

# VALUATION OF SHARES / BUSINESS

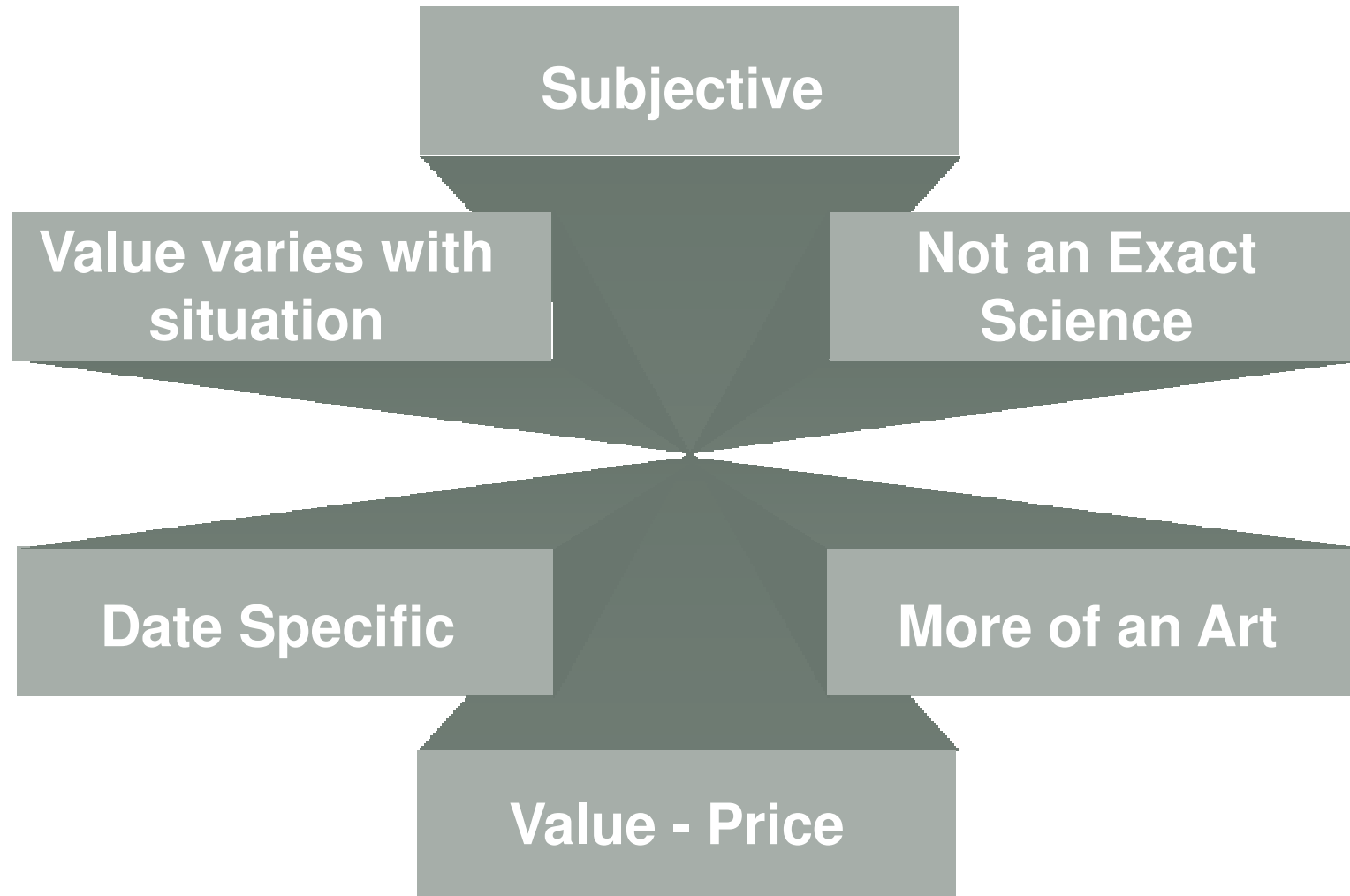
-CA Sujal Shah

12<sup>th</sup> December 2015

WIRC Mega Conclave  
on 'New Horizons for  
The Profession'



