VALUATION UNDER COMPANIES ACT

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VALUATION
Introduction

What is Valuation :

- The process of determining the current worth of an asset or a company
- Various techniques to determine value – some subjective, others objective
- Valuation is not an exact 'Science', it is more an 'Art'
- Valuation is influenced by the valuer's judgment, knowledge of the business, analysis, interpretation and methodology used
- Its different from Price

Once the 'value' is determined, what follows is detailed negotiations between the purchaser and seller and if there is an agreement between the two, the 'price' of the asset (whether of shares or business) gets established. It is quite possible that the price is either far higher or far lower than the fair value.

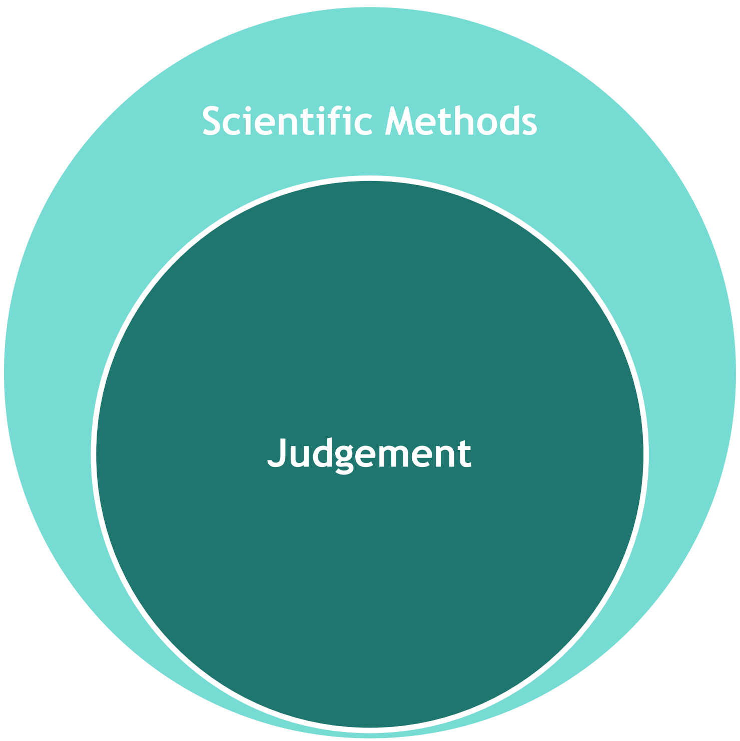
As Warren Buffet describes:
"Price is what you pay & Value is what you get"

VALUATION
Myths

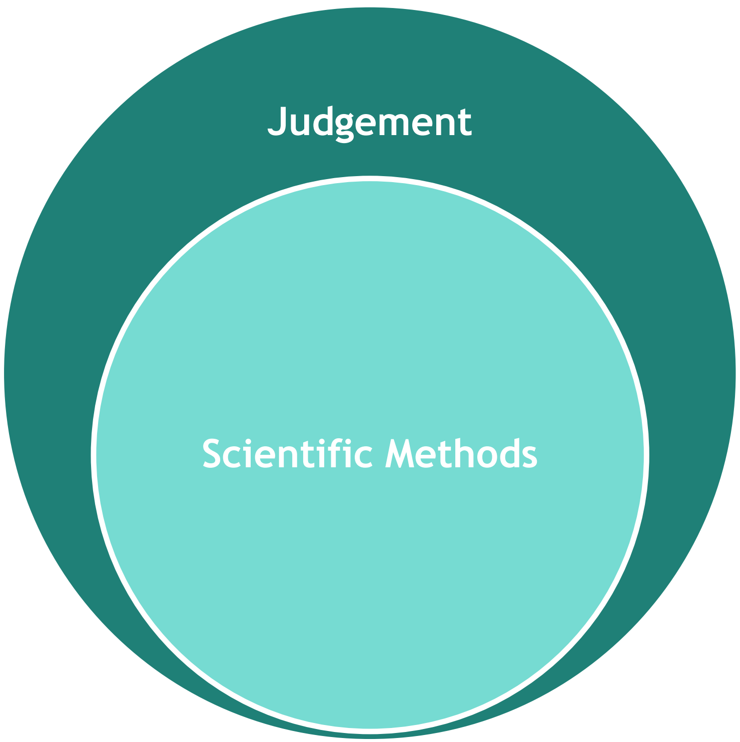
- Valuation is objective
- Valuation is a science
- Valuation gives a precise number
- A single valuation serves more than one purpose
- A complex financial model gives better valuation
- All valuation approaches and methods apply in all situations
- There is a single definition of value

VALUATION
Art or Science?

THEORY



PRACTICE



VALUATION

Role varies in Different Arenas

Valuation in Portfolio Management	Valuation in Acquisition Analysis	Valuation in Corporate Finance	Valuation for Legal and Tax Purposes	Others
Fundamental Analysis	Business	Corporate Restructuring	Income Tax	Family Separations
Activist Investors	Equity Stake	Swap Ratios for Mergers/De-mergers	FEMA	ESOPs
Chartists	Brand/Parents/ Copyrights	Listing of New Shares	SEBI	PSU Divestments
Information Traders			IBC	

VALUATION REQUIREMENT UNDER DIFFERENT STATUTES

Companies Act, 2013

- Sec. 62 - Further Issue of Share Capital
- Sec. 192 - Assets valuation involved in arrangement of non-cash transactions involving directors
- Sec 230/232 - Valuation under Scheme of Compromise/Arrangement or Scheme of Corporate Debt Restructuring
- Sec. 236 - Valuation for Purchase of Minority Shareholding
- Sec 281/ 319 – Valuation under liquidation
- Sec. 305 - Report on assets for declaration of solvency in case of proposal to wind up voluntarily

