ESTD. 1973
PROFESSIONAL EXCELLENCE

C.V.O.CA'S NEWS & VIEWS

FOR MEMBERS / SUBSCRIBERS / VOL. 25 - NO. 6 JANUARY 2022

From President's Desk...

Dear Professional Colleagues and Readers,

It's really proud moment for all of us that our CVOCA members are elected at Central Council and Regional Council of ICAI with Grand success in election held in December 2021. Mrs. Priti P. Savla is the first CVOCA women member to enter Central Council in the history with highest first preference votes. Mr. Ketan Saiya has been elected at regional council of WIRC of ICAI. Heartiest congratulations to both for such a great victory and all the very best for the upcoming times in their terms.

"Where there is Unity, there is always Victory."

Overview of Economy in 2020-21

The Indian economy was negatively impacted by an unprecedented health crisis in 2020-21 with the highly contagious corona virus (Covid-19) spreading across the country. However, the same is expected to rebound strongly in 2021-22 owing to preventive measures taken by Government and Awareness among the people.

"The Tunnel just got longer, but you can still see the light".

Panic has spread across the world after the discovery of the Omicron variant of corona virus, which has been classified as a 'variant of concern' by the World Health Organisation (WHO).

If Omicron becomes the dominant Covid-19 variant, in terms of transmissibility and vaccine resistance, it could cause severe disruption to already battered supply chains. This will result in higher inflation for a prolonged period and a slowdown in global economic recovery.

India Stock Market is already under pressure from FII selling, the rapid spread of the Omicron variant of Covid-19 is now casting a shadow of uncertainty on Nifty's outlook in the next few months.

The stock market might struggle to find direction in the last trading week of the year as a surge in cases of the Omicron variant of Covid-19 continues to weigh on investors' mind.

Hon. PM Narendra Modi inaugurated and laid the foundation stone of hydropower projects worth over Rs 11,000 crores. The Prime Minister said that 'ease of living' of the people of the country is one of the foremost priorities and electricity plays a huge role in this. Hydro-power projects launched recently reflect India's commitment to eco-friendly development. Also he announced pan-India Vaccination of 15-18 Years of children from 3d January, 2022.

Celebrating Health – Hit Hard, Run Fast, Catch Tough

After lot of pressure of due dates, let us relax and gather for participation in Box Cricket League organised on 22nd January, 2022. I request all members to come forward & join the fun.

This Christmas brought gift of happiness, health, success, positive vibes and new hopes for the New Year 2022. Let us make new resolution that makes health, wealth & happiness in our lives at the start of the year.

"Wishing you all a very Happy & Healthy New Year– 2022."

Thank you all..... Always in Gratitude

CA Rahul Nagda

January 1, 2022

304, Jasmine Apartment, Dada Saheb Phalke Road, Dadar (East), Mumbai - 400 014. Tel.: 2410 5987 I E-mail : info@cvoca.org I Website : www.cvoca.org
Follow us on : @cvocain @CVOCA Association @cvoca http://bit.ly/cvocayt


VALUATION

HOPE AND ACTION

CA Dinesh Shah
Email : swastikdns@hotmail.com

FROM THE DESK OF CHAIRMAN

The ongoing wave-1 and wave-II of Covid -19 pandemic continues to create a grave crisisin publicfor health, economy and other aspects of human society. Mankind is facing with the immediate andurgent challenge of restoring social connections and people's livelihoods while halting the spread of infections.

The sudden disruptions of our daily lives during this unprecedented time have given rise to deeper appreciation of the ways in which our lives and livelihoods are supported and sustained by the efforts of so many others. We have been able to surmount the sever challenges of the pandemic thanks to the dauntless efforts of frontline health workers and all those whose work helps secure the lifelines of society.

Applauding selfless struggles, by all frontline health workers, NGO's, Security personnel's, to quote Gandhiji's. He stated: "It's a matter of whether one touches the life of an individual. We can't look after thousands of people. but if we can touch one person's life and save that life that is the great change that we can effect."

To uplift those in our immediate vicinity; to help the individual in front of us, this, I believe is the vital perspective, we must adopt in our communities as we work, step by step to solve problems and rebuild society from the ravages of the pandemic.

While the pandemic seems to have finally begun to subside the work of steadily resolving a host of problems in economy and society- all of which have been deeply impacted – still lies ahead. India's economy is poised for a rebound this year, that further constrained activity and took a heavy toll on its people.

"What happens in India has a big impact, both in the region and in the world," India's broad range of fiscal, monetary and health responses to the crisis supported its recovery and, along with economic reforms, are helping to mitigate a longer-lasting adverse impact of the crisis,

Though policy steps and rigorous implementation helped mitigate the pandemic, to great extent, But it's still likely to result in greater poverty and inequality.

New infections have fallen significantly and vaccination rates have risen to surpass a billion doses, although another resurgence is not impossible even if it seems unlikely today."There's a lot of uncertainty about COVID," We cannot rule out future waves."

In addition to the Covid-19 crisis we are also confronted by the reality of climate change . The year 2021 has been one of unparalleled challenges, with countries around the world navigating many crises simultaneously With firm conviction that our steady efforts to tackle these difficulties are helping to build a world in which every person can live in safety and security, let us begin to plant seeds of hope and action exactly where we are .

!!!! TREAT OTHER THE WAY YOU WANT TO BE TREATED !!!!

!!!! REMEMBER THE SOUL IS ON JOURNEY !!!!

Thank you all..... Always in Gratitude

CA Dinesh Shah

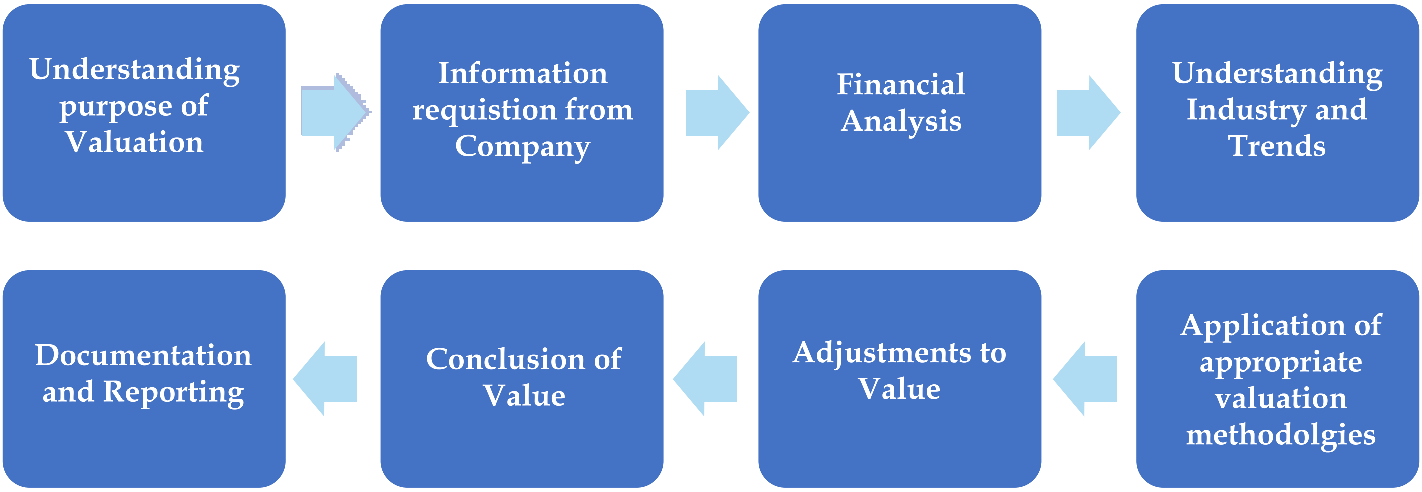
OVERVIEW OF VALUATION


CA Paras Savla
Email : paras@psaindia.net
CA Neerav Gala
Email : neeravgala@gmail.com

