

CORPORATE VALUATION ISSUES IN CIVIL LITIGATION IN HUNGARY¹

OTÁZKY OCEŇOVANIA PODNIKOV V OBČIANSKOPRÁVNÝCH SPOROCH V MAĎARSKU

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<https://doi.org/10.33542/SIC2023-1-01>

ABSTRACT

This article presents the Hungarian court practice on the criteria governing the valuation of certain companies and their shares. In civil litigation, Hungarian courts are confronted with this problem in family law disputes, and increasingly often in cases where the issue of determining the value of a company's shareholding arises in disputes between professional economic operators, in particular when a dispute arises between the parties in connection with a share purchase agreement. In addition to procedural issues, serious technical issues arise in lawsuits concerning the determination of the share of a company or the value of a given company. The article describes the Hungarian court practice which has elaborated the criteria for the valuation of companies and describes the company valuation aspects. The article also describes the requirements for the person of the expert, the fact that it is always for the expert and not the court to determine the expert's method, and the evaluation standards and methodological guides that the expert should take into account when carrying out the evaluation.

ABSTRAKT

Tento článok prezentuje maďarskú súdnu prax týkajúcu sa kritérií, ktorými sa riadi oceňovanie určitých spoločností a obchodných podielov v nich. V občianskoprávných sporoch sa maďarské súdy stretávajú s týmto problémom v rodinnoprávnych sporoch a čoraz častejšie v prípadoch, keď sa otázka určenia hodnoty podielu v spoločnosti vyskytne v sporoch medzi profesionálnymi hospodárskymi subjektmi, najmä ak medzi stranami vznikne spor v súvislosti so zmluvou o kúpe podielu. Okrem procesných otázok vznikajú v súdnych sporoch týkajúcich sa určenia obchodného podielu alebo hodnoty danej spoločnosti aj závažné technické otázky. Článok opisuje maďarskú súdnu prax, ktorá vypracovala kritériá oceňovania spoločností, a opisuje aspekty oceňovania spoločností. V článku sú opísané aj požiadavky na osobu znalca, skutočnosť, že metódu znalca určuje vždy znalec, a nie súd, a oceňovacie štandardy a metodické príručky, ktoré by mal znalec pri oceňovaní zohľadniť

I. INTRODUCTION

In civil litigation, questions often arise that require the determination of the value of a company (corporation) or a share in a company. Following the change of the socio-economic system, the number and complexity of such cases has increased, but over the past 30 years a coherent and uniform judicial practice has developed to deal with such problems. In civil litigation, courts are confronted with this problem in family law disputes, in matrimonial and partnership property division disputes, and increasingly often in cases where the issue of

¹ The study was carried out in the framework of the EFOP-3.6.1-16-2016-00022 "Debrecen Venture Catapult Program".

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determining the value of a company's shareholding arises in disputes between professional economic operators, in particular when a dispute arises between the parties in connection with a share purchase agreement. In such lawsuits, the courts have to determine the value of a given share primarily on the basis of invalidity claims, on the basis of a claim for usury or a claim for conspicuous disproportionate value, and on the other hand, in connection with the enforcement of warranty claims, there is a need to determine the actual market value of the given share in the company at the time of the transaction. In addition, in connection with other business transactions, the contracting parties also go to court, so the need to determine the value of a share arises in the event that a given transaction includes shares (possibly other securities) as collateral, the determination of the value of which at the time of satisfaction is the core of the dispute. All of these questions have posed serious challenges to judicial practice in recent times, to which, however, case law has sought to provide adequate answers.

In the following, we review the practice that has developed not primarily in family law but in economic litigation, and on the basis of which the general criteria according to which the court can make a decision on the merits of the case can be determined. As a starting point, it should be noted that, in addition to legal issues, there are serious professional issues in this type of litigation that require the involvement of an expert. Our former Code of Civil Procedure also stipulated that if special expertise not available to the court is required to establish or assess a fact or other circumstance of importance in the case, the court shall appoint an expert.³ The current Code of Civil Procedure also states that an expert must be used if special expertise is required to determine the scope of the dispute or to establish or assess a fact that is of importance in the litigation.⁴

Thus, in addition to procedural issues, serious technical issues arise in lawsuits concerning the determination of the share of a company or the value of a given company. Our aim, of course, is not to examine the specific technical issues of business valuation, but to give a brief overview of the legally relevant factors that arise in this type of litigation. In addition to the issues of procedural and substantive law, we will examine the relevant issues of expert involvement, briefly touching on the expert methods to be used and their evaluation in litigation. We emphasize that we do not wish to go into economics, but the specific nature of the subject makes it essential to look at some basic economic issues, from a litigation and substantive law perspective. Company valuation is important not only in civil litigation, but also in the business sector, which has developed and become increasingly important since the early 1990s with the emergence of the market economy.⁵ However, these are not covered in this paper. Due to space constraints, we do not attempt to present the European legal framework on the subject in this paper. A comparative presentation of the European framework could form part of a separate study.

II. THE RELEVANT CASE LAW

In the field of determining the value of companies and shares in companies, the court practice has elaborated the criteria for the valuation of companies, thus emphasising (i) the need to determine the actual market value, (ii) the determination of the relevant date, and (iii) the issue of the determination of the relevant method by an expert, which does not exclude the possibility of using a combination of methods, and (iv) the case law also attaches importance as a starting point for the existence of the conditions for the continued operation of the company under investigation (going concern principle).

³ Act III of 1952 Article 177 Paragraph (1).

⁴ Act CXXX of 2016 Article 300 Paragraph (1).

⁵ RESZEGI, L: The "art" of company valuation in emerging countries. In: DAMODARAN, A: The Valuation Handbook, a guide to investing in shares, buying and selling companies, Alinea Kiadó, Budapest, 2015, p. 217.

