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THE VALUATION PROFESSIONAL

YOUR INSIGHT JOURNAL

ICMAI REGISTERED VALUERS ORGANISATION

RECOGNISED RVO UNDER INSOLVENCY AND BANKRUPTCY BOARD OF INDIA

PROMOTED BY: THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

INDEX

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About ICMAI Registered Valuers Organisation

The Companies Act, 2013 brought into the light the concept of 'Registered Valuers' to regulate the practice of Valuation in India and to standardize the valuation in line with International Valuation Standards. Consequentially, The Ministry of Corporate Affairs (MCA) notified the provisions governing valuation by registered Valuers [section 247 of the Companies Act, 2013] and the Companies (Registered Valuers and Valuation) Rules, 2017 , both came into effect from 18 October, 2017.

In view of the above, the Institute of Cost Accountants of India (Statutory body under an Act of Parliament) has promoted **ICMAI Registered Valuers Organisation (ICMAI RVO)**, a section 8 company under Companies Act, 2013 on 23rd February 2018, which is recognised under Insolvency and Bankruptcy Board of India (IBBI) to conduct educational courses on Valuation for three different asset classes - Land & Building, Plant & Machinery and Securities or Financial Assets and to act as frontline regulator as Registered Valuers Organisation.

MD MESSAGE

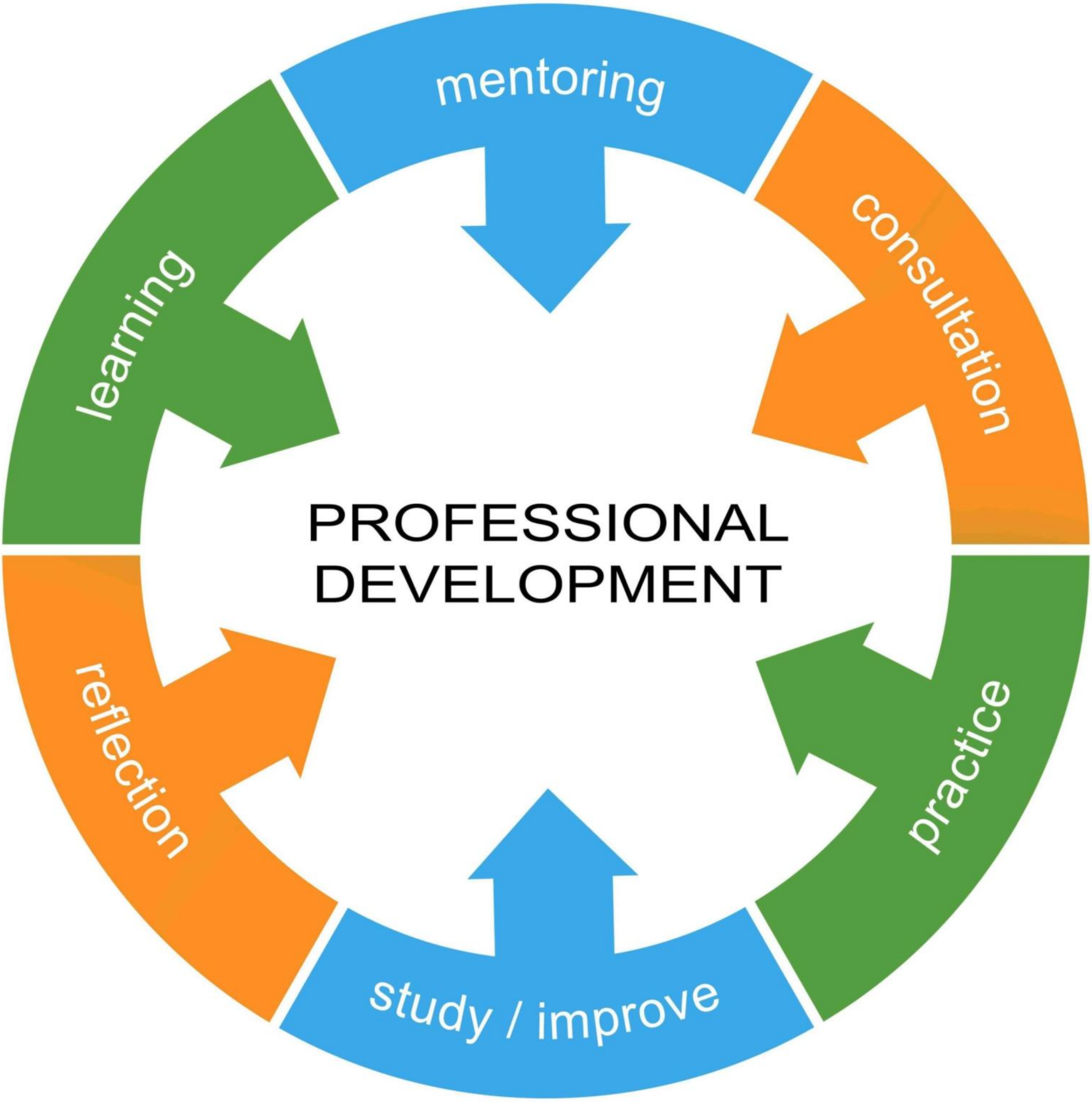
Dear Readers,

The business world is changing very significantly with newer very disruptive business models emerging in corporate landscape across the world. Many of these new ventures have Profit less turnover or Cashless profit and these are incurring huge losses. Bur their valuations are soaring very high. The reason being that the key success parameter for a business today is it's ability to create value, preserve value and enhance value for the stakeholders over short, medium and long term.

Business Valuation is an exercise, if properly undertaken, that will give an unbiased, credible assessment of the value of a business. The purpose of a valuation is to track the effectiveness of your strategic decision-making process and provide the ability to track performance in terms of estimated change in value, not just in revenue. There are many other circumstances in modern business why valuations are important. These include financial reporting, legal disputes, fund raising, intellectual property and when it comes to determining relative performance of a business. It is an essential input to many of the decisions that boards, management, regulators and investors make every day in modern business.

ICMAI Registered Valuers Organization, a wholly owned subsidiary of the Institute of Cost Accountants of India is a section 8 company registered under the Companies Act, 2013 and is recognized by the Insolvency and Bankruptcy Board of India. It enrolls members under all the three asset classes viz. Securities and Financial Assets, Plant and Machinery, and Land and Building and looks after their monitoring, Grievances, Inspection, and disciplinary aspects.

Dr. S K Gupta
Managing Director


mentoring
consultation
practice
study / improve
reflection
learning
PROFESSIONAL
DEVELOPMENT

Professional Development Programs

January'2021 to March'2021	
Date	PD Programs
8th to 10th January	Master Class on Valuation
15th -17th January	Certification Course on Valuation
22nd to 24th &28th to 31st January	50 hours Valuation Course on securities or Financial Assets
23rd - 25th January	Master Class on Valuation
29th to 31st January & 4th to 7th February	50 hours Valuation Course on Land and Building asset class.
05th -07th February	Master Class on Valuation
14th February	Webinar on Valuation of E-Commerce Companies
18th February	Webinar on Insight on Valuation Reports
22nd February	Webinar on Inspection of Registered Valuers
27th February	Workshop on How to use financial Modeling in Valuation
02nd March	Master Class on Valuation
5th to 7th & 11h to 14th March	50 hours Valuation Course on securities or Financial Assets
06th March	Master Class on Valuation
08th Marc	Seminar on the occasion of international Women's Day
10th March	Enhancing Professional Effectiveness
14th March	Master Series on Case Studies on Valuation
17th March	Master class on Best Practices in Valuation

Upcoming Professional Development Programs

DATE	PD Programs
20th March,2021	9th Online Mandatory COP Program
21th March 2021	What Valuation is all about
24th March 2021	Master Class on All about fair Valuation
26th to 28th March & 1st to 4rth Aaril,2021	50 hours Valuation Course on Land and Building asset class.
26th to 28th March & 1st to 4rth Aaril,2021	50 hours Valuation Course on Land and Building asset class.
28th March 2021	Master Class on Myths of Valuation
31st March 2021	Master Class on Valuation


Articles

An insight into Valuation of E- Commerce companies

Dr.S.K.Gupta
Managing director
ICMAI Registered Valuers Organisation

E Commerce refers to paperless exchange of business information using electronic data interchange, electronic mail, electronic bulletin boards, electronic funds transfer. World Wide Web and other network-based technologies. Also known as electronic commerce or internet commerce, it refers to the buying and selling or provision of goods and services, or the transmitting of funds or data, over an electronic network .Ecommerce is often used to refer to the sale of physical products online, but it can also describe any kind of commercial transaction that is facilitated through the internet. Ecommerce allows consumers to electronically exchange goods and services with no barriers of time or distance. The rapid emergence of e-commerce is radically transforming the business landscape. Startup firms are capturing new opportunities in the electronic market place through innovative business models. Established firms are racing to transform and adapt their old business models to the new environment. As we enter the twenty-first century, e-commerce, with its dynamic, rapidly growing and highly competitive characteristics, promises new avenues for the creation of wealth.

Types of E-Commerce Models

Electronic commerce can be classified into four main categories. The basis for this simple classification is the parties that are involved in the transactions. So the four basic electronic commerce models are as follows,

- **Business to Business:** Here the companies are doing business with each other. The final consumer is not involved. So the online transactions only involve the_manufacturers wholesalers, retailers etc.
- **Business to Consumer:** Here the company will sell their goods and/or services directly to the consumer. The consumer can browse their websites and look at products, pictures, read reviews. Then they place their order and the company ships the goods directly to them. Popular examples are Amazon, Flipkart, Jabong etc.
- **Consumer to Consumer:** Where the consumers are in direct contact with each other. No company is involved. It helps people sell their personal goods and assets directly to an interested party. Usually, goods traded are cars, bikes, electronics etc. OLX, Quikr etc follow this model.
- **Consumer to Business:** This is the reverse of B2C, it is a consumer to business. So the consumer provides a good or some service to the company. Say for example an IT freelancer who demos and sells his software to a company. This would be a C2B transaction.

Most online companies fit into one of these five categories:

1. **Lead generation:** A business that supplies leads to a partner business.
2. **Content and media:** An entertainment or affiliate website, such as *Forbes* or *Entrepreneur*.
3. **Membership and subscription:** A site that pay-gates educational content, such as Lynda.
4. **E-commerce:** An online store where various goods are sold, like Amazon.
5. **SaaS and software products:** A subscription to a tool that makes your life or business easier, such as Hootsuite.

The Current State of E-Commerce

The Current State of E-Commerce

E-Commerce is a huge platform which is growing at an unprecedented rate all over the world. People from every age whether they are children, millennials, or old loves to shop from different e-stores. Online shopping provides more happiness as compared to physical shopping stores. The reason is simple as we have a lot of websites and apps focusing e-commerce, it has become simple to find anything on e-store that you want to buy immediately. In the coming years, it is expected that growth of e-commerce will increase like never before with all the current technologies. After nearly 20 years of delivering roughly the same e-commerce experience, the industry is finally beginning to make some big strides. What's exciting is that these strides are not just focused on the online shopping experience, but the merging of offline with online to create some truly unique and brand-driven experience for consumers. Even more exciting, the democratization of e-commerce means that this is no longer limited to large companies. Global ecommerce is growing at an unprecedented pace. In 2017 it reached around $2.3 trillion and is expected to hit $4.5 trillion in 2021. In the US alone, e commerce represents almost 10 percent of retail sales — a figure that is growing by nearly 15 percent each year. In the next few years, we're going to begin seeing some of the biggest advancements in e-commerce with the addition of augmented reality and virtual reality. To say the future of the e-commerce industry is bright would be an understatement

Valuation principles in the e-commerce sphere: Traditional methods of valuation vs other relevant factors

The old saying goes that something is worth whatever someone is willing to pay for it. Still, buyers don't want to pay more than they have to, and sellers don't want to get less. Certain objective criteria can determine the fair value of an e-commerce business that buyers and sellers can agree on, or at least serve as the basis for negotiation. There are several methods commonly used to determine the value of an e commerce company. In some cases, multiple methods are used for accuracy and due diligence purposes.

Discounted Cash-flow Analysis:

One of the most thorough ways to value a business .It Involves forecasting the free cash flows of the company and discounting them with a rate (WACC) to consider the time value. DCF should be a serious consideration with stable business and predictable cash flows. The variance in monthly cash flows, immaturity of business model and quality of financial data available for E-com business makes it just a point of comparison. In a traditional valuation method Discounted Cash Flow method is generally used as it is the most preferred method. But as E-commerce is slightly different from traditional businesses mainly due to their high reliance on goodwill, multiple of earning method is preferred.

