MAY 2022

THE VALUATION PROFESSIONAL

YOUR INSIGHT JOURNAL

ICMAI REGISTERED VALUERS ORGANISATION

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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INDEX

About ICMAI Registered Valuers Organisation
Governing Board of ICMAI RVO *4*
From the Chairman's Desk *5*
From the President's Desk *6*
From the MD's Desk *7*

PROFESSIONAL DEVELOPMENT PROGRAMS 9

ARTICLES
Discernible divergence in the valuation arrived at by two different Registered Valuers in each asset class in IBC matters: Reasons and Recommendations 12
Analysis of EBITDA and Normalization of EBITDA 17
Bases, Methods and Importance of Valuation for Plant & Machinery 24
Authenticity of Data while Assessing Valuation of Land & Building Property 27
Valuation is an Art, Science, Craft or Mystery 30
Valuation of Know How 32

OTHER READINGS
Valuing Firms in Distress 34

MULTIPLE CHOICE QUESTIONS 40
CASE LAWS 47
PRIZE-WINNING ENTRIES OF THE ESSAY COMPETITION ORGANIZED BY ICMAI REGISTERED VALUERS ORGANIZATION 54
SNAPSHOTS 56
SUMMER BOOTCAMP
ONLINE CERTIFICATE COURSE ON VALUATION 58
PUBLICATIONS 59
AMBASSADORS-ICMAI RVO 61
OPPORTUNITIES FOR REGISTERED VALUERS 63
PROCESS FOR BECOMING REGISTERED VALUER 64
FORMAT AND FREQUENCY OF EXAMINATION 66

ICMAI REGISTERED VALUERS ORGANISATION

RECOGNISED RVO UNDER INSOLVENCY AND BANKRUPTCY BOARD OF INDIA

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Managing Director

FROM THE CHAIRMAN's DESK

CS (Dr.) Shyam Agarwal
Chairman
ICMAI Registered Valuers Organisation

The much-awaited Life Insurance Corporation of India (LIC) IPO (initial public offering) is set to open next week. Even as LIC issue size is trimmed down to 3.5% of equity, from 5% planned earlier; it will still be the largest ever to hit Dalal Street. The insurance company is valued at just over Rs 6 lakh crore. LIC IPO looks reasonably valued in the context of its size and dominance of the insurance market. This insurance behemoth however will keep on losing market share, going forward, and may not be a preferred company among the young, which could impact longer term valuations. Here are edited excerpts from the interview.

The Life Insurance Corporation's (LIC's) initial public offering (IPO) size will have a price band of Rs 902 to Rs 949, resulting in the issue size being between Rs 20,000 crore and Rs 21,000 crore, depending on the final price, making it the country's largest IPO even after being scaled down due to choppy market conditions triggered by the war in Ukraine.

LIC is reasonably valued in the context of its size and dominance of the insurance market. The only issue facing the company post listing will be growth as it has not been growing much with the entire growth in the insurance industry being dominated by the private sector players. LIC will keep on losing market share going forward, and it is not a preferred company among the young and that could impact longer term valuations.

FROM THE PRESIDENT's DESK

CMA P. Raju Iyer
Nominee Director
ICMAI Registered Valuers Organisation

President
The Institute of Cost Accountant of India

The key challenge in valuation is looking at and using an appropriate cost of capital factor. Developing cost of capital in troubled times should be nothing new. We saw this in 2008 after the financial crisis and it should be dealt with in a similar fashion. What is critical to remember is that we value businesses based on what is known or knowable at the valuation date and we must consider what the investing public is thinking at the date of the valuation. While many tried to deal with risk-free rates and the 'flight to safety' back in 2008, that almost became the new normal. Thought must be given to the fact that the risks associated with the cash flow of the particular business that you are valuing is what the discount rate must be based on. If all you do is a mechanical computation to build up a discount rate, you are most likely going to be wrong. You need to use common sense and think about how the risk of receiving the cash flows is impacted at the date of the valuation.

For the development of cost of capital, given the market uncertainty, one needs to critically consider the impact of the current market uncertainties on the business operations in developing the forecast. In determining the nature and extent of the impact on the business and valuation assumptions, the following potential issues may need to be considered:

- "Store or facility closures;
- "Loss of customers or customer traffic;
- "The impact on distributors;
- "Supply chain interruptions;
- "Production delays or limitations;
- "The impact on human capital;
- "Regulatory changes; and
- "The risk of loss on significant contracts.

FROM THE MD's DESK

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

Emerging markets continue to offer huge opportunities and challenges. Rapid economic growth and favourable demographics make them hugely attractive destinations for investment and expansion. Conversely, economic volatility, political instability and complex business environments present a level of risk.

Business valuation tends to be a complicated with numerous factors that need to be evaluated and quantified in order to muster up an effective result. Key among those factors are company-specific risk premiums and the methodology used to calculate them, beta risk. One of the lessons learned from the COVID-19 crisis is that a coherent narrative is more important than ever in business valuation

With such a disruptor as COVID-19, what happened to the subject company becomes more key in the overall valuation report. The answers to the following questions will help the valuator understand what happened to the subject company:

- Where was this company before the crisis?
- What happened to it when the crisis hit?
- How did it respond?
- Did it rise to the challenge and retool to deal with the crisis?
- How did it treat its customers and employees?
- Did it avail itself of government stimulus money?
- How is it emerging from the crisis—is it stronger or crippled?

PROFESSIONAL DEVELOPMENT

ICMAI REGISTERED VALUERS' ORGANISATION

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The Institute of Cost Accountants of India
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Lodhi Road, New Delhi – 110003

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PROFESSIONAL DEVELOPMENT PROGRAMS

March '2022 to May '2022	
Date	**PD Programs**
02nd March 2022	Emerging Professional Opportunities Current Economic Scenario and its Effects on Valuation
05nd -06rd March 2022	Power Learning Session – AVM and Data Analysis Tools
08th March 2022	Seminar on the occasion of International Women's Day
09th 10th 11th March 2022	Certification Course on Valuation of Intangible Assets
12th -13th March 2022	Certificate Course on Valuation-Online Mode
15th March 2022	Current Economic Scenario and its Effects on Valuation
16th -17th March 2022	Certification Course on IVS (Revised)
19th -20th March 2022	Certificate Course on Advanced Valuation
23rd -24th March 2022	Master Class How to Execute a Valuation Assignment
26th -27th March 2022	Certificate Course on Valuation
30th -31th March 2022	Certificate Course on Proficiency in Valuation
06th -07th April 2022	Certificate Course on Valuation
10th April 2022	Certificate Course on Valuation Report
13th -14th April 2022	Certificate Course on Valuation for Insolvency Professionals
15th April 2022	Learning Session Valuation approaches and techniques to find the fair value
17th April 2022	Certificate Course on Improving Valuation Competency
20th April 2022	Master Class on Valuation
21st April 2022	NATIONAL CONCLAVE ON PROFESSION AND PRACTICE OF VALUATION: VISION 2025
22nd -23rd April 2022	Professional Development Program -Enhancing Valuation Competency
23rd -24th April 2022	Certificate Course on Building Competency in Valuation
26th April 2022	Findings and Learnings of Peer Review
28th -29th April 2022	Master Class Revised International Valuation Standards Effective from 31st January 2022
1st May 2022	Valuation Bootcamp
02nd May 2022	Seminar on the Occasion of 5th Foundation Day ICMAI RVO
04th -05th -06th May-2022	Mastering Shades of Valuation
07th -08th May 2022	Workshop on Valuation
11th May 2022	Learning Session Emerging Business and Economic Environment
12th -13th May 2022	Master Class on Valuation

PROFESSIONAL DEVELOPMENT PROGRAMS

50 Hours Training Programs

March '2022 to May '2022	
Date	**Programs**
25th -27th March 2022 & 31st March 2022-03rd April 2022	50 hours Valuation Course on Land & Building and Plant & Machinery
25th -27th March 2022 & 31st March 2022-03rd April 2022	50 hours Valuation Course on Securities or Financial Assets
13th -15th May 2022 & 19th -22nd May 2022	50 hours Valuation Course on Land & Building and Plant & Machinery
27th 29th May 2022 to 01st -04th June 2022	50 hours Valuation Course on Securities or Financial Assets

Upcoming Professional Development Programs

Date	PD Programs
27th 29th May 2022 to 01st -04th June 2022	50 hours Valuation Course on Securities or Financial Assets

Articles

DISCERNIBLE DIVERGENCE IN THE VALUATION ARRIVED AT BY TWO DIFFERENT REGISTERED VALUERS IN EACH ASSET CLASS IN IBC MATTERS: REASONS AND RECOMMENDATIONS

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

The Perspective

The need and requirement of valuation under Insolvency and Bankruptcy Code 2016 is central for achieving the core objectives of the IBC. Appropriate and credible valuations would lead to desired outcomes in terms of CIRP or liquidation preventing a viable company being pushed into liquidation, and an unviable company getting revived and rescued. The IBC along with Rules and Regulations framed thereunder, have laid down the basic regulatory requirement for valuation of assets of the corporate debtor:

As per Regulation 27 of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("CIRP" Regulations), the Resolution Professional shall within seven days of his appointment, but not later than forty-seventh day from the insolvency commencement date, appoint two Registered Valuers to determine the fair value and the liquidation value ofthe corporate debtor in accordance with regulation 35.

The term Fair Value and Liquidation Value have been defined under CIRP Regulations as follows:

Clause 2(hb): *"Fair Value" means the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion.*

Clause 2(k): *"Liquidation Value" means the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date.*

As per Regulation 35 of CIRP Regulations, the Fair Value and Liquidation Value shall be determined in the following manner:

a. the two Registered Valuers appointed under regulation 27 shall submit to the Resolution Professional an estimate of the Fair Value and of the Liquidation Value computed in accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the Corporate Debtor;

b. if in the opinion of the Resolution Professional, the two estimates of a value are significantly different, he may appoint another Registered Valuer who shall submit an estimate of the value computed in the same manner; and

c. the average of the two closest estimates of a value shall be considered the fair value or the Liquidation Value, as the case may be.

The Perception

It may not always be possible to have similar or close conclusions when the exercise of valuation under IBC is being done by two independent Registered valuers. The two valuers, while they may adopt same valuation standards would still have differing opinion / views as to the industry, condition of assets, future of corporate debtor etc. These differing views/ opinions would make them adopt different discount/ premium factors and approaches while carrying out valuation which would result into different conclusions.

The IBC Regulations do not specify what difference in valuation provided by the two Registered Valuers is acceptable or not acceptable. The regulations leave it to the Resolution Professional / Committee of Creditors to decide whether a third valuer is required to be appointed or not. Very

often the Resolution Professional gets concerned if the difference is more than 10%. Unfortunately, neither the RP or the COC go into the details of the valuation reports as to what has caused this difference in valuation. This may also be due either to the RP or the COC members being technically not competent to understand the valuation process and methodology / study the valuation reports in detail or simply may not have the inclination to go deeper into the matter. This also results in sub-standard valuation work getting accepted in important decision making regarding fate of company in distress.

The valuation report is the most important document in the Corporate Insolvency Resolution/ Liquidation Process which must be used as an instrument to maximize the assets of the corporate debtor which is the major objective of IBC 2016. However, the valuation exercise is seldom treated with the importance it deserves. The RPs and the COC want to hire valuers who are giving lowest quotes without checking if the valuer has a capability as reflected in the quality of previous assignments handled by him. The RP only looks at the final conclusion number to see if the difference is more / less than 10%. He seldom checks if the assumptions/ views/ opinions are uniformly considered by the two valuers. Many a time, the RP doesn't have / provide the relevant and required documents and information pertaining to the assets to the Registered valuers. The valuers then make their own assumptions which at times leads to very divergent valuations in respect of same Corporate debtor.

On the Registered valuers side, it has almost become a rhetoric to believe and propagate that Valuation is an art and not a science. To a certain extent this message is being perceived by the valuer's community with a wrong connotation and the valuers have started thinking that whatever difference in valuation arises it is bound to be there since valuers are 'ártists' with distinct views and not scientists who would follow a strict valuation principles , protocol and line of action. This has resulted into lack of desired discipline and rigor which is required in valuation matters.

After all, the whole idea of having two independent Registered valuers was to have two learned views which would help make a rational decision about a corporate debtor.

Possible reasons for discernible difference in valuation provided by 2 RVs in each asset class in IBC matters

- Valuers may use different definitions related to Liquidation value in CIRP: Valuers may assume a different premise for Liquidation Value, while one valuer in CIRP may assume Liquidation Value to be based on the definition under IVS which is realization value of assets when assets are sold on a piecemeal basis. While the other valuer may assume premise for Liquidation value as per Regulation 32(e) of the IBBI (Liquidation Process) Regulation 2016 which is value of the CD as a going concern. This will often lead to divergence in values. lack of availability of relevant information and documents - so it's all about interpretation
- Financial statements provided to the Registered valuers may not reflect the real picture
- there is no standard discount with respect to Fair Market Value for a particular industry
- No proof of how old is the asset and in which condition
- Valuers don't use the same set of information when valuing the same assets. Some Valuers may have additional information, while others may be working with limited information and/or additional assumptions, which may be unsubstantiated.
- Values computed during Liquidation Process: Divergence in Values may be due to inconsistent assumptions under 32 (a) to (f) for the two valuers. Valuation computed by Valuers during Liquidation is a bit more complex. The Regulation 32 (a) to (f) imagines a no of possibilities under which sales of assets or CD's business can materialize.
  a. Liquidator may sell assets on a standalone basis.
  b. Assets on a slump sale basis
  c. Set of assets collectively
  d. Assets in parcels
  e. CD as a Going concern
  f. The businesses of the assets as a going concern
- Work is awarded to different asset category Valuers in CIRP or Liquidation and Intangible assets are left out: Under IBC, Valuers may be awarded work separately for valuation of three asset categories. (Over all six valuers, two for each asset category). This, can lead to divergent, approaches and premises of Valuation for asset categories, while Plant and Machinery may compute values using replacement cost method, Land may be valued on market basis and buildings on replacement cost basis.

While realization value is computed for financial assets and Intangibles. Significant intangibles like Sales contracts, raw material contracts, mining rights, technical knowhow / trained manpower, may be completely left out by valuers.

- It is not always known whether list of all the machines has been provided to the Registered Valuer, whether machines are in working condition or are even having all the parts
- complete details of the status of legal cases or any litigation in respect of matters pertaining to business or promotors are generally not available In some cases, factors in the plant leading to under Utilization of assets in reality may be completely ignored as Valuers may simply derive replacement costs and not consider a large percentage of non-utilized assets/ over-sized assets, leading to over valuation of assets.
- Physical inspection may not be carried out properly by the Registered valuer
- Valuers work in isolation and silos while preparing valuations, which is fair since confidentiality and independence are to be preserved. However, valuation reports are finalized and submitted without a detailed formal review of all aspects of valuations by personnel competent enough to analyze and review the valuations being submitted
- Lack of appropriate understanding of type of stock and salability factor of different types of inventory
- Relying blindly on data given by Resolution Professional / Corporate debtor and RV not doing intense market survey / research to gather sector characteristics
- Valuation exercise is basically a judgmental one and is based on various perceptions formed by different valuers. Sometimes the difference is due to different understanding of the data made available to them. It is also due different methodologies. Specially the land and building valuations is based on different perceptions about the type of land , market value , premium due to corner or some other specialty, circle rate , etc. The building values are also calculated on different parameters as the cost of construction varies in each of valuers mind. Since there is no fixed formula - the values will always be different as per the judgement of each valuer
- Not investing time in vendor and client insight with regard to product and services offered by corporate debtor
- Differences in valuation can arise in CIRP Valuation if everything else remaining same, Valuers make different assumptions / premises about the business of the CD while carrying out valuation under CIRP

  A. Valuer A makes Going Concern assumption (premise);

  B. Valuer B assumes Business is closed unlikely to resume/restart, this may lead to estimating value of assets, using different methods than in the case of a Going concern assumption.

- Valuer A ends up using Income approach which may be inclusive of contribution from personal tangible, land & building, financial assets and intangible assets but in case of a closed business assumption valuers may use cost approach for valuing moveable assets and sum it up with land using market approach and compute realizable value for inventories and other current assets and value intangibles for what they are worth separately. This may lead to Valuers A and B arriving at divergent values
- Differences can arise in CIRP values if everything else remaining same, Valuers take significantly different sales forecasts/ utilization/ revenue rates.

  A. Under Going Concern assumption, assumptions may vary related to plants Capacity utilization during forecast, price realization leading to different revenue forecasts. For example, if Valuer A takes an assumption of 50% PLF for a power plant, he may end with a much lower value than another Valuer who assumes PLF at 60~65%. This can be checked by doing sensitivity calculations at varied PLF. If Revenue unit rates / Sales rate assumptions are quite divergent, again this can lead to different values even though capacities utilization assumed are same. Again, this can be prevented performing sensitivity calculations in relation to rates. Similarly with different computations

around discount factors for present Value calculations of Cash flows Valuers may arrive at divergent values.

B. Values may be divergent between two valuers, if one valuer uses a sales comparison approach to value a going concern while the other uses an income approach. Assessment then needs to be made if sales comparison is of a comparable asset, under similar market conditions.

- Not investigating legal agreements which have direct implications on value especially in real estate projects
- Valuers don't use similar assumptions claiming the need for their independence, which is fair
- Valuers, while following the requisite and mandatory Valuation Standards use their own customized/bespoke valuation model(s), which are based on their individual interpretation of the Valuation Standards. There can be a difference in interpretation, which leads to inaccurate models being created and adopted.
- Valuers, between them, don't have similar level of experience when valuing the same asset(s) and liability (ies). Further, Valuers don't have similar past exposure to valuing asset(s) and liability (ies) like the asset(s) and liability (ies) being valued.
- Assuming arbitrary % while valuing debtors, inventories, loans and advances or other financial assets without a rational basis. Both the Valuers have their own perspective in understanding the value, importance and usefulness of asset and therefore probability of recovery is also different.
- Different uses of land and Building : Every land and building has a different use for different person. Therefore while valuing the Land and building so many factors play different roles to both the Valuers, like area where land and building is situated, further how highest and best use of that asset can be done, then Calculation of the construction value of the asset.
- Different uses of Plant and Machinery : When a Valuer is valuing Plant and Machinery it is very important as to how they are valuing, what method they are applying and what different usage of that machinery are? May be one Valuer is valuing at Written down value and another one at replaceable value. Further whether Valuers are aware of different uses of that Plant and machinery, that is what will be the demand of the plant and machinery at the time of sale.

Because of above scenarios, how one Registered valuer perceives the company / value vs the other Registered Valuer is bound to differ .This also drives one to be conservative at times.