IBC Code 2016

- IBC requires valuation of assets

FEMA

- Transfer or Issue of security under Foreign Exchange Management Regulations 2000

SEBI

- Transfer or Issue of security under Preferential Allotment Guidelines of the SEBI (ICDR) Regulations, 2009
- Open offer price as per Regulation 8 of SEBI Takeover Regulations, 2011

Income Tax Act, 1961

- Sec. 17 – Exercise of options by the employer
- Sec. 45(1) – Charging section of capital gains
- Sec. 56 - Transfer of property (incl. shares and securities) to individual, HUF and closely held company without consideration
- Sec. 92C – Transfer pricing valuation

Ind AS

- Ind AS 113 –Fair Value Measurement
- Ind As 36 - Impairment of Assets
- Ind AS 103 –Business Combination
- Ind AS 38 – Intangible Assets
- Ind AS 16 – Property, Plant & Equipment
- Ind AS 102 – Share Based Payment
- Ind AS 109 – Financial Instruments
- Ind AS 40 – Investment Property

COMPANIES ACT 2013

Registered Valuer

The Companies Act 2013 (“2013 Act”) has introduced the concept of a 'Registered Valuer' under a separate chapter which intends to cover all kinds of valuation requirements.

As per Chapter XVII Section 247 of the Act, where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities under the provision of this Act, it must be valued by a Registered Valuer.

The concept of valuation as a code is new for the 2013 Act. The rationale behind introducing this is to set certain valuation standards and regulate the practice which will bring transparency and better governance during a valuation exercise.

Chapter XVII Section 247 of the 2013 Act read with Companies (Registered Valuer and Valuation) Rules 2017, lay down the criteria for registration, model code of conduct for the valuer, approach and methods to be used by registered valuers, contents of the Valuation Report, etc.

These Draft Rules were open for suggestions and the final Rules are awaited and could be subject to changes.

COMPANIES ACT 2013

Registered Valuer

As per the 2013 Act, all valuations need to be carried out by a Registered Valuer and for valuation requirement of a company, the Registered Valuer shall be appointed by the Audit Committee or in its absence, by its Board of Directors.

The Draft Rules define "Registered Valuer" and state that a person to be eligible to act as a valuer, must register with the with the registration Authority under rule 7(6) of the aforesaid rules.

Registration Authority has been defined as the Insolvency and Bankruptcy Board Of India Established Under the Insolvency and Bankruptcy Code, 2016

COMPANIES ACT 2013

Registered Valuer - Eligibility

No Individual shall be eligible to be a registered valuer if he –

- Has not passed the Valuation Examination in the 3 years preceding the date of making an application subject to certain exceptions
- does not have the qualification and experience as specified

  An Individual should have following qualification to be eligible for registration under rule 5 –

  - Post-graduate degree, in the specified discipline , from a university established, recognized or incorporated by law in India and at least 3 years of experience in the discipline thereafter; or
  - a Bachelor's degree, in the specified discipline, from a university established, recognized or incorporated by law in India and at least 5 years of experience in the discipline thereafter; or
  - membership of a professional institute set up under an Act of Parliament and at least five years' experience after such membership.
- is a minor
- Has been declared of unsound mind
- Is an discharged bankrupt, or has applied to be adjudicated as an bankrupt;
- is a person not resident in India
- Has been convicted by any competent court for an offence punishable with imprisonment term as specified
- Is not a valuer member (holding certificate Of practice) of a valuation professional organization
- Is not a fit and proper person as defined in the rules

COMPANIES ACT 2013

Registered Valuer - Eligibility

No partnership entity shall be eligible to be a registered valuer if –

- If it has incurred any if the disqualifications as listed earlier as applicable to a firm
- If it is undergoing as insolvency resolution or bankruptcy process or in an undischarged bankrupt
- Any of it partners have incurred the disqualifications as listed above
- If a majority of its partners practicing in India are not registered valuers
- Or if none of the partners is a registered valuer for the class of assets, for the valuation of which it seeks to be a registered valuer

COMPANIES ACT 2013

Valuation Standards

- As per rule 18, a registered valuer shall make valuations as per the Valuation Standards notified from time to time by the Central Government.
- Until such time as the Valuation Standards are notified by the Central Government, a valuer shall make valuations as per :
  - Internationally accepted valuation methodology;
  - Valuation Standards adopted by any valuation professional organization; Or
  - Valuation Standards specified by Reserve Bank of India, Securities and Exchange Board of India or any other statutory regulatory body

COMPANIES ACT 2013

Valuation Report - Contents

As per Rule 18, the valuer shall, in his/ its report shall state the following:-

- Background information of the asset being valued;
- Purpose of valuation and appointing authority;
- Identity of the valuer and any other experts involved in the valuation;
- Disclosure of valuer interest/conflict, if any;
- Date of appointment, valuation date and date of report;
- Sources of information;
- Procedures adopted in carrying out the valuation;
- Valuation methodology;
- Major factors that influenced the valuation;
- Conclusion; and
- Caveats, limitations and disclaimers

VALUATION UNDER IBC, 2016

VALUATION UNDER IBC, 2016

Guidelines

- Insolvency and Bankruptcy Code, 2016 (‘**IBC 2016**’) has been enacted to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto

- Valuation is one of the key considerations under IBC 2016.

- Two registered valuers need to be appointed by the Interim resolution professional (‘**IRP**’) within seven days of his appointment.

- Internationally accepted valuation standards to be adopted for valuation.

- Basis of Valuation : ***Liquidation Value i.e. estimated realizable value of the assets of the corporate debtor*****,** ***if the corporate debtor is liquidated on the insolvency commencement date***; and

- Valuers to undertake physical verification of the inventory and fixed assets of the corporate debtor.

