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Saudi Authority for Accredited Valuers

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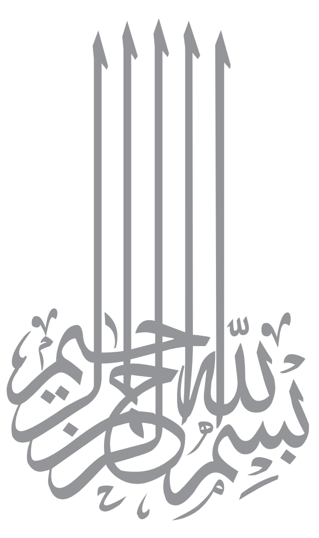
بسم الله الرحمن الرحيم

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1

Glossary

Glossary

Acquisition — The purchase of one corporate entity or business or Assets by another, with the acquiring company's shareholders gaining control.

Acquisition Premium — The difference between the price paid per share in a takeover of a public company and the share price before the announcement of the attempt at a takeover. This can also be calculated on the basis of total invested capital. See also Market Participant Acquisition Premium.

Active Market — A market in which transactions take place with sufficient frequency and volume to provide pricing information on a continuing basis.

Adjusted Net Asset Value (NAV) — An asset valuation method where all Assets and liabilities are individually revalued including Assets and liabilities not on the balance sheet and liabilities are deducted from Assets to estimate value. This is the Summation Method under the Cost Approach in IVS. This is also known as the "adjusted book value method" and the "asset accumulation method" in the International Valuation Glossary.

Amalgamation — The joining or merging of two or more previously separate corporate entities on the basis of equality of interest. Also known as a merger. In an amalgamation or merger the acquiring company's stockholders do not gain control of the enlarged entity.

Arbitrage Pricing Theory (APT) Model — A multi-factor asset-pricing model, which predicts an asset's returns using the relationship between the asset and macroeconomic risk factors. It incorporates several systematic risk factors.

Arm's Length — An arm's length transaction is one between parties who do not have a particular or special relationship and who are each acting independently.

Articles of Association — A document that contains the constitution of a company with regard to matters such as the powers of directors and members, the holding of meetings and votes, etc. It also provides guidelines for a company's operations. There may be further requirements between certain or all shareholders in a Shareholders' Agreement.

Assembled Workforce

Also known as Workforce in Place. The team of employees who work in a Business. This is a concept that is used when calculating Contributory Asset Charges in the valuation of Intangible Assets. The Workforce in Place is an Intangible Asset but one which is nor recognized for financial reporting purposes.

Asset

A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity[1].

Asset Approach or Asset-Based Approach

The same as the Cost Approach in IVS

Asset-Liability Symmetry

The concept that financial liabilities can be valued at the same amount as the related asset.

Asset Retirement Obligation

A legal (or constructive) obligation that can arise when dealing with tangible long-life wasting Assets such as mines or oil wells. These obligations arise when the retirement of the asset requires the restoration of the asset site to minimum standards. Also known as a Disposal Cost. See also Salvage Value.

Assumptions

Assumed facts that are consistent with, or could be consistent with, those existing at the date of the valuation. See also Special Assumptions.

Attrition

The rate of loss of existing customers, a group of contracts, workforce or other Assets or the rate of decay of existing technology. The rate of attrition of customers varies according to any inherent advantage of the company, customer loyalty, switching costs and also the length of its contractual arrangements.

Back-Testing

The comparison of the valuation metrics used by the valuer in an earlier valuation with the actual metrics achieved on an exit.

Bases of Value

Bases of value (sometimes called standards of value) describe the fundamental measurement assumption on which the reported values will be based. [2]There are six IVS Bases of Value and other Bases of Value defined by other bodies.

1 International Financial Reporting Standards Framework

2 International Valuation Standards (IVS) 104 2020 section 10.1

Beta A measure used to assess the systematic risk or relative volatility of a single security or portfolio, relative to the overall market. It is computed as the volatility of a security (as measured by standard deviation) relative to the volatility of the market, multiplied by the correlation of the security with the market.

Bid-Ask Spread or Bid-Offer Spread The difference between the price at which an investor can purchase (the ask or offer price) and at which it can sell (the bid price) of a security. Less liquid stocks have a larger spread between the purchase and the selling price.

Black Scholes Option Model A model, with the status of a mathematical proof, devised for the pricing of Option contracts in the markets. The Black Scholes Call Option Model can be used for the valuing of stock when there are several classes of stock. The Black Scholes Put Option Model can be used for considering the Discount for Lack or Marketability (DLOM).

Blockage Discount An amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the value of each share of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volumes. [3] The concept is that a large block of stock offered for sale on the same day would reduce the market price.

