OVERVIEW OF VALUATION

INTRODUCTION

- The Ministry of Corporate Affairs notified the Companies (Registered Valuers and Valuation) Rules, 2017
- On 18th October, 2017,
- to implement the provisions of Section 247 of the Companies Act, 2013.
- With effect from 1st February, 2019, the business valuation and all other valuations related thereto can be carried out by only Registered Valuer.

  With this, a new and exclusive profession has emerged and it is known as Registered Valuer. MCA has assigned duty of regulating and developing the profession to Insolvency and Bankruptcy Board of India (IBBI). Initially three streams of valuation have been identified –

  (i) Land and Building;

  (ii) Plant and Machinery;

  (iii) Securities or Financial Assets.

  Syllabus, examination pattern and other nitty gritties are being taken care of by IBBI as apex authorities.

- Present position:

- Registered Valuer Organizations (RVO) -14
- Registered Valuers -3352
- RVO entities -26
- Information as per IBBI Website.

Until now, the business valuations were being carried out by varied professionals – such as

Company Secretaries,

Chartered Accountants,

Certified Valuers,

Investment (Merchant) Bankers,

Cost Accountants,

Chartered Engineers,

Empaneled Valuers and so on.

It is expected that in times to come, the Registered Valuers will get recognitions in other business laws as well.

Understanding valuation

helps in intelligent decision making.

True for both individual assets as well as for business entity as a whole.

Valuation of certain assets is relatively easier in comparison to other assets.

Possible to have set of basic principles to determine the values of all types of assets – real as well as financial assets.

What is Value:

Value is neither ‘cost’ nor ‘price’.

May be different for different people

Degree of Exactness is less as compared to cost or price.

	Cost	Price	Value
Definition	Amount incurred in the production of the goods and / or provision of services	Money or amount paid to buy the goods and/ or services.	Estimate-provided by a professional
Identification	Can be identified with a provider/manufacturer	Can be identified with a user who has exercised the option	Can be identified with a prospective user who may or may not exercise the option
Kinds			Intrinsic Value-based on Fundamental Analysis Actual Value Specific Value Investment Value Market Value Assessed Value as per Authorities Book Value Liquidation Value Salvage Value- Replacement Value-Cost of replacing Exchange Value Esteem Value say Lad Rover Synergistic Value like Cup and Saucer
Base or Basis			Valuation base refers to the type of value being used. Basis is different from base.

- Carrying out business valuation
  - challenging and complex issue.
  - Fair knowledge and grasp required of the following:
    - ➢ economy of the world and of nation,
    - ➢ industry and its changing trends,
    - ➢ accounting and taxation aspects,
    - ➢ legal regime,
    - ➢ emerging technologies and other factors

Valuation is not absolute science and is dependent upon number of varying factors like –

- purpose,
- stage of business – infancy, growing, maturity, downtrend;
- financials and regular financial burden;
- growth potential in foreseeable future;
- basic characteristics of industry and its trends;
- term - short term, medium term and long term;
- quality of management and promoters; quality of professionals, corporate governance, compliances and so on.

These complexities have led to emergence of the following:

- valuation principles and valuation theories;
- valuation approaches and methodologies;
- methods of valuation and valuation adjustments (for discounts and premiums);
- valuation standards and trends; and many more.

MEANING OF VALUE AND VALUATION

- **The meaning of the term value can be expressed:**

1. As a noun being the material or monetary worth of something.
2. As a verb defined as estimate in monetary worth of
3. In terms of market value - as a fair return or equivalent in goods, services, or money for something exchanged.

- As defined in Investopedia, the term Value is the monetary, material or assessed worth of an asset, good or service. “Value” is attached to a myriad of concepts including shareholder value, value of a firm, fair value, book value, enterprise value, net asset value (NAV), market value, private market value, value stock, value investing, intrinsic value, value-added, economic value added, value chain, value proposition and others.