- At later stages, in specific circumstances, ‘Going Concern Value’ of the corporate debtor may need to be undertaken

LIQUIDATION VALUE
Introduction

- Liquidation literally means turning a business's assets into readily available cash

- The Liquidation Value is the estimated amount of money that an asset or company could quickly be sold for, such as if it were to go out of business. In a normal growing profitable industry, a Company's liquidation value is usually much less than the current share price. In a dying industry, the liquidation value may exceed the current share pricevalue. This usually means that the Company should go out of business

- There are two types of Liquidation Value, depending on the time available for the liquidation process:
  1. Orderly liquidation value: this assumes that the enterprise can afford to sell its assets to the highest bidder. It assumes that the seller can take a reasonable amount of time to sell each asset in its appropriate season and through channels of sale and distribution that fetch the highest price reasonably available

  2. Distress liquidation value: this is an 'emergency' price. This assumes that the enterprise must sell all its assets at or near the same time, to one or more purchasers. The assumption is that the typical purchaser for the assets is a dealer who specialized in the liquidation of the entire assets of a Company. For obvious reasons, distress Liquidation Value will always be lower than the Orderly Liquidation Value.

- Depending on the enterprise and the nature of its assets, the difference between the two values can be substantial.

VALUATION METHODS

Asset Valuation

- Depreciated Replacement Value Method
- Direct Comparison Method
- Market Price Method
- Discounted Cash Flow Method

VALUATION METHODS

Asset Valuation

Depreciated Replacement Value Method

- Depreciated replacement cost is an optimized form of replacement cost method to make the estimate more realistic by adding the aspect of depreciation to a simple replacement cost concept for valuation purposes.
- DRV in the present condition takes into account the following:
  - Current costs to put up a similar facility from erection stage;
  - Total Service Life the asset is expected to give taking into account the design and specifications, quality of manufacture / construction;
  - Balance Service Life considering present condition of the asset and overall usage and utilization;
  - Standard of maintenance, overhauls and reconditioning carried out.

Direct Comparison Method

- The direct comparison approach involves a comparison of the subject property to similar properties that have actually sold in arms – length transactions or are offered for sale.
- This approach demonstrates what buyers have historically been willing to pay (and sellers willing to accept) for similar properties in an open and competitive market and is particularly useful in estimating the value of the land and properties that are typically traded on a unit basis
- In the absence of a sale of the subject, sales prices of comparable properties are usually considered the best evidence of market value

VALUATION METHODS

Asset Valuation

Market Price Method

- Under this method, current basic price of the asset was obtained from manufacturer/ vendor by taking budgetary quotations (verbal or written).
- To the basic cost, all additional costs on account of taxes & duties, transportation, loading/unloading, insurance, installation and commissioning, etc. as applicable were added.
- In some of the major assets, the costs are bench marked to market costs and then apportioned to individual assets in proportion of original costs.

Discounted Cash Flow Method

- Discounted Cash Flow (DCF) Method values the asset using the concepts of the time value of money.
- All future cash flows which are expected to flow from the asset under consideration are estimated and discounted by using the appropriate cost of capital to give their present values .
- The sum of the present values of such future cash flows is considered the value of the asset.
- Such method is mainly used when the individual asset is capable of generating the cash flows or when the cash flow can be specifically attributed to that particular asset.

KEY ASSETS UNDER VALUATION

Fixed Assets
- Plant & Machinery
- Land
- Building

Current Assets
- Inventories
- Trade Receivables
- Loans & Advances

Investments
- Investment in Subsidiaries
- Investment in Associates / Joint Ventures
- Other Quoted / Unquoted Instruments

Personnel with relevant technical expertise will be required to value specific assets

KEY VALUATION CONSIDERATION

Asset Wise

Land

Key factors to be considered:

- Land Location
- Structure of Land
- Existing market rate
- Restriction on Land use/ sale of land

Plant & Machinery

Key factors to be considered:

- Usage and Capacity
- Physical Inspection
- Wear & tear
- Age and Useful life
- Maintenance Schedule
- Type of Structure (removeable or not)
- Fungibility of Plant

Building

Key factors to be considered:

- Physical Condition
- Age and Useful life
- Type of Construction

KEY VALUATION CONSIDERATION

Asset Wise

Trade Receivables

Key factors to be considered:

- Debtors Ageing- time buckets
- Supporting documents/Agreements/ PO/Terms
- Charge on assets
- Past customer track record

Investments

Key factors to be considered:

- Quoted / Unquoted
- Industry specific factors
- Terms of investment agreement
- Convertible or Non-convertible Investments
- Operating or Non-operating