The Metropolitan Court of Appeal pointed out that „however, the current market value of shares could be influenced by several factors, such as the company's capital, its assets, the way in which it is used, the company's business policy, its position in the market, the current state of the market, future expectations regarding the company, etc., and could have an impact on the interest in and supply of shares. If the company suffers a loss of assets due to a circumstance, this circumstance may adversely affect the market value of the shares issued by it, the loss suffered by the shareholder, the loss of assets, can only be reflected in the loss of value of his shares. ...”⁶ This decision of the Court of Appeal was upheld by the Supreme Court (Curia) as the court of review.⁷

In another decision, the Metropolitan Court of Appeal also emphasized that the current market value of shares is influenced by several factors, such as the company's capital, assets, market position, future expectations regarding the company. „However, the mere fact that the value of a given unlisted security is influenced by a number of factors and that there are several elaborate methods for determining the market value, which attach importance to different factors, and that even experts in litigation and private experts cannot agree on the application of these methods, does not in itself provide a basis for finding that the market value is not proven.”⁸

As a matter of procedural law, the Court of Appeal noted in this decision that the expert opinions and private opinions obtained in the case used different valuation methods, from which the experts also drew different conclusions on the market value of the shares under investigation, which does not mean, however, that the market value is unprovable, but that the expert evidence must continue, not until the expert opinion supporting the plaintiff's claim is obtained, but until the court can take a position on the market value of the securities in the case on the basis of the available expert opinions, by evaluating and comparing them.⁹ This decision also points out that the market value of a given share at a given point in time implies an assessment of the future profitability of the share, i.e. a claim for compensation based on the loss of wealth indicated in the market value of the shares would be a double claim for dividends as lost profits.¹⁰

In the case of a claim for damages based on a reduction in the value of the shares, it is possible to determine the market value at the time of the judgment or the value at the time of the damage.¹¹ According to the professional rules of corporate valuation, the value of a share is determined not only by the expected return, but also by the size of the dividend and the rate of dividend growth,¹² and the valuation is also determined by whether it is an ordinary share or a preference share. The case law has shown, not only in relation to company valuation, but also in relation to other expert issues (e.g. the determination of usage fee), that not necessarily one method can be used, but a combination of several methods. In that case, the court emphasized that, in addition to the approach taken by the court-appointed expert, the expert must also take into account the private expert's opinion based on a different methodology provided by one of the parties to the dispute.¹³

In case-by-case decisions of judicial practice, company valuation aspects are articulated as follows:

⁶ Metropolitan Court of Appeal Judgment No. 16.Gf.40.521/2012/9.

⁷ Curia judgment No. Gfv.VII.30.055/2014/7.

⁸ Metropolitan Court of Appeal Order No. 16.Gf.40.628/2014/7-II.

⁹ Metropolitan Court of Appeal Order No. 16.Gf.40.628/2014/7-II.

¹⁰ Metropolitan Court of Appeal Order No. 16.Gf.40.628/2014/7-II.

¹¹ Metropolitan Court of Appeal Order No. 16.Gf.40.628/2014/7-II.

¹² MADLOVICS, E, S: Valuation of Investments, National Institute for Vocational and Adult Education, Financial Tasks, p. 28, source: www.nive.hu.

¹³ BDT 2021.84. (Repository of Court Decisions).

- (i) In determining the value of the shareholding of a member of the company, the starting point is not the book value but the actual market value, which may require the appointment of an expert or further evidence.¹⁴
- (ii) In the case of shares, the provisions applicable to the security shall prevail, except that a special rule shall apply to the determination of the market value of the security, the burden of proving the normal market value being on the party providing evidence.¹⁵
- (iii) In the case of non-listed shares, the relevant market value at the relevant time must be determined, and the cash equivalent of a given security shall be the amount for which it can be sold.¹⁶ In the case of other companies (limited liability companies), the judicial practice also considers the determination of the market value to be the applicable one.¹⁷
- (iv) Approaching the issue from a tax law perspective, the case law also points out that in the case of assets acquired by an individual in the form of securities, the arm's length value must be determined by the method set out in the law.¹⁸ The case law refers to Act CXVII of 1995 on personal income tax Article 3 Point 9., according to which normal market value is the consideration that independent parties would or would assert between themselves in comparable circumstances, between unrelated parties, the arm's length market value must be determined by one of the methods set out in the law, which are:
 - the comparative pricing method, whereby the arm's length price is the price at which independent parties would sell a comparable good or service in an economically comparable market,
 - the resale price method, whereby the arm's length price is the price at which the product or service is sold to an independent party in an unmodified form, less the reseller's costs and normal profit,
 - the cost and income method, whereby the normal market value is the direct cost of the product or service plus the normal profit,
 - other method, if the normal market value cannot be determined by any of the previous methods.

With regard to the comparative market price, the court underlines that it can only be established if the participants in the market are acting in comparable circumstances, and that the determination of the circumstances can only be made within a rational timeframe. The fact that a company is a closed joint stock company, where there may be no turnover of shares for years, does not require the extension of the market price comparison over time, but precludes the application of the comparative price method in the absence of other legal conditions. As for the other method, the Supreme Court points out that it could be any relevant method that could reasonably justify the normal market value.

- (v) In relation to the determination of the value of shares, the Supreme Court pointed out, emphasizing the consistency of the case law in this respect, that „in the operational phase of a limited liability company, the share in the company is a transferable right of a movable nature and its value, like that of other assets, is therefore usually determined on the basis of the actual transaction data, i.e., in the case of its actual sale, at the sale price stipulated in the sales contract, or, in the absence of an actual sale, by means of an estimate, if necessary with the assistance of experts in real estate, motor vehicles, property and other matters, on the basis of the opinion of an accountant or a combination of these experts. However, the purchase price cannot be used as a basis for determining the actual market value of the share even if the share has actually been sold ... even if the purchase

¹⁴ BH 2006.16. (Court Decisions).

