VALUATIONS FOR RE-ORGANISATIONS

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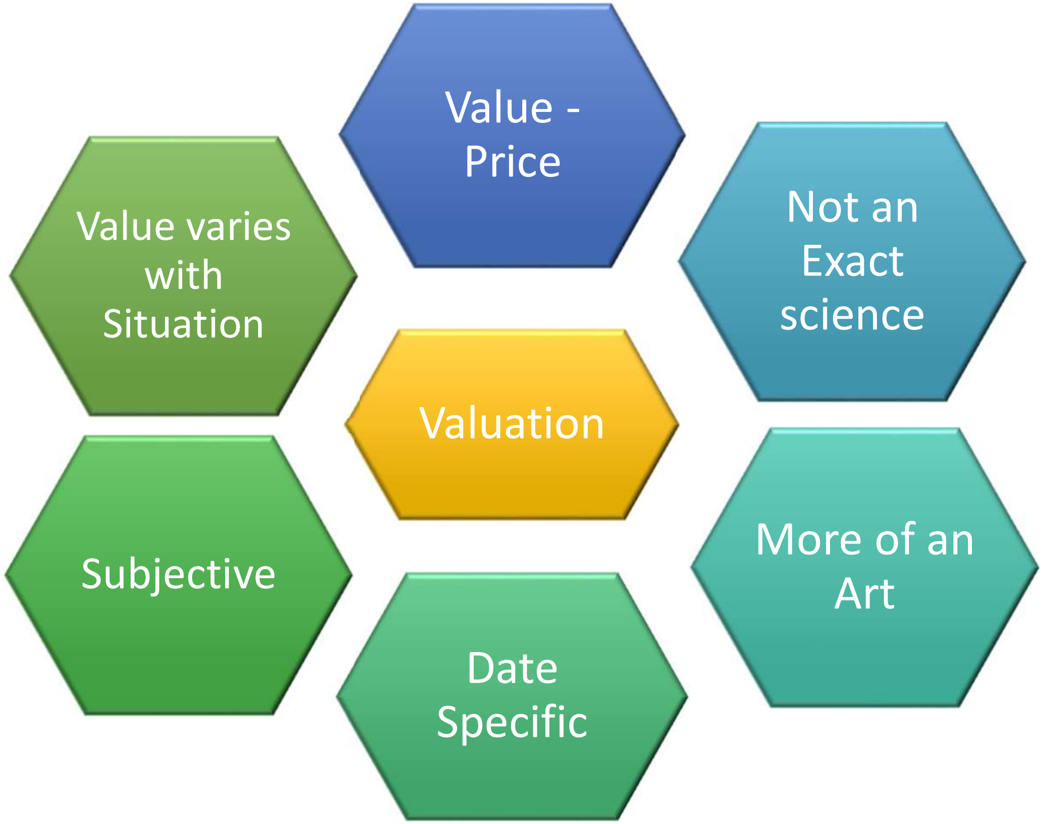
VALUATION CONCEPTS & PURPOSE

VALUATION CONCEPTS



TYPES OF ASSETS

- Securities or Financial Assets
- Business
- Intangible Assets
- Land and Building
- Plant and Machinery
- Others
  - Jewellery
  - Archaeological Collections
  - Drawings
  - Paintings
  - Sculptures

PURPOSE OF VALUATION

Business Valuation	Regulatory	Intangibles	Financial Reporting
Restructuring	FEMA	Purchase / Sale	Purchase Price Allocation
Purchase / Sale of shares / business	Income Tax Act	Hypothecation	Private Equity/ Venture Capital Funds
Litigation / Family Settlements	SEBI Regulations	Accounting for purchase	Financial Instruments
Fund raising	Companies Act	Impairment	Ind AS reporting – Fair Value / Impairment