- The term value is a subjective term as it differs from person to person and from time to time depending upon his or her conception about value. In our daily life we use this word interchanging it for price, cost, worth etc. It is understood as the monetary worth of something.
- Perception: Value is defined as worth of the goods and services. It is determined by the person who seeks the perceived value. Value is something that the beholder holds in his eyes. It is a function of usefulness of commodity, severity of needs, and availability of things for satisfaction and above all easy to market or transfer. Thus value is influenced by the time, place and purpose. Value is degree of desirability to have the product or services.
- Different in personal and business perspective : A person will take the decision based on his needs, and use / esteem value of the products or service and availability of funds at his disposal. Usefulness of product or service drives the value. But in commercial world, the needs differ. Hence decision to buy or sell will depend upon revenue that can be generated and not on desired esteem value. In that sense value in the context of end consumption and value in the context of inputs to business / commerce will have different perceptions and applications.

- Fair value of closely held security is determined by what a willing buyer is ready to pay to a willing seller whereas fair value of listed security is its market value on which it has been traded at particular time on a particular date.
- Intrinsic value is something different. It refers to the perceived value of a security based on future earnings or some other company attribute unrelated to the market price of a security. On the basis of analysis, the valuer is able to determine whether a company or asset is overvalued or undervalued by the market.

PREMISES OF VALUATION

❑Primary Premises of Valuation:-

- The International Glossary of Business Valuation Terms ("Glossary") defines premise of value as "an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation." There are two main premises of Value in Business Valuation:
- **Going Concern Valuation** and Liquidation Valuation.
  - The Glossary defines Going Concern Valuation as "the value of a business enterprise that is expected to continue to operate into the future.
  - Has both Tangible and Intangible Elements: The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant and the necessary licenses, systems and procedures in place." This concept is based on the assumption that a business enterprise is expected to continue operations into perpetuity.

- Liquidation Valuation – The Glossary defines liquidation value as "the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either 'orderly' or 'forced/stressed .' Orderly liquidation value refers to the situation in which the asset or assets are sold over a reasonable period of time to maximize liquidation value whereas in forced /stressed sale , liquidation value of the asset or assets is lower as the assets are sold as quickly as possible."(Aaj hi Bechunga)

❑Other Premises of Valuation

- **Fair market Value in Continued Use (for going Concern)** – The estimated amount, expressed in terms of money, that may be reasonably expected for a property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, as of a specific date and assuming that the business earnings support the value reported. This amount includes all normal direct and indirect costs, such as installation and other assemblage costs to make the property fully operational. Intention is to operate at the same location.

- **Fair market Value (FMV)** – Removal – The estimated amount, expressed in terms of money, that may be reasonably expected for a property, in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, as of a specific date, considering the cost of removal of the property to another location.
- **Value in exchange** – Akin to barter . Value is assumed as exchange of business, business interest or property. Some sort of hypothetical transaction is assumed in the valuation. The FMV or market value and the fair value standard to a very limited exchange can be categorized under value in exchange premise.
- **Value in use** – This premise contemplates value assuming that assets are engaged in generation of income.
- **Value in place** – This premise contemplates value assuming that assets are ready for use but not engaged for generating income.
- **Value to the specific holder** – This premise contemplates the value in the hands of a particular or specific buyer or holder of the assets. Marketability is not the criteria in this place. The investment value falls under the premise of value and in certain cases even fair value.

PURPOSE OF VALUATION

❑Purpose of Value:-

Business valuation is carried out to know the business and helps in strategic decision making. Appropriate purpose for valuation becomes the bases of valuation .This decision may be related to following:

1. **Strategic Partnership, Joint Venture and Collaborations** – Valuation is needed while evaluating decision on Strategic Partnership or Joint Venture or Foreign Collaboration. These have potential to give competitive edge over others in the form of advanced technology or production processes, additional finance, expanding customer base, reengineering of existing product, new products or services, intensive and extensive market coverage.

2. **Merger**, acquisition or take over so that interested party can obtain fair market value – Predominant Objective is important.
   A Party who enters into a transaction with another for acquiring a business would like to acquire a business as a going concern for the purpose of continuing to carry the same business, might compute the valuation of the target company on a going concern basis.

On the other hand, if the intention of the acquirer is to acquire any property such as land, rights, or brands, the valuation would be closely connected to the market price for such property or linked to the possible future revenue generation likely to arise from such acquisition. In every such transaction, therefore, the predominant objective in carrying out a valuation is to put parties to a transaction in a comfortable position so that no one feels aggrieved.

2. **At the time of Peaceful Exit** – Valuation is required to be worked out at the time of resolving the disputes among stakeholders; purchase of equity from dissenting shareholders; stake sale or exit by co-venturers, strategic partners, foreign collaborator or strategic investors; divestment by existing promoters in favour of strategic investors.

