Three objections were taken to the use of the trading figures available from Herbel after the transaction took place:

a) The accounts post-date the transaction
b) They only cover a period of four months
c) It is unclear how many units the accounts covered

a) Post-dated accounts

64. There was no evidence of historic trading figures prior to acquisition. Accordingly, Mr Stanbury relied upon the operating profit derived from Herbel's accounts for the year ending 31 December 2009. The transaction was dated 1 September 2009 so the accounts covered the first four months of Herbel's ownership of the five Kram outlets. Page 2 of the accounts referred to "the acquisition of five KFC outlets from a third party five new KFC outlets opened in the current year". The accounts identified the income and costs of the acquisitions separately from which Mr Stanbury derived the earnings figure of £162,408. He then grossed this up to arrive at an annual earnings figure of £487,224.

65. Mr Epstein's Rebuttal Report stated that the post-acquisition figures reflected management and other changes likely to have been implemented by Herbel. Kram's accounts for the year ended 30 November 2008 showed that it was achieving a gross profit margin of 28% whereas Herbel's figures showed the outlets were making a gross profit margin of 42.5%, a significant increase. The use of that enhanced profit was not a reliable way of assessing a multiple of what was acquired from Kram. He confirmed that in oral evidence, saying that multiples were nearly always calculated by reference to historic profits. He agreed that he had looked at projected profits to analyse the East Anglian transaction but said that was because the outlets were making a loss so it was impossible to use historic data. A purchaser will look at what profit they anticipate making but there is no evidence as to whether the post-acquisition trading met their expectations or not.

66. Further, his view was that Herbel would not have paid to Kram a price which reflected the whole of the profit they expected to be able to make. The parties would compromise and split the benefit of the anticipated improvements.

67. Mr Willis said in oral evidence that in the real world when advising on a property acquisition there were two approaches, to look at historic trading figures and to look at the future trading potential of the business. It was very rare that historic information is of great relevance unless it is a mature company i.e. one that has been trading for some years in established units whose condition has been kept up and growth was not expected. He also said that RICS guidance notes say that a valuer must assess trading potential but use existing trading figures as a starting point.

68. Mr Stanbury agreed in cross examination that you normally adopt the approach of calculating value based on historic trading data but he said that was because generally you do not have anything else. Where other evidence is available it is more 'real world.' That's not to say that one approach is more robust than the other. He agreed that he did not know what Herbel's expectations were when they entered into the transaction and they would have had the historic data. He agreed that his approach of valuing the business on the basis of all the improvements in efficiency and performance achieved by Herbel assumed Herbel would have paid a price reflecting every bit of profit they hoped to make.

b) Period of trading

69. Mr Epstein's Rebuttal Report stated that there was no evidence that the acquisition's figures covered a four-month period, which was an assumption on Mr Stanbury's part. In oral evidence he said that the completion date of the contract does not necessarily tie in with the date the new owner starts trading. There were transactions where the contract gave the purchaser the right to receive income from the units before the transaction date.

70. In oral evidence Mr Stanbury said it would be highly illogical not to include trading results for the acquired outlets from the date of acquisition. He did not think that the figures would have been affected by Christmas trading. However, they were more likely to go up than down after four months which would reduce the multiplier.

c) Number of units

71. In November 2009 Herbel took a new lease of a further unit in Barnstaple. There is no definitive evidence as to how this impacted on the transaction or the post-acquisition trading figures. Although Mr Willis's Report stated that it is likely that this would have been reflected in the sale price for the transaction this point was not pursued and did not form part of Mr Stanbury's final analysis of the transaction.

72. Of more relevance, the claimant argued that some of the four months trading accounts may include income from this outlet. The accounts cover the period September to December 2009 inclusive and the last two months therefore included the period after the new lease of the high street Barnstaple premises was granted.

73. Mr Epstein's Rebuttal Report stated that he would have expected the 2009 accounts to have included income from all Herbel's acquisitions and removal of any income from the outlet acquired in November would reduce the income and therefore increase the multiplier. Mr Booth asked Mr Epstein to estimate the adjustment that would needed to be made to the Kram transaction to reflect the presence of the sixth unit. He said that there were five units trading for four months, and one further unit for two months. This totalled 22 months of unit trading, and of this, the two months trading of the sixth unit represented one-eleventh, and therefore an adjustment of 9% would be required.

