



Valuations for Financial Reporting

- Key considerations under COVID-19 Situation

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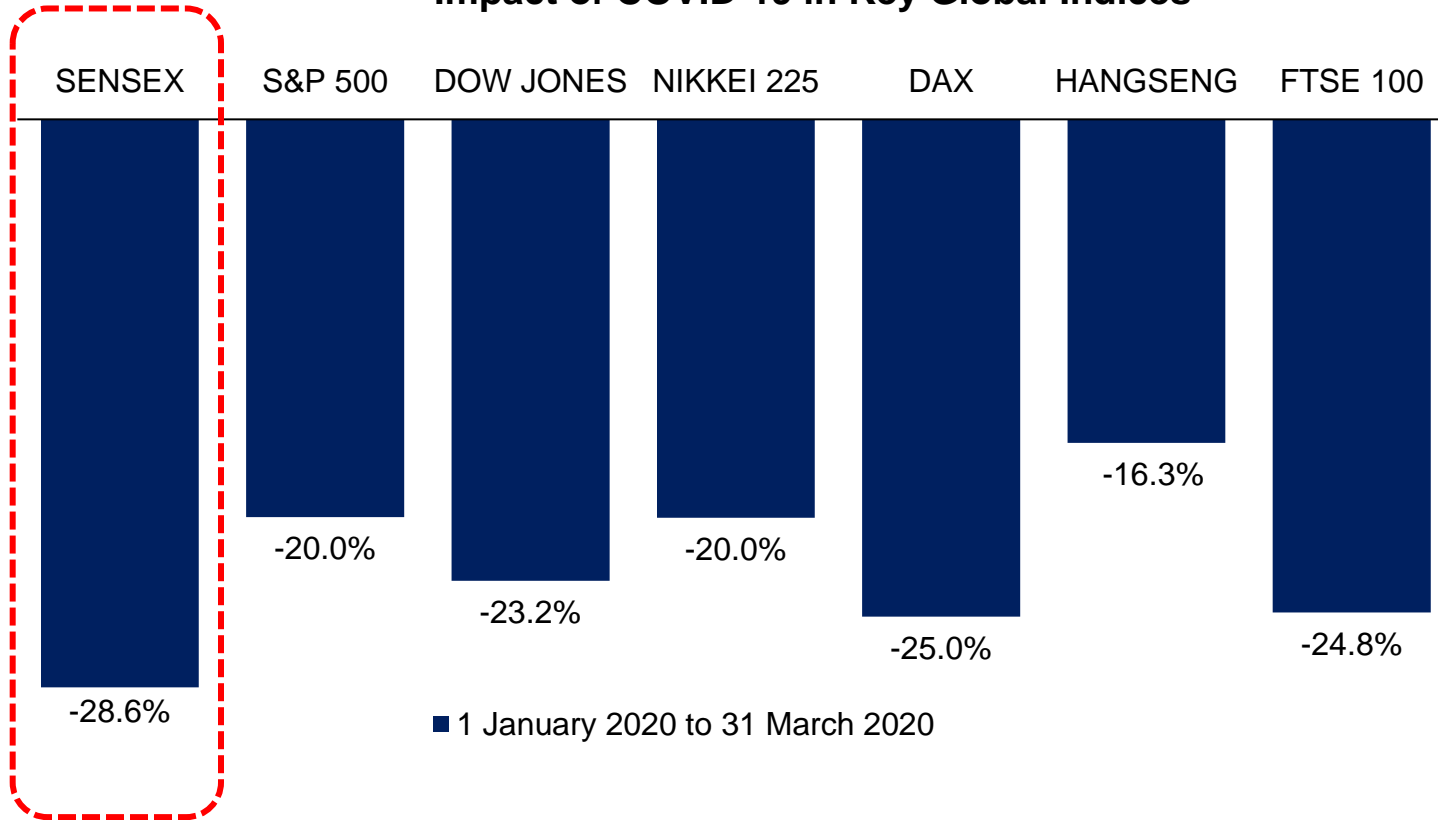
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BSE	Bombay Stock Exchange	IRR	Internal Rate of Return
Capex	Capital Expenditures	IT	Information Technology
CoCo	Comparable Companies	Kd	Cost of Debt
CoTrans	Comparable Transactions	Ke	Cost of Equity
CAGR	Compounded Annual Growth Rate	LIBOR	London Interbank Offer Rate
DAX	Stock Market Index (Frankfurt Stock Market)	MIBOR	Mumbai Interbank Offer Rate
DCF	Discounted Cash flow	M&A	Mergers & Acquisition
Dow Jones	Stock Market Index (United States Stock Market)	NAV	Net Asset Value
EBIT	Earnings Before Interest and Tax	Nikkei	Stock Market Index (Tokyo Stock Market)
EBITDA	Earnings Before Interest, Tax, Depreciation & Amortization	PAT	Profit After Taxation
ERP	Equity Risk Premium	PBT	Profit Before Taxation
EV	Enterprise Value	PV	Present Value
FCFE	Free Cashflow for Equity	Rf	Risk Free Rate
FCFF	Free Cashflow to Firm	Rm	Market Return
Fed Rate	Federal Funds Rate	Rp	Market Risk Premium
FMCG	Fast-Moving Consumer Goods	SA	Standards on Auditing
FTSE	Stock Market Index (London Stock Market)	SENSEX	BSE SENSEX 30 Index
FY	Financial Year	S&P 500	Stock Market Index (United States Stock Market)
G&A	General & Administration	TTM	Trailing Twelve Months
Hang Seng	Stock Market Index (Hong Kong Stock Market)	WACC	Weighted Average Cost of Capital
IGAAP	Indian Generally Accepted Accounting Principles	WARA	Weighted Average Return on Assets
IndAS	Indian Accounting Standard	YoY	Year on Year

Stock Markets reaction to the COVID-19 situation – Most of the key global indices have recorded decline of over 20%, Key sector indices in India recorded a negative growth since 1 January 2020



Impact of COVID-19 in Key Global Indices



1 January 2020 to 31 March 2020

Basic Material
-32.3%

Consumer Discretionary
-30.9%

Energy
-29.3%

FMCG
-10.1%

Finance
-38.5%

Healthcare
-9.5%

Industrials
-36.1%

IT
-17.0%

Telecom
-12.9%

Utilities
-27.0%

Source: Secondary Research including BSE website, Yahoofinance

Source: Secondary Research including BSE website

How does this impact Financial Reporting ?



