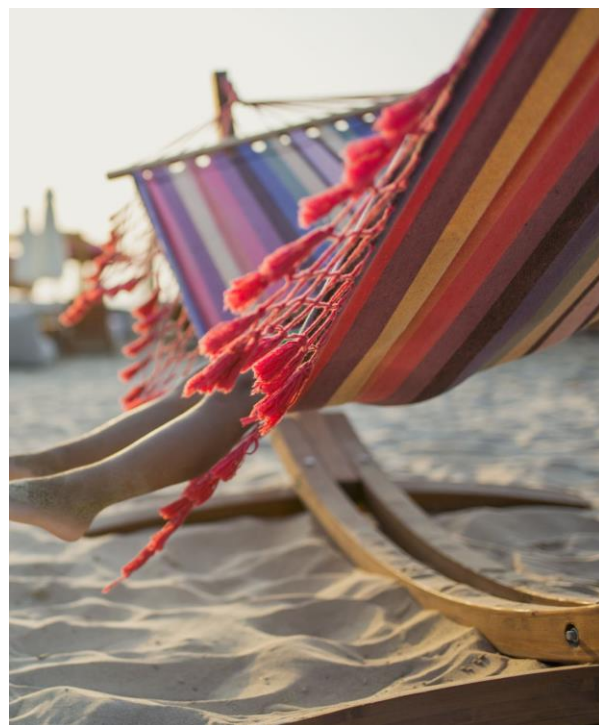

Series of Virtual CPE Meeting's on **Valuation Standards**

Organized by : **Bengaluru Branch of SIRC of ICAI**

**9 hrs.
CPE**
(3 hrs. Per Day)

October 1 2021



MENU

ICAI Valuation Standard 301 - Business Valuation
ICAI Valuation Standard 302 - Intangible Assets
ICAI Valuation Standard 303 - Financial Instruments

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301

Business Valuation



301

- The objective of this Standard is to establish uniform concepts, principles, practices and procedures for valuers performing valuation services.
 - Scope includes all valuation of businesses except where the provisions are inconsistent with any laws
-

VALUATION

- Byjus acquisition of Epic
- 500 million \$= Rs 3750 crores
- Turnover of around 40 million \$
- 12.5 times turnover

Other Metrics

- 50 million children
 - 2 million teachers
-

VALUATION

With revenue of \$253 million and EBITDA of \$42 million in the year ended March 2021, BillDesk's \$4.7 billion valuation is 112 times its EBITDA and 18.6 times its revenue.

The valuation multiples are similar to those of the fastest-growing payment companies in the world. Adyen, a payments company listed in Europe that's considered a proxy for ecommerce growth, trades at 223 times its 2020 trailing operating income and 23 times its revenue. It reported a 37% growth in revenue to \$4.3 billion in 2020 and has a market capitalization of nearly \$100 billion.

Worldline, another payments processing listed in France, is trading at a revenue multiple of 6.38 times and enterprise value multiple of 33.6 times.

SIGNIFICANT ELEMENTS

- Business Valuation is the act or process of determining the value of a business enterprise or ownership interest therein
 - Enterprise Value
 - Business Value
 - Equity Value
-

METHODOLOGY

- define the premise of the value;
 - analyse the asset to be valued and collect the necessary information;
 - identify the adjustments to the financial and non-financial information for the valuation;
 - consider and apply appropriate valuation approaches and methods;
 - arrive at a value or a range of values; and
 - identify the subsequent events, if any
-

