

# **Technical Guide on Valuation**

## **(Revised Edition 2021)**



**Valuation Standards Board ICAI**  
**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
**New Delhi**

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**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA**  
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**NEW DELHI**

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# Foreword

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The happenings around the globe in the recent periods have brought about an accentuated appreciation of the implications of changing times. Immediately after the spread of COVID-19 was identified and reported in the months of March and April 2020, the global markets saw a steep drop. The economic and social lockdowns that followed further led to a massive global economic slowdown. But due to the various measures taken by the governments globally, the situation is improving slowly but steadily. These changing times make it appropriate for us to ponder over, at this juncture, more so than ever, on the impact of environment on valuation.

At times, in the valuation engagement, there is also a need to determine the ownership of various assets to check whether it is to be included in the valuation. This happens when the transactions are layered, hidden and financials are not even constructed completely. This issue becomes more important in case of assets which are spread across wide geographies, covered by different regulations and requirements, or intangible assets such as brand name etc.

The Government of India realised the need for an institutional framework for the valuation profession and to design a regulatory framework that is grounded on realities and meets the expectations of the stakeholders, and for the purpose extensive consultations were made.

I am happy to note that the Valuation Standards Board of ICAI has come out with this revised publication and has updated it as per the latest developments to facilitate the valuers in understanding different aspects of valuation. I extend my sincere appreciation to the entire Board and specially appreciate the efforts put in by CA. Pramod Jain, Chairman and CA. Dheeraj Kumar Khandelwal, Vice- Chairman, Valuation Standards Board for initiating and updating this publication.

I am sure that this publication would be of great help to the members and other stakeholders.

**CA. Atul Kumar Gupta**  
President ICAI

Date: 29<sup>th</sup> January 2021

Place: New Delhi



# Preface

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Different Regulators like RBI, SEBI, CBDT, MCA, IBBI, etc. - require valuation for a variety of purposes which is required to be uniform and standardized. The Companies (Registered Valuers and Valuation) Rules, 2017 provides a unified institutional framework for development and regulation of valuation profession, which has become mandatory for valuations required under the Insolvency and Bankruptcy Code 2016 (Code) and the Companies Act, 2013. Three Asset Classes have been specified for Valuation being “Plant and Machinery”, Land and Building and Financial or Securities Asset Class.

The Government of India taking together, the developments like role of professions in a market economy, need for consolidation of Valuation requirements, evolution of valuation profession, evolution of institutional framework for professions, and contemporary thought on regulatory design – gave a fresh look at the institutional framework for valuation profession and has proposed to form National Institute of Valuers.

The importance of valuations to its users continues to increase and with it come a quest for greater objectivity, transparency and accuracy. Corporates, investors, private equity players, lenders routinely rely on valuations for various purposes such as transactions, regulatory filings, impairment testing, financial reporting, security coverage, etc. The recent advances in the Indian valuation landscape, has warranted a greater emphasis on the accurate valuation, as the assets are critical drivers of corporate value.

Considering the changes in the Regulatory Framework and other modalities, the Valuation Standards Board of the Institute of Chartered Accountants of India decided to revise the Technical Guide on Valuation. Also, there was a need to give clarification on the use of pre-tax profits and post-tax capitalization rate, hence paragraph 3.6.19A has been inserted in this revision.

We take this opportunity in thanking the President of ICAI CA. Atul Kumar Gupta and Vice President, CA. Nihar N. Jambusaria for their thought leadership and continued encouragement in bringing out the publication.

We place on record our appreciation to members of the Valuation Standards Board, Co-opted members and Special Invitees for their help and guidance in framing and bringing out this publication.

We, on behalf of the Valuation Standards Board, would like to put on record our appreciation to CA. T. V. Balasubramanian and CA. Rajan Wadhawan for their contribution in updating this Technical Guide.

We would like to thank CA. Sarika Singhal, Secretary, Valuation Standards Board for revising the publication and providing her technical and administrative support.

We sincerely believe that the members of the profession, valuers, industries and other stakeholders will find the publication immensely useful.

**CA. Pramod Jain**  
Chairman  
Valuation Standards Board, ICAI

**CA. Dheeraj Kumar Khandelwal**  
Vice Chairman  
Valuation Standards Board, ICAI

Date: 5<sup>th</sup> January, 2021

Place: New Delhi

## Foreword to the First Edition

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In today's competitive world, there has been a spate of mergers and acquisitions, significant private equity investments, reforms in taxation laws, higher use of principle of fair value in accounting standards, etc necessitating the need for determining the value of the shares, assets (intangible and tangibles) and liabilities so transferred. In view of these developments, the Valuation Standards Board decided to revise the Technical Guide on Valuation last published in 2009. This Guide encompasses several developments that took place in the Indian regulatory and business environment pertaining to Valuation since then.

The Technical Guide aims to provide a contemporary analysis of practical issues in Valuation. It brings together the approaches, rules and principles involved in Valuation as laid down by law, the statutory guidelines, and the decisions of Courts as well as established valuation practices. All these aspects together make this technical guide an encyclopedia and readily usable work on the subject.

The Guide begins with a discussion of the various approaches to valuation, followed by a separate chapter on the valuation of intangible and tangible assets as well as on other special considerations that influence valuation or the valuation process. The last chapter briefly outlines the manner in which members may furnish the Report on Valuation.

I congratulate the Valuation Standards Board in taking this initiative of revising the publication and updating it as per the latest developments to facilitate the valuers in understanding share valuation. I extend my sincere appreciation to the entire Board and specially appreciate the efforts put in by CA. M. P. Vijay Kumar, Chairman Valuation Standards Board and CA. Dhinal A. Shah Vice- Chairman, Valuation Standards Board for initiating and updating this publication.

I am sure that this publication would be of great help to the members and other stakeholders.

Date: 27<sup>th</sup> June 2018  
Place: New Delhi

**CA. Naveen N.D. Gupta**  
President ICAI  
ICAI RVO





## Preface to the First Edition

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The Technical Guide on Share Valuation published in 2009 is amongst one of the important guidance on valuation issued by ICAI and is referred not only by Chartered Accountants but also by valuation professionals from across all professions.

Since 2009, there have been several developments in valuation space with the notification of Companies Act 2013, the introduction of the Fair Valuation standard in Indian Accounting Standard (“Ind AS”) 113, various amendments in the pricing guidelines issued by Reserve Bank of India (“RBI”) with respect to FEMA regulations and by Securities and Exchange Board of India (“SEBI”) on the substantial acquisition of shares and takeover code and in taxation. The Mergers and Acquisitions space and the Private Equity investment transactions have also been growing at rapid pace, more so now with significant Government focus on encouraging startups. Furthermore, the notification of “Companies (Registered Valuers and Valuation) Rules, 2017” places further emphasis on developing a robust and structured valuation framework in the Indian context.

Considering the need for updating the knowledge and enhancing the professional competencies of our members, the Valuation Standards Board of the Institute of Chartered Accountants of India has decided to revise the Technical Guide on Share Valuation and make it more comprehensive to include various aspects of Valuation with the title of the publication “Technical Guide on Valuation”.

Corporate valuations, whether of physical, financial or intangible assets are playing an increasing central role in investment decisions as well as risk assessments. The need to perform credible valuations is well established, for every transaction of transfer, be it shares, sale of tangible assets such as land, building, plant and machinery or a strategic investment in intangibles such as intellectual property. The valuation of businesses and assets is a multi-facet discipline driven by various factors such as the purpose of valuation, statutory requirements, business drivers, macro and micro economic environment, government policies as applicable to the asset being valued. Theoretically, there are established approaches for valuation. However, the application of the correct approach and principles is crucial in determining an accurate fair value.

In this connection we take this opportunity in thanking the President of ICAI CA. Naveen N. D. Gupta and Vice President, CA. Prafulla P Chajjed for their thought leadership and continued encouragement in bringing out the publication.

We place on record our appreciation to members of the Valuation Standards Board, Co-opted members and Special Invitees for their help and guidance in framing and bringing out this publication.

We would like to express our gratitude towards CA. Ved Jain, Past President ICAI and CA. Harinderjit Singh, Past Council Member and the then Chairman, Research Committee in bringing out this publication.

We, on behalf of the Valuation Standards Board, would like to put on record our appreciation to CA. Rajan Wadhawan and his colleague Shankar Bhargava who prepared the updated draft of this Technical Guide.

We would like to thank CA. Sarika Singhal, Secretary Valuation Standards Board for her technical and administrative support.

We sincerely believe that the members of the profession, valuers, industries and other stakeholders will find the publication immensely useful.

**CA. M. P. Vijay Kumar**  
Chairman  
Valuation Standards Board, ICAI

**CA. Dhinal A. Shah**  
Vice Chairman  
Valuation Standards Board, ICAI

Date: June, 2018

Place: New Delhi

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## Introduction

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1.1 Corporate valuations, whether of physical, financial or intangible assets owned by a company, play an important role in today's regulatory, investment and risk environment. The concept of value is not absolute. The nature of value is uncertain and further states that it is an estimate of the most probable of a range of possible outcomes based on assumptions made in the valuation process. The valuation of a company/business/asset involves the use of judgment, experience and knowledge. The valuer undertaking this work should possess knowledge of the analysis and interpretation of financial statements backed by a practical appreciation of business affairs and investments. A valuation based on quantitative information alone may not be adequate. Other factors such as the perspective of value, purpose of valuation, what is being valued, premises of value and date of valuation play a vital role in a valuation assignment.

1.2 Relevant parameters that must be kept in mind while assessing the value of a company/business/asset/liability include the following:

**Perspective of value:** The concept of value represents the perception of the future usefulness or the expected benefits of the subject being appraised. Hence, it is critical to establish whose view point is most represented in an estimate of value. For example, the value of a company to a strategic buyer versus a financial buyer in a potential transaction scenario can often vary.

**Purpose of valuation:** No single method is universally applicable to all valuation purposes. Furthermore, the underlying purpose of the valuation can impact the basis of value to be utilised. While valuation exercises can be triggered to satisfy various requirements, an indicative list is as follows:

*Financial reporting:*

- Share valuation for goodwill and asset impairment testing under Indian Accounting Standard ("Ind AS") 36;

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- Intangible asset valuation for business combinations under Ind AS 103; and
- Employee stock option plan (“ESOP”) valuation under IndAS102.

### *Strategic decision making:*

- Strategic value analyses for fund mobilisation (including providing asset as a security/collateral), acquisitions, divestitures and joint ventures;
- Restructuring valuation advice for mergers, demergers and spin-offs; and
- Legal, dispute and tax issues, valuation of claims, fairness opinions.

### *Regulatory requirements:*

- Valuation as per various provisions of the Companies Act 2013;
- Valuations for cross-border share transactions between resident and non-resident entities per Foreign Exchange Management Act (“FEMA”) guidelines;
- Valuations under Insolvency and Bankruptcy Code, 2016; and
- Income tax (including transfer pricing) related valuations.

***What is being Valued?*** Valuations can vary greatly based on the subject of the valuation. For example, a valuer has to access and determine the unique characteristics in a given valuation based on whether the subject of the valuation is a business/enterprise, equity, nature of instrument, tangible or intangible assets or liabilities.

***Valuation Bases<sup>1</sup>:*** Valuation base means the indication of the type of value being used in an engagement. The basis of value is closely related to the purpose of a given valuation exercise. Different valuation bases may lead to different conclusions of value. Therefore, it is important for the *valuer* to identify the bases of value pertinent to the engagement. The following commonly utilized standards of value represent the concept of value as viewed from varying perspectives.

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<sup>1</sup>References: ICAI Valuation Standards 2018 – ICAI Valuation Standard 102 Valuation Bases

- “Fair value is 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 valuation date.”
- Fair value, as defined in Ind AS 113 (Fair Value Measurements) is a common basis of value associated with financial reporting valuations and is utilised throughout the Indian Accounting Standards. For a perspective, The International Valuation Standards Board (“IVSB”) considers the definition of Fair Value in accounting standards to be generally consistent with the IVSB’s definition of Market Value.
- “Participant specific value is the estimated value of an asset or liability considering specific advantages or disadvantages of either of the owner or identified acquirer or identified participants.”
- “Liquidation value is the amount that will be realised on sale of an asset or a group of assets when an actual/hypothetical termination of the business is contemplated/assumed.

Liquidation value can be carried out under the premise of an orderly transaction with a typical marketing period or under the premise of forced transaction with a shortened marketing period. The *valuer* must disclose whether an orderly or forced transaction is assumed.”

- Synergistic value on the other hand is the result of combining effect of two or more assets or group of assets and liabilities or two or more entities in terms of their value and benefits will be or is likely to be, greater than that of their individual values on a standalone basis. Synergy is a term that is most commonly used in the context of mergers and acquisitions.

Synergy results from incremental benefits that accrue to the acquirer on account of economies of scale or other post-acquisition factors, such as realisation of increased discretionary cash flow (as a result of the combinations of two or more business operations over and above the aggregate discretionary cash flow of the two business viewed separately), or reduced risk in attaining same when two businesses combines.



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While, Fair value will consider synergies which are available to market participants in general, Participant Specific Value will consider synergies which may be specifically available only to the concerned participant(s).

- In some engagements, a *valuer may be* required to adopt valuation bases prescribed by regulations or as agreed upon between the parties. In those cases, valuation bases will be applied considering the relevant regulations, agreement or arrangement, e.g., valuation requirements under:
  - (a) Income Tax Act;
  - (b) SEBI Regulations; or
  - (c) The Insolvency and Bankruptcy Code.

In transactions of the nature of –merger or amalgamation of companies or merger or demerger of businesses, the consideration is often discharged primarily by issue of securities in the nature equity of the acquirer or transferee entity with reference to an exchange ratio or entitlement ratio, considering the relative values.

Such relative values are generally arrived at by applying an appropriate valuation approach or a combination of valuation approaches. If a combination of valuation approaches or methodologies is adopted, appropriate weightages are assigned to arrive at a single value. Relative values are usually derived by using similar valuation approaches, methodologies and weightages.

Use of differing methodologies or approaches may be justified in some circumstances, e.g., merger of a listed company and an unlisted company where market price method would be relevant only for the listed company.

Valuation base selected by a *valuer* shall be appropriate considering the purpose of engagement and the terms of the engagement. The *valuer* shall use the relevant valuation approach careful consideration needs to be given to the underlying premise of value. There can be a profound impact on the resulting and adhere to other assumptions associated with the valuation bases.

**Premise of Value:** Premise of Value refers to the conditions and circumstances how an asset is deployed.

While assessing the value of a business enterprise, equity stakes or assets, value of a business or an asset depending on the assumed premise of value. The common premises of value concepts are as follows.

- The highest and best use is the use of a non- financial asset by market participants that would maximise the value of the asset or the group of assets (e.g., a business) within which the asset would be used.
- Going concern value premise is the value of a business enterprise that is expected to continue to operate in the future
- As-is-where-is basis is a premise of the value will consider the existing use of the asset which may or may not be its highest and best use.
- An orderly liquidation premise refers to the realisable value of an asset in the event of a liquidation after allowing appropriate marketing efforts and a reasonable period of time to market the asset on an as-is, where-is basis.
- The *liquidation* premise assumes that the business will not continue in its current use in the production of income and will be dismantled. This is usually driven by the notion that it is more desirable for the business to discontinue its operations rather than function under a going concern premise. When considering an orderly liquidation, the expected gross proceeds from the sale of assets is held under orderly sales conditions over a reasonable timeframe in which potential purchasers are identified.
- Forced transaction is a transaction where a seller is under constraints to sell an asset without appropriate marketing period or effort to market such asset.
- In a forced liquidation, there is usually a sense of urgency, a lack of adequate time to find purchasers and more often than not, fire sale values apply.

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**Valuation Date:** Valuation date is the specific date at which the *valuer* estimates the value of the underlying asset.

Valuation is time specific and can change with the passage of time due to changes in the condition of the asset to be valued and/ or market. Accordingly, valuation of an asset as at a particular date can be different from other date(s)

The valuation date is sometimes also referred to as measurement date.

For example, the value of share can vary significantly over a short time span of a few months, depending on factors such as financial performance and the overall robustness of the economy. Furthermore, depending on the purpose of the valuation and the basis of value, a valuation exercise will only consider information that was 'known or knowable' as of the date of valuation.

- 1.3 Valuation, being a complex subject, is limited to experts and is often surrounded by a number of myths. Common generalizations and potential misunderstandings about valuation are discussed below:
- (a) Valuation models are quantitative with a focus on financial parameters such as revenue, earnings and assets. However, quantitative rigor does not necessarily imply that valuation is free from the subjectivity and bias of a valuer. Valuation models are often driven by inputs that are prone to subjective judgments that can be impacted by bias. For instance, a target company may inevitably overvalue itself by utilizing unrealistic/unsubstantiated business forecasts.
  - (b) Valuation is riddled with a common place notion that a detailed valuation exercise will provide a precise estimate of value. The truth is that any valuation is only as good as its underlying assumptions, which, in turn, are the function of a number of present and forward-looking factors. A careful valuation exercise, at best, can give an indicative range of value subject to the reasonableness of the assumptions utilized.
  - (c) Valuation is pertinent to a particular point of time and varies with changes in business, industry and macro-economic environment. For example, the movement of the US Dollar

against the Indian Rupee has led to a substantial change in the valuation of export-driven companies.

- 1.4 Valuation is not an exact science and is driven, inter-alia, by the purpose of valuation, statutory requirements, business factors, etc. Valuation, in practice, is guided by a number of approaches as suitably adjusted for business/asset specific nuances.
- 1.5 In general terms, there are three globally accepted approaches to valuation –Income Approach, Market Approach and Cost Approach. The approaches, rules and principles involved in valuation as laid down by law, statutory guidelines, and decisions of courts as well as established valuation practices are dealt within the following chapters.
- 1.6 This technical guide incorporates practical aspects of valuation considering the current macro-economic environment, changes in the regulatory and legal environment and prevalent industry practices.

## Fair Value Concepts

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- 2.1 With the introduction and the subsequent adoption of Ind AS by many Indian companies, the emphasis on valuation has increased.
- 2.2 The basis of value is closely related to the purpose of a given valuation exercise and can often vary. Selecting an appropriate basis of value is critical. For example, Fair Value is generally used for financial reporting purposes while Fair Market Value is used for tax reporting purposes. Other standards of value include investment value, liquidation value etc. Investment value reflects the value to a specific buyer/seller while liquidation value reflects the possible price of a business or an asset when operations are being discontinued or the assets/liabilities are being sold piece meal. Typically, Fair Value is a commonly utilized basis of value. Ind AS 113 – Fair Value Measurement defines Fair Value as:

*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.*

- 2.3 Key aspects of Fair Value as per Ind AS 113 include:
- (a) Fair Value is based on the exit price i.e. the price that would be received to sell an asset or paid to transfer a liability, not the transaction price or entry price or the price that was actually paid for the asset or that was received to assume the liability. Generally, entry and exit prices are different. The idea of exit price is based on expectations about the sale or transfer price from the perspective of market participants as of the valuation date.
  - (b) Fair Value emphasizes the concepts of a “principal market” and the “most advantageous market” with respect to the business/asset being valued. The principal market is defined as the market with the greatest volume and level of activity for the subject asset or liability. Ind AS 113, specifies that in the

absence of a principal market, the most advantageous market should be considered. The most advantageous market is the market that maximizes the amount that would be received to sell a given asset or minimizes the amount that would be paid to transfer the liability, after taking into account transaction costs and transportation costs.

- (c) Fair Value measurements should reflect market participant assumptions in pricing an asset or liability. Market participants are assumed to be buyers and sellers in the principal (or most advantageous) market that are knowledgeable independent, unrelated parties willing and able to transact for the asset or liability being Fair Valued without compulsion.
- (d) The highest and best use (“HABU”) of a nonfinancial asset or group of nonfinancial assets and nonfinancial liabilities is the use by market participants that maximises the value of the nonfinancial assets/liabilities. This Fair Value concept considers (i) the different ways of utilizing the individual asset/liability, i.e. the highest and best use, and (ii) the valuation premise, whether the maximum value is on a standalone basis or in combination with other assets.
- (e) Fair Value measurements should consider characteristics of the assets/liabilities being valued such as the condition, location, restrictions associated with the sale or use of an asset as applicable. Liability fair valuations should reflect non-performance risk.

2.4 Fair value hierarchy: To promote consistency and comparability in fair value measurements, Ind AS 113 establishes a Fair Value hierarchy that categorises valuation related inputs into three levels, namely:

- (a) Level 1 inputs - these inputs are quoted prices (unadjusted) in active markets for identical assets/liabilities that the entity can access at the measurement date. As a quoted price in an active market provides the most reliable evidence of Fair Value, it should be utilized to measure Fair Value whenever available. Common examples of Level 1 inputs include listed equity securities and open ended mutual funds with daily published net asset values.

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- (b) Level 2 inputs - these inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include (i) quoted prices for similar assets or liabilities in active markets; (ii) quoted prices for identical/similar assets or liabilities in markets that are not active; (iii) inputs other than quoted prices that are observable for the asset or liability, such as interest rates, yield curves, and implied volatilities; and (iv) market-corroborated inputs. Adjustments to Level 2 inputs vary depending on factors specific to the asset or liability, including (i) condition or location of the asset; (ii) the extent to which inputs relate to items that are comparable to the asset or liability; and (iii) the volume or level of activity in the markets within which the inputs are observed.
  - (c) Level 3 inputs - these inputs are unobservable inputs for assets/liabilities. Unobservable inputs are used to measure Fair Value to the extent that relevant observable inputs are not available. The unobservable inputs should reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. An entity should develop unobservable inputs using the best information available. In developing unobservable inputs, an entity may begin with its own data, but it should adjust the data to ensure consistency with a market participant view point. Common examples of Level 3 inputs include management prepared business forecasts utilized in a discounted cash flow model.
- 2.5 In estimating the Fair Value of an asset/liability, valuation techniques are used that are appropriate under the circumstances and for which sufficient data is available to measure Fair Value, thus maximising the use of relevant observable inputs and minimising the use of unobservable inputs.
- 2.6 In some cases a single valuation technique will be appropriate, for example when valuing an asset/liability using Level 1 quoted prices in an active market for identical assets/liabilities. In other cases, multiple valuation techniques can be considered i.e. when valuing a cash-generating unit. If multiple valuation techniques are used, the results should be evaluated considering the reasonableness of the range of values.

- 2.7 Valuation techniques used to measure Fair Value should be applied consistently. However, a change in a valuation technique or its application is reasonable if the change results in a measurement that is equally or more representative of Fair Value under the circumstances (for example a change in the entity's product offerings, a change in business environment, a change in the industry or market conditions etc).



## Income Approach

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- 3.1 The potential earning power of a company is generally a key factor for business or share valuations, however there may be occasions, especially in valuations for compensation, where other considerations become relatively more important. In the absence of any other special motive, an investor is principally interested in a company's ability to continue earning profits.
- 3.2 The dominance of profits for valuation of shares was emphasised in McCathies case (Taxation, 69 CLR 1) where it was said that "the real value of shares which a deceased person holds in a company at the date of his death will depend more on the profits which the company has been making and should be capable of making, having regard to the nature of its business, than upon the amount which the shares would realise on liquidation". This has had the approval of the Indian Courts in Commissioner of Wealth Tax v. Mahadeo Jalan's case (S.C.) (86 ITR 621) and Additional Commissioner of Gift Tax v. Kusumben D. Mahadevia (S.C.) (122 ITR 38).
- 3.3 In the case of Ahlenime V. Bunn. L. Humphreys (1934), an American case, the Court went to the extent of saying that, "Mere book value should not govern in determining the value of shares of objecting share-holders..... The use of book value, especially, to measure the value of corporate shares owing to multifarious uses for which they are employed, is generally condemned as unsound." Thus, in several cases, the profits basis has been held to be more appropriate than the assets basis for valuing shares.
- 3.4 The Income Approach indicates the value of a business based on the value of the cash flows that a business is expected to generate in future. This approach is appropriate in most going concern situations as the worth of a business is generally a function of its ability to earn income/cash flow and to provide an appropriate return on investment.

- 3.5 The Income Approach includes a number of methods, such as Discounted Cash Flow (DCF) Method, Relief from Royalty (RFR) Method, Multi-Period Excess Earnings Method (MEEM), With and Without Method (WWM) and Option pricing models such as Black-Scholes-Merton formula or binomial (lattice) model which are discussed in detail in the subsequent paragraphs.

### **DISCOUNTED CASH FLOW**

- 3.6 The Discounted Cash Flow method indicates the Fair Value of a business based on the value of cash flows that the business is expected to generate in future. This method involves the estimation of post-tax cash flows for the projected period, after taking into account the business's requirement of reinvestment in terms of capital expenditure and incremental working capital. These cash flows are then discounted at a cost of capital that reflects the risks of the business and the capital structure of the entity.
- 3.6.1 Discounted Cash Flow is the most commonly used valuation technique, and is widely accepted by valuers because of its intrinsic merits, some of which are as follows:
- (a) Theoretically, it is a very sound model because it is based upon expected future cash flows that will determine an investor's actual return;
  - (b) It is based on expectations of performance specific to the business, and is not influenced by short-term market conditions or non-economic indicators;
  - (c) It is not as vulnerable to accounting conventions like depreciation, inventory valuation in comparison with the other techniques/approaches since it is based on cash flows rather than accounting profits;
  - (d) It is appropriate for valuing green-field or start-up projects, as these projects have little or no asset base or earnings which render the Cost Approach (net asset value) or the Market Approach (application of market multiples) inappropriate. However, it is important that valuation must recognise the additional risks in such a case (e.g. project execution risk, lack of past track record, etc.) by using an appropriate discount rate.

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3.6.2 Although the Discounted Cash Flow method is widely used for valuation because of its inherent benefits, it still has its share of drawbacks. Major shortcomings of this model are as follows:

- (a) It is only as good as its input assumptions. Following the “garbage in, garbage out” principle, if the inputs - Cash Flow Projections, Discount Rate, and Terminal Value - are wide off the mark, then the value generated by using this model does not reflect the fair value.
- (b) It does not take into account several other factors, such as investment risk associated with opportunity cost, i.e. investments that could return greater cash flow yields would add an unrealised element of risk, unforeseen variations in future cash flow, and other non-financial factors.

### 3.6.3 Free Cash Flow to Equity (“FCFE”)

FCFE refers to cash flows available to equity shareholders and therefore, cash flows after interest, dividend to preference shareholders, principal repayment and additional funds raised from lenders / preference shareholders are considered.