Relevance of Valuation in Financial Reporting

Fair Valuation

Valuation in COVID-19 Scenario

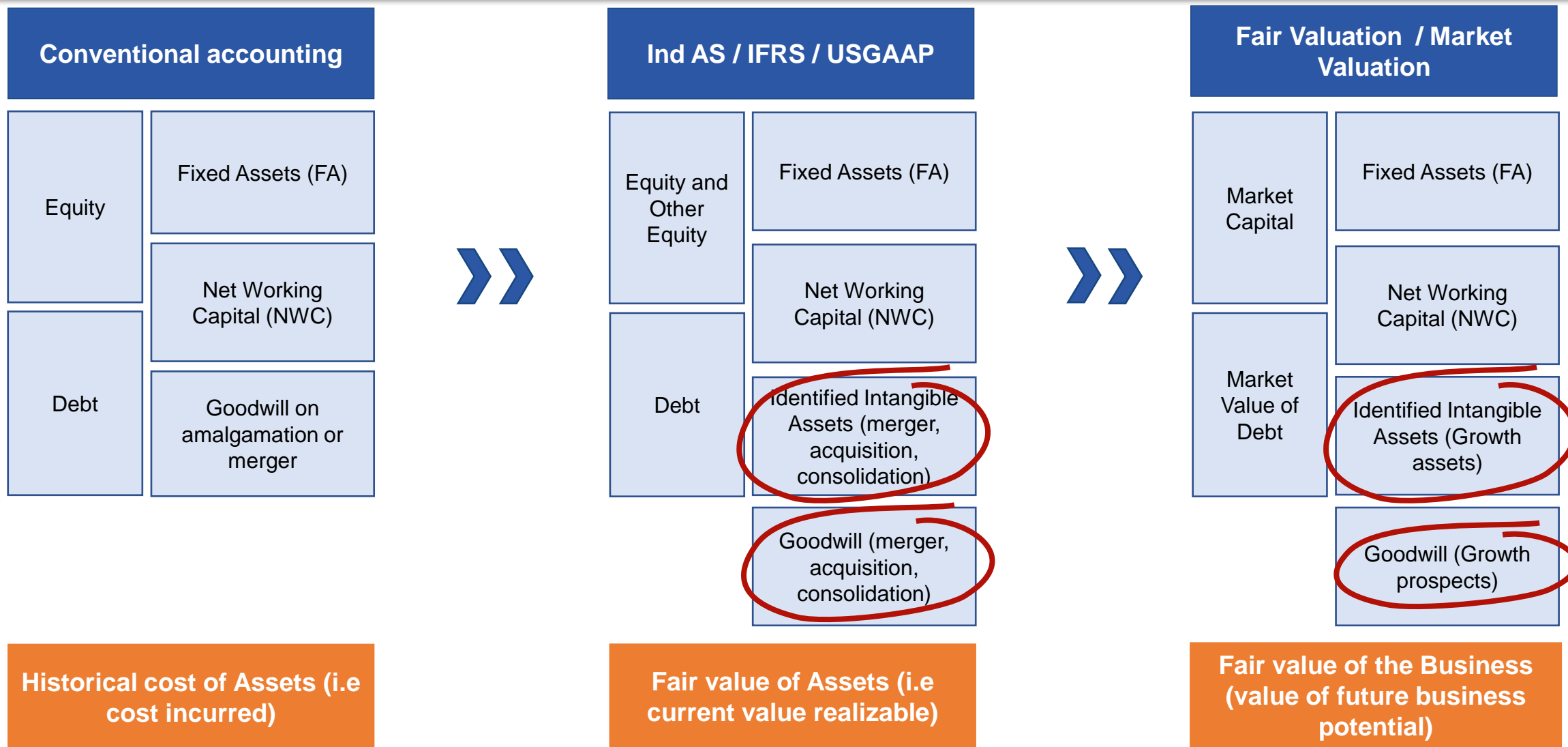


Relevance of Valuation in Financial Reporting

Fair Valuation

Valuation in COVID-19 Scenario

Financial Reporting is in transition phase from reporting Historical Cost of investment to Fair Value of Invested Capital. However, Fair Value of the Business would include growth assets / self created intangibles



Transition to reporting Fair Value of Invested Capital has included some of the identified intangibles



Case Study - Infosys

2.2.1 Reconciliation of equity as previously reported under IGAAP to Ind AS

in ₹ crore

Particulars	Note	Opening Balance Sheet as at April 1, 2015			Balance Sheet as at March 31, 2016		
		IGAAP	Effects of transition to Ind AS	Ind AS	IGAAP	Effects of transition to Ind AS	Ind AS
ASSETS							
Non-current assets							
Property, plant and equipment		7,685	–	7,685	8,637	–	8,637
Capital work-in-progress		776	–	776	960	–	960
Goodwill	(a)	3,595	(504)	3,091	4,476	(712)	3,764
Other intangible assets	(a)	66	572	638	67	918	985
Investment in associate		93	–	93	103	–	103
Financial assets							
Investments	(b)	1,305	–	1,305	1,714	–	1,714
Loans		31	–	31	25	–	25
Other financial assets		173	–	173	286	–	286
Deferred tax assets (net)	(c)	536	–	536	533	3	536
Income tax assets (net)		4,089	–	4,089	5,230	–	5,230
Other non-current assets		698	–	698	1,357	–	1,357
Total non-current assets		19,047	68	19,115	23,388	209	23,597
Current assets							
Financial assets							
Investments	(b)	872	2	874	75	–	75
Trade receivables		9,713	–	9,713	11,330	–	11,330
Cash and cash equivalents		30,367	–	30,367	32,697	–	32,697
Loans		222	–	222	303	–	303
Other financial assets		4,527	–	4,527	5,190	–	5,190
Other current assets		1,541	–	1,541	2,158	–	2,158
Total current assets		47,242	2	47,244	51,753	–	51,753
Total assets		66,289	70	66,359	75,141	209	75,350

Source: Secondary Research including Ace Equity, Company Financials

Market Capital factors value of future growth prospects representing growth assets (goodwill, human capital, intangible assets) not captured in the Financial Reports, which can be negative forecasts also



Net worth as at 31 March 2016 (INR Million)	Indian GAAP	INDAS	Market Capital
Infosys	578,260	617,790 ↑	2,786,669 ↑
Wipro	449,110	468,302 ↑	1,391,756 ↑
Reliance Industries	2,469,050	2,349,120 ↓	3,081,397 ↑
Indian Oil Corporation	774,083	914,057 ↑	932,346 ↑
TCS	658,628	714,270 ↑	4,956,618 ↑
Bharti Airtel	497,441	708,285 ↑	1,402,687 ↑
Tata Steel	324,281	445,135 ↑	309,927 ↓

Source: Secondary Research including BSE website, Ace Equity, Company Financials

- Investor expectations of returns from Equity / Debt

- WACC (Weighted Average Cost of Capital)

