MODULE I - VALUATION APPROACHES – AN OVERVIEW

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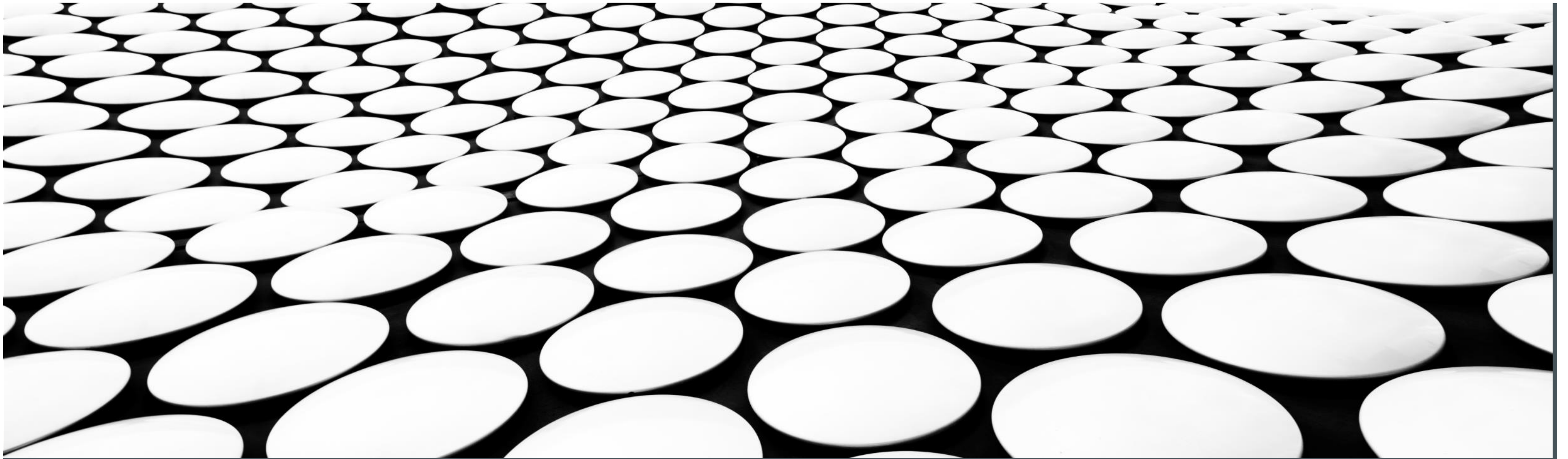