Precedent Transactions:

This method is used to determine the value of a business based on similar acquisitions in the past. This is the average of all the earnings multiples that E- commerce businesses are selling for in a particular year. A multiple of 2.62 means that, on average E-commerce industries are selling for 2.62 times the Net profit .Other factors like growth trends, traffic sources and business model also goes into valuation to find whether a business is worth less or more. This can be tricky, however, as the valuation criteria even for similar businesses may be different and not relevant to a particular situation. It is therefore important to identify the metrics used for the transaction to come up with an accurate comparison. Even then, this is more of a "reality-check" than what ultimately determines an e-commerce company's valuation.

Earnings-Multiple:

Earnings-multiple involves multiplying the discretionary cash-flow by a multiple that is determined on a case-by-case basis, calculated by analysing several variables: financials, traffic, operations, niche, customer base, and other relevant factors. The first step in arriving at an accurate valuation of an e-commerce business using earnings multiple is to determine earnings or "net revenue." For companies with an estimated value of $10 million or less, the Seller's Discretionary Earnings method is used almost exclusively. DE is a relatively simple formula. Cost of goods sold, and operating expenses are subtracted from gross revenue. Then, assuming that the business is owner-operated, any salary taken by the owner is added back into earnings. This is considered a discretionary expense that a new owner could elect to reduce or not to pay. Adding owner compensation back into revenue helps uncover the true earnings power of the business. Examples of additional expenses that may also be added back might include personal travel or any other discretionary personal expenditures that have been passed through the business for tax purposes.

E-commerce businesses with an estimated value of $10 million or more tend to have more complex ownership structures with multiple stakeholders. With EBITDA, any compensation paid to an owner is considered a legitimate operating expense and is not added back. EBITDA is used to gauge the performance of a business in terms of profitability before certain uncontrollable or non-operational expenses. EBITDA is the industry standard for valuing and comparing the valuations of different companies for businesses valued at over $10 million. Commonly used multiples are • P/E ratio • EV/EBITDA • EV/NOPAT.

Gross Merchandise Value (GMV)

GMV is a key metric of the e-commerce industry's valuation and performance. GMV or gross revenue in e-commerce jargon, refers to the sale price charged to the customer multiplied by the number of items sold, and does not include discounts, cost of returns and other costs. GMV has traditionally been an important metric for online retail companies, which often see it as a measure of growth. Some investors also use GMV as a key factor when determining the valuation of an e-commerce firm. Some people regard GMV figures as controversial. Since GMV often takes into account the total value of the transaction without factoring in any returns or cancellations, the figure does not accurately represent actual revenue. For example, in its annual report Alibaba defines GMV as the total value of confirmed orders closed over its marketplace platforms, regardless of whether the transactions are ultimately completed. However, during Singles' Day GMV is defined as transactions settled via the AliPay platform.

Revenue and Growth-Based Valuations

For the vast majority of e-commerce businesses, either SDE or EBITDA will prove sufficient for determining earnings. However, for some fast-growing, typically well-capitalized companies that are investing heavily in technology and future growth, neither benchmark will be effective. In this instance, it is possible to forecast future earnings based on revenue and growth, even if expenses currently exceed income. Earnings forecasts based on revenue are inherently more volatile than those using SDE or EBITDA as they are based solely on growth. For this reason, they are only used when neither SDE nor EBITDA is effective. In some instances, a blended approach may be taken, and SDE or EBITDA may be combined with forecasts based on revenue. It is essential with an e-commerce valuation to break down revenue in several ways, the crucial ones being:

Breakdown of revenue by customer, Breakdown of revenue by product, Breakdown of revenue by supplier. By analysing each of these, it is possible to spot potential strengths and weakness in each revenue stream. For example, if 15% or more of revenue derives from a single customer, the business could be put at considerable risk if that customer were to leave. Certainly, any customer that is responsible for such a significant share of revenue must be paid close attention to. Similarly, focusing attention on what percentage of revenue is derived by sales of each product may identify areas of opportunity and risk. If a large proportion of income comes from one product, how susceptible is the business to a competitor coming along and selling it for a lower price? Is it a trendy item that may have a limited shelf-life?

E-commerce is a business like any other business, so besides the usual financials such as gross revenues and net income, profitability, costs of inventory and operating expenses, among other standard measurements, there are certain valuation factors that have to be considered while determining the worth of an E-commerce company irrespective of the methods used :

Customer Base and Market Outlook: A company with an active customer base and positive market outlook will be worth more. Active customer base means large number of repeat customers. It shows their product and service quality and the factors include 1. Size of company's email list 2. Churn rate 3. Uniqueness of customer base 4. Rate of growth of customer base 5. No. of competitors in same market 6. Cost of acquiring new customers

Brand Recognition: A recognizable brand with a well good brand identity will be worth more as the business will have large customer base and more goodwill .Branding is very crucial for competing and shows a loyal and growing customer base and also an already established presence in the market. The relative strength of a brand can be assessed in numerous ways. These include Google search rankings by company name and products/services, quality and quantity of customer reviews, social media forums concerned with relevant product offerings and general discussions related to the e-commerce company's particular markets. Most importantly, a good brand will be the factor that makes the customer choose your product over your competitors.

Traffic: Traffic is the heart of any e-commerce businesses. For that exact reason, traffic plays a key role in the valuation process. Not all traffic is created equal and some will be of higher quality than others. For example, a store might get 500 visitors from a viral Facebook post, but if that doesn't lead to any sales the traffic was all for nothing. For this reason, traffic statistics can sometimes be misleading in the valuation process and requires sufficient research to determine the quality of the traffic. More traffic isn't always better and often times it's the case of quality over quantity. One of the best ways to determine the quality of the traffic is to use a measurement called revenue

- Per user (RPU).This metric shows how much each visitor is worth to a business.
- **Operational Costs:** Like any other businesses E-com also require certain overheads to operate the business .So a comparison of cost and profitability has to be done. How the underlying costs can be transferred to the new owner? How underlying costs can be reduced?
- **Supplier Agreements:** Are the current suppliers willing to stay on board with the new owner? Are there any special agreements or deals in place with the supplier? If so, will this be continued with the new owner?

- **Scalability:** Can current operations ramp up and expand under new ownership without incurring prohibitive costs? Is there room to expand into new products?
- **Assets:** Is there physical property that has value to new ownership? Can unwanted assets be liquidated or otherwise disposed off easily? What is the book value of the business if everything was sold?
- **Payroll:** Are current staffing levels sufficient, how are they managed, are salaries competitive to retain essential talent, and will talent likely stay if ownership changes?
- **Trademarks and Licenses:** Are there any proprietary products or processes that provide unique competitive advantage?
- **Liabilities:** What debts does the company have, what is its credit history, has the company every had difficulty meeting its debt obligations?
- **Owner Involvement:** This could be the factor that could make or break a deal for any e-commerce valuation. To what extent can the business continue to operate successfully without the current owner at the helm, either because of the owner's technical knowledge, relationships with customers and employees, and/or reputation in the industry?
- **Seasonality:** More so than most other online business models, e-commerce companies may find themselves highly prone to seasonality. Depending on the niche and the type of products the e-commerce store sells. The longer the company has been in business, the easier it is to spot trends in seasonality and plan for them
- **Chargebacks, Returns, and Refunds:** Customer returns, refunds and chargebacks are a fact of life for virtually all e-commerce businesses. They can also be a highly expensive one. The estimated cost of returning merchandise in the United States is predicted to reach $550 billion by 2020. Overall, returns, refunds, and chargebacks are an area where many e-commerce businesses have room for improvement. Taking steps to reduce them can benefit the bottom line as well as customer satisfaction.
- **Life Value (LTV):** The Lifetime Value (LTV) of a customer is total value, on average, that a business can expect to earn. This is one of the most subjective e-commerce metrics, as there are many different ways to think about "value". This is an important e-commerce valuation metric. One of the most accurate ways to think about value is Contribution Margin after Marketing (CMAM) per customer, per year. Once we have defined value, we need to know how long this customer will remain active, before they have churned. To account for this, we take the observable Churn Rate over time for the business. The detailed LTV formula is: LTV = CMAM (annual) / churn rate
- **Customer acquisition cost:** Naturally, it costs something to acquire a new customer. This value is called customer acquisition cost. In order to make money, customer acquisition cost needs to be less than the customer lifetime value. Ideally, acquisition cost should be less than average order value so you make money off every new customer.

- **Viral Coefficient:** The viral coefficient represents the degree of exponential growth a company experiences by looking at the number of invitations or referrals sent per user, the conversion rate of those invitations, and the total number of current users.

- **Viral Coefficient:** The viral coefficient represents the degree of exponential growth a company experiences by looking at the number of invitations or referrals sent per user, the conversion rate of those invitations, and the total number of current users.
- **Net Promoter Score:** Net Promoter score is a simple survey that measures your customers' satisfaction with your brand and products. It asks two questions: How likely are you to recommend us to a friend? (Scale of one through 10.) Can you tell us why you responded with that number?

Final thoughts

The key areas listed above are a good starting point, but should not be considered a comprehensive guide to valuing an online business. Each business comes with its own intricacies and complexities .Traditionally, tried and tested methods such as discounted cash flow, earnings multiple ,growth and risk estimation have consistently been applied to value the worth of a business. While these methods continue to be relevant today, it appears that such established fundamentals are tweaked in the domain of e-commerce valuation. Increasingly, valuations in respect of e-commerce companies are moving away from such established methods towards a consideration of a plethora of factors which vary widely, lack consistency and persons valuing such companies frequently "cherry-pick" the favourable factors to do valuations.

Valuation of Equity Shares – Imperatives from A Valuers Perspective

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NMIMS University School of Business Management

Introduction

In the history of human civilisation, the first commercial transaction was conducted when one person gave the other something in exchange of receiving some other thing, and the process went on. There is no recorded history of the method by which the quantities of goods, to be exchanged, used to be determined for such barters in those embryonic days. However, one can guess that, the principles such as degree of usefulness, aggregated volume of requirements, availability of those goods in demand, and extent of risks and efforts to gather those goods from Mother Nature used to be the factors to determine the quantum of reciprocity. The perceived position is that such factors are in no way different from the process of producing and selling various tangible / intangible assets and services in present day circumstances.

In simple terms the definition of cost, therefore, is the value of any kind sacrificed to get in exchange or create another value. Even after thousands of years since that first barter, the principles, and factors for ascertaining value in exchange have perhaps not changed much. However, types and medium of values to be exchanged have changed. One of the most wanted types of store of value in present times is financial assets, and out of that type equity shares is the one of the most frequently exchanged ones. Some of the critical points that are to be handled and processes to be followed while exploring the value of an equity share, which is also known as 'stock' of a company, for an investment decision is the subject matter of this paper.

Objective

This article will be written with an exploratory approach. Discussions on traditional theories will be avoided to the extent can be considered as read. The primary objective is to revisit the factors to be explored, imperatives, processes and cautions to be observed while exploring and estimating the best possible exchange value of equity shares of a company from the perspective of a Valuer. This objective has been set bearing in mind that the task of a Valuer is difficult, critical and of high commercial consequences. Her / his job is to successfully explore that meeting point at which both the buyer and seller will have no qualm about the value and would happily close the deal, albeit happiness is a subjective term. At least efforts can be made for that.

This paper would examine those imperatives of a Valuer which can be of practical help to explore that meeting point at which the buyer and seller would be happy to shake hands with least possible doubt. Those imperatives are not only connected with setting of assumptions and conducting exploratory exercise, but also related to construction of valuation models, application of tools, and mistakes that may lead to unforgivable errors with professional liability.

Revisit Valuation of Equity Shares

Tons of papers have been inked and zillions of bytes have been burnt in cyberspace for theoretical and experiential narratives on valuation of equity shares. Ironically, the points which often do not get registered are that an equity share as a financial instrument per se is not and cannot be valued. Neither one can equate the value of shares with the net value of those assets which have been created by allocation of equity fund and undistributed profit. Other than profit earning abilities of the entity from those assets, inter-play of intangible factors such as deference for '4P Bottom line', good governance, track record and fair-playing practices of its executives, etc. are also equally important from the perspective of a sensible investor.