Recommendations for minimizing discernible difference between valuation provided by two Registered valuers in each asset class in IBC matters

- At the time of commencement of the valuation process, the RP and the COC should have a meeting with the Registered valuers and discuss the various parameters (already finalized by RP and COC) which should be considered by the valuers in their working. Such meetings should encourage the inclusion of valuers views as well so that all (two valuers, RP, COC) are on the same page right in the beginning of the exercise.
- The appointment of valuers should be done carefully by the RP.
- The RP/ COC should give a common briefing to both the valuers in the beginning.
- There is an imperative need for developing Valuation Standards under IBC so as to provide a uniform basis for valuation exercise carried out by two Registered valuers for each asset class
- The art vs science perception should change (consciously conveyed to valuers)
- RP should make a comparison chart in respect of the valuations provided by the two Registered valuers and first understand the differences and reasons thereof.
- RP should specify Going Concern or alternate or both premises in the scope of work.
- The scope of work should clarify agreed premises for both valuers using same definition of Liquidation Value
- Selection of Valuers for each asset and/or liability must be done after careful perusal and review of their past experience and exposure to valuing asset(s) and/or liability (ies) that are similar to the asset(s) and/or liability (ies) to be valued. This shall be factored

in by the IP at the time of appointment

- Registered valuer needs to discuss the valuation report with RP and explain the reasons for the difference and Justification. This will help in bridging the gap between RP and RVs perspectives.
- Insolvency Professional must deep dive in to the valuation report provided by the Registered valuer and get logical understanding of process and methodologies adopted by Registered Valuer .RP may dedicate senior person to track and review the entire cycle of valuation process to understand and facilitate appropriate valuation)
- The Registered Valuers should clearly outline in the report that which intangibles have been accounted in the approach used. That in case of a closed company where some of these intangibles cannot be realized separately, a clear mention is made of intangibles that are possible to realize separately and where some of these intangibles are to be considered as integrated with other assets and those have been valued as other assets.
- There is a need for Resolution professionals pushing for some sort of iterative work when draft reports are shared to bring parity in the approaches and ensuring that consistent Discount factors or assumptions related to forecasts are made.
- A common virtual data room must be created for information about each asset and liability, and Valuers must access and refer to the same information in the same data room when valuing the same asset(s) and/or liability (ies).
- A format / template that requires reason(s) and basis (es) for selection and justification of assumptions used needs to be designed and made mandatory for adoption by all Registered Valuers in every valuation report.
- There needs to be a set of basic guidelines and model valuation model templates (which may customized considering the asset(s) and/or liability (ies) being valued) that need to be followed by Valuers. While modifications may be permitted on certain areas, the overall construct and fundamental logic must not be tampered with when modifying the same. Rule 8(3) of the valuation rules to be strictly followed by RV's. Also guideline on liquidation discount on certain assets especially those in deep distress may be provided by the regulator.
- A platform needs to be created that allows for discussion between Registered Valuers valuing the same assets in the presence of Resolution professional who will mediate the discussions. These discussions must focus only on assumptions, premise, approaches, availability and quality of information / documents aspects, and not on the final valuations being arrived at by the individual Valuers
- There is an imperative need for capacity building of Resolution Professionals in valuation domain. The Resolution Professionals should be exposed to a Structure Course in valuation

ANALYSIS OF EBITDA AND NORMALIZATION OF EBITDA

Ishan Tulsian
Registered Valuer SFA (IBBI)

Meaning and significance of EBITDA:

EBITDA means *Earnings Before Interest, Taxes, Depreciation and Amortization* and is a useful measure of operating performance by allowing evaluation of productivity, efficiency and return on capital, without considering the impacts of interest expenses, asset base, tax expenses, and other operating costs. EBITDA is used by analysts and other professionals to compare companies across and within the same industry.

The most widely used and comparable measure of cash flow is EBITDA as it represents a business's cash-generating ability before the impact of burden by capital assets, debt and taxes. Therefore, businesses with varying levels of debt, capital assets or even subject to different tax rates may be compared with each other since there are no such impacts on EBITDA.

Meaning and significance of Normalisation of EBITDA:

Normalization of EBITDA is the process of eliminating non-recurring, extraordinary, and irregular or non-core expenses or income which after adjustments represent the future earning capacity which may be expected from the business by the buyer.

Normalized or Adjusted EBITDA is an effective valuation tool which may prove to be useful during acquisition of a business since it eliminates deviations and irregularities and regularizes historical streams of cash flows.

It is suggested to calculate the EBITDA from the most recent trailing 12 months financial statements. Thereafter, the buyer and seller shall apply several normalizing adjustments and "add-backs" to EBITDA to calculate the Adjusted EBITDA. The adjusted EBITDA represents the earning stream moving forward for the buyer and may reflect certain non-recurring expense items which may be debited in the Income Statement and which may cease after the transaction is closed and may require to be added back to the EBITDA.

It is imperative to determine the underlying earning capability of the business and it is advisable to the buyer to estimate the negative adjustments to historical EBITDA as well, which may be in the nature of new expense items, post acquisition that may reduce the going-forward EBITDA.

Amongst other popular valuation methods to value a business, multiple of the company's normalized EBITDA is an easy and effective method for valuing a company (i.e. 6x TTM EBITDA). Usually, normalizing EBITDA leads to a higher post acquisition EBITDA by adding back non-recurring and extraordinary expenses and therefore, the sellers and their engaged investment bankers are motivated to obtain such a higher EBITDA which would lead to a higher valuation of business by the EBITDA Multiple method.

On the contrary, the buyers are alert to ensure that such normalization adjustments do not lead to an overstated EBITDA and they do not pay for such value of business which may not be realized in the future. A significant amount of time is invested by the buyer in verifying and scrutinising the normalisation adjustments made by the seller as well, as sifting through books of accounts and forecasted financials to unearth non-recurring income that may reduce the EBITDA and therefore the transaction price.

Formula for EBITDA and Normalised/Adjusted EBITDA:

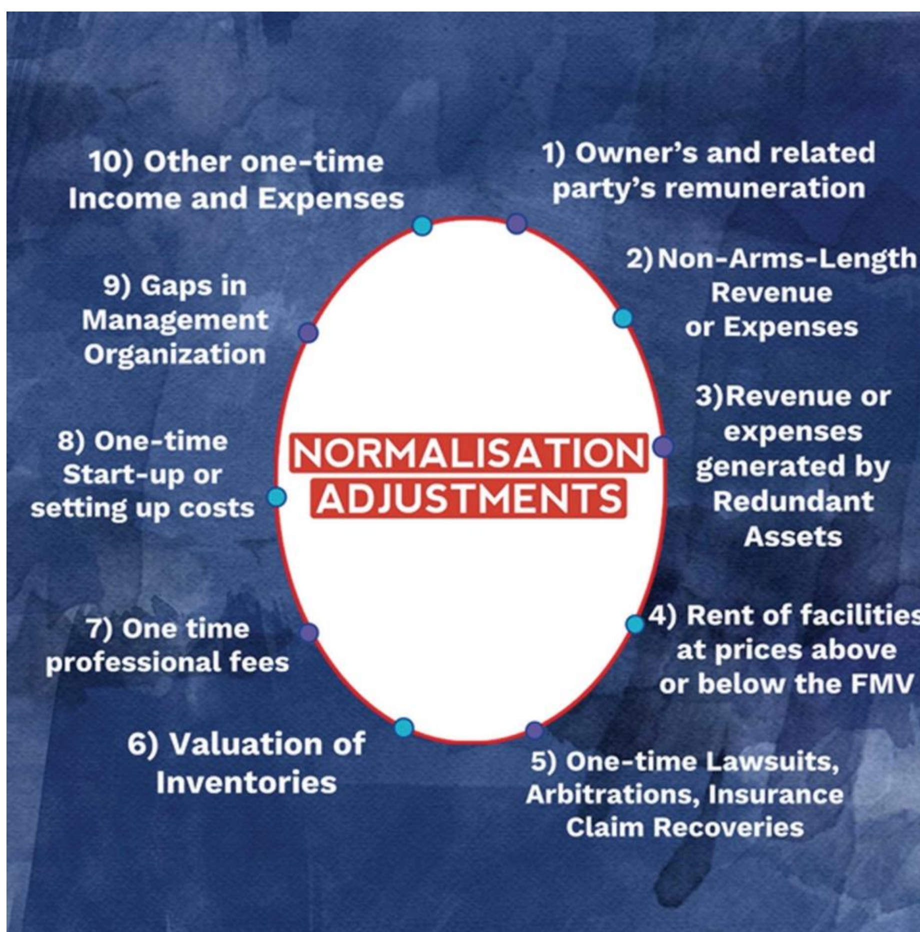
Standard EBITDA= net income + income tax + interest expense + depreciation and amortization

Normalized EBITDA= Standard EBITDA +/- Adjustments

There are few scenarios in which Normalisation of EBITDA becomes imperative and which are as follows:

1. Non-recurring, irregular or one-time income, revenue or expense which is not expected to recur each year.
2. Amounts of income, expense, capital assets, revenue which are not recorded at the fair market value in the financial statements.
3. Overly aggressive or conservative application of an accounting policy or accounting estimate.Below are some of the most common adjustments found in small to mid-size companies grouped under non-recurring and non-core revenues and expenses.

These adjustments that are made to EBITDA can vary widely by industry, company, time, and case by case:-



Source: *Self*

Detailed analysis of Normalizing Adjustments:

1. Owner's and related party's remuneration and Compensation:

A. Business owners, usually of private limited companies, having control over the amount of remuneration to be paid to self, often may remunerate themselves with a higher or a lower salary than as compared to that of an independent third-party manager.

B. Therefore, their remuneration may not be marked-to-market and may reek of owner's bias since they may provide for a higher remuneration as a tax mitigation strategy in a certain financial year or may provide for a lower salary than fair market value in order to record a higher net income for a certain financial year.

C. Also, the owner may declare extraordinary bonuses at the end of the year to the managerial personnel in order to save income tax for the business entity.

D. Therefore, in order to remove the owner's bias, the valuer may add back such superfluous or understated remuneration and subtract the remuneration paid to a third-party manager for similar services towards either operational management, intellectual engagement or business development paid in similar organisations in alike circumstances, to the recurring EBITDA to obtain a normalized EBITDA.

E. Specific owner-related business and personal expenses debited to the income statement which may not continue to incur after the business acquisition transaction may be added back to the historical EBITDA. Example of such expenses may be expenses related to personal vehicles, health or life or auto insurance, Keyman Insurance, inordinately high travelling and accommodation expenses, entertainment expenses and club and association memberships.

F. Higher salaries and other remuneration paid to certain

family members who may not be actively involved in the operations of the business may be added back and salary of third-party manager at fair market value or at a market-based salary may be subtracted to obtain the recurring EBITDA.

G. Such owner-related expenses may not be eliminated in such circumstances when the potential buyer is anticipating a replacement of the owner who may require similar services, perquisites or other benefits valued similarly.

2. Non-Arms-Length Revenue or Expenses:

A. Such revenue or expenses are a result of related party transactions of the business entity with its related parties at a price which is higher or lower than the market rates and requires modification in the historical EBITDA by eliminating such revenue or expenses and taking into consideration such revenues or expenses which are at Arms-Length pricing and are between two unrelated and independent parties.

B. Few examples of sales or expenses that are not at an arm's-length transaction are (a) Related entities selling products or services to each other at marked-up rates and/or (b) Cross use of employees at no or inadequate remuneration which is not in tandem with the market rates of similar labour input.

C. In case the company under valuation is a subsidiary company of a holding company and majority of its sales are made to its holding company at non-arm's length pricing which may for instance be at a higher rate than the market rate, then the valuer is required to normalize the EBITDA by eliminating the effect of such inflated profit due to such inflated sales to a related party and instead ensure that EBITDA reflects the fair market value of these supplies, when the subsidiary company goes up for sale.

D. In case the company under valuation, purchases supplies from a supplier company in which a director of the former company is interested or a major shareholder and the purchases are made at a price higher than the market value, then the valuer is required to normalize the EBITDA by eliminating the effect of such understated profit due to such inflated purchases from a related party and instead ensure that EBITDA reflects the fair market value of these supplies, when the said company goes up for sale.

E. There may be certain rebates or discounts of which the benefits may not pass on to a new owner and such transactions may also be categorised as at being at non-arm's-length and the valuer should consider reducing such amounts from the historical EBITDA.

F. In case there is synergistic value by virtue of the nature of the transaction itself, then the transaction may not be considered marked-to market, for example say, there may be synergistic value created in certain purchase transactions between a research-based pharmaceuticals company and a retail-based pharmaceuticals company and the same may not be considered to be at market price, then the valuer may have to consider normalizing the EBITDA in case one of the companies goes up for sale but not with the other company.

3. Revenue or expenses generated by Redundant Assets:

A. Expenses incurred on redundant assets or non-productive assets i.e. assets owned by the company that don't contribute to revenue-generating activities or towards the operation of the business, may be added back to the historical EBITDA to normalize the recurring EBITDA.

B. Income from redundant assets or non-productive assets i.e. assets owned by the company that don't contribute to revenue-generating activities or towards the operation of the business, are subtracted from the historical EBITDA to normalize the recurring EBITDA.

C. Say for example, a guest house is maintained for the use and welfare of the employees of the company and such use was provided as an incentive for good performance of such employees or such a guest house was excessively used during COVID times. Since, the guest house is not directly related to the operation of the business and therefore, expenses incurred on its maintenance may be added back to the EBITDA to normalize it.

D. Say for example, a company has 4 manufacturing units and one of it becomes redundant or non-operational due to any reason, then expenses incurred on maintaining the redundant unit may be added back to the EBITDA to normalize it since no corresponding revenue from such a unit may be estimated in the future.

4. Rent of facilities at prices above

or below the Fair Market Value:

A. The seller may own real estate properties in a separate legal entity and may have an existing lease/rental contract with the company under valuation, wherein the latter company may be paying rent above or below the market rent and necessary adjustments are required to be carried out in the historical EBITDA to reflect the fair market rent level.

B. Say for example, in case the office property is given out on rent by the owner-director of a company or the shareholder-director of its holding company and such rent amount is higher than the market rates of rent of similar properties in similar location, then upward adjustments may be required in EBITDA by adding back the arbitrary and non-arm's length rent and reducing the true market rent.

C. Say for example, usually Public Sector Undertakings (PSUs) maintain offices occupied on rent which may be much lower than the market value of rent of similar commercial properties in the same location. Therefore, the EBITDA may be normalized by subtracting the market rent and adding back the actual lower rent. Additionally, the valuer may have to review such rental/ lease contracts for the expiry period and other clauses too.

D. In case a real estate property is owned by the business entity and is redundant or does not contribute to the core-operations of the business or is not critical to the operations and the buyer doesn't intend to avail the property, then related expenses such as insurance, maintenance and property tax and any rental income are required to be removed from the historical EBITDA.

5. Lawsuits, Arbitrations, Insurance Claim Recoveries and One-time disputes:

A. In case the entity is undergoing any one-time or inordinately high and unusual lawsuit which shall not recur in the future, then, it would be appropriate to add back such expenses to the historical EBITDA. It is pertinent to note that regular ongoing legal expenses for which provisioning has been made shall not be considered to be added back to EBITDA.

B. Say for example, making provisions for the expected credit loss on trade receivables is a regular exercise and may not be considered as a one-time event. However, in regard to any extraordinary income or expense in the nature of lawsuits, arbitrations, Insurance Claim recoveries and one-time disputes that may have been settled during the review period and may not recur may require either adding back or subtracting, as the case may be, from EBITDA to normalize it.

C. In case of an insurance recovery on the death of the managing director by virtue of a Keyman Insurance policy undertaken by the company or insurance claim recovery on loss of stocks due to cyclone or insurance recovery on demolition of immovable property due to any natural calamity, such extraordinary incomes would be deducted from EBITDA to normalize it.

6. Valuation of Inventories:

A. During Covid-19 times, the demand for certain FMCG goods had spiked and the suppliers maintained multiple times of the volume of stock to meet the increase in demand, however as soon as the lockdowns were lifted, the demand regularized and the fast movement of stock that lasted for a brief period regularized and resulted in piling up of high volume of closing stock for such suppliers. Therefore, normalization in stock may be required in case of non-recurrent spells of such unexpected stock movement due to unavoidable factors.

B. In certain cases, due to the innate nature of the inventory, the value of the inventory may rise or fall substantially, which may affect the valuation of the business as is in the case of jewellery, gold and other precious metals and stones inventory for jewellers and in computing the normalized EBITDA, the valuer may have to take into consideration the future forecasted prices of such precious metals during the forecasted period and may consider the same to ensure relevant valuation of business.

C. In case the business requires equipments to provide services which shall further require the purchase of parts and components throughout the year. Usually, an estimated general allowance is provided to meet the expenditure of such parts and components and in case the value of such parts exceeds such an allowance provided, then it may be advisable to value this inventory close to the date of selling of business. Also, any excess amount of value of such parts over and above the general allowance may be added back to EBITDA to normalize it.

D. The management should identify the value of slow-moving inventory or obsolete

inventory which is required to be written off or sold as scrap. The valuer should ensure normalization in inventory by eliminating such type of stock from the closing balance of inventory so that the valuation of business is not affected.

7. One time professional fees:

A. There may be one-time professional fees paid in regard to setting up a new service vertical or a business unit or a branch and additionally other related costs may be incurred such as research and development costs, marketing costs, training costs and other setting up costs, which are non-recurring in nature and are specific to the new service vertical. Such non-recurring expenses should be added back to the EBITDA to normalize it.

B. In case the business is currently subject to the exposure of a one-time or inordinately and unusually high amount of payout due to a lawsuit which further involves the payout of a non-recurring third-party professional legal fees, consulting fees, accounting fees and/or engineering fees, then such amounts of professional fees should be considered to be added back to the historical EBITDA.

C. However, regular legal expenses which is a part and parcel of the operation of the business and for which a provision may also have been created, would not be considered to be added back to EBITDA since such expenses are due to the innate nature of the business and shall be expected to be continued in the future as well.

D. Once the buyout transaction goes through, the buyer's existing support infrastructure including the accounting department, engineering staff, legal staff, Human Resource department or other professional departments would continue and such professional third-party expenses for similar services would no longer be required to be incurred, therefore, such expenses are to be added back to the Historical EBITDA.

E. One-time professional fees may be required for the set-up of family trusts, HUFs, entity restructuring or insurance claims and since such expenses are non-recurring in nature are to be considered to be added back or subtracted, as the case may be, to the Historical EBITDA.

8. One-time Start-up or setting up costs:

A. Such start-up costs and related setting up costs are non-recurring and considered sunk costs that will not be incurred going forward and in case the same has been incurred in relation to the launch of a new business vertical in the same period, then it should be added back to the historical EBITDA.

B. Say for Example, in case of valuation of Swiggy wherein the core business model is that of food delivery but recently Swiggy has started a new service vertical of grocery delivery named Swiggy Instamart. While considering the historical results of Swiggy, the set-up costs and other associated costs in regard to the new vertical being a one-time expenditure which shall not recur, may be added back to the historical EBITDA for its normalization, unless the incidence of introduction of new service verticals is frequent.

9. Gaps in Management Organization:

A. In case the organisation is primarily owner-driven or post acquisition by the buyer, existing key managerial personnel may exit the organisation and the buyer may require to hire new talent to fill the gaps in the top line and the functional level of the management. There would likely be a negative adjustment to EBITDA for remuneration, benefits and other items related to the new hires.

B. Also, a simple bookkeeper may be required to be replaced with a more experienced financial executive or a virtual CFO, financial controller or a Chartered Accountant as per the growing requirement of the organisation by the buyer and such additional remuneration may have a negative impact on the historical EBITDA.

10. Other one-time Income and Expenses:

A. Discretionary extraordinary nature of income or expenses which are non-recurring may be classified in this category such as record one-time employee bonuses or special donation expenses which should be considered to be added back to EBITDA to normalize it.

B. In case of excessive amount or a meagre amount of repair and maintenance expenses have been incurred in certain years, then forecasting of adequate amount of repair and maintenance costs should be made with regard to the age and condition of the fixed assets which shall be incurred in the future.

C. In certain cases, business owners may have aggressively expensed the purchase price

of capital assets instead of capitalizing the same and to claim depreciation expense over time on the balance sheet. The valuer should ensure that the historical EBITDA has not been negatively impacted by such accounting practice of the seller.

D. The valuer should evaluate and be aware of other extraordinary items such as changes in amount of upcoming insurance (positive or negative), upcoming wage rates increases (negative), fire, cyclone or other natural disasters that have caused one-time expenses for repair or reconstruction (positive), a one-time major building renovation or repair cost (positive), non-IND-AS or non-Indian GAAP or unusual accounting practices adopted by the seller (positive or negative), and deferred capital expenditures/maintenance on equipment (negative).

E. Additionally the valuer should be alert and sift out other non-recurring and one-time expenses such as loss due to fraud, misfeasance, theft or siphoning off funds, loss caused due to labour strike or lockouts, unusual amount of gain or losses on disposal of assets, one-time movement and relocation of office expenses, extraordinary human resource related expenses such as CEO recruitment fees or severance package costs of other KMPs, goodwill impairment, and unusual gain or loss due to Foreign Exchange fluctuations and carry out necessary normalization adjustments to the historical EBITDA.