Bottom-up Method A method under the income approach for the valuation of certain non-financial liabilities .

Build Up Model A model used to calculate the required rate of return on a security by adding various risk premiums to the risk-free rate. For example, the build-up model may comprise risk free rate, Equity risk premium, size premium and company specific risk premium. It differs from CAPM as Beta is not used to adjust the Equity risk premium.

Business A business conducts a commercial, industrial, service or investment activity. Businesses can take many forms, such as corporations, partnerships, joint ventures and sole proprietorships.

Business Risk The degree of uncertainty of realizing expected future returns resulting from factors other than financial leverage.[4]

3 International Valuation Glossary
4 International Valuation Glossary

Business Valuation	The practice of determining the economic value of a company or business or ownership interest therein.
Calibration	the use of relevant inputs as of the date that an earlier investment in an entity was made; updated inputs as of a subsequent measurement date are then used in order to generate the current value. This is particularly important when a valuation technique that uses unobservable inputs is to be used to measure value in subsequent periods. This is recommended for use in the Guide issued by the AICPA: “Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies” and also by the International Private Equity and Venture Capital Valuation (IPEV) Guidelines. There may be various funding rounds when dealing with a venture capital investment. Calibration is then an important valuation technique as it ensures that after initial recognition the reporting entity is using valuation techniques that reflect current market conditions at the measurement date.
Call Option	An option contract giving the holder of the option the choice to buy stock in the future at a stated price. See also Put Option, Option, and Black Scholes Option Model.
Capital Asset Pricing Model (CAPM)	An asset pricing model used to determine the expected rate of return of a security by adding a risk premium to the rate on a risk-free security. The risk premium is comprised of the Equity (or Market) Risk Premium adjusted by the Systematic Risk (or Beta) of the security. Conceptually it captures the incremental (systematic) risk that investors need to be compensated for when investing in risky securities (typically stocks) relative to investing in a risk-free security.
Capital Market Authority (CMA)	The Saudi government’s financial regulatory authority responsible for capital markets in Saudi Arabia.
Capitalization	a conversion of the economic benefits of a single period into value.
Capitalization Factor	any multiple or divisor used to convert into value the expected economic benefits of a single period.

Capitalization of Earnings Method
a method within the income approach whereby expected economic benefits for a representative single period are converted to value through division by a cap rate or multiplication by a multiple.

Capitalization Rate (cap rate)
The rate used to convert into value the expected economic benefits of a single period. The cap rate is the inverse of the market multiple and is usually expressed as a percentage. The expected economic benefits are divided by the cap rate (or multiplied by the market multiple). The cap rate equals the discount rate less growth.

Capital Structure
The composition of the Equity financing and Debt financing of a business. Financial analysis will be based on book amounts. For valuation purposes the figures should be the market values.

Cash Equivalents
Assets in a business that can be converted into cash. Examples are realizable investments, amounts due from officers and amounts due from other related parties.

Client
The person, persons, or entity for whom the valuation is performed. This may include external Clients (i.e., when a Valuer is engaged by a third-party client) as well as internal Clients (i.e., valuations performed for an employer). [5]

Closed End Investment Companies (CEICs)
Investment companies listed on a stock exchange that raise a fixed amount of capital through an IPO. The CEIC invests its capital in the stock of other public or private companies. The purchase of the stock of a CEIC is therefore a simple way of a small investor achieving diversification.

Company Specific Risk Premium
The additional risk arising from factors other than those factors correlated with the investment market. The investor requires an additional return to compensate for the additional risk.

Comparable Public Company (or Guideline Public Company) Method
A valuation method under the Market Approach, which uses the market multiples derived from the market prices of the securities of public traded companies in an open actively traded market in the same or similar line of business as the private company being valued. This is one of the two main methods under the Market Approach in IVS.

5 IVS, 2020 Glossary, section 20.2

Comparable Companies Multiple — A financial metric used in the Comparable Public Company Method to value a company, generally the market value of a company's stock or invested capital divided by a company measure.

Comparable Transaction (or Guideline Transaction) Method — A valuation method under the market approach, which uses pricing multiples as derived from acquisition transactions of significant interests in public and private companies, which are engaged in the same or similar lines of business as the private company being valued. This is one of the two main methods under the market approach in IVS.

Comparable Transaction Multiple — A financial metric used in the Comparable Transaction Method to value a company.

Completion — The point at which a sale and purchase of an asset takes place.

Compounded Annual Growth Rate (CAGR) — The annualized growth rate of an investment over a period of time greater than a year.

Contingent Consideration — Consideration that varies according to results achieved after Completion. A purchase transaction may be structured so that the amount which is paid is based on revenues achieved or profits realized in the two or three years after Completion.

