



Valuation - Basics & Practical Aspects

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Valuation

Valuation is the process of determining the “Economic Worth” of an Asset or Liability under certain “Assumptions (properly defined)” and “Limiting Conditions (explicitly mentioned)” and subject to the “Data (MRL)” available on the “Valuation Date (key to valuation)”

Valuation Needs / Reasons

Merger/ Acquisitions/ Demerger	IPO/Issue of Securities	Preferential / QIP / IPP Issue	Conversion of Securities	Takeover	Capital Reduction
Buy-back	ESOP	IPR Valuations	Tangibles / Intangibles	Other Corporate Restructuring	Financing Needs
Ind AS	Companies Act / NCLT	Various Courts	Arbitration / Mediation	SEBI	IBC
RBI / FEMA	Income Tax	SARFAESI	Equity Research	Dispute / Litigation Resolutions	Dissolution

Regulatory Framework

Applicable Laws /
Rules

Section 247 of Companies Act, 2013

Companies (Registered Valuers and Valuation) Rules, 2017

Valuation Standards

Applicability of Provisions for Registered Valuer:

1. Companies Act, 2013
2. The Securities and Exchange Board of India (Real Estate Investment Trusts) regulations 2014
3. The Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014 - SEBI (InvIT) Regulations
4. Insolvency & Bankruptcy Code, 2016

Registered Valuer applicability under Companies Act

Specific Provisions under the Companies Act, 2013 which Require Valuation Report from a Registered Valuer

Sl. No.	Section	Particulars
1	62(1)C	Valuation report for further issue of shares
2	192(2)	Valuation of assets involved in arrangement of non-cash transactions involving directors
3	230(2)(c)(v)	Valuation of shares, property and assets of the company under a scheme of corporate debt restructuring
4	230(3)	Valuation report along with notice of creditors/shareholders meeting –under scheme of compromise/arrangement
5	232(2)(d)	The report of the expert with regard to valuation, if any, would be circulated for meeting of creditors/members
6	232(3)(h)	The valuation report to be made by the tribunal for exit opportunity to the shareholders of transferor company – under the scheme of compromise/arrangement in case the transferor company is listed company and the transferee company is an unlisted company
7	236(2)	Valuation of equity shares held by the minority shareholders
8	281(1)	Valuing assets for submission of report by liquidator

Specific provisions under Insolvency Bankruptcy Code, 2016 - Where Valuation by a Registered Valuer is mandated

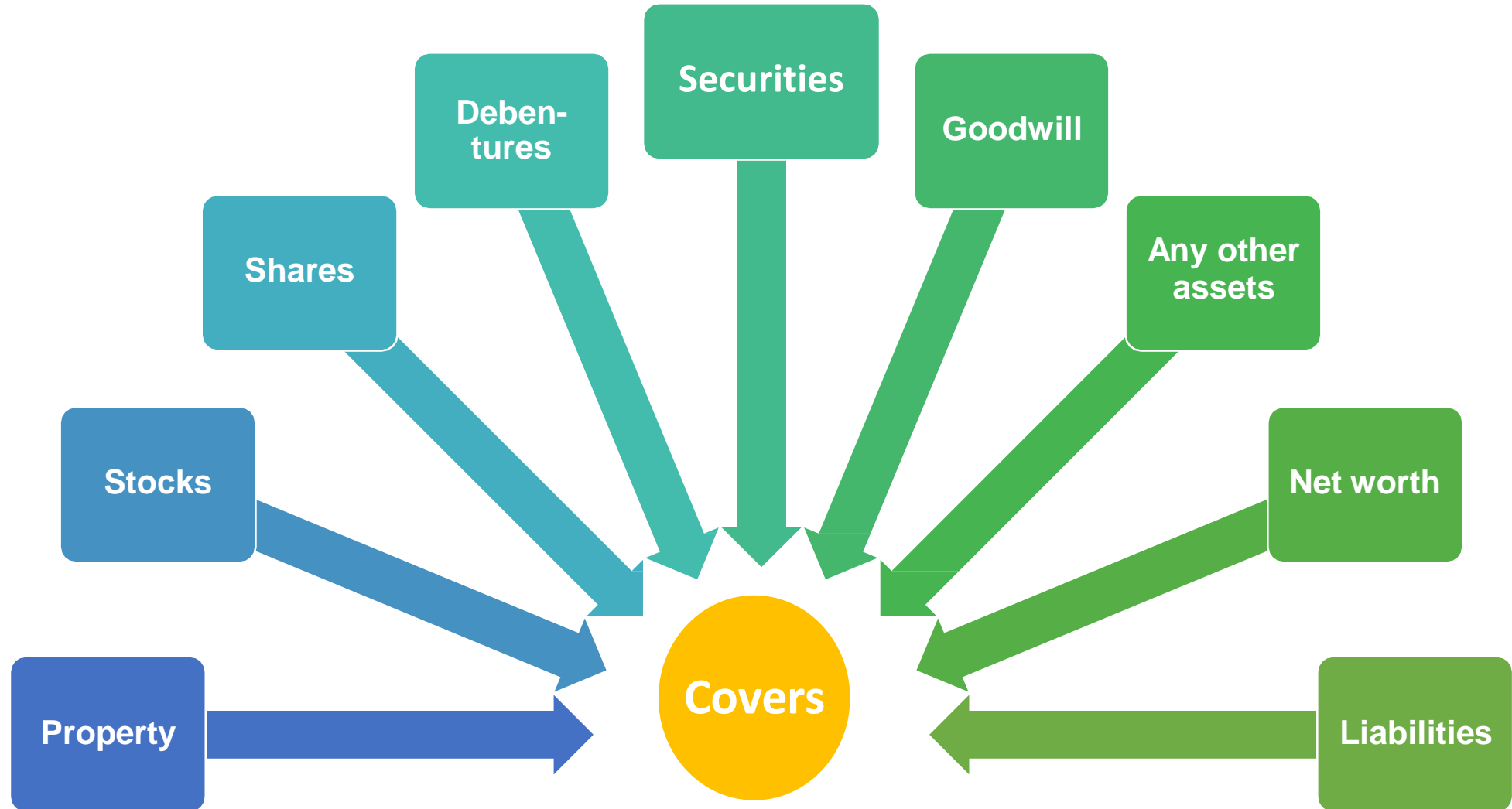
Regulation 27 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 deals with appointment of registered valuers.

It states that Resolution Professional (RP) shall within 7 days of his appointment, appoint two registered valuers to determine the fair value and the liquidation value of the corporate debtor in accordance with Regulation 35.

Under the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, 'Registered Valuer' means a person registered as such in accordance with the Companies Act, 2013 and rules made thereunder

Companies Act, 2013

Section 247 - Valuation by Registered Valuers



Valued by

- a person having such **qualifications and experience**

registered

- as a **valuer**

member

- of an **organisation recognised**

Manner, terms
and conditions

- as may be prescribed

Appointed by

- **audit committee** or
- in its absence by **BOD**

Sub-section - 2 - Duties and Obligations

make an impartial, true and fair valuation of any assets which may be required to be valued

exercise due diligence while performing the functions as valuer

make the valuation in accordance with prescribed rules

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 3 years prior to his appointment or 3 years after valuation of assets was conducted by him.