The process of Normalization of historical EBITDA may be illustrated using the following example

S.No	Particulars	Effect on EBITDA	Amount (in Rs.)
	Historical EBITDA		10,50,75,250
a)	Incremental remuneration paid to owner versus marked-to-market remuneration of third-party manager i.e. adjustment for owner's bias	(+)	15,75,000
b)	Incremental remuneration paid to inactive owner's relatives versus marked-to-market remuneration of similar third-party manager i.e. adjustment for owner's bias	(+)	6,45,000
c)	Inordinately high owner-specific expenses including health, auto and life insurance, club memberships and travelling expenses not to be incurred post acquisition transaction by the buyer.	(+)	7,15,000
d)	Incremental income due to related party transactions at Non-Arms-Length prices.	(-)	25,75,000
e)	Remuneration not charged to group entities on cross-use of manpower services	(+)	5,85,000
f)	Expenses incurred on Redundant Assets	(+)	5,25,000
g)	Incremental rental expenditure due to Rent of facilities at prices above the Fair Market Value	(+)	8,85,000
h)	Lawsuits, Arbitrations and One-time disputes	(+)	12,45,250
i)	One-time professional fees	(+)	3,50,000
j)	One-time Start-up or setting up costs	(+)	17,89,000
k)	Remuneration of new key managerial personnel hired to fill the role of the owner	(-)	25,85,000

l)	One-time extraordinary bonus to KMPs	(+)	7,75,000
m)	Loss on damage to P&M due to *Amphan* cyclone	(+)	4,25,000
n)	Non-recurring Insurance claim received on loss of inventory due to fire- breakout	(-)	2,50,000
o)	One-time Special donation expense	(+)	1,50,000
p)	Expensing of acquisition of fixed asset instead of capitalization (Adjustment net of depreciation)	(+)	12,75,000
q)	Loss due to non-recurring fraud and misfeasance by company staff	(+)	3,50,000
r)	Unusual gain on disposal of fixed asset	(-)	4,50,000
s)	EBITDA overstated due to adoption of inappropriate accounting policies and practices now adjusted	(-)	3,65,000
t)	One-time expenses on relocation of registered office	(+)	4,25,000
u)	Unusual gain due to foreign exchange fluctuations.	(-)	6,45,000
v)	No requirement of expenses of third-party professional services due to presence of buyer's support infrastructure.	(+)	9,65,000
	Normalized EBITDA		11,08,84,500

Source: *Self*

In case the Registered Valuer adopts EBITDA multiple of 8x as the valuation methodology, then it is notable that the Valuation of the business, considering Standard EBITDA before normalization adjustments, is Rs. 84,06,02,000 and the Valuation of the business, considering Adjusted/Normalized EBITDA after normalization adjustments, is Rs. 88,70,76,000. The incremental EBITDA due to normalization adjustments is Rs. 58,09,250 and therefore, an amount of Rs. 4,64,74,000 (i.e. Rs. 58,09,250 x 8) is to be paid more by the buyer since the valuer while adopting any valuation methodology including the EBITDA multiple method of relative valuation of business, would consider the parameter of Normalized EBITDA instead of Standard EBITDA being more reflective of the true value of the business.

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BASES, METHODS AND IMPORTANCE OF VALUATION FOR PLANT & MACHINERY

CMA Shweta Shah
Tax Professional

The basis of valuation for a machinery valuation could be Market Value, Equitable Value or Fair Value. Each of these three bases has its own definition.

The basis of valuation is determined by the purpose of valuation, for example if the purpose of the exercise is to ascertain an expected selling / asking price on the open market, then Market Value is the appropriate basis. However, if a closed (private treaty) transaction is envisaged involving a sale to an identified purchaser and one wants to determine the fair price to be paid, then potentially Equitable Value would be appropriate.

If the valuation is for Financial Statement purposes, e.g. to determine the balance sheet value of some assets, then the Accounting Standards (IFRS and UK GAAP) dictate that the basis of valuation should be Fair Value.

Definitions:

- Market Value: The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgably, prudently and without compulsion.
- Equitable Value: The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.
- Fair Value: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market (sector) participants at the measurement date.

Fundamental assumptions must then be adopted under each basis, the most common being in respect of Market Value or Equitable Value, i.e. whether the machinery is to be valued as a whole in-situ, for use in its working place (i.e. as a 'turn key operation') or valued for removal from the premises at the expense of the purchaser ('ex-situ value').

(n.b. one other 'Basis of valuation' would be 'Insurance Valuation' which considers the reinstatement (replacement) cost of the assets in the event of a loss (either reinstated as new ('new for old'), or replacement with second hand assets of the same age ('indemnity'), however, some would say this is an assessment rather than a valuation per se).

The method of valuation, on the other hand, is determined by the approach the valuer uses to reach his or her opinion on whatever basis they have adopted. All valuations adopt either a market approach, a cost approach or an income approach (or a combination of these approaches).

So when we receive an instruction, the first thing to be determined is what is to be valued (i.e. the subject matter and the interest) and who the client is. Then we need to know the purpose of valuation, so that we can advise as to correct basis of valuation (we also need to know where the assets are located and when they need to be valued, i.e. the date of valuation). I call the ascertaining of this information at the outset the 'who, what, why, where and when' rule.

Once these facts are established, we can determine the most appropriate method of valuation, for example:

1. The comparison method (i.e. analysing historical market transactions) which is a 'market approach';
2. The Depreciated Replacement Cost (DRC) method (i.e. depreciating the new replacement price / cost of the machine by estimating its age, economic life and residual value, in order to opine on its current value) which is a 'cost approach', or;
3. A combination of the above two approaches (which is often my favoured approach), i.e. a DRC framed with reference to market evidence.

Plant & Machinery valuations generally adopt one of these methods, however, the comparison method can also be stretched to include speaking with dealers for anecdotal market evidence / opinions and considering asking prices for similar assets.

Income approaches can sometimes be adopted for machines which have an income stream directly attributable to them, but this is rare in my experience. The income approach is much more commonly used to value intangible assets / goodwill.

Finally, the basis and method of valuation should, if appropriate, also have reference to the best method of sale envisaged. For example, if we are considering a sale by auction to be the best way of maximising the realisation, then Market Value ex-situ assuming a sale as individual items is appropriate (and the prime method of valuation would be to seek auction sale comparables).

If however, a sale of all the machines by private treaty for removal is considered a better option, then Market Value ex-situ assuming a sale of the assets as a whole is more appropriate, and all comparable market evidence would be sought and considered."

Need & Importance of plant and machinery valuation:

1. Realistic Financial Reporting!

It's important to correctly record the fair market value of the plant and facilities. Your financial statements should make it easy for consumers to understand an entity's spending inland, facility, and facilities, as well as improvements in that investment.

2. Verification of Assets!

Both plant and machinery valuers must understand the properties they are purchasing.

When you go through the plant and machinery valuation process, you'll see that this is an opportunity that the company will use. That is critical for the long-term success of every business.

3. Estimated Useful Life Left!

When calculating the remaining useful life, valuation is also essential. The remaining usable life of a plant or machine is the amount of time it will work until it has to be repaired or replaced.

Understanding this will aid in scheduling repairs, avoiding downtime, and optimizing operational performance.

4. Regulation of Risks!

It's essential to stay on top of possible threats to your company if you want to manage them successfully and efficiently.

If you have a valuation, you'll be able to figure out what financial and logistical risks you could face. This aids you in comprehending the possible threats to which you should be alert as a company going forward.

5. Valuation of a Business!

You must thoroughly and independently log your plant and machinery valuation in addition to benefiting your company.

This allows you to know just how much all of your most valuable investments are worth to your company, which is critical in today's business world.

If you do so, you can have a much better chance of getting a fair valuation.

6. Purchasing and Trading Machinery!

Keeping a value in mind, on the other hand, allows you to know what you could/should buy and sell for when the time comes.

This encourages you to get the highest offer for your money while still ensuring that you are not misled by what constitutes a "fair deal" for your business.

7. Finance for Equipment!

Finally, plant and machinery valuation are essential because it determines how much funding you will need.

A complete valuation package will assist you with getting the work done quickly and reliably if you need to put in additional equipment to finish an assignment.

This informs you of the amount of money you'll need to raise if you want to grow further.

Plant and Machinery Valuers – What They Do?

- ✓ Plant and machinery valuers are used to determine an organization's plant, machinery, and equipment valuation.
- ✓ The complexity of plant and machinery valuers can be significant in sectors such as transportation, warehousing and logistics, forestry, and manufacturing.
- ✓ Regardless of the sector, valuing specific properties requires the services of a valuation expert for many purposes.

How to become a Registered Valuer?

The Central Government, vide a notification dated 23rd October, 2017, issued the Companies (Removal of Difficulties) Second Order, 2017 to provide that valuations required under the Companies Act, 2013 shall be undertaken by a person who, having the necessary qualifications and experience, and being a valuer member of a recognised valuer organisation, is registered as a valuer with the Authority. Vide another notification on the same date, the Central Government delegated its powers and functions under section 247 of the Companies Act, 2013 to the Insolvency and Bankruptcy Board of India (IBBI) and specified the IBBI as the Authority under the Companies (Registered Valuers and Valuation) Rules, 2017.

The Companies (Registered Valuers and Valuation) Rules, 2017, as amended, require that only a person registered with the IBBI as a registered valuer can conduct valuations required under the Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016 with effect from 1st February, 2019. A person, who is rendering valuation services under the Companies Act, 2013, may continue to do so without a certificate of registration up to 31st January, 2019.

There are three categories of Registered Valuer on the basis of Assets Class:

Land & Building Valuer

Plant & Machinery Valuer

Securities or Financial Assets Valuer

Become a Registered Valuer

Step-I: Qualification and Experience

As per rule 4 read with Annexure-IV of the *Companies (Registered Valuers and Valuation) Rules, 2017*, an individual shall have the following qualifications and experience to be eligible for registration as Registered Valuer:

In short:

Graduate + 5 years post qualification experience, or

Post Graduate + 3 years post qualification experience, or

Membership of a professional institute + 3 years post qualification experience.

Asset Class	Qualifications	Experience in specified qualifications discipline
Plant & 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;	5 Years
	(ii) Post Graduate on above courses.	3 Years
Land & Building	(i) Graduate in Civil Engineering, Architecture, or Town Planning or equivalent;	5 Years
	(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)	3 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).	3 Years
	(ii) Post Graduate in Finance	3 Years

Other eligibility criteria as under:

1. is not a minor;
2. has not been declared to be of unsound mind;
3. is not an undischarged bankrupt, or has not applied to be adjudicated as a bankrupt;
4. is a person resident in India; *Explanation*.— For the purposes of these rules 'person resident in India' shall have the same meaning as defined in clause (v) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999) as far as it is applicable to an individual;
5. has not been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence: Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;
6. has not been levied a penalty under section 271J of Income-tax Act, 1961 (43 of 1961) and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal, as the case may be has expired, or such penalty has been confirmed by Income-tax Appellate Tribunal, and five years have not elapsed after levy of such penalty; and
1. is a fit and proper person: Explanation.— For determining whether an individual is a fit and proper person under these rules, the authority may take account of any relevant consideration, including but not limited to the following criteria-
   i) integrity, reputation and character,
   ii) absence of convictions and restraint orders, and iii) competence and financial solvency.

Step-II Enrollment with a Registered Valuer Organisation (RVO)

A person possess qualifications as described under step-I, seek enrollment as a valuer member of a RVO recognized by the IBBI.

Step-III: Educational course

After enrolment, as a member of a RVO, complete the educational course recognised by the IBBI.

The syllabus, format and frequency of the valuation examination, including qualifying marks, shall be published on the website of IBBI at least three months before the examination. An individual may appear for the valuation examination any number of times. An individual who passes the valuation examination, shall receive acknowledgement of passing the examination.

Step-IV: Syllabus & Valuation Examination

Register and pass the computer based Valuation Examination of the relevant Asset Class conducted by the IBBI.

Step-V: Register as Registered Valuer

Once passed the Valuation Examination, a members can apply for registration within 3 years preceding the date of making an application for registration.

References:

1. */ibclaw.in/how-to-become-a-registered-valuer/*
2. *https://www.rakeshnarula.com/blog/plant-and-machinery-valuation-know-its-worth/*
3. *https://www.marriottco.co.uk/bases-methods-valuation-plant-machinery/*

AUTHENTICITY OF DATA WHILE ASSESSING VALUATION OF LAND & BUILDING PROPERTY

Sohom Sen
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Introduction

Valuation of Land & Building is a method to calculate the estimated Fair market Value of a Property which should be exchange on the valuation date between a willing buyer and A Willing seller in an Arm's length transaction [1.] But before we assess the value of a subject, firstly we need to check out the title or ownership of the particular. The valuation on Land and building field is not only limited to assess the structure or market's demand & supply. Also it includes the legal status of the property. Inthis article I am Discuss about some points regarding some data's, which are must needed for checkout the authenticity of the title of the Land or Land & Building Properties.

A. Reasons to Authenticate the Title

In our country India, It is necessary to authenticate title of a Land or Land with Building which is owned. One who needs to transfer the property it must be free from all charges, encumbrances. Before convey of the immovable properties, between two living persons' are happen we must ensure the lien or charges or any other legal encumbrances are there or not. Because there are many frauds were already happened in our country which results losses of crores of amount into wrong hand. Some of the types are Forged Deed Fraud, Loan on Fake Title, Unclear Property Title &So on.

After the Land reforms & revenue act is passed and came into scenario, frauds on the property or Real estate market becomes high, some of are Emmar Properties Scam, Rangmahal Cooperative Group Housing Scheme Scam, Noida Land Scam[2] and So on. Which scams and frauds are not only affected the People's Trust and Faith on Indian housing industry also affects the Indian economy very much. The Govt. Taxation on real estate, RERA Act, Stamp Duty Charges, Demonetization, invasion of GST, FDI, urban and rural Bylaws all these factors indirectly restrics fraudulent transactions and Investments in very minor percentage.

By Keeping all the scenario in mind, the Indian (land and building) valuation industry also beware ofthe frauds and trying to keeps bank and financial intuitions on safe side by making mistakes or fundon fraudulent properties.

B. List of the documents which are need to be checked

There are List of Documents which is needed to check during valuation and inspection of Land or Land & Building Properties:

1. Title Deed
2. Mutation of the Land
3. Khatian or Porcha or Record of Rights online check
4. Land Conversion and Land Use Compatibility Certificate
5. Sanction Building Plan Or Site Plan
6. Holding Tax
7. Market Survey & Neighborhood.

These are the list of documents before persuing a valuation work of a project based on Land &Building. Since those documents are linked with each other, I will discuss it on the next point.

C. Points in Brief

1. Title Deed – Title Deeds of a property are the legal document that transfers ownership of the property. They are typically used to transfer property from one individual to another. A

   Document that state and proves a living person's right to own a piece of land or land and building[3]. Basically a deed is a formal document that defines how a property is owned, transferred and inherited.

   So, it is necessary to obtain and check the title deed or ownership deed. In the case of

bank loan purpose sometimes it is seen that the applicant is not owner (who owns the property), in that case the relationships to the owner are need to verify during the valuation work.

2. Mutation of Land Or Property – Mutation of a Land or Land and Building, is a process of recording the charge or transfer in the Title of Ownership, once the property is transferred or sold[4]. Once Mutation is done, the same is recorded in the Land revenue Department. Mutation is a Process is not legally enforceable but it is an important document as a proof of possession, Proof of land related disputes at the local level. The Supreme Court clarified that mutation does not give title to property. It also confirmed that a land mutation in revenue records does not create or destroy the title over any property. It only allows the person to pay the land revenue in whose name the mutation has been made[5].

   In the Bank or FI's Valuation Cases, when some valuation work for recent resell property is there, Mutation of the property in the name of new Owner has to be checked.

3. Khatian Or Porcha Or Record of Rights – khatian is generally done after taking possession of the property, It helps to minimize the land related disputes which is generally occurred by claiming others land, it also helps avoid the legal hassles in the court in transparent manner.

   Khatian is the individual land record certificate, indicates genuine title over the land. The term "Khatian" is commonly used to mean "record-of-rights". Every entry of the khatian shows its own khatian number, plot numbers, bata plot numbers, area, mouza, names and shares of the possessors, descriptions of their rights and superior interests etc. Different Khatians had been prepared during different surveys. Such as, C.S. khatian prepared during Cadastral survey (1892-1898) under the Bengal Tenancy Act, 1885; S.A. khatian prepared during the State Acquisition Survey under the State Acquisition and Tenancy Act, 1950; R.S. Khatian prepared during the Revisional Survey (1925-1930)[6].

4. Land Conversion and Land use Compatibility certificate (L.U.C.C) – Land conversion and Land Use compatibility certificate is permission of usage of the land from the Government. It Notifies in Section 4C of Land Revenue act,1955[7].

   Generally the land is a Limited resource in the world it cannot be stretched or produced. Land is one of the main factors of production employability, productivity, and so on. So by the changing the classification of land it can be possible. As an Example, from today, many years back, The Salt Lake of Kolkata city is just an Agricultural field. after many years later when the population, productivity rises of Kolkata city, People needs Home to stay, so the Govt. Change the Classification of Particular piece agricultural Land into Homestead or bastu Land, so By Changing the Classification the Govt. Records the piece of land as a homestead land and earn tax as a revenue from the particular land. This is happens all over the India. It helps to separate the zoning system in an organised manner that is Bastu land, Industrial Land, Commercial Land, Khas or Vested Land, Godown, Agricultural Land and So on. So, Usage of Land is Must Checked before giving value, as because in the manner of Usage and Classification of Land is differ, it Affects the Value, which leads to economical obsolence.

   Also by Violating the usage of land may leads to legal encumbrances from Local or ULB's.

   L.U.C.C is same as Conversion, Before erect a new structure on the Land, the L.U.C.C is needed for Sanctioning the Drawing from the Concerned authority.

5. Sanction Building Plan or Site Plan of the Land – When someone wishes to erect a new building on a Land, The Building plan is need to be prepared By Licensed building Surveyor or A Structural Engineer. As per the rules when a R.C.C Building is constructed it follows some of the bylaws which is made by ULB's which must be included in National Building code. Some of these are Width of the access road, Setback from the boundaries from the land, Land Coverage, FSI, Water Harvesting system and so on. These bylaws should be followed when construction of a New Structure, which is directly associate with the value

of the Said property. Generally when a plan is Drawn, the Owner name (Owner of the Landed Property) and Physical and Legal address should be mentioned. During the Valuation of a Building which is constructed it must be tally with Sanction Building plan. The Plinth area and ground coverage area must be check physically. If there is any minor violation is observed it must be noted in remarks of the report.

In case of Gram Panchayet area, Building plan need to be passed from concerned authority i.e. Pradhan or Secretary or Nirman Sahayak, or Block Development Officer. For Tin shaded semi pucca structure there is No such rules are there except the set back. Sanction Plan is Very much important while accessing value of the building, It Complies bylaws and minimizes risk of Demolition of the structure.

On other hand Site plan ensures that Land Shape, Size, area which are owned. It ensures the particular piece of land is in the name of Owner. Generally when a Title Deed is made, the site plan is Provide along with that which includes Plot no, khatian No, Boundaries of the said landed property and so on.

6. Holding Tax - Holding tax or property tax is that annual charge which you pay to the municipal body such as the panchayat, municipality or municipal corporations in your area. The money earned by levying the holding tax is used for maintenance and upkeep of the basic infrastructure and other key facilities in the area including the sewage system, lighting, parks, etc.

   Holding tax is needed to be paid o yearly basis. If not paid the Legal Charges or Lien of ULB's are get into the particular property which are arising a problem during Transfer or Sale of the property. So, during the valuation, The Current Holding Tax or Property Tax Receipt mustbe collected.

7. Market Survey – Moreover Local Enquiry is necessary while inspecting the property.

Conclusion – The Ownership is a Final & Foremost thing of an Individual. The above mentioned points are necessary data while doing valuation. So, Title of a Land or Land & Building property is need to be obtained to avoid legal encumbrances, local problems and so on.