Contributory Assets — Any tangible or Intangible Assets required for the generation of the cash flows associated with the valuation of intangible Assets. This is part of the calculations using the Excess Earnings Method for valuing certain intangible Assets.

Contributory Assets Charge — A charge deducted from the cash flows relating to the intangible asset being valued using the MPEEM to reflect a fair return on the contributory Assets. [6]

Control — The power to direct the management and policies of a business. This is normally achieved by holding more than %50 of the voting shares.

Controlling Interest — A share holding that gives the power to control the Business.

Controlling Non-Liquid Interest — A share holding in a private company which gives the power to control the business.

6 International Valuation Glossary 1.1

Cost Approach It provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility. [7] This is one of the three valuation approaches in IVS.

Cost of Capital The expected rate of return that the market requires for particular investments.

Cost of Debt (COD) The effective rate a company pays on its Debt obligations.

Cost of Equity (COE) The rate of return Equity holders expect in return for investing in the Equity securities of company i.e. compensation for undertaking the risk of owning Equity interests.

Cost Savings Method A method under the income approach whereby an asset is valued by reference to the costs which are avoided or reduced as a result of owning the asset. An example of the Cost Savings Method is the Relief from Royalty Method for valuing certain intangible Assets.

Country Risk The risks associated with the political governance structures or financial risks in another country.

Credible Of or worthy of belief. Valuation standards note that a valuation opinion should be credible.

Credit Risk The risk of a financial loss as a result of another party failing to discharge an obligation.

Currency Risk The risk that future cash flows in another currency will fluctuate because of changes in currency exchange rates. The Currency Risk is separate from Country Risk.

Current Use/ Existing Use The current way an asset is used. The current use may be, but is not necessarily, also the highest and best use. This is one of the four premises in IVS.

Current Value Method (CVM) An allocation of the Enterprise value or total Equity value to the various securities assuming a sale of the business on the valuation date. This method may not provide credible valuations when there are various classes of shares in existence.

7 IVS 2020,105, section 60.1

Customer-Related Intangible Assets	Intangible Assets such as lists of customers, order backlog and customer contracts.
Debt	In business valuation this conventionally relates to interest-bearing Debt. This can be all interest-bearing Debt or long-term interest-bearing Debt.
Deferred Tax Asset (DTA)	Deferred Tax is an accounting concept. It arises if there are timing differences between the recognition of revenues and costs in the accounting income statement and their recognition for tax purposes. If the timing differences result in tax being paid in advance, a deferred tax asset is recognized. An example is a piece of plant which is depreciated over five years in the income statement but the tax depreciation is over ten years.
Deferred Tax Liability (DTL)	See the definition of Deferred tax asset above. If the timing difference is such that the relevant tax is paid in arrears, a deferred tax liability is recognized. Using the above example, if the tax depreciation is over two years, a deferred tax liability would be recognized.
Discount for Lack of Control (DLOC)	An amount or percentage deducted from a control value to reflect the absence of some or all of the powers of Control.
Discount for Lack of Liquidity	An amount or percentage difference between the value of a liquid asset and an illiquid to reflect a reduced frequency of transactions in the asset being valued.
Discount for Lack of Marketability (DLOMI)	The discount applied to determine the value of shares reflecting the relative absence of marketability.
Discount Rate	A rate of return used to convert a future cash flow sum into a present value.
Discounted Cash Flow (DCF) Method	A valuation method under the income approach, which discounts future expected cash flows to a present value using a discount rate. This is the main method under the income approach in IVS. All other income approach methods are variations on the DCF method.
Discounted Future Earnings Method	A valuation method under the income approach, which discounts future expected economic benefits to a present value using an appropriate discount rate.

Disposal Cost	A negative terminal value that can arise when dealing with wasting Assets such as mines or oil wells. Also known as an Asset Retirement Obligation. See also Salvage Value.
Distributor Method	A valuation method under the income approach for the valuation of certain customer-related intangible Assets. The margins made by businesses which act solely as distributors can be used to determine the proportion of profits which relate to customer-related intangibles. This is one of the five income approach methods advocated by IVS for the valuation of intangible Assets.
EBIT	Earnings before interest and tax/zakat expense. This represents the operating income of the Valuation Subject.
EBITA	Earnings before interest, tax/zakat and amortization expenses ,
EBITDA	Earnings before interest, tax/zakat, depreciation and amortization expense.
EBITDAt	Earnings before interest, tax/zakat, and depreciation and amortization expense in the terminal period.
Economic Life	the period of time over which an asset is expected to generate either profits or cost savings. Economic life commonly ends when the capital expenditure required to maintain the asset is higher than the cash flows from the asset.
Engagement Letter	The legal agreement between a professional firm and its Client, detailing the scope of services in exchange for compensation and other key engagement terms and conditions.
Enterprise (1)	A Business.
Enterprise (2)	The Equity in a business plus its Debt and less any cash or cash equivalents available to repay the Debt and less any non-operating Assets in the business.
Enterprise Value	The total value of the Equity in a business plus the value of its Debt and less the value of any excess cash or cash equivalents less any non-operating Assets in the business.