PROCESS OF VALUATION

STEPS IN VALUATION

1

Information

- Obtaining information
- Business Understanding

2

Analysis

- Data Analysis and review
- Discussion with the Management

3

Valuation Methodologies

- Selection of method
- Conducting sensitivity analysis

4

Recommendation

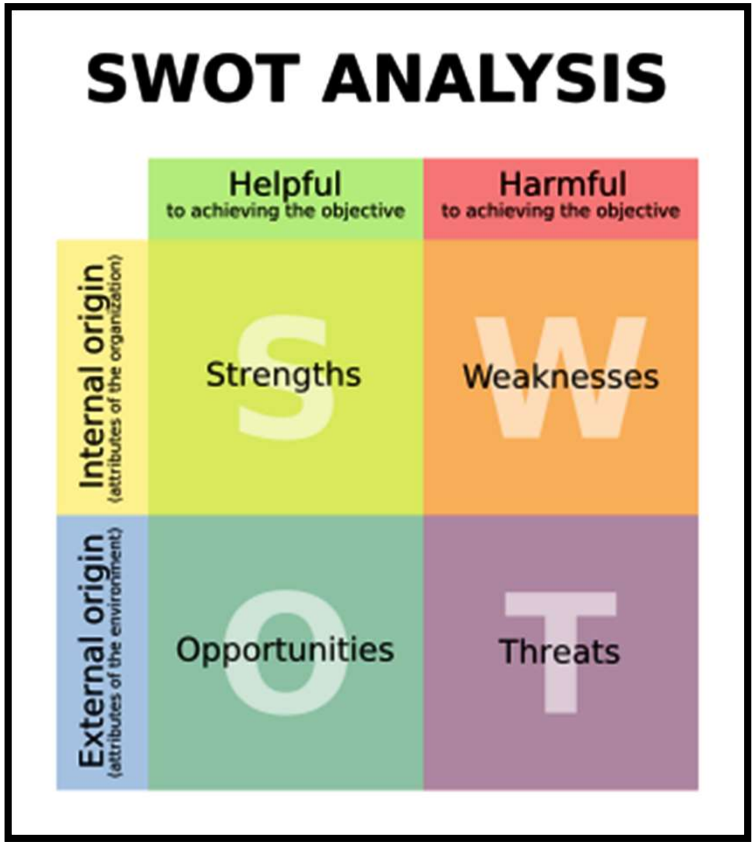
- Assigning Weights
- Recommendation
- Reporting

SOURCES OF INFORMATION

- Historical data such as audited results of the Company
- Industry & Company overview
- Future projections
- Management Discussion
- Stock market quotations / announcements
- Publicly available data on comparable companies
- Market surveys, news paper reports
- Representation by Management

ANALYSIS OF THE COMPANY

- Understanding of the Business
- Industry Analysis
- Existing policy/ legal framework
- SWOT Analysis
- Profitability Analysis
- Financial Ratio Analysis
- Projection analysis
  - Installed capacity
  - Revenue and Expenses ratio analysis
  - Capital expenditure – increasing capacities
  - Working capital requirements
  - Alternate scenarios / sensitivities



VALUATION METHODOLOGIES

VALUATION METHODOLOGIES

INCOME APPROACH

- Discounted Cash Flow Method

MARKET APPROACH

- Market Price Method
- Comparable Companies Multiple Method
- Comparable Transactions Multiple Method

COST APPROACH

- Net Assets Value Method
- Replacement Value/ Realizable Value Method

INCOME APPROACH

DISCOUNTED CASH FLOW (DCF) METHOD

1. Values a business based on the expected cash flows over a period of time
2. Considers cash flows and not accounting profit
3. Value of business is aggregate of discounted value of the cash flows for the explicit period and perpetuity
4. Involves determination of discount factor and growth rate for perpetuity

DCF - PARAMETERS

Cash Flows

- Projections
- Free Cash Flow to Firm ('FCFF') or Free Cash Flow to Equity ('FCFE')
- Horizon (Explicit) period
- Growth rate for perpetuity

Discounting rate

- Cost of Equity
- Cost of Debt
- Debt Equity ratio

FCFE V/S FCFF

Free Cash Flow to Equity	**Free Cash Flow to Firm**
• Discount cash flows to equity • Cash flows after considering all expenses, tax, *interest* and *debt additions/re-payments* • Discount rate: Cost of Equity	• Discount cash flows to firm • Cash flows after considering all expenses and taxes, but prior to interest and debt additions/re-payments • Discount rate: WACC

CASH FLOWS

- Gross operational cash flows (EBIDTA)
- Less: Tax
- Less: Working capital requirements
- Less: Capex requirements