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VALUATION IS AN ART, SCIENCE, CRAFT OR MYSTERY

Kannan Ramasamy
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Valuation is art or science as a long debate is going on in business world while Professor **Aswath Damodaran** (New York University Stern School of Business) says, valuation is neither Art nor Science and it's a craft "Unlike physics and mathematics, indisputably sciences with immutable laws, valuation has principles but none that meet the precision threshold of a science, At the other extreme, valuation is not an art, where your creative instincts can guide you to wherever you want to go and geniuses can make up their own rules. I believe that valuation is a craft, akin to cooking and carpentry." Professor, renowned as Valuation Guru also said Valuation is a story and it cannever just be about numbers only and a good valuation always has a story embedded in it.

There are many values in use viz ; Market Value, Fair Market Value, Liquidation Value, Investment Value, Equity Value, Synergistic Value, Inherent value, Embedded Value, Forced Liquidation Value, Intrinsic Value; we cannot be sure any other values here missed out. As per The International Valuation Standards Council (IVSC), some of these are called as *Bases of value* or standards of *value* that describe the fundamental premises on which the reported *values* will be based. IVSC also states that It is critical that the *basis (or bases) of value* be appropriate to the termsand *purpose* of the valuation assignment, as a *basis of value may* influence or dictate a *valuer's* selectionof methods, inputs and assumptions, and the ultimate opinion of *value*.

With all the above, I would like to add my view to art or science or craft as Valuation is mysteryespecially if at all if are able to analyse the IPO Valuation or IPO prices, the valuation is reallymysterious. Some time back LIC Valuation is being talked around 12-13 lakh Crores and now it is about 6 lakh Crores. The LIC IPO is among top trends and searches in Google for the past fewdays/months. The hyped campaign by many in business circles, Govt, LIC, media etc have already yielded results with opening up of around 35 lac new demat accounts.

Recent news item in Times of India on 26 April shown this IPO is the biggest along with 6 other high amount IPOs since 2008. This triggered the author's analysis on those IPOs and their current position are not encouraging as envisaged. Please review the chart shown on those companies Reliance Power in 2008, Coal India in 2010, New India Assurance in 2017, General Insurance Company (GIC) in 2017, SBI Cards in 2020 and Paytm in 2021. All these shares except Reliance Power had been listed on reduced prices in exchanges on different valuations. Later Reliance Power (3:5), New India Assurance (1:1) and GIC (1:1) issued bonus shares to the stock holders in the same year of IPO's. Currently only SBI Cards current market price is higher than the IPO issue price. (See the chart).

In reviewing the last Calendar year 2021; Out of 63 IPO's (As per NSE Public domain), 40 IPO prices are higher than the current Market prices ranging in absolute increase in the range of 1% to 292% irrespective of period of investment and 23 IPO prices are less than current market prices, ranging in absolute reduction in the range of -1% to -73% irrespective of period of investment.Author resisting himself going into the merits of loss/gain investors are making or the risk involved with small time retail investors with their savings in this analysis, our main focus on the valuation techniques and their mysterious outputs.

All these IPO Valuation, Pricing done by merchant Bankers, we are not privy to the valuation techniques or Valuation processes to arrive at these valuations.

Another scenario of Valuation might be; in Feb 2022, Government has said that 43 large corporate debtors, each having total admitted claims of ₹ 2,500 crore and more were resolved through the Insolvency and Bankruptcy Code (IBC) till December 31, 2021. Along with this added information was that these corporate debtors owed a total of ₹ 5.44 lakh crore to financial creditors while their liquidation value was ₹ 1.06 lakh crore. Further, realisable value for financial creditors through the approved resolution plans was ₹ 1.91 lakh crore, which is 179 per cent of the liquidation value of these corporate debtors, and 35 per cent of the admitted claims. Here the Realisable Value is 179% higher than liquidation Value of 1.06 Lakh Crores, These Valuation might have been done by Valuers, registered with IBBI. But the credit facility was extended to the tune of 5.44 lakh Crores (Considering even only 5 Lakh Crores, leaving the interest portion etc.) must have been based on the fair market Valuation of at least double the amount assuming Banks or Financial creditors must have done Proper credit appraisal of the project, creditworthiness of clients and their skill and experience should be carried out. Along with conducting these analyses, banks should also do a sensitivity analysis and should build safeguards against external factors.

With all the above thoughts for pondering, author wonders and concluded with many names or bases of Valuation, we should add one more that is **Mysterious Valuation**

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VALUATION OF KNOW HOW

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In the context of industrial property (now generally viewed as intellectual property or IP), know-how is a component in the transfer of technology in national and international environments, co-existing with or separate from other IP rights such as patents, trademarks and copyright and is an economic asset. Know-how can be defined as confidentially held, or better, closely held information in the form of unpatented inventions, formulae, designs, drawings, procedures and methods, together with accumulated skills and experience in the hands of a licensor firm's professional personnel which could assist a transferee/ licensee of the object product in its manufacture and use and bring to it a competitive advantage. It can be further supported with privately maintained expert knowledge on the operation, maintenance, use/ application of the object product and of its sale, usage or disposition.

The know-how is the result of professional experience! The know-how is a set of unique technical skills and/or special knowledge acquired in a specific area.

In an industrial company, for example, know-how applies to a particular modus operandi for the design, production or customer service; in the medical sector, it could be a specific gesture by a surgeon, etc. The know-how makes it possible to differentiate a quality of service, to enhance the brand image of the company, etc.

Know-how and trade secrets are the intangible assets of almost every organisation. They may be documented in files, diagrams, drawings, or archives, yet such materials are usually only a small part of the entire asset in the form of know-how or trade secrets.

The sharing and transferability of know-how is the basis of its economic appraisal, which is based on complementary methodologies projecting the future usefulness of the costs incurred, the relief from royalties by the license or the differential income from internal exploitation. Unlike patents, the know-how is not independently negotiable and is more difficult to enforce against third parties, but at the same time it retains some characteristics of confidentiality that with the patenting in part must be disclosed.

Trade secrets and know-how, unlike patents, may be licensed in perpetuity. The quid pro quo for the licensee's payment is disclosure and access to the technology.

The methods of valuing the intellectual capital of enterprises include three groups: market methods, income methods and cost methods. The most popular method is that of license fee exemption and of income distribution.

The methods are explained below:-

1. **License Fee Exemption Method:-** The method of exemption from license fees assumes that companies and organisations may choose whether to favour ownership of the asset or whether to conclude a license agreement with the owner. Fair value is calculated as the present value of the hypothetical money paid to the owner of the asset from which the company is relieved in the event it owns the asset.
2. **Income Distribution Method:-** The method of income distribution establishes additional cash flows (income) generated by the use of the intellectual capital of enterprises and thanks to an appropriate distribution of these flows between the licensor and the licensee. Fair value is calculated as the present value of the hypothetical income of the licensor.

A factor of production – know-how

The term know-how is an important factor of production, as it involves accumulated skill and knowledge. In some cases, it may also involve trade secrets.

Factors of production are the building blocks or elements that we use to produce products and services. They include enterprise (entrepreneurship), labor, capital, and land.

In a franchise, it is the accumulated knowledge or set of information and skills that have helped the business succeed. This information includes marketing, operation processes, and finance. The franchisee also benefits from the franchisor's management skills. The transfer of know-how from the franchisor to franchisee is a major factor in the high success rate of franchises.

OTHER READINGS

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Valuing Firms in Distress

Aswath Damodaran

The Going Concern Assumption

- Traditional valuation techniques are built on the assumption of a going concern, I.e., a firm that has continuing operations and there is no significant threat to these operations.
  - In discounted cashflow valuation, this going concern assumption finds its place most prominently in the terminal value calculation, which usually is based upon an infinite life and ever-growing cashflows.
  - In relative valuation, this going concern assumption often shows up implicitly because a firm is valued based upon how other firms - most of which are healthy - are priced by the market today.
- When there is a significant likelihood that a firm will not survive the immediate future (next few years), traditional valuation models may yield an over-optimistic estimate of value.

Why distress matters…

- Some firms are clearly exposed to possible distress, though the source of the distress may vary across firms.
  - For some firms, it is too much debt that creates the potential for failure to make debt payments and its consequences (bankruptcy, liquidation, reorganization)
  - For other firms, distress may arise from the inability to meet operating expenses.
- When distress occurs, the firm's life is terminated leading to a potential loss of all cashflows beyond that point in time.
  - In a DCF valuation, distress can essentially truncate the cashflows well before you reach "nirvana" (terminal value).
  - A multiple based upon comparable firms may be set higher for firms that have continuing earnings than for one where there is a significant chance that these earnings will end (as a consequence of bankruptcy).

The Purist DCF Defense: You do not need to consider distress in valuation

- If we assume that there is unrestricted access to capital, no firm that is worth more as a going concern will ever be forced into liquidation.
  - Response: But access to capital is not unrestricted, especially for firms that are viewed as troubled and in depressed financial markets.
- The firms we value are large market-cap firms that are traded on major exchanges. The chances of these firms defaulting is minimal…
  - Response: Enron and Kmart….
- Firms that default will be able to sell their assets (both in-place and growth opportunities) for a fair market value, which should be equal to the expected operating cashflows on these assets.
  - Response: Unlikely, even for assets-in-place, because of the need to liquidate quickly.

The Adapted DCF Defense: It is already in the valuation

- The expected cashflows can be adjusted to reflect the likelihood of distress. For firms with a significant likelihood of distress, the expected cashflows should be much lower.
  - Response: Easier said than done. Most DCF valuations do not consider the likelihood in any systematic way. Even if it is done, you are implicitly assuming that in the event of distress, the distress sale proceeds will be equal to the present value of the expected cash flows.
- The discount rate (costs of equity and capital) can be adjusted for the likelihood of distress. In particular, the beta (or betas) used to estimate the cost of equity can be estimated using the updated debt to equity ratio, and the cost of debt can be increased to reflect the current default risk of the firm.
  - Response: This adjusts for the additional volatility in the cashflows but not for the truncation of the cashflows.

Dealing with Distress in DCF Valuation

- *Simulations:* You can use probability distributions for the inputs into DCF valuation, run simulations and allow for the possibility that a string of negative outcomes can push the firm into distress.
- *Modified Discounted Cashflow Valuation:* You can use probability distributions to estimate expected cashflows that reflect the likelihood of distress.
- *Going concern DCF value with adjustment for distress:* You can value the distressed firm on the assumption that the firm will be a going concern, and then adjust for the probability of distress and its consequences.
- *Adjusted Present Value:* You can value the firm as an unlevered firm and then consider both the benefits (tax) and costs (bankruptcy) of debt.

I. Monte Carlo Simulations

- Preliminary Step: Define the circumstances under which you would expect a firm to be pushed into distres.
- Step 1: Choose the variables in the DCF valuation

that you want estimate probability distributions on.

- Steps 2 & 3: Define the distributions (type and parameters) for each of these variables.
- Step 4: Run a simulation, where you draw one outcome from each distribution and compute the value of the firm. If the firm hits the "distress conditions", value it as a distressed firm.
- Step 5: Repeat step 4 as many times as you can.
- Step 6: Estimate the expected value across repeated simulations.

II. Modified Discounted Cashflow Valuation

- If you can come up with probability distributions for the cashflows (across all possible outcomes), you can estimate the expected cash flow in each period. This expected cashflow should reflect the likelihood of default. In conjunction with these cashflow estimates, you should estimate the discount rates by
  - Using bottom-up betas and updated debt to equity ratios (rather than historical or regression betas) to estimate the cost of equity
  - Using updated measures of the default risk of the firm to estimate the cost of debt.
- If you are unable to estimate the entire distribution, you can at least estimate the probability of distress in each period and use as the expected cashflow:

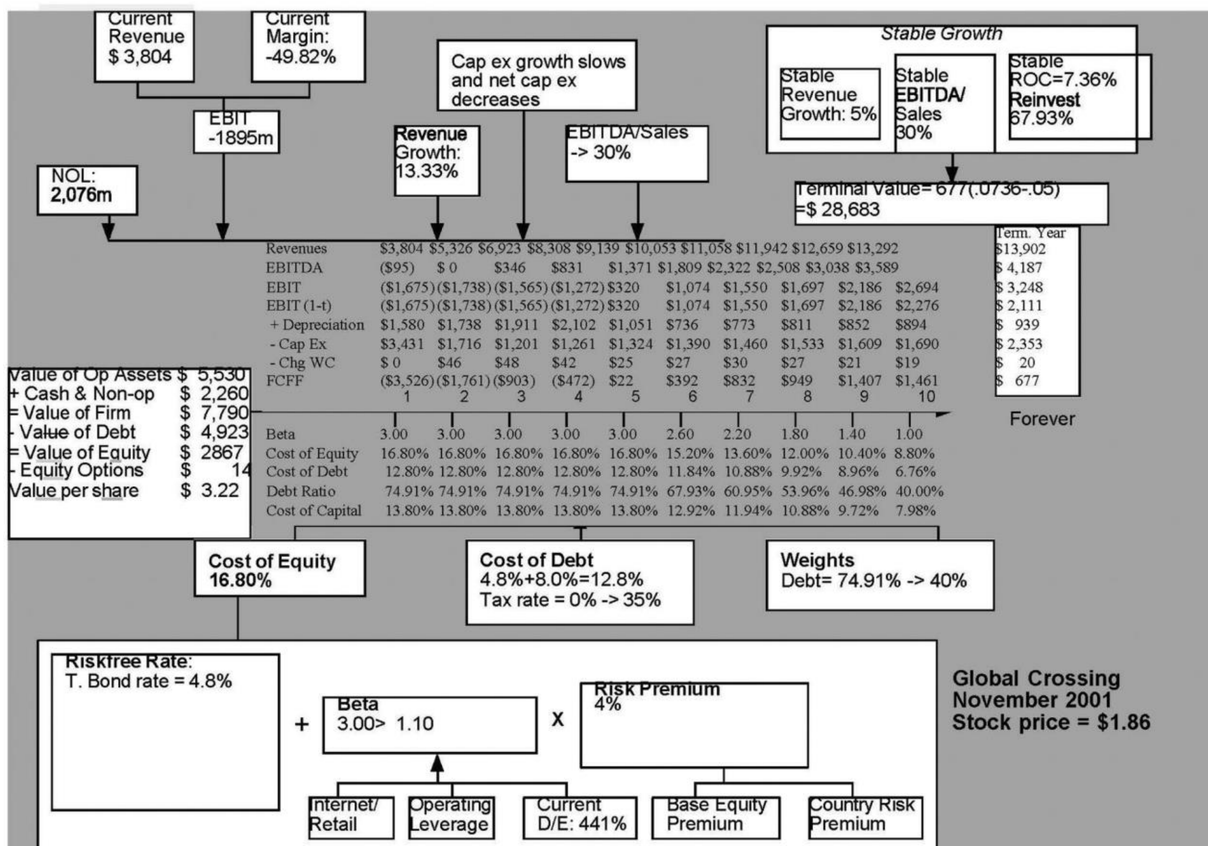
$$\text{Expected cashflow}_t = \text{Cash flow}_t * (1 - \text{Probability of distress}_t$$

III. DCF Valuation + Distress Value

- A DCF valuation values a firm as a going concern. If there is a significant likelihood of the firm failing before it reaches stable growth and if the assets will then be sold for a value less than the present value of the expected cashflows (a distress sale value), DCF valuations will understate the value of the firm.
- Value of Equity= DCF value of equity (1 - Probability of distress) + Distress sale value of equity (Probability of distress)

Step 1: Value the firm as a going concern

- You can value a firm as a going concern, by looking at the expected cashflows it will have if it follows the path back to financial health. The costs of equity and capital will also reflect this path. In particular, as the firm becomes healthier, the debt ratio (which is high at the time of the distress) will converge to more normal levels. This, in turn, will lead to lower costs of equity and debt.
- Most discounted cashflow valuations, in my view, are implicitly going concern valuations.



Step 2: Estimate the probability of distress

- We need to estimate a cumulative probability of distress over the lifetime of the DCF analysis - often 10 years.
- There are three ways in which we can estimate the probability of distress:
  - Use the bond rating to estimate the cumulative probability of distress over 10 years
  - Estimate the probability of distress with a probit
  - Estimate the probability of distress by looking at market value of bonds.

a. Bond Rating as indicator of probability ofdistress

Rating Cumulative probability of distress

	5 years	*10 years*
AAA	0.03%	0.03%
AA	0.18%	0.25%
A+	0.19%	0.40%
A	0.20%	0.56%
A-	1.35%	2.42%
BBB	2.50%	4.27%
BB	9.27%	16.89%
B+	16.15%	24.82%
B	24.04%	32.75%
B-	31.10%	42.12%
CCC	39.15%	51.38%
CC	48.22%	60.40%
C+	59.36%	69.41%
C	69.65%	77.44%
C-	80.00%	87.16%

b. Bond Price to estimate probability of distress

- Global Crossing has a 12% coupon bond with 8 years to maturity trading at \$ 653. To estimate the probability of default (with a treasury bond rate of 5% used as the riskfree rate):

$$653 = \sum_{t=1}^{t=8} \frac{120(1 - \pi_{Distress})^t}{(1.05)^t} + \frac{1000(1 - \pi_{Distress})^8}{(1.05)^N}$$

- Solving for the probability of bankruptcy, we get
  - With a 10-year bond, it is a process of trial and error to estimate this value. Thesolver function in excel accomplishes the same in far less time.

$\pi_{Distress}$ = Annual probability of default = 13.53%

- To estimate the cumulative probability of distress over 10 years:
- Cumulative probability of surviving 10 years = $(1 - .1353)^{10}$ = 23.37%
- Cumulative probability of distress over 10 years = 1 - .2337 = .7663 or76.63%

c. Using Statistical Techniques

- The fact that hundreds of firms go bankrupt every year provides us with a rich database that can be mined to answer both why bankruptcy occurs and how to predict the likelihood of future bankruptcy.
- In a probit, we begin with the same data that was used in linear discriminant analysis, a sample of firms that survived a specific period and firms that did not. We develop an indicator variable, that takes on a value of zero or one, as follows:

  Distress Dummy = 0 for any firm that survived the period
  = 1 for any firm that went bankrupt during the period

- We then consider information that would have been available at the beginning of the period. For instance, we could look at the debt to capital ratios and operating margins of all of the firms in the sample at the start of the period. Finally, using the dummy variable as our dependent variable and the financial ratios (debt to capital and operating margin) as independent variables, we look for a relationship:

  Distress Dummy = a + b (Debt to Capital) + c (Operating Margin)

Step 3: Estimating Distress Sale Value

- If a firm can claim the present value of its expected future cashflows from assets in place and growth assets as the distress sale proceeds, there is really no reason why we would need to consider distress separately.
- The distress sale value of equity can be estimated
  - as a percent of book value (and this value will be lower if the economy is doing badly and there are other firms in the same business also in distress).
  - As a percent of the DCF value, estimated as a going concern

Step 4: Valuing Global Crossing with Distress

- Probability of distress
  - Cumulative probability of distress = 76.63%

- Distress sale value of equity
  - Book value of capital = $14,531 million
  - Distress sale value = 25% of book value = .25*14531 = $3,633 million
  - Book value of debt = $7,647 million
  - Distress sale value of equity = $ 0
- Distress adjusted value of equity
  - Value of Global Crossing = $3.22 (1-.7663) + $0.00 (.7663) = $ 0.75

I. Adjusted Present Value Model

- In the adjusted present value approach, the value of the firm is written as the sum of the value of the firm without debt (the unlevered firm) and the effect of debt on firm value
- Firm Value = Unlevered Firm Value + (Tax Benefits of Debt - Expected Bankruptcy Cost from the Debt)
  - The unlevered firm value can be estimated by discounting the free cashflows to the firm at the unlevered cost of equity
  - The tax benefit of debt reflects the present value of the expected tax benefits. In its simplest form,

    Tax Benefit = Tax rate * Debt
  - The expected bankruptcy cost can be estimated as the difference between the unlevered firm value and the distress sale value:

    Expected Bankruptcy Costs = (Unlevered firm value - Distress Sale Value)* Probability of Distress

Relative Valuation: Where is the distress factored in?

- Revenue and EBITDA multiples are used more often to value distressed firms than healthy firms. The reasons are pragmatic. Multiple such as price earnings or price to book value often cannot even be computed for a distressed firm.
- Analysts who are aware of the possibility of distress often consider them subjectively at the point when the compare the multiple for the firm they are analyzing to the industry average. For example, assume that the average telecomm firm trades at 2 times revenues. You may adjust this multiple down to 1.25 times revenues for a distressed telecomm firm.