VALUATION APPROACHES

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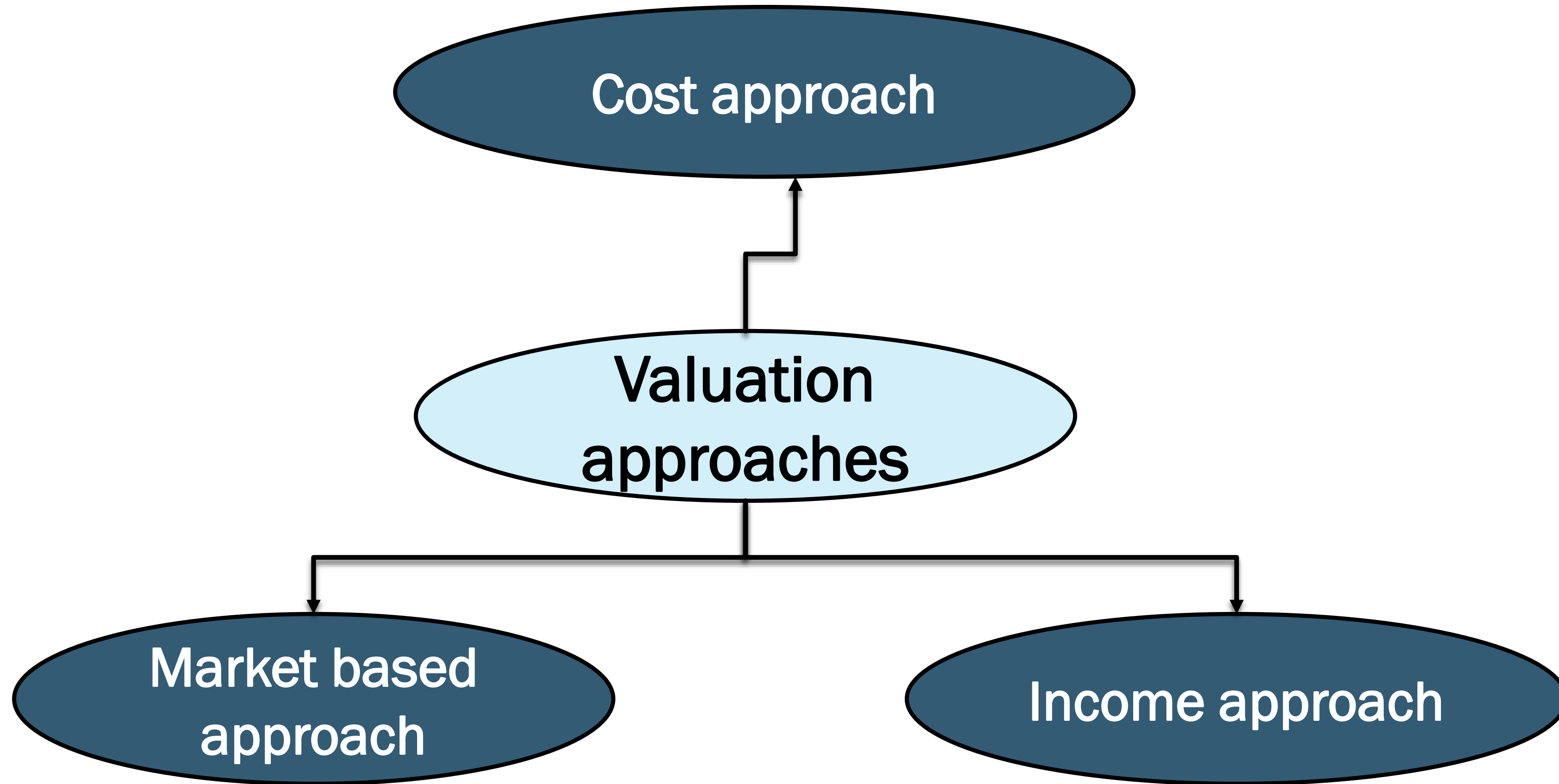


