Series - 7

# Valuation: VCM ATQs "Learnings from Judicial Pronouncements on Valuation- How far the verdicts and findings relevant now?"

VALUATION STANDARDS BOARD
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up under an Act of Parliament)
New Delhi

**Series-7**

# Valuation: VCM ATQs
# "Learnings from Judicial Pronouncements on Valuation- How far the verdicts and findings relevant now?"

**Valuation Standards Board**
**The Institute of Chartered Accountants of India**

## Preamble

Valuation Standards Board of ICAI (VSB) had organised a live Virtual CPE Meeting (VCM) on the topic- "Learnings from Judicial Pronouncements on Valuation- How far the verdicts and findings relevant now?" on 4th July, 2021. The details of the VCM are as under:

| | |
|---|---|
| **President ICAI:** | CA. Nihar N. Jambusaria |
| **Vice President ICAI:** | CA. Debashis Mitra |
| **Address by**: | CA. Anil Bhandari, Chairman, VSB, ICAI<br>CA. M. P. Vijay Kumar, Vice- Chairman, VSB, ICAI |
| **Speaker**: | CA. Sumit Dhadda |
| **Director:** | Shri Rakesh Sehgal, Director, ICAI |
| **Secretary**: | CA. Sarika Singhal, Deputy Secretary, ICAI |

The Webcast received an overwhelming response and was attended by more than 1600 viewers. The said webcast can be viewed again at https://live.icai.org/vsb/vcm/04072021/

There were many questions raised during the webcast. We have prepared answers to the questions (ATQs) raised during the webcast, which does not require application of valuation practices and principles. Also, repetitive questions and questions not related to the subject matter have not been answered.

We would also like to mention that the Valuation Standards Board has brought out many publications and Concept papers that may be referred for guidance and reference. All the below publications are available on the Committee link at ICAI website i.e., https://icai.org/post/valuation-standards-board

- ICAI Valuation Standards 2018
- Educational Material on ICAI Valuation Standard 103 - Valuation Approaches and

Methods

- Educational Material on ICAI Valuation Standard 301- Business Valuation
- Valuation: Professionals' Insight- Series- I, II, III, IV, V and VI
- Answers to the Questions raised during the Live Webcast on "Valuation and Valuation Standards Compliance and other aspects under various Laws"
- Technical Guide on Valuation
- Frequently Asked Questions on Valuation
- Concept Paper on findings of Peer Review of Valuation Reports
- Concept Paper on All About Fair Value
- Sample Engagement Letter for accepting Valuation assignment
- Valuation: VCM ATQ's – Series - I, II, III, IV, V and VI

The answers have been given for reference purposes. Detailed analysis may be done, and other material may be referred.

Valuation Standards Board
New Delhi
31st July, 2021

# Brief Note on Valuation and Learnings from Important Judicial Pronouncements in Valuation

## 1. Miheer H. Mafatlal Vs. Mafatlal Industries Ltd. (1997) 1 SCC 579

### Background Facts

The Scheme of Amalgamation of M/s Mafatlal Industries (MIL) being the transferee company and the Mafatlal Fine Shipping and Manufacturing Company Limited (MFL) being the transferor company was proposed. The directors of the respondent-company MIL and transferor-company MFL approved the proposal for amalgamation of the MFL with MIL and pursuant to the respective resolutions passed by them the detailed Scheme of Amalgamation was finalised. The directors of both the companies were of the opinion that such amalgamation was in the interest of both the companies.

It is pertinent to note at this stage that the appellant who had objected to the amalgamation before the High Court in the present proceedings so far as the amalgamation of the transferee-company is concerned, was himself one of the directors of the transferor-company being MFL.

Sequence of events is as follows:

- Gujarat High Court sanctioned the Scheme
- Appeal was filed against the impugned judgement and the said appeal was dismissed.
- Further Appeal was filed before the Hon'ble Supreme Court. The Case came for Appeal by Special Leave

### Issues Raised

In view of the aforesaid rival contentions, the following points arised for our determination:

1. Whether the respondent company was guilty of hiding the special interest of its director Shri Arvind Mafatlal from the shareholders while circulating the explanatory statement supporting the Scheme and whether thereby the voting by the equity shareholders got vitiated?
2. Whether the Scheme is unfair and unreasonable to the minority shareholders represented

by the appellant?

3. Whether the proposed Scheme of Amalgamation was unfair and amounted to suppression of minority shareholders represented by the appellant and hence liable to be rejected?
4. Whether separate meetings of minority shareholders represented by the appellant were required to be convened on the basis that the appellant's group represented a special class of equity shareholders?
5. Whether the exchange ratio of two equity shares of MIL for five equity shares of MFL was ex facie unfair and unreasonable to the equity shareholders of MIL and consequently the Scheme of Amalgamation on that account was liable to be rejected?

**Court View**

The Supreme Court of India in the landmark case of Miheer H Mafatlal V/s. Mafatlal Industries Limited elaborately explained the role of the Tribunal while considering a scheme of merger or amalgamation. The court said that "act as a court of appeal and sit in judgment over the informed view of the concerned parties to the compromise as the same would be in the realm of corporate and commercial wisdom of the concerned parties. The court has neither the expertise nor the jurisdiction to delve deep in to the commercial wisdom exercised by the creditors and members of the company who have ratified the scheme by the requisite majority. The Court acts as an umpire in a game of cricket to see that both the teams play their game according to the rules and do not overstep the limits. But subject to that how best the game is to be played is left to the players and not the umpire".

The court also gave certain guidelines in this particular case which are as follows:

The sanctioning Court (now Tribunal) has to see that all the requisite statutory provisions are complied with.

- The scheme has been backed by the majority votes in meetings which is required for the sanctioning of the scheme.
- The concerned meetings of the shareholders enable the voters to arrive at an informed decision for approving the scheme and the majority decision of the voters is just and fair.
- All the necessary materials and evidence including resolutions, minutes of the meetings, etc. have been placed before the NCLT.

- The proposed scheme does not violate any provision of the law or contrary to public policy and therefore to derive the real purpose underlying the scheme, the corporate veil could be lifted to determine whether the scheme is good or not.
- The tribunal has to satisfy itself that members, creditors or shareholders as the case maybe were acting bonafide and not coercing the minority.
- Once the above parameters are found to be met, the tribunal does not have any jurisdiction to sit in appeal over the commercial wisdom of the majority of class persons who have given approval to the scheme.

**Key takeaways in the case of Miheer H. Mafatlal Vs. Mafatlal Industries Ltd. (1997) 1 SCC 579**

- In the mentioned case law, the Court considered the fact that before formulating the proposed Scheme of Compromise and Amalgamation, an expert opinion was obtained by the respondent-company as well as the transferor-company on whose Board of Directors appellant himself was a member.
- The Court further suggested that since valuation of shares is a complex problem so it should be appropriately left to the consideration of experts in the field of accountancy i.e., Chartered Accountants.
- The valuer considering all the relevant aspects and obviously keeping in view the accounting principles underlying the valuation of shares suggested the exchange ratio at 5:2, which was found acceptable by both, the Board of Directors of the respondent-company as well as the Board of Directors of the transferor-company and was later objected by the director of transferor company who earlier gave green signal to the Scheme.
- The counsel of appellate suggested that the proper exchange ratio would be one share of transferee-company to six shares of transferor-company. It was difficult to appreciate the said contention of the appellant. It must be kept in view that the appellant never bothered to personally remain present in the meeting of equity shareholders for pointing out the unfairness of this exchange ratio.
- The Supreme Court finally concluded that 'Once the exchange ratio of the shares of the transferee company to be allotted to the shareholders of the transferor company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the

court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies.