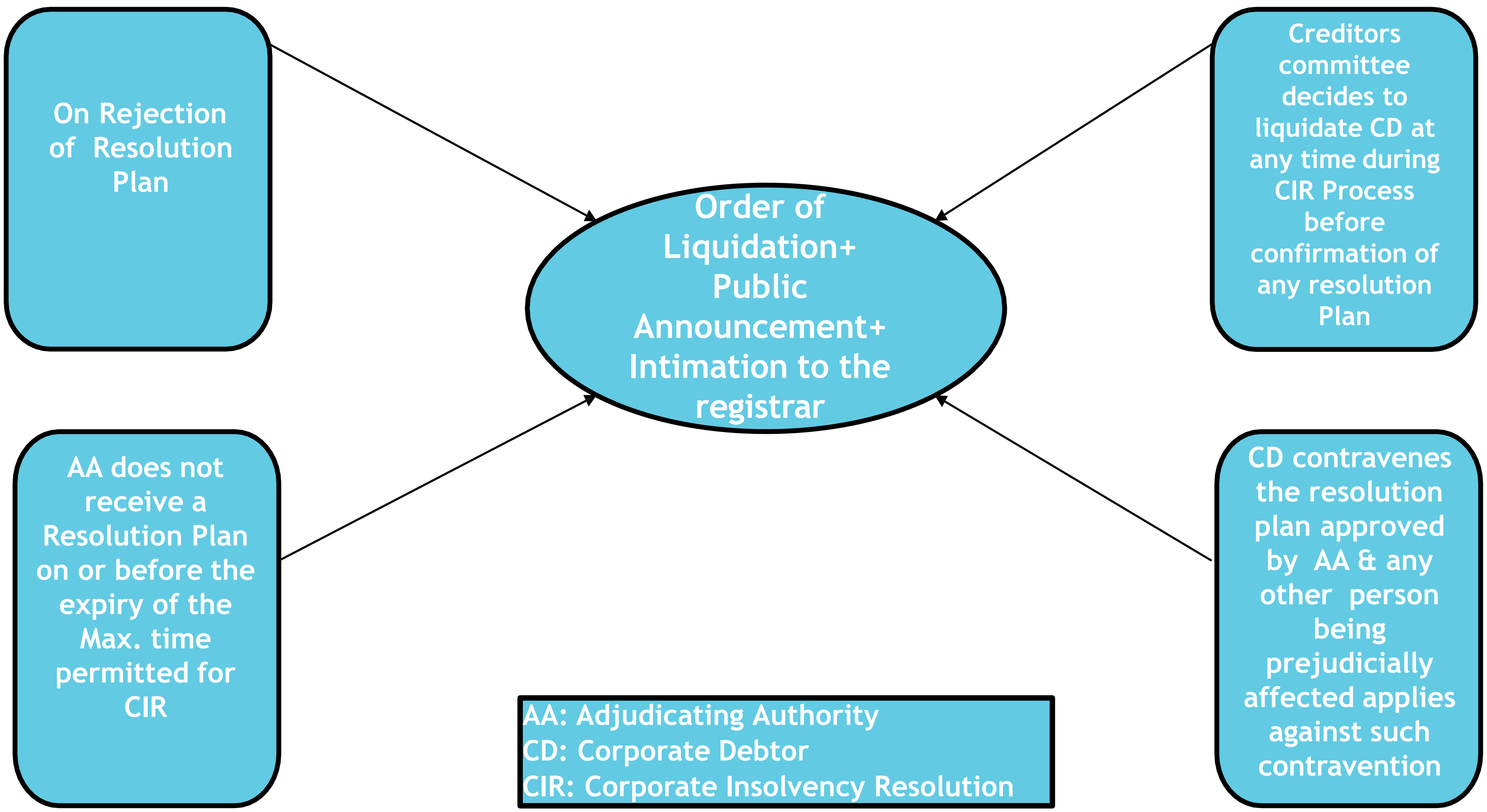
Inventory

Key factors to be considered:

- Physical Verification vis-a-vis stock records
- Categorization of Inventory into slow moving, obsolete and fast moving.
- Appropriate adjustments to each category of inventory

LIQUIDATION PROCESS & VALUATION

Circumstances Leading to Liquidation



LIQUIDATION PROCESS & VALUATION

Liquidation and distribution of recovery proceeds

Initiation of Liquidation u/s 33

Appointment of Liquidator u/s 34

To make public announcement u/s 102 , To call upon stakeholders to submit their claims as on liquidation commencement date u/s 35(2) and to provide last date for submission of claim (30 days from the liquidation commencement date)

Submission of the preliminary record to the Adjudicating Authority

Submission of claim by different stakeholders. Verification of stakeholder's claims and preparation of final list of stakeholders by the liquidator.

Asset memorandum by the liquidator and valuation by at least two independent valuers.

Asset sale either by auction or by private sale. Distribution of proceeds

Liquidation commencement date: means the date on which proceedings for liquidation commence in accordance with section 33 or section 59 of the Code (Y)

LIQUIDATION PROCESS & VALUATION

Priority in liquidation - Comparison

As per Companies Act 2013

Liquidation Costs
↓
Government dues of 12 months
↓
Workmen dues and Secured Creditors Debt
↓
Workmen dues
↓
Employees' dues
↓
Unsecured Creditors
↓
Preference Shareholders
↓
Equity Shareholders

As per IBC 2016

Insolvency Process Costs
↓
Liquidation Costs
↓
Workmen dues of 24 months and Secured Creditors Debt (to the extent of Security?)
↓
Employees' dues of 12 months
↓
Unsecured financial creditors
↓
debts & unpaid dues of secured creditors
↓
Other debt (including trade creditors)

Preference Shareholders
↓
Equity Shareholders

LIQUIDATION PROCESS & VALUATION

Priority in liquidation - Example

Table 1 - Total Value realized by liquidator

Assets	Book Value (INR million)	% of Total Asset	Amount Realized (INR million)
Land and Building	5,100	65%	3,315
Furniture and fittings	500	30%	150
Stock	400	45%	180
Debtors and prepayments	450	40%	180
Other Current Assets	300	55%	165
Cash	250	100%	250
Insurance Claim			150
	7,000		**4,390**

LIQUIDATION PROCESS & VALUATION

Priority in liquidation - Example

Table 2 – Total Value of Liability

Liability	Amount (INR million)
Cost of realizing Assets	100
Insolvency resolution process cost	150
Liquidation process costs	100
Workmen's dues	
- for a period of 24 months preceding the reference date	80
- for a period prior to 24 months preceding the reference date	70
Debt owned to secured creditors who have relinquished security interest	1,500
Debt owned to secured creditors whose part of the debt remains unpaid after enforcement of security interest *	500
Wages owned to employees	
- for a period of 12 months preceding the reference date	80
- for a period prior to 12 months preceding the reference date	70

* Assumed that the secured creditors have debt amounting to INR 500 Million out of which INR 300 has been realized from enforcement of security deposits.

