VALUATION (20 marks)

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Lesson 12
Overview of Business Valuation

INTRODUCTION

Valuation is a process of appraisal or determination of the value of certain assets, i.e., tangible or intangible, securities, liabilities and a specific business as a going concern or any company listed or unlisted or company undergoing liquidation or other forms of organization, partnership or proprietorship. 'Value' is a term signifying the material or monetary worth of a thing, which can be estimated in terms of medium of exchange. In other words, it is an assessment resulting in an expression of opinion rather than arithmetical exactness.

Business valuation requires a working knowledge of a variety of factors, and professional judgment and experience. This includes recognizing the purpose of the valuation, the value drivers impacting the subject company, and an understanding of industry, competitive and economic factors, as well as the selection and application of the appropriate valuation approach (es) and method(s).

The parties need a value for exchange goods or services for which either market does not exist, or market discovers a spurious price for a variety of reasons, including manipulation. They may also need value of an asset for a variety of purposes. Valuation is a key financial information relied upon by investors and used to support decisions in financial markets, having direct impact on the public interest (IVSC, 2014). The services rendered by valuers also helps in avoiding 'market collapse' due to imperfect information (Bartke & Reimund, 2015). Some of the NPAs in the banking system are attributed to decisions based on such valuations. The Committee of Creditors may unjustly liquidate a company if it uses an inflated reference value for comparison with the value offered by resolution plans. Such decisions arising from use of inappropriate values has the potential to distort market and misallocate resources in a market economy. Sustainable economic growth can only be built on valuations that are trusted by investors, creditors, tax authorities, governments, regulators and others.

Generally, the valuation process has four parts.

i. First, pre-valuation process where the valuer and the client agree on the terms of engagement.
ii. Second, investigation which is the formal or systematic examination or research undertaken on the property.
iii. Third, data handling and interpretation which requires processing and calculation of data, qualification and verification of data, and analysis of data.
iv. Fourth, post-valuation process reporting, which provides for a single value, presented in the valuation report

    The valuation report provides clients with an independent, comparable evidence and a written confirmation of the value of a property that is neither ambiguous nor misleading. Further, the determination of the value and delivery of the valuation report is made by the valuer on the basis of a framework such as RICS Red Book or the IVS (International Valuation Standards). These standards inter alia provide for the bases of value which are the fundamental measurement assumptions on which values are based, and the approaches and methods which are used to attain different valuation bases.

    The valuation process is a complex process and requires multiple skills. In order to determine value, a valuer is required to make several judgments and must possess a mix of competencies.

NEED FOR VALUATION

Valuation of business plays a very vital role, therefore a business owner or individual may need to know the value of a business. The fair market value standard consists of an independent buyer and seller having the requisite knowledge and facts, not under any undue influence or stressors and having access to all of the information to make an informed decision. Business valuation is carried out to know the business and helps in strategic decision making. Appropriate purpose for valuation becomes the bases of valuation. The strategic decision making in Business Valuation may be related to following:

1. **Merger, acquisition or take over so that interested party can obtain fair market value -** A Party who enters into a transaction with another for acquiring a business as a going concern, he might compute the valuation of the target company on a going concern basis. On the other hand, if the intention of the acquirer is to acquire any property such as land, rights, or brands, the valuation would be closely connected to the market price for such property or linked to the possible future revenue generation likely to arise from such acquisition.
2. **Strategic Partnership, Joint Venture and Collaborations -** Valuation is needed while evaluating decision on Strategic Partnership or Joint Venture or Foreign Collaboration. These have potential to give competitive edge over others in the form of advanced technology or production processes, additional finance, expanding customer base, reengineering of existing product, new products or services, intensive and extensive market coverage.
3. **ESOP, ESPS and Employee Retention -** These are various tools to retain employees for longer period. ESOP is incentive arrangement made by employer for retaining its key employees by allowing them to purchase the shares of company at a fixed price on the date of the grant. ESOPs are taxable at the time of purchase of shares as salary income (perquisites) in the hands of employees. Difference in fair market price and issued price is taxable as salary on the date of issue of shares whereas difference between actual sale price and fair market value is taxable as capital gain in the hands of employees.
4. **At the time of Peaceful Exit -** Valuation is required to be worked out at the time of resolving the disputes among stakeholders; purchase of equity from dissenting shareholders; stake sale or exit by co-ventures, strategic partners, foreign collaborator or strategic investors; divestment by existing promoters in favour of strategic investors.
5. **Specific Situations -** Minority oppression cases, economic damages computations, ownership disputes, cases of insolvency and bankruptcy, breach of contract, during submission of resolution plans, during liquidation and winding up, as part of succession planning, the death or disability of the owner.
6. **Under Company Law provisions -** Valuation is mandatorily required at the time of further issue of shares; issue of shares for consideration other than cash; private placement of shares.
7. **Under Other Laws -** Valuation is required to be carried out under various laws in various situations. Regulations and Rules issued under various Acts have situation specific requirement for valuation like SEBI Act, Foreign Exchange Management Act (FEMA), Income Tax Act, Customs Act, Stamp Duty Act, IBC Code, 2016.
8. **For Insurance Coverage -** Valuation of asset for insurance cover need to be carefully assessed so that, on side it covers the damage to the fullest extent possible and on the other insurance premium is not in excess. In the matter of insurance, valuation is twin edge sword. Over valuation is harmful because it results into higher premium whereas under valuation is equally harmful as it will lead to exposed coverage in case of accidental damage to the assets.
9. **Court Directed Valuations -** Some times, business valuations are carried out as per the directions of the court. NCLT issues directives and appoint valuers in the matters of oppression and mismanagement. High Courts appoints valuers to resolve disputes and in winding up matters. ITAT and other tribunals may also engage valuers in certain situations.
10. **During winding up process -** The business assets are valued by the office of Official Liquidators. They are attached to High Courts. In Insolvency and Bankruptcies, valuers are appointed by Resolution Professionals to carry out valuation on Insolvency commencement date. In liquidation, company liquidators are required to appoint valuers to carry out valuation on liquidation commencement date. In case of voluntary winding up, company Board is required to engage valuer before issuing solvency certificate.
11. **For IPO and FPO -** Valuation of securities is required to be worked out at the time of listing of securities of the company. SEBI is regulatory authority. Under various regulations, SEBI has prescribed the requirement of valuation as well as valuation methodology.
12. **At the Time of Debt Funding -** At the time of business loans and debt funding, valuation is required to be worked out for the purpose of assessing security cover and need of funds of the business.

A market economy needs valuations of assets to facilitate a variety of transactions. For example, the corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 (Code) envisages estimation of fair value and liquidation value of the assets of the corporate debtor. These values serve as reference for evaluation of choices, including liquidation, and selection of the choice that decides the fate of the corporate debtor, and consequently of the stakeholders. A wrong valuation may liquidate an otherwise viable company, which may be disastrous for an economy. A banker determines the amount of loan that can be sanctioned against security of an asset. He may not have adequate protection, where it gives loan against the security of an asset whose value is overestimated. Some of the NPAs in the banking system are attributed to decisions based on such valuations.

A business valuation is a complex financial analysis that should be undertaken by a qualified valuation professional with the appropriate credentials. Business owners who seek a low-cost business valuation are seriously missing out on the important benefits received from a comprehensive valuation analysis and valuation report performed by a certified valuation expert. These benefits help business owners negotiate a strategic sale of their business, minimize the financial risk of a business owner in a litigation matter, minimize the potential tax that a business owner or estate may pay in gift or estate tax as well as provide defense in an audit situation.

FACTORS INFLUENCING VALUATION

After having done the due diligence process, the next step is to value the business for the purpose of deciding the swap ratio. A company will change the hand of ownership only when the fair market value is arrived to the satisfaction of the owner's of the seller company. Similarly the buyer company will be ready to pay for the price if it is in the beneficial interest of its owners too. The valuation of the assets and liabilities of the business entity depends upon the various factors. These factors may be as under:

- The past dividend track record of the companies.
- The past earning of the companies.
- The price of shares trading at the bourses of the companies, before the news of the merger deal and after the announcement of the deal.
- Bonus track record of the companies. IPO/ FPO of the companies. Past history of the prices of the shares of the companies.
- The voting strength in the merged entity of the shareholders.
- The net worth of the companies.
- Net assets of the companies.
- Liquidity in the Company.
- The underlying net tangible asset.
- Conditions of business (Running/closed).
- Future earnings and projections.
- Order Book status, number of ongoing projects, customer future projections.
- Future capacity utilisation.
- Cash flows.
- Net Present Value (NPV).
- Expected Rate of Return (ERR).

GENERAL PRINCIPLES OF BUSINESS VALUATION

In almost all business valuations, there are some principles, which are:

- **Principle of Time Value of Money:** This principle suggests that the value can be measured by calculating the present value of future cash flows discounted at the appropriate discount rate.
- **Principle of Risk and Return:** This principle believes that the investors are basically risk averse and on the other hand expects higher amount of wealth. Higher the risk, higher may be possibility of return and vice versa.
- **Principle of Substitution:** This principle believes that understanding the market with competitive forces are very important in order to decide the price consideration. The risk averse investor will not pay more than that of the substitute available in the market.

- **Principle of Alternatives:** This principle suggests that one should explore the various alternatives available in the market and should not rest only on one option. The benefits of vetting of various alternatives will give a comparative valuation and a prudent investor will choose the most beneficial alternative to his portfolio.
- **Principle of Expectation:** Cash flows are based on the expectations about the performance in future and not the past. In the case of mature companies, we may assume that the growth from today or after some certain period would be constant.
- **Principle of Reasonableness:** In valuation the principle of reasonableness is most important. It takes into consideration various aspects viz: nature of business, historical background, brand image, book value of the stock, earning capacity, dividend tract record, etc.

PURPOSE OF VALUATION

Valuation has been debated in India as an art or science and substantial part of the litigation in Mergers & Acquisitions (M&A) takes place on the issue of valuation as it involves an element of subjectivity that often gets challenged. The introduction of concept of Registered Valuer had been notified under Chapter XVII of the Companies Act 2013 to set the Indian valuation standards for standardizing the use of valuation practices in India, leading to transparency and better governance. The Institute of Chartered Accountants of India (ICAI) has issued and adopted Valuation Standards known as ICAI-Valuation Standards. Section 247 (2) of the Companies Act, 2013 mandates that a valuer shall

a) make an impartial, true and fair valuation of any assets;
b) exercise due diligence while performing the functions as valuer;
c) make the valuation in accordance with the Valuation. Rules; and
d) not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during three years prior to his appointment as valuer or three years after valuation of assets was conducted by him.

Companies (Registered Valuers and Valuation) Rules, 2017 (Valuation Rules) inter alia provides for:

a) registration of valuers, who may be individuals or partnership firms or companies, with Insolvency and Bankruptcy Board of India (IBBI) for conduct of valuation of different classes of assets under the Companies Act, 2013;
b) recognition of Registered Valuers Organisations (RVOs) to enroll valuer members, enforce a code of conduct on them, and conduct training and educational courses for its members; and
c) mechanism for notification and modification of valuation standards based on the recommendations of the "Committee to advise on valuation matters".

The Central Government delegated its powers and functions under section 247 of the Act to the Insolvency and Bankruptcy Board of India (IBBI) and specified it as the Authority under the said Rules. Only a person registered with the Authority as Registered Valuers can conduct valuations required under the Companies Act, 2013 and the Code. Subject to meeting other requirements, an individual is eligible to be an Registered Valuers, if he:

a) is a fit and proper person,
b) has the necessary qualification and experience,
c) is a valuer member of an RVO,
d) has completed a recognised educational course as member of an RVO,
e) has passed the valuation examination conducted by the Authority within three years preceding the date of making the application for registration, and
f) is recommended by the RVO for registration as a valuer. The individual is required to have either a post-graduate qualification in the specified discipline and three years' experience, or a bachelor's degree in the specified discipline and five years' experience.

VALUATION STANDARDS

Emphasis on valuation standards assumed greater prominence in the last quarter of the 20th Century as a result of the financial collapses which was traced to property related valuations /transactions. The concern to avoid such collapses led to the emergence of valuation standards, first on a national and then on an international level (Gilbertson & Preston, 2005). RICS responded to the 1970s property crash in the UK by publishing the Red Book, setting out standards of valuation and professional conduct expected of valuers, while the Federal Government in the USA responded to the "savings and loan" crisis of the late-1980s by insisting on uniform appraisal standards and the licensing of valuers in each State.

Two sets of standards, namely,

I. International Valuation Standards (IVS) issued by the International Valuation Standards Council (IVSC), and
II. the Royal Institution of Chartered Surveyors (RICS) Red Book, command great respect among the stakeholders. IVS comprises five 'General Standards' and six 'Asset-specific Standards'.
   - The General Standards contain standards applicable to valuation of all asset classes, covering scope of work, investigations and compliance, bases of value, valuation approaches and methods, and reporting.
   - The Asset-specific Standards include requirements related to specific types of asset valuation, including background information on the characteristics of each asset type that influence value and additional asset-specific requirements regarding common valuation approaches and methods used. These cover businesses and business interests, intangible assets, plant and equipment, real property interests, development property and financial instruments.

IVS allows flexibility to meet national requirements. Reportedly, some countries have adopted IVS as national standards, and some have adopted IVS with amendments to meet the requirements of national legislations. RICS Red Book adopts and applies IVS. The standards take three forms:

a) professional standards centred around ethics and conduct,
b) technical standards centred on common definitions and conventions,
c) performance or delivery standards centred on rigour in analysis and objectivity of judgement.

RICS also allows departures to meet local statutory or regulatory requirements. Red Book with departures is called national association valuation standards, which have been published in some countries. RICS Valuation Standards – Global and India issued in May 2011 provides four India-specific guidance notes:

a) valuation for financial statements,
b) valuation for secured lending,
c) development land in India, and
d) valuation for tax purposes in India.

It is understood that RICS is working on a national supplement to Red Book for India for valuations undertaken subject to Indian jurisdiction. The Valuation Rules (Rule 8) mandate that an RV shall, while conducting a valuation, comply with the valuation standards as notified or modified by the Central Government. Until the valuation standards are notified or modified by the Central Government, a valuer shall make valuations as per

a) internationally accepted valuation standards; or
b) valuation standards adopted by any RVO.

Rule 18 of the Valuation Rules enables the Central Government to notify and modify, from time to time, the valuation standards based on the recommendations of the Committee to advise on valuation matters.