4. **ESOP, ESPS and Employee Retention** – These are various tools to retain employees for longer period. ESOP is incentive arrangement made by employer for retaining its key employees by allowing them to purchase the shares of company at a fixed price on the date of the grant. In this waiting period is known as 'vesting period' and the period in which ESOP can be availed by the employee is known as 'exercise period'. Certain percentage of shares is kept in ESOP trust fund until the option to buy share is exercised by the employee. If the employee leaves the company or his services are terminated before the completion of vesting period, then he loses the options to buy the share at pre-decided price which is usually less than market price at the time of exercise period. Lapsed options cannot be converted into shares. ESOPs are taxable at the time of purchase of shares as salary income (perquisites) in the hands of employees. Difference in fair market price and issued price is taxable as salary on the date of issue of shares whereas difference between actual sale price and fair market value is taxable as capital gain in the hands of employees.

5. **Specific Situations** – Minority oppression cases, economic damages computations, ownership disputes, cases of insolvency and bankruptcy, breach of contract, during submission of resolution plans, during liquidation and winding up, as part of succession planning, the death or disability of the owner;
6. **Under Company Law provisions** – Valuation is mandatorily required at the time of further issue of shares; issue of shares for consideration other than cash; private placement of shares;
7. **Under Other Laws** – Valuation is required to be carried out under various laws in various situations. Regulations and Rules issued under various Acts have situation specific requirement for valuation SEBI Act, Foreign Exchange Management Act (FEMA), Income Tax Act, Customs Act, Stamp Duty Act, IBC Code, 2016.
8. **At the Time of Debt Funding** – At the time of business loans and debt funding, valuation is required to be worked out for the purpose of assessing security cover and need of funds of the business.

9. **For Insurance Coverage** – Valuation of asset for insurance cover need to be carefully assessed so that, on side it covers the damage to the fullest extent possible and on the other insurance premium is not in excess. In the matter of insurance, valuation is twin edge sword. Over valuation is harmful because it results into higher premium whereas under valuation is equally harmful as it will lead to exposed coverage in case of accidental damage to the assets.
10. **Court Directed Valuations** – Some times, business valuations are carried out as per the directions of the court. NCLT issues directives and appoint valuers in the matters of oppression and mismanagement. High Courts appoints valuers to resolve disputes and in winding up matters. ITAT and other tribunals may also engage Valuers in certain situations.
11. **During winding up process** – The business assets are valued by the office of Official Liquidators. They are attached to High Courts. In Insolvency and Bankruptcies, Valuers are appointed by IRPs and RPs to carry out valuation on Insolvency commencement date. In liquidation, company liquidators are required to appoint Valuers to carry out valuation on liquidation commencement date.

In case of voluntary winding up, company Board is required to engage valuer before issuing solvency certificate

12. **For IPO and FPO** – Valuation of securities is required to be worked out at the time of listing of securities of the company. SEBI is regulatory authority. Under various regulations, SEBI has prescribed the requirement of valuation as well as valuation methodology.

Homework: Please insert the relevant Sections of Company Law , IBC, Income Tax, FEMA etc./SEBI Regulations against each of the above points.

VALUATION STANDARDS

- Valuation standards are yet to be issued by the Central Government. As per Rule 8, during this intermittent period (until valuation standards are notified or modified), the valuer is supposed to follow:

i. Internationally accepted valuation standard

ii. Valuation standards adopted by any registered Valuers organization

- Rule 17 of Companies (Registered valuers and valuation) Rules, 2017 empowers Central Government to notify as well as to modify the valuation standards on the basis of recommendation of the committee set up by the central government under Rule 19.

- “Committee to advice on valuation matters” has already been constituted by the Central Government. This committee is chaired by Sh. R Narayanswamy, Professor, Finance and Accounts of IIM, Bangalore. The committee comprises members from Ministry of Law and Justice, IBBI, Ministry of Corporate Affairs, CBDT, RBI, SEBI, IRDAI, IOV RVO, ICSI RVO, CII, FICCI, etc. The committee also carries the mandate “to make recommendations to the Central Government on formulations and laying down of valuation standards and policies for compliance by companies and registered valuers.” This can be expected that soon India will have its own valuation standard.
  Link for a quick snapshot of Draft Valuers Bill,2020 in 30 minutes flat is https://www.youtube.com/watch?v=1OMhx6ay8Ww

❑ **Some of the internationally accepted valuation standards are:**

1) **International Valuation Standards (IVS):** the standards are issued and adopted by The International Valuation Standards Council (IVSC). IVSC is headquartered in London. IVSC is an independent; not- for-profit organization promoted by United Nations; and is global standard setter for valuation practice and the valuation profession.

