SEMINAR ON VALUATION OF SECURITIES & FINANCIAL ASSETS (WIRC OF ICAI)

Introduction to Valuation, Valuation Methods and Valuation under Different Laws

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INTRODUCTION TO VALUATION

EVOLUTION OF VALUATION REGULATIONS

1957-1989

Wealth Tax Rules, 1957 prescribed valuation of unquoted shares

Prior 1992

CCI Guidelines for issue of shares at premium

Since 1992

SEBI Act was introduced wherein Cos. were free to price their issues in consultation with the Merchant Bankers

2010

FEMA - DCF for valuations in case of issue / transfer of shares of Indian company which was subsequently changed to internationally accepted valuation methodology

2017 & 2018

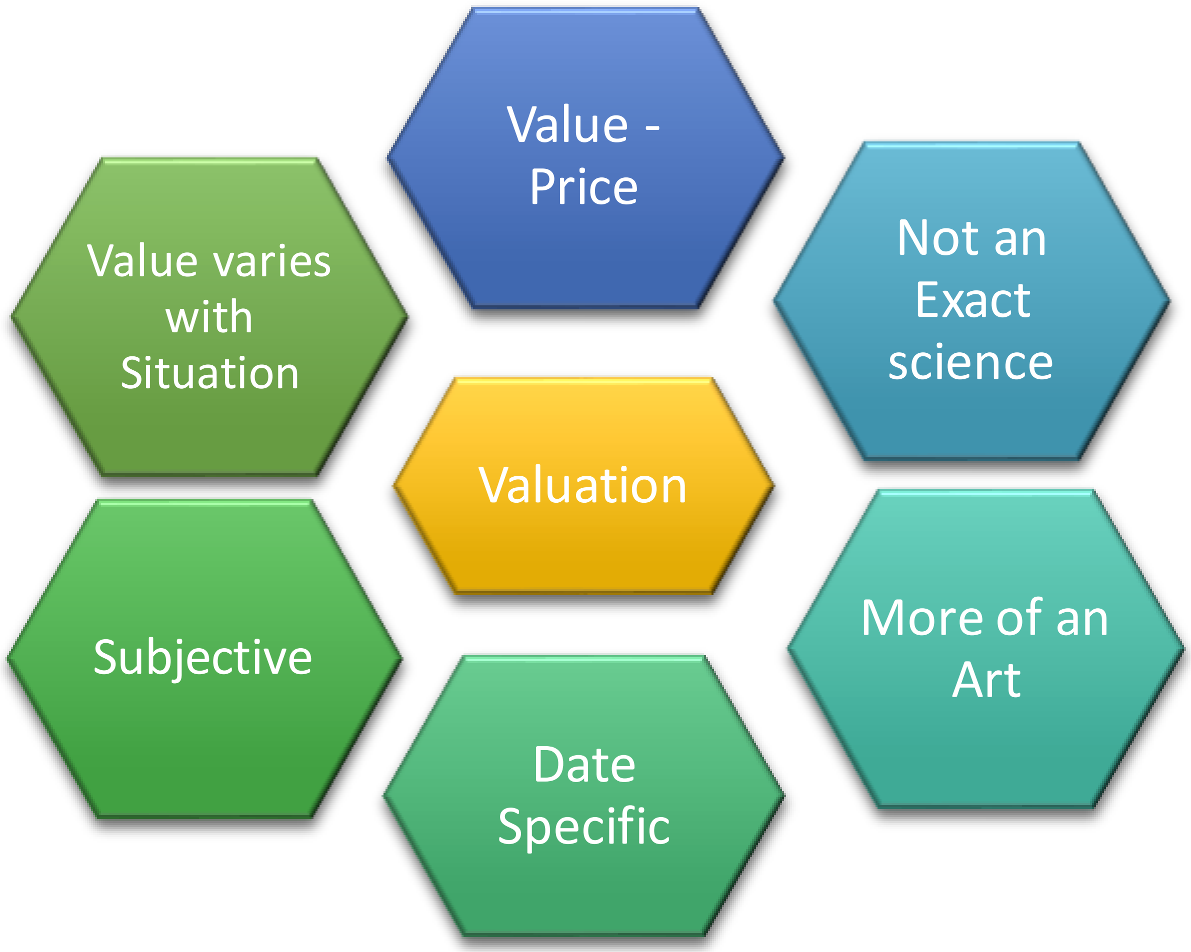
The MCA notified Companies (Registered Valuers and Valuation) Rules, 2017 ('Rules') w.e.f. 18 Oct 2017