Equitable Value The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties. [8] This is one of the six IVS bases of value

Equity the owner's interest in a business after deducting all liabilities.

Equity Risk Premium The additional rate of return required by investors over the risk-free return to reflect the additional risk of investing in Equity instruments compared to risk free instruments.

Evidential Skepticism The exercise of due professional care by challenging information provided with an appropriate level of enquiry. The level of skepticism should be based on the possible lack of Objectivity within the information provided.

Excess Earnings The Company's anticipated earnings that are greater than the required rate of return on the asset base,

Excess Earnings Method a method which values an intangible asset as the present value of the cash flows attributable to the subject intangible asset after excluding the proportion of the cash flows which are attributable to other Assets required to generate the cash flows ("Contributory Assets") [9]. Also known as the Multi-Period Excess Earnings Method. This is one of the five income approach methods advocated by IVS for the valuation of intangible Assets.

Exercise Price the price that is payable when an option is exercised. This is more commonly known as the Strike Price.

Existing Use See Current Use/Existing Use.

Exit Price The price that would be received to sell an asset or paid to transfer a liability.

Expected Cash Flows the probability-weighted average of a set of cash flows. This can be contrasted with the most likely cash flows; the most likely cash flows are the cash flows which are considered to have the highest probability of being achieved.

Expert a specialist who provides opinions in respect of his area of specialism. Such Experts are often appointed as part of litigation; they are different from factual witnesses in that they are able to give their opinions in Court.

8 IVS 104 ,2020, section 50.1
9 IVS 210 ,2020, section 60.6

Expert Determination

A means of settling a dispute by appointing an Expert who will determine the matter in dispute in accordance with the instructions given to him or her.

Expert Witness

an expert who gives opinions within his area of specialism. Other witnesses are only able to recount facts known to them.

Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. [10]

Fairness Opinion

An opinion as to whether or not the consideration paid or received in a transaction is fair from a financial point of view. Such opinions are given on private transactions, non-arm's length transactions relating to public securities, public company takeovers, and significant acquisitions by public companies.

Financial Risk

the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage.[11] This should be compared with Business Risk which relates to all risks in a business other than Financial risk.

Firm (1)

a Business.

Firm (2)

The same as Enterprise (2): The Equity in a business plus its Debt and less any cash or cash equivalents available to repay the Debt and less any non-operating Assets in the business. This is the meaning in the definition "Free Cash Flows to Firm".

Forced Liquidation or Forced Sale

The circumstances when a seller is under compulsion to sell and, as a consequence, a proper marketing period is not possible and buyers may not be able to undertake adequate due diligence. The price that could be obtained in these circumstances will depend on the nature of the pressure on the seller and the reasons why proper marketing cannot be undertaken.[12] Forced Sale is one of the four premises in IVS.

10 IFRS 13

11 International Valuation Glossary

12 IVS, 104 2020, section 170.1

Free Cash Flow to Equity (FCFE)	Cash flow available to the Equity holders of the company after all operating expenses (including taxes, zakat), interest, principal payments and necessary investments in working and fixed capital have been paid/ made.
Free Cash Flow to the Firm (FCFF)	Cash flow available to both Equity holders and Debt holders of the company after all operating expenses (including taxes/zakat relating to EBIT), and necessary investments in working capital and fixed capital have been paid/ made. These cash flows are before interest expense, Debt repayments and dividends on preference capital.
Fulfilment	The discharge of a performance obligation of a liability.
General Authority of Zakat and Tax (GAZT)	A government agency that reports to the Ministry of Finance. Its objective is to assess and collect tax/zakat from companies.
Going Concern	A business that will operate in the foreseeable future.
Goodwill	the residual intangible asset arising as a result of economic benefits exceeding the returns required on the tangible net Assets and the identified intangible Assets. From an accounting viewpoint goodwill represents the excess of the purchase price of an acquired business over the value of the net identifiable tangible and intangible Assets acquired.
Gordon Growth Model	A valuation tool which determines value, based on the economic benefit of a single period. That economic benefit is expected to grow at a constant average annual compound rate of growth into perpetuity. The formula is $CF_1/(k-g)$. CF1 is the cash flow in the period immediately after the valuation date; k is the cost of capital and g is the rate of growth. (CF_1 is the same as the cash flows for the period up to the valuation date (CF_0) as increased by the rate of growth.) The Gordon growth model is based on the mathematical formula for an annuity increasing at a constant rate. When the annuity is deemed to continue in perpetuity this formula simplifies to that shown above.
Greenfield Method	An alternative method for the valuation of the most important Intangible Asset. It is assumed that the only asset of the business is that Intangible Asset. All other tangible and Intangible Assets must be bought, built or rented. This is one of the five income approach methods advocated by IVS for the valuation of intangible Assets.