Sub-section - 3 & 4 - Contraventions of Provisions of Act and Rules

Punishment u/s 247(3)

- **Fine** – Minimum Rs. 25,000/- Maximum Rs. Rs. 1 Lakh
- **Imprisonment + Fine** = Maximum one year with fine Minimum Rs. 1 lakh and Maximum Rs. 5 Lakhs - if contravention done with the intention to defraud company or its members

Damages u/s 247(4)

- If convicted u/s 247(3), he shall be liable to:
- (i) **refund remuneration** received to the company and
- (ii) **pay damages** to the Co. or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

Companies (Registered Valuers and Valuation) Rules, 2017

Chapters & Rules:

Chapter	Chapter Name	Rules Coverage
I	PRELIMINARY	1 to 3
II	ELIGIBILITY, QUALIFICATIONS AND REGISTRATION OF VALUERS	3 to 11
III	RECOGNITION OF REGISTERED VALUERS ORGANISATIONS	12 to 14
IV	CANCELLATION OR SUSPENSION OF CERTIFICATE OF REGISTRATION OR RECOGNITION	15 to 17
V	VALUATION STANDARDS	18 to 19
VI	MISCELLANEOUS	20 to 21

Rule-1 (3) - Applicability

These rules shall apply for valuation 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 the Act or these rules.

Explanation - It is hereby clarified that conduct of valuation under any other law other than the Act or these rules by any person shall not be affected by virtue of coming into effect of these rules

Rule-2 - Definitions

Authority

- an authority specified by Central Govt. u/s 458 of Companies Act, 2013 to perform the functions under these rules

Asset class

- a distinct gr. of assets like land & building, machinery & equipment, displaying similar characteristics, that can be classified and requires separate set of valuers for valuation;

Certificate of recognition

- certificate of recognition granted to a registered valuers organisation under Rule 13(5) and the term "recognition" shall be construed accordingly

Certificate of registration

- certificate of registration granted to a valuer under sub-rule (6) of rule 6 and the term "registration" shall be construed accordingly

Registered valuers organisation

- a registered valuers organisation recognised under Rule 13(5)

Valuation standards

- standards on valuation referred to in rule 18

Valuer

- a person registered with the authority in accordance with these rules and the term "registered valuer" shall be construed accordingly

Rule-3 Eligibility for registered valuers

A person (**INDIVIDUAL**) shall be eligible to be a registered valuer if he:

- a) Is a **valuer member** of a registered valuers organisation.
- b) Is **recommended by registered valuers organisation** of which he is a valuer member for registration as a valuer
- c) Has **passed valuation examination** under rule 5 within 3 years preceding the date of making an application for registration under rule 6
- d) **Possesses the qualifications and experience** as specified in rule 4
- e) Is **not a minor**
- f) Has not been **declared to be of unsound mind**
- g) Is **not an undischarged bankrupt**, or has **not applied to be adjudicated as a bankrupt**
- h) Is a person **resident in India** as defined u/s 2(v) of the FEMA, 1999
- i) **Not convicted** for an offence **punishable with imprisonment for a term exceeding 6 months or for an offence involving moral turpitude**, and a **period of 5 years has not elapsed** from the date of expiry of sentence **Provided** that if a person has been convicted of any offence and sentenced to **imprisonment for a period of 7 years or more**, he shall **not be eligible to be registered**
- j) **Not levied a penalty u/s 271J of Income Tax Act, 1961** and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal (ITAT), as the case may be has expired, or such penalty has been confirmed by ITAT, and 5 years have not elapsed after levy of such penalty
- k) Is a **fit and proper person**

Rule-4 - Qualifications and experience

An individual shall have following qualifications and experience to be eligible for registration namely:-

Qualification

Post-graduate degree / diploma, in specified discipline, from a University or Institute established, recognised or incorporated by law in India

Bachelor's degree or equivalent, in specified discipline, from a University or Institute established, recognised or incorporated by law in India

Membership of a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession

Experience

Minimum 3 years of experience in the specified discipline thereafter

Minimum 5 years of experience in the specified discipline thereafter

Minimum 3 years experience after such membership

Rule-4 - Qualifications and experienceContd

ANNEXURE-IV - Eligibility Qualification and Experience for Registration as Valuer

Asset Class	Eligibility - Qualifications	Experience in specified discipline
Plant and Machinery	(i) Graduate in Mechanical, Electrical, Electronic and Communication, Electronic and Instrumentation, Production, Chemical, Textiles, Leather, Metallurgy, or Aeronautical Engineering, or Graduate in Valuation of Plant and Machinery or equivalent	(i) Five years
	(ii) Post Graduate on above courses	(ii) Three years
Land and Building	(i) Graduate in Civil Engineering, Architecture, Town Planning or equivalent	(i) Five years
	(ii) Post Graduate on above courses and also in valuation of land and building or Real Estate Valuation (a two-year full time post graduation course)	(ii) Three years
Securities or Financial Assets	(i) Member of ICAI, ICSI, ICAI-CMA, Master of Business Administration or Post Graduate Diploma in Business Management (specialisation in finance).	Three years
	(ii) Post Graduate in Finance	Three years

Rule	Description
Rule No. 5	Valuation Examination
Rule No. 6	Application for certificate of registration
Rule No. 7	Conditions of Registration

Rule-8 - Conduct of Valuation - Valuation Standards

(1) Registered valuer shall, while conducting a valuation, comply with valuation standards as notified or modified under rule 18

Provided that until valuation standards are notified or modified by Central Govt., a valuer shall make valuations as per:

a) internationally accepted valuation standards

b) valuation standards adopted by any registered valuers organisation

(2) Registered valuer may obtain inputs for his valuation report or get a separate valuation for an asset class conducted from another registered valuer, in which case he shall fully disclose the details of the inputs and particulars etc. of the other registered valuer in his report and liabilities against the resultant valuation, irrespective of the nature of inputs or valuation by the other registered valuer, shall remain of the first mentioned registered value.