74. Mr Willis then gave evidence to the effect that the lease of the high street Barnstaple outlet is dated 1 September 2009 with a commencement date of 29 October 2009 and a rent free period of 12 months with upwards only rent reviews. He said that it was formerly a Wimpey Bar and he assumed the site was taken for conversion to a KFC. The rent free period would be commensurate with the need for a fitting out period and as an incentive, therefore it was highly unlikely that the outlet was trading during 2009.

75. Mr Stanbury drew attention to the fact that Herbel's accounts refer to acquisition of five new properties which opened in the current year, not six.

"East Anglia"

76. In the light of the limited comparable evidence available, Mr Epstein relied upon evidence of other transactions which he described as a 'sense check' of his assessment of the Marz/Marsden comparable. The main one was the purchase on 29th September 2008 by SME Trading Ltd of four existing KFC franchises in East Anglia that were sold by KFC GB Limited. They comprised three leasehold and one freehold property.

77. The freehold Sudbury property was valued at £1.1m based on a market rent of £52,000 per annum. The consideration in excess of the freehold value was £1,585,000. Accounts for the last year's trading by KFC GB Limited showed that each outlet was making a loss. Mr Epstein adjusted that to reflect the market rent for the Sudbury property, a 6% royalty, cost savings and additional sales which the claimant anticipated. He calculated an EBIT multiplier of 21 to 34, depending on the level of costs savings.

78. TfL did not dispute the calculations but criticised reliance on this transaction on the grounds that the analysis depended on the level of sales and costs savings which it was anticipated could be achieved.

79. Mr Esmail's witness statement said that the outlets were not loss making to KFC GB Limited but would be to the claimant after adding a 6% royalty. However, in cross examination he agreed that was wrong and they were loss making to KFC GB Limited. He said he had done his witness statement from memory and checked some information but not that.

80. His statement said the claimant made a number of assumptions as to the improvements which it could make to trading at the East Anglian outlets. These were an increase in sales by ensuring they opened and closed on time, reducing the cost of labour by running a more efficient operation with better trained staff and reducing the cost of sales by monitoring waste more closely, ordering more effectively and reducing the theft of products. The claimant had target percentages that the other businesses ran to and used those to calculate the difference between the figures KFC GB Limited had achieved and what the claimant could achieve. The claimant estimated cost savings of between £150,000 and £180,000 would have been achieved with a net profit of between £70,000 and £100,000.

81. In oral evidence he said that the claimant put in a nominal factor of an 8% increase on sales. The level of uplift in sales can vary but generally they see a 20% uplift in sales and in some stores sales have tripled after the first couple of years.

82. Mr Epstein's final analysis took the annual loss of £43,541 as a starting point, then deducted the notional market rent for the Sudbury property (£52,000) and a 6% royalty which the claimant would have to pay (£122,000) in order to arrive at a negative earnings figure of £217,541. He then added cost savings of £150,000 or £180,000 and an 8% increase in sales of £162,895 less cost of sales of £49,388 in order to arrive at an earnings figure of £45,966

(assuming £150,000 savings) or £75,966 (assuming £180,000 savings). These gave rise to an EBIT multiplier of 34.48 and 20.86 respectively.

83. Mr Epstein produced the claimant's accounts for the four East Anglian outlets for the years ended 31 March 2009 and 2010. These show that although sales dropped and trading losses increased post acquisition in 2009, by March 2010 sales had increased at three of the outlets by 10% to 22% over pre-purchase sales levels (Sudbury had almost reached pre-purchase sales levels) and two of the outlets were profitable. Total annual trading losses across all four outlets had reduced to about £5,000 (excluding interest).

84. Mr Stanbury's Rebuttal Report criticised the use of prospective rather than anticipated trading figures and described the anticipated cost savings as unsubstantiated and speculative. He pointed to the continued losses some of the businesses were making. The lack of transparency affected the reliability of this as a comparable transaction. He also said that because the transaction was eight months before the valuation date it was before the onset of the recession.

"Demipower"

85. As a further "sense check" on the multiple which he had derived from the Marz/Marsden transaction, Mr Epstein considered the purchase by Demipower (1991) Ltd ("Demipower") of three north London KFC franchises.

86. In Autumn 2012, Yum offered two new clutches of outlets to a group of its existing franchisees, including the claimant. One of these clutches comprised existing outlets at Archway, Wembley and Harlesden. Offers were invited in excess of £1m for the three outlets plus two trading zones.[3] Yum provided the invited franchisees with summary trading figures for the three stores, which showed a pre-tax profit of £61,942 during the previous 26-week period.