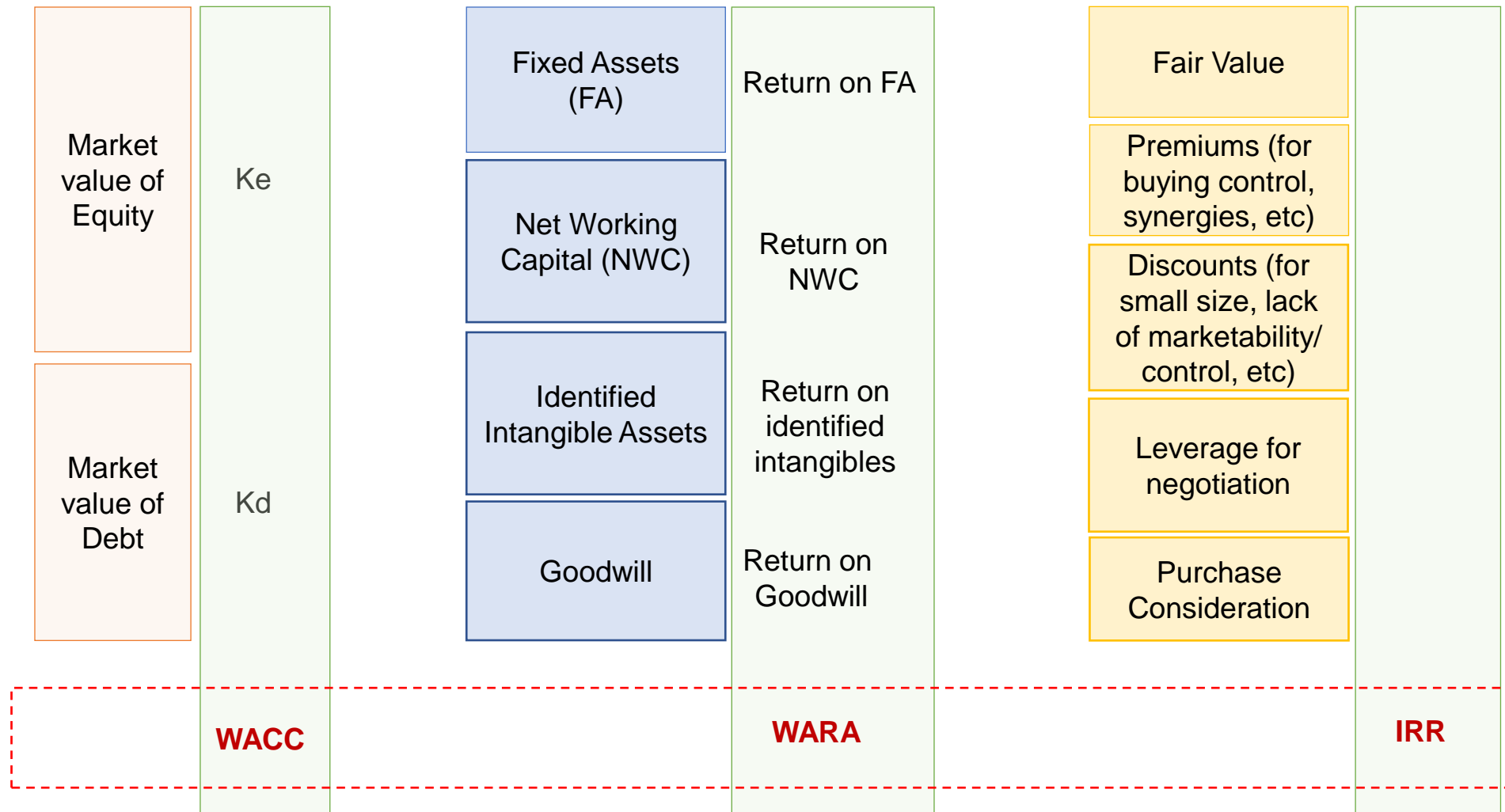
- Returns from assets based on the mix (whether or not recorded in the books)

- WARA (Weighted Average Return on Assets)

- Market premiums and discounts, alternate investment opportunities

- IRR (Internal Rate of Return)

Valuer's perspective is to capture Fair Value of Equity and Debt which would match the Fair Value of total assets (whether or not reported). Investment opportunity can then be evaluated for IRR



Given the current transition towards Fair Value reporting, valuation is part of the financial reporting process



Normal instances
where need for
valuation arises

- Fair Value reporting
- Revaluation of fixed assets (land, building, plant and equipment)
- Valuation of intangible assets (brand/trademark, customer relationships, technology, goodwill, etc)
- Business combinations (Purchase Price Allocations)
- Valuation of Investments
- Merger/Demerger situations
- Impairment testing
- Transfer Pricing (Transfer of IP, intangible, equity, related party transactions)
- Valuation of Investments
- Valuation financial assets or financial liabilities (likes compound instruments, options, contingent settlements, puttable instruments, etc)
- Litigation
- Carve out / spin off / other restructuring situations



Relevance of Valuation in Financial Reporting

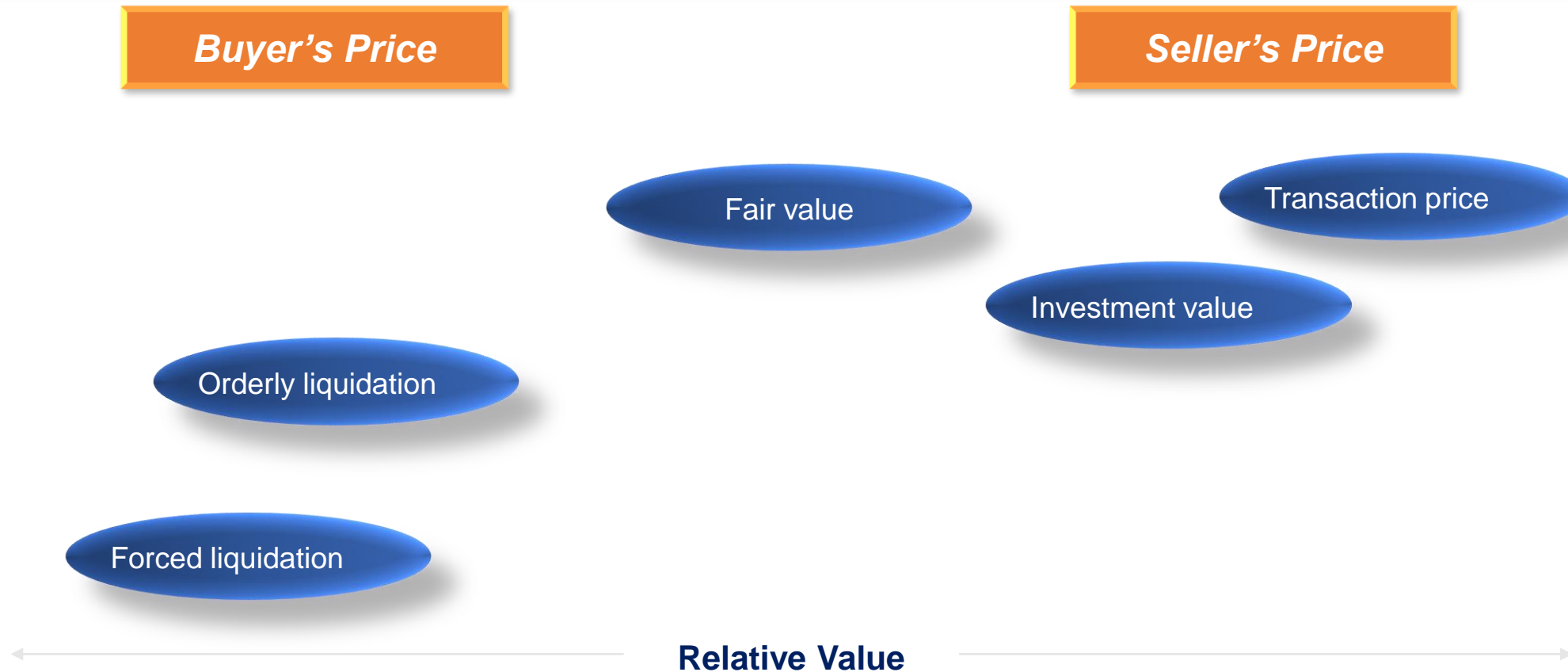
Fair Valuation

Valuation in COVID-19 Scenario

What impact due to COVID-19? For answer to this question, we need to stay focused on the definition of Fair Value and normalize any aberrations due to uncertainties