ICAI issues Valuation Standards w.e.f. 01 Jul 2018

REGISTERED VALUER

- Section 247 of the Companies Act, 2013 ('Act') provides:
  - Valuation of property, stocks, shares, debentures, securities, goodwill or other assets / liabilities / networth of a company under the Act
  - To be done by a Registered Valuer (RV)
  - Appointed by Audit Committee or in its absence the Board of Directors of that company
- Further, as per Section 247(2) of the Act, RV shall
  - make an **impartial**, **true** and **fair** valuation of assets;
  - **exercise due diligence** while performing the functions as valuer;
  - make the valuation in accordance with such rules as may be prescribed; and
  - not undertake valuation of any assets in which **he has a direct or indirect interest** or becomes so interested at any time during a period of **three years prior** to his appointment as valuer or **three years after** the valuation of assets was conducted by him.

VALUATION CONCEPTS



TYPES OF ASSETS

- Securities or Financial Assets
- Business
- Intangible Assets
- Land and Building
- Plant and Machinery
- Others
  - Jewellery
  - Archaeological Collections
  - Drawings
  - Paintings
  - Sculptures

PURPOSE OF VALUATION

Business Valuation	Regulatory	Intangibles	Financial Reporting
Restructuring	FEMA	Purchase / Sale	Purchase Price Allocation
Purchase / Sale of shares / business	Income Tax Act	Hypothecation	Private Equity/ Venture Capital Funds
Litigation / Family Settlements	SEBI Regulations	Accounting for purchase	Financial Instruments
Fund raising	Companies Act	Impairment	Ind AS reporting – Fair Value / Impairment

PROCESS OF VALUATION

STEPS IN VALUATION

1 → 2 → 3 → 4

1. Information
- Obtaining information
- Business Understanding

2. Analysis
- Data Analysis and review
- Discussion with the Management

3. Valuation Methodologies
- Selection of method
- Conducting sensitivity analysis

4. Recommendation
- Assigning Weights
- Recommendation
- Reporting

SOURCES OF INFORMATION

- Historical data such as audited results of the Company
- Industry & Company overview
- Future projections
- Management Discussion
- Stock market quotations / announcements
- Publicly available data on comparable companies
- Market surveys, news paper reports
- Representation by Management

VALUATION METHODS

VALUATION METHODS

INCOME APPROACH

- Discounted Cash Flow Method

MARKET APPROACH

- Market Price Method
- Comparable Companies Multiple Method
- Comparable Transactions Multiple Method

ASSET APPROACH

- Net Assets Value Method
- Replacement Value/ Realizable Value Method

INCOME APPROACH

DISCOUNTED CASH FLOW (DCF) METHOD

1. Values a business based on the expected cash flows over a period of time
2. Considers cash flows and not accounting profit
3. Value of business is aggregate of discounted value of the cash flows for the explicit period and perpetuity
4. Involves determination of discount factor and growth rate for perpetuity

DCF - PARAMETERS

Cash Flows

- Projections
- Free Cash Flow to Firm ('FCFF') or Free Cash Flow to Equity ('FCFE')
- Horizon (Explicit) period
- Growth rate for perpetuity

Discount Rate

- Cost of Equity
- Cost of Debt
- Debt Equity ratio

FCFE V/S FCFF

Free Cash Flow to Equity	**Free Cash Flow to Firm**
• Discount cash flows to equity • Cash flows after considering all expenses, tax, *interest* and *debt additions/re-payments* • Discount rate: Cost of Equity	• Discount cash flows to firm • Cash flows after considering all expenses and taxes, but prior to interest and debt additions/re-payments • Discount rate: WACC

CASH FLOWS

- Gross operational cash flows (EBIDTA)
- Less: Tax
- Less: Working capital requirements
- Less: Capex requirements

