KIRTANE & PANDIT LLP

Chartered Accountants

Adding Valuation as a practice area

Discounted Cash flow Valuation

CA Gaurav Sukhija
Partner
Registered Valuer
Kirtane and Pandit LLP
M. Com, B. Com (Hons)
ex – Deloitte
+91-99118 14171
Gaurav.sukhija@kirtanepandit.com

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Experience

- Gaurav is **Partner – National leader** with the Valuations and Transaction advisory practice of Kirtane & Pandit and is based out of New Delhi. Gaurav is a registered valuer under IBBI.
- Gaurav has work experience spread across providing valuation advisory, Due Diligence, M&A tax.
- As a valuation professional, Gaurav has undertaken valuations of businesses (equity & enterprise); tangible assets & intangible assets like brands, patents and customer relationships; financial instruments and loan assets to assist clients in their strategic (M&A, litigation support, fund raising, corporate restructuring) etc.
- Gaurav has worked with Deloitte in the Financial Advisory Services divisions and with SS Kothari Mehta & Company in the Mergers and Acquisition division.
- Gaurav has performed several roles ranging from audits, compliances to advisory during the course of his career, which gives him a view and understanding of the overall operations of the company. His clients include multi-national corporations, multi-lateral institutions, and Indian companies in the private and public sector and government agencies.
- Gaurav has done valuation for industries such as IT, ITes, Startups, fund houses, Manufacturing entities, Automobile company, Trading entities and block chain based companies.

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Valuation as a topic

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Valuation regulatory requirements

- Valuation for issue and transfer of shares and convertible or redeemable instruments of indian companies under section 56 of the **Income Tax Act**
- Valuation for determination of capital gains tax under section 50ca of the **Income Tax Act**
- Valuation for indirect transfer of shares of foreign company where significant business operations lie in india under section 9 of the **Income Tax Act**
- Valuation for issue of shares and convertible instruments of Indian companies under **Companies Act 2013**
- Valuation for issue of shares and fully convertible instruments of Indian companies under **RBI FDI** regulations
- Valuation for acquisition / investment into shares of foreign companies under **RBI ODI** regulations
- Valuation **M&A** under section 230-232 of the **Companies Act** for the purposes of business combinations
- **Purchase Price Allocation** in case of acquisition of assets for financial reporting purposes
- Valuation for preferential allotment and takeover code as per **SEBI** regulations
- Valuations under **SEBI** alternate investment fund regulations
- Valuation of **sweat equity shares**
- Valuation for assets of corporate debtor (liquidation value and fair value) as per **Insolvency & Bankruptcy Code**
- Valuations for financial reporting purposes under **IND AS** (purchase price allocation, fair value under **IND AS 113**, impairment assessment under **IND AS 36**, financial instruments under **IND AS 109, IND AS 32** and **IND AS 107** etc.

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Valuation regulatory requirements

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Purpose	Regulatory	Accounting	Dispute Resolution
• Merger • IPO • Acquisition/ investment • Internal management analsys • Intangible asset valuation	• Income tax act • SEBI • RBI- FEMA • Companies Act • IBBI	• ESOP • Purchae price allocation • Impairment analysis • 409(A) US ESOP valuations	• Company Law • Court order • Mediation • Arbitration

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Valuation regulatory requirements

