



Reporting Aspects

Discounted Cash Flow (DCF) Valuation

B. K. KHARE & Co.
CHARTERED ACCOUNTANTS
CA Shirish S. Rahalkar



The Chartered Accountant Act says,

2

- Clause (3) Part I – Second Schedule of The Chartered Accountant Act, 1949 states –
- Practising member **prohibited** from permitting his name or the name of his firm to be used in connection with an **estimate of earnings** contingent upon future transactions in a manner which may lead to the belief that he **vouches for the accuracy** of the forecast

Value, Valuation and Valuer

3

• f... thing

The use of professional judgment is an essential component of estimating value

• a...

- An estimation of something's worth, esp. one carried out by a **professional appraiser**

Valuation Process

Follow business valuation practice standards

4

- Accepting engagement following client acceptance procedures

- Understanding and documenting engagement terms

- Obtain sufficient and relevant data
 - From client
 - From public domain

Valuation Process

Follow business valuation practice standards

5

- Select a valuation method
- Evaluate and process data to arrive at value / value range
- Validate the findings by alternative methods
- **Issue valuation report**

Business Valuation: approaches

6

- Asset Based
 - ▣ Used in liquidation
 - ▣ generally indicative of lowest value

- Income Based (Future cash flows)
 - ▣ - for a going concern ownership

- Market Based
 - ▣ Comparison with peers

Income Based: Discounted Cash-flow Method

7

- *Premise is that*
 - ▣ Value is 'present value of **future** cash flows'
- *Method therefore entails*
 - ▣ **Evaluation of projections:** revenues, expenses, investments and repayments
- *Involves number of assumptions*
 - ▣ Reasonableness of future cash flows
 - ▣ Industry and Economic Scenario
 - ▣ **Discount rate**



DCF Method: Contents of Report

8

- Introduction
- Sources of information
- Analysis of information
- **Approaches and methods considered and used**

DCF Method: Contents of Report

9

- Valuation adjustments
- **Conclusion of value / value range**
- Appendices and exhibits
 - ▣ **Assumptions, Limiting Conditions**
 - ▣ Disclaimers
 - ▣ Supplementary information

Introduction

10

- Client, Valuer and Subject interest
- Description of the subject interest
- Purpose / intended use of the valuation
- Intended users of the valuation
- Ownership control characteristics

Introduction

11

- Applicable premise of value
- Valuation date and Report date
- Type of report issued
 - Detailed report
 - Summary Report
 - Calculation Report
- Use of the work of specialist or expert

Introduction

12

- Comment on subsequent events, if any
- Reference to law under which valuation is done (if applicable)
 - RBI Guidelines
 - SEBI Guidelines
- Jurisdictional exception from Valuation Standard arising out of above

Source of information: **Management**

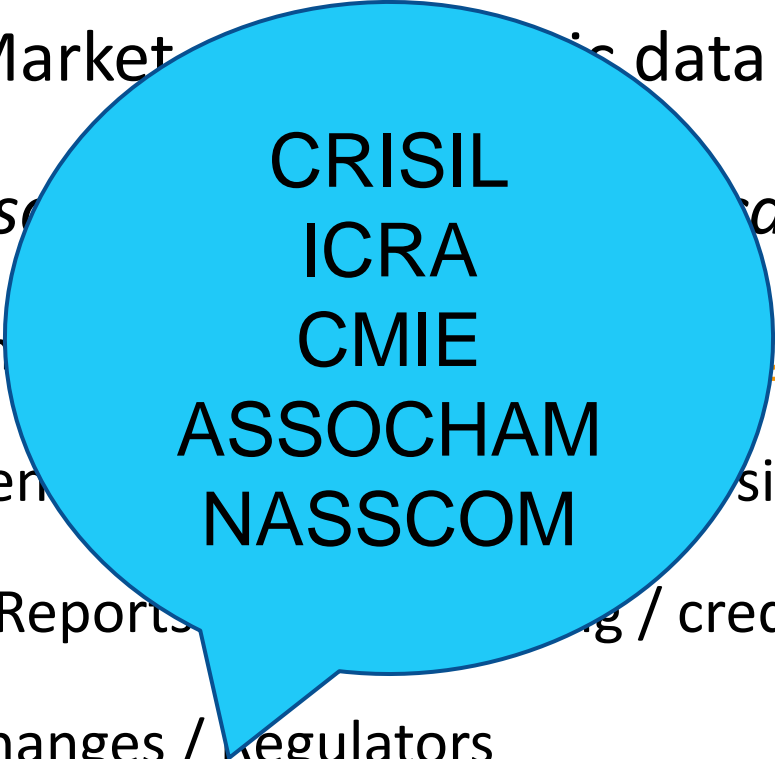
13

- Financial and non-financial information obtained from the management
 - Note on business plans
 - Projections of profitability, cash flows
 - Important agreements / arrangements
 - Capital Structure
 - Answers to specific questions and issues raised from time to time
 - Report of other valuer relied upon, if any