FCFF

Enterprise Value

- Less: Interest payment & additions/ repayment for loans

FCFE

Equity Value

DISCOUNTING FACTOR

Weighted Average Cost of Capital (WACC) =

$$\left\{ \frac{D}{(D + E)} \times Kd \right\} + \left\{ \frac{E}{(D + E)} \times Ke \right\}$$

D = Debt

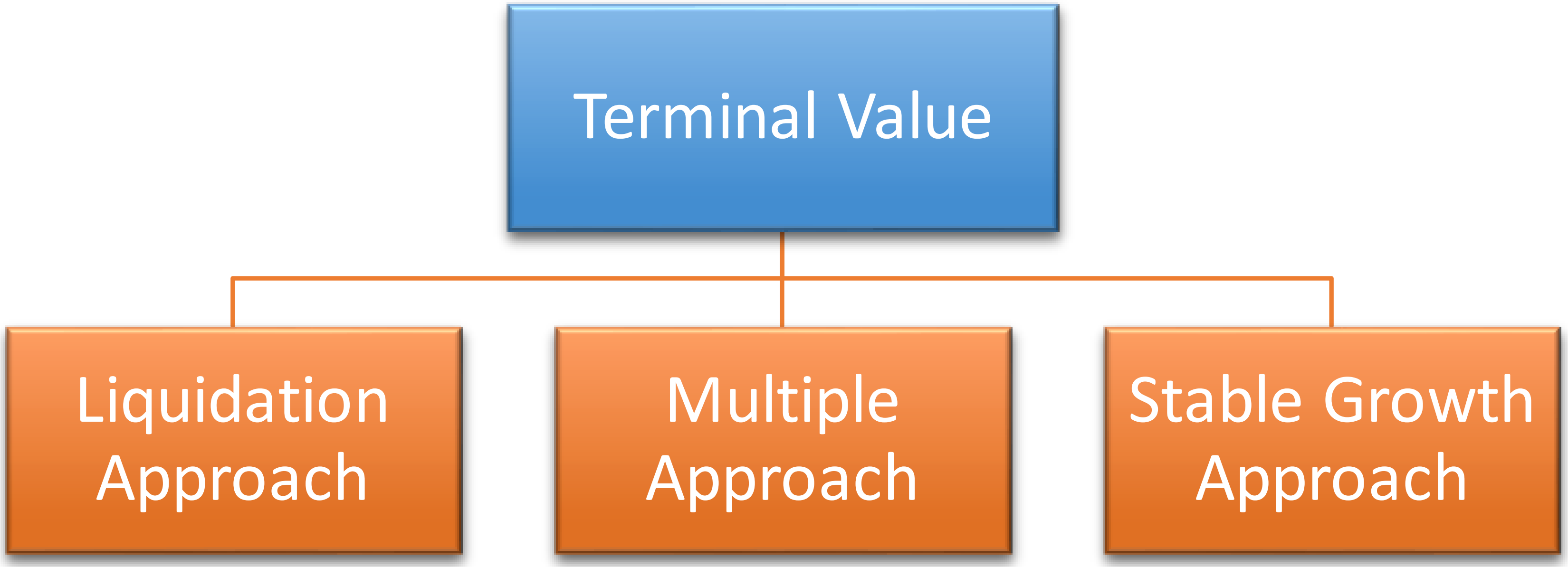
E = Equity