Gross Domestic Product (GDP)
The economic value of all the finished goods and services produced in an economy typically over a year. It is one of the primary indicators to gauge the economic performance of a country or region and to make international comparisons.

Highest and Best Use
The use, from a market participant perspective, that would produce the highest value for an asset.[13] This is one of the four premises of value in IVS. It must be physically possible, financially feasible, legally allowed and within the reasonable knowledge of market participants.

Hypothetical Condition
The same as Special Assumption: An assumed fact that differ from those existing at the date of the valuation.

Impairment
A loss in value of an asset due to unexpected declines in expected future economic benefits.

Income Approach
It provides an indication of value by converting future cash flow to a single current value. Under the income approach, the value of an asset is determined by reference to the value of income, cash flow or cost savings generated by the asset.[14] This is one of the three valuation approaches in IVS.

Independence Confirmation
A statement confirming independence from conditions and relationships, in the context of an engagement, which would compromise the integrity or objectivity of the company or person involved.

Information Requirement List (IRL)
A list sent to the client in order to obtain relevant information of the client's business available to use in conducting a valuation.

Initial Public Offering (IPO)
The shares of a private company, which are offered to the public for the first time, when the company becomes a public company

Intangible Assets
A non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and/or economic benefits to its owner.[15]

13 IVS 104 ,2020, section 140.1
14 IVS 105 ,2020, section 40.1
15 IVS 210 ,2020, section 20.1

Intellectual Property (IP)	Intangible Assets that enjoy special legal recognition and protection, often by statutory authorities. IP is often thought of as “creations of the mind”. Examples are trademarks, trade names, patents and copyright.
Internal Rate of Return (IRR)	A discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.
Internal Valuation Professional	A valuation professional who is employed by the owner of an asset.
International Financial Reporting Standards (IFRS)	A set of international accounting standards stating how transactions and other events should be accounted for in the financial statements and to help investors and other users of financial information to make economic decisions. The standards relate to how transactions are measured and how they are disclosed in financial statements.
International Valuation Standards (IVS)	Standards for undertaking valuation assignments using generally recognized concepts and principles that promote transparency and consistency in valuation practice.
Intrinsic Value (1)	The value that an investor considers to be the true or real value of an asset. Such an investor considers that the market value will move to equate to the intrinsic value when other market participants reach the same conclusion.
Intrinsic Value (2)	The difference between the exercise price or strike price of an option and the market value of the underlying security.
Invested Capital Net Cash Flows	Cash flows available to the Equity holders and Debt holders of the company after all operating expenses (including taxes/zakat relating to EBIT), and necessary investments in working capital and fixed capital have been paid/made. These cash flows are before interest expense, Debt repayments and dividends on preference capital. This is the same definition as Free Cash Flows to the Firm.
Investment Value	An entity specific basis of value that represents the value of an asset to a particular owner for individual investment or operational objectives. This is one of the six IVS bases of value.

Joint Venture	A joint arrangement where two parties have joint control of the arrangement and rights to the net Assets of the arrangement. It normally involves sharing of resources, which could include capital, personnel, physical equipment, facilities or intellectual property such as patents.[16]
Jurisdiction	The legal and regulatory environment in which a valuation engagement is performed. This generally includes laws and regulations set by governments (e.g., country, state and municipal) and, depending on the purpose, rules set by certain regulators (e.g., banking authorities and securities regulators).[17]
Levels of Value	The relationships between holdings of stocks in the public markets with Controlling Interests and Non-Controlling Interests in private companies. This enables the Discount for Lack of Control (DLOC) and the Discount for Lack of Marketability (DLOM) to be related to the differences between the various types of interests.
Levered Beta	The Beta reflecting the capital structure including Debt.
Liability	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.[18]
Liquid Value	The value of a security which has the quality of Liquidity.
Liquidation	The process of converting Assets into cash and settling obligations with creditors.
Liquidation Value	The amount that would be realized when an asset or group of Assets are sold on a piecemeal basis. Liquidation value should take into account the costs of getting the Assets into saleable condition as well as those of the disposal activity.[19] This is one of the six IVS bases of value.

