YOUR INSIGHT JOURNAL

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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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FROM THE CHAIRMAN's DESK

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

The role of a Valuation Analyst is to determine the extent to which the value from a product is delivered and then quantify it.

A product can deliver value to it's user in various forms. The value addition may be economic or emotional. The quantification of value or identification of the magnitude of value is called pricing. Now, pricing might seem simple to you but it's not that simple. It highly varies with individuals and circumstances. Valuation is relative not absolute and it varies with our priorities. Also, you should be made aware that human priorities depends on both internal as well as external factors. Valuation varies with human priority and priority depends on internal and external conditions.

While the view of value and the entire process of value creation, production, and delivery downstream are important, there are now emerging views concerning the overall activities and relationships of the value creation and delivery process. "Value" in the context of consumer and organizational transactions implies value to be a positive net result of benefits received by adding value to both customer and supplier, less the costs involved.

There are two main ways to measure a company's ability to create value: from an 'external' perspective, focusing on the rise or fall in its share price over time; or from an 'internal' perspective, by analysing its business fundamentals. Both are likely to tell different but equally valid stories. The main difference is that the external view incorporates market expectations of a company's ability to generate additional value in the future. Whether these are reasonable is another issue which we address later

FROM THE PRESIDENT's DESK

CMA Vijender Sharma
Nominee Director
ICMAI Registered Valuers Organisation

President
The Institute of Cost Accountant of India

Asset valuation helps identify the right price for an asset, especially when it is offered to be bought or sold.

It is beneficial to both the buyer and the seller because the former won't need to pay more than the asset's value nor will the latter be paid less than the asset's value. It is also 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. Asset pricing is seen as the biggest challenge to return generation in 2020 across all private capital asset classes, according to a reports. Everyone wishes to have a pool of investments that could yield maximum returns. But, at times, they undermine the associated risks with those instruments and end up creating something which finally leaves a bad taste.

Valuation is becoming a global profession particularly with the recognition of various designations internationally. The issues facing values in one country are impacting on valuation professionals in other countries. Valuation is an art and science of estimating the value for a specific purpose of a particular interest in property at a particular moment in time taking into account all features of the property and considering all factors of the market.

FROM THE MD's DESK

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

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. People focus on publicly traded stocks and assume that every investor is perfectly diversified (to use the CAPM). If everyone is perfectly diversified, or can easily become so, then all investors are homogeneous and, therefore, irrelevant from an individual perspective. Thus, beta (in the CAPM) is all that matters.

One can use total beta (TB), defined as the standard deviation of a stock/standard deviation of the market, to calculate the general equity stock market participants' total cost of equity (TCOE), or their unsystematic risk premium—if necessary.Then, and only then, can the analyst carefully compare the subject company to the guidelines to select a TCOE or unsystematic risk premium for the subject company since, as pointed out, this risk is not about any unique or "company-specific" risk per se. If you use TB, there is no need to select the subject company's beta (or industry risk premium in the buildup method), the alleged and dubious size premium, and then completely guess at the CSRP. So you either have to select and defend three selections (beta/industry risk premium, the size premium, and the CSRP) in the buildup method

PROFESSIONAL DEVELOPMENT

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PROFESSIONAL DEVELOPMENT PROGRAMS

March'2023 to May'2023	
Date	**PD Programs**
1st March 2023	Seminar on Journey and Success Stories of Women
03rd-04th March 2023	Master Class
05th March 2023	Achieving Excellence in Valuation
06th March 2023	International Women's Day
09th-10th March 2023	Master class on Valuation
13th-14th March 2023	Workshop on Valuation
15th March 2023	Interactive Meet of Registered Values
16th-17th March 2023	Learning Session on Valuation
18th-19th March 2023	Certificate Course in Valuation Standards
20th-21st March 2023	Master Class on Valuation
22nd March 2023	Valuation boot Camp
23rd-24th March 2023	Learning Session on Valuation
25th-26th March 2023	Master Class on Valuation
25th-26th March 2023	Crash Course Preparation for Valuation Examination
27th-28th March 2023	Learning Session on Valuation
29th March 2023	Competency Building Program in Valuation
30th-31st March 2023	Valuation Roundup
05th-06th April 2023	Achieving Excellence in Valuation
08th-09th April 2023	Workshop on Valuation
13th-14th April 2023	Master Class on Valuation
15th-16th April 2023	Valuation Bootcamp
15th-16th April 2023	Crash Course Preparation for Valuation Examination
20th-21st April 2023	Learning Session on Valuation
25th-26th April 2023	Master Class on Valuation
29th -30th April 2023	Learning Session on Valuation
2nd May 2023	ICMAI RVO in association with IBBI organises Valuation Bootcamp
6th -7th May 2023	2 Days Focused Learning Program of Case Studies (Securities or Financial Assets)
7th May 2023	Learning Session on Valuation
11th -12th May 2023	Master Class on Valuation
17th -18th May 2023	Learning Session on Valuation
20th -21st May 2023	Bootcamp on Valuation
24th -25th May 2023	Workshop on Valuation

50 Hours Training Programs

March`2023 to May'2023	
Date	**Programs**
17th Mar to 19th Mar & 23rd Mar to 26th Mar 2023 (Seven Days Program)	50Hrs Educational Course on Valuation in Securities or Financial Assets
7th April to 9th April and 13th April to 16th April 2023 (Seven Days Program)	50Hrs Educational Course on Valuation in Securities or Financial Assets
21st Apr to 23rd Apr & 27th Apr to 30th Apr 2023 {Seven Days Program}	50 Hrs. Educational Course on Valuation (Plant & Machinery, Land & Building
02nd June to 04th June & 08th June to 11th June 2023 {Seven Days Program}	50 Hrs. Educational Course on Valuation (Plant & Machinery, Land & Building

Articles

ARTICLE

VALUATION
CONCEPTS, ORIGIN AND IMPORTANCE

CMA P.A.N. Murty

This paper is intended for evoking interest in the minds of students who are willing to take up this profession and contains general Principles instead of weighing pros and cons of different valuation techniques and methods. For more understanding of the subject, one has to go through standard Accounting Text Books like Shukla & Gravel with good text books of Economics.

When treated as a Noun, it's a Professional judgement a bout how much money something is worth. Back at about 6000 years Mesopotamia tribes adopted bartering by the Phoenicians. In India the same is prevailent from Vedic period. It's a system of exchange in which participants in a transaction directly exchange goods or services for other goods or services without using a medium of exchange, such as money. At some period Salt has been used to exchange goods/services including Gold and precious metals till the currency came in to existance, removing the difficulties in valuation.

A When business grow within and outside of any country, the valuation of different country 's currencies evolved. Economists evolved different methods to value different currencies on perpetual basis. Value of any asset is dynamic in nature and cannot be constant at all times, and all the stake holders must be satisfied.

Here, we must understand that the Valuation is a process of determining the worth of an asset or company, since it provides prospective buyers with an idea of how much they should pay for an asset or company and for prospective sellers how much they should sell for.

NECESSITY OF ASSET VALUATION

In case of an on going business, the valuation of any Asset is very simple i.e., the Book Value. But, when the business is required to undergo changes due to Absorption, Amalgamation or Reconstructions, the Assets of the Company must be valued in a fair and equitable method so to say the Liabilities also (since out liability is some one's asset), perfectly satisfying all the Stake holders viz.. Shareholers, Financers, and even Government to see that tax is not foregone. So it is like an act of balancing on a rope! Valuation of Assets also required for Investment analysis, Capital Budgeting and Litigation.

In case of funding, we might need an objective valuation for negotiations with the banks or any potential investor for raising funds. Professional documentation for your business worth is necessary as it can enhance credibility to your lenders.

EXISTING VALUATION METHODS

1. The Market Capitalisation – This being the simple and most effective method of a company valuation.
2. Times Reveneu Method – It suggests a stream of revenue generated over a specific time period multiplied by a number determines by the condition of the ind ustry and economic environment, viz: A tech company be valued at 3X revenue while a service company at 0.5X revenue. This is not absolute and may change from time to time and industry to industry.
3. Earning Multiplier Method – This method can determine the real value of the business more accurately that the Times Revenue Method. This method depends on the company's profits to determine financial success as the Sales Revenue cannot be accurate. This method adjusts future earnings against the current cashflow, which could be reinvested at the recent interest rate over the exact same time period. This earnings multiplier adjusts the P/E ratio to account for original interest rate.
4. Discounted Cash flow Method
5. Book Value Method (Historical Cost less the Depreciation charged till date)
6. Liquidation value.
7. Apart from ABOVE, as per necessity, (i) Break up value; (ii) Replacement Value, (iii) Asset based valuation etc. are in vogue.

WHO HIRE VALUATION EXPERTS

1. Primarily Insurance Companies are using the services of Surveyor/Valier to assess the damages of any Asset. Stock etc in differently situations of their business..

2. Banks often use the services of Business valuers to help them risk free financing.

3. In cases of Mega Mergers by Amalgamations, Absorptions and Reconstruction of companies, the specialised services are required to be used to enable satisfying different stake holders.

4. Valuation of Asset most accurately is the crux of Insolvancy Proceedings and therefore, CGLT gives approval for appointment of Qualified Valuers, in each instant

Who can be Registered Valuers

Ministry of Corporate Affairs (MCA) and Insolvancy and Bankruptcy Board of India (IBBI) approves (i) CMAs, (ii) Cas and (iii) CSs to take up the Valuation Profession after fulfilling the required parameters. They are all imparting specialised training to make the profession a competetive one.

Who can be Registered Valuers

Valuation methods followed in each case shall vary and canot be same and hence it is to be regarded as a separate profession. The job is highly technical involved with utmost precission and the valuaer must instil confidence in the minds of different stake holders that proper justice is done to them by his services i.e., he must be non-controversial.

With the passage of time and as per research being carried out by different Institutions, more lucrative methods may evolve and Valuation become a very mch important subject

VALUATION OF COPYRIGHT

Dr. S K Gupta
Managing Director
ICMAI Registered Valuers Organization

TS is true with all intellectual property, a copyright has a special set of legal rights and protections that is afforded to the copyright owner. These legal rights are the basis for the value of a copyright.Section 62(1) (b) of Companies Act, 2013.

The Perspective

The resources of a business such as technology, copyright, trademarks and other IP are the building blocks of Brand Value. When we hear the word value, what comes into one's mind? For some, the word value may mean something worthy, something precious, something that is valuable, or something that is important. Most of us value our possessions, skills, knowledge, and property, which may include a cell phone, clothes, watches, cars, houses, farms, land, domestic animals, laptops, and music systems, to name a few. Children value the little scribbling or drawings they make on papers, walls, boards, or even the toys they create for themselves from paper, clay, boxes, wire, and many more. These are just a few items, which their owners may value.

However, when it comes to intellectual property (IP), which are the human mind's creations and coming in the form of intangible assets, a few people know and appreciate their value. Nevertheless, products of creativity and innovation can change one's life and even a country's economy. Intellectual property is as valuable (if not more) as any other property that a person may hold and treasure. Copyright and intellectual property valuation and audits requires a unique kind of business precision. IP is divided into two branches, Industrial Property, and copyright. This article addresses the copyright perspective

Prerequisites

To be able to value an IP asset, the asset should meet the following conditions:

- It must be separately identifiable (subject to specific identification and with a recognizable description)
- There should be tangible evidence of the existence of the asset (e.g. a contract, a license, a registration document, record in financial statements, etc.)
- It should have been created at an identifiable point in time.
- It should be capable of being legally enforced and transferred.
- Its income stream should be separately identifiable and isolated from those of other business assets.
- It should be able to be sold independently of other business assets.
- It should be subject to destruction or termination at an identifiable point in time

What is a copyright?