PREMISE

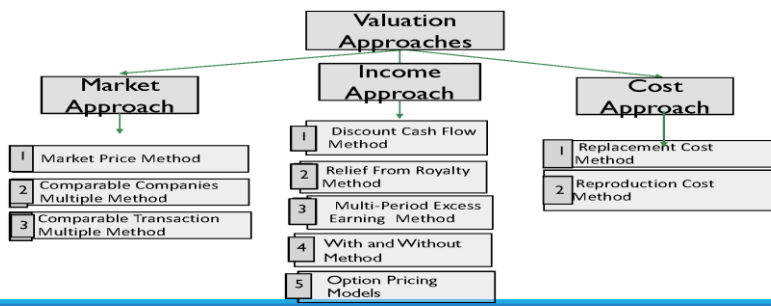
- Premise of the value refers to the conditions and circumstances how an asset is deployed.
 - The premise shall always reflect the facts and circumstances underlying each valuation engagement
-

ASSET ANALYSIS

- nature of the asset to be valued;
 - scope and purpose of the valuation engagement;
 - The valuation date;
 - the intended use of the valuation;
 - the applicable ICAI Valuation Standard;
 - the applicable premise of value;
 - assumptions and limiting conditions; and
 - applicable governmental regulations or regulations prescribed by other regulators or other professional standards;
-

APPROACHES AND METHODS

APPROACHES AND METHODS



MARKET APPROACH

- Market approach is a valuation approach that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) assets, liabilities or a group of assets and liabilities, such as a business
 - The following are the common methodologies for the market approach:
 - Market Price Method;
 - Comparable Companies Multiple Method; and
 - Comparable Transaction Multiple Method.
-

MARKET APPROACH?

- Comparable company transaction method
 - Valuation by stage method
 - VC Exit method
 - 5 times raise method
 - First Chicago method
 - Gross profit * Competitor multiple
 - Risk factor summation method
 - Scorecard Valuation method
 - Berkus method
-

INCOME APPROACH

- Income approach is the valuation approach that converts maintainable or future amounts (e.g., cash flows or income and expenses) to a single current (i.e. discounted or capitalised) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.
-

COST APPROACH

- Cost approach is a valuation approach that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
 - The following are the commonly used valuation methods under the cost approach:
 - (a) Replacement Cost Method; and
 - (b) Reproduction Cost Method.
-

LIQUIDATION VALUE

- Realisable Value of Assets
 - Settlement Value of Liabilities
-

BENCHMARKING

- Rule of thumb or benchmark indicator is used as a reasonable check against the values determined by the use of other valuation approaches in a valuation engagement.
 - It shall not be used as the only method to determine the value of the asset to be valued.
-

SPECIFIC REQUIREMENTS

- Non-operating assets should be valued based on their realisable values net of costs and outgoes and added to the value arrived under the various approaches to derive the value for ownership interest.
 - Inter-company adjustments or substantial cross holdings between companies in the business valuations should be considered at fair value
-

CAPITAL STRUCTURE

- Assigning value to equity and debt
- Equity is residual after removing debt

VALUE

- Value is an estimate of a business or business ownership interest, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.
-

302

INTANGIBLE ASSETS

OBJECTIVE

- The objective of this Standard is to prescribe specific guidelines and principles which are applicable to the valuation of intangible assets that are not dealt specifically in another Standard.
-

WHEN?

- Business Combinations
 - Impairment Testing
 - TP
 - Intangible Asset purchase
 - insurance, such as determining the personal worth of a celebrity/football franchise/cricket franchise
-

INTANGIBLE ASSET?

- Computer Software
 - An intangible asset is an identifiable non-monetary asset without physical substance
-

GOODWILL

- The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill.
 - Goodwill is defined as an asset representing the future economic benefits arising from a business, business interest or a group of assets, which has not been separately recognised in another asset
-

TYPES

- Customer-based intangible assets;
 - Marketing-based intangible assets;
 - Contract-based intangible assets;
 - Technology-based intangible assets; or
 - Artistic-based intangible assets.
-

EXAMPLES

TYPE	EXAMPLE
Customer-based	Customer Contracts, Lists, Relationships
Marketing-based	Trade mark, Brand, Trade design
Contractual	Lease, non-compete, licensing, royalty
Technology-based	Patents, know-how, Software
Artistic based	Films, books, music