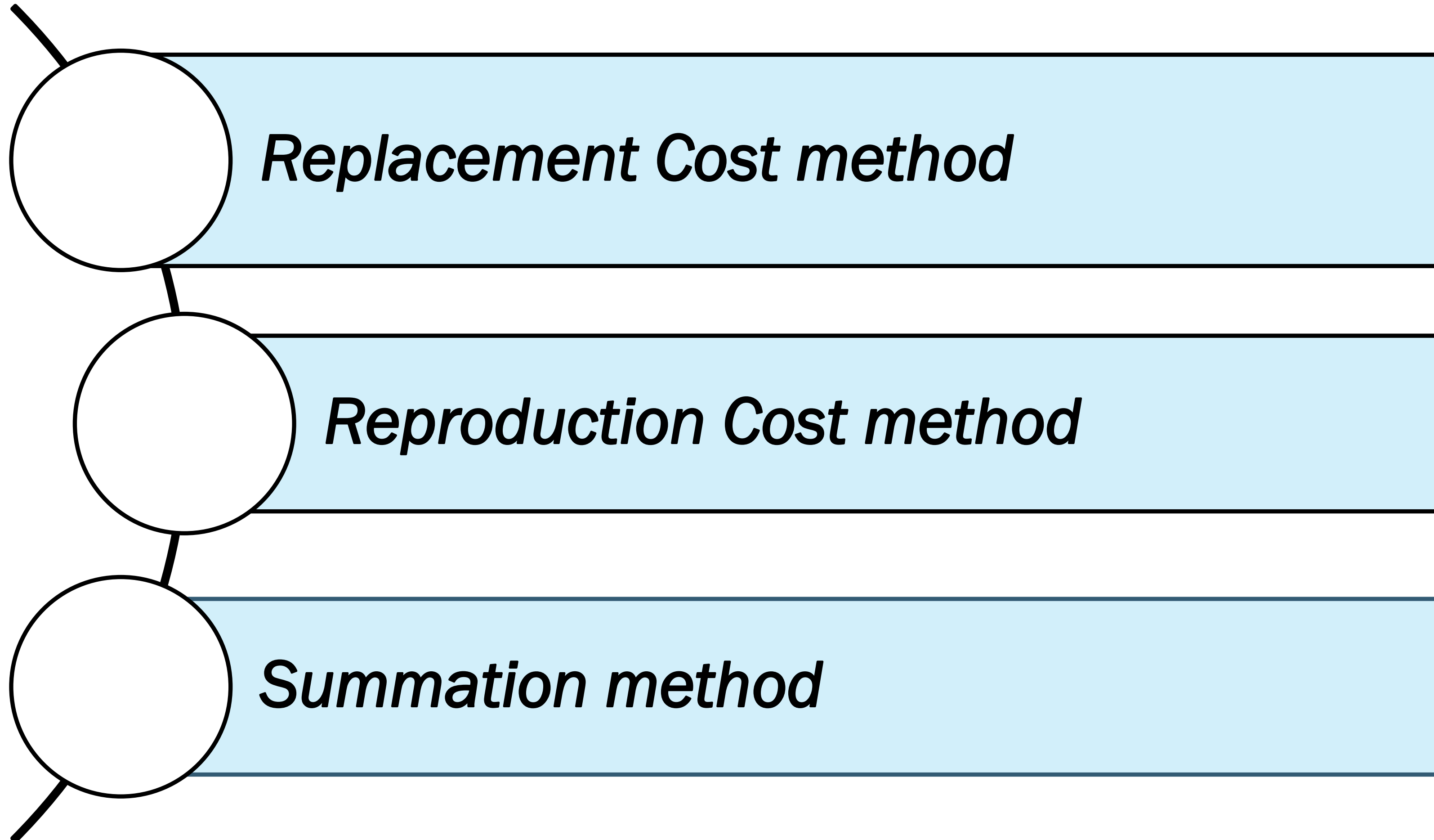
COST (NET ASSET) APPROACH

- This approach is also called Asset based approach, which is synonymous to asset accumulation approach, net asset value approach, the adjusted book value method and the asset build up method.

- The objective of this method is to study and assess values to the company’s assets and liabilities to generate value of the business. In this approach, the substance value, which assets minus liabilities must be positive. If however, liabilities are higher than assets, then this method loses its relevance.

- The drawback of this approach is that it uses balance sheet carrying values which are quite different from the real value, especially for assets when these are depreciated over their useful lives. In such cases the real value would represent the fair market value of the assets as ascertained in open market.

COST (NET ASSETS) APPROACH



REPLACEMENT COST METHOD

- This method also known as ‘Depreciated Replacement Cost Method’ involves valuing an asset based on the cost that a market participant shall have to incur to recreate an asset with substantially the same utility (comparable utility) as that of the asset to be valued, adjusted for obsolescence.

- The steps involved in valuing an asset under this method are as under:
  (a) estimate the costs that will be incurred by a market participant for creating an asset with comparable utility as that of the asset to be valued;
  (b) assess whether there is any loss on account of physical, functional or economic obsolescence in the asset to be valued; and
  (c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the asset to be valued

REPRODUCTION COST METHOD

- This method involves valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the asset to be valued, adjusted for obsolescence.

- The steps involved in valuing an asset under this method are as under:
  - (a) estimate the costs that will be incurred by a market participant for creating a replica of the asset to be valued;
  - (b) assess whether there is any loss of value on account of physical, functional or economic obsolescence in the asset to be valued; and
  - (c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the asset to be valued.