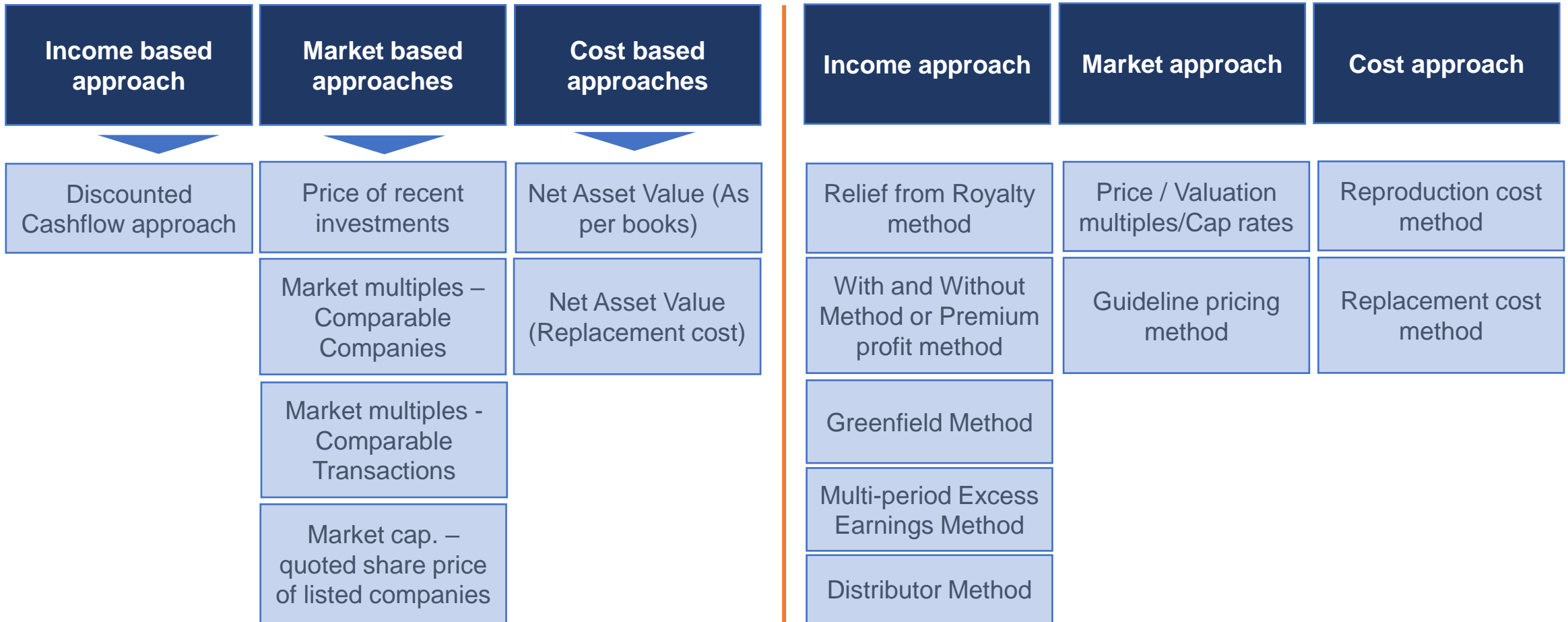


The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.



Business Valuation

Intangible Asset Valuation





Relevance of Valuation in Financial Reporting

Fair Valuation

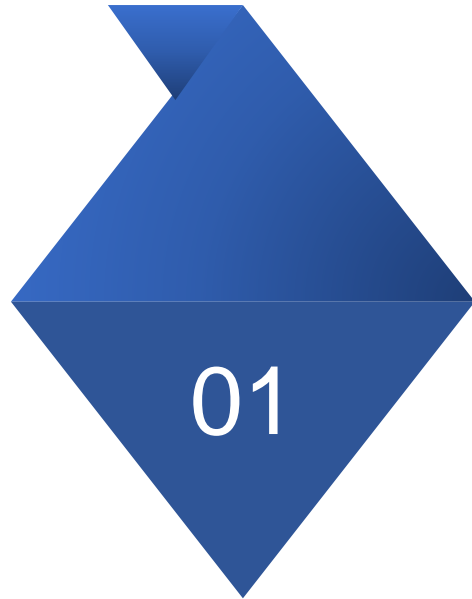
Valuation in COVID-19 Scenario

Does market capital as at 31 March reflect Fair Value?

Adjustments in DCF Method?

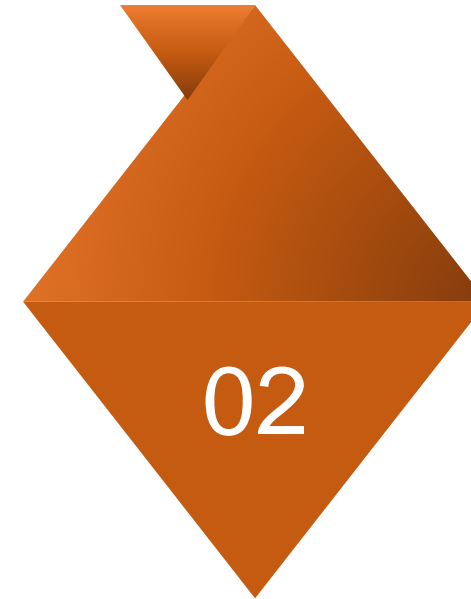
Adjustments in Market based approaches?

Under Discounted Cash Flow (DCF) Method, the impact of the current situation can be studied under cashflows or discount rate