A legal right granted to an intellectual property owner is copyright. It helps protect the creator of the original material so that no one can duplicate or use it without authorization. Copyright is an important practical component of intellectual property / IP rights, brands and intangible assets. In general, copyright protects work such as:

Categories of materials that may be subject to copyright

These several categories of works that are subject to copyright protection are listed below:

- artistic—including paintings, sculptures, and drawings
- choreographic works—including ballet
- dramatic works—including plays and operas
- literary works—including books, manuscripts, newspapers, magazines, poetry, and advertisements

- musical works—including compositions, song lyrics, and advertising jingles (musical works include the compositions themselves and the recordings of the works)
- pictorial and photographic—including cartoons, pictures, maps, prints, drawings, and photographs
- video and audio visual works—including movies and motion pictures, music videos, and television programs

A Copyright provides for a bundle of exclusive rights to authors of original literary, musical, dramatic and artistic works, the sole right to authorize (or prohibit) the following uses of their copyrighted works:

- To reproduce all or part of the work.
- To make new (derivative) versions.
- To distribute copies by selling, renting, leasing, or lending them.
- To perform (that is, to recite, dance, or act) the work publicly.

To display the work publicly, directly, or by means of film, TV, slides, or other device or process

What are the benefits of copyright valuation?

As is true with all intellectual property, a copyright has a special set of legal rights and protections that is afforded to the copyright owner. These legal rights are the basis for the value of a copyright. A copyright can confer monopoly to the owner by creating a barrier to entry and thereby translate to buying power and greater profit margins for the owner.

The value of copyrights can be a significant factor in determining reasonable royalty rates for licensing agreements. Further, the value of copyrights can be an important factor in determining damages in cases of copyright infringement. Copyright used to generate the following benefits

* Increases the pricing power

* Greater Profit Margins

* Litigation award (PV of award less cost)

* Protect from threat of litigation

* Additional Sales

* Reduced Marketing

* Incremental margin

Copyright valuation

As with any form of valuation, the first step in copyright valuation is determining why the valuation is required. Are you faced with a licensing deal, merger, acquisition or litigation? Copyright protection is often a key asset in mergers, acquisitions and bankruptcy transactions. A copyright benefits from a specific bundle of legal rights that provides the author/creator the right to authorize or to prohibit the uses of the copyrighted work. Pertinent questions that pinpoint the nuances that affect value, such as:

- Is the work registered?
- Is the work factual?
- Does fair use erode value?
- Is the work made for hire?
- Does the copyright provide notice?
- Is the copyright in the public domain?

Widely adopted copyright valuation approaches

When carrying out a copyright valuation Intangible Business adopts widely accepted approaches based on a combination of the income, market and cost approaches.

The income approach: uses estimates of future estimated economic benefits or cash flows and discounts them, for the associated time and risks involved, to a present value. Each type of copyright has key sensitivities to consider such as the duration of the copyright and the expected lifetime of its creator. Another key consideration during copyright valuation is what drives the value of the copyright. The Income method values the IP asset based on the amount of economic income that the IP asset – Copyright is expected to generate, adjusted to its present day value. To determine the Economic Income

- Project the revenue flow or cost savings generated by the Copyright over the remaining useful life (RUL) of the asset.
- Offset those revenues/savings by costs related directly to the Copyright. Here, Costs could comprise labour, materials, required capital investment and any appropriate economic rents or capital charges.
- Take account of the risk to discount the amount of income to a present day value by using the discount rate or the capitalization rate

The Various Income Approach Methods typically involve some form of the following types of Analysis

- Incremental Income Analysis: This is the estimation of the difference between the amount of income that the owner/operator would generate with the use of the subject copyright and the amount of income the same owner/operator would generate without the use of the subject

- copyright.
- Profit Split Income Analysis: The estimation of the total income that the owner/operator would generate from the use of the copyright where the total income estimate is split between the copyright and all of the other tangible and intangible assets that contribute to the generation of the owner/operator total income estimate.
- Residual or excess Income Analysis: The estimation of the residual owner/operator income with the ownership/operation of the copyright. This residual income analysis is accomplished by first estimating the total owner/operator income.

The analyst then identifies and values all of the owner/operator tangible and intangible assets. A fair rate of return, which represents a capital charge or an economic rent, is then assigned to each category of the tangible and intangible assets. The analyst would then subtract the capital charge on contributory assets from the total owner/operator income estimate. Finally, the residual or excess income is assigned to the copyright.

The market approach: uses market based indicators of value. For copyright this can be transactions involving selling, buying, franchising or licensing copyright and related IP rights, which are often in practice bundled together. The Market Method is based on comparison with the actual price paid for a similar IP asset under comparable circumstances. Market approach methods are commonly used in a copyright valuation analysis

- **The cost approach:** This method is based on the intention of establishing the value of an IP asset by calculating the cost of developing same or identical IP asset either internally or externally.

The method aims to determine the value of an IP asset at a particular point of time by aggregating the direct expenditures and opportunity costs involved in its development and considering obsolescence of an IP asset. The Cost Method is generally the least used method as, in most cases, it is considered suitable only as a supplement to the income method. Both creation cost and re-creation cost methods may be used with regard to copyright valuation analysis. In all cost approach valuation analyses of copyrights, the analyst should consider as cost components both, the developer's profit and the entrepreneurial incentive – both of which often represent the largest components of value. The cost approach has certain limitations when analysing of a corporation-owned copyright and is often considered to provide a minimum estimate of value — as opposed to a maximum estimate of value.

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TERMINAL VALUE (TV)

CA. Madhusudan Kr. Poddar
FCA, IP, RV (SFA), B. Com (H), D.I.S.A. D.I.R.M., CAME

What Is Terminal Value (TV)?

The Life of Business as going concern is infinite. But we can reasonably forecast cash flow only for a limited number of year termed as explicit forecast period. Terminal Value represents the present value at the end of explicit forecast period of all subsequent cash flows to the end of the life of the asset or into perpetuity (if the asset has an indefinite life). Terminal value often comprises a large percentage of the total assessed value.

Understanding Terminal Value

Forecasting gets difficult as the time horizon grows longer. At the same time, businesses assumed to have infinite life need to be valued. To "solve" this, a valuer can use model like discounted cash flow (DCF), along with certain assumptions to derive the total value of a business or project.

Discounted cash flow (DCF) method is based on the theory that an asset's value is equal to all future cash flows derived from that asset. These cash flows must be discounted to the present value at a discount rate representing the cost of capital.

DCF has two major components:

- Value of cash flow for explicit forecast period and
- Terminal value

The explicit forecast period is usually about three to five years. Cash flow projection can not be accurately made for a period longer than that. This is where calculating terminal value becomes important. It measures the value of Company at the end of explicit forecast period.

Key points

Terminal value (TV) determines a company's value into perpetuity beyond the explicit forecast period—usually three to five years.

Valuer calculate terminal value as a key component of the discounted cash flow model (DCF) value of a business.

Value of cash flow for the Explicit forecast period and terminal value are both integral components of DCF.

Types of Terminal Value

There are three most common methods for calculating terminal value are perpetual growth (Gordon constant Growth Model), exit multiple, salvage & liquidation value.

Gordon (Constant) Growth Model:

In business valuation, free cash flow or dividends can be forecast for a discrete period of time, but it is challenging to estimate the cash flow for period stretching further into the future. Moreover, it is difficult to determine the precise time when a company may cease operations. To overcome these limitations, investors can assume that cash flows will grow at a stable rate forever, starting at some point in the future.

The terminal growth rate is the constant rate that a company is expected to grow at forever. This growth rate starts at the end of the last forecasted cash flow period in a discounted cash flow model and goes into perpetuity. A terminal growth rate is usually in line with the long-term rate of inflation, but not higher than the historical gross domestic product (GDP) growth rate.

The formula to calculate terminal value is:
$[FCF \times (1 + g)] / (d - g)$
Where:
FCF = free cash flow for the last forecast period
g = terminal growth rate
d = discount rate (which is usually the weighted average cost of capital)

Key points

- Assumes that a business has an infinite life and a stable growth rate of cash flows.
- The model assume only single constant growth rate. Model does not consider possibility of multiple growth rates.
- The expected growth rate should be constrained (capped) to be less than or equal to the growth rate of the economy in which the business operates.
- Various factors like the size of a company, existing growth rate, competitive landscape, profit reinvestment ratio, etc. have to be kept in mind while estimating the stable growth rate.

Key points
Exit Multiple Method

If investors assume a finite window of operations, there is no need to use the perpetuity growth model. Instead, the terminal value must reflect the net realizable value of a company's assets at that time. This often implies that the equity will be acquired by a larger firm, and the value of acquisitions are often calculated with exit multiples.

Exit multiples estimate a fair price by multiplying financial statistics, such as sales, profits, or earnings before interest, taxes, depreciation, and amortization (EBITDA) by a factor that is common for similar firms that were recently acquired. The terminal value formula using the exit multiple method is the most recent metric (i.e., sales, EBITDA, etc.) multiplied by the decided upon multiple (usually an average of recent exit multiples for other transactions).3 Investment banks often employ this valuation method, but some detractors hesitate to use intrinsic and relative valuation techniques simultaneously.

Key points

- It involves application of market multiple (EV/EBITDA, EV/Sales, etc.) to the perpetuity earnings/ income.
- The multiple comes from looking at what peer group companies are trading in the market. In this method valuers are ultimately using the “Market Approach” to determine the single largest component of cash flow in the DCF method. Hence the end result is a mix of both the market approach and income approach.

Salvage or Liquidation Value

This method is used in case we see the firm is not a going concern and might cease operations. The terminal value is calculated by determining the salvage or realizable value of all the assets less costs to be incurred for disposing such an asset.

Why Do We Need to Know the Terminal Value of a Business or Asset?

Most companies do not assume they will stop operations after a few years. They expect business will continue forever (or at least a very long time). Terminal value is an attempt to anticipate a company's future value and apply it to present prices through discounting.

How important is terminal value?

Terminal value accounts for a significant portion of the total value of a business in a DCF model, as it represents the value of all future cash flows beyond the projection period. This means that the assumptions made about terminal value can have a significant impact on the overall valuation of a business.

What Does a Negative Terminal Value Mean?

A negative terminal value would be estimated if the cost of future capital exceeded the assumed growth rate. In practice, however, negative terminal valuations cannot exist for very long. A company's equity value can only realistically fall to zero at a minimum, and any remaining liabilities would be sorted out in a bankruptcy proceeding.

Conclusion

Terminal value is the estimated value of an asset at the end of its explicit forecast period. It is used for in business valuation under DCF method. Terminal value account for a significant portion of the total value of a business. Terminal value can be calculated using three methods: the perpetual growth method, the exit multiple method, the liquidation/salvage value method. It is important to carefully consider the assumptions made when calculating terminal value as they can have a significant impact on the overall valuation of a business

ESG FACTORS IN VALUATION

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As the term sustainable investing gaining momentum among institutional and retail investors, the corporates across the globe are witnessing an influx of capital which aims to support sustainability in corporate practices. Although the concept of sustainability has been around for ages, yet it has started gaining more concrete shape during the 20th century. The term 'ESG' is soaring in this context. Environment, Social and Governance (ESG) is viewed as a philosophy which guides the social responsibility where benchmarks of responsible corporates are pinned while evaluating and considering a corporate for banking the money as investment. According to report by PwC, investors have started preferring and embracing ESG investing on a huge scale. It has been estimated that ESG investing would rise to $33.9 trillion by 2026. Further, it has been indicated that ESG oriented assets under management would rise double to $10.5 trillion in US, $19.6 trillion in Europe, $3.3 trillion in Asia Pacific region in 2026.

(Source: ESG factors from BWFA.com)

Recent years, investors have started infusing huge amount of funds and capital to support the sustainability practices among corporates. ESG can turn tables for companies in this context. Lack of ESG considerations hold the potential to jeopardise the long term sustainability of companies. ESG acts as a driver of business value. "E" refers to 'Environment' i.e. how much responsive the company is while using its resources and maintaining emission levels; "S" indicates 'Social' i.e. what are the actions taken and how company is maintaining its relations with its stakeholders; "G" indicates 'Governance' i.e. what is the response and behavior of company while managing "E" and "S" factors. ESG is set of inter-linked, qualitative, non-financial factors operating to make markets realize the relevance of sustainability in a company's actions. Five principal ways that have been identified through which good ESG practices can influence the valuation. First, top-line growth i.e. ESG based actions can lead to evolution of new products and services better aligned with customer needs, lead to discovery of new markets, and bring premium to sustainable products. Second, reduction in litigation charges i.e. ESG based actions can bring in more government support, access to subsidies, and lower litigation hassles from regulatory authorities. Third, improved capital allocation and asset optimization i.e. ESG based practices can lead to allocation of capital into the projects that would bring more sustainable investment opportunities. Fourth, cost reduction i.e. ESG based practices can reduce carbon footprint, lower emissions, and costs incurred on managing wastes. Fifth, increased labor productivity i.e. ESG practices can bring in talent to the corporate and make better minds to work towards a sustainable future.