This method indicates the equity value based on the present value of the cash flows attributable to the equity holders in the future. Such cash flows are discounted at a discount rate (the cost of equity) that reflects the time value of money and the risks associated with the cash flows.

### 3.6.4 Free Cash Flow to Firm (FCFF)

FCFF refers to cash flows that are available to all the providers of capital, i.e. equity shareholders, preference shareholders and lenders. Therefore, cash flows required to service lenders and preference shareholders such as interest, dividend, repayment of principal amount and even additional fund raising are not considered in the calculation of FCFF.

This method indicates the value of a business enterprise based on the present value of the cash flows that the business can be expected to generate in the future. Such cash flows are discounted at a discount rate (the cost of capital or Weighted Average Cost of Capital -WACC) that reflects the time value of money and the risks associated with the cash flows.

3.6.5 Valuation utilizing the Discounted Cash Flows is based on three factors: Cash Flow Projections, Discount Rate and Terminal Value.

### **Cash Flow Projections**

3.6.6 The first and most critical input of the Discounted Cash Flow model is the cash flow projections. As stated earlier, the Discounted Cash Flow value is as good as the assumptions used in developing the projections. These projections should reflect the best estimates of the management and take into account various macro and micro-economic factors affecting the business. More specifically, Ind AS specifies that “an entity shall base cash flow projections on reasonable and supportable assumptions that represent management’s best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.” Some of the important points to be kept in mind with regards to cash flow projections are stated below:

- (a) Cash flow projections should reasonably capture the growth prospects and earnings capability of a company. The earning margins of a company should be determined based on its past performance, any envisaged savings, pressure on margins due to competition, etc.
- (b) Discontinuation of a part of the business, expansion programs and any major change in the policies of the company may provide occasions for making a break with the past.
- (c) The discontinuation of a part of the business can be easily dealt with by a valuer. A part of the profits earned by such business in the past will have to be excluded from future projections.
- (d) The effect of expansion schemes can present more complex problems. For these, the valuer will have to apply judgment about the potential impact such schemes may have on profitability. The state of execution at the time of valuation should be given due consideration. Mere paper plans for expansion should not be taken into account. If reasonable indications of expected future profit are available, then such profits taken on a reasonable basis - to take care of the risk

## Technical Guide on Valuation

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and uncertainty involved - may be included in the projections of the company. If, however, the profits are expected to be realised after a lapse of some years or if material amounts have yet to be incurred before profits are realised, due consideration will have to be given to these circumstances. In such circumstances, separate value may be attributed to such new investments and is added to the value of the existing stream of business.

- (e) In turnaround cases, the uncertainty of higher profits is much greater. Careful evaluation of the steps actually taken to implement a turnaround strategy must be undertaken before a valuer accepts management's claims that in future the company will earn profits. If necessary, reports of technical or other consultants should be taken into consideration.
- (f) In case of companies witnessing cyclical fluctuations, care should be taken to select the forecast period, which should necessarily cover the entire business cycle of a company.
- (g) Effects of change in the policy of the company may be taken into account by the valuer if they are known in advance and the effects are capable of being reliably quantified. These can include changes associated with the utilisation of productive capacity, organisational set-up, product-mix, financing policy. Their treatment in the projection of future profits will depend entirely upon the effect, which in the opinion of the valuer, such changes will have on such future profits.
- (h) An appropriate allowance must be made for capital expenditure in projections. They should not include capital expenditure only for capacity expansion or growth but also for maintenance of the existing operations.
- (i) However, the valuer has to remain vigilant and ensure that the projections are consistent with the purpose of the valuation and the associated basis of value. For example, while performing a valuation under Ind AS 36 Impairment of Assets, utilizing a Value in Use standard, the guidance indicates that base cash flow projections shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings (to

which an entity is not yet committed) or from improving or enhancing the assets' performance. Further, the pronouncement states that projections based on budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified. Management may use cash flow projections longer than five years if it is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

- (j) Working capital requirement forms another important component. Projections should appropriately account for working capital needs of the business in its different phases.
- (k) Income tax outflow also impacts the value of a business and should incorporate any tax benefits like tax holiday, accumulated losses, etc. In making projections, notional tax calculated at the rates expected to be applicable to the company in future should normally be deducted. For instance, the rate may change if the company is planning to undertake activities on which tax incidence is lower. Where such rates are not available, the current rates of taxes may be considered a good indicator. Tax benefits due to accumulated losses, accumulated development rebates or allowance, investment allowance, unabsorbed depreciation etc. should not generally be adjusted to the tax rate; instead, these should be considered separately. The past unabsorbed tax shelter is valued by using the Discounted Cash Flow method, for the actual years in which the tax shelter would be availed. A reduction in the effective tax rate due to exemptions for new industrial unit relief, export profits etc., should be very carefully considered, depending on the period for which they would be available. A prudent valuer would perhaps compute an effective tax rate each year for the forecast period, based on the current year's tax rate and statutory deductions available and a reasonable view of profits.

### Discount Rate

3.6.7 The next step in the Discounted Cash Flow model is the determination

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of an appropriate rate to discount future cash flows. Discount rate is the aggregate of risk-free rate and risk premium to account for riskiness of the business. Key inputs or adjustments for calculating the discount rate are discussed below followed by an illustration:

- (a) Theoretically, risk-free rate is the rate of return on an asset with no default risk. In practice, long-term interest rates on government securities are used as a benchmark.
- (b) Typically riskier investments should have a higher return. This necessitates the incorporation of an appropriate risk premium in the discount rate. There exist a number of models for determination of risk premiums, such as the capital asset pricing model, arbitrage pricing model, multi-factor model, etc. Risk premium is also adjusted to incorporate risks associated with the stage and size of business and other company or project-specific risks.
- (c) The rate estimated by using the above will provide the discount rate, assuming only equity financing or the cost of equity. For a leveraged company, the discount rate should be adjusted for financial leverage. Practically speaking, a discount rate for a leveraged company is the weighted average cost of capital with appropriate weightages to cost of equity and post-tax cost of debt, considering existing or targeted debt-equity ratio, industry standards and other parameters.
- (d) In companies consisting of two or more businesses, cash flow projections should be estimated separately, with the application of discount rates appropriate to the individual businesses.

### Discount rate illustration

3.6.8 The Weighted Average Cost of Capital (“WACC”)<sup>2</sup> is a commonly used method to compute a discount rate which is applied to the projected cash flows in the Income Approach. The WACC represents the economic return (or yield) that an investor would have to give up by investing in the subject investment instead of all available alternative investments that are comparable in terms of risk and other investment characteristics.

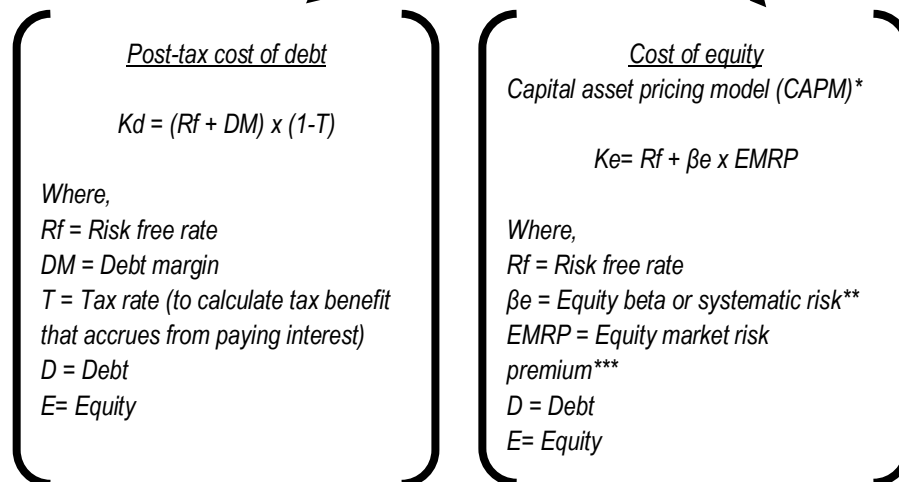
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<sup>2</sup>Source: Pratt, S and Niculita, A. Valuing a Business – The Analysis and Appraisal of Closely Held Companies, McGraw-Hill, 2008

## Income Approach

The WACC is calculated by weighing the required returns on interest bearing debt, preference share capital/hybrid securities and ordinary equity capital in proportion of their estimated percentages in an expected industry capital structure or other structures as appropriate.

$$\text{WACC} = K_d \times \frac{D}{D+E} + K_e \times \frac{E}{D+E}$$



\*CAPM is a widely used methodology for estimating cost of equity. Other methods include deductive models (such as dividend growth models), amongst others.

\*\*Equity beta: Estimated by regressing actual returns for a listed share against return on relevant stock market as a whole. Equity beta unlevered to arrive at an asset beta and then re-levered at the target capital structure using formulae such as those derived by Harris-Pringle, Modigliani-Miller or Miles-Ezzell.

\*\*\*Brealey Myers in *Principles of Corporate Finance* describes the EMRP as the difference between returns expected on the market and interest rates on treasury bills. Prof Aswath Damodaran in his paper *Equity Risk Premiums: Determinants, Estimation and Implications – The 2017 Edition* highlights the survey method, historical premium method and the implied premium method as three ways to estimate the EMRP.



## Terminal Value

- 3.6.9 Under the going concern premise, the value of a business should account for the cash flows over the entire life of a company, which can be assumed to be infinite. As discrete period cash flows are only estimated over the forecast period, a terminal value is computed to reflect the value of the cash flows arising after the forecast period. While the terminal value can be computed in a number of ways; some prominent ones are discussed below:
- (a) Perpetual growth model assumes that a business has an infinite life and a stable growth rate of cash flows. Terminal value is derived mathematically by dividing the perpetuity cash flows (cash flows which are expected to grow at a stable pace) with the discount rate as reduced by the stable growth rate. Estimation of the stable growth rate is of great significance because even a minor change in the stable growth rate assumption can have a profound impact on the terminal value and hence the overall business value. 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.
  - (b) For companies that are expected to grow significantly beyond the discrete projection period, “super-normal” growth should be factored into the terminal value with supportable rationale. In such cases a valuer should understand the business rationale for the expected growth, associated risks and the time period over which management expects the cash flows to reach stable inflationary growth. In such cases a “two-stage” or “H-model” may be applied in estimating the terminal value. Such models assume a high growth rate for a finite period post the discrete period (stage 1) after which growth is expected to normalize in line with long term industry/ macro-economic trends (stage 2).
  - (c) The application of multiples involves the determination of an appropriate multiple to be applied on perpetuity earnings or revenues. Multiples are estimated by an analysis of the comparable companies. Though this method is simpler and brings in the advantages of the Market Approach, it does not qualify as a preferred approach as it is often difficult to accurately estimate an exit multiple that is appropriate

to apply to the cash flows of a business especially at the end of the forecast period which is often five or more years into the future.

- (d) In valuations that assume a finite life of a business, terminal value is estimated to be the liquidation value, which is based on the book value of the assets typically adjusted for inflation. But this does not reflect the earning power of the assets. Alternatively, discounting expected cash flows from sale of such assets at an appropriate discount rate would provide a better estimation of liquidation value. Generally, a finite life assumption is considered for infrastructure projects where the concession/license period is provided in the concession agreement, e.g. toll road, construction joint venture for a project, transmission concession, telecom license.

### **MAINTAINABLE PROFITS BASIS**

3.6.10 In this method a reasonable estimate of the average future maintainable profits is made by considering past earnings, their trend and future plans of the company. The estimated average future maintainable profit after deducting the preferred rights, if any, is capitalised at an appropriately selected rate to arrive at the value of the equity.

3.6.11 This approach to valuation needs the determination of two factors, viz. (1) average future maintainable profits and (2) the rate of capitalisation.

### **Average Future Maintainable Profits**

3.6.12 Determination of average future maintainable profits is a complicated and delicate task, as it involves not only the objective consideration of the available financial information but also the subjective evaluation of many other factors, such as capabilities of a company's management, general economic conditions, government policies, etc. Guiding principles may be laid down here only in respect of the former; the valuer will have to give due consideration to the latter according to his reading of the situation in each individual case. To arrive at the future maintainable profits of a company, the required steps are: (a) Calculation of the past pre-tax average earnings; and (b) projection of the future pre-tax maintainable profits.

## Calculation of the Past Pre-Tax Averages Earning

- 3.6.13 In order to calculate the past average earnings of a company, it is necessary to decide upon the number of years the results of which should be taken for averaging, select these years, and adjust their profits to make them acceptable for averaging. It is also a common practice to assign different weights to different years while working out future maintainable profits.
- 3.6.14 The number of years to be selected must be reasonably large so as to cover the length of a business cycle (which would include recovery, peak and recession phases of the cycle), as an average for a shorter period might not be representative of a fair average. This could apply only if the business is subject to cyclical fluctuations. The period, if selected in the aforesaid manner gets closer to the average future earnings. Inflationary conditions as of the valuation date should be accessed in determining the number of years utilized in estimating the average. For companies having a steady and gradual growth, average of a shorter period may be more useful. In some unusual circumstances, average of a still shorter period or even one year's profit may be useful for predicting future earnings, such as where change in the business or a change in trading conditions force the valuer to discard earlier years and to rely upon one year only or to select certain normalised years and exclude others. The period over which the average can reflect the correct future earnings of a company will depend upon the facts of the case, including the length and nature of the business cycle in the industry in which the company is operating.
- 3.6.15 The years chosen for averaging the past earnings of a company should be normalized years. In case the events occurring in a year could be so adjusted as not to distort the estimated past average profit, the year is included as normal. If the events in a year are such as would yield an average which, even after making adjustments remains distorted, e.g., strike or fire, if such event affects operations for a substantive part of the year, the year is excluded as abnormal. If the company has incurred a loss in a particular year, it does not necessarily become an abnormal year.

3.6.16 Some necessary adjustments need to be made for averaging past earnings. Even though the Companies Act, 2013, makes it obligatory for the companies to disclose a true and fair view of the profit or loss in their accounts (which are the primary source of information for this method of valuation) there is still a need for some adjustments to make the future average maintainable profits more reliable. Some such important adjustments are:

- (a) Elimination of material non-recurring items such as losses of exceptional nature through strikes, fires, floods and theft, etc., profit or loss of any isolated transaction not being part of the business of the company, lump-sum compensation or retiring allowance, damages and costs in legal action, receipt of commission for a special service, etc.
- (b) Elimination of any abnormal or exceptional capital profit or loss or receipt or expense, e.g., abnormal repair charges in a particular year which may have been taken into the Statement of profit and loss.
- (c) Elimination of profits or losses from sale of investments that are not expected to recur in future. In the case of an investment company or the investment division of a manufacturing company, unrealised capital appreciation in the value of investments would also have to be taken into account.
- (d) Adjustments for any interest, remuneration, commission etc. foregone by directors or others.
- (e) Adjustments for any matters suggested by notes appended to the accounts or by qualifications in the auditors' report, such as provision for bad and doubtful debts, gratuities etc.
- (f) Adjustments for any inconsistencies in the accounting policies and their compliance with generally accepted accounting principles. For example, in the case of depreciation, it should be ensured that the provision in each year is adequate and is calculated consistently both as to the basis and rates. Similarly, in the case of shares, it should be ensured that the basis of valuation is consistent from year to year and is in accordance with the generally accepted accounting principles.

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3.6.17 In the computation of future maintainable average profit, the courts have, in a number of cases, made the following adjustments and rejections:

- (a) In Abraham' case<sup>3</sup>, the judgment approved of estimated additional income from idle cash being included in future maintainable profits.
- (b) In McCathie's case<sup>4</sup>, McCathie V. Federal Commissioner of Taxation, 69 C.L.R. 1. directors' fees were reduced to a figure considered to be relevant.
- (c) Applicable portion of profits and assets of controlled subsidiaries were combined with the profit of the parent company in Martin's case<sup>5</sup>.

### Projection of the future pre-tax maintainable profit

3.6.18 Projection is not an easy matter, because it is essentially an estimation of risks and uncertainties in future. The average profit earned by a company in the past could normally be taken as the average profit that would be maintainable by it in the future, if the future is considered as a continuation of the past. If future performance of a company is viewed as departing significantly from the past, then appropriate adjustments will needed before accepting the past average profit as the future maintainable profit of the company. The valuer must keep in mind the points related to cash flow projections discussed in paragraph 3.6.6 under Discounted Cash Flow model for making such adjustments.

3.6.19 Since the stream of profits are available in the future years and the valuation is performed to determine the consideration as at present, many valuers use the technique of the discounted cash flow to work out the value of the business. In other words, the future maintainable profits are discounted to their present value before the average profit is worked out. The rate of discount is normally the weighted average cost of capital to the purchaser.

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<sup>3</sup> Abraham V. Federal Commissioner of Taxation, 70 C.L.R. 23

<sup>4</sup>McCathie V. Federal Commissioner of Taxation, 69 C.L.R. 1

<sup>5</sup> Kent and Martin V. Federal Commissioner of Taxation (Not Reported) Adapted from Adamson's "Valuation of Company Shares and Business" (1966) page 111.

### **Determination of post-tax future maintainable profits**

3.6.19A The taxation regime could have changed over the years in the past and also the taxation in the past may have been impacted by factors such as tax holiday, past carry forward losses etc., and that is the reason for selecting pre-tax profits of the past year to be used as the basis for estimating the future maintainable profits in the previous paragraphs. However, once the pre-tax future maintainable profits are determined, the same needs to be adjusted for taxation. Taxation adjustment should be effected considering the likely rate applicable in the future for the entity or business under valuation and guidance generally is taken from the tax rates substantially enacted as at the time of conducting the valuation engagement. At times, it may also be important to consider the likely levels of revenue / profitability / structure of the entity or business to determine the applicable rate (from amongst various rates prescribed under the tax laws), the applicable rate of surcharge etc.

### **The Rate of Capitalisation**

3.6.20 The next step in the method of valuation is the selection of the rate at which the estimated future average maintainable profit after tax and adjustment of preferred rights is capitalised to arrive at the total value of the equity capital of the company. For calculating the rate of capitalisation, a valuer has to keep in mind the factors discussed under the Discounted Cash Flow model in the paragraph 3.6.7.

3.6.21 Where a company has two or more different businesses, it is appropriate to determine their maintainable profits separately, and apply the rate of capitalisation appropriate to the individual businesses.

### **Dividend Discount Model**

3.6.22 It is the simplest model for valuing equity. The Dividend Discount model equates the value of a share to the present value of dividends expected to be received. It works similar to the Discounted Cash flow model.

3.6.23 Expected dividends and the cost of equity form the two basic components of the Dividend Discount model. To estimate dividends, assumptions about expected future growth rates in earnings and

payout ratios have to be developed. The required rate of return on a share is determined by its riskiness, measured differently in different models, as discussed under the Discounted Cash Flow model.

3.6.24 This model is not used in most practical situations as dividends may not reflect the true profitability of a business and payout is a management decision. Accordingly, this model suffers from a number of issues like forecasting of dividend pay-outs, non-applicability of the model to non-dividend paying companies, retention of profits for capital expenditure, etc. and is generally limited in its application.

### **Relief From Royalty (RFR) Method**

3.7 RFR Method is a method in which the value of the asset is estimated based on the present value of royalty payments saved by owning the asset instead of taking it on lease. It is generally adopted for valuing intangible assets that are subject to licensing, such as trademarks, patents, brands, etc.

The fundamental assumption underlying this method is that if the intangible asset to be valued had to be licensed from a third-party owner there shall be a royalty charge for use of such asset. By owning the said intangible asset, royalty outgo is avoided. The value under this method is equal to the present value of the licence fees / royalty avoided by owning the asset over its remaining useful life.

The following are the major steps in deriving a value using the RFR method:

- (a) obtain the projected income statement associated with the intangible asset to be valued over the remaining useful life of the said asset from the client or the target;
- (b) analyse the projected income statement and its underlying assumptions to assess the reasonableness;
- (c) select the appropriate royalty rate based on market-based royalty rates for similar intangible assets or using the profit split method;
- (d) deduct costs associated with maintaining licencing arrangements for the intangible asset from the resultant royalty savings;

- (e) apply the selected royalty rate to the future income attributable to the said asset;
- (f) use the appropriate marginal tax rate or such other appropriate tax rate to arrive at an after-tax royalty savings;
- (g) discount the after-tax royalty savings to arrive at the present value using an appropriate discount rate; and
- (h) Tax amortisation benefit, if appropriate, should be added to the overall value of the asset.

### **Multi-Period Excess Earnings Method (MEEM)**

3.8 *MEEM* is generally used for valuing intangible asset that is leading or the most significant intangible asset out of group of intangible assets being valued.

The fundamental concept underlying this method is to segregate the earnings attributable to the intangible asset being valued. Intangible assets which have a finite life can only be used to value using MEEM. The value under this method is equal to the present value of the incremental after-tax cash flows ('excess earnings') attributable to the intangible asset to be valued over its remaining useful life.

The following are the major steps in deriving a value using the MEEM:

- (a) obtain the projections for the entity or the combined asset group over the remaining useful life of the said intangible asset to be valued from the client or the target to determine the future after-tax cash flows expected to be generated;
- (b) analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
- (c) Contributory Asset Charges (CAC) or economic rents to be reduced from the total net after-tax cash flows projected for the entity/combined asset group to obtain the incremental after-tax cash flows attributable to the intangible asset to be valued;
- (d) the CAC represent the charges for the use of an asset or group of assets (e.g., working capital, fixed assets, assembled workforce, other intangibles) based on their respective fair values and should be considered for all assets, excluding



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- goodwill, that contribute to the realisation of cash flows for the intangible asset to be valued;
- (e) discount the incremental after-tax cash flows attributable to the intangible asset to be valued to arrive at the present value using an appropriate discount rate; and
- (f) Tax amortisation benefit, if appropriate.

### With and Without Method (WWM)

3.9 Under WWM, the value of the intangible asset to be valued is equal to the present value of the difference between the projected cash flows over the remaining useful life of the asset under the following two scenarios:

- (a) business with all assets in place *including* the intangible asset to be valued; and
- (b) business with all assets in place *except* the intangible asset to be valued.

The following are the major steps in deriving a value using the WWM :

- (a) obtain cash flow projections for the business over the remaining useful life of the said asset to be valued under the following two scenarios:
  - (i) business with all assets in place including the intangible asset to be valued; and
  - (ii) business with all assets in place except the intangible asset to be valued.
- (b) analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
- (c) discount the difference between the projected cash flows under two scenarios to arrive at the present value using an appropriate discount rate; and
- (d) Tax amortisation benefit, if appropriate.

### Option Pricing Models

3.10 There are several methods to value options, of which the Black-Scholes-Merton Model and Binomial Model are widely used. The important inputs required in these models are as under:

- (a) current price of asset to be valued;
- (b) exercise price;
- (c) life of the option;
- (d) expected volatility in the price of the asset;
- (e) expected dividend yield; and
- (f) risk free interest rate.

These models value options by creating replicating portfolios composed of asset to be valued and riskless lending or borrowing.

3.11 MEEM, Relief from Royalty method, With and Without method are used only for valuation of intangible assets and Option Pricing Models are used in case of valuation of options. Specific guidance on the aforesaid valuation methods is provided in other relevant ICAI Valuation Standards.

## Market Approach

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- 4.1 Compared to the Income Approach that incorporates company-specific estimates to arrive at the firm's intrinsic value, the Market Approach relies on relative valuation to arrive at the value of a business, based upon how similar assets are priced in the market.
- 4.2 The use of relative valuation and more specifically the Market Approach is widespread, especially in equity research reports and acquisition valuations. This is primarily because of its benefits, some of which are listed below:
- (a) It is easy to use, simple to comprehend and is hence, less time consuming and easily understood by users.
  - (b) It incorporates information from other valuations in a simple way and provides consistency in the valuation process by ensuring that valuation is in line with other comparative valuations.
  - (c) It relies upon market information and implicitly embodies current market consensus about assumptions such as the discount rate and growth rate. Hence, it reflects the current mood of the market.
- 4.3 The Market Approach provides a reasonable basis for valuation and is relatively a quick approach in its application, but it suffers from a number of limitations:
- (a) Relative valuation is as good as the valuation of the comparable companies and suffers from volatility of the market. For example, in case the market is overvaluing comparable companies, the relative valuation will also lead to overstatement of value.
  - (b) Identifying comparable companies with similar growth rates, business composition, stage and riskiness of business is a difficult task and finding a perfect match is extremely

challenging. Adjusting the multiples for company-specific information is subjective and, thus, debatable.

- (c) Differences in accounting policies related to revenue-recognition, depreciation, etc., though adjustable to a certain extent, can result in a distorted valuation.
- (d) The Market Approach or relative valuation is more commonly applied to historical data and can result in the undervaluation of a company with a significant future potential or benefit that may arise due to beneficial circumstances such as market expansion.

4.4 The Market Approach can be applied through different methods, namely Market Price Method, Comparable Companies Multiple Method, Comparable Transaction Multiple Method and Prior Sale of Business Method, which are discussed in detail in the following paragraphs.

### Market Price Method

- 4.5 In this method, a *valuer* shall consider the traded price observed over a reasonable period while valuing assets which are traded in the active market. A *valuer* shall also consider the market where the trading volume of asset is the highest when such asset is traded in more than one active market.
- 4.6 A *valuer* shall use average price of the asset over a reasonable period. The *valuer* should consider using weighted average or volume weighted average to reduce the impact of volatility or any one time event in the asset.

### Comparable Companies Multiple Method

- 4.7 Market Comparable Method involves the identification of comparable companies followed by the derivation of market based multiples. While applying such multiples to the subject company's financial metrics (e.g. revenue or earnings), careful adjustments to account for differences in fundamentals between the comparable companies and the subject must be undertaken.
- 4.8 Theoretically, a comparable company is the one with cash flows, growth potential and risk similar to the company being valued.

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Conventionally, looking at the companies within the sector provides a better-matched and similar-profiled set of comparable companies. Alternatively, in some cases, it is necessary to look across sectors to identify comparable companies. In practice, one seldom finds exactly similar companies.

