ASIT MEHTA & ASSOCIATES
CHARTERED ACCOUNTANTS

Knowledge Update

Valuation of business and assets: When does it apply?

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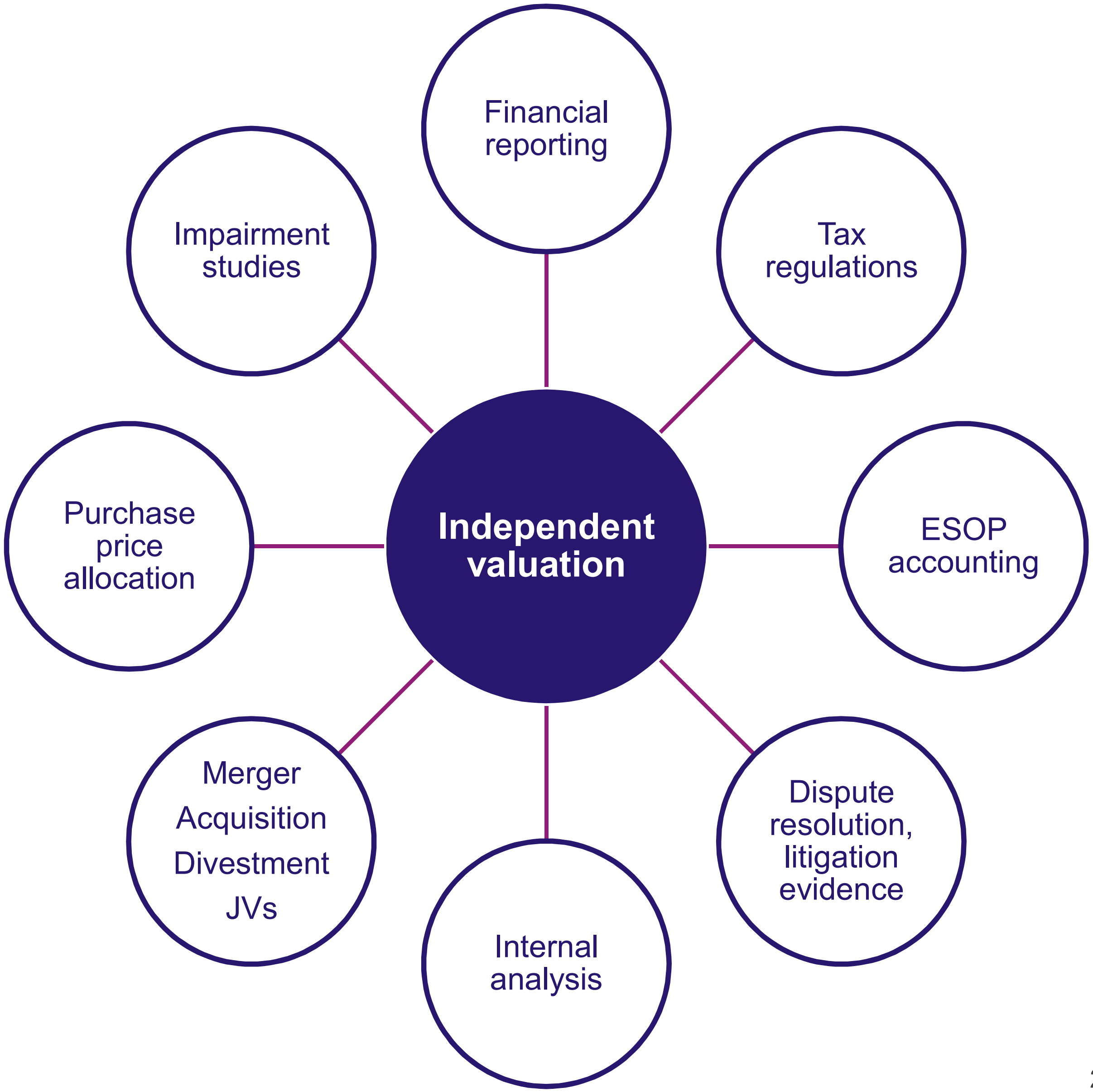
Valuation requirements in a typical business

Valuations are required by growing businesses at *various stages* in their life cycle. While traditionally these have been driven by transactions, the *Indian regulatory environment is tightening* in a manner that suggests that these will be required even on an ongoing basis for issues such as carrying value of investments, goodwill impairment assessments, etc.

This is discussed further on the following pages.



Normal course of business

Impairment: Ind AS 36 / IAS 36 (IFRS) / ASC 350 (US GAAP)

- Global accounting standards require that the subsidiaries, assets and CGUs held by a company *be tested annually for impairment*.
- Each GAAP has *unique exemptions or methods* and must be studied carefully to apply the principles correctly.