¹⁵ EBH 2008.1918. (Court Decision of Principle).

¹⁶ BH 1998.437. (Court Decisions).

¹⁷ BH 2002.104. (Court Decisions).

¹⁸ BH 2013.82. (Court Decisions).

price is fictitious or otherwise questionable.¹⁹ In this decision, the Supreme Court also emphasizes the consistent judicial practice according to which the value of a shareholding in a company is determined not by the so-called book value under the Accounting Act, but by the actual market value, which is determined on the basis of the company's legal form and stage of existence at the valuation date. The Supreme Court stresses that the actual market (free market) value can be determined - as in the case of other assets - primarily on the basis of comparative data, i.e. on the basis of the purchase prices stipulated in the sales contracts for the shares of the same company. If this is not possible, or the veracity of the comparative data is in doubt, the basis for determining the turnover value of the share of the limited liability company shall be the so-called market value.

In determining the value of a share in a limited liability company, the Supreme Court refers to the underlying economic literature and, within it, to the literature and expert practice on company and company valuation, from which several different methods are outlined. Based on the literature, the supreme judicial forum emphasizes that, on the one hand, the real and fair market value of the company must be determined by the expert by taking into account the so-called going concern value and the liquidation value, whichever is the higher of the two. Of these values, the operating value corresponds to the income-generating capacity of the continuously operating enterprise, i.e. the present value (discounted value) of the expected cash flows from the enterprise. The liquidation value corresponds to the net asset value of the company, i.e. the value less the market price of its assets. The liquidation value is *"nothing more than the difference between the cash receipts expected from the sale of the company's assets and the outstanding liabilities, less the costs of liquidation."*²⁰

- (vi) The Supreme Court emphasizes that the method used in other accounting practices, or a combination of different methods, may be used as a measure of value, including the so-called yield-based method. The most commonly accepted measure of value is the real market value, which is the value that is "the price, in money or money's equivalent, for which property exchanges hands between a willing buyer and a willing seller, provided that the parties have sufficient information about the relevant facts and neither is acting under duress. This definition also includes the ability and willingness of the parties to buy or sell." (Shannon Pratt: Business valuation and practice - Pfv.II.21.820/2007/7).²¹ In determining the fair market value of a share in a limited liability company, the income, market or cost approach, or a combination of the three, is accepted in case law.

In this context, (i) in the context of the income approach, the case law refers to the discounted cash flow analysis, which determines the value as a function of the present value of the future economic benefits from ownership, discounting the future net cash flows available for distribution per year to present value by a market rate of return; (ii) in the market approach, the case law compares the financial position and operating results of the company in question with those of publicly listed companies similar to the company under investigation by analysing recent sales and offers of similar assets; and based on the cost approach method, the value is determined by the case law on the basis of the cost of reproducing or replacing the asset.²²

- (vii) In the context of the justification of the determination of the actual market value instead of the book value, the case law points out that the book value does not correspond to the so-called value of the given asset or liability at the balance sheet date, because write-

¹⁹ BH 2009.271. (Court Decisions).

²⁰ CSIRMAZ, L: Valuation of company shares in matrimonial property division proceedings, expert evidence-expert competence, Debreceni Legal Workshop, vol. IX, 2014 Issue 3-4 (30 December 2014), p. 4.

²¹ BH 2009.271. (Court Decisions).

²² BH 2009.271. (Court Decisions).

downs and write-ups are based on estimates, the part of the value of assets and liabilities may be shown as a reserve as part of equity, with an indication of the sign, and valuation may be based on different principles and different types of prices (past, present or future.) The purpose of establishing and reporting the book value is not to show the "real value" (= purchase price) at the balance sheet date, but to enable the balance sheet to be drawn up after a full valuation of assets and liabilities, which allows market operators to determine the value of assets, equity and profits, and the State to check tax compliance and the calculation of the tax base and tax. The scope of the Accounting Act does not extend to civil law property relations between business entities, and the book value determined in accordance with the Accounting Act is not suitable as a basis for a realistic and fair accounting for the determination of value, even in civil law relations between business entities.²³

- (viii) According to judicial practice, it is also a fundamental question to determine whether the company can be considered as a going concern, i.e. whether the going concern principle applies or whether the conditions for the company's continued operation are not ensured, and therefore only a so-called liquidation value can be determined. The Hungarian economic literature has taken a clear position on the issue that if a company is in liquidation, only liquidation value can be determined.²⁴

The principle of going concern is precluded if it can be inferred from both the company's internal factors and the macroeconomic environment that the basic conditions for the company's continued existence are not met. The relevant problems may be (i) difficulties in operational management, e.g. lack of a business plan, lack of investment, lack of market responsiveness (ii) a governance impasse, e.g. no one has the majority of votes required by the articles of association to take the basic decisions needed, and (iii) disputes between owners, such as pending litigation that threatens the operation of the company, which may be between the shareholders of the company, between the company and the shareholder or between the company and a third party, or (iv) if the conditions for the company's lawful operation are lacking, it cannot elect a supervisory board of directors without the required majority of votes, it does not have an elected auditor, it does not have approved financial statements, and (v) the adverse macroeconomic environment, such as economic uncertainty, high inflation, high country risk, and (vi) industry-specific problems (general downturn in the industry, lack of adaptability to technological change, failure to adapt to stricter environmental requirements), finally, (vii) company-specific problems (unclear ownership of productive assets, falling turnover in real terms, low financial returns) are all factors which tend to rule out the going concern principle. And if these conditions are met, it can be concluded from an expert's point of view (see next chapter for details) that all the methods that assume the continued operation of the company cannot be used. In such a case, an asset-based liquidation valuation may be used.

