MARCH'2021

THE VALUATION PROFESSIONAL

YOUR INSIGHT JOURNAL

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ICMAI REGISTERED VALUERS ORGANISATION
RECOGNISED RVO UNDER INSOLVENCY AND BANKRUPTCY BOARD OF INDIA
PROMOTED BY: THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

About ICMAI Registered Valuers Organisation

The Companies Act, 2013 brought into the light the concept of 'Registered Valuers' to regulate the practice of Valuation in India and to standardize the valuation in line with International Valuation Standards. Consequentially, The Ministry of Corporate Affairs (MCA) notified the provisions governing valuation by registered Valuers [section 247 of the Companies Act, 2013] and the Companies (Registered Valuers and Valuation) Rules, 2017, both came into effect from 18 October, 2017.

In view of the above, the Institute of Cost Accountants of India (Statutory body under an Act of Parliament) has promoted **ICMAI Registered Valuers Organisation (ICMAI RVO)**, a section 8 company under Companies Act, 2013 on 23rd February 2018, which is recognised under Insolvency and Bankruptcy Board of India (IBBI) to conduct educational courses on Valuation for three different asset classes - Land & Building, Plant & Machinery and Securities or Financial Assets and to act as frontline regulator as Registered Valuers Organisation.

ICMAI Registered Valuers Organisation is an Academic Member of International Valuation Standards Council.

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(Nominee Director)

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(Managing Director)

CHAIRMAN'S MESSAGE

Dear Readers,

We are living through one of the most challenging and uncertain times in recent history for valuers, the uncertainty which permeates all markets will inevitably lead to challenges, not just in terms of carrying out valuations and determining value, but also in the reporting of those values in a way that is both helpful and informative to users. The assessment of value is indeed an art form as much as it is a science. Business valuation is a process and a set of procedures used to estimate the economic value of an owner's interest in a business.

Valuation of business is an essential tool for a business owner to assess both opportunities and opportunity costs as they plan for future growth and eventual transition. It provides either a point-in-time assessment of relative value for an owner, or perhaps the price a buyer would be willing to acquire the business.

The Covid-19 pandemic reminds us of the difficulties inherent in factoring the impact of a crisis into asset valuation exercises. The value of an asset is closely linked to its ability and probability of generating future gains. However, in times of crisis, the future appears much more uncertain and the field of possibilities is therefore much wider.

I am pleased to note that ICMAI Registered Valuers Organization has taken an intuitive to roll out a monthly Journal – **The Valuation Professional** for continuous updation and professional development of all valuation practitioners.

I wish the Editorial Board and the team members engaged in bringing out this knowledge rich publication a great success,

CS(Dr.) Shyam Agrawal
Chairman
ICMAI Registered Valuers Organization

PRESIDENT'S MESSAGE

Dear Readers,

I am happy that the ICMAI Registered Valuers Organization is bringing out a Monthly Journal – **The Valuation Professional**. Valuation refers to the process of determining the present value of a company or an asset. Valuations can and should be used as a powerful driver of how you manage your business. The purpose of a valuation is to track the effectiveness of your strategic decision-making process and provide the ability to track performance in terms of estimated change in value, not just in revenue.

The global spread of COVID-19 is having a significant impact on the global economy and financial markets, with increased volatility and business disruption worldwide. Concerns about the fair value of companies have emerged as valuation of illiquid investments and various asset classes has become challenging for valuers given the current state of market uncertainty.

I am sure the Journal would provide insightful articles, Case laws relating to valuation and other contemporary information relevant to the Professional Valuers so as to enable them to keep abreast with the latest happenings and developments in valuation domain.

My best wishes to the Editorial team and other contributors to the Journal.

CMA Biswarup Basu
Nominee Director
ICMAI Registered Valuers Organization
President
Institute of Cost Accountants of India

MD'S MESSAGE

Dear Readers,

Businesses spend considerable time and energy trying to enhance company value by developing growth plans with well-defined goals. These plans are designed to maximize value over time, the business valuation professional will first consider the purpose and objective of the valuation. They will then look at the nature and background of the business, its products and services, as well as the industry life cycle, economic and political environment. Unique factors are then considered, including customer relationships, executive compensation, as well as excess assets, working capital, and liabilities.

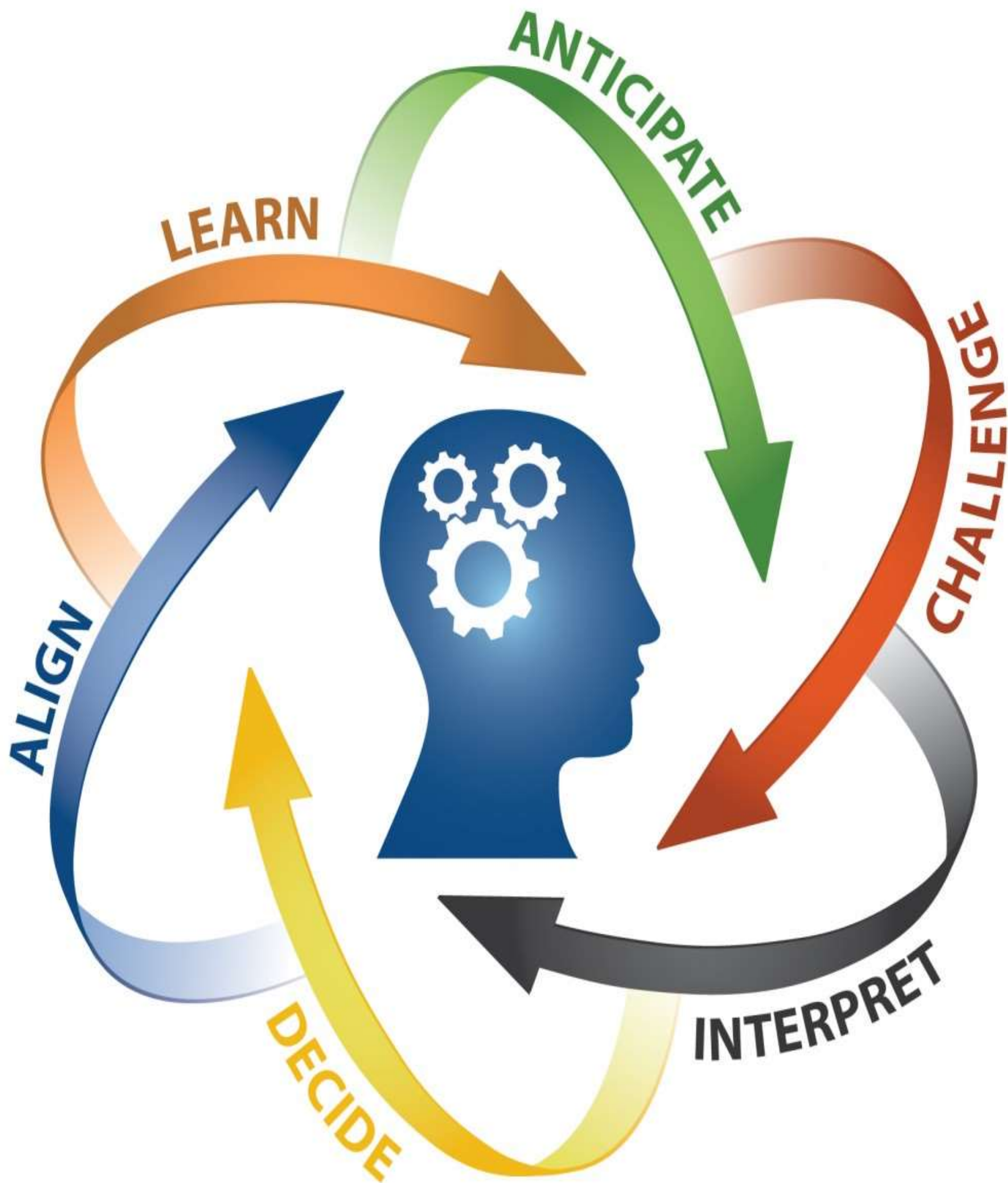
Considerations which could have a profound influence on value include goodwill or other intangible assets, the dependency on an owner or key employee(s), diversity of the customer base, market position and the competitive landscape of the industry. "How will the current state of the economy and its aftereffects impact the value of businesses?" This is a difficult question to answer because of the company-specific variables involved and the uncertainties surrounding the pandemic.

The Professional Valuers need to understand the dynamics of the new business and work out rational and logical valuations using realistic / achievable assumptions. Towards this end the Journal of ICMAI Registered Valuers Organization would provide relevant knowledge and macro inputs to help the valuers carve out effective valuations

We would look forward to your candid feedback to help us improve the content and relevance of our Journal.

Dr. S K Gupta
Managing Director
ICMAI Registered Valuers Organization

Professional Development Programs



Professional Development Programs

February'2021 to April'2021	
Date	PD Programs
05th -07th February	Master Class on Valuation
14th February	Webinar on Valuation of E-Commerce Companies
18th February	Webinar on Insight on Valuation Reports
22nd February	Webinar on Inspection of Registered Valuers
27th February	Workshop on How to use financial Modeling in Valuation
02nd March	Master Class on Valuation
05th to 07th & 11th to 14th March	50 hours Valuation Course on securities or Financial Assets
06th March	Master Class on Valuation
08th Marc	Seminar on the occasion of international Women's Day
10th March	Enhancing Professional Effectiveness
14th March	Master Series on Case Studies on Valuation
17th March	Master class on Best Practices in Valuation
21th March	Master Class on All about fair Valuation
23rd March	Master Class on Myths of Valuation
26th to 28th March & 01st to 04rth April	50 hours Valuation Course on Land and Building asset class.
26th to 28th March & 01st to 04rth April	50 hours Valuation Course on Land and Building asset class.
28th March	What is Valuation all about
30th March	Master Class on Valuation
31st March	Master Class on Valuation
04th April	Master Class (Valuation in Times of COVID)
07th April	Master Class (The Essence of Valuation Report)
11th April	Second Edition of Master Series Case Studies on Valuation
15th April	Master Class Global Trends in Valuation
18th April	Mastering Essentials of Valuation

Upcoming Professional Development Programs

DATE	PD Programs
21st April 2021	Master Class on Valuation in VUCA Scenario
25th April 2021	Master Class on Valuation
29th April 2021	Master Series/Case Studies on Valuation
23rd April to 25th April & 29th April to 02nd May 2021	**13th Online Weekend Batch** 50 hours Valuation Course on Securities or Financial Assets
01st May to 07th May 2021 (Seven Days)	**1st Online Regular Batch** 50 hours Valuation Course on securities or Financial Assets
01st May 2021 to 16th May 2021 (01st , 02nd , 08th , 09th , 15th , 16th May 2021)	**1st Online Women Special Batch** 50 hours Valuation Course on securities or Financial Assets

Articles

Startups : An insight into characteristics and valuation methods

Dr.S.K.Gupta
Managing Director
ICMAI Registered Valuers Organisation

Business valuation is never straightforward - for any company. For startups with little or no revenue or profits and less-than-certain futures, the job of assigning a valuation is particularly tricky. For mature, publicly listed businesses with steady revenues and earnings, normally it's a matter of valuing them as a multiple of their earnings before interest, taxes, depreciation, and amortization (EBITDA) or based on other industry specific multiples. But it's a lot harder to value a new venture that's not publicly-listed and may be years away from sales.

What Is a Startup

A startup company is a new business that is potentially fast growing and aims to fill a hole in the marketplace by developing and offering a new and unique product, process, or service but is still overcoming problems. Most countries of the world consider the development and implementation of innovative technologies as a necessary thing for the economic growth. So, to make the country a leader in innovation and, as a result, to make the country a competitive one, it is necessary to develop and commercialize new products and technologies or, in other words, to develop the startup business sphere. It may be a cliché that the entrepreneurs provide the energy for economic growth, but it is also true that vibrant economies have a large number of young, idea businesses, striving to get a foothold in markets. Young ventures have seized control of billions of lives providing solutions to everyday problems that seemed to be non-existent before

A startup is equivalent to a unique idea which can have an immense value. According to Blank et Dorf (2014, p. 56), a "startup is a group of people looking for a repeatable and scalable business model, working under conditions of extreme uncertainty.A startup is typically a venture that aims to bring a new and innovative service, product or process into the marketplace. The founder is generally the entrepreneur who runs with the idea. The founder often starts small and looks for angel / venture funding. There are a number of avenues that can be utilized to secure funding and get momentum. The founder is often a passionate new entrepreneur from a venerable B-school who does not want to limit the potential of the idea, a group of young and fired up management and technology majors can be instrumental in initiating a dynamic platform. The risk here is not huge as the founders still have the option to go back to the drawing board if the venture faces problems. In the other scenario the founders could be experienced veterans of the technology or corporate world who have given up humongous salaries to set up their dream project. This is more fraught with risks as the capital and labor in the initial stages is often the life savings of the entrepreneur.

