Case study on the Valuation Report -Securities and Financial Assets (SFA)

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Objective of IBC:-

In the preamble it is said that

"An Act to consolidate and amend the laws relating to re-organisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.

BE it enacted by Parliament in the Sixty-seventh Year of the Republic of India as follows: -"

Valuation of Assets under IBC

Valuation is an important part of the Corporate Insolvency Resolution Process. A proper understanding of "Fair Value" and "Liquidation value is essential for protecting the interests of stakeholders and to come up with a proper Resolution Plan, which is the objective of the Code.

Appropriate and credible valuation is critical for IBC matters, otherwise a viable firm may get pushed into liquidation, or an unviable firm may remain alive. Both the situations would lead to inefficient social and economic outcomes.

Different types of Assets

- Valuation of assets is a key factor for an informed decision making under the Code.
- The key objective of valuation under the Code is to be transparent and have credible determination of value of the assets to facilitates comparison and informed decision making by the Committee of Creditors, Stakeholders' Consultation Committee, Adjudicating Authorities.
- The Registered Valuers are certified to value assets in three category of asset classes
- **a.** Land and Building: Depends on the sort of building, its structure, durability, location, size, shape, frontage, types and quality of building materials used and cost of these materials;
- **b. Plant and Machinery**: Calculate market value of the plant and machinery which helps in running the day to day business of the organization;
- c. Securities or Financial Assets: Securities are tradable financial instruments used to raise capital in public and private markets. There are primarily three types of securities: (i) equity shares which provides ownership rights to the holders; (ii) Debt essentially loans repaid with periodic payments; and (iii) hybrids.

Fair Value and Liquidation Value

The term 'fair value' and 'liquidation value' have been defined under the Code as follows:-

<u>Fair Value</u> means the estimated realisable value of the assets of the CD if they are to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an Arm's Length Transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion.[Regulation 2(1)(hb) of IBBI CIRP Regulations 2016].

<u>Liquidation Value</u> means the estimated realizable value of the assets of the CD, if the CD were to be liquidated on the insolvency commencement date. [Regulation 2(1)(k) of IBBI CIRP Regulations 2016].

Valuation methodology for valuation of Securities and Financial Assets (SFA) Regulation 35(1)(a) of the IBBI CIRP Regulations, 2016.

There are various methods adopted for valuation of assets/instruments including financial assets/instruments of an entity. Certain methods are based on asset/instrument value while certain other methods are based on the earnings potential of the asset/ instrument.

Each method proceeds on different fundamental assumptions which have greater or lesser relevance and at times even no relevance, to a given situation. Thus, the methods to be adopted for a Particulars valuation exercise must be judiciously chosen.

The valuation approaches and methods shall be selected in a manner which would maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Cost Approach

The cost approach reflects the amount that would be required currently to replace the service capacity of an asset. Often, the value of the asset/instrument is driven in terms of the investment that would be required to replace the assets they have assembled.

Net Asset Value ("NAV") Method

The Net Assets Value Method represents the value with reference to historical cost of assets owned by the company and the attached liabilities as on the valuation date. Such value generally represents the support value in case of profit-making business.

Income Approach

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

Discounted Cash Flow ("DCF") Method

The DCF method values the asset by discounting the cash flows expected to be generated by the asset or instrument for the explicit forecast period and also the perpetuity value (or terminal value) in case of assets/instruments with indefinite life. The DCF method is one of the most common methods for valuing various assets/ instruments such as shares, debt instruments, etc.

This method involves discounting of future cash flows expected to be generated by an asset/ instrument over its life using an appropriate discount rate to arrive at the present value.

The following are important inputs for the DCF method:

Cash flows; Discount rate; and Terminal value

Market Approach

Market approach is a valuation approach that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) assets and instruments.

The following are some of the instances where a valuer applies the market approach:

(a)where the asset/instrument to be valued or a comparable or identical asset/instrument is traded in the active market; (b) there is a recent, orderly transaction in the asset/ instrument to be valued; or (c) there are recent comparable orderly transactions in identical or comparable asset(s)/ instrument(s) and information for the same is available and reliable.