Rule-8 - Conduct of Valuation - Contents of valuation reports

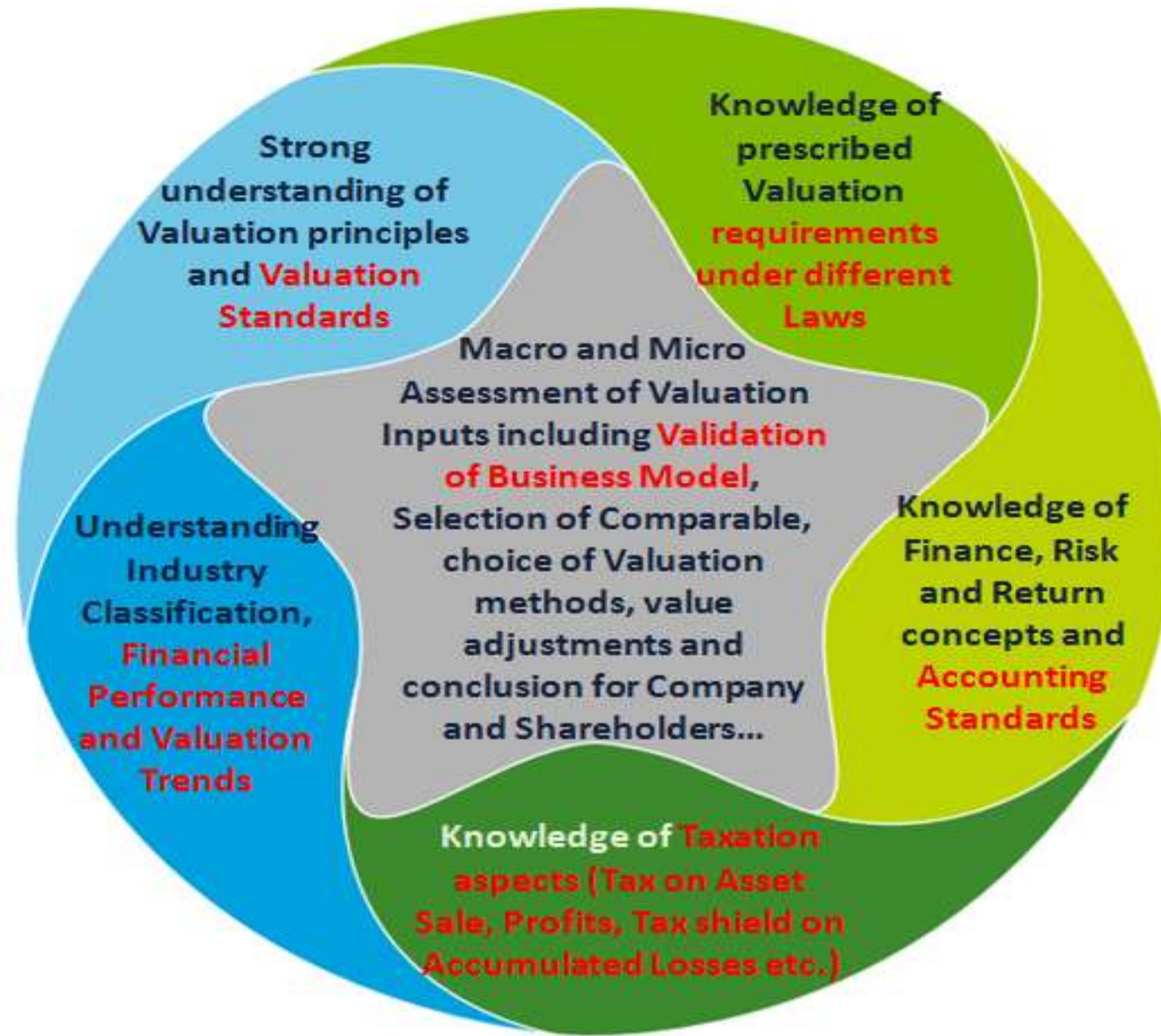
Contents of Valuation Reports

- background information of the asset
- purpose of valuation and appointing authority
- identity of the valuer and any other experts involved in the valuation
- disclosure of valuer interest or conflict, if any
- date of appointment, valuation date and date of report
- inspections and/or investigations undertaken
- nature and sources of the information used or relied upon
- procedures adopted in carrying out the valuation and valuation standards followed
- restrictions on use of the report, if any
- major factors that were taken into account during the valuation
- conclusion
- caveats, limitations and disclaimers

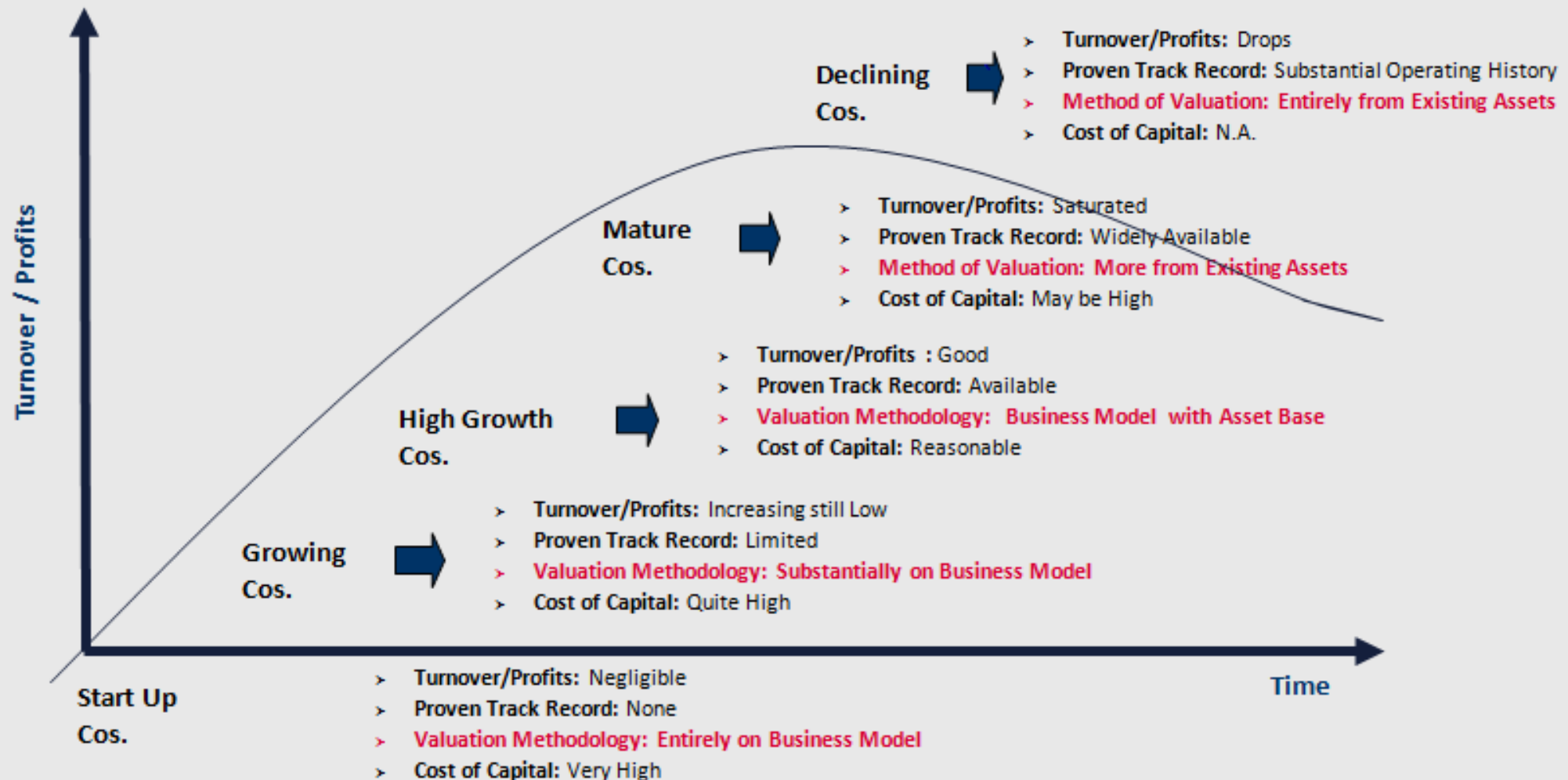
Rule	Description
Rule No. 9	Temporary surrender of Registration Certificate
Rule No. 11	Transitional Arrangements
Rule No. 12	Eligibility for registered valuers organisations
Rule No. 13	Application for recognition
Rule No. 14	Conditions of Recognition
Rule No. 18	Valuation Standards
Rule No. 19	Committee to advise on Valuation Matters