FCFF

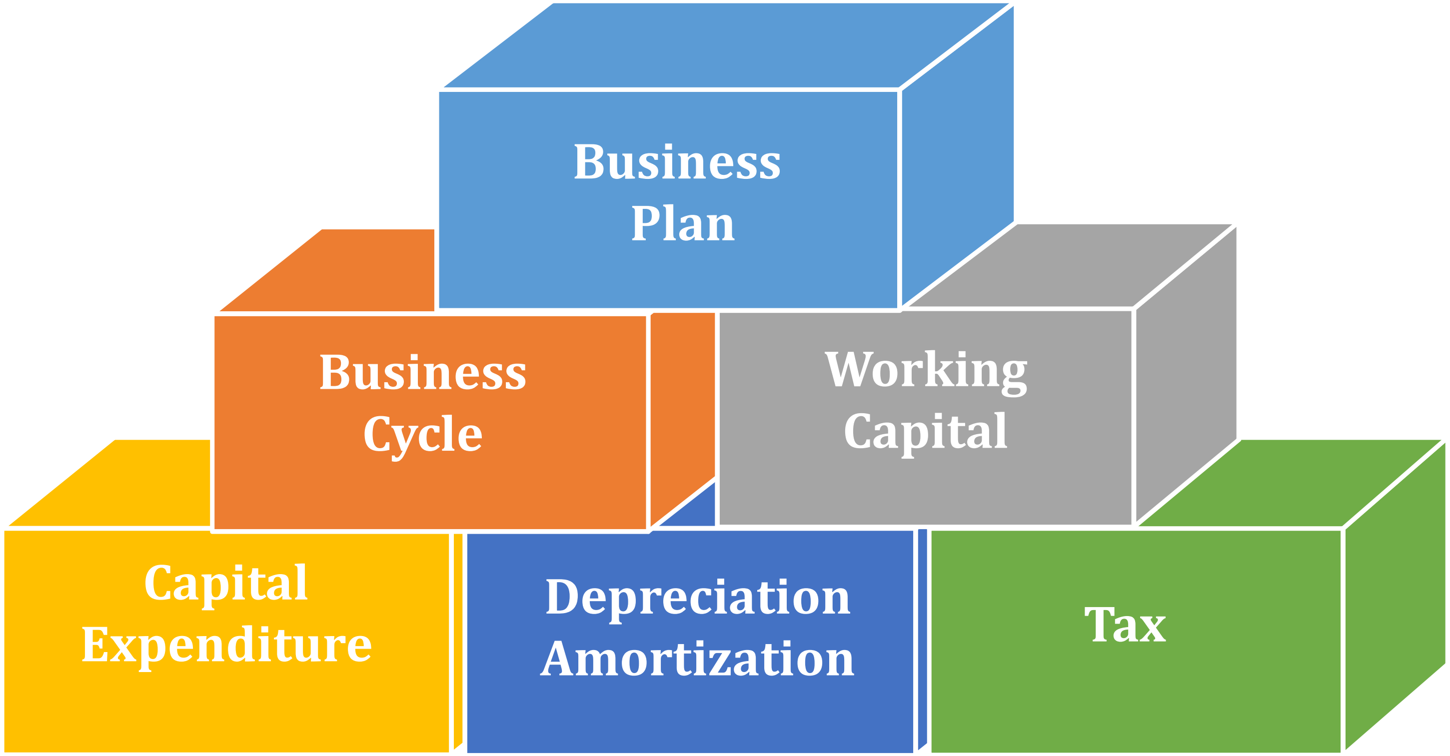
Enterprise Value

- Less: Interest payment & additions/ repayment for loans

Equity Value

FCFE

CASH FLOWS



Factors to be considered for reviewing projections:

- Industry/Company Analysis
- Dependence on single customer/ supplier
- Existing policy/ legal framework
- Capital expenditure – increasing capacities
- Working capital requirements
- Alternate scenarios / sensitivities

DISCOUNTING FACTOR

Weighted Average Cost of Capital (WACC) =

$$\left\{\frac{D}{(D+E)} \times Kd\right\} + \left\{\frac{E}{(D+E)} \times Ke\right\}$$