87. Demipower's financial statements for the year ending 31 October 2013 indicated that the company had acquired three sites from Yum in August 2013. Mr Epstein's assumption that these were the Archway, Wembley and Harlesden franchises was unchallenged. The total acquisition cost was £944,741, comprising £233,896 for leasehold premises, £370,069 in respect of fixtures, fittings and equipment, and £340,776 for goodwill. Mr Epstein assumed that the total figure included some costs, and therefore assumed a net purchase figure of £925,000, which he said equated to a multiple of 14.9. Mr Epstein accepted that his figure did not account for any anticipation of increased efficiency on the part of the purchaser, and had that been the case, the multiplier would reduce.

88. In closing submissions, it was common ground between counsel that the transaction was of limited help, being over four years after the valuation date.

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[3] It is common ground that no value was attributable to the trade zones

The DCL report

89. In addition to the four comparable transactions, we also heard evidence in respect of the DCL report on the value of the claimant's interest in the reference premises. It was prepared by expert valuers on the joint instruction of both parties. DCL adopted a fair maintainable earnings figure of £135,000 on an EBITDA basis and a multiplier of 7 which, rounded up, gave a valuation of £950,000. Mr Stanbury's Report contained a passing reference to DCL's discussion of comparable evidence in his paragraph 3.70. The relevant part of the report states as follows:

> "The most recent significant inter franchisee transaction was the sale of a portfolio of 14 KFC restaurants situated across the Midlands by Marsden to Marz in June 2008. The full details of this transaction are confidential however we have discussed the matter with Marz' financial advisers, who we understand were closely involved in the transaction and who have been involved with other inter franchise deals within the last few years.
>
> At the time of the transaction, we understand that the leasehold multiple (YP) was in excess of 7 times EBITDA and we understand that this was before factoring in head office management costs. Such a multiple is significantly higher than we would usually expect to see for a single unit operation.
>
> We have also sought direct advice from KFC (Yum Brands) specifically to ascertain the sort of multiples they are achieving in the Greater London area when selling units on from central managements to the franchise sector. We understand an example of this would be the unit at Baker Street in Central London. Again full details of transactions are confidential however we are advised that they have achieved multiples (YP) in the current market of 8 times EBITDA or once times net sales on leaseholds."

90. In his rebuttal report Mr Epstein stated that the DCL valuation was not robust, being an assessment of the market value of a single unit rather than the loss to the owner, but also because DCL did not have sufficient financial information to analyse the Marz/Marsden transaction and the multiple relied upon as relating to that transaction was wrong. In oral evidence he added that the DCL valuation was prepared on an EBITDA basis whereas the equivalent EBIT multiplier, which would make it consistent with the valuation in this case, would be 11.7. In cross examination he conceded that he should have referred to the DCL report but maintained that, whatever had been said to DCL by a financial advisor for Marz, DCL had misstated the correct position so far as the Marz/Marsden multiplier was concerned.

91. In oral evidence Mr Willis said that DCL were a very experienced firm of valuers and therefore unlikely to have misreported what they were told. His own discussion with bank managers specialising in franchises suggested that prior to the recession a multiplier of 1 to 1.2 times turnover was being used but this dropped off with the recession and DCL's valuation came in at 95% of turnover.

92. Finally, Mr Stanbury said in oral evidence that there was a significant disjunct between the DCL valuation and the multiplier of 17, for which there had to be a reason. He thought it was because Mr Epstein had used historical trading figures whereas DCL's approach was on a more forward-looking basis. But, even if one adjusted the analysis to reflect EBIT and a multiplier of 11.7, you would still end up with the same valuation.

93. Mr Stanbury accepted in cross examination that, in seeking to suggest that his EBITDA figure of 7.5 was proximate to the 7 used by DCL, he had been wrong. His figure of 7.5 was, in fact, on an EBIT basis. His 7.5 should in fact be compared with a DCL equivalent of 11.7, which was not as proximate.