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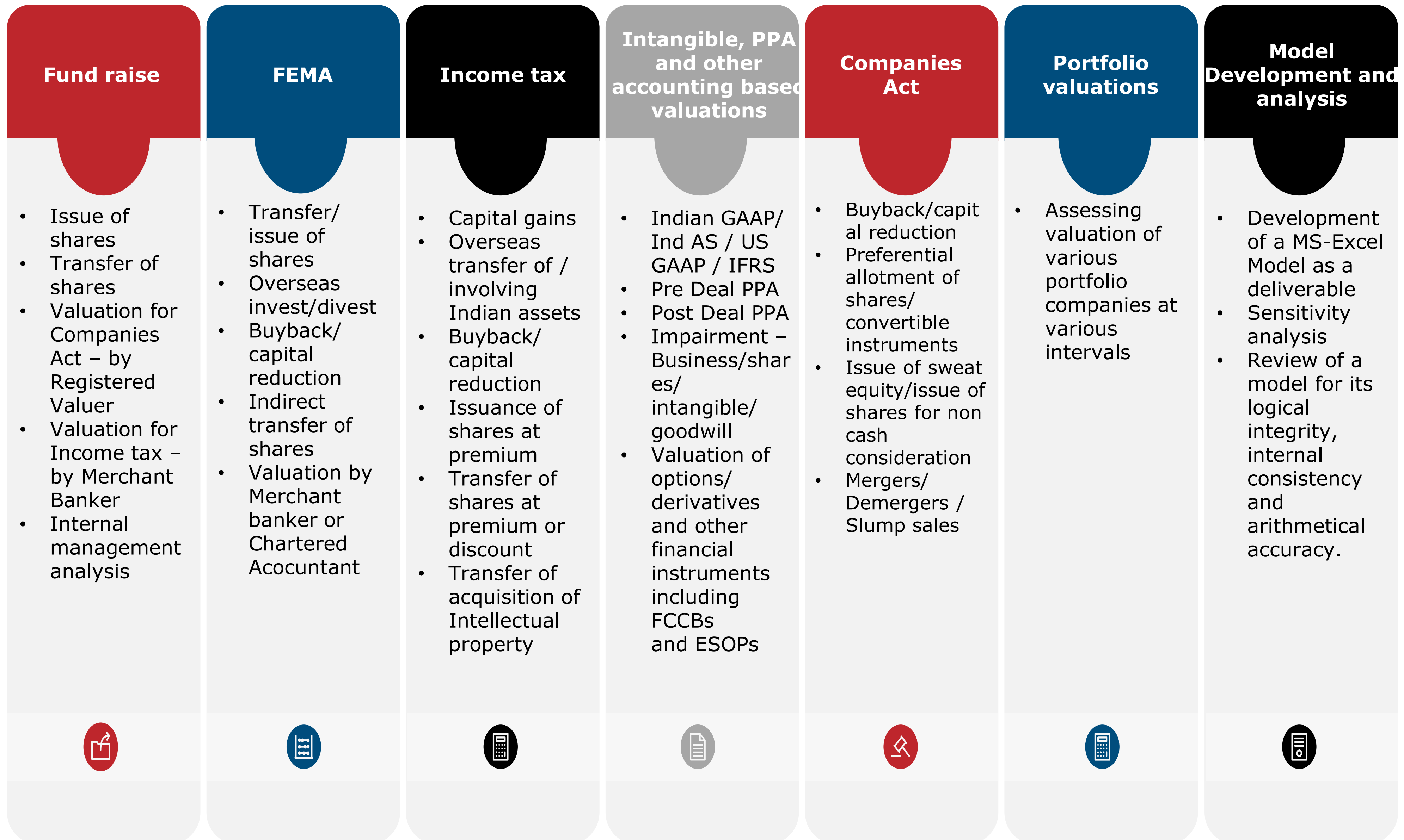

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What is a Startup?

i. Upto a period **of ten years** from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India.

ii. **Turnover** of the entity for any of the financial years since incorporation/ registration has not exceeded **One Hundred Crore Rupees**.

iii. Entity is working **towards innovation, development or improvement of products or processes or services,** or if it is a scalable business model with a high potential of employment generation or wealth creation.

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Should startup take exemption ??

It has not invested in any of the following assets,–

a) **building or land** appurtenant thereto, being a residential house, other than that used by the Startup for the purposes of renting or held by it as stock-in-trade, in the ordinary course of business;
b) **land or building, or both, not being a residential house**, other than that occupied by the Startup for its business or used by it for purposes of renting or held by it as stock-in trade, in the ordinary course of business;
c) **Loans and advances**, other than loans or advances extended in the ordinary course of business by the Startup where the lending of money is substantial part of its business;
d) **capital contribution** made to any other entity;
e) **shares and securities**;
f) **a motor vehicle, aircraft, yacht or any other mode of transport**, the actual cost of which exceeds ten lakh rupees, other than that held by the Startup for the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business;
g) **jewellery** other than that held by the Startup as stock-in-trade in the ordinary course of business;
h) any other asset, whether in the nature of capital asset or otherwise, of the nature specified in sub-clauses (iv) to (ix) of clause (d) of Explanation to clause (vii) of sub-section (2) of section 56 of the Act.