Business Valuation

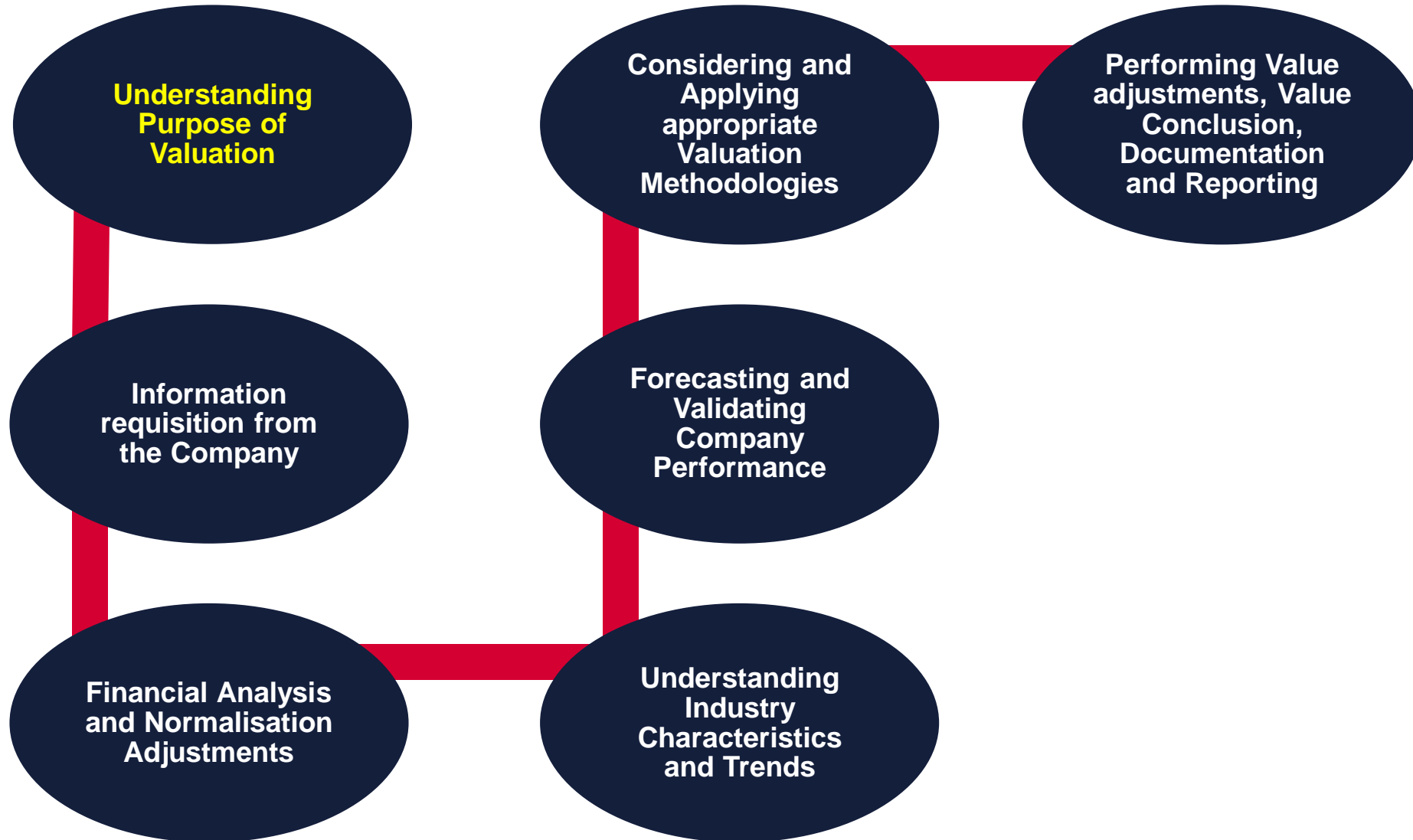
Business
Valuation is
“beyond the
numbers”



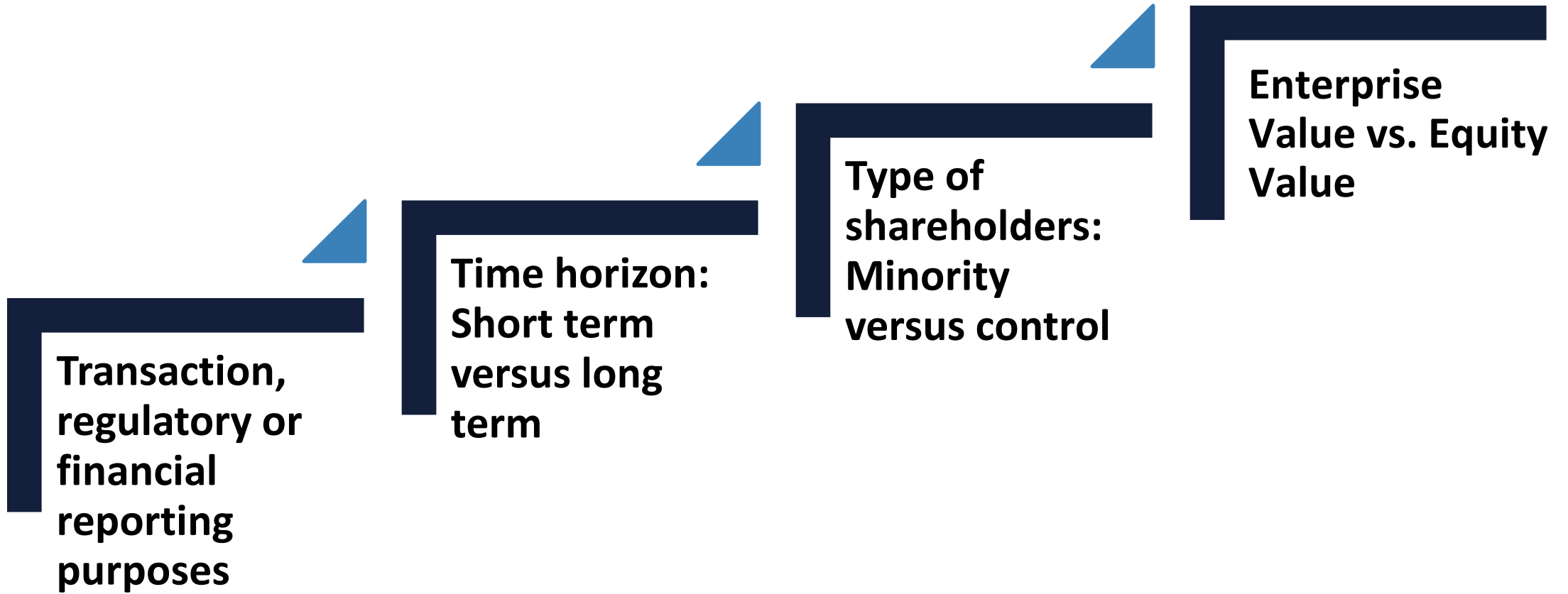
Valuation across business cycle follow the LAW of ECONOMICS



Valuation Process



Understanding Purpose of Valuation



Premise of Value

Premise of Value relates to the assumptions upon which the valuation is based.