Legendary economist John M Keynes wrote that *"Stock valuation is not a prediction but a convention, which serves to facilitate investment and ensure that stocks are liquid, despite being underpinned by an illiquid business and its illiquid investments, such as factories."* One can analyse in contemporary context the underlying thoughts of his words of wisdom in the following lines bearing in mind the words '*to facilitate investments*':

- What is / are the intended option(s) of securities or financial assets and how the same has been structured?
- How much fund allocation is to be made and in what proportion of total portfolio value?
- What is the time horizon of staying invested?
- What is the expected rate of return?
- What are the risks associated with it?
- To what extent validations are possible using level 1 to level 3 evidences, as defined in Ind AS and IFRS, in case relative valuation methods are applied?
- What type of decision(s) will be taken, e. g., M&A with or without valued synergy component, pre-money and post-money mile-stone valuations in respect of funding through equity / quasi-equity instruments by an AIF, private placements to HNIs and Institutional Investors, strategic investment by a 'White Night' and so on.

Legendary investor Warren Buffet said, *"Price is what you pay. Value is what you get."* Therefore, while determining price to be paid the need is to estimate what is the present value of returns the investor will receive during the tenure of staying invested, and disposal value at the end. Hence, the price one pays for buying an equity share may not match the measured present value of all returns. This is because reward against risks taken are also to be included in the return, around which there would be varying degrees of uncertainties. It will be pertinent to remember that unique statement of Bryan Dyson, ex CEO of Coca Cola, *"Value has a value if its value is valued."*

One of his primary considerations could, therefore, be quality of governance and managerial capabilities of executives of the investee company who can run the show with fair, ethical and transparent policies and procedures. The author wants to add 'sustainability, as one of the key factors, because not all investors are day traders or short-term players. If in his words "*In the business world, the rear-view mirror is always clearer than the windshield",* the Valuer must see the seeds in the womb of time using her / his

Power of intuition and forecasting. She / he is duty bound to sensibly consider 'would be near actual assumptions' while assessing performance of the entity and consequential cash flow in foreseeable future. The Valuer must also test and validate those assumptions considering impacts emanated from the dynamics of emerging business ecosystem and the dimensions of VUCA elements shrouded with risks.

Non-financial Considerations

Experiential learning points of the author suggest that in any exercise valuation professionals generally get overwhelmed and preoccupied by financial factors. Hardly any time is left for them to take into consideration material findings from due diligence exercises related to the following non-financial factors while reviewing and validating assumptions and financial numbers that have come out in the valuation model as well as multipliers for relative valuation(s):

- Product life cycle and impacts of present and probable future developments in technology that may cause disruptions or displacement from 'Blue Ocean' to 'Red Ocean' space of industry sector.
- Products, human capital and its rate of attrition, business and revenue models, efficiency of operations and location of the company's product generation facility(ies) which are some of the key drivers for surplus generation.
- Size of the company and the degree of sustainable competitive advantages with continuous R&D / innovative initiatives to stay ahead of competition and / or retain first mover's advantage.
- Extent of digital transformation of strategic planning and operating processes that are essential to stay ahead of or remaining in competition.
- Emerging drivers and dampeners for growth in financial market, industry sector, and impact of coupling factors from global events.
- Impacting factors stemming from the dynamics of socio-economic, geo-political, geo-physical and etho-cultural developments.
- Perceptions of external stakeholders about the following to the extent appropriate:
- History and track records of the company and its CXOs,
- Product and corporate brand images,
- Effectiveness of the Board of Directors, and
- Resilience, flexibility, and performance of the company in difficult times.
- Vision, mission, cultural values, and long-term business strategies for growth.

The reader will agree that a professional Valuer with ethical and emotional intelligence can hardly afford to forget or ignore the above intangible factors.

Contingent Claim Valuation

This aspect of valuation can pose tricky challenges and dilemma for the Valuer. In real life there are instances when due diligence exercises reveal that the company, whose equity shares are to be valued, is in advanced stage of getting an intellectual property right registered for a new product and / or technology. This can happen in case of a pharmaceutical company getting in near future patent rights for a new drug with potentials for substantial value additions and consequential cash flows. Another possible case could be that of an oil field or mine under exploration, about which none is sure of the ultimate outcome and extent of commercial success there from till actual exploration starts and the quantum of deposit is known with reasonable certainty.

In a pharmaceutical company's case management will argue that because revenue generation would soon commence post registration of patent by the appropriate authority and approval from the country's Drug Administrator, related cash flows should be considered for valuation. A soon to happen case in point would be for those companies which will reach near to patent right registration in respect of vaccine for protection against Covid-19 and / or drug for curative treatment. Situations would not be much different in cases of entities in any other industry sectors under similar circumstances.

Ideally the Valuer should not consider future cash flows from the new product as fructification of management's claim is contingent upon registration of the patent and other required approvals. There could be varying degrees of certainty / uncertainty of those happening. Yet at the same time she / he cannot ignore management's claims in cases when it is more likely than not that the company will meet success.

The author is of the view that the Valuer in such a situation should develop a completely independent model for assessing the value addition that may take place because of the new product. This should be done after exploring the value of its equity shares from existing business. The tools and methods she / he will apply for these two value exploration exercises may differ depending the merits of each.

In the final report the Valuer should first state the value of each share with needful narratives, caveats, etc based on the exercise done for existing business. Thereafter the value addition from the new product(s) should be added specifically stating that this component is based on the contingent claim of management along with justifications provided, assumptions, sensitivities, documentary evidence caveats, etc. Thus, total value of a share would be the sum of two values. This would convey all required details and help the investor to form an informed judgement about the price to be paid. This would have not been possible if the such separate explorations would have not been done.

Additional Risk Factors for CAPM

Calculation of weighted average cost of capital (WACC) is a common task for any Valuer while applying discounted cash flow model (DCF). One of the components of WACC is the weighted cost of equity and for calculating that generally CAPM is used, for which β is an important input. It represents the extent of risk, in terms of volatility in return, associated with the stock under valuation. β is used as a multiplier to assess the risk premium expected by an investor over risk free return. This is determined with reference to the rate of return from the overall secondary capital market index and / or that of the industry sector to which the company belongs.

Without getting into much of theoretical discourse let the author introduce certain additional risk factors. Such additions by way of percentage of additional return should be considered for specific risks. The same should be based on assessment of mostly intangible factors, as explained above, and impacts thereof on returns generated by a company. The revised CAPM formula could be as under:

$R_f + \beta \times (MRR - R_f) + K_s + K_i + K_z + K_t + K_l + K_m + K_c$

Where:

K_s = Sovereign risk if the entity under valuation is in a different country.

K_i = Industry or sector specific risk in case the β considered is that of the overall Market index.

K_z = Size specific risk as compared to the average industry size in terms of capacity of production and / or annual turnover.

K_t = State of technology applied by the company vis-à-vis other players and risk of getting disrupted by a stratup.

K_l = Location specific risk, e. g., if the company’s assets are in a risky location.

K_m = Management specific risk if findings from due diligence are grossly adverse.

K_c = Cyclical risk if the company’s product is on the downslide stage of product life cycle.

Consideration of and ascribing a value in percentage terms for most of the above additional risks related returns are of critical importance, if the decision by the investor is with reference to a hurdle rate of return. That rate is generally the average of rates of returns from other businesses of the investor. Such investors for example could be a conglomerate investing for a merger or acquisition transaction, or a Private Equity Fund deciding the floor rate of return at the point of exit via IPO failing which some other condition would apply. Readers may put the above into practice under the aforesaid circumstances because market β, calculated by traditional methods, may not consider the aforesaid risks specific to a company / set of assets.

Concerns and Cautions for Valuation

Any professional Valuer is expected to keep up ethics and honesty of purpose, take all possible precautions, and comply with all standards, legal and regulatory provisions in the value exploration exercise. Debates are not uncommon in the corridors of professional firms and corporate houses on a critical issue, i.e., whether the perspective and imperatives of a valuer should be different depending upon her / his engagement by a buyer or a seller. The author is of the view that there is no scope for any such debate on this issue.

It is frequently overlooked that a Valuer can explore and assess only one value, repeat only one value, for any financial asset which is its value in the best of her / his assessment. No argument can and should convince a Valuer to change the same even if the engaging client changes from a buyer to a seller and vice versa.

Experiential learning points gathered by the author from both his corporate and present academic engagements suggest that misses, errors, bias in judgement, albeit may be unintended, are quite common. Hence, in this section certain dos and don’ts have been listed from the perspective of a Valuer which should be considered based on her / his best judgement, and merits of each case.

Assumptions and Methods – Imperatives and Cautions

1. Be clear about the nature of the investors, their long and short-term objectives and investment rationales on whose behalf the valuation is being done. This will facilitate the Valuer to find answers to a couple of important questions. For example, whether the Valuer can comply with all provisions of Section 247 of the Companies Act, 2013 and related Valuation Standards while working on the engagement, whether an appropriate report is available based on pre-valuation due diligence done by a reliable organisation, or to be done by her / him, etc.
2. Conduct SWOTC Analysis followed by assessment of impacts out of findings form due diligence are steps the must. The route to be followed in sequence is SWOTC > Strategy > Tactics > Action Steps > Projected Value Impacts from findings of Due Diligence and Adjustments required to take care of those.
3. Be clear about the driver(s) of future growth and profit while selecting the valuation method. Each method stresses upon certain drivers, e. g., for relative valuation using ‘Price to Sales’ assumes that if turnover is achieved profit and free cash flow will be a follow through.
4. Be careful to independently judge requirements of various related stakeholders, other than the client who may directly and / or indirectly be impacted by the valuation report. Apply models, select assumptions, and measure values accordingly. Assess what all information and evidence from level 1, level 2 and level 3 category sources, as defined by Ind AS / IFRS, are available which will be used for validation.
5. If the model is based on projected cash flows (DCF) and / or relative valuation tools based on earnings of any form, say EV-EBIDTA, EV-Sales or PE Times, etc. do not directly start from and end with only the cash flow forecast. Construction of projected Income Statement, Balance Sheet and Cash Flow Statement in compliance with the related accounting and reporting standard is a must to ensure that no error has crept while developing the model.
6. Avoid modelling of Cash Flow Stream with EBIDTA as the starting point. This is a dangerous practice bearing in mind that many assumptions, as detailed in the previous point, are being infused into one financial variable, i. e., EBIDTA.

3. Be extremely careful while selecting / calculating factors for WACC, Beta and Growth Rate in perpetuity. The Valuer may like to consider the points mentioned elsewhere in this article. Adequate care must also be taken in selection of Peer Company while using multipliers for relative valuation tools.

4. Identify factors for sensitivity testing through analyses of various measured / assigned values to assumptions, e. g., growth in volume of operations, sales price, material costs, ability to pass on inflationary cost increases of inputs through sales price, WACC, etc. Be careful about historical background of the business group, promoter specific issues, managerial track records of leadership team and other stakeholders' perceptions. Adjust negative financial scores, if need be, for one or more of these by factoring in additional risk-based return into the WACC as discussed in a previous section.

5. Do not forget to make provision for capital expenditure related to maintenance and sustenance of operations in future years. Also assess the need for additional capex in consultation with management that may be needed to meet additional volume as growth takes place in line with the related assumption. This in turn will need provisions for additional interest pay-outs on loans, if taken, depreciation and tax shield thereon.

10. Create the near actual draft base case of valuation and then apply factors of aggression and / or pessimism for testing sensitivity for further analyses and adjustment of assumptions before finalising those assumptions to be considered for the new base case to be reported.

11. Validate the found value of equity shares, as stated in the preceding point, with reference to the high and low prices of recent past in case of a listed company; and for others by comparing movements in Indices like Sensex or NIFTY and / or related industry / sector index based on the stock category like Blue Chip, Large Cap, Mid Cap, Small Cap etc., as appropriate.

12. Critically analyse, validate, and be reasonably assured through discussions with management, and if necessary written undertakings from the Company, that the all the assumptions can be sustained.

13. Take adequate care in deciding and articulating the narratives, caveats, exclusions, etc. to be inserted in the report. The report should also contain, inter alia, the process followed and the rigour and intensity with which the exercise has been handled by the Valuer and her / his team members.

    For this purpose, all working papers and digital records are to be carefully preserved.