- 4.9 The next step is to arrive at a standardised set of ratios for comparison, commonly known as multiples. Multiples are a ratio of the enterprise value/equity value over different financial parameters like Revenue, Earnings before Interest, Tax, Depreciation and Amortisation (“EBITDA”), Profit after Tax (“PAT”), Earnings per Share (“EPS”), book value etc., with some being preferred over the others. For example, EBITDA multiple is preferred over PAT multiple so as to eliminate the effect of differences in depreciation policies and the impact of leveraging.
- 4.10 As comparable companies are not exactly similar to the company being valued, the multiples derived from such companies cannot be applied sacrosanct, and thus merit various subjective adjustments to account for differences in risk profile, growth rate, etc. For example, a company with higher EBITDA margin should command a better multiple than an average performer or a positive adjustment is required for a company with better growth potential.
- 4.11 In some cases, multiples of non-financial parameters are also used. For example, it is a common practice to evaluate oil companies using multiples of value per barrel of oil or in case of banking shares using value based on the loan portfolio. Furthermore, while valuing hospitals, valuation practitioners rely on industry specific metrics such as enterprise value/operating hospital bed.

### Comparable Companies Transaction Method

- 4.12 A variant of the Comparable Companies Multiple Method, the Comparable Companies Transaction Method uses transaction multiples in place of trading multiples. Transaction multiples, as the name suggests, are the multiples implied in the recent acquisitions/disposals of comparable companies.
- 4.13 This method is especially useful if there are limited comparable companies. Also, it incorporates the market sentiments in a better

way, as the multiples, unlike trading multiples which are affected by the inefficiencies of the market, are based on an informed negotiation between buyers and sellers.

- 4.14 Various factors should be considered while using transaction multiples. These are nature of transaction - hostile deal, group restructuring, industry trends, negotiation or control premiums that may have been paid, time of transaction - whether at the high or low of industry cycle, consideration - share or cash, contingent to future performance, etc.
- 4.15 This method suffers from limitation of data availability, as the requisite information relating to transactions, specially about private companies, is seldom available.

### **Prior Sale of Business Method**

- 4.16 Prior Sale of Business Method, like the Market Transaction Method, makes use of transaction multiples. However, transaction multiples used in this case are the ones implied in the prior transactions involving the subject company itself. For example, an earlier stake sale in business can be used to provide a benchmark valuation of a company, provided the same was between unrelated parties.
- 4.17 Transaction multiples should be adjusted for timings of the transactions and intermediate changes in the stage of business, earnings margin, growth rate, etc.

## Cost Approach

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- 5.1 Valuation on Net Assets is computed by taking the net value of a business's assets, subtracting therefrom the amount of the liabilities and preferred share-holders' claims and dividing the remainder among the equity shareholders according to their individual rights.
- 5.2 This basis has to be used for valuation for certain specific purposes, e.g., special provisions of various tax laws. It may be appropriate to value shares on asset basis under many other circumstances, the more important of which are mentioned below:
- (a) In cases where there is paucity of information about profits that would serve as a basis of valuing shares, such as:
- (i) In case of new companies whose accounts do not serve as a guide to future profits.
- (ii) Where a company has been trading at a loss and there are no prospects of earning any profit in the foreseeable future. The compensation paid to various airline companies that were nationalised was fixed on the basis of valuation of their assets, because most of the companies had incurred heavy losses in past years. In *Dean V. Prince and others* (1954) 1All E.R. 749, it was observed:
- “In the case of a private company carrying on a profitable business it is no doubt true that a sound and obvious basis of a calculation would be in accordance with the expectation of profit for the future, particularly when the shares in question constitute a majority holding. In my judgment, however, Mr. Jenkinson rightly rejected any such basis of valuation in the present case, for a continued expectation of loss would produce necessarily a negative result - a calculation on the basis of profits (that is, upon the basis of expected returns on

the footing of the company continuing as a going concern) being out of the way, Mr. Jenkinson, I think, turned clearly to a break-up value as on a forced sale as the only available alternative.”

However, in such cases, the fact that there is no profit earnings capacity should be taken into account and in appropriate cases a discount on net assets value should be worked out.

- (iii) In case of companies where there is no reliable evidence of future profits due to:
    - Profound fluctuations in business, or
    - disruption in business.
  - (b) Other circumstances, such as, when it is intended to liquidate the company and to realise the assets and distribute the net proceeds among shareholders.
  - (c) The Cost Approach and its variant, Underlying Asset Approach can also be utilized in valuing holding companies, real estate companies and investment holding companies etc.
- 5.3 Referring to the asset basis of valuation in Murdoch's case<sup>6</sup>, Justice Williams said that one of the main items to be taken into account is the safety of the capital assets in which the shareholders' fund is invested and in McCathie's case<sup>7</sup>, His Lordship again emphasised that a prudent purchaser takes care to ensure that his purchase money is well secured by tangible assets.
- 5.4 Assets value also becomes a material factor in valuation of shares where assets are surplus to existing business operations, e.g., excess land in a manufacturing company. Assets value also provides guideline for valuation of shares of companies whose future profits are indeterminable either because of newness, dislocation, losses in business or due to business fluctuations. It is equally important in valuing shares where the merger is not in the nature of a pooling of interests but that of a purchase.

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<sup>6</sup> Murdoch (Sir James) Re: Perpetual Trustee Co. V. Federal Commissioner of Taxation, 65 C.L.R. 537

<sup>7</sup>Mc Cathie V. Federal Commissioner of Taxation, 69 C.L.R. 1



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- 5.5 The liquidated value of net tangible assets is normally the minimum value of a whole company and will prevail even if its earning capacity is very low or in the negative, subject to any discounting in appropriate cases as provided in above paragraphs. In adopting this liquidation basis for valuation, the valuer should give adequate consideration to what Justice Kennedy called ‘the reluctance to wind-up’. In *Keesings V. Commissioner of Stamp Duties*, he assigned a value of 30 per cent of the net realisation to this factor and added it to the net realisation to arrive at the value of shares. The Judge in another English case suggested 33 1/3 per cent of the net realisation to this factor. Costs of liquidation and tax consequences thereof should be taken into account. It may, however, be noted that such additions can be made only in the case of concerns, which may at present be incurring losses, but there is a possibility of a turnaround.
- 5.6 Under appropriate circumstances, a valuer should consider the necessity of physical verification of tangible assets. Factoring in any due diligence findings on assets may also be required while ascertaining the value of the assets in certain cases.
- 5.7 Based on his assessment of a business and discussions with its management, a valuer should identify and value the intangible assets of a business.
- 5.8 In some instances, the *valuer* may consider using other valuation approaches in combination with cost approach, such as:
- (a) the asset has not yet started generating income / cash flows (directly or indirectly);
  - (b) an asset of substantially the same utility as the asset to be valued can be created but there are regulatory or legal restrictions and involves significant time for recreation; or
  - (c) the asset was recently created.
- 5.9 The two most commonly used valuation methods under the Cost approach are Replacement Cost Method and Reproduction Cost Method.

**Replacement Cost Method: *Replacement Cost Method*, also known as ‘*Depreciated Replacement Cost Method*’ involves valuing an asset based on the cost that a market participant shall**

**have to incur to recreate an asset with substantially the same utility (comparable utility) as that of the asset to be valued, adjusted for obsolescence.**

The physical properties of the new asset may or may not be similar to the one under valuation, but the former asset should bear comparable utility. Obsolescence includes physical deterioration, functional (technological) and economic obsolescence. The term obsolescence connotes a wider meaning than the term depreciation adopted for financial reporting or tax purposes.

The following are the major steps in deriving a value using the Replacement Cost method:

- (a) estimate the costs that will be incurred by a market participant for creating an asset with comparable utility as that of the asset to be valued;
- (b) assess whether there is any loss on account of physical, functional or economic obsolescence in the asset to be valued; and
- (c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the asset to be valued.

**Reproduction Cost Method: *Reproduction Cost Method* involves valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the asset to be valued, adjusted for obsolescence.**

The following are the major steps in deriving a value using the Reproduction Cost method:

- (a) estimate the costs that will be incurred by a market participant for creating a replica of the asset to be valued;
- (b) assess whether there is any loss of value on account of physical, functional or economic obsolescence in the asset to be valued; and
- (c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the asset to be valued.

**Obsolescence: Under the *Replacement Cost Method* or the *Reproduction Cost Method*, the estimated cost of creating an asset is required to be adjusted for depreciation on account of obsolescence in the asset to be valued.**

The following are common types of obsolescence

- (a) *Physical obsolescence* represents the loss in value on account of decreased usefulness of the asset as the useful life expires.
- (b) *Functional (technological) obsolescence* represents the loss in value on account of new technological developments; whereby the asset to be valued becomes inefficient due to availability of more efficient replacement assets.
- (c) *Economic (external) obsolescence* represents the loss in value on account of decreased usefulness of the asset caused by external economic factors such as change in environmental or other regulations, excess supply, high interest rates, etc.

### Procedure

- 5.10 The steps necessary for valuation using Cost Approach /Underlying Asset basis are:
- 1. Ascertaining value of assets.
  - 2. Ascertainment of value of liabilities (including contingent liabilities).

### Valuation of Assets

- 5.11 The valuation of assets can be carried out using the following approaches, i.e.
- (a) Book value.
  - (b) Net replacement value.
  - (c) Net realisable value.
- 5.12 If valuation of assets is done on the basis of their book value, certain adjustments need to be made. It should be recognised that book value reflects only the historical cost of assets, which in the case of old concerns may be much lower than their economic value. Investments are generally recognised at their market values even where other assets are considered at their book value.

- 5.13 If a concern is being valued on a going concern basis, net replacement value of the assets gives a fair measure of their current value. However, in this case too intangible assets may need to be valued and added to recognise the fact that individual net replacement value of the assets does not represent the inherent strength of the concern.
- 5.14 Where a concern is being wound up, its assets are best valued on the basis of their net realisable value.
- 5.15 In practice while applying Underlying Asset Approach often a combination of book values, replacement values and realisable values is adopted. For example, even where a concern is being valued on going concern basis, excess assets may be valued at their net realisable values.
- 5.16 Intangible assets of a company have also to be included, no matter whether they are shown in the books or not. Intangible assets generally consist of goodwill, patents, trade-marks, copyrights, etc. Their book value/net replacement cost/net realisable value/fair value, as the case may be, has to be included. Goodwill is generally inseparable from business, and it can fetch a price only if the business is sold on a going concern basis. The valuation of intangible assets is a complicated matter and is discussed in some detail in chapter 7.
- 5.17 Some considerations for arriving at the value of the various classes of assets and liabilities are given below.

### *Fixed Assets*

- 5.18 The valuation of fixed assets is detailed in chapter 6.

### *Investments*

- 5.19 Shares and securities that are regularly traded in stock exchange may be valued on the basis of the prices quoted there at. It must, however, be seen that there is regular trading in those scrips, as an isolated transaction may lead to erroneous results. In cases of quoted shares with isolated transactions and unquoted shares, a secondary valuation may be necessary, if the amount is material.

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### *Inventory*

- 5.20 Due allowance/adjustment should be made for any obsolete, unusable or unmarketable stocks held by the company.

### *Sundry Debtors*

- 5.21 Appropriate allowance/adjustment should be made for any bad debts and debts which are doubtful of recovery.

### *Contingent Assets*

- 5.22 If the company has made escalation claims, insurance claims or other similar claims, then the possibility of their recovery should be carefully made on a conservative basis, particularly having regard to the time frame in which they are likely to be recovered.

### *Development Expenses*

- 5.23 These arise:

- (a) in the case of a new company, when it is in the process of executing its project; and
- (b) in the case of an old company, when there is an expansion of the existing production lines or diversification for entering into new business

These should be reviewed and the costs that have been incurred for completing the project should be included.

### *Valuation of Liabilities*

- 5.24 The amount of liabilities shown in the books of companies may generally be accepted after proper scrutiny. Due consideration should, however, be given to contingent liabilities and short provisions for expenses. If necessary, legal opinion should be sought for ascertaining the sustainability of claims or contingent liabilities.
- 5.25 Where liability for taxation has not been provided in the accounts, appropriate amount should be included in the liability. Similar adjustment may be required for proposed dividend. In case the company has set aside any specific reserves to meet any future losses, it should be ascertained whether they are reserves or provisions. If there is a definite reason to regard them as provisions,

they should either be included in liabilities or deducted from the related assets.

- 5.26 While valuing equity shares, the dues of preference shareholders have also to be included in the liabilities. These rights can be ascertained from the terms of issue. Where such shareholders also have a right to participate in the surplus, the applicable amounts of such surplus should be included as liabilities, together with the paid-up value of such shares.

### **Special Consideration in Cases of Liquidation**

- 5.27 Where the business of a company is being liquidated, its assets have to be valued as if they have been sold individually and not on a going concern basis. In such cases, the total net realisable value will often be less than that on the basis of a going concern. When a company itself is in liquidation, but its business is being continued, this consideration does not apply. However, a special provision has to be made for cost of liquidation. On the other hand, if a company itself is in liquidation and its business is also being liquidated, the assets will be valued on a liquidation basis; a provision will also have to be made for the cost of liquidation. The tax consequences of liquidation have also to be considered. If fixed assets are to be sold at a price in excess of cost, the capital gains tax and withdrawal of tax relief, such as investment allowance/investment deposit allowed in the past should also be taken into account.

## Tangible Assets Valuation

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6.1 In order to estimate the fair value of the tangible assets, the following three approaches are typically employed: the Cost Approach, Market Approach - Sales Comparison, and Income Approach.

### 6.2 **Cost approach**

The principle behind the Cost Approach is that a prudent investor will not purchase an asset for more than it will cost him to replace this asset with an asset of comparable utility.

A valuation analysis using the Cost Approach typically involves the following steps:

- (a) Estimate replacement or reproduction cost new, based on:
  - (i) The trended reproduction cost method, which uses analytical trending where, based on the fixed asset register, assets are categorized into similar appraisal groups. Using historical cost and acquisition date, current reproduction cost new estimates are developed by multiplying the cost data by inflationary/deflationary trend factors that reflect various types of assets and their respective ages; or
  - (ii) The direct replacement cost method, which uses:
    - Price estimates from sources such as manufacturers, major vendors, construction and erection companies, engineers; and
    - Capacity factors in the case of process-related facilities from engineering companies, or other sources, providing an estimate of a "greenfield" cost per unit of production. The production rate of the facility is multiplied by this cost per unit. Further adjustments may be necessary for facilities with varying units of production.

## Tangible Assets Valuation

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- (b) Estimate total economic life and effective age;
- (c) Depreciate replacement/reproduction cost new over economic life to reflect obsolescence related to effective age; and
- (d) Adjust for additional functional/economic obsolescence:
  - Functional obsolescence is the loss in value or usefulness of an asset caused by inefficiencies or inadequacies of the property itself, when compared to a more efficient or less costly replacement property that new technology has developed.
  - Economic obsolescence is the loss in value or usefulness of an asset caused by factors external to the asset. These factors may have included increased cost of materials, labor, utilities, reduced demand for the product, increased competition, environmental regulations, or similar factors.

### 6.3 Market Approach - Sales Comparison

- (a) The principle behind the sales comparison method is that the value of the asset is equal to the market price of an asset of comparable features such as location and size.
- (b) A valuation analysis using the sales comparison method typically involves the following steps:
  - (i) Analyze comparable transactions or sales data to determine unit prices for comparable assets;
  - (ii) Adjust for differences between comparable property and subject property such as location, size, market conditions, utility services, etc.;
  - (iii) Apply adjusted unit price to subject property;
  - (iv) Adjust for obsolescence factored into sales prices, where appropriate; and
  - (v) Adjust for additional functional/economic obsolescence not reflected in the comparable transactions.



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- (c) It should be noted that obtaining reliable data on the actual price of the historical transactions can be challenging.

### 6.4 Income Approach

- (a) The principle behind the Income Approach is that the value of the asset is equal to the earnings potential of this asset, i.e., the present value of net rental savings attributable to owning the asset.
- (b) A valuation analysis using the Income Approach typically involves the following steps:
  - (i) Determine appropriate rental yield for subject asset;
  - (ii) Estimate total economic life and effective age;
  - (iii) Determine effective gross income;
  - (iv) Deduct operating expenses associated with the asset;
  - (v) Derive investor's required rate of return for subject asset and capitalize effective net income; and
  - (vi) Adjust for additional functional/economic obsolescence.
- (c) The application of the Income Approach may be limited in situations where the income stream cannot be allocated reasonably and effectively to each of the individual tangible assets or groups of assets that comprise the business.

## Intangible Assets Valuation

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- 7.1 Intangible assets are assets that do not have a physical identity. More specifically, Ind AS 38-Intangible Assets, defines an intangible asset as “an identifiable non-monetary asset without physical substance”. These assets represent a company’s right or claim to future benefits arising from their use. Corporate intellectual property items such as patents, trademarks, copyrights, business methodologies, customer related intangibles, brands and goodwill are all common intangible assets in today’s marketplace.
- 7.2 With recent developments in the Indian valuation landscape, a greater emphasis is being placed on the valuation of intangible assets, under the following scenarios:
- (a) It may be required under the applicable accounting standards, for example Ind AS 103 - Business Combinations, Ind AS 36-Impairment of Assets, Ind AS 38 – Intangible Assets etc.<sup>8</sup>
  - (b) Further, Income Tax Act, 1961 allows amortisation of certain acquired intangible assets as tax deductible which also necessitates allocation of sales consideration in acquisitions to different tangible and intangible assets.
  - (c) Valuation of these assets is also required in the case of transactions involving sale of stand-alone intangible assets like brands, trademarks, trade names, patents, etc.
- 7.3 Key attributes associated with intangible assets include:
- (a) Identifiability -  
As per Ind AS 38, the definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognized is an asset representing future

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<sup>8</sup>It may be noted that Ind AS guidance on intangible assets and business combination has significant similarities when compared with IFRS

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economic benefits arising from other assets acquired and/or liabilities assumed in a business combination that are not individually identified and separately recognized. An intangible asset is considered as identifiable, if the asset meets either of the following criteria detailed in Ind AS 36:

- (i) Contractual-legal criterion - asset arises from contractual or other legal rights, regardless of whether these rights are transferable or separable from the acquired business or from other rights and obligations; or
- (ii) Separability criterion - asset is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so.

Intangible assets that meet either of these criteria are considered identifiable. However, some intangible assets do not typically meet either of the identifiable criteria and, therefore, would not be recognized as separate intangible assets, such as, non-contractual customer relationships that are not separable, customer service capability, and specially trained employees.

- (b) Control - Control can be defined as the power to obtain the future economic benefits associated with an asset and the ability to restrict the access of others to those benefits. In the context of intangible assets, control is often demonstrated through legal rights that are enforceable in a court of law. However, legal enforceability is not a necessary prerequisite for control because businesses are often able to control future economic benefits through other means.
- (c) Future economic benefits—Existence of future economic benefits forms an important attribute of intangible assets. Such benefits from an intangible asset may include product or service related revenues, cost savings or other benefits resulting for the use of the asset by an entity.

- (d) Based on function, intangible assets that are separable can be categorized as follows:<sup>9</sup>
  - (i) Contract based intangible assets represent the value of rights that arise from contractual agreements, such as non-competition agreements, licenses, permits, royalty agreements etc.
  - (ii) Customer based intangible assets normally include customer related intangibles, such as customer relationships (both contractual and non-contractual), backlogs, customer lists etc.
  - (iii) Marketing based intangible assets are normally used in marketing or promotion of products or services, such as trademarks or trade names, service marks, copyrights, internet domain names etc.
  - (iv) Technology related intangible assets are generated from contractual or non-contractual rights to use patented or unpatented technology, software, databases (including title plants), trade secrets, technical know-hows, technical designs etc. among others.
  - (v) Artistic related intangible assets arise from the right to benefits from artistic works, such as royalties from pictures, photographs, videos, plays, books, magazines, newspapers, films and music etc.

7.4 The price paid by an entity to separately acquire an intangible asset reflects expectations about the future economic benefits embedded in the asset, even if there is certain level of uncertainty regarding the timing or the amount of the inflow. The cost of a separately acquired intangible asset can usually be measured reliably, which normally comprises of (i) purchase price of the asset (including import duties, non-refundable purchase taxes, after deducting trade discounts and rebates); and (ii) any directly attributable cost of preparing the asset for its intended use.

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<sup>9</sup>ICAI Valuation Standard 302: INTANGIBLE ASSETS,” ICAI Valuation Standards 2018, May 2018

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- 7.5 Per Ind AS 103, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset reflects market participants' expectations at the acquisition date about the probability that the expected future economic benefits embedded in the asset will flow to the acquirer entity. The acquirer entity may recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives.
- 7.6 In the context of Ind AS 103, implied goodwill is computed on a residual basis and not valued directly through the application of the Income, Market or Cost Approach. As such goodwill is subject to change given any potential modifications to the total consideration and the Fair Value of acquired assets and liabilities. The rate of return on goodwill typically attracts an additional risk premium as goodwill is considered to be riskier than the other identified intangible assets. In addition to the workforce, which forms part of goodwill, the residual goodwill may implicitly include value not separately attributed to an asset related to the business driven by future business. A valuer should holistically assess whether the residual goodwill in a business combination is appropriate in the context of the business and the overall transaction.
- 7.7 A valuer must carefully assess the life attributable to a subject intangible as it is a significant assumption that can profoundly impact value. Definite intangible assets have a finite life, and are usually limited by a legal right to use them e.g., lease contracts. Indefinite intangible assets have an infinite life and stay with the company as long as the company continues its operations, e.g., its brand name. Key considerations in determining the life on an intangible asset include the period over which the asset is expected to be used and to contribute to cash flows, historical precedence of similar assets etc. Legal, regulatory or contractual provisions that may limit the useful life on an asset or anticipated changes in consumer preferences as well as other economic and industry trends can also play a role in determining an appropriate useful life.
- 7.8 Valuation of intangible assets is performed for a variety of purposes, such as financial reporting, tax reporting, litigation and/or legal purposes, amongst others. It is the valuer's responsibility to

understand the purpose of the valuation and assess whether intangible assets are required to be valued, separately or grouped with other assets.

- 7.9 The three primary approaches discussed earlier viz. Income, Market and Cost approaches or a combination of these approaches are typically used to value intangible assets. For some assets, various methods are usually attempted to ascertain value, for other assets, one method is usually employed. For example, franchise agreements, licenses, software licenses, etc. are valued by using different approaches whereas customer lists and engineering drawings are generally valued by using Income and Cost approaches respectively.

### Income Approach

- 7.10 The income approach bases value on the cash flows an asset is expected to generate over its useful life. Generally, the income approach should be used as the primary basis of value for intangible assets only if the following criteria are met:

- (i) the primary economic benefit associated with the subject intangible asset is its ability to generate income, or reduced costs, and
- (ii) the future economic benefits can be reasonably forecasted.

The Income Approach utilizes projected cash flows a prudent investor would expect the subject asset to generate, taking care to reasonably exclude the cash flow contributions of other tangible and intangible assets. The estimated annual cash flows are then converted to present value by applying a rate of return appropriate to the risk of the asset. The present values of such yearly cash flows are summed to estimate the value.

- 7.11 The discount rate to be employed for valuing an intangible asset depends on the risk and liquidity of the type of asset being acquired. For example, patents, in process research and development ("IPR&D") etc. are more risky and/or less liquid as compared to trade name, trademarks, non-competition agreements, etc. It is generally appropriate to address this issue by assigning reasonable premiums or discounts to the overall company discount rate when valuing specific assets.

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- 7.12 The Income Approach is used to value a wide range of intangible assets including developed technology, non-competition agreements, trade names/trademarks/domain names, and customer related intangibles.
- 7.13 Some of the common methods under the Income Approach used to value intangible assets include Relief from royalty, With and without, Multi-period excess earning, and Distributor and Greenfield.
- 7.14 **Relief-from-royalty method** - This method is based on a hypothetical royalty (typically calculated as a percentage of revenue) that the owner will otherwise be willing to pay in order to use the asset—assuming it was not already owned.

The relief-from-royalty method is perceived as a simpler approach in valuing market-related intangibles. However, determination of the royalty rate can be a complex process and the following factors, amongst others, should be considered while analysing royalty rates:

- (i) **Assets:** For example, a royalty rate paid for a trademark in isolation will likely be lower than one for a bundled asset, including trademarks and product formulations.
- (ii) **Rights (for example, geography, term and usage):** All things being equal, a royalty rate paid for the right to use an intangible asset within a limited geography or specific customer channel for a limited time will likely be different than that paid for perpetual rights with unfettered usage.
- (iii) **Economic returns:** Typically, assets providing higher returns will warrant higher royalty rates. This issue may arise when comparing royalty rates paid at different points within the supply chain. Returns on wholesale revenues can differ significantly from those on retail revenues.
- (iv) **Upfront fees or ongoing cost sharing:** Licensees who are willing to pay an upfront fee or share in future marketing or advertising expenses may be able to negotiate a lower royalty rate.

While common in practice, the use of broadly comparable licensing transactions or simplified rules of the thumb may lead to inappropriate conclusions and create hurdles during an audit or regulatory review.

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Under *relief-from-royalty-method*, the value of an intangible asset is determined by estimating the value of total costs saved that would have otherwise been paid by the user as royalty payments, if had been taken on lease from another party. Alternatively, it could also indicate the value of an intangible asset that could have fetched cash flows in the form of royalty payments, had it been leased to a third party. Any associated costs expected to be incurred by the licensee needs to be adjusted from the forecasted revenues.

The following are the major steps in the RFR method:

- (a) *obtain the projected income statement associated with the intangible asset to be valued over the remaining useful life of the said asset.* The value of the intangible asset to be valued is determined by first considering projections (of royalty income adjusted with associated expenses like maintenance or marketing) relevant to the intangible asset to be valued for its estimated useful life. Forecasted revenue is royalty computed as a percentage of revenue using an appropriate royalty rate.
- (b) *analyse the projected income statement and its underlying assumptions to assess the reasonableness.*
- (c) *select the appropriate royalty rate based on market-based royalty rates for similar intangible assets:* An appropriate royalty rate (which can be based on royalty rates of similar transactions or can be determined using the profit-split method).
- (d) *apply the selected royalty rate to the future income attributable to the said asset:* The selected royalty rate is then applied to the cash flows so determined. Royalty rate should consider the features of the intangible asset to be valued relevant to the profit attributable to the intangible asset to be valued or the observed transactions to determine the royalty rate. Other factors that should be considered to determine the royalty rate are the significance of the intangible asset to be valued to its owner and the expected economic life of the intangible asset with any risks relating to obsolescence.
- (e) *use the appropriate marginal tax rate or such other appropriate tax rate to arrive at an after-tax royalty savings.*



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- (f) *discount the after-tax royalty savings to arrive at the present value using an appropriate discount rate: The value of the intangible asset to be valued is the present value of the after-tax cash flows so computed by using an appropriate risk-adjusted discount rate.*
- (g) Tax amortization benefit (TAB), if appropriate considering nature of the asset and purpose of the engagement, should be added to the overall value of the intangible asset.