Characteristics of startups

As we noted in the last section, young companies are diverse, but they share some common characteristics. In this section, we will consider these shared attributes, with an eye on the valuation problems/issues that they create.

1. No history: At the risk of stating the obvious, young companies have very limited histories. Many of them have only one or two years of data available on operations and financing and some have financials for only a portion of a year, for instance.

2. Small or no revenues, operating losses: The limited history that is available for young companies is rendered even less useful by the fact that there is little operating detail in them. Revenues are small or non-existent for idea companies and the expenses often are associated with getting the business established, rather than generating revenues. In combination, they result in significant operating losses.

3. Dependent on private equity: While there are a few exceptions, young businesses are dependent upon equity from private sources, rather than public markets. At the earlier stages, the equity is provided almost entirely by the founder (and friends and family). As the promise of future success increases, and with it the need for more capital, venture capitalists become a source of equity capital, in return for a share of the ownership in the firm.

4. Many don't survive: Most young companies don't survive the test of commercial success and fail.

5. Multiple claims on equity: The repeated forays made by young companies to raise equity does expose equity investors, who invested earlier in the process, to the possibility that their value can be reduced by deals offered to subsequent equity investor

6. Investments are illiquid: Since equity investments in young firms tend to be privately held and in non-standardized units, they are also much more illiquid than investments in their publicly traded counterparts.

Difference Between Startup Valuation and Mature Business Valuation

Startup businesses will usually have little or no revenue or profits and are still in a stage of instability. It is likely their product, procedure, or service has reached the market yet. Because of this it can be difficult to place a valuation on the company. With mature publicly listed businesses that receive steady revenue and earnings it is a lot easier. All you have to do is value the company as a multiple of their earnings before interest, taxes, depreciation, and amortization (EBITDA). Valuing a startup is more of an art than science, what we meant is that the most scientific methods of valuation Discounted Cash Flows (DCF), Net Asset Value (NAV), Comparable Method, etc. seem to fall apart when it comes to startup as most of the startups are pre-revenue and focuses on growth more than positive cash flows, some are creating their own niche and thus, no comparable exists, some are just an idea which has yet to be fully accepted by the end users

Startup valuation essentially points out the worth of your business—its idea, the product or service and so on. Start-up valuation is different from valuing any running business due to many reasons. Start-ups may not have :

- Business experience
- Operational skill set
- Brand name for their products/services
- Strong R&D base
- Dedicated execution team
- Experience of affording sudden economic shocks
- A required amount of fund etc.

What determines a startup value?

A startup is like a box. A very special box. The box has a value. Its value increases as you put more things in the box The valuation of startup companies is determined by a cohort of positive and negative factors

Positive Factors

- **Traction** – One of the biggest factors of proving a valuation is to show that your company has customers
- **Reputation** – If a startup owner has a track record of coming up with good ideas or running successful businesses, or the product, procedure or service already has a good reputation a startup is more likely to get a higher valuation, even if there isn't traction
- **Prototype** – Any prototype that a business may have that displays the product/service will help.
- **Revenues** – More important to business to business startups rather than consumer startups but revenue streams like charging users will make a company easier to value
- **Supply and Demand** – If there are more business owners seeking money than investors willing to invest, this could affect your business valuation. This also includes a business owner's desperation to secure an investment, and an investors willingness to pay a premium.
- **Distribution Channel** – Where a startup sells its product is important, if you get a good distribution channel the value of a startup will be more likely to be higher.
- **Hotness of Industry** – If a particular industry is booming or popular (like mobile gaming) investors are more likely to pay a premium, meaning your startup will be worth more if it falls in the right industry.

Negative Factors

- **Poor Industry** – If a startup is in an industry that has recently shown poor performance, or may be dying off.
- **Low Margins** – Some startups will be in industries, or sell products that have low-margins, making an investment less desirable.
- **Competition** – Some industry sectors have a lot of competition, or other business that have cornered the market
- **Management Not Up To Scratch** – If the management team of a startup has no track record or reputation, or key positions are missing.
- **Product** – If the product doesn't work, or has no traction and doesn't seem to be popular or a good idea.
- **Desperation** – If the business owner is seeking investment because they are close to running out of cash.

Literature review

There are fewer topics more cloaked in mystery, black magic and aspiration than [startup] valuation. People regularly speak of inflated valuations—or insane valuations—but it is difficult to know what anchors the numbers (Vetter, 2016). research has shown that the valuation is important because it aligns the ambitions of the entrepreneur and investor, helps structure and assure a fair treatment (Clercq et al. 2006) and reduces the sources of potential conflict between the entrepreneur and the investor (Zacharakis, Erikson, and Bradley 2010). The seminal venture capital study by Tyebjee and Bruno (1984) shows that the venture capital investment follows a somewhat well-defined process – starting from deal origination and ending at the exit of investment. In this staged process, the valuation of an entrepreneurial firm is one of the most important and challenging issues facing both entrepreneurs and

venture capitalists. Tyebjee and Bruno (1984) maintain that establishing the price of venture capital is the heart of any negotiation between the founders of the venture and potential investors. According to mainstream finance theory, the economic value of any investment is the present value of its future cash flows (Brealey, Myers, and Allen 2007). Simple as it is, this axiom definition of economic value presents a challenge to financial valuation methods when applied to valuating a new venture. The commonly used valuation techniques in corporate finance (e.g. discounted cash flow method, earning multiple method and net asset method, etc.) depend on strict assumptions and require information that new ventures typically cannot provide (such as accounting information). Hence, their applicability is severely limited in valuating early-stage new ventures and both venture capitalists and entrepreneurs are frustrated by huge variance of valuations computed from the extant methods for exactly the same new venture. Practically, the practice of startup valuation by venture capitalists remains a 'guess' and 'alchemy'.

The need for more rigorous research in venture capital investment, in general, has also been recognized by many prominent entrepreneurship scholars. For example, Barry (1994, 3) points out that 'in spite of the intriguing issues in venture capital finance, relatively little has been published on this subject in the most influential finance journals'. Furthermore, some studies (see, e.g. Waldron and Hubbard 1991; Hall and Hofer 1993; Gompers 1999) review studies of startup valuation in both the entrepreneurship and corporate finance literature and find that there is a gap in the extant literature. More recently, several studies in the entrepreneurial finance literature have investigated the factors that influence the investment process. For example, Silva (2004) studies venture capitalists' (VCs) decision-making and finds that their attention is focused on the entrepreneur, the business idea, its sustainable advantages and growth potential. According to his study, the financial projections of the prospect do not seem to play a major role in the selection of early-stage projects. Levie and Gimmon (2008) explain why there is a suboptimal evaluation by investors of the human capital of first-time high tech venture founders – they support the idea that there is a gap between in-use and espouse investment criteria, and extensive use of gut feeling in decision-making

Theoretical framework and hypotheses According to the finance literature (Brealey, Myers, and Allen 2007), the valuation process of the firm is complex because of the diversity of factors that come into play. It goes far beyond pure financial considerations of balance sheets, income statements and the financial forecasts. For example, industry characteristics, such as intensity of rivalry, entry and exit barriers, and firm characteristics, such as its development stage and competitiveness, are qualitative rather than quantitative factors which significantly influence firm value.The Most Popular Startup Valuation Methods

Funding Stages

Because startups typically go through a series of 'funding stages' their valuations can differ after each round of funding, and typically they'll want to show growth between each round, the usual funding stages are as follows,

1. **Seed Funding** – Typically known as the 'friends and family' round because it's usually people known to the business owner who provide the initial investment. But, Seed funding can also come from someone not known to the founder called an 'Angel Investor'. Seed Capital is often given in exchange for a percentage of the equity of the business, usually 20% or less.
2. **Round A Funding –** This is the stage that venture capital firms usually get involved. It is when startups have a strong idea about their business and product and may have even launched it commercially. The Round A funding is typically used to establish a product in the market and take the business to the next level, or to make up the shortfall of the startup not yet being profitable.
3. **Round B Funding –** The startup has established itself but needs to expand, either with staff growth, new markets or acquisitions.

4. **Debt Funding –** When a startup is fully established it can raise money through a loan or debt that it will pay back, such as venture debt, or lines of credit from a bank.
5. **Mezzanine Financing and Bridge Loans** – Typically the last round of funding where extra funds are acquired in bridge financing loans in the run up to an IPO, acquisition, management buyout, or leveraged buyout. This is usually short-term debt with the proceeds of the IPO or buyout paying it back.
6. **Leveraged Buyout (LBO)** – A Leveraged Buyout is the purchase of a company with a significant amount of borrowed money in the form of bonds or loans instead of cash. Usually the assets of the business being purchased are used as leverage and collateral for the loan used to purchase it.
7. **Initial Public Offering (IPO)** – An Initial Public Offering is when the shares of a company are sold on a public stock exchange where anyone can invest in the business. IPO opening stock prices are usually set with the help of investment bankers who help sell the shares.

Valuing Start-up Companies: Estimation Issues and Valuation Challenges

How to valuate a company accurately is a meaningful question especially for a venture investor because it reflects the return the investor may receive.The review of some of the classical approaches to valuating of business shows that the existing methods of valuation are not able to provide consistent results for an early-stage businesses. They require accounting information that a new venture typically cannot provide. That is the main problem. With startup valuations there is no substantial information to base a valuation on other than assumptions and educated guesses.

Startups are difficult to value for a number of reasons. Some are start-up and idea businesses, with little or no revenues and operating losses. Even those young companies that are profitable have short histories and most young firms are dependent upon private capital, initially owner savings and venture capital and private equity later on. As a result, many of the standard techniques we use to estimate cash flows, growth rates and discount rates either do not work or yield unrealistic numbers. In addition, the fact that most young companies do not survive has to be considered somewhere in the valuation. In this paper, we examine how best to value young companies. We use a combination of data on more mature companies in the business and the company’s own characteristics to forecast revenues, earnings and cash flows. We also establish processes for estimating discount rates for private capital and for adjusting the value today for the possibility of failure. A startup company’s value, is largely dictated by the market forces in the industry in which it operates. Specifically, the current value is dictated by the market forces in play TODAY and TODAY’S perception of what the future will bring.

The Dark Side of Valuation With the estimation challenges that analysts face in valuing young companies, it should come as no surprise that they look for solutions that seem to, at least on the surface, offer them a way out. Many of these solutions, though, are the source of the valuation errors we see in young company valuations. The biggest determinant of your startup’s value are the market forces of the industry & sector in which it plays, which include the balance (or imbalance) between demand and supply of money, the recency and size of recent exits, the willingness for an investor to pay a premium to get into a deal, and the level of desperation of the entrepreneur looking for money. *You need to pay attention to elements that influence growth*. The most common things to look at include things such as: The hotness of the industry, The capabilities of the startup team, product or service and its competitive advantage.

There are many different methods used in deciding on a startup's valuation which are discussed hereunder

- Venture Capital Method
- Berkus Method
- Scorecard Valuation Method
- Risk Factor Summation Method
- Cost-to-Duplicate Method
- Discounted Cash Flow Method
- Valuation By Stage Method
- Comparable Method
- The Book Value Method
- Potential value at exit
- Sum of the parts method
- First Chicago Method

Venture Capital Method

The Venture Capital Method (VC Method) is one of the methods for showing the pre-money valuation of pre-revenue startups. The concept was first described by Professor Bill Sahlman at Harvard Business School in 1987.