Kd = Post tax cost of debt

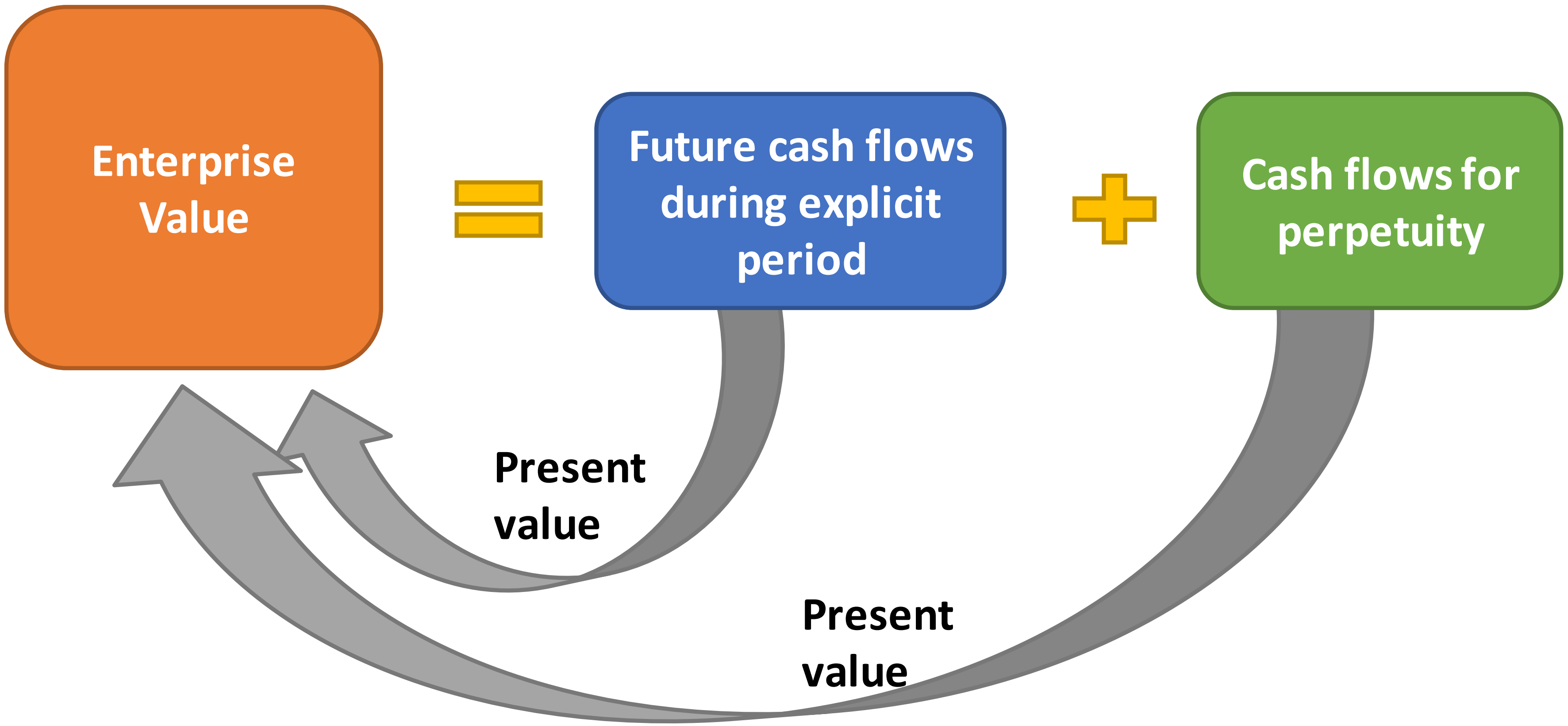
Ke = Cost of equity

TERMINAL VALUE

- Terminal Value is the residual value of business at the end of projection period used in discounted cash flow method



DCF VALUE


Enterprise Value
Future cash flows during explicit period
Cash flows for perpetuity
Present value
Present value