7.15 **With and without method** - The fundamental concept underlying this method is that the value of the subject intangible asset is the difference between an established, ongoing business and one where the subject intangible asset does not exist. Key inputs of this method are the assumptions to what extent and how long the cash flows of the business get affected (adversely) in absence of the subject intangible asset.

The 'with and without method' is typically used in order to value intangibles such as covenant not to compete agreements. Under this method, the value of the subject intangible asset is calculated by taking the difference between the business value estimated under two sets of cash flow projections:

- (a) value of the business with all assets in place as of the valuation date
- (b) value of the business with all assets in place except the subject intangible asset at the valuation date.

While this method is intuitive and transparent in its approach to isolate the cash flows associated with the subject intangible, key inputs are often challenging to estimate and include assumptions on the extent and duration over which the cash flows of the business get adversely affected in absence of the subject intangible asset.

The value of an intangible asset using the With and Without Method (WWM) is computed by comparing the below-mentioned scenarios in which the business:

- (a) utilises the intangible asset to be valued ('With' scenario); and
- (b) does not utilise the intangible asset to be valued ('Without' scenario).

It should be noted that all other factors relating to valuation should remain constant.

The following are the major steps in deriving a value using the WWM :

- (a) obtain the projections comprising revenue, expenses, working capital and capital expenditure under the following two scenarios:
  - (i) with scenario; and
  - (ii) without scenario.
- (b) discounted the projections obtained under two scenarios to present value using an appropriate discount rate;
- (c) difference between present value of cash flows under two scenarios is considered to be the value of the intangible asset. The difference so computed can also be probability-weighted depending on the likelihood of competition expected to affect the cash flows; and
- (d) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.

The value of the intangible asset can also be computed by determining the difference in the value of the business under 'with' and 'without' scenarios. The value of the intangible asset under both approaches, i.e. using difference in cash flows or business values, should be similar. Further, the discount rate used in both approaches shall be same.

This method is commonly used for valuation of non-compete agreements.

- 7.16 **Multi period excess earnings method** - The excess earnings method calculates the value of an asset based on the expected revenue and profits related to that particular asset, reduced by the portion of those profits attributable to other supporting assets (tangible and intangible) that contribute to the generation of cash flow (for example, working capital, fixed assets, assembled workforce etc.)

The MEEM is used to value an intangible asset which is the primary intangible asset of the business. For example, for valuation of two

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intangible assets, say customer contracts and intellectual property rights, MEEM should be considered for valuation of one of the intangible asset while the other intangible asset should be valued using another method, unless both intangible assets are significant for the business.

Under this method, the value of an intangible asset is equal to the present value of the incremental after-tax cash flows ('excess earnings') attributable to the intangible asset to be valued over its remaining useful life. In other words, it is the present value of the excess cash flows attributable to the intangible asset to be valued (based on attrition rate of customers) as adjusted by the associated expenses required for the generation of the cash flows and cash flows pertaining to contributory assets (assets that contribute to the cash flows relating to the intangible asset to be valued).

The following are the major steps in deriving a value using the MEEM :

- (a) obtain the projections for the entity or the combined asset group over the remaining useful life of the said intangible asset to be valued from the client or the target to determine the future after-tax cash flows expected to be generated;
- (b) analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
- (c) Contributory Asset Charges (CAC) or economic rents to be reduced from the total net after-tax cash flows projected for the entity/combined asset group to obtain the incremental after-tax cash flows attributable to the intangible asset to be valued;
- (d) the CAC represent the charges for the use of an asset or group of assets (e.g., working capital, fixed assets, assembled workforce, other intangibles) based on their respective fair values and should be considered for all assets, excluding goodwill, that contribute to the realization of cash flows for the intangible asset to be valued;
- (e) the incremental after-tax cash flows attributable to the intangible asset to be valued to arrive at the present value using an appropriate discount rate; and

- (f) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.

Contributory assets are assets that assist/support the intangible asset to be valued to generate cash flows and are used in combination with the intangible asset to be valued. Contributory asset charge (CAC) is widely used by the *valuers* and refers to the return on assets supporting the cash flow generation of the intangible asset to be valued. Contributory assets could be in the form of working capital, fixed assets, assembled workforce and any other intangible asset so considered and valued. An appropriate rate of return on each asset needs to be determined and shall be applied to the revenues to arrive at the CAC. The rate of return will depend on the nature of asset and is considered on post-tax basis.

For customer-based intangible assets, a *valuer* needs to consider attrition, which refers to the possible expected loss of customers which is based on the historical behavior of customers. Attrition can either be calculated using the mid-point convention (average of beginning and end of the year) or by considering the year-on-year customer count or change in revenue.

The excess earnings method values an asset based on expected future income, adjusted for the returns of other assets contributing to cash flow (that is, contributory assets). While this method is typically used in order to determine the value of the 'primary' cash generating intangible of the business, careful consideration needs to be given as to how the company's other assets help contribute to the sales process, and the manner in which a return for these 'supporting assets' should be reflected in the valuation of the primary intangible. The excess earnings method is not typically used to value both the primary intangible as well as other supporting intangibles due to the potential double counting of cash flow as well as issues related with 'cross charging'. Therefore, an alternative valuation method needs to be applied, where possible.

- 7.17 **Distributor method** – this method is a variation of the excess earnings method, which is used to value customer-related intangible assets in certain circumstances. The distributor method is based on the assumption that a business is comprised of various functional

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components (such as manufacturing and distribution etc.) and that market-based data may be used, if available, to reasonably isolate the revenue, earnings, and cash flow related to these functional areas. As distributors normally perform functions related to distribution of products to customers rather than developing or manufacturing the asset, information on profit margins earned by distributors should be used to estimate the excess earnings attributable to customer related intangible assets. Thus, the distributor method assumes the returns to a customer related asset are comparable to the economic profits generated by a hypothetical intermediary, which is the distributor in this case.

The distributor method is normally used to value customer related intangible assets when another intangible asset is considered as the primary intangible asset and is valued using the excess earnings method.

The following are the major steps in deriving a value using the distributor method:

- (a) prepare revenue and expenses projections of existing customers relationships along with relevant attrition;
- (b) determine profit margins of distributors who are comparable to the subject business and apply the same to the cash flows projected;
- (c) determine the support of distributor contributory assets like working capital, fixed assets, workforce, etc;
- (d) determine excess earnings after considering the contributory asset charges;
- (e) compute the present value of cash flows using an appropriate discount rate; and
- (f) calculate tax amortisation benefit, if appropriate and applicable, and add it to the value of the intangible asset to be valued.

7.18 **Greenfield method** – under this method, the value of an intangible is estimated using cash flow projections that assume the only asset of the business as of the valuation date is the subject intangible. All other tangible and intangible assets must be bought, built or rented.

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This method is similar to the excess earnings method as it identifies the excess cash flow associated with the subject asset. However, instead of adjusting contributory asset charges from the cash flows, the greenfield method assumes that the owner of the subject asset need to build, buy or rent the contributory assets. This method is normally used in valuing franchise-based intangible assets and broadcast spectrum intangibles.

The following are the major steps in deriving a value using the greenfield method:

- (a) prepare cash flow projections with the premise that the intangible is the only asset in the business;
- (b) project the related revenues, expenses, working capital and capital;
- (c) project the amount and timing of expenditure relating to acquisition, creation or rentals of other assets required by the intangible asset to be valued;
- (d) compute the present value of the net cash flows using an appropriate discount rate; and
- (e) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.

### Market Approach

- 7.19 The Market Approach values the intangible assets on the basis of market based metrics, such as prices paid in actual transactions. This approach should be used as the primary basis for valuing intangible assets only if the following criteria are met:
- (i) The transaction is based on arm's length assumption and information is available on identical or similar intangible assets on or near the valuation date; and
  - (ii) Sufficient information on the transaction is available that helps the valuer to adjust for all significant differences between the subject intangible asset and those involved in the transactions.
- 7.20 Where market information on either prices or valuation parameters is available, it is often necessary to make adjustments to these to reflect

differences between the subject asset and those involved in the transactions, as it is rarely possible to find market evidence of transactions involving identical assets. These adjustments are required to reflect the differentiating characteristics of the subject intangible asset and the assets involved in the transactions. These adjustments may be qualitative in nature, rather than quantitative factors. However, the need for significant qualitative adjustments may indicate that another approach would be appropriate for the valuation.

- 7.21 The Market Approach is often inapplicable to the valuation of intangible assets. Intangible assets are often purchased "bundled" with other assets, so the price paid for an individual intangible asset is not observable with certainty. Without knowing the amount paid for an asset in a transaction, the Market Approach would not serve as a useful valuation measure for an individual intangible asset. The common methodologies for the market approach are Price/Valuation multiples/Capitalisation rates and Guideline pricing method.

**Price/Valuation multiples/Capitalisation rates:** This method considers certain multiples/Capitalisation rates to arrive at the valuation of a comparable intangible asset. The multiples shall be adjusted appropriately to factor in any differences between the intangible asset to be valued and comparable intangible asset.

**Guideline pricing method:** This method determines the value of an intangible asset by considering the price paid in an orderly transaction for a comparable intangible asset (called as the guideline intangible asset which is similar to the intangible asset to be valued).

However, in most instances, it may be difficult to obtain reliable data in the form of a public transaction, valuation multiple or a guideline intangible asset.

### Cost Approach

- 7.22 The Cost Approach values intangible assets by examining costs that would currently be required to replace the asset. The premise of this approach is that an investor would pay no more for an asset than what would be required to replace it. The Cost Approach also considers the reproduction cost as the value of the intangible asset. However, as intangible assets do not have physical form that can be reproduced

(even intangible assets like technology are reproduced based on their functionality and not exact codes), the Replacement Cost Method is the widely used under the Cost Approach.

**Reproduction Cost Method:** *Reproduction Cost Method* involves valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the asset to be valued, adjusted for obsolescence.

Under this method, the value of an intangible asset is the total cost (based on current prices) to produce an exact replica of the intangible asset to be valued. Nevertheless, since intangible assets are generally not developed (other than certain assets like software), any intangible asset that can be hypothetically developed using the same function and utility, can provide a value base for the intangible asset to be valued.

Costs to reproduce could include data-sets like direct costs, indirect costs, developer's profit for the intangible asset, etc. The cost obtained under this method shall be adjusted for any physical, functional or economical obsolescence.

**Replacement Cost Method:** *Replacement Cost Method* involves valuing an asset based on the cost that a market participant shall have to incur to recreate an asset with substantially the same utility (comparable utility) as that of the asset to be valued, adjusted for obsolescence.

Under this method, the value of an intangible asset is the total cost (based on current prices) to produce an asset similar to the intangible asset to be valued. Nevertheless, since intangible assets are generally not developed (other than certain assets like software), any intangible asset that can be hypothetically developed using the same function and utility, can provide a value base for the intangible asset to be valued. Costs to replace could include datasets like direct costs, indirect costs, developer's profit for the intangible asset, etc. The cost obtained under this method shall be adjusted for any physical, functional or economical obsolescence.

- 7.23 The Cost Approach should be used to value the intangible assets only if the following criteria are met:



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- (i) It would be possible for market participants to recreate an intangible asset of similar utility to the subject asset;
- (ii) There are no legal restrictions or other types of barriers to entry preventing market participants from recreating an asset of similar utility to the subject asset; and
- (iii) The intangible asset can be recreated quickly enough that a market participant will not be willing to pay a significant premium for the ability to use the subject asset immediately.

As such, the Cost Approach is normally used to value intangible assets that are not primary or significant in nature from market participants' point of view. The Cost Approach may also be used when no other approach can be applied, however, a valuer should analyse all alternative methods in such cases.

- 7.24 While applying the cost approach, the valuer should consider few points, such as
- (a) direct costs needed in replacing the asset, such as number of employees and their salaries, total time required to replace the asset etc.;
  - (b) profit margin on the expenses incurred, if applicable. As assets acquired from a third party would normally include the total costs along with a profit margin on those costs, it may be appropriate to include a profit margin on the costs incurred;
  - (c) opportunity cost, if applicable. The opportunity cost considers the economic cost of deploying resources in replacing the subject intangible asset; and
  - (d) obsolescence factors (economic or technological obsolescence) if any.
- 7.25 The Cost Approach, though effective for some replicable assets, such as software and assembled workforce, is not always a useful indication of value for other intangibles. It tends to look backwards in time, which is not the way most buyers and sellers view assets or transactions. Even a relatively simple piece of software, if it provides a competitive advantage that generates incremental profits, may have a value significantly different than its cost. Further, not all costs are

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incurred wisely, efficiently, or successfully. Many research projects that entail significant outlays of funds do not result in the creation of any asset value. Application of this approach to such assets may produce misleading result.

However, because the cost of an item is an indication of what one investor is willing to invest in the hoped-for creation of an asset, the Cost Approach is not without merit.

## Valuation Conclusion

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### Selection of Basis of Valuation

- 8.1 Selection of an appropriate approach — Income, Market, or Cost — as well as the technique/model within the selected approach by a valuer is dependent on the facts and circumstances of the case. In practice, however, a combination of all the approaches is used by assigning appropriate weightage to each approach.
- 8.2 The appropriateness of any approach and also the weightage assigned to each approach in case of a combination of two or more approaches used has been the subject of a number of litigations and deliberations. Various judicial pronouncements have upheld the valuation based on a combination of two or more approaches.
- 8.3 The Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.* (*Miheer H. Mafatlal v. Mafatlal Industries Ltd.* (1996) 4 Comp LJ 124 (SC)) held that once the exchange ratio of the shares of the transferee company to be allotted to the holders of shares in the transferor company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation, and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by an overwhelming majority of the shareholders of the two companies.
- 8.4 In *Hindustan Lever Employees Union v. Hindustan Lever Ltd.*, (1994) 4 Comp LJ 267 (SC) the Supreme Court held that it is not the part of the judicial process to examine entrepreneurial activities to ferret out flaws. The court is least equipped for such oversights, nor indeed, it is a function of the judges in our constitutional scheme. It cannot be said that the internal management, business activity or institutional operation of public bodies can be subjected to inspection by the court. It is incompetent and improper to do so and, therefore, out of bounds. Nevertheless, the broad parameter of fairness in administration, bona

fides in action and the fundamental rules of reasonable management of public business, if breached, will become justiciable. The court's obligation is to satisfy that the valuation has been in accordance with the law and the same has been carried out by an independent body.

- 8.5 Although the question of valuation of shares and fixation of exchange ratio is a matter of commercial judgment and not for the court to judge it, yet the court cannot abdicate its duty to scrutinise the scheme with vigilance. It is not expected of the court to act as a rubber stamp simply because the statutory majority has approved the scheme and there is no opposition to it. The court is not bound to treat the scheme as a *fait accompli* and to accord its sanction merely upon a casual look at it. It must still scrutinise the scheme to find out whether it is a reasonable arrangement which can, by reasonable people conversant with the subject be regarded as beneficial to those who are likely to be affected by it. Where there is no opposition, the court is not required to go deeper. However, when there is opposition, the court not only will but must go into the question and if it is not satisfied about the fairness of the valuation, it would be justified in refusing to accord sanction to the scheme, as was held by the court [Carron Tea Co. Ltd. (1966) 2 Comp LJ: 278 (Cal)]

### Special Considerations

- 8.6 While valuing shares, a number of situations may arise in which special consideration has to be given to several important factors. Some important ones are discussed below.

### Controlling Interest and premiums

- 8.7 When a parcel of shares carrying controlling interest in a company is to be valued, special consideration has to be given to the controlling interest factor. This flows from the fact that the purchaser of such a parcel of shares does not only acquire the shares of a company but also its control, which in itself is a valuable right. The purchaser has, therefore, to pay for this control too. The concept of control premiums is driven by the perceived incremental value that an acquirer believes can be generated by acquiring control over the company's operations and being able to extract higher cash flows post acquisition.

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- 8.8 Market evidence of control premiums can be observed in transactions that involve acquisition of target companies where a controlling interest is being exchanged. In order to obtain unbiased and accurate pricing information, control premiums are typically analysed for completed transactions where the target company is publicly traded.
- 8.9 Reported examples of Indian transactions include JTEKT Corp's acquisition of Sona Koyo Steering at an implied premium of approximately 13%<sup>10</sup> on Sona Koyo Steering's market price 30 days prior to the transaction. In another example, the implied premium in Bayer's acquisition of Monsanto India was also at 7% premium<sup>11</sup> on Monsanto India's market price 30 days prior to the public announcement.
- 8.10 Business owners consider a controlling interest to have greater value than a minority interest under the premise that the purchaser will be able to effect changes in the business structure and influence overall business policies. Empirical market data corroborates that control premiums observed in successful transactions vary greatly. Some of the many factors affecting the magnitude of a given control premium are listed below:
- (a) The nature of business opportunities which are currently not being effectively monetised.
  - (b) The perceived quality of the existing management
  - (c) The ability of the target company to integrate into the acquirer's business and the probability that the management will be able to implement change/new initiatives.
  - (d) The competitive landscape of the industry in which the target operates.
- 8.11 Controlling interests are usually more valuable than minority shares because they often contain a bundle of rights that minority

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<sup>10</sup>Based on Sona Koyo Steering's transaction price of 84 INR per share announced on 06 February 2017 and Sona Koyo Steering's closing price of 62.95 INR per share as on 06 Jan 2017. Retrieved from [www.nseindia.com](http://www.nseindia.com).

<sup>11</sup>Based on Monsanto India's transaction price of 2,481.6 INR per share announced on 21 September 2016 and Monsanto India's closing price of 2,326.8 INR per share as on 22 August 2016. Retrieved from [www.nseindia.com](http://www.nseindia.com).

shareholders do not enjoy. The rights afforded by 'control' can vary across a broad spectrum depending on transaction-specific nuances. Hence, it is important to carefully analyse the magnitude of the stake being acquired in a transaction in conjunction with the rights that the acquirer will possess post transaction, as these factors directly impact the magnitude of the control premium paid.

- 8.12 In the Indian context, the Companies Act, 2013 provides guidance on major corporate actions for which ordinary and special resolutions are required to be passed and the associated level of control/majority required. Specifically, a resolution can be deemed as an ordinary resolution if it is required to be passed by the votes cast—whether on a show of hands, electronically or through a poll—in favour of the resolution (i.e. at least 51% votes required). On the other hand, in the case of special resolutions, the votes required are in excess of three-fourth of the total votes cast.
- 8.13 While assessing the applicability and magnitude of control premiums, company- and transaction-specific factors should be analysed. For example, cases may arise where less than 50% shareholding may form part of a given transaction; however, 'effective control' may still exist if the balance shares are widely dispersed. Also, there could be an instance where a minority shareholder possesses effective control by owning the majority of voting shares in a company which has both voting and non-voting classes of shares. Accordingly, transactions should be analysed on a case-by-case basis to ascertain the appropriate application of control premiums.
- 8.14 Two methods are typically used in estimating control premiums:
- (i) One can arrive at an implied control premium by analysing the M&A transaction data, focusing on listed target companies where control was transferred, either partially or fully. Under this method, the implied control premium can be estimated by comparing the 'unaffected' market price of the target company at various time intervals (ranging from a few days to several weeks) prior to the acquisition with the acquisition price paid by the acquirer.
  - (ii) Alternatively, one can analyse open offer data to estimate an implied control premium. An open offer is an offer providing an

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exit option to the shareholders of a target company on account of the change of control or substantial acquisition of shares occurring in the target company. Similar to the methodology that utilises M&A transactions to derive control premium data, one needs to compare the market price of the target company prior to the public announcement of the open offer with the open offer price to estimate the resulting control premium.

- 8.15 In many cases, it will be found that a particular purchaser will also get some additional advantages because of his own individual circumstances as, for example, when he can earn additional profits by combining the business of the company to be acquired with his existing business or by avoiding competition with his existing business. In such cases, such a purchaser will perhaps be prepared to pay a higher amount than others. The additional value to an individual purchaser should be considered as a premium which that particular buyer may be willing to pay.
- 8.16 While the above considerations are relevant, the value of a controlling block of shares can be substantially depressed if the amount required to be invested involves a large sum of money. The very magnitude of the transaction may depress the value because the number of likely buyers interested in paying such substantial amounts of money may be limited.
- 8.17 The valuer will have to be cautious in situations such as joint controlling interest by joint venture (“JV”) partners as a control premium may not be applicable.

### Restrictions on Transfers

- 8.18 Marketability is one of the important factors to be considered in the valuation of shares. Though public companies are required not to place any restrictions on such transfers, many of them hold the shares so closely that easy transferability gets restricted. Again, in a number of cases, shares are not listed on stock exchange(s). Private companies, by their very definition, are required to restrict the transfer of their shares. Such restrictions may vary considerably in their scope and nature - from a general power of the Board to refuse registration of transfer, to a preemptive power of the existing shareholders to acquire the shares of a member desirous of selling them at a stated price.

## Valuation Conclusion

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- 8.19 Restrictions on transfer of shares generally have a depressing effect on their Fair Value inasmuch as the ready market for sale is restricted. This depends upon the severity of the restriction. A general power of the Board of a public company to refuse registration of a transfer may not have much effect; but the pre-emptive right to buy shares at a price stated in the Articles of Association of a private company may keep the value of shares limited to such prices.
- 8.20 The following cases illustrate the effect of restricting the free transferability of shares:
- (a) In *Salvesen's case*<sup>12</sup>, a reduction of 24 percent of the market value per share was made on account of the restrictions imposed on the transfer of shares. In this case there was a somewhat unusual and stringent clause that any holder of less than 10 per cent of equity shares could be compelled to transfer them at any time.
  - (b) In *Crossman's case*<sup>13</sup>, an addition of about 1 and a ½ percent to yield rate was allowed for both the non-marketability and depreciatory effect of the restrictions on transfer present in the Articles of Association of a company. The restriction was that shares had first to be offered to their existing shareholders at a price fixed under a formula laid down in the articles.
  - (c) In *Myer's*<sup>14</sup> and *Murdoch's*<sup>15</sup> cases, where the blocks of shares subject to valuation carried 75 per cent of equity shares and consequently enabled the holders to pass a special resolution to alter the Articles of Association containing the restrictions on transfer, it was held that such restrictions did not depress the value of shares.
  - (d) A discordant note has also been struck in the case of *Abreham's v. Federal Commission of Taxation*<sup>16</sup>. Mr. Justice Williams stated with regard to the restrictive clauses in the

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<sup>12</sup> *Salvesen's Trustees v. C.L.R.* (1930) S.L.T. 387.

<sup>13</sup> *IRC v. Crossman* (1937) A.C. 26.

<sup>14</sup> *Myer v. Commissioner of Taxes* (1937) V.L.R. 106.

<sup>15</sup> *Perpetual Trustee Co. v. Federal Commissioner of Taxation* (re Sir James Murdoch) 65 C.L.R. 573

<sup>16</sup> 70 C.L.R. 23



Articles of Association that a share in a partnership would have the same disadvantages, but, it had never been suggested that such a share should be discounted on this account. To a prudent purchaser, willing to give full value for the shares, this restriction should not have any dissuading effect. But this case should not be cited for establishing a new principle.

### Capital Structure

- 8.21 The capital structure of a company may, in some cases, have some effect upon the value of its shares. When the ratio of its equity share capital to the total long-term funds employed, i.e., equity plus borrowings, is unduly low, the element of risk involved in such shares will be high. The operating profits of a company have to be applied first to pay interest on borrowed funds and dividends on preference capital and only the remainder is attributable to the equity capital. If the borrowings and preference capital are very large in comparison to the equity capital, a large proportion of profits is used in meeting their claims and only a small amount is left for the equity capital. Due to the relatively small equity capital in such cases, even a small left-over surplus might give a fair return thereon. But this return will be greatly affected by fluctuations in profit, and even a slight variation in the total profits may increase or reduce the rate of equity dividend to a great extent. In such businesses, it has to be ensured that the rate of return on investment is higher than the rate of interest on borrowed funds.

### Different Classes of Shares

- 8.22 If there is only one type of equity shares, the amount of net surplus has to be divided among them equally. If there are different types of equity shares, the terms of issue of the shares should be considered for arriving at their valuation. For example, if a private limited company, which is not a subsidiary of a public company, has equity capital of two types, this factor should be taken into consideration in the valuation of shares. Further, if the amounts paid for same types of shares are different, the valuation will have to be appropriately prorated. Furthermore, other factors such as voting vs. non-voting rights, conversion rights, dividends and coupon rates need to be taken into consideration by the valuer while performing a valuation.

### **Surplus Assets**

- 8.23 All the assets of a business which are not used in the normal operations of the business such as investments, surplus land, surplus cash at bank, etc. should be identified and segregated from the operating assets. These assets may yield a different return on investment than the operating assets and, accordingly, should be valued separately. Similarly, any liability related to such assets should also be treated separately. It should be ensured that the current or future earnings used for valuation of the business should exclude any income or expense pertaining to such surplus assets.
- 8.24 Surplus assets should be valued at their current Fair Value and added to the value of a business.

### **Adjustment for Contingent Liabilities**

- 8.25 Contingent liabilities relate to uncertain events that may or may not create true liabilities. In professional practices, these appear on balance sheets, e.g., due to pending litigation claiming malpractice or disputed billing. The appearance of the word 'contingent' on financial statements should trigger deep exploration by a valuer, and full assessments of potential impacts on business values.

### **Special Considerations in case of Amalgamations**

- 8.26 Two special issues arise in the case of amalgamations: nature of amalgamation and treatment of losses. An amalgamation may be a purchase of the undertaking of one company by another through a process of business combination. In this case, it has to be considered that the shareholders of the former company have given up their controlling interest in the company. Hence, while computing the value of such equity shares/assets acquired, a valuer would consider Fair Value as the premise under Ind AS 103. Alternatively, an amalgamation could result in a pooling of interests/book value basis where the shareholders of both the merging companies have a substantial stake in the equity of the merged company as is the case of a common control transaction.
- 8.27 The second special feature is in relation to the tax shelter of one of the merging companies. This is really an off-balance sheet asset which acquires significance by virtue of Section 72A of the Income

Tax Act, 1961. This can be explained with the help of an example. A Ltd. has accumulated losses of INR 1 crore and B Ltd. earns every year taxable profit of INR 1 crore. Because of a rehabilitation plan, A Ltd. would start earning taxable profit of INR 50 lacs from the sixth year. The valuer has to carefully ascertain whether the merging company (A Ltd.) on a stand-alone basis will be able to take advantage of its accumulated tax shelter in future and, if so, from which year. This situation should then be compared with the additional benefit emerging on account of merger. A value may be considered for this benefit and thereafter be shared in an appropriate ratio between the shareholders of the two companies.

