Other Methods of Valuation and Common Errors in Valuation Reports/Valuation

Contents

- Valuation Methodologies
- Market Approach (CCM and CTM) and Challenges
- Market Approach (Market Price) and Challenges
- Asset Approach (NAV)
- Common Pitfalls in Application of Valuation Methods
- Common Errors in Valuation Report
- Key Takeaways

Valuation Methodologies

- Why can two valuers arrive at different values?

Method	Value (INR Crs)
DCF	1,050
CCM	900
CTM	1,125
NAV	675

- Which value is correct?

- All of them could be correct depending on purpose, assumptions and methodology.

Valuation Methodologies

Asset Approach

- Net Asset Value (NAV)
- Liquidation Value

- Generally, combination of methods are preferred
- Approaches are not exclusive; but complement each other
- More than one right way to value

Market Approach

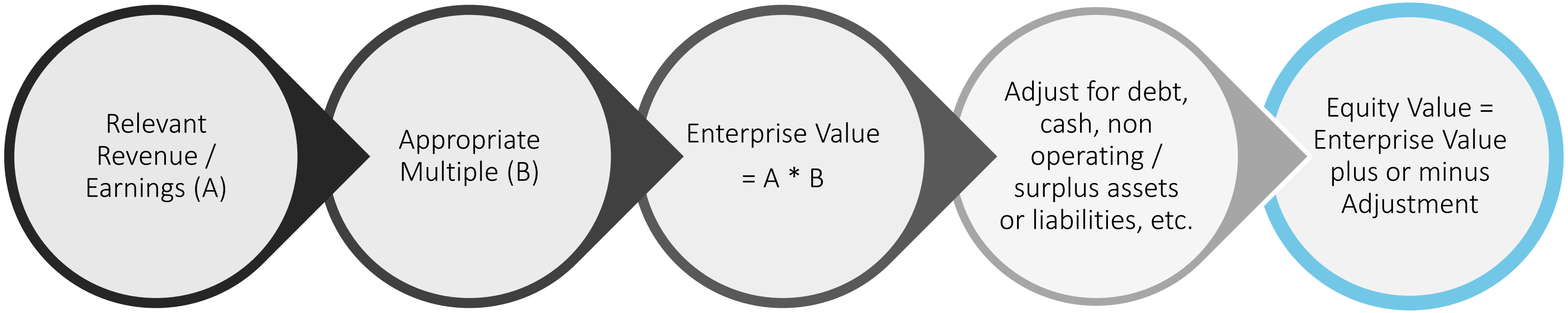
- Market Price
- Comparable Companies Multiples Method (CCM)
- Comparable Transactions Multiples Method (CTM)

Earnings Approach

- Discounted Cash Flow Method (DCF)
- Earnings Capitalisation

Market Approach – CCM and CTM

Comparable Companies Multiples (CCM)	Comparable Transactions Multiples (CTM)
Multiples/Benchmarks of listed companies	Multiples/Benchmarks of transactions
Typically produces a minority value since market prices reflect minority trading interests	Generally provides a control value as transaction prices often include a control premium
Principle of substitution: investors compare with similar listed businesses	Principle of substitution: buyers compare with similar acquisition transactions
Reflects current market sentiment and readily available data	Captures actual acquisition pricing and control considerations
Common multiples used - EV/Revenue, EV/EBITDA, P/E, EV/EBIT	Common multiples used - EV/Revenue, EV/EBITDA, EV/EBIT, implied acquisition multiples



Challenges - CCM

The primary challenge lies in selection of the **right set of companies**.

Niche Sector

- Few listed peers available.
- Peers may be from adjacent industries.
- Multiples are often driven by company specific factors

Trading % of Comparable Company

- Market sentiment and liquidity play an important role.
- Values can be distorted by cyclical turns.

Local vs. Global Set

- Local Comparables: More relevant but can be limited at times.
- Global Comparables: Larger sample but different market conditions.
- Currency, accounting practices and market differences reduce comparability.

Choosing the Right Metric

- EV/Revenue
- P/E
- EV/EBITDA

Challenges - CTM

The primary challenge lies in selection of the truly comparable transactions.

Data Availability and Reliability

- Limited access to transaction details.
- Disclosed information may be incomplete.
- Data quality varies across transactions.

Stake and Control Differences

- Valuation varies by ownership stake acquired.
- Control premiums can distort comparability.
- Illiquidity impacts transaction pricing.