"Living on our planet, today, requires a lot more imagination than we are made to have. We lack imagination and repress it in others."
— Nassim Nicholas Taleb, The Black Swan: The Impact of the Highly Improbable

1. Introduction to Valuation

In layman's term valuation is the process of analyzing the worth of an asset. To objectively derive the worth of an asset, it becomes pertinent to know what drives the value of an asset. Some assets are easier to value than others, the details of the valuation may vary from asset to asset, and the uncertainty associated with value estimates is different for different assets, but the core principles remain the same.For valuing financial assets, there are primarily three approaches for valuation which are explained in the article.Steps to follow for a valuation assignment –



2. Difference between Price and Value

We often come across two types of statements –

- *An investor does not pay more for an asset than it is worth*
- *The value lies in the eyes of the beholder and that any price can be justified if investors are willing to pay the price*

Though the above statements may hold some ground while buying art/design where decisions are driven by sentiment or emotion, for financial assets -value is to be backed up by reality by estimating the cash flows an asset is expected to generate.Warren Buffet has said that '*Price is what you pay; value is what you get.*'

Meaning	Price is the amount paid for the acquisition of a product / service	Value is the utility value/worth of product / service to a consumer
Meaning in short	*What you pay*	*What you get*
Determination	Determined from the customer's or marketer's perspective	Determined from the consumer's perspective
Estimation	By Policy pricing	By usefulness
Monetary Measurement	Yes	No
	Price is the same for all	Value to each person varies

3. Valuation Standards

Standards are the one that helps in bringing the uniformity in whole valuation exercise.The International Valuation Standards Council is the body responsible for setting the International Valuation Standards. Ithas issued various valuation standards. In India, ICAI has issued ICAI Valuation Standards 2018 as a benchmark for Valuation Practices applicable for Chartered Accountants for valuation of Securities and Financial Assets. The Valuation Standards have been issued by the ICAI to set up concepts, principles and procedures which are generally accepted internationally having regard to legal framework and practices prevalent in India. Valuation standards are introduced so that valuation is carried on basis of established principles. ICAI Valuation Standards covers the valuation of financial assets. In India, no other body has issued valuation standards.Some of the Registered Valuers Organization has adopted International Valuation Standards (IVS). The following Valuation Standards have been issued by ICAI (ICAI VS) and International Valuation Standards Council:

ICAI Valuation Standards	International Valuation Standards
1. ICAI VS 101 - Definitions 2. ICAI VS 102 - Valuation Bases 3. ICAI VS 103 - Valuation Approaches and Methods 4. ICAI VS 201 - Scope of Work, Analyses and Evaluation 5. ICAI VS 202 - Reporting and Documentation 6. ICAI VS 301 - Business Valuation 7. ICAI VS 302 - Intangible Assets 8. ICAI VS 303 - Financial Instruments	1. IVS 101 Scope of Work 2. IVS 102 Investigations and Compliance 3. IVS 103 Reporting 4. IVS 104 Bases of Value 5. IVS 105 Valuation Approaches and Methods 6. IVS 200 Business and Business Interests 7. IVS 210 Intangible Assets 8. IVS 220 Non-Financial Liabilities 9. IVS 300 Plant and Equipment 10. IVS 400 Real Property Interests 11. IVS 410 Development Property 12. IVS 500 Financial Instruments

Applicability of Indian Valuation Standards:

- These ICAI Valuation Standards will be applicable for all valuation engagements carried by Chartered Accountants on a mandatory basis under the Companies Act 2013.
- In respect of Valuation engagements under other Statutes like Income Tax, SEBI, FEMA,etc., it will be on a recommendatory basis for the members of the Institute. These Valuation Standards are effective for the valuation reports issued on or after 1st July 2018.
- These ICAI Valuation Standards will be effective till Valuation Standards are notified by the Central Government under Rule 18 of the Companies (Registered Valuers and Valuation) Rules, 2018. Till now no Standards has been notified by Central Government.

4. Purpose of Valuation

Valuation is required to be carried for various purposes. It can be classified broadly under 2 categories – Regulatory and non-regulatory. Valuations are usually carried out in India under various Indian laws –

Company Law	Income Tax Law	SEBI	FEMA – RBI	Insolvency and Bankruptcy Code
Fresh issue of securities	Fresh issue of securities	Fresh issue of securities	Fresh issue of securities – FDI / ODI	CIRP
Transfer of securities	Transfer of securities	Transfer of securities	Transfer of securities – FDI / ODI	Liquidation
Business Combination / Scheme of Arrangement	Sale of business under slum sale	Buyback of shares	Infusion of capital in LLP / partnership firm	
Issue of ESOP / sweat equity Purchase Price Allocation	Indirect transfer of shares ESOP	Delisting of shares		
Who can perform Valuation#				
Registered Valuer	Merchant Banker; Chartered	Registered Valuer; Chartered	Merchant Banker; Chartered	Registered Valuer

Different professionals are required to undertake valuation depending upon the nature of the transaction and law. E.g. in the case of valuation under 11UA Chartered Accountant is not entitled to carry valuation using Discounting Cash Flow Method.

The same transaction may require different valuation reports under different laws and such valuation may be required to be carried by the different persons.E.g.Issue of shares - may require valuation by Chartered Accountant under FEMA, Registered Valuer under Companies Act and Merchant Banker under Income-tax Act.

5. Valuation Methodologies

i. To determine fair value, a valuer may, therefore, use any of the approaches as per the generally / internationally accepted valuation methodologies which in its opinion are most appropriate based on the facts of each valuation.

ii. The internationally / generally accepted valuation methodologies have been discussed hereinafter, along with the reasons for the choice of the approach used based on the facts of the company.

5. 1. Market Approach

Under this approach, the valuation is done based on the quoted market price of the company in case it is a publicly-traded company, or publicly traded comparable businesses/date is reviewed in order to identify a peer group similar to the subject company and then their multiples are applied to the entity being valued to determine the fair value. Types of Multiples widely used –

Enterprise Value (EV) Multiples	Equity Multiples
EV/Revenue	P / E Ratio
EV/EBITDAR	Price / Book Ratio
EV/EBITDA	Dividend Yield
EV/Invested Capital	Price / Sales

Commonly used Multiples by Sector –

Multiple	Sector	Rationale / Comments
EV/Revenue	Various	Early-stage companies
EV/Subscriber	Various	Subscriber based companies
EV/EBITDA	Various	Many Industrial and Consumer industries, but not Banks, Insurance, Oil & Gas and Real
EV/EBITA	Various	Commonly used in several Media industry sub-sectors, Gaming, Chemicals and Bus &
EV/EBITDAX	Oil & Gas	Excludes exploration expenses
EV/EBITDAR	Retail, Airlines	Used when there are significant rental and lease expenses incurred by business
EV/Reserves	Oil & Gas	Used when looking at Oil & Gas fields and companies heavily involved in upstream. Gives an indication of how much the field is worth on a per-barrel basis
EV/Production	Oil & Gas and Airports	For producing fields, gives value on a barrel per day production basis.For container ports, gives value per ton of cargo handled.