### Other Factors

8.28 Though valuation is mainly driven by financial factors like earnings, assets, etc., some other factors require careful evaluation as an integral part of the mechanics of share valuation. The most noteworthy of these are:

(a) **The nature of a company's business**

A company's business may depend on the success of other industries (as with the producer of raw materials for other manufacturers), seasonal conditions, etc.

(b) **The caliber of managerial personnel**

A business managed by professional managers allied to people with similar ability would command a premium when compared to another which is crucially dependent for its success on a single executive, however outstanding the professional might be.

(c) **Prospects of expansion**

A case in point would be that of ancillary small-scale units, which have the potential for growth as they can supply inputs to large companies that are dependent on their products.

(d) **Competition**

A business may prosper when nurtured under sheltered circumstances (e.g. import restrictions), but may flounder under 'open market' conditions.

(e) **Government policy**

Government policy in general and in relation to particular industry (as with restriction or banning of manufacture of alcohol in the case of alcohol based chemical industries).

(f) **Prevailing political climate**

Political climate in an area can affect the prosperity of a business, e.g. tourism trade is directly affected due to breakdown in the law and order situation in a state.

(g) **Risk of obsolescence of items manufactured**

In case the products manufactured by an enterprise face a higher risk of obsolescence, it may influence the value of its shares adversely.

(h) **Existence of convertible rights**

Existence of convertible rights would also affect the value of a share.

(i) **The effect of other external factors**

The value of shares is also affected by factors such as war, embargo or other restrictions on international trade or disruptions in international trade.

(j) **Rights which are not on the Balance Sheet**

The valuer will also need to take into account circumstances where specific rights to buy or sell an asset or settle a liability exist in a business. Such rights may not be reflected in the company's balance sheet but would need to be taken into account by valuer as part of the valuation.

## Valuation of Shares for Other Purposes

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### Valuation for Purpose of Stamp Duty

- 9.1 When an instrument is chargeable with ad valorem duty in respect of any share, such duty shall be calculated on the value of the share according to the average price or the value thereof on the instrument (Section 21 of Indian Stamp Act, 1899).
- 9.2 For the purposes of the Indian Stamp Act, 1899, the words 'average price' means perhaps the market price. In case of quoted shares, if there are many quotations of the shares in question on the date of the instrument, then the average price is to be taken for stamp duty purposes. In case of unquoted shares, market value has to be ascertained for the purpose of this provision. In case of transfer of immovable property, stamp duty is paid on market value (or circle rate) of the property. This view is supported by the Bombay High Court in the case of Madhusudan Dwarkadas Vora vs. Superintendent of Stamp Duty (141 ITR 802). In the said case, the honourable judge quoting the judgment of Mysore High Court, given in case of CED vs. J. Krishnamurty (1974) (96 ITR 87), said "...the Court was concerned with the valuation of unquoted shares for the purpose of estate duty. There was no such rule under the Estate Duty Act for such valuation. The court observed that in the absence of rules, valuation for the purpose of the Act had to be made in accordance with the well recognised valuation method followed in India. The method of valuation prescribed by rule 1D of Wealth Tax Rules being the only statutorily recognised method of valuation of unquoted shares it would not be wrong to adopt the method for Estate Duty Act purposes."
- 9.3 Where the stamp duty has to be paid on the sale of shares, the actual selling price will be taken for its calculation.

### **Valuation for Court Fees**

- 9.4 For purposes of court fees, if shares have a market value at the date of presentation of the plaint, then such market value will be taken into consideration. In case shares have no market value, the value stated by the plaint is accepted for purposes of paying court fees. (Section 7(iii) & (iv) (a) of the Court Fees Act, 1870).

### **Valuation for Probates**

- 9.5 While petitioning for the grant of probate or letters of administration, the probate duty has to be paid on the value of shares calculated at the price of day.
- 9.6 Although the price of the day is not explained, it seems that it means market price (Section 19-I and Item 11 of Schedule I of Court Fees Act, 1870).

### **Valuation for Bank Advances**

- 9.7 Bankers value shares because against them they advance loans. They ascertain the value of shares to measure the value of the security that will be provided by them. Generally, banks give advances against quoted shares and therefore it is reasonable to base their value on market quotations. In case, bankers are to advance loans against unquoted shares, their value has to be estimated according to what they would fetch in the market.

### **Valuation of Shares under Companies Act, 2013**

- 9.8 As per the provisions of the Companies Act 2013, valuation is required from a Registered Valuer under the following circumstances:

<b>Circumstances</b>	<b>Relevant sections</b>	<b>Valuation</b>
Further issue of shares (except a right issue to existing shareholders or to employees under ESOP)	Section 62 (1) (c)	Share valuation
Asset transfer to directors of the company for	Section 192 (2)	Asset valuation

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consideration other than cash		
Scheme of Compromise/ Arrangement	Section 230 (3) and 232 (2) (d) and (3) (h)	Relative valuation of shares and determination of share exchange/entitlement ratio
Corporate Debt Restructuring	Section 232 (2) (c)	Asset and share valuation
Purchase of minority shareholding	Section 236 (2)	Valuation of the minority shareholding
Determination of Reserve Price for Company Administrator for sale of undertaking or lease rent or share exchange ratio	Section 260 (2) (c)	Share and asset valuation for determination of reserve price of the company
Winding up of the company	Section 281 (1) (a) and Section 305 (2) (d)	Valuation of assets of the company
A company (the transferor company) is proposed to be, or is in the course of being, wound up voluntarily and the whole or any part of its business or property is proposed to be transferred or sold to another company	Section 319 (3) (b)	Valuation of the interest of dissenting member of the transferor company who did not vote in favor of the special resolution for transfer, as may be required by the Company Liquidator

## Registered Valuer

In October 2017, the Ministry of Corporate Affairs notified section 247 of the Companies Act, 2013 and the Companies (Registered Valuers and Valuation) Rules, 2017 relating to valuation by Registered Valuers. The Rules provides for registration of valuers for carrying out valuation under Companies Act 2013. The Rules also lay out eligibility, qualification and experience required to become a registered valuer, the model code of conduct of a registered valuer and the process to get registered. Refer Appendix B for the details.

## Valuation of Shares for Other Purposes

### Valuation of Shares under Income Tax Act, 1961

As per Income Tax Act, valuation of share of a company is required under the following circumstances:

Circumstances	Relevant section	Valuation
Transfer of unquoted share to Individual or Company	Section 56 (2) (vii) and (viiia) and Section 50CA	Share valuation as per book value of net assets as per Rule 11UA and Rule 11 UAA
Issue of unquoted share by a Company	Section 56 (2)(viib)	Share valuation as per book value of net assets or Discounted Cash Flow method at the option of assessee (issuing company)
Indirect transfer : Transfer of share or interest in a foreign company, where the foreign company derives substantial value from assets/ company located in India	Section 285A, section 9(1)(i) read with Rule 11UB and 11UC	(i) Valuation of the unquoted Indian company/asset in accordance with any internationally accepted valuation methodology for valuation of shares on arm's length basis as increased by the liability, if any, considered in such determination. (ii) Valuation of the quoted Indian company share based on higher of average of weekly high and low of the closing price during six month period or two weeks period preceding the valuation date.

### Valuation of shares as per RBI-FEMA Guidelines

- 9.9 As per Foreign Exchange Management Regulations 2017, notified vide Notification No. FEMA 20(R)/2017-RB dated 7 November 2017 by the Reserve Bank of India ("RBI"), in case of transfer or issue of shares of an Indian company to or by a non-resident shall be carried



out based on pricing determined by considering internationally accepted pricing methodologies.

### Valuation of shares as per SEBI Guidelines

- 9.10 The Securities and Exchange Board of India (“SEBI”) has issued a set of guidelines to be complied with by all companies listed or proposing to be listed on Stock Exchange for making issue of capital any time after promulgation of the Securities and Exchange Board of India Act, 1992. Subsequently, SEBI has also issued a number of clarifications on these guidelines from time to time.
- 9.11 The guidelines issued by SEBI provide that companies are free to price their issues subject to adequate disclosure. The onus, therefore, is on investors to evaluate whether the price at which a company issues its shares, is fair or not. SEBI, while vetting the draft prospectus, merely ensures, on the basis of the information furnished to it, that adequate disclosures have been made in the offer document so that the investors can make informed investment decisions. However, the SEBI guidelines also contain stipulation as to minimum promoters’ contribution and lock-in period thereof. It is to ensure that the interests of the promoters of the issuing company are fairly tied up with the interests of outside investors.
- 9.12 The SEBI guidelines require that the issuing company, which decides to price its issue at a premium, gives justification for the issue price in their prospectuses or the letters of offer. While the guidelines do not provide any explicit guidance for such justification, both qualitative and quantitative factors are usually considered. Appendix 'A' gives some cases of disclosures made by companies, to give an indication of prevailing practices in this regard.
- 9.13 SEBI has also provided guidelines for valuation of shares and assets under following circumstances:

#### ***Open Offer***

SEBI has laid down guidelines in SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 for open offers to the public in case of substantial acquisition of shares or takeover of a listed company. The guidelines, inter-alia, lay down the pricing norms for the open offer to be followed in case of a takeover.

## Valuation of Shares for Other Purposes

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### ***Preferential allotment***

As per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and subsequent amendment to it, in case of preferential issue of infrequently traded shares, valuation of shares are required. Further, in case of preferential allotment to promoters for consideration other than cash, valuation of assets in consideration for which the equity shares are issued shall be carried out by an independent chartered accountant or a merchant banker.

### ***Issue of sweat equity against intellectual property rights***

As per SEBI (Issue of Sweat Equity) Regulations, 2002 and subsequent amendments, a listed company can issue sweat equity shares against intellectual property rights based on the fair valuation of the intellectual property as determined by a merchant banker.

### ***Delisting of equity shares***

In case equity shares of a company are compulsorily delisted by a recognised stock exchange, the recognised stock exchange shall appoint an independent valuer or valuers as per SEBI (Delisting of Equity Shares) Regulations, who shall determine the fair value of the delisted equity shares.

### ***Scheme of Arrangement***

As per regulations 11, 37 and 94 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and circular issued by SEBI dated March 10, 2017, under following circumstances a listed company undertaking scheme of arrangements will require valuation of its shares from an independent chartered accountant:

- change in the proportion of shareholding of any of the existing shareholders of the listed entity in the resultant company; or
- new shareholder being allotted equity shares of the resultant company; or
- existing shareholder exiting the company pursuant to the Scheme of Arrangement.

## Valuation of Options

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- 10.1 An option provides the holder with the right to buy or sell a specified quantity of an underlying asset at a fixed price (called a strike price or an exercise price) at or before the expiration date of the option.
- 10.2 A call option gives the buyer of the option the right to buy the underlying asset at the exercise price, at any time prior to the expiration date of the option. The buyer pays a price for this right. If at expiration, the value of the asset is less than the strike price, the option is not exercised and expires worthless. If, on the other hand, the value of the asset is greater than the strike price, the option is exercised and the buyer of the option buys the asset at the exercise price.
- 10.3 A put option gives the buyer of the option the right to sell the underlying asset at the exercise price, at any time prior to the expiration date of the option. The buyer pays a price for this right. If the value of the underlying asset is greater than the strike price, the option will not be exercised and will expire worthless. If on the other hand, the value of the underlying asset is less than the strike price, the owner of the put option will exercise the option and sell the asset at the strike price.
- 10.4 A number of business situations have characteristics of options that ultimately affect the valuations of their intangibles. Accordingly such options have to be valued. Some of the prominent ones are illustrated below:
- (i) Natural resource companies, such as oil and mining companies, generate cash flows from their existing reserves but they also have undeveloped reserves that they can develop, if they choose to do so. They will be much more likely to develop these reserves if the price of the resource (oil, gold, copper) increases.

- (ii) A patent provides a company with the right to develop and market a product or service and thus can be viewed as an option. While an undeveloped patent may not be financially viable today and doesn't generate cash flows as of the valuation date, it can still have considerable value to the company owning it because it can be developed in future.
- (iii) Employee Stock Options carry the right, but not the obligation, to buy a certain amount of shares in a company at a predetermined price and present a need for using option valuation techniques.

10.5 The value of an option is determined by a number of variables relating to the underlying asset and financial markets.

- *Current Value of the Underlying Asset:* Options are assets that derive value from an underlying asset. Consequently, changes in the value of the underlying asset affect the value of the options on that asset. Since calls provide the right to buy the underlying asset at a fixed price, an increase in the value of the asset will increase the value of the calls. Puts, on the other hand, become less valuable as the value of the asset increases.
- *Variance in Value of the Underlying Asset:* The buyer of an option acquires the right to buy or sell the underlying asset at a fixed price. The higher the variance in the value of the underlying asset, the greater will be the value of the option. This is true for both calls and puts.
- *Dividends Paid on the Underlying Asset:* The value of the underlying asset can be expected to decrease if dividend payments are made on the asset during the life of the option. Consequently, the value of a call on the asset is a decreasing function of the size of expected dividend payments, and the value of a put is an increasing function of expected dividend payments.
- *Strike Price of Option:* A key characteristic used to describe an option is the strike price. In the case of calls, where the holder acquires the right to buy at a fixed price, the value of the call

## Technical Guide on Valuation

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will decline with increase in the strike price. In the case of puts, where the holder has the right to sell at a fixed price, the value will increase with increase in the strike price.

- *Time to Expiration on Option:* Both calls and puts become more valuable as the time to expiration increases. This is because the longer time to expiration provides more time for the value of the underlying asset to move, increasing the value of both types of options. Additionally, in the case of a call, where the buyer has to pay a fixed price at expiration, the present value of this fixed price decreases as the life of the option increases, increasing, in turn, the value of the call.
- *Risk-free Interest Rate Corresponding to the Life of Option:* Since the buyer of an option pays the price of the option upfront, an opportunity cost is involved. This cost will depend upon the level of interest rates and the time to expiration of the option. The risk-free interest rate also enters into the valuation of options when the present value of the exercise price is calculated, since the exercise price does not have to be paid (received) until expiration on calls (puts). Increases in the interest rate will increase the value of calls and reduce the value of puts.

10.6 Various option pricing models, which work on a number of assumptions and inputs, are used to arrive at the value of options. In practice, Black-Scholes and a simpler Binomial Model are preferred for option pricing.

10.7 The Black-Scholes Model is a mathematical formula for calculating the theoretical value of call and put options that may be derived from the assumptions of the model. The fundamental insight of Black-Scholes is that the call option is implicitly priced if the share is traded.

The following assumptions are pertinent while utilising the Black-Scholes Model:

- (a) Share pays no dividends.
- (b) Option can only be exercised upon expiration.
- (c) Market direction cannot be predicted.
- (d) No commissions are charged for the transaction.

- (e) Interest rates remain constant.
  - (f) Share returns are normally distributed, thus volatility is constant over time.
- 10.8 The Binomial Model produces a binomial distribution of all the possible paths that a share price could take during the life of the option. A binomial distribution, simply known as a "Binomial Tree", assumes that a share can only increase or decrease in price all the way until the option expires and then maps it out in a "tree". It then fills in the theoretical value of that share's options at each time step from the very bottom of the binomial tree all the way to the top, where the final, present, theoretical value of a share option is arrived. Any adjustments to share prices at an ex-dividend rate or option prices as a result of early exercise of options are worked into the calculations at each specific time step.
- 10.9 The Binomial Model provides flexibility of early exercisable behaviour that may be incorporated for valuing American options. For perspective, the primary distinction between American and European options relates to when the options can be exercised. A European option may be exercised only at the expiration date of the option, i.e. at a single pre-defined point in time. However, an American option can be exercised at any time before the expiry of the option. The Binomial Model is said to be more accurate particularly for longer-dated options since it is able to handle a variety of conditions.
- 10.10 In addition to the Black-Scholes and the Binomial Model, the Monte Carlo Simulation Model is also used to estimate the value of an option with multiple sources of uncertainty or with complicated features. The Monte Carlo Simulation Model is deployed to (i) generate a large number of possible (but random) price paths for the underlying stock through the method of simulation; (ii) calculate the respective payoff of the option for each path; and (iii) use these payoffs to estimate the fair value of the option.
- 10.11 Compared to the Black-Scholes and Binomial Model, the Monte Carlo Simulation Model is more complicated and resource intensive. The model is applied only in cases requiring incorporation of multiple level of uncertainty in the inputs considered for the option valuation.

## Valuation of Preference Shares

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- 11.1 The two dominant characteristics of a preference share are that it has a preference regarding both the dividend and capital. Besides these, a preference share may have other benefits also; but they are not obligatory and depend on the terms of issue and provisions in the Memorandum and Articles of Association of the company concerned.
- 11.2 Because of the limit placed on the dividend which may be paid on a preference share and the preferred right for payment of dividend and of capital, the considerations applicable for the valuation of equity shares are not wholly applicable to the valuation of preference shares.
- 11.3 Consideration should first be given to the rate of capitalisation. As can be readily seen, the risk involved in investment in preference shares is considerably less than that in equity shares. It follows, therefore, that the expected rate of return on preference shares is also lower, with the consequent effect upon the rate of capitalisation.
- 11.4 The rate of capitalisation will depend not only on the percentage of dividend but also on the other benefits attached to the preference shares. Some of these additional benefits which a preference share may carry and their effect on the rate of capitalisation and other aspects of valuation are stated below:
- (a) Preference shares may be cumulative preference shares. In such cases, the risk involved is still lower, with a corresponding effect on the rate of capitalisation. In cases where there is uncertainty of future dividends, this is an important right and a preference share not carrying this right will be valued at a substantially lower figure.
  - (b) A preference share may be a participating preference share. In this case, it partly partakes of the characteristics of equity shares and therefore, the rate of capitalisation in respect of the additional dividend which may be paid will not be the same as for the fixed dividend. If this additional payment is unrestricted,

## Valuation of Preference Shares

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then the rate of capitalisation in respect thereof may be taken considerably close to the rate of capitalisation for equity shares, the difference being due to unequal voting rights. If there are restrictions on the quantum of such additional dividends, then the rate of capitalisation will be somewhere between the rate of capitalisation for the fixed dividend and that for equity shares, depending upon the exact terms of issue. It may also be mentioned here that the possibility of the payment of additional dividend in future will be determined for calculating the maintainable future profits and the payment ratio of the company, and on the terms of payment of such additional dividend. If it is found that the payment of such additional dividend is not expected to be a regular feature, then it would be appropriate to take the present worth of such additional dividend as is expected to be paid in future from time to time.

- (c) Preference shares may also carry a right to share in the residual value in the event of winding up. In such cases, a definite value may be placed for this right only when it is known that the winding up is imminent.
- (d) Preference shares may have a right of conversion into equity shares. It may be optionally convertible preference share and compulsorily convertible preference shares. The additional value to be placed on such preference shares will depend upon the exact terms of the right to convert or the conversion option and other factors such as the associated coupon rate and the conversion date. The price at which conversion can be effected is also relevant. The price of a preference share will in such a case vary, as the price of an equity share rises above the option price.
- (e) In certain circumstances, preference shares also carry voting rights. In case of private companies which are not subsidiaries of public companies there is no legal provision to regulate such rights; they depend on the Memorandum and Articles of Association of the company concerned. In case of public companies and their private subsidiaries, preference shareholders have voting rights in respect of resolutions that



## Technical Guide on Valuation

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directly affect their rights and also in respect of resolution when dividends on such shares remains unpaid for certain periods as specified in law. Preference shares currently carrying unrestricted voting rights become very important in situations where the control of a company is sought to be transferred. Any additional value in respect of this right should, however, be considered after taking into consideration the circumstances of each individual company.

- 11.5 Problems can arise in the valuation of preference shares with substantial arrears of cumulative dividends. If a company has reached a profit earning stage, the value of the arrears of dividend should be added to the value of the share.
- 11.6 Apart from the special considerations mentioned above, the value of a preference share is equal to the value arrived at by dividing the actual rate of dividend by the normal expected rate of capitalization.

## Valuation Report

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- 12.1 A chartered accountant may be called upon to give his report on the valuation of shares in different situations, such as, for take-over of a company/acquisition of a significant block of shares, merger, taxation purposes, submission to authorities like the RBI/Authorised Dealer for FEMA purposes. As such, there is no particular form for preparing a Report, but some general principles could be borne in mind.

### General Principles

- 12.2 While preparing a Report, it is important that one states its purpose explicitly and ensures that the facts are presented with clarity so that the reader of the Report appreciates it in that context.
- 12.3 The factors that have been considered for arriving at the ultimate valuation should be clearly spelt out.
- 12.4 While it is difficult to specify the exact form of the Report, the following illustrative outline may be useful.
- (a) **Introduction/purpose of valuation**

This may contain background information about the report and its purpose, say, merger, share buyback, etc.
  - (b) **Valuation date**

The valuer may state the valuation date clearly at the outset. As the valuation is time-specific, this information is critical for the reader of the report.
  - (c) **History**

This section may deal with the history of a company (or companies, in case of merger). The matter may be divided into sub-sections that deal with the date of incorporation, whether listed or not, authorised and paid-up capital, turnover, profits, dividend and asset base.

(d) **Business of the company**

This part would explain the business of a company, i.e., whether trading or manufacturing, the items dealt in or manufactured, the location of the factory, factors peculiar to the business, and such other matters.

(e) **Sources of information**

This section may state the sources of information obtained for the purpose of valuation, such as Articles of Association, audited accounts, profit projections, realisable value of assets, other secondary sources of information, period for which or date on which data is obtained, and other relevant sources.

(f) **Methodology**

This part may contain the methodology adopted for valuation. It should also include the rationale for appropriateness or otherwise of a particular approach(s) used.

(g) **Key valuation considerations**

This part may deal with the valuation considerations critical to the valuation process. Some of the factors considered in valuing the shares which may be included in the report are:

- (i) Discussion on the financial projections of a company, highlighting main assumptions and management representations.
- (ii) Discussion on discount rate, growth rate used for computing terminal value considered in the valuation, including the methodology for arriving at the discount rate, sources of information, etc.
- (iii) Any adjustment on account of accumulated losses/unabsorbed depreciation.
- (iv) Any adjustment for valuing a controlling or minority stake, discount for illiquidity, etc.
- (v) Brief analysis of the peer set companies used in relative valuation.

- (vi) Adjustments to the multiples based on the peer set company, including rationale for the same.
- (vii) Details of the surplus assets and treatment thereof in the valuation.
- (viii) Any other special factors, such as government subsidy, tax breaks, etc.

(h) **Fair Value**

This paragraph should deal with the valuation on the basis of discussion in the preceding part of the Report (and in case of amalgamation, also the exchange ratio). This paragraph should also offer justification for the approaches actually adopted. It could also deal with the justification of adjustments considered necessary for arriving at the value, for example, of the discounting due to restriction on transfer of shares; reduction made in the net maintainable profit due to changed circumstances; or weightage given to certain recent years in arriving at the Fair Value, etc.

(i) **Computation**

Usually, the report should also contain annexures giving information regarding the working of the approaches employed for valuation.

(j) **Limiting conditions**

This paragraph should contain the appropriate caveats which limit the scope of valuation. Few indicative caveats are:

- (i) The valuer should state any scope limitations and also the non-availability of any pertinent information and its possible effect on valuation.
- (ii) It is important to draw reader's attention to the fact that the valuation is specific to the time and purpose of valuation. It should also be mentioned that the valuation is not an exact science and the conclusions arrived at in many cases will be subjective and dependent on the exercise of individual judgment.

## Technical Guide on Valuation

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- (iii) It is also important to mention the extent of reliance placed by the valuer on the information provided by the management and information available in the public domain.
- (iv) Under appropriate circumstances, a valuer should also limit his liability by restricting distribution of report to the management/company.
- (v) A valuer should highlight the fact that valuation does not include the auditing of financial data provided by the management and, therefore, does not take any responsibility for its accuracy and completeness. Further, valuation should not be considered as an opinion on the achievability of any financial projections mentioned in the report.

## Appendix 'A'

# Examples of Justification of Issue Prices in Prospectuses of Certain Companies<sup>17</sup>

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*The following are the extracts from prospectuses of certain companies which have recently made public issues of shares. These extracts contain the justification given by the respective companies for the premium charged by them. These extracts are given to illustrate the prevailing practices and to generate discussion whether the premium charged was justifiable in the facts and circumstances of the various cases.*

### **Initial Public Offer – The New India Assurance Company Limited**

#### **BASIS FOR OFFER PRICE**

The Offer Price will be determined by the Company and the selling shareholders, in consultation with the Book Running Lead Managers ("BRLM"s), on the basis of assessment of market demand for the equity shares issued through the book building process and on the basis of quantitative and qualitative factors. The face value of the equity shares is INR 5 each and the Offer Price is 154 times the face value at the lower end of the price band and 160 times the face value at the higher end of the price band.

#### **Quantitative factors**

Information presented in this section is derived from the Company's restated financial statements. The quantitative factors, which form the basis for computing the price, are as follows.

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<sup>17</sup>The prices in the issues illustrated were to be decided by way of book building and accordingly, were not mentioned in the prospectus. Therefore, no price is mentioned in the appendix.

## Technical Guide on Valuation

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### 1. Weighted average adjusted earnings per share (EPS)

*On a standalone basis:*

<b>Financial Year End</b>	<b>Basic EPS (INR)</b>	<b>Diluted EPS (INR)</b>	<b>Weight</b>
March 31, 2017	10.25	10.25	3
March 31, 2016	11.68	11.68	2
March 31, 2015	17.18	17.18	1
<b>Weighted average</b>	<b>11.88</b>	<b>11.88</b>	

For the three months ended June 30, 2017, Basic EPS and diluted EPS (not annualised) were INR 6.24.

*On a consolidated basis:*

<b>Financial Year End</b>	<b>Basic EPS (INR)</b>	<b>Diluted EPS (INR)</b>	<b>Weight</b>
March 31, 2017	10.72	10.72	3
March 31, 2016	12.02	12.02	2
March 31, 2015	17.70	17.70	1
<b>Weighted average</b>	<b>12.32</b>	<b>12.32</b>	

For the three months ended June 30, 2017, Basic EPS and diluted EPS(not annualised) were INR6.29.

