

# **Valuation of Equity Shares**



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**WIRC – Seminar on Valuation**

# Presentation Overview

龔 Valuation Concept

龔 Valuation Approaches

龔 Selection of Methods

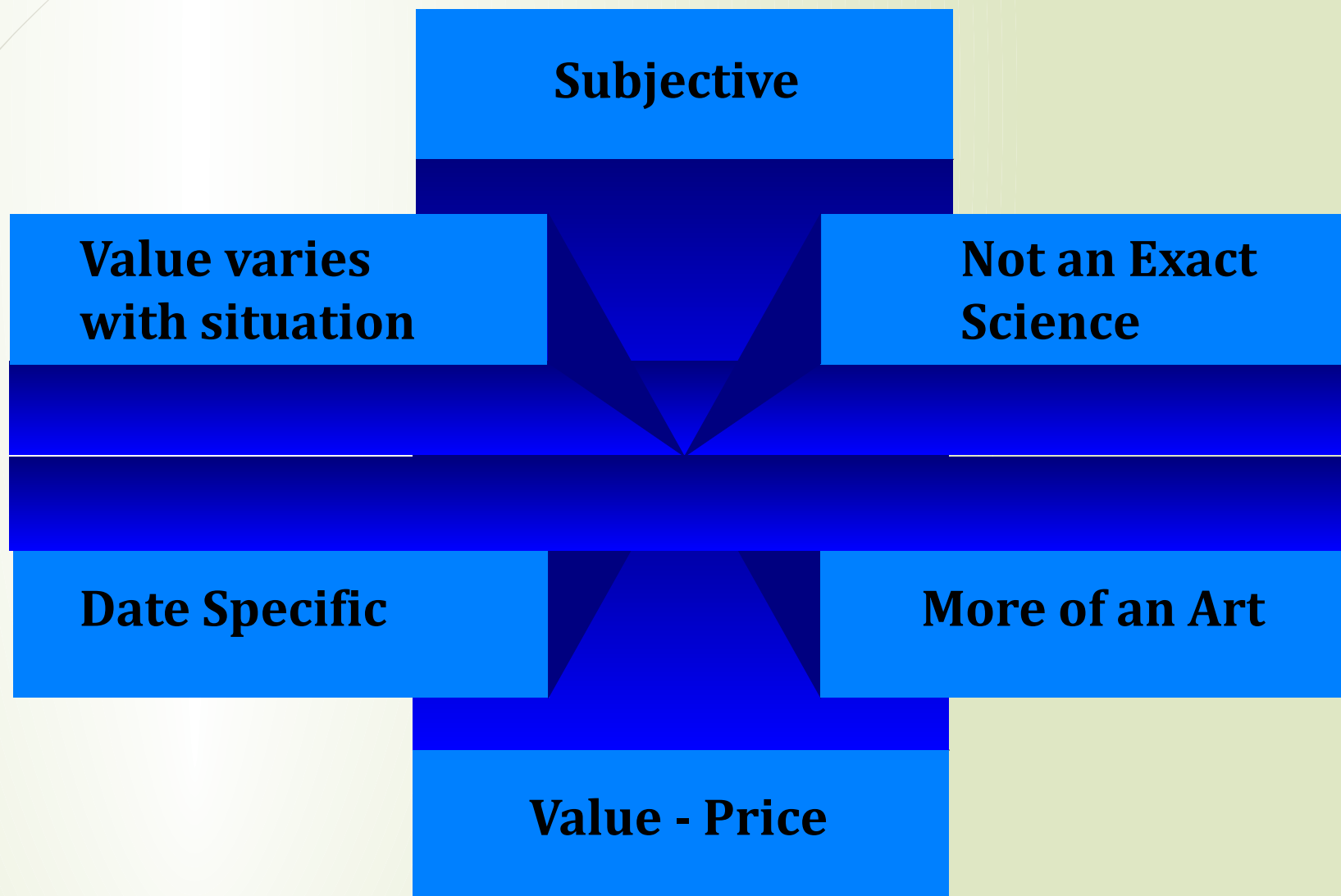
龔 Requirements under various laws & situations