Though experts and professionals have started recognizing the importance of ESG and ESG is becoming a concern at global level, yet valuation models incorporating ESG considerations are still in infancy stages. International Valuation Standards Council released Perspective paper "ESG and Business Valuation" to discuss incorporation of ESG factors into valuation analysis. ESG represents myriad of factors which evaluates the long term financial viability and sustainability of an enterprise.ESG disclosures are non-financial by nature. It has been misconceived for ESG not to have financial impact.

Incorporating ESG factors calls for taking a shift away from traditional approach of following factors that work to create value for a longer term. Under the conventional lens of valuation, cash flow drivers are considered to evaluate business valuation. These drivers underlie in conventional sales growth, profitability measures and capital expenditure numbers. Such estimates are largely economic in nature. Whereas under ESG based valuation, managers will have to expand their viewpoint on risks and opportunities. For instance, companies will have to pay a lot of attention in incorporating the impact of climate changes in their financial forecasts. Also, managers might be struggling to figure out the quantification of risks and opportunities related to climate emissions, climate change and other environmental factors. Under the modern lens of ESG based valuation, managers would look out in three dimensions 'E', 'S' and 'G'. 'E' under ESG lens, would be incorporating additional risks that are embedded in climate change, carbon emissions, environmental safety or weather conditions. Eg. The concern of keeping the water usage in control for beverage based companies, carbon emissions for companies dependent on conventional sources of fuel consumption. 'S' under ESG lens, would be incorporating the impact of social factors

based on stakeholders on revenue and cost. Eg. Employee unrest in garment industry, poor labor conditions, health and safety issues. 'G' under ESG lens, would be incorporating the impact of governance practices and policies of companies on the cashflows either in the form of taxes, fines or subsidies.

Similarly, while following 'Market Approach' valuation should consider identification and assessment of ESG practices on company. This calls for development of criteria, calibration of inputs form market to estimate the value comparable to peers. Whereas while following income approach, valuation would consider the impact of ESG practices into discount rate or cash flows itself.

ESG factors must be reflected into cash flow projections as well. This calls for explicit evaluation of value created by ESG practices for the company, including the impact on long term growth rate. As valuation is assumed to be sensitive to assumptions of long term growth rate, so the estimates for growth rates must incorporate ESG factors andfuture cash flows. The point of concern is figuring out the extent of impact on future cash flow, identification of the quantum of ESG factors on FCF, impact on long term growth rate.

The challenges faced by ESG based valuation are discussed as follows. First, the existing practices are not standardized. Practices, procedures and methodologies followed by valuers for estimating ESG indicators are not based on globally accepted standards and call for a lot of qualitative judgment. However, disclosures and reporting of ESG data and factors are still under development. Scoring on the grounds of ESG factors would be judgmental, and different practitioners assign different weightings/scorings to different ESG factors and practices by companies.

Another challenge would be estimation of extent of adjustment to be considered for cashflows and discount rates. Valuers must pay attention in not counting the risks of poor ESG practices twice. There should not be double counting of risks in the discount rate. For instance, in case the company has high ESG related risk, eg. Automotive industry, then it is wise to be careful while estimating downward adjustments in cashflows as the negative impact would already have been captured in industry beta.

Second, ESG practices are not all prevalent. These are mainly concentrated in developed nations. Large population across the globe is still not concerned with ESG, so it seem to be a long way in promotion of integrating ESG with valuation practices. Similarly, while applying materiality on ESG factors, valuers should consider internal assessments of companies as well as social media feeds in order to capture the impact of market sentiment of ESG risks.

Third, data, technical skills and sources of information are not readily available. ESG based valuation becomes more challenging especially when the information is not readily available. Lack of reliable ESG data, requirement of third party assessment, audit of cost impact analysis, ESG credentials, avoidance of 'greenwashing' practices are the tough calls on ESG based valuation. Subjectivity and judgement must be avoided in valuation. Lastly, there are a number of political uncertainties that revolve around the valuation practices based on ESG.

Thus, ESG considerations must be quantified and considered in valuations. Considering the implicationof ESG factors on long term sustainability of business and potential impact on financial viability of company, we can expect a paradigm shift in valuation practices considering long term benefits of ESG based factors in long term valuation, while simultaneously balancing the requirement of short term factors influencing firm valuation. Integrating ESG in valuation frameworks can allow the corporates to quantify and realize the benefits of environmental, social and governmental practices.

ARTICLE

MAXIMIZING VALUE:

An analysis of Valuation Provisions in the IBC Framework and possible improvements

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Valuation is an indispensable aspect of the insolvency resolution process or liquidation process as it enables stakeholders to obtain a precise understanding of the ***Corporate Debtor's (CD)*** *financial position on a particular date. To ensure that all parties involved in the process, including Resolution Professional (RP), CoC, other creditors of CD, statutory and regulatory authorities, shareholders, etc., have a comprehensive understanding of the assets and liabilities of the CD and can make informed decisions to maximise its value, accurate valuation is essential. In this article, the author aims to analyse current valuation provisions under the IBC framework and identify opportunities for further enhancements to the valuation process.*

Statutory Provisions relating to valuation under CIRP and Liquidation Process Regulations:

1.1 **Regulation 2(1)(hb) of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations 2016 – Definition of the Fair Value:**

1.1.1 "**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."

1.2 **Regulation 2(1)(k) of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations 2016 – Definition of the Liquidation Value:**

1.2.1 "**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**."

1.3 **Regulation 27(1) of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations 2016 – Appointment of Professionals:**

1.3.1 "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** of the corporate debtor **in accordance with regulation 35**."

1.4 **Regulation 35(1) of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations 2016 – Fair Value and Liquidation Value:**

1.4.1 **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 the two estimates of a value **in an asset class are significantly different**, or on receipt of a proposal to appoint a third registered valuer from the committee of creditors, the resolution professional may **appoint a third registered valuer for an asset class** for submitting an estimate of the value computed in the manner provided in clause (a)."

Explanation. - For the purpose of clause (b),
(i) **"asset class"** means the definition provided under the **Companies (Registered Valuers and Valuation) Rules, 2017;**
(ii) "**significantly different"** means a difference of twenty-five per cent. in liquidation value **under an asset class** and the same shall be calculated as **(L1-L2)/L1**, where,
L1= higher valuation of liquidation value
L2= lower valuation of liquidation value.]

(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."

1.5 **Regulation 32 of IBBI (Liquidation Process) Regulations 2016 – Sale of Assets, etc:**

1.5.1 "**The liquidator may sell-**

(a) an asset on a standalone basis;
(b) the assets in a slump sale;
(c) a set of assets collectively;
(d) the assets in parcels;
(e) the corporate debtor as a going concern; or
(f) the business(s) of the corporate debtor as a going concern:

Provided that where an asset is **subject to security interest**, it shall not be sold under any of the clauses (a) to (f) unless the security interest therein has been relinquished to the liquidation estate**.**"

1.6 **Regulation 35(2) and Regulation 35(3) of IBBI (Liquidation Process) Regulations 2016 – Valuation of Assets intended to be sold:**

1.6.1 **"(2)** In cases not covered under sub-regulation (1) or where the liquidator is of the opinion that **fresh valuation is required** under the circumstances, he shall within seven days of the liquidation commencement date, appoint two registered valuers to **determine the realisable value of the assets or businesses under clauses (a) to (f) of regulation 32** of the corporate debtor………"

1.6.2 "**(3)** The Registered Valuers appointed under sub-regulation (2) shall independently submit to the liquidator the estimates of **realisable value** of the assets or businesses, as the case may be, **computed in accordance with the Companies (Registered Valuers and Valuation) Rules, 2017,** after physical verification of the assets of the corporate debtor.

2. **Critical analysis of Statutory Provisions relating to valuation under CIRP Regulations:**

2.1 To fully understand the requirements outlined in Regulation 27 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, **it must be read in conjunction with** Regulation 35. These regulations mandate that the Resolution Professional overseeing the insolvency proceedings must appoint two Registered Valuers who will determine the **fair value and liquidation value** of the Corporate Debtor's assets, using **internationally accepted valuation standards (IVS)**. To ensure accuracy, the Registered Valuers must perform a **physical verification** of the inventory and fixed assets owned by the Corporate Debtor as of the Insolvency Commencement Date.

It is worth noting that the valuation of the Corporate Debtor's assets must be performed for each "**asset class**" separately, as per IBBI Regulations. In terms of Rule 2(1)(c) of the Companies (Registered Valuers and Valuation) Rules 2017 "**asset class**" means a **distinct group of assets**, such as **land and building**, **machinery, and equipment**, displaying **similar characteristics**, that can be classified and requires **separate set of valuers for valuation."**

2.2 **"Fair value"** and **"Market value"** are both standards of value used in various financial contexts. The International Valuation Standards (IVS) provide guidance on **standards of value or bases of value**, with **IVS 104** specifically outlining the "**Market Value**" standard. On the other hand, **IFRS 13 and IND AS 113** provide guidance on determining **"Fair Value"** for financial reporting purposes. Fair value, as defined by IFRS, refers to "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." This **differs from the meaning of fair value under CIRP Regulations**, which apparently aims to determine **"market value"** for the purpose of insolvency resolution through ownership transfer.

2.3 The IVS definition of **market value** is akin to the definition of **Fair Value** under CIRP Regulations, as it refers to "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 knowledgeably, prudently and without compulsion". It is worth noting here that there are notable differences between fair value as per IFRS and market value as per IVS. Fair value is based on market participants' assumptions, while market value is based on a hypothetical transaction between a willing buyer and willing seller. Additionally, fair value is often used for financial reporting purposes, while market value is often used for valuation purposes.

2.4 Valuing a distressed company (Corporate Debtor) **requires a tailored approach** that considers **various factors**, such as the nature and condition of the assets, the level of distress, and the purpose of the valuation, etc. While international valuation standards can provide guidance, the **most appropriate approach** for valuing a distressed company will depend on the **specific circumstances** of the company and the assets being valued, as determined by the RV based on actual ground realities.

2.5 The primary goal of the CIRP Regulations is to achieve **insolvency resolution through ownership transfer**, with liquidation only being used as a last resort. As such, determining the fair value (market value) of **each asset class separately** during CIRP may not always be the **most appropriate approach**.

2.6 For distressed companies, a more holistic approach that determines the fair value

(market value) of the company as a whole is often more suitable. This is because a distressed company's overall value is influenced by numerous factors that are difficult to quantify on **an asset class-by-asset class basis**, such as the company's brand, customer relationships, and management

team, etc. Valuing the company as a whole, provides a more comprehensive analysis of the company's financial position, including its liabilities, debt obligations, and potential restructuring costs. Therefore, a comprehensive analysis of the company's value is typically required to ensure that an **appropriate value** is assigned during the insolvency resolution process, rather than **focusing on individual asset classes**.

2.7 Furthermore, a holistic approach can provide a **more accurate picture** of the company's potential for **future growth and profitability**. It can help identify **key value drivers** and opportunities for improvement and can support the development of an **effective turnaround plan**. By valuing the company as a whole,

stakeholders can gain a **deeper understanding of the company's financial position**, allowing them to make more informed decisions and achieve the **best possible outcome** for all parties involved.

2.8 Additionally, if a distressed company is expected to continue operating in the foreseeable future, valuing the company with a "**going concern assumption**" may be **more appropriate**. This approach assumes that the company will **continue to operate indefinitely**, and that its assets will **continue to generate income in the future**. It is typically used in the valuation of a company as a whole, rather than for **individual asset classes**. This approach considers the company's potential for future growth and profitability.