Impact on Cash Flows

OR

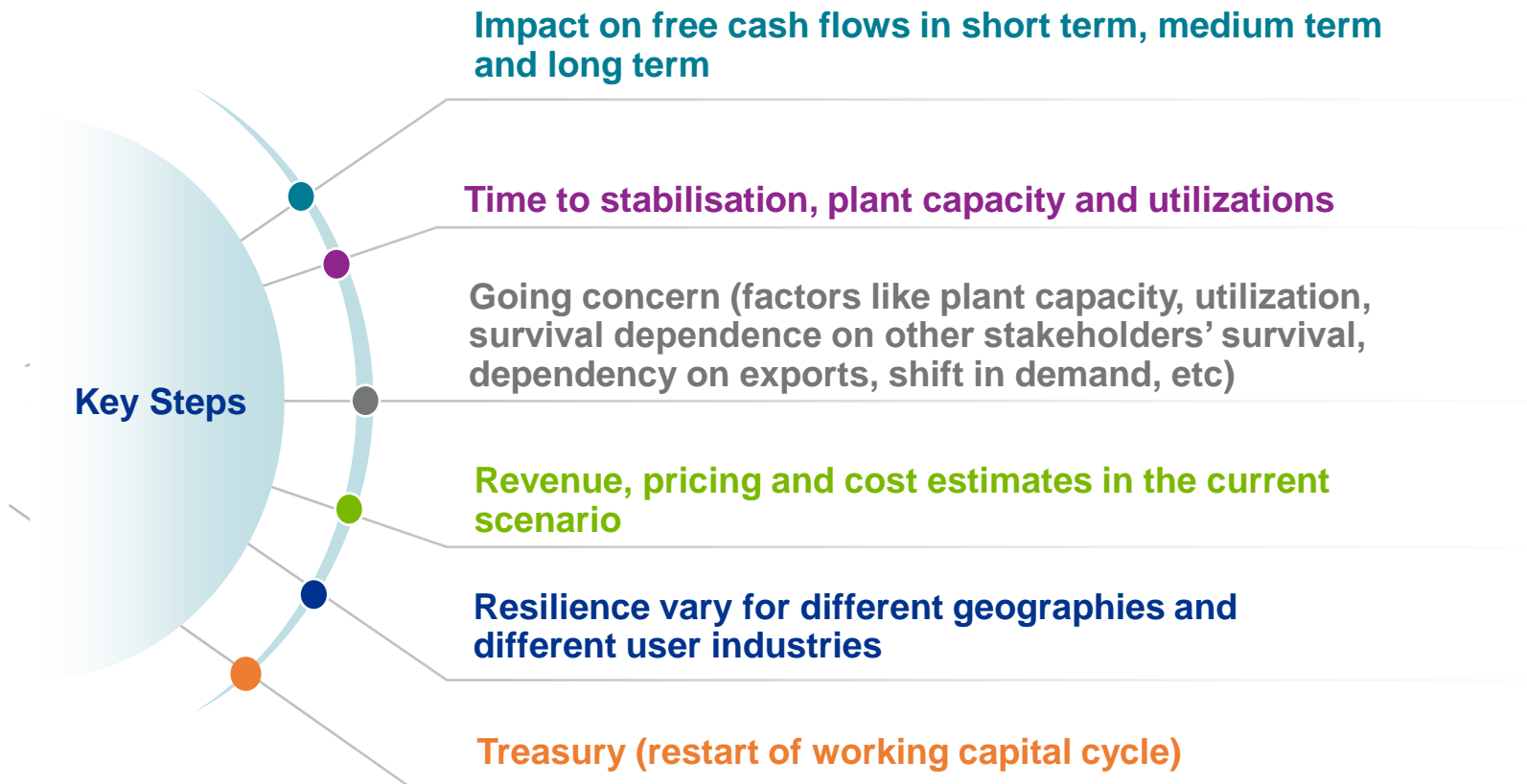


Impact on Discount Rate

Important to avoid double dip effect by adjusting both the cashflows and the discount rate

Free Cashflows

Discount Rate



Cost of Equity:

- Decrease in R_f as investor preference shift towards Govt. Securities till better visibility
- Increase in Beta due to shift in investor priorities
- Increase in market risk premium to capture higher market risks

Cost of Debt:

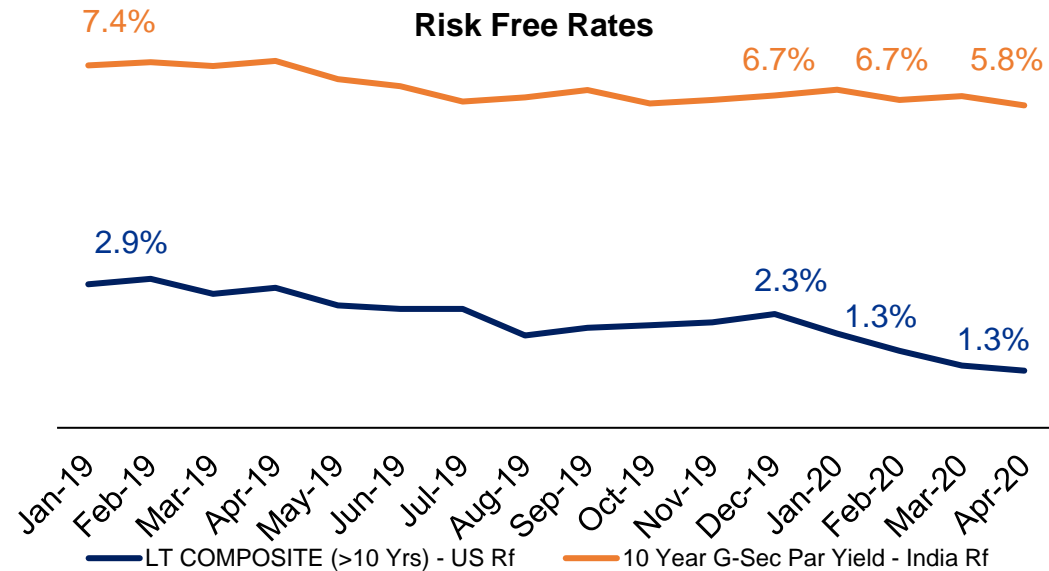
- Decrease in cost of debt due to lower R_f and decrease in offtake of debt

Some Considerations while evaluating Free Cashflows



Particulars	Key Considerations
Revenue	Enforceability of the contracts, Transaction Price, Feasibility of deliveries, Credit terms, Timing of revenue recognition, liquidated damages, forex fluctuations and any other specific matters
Inventories	Abnormal costs incurred, valuation for perishable inventories, Year End inventory count
Tangible & Intangible Assets	Impairment Testing, useful lives and residual values re-estimate
Financial Instruments	Requirement for reclassification of Financial Assets, changes in interest rate, volatility and credit risk been considered
Leases	Impact of rent concessions, waivers, any modifications to contract terms
Employee Benefits	Labour laws, Union settlements, cost of available of labour, Re- training or upskilling cost, ESOP plan modifications which are linked to performance targets, provisions reverification
Taxes	Profits uncertainty for accounting Deferred Tax Asset
Provisions	Onerous contracts, measures to qualify as a restructuring activity
Government Grants	Any expectations on government grants and its accounting and disclosure requirements
Selling and Marketing	Spend on major advertisement or campaigns, discounts and dealer incentives
Presentation & Disclosures	Specific disclosures on account of COVID-19 situation