16 IFRS 11 – Joint Arrangements
17 IVS, 2020 Glossary, section 20.5
18 International Financial Reporting Standards Framework
19 IVS, 104 ,2020, section 80.1

Liquidity	The ability to convert an asset into cash rapidly, for a known price, without the transaction affecting that price, with a modest bid-offer spread and with modest dealing costs.
Majority Control	the control provided by a majority interest, normally an interest of more than % 50 of the votes in a business. This is the same as Control.
Management Information Systems (MIS)	financial information in whatever form, which provides management of a business with regular reports on the operations of the business.
Market Approach	This provides an indication of value by comparing the asset with identical or comparable (that is similar) Assets for which price information is available. [20] This is one of the three valuation approaches in IVS.
Market Capitalization	the total Equity value of a public company, calculated as the share price multiplied by the number of shares outstanding.
Market Multiple	the market value of a public company's shares divided by a relevant measure such as net income after tax, etc.
Market Participants	all individuals or other entities that are potential buyers of the asset.
Market Participant Acquisition Premium (MPAP)	The observable premiums paid and offered on takeovers and attempted takeovers of public companies.
Market Rent	The estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion. This is one of the six IVS bases of value.
Market Risk	The risk that is present in the entire market and that cannot be diversified. Also known as Systematic Risk.

20 IVS 2020,105, section 20.1

Market Value The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.[21] This is one of the six IVS bases of value.

Marketability The relative ability to transfer an asset or liability. See also Discount for Lack of Marketability (DLOM)

Material or Significant Inputs and assumptions are Material or Significant if the impact on the valuation could reasonably be expected to influence the decisions of users of the valuation. This is a similar concept to the use of the word "material" in the context of the truth and fairness of financial statements.

May The word "may" describes actions and procedures that Valuers have a responsibility to consider. Matters described in this fashion require the Valuer's attention and understanding. How and whether the Valuer implements these matters in the valuation engagement will depend on the exercise of professional judgement in the circumstances consistent with the objectives of the standards.[22]

Mid-Year Discounting a convention used in the discounted future earnings method that reflects economic benefits all being generated at the middle of the year. Also known as the mid-year convention.[23]

Minority Discount a discount for lack of control applicable to a non-controlling or minority interest.[24]

Minority Interest an ownership interest which does not have control. This is often an interest of less than %50 of the voting interest in a business, but this depends on the distribution of other shareholders. Also known as Non-Controlling Interest.

Most Advantageous Market The market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.

21 IVS, 104 ,2020 section 30.1
22 IVS, 2020, Glossary
23 International Valuation Glossary
24 International Valuation Glossary

Multi-Factor Model A model, which incorporates various factors, based on the risks of the investment to determine the required rate of return of an asset/security. These factors could vary from size to macroeconomic factors.

Multi-Period Excess Earnings Method a Method which values an Intangible Asset as the present value of the cash flows attributable to the subject Intangible Asset after excluding the proportion of the cash flows which are attributable to other Assets required to generate the cash flows ("Contributory Assets"). Also known as the excess earnings method. This is one of the five income approach methods advocated by IVS for the valuation of intangible Assets.

Multiple the inverse of the capitalization rate. The multiple (and the cap rate) may refer to any metric, such as sales revenue, EBITDA, EBIT, NOPAT, net income after tax or Net Book Value.

Must The word "must" indicates an unconditional responsibility. The Valuer must fulfill responsibilities of this type in all cases in which the circumstances exist to which the requirement applies.[25]

Net Asset Value The difference between Assets and liabilities, normally at current market values and not at accounting book values. This is the product of the summation method under the cost approach.

Net Book Value also known as net book amount. The difference between Assets and liabilities as they appear on the balance sheet of the business.

Net Income Net income or net income after tax is a company's total earnings (or profit) after all expenses have been deducted from sales and after taxation/zakat charges. It represents earnings after deducting cost of goods sold, operating expenses, interest, gains and losses, and taxes for an accounting period.

Net Operating Profit After Tax (NOPAT) The earnings before interest and taxation/zakat (EBIT) as reduced by a tax charge at the effective rate. The tax charge at the effective rate percentage is calculated on the tax chargeable on profits before tax. This tax rate is then applied to EBIT. The effect of this is the adding back of the tax relief on the interest expense. If a firm has interest-bearing Debt, the tax charge in calculating NOPAT is higher than the tax charge on the profits or earnings before tax.

25 IVS, 2020, Glossary

Net Present Value

The value, at a specified date, of future cash inflows less cash outflows, calculated using an appropriate discount rate.

Net Realizable Value

The net proceeds obtainable on the sale of an asset or a group of Assets, after providing for all costs of disposal, including taxation.