Discussion

<u>"Marz/Marsden"</u>

Timing and the impact of the recession

94. Although, all other things being equal, it is preferable to have a comparable transaction which took place at a similar time to the valuation date, this is not always possible. It is not unusual to use comparables for which an adjustment has to be made to reflect the difference in date by reference to movements in the market as evidenced by other transactions. In this case that is not possible because of the paucity of potentially comparable transactions. TfL therefore rely upon evidence of the recession and the changing fortunes of the economy between March 2008 and May 2009 as demonstrating that Marz/Marsden cannot be relied upon as a comparable. If it were to be used as a comparable, none of the witnesses suggested any adjustment which should be made to reflect the difference in dates because there is not the direct evidence to enable them to do so.

95. The difficulty with TfL's case is that it rests largely upon evidence about the economy in general rather than evidence specific to the QSR sector and KFC in particular. There is no doubt that the UK economy suffered a severe recession that began in the autumn of 2008 in the middle of the period between the Marz/Marsden transaction and the valuation date. However, it is common ground that the economic downturn began before that. Mr Willis accepted it was underway at the beginning of 2008 and Mr Henderson said it began in early autumn 2007 and the downturn was in full flow by the beginning of 2008. More importantly, the evidence as to the impact that the economic downturn and recession had on the QSR sector and KFC is largely one way. In the UK the press and other articles reported that fast food companies including KFC were benefitting from the recession as a result of customers 'trading down' from other types of restaurant. This is supported by the other documentary evidence including extracts from Director's Reports from KFC franchise companies. Benefits included increased sales on a like for like basis, expansion of the number of outlets and, critically, profits were being maintained or increased. The net profit of the claimant's business in the premises was also increasing during this period.

96. Mr Willis's somewhat belated assertion in oral evidence that these improvements represented a short term position only is not supported by his written evidence or any other document he was able to point the Tribunal to. Indeed, the expansion of KFC franchises in terms of sales, units and profits continued into 2010 on the evidence in the Director's Reports.

97. As to whether KFC franchisees wishing to expand would be able to obtain the finance to do so, Mr Esmail's evidence was that the claimant did just that in September 2008, acquiring the East Anglian units using 70% bank finance. Further, the Director's Reports show that other franchisees were acquiring or planning to acquire new units during this period and there is evidence that these acquisitions were made with the assistance of bank finance (Demipower). Mr Willis's assertion that "funding was virtually unobtainable" is simply unsustainable. Moreover, he accepted in cross examination that even during the recession banks need to lend money and that an established franchise company with a good track record would have raised funds to acquire KFC outlets.

98. Finally, we are not persuaded that the evidence as to PE ratios and share prices of McDonalds or Yum Brand provides any assistance on this issue. As Mr Stanbury accepted, PE ratios fluctuate according to the dates of publication of financial results and are not indicative of the effect of the recession. Further, variations in the share value of these companies in a global market does not necessarily assist in determining the market in the UK. In any event, the value of their shares rose during the relevant period.

99. We conclude that there is no credible evidence that the deterioration in the general economic climate between March 2008 and May 2009 had an adverse impact on the QSR sector or KFC in particular such as to undermine the use of Marz/Marsden as a comparable or that any adjustment should be made to it.

The effect of the proportion of freehold outlets on the multiple

100. As regards whether there should be an adjustment to the multiple to reflect the higher proportion of freeholds, we note that the parties agreed that Mr Epstein had accurately removed the (independently valued) freehold outlets from the sale price before analysing the multiple achieved – which is agreed at 17.

101. We accept Mr Epstein's unchallenged evidence that this reference is concerned with the assessment of the loss to the claimant as a result of the scheme – a point which we emphasised at the conclusion of the hearing. We are also persuaded by the closing submissions of Mr Booth and Ms Clutten that, consequently, the assessment is whether there is a materially different value in a trading business run from premises with the benefit of the leasehold assumed to be enjoyed by the claimant on a new lease, to one run from freehold premises, such that a downward revision of the Marz/Marsden multiple is justified.

102. In this regard, Mr Esmail's evidence was that the type of tenure would be immaterial – it was the profitability that was the key driver to value, although he accepted that his group of

companies "like" freeholds. Whilst Mr Esmail might not be expected to give evidence with the independence and objectivity of an expert witness, we found his evidence to be persuasive and indicative of his activities in the franchise world over many years.

103. Mr Stanbury confirmed that he relied wholly on Mr Willis's evidence on this point. We were unpersuaded by Mr Willis's view that an adjustment should be made to reflect the additional security derived from trading from a freehold which was largely unsupported by evidence, simply being an opinion based on his, undefined, research and experience. That is not to say we considered his evidence misleading, but it would have carried greater weight in our view had his views, which were in many respects given for the first time in oral evidence, been explained in his expert reports, and substantiated by documents.