Looking at foreign court practice based on the valuation of companies according to international standards, we can cite the London High Court judgment in the case of *Signia Wealth v Vector Trustees Ltd*, which concerned the valuation of a 49% block of shares in a public limited company. The court made the following important findings:

- the key issue is to determine the correct valuation method and the correct EBITDA at the valuation date, as well as other risk factors that may affect the market value of the equity package;

²³ EBH 2001.424. (Court Decision of Principle).

²⁴ VÁRKONYI, P: The methodological challenges of evaluating small and medium-sized enterprises. In: *Marketing & Management*. vol. 35, 2019, issue 4, page 64.

- of the two commonly used valuation methods (the discounted cash flow method and the comparative (indicator-based) method), the court ruled in favour of the latter, given that the former method is only applicable in the case of reliable forecasting of future cash flows, which was not available in the case at hand. In the case at hand, the experts unanimously concluded that the discounted cash flow method is not appropriate in such a case;
- in the case of the comparative method, the company value is determined on the basis of comparable listed companies using valuation ratios, of which the EV/EBITDA valuation multiplier may be used, which is the most reliable tool for determining the company value;
- other factors affecting the market value must also be taken into account, such as the contractual terms of the shares, which in the case in question meant determining the value by half of the EV/EBITDA ratio;
- in equity valuation in general, one has to take into account certain axiomatic statements and principles, such as (i) that firms that are inefficient in converting their assets into cash are much less valuable than those that are efficient in doing so, and (ii) when applying the comparative method, it is important to find companies that are genuinely comparable to the company under valuation.²⁵

III. EXPERT COMPETENCE AND EVALUATION METHODS

1. Persons of experts

In litigation concerning the valuation of a company, experts play a central role, as they are the people with the expertise to determine the market value of a particular shareholding (share, or a whole company) at the relevant time. The experts themselves and the method they use are particularly relevant in this context. The former is primarily a question of law, while the latter is essentially a technical question.

Determining the person of the expert and the appropriate competence of the expert is a particularly difficult issue, because if the court does not appoint an expert with the appropriate competence, the "result" (expert opinion) obtained cannot be used as a basis for a judgment. The annexes of the IM Decree 9/2006 (II.27.) on the fields of forensic expertise and the related qualification and other professional conditions contain the definition of the fields of forensic expertise and the related qualification conditions, of which Annex 10 specifies the fields of economics, customs and other financial fields. The areas of expertise listed here are accounting, finance and capital markets, in which experts can be considered as forensic experts to be called upon in court.²⁶ In principle, it can be agreed with the literature that it would be justified to create a separate field of expertise, specifically asset valuation, as a field requiring complex knowledge, in order to enable courts to appoint persons with such competence, avoiding anomalies and processes leading to the prolongation of litigation due to the selection of an expert with the appropriate competence.²⁷

According to court practice, the appointment of a financial or capital market expert as opposed to an accountant is justified even in the context of the valuation of shares in a company that is not listed on the stock exchange.²⁸ However, the appointment of a panel of forensic experts on money and capital markets could also be considered, but not in the context of a review of previous advice.²⁹ A panel of experts may be appointed if, following the appointment of a new expert, a new expert has to be appointed and the subject matter falls within the competence of the panel of experts by law.³⁰ The appointment of a panel of experts is regulated

²⁵ Source: Oxera Agenda, May 2018, <https://www.oxera.com>.

²⁶ Annex 10, points 4, 5 and 6 of Decree of the Minister for Justice No. 9/2006 (27.II.2006).

²⁷ CSIRMAZ, L: Valuation of company shares in matrimonial property division proceedings, expert evidence-expert competence, Debreceni Legal Workshop. vol. IX, 2014 issue 3-4 (30 December 2014), pp. 6-7.

²⁸ Metropolitan Court of Appeal Order No. 16.Gf.40.628/2014/7-II.

²⁹ Metropolitan Court of Appeal Order No. 16.Gf.40.628/2014/7-II.

³⁰ Act CXXX of 2016, Article 315 Paragraph (2).

by law as an option and not mandatory. The significance and weight of the expert question, the contradiction in the expert opinion, and the degree of concern may be decisive in deciding whether to appoint an additional expert or panel of experts in the “third round”.³¹ The Ministerial Explanatory Memorandum of the new Code of Civil Procedure took a contrary - in our opinion erroneous - position, which, in its interpretation of the statutory conditions (Article 315 Paragraph (2)), the appointment of an expert panel is mandatory, irrespective of the fact that the wording of the law only refers to the possibility of appointing an expert panel.³² According to the old Code of Civil Procedure, a panel of experts could be seconded if the professional issue arising in the lawsuit could not be clarified during the personal hearing of the seconded expert after the submission of two independent opinions. However, it is stated in the legislation that the expert panel is not obliged to review previous expert opinions, and its opinion is considered to be the same as that of the expert.³³

The Expert Panel of Forensic Experts in the Money and Capital Markets may act in specialised matters arising in the areas of expertise listed in Annex 10, point 2 (insurance), point 5 (money market) and point 6 (capital market) of IM Decree No. 9/2006 (27.II.27.), on the basis of the Act on the Organisation and Functioning of the Expert Panel of Forensic Experts.³⁴ This panel has legal personality and its statutes are issued by the Minister of Justice with the approval of the Minister responsible for the regulation of the financial, capital and insurance markets.³⁵ However, it is not currently operational, although members were appointed in 2016,³⁶ the Panel did not start to function, the mandate of the appointed members expired in 2021 and no new members were appointed.

2. The expert methods

With regard to expert methods, the expert competence of the definition of the method and the need to take into account the relevant standards can be mentioned, as well as the individual relevant methods.