LIQUIDATION PROCESS & VALUATION

Priority in liquidation - Example

Table 2 - Total Value of Liability

Liability	Amount (INR million)
Debts owned to unsecured creditor in respect of financial debt	990
Government Dues	
- for a period of 24 months preceding the reference date	100
- for a period prior to 24 months preceding the reference date	50
Operational creditor	760
Preference Share Capital	750
Equity Share Capital	800

LIQUIDATION PROCESS & VALUATION

Priority in liquidation - Example

Table 3 - Order of priority

Section Reference	Order of priority	Amount (INR million)	Amount (INR million)
	I . Total Value realized during Liquidation		
	Realised from assets	4,240	
	Less : cost of realising secured assets	100	
	Collection from insurance claim	150	4,290
	II. Distribution as per Section 53 of IBC		
53 (1)(a)	Insolvency resolution process cost	150	
53 (1)(a)	Liquidation process costs	100	(250)
	Balance		**4,040**
	III. Amount for Workmen & Secured Creditors		
53 (1)(b)(i)	Workmen's dues for a period unto 24 months	80	
53 (1)(b)(il)	- Debt owned to secured creditors who have relinquished security interest - Secured financial creditors whose part of the debt remains unpaid	1500 300	(1880)
	Balance		**2,160**

LIQUIDATION PROCESS & VALUATION

Priority in liquidation - Example

Section Reference	Order of priority	Amount (INR million)	Amount (INR million)
	IV. Amount for distribution to employees		
53 (1)(c)	Wages owned to employees for a period of 12 months prior to reference date	80	(80)
	Balance		**2,080**
	V. Amount for financial unsecured creditors		
53 (1)(d)	Debts owned to unsecured creditor in resect of financial debt	990	(990)
	Balance		**1,090**
	VI. Amount for government dues & part secure financial creditors whose paid amount remains unpaid		
53 (1)(e)	Statutory Dues for 24 months	100	
53 (1)(e)	Secured Financial creditors	200	(300)
	Balance		**790**

LIQUIDATION PROCESS & VALUATION

Priority in liquidation - Example

Section Reference	Order of priority	Amount (INR million)	Amount (INR million)
53 (1)(e)	**VII. Amount for remaining debt and dues**		
	- Operational creditor - Workmen's dues for a period prior to 24 months preceding the reference date - Wages owned to employees for a period prior to 12 months preceding the reference date - Government dues for a period prior to 24 months preceding the reference date	760 70 70 50	**(950)**
	Balance		**(160)**
53 (1)(g)	**VIII. Amount for Preference Shareholders**		
	- Preference Shareholder	400	**(400)**
	Balance		**(560)**
	IX Amount for Equity Shareholders		
53 (1)(h)	- Equity shareholders	800	**(800)**
	Balance		**(1,360)**

LIQUIDATION PROCESS & VALUATION

Final Summary

Liquidation Value to Operational Creditors

Liability	Actual Claims (INR million)	Value actually paid (INR million)
Workmen's dues		
- for a period of 24 months preceding the reference date	80	80
- for a period prior to 24 months preceding the reference date	70	58.2*
Wages owned to employees		
- for a period of 12 months preceding the reference date	80	80
- for a period prior to 12 months preceding the reference date	70	58.2*
Government Dues		
- for a period of 24 months preceding the reference date	100	100
- for a period prior to 24 months preceding the reference date	50	41.6*
Operational creditor	760	632*
Total	**1,210**	**1,050**

* The amount has been paid on a pari passu basis

LIQUIDATION PROCESS & VALUATION

Final Summary

Liquidation Value to Financial Creditors

Liability	Actual Claims (INR million)	Value actually paid (INR million)
Debt owned to secured creditors who have relinquished security interest	1,500	1,500
Debt owned to secured creditors whose part of the debt remains unpaid after enforcement of security interest	500	500 (300+200)
Debts owned to unsecured creditor	990	990
Total	**2,990**	**2,990**