Ways of dealing with distress in Relative Valuation

- You can choose only distressed firms as comparable firms, if you are called upon to value one.
  - Response: Unless there are a large number of distressed firms in your sector, this will not work.
- Adjust the multiple for distress, using some objective criteria.
  - Response: Coming up with objective criteria that work well may be difficult to do.
- Consider the possibility of distress explicitly
  - Distress-adjusted value = Relative value based upon healthy firms (1 - Probability of distress) + Distress sale proceeds (Probability of distress)

I. Choose Comparables

Company Name	*Value to Book Capital*	*EBIT*	*Market Debt to Capital Ratio*
SAVVIS Communications Corp	0.80	-83.67	75.20%
Talk America Holdings Inc	0.74	-38.39	76.56%
Choice One Comm. Inc	0.92	-154.36	76.58%
FiberNet Telecom Group Inc	1.10	-19.32	77.74%
Level 3 Communic.	0.78	-761.01	78.89%
Global Light Telecom.	0.98	-32.21	79.84%
Korea Thrunet Co. Ltd Cl A	1.06	-114.28	80.15%
Williams Communications Grp	0.98	-264.23	80.18%
RCN Corp.	1.09	-332.00	88.72%
GT Group Telecom Inc Cl B	0.59	-79.11	88.83%

Metromedia Fiber ‘A’	0.59	-150.13	91.30%
Global Crossing Ltd.	0.50	-15.16	92.75%
Focal Communications Corp	0.98	-11.12	94.12%
Adelphia Business Solutions	1.05	-108.56	95.74%
Allied Riser Communications	0.42	-127.01	95.85%
CoreComm Ltd	0.94	-134.07	96.04%
Bell Canada Intl	0.84	-51.69	96.42%
Globix Corp.	1.06	-59.35	96.94%
United Pan Europe Communicatio	1.01	-240.61	97.27%
Average	0.87		

II. Adjust the Multiple

- In the illustration above, you can categorize the firms on the basis of an observable measure of default risk. For instance, if you divide all telecomm firms on the basis of bond ratings, you find the following -

Bond Rating	*Value to Book Capital Ratio*
A	1.70
BBB	1.61
BB	1.18
B	1.06
CCC	0.88
CC	0.61

- You can adjust the average value to book capital ratio for the bondrating.

III. Multiple Valuation + Distress Value

- You could apply the average value to book capital ratio of all telecomm firms to value Global Crossing as a going concern.
  - Going concern value = Average for telecomm firms * BV of capital for Global Crossing
- Once you have the going concern value, you could use the same approach you used in the DCF approach to adjust for distress sale value.

Other Considerations in Valuing Distressed firms

- With distressed firms, everything is in flux - the operating margins, cash balance and debt to name three. It is important that you update your valuation to reflect the most recent information that you have on the firm.
- The equity in a distressed firm can take on the characteristics of an option and it may therefore trade at a premium on the DCF value.

Closing Thoughts

- Distress is not restricted to a few small firms. Even large firms are exposed to default and bankruptcy risk.
- When firms are pushed into bankruptcy, the proceeds received on a distress sale are usually much lower than the value of the firm as a going concern.
- Conventional valuation models understate the impact of distress on value, by either ignoring the likelihood of distress or by using ad hoc (or subjective) adjustments for distress.
- Valuation models - both DCF and relative - have to be adapted to incorporate the effect of distress.

MULTIPLE CHOICE QUESTIONS

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MULTIPLE CHOICE QUESTIONS

MCQ FOR SFA

1 Total value of all final goods and services produced in a country during one year is:
a) NNP
b) GNP
c) GDP
d) NI

Ans) GDP

2 The difference between revenue expenditure and revenue receipts is
a) Revenue deficit
b) Fiscal deficit
c) Budget deficit
d) Primary deficit

Ans) Revenue deficit

3 The difference between total expenditure and total receipts except loans and other liabilities is called
a) Fiscal deficit
b) Budget deficit
c) Budget deficit
d) Budget deficit

Ans) Fiscal deficit

4 Which of the following may not be a part of projected Financial Statements?
a) Projected IncomeStatement
b) Projected TrialBalance
c) Projected Cash Flow Statement
d) Projected Balance Sheet.

Ans) Projected Trial Balance

5 Stock split is a form of
a) Dividend Payment
b) Bonus Issue
c) Financial restructuring
d) Dividend in kind

Ans) Financial restructuring

6 A preliminary prospectus is known as a
a) golden parachute.
b) red herring.
c) blue sky.
d) green shoe.

Ans) red herring.

7 First rating agency of India is
a) CRISIL
b) ICRA
c) SMERA
d) MOODY

Ans) CRISIL

8 The process of protecting oneself against future price changes by shifting some or all of the risk to someone else is called:
a) speculating
b) investing
c) hedging
d) gambling

Ans) hedging

9 Organised markets that enable new issues of equity and debt to be traded.
a) Secondary markets
b) Primary capital markets
c) BSE
d) NSE

Ans) Primary capital markets

10 The rate at which commercial banks make funds available to people is known as:
a) Success Rate
b) Bank Rate
c) Borrowing Rate
d) Lending Rate

Ans) Lending Rate

11means bailment of goods as security for payment of debt:
a) Hypothecation
b) Overdraft
c) Pledge
d) Consumer Credit

Ans) Pledge

12 Measurement and disclosure do not apply to which of the following?
a) Leasing based transactions
b) Net realizable values/Impairment of Assets
c) Share based payments
d) Price received to sell or buy an asset

Ans) Price received to sell or buy an asset

13 Which of the following statement is true?
a) Debenture holder is an owner of the company
b) Debenture holder can get back its money only on the liquidation of the company
c) A debenture issued at a discount can be redeemed at a premium
d) A debenture holder receives interest only in the event of profits

Ans) A debenture issued at a discount can be redeemed at a premium

14 Belated return can be filed by an assessee earlier or before completion of assessment and:
a) 6 months
b) 1 year
c) 2 years
d) 3 years

Ans) 1 year

15 Which of the following is not a capital receipt?
a) 'Salami' for settlement of tenancy
b) Insurance claim received on machinery lost by fire
c) Lump-sum received on sale of shares
d) Goods sold for cash under 'Patent Rights'

Ans) Goods sold for cash under 'Patent Rights'

16 Compensation for cancellation of a license by the government resulting in cessation of business is:
a) A casual receipt
b) A capital receipt
c) A revenue receipt
d) None of the above

Ans) A revenue receipt

17 Compensation received for loss of

MULTIPLE CHOICE QUESTIONS

trading asset is a:
a) Capital receipt
b) Revenue receipt
c) Casual receipt
d) None of the above

Ans) Capital receipt

18 Which of the following is not a revenue expense?
a) Rent of office building
b) Sales tax and excise duty paid
c) Payment made on dismissal of company
d) Remuneration to employers of a temporary employee

Ans) Rent of office building

19 Any payment made to discharge a revenue liability, if refunded later on, shall be:
a) A revenue receipt
b) A capital receipt
c) A casual receipt
d) None of the above

Ans) A revenue receipt
20 Residential status of taxable entities is:
a) Fixed in nature
b) Can change from year to year
c) Fixed once in 5 years
d) None of the above

Ans) Can change from year to year

21 Income received in India is taxable in the hands of:
a) Resident only
b) Resident and ordinarily resident only
c) Non-resident only
d) All assesses

Ans) All assesses

22 Exempted incomes are defined under section:
a) 15 of Income Tax Act
b) 18 of Income Tax Act
c) 10 of Income Tax Act
d) 20 of Income Tax Act

Ans) 10 of Income Tax Act

23 The basic exemption limit in case of a resident individual of the age of below 60 years is Rs .... (AY 2021-22)
a) Rs 2,00,000
b) Rs 2,50,000
c) Rs 3,00,000
d) Rs 5,00,000

Ans) Rs 3,00,000

24 A resident individual (whose net income does not exceed Rs 3,50,000) can avail rebate under section 87A. It is deductible from income-tax before calculating education cess. The amount of rebate is 100 percent of income-tax or Rs ...., whichever is
a) 10000
b) 2500
c) 2000
d) 1000
Ans) 2500

25 Which of the following is an agriculture income?
a) Dividend paid by a company out of its agriculture income
b) Share of Profit by a Partner from a firm engaged in an agriculture operation
c) Income from supply of water by a assessee from a tank in its agricultural land
d) Interest received by a money lender in the form of agricultural produce

Ans) Share of Profit by a Partner from a firm engaged in an agriculture operation

26 Which of the following incomes received by an assessee are exempt under section 10 of the Income Tax Act?
a) Agricultural Income
b) Salary of a partner from a firm
c) Salary received by a member of a ship's crew
d) All of the above

Ans) Agricultural Income

27 If control and management of its affairs was fully in India, a foreign company becomes:
a) Resident in India
b) Ordinarily resident in India
c) Non-resident
d) None of the above

Ans) Resident in India

28 A domestic company is taxable at 30%. However, tax rate is 25% if turnover or gross receipt of the company does not exceed: (AY 2021-22)
a) Rs 250 crore
b) Rs 25 crore
c) Rs 10 crore
d) Rs 200 crore
Ans) Rs 250 crore

29 Which of the following is not included in taxable income?
a) Income from smuggling activity
b) Casual Income
c) Gifts of personal nature subject to a maximum of 50,000 received in cash
d) Income received in kind

Ans) Gifts of personal nature subject to a maximum of 50,000 received in cash

30 Unexplained cash credits are chargeable to tax @ .... :
a) 0.1
b) 0.2
c) 0.15
d) 0.3

Ans) 0.3

31 Income from subletting of house property is taxable under the head .... :
a) Income from House Property
b) Profits & Gains from Business or Profession
c) Income from Other Sources
d) Capital Gains

Ans) Income from Other Sources

32 When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that:
a) Maximises the use of relevant observable inputs
b) Minimises the use of unobservable inputs.
c) both (a) and (b)
d) either (a) or (b)

Ans) c

MULTIPLE CHOICE QUESTIONS

33 In case of financial assets, an enity needs toidentify the principal market or, in the absence of a principal market, the most advantageous market.
a) TRUE
b) FALSE
c) All of these
d)None of the above

Ans) b

34 The price that would be received is 26, transaction costs in that market are 3 and the costs to transport the asset to that market are 2. Calculate the fair value of the asset, if market it is the principal market.
a) 26
b) 23
c) 21
d) 24

Ans) d

35 The price that would be received is 26, transaction costs in that market are 3 and the costs to transport the asset to that market are 2. Calculate the fair value of the asset, if market it is the most advantageous market.
a) 26
b) 23
c) 21
d) 24

Ans) c

36 Level 2 input does not include
a) quoted prices for similar assets or liabilities in active markets
b) quoted prices for identical or similar assets or liabilities in markets that are not active
c) quoted prices for identical assets or liabilities in active markets
d) market-corroborated inputs
Ans) c

37 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

Ans) All valuation approaches must be considered

38 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,Interation & Future benefits

Ans) Principle of substitution,Interation & Future benefits

39 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

Ans) for 'sell"

40 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

Ans) The control premium, The synergy premium

41 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

Ans) Two different approaches

42 Which one of the following methods do Valuators commonly use for valuation of Brands? (choose the nearest definition)
a) Sales multiples
b) Relief from Royalty
c) Real Option methodology
d) P/E multiples

Ans) Relief from Royalty

43 What doesnot valuation report include?
a) General description of the property
b) Resource management
c) Valuation process describing methods used
d) moderate level of assurance

Ans) moderate level of assurance

44 In arbitrage pricing theory, higher required rate of return is usually paid on stock_
a) higher market risk
b) higher dividend
c) lower dividend
d) lower market risk

Ans) higher market risk

45 Which of the following statements is false?
a) The primary assumption of the APT is that security returns are generated by a linear factor model
b) A benefit of the APT is that it does not specify which variables are the best to use as a common factor
c) The APT is considered to be less restrictive than the CAPM
d) In practice, researchers claim that we need at least two factors for the APT model.

Ans) A benefit of the APT is that it does not specify which variables are the best to use as a
common factor

46 Which of the following is an assumption of the APT?
a) All investors hold the market portfolio
b) Investors are risk averse
c) Short sales are allowed
d) Investors follow the mean-variance rule

Ans) Short sales are allowed

47 According to the APT, the value of the firm-specific factor is expected to be, on average_
a) more important than the value of the common factors

MULTIPLE CHOICE QUESTIONS

b) zero
c) positive
d) greater than the value of the common factors

Ans) zero

48 Arbitrage opportunity means you can earn a positive return with_
a) low risk
b) positive initial investment and zero risk
c) zero initial investment and zero risk
d) zero initial investment and some risk

Ans) zero initial investment and zero risk

49 Which of the following statements is true according to the theory of arbitrage?
a) Rational investors will arbitrage in a manner consistent with their risk tolerance
b) High-beta stocks are consistently under priced
c) Low-beta stocks are consistently overpriced
d) Positive alpha stocks will quickly disappear

Ans) Positive alpha stocks will quickly disappear

50 In a multi-factor APT model, the coefficients on the macro factors are often called ______.
a) systemic risk
b) firm-specific risk
c) idiosyncratic risk
d) factor loadings

Ans) factor loadings

51 The securities which are providing a fixed income to the investors is known as_
a) Fixed income securities
b) Short term securities
c) Medium term securities
d) Medium & short term securities

Ans) Fixed income securities

52 Yield-to-Maturity on a bond has increased from 8% to 9%. Then, the duration of the bond will_
a) Increase
b) Decrease
c) Remain unchanged
d) Nothing can be concluded from the given information.

Ans) Decrease

53 If coupon rate is equal to going rate of interest then bond will be sold_
a) at par value
b) below its par value
c) more than its par value
d) seasoned par value
Ans) at par value

54 The "modified duration" used by practitioners is equal to the Macaulay duration_
a) times the change in interest rate.
b) times (one plus the bond's yield to maturity).
c) divided by (one minus the bond's yield to maturity)
d) divided by (one plus the bond's yield to maturity)

Ans) divided by (one plus the bond's yield to maturity)

55 Given the time to maturity, the duration of a zero-coupon bond is higher when the discount rate is_
a) higher
b) lower
c) The bond's duration is independent of the discount rate.
d) equal to the risk free rate.

Ans) The bond's duration is independent of the discount rate.

56 The Majority shareholder in CRISIL is _________?
a) Standard and Poors'
b) Poors'
c) Moody's
d) Dun and Bradstreet

Ans) Standard and Poors'

57 Type of rating to which all credit rating agencies does not consider is classified as
a) split rating
b) sinking rating
c) automated rating
d) floating rating

Ans) split rating

58 What is the current rating (as of April 28, 2015) of India by S&P?
a) AA
b) A
c) BBB
d) BB

Ans) BBB

59 CAMEL Model stands for_
a) Capital , Assets, Market, Earnings, Leverage
b) Capital, Action, Market, Earnings, Liquidity
c) Capital, Assets, Management, Earnings, Liquidity
d) Capital, Assets, Management, Earnings, Lliabilities

Ans) Capital, Assets, Management, Earnings, Liquidity

60 Credit Rating is an expression of opinion of an agency, regarding a debt instrument on a specific date, dependent on_
a) Organizational Structure
b) Products & Services
c) Risk Evaluation
d) Products evaluation

Ans) Risk Evaluation

61 Which of the following is not a measure to reduce credit risk in derivatives?
a) Netting
b) Collateralization
c) Downgrade Triggers
d) Upgrade Triggers

Ans) Upgrade Triggers

62 The credit rating of the firm is AAA, the description of the rating is;
a) issuer has missed one or more interest or principal payment."
b) Capacity to pay interest plus Principal is High"
c) Capacity to pay interest plus Principal is slightly susceptible to adverse economic conditions"

MULTIPLE CHOICE QUESTIONS

d) Significant chances that issuer could miss interest payment."

Ans) Capacity to pay interest plus Principal is High"

63 The credit rating of the firm is A, the description of the rating is;
a) issuer has missed one or more interest or principal payment."
b) Capacity to pay interest plus Principal is adequate Slightly speculative"
c) Capacity to pay interest plus Principal is slightly susceptible to adverse economic conditions"
d) Significant chances that issuer could miss interest payment."

Ans) Capacity to pay interest plus Principal is slightly susceptible to adverse economic conditions

64 The credit rating of the firm is BB, the description of the rating is;
a) . issuer has missed one or more interest or principal payment."
b) Capacity to pay interest plus Principal is adequate. Slightly speculative"
c) Capacity to pay interest plus Principal is slightly susceptible to adverse economic conditions"
d) Significant chances that issuer could miss interest payment."

Ans) Significant chances that issuer could miss interest payment."

65 In binomial approach of option pricing model, last step for finding an option is_
a) price hike
b) price value
c) put price
d) call price

Ans) call price

66 In binomial approach of option pricing model, fourth step is to create_
a) equalize domain of payoff
b) equalize ending price
c) riskless investment
d) high risky investment

Ans) riskless investment

67 Second step in binomial approach of option pricing is to define range of values_
a) at expiration
b) at buying date
c) at exchange closing time
d) at exchange opening time

Ans) at expiration

68 The following statements about simulation models are true except:
a) Simulation models enable the financial manager to analyze risky projects without estimating the approximate cost of capital
b) Simulation models are complex and expensive to develop
c) Simulation models are specific to the project and every project requires anew simulation model
d) Simulation models usually ignore opportunities to expand or abandon the project

Ans) Simulation models enable the financial manager to analyze risky projects without estimating the approximate cost of capital

69 Monte Carlo simulation is likely to be most useful:
a) For simple problems
b) For problems of moderate complexity
c) For very complex problems
d) Regardless of the problem's complexity

Ans) For very complex problems

70 The following is not among the steps involved in the Monte Carlo method:
a) Modeling the project
b) Specifying the numbers on the roulette wheel
c) Specifying probabilities
d) Simulating the cash flows

Ans) Specifying the numbers on the roulette wheel

71 Which of the following statements are NOT true of simulation?
a) A simulation model cannot prescribe what should be done about a problem
b) The equations describing the operating characteristics of the system are known
c) Simulation models the behaviour of a system
d) Simulation models can be used to study alternative solutions to a problem

Ans) The equations describing the operating characteristics of the system are known

72 Monte Carlo simulation gets its name from which of the following?
a) Data collection
b) Analysis
c) Model formulation
d) Random-number assignment

Ans) Random-number assignment

73 The first step in simulation is to_
a) set up possible courses of action for testing.
b) construct a numerical model.
c) validate the model.
d) define the problem.

Ans) define the problem.

74 The three types of mathematical simulation models are_
a) operational gaming, Monte Carlo, systems simulation.
b) Monte Carlo, queuing, maintenance policy.
c) Monte Carlo, systems simulation, computer gaming.
d) system simulation, operational gaming, weather forecasting.

Ans) operational gaming, Monte Carlo, systems simulation.

75 Simulation should be thought of as a technique for_
a) increasing one's understanding of a problem.
b) obtaining a relatively inexpensive solution to a problem.
c) obtaining an optimal solution to a problem.
d) providing quick and dirty answers to complex problems.

MULTIPLE CHOICE QUESTIONS

Ans) increasing one's understanding of a problem.