- The International Valuation Standards (IVS) are standards for undertaking valuation assignments using generally recognized concepts and principles that promote transparency and consistency in valuation practice. Complete text of IVS series is available at http://www.cas.org.cn/ docs/2017-01/20170120142445588690.pdf. The international valuation standards are:

i. IVS 101 – relates to 'Scope of work'

ii. IVS 102 - relates to 'Investigations and Compliance'

iii. IVS 103 – relates to 'Reporting'

iv. IVS 104 - relates to 'Bases of Value'

v. IVS 105 – relates to 'Valuation Approaches and Methods'

vi. IVS 200 – relates to 'Business and Business Interests'

vii. IVS 210 – relates to 'Intangible Assets'

viii. IVS 300 - relates to 'Plant and Equipment'

ix. IVS 400 – relates to ‘Real Property Interests’

x. IVS 410 - relates to ‘Development Property’

xi. IVS 500 - relates to ‘Financial Instruments’

2) **International Private equity and Venture (IPEV) Valuation guidelines, 2015:** These guidelines are applicable to Alternative Investment Funds (AIF) also known as “Private Equity Funds”. These guidelines are useful in reference to seed capital, start up venture capital, buyouts, growth capital, development capital, credit line and other financial instruments held by such entities. IPEV Valuation guidelines also help in valuing investments by other entities like daughter funds (fund of funds). These guidelines are in harmony with fair value principles in IFRS, US GAAP and IVSC. Complete text of IPEV valuation guidelines is available at http://www.privateequityvaluation.com/Portals/0/Documents/ Guidelines.

3) AICPA (American Institute of Certified Public Accountants) accounting and valuation guide is useful in valuations. The Guide provides practical tools for valuing portfolio company investments. It also provides an overview and understanding of the valuation process and the roles and responsibilities of the parties to the process. Complete text of practice guide is available at official website of AICPA i.e. www.aicpa.org.

4) European Valuation Standards are issued by European Valuation Standards Board (EVSB). EVS has prescribed five standards for valuation and updated version was issued in 2016. These are:

i. EVS 1 relates to Market Value

ii. EVS 2 relates to Valuation Bases Other than Market Value

iii. EVS 3 relates to the Qualified Valuer

iv. EVS 4 relates to the Valuation Process

v. EVS 5 relates to Reporting the Valuation.

Complete text of EVS is available at
https://www.ipav.ie/sites/default/files/blue_book_evs_2016.pdf

❑RVO adopted Valuation Standards are:

- The ICAI Valuation Standards have been issued by ICAI Valuation Standard Board. The series of standards comprises of IVS-101, 102, 103, 201, 202, 301, 302, 303 (totaling eight) till date and these are applicable w.e.f 1st July, 2018. The ICAI has assigned two tasks to Valuation Standards Board' – framing of valuation standards' and issuance of guidance material on standards. Complete text of valuation standards is available at
https:// resource.cdn.icai.org/51432vsb41162.pdf

A Quick Recap of Basic Concepts of Valuation

- ❖Introduction
  - ❖Governing Section:
    - ❖Section 247 and Companies (Registered Valuers and Valuation) Rules 2017
  - ❖W.e.f 1st Feb 2019,Valuation only by a registered valuer.
  - ❖Regulator: IBBI
  - ❖Three types of Valuation: Land and Building, Plant and Machinery, Securities or Financial assets
    RVOs,RVEs and RVs
    Draft Valuers Bill,2020
    http://www.mca.gov.in/Ministry/pdf/Notice_14042020.pdf

- Premises of Valuation
    - Primary Premises-Going Concern Valuation, Liquidation Valuation,
    - Other Premises-FMV in continued Use,FMV in case of Removal, Value to the specific holder etc.