D = Debt

E = Equity

Kd = Post tax cost of debt

Ke = Cost of equity

COST OF EQUITY

- In CAPM Method, all the market risk is captured in the beta, measured relative to a market portfolio, which atleast in theory should include all traded assets in the market place held in proportion to their market value

$$Ke = (Rf + (\beta \times Erp))$$

Where,

Ke = Cost of Equity

Rf = Risk free return

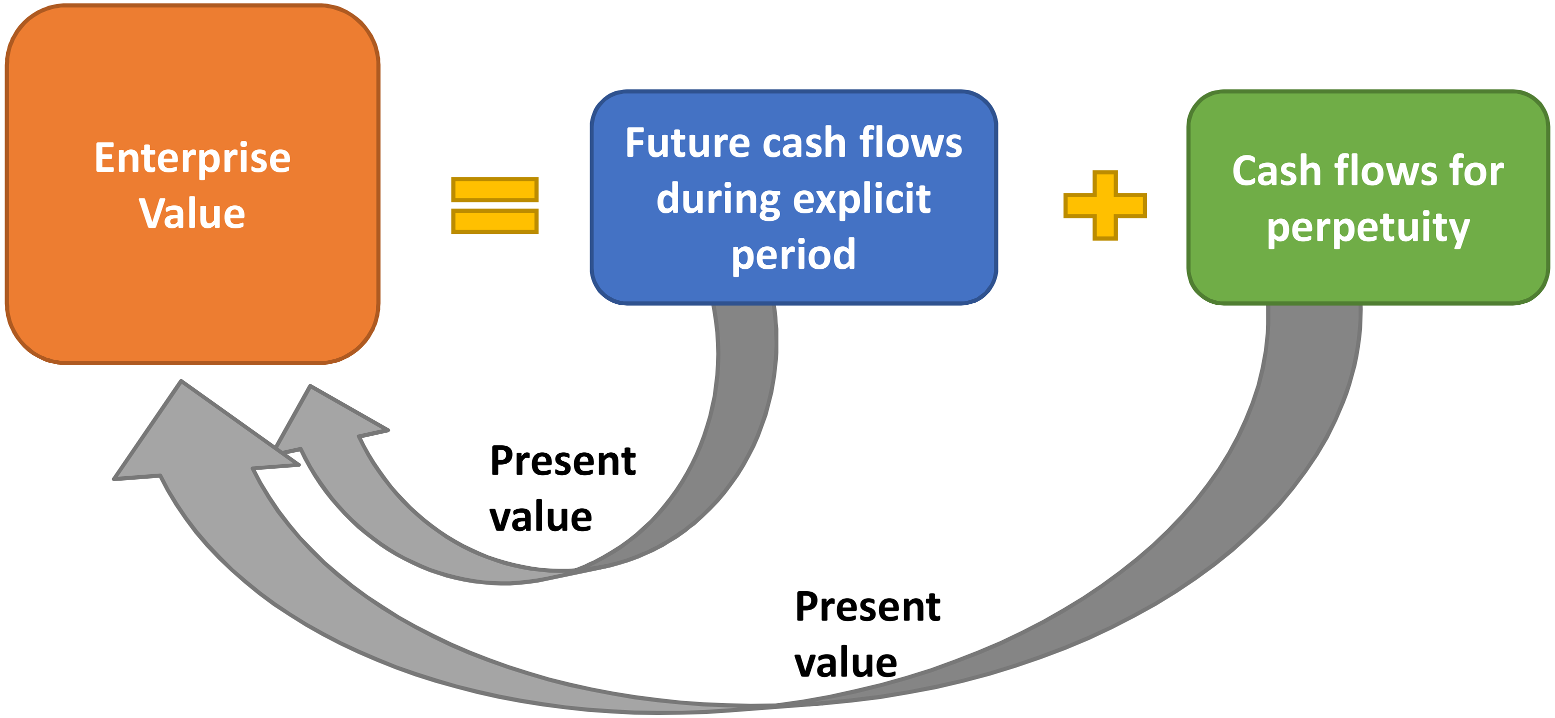
Erp = Equity risk premium

β = Beta

COST OF DEBT

- Rate at which a firm can borrow money today and will depend on the default risk embedded in the firm
- Possible sources of information:
  - Cost of debt currently incurred
  - Current market cost of borrowing incurred by comparable companies that have similar credit rating