76 Which of the following is NOT an example of a financial asset/liability?
a) Advances received on a construction project
b) A contract that will be settled in the company's own equity
c) Cash
d) Shares

Ans) Shares

77 What is the manner of selling the assets of corporate debtor under the liquidation process, if assets are of perishable nature:
a) Private Sale
b) Auction
c) Sale on standalone basis
d) Sale of asset by any method except on standalone basis

Ans) Private Sale

78 What is an ordinary manner of selling the assets of corporate debtor under the liquidation process_
a) Auction
b) Private Sale
c) Sale on standalone basis
d) Any suitable method adopted by the liquidator

Ans) Auction

79 In Bengal Tea Industries Ltd & Ors. vs. Union of India, a Division Bench of the Calcutta High Court held that:
a) In a scheme of amalgamation of two companies, it is necessary in law to call for a meeting of the creditors and obtain their views on the scheme
b) In a scheme of amalgamation of two companies, it is not necessary in law to call for a meeting of the director and obtain their views on the scheme
c) In a scheme of amalgamation of two companies, it is not necessary in law to call for a meeting of the creditors and obtain their views on the scheme
d) None of the above

Ans) In a scheme of amalgamation of two companies, it is not necessary in law to call for a meeting of the creditors and obtain their views on the scheme

80 Bengal Tea Industries Ltd &Ors. vs. Union of India, a Division Bench of the Calcutta High Court held that:
a) In the event, any shareholder of the Transferee Company had appeared before the Court and had objected to the valuation of the shares or to the exchange ratio, the matter would have taken an entirely different complexion and the Court would have been inclined
b) In the event, any shareholder of the Transferor Company had appeared before the Court and had objected to the valuation of the shares or to the exchange ratio, the matter would have taken an entirely same complexion and the Court would have been inclined
c) In the event, any shareholder of the Transferor Company had appeared before the Court and had objected to the valuation of the shares or to the exchange ratio, the matter would have taken an entirely different complexion and the Court would not have been inclined
d) None of the above

Ans) In the event, any shareholder of the Transferor Company had appeared before the Court and had objected to the valuation of the shares or to the exchange ratio, the matter would have taken an entirely different complexion and the Court would have been inclined

Use the following information to answer Questions 81-82

Sun Pharma is a large pharmaceutical company based in Sri Lanka that manufactures prescription drugs under license from large multinational pharmaceutical companies. Delenga Mahamurthy, CEO of Sun Pharma, is evaluating a potential acquisition of Island Cookware, a small manufacturing company that produces cooking utensils.
Mahamurthy feels that Sun Pharma's excellent distribution network could add value to Island Cookware. Sun Pharma plans to acquire Island Cookware for cash. Several days later, Sun Pharma announces that they have acquired Island Cookware at market price.

81 Sun Pharma's most appropriate valuation for Island Cookware is its:
a) sum-of-the-parts value.
b) investment value.
c)liquidation value.
d)none of the above

Ans) investment value.

82 Upon announcement of the merger, the market price of Sun Pharma drops. This is most likely a result of:
a) the unrelated business effect.
b) the tax effect.
c) the conglomerate discount.
d) none of the above

Ans) the conglomerate discount.

Use the following information to answer Questions 83-90

Guardian Capital is a rapidly growing US investment firm. The Guardian Capital research team is responsible for identifying undervalued and overvalued publicly traded equities that have a market capitalization greater than $500 million. Due to the rapid growth of assets under management, Guardian Capital recently hired a new analyst, Jack Richardson, to support the research process. At the new analyst orientation meeting, the director of research made the following statements about equity valuation at Guardian:

Statement 1- "Analysts at Guardian Capital seek to identify mispricing, relying on price eventually converging to intrinsic value. However, convergence of the market price to an analyst's estimate of intrinsic value may not happen within the portfolio manager's investment time horizon. So, besides evidence of mispricing, analysts should look for the presence of a particular market or corporate event—that is, a catalyst—that will cause the

MULTIPLE CHOICE QUESTIONS

marketplace to re- evaluate the subject firm's prospects."
Statement 2- "An active investment manager attempts to capture positive alpha. But mispricing of assets is not directly observable. It is therefore important that you understand the possible sources of perceived mispricing."
Statement 3- "For its distressed securities fund, Guardian Capital screens its investable universe of securities for companies in financial distress."
Statement 4- "For its core equity fund, Guardian Capital selects financially sound companies that are expected to generate significant positive free cash flow from core business operations within a multiyear forecast horizon."
Statement 5- "Guardian Capital's research process requires analysts to evaluate the reasonableness of the expectations implied by the market price by comparing the market's implied expectations to his or her own expectations."

After the orientation meeting, the director of research asks Richardson to evaluate three companies that are retailers of men's clothing: Diamond Co., Renaissance Clothing, and Deluxe Men's Wear. Richardson starts his analysis by evaluating the characteristics of the men's retail clothing industry. He finds few barriers to new retail entrants, high intra-industry rivalry among retailers, low product substitution costs for customers and a large number of wholesale clothing suppliers. While conducting his analysis, Richardson discovers that Renaissance Clothing included three non- recurring items in their most recent earnings release: a positive litigation settlement, a one- time tax credit, and the gain on the sale of a non-operating asset.

To estimate each firm's intrinsic value, Richardson applies appropriate discount rates to each firm's estimated free cash flows over a ten- year time horizon and to the estimated value of the firm at the end of the ten- year horizon. Michelle Lee, a junior technology analyst at Guardian, asks the director of research for advice as to which valuation model to use for VEGA, a fast-growing semiconductor company that is rapidly gaining market share. The director of research states that "the valuation model selected must be consistent with the characteristics of the company being valued." Lee tells the director of research that VEGA is not expected to be profitable for several more years. According to management guidance, when the company turns profitable, it will invest in new product development; as a result, it does not expect to initiate a dividend for an extended period of time. Lee also notes that she expects that certain larger competitors will become interested in acquiring VEGA because of its excellent growth prospects. The director of research advises Lee to consider that in her valuation.

83 Based on Statement 2, which of the following sources of perceived mispricing do active investment managers attempt to identify? The difference between:
a) intrinsic value and market price.
b) estimated intrinsic value and market price.
c)intrinsic value and estimated intrinsic value.
d)none of the above

Ans) intrinsic value and market price.

84 With respect to Statements 3 and 4, which of the following measures of value would the distressed securities fund's analyst consider that a core equity fund analyst might ignore?
a) Fair value
b) Liquidation value
c) Fair market value
d) none of the above

Ans) Liquidation value

85 With respect to Statement 4, which measure of value is most relevant for the analyst of the fund described?
a) Liquidation value
b) Investment value
c) Going- concern value
d) none of the above
Ans) Going- concern value

86 According to Statement 5, analysts are expected to use valuation concepts and models to:
a) value private businesses.
b) render fairness opinions.
c)extract market expectations.
d)none of the above

Ans) extract market expectations.

87 Based on Richardson's industry analysis, which of the following characteristics of men's retail clothing retailing would positively affect its profitability? That industry's:
a) entry costs.
b) substitution costs.
c) number of suppliers.
d) none of the above

Ans) number of suppliers.

88 Which of the following statements about the reported earnings of Renaissance Clothing is most accurate? Relative to sustainable earnings, reported earnings are likely:
a) unbiased.
b) upward biased.
c) downward biased
d) none of the above

Ans) upward biased.

89 Which valuation model is Richardson applying in his analysis of the retailers?
a) Relative value
b) Absolute value
c) Sum- of- the- parts
d) none of the above

Ans) Absolute value

90 Which valuation model would the director of research most likely recommend Lee use to estimate the value of VEGA?
a) Free cash flow
b) Dividend discount
c) P/E relative valuation
d) none of the above

Ans) Free cash flow

Source : Judicial Pronouncements in Valuation, Published by Valuation Standards Board and ICAI Registered Valuers Organization, The Institute of Chartered Accountants of India

Case No. 1
Miheer H. Mafatlal Vs Mafatlal Industries Ltd. Ors. (1996)

IN THE SUPREME COURT OF INDIA
Appellant: Miheer H. Mafatlal Vs.
Respondent: Mafatlal Industries Ltd.

Civil Appeal No. 11879 of 1996
Decided On: 11.09.1996

1. Brief Facts of the Case

The Scheme of Amalgamation of M/s Mafatlal Industries (MIL) being the transferee company and the Mafatlal Fine Shipping and Manufacturing Company Limited (MFL) being the transferor company was proposed.

The transferor-company MFL was proposed to be amalgamated with the respondent-company MIL under the following circumstances and for the following reasons:

i. The proposed amalgamation will pave the way for better, more efficient and economical control in the running of operation.

ii. Economies in administrative and management costs will improve in combined profitability.

iii. The amalgamated company will have the benefit of the combined reserves, manufacturing assets, manpower and cash flows of the two companies. The combined technological, managerial and financial resources are expected to enhance the capability of the amalgamated company to invest in larger and more sophisticated projects to ensure rapid growth.

iv. The amalgamated company will have a strong and large resource base. With a strong resource base, the risk bearing capacity of the amalgamated company will be substantial. Hitherto, with limited

Miheer H. Mafatlal Vs Mafatlal Industries Ltd. Ors. (1996)

resources and capacity, either company had to forego business opportunities that would otherwise have been profitable to the group.

v. "Exports" have been identified as a 'thrust' area for both the companies and response in time to customers'needs is considered to be critical in this area of operations. An amalgamated company will be strategically better placed to reduce the response time. Customers' confidence in dealing with such a mega company ensures timely delivery of large orders.

vi. The amalgamated company will be able to source and absorb new technology and spend on Research and Development, Market Surveys etc. more comprehensively.

vii. More particularly in the Textiles Division, with 5 operating units at the company's disposal, the flexibility in operations will be very much pronounced. The Managers will not be inhibited by capacity constraints and will have the freedom of choosing from various options.

viii. Both the companies have been subject to the pressures of raw material price fluctuations and of adverse market conditions in their respective product mix. Hence, the amalgamation will neutralise the adverse effects of contrary business cycles. The operations of one unit will be complementary to the other and stable profitability will be achieved.

The directors of both the companies approved the proposal for amalgamation of the MFL with MIL and pursuant to the respective resolutions passed by them the detailed Scheme of Amalgamation was finalised. The directors of both the companies were of the opinion that such amalgamation was in the interest of both the companies.

It is pertinent to note at this stage that the appellant who had objected to the amalgamation before the High Court in the present proceedings so far as the amalgamation of the transferee company is concerned, was himself one of the directors of the transferor-company being MFL.

Sequence of events is as follows:

- Transferor company filed an application at Bombay High Court and the court sanctioned the Scheme of Amalgamation.
- The Transferee company approached the Gujarat High Court for approving the scheme.
- Appellant who was one of the shareholders of the transferee-company filed his objection to the Scheme of Amalgamation moved under Section 391 of the Companies Act, 1956.
- In the meeting of equity shareholders convened pursuant to the order of the High Court, overwhelming majority of the equity shareholders approved the Scheme.
- Pursuant to the public advertisement, only the present appellant filed an affidavit opposing the Scheme of Amalgamation.
- The Single Judge Bench of Gujrat High Court sanctioned the said Scheme moved on behalf of the respondent transferee-company.
- Appeal was filed against the impugned judgement before the Division Bench and the said appeal was dismissed.
- Further Appeal was filed before the Hon'ble Supreme Court. The Case
- came for Appeal by Special Leave.

2. Issues Raised before the Hon'ble Supreme Court

In view of the aforesaid rival contentions, the following points were raised for determination:

i. Whether the respondent company was guilty of hiding the special interest of its director Shri Arvind Mafatlal from the shareholders while circulating the explanatory statement supporting the Scheme and whether thereby the voting by the equity shareholders got vitiated?
ii. Whether the Scheme is unfair and unreasonable to the minority shareholders represented by the appellant?
iii. Whether the proposed Scheme of Amalgamation was unfair and amounted to suppression of minority shareholders represented by the appellant and hence liable to be rejected?
iv. Whether separate meetings of minority shareholders represented by the appellant were required to be convened on the basis that the appellant's group represented a special class of equity shareholders?
v. Whether the exchange ratio of two equity shares of MIL for five equity shares of MFL was ex facie unfair and unreasonable to the equity shareholders of MIL and consequently the Scheme of Amalgamation on that account was liable to be rejected?

3. The relevant provisions of the Companies Act, 1956

The relevant provisions thereof read as under:

Section 391

391. (1) Where a compromise or arrangement is proposed –

a. between a company and its creditors or any class of them; or

b. between a company and its members or any class of them;

the Court may, on the application of the company, or, of any creditor or member of the company, or, in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Court directs.

(2) If a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting either in person or, where proxies are allowed under the rules made under Section 643, by proxy, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors, all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company :

Provided that no order sanctioning any compromise or arrangement shall be made by the Court unless the Court is satisfied that the company or any other person by whom an application has been made under Sub-section (1) has disclosed to the Court, by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under Sections 235 to 251, and the like.

Section 392

392 (1) Where a High Court makes an order under Section 391 sanctioning a compromise or an arrangement in respect of a company, it –

a. shall have power to supervise the carrying out of the compromise or arrangement; and

b. may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement.

(2) If the Court aforesaid is satisfied that a compromise or arrangement sanctioned under Section 391 cannot be worked satisfactorily with or without modifications, it may, either on its own motion or on the application of any person interested in the affairs of the company, make an order winding up the company, and such an order shall be deemed to be an order made under Section 433 of this Act.

(3) The provisions of this section shall, so far as may be, also apply to a company in respect of which an order has been made before the commencement of this Act under Section 153 of the Indian Companies Act, 1913 (7 of 1913), sanctioning a compromise or an arrangement.

Section 393

393 (1) Where a meeting of creditors or any class of creditors, or of members or any class of members, is called under Section 391,-

i. with every notice calling the meeting which is sent to a creditor or member, there shall be sent also a statement setting forth the terms of the compromise or arrangement and explaining its effect : and in particular, stating any material interests of the directors, managing director, managing agent, secretaries and treasurers or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise, and the effect on those interests, of the compromise or arrangement, if, and in so far as, it is different from the effect on the like interests of other persons; and

ii. in every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid on a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid.

4. Decision of the Court

The Decision against the issues raised before the court were as under:-

Issue No. 1

Whether the respondent company was guilty of hiding the special interest of its director Shri Arvind Mafatlal from the

shareholders while circulating the explanatory statement supporting the Scheme and whether thereby the voting by the equity shareholders got vitiated?

Decision

Out of 100% of the share capital, 75.75% in value participated of which 95.75% voted in favour of the proposed Scheme. Out of 95.75% of the votes in value, a paltry 8.43% of votes had been attributed to Arvind Mafatlal group consisting of individuals and trust. While 39.45% were the votes attributable to financial institutions which can be said to have no interest other than their own interests as men of business in considering the proposed Scheme. Over 23% of votes have been attributed to public limited companies or private limited companies which held the shares of MIL and in which Arvind Mafatlal was also alleged to have interests.

Thus, the requisite statutory majority of votes approving the scheme could not have been adversely affected by the non-mentioning of this pending litigation in the explanatory note even assuming that the Division Bench was right in holding that it was required to be informed to the voters as per the requirements of Section 393(1)(a) of the Companies Act, 1956.

Issue No. 2

Whether the Scheme is unfair and unreasonable to the minority shareholders represented by the appellant?

Decision

Financial Institutions and statutory corporations held a substantive percentage of shares in respondent-company. This class of shareholders who are naturally well informed about the business requirements and economic needs and the requirements of corporate finance in the light of their personal interest would not have wholly approved the Scheme if it was contrary to the interest of shareholders as a class. Individual personal interest of a minority shareholder like the appellant is absolutely out of consideration when such class meeting acting for the benefit to the whole class of equity shareholders take up the consideration of the Scheme for its approval. Consequently, it could not be said that the majority shareholders had sacrificed the class interest of appellant minority shareholders when they voted with overwhelming majority in favour of the Scheme.

Issue No. 3

Whether the proposed Scheme of Amalgamation was unfair and amounted to suppression of minority shareholders represented by the appellant and hence liable to be rejected?

Decision

No such situation ever existed both at the time when the Scheme of Compromise and Arrangement was cleared and proposed by the Board of Directors of both the transferor and transferee companies and also at the stage when the Scheme was put to vote before the meeting of equity shareholders forming a common class of which the appellant was also a member though a minority member.

Issue No. 4

Whether separate meetings of minority shareholders represented by the appellant were required to be convened on the basis that the appellant's group represented a special class of equity shareholders?

Decision

Unless a separate and different type of Scheme of Compromise is offered to a sub-class of a class of creditors or shareholders otherwise equally circumscribed by the class; no separate meeting of such sub-class of the main class of members or creditors is required to be convened. On the facts of the present case, the appellant has not been able to make out a case for holding a separate meeting of dissenting minority equity shareholders represented by him.

Issue No. 5

Whether the exchange ratio of two equity shares of MIL for five equity shares of MFL was ex facie unfair and unreasonable to the equity shareholders of MIL and consequently the Scheme of Amalgamation on that account was liable to be rejected?

Decision

When the Scheme as a whole is examined and found to be advantageous to the economic and commercial interest of shareholders as a class, only one or two items implicatory for deciding the exchange ratio cannot tilt the balance as so many factors and aspects would enter that exercise. The Supreme Court finally concluded that 'Once the exchange ratio of the shares of the transferee company to be allotted to the shareholders of the transferor company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the Court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies.

5. Court's Observations and Key Learnings for Valuers from the above Case

- As per the statutory provisions of Sections 391 and 393 of the Companies Act, 1956 the question of void ability of the scheme will have to be judged subject to the rider that a scheme sanctioned by majority will remain binding to a dissenting minority of creditors or members, as the case may be, even though they have not consented to such a scheme and to that extent absence of their consent will have no effect on the scheme.
- In case of such a Scheme of Compromise and Arrangement put up for sanction of a Company Court (now NCLT) it will have to be seen whether the proposed scheme is lawful and just and fair to the whole class of creditors or members including the dissenting minority to whom it is offered for approval and which has been approved by such class of persons with required majority vote.

- It is the commercial wisdom of the parties to the scheme who have taken an informed decision about the usefulness and propriety of the scheme by supporting it by the requisite majority vote that has to be kept in view by the Court. The Court certainly would not act as a Court of appeal and sit in judgment over the informed view of the concerned parties to the compromise as the same would be in the realm of corporate and commercial wisdom of the concerned parties.
- The Court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the company who have ratified the Scheme by the requisite majority. Consequently, the Company Court's (NCLT's) jurisdiction to that extent is peripheral and supervisory and not appellate.
- The Court acts like an umpire in a game of cricket who has to see that both the teams play their game according to the rules and do not overstep the limits. But subject to that how best the game is to be played is left to the players and not to the umpire.

The court also gave certain guidelines pertaining to the scope and ambit of the jurisdiction of the Company Courts which are as follows:

i. The sanctioning Court has to see to it that all the requisite statutory procedure for supporting such a scheme has been complied with and that the requisite meetings as contemplated by Section 391(1)(a) of the Companies Act, 1956 (the Act) have been held.

ii. That the scheme put up for sanction of the Court is backed up by the requisite majority vote as required by Section 391(2) of the Companies Act, 1956.

iii. That the concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at an informed decision for approving the scheme in question. That the majority decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.

iv. That all necessary material indicated by Section 393(1)(a) of the Companies Act, 1956 is placed before the voters at the concerned meetings as contemplated by Section 391(1) of the Companies Act, 1956.

v. That all the requisite material contemplated by the proviso of Sub-section (2) of Section 391 of the Companies Act, 1956 is placed before the Court by the concerned applicant seeking sanction for such a scheme and the Court gets satisfied about the same.

vi. That the proposed scheme of compromise and arrangement is not found to be violative of any provision of law and is not contrary to public policy. For ascertaining the real purpose underlying the Scheme with a view to be satisfied on this aspect, the Court, if necessary, can pierce the veil of apparent corporate purpose underlying the scheme and can judiciously X-ray the same.

vii. That the Company Court (now NCLT) has also to satisfy itself that members or class of members or creditors or class of creditors, as the case may be, were acting bona fide and in good faith and were not coercing the minority in order to promote any interest adverse to that of the latter comprising of the same class whom they purported to represent.

viii. That the scheme as a whole is also found to be just, fair and reasonable from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant.

ix. Once the aforesaid broad parameters about the requirements of a scheme for getting sanction of the Court are found to have been met, the Court will have no further jurisdiction to sit in appeal over the commercial wisdom of the majority of the class of persons who with their open eyes have given their approval to the scheme even if in the view of the Court there would be a better scheme for the company and its members or creditors for whom the scheme is framed. The Court cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the Court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction.

Case No. 2
Hindustan Lever Employees' Union Vs Hindustan Lever Limited and Ors. (1994)

IN THE SUPREME COURT OF INDIA

Appellant: Hindustan Lever Employees' Union Vs.

Respondent: Hindustan Lever Limited and Ors.