SIGNIFICANT CONSIDERATIONS

- to determine the purpose and objective of the overall valuation assignment;
 - to consider the legal rights of the intangible asset to be valued, for example, a registered trademark may have a higher value as compared to an unregistered trademark. However, an unpatented technology (as not in public domain) may have a higher value than a patented technology;
 - to evaluate the highest and best use considerations;
 - to assess the history and development of the intangible asset; or
 - to consider any specific laws or regulations guiding the intangible asset valuation in the country, for example, royalty payments in India are regulated
-

USEFUL LIFE

- Finite or indefinite
 - Customer relationships dependent on the attrition. Attrition refers to the possible expected loss of customers which is based on the historical behavior of customers. Historical attrition can be based on the following:
 - Variable loss rate: dependent on the age of customer relationship;
 - Constant loss rate: calculated as a percentage of previous year's
 - parameters
-

DISCOUNT RATES

- Discount Rate is the return expected by a market participant from a particular investment and shall reflect not only the time value of money but also the risk inherent in the asset being valued as well as the risk inherent in achieving the future cash flows.
 - In case of a business valuation or valuation of all assets, a valuer shall determine the Weighted Average Return on Assets (WARA) to confirm the reasonableness of the discount rate / WACC so considered for valuation of the intangible asset. WARA is the expected rate of return on a particular asset and can be determined based on the riskiness involved for a particular asset.
-

TAB

- Tax Amortisation Benefit (TAB) is a hypothetical benefit available to a market participant by way of amortisation of the acquired intangible assets, thereby reducing the tax burden.
-

MARKET APPROACH

- The following are the common methodologies for the market approach:
 - Price/Valuation multiples/Capitalisation rates;
 - Guideline pricing method.
-

INCOME APPROACH

- Income approach is the valuation approach that converts maintainable or future amounts (e.g., cash flows or income and expenses) to a single current (i.e. discounted or capitalised) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.
-

METHODS

- Relief-from-royalty-method;
 - Multi-period Excess Earnings Method (MEEM);
 - With-and-Without method or premium profit method;
 - Greenfield method; and
 - Distributor method
 - Relief-from-royalty-method
-

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 it had been taken on lease from another party
-

STEPS

- obtain the projected income statement associated with the intangible asset to be valued over the remaining useful life of the said asset
 - analyse the projected income statement and its underlying assumptions to assess the reasonableness.
 - select the appropriate royalty rate based on market-based royalty rates for similar intangible assets
 - apply the selected royalty rate to the future income attributable to the said asset
-

STEPS

- use the appropriate marginal tax rate or such other appropriate
 - tax rate to arrive at an after-tax royalty savings.
 - 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.
-

RFR

Tradename (\$millions)	2011	2012	2013	2014	2015	Residual
Revenues	1,016	1,091	1,146	1,203	1,264	1,327
Royalty Rate	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
Royalty Savings	36	38	40	42	44	46
Taxes	35.0%	(12)	(13)	(14)	(15)	(16)
After-Tax Royalty Savings	23	25	26	27	29	30
Long-term Growth	2.5%					216
Discount Periods	0.5	1.5	2.5	3.5	4.5	4.5
Discount Factor	16.5%	0.93	0.80	0.68	0.59	0.50
Present Value	21	20	18	16	14	108
Total	198					
TAB	29					
Fair Value	227					

5 Tax Basis

- Assumption of depreciable tax basis for asset

4 Discount Rate

- Cost of equity
- Indefinite life
- Revenue growth risk
- Brand recognition, competition, and margin
- WARA

1 Revenues

- Based on forecast for all branded revenues

2 Royalty Rate

- Comparable research range of 2% to 6%

Brand Margin	B2B	Retail	Diff
Product Price	50	100	50
Marketing Cost	6	8	3
Net Profit	44	92	47
%	89%	92%	3%

3 Life

- Assumption of an indefinite life

MEEM

- 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)
-

STEPS

- 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;
 - analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
 - 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;
 - the CAC represent the charges for the use of an asset or group
 - 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
 - Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset
-