2.1. Definition of the expert method

A cardinal issue in company valuation litigation is the determination of the methods used by the expert to establish the actual market value at the relevant time. In this context, we must primarily take as a starting point the provisions of the Act on Forensic Experts, which assigns to forensic experts the task of deciding the technical issue and helping to establish the facts, on the basis of the secondment or assignment of the authority, using the results of scientific and technical progress, while respecting the requirements of independence and impartiality.³⁷ The Law on Experts also states that forensic experts must carry out their activities to the best of their knowledge, in compliance with the provisions of the law on experts and other legislation, as well as the professional rules governing their activities.³⁸ It is always up to the expert to determine the appropriate expert method, and the court cannot decide on this in the absence of knowledge of the subject matter. According to the law on experts, the expert's opinion must contain a brief description of the test method, stating that the expert cannot be instructed on the professional findings of the opinion.³⁹

The determination of the expert's method is therefore a matter for the expert's exclusive competence. Neither the parties nor the court can take a position on the question of which

³¹ Resolution of the Consultative Body on the new Code of Civil Procedure No. 12.

³² Act CXXX of 2016, Ministerial Explanatory Memorandum, Explanatory Memorandum to Article 315.

³³ Act III of 1952 Article 183 Paragraph (2).

³⁴ 33/2007 (VI.22.) IRM Decree Article 29.

³⁵ 33/2007 (VI.22.) IRM Decree Article 30.

³⁶ Notice of the Minister for Justice on the list of members of the Financial and Capital Markets Panel, published in the Official Journal 2016/34.

³⁷ Act XXIX of 2016 Article 3 Paragraph (1).

³⁸ Act XXIX of 2016 Article 3 Paragraph (3).

³⁹ Act XXIX of 2016 Article 47 Paragraph (2).

method the expert uses. The reason for this is that neither the parties nor the court has the necessary expertise in the subject matter and is therefore not entitled to take a position on the method of examination to be used by the expert. „The expert may not be instructed by the parties and is subject to the strict rules of disqualification and conflict of interest that apply to judges.“⁴⁰

The constant judicial practice clearly leaves it to the competence of the expert to decide on which method to base his expert opinion, which choice and its possible unfoundedness remains at the expert's risk, especially if the parties - justifiably - contest it in their findings on the expert opinion, but there is no legal possibility for the court to prescribe the expert's method of examination at the request of any litigant: „It is not unlawful to account for the value of a partnership interest in a matrimonial community property on the basis of the book value of the company if the asset value necessary to establish a fair market value cannot be determined due to a lack of adequate data. [...] the real market value of the disputed shares cannot be determined on the basis of the so-called going concern value of the company, i.e. the income-based valuation method, because the necessary data (market situation of the company, customer base, etc.) cannot be established today for the determination of the liquidation value due to the passage of time, going back five years, the data necessary for the application of the asset-based valuation method were not fully provided by the defendant to the expert, despite repeated requests by the court and the imposition of a fine. For all these reasons, the expert himself stated that, on the basis of the available litigation data, the real market value of the shares could be determined on the basis of the book value of the company.“⁴¹

As regards the general expert competence to determine the expert method, the following decisions of high courts may be mentioned: (i) "In accordance with general practice, the expert shall determine the methods to be used in carrying out the tests and the data to be used in drawing up her opinion."⁴² (ii) "It is not for the court to determine the method of examination required to give an opinion, but for the experts, as they have expertise in this area."⁴³

2.2. The need to take account of evaluation standards

For the valuation of shares, the generally accepted, non-legislative and therefore non-binding, but professionally accepted standards are the IVS 2017, which is the International Valuation Standard issued by the International Valuation Standards Committee⁴⁴ and is also applied to the valuation of real estate.⁴⁵ From the IVS 2017 standard, the most commonly quoted standard is 104 (basis of value), where point 30 defining market value as the basis of valuation is of particular importance, emphasizing that the assessment should be made only in relation to market conditions and circumstances at the date of valuation, ignoring factors that can only be known retrospectively at a later date.⁴⁶ Another standard from the IVS 2017 is IVS 105, which is relevant to our topic and deals with assessment approaches and methods.

⁴⁰ VIRÁG, CS: Sources of Expertise - An International Theoretical Perspective. In. Curia Case Law Analyst Group: Expert Evidence in Court Proceedings, 2014, p. 13.

⁴¹ BH 2010. 216. (Court Decisions).

⁴² Civil principle decision No. 1601/2007.

⁴³ Decision No. 3.Pf.21.148/2010/5 of the Metropolitan Court of Appeal.

⁴⁴ for the International Valuation Standards, see: Jay E. FISHMAN, Shann on P. PRATT, William J. MORRISON: Standards of Value: Theory and Applications, Second Edition, John Wiley & Sons, Inc, 2013, ISBN 9781118138533, pp. 347-358, <https://onlinelibrary.wiley.com/doi/epdf/10.1002/9781119204244.app1>, <https://doi.org/10.1002/9781119204244.app1>.

⁴⁵ CSIRMAZ, L: Evaluation standards, source: <http://ingatlan-ertekeles.eu>, p. 3.

⁴⁶ International Valuation Standards 2017, International Valuation Standards Council, IVS 104.30.2. and 30.2.h).

2.3. The different evaluation methods

Not only the international⁴⁷, but also the Hungarian economic literature deals in detail with the issue of business valuation,⁴⁸ but as these are basically economic issues, we will not deal with them in detail in this paper, but only give a brief overview of the relevant methods.