The effect of the proportion of drive-thru outlets on the multiple

104. We have reached similar conclusions in respect of the proportion of drive-thru's in the Marz/Marsden portfolio in comparison with that of the claimant. We accept that the main reason for the dominance of drive-thru's in KFC's expansion (and we note in passing that this was in their capacity as franchisor) is that high street locations were largely saturated.

105. We are equally unpersuaded that drive-thru's have guaranteed profitability, or are necessarily more profitable than other outlets. We have again placed weight on Mr Esmail's evidence, as an operator of both types of outlets, that there are higher unit costs for drive-thru outlets, on larger sites, and that several of SME group's drive-thru outlets were loss making, whereas the reference premises were profitable. In contrast, Mr Willis's assertions that drive-thru's have a lower unit cost were not supported by hard evidence and when asked what research had informed his assessment he was unable to point to any. We have not placed weight on the Smith Cooper "Deal Dispatch" document which was plainly part of a marketing exercise.

106. In summary, we reject the acquiring authority's criticism of the Marz/Marsden transaction, and have placed significant weight upon it, subject to the points made in our conclusions.

"Herbel/Kram"

107. In our judgment there are a number of serious difficulties with Mr Stanbury's analysis which significantly affect the reliability of the Herbel/Kram transaction as a comparable.

Freehold

108. It is agreed that the profile of the Herbel/Kram portfolio was similar to that of the claimant, and that no adjustment was therefore required to reflect the portfolio mix.

109. However, as regards the freehold value, and the notional rent to be deducted, we are not satisfied that there is sufficiently reliable evidence available in order to make an accurate calculation. Whilst the parties both applied a yield of 7 to 8%, the actual freehold value of the outlet is entirely speculative. We do not consider that much weight can be put on an inter-company transfer, and we do not accept Mr Walton's closing submission that it was simply a case of Mr Stanbury adopting a figure of £1.5 million, and Mr Epstein £1.41 million. That seems to us to portray Mr Epstein's reliance on the figure rather higher than was in fact the case. His starting point was that there is insufficient information to be able to value the freehold (or, therefore, to identify the notional rent).

110. It is clear that *some* notional rent should be deducted from the earnings figure, but the amount of that rent cannot, in our view, be ascertained with any degree of confidence.

'Put and call' option

111. We note that the parties to the transaction did not place any financial value on the option. Any value ascribed to the option is therefore an ex post facto rationalisation with no evidence to support it. That the option had an intrinsic value there can be no doubt, otherwise the parties would not have entered into it. However, there is no evidence as to what that was or the respective values it had to either party to the transaction. Quite apart from the fact that Mr Farnsworth said that no separate value was put on the option in the transaction, neither did he endorse Mr Stanbury's valuation of it.

112. Second, there is no evidence as to the terms of the transaction which would enable any valuation of the option to be made. As Mr Stanbury himself said in paragraph 3.60 of his report, in order to use the established methodology for valuing an option

> "it is necessary to have access to the specifics of the transaction deal (both the initial purchase and, critically, the purchase of the remaining equity five years later)."
>
> (emphasis added)

113. Further, in cross examination Mr Stanbury described the purchase price of the shares as "absolutely relevant." Yet there is no evidence as to the terms of the option in the 2009 transaction or as to what the ultimate purchase price of Kram's shares was to be. In the absence of this information it is quite impossible to ascribe a value to the option. Mr Stanbury's 'minimum' value involves assuming that the eventual sale price of Kram's shares is identical to the shares value at the time of the option whereas without knowing what the eventual sale price was to be, there is no way of calculating the value to Herbel of the option. If Herbel acquired the right to buy the shares for £1, the value of the option to Herbel would be very different than if it acquired the right to buy the shares for £1m. Mr Willis also described it as "difficult to ascertain the value of" the 'put and call' option (Report paragraph 5.21).

