



Valuation considerations post M&A

Presented by

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Topics for discussion

- Value v/s price
- Recognizing intangibles in the post combination balance sheet
- Earn-outs

Are you valuing or pricing?

TITANIUM




₹ 15.87 Cr
₹ 39,995 per sqft


3 BHK Apartment for sale in Worli 3968 sqft [Map](#) Posted Yesterday
[4 Quick Facts](#)

Society: [Omkar 1973](#)
Status: Under Construction (Ready by Dec '17)
Details: 3 Bath | Unfurnished | 1st Floor (of 76) [View Details](#)
Description: 3 bhk Flat On sale in multistorey apartment available in Worli, Mumbai...

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₹ 7.05 Cr
₹ 40,799 per sqft

3 BHK Apartment for sale in Worli 1728 sqft [Map](#) Posted Yesterday
[4 Quick Facts](#)


Society: [The Park](#)
Status: Under Construction (Ready by Jun '20) . Freehold
Details: 3 Bath | Unfurnished | 1st Floor (of 80) [View Details](#)
Description: 3 BHK multistorey apartment flat sale in Worli, Mumbai...

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₹ 3.22 Cr
₹ 50,000 per sqft

2 BHK Apartment for sale in Dadar East 0.4 Km away 644 sqft [Map](#) Posted Yesterday
[4 Quick Facts](#)

Society: [Sugee Mahalaxmi](#)
Status: Under Construction (Ready by Mar '20) . Freehold
Details: 2 Bath | Unfurnished | 11th Floor [View Details](#)

Are you valuing or pricing?

A competition was valued at 3 times Revenue or 10 times EBITDA, I clocked US 20 mn of revenue last year so I should be valued at US 60 mn.

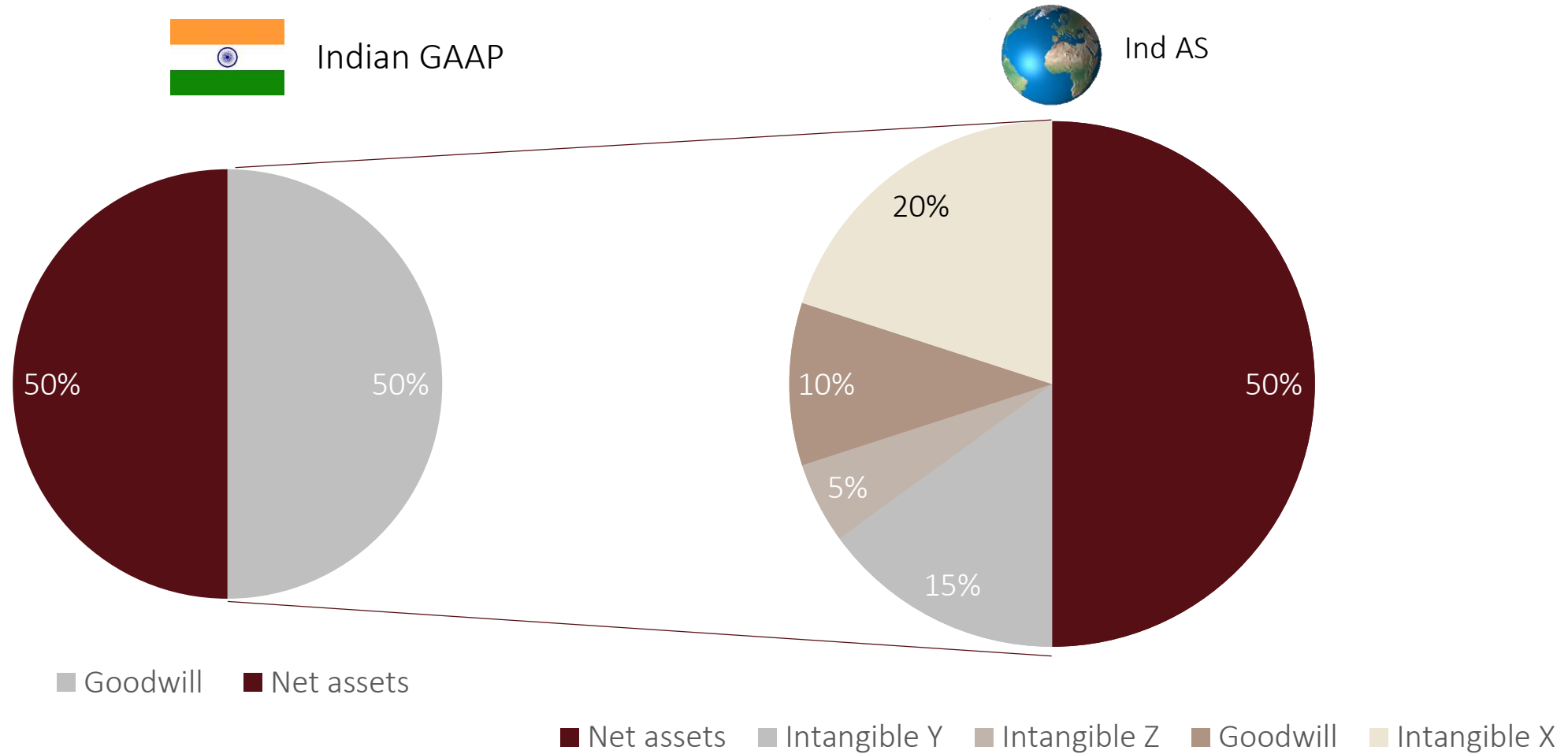
Dates	Market Multiples		Valuation	
	Revenue	EBITDA	Revenue – 20 mn	EBITDA – 6 mn
1.1.2016	3 x	10 x	60 mn	60 mn
30.6.2016	3.5 x	11 x	70 mn	66 mn
31.12.2016	4 x	12.5 x	80 mn	75 mn