Spl. Leave Petn. (C) No. 11006 of 1994 etc. Decided On: 24.10.1994

1. Brief Facts of the Case

This case arose from the Merger under the Companies Act, 1956 of the two big companies-one, Hindustan Lever Limited (HLL), a subsidiary of Uni Lever (UL), London based multi-national company, and other Tata Oil Mills Company Ltd. (TOMCO), the first Indian company found in 1917 and public since 1957. The merger was challenged in the High Court by few shareholders of TOMCO, Federation of Employees Union of both the TOMCO and HLL, Consumer Action Group and Consumer Education and Research Centre. The High Court rejected the appeal and hence, a Petition was filed before the Supreme Court of India challenging the same.

TOMCO manufactured and sold products like soaps, detergents, toiletries and animal feeds. HLL also manufactured and sold similar products. Both the Companies had their registered office at Bombay. TOMCO had more than 60,000 shareholders with the following break-up:

Particulars	% of holding
Tata Group	22%
Financial Institutions	41%
General Public	37%

Business of Tata Oil Mills Co. Ltd. ("TOMCO") started declining in the year 90 - 91, they incurred a loss of Rs 13 Crore in the year 91-92 and another Rs 16

Crores in the first half of the year 92-93. Hence, the Board of TOMCO Ltd. decided to collaborate with Hindustan Lever Ltd. ("HLL"), a 100% subsidiary of Unilever ("UL"). The Scheme, inter alia, provided for transfer and vesting in HLL of the Undertaking and business of TOMCO together with assets and liabilities excluding certain assets and/or licence rights to use certain premises.

Both TOMCO & HLL availed service of Senior Partner of a reputed Chartered Accountant firm, for the purpose of evaluation of the share-price of the two Companies in order to arrive at a fair share exchange ratio. The said person was also a director of TOMCO.

He gave the Valuation Report and recommended an exchange ratio of two equity shares of HLL for every fifteen ordinary shares of TOMCO. The Board of Directors of both the Companies at their separate and independent meetings accepted the recommendation and approved the Scheme of Amalgamation.

The valuation of the shares for exchange ratio was determined by combining three well-known methods –

a. the yield method;
b. the asset value method; and
c. the market value method

The Valuation was further checked and approved by two other independent bodies at the instance of shareholders of TOMCO by the High Court and it has been found that the determination did not suffer from any infirmity.

2. Scheme of Events

i. Company Application No. 250 of 1993 filed by TOMCO.

ii. The Court passed an order of 29th April, 1993 directing TOMCO to call the meetings of the debenture holders, creditors, ordinary shareholders arid preference shareholders on 29th and 30th June, 1993.

iii. Individual notices of the said meetings together with a copy of the Scheme of Amalgamation, the statement as settled by the Company Registrar and as required under Section 393(1)(a) of the Companies Act, 1956 (the Act) and a proxy form was sent to concerned members as required by law.

iv. The meeting of the ordinary shareholders was held on 29th June, 1993 and was attended by 1,294 members holding 85,85,009 ordinary shares and by 1,652 members holding 55,18,251 ordinary shares through proxies. In the shareholder's meeting amendment was proposed to the effect that the exchange ratio should be 5:15 shares in place of 2:15 shares as envisaged in the Scheme. 99.64% of ordinary shareholders voted against amendment and 99.72% voted in favour of the Scheme as proposed.

v. Debenture holders voted 99%, secured creditors voted 100%, unsecured creditors voted 84.30% and preference shareholders voted 100% in favour of the Scheme.

vi. Similar directions were also issued to HLL by the Court on 29th April for convening the meeting on 30th June, 1993 of the equity shareholders and creditors,

vii. On 30th June, 1993, shareholders of HLL at their Extraordinary General Meeting approved the proposed scheme by the requisite majority.

viii. The meeting of the creditors was held on 2nd July, 1993 under the chairmanship of Mr. S.M. Datta, Chairman of HLL, as directed by the Court. The creditors also voted for the Scheme.

ix. The merger scheme was challenged by few shareholders of TOMCO, Federation of Employees Union of both the TOMCO and HLL, Consumer Action Group and Consumer Education and Research Centre.

3. Issues Raised by the objectors

According to the appellants, the Scheme should not be sanctioned for the following reasons:

i. Violation of Section 393(1)(a) of the Act in not making required disclosures in the explanatory statement.

ii. Valuation of share exchange ratio is grossly loaded in favour of HLL.

iii. Ignoring the effect of provisions of the Monopolies and Restrictive Trade Practices Act (the Monopolies & Restrictive Trade Practices Act).

iv. Interest of employees of both the Companies was not adequately taken care of.

v. Preferential allotment of shares at less than market price to Unilever is not in public interest.

vi. Mala fide on account of existence of quid pro quo between Unilever and Tata Sons Ltd.

vii. Valuer's Report is not acceptable to the TOMCO shareholders as he was a director of TOMCO and further as the valuation of the shares for exchange ratio was determined by combining three methods of valuation.

One shareholder of TOMCO, Mr. M.C. Jajoo, gave direction to two Valuers to give their opinion on the Valuation Report. The said two Valuers by their joint letter with copy to Mr. Jajoo confirmed that the share exchange ratio determined by the Valuer was proper.

4. Court's Observations and Decision in the case

i. With respect to the first contention that Valuer's report

is not acceptable to the TOMCO shareholders, as the valuation of the shares for exchange ratio was determined by combining three methods, the court's observations were as under:-

Equity Share Data

Hindustan Lever Ltd. – Market Price as on 17th Jun 1993 was Rs. 375

As at	31.12.92	31.12.91	31.12.90
Face Value/Share (Rs.)	10	10	10
Book Value/Share (Rs.)	23.8	20.75	27.36
EPS (Rs.)	42%	38.50%	42%
Dividend (%)	7.03	5.73	6.29

The Tata Oil Mills Company Ltd. - Market Price as on 17th Jun 1993 was Rs. 52.50

As at	31.12.92	31.12.91	31.12.90
Face Value/Share (Rs.)	10	10	10
Book Value/Share (Rs.)	29.75	29.45	36.17
EPS (Rs.)	0.3	0.5	5.19
Dividend (%)	0.0%	12.5%	20.0%

The Market price of TOMCO share truly reflected the bleak outlook of the Company, hence it cannot be said that the market price as on 17.6.93 did not reflect the true picture of the value of the Company's shares.

On the market price basis as on 17.6.93 (the last price available before the circular letter dated 21.6.93 issued to the shareholders of the two Companies), the exchange ratio of 2:15 was very apt. If the yield method was adopted, the ratio would be astronomically high in favour of HLL. But, if the book value was taken per share, then TOMCO shares would be of higher value than HLL shares.

In this respect, the court has held that the usual rule is that shares of the going concern must be taken at quoted market value but in case of amalgamation, a combination of all or some of the methods of valuation may be adopted for the purpose of fixation of the exchange ratio of the shares of the two companies. It was noted that even in such a situation, the book value method has been described as more of talking-point than a matter of substance.

ii. With respect to the next contention that Valuer's report is not acceptable to the TOMCO shareholders as he was a Director of TOMCO, the courts observations were as under:-

The Valuer was a Director of TOMCO and HLL had no difficulty in accepting the share exchange ratio fixed by him, even though he was a Director of TOMCO. Hence if there was any bias, it should have been in favour of TOMCO and not against TOMCO.

iii. With respect to the next contention that Valuation of Shares exchange ratio is grossly loaded in favour of HLL the Court's observations were as under:-

- Jurisdiction of the Court in sanctioning a scheme of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetic test.
- A Company Court does not exercise appellate jurisdiction. It exercises a jurisdiction founded on fairness.
- What requires a thoughtful consideration is whether the Company Court has applied its mind to the public interest involved in the merger.
- It is not required to interfere only because the figure arrived at by the Valuer was not as better as it would have been if another method would have been adopted.
- What is imperative is that such determination should not have been contrary to law and that it was not unfair to the shareholders of the company which was being merged.
- Court'sobligationistobesatisfiedthatvaluation was in accordance with the law and it was carried out by an independent body.
- Since 95% of the shareholders who are the best judge of their interest and are better conversant with market trends agreed to the valuation determined, the court declined to interfere with the same.
- It was held that sales by open public auction or inviting tenders from general public may have fetched more price due to competition, but that could not result in vitiating the determination of the valuation. The amalgamation cannot be faulted for this reason.

iv. With respect to the contention that the interest of employees of both the companies was not adequately taken care of, the Court'sobservations were as under:-

- The scheme of amalgamation provided that all the staff, workmen or other employees in the service of the transferor company (TOMCO) immediately preceding the effective date shall become the staff, workmen and employees of

the transferor company.

- There were Clauses in the scheme of amalgamation that protected the interest by providing that the terms and conditions of such employees shall not be less favourable and all benefits such as PF etc. shall stand transferred to the HLL.
- The grievance of the employees that no safeguard had been provided for Hindustan Lever Employees Union appeared to be off the mark as it is the interest of the employees of TOMCO which had to be protected.

v. With respect to the contention that a foreign company was being given a large interest in the assets of TOMCO at a gross undervalue the Court held as under:-

- The shareholder has no interest in the assets of the company while the company is in existence. It is only at the stage of liquidation of the company that the shareholders become interested in the assets of the company. The share of any member in a company is movable property and transferable in the manner provided by the Articles of the company.

vi. The Apex Court also relied upon its judgement in the case of Fertilizer Corporation Kamgar Union v. Union of India, wherein it held that " ...it if not a part of the judicial process to examine entrepreneurial activities to ferret out flows. The Court is least equipped for such oversights. Nor, indeed, it is the function of the judges in our constitutional scheme. "Now merely because the scheme envisages allotment of 51% equity shares to Unilever, the scheme cannot be held to be against public interest.

In view of the aforesaid, the Appeals and the Special Leave Petitions were dismissed.

5. Key Learnings for Valuers from the above Case

i. More than 95% of the shareholders who are the best judge of their interest and are better conversant with market trends agreed to the valuation determined and hence, it could not be interfered by Courts as, certainly, it is not part of the judicial process to examine entrepreneurial activities to ferret out flaws.

ii. The Court in sanctioning a claim of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetical test. A Company Court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on fairness. It is not required to interfere only because the figure arrived at by the Valuer was not as better as it would have been if another method would have been adopted. What is imperative is that such determination should not have been contrary to law and that it was not unfair for the shareholders of the company which was being merged. The Court's obligation is to be satisfied that valuation was in accordance with law and it was carried out by an independent body.

iii. The following factors must be taken into account while determining the share exchange ratio. The stock exchange prices of shares of two companies, dividend presently paid on the shares of the company, relevant growth prospects of two company, the cover (ratio of after -tax earnings to dividends paid during the year) for the present dividend of two company, the relative gearing of the shares of two company, the value of net assets of two company, voting strength in the merged enterprise of the shareholders, past history of prices of two companies.

iv. It is not required to interfere only because the figure arrived at by the Valuer was not as better as it would have been if another method would have been adopted.

v. It was further held that the exchange ratio determined cannot be considered as malafide merely on the fact that the share exchange ratio is calculated through combination of three well-known methods i.e., net worth, market value and earning method.

vi. It was further held that "Afinancial institution holding 41% of shares of the transferor company did not find any fault in the valuation of share, the Court should not interfere with such valuation."

Prize-winning entries of the Essay Competition organized by ICMAI Registered Valuers Organization

Importance of Valuation- Building Aatmanirbhar Bharat

CMA Surya Narayan Mishra
MCOM, LLB, MFM, MBA, DCA, FCMA

Introduction:

What is Valuation: Valuation is the analytical process of determining the current (or projected) worth of an asset or a company. There are many techniques used for doing a valuation. An analyst placing a value on a company looks at the business's management, the composition of its capital structure, the prospect of future earnings, and the market value of its assets, among other metrics.An accurate valuation of a closely held 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.

What is Aatmanirbhar Bharat : Atmanirbhar Bharat (Devanagari: आत्मनिर्भर भारत, ISO: Āatmanirbhara Bhārata) which translates to 'self-reliant India', is a phrase used and popularized by the Prime Minister of India Narendra Modi and the Government of India in relation to the economic vision and economic development in the country.

Prime Minister Narendra Modi recently announced in his address to the nation in 12th may 2021 an economic package of Rs 20 trillion to tide over the coronavirus crisis under the Atmanirbhar Bharat Abhiyan. He said the economic package would play an important role in making India 'self reliant' and that it would benefit labourers, farmers, honest tax payers, MSMEs and the cottage industry. He said making the country self-reliant was the only way to make 21st century belong to India. According to the government, it is not protectionist in nature.

The english phrase has been used by Modi since 2014 in relation to national security, poverty and digital India. The first popular mention in hindi came in the form of the ‹Atmanirbhar Bharat Abhiyan' or 'Self-Reliant India Mission' during the announcement of India's COVID–19 pandemic related economic package in 2020. Since then phrase has been used across ministries such as the Ministry of Consumer Affairs, Food and Public Distribution, the Ministry of Education and the Ministry of Defence in relation to press releases, statements and policies. The phrase has also been used by the government in relation to India›s new National Education Policy and the 2021 Union Budget of India. The concept under the premiership of Narendra Modi has been adapted from previous explanations and usages of the concept in the Indian sub-continent.

Importance of Business valuation: A business valuation provides the business owner with multiple facts and figures regarding the actual worth or value of the company in terms of market competition, asset values, and income values. This information is something that all business owners should have available.

Necessity of Valuation in building of Aatmanirbhar Bharat:

Before discussing brief on above necessity we should know the Importance & Method of Valuation and also know the Five Pillar of Aatmanirbhar Bahrat:-

Most qualified CMA as an independent business appraisers we should follow the following business valuation methods:

- Capitalization of earnings – The calculation begins with annual earnings over one or more years. It then divides earnings by a "cap rate" that reflects the cost of capital and the risk of the company. For example, suppose a company has average annual earnings of $200,000 and a cap rate of 10%. Under this method, its estimated value would be $200,000/10% = $2 million.
- Discounted cash flow – This method, often used to value new businesses or companies with volatile earnings, begins by forecasting future earnings over several years. To account for the time value of money, a discount rate is then applied to each year of forecasted earnings.
- Comparable Sales and Discounts – Some appraisers modify their estimates of value based on recent sales of comparable companies in the same market or industry.

As a professional fellow of Cost Accountant, we should know the pillar of Atma Nirbhar Bharat:

The Five pillars of Aatmanirbhar Bharat focus on:

*. Economy:- Quantum jumps, not incremental changes

*.Infrastructure:- Represents modern India

*.System:- Technology-driven systems

*. Vibrant Demography: - Vibrant Demography of the largest democracy

*.Demand:-

The Five phases of Aatmanirbhar Bharat are:

*. Phase-I: Businesses including MSMEs

*.Phase-II: Poor, including migrants and farmers

*.Phase-III: Agriculture

*.Phase-IV: New Horizons of Growth

*.Phase-V: Government Reforms and Enablers

Valuations can be instrumental when it comes to accomplishing your objectives, and knowing the value of your business (throughout its life cycle) can be a helpful and effective management tool. Following, we'll explore several reasons why valuations are essential as your business continues to grow and evolve.

1. Valuations provide a baseline. Just like getting an annual physical at the doctor's office, regular valuations provide a baseline. They serve as an indication of what you're doing right

and what you could be doing better. Some years your value may be up, other years it may be down a little bit (particularly in the event of a market correction). But without knowing your baseline, you have no solid evidence of how you're doing. Think of a valuation as a health metric for your business that serves to measure your business's blood pressure.

2. Valuations help chart the course for the future. Simply put, you don't know where to go if you don't know where you are. Valuations can help you determine ways to improve the business. Perhaps a valuation will indicate the need for a technology investment or hiring an employee. Maybe you'll come to the realization that an expense can be reduced or eliminated. Valuations can often help an owner make a change to the business or assist with a decision they may have been having difficulty with.

3. Valuations measure progress. Performed regularly, valuations provide a pretty good measure of how you're doing compared to the path you've set for your business. To be most effective, valuations should be utilized in tandem with your strategic business plan and should be referred to as a component of any significant decision.

4. Valuations can identify gaps. A comprehensive valuation will utilize key performance indicators (KPIs) to look at the non-financial aspects of a business that are actually the underlying value drivers. Examples are corporate structure, client demographics, technology usage, and firm infrastructure. KPIs are instrumental in identifying areas of potential improvement for the business – and ultimately provide ways to increase value.

5. Valuations help you manage your business. 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. This helps you to take a holistic look at your business and make decisions that are highly impactful for your bottom line. It allows you to understand the subtle dynamics of your business and avoid unforeseen consequences of seemingly insignificant decisions.

6. Valuations create accountability. Now that you've utilized a valuation to identify gaps and set a path for the future (with measurable goals), you have, in essence, made yourself accountable for achieving those goals and can create discipline around them. Remember, this should be used as a component of your strategic business plan – because if you can measure it, you can manage it.

7. Valuations provide a benchmark. With little to no public data available on what businesses in this industry sell for (the vast majority of deals are never published), knowing your baseline value can allow you to benchmark yourself (via KPIs) against your peers, as well as "Best Practices" standards.

8. Valuations provide a perspective on price. When it comes times to transition (and all businesses will eventually transition), your historical valuations (remember, valuations should be an ongoing exercise) provide a starting point for price. Whether it's an external sale or internal next-generational transfer, you now have an idea of what your business could be worth to a prospective buyer (though price is only one component of a deal). Owners often have an unrealistic valuation expectation – having a baseline valuation and understanding what drives that value can help eliminate any surprises down the road.

9. Valuations can provide the gateway to capital. If you are considering borrowing capital for an acquisition or other business investment, any lender will want to know what leverage lies in your business. Your valuation is the first step in the process of securing capital.

10. Valuations are part of your estate plan. For an owner, the business value typically represents 50-70% of their personal net worth. More often than not, owners fail to diversify the concentrated stock position they hold in their own business. Knowing how the business value impacts your personal financials can help you better plan for your family's future.

- Unquestionably, valuations serve many purposes and go well beyond "what someone would pay for your business". Used properly, valuations allow you to see the inner-workings of what's really going on in your business. That insight puts you in a competitive position as you strive to strengthen and increase the value and overall performance of the business.

  It is very important as a valuer what is the purpose of Business valuation in the building of Aatmanirbhar Bharat, as we know purpose of valuation for realistic valuation:-

  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., A start up entrepreneur want to at least reach the break even point in the initial stage and how the cost can reduce than revenue and best way of valuation to earn profit.

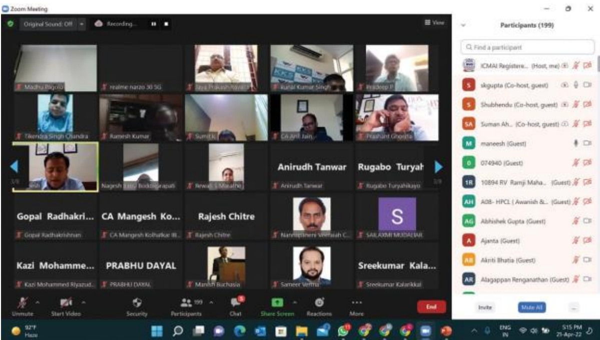
  To determining the current (or projected) worth of an asset or a company An analyst placing a value on a company looks at the business's management, the composition of its capital structure, the prospect of future earnings, and the market value of its assets, among other metrics.

- To acquire most assets in limited liabilities and borrowings , some what business valuation in regards to start-up is very essentials when IPO will issue on such start-up

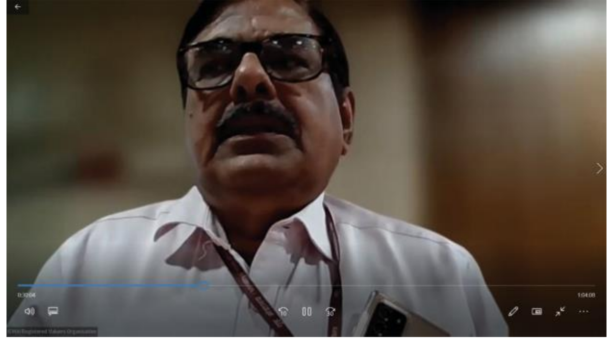
Conclusion.:

Aatmanirbhar Bharat promises to provide benefits to everyone from every sector. It aims to be self resilient to face the competition with the global supply chain. The package will support the poor, labourers and migrant workers from both organized as well as unorganised sectors in this connection valuation is very necessary to proper evaluation and valuation of the project with respect to Aatmanirbhar Bharat building and achievement of it , without proper valuation impact is null and success rate will be zero.