## 2. Dinesh Vrajlal Lakhani V/s. Parke Davis (India) Ltd. [2005] 124 Comp Case 728 (Bom)

### Background Facts

The Learned Judge sanctioned a Scheme of Amalgamation of Parke-Davis (India) Ltd. with Pfizer Limited. The scheme was called into question.

Pfizer, the transferee was incorporated on 21st November, 1950 with the object of carrying on the business of the manufacture of and of a dealer in pharmaceutical, medical, chemical, industrial, and other preparation and articles.

Parke Davis, the transferor, was incorporated on 18th April, 1958, with the main object to manufacture, refine, import, export, buy, sell and deal in drugs, medicines and chemicals, pharmaceutical, herbal, bacteriological and biological products and the preparation of all kinds of toilet articles and cosmetic articles.

### The Share Exchange Ratio

The proposed Scheme of Amalgamation provided for a Share exchange ratio wherein the Transferee was required to issue and allot 4 equity shares of Rs.10/- each to every equity shareholder of the Transferor whose name appears in the Register of Members on the record date for every 9 equity shares of Rs.10/- each held in the Transferor. The Board of Directors of the Transferor and the Transferee accepted the suggested ratio.

### Issues Raised

Before the Learned Company Judge, there were 16 objectors, shareholders of the Transferor who opposed the Scheme of Amalgamation. The arguments were advanced by two of them, Mr. Dinesh Lakhani and Mr. Janak Mathuradas. The objections raised by the objectors were:

1. The swap ratio proposed in the Scheme of Amalgamation was unfair to the shareholders and against the interest of minority shareholders of the Transferor;
2. The detailed valuation report of the Chartered Accountant was not made available to the objectors;
3. Shri Lakhani had moved a resolution for amendment of the swap ratio but the amendment was rejected by the Chairman without putting it to vote;
4. The Chairman had not conducted the proceedings properly; he was the Chairman of the Board of Directors of the Transferor and an alternate Director of the Transferee, besides being a partner of Crawford Bayley & Co. Solicitors, who was Solicitor of both the Transferor and Transferee. It was contended that the Chairman had a vested interest in the Scheme of Amalgamation and his acting as Chairman of the meeting was prejudicial to the interest of the members of the Company;
5. The Chairman had not disclosed in his report to the Court that 18 persons had spoken against the resolution, nor did he mention that the amendment to the resolution had been moved;
6. There were discrepancies in the report of the Scrutineers and several votes had been shown as invalid without assigning any reason;
7. Several persons had voted more than once in the Meeting which was impermissible under the law;
8. Objections had been filed that there were workmen of the Transferor whose services had been terminated and on whose behalf proceedings were pending before the Deputy Commissioner of Labour.

**The Court View**

The Learned Judge held that it was not the case before him that the swap ratio was contrary to the law or that the experts who submitted the valuation report were not independent.

The Learned Single Judge noted that in the report of the Scrutineers, it had been pointed out that when shares are held jointly either with any one or more joint names being different or the order of the joint names differing, they had been given different folio numbers and were treated as different members.

In so far as the objections filed by the workers were concerned, the Learned Judge noted that they were no longer in the employment of the Company and their matters were pending either before the appropriate Court or the Commissioner of Labour. There was an averment in the petition that all pending litigation of the transferor would be contested by the transferee and all liabilities that may be incurred by the transferor would be taken over by the transferee.

In that view of the matter, it was held that the interests of these workers were duly protected. Having regard to these facts and circumstances, the Learned Single Judge had allowed the Company Petition and sanctioned the proposed amalgamation.

In this case, it was ruled that the Court will not for instance interfere only because the valuation adopted by the valuer may have been improved upon had another method been adopted. The Court is neither a valuer nor an appellate forum to re-appreciate the merits of the valuation. What the court has to ensure is that the determination should not be contrary to the law or unfair to the shareholders of the company which has been merged.

**Key takeaways in the case of Dinesh Vrajlal Lakhani vs. Parke Davis (India) Ltd. [2005] 124 Comp Case 728 (Bom)**

- Under this case law, a few of the shareholders of the transferor company opposed the Scheme of Amalgamation. According to them, the swap ratio proposed in the Scheme of Amalgamation was unfair and against the interest of minority shareholders of the transferor. Also, the Chairman of the Company rejected the resolution for amendment in the swap ratio.

- The Learned Judge held that while considering a Scheme of Amalgamation, the Court does not exercise an appellate jurisdiction, but a jurisdiction founded on fairness. The Court would not interfere with the swap ratio adopted on the advice of an expert unless it was contrary to the law. The Learned Judge held that it was not the case before him that the swap ratio was contrary to the law or that the experts who had submitted the valuation report were not independent.

## 3. Brooke Bond Lipton India Ltd. [1999] 98 Comp Cas 496 (Cal)

### Background Facts

This is an application for approval of the scheme of amalgamation between Brooke Bond Lipton India Ltd., the transferor-company and Hindustan Lever Ltd., the transferee-company. Both the transferor and the transferee were subsidiaries of Unilever plc. Further, both the transferor and the transferee were under a common management and had several common directors.

Five shareholders holding 298 shares objected to the scheme. None of them had shown any interest in the matter till their sudden appearance in the court at a belated stage. None of them had any correspondence with the company on the subject seeking any clarifications on any queries or doubts they may have had on any aspect of the proposed amalgamation. None of them, inspected the valuation report when the same was offered for public inspection prior to the court convened meeting. None of them, attended the court convened meeting to present their point of view and in the event of their having a difference of opinion, moving an appropriate amendment resolution for consideration by other members so that a decision on their objections was taken by the totality of shareholders in the meeting in keeping with the spirit of shareholders' democracy.

None of the objectors attended the meeting or for the inspection of the valuation report which showed a total lack of interest in the scheme. In fact, no shareholder asked for an inspection of the report.

### Issues Raised

The main objections urged/raised by the objectors were as follows:

a) In view of the overwhelming shareholding majority of Unilever they should be placed in a different class and accordingly the shareholders as a class, have not been properly represented.
b) Since without the consent of the landlord tenancies cannot be transferred, the scheme is prejudicial.
c) The exchange ratio has not been properly or fairly determined.

d) The valuation report does not value the assets of the Company properly in that the value of the brands has not been taken into account.

**The Court View**

- That the proposed scheme of compromise and arrangement was not found to be violative of any provision of law and was not contrary to public policy.
- That the scheme as a whole was also found to be just, fair and reasonable from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them, for whom the scheme is meant.
- On the question of exchange ratio of the shares the Supreme Court inter alia held as follows (page 838):
  - "Once the exchange ratio of the shares of the transferee-company to be allotted to the shareholders of the transferor-company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest."
  - In a Scheme of amalgamation, if the ratio of exchange has been fixed by an experienced and reputed firm of chartered accountants, then in absence of any charge of fraud against them, court will accept such valuation and ratio of exchange.
- A mere allegation of fraud is not enough; it must be a proper charge of fraud with full particulars.
- No charge made or established in the instant case.

**Key takeaways in the case of Brooke Bond Lipton India Ltd. [1999] 98 Comp Cas 496 (Cal)**

- In accordance with the specified case law, under the scheme of Amalgamation in consideration of the transfer and vesting of the undertaking of the transferor-company in the transferee- company, the transferee-company shall issue 9 equity shares to every shareholder of the transferor company for every 20 shares held by them.

- The sanction or approval of the appropriate authorities concerned was obtained in respect of any of the matters in respect of which such sanction or approval is required.
- The Supreme Court clarified, "Once the exchange ratio of the shares of the transferee-company to be allotted to the shareholders of the transferor-company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest."
- It was further held that "if the ratio of exchange has been fixed by an experienced and reputed firm of chartered accountants, then in the absence of any charge of fraud against them, the court will accept such valuation and ratio of exchange."

Hence, no charge made or established in the instant case.