Cautions and Checks for Excel Sheet based Modelling

14. Create the excel based model on an automated basis so that changes can be inserted, and various scenarios can be created without pains. Do not get carried away by the value you get in the final base case. Make it a part of the valuation process to double check the following to ensure all possible accuracies achieved:

a. Assumptions and numbers ascribed to each assumption,

b. No number has been hard coded in excel sheets except for assumptions,

c. Correctness of model creation, cell links, and formulae for automatic calculations and validation of calculated numbers,

d. Decimal places of mathematical numbers are judiciously chosen so the that the ultimate value per share do not get materially impacted,

e. Mathematical accuracy of each number by comparative horizontal analysis, and

f. Sensitivity of each assumption in the valuation model.

15. Apply validation tests by comparing yearly results of key ratios with those of Year 0, e. g., EBITA to Sales, Debt-Equity Ratio, Current Ratio, Velocity Ratios, Year Specific ROIs, etc. with reference to the assumptions.

Validate impact of one ratio from Income Statement with the other of Balance Sheet, e. g. growth in Sales vs. movements in various elements of current assets and net cash flow from operations as reflected by the net operating cash flow in Cash Flow Statement. Such validations are essential to ensure that the model is squarely accurate in terms of mathematical accuracies and capturing financial impacts of all assumptions.

From the above list of fifteen points readers may be inquisitive to know why the author has got down to such levels of nitty-gritties. Answer to this lies in the axiomatic statement that "A valuation exercise is as good and effective as the assumptions are and as accurate as they have been captured and calculated in valuation model." Again, even a mistake of ten paise in the per share value may cost the buyer considerable sum of money when the number of shares to be exchanged is in millions.

It is pertinent to bear in mind that if the company has more than one independent business units (CGUs) / products and / or services, risks, and rewards for which are entirely different, the Valuer must conduct more than one valuation exercises for each such CGU, and then calculate the value of equity shares of the company with sum of parts. For such two exercises she / he must follow all the steps and conduct the processes with equal rigour and intensity.

Steps for Valuation Process

Valuation of a company's share can never be claimed to be an exact science. Elements of subjectivity in varying degrees may creep in because the Valuer will have to apply her / his judgements at many steps. But none can claim with certainty that the assessed value per share will cent percent match in course of time. However, no effort should be spared to ensure that minimum number of doubts and questions are raised on the final report, and all those can be explained with due justifications and professional ethics. The reader will appreciate and accept that only knowledge and experience may not ensure quality and speed of a deliverable.

The author, therefore, is keen to add this section, may be at the cost of repetition of a couple of points with different dimension. The Valuer and her / his team members must consciously and diligently conduct the exercise to ensure that in the valuation report flaws and scope of raising questions is unknowingly left to the barest minimum, if not none. The predominant two objectives are to finally arrive at that best estimated value per share, which both the buyer and seller would find as the meeting point of minds, and submission of a professionally articulated report of the highest order. For achieving these, the above cautions and imperatives are strictly to be adhered to while navigating the actual valuation exercise through the following ten steps.,

i. Conduct Macro-economic analyses with information inputs from reliable sources that are relevant for the business and industry sector of the company under valuation. Objectives are to appreciate overall impacts of future developments and dynamics of economic situation of the country (ies), in which the business units of the company operate which in turn will facilitate the process of forward-looking estimation.
ii. The next step is to conduct PESTEL and Porter 5 Analyses for the industry and sector(s), in which the company operates / will operate, to understand and appreciate the probable business scenario in the forward path. This will help assessing the probability of new competitors entering fray and biting market share and / or come out with improved alternative products / services. The Valuer will also be able to assess the extent of the entity's capacity to sustain existing business and accomplish the projected growth.
iii. Review of all information available in public domain about the conglomerate, business group and / or the company through desk top due diligence is the next step. The Valuer needs to analyse all available information and perceptions of external stakeholders about the company. This will better equip her / him to identify areas and issues for which answers and evidence are to be gathered from detailed due diligence.
iv. At this stage the Valuer is expected to receive the formal engagement letter and signed the 'Nondisclosure Agreement' which will enable her / him and team members to access key information from the digital archives of the Company. The Valuer should also hold conversations with leadership team members for gathering detailed information on:
   - Findings from in-house analyses of SWOTC, Due Diligence and perceived risks,
   - Comments on trend of performance in immediate past few years and reasons for ups and downs in key financial indicators,
   - Long-term plans for operations including cost management, capital expenditure, fund raising, etc.,
   - Assumptions for operations in foreseeable future which the Valuer will need for building the model,
   - Policies, systems, and processes for management of risks, sustainability, corporate governance, etc.

   Such conversations will also help the Valuer for gathering first-hand idea of the managerial capabilities and track records.

i. Time is now to prepare the preliminary earnings model based on the trend emerging from past five years' audited financial performance and assumptions considered for projections. However, different steps are to be followed for this if the company is a startup and do not have history of past performance.

ii. To validate his first found numbers the Valuer is expected to conduct comparative review and analyses of the results generated at step v above vis-à-vis industry peers. Based on findings of this one more review of both operating and financial assumptions should be done with risk enabled performance management (REPM) approach. In other words, risks and contingencies which are of probable nature (more likely than not, as defined by Ind AS) are to be factored by adjusting the ascribed numbers of related assumptions.

i. The Valuer can now finalise the WACC, DCF model and complete the draft base case to ascertain the first explored value per equity share.

ii. The Valuer will also have to select at this stage additional tool(s) that she / he will use for valuation out of options such as , Relative Valuation with multipliers of carefully selected peer company(ies), e.g., EV-EBIDTA, PE Times etc., Dividend Discounting, and so on. She / he can also use multiple tools and derive the final value by applying carefully thought out weight to the per share value calculated by using each tool.

iii. Sensitivity analyses is due at the stage for testing the extent of variations in the value found in steps vii and viii. Objective is to identify those operating elements and related assumptions due to which variation in value per share is more than acceptable. At this stage she / he may or may not revisit the assumptions for another round before finalising the base case. She / he also needs to decide about sensitivity tests to be reported for benefit of the investor so that he can take an informed judgement and decide.

The Valuer can now finalise the base case and prepare his Draft Report (DR-V1) in a professional format. This should contain all standard narratives, assumptions, tables, safe harbour clause, caveats, exclusions, etc. and other required appendices to ensure that the report conveys complete information, including for process followed, evidences relied upon and final recommendation leaving no scope for any ambiguity.

The report should also contain names of the core team members who have done the work, contact details of the SPOC who may be contacted in case of any requirement. A declaration is also to be added stating that the said team and the Valuer in-charge of the professional engagement do not have any direct and indirect commercial interest in the investment decision of the client except fees for the professional service.

i. The DR-V1 should then go for three consecutive reviews. The first review should be by the senior professional under whose supervision the team has worked. After needful modification is done for incorporating her / his comments, the revised DR-V2 should go for the second round of review by a senior in-house professional. This peer review should be done independently and dispassionately for insightful oversight and quality assurance. After changes suggested by him the DR-V3 should be sent to an external senior professional who is not connected with the assignment and the firm of Valuers. This step may be skipped, if considered avoidable.

After incorporation of all changes, as suggested by the external reviewer in DR-V3, the report becomes ready for submission to the client.

Conclusion

It may not be much of an exaggeration if the author takes liberty to comment that in contemporary times valuation as a service has almost been relegated to a commodity. Several laws and regulations have been enacted / promulgated by appropriate authorities as deterrents. Their objective is to prevent such deterioration and ensure that the sanctity of the valuation process and valuation as a profession are held at high esteem. But reality does not depend on idealism and takes its own course in respect of almost all professions. However, conscientious professionals make all possible efforts and ensure that they do all that they are expected to do holding their professional ethics at the highest pedestal. The author will consider this work to meet a little success if any such valuation professional finds a few points to take home from this paper.

Registered Valuer and Valuation under Insolvency and Bankruptcy Code 2016:

FCS Anuradha Gupta
Insolvency Professional (IP)
Registered Valuer (S&FA) (RV)

The key of a successful Corporate Insolvency Resolution process lies in the correct and proper valuation of assets.

The Preamble to the Insolvency and Bankruptcy Code provides as under

"An Act 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 <u>maximization of value of assets of such persons,</u> 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"

Hence it can be seen that one of the prime objective of Insolvency and Bankruptcy Code is maximization of the value of assets and having a transparent and credible determination of value to facilitate comparison and informed decision making is a critical element towards achieving the objective ".

Requirements of Valuation under the Code

Various Regulations and Sections under the IBC requires a Resolution Professional (RP) to get a valuation done in respect of a Corporate Debtor under CIRP/Liquidation by a Registered Valuer.

Some of the situation requiring the valuation may be summarized as under

- Liquidation and Fair value under Regulation 35 and Regulation 27 of CIRP regulations
- Valuation of assets proposed to be sold under Regulation 35 of Liquidation regulation
- Valuation Report at the time of initiation of Voluntary liquidation process under Regulation 3(1)(b) (ii) of Voluntary Liquidation Rules
- Appointment of valuer and valuation under Regulation 26 and Regulation 34 of IBBI Fast Track process
- Section 59 and section 46 of the Code

Registered Valuer under the CODE

The term valuer has not been defined under the code but the same has been mentioned under the Regulations:

1. <u>**CIRP Regulation 2016 – Reg 2(m):** "registered valuer" means a person registered as such in accordance with the Companies Act, 2013 (18 of 2013) and rules made thereunder;</u>
2. <u>**Liquidation regulations- Reg 2 (h):** "registered valuer" means a person registered as such in accordance with the Companies Act, 2013 (18 of 2013) and rules made</u> there under

So it can be observed that valuer has been defined under the Regulations as the person who is a registered valuer under the Companies Act 2013. The provisions relating to Registered Valuer is governed by Section 247 of Companies Act 2013 read along with rules framed there under.

Section 247 of the Companies Act 2013

247. (1) Where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets (herein referred to as the assets) or net worth of a company or its liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience, registered as a valuer and being a member of an organisation recognised, in such manner, on such terms and conditions [as may be prescribed] and appointed by the audit committee or in its absence by the Board of Directors of that company.

The *Companies* (*Registered Valuers and Valuation*) *Rules*, *2017* defines the Valuer as under

Rule 2 (j) "Valuer" means a person registered with the authority in accordance with these rules and the term "registered valuer" shall be construed accordingly.

The aforesaid Rules also prescribe the qualification, experience and procedure for being registered as the registered Valuer.

So analyzing the above it may be concluded that for a person to be appointed as a valuer under the Code, he/she should be registered with the Authority as on the date of appointment

Authority under the Rules:

Under Rule 2(b) of aforesaid rules : "authority" means an authority specified by the Central Government under section 458 of the Companies Act, 2013 to perform the functions under these rules;

By virtue of notification dated 20th October 2017, IBBI has been specified as the authority for the purpose of section 247 and The *Companies* (*Registered Valuers and Valuation*) *Rules*, *2017*

Only valuer registered under The Companies (Registered Valuers and Valuation Rules 2017 to be appointed as Valuer

IBBI Circular IBBI/RV/019/2018 (w.e.f 1st February, 2019) specifies that only Valuers registered with the Board under the Companies (Registered Valuers and Valuation) Rules, 2017 may be appointed by the IP during the Insolvency resolution process.

The IBBI has taken strict actions against the Resolution Professionals who have appointed the Valuers in contravention of the above definition and circular

The cautions to be taken by the RP while appointing a valuer

The valuer as on date of appointment should be registered with the authority (IBBI)

The valuer should not be

Relative of resolution professional (RP)

Related party of corporate debtor

An auditor of the corporate debtor at any time during the five years preceding the insolvency commencement date; or

A partner or director of the insolvency professional entity of which the resolution professional is a partner or director.

The RP should preferably get a non-disclosure agreement from the Valuer for non-disclosure of values/ information received during the CIRP/liquidation process

<u>Determination of Value by the Registered Valuer</u>

Under the CIRP Regulation 35

(1) Fair value and liquidation value shall be determined in the following manner:-

a. the two registered Valuers appointed under regulation 27 shall submit to the resolution professional an estimate of the fair value and of the liquidation value computed in accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor;

b. if in the opinion of the resolution professional, the two estimates of a value are significantly different, <u>he may appoint another registered valuer</u> who shall submit an estimate of the value computed in the same manner; and

c. the average of the two closest estimates of a value shall be considered the fair value or the liquidation value, as the case may be.