# Overview





---

**WHEN IS VALUATION  
REQUIRED?**

## 1. **Restructuring:**

- Relative Valuation during-
  - Amalgamation- Swap Ratio
  - Demerger- Entitlement Ratio
- Fair Valuation for-
  - Purchase / Sale of Business
  - Buy Back Of Shares

## 2. **For Income Tax Purposes-**

- Transfer Pricing
- Section 56 (2)

## 3. **For FEMA:**

Shares of Indian Co. issued / transferred to a Non-Resident:

- Quoted – as per SEBI guidelines
- Unquoted – Any internationally accepted valuation methodology

*Contd...*

#### 4. **As per SEBI guidelines-**

- Merger/ Demerger approval
- Preferential Allotment
- Delisting

#### 5. **For Accounting Purposes:**

- Purchase Price Allocation
- For various Ind AS including-
  - Ind AS 38 – Intangible Assets
  - Ind AS 103 – Business Combinations
  - Ind AS 36 – Impairment of Assets
  - Ind AS 28 – Investment in Associates and Joint Ventures
- Valuation to be done as per Ind AS 113 – Fair Value Measurement

#### 6. **For Other purposes like**

- Family Separation
- Portfolio value of investments
- Litigation etc.



---

# COMMONLY USED VALUATION METHODOLOGIES

# Valuation Methodologies

## Earnings Based Approach

- Earnings Multiple
- Discounted Cash Flow

## Market Approach

- Market Price
- Market Comparables

## Asset Based Approach

- Net Assets
- Replacement value/  
Realisable value

# Common adjustments

- Contingent Liabilities/Assets
- Investments
- Surplus Assets
- Preference Shares
- ESOPs / Warrants
- Tax concessions
- Auditors Qualification
- Findings of Due Diligence Reviews





# 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



---

# Critical Aspects - Valuation

# Critical Aspects - Valuation

- Issues in forecasting
- Selection of methods
- Difficulty in obtaining comparable multiples
- Thinly traded/ Dormant Scrip - Low Floating Stock, Unusual fluctuations in Market Price
- Loss making companies

*Contd...*

## Critical Aspects - Valuation

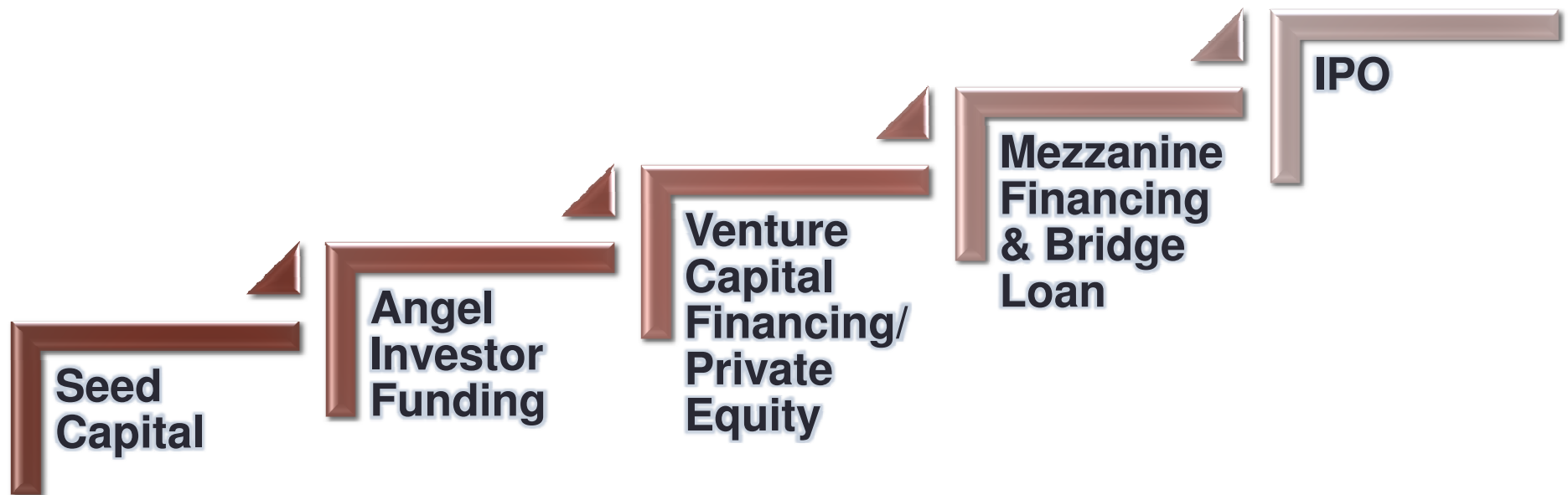
- Illiquidity discount & control premium
- Transaction Structure
- Procedural and Regulatory Issues
- Relying on Technical Valuer's Report
- Joint Reports
- Fairness Opinion by Merchant Bankers
- Management Representations