2.9 While a holistic approach to valuing a distressed corporate person **is often appropriate,** in some cases, a separate valuation for each asset class may be necessary or more appropriate. For instance, if a distressed corporate person holds a portfolio of assets that are **not directly related to its core business**, such as real estate holdings or investments in other companies or has a valuable **portfolio of intellectual property rights (IPR)**, a separate valuation **for each asset class may be necessary**. In such cases, valuing each asset class separately ensures that each type of asset is valued accurately and appropriately, based on its **unique characteristics** and market conditions. Ultimately, the approach to fair value (market value) of a distressed corporate person **should be tailored to the specific circumstances** of the CD **and the assets being valued**, with the **goal of achieving the best possible outcome for all stakeholders involved.**

2.10. The Liquidation Value is an important standard of value used in business valuation. According to IVS 104, the Liquidation Value is defined as the amount that would be realized when an asset or group of assets is sold on a piecemeal basis. This standard of value considers the costs of getting the assets into saleable condition, as well as the costs of the disposal activity. There are two different premises of value under which the Liquidation Value can be determined: an orderly transaction with a typical marketing period, or a forced transaction with a shortened marketing period. The first premise assumes that the sale will take place under normal market conditions, while the second premise assumes that the sale will occur under more urgent or distressed conditions.

2.11 According to IVS, it may be appropriate to conduct a separate valuation for each asset class of a Corporate Debtor to determine its Liquidation Value on the Insolvency Commencement Date. It is important to note that the Liquidation Value is typically lower than the value that could be obtained if the assets were sold as a going concern. This is because there may be time pressure and buyers may be less willing to pay full value for assets that are being sold individually rather than as part of a larger business. Despite its limitations, the Liquidation Value approach can provide a more accurate estimate of the value that could be obtained if the assets were sold individually. It can also help to avoid overvaluing assets based on a Going Concern assumption that may not be realistic in the context of liquidation. However, it is important to recognize that the Liquidation Value may not reflect the long-term earning potential of the assets or their strategic value to a potential buyer.

3. **Critical analysis of Statutory Provisions relating to valuation under Liquidation Process Regulations:**

3.1 Regulations 32 and 35 of the IBBI (Liquidation Process) Regulations, 2016 provide important guidance on the valuation of assets and businesses in the context of liquidation. Specifically, the Liquidator is required to appoint two Registered Valuers to determine the realisable value of the assets or businesses with the assumption that they may be sold in a variety of ways:

A. An asset on a standalone basis.
B. The assets in slump sale.
C. A set of assets collectively.
D. The assets in parcels.
E. The Corporate Debtor as a going concern; or
F. The business(s) of the Corporate Debtor as a going concern.

3.2. These provisions afford the Liquidator and Registered Valuers a great deal of flexibility in undertaking valuations under the IBBI (Liquidation Process) Regulations, 2016. This is in contrast to the more prescriptive requirements for valuation under the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. By providing a range of options for the sale of assets and businesses, the IBBI (Liquidation Process) Regulations, 2016 allow for a more elaborate and tailored approach to valuation that can better reflect the specific circumstances of each case.

3.3 The IBBI (Liquidation Process) Regulations mandate the computation of the "**Realizable Value**" of assets. Although not considered a **standalone standard of value** under the **International Valuation Standards (IVS**), the Realizable Value is a **widely used concept** in valuation practice, especially in the **context of liquidation**. It is the estimated amount that could be obtained from the sale of an asset or group of assets in an **orderly or forced sale scenario**, after accounting for the costs associated with the sale. This represents the **net amount that would be realized** by the seller after deducting expenses like broker fees, legal fees, and marketing costs. Realizable Value is typically lower than the fair market value or going concern value of an asset or business as it reflects the likely outcomes of a sale in **a less-than-ideal market condition**. The Realizable Value is an essential concept in liquidation as it represents the amount that creditors **can expect to receive** from the sale of the debtor's assets.

3.3 It is important to note that the valuation process under IBBI regulations, except for Liquidation Process Regulations, requires compliance with "Internationally accepted valuation standards. (IVS)" However, under Liquidation Regulations, the valuation should follow the Companies (Registered Valuers and Valuation) Rules, 2017. These rules mandate either internationally accepted valuation standards or the valuation standards adopted by any Registered Valuers Organization (RVO). In India, the Institute of Chartered Accountants of India has notified the ICAI VS, which is based on IVS with some deviations. While most RVOs have adopted IVS, a few have adopted ICAI VS. As a result, there may be differences in valuation estimates submitted by two valuers under identical Liquidation Process, with one following IVS and the other following ICAI VS.

4. **Conclusion:**

4.1 In conclusion, the interpretation of legal and regulatory provisions is subject to change and may require clarification or revision over time. It is crucial to conduct continuous reviews and refinements of these provisions to ensure they remain relevant and effective. Consequent to analysis of the various valuation provisions under the IBC framework, as per the details given in the preceding paragraphs, it is evident that there is a need for further improvements to achieve the objective of maximizing the value of the assets of the Corporate Debtor. The following points need to be considered in this regard:

4.1.1 The valuation provisions related to asset class-wise valuation under IBBI

(Insolvency Resolution Process for Corporate Persons) Regulations 2016 require review. It is suggested that the Resolution Professional / Registered Valuer be granted flexibility to choose an appropriate valuation approach that is tailored to the unique circumstances of each case, based on the actual ground reality. This will enable a more accurate estimation of the value of the assets, which is critical for successful resolution of the insolvency process and for maximisation of value of the CD.

4.1.2 The term "**Realisable Value**" as incorporated under IBBI (Liquidation Process) Regulations 2016 requires further clarification. Its meaning / definition should be incorporated into the Liquidation Process Regulations to eliminate any ambiguity. This will ensure that all stakeholders have a clear understanding of the term and can make informed decisions based on its definition, thereby facilitating a smooth and efficient liquidation process.

4.1.3 Further clarification is required on the exact **standard of value** referred to by the term "**Fair Value**" as defined in IBBI (Insolvency Resolution Process for Corporate Person) Regulations, 2016, to eliminate any confusion or ambiguity surrounding its interpretation.

Uniform guidance is needed for computing valuation estimates according to **internationally accepted valuation standards** across all IBBI regulations, including IBBI (Liquidation Process) Regulations, 2016, to ensure consistency and accuracy in the valuation process.

Disclaimer: This article is intended to provide general information on the topic of discussion and should not be relied upon as professional advice. The information provided may not be suitable for all situations, and readers are encouraged to exercise their own judgment and conduct their own research before making any decisions based on the content of this article. This article is not intended to be used for academic, legal, or compliance purposes, and readers should seek professional advice for such matters.

OTHER READINGS

ICMAI REGISTERED VALUERS' ORGANISATION

Registered Office
The Institute of Cost Accountants of
India 4th Floor, CMA Bhawan 3,
Institutional Area Lodhi Road, New
Delhi – 110003

www.rvoicmai.in

OTHER READINGS

Perspectives Paper: ESG and Business Valuation

PERSPECTIVES PAPER:

ESG and Business Valuation

The IVSC issues Perspectives Papers from time to time, which focus on pertinent valuation topics and emerging issues. Perspectives Papers serve a number of purposes: they initiate and foster debate on valuation topics as they relate to the International Valuation Standards (IVS); they provide contextual information on a topic from the perspective of the standard setter; and they support the valuation community in their application of IVS through guidance and case studies.

Perspectives Papers are complementary to the IVS and do not replace or supersede the standards.Valuers have a responsibility to read and follow the standards when carrying out valuations.

By: Kevin Prall, IVSC Business Valuation Technical Director with contributions from the Business Valuation Standards Board and the ESG Working Group

The IVSC has issued this Perspectives Paper to initiate discussion and debate on the topic of ESG in business valuation. Share your thoughts and perspectives with us through LinkedIn

The ESG Landscape

Environmental, Social, and Governance(ESG) factors have become central tenetsin the capital allocation process for both the providers of capital (e.g., investors) and the users of capital (e.g., corporations).

Many institutional investors leverage ESG filters to guide their investment strategiesand improve returns. A recent study by Morningstar discovered a majority of sustainable funds have outperformedtheir traditional peers over multiple time horizons. Over the 10-year period ending

in 2019, 59% of sustainable funds across the categories considered beat their traditional counterpart.[1]

Additionally, C-Suite management has begun incorporating ESG considerations into their capital budgeting processes to gain a fuller understanding of their ability to drive sustainable financial performance.In fact, 9 out of 10 companies in the S&P

500 produced sustainability reports in 2019[2]. For those that don't yet produce sustainability reports, political and investorpressures are only expected to mount.[3]

The events of 2020 have only acted to accelerate the broader adoption of ESG frameworks.

- E - Environmental disasters have become too prevalent and destructive to ignore.

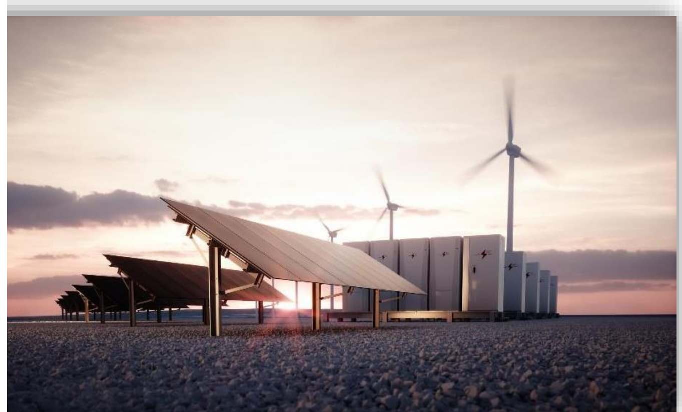
- S - Social unrest has obligatedenterprises to take a point of view on issues important to their workforce and broaderstakeholders.

- G - The pandemic has challenged the governance structures of every industry and forced management to continuously pivot as they guide a path to recovery.

Though fewer people today debate the importance of ESG and its impact on value creation, most struggle to make sense of the web of interconnected standards, disclosure requirements, and ESG ratings. The lack of uniformity results in wildly varying disclosures, and in effect, ahesitancy from the valuation profession towholeheartedly embrace the value creation impact of ESG.

Like other market participants, for valuers to successfully incorporate ESG into valuations they will need reliable ESG metric reporting that is consistent between companies, across geographies, and over time.

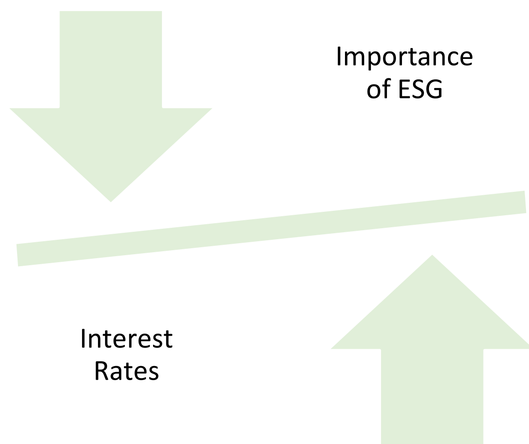
The IFRS Foundation has begun a projecton ESG by seeking input on the need for a global set of internationally recognised ESG standards, and gauging support for its role in developing such standards, through the issuance of a recent Consultation Paper[4]. While some believe that the inclusion of ESG in financial reporting is untenable, Nick Anderson's 2019 article "IFRS Standards and climate- related disclosures" demonstrates thelinkages between ESG and value creation.[5] Specifically, Anderson notes *Valuation, Risk, and Performance*, the authors conclude that companies' ESG information positively impacted their valuation and performance, both throughthe systematic risk inputs (e.g. a lower cost of capital and higher valuation multiples), and their unsystematic risk profile (e.g. higher profitability and lower exposures totail risk).[12]



Occurring in tandem to the ESG debate, isone on how to better disclose and reporton the value creation through investmentsin unrecorded intangible assets. Like ESG, value creation through investment in intangible assets is disproportionally focused on long-term prospects. In that light, consideration of unrecorded intangible assets in the ESG framework, may represent a more complete framework to uncover the true nature of an enterprises' financial sustainability

The Decline of Interest Rates and The Rise of ESG

While the events of 2020 have placed additional emphasis on the importance of ESG, there is another factor that helps to explain the meteoric rise of ESG in the capital allocation process. As valuers well know, a decline in interest rates increases the present value of future benefits. The further in the future the benefit, the greater the relative increase in present value from any decrease in interest rates. Low short-term interest rates are nothing new, but the 2020 economic crisis has brought about an unprecedented expectation for a prolonged period of low interest rates. If one assumes the lower interest rates result in a lower cost of capital for businesses, the relative value of lasting cash flows has increased at the expense of those in the near term. Given that a greater percent of the present value of cash flows for organisations now resides in the distant future, it should come as no surprise that the ESG framework has taken on greater importance.