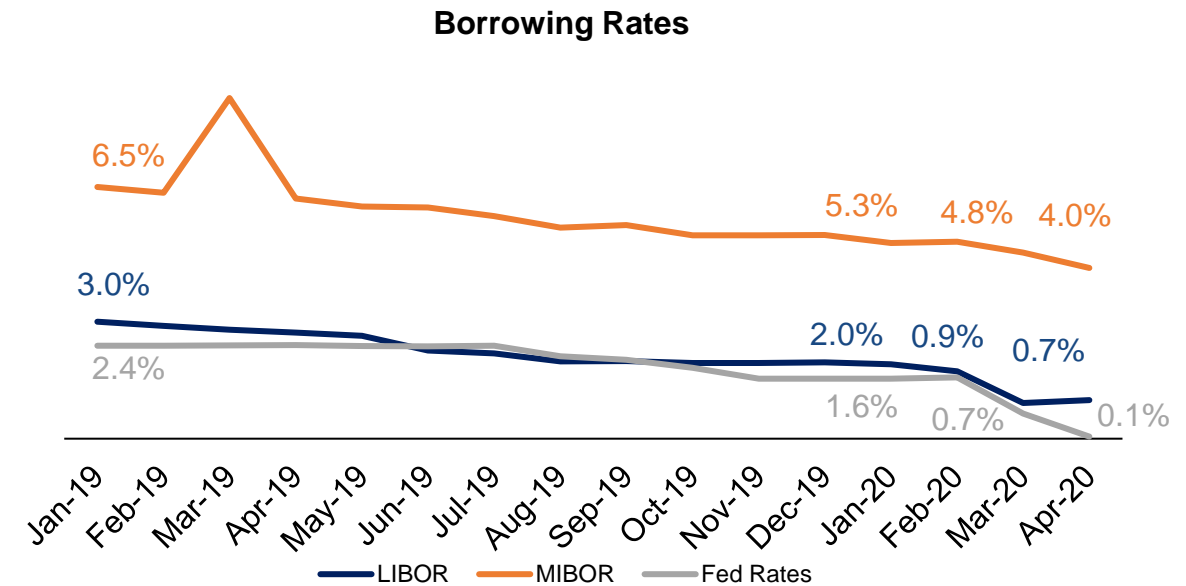
Key movements in the discount rate - Risk Free Rate and Borrowing Rate have declined since the pre-COVID-19 scenario



Source: Secondary Research including RBI Website, US Treasury

Key Points

- We have analysed 10 Year Government Securities Yield Rate of India and Long Term Composite (>10Years) of US :
 - Risk Free Rate in US reduced from 2.3% in December 2019 to 1.3% in March 2020.
 - Risk Free Rate in India reduced from 6.7% in December 2019 to 5.8% in May 2020.



Source: Secondary Research including Fed Primate Rate, Fred Economic Research, FBIL

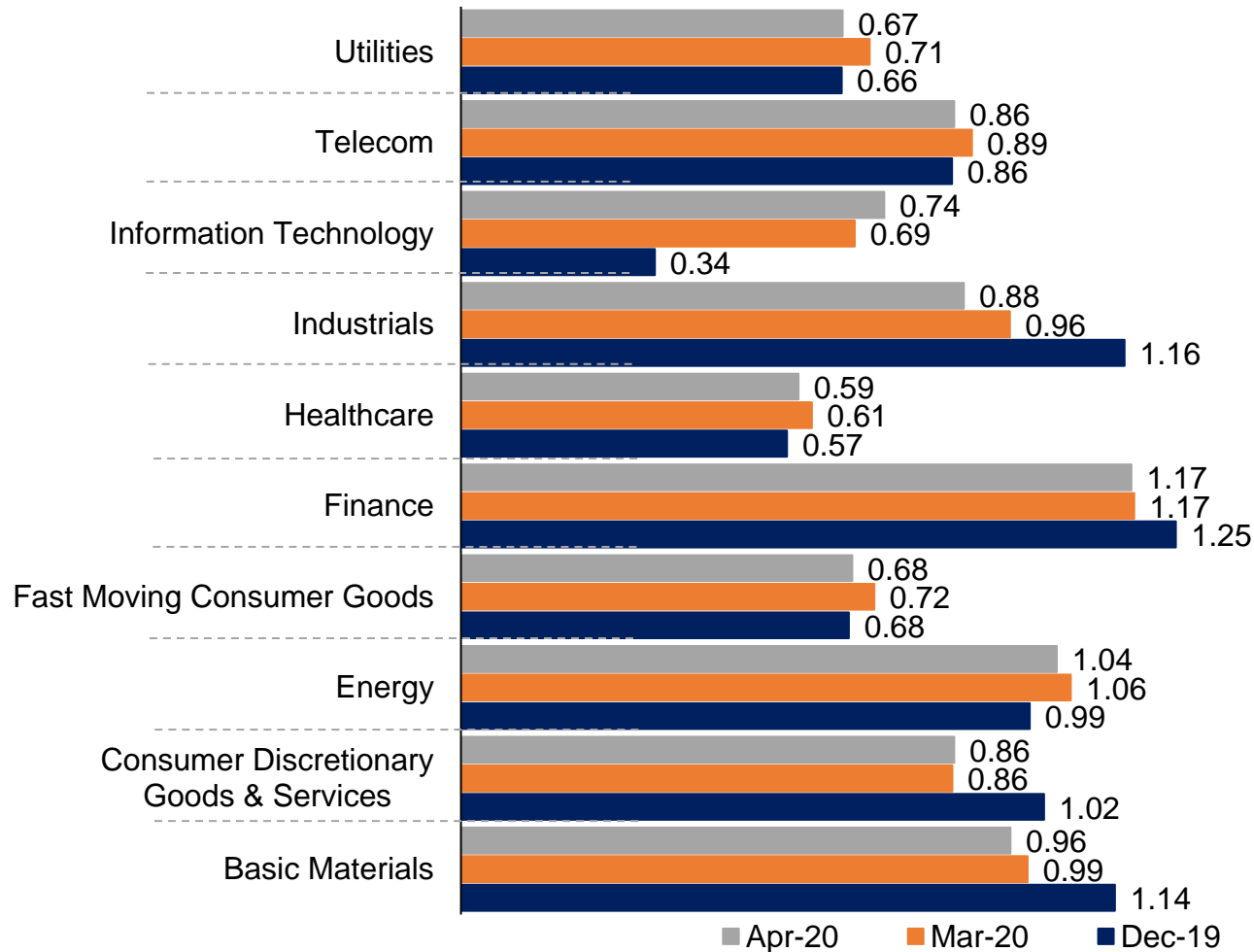
Key Points

- We have analysed LIBOR, MIBOR and US Federal Rates as benchmark rates for borrowing:
 - LIBOR reduced from 3.0% in January 2019 to 2.0% in December 2019 and further to 0.9% in March 2020.
 - MIBOR reduced from 6.5% in January 2019 to 5.3% in December 2019 and further to 4.8% in March 2020.
 - US Federal Rate reduced from 2.4% in January 2019 to 1.6% in December 2019 and further to 0.7% in March 2020.

Further, Beta (index for capturing systematic market risks in discount rates) of key sectors have increased on account of risks associated with uncertainties



1-Year Beta for Major Sectors

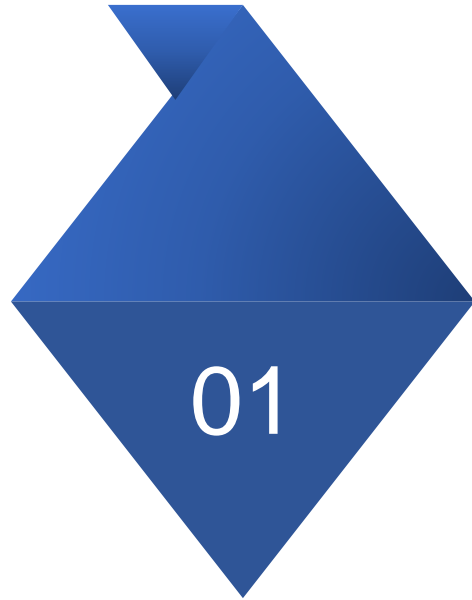


Key Points

- We have analysed 1 year Beta of Key Sectors in SENSEX:
 - Beta for many sectors have increased due to extreme volatility in the market during the period March to April 2020.
 - Information Technology Sector has seen major increase in the beta owing to volatility during this period.
 - On an average, Beta has increased around 5-8% in the three months across major sectors.