Are you valuing or pricing?


Do you really require a valuation model to close an M&A deal?


Do you really require a valuation model post the deal closure?

Valuation consideration post M&A



Valuation consideration post M&A

 Indian GAAP	
Description	Amount
Assets:	
Cash	5
Accounts receivable	20
Plant, property and equipment	90
Goodwill	95
Total	210
Liabilities	
Accounts payable	10
Accrued expenses	15
Deferred revenue liability	25
Share capital	
Debt	20
Equity	140
Total	210

 Ind AS	
Description	Amount
Assets:	
Cash	5
Accounts receivable	20
Plant, property and equipment	90
Customer relationships	40
Tradename	15
Non-compete	5
Goodwill	35
Total	210
Liabilities	
Accounts payable	10
Accrued expenses	15
Deferred revenue liability	25
Share capital	
Debt	20
Equity	140
Total	210

95

Question on Post M&A valuations

Various stakeholders of a company, including the CxO's have several queries on the impact of the business combination standards on their financial statements. Some of the common queries we have come across include:

- What are the **projections required for the purpose of valuation of intangibles**? Why are they most important input for appraisers?
- How does one determine an **acquired intangibles useful life**? – CASH FLOWS
- I acquired a **Tradename that I do not intend to discontinue**, what will be the useful life of that Tradename? - INDEFINITE
- How much time do we have post acquisition to close the acquisition accounting entries? **Measurement period adjustments**
- Do we need to **fair value our tangible assets**? - YES
- How is the **earn-out classification** determined? What portion of it impacts the goodwill?
- What if our **earn-out payments** differ from what was estimated as fair value at the time of acquisition?

Valuation consideration post M&A

Multi-period excess earnings method ("MPEEM")

Particulars	2017	2018	2019
Revenue	xx	xx	xx
Cost of goods sold	(xx)	(xx)	(xx)
Gross margin	xx	xx	xx
<u>Operating expenses</u>			
Selling, general and administrative expenses	(xx)	(xx)	(xx)
Other operating expenses	(xx)	(xx)	(xx)
EBITDA	xx	xx	xx
Depreciation and amortization	(xx)	(xx)	(xx)
EBIT	xx	xx	xx
Minus: Hypothetical charge for use of trade name	(xx)	(xx)	(xx)
EBIT - adjusted	xx	xx	xx
Minus: Interest expense	(xx)	(xx)	(xx)
EBT	xx	xx	xx
Minus: Income Taxes	(xx)	(xx)	(xx)
After-tax earnings	xx	xx	xx
Plus : Depreciation and amortization	xx	xx	xx
Plus : Assembled workforce growth investment	xx	xx	xx
Cash flow	xx	xx	xx

Used to value the Primary income generating asset (PIGA)

Valuation consideration post M&A

Multi-period excess earnings method ("MPEEM")

Particulars	2017	2018	2019
Cash flow	xx	xx	xx
<u>Contributory charges to primary intangible</u>			
Minus: Fair Return on Working Capital	(xx)	(xx)	(xx)
Minus: Fair Return on Fixed Assets	(xx)	(xx)	(xx)
Minus: Fair Return of Fixed Assets	(xx)	(xx)	(xx)
Minus: Fair Return on Assembled Workforce	(xx)	(xx)	(xx)
Minus: Fair Return on Patents	(xx)	(xx)	(xx)
Cash flow after Contributory Charges	xx	xx	xx
Discounting Period	xx	xx	xx
Present Value Factor	xx	xx	xx
Present Value of Cash Flows	xx	xx	xx
Sum of Present Value of Cash Flows			XX
Tax Savings of Amortization			xx
Fair value of primary intangible			XX