*Basic and diluted earnings per equity share are computed in accordance with Accounting Standard 20 'Earnings per Share' notified by Companies (Accounting Standards) Rules, 2006 (as amended).*

**2. Price/earning (P/E) ratio in relation to the Price Band of INR 770 to INR800 per Equity Share**

<i>Particulars</i>	<i>P/E at the lower end of the Price Band (number of times)</i>	<i>P/E at the higher end of the Price Band (number of times)</i>
Based on basic EPS for the year ended March 31, 2017 on a standalone basis	75.12	78.05
Based on basic EPS for the year ended March 31, 2017 on a consolidated basis	71.83	74.63
March 31, 2016		
Based on diluted EPS for the year ended March 31, 2017 on a standalone basis	75.12	78.05
Based on diluted EPS for the year ended March 31, 2017 on a consolidated basis	71.83	74.63

**3. Weighted average return on net worth (RoNW)**

*As per Restated Standalone Financial Statements:*

<i>Financial period</i>	<i>RoNW (%)</i>	<i>Weight</i>
March 31, 2017	6.93	3
March 31, 2016	8.20	2
March 31, 2015	12.83	1
<b>Weighted average</b>	8.34	

For the three months ended June 30, 2017, RoNW (not annualised) was 4.04%.



## Technical Guide on Valuation

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*As per Restated Consolidated Financial Statements:*

<b>Financial period</b>	<b>RoNW (%)</b>	<b>Weight</b>
March 31, 2017	6.81	3
March 31, 2016	7.84	2
March 31, 2015	12.32	1
<b>Weighted average</b>	<b>8.07</b>	

For the three months ended June 30, 2017, RoNW (not annualised) was 3.99%.

#### **4. Minimum return on total net worth after the Offer, required for maintaining pre-Offer EPS as at March 31, 2017**

To maintain pre-Offer basic and diluted EPS:

- (a) Based on Restated Standalone Financial Statements:
  - (i) At the Floor Price - 6.07%
  - (ii) At the Cap Price - 6.04%
- (b) Based on Restated Consolidated Financial Statements:
  - (i) At the Floor Price - 6.13%
  - (ii) At the Cap Price - 6.10%

#### **5. Net asset value (NAV) per Equity Share (face value of INR 5 each)\***

<b>NAV per equity share</b>	<b>Restated Standalone Financial Statements</b>	<b>Restated Consolidated Financial Statements</b>
As on March 31, 2017	151.08	157.46
As on June 30, 2017	158.22	164.04
At Floor Price	175.71	181.37
At Cap Price	176.59	182.24
At Offer Price	[●]	[●]

\* Net asset value per equity share has been adjusted for changes in capital due to split of equity shares into shares of INR 5 each and bonus in the ratio of 1:1 after split.

## 6. Comparison with listed industry peers

	<i>Revenue from operations (INR in million)</i>	<i>Face Value per Equity Share ( INR)</i>	<i>P/E(1)</i>	<i>EPS(Basic) (2)( INR)</i>	<i>Return on Net Worth (3) (%)</i>	<i>Net Asset Value / Share(4)( INR)</i>
The New India Assurance Company Limited	205,536.23	5	[●]	10.72	6.81	157.46
<b>Peer Group (5) (6)</b>						
ICICI Lombard General Insurance Company Ltd	71,804.90	10	47.45	14.32	18.44	82.57

- (1) *P/E is calculated as price as on October 6, 2017/ EPS (Basic). Price source: The Bombay Stock Exchange (“BSE”)*
- (2) *EPS - basic reported as in prospectus filed by the Company.*
- (3) *Return on Net Worth has been computed as net profit after tax (as restated) divided by average net worth for financial year ending March 2017*
- (4) *Net Asset Value per Equity Share has been computed as net worth divided by total number of equity shares outstanding at the end of March 2017*
- (5) *All financial information is based on consolidated financial statements for the financial year ending March 2017*
- (6) *All financial information has been sourced from prospectus filed by the Company*

The Offer Price of [●] has been determined by the Company and the selling shareholders in consultation with the BRLMs, on the basis of demand from investors for Equity Shares through the Book Building Process and, is justified in view of qualitative and quantitative parameters.

## Initial Public Offer – HDFC Standard Life Insurance Company Limited

### BASIS FOR OFFER PRICE

The Offer Price will be determined by the Company and the promoter selling shareholders, in consultation with the managers, on the basis of assessment of market demand for the equity shares offered through the book building process and on the basis of quantitative and qualitative factors. The face value of the equity shares is INR 10 each and the offer price is [●] times the face value at the lower end of the price band and [●] times the face value at the higher end of the price band.

### Quantitative factors

The information presented in this section is derived from the Company's restated consolidated financial information and restated standalone financial information. Some of the quantitative factors, which form the basis for computing the price, are as follows.

#### 1. Basic and diluted earnings per share (EPS)

*On a standalone basis:*

<i>Financial Year End</i>	<i>Basic EPS (INR)</i>	<i>Diluted EPS (INR)</i>	<i>Weight</i>
March 31, 2017	4.5	4.4	3
March 31, 2016	4.1	4.1	2
March 31, 2015	3.9	3.9	1
<b>Weighted average</b>	<b>4.3</b>	<b>4.2</b>	

For the six months ended September 30, 2017, the basic and diluted EPS was INR 2.8 and INR 2.8, respectively.

*On a consolidated basis:*

<i>Financial Year End</i>	<i>Basic EPS (INR)</i>	<i>Diluted EPS (INR)</i>	<i>Weight</i>
March 31, 2017	4.4	4.4	3
March 31, 2016	4.1	4.1	2
March 31, 2015	3.9	3.9	1
<b>Weighted average</b>	<b>4.2</b>	<b>4.2</b>	

For the six months ended September 30, 2017, the basic and diluted EPS was INR2.8 and INR2.8, respectively.

**2. Price/Earning (“P/E”) ratio in relation to Price Band of INR [●] to INR[●] per Equity Share**

<i>Particulars</i>	<i>P/E at the lower end of the Price Band (no. of times)</i>	<i>P/E at the higher end of the Price Band (no. of times)</i>
Based on basic EPS for the year/period ended March 31, 2017	[●]	[●]
Based on diluted EPS for the year/period ended March 31, 2017	[●]	[●]

Industry P/E Ratio

Average: 51.4

Highest: 69.4

Lowest: 33.4

**3. Average Return on Net Worth (RoNW)**

*As per Restated Standalone Financial Statements:*

<i>Financial period</i>	<i>RoNW (%)</i>	<i>Weight</i>
March 31, 2017	25.7	3
March 31, 2016	29.0	2
March 31, 2015	35.1	1
Weighted average	28.4	

*As per Restated Consolidated Financial Statements:*

<i>Financial period</i>	<i>RoNW (%)</i>	<i>Weight</i>
March 31, 2017	25.6	3
March 31, 2016	28.9	2
March 31, 2015	35.2	1
<b>Weighted average</b>	28.3	

## Technical Guide on Valuation

### 4. Minimum return on total net worth after the Offer, required for maintaining pre-offer EPS as at September 30, 2017:

There will be no change in the net worth post-offer, as the offer is by way of offer by the promoter selling shareholders.

### 5. Net asset value per equity share (face value of INR 10 each)

As per restated standalone financial information:

Fiscal/Period Ended	Net Asset Value per Equity Share (INR)
March 31, 2017	19.2
March 31, 2016	15.6
March 31, 2015	12.7

As per restated consolidated financial information:

Fiscal/Period Ended	Net Asset Value per Equity Share (INR)
March 31, 2017	19.1
March 31, 2016	15.6
March 31, 2015	12.7

### 6. Comparison with listed industry peers

Name of the company	Unconsolidated/ Consolidated	Face Value per Share (INR)	EPS (Basic) (4) (INR)	EPS (Diluted) (4) (INR)	NAV / Share(5) (INR)	P/E (6) (INR)	RONW (%) (3,7)
ICICI Prudential Insurance Company Limited (1)	Consolidated	10	11.7	11.7	44.6	33.4	28.7
SBI Life Insurance Company Limited (2)	Consolidated	10	9.6	9.6	55.5	69.4	18.6
<b>Industry Average</b>		<b>10</b>	<b>10.7</b>	<b>10.7</b>	<b>50.1</b>	<b>51.4</b>	<b>23.7</b>

- (1) *Financials for ICICI Prudential Insurance Company Limited are sourced from its audited consolidated financial statements as on March 31, 2017 filed with the stock exchanges.*
- (2) *Financials for SBI Life Insurance Company Limited are sourced from its audited consolidated financial statements as on March 31, 2017 as part of the prospectus dated September 25, 2017.*
- (3) *Net worth for the companies has been computed as sum of share capital credit/ (debit) fair value change account and reserves and surplus. Share application money pending allotment not included as part of net worth.*
- (4) *Basic and Diluted EPS refer to basic and diluted EPS sourced from the audited consolidated financial statements as on March 31, 2017 of ICICI Prudential Life Insurance Company Limited filed with the stock exchanges; Basic and Diluted EPS refer to the basic and diluted EPS sourced from the prospectus dated September 25, 2017 for SBI Life Insurance Company Limited.*
- (5) *NAV is computed as the closing net worth of the companies, computed as per Note 2, divided by the closing outstanding number of fully paid up equity shares as sourced from the shareholding pattern as on March 31, 2017 filed with the stock exchanges.*
- (6) *P/E Ratio has been computed as the closing market price of ICICI Prudential Life Insurance Company Limited and SBI Life Insurance Company Limited on BSE sourced from BSE website as of October 24, 2017 divided by the basic EPS as described in Note 4.*
- (7) *RoNW for ICICI Prudential Life Insurance Company and SBI Life Insurance Company Limited has been computed as net profit after tax divided by the average net worth of preceding two Fiscals of these companies as per Note 3.*

The Offer Price of [●] has been determined by the Company and the promoter selling shareholders in consultation with the managers, on the basis of demand from investors for equity shares through the book building process and, is justified in view of qualitative and quantitative parameters.

## Open Offer - Crompton Greaves Consumer Electricals Limited

Open Offer for acquisition of 28,44,244 (Twenty Eight Lakhs Forty Four Thousand Two Hundred Forty Four only) fully paid up equity shares of INR 10/- each from public equity shareholders of Rajkumar Forge Limited (hereinafter referred to as “Target Company” or “RFL”) except parties to Share Purchase Agreement (“SPA”) dated May 18, 2016 by Western India Forgings Pvt. Ltd, Krishankumar Jindal and Arun Jindal (hereinafter referred to as “Acquirers”) pursuant to and in accordance with Regulations 3(1) and 4 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as amended (“Regulations”).

**Offer Size:** The Acquirers are hereby making a mandatory Open Offer in terms of SEBI (SAST) Regulations, 2011 to the equity shareholders of the Target Company to acquire up to 28,44,244 (Twenty Eight Lakhs Forty Four Thousand Two Hundred Forty Four only) fully paid up equity shares (“Offer Size”) bearing a face value of INR10/- each representing 26.00% of the total issued, subscribed, paid up and voting capital of the Target Company.

**Type of offer:** This is a Triggered Offer under Regulations 3(1) & 4 of SEBI (SAST) Regulations, 2011

**Price/consideration:** An offer price of INR32/- (Rupees Thirty Two Only) per fully paid up equity share of INR10/- each of the Target Company (hereinafter referred to as “Offer Price”) will be offered to the equity shares tendered in the Offer. Assuming full acceptance, the total consideration payable by the Acquirers will be INR9,10,15,808/- (Rupees Nine Crores Ten Lakhs Fifteen Thousand Eight Hundred And Eight only) (hereinafter referred to as “Offer Consideration”).

The Equity Shares of the Target Company are listed on BSE and NSE. 2. The Equity Shares of the Target Company were allotted on 22 March 2016 and received listing and trading approval from the Stock Exchanges on 11 May 2016. The Equity Shares started trading on BSE and NSE on 13 May 2016. As such, there is no trading history for the Target Company, as on the date of the PA. Since the Equity Shares of the Target Company, during the twelve calendar months preceding the calendar month in which the PA was made, have trading turnover of less than 10.00% (Ten percent) of total number of shares of the Target Company, the Equity Shares of the Target

## Appendix

Company are not frequently traded in terms of Regulation 2(1)(j) of the SEBI (SAST) Regulations. Accordingly, the minimum offer price is calculated in terms of Regulation 8(2) of the SEBI (SAST) Regulations:

S.No	Particulars	INR / Equity Share
<b>A</b>	The highest negotiated price per Equity Share (including the Exclusivity Fees) for any acquisition under an agreement attracting the obligation to make a public announcement of an open offer i.e. the price per share under the Transaction Documents	<b>93.57</b>
<b>B</b>	The volume weighted average price paid or payable per Equity Share for acquisitions by the Acquirers during the fifty two weeks immediately preceding the date of the PA	Not applicable
<b>C</b>	The highest price per Equity Share paid or payable for any acquisition by the Acquirers during the twenty six weeks immediately preceding the date of the PA	Not applicable
<b>D</b>	The volume weighted average market price per Equity Share for a period of sixty trading days immediately preceding the date of the PA as traded on the BSE , being the only stock exchange on which the Equity Shares were listed during such period and such shares being frequently traded	Not applicable as the Equity Shares are not frequently traded
<b>E</b>	Given the Equity Shares are not frequently traded in terms of Regulation 2(1)(j) of the SEBI (SAST) Regulations, the Acquirers and the PAC appointed two (2) independent Chartered Accountant firms to undertake a valuation exercise under the provisions of Regulation 8(2)(e) of SEBI (SAST) Regulations	*Bansi S. Mehta & Co.: 96.00 **SSPA & Co.: 92.09 Detailed valuation parameters are given below

*\*Bansi S. Mehta & Co., Chartered Accountant, (Firm Registration Number: 100991W) has undertaken an independent valuation exercise and issued a*



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*valuation report dated 12 May 2016 under the provisions of Regulation 8(2)(e) of SEBI (SAST) Regulations. They have used Earnings methods and Turnover multiple approaches to arrive at a fair value of INR 96.00 (Rupees ninety six only) per Equity Share of the Target Company.*

*\*\*SSPA & Co., Chartered Accountant, (Firm Registration Number: 128851W) has undertaken an independent valuation exercise and issued a valuation report dated 12 May 2016 under the provisions of Regulation 8(2)(e) of SEBI (SAST) Regulations. They have used Income approach to arrive at a fair value of INR 92.09 (Rupees ninety two and nine paise only) per Equity Share of the Target Company.*

### **Open Offer - Sharp India Limited**

Open offer ("Offer") for acquisition of up to 6,486,000 (Six million four hundred and eighty six thousand) fully paid-up equity shares of face value of INR 10 (each an "Equity Share"), representing 25% (Twenty five percent) of the fully diluted voting share capital of Sharp India Limited ("Target Company") by Sharp Corporation ("Sharp Corporation" / "Acquirer") along with Hon Hai Precision Industry Co., Ltd. ("PAC1" / "Hon Hai"), Foxconn (Far East) Limited ("PAC2" / "FFE"), Foxconn Technology Pte. Ltd ("PAC3" / "FTP") and SIO International Holdings Limited ("PAC4" / "SIO" collectively with Hon Hai, FFE and FTP shall be referred to as the "PAC" / "Allottees"), in their capacity as the persons acting in concert with the Acquirer. Save and except for the PAC, no other person is acting in concert with the Acquirer for the purpose of this Offer. This public announcement ("Public Announcement") is being issued by ICICI Securities Limited (the "Manager to the Offer") for and on behalf of the Acquirer and the PAC, to the Public Shareholders (as defined below) of the Target Company pursuant to and in compliance with Regulations 3, 4 and 5(1), and other applicable regulations of the SEBI (SAST) Regulations. For the purpose of this Public Announcement, "Public Shareholders" shall mean all the public shareholders of the Target Company, excluding (i) the shareholders forming a part of the promoter / promoter group of the Target Company, and (ii) the persons acting in concert or deemed to be acting in concert with the Acquirer.

**Offer Size:** Up to 6,486,000 (Six million four hundred and eighty six thousand) fully paid-up equity shares of face value of INR 10, representing 25% (Twenty-five percent), of the fully diluted voting equity share capital of the Target Company ("Voting Share Capital"), as of the 10th (tenth) working day from the closure of the tendering period.

**Type of offer (Triggered offer, voluntary offer / competing offer, etc.):**

The Offer is a mandatory offer made by the Acquirer and the PAC in compliance with Regulations 3, 4 and 5(1) of SEBI (SAST) Regulations. The thresholds specified under Regulation 5(2) of the SEBI (SAST) Regulations are not applicable. This Offer is not subject to any minimum level of acceptance.

**Price / consideration:** INR 53.18 (Indian Rupees Fifty three point one eight)] per Equity Share (“Offer Price”). The Offer Price has been calculated in accordance with Regulation 8(3) of the SEBI (SAST) Regulations. The Offer Price shall be enhanced by an amount equal to a sum determined at the rate of ten per cent per annum for the period between the date on which the intention or the decision of the Primary Transaction (as defined herein below) was announced in the public domain i.e. 25 February 2016, and the date of the detailed public statement, in compliance with the Regulation 8(12) of SEBI (SAST) Regulations.

The offer price mentioned in the PA of INR 53.18 (Indian Rupees Fifty three and eighteen paise) per Equity Share was in terms of Regulations 8(3) of SEBI (SAST) Regulations, in view of the following:

S.No	Particulars	INR / Equity Share
(a)	Highest negotiated price per Equity Share, if any, of the Target Company for any acquisition under Not Applicable the Primary Transaction.	<b>93.57</b>
(b)	Volume-weighted average price paid or payable for any acquisition, whether by the Acquirer or by any person acting in concert with the Acquirer, during the 52 (Fifty-two) weeks immediately preceding 25 February 2016 (being the earlier of the date on which the Primary Transaction is contracted, and the date on which the intention or the decision to enter into the Primary Transaction is announced in the public domain).	Not Applicable
(c)	Highest price paid or payable for any acquisition, whether by the Acquirer or by any person acting in concert with the Acquirer,	Not Applicable

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	during the twenty-six weeks immediately preceding 25 February 2016 (being the earlier of the date on which the Primary Transaction is contracted, and the date on which the intention or the decision to enter into the Primary Transaction is announced in the public domain).	
(d)	Highest price paid or payable for any acquisition, whether by the Acquirer or by any person acting in concert with the Acquirer, between 25 February 2016 (being the earlier of the date on which the Primary Transaction is contracted, and the date on which the intention or the decision to enter into the Primary Transaction is announced in the public domain) and the date of the PA.	Not Applicable
(e)	Volume-weighted average market price of the Equity Shares for a period of 60 (Sixty) trading days immediately preceding 25 February 2016 (being the earlier of the date on which the Primary Transaction is contracted, and the date on which the intention or the decision to enter into the Primary Transaction is announced in the public domain) as traded on the BSE.	INR 53.18 per Equity Share
(f)	Per Equity Share value, as required under Regulation 8(5) of SEBI (SAST) Regulations.	Not Applicable

*Note: In terms of regulation 8(12) of the SEBI (SAST) Regulations, in case of an indirect acquisition other than indirect acquisition referred in Regulation 5(2) of SEBI (SAST) Regulations, the offer price shall stand enhanced by an amount equal to 10% per annum for the period between 25 February 2016, being the earlier of the date on which the Primary Transaction is contracted or the date on which the intention or the decision to make the Primary Transaction is announced in the public domain, and the date of the detailed public statement, i.e. 1 September 2016, provided that such period is more than 5 (Five) working days*

## Appendix 'B'

# Companies (Registered Valuers and Valuation) Rules, 2017

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In exercise of the powers conferred by section 247 read with sections 458 and 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following Rules, namely:-

### CHAPTER I PRELIMINARY

1. **<sup>18</sup>Short title, commencement and Application.**— (1) These rules may be called the Companies (Registered Valuers and Valuation) Rules, 2017.
  - (2) They shall come into force on the date of their publication in the Official Gazette.
  - <sup>19</sup>(3) These rules shall apply for valuation in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities under the provision of the Act or these rules.
2. **Definitions.**— (1) In these rules, unless the context otherwise requires—
  - (a) “Act” means the Companies Act, 2013 (18 of 2013);
  - (b) “authority” means an authority specified by the Central Government under section 458 of the Companies Act, 2013 to perform the functions under these rules;
  - (c) “asset class” means a distinct group of assets, such as land and building, machinery and equipment, displaying similar

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<sup>18</sup> Subs. by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018. Before substitution, it stood as under:  
“Short title and commencement”

<sup>19</sup> Inserted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018.

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- characteristics, that can be classified and requires separate set of valuers for valuation;
- (d) “certificate of recognition” means the certificate of recognition granted to a registered valuers organisation under sub-rule (5) of rule 13 and the term “recognition” shall be construed accordingly;
  - (e) “certificate of registration” means the certificate of registration granted to a valuer under sub-rule (6) of rule 6 and the term “registration” shall be construed accordingly;
  - (f) “partnership entity” means a partnership firm registered under the Indian Partnership Act, 1932 (9 of 1932) or a limited liability partnership registered under the Limited Liability Partnership Act, 2008 (6 of 2009);
  - (g) “Annexure” means an annexure to these rules;
  - (h) “registered valuers organisation” means a registered valuers organisation recognised under sub-rule (5) of rule 13;
  - (i) “valuation standards” means the standards on valuation referred to in rule 18; and
  - (j) “valuer” means a person registered with the authority in accordance with these rules and the term “registered valuer” shall be construed accordingly.
- (2) Words and expressions used but not defined in these rules, and defined in the Act or in the Companies (Specification of Definitions Details) Rules, 2014, shall have the same meanings respectively assigned to them in the Act or in the said rules.

### CHAPTER II

#### ELIGIBILITY, QUALIFICATIONS AND REGISTRATION OF VALUERS

3. **Eligibility for registered valuers.**— (1) A person shall be eligible to be a registered valuer if he-
- (a) is a valuer member of a registered valuers organisation;
- Explanation.*— For the purposes of this clause, “a valuer member” is a member of a registered valuers organisation who

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- possesses the requisite educational qualifications and experience for being registered as a valuer;
- (b) is recommended by the registered valuers organisation of which he is a valuer member for registration as a valuer;
  - (c) has passed the valuation examination under rule 5 within three years preceding the date of making an application for registration under rule 6;
  - (d) possesses the qualifications and experience as specified in rule 4;
  - (e) is not a minor;
  - (f) has not been declared to be of unsound mind;
  - (g) is not an undischarged bankrupt, or has not applied to be adjudicated as a bankrupt;
  - (h) is a person resident in India;

*Explanation.*— For the purposes of these rules ‘person resident in India’ shall have the same meaning as defined in clause (v) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999) as far as it is applicable to an individual;

- (i) has not been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence:

*Provided* that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;

- (j) has not been levied a penalty under section 271J of Income-tax Act, 1961 (43 of 1961) and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal, as the case may be has expired, or such penalty has been confirmed by Income-tax Appellate Tribunal, and five years have not elapsed after levy of such penalty; and
- (k) is a fit and proper person:

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*Explanation.*— For determining whether an individual is a fit and proper person under these rules, the authority may take account of any relevant consideration, including but not limited to the following criteria-

- (i) integrity, reputation and character,
  - (ii) absence of convictions and restraint orders, and
  - (iii) competence and financial solvency.
- (2) No partnership entity or company shall be eligible to be a registered valuer if-
- (a) it has been set up for objects other than for rendering professional or financial services, including valuation services and that in the case of a company, it is <sup>20</sup>not a subsidiary, joint venture or associate of another company or body corporate;
  - (b) it is undergoing an insolvency resolution or is an undischarged bankrupt;
  - (c) all the partners or directors, as the case may be, are not ineligible under clauses (c), (d), (e), <sup>21</sup>(f), (g), (h), (i), (j) and (k) of sub-rule (1);
  - (d) three or all the partners or directors, whichever is lower, of the partnership entity or company, as the case may be, are not registered valuers; or
  - (e) none of its partners or directors, as the case may be, is a registered valuer for the asset class, for the valuation of which it seeks to be a registered valuer.
- 4. Qualifications and experience.**— An individual shall have the following qualifications and experience to be eligible for registration under rule 3, namely:-
- (a) post-graduate degree or post-graduate diploma, in the specified discipline, from a University or Institute established, recognised

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<sup>20</sup> Omitted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018. Before omission, it stood as : “not”.

<sup>21</sup> Inserted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018.

- or incorporated by law in India and at least three years of experience in the specified discipline thereafter; or
- (b) a Bachelor's degree or equivalent, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least five years of experience in the specified discipline thereafter; or
  - (c) membership of a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession with at least three years' experience after such membership<sup>22</sup>~~and having qualification mentioned at clause (a) or (b).~~

*Explanation-I.*— For the purposes of this clause the 'specified discipline' shall mean the specific discipline which is relevant for valuation of an asset class for which the registration as a valuer or recognition as a registered valuers organisation is sought under these rules.

*Explanation-II.*— Qualifying education and experience<sup>23</sup>~~and examination or training~~ for various asset classes, is given in an indicative manner in **Annexure-IV** of these rules.

<sup>24</sup>[Explanation III – for the purposes of this rule and Annexure IV, 'equivalent' shall mean professional and technical qualifications which are recognised by the Ministry of Human Resources and Development as equivalent to professional and technical degree.]

- 5. Valuation Examination.**— (1) The authority shall, either on its own or through a designated agency, conduct valuation examination for one or more asset classes, for individuals, who possess the qualifications and experience as specified in rule 4, and have completed their educational courses as member of a registered valuers organisation,

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<sup>22</sup> Omitted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018. Before omission, it stood as : "and having qualification mentioned at clause (a) or (b)"

<sup>23</sup> Omitted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018. Before omission, it stood as : "and examination or training".

<sup>24</sup> Inserted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018



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to test their professional knowledge, skills, values and ethics in respect of valuation:

Provided that the authority may recognise an educational course conducted by a registered valuers organisation before its recognition as adequate for the purpose of appearing for valuation examination:

Provided also that the authority may recognise an examination conducted as part of a master's or post graduate degree course conducted by a University which is equivalent to the valuation examination.