Provided the Startup shall not invest in any of the assets specified in sub-clauses (a) to (h) for the **period of seven years** from the end of the latest financial year in which shares are issued at premium

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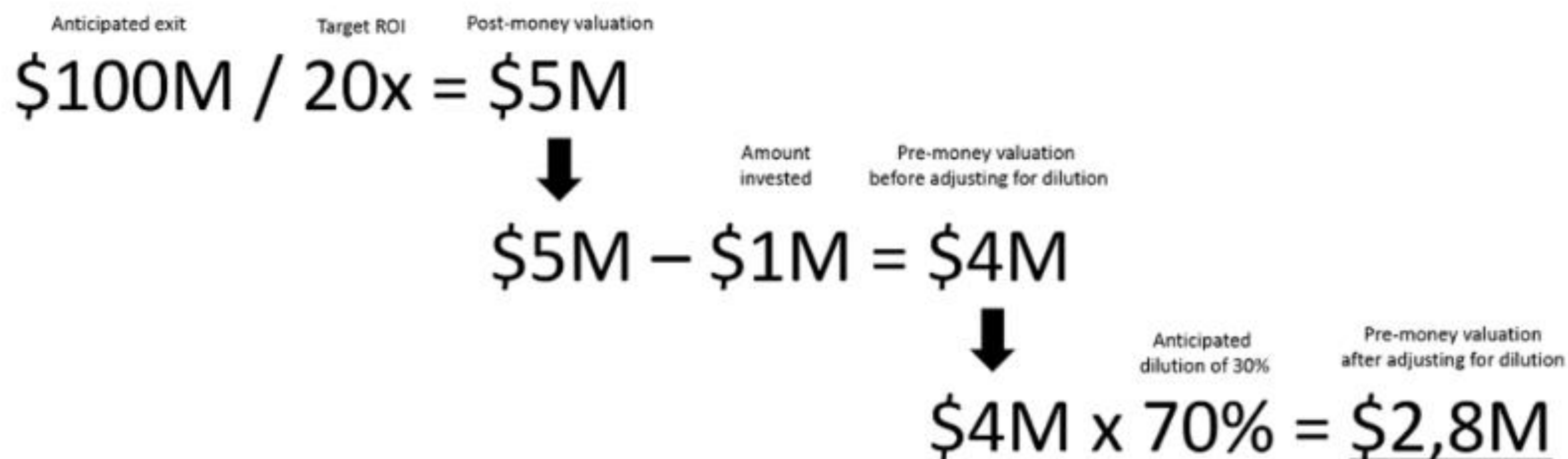
Valuation methodologies



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The Berkus Method

For a box expected to reach at least $20M in revenue by year 5

1.	Sound idea (basic value)	**$300k**
2.	Prototype (technology)	**$500k**
3.	Quality management team (execution)	**$300k**
4.	Strategic relationships (go-to-market)	**$200k**
5.	Product rollout or Sales	**$100k**

BOX PRE-MONEY VALUATION (max. $2M) $1,400,000

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The Risk Factor Summation Method

INITIAL VALUE				**$1,500,000**
1.	MANAGEMENT RISK	*Very low*	*+$500,000*	$2,000,000
2.	STAGE OF THE BUSINESS	*Normal*		
3.	LEGISLATION/POLITICAL RISK	*Normal*		
4.	MANUFACTURING RISK	*Normal*		
5.	SALES AND MANUFACTURING RISK	*Normal*		
6.	FUNDING/CAPITAL RAISING RISK	*Normal*		
7.	COMPETITION RISK	*Very high*	*-$500,000*	$1,500,000
8.	TECHNOLOGY RISK	*Low*	*+$250,000*	$1,750,000
9.	LITIGATION RISK	*Very low*	*+$500,000*	$2,250,000
10.	INTERNATIONAL RISK	*Normal*		
11.	REPUTATION RISK	Very low	+$500,000	$2,750,000
12.	POTENTIAL LUCRATIVE EXIT	Normal		
BOX VALUATION				**$2,750,000**

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The Scorecard Valuation method

		Weight	vs. average project
1.	TEAM CAPACITY	*40%*	125%
2.	PRODUCT/TECHNOLOGY READINESS	30%	100%
3.	MARKET SIZE	20%	15%
4.	COMPETITION	10%	75%

***

INITIAL VALUE	$1,500,000
MULTIPLIER	117,5%
BOX VALUATION	**$1,760,250**

Your box is 17,5% better than an average similar box.

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Valuation process

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Valuation methodologies

There are several commonly used and accepted methods for determining the value of shares / businesses, which one can apply in the present valuation exercise, to the extent relevant and applicable, such as:

PWC research -

The primary valuation approaches remain the income approach (discounted cash flow) and market approach (based on market multiples). The general indication from respondents is that the income approach remains the primary valuation methodology, used by 58% of respondents, while the market approach is also an important methodology, with 42% of the respondents using it as their preferred approach.

Cost approach

- **Net asset value ("NAV"):** The asset based valuation approach is based on the underlying net assets and liabilities of the company on a book / replacement / realisable value basis.