Multiple	Sector	Rationale / Comments
EV/Capacity	Oil & Gas	For refiners, gives a value metric in terms of barrel per day of refining capacity
Market Cap/Book Value ("P/BV")	Technology / Banks/ Insurance	Used for the Semiconductor industry. Book value of equity is used since there can be significant earnings fluctuation in this sector.
EV/FFO	Real Estate	Principally used in the US
P/E	Various	Often using normalized cash earnings, excluding both exceptional items and
PEG ratio	High Tech,	Big differences in growth across companies.
(EV/EBITDA)/EBITDACAGR	High Growth	Used in Specialty Retail industry and when valuing emerging markets.

When to use –

- Where the comparable asset is traded actively in the market
- Existence of recent transactions pertaining to the asset
- Existence of recent transactions pertaining to the comparable assets which is reliable

Advantages	Limitations
Easy to use	Difficulty in identification of comparable
Less time consuming	Completely dependent on the selection of comparable
Easily understood by users	
Reflects current market trends	

5.2. Income Approach

The income Approach of valuation methods is based on the premise that the current value of any business is an output of future value that an investor can expect to receive by way of cash flows. It is an approach that converts maintainable or future amounts to a single current value. The fair value is determined based onthe value indicated by current market expectations about those future amounts.

5.2.1. Discounted Cash Flow Method

The Discounted Cash Flow ("DCF") method, an application of the Income Approach, is arguably one of the most recognized tools to determine the value of a business.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. 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.

When to use –

- Cash flows are currently positive
- Cash flows can be estimated with some reliability for future periods

Advantages	Limitations
Based on performance expectations of	Only as good as the input
Not vulnerable to accounting conventions like depreciation and inventory valuation	Does not consider investment risk associated with opportunity cost

5.2.2. Profit Earning Capacity Value (PECV) Method

It involves determining the future maintainable earning level of the entity fromits normal operations. Thevaluer must give optimal weights to each financial year considering the profit trend andcyclical nature of business. This maintainable profit, considered on a post-tax basis, isthen capitalized at a rate, which in the opinion of the valuer, combines an adequateexpectation of reward from enterprise and risk, to arrive at the business value. The selection of the Capitalization Rate,the inverse of the Price Earning ('PE') Multiple, is a judgment of the valuer considering strengths and weaknesses of the company as well as market situationsprevailing at the time of valuation.

When to use –

- The future cash flows cannot be reasonably estimated
- Historical earnings represent a fair business situation

Advantages	Limitations
Easy to use	Based on historical earnings

5.3. Asset Approach

A 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). In certain situations, the historical cost of the asset may be considered by the valuer where it has been prescribed by the applicable regulation.The cost approach is based on the inherent assumption that the value of a business or investment can be determined based on the cost to rebuild or replace the business.

When to use –

- Specifically used for asset-intensive firms, holding companies, distressed entities
- Can be quickly recreated with substantially the same utility as the asset to be valued
- The liquidation value is to be determined
- Income approach and/or market approach cannot be used

Advantages	Limitations
An easy and quick method of	Ignores the amount, duration and timing of
Useful for asset-intensive assets	Does not consider the risk characteristics of the asset
	Intangible assets, contingent liabilities are not accounted for
	Not the most preferred method for estimating enterprise value of going concerns

6. Bias in Valuation

6.1. Sources of Bias

We rarely start a valuation assignment with a clean slate. We usually tend to form views on the value of an asset even before inputting the numbers in the models as a result of which our value conclusions tend to be closer to our biases. Hence, we already begin with a perception about the asset being valued. Some of the sources of bias are -

- Read something in the press / news (good or bad) about the company;
- Heard from an expert that it was under or overvalued
- Management discussions of performance
- Summaries of how many analysts are bullish and bearish about the stock

6.2. How to reduce biases

At the end of the day, valuation is not performed by analysts in a vacuum. These could be some ways to reduce biases –

i. Reduction of institutional pressures

ii. De-link valuations from reward/punishment

iii. No pre-commitments

iv. Self-Awareness

v. Honest reporting

7. Valuation is an Estimate – Imprecision and Uncertainties

- Undertaking a valuation is unique for every transaction and requires efforts, application of mind and thought for each assignment separately. Only guiding principles can be adopted and considered by the valuer while undertaking each assignment.

- Value' is an estimate of the value of a business or assets, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment.Value for the same assets at the same point in time could differ from person to person based on each individual's perception.

- Valuation by its very nature, cannot be regarded as an exact science and the conclusions arrived at in many cases will be subjective and dependent on the exercise of individual judgment. Given the same set of facts and using the same assumptions, expert opinions may differ due to the number of separate judgment decisions. A valuation cannot be judged by its precision. We can value a mature company with relatively few assumptions and be reasonably comfortable with the estimated value.

7.1. Causes of Uncertainties –

Certain uncertaintiescannot be avoided during valuation. Since no one knows what the future holds, we make our best estimates with what information we have at the time of valuation.

a. Estimation Uncertainty

b. Firm-specific Uncertainty

c. Macroeconomic Uncertainty

7.2. Responsesto Uncertainties–

- The advantage of breaking down the uncertainties into the above categories gives us an idea of what we can control, what we can manage and what we can pass through into the valuation. The idea is not to be completely hopeless because of uncertainties but mitigates them.

- Simulations, Decision Trees and Sensitivity Analyses are tools that help us mitigate uncertainty but not eliminate it.The primary focus of the analysts should be on making their best estimates of firm-specific information and steer away from bringing in their views on macroeconomic variables.

8. Valuation Complexities

Valuation models have become complex over time majorly because of two reasons - computers have become more powerful and information is available in plenty along with ease of access to such information. More detailed and complex models mean more inputs for details to be built into the model which also results in chances of potential errors. Some of the Costs of Complexity are -

1. **Overload of Information -** Contrary to popular belief, it's not always true that more information leads to accurate valuations. Valuation models follow the '*Garbage in – Garbage out*' principle meaning the quality of output is only as good as the quality of inputs.

2. **Black Box Syndrome -** As the models are more complex nowadays, it is becoming more common that the valuation models are often looked at as the black box which gives out values by the input of certain pre-defined parameters.

3. **Big vs Small Assumptions -** Complex models usually have sections for all types of inputs based on which the model is run. It is a common occurrence that the valuer fails to comprehend the complete impact of the input assumptions on the overall value.