Pre-Money vs. Post-Money Valuation

- Incorrect treatment can skew valuation.
- Requires consistent basis for comparison.
- Deal structures may differ significantly.

Shareholder Agreement (SHA) Rights

- Special rights may affect transaction value.
- Liquidation preferences can inflate pricing.
- Transaction premiums may include contractual benefits.

Market Approach – Market Price Method

- Valuation derived from the quoted market prices of the shares of the company.
- Volume weighted average price (VWAP) of the shares as quoted on a recognized stock exchange over appropriate period.
- Time horizon:
  - Most recent – Generally periods of **3 / 6 / 9 months** should be computed to do a trend analysis
- The prices from the stock exchange where the trading volumes are higher to be considered.
- Regularly and freely traded with adequate volumes.
  - Generally a threshold of **10% trading over the last 12 months** – frequently traded.
- Changes in capital structure of the company – bonus / split etc. to be factored accordingly.
- Price during unaffected period.

Challenges – Market Price Method

Market prices may be influenced by regulatory requirements, liquidity, and short-term market movements, rather than intrinsic value.

SEBI Preferential Issue Guidelines

- Valuation must comply with SEBI-prescribed pricing norms.
- Formula-based pricing may differ from fair market value.
- Historical trading prices may not reflect current fundamentals.

SEBI Takeover Regulations

- Open offer pricing is determined by regulatory guidelines.
- Control premiums may influence valuation.
- Regulatory pricing may differ from prevailing market sentiment.

Other Challenges

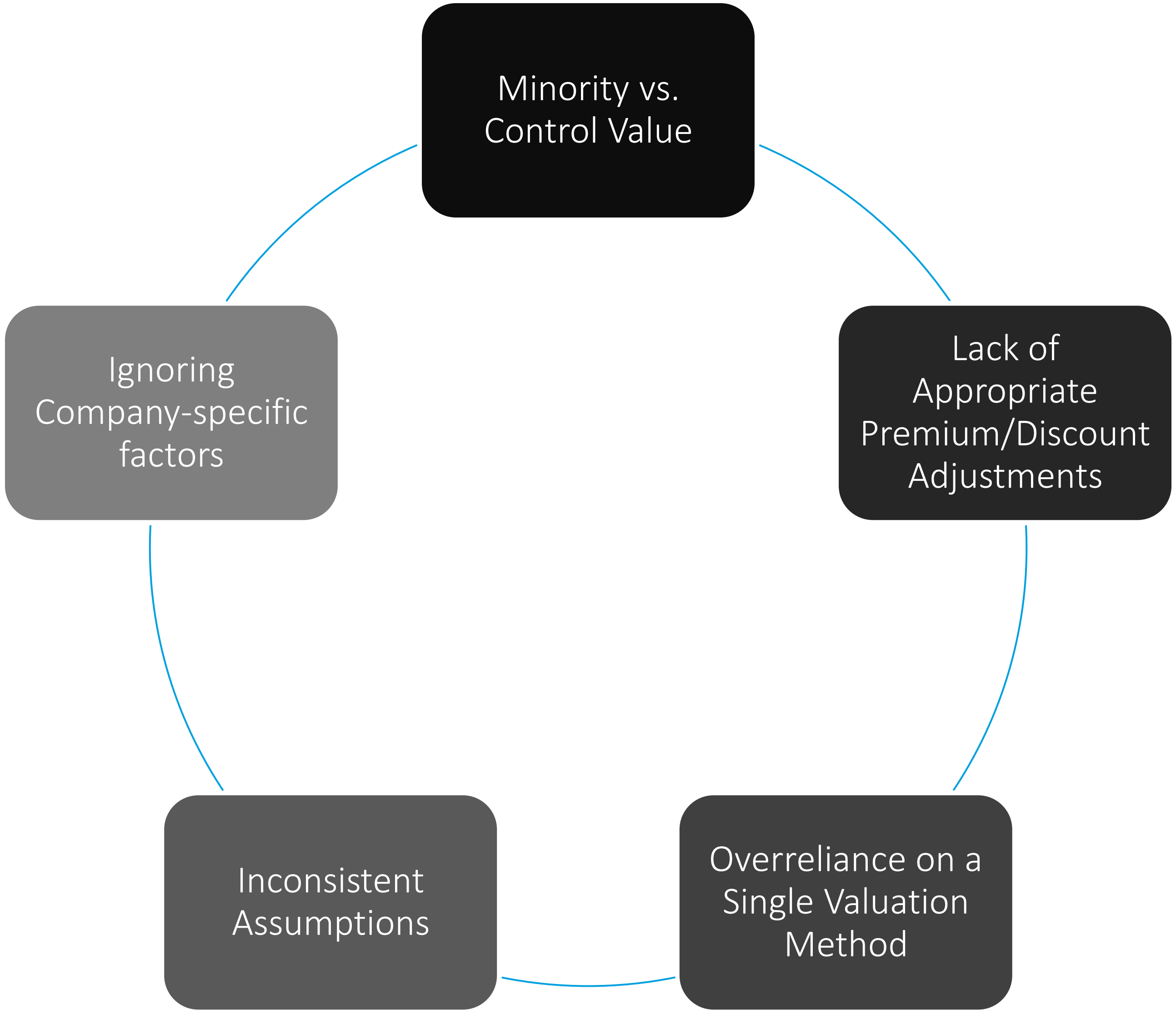
- Low trading liquidity can distort market prices.
- Short-term market sentiment may impact valuation.
- Economic, industry, or company-specific events can cause price volatility.