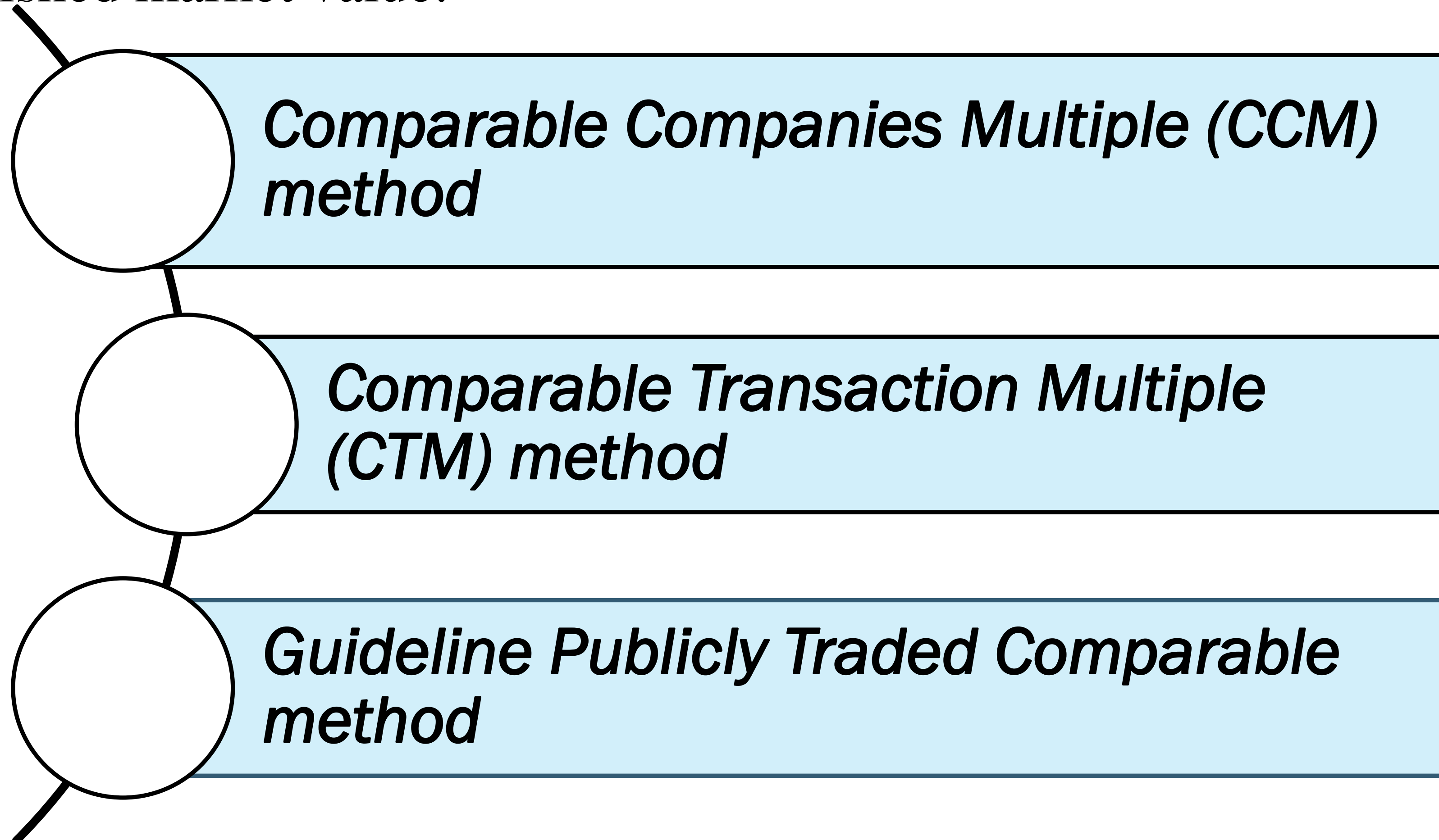
SUMMATION METHOD

- This method is also referred to as the underlying asset method, and is typically used for investment companies or other types of assets or entities for which value is primarily a factor of the values of their holdings.

- The key steps in the summation method are:
  (a) value each of the component assets that are part of the subject asset using the appropriate valuation approaches and methods, and
  (b) add the value of the component assets together to reach the value of the subject asset.

MARKET BASED APPROACH

This approach determines enterprise value by comparing one or more aspects of the subject enterprise to the similar aspects of other entities which have established market value.



COMPARABLE COMPANIES MULTIPLE METHOD

Comparable Companies Multiple Method, also known as Guideline Public Company Method, involves valuing an asset based on market multiples derived from prices of market comparables traded on active market.

COMPARABLE TRANSACTIONS MULTIPLE METHOD

Comparable Transaction Multiple Method, also known as '*Guideline Transaction Method*' involves valuing an asset based on transaction multiples derived from prices paid in transactions of asset to be valued/market comparables (comparable transactions).

