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IBBI/RV/02/2020/12790

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Enterprise Value

In *Miheer H. Mafatlal vs. Mafatlal Industries Ltd.*, the Hon'ble Supreme Court affirmed that the valuation of shares is a complex and technical matter of "business judgment", and should be left for the experts to decide. Since then, time and again, the role of valuer has been considered to be crucial in the business and commercial world.

In the last two decades, the role of valuers and the valuation profession has seen a new sunlight with various statutes making valuation requirements mandatory and commercial decisions being based on such valuations.

Valuers are usually required to estimate fair value / liquidation value / market value / equitable value etc., depending on the purpose of valuation and requirement of statute. However, now the focus of valuers and stakeholders is getting shifted towards Enterprise Valuation which is a wider and a much better gauge to measure the value of a business or an organization as a whole.

What is Enterprise Value?

"Enterprise Value (EV) is a financial metric representing a company's total value, encompassing its equity, debt, and cash holdings, and serves as the theoretical cost to acquire the business."

It's calculated using the formula:

Enterprise Value = Market Capitalization + Total Debt - Cash and Cash Equivalents.

Need for Enterprise Value

Enterprise value is a gauge to measure the total value of a company or a business and helps to reflect the company's actual financial position. It gives a prospective investor the correct value of the company and how much debt it contains, and hence reflects the economic value of the company or the business.

A simple example can well explain this:

If an investor intends to acquire a business for Rs. 100 million and the business is Rs. 5 million in debt, then the investor is actually spending Rs. 105 million for acquiring the company. Although the direct payment may be Rs. 100 million, the investor will end up paying Rs 5 million eventually, perhaps once he starts operating the business. Hence, considering the Enterprise value gives the actual cost of acquisition to an investor.

Enterprise Value vs. Market Capitalization

Let us consider company XYZ Ltd. with the following details:

Market capitalization	\$50 million
Debt	\$5 million
Cash Reserve	Nil
Enterprise Value	\$55 million

Considering another company, PQR Ltd

Market capitalization	\$50 million
Debt	Nil
Cash reserve	\$1 million
Enterprise Value	\$49 million

Though the market capitalization of both companies is the same, the enterprise value differs. Hence, the stakeholders/investors should not simply base the value on the market capitalization, but instead consider the enterprise value for an informed decision-making

Air India Disinvestment – Role of Enterprise Value

In 2001, an attempt was made to offload 40% of the equity of Air India. Initially, several foreign airlines, including Lufthansa, Swiss Air, Air France-Delta, British Airways, Emirates, and Singapore Airlines, expressed interest. When the government clarified that any foreign airline would have to partner with an Indian company to bid, most airlines pulled themselves out of the race.

The Government then offered to sell a 76 percent stake in the state-owned airliner in 2018. However, it could not receive a successful bid then.

The Government reopened its process in January 2020, this time with the intention of disinvesting completely. The disinvestment involved a 100 percent sale of the

Government's shareholding in the company, including Air India Express Limited and Air India SATS Airport Services. In this round of the disinvestment process, the buyer was to take on Rs 23,286 crore of debt out of a total ₹60,074 crore but still could not attract bidders and prospective buyers.

The government later tweaked the bidding parameters. To allow prospective bidders the flexibility to decide the level of debt they wish to take on, along with the loss-laden airline, the government allowed bidders to place their bids based on enterprise value, which accounts for the company's equity and debt and this resulted in finally achieving the target of disinvesting Air India.

Air India was disinvested using an Enterprise Value (EV) bidding approach to attract bidders due to the company's massive accumulated debt, which made a traditional equity sale unappealing and potentially stalled the process.

EV method allowed bidders to quote a combined value for the company's debt and equity, giving them flexibility to decide the level of debt they would take on and making the overall transaction more attractive for potential investors.

Enterprise Value under IBC

Insolvency and Bankruptcy Code (IBC) 2016 is a game changer for the stressed entities providing them with a last opportunity to revive and survive before being liquidated. Currently, IBC 2016 and corresponding regulations require estimation of Fair and Liquidation value under CIRP regulations and Realizable value under the Liquidation regulations.

However, a need is being felt both at the part of investors/stakeholders and the authorities to consider Enterprise Value to keep the entire process transparent and encourage the resolution applicants/bidders to come forward with better resolution plans/bids to ensure maximization of the value of the Corporate Debtor. The matter is under consideration of the authorities, and likely some amendments in the corresponding regulations may be seen soon. Hence the valuer should now focus on becoming an Enterprise valuer instead of Asset valuer.

How to become an Enterprise Valuer?

It is high time for the valuers to diversify their area of expertise and sharpen their valuation skills. To be an Enterprise Valuer, one has to be well-conversant with all aspects of valuation without limiting himself/herself to the respective asset class. As an Enterprise Valuer, the valuer should have knowledge of all three asset classes, viz land-building, plant-machinery, and financial assets. The valuer should also equip himself/herself with techniques and skill set required for business valuation, intangible asset valuation, financial and non-financial liabilities. Apart from above, ESG impact and knowledge of AI will help the valuer to discharge his responsibilities with precision and perfection.

However, it must be remembered that greater roles come with greater responsibilities and accountability. Hence, the valuer should make himself updated with the relevant laws and statutes and also should be ready to face any litigation, challenges that arrive in course of such valuation.

Time has come when valuers are required to break the barriers of asset classification and adopt the process of learn, unlearn and relearn to get future ready and face the upcoming challenges and rebrand himself/herself as a Business/Enterprise Valuer.