Market Price Method

Under Market Price method the traded price observed over a reasonable period while valuing assets/ instruments which are traded in the active market is considered. The market price of an asset/ instrument as quoted in an active market is normally considered as the fair value of said asset/instrument where such quotations are arising from the asset instrument being regularly and freely traded in, subject to the element of speculative support that maybe inbuilt in the value of the asset/ instrument.

Valuation Analysis

Valuation exercise involves estimating a fair and liquidation values of assets based upon reliable and observable inputs/ information made available to the valuer.

The following value estimates are based upon such limited information gathered from corporate debtor, resolution professional/Liquidator and provisional financial statements as on valuation date and best professional judgement of the valuer.

We have adopted the adjusted NAV Method under cost approach for determining the value of assets under SFA segment. Adjustment as appropriate have been made to the respective book values considering inter alia ageing analysis, the nature of the assets, other relevant factors and discussion with the management.

Valuation Analysis (contd.)

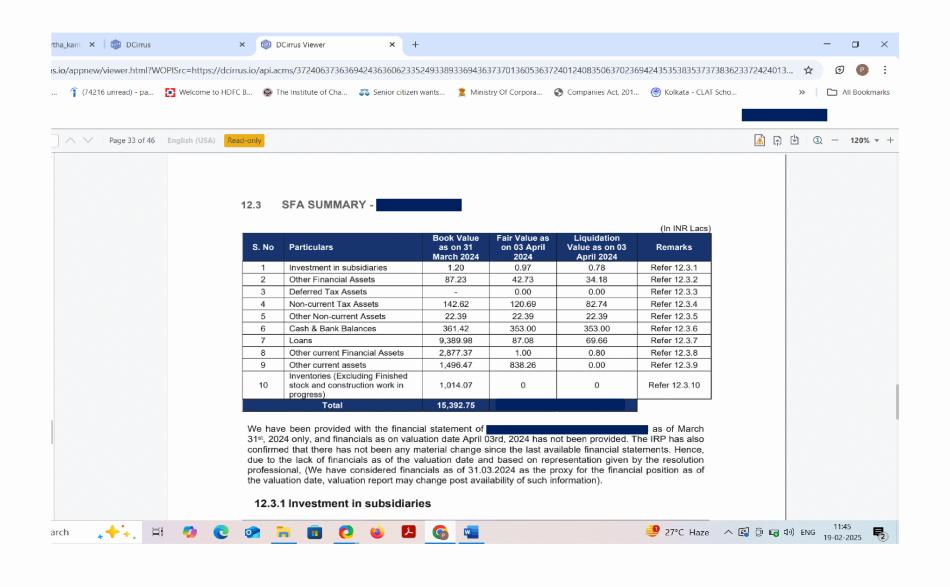
The valuer had sought for the following information form the resolution professional, with regards to, assets subject to valuation under the Securities and Financial Assets (SFA) class and appearing on the face of the latest available unaudited financial statements of the Company i.e. for the year ended 31st March 2024.

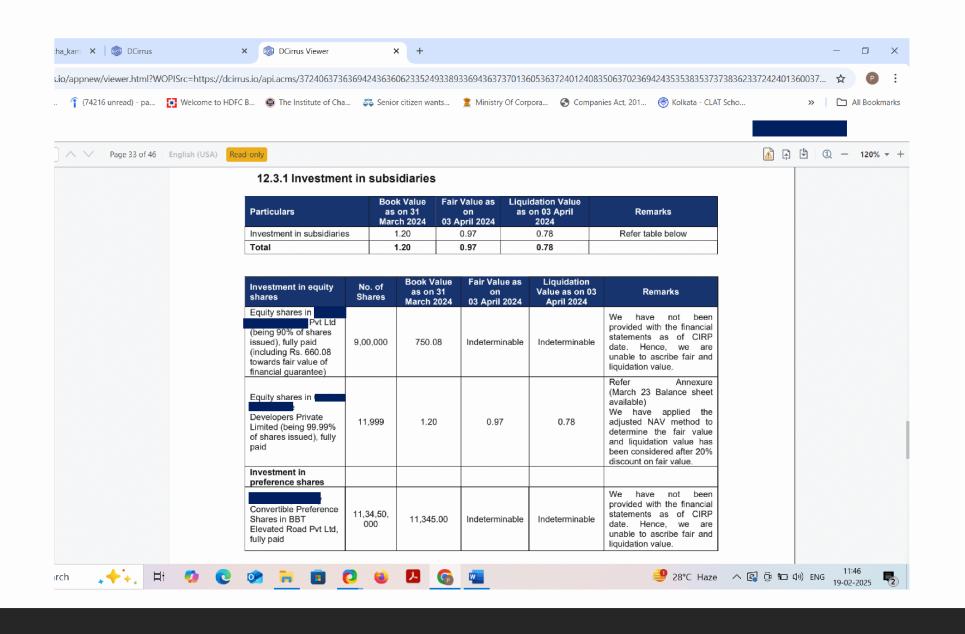
We have been provided with the financial statement of as of 31st March 20124 only, and financials as on valuation date April 03rd, 2024 has not been provided. The IRP has also confirmed that there has not been any material change since the last available financial statements.