- Purpose of Valuation
    - Merger,Acquisition,Takeover
    - Strategic Partnership, Joint Venture and Collaboration
      ESOP and employee retention
    - At the time of Peaceful Exit
    - Specific Situations-IBC, Liquidation, Winding up etc.
    - Mandatory under Company Law: IPO, FPO, issue of shares for consideration other than cash, private placement
    - Under Other Laws: Income Tax, FEMA, Customs etc.
    - For Insurance Coverage
    - Court Directed Valuations
    - During Winding Up
    - At the time of Debt Funding

- Valuation Standards
  - International Valuation Standards-General VS 101 to 105.Asset Specific VS-210,300,400,410,500
  - IPEV Guidelines
  - AICPA Guide
  - European Valuation Standards
  - RVO adopted Valuation Standards

- Valuation Engagement-Scope of Work
    - Valuation Engagement-Results in a conclusion of value which is basically an opinion. Two types-Detailed Report and Summary Report
    - Calculation Engagement-In IBC, two or more valuations are to be carried out and an average taken for decision purposes.
    - Fairness Opinion(Valuation Review)Engagement-Akin to Peer Review, it involves review of work of another valuer.
- Valuation Process-Enquiry, Engagement, Action , Site Visit, Documentation , Report
- Valuation Report
    - Mandatory Contents-Background Information of the asset being valued , Purpose of Valuation, Identity of Valuer and other experts, Disclosure of Interest if any , Date of appointment , valuation date and date of report, Sources of Information, Procedure and Methodology , Caveats, Limitations and Disclaimers
    - Additional Contents-Projected Financials, Analysis , Confirmation that it is as per applicable standards etc.
    - Contents of review report as per IVS 103-Scope of Work, Assumptions , Date of RR, Conclusion of the Reviewer

- ❖Valuation Documentation-Valuation papers and Back up papers for 3 years. Ideally for 8 years.
  - ❖Indicative List includes Proposal, acceptance, copy of Board Resolution, Engagement Letter, NDA, Financial Information, Non-Financial Information, declaration by Management for informational gaps, Source of Third Party information, Calculation ,tools used etc.
- ❖Documentation Retention-As per applicable legislation. By both Valuers and client party
- ❖Penal Provisions-As per Section 247(3) and (4)
  - ❖Procedural Contravention-Fine Rs.25000 to Rs.100000
  - ❖Intention to fraud-Imprisonment upto one year and fine Rs.100000 to Rs.500000
- ❖Effect of Conviction
  - ❖Refund of Fees
    Pay damages to affected party

Basic Concepts of Valuation

- Total enterprise value (TEV) means the actual economic value of a company at a given point of time
- Market capitalization means the market value of all outstanding shares
- There are three approaches to business valuation:
  - Discounted cash flow valuation
  - Relative valuation
  - Contingent claim valuation
- The discounted cash flow valuation relates to the value of an asset to the present value of expected future cash flows on that asset
- Relative valuation means estimating the value of an asset by looking at the pricing of 'Comparable' assets relative to a common variable like earnings, cash flows, book value or sales
- Contingent claim valuation means using option pricing models to measure the value of assets that share option characteristics

- The factors responsible for uncertainties in business valuation are:
  - Macro-economic factors
  - Business cycle, its growth potential in the industry in which it operates
  - Competitors position in the market
- Book value is an accounting concept. It implies historical assets less outside liabilities
- Intrinsic value represents the true or real value on the basis of an analysis of fundamentals without considering the prevailing price in the market
- Common valuations errors:
  - The purpose of the valuation report is not specified
  - The standard of value not mentioned
  - Valuation report does not consider the premise of value
- Internal factors that affect the valuation:
  - Consistent dividend payment track record
  - Market for the products and goodwill of the firm
  - Industrial relations and reputation of the management

- External factors that affects the valuation:
- Stability in the economy
- Stable Government
- Taxation
- The fundamental basis for valuation are :
- Cash flows
- Returns
- Operational variables
- The assets based approach of valuation can be measured by method of the liquidity value and the replacement cost
- The equity value of a company is the value of the shareholders claims in the company whereas, the enterprise value of a company denotes the value of the entire company to all its claim holders
- Basis for discounted cash flow valuation:
- To estimate the life of the asset
- To estimate the cash flows during the life of the asset
- To estimate the discount rate to apply to these cash flows to get present value