Rule 19 of the Valuation Rules empowers the Central Government to constitute a committee to make recommendations on formulation and laying down of valuation standards and policies for compliance by companies and RVs. The Central Government constituted the Committee to advise on valuation matters.

REGULATORY ASPECTS AS TO VALUATION

Valuation provisions under the Companies Act, 2013

Section 247 of the Companies Act, 2013 Section 247 seeks to provide that valuation in respect of any property, stocks, shares, debentures, securities, goodwill or any other assets or net worth of a company or its assets or liabilities shall be valued by a person having such qualification and experience and registered as a valuer, in accordance with such rules as may be prescribed.

Valuation by Registered Valuers

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.
2. The valuer appointed under sub-section (1) shall, —
   a) make an impartial, true and fair valuation of any assets which may be required to be valued;
   b) exercise due diligence while performing the functions as valuer;
   c) make the valuation in accordance with such rules as may be prescribed; and
   d) not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during a period of three years prior to his appointment as valuer or three years after the valuation of assets was conducted by him.
3. If a valuer contravenes the provisions of this section or the rules made thereunder, the valuer shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees: Provided that if the valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.
4. Where a valuer has been convicted under sub-section (3), he shall be liable to
   I. refund the remuneration received by him to the company; and
   II. pay for damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

The Companies (Registered Valuers and Valuation) Rules, 2017

The Central Government vide its Notification dated 18-10-2017 notified the Companies (Registered Valuers and Valuation) Rules, 2017. The notification of these Rules shall, while bringing about a clarity regarding various aspect of valuation will have a major impact on the industry, professionals, stakeholders and the government as well. These rules envisage formation of Registered Valuers Organisations for enrolling and imparting continuous education to Registered Valuers.

Though there is some consensus among professional valuers about generally accepted approaches, methods and procedures; however, a need was felt for education, training, regulation and standardization of prevalent practices in valuation.

The notification of these Rules will lead to the setting-up of Valuation Standards that will improve transparency and governance. Introduction of Valuation Standards will ensure that the valuation reports disclose a true, fair and complete view and result in greater objectivity in valuation procedures. The increased transparency and fairness in the valuation system shall also boost stakeholders' confidence alongside plugging of loopholes in valuation.

Eligibility for registered valuers (Rule 3)

1. person shall be eligible to be a registered valuer if he-
   a) is a valuer member of a registered valuers organisation;
   b) is recommended by the registered valuers organisation of which he is a valuer member for registration as a valuer;

c) has passed the valuation examination under rule 5 within three years preceding the date of making an application for registration under rule 6;
d) possesses the qualifications and experience as specified in rule 4
e) is not a minor;
f) has not been declared to be of unsound mind;
g) is not an undischarged bankrupt, or has not applied to be adjudicated as a bankrupt;
h) is a person resident in India; Explanation – For the purposes of these rules 'person resident in India' shall have the same meaning as defined in clause (v) of section 2 of the Foreign Exchange Management Act, 1999 as far as it is applicable to an individual;
i) has not been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence: Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;
j) has not been levied a penalty under section 271J of Income-tax Act, 1961 and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal, as the case may be has expired, or such penalty has been confirmed by Income-tax Appellate Tribunal, and five years have not elapsed after levy of such penalty; and
k) is a fit and proper person:

Explanation – For determining whether an individual is a fit and proper person under these rules, the authority may take account of any relevant consideration, including but not limited to the following criteria-

I. integrity, reputation and character,
II. absence of convictions and restraint orders, and
III. competence and financial solvency.

2. No partnership entity or company shall be eligible to be a registered valuer if-
   a) it has been set up for objects other than for rendering professional or financial services, including valuation services and that in the case of a company, it is a subsidiary, joint venture or associate of another company or body corporate;
   b) it is undergoing an insolvency resolution or is an undischarged bankrupt
   c) all the partners or directors, as the case may be, are not ineligible under clauses (c), (d), (e), (f), (g), (h), (i), (j) and (k) of sub-rule (1);
   d) three or all the partners or directors, whichever is lower, of the partnership entity or company, as the case may be, are not registered valuers; or
   e) none of its partners or directors, as the case may be, is a registered valuer for the asset class, for the valuation of which it seeks to be a registered valuer

Qualifications and experience (Rule 4)

An individual shall have the following qualifications and experience to be eligible for registration under rule 3, namely:-

a) post-graduate degree or post-graduate diploma, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least three years of experience in the specified discipline thereafter; or
b) a Bachelor's degree or equivalent, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least five years of experience in the specified discipline thereafter; or
c) membership of a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession with at least three years' experience after such membership.

Explanation-I: For the purposes of this clause the 'specified discipline' shall mean the specific discipline which is relevant for valuation of an asset class for which the registration as a valuer or recognition as a registered valuers organisation is sought under these rules.

Explanation-II: Qualifying education and experience for various asset classes is given in an indicative manner in Annexure-IV of these rules.

Explanation-III: for the purposes of this rule and Annexure IV, 'equivalent' shall mean professional and technical qualifications which are recognised by the Ministry of Human Resources and Development as equivalent to professional and technical degree.

Valuation examination & certificate of registration (Rule 5 & 6)

1. An individual who passes the valuation examination shall receive the acknowledgment of passing the examination.
2. After submitting necessary papers along with application for examination, the authority upon satisfaction may grant the certificate of registration to the applicant to carry out activities of registered valuer.

Conditions of Registration (Rule 7)

The registration granted under rule 6 shall be subject to the conditions that the valuer shall -

a) at all times possess the eligibility and qualification and experience criteria as specified under rule 3 and rule 4;
b) at all times comply with the provisions of the Act, these rules and the Bye-laws or internal regulations, as the case may be, of the respective registered valuers organisation;
c) in his capacity as a registered valuer, not conduct valuation of the assets or class(es) of assets other than for which he/it has been registered by the authority;
d) take prior permission of the authority for shifting his/ its membership from one registered valuers organisation to another;
e) take adequate steps for redressal of grievances;
f) maintain records of each assignment undertaken by him for at least three years from the completion of such assignment;
g) comply with the Code of Conduct of the registered valuers organisation of which he is a member;
h) in case a partnership entity or company is the registered valuer, allow only the partner or director who is a registered valuer for the asset class(es) that is being valued to sign and act on behalf of it;
i) in case a partnership entity or company is the registered valuer, it shall disclose to the company concerned, the extent of capital employed or contributed in the partnership entity or the company by the partner or director, as the case may be, who would sign and act in respect of relevant valuation assignment for the company;
j) in case a partnership entity is the registered valuer, be liable jointly and severally along with the partner who signs and acts in respect of a valuation assignment on behalf of the partnership entity;
k) in case a company is the registered valuer, be liable along with director who signs and acts in respect of a valuation assignment on behalf of the company;
l) in case a partnership entity or company is the registered valuer, immediately inform the authority on the removal of a partner or director, as the case may be, who is a registered valuer along with detailed reasons for such removal; and
m) comply with such other conditions as may be imposed by the authority.

Conduct of valuation (Rule 8)

1. The registered valuer shall, while conducting a valuation, comply with the valuation standards as notified or modified under rule 18: Provided that until the valuation standards are notified or modified by the Central Government, a valuer shall make valuations as per-
   a) internationally accepted valuation standards;
   b) valuation standards adopted by any registered valuer's organisation.
2. The registered valuer may obtain inputs for his valuation report or get a separate valuation for an asset class conducted from another registered valuer, in which case he shall fully disclose the details of the inputs and the particulars etc. of the other registered valuer in his report and the liabilities against the resultant valuation, irrespective of the nature of inputs or valuation by the other registered valuer, shall remain of the first mentioned registered valuer.
3. The valuer shall, in his report, state the following: -
   a) background information of the asset being valued;

b) purpose of valuation and appointing authority;
c) identity of the valuer and any other experts involved in the valuation;
d) disclosure of valuer interest or conflict, if any;
e) date of appointment, valuation date and date of report;
f) inspections and/or investigations undertaken;
g) nature and sources of the information used or relied upon;
h) procedures adopted in carrying out the valuation and valuation standards followed;
i) restrictions on use of the report, if any;
j) major factors that were taken into account during the valuation;
k) conclusion; and
l) caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

Functions of a Valuer (Rule 10)

A valuer shall conduct valuation required under the Act as per these rules.

Eligibility for Registered Valuers Organisations (Rule 12)

1. An organisation that meets requirements under sub-rule (2) may be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes if
   I. it has been registered under section 25 of the Companies Act, 1956 (1 of 1956) or section 8 of the Companies Act, 2013 (18 of 2013) with the sole object of dealing with matters relating to regulation of valuers of an asset class or asset classes;
   II. it is a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession; Provided that, subject to sub-rule (3), the following organisations may also be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes, namely:-
      a) an organisation registered as a society under the Societies Registration Act, 1860 or any relevant state law, or;
      b) an organisation set up as a trust governed by the Indian Trust Act, 1882.
2. The organisation referred to in sub-rule (1) shall be recognised if it –
   a) conducts educational courses in valuation, in accordance with the syllabus determined by the authority, under rule 5, for individuals who may be its valuers' members, and delivered in class room or through distance education modules and which includes practical training;
   b) grants membership or certificate of practice to individuals, who possess the qualifications and experience as specified in rule 4, in respect of valuation of asset class for which it is recognised as a registered valuers organisation;
   c) conducts training for the individual members before a certificate of practice is issued to them;
   d) lays down and enforces a code of conduct for valuers who are its members;
   e) provides for continuing education of individuals who are its members;
   f) monitors and reviews the functioning, including quality of service, of valuers who are its members; and
   g) has a mechanism to address grievances and conduct disciplinary proceedings against valuers who are its members.
3. A registered valuers organisation, being an entity under proviso to sub-rule (1), shall convert into or register itself as a company under section 8 of the Companies Act, 2013, within one year from the date of commencement of these rules.

Model Code of Conduct for Registered Valuers

➢ **Integrity and Fairness**

1. A valuer shall, in the conduct of his/its business, follow high standards of integrity and fairness in all his/its dealings with his/its clients and other valuers.
2. A valuer shall maintain integrity by being honest, straightforward, and forthright in all professional relationships.
3. A valuer shall endeavour to ensure that he/it provides true and adequate information and shall not misrepresent any facts or situations.

4. A valuer shall refrain from being involved in any action that would bring disrepute to the profession.
5. A valuer shall keep public interest foremost while delivering his services.

- **Professional Competence and Due Care**

6. A valuer shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.
7. A valuer shall carry out professional services in accordance with the relevant technical and professional standards that may be specified from time to time
8. A valuer shall continuously maintain professional knowledge and skill to provide competent professional service based on up-to-date developments in practice, prevailing regulations/guidelines and techniques.
9. In the preparation of a valuation report, the valuer shall not disclaim liability for his/its expertise or deny his/its duty of care, except to the extent that the assumptions are based on statements of fact provided by the company or its auditors or consultants or information available in public domain and not generated by the valuer.
10. A valuer shall not carry out any instruction of the client insofar as they are incompatible with the requirements of integrity, objectivity and independence.
11. A valuer shall clearly state to his client the services that he would be competent to provide and the services for which he would be relying on other valuers or professionals or for which the client can have a separate arrangement with other valuers.

- **Independence and Disclosure of Interest**

12. A valuer shall act with objectivity in his/its professional dealings by ensuring that his/its decisions are made without the presence of any bias, conflict of interest, coercion, or undue influence of any party, whether directly connected to the valuation assignment or not.
13. A valuer shall not take up an assignment if he/it or any of his/its relatives or associates is not independent in terms of association to the company.
14. A valuer shall maintain complete independence in his/its professional relationships and shall conduct the valuation independent of external influences.
15. A valuer shall wherever necessary disclose to the clients, possible sources of conflicts of duties and interests, while providing unbiased services.
16. A valuer shall not deal in securities of any subject company after any time when he/it first becomes aware of the possibility of his/its association with the valuation, and in accordance with the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 or till the time the valuation report becomes public, whichever is earlier.
17. A valuer shall not indulge in “mandate snatching” or offering “convenience valuations” in order to cater to a company or client’s needs.
18. As an independent valuer, the valuer shall not charge success fee.
19. In any fairness opinion or independent expert opinion submitted by a valuer, if there has been a prior engagement in an unconnected transaction, the valuer shall declare the association with the company during the last five years.

- **Confidentiality**

20. A valuer shall not use or divulge to other clients or any other party any confidential information about the subject company, which has come to his/its knowledge without proper and specific authority or unless there is a legal or professional right or duty to disclose.

- **Information Management**

21. A valuer shall ensure that he/ it maintains written contemporaneous records for any decision taken, the reasons for taking the decision, and the information and evidence in support of such decision.
    This shall be maintained so as to sufficiently enable a reasonable person to take a view on the appropriateness of his/its decisions and actions.
22. A valuer shall appear, co-operate and be available for inspections and investigations carried out by the authority, any person authorised by the authority, the registered valuers organisation with which he/it is registered or any other statutory regulatory body.

23. A valuer shall provide all information and records as may be required by the authority, the Tribunal, Appellate Tribunal, the registered valuers organisation with which he/it is registered, or any other statutory regulatory body.
24. A valuer while respecting the confidentiality of information acquired during the course of performing professional services, shall maintain proper working papers for a period of three years or such longer period as required in its contract for a specific valuation, for production before a regulatory authority or for a peer review. In the event of a pending case before the Tribunal or Appellate Tribunal, the record shall be maintained till the disposal of the case.

➢ **Gifts and hospitality**

25. A valuer or his/its relative shall not accept gifts or hospitality which undermines or affects his independence as a valuer.
    Explanation. - For the purposes of this code the term 'relative' shall have the same meaning as defined in clause (77) of Section 2 of the Companies Act, 2013 (18 of 2013).
26. A valuer shall not offer gifts or hospitality or a financial or any other advantage to a public servant or any other person with a view to obtain or retain work for himself/ itself, or to obtain or retain an advantage in the conduct of profession for himself/ itself.

➢ **Remuneration and Costs**

27. A valuer shall provide services for remuneration which is charged in a transparent manner, is a reasonable reflection of the work necessarily and properly undertaken, and is not inconsistent with the applicable rules.
28. A valuer shall not accept any fees or charges other than those which are disclosed in a written contract with the person to whom he would be rendering service.

➢ **Occupation, employability and restrictions**

29. A valuer shall refrain from accepting too many assignments, if he/it is unlikely to be able to devote adequate time to each of his/ its assignments.
30. A valuer shall not conduct business which in the opinion of the authority or the registered valuer organisation discredits the profession.