It uses the following formulas:

- Return on Investment (ROI) = Terminal (or Harvest) Value ÷ Post-money Valuation
- Post-money Valuation = Terminal Value ÷ Anticipated ROI

Terminal (or Harvest) value is the startup's anticipated selling price in the future, estimated by using reasonable expectation for revenues in the year of sale and estimating earnings

Berkus Method

The Berkus Method assigns a range of values to the progress startup business owners have made in their attempts to get the startup off of the ground. Sound Idea *(basic value),* Prototype *(reducing technology risk),* Quality Management Team *(reducing execution risk,* Strategic relationships *(reducing market risk),* Product Rollout or Sales *(reducing production risk). Each factor enhances the valuation of the startup.*

Scorecard Valuation Method

The Scorecard Valuation Method uses the average pre-money valuation of other seed/startup businesses in the particular business segment, and then judges the startup that needs valuing against them using a scorecard in order to get an accurate valuation

- The first step is to find out the average pre-money valuation of pre-revenue companies in the region and business sector of the target startup
- The next step is to find out the pre-money valuation of pre-revenue companies using the Scorecard Method to compare. The scorecard is as follows,
    - **Strength of the Management Team** – 0-30 percent
    - **Size of the Opportunity** – 0-25 percent
    - **Product/Technology** – 0-15 percent
    - **Competitive Environment** – 0-10 percent
    - **Marketing/Sales Channels/Partnerships** – 0-10 percent
    - **Need For Additional Investment** – 0-5 percent
    - **Other** – 0-5 percent
- The final step is to assign a factor to each of the above qualities based on the target startup and then to multiply the sum of factors by the average pre-money valuation of pre-revenue companies

Risk Factor Summation Method

The Risk Factor Summation Method compares 12 elements of the target startup to what could be expected in a fundable and possibly profitable seed/startup using the same average pre-money valuation of pre-revenue startups in the area as the Scorecard method. The 12 elements are,

- Management
- Stage of the business
- Legislation/Political risk
- Manufacturing risk
- Sales and marketing risk
- Funding/capital raising risk
- Competition risk
- Technology risk
- Litigation risk
- International risk
- Reputation risk
- Potential lucrative exit

Each element is assessed as follows:

- +2 - very positive for growing the company and executing a wonderful exit
- +1 - positive
- 0 - neutral
- -1 - negative for growing the company and executing a wonderful exit
- -2 - very negative

Cost-to-Duplicate Method

This approach involves looking at the hard assets of a startup and working out how much it would cost to replicate the same startup business somewhere else. The idea is that an investor wouldn't invest more than it would cost to duplicate the business. For example if you wanted to find the cost-to-duplicate a software business, you would look at the labour cost for programmers and the amount of programming time that has been used to design the software. The big problem with this method is that it doesn't include the future potential of the startup or intangible assets like brand value, reputation or hotness of the market.

Discounted Cash Flow (DCF) Method

This method involves predicting how much cash flow the company will produce, and then calculating how much that cash flow is worth against an expected rate of investment return. A higher discount rate is then applied to startups to show the high risk that the company will fail as it's just starting out.This method relies on a market analyst's ability to make good assumptions about long term growth which for many startups becomes a guessing game after a couple of years.

Valuation by Stage

The valuation by stage method is often used by angel investors and venture capital firms to come up with a quick range of startup valuation.

This method uses the various stages of funding to decide how much risk is still present with investing in a startup. The further ahead a business is along the stages of funding the less the present risk. A valuation-by-stage model might look something like this:

- Estimated Company Value Stage of Development
- Has an exciting business idea or business plan
- Has a strong management team in place to execute on the plan

- Has a final product or technology prototype
- Has strategic alliances or partners, or signs of a customer base

Comparables Method

This method is to literally look at the implied valuations of other similar startups, factoring in other ratios and multipliers for things that may not be similar between the two businesses. Knowledge of other businesses in an industry and geographical location and what they are valued at is key to figuring out the value of a startup in the same industry and location, which is why several of the startup valuation methods include this

The Book Value Method

This method is based solely on the net worth of the company. i.e. the tangible assets of the company. This doesn't take into account any form of growth or revenue, and is usually only applied when a startup is going out of business.

Potential Value at exit

The goal of the early-stage investors is to look for 10 to 20 times the return on their investments. This is by far one of the most used processes to establish valuations. The investor guestimates the exit value of the company based on recent mergers and acquisition (M&A) transactions in the sector and sometimes also looks at the valuation of similar public companies.

Sum of the parts method

Sum-of-the-parts ("SOTP") or "break-up" analysis provides a range of values for a company's equity by summing the value of its individual business segments to arrive at the total enterprise value (EV). Equity value is then calculated by deducting net debt and other non-operating adjustments. For a company with different business segments, each segment is valued using ranges of trading and transaction multiples appropriate for that particular segment

First Chicago Method

This method factors in the possibility of a startup really taking off, or really going badly. To do this it gives a business owner three different valuations

- Worst case scenario
- Normal case scenario
- Best case scenario

No one approach as explained above would provide the right valuation for startups. Sophisticated angels and entrepreneurs use several methods to value a startup because no single method is useful every time. Multiple methods also help in the negotiation process because an average can be determined from among them. Since most startups have little-to-no history, revenue and earnings, there isn't much information to analyze or plug into a spreadsheet. To close this gap, angels can look for clues from similar startup deals in the same region and industry. Like real estate, valuations will go up and down depending on market forces. Expect lower valuations during a recession and higher in boom times when there is more competition for investment. Startup valuations may also be adjusted up or down based on the strength of the management team, location of the business, industry or market.

Like Payne says, "It really is an art. Entrepreneurs and professors would love for it to be something that we just throw an Excel spreadsheet at. But there is no perfect methodology to establish the pre-money valuation of pre-revenue ventures, making it even more important for investors and entrepreneurs to know how the number is derived."

Conclusion

A start-up is characterised by having little or no revenue, negative cash flows, being mostly lossmaking, having short histories, a binary business model and being dependent on equity financing. It is extremely hard to determine the accurate value of a company while it is in its infancy stages as its success or failure remains uncertain. Valuing a business at any stage of it's lifecycle is difficult, but early stage is particularly problematic. Remember that valuations are nothing but formalized guesstimates. For an established business, knowing the valuation is rather straightforward. The market value of the business can be calculated using tangible metrics and assets, such as revenue, profits and customers.Just as beauty lies in the eyes of the beholder, value too is based upon the outlook of the person who is valuing the company. *Value is therefore a relative concept.*

There's a saying that startup valuation is more of an art than a science. Startup valuation, as frustrating as this may be for anyone looking for a definitive answer, is, in fact, a relative science, and not an exact one. Valuing a start-up comprises throws up many problems, the first one of them being that it is extremely hard to tell what the future of the company will be, or more precisely if it will survive at all in the coming years. Because of this an estimation has be to be used, which is why several startup valuation method frameworks have been invented to arrive at reasonable acceptable valuation of startups.

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Changing Map and Facets of Valuation Profession Present Legal Framework in Valuation

Mr. Suresh Kumar Johar

Registered Valuer

Rationale of Registered Valuer Concept

Registered Valuer Concept (RVC) has emerged with the introduction of Section 247 of the Companies Act, 2013 with an objective:

- To regulate the valuation of the various assets and liabilities related to a Company;
- To standardise the procedures of valuation; and
- To introduce and synchronize the best practices in the valuation compatible to the International Valuation Standards.

Valuation by Registered Valuers

Section 247 (1) of the Companies Act, 2013 provides: "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.

Registered valuers are, thus, empowered under **Section 247 of the Act** that specifies that any valuation requirements under the Act shall be fulfilled by a person having the prescribed qualifications and experience and is registered as a valuer with the Registration Authority under the Act. The appointment of registered valuers, of course, need to be done only either by the Audit Committee or in its absence by the Board of Directors of the Company.

Registered Valuers and Valuation) Rules

- The Central Government has, accordingly, notified the Companies (Registered Valuers and Valuation) Rules, 2017, in exercise of powers conferred by section 247 read with sections 458, 459 and 469 of the Companies Act, 2013 (18 of 2013) to conduct and regulate the valuation by the Registered Valuers.
- These rules came into force on 18th October 2017 and are amended four times, last being the 13th November 2018.

Transitional Stage

- Section 247 of the Companies Act, 2013 and the Companies (Registered Valuers and Valuation) Rules, 2017, both notified and came into effect from 18 October, 2017.
- In accordance with these rules, only a registered valuer will be entitled to conduct the valuation of assets and liabilities wherever it is required under the various provisions of the Companies Act, 2013 with effect from 18th October 2017,
- The transitional period, in fact, was relaxed twice and extended upto 31st January due to paucity of Qualified Registered Valuers to conduct the valuation.

Consequent to these relaxation, any person who was rendering valuation services under the Companies Act 2013, on the date of commencement of the rules, will continue to

- render such valuation services without a certificate of registration under these rules upto 31st January, 2019.

Applicability of Section 247 & Valuation Rules for valuation under other laws

- Valuation of assets or liabilities or other property or net worth of the Company may also be required for some specific purpose under other laws or regulatory authority such as FEMA, SEBI etc.
- MCA has also clarified, in such cases, that conduct of valuation by any person under any law other than the Companies Act 2013, or these rules shall not be effected by reason or virtue of coming into effect of these rules unless the relevant other laws or other regulatory bodies require valuation by such person in accordance with these rules in which case these rules shall apply for such valuation also from the date specified under the laws or by the regulatory bodies.

Effective Implementation

With effect from February 01, 2019, the valuation reports as required under the **(i) Companies Act, 2013 and (ii) Insolvency and Bankruptcy Code, 2016** and as specified hereunder**,** has to be obtained from Registered Valuers registered with IBBI in terms of rules 3, 4, 5 and 6 regarding examination, eligibility, qualification and registration of valuers under the Companies (Registered Valuers and Valuation) Rules, 2017.

1. **Companies Act, 2013 (Few examples)**
   - *Further issue of capital under* **Section 62(1) (c) of the Companies Act, 2013 read with Rule 13(1) of the** Companies (Share Capital and Debentures) Rules, 2014**.**
   - Restriction on non-cash transactions involving directors under **Section 192(1) and 192(2).**
   - **Power to make compromise or arrangement with the creditors under Section 230 (2) (c) (v) and Section 230 (3).**
   - Merger and amalgamation of companies under **Section 232 (2) (d) and Section 232 (3) (h) (B).**
   - Purchase of minority shareholdings under Section 236(2).
   - Issue of sweat equity shares under Section 53 read with **Rule 8(6), (7), (9) and (12) of the Companies (Share Capital and Debentures) Rules, 2014.**
   - **Others**
2. **Insolvency and Bankruptcy Code, 2016**
   - For Corporate Insolvency Resolution Process (CIRP) and
   - Liquidation Process

Any person may, however, continue to render valuation services under any other law such as FEMA, Income Tax Act or any other law, which has not specifically as of now stipulated requirement for valuation to be undertaken by a registered valuer(s).

Registered Valuers.

- A registered valuer means a person registered with the Registration Authority under Rule 7(6) of the Companies (Registered Valuers and Valuation) Rules, 2017 for carrying out valuation of assets belonging to a class or classes of assets. {Rule 3(j)}
- The registered valuer has to comply with the code of conduct as prescribed (as per **Annexure-I** of these rules) under rule 7 (g) read with rule 12 (2) (d) of the valuation Rules 2017, during the conduct of their professional assignment as registered valuer.
- Any violation of provisions of section 247 or any of the rules framed thereunder will attract the penalty to the extent as provided under section 247(3) of the Companies Act 2013.

Administering Authority

Insolvency and Bankruptcy Board of India (IBBI) has been specified by way of notification dated 23rd October, 2017 as the an Authority under Rule 2 (1) (b) of the Companies (Registered Valuers and Valuation) Rules, 2017, by the Central Government under section 458 of the Companies Act, 2013, to administer and perform functions under the said rules, as the an Authority (Registration Authority) to regulate and administer the registered valuers.

Eligibility to be registered as a valuer under the Companies Act, 2013?

An individual, a partnership entity or a company are eligible for registration as registered valuers subject to complying the eligibility requirements provided for in rule 3 of the Companies (Registered Valuers and Valuation) Rules, 2017.

Subject to meeting other requirements provided in rule 3, rule 4 and 5 (1) of Companies (Registered Valuers and Valuation) Rules, 2017:

1. **An individual is eligible to be a registered valuer, if he**
    - Is a fit and proper person; (Rule 3 (1) (k))
    - Has the necessary qualification and experience; (Rule 4)
    - Is a valuer member of a Registered Valuer Organisation **(RVO**);
    - Has completed a recognised educational course as member of a RVO;
    - Has passed the valuation examination conducted by the IBBI under Rule 5, and
    - Is recommended by the RVO for registration as a valuer.

2. **A Partnership entity or Company**
    - A partnership entity or a Company need to comply with the other additional conditions as specified under Rule 3 (2) of the Companies (Registered Valuers and Valuation) Rules, 2017, for being eligible to be a registered valuer.

Registered Valuer Organisation (RVO)

- Registered Valuers Organisation (RVO) is an organisation recognised under sub-rule (5) of rule 13 of the Companies (Registered Valuers and Valuation) Rules, 2017
- RVO is the first line of regulators who grant membership.
- An applicant (Perspective Registered Valuer) has to be first a member with an RVO before seeking registration as a registered valuer with IBBI under rule 6 of the Companies (Registered Valuers and Valuation) Rules, 2017.