9. Specific Valuation Methodologies

Apart from the valuation methodologies explained earlier, there are certain other valuation methodologies that are used to value certain specific items. A brief of these methods is explained as under –

9.1. Valuation of Intangibles

The most commonly used Income methods of Valuation of Intangible Assets are –

- Relief from Royalty Method
- Multiperiod Excess Earnings Method (MPEEM)
- With and Without Method (WWM)

9.2. Valuation of Startups

Apart from the above methods, some of the methods of Valuation of startups are -

- Berkus Method
- Scorecard Valuation Method
- Risk Factor Summation Method
- Venture Capital Method

9.3. Contingent Claim Valuation

A contingent claim or option is an asset that pays off only under certain contingencies - if the value of the underlying asset exceeds a pre-specified value for a call option, or is less than a pre-specified value for a put option.Option Pricing Models are mathematical models that use certain variables to calculate the theoretical value of an option.

9.3.1. Black-Scholes Model

The Black-Scholes model is the most widely used method of Option valuation. The Black-Scholes model makes certain assumptions:

- The option is European and can only be exercised at expiration.
- Markets are efficient (i.e., market movements cannot be predicted).
- There are no transaction costs in buying the option.
- The risk-free rate and volatility of the underlying are known and constant.
- The returns on the underlying are normally distributed.

9.3.2. Binomial Model

The binomial option pricing model is a model that is used to price options and is based on the concept of no-arbitrage.The assumptions in binomial option pricing models are as follows:

- There are only two possible prices for the underlying asset on the next day. From this assumption, this model has got its name as Binomial option pricing model (Bi means two)
- The two possible prices are the up-price and down-price
- The underlying asset does not pay any dividends
- The rate of interest (r) is constant throughout the life of the option
- Markets are frictionless i.e. there are no taxes and no transaction cost
- Investors are risk-neutral i.e. investors are indifferent towards risk

9.3.3. Monte Carlo Simulation Model

Monte Carlo methods are a class of computational algorithms that are based on repeated computation and random sampling. Since the option is priced under risk-neutral measure, the discount rate is the risk-free interest rate. In order to get a good estimate from simulation, the variance of the estimator should go to zero and thus the number of samples should go to infinity, which is computationally not feasible.

10. Adjustments in Valuation

- **Discount for Lack of Marketability (DLOM) -**DLOM is based on the premise that an asset that is readily marketable commands a higher value than an asset that requires a longer period / more efforts to be sold or an asset having a restriction on its ability to sell. An investor will always pay less for an illiquid asset when compared with a similar asset with higher liquidity.
- **Control Premium and Discount for Lack of Control (DLOC) -** Control Premium generally represents the amount paid by the acquirer for the benefits it would derive by controlling the acquiree's assets and cash flows.In converse situations, DLOC would be applied to derive the value of minority shareholding from the value of control stake.
- **Synergy-** Synergy is a concept which indicates that the 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.

11. Rules of Thumb:

Rule of Thumb for certain valuation assumptions and inputs –

- **Risk-Free Rate**– Risk-free rate is usually considered as 10-year Government Bond Yield or higher tenureGovernment Bond Yield.
- **Illiquidity discount**–As Prof. Damodaran suggests in his paper, illiquidity discount is usually applied in the range of 20-30%.
- **Beta** – In case of unavailability of listed comparable peer companies, beta is usually considered as 1.

- **Terminal Growth Rate**–Terminal growth rate for a company is usually considered slightly higher than the country's GDP growth rate.
- For most companies, the Cost of Equity is usually higher than the Cost of Debt.
- Cash flows of mature companies are usually in an increasing trend.

12. Conclusion:

In the ultimate analysis, the valuation will have to involve the exercise of judicious discretion and judgment taking into account all the relevant factors. There will always be several factors. E.g. present and prospective competition, the yield on comparable securities and market sentiments, etc. which are not evident from the face of balance sheets but which will strongly influence the worth of a share. This concept is also recognised in judicial decisions. For example, Viscount Simon Bd in Gold Coast Selection Trust Ltd. vs. Humphrey reported in 30 TC 2019 (House of Lords) as quoted by the Supreme Court of India in the case reported in 176 ITR 417 as under:

"If the asset takes the form of fully paid shares, the valuation will take into account not only the terms of agreement but a number of other factors, such as prospective yield, marketability, the general outlook for the type of business of the company which has allotted the share, the result of a contemporary prospectus offering similar shares for subscription, the capital position of the company, so forth. There may also be an element of value in the fact that the holding of the shares gives control of the company. If the asset is difficult to value, but is nonetheless of a money value, the best valuation possible must be made. Valuation is art, not an exact science. Mathematical certainty is not demanded nor indeed is it possible."

Is DCF the most popular method for valuation - Issues and Challenges in DCF Valuation

CA Keval Mamania
Email : mamania55@gmail.com

Introduction

The blockbuster IPOs of new-age tech companies such as Nykaa, Zomato, Paytm, show that the valuation game has changed, and the focus has shifted from earnings to super normal growth potential. Who would have thought a year ago amid global crisis that these tech unicorns would raise funds in the range of Rs. 5,300cr to Rs.18,300cr from the Indian primary market, successfully? The question one might have here is that are these valuations sustainable, how long a company can survive with negative earnings and cash flows? Well, the established valuation methods focused on earnings and cash flows are unable to aid in justifying such higher valuation and only time will tell whether these Hi-tech unicorns with huge negative reserves can sustainsuch valuations in future. Let's deflect our attention from these startups to relatively more matured companies, which form majority in Indian equity market. Such companies are assumed to be *going concern* and can be valued using the below two commonly used valuation methods:

i) Income approach – Discounted cash flow method (the intrinsic value approach); and

ii) Market approach – Public company comparable and precedent transaction approach

While the Discounted Cash Flow method ("DCF") is the most popular method of valuation, the DCF values are often corroborated with the market approach as the later reflects the current market/industry condition.

What Is Discounted Cash Flow method?

Discounted cash flow (DCF) is a valuation method used to estimate the value of an investment/business based on its expected future cash flows. DCF analysis attempts to figure out the value of an investment today, based on projections of how much money it will generate in the future.

Why is Discounted Cash Flow method the most popular method of valuation?

DCF is practically the most widely applied valuation methodology as it attempts to measure the value created by a business directly and precisely through its net cash inflows. It makes sense theoretically, as the value of a firm ultimately derives from the inherent value of its future cash flows to its stakeholders. We will now understand the basics of DCF and each of its components.

Basics ofDiscounted Cash Flow method

In DCF, the valuer estimates the cash flow of any business after all operating expenses, taxes and the necessary investments in capital expenditure and working capital is being met. DCF method can result in either Enterprise Value or the Equity Value based on the type of cash flows considered i.e., Free cash to the firm ("FCFF") will result in Enterprise Value and free cash flows to equity ("FCFE") will result in Equity Value. The FCFF is discounted at the Weightage Average Cost of Capital ("WACC") and FCFE is discounted at Cost of Equity ("Ke") to arrive at Enterprise or Equity Value, respectively.

Key components ofDiscounted Cash Flow method

Step 1 - Forecasting unlevered free cash flows:

We need to forecast the cash flows a company generates from its core operations after accounting for all operating expenses and investments in working capital and capital expenditure. These cash flows are called unlevered free cash flows. Unlevered free cash flow is used to remove the impact of capital structure on a firm's value and to make companies Enterprise Value more comparable.

Step 2 – Computing the Terminal Value

The unlevered free cash flows are projected for a finite number of years depending on the underlying asset under valuation (*more often than not - 5 years*) and to capture the remaining value at the end of FCFF projection period we calculate the Terminal Value ("TV"). Terminal Value is one of the most important variable in the DCF calculation as it contributes roughly about 60%-70% of the total Enterprise Value. The major inputs required to compute the Terminal Value are long term growth rate required to calculate the maintainable FCFF and long term WACC required to discount the maintainable FCFF in the terminal year.