While much of the ESG frameworkemphasises the creation of sustainable financial performance, it also focuses investors and organisations on the mitigation of future risks and liabilities. As the decline in cost of capital makes futurecash inflows more valuable, it has the same effect on cash outflows (i.e. liabilities related to ESG considerations).

ESG provides a structure to identify andquantify potential future liabilities through explicit forecast adjustments or scenario analysis, rather than assume such tail risksreside implicitly in the terminal assumptions.

The fundamental degradation in near term profits resulting from the pandemic has also placed additional value on the lasting prospects of an enterprise. Specifically, an analysis of 24 broad industries shows that 21 of the industries are expected to experience a reduction inexpected 2020 profits as compared topre-COVID expectations.[13]

Furthermore,the expected recovery curve is relatively flat and prolonged, as 20 of the 24 industries are projected to still be below their pre-COVID expectations in thefurthest forecasted out year (e.g. 2022 to 2024 depending on industry). This broad decline in discrete period expected cash flows, much like the decline in interest rates, also acts to shift focus toward the long-term prospects of enterprises. The combination of these phenomena has manifested in the equity markets as "falling earnings coincided with much higher valuations of future earnings, as lower interest rates and bond yields madestocks look more attractive."[14]

A simplistic example shows the impact of these two changes. In the pre-COVID example, the discrete period represents 36% of the total value.

Pre-Covid Scenario	2020	2021	2022	2023	2024	Terminal
Free Cash Flow	$ 10.0	$ 10.5	$ 11.0	$ 11.6	$ 12.2	$ 12.4
Terminal Value						$ 124.0
Discount Factor	0.94	0.84	0.75	0.67	0.60	0.60
Discounted Cash Flow	$ 9.4	$ 8.9	$ 8.3	$ 7.8	$ 7.3	$ 74.5
	$'s	% of Total		Discount Rate		
Discrete Period Value	$ 41.7	35.9%		12%		
Terminal Value	$ 74.5	64.1%				
Total	$ 116.0	100.0%				

However, a hypothetical decrease in the cost of capital of 200 bps[15], combined witha decrease in discrete period cash flows consistent with the expected recovery curve for many industries,[16] results in a post-COVID scenario whereapproximately 13% of the aggregate valuehas shifted from the discrete period to theterminal period.

Post-Covid Scenario	2020	2021	2022	2023	2024	Terminal
Free Cash Flow	$ 4.0	$ 6.0	$ 8.0	$ 10.0	$ 12.2	$ 12.4
Terminal Value						$ 155.0
Discount Factor	0.95	0.87	0.79	0.72	0.65	0.65
Discounted Cash Flow	$ 3.8	$ 5.2	$ 6.3	$ 7.2	$ 7.9	$ 100.9
	$'s	% of Total		Discount Rate		
Discrete Period Value	$ 30.4	23.1%		10%		
Terminal Value	$ 100.9	76.9%				
Total	$ 131.0	100.0%				

Given the ever-increasing adoption of ESG by market participants, as well the current market conditions that have placed additional weight on lasting value,valuers should begin incorporating ESG considerations into the business valuationframework.

Incorporation into the Business Valuation Framework

The novelty of the ESG framework may cause some to assume a fundamental change to valuation methods and procedures is necessary. However, consideration of ESG should be a matter of incorporation rather than assimilation.

The Market Approach - While ESG data and disclosures are becoming morestandardised for public companies, most companies that are the subject of valuation exercises are private. As such, to account for ESG factors a valuer will be required to:

1) Identify and assess the relevant ESG criteria for the comparable companies and industry, then

2) Assess the performance of the subject company for such criteria, and

3) Calibrate the market inputs (e.g., EBITDA multiple, etc.) to the subject entity to take into accountthe relevant performance ascompared to the comparable companies.

At first impression, this process appears daunting. However, such a process has direct parallels to existing procedures in which a valuer must:

1) Understand the size, risk, futuregrowth, business comparability,etc. of the comparable companies,then

2) Assess the performance andcharacteristics for the subject company, and

3) Calibrate the market inputs to the subject entity to take into accountthe relevant performance ascompared to the comparable companies.

By integrating ESG considerations into thecurrent market approach procedures, thetask becomes more manageable (see IVS Section 105, paragraphs 20 and 30).

The Income Approach – While the incomeapproach requires similar calibrations to compare the performance and characteristics of the subject entity to that of the comparable companies, the greater reliance on future expectations and the explicit consideration in the forecast doesadd an additional layer of complexity.

The bifurcation of responsibility over forecast assumptions between management and the valuer is a complexand evolving area. As noted by the IVSC, practice has been trending toward additional onus on valuers to consider therisks inherent in the forecast (see IVS Section 105, paragraphs 50.36 through 50.40). However, management is typically still responsible for derivation of the forecast. The ESG framework presents a new set of factors for valuers to consider,but also for management consideration. Additionally, management will be best equipped to identify, consider, and quantify many of the considerations noted in the framework. As such, incorporation of an ESG framework into business valuation procedures will requireeducation of both management and valuers.

Fortunately, work is underway to develop best practices and frameworks for explicitly incorporating such risks into forecasts. For example, the Canadian Chapter of the A4S CFO Leadership Network has formed a Valuation &Climate Change Task Force which hasdeveloped a draft framework for climate change and valuation.

While the systematic and explicit consideration of ESG factors by valuers isin its infancy, many ESG factors are likely already incorporated into valuations implicitly. Due to the overlap and correlation between ESG factors and certain pre-financial characteristics already considered by valuers, care must be taken to not double count such characteristics as “new ESG risks”.

For example, it’s common in practice toinclude a risk premium to the discount rate (or discount to the comparable company multiples) to account for the relatively smaller size of the subject company. These risk premiums are supported by historical analysis that shows a statistically higher rate of return for smaller companies as compared to larger. However, an examination of criteria often cited as the rationale for theexistence and magnitude of size premiums used in the discount rate derivation, shows overlap with what manywould consider to be “ESG” factors. As such, current practice may partially account implicitly for some of the risk calibration of ESG factors from large public companies, to that of the subject. This represents just one example of potential overlap, as multiple other aspects of the income approach will require specific consideration, including:

- Beta – Reliable output from the CAPM requires the identification of sufficiently comparable public companies. As with the market approach, ESG characteristics may need to be added to the current framework for comparable company screening and identification.
- Long-term Growth – A core concept of ESG investing is to acknowledge that not all companies have the same structures in place to drive long- term sustainable growth.

As such, a blanket reliance on standard long-term growth rates, with only minor consideration of industry and/or geographic growth rates, is likely to be insufficient. In fact, evidence suggests that ESG criteria is strongly correlated to long-term survivorship likelihoods, with a positive impact on the long-term growth rate. As displayed above, given the low interest rate environment, valuations have become extremely sensitive to the long-term growth rate assumption. Furthermore, for low- performing ESG companies, many may argue that a long-term rate of decline, rather than growth, may be more appropriate.

- Alpha – Adjustments for additional risk in the cash flow projections requires detailed consideration (see IVS Section 105, paragraphs 50.36 through 50.40).

  Understanding the ESG profile of the subject, comparison to the comparable public companies used to derive other inputs to the analysis (e.g., Beta), and interplay with projected cash flows, are all potential areas for investigation.

These considerations are highly technical and complex issues that likely requiresadditional deliberation for any ESG framework

Next Steps

ESG solutions require collaboration between stakeholders throughout the capital markets. Currently there is no shortage of opinions when it comes to how, and even if,[17] to proceed with the standardisation of ESG disclosures andreporting. However, regardless of thepath taken by standard setters, including the IVSC, ESG factors represent fundamental considerations to inform valuation analysis. As such, these first steps to begin incorporating ESG considerations into valuation practice are critical for the relevance, and therefore the sustainability, of the profession.

The IVSC would be interested to hear yourviews on this paper and on ESG as itrelates to valuation. Share your feedbackthrough the IVSC Group page on LinkedInor by emailing contact@ivsc.org

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MULTIPLE CHOICE QUESTIONS

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MULTIPLE CHOICE QUESTIONS

MCQ FOR SFA

1.If we compare GDP and GNP, then:
a)GNP = GDP - net income from abroad
b)GNP = GDP + net income from abroad
c)GNP = NNP - net incomefrom abroad
d)GNP = NNP + net income from abroad

Ans) GNP = GDP + net income from abroad

2.The value of national income adjusted for inflation is called
a)Per capita income
b)Disposable income
c)Inflation rate
d)Real national income

Ans) Real national income

3.The net value of GDP after deducting depreciation from GDP is
a)Net national product
b)Net domestic product
c)Gross national product
d)Disposable income

Ans) Net domestic product

4.Risk in capital budgeting implies that the decision maker knows _ of the cash flows.
a)Variability
b)Certainity
c)Probability
d)UnCertainity

Ans) Probability
c)Probability
d)UnCertainity

Ans) Probability

5.Retained earnings are
a)an indication of a company's liquidity
b)the same as cash in the bank.
c)not important when determining dividends.
d)the cumulative earningsof the company after dividends.

Ans) the cumulative earnings of the company after dividends

6.The market value of the firm is the result of___________

a)dividend decisions
b)working capital decisions
c)capital budgeting decisions
d)trade off betweenrisk and return

Ans) trade off between risk and return

7.Dividends are the ---------- of a company distributed amongst members in proportion to their shares
a)Divisible profits
b)Indivisible profits
c)Reserves
d)Fund

Ans) Divisible profits

8.Financial decision involve Investment decision, Dividend decisions, Financing decisions or Liquidity decisions
a)Investment, financingand dividend decisions
b)Investment and financing
c)Investment,financing and liquidity decisions
d)financing and liquidity decisions

Ans) Investment, financing and dividend decisions

9.Which of the following is not a capital budgeting deci-sion?
a)Expansion Programme
b)Merger
c)Replacement of an Asset
d)Inventory Level

Ans) Inventory Level

10.What type of audit opinion is preferred when analyzing financial statements?
a)Qualified
b)Adverse
c)Unqualified
d)All of the above

Ans) Unqualified

11.Which of the following helps in analyzing return to equity shareholders?
a)Net Profit Ratio
b)Earnings Per Share
c)Return of Assets
d)Return on Investments

Ans) Earnings Per Share

12.In 'Percentage of Sales' Method of preparation of projected financial statements, the operating expenses should be projected on the basis of:
a)% of Gross Profit
b)% of Cost of Goods Sold
c)% of Profit before Tax
d)% of Sales

Ans) % of Sales

13.The best ratio to evaluate short-term liquidity is:
a)Cash Ratio
b)Current Ratio
c)Working Capital Ratio
d)Debt to Asset Ratio

Ans) Cash Ratio

14.Under which of the following kinds of business concepts it is assumed that the organization will last for a long time.

a)Accounting Entity
b)Going Concern Entity
c)Money Measuring Entity
d)Accounting Period

Ans) Going Concern Entity

15.The going concern concept is concerned with the following:

a)Accounting for all enterprises as a going concern
b)Allowing predictions to be used in the preparation of financial statements
c)Valuing assets at their realisable amounts
d)Preparing financial statements based on the assumption that they will operate into the foreseeable future, and abandoning the concept if this assumption does not hold

Ans) Preparing financial statements based on the assumption that they will operate into the foreseeable future, and abandoning the concept if this assumption does not hold

16.Companies not disclosing an immanent bankruptcy would violate the_

a)Business Entity Concept
b)Going Concern Concept
c)Consistency Concept
d)Monetary Unit Assumption

Ans) Going Concern Concept

17.A declaration of solvency is required to be signed by the directors of the company in order for:

a)the liquidation to proceed as a creditors voluntary winding-up;
b)the liquidation to proceed as a members voluntary winding-up;
c)the court to make an order for liquidation;
d)a liquidator to resign and the company to continue trading.