Source of information: **Public Domain**

14

- Industry, Market Research, Economic data
 - (state sources, *information clearly*)
- Public domain [google.com](http://www.google.com)
- Government websites
- Research Reports (e.g. / credit rating agencies)
- Stock Exchanges / Regulators



Analysis of the information

15

- Identify 'derived' information specifically
- Normalization of financial information and rationale behind it
- Historical and projected financial information
Comparison with economic and industry trends / scenario
- Visit to subject entity's facility, etc.

Approaches and methods considered and used

16

- Discuss minimum methods
- Discuss the background and objective of valuation
- Follow elimination process if possible
- Rationale for selection of most appropriate method/s (in this case DCF method)
 - *It may be a regulatory requirement*

DCF Valuation: FCFE / FCFF

17

- Future cash flows for foreseeable future normalised (say a period of 5 to 10 years)
- Tax Rate assumption based on current tax regime
- Growth during forecast period
- Growth in perpetuity
- Capex and permanent working capital deducted

DCF Valuation: FCFE / FCFF

18

- Risk free rate of return (G Sec return for comparable period)
- Market Beta β
- Expected rate of return for the industry / segment
- Debt Equity Ratio
- Discount Rate / Weighted Average Cost of Capital

DCF Valuation: FCFE / FCFF

19

- Company / Entity Specific Risk Premium
- Discount Rate applied
- Present Value of cash flows in forecast period
- Present Terminal Value at the end of forecast period

Valuation Adjustments

20

- Non-operating assets / excess operating assets
- Repayment of debt , non-trade investments, cash
- Discount for lack of marketability / illiquidity
- Describe adjusted vs. pre-adjusted value
- Identify per share value

Conclusion of Value

21

- Rationale behind conclusion of value
- Specific mention of estimate of value / value range
- Reference to scope, assumptions and limitations
- Valuation date
- No obligation to update report for subsequent events

Appendices, Exhibits and Representations

22

- Representations of the Valuer
 - Assumptions, Limiting Conditions, Disclaimers
- Reproduce information used to the extent considered relevant in the form of appendices and exhibits

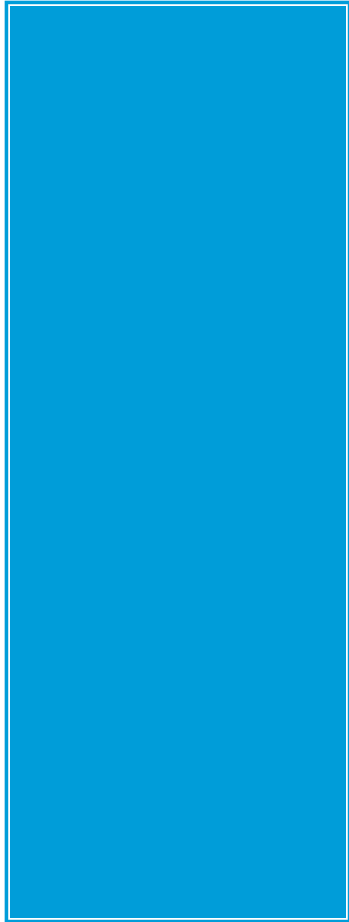
Way Forward

23

- **Companies Bill, 2012**
- Section 247 : ‘Registered Valuer’
- Valuer to have such qualifications as may be prescribed
- Valuer to exercise due care and comply rules (*ambp*)
- Contravention is punishable with imprisonment

Views are Welcome!

24



Shirish S. Rahalkar

Associate Director

B. K. Khare & Co.

Chartered Accountants

You may reach me: shirishrahalkar@bkkhareco.com

Information contained in this document is intended only to provide a perspective on DCF valuation: Reporting Aspects and the process followed in relation to such and related engagements. It should be in no way construed to be an opinion or advise of any character and is in no way represented as such. The information provided herein should not be used and reproduced and should be considered privileged and only for the intended recipients.