Looking at the international literature, there are two main approaches to valuation, one is fundamental valuation, according to which "the intrinsic value of an asset is determined by two things: the cash flows that flow into it over its lifetime and the perceived uncertainty of those cash flows," in the case of valuation by the relative method, the given asset is examined according to the market pricing of similar assets.⁴⁹ The focus of the valuation is always on the time value of money, i.e. the fact that a future flow of money is always worth less than the current one, given the primary nature of consumption in the present compared to the future, the effect of inflation in reducing the purchasing power of money, and the uncertainty of the future flow of money.⁵⁰ The economics literature also stresses that a different conclusion can be reached if a company is valued as a whole or only its equity.⁵¹ With respect to fundamental and relative (multiples) valuation, Damodaran points out that for the same point in time, the same company will usually not give the same result, given that market efficiency or inefficiency is examined from a different perspective, in the former case assuming that markets make mistakes in pricing shares, but these are later corrected and can be considered as the industry standard for the market as a whole, while in the latter (multiples) valuation the hypothesis is that market pricing is correct.⁵² Damodaran also points out that a different method can be used to evaluate a young, growing company and a mature or declining company.⁵³

The most detailed technical aspects of company valuation are covered in a monograph by the foremost expert on the subject,⁵⁴ in which the author describes in detail the different valuation approaches and the various valuation methods and models, distinguishing between the valuation of private and public companies and between companies at different stages of their life cycle (young or start-up companies, companies close to bankruptcy, or companies in loss). One of the best-known international economic literature, also available in Hungarian, describes the details of the DCF (Discounted Cash-flow) model for the valuation of shares.⁵⁵

Similarly to the above, the Hungarian legal literature also distinguishes between asset-based valuation and market-based valuation, the former focusing on the assets and liabilities (wealth) of the company under consideration at a given point in time, i.e. an examination of all assets and all liabilities, and considering the net asset value as the same as the value of the company, for market-based valuation, comparative indicators (P/E, EV/EBIT, EV/EBITDA, P/S, etc.) are

⁴⁷ DAMODARAN, A – CORNELL, B: The Big Market Delusion: Valuation and Investment Implications, *Financial Analysts Journal*, 2020, 76(2), pp. 15–25, <https://doi.org/10.2139/ssrn.3501688>.

⁴⁸ TAKÁCS, A: The relationship between fundamental enterprise value and capital market value in Hungarian listed companies, PhD thesis, University of Pécs, Faculty of Economics, Doctoral School of Business Administration, 2008, András TAKÁCS: The relationship between the calculated enterprise value and the share price of Hungarian listed companies, *Statistical Review*, Vol. 85, No. 10-11, pp. 933-964, VÁRKONYI, P: The methodological challenges of evaluating small and medium-sized enterprises. In: *Marketing & Management*. vol. 35, 2019, issue 4, pp. 63-74, BÉLYÁCS, I: Investment Theory, University of Pécs, 2001, András TAKÁCS: Difference in stock price drivers in case of global manufacturing and servicing companies, *International Journal of Business Excellence*, 2021, 25(3), pp. 320-333.

⁴⁹ DAMODARAN, A: *The Valuation Handbook, a guide to investing in shares, buying and selling companies*, Alinea Publishing, Budapest, 2015, p. 16.

⁵⁰ DAMODARAN, A: *The Valuation Handbook, a guide to investing in shares, buying and selling companies*, Alinea Publishing, Budapest, 2015, p. 26.

⁵¹ DAMODARAN, A: *The Valuation Handbook, a guide to investing in shares, buying and selling companies*, Alinea Publishing, Budapest, 2015, p. 43.

⁵² DAMODARAN, A: *The Valuation Handbook, a guide to investing in shares, buying and selling companies*, Alinea Publishing, Budapest, 2015, p. 82.

⁵³ DAMODARAN, A: *The Valuation Handbook, a guide to investing in shares, buying and selling companies*, Alinea Publishing, Budapest, 2015, Chapters 5-8.

⁵⁴ DAMODARAN, A: *Investment Valuation, Methods and Procedures*, Panem Könyvkiadó Kft., Budapest, 2006.

⁵⁵ BREALEY - MYERS: *Modern Corporate Finance*, Panem Ltd., Budapest, 2011, pp. 61-94.

taken into account.⁵⁶ In addition, the author mentions yield-based valuation as a separate category, typically a discounted cash-flow approach, as the most commonly used method, according to which "the value of an asset under the DCF method is equal to the present value of expected future cash flows."⁵⁷ In the literature on expert activities in Hungary, there is also a demand for the definition of uniform principles and criteria in the form of methodological letters for a specific field, on the basis of which the evaluation can be carried out.⁵⁸

András Takács, one of the country's renowned experts on company valuation, emphasises that business valuation is an independent science and professional field that requires knowledge and experience beyond the accounting - accounting expert - tasks, and where the asset value method, the DCF method and the comparative (multiplier) method can be distinguished.⁵⁹ The author points out that a fundamental condition for the application of the method is that the going concern principle applies, that the company is operating profitably and that the business environment is predictable, with future returns and cost of capital being reliably predictable.⁶⁰ In Hungarian valuation practice, the DCF method is also the most commonly used method, given its economic and mathematical soundness.⁶¹ The DCF method is also applicable to companies engaged in manufacturing and service activities.⁶² Within the DCF method, the author also distinguishes between free cash flow (FCF) and equity cash flow (ECF) models.⁶³ In the context of market value-based (comparative or multiples) valuation, Takács points out that the value of a company is defined as a multiple of an accounting indicator, which can be calculated on the basis of historical company-specific or industry-specific data, even in this case, however, it is a precondition that the going concern principle applies, that the company is profit-oriented and that the environment is predictable, that future returns and the cost of capital can be predicted with certainty, otherwise only asset value and not return value can be calculated.⁶⁴ Multiplier valuation is rarely used in Hungarian practice, taking into account that it can only be used for listed companies if data of a comparable publicly traded company are available as comparables.⁶⁵

The author also stresses the importance of IVS 2017 as a relevant standard for valuation practice, in particular the need to apply IVS 104 value bases and IVS 105 valuation approaches and methods, in the context of the valuation of the IVS 2017, the author highlights that three

⁵⁶ VÁRKONYI, P: The methodological challenges of evaluating small and medium-sized enterprises. In: *Marketing & Management*, vol. 35, 2019, issue 4, p. 64-65.