Step 3 – Computing the Discount rate

The discount rate refers to the interest rate used to determine the present value of the FCFF and TV. We use WACC to calculate the appropriate discount rate. Simply stated, WACC is the "cost" of each form of capital the company has, weight them by their percentages, and then add them up. The two major inputs in calculating WACC are (i) cost of equity - Risk-Free Rate (Rf) + Equity Risk Premium (ERP) * Levered Beta and (ii) cost of debt – It represents the returns on the company's debt, mostly from interest, but also from the changes in market value of the debt. The WACC computed can be different for the FCFF projection period and terminal year depending on the riskiness of the cashflows and other macro-economic risks namely country risk premium, size premium, default risk, etc. higher the risks higher the discount rate and vice versa. To summarize, the WACC computed represents what one would earn each year, over the long term, if invested proportionally in the company's entire capital structure.

Step 4 – Computing the present values

By discounting each year FCFF and terminal year cash flows with the appropriate discount rate we arrive at the present values of FCFF and terminal year cash flows. The method of discounting cash flows we studied theoretically is end-period discounting however, it is incorrect as it discounts the future value of cash flow too aggressively by assuming that the total value of the cash flow in each year is calculated at the end of that year. Therefore, it is advisable to use the mid-period discounting which considers that the flow of cash is distributed throughout that year (uniform cash flows).

Step 5 – Computing the Enterprise Value and Equity Value

Enterprise Value - Aggregating the present value of each year FCFF and the present value of terminal year cash flows we arrive at the Enterprise Value. Enterprise Value represents the total value of the business. Along with the equity value it also includes short-term and long-term debt.

Equity Value - To calculate the Equity Value from Enterprise Value, add non-operating assets and subtract financial liabilities. In simple terms, add cash and cash equivalents and subtract short-term/long-term debt, preferred stock, and minority interest as applicable.

Major advantages of using DCF method of valuation

- DCF techniques are considered superior to other methods since they consider the earnings of a project over its entire economic life, and the time value of money flows;
- The DCF method automatically gives more weight to units of money, which are nearer than those, which are distant. But other methods treat distant units of money unrealistically with the same weight as present units;
- The DCF method allows a ready comparison to be made between projects having different lives and different timings of each flow by facilitating comparison at the same point of time;
- It can be used to calculate the Internal Rate of Return ("IRR") (by using goal seek) given that we have information about the Enterprise and/or Equity Value; and
- It is useful to determine the intrinsic value of the business.

Major disadvantages of using DCF method of valuation

- DCF method is extremely sensitive to the inputs assumed. Any incorrect assumption with lead to distorted equity value. As said - Garbage in, Garbage out;
- The DCF method does not account for the current market scenario and it highly dependent on the quality of forecast used by the preparer; and
- It does not take in to account the relative valuations of the competitors.

To mitigate the above cons, preparers generally corroborate the DCF value with the market approach of precedent transaction analysis or comparable companies' analysis.

Conclusion

When you buy a stock, you trade cash for a portion of the future cash flows of a business. When you sell a stock, you trade the future cash flows for current cash. It's a form of time travel: if you buy a stock at a price less than its perceived value, you are essentially traveling into the future and judging that today's expectations for future cash flows are too low. Selling stock that is perceived to be overvalued is a symmetrical move. In essence "Everything is a DCF model" as quoted by *Michael J. Mauboussin and Dan Callahan.*

To conclude, the intrinsic value determined by the present value of future cash flows is useful to understand the valuation of a cash generating asset.

◆◆◆

Decoding pre-money & post-money valuation

CA Litesh Gada
Email : litesh@aureusassets.com

Decoding pre-money & post-money valuation

Business valuation is the process of determining the current (or projected) worth of an asset or a company. There are many techniques used for doing a valuation. Some of the important inputs considered while carrying out the valuation exercise are business's management, business model, future earnings and profit margins, size of the market, scalability of the business, funds required to achieve growth, competition, market share etc.

Typically, business valuation is carried out when a company is looking to raise funds, one or more of the existing shareholders are looking for an exit, sale / acquisition of a business or part of business, merger with another company, issuing ESOPs to employees etc.

What's the Difference between Pre-Money and Post-Money valuation

Pre-money valuation refers to the value of a company excluding the latest round of funding. Pre-money valuation indicates the value of a Company before it the next round of investment.

Post-money valuation refers to the value of a company after it raises money. This includes the latest round of funding.

For example, if an investor is willing to invest INR 20,000,000 and the pre-money valuation is INR 80,000,000, then the post-money valuation will be INR 100,000,000 and investor will get a 20% stake for the investment.

Post-money valuation = Pre-money valuation + Investment amount

Taking the above example further, assume that the Company has paid up capital of INR 1,000,000 and the no of issued shares is 100,000.

Particulars	Amount (in INR)
Pre-money value	80,000,000
No of shares	100,000
Pre-money value per share (80,000,000 / 100,000)	800
Investment amount	20,000,000
No of additional shares issued (20,000,000 / 800)	25,000
Post-money no of shares (100,000 + 25,000)	125,000
Post-money value (125,000 X 800)	100,000,000
Stake for fresh investment (25,000 / 125,000)	20%

Alternatively, if an investor is willing to invest INR 20,000,000 and the post-money valuation is INR 80,000,000, then the pre-money valuation will be INR 60,000,000 and investor will get a 25% stake for the investment.

Pre-money valuation = Post-money valuation - Investment amount

Particulars	Amount (in INR)
Post-money value	80,000,000
Investment amount	20,000,000
Pre-money value	60,000,000
No of shares	100,000
Pre-money value per share (60,000,000 / 100,000)	600
Investment amount	20,000,000
No of additional shares issued (20,000,000 / 600)	33,333
Post-money no of shares (100,000 + 33,333)	133,333
Post-money value (133,333 X 600)	80,000,000
Stake for fresh investment (33,333 / 133,333)	25%

As you can see from the above examples, the valuation method used can affect the stake for fresh investment. This is because of the amount of value given to the company before fresh investment.

If a company is valued at INR 80,000,000, the value is high if it is pre-money than if it is post-money because the pre-money valuation does not include the investment amount of INR 20,000,000. There is variance in percentage stake due to the difference in the way value is calculated. Therefore, it is important to know which value is being quoted during the negotiation.

Further, in case where there is no fresh infusion of capital, the Pre-money valuation and Post-money valuation are the same.

If an investor is willing to invest INR 20,000,000 buy to stake from one of the existing shareholders at a pre-money valuation is INR 80,000,000 then investor will get a 25% stake for the investment.

Post-money valuation = Pre-money valuation + Investment amount

80,000,000 = 80,000,000 + 0

Particulars	Amount (in INR)
Pre-money value	80,000,000
No of shares	100,000
Pre-money value per share (80,000,000 / 100,000)	800
Investment amount (No fresh investment)	0
No of additional shares issued (0 / 800)	0
Post-money no of shares (100,000 + 0)	100,000
Post-money value (100,000 X 800)	80,000,000
No of shares to be transferred (20,000,000 / 800)	25,000
Stake for secondary sale (25,000/ 100,000)	25%

There are also cases where promoters ignore these valuation concepts and negotiate the valuation based on assumption. Due to this, they end up giving up a higher stake to the investor.