## 4. Hindustan Lever Employees Union V/s Hindustan Lever Ltd. And Others (1995) (83 COMPCASE 30) (SC)

**Background Facts**

Tata Oil Mills Co. Ltd. ("TOMCO") business declined in the year 90-91. Shareholding of TOMCO – 22% by TATA, 41% by ICICI, 37% by General public. They incurred a loss of Rs 13 Crore in the year 91-92. They decided to move out and collaborate with Hindustan Lever Ltd. ("HLL"), a 100% subsidiary of Unilever ("UL"), a London based multinational company.

Both TOMCO & HLL availed service of Mr. Y.H. Malegam, Senior Partner of M/s. S.B. Billimoria and Company, Chartered Accountants, former President of Institute of Chartered Accountants and the Director of Reserve Bank of India, for the purpose of evaluation of the share-price of the two Companies in order to arrive at a fair share exchange ratio.

Mr. Malegam gave valuation report and recommended an exchange ratio of two equity shares of HLL for every fifteen ordinary shares of TOMCO. The Board of Directors of both the Companies at their separate and independent meetings accepted the recommendation and approved the Scheme of Amalgamation.

The valuation of the shares for exchange ratio was determined by combining three well-known methods –

a) the yield method;
b) the asset value method; and
c) the market value method

**Issues Raised**

a) Valuation of Shares exchange ratio is grossly loaded in favour of HLL.
b) Also question raised on valuer appointment that Mr. Malegam is a director of TOMCO
c) Interest of employees of both the companies was not adequately taken care of.

One shareholder of TOMCO, Mr. M.C. Jajoo, gave direction to M/s. A.F. Ferguson and M/s. N.M. Raiji & Go., Chartered Accountants, to give their opinion on the valuation report of Mr. Malegam. M/s. Ferguson and M/s. N.M. Raiji by their joint letter with copy to Mr. Jajoo confirmed that the share exchange ratio determined by Mr. Malegam was proper.

**Court View**

- Jurisdiction of the Court in sanctioning a scheme of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetic test.
- A company court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on fairness.
- It is not required to interfere only because the figure arrived at by the valuer was not as better as it would have been if another method would have been adopted.
- What is imperative is that such determination should not have been contrary to law and that it was not unfair to the shareholders of the company which was being merged.
- Court's obligation is to be satisfied that valuation was in accordance with the law and it was carried out by an independent body.
- Since 95% of the shareholders who are the best judge of their interest and are better conversant with market trends agreed to the valuation determined, the court declined to interfere with the same.
- In case of amalgamation, a combination of all or some of the methods of valuation may

be adopted for the purpose of fixation of the exchange ratio of the shares of the two companies.

**Key takeaways in the case of Hindustan Lever Employees' Union V/s. Hindustan Lever Limited**

- According to the given case, share exchange ratio had been determined by combining the three methods by a well reputed valuer of a chartered accountant firm and a director of TOMCO (Tata Oils Mills Co.).
- Following factors must be taken into account while determining the share exchange ratio- The stock exchange prices of shares of two companies, Dividend presently paid on the shares of the company, relevant growth prospects of two company, the cover (ratio of after-tax earnings to dividends paid during the year) for the present dividend of two company, the relative gearing of the shares of two company, the value of net assets of two company, voting strength in the merged enterprise of the shareholders, past history of prices of two companies.
- They held that the jurisdiction of the Court in sanctioning a claim of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetical test. A company court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on fairness.
- It is not required to interfere only because the figure arrived at by the valuer was not as better as it would have been if another method would have been adopted.
- It was further held that the exchange ratio determined cannot be considered as malafide merely on the fact that the share exchange ratio is calculated through combination of three well known methods i.e., net worth, market value and earning method.
- It was also held that "More than 95% of the shareholders who are the best judge of their interest and are better conversant with market trend agreed to the valuation determined, so it could not be interfered by courts."
- It was further held that "A financial institution holding 41% of shares of the transferor company did not find any fault in the valuation of share, the court should not interfere with such valuation."

## 5. Dr. Mrs. Renuka Datla V/s. Solvay Pharmaceuticals B.V. & ORS. (2003) (265 ITR 435) (SC)

### Background Facts

According to the terms of settlement, M/s. Solvay Pharmaceuticals and Mr. Vasant Kumar have agreed to purchase 4.91% shares held by the petitioners (Dr. Renuka Datla/Dr. Vijay Kumar) in the two companies namely Duphar Pharma India Ltd. (DPIL renamed as Solvay Pharma India Ltd.) and Duphar Interfran Ltd. (DIL), the petitioners having agreed to sell the said shares, Shri Y.H. Malegam, Chartered Accountant, Mumbai had to evaluate the intrinsic worth of both the Companies— DPIL and DIL as going concerns and the value of the said 4.91% shares held by the petitioners in those two Companies "by applying the standard and generally accepted method of valuation". Shri Malegam should give an opportunity to the respective parties to make their submissions.

The valuer considered Asset based method, Earning based method and Market based method of valuation.

DCF was not applied in absence of any independent projections and the projections provided by parties substantially differing.

### Issues Raised

The petitioners had objected to the valuation wherein a prayer was made to submit a supplementary valuation report after adding 'control premium' to 4.91% shares and by adopting the DCF method of valuation and including therein the value of Vertin and Colopsa brands. In other words, the main objections were:

1. That the control premium had not been added
2. The value of the brands Vertin and Colopsa, which according to the petitioners continued to be the property of DIL, was not included;
3. Discounted cash flow method had not been adopted though it is a generally accepted method, even according to the Valuer.

**Court View**

1. If the valuer applied the standard method of valuation, and had considered the matter from all appropriate angles without taking into account any irrelevant material or eschewing from consideration any relevant material, his valuation could not be challenged on the ground of its being vitiated by fundamental error.
2. The court sounded a note of caution observing that valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field of accountancy.
3. Even when finality attaches to the decision of the valuer, the court could still interfere if the valuation was made on a fundamentally erroneous basis, or a patent mistake had been committed by the valuer, or that the valuation was vitiated by a demonstrably wrong approach or a fundamental error going to the root of the valuation.
4. In respect of projections, the valuer had chosen the best possible method by capitalising past earnings and also considering maintainable profits.

The plea that the valuation was vitiated by fundamental errors could not be accepted.

**Key takeaways in the case of Dr. Mrs. Renuka Datla Vs. Solve Pharmaceuticals B.V & Ors.**

- In the given Case, shares held by petitioner in 2 companies were to be purchased by Solvay Pharmaceuticals and Mr. Vasant Kumar.
- A Chartered Accountant had to evaluate the intrinsic worth of both the companies as a going concern and value the 4.91% shares held by petitioner by following the standard and generally accepted method of valuation.
- The valuer considered 3 methods namely asset base, earning base and market base.
- Discounted cash flow (DCF) was not applied in the absence of independent projections and the projection provided by parties substantially differed.
- It was held that "If the valuer had applied the standard method of valuation, considering the matters from all appropriate angles, his valuation could not be challenged on the ground of being vitiated by fundamental error."

- It was further held that "If a valuer has not added control premium in intrinsic value and the same has not been specifically mentioned in the terms of settlement, the treatment done by valuer will be considered as correct."
- 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.

## 6. G.L. Sultania and Another V/s SEBI and Others (2007) (5 SC 133) (SC)

### Background Facts

The issue in the instant case was on valuation of shares by SEBI under the 'Takeover Code'. Offer for takeover of Hindustan National Glass and Industries Ltd. by ACE Glass Containers Ltd and C.K. Somany.

It is stated very briefly that one C.K. Somany and Ace Glass Containers Ltd., (hereinafter referred to as "acquirers") had acquired 7.3% of the shares of Hindustan National Glass and Industries Ltd., (hereinafter referred to as the "target company"). By this acquisition, the acquirers had triggered the code under Regulation 11.