Asset Approach – Net Asset Value (NAV) Method

- Value based on :
  - Historical Book Value OR
  - Replacement Cost OR
  - Realizable Value

  of underlying assets and liabilities
- Relevant in the case of liquidation of a company or in the case of a company where the earning potential of a company is not getting captured appropriately under the Income or Market approaches.
- Relevant for evaluating surplus/non-operational assets and contingent/off-balance sheet liabilities
- **Generally not used since valuations are carried out on a going concern basis without an intention to dispose off operating assets.**

Common Pitfalls in Application of Valuation Methods



Common Pitfalls in Application of Valuation Methods

Minority vs. Control Value

- Market-based valuations often reflect minority shareholder value.
- Applying minority value to a controlling stake without adjustment can undervalue the business.
- Control valuations may require a control premium for decision-making rights and strategic flexibility

Lack of appropriate premiums / discounts

- Failure to adjust for control premium or minority discount.
- Ignoring discount for lack of marketability (DLOM) in private companies.
- Can lead to significant overvaluation or undervaluation

Overreliance on a Single Valuation Method

- Different methods capture different value drivers.
- Using only one method may produce a biased outcome.
- Triangulating across methods improves reliability.

Common Pitfalls in Application of Valuation Methods

Inconsistent Assumptions

- Different growth, margin, or risk assumptions across methods.
- Lack of consistency reduces credibility of valuation conclusions.
- Small assumption changes can materially affect value.

Ignoring Company-Specific Factors

- Unique risks, customer concentration, or key person dependency may be overlooked.
- Historical performance may not reflect future prospects.
- Generic market multiples may not capture business-specific characteristics.

Valuation conclusions can be misleading if ***ownership rights, liquidity, and appropriate adjustments are not correctly considered.***

Common Errors in Valuation Report

Purpose

- Unclear valuation objective
- Methodology not aligned to purpose

Valuation Date

- Incorrect or inconsistent valuation date
- Events considered beyond the valuation date

Triangulation

- Reliance on a single method
- Inadequate cross-checking of results

Mathematical Accuracy

- Calculation errors
- Formula and linkage mistakes

Source of Data

- Unverified or outdated information
- Inadequate disclosure of data sources

Scope Limitations

- Key assumptions not disclosed
- Limitations not adequately stated

Client Details

- Incorrect client/entity identification
- Misalignment with engagement terms

Access and Reliance

- Insufficient access to information
- Overreliance on management representations

Key Takeaways

- No single valuation method is sufficient; use multiple approaches and triangulate results.
- Selection of peers and transactions is critical and often has the biggest impact on valuation outcomes.
- Understand the ownership being valued: minority, control, marketable, or illiquid interests require appropriate adjustments.
- Valuation multiples are context-driven and should be interpreted considering industry, growth, risk, and market conditions.
- Regulatory requirements (SEBI, Companies Act, FEMA, etc.) may influence valuation methodology and conclusions.
- Professional judgment is as important as technical calculations in arriving at a reasonable valuation.
- Accurate data, clear assumptions, and transparent disclosures are fundamental to a credible valuation.
- A valuation report should clearly state its purpose, scope, limitations, and basis of value.
- Valuation is an estimate of value, not an exact science, and should be viewed as a range supported by analysis.

Robust valuations combine ***sound methodology, reliable data, professional judgment*** *and* ***transparent reporting****.*

Thank You