114. Third, as Mr Stanbury confirmed in answer to questions from the Tribunal, his approach assumes that all of the value of the option was in the 'call' element i.e. that it was of value to the buyer (Herbel) only. This approach fails to take into account two matters. The option must have had some benefit to Kram otherwise it would not have agreed to it. In fact, the evidence suggests the 'put' element of the option was important. The Smith Cooper article states:

> "This transaction represents the culmination of [Kram's shareholders'] plan to dispose of the restaurants operated by Kram over a five year period. Implementation of this plan commenced five years ago with Smith Cooper advising on the disposal of the trade and assets of five of Kram's nine stores to Herbel, and the negotiation of a put and call option to sell the shares to Kram around five years later.
>
> The most recent transaction sees Kram's principal owners, Mark and Hazel Hodding, retire from the KFC business that they have been involved with for nearly 25 years."

115. It is plain that the ability to sell the company five years later was an important part of Kram's shareholders' retirement plans. Further, Mr Willis's evidence was that the retiring shareholders would have wanted to sell the company later in order to get tax relief and that the option "worked for both sides." Even Mr Stanbury accepted that the 'put' element of the option had value to the sellers.

116. Further, by valuing only the 'call' element of the option, Mr Stanbury has ignored any element of risk to Herbel. Although Kram's accounts show that in the five years after 2009 Kram recorded profits from trading in its remaining four KFC outlets, that could not have been known at the date of the transaction. Kram's accounts for the year ended 30 November 2008 show that the company was making a loss and there is no evidence as to the trading figures of their five outlets prior to sale. Acquiring the shares involved acquiring the company's balance sheet, liabilities and assets, and although the price paid by Herbel in 2009 exceeded Kram's then liabilities there is no indication as to what the company's liabilities would be five years later.

Post-acquisition accounts

117. The common position in the written reports of the expert accountants who are valuing the claimant's business is that earnings should be calculated using historic trading figures where available. In cross examination Mr Willis sought to distance himself from this approach by suggesting that it is "very rare" for such information to have great relevance unless the company (and its trading outlets) is 'mature.' We are not impressed by this evidence. Nowhere was this point made in Mr Willis's written reports, the point was not put to Mr Epstein in cross examination and it directly contradicts the written evidence of Mr Stanbury. In oral evidence, Mr Stanbury sought to pick up Mr Willis's point and distance himself somewhat from his written reports on this issue. In our judgment this was an opportunistic attempt to row back from the agreement he had reached with Mr Epstein to use only historic trading figures to analyse the Marz/Marsden transaction.

a) Post-dated accounts

118. However, there is no dispute that as well as looking at historic trading figures a purchaser will consider what potential the business has for him, how much profit he can make and what changes he may wish to make in order to enable him to do so. Mr Epstein said so expressly when explaining the approach adopted towards the purchase of the East Anglian units. Further Mr Epstein agreed that it is normal for a purchaser to consider what trading he could do.

119. In our judgment the problem with the analysis of the Herbel/Kram transaction is not that it includes consideration of the post-acquisition figures per se, rather that there is no evidence of the historic trading figures other than in a very general sense from Kram's accounts. There is no doubt that Herbel would have had such figures and that it would have taken them into account. Further, when agreeing a price, Kram would be considering what it thought the businesses were worth based on historic figures and would not necessarily be privy to Herbel's future plans. It is also impossible to tell whether or not the actual trading met Herbel's expectations. Finally, we agree that, even if the post-acquisition trading did reflect Herbel's projections, to value the business on that basis assumes that Herbel would be willing to pay a purchase price which takes into account all of the profit it anticipated to make i.e. to 'gift' that profit to Kram. In reality Herbel would split the anticipated profit in some way when arriving at what it considered was a fair price.

b) Period of Trading

120. Were this comparable otherwise reliable evidence, we would not have discounted the post-acquisition accounts on the basis that Herbel might have had a right to the profits from a date prior to the date of acquisition. Although Mr Epstein said this can happen, there is no evidence that it did in this case and we consider the more normal position to be that profits (and their inclusion in the accounts) date from the time of acquisition, as was the case with the East Anglian properties.

121. However, the fact that the only trading figures at all relate to a period as short as four months and immediately after acquisition add weight to the other points we have already made which undermine the reliability of this transaction as a comparable.

122. In fact, owing to the way Mr Stanbury has extrapolated his four months trading figure, he is effectively asking us to place reliance on a figure which is, in effect, 21 times a short period of four months' trading figures. In our view that undermines the reliability of the comparable.

c) Number of Units

123. As to whether profits from a sixth unit are included in the four months of accounts, we consider that there is no evidence this was the case, and indeed all the evidence suggests to the contrary. Herbel's accounts specifically refer to five outlets having been acquired and opened in that accounting year. If a sixth unit had also opened, we consider the accounts would have said so. Further, Mr Willis's evidence also strongly supports the view that the Barnstaple high street outlet had not opened before the end of 2009. If the unit had previously been a Wimpey Bar, a period of

refurbishment and/or fitting out would inevitably have been required and this is consistent with a one year rent free period having been allowed in the lease.