Market approach

- **Market prices method:** The valuation derived from the quoted market prices of the shares of the subject company.
- **Comparable companies multiples method ("CCM"):** An approach that entails looking at market quoted prices of comparable companies and converting that into the relevant multiples. The relevant multiple after adjusting for factors like size, growth, profitability, etc is applied to the relevant financial parameter of the subject company.
- **Comparable transactions multiples method ("CTM"):** Valuation based on price paid in recent transactions which includes reviewing published data on actual transactions involving either minority or controlling interests in either publicly traded or closely held companies. Similar to comparable companies analysis, the transaction price is converted into a relevant multiple and applied, after adjustments for factors like size, growth, profitability, control etc. to the relevant financial parameter of the subject company.

Income approach

- **Discounted cash flow method ("DCF"):** Discounts forecasted cash flows to the present using a relevant discount rate. The discount rate, weighted average cost of capital ("WACC") or cost of equity ("CoE") (depending on the cash flows being used), reflect the return expectations from the asset depending on the inherent risks in the cash flows.

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Discounted Cash flow method

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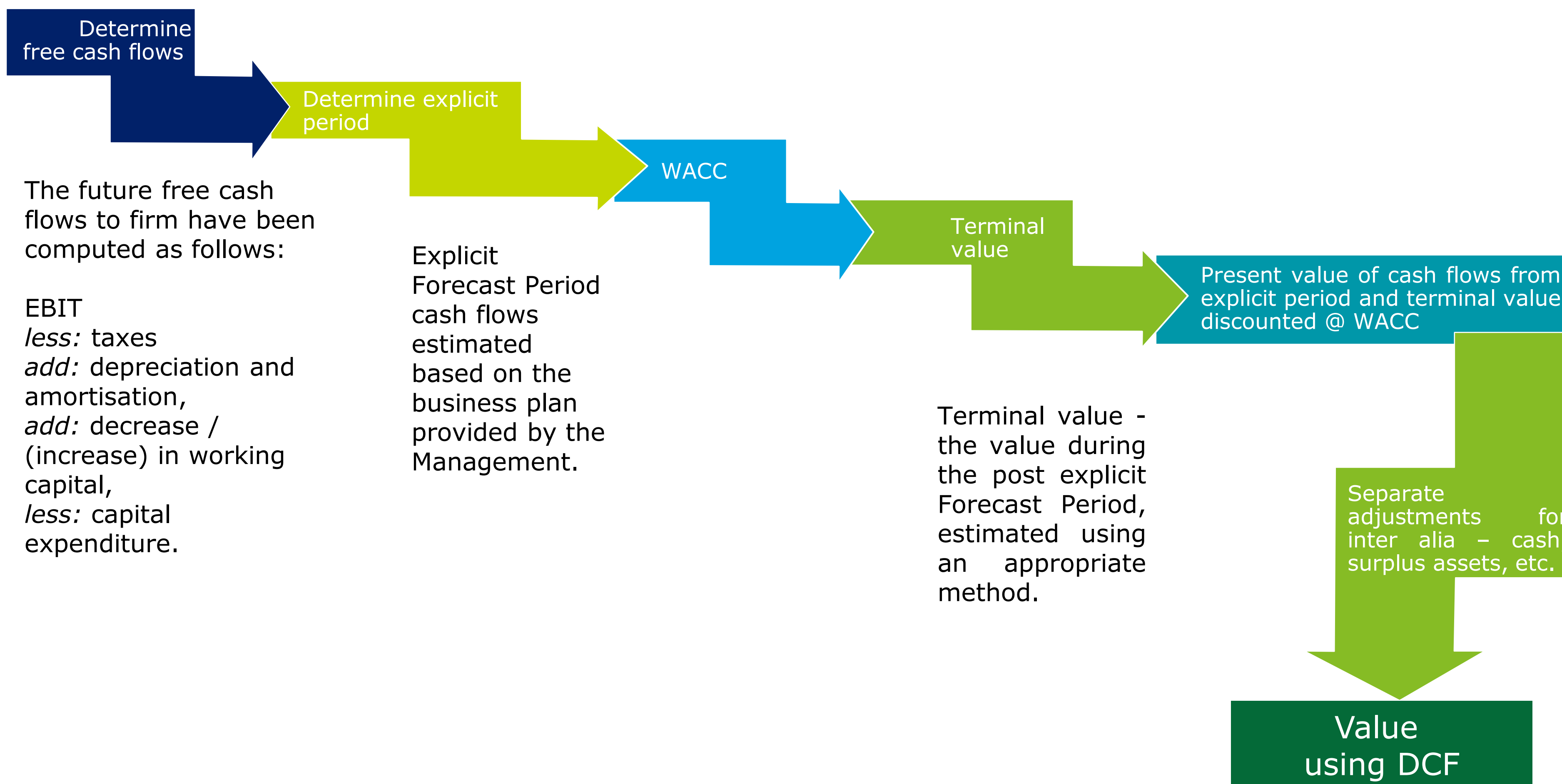
DCF method

The discounted free cash flow technique is one of the most detailed approaches to valuation of a business. In this technique the projected free cash flows from business operations are discounted at the weighted average cost of capital ("WACC") and the sum of such discounted free cash flows is the value of the business.