龔 Critical Aspects in Valuation

龔 Opportunities for Professionals

# Valuation Concept

# Valuation Overview



# Why Valuation?

# Valuation Approaches

# Principal Approaches of Valuation

- 匱 Discounted Cash Flow Method
- 匱 Earnings Multiple Method
- 匱 Market Price Method
- 匱 Market Comparable Method
- 匱 Net Assets Method

# Discounted Cash Flow Method

- Values a business based on the expected cash flows over a period of time
- Involves determination of discount factor and growth rate of profitability
- Value of business is aggregate of discounted value of the cash flows for the explicit period and perpetuity
- Consider cash flows & not profit
- DCF parameters:
  - Cash Flows
    - Projections
    - Horizon Period
    - Growth Rate
  - Discounting
    - Cost of Equity
    - Cost of Debt
    - Weighted Average Cost of Capital ('WACC')



# DCF – When to use?

鼈 Most appropriate for valuing firms:

擱 Limited life projects

擱 Large initial investments and predictable cash flows

擱 Regulated business

擱 Start-up companies

# Earnings Multiple Method

- Commonly used Multiples:
  - Price to Earnings Multiple
  - Enterprise Value / EBITDA Multiple
- Parameters:
  - Capitalization Rate / Multiple
  - Future Maintainable Profits

# Earnings Multiple Method

- Multiple to be applied represent the growth prospects / expectations of the Company
  
- Factors to be considered while deciding the multiple:
  - Past and Expected Growth of the Earnings
  - Performance vis-à-vis Peers
  - Size & Market Share
  - Historical multiples enjoyed on the Stock Exchange by the Company and its peers

# Market Price Method

- 鼈 Evaluates the value on the basis of prices quoted on the stock exchange
- 鼈 Thinly traded / Dormant Scrip – Low Floating Stock
- 鼈 Significant and Unusual fluctuations in the Market Price
- 鼈 It is prudent to take weighted average of quoted price for past 6 months
- 鼈 Regulatory bodies often consider market value as important basis – Preferential allotment, Buyback, Takeover Code

# Market Comparables

- 鼈 Generally applied in case of unlisted entities
- 鼈 Estimates value by relating an element with underlying element of similar listed companies.
- 鼈 Based on market multiples of Comparable Companies
  - 擱 Book Value Multiples
  - 擱 Industry Specific Multiples
  - 擱 Multiples from Recent M&A Transactions.

# Net Assets Value Method

Net Assets Value Method represents the value with reference to historical cost of assets owned by the Company and the attached liabilities on the valuation date.

# Selection of Methods

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Situation	Approach
Knowledge based companies	Earnings/Market
Manufacturing Companies	Earnings/ Market/ Net Asset
Brand Driven companies	Earnings/Market
Investment/Property companies	Net Asset
Company going for liquidation	Net Asset

Generally Market Approach is used in combination with other methods or as a cross check



# Reaching a Recommendation

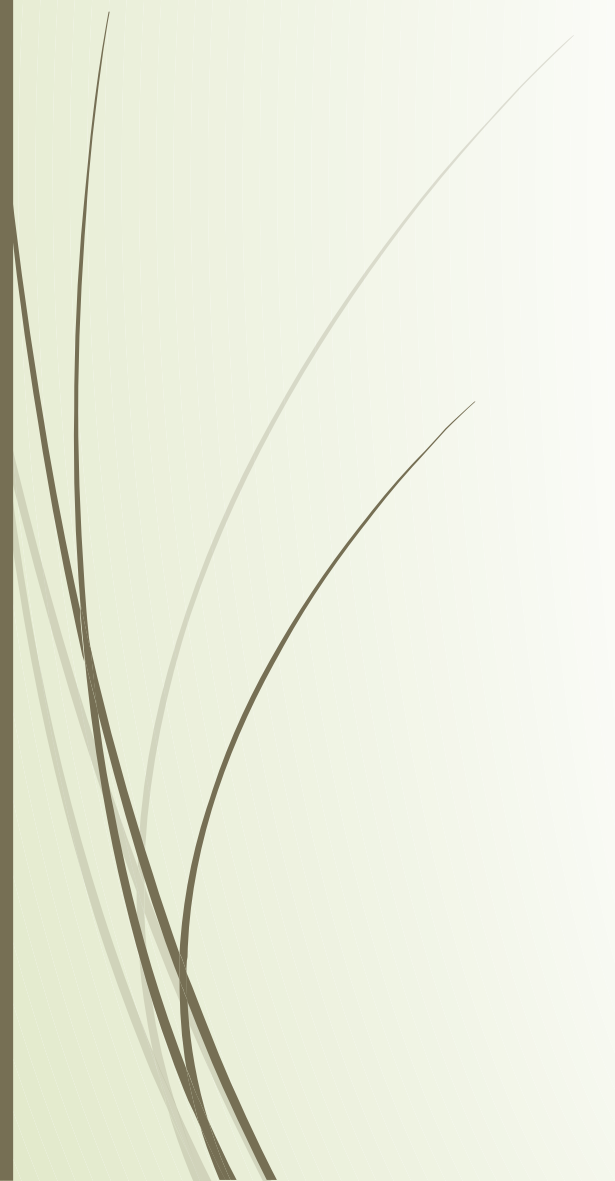
- ⚡ Methods throw a range of values
- ⚡ Consider the relevance of each methodology depending upon the purpose and premise of valuation
- ⚡ Mathematical weightage
- ⚡ Professional judgment
- ⚡ Subjective Value