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

Face Value of Equity Shares (Regulation 27)

The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, advertisements and application forms, along with the price band or the issue price in identical font size.

Pricing (Regulation 28)

1. The issuer may determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book building process, as the case may be.
2. The issuer shall undertake the book building process in the manner specified in Schedule XIII.

Price and price band (Regulation 29)

1. The issuer may mention a price or a price band in the off er document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before filing the prospectus with the Registrar of Companies: Provided that the prospectus filed with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.
2. The cap on the price band, and the coupon rate in case of convertible debt instruments, shall be less than or equal to one hundred and twenty per cent. of the floor price. Provided that the cap of the price band shall be at least one hundred and five percent of the floor price.
3. The floor price or the final price shall not be less than the face value of the specified securities.

4. Where the issuer opts not to make the disclosure of the floor price or price band in the red herring prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of Schedule X.
5. The announcement referred to in sub-regulation (4) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" of the offer document.
6. The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the stock exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the stock exchange(s).

Differential Pricing (Regulation 30)

1. The issuer may offer its specified securities at different prices, subject to the following:
   a) retail individual investors or retail individual shareholders or employees entitled for reservation made under regulation 33 may be offered specified securities at a price not lower than by more than ten per cent. of the price at which net offer is made to other categories of applicants, excluding anchor investors;
   b) in case of a book-built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants;
   c) In case the issuer opts for the alternate method of book building in terms of Part D of Schedule XIII, the issuer may offer the specified securities to its employees at a price not lower than by more than ten per cent. of the floor price.
2. Discount, if any, shall be expressed in rupee terms in the offer document.

Pricing of Frequently Traded Shares (Regulation 164)

1. If the equity shares of the issuer have been listed on a recognised stock exchange for a period of 90 trading days or more as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than higher of the following:
   a) The 90 trading days 'volume weighted average price of the related equity shares quoted on the recognised stock exchange preceding the relevant date; or
   b) the 10 trading days' volume weighted average prices of the related equity shares quoted on a recognised stock exchange preceding the relevant date. Provided that if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.
2. If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than 90 trading days as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than the higher of the following:
   a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of compromise, arrangement and amalgamation under sections 230 to 234 the Companies Act, 2013, as applicable, pursuant to which the equity shares of the issuer were listed, as the case may be; or
   b) the average of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during the period the equity shares have been listed preceding the relevant date; or
   c) the average of the 10 trading days' volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date. [Provided that if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.
3. Where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of 90 trading days from the date of listing on a recognised stock exchange with reference to the 90 trading days' volume weighted average prices of the related equity shares quoted on the recognised stock exchange during these 90 trading days and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer. Provided that if the Articles of Association

of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.

4. (a) A preferential issue of specified securities to qualified institutional buyers, not exceeding five in number, shall be made at a price not less than the 10 trading days' volume weighted average prices of the related equity shares quoted on a recognised stock exchange preceding the relevant date. Provided that if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue:

   (b) no allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to the promoters of the issuer: Provided that a qualified institutional buyer who does not hold any shares in the issuer and who has acquired rights in the capacity of a lender shall not be deemed to be a person related to the promoters. Explanation. —For the purpose of this clause, a qualified institutional buyer who has any of the following rights shall be deemed to be a person related to the promoters of the issuer: -

   a) rights under a shareholder's agreement or voting agreement entered into with promoters or promoter group;
   b) veto rights; or
   c) right to appoint any nominee director on the board of the issuer.

5. For the purpose of this Chapter, "frequently traded shares" means the shares of the issuer, in which the traded turnover on any recognised stock exchange during the 240 trading days preceding the relevant date, is at least ten per cent of the total number of shares of such class of shares of the issuer: Provided that where the share capital of a particular class of shares of the issuer is not identical throughout such period, the weighted average number of total shares of such class of the issuer shall represent the total number of shares.

   Explanation: For the purpose of this regulation, 'stock exchange' means any of the recognised stock exchange(s) in which the equity shares of the issuer are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding 90 trading days prior to the relevant date.

SECURITIES AND EXCHANGE BOARD OF INDIA (SHARE BASED EMPLOYEE BENEFITS AND SWEAT EQUITY) REGULATIONS, 2021

Employee Stock Option Scheme (ESOS)

Pricing-Regulation 17

The company granting options to its employees pursuant to an ESOS shall be free to determine the exercise price subject to conforming to the accounting policies specified in regulation 15 of these regulations.

Accounting Policies - Regulation 15

Any company implementing any of the share-based schemes shall follow the requirements including the disclosure requirements of the Accounting Standards prescribed by the Central Government in terms of section 133 of the Companies Act, 2013 including any 'Guidance Note on Accounting for employee share-based Payments' issued in that regard from time to time.

Employee Stock Purchase Scheme (ESPS)

Pricing and lock-in-Regulation 22

1. A company may determine the price of shares to be issued under an ESPS, subject to conforming to the accounting policies specified under regulation 15 of these regulations.
2. Shares issued under an ESPS shall be locked-in for a minimum period of one year from the date of allotment: Provided that in case where shares are allotted by a company under an ESPS in lieu of shares acquired by the employee under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in period required under this sub-regulation. Provided further that in the event of death or permanent incapacity of an employee, the requirement of lock-in shall not be applicable from the date of death or permanent incapacity.

3. If ESPS is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees pursuant to ESPS shall not be subject to any lock-in.

Issue of Sweat Equity by a Listed Company

Pricing-Regulation 33

The price of sweat equity shares shall be determined in accordance with the pricing requirements stipulated for a preferential issue to a person other than a qualified institutional buyer under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

SECURITIES AND EXCHANGE BOARD OF INDIA (DELISTING OF EQUITY SHARES) REGULATIONS, 2021

Discovered Price-Regulation 20

1. After fixation of the floor price under sub-regulation (2), the discovered price shall be determined through the reverse book building process in the manner specified in Schedule II of these regulations, and the Manager to the offer shall disclose the same in the detailed public announcement and the letter of offer.
2. The floor price shall be determined in terms of regulation 8 of Takeover Regulations as may be applicable.
3. The reference date for computing the floor price would be the date on which the recognized stock exchange(s) was required to be notified of the board meeting in which the delisting proposal was considered and approved.
4. The acquirer shall have the option to provide an indicative price in respect of the delisting offer, which shall be higher than the floor price calculated in terms of sub-regulation (2).
5. The acquirer shall also have the option to revise the indicative price upwards before the start of the bidding period and the same shall be duly disclosed to the shareholders.
6. The acquirer may, if it deems fit, pay a price higher than the discovered price determined.

THE COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014

Issue of sweat equity shares (Rule 8)

Under the Companies (Share Capital and Debentures) Rules, 2014, the sub rules of rule 8 states that the:

The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.

The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.

A copy of gist along with critical elements of the valuation report obtained under clause (6) and clause (7) shall be sent to the shareholders with the notice of the general meeting.

Where sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect there of obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company-

a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

SEBI (SAST) REGULATIONS, 2011

Offer Price

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SEBI (SAST) Regulations, 2011 for frequently or infrequently traded shares

Consolidated FDI Policy 2020

Issue Price of Shares

Price of shares issued to persons resident outside India under the FDI Policy, shall not be less than–

a) the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company are listed on any recognised stock exchange in India;

b) the fair valuation of shares done by a SEBI registered Merchant Banker or a Chartered Accountant as per any internationally accepted pricing methodology on arm's length basis, where the shares of the company are not listed on any recognised stock exchange in India; and

c) the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment.

However, where non-residents (including NRIs) are making investments in an Indian company in compliance with the provisions of the Companies Act, as applicable, by way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

VALUATION REQUIREMENTS UNDER DIFFERENT STATUTES IN INDIA

There are various laws in India which requires valuations from professionals e.g. the Companies Act, 2013, the Insolvency and Bankruptcy Code, 2016, the Indian Accounting Standards (Ind-AS), the Securities and Exchange Board of India Regulations, the Income Tax Act, 1961 and the Foreign Exchange Management Act, 1999

VARIOUS EXPRESSION OF VALUE

The definition of "value" is appearing in International Valuation Standards, ICAI Valuation Standards, Indian Accounting Standards and IBBI Regulations. The definition of value is in fact linked with the purpose of valuations. Upon comparison of these definitions one can observe that in all these definitions, it is specially mentioned that the value is an estimated amount or it may be an estimated amount for which an asset or liability should be exchanged or an estimated amount that would be realised on sale of assets or group of assets.

The various expression used for valuation are: -

1. Fair Market value

Estimated amount for which an asset or liability should exchange between willing buyer and a willing seller in an arm length transaction after proper marketing the parties acted knowledgeably, prudently and without compulsion. The concept of market value presumes a price negotiated in an open and competitive market where the participants are acting freely. In other words, fair market value is price at which the property would change hands between a willing buyer and a willing seller, where both are not under any compulsion to buy and sell and they have reasonable knowledge of relevant facts and information. This means that any representative price would not work if it affects buyer's or seller's unique motivations. This would be an example of investment value, defined by real estate terminology as "value to a particular investor based on individual investment requirements."

2. Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Thus, fair value is defined as

i. **Exit price:** The price that would be received to sell an asset
ii. **Market based:** Fair value is determined by transaction between market participants and it is not entity based
iii. **Orderly transaction:** A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (e.g. a forced liquidation or distress sale)

iv. **Price:** The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability.

3. Book Value

Book value is the historical value, synonymous to shareholders' equity, net worth, and net book value. It is the difference between total assets and the total liabilities appearing in the balance sheet of a company on a particular date. In any balance sheet, assets are recorded at historical costs, while the net of accumulated depreciation and liabilities are recorded at the face value.

4. Intrinsic Value

Intrinsic value is the real value of a company based on fundamental analysis of qualitative and quantitative factor and does not consider the Market value in any manner. It is measured as the present value of future cash flows from an asset or company by using an appropriate discount rate. The qualitative factors include company's performance, productivity, business management and market factors. The quantitative factors include financial statement and accounting data. The qualitative and quantitative factors assess in projecting future cash flows, growth rate and appropriate discount rate.

5. Replacement Value

Replacement value is the current cost of acquiring a similar new property which is likely to produce the nearest equivalent utility to the property being valued. An estimate of replacement cost takes into account how an asset would be replaced with newer materials and current technology. Replacement value is not the same as reproduction value, which is the cost of a duplicate asset, based on current prices. Replacement value and reproduction cost are used in the valuation of tangible assets that do not produce income directly, such as furniture and fixture, office equipment, and so on.

6. Going Concern Value

Going concern value is the value of a business that is expected to continue to the future. It takes into account various intangible assets of the organization. The intangible elements of going concern value result from successful continuation of business. Factors like trained workforce, brands, formulations, trademarks, recipes (in fast food and eating joints), operational systems, necessary licenses, and so on, generate value for intangible assets, for which substantial costs are incurred by the company. The going concern value is relevant in the decision of mergers and acquisitions. Sometimes, an 'in-place value' is said to be relevant to assets because they are in working condition and they help produce income.

For example, a fully depreciated asset can fetch some value because it is in place, functioning satisfactorily and generating cash. According to ICAI Valuation Standard 102, "Going concern value is the value of a business enterprise that is expected to continue to operate in the future". The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, the necessary licenses, marketing systems, and procedures in place etc Example of Going-Concern Value For example, suppose that the liquidation value of Widget Corp. is $10 million. This sum represents the current value of inventory, buildings and other tangible assets that can be sold assuming that the company is completely liquidated. However, Widget Corp. as going-concern value could very well be $60 million, as the compan's reputation of being the world's leading widget producer and its ownership of patents and associated rights for widget production mean that the company should have a large and steady stream of future cash flows.

7. Equity Interest Value

Equity interest of an investor in a business can be considered as an investment. The purchase of an equity interest in a closely held company can be considered as a long-term investment and in a listed company; it can be viewed as short-term investment. The equity investors not only expect to receive the investment (amount invested or principal) back from the company, but also expect to receive a fair return on the investment in the form of dividend. In addition, in the case of listed companies, the investors have an exit route through the stock market. Therefore, capital appreciation is regarded as an important part of return. This can be expressed in terms of the equation.

Return on equity investment

$$\frac{\text{Cash Flow (dividend)} + \text{closing market price} - \text{opening market price}}{\text{opening market price}}$$

8. Insurable Value

Insurable value is the value of destructible portion of an asset that requires to be insured to indemnify the owner in the event of loss. This type of value has significant relevance, sometimes in M&A decisions as insurance reduces the risk of the property. Of course, post-acquisition review of insurance coverage of property can be done with little impact on the valuation. For example, in case of a real estate property, the insurable interest will mostly be the market value of the property. However, the insurable value does not include the land on which the property stands.

9. Value-in-use and Value-in-exchange

Value-in-use or value-in-exchange is a condition under which certain assumptions are made in valuing assets. It is associated with assets that are already in productive use and can be described as the value of an asset, for a particular use or to a particular user, as part of a going concern. However, it is important to understand the concept since the value of acquired assets (especially furniture, fixtures, equipment, and premises) in M&A transactions is influenced significantly by their use in the post-acquisition period. When specific assets used by any going business are valued, it is generally assumed that those assets will remain in their most productive use. Value-in exchange is opposite to value-in-use; it relates to the value of a property or an asset exchanged for itself, and separate from an operating entity. Typically, the value-in exchange is less than the value-in-use of an asset in a going business enterprise

10. Goodwill Value

The term goodwill is defined as an asset representing the future economic benefits arising from a business, business interest or a group of assets, which has not been separately recognised in other assets. (ICAI Valuation Standard-101) Goodwill is a specific type of intangible asset that arises when a business as a whole has value greater than the value of its identified intangible assets. Goodwill is also the sum total of imponderable qualities of a company which attract the customers to a business and it makes the stakeholders of the company give continued patronage. From M&A perspective, the value of goodwill is calculated as the difference between the price paid for an acquired business and the fair market value of the assets acquired (both tangible and separately identified intangible) and the net of the liabilities. The concept of goodwill value has important applicability to banks for tax, financial reporting, and regulatory reasons.

11. Salvage Value

Salvage value is the amount that can be realised upon sale or disposal of an asset after it is found no longer useful to the current owner and is to be taken out of service. This is not as era value, which is no more useful to any one for any purpose. Knowledge of salvage value in the target company is significant for any acquisition decision.