GOING CONCERN

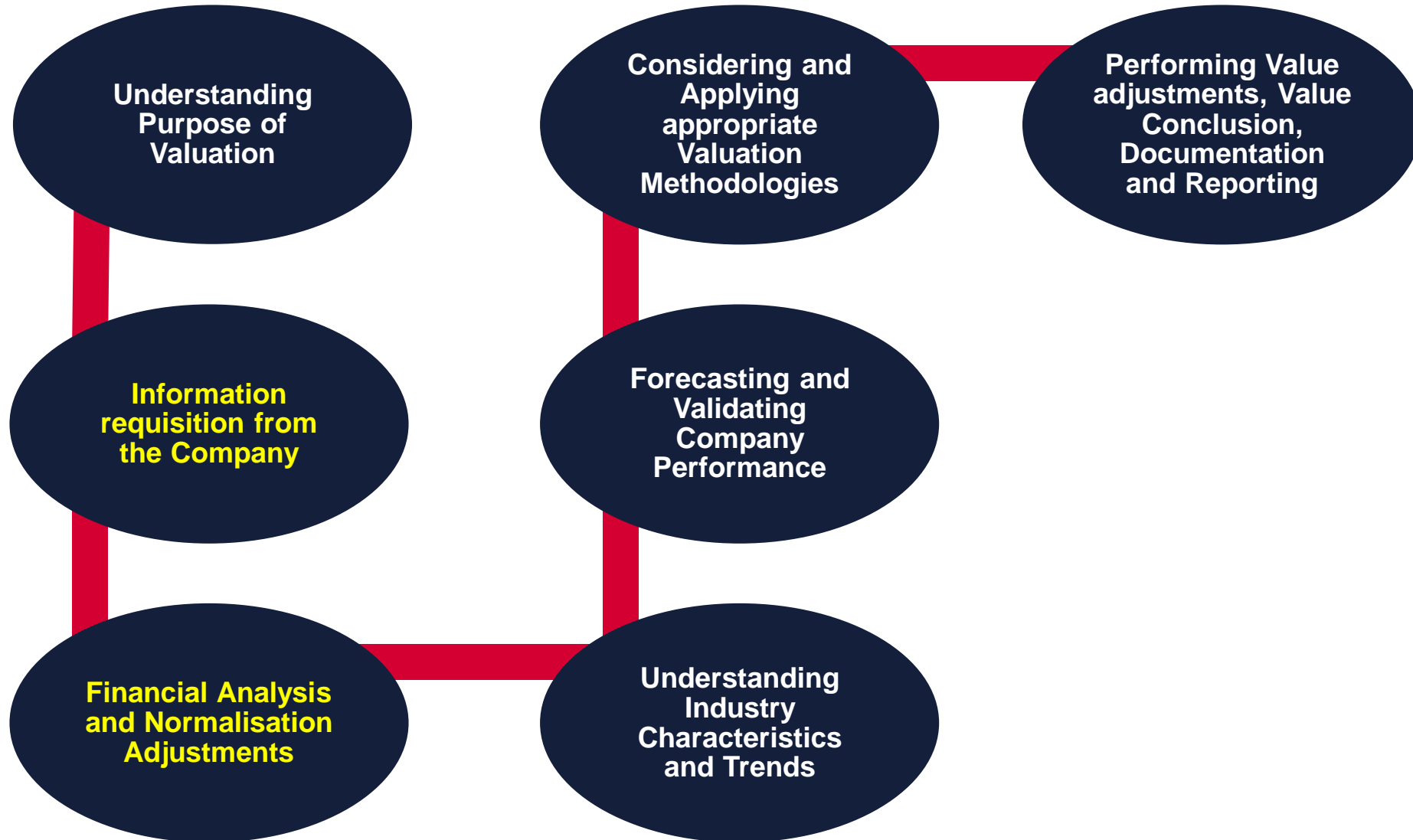
Value as an ongoing operating business enterprise

LIQUIDATION

Value when business is terminated . It could be 'forced' or 'orderly'

- **Value-in-use**
- **Value-in-exchange**

Valuation Process



Financial Analysis and Normalisation Adjustments

Analysis of the past financial performance of a company is necessary for forecasting its future performance.

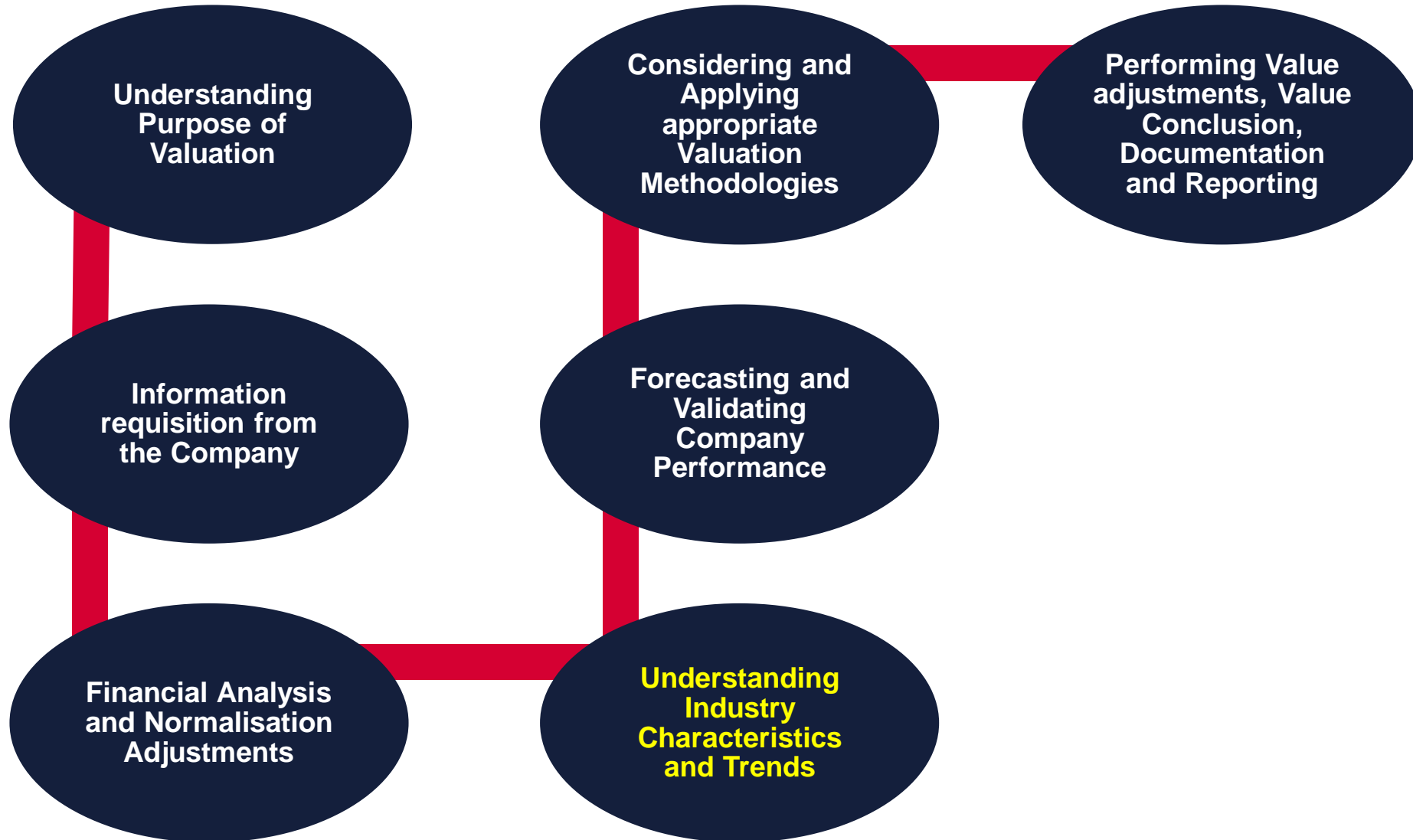
Besides financial statements, the **annual report of a company includes a lot of information considered important for analysis of the company.** This includes -