# Other Value Drivers



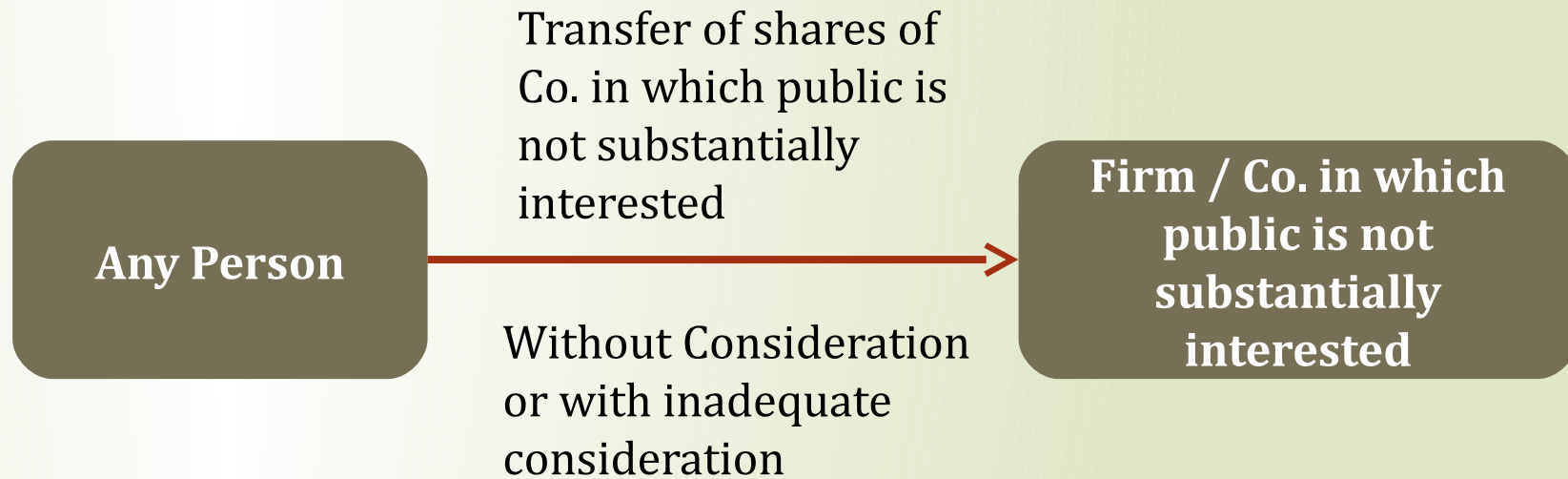
# **Requirements under Various Laws & Situations**