- Distinct ways to categorize the discounted cash flow model:
  - Going concern vs asset valuation
  - Equity valuation versus firm valuation
  - Variations on DCF models
- Cash value added (CVA) is the excess of cash generated over and above the requirement of cash
- Cash value added can be calculated as:

  Cash value added= operating cash flow-operating cash flow demand
- Operating cash flow is calculated as:

  Operating cash flow(OCF) = EBITDAI + Increase in working capital – Non-strategic Investments
- Cash flow return on investment is calculated as:

  Sustainable cash flow/Cash invested
- Relative value of growth(RVG) can be calculated as:

  Value of 1% growth(VG)/value of 1% improvement in margin(VM)
- Limitations of EVA method of firm valuation:
  - Needs calculation of invested capital for every year which depends on valuation issues
  - Economic profits as excess returns are fairly subjective, depending on the valuation of invested capital
  - Economic profit framework may provide data including illusionary accuracy of the quantified business plan

- Beta is the measure of equity risk relative to market portfolio
- When beta =1, it means Average risk investment
- When beta>1, it means above Average risk investment
- When beta<1, it means below Average risk investment
- When beta=0, it means Riskless investment
- Cost of debts depends upon:

- The general level of interest rates
- The credit risk premium
- The firm’s tax rate

- Weighted average cost of capital (WACC) is the rate that a company is expected to pay to all its capital owners to finance its assets. It is the minimum return that a company must earn on an existing asset base to satisfy its creditors, owners, and other providers of capital. If this is not met, they would need to invest elsewhere
- Valuation is often a combination of cash flow and time value of money.
- Book value is the historical value
- Liquidation value is the net amount that can be realized if the business is terminated and the asset are sold piece-meal

- Return on equity investment is calculated by:

  Cash flow + (Closing market price – Opening market price)/opening market price

- Discounted cash flow analysis determines:

  - A company's current value according to its estimated future cash flows

- Valuation is the process of determining the present value of assets
- The Indian valuation standards (Ind VS) have been issued by the ICAI.

VALUATION ENGAGEMENT- SCOPE OF WORK

- Valuation engagements for business valuation have very vast scope of work. This scope of work is going to increase in times to come. With more maturity and diversity in Indian economy, the scope of work will increase. Basically three types of services are provided under valuation engagements:

I. Valuation engagement –

According to the AICPA, a valuation engagement results in a "conclusion of value," which is basically an opinion on the value of the business or ownership interest. Analyst has to estimate value of subject interest by applying all the valuation approaches and methods (i.e. asset-based, income-based and market-based) appropriate for the situation and exercise appropriate professional judgement under the circumstances that results in conclusion of value .

- In Valuation engagement there are two levels of services:

a) **Detailed Report** – In depth analytical report is prepared giving detail of the sources, application, of data structured information, reasoning of conclusion value by valuation expert.

b) **Summary report** – Summary format containing the main points of the detailed report.

II. **Calculation engagement-**

The valuation professional and client must agree in advance before taking up the valuation assignment on the scope, approaches and methods and the extent of procedures that will be used to calculate the value of a business or interest. They may agree upon the result of the value under this calculation. Since the scope is very limited the resultant value may differ if full and detailed valuation is undertaken. In insolvency cases, two or more valuations are carried out and an average of the values is taken for decision purposes.

III. Fairness opinion (Valuation Review) Engagement

In fairness opinion engagement, the valuer reviews the work of another valuer and gives his opinion about efficacy of the valuation. Such engagements are also known as review of valuations.

- **Characteristics of Effective Valuer:**

a) Knowledge of valuation requirements under various laws

b) Thorough understanding of valuation principles, approaches and methodologies; valuation standards, accounting standards and valuation rules; Valuation formulas, methods and their application

c) Grasp on macro-economic environment, global and national trends on industry and commerce

d) Effective knowledge of changing business environment, legal and regulatory requirements,

e) Updating about valuation related laws, rules, code of conduct, penal provisions, judicial pronouncements and other requirements;

f) Analytical ability about commercial agreements and contracts; annual financial statements; financial data and projections; likely impact of global, national and industrial trends on company / business entity;

g) Expert knowledge of sectoral dynamics; ‘rule of thumb’ of various industries; valuation process, code of conduct, formats and documentation involved in valuation

h) Knowledge of taxation aspects, regulatory aspects, taxation aspects

i) Awareness about market multiples in reference to listed companies; recent deals and transactions in reference to unlisted entities, new and emerging industries and ‘rule of thumb’ for various industries; changing dynamics and technologies in various industries; industrial trends and latest developments.