Ans) the liquidation to proceed as a members voluntary winding-up;

18.Under which of the following condition can an Adjudicating Authority order the liquidation of corporate debtor:

a)When the committee of creditors of corporate debtor decides to liquidate after thconfirmation of resolution plan
b)When half of the committee of creditors of corporate debtor decides to liquidatebefore the confirmation of resolution plan
c)When half of the committee of creditors of corporate debtor decides to liquidate after the confirmation of resolution plan
d)When the committee of creditors of corporate debtor decides to liquidate before the confirmation of resolution plan

Ans) When the committee of creditors of corporate debtor decides to liquidate before the confirmation of resolution plan

19.What is the nature of liquidation order:
a)Deemed to be a notice of discharge to the officers of the corporate debtor
b)Deemed to be a notice of discharge to the financial creditor
c)Deemed to be a notice of discharge to the officers and workmen of the corporatedebtor
d)Deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor

Ans) Deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor

20.The fees for the liquidation process shall be paid to the liquidator from the proceeds of ________________:

a)Realised liabilities of corporate debtor
b)Liquidation estate
c)Liquidation fund

d)Capital Reserves of the corporate debtor

Ans) Liquidation estate

21.Which of the following assets are included in the liquidation estate:

a)assets held in trust for any third party
b)bailment contracts
c)tangible assets, whether movable or immovable
d)sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund

Ans) tangible assets, whether movable or immovable

22.Which of the following assets are not included in the liquidation estate:

a)tangible assets, whether movable or immovable
b)contractual arrangements which do not stipulate transfer of title but only use of theassets
c)assets that may or may not be in possession of the corporate debtor including but not limited to encumbered assets
d)assets subject to the determination of ownership by the court or authority

Ans) contractual arrangements which do not stipulate transfer of title but only use of the assets

23.Which of the following is to be recovered first from the proceeds of liquidation estate

a)insolvency resolution process costs and the liquidation costs
b)debts owed to a secured creditor
c)workmen's dues for a period of twenty-four months preceding the liquidation commencement ate
d)preference shareholders

Ans) insolvency resolution process costs and the liquidation costs

24.Which of the following is to be recovered last from the proceeds of liquidation estate:

a)debts owed to a secured creditor for any amount unpaid following the enforcementof security interest
b)any remaining debts and dues
c)workmen's dues for the period of twenty-four months preceding the liquidation commencement date
d)equity shareholders or partners

Ans) equity shareholders or partners

25.The Indian Stamp Act, 1899 came into force on:

a)1st June 1899
b)1st July 1899
c)1st November 1899
d)1st December 1899

Ans) 1st July 1899

26.Any mark of seal or endorsement by any agency or person duly authorized by the state government, for the purpose of duty chargeable under Indian Stamp Act, 1899 is called .... :
a)Bond
b)Receipt
c)Bill of Exchange
d)Stamp

Ans) Stamp

27.Every instrument written upon paper stamped with an impressed stamp shall be written in such manner that the stamp may appear on the .... and cannot be used for or applied to any other instrument:

a)Face of the instrument
b)Back of the instrument
c)Both (a) and (b)
d)None of the above

Ans) Face of the instrument

28.All instruments chargeable with duty and executed by any person in India shall be stamped .... :

a)Before execution
b)At the time of execution
c)Before or at the time of execution
d)None of the above

Ans) Before or at the time of execution

29.Every instrument chargeable with duty executed only out of India, and not being a bill of exchange or promissory note, may be stamped within .... after it has been first received in India:

a)One month
b)Two months
c)Three months
d)Six months

Ans) Three months

30.In which of the following instruments, expenses of providing proper stamp shall be borne by the person drawing, making or executing such instrument?

a)Bill of exchange
b)Debenture
c)Promissory note
d)All of the above

Ans) All of the above

31.Who has the adjudicating authority with respect to proper stamping?

a)Magistrate
b)Collector
c)Bank Official
d)None of the above

Ans) Collector

32.Fair value is focused on the assumptions of the market place and is not entity specific. Which of the following assumptions does Ind AS113 take into account?

a)It takes into account any assumptions about the highest price that can be paid
b)It takes into account any assumptions about reliability
c)It takes into account any assumptions about risk
d)It takes into account any assumptions about going concern

Ans) c

33.IFRS 13 does not specify the unit of account for measuring fair value. This means that it is left to the individual standard to determine the unit of account for fair value measurement. What is meant by the 'unit of account'?

a)The collection of assets or liabilities of which these elements form part
b)The market value of the asset or liability
c)The single asset or liability or group of assets or liabilities
d)The value of the asset or liability

Ans) c

34.Prices to be used under Ind AS113 are those in 'an orderly transaction'. what is meant by an orderly transaction?

a)One that assumes exposure to the market for a period before the date of measurement to allow for normal marketing activities and to ensure that it is a forced transaction
b)One that assumes exposure to the market for a period before the date of measurement to allow for normal marketing activities and to ensure that it is not a forced transaction
c)One that assumes exposure to the market for a period before the date of measurement to allow for normal marketing activities and there has been significant trading in the asset or liability
d)One that assumes no exposure to the market for a period before the date of measurement to allow for normal marketing activities and to ensure that it is not a forced transaction

Ans) b

35.Fair value measurements are categorised into a three-level hierarchy, based on the type of inputs to the valuation techniques used. What inputs are required for a fair value measurement to be classified as level 3 inputs?

a)Inputs other than quoted prices that are directly or indirectly observable for that asset or liability
b)Unadjusted quoted prices in active markets for items identical to the asset or liability being measured
c)Inputs based on the highest and best use of the asset as determined by a market participant
d)Inputs which must be developed to reflect the assumptions that market participants would use when determining an appropriate price for the asset or liability

Ans) d

36.The guidance includes enhanced disclosure requirements that could result in more work for reporting entities. Which of the following disclosures are not required by IFRS 13?

a)Transfers between Levels 2 and 3
b)Information about the hierarchy level into which fair value measurements fall
c)Disclosures for Level 3 measurements that include a reconciliation of opening and closing balances
d)Methods and inputs to the fair value measurements

Ans) a

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

a)Market
b)Cost
c)Market or cost which ever is lower
d)Market or cost which ever is higher

Ans) Market

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

a)Product or service diversification
b)Management competence
c)Inflation
d)Inventory control

Ans) Inflation

39.Principal methods of Valuation are:

a)Market approach, Asset approach, Income approach
b)Discounted cash flow method,Net assets method, Market price method
c)Market approach, discounted cashflow method, Asset approach
d)Asset approach, Income approach, discounted cash flow method

Ans) Market approach, Asset approach, Income approach

40.Investment value is the value
a)to a particular investor
b)to a hypothetical investor
c)in the marketplace
d)in tax valuations

Ans) to a particular investor

41.What are price-earnings valuations usually based on?

a)Gross profit.
b)Operating profit.
c)EBITDA
d)Free cash flow.

Ans) EBITDA

42.For which of the following types of company would Net AssetValue (NAV) probably be an unsuitable basis for valuation?

a)A property investment company like Land Securities.
b)An investment trust like Alliance Trust.
c)An advertising agency like M&C Saatchi
d)A mining company like BHP Billiton

Ans) An advertising agency like M&C Saatchi

43.Allowing for bankruptcy costs and an increasing probability of bankruptcy with increasing financial leverage, we should expect __________ than would be the case without bankruptcy costs.

a)the premium for business risk to be higher
b)the premium for business risk to be lower
c)the premium for financial risk should rise by less
d)the premium for financial risk should rise by more

Ans) the premium for financial risk should rise by more

44......... is the use of historic data to determine the direction of future trends:

a)Due diligence
b)Due care
c)Forecasting
d)Projected report

Ans) Forecasting

45.What is forecasting?

a)A random target set as per the current performances
b)A scientific guesswork based upon serious study
c)Guessing the future outcome as per whims and whence of the forecasting
d)None of the above

Ans) A scientific guesswork based upon serious study

46.Which of the following is not a forecasting tool?

a)Cash Flow Statement
b)Production chart
c)Organization
d)None of the above

Ans) None of the above

47.......... assume that a relationship exists between one or more items and that a change in one item will cause a change in the other:

a)Scenario writing
b)Time series analysis
c)Causes model
d)Delphi technique

Ans) Causes model

48.Which of the following is/are a forecasting technique?

a)Judgemental
b)Time series
c)Associative
d)All of the above

Ans) All of the above

49........... elements of a time series sit above or below the trend line and may recur for a year or longer:

a)Cyclical
b)Trend
c)Seasonal
d)Irregular

Ans) Cyclical

50. One of the quantitative techniques of forecasting is:

a)Causes model
b)Time series analysis
c)Delphi technique
d)Scenario writing

Ans) Time series analysis

51............ assumes that forecasts from a group of individuals, with relevant expertise and experience, working in a systematic way, will be more useful than those from unstructured discussion group, where the individuals will have little opportunity to

a)Delphi Technique
b)Causes model
c)Time series analysis
d)Scenario writing

Ans) Delphi Technique

52.In cash flow statement, the item of interest is shown in:

a)Financing Activities
b)Investing Activities
c)Operating Activities
d)Both (a) and (b)

Ans) Both (a) and (b)

53.An example of a cash flow from a financing activity is:
a)Receipt of cash from sale of land
b)Receipt of cash from collection of accounts receivable
c)Payment of cash for acquisition of treasury stock
d)Payment of cash for new machinery

Ans) Payment of cash for acquisition of treasury stock

54.Which of the following is not a cash inflow?

a)Decrease in creditors
b)Decrease in debtors
c)Sale of fixed assets
d)Issue of shares

Ans) Decrease in creditors

55.Which of the following is not a cash outflow?

a)Increase in stocks
b)Increase in prepaid expenses
c)Increase in creditors
d)Increase in debtors

Ans) Increase in creditors

56.Discounted cash flow analysis is also classified as:

a)Time value of bonds
b)Time value of money
c)Time value of gold
d)Time value of stock

Ans) Time value of money

57.Where cash flows are more than capital invested for rate of return than Net Present Value will be:

a)Positive
b)Independent
c)Zero
d)Negative

Ans) Positive

58.In capital budgeting, a technique which is based upon Discounted Cash Flow is classified as:

a)Net future value method
b)Net equity budgeting method
c)Net present value method
d)Net capital budgeting method

Ans) Net present value method

59.If compounding is done quarterly in a year, the effective rate of interest is equal to:

a)(1+nominal rate of interest)/4
b)(1+nominal rate of interest/4)4
c)4*nominal rate of interest
d)(Nominal rate of interest)/4

Ans) (1+nominal rate of interest/4)4

60.Which of the following statements is correct concerning the weighted average cost of capital (WACC):

a)The WACC may decrease as a firm's debt-equity ratio increases
b)In the computation of WACC, weight assigned to the preferred stock is based on the coupon rate multiplied by the par value of the stock
c)A firm's WACC will decrease as the corporate tax rate decreases
d)The weight of the common stock used in the computation of the WACC is based on the number of shares outstanding multiplied by the book value per share

Ans) The WACC may decrease as a firm's debt-equity ratio increases

61............ is to provide a foundation for developing future expectations about the subject company by eliminating non-recurring, non-operating or discretionary items and to present the past results of the subject company on a consistent basis:

a)Normalizing adjustments
b)Valuation premises
c)Valuation base
d)None of the above

Ans) Normalizing adjustments

62........... is based on the premise that an asset which is readily marketable commands a higher value than an asset which requires longer marketing period to be sold or an asset having restriction on its ability to sell:

a)Discount for Lack of Control (DLOC)
b)Discount for lack of marketability (DLOM)
c)Both (a) and (b)
d)None of the above

Ans) Discount for lack of marketability (DLOM)

63.Higher the liquidity and control, ... would be the discount on valuation of the financial instrument:

a)Higher
b)Lower
c)Both ways
d)None

Ans) Lower

64.Funding Cost adjustment adjusts:

a)Value for the implied benefit of upfront payments on derivatives
b)Value for implied cost of upfront payments on derivatives
c)The cost/benefit of interest on cash collateral
d)The cost of providing initial margin