- Management discussion and analysis report (MDA)
- Independent auditor's report
- Accounting policies and disclosures
- Related party transactions
- Segment reporting and
- other aspects.

Closely held companies require significant adjustments to estimate the normalised earnings of the company (Related party transactions)

The non-recurring and non-operating items also need segregation from the financial statements

Valuation Process



Understanding Industry Characteristics and Trends

Knowledge of industry is necessary and essential for preparation and review of financial forecasts of any company

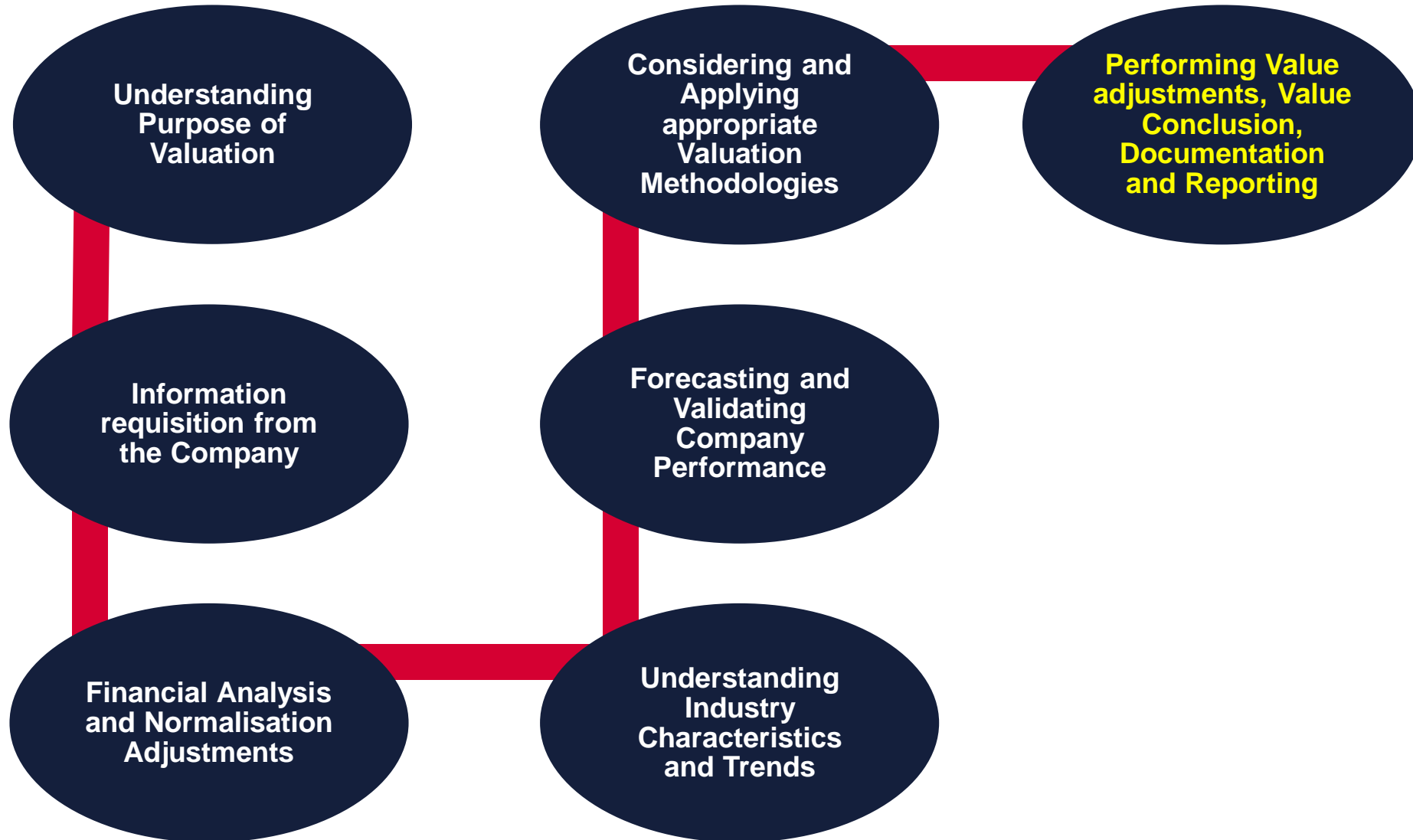
Different Industries have different risk and return characteristics and competitive advantages

Basic economic factors— supply and demand—provide a fundamental framework for understanding an industry.

While forecasting, past data does provide a basis. However, newer technology and changing government regulations have an impact on changing the business models of companies, significantly.

- **Understanding basis of classification of industries is important**
- The National Industrial Classification, 2008 (NIC) in India based on the United Nations International Standard Industrial Classification (ISIC) - economic activity wise data
- **Internationally**, for industry classification reliance is given upon Global Industry Classification Standard (GICS) developed by Standard & Poor's and Morgan Stanley - The GICS combines the companies in a sector, industry group, industry and sub-industry based on the principal product and services of the companies and their revenue contribution.
- **The S&P BSE indices in India have also made an industry classification system in line with GICS.**

Valuation Process



Performing Value Adjustments

Discounts and Premiums come into picture when there exists difference between the subject being valued and the methodologies applied. As this can translate control value to non-control and vice-versa, so these should be judiciously applied.

Discount at Company Level

The company level discounts affect the equity value of the company and are applied before any apportionment is made to the shareholders. Major types of company level discounts include the following:

- Key Person Discount
- Discount for Contingent Liabilities
- Diversified Company Discount
- Holding Company Discount
- Liquidation Discount (Tax Payout on Appreciation of Assets)

Discounts and Premium at Shareholder Level

The shareholder level discounts affect the value of specific shareholders and are applied after distribution of the equity value to the respective shareholders. Major types of shareholder level discounts include the following:

- Discount for Lack of Control (DLOC)
- Discount for Lack of Marketability (DLOM)
- Control Premium

Performing Value Adjustments

Operating Assets

- Assets used in the operation of the business including working capital, Property, Plant & Equipment & Intangible assets
- Valuing of operating assets is generally reflected in the cash flow generated by the business

Non - Operating Assets

- Assets not used in the operations including excess cash balances, and assets held for investment purposes, such as vacant land & Securities (which are not generating any operational income) are the non-operating assets.
- Investors generally do not give much value to such assets and Structure modification may be necessary

Treatment of Non-operating Assets

The value of such non-operating asset should be added separately to arrive at the enterprise value.