COMPARABLE TRANSACTIONS MULTIPLE METHOD AND COMPARABLE TRANSACTION MULTIPLE METHOD COMPARED

Comparable Companies Multiple (CCM) Method	Comparable Transaction Multiple (CTM) Method
(a) identify the market comparables;	(a)identify comparable transaction appropriate to the asset to be valued;
(b) select and calculate the market multiples of the identified market comparables;	(b)select and calculate the transaction multiples from the identified comparable transaction;
(c)compare the asset to be valued with the market comparables to understand material differences; and make necessary adjustments to the market multiple to account for such differences, if any;	(c)compare the asset to be valued with the market comparables and make necessary adjustments to the transaction multiple to account where differences, if any existed;
(d)apply the adjusted market multiple to the relevant parameter of the asset to be valued to arrive at the value of such asset; and	(d)apply the adjusted transaction multiple to the relevant parameter of the asset to be valued to arrive at the value of such asset; and
(e)if value of the asset is derived by using market multiples based on different metrics/parameters, the valuer shall consider the reasonableness of the range of values.	(e)if valuation of the asset is derived by using transaction multiples based on different metrics or parameters, the valuer shall consider the reasonableness of the range of values and exercise judgement in determining a final value.

GUIDELINE PUBLICLY TRADED COMPARABLE METHOD

- The guideline publicly traded method utilises information on publicly-traded comparables that are the same or similar to the subject asset to arrive at an indication of value.

- The key steps in this method are depicted as under:
  - (a) identify the valuation metrics/comparable evidence that are used by participants in the relevant market,
  - (b) identify the relevant guideline publicly traded comparables and calculate the key valuation metrics for those transactions,
  - (c) perform a consistent comparative analysis of qualitative and quantitative similarities and differences between the publicly traded comparables and the subject asset,
  - (d) make necessary adjustments, if any, to the valuation metrics to reflect differences between the subject asset and the publicly traded comparables,
  - (e) apply the adjusted valuation metrics to the subject asset, and
  - (f) if multiple valuation metrics were used, weight the indications of value.

INCOME BASED APPROACH

- This approach is commonly called Discounted Cash flow approach. It is universally accepted as by far the most appropriate method used for business valuations.

- According to the income-based approach the business valuer must make estimation of the following elements highlighted below:
  (a) Estimation of business life expectancy
  (b) Estimation of future income flows that a business will generate during its life expectancy
  (c) Estimation of discount rate in order to calculate the present value of the estimated income flows.

BASES OF VALUATION

Historical cost	Assets are recorded at the amount of cash or cash equivalents paid or fair value of the other consideration given at the time of acquisition.
Current cost	Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset were acquired currently.
Realizable (settlement) value	Assets are carried at the amount of cash or cash equivalents that could be currently be obtained by selling the asset in an orderly disposal, which is the result of an arm's length transaction between knowledgeable and willing parties less the cost of disposal.
Present value	Assets are carried at the present value of the estimated future net cash flows that the item is expected to generate in the normal course of business from the continuing use of an asset and from its disposal at the end of the useful life

BASES OF VALUATION *(International Valuation Standards 2017)*

Bases of valuation	Definition
Market Value	Market Value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion
Market Rent	Market Rent is the estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
Equitable Value	Equitable Value is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.
Investment Value/Worth	Investment Value is the value of an asset to a particular owner or prospective owner for individual investment or operational objectives.
Synergistic Value	Synergistic Value is the result of a combination of two or more assets or interests where the combined value is more than the sum of the separate values. If the synergies are only available to one specific buyer then Synergistic Value will differ from Market Value, as the Synergistic Value will reflect particular attributes of an asset that are only of value to a specific purchaser. The added value above the aggregate of the respective interests is often referred to as "marriage value."
Liquidation Value	Liquidation Value is the amount that would be realised when an asset or group of assets are sold on a piecemeal basis. Liquidation Value should take into account the costs of getting the assets into saleable condition as well as those of the disposal activity. Liquidation Value can be determined under two different premises of value: (a) an orderly transaction with a typical marketing period, or (b) a forced transaction with a shortened marketing period

BASES OF VALUATION *(Indian Valuation Standards 102, 2018)*

Bases of valuation	Definition
(a) **Fair value**	It is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date.
(b) **Participant specific value**	It is the estimated value of an asset or liability considering specific advantages or disadvantages of either of the owner or identified acquirer or identified participants.
(c) **Liquidation value**	It is the amount that will be realised on sale of an asset or a group of assets when an actual/hypothetical termination of the business is contemplated/assumed.

THANK YOU!