# Corporate Restructuring



# Income Tax Act

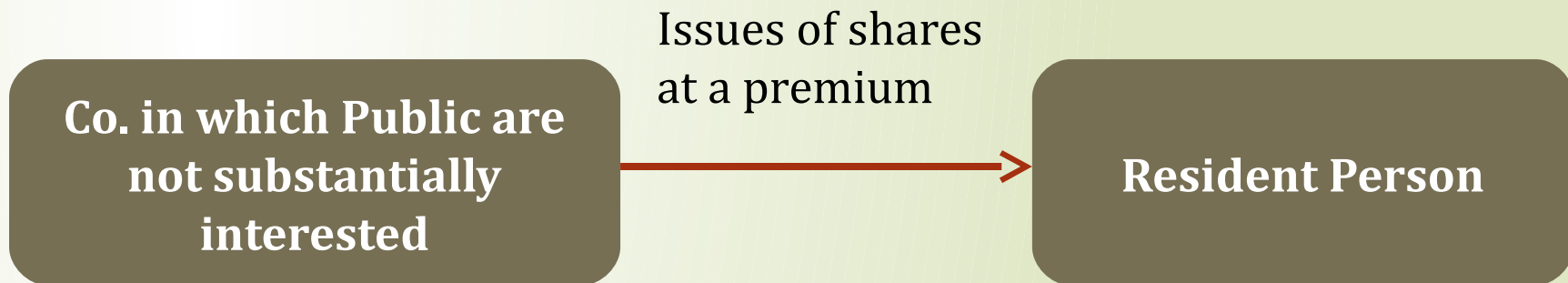
## 鼈 Sec 56(2)(viiia)



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# Income Tax Act

## 鼈 Sec 56(2)(viib)



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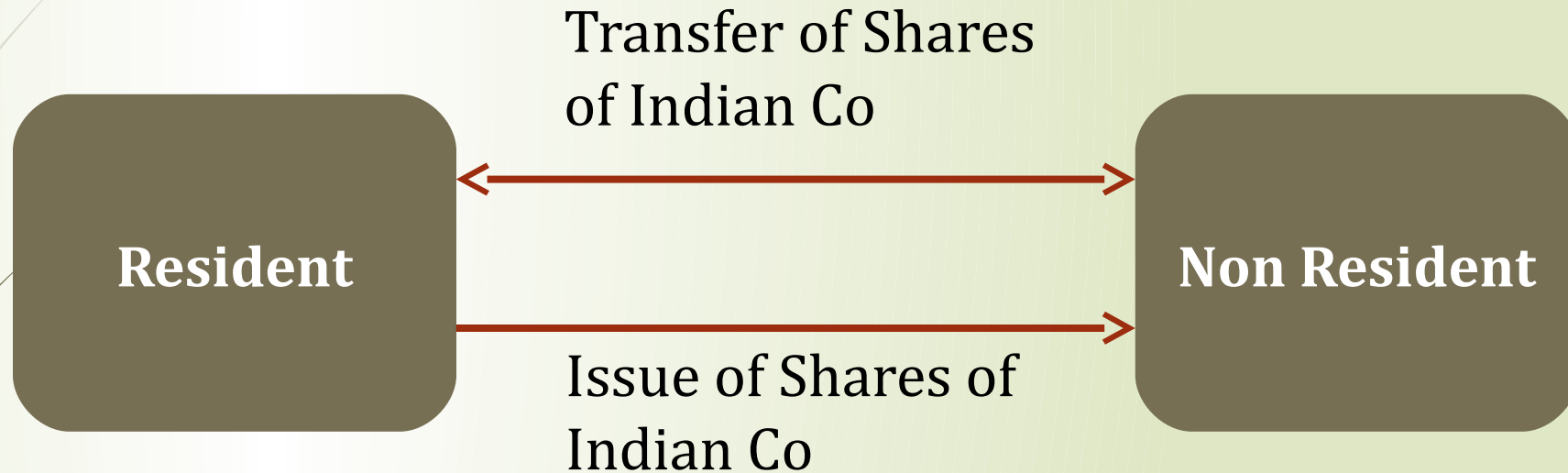
# Transfer Pricing



⚡ Transfer should be at Arm's Length Price (ALP)