(2) After the receipt of resolution plans in accordance with the Code and these regulations, the resolution professional shall provide the fair value and the liquidation value to every member of the committee in electronic form, on receiving an undertaking from the member to the effect that such member shall maintain confidentiality of the fair value and the liquidation value and shall not use such values to cause an undue gain or undue loss to itself or any other person and comply with the requirements under sub-section (2) of section 29:

(3) The resolution professional and registered valuers shall maintain confidentiality of the fair value and the liquidation value.”.

Recent IBBI JUDGMENTS relating to valuer/valuation

Case 1

Order No. IBBI/DC/27/2020 24th August, 2020- Disciplinary Committee - IBBI

In this case a Show cause notice (SCN) was issued to the Resolution professional for appointing an unregistered valuer (valuer not registered with the authority) as the valuer in a CIRP process.

The SCN alleged contraventions of section 208 (2) (a) & (e) of the Insolvency and Bankruptcy Code, 2016 (Code), regulation 7(2) (a), (h) and (i) of the IBBI (Insolvency Professionals) Regulations, 2016 (IP Regulations) and the Code of Conduct under regulation 7(2) thereof, regulation 27 the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations 2016 (CIRP Regulations) and IBBI Circular No. IBBI/RV/019/2018 dated 17th October 2018. The SCN also alleged contravention on part of RP for non adherence to the timeline regarding the appointment of the valuer.

Submission by RP

The RP in his written reply and personal hearing submitted that the said valuer provided him the certificate of passing the exam and the mark sheet and ensured to provide the certificate of registration at the earliest. According to the RP, the said valuer posed himself as a registered valuer and the RP was not aware that he was not registered with IBBI as on the date of appointment. And this fact came to his knowledge only when he received the certificate of registration of a later date.

However the RP submitted that when he came to knew of this fact, the valuer fees was refunded to debtor hence no loss incurred to CD.

Findings and observations

The valuation by an unregistered valuer may adversely affect the credibility of whole CIRP and the resolution based on such valuation. In the instant matter, there is a lapse or negligence on the part of RP for not taking due diligence while appointing a valuer not having registration certificate on the date of his engagement as a valuer which has resulted in contravention of various provisions of the Code, regulations and as also of the said Circular dated 17.10.2018

Conclusion

There was a contravention of the following provisions of the Code and Regulations:- I (a) Clause (d) of sections 25 (2) and clauses (a) and (e) of 208 (2) of the Code; (b) Clauses (a),(h) and (i) of regulation 7(2) of the IP Regulations read with clauses 10 and 14 of the Code of Conduct contained in the First Schedule of the IP Regulations; (c) Regulation 27 of the CIRP Regulations

The DC found the RP guilty of irregularities related to appointment of valuer (qualification as well as the timeline) and the RP was debarred from accepting new assignment for a period of three months.

Case study 2

Order No. IBBI/DC/25/2020 02nd June 2020 Disciplinary Committee- IBBI

In this case RP appointed two firms A and B as Valuers on 23rd February 2019. However, it was observed that the RP appointed Valuers who were not registered with the Board as on the date of appointment which was in violation of the directions issued by the IBBI. Accordingly a SCN was issued to RP.

Submission by the RP:

- The RP was informed that these firms have registered Valuers as their partners or on

Findings and observations:

The third valuer can be appointed only if the RP is of the opinion that the two valuation are significantly different and this power cannot be delegated to anyone else including the COC. The fees for third valuation paid in this case was an unnecessary financial burden on the corporate debtor

Conclusion

The DC concluded that this was a of contravention of Section 208(2)(a) and (e) of the Code, Regulation 35(1)(b) of the CIRP Regulations and Regulation 7(2)(a) and 7(2)(h) of the IP Regulations, read with clauses 2,3,5 and 14 of the Code of Conduct as given in the First Schedule of the IP Regulations.

The role of a Resolution Professional is pivotal in any CIRP process. He is burdened with a number of duties and responsibilities failing which he may be held liable for contraventions and non compliances. Though doing the valuation of assets is not the responsibility of the RP but getting the same done from a qualified and duly registered valuer in accordance within the prescribed timeline and as per the regulations is definitely the responsibility of the RP. Hence proper precautions should be taken by an Insolvency Professional in appointing the valuer by adhering to the timeline and the eligibility criterion

The DC observed this as misinterpretation of law and non-compliance

The DC also observed a discriminatory treatment by the RP in this case. Where one valuer's services were discontinued for non-registration, the other valuer's service despite the same ineligibility, continued as the Valuers for the CD for further 6 months until they got registered on 29th August 2019. This differential treatment given to the two Valuers firms on the same issue is jarring as opined by the DC.

The DC found that there was a violation of Section 208(2)(a) and (e) of the Code, Regulation 27 of the CIRP Regulations, Regulation 7(2)(a), 7(2)(h) and 7(2)(i) of the IP Regulations, read Page 6 of 22 with clause(s) 1, 2, 10 and 14 of the Code of Conduct of the said IP Regulations and IBBI Circular IBBI/RV/019/2018 dated 17.10.2018.

Case 3

Order No. IBBI/DC/22/2020 21st April 2020- Order of Disciplinary Committee (DC)

In this case a SCN was issued to the RP in which along with other contravention, the following was also pointed out:

The liquidation value given by the two Valuers was Rs 175cr and Rs 215 cr. . . Third valuer was appointed in the COC meeting though there was no significant difference in the valuation done by the two Valuers. The RP in his reply admitted and agreed that there was no significant difference in the valuation and stated that the third valuer was appointed on insistence of Committee of Creditors (COC) and the RP had no ground to challenge the same.

START UP VALUATION
THE DILEMMA OF FREE CASH FLOWS

Mr.KAPIL MAHESHWARI-MBA

Introduction

The valuation of the Start Ups has been one of the most discussed topic for investment professionals in 2020 and in 2021 with several billion dollar worth IPO's planned by Indian Technology Start-ups the discussion is further gaining steam. Generally, Price of Recent Investment (PORI) is further gaining steam. Generally, Price of Recent Investment (PORI) is considered to be a fair indicator of the value of the start-up. Under PORI, if the last investor has come at say $100 million valuation, this becomes the benchmark for the next investor coming in. Considering that the recent investment satisfies the level 1 input of valuation as per accounting guidelines and also satisfies market approach application criteria, PORI definitely holds significant weight as an indicator of fair value. The big challenge however is that many times the initial investors would have got something more than an equity shareholder (in form of certain controls or covenants) and equating that to ordinary equity share value could be misleading. Also in an IPO the focus will shift from last Investment Price to multiples of comparable globally listed peers (as Indian peers may not be listed) Additionally with high volatility in the values of start-ups, the date of valuation is an important parameter for the analyst to consider. Broadly, the main difference between early stage start up and mature publicly listed business is that the listed company will have more concrete facts and figures to work upon. A steady stream of revenue and profitability makes it easier to estimate the Free Cash Flows which are non-existent for early stage start-ups. **This is the great dilemma for Valuer as how reliable are the future projections and free cash flow estimates provided by the management and the approach to take** In the subsequent section, we have touched upon the basic checks which the Valuer can consider while applying the Income approach for Start-up Valuations Also, one additional parameters which one shall consider while evaluating start-ups is the probability of success/failure. As per HBR, on an average - good plans, people, and businesses succeed only one in ten times. The valuer can therefore use an acceptable matrix which can estimate the probability of success or failure of the start- up based on management expertise, demand, pricing and moat around the business

Also, one additional parameters which one shall consider while evaluating start-ups is the probability of success/failure. As per HBR, on an average - good plans, people, and businesses succeed only one in ten times. The valuer can therefore use an acceptable matrix which can estimate the probability of success or failure of the start- up based on management expertise, demand, pricing and moat around the business ten times. The valuer can therefore use an acceptable matrix which can estimate the probability of success or failure of the start- up based on management expertise, demand, pricing and moat

START UP CLASSIFICATION AND APPROACH

Start Ups can be broadly classified into two categories:

1) **Revenue Generating Start Ups**
2) **Pre Revenue Start Ups**

For Revenue Generating Start-ups there is a proof of concept and of the product's ability to generate revenue. These start-ups may not be profit making however their ability to generate revenue makes them less riskier than the pre revenue stage companies.

DCF is an acceptable valuation method for revenue generating start-ups, however some key points shall be kept in mind are:

- The start-ups may take long to turn profitable, so the explicit forecast period should be longer in duration.
- Growth is a product of Return on Capital (ROC) and Reinvestment Rate (RIR) so make sure that requisite reinvestment which commensurate with projected Growth is done by the company.
- PV of Terminal Value may range from 60-80% of the total value of the start up
- Discount Rate shall reflect the Target Return to an Investor

Apart from Income approach, one can corroborate the findings using the market approach by making necessary adjustments.

For Pre Revenue Start-ups it becomes more complex as actual revenue numbers are not available and thus proof of concept is not established. The additional factors thus to consider in such cases are:

a) **Traction** which can be objectively quantified through number of users, quality of customers etc.
b) **Strength of Founding Team** highlighted through their relevant experience, skill and commitment to the business

Discount Rate Estimates

Stage & Target Return	
Start Up	50-70%
Stage I	40-60%
Stage II	35-50%
Bridge/ IPO	25-35%

**Source: Prof Aswath Damodaran*

We are our choices. Build yourself a great story. - **Jeff Bezos**

ADD-ON VALUATION METHODS FOR PRE REVENUE

Apart from traditional valuation methods, some of the other commonly used Valuation methods by Investors to value pre revenue start-ups are:

Method 1: Berkus Method

Investor Dave Berkus came up with a simple formula of breaking the company into 5 parameters giving each a rating upto $50,000 each:

a) Idea or the Basic Concept
b) Prototype and Technology involved
c) Quality of the Management Team
d) Strategic Relationships / Connections
e) Product Rollout or Launch Plan

However the matrix does not take market into consideration and the maximum value is capped at $2.50 million per start up.

Method 2: Venture Capital (VC) Method

Harvard Professor Bill Sahlman devised the Venture Capital method which is popular amongst the Investors. It has 2 stages:

1. First the Terminal Value of the business in the harvest year is calculated.
   Terminal Value = Revenue (Proj) x Margin (Proj) x Industry P/E
2. Second the Terminal Value is tracked back with the expected ROI and Investment amount to calculate the pre-money value

Method 3: Cost to Duplicate (CTD) Method

In this method, physical assets of the startup is assessed and then estimate how much it would take to duplicate the startup elsewhere. For example, a tech startup could consider the expenses in developing the prototype, IPR costs and other R&D expenses. The flip side is that this is not a forward looking valuation exercise.

Concluding Thoughts

zomato

Indicative Valuation: $5.4 Bn
Key Investors: Info Edge, Tiger Global, Kora, Fidelity

DELHIVERY

Indicative Valuation: $3.2 Bn
Key Investors: Soft Bank, Nexus, Multiples, CPPIB

pb

Indicative Valuation: $2 Bn
Key Investors: Soft Bank, Tiger Global, Tencent

Flipkart

Indicative Valuation: $25 Bn
Key Investors: Soft Bank, Tiger Global, Tencent

***About the Author** - The author is a practicing Registered Valuer (S&FA), with over 15 years of experience and also holds High Honors in Advanced Valuation Programme by NYU Stern University. These are his personal views. For any query you can reach him directly at*

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ICMAI REGISTERED VALUERS ORGANISATION

RECOGNISED RVO UNDER INSOLVENCY AND BANKRUPTCY BOARD OF INDIA

PROMOTED BY: THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

CASE-1

MIHEER H. MAFATLAL Vs. MAFATLAL INDUSTRIES LTD. 11/09/1996
Comp Cas 792 ; [1996] 4 Comp LJ 124 (SC).

Amalgamation of two companies - Mafatlal Industrited (MIL) Transfree and Mafatlal Fine Spinning and Manufacturing Company Limited (MFL) Transferor.

Shareholders approved the scheme by overwhelming majority and the Scheme was sanctioned by Gujarat High Court

Objections raised by the appellant, a shareholder of the transferee company MIL

The exchange ratio of equity shares of the transferor and transferee companies was ex facie unreasonable and unfair to the shareholders of the transferee company

Key Issues

1) Whether the respondent-company was guilty of hiding the special interest of its director Arvind Mafatlal from the shareholders while circulating the explanatory statement supporting the Scheme and whether thereby the voting by the equity shareholders got vitiated.

2) Whether the Scheme is unfair and unreasonable to the minority shareholders represented by the appellant.