VALUATION APPROACH & METHODOLOGY

VALUATION APPROACH

Business Valuation

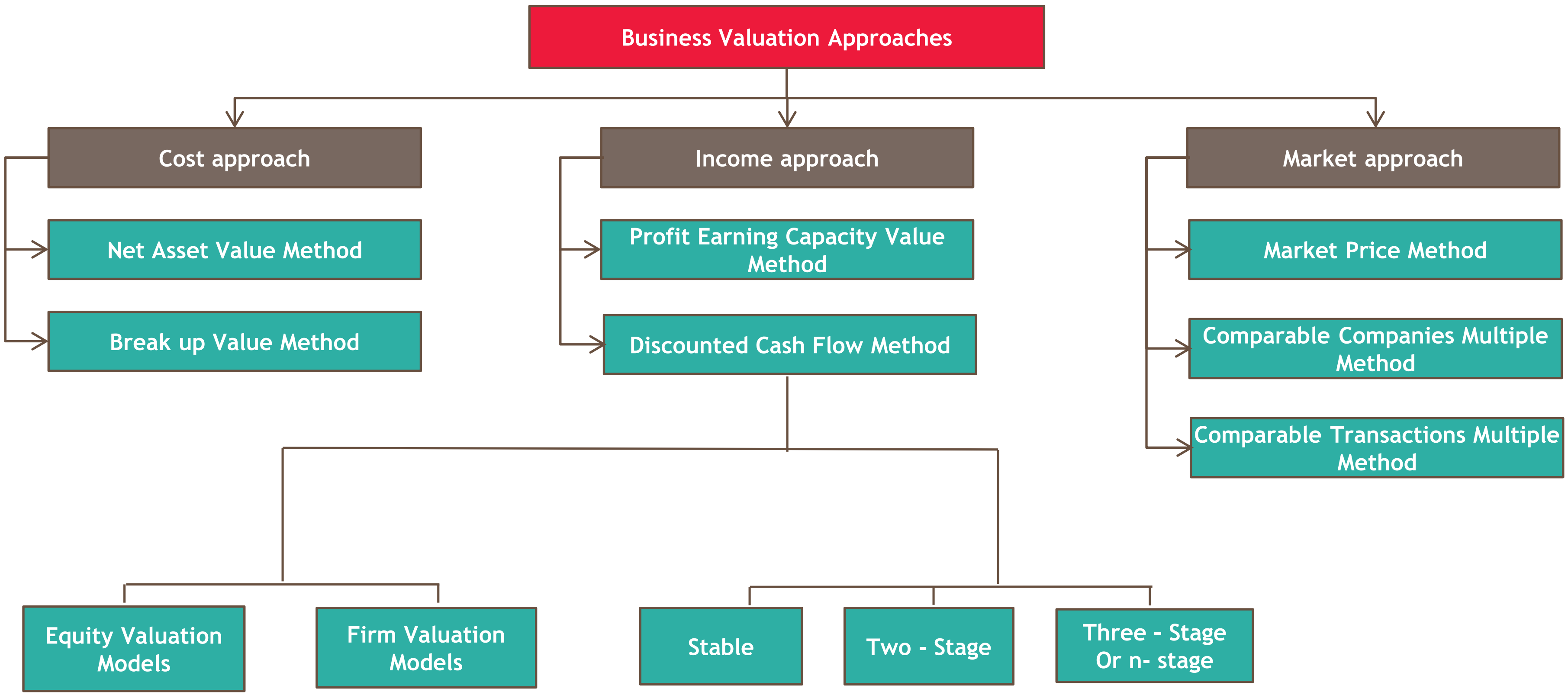
Company Analysis → Industry Analysis → Identification of key value drivers → Appropriate Valuation Method → Derivation of the Value

Globally accepted methods of valuation for determining the value of shares/business includes :

Cost Approach	Income Approach	Market Approach
• Pay not more than what it would cost to replace	• Pay not more that the present value of future returns	• Pay not more than what a comparable property could be purchased

VALUATION METHODOLOGIES

Business Valuation



COST APPROACH

The cost approach values the underlying assets of the business to determine the business value. This valuation method carries more weight with respect to holding companies than operating companies. Also, asset value approaches are more relevant to the extent that a significant portion of the assets are of a nature that could be liquidated readily if so desired. This method has the disadvantage of only considering the status of the business at one point in time.

Net Asset Value Method = Assets (incl. Intangible Assets) – Liabilities (incl. contingent liabilities)

*This method is appropriate in a case where the major strength of the business is its asset base rather than its capacity or potential to earn profits.

Break Up Value Method = Realizable value of Assets (incl. Intangible Assets) – Realizable value of Liabilities (incl. contingent liabilities)

*This Valuation approach is mostly used in case of companies where there are huge operating investments or surplus marketable investments.

INCOME APPROACH

Source of Information

Historical Results

- Past Annual Reports
- Management Discussions, Directors Reports etc

Future Projections

- Future expected profitability, balance sheet and Cash Flows
- Detailed Assumptions
- Cover entire business cycle

Management Discussions

- Not restricted to just the Finance Department
- Written representation from management

Market Surveys, Other Publications

- Public reliable data sources
- Independent Industry Research Houses

Data on Comparable Companies

- Understand industry dynamics
- Projections in line or not

INCOME APPROACH

Discounted Cash Flow (DCF) Method

DCF = Explicit Period + Terminal Value (TV) ± Adjustments = Equity Value

Explicit Period

- FCFF → EBITDA – Capital Expenditure – Incremental Working Capital - Tax + WACC* = NPV of Explicit Period
- FCFE → EBT + Depreciation-Loan Repayment -Capital Expenditure – Incremental Working Capital - Tax + Ke** = NPV of Explicit Period

TV

- FCFF = $\dfrac{\text{CFn+1}}{(\text{WACC – TVG})}$
- FCFE = $\dfrac{\text{CFn+1}}{(\text{Ke – TVG})}$

INCOME APPROACH

Discounted Cash Flow (DCF) Method

***WACC = (D x Kd + E x Ke) / (D + E)**

- Where,
- D = Debt part of capital structure
- Kd = Cost of debt (post tax)
- E = Equity part of capital structure

****Ke = Rf + B (Rm - Rf) + SCRP + CSRP**

- Where,
- Ke = Cost of equity
- Rf = Risk free rate of return (generally taken as 10-year Government Bond Yield)
- B = Beta Value (Sensitivity of the stock return to market returns
- Rm = Market rate of return (generally taken as long-term average return of stock market)
- SCRP = Small Company Risk Premium
- CSRP= Company specific Risk premium

Terminal Value = (1+g) / (WACC - g)

- Estimated Terminal Value is discounted to present day at company's cost of capital based on the discounting factor of last year projected cash flows

MARKET APPROACH

The valuation is based on the market value of the company in case of listed companies and comparable companies trading or transaction multiples for unlisted companies. The Market approach generally reflects the investors' perception about the true worth of the company.

Listed Companies

Market Price Method

The market price of an equity share of the company as quoted on a recognized stock exchange is considered as the fair value of the equity shares of that company.
However, such shares shall trade regularly and freely.