EXAMPLE – FREE CASH FLOW TO FIRM

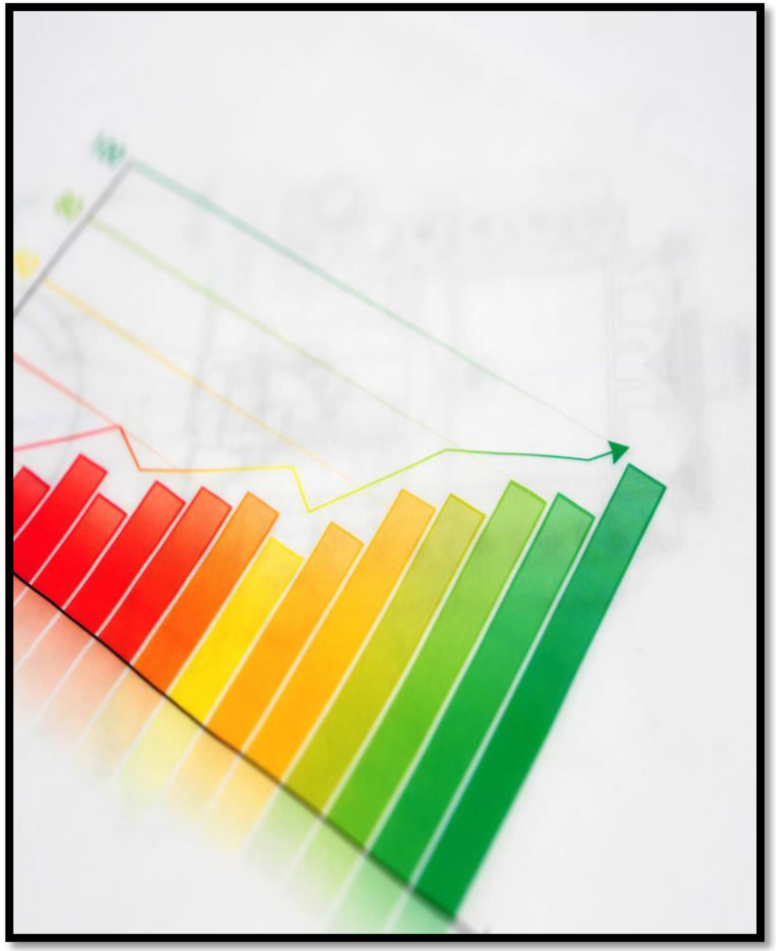
(INR Lacs)

Particulars		2019-20	2019-20	2020-21	Perpetuity
Operating PBT		**430**	**518**	**596**	
Add:					
Interest		56	44	46	
Depreciation		70	80	86	
EBITDA		**556**	**642**	**728**	
Less: Outflows					
Capital Expenditure		45	45	45	
Incremental Working Capital		20	30	40	
Tax		158	182	208	
Total Outflow		**223**	**257**	**293**	
Free Cash Flow (FCF)		**333**	**385**	**435**	
Cash Flow for 2020-21					**435**
Growth Rate					5%
Capitalised Value for Perpetuity					**5,709**
Discounting Factor	13%	0.88	0.78	0.69	0.69
Net Present Value of Cash Flows		**295**	**302**	**301**	**3,957**
Enterprise Value					**4,855**
Less: Loan Funds					(930)
Less: Preference Share Capital					(150)
Add: Surplus Cash					150
Less: Contingent Liabilities					(20)
Add: Value of Investments					850
Adjusted Value For Equity Shareholders					**4,755**
No. of Equity Shares					9,00,000
Value per share (INR) (FV INR 10)					**528**

MARKET APPROACH

MARKET PRICE METHOD

- Evaluates the value on the basis of prices quoted on the stock exchange
- It is prudent to take weighted average of quoted price over a reasonable period
  - Significant and Unusual fluctuations in the Market Price
- Thinly traded / Dormant Scrip – Low Floating Stock
- Regulatory bodies often consider market price as important basis – Preferential allotment, Takeover code



EXAMPLE - MARKET PRICE METHOD

Months	Volume	Turnover (INR)
Mar-19	307,47,812	46099,75,753
Apr-19	120,40,227	26978,68,740
May-19	196,03,244	39762,64,011
Jun-19	161,08,953	35732,16,654
Jul-19	181,15,567	49370,62,216
Aug-19	299,08,604	67354,15,743
Total	**1265,24,407**	**265298,03,117**
Value per Share (INR)		**210**

COMPARABLE COMPANIES MULTIPLE METHOD

Earnings Based

- EBITDA Multiple (EV / EBITDA)
- Revenue Multiple (EV / Revenue)