Ans) Value for implied cost of upfront payments on derivatives

65.Which of the following is the major difference between fixed maturity plans and fixed deposits?

a)Fixed period investments
b)Guaranteed returns
c)Maturity periods options
d)All of the above

Ans) Guaranteed returns

66.Which of the following is not the feature to invest in fixed income securities:

a)Liquidity
b)Can be used as a collateral
c)Diversification
d)Cannot be used as a collateral

Ans) Cannot be used as a collateral

67.Which of the following is a fixed income security?

a)PPF
b)NSE
c)Post office monthly income scheme
d)All of the above

Ans) All of the above

68.A fixed income security is issued by:

a)Government
b)Corporations
c)Other entity
d)All of the above

Ans) All of the above

69.Medium-term bonds have a maturity of:

a)1 to 3 years
b)1 to 5 years
c)3 to 5 years
d)3 to 10 years
Ans)3 to 10 years

70.A bond whose price is equal to its face value is called to be sold at:

a)Par
b)Below par
c)Above par
d)None of the above

Ans) Par

71.Treasury bills are issued at:

a)Face value
b)Discount
c)Market value
d)Maturity value

Ans) Discount

72.Treasury bills pay interest at:

a)Coupon rate monthly
b)Coupon rate semi-annually
c)Coupon rate yearly
d)Bank rate yearly

Ans) Coupon rate semi-annually

73.Government securities commonly referred as:

a)G-Secs
b)Govt Securities
c)G Securities
d)Government Securities

Ans) G-Secs

74.A commercial paper can be issued for the maximum duration of:

a)45 days
b)90 days
c)180 days
d)364 days

Ans) 364 days

75.What is the minimum maturity of a commercial paper:

a)3 days
b)7 days
c)15 days
d)30 days

Ans) 7 days

76.Interest rate and bond prices are:

a)Move in same direction
b)Move in opposite direction
c)Have no relationship
d)Sometimes in same direction, sometimes in opposite direction

Ans) Move in opposite direction

77.Which of the following risk is involved in debt instrument?

a)Liquidity risk
b)Reinvestment risk
c)Default risk
d)All of the above

Ans) All of the above

78.Who or what is a person or institution designated by a bond issuer as the official representative of the bondholders?

a)Indenture
b)Debenture
c)Bond
d)Bond Trustee

Ans) Bond Trustee

79.What is the zest of the Supreme Court decision in the case of Hindustan Lever Employee's Union (Supra) (1995) Supp (1) SCC 499:

a)The Jurisdiction of the court in sanctioning a claim of merger is not to ascertain mathematical accuracy if the determination satisfied the arithmetical test
b)A company court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on fairness
c)Both (a) and (b)
d)None of the above

Ans) Both (a) and (b)

80.In the case of Hindustan Lever Employee's Union (Supra) (1995) Supp (1) SCC 499, the Supreme Court accepted the ratio of .... as income, market and asset approach on which the valuation was based:

a)0.042372685185
b)0.043078703704
c)0.084733796296
d)0.084050925926

Ans) 0.084733796296

The following information relates to Questions 81-84

Darshan is an analyst and is responsible for issuing either a buy, hold, or sell rating for the shares of Company A and Company B. The appropriate valuation model for each company was chosen based on the following characteristics of each company:

Company A is an employment services firm with no debt and has fixed assets consisting primarily of computers, servers, and commercially available software. Many of the assets are intangible, including human capital. The company has a history of occasionally paying a special cash dividend.

Company B operates in three unrelated industries with differing rates of growth: tobacco (60% of earnings), shipbuilding (30% of earnings), and aerospace consulting (10% of earnings). The company pays a regular dividend that is solely derived from the earnings produced by the tobacco division. Darshan considers the following development in making any necessary adjustments to the models before assigning ratings:

Company B has finalized the terms to acquire 70% of the outstanding shares of Company X, an actively traded tobacco company, in an all- stock deal.

Darshan assigns ratings to each of the companies and provides a rationale for each rating. The director of research asks Darshan: “How did you arrive at these recommendations? Describe how you used a top- down approach, which is the policy at our company.”

Darshan replies, “I arrived at my recommendations through my due diligence process. I have studied all of the public disclosure documents; I have participated in the company conference calls, being careful with my questions in such a public forum; and I have studied the dynamics of the underlying industries. The valuation models are robust and use an extensive set of company- specific quantitative and qualitative inputs.”

81.Based on Company A’s characteristics, which of the following absolute valuation models is most appropriate for valuing that company?

a) Asset based
b) Dividend discount
c)Free cash flow to the firm
d)none of the above

Ans) Free cash flow to the firm

82.Based on Company B’s characteristics, which of the following valuation models is most appropriate for valuing that company?

a) Asset based
b) Sum of the parts
c)Dividend discount
d)none of the above

Ans) Sum of the parts

83.Which of the following is most likely to be appropriate to consider in Company B’s valuation of Company X?

a) Blockage factor
b) Control premium
c)Lack of marketability discount
d)none of the above

Ans) Control premium

84.Based on Darshan's response to the director of research, Darshan's process could have been more consistent with the firm's policy by:

a) incorporating additional micro- level inputs into her valuation models.
b) evaluating the impact of general economic conditions on each company.
c)asking more probing questions during publicly available company conference calls.
d)none of the above

Ans) evaluating the impact of general economic conditions on each company.

The following information relates to Questions 85-87

Company	Book Value of Equity 2015 (millions of $)	Sales 2015 (millions of $)	ares Outstanding (millions)	Price 2015 ($)
Pfeiffer, Inc.	19,950	32,373	6,162	31.37
Mapps, Inc.	61,020	32,187	10,771	25.63

Peer Group	Mean P/B	Median P/B	Mean P/S (sales in millions of $)	Median P/S (sales in millions of $)
Medical-Drugs	5.622	4.250	8.708	4.530
Applications Software	4.100	2.140	3.420	1.440

Pfeiffer belongs to the Medical-Drugs group and Mapps belongs to the Applications Software group.

85.The current price-to-book and price-to-sales ratios for Pfeiffer are closest to:

P/B P/S
a)3.238 5.254
b)3.238 5.971
c)9.688 5.971
d)none of the above

Ans) 3.238 5.971

86.The current price-to-book and price-to-sales ratios for Mapps are closest to:

P/B P/S
a)4.524 8.578
b)5.665 2.988
c)4.524 2.988
d)none of the above

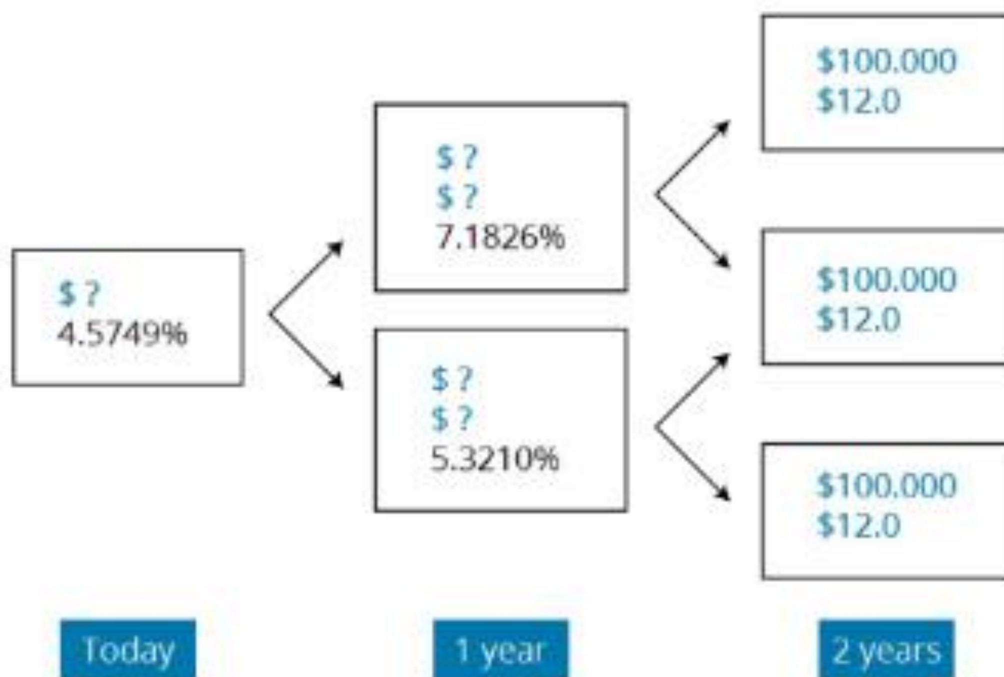
Ans) 4.524 8.578

87. Which of the following statements is most accurate, given the financial data on Pfeiffer, Mapps, and the two industries?

a) Both stocks are relatively overvalued.
b) Both stocks are relatively undervalued.
c)One stock is relatively overvalued and the other is relatively undervalued.
d)none of the above

Ans) Both stocks are relatively overvalued.

The following information relates to Questions 88-90



88. The value today of an option-free, 12% annual coupon bond with two years remaining until maturity is closest to:

a) 110.525.
b) 111.485.
c) 112.282.
d) none of the above

Ans) 112.282.

89.The value of the bond and the value of the embedded call option, assuming the bond in Question 2 is callable at $105 at the end of Year 1, are closest to:

	Callable bond value	Embedded call option value
a)	110.573	1.709
b)	110.573	0.642
c)	111.640	0.642
d)	none of the above	
Ans)	111.640	0.642

90.The value of the bond and the value of the embedded put option, assuming the bond in Question 2 is putable at $105 at the end of Year 1, are closest to:

	Putable bond value	**Embedded put option value**
a)	112.523	0.241
b)	112.523	1.646
c)	113.928	1.646
d)	none of the above	

Ans) 112.523 0.241

Interactive Session on International Valuation Standards on 16th May 2023

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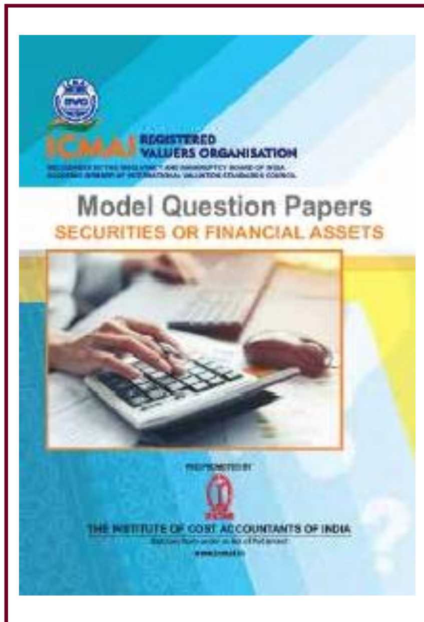