Therefore, it is important that you do a working on pre & post-money valuation when you are looking to raise funds for your company.

◆◆◆

INDIAN UNICORN VALUATION

CA Harsh Dedhia
Email : harsh_dedhia86@yahoo.com

"Beauty lies in the eyes of the beholder. Value lies in the hold of the acquirer"

The above statement holds apt for the new age businesses which are comparatively newly formed cutting-edge technology businesses. Most of these businesses are burning cash and eroding capital yet in the eyes of their Investors they are valuable investments. Valuing such start-up businesses in the present complex and dynamic world is not an easy task. Although many a times, profit is a misfit for valuing a startup, cashflows often end up in doing little justice to the task they were employed to undertake in the first place.Valuing a startup is similar to connecting the dots and sometimes ought to follow or attempt unconventional methods.

Since the advent of technology and internet such businesses have evolved and augmented from merely a start-up to a graduated start-up and the successful ones are now known as **"Unicorns".** This article is a humble attempt to understand what goes behind those funding deals and how the unicorns have achieved the valuations they are enjoying. Only time will tell whether these valuations will sustain, whether the new age tech business itself will sustain or whether they will replace the current top 50 blue chips.

Concept and History of Unicorns

In the start-up ecosystem, a unicorn is a term used for privately held start-up company valued at over USD 1 billion (approximately Rs.7,500 crore) and is generally Venture Capital (VC) funded.

Aileen Lee, U.S. based venture capitalist, first wrote about unicorns in the venture capital world in her article, "*Welcome to the Unicorn Club: Learning from Billion-Dollar Start-ups (2013)*". Here, she looked at software start-ups founded in the U.S.A. in the 2000s and estimated that only 0.07% of them ever reach a USD 1 billion valuation. Start-ups that managed to reach the USD 1 billion mark, she noted, are so rare that finding one is as difficult as finding a mythical unicorn and thus the term "**Unicorn**".As for "Decacorn", it is a term for a company valued at more than USD 10 billion, while "Hectocorn" is used for a company valued over USD 100 billion.

As per data maintained by an information platform website[1], there have been a total of 79 start-ups in India which have achieved the unicorn status till December 2021. Some of the start-ups at the helm of the valuations are widely known to the markets and media. There are some underdogs in the field of Saas, Fintech, E-commerce, Logistics which have performed well as far as their valuations are concerned but are not so widely known like:

[1]*https://www.ventureintelligence.com/Indian-Unicorn-Tracker.php*

- Postman – ApplicationProgramming Interface(API) development and testing (Valuation ~USD 5.6 billion)
- Digit –General Insurer with tech-enabled processes (Valuation ~USD 3.5 billion)
- Unacademy – Online education like language, programming, job preparation web portal (Valuation ~USD 3.4 billion)

Valuing a Start-up Business

Basic premise for a valuation of any company is going concern assumption and fair value concept.Cost approach of valuation cannot be effectively utilized for valuing a start-up company since it is difficult to estimate how much money will be spent in future. Market comparable approach is a worthy replacement but measuring a start-up's projections against historical performance of established companies would not lead to a realistic comparison because projecting earnings for a start-up company involves making a definitive judgment on the probabilities of success of a new business. Thus, income approach is the appropriate approach which will take into account the forecasted income from business.

While using Income approach in Valuation, more so Discounted Cashflow (DCF) method, valuing a company meansdiscounting the future cashflows to present value at an appropriate rate. The value of start-ups is generally based on how investors and venture capitalists feel they will grow and develop, so it all comes down to longer-term forecasting. Like for instance in case of Zomato, in the span of ten years there were more than ten rounds of funding, starting from Series A to Series J. This means that such disruptive businesses should not be fragile and should have a higher success rate of growth. Thus, more often than not,their valuations have nothing to do with the way they perform financially. In fact, many of these businesses rarely generate any profits when they first get running. Therefore, most of the startup funding deals are not based on DCF method.

Thus, in practice there are some other methods which are used for start-up funding deals which are as follows:

<u>Gross Merchandise Value method</u>

For many e-commerce entities gross merchandise value (GMV) is used to value e-commerce business, where the focus is only on top-line of the entity and profitability is ignored. In lay layman's terms, GMV isthe value of the merchandise sold over a period of time, without taking into account the discounts offered, the cashbacks granted or any other expense in connection to the sale. Thus, to quote a simple example, a commodity worth Rs.1000 was offered at 50% discount, that is, at Rs.500. Furthermore, the customer was offered a 10% cashback, and thus he paid an amount of Rs.450 for the product. Though the cash inflow is Rs.450, the GMV is Rs.1000.

GMV is often used to determine the health of an e-commerce site's business because its revenue will be a function of gross merchandise sold and fees charged. It is most useful as a comparative measure over time, such as current quarter value versus previous quarter value. There is also the flip side of this method. Just to attain higher valuation based on the gross value, cheap selling techniques like huge discounts and cashbacks become a trade practice which results into operating loss for the transaction. Another noteworthy point to be carried home is the fact that GMV nowhere considers 'profitability' of the transaction from the e-commerce website's perspective. Thus, many venture capitalists no longer consider GMV as the sole substratum for valuing e-commerce businesses.

Venture Capital Method

It is most common approach to value young companies. It is a valuation based on expectation of venture capital investor. Investor will try to obtain return on its investment commensurate with the risk it perceives. This method starts by defining return on investment (ROI). Objective of investor is pre-determined exit date & pre-determined ROI. It generally focuses on revenue and earnings and ignore intermediate items like working capital requirements, capex requirements, etc. It also tends to ignore cash flows.

In this method, the earnings of the private firm are forecasted in a future year, when the company can be expected to go public. These earnings, in conjunction with a price-earnings multiple, estimated by looking at publicly traded firms in the same business, is used to assess the value of the firm at the time of the initial public offering; this is called the exit or terminal value. Discounting the terminal value arrived with ROI to arrive at the present value. Value arrived as above is 'post-money' value.

Post Money Value = Pre-money value + New Capital infusion by Venture Capital investor

For Instance:

Particulars	Scenario 1	Scenario 2
Annual Earning as on date	1,00,00,000	1,00,00,000
Growth in Earnings	20%	15%
No. of Years to Exit	10	15
P/E Multiple	12	10
Initial Investment by Founders	20,00,000	20,00,000
Required Rate of Return	35%	25%
Equity Stake of VC Investor	10%	15%
Current No. of Shares	10,00,000	10,00,000
Annual Earning as on Exit	6,19,17,364	8,13,70,616
Future Value of Startup	74,30,08,371	81,37,06,163
Value of Startup (Post Money Valuation)	**3,69,53,538**	**2,86,29,740**
Number of Shares owned by VC Investor	1,11,111	1,76,471
Total Outstanding Shares	11,11,111	11,76,471
Price per Share	**33.26**	**24.34**
Pre Money Valuation	3,32,58,184	2,43,35,279
New Capital Infusion by VC Investor	**36,95,354**	**42,94,461**

Unit based Economics in case of Start-ups[2]

There is a certain user-based economics. In the start-up language it is generally referred to as customer cohort. At the outset, it is important to differentiate between a user and a customer. A user may be a paying user or a free user, whereas a customer is generally a paying customer. Accordingly, it is important to note that as a term, user is much wider than the term customer, in the start-up discussion. Accordingly, for valuing a start-up based on the user base, it is critical to work out how much money is the start-up expecting to generate from its users? Hence, it is a factor of three things that come into picture:

[2] *From article "Understanding the Valuation drivers of new-age modern technology enabled businesses" in Valuation: Professionals' Insight Series – 6 of ICAI*

(i) Existing users (Already achieved – stage of the start-up to see if it has a value proposition)

(ii) Future users (Growth potential coupled with scalability)

(iii) The above two inflows would be adjusted for Costs involved (User acquisition costs as well as business costs)

For valuing the existing users, factors like revenue per user, renewal rate, life of user with the start-up and associated costs of existing users are considered. For new users, in addition to the associated costs, the user acquisition costs are to be adjusted to identify the profit potential of the business.