The code having been triggered, acquirers were directed to make an open offer under the provisions of the Takeover Code by order dated 2.9.2003. The merchant banker appointed by the acquirer in accordance with the Regulation determined the price of shares to be offered to the shareholders in accordance with the Regulation at Rs. 40 per share. Some of the appellants not being satisfied with the price of the share which was offered to the shareholder under Regulation objected to the price being low.

It appears that the appellant who wished to exit from the company filed objections before SEBI questioning the valuation made by Deloitte at Rs. 43.02 per share. SEBI took serious note of the objections and appointed an independent valuer M/s. Patni & Co., Chartered Accountant, to once again value the shares of the target company under Regulation 20(5) of the Takeover Code. Thereafter, Patni & Co., Chartered Accountant, carried out valuation of the target company and submitted a report on 20.5.2004 to SEBI. They also forwarded the valuation report to the merchant bankers and the acquirers. The valuation was done on the

basis of the market price of the shares of the target company and other methods as required under accounting principles and Patni revised the valuation to 63.50 per share by one method and Rs.64.17 plus interest per share as per the method approved by the Supreme Court in Hindustan Lever employees Union case reported in AIR 1995 (1) Supp SCC 499. The acquirers felt aggrieved by the hike in the valuation and felt that the valuation by Deloitte at Rs. 43.02 was reasonable. The merchant bankers pursuant to this objection by the acquirers wrote a letter dated 9.3.2005 to SEBI on this aspect of the matter. SEBI permitted the merchant bankers to obtain valuation from a third Chartered Accountant.

Accordingly, the merchant bankers in consultation with SEBI appointed Chadha & Co. to carry out the valuation of the shares of the target company. Chadha & Co., submitted a report on 13.4.2005 stating that the fair market value of the share was Rs. 60.04 of the target company.

SEBI after considering all the three reports felt that in public interest justice must be done to the shareholders and held that the highest price per share amongst the three valuations be the fair price. The merchant bankers and acquirers accepted the suggestion of SEBI.

It may be noticed that the appellant G.L. Sultania had complained to the Board against the valuation of shares by the Merchant Banker and while doing so he had enclosed copies of two valuation reports of M/s. Anand K. Associates and M/s. Sanjay Bajoria and Associates valuing the shares of the target company at much higher rates namely, Rs.408/- and Rs.590/- per share. The SEBI rejected those reports as the shares were valued at abnormally high rates.

**Issues Raised**

1) First objection before the SAT was that the SEBI, as well as the Merchant Banker had not properly valued the shares of the target company in accordance with SEBI (Substantial Acquisition of Shares and Takeovers) Regulations.
2) Shares were valued by 3 CA firms, namely, Deloitte, Chadha & Co. M/s. Patni & Co. who valued shares at Rs.43.02, Rs.60.04 & Rs.64.17 respectively. SEBI Board accepted the highest valuation report amongst these three.
3) Learned counsel argued that the price approved by the Board was not a fair price.

**Court View**

The court held that unless it is shown to the court that some well accepted principles of valuation has been departed from without any reason, or that the approach, adopted is patently erroneous or that relevant factors have not been considered by the valuer or that the valuation was made on a fundamentally erroneous basis or that the valuer adopted a demonstrably wrong approach or a fundamental error going to the root of the matter the court cannot interfere with the valuation of an expert.

**Key takeaways in the case of G.L Sultania and Another V/s. Securities and Exchange Board of India.**

- According to the mentioned case law, Appellant claimed that the SEBI as well as merchant banker had not valued the shares of the target company under the "takeover code" and the Board had taken all the necessary precaution to safeguard the interest of shareholders to ensure payment of best price for the shares sold by them.

- Learned counsel of appellant had provided valuation report of two chartered accountants before the Board, which valued the shares of target company at Rs.590/- per share and Rs. 480/- per share. The Board had rejected the report of these valuers as the shares were valued at an abnormally high price with a vast difference of Rs. 182/- per share.

- On the contrary, the Board appointed its own valuer to value the shares of the target company and ultimately the report of valuer appointed by the Board was accepted by the acquirer.

- The court held that "Board committed no error in accepting the report, as valuer has acted in a reasonable manner. Unless it is shown to the court that some well accepted principle of valuation has been departed from without any reason or that the approach adopted is erroneous, the court cannot interfere with the valuation of an expert."

Hence, Board had exercised its discretion wisely.

## 7. Cadbury India Limited – Brief discussion on Bombay High Court Judgement dated 9th May 2014

### Background Facts

Cadbury India Ltd. was incorporated on 19th July 1948 under the name of Cadbury Fry (India) Pvt. Ltd. Cadbury India was a subsidiary of Cadbury Schweppes Overseas Limited which in turn was held by Cadbury Plc, UK. This was later taken over by Kraft Food Inc. Cadbury has a policy of operating globally only through wholly owned subsidiaries, however, exceptions have had to be made only for compelling business reasons, foreign investment laws or foreign exchange restrictions.

Following economic liberalisation of 2002, FDI was allowed up to 100%. Thereafter, Cadbury Schweppes and another group company, i.e., Cadbury Mauritius Ltd. increased their collective holdings in Cadbury India to 90%, by making various open market offers, and public shareholding fell below 10%.

Consequently, Cadbury India got de-listed from the stock exchanges. Over time, the shareholding of the Cadbury Group increased to about 97.58% through a series of open and buy-back offers. The details of some of these are listed below.

| Year of Buyback | Price per share | No. of shares bought Back |
|---|---|---|
| 2002-2006 | 500 | 14,15,271 |
| 2006 | 750 | 13,52,605 |
| 2007 | 815 | 11,53,374 |
| 2008 | 950 | 10,20,300 |
| 2009 | 1030 | 11,16,168 |

In 2009 only 2.4% of shares were held by public, CIL made an offer to these remaining minority shareholders at Rs. 1,340 per share, based on valuation reports from two reputed and independent valuers.

**Issues Raised**

The petition was filed by the minority shareholders before the Mumbai High Court on the contention that Cadbury India Ltd had been under-valued and they are being suppressed due to minority shareholding.

**Court View**

Thereafter, an order was passed by the High Court appointing a third valuer as independent valuer. This valuation was to be as on the appointed date and based on the unaudited balance sheet as on 31st July 2009.

The third valuer submitted its valuation report on 20th May 2010 ("the first report") wherein it adopted the Comparable Companies Multiples ("CCM") method of valuation using Nestle, GSK & Britannia as the comparable companies, and returned a value of Rs. 1,743/- per fully paid-up equity share.

In the aforementioned report, following is worth noting:

1) Valuer did not take into account any premium,
2) The PE multiple was arrived at considering factors like stock market trends, size and growth trends of comparable companies vis-à-vis CIL, market share of CIL in the chocolate segment.
3) The selected PE multiple was higher than the then prevailing PE multiples of BSE Sensex and BSE FMCG Index.
4) Nestle and Britannia both had factories located in the tax benefit zone in Uttarakhand.

However, the minority shareholders opposed this report as well and produced their own valuation of Rs 2,500 per share and demanded that the valuation shall be done on DCF Method. This valuation of 2,500 was not based on any data or material pertaining to Cadbury India, but on the supposed market value of Nestle India Limited. The minority shareholders held that since on 19th January 2010, Nestle's shares were being traded at Rs. 2,542/- per share, Cadbury India's shares should be at least Rs. 2,500/-, for the two must be held to be "competitors".

The court found the valuation approach completely untenable and further directed the third valuer to update its valuation report dated 20th May 2010 taking into account the valuation of the Company based on the Discounted Cash Flow ("DCF") method along with the CCM method.