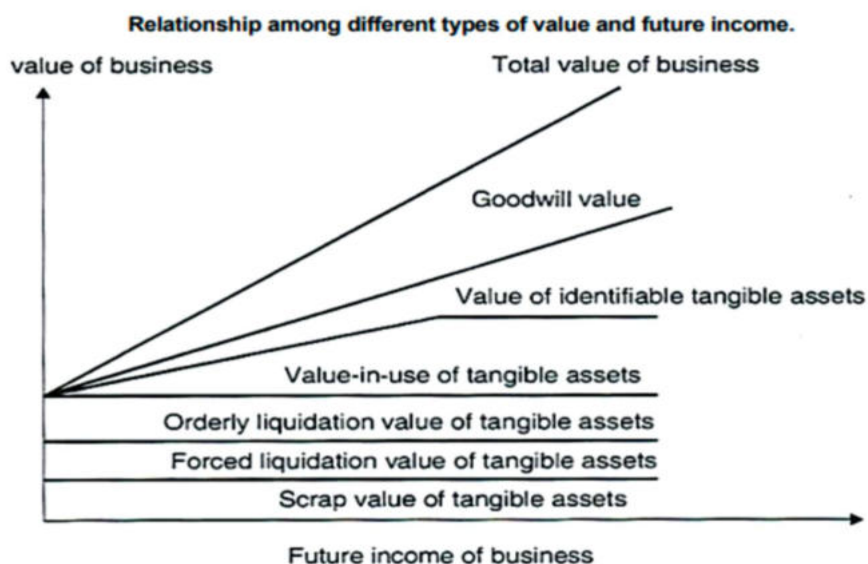
12. Liquidation Value

According to IVS 104 Bases of Value: Liquidation Value is the amount that would be realised when an asset or group of assets are sold on a piecemeal basis. Liquidation Value should take into account the costs of getting the assets into saleable condition as well as those of the disposal activity. "Liquidation Value" according to IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Clause 2(k) means the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date. According to ICAI Valuation Standard 102 (Valuation Bases), Liquidation value is the amount that will be realised on sale of an asset or a group of assets when an actual/hypothetical termination of the business is contemplated/ assumed. Liquidation value can be carried out

I. under the premise of an orderly transaction with a typical marketing period; or
II. under the premise of forced transaction with a shortened marketing period.

The valuer must disclose whether an orderly or forced transaction is assumed. The net amount is determined after considering estimated cost of disposal.

RELATIONSHIP AMONG DIFFERENT TYPES OF VALUE



The relationship among the various types of values discussed earlier in the context of total business value or enterprise value. The diagram exhibits how different levels of future income of a business affect the various types of value.

- The lowest expected value of a business is the scrap value of tangible assets, which is the same no matter what the income level is of the enterprise. The scrap value of equipment is constant, at a given point in time, irrespective of the earnings of the business that owns it.
- Forced liquidation value is the second lowest potential value, but from a practical point of view, this is perhaps the lowest value a business as a whole. Like scrap value, forced liquidation value remains the same, no matter what the income of the enterprise.
- Orderly liquidation value is conceptually identical to forced liquidation, except that a higher value is usually received because more time is allowed to find a buyer.
- Value-in-use of the tangible assets typically increases with the income of the business up to the point at which the value-in-use equals the replacement value of the asset.
- At zero income, the value-in-use and orderly liquidation value are theoretically equivalent, but as the business becomes more successful, the importance of the tangible assets becomes more significant. Hence, value-in-use exceeds orderly liquidation value.
- The value of identifiable intangible assets also tends to increase as the income of the business increases Along with the tangible assets and the income of the business, the importance of the identifiable intangibles also grows. Goodwill value will always increase with the earnings of the business because it is computed as the difference

between the value of the total business and the value of the tangible and identified intangible assets. Consequently, as the earnings of the business grow, so does its total goodwill and enterprise value. The cumulative result is therefore the total business value. This is the value of the tangible and intangible assets, and it increases along with the future income prospects of the business.

PRICE AND VALUE DIFFERENTIATION

Generally, the term value and price are used interchangeably. However, both are different terms having different meaning. Price is determined by demand and supply of underlying asset while valuation is a process of estimating economic worth of a given asset or undertaking which depends upon the purpose of valuation as well as judgement of valuer. Price is the valuable consideration for which a thing is bought and sold. Most of the time, price and value differ indicating differences in perceptions between the buyers and sellers. The fact that price obtained for an asset differs from its valuation does not necessarily indicate that the valuation was wrong. It may arise because the purchaser is unaware of the availability of the asset or the buyer believes that the price is lower than the worth of the asset. A reverse situation may also arise when the seller feels that the price he is charging is much above the worth of the asset.

In essence, the difference between the price obtained and the valuation is the result of only the market imperfections and not necessarily indicate imperfections in the valuation process. The difference may arise because the valuer has adopted advisory approach rather than act as impartial appraiser of value. Owing to the complexities and interrelationships of value, purpose of valuation, methodologies used and information considered, rarely will two valuers value the same company at the same amount. The subjective components involved in the valuation, even though mitigated by professional judgment and experience, can hardly be eliminated.

PROCESS OF VALUATION

Valuation is a process used to determine the economic value of a company, asset, or investment opportunity. The process typically involves several steps, methodologies, and considerations. Here's a general outline of the valuation process:

1. Gather Information: Collect all relevant data about the company or asset being valued. This includes financial statements, market trends, industry benchmarks, and any other pertinent information.
2. Select Valuation Method: Choose the appropriate valuation method based on the nature of the asset and the purpose of the valuation. Common valuation methods include:
   - Comparable Company Analysis (CCA): Compares the target company to similar publicly traded companies to determine a valuation multiple.
   - Comparable Transactions Analysis (CTA): Examines recent transactions involving similar companies to estimate the value of the target company.
   - Discounted Cash Flow (DCF) Analysis: Calculates the present value of future cash flows generated by the company.
   - Asset-Based Valuation: Determines the value of a company based on the value of its assets minus liabilities.
3. Conduct Financial Analysis: Analyze the financial statements of the company, including the income statement, balance sheet, and cash flow statement. This helps assess the company's historical performance, growth prospects, and financial health.
4. Perform Market Analysis: Evaluate the industry and market conditions in which the company operates. Consider factors such as competition, regulatory environment, technological advancements, and market trends.
5. Apply Valuation Methodology: Utilize the selected valuation method to calculate the value of the company or asset. This may involve applying financial ratios, estimating future cash flows, or adjusting for market comparable.
6. Consider Risk Factors: Assess the risks associated with the company or investment opportunity. Factors such as market volatility, operational risks, competitive landscape, and regulatory compliance can impact valuation.
7. Sensitivity Analysis: Conduct sensitivity analysis to evaluate how changes in key assumptions or variables affect the valuation results. This helps identify the sensitivity of the valuation to different scenarios.
8. Finalize Valuation Report: Prepare a comprehensive valuation report summarizing the analysis, methodologies used, key assumptions, and valuation conclusions. The report should be well documented and clearly communicate the rationale behind the valuation.

9. Review and Validation: Review the valuation report for accuracy and consistency. Validate the results by seeking feedback from other stakeholders or industry experts if necessary.
10. Present Findings: Present the valuation findings to relevant parties, such as company management, investors, lenders, or regulatory authorities. Be prepared to address any questions or concerns raised during the presentation.
11. Update Valuation: Periodically review and update the valuation as conditions change, such as significant events, changes in market dynamics, or new information becoming available.

For carrying out any valuations, the valuer has to look into the purpose of valuation. The next step will be to finalise the Bases of Value/Premises and accordingly the valuation approaches and methods will be decided by considering various factors.

The steps involved in valuation process are:

- Purpose of valuation
- Bases of Value
- Premises of Value
- Business Valuation Approaches
- Determination of Required Value
- Documentation
- Preparation of Valuation Report.

The purposes of valuation are important because different methods of valuations produce different values. Before a valuation exercise is undertaken, the valuer has to define the purpose of each valuation in clear terms. In fact, there is no single method of valuation that can be universally applied to all valuation purposes. Unless carefully done, a business valuation may fail to arrive at a conclusive valuation figure. The valuer may fail to match the valuation methodology with the purpose for which it is being done. The value conclusion can become useless if it is used for a purpose other than that intended for. Valuations, especially business valuations, are needed for different purposes and their purpose is to have an impact on the type of value derived and the methodologies adopted.

For any valuation the **"Bases of value"** describe the fundamental premises on which the reported values will be based. Therefore, it is critical that the basis (or bases) of value be appropriate to the terms and purpose of the valuation assignment. List of Bases of Value have been described in International Valuation Standards IVS 104 and ICAI Valuation Standards, ICAI VS 102. Before commencement of any valuations, the valuer must consider the parameters for selection of bases of like

a) nature of the asset to be valued;
b) scope and purpose of the valuation engagement;
c) valuation date/ measurement date;
d) intended purpose of the valuation;
e) applicable bases /standard of value;
f) applicable premises of value;
g) assumptions and limiting conditions; and
h) applicable governmental regulations.

It has been specifically mentioned that ICAI VS 102 will not be applicable in those cases where a valuer is required to adopt valuation bases that are prescribed either

a) by a Statute/ Regulations; or
b) agreed between the parties.

The **Premises of value** describes the circumstances of how an asset or liability is used. In a given set of circumstances, a single premise of value may be adopted while in some situations multiple premises of value may be considered. Accurate valuation requires appropriate application of the available approaches to determine value, a clear understanding of the exact investment in a business that is being sold or acquired, and a clear measure of the returns that the company generates. Business varies in the nature of their operations, the markets they serve, and the assets

they own. For this reason, the body of business valuation knowledge has established three primary approaches by which businesses may be appraised. The three Principal Business Valuation Approaches are:

- Market Approach
- Income approach
- Asset Approach

Market Approach

Market approach is a valuation approach that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) assets, liabilities or a group of assets and liabilities, such as a business. In market approach, the valuer has to get reliable information about the comparable or identical asset is traded in the active market and such transactions must be a recent and orderly transaction as well identical or comparable asset(s).

- Valuer should not use market approach if:
- the asset has fewer identical or comparable assets
- the asset to be valued or its market comparable are not traded in the active market;
- sufficient information on the comparable transaction(s) is not available;
- there is no recent transaction either in the asset or in the market comparable; or
- there are material differences between the asset to be valued and the market comparable, which require significant adjustments.

Three Valuation methods under the market approach:

- Market Price Method
- Comparable Companies Multiple (CCM) Method
- Comparable Transaction Multiple (CTM) Method

Income Approach

The income business valuation approach is based on the idea of valuing the present value of future economic monetary benefits. This approach estimates business value by considering the present value of future income accruing over a period of time. Present Value of future income is calculated using time value of money concept:

The methods most commonly used by business valuation professionals include

I. the Capitalization of Earnings Method;
II. the Discounted Earnings Method (Discounted Cash Flow Method); and
III. Dividend Discount Method (used for valuation of shares).

Cost Approach

The cost approach provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction, unless undue time, inconvenience, risk or other factors are involved. This approach tends to determine the business value on the basis of value of assets of the business. It is specifically useful for asset intensive firms, valuing holding companies as well as distressed entities that are not worth more than their overall net tangible value. The cost approach should be applied and afforded significant weight under the following circumstances:

a) participants would be able to recreate an asset with substantially the same utility as the subject asset, without regulatory or legal restrictions, and the asset could be recreated quickly enough that a participant would not be willing to pay a significant premium for the ability to use the subject asset immediately (nothing special in the assets).
b) the asset is not directly income-generating and the not in unique nature of the asset makes using an income approach or market approach unfeasible.

The methodologies adopted under cost approach are as under:

- Replacement Cost Method
- Reproduction Cost Method
- Summation Method-Sum of part Method.

PRINCIPLES OF VALUATION

Valuation principles serve as guiding concepts or standards that underpin the process of determining the value of assets, companies, or investments. These principles help ensure that valuations are conducted consistently, objectively, and accurately. Some of the key principles of valuation include:

Principle of Value Maximization: The primary objective of valuation is to determine the maximum value of an asset or investment opportunity. This principle reflects the notion that investors seek to maximize their returns and that asset should be valued based on their potential to generate future cash flows or benefits.

Principle of Market Efficiency: Valuations should take into account market prices and information. In efficient markets, asset prices reflect all available information and are considered fair representations of their intrinsic value. Valuations should consider market dynamics and incorporate relevant market data and trends.

Principle of Risk and Return: Valuations should incorporate the relationship between risk and expected return. Assets with higher risk levels should command higher expected returns to compensate investors for taking on additional risk. Valuations should assess and quantify the risks associated with an investment and adjust the discount rate or required rate of return accordingly.

Principle of Time Value of Money: The time value of money principle recognizes that a dollar received today is worth more than a dollar received in the future due to the opportunity to invest and earn returns. Valuations should discount future cash flows or benefits to their present value using an appropriate discount rate, such as the cost of capital or the risk-free rate.

Principle of Substitution: The principle of substitution suggests that the value of an asset is determined by the cost of acquiring a substitute asset with similar characteristics and utility. This principle is particularly relevant in the valuation of tangible assets and real estate, where the value is often determined by comparing prices of similar properties or assets.

Principle of Arm's Length Transaction: Valuations should be based on hypothetical transactions that would take place between willing and knowledgeable parties, each acting in their self-interest and without undue pressure or compulsion. This principle ensures that valuations reflect fair market value and are not influenced by external factors or special circumstances.

Principle of Consistency: Valuations should be conducted using consistent methodologies, assumptions, and data sources to ensure reliability and comparability. Consistency in valuation practices allows for meaningful comparisons over time and across different assets or companies.

Principle of Transparency and Disclosure: Valuation processes and methodologies should be transparent, well-documented, and disclosed to relevant stakeholders. Transparency enhances credibility and allows stakeholders to understand the basis for the valuation conclusions.

1. The value of anything tends to be determined by the cost of acquiring an equally desirable substitute, and this is known as the principle of substitution.
2. The amount of return (profit) that a business provides to its owner is based on the rate of return expected on the investment. A fundamental relationship exists between the rate of return from an investment and the amount of risk involved in the investment. The greater the risk involved, the greater the required rate of return.

In other words, the greater the risk that an owner will lose a particular deal, the greater the 'odds' (ROI) that will be placed on that owner. There are various types of investments that carry different levels of risk and, therefore, different potential returns.