Conditions for Registration with Authority (IBBI)

The detailed process of application for registration as Registered Valuer with the Registration Authority coupled with the conditions for such registration are provided under various Rules of Companies (Registered Valuers and Valuation) Rules, 2017:

- For an individual: Rules 7 to 11 and
- Partnership Entity or a Company - Rules 12 to 15.

Valuation Standards (Rule 2(1) (i)

- A registered valuer shall make valuations as per the Valuation Standards notified from time to time by the Central Government as provided in Rule 18(1) read with rule 8(1) (a) (b).
- Until such time as the Valuation Standards are notified by the Central Government, a valuer shall make valuations as required under Rule 8 as per:
  a. an internationally accepted valuation methodology; or
  b. valuation standards adopted by any valuation professional organisation;
  c. Clause removed. – Not required.

Class of Assets

Rule 2 (1) (c) defines the **"Asset Class"** as a distinct group of assets, such as land and building, machinery and equipment, displaying similar characteristics, that can be classified and requires separate set of valuers for valuation. Registered valuers can be registered for three class of assets. The three class of assets are:

1. Land and Building;
2. Plant and Machinery
3. Securities or Financial Assets (SFA).

Conduct of Valuation

A registered valuer can undertake valuation of assets only for the class of asset for which he/she/it is registered for after meeting the eligibility criteria specified for such asset class.

Prospective Development in Valuation

The Draft Valuers Bill, 2020

Government of India has proposed to place before the parliament the bill "Draft Valuers Bill, 2020", which has been drafted to establish a National Institute of Valuers (NIV) and to create an institutional framework to regulate and develop valuation as a profession.

The Draft Valuers Bill, 2020 envisages to establish National Institute of Valuers (NIV) along with a separate regulator to administer the conduct, profession of Registered Valuers and regulate the market of valuation services. The rationale behind establishing the NIV is to promoting practices and standards of professional conduct, including implementing knowledge based valuation standards for valuers.

An individual will have to complete either a national or graduate valuation programme to be registered as a valuer, and such programmes will range from two to four years, depending on the educational qualifications of the applicant.

Streamlining the Legal Framework

The existing Companies (Registered Valuers and Valuation) Rules, 2017 provides a law and structure for regulation of valuation as a profession. The rules encompass framework for valuation under the Companies Act, 2013 and the IBC 2016 only. The Draft Valuers Bill, 2020 is, in contrast, aimed at covering all valuation related services in the country. Therefore, for the purposes of such unification, Section 247 of the Companies Act 2013, which provides for valuation by registered users, may have to be modified or undergo a major change or the pre-existing valuation rules will have to be rescinded and replaced by the new set of rules under the proposed Bill.

Feature and Scope of valuation under New Bill

The Draft Valuers Bill, 2020 has proposed plethora of new features in the valuation profession such as:

1. Will promote and develop valuation services as full fledge profession like ICAI, ICSI, ICMAI enhancing huge academic as well as employment opportunities in the country.
2. Valuation related educational course, Admission, Examination, Recognition etc. will witness a new shape and color under new framework.
3. Will bring the whole of valuation profession and field into one net i.e. new framework may encompass valuations under other laws in a phased manner reasoned by the experience and the needs of the time in due course.

4. In fact, proposed framework will consolidate valuation services required in various laws and bring them under one umbrella.
5. Asset class may see an entry of new class of asset i.e. **"Intangible Assets**" in line with the happening in the world over with respect to the role and impact of valuation of intangibles in the enterprises value.
6. Constructive and novice provisions to promote, develop and regulate the profession of valuers, valuation services and to protect the interests of users of valuation services in country.

Future of valuation profession in the country - Presence in world map

The development of valuation as a profession would bring the country at par with systems and valuation framework in other countries of the world, but certain hindrances or constrains are nevertheless exist such as fast changing world of financial modelling, technological advancement or automation and its usage in valuation process, complex structure of Indian economy, absence of competition, mind-set of people etc.

As we all witnessing, valuation profession is in itself experiencing swift changes in its structure globally. The structural changes as proposed in the bill will take care of such hindrances or hiccups in the due course either based on adopting the best practices prevalent in world or learning from the experience, as the time passes and valuation profession gets matured.

The Draft Valuers Bill, 2020, is expected to open not only a new avenue of profession, but will create conducive environment for enhanced employment generation measures for existing and growing workforce of the country. At the optimistic scenario, technological transition will play supporting role in strengthening the rationale behind the bill. However it cast a major shift in the mind-set and the responsibility of the profession and its members collectively to adapt it holistically in the furtherance of objectives of proposed Bill.

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SOME ISSUES REGARDING VALUATION

CMA Babu L. Gurjar
Practicing Cost Accountant
Insolvency Professional (IP)
Registered Valuer (S&FA) (RV)

The valuation of assets has always been a major challenge and a vital and pivotal contributory factor in the developing Indian economy.

While valuers bill is underway, the government felt the need to reform the valuation techniques and methodologies to create a comprehensive robust valuation mechanism in the country.

In this backdrop, *s*ection 247 of Companies Act 2013 is a revolutionary step towards valuation of assets or net worth or liabilities of a company in India. With the introduction of this section, an attempt has been made to regularize the entire process and methodology of valuation by bringing it under the ambit of a regulatory authority i.e. Insolvency and Bankruptcy Board of India (IBBI). It is well supported by properly formulated rules titled as the Companies (Registered Valuers and Valuation) Rules, 2017.

Besides valuation under various provisions of Companies Act, SEBI regulations and other purposes, valuers duly registered under these provisions also undertake valuation under Insolvency and Bankruptcy Code (IBC).

The Section 247 (1) and (2) of Companies Act, 2013 is as under:

"247. (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 or after the valuation of assets."

Accordingly, IBBI has implemented and put in place a detailed process and procedures in ensuring to provide registration certificates for 3 type of Asset Class Registered Valuers i.e.

1. Plant and Machinery,
2. Land and building and
3. Security or Financial Assets.

In terms of Annexure IV of Valuation Rules 2017, Eligibility criteria specified for registration of Valuer are as under:

Asset Class	Eligibility	Experience in specified Qualifications discipline.
	Qualifications	
Plant and Machinery	(i) Graduate in Mechanical, Electrical, Electronic and Communication, Electronic and Instrumentation, Production, Chemical, Textiles, Leather, Metallurgy, or Aeronautical Engineering, or Graduate in Valuation of Plant and Machinery or equivalent; (ii) Post Graduate on above courses	(i)Five Years . (ii) Three years
Land and Building	(i) Graduate in Civil Engineering, Architecture, or Town Planning or equivalent;. (ii) (.(ii) Post Graduate on above courses and also in valuation of land and building or Real Estate Valuation (a two-year full time post-graduation course)	(i)Five years (ii) Three years
Securities or Financial Assets	(i) Member of Institute of Chartered Accountants of India, Member of Institute of Company Secretaries of India, Member of the Institute of Cost Accountants of India, Master of Business Administration or Post Graduate Diploma in Business Management (specialization in finance) (ii) Post Graduate in Finance	Three years
Any other asset class along with corresponding qualifications and experience in accordance with rule 4 as may be specified by the Central Government.		

Thus a very earnest attempt is initiated based on a very broad view of IBBI in regulating the entire valuation system at large so as to comply with International Valuation Standards. IBBI has stipulated rigorous standards of eligibility criteria e.g. qualifications & experience, examination, Pre Examination Education course etc.

IBBI has decided to have two tier control mechanism for its registered valuers. Although the final control shall rest with IBBI, it has ensured to have RVOs in the first tier control, besides providing continuing education programs. Many RVOs have been recognized as per regulations so as to ensure healthy competition culminating in quality valuation outputs

However, it has always been a evolutionary process while developing any profession especially the valuation profession. Therefore, there is a dire need to have continuous discussions on procedural issues for appropriate measures to develop remedial measures

Some of the vital features and basic factors requiring discussion are mentioned below:

Who can undertake enterprise valuation of an entity?

Any Registered Valuer can take up the assignment under the provisions of Companies Act, IBC or any other purpose for the asset class for which he/ she is registered. However, valuation of Enterprise is a comprehensive one, hence the question arises as which RV can value an enterprise or company as a whole. In the absence of a specific mention, it is difficult to conclude.

However, in a corporate entity, the value of shares/ securities can be evaluated only by SFA Category Registered Valuer. Also, the value of shares cannot be ascertained until the value of the company as a whole is decided. Thus, it is implied that the value of a company as a whole can be ascertained by SFA Category Registered Valuer, of course, based on and after getting the assets duly valued by RVs viz Land & building and Plant & Machinery.

Generally, value of a company/ enterprise as a whole or a specific part i.e. division/ department/ branch/ unit or intangible asset (which is a separate and distinctly but indirectly contributing to overall revenues) is determined by RV SFA

Similarly, for merger, amalgamation, absorption, consolidation, acquisition, demerger etc. the task of valuation is taken up by RV SFA, subject to need based support from other category valuers.

Thus, there is a need to discuss and settle a procedural mechanism in evaluating a company/ enterprise as a whole to be entrusted to RV SFA category based on and after getting the assets duly valued by other category RVs.

Appointment of registered valuers under IBC

As per regulation 27 in CIRP and regulation 35 of Liquidation Process, the concerned RP / liquidator has to appoint two RVs to determine the fair value and liquidation value of the Corporate Debtor. Now, the question arises as which type of two registered valuers to be appointed? There is no clarity about the same. Therefore, to avoid any type of legal complications, the insolvency professionals generally appoint two set of registered valuers i.e. two number of valuers form each type of three asset class (in total 6 numbers) as per common discussions, Better, it may be clarified.

Since each type of valuer will value only specific type of assets, then, there is a question as who (which type of valuer) will provide the Enterprise Value as a whole? It is earnestly suggested that enterprise value be done by RV SFA. Clarity is however, required in this regard.

Another factor is inventory valuation (raw material, WIP, finished goods, stores & spares etc). There are different opinions for the same. Some opine that this task may be performed by RV SFA but few suggest about RV Plant & Machinery.

In some cases, technical issues become important for inventory valuation, but it always involves the basic issue regarding element costing (accounting) therefore, matter needs further discussion to decide whether a joint valuation will be better for inventory.

With reference to receivables in case of CIRP or liquidation, it is certain that all the debtors (receivables) cannot be recovered. Whether there should be some method to ascertain the realistic recoverable amount?

Valuation of special category of assets

Under Companies Registered Valuers and Valuation Rules 2017, it is also required to be specified about valuation of agricultural land, plantations, forests, mines and quarries, jewellery, art work etc. to avoid any ambiguity.

Valuation under Income Tax Act and FEMA Act

In case of Income Tax Act, 1961, valuation certificates issued by Chartered Accountant / Merchant Banker are accepted and in case of Foreign Exchange Management Act, 1999 – valuation certificate issued by Chartered Accountant / Merchant Banker/ CPA are accepted. It is not clear as why provisions are not being made in the respective enactments to accept valuation certificates of valuers registered with IBBI.

Registration under Wealth Tax Act

Some banks/ institutions are demanding registration under Wealth Tax Act from the IBBI registered RVs. It is to be noted that IBBI RV selection is based on well-defined specific eligibility criteria, exams, training (before and after registration) etc. Whereas registration of valuers under sec. 34 AB of WT Act is just a random registration process without any exams/ training. Hence it is really felt unnecessary as to why RV duly registered with IBBI be once again compelled to get registered under Wealth Tax Act. This should be considered to be done away with.

It is further observed that some banks are accepting valuation upto certain amount say upto Rs.2 Crore from Un-Registered valuers. Will it not be a compromise with quality of credit? Respective RVOs can play an important role by arranging awareness campaigns among the banks, financial institutions and other user groups.

Requirement of Panel for RVs for SEBI

IBBI prepares panel of Insolvency Professionals to act as Administrators under SEBI (Appointment of Administrator and Procedure for Refunding to the Investors) Regulations, 2018. On the similar lines, IBBI may consider also to prepare panel of registered valuers for valuation under various provisions of SEBI Regulations.

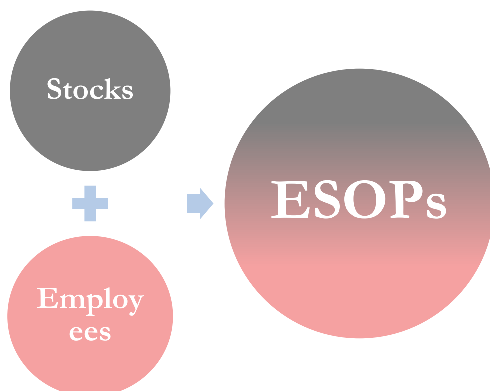
The above suggestions are in line with the continuing efforts of IBBI for smoothening and streamlining the procedures.