3) Whether the proposed Scheme of Amalgamation was unfair and amounted to suppression of minority shareholders represented by the appellant and hence liable to be rejected.

4) Whether separate meeting of minority shareholders represented by the appellant was required to be convened on the basis that the appellant's group represented a special class of equity shareholders.

5) Whether the exchange ratio of two equity shares of MIL for five equity shares of MFL was ex facie unfair and unreasonable to the equity shareholders of MIL and consequently the Scheme of Amalgamation on that account was liable to be rejected.

The Supreme Court held that :

1. The sanctioning court has to see to it that **all the requisite statutory procedure for supporting such a scheme has been complied with** and that the requisite meetings as contemplated by Section 391(1)(a) of the Companies Act, 1956, have been held.

2. That the scheme put up for sanction of the court is backed up by **the requisite majority vote** as required by Section 391, Sub-section (2) of the Companies Act, 1956, (3) That the concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at an informed decision for approving the scheme in question. That the **majority decision of the concerned class of voters is just and fair to the class as a whole** so as to legitimately bind even the dissenting members of that class.

2. That **all necessary material** indicated by Section 393(1)(a) of the Companies Act, 1956, **is placed before the voters** at the concerned meetings as contemplated by Section 391, Sub-section (1) of the Act.
3. That **all the requisite material** contemplated by the proviso to subsection (2) of Section 391 of the Companies Act, 1956, **is placed before the court** by the concerned applicant seeking sanction for such a scheme **and the court gets satisfied about the same**.
4. That the proposed scheme of compromise and arrangement is **not found to be violative of any provision of law and is not contrary to public policy**. For ascertaining the real purpose underlying the scheme with a view to be satisfied on this aspect, the court, if necessary, **can pierce the veil of apparent corporate** purpose underlying the scheme and can judiciously X-ray the same.
5. That the company court has also to satisfy itself that **members** or class of members or creditors, or class of creditors, as the case may be, **were acting bona fide and in good faith and were not coercing the minority** in order to promote any interest adverse to that of the latter comprising the same class whom they purported to represent.
6. That the scheme **as a whole** is also found to be **just, fair and reasonable from the point of view of prudent men** of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant.
7. Once the aforesaid broad parameters about the requirements of a scheme for getting sanction of the court are found to have been met, the court will have no further jurisdiction to sit in appeal over the commercial wisdom of the majority of the class of persons who with their open eyes have given their approval to the scheme even if in the view of the court there could be a better scheme for the company and its members or creditors for whom the scheme is framed. The court cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction."
8. Once the exchange ratio of the shares of the transferee-company to be allotted to the shareholders of the transferor-company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest."

10. Once the exchange ratio of the shares of the transferee-company to be allotted to the shareholders of the transferor-company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest."

Other Observations by SC:

If a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, at the meeting, agree to any compromise or arrangement, the compromise or arrangement, shall, if sanctioned by the Court, be binding on all the creditors, all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company:

"It is a matter for the shareholders to consider commercially whether amalgamation or merger is beneficial or not. **The court is really not concerned with the commercial decision of the shareholders until and unless the court feels that proposed merger is manifestly unfair or is being proposed unfairly and/or to defraud the other shareholders**. Whether the merged companies will be ultimately benefitted or of expenses is a matter for the shareholders to consider.

it was for the equity shareholders who acted bona fide in the interest of their class as a whole to accept even a less favourable ratio considering other benefits that may offset such less favourable ratio once an amalgamation goes through.

Working results of the company for the last five years ended 31st March 1993 showed that the earning per equity share after depreciation and tax for the transferee company was Rs. 30/- while earning that of transferor-company was only Rs. 7/-

On the basis of the Balance Sheet as on 31st March 1993 for transfree-company value per equity share of Rs. 100/- each was Rs. 1,515/- while that for the transferor-company the break-up value per equity share was Rs. 259/-. That may be so. But as a package deal when the Scheme as whole is examined and found to be advantageous to the economic and commercial interest of shareholders as a class only **one or two item simpliciter for deciding the exchange ratio cannot tilt the balance as so many factors and aspects would enter that exercise**.

For arriving at the fair of share, three well known methods are applied:

(1) The manageable profit basis method (Earnings Per Share Method)

(2) The net worth method or the beak value method, and

(3) The market value method,"

That valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field of accountancy.

It was undertaken by expert body of chartered accountants like M/s C.C. Chokshi & Co.

The Court cannot, therefore, undertake the exercise of scrutinising the scheme placed for its sanction with a view to finding out whether a better scheme could have been adopted by the parties. This exercise remains only for the parties and is in the realm of commercial democracy permeating the activities of the concerned creditors and members of the company who in their best commercial economic interest by majority agree to give green signal to such a compromise or arrangement.

CASE-2

Hindustan Lever Employees' Union vs Hindustan Lever Limited And Ors on 24 October, 1994. Supreme Court of India SLP(civil)11006 of 1994

Merger of the two big companies- Hindustan Lever Limited (HLL), a subsidiary of Uni- Lever (UL), London and Tata Oil Mills Company Ltd. (TOMCO) Bombay High Court approved the scheme.

Objections to the Scheme by the Appellants:

Violation of Section 393(1) (a) of the Companies Act in not making required disclosures in the explanatory statement.

a) **Valuation of share exchange ratio is grossly loaded in favour of HLL. Exchange ratio fixed was 2 shares of HLL in exchange of 15 shares of TOMCO. If valuation was done by the net asset method, the exchange ratio should have been 1:2 in favour of TOMCO. TOMCO was to pay Rs. 366 for every HLL share, but Unilever was paying only Rs. 105 per HLL share**.

b) Ignoring the effect of provisions of the Monopolies and Restrictive Trade Practices Act (the MRTP Act).

c) Interest of employees of both the Companies was not adequately taken care of.

d) **Preferential allotment of shares at Rs. 105 per share, less than market price to Unilever which is not in public interest.**

e) Mala fides on account of existence of quid pro quo between Unilever and Tata Sons Ltd.

Objection to the Valuation Reports demanding independent valuation:

ICICI in its valuation report stating that it was only on the basis of the material supplied by HLL and **not on the basis of any independent verification.**

Mr. Y H Malegam, Valuer was a Director of ICICI. He was Senior Partner of M/s. S.B. Billimoria and Company, Chartered Accountants, former President of Institute of Chartered Accountants and the Director of Reserve Bank of India.

A combination of different methods of valuation was adopted, which was clearly against the law laid down by the Supreme Court in the case of Commissioner of Gift Tax, Bombay v. Smt. Kuswnben Mahadevia, 122 ITR 38.

If the valuation was done by the net asset method, the exchange ratio should have been 1:2 in favour of TOMCO.

Market value of the shares of the two Companies was taken at a point of time when the price of TOMCO shares was the lowest for a period of 27 months.

A valuation report by another valuer, G. Rai & Co., CA. put book value of equity share of TOMCO as on 31. 3.1992 based on its audited balance sheet at Rs.57. 58 per share and that of HLL at only Rs.28.84 per share. This, demonstrated the absurdity of the valuation that had been made of the shares of the two Companies The exchange ratio was obviously unfair to the shareholders of TOMCO.Preferential allotment of shares to Unilever was part of the Scheme of Amalgamation. The Board should have explained why Rs. 366 was being paid for every HLL share by TOMCO, when Unilever was paying only Rs. 105 per HLL share.

SC Observed that:

We are unable to uphold any of the above contentions.

The overwhelming majority of the shareholders had approved the Scheme at the meeting called for this purpose and had approved the exchange ratio. In fact, a proposal for amendment of the exchange ratio was also rejected by the overwhelming majority of 99% shareholders. There is no reason to presume that the shareholders did not know what they were doing.

Two independent valuers - A.F. Ferguson and N.M. Raiji & Co. - had valued the shares and came to the conclusion that exchange ratio of 15:2 was correctly determined by Mr. Malegam.

The position got worse in the year 1993-94. The in the region of Rs. 16 crores and had to sell not only investments, but also fixed assets of the Company.

In the background of these facts that the company suffered huge operating loss, it cannot be said that the market price as on 17.6.93 did not reflect the true picture of the value of the Company's shares. On the market price basis as On 17.6.93 the exchange ratio of 2:15 was very fair. If the yield method is adopted, the ratio would be astronomically high in favour of HLL. But, if the book value is taken per share, then TOMCO shares would be of higher value than HLL shares.

On the question as to what method should be adopted for arriving at a proper exchange ratio - The usual rule is that shares of the going concern must be taken at quoted market value. The valuer adopted a combination of three well-accepted methods to arrive at the fair value of the shares. The methods are: (I) the yield method; (II) the asset value method; and (III) the market value method. After considering all the relevant factors, the valuer recommended in exchange ratio of 2 equity shares of HLL for every 15 ordinary shares of TOMCO.

In case of amalgamation a combination of all or some of the methods of valuation may be adopted for the purpose of fixation of the exchange ratio of the shares of the two companies. It is to be noted that even in such a situation, the book value method has been described as 'more of talking-point than a matter of substance'.

It is also to be noted that the financial institutions who held 41% of the shares of TOMCO, did not find any fault in the method of valuation of the shares.

On Mr. Malegam being a Director of TOMCO. HLL had no difficulty in accepting the share exchange ratio fixed, even though he was a Director of TOMCO, If there was any bias, it should have been in favour of TOMCO and not against TOMCO.

This exchange ratio was endorsed by two other eminent firms of Chartered Accountants and also by ICICI. We are unable to uphold the contention that there was any impropriety in the valuation of the shares.

The shareholder has no interest in the assets of the company While the company is an existence. It is only at the stage of liquidation of the company that the shareholders become interested in the assets of the company.

In any event, whether Unilever was paying the proper price for the shares or not, is a question which is now before the Bombay High Court in a separate proceeding Hindustan Lever Ltd. & Ors. v. Reserve Bank of India & Ors., Writ petition No, 1666 of 1994. The Reserve Bank of India has not granted approval to the proposal of allotting 29,84,347 equity shares of Rs. 10 fully paid up at a premium of Rs. 95 per share. According to the guidelines set by the Reserve Bank of India, a premium of Rs. 346 will have to be paid per share

CASE-3

Dr. Mrs. Renuka Datla vs Solvay Pharmaceutical B.V. & Ors on 30 October, 2003, Supreme Court of India

Dispute between the shareholders of two pharmaceutical companies

According to the terms of settlement, M/s. Solvay Pharmaceuticals (R1) and Mr. Vasant Kumar (R3) had agreed to purchase 4.91% shares held by the petitioners in the two companies namely Duphar Pharma India Ltd. (DPIL renamed as Solvay Pharma India Ltd.) and Duphar Interfran Ltd. (DIL). As per the Terms of settlement valuation was to be done of the intrinsic worth of the two companies and the value of 4.91% shares in the said two companies held by the petitioners.

Mr. Y.H. Malegam, Chartered Accountant, Mumbai was appointed for valuation "by applying the standard and generally accepted method of valuation". Mr. Malegam after assessing the intrinsic worth of the two Companies as going concerns, the valued 4.91% shares at Rs.8.24 crores.

The Valuer considered three methods of valuation. (1) Asset based (2) Earning based (3) Market based.

While working out the earning based valuation, the value on the basis of **capitalization of past earnings was adopted instead of** commonly used methodology, **future earnings** based valuation for the following reasons:

(1) No independent (third party) projections have been provided;

(2) Both parties have provided projections which differed substantially

A higher weightage was given to the earnings value as compared to its asset value, considering that the value of a company/business would be more influenced by its earnings value. **Asset based value 1/3rd weightage and Earnings based value 2/3rd weightage without adding the element of control premium**.

Objections:

'Control premium' to value of 4.91% shares which formed part of the combined holding of 25% of the Indian promoters' was not added. Certain special rights and privileges were attached to these promoters' shareholding and, therefore, the intrinsic worth of the shares should have been assessed by adding the control premium.

Higher weightage was given to earnings

Value of Vertin and Colopsa brands which are the original research products of the foreign promoter were not included for valuation

If the data and projections furnished by the parties was not reliable the Valuer should have secured the relevant data from independent sources or could have called for further particulars.

SC Observed that:

Court could intervene:

If the valuation was made on a fundamentally erroneous basis, or a patent mistake had been committed by the valuer, or

That the valuation was vitiated by a demonstrably wrong approach or a fundamental error going to the root of the valuation.

