

Private Equity

Valuations – Issues and Challenges

Western India Regional Council

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Objective

- ⇒ Discussing and understanding the issues and challenges related to valuation at the time of PE deal.
- ⇒ Practical Insight from an operational perspective of the key issues & factors that one need to consider.



Valuation

Valuation is relative to a **specific point in time**

What is being valued
Why it is being valued
Secure definition of "value"

Going concern vis-à-vis liquidation
Premium for control, efficiency and synergy

Context

Timing

Basis

Extent of control

Forward looking & Cashflows key

Premise

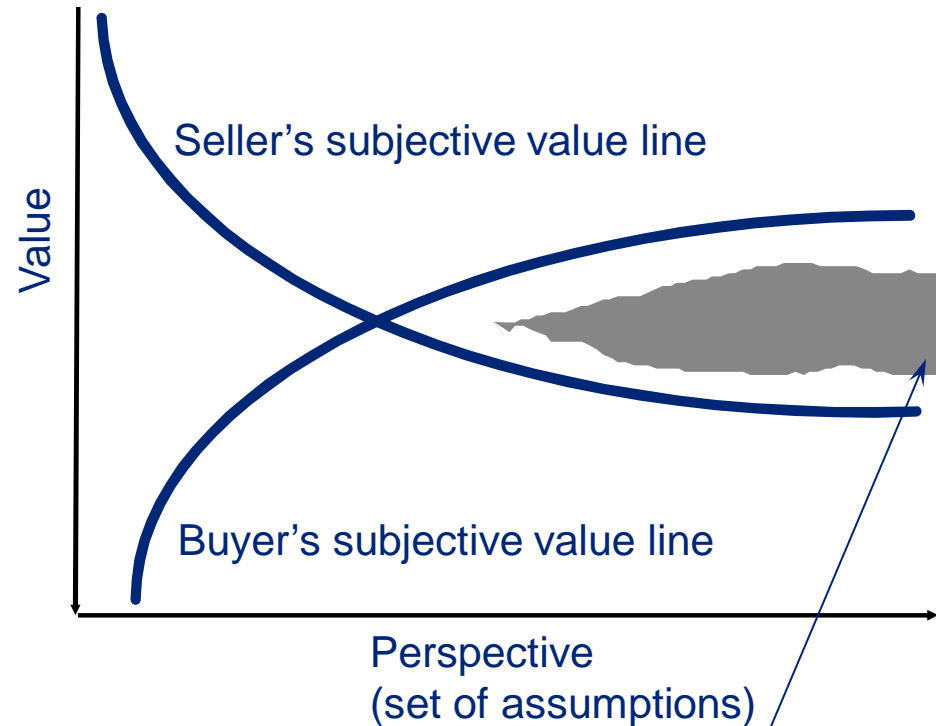
Asset Method

Income Method

Market Method

What is Valuation

- Principles of valuation
 - Fair value and negotiated price
 - Business value more than assets
 - Control premium
- 3 key points to remember:
 - Valuation involves “informed subjectivity”
 - Price is different from value
 - Deal is made at a Negotiated Price



Area in which a market exists

"Price is what you pay. Value is what you get."
- Warren Buffett



Private Equity Investor - Thrust areas

- Promoter integrity
- Quality of top management
- Sustainability of business model
- Scalability of business model
- Profitability of core operations
- Reliable systems / processes / MIS
- Ascertain and cap potential liabilities
- Potential Exit routes
- Structuring a deal - emerging sectors - Healthcare, Education – unorganized
- Investment in form of equity or convertibles or performance linked stake
- Other Rights / Covenants / Agreements
- Regulatory (FEMA, Tax) - @ time of entry and exit.

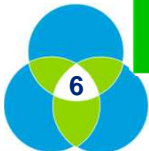


Identifying key value drivers & key risk areas

Valuation - Issues & Challenges

- ➔ No much history - Small or no revenues, operating losses or small profit
- ➔ Proforma Revenue / Profitability
- ➔ Capex required to maintain the business
- ➔ Cost of creating a 2nd level management platform
- ➔ Dependent on private investments
- ➔ Surviving the commercial test
- ➔ Difficulty in getting right comparable companies
- ➔ Pre money or Post money valuation
- ➔ Discount rate - SCRP / Hurdle rate for PE
- ➔ DD issues related to Revenue / Profits / Liabilities / Debts – ascertain - adjustments in valuation
- ➔ DD issues that are difficult to quantify – to be covered in Agreement / Negotiation
- ➔ Related party transaction – arms length pricing, managerial remuneration / other transactions
- ➔ Certain revenue streams / business practices to be foregone on PE investment
- ➔ Exit – how to ring-fence agreed return (convertibles, ratchets, currency of return)

Valuation is not just a SCIENCE, but an ART
Final recommendation – common sense & reasonableness



Projections - The Questions & Counter

Whether the assumptions consider realistic growth of the industry and the company's market share?

Whether the company intends to venture into new lines of businesses?

Are the assumptions stretched:

Reasonable?

Comparable in relation with the past trend of the company / industry / peer group?

Whether the company plans to expand its existing infrastructure?

Whether growth in different heads of expenses is reasonable and correlated to the growth in revenues / operations where applicable?

Stage 2 : Whether the projections need to be extended till company reaches stable state of affairs?