- (2) The authority shall determine the syllabus for various valuation specific subjects or assets classes for the valuation examination on the recommendation of one or more Committee of experts constituted by the authority in this regard.
  - (3) The syllabus, format and frequency of the valuation examination, including qualifying marks, shall be published on the website of the authority at least three months before the examination.
  - (4) An individual who passes the valuation examination, shall receive acknowledgement of passing the examination.
  - (5) An individual may appear for the valuation examination any number of times.
- 6. Application for certificate of registration.**— (1) An individual eligible for registration as a registered valuer under rule 3 may make an application to the authority in **Form-A of Annexure-II** along with a non-refundable application fee of five thousand rupees in favour of the authority.
- (2) A partnership entity or company eligible for registration as a registered valuer under rule 3 may make an application to the authority in **Form-B of Annexure-II** along with a non-refundable application fee of ten thousand rupees in favour of the authority.
  - (3) The authority shall examine the application, and may grant twenty one days to the applicant to remove the deficiencies, if any, in the application.
  - (4) The authority may require the applicant to submit additional documents or clarification within twenty- one days.

- (5) The authority may require the applicant to appear, within twenty one days, before the authority in person, or through its authorised representative for explanation or clarifications required for processing the application.
- (6) If the authority is satisfied, after such scrutiny, inspection or inquiry as it deems necessary, that the applicant is eligible under these rules, it may grant a certificate of registration to the applicant to carry on the activities of a registered valuer for the relevant asset class or classes in **Form-C** of the **Annexure-II** within sixty days of receipt of the application, excluding the time given by the authority for presenting additional documents, information or clarification, or appearing in person, as the case may be.
- (7) If, after considering an application made under this rule, the authority is of the *prima facie* opinion that the registration ought not be granted, it shall communicate the reasons for forming such an opinion within forty-five days of receipt of the application, excluding the time given by it for removing the deficiencies, presenting additional documents or clarifications, or appearing in person, as the case may be.
- (8) The applicant shall submit an explanation as to why his/its application should be accepted within fifteen days of the receipt of the communication under sub- rule (7), to enable the authority to form a final opinion.
- (9) After considering the explanation, if any, given by the applicant under sub-rule (8), the authority shall either –
  - (a) accept the application and grant the certificate of registration; or
  - (b) reject the application by an order, giving reasons thereof.
- (10) The authority shall communicate its decision to the applicant within thirty days of receipt of explanation.
- 7. Conditions of Registration.**— The registration granted under rule 6 shall be subject to the conditions that the valuer shall –
  - (a) at all times possess the eligibility and qualification and experience criteria as specified under rule 3 and rule 4;

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- (b) at all times comply with the provisions of the Act , these rules and the Bye-laws or internal regulations, as the case may be, of the respective registered valuers organisation;
- (c) in his capacity as a registered valuer, not conduct valuation of the assets or class(es) of assets other than for which he/it has been registered by the authority;
- (d) take prior permission of the authority for shifting his/ its membership from one registered valuers organisation to another;
- (e) take adequate steps for redressal of grievances;
- (f) maintain records of each assignment undertaken by him for at least three years from the completion of such assignment;
- (g) comply with the Code of Conduct (as per Annexure-I of these rules) of the registered valuers organisation of which he is a member;
- (h) in case a partnership entity or company is the registered valuer, allow only the partner or director who is a registered valuer for the asset class(es) that is being valued to sign and act on behalf of it;
- (i) in case a partnership entity or company is the registered valuer, it shall disclose to the company concerned, the extent of capital employed or contributed in the partnership entity or the company by the partner or director, as the case may be, who would sign and act in respect of relevant valuation assignment for the company;
- (j) in case a partnership entity is the registered valuer, be liable jointly and severally along with the partner who signs and acts in respect of a valuation assignment on behalf of the partnership entity;
- (k) in case a company is the registered valuer, be liable alongwith director who signs and acts in respect of a valuation assignment on behalf of the company;
- (l) in case a partnership entity or company is the registered valuer, immediately inform the authority on the removal of a partner or

director, as the case may be, who is a registered valuer along with detailed reasons for such removal; and

- (m) comply with such other conditions as may be imposed by the authority.

**8. Conduct of Valuation.—** (1) The registered valuer shall, while conducting a valuation, comply with the valuation standards as notified or modified under rule 18:

Provided that until the valuation standards are notified or modified by the Central Government, a valuer shall make valuations as per-

- (a) internationally accepted valuation standards;
- (b) valuation standards adopted by any registered valuers organisation.

(2) The registered valuer may obtain inputs for his valuation report or get a separate valuation for an asset class conducted from another registered valuer, in which case he shall fully disclose the details of the inputs and the particulars etc. of the other registered valuer in his report and the liabilities against the resultant valuation, irrespective of the nature of inputs or valuation by the other registered valuer, shall remain of the first mentioned registered valuer.

(3) The valuer shall, in his report, state the following:-

- (a) background information of the asset being valued;
- (b) purpose of valuation and appointing authority;
- (c) identity of the valuer and any other experts involved in the valuation;
- (d) disclosure of valuer interest or conflict, if any;
- (e) date of appointment, valuation date and date of report;
- (f) inspections and/or investigations undertaken;
- (g) nature and sources of the information used or relied upon;
- (h) procedures adopted in carrying out the valuation and valuation standards followed;
- (i) restrictions on use of the report, if any;

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- (j) major factors that were taken into account during the valuation;
- (k) conclusion; and
- (l) caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

**9. Temporary surrender.**— (1) A registered valuer may temporarily surrender his registration certificate in accordance with the bye-laws or regulations, as the case may be, of the registered valuers organisation and on such surrender, the valuer shall inform the authority for taking such information on record.

(2) A registered valuers organisation shall inform the authority if any valuer member has temporarily surrendered his/its membership or revived his/ its membership after temporary surrender, not later than seven days from approval of the application for temporary surrender or revival, as the case may be.

(3) Every registered valuers organisation shall place, on its website, in a searchable format, the names and other details of its valuers members who have surrendered or revived their memberships.

**10. Functions of a Valuer.**— A valuer shall conduct valuation required under the Act as per these rules <sup>25</sup>and he may conduct valuation as per these rules if required under any other law or by any other regulatory authority.

**11. Transitional Arrangement.**— Any person who may be rendering valuation services under the Act, on the date of commencement of these rules, may continue to render valuation services without a certificate of registration under these rules upto 30<sup>th</sup> September, <sup>26</sup>2019 ~~2018~~:

Provided that if a company has appointed any valuer before such date and the valuation or any part of it has not been completed before 31st

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<sup>25</sup> Omitted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018. Before omission, it stood as: "and he may conduct valuation as per these rules if required under any other law or by any other regulatory authority".

<sup>26</sup> Substituted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018.

March, 2019 <sup>27</sup>2018, the valuer shall complete such valuation or such part within three months thereafter.

~~*Explanation.*— It is hereby clarified that conduct of valuation by any person under any law other than the Act, or these rules shall not be effected by virtue of coming into effect of these rules unless the relevant other laws or other regulatory bodies require valuation by such person in accordance with these rules in which case these rules shall apply for such valuation also from the date specified under the laws or by the regulatory bodies.~~<sup>28</sup>

### CHAPTER III

#### RECOGNITION OF REGISTERED VALUERS ORGANISATIONS

**12. Eligibility for registered valuers organisations.—** (1) An organisation that meets requirements under sub-rule (2) may be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes if —

- (i) it has been registered under section 25 of the Companies Act, 1956 (1 of 1956) or section 8 of the Companies Act, 2013 (18 of 2013) with the sole object of dealing with matters relating to regulation of valuers of an asset class or asset classes and has in its bye laws the requirements specified in **Annexure-III**;
- (ii) it is a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession;

Provided that, subject to sub-rule (3), the following organisations may also be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes, namely:-

- (a) an organisation registered as a society under the Societies Registration Act, 1860 (21 of 1860) or any relevant state law, or;
- (b) an organisation set up as a trust governed by the Indian Trust Act, 1882 (2 of 1882).

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<sup>27</sup> Substituted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018.

<sup>28</sup> Omitted by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018.

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- (2) The organisation referred to in sub-rule (1) shall be recognised if it –
- (a) conducts educational courses in valuation, in accordance with the syllabus determined by the authority, under rule 5, for individuals who may be its valuers members, and delivered in class room or through distance education modules and which includes practical training;
  - (b) grants membership or certificate of practice to individuals, who possess the qualifications and experience as specified in rule 4, in respect of valuation of asset class for which it is recognised as a registered valuers organisation;
  - (c) conducts training for the individual members before a certificate of practice is issued to them;
  - (d) lays down and enforces a code of conduct for valuers who are its members, which includes all the provisions specified in **Annexure-I**;
  - (e) provides for continuing education of individuals who are its members;
  - (f) monitors and reviews the functioning, including quality of service, of valuers who are its members; and
  - (g) has a mechanism to address grievances and conduct disciplinary proceedings against valuers who are its members.
- (3) A registered valuers organisation, being an entity under proviso to sub-rule (1), shall convert into or register itself as a company under section 8 of the Companies Act, 2013 (18 of 2013), and include in its bye laws the requirements specified in **Annexure-III**, within one year from the date of commencement of these rules.
- 13. Application for recognition—** (1) An eligible organisation which meets the conditions specified in rule 12 may make an application for recognition as a registered valuers organisation for asset class or classes to the authority in **Form-D** of the **Annexure-II** along with a non-refundable application fee of rupees one lakh in favour of the authority.

- (2) The authority shall examine the application, and may grant twenty-one days to the applicant to remove the deficiencies, if any, in the application.
  - (3) The authority may require the applicant to submit additional documents or clarification within twenty-one days.
  - (4) The authority may require the applicant to appear, within twenty-one days, before the Authority through its authorised representative for explanation or clarifications required for processing the application.
  - (5) If the authority is satisfied, after such scrutiny, inspection or inquiry as it deems necessary that the applicant is eligible under these rules, it may grant a certificate of recognition as a registered valuers organisation in **Form-E of Annexure-II**.
  - (6) If, after considering an application made under sub-rule (1), the authority is of the *prima facie* opinion that recognition ought not to be granted, it shall communicate the reasons for forming such an opinion within forty-five days of receipt of the application, excluding the time given by it for removing the deficiencies, presenting additional documents or clarifications, or appearing through authorised representative, as the case may be.
  - (7) The applicant shall submit an explanation as to why its application should be accepted within fifteen days of the receipt of the communication under sub- rule (6), to enable the authority to form a final opinion.
  - (8) After considering the explanation, if any, given by the applicant under sub- rule (7), the authority shall either –
    - (a) accept the application and grant the certificate of recognition; or
    - (b) reject the application by an order, giving reasons thereof.
  - (9) The authority shall communicate its decision to the applicant within thirty days of receipt of explanation.
- 14. Conditions of Recognition.**— The recognition granted under rule 13 shall be subject to the conditions that the registered valuers organisation shall-



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- (a) at all times continue to satisfy the eligibility requirements specified under rule 12;
- (b) maintain a register of members who are registered valuers, which shall be publicly available;
- (c) admits only individuals who possess the educational qualifications and experience requirements, in accordance with rule 4 and as specified in its recognition certificate, as members;
- (d) make such reports to the authority as may be required by it;
- (e) comply with any directions, including with regard to course to be conducted by valuation organisation under clause (a) of sub-rule (2) of rule 12, issued by the authority;
- (f) be converted or registered as company under section 8 of the Act, with governance structure and bye laws specified in **Annexure-III**, within a period of ~~one year~~<sup>29</sup>(two years) from the date of commencement of these rules if it is an organisation referred to in proviso to sub-rule (1) of rule 12;
- (g) shall have the governance structure and incorporate in its bye laws the requirements specified in Annexure-III within one year of commencement of these rules if it is an organisation referred to in clause (i) of sub-rule (1) of rule 12 and existing on the date of commencement of these rules;
- (h) display on its website, the status and specified details of every registered valuer being its valuer members including action under rule 17 being taken against him; and
- (i) comply with such other conditions as may be specified by authority.

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<sup>29</sup> Subs. by the Companies (Registered Valuers and Valuation) Third Amendment Rules, 2018, rule 3 (w.e.f. 25-09-2018).

**CHAPTER IV  
CANCELLATION OR SUSPENSION OF CERTIFICATE OF REGISTRATION  
OR RECOGNITION**

**15. Cancellation or suspension of certificate of registration or recognition.-** The authority may cancel or suspend the registration of a valuer or recognition of a registered valuers organisation for violation of the provisions of the Act, any other law allowing him to perform valuation, these rules or any condition of registration or recognition, as the case may be in the manner specified in rule 17.

**16. Complaint against a registered valuer or registered valuers organisation.-** A complaint may be filed against a registered valuer or registered valuers organisation before the authority in person or by post or courier along with a non-refundable fees of rupees one thousand in favour of the authority and the authority shall examine the complaint and take such necessary action as it deems fit:

Provided that in case of a complaint against a registered valuer, who is a partner of a partnership entity or director of a company, the authority may refer the complaint to the relevant registered valuers organisation and such organisation shall handle the complaint in accordance with its bye laws.

**17. Procedure to be followed for cancellation or suspension of registration or recognition certificate.—** (1) Based on the findings of an inspection or investigation, or a complaint received or on material otherwise available on record, if the authorised officer is of the prima facie opinion that sufficient cause exists to cancel or suspend the registration of a valuer or cancel or suspend the recognition of a registered valuers organisation, it shall issue a show-cause notice to the valuer or registered valuers organisation,;

Provided that in case of an organisation referred to in clause (ii) of sub-rule (1) of rule 12 which has been granted recognition, the authorised officer shall, instead of carrying out inspection or investigation, seek the information required from the registered valuers organisation within the time specified therein and in the case of a default, give one more opportunity to provide the information within specified time failing which or in the absence of sufficient or satisfactory information provided, either initiate the process under this

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rule or refer the matter to the Central Government for appropriate directions.

- (2) The show-cause notice shall be in writing and shall state-
  - (a) the provisions of the Act and rules under which it has been issued;
  - (b) the details of the alleged facts;
  - (c) the details of the evidence in support of the alleged facts;
  - (d) the provisions of the Act or rules or certificate of registration or recognition allegedly violated, or the manner in which the public interest has allegedly been affected;
  - (e) the actions or directions that the authority proposes to take or issue if the allegations are established;
  - (f) the manner in which the person is required to respond to the show-cause notice;
  - (g) consequences of failure to respond to the show-cause notice within the given time; and
  - (h) procedure to be followed for disposal of the show-cause notice.
- (3) The show-cause notice shall be served in the following manner by-
  - (a) sending it to the valuer or registered valuers organisation at its registered address by registered post with acknowledgment due; or
  - (b) an appropriate electronic means to the email address provided by the valuer or registered valuers organisation to the authority.
- (4) The authorised officer shall dispose of the show-cause notice by reasoned order in adherence to the principles of natural justice.
- (5) The order in disposal of a show-cause notice may provide for-
  - (a) no action;
  - (b) warning; or
  - (c) suspension or cancellation of the registration or recognition; or
  - (d) change in any one or more partner or director or the governing board of the registered valuers organisation.

- (6) An order passed under sub-rule (5) cancelling the recognition of a registered valuers organisation, shall specify the time within which its members may take membership of another registered valuers organisation recognised for valuation of relevant asset class without prejudice to their registration.
- (7) The order passed under sub-rule (5) shall be issued to the concerned person immediately, and published on the website of the authority.
- (8) The order passed under sub-rule (5) shall not become effective until thirty days have elapsed from the date of issue of the order unless stated otherwise.
- (9) Any person aggrieved by an order of the authorised officer under sub-rule (5) may prefer an appeal before the authority.

*Explanation.*— For the purposes of this rule, the authorised officer shall be an officer as may be specified by the authority.

#### **CHAPTER V VALUATION STANDARDS**

- 18. Valuation Standards.**— The Central Government shall notify and may modify (from time to time) the valuation standards on the recommendations of the Committee set up under rule 19.
- 19. Committee to advise on valuation matters.**— (1) The Central Government may constitute a Committee to be known as “Committee to advise on valuation matters” to make recommendations on formulation and laying down of valuation standards and policies for compliance by companies and registered valuers.
  - (2) The Committee shall comprise of-
    - (a) a Chairperson who shall be a person of eminence and well versed in valuation, accountancy, finance, business administration, business law, corporate law, economics;
    - (b) one member nominated by the Ministry of Corporate Affairs;
    - (c) one member nominated by the Insolvency and Bankruptcy Board of India;
    - (d) one member nominated by the Legislative Department;

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- (e) up to four members nominated by Central Government representing authorities which are allowing valuations by registered valuers;
  - (f) up to four members who are representatives of registered valuers organisations, nominated by Central Government.
  - (g) Up to two members to represent industry and other stakeholder nominated by the Central Government in consultation with the authority;
  - (h) <sup>30</sup>Presidents of the Institute of Chartered Accountants of India, the Institute of Company Secretaries of India, the Institute of Cost Accountants of India as ex-officio members.
- (3) The Chairperson and Members of the Committee shall have a tenure of three years and they shall not have more than two tenures.

### CHAPTER VI MISCELLANEOUS

- 20. Punishment for contravention.-** Without prejudice to any other liabilities where a person contravenes any of the provision of these rules he shall be punishable in accordance with sub-section (3) of section 469 of the Act.
- 21. Punishment for false statement.—** If in any report, certificate or other document required by, or for, the purposes of any of the provisions of the Act or the rules made thereunder or these rules, any person makes a statement,—
- (a) which is false in any material particulars, knowing it to be false;  
or
  - (b) which omits any material fact, knowing it to be material,
- he shall be liable under section 448 of the Act.

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<sup>30</sup> Inserted by the Companies (Registered Valuers and Valuation) Second Amendment Rules, 2018, (w.e.f. 14-06-2018).

**ANNEXURE-I**  
**MODEL CODE OF CONDUCT FOR REGISTERED VALUERS**

[See clause (g) of rule 7 and clause (d) of sub-rule (2) of rule 12]

**Integrity and Fairness**

1. A valuer shall, in the conduct of his/its business, follow high standards of integrity and fairness in all his/its dealings with his/its clients and other valuers.
2. A valuer shall maintain integrity by being honest, straightforward, and forthright in all professional relationships.
3. A valuer shall endeavour to ensure that he/it provides true and adequate information and shall not misrepresent any facts or situations.
4. A valuer shall refrain from being involved in any action that would bring disrepute to the profession.
5. A valuer shall keep public interest foremost while delivering his services.

**Professional Competence and Due Care**

6. A valuer shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.
7. A valuer shall carry out professional services in accordance with the relevant technical and professional standards that may be specified from time to time
8. A valuer shall continuously maintain professional knowledge and skill to provide competent professional service based on up-to-date developments in practice, prevailing regulations/guidelines and techniques.
9. In the preparation of a valuation report, the valuer shall not disclaim liability for his/its expertise or deny his/its duty of care, except to the extent that the assumptions are based on statements of fact provided by the company or its auditors or consultants or information available in public domain and not generated by the valuer.

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10. A valuer shall not carry out any instruction of the client insofar as they are incompatible with the requirements of integrity, objectivity and independence.
11. A valuer shall clearly state to his client the services that he would be competent to provide and the services for which he would be relying on other valuers or professionals or for which the client can have a separate arrangement with other valuers.

### Independence and Disclosure of Interest

12. A valuer shall act with objectivity in his/its professional dealings by ensuring that his/its decisions are made without the presence of any bias, conflict of interest, coercion, or undue influence of any party, whether directly connected to the valuation assignment or not.
13. A valuer shall not take up an assignment if he/it or any of his/its relatives or associates is not independent in terms of association to the company.
14. A valuer shall maintain complete independence in his/its professional relationships and shall conduct the valuation independent of external influences.
15. A valuer shall wherever necessary disclose to the clients, possible sources of conflicts of duties and interests, while providing unbiased services.
16. A valuer shall not deal in securities of any subject company after any time when he/it first becomes aware of the possibility of his/its association with the valuation, and in accordance with the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 or till the time the valuation report becomes public, whichever is earlier.
17. A valuer shall not indulge in “mandate snatching” or offering “convenience valuations” in order to cater to a company or client’s needs.
18. As an independent valuer, the valuer shall not charge success fee.
19. In any fairness opinion or independent expert opinion submitted by a valuer, if there has been a prior engagement in an unconnected

transaction, the valuer shall declare the association with the company during the last five years.

**Confidentiality**

20. A valuer shall not use or divulge to other clients or any other party any confidential information about the subject company, which has come to his/its knowledge without proper and specific authority or unless there is a legal or professional right or duty to disclose.

**Information Management**

21. A valuer shall ensure that he/ it maintains written contemporaneous records for any decision taken, the reasons for taking the decision, and the information and evidence in support of such decision. This shall be maintained so as to sufficiently enable a reasonable person to take a view on the appropriateness of his/its decisions and actions.
22. A valuer shall appear, co-operate and be available for inspections and investigations carried out by the authority, any person authorised by the authority, the registered valuers organisation with which he/it is registered or any other statutory regulatory body.
23. A valuer shall provide all information and records as may be required by the authority, the Tribunal, Appellate Tribunal, the registered valuers organisation with which he/it is registered, or any other statutory regulatory body.
24. A valuer while respecting the confidentiality of information acquired during the course of performing professional services, shall maintain proper working papers for a period of three years or such longer period as required in its contract for a specific valuation, for production before a regulatory authority or for a peer review. In the event of a pending case before the Tribunal or Appellate Tribunal, the record shall be maintained till the disposal of the case.

**Gifts and hospitality**

25. A valuer or his/its relative shall not accept gifts or hospitality which undermines or affects his independence as a valuer.

*Explanation.*— For the purposes of this code the term ‘relative’ shall have the same meaning as defined in clause (77) of Section 2 of the Companies Act, 2013 (18 of 2013).



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26. A valuer shall not offer gifts or hospitality or a financial or any other advantage to a public servant or any other person with a view to obtain or retain work for himself/ itself, or to obtain or retain an advantage in the conduct of profession for himself/ itself.

### **Remuneration and Costs**

27. A valuer shall provide services for remuneration which is charged in a transparent manner, is a reasonable reflection of the work necessarily and properly undertaken, and is not inconsistent with the applicable rules.
28. A valuer shall not accept any fees or charges other than those which are disclosed in a written contract with the person to whom he would be rendering service.

### **Occupation, employability and restrictions**

29. A valuer shall refrain from accepting too many assignments, if he/it is unlikely to be able to devote adequate time to each of his/ its assignments.
30. A valuer shall not conduct business which in the opinion of the authority or the registered valuer organisation discredits the profession.

**ANNEXURE-II**

**FORM-A**

[See sub-rule (1) of rule 6]]

**Application for registration as a valuer by an individual**

To

The Authority

*[Insert address]*

From

*[Name and address]*

*Subject: Application for registration as a valuer*

**Sir/Madam,**

I, having been enrolled as a member with the (please write the name of the Registered valuers organisation), hereby apply for registration as a valuer under section 247 of the Companies Act, 2013 read with sub-rule (1) of rule 6 of the Companies (Registered Valuers and Valuation) Rules, 2017 for the following class(es) of assets:-

(a) \_\_\_\_\_

(b) \_\_\_\_\_

My details are as under:

**A. PERSONAL DETAILS**

1. Title (Mr/Mrs/Ms):
2. Name:
3. Father's Name:
4. Mother's Name:
5. Date of Birth:
6. PAN No.:
7. AADHAAR No.:
8. Passport No.:

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9. Address for Correspondence:
10. Permanent Address:
11. E-Mail Address
12. Mobile No:

### **B. EDUCATIONAL, PROFESSIONAL AND VALUATION EXAMINATION QUALIFICATIONS**

#### **1. Educational Qualifications**

[Please provide educational qualifications from Bachelor's degree onwards]

Educational Qualification	Year of Passing	Marks (Per cent.)	Grade/Classes	University/College	Remarks, if any

#### **2. Professional Qualifications [excluding valuation specific courses]**

Professional Qualification [excluding valuation specific education /courses]	Institute/ Professional Body	Membership No. (if applicable)	Date of enrolment	Remarks, if any

**3. (a) Details of valuation examination passed**

Date of examination	Asset class, if any	Marks secured	Percentage

**(b) Valuation Qualifications**

Valuation specific qualification/course	Recognised Registered Valuers Organisation		Asset class	Membership No. in Registered Valuers Organisation	Remarks, if any.
	Name	Recognition No			

**C. WORK EXPERIENCE**

1. Are you presently in practice / employment? (Yes or No)
2. Number of years in practice or of work experience in the relevant profession or in valuation (in years and months):
3. If in practice, address for professional correspondence:
4. Number of years in employment (in years and months):
5. Experience Details

Sl No	From Date	To Date	Employment / Practice	If employed, Name of Employer and Designation	If in practice, experience in the relevant profession/ valuation	Area of work

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### **D. REGISTERED VALUERS ORGANISATION**

1. Please give details of the registered valuers organisation of which you are a member.
2. Please state your membership number.

### **E. ADDITIONAL INFORMATION**

1. Have you ever been convicted for an offence? Yes or No.  
If yes, please give details.
2. Are any criminal proceedings pending against you? (Yes or No)  
If yes, please give details.
3. Have you ever been declared as an undischarged bankrupt, or applied to be adjudged as Bankrupt? (Yes or No)  
If yes, please give details.
4. Please provide any additional information that may be relevant for your application.

### **F. ATTACHMENTS**

1. Copy of proof of residence.
2. Copies of documents in support of educational qualifications, professional qualifications and Registered Valuation Examination qualifications.
3. Copies of documents demonstrating practice or work experience for the relevant period.
4. Copies of certificate of employment by the relevant employer(s), specifying the period of such employment.
5. Income Tax Returns for the last three years.
6. Copy of proof of membership with a registered valuers organisation.
7. Passport-size photo.
8. Evidence of deposit / payment of five thousand rupees.

**G. AFFIRMATIONS**

1. Copies of documents, as listed in section F of this application form have been attached/ uploaded. The documents attached/ uploaded are .....

I undertake to furnish any additional information as and when called for.

2. I am not disqualified from being registered as a valuer under the Companies (Registered Valuers and Valuation) Rules, 2017.

3. This application and the information furnished by me along with this application is true and complete. If found false or misleading at any stage, my registration shall be summarily cancelled.

I hereby undertake to comply with the requirements of the Companies Act, 2013, the rules made thereunder, the directions given by the authority, and the bye-laws, directions and guidelines issued or the resolutions passed in accordance with the bye-laws by the registered valuers organisation with which I am enrolled.

4. The applicable fee has been paid.

Name and Signature of applicant

Place:

Date:

**VERIFICATION BY THE REGISTERED VALUERS ORGANISATION**

We have verified the above details submitted by ... who is our member with membership no. ...and confirm these to be true and correct.

We recommend registration of ... as a valuer.