ESOP VALUATIONS
EMPLOYEE BONANZA FOR WEALTH CREATION

Mr. KAPIL MAHESHWARI-MBA

Introduction

In the past couple of decades, as a part of the employees' compensation packages, firms are increasingly providing employee options and restricted stocks. Although, this trend emerged with the rise of startups in the country who were not able to pay cash-based compensation to their employees, larger firms have used this option to align the interest of their employees with that of the shareholders.

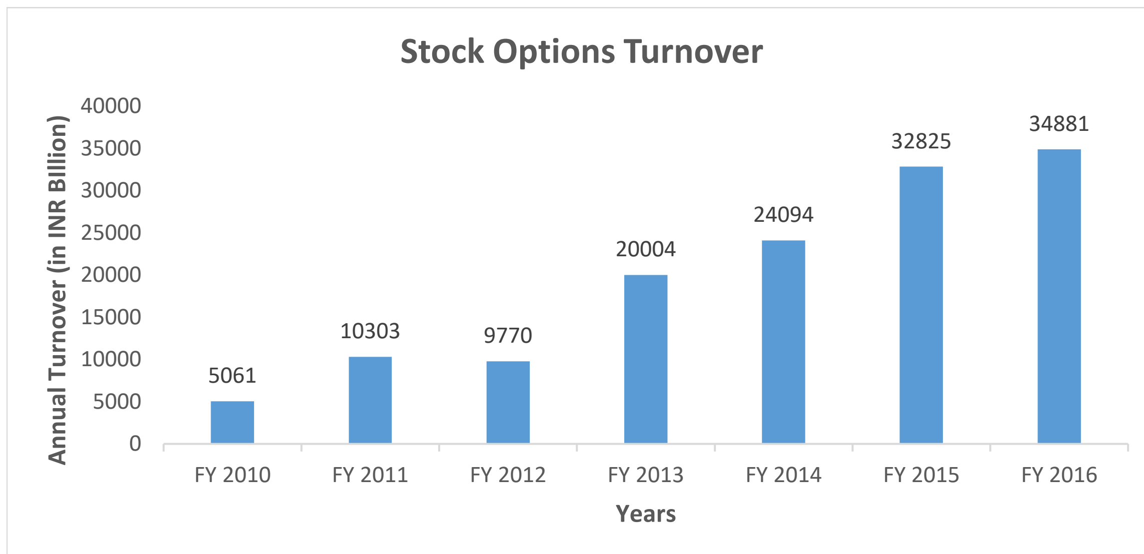


Sec 2(37) of Companies Act, 2013 defines "employees stock option" which means, 'the option given to the directors, officers or employees of the company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.'

This provision needs to be read with Rule 12 of The Companies (Share Capital and Debentures) Rules, 2014

Market Data

According to study by Statista, the annual stock options turnover from FY 2010 through FY 2016 has increased from INR 5,061 billion to INR 34,881 billion. Most of the turnover goes to the unicorns which started increasing after FY 2012 in India. The growth in the equity options can also be shown with the help of options overhang. An option overhang is the number of employee options outstanding as a percentage of total shares outstanding.



Which companies use options?

According to a study by the Investor Responsibility Research Centre (IRRC), technology companies have the biggest overhang of 24.4% in 2003 and the utility companies have the smallest amounting to less than 8%. There are variety of reasons why these differences exist between sectors which may include a non-exhaustive list of the following:

i) Age and Growth Potential of a firm impacts the use of ESOPs to a large extent. The younger companies or the startups use the equity options more when compared with more mature companies because the younger companies might not have sufficient amount of funds to compensate their employees at their embryonic stage.

ii) Riskiness of a firm may affect the use of ESOPs as a riskier firm will use equity options more frequently than a less risky firm which has a stable cash flow pattern.

iii) There is also a tax advantage that the firms get while using the ESOPs in their employee compensation plan.

Indian Accounting Standard 102

The objective of this Standard is to specify the financial reporting by an entity when it undertakes a **share-based payment transaction**. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees.

Binomial model is more suitable for cases where ESOPs are exercisable anytime during the exercise period. In cases where ESOPs are exercisable only at the end, Black-Scholes Merton should be used, or else this feature should be suitably adjusted in the Binomial model. However, where exercise periods are relatively short, both models may give similar results.

If the early exercise of the option is expected, this factor should be taken into account for computing the value of the option. A group of employees should be created on the basis their exercise pattern and then the weighted average life can be determined.

In case of volatility, past history might not necessarily reflect the future volatility pattern of the stock. Also, any extraordinary periods such as in case of takeover bids or any unit sale of the business should be ignored while computing the volatility.

Any increase in the pay-out rate of dividend should be factored to account for future estimates. Note that if the employees are eligible for dividend payments during the vesting period, then such dividends should not be considered for ESOP valuation.

ESOP Valuation Methods

- Black-Scholes Merton Model (Most-widely used model)
- Binomial Model (More flexible and can be used in various scenarios)
- Monte Carlo Simulation (Not widely used model)

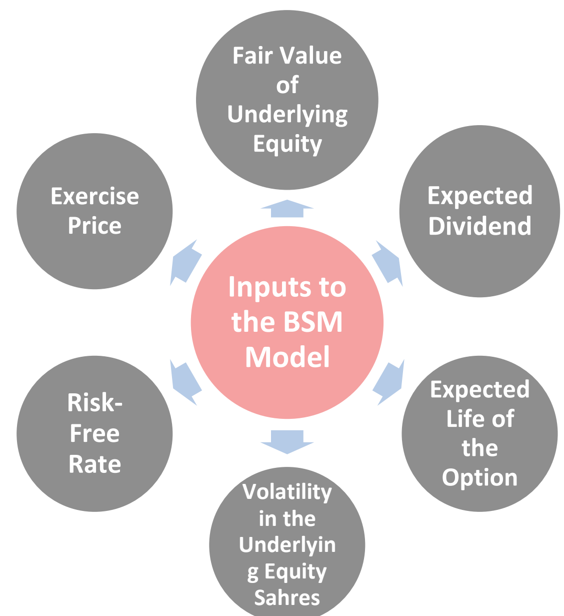
Black-Scholes Merton Model: The model estimates the variation over time of the underlying stock, and derives the price of the Option using the implied volatility of the underlying stock. The formula for computing the value of an option using BSM Model is;

Wherein; ‘S’ is the fair value of equity shares;

‘N’ is $\text{Option Value} = S \times N(d_1) - Xe^{-rt} \times N($ al distribution

$$d_1 = \frac{\ln\left(\frac{S}{X}\right) + \left(r + \frac{\sigma^2}{2}\right)t}{\sigma \times \sqrt{t}}$$

$$d_2 = d_1 - \sigma \times \sqrt{t}$$



‘X’ is the exercise value,

‘ln’ is the natural log,

‘r’ is the risk-free rate,

‘t’ is the expected life of the option and,

‘σ’ is the expected volatility in the stock

The fair value of the equity shares of the company is required on the valuation date, which is usually the grant date. Although the value of the stock can be determined using either using the formula provided by Section 56 of the Indian IT Act or by using the DCF approach. According to the IT Act, the fair value of equity shares is determined using the formula:

$$\text{Fair Market Value} = (\text{BV of Assets} - \text{BV of Liabilities}) \times \frac{PV}{PE}$$

Wherein; 'PV' is the paid-up value of equity shares and 'PE' is the paid-up amount shown in the balance sheet.

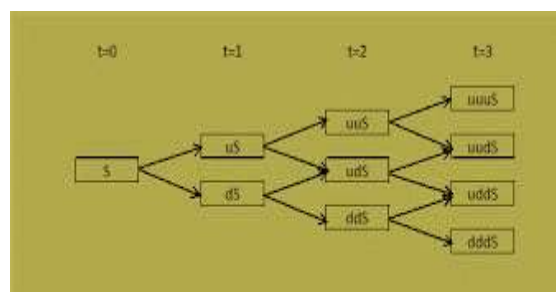
- The number of shares will increase as the options are issued; thereby, resulting in the stock price to decrease. A simple adjusted stock price can then be determined using the following formula:

$$\text{Adjusted Stock Price} = \text{Current Stock Price}\left[\frac{n_{\text{Shares Outstanding}}}{n_{\text{Shares Outstanding}} + n_{\text{Options}}}\right]$$

As a result, the decreased stock price tends to decline the value of the option.

- The life of an option will be affected when these options are granted because of illiquidity. Since the options granted to the employees cannot be traded, the employees are only wealthy on paper. Due to this reason, the employees are induced the exercise the options early and forgo any time premium that they would have received. As a consequence, the value of the option will decrease due to reduced life.
- The expected volatility measures the level of fluctuations in the value of the underlying equity shares. This input can be measured with the help of standard deviation or beta. If the company's shares are listed, then their volatility can be directly computed. However, in case of an unlisted company, the volatility of comparable companies is taken and used as a proxy for the subject company.
- The risk-free rate is generally the government bond yield. It is taken on the grant date of the ESOP. The tenure of the bond yield is generally taken to be equivalent to the expected life of the option.
- An adjustment for the probability of vesting should be done wherein this probability will then be multiplied with the value of option to ascertain the expected value for the same.
- The companies can have a tax benefit on issuing stock options because the difference between the stock price and the exercise price can be treated as an expense for the purpose of tax deduction. Thus, it helps in reducing the drain on the value created by issuing options.

Binomial Model: This model is more flexible than the BSM Model because it not only allows flexibility to adjust for the early exercise, but also to allow factoring of the vesting period. The binomial model assumes that the option is American Style (it can be exercised any time before maturity), the share price only moves in two directions, it involves the creation of various nodes at different time intervals and at each node, the expected share price and the expected value of the option is calculated. Although there could be hundreds of possible variations in the stock price, which could result in creation of a decision tree, the value of the option computed through this model comes closer to that from the Black-Scholes Merton Model. In a simplistic way, the value of an option can be determined with the help of a single stock price (S) at a particular time (let's say t = 0). Now, the probability of



an upward move in the stock price gives an up factor (u) and the probability of a downward move gives a down factor (d). Once these up and down factors are multiplied with the stock price, the stock price at the future time period (let's say t = 1) will be determined. In a similar way, numerous nodes determining the stock price at future time period will be computed and a binomial tree will be constructed.

Now, the main question comes, as how can we determine the value of an option?

- Once a decision tree is prepared, the risk neutral probabilities (п) for up and down movements are computed. The formula for the same is; $\pi = \frac{(1 + tr) - d}{u - d}$
  Wherein; 't' is the life of the option, 'r' is the risk-free rate, 'd' is the down factor and 'u' is the up factor.
- Also, compute the value of the call option when the time period t = 1 when there is an up move (C^+) and a down move (C^-) by taking the maximum of zero or the excess of stock price (S) over the strike price (X).
- Finally, the expected value of the call option (C_0) can be estimated using this formula;
  $$C_0 = \frac{\pi \times C^+ + (1 - \pi) \times C^-}{(1 + r)}$$

Market Reaction to ESOPs

An argument can be made on how the market reacts to the issuance of ESOPs by a listed company. This can be viewed from three dimensions:

1) **What is the reaction of the market at the time when ESOPs are granted?** It is not evident that the issue of ESOPs in itself bad news for the market because even if the companies did not grant ESOPs it could now do so because it is the normal cost of doing business now a days. Thus, it shouldn't be taken either as a good or the bad news by the market.

2) **How does the market react when the options are exercised?** As per the data captured by Garvey and Milbourn in 2002, the market reacts negatively to the option exercise associated dilution. This means that the market did not fully incorporate the option overhang and ideally in an efficient market, the potential dilution of stock at the time of exercising the option should be a non-event with no stock price consequence.

3) **Does the market incorporate the option overhang when valuing equity in a publicly traded company?** The market price has been seen to be lower for the companies whose overhang is high (usually about 6%). Thus, any adjustment to ESOPs in valuation yields a value which is pretty much closer to the market price. Hence, it can be argued that the market considers the value of outstanding options at the time of company valuation.