MEEM

		2011	2012	2013	2014	2015	2016
Revenues	1	945	992	1,042	1,094	1,149	1,206
Customer Erosion	20.0%	80%	64%	51%	41%	33%	26%
Existing Customer Rev.		756	635	533	448	376	316
COGS		440	368	309	261	218	183
Operations		74	60	49	40	33	27
S&M	3	-	-	-	-	-	-
G&A	2	19	15	12	10	8	7
EBITDA		223	192	164	137	117	99
Depreciation		73	57	46	37	29	24
EBIT		151	135	118	100	87	76
Taxes	35.0%	53	47	41	35	31	27
Fixed Assets	3.3%	25	21	18	15	13	11
Brand	2.3%	17	14	12	10	9	7
Working Capital	0.7%	5	4	4	3	3	2
License	0.8%	6	5	4	4	3	3
Workforce	0.3%	3	2	2	2	1	1
		42	40	37	32	29	26
Discount Periods		0.5	1.5	2.5	3.5	4.5	5.5
Discount Factor	5	0.93	0.81	0.71	0.61	0.53	0.46
Present Value		39	33	26	20	15	12
Discrete Period	144						
Residual	31						
Total	175						
TAB	28						
Fair value	6	203					

1 Revenues
<ul style="list-style-type: none"> Based on overall forecast revenues for the business, assuming: <ul style="list-style-type: none"> Existing subscribers will experience 20% annual attrition Existing subscribers revenues, net of attrition, will grow at the same rate as new subscribers On-demand revenues are attributable to technology rather than customers
2 Costs
<ul style="list-style-type: none"> COGS, operating costs, G&A, and depreciation assumed to attribute to existing customer revenues on a pro-rata basis with new customer revenues
3 S&M Costs
<ul style="list-style-type: none"> S&M costs excluded assuming no incremental selling costs to existing customers, and a brand CAC to cover general marketing
4 Contributory Asset Charges
<ul style="list-style-type: none"> Next Slide
5 Discount Rate
<ul style="list-style-type: none"> Reflects cost of equity, adjusted for risk profile
6 Tax Basis
<ul style="list-style-type: none"> Assumption of depreciable tax basis for asset

WITH AND WITHOUT METHOD

- Under this method, 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 :
 - business with all assets in place including the intangible asset to be valued; and
 - business with all assets in place except the intangible asset to be valued.
-

STEPS

- obtain the projections comprising revenue, expenses, working capital and capital expenditure under both scenarios
 - discounted the projections obtained under two scenarios to present value using an appropriate discount rate;
 - 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
 - Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset
-

WAW

	2011	2012	2013	2014	2015	Residual	
Regular	945	992	1,042	1,094	1,149		
On-Demand				55	86		
Revenues ¹	945	992	1,042	1,149	1,235		Revenues • Based on overall forecast revenues for the business, excluding on-demand revenues assuming: • Pre-revenue 'build' period of 3 vs. 5 year • Equivalent ramp-up pattern towards 10% of regular subscribers
Regular	520	546	573	602	632		
On-Demand				35	35		
COGS	520	546	573	637	667		
Operations	93	93	96	103	108		
S&M	127	128	131	141	148		
G&A ³	23	23	24	26	27		
R&D ³	20	20	20	13	13		Costs • COGS, Operating Costs, S&M, G&A based on proration of total revenues between regular vs. on-demand business – assumed incremental to on-demand business (capital costs excluded)
EBITDA	162	182	199	230	272		
Depreciation	98	98	98	99	99		
EBIT	64	84	100	131	173		
Taxes ^{35%}	22	29	35	46	61		
After-tax earnings	139	153	164	184	212		
Capital Expenditures	100	100	100	100	100		
Working Capital	4	4	4	9	7		
	36	49	60	75	105		
Long-term Growth ^{2.5%}						1,438	
Discount Periods	0.5	1.5	2.5	3.5	4.5	4.5	
Discount Factor ^{13.5%}	0.94	0.83	0.73	0.64	0.57	0.57	
Present Value	33	41	43	48	59	813	
Without Technology	1,038						
With Technology	1,192						
Technology Value	361						
TAB	28						
Fair Value	188						