In line with the aforesaid direction, the third Valuer performed valuation based on both the methods and gave equal weightage to both and came up with a valuation of Rs. 2,014.5 per share. The basic assumptions considered in the same were as under:

1) CAGR of sales for next 10 years considered at 18.3% as against 14.5% of last 10 years
2) Cost of Equity considered at 11%, wherein Rf = 7% and Rm = 15%; Beta Considered based on betas of comparable companies @ 0.50
3) Debt/Equity Ratio = 0, hence WACC = Cost of Equity
4) Terminal Growth Rate considered @6% based on comparison between future projections with past performance, and with the projections of comparable companies.
5) Income Tax was considered flat @ 33.33% assuming that Tax regimes are liable to change at short notice. Hence in long run a flat tax rate in a projection might, in fact, provide a very realistic and fairer value than something that is presently at a lower marginal rate.
6) Equal Weightage was given to both CCM and DCF method to arrive at final valuation

The revised Valuation of Rs 2,014/- as well was challenged by the minority shareholders but the High Court, in a detailed judgment, agreed with third valuer's approach and dismissed all objections raised against the report.

**Key takeaways in the case of Cadbury India Limited**

- The court held that "In order to decline sanction it must be shown that the valuation is ex-facie unreasonable. The mere existence of other possible methods of valuation would not be sufficient to deny sanction to such a scheme.
- It was held that the assent of the court would be given if:
  - ✓ the scheme is not against the public interest;
  - ✓ the scheme is fair and just; and
  - ✓ the scheme does not unfairly discriminate against or prejudice a class of shareholders"
- Hence, it was held that the valuation of Rs. 2,014.50/- per fully paid-up equity share as

arrived at by the Court-appointed valuer in its second (supplementary) report dated 29th July 2011 was accepted.

## 8. What is the Revenue Ruling 59-60 (of USA)?

The Revenue Ruling, Published in 1959, (Internal Revenue Service, Revenue Ruling 59 60, 1959-1 C.B. 237) is one of the earliest expositions in business valuation. The purpose of the Ruling is to outline general approaches, methods and factors to be considered while valuing shares of closely held companies or shares of companies whose market quotations are not available or scarcely available. Even though the Ruling was delivered for estate tax, gift tax and income tax, its principles are considered for valuation of any business and the seven factors which must be considered in the valuation are given below:

- The nature of the business and the history of the enterprise from its inception.
- The economic outlook in general and the condition and outlook of the specific industry in particular.
- The book value of the stock and financial condition of the business.
- The earning and the dividend-paying capacity of the company.
- Whether or not the enterprise has goodwill or other intangible value.
- Sales of the stock and the size of the block of stock to be valued.
- The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.

**Answer to Questions raised during the Virtual CPE Meeting Series "Sundays with Valuation Experts" on the topic "Learnings from Judicial Pronouncements on Valuation- How far the verdicts and findings relevant now?" held on 4th July, 2021**

| S. No | Question | Answer |
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| 1. | In the case of **Hindustan Lever Employees' Union Vs. Hindustan Lever Limited** it was held that the Court's obligation is only to be satisfied that valuation was in accordance with law, and it was carried out by an independent body.<br><br>But given that Valuation methods are generally not prescribed under law (other than IT Act) and is more of a professional judgement, in your opinion kindly share implication of this judgement on valuation? | This was a significant judgement as it involved merger of companies from two big corporate houses of that time, one being Hindustan Lever Limited and other Tata Oil Mills Company (TOMCO).<br><br>While 99% shareholders agreed to the swap ratio decided in the scheme, less than 1% of the shareholders objected to the valuation done. The appellants held that the exchange ratio determined was mala fide as it was calculated through combination of three methods i.e., net worth, market value and earning method. Instead, if only cost approach was adopted the value arrived would have been much higher.<br><br>The Court held that the jurisdiction of the Court in sanctioning a claim of merger is not to ascertain mathematical accuracy if the determination satisfied the arithmetical test. A company court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on Fairness. It is not required to interfere only because the figure arrived at by the valuer was not as better as it would have been if another method would have been adopted.<br><br>The Court also got the valuation report verified by two other independent valuers who also held |

| S. No | Question | Answer |
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| | | that the valuation was true and fair and accepted that the weightage of 2:2:1 allotted to Income, Market, and Asset Approach in the valuation report was also fair.<br><br>It was also held that the exchange ratio determined cannot be considered as mala fide merely on the fact that the share exchange ratio is calculated through combination of three well known methods i.e., net worth, market value and earning method.<br><br>Also, more than 95% of the shareholders who are the best judge of their interest and are better conversant with market trend agreed to the valuation determined, so it could not be interfered by the courts. Also, a financial institution holding 41% of shares of the transferor company did not find any fault in the valuation of share, so the court should not interfere with such valuation.<br><br>In the speaker's view the above judgement is still very much relevant. Further, as long as the valuation engagements are being carried out in accordance with the Valuation Standards and high level of professional skepticism, a valuer shall not fret about being reviewed by the courts later. |
| 2. | In the case of Miheer H. Mafatlal Vs. Mafatlal Industries Ltd. - it was held that the scope of court is limited and can only intervene | In the given case, Mr. Miheer H. Mafatlal, the appellant, was the director of Mafatlal Fine Spinning and Manufacturing Company Limited (MFL) as well as the shareholder of Mafatlal |

| S. No | Question | Answer |
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| | when valuation is not just and fair. Kindly share your view in respect of this contention.<br><br>It was also held that individual personal interest of minority shareholder is of no concern unless it is affecting class interest of such shareholders. Does it still hold good in current scenario? | Industries Limited ('MIL'). He did not raise any objection when the scheme was approached for sanction in the Bombay High Court but raised an objection during the approval of the scheme in the Gujarat High Court.<br><br>In this respect, he provided that as director of MFL he did not raise objection because the deal was beneficial for the shareholders of MFL and so it would not have been correct on his part to object based on his individual interest, but now as a shareholder of MIL he is objecting, as the valuation arrived under the scheme is not beneficial for him in his individual capacity.<br><br>Various contentions were raised by the appellant against the valuation done but no substantial deviation/error in valuation report was pointed out by him.<br><br>The Court appointed independent valuers to review the valuation proposal and they also did not find anything substantially objectionable in the valuation report. The Supreme Court finally concluded that - Once the exchange ratio of the shares of the transferee company to be allotted to the shareholders of the transferor company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the |

| S. No | Question | Answer |
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| | | overwhelming majority of the shareholders of the two companies. The shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be determined to their interest.<br><br>In the speaker's opinion, under current scenario, with the Registered Valuers Rules, Valuation Standards and IBBI guidelines in place, valuation methodologies and valuer's responsibility are much more structured and defined and in case of any deviation, a valuer is expected to give adequate justification in his valuation reports.<br><br>Hence, disputes and disagreements are expected to reduce significantly. However, it is important to note that stalwart judgement like this still holds good in present day scenario. |
| 3. | What are the major takeaways from the case of Miheer H. Mafatlal Vs. Mafatlal Industries Ltd. and Hindustan Lever Employees' Union Vs. Hindustan Lever Limited? | Kindly refer to the brief note shared above in the Booklet which shares all the key takeaways of the case. |
| 4. | In the case of **Sultania and Another Vs. The Securities and Exchange Board of India** the court cited the case of Miheer H. Mafatlal and held that since no principle of valuation has been departed from, so court will not interfere with the valuation of an expert. | In the speaker's view, it is a fair inference. Courts have often held that they are not experts in valuation and hence it is better left to the judgement of experts in the field of valuation and accountancy.<br><br>Further, the court's job is not to look into mathematical accuracy of the valuation reports. A court's intervention is only required in case it is |