3. Many owners of businesses feel that their businesses have- no intangible assets value. Therefore, such businesses are sold and transferred at tangible asset values only. It follows that intangibles exist if a business has excess earnings, and values are determined by capitalizing the excess earnings.
4. The given fact gives rise to two key questions:
   i. What are excess earnings?
   ii. What is an appropriate capitalization rate?
   - Excess earnings are the earnings of the company in excess of the average earnings of companies with similar activities and size. But it is difficult to define an appropriate capitalization rate. Today, valuation has become an important topic of interest. Various methods and factors are used in valuing closely held businesses.
   - These methods are not alternatives to one another; but all or many of the methods may need to be considered.
   - Many formulas are tied to 'earnings' rather than 'excess earnings. Earnings are multiplied or capitalized by certain industry factors or 'public' company comparable factors.
   - It is recognized that if 'comparable' factors are not available, then other methods can be used.
5. Valuations cannot be made on the basis of a prescribed formula. There is no means whereby mathematical weights and the various applicable factors in a particular valuation case can be assigned in deriving the fair market value. Thus, no useful purpose is served by taking an average of several factors (for example, book value, capitalized earnings and capitalized dividends) and basing the valuation on the result. Such a process excludes active consideration of other pertinent factors, and the end result cannot be supported by a realistic application of the significant facts in the case except by mere chance.
6. Sometimes, it may not be possible to make a separate appraisal of the tangible and intangible assets of the business. An enterprise has a value on an ongoing concern basis. Whatever intangible values are available, may be measured by the amount by which the appraised value of the tangible assets exceeds the net book value of such assets. In addition to the fundamentals of business valuation, there are other sources of information which valuation professionals should read and/or add to their library in the valuation business assignments. In particular, the valuer should be familiar with the business related texts which may include books, research papers, articles, seminars, and interactions with notable valuation mentors or other business mentors. It is in fact a subject of continuous learning.

HINDRANCES / BOTTLENECKS IN VALUATION

When we are in the process of valuing a business, a detailed, comprehensive analysis and the ability to develop accurate projections and assumptions are necessities. Business valuation also requires the application of finance theory in the appropriate places and using professional judgment. Some of the most common hindrances include:

1. Value, as a concept, is ambiguous. An asset has different values depending on the purpose or context.
2. Everyone has an opinion of value about a business, a tangible asset, or an intangible asset but actually, the term 'value' means different things to different people. The problems faced by the valuers are enormous. They have to bring forward an appropriate definition of value for a specific valuation.
3. Mathematical certainty or certainty of one output based on specific set of inputs is neither demanded, nor possible in valuation discipline. Being context specific, the value keeps on fluctuating. It is for the valuers to express the value attributed by them to the asset, which is estimated on the basis of the facts drawn from the evidence before them. Valuation is an art more than a science and is an interdisciplinary study drawing upon law, economics, finance, accounting, and investment. It is a procedure, essentially, a bringing together of the economic concept of value and the legal concept of property. Valuation discipline is neither science nor an art; it is a craft, i.e., a skill that one learns by doing. The more one does it, the better one gets at it.

4. Valuation may be considered a science but, to a large extent, valuation variables require inherent subjectivity. In other words, valuation is not a precise science as there is always imperfection in the market. Even in rare instances, where the valuer has perfect knowledge of the market, the market does not have the perfect knowledge of value as well as the valuation methodology and process. Right valuation requires logical and methodical approach and careful application of the basic principles. This means that there may not be a prescribed format or a preferred methodology, which is to be adopted always.
5. Any business valuation activity is based on the hypothetical consideration that there is an arm's length sale of a business between a willing buyer and a willing seller, usually for cash. Any valuation theory attempts to search for truth and relates to the practice in order to understand valuation theory.
6. One of the frequent sources of legal confusion between cost and value is the tendency of courts, in common with other persons, to think of value as something inherent in the thing being valued, rather than an attitude of persons toward that thing in view of its estimated capacity to perform a service. Whether or not, as a matter of abstract philosophy, a thing has value except to people to when it has value, is a question that need not be answered for the sake of appraisal theory. Certainly, for the purpose of a monetary valuation, property has no value unless there is a prospect that it can be exploited by human beings.
7. In a business valuation, the value of an interest in business is typically considered to be equal to the future benefits that are to be received from the business, discounted to the present value, at an appropriate discount rate. However, this simple definition of value raises the following issues to be addressed:
   I. How to define 'benefits'?
   II. Future projections may be extremely difficult to make and also very difficult to get interested parties to agree to.
   III. What is an appropriate discount rate that reflects the risk inherent in the subject entity
8. Developing reasonable assumptions for projections based on historical trends and expected future occurrences and documenting the reasoning behind those assumption choices
9. Gathering the appropriate market comparable (both public and private) and documenting the reasoning behind the market comparable choices.
10. Choice of Valuation Standards to be followed.
11. Drafting a comprehensive valuation report.
12. Remaining compliant with International Valuation Standards (IVS) or ICAI Valuation Standards IRS guidelines and other industry standards.

PRINCIPLES OF VALUATION TO BE FOLLOWED BY VALUERS

Ethics	Valuers must follow the ethical principles of integrity, objectivity, impartiality, confidentiality, competence and professionalism to promote and preserve the public trust.
Competency	At the time the valuation is submitted, valuers must have the technical skills and knowledge required to appropriately complete the valuation assignment.
Compliance	Valuers must disclose or report the published valuation standards used for the assignment and comply with those standards
Basis (ie, Type or Standard) of Value	Valuers must select the basis (or bases) of value appropriate for the assignment and follow all applicable requirements. The basis of value (or bases) must be either defined or cited.
Date of Value Effective Date/Date of Valuation	Valuers must disclose or report the date of value that is the basis of their analyses, opinions or conclusions. Valuers must also state the date they disclose or report their valuation
Assumptions and Conditions	Valuers must disclose significant assumptions and conditions specific to the assignment that may affect the assignment result.
Intended Use	Valuers must disclose or report a clear and accurate description of the intended use of the valuation.
Intended User(s)	Valuers must disclose or report a clear and accurate description of the intended user(s) of the valuation

Scope of Work	Valuers must determine, perform, and disclose or report a scope of work that is appropriate for the assignment that will result in a credible valuation
Identification of Subject of Valuation	Identification of Subject of Valuation
Data	Valuers must use appropriate information and data inputs in a clear and transparent manner so as to provide a credible valuation.
Valuation Methodology	Valuers must properly use the appropriate valuation methodology (ies) to develop a credible valuation.
Communication of Valuation	Valuers must clearly communicate the analyses, opinions and conclusions of the valuation to the intended user(s).

Lesson 13
Valuation of Business and Assets for Corporate Restructuring

BUSINESS VALUATION

Valuation is the process of determining the economic worth of a company/business based on its business model and external environment and supported with reasons and empirical evidence. During valuation, a valuer looks at the company's management, composition of its capital structure, the prospect of future earnings and market value of assets, etc. Proper valuation helps an entity or business make an intelligent decision. In a merger or amalgamation or demerger or acquisition, valuation is essential to fix the value of the shares to be exchanged in a merger or the consideration payable for an acquisition.

The valuation plays a

very important role during the resolution of existing debts, unlocking of hidden value and assets, introduction of risk capital and in some cases a turnaround of the underlying business can lead to substantial profits on exit from the investments.

The use of different valuation techniques and principles has made valuation a subjective process. Conflict in valuation could result from the choices with respect to any of these namely valuation base or approach or method or technique. In the case of merger, for instance, the asset value can be determined both at the market price and the cost price. A great deal depends upon the rationale of the parties to a transaction and therefore, it is important that the merging parties should first discuss and agree upon the valuation bases, approaches, methods and techniques.

Valuation models are used to determine the true value of a business mostly by financial market participants. Business valuation can be for the entire company or a part of the operations of a company. There are tools and methods used for valuation. Usually the valuation is done by analysing the financial statements, the cash flows and other market factors.

Valuation involves financial modelling. This financial model can be different for different entities, as because one financial model for an industry may not be suitable for another industry and the choice of model to use for the industry is subjective.

Valuation Motives

An important aspect in the merger/amalgamation/takeover activity is the valuation aspect. The method of valuation of business, however, depends to a great extent on the acquisition motives. The acquisition activity is usually guided by strategic behavioural motives. The reasons could be

a) either purely financial (taxation, asset-stripping/correcting valuation errors, financial restructuring involving an attempt to augment the resources base and portfolio-investment) or
b) business related (expansion/ diversification, addressing poor performance) or
c) behavioural reasons have more to do with the personal ambitions or objectives (desire to grow big) of the top management.

NEED FOR BUSINESS VALUATION

Business valuation refers to the process of determining the economic worth or value of a business or company. It involves assessing the various factors that contribute to the financial value of the business, such as its assets, liabilities, financial performance, market position, and growth potential.

The need for business valuation arises in several situations:

1. **Mergers and Acquisitions:** Valuation is crucial when companies are considering buying or selling businesses. It helps determine a fair price for the acquisition or sale and enables negotiation between the parties involved.
2. **Investment Analysis:** Investors, both individual and institutional, require business valuations to assess the potential return on investment and determine if a business is a viable investment opportunity.

3. **Financial Reporting:** In some cases, businesses need to estimate the value of their assets for financial reporting purposes, such as for accounting standards or compliance requirements.
4. **Shareholder Disputes:** During shareholder disputes, business valuation can help determine the fair value of shares or ownership interests.
5. **Estate Planning:** Valuing a business is essential for estate planning and determining the value of business assets to distribute among beneficiaries or for tax purposes.
6. **Litigation and Legal Proceedings:** Business valuations may be necessary in legal situations, such as divorce settlements, partnership dissolutions, or damage claims.
7. **Strategic Planning:** Valuations are useful in strategic planning to assess the overall financial health of the business, identify areas for improvement, and make informed decisions about growth strategies or restructuring.

SITUATIONS REQUIRING VALUATION

The following are some of the usual circumstances when valuation of shares or enterprise becomes essential:

1. When issuing shares to public either through an initial public offer or by offer for sale of shares of promoters or for further issue of shares to public.
2. When promoters want to invite strategic investors or for pricing a first issue or a further issue, whether by way of a preferential allotment or rights issue.
3. In making investment in a joint venture by subscription or acquisition of shares or other securities convertible into shares.
4. For making an 'open offer' for acquisition of shares.
5. When company intends to introduce a 'buy back' or 'delisting of shares'.
6. In schemes involving mergers/demergers, share valuation is resorted to determine the consideration for the purpose of issue of shares or any other consideration to shareholders or transferor of demerged companies.
7. On directions of Tribunal or other statutory Authority.
8. For determining fair price for effecting sale or transfer of shares as per Articles of Association of the company.
9. As required by the agreements between two parties.
10. To determine purchase price of a 'block of shares', which may or may not give the holder thereof a controlling interest in the company.
11. To value the interest of dissenting shareholders under a scheme of amalgamation, merger or reconstruction.
12. Conversion of debt instruments into shares.
13. Advancing a loan against the security of shares of the company by the Bank/Financial Institution.
14. As required by provisions of law such as the Companies Act, 2013 or Foreign Exchange Management Act, 1999 or Income Tax Act, 1961 or the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 [the Takeover Code] or SEBI (Buy Back of Securities) Regulations, 2018 or Delisting Guidelines.

FACTORS INFLUENCING VALUATION

Determining the value of a business is a complicated and intricate process. Valuing a business requires the determination of its future earnings potential and the risks inherent to those future earnings. The process of arriving at this value includes a detailed analysis of its mix of physical and intangible assets, and the general economic and industry conditions. Major factors influencing the valuation of a business include:

- debt equity ratio
- nature of business and its growth history
- customer base
- areas of operations
- audited financial statements
- management team and its competency
- litigation and disputes
- related party transactions, etc.

The other salient factors include:

1. The stock exchange price of the shares of the two companies before the commencement of negotiations or the announcement of the bid.
2. Dividends paid on the shares.
3. Relative growth prospects of the two companies.
4. In case of equity shares, the relative gearing of the shares of the two companies. (‘gearing’ means ratio of the amount of issued preference share capital and debenture stock to the amount of issued ordinary share capital.)
5. Net assets of the two companies.
6. Voting strength in the merged (amalgamated) enterprise of the shareholders of the two companies.
7. Past history of the prices of shares of the two companies.
8. Merger and amalgamation deals can take a number of months to complete during which time valuations can fluctuate substantially. Hence provisions must be made to protect against such swings.

Preliminary Steps in Valuation

A business valuation involves analytical and logical application/analysis of historical/future tangible and intangible attributes of business. The preliminary study to valuation involves the following aspects:

1. Purpose of valuation.
2. Goodwill/Brand name in the market.
3. Business environment of the entity to be valued.
4. Estimation/forecast of future cash flows as accurately as possible.
5. Is company listed on any stock exchange?
6. If listed, whether shares of the company are traded frequently?
7. The industry in which the entity is part of.
8. The industry P/E ratio, past and future growth rate.
9. Who are the competitors locally, internationally?
10. Whether any similar valuation has been done recently
11. The technology concerning the enterprise and its probability of obsolescence.
12. The accepted discounting rate.
13. Study of market capitalization aspects.
14. Identification of hidden liabilities through analysis of material contracts.

BUSINESS VALUATION METHODS

Valuing a business typically involves assessing its assets, liabilities, financial performance, market position, growth potential, and other relevant factors. Several different methods and approaches are used to determine the value of a business, and the choice of method depends on the nature of the business, industry, purpose of the valuation, and available data. Followings are some commonly used business valuation methods:

1. **Market Approach:** This method determines the value of a business by comparing it to similar businesses that have recently been sold or are publicly traded. It relies on market data and transactions to estimate the value.
2. **Income Approach:** This method values a business based on its expected future income or cash flow. It involves discounting projected future cash flows to their present value using an appropriate discount rate.
3. **Asset Approach:** This method focuses on the value of the assets and liabilities of a business. It assesses the net asset value by subtracting liabilities from the fair market value of the assets.
4. **Multiple-based Approach:** This method uses financial ratios or multiples (such as price-to-earnings ratio or price-to-sales ratio) derived from comparable companies or industry averages to estimate the value of a business.

The choice of valuation method depends on factors such as the purpose of the valuation, the industry in which the business operates, the availability and reliability of data, and the specific circumstances surrounding the valuation. It's worth noting that business valuation is not an exact science, and different methods may yield different results. Professional valuation experts or appraisers are often hired to conduct thorough and objective business valuations, taking into account all relevant factors and applying their expertise to ensure an accurate and reasonable valuation.

It's important to consult with professionals or conduct in-depth research when conducting a business valuation, as it can have significant implications for decision-making, negotiations, and financial transactions related to the business.