VALUATION PROCESS

- The business valuation involves analytical application of historical and future attributes of business. The Valuation process involves the following steps:

1) Enquiry from client followed by collection of elementary information further followed by submission of proposal for valuation
2) Receipt of intimation about appointment as valuer along with copy of resolution passed in either audit committee or Board.
3) Signing of valuation engagement letter. This shall contain:

a. Define valuation assignment with terms and condition;
b. Effective date of valuation;
c. Purpose of valuation;

d. Intended use of report;
e. Nature of engagement – valuation engagement or calculation engagement or fairness opinion;
f. Standards and premises of valuation;
g. Methods and techniques of valuation to be used along with the reasoning;
h. Type of asset or liability and how it is used or classified by the client;
i. Material involvement of valuers or independent status of valuers;
j. Nature of business;
k. Applicable laws rules and regulation;
l. Using help of other experts and the extent of reliance placed upon their reports;
m. Fundamental assumptions underlying in the report;

n. Special assumptions (if any) and limitation / reservation;
o. Special instructions;
p. Departures;
q. Hypothetical condition used in the assignment;
r. Deliverables / disclosures;
s. The requirement of management representation including management approval for business forecast which will be used in the valuation exercise; and fees for engagement.

4) After Engagement letter, valuation process starts with preliminary study and collection of data relating to valuation involving the following aspects

a. Analysis of business history
b. Business operation

c. Profit trends
d. Brand name in the market
e. Conducting SWOT analysis and market research
f. Collecting financial and non financial information
g. Economic, business, industry, company analysis
h. Company strategy and risk analysis
i. Exchange Risk
j. Market Capitalization aspects
k. Future earning over a period and patterns and its sustainability
l. Forecast cash flows and free cash flows

5) Site visit and verification of data, processed information
6) Physical verification of inventory, other moveable and immoveable assets

7) Documentation

8) Determining valuation methods and approach – Income approach, Market Approach, Asset Approach

9) Valuation synthesis & revisiting the assumptions and decision made during the valuation process, prospective analysis, Value adjustments, Final value calculation and value reasonable check and value conclusion, subsequent even expressed as either single amount or range of amount.

10) Report preparation – giving the extent of the Valuer's investigations nature and source of information and application of this information, along with the justification for value conclusion.

VALUATION REPORT

- Mandatory contents of valuation report are prescribed in Companies (Registered valuers and valuation) Rules, 2017. These are as under:

a) Background information of the asset being valued;

b) Purpose of valuation and appointing authority;

c) Identity of the valuer and any other experts involved in the valuation;

d) Disclosure of valuer interest/conflict, if any;

e) Date of appointment, valuation date and date of report;

f) Sources of information;

g) Procedures adopted in carrying out the valuation;

h) Valuation methodology;

i) Major factors that influenced the valuation;

j) Conclusion; and

k) Caveats, limitations and disclaimers

- The good valuation reports usually have some additional contents. These contents are recommendatory in nature:

a) Projected financial information – latest business plan, cash flows and forecast for 3 – 5 years depending upon various assumptions made and agreed.

b) Other details – principal agreements, litigations, policies,

c) Scope and Limiting Condition – This section contain the information about the valuers, and his roles and responsibilities, standards to be adhered by him, statement on use of third party expert service, confidentiality of data or information collected by him during the process of valuation

d) Confirmation that valuation is undertaken subject to compliance with applicable relevant rules and regulations by appropriate government authorities;

e) Analysis - Industry Analysis; SWOT Analysis; Risk analysis Disaster management, succession plan, etc.

f) Ideally, the Report should include a minimum of three relevant comparables for each valuation.

g) Valuation opinion and conclusions – Valuer must give a single value or range of values along with reasonable justification for arriving at. Further if there is any valuation report for prior period, same should be disclosed whether valuation was carried out by same valuer or different valuer and whether same methods and technique were used or not. If different method is used then valuer must disclose the reason with justification for using different methods.

h) Annexures – All detailed calculation including excel sheets, various analysis of data, list of sources of information