---

# VALUATION OF START-UPS

# Stages Of Start-up Funding



## Irony Of Start-up Funding

- Generally, Investors require the start-up to grow multiple times within a short span. If they don't, more cash will come at unfavourable terms or they may run out of cash
- Hence two funding strategies:
  - 1) Raise maximum at highest possible valuation and spend all money fast to grow as fast as possible. Higher valuation results in lower dilution of initial stage
  - 2) Raise only for critical needs. Spend only on needed. Aim steady growth. It may not get in news but surely higher valuation in next round

# Investor's Perspective

- When can they exit?
- Value at time of exit?
- Funding required till exit?
- Means of exit other than IPO?
  
- Other Valuation Factors:
  - Clicks (Direct/ Indirect)
  - Number of Users
  - Turnover
  - Ad Spend
  - Search Engine Ad Spend
  - Online Banner / Ad Campaign
  - Number of Orders



# E-Comm Co. v/s Traditional Co.

## Flipkart

FY 2014-15

- GMV of ~INR 25,000 crs
- Sales of INR 10,390 crs
- Loss of INR 1,933 crs
- Valuation as per recent funding: INR ~77,000 crs

**Value –  
INR  
75,000  
crs**

## Bajaj Auto

- Incorporated in 1930's
- World's 6th Largest Manufacturer of Motorcycles
- World's largest 3-wheeler manufacturer
- Cumulative 5 Years profit of INR ~15,440 Crs



---

# JUDICIAL PRONOUNCEMENTS

# Judicial Pronouncements

- *“Exchange Ratio not disturbed by Courts unless objected and found grossly unfair”*
  - **Miheer H. Mafatlal Vs. Mafatlal Industries (1996) 87 Com Cases 792**
  - **Dinesh v. Lakhani Vs. Parke-Davis (India) Ltd. (2003) 47 SCL 80 (Bom)**
- *“DCF Method is an acceptable method. A combination of methods can be accepted for valuation. Intrinsic value cannot include control premium.”*
  - **Mrs Renuka Datla V/s Solvay Pharmaceutical B.V. & Ors. (2003)**
- *“It is fair to use combination of three well known methods - asset value, yield value & market value”*
  - **Hindustan Lever Employees ‘ Union Vs. HLL (1995) 83 Com. Case 30 SC**

*Contd...*

# Judicial Pronouncements

- *“Courts do not have the expertise, the time or the means to carry out a valuation itself. What the Court’s approach must be to examine whether or not a valuation report is demonstrated to be so unjust, so unreasonable and so unfair that it could result and result only in a manifest and demonstrable, inequity or injustice.”*
- *“No valuation is to be disregarded merely because it has used one or the other of various methods. It must be shown that the chosen method of valuation is such as has resulted in an artificially depressed or contrived valuation well below what a fair-minded person may consider reasonable.”*
  - **Cadbury India Limited Vs. Mrs Malati Samant and Mr Alok C. Churiwala (Samant Group and Churiwala Group) (2014) (Bom HC)**

THANK  
YOU!