Enterprise Value

- PE Multiple

Equity Value

Asset Based

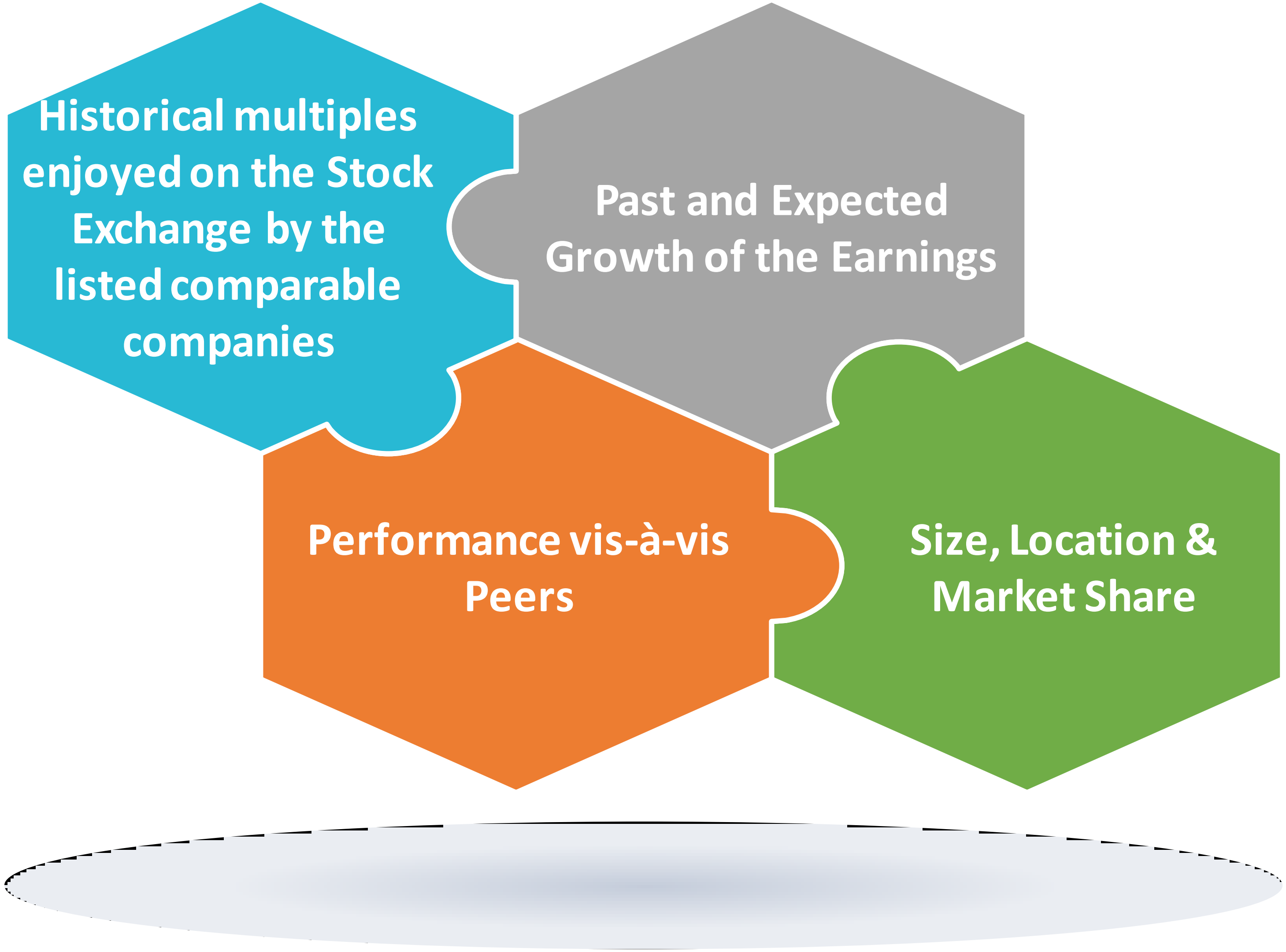
- Book Value Multiple

Equity Value

MARKET MULTIPLES

- Generally applied in case of unlisted entities
- Estimates value by relating an element with underlying element of similar listed companies
- Based on market multiples of Listed Comparable Companies
  - PE Multiple
  - EV/EBITDA Multiple
  - Revenue Multiple
  - Book Value Multiple
  - Industry Specific Multiple
    - EV/ Tonne – Cement Manufacturing Companies
    - EV/ Bed – Hospital Business
    - EV/ Room Keys – Hotel Business
    - EV/ Tower – Telecom Tower Companies
    - % of AUM – Asset Management Companies