Unlisted Companies

Comparable Companies Multiples ("CCM") Method

Comparable Transaction Multiples ("CTM") Method

Valuation is determined on the basis of key multiples derived

Multiples

Earning Multiples
- PE
- EV/EBITDA

Revenue Multiples
- EV/Revenue

Industry Specific Variables

Book Value Multiples
- Price/Book Value

MARKET APPROACH

Earning Multiples	
Established organizations having stable earning	Price Earning (PE)
Companies indulged in manufacturing or engineering business	EV/EBITDA
Revenue Multiples	
Startups or Organizations in initial phase of establishment	EV/Revenue
Book Value Multiples	
Banks, Non-Banking Financial Institutions or Financial Institutions	Equity Value/Asset Size
AMC of Mutual Fund	EV/Asset under management
Industry Specific Variables	
Hospital	EV/No. of Beds
Power	EV/Capacity in megawatt
Hotel	EV/No. of Rooms
Telecom Tower Companies	EV/No. of Towers and EV/No. of Tenants

VALUATION METHODOLOGIES

Business Valuation

Asset Based Valuation

- Relates value of asset based on replacement cost or liquidation value or book value

Relative Valuation

- Estimates value of asset by looking at price of comparable assets relative to common variables like earnings, cash flows, book value, sales

Discounted Cash Flows

- Relates value of asset to Present value of expected future cash flows on asset

VALUATION METHODOLOGIES

Business Valuation - Summary

Asset Based Valuation

- Liquidation
- Going Concern an issue
- Separate and marketable assets

Relative Valuation

- No positive cash flows
- Large no. of similar assets

Discounted Cash Flows

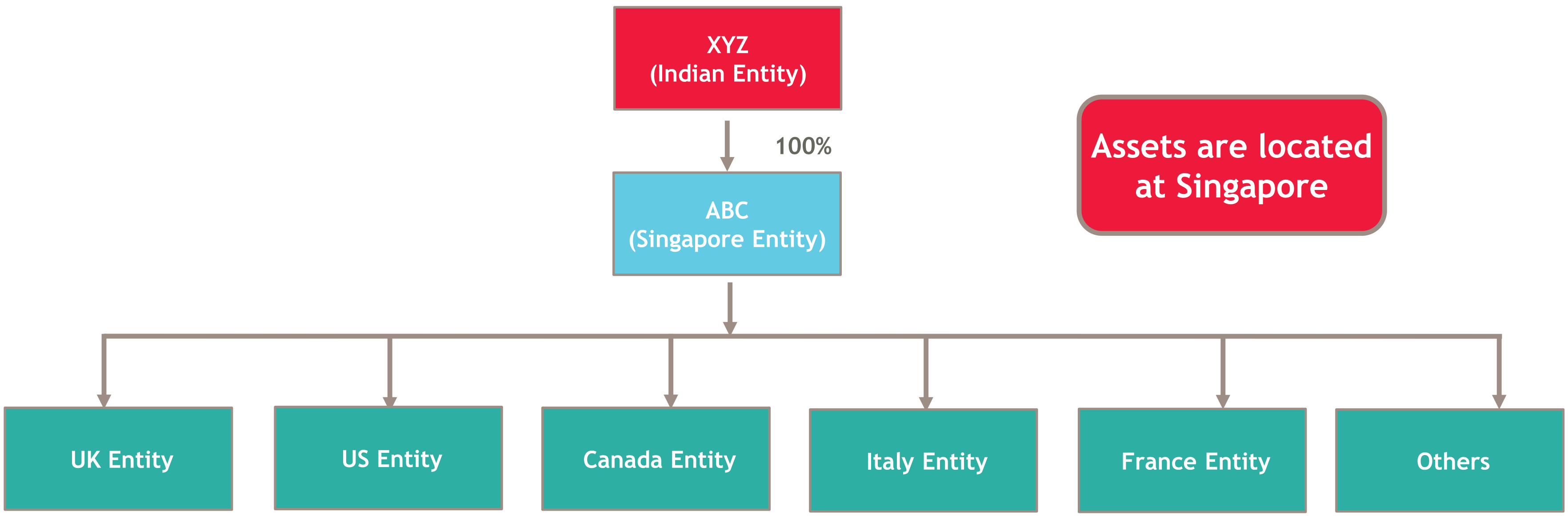
- Assets generating
- Going Concern

VALUATION METHODOLOGIES

Case Study

XYZ is an Indian Entity which is in the business of providing telecommunication services . XYZ carries out its operation overseas through investment in the foreign subsidiaries. XYZ holds 100% ownership in ABC Company, a Singapore based entity, which then invest in various foreign subsidiaries. The operation of the company is mainly carried out through these subsidiaries. Indian Operation are restricted only up to 5% of the total business at the global level. The assets of all these entities are located in say Singapore