NATIONAL CONCLAVE ON PROFESSION AND PRACTICE OF VALUATION VISION 2025



SEMINAR ON THE OCCASION OF 5th FOUNDATION DAY ICMAI RVO



ICMAI Registered Valuers Organization

(A Subsidiary company of the Institute of Cost Accountants of India)

Announces

Summer Bootcamp

Online Certificate Course on Valuation

Objective of the Course: Valuation is the crux of all market transactions. In the Business worldvaluation is the key for companies at every stage of their life cycle. Valuation expertise opens upnew vistas of professional engagement in various sectors of economy. This course has been designed for the faculty and the students of Post Graduate courses in Commerce and Management so as to provide them knowledge inputs in the domain of valuation for enhancing their Potential Quotient in the Business and Academic world.

Eligibility: Faculty of Commerce / Management and students of B.Com, BBA, BBS, M.Com, MMS, MBA, PGDBM, Research Scholars in Commerce and Management, CMA, CA, CS, CFA Concept and purpose of valuation

- Approaches and Methods of valuation
- Environmental Scanning for valuation
- Assumptions and projections for valuation
- Valuation for Mergers and Acquisition
- Valuation of Startup Companies
- Valuation of Shares
- Use of Excel / R Studio / Python for Valuation
- Caveats, Disclaimers and Limitations in valuation
- Preparing a valuation Report

Schedule of Course

Course starting from 4th June, 2022

Course will end on 18th June, 2022

Weekend sessions Saturday and Sunday - 3 pm to 6.30 pm

Last date for Registration: 30th May, 2022

Course Faculty : The Course would be delivered by experienced valuation professionals

Methodology : The Course would be delivered using hands on exercises / Case studies

Course Fee : Rs.1500 for Faculty and Rs.800 for students (All inclusive)
20% discount for Registrations before 25th May, 2022

Enquiries: Pl contact manager@rvoicmai.in / 9555215557

Certificate will be awarded to all participants

Registration Link:

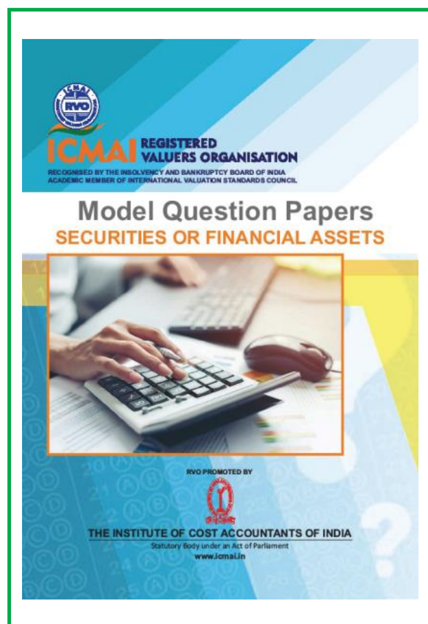
https://docs.google.com/forms/d/e/1FAIpQLSegiaK8LSJnsSSiXCAaTe-nCJ_7hOJAVsG3xjsvqg9Dg0cF0g/viewform

LIMITED SEATS

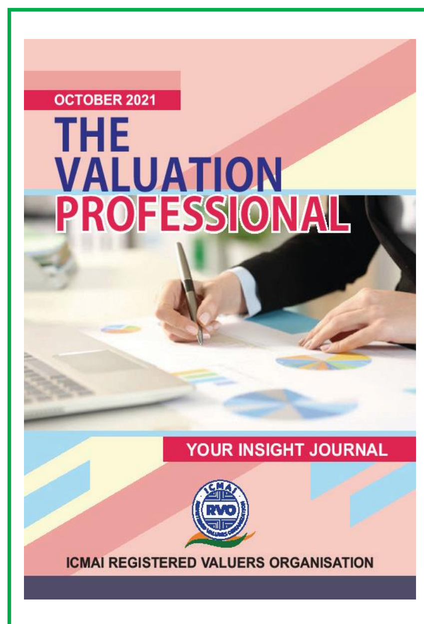
BANK DETAILS FOR MAKING PAYMENT OF FEES

Name of Company:	*ICMAI Registered Valuers Organisation*
Account No:	*6648752076*
Bank Name:	*Indian Bank*
IFSC Code:	*IDIB000D008*
Branch:	*Defence Colony*

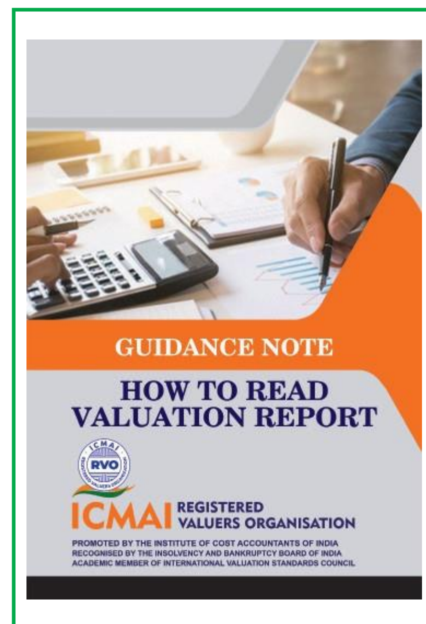
PUBLICATIONS



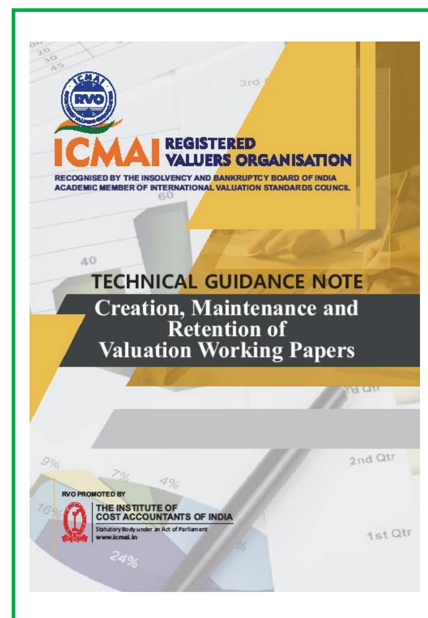
Model Question Papers
Securities or Financial Assets



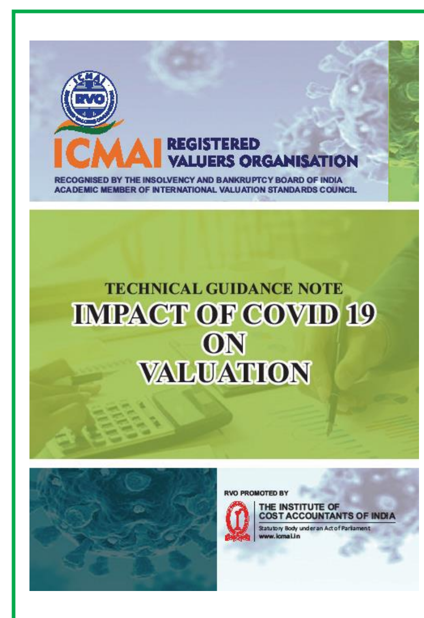
The Valuation Professional



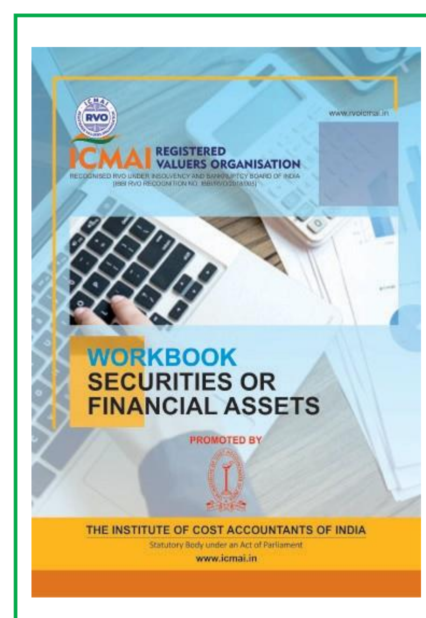
Guidance Note
How to Read Valuation Report



Technical Guidance Note
Creation Maintenance and
Retention of Valuation Working
Papers



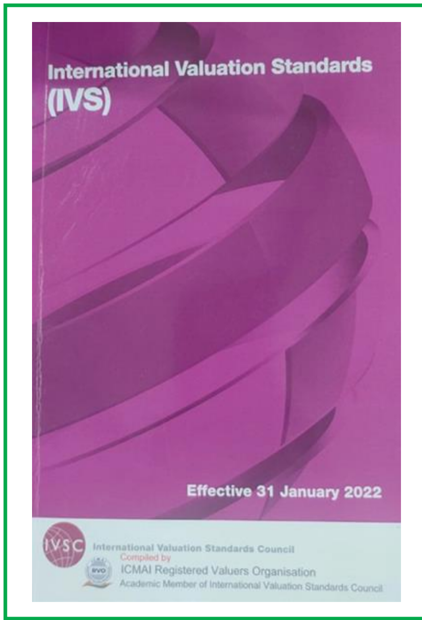
Technical Guidence Note
Impact of Covid 19
on Valuation



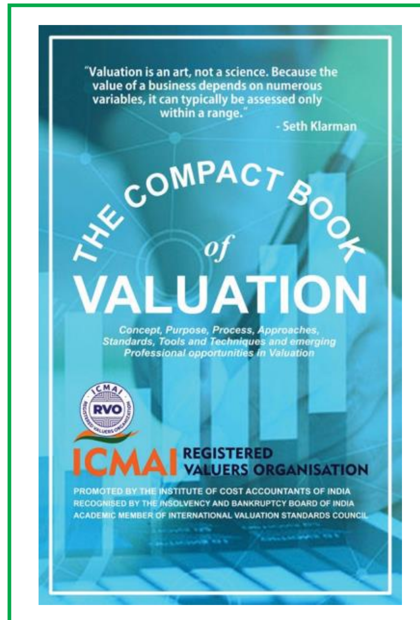
Work Book
Securities or Financial Assets

Link:- https://www.rvoicmai.in/publication/

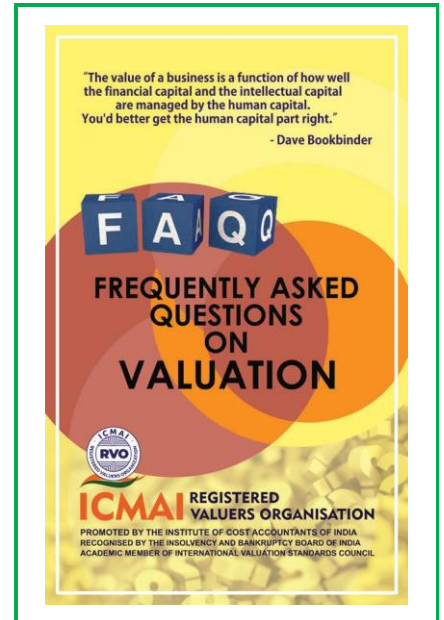
PUBLICATIONS



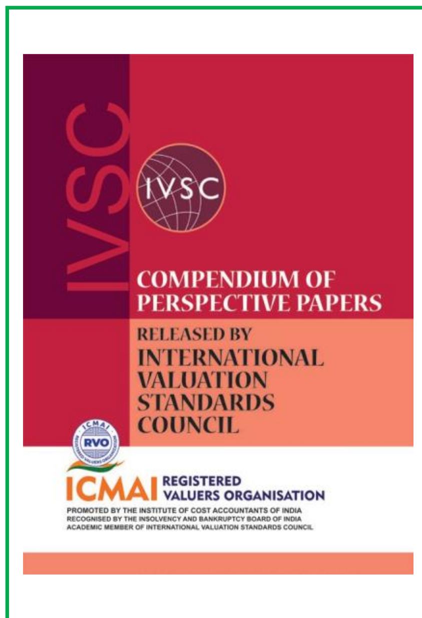
International Valuation Standards



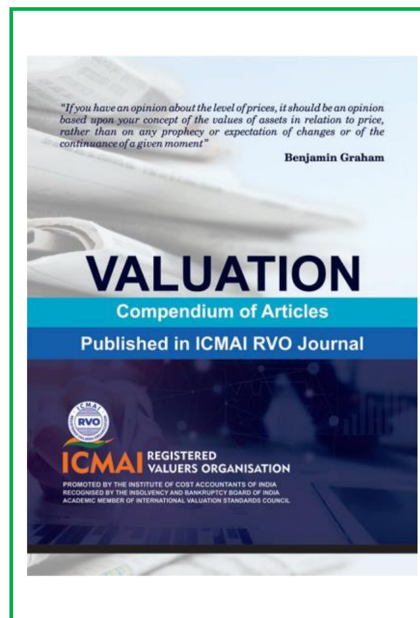
The Compact Book of Valuation



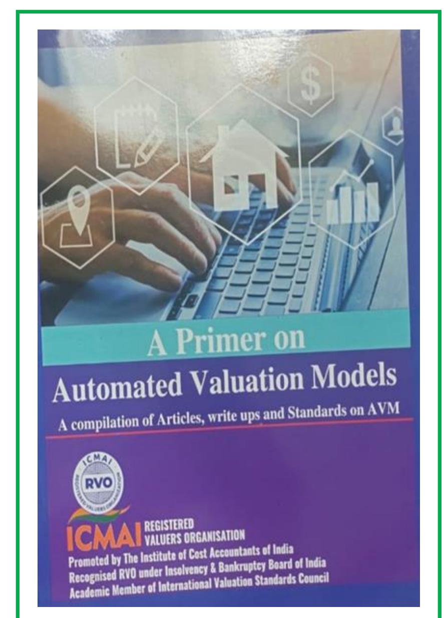
FAQ
Frequently Asked Questions on Valuation



Compendium of Perspective Papers



Compendium of Articles



Automated Valuation Models

Link:- https://www.rvoicmai.in/publication/

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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*
- *Merger and Amalgamations*
- *Demergers*
- *Scheme of compromise or arrangement with creditors/members*
- *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*

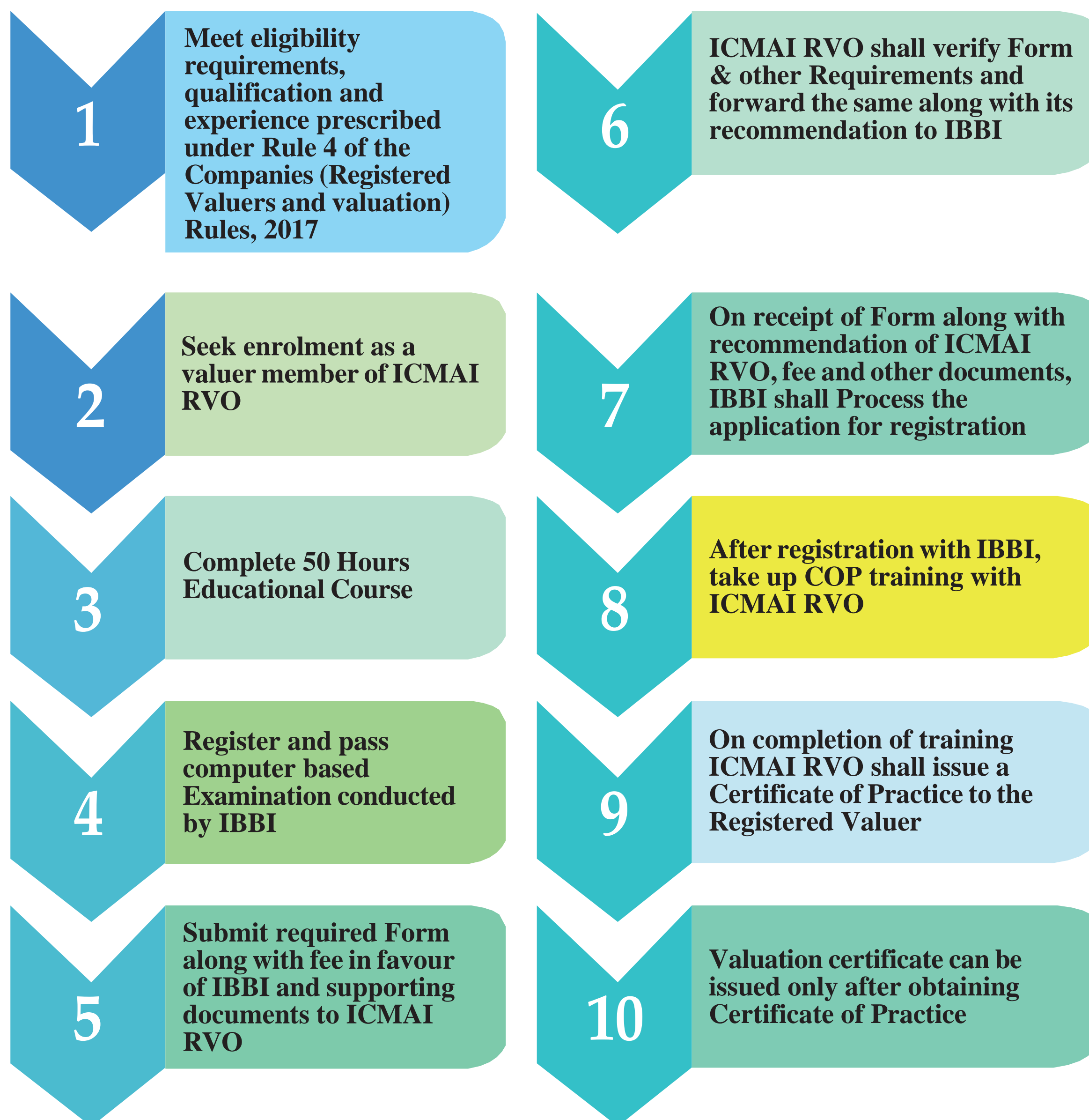
Insolvency and Bankruptcy Code 2016

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

Income Tax Act, 1961

- *Valuation Methodology for Issue of Unquoted Equity Shares – Rule 11UA(2)2 56(2)*
- *Issue of Unquoted Shares (Other Than Equity Shares) – Rule 11UA(1)(c)(c)*
- *Transfer of Shares and other Securities*
- *Valuation for Capital Gains*
- *Transfer Pricing – International Transactions between Associated Entities*
- *Indirect Transfer Pricing – Capital Gain arising to Non-Resident on transfer of shares of foreign company*
- *Valuation of Equity Shares held by the Minority share Holders.*

PROCESS FOR BECOMING REGISTERED VALUER



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 I ndia or abroad.".*		

PROCESS FOR IBBI EXAMINITION

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

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 https://certifications.nism.ac.in/nismaol/
e. A fee of Rs.1500 (One thousand five hundred rupees) is applicable on every enrolment;
f. The duration of the examination is 2 hours;
g. A candidate is required to answer all questions;
h. A wrong answer attracts a negative mark of 25% of the marks assigned for the question;
i. A candidate needs to secure 60 % of marks for passing;
j. A successful candidate is awarded a certificate by the Authority;
k. A candidate is issued a temporary mark sheet on submission of answer paper;
l. No workbook or study material is allowed or provided;
m. No electronic devices including mobile phones and smart watches are allowed; and
n. 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.

Disclaimer:

The information contained in this document is intended for informational purposes only and does not constitute legal opinion, advice or any advertisement. This document is not intended to address the circumstances of any particular individual or corporate body. Readers shouldnot act on the information provided herein without appropriate professional advice after a thorough examination of the facts and circumstances of a particular situation. There can be no assurance that the judicial/quasi-judicial authorities may not take a position contraryto the views mentioned herein.

ICMAI REGISTERED VALUERS ORGANISATION

RECOGNISED RVO UNDER INSOLVENCY AND BANKRUPTCY BOARD OF INDIA

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