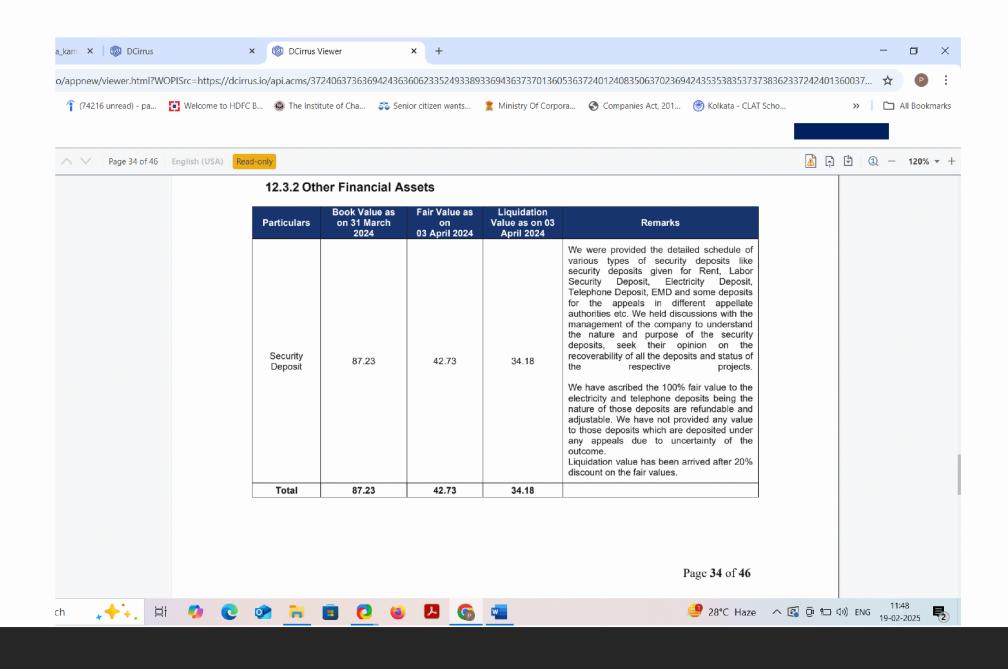
Hence, due to the lack of financials as of the valuation date and based on representation given by the resolution professional, (We have considered financials as of 31.03.2024 as the proxy for the financial position as of the valuation date, valuation report may change post availability of such information).