With vs Without

- Deduct value of business with technology vs. without
- Assumption of depreciable tax basis for asset, not businesses

Residual

- Reflects original residual value after ramp-up period (including WACC)

Discount Rate

- Reflects heightened risk to overall business over ramp-up period

GREENFIELD METHOD

- The basic assumption for valuation using the greenfield method is that the intangible asset to be valued is the only asset with all other tangible or intangible assets being created, leased or acquired.
 - Instead of the contributory asset charge generally deducted from the cash flows, a valuer is required to subtract replacement cost of the asset that is required to be built or bought.
-

STEPS

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

GREENFIELD

		2011	2012	2013	2014	2015	Residual	
Revenue	Regular	102	305	508	813	900		1
	On-Demand	-	-	-	-	45		
		102	305	508	813	945		
COS	Regular	56	168	279	447	495		1
	On-Demand	-	-	-	20	40		
		56	168	279	467	535		
Gross Profit		46	137	229	346	410		
Operating Costs		15	40	60	80	85		
R&D		3	10	20	15	12		
		18	50	80	95	97		
S&M		35	55	65	100	120		
G&A		5	10	15	20	24		
EBITDA		(12)	22	69	131	169		
		-12%	7%	14%	16%	18%		
Capex		370	150	120	110	110		
Working Capital		8	16	16	24	11		
		(390)	(144)	(68)	(4)	48		
Residual Value							1,199	2
Discount Periods		0.5	1.5	2.5	3.5	4.5	4.5	
Discount Factor	20%	0.9	0.8	0.6	0.5	0.4	0.4	
Present Value		(356)	(110)	(43)	(2)	21	528	
Total		38						
Tax Amortization Benefit		5						4
Fair Value of License		43						

Revenues

- Assumed original 2005 through 2010 start-up costs would be equally applicable as at valuation date, including ramp-up and commercialization pattern, margins, and capital costs, with the exception of:
 - Reduced time-period by 1 year, assuming 2005 activities could be truncated
 - Excluded year 1 start-up costs for G&A and operations (\$15 million), assuming these costs relate to licensing activities

Residual Value

- Based on current purchase price as representative of exit value

Discount Rate

- Reflective of 'start-up' type required rates of return

Tax Basis

- Assumption of depreciable tax basis for asset

DISTRIBUTOR METHOD

- This is a variation of MEEM and is adopted for valuation of customer-based assets when MEEM is applied to value another intangible asset (considered to be more significant). The fundamental assumption used in this method is that cash flows of each segment of a particular business are expected to generate profits
-

STEPS

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

COST METHODS

- Reproduction Cost Method
 - Replacement Cost Method
-

303

FINANCIAL INSTRUMENTS

BASICS

- Considering the multiple categorisation and different usages of a financial instrument valuation, detailed consideration of purpose of valuation and the features of the instrument being valued is essential to identify the relevant information available to be perused for valuing the instrument
-

METHOD

- Financial instruments being generally aligned to market linked factors, the usage of market linked methods with observable inputs is usually the preferred approach to arrive at a value. Valuation of certain financial instruments, for example, equity instruments, may in situations be based on the inherent business valuation from which the financial instrument derives value
-

METHODS

- A valuer shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure the value, maximising the use of relevant observable inputs and accordingly minimising the use of unobservable inputs.
-

RISKS

- Counterparty risk
 - Capital leveraging
 - Security hierarchy
 - Collateral and default protection
 - History of default
-

CONTROL ENVIRONMENT

- A valuer placing reliance upon an internally performed valuation, shall consider the reliance on the control environment, its adequacy and independence.
-

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