Also laid down that:

If the valuer applied the standard methods of valuation,

Considered the matter from all appropriate angles without taking into account any irrelevant material or eschewing from consideration any relevant material,

His valuation could not be challenged on the ground of its being vitiated by fundamental error.

’Vertin’ and ’Colospa’ brands, were not the assets of DPIL. The assets as per the relevant records have to be taken into account by the Valuer and that has been done. We, therefore, find no apparent error in excluding those brands.

When there are vast discrepancies between the projection given by the parties and independent projections have not been provided, the Valuer has chosen the best possible method of evaluation by capitalizing the past earnings. In doing so, the future maintainable profits based on past performance is also an element that has gone into the calculation. No prejudice whatsoever is shown to have been caused to the petitioners by the earnings based.

The terms of settlement do not, either in express terms or by necessary implication, contemplate the valuation by determining the intrinsic worth of 4.91% shares, having due regard to their special or distinctive characteristics. The holding of 4.91% does not give any special advantage to the holder or in this case since the respondents collectively held 60.5% of the share capital of each company. On that consideration, the value of the shares can only be 4.91% of the intrinsic worth of the two companies.

What has not been said in the terms of settlement in specific and clear terms cannot be superimposed by the Court while interpreting the terms of settlement. The language employed in the terms of settlement does not even necessarily imply that special weightage in the form of 'control premium' has to be given to these 4.91 % shares.

the Valuer approached the question of valuation having due regard to the terms of settlement and applying the standard methods of valuation. The valuation has been considered from all appropriate angles. No case has been made out that any irrelevant material has been taken into account or relevant material has been eschewed from consideration by the Valuer.

Ordered for payment of Rs. 8.24 crores representing the value of 4.91% shares together with interest @ 9 per cent for a period of 12 months.

CASE-4

G.L. Sultania and Another vs The Securities and Exchange Board. Supreme Court Appeal (civil) 1672 of 2006 **on 16 May, 2007**

Case of valuation of infrequently traded shares of listed company under SEBI takeover code Objections

The SEBI and Merchant Banker had not properly valued the shares of the target company in accordance with the parameters laid down in Regulation 20(5) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as the 'Takeover Code').

Facts

Case of takeover of a listed public company

Acquirers - ACE Glass Containers Ltd., and C.K. Somany Target company - Hindustan National Glass and Industries Ltd.

Shares of the target company were infrequently traded and Public share-holding was less than 0.30%.

The Somany family comprising of four brothers held equal shares in the target company.

In 1994 about 40% of the equity capital of the target company was transferred to C.K. Somany pursuant to a family settlement arrived at between the brothers.

According to the appellants on August 5, 1994 there was an agreement between C.K. Somany, and his brothers for the sale of the entire balance shareholding in the target company held by his brothers to

C.K. Somany at the price of Rs.267/- per share, which was disputed.

During pendency of the matter, another MoU was done between C.K. Somany and his brother S.K. Somany to acquire 7.30% of the shares @ Rs.40 per share in the target company, that triggered the provisions of the Takeover Code and C.K. Somany was obliged to make a public offer.

Public offer was made at Rs.40 per share as determined by the Merchant Banker -. UTI Bank

On complaint by the appellants, Deloitte Haskin and Sells, a CA firm was appointed by the acquirers in consultation with the Merchant Banker, who determined the price of each share as Rs.43.02 per share.

The appellants still persisted with their objection. SEBI then appointed Patni & Company to value the shares, who valued the shares at .64.17.

Appellant G.L. Sultania again complained and submitted two more valuation reports from Anand K. Associates and Sanjay Bajoria and Associates who valued the shares at much higher rates of Rs.408/- and Rs.590/- per share respectively.

SEBI accepted the valuation report of Patni and approved the draft letter of offer.

Where the shares of the target company are infrequently traded, the offer price shall be determined taking into account the following factors:-

(a) **the negotiated price under the agreement**

(b) **the highest price paid by the acquirer or persons acting in concert with him for acquisitions, during the twenty-six week period prior to the date of public announcement.**

(c) **other parameters including return on net worth, book value of the shares of the target company, earning per share, price earning multiple vis-a-vis the industry average**;

The aforesaid Regulation, mandates that the parameters expressly laid down therein must in all cases be considered by the valuer since they are basic and essential. If the valuation report discloses non consideration of any of the enumerated parameters, the report shall stand vitiated for that reason. This does not prevent the valuer from considering other relevant factors according to accepted principles of valuation of shares.

Court Observed that:

The Regulation seeks to protect the interest of an investor by ensuring that he gets a fair price for his shares in the target company.

Not any one of the parameters is in itself decisive. All the factors have to be considered and the valuation arrived at.

Regulation does not prescribe the weightage to be assigned to different enumerated parameters. Many imponderables enter the exercise of share valuation, therefore, the **weightage to be given to the different factors that go into the process of valuation, must be left to the wisdom, experience and knowledge of the experts in the field of share valuation.**

the method of share valuation which involves subjective and objective considerations, there is considerable scope for difference of opinion even amongst experts. Even if the correct principles are applied, different valuers may arrive at different valuations. **Each one of them may be right, yet the valuations may differ.**

Mathematical precision and exactitude are not the attributes of share valuation, for at best the valuation arrived at by an expert is only his opinion as to what the value of the share should be. No doubt the variation may not be very wide between two valuations prepared honestly by two valuers applying the correct approach and the correct principles, but some variation is unavoidable.

About valuation by M/s. Patni and Company

It has proceeded on the basis of financial data made available to it by the target company.

It used the three commonly adopted methods of valuation of shares, namely, the Net Asset Method, The Profit Earning Capacity Method, and the Market Price Method.

Each method proceeds on different fundamental assumptions, which have greater or lesser relevance, and at times there is no relevance of a particular methodology to a given situation.

the principle that for working out the average profit, profit of only those years which were normal and not affected by abnormal situations should be considered, was approved In Hindustan Lever.

Took capitalization rate as 15% as suggested for manufacturing Companies in erstwhile Controller of Capital Issues guidelines.

Revaluation Reserve and Contingent Liabilities were excluded

having regard to the infrequently traded shares of the Company, the average of market price of six months prior to October 7th, 2002, the reference date as stated in the letter of offer has been considered

Patni and Company has expressly noticed the provisions of Regulation 20(5) and concluded that applying clause (a) and (b) of Regulation 20(5) the offer price of the shares cannot be less than Rs.40/- per share being.

Adverting to the parameters enumerated in clause (c) of Regulation 20(5) value worked out:, Book Value Rs.83.02 per share.

Profit Earning Capacity Value Rs.34.39 per share.

The earning per share has been worked out by multiplying average earning per share by Industry Profit Earning which is taken as 9.60 for the sector Glass and Glass Products.

So calculated the price per share comes to Rs.67.97 paise.

After taking the values worked out by the three methods PECV, NAV and EPS and giving them weightage, the value per share comes to Rs.57.55 per share.

To arrive at the fair market value, M/s. Patni and Company after analyzing the financial results and decided to exclude the year of abnormally low profits and abnormally high profits thereafter applying

the same weightage as in Hindustan Lever, (except for the market price) the fair value per share has been found to be Rs.63.50 paise.

The weightage for market value was reduced from 2 to 1 because in the case of infrequently traded shares, the market price has less relevance.

The objections only demonstrate that they are really matters within the realm of the experts to determine and the Court may not be justified in delving into those matters, which must be left to the wisdom, expertise and experience of a qualified valuer.

Valuation per share by:

Deloitte Haskin and Sells valued at Rs.43.02 Patni and Company valued at Rs.64.17 Chadha and Company valued at Rs.60.04.

Industry Composite P/E ratio of 20.9 is calculated based on P/E ratio of 3 profit making companies only, thereby ignoring the performance of other 9 companies. Moreover P/E ratio of glass and glass product industry is very fluctuating because of infrequent trading of shares of most of the companies in this sector. It is for these reasons that **P/E ratio of 9.6 was considered as the industry P/E ratio.**

ACE Glass was a potentially sick company registered with the BIFR having carry forward losses of Rs.266 crores as on March 31, 2003 and there was no reasonable prospect of earning any dividend from ACE Glass in the immediate foreseeable future. There was no question of consolidating the net worth of ACE glass into the net worth of the target company or the profit earning capacity of ACE Glass with the profit earning capacity of the target company.

He submitted that it is well recognized that a shareholder in a company does not ipso facto have a right in the assets of the company and that his right is only to receive dividends from the company. The value of the assets of the target company cannot be included to the value of the assets of the holding company, more so in the case of an associate company.

As per normal accounting practices, **for determining the value of shares as a going concern only individual financial statements are considered because parent company is entitled to dividend only and has no right whatsoever in the assets of subsidiary** and associate companies.

Profit Earning Capacity Value should not be calculated on the basis of past earnings alone as done by the valuer, but on future maintainable profit basis. **The fallacy of the valuation** lies in the fact that valuing the shares in accordance with PECV method, **the valuer arrived at a figure of 55.06 per share while undertaking the said exercise in accordance with HLL guidelines and the said value is reduced to Rs.34.39 while adopting the very same method but while valuing the shares in terms of Regulation 20(5).**

The valuer adopted the higher of the two values.

This court would not interfere with the valuation of an expert unless it is shown that:

Some well accepted principle of valuation has been departed from without any reason, or that the approach adopted is patently erroneous or

That relevant factors have not been considered by the valuer or

That the valuation was made on a fundamentally erroneous basis or that the valuer adopted a demonstrably wrong approach or

a fundamental error going to the root of the matter,

Having considered all aspects of the matter, we are satisfied that the valuer, Patni & Company have not committed any such error which may justify our interference.

They have considered all the factors relevant under Regulation 20(5)) of the Takeover Code and have adopted a reasonable approach which does not call for interference by us.

It may be that views may differ and it is no gain saying that even experts may differ in their conclusions or even reasoning.

The court must take notice of this fact and must not interfere unless there are compelling reasons to upset the finding of the expert valuer on grounds such as those enumerated in the earlier part of the judgment or other similar ground.

Regarding valuation reports of M/s. Sanjay Bajoria & Associates and M/s. Anand K. Associates who valued the shares at Rs.590/- and Rs.408/- per share respectively. The Board, in our opinion, has given good reasons for rejecting those reports. The shares were valued at abnormally high rates and as between the two reports there was a vast different of Rs.182/- per share. This great disparity itself furnishes a good ground for rejecting these reports particularly, when the valuation reports of three other Valuers had valued the shares at much lower rates.

Board committed no error in accepting the report of Patni & Co. The Board has acted in a reasonable manner and made its best efforts to secure a reasonable price for the shares of the shareholders. It has exercised its discretion wisely and we find no reason to interfere.

Appeals dismissed but without any order as to costs.

CASE-5

Brooke Bond Lipton India Ltd...Vs. Unknown, Calcutta High Court 1999- 98 Comp Case 496 Cal

Scheme of amalgamation between Brooke Bond Lipton India Ltd., Transferor Company with Hindustan Lever Ltd. transferee Company. Both being subsidiaries of Unilever plc. With common management and several common directors.

In the meeting of the transferor company, 99.5 per cent of the members present and voting, voted in favour of the amalgamation

The scheme had already been approved by the Bombay High Court and there was no objection by the Regional Director.

Objectors- Five very small shareholders with total shareholding of 298 shares of the face value of Rs. 2,980.

None of them: had any correspondence with the company seeking any clarifications or doubts on any aspects of the proposed amalgamations; inspected the valuation report when tendered for inspection to the members; attended the court convened meeting

The main objections to the Scheme were:

a) In view of the overwhelming shareholding majority of Unilever they should be placed in a different class and accordingly the shareholders as a class, have not been properly represented.

b) Since without the consent of the landlord tenancies cannot be transferred, the scheme is prejudicial.

c) The exchange ratio has not been properly or fairly determined and unfair to the shareholders of Brooke Bond Lipton India Ltd.

d) The valuation report did not value the assets of the company properly in that the value of the brands has not been taken into account.