124. Nevertheless, this does not assist in overcoming the concerns we have already expressed about the reliability of this comparable.

“East Anglia”

125. There is no dispute on the figures as to the analysis of this transaction carried out by Mr Epstein or that the deductions he made in his final analysis are appropriate.

126. Therefore, the correctness of the analysis depends upon the validity of the assumptions made as to increased sales and cost savings. As to sales, although these dropped in the period immediately following the transaction, by 18 months later they increased by 22% (Cambridge), 17% (Mildenhall) and 10% (Newmarket) over sales prior to the transaction. At Sudbury sales increased but only to just below the level they were before the transaction. This suggests that the claimant’s assumptions as to sales growth were cautious and, for the most part, sales increased significantly more than Mr Epstein’s analysis allowed for.

127. The anticipated costs savings had not materialised by March 2010 by which stage the profits (losses) were (£25,186) (Cambridge), £21,291 (Mildenhall), £28,249 (Newmarket) and (£29,760) (Sudbury). However, plainly the claimant would not have acquired these four outlets unless it considered it could make some profit, even if only a marginal one as Mr Esmail suggested in cross examination. The more profitable the trading, the lower the multiple would be. Applying TfL’s multiple of 7 to the purchase price would give rise to expected earnings across the four outlets of about £226,000 whereas applying the claimant’s multiplier of 17 would give rise to expected earnings of £93,000. Both figures are in stark contrast to the loss of about £5,000 in the year after acquisition.

128. We do not consider there is sufficient evidence as to the maintainable earnings of the East Anglian outlets to enable this transaction to be used as a reliable comparable. However, it is a market transaction around the relevant time and for the reasons we have already given we do not consider any adjustment is appropriate to reflect the fact that the transaction took place 8 months before the valuation date. Insofar as it assists at all, in our judgment the transaction suggests that a multiple nearer that of the claimant rather than TfL is appropriate.

“Demipower”

129. It is common ground that little weight can be placed on this comparable. We note, however, Mr Walton's submission that Mr Epstein's analysed multiple of circa 15 is based on historic accounts rather than taking into account Demipower's expectation of future profit levels.

DCL Report

130. In our judgment the proper starting point is that this valuation represents no more than the expert opinion of another valuer who has not been called to give evidence and whose opinions, and the facts on which they are based, cannot be tested. For that reason alone, the valuation can carry little weight.

131. Moreover, as Mr Stanbury pointed out, there is a significant disjunct between the multiplier used by DCL and reportedly given to them by someone on behalf of Marz, and the multiplier not only used by Mr Epstein but also agreed by Mr Stanbury as the correct analysis of the Marz/Marsden transaction. As Mr Stanbury suggested this may be because in addition to relying on historic trading information, Marz would have had regard to the potential future profits of their operations. However, if the correct analysis of the Marz/Marsden transaction is a multiplier of 7, then the profits which Marz must have anticipated making were a huge increase over previous trading and in the order of an average of £2,764,500 (the adjusted purchase price of £19,351,707 divided by 7). That is nearly two and a half times greater than the previous earnings and represents almost £200,000 per unit. In the context of the earnings figures for the premises and other KFC franchises for which we have seen figures, in our judgment this is completely unrealistic and cannot explain the discrepancy between the information apparently given to DCL on behalf of Marz and the multiplier of 17.

132. It follows that there must have been a misunderstanding of some kind between DCL and whoever they spoke to. This may happen even with experienced professionals where information is passed on orally from one person to another, sometimes through several people. Given the discrepancy and the fact that DCL used the same multiplier as that which they thought had been used in the Marz/Marsden transaction, there must be significant doubt about the reliability of this valuation. We also note the fact that DCL did not have access to as much financial information as do the parties to this case.

133. As to the submission that the DCL valuation broadly fits with the once times net sales approach put forward by Yum, neither of the expert accountant valuers in this case suggested that this was an appropriate valuation method.