| S. No | Question | Answer |
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| | In most of the cases a similar approach has been taken by the courts for valuation which makes one think that valuation reports are often treated sacrosanct by courts and rarely disputed. Please share your view is that a fair inference. | pointed out that there is a serious fraud or gross negligence in valuation done and there is a major deviation from the well-established valuation principles.<br><br>Courts have often held that a mere difference in opinion between different parties cannot be entertained by courts as it is not a question of law but a matter of facts and hence cannot be settled at court. In most of the cases, we have seen that courts have not tinkered with the valuation done by the valuers except in the case of Cadbury India Limited. |
| 5. | Kindly share some key judgement passed by Indian judiciary protecting interest of minority shareholder wherein the valuation was against the interest of minority shareholders and was found to be unfair or unreasonable. | In case of Cadbury, the Co. offered a share price of Rs 1340/- per share to the minority shareholders, based on the valuation reports of two reputed and independent valuers.<br><br>The same was contested by the minority shareholders, and therefore, the High Court appointed a third valuer which returned a value of Rs. 1,743/- per fully paid-up equity share, based on the CCM Method.<br><br>However, the same was again opposed by the Minority Shareholders, on the ground that the value presented by the Court appointed Valuer was still undervalued and should be based on DCF Method, and accordingly presented their own valuation of Rs 2500/- per share.<br><br>In line with the demands of the Minority Shareholders, the Court directed the Valuer to |

| S. No | Question | Answer |
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| | | perform the valuation based on both the methods and hence, the Valuer finally derived at a share price of Rs. 2,014.5 per share which was though opposed again by the Minority Shareholders, but was still finalised by the Court based on certain grounds. |
| 6. | In the case of **Cadbury India Limited,** the Bombay High Court adopted average of value determined under market approach and DCF method when the range of difference between both the values was substantial. What is your view on same? | In the given case, Cadbury India Limited made an offer to its 2.4% shareholders at Rs. 1,340 per share, based on valuation reports from two reputed and independent valuers. Against same petition was filed by the minority shareholders before the Mumbai High Court on the contention that Cadbury India Ltd has been under-valued and they are being suppressed due to minority shareholding.<br><br>Thereafter an order was passed by the High Court appointing an independent valuer who adopted the Comparable Companies Multiples ("CCM") method of valuation using Nestle, GSK & Britannia as the comparable companies, and returned a value of Rs. 1,743/- per share. However, the minority shareholders opposed this report as well and produced their own valuation of Rs 2,500 per share and demanded that the valuation shall be done on DCF Method.<br><br>The Court further directed the independent valuer to update its valuation report by considering Discounted Cash Flow ("DCF") method along with the CCM method. The valuer performed valuation based on both the methods and gave equal weightage to both and came up |

| S. No | Question | Answer |
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| | | with a valuation of Rs. 2,014.5 per share. This was again contested by the minority shareholders before the High Court.<br><br>However, the court dismissed all objections raised against the report and accepted the value of Rs. 2,014.5/- per share and held that in order to decline sanction it must be shown that the valuation is ex-facie unreasonable. The mere existence of other possible methods of valuation would not be sufficient to deny sanction to such a scheme.<br><br>**It was held that the assent of the court would be given if:**<br>**(1) the scheme is not against the public interest;**<br>**(2) the scheme is fair and just; and**<br>**(3)the scheme does not unfairly discriminate against or prejudice a class of shareholders**<br><br>In such cases, the main objective of the court is to see that whether the valuation is prima facie fair to all, as it is not possible to satisfy all the parties at any point of time. Under the given case, the weightage of 50:50 given was accepted by the court as it was based on the Professional Judgement of the valuer and also since both the approaches were subjective and neither could be held better than the other. |

| S. No | Question | Answer |
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| | | Further, any other weightage assigned would have also been challenged as it too would have been subjective. Thus, the 50:50 ratio gave the valuer a safe option for valuation and hence, was found fair by the court in the given circumstance. |
| 7. | One of the key aspects underlying disputes in valuation of minority holdings has been the **treatment accorded to assets which could be put to better use** than what is presently being done with them (e.g.: prime property). Kindly discuss the case of Cadbury India Limited in this perspective and what was the Bombay High Court's contention on this issue? | One of the key areas of dispute in valuation for minority holdings is the use to which certain properties are put into. For historic reasons, company may be operating its facilities from some prime property, which may have a significantly higher market value than what can be attributed to it in its present use.<br><br>This becomes even more complicated when the use is not for its critical factory operations, which is difficult to move and it is being used for say residential accommodation or office space etc.<br><br>One of the much-repeated allegations in the case of Cadbury India Limited relates to the sale of Cadbury House. Cadbury India during the course of litigation sold part of this property at Bhulabhai Desai Road and the appellant contended that this affects Cadbury India's share valuation and must be taken into account inter alia because that property had significant development potential.<br><br>The court noted that there were two problems with this and rejected the plea.<br><br>The first is that this involved yet another change in the valuation parameters. The court held that the sale is a matter post facto. It simply cannot |

| S. No | Question | Answer |
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| | | be that on account of the vagaries of litigation, a petitioner can constantly shift stands in this manner.<br>Second, while the sale price of the property may be known, the value of the development or redevelopment of that property is predicated on several imponderables, incapable of quantification. All that development is subject to development control rules which change frequently.<br><br>There may be other restrictions and hence, it would require an entirely distinct set of metrics to evaluate the development potential of this property. |
| 8. | In the case of **Dr. Mrs. Renuka Datla Vs. Solvay Pharmaceutical B.V. & Ors.** it was held that if the parties wanted a special treatment to be given to these shares and a **control premium** or the like has to be added, it should have been specifically and expressly mentioned in the terms of settlement.<br><br>You will agree that control premium is an important aspect of valuation and also prescribed by ICAI Valuation Standards 2018, so in your view how far is the above contention still relevant? | This is a classic case wherein the appellant faced substantial loss on account of poor drafting of the terms of settlement. While drafting an agreement/settlement one shall ensure to incorporate all the points that are there in his/her mind, and nothing shall be left to the interpretation of the readers.<br><br>In the given case, according to the terms of settlement, the respondents agreed to purchase 4.91% shares held by the petitioner in the two companies namely Duphar Pharma India Ltd. (DPIL renamed as Solvay Pharma India Ltd.) and Duphar Interfran Ltd. (DIL).<br><br>The Valuer considered three methods of valuation:<br>(1) Asset-based |

| S. No | Question | Answer |
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| | | (2) Earning based<br>(3) Market-based,<br><br>but the petitioner objected to the valuation on multiple grounds and one of them was that the control premium has not been added.<br><br>The Court held that, if the parties wanted a special treatment to be given to these 4.9% shares and a control premium or the like has to be added, it should have been specifically and expressly mentioned in the terms of settlement.<br><br>What has not been said in the terms of settlement in specific and clear terms cannot be superimposed by the Court while interpreting the terms of settlement. If the petitioners had insisted on the incorporation of such a provision, it could very well be that the other party or parties would not have agreed to such stipulation.<br><br>The Court cannot, therefore, give any direction in regard to control premium. |
| 9. | In the above case of Dr. Mrs. Renuka Datla Vs. Solvay Pharmaceutical B.V. & Ors. the contention raised by the appellant was put down holding that the Valuer has approached the question of valuation having due regard to the **terms of settlement** and applying the standard methods of valuation. | As discussed above, this is a classic case wherein the appellant faced substantial loss on account of poor drafting of the terms of settlement. While drafting an agreement one shall ensure to incorporate all the points that is there in his/her mind, and nothing shall be left to the interpretation of the readers. |