Valuation consideration post M&A

Relief from royalty method

Particulars	2017	2018	2019
Total revenue	XX	XX	XX
Probability of continuing use of intangible assets in respective year	X%	X%	X%
Probability of not having previously discontinued use of intangible asset	X%	X%	X%
Cumulative probability of continuing to use the intangible asset	X%	X%	X%
Pre-tax royalty relieved, adjusted for probability	XX	XX	XX
Less: Income taxes	XX	XX	XX
After-tax royalty relieved	XX	XX	XX
Discount period	XX	XX	XX
Present value factor	XX	XX	XX
Present value of after-tax royalty relieved	XX	XX	XX
Sum of the present value of after-tax royalty relieved			XX
Tax amortization benefit			XX
Fair value of intangible asset			XX

Used to
generally value
Trade name /
Brand name

Valuation consideration post M&A

Fair valuation of lease agreements

Particulars	2017	2018	2019
As per market	XX	XX	XX
As per contract	XX	XX	XX
Favorable/(unfavorable) terms	XX	XX	XX
Debt free net income	XX	XX	XX
Discounting period	XX	XX	XX
Discounting factor	XX	XX	XX
PV of favorable/(unfavorable) lease terms	XX	XX	XX
Total PV - Favorable/(unfavorable) lease terms			XX

Valuation consideration post M&A

Cost build-up approach

Name of employee	Employee classification	Hourly salary	Working hours	Annual salary	Fringe benefits	Bonus	Total salary	Average advertising & recruitment costs	Average relocation costs	Hiring costs	Direct training costs	Time till full productivity	Lost productivity	Total replacement cost
A		xx		xx	X%	xx	xx	xx	xx	xx				xx
B		xx		xx	X%	xx	xx	xx	xx	xx				xx
C		xx		xx	X%	xx	xx	xx	xx	xx				xx
D		xx		xx	X%	xx	xx	xx	xx	xx				xx
Total							XX							XX

Valuation consideration post M&A

Lost profit method

Particulars		2017	2018	2019
<u>Projections with non compete in place</u>				
Total revenue		xx	xx	xx
Operating margin		xx	xx	xx
EBIT		xx	xx	xx
<u>Projections without non compete in place</u>				
Lost profit due to competition		xx	xx	xx
Operating margin		xx	xx	xx
Lost profit-EBIT		xx	xx	xx
Minus: Taxes	40%	(xx)	(xx)	(xx)
After tax lost profit		xx	xx	xx
Profit loss if competition starting in year	2017	xx	xx	xx
Profit loss if competition starting in year	2018		xx	xx
Profit loss if competition starting in year	2019			xx

Used to value
Non compete

Valuation consideration post M&A

Lost profit method

Expected profit loss	Annual probability of leaving (a)	Probability of not having previously left (b)	Joint probability of leaving (a*b)	Probability of competing (c)	Probability of leaving & competing (a*b*c)	2017	2018	2019
Decision to leave in 2017 and compete in 2017	X%	X%	X%	X%	X%	xx	xx	xx
Decision to leave in 2018 and compete in 2018	X%	X%	X%	X%	X%		xx	xx
Decision to leave in 2019 and compete in 2019	X%	X%	X%	X%	X%			xx
Adjusted annual after tax lost profit						xx	xx	xx
Present value factor						xx	xx	xx
Present value of after tax lost profit						xx	xx	xx
Sum of present values								xx
Tax saving of amortisation								xx
Fair value of non-compete clause								xx

Earnouts

Illustration

ABC Co., an east coast maker of widgets, decides to expand its market by acquiring a west coast widget maker for \$10 million cash plus an additional cash payment if certain volume and profitability targets are met at the end of year 2. The west coast widget maker's sole owner (and CEO) will be employed by the post-acquisition entity as president of the west coast division.

Scenario 1:

The terms of the additional payment also require the former owner/CEO of the west coast widget maker to be employed at the newly formed division to earn the consideration.

Scenario 2:

The terms of the additional payment permit the former owner/CEO of the west coast widget maker to be paid regardless of his employment status.

Analysis and conclusion

Component	Conditions	Consideration	Compensation
Initial payout of \$10 million cash	N/A	✓	
Additional cash payment :			
Scenario 1	Performance plus employment		✓
Scenario 2	Only performance condition	✓	

Approaches to valuing earn-out payments

I. Probability – adjusted income approach

- i. Discounted cash flow analyses
- ii. Probability weighted expected return method (“PWERM”) or scenario methods

II. Option based models

- i. Black-scholes
- ii. Lattice

III. Monte carlo style analyses

- i. Monte-carlo simulation

Thank you

We would be delighted to answer any questions



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