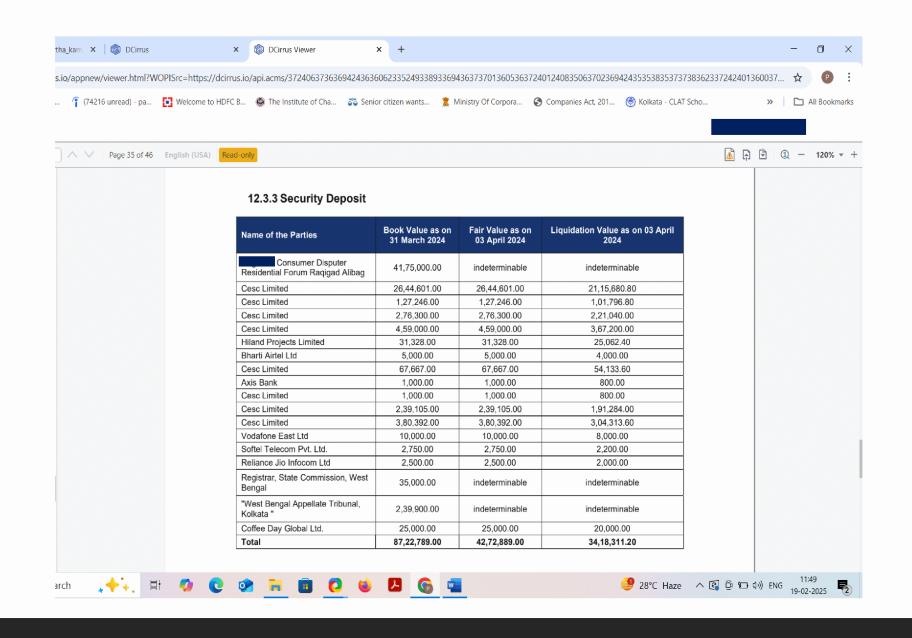
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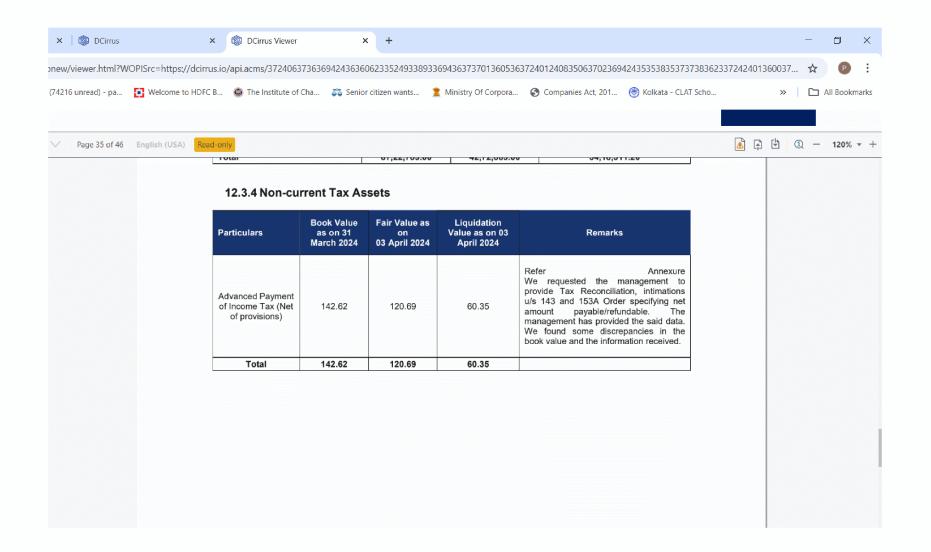
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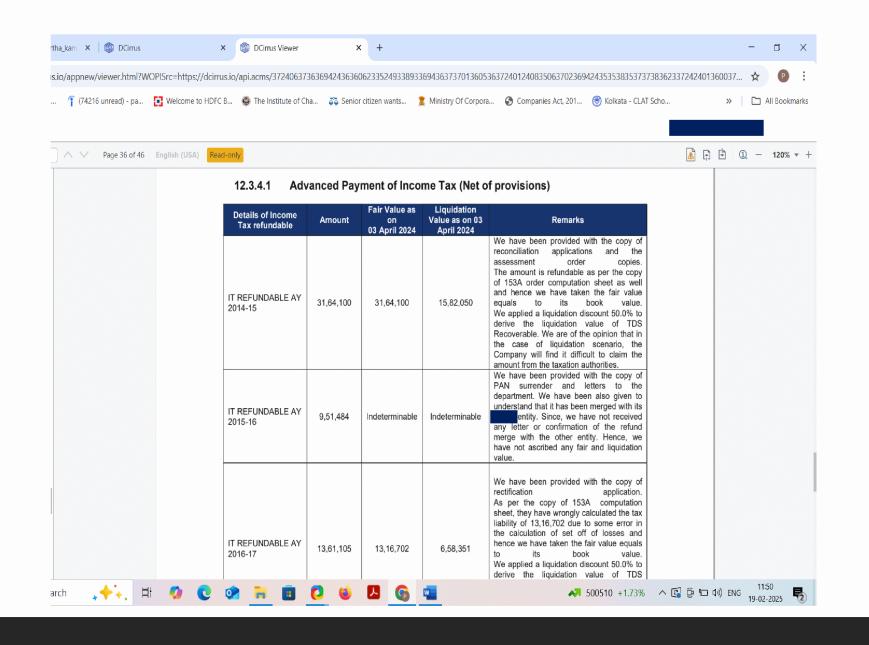