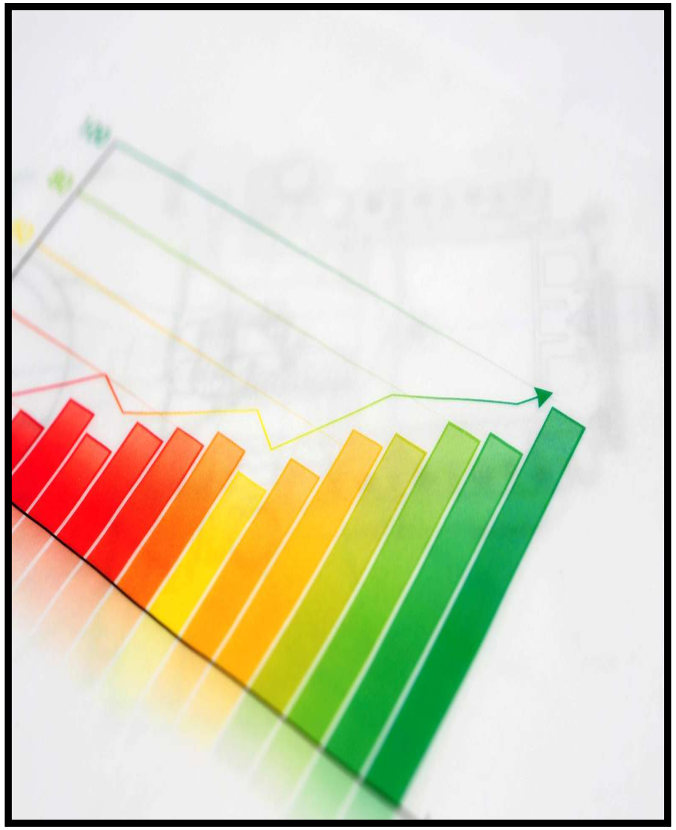
DCF VALUE


Enterprise Value
Future cash flows during explicit period
Cash flows for perpetuity
Present value
Present value

MARKET APPROACH

MARKET PRICE METHOD

- Evaluates the value on the basis of prices quoted on the stock exchange
- It is prudent to take weighted average of quoted price over a reasonable period
  - Significant and Unusual fluctuations in the Market Price
- Thinly traded / Dormant Scrip – Low Floating Stock
- Regulatory bodies often consider market price as important basis – Preferential allotment, Takeover code



COMPARABLE COMPANIES MULTIPLE METHOD

Earnings Based

- EBITDA Multiple (EV / EBITDA)
- Revenue multiple (EV / Revenue)

→ **Enterprise Value**

- PE Multiple

→ **Equity Value**

Asset Based

- Book Value Multiple

→ **Equity Value**

MARKET MULTIPLES

- Generally applied in case of unlisted entities
- Estimates value by relating an element with underlying element of similar listed companies
- Based on market multiples of Listed Comparable Companies
  - PE Multiple
  - EV/EBITDA Multiple
  - Revenue Multiple
  - Book Value Multiple
  - Industry Specific Multiple (in recent comparable transactions)
    - EV/ Tonne – Cement Manufacturing Companies
    - EV/ Bed – Hospital Business
    - EV/ Room Keys – Hotel Business
    - EV/ Tower – Telecom Tower Companies
    - % of AUM – Asset Management Companies

MAINTAINABLE PROFITS

Based on past performance and / or estimates

Elimination of material non-recurring/ non operational items

Adjustment for capacity recently added

Profits of various years averaged (simple or weighted)

MULTIPLE


Historical multiples enjoyed on the Stock Exchange by the listed comparable companies
Past and Expected Growth of the Earnings
Performance vis-à-vis Peers
Size, Location & Market Share

COST APPROACH

NET ASSETS VALUE ('NAV') METHOD

Total Assets (excluding Miscellaneous Expenditure and debit balance in Profit & Loss Account)
Less: Total Liabilities
NET ASSET VALUE

OR

Share Capital
Add: Reserves
Less: Miscellaneous Expenditure
Less: Debit Balance in Profit & Loss Account
NET ASSET VALUE

REPLACEMENT / REALISABLE VALUE METHOD

Replacement value of assets	Realisable value of assets
• Cost of new asset • Similar condition • Equivalent utility • Depreciation for obsolescence	• Cost of disposal • Tax on sale (STCG, LTCG etc.) • Time required