⚡ ALP = Fair Value

# FEMA

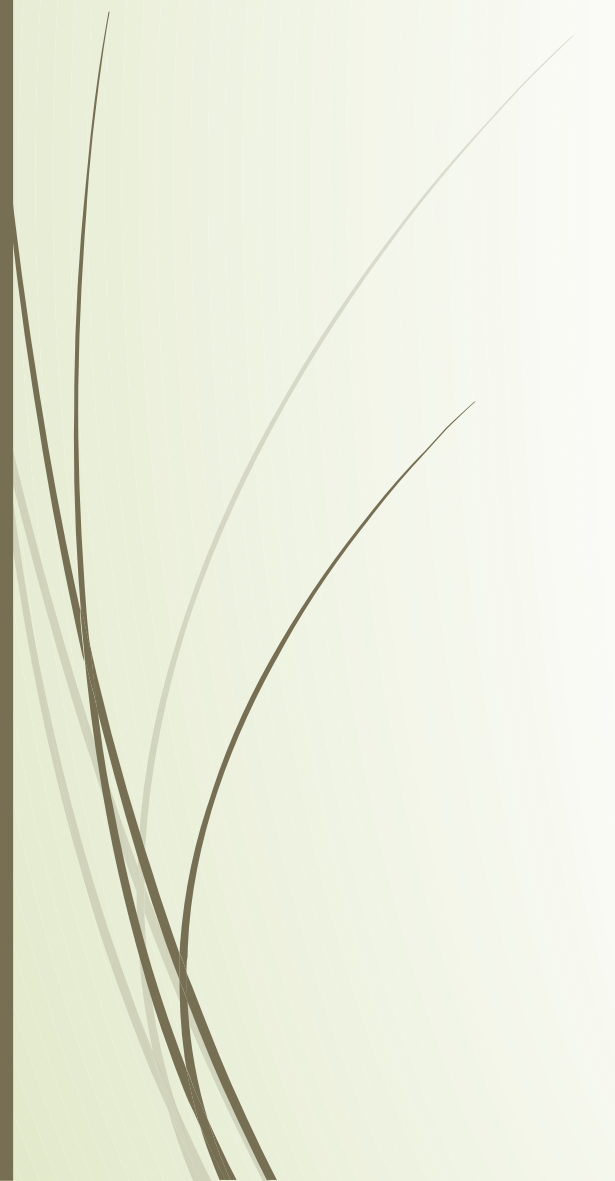


⚠ Quoted – as per SEBI guidelines

⚠ Unquoted – Any internationally accepted valuation methodology



# Accounting Purpose



# SEBI

1

2

3

# Critical Aspects in Valuation

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- 鼈 Surplus Assets
- 鼈 Contingent Assets / Liabilities
- 鼈 Convertible Instruments
- 鼈 Difficulty in obtaining comparable multiples
- 鼈 Loss making companies & Start-up companies
- 鼈 Illiquidity discount & control premium
- 鼈 Transaction Structure
- 鼈 Relying on Technical Valuer's Report
- 鼈 Joint Reports
- 鼈 Management Representations
- 鼈 Finds of Due Diligence Review

# Opportunities for Professionals

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## Valuation Requirement:

幣 For Transaction Closure

幣 For Regulatory Approval

幣 For Compliance

幣 For Internal Use

*(Contd.)*

# Opportunities for Professionals

## Competence for Valuation

- What we are taught in CA course is more than sufficient
- Read books on valuation E.g. Damodaran, Mckinsey, etc.
- Broad knowledge of economy and industries
- Training with a valuation firm
- Use of common sense
- Be open to new thoughts
- Keep your eyes and ears open
- Use of Technology

*(Contd.)*

# Opportunities for Professionals

## Regular Reading

鼈 Newspapers / Business Magazines

鼈 Financial Statements

鼈 Stock Exchange Announcements

鼈 Journals of Professional bodies

鼈 Tax Updates



# Best Practices

- ⚠ Rationale for various parameters used in valuation
- ⚠ Arithmetical accuracy of the model
- ⚠ Detailed office notes on valuation
- ⚠ Regular Internal training of employees & Internal peer review
- ⚠ Strict Adherence to Code of Conduct of the Institute
- ⚠ Internal Code of Conduct at office i.e. Confidentiality and Appointment of new employees and Restriction of trading in stocks
- ⚠ Withholding Client Pressure for unreasonable valuations / timelines
- ⚠ Creating goodwill will take a long time, destroying it will take a second

**THANK YOU!**