- The contents of the review report as per IVS 103 are:

i. Scope of work in reference to the assignment.
ii. Reference to the valuation report to be reviewed along with brief about inputs and assumptions considered in valuation report.
iii. Date of the review report
iv. Conclusion of the reviewer about valuation report and summary recommendations.
v. Some of the SEBI regulations compulsorily ask for fairness opinion. The contents of the fairness opinion are:
vi. Reference to valuation report being referred.
vii. Conclusions by way of statement(s) about fairness of valuation arrived.
viii. Declarations about independence
ix. Date of fairness opinion

VALUATION DOCUMENTATION

- Companies (Registered Valuers and Valuation) Rules, 2017 puts an onus on registered valuers to preserve working papers (including back up papers) for a period of three years. Ideally these papers shall be preserved for a period of 8 years. Valuation documents are the principal written records as an evidence to support the value and valuation process. During the valuation process, the valuer:

a) Goes through various documents,

b) Records his / her observations,

c) Makes relevant calculations

d) Record these calculations; and

e) Analyze and corroborate results.

- In this process, a lot of documents are generated which provide the basis of the conclusion on the valuation of the subject matter. Valuer is under legal obligation to preserve all such documents which have been used in arriving at valuation conclusions. These documents are critical for future reference in case of any litigation or otherwise. Otherwise also, the documents shall be preserved for the sake of transparency and risk factors involved in valuation. These serve the purpose of evidence for:

a) The valuer who has submitted the report had undertaken the valuation exercise;

b) The valuer has conducted the valuation process / exercise in accordance with generally accepted principle and standards of valuation;

c) Valuation conclusion- valuation documentation should demonstrate that valuation conclusion arrived at are based on data and information collected and are sufficient in the terms of quantity and quality.

- Valuation documentation should include (indicative list and more items may be added based on the facts and circumstances of each case and dependent upon judgement of the Valuer):

a) Proposal and its acceptance along with copy of resolution passed in Board/Audit committee meeting;

b) Engagement letter and NDA, if any;

c) Financial information - Past audited annual financial statements and signed copy of financial projections, cost records;

d) Non-financial information - Clientele details – Master data, MOA, AOA, shareholding pattern, various contracts, shareholders agreement(s), ongoing litigation and orders; Fixed Assets Register along with details of non-core assets;

e) Declarations by the management for informational gaps;

f) A copy of the previous valuation report of a subject matter of valuation exercise, if any;

g) Source of third party information and information gathered & analyzed to obtain the understanding of factual matter that may affect the value of the subject interest;

h) The source, application of data and or information analyzed & supportive evidential matter obtained, examined, & critically evaluated;

i) Documents which are pertaining to assumptions;

j) Details on tools used to analyze the company's financial information;

k) Supportive documents relied on for basis used for valuation, methods and technique used in valuation;

l) Documents pertaining to any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied;

m) Computation sheets in excel formats

❑Documentation Retention

- It is necessary that documents pertaining to valuation should be maintained as per the applicable legislation on subject matter of valuation. Documentation pertaining to valuation shall be retained by not only valuers but also by the client party.

❑Penal Provisions

- Penal provisions are provided in Sub-Section (3) and (4) of Section 247. These are:

i. Procedural contravention of provisions of Section or rules there under - penalty between 25000/- to 1,00,000/- (that means valuer shall be extra careful for back up papers like resolution passed in Audit Committee / Board; for conflict of interest; for exercising due diligence while performing the functions as valuer and so on;

ii. If intention to defraud the company or its members is proved - then valuer is punishable with imprisonment for a term which may extend to one year and with fine between 1,00,000/- to 5,00,000/-.

iii. In case of conviction of valuer, he us further liable to:

a) Refund the remuneration received by him to the company

b) Pay for damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars in his report.

SUMMARY

- Understanding valuation helps in intelligent decision making. This is true for both individual assets as well as for business entity as a whole. Valuation of certain assets is relatively easier in comparison to other assets.
- Carrying out business valuation is challenging and complex issue.
- The term Value is the monetary, material or assessed worth of an asset, good or service.
- "Valuation is the analytical process of determining the current (or projected) worth of an asset or an entity.
- Fair value of closely held security is determined by what a willing buyer is ready to pay to a willing seller whereas fair value of listed security is its market value on which it has been traded at particular time on a particular date.
- Waiting period is known as 'vesting period' and the period in which ESOP can be availed by the employee is known as 'exercise period'.