| S. No | Question | Answer |
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| | Kindly share key learning from the case with respect to importance of terms of settlement in present scenario. | To avoid damages one shall apply a thorough mind and try and engage professional help in such situations. |
| 10. | Can auditor of a company give valuation report under Income Tax Act for issue of share when value is arrived only on asset method (book value)? | Under Income Tax Act an Accountant is defined as per explanation to section 288(2).<br>*""accountant" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) who holds a valid certificate of practice under sub-section (1) of section 6 of that Act, but does not include [except for the purposes of representing the assessee under sub-section (1)]—*<br>*(a) in case of an assessee, being a company, the person who is not eligible for appointment as an auditor of the said company in accordance with the provisions of sub-section (3) of section 141 of the Companies Act, 2013 (18 of 2013); or*<br>*(b) in any other case, —*<br>*i. the assessee himself or in case of the assessee, being a firm or association of persons or Hindu undivided family, any partner of the firm, or member of the association or the family;*<br>*ii. in case of the assessee, being a trust or institution, any person referred to in clauses (a), (b), (c) and (cc) of sub-section (3) of section 13;*<br>*iii. in case of any person other than persons referred to in sub-clauses (i) and (ii), the person who is competent to verify the return* |

| S. No | Question | Answer |
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| | | *under section 139 in accordance with the provisions of section 140;*<br>*iv. any relative of any of the persons referred to in sub-clauses (i), (ii) and (iii);*<br>*v. an officer or employee of the assessee;*<br>*vi. an individual who is a partner, or who is in the employment, of an officer or employee of the assessee;*<br>*vii. an individual who, or his relative or partner—*<br>*I. is holding any security of, or interest in, the assessee:*<br>*Provided that the relative may hold security or interest in the assessee of the face value not exceeding one hundred thousand rupees;*<br>*II. is indebted to the assessee:*<br>*Provided that the relative may be indebted to the assessee for an amount not exceeding one hundred thousand rupees;*<br>*III. has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee:*<br>*Provided that the relative may give guarantee or provide any security in connection with the indebtedness of any third person to the assessee for an amount not exceeding one hundred thousand rupees;*<br>*viii. a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed;* |

| S. No | Question | Answer |
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| | | *ix. a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction."* |
| 11. | Kindly share a case wherein the Tax Officer rejected DCF valuations and also share the basis for rejection. | In a recent case of **Vodafone M-Pesa** in 2020, the company issued shares using DCF method and the assessing officer rejected the valuation citing that the DCF valuation is not correct as cash flow from operations is not positive and hence there is no basis to make a reliable forecast. The AO rejected the valuation report and himself calculated the value of shares using NAV method of valuation.<br><br>Aggrieved with the above order assessee preferred appeal before Ld. CIT(A). CIT(A) accepted the contentions of the assessee with regards to valuation of shares based on DCF method but accepted the DCF valuation only to the extent of actual performance in the subsequent years and accordingly ascertained the fair value to be 40% of the projected value/ per share.<br><br>Aggrieved by this order the assessee preferred an appeal before the Ld. ITAT. They allowed the appeal filed by the assessee on the grounds that valuation is an exercise conducted at a particular point of time and has to be carried out based on the information available as on the date of valuation. Hence the projections under DCF method cannot be compared or tested with the |

| S. No | Question | Answer |
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| | | actuals after 3 or 4 years by tax authorities. The Ld. ITAT also held that if the valuer can justify his workings and projections considered then no one can question the accuracy of the same based on variance from actual performance. |
| 12. | Share some cases where Company issued shares by valuing immovable property at fair value and same was accepted by Department. In Income Tax Act, for issue of shares, the formula under Rule 11UA(2) says, asset – liability is to be determined at book value of the assets, but if company wants to issue share by fair value of land then will it be accepted? | **For Issue of Shares kindly refer to**<br>Explanation to Section 56(2)(viib)<br>*"For the purposes of this clause,—*<br>*(a) the fair market value of the shares shall be the value—*<br>*(i) as may be determined in accordance with such method as may be prescribed; or*<br>*(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, whichever is higher;* "<br><br>As per clause (i) of the above explanation, an assessee has two options under Rule 11UA(2)(b) i.e., DCF method and Book Value Method.<br><br>But as per clause (ii), an assessee can also undertake valuation as per his choice provided; he can convince the AO about it.<br><br>Hence, for a company which has only immoveable property, instead of using book value (which is not adjusted for market value of properties in the case of 56 (2) (vii)(b) or a |

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| | | discounted cash flow method, it may be more appropriate to use market value of the immoveable property to determine the share price. However, the same shall be substantiated to the Assessing Officer.<br><br>Further, in the case of **NABH Multitrade Pvt. Ltd**, Ld. ITAT Jaipur observed that the assessee had exercised an option to value the share under DCF Method, however, AO worked out the value based on NAV Method based on the book value figures only, by considering the value of the assets shown in the Balance Sheet as on 31.03.2013. The ld. CIT(A) also, though considered the case in context of Rule 11UA(2)(b), yet his act of asking the assessee & his Chartered Accountant to prepare and submit a valuation report only on actual figures, was nothing but a valuation done on the basis of NAV Method u/r 11UA(2)(a) only.<br><br>The ITAT held that the Authorities wanted to impose upon the method of valuation of their own choice, completely disregarding the legislative intent which has given an option to the assessee to choose any one of the two methods of valuation of his choice. It also held that the action of the Authorities was not justified, and assessee has got all the right to choose a method which cannot be changed by the Assessing Officer. |
| 13. | In an Unlisted Co. exit option, the valuation was done by a registered | In the speaker's view, NCLT can order fresh valuation only if the appellant has raised a |

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| | valuer which was fair tested by a merchant banker. The scheme was approved by 90% shareholders. Can NCLT order for a fresh valuation? | question on the fundamental gross errors in valuation. |
| 14. | In the Hindustan Lever case, YH Malegam, the valuer was a director on the board of TOMCO and under current law, he would have had a conflict of interest. Based on this premise, can the HLL case be distinguished from, and not followed, in current litigation? | In the given case the appellant, who was a shareholder of TOMCO raised objection on appointment of Mr. YH Malegam as valuer on the grounds of conflict of interest, as he was also a director in TOMCO.<br><br>Against this contention, the court asked the appellant that considering the fact that Mr. Malegam was a director of TOMCO, and if he was being unfair, then he would have only arrived at a value which must be beneficial/favourable to TOMCO shareholders. Hence, in the given situation it is the Hindustan Lever Limited (HLL) shareholders who should have raised this objection and not TOMCO shareholders.<br><br>Further, the court observed that Mr. Malegam as an independent director of TOMCO did not hold any shares in TOMCO or HLL. Further, both HLL and TOMCO were well aware about the facts and still jointly appointed him as the valuer based on his reputation as a knowledgeable valuer and laid faith on his professional judgement and skepticism. Hence, the contention of appellant was rejected by the court.<br><br>However, in today's scenario such an appointment cannot happen as the law does not |

| S. No | Question | Answer |
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| | | permit the same. One is not just expected to conduct his professional engagements independently, but shall also be seen as an independent valuer without any conflict of interest. |
| 15. | Where can we access the recordings for the previous sessions? | All the links to previous sessions can be accessed from Valuation Standards Board webpage at ICAI website.<br><br>Link is as under:-<br>http://icai.org/post/valuation-standards-board |
| 16. | When as a valuer we undertake expert due diligence on the projections, is it not important to have knowledge about the Company, its working, political and economic conditions, etc.? And how the results of due diligence will be applied while carrying out the valuation exercise? | Kindly refer to para 26-28 of ICAI Valuation Standard 201- Scope of Work, Analyses and Evaluation.<br><br>The excerpt of para 26-28 of the ICAI Valuation Standard 201 are as follows:<br>*"Analyses and Evaluation*<br>*26. The extent of analyses to be carried out by the valuer in relation to the engagement shall be based on the purpose of the valuation assignment and the terms of engagement.*<br>*27. The judgments made by the valuer during the course of assignment, including the sufficiency of the data made available to meet the purpose of the valuation, must be adequately supported.*<br>*28. The valuer shall carry out relevant analyses and evaluations through discussions, inspections, survey, calculations and such other means as may be applicable and available to that effect."* |