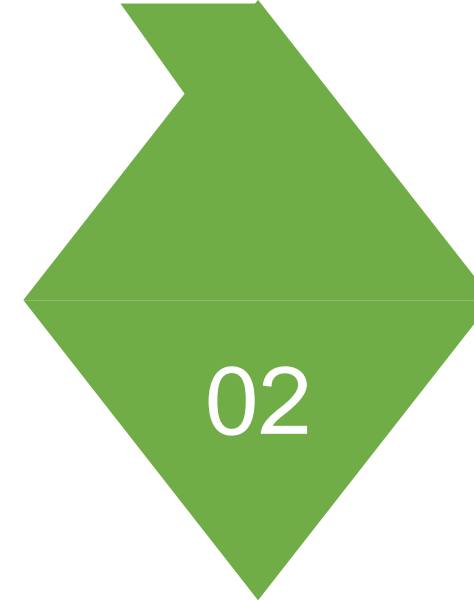
Source: Secondary Research including BSE website

While carrying out valuation using Market Approaches, impact can be captured either in the valuation parameter or the market multiple



Impact on Valuation Parameter
(Revenue, EBITDA, EBIT, PAT)

OR



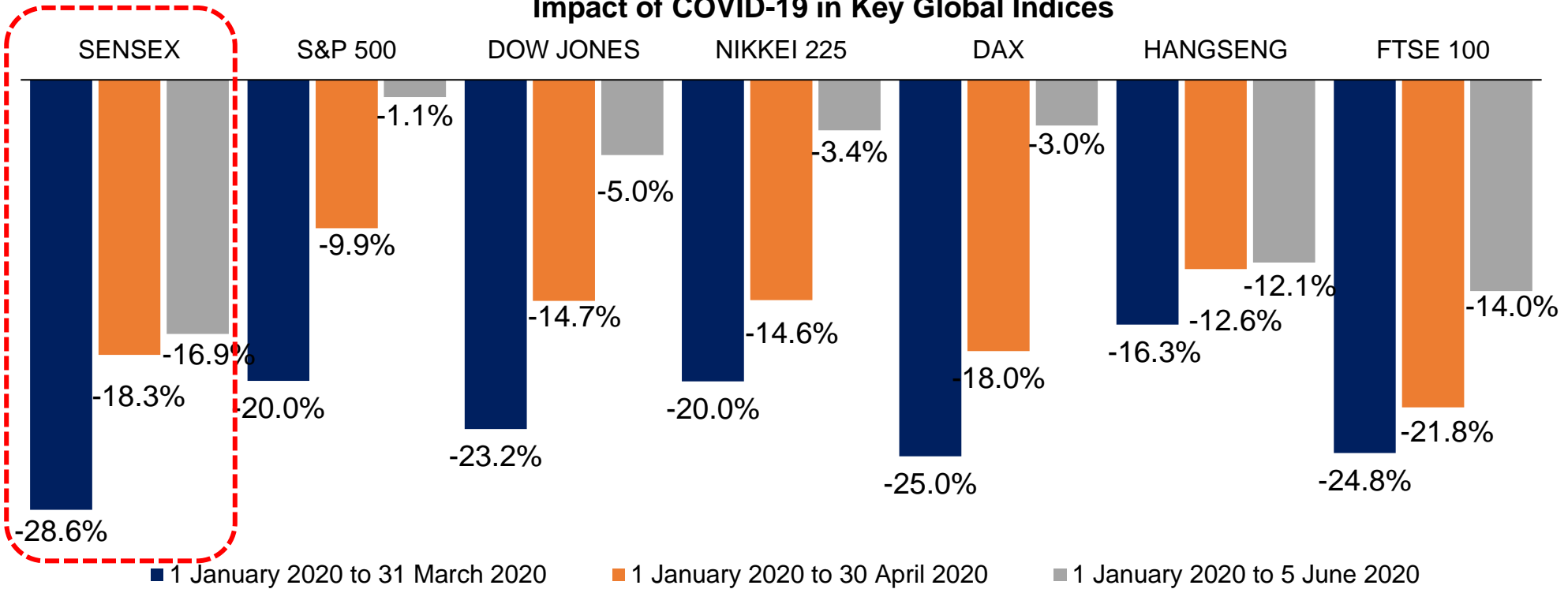
Impact on the market multiple

Important to avoid double dip effect by adjusting both the valuation parameter and the market multiple

While Stock Markets globally declined sharply as an immediate reaction of COVID-19 Situation, there is positive trend in most of the indices in the last 2 months



Impact of COVID-19 in Key Global Indices



Period	SENSEX	S&P 500	DOW JONES	NIKKEI 225	DAX	HANGSENG	FTSE 100
Dec-19	41,253	3,230	28,538	23,656	13,249	28,189	7,542
Mar-20	29,468	2,584	21,917	18,917	9,935	23,603	5,672
Apr-20	33,717	2,912	24,345	20,193	10,861	24,643	5,901
Jun-20	34,287	3,193	27,111	22,863	12,847	24,770	6,484

Source: Secondary Research including BSE website, Yahoofinance

In India, most of the sectors have shown signs of positive trend post March 2020. Healthcare and Telecom sectors have recorded positive growth over January 2020



1 January 2020 to 31 March 2020

Basic Material -32.3%	Consumer Discretionary -30.9%
Energy -29.3%	FMCG -10.1%
Finance -38.5%	Healthcare -9.5%
Industrials -36.1%	IT -17.0%
Telecom -12.9%	Utilities -27.0%

1 January 2020 to 30 April 2020

Basic Material -20.5%	Consumer Discretionary -21.5%
Energy -10.3%	FMCG -5.6%
Finance -30.1%	Healthcare 14.2%
Industrials -27.6%	IT -8.0%
Telecom 1.6%	Utilities -17.7%

1 January 2020 to 5 June 2020

Basic Material -12.2%	Consumer Discretionary -15.8%
Energy -3.9%	FMCG -3.3%
Finance -31.5%	Healthcare 20.3%
Industrials -22.0%	IT -5.8%
Telecom 21.4%	Utilities -14.4%

Source: Secondary Research including BSE website

Market Approach – Case Study of impact indicates the market multiple of companies in the Information Technology recorded sharp decline in December 2019 and recovery post March 2020