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Sources of information

The valuation analysis was undertaken on the basis of the following information relating to the Company provided to us by the Management and information available in public domain:

- Audited financial statements
- Provisional financial statements as on valuation date
- Projected profit and loss accounts of the Company for a period of five years
- Anticipated working capital requirement and the capital expenditure over the Forecast Period.
- Fully dilutive Shareholding pattern as on valuation date
- Other relevant details such as history, shareholding pattern, its past and present activities, future plans and prospects and other relevant information and data.

We have also received the necessary explanations, information and representations, which we believed were reasonably necessary and relevant to the present valuation exercise from the Management.

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Pillars of DCF

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Pillars of Discounted cash flow method

01 Projections

02 Discount rate (WACC)

03 Terminal value

04 After adjustments

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Pillar 1 - Projections

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Pillar 1 - Projections

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Common sizing

Initiating coverage reports and analyst reports

Year on year growth patterns

Budget or target but not aspirational

Industry trends

Specifically talking about Total addressable market,, Total serviceable market, company capacity, eg. Aeroplane industry % market share, etcy

Check whether same projectons are given to investor or not

Some important terms

- TAM – Total Addressable Market
- SAM – Serviceable Addressable Market
- SOM – Serviceable Obtainable Market
- CAC – Customer acquisition cost
- RoAS- return on ad spend

Pillar 1 – FCFF or FCFE

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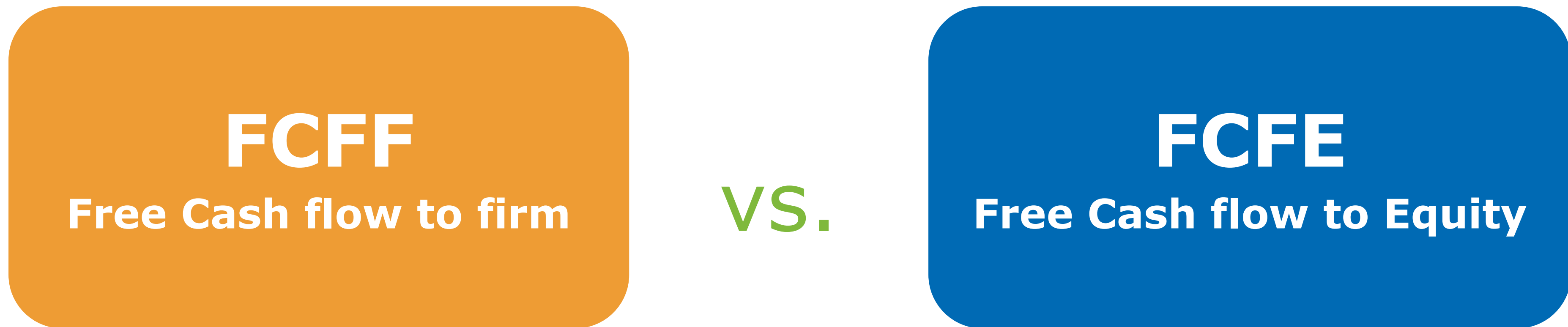
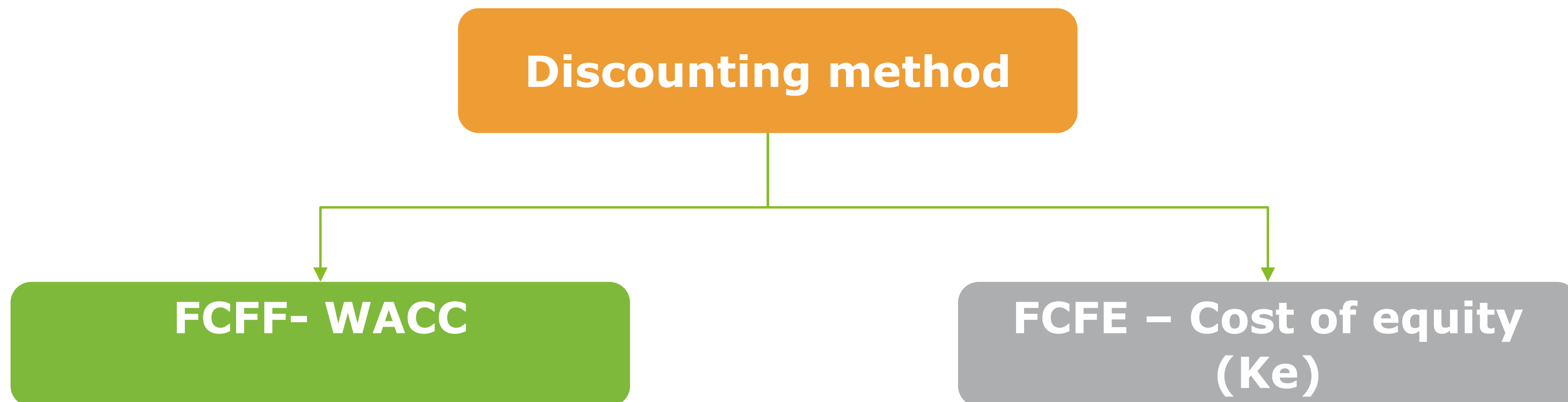