Nominal Cash Flows

The actual amount of money that a business expects to receive or pay in future periods. Nominal cash flows are based upon assumptions which include assumptions as to rates of inflation in the future. This can be contrasted with Real Cash Flows.

Non-Controlling Interest

An ownership interest which does not have control. It is often less than 50% of the voting interest in a business but this depends on the distribution of the rest of the shares. Also known as a Minority Interest

Non-Disclosure Agreement (NDA):

A legal contract, which states the confidentiality terms, shared between at least two parties. It describes the information which could be shared between the parties and the information which should not be accessible for the public.

Non-Financial Liabilities

Those liabilities requiring a non-cash performance obligation to provide goods or services.[26]

Non-Operating Assets

Assets which are not required for use in the income-producing operations of the Business.[27]

Normalized Earnings

Economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.[28] Noneconomic items include remuneration paid to owners and related parties at above or below market rates – and any other similar transactions.

Objectivity

Making impartial judgements as to the reliability of inputs and assumptions. Such judgements need to be made in a way that promotes transparency and minimizes subjective factors.

26 IVS, 220 ,2020, section 20.1
27 IVS, 200 ,2020, section 120.1
28 International Valuation Glossary

Option
An opportunity, but not an obligation, to buy or sell stock in the future for a stated price. Option contracts are bought and sold in the public markets as a form of financial derivative. See also Black Scholes Option Model, Call Option and Put Option.

Option Pricing Method (OPM)
The valuation of different share classes by treating each share class as an option on the cash flows from the enterprise. The OPM most frequently relies on the Black-Scholes Option Pricing Method.

Orderly Liquidation
The value of a group of Assets that could be realized in a Liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis. [29] This is one of the four premises of value in IVS. The term “as-is, where-is” refers to the condition and the location of the Assets being realized. The seller is deemed to sell the Assets in their existing condition and at the location where the Assets are held.

Participant
The word “participant” refers to the relevant participants pursuant to the basis (or bases) of value used in a valuation engagement. Different bases of value require valuers to consider different perspectives, such as those of “market participants” (e.g., Market Value, IFRS Fair Value) or a particular owner or prospective buyer (e.g., Equitable Value, Investment Value).[30]

Performance Obligation
The obligation contained within a liability. For a financial liability the performance obligation is settlement in cash, known as Fulfilment. For a Non-Financial Liability the Performance Obligation is the provision of goods or services, and this requires a fulfilment effort.

Portfolio
an assemblage of various Assets or liabilities held or managed by a single entity. [31]

Post-Money Value
the value of a business immediately following its most recent round of financing. See also Pre-Money Value.

29 IVS, 104 ,2020, section 160.1
30 IVS, 2020, Glossary, section 20.8
31 International Valuation Glossary

Preference Share or Preferred Share

a financial instrument which has the legal form of a share (in accordance with the relevant jurisdiction) but which is not part of the Equity of the company. A Preference Share can be entitled to a fixed dividend each year. There is a very broad range of possible Preference Share Features. Although such instruments are legally shares, with a possible entitlement to dividends, they are accounted for as Debt under IFRS and any dividend payments are shown as interest expense. If they have features such as conversion options and significant variable participation in the earnings of the company they may be treated as Equity.

Premise of Value

This describes the circumstances of how an asset or liability is used. IVS describe four premises of value. These are highest and best use; current use/existing use; [32] orderly Liquidation; forced sale. The first two are going concern premises and the second two are Liquidation premises.

Premium Profit Method

Projections are prepared for two scenarios: in one the business uses the relevant intangible asset; in the other the business does not use the relevant intangible asset. This is more commonly known as the "With and Without Method" and is normally used for the valuation of non-competition agreements. This is one of the five income approach methods advocated by IVS for the valuation of intangible Assets.

Pre-Money Value

The value of a business immediately before its most recent round of financing. See also Post-Money Value.

Present Value

The value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.[33] Also known as "Net Present Value".

Price

The consideration paid in an actual transaction involving the purchase and sale of an asset.

Price/ Earnings Ratio (P/E)

A company's stock/share price divided by the company's earnings per share. Also known as Price/earnings multiple.

32 IVS, 104 ,2020, section 130.1

33 International Valuation Glossary

Principal Market the market with the greatest trading volume for the asset.

Prior Transaction Method A method under the market approach that considers previous transactions in the shares of a company. The actual price in the transaction can serve as a basis of valuation. Also implied multiples of revenue or other financial measures can be developed and used as a basis for valuation. See also Calibration.