Required: Present value of future cash flows to assess fair value of the asset or CGU, compared to carrying value

Business combination: Ind AS 103 / IFRS 3 / ASC 805 (US GAAP)

- All accounting standards prescribe methods to account for acquisitions and recognition of intangible assets acquired.
- Each GAAP also requires a *calculation of goodwill* and annual testing for *impairment* of goodwill and/or intangible assets thereafter.

Required: Allocation of transaction price to all assets (tangible, intangible and goodwill) and annual impairment testing

Investments: Ind AS 109 / IAS 39 and IFRS 13 / ASC 320 (US GAAP)

- Global accounting standards specify methods for valuation of financial investments held by a company at *acquisition as well as annually*.
- Each GAAP has *unique exemptions or methods* and must be studied carefully to apply the principles correctly.

Required: Estimating fair value of equity or debt instruments held by the company, annual mark-to-market adjustments

Intangible assets: Ind AS 38 / IAS 38 (IFRS) / ASC 350 (US GAAP)

- Accounting standards prescribe methods to capitalise *self-generated or acquired* intangible assets
- Methods may vary and intangible assets must be tested for *impairment and remaining useful life* annually

Required: Consider cost of assets, benchmark transactions of similar assets, present value of future benefit from the intangible asset, etc.

Normal course of business (cntd.)

Capital gains tax: Global tax requirements

- Tax regulations across the world require the payment of capital gains tax *on sale of an asset or business*
- Some jurisdictions also require that the *"tax cost base"* of an asset be re-set to fair value, or may tax a *bargain purchase* of an asset

Required: External valuation of the asset or entity to arrive at the estimated cap gains tax liability for the seller and/or acquirer.

Forex regulations: India and certain other jurisdictions

- In cases where an overseas entity infuses capital into a domestic entity, forex regulations often require that an assessment be made as to whether the infusion is taking place at "fair value"
- This is meant to ensure that shares are not acquired at inflated or deflated prices.

Required: External valuation of the future cash flows to assess fair value of the company

Purchase price accounting for tax: Global tax requirements

- Most regulations require a *tax cost base or a fair value* to be assigned to various assets and liabilities of a business when it is acquired
- This is meant to aid in future capital gains assessments on assets that are sold

Required: External valuation to assess the tax liability and/or tax cost base for specific assets including intangible assets of a business

Internal analysis:
Discretionary

- Management is often keen to assess the value of a business. This could be for *internal analysis and identifying focus areas*, or when contemplating *raising capital or selling a partial stake* in the business.
- Important in both early-stage and stable businesses

Required: Strategic and market insight, creation of a business model to estimate business value

Special circumstances

- Raising debt for the company based on its fair value of equity
- Negotiation of acquisition value
- Pre-transaction assessment of value and synergies by building a business model
- Assessment of acquisition opportunities (JV, acquisition, merger, setting up a new company, etc.)
- Litigation / dispute over asset values
- Assessment of exit opportunities (sale, divestiture, asset sale, IPO, etc.)
- Share swap ratios and fairness thereof for a merger of two entities
- Employee stock options and sweat equity

In addition to the valuation itself, it is important to also assess the following:

- *Funding options and leverage*
- *Accounting implications at transaction date and in future*
- *Tax implications at transaction date and in future*
- *Implication of foreign exchange regulations*
- *Company law regulations and their impact*
- *Shareholder protection regulations and their impact*
- *Anti-monopoly / promotion of competition regulations and their relevance*
- *Transition and integration issues*

Our work: a snapshot

Recruitment consulting company and its parent entity in the UK

Valuation of assets and liabilities for tax purposes in relation to a retrospective tax matter raised by Indian tax authorities

FMCG company and its parent entity in Greece

Fair valuation of equity using a forecast cash flows model to comply with Reserve Bank of India norms

Furniture fittings company and its parent entity in Austria

Fair valuation of equity using a forecast cash flows model to comply with Reserve Bank of India norms

Construction certifications company and its parent entity in Italy

1: Fair valuation for a proposed stake sale to a third party
2: Fair valuation of equity to comply with Reserve Bank of India norms

Architecture and interior design firm and an Australian acquirer

Fair valuation of an early-stage Indian design firm for a potential acquirer in Australia using a variety of market-based and forecast-based methods

Medical devices manufacturer and its parent entity in the USA

Fair valuation of equity using a forecast cash flows model to comply with Reserve Bank of India norms

Industrial lubricants manufacturer, European and Indian JV partners

Fair valuation of equity in relation to 50% stake sale by one JV partner to another to comply with Reserve Bank of India norms

Auto components manufacturer, European and Indian JV partners

Fair valuation of equity in relation to stake sale by one JV partner to another

Premium residential complex in Mumbai, India

Valuation of real estate using market benchmarks for tax purposes

Industrial design and documentation company

Fair valuation of equity using a forecast cash flows model to comply with Reserve Bank of India norms

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