The key difference between Unlevered Free Cash Flow and Levered Free Cash Flow is that Unlevered Free Cash Flow excludes the impact of interest expense and net debt issuance (repayments), whereas Levered Free Cash Flow includes the impact of interest expense and net debt issuance (repayments).



Pillar 2 – Discount rate

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Pillar 2 – Discount rate

- WACC is a rate of return that an investor would expect to receive if capital were invested in a similar venture.
- The WACC, which is the weighted average of the costs of equity and debt of the business, has been worked out as follows:

WACC = Ke (e/(d+e)) + Kd(d/(d+e)), where:

- Ke represents the cost of equity, i.e. the return required by equity shareholders;
- Kd represents the after-tax cost of debt, i.e. the return required by debt holders;
- e represents the value of equity; and
- d represents the value of debt.

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Pillar 2 – Discount rate

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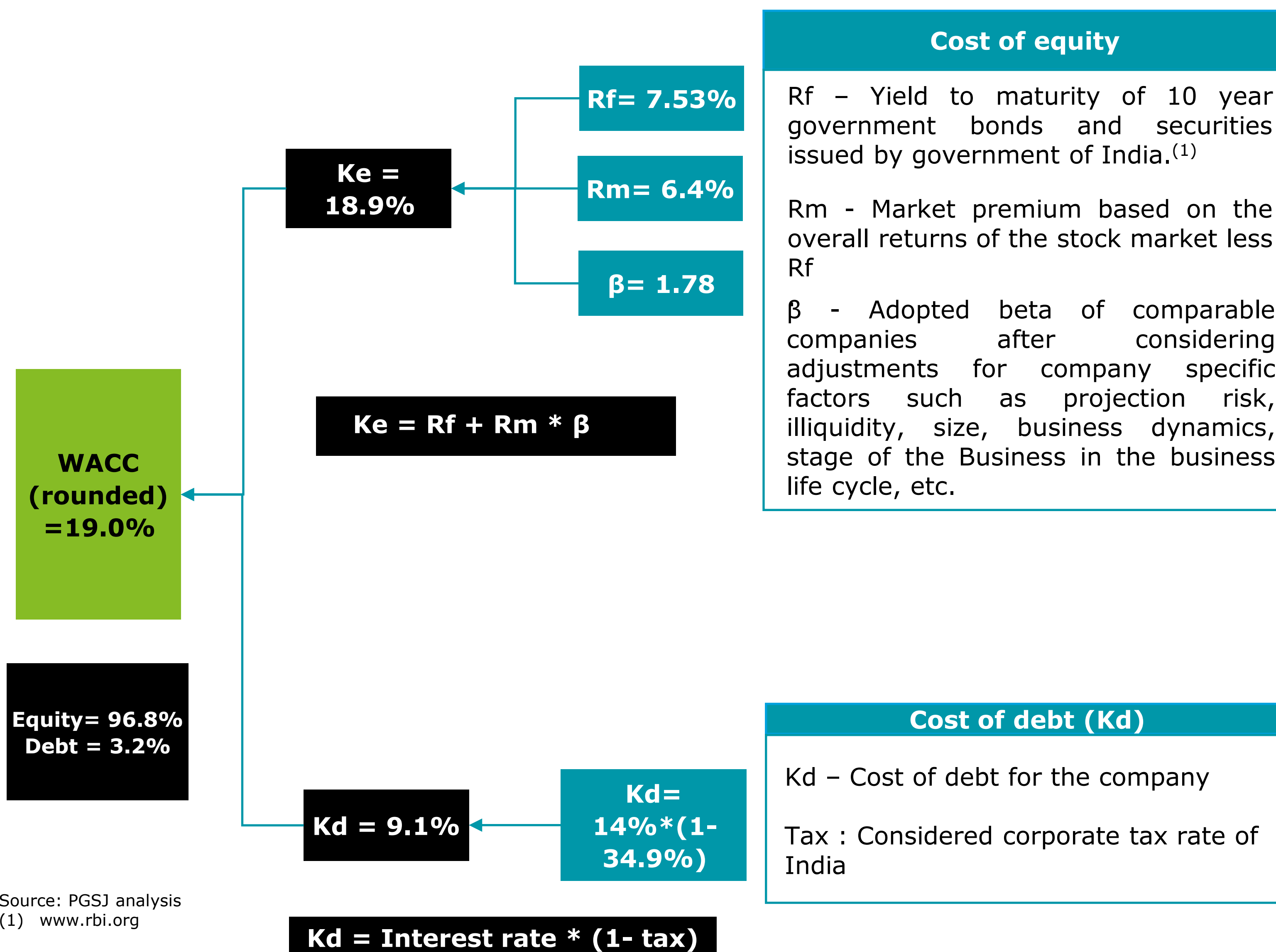