CASE LAWS ON VALUATION

CASE-1

Case Laws Compiled and Contributed by
CMA Padma Ganesh
IP & RV (SFA)

Cushman And Wakefield India Private Limited Vs UOI -W.P.(C) 9883/2018, CM No. 38508/2018
Knight Frank (India) Private Limited Vs UOI - W.P.(C) 9889/2018, CM No. 38522/2018
CBRE South Asia Private Limited Vs UOI - W.P.(C) 9890/2018, CM No. 38524/2018
Jones Lang Lasalle Property Consultants (India) Private Limited Vs UOI - W.P.(C) 9927/2018, CM No. 38673/2018

Before the High Court of Delhi at New Delhi
Judgement date: 31.01.2019

As these four writ petitions involved a common issue with common facts, the same were decided by the common order.
The petitioners, being a subsidiary of a reputed body corporate, were engaged in the business of real estate consultancy services including provision of real estate valuation services and enjoyed a good reputation. They had also invested time, money and experience in creating a pool of resources to carry out quality valuation services in India. On October 18, 2017, Section 247 of the Companies Act, 2013 was notified along with the Companies (Registered Valuers and Valuation) Rules, 2017 (RV Rules).

The counsel for the petitioner submitted that Rule 3(2)of the RV Rules and in particular Rule 3(2)(a) explicitly provided that a company shall not be eligible to be a Registered Valuer, if it is a subsidiary, joint venture or associate of another company or body corporate, and that this has impaired the right of the petitioners to carry on trade and business, which is guaranteed by the Constitution of India, as it ousted the petitioner from being a Registered Valuer merely on the ground of their being a subsidiary of a body corporate, and that this was discriminatory and arbitrary. He also submitted that the impugned Rule shall perniciously affect investment / acquisition of assets in India as both Indian and foreign investors rely on globally recognized valuation service providers, such as the petitioner. *In substance, the challenge in these petitions was to declare Rule 3(2) of the Companies (Registered Valuers and Valuation) Rules, 2017 as unconstitutional for violating Article 14, Article 19(1)(g) and Article 301 of the Constitution of India.*

On the other hand, learned Additional Solicitor General (ASG) appearing for the respondents justified the impugned Rule. According to her, the Rules are self-contained code intended to apply for the purposes of valuation under the provisions of the Companies Act, 2013 or the RV Rules. She also stated that the explanation to Rule 1(3) clearly stipulates that the conduct of valuation under any other law other than the Companies Act, 2013 shall not be affected by the coming into the effect of the Rules in question. She added that the endeavor of the Rules is to introduce a class of professionals where the focus is on the professionals' skills of the individuals rather than a business venture while bringing out the provisions of Rule 3(2)(d) and (e), Rule 7(h) and also the procedure for obtaining registration as a 'Registered valuer'. ASG further submitted that in order to maintain the integrity of the profession there ought to be no conflict of interest. Hence, the Rules do not suffer from the vires of excessive delegation as contended by the petitioners' counsel. She added that Professionalism as a registered valuer can be achieved only if the body is professionally independent and is set up exclusively for professional valuation services.

Hon'ble High Court held that the objective and intention behind laying down the impugned Rule is clearly to introduce higher standards of professionalism in valuation industry, specifically in relation to valuations undertaken for the purpose of Companies Act and IBC, 2016. It was also held that the exclusion of a subsidiary company, joint venture or associate of other company, for purpose of eligibility for registration as valuer is reasonable in view of the justification given by the respondents and the ASG's reliance on the judgment of the Supreme Court in the case of ***Dr. Haniraj L. Chulani***. It was further held that the test of permissible classification, is fully satisfied in the impugned Rules and keeping in view the position of law and the reasoning given by the respondents and making eligible only companies other than subsidiary companies, associate companies and joint ventures for the purpose of registration as valuer, a separate class has been carved out based on classification which is founded on intelligible differentia and as such the Rule cannot be faulted.

Hon'ble High Court held that they do not see any merit in the only ground urged by the petitioners. The petitions were dismissed as infructuous.

CASE-2

NATIONAL COMPANY LAW APPELLATE TRIBUNAL, NEW DELHI

Company Appeal (AT) No.272/2018
Judgment date : 09.07.2019
[Arising out of Order dated 29th June, 2018 passed by National Company Law Tribunal, Chennai Bench, Chennai in CP No.56 of 2017]
Gopakumar Nair & Asha Devi vs OBO Bettermann India Pvt. Ltd. (OBIPL) & OBO Bettermann Holdings – GMBH (OBO Germany)

CP filed u/s. 241 to 244 of Companies Act, 2013 against OBO Betterman India Pvt. Ltd. OBO Germany was a shareholder in OBIPL. Earlier OBIPL was in the name of 'Cape Electric India Pvt. Ltd. (CEIPL) with the appellants holding 100% shares. OBO Germany became a shareholder in CEIPL to the extent of 76% initially and later 99.64% of the shares and the company came to be known as OBIPL. OBO Germany made attempts to buy out the remaining 0.36% shares from the appellants pursuant to "Put and call" option agreement. When the appellants did not respond, notices were issued to the OBIPL u/s 236 of Companies Act, 2013 and went ahead to buy the shares of the appellants valued @ 1.70 per share by a Chartered Accountant engaged for the purpose. The Demand drafts towards the value of shares held by the appellants were sent to the appellants which they never presented.

Issues mainly decided in the present case were:

Maintainability of company petition
Applicability of Sec 236 of Companies Act, 2013
Invoking of Sec 236-Valuation by registered valuer

NCLT, Chennai had dismissed the petition of the appellants stating that they were not eligible to make application u/s. 241 of Companies Act, 2013 since they both were no longer shareholders of OBIPL since the shares had been acquired by OBO Germany u/s 236. NCLAT held that u/s. 244(1)(a), the appellants constituted 2 out of 3 members of OBIPL and hence CP u/s 241 was maintainable.

To ascertain the applicability of Sec 236 of Companies Act, 2013, NCLAT dissected each of the sections under Chapter XV of Companies Act, 2013 and held that Sec. 236 was not applicable in the present instance.

NCLAT further went to examine a situation wherein, had Sec 236 been applicable, whether it was invoked legally. Here, the importance of the role of registered valuers was discussed. Sec 236(2) which provides for valuation of the price of shares to be offered to minority shareholders at the hands of a registered valuer was discussed along with Sec 247-Valuation by registered valuers. Though Valuation rules had not been notified at the relevant time when OBO Germany sent notice u/s. 236, NCLAT discussed the importance of valuation by registered valuers since, in their opinion, Sec. 236 had the potential of forcibly taking away the shares of the original appellants.

Impugned order was set aside by NCLAT and the matter remanded back to NCLT, Chennai for deciding on issues other than maintainability and applicability of Sec. 236 of CA, 2013.

CASE-3

NCLT, Chandigarh
CA No.133/C-II/2015
RT CA No.04/Chd/Pb/2017
in
CP No.89(ND)/2009 (Decided matter)Under Regulation 44 of Company Law Board Regulations, 1991.
Ravinder Kumar Magoo Vs AMA India Enterprises Pvt. Ltd. (R-1) & Alessandro Malavolti (R-2)
And in the matter of AMA India Enterprises Pvt. Ltd.
Judgement date : 21.01.2019

CP was filed before the Company Law Board by Shri Ravinder Kumar Magoo against R-1 and R-2 seeking relief against the acts of R-2 being prejudicial to his interest and oppression against him. Shareholders of R-1 were the appellant with 25%, R-2 with 75% and AMA SPA (an Italian Company) with one share. Appellant failed to prove his case, however, to end litigation, CLB directed the respondents to provide exit to the appellant on fair valuation as on 31.03.2014. For this purpose a valuer was appointed with a direction to submit the report within 2 months from the date of order and thereupon consideration to be paid to the appellant within one month
The valuer considered 5 valuation methods- and after discussing the pros and cons of each method, finally concluded to adopt adjusted NAV method. 20% control premium was added to the adj. fair value per share. R-1 submitted that the valuation report violated the order of CLB with respect to cut-off date, wrong application of control premium, etc. and therefore another valuer be appointed. Appellant submitted that the valuer had not considered the valuation, on the basis of which, another partner of the company holding 25% of the shares was given exit. It was also stated a few years ago there was an offer from R-2 to the appellant for his exit and that value too had not been considered. The appellant sought a review of the valuation report. The valuer replied that every aspect of valuation had been carried out in strict compliance of the order of CLB taking into account all relevant factors.
At a later late, the appellant stated that he would like to waive the objections raised by him in case the value determined by the valuer was paid to him immediately for his 25% shareholding.
The case was transferred to NCLT, Chandigarh after the setting up of NCLTs. After hearing the submissions from both sides, NCLT directed that the valuation adjustment ought to be reduced by 8% considering Cost Inflation Index. It also held that the control premium of 20% was not justified. It rejected all other claims of both the parties.

Appellant sought interest based on CLB's order that consideration towards exit ought to be paid within a month of receipt of valuer's report. However, R-1 submitted that such interest was not payable since appellant had raised objections to the valuer's report and the matter remained pending. However, NCLT ordered that Simple Interest @12% p.a. be paid from the date of withdrawal of appellant's objections to the valuation report till the date of payment and also that fair value be calculated in consonance with RBI circular w.r.t. FEMA.

In this case, an appeal was filed before NCLAT by both the parties against the order of NCLT, Chandigarh. The appeal of Shri Ravinder Kumar Magoo was with respect to the 8% adjustment considering Cost Inflation Index and not allowing 20% control premium and also seeking 18% interest on delayed payment towards consideration of shares for exit. M/s. AMA India Enterprises Pvt. Ltd. appealed against the impugned order as a whole.

NCLAT, by its order dated 11.02.2020, upheld the order of the NCLT except modifying the rate of interest. NCLAT fixed the rate of interest @9% considering the overall scenario of the economy and the prevailing rate of interest in the market.

CASE-4

NCLT, Mumbai
Corporation Bank in the matter of ICICI Bank Vs Unimark Remedies
Judgment date : 20.01.2020

Miscellanous Application referred to Member (Judicial), NCLT, Mumbai by an order of Hon'ble President, NCLT, Principal Bench, New Delhi vide order dated 4th November, 2019 to adjudicate on the brief issue whether fresh valuation can be ordered in view of the dissenting judgement. The Hon'ble Judicial Member ordered a fresh valuation and whereas the Hon'ble Technical Member dissented with the order of valuation.
The application was filed by dissenting Financial Creditors (FC) with 7.69% voting rights due to stark contrast in the value of both tangible and intangible assets as per BS for FY 2017-18 and as per valuations arrived at by the two Registered Valuers. Corporate Debtor (CD) had been issued warning letters by US-FDA due to certain non-compliances. The intangible asset of CD had been valued at zero by both the RVs based on the warning letter. The RVs were of the opinion that due to such warning letters, USFDA could issue import alerts at any time and in that case exports by the CD would be completely stopped.

Submissions of the Resolution professional, CoC, successful Resolution applicant, unsuccessful Resolution applicant and the promoter were examined in this case. Based on the proceedings in the said case,

NCLT observed that the warning letters contemplate corrective actions by the CD. The reasoning of the two registered valuers in assigning a NIL value to the intangible assets of CD was observed to be absolutely untenable. NCLT further observed that the Valuers had not referred to any method of valuation in their report, no comparison was drawn of valuing the intangible assets of other Pharmaceutical Companies particularly in relation to the Domestic and International standard of valuation of such Intangible assets worldwide.

Therefore, assigning nil value to Intangible assets was held to be an error on the face of the two Valuation Reports and hence the appointment of a fresh valuer was ordered with a limited scope of providing a fair value of Intangible assets

Later an appeal was filed before NCLAT by Asset Reconstruction Company (India) Ltd. (Resolution Applicant), challenging the decision of fresh valuation by NCLT, Mumbai on the ground that it was not permissible.
However, by its order dated 13.03.2020, the decision of the NCLT, Mumbai was upheld by NCLAT, stating that it is open to the Adjudicating authority to satisfy itself of the plan approved by the CoC.

CASE-5

NCLT, Chennai
Indian Bank Vs J. Karthiga, RP of Solidaire India Ltd.
Judgement date : 22.07.2019

Among other issues, Indian Bank and International Asset Reconstruction Co. Pvt. Ltd. sought relief from NCLT, Chennai to direct the RP to conduct valuation of the property of the CD to arrive at proper fair value and liquidation value.

Relief was sought w.r.t the valuation of 16 grounds of land assigned to the CD by the Govt. of Tamil Nadu through an Assignment Deed. The applicant Bank alleged that Liquidation value given by the RV was very low as compared to the value given by the valuer of the Bank's Panel valuer and that the Liquidation value was incomparable to the market value of the asset.

RP's counsel put forth that the land was assigned to the CD by the Govt. of Tamil Nadu against some nominal charges with a mandate that the land shall be used only for the purpose for which it was assigned without any alienation or creation of third party rights in respect of this land. It was further submitted that ownership or lease holdings rights were not conferred on the CD by the Govt. of Tamil Nadu and for this reason, the land would fetch the same money that was paid to Tamil Nadu Govt. in the event the property was taken back by the Govt.