⁵⁷ VÁRKONYI, P: The methodological challenges of evaluating small and medium-sized enterprises. In: *Marketing & Management*, vol. 35, 2019, issue 4, p. 66.

⁵⁸ CSIRMAZ, P: The main rules of expert opinion and the problem of methodological letters, in Curia Case Law Analyst Group, summary opinion, *Expert Evidence in Court Proceedings (Studies on expert evidence)*, Budapest, 19 December 2014, p. 163.

⁵⁹ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, *Hungarian Chamber of Legal Experts*, 28 November 2019, pp. 2-3, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁶⁰ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, *Hungarian Chamber of Legal Experts*, 28 November 2019, p. 6, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁶¹ CSIRMAZ, L: Valuation of company shares in matrimonial property division proceedings, expert evidence-expert competence, *Debreceni Legal Workshop*. vol IX, 2014 issue 3-4 (30 December 2014), p. 5.

⁶² TAKÁCS, A - ERB, E.C: The residual income model cannot challenge the discounted cash flow method in stock valuations – An analysis of global manufacturing and service companies, *International Journal of Sustainable*, 2021, vol. 13, issue 4, pp. 323-335, <https://www.inderscienceonline.com/doi/abs/10.1504/IJSE.2021.118618>, <https://doi.org/10.1504/IJSE.2021.118618>.

⁶³ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, *Hungarian Chamber of Legal Experts*, 28 November 2019, p. 6, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁶⁴ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, *Hungarian Chamber of Legal Experts*, 28 November 2019, pp. 9, 11, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁶⁵ CSIRMAZ, L: Valuation of company shares in matrimonial property division proceedings, expert evidence-expert competence, *Debreceni Legal Workshop*. vol IX, 2014 issue 3-4 (30 December 2014), p. 5.

approaches (market-based, income-based and cost-based) are considered acceptable by the standard,⁶⁶ where the market-based valuation (multiplier method) uses a multiplier derived from the data of the reference sample, where the comparison sample consists of firms with similar parameters and where comparative data are available at the time of valuation, in an income-based valuation, the source of the company's value is the present value of its expected future cash flows, and whereas in a cost-based valuation, "the source of a company's value is the value of the physical assets it holds at the time of valuation." The expert stresses that it is always the responsibility of the valuer to choose the right method, that several methods can be used to calculate a value, but that the expert should take a position in favour of a single value.⁶⁷

If the expert (valuer) has used two or more different methods to determine the value, a simple weighting of the two is not an appropriate solution, and the higher value should be accepted on the basis of the "highest and best use principle."⁶⁸ Information (literature, standards, data) that is not known or available at the time of the assessment should not be taken into account in the assessment.⁶⁹ In his summary of current trends, András Takács examines all aspects of business valuation.⁷⁰ In the Hungarian corporate valuation literature, there is a common perception that either a fundamental or a market comparative valuation can be used.⁷¹

The Hungarian practice is properly oriented by the methodological guide for forensic accountants (prepared in 2014 by Gyula Bartha and Tünde Kolbe, forensic accountants), Chapter VI of which deals with the determination of the market value of a company, highlighting the most important features of business valuation:

- (i) in determining the market value, it is necessary to determine the value that an enterprise can represent at a given time, under certain circumstances and conditions;
- (ii) the market value of the company is the price that independent investors are willing to pay in open market conditions for the possession of the property;
- (iii) the determination of market value is generally future-oriented and shows how much money the company is expected to be able to generate;
- (iv) overall, a company is actually worth as much as it can be sold;
- (v) among the myriad of circumstances and factors influencing the market value of companies, whether the company is (i) a listed multinational or a small domestic enterprise, (ii) an important factor is how the sale will be made, i.e. publicly or secretly, in one go or in stages, (iii) whether a controlling or minority stake is to be sold, (iv) the competence of the management, whether there are significant failures in the past, (v) what pending litigation is involved, etc.⁷²

In the area of corporate valuation, one of the most pronounced issues in the valuation of companies is when a minority interest, rather than the whole company or a majority stake in the company, is sold and therefore the value of that minority interest is determined. The unique

⁶⁶ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, Hungarian Chamber of Legal Experts, 28 November 2019, pp. 13, 15, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁶⁷ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, Hungarian Chamber of Legal Experts, 28 November 2019, pp. 17-20, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁶⁸ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, Hungarian Chamber of Legal Experts, 28 November 2019, p. 22, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁶⁹ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, Hungarian Chamber of Legal Experts, 28 November 2019, p. 24, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁷⁰ TAKÁCS, A: Modern Company Valuation, Akadémiai Kiadó, Budapest, 2021.

⁷¹ RESZEGLI, L: The "art" of company valuation in emerging countries. In: DAMODARAN, A: The Valuation Handbook, a guide to investing in shares, buying and selling companies, Alinea Kiadó, Budapest, 2015, p. 219.