Cost of equity

Rf – Yield to maturity of 10 year government bonds and securities issued by government of India.[1]

Rm - Market premium based on the overall returns of the stock market less Rf

β - Adopted beta of comparable companies after considering adjustments for company specific factors such as projection risk, illiquidity, size, business dynamics, stage of the Business in the business life cycle, etc.

Cost of debt (Kd)

Kd – Cost of debt for the company

Tax : Considered corporate tax rate of India

Source: PGSJ analysis
(1) www.rbi.org

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Pillar 2 – Discounts and premiums

Minority discounts

The minority discount relates to the lack of control that minority shareholders have over the operation and corporate policy of a given investment.
Ranges between 10% to 25%

Control Premium

Control premium relates to the additional value associated with the ability to control the distribution of cash generated by a company, which includes the ability to influence the timing and size of its dividend distribution.
Ranges between 10% to 33%

Discount for size margin and business dynamics

It is comparing our subject company to comparable companies
Ranges between 25% to 50%

Discount for lack of Marketability

Marketability can be defined as 'the ability to convert the business ownership interest (at whatever ownership level) to cash quickly, with minimum transaction and administrative costs in so doing and with a high degree of certainty of realising the expected amount of net proceeds
Ranges between 20% to 60%

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Pillar 3 – Terminal value

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Pillar 3- Terminal year assumptions

Gordon Growth method

The Gordon growth model (GGM) is a formula used to determine the intrinsic value of a stock based on a future series of dividends that grow at a constant rate.

H model

The H-model is a quantitative method of valuing a company's stock price. The model is very similar to the two-stage dividend discount model. However, it differs in that it attempts to smooth out the growth rate over time, rather than abruptly changing from the high growth period to the stable growth period. The H-model assumes that the growth rate will fall linearly towards the terminal growth rate.

Exit Multiple method

The method assumes that the value of a business can be determined at the end of a projected period, based on the existing public market valuations of comparable companies

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Pillar 4 – After adjustments

