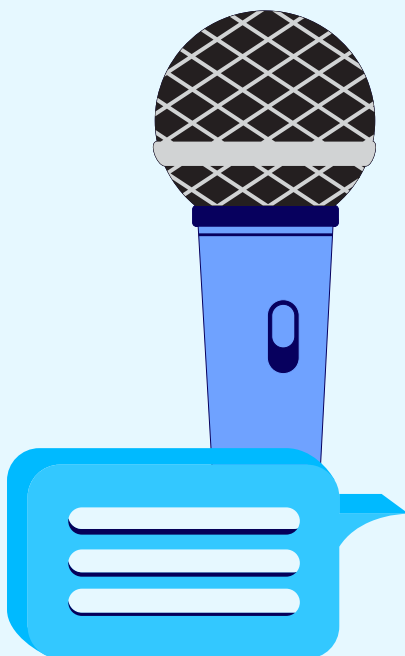




Approach for valuation of intangibles depends on factors like criticality of any intangible to the business and how difficult or time consuming it is to replicate such intangible.



INTERVIEW WITH PARAG MEHTA



SIDDHARTH: How are you approaching the valuation of intangible assets like brand equity, proprietary data, and digital platforms - especially when they don't fit neatly into traditional models?



Approach for valuation of intangibles depends on factors like criticality of any intangible to the business and how difficult or time consuming it is to replicate such intangible.

For valuation of brands typically there are two methods, i.e., multi-period excess earnings (MEEM) and relief from the royalty (RFR) method.

MEEM is used when the brand is very critical to the business like a B2C consumer business with strong brands whereas RFR method is used when the brand is not a very critical element of the business e.g., B2C business with weaker brand of B2B business that uses brand.

For propriety data and digital platforms, the cost approach is used for valuation if these intangibles are not difficult to replicate and can be recreated in a shorter time frame. Otherwise, income based approaches are generally used.

SIDDHARTH: How do you balance traditional valuation approaches like DCF or option pricing with real-world deal considerations such as strategic value, synergies, or buyer behavior?



Fair valuation as concept is done based on as-is-where-is basis without factoring any kind of desperation or compulsion on part of buyer or seller. However, in real-deal situations often there are multiple buyers and hence the highest bidder would get the deal. This is where the strategic value or synergies any buyer can extract from the acquisition can get a deal to that buyer. Strategic or synergy value can be estimated based on additional profits/cash flows that a buyer can generate from acquisition of the target due to incremental efficiencies/elimination of competition etc. Buyer behavior is difficult to quantify and factor in the valuation model as it is driven more by desperation on the part of the buyer to get the deal in a competitive scenario.

SIDDHARTH: With ESG themes becoming more central to investment decisions, how are you incorporating ESG-related risks or strengths into your valuation frameworks?



We are in early days of systematically incorporating ESG factors in valuation models. However, considering the criticality of ESG aspects for business and investment decisions in current times, a valuer needs to ensure that no major ESG related red flags exist for valuation subject.

Valuer can also ensure that the management has factored any ESG related risks or advantages in the business plan, but be careful to not double count these, e.g., if business plan factors ESG related risks and benefits the valuer should not again consider it in the discount rate.

Also, the quality of disclosures made by the comparable companies will also be a factor that will determine how the valuer considers ESG aspects in his valuation.



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Indian valuation benchmarks depend on country-specific variables, requiring careful adjustment when using global data.

SIDDHARTH: When working with early-stage or high-growth companies where financial data is limited, what alternative metrics or signals do you rely on to arrive at a credible valuation?



Honestly, arriving at a credible valuation for very early-stage companies without financial data (e.g., pre-revenue companies) is extremely unlikely. Any investor or buyer will invest in the company based on factors like potential of product / solution / service, market potential and more importantly founders' background, profile and ability. However, whether it was the appropriate deal price, will only be proven in hindsight. There are certain negative indicators though, which may help the valuer to understand significant value destruction, like start-up about to exhaust cash and not able raise fresh funds, prolonged delays in launch of products / solutions / services, founders disassociating themselves from the start-up etc.

SIDDHARTH: What are the key challenges in applying global valuation benchmarks to Indian companies?



Valuation benchmarks for India are driven by the India specific parameters like risk free rate, equity market returns, industry volatility, growth potential etc. These factors may vary significantly between country to country depending on the economic life cycle (i.e., developed vs developing vs underdeveloped economies) and other country specific factors. Hence, use of global valuation benchmarks in Indian companies' valuation may not give fair results.

In cost of capital survey conducted by EY, on a question related to how does India cost of capital compares with that of developed countries, 60%-65% participants (industry players and analysts) responded that cost of capital for India based companies is higher by 2%-7%.

In absence of adequate comparable valuation benchmarks in India, one may use global benchmarks after making appropriate adjustments for risk and growth profile of the specific country as compared to India.

Also, it may be ok to use valuation benchmarks of global start-up companies with new business models to value India based comparable start-ups as the inherent risk profile and growth potential for such companies may be comparable, due care needs to be applied though.

ABOUT

Interviewee

PARAG MEHTA

Parag Mehta, partner Ernst & Young valuations practice, is a Chartered Accountant and a Cost Accountant with an extensive experience of more than 25 years in Valuations. He has been involved in valuations for many of the largest and marquee transactions in Consumer,

Life Sciences, Banking & Financial Services and, Media & Entertainment sectors, in India. He has done 2,500+ valuations for various purpose including transactions, restructurings, court filings, regulatory & tax filings, dispute resolution, accounting etc.



Interviewer

ABOUT

SIDDHARTH

JAIN

Siddharth Jain, CFA, FMVA, is a finance professional with over 14 years of experience in valuation, financial analysis, and transaction advisory. He has worked with RKL LLP, S&P, Resurgent, Deep Industries, and E&Y, and currently serves as Vice President - Valuation at SPA Capital Advisors Ltd.

Siddharth specializes in M&A valuations, private company valuations, equity compensation valuations, and financial due diligence. He is the author of "Business Valuation: A Handy Guide for Beginners and Professionals", available on Amazon and Flipkart, which has received positive feedback from readers in India and abroad.

Siddharth is an active volunteer and member of the Public Awareness Committee (PAC) at CFA Society India, Siddharth is passionate about sharing knowledge and regularly teaches financial modelling, business valuation, investment banking, CFA, and FRM courses to finance professionals and students.