COMMON ADJUSTMENTS

- Market value of the investments
- Other non-operating surplus assets
- Surplus cash
- Contingent liabilities / assets
- Loan Funds
- Preference Share Capital
- ESOPs / Warrants
- Convertible Instruments
- Tax Concessions

BUSINESS RE-ORGANISATION – VALUATION ASPECTS

MERGER / DEMERGER – VALUATION ASPECTS

- In case of mergers and demergers, a relative valuation needs to be carried out
- Relative values are determined by
  - using similar valuation approaches / methods; and
  - applying similar weightages to values arrived under each approach / method
- Use of different approach / methods may be appropriate in certain cases, such as:
  - Merger of an investment holding company into technology company
    - Investment holding company - asset approach
    - Technology company - market approach / income approach
- Share exchange ratio for Merger – valuation of shares of Transferor Co and of Transferee Co
- Share entitlement ratio for Demerger – valuation of Demerged Undertaking and of Resulting Co
- Examples:
  - Merger - IDFC Bank and Capital First
  - Demerger - Cement Business Division of Century Textiles and Industries Limited into Ultratech Cement Limited

MERGER / DEMERGER – VALUATION ASPECTS (…CONT)

SHARE EXCHANGE RATIO

Merger of Co A into Co B

Valuation Approach	Co A		Co B	
	Value per share (INR)	Weights	Value per share (INR)	Weights
Asset Approach	25.00	0%	120.00	0%
Income Approach	116.00	50%	285.00	50%
Market Approach	120.00	50%	305.00	50%
Relative value per share	**118.00**	**100%**	**295.00**	**100%**
Exchange ratio (rounded off)	**2.50**			

2 (two) equity shares of Co B of face value of INR 10 each fully paid up for every 5 (five) equity shares of Co A of face value of INR 100 each fully paid up

SHARE ENTITLEMENT RATIO

Demerger of 'Undertaking X' of Co A into Co B

Valuation Approach	Undertaking X of Co A		Co B	
	Value per share (INR)	Weights	Value per share (INR)	Weights
Asset Approach	10.00	0%	120.00	0%
Income Approach	58.00	50%	285.00	50%
Market Approach	60.00	50%	305.00	50%
Relative value per share	**59.00**	**100%**	**295.00**	**100%**
Entitlement ratio (rounded off)	**5.00**			

1 (one) equity share of Co B of face value of INR 10 each fully paid up for every 5 (five) equity shares of Co A of face value of INR 100 each fully paid up

SLUMP SALE – VALUATION ASPECTS

- Sale of an undertaking will qualify as a slump sale if following conditions are satisfied [Section 2(42C)]:
  - Sale for a lumpsum consideration
  - Materials available on record do not indicate item-wise value of the assets and liabilities transferred
- In case of slump sale, a <u>fair valuation of the Business</u> needs to be ascertained
- Different approaches / methods to be used as may be appropriate
- Examples:
  - Sale of Urea Business of Tata Chemicals Limited to Yara Fertilizers India Private Limited
  - Sale of Phosphatic Fertilisers Business and Trading Business of Tata Chemicals Limited to IRC Agrochemicals Private Limited

BUYBACK – VALUATION ASPECTS

- Company acquires its own shares from the existing shareholders for returning excess cash (not required for business) to shareholders and thereby improving return on equity
- Provisions of section 68 of the Co Act 2013 to be followed
  - In case of listed companies, SEBI (Buy Back of Securities) Regulations also applicable
- In case of buyback, Buyback price needs to be ascertained
- Different approaches / methods to be used as may be appropriate

CAPITAL REDUCTION – VALUATION ASPECTS

- Capital Reduction is the process of reducing share capital of the company for one of the following reasons:
  - where the share capital is unrepresented by available assets; or
  - Pay off any paid up share capital which is in excess of the wants of the company.
- Process under section 66 of the Co Act 2013 to be followed
  - Approval of NCLT to be obtained
  - In case of listed companies, SE approval also required
- In case of capital reduction, <u>fair value per equity share</u> needs to be ascertained
- Different approaches / methods to be used as may be appropriate

THANK YOU !