Different Valuation Approaches

Considering and Applying appropriate Valuation Approach



Valuation Approaches

Fundamental



**Income
Approach**

- Discounted Cash Flow Method
(Projected Time Value)

**Asset
Approach**

- Book Value Method
- Liquidation Value Method
- Replacement Value Method

Valuation Approaches

- Comparable Companies
Market Multiples
Method (**Listed Peers**)
- Comparable Transaction
Multiples Method
(**Unlisted Peers**)
- Market Value Method
(**For Quoted Securities**)

**Market Based
Approach**



Relative

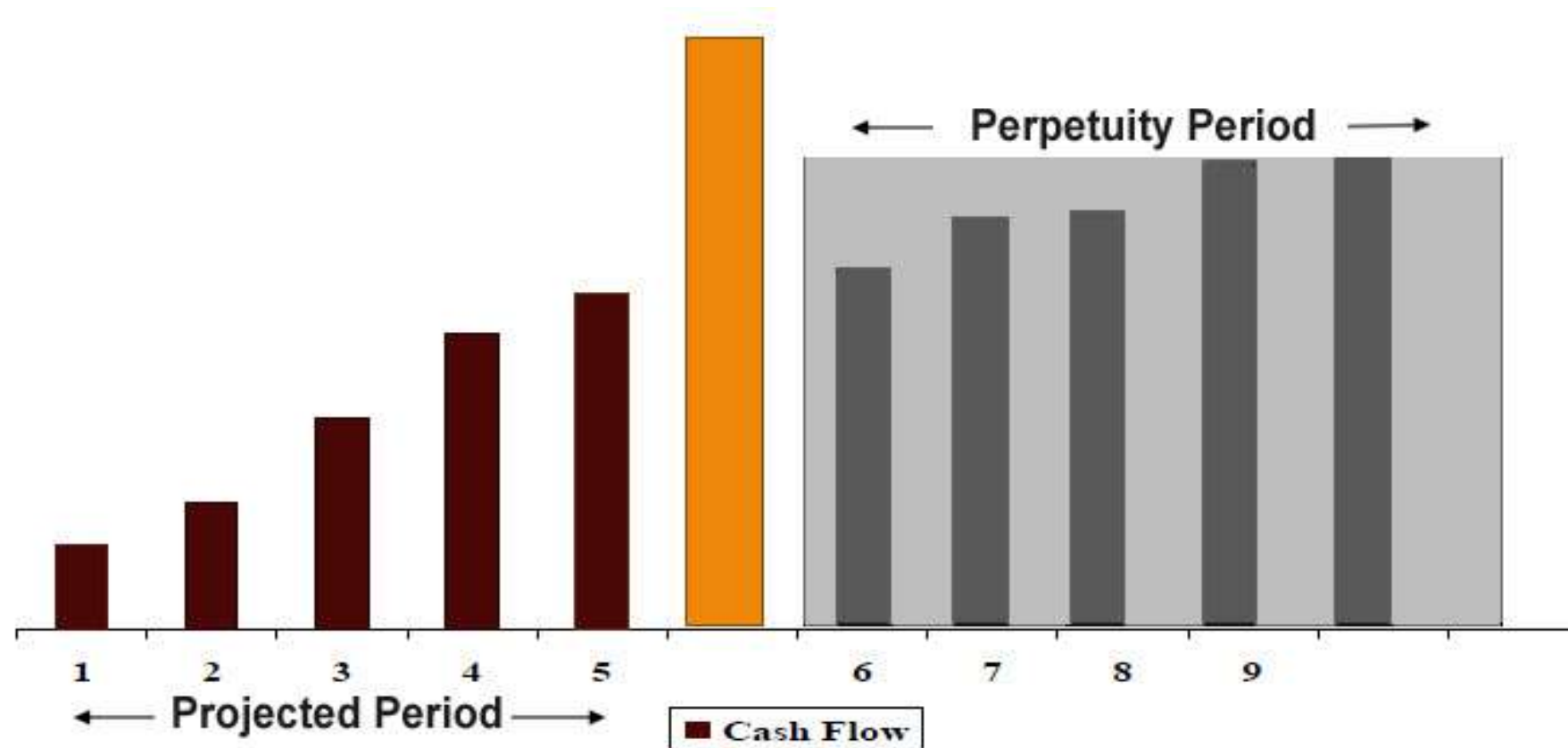
Valuation Approaches



- **Venture Capitalist Method (Start Up)**
- **Rule of Thumb (Industry wise)**
- **Relief from Royalty (RFR) Method (Intangible Asset)**
- **With and Without Method (WWM) (Intangible Asset)**

Discounted Cash Flow Valuation

Free cash flows - value trend



Terminal Value is calculated for the Perpetuity period based on the Adjusted last year cash flows of the Projected period.

FREE CASH FLOWS

Free cash flows to firm (FCFF) is calculated as

Free cash flow
calculation

$$\text{EBITDA} - \begin{matrix} \text{Taxes} \\ \text{Change in Non Cash Working} \\ \text{capital} \\ \text{Capital Expenditure} \end{matrix} = \text{Free Cash Flow to Firm}$$

Note that an alternate to above is following (FCFE) method in which the value of Equity is directly valued in lieu of the value of Firm. Under this approach, the Interest and Finance charges is also deducted to arrive at the Free Cash Flows. Adjustment is also made for Debt (Inflows and Outflows) over the definite period of Cash Flows and also in Perpetuity workings.

Theoretically, the value conclusion should remain same irrespective of the method followed (FCFF or FCFE), (Provided, assumptions are consistent).