⁷² Methodological Guide (by Gyula Bartha and Tünde Kolbe), Hungarian Chamber of Auditors, www.mkvk.hu, Chapter 6.

feature of this situation is that it is a share interest that affects the life of the company and cannot influence its operations and strategy.⁷³

Since a minority shareholding does not enable the holder to influence the operation of the company, its value is less than the value that would otherwise be represented mathematically by its proportion of the total value of the company. In the context of corporate valuations, such situations are dealt with by applying a so-called minority discount, which means that the value of the minority shareholding is reduced according to certain criteria. Such factors may include the composition of the company's management, certain privileges granted to the owners (options, pre-emption rights) or the specific features of the company's operation.⁷⁴ Based on the criteria taken into account, the actual size of minority discounts applied varies between 20-50% according to Hungarian practice, which is typically lower than the discounts applied in Western European and American practice.⁷⁵ The minority discount is actually a ratio expressing the lack of control over the company.⁷⁶

The methodological guide briefly describes the methods that can be used, highlighting the following:

- (i) the equity-based company valuation (book value based) method shows how much income the owners would receive if the company ceased to exist at the valuation date, if its assets and liabilities were "sold";
- (ii) in the case of multiples, multiply the result calculated in some way by the multiplier at the industry level;
- (iii) the basic economic value analysis is based on the actual market return, but this method is only applicable to profitable companies;
- (iv) discounted cash-flow based firm valuation measures the value of a firm based on its ability to generate income that it can realise in cash as income over the long term. The method is based on past data and assumes a specific growth rate based on trends in the actual data, but does not take into account future changes.⁷⁷

IV. CONCLUSION

The problems encountered by the courts in determining the value of different companies and the value of shares in them, which can be referred to as the problem of company valuation using economic terminology, have been described in detail above. In this context, it is the responsibility of the court to appoint an appropriate expert (accounting expert, financial market or capital market expert, possibly an auditing expert), taking into account the technical issue. It is then the responsibility of the expert to determine the appropriate expert methodology. Of particular relevance in this context is the expert's assessment of whether the going concern principle applies, as this is a key determinant of the methodology to be applied. When valuing a company, experts should take into account the life cycle of the company and whether the company as a whole or a specific part of the company (shareholding) is being valued. Different methods can be considered for a listed company and an over-the-counter (OTC) company.

⁷³ ALMÁSI, L: Valuation of minority shareholdings - discounts in valuations, <https://www.rsm.hu/blog/2020/07/kisebbsegi-uzletresz-ertekelese-diszkontok-az-ertekeleseknél>, p. 1.

⁷⁴ ALMÁSI, L: Valuation of minority shareholdings - discounts in valuations, <https://www.rsm.hu/blog/2020/07/kisebbsegi-uzletresz-ertekelese-diszkontok-az-ertekeleseknél>, p. 3.

⁷⁵ ALMÁSI, L: Valuation of minority shareholdings - discounts in valuations, <https://www.rsm.hu/blog/2020/07/kisebbsegi-uzletresz-ertekelese-diszkontok-az-ertekeleseknél>, p. 3-4.

⁷⁶ TAKÁCS, A: Challenges of company and business share valuation from the perspective of forensic experts, Hungarian Chamber of Legal Experts, 28 November 2019, p. 26, https://misk.hu/files/szakmai-tagozatok/10/Dr_Takacs_Andras_Vallalat_es_uzletresz_ertekelesi_kihivasok_igazsagugyi_szakertoi_szemmel.pdf.

⁷⁷ Methodological Guide (by Gyula BARTHA and Tünde KOLBE), Hungarian Chamber of Auditors, www.mkvk.hu, Chapter 6.

Each method may lead to different results, but it is not professionally justified for the expert to average the company values obtained by these different methods. The legal literature also - citing court decisions - considers it impossible to determine the market value of a company's shares as the average of the asset-based and the income-based value, taking into account that the asset-based (liquidation) value and the income-based (market) value cannot exist simultaneously at a given point in time, given that the company is either operating or being liquidated at that point in time.⁷⁸ This approach in the literature is partly contradicted by the court's position, which takes into account both expert opinions containing company values calculated according to different expert methods.

For our part, we consider the latter methodology to be acceptable in view of the fact that it is a matter of fundamental legal discretion which expert opinions are taken into account by the court and to what extent. The final decision must be taken by the court on the basis of the expert opinions. However, both the valuation reports and the court judgments based on them will in any case be only an estimate, as it can be clearly concluded from the valuation reports and the court judgments that no precise valuation can be made, given the numerous subjective factors and criteria that make it possible to determine only an approximate value.

The legal literature has also taken the view that corporate valuation is a multidisciplinary field where, in addition to legislation, the literature on corporate valuation, legal literature and case law of the courts are also relevant.⁷⁹ Although different methods may lead to different definitions of value, the concept of value (which is not the same as the concept of price) is clearly defined in the legal literature, the market value is the same as the market value determined as the consideration for ownership.⁸⁰ It is important to keep in mind the generally accepted principle that the market value of a company is not equal to the sum of the values of its individual assets, i.e. "*... the sum of the assets on the balance sheet ... is always worth more than the sum of the individual market values,*" It follows that the determination of the value of a company can be described as a single specialised issue, requiring a myriad of specialised skills.⁸¹

KEY WORDS

civil litigation, valuation of companies, valuation of the share of a company, forensic expert, evaluation standards, expert's method, Hungarian civil procedure, Hungarian court practice

KEÚČOVÉ SLOVÁ

občiansko-právne spory, oceňovanie spoločností, oceňovanie obchodného podielu, súdny znalec, oceňovacie štandardy, znalecká metóda, maďarské občianske súdne konanie, maďarská súdna prax

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⁷⁸ CSIRMAZ, L: Valuation of company shares in matrimonial property division proceedings, expert evidence-expert competence, Debreceni Legal Workshop. vol IX, 2014 issue 3-4 (30 December 2014), p. 4.

⁷⁹ CSIRMAZ, L: Valuation of company shares in matrimonial property division proceedings, expert evidence-expert competence, Debreceni Legal Workshop. vol IX, 2014 issue 3-4 (30 December 2014), p. 2.

⁸⁰ CSIRMAZ, L: Valuation of company shares in matrimonial property division proceedings, expert evidence-expert competence, Debreceni Legal Workshop. vol IX, 2014 issue 3-4 (30 December 2014), p. 3.

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