VALUATION PRINCIPLES AND TECHNIQUES FOR MERGER

When conducting a valuation for a merger, there are several principles and techniques that can be applied. Here are some key principles and techniques used in merger valuation:

1. **Comparable Company Analysis:** This technique involves identifying comparable companies in the same industry or sector and analysing their financial metrics, such as price-to-earnings ratio (P/E), price-to-sales ratio (P/S), or enterprise value-to-EBITDA ratio (EV/EBITDA). The valuation multiples derived from these comparable companies can then be applied to the target company to estimate its value.
2. **Discounted Cash Flow (DCF) Analysis:** DCF analysis is a widely used valuation technique that estimates the present value of a company's future cash flows. It involves projecting the expected cash flows of the merged entity and discounting them back to their present value using an appropriate discount rate, such as the weighted average cost of capital (WACC). The sum of these discounted cash flows represents the estimated value of the merged entity.
3. **Synergy Analysis:** Synergy refers to the potential benefits and cost savings that can be achieved through the merger. It is important to assess and quantify the synergistic effects of the merger, such as increased revenue, cost reductions, economies of scale, or market expansion. These synergies can then be incorporated into the valuation analysis to determine the enhanced value of the merged entity.
4. **Asset-Based Valuation:** This approach involves assessing the value of the tangible and intangible assets of the companies involved in the merger. It includes analysing the fair market value of assets, such as property, plant, and equipment (PP&E), inventory, intellectual property, and brand value. Liabilities are subtracted from the asset value to derive the net asset value, which forms the basis of the valuation.
5. **Market Capitalization:** Market capitalization is a straightforward valuation technique that calculates the value of a company based on its market price per share multiplied by the number of outstanding shares. In the context of a merger, this technique can be used to determine the relative value of the merging entities and the resulting ownership structure.
6. **Transaction Multiples:** Transaction multiples involve analysing historical merger and acquisition transactions in the same industry to determine valuation benchmarks. This includes assessing multiples such as the purchase price-to-sales ratio (PP/S), purchase price-to-earnings ratio (PP/E), or enterprise value-to-revenue ratio (EV/Revenue) observed in past transactions. These multiples can then be applied to the financial metrics of the merging entities to estimate their value.

ASSET-BASED APPROACH

The Asset-Based Approach is a valuation method that assesses the value of a business based on its net asset value. It involves calculating the fair market value of the company's assets and subtracting its liabilities to arrive at the net asset value.

Illustration 1:

Let's consider a company called ABC Manufacturing. ABC Manufacturing has the following assets and liabilities:

- Cash and Cash Equivalents: Rs. 100,000
- Accounts Receivable: Rs. 200,000
- Inventory: Rs. 300,000
- Property, Plant, and Equipment: Rs.1,000,000
- Total Assets: Rs. 1,600,000
- Accounts Payable: Rs. 150,000
- Long-Term Debt: Rs. 500,000
- Total Liabilities: Rs. 650,000

To calculate the net asset value using the Asset-Based Approach, we subtract the total liabilities from the total assets:

Net Asset Value = Total Assets - Total Liabilities

Net Asset Value = Rs. 1,600,000 - Rs. 650,000 = Rs.950,000

In this example, the net asset value of ABC Manufacturing is Rs.950,000. This represents the estimated value of the company's assets after deducting its liabilities.

It's important to note that the Asset-Based Approach may not capture intangible assets such as intellectual property, brand value, or customer relationships, which could significantly impact the overall value of a business. Therefore, this approach is most suitable for asset-intensive industries or situations where the company's tangible assets represent a significant portion of its value. The Asset-Based Approach is one of several valuation methods, and it's advisable to consider other approaches and factors when conducting a comprehensive business valuation.

Illustration 2:

Let's assume we're valuing a company called XYZ Services. XYZ Services has the following assets and liabilities:

- Cash and Cash Equivalents: Rs.150,000
- Accounts Receivable: Rs.200,000
- Inventory: Rs. 100,000 Property,
- Plant, and Equipment: Rs. 500,000
- Intangible Assets (e.g., patents, trademarks): Rs. 300,000
- Total Assets: Rs.1,250,000
- Accounts Payable: Rs. 100,000
- Long-Term Debt: Rs. 400,000
- Total Liabilities: Rs.500,000

To calculate the net asset value using the Asset-Based Approach, we subtract the total liabilities from the total assets:

Net Asset Value = Total Assets - Total Liabilities

Net Asset Value = Rs.1,250,000 - Rs.500,000

Net Asset Value = Rs. 750,000

In this example, the net asset value of XYZ Services is Rs.750,000. This represents the estimated value of the company's assets after deducting its liabilities.

It's important to note that the Asset-Based Approach focuses primarily on tangible assets and may not fully capture the value of intangible assets, such as brand reputation, customer relationships, or intellectual property. Therefore, when using this approach, it's crucial to consider the specific industry, market conditions, and the relevance of intangible assets to get a comprehensive understanding of the business's value.

Please note that business valuation involves various factors and considerations, and the Asset-Based Approach is just one method among several others. It's always advisable to consult with valuation professionals and consider multiple approaches to arrive at a well-rounded assessment of a company's value.

Illustration 3:

ABC Ltd. has the following values in its books:

Particulars	(Rs. in thousand)
Land and building	300
Plant and machinery	200
Inventory	200
Investment	100
Receivables	300
Cash	100
Current liabilities	300
Term loans	200

Land and buildings will fetch 500 more. Plant and machinery will fetch 100 less. Inventory will fetch 50 less. Receivables will fetch 50 less. Current liabilities of 50 will not be payable. Calculate the net realizable value of this business.

	Book Value	Impairment/Appreciation	Realizable Value
Assets			
Land & Buildings	300	+500	800
Plant & Machinery	200	-100	100
Investments	100		100
Inventory	200	-50	150
Receivables	300	-50	250
Cash	100		100
TOTAL	1200	300	1500
Liabilities			
Bank Borrowings	200		
Current Liabilities	300	-50	250
		Net Realisable Value	1050

INCOME-BASED APPROACH

In the income-based approach, as the name suggests, value of the business is calculated based on future income flows of the entity. In this approach the most important factor is determination of future cash flows of the business. The more accurate the forecast of cash flows, more correct will be the valuation. The future cash flows of the business are discounted at a predetermined rate to arrive at the present value of the business.

Another way of income approach is based on market capitalisation. In this approach the net earnings are capitalised. For this the earnings before interest and tax depreciation and amortization is considered. Another method used is to look at the price earnings of similar businesses. By comparing similar businesses, model is built and the share price of the company under consideration is estimated.

For example, company-A is in FMCG business, and we want to find out the value of the business. The earnings per share of company-A is Rs. 5.5. Now let us look at businesses in the FMCG industry which are listed on the stock exchange. Company-B has price earnings ratio of 39. Company-C has a price earnings ratio of 45. Another FMCG company-D has a price earnings ratio of 33. The average price earnings ratio of companies B, C and D is 39. Now let us apply this average ratio to company-A's earnings per share. 5.5 × 39 = 214.5. So, the value of the company A per share is Rs. 214.5.

Suppose the earnings of the company is Rs. 2 crore then the value of the company is 2 × 39 equal to Rs. 68 crores. This method of calculation can be tricky because in a volatile market the prices of stocks may fluctuate widely. Moreover, listed companies always have a better valuation because of the liquidity. Normally unlisted companies' evaluation is reduced by 30 to 50%. That is if a listed company's value is Rs. 100 crore then a similar but unlisted company will have a value of only Rs.50 crore with other things remaining same. The price earnings approach is useful in takeovers and mergers.

MARKET BASED APPROACH

Under the market-based approach, we look for a similar business which has changed hands in the recent past and value the target entity on the same basis. If exactly similar business transaction is not available, a closely similar transaction can be taken, and adjustments can be made for any variations in any parameter to arrive at the correct valuation. The adjustments can be for difference in size, quantity, or quality. It is easy to value a company which is publicly traded. However, when a similar company is not available then it becomes necessary to adjust as mentioned above.

There are two popular types of market approach methods, one is based on guideline transaction method and the other based on guideline public method, i.e., publicly traded entity. Market approach method is useful in case of Real Estate Company because we can easily estimate by looking at similar sale transactions. Also, we can look at recent merger and acquisition transactions in the same industry and make adjustments for any size, product or other relevant factor to arrive at the target company valuation. There is also another method called back solve method. This involves analysis of equity transactions of the target entity in the past 12 months with unrelated investors.

Importance of Market-Based Approach

1. **Relies on Real Market Data:** The Market-Based Approach utilizes actual transaction data from the market, providing a real-world benchmark for valuation.
2. **Consideration of Market Perception:** This approach considers how the market perceives the value of similar assets or businesses, reflecting investor sentiment and market dynamics.
3. **Simplicity and Transparency:** Market comparables are relatively easy to understand and transparent, making this approach accessible to a wide range of users.
4. **Validation of Other Methods:** Market-based valuations can serve as a validation or sanity check for other valuation methods, providing additional insight into the value of the subject entity.

Calculation Technique:

The Market-Based Approach involves comparing the subject entity to similar entities or transactions in the market and applying relevant valuation multiples. Common multiples used in the Market-Based Approach include Price-to-Earnings (P/E) ratio, Price-to-Book (P/B) ratio, Price-to-Sales (P/S) ratio, and Price-to-EBITDA (P/EBITDA) ratio.

DISCOUNTED CASH FLOW (DCF) APPROACH

The Discounted Cash Flow (DCF) technique is a widely used method for business valuation. It estimates the present value of a company's projected future cash flows, taking into account the time value of money. The DCF technique involves the following steps:

1. **Project Future Cash Flows:** Forecast the future cash flows of the business over a specific period. Cash flows typically include operating cash flows, capital expenditures, working capital changes, and any other significant cash flow components.
2. **Determine the Discount Rate:** Select an appropriate discount rate, often the company's weighted average cost of capital (WACC). The discount rate represents the required rate of return expected by an investor considering the risk associated with the investment. It reflects the opportunity cost of investing in the company rather than alternative investments.
3. **Discount Cash Flows:** Apply the discount rate to each projected period's cash flow to calculate the present value of the cash flows. This involves dividing each projected cash flow by (1 + discount rate) raised to the power of the respective period.

4. **Calculate Terminal Value:** Estimate the value of the company beyond the projected period, usually based on a perpetuity or exit multiple. The terminal value represents the value of the business's cash flows beyond the projection period.
5. **Sum the Present Values:** Sum up the present values of the projected cash flows and the terminal value to obtain the total present value of the future cash flows. This represents the estimated value of the business.
6. **Sensitivity Analysis:** Perform sensitivity analysis by varying key assumptions such as cash flow projections, discount rate, and terminal value to assess the impact on the estimated value.
7. **Compare to Market and Comparable Companies:** Consider market conditions, industry trends, and comparable company valuations to evaluate the reasonableness of the estimated value.

It's important to note that the accuracy of the valuation heavily depends on the quality of cash flow projections, appropriate selection of the discount rate, and other assumptions made during the process. The DCF technique requires careful consideration and professional expertise in financial analysis to ensure a comprehensive and accurate valuation of the business.

Illustration:

Assume ABC Manufacturing Company is projected to generate the following cash flows over the next five years:
Year 1: 500,000
Year 2: 600,000
Year 3: 700,000
Year 4: 800,000
Year 5: 900,000
The discount rate for ABC Manufacturing Company is determined to be 10%.

Step 1: Calculate the Present Value (PV) of Cash Flows

PV Year 1 = 500,000 / (1 + 0.10)^1 = 454,545 PV Year 2 = 600,000 / (1 + 0.10)^2 = 495,868 PV Year 3 = 700,000 / (1 + 0.10)^3 = 513,310 PV Year 4 = 800,000 / (1 + 0.10)^4 = 526,446 PV Year 5 = 900,000 / (1 + 0.10)^5 = 535,714

Step 2: Calculate the Sum of PV Cash Flows

Sum of PV Cash Flows = PV Year 1 + PV Year 2 + PV Year 3 + PV Year 4 + PV Year 5 Sum of PV Cash Flows = 454,545 + 495,868 + 513,310 + 526,446 + 535,714

Sum of PV Cash Flows = 2,525,883

Step 3: Determine the Terminal Value

Assume the terminal value is estimated to be 10 million. To calculate the present value of the terminal value, we need to select an appropriate exit year and discount it back to the present value using the discount rate.

Assuming the exit year is Year 5: PV Terminal Value = 10,000,000 / (1 + 0.10)^5 = 6,209,677

Step 4: Calculate the Total Present Value

Total Present Value = Sum of PV Cash Flows + PV Terminal Value Total Present Value = 2,525,883 + 6,209,677 Total Present Value = 8,735,560

In this example, the estimated valuation of ABC Manufacturing Company using the DCF technique is approximately 8,735,560. This represents the present value of the projected cash flows and the terminal value discounted at the appropriate rate. Remember that this is a simplified example, and additional factors, such as growth rates, risk factors, and sensitivity analysis, should be considered for a comprehensive valuation.

VALUATION UNDER SEBI (SAST) REGULATIONS, 2011

The Securities and Exchange Board of India (SEBI) Substantial Acquisition of Shares and Takeovers (SAST) Regulations, 2011, govern the acquisition of shares and control of companies in India. The regulations aim to ensure fair practices and protect the interests of shareholders during the acquisition process. While the SEBI (SAST) Regulations primarily focus on the acquisition of shares, they also include provisions related to valuation. Here are some key aspects of valuation under the SEBI (SAST) Regulations, 2011:

1. **Valuation of Shares:**
   - Regulation 8 of the SEBI (SAST) Regulations mandates that the acquirer must disclose the highest price paid for the shares of the target company in the 26 weeks preceding the public announcement of the acquisition.
   - If the acquisition involves a preferential issue of shares, the price at which the preferential issue is made must be disclosed.
   - The valuation of shares is important in determining the price to be paid by the acquirer and for assessing the fairness of the transaction.
2. **Open Offer Price:**
   - Regulation 20 of the SEBI (SAST) Regulations specifies that the open offer price should be determined by the acquirer based on the valuation of the shares of the target company.
   - The open offer price is the price at which the acquirer intends to acquire shares from the public shareholders of the target company.
   - The acquirer must ensure that the open offer price is fair and in compliance with the SEBI (SAST) Regulations.
3. **Registered Valuers:**
   - The SEBI (SAST) Regulations require the appointment of a registered valuer for determining the valuation of shares.
   - Regulation 22 mandates that the valuer must be a merchant banker, registered with SEBI, and should have expertise in valuation.
   - The valuer plays a crucial role in assessing the fair value of shares and providing an independent opinion on the valuation.
4. **Valuation Report:**
   - Regulation 35 of the SEBI (SAST) Regulations requires the acquirer to submit a valuation report to SEBI.
   - The valuation report provides details of the valuation methodology, assumptions, and factors considered in determining the valuation of shares.
   - The report is a crucial document that helps establish the fairness of the acquisition and provides transparency to the regulators and shareholders.