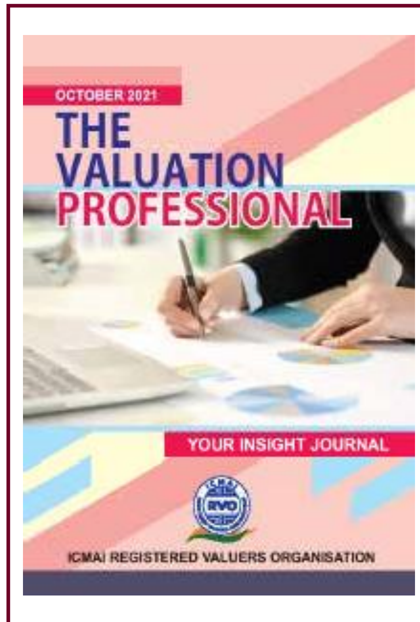

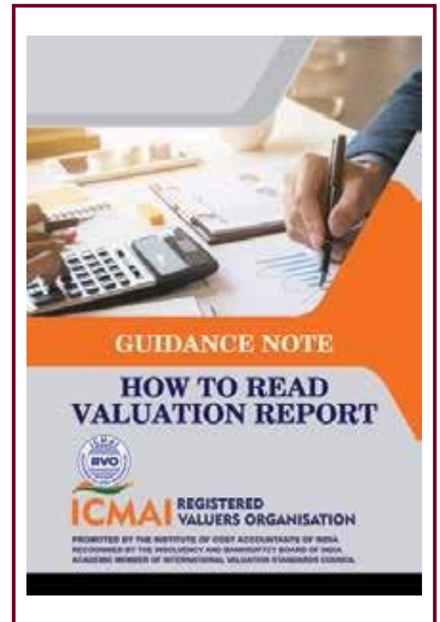

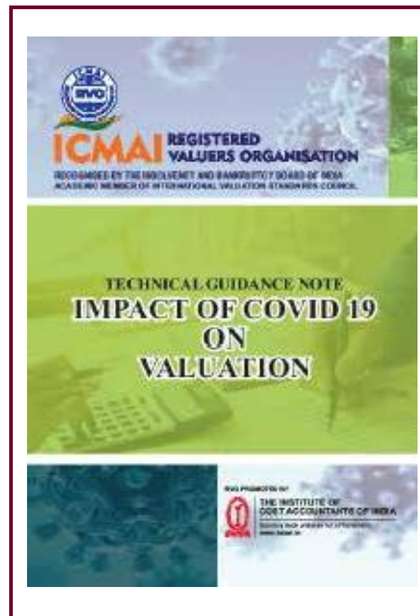

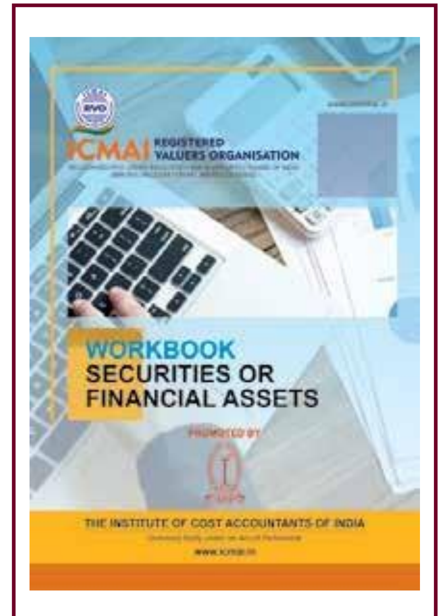

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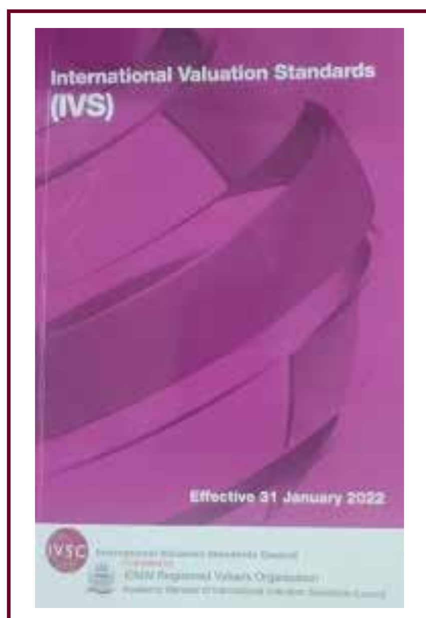

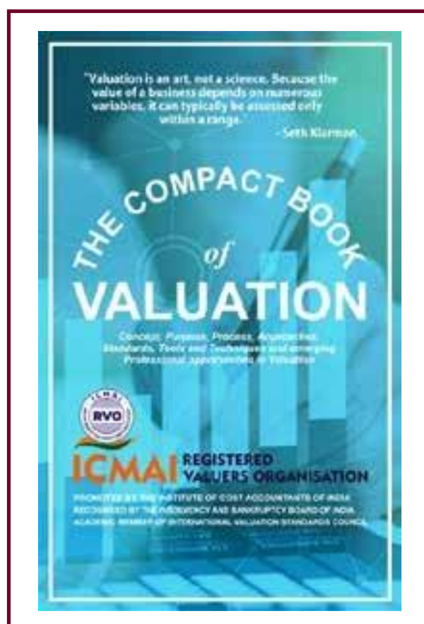

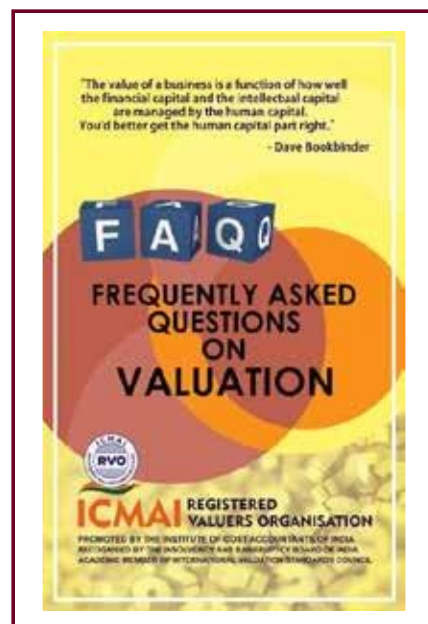

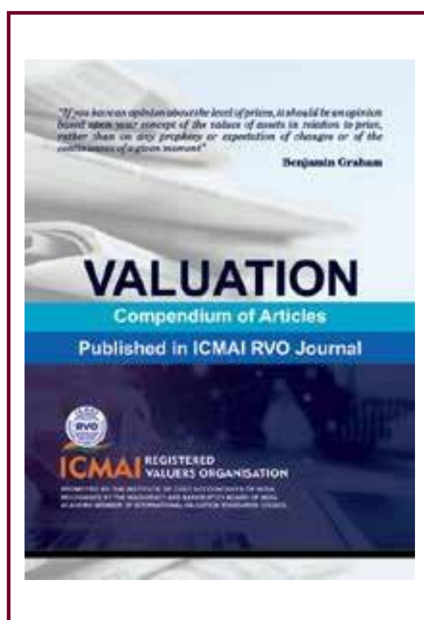

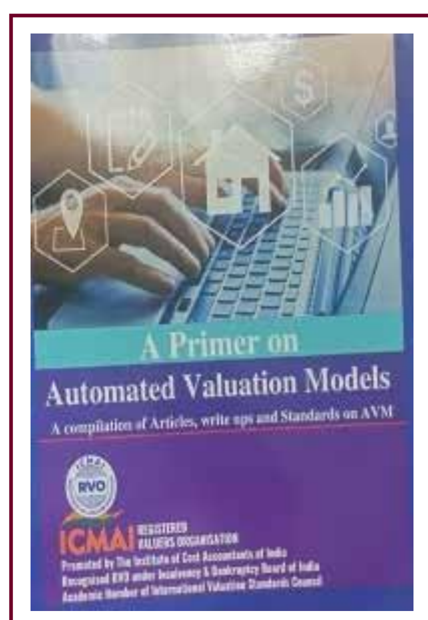

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GLOSSARY OF TERMS USED IN VALUATION

A

Adjusted Book Value Method: a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values.

Arbitrage Pricing Theory: a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

Asset (Asset-Based) Approach: a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

B

Beta—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Blockage Discount: an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

Business Enterprise: a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Business Risk: he degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage.

Business Valuation: the act or process of determining the value of a business enterprise or ownership interest therein.

C

Capital Asset Pricing Model (CAPM): a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization: a conversion of a single period of economic benefits into value.

Capitalization Factor: any multiple or divisor used to convert anticipated economic benefits of a single period into value.

Capitalization of Earnings Method: a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

Capitalization Rate: any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure: the composition of the invested capital of a business enterprise, the mix of debt and equity financing.

Cash Flow: cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

Common Size Statements: financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control: the power to direct the management and policies of a business enterprise.

Control Premium: an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise, to reflect the power of control.

Cost Approach: a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital: the expected rate of return that the market requires in order to attract funds to a particular investment.

D

Debt-Free: we discourage the use of this term. See Invested Capital

Discount for Lack of Control: an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability: an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights: an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

Discount Rate—a rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method: a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Discounted Future Earnings Method—a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

E

Economic Benefits: inflows such as revenues, net income, net cash flows, etc.

Economic Life: the period of time over which property may generate economic benefits.

Equity: the owner's interest in property after deduction of all liabilities.

Equity Net Cash Flows: those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing

Equity Risk Premium—a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings: that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method: a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of

a) the value of the assets derived by capitalizing excess earnings and

b) the value of the selected asset base. Also frequently used to value intangible assets. See Excess Earnings.

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*

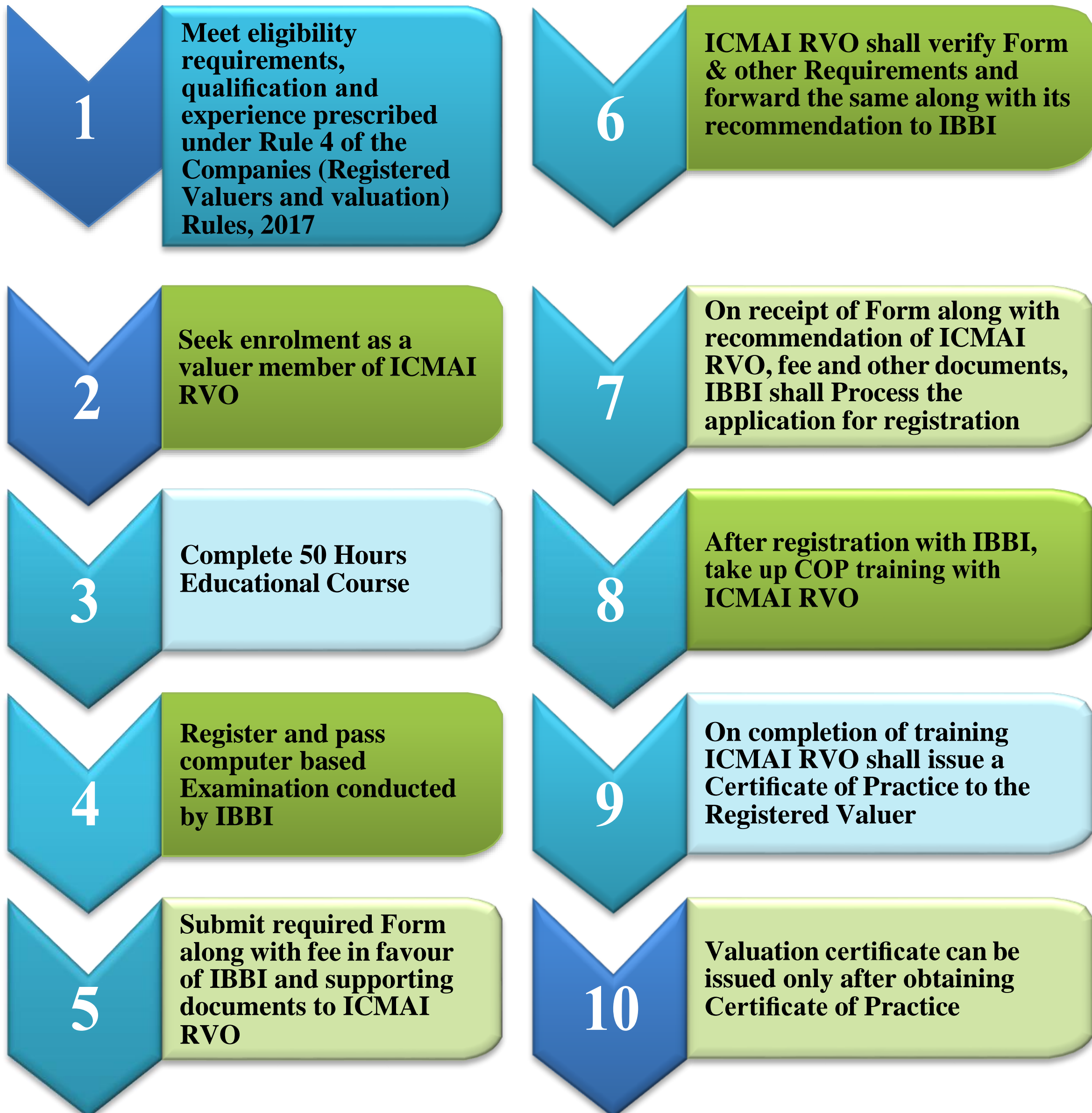
Insolvency and Bankruptcy Code 2016

- *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 Register Valuer



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

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

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