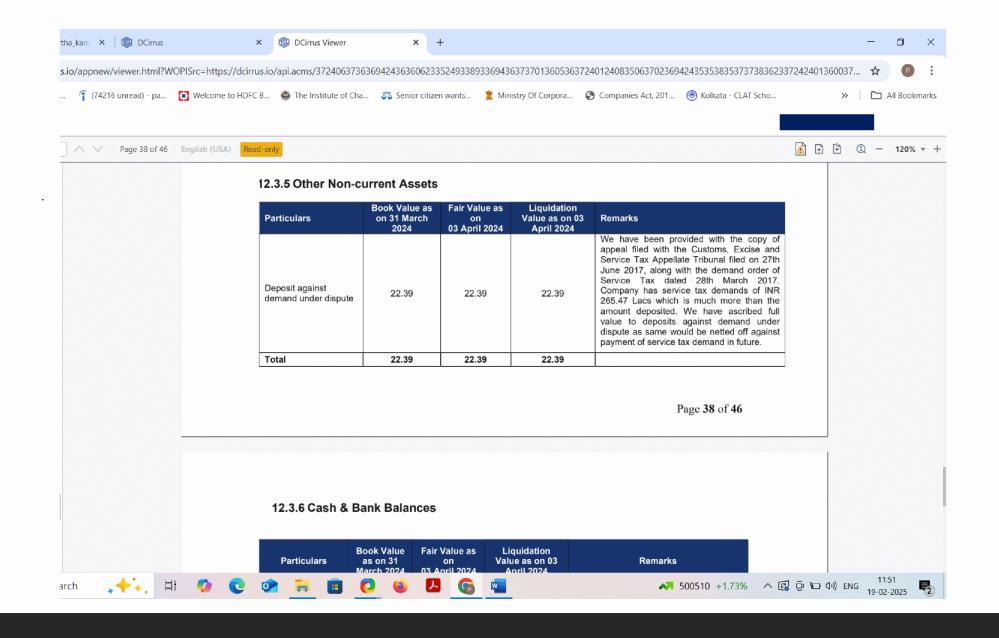


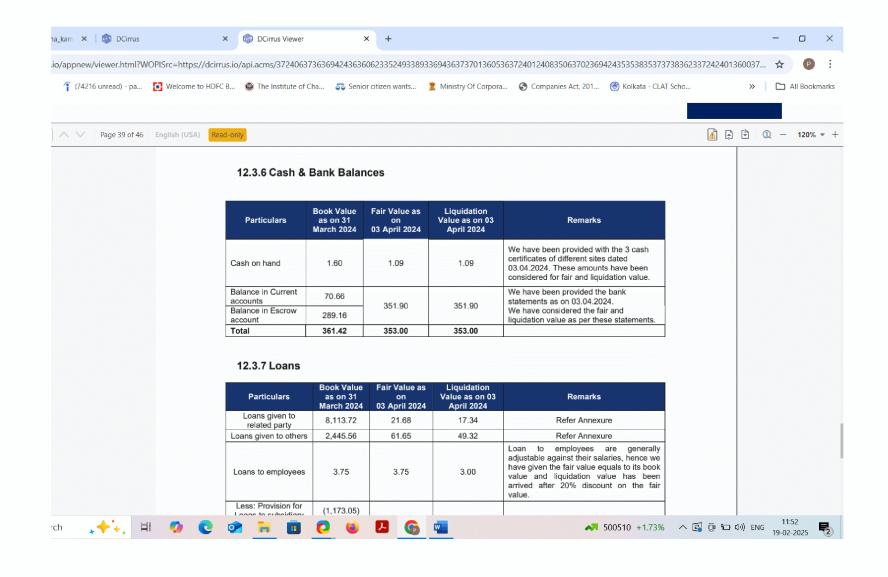


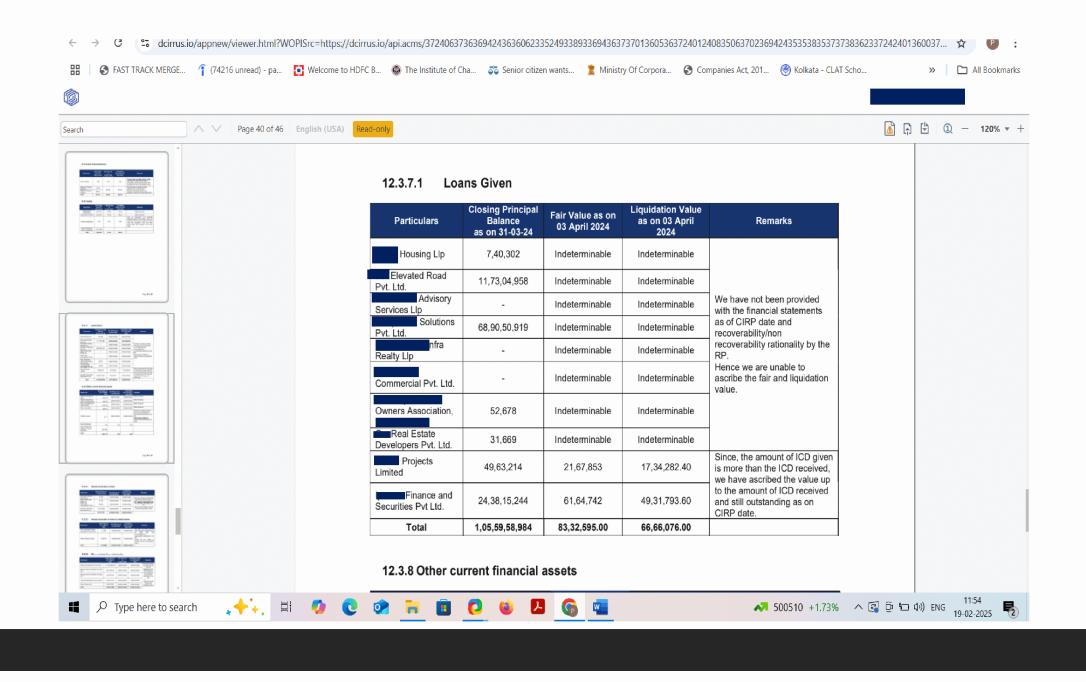


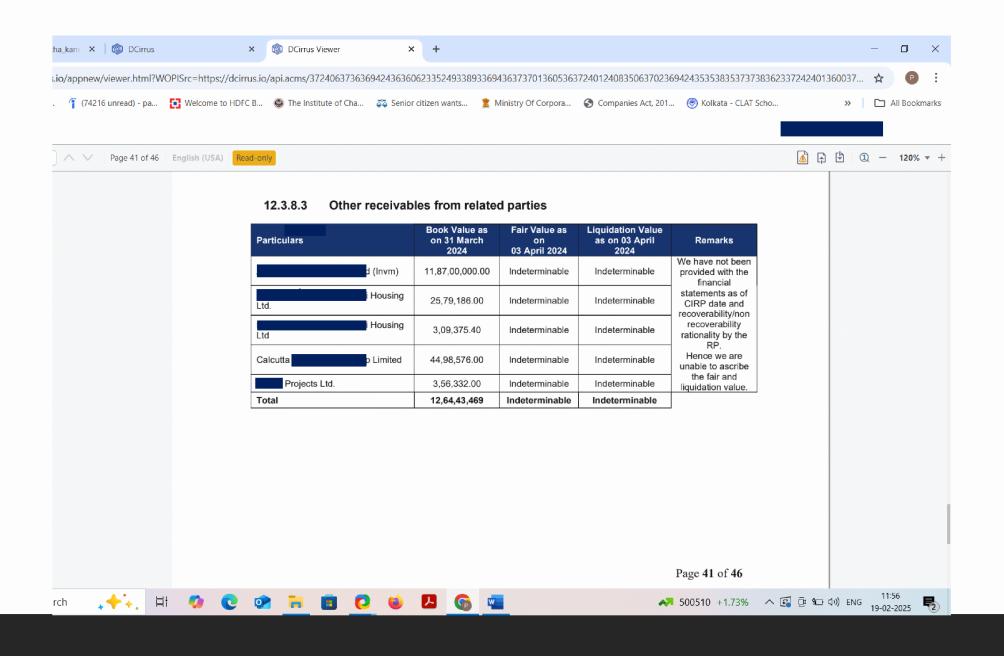


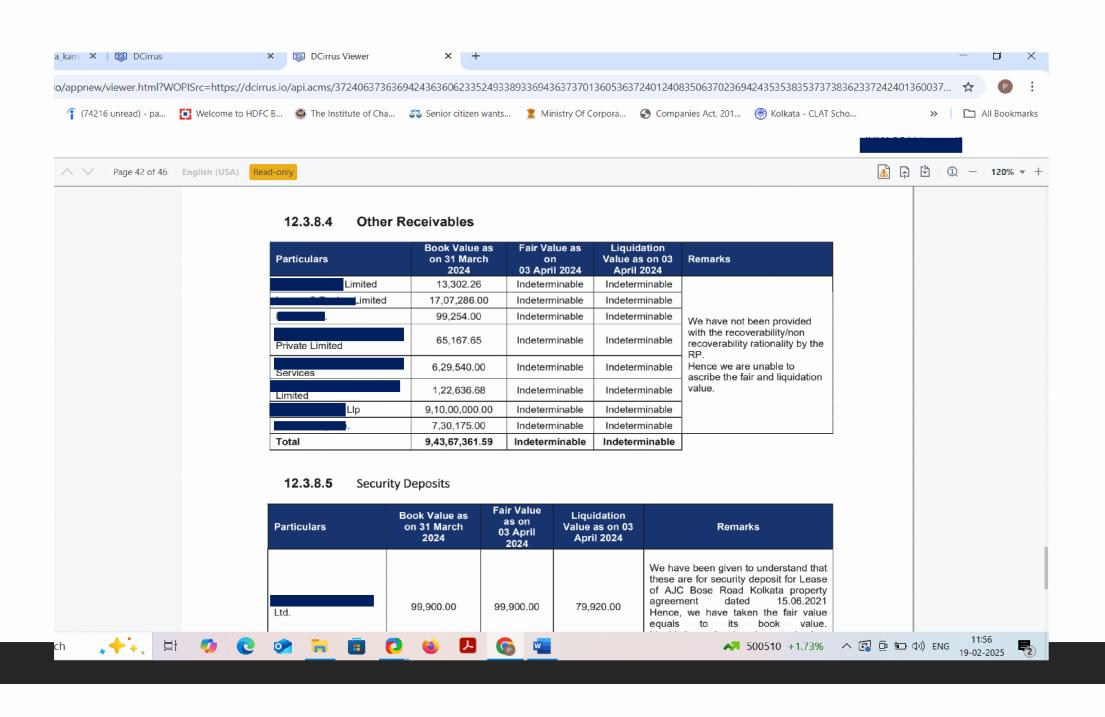












Supreme Court observations on the valuation method so adopted

Renuka Datla Vs. Solvay Pharmaceutical B.V. and Ors.

[Special Leave Petition (C) No. 18035 of 2000 with Interlocutory Application No. 2 of 2002 with S.L.P. (C) Nos. 18041-18042/2000 with I.A. Nos. 3 and 4/2002]

- The valuation approaches and methods shall be selected in a manner which would maximise the use of relevant observable inputs and minimise the use of unobservable inputs. In the given case the Valuer didn't select the DCF method as adequate inputs i.e. the projected cash flows were not available from an independent party and also there were vast discrepancies between the projections given by the parties.
- Further DCF method was not considered by Valuer due to unavailability of independent projections. In respect of projections, the Valuer had chosen the best possible method by capitalizing past earning and considering maintainable profits

Supreme Court observations on the valuation method so adopted

Renuka Datla Vs. Solvay Pharmaceutical B.V. and Ors. (contd.)

An explanation on Valuation Methodology applied to arrive at a specific valuation and 'selection' of any particular method or for 'disregarding' any approach shall always be included in a valuation report. In the given case the Valuer, clearly shared the logic and understanding behind the selection of Valuation Methodology and assignment of weightage in his Valuation Report. This surely helped him when his Valuation Report was being tested by the Court.

Thank You