NCLT observed that the valuation report of the Bank's panel valuer had not discussed the title of the land and there was nothing to support the market value claimed in the report. Further, it was also observed that there was no ground for re-examining the valuation process other than insisting that the land would fetch market value.
NCLT held that since ownership or lease holdings rights were not conferred on the CD, it could not be assumed that the land be valued on market value. Hence it was held that Valuation given by the Valuers and the determination of the liquidation value of the asset by the RP cannot be re-examined by looking at the allegation made by this Applicant Bank.

CASE-6

Alok Kaushik Vs Mrs. Bhuvaneshwari Ramanathan & Others.
Civil Appeal No. 4065 of 2020 Before the Hon'ble Supreme Court
Judgement dated 15.03.2021

The appeal arose out of CIRP proceedings related to Kavveri Telecom Infrastructure Limited ("**Corporate Debtor**" or **"CD"**) by The National Company Law Tribunal, Bengaluru ("**NCLT**" or "**Adjudicating Authority**") by its order dated 21 March 2019. The first respondent was appointed as the Resolution Professional ("**RP**") in the said CIRP.

The issue in the present appeal related to the costs, charges, expenses and professional fees payable to a registered valuer appointed after the initiation of the CIRP under the IBC, in a situation where the CIRP is eventually set aside by the Adjudicating Authority or, as the case may be, Appellate Authority.

The RP appointed the appellant as a registered valuer of the Plant and Machinery of the CD, to value the plant and machinery at 115 sites of the CD across India. The appellant's appointment fee (Rs 7.50 lakhs plus applicable GST) and other expenses were ratified by the Committee of Creditors ("**CoC**").

The appellant claimed to have conducted valuation work of over 84 sites and to have visited 40. Further, several outstation meetings were also stated to have been conducted between the appellant and the first respondent. The appellant stated that he paid for expenses in the sum of Rs 52,000.

In the meantime, The National Company Law Appellate Tribunal ("**NCLAT**" or "**Appellate Authority**") set aside the initiation of CIRP against the CD and remanded the matter back to the NCLT to decide on the issue of CIRP costs. Accordingly, NCLT decided on the fee of the RP and reduced it by 20% from the fee ratified by the CoC.

In view of the order of the NCLAT, the RP cancelled the appointment of the appellant. In relation to the fee payable to the appellant, the RP requested him to consider a waiver. In return, the appellant agreed to reduce his fee by 25% from the fee ratified by the CoC, along with the expenses payable. However, after a few months, the RP informed the appellant that the fee as ratified could not be paid, and paid a sum of Rs 50,000. The appellant then filed an application under Section 60(5) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") before the NCLT challenging the non-payment of the fees. However, the NCLT dismissed the application concluding that it had been rendered *functus officio*. In appeal, the NCLAT by its order rejected the contention of the appellant, noting that an amount of Rs 50,000 had already been paid over. The appellant moved Hon'ble Supreme Court in an appeal under Section 62 of the IBC, for challenging the order of the NCLAT.

Hon'ble Supreme Court observed that in a situation, where the CIRP was set aside by the Appellate Authority, there has to be within the framework of the IBC, a modality for determining the claim of a professional valuer such as the appellant.

In its order dated 15 March, 2021, Hon'ble SC has discussed the definition of "insolvency resolution process costs", "resolution professional costs" and Provisions relating to withdrawal of application under IBC laws. Hon'ble SC has also discussed the jurisdiction of NCLT/NCLAT u/s 60(5)(c) of the IBC as also the grievance redressal mechanism of IBBI u/s 217, 218 and 220 of the IBC. Hon'ble SC held that the availability of a grievance redressal mechanism under the IBC against an insolvency professional does not divest the NCLT of its jurisdiction under Section 60(5)(c) of the IBC to consider the amount payable to the appellant. In any event, the purpose of such a grievance redressal mechanism is to penalize errant conduct of the RP and not to determine the claims of other professionals which form part of the CIRP costs.

Hon'ble SC accordingly allowed the appeal and set aside the impugned judgment and order of the NCLAT and remitted the proceedings back to the NCLT for determining the claim of the appellant for the payment of the professional charges as a registered Valuer appointed by the RP in pursuance of the initiation of the CIRP. In order to facilitate a fresh determination by the NCLT, the order passed by the NCLAT was also set aside and CA No 192 of 2020 stood restored to the file of the NCLT for determination afresh in the light of the observations.

International Valuation Standards (IVS)

Effective 31 January 2020

IVS Framework

1. Compliance with Standards

1.1 When a statement is made that a *valuation* will be, or has been, undertaken in accordance with the IVS, it is implicit that the *valuation* has been prepared in compliance with all relevant standards issued by the IVSC.

2. Assets and Liabilities

2.1 The standards can be applied to the *valuation* of both *assets* and liabilities. To assist the legibility of these standards, the words *asset* or *assets* have been defined to include liability or liabilities and groups of *assets*, liabilities, or *assets* and liabilities, except where it is expressly stated otherwise, or is clear from the context that liabilities are excluded.

3. Valuer

3.1 Valuer has been defined as "an individual, group of individuals, or a firm possessing the necessary qualifications, ability and experience to undertake a valuation in an objective, unbiased and competent manner. In some jurisdictions, licensing is required before one can act as a valuer. Because a valuation reviewer must also be a valuer, to assist with the legibility of these standards, the term valuer includes valuation reviewers except where it is expressly stated otherwise, or is clear from the context that valuation reviewers are excluded.

4. Objectivity

4.1 The process of *valuation* requires the *valuer* to make impartial judgements as to the reliability of inputs and assumptions. For a *valuation* to be credible, it is important that those judgements are made in a way that promotes transparency and minimises the influence of any subjective factors on the process. Judgement used in a *valuation must* be applied objectively to avoid biased analyses, opinions and conclusions.

4.2 It is a fundamental expectation that, when applying these standards, appropriate controls and procedures are in place to ensure the necessary degree of objectivity in the valuation process so that the results are free from bias. The IVSC Code of Ethical Principles for Professional Valuers provides an example of an appropriate framework for professional conduct.

5. Competence

5.1 Valuations must be prepared by an individual or firm having the appropriate technical skills, experience and knowledge of the subject of the valuation, the market(s) in which it trades and the purpose of the valuation.

5.2 If a valuer does not possess all of the necessary technical skills, experience and knowledge to perform all aspects of a valuation, it is acceptable for the valuer to seek assistance from specialists in certain aspects of the overall assignment, providing this is disclosed in the scope of work (see IVS 101 Scope of Work) and the report (see IVS 103 Reporting).

5.3 The *valuer must* have the technical skills, experience and knowledge to understand, interpret and utilise the work of any specialists.

6. Departures

6.1 A “departure” is a circumstance where specific legislative, regulatory or other authoritative requirements must be followed that differ from some of the requirements within IVS. Departures are mandatory in that a valuer must comply with legislative, regulatory and other authoritative requirements appropriate to the purpose and jurisdiction of the valuation to be in compliance with IVS. A valuer may still state that the valuation was performed in accordance with IVS when there are departures inthese circumstances.

6.2 The requirement to depart from IVS pursuant to legislative, regulatory or other authoritative requirements takes precedence over all other IVS requirements.

6.3 As required by IVS 101 Scope of Work, para 2.3 (n) and IVS 103 Reporting, para 1.2 the nature of any departures must be identified (for example, identifying that the valuation was performed in accordance with IVS and local tax regulations). If there are any departures that significantly affect the nature of the procedures performed, inputs and assumptions used, and/or valuation conclusion(s), a valuer must also disclose the specific legislative, regulatory or other authoritative requirements and the significant ways in which they differ from the requirements of IVS (for example, identifying that the relevant jurisdiction requires the use of only a market approach in a circumstance where IVS would indicate that the income approach should be used).

6.4 Departure deviations from IVS that are not the result of legislative, regulatory or other authoritative requirements are not permitted in valuations performed in accordance with IVS.

IVS-101 Scope of Work

1. Introduction

1.1 A scope of work (sometimes referred to as terms of engagement) describes the fundamental terms of a valuation engagement, such as the asset(s) being valued, the purpose of the valuation and the responsibilities of parties involved in the valuation.

1.2 This standard is intended to apply to a wide spectrum of valuation assignments, including:

a) valuations performed by valuers for their own employers ("in-house valuations"),
b) valuations performed by valuers for clients other than their employers ("third-party valuations"), and
c) valuation reviews where the reviewer may not be required to provide their own opinion of value.

2. General Requirements

2.1 All *valuation* advice and the work undertaken in its preparation *must* be appropriate for the intended *purpose*.

2.2 A *valuer must* ensure that the intended recipient(s) of the valuation advice understand(s) what is to be provided and any limitations on its use before it is finalised and reported.

2.3 A *valuer must* communicate the scope of work to its *client* prior to completion of the assignment, including the following:

a. **Identity of the *valuer***: The *valuer* may be an individual, group of individuals or a firm. If the *valuer* has any material connection or involvement with the subject *asset* or the other parties to the *valuation* assignment, or if there are any other factors that could limit the *valuer's* ability to provide an unbiased and objective *valuation*, such factors *must* be disclosed at the outset. If such disclosure does not take place, the valuation assignment is not in compliance with IVS. If the *valuer* needs to seek *material* assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance *must* be made clear.

b. **Identity of the *client(s)* (if any):** Confirmation of those for whom the valuation assignment is being produced is important when determining the form and content of the report to ensure that it contains information relevant to their needs.

c. **Identity of other *intended users* (if any):** It is important to understand whether there are any other *intended users* of the valuation report, their identity and their needs, to ensure that the report content and format meets those users' needs.

d. ***Asset(s)* being valued**: The *subject asset* in the valuation assignment *must* be clearly identified.

e. **The valuation currency**: The currency for the *valuation* and the final valuation report or conclusion *must* be established. For example, a *valuation* might be prepared in euros or US dollars. This requirement is particularly important for valuation assignments involving *assets* in multiple countries and/or cash flows in multiple currencies.

f. ***Purpose of the valuation:*** The *purpose* for which the valuation assignment is being prepared *must* be clearly identified as it is important that valuation advice is not used out of context or for *purposes* for which it is not intended. The *purpose of the valuation* will also typically influence or determine the basis/bases of *value* to be used.

g. **Basis/bases of value used**: As required by IVS 104 *Bases of Value*, the valuation basis *must* be appropriate for the *purpose of the valuation*. The source of the definition of any basis of value used *must* be cited or the basis explained. This requirement is not applicable to a valuation review where no opinion of *value* is to be provided and the reviewer is not required to comment on the basis of value used.

h. **Valuation date**: The valuation date *must* be stated. If the valuation date is different from the date on which the valuation report is issued or the date on which investigations are to be undertaken or completed then where appropriate, these dates *should* be clearly distinguished.

i. **The nature and extent of the *valuer's* work and any limitations thereon**: Any limitations or restrictions on the inspection, enquiry and/or analysis in the valuation assignment *must* be identified (see IVS *Framework*, paras 6.1-6.4) If relevant information is not available because the conditions of the assignment restrict the investigation, these restrictions and any necessary assumptions or special assumptions (see IVS 104 *Bases of Value*, paras 200.1-200.5) made as a result of the restriction *must* be identified.

j. **The nature and sources of information upon which the *valuer* relies**: The nature and source of any relevant information that is to be relied upon and the extent of any verification to be undertaken during the *valuation* process *must* be identified.

k. **Significant assumptions and/or special assumptions:** *All significant assumptions and special assumptions that are to be made in the conduct and reporting of the valuation assignment must be identified.*

l. **The type of report being prepared:** The format of the report, that is, how the *valuation* will be communicated, *must* be described.

m. **Restrictions on use, distribution and publication of the report**: Where it is necessary or desirable to restrict the use of the *valuation* or those relying on it, the *intended users* and restrictions *must* be clearly communicated.

n. **That the *valuation* will be prepared in compliance with IVS and that the *valuer* will assess the appropriateness of all *significant* inputs**: The nature of any departures *must* be explained, for example, identifying that the *valuation* was performed in accordance with IVS and local tax regulations. See *IVS Framework* paras 60.1-60.4 relating to departures.

2.4 Wherever possible, the scope of work *should* be established and agreed between parties to a valuation assignment prior to the *valuer* beginning work. However, in certain circumstances, the scope of a valuation engagement *may* not be clear at the start of that engagement. In such cases, as the scope becomes clear, *valuers must* communicate and agree the scope of work to their *client*.