(Name and Signature)

Authorised Representative of the Registered Valuers Organisation

Seal of the Registered Valuers Organisation

Place:

Date:

**FORM-B**

(See sub-rule (2) of rule 6)

**Application for registration as a valuer by a partnership entity/Company**

To

The Authority,

*[Insert address]*

From

*[Name and address]*

*Subject: Application for registration as a valuer*

**Sir/Madam,**

I, being a partner/director (strike off whichever is not applicable), being duly authorised for the purpose by the partnership entity/company through a resolution/deed (strike out whichever is not applicable) apply on behalf of [ name and address of applicant partnership entity/company], and on behalf of its partners/directors, for registration as a valuer under section 247 of the Companies Act, 2013 read with sub-rule (2) of rule 6 of the Companies (Registered Valuers and Valuation) Rules, 2017 for the following class(es) of assets :-

(a) \_\_\_\_\_

\_\_\_\_\_The details are as under:

**A. DETAILS OF THE PARTNERSHIP ENTITY/COMPANY**

1. Name:
2. Registration Number/ LLP Number/CIN Number:
3. PAN No.:
4. Address for Correspondence or registered office:
5. Permanent Address:

- 6. E-Mail Address
- 7. Telephone No.:
- 8. Others:

**B. PERSONAL DETAILS OF EACH PARTNER/DIRECTOR**

Title (Mr/Mrs/Ms):

- 1. Name:
- 2. Father's Name:
- 3. Mother's Name:
- 4. Date of Birth:
- 5. PAN No.:
- 6. AADHAAR No.:
- 7. Passport No.:
- 8. Address for Correspondence:
- 9. Permanent Address:
- 10. E-Mail Address
- 11. Mobile No.:
- 12. Others:

**C. EDUCATIONAL, PROFESSIONAL AND VALUATION EXAMINATION QUALIFICATIONS OF PARTNERS/DIRECTORS**

**1. Educational Qualifications**

[Please provide educational qualifications from Bachelor's degree onwards for each partner/director]

Educational Qualification	Year of Passing	Marks (per cent.)	Grade/ Class	University/College	Remarks, if any



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### 2. Professional Qualifications for each partner/director

Professional Qualification	Institute/ Professional Body/ registered valuers organisation	Membership No. (If applicable)	Membership No. (if applicable)	Remarks, if any

### 3.(a) Details of valuation examination passed (for all partners/directors who are registered valuers)

Date of examination	Asset class, if any	Asset class, if any	Percentage

### (b) Valuation Qualifications (for all partners/directors who are registered valuers)

Valuation specific qualification/course	Recognised Registered Valuers Organisation		Asset class	Membership No. in Registered Valuers Organisation	Remarks, if any.
	Name	Recognition No			

## D. REGISTERED VALUERS ORGANISATION

- Please give details of the registered valuers organisation of which you are a member. Please state your membership number.

2. Please give details of the registered valuers organisations of which your partners are members. Please state your membership number.

**E. ADDITIONAL INFORMATION**

1. Have you or any of your partners/directors ever been convicted for an offence? (Yes or No).  
If yes, please give details.
2. Are any criminal proceedings pending against you or your partners/directors? (Yes or No)  
If yes, please give details.
3. Are you or any of your partners/directors undischarged bankrupt, or have applied to be adjudged as a bankrupt? (Yes or No)  
If yes, please give details.
4. Please provide any additional information that may be relevant for your application.

**F. ATTACHMENTS**

1. Copy of proof of residence of itself and its partners/directors.
2. Copies of documents in support of educational qualifications, professional qualifications and valuation qualifications of partners/directors.
3. Financial statements/ Income Tax Returns for the last three years.
4. Copy of proof of membership with a registered valuers organisation .
5. Passport-size photo.
6. Evidence of deposit / payment of ten thousand rupees.

**G. AFFIRMATIONS**

1. Copies of documents, as listed in section F of this application form have been attached/ uploaded. The documents attached/ uploaded are .....

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- I undertake to furnish any additional information as and when called for.
2. I am not disqualified from being registered as a valuer under the Companies (Registered Valuers and Valuation) Rules, 2017.
  3. This application and the information furnished by me along with this application is true and complete. If found false or misleading at any stage, the registration of the applicant shall be summarily cancelled.
  4. I hereby undertake that the partnership entity/company and its partners/directors shall comply with the requirements of the Companies Act, 2013, the rules made thereunder, the directions given by the authority, and the bye-laws, directions and guidelines issued or the resolutions passed in accordance with the bye-laws by the registered valuers organisation with which I am enrolled.
  5. The applicable fee has been paid.

Place: \_\_\_\_\_ Name and Signature of applicant's representative

Date: \_\_\_\_\_

### **VERIFICATION BY THE REGISTERED VALUERS ORGANISATION**

We have verified the above details submitted by ... who is our member with membership no. ...and confirm these to be true and correct. We recommend registration of ... as a valuer.

(Name and Signature)

Authorised Representative of the Registered Valuers Organisation

Seal of the Registered Valuers Organisation

Place: \_\_\_\_\_

Date: \_\_\_\_\_

**FORM-C**

(See sub-rule (6) of rule 6)

**CERTIFICATE OF REGISTRATION**

**VALUER REGISTRATION NO.**

1. In exercise of the powers conferred by Section 247 of the Companies Act, 2013 read with sub-rule (6) of rule 6 of the Companies (Registered Valuers and Valuation) Rules, 2017 the Authority hereby grants a certificate of registration to *[insert name]*, to act as a valuer in respect of *[insert asset class]* in accordance with these rules.
2. This certificate shall be valid from *[insert start date]*.

Date:

(Name and Designation)

Place:

For and on behalf of the Authority

**APPENDIX**

**FORM-D**

(See sub-rule (1) of rule 13)

**APPLICATION FOR RECOGNITION**

To

The Authority

*[Insert address]*

From

*[Name and address]*

Subject: Application for grant of certificate of recognition as a registered valuers organisation

**Madam/Sir,**

1. I, being duly authorised for the purpose, hereby apply on behalf of *[name and address of the applicant]* for grant of certificate of recognition as a registered valuers organisation in respect of the following class(es) of assets:

(a)

(b)

and enclose a copy of the board resolution authorising me to make this application and correspond with the authority in this respect.

2. Copies of the articles of association, memorandum of association, trust deed, bye-laws and code of conduct, as applicable, of the applicant are enclosed.

3. I, on behalf of *[insert name]*, affirm that the applicant is eligible to be recognised as a registered valuers organisation for the abovementioned class(es) of assets.

4. I, on behalf of *[insert name]*, hereby affirm that –

(a) all information contained in this application is true and correct in all material respects,

- (b) no material information relevant for the purpose of this application has been suppressed, and
  - (c) recognition granted in pursuance of this application may be cancelled summarily if any information submitted is found to be false or misleading in material respects at any stage.
5. If granted recognition, I, on behalf of [insert name], undertake to comply with the requirements of the Act, the rules, directions or guidelines issued by the authority, and such other conditions and terms as may be contained in the certificate of recognition or be specified or imposed by the authority subsequently, including the requirement to convert into a company registered under section 8 of the Companies Act, 2013 within the required period, if applicable.

Yours faithfully, Authorised Signatory

(Name)

(Designation)

Date:

Place:

**APPENDIX TO FORM-D**

**PART**

**GENERAL**

1. Name of the applicant.
2. Address of registered office and principal place of business of the applicant.
3. Corporate Identification Number (CIN)/ PAN/ Other Identification Number.
4. Name, designation and contact details of the person authorised to make this application and correspond with the authority in this respect.

**PART II**

**STRUCTURE AND GOVERNANCE**

1. Please provide brief details of the applicant's-
  - (i) form of establishment
  - (ii) ownership structure
  - (iii) governance structure

**PART III**

**MEMBERSHIP AND EXAMINATION**

1. Please provide brief details of the
  - (i) number of members who practice valuation and are already registered with the applicant
  - (ii) specific discipline (in terms of rule 4):
  - (iii) other criteria/ qualifications for and manner of registration with the applicant

**Note:** In case of organisations referred to in clause (ii) of sub-rule (1) of rule 12, in lieu of information at (i), they may provide brief details of the number of members who have passed the valuation specific course conducted by the organisation.

2. Please provide brief details of any examination conducted for registration of members with the applicant.
3. Please provide brief details of the requirements of continuous education of the applicant's members.

**PART IV**

**CODE OF CONDUCT**

1. Please state if the Code of Conduct of the applicant is in compliance with the Companies (Registered Valuers and Valuation) Rules, 2017.
2. Please specify the clause number of the provisions of the Code of Conduct which are in addition to the provisions of the model Code of Conduct specified in the Companies (Registered Valuers and Valuation) Rules, 2017 (if any).

**PART V**

**MONITORING AND DISCIPLINE**

1. Please provide details mechanisms employed by the applicant to monitor its members.
2. Please provide details of mechanisms employed by the applicant to redress grievances against its members and itself.
3. Please provide details of disciplinary mechanisms employed by the applicant.

Please provide any other details you consider relevant in support of the application.

Authorised Signatory.

(Name)

(Designation)

Date:

Place:



**FORM-E**

(See sub-rule (5) of rule 13)

**CERTIFICATE OF RECOGNITION REGISTERED VALUERS  
ORGANISATION RECOGNITION NO.**

1. In exercise of the powers conferred by sub-rule (5) of rule 13 of the Companies (Registered Valuers and Valuation) Rules, 2017 the Registration hereby grants a certificate recognising *[insert name]*, as a registered valuers organisation for the valuation of *[insert class(es) of assets]*.

Conditions of Recognition

2. *[Insert Name]* shall admit as members who possess the educational qualifications and experience as specified herein under:
3. Conditions as laid down in rule 14 *[give in detail]*
4. This certificate of recognition shall be valid from *[insert start date]*.

(Name and Designation)

For and on behalf of the Authority

Date:

Place:

**ANNEXURE - III**

(See sub-rule (3) of rule 12 and clauses (f) and (g) of rule 14)

**Governance Structure and Model Bye Laws for registered valuers organisation**

**Part I**

**1. Governance Structure**

No person shall be eligible to be recognised as an registered valuers organisation unless it is a company registered under section 8 of the Companies Act, 2013 with share capital, and –

- (a) its sole object is to carry on the functions of a registered valuers organisation under the Companies Act, 2013;
- (b) it is not under the control of person(s) resident outside India,
- (c) not more than forty-nine per cent. of its share capital is held, directly or indirectly, by persons resident outside India; and
- (d) it is not a subsidiary of a body corporate through more than one layer:
- (e) Explanation: “layer” in relation to a body corporate means its subsidiary;
- (f) itself, its promoters, its directors and persons holding more than ten percent. of its share capital are fit and proper persons.

**2. Registered Valuers Organisation to Have Bye-Laws**

- 1. The registered valuers organisation shall submit to the authority its bye-laws along with the application for its registration as a registered valuers organisation.
- 2. The bye-laws shall provide for all matters specified in the model bye-laws in Part II.
- 3. The bye-laws shall at all times be consistent with the model bye-laws.
- 4. The registered valuers organisation shall publish its bye-laws, the composition of all committees formed, and all policies created under the bye-laws on its website.

**3. Amendment of Bye-Laws**

1. The Governing Board may amend the bye-laws by a resolution passed by votes in favour being not less than three times the number of the votes, if any, cast against the resolution, by the directors.
2. A resolution passed in accordance with sub-bye law (1) shall be filed with the authority within seven days from the date of its passing, for its approval.
3. The amendments to the bye-laws shall come into effect on the seventh day of the receipt of the approval, unless otherwise specified by the authority.
4. The registered valuers organisation shall file a printed copy of the amended bye-laws with the authority within fifteen days from the date when such amendment is made effective.

**4. Composition of the Governing Board.**

1. The Governing Board shall have a minimum of \_\_\_\_ [Insert number] directors.
2. More than half of the directors shall be persons resident in India at the time of their appointment, and at all times during their tenure as directors.
3. Not more than one fourth of the directors shall be registered valuers.
4. More than half of the directors shall be independent directors at the time of their appointment, and at all times during their tenure as directors:

*Provided* that no meeting of the Governing Board shall be held without the presence of at least one independent director.

5. An independent director shall be an individual –
  - (a) who has expertise in the field of finance, law, management or valuation;
  - (b) who is not a registered valuer;

- (c) who is not a shareholder of the registered valuers organisation;  
and
  - (d) who fulfils the requirements under sub-section (6) of section 149 of the Companies Act, 2013.
6. The directors shall elect an independent director as the Chairperson of the Governing Board.
- Explanation* - For the purposes of bye laws, any fraction contained in
- (a) 'more than half' shall be rounded off to the next higher number;  
and
  - (b) 'not more than one- fourth' shall be rounded down to the next lower number.

## PART II

### MODEL BYE-LAWS OF A REGISTERED VALUERS ORGANISATION

#### I. GENERAL

- 1. The name of the registered valuers organisation is “\_\_\_\_\_” (hereinafter referred to as the ‘Organisation’).
- 2. The ‘Organisation’ is registered as a company under section 8 of the Companies Act, 2013 (18 of 2013) with its registered office situated at \_\_\_\_\_ [provide full address].
- 3. These bye-laws may not be amended, except in accordance with this Annexure.

#### II. DEFINITIONS

- 4. (1) In these bye-laws, unless the context otherwise requires -
  - (a) “certificate of membership” means the certificate of membership of the Organisation granted under bye-law 10;
  - (b) “Act” means the Companies Act, 2013 (18 of 2013);
  - (c) “Governing Board” means the Board of Directors or Board of the Organisation as defined under clause (10) of section 2 of Companies Act, 2013 (18 of 2013);

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- (d) “relative” shall have the same meaning as assigned to it in clause (77) of section 2 of the Companies Act, 2013 (18 of 2013);
- (2) Unless the context otherwise requires, words and expressions used and not defined in these bye-laws shall have the meanings assigned to them in the Companies Act, 2013 (18 of 2013).

### III. OBJECTIVES

- 5. (1) The Organisation shall carry on the functions of the registered valuers organisation under the Companies (Registered Valuers and Valuation) Rules, 2017, and functions incidental thereto.
- (2) The Organisation shall not carry on any function other than those specified in sub-clause (1), or which is inconsistent with the discharge of its functions as a registered valuers organisation .

### IV. DUTIES OF THE ORGANISATION

- 6. (1) The Organisation shall maintain high ethical and professional standards in the regulation of its members.
- (2) The Organisation shall –
  - (a) ensure compliance with the Companies Act, 2013 and rules, regulations and guidelines issued thereunder governing the conduct of registered valuers organisation and registered valuers;
  - (b) employ fair, reasonable, just, and non-discriminatory practices for the enrolment and regulation of its members;
  - (c) be accountable to the authority in relation to all bye-laws and directions issued to its members;
  - (d) develop the profession of registered valuers;
  - (e) promote continuous professional development of its members;
  - (f) continuously improve upon its internal regulations and guidelines to ensure that high standards of professional and ethical conduct are maintained by its members; and
  - (g) provide information about its activities to the authority.

**V. Committees of the Organisation**

**Advisory Committee of Members.**

7. (1) The Governing Board may form an Advisory Committee of members of the Organisation to advise it on any matters pertaining to-
  - (a) the development of the profession;
  - (b) standards of professional and ethical conduct; and
  - (c) best practices in respect of Valuation.
- (2) The Advisory Committee may meet at such places and times as the Governing Board may provide.

**Other Committees of the Organisation.**

8. (1) The Governing Board shall constitute-
  - (a) one or more Membership Committee(s) consisting of such members as it deems fit;
  - (b) a Monitoring Committee consisting of such members as it deems fit;
  - (c) one or more Grievance Redressal Committee(s), with not less than three members,;
  - (d) one or more Disciplinary Committee(s) consisting of at least one member nominated by the authority.
- (2) The Chairperson of each of these Committees shall be an independent director of the Organisation.

**VI. Membership**

**Eligibility for Enrolment.**

9. No individual shall be enrolled as a member if he is not eligible to be registered as a registered valuer with the authority:

*Provided* that the Governing Board may provide additional eligibility requirements for enrolment:

*Provided* further that such additional requirements shall not discriminate on the grounds of religion, race, caste, gender, place of birth or professional affiliation.

### Process of Enrolment as Member.

10. (1) An individual may apply for enrolment as a member by submitting an application in such form, in such manner and with such fees as may be specified by the Organisation.
- (2) The Organisation shall examine the application in accordance with the applicable provisions of the rules, regulations and guidelines thereunder.
- (3) On examination of the application, the Organisation shall give an opportunity to the applicant to remove the deficiencies, if any, in the application.
- (4) The Organisation may require an applicant to submit additional documents, information or clarification that it deems fit, within reasonable time.
- (5) The Organisation may reject an application if the applicant does not satisfy the criteria for enrolment or does not remove the deficiencies or submit additional documents or information to its satisfaction, for reasons recorded in writing.
- (6) The rejection of the application shall be communicated to the applicant stating the reasons for such rejection, within thirty days of the receipt of the application, excluding the time given for removing the deficiencies or presenting additional documents or clarification by the Organisation, as the case may be.
- (7) The acceptance of the application shall be communicated to the applicant, along with a certificate of membership.
- (8) An applicant aggrieved of a decision rejecting his application may appeal to the Membership Committee of the Organisation within thirty days from the receipt of such decision.
- (9) The Membership Committee shall pass an order disposing of the appeal in the manner it deems expedient, within thirty days of the receipt of the appeal.

### Membership Fee

11. The Organisation may require the members to pay a fixed sum of money as its annual membership fee.

**Register of Members**

12. (1) The Organisation shall maintain a register of its professional members, containing their-
- (a) name;
  - (b) proof of identity;
  - (c) contact details;
  - (d) address;
  - (e) date of enrolment and membership number;
  - (f) date of registration with the authority and registration number;
  - (g) details of grievances pending against him with the Organisation;
  - (h) details of disciplinary proceedings pending against him with the Organisation; and
  - (i) details of orders passed against him by the authority or Disciplinary Committee of the Organisation.
- (2) The records relating to a member shall be made available for inspection to-
- (a) the authority,
  - (b) any other person who has obtained the consent of the member for such inspection.

**VII. DUTIES OF MEMBERS**

13. (1) In the performance of his functions, a member shall-
- (a) act in good faith in discharge of his duties as a registered valuer;
  - (b) discharge his functions with utmost integrity and objectivity;
  - (c) be independent and impartial;
  - (d) discharge his functions with the highest standards of professional competence and professional ethics;
  - (e) continuously upgrade his professional expertise;



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- (f) comply with applicable laws in the performance of his functions; and
  - (g) maintain confidentiality of information obtained in the course of his professional activities unless required to disclose such information by law.
14. The Organisation shall have a Code of Conduct that shall be consistent with, and that shall provide for all matters in the Code of Conduct as specified in the Annexure-I.

### VIII. MONITORING OF MEMBERS

15. The Organisation shall have a Monitoring Policy to monitor the professional activities and conduct of members for their adherence to the provisions of the Act, rules, regulations and guidelines issued thereunder, these bye-laws, the Code of Conduct and directions given by the Governing Board.
16. A member shall submit information about ongoing and concluded engagements as a registered valuer, in the manner and format specified by the Organisation, at least twice a year stating inter alia, the date of assignment, date of completion and reference number of valuation assignment and valuation report.
17. The Monitoring Committee shall review the information and records submitted by the members in accordance with the Monitoring Policy.
18. The Monitoring Policy shall provide for the following -
- (a) the frequency of monitoring;
  - (b) the manner and format of submission or collection of information and records of the members, including by way of inspection;
  - (c) the obligations of members to comply with the Monitoring Policy;
  - (d) the use, analysis and storage of information and records;
  - (e) evaluation of performance of members; and
  - (f) any other matters that may be specified by the Governing Board.
19. The Monitoring Policy shall –
- (a) have due regard for the privacy of members,

- (b) provide for confidentiality of information received, except when disclosure of information is required by the authority or by law, and
  - (c) be non-discriminatory.
20. The Organisation shall submit a report to the authority in the manner specified by the authority with information collected during monitoring, including information pertaining to -
- (a) the details of the appointments made under the Act/these Rules,
  - (b) the transactions conducted with stakeholders during the period of his appointment;
  - (c) the transactions conducted with third parties during the period of his appointment; and
  - (d) the outcome of each appointment.

**IX. Grievance Redressal Mechanism**

21. (1) The Organisation shall have a Grievance Redressal Policy providing the procedure for receiving, processing, redressing and disclosing grievances against the Organisation or any member of the Organisation by-
- (a) any member of the Organisation;
  - (b) any person who has engaged the services of the concerned members of the Organisation; or
  - (c) any other person or class of persons as may be provided by the Governing Board.
- (2) The Grievance Redressal Committee, after examining the grievance, may-
- (a) dismiss the grievance if it is devoid of merit; or
  - (b) initiate a mediation between parties for redressal of grievance.
- (3) The Grievance Redressal Committee shall refer the matter to the Disciplinary Committee, wherever the grievance warrants disciplinary action.

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22. The Grievance Redressal Policy shall provide for-
- (a) the format and manner for filing grievances;
  - (b) maximum time and format for acknowledging receipt of a grievance;
  - (c) maximum time for the disposal of the grievance by way of dismissal, reference to the Disciplinary Committee or the initiation of mediation;
  - (d) details of the mediation mechanism
  - (e) provision of a report of the grievance and mediation proceedings to the parties to the grievance upon dismissal or resolution of the grievance;
  - (f) action to be taken in case of malicious or false complaints;
  - (g) maintenance of a register of grievances made and resolutions arrived at; and
  - (h) periodic review of the Grievance Redressal Mechanism.

### **X. DISCIPLINARY PROCEEDINGS**

23. The Organisation may initiate disciplinary proceedings by issuing a show-cause notice against members-
- (a) based on a reference made by the Grievances Redressal Committee;
  - (b) based on monitoring of members;
  - (c) following the directions given by the authority or any court of law; or
  - (d) *suo moto*, based on any information received by it.
24. (1) The Organisation shall have a Disciplinary Policy, which shall provide for the following -
- (a) the manner in which the Disciplinary Committee may ascertain facts;
  - (b) the issue of show-cause notice based on the facts;

- (c) disposal of show-cause notice by a reasoned order, following principles of natural justice;
  - (d) timelines for different stages of disposal of show cause notice; and
  - (e) rights and obligations of the parties to the proceedings.
- (2) The orders that may be passed by the Disciplinary Committee shall include-
- (a) expulsion of the member;
  - (b) suspension of the member for a certain period of time;
  - (c) admonishment of the member;
  - (d) imposition of monetary penalty;
  - (e) reference of the matter to the authority, which may include, in appropriate cases, recommendation of the amount of restitution or compensation that may be enforced by the authority; and
  - (f) directions relating to costs.
- (3) The Disciplinary Committee may pass an order for expulsion of a member if it has found that the member has committed-
- (a) an offence under any law for the time being in force, punishable with imprisonment for a term exceeding six months, or an offence involving moral turpitude;
  - (b) a gross violation of the Act, rules, regulations and guidelines issued thereunder, bye-laws or directions given by the Governing Board which renders him not a fit and proper person to continue acting as a registered valuer.
- (4) Any order passed by the Disciplinary Committee shall be placed on the website of the Organisation within seven days from passing of the said order, with one copy each being provided to each of the parties to the proceeding.
- (5) Monetary penalty received by the Organisation under the orders of the Disciplinary Committee shall be used for the professional development.

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25. (1) The Governing Board shall constitute an Appellate Panel consisting of one independent director of the Organisation, one member each from amongst the persons of eminence having experience in the field of law and field of valuation, and one member nominated by the authority.
- (2) Any person aggrieved of an order of the Disciplinary Committee may prefer an appeal before the Appellate Panel within thirty days from the receipt of a copy of the final order.
- (3) The Appellate Panel shall dispose of the appeal in the manner it deems expedient, within thirty days of the receipt of the appeal.

### **XI. Surrender of Membership and Expulsion from Membership**

#### **Temporary Surrender of Membership.**

26. (1) A member shall make an application for temporary surrender of his membership of the Organisation at least thirty days before he-
- (a) becomes a person not resident in India;
  - (b) takes up employment; or
  - (c) starts any business, except as specifically permitted under the Code of Conduct;
  - (d) and upon acceptance of such temporary surrender and on completion of thirty days from the date of application for temporary surrender, the name of the member shall be temporarily struck from the registers of the Organisation, and the same shall be intimated to the authority.
- (2) No application for temporarily surrender of membership of the Organisation shall be accepted if -
- (a) there is a grievance or disciplinary proceeding pending against the member before the Organisation or the authority, and he has not given an undertaking to cooperate in such proceeding; or
  - (b) the member has been appointed as a registered valuer for a process under the Companies Act, 2013, and the appointment of another registered valuer may be detrimental to such process.

- (3) A member may make an application to revive his temporarily surrendered membership when the conditions for temporary surrender as provided in sub-clause (1) cease to be applicable, and upon acceptance of the application for revival, the name of the member shall be re-inserted in the register of the Organisation, and the same shall be intimated to the authority.

**Surrender of Membership**

27. (1) A member who wishes to surrender his membership of the Organisation may do so by submitting an application for surrender of his membership.
- (2) Upon acceptance of such surrender of his membership, and completion of thirty days from the date of such acceptance, the name of the member shall be struck from the registers of the Organisation, and the same shall be intimated to the authority.
28. Any fee that is due to the Organisation from a member surrendering his membership shall be cleared prior to his name being struck from the registers of the Organisation.
29. The Organisation may refuse to accept the surrender of membership by any member if -
- (a) there is any grievance or disciplinary proceeding pending against the member before the Organisation or the authority; or
  - (b) the member has been appointed as a registered valuer process under the Companies Act, 2013, and the appointment of another registered valuer may be detrimental to such process.

**Expulsion from Membership.**

30. A member shall be expelled by the Organisation—
- (a) if he becomes ineligible to be enrolled under bye-law 9;
  - (b) on expiry of thirty days from the order of the Disciplinary Committee, unless set aside or stayed by the Appellate Panel;
  - (c) upon non-payment of membership fee despite at least two notices served in writing;
  - (d) upon the cancellation of his certificate of registration by the authority;
  - (e) upon the order of any court of law.

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<sup>31</sup>ANNEXURE-IV

**Indicative Matrix on requisite qualifications/experience in specified discipline**

(See Explanation II to rule 4)

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

**Note.-** The eligibility qualification means qualification obtained from a recognised Indian University or equivalent whether in India or abroad.

<sup>31</sup> Subs. by the Companies (Registered Valuers and Valuation) Fourth Amendment Rules, 2018, w.e.f. 13-11-2018.