| S. No | Question | Answer |
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| | | Further one can refer to the Revenue Ruling 59-60(of USA), even though the Ruling was delivered for estate tax, gift tax and income tax, its principles are considered for valuation of any business and the seven factors which must be considered in the valuation are given below:<br>• The nature of the business and the history of the enterprise from its inception.<br>• The economic outlook in general and the condition and outlook of the specific industry in particular.<br>• The book value of the stock and financial condition of the business.<br>• The earning and the dividend-paying capacity of the company.<br>• Whether or not the enterprise has goodwill or other intangible value.<br>• Sales of the stock and the size of the block of stock to be valued.<br>• The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the- counter. |
| 17. | Please give your opinion in the following cases decided on valuation –<br><br>**In re Appraisal of Columbia Pipeline Grp., Inc., 2019 Del. Ch. LEXIS 303 (Aug. 12, 2019)** This statutory appraisal case came in the wake of some key rulings | In US there are two terms used for valuation i.e., Fair Value and Fair Market Value. In case of dispute for Commercial court purposes the term 'Fair Value' is used, while for Tax and Revenue purpose the term 'Fair Market Value' is used. For a public listed company, the more realistic valuation is one based on the latest transaction price. DCF Approach is more subjective |

| S. No | Question | Answer |
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| | from the Delaware Supreme Court that have embraced the use of market evidence to establish fair value when dealing with a publicly traded company. The Court of Chancery (V.C. Laster) here found the unadjusted deal price was the best fair value indicator, focusing its analysis on the soundness of the sale process. Declining to give much attention to the petitioner expert's discounted cash flow (DCF) analysis, the court said the DCF was only a "second-best method" under the circumstances.<br><br>**In re Stillwater Mining Co. 2017 0385 JTL, 2019 Del. Ch. LEXIS 320 (Aug. 21, 2019).**<br>This case is a companion to Columbia Pipeline, with Vice Chancellor Laster again relying on the deal price for fair value. In both cases, the subject was a publicly traded company and the sale process, although flawed, was sound enough when compared to the Supreme Court's key cases. Columbia Pipeline and Stillwater exemplify the court's preference for the transaction price rather than a DCF value when dealing with an arm's-length transaction. | considering the fact that it is an estimation based on multiple assumptions.<br><br>But in case of Indian Context the above cannot be held completely true and is subjective. The markets are not perfect and hence, the share price in stock exchange is not just impacted by the interplay between demand and supply. The stock prices in the market are often found to be overvalued or undervalued on account of various socio-economic factors, market sentiments and also at times vested interest in trading. Hence, valuation based on market price need not always be the fair value. Further, DCF method takes into consideration the intrinsic value and the future growth plans of an asset too unlike market approach which is historic. Hence, a blend of both the methods is often considered as an ideal valuation methodology in case of public listed companies. |

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| 18. | Is there a specific method of calculating ENTERPRISE VALUE - how it is accepted in the market? Kindly answer with a perspective of sale of business enterprises - like PSUs. | Equity value is the total value of all outstanding stock of the company whereas enterprise value is the total net worth of a company net of cash and debt.<br><br>Equity value is calculated by multiplying price of a single share of stock with the number of shares outstanding whereas enterprise value is calculated after deducting cash, investments, and debt from equity value.<br><br>In case, there are material debts in the company the free cash flow for equity becomes trickier and hence, a valuer shall first determine the enterprise value using the Free cash flow for firm and thereafter reduce value of debt from it to arrive at equity value.<br><br>Enterprise valuation is being used as a basis for determining divestment in PSUs by Government of India, primarily because it gives them the flexibility to structure the debts as most of these entities are carrying a higher-than-normal level of debts. Case in example is Air India. |
| 19. | Where valuation reports are found to be inadequate by the court, and fresh valuation is ordered, what stand should be taken by the registered valuer whose reports were overruled by the court? | As per IBBI guidelines- "In case your report is picked up for any questioning, the valuer should be able to justify his work through his working paper or his report and his work should be able to withstand the judicial scrutiny." |

| S. No | Question | Answer |
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| 20. | Kindly discuss the case of Kingfisher Airlines on the grounds of excess valuation of their brand which was relied by the banker resulting in significant loss to bankers? | In the speaker's opinion, on a hindsight, everyone can be an expert and question the projections, but as on the date of valuation no one can project the future accurately as there are multiple assumptions that a valuer undertakes with respect to the company, industry and various micro and macro-economic factors.<br><br>In the case of Kingfisher, there is no doubt that the brand was a preferred choice over its competitors as on the valuation date and also the key managerial person of the company was a sitting member to the parliament and a well-known personality himself which also carried a premium for the company.<br><br>It is the bankers who should have exercised greater diligence and should not have accepted high weightage to the brand value in the total valuation of the company in the initial stage of granting loan. When a company loses its going concern status its brand value is the first asset that loses its value and hence is non-recoverable as no one will be willing to buy a tainted brand.<br><br>Later when the airline was declared an NPA, the bankers appointed an independent valuer to determine the brand value of the company. They ascertained that the actual brand value was much lower than what was initially estimated. However, we need to understand that while valuing at hindsight we can always find errors, but one needs to appreciate the conditions that |

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| | | existed at the time of valuation and as on that date the brand of Kingfisher was a big one and was a preferred choice over all its competitors. |
| 21. | What is important- price of share or value of company? | The term 'price' indicates the amount at which particular asset is bought or sold in an open market in a particular transaction.<br><br>Whereas, the term 'value' indicates the worth of that asset in normal circumstances or the amount at which it should be exchanged.<br><br>The price may be understood as "the amount of money or other consideration asked for or given in exchange for something else". The price is, therefore, an outcome of a transaction whereas, the value may not necessarily require the existence of a transaction. The value exists even if some assets which may not be generating cash flows today but can generate in the future on the happening of some event/s.<br><br>Value of an asset depends on many factors including the investor, the structure, the market place, and the approach and sometimes the ultimate selling price can be greater than the value.<br><br>The quote for listed companies is the price at which the transaction has occurred. While, the intrinsic value could be different as perceived by different valuers, which is why some stock analysts provide advice on buy / sell based on their assessment. |

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| 22. | In case of capital reduction in MNC, Valuation was done in 2017 and application made to NCLT, but it was approved in 2020-2021 and amount was disbursed. During the intervening period financial performance improved.<br><br>Can minority shareholders demand revised value since they continued to be shareholders, as in all fairness, value should be on the date of transaction? | Yes, the Minority shareholders can demand a revised value in the given situation. |
| 23. | Please throw some light on the Kingfisher valuation case. | Kindly refer to answer for Question No. 21 above. |
| 24. | A Pvt Ltd. Co is registered in Feb'21 with Indian Directors on Board. On March 24th, 2021, a foreign company transferred the share application money to the transferee shareholders. The Indian company is exclusively providing services to this foreign company.<br><br>Shall valuation be done on a 'A-L' formula, or any other method shall be followed. No sales booked till date. But expenses are incurred on project from advance received from same foreign company. Please guide. | It is a case of transfer of shares and hence one should value the shares under Rule 11UA(1)(c)(b). The Rule provides for a specific book value method wherein assets specified in the Rule like Jewellery, bullion, properties are to be re-valued and the rest must be taken at book value. |

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| 25. | A private limited company whose book value is Rs 80/- (and shares are held by family members and companies owned by family members) wants to further issue shares at a face value of Rs. 10/- only.<br><br>Can the issuing company do it without going for any kind of valuation? Will there be any issue under section 56 (2)(vii)? | If Shares are issued at Face Value, then 56(2)(vii)(b) will not be attracted. |
| 26. | The accountability of a Valuer is towards whom, the stakeholders relying on the report or the authorities? | The Accountability of a Valuer is towards the intended users of the Valuation Report, and it can be both the authorities and the stakeholders. |

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