CASE STUDIES

One notable case study in the Indian context is the valuation of Flipkart, a leading e-commerce company in India. Flipkart was founded in 2007 by Sachin Bansal and Binny Bansal and grew rapidly to become one of India's largest online marketplaces. Over the years, the company attracted significant investments from various investors, resulting in multiple valuation rounds. Here is a summary of Flipkart's valuation journey:

Case Study 1:

1. Initial Valuation: In its early stages, Flipkart secured its initial funding from small investors and angel investors. In 2009, the company raised approximately $1 million in its first round of funding at a valuation of around $5 million.
2. Early Growth and Investor Interest: Flipkart experienced significant growth and gained traction in the Indian e-commerce market. As a result, it attracted investments from prominent venture capital firms. In 2010, the company raised $10 million from Accel Partners and Tiger Global Management at a valuation of around $50 million.
3. Continued Expansion and Funding: Flipkart continued to expand its operations and gained market share. The company received multiple rounds of funding in subsequent years. In 2011, Flipkart raised $20 million in a funding round led by Tiger Global Management, valuing the company at around $1 billion.
4. Steady Growth and Billion-Dollar Valuation: Flipkart's growth trajectory remained strong, and it secured significant investments from both existing and new investors. In 2014, the company raised $1 billion in a funding round led by Tiger Global Management, DST Global, and others, valuing Flipkart at approximately $7 billion. This marked the first Indian e-commerce company to achieve a billiondollar valuation.
5. Valuation Ups and Downs: Flipkart faced intense competition from international players and witnessed increased competition in the Indian e-commerce market. In subsequent years, the company faced some downward adjustments in valuation due to changes in market dynamics and increased competition. For instance, in 2017, SoftBank Vision Fund invested $2.5 billion in Flipkart, valuing the company at around $11.6 billion.
6. Walmart Acquisition: In 2018, US retail giant Walmart acquired a majority stake in Flipkart for $16 billion, valuing the company at approximately $20 billion. This acquisition provided an exit for several early investors and represented one of the largest acquisitions in the Indian startup ecosystem.

The Flipkart case study showcases the valuation journey of an Indian e-commerce company, highlighting the different stages of funding, investor interest, market dynamics, and the impact of competition on the company's valuation. It demonstrates how a startup's valuation can evolve over time based on its growth, performance, and external factors influencing the market.

Case Study 2:

XYZ Tech Solutions is a fast-growing technology company specializing in software development and IT services. The company was founded five years ago and has experienced rapid revenue growth and a strong customer base. The management team is exploring options for fundraising and needs to determine the valuation of the business.

Key Information:

1. **Financial Performance:**
   - Year 1: Revenue - $2 million, Net Income - $500,000
   - Year 2: Revenue - $3 million, Net Income - $800,000
   - Year 3: Revenue - $5 million, Net Income - $1.2 million
   - Year 4: Revenue - $7 million, Net Income - $1.8 million
   - Year 5: Revenue - $10 million, Net Income - $2.5 million
2. **Industry Analysis:**
   - Comparable companies in the same industry are trading at an average Price-to-Earnings (P/E) ratio of 15x.
   - The average Enterprise Value-to-Revenue (EV/Revenue) multiple is 2.5x.
3. **Discount Rate:** 10% The discount rate represents the required rate of return considering the risk associated with the investment.

Solution:

1. Calculate Average Net Income: Average Net Income = (Net Income Year 1 + Net Income Year 2 + Net Income Year 3 + Net Income Year 4 + Net Income Year 5) / 5 Average Net Income = ($500,000 + $800,000 + $1,200,000 + $1,800,000 + $2,500,000) / 5 Average Net Income = $1,360,000
2. Estimate the Earnings Value: Earnings Value = Average Net Income * P/E Ratio Earnings Value = $1,360,000 * 15 Earnings Value = $20,400,000
3. Estimate the Revenue Value: Revenue Value = Revenue Year 5 * EV/Revenue Multiple Revenue Value = $10,000,000 * 2.5 Revenue Value = $25,000,000
4. Calculate Present Value (PV) of Earnings Value: PV of Earnings Value = Earnings Value / (1 + Discount Rate) ^ Number of Years Assuming a projection period of 5 years, PV of Earnings Value = $20,400,000 / (1 + 0.10) ^ 5 PV of Earnings Value = $12,187,365
5. Calculate Present Value (PV) of Revenue Value: PV of Revenue Value = Revenue Value / (1 + Discount Rate) ^ Number of Years Assuming a projection period of 5 years, PV of Revenue Value = $25,000,000 / (1 + 0.10) ^ 5 PV of Revenue Value = $14,911,242
6. Calculate Valuation: Valuation = PV of Earnings Value + PV of Revenue Value Valuation = $12,187,365 + $14,911,242 Valuation = $27,098,607

In this case, the estimated valuation of XYZ Tech Solutions is approximately $27,098,607 based on the average net income, industry multiples, and discount rate applied to both earnings and revenue values. It's important to note that this is a simplified valuation approach, and additional factors, such as the company's growth prospects, market conditions, and competitive landscape, should be considered for a comprehensive valuation analysis.

AMALGAMATION AND VALUATION

Amalgamation refers to the combination of two or more companies into a single entity. It involves the merging of assets, liabilities, and operations of the companies to form a new entity or for one company to absorb another. Valuation plays a crucial role in determining the terms of the amalgamation, including the exchange ratio for the shares of the companies involved. Valuation in the context of amalgamation involves assessing the value of each company participating in the amalgamation to determine the exchange ratio or share swap ratio. The exchange ratio determines the number of shares of the acquiring company that will be issued in exchange for the shares of the target company.

Valuation methods such as the market value approach, asset-based approach, income-based approach, or a combination of these approaches can be used to determine the fair value of the companies involved. The valuation process typically involves the following steps:

1. **Gather Financial Information:** Collect the financial statements and relevant information of the companies involved, including their assets, liabilities, revenues, and expenses.
2. **Select Valuation Method:** Determine the appropriate valuation method or combination of methods based on the nature of the business, industry standards, and regulatory requirements. Common methods include the market approach, income approach, and asset-based approach.
3. **Perform Valuation Analysis:** Apply the chosen valuation method(s) to assess the value of the companies. This may involve analysing financial statements, forecasting future cash flows, considering market comparable, and applying appropriate valuation multiples or discount rates.
4. **Determine Exchange Ratio:** Once the values of the companies are determined, the exchange ratio or share swap ratio is calculated. The ratio determines how many shares of the acquiring company will be issued for each share of the target company.
5. **Consider Other Factors:** Apart from valuation, other factors such as strategic fit, synergies, and management considerations are also considered during the amalgamation process.
6. **Obtain Approvals:** The valuation results and exchange ratio are presented to the board of directors and shareholders of the companies involved. They must approve the terms of the amalgamation, including the valuation methodology and the exchange ratio.

Case Study:

Assume Company A and Company B are merging through an amalgamation. The financial information of both companies is as follows:

Company A:

Shareholders' Equity: 10 million
Total Assets: 20 million
Total Liabilities: 5 million

Company B:

Shareholders' Equity: 15 million
Total Assets: 25 million
Total Liabilities: 8 million

To determine the exchange ratio for the amalgamation, we will use the book value method, which considers the net asset value of each company.

Step 1: Calculate the Net Asset Value (NAV) of each company:

Company A NAV = Shareholders' Equity of Company A = 10 million

Company B NAV = Shareholders' Equity of Company B = 15 million

Step 2: Determine the Exchange Ratio:

Exchange Ratio = NAV of Company A / NAV of Company B

Exchange Ratio = $10 million / $15 million Exchange Ratio = 0.67 This means that for every share of Company B, 0.67 shares of Company A will be issued in the amalgamation.

Step 3: Assess the Value of Amalgamated Company:

To assess the value of the amalgamated company, we need to consider the post-amalgamation financials.

Assuming the combined assets of the amalgamated company after the merger are 45 million and the total liabilities are 13 million:

Amalgamated Company Shareholders' Equity = Combined Assets - Total Liabilities Amalgamated Company Shareholders' Equity = 45 million - 13 million

Amalgamated Company Shareholders' Equity = 32 million

The value of the amalgamated company will be 32 million.

Step 4: Allocate Shares to Shareholders:

Based on the exchange ratio, shareholders of Company B will receive 0.67 shares of Company A for each share of Company B held. For example, if a shareholder of Company B holds 1,000 shares, they will receive 0.67 * 1,000 = 670 shares of Company A.

SLUMP SALE

A slump sale refers to the transfer of an undertaking, business, or division of a company as a going concern, where all assets and liabilities are transferred as a package to another entity. In a slump sale, the business is sold as a whole, and individual assets and liabilities are not separately identified or valued. The consideration for the slump sale is usually a lump sum amount.

Here's an example to illustrate the concept of a slump sale:

- Company A owns and operates a manufacturing division that manufactures and sells electronic devices. Company B is interested in acquiring the entire manufacturing division through a slump sale.
- In the slump sale agreement, Company A transfers the entire manufacturing division, including all its assets and liabilities, to Company B. This includes manufacturing equipment, inventory, intellectual property rights, customer contracts, employees, and any other assets and liabilities associated with the division.
- The consideration for the slump sale is agreed upon between Company A and Company B. It could be a fixed amount, a combination of cash and shares, or any other form of consideration. The exact terms of the sale, including payment timelines and any warranties or representations, are negotiated and documented in the agreement.
- After the slump sale is completed, Company A no longer operates the manufacturing division, and Company B becomes the new owner of the division. Company B assumes all the assets, liabilities, and ongoing operations of the division, including customer relationships, supplier contracts, and any legal or financial obligations.

It's important to note that the tax and legal implications of a slump sale can vary across jurisdictions. It is advisable to consult with tax and legal professionals to ensure compliance with applicable laws and regulations and to understand the specific implications of a slump sale in a particular context.

Slump sale is a strategic transaction used by companies to divest or acquire business divisions as a going concern. It offers advantages such as simplicity, continuity of operations, and tax efficiency. However, careful consideration of accounting and tax implications is essential for both the seller and the buyer to optimize the outcome of the transaction.

- **Features of Slump Sale**

Transfer of Business as a Going Concern: The buyer acquires the business in its entirety, including all asset and liabilities necessary for its operation.

Single Transaction: Slump sale is typically executed as a single transaction, where the entire business is transferred for a lump sum consideration.

No Break in Continuity: The business continues to operate seamlessly after the transfer, ensuring continuity of operations and customer relationships.

- **Process of Slump Sale**

Negotiation and Agreement: The buyer and seller negotiate the terms of the slump sale, including the consideration, assets and liabilities to be transferred, and any conditions precedent.

Due Diligence: The buyer conducts due diligence to assess the assets, liabilities, and potential risks associated with the business being acquired.

Documentation: Legal documents such as the slump sale agreement, transfer deeds, and relevant contracts are drafted and executed to affect the transfer.

Approval and Registration: The slump sale transaction may require approval from regulatory authorities and

compliance with statutory requirements. The transfer documents are registered with the appropriate authorities.

- **Accounting Treatment of Slump Sale:**

Purchase Price Allocation: The purchase price is allocated to the assets and liabilities acquired based on their fair values at the date of transfer.

Recognition of Gain or Loss: Any difference between the purchase price and the net assets acquired is recognized as a gain or loss in the financial statements of the seller.

➢ **Tax Implications of Slump Sale:**

Capital Gains Tax: The seller may be liable to pay capital gains tax on the difference between the sale consideration and the cost of acquisition of the business.

Tax Treatment of Assets and Liabilities: The tax treatment of assets and liabilities transferred in a slump sale may vary based on applicable tax laws and regulations.

Case Study:

1. Introduction: This case study examines the slump sale of ABC Manufacturing Company, a leading player in the automotive components industry. The slump sale was executed to streamline operations, divest non-core assets, and consolidate resources for the company's core business activities.

2. Background: ABC Manufacturing Company had diversified its operations over the years, expanding into multiple sectors and product lines. However, this diversification had resulted in operational complexities and resource allocation challenges. To refocus on its core competencies and improve profitability, the company decided to undertake a slump sale of non-core business segments.

3. Rationale for Slump Sale: The key reasons for pursuing a slump sale were as follows:

a) Strategic Focus: The slump sale aimed to enable ABC Manufacturing Company to concentrate its resources and efforts on its core business activities. By divesting non-core assets, the company could redirect its attention to areas where it held a competitive advantage and maximize growth opportunities.
b) Cost Rationalization: The non-core business segments were associated with additional costs, such as separate management teams, infrastructure, and overhead expenses. Through the slump sale, the company could eliminate these costs and achieve operational efficiencies.
c) Debt Reduction: In some cases, non-core business segments might have been burdened with significant debt. The proceeds from the slump sale could be utilized to repay debt, thereby strengthening the company's financial position and reducing interest obligations.

4. Slump Sale Process: The slump sale process involved the following steps:

a) Identification of Non-Core Assets: The management conducted a thorough evaluation of the company's businesses and identified the non-core assets that would be divested. This assessment involved analyzing financial performance, growth prospects, and strategic alignment with the company's long-term objectives.
b) Valuation and Pricing: The non-core assets were valued based on their fair market value, taking into account factors such as asset condition, market demand, and future cash flows. The pricing of the slump sale was determined through negotiations with potential buyers or investors.
c) Due Diligence: The potential buyers or investors performed due diligence on the non-core assets to assess their financial, operational, and legal aspects. This step ensured transparency and minimized risks associated with the slump sale.
d) Agreement and Execution: Once the negotiations and due diligence were completed, a formal agreement was drafted, outlining the terms and conditions of the slump sale. The execution of the agreement involved the transfer of ownership and assets, including tangible and intangible assets, contracts, and employees.
e) Post-Sale Transition: Following the slump sale, ABC Manufacturing Company focused on smoothly transitioning the divested business segments to the new owners. This involved ensuring a seamless handover of operations, customer relationships, and support functions.