MULTIPLE


Historical multiples enjoyed on the Stock Exchange by the listed comparable companies
Past and Expected Growth of the Earnings
Performance vis-à-vis Peers
Size, Location & Market Share

COMPARABLE TRANSACTION MULTIPLE METHOD

- Determines the value based on any recent transaction in the Comparable Companies
- Multiples derived from recent M&A transactions are considered
  - EV/EBITDA
  - EV/Sales
  - Book Value Multiple
  - Industry Specific Multiple
- Generally, used as a cross check

EXAMPLE – EV/EBITDA MULTIPLE

(INR Lacs)

Particulars	XYZ Ltd		
	Adj.EBITDA	Weight	Product
2017-18	384	0	-
2018-19	535	1	535
2019-20	556	1	556
TOTAL		**2**	**1,091**
Maintable EBITDA			**546**
EV/EBITDA Multiple			9
ENTERPRISE VALUE			4,910
Adjustments			
Add: Value of Investments			850
Less: Contingent Liabilities			(20)
Add: Surplus Cash			150
Less: Loan Funds			(930)
Less:Preference Share Capital			(150)
Adjusted Equity Value			**4,810**
No. of Equity Shares (FV - INR 10 each)			9,00,000
Value per share (INR)			**534**

ASSET APPROACH

NET ASSETS VALUE ('NAV') METHOD

Total Assets (excluding Miscellaneous Expenditure and debit balance in Profit & Loss Account)
Less: Total Liabilities
NET ASSET VALUE

OR

Share Capital
Add: Reserves
Less: Miscellaneous Expenditure
Less: Debit Balance in Profit & Loss Account
NET ASSET VALUE

EXAMPLE – NAV METHOD

(INR Lacs)

Particulars	XYZ Ltd	
Net Fixed Assets		1,000
Current Assets	2,450	
Current Liabilities	(1,565)	
Net Current Assets		885
Investments		500
Deferred Tax Liabilities		(100)
Loan Funds		(930)
Net Assets Value		**1,355**
Adjustments:		
Add: Appreciation in the value of investments		350
Less: Preference Share Capital		(150)
Less: Contingent Liabilities		(20)
Adjusted Net Assets Value		**1,535**
No. of Equity Shares (FV - INR 10 each)		9,00,000
Value per share (INR)		**171**

REPLACEMENT / REALISABLE VALUE METHOD

Replacement value of assets

- Cost of new asset
- Similar condition
- Equivalent utility
- Depreciation for obsolescence

Realisable value of assets

- Cost of disposal
- Tax on sale (STCG, LTCG etc.)
- Time required

COMMON ADJUSTMENTS

- Market value of the investments
- Other non-operating surplus assets
- Surplus cash
- Contingent liabilities / assets
- Loan Funds
- Preference Share Capital
- ESOPs / Warrants
- Convertible Instruments
- Tax Concessions

SELECTION OF METHODS

Situation	Approach
Knowledge based companies	Income / Market
Manufacturing companies	Income / Market/ Asset
Brand driven companies	Income / Market
Start up companies	Income / Market
Limited life projects	Income
Investment / Properties companies	Asset
Company going for liquidation	Asset

VALUATION UNDER DIFFERENT LAWS

FOREIGN EXCHANGE MANAGEMENT ACT, 1999

INDICATIVE LIST OF TRANSACTIONS:

- Fresh Issue of Indian Company Shares by subscription to Memorandum of Association
- Issue of Shares or Securities by an Indian company to a Non-Resident
- Transfer of Shares or Securities by a Resident to a Non-Resident
- Transfer of Shares or Securities by a Non-Resident to a Resident

Valuation: In case of issue or transfer of shares or securities following approach is to be adopted:

- **Listed Securities -** the price worked out in accordance with the relevant SEBI guidelines, or preferential allotment price of shares determined under the SEBI Guidelines or in case of a company going through a delisting process as per the SEBI (Delisting of Equity Shares) Regulations, 2009.
- **Unlisted Securities -** internationally accepted pricing methodology for valuation, on an arm's length basis, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant.