2.5 A written scope of work *may* not be necessary. However, since *valuers* are responsible for communicating the scope of work to their *client*, a written scope of work *should* be prepared.

2.6 Some aspects of the scope of work *may* be addressed in documents such as standing engagement instructions, master services agreements or a company's internal policies and procedures.

3. Changes to Scope of Work

3.1 Some of the items in para 2.3 *may* not be determinable until the valuation assignment is in progress, or changes to the scope *may* become necessary during the course of the assignment due to additional information becoming available or matters emerging that require further investigation. As such, whilst the scope of work *may* be established at the outset, it *may* also be established over time throughout the course of the assignment.

3.2 In valuation assignments where the scope of work changes over time, the items in para 2.3 and any changes made over time *must* be communicated to the *client* before the assignment is completed and the valuation report is issued.

VALUATION QUIZ

ICMAI REGISTERED VALUERS ORGANISATION

RECOGNISED RVO UNDER INSOLVENCY AND BANKRUPTCY BOARD OF INDIA

PROMOTED BY: THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

Multiple Choice Question

1. In measuring value, which of the following 'approach', would you use?

A. Cost & Income

B. Cost & Market

C. Market & Income

D. Cost, Market & Income

2.Which of the following date is appropriate relating to valuation?

A. The date the report is signed

B. The date the analysis is finished

C. The effective date of the valuation

D. The date the report is sent to the client

3.Which of the following method is included in Income based approach?

A. Underlying Asset Method

B. Realizable Value Method

C. Market Price Method

D. Discounted Cash Flow Method

4.Which of the following is a suitable method for valuation of knowledge-based companies?

A. Knowledge

B. Earnings

C. Market

D. Market & Earning

5. Fair value is based on, which of the following concept?

A. Market

B. Cost

C. Market or cost whichever is lower

D. Market or Cost whichever is higher

6. Which of the following is external factors that can affect value?

A. Product or service diversification

B. Management competence

C. Inflation

D. Inventory control

7. Principal methods of Valuation are:

A. Market approach, Asset approach, Income approach

B. Discounted cash flow method, Net assets method, Market price method

C. Market approach, discounted cash flow method, Asset approach

D. Asset approach, Income approach, discounted cash flow method

8. Investment value is the value

A. to a particular investor

B. to a hypothetical investor

C. in the marketplace

D. in tax valuations

9.Which of the following is considered standards of value?

A. Liquidation of Value

B. Actual value

C. Going concern value

D. Investment value

10. While valuing 'synergy' which of the following is to be looked at!

A. Operating synergy

B. Financial synergy

C. Operating synergy & Financial synergy

D. Operating synergy or Financial synergy

11. When valuation process is under multiple scenarios, you take into consideration,

A. Scenarios

B. Ranges of value

C. Ranges of value or Scenarios

D. Ranges of value & Scenarios

12. Which of the following is the "as of" date for valuation?

A. Anytime within one year

B. Date that the report is signed

C. "As of" a single point in time or six months later

D. "As of" a single point in time

13. Which of the following statement is true?

A. All valuation approaches must be considered

B. All valuation approaches must be applied

C. All valuation methods must be applied

D. Indications of value should be averaged

14. Which of the following principle of valuation would be more appropriate in respect of M & A

A. Principle of Integration

B. Principle of future Benefits

C. Principle of substitution

D. Principle of substitution, Integration & Future benefits

15. If the market value of security is above its intrinsic value, it is good_

A. for 'auction"

B. for 'buy"

C. for 'sell"

D. for retain

16. While measuring the investment value we may add to the stand alone value of the business the followings:

A. Value premium, price premium

B. Market premium, control premium

C. Synergy premium, market premium

D. The control premium, The synergy premium

17. As an appraiser and in order to avoid bias in valuation, you would normally use_

A. One approach

B. Two different approaches

C. Better approach

D. Best approach

18. Valuation done under Enterprise Model (DCF) and Economic Profit Model lead to identical results?

A. The Statement is True

B. The Statement is False

C. The Statement is conflicting as they are not used in valuation models

D. One cannot comment

19. When valuing equity of high-growth companies, the bulk of the value will come from the_

A. Market value

B. Intrinsic value

C. Terminal value

D. Fair value

20. The difference between going concern value and liquidation value at the valuation date

refers to:

A. Adjusted Book Value Method

B. Arbitrage Pricing Theory

C. Absolute risk

D. Asset based approach

21. Which of the following is not one of the three fundamental methods of firm valuation?

A. Discounted cash flow.

B. Income or earnings - where the firm is valued on some multiple of accounting income or earnings.

C. Balance sheet - where the firm is valued in terms of its assets.

D. Market share.

22.The complete absorption of one company by another,wherein the acquiring firm retain s its identity and the acquired firm ceases to exist as a separate entity, is called a:

A. merger

B. consolidation

C. tender offer.

D. spinoff

23. A firm that acquires another firm as part of its strategy to sell off assets, cut costs, and operate the remaining assets more efficiently is engaging in

A. a strategic acquisition

B. a financial acquisition

C. two-tier tender offer

D. shark repellent

24. What is the most likely reason that a firm (which is highly profitable) might consider acquiring a firm that has had large recent losses and will continue to have losses into the near future?

A. Hubris

B. White knight

C. Tax-loss usage

D. Increase assets

25. A firm can acquire another firm ___________.

A. only by purchasing the assets of the target firm

B. only by purchasing the common stock of the target firm

C. by either purchasing the assets or the common equity of the target firm.

D. None of the above are methods of acquiring the target firm

Answer Key.

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
D	**C**	**D**	**D**	**A**	**C**	**A**	**B**	**D**	**C**	**D**	**D**	**A**	**D**	**C**	**D**	**B**	**A**	**C**	**C**	**D**	**A**	**B**	**C**	**C**

Glossary of Valuation Terms

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Glossary of Valuation Terms

Internal Rate of Return—a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value—the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price or strike price of an option and the market value of the underlying security.

Invested Capital—the sum of equity and debt in a business enterprise. Debt is typically a) all interest bearing debt or b) long-term interest-bearing debt.

Invested Capital Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments

Investment Risk—the degree of uncertainty as to the realization of expected returns.

Investment Value—the value to a particular investor based on individual investment requirements and expectations

Key Person Discount — an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta—the beta reflecting a capital structure that includes debt

Limited Appraisal—the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scop.

Liquidity—the ability to quickly convert property to cash or pay a liability.

Liquidation Value—the net amount that would be realized if the business is terminated and the assets are sold. Liquidation can be either "orderly" or "forced."

Majority Control—the degree of control provided by a majority position.

Majority Interest—an ownership interest greater than 50% of the voting interest in a business enterprise.

Market (Market-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Market Capitalization of Equity—the share price of a publicly traded stock multiplied by the number of shares outstanding.

Market Capitalization of Invested Capital—the market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple—the market value of a company's stock or invested capital divided by a company measure

Marketability—the ability to quickly convert property to cash at minimal cost.

Merger and Acquisition Method—a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting—a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

OPPORTUNITIES FOR REGISTERED VALUERS

Companies Act, 2013

- Private placement of shares
- Issue of Share on Preferential basis
- Issue of Shares for consideration other than cash
- Issue of Sweat Equity Shares
- Non- cash transaction involving directors
- Mergers and Aquisions
- Demergers
- Scheme of compromise or arrangement with creditors/member
- Submission of report by company liquidator
- Purchase of minority shareholding

SEBI Regulations

- SEBI (Issue and listing of Securitised debt Instruments and Security receipts) Regulation,2008
- SEBI (Infrastructure Investment Trusts) Regulations, 2014
- SEBI (Real Estate Investment Trusts) Regulations,2014
- SEBI (Listing Obligations and Disclosure Requirements) Regulations,2015
- SEBI (Issue of capital and Disclosure requirements) regulations,2018
- SEBI(Appointment of Administrator and procedure for refunding to the investors) Regulations,2018

Insolvency and Bankruptcy Code 2016

- Determination of value of assets, realizable value, Fair value and liquidation value as the case may be

Process for becoming Register Valuer
1
• Meet eligibility requirements, qualification and experience prescribed under Rule 4 of the Companies (Registered Valuers and valuation) Rules, 2017
2
• Seek enrolment as a valuer member of ICMAI RVO
3
• Complete 50 Hours educational course
4
• Register and pass computer based Examination conducted by IBBI
5
• Submit requite Form along with fee in favour of IBBI and supporting documents to ICMAI RVO
6
• ICMAI RVO shall verify Form & other requirements and forward the same along with its recommendation to IBBI
7
• On receipt of Form along with recommendation of ICMAI RVO, fee and other documents, IBBI shall Process the application for registration
8
• After registration with IBBI, take up COP training with ICMAI RVO
9
• On completion of training ICMAI RVO shall issue a Certificate of Practice to the registered valuer
10
• Valuation certificate can be issued only after obtaining Certificate of Practice

EDUCATIONAL QUALIFICATION & EXPERIENCE
For 50 Hours Educational Course

Asset Class	Eligibility/ Qualification	Experience in specified discipline.
Plant and Machinery	(I) Graduate in Mechanical, Electrical, Electronic and Communication, Electronic and Instrumentation, Production, Chemical, Textiles, Leather, Metallurgy, or Aeronautical Engineering, or Graduate in Valuation of Plant and Machinery or equivalent; (ii) Post Graduate on above courses.	(I) Five years (ii) Three years
Land and Building	(I)Graduate in Civil Engineering, Architecture, or Town Planning or equivalent; (ii) Post Graduate on above courses and also in valuation of land and building or Real Estate Valuation (a two-year full time post-graduation course).	(I) Five years (ii) Three years
Securities or Financial Assets	(I)Member of Institute of Chartered Accountants of India, Member of Institute of Company Secretaries of India, Member of the Institute of Cost Accountants of India, Master of Business Administration or Post Graduate Diploma in Business Management (specialisation in finance). (ii) Post Graduate in Finance	Three years

Any other asset class along with corresponding qualifications and experience in accordance with rule 4 as may be specified by the Central Government.

Note,:- The eligibility qualification means qualification obtained from a recognized Indian University or equivalent Institute whether in India or abroad.".

PROCESS FOR IBBI EXAMINITION

1. The candidate may enroll for the examination on payment of the fee as prescribed by IBBI
2. Online examination with objective multiple-choice questions
3. The duration of the examination is 2 hours
4. Wrong answer attracts a negative mark of 25% of the assigned for the question
5. A candidate needs to secure 60% of marks for passing.

Format and Frequency of Examination

Format and Frequency of Examination

a. The examination is conducted online (computer-based in a proctored environment) with objective multiple-choice questions;
b. The examination centers are available at various locations across the country;
c. The examination is available on every working day;
d. A candidate may choose the time, the date and the Examination Centre of his choice for taking the Examination. For this purpose, he needs to enroll and register at
e. https://certifications.nism.ac.in/nismaol/
f. A fee of Rs.1500 (One thousand five hundred rupees) is applicable on every enrolment;
g. The duration of the examination is 2 hours;
h. A candidate is required to answer all questions;
i. A wrong answer attracts a negative mark of 25% of the marks assigned for the question;
j. A candidate needs to secure 60 % of marks for passing;
k. A successful candidate is awarded a certificate by the Authority;
l. A candidate is issued a temporary mark sheet on submission of answer paper;
m. No workbook or study material is allowed or provided;
n. No electronic devices including mobile phones and smart watches are allowed; and
o. Use of only a non-memory-based calculator is permitted. Scientific Calculators (memory based or otherwise) are not allowed.

GUIDELINES FOR ARTICLES

The articles sent for publication in the journal "The Valuation Professional" should conform to the following parameters, which are crucial in selection of the article for publication:

- ✓ The article should be original, i.e. Not
- ✓ Published/ broadcasted/hosted elsewhere including any website.
- ✓ A declaration in this regard should be submitted to ICMAI-RVO in writing at the time of submission of article.
- ✓ The article should be topical and should discuss a matter of current interest to the professionals/readers.
- ✓ It should preferably expose the readers to new knowledge area and discuss a new or innovative idea that the professionals/readers should be aware of.
- ✓ The length of the article should not exceed 2500-3000 words.
- ✓ The article should also have an executive summary of around 100 words.
- ✓ The article should contain headings, which should be clear, short, catchy and interesting.
- ✓ The authors must provide the list of references, if any at the end of article.
- ✓ A brief profile of the author, e-mail ID, postal address and contact numbers and declaration regarding the originality of the article as mentioned above should be enclosed along with the article.
- ✓ In case the article is found not suitable for publication, the same shall be communicated to the members, by e-mail.

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