134. Mr Epstein's evidence was that his analysis of 16.96 on an EBIT basis equated to an EBITDA multiplier of 11.7. Mr Stanbury did not disagree with this figure, and accepted that his 7.5 was not as proximate to the DCL figure as he suggested. We consider that the DCL report does not provide support for TfL's valuation of the claimant's business, whether using a multiple of 7 or the actual valuation of £950,000. But whilst it does not undermine the claimant's use of a multiple of 17, neither does it support it. In the absence of evidence from the DCL valuer, who might have shed light on the valuation and the assumptions made, we consider the DCL report to have little evidential value.

Conclusions

135. Owing to the parties' agreement as to the question that we have been asked to determine, we are constrained to simply apply a multiplier to an agreed multiplicand of assumed earnings.

136. We start by re-emphasising the paucity of evidence in this case, which is particularly regrettable when the amount in dispute is over £1 million. As we indicate above, we have derived little assistance from the DCL report, or from the Demipower transaction. We consider that the East Anglia transaction, whilst not particularly reliable, is balanced more in favour of the claimants than of the acquiring authority. That leaves two comparable transactions, between which we are asked to place reliance.

137. On a first glance, the Herbel/Kram transaction might have been thought to be one upon which we should place great weight, being close in time, and in respect of a similar portfolio, but as we have indicated above it is susceptible to a number of valid criticisms which, in our view, throws significant doubt on its reliability.

138. That leaves the Marz/Marsden transaction, which remained largely unscathed despite searching questions by TfL. In our view that is the most reliable transaction, but we do not consider it sufficiently robust to simply adopt the multiple of 17, in the light of the evidence as a whole.

139. As we indicated at the end of the hearing, and as Mr Booth and Ms Clutten emphasised in closing, what we are concerned with in this reference is the value to the claimant of what they have lost as a result of the CPO. Whilst both parties, in an attempt to at least apply some degree of rigour to comparable evidence, have derived multiples from sales of either outlets, or of business themselves, none of the evidence actually goes to the heart of what we are attempting to ascertain.

140. In our view, there are several factors which point to a higher multiple than a lower one: the fact that the claimant had been operating from the premises for some years; that they are part of a group which is plainly experienced in operating KFC franchises; that the premises was profitable notwithstanding the high rent and had the assumed benefit of a new 15-year lease. There is little doubt in our mind that the CPO has deprived the claimant of a profitable future.

141. We are also mindful that some regard must be had to future trading performance when analysing sales. There is no doubt in our mind that, for instance, when purchasing the East Anglia portfolio, SME Trading Limited anticipated that they would have been able to improve the trading performance of the units, otherwise it would not have paid in excess of £1.5 million, on top of freehold value, for loss-making units. Although Mr Epstein said that the analysis of that transaction had to use projected profits because the outlets were making a loss so it was impossible to use historic data, he also agreed that any purchaser will look at the profit they anticipate making. Just as we consider it is unreliable to analyse a transaction on the basis that the price will reflect every bit if profit anticipated by the purchaser (as in the case of Mr Stanbury's

analysis of Herbel/Kram), it is equally inappropriate to analyse a transaction on the basis that the price will reflect *none* of the anticipated future profit.

142. It is clear to us that significant weight can be placed on the Marz/Marsden transaction, however, notwithstanding the multiplier of 17 was agreed, for the reasons we have given we consider that some reduction should be made to that multiplier to reflect the likely forward-looking nature of future profitability.

143. Doing the best we can with what we again stress was very limited evidence, we consider that the appropriate multiplier in this case is 14. This would produce a loss to the claimant of £1,498,000. We acknowledge that this multiplier is significantly in excess of previous findings of the Tribunal, and should not be taken to amount to a precedent for future cases.

Disposal

144. We determine compensation on the following basis:

Item	Amount
Extinguishment:	£1,498,000
Occupier's loss:	£5,179.25
Legal fees	£54,081.98
Surveyor's fees	£82,297.55
Accountant's fees	£24,310.26
Management time	£7,500.00
Staff redundancy costs	£14,282.00
Planning Consultant's fees	£13,205.00
Equipment and removals	£8,643.00
Electrics	£470.00
Total:	**£1,707,969.04**

145. In addition, the claimant is entitled to statutory interest.

146. This decision is final on all matters other than the costs of the reference. The parties may now make submissions on costs, and a letter giving directions for the exchange of submissions accompanies this decision.

Dated: 6 March 2017

Her Honour Judge Alice Robinson

P D McCrea FRICS