INCOME TAX ACT, 1961

INDICATIVE LIST OF TRANSACTIONS:

Section	Valuation Requirement
Sec 56(2)(viib)	for issue of unquoted shares. FMV of such shares to be computed in accordance with Rule 11UA
Sec 56(2)(x) and Sec 50CA	for transfer of unquoted shares (also covers sum of money, immovable property, other property)
Sec 50B	Slump sale of a business
Sec 92	Transfer pricing provisions

COMPANIES ACT, 2013

INDICATIVE LIST OF TRANSACTIONS:

Section	Valuation Requirement
54(1)(d)	Issue of Sweat Equity Shares in case of unlisted companies
62(1)(c)	Issue of shares / convertible securities on preferential basis by unlisted company for cash or for consideration other than cash
67(3)(b)	Provision of money by company for purchase of its own shares by employees or by trustees for the benefit of employees
192(2)	Transactions involving transfer of assets for non-cash consideration to / from directors
230 & 232	Scheme of Compromise/Arrangement or Scheme of Corporate Debt Restructuring
234	Cross border merger of an Indian Co. into Foreign Co. or vice versa
236	Purchase of minority share holding
281	Winding up of a company

SEBI (SUBSTANTIAL ACQUISITION OF SHARES & TAKEOVERS) REGULATIONS, 2011

- **Frequently traded shares** - the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period,

- **Not frequently traded -** the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies

SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS), REGULATIONS, 2018

- As per SEBI ICDR Regulation, the price of frequently traded equity shares pursuant to preferential allotment shall be **higher of**:
  - the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the **twenty six weeks** preceding the relevant date; or
  - the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the **two weeks** preceding the relevant date.
- Where the shares of an issuer are not frequently traded, the price determined by the issuer shall take into account the valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies

SEBI REGULATIONS - MERGER / DEMERGER

- Following disclosure needs to be made by a valuer in the valuation report:

Valuation Approach	XYZ Ltd.		PQR Ltd.	
	Value per share	Weight	Value per share	Weight
Asset Approach	x	a	y	d
Income Approach	x	b	y	e
Market Approach	x	c	y	f
Relative value per share	x		y	
Exchange / Entitlement Ratio (rounded off)			xx	

Ratio : "x (xxx) equity share of XYZ Ltd of INR 10 each fully paid up for every y (yyy) equity shares of PQR Ltd of INR 10 each fully paid up"

In case any approach is not used for arriving at the share exchange / entitlement ratio, detailed reasons for the same need to be provided by the valuer in his report

JUDICIAL PRONOUNCEMENTS

JUDICIAL PRONOUNCEMENTS

"Exchange Ratio not disturbed by Courts unless objected and found grossly unfair"

- Miheer H. Mafatlal Vs. Mafatlal Industries (1996) 87 Com Cases 792
- Dinesh v. Lakhani Vs. Parke-Davis (India) Ltd. (2003) 47 SCL 80 (Bom)

"Valuation will take into account number of factors such as prospective yield, marketability, the general outlook for the type of business of the company, etc. Valuation is an art, not an exact science. Mathematical certainty is not demanded, nor indeed is it possible"

- Viscount Simon Bd in Gold Coast Selection Trust Ltd. vs. Humphrey reported in 30 TC 209 (House of Lords)

"It is fair to use combination of three well known methods - asset value, yield value & market value"

- Hindustan Lever Employees ' Union Vs. HLL (1995) 83 Com. Case 30 SC

JUDICIAL PRONOUNCEMENT

“It is not possible for a Court to go into the exercise of carrying out a valuation itself. Courts do not have the expertise, the time or the means to do this. I do not believe that they are expected to do it. What the Court’s approach must be to examine whether or not a valuation report is demonstrated to be so unjust, so unreasonable and so unfair that it could result and result only in a manifest and demonstrable, inequity or injustice. This injustice must be shown to apply to a class.”

“No valuation is to be disregarded merely because it has used one or the other of various methods. It must be shown that the chosen method of valuation is such as has resulted in an artificially depressed or contrived valuation well below what a fair-minded person may consider reasonable.”

- Cadbury India Limited Vs. Mrs Malati Samant and Mr Alok C. Churiwala (Samant Group and Churiwala Group) (2014) (Bom HC)

THANK YOU !