Cost of capital calculation

DISCOUNT RATE - WEIGHTED AVERAGE COST OF CAPITAL

$$\text{WACC} = \frac{(K_d \times D) + (K_e \times E)}{(D + E)}$$

Where:

D = Debt part of capital structure

E = Equity part of capital structure

K_d = Cost of Debt (Post tax)

K_e = Cost of Equity

In case of following FCFE, Discount Rate is K_e and Not WACC

Cost of Equity

calculation

DISCOUNT RATE - COST OF EQUITY

The Cost of Equity (K_e) is computed by using Modified Capital Asset Pricing Model (Mod. CAPM)

Mod. CAPM Model

$$k_e = R_f + B (R_m - R_f) + \text{SCR}P + \text{CSR}P$$

Where:

R_f = Risk free rate of return (Generally taken as 10-year Government Bond Yield)

B = Beta Value (Sensitivity of the stock returns to market returns)

K_e = Cost of Equity

R_m = Market Rate of Return (Generally taken as Long Term average return of Stock Market)

SCR_P = Small Company Risk Premium

CSR_P = Company specific Risk premium

Terminal calculation

PERPETUITY FORMULA

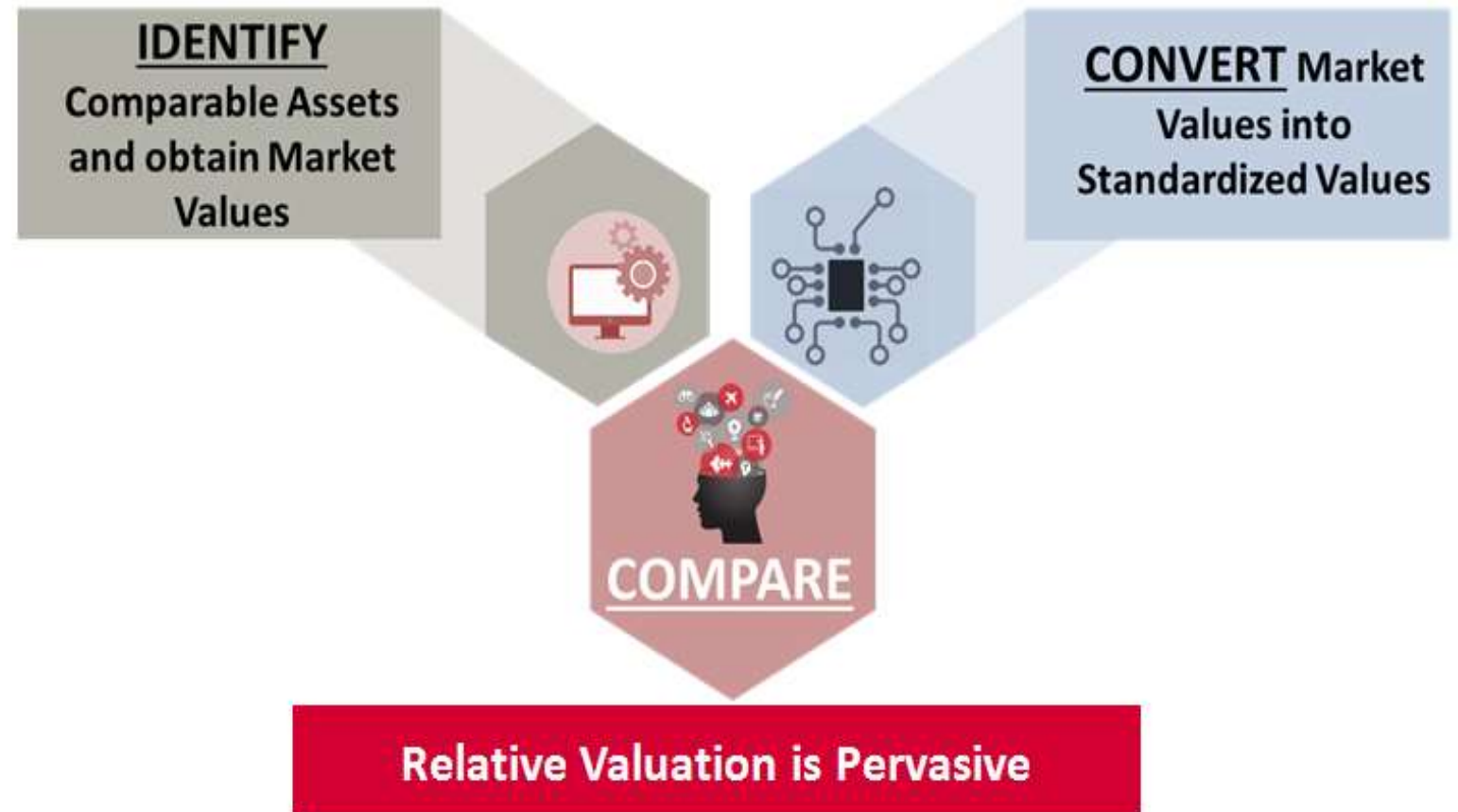
- Usually comprises a Large part of Total Value and is sensitive to small changes
- Capitalizes FCF after definite forecast period as a growing perpetuity;
- Estimate Terminal Value using Terminal Value Multiplier applied on last year cash flows
- Gordon Formula is often used to derive the Terminal Cash Flows by applying the last year cash flows as a multiple of the growth rate and discounting factor
- Estimated Terminal Value is then discounted to present day at company's cost of capital based on the discounting factor of last year projected cash flows

$$\frac{(1 + g)}{(WACC - g)}$$

IMPORTANT TIP- It is advised to do Sanity check by applying Relative Valuation Multiples to the Terminal Year Financials and also doing Scenario Analysis.

What is Relative Valuation

The Value of an asset is compared to the values assessed by the market for similar or comparable assets.



Standardizing

Value

The valuation ratio typically expresses the valuation as a function of a measure of Key Financial Metrics



Multiples can be misleading

To use a multiple you must:

- Know what are the fundamentals that determine the multiple and how changes in these fundamentals change the multiple
- Know what the distribution of the multiple looks like (Mean/Median/Outliers)
- Ensure that both the denominator and numerator represent same group
 - PE, Book Value, Mcap/Sales Multiples result in Equity Value
 - EBIT, EBITDA, EV / Sales Multiple result in Enterprise Value
- Ensure that firms are comparable (Business Model, Product Profile, Geography, Stage & Size of Business, Profitability margins, Borrowings etc. play a crucial role in finding “Comps”)

‘Valuation Approaches, globally’-
Weighted Average work out

**Income
Approach**



**Asset
Approach**



**Market
Approach**



Indian Valuation Standards

Valuation Standards	Description
Valuation Standard 101 - Definitions	This standard acts as a basic guide which prescribes specific definitions and principles which are applicable to Valuation Standards, dealt specifically in other standards.
Valuation Standard 102 - Valuation Bases	This standard deals with different types of valuation bases used in professional valuations. It also prescribes the measurement assumptions on which the value will be based and explains the premises of values .
Valuation Standard 103 – Valuation Approaches and Methods	This standard defines and provide guidance on approaches and methods for valuing an asset.
Valuation Standard 201 - Scope of Work, Analyses and Evaluation.	This standard gives us the basics for determining and documenting the scope/terms of a valuation engagement , responsibilities of the valuer and the client, the extent of analyses and evaluations to be carried out by the valuer and responsibilities of the valuer while relying on the work of other experts.
Valuation Standard 202 - Reporting and Documentation	This Standard provides the: (a) minimum content of the valuation report; (b) basis for preparation of the valuation report ; and (c) basis for maintaining sufficient and appropriate documentation.

Valuation Standards	Description
Valuation Standard 301 - Business Valuation.	This Standard provides guidance for business valuers who are performing business valuation or business ownership interests valuation. It provides the broad framework of generally accepted principles, theories and procedures.
Valuation Standard 302 - Intangible Assets.	The objective of this Standard is to prescribe specific guidelines and principles which are applicable to the valuation of intangible assets that are not dealt specifically in another Standard.
Valuation Standard 303 - Financial Instruments	This Standard establishes principles, suggests methodology and considerations to be followed by a valuer in performing valuation of financial instruments.

Thank You!

Contact

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