User acquisition costs are the costs that are incurred by the start-up in acquiring a user. These are in the form of marketing spends, as well as the significant spending in the form of lucrative deals that are offered to the first-time users or to all users in the initial phase of the life-cycle of the start-up.Business costs are the operational costs of the start-ups that are required to be incurred by the start-up for the purpose of running its business.

A depiction of the above discussion, in context of a start-up, in a tabular format for comparing the Good and the Bad, in a relative sense, can typically be as under:

Point	The Good	The Bad
Losing money	Where money is being lost for user acquisition. Such type of cash burns is funded by VC only at the pretext of super normal growth.	Where money is being lost for business expenses.
High costs	Where higher costs are attributable to fixed expenses, which have the potential to grow revenue in the future, without corresponding increase in costs.	Where higher costs are attributable to variable expenses, which will increase with the increase in scale of operations.
Growth	Increase in the number of users backed with growth in per user revenue, backed by cross-selling and upselling.	Growth only supported by increase in number of users with low per user revenue
Life Cycle Relevance	A start-up that focuses the relevant attribute from either of user growth, revenue growth or revenue sustainability, in tandem with the life cycle where it is.	A start-up that focuses the relevant attribute from either of user growth, revenue growth or revenue sustainability, not in tandem with the life cycle where it is. For example, a young start-up focusing on revenue growth from existing users, rather than focusing on user growth, would potentially lose more users which would hamper its growth.

Point	The Good	The Bad
Surviving through uncertainty	Businesses which have serious users i.e., users that repeat/renew as well as come back to the business more often are less susceptible to adjustments on account of uncertainty. This kind of business creates a benefit of exclusivity or the choice of first preference for the users, which commands a premium in valuation.	Businesses which have casual users i.e., users who are not repetitive as well as those which do not transact but look at the business as an option, are more susceptible to adjustments on account of uncertainty.

Some Indian Unicorns:

In India, till December 2021 there are two start-up giants which have attained a valuation of decacorn viz., Flipkart and Byju's. Both of these companies are not listed on any stock exchange. Also, very few data points are available in public domain. So, it is difficult to gauge their valuations. As far as listed start-ups are concerned, there are three such companies as of now viz., Zomato, Paytm and Nykaa which have attained a valuation of decacorn. Thus, one can analyse valuation of unicorns through these three companies.

Before we gauge the data points of valuation of these unicorns, a question might arise that how Indian bourses or regulator are allowing such loss-making companies to get listed on stock exchange? Some of the conditions for raising funds through IPO for Startups under National Stock Exchange areas follows[3]:

- Proven track record of atleast 3 years of either the applicant company, promoters or the erstwhile enterprise
- Networth should be positive
- Capitalisation of the applicant's equity shall not be less than Rs.25 crore (Capitalisation will be the product of the issue price and the post issue number of equity shares)

As can be seen from above, profit is not the criteria for raising funds through IPO. The Networth of the company should be positive although this criterion shall not be applicable to companies whose proposed issue size is more than Rs.500 crore

Also, as per the Issue of Capital and Disclosure Requirements (ICDR) Regulations of SEBI, if a start-up can get Qualified Institutional Buyers (Mutual Funds, AIFs, etc.) to back at least 75% of the issue then they can go public even if they are making losses. Hence, this comparatively new phenomenon of 'trading of loss business' is now allowed by the regulator in India.

[3] *https://www.nseindia.com/companies-listing/raising-capital-public-issues-eligibility-equity-debt*

Zomato (Zomato Ltd.)

Zomato started in 2008 as an online platform providing food guide and restaurant directory. It eventually ventured into food delivery business. It has a network of more than 3.5 lakh restaurant partners and 4.4 lakh delivery partners which mitigates concentration risk of business. It has raised funds around Rs.1.43 lakh crore through VC funding before its IPO. Much of the funds have gone into acquisition of companies like Runnr, TechEagle, Uber Eats India, etc. which has strengthened the network and supply chain of Zomato.It has an impeccable commitment of 13 years and is also recognised as one of the best Indian brands.

Business Model of Zomato broadly includes:

- Transaction fees – Transaction fees charged from food ordering and delivery ranges from 20% to 25% of the gross order value
- Advertising – Restaurants listing on Zomato pay a fixed fee to get listed on the platform
- Subscriptions – Subscriptions to Zomato Gold Pro from customers to get discount on food and delivery

India's food service industry is approximately USD 65 billion, out of which online food delivery business is hardly 7-10% as per one management consulting firm, which tantamount to USD 4.5 billion. Market share of Zomato in online food service business is approximately 42%. China's online food service industry is approximately USD 90 billion. Although it is not a proper comparison considering the per capita GDP and internet usage for food service between both the countries but overall, it emphasises that India's market of online food service is not so matured and has ample scope to grow.

Let's look at some of the data points of Zomato to understand the journey of recent past

(Rs. In crore)

Particulars	March 2019	March 2020	March 2021
Sales	1,313	2,605	1,994
Operating Profit	(2,287)	(2,388)	(480)
Profit after Tax	(965)	(2,367)	(813)
Gross Order Value	5,387	11,221	9,483
Investment of Venture Capitalist	~34,599	~10,644	~83,274
Enterprise Value	15,480	24,750	40,500
EV/Sales	11.79	9.5	20.3

As can be seen from the above exhibit till March 2021, Zomato had operating loss. Per unit cost economics was also negative owing to high selling and administration expense. Thus, in such cases free cashflows will not do justice. Use of different multiples like EV/Revenues, EV/Gross Income, EV/User are more appropriate to value such companies. Also, one interesting fact to note is that the Enterprise Value has been steadily increasing due to VC funding rounds. Post IPO, Zomato is valued at nearly double the Enterprise value as on March 2021.

"The biggest reason why Zomato is losing money is because it is comparatively a young company that is trying to take advantage of a market with immense growth potential, not because it cannot make money. In fact, if Zomato cut back on customer acquisitions and platform investments, my guess is that it could show an accounting profit, but if it did so, it would be worth a fraction of what it is today."

– Aswath Damodaran

Paytm (One97 Communications Ltd.)