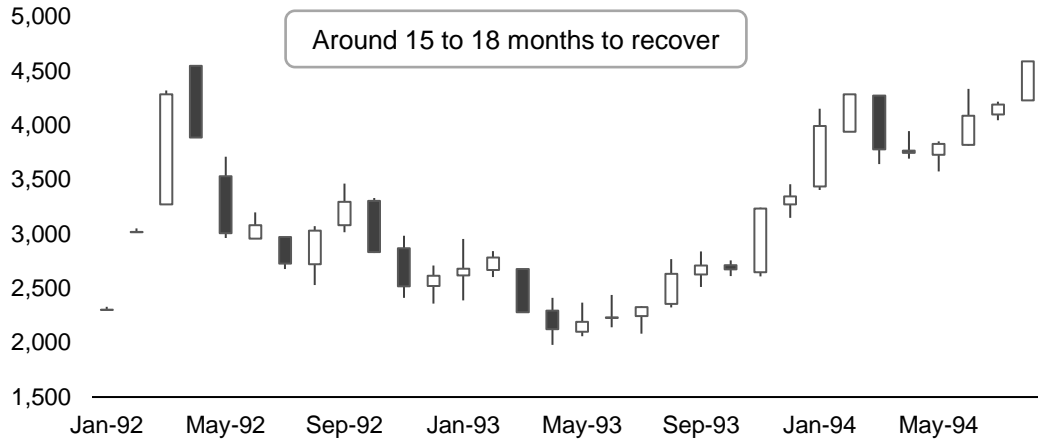
S No Company	As on 31 December, 2019		As on 31 March, 2020		As on 30 April, 2020		As on 5 June, 2020	
	EV/Revenue	EV/EBITDA	EV/Revenue	EV/EBITDA	EV/Revenue	EV/EBITDA	EV/Revenue	EV/EBITDA
1 Mphasis Ltd.	1.9	10.5	1.3	6.8	1.4	7.5	1.7	9.3
2 Tech Mahindra	1.9	11.6	1.3	8.7	1.3	8.3	1.4	8.9
3 HCL Technologies Ltd	2.2	9.5	1.6	6.6	2.0	8.3	2.2	8.8
4 Wipro Ltd.	1.9	9.3	1.4	7.2	1.4	6.9	1.6	8.2
5 TCS	5.0	18.7	4.2	15.6	4.6	17.3	4.7	17.6
6 Infosys	3.3	13.4	2.8	9.7	3.1	11.0	3.1	10.8
7 L&T Infotech Ltd	1.6	8.8	1.2	6.5	1.4	7.3	1.1	6.0
8 Hexaware	1.8	11.3	1.2	7.3	1.4	8.9	1.6	9.9
Median	1.9	10.9	1.4	7.2	1.4	8.3	1.7	9.1
Mean	2.5	11.6	1.9	8.5	2.1	9.4	2.2	9.9

Source: Secondary Research including BSE website, Ace Equity, Company Annual Reports

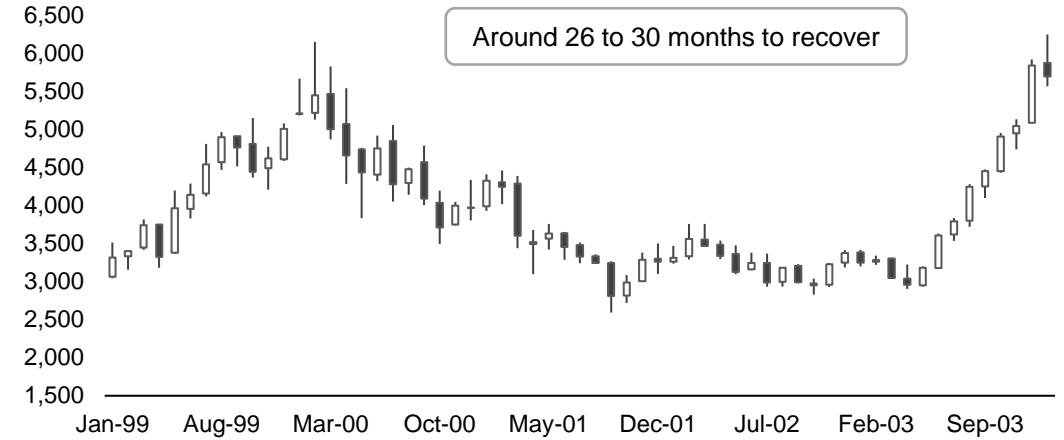
Historical Stock Market Crash and reaction of SENSEX



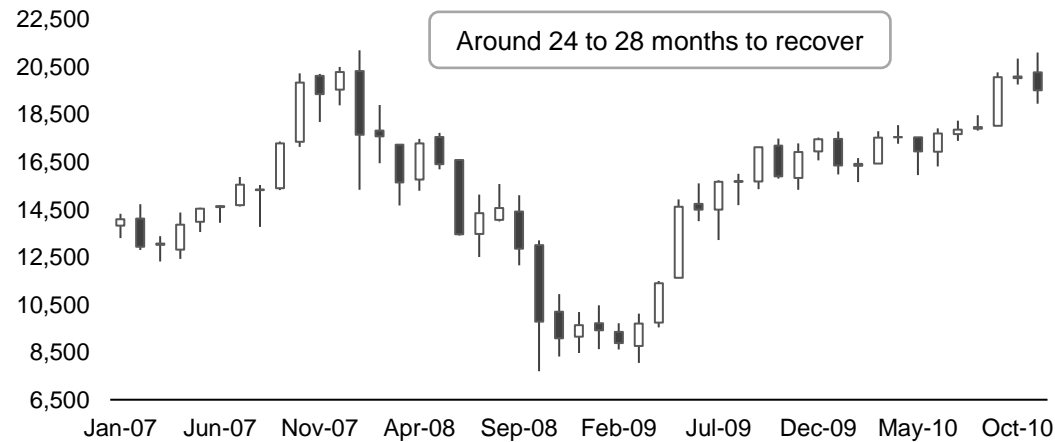
SENSEX during Harshad Mehta Scam



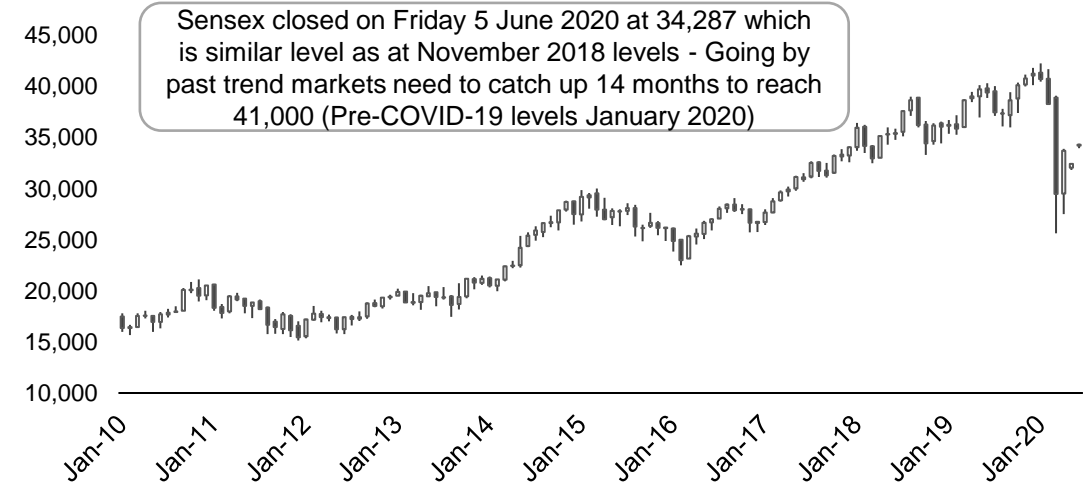
SENSEX during Dot-Com Crisis



SENSEX during Financial Crisis (Great Recession)



SENSEX



Source: Secondary Research including BSE website



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