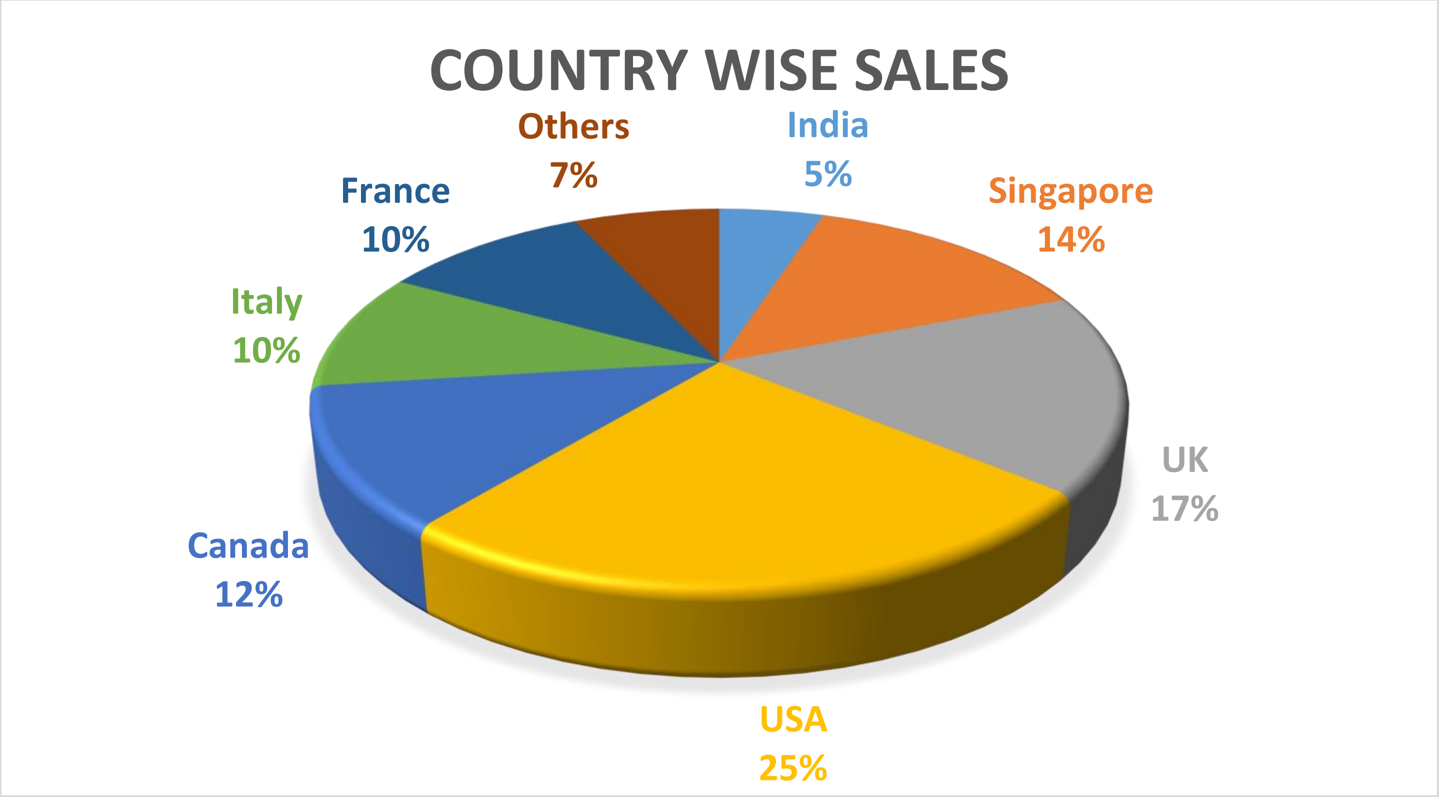
The following is the corporate structure of the entire group:



VALUATION METHODOLOGIES

Case Study

Following is the revenue contribution of each of these entities on a consolidated basis



VALUATION METHODOLOGIES

Case Study - Data Available

Particulars	Risk Premium	Beta of the comparable	Risk Free rate	Average PE Multiple (times)
India	8.8%	1.09	7.7%	8.7
Singapore	5.6%	1.7	6.5%	10.9
UK	6.2%	1.64	6.4%	7.7
USA	5.9%	1.3	5.4%	8.1
Canada	5.9%	0.67	5.0%	7.6
Italy	8.4%	0.87	8.5%	8.9
France	6.4%	0.85	7.4%	10.1

Which one to be considered ?

VALUATION METHODOLOGIES

Factors for consideration

Following are the key factors the valuer will have to decide upon while carrying out the valuation of the XYZ Company

- The Risk Free Interest Rate should be taken of which country ?
- The Comparable considered for beta calculation should be global or of a particular country ?
- While calculating the risk premium in the cost of equity, which countries risk premium should be adopted ?
- On what basis, the company risk premium of the company depends on ?
- What should be the basis of finding out the comparable companies for the purpose of carrying of relative valuation ?

VALUATION

Distress Firm Valuation

Following are the signs /consequences of the firm being classified as distressed firm

- Stagnant or Declining Revenues
- Shrinking or Negative Margins
- Asset divestitures
- Financial Leverage
- Liquidity Constraints
- Financial Restructuring
- Bankruptcy

VALUATION

Distress in Discounted Cash flow Valuation

Parameters	Particulars
Discount Rate	▪ The discount rate is used to adjust for risk in discounted cash flow valuation ▪ Riskier firms have higher costs of equity, higher costs of debt and usually have higher costs of capital than safer firms. ▪ The cost of capital for a distressed firm, estimated correctly, should be higher than the cost of capital for a safer firm.
Expected Cash Flow	▪ The expected cash flow in a year should be the probability-weighted estimate of the cash flows under all scenarios for the firm, ranging from the best to the worst case. ▪ one should estimate the expected cash flows under all scenarios and use the expected values in our valuation. ▪ The expected cash flows would be much lower for a firm with a significant probability of distress.
Beta	▪ The beta considered for adjusted to incorporate the element of distress in it. ▪ Since the distress firm have a high debt - equity ratio, levered betas that are significantly higher than regression betas
Risk Premium	▪ Additional risk should be adjusted to the cost of equity in order to arrive at accurate valuation ▪ Either the cash flows or the expected cash flows should be adjusted

VALUATION

Distress in Relative Valuation

- Revenue and EBITDA multiples are used more often to value distressed firms than the price multiples
- For firms that make heavy infrastructure investments, where depreciation and amortization is a significant charge against operating income and there are substantial interest expenses, the EBITDA is often positive while net income is negative.
- For some firms, even EBITDA is negative and revenue multiples are only multiples that yield positive values.
- There are two approach for choosing the comparable for the distress firm :
  1. In the first, the valuer compare a distressed company's valuation to the valuations of other distressed companies.
  2. In the second, the valuer use healthy companies as comparable companies, but find a way to adjust for the distress that the firm is facing.

KEY TAKE AWAYS

Thank You

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