Requested for appointment of an independent valuer

Deficiencies pointed out in the valuation report of S. B. Billimoria and Co, and N. M. Raiji and Co., chartered accountants.

a) No details have been given by the valuers. They have not carried out any independent audit or test to verify the accuracy of the information supplied by the management of the companies and the audited financial statements.

b) does not disclose the value per share of either the company or Hindustan Lever Ltd. and as such the basis of arriving at the exchange ratio referred to in the said valuation report and in the scheme has not been disclosed.

c) no valuation has been conducted "on assets basis". The company owned a large number of well- known brands - Kissan, Kwality, Dalda, Anikspray, Brooke Bond, Lipton, Red Label Tea, Yellow Label Tea, Green Label Tea, Bru, Cafe, Milkana, etc. with huge market value. Some brands like Kwality, Anikspray etc. were acquired by the company upon payment of massive sums of money. The value of such trademarks and brand names are not reflected in the audited accounts of the company. The value of such trademarks and brand names has not been taken into account for the exchange ratio.

d) No provision has been made in the scheme with regard to the shareholding of the company in Hindustan Lever Ltd. The report take into account only book value of the said shares which is much below the market price.

e) Irrelevant matters have also been taken into account in arriving at the exchange ratio such as disputed share premium of Rs. 17,758 lakh with Hindustan Lever Ltd. lying in an "escrow".

f) The scheme provides that the shareholding of Hindustan Lever Ltd. and its subsidiaries in the company are to be cancelled. Yet the value of such shares had been taken into consideration in arriving at the exchange ratio. Such shareholding were substantial.

Deficiencies pointed out in the valuation report of ANZ Grindlays bank and ICICI Securities and Financial Company Ltd.

a) Merely adopted the valuation of S. B. Billimoria and Co. and N. M. Raiji and Co. and no independent exercise was undertaken.

b) The appraisal report records that the exchange ratio arrived at in the valuation report are fair and reasonable to the shareholders of Hindustan Lever Ltd. but no such opinion is found with regard to the shareholders of Brooke Bond Lipton India Ltd.

c) one of the joint valuers i.e**. N. M. Raiji and Co. were statutory auditors not only of ICICI Securities and Finance Co. Ltd. but also of its holding company** i.e. the Industrial Credit and Investment Corporation of India Ltd. (ICICI) and a host of its other subsidiaries.

HC relied on the judgment of SC in <u>Miheer H. Mafatlal v. Mafatlal Industries Ltd.</u> <u>and Hindustan</u> <u>Lever Employees' Union v. Hindustan Lever Ltd</u>. and held that:

(a) The proposal would have been passed even without the voting by Unilever by overwhelming majority. Both the transferor and the transferee being already subsidiaries of Unilever and there is no change whatsoever

(b) It is only after the scheme is sanctioned that the consent of the landlord has to be obtained. The court cannot assume that the consent will not be granted. If such a proposition is accepted that will amount to the fact that no scheme of amalgamation by the transferor-company with monthly tenancies can be sanctioned.

(c) & (d)

It has been repeatedly held in several decisions that if the ratio of exchange has been fixed by an experienced and reputed firm of chartered accountants, then in the absence of any charge of fraud against them the court will accept such valuation and ratio of exchange. A mere allegation of fraud is not enough, it must be a proper charge of fraud with full particulars. In the instant case, there is no charge made or established.

The method followed by the valuer has been specifically approved by the Supreme Court in the merger of the transferee and TOMCO where the same valuers have submitted a valuation report and had followed exactly the same procedure.

The objection with regard to exchange ratio of shares cannot be accepted as the **valuer was asked to provide an exchange ratio and not to provide the value of the shares**. The report is similar to the one upheld by the Supreme Court in

It is well-recognised that the brands are part of the goodwill of the business and cannot be valued separately.

The auditor of the transferor-company Lovelock and Lewes has also certified that the valuation is fair and reasonable."

The scheme was sanctioning the scheme, subject to the condition that the shares to the extent of 2,36,910 held by Brooke Bond Lipton India Ltd. in Hindustan Lever Ltd. will be sold in accordance with law within December 31, 1996.

CASE-6

Dinesh Vrajlal Lakhani vs Parke Davis (India) Ltd Bombay High Court, 2005

Scheme of Amalgamation of Parke-Davis (India) Ltd. with Pfizer Limited

Key Issues:

Amendment proposed for an alteration of the swap ratio was not allowed

Vote of one shareholder present in the meeting, was counted more than once in respect of different folios of shares.

Order made by the Court cannot have effect until a certified copy of the order has been filed with the Registrar. There was a clear illegality on the part of the company in acting on the basis of an authenticated copy of the order of the Learned Company Judge.

The Court held:

At the meeting which is convened by the Court, it is entirely for the members in their commercial wisdom to determine whether the Scheme of Amalgamation as proposed should be accepted or rejected.

The members are entitled to determine as to whether the swap or exchange ratio ought to be accepted or rejected, or whether is not in their interest. That is a matter of their commercial wisdom.

At a meeting convened by the Court for considering proposed amalgamation, there cannot obviously be an amendment of the swap ratio. The swap or exchange ratio constitutes a determination of valuers who, are Chartered Accountant of repute. The swap ratio is a matter not only of acceptance for the transferor and its members but for the transferee and its members as well. The transferee has to allot shares upon amalgamation to the shareholders of the transferor. Obviously even if the shareholders of the transferor consider that a more favourable swap ratio should have been adopted, that cannot be foisted on the transferee since the terms of the proposed compromise are matters of mutual acceptance between the transferor and transferee.

The swap ratio is an integral part of the proposal which is before the meeting and an amendment to the swap ratio will operate to nullify the basis of the Scheme of Amalgamation. Whether the Scheme of Amalgamation should or should not be accepted is for the members of the Company to decide but, there can be no gain saying that an amendment to the swap ratio would nullify basis and foundation of the Scheme of Amalgamation.

Resolution was passed with an overwhelming majority of 99.94 per cent shareholders in support. Therefore, in any event of the matter, we do not find any infirmity or ground for interference.”

An authenticated copy of the order of the Court is an authentic version of the order of the Court. There is, therefore, due compliance with the provisions of law.”

The shareholders in their commercial wisdom have thought it fit that the Scheme should be approved. Consistent with the well-settled principle of law, this Court would be slow to interfere with the decision of the shareholders.

The jurisdiction of the Court in such matters is not appellate in nature, but is founded on fairness. The Court will not for instance interfere only because the valuation adopted by the valuer may have been improved upon had another method been adopted.

The Court is neither a valuer nor an appellate forum to reappreciate the merits of the valuation. What the Court has to ensure is that the determination should not be contrary to law or unfair to the shareholders of the Company which has been merged.

Glossary of Valuation Terms

ICMAI REGISTERED VALUERS ORGANISATION
RECOGNISED RVO UNDER INSOLVENCY AND BANKRUPTCY BOARD OF INDIA
PROMOTED BY: THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

Glossary of Valuation Terms

Adjusted Book Value Method—a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values.

Arbitrage Pricing Theory—a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

Asset (Asset-Based) Approach—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Beta—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Business Enterprise—a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Capital Asset Pricing Model (CAPM)—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization—a conversion of a single period of economic benefits into value.

Capitalization Factor—any multiple or divisor used to convert anticipated economic benefits of a single period into value.

Discount for Lack of Control—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Economic Benefits—inflows such as revenues, net income, net cash flows, etc.

Economic Life—the period of time over which property may generate economic benefits.

Fair Market Value—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.

Financial Risk—the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See Business Risk.

Forced Liquidation Value—liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Going Concern—an ongoing operating business enterprise.

Goodwill—that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

Guideline Public Company Method—a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business, and that are actively traded on a free and open market.

Income (Income-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

OPPORTUNITIES FOR REGISTERED VALUERS

Companies Act, 2013

- Private placement of shares
- Issue of Share on Preferential basis
- Issue of Shares for consideration other than cash
- Issue of Sweat Equity Shares
- Non- cash transaction involving directors
- Mergers and Aquisionts
- Demergers
- Scheme of compromise or arrangement with creditors/member
- Submission of report by company liquidator
- Purchase of minority shareholding

SEBI Regulations

- SEBI (Issue and listing of Securitised debt Instruments and Security receipts) Regulation,2008
- SEBI (Infrastructure Investment Trusts) Regulations, 2014
- SEBI (Real Estate Investment Trusts) Regulations,2014
- SEBI (Listing Obligations and Disclosure Requirements) Regulations,2015
- SEBI (Issue of capital and Disclosure requirements) regulations,2018
- SEBI(Appointment of Administrator and procedure for refunding to the investors) Regulations,2018

Insolvency and Bankruptcy Code 2016

- Determination of value of assets, realizable value, Fair value and liquidation value as the case may be

Process for becoming Register Valuer

1. Meet eligibility requirements, qualification and experience prescribed under Rule 4 of the Companies (Registered Valuers and valuation) Rules, 2017
2. Seek enrolment as a valuer member of ICMAI RVO
3. Complete 50 Hours educational course
4. Register and pass computer based Examination conducted by IBBI
5. Submit requite Form along with fee in favour of IBBI and supporting documents to ICMAI RVO
6. ICMAI RVO shall verify Form & other requirements and forward the same along with its recommendation to IBBI
7. On receipt of Form along with recommendation of ICMAI RVO, fee and other documents, IBBI shall Process the application for registration
8. After registration with IBBI, take up COP training with ICMAI RVO
9. On completion of training ICMAI RVO shall issue a Certificate of Practice to the registered valuer
10. Valuation certificate can be issued only after obtaining Certificate of Practice

EDUCATIONAL QUALIFICATION & EXPERIENCE
For 50 Hours Educational Course

Asset Class	Eligibility/ Qualification	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; (ii) Post Graduate on above courses.	(I) Five years (ii) Three years
Land and Building	(I)Graduate in Civil Engineering, Architecture, or Town Planning or equivalent; (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).	(I) Five years (ii) Three years
Securities or Financial Assets	(I)Member of Institute of Chartered Accountants of India, Member of Institute of Company Secretaries of India, Member of the Institute of Cost Accountants of India, Master of Business Administration or Post Graduate Diploma in Business Management (specialisation in finance). (ii) Post Graduate in Finance	Three years

Any other asset class along with corresponding qualifications and experience in accordance with rule 4 as may be specified by the Central Government.

Note,- The eligibility qualification means qualification obtained from a recognized Indian University or equivalent Institute whether in India or abroad.".

PROCESS FOR IBBI EXAMINITION

1. The candidate may enroll for the examination on payment of the fee as prescribed by IBBI
2. Online examination with objective multiple-choice questions
3. The duration of the examination is 2 hours
4. Wrong answer attracts a negative mark of 25% of the assigned for the question
5. A candidate needs to secure 60% of marks for passing.

Format and Frequency of Examination

Format and Frequency of Examination

a. The examination is conducted online (computer-based in a proctored environment) with objective multiple-choice questions;
b. The examination centers are available at various locations across the country;
c. The examination is available on every working day;
d. A candidate may choose the time, the date and the Examination Centre of his choice for taking the Examination. For this purpose, he needs to enroll and register at
e. https://certifications.nism.ac.in/nismaol/
f. A fee of Rs.1500 (One thousand five hundred rupees) is applicable on every enrolment;
g. The duration of the examination is 2 hours;
h. A candidate is required to answer all questions;
i. A wrong answer attracts a negative mark of 25% of the marks assigned for the question;
j. A candidate needs to secure 60 % of marks for passing;
k. A successful candidate is awarded a certificate by the Authority;
l. A candidate is issued a temporary mark sheet on submission of answer paper;
m. No workbook or study material is allowed or provided;
n. No electronic devices including mobile phones and smart watches are allowed; and
o. Use of only a non-memory-based calculator is permitted. Scientific Calculators (memory based or otherwise) are not allowed.

GUIDELINES FOR ARTICLES

The articles sent for publication in the journal "The Valuation Professional" should conform to the following parameters, which are crucial in selection of the article for publication:

- ✓ The article should be original, i.e. Not
- ✓ Published/ broadcasted/hosted elsewhere including any website.
- ✓ A declaration in this regard should be submitted to ICMAI-RVO in writing at the time of submission of article.
- ✓ The article should be topical and should discuss a matter of current interest to the professionals/readers.
- ✓ It should preferably expose the readers to new knowledge area and discuss a new or innovative idea that the professionals/readers should be aware of.
- ✓ The length of the article should not exceed 2500-3000 words.
- ✓ The article should also have an executive summary of around 100 words.
- ✓ The article should contain headings, which should be clear, short, catchy and interesting.
- ✓ The authors must provide the list of references, if any at the end of article.
- ✓ A brief profile of the author, e-mail ID, postal address and contact numbers and declaration regarding the originality of the article as mentioned above should be enclosed along with the article.
- ✓ In case the article is found not suitable for publication, the same shall be communicated to the members, by e-mail.

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