Paytm started in 2010 as an Indian multinational fintech company that specialises in digital payments. It has a user base of nearly 450 million and has also tied up with 17 million merchants, most of which are QR code-based small merchants. From a payment and wallet service company, it has now expanded its business segments into e-commerce, investing, broking, consumer internet and payment bank. In short, over time it has used its platform of users to launch itself into almost every online activity. In case of Person-to-Merchant market of digital payments, Paytm's market share is 52%. Paytm also has plans to convert its payment bank into a small finance bank. As far as offline payment system is concerned, Paytm accounts for nearly 10-15% of total Person-to-Merchant POS Machines installed in the country.

Telecommunication and data usage have increased in India by leaps and bounds in last decade due to various reasons like cheaper data price, cheaper smart phones and high tele density in rural areas. Thus, the interface between business to consumer had a paradigm shift from physical to digital which has compelled many new age tech businesses to get their payment mechanism on mobile phones too. Unified Payment Interface (UPI) is a pathbreaking application layer devised by National Payments Corporation of India for cashless transactionswhich allows B-to-B or even merchant payments. UPI transactions have crossed around Rs.1 trillion daily in 2021. As a consequence, wallet operators already have more merchants signed up than the POS machines set up by all banks cumulatively in the last two decades. Digital payments have increased at a staggering rate of ~10.5x in last five years which now constitutes nearly 30% of the retail transactions.

Retails digital lending has reached around USD 110 billion due to many fintech companies who have ventured into specialized as well as short-term lending through faster disbursements, although average ticket size of fintech loan is quite small.

Some of the data points of Paytm to understand the valuation it has reached

(Rs. In crore)

Particulars	March 2019	March 2020	March 2021
Sales	3,050	3,115	2,667
Operating Profit	(4,115)	(2,465)	(1,677)
Profit after Tax	(3,960)	(2,833)	(1,560)
Gross Order Value	2,29,200	3,03,200	4,03,300
Investment of Venture Capitalist	~2,500	~7,550	0
Enterprise Value	90,200	1,20,000	1,23,750
EV/Sales	29.57	39.34	46.40

As can be seen from the above exhibit, gross order value is increasing exponentially since Paytm has been expanding its business in all the walks of online transactions. Although the operating profit and PAT have been decreasing since last three years but the interesting fact is sales are stagnant. It gives an indication that the take rate (aggregator's charges) on gross order value is decreasing year on year. This is mainly because the company is more focused on the number of transactions rather than the value of those transactions. Although a company like Paytm which is in super normal growth phase can have a pretext of lower take rate but if the cash burnouts have to be reduced then the take rate has to increase over time. Again, in the case of Paytm, use of different multiples like EV/Revenues, EV/User are more appropriate to value such companies.EV/Sales have been increasing year on year which is too high as compared to some international peers like Paypal and Visa. Interestingly, Post IPO the valuation has decreased from Rs.150,000crores to Rs.90,000 crores.

Nykaa (FSN E-Commerce Ventures Ltd.)

Nykaa is an Indian lifestyle marketplace for beauty, wellness, and fashion products, started in 2012. The company has expanded from online-only to an omnichannel model to sell the products. It has around 80 brick-and-mortar stores in India along with its online e-commerce website and mobile applications. It claims to have over 3 lakh products across 1500 brands. It has raised funds around Rs.1.1thousand crore through VC funding before its IPO.

In India, there are three modes of selling beauty and wellness products viz., unorganized retail, organized branded stores and online marketplace. The first two methods face a lot of accessibility issues whereas online marketplace hasresolved this issue. The online market size for beauty and personal products is around USD 1.2 billion which is not more than 10% of the total market of beauty and personal products as per the Management & Discussion Analysis of Nykaa's Annual Report. E-commerce operators for such products work on two models either as an aggregator/ marketplace (for e.g: Amazon) or as an own platform/ holding inventory (for e.g: D-Mart). Aggregators are merely a mediator between buyers and sellers and earn some % of transactions whereas own platformmodel hoards the inventory in their own warehouses and then sell products using their bargaining power.

Some of the data points of Nykaa to understand the valuation it has reached

(Rs. In crore)

Particulars	March 2019	March 2020	March 2021
Sales	1,111	1,768	2,441
Operating Profit	21	83	163
Profit after Tax	(25)	(17)	62
Gross Order Value	1,650	2,685	4,046
Investment of Venture Capitalist	~108	~100	~86.5
Enterprise Value	5,430	9,000	33,750
EV/Sales	4.89	5.09	13.82

Most interesting fact which seldom occurs in start-up world is "profits". Since last 3 years Nykaa has reported operating profits and in the last year bottom-line also became positive. This is mainly because Nykaa has opted for holding inventory model rather than aggregator model. This strategy has not only helped the company to sell products at their price but has also solved a problem of duplicate or obsolete products as the products that are sold are under the control of their own warehouses. Enterprise Value has increased at a rate faster than the increase in sales becauseof optimizing cost along with customer retention, which has helped the company to report profits. Post IPO, Nykaa has achieved a valuation of decacorn.

Conclusion:

Principles of Valuation will remain same for any company in all the markets but conventional methods would need to be replaced by newer methods. Most of the unicorns are money-losing, cash burning enterprise now but they are in the early life cycle of the business. Most of them are on track to deliver a viable business model. For such companies, network is the biggest asset. Network carries an inherent value which is gauged by the potential investor and thus, they don't have second thoughts to pump in the money. When such companies grow through their network, it is easier from them to grow. Valuation isn't a one-dimensional game wherein a straight-jacketed formula can be conveniently laid down. It is not a uni-regressional model. And that is the reason why a loss-making company is traded at a unicorn valuation.

◆◆◆

List of CVOCA Members who have qualified as Registered Valuers (Securities & Financial Assets) under Companies Act, 2013

List is based on the details shared by members as on 30th November, 2021

(Name below are in alphabetic order)

Aashay Hasmukh Dedhia
99201 84889
aashayhdedhia@gmail.com

Gautam Rajesh Mota
95943 39945
gautam@cgcaindia.com

Harsh Hasmukh Dedhia
98924 44121
harsh_dedhia86@yahoo.com

Kiran Jivraj Nisar
92232 67344
kiran_nisar@hotmail.com

Litesh Korshi Gada
98336 57656
liteshgada@gmail.com

Neerav Mulchand Gala
98191 95731
neeravgala@gmail.com

Paras Khimji Savla
98216 57543
paras@psaindia.net

Sachin Premji Chhadawa
99206 18833
sachin@sachinfcs.com

Heartiest Congratulations

Heartiest Congratulations to dynamic and vibrant members of CVOCA association for being elected at Central Council(CC) and Regional Council (WIRC) for the term 2022-2025

CA Priti Paras Savla

(Village-Vanki)

She is currently CVOCA managing committee member

CA Ketan Damji Saiya

(Village-Mokha)

He is Past President (2011-2012) of CVOCA

We wish all the success to CA Priti Savla and CA Ketan Saiya at the Council level in the coming days.
We also Thank all the Past Presidents, Seniors, Core Group Members and Members of Association who have Voted, Guided, Supported and Helped in the entire Election Process.

EVENTS IN RETROSPECT

Day & Date	Committee	Program Name	Speaker	Attendance / Views
28th November 2021 Virtual Meeting	Program Committee	Importance of Emotional & Mental Health	Speaker - BK Shivani Didi	2700+ views