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Pillar 4- After adjustments

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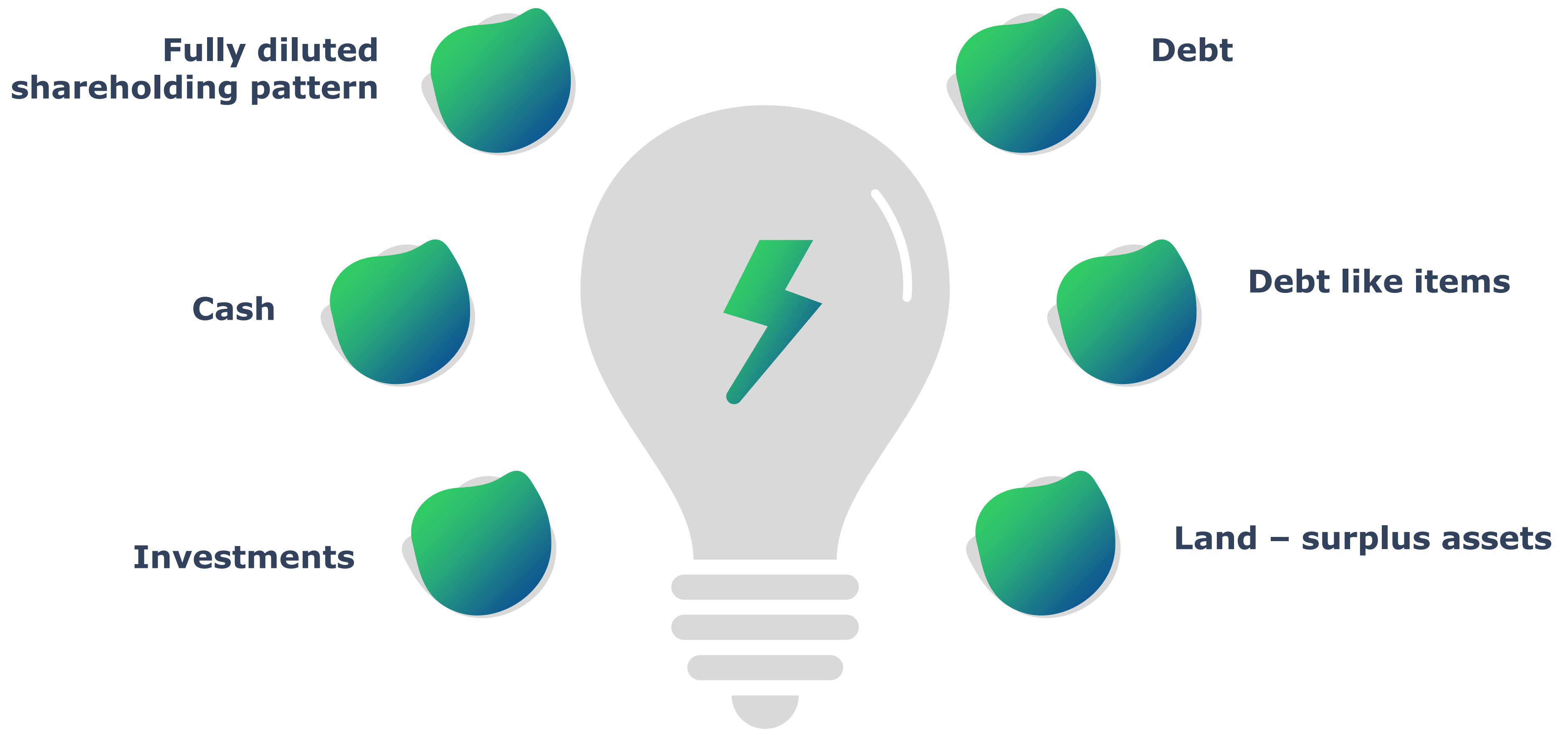

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About K&P

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6+ Decades of Experience

30+ Partners

Client spread across 30+ Industries

Operating across India with 7 Offices

700+ Employee Strength

Global Reach across 15+ countries

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Follow Us On:

kpca@kirtanepandit.com

www.kirtanepandit.com

Pune
5th Floor, Wing A, Gopal House, S.No. 127/1B/11,
Plot A1, Kothrud,
Pune – 411 038, India
Contact no : +91 20 67295100 / 25433104
E-mail :kpca@kirtanepandit.com

Mumbai
601, 6th Floor, Earth Vintage, Senapati Bapat
Marg, Dadar West,
Mumbai- 400 028, India
Contact no :022 69328846 / 47 / 48
E-mail :kpcamumbai@kirtanepandit.com

New Delhi
272, Rajdhani Enclave, Pitampura,
Delhi-110034, India
Contact no : +91-9911814171
E-mail :kpcadelhi@kirtanepandit.com

Nashik
Flat No. A- 102, Malpani Saffron, Near Hotel Express
Inn, Pathardi Phata,
Nashik -422010, India
Contact no : +91 253 2386644
E- mail :kpcanashik@kirtanepandit.com

Chennai
No. 11,2nd Floor Rosy Tower, 7 Nungambakkam
High Road,
Chennai - 600 034, India
Contact no : +91 99164 66614
E-mail :kpcachennai@kirtanepandit.com

Bengaluru
No. 63/1, I Floor, Makam Plaza, III Main Road,
18th Cross, Malleshwaram, Bengaluru – 560
055, India
Contact no :080 23443548 / 23461455
E-mail :kpcabengaluru@kirtanepandit.com

Hyderabad
401 to 405, 4th Floor, Sanatana Eternal,
3-6-108/1, Liberty Road, Himayatnagar,
Hyderabad - 500 029, India
Contact no : +91 99127 41089 / 94400 55917 /
98480 44743 / 98480 46106
E-mail :kpcahyderabad@kirtanepandit.com