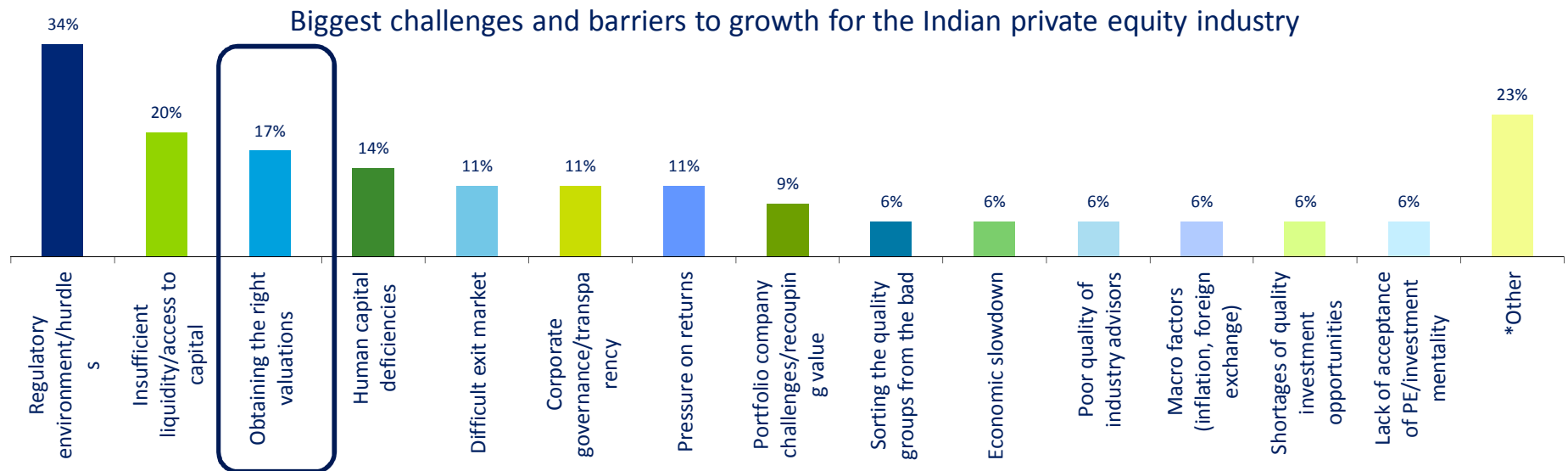
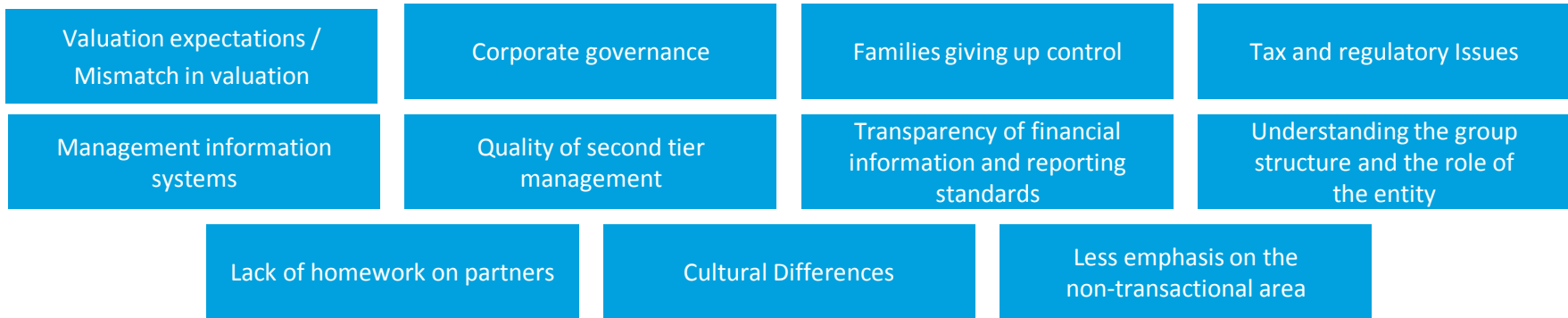
Forecasting
Free Cash
Flows

THE VALUER'S COUNTER

- ➔ Discuss issues to make necessary adjustments in order to make projections more reasonable.
- ➔ Cue from other emerging markets / industries
- ➔ Robust financial model must – to study different scenarios / sensitivity due to changes in income / expense / timing / Capex/ working capital, etc.



Doing deals in India — Key issues to consider



'Other' includes: liberalisation of the market, political instability, lack of debt finance, enforceability of contracts, cross-border growth, uncertainty caused by forthcoming elections, reduced appetite of foreign investors, fundraising problems

Source: Deloitte PE Survey 2010



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Volatile Macro economic factors

Bad corporate governance

Non supportive regulatory environment

Difficult to get access capital

Aggressive stand of tax authorities

Forex implications

PE



THANK YOU

This document discusses various methods and process of valuation. The style contained herein is intended to make aware the valuation process in relation to general issues and concerns. The approach might be different in light of specific issues that are in nature different in context and character.

Further, the information contained in this document is intended only to provide a perspective on valuation methods and the process followed in relation to such and related engagements. It should be in no way construed to be an opinion or advise of any character and is in no way represented as such. The information provided herein should not be used and reproduced and should be considered privileged and only for the intended recipients.