5. Outcomes and Results: The slump sale of non-core assets yielded several positive outcomes for ABC Manufacturing Company:

a) Enhanced Focus and Efficiency: By divesting non-core assets, the company could concentrate its resources and expertise on its core business activities. This led to improved operational focus, increased efficiency, and better utilization of available resources.

b) Improved Financial Performance: The slump sale resulted in a reduction of costs associated with non-core assets, leading to improved financial performance. The company could reallocate capital and reinvest in core business activities, thereby enhancing profitability and shareholder value.
c) Debt Reduction: If the non-core assets carried significant debt, the proceeds from the slump sale could be utilized to repay debt obligations. This reduced interest expenses and improved the company's overall financial health.
d) Strategic Alignment: The slump sale allowed ABC Manufacturing Company to align its business portfolio with its long-term strategic objectives. By divesting non-core assets, the company could focus on its core core competencies and capitalize on growth opportunities in its primary market.

6. Conclusion: The slump sale of non-core assets enabled ABC Manufacturing Company to streamline operations, consolidate resources, and improve profitability. By focusing on its core business activities, the company achieved strategic alignment, cost rationalization, and enhanced financial performance, ultimately leading to increased shareholder value.

DEMERGER

Demerger is a corporate restructuring process in which a company transfers one or more of its divisions, subsidiaries, or business units into separate independent entities. In a demerger, the assets, liabilities, and operations of the division or subsidiary are divided and distributed among the newly formed entities or existing companies.

Here's an example to illustrate the concept of a demerger:

Company XYZ is a conglomerate with diverse business operations, including a pharmaceutical division and a real estate division. The company decides to demerge its real estate division into a separate entity called Company R, which will be a standalone real estate company.

The demerger process involves the following steps:

1. **Planning and Announcement:** Company XYZ's management identifies the real estate division as a separate entity with its own growth potential. The decision to demerge the division is made, and the company announces its plans to shareholders and stakeholders.
2. **Valuation and Asset Allocation:** The real estate division's assets, liabilities, and operations are evaluated and valued. The valuation determines the distribution of assets and liabilities between the parent company (Company XYZ) and the new entity (Company R). This may involve conducting a separate business valuation for the real estate division.
3. **Legal and Regulatory Requirements:** Company XYZ complies with legal and regulatory requirements specific to the jurisdiction where the demerger is taking place. This may involve obtaining approvals from shareholders, regulatory authorities, and other relevant parties.
4. **Implementation:** The demerger is executed by transferring the identified assets, liabilities, and operations of the real estate division from Company XYZ to Company R. This could involve transferring property titles, contracts, employees, and other necessary arrangements to ensure the smooth functioning of the new entity.
5. **Shareholder Allocation:** Company XYZ determines how the shares of the newly formed entity (Company R) will be allocated among its existing shareholders. This can be done through a share swap ratio, where shareholders receive shares of the new entity in proportion to their holdings in the parent company.
6. **Independent Operations:** After the demerger, Company R operates as an independent real estate company, having its own management, board of directors, financials, and strategic direction. Company R can raise funds, make investments, and pursue growth opportunities specific to its real estate business.

A demerger allows the parent company to focus on its core operations, while the demerged entity can operate autonomously and pursue its own growth strategies. It can unlock value by creating separate entities with specialized expertise and clearer market positioning.

It's important to note that the specific details and processes of a demerger can vary based on legal requirements, regulatory frameworks, and company-specific considerations. Professional advice from legal, financial, and tax experts should be sought to ensure compliance with applicable laws and to handle the complexities involved in a demerger.

➢ **Reasons for Demergers**

Focus on Core Business: Companies may opt for demergers to focus on their core competencies and streamline operations.

Unlocking Value: Demergers can unlock the hidden value of distinct business units by allowing them to operate independently and pursue their strategies.

Financial Flexibility: Separate entities can access capital markets and financing opportunities that may not have been available as part of a larger conglomerate.

➢ **Types of Demergers**

Partial Demerger: Only a portion of the business is spun off into a separate entity.

Complete Demerger: The entire business is divided into separate entities.

Split-up Demerger: The parent company splits into multiple independent entities.

Equity Carve-out: The parent company sells a portion of its subsidiary's shares to the public while retaining control.

➢ **Legal and Regulatory Framework**

Demergers are subject to various legal and regulatory requirements, including approval from shareholders, creditors, and regulatory authorities. Companies must comply with company law provisions, securities regulations, and taxation laws governing demergers.

➢ **Accounting Treatment**

Accounting for demergers involves allocating the assets, liabilities, and equity of the parent company among the demerged entities based on their fair values. The process may include adjustments for goodwill, intangible assets, and contingent liabilities.

➢ **Taxation Implications**

Demergers can have significant tax implications for both the parent company and the spun-off entities. Tax considerations include capital gains tax, stamp duty, transfer pricing, and tax consolidation rules. Companies must carefully plan the demerger structure to optimize tax outcomes.

PRINCIPLES AND TECHNIQUES OF REPORTING

Valuation Report exercise is based on the observation, inspection, analysis, and calculation. During this process, the valuer goes through various documents, records his observation, makes relevant calculation and records these calculations and analyses results. In this process, many documents are generated which forms the basis of his conclusion on the valuation of the subject matter. It is very necessary for him to preserve all such records so that these documents may help him to substantiate his conclusion on valuation. Moreover, all these documents also become the matter of reference in near future.

CONTENTS OF SUMMARIZED VALUATION REPORT

An expert group of Ministry of Corporate Affairs suggested the following coverage in case of the Valuation Report for Corporate Strategies. Considering the shareholder's interest and the need for transparency and upholding corporate governance principles and after taking into consideration aspects of minority interest, transparency and corporate governance the Expert Group recommended that the following matters should compulsorily be covered in the Valuation Report, in a clear, unambiguous and non-misleading manner, consistent with the need to maintain confidentiality:

1. Background Information
2. Purpose of Valuation and Appointing Authority
3. Identity of the valuer and any other experts involved in the valuation

4. Disclosure of valuer Interest/Conflict, if any
5. Date of Appointment, Valuation Date and Date of Report
6. Sources of Information
7. Procedures adopted in carrying out the Valuation
8. Valuation Methodology
9. Major Factors influencing the Valuation
10. Conclusion
11. Caveats, Limitations and Disclaimers.

Background Information	The valuation report should briefly cover the following: • Brief particulars of company or business which is the valuation subject • Proposed Transaction • Key historical financials • Capital structure of the company, if relevant, and any changes because of the proposed transaction • Shareholding pattern, any significant changes (Promoters/FIs), and any changes as a result of the transaction (Note – a table of before and after shareholding patterns ought to be disclosed) • High/low/average market volumes/price for last six months, where applicable • Related party issues with respect to the transaction.
Purpose of Valuation & Appointing Authority	The context and purpose of the valuation and the appointing authority commissioning the exercise must be clearly stated e.g. the Management's decision to seek an advisory opinion should be disclosed, or, the Audit Committee Chairman's decision to appoint or the appointment of an independent valuer itself should be disclosed with the date of the decision.
Identity of the valuer and any other experts involved in the valuation	Identity of the Registered Valuer (with his registration number) as well as organization doing the valuation and any other experts consulted in the process of valuation. The separation of the advisory team and details of the Chinese walls maintained between the independent valuer team and the advisory team, if appointed with of the degree of strict separation and compliance of Chinese walls should be mentioned.
Disclosure of Valuer Interest/Conflict, if any	The Expert Group also recommends that a valuer shall disclose in his Report, possible sources of conflict and material interests, including association or proposed association/with the company, its associates, the counterparty to the transaction or its associates, in the form of auditor, lead advisor or in any other capacity, together with the nature of the fee arrangements for the same. If the valuer has a separate advisory engagement, the conflict disclosure should clearly record that neither the valuer or the members of the team working on the independent valuation have directly or indirectly, through the client or otherwise shared any advisory perspective or have been influenced or undertaken advocating a management position in determining the value.
Date of Appointment, Valuation Date and Date of Report	The Report should clearly state the date of the appointment of the valuer, Valuation Date (i.e. the date as of which the valuation assessment is done if this be other than the date of the report) and the date of the report.
Sources of Information	The valuer should clearly indicate in the report the principal sources of information, both internal and external, which have been relied upon for the purpose of valuation.
Procedures adopted in carrying out the valuation	Procedures adopted in carrying out a valuation may vary with circumstances, nature, and purpose of valuation as well as information and time available. The principal procedures adopted by the valuer in carrying out the valuation should be set out briefly in the report. Such procedures may typically include: • Review of past Financials • Review and analysis of financial projections • Industry analysis • SWOT analysis • Comparison with similar transactions • Comparison with other similar listed companies

	• Discussions with Management • Review of principal agreements/documents etc.
Procedures adopted in carrying out the valuation	Procedures adopted in carrying out a valuation may vary with circumstances, nature, and purpose of valuation as well as information and time available. The principal procedures adopted by the valuer in carrying out the valuation should be set out briefly in the report. Such procedures may typically include: • Review of past Financials • Review and analysis of financial projections • Industry analysis • SWOT analysis • Comparison with similar transactions • Comparison with other similar listed companies • Discussions with Management • Review of principal agreements/documents etc. **The valuer should also include in his report:** • an affirmative statement that information provided and assumptions used by Management/Others in developing projections have been appropriately reviewed and enquiries made regarding basis of key assumptions in the context of analysis of business being valued and the industry/economy; and • an affirmative statement on adequacy of information and time for carrying out the valuations; with such modifications as may be appropriate and warranted. The affirmative statement shall not negate the professional liability for expertise applied in determining value and if the degree of inadequacy of information is severe, fundamental questions and information as assessed by the valuer as key for the appropriate stage of valuation needs to be disclosed.
Valuation Methodology	Where as one method may be more or less applicable to a particular case, they are often used in conjunction to arrive at the fair value of a company/asset/business. The following are some of the methods which are often used for valuations. The methods enumerated below are merely illustrative and not exhaustive. • Asset Approach • Book Value, Adjusted Book Value, and Liquidation Value • Income Approach • Capitalization of Earnings, Capitalization of Excess Earnings, and Discounted Future Earnings/ Cash Flows. • Market Approach Current Market Prices, Historical Market Prices, Price to Earnings, Price to Revenue, Price to Book Value, Price to Enterprise Value, etc. Comparable transactions/Valuations Comparable International and Domestic Transactions. The valuation methodology adopted by the valuer must be disclosed. The valuer should mention in the report the rationale and appropriateness for the adoption of a particular method, or a combination of methods and emphasis/reliance placed on the chosen method/combination of methods in reaching the final conclusion.
Major Factors influencing the Valuation	The valuer should also mention any key factors which have a material impact on the valuation of shares, including inter- alia the size or number of the corporate assets or shares, its/their materiality or significance, minority or majority holding and changes on account of the transaction, any impacts on controlling interest, proposed dividend, or past profit of the company, proportion of assets and liabilities, diminution or augmentation therein and marketability or lack thereof.
Conclusion	In conclusion, the report must contain clear statement of the value ascribed to the business/assets in question.
Caveats, Limitations and Disclaimers	Any caveats, limiting condition or other disclaimers to the report must be clearly stated with appropriate specificity i.e. the valuer shall not disclaim liabilities for his expertise or deny his duty of care.

RELATIVE VALUATION AND SWAP RATIO

Relative valuation is a method of valuing a company or asset by comparing it to similar companies or assets in the same industry or market. It involves analysing various financial and non-financial metrics of comparable companies and using them as benchmarks to determine the relative value of the target company. Swap ratio, on the other hand, is the ratio at which shares of one company are exchanged for shares of another company in a merger, acquisition, or demerger. It determines the proportionate ownership of shareholders in the combined or newly formed entity. In the context of a merger or demerger, the swap ratio is determined based on the relative valuation of the companies involved. Here's how the swap ratio and relative valuation are interconnected:

1. **Relative Valuation Analysis:**
    - **Comparable Company Analysis:** Comparable companies in the same industry are identified, and their financial metrics such as price-to-earnings ratio (P/E ratio), price-to-sales ratio (P/S ratio), or enterprise value-to-EBITDA (EV/EBITDA) are analysed.
    - **Relative Multiples:** The financial metrics of the comparable companies are used as multiples. For example, if the average P/E ratio of comparable companies is 15, it implies that investors are willing to pay 15 times the earnings for similar companies.
    - **Application to the Target Company:** The multiples derived from the comparable company analysis are applied to the target company's financial metrics (such as earnings, sales, or EBITDA) to determine its estimated value.
2. **Determining Swap Ratio:**
    - **Valuation of Companies:** The relative valuation analysis helps determine the value of each company involved in the merger or demerger.
    - **Negotiation and Agreement:** The swap ratio is then negotiated between the companies based on their respective valuations and the ownership stake desired by each party.
    - **Share Exchange:** The agreed-upon swap ratio determines the number of shares of the acquiring company that will be exchanged for each share of the target company or vice versa.

The swap ratio is typically expressed as a fraction or ratio. For example, a swap ratio of 1:3 means that for every three shares of the target company, the shareholders will receive one share of the acquiring company. The swap ratio considers the relative value of the companies to ensure a fair exchange of shares between the merging or demerging entities. It takes into account factors such as market conditions, financial performance, growth prospects, synergies, and shareholder interests. It's important to note that the swap ratio is subject to negotiation and agreement between the companies involved, and it can be influenced by various other factors beyond relative valuation, including strategic considerations, regulatory requirements, and management decisions. Professional advice from financial advisors, valuation experts, and legal professionals is essential to ensure that the swap ratio is fair and equitable for all parties involved and complies with applicable laws and regulations.

Illustration:

Company XYZ, the parent company, is demerging its subsidiary, SubCo, into a separate entity called NewCo.

Let's assume the following information:

1. Company XYZ:
    - Number of outstanding shares: 10 million
    - Market price per share: Rs. 50
2. SubCo:
    - Number of outstanding shares: 5 million
    - Market price per share: Rs.30

To determine the swap ratio, we need to calculate the relative value of SubCo compared to Company XYZ. We can do this by comparing the market capitalization of the two companies.
Market capitalization of Company XYZ = Number of shares * Market price per share = 10 million * 50 = 500 million
Market capitalization of SubCo = Number of shares * Market price per share= 5 million * 30 = 150 million
Now, let's calculate the swap ratio:

Swap ratio = Market capitalization of SubCo / Market capitalization of Company XYZ = 150 million / 500 million= 0.3
This means that for every 0.3 shares of SubCo, shareholders of Company XYZ will receive one share of NewCo. Let's assume a shareholder of Company XYZ owns 1,000 shares. Based on the swap ratio, they would receive:
Number of NewCo shares = Number of Company XYZ shares * Swap ratio = 1,000 * 0.3 = 300 shares of NewCo