Probability-Weighted Expected Return Method (PWERM) The valuation of various Equity securities assuming various future outcomes. The share value is the present value of expected future investment returns, with each of the various outcomes being weighted for their relative probability. This is typically used for the valuation of different share classes when a company is close to exit

Professional Skepticism The combination of Evidential Skepticism and Self-Skepticism. The valuation professional has to consider the Credibility of the evidence provided, in the form of projections and other evidence as inputs for the purpose of the valuation. The valuation professional also has to challenge his/her own judgements as these are also inputs into the valuation.

Profit After Tax (PAT) The profit after deducting tax expenses. Also known as Net Income and Net Income After Tax.

Prospective Financial Information forecasts of financial performance used to estimate future cash flows in a discounted cash flow analysis.

Purchase Price Allocation the allocation of the price paid for a business among the Assets acquired.[34] Under a Purchase Price Allocation the values of real estate and possibly plant are stated at market value. Purchase Price Allocation also involves the valuation of individual Intangible Assets. The residual figure is accounted for as goodwill.

Purpose of Valuation The reason(s) a valuation is performed. Common purposes include (but are not limited to) financial reporting, tax reporting, litigation support, transaction support, and to support secured lending decisions.[35] Also known as Valuation Purpose.

34 International Valuation Glossary
35 IVS, 2020, Glossary, section 20.9

Put Option

An option contract giving the holder of the option the choice to sell stock in the future at a stated price. See also Call Option, Option, and Black Scholes Option Model.

Quality and Risk Management (Q&RM)

The practice of identifying, quantifying, mitigating and managing a company's risk. It involves a team providing coordinated advice and assistance on independence, conflicts, compliance, regulatory, policy, security and risk management issues.

Rate of Return

An amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of the amount of the investment.36

Real Cash Flows

cash flows which do not include the effect of price changes through inflation over time. See also Nominal Cash Flows. Nominal cash flows can be changed to real cash flows by removal of the effects of inflation on the projected figures.

Real Estate Investment Trusts (REITs)

A corporation or trust that invests in real estate. The rules relating to REITs vary according to jurisdiction. They are commonly public companies which are not subject to corporate taxation, provided that substantially all of the income is distributed to stockholders.

Relief from Royalty Method

The value of an intangible asset is estimated by considering the hypothetical royalty payments that are saved through ownership of the asset. This is one of the five income approach methods advocated by IVS for the valuation of intangible Assets.

Replacement Cost Method

A Method under the Cost Approach that indicates value by calculating the cost of a similar asset offering equivalent utility. This is a Method of main interest to plant valuers.

Reproduction Cost Method

A Method under the Cost Approach that indicates value by calculating the cost to recreating a replica of an asset. This is a Method of main interest to plant valuers.

36 International Valuation Glossary

Request for Proposal (RFP):	A document, which solicits proposal in which a company obtains funding for specific projects through a bidding process between potential suppliers of capital.
Residual Value	The value as at the end of the discrete projection period in a discounted future earnings model.37 More commonly known as Terminal Value.
Return on Equity	The amount, expressed as a percentage, earned on a company's common Equity for a given period.38
Return on Invested Capital	The amount, expressed as a percentage, earned on a company's invested capital for a given period.39
Risk Free Rate	The rate of return available in the market on an investment free of default risk.40 The concept is that all other investments require a higher return to compensate for the risk within them.
Risk Management Action Plan (RMAP)	A tool used by managers to identify and estimate impacts of potential risks, along with solutions to the risk issues.
Risk Premium	A rate of return added to a risk-free rate to reflect the risk of a business or specific asset of a business.
Royalty	A payment made for the use of an asset, especially an Intangible Asset or a natural resource.41 A gross royalty rate means that all responsibilities and expenses associated with the ownership of the intangible asset are the responsibility of the owner (licensor) of the intangible. A net royalty rate means that such responsibilities and expenses are transferred to the licensee.
Rules-of-Thumb	These are sector-specific valuation benchmarks. They are common in certain retail sectors with small businesses. They are sometimes based on multiples of revenue or the volume sales of specific goods or services. They can also be based on the Sellers' Discretionary Earnings or Cash Flow. They should not be given substantial weight unless it can be shown that buyers and sellers place significant reliance on them. This is a subsidiary method under the market approach.

37.38.39.40.41 International Valuation Glossary

Salvage Value	The Terminal Value of an asset computed under the cost approach. The Salvage Value is the proceeds of sale less all the costs of disposal.
Saudi Arabian Monetary Authority (SAMA)	The central bank of the Kingdom of Saudi Arabia.
Scope of Work or Terms of Engagement	The fundamental terms of a valuation engagement, such as the Assets being valued, the purpose of the valuation and the responsibilities of parties involved. In order to be compliant with IVS it is necessary for 14 specific matters to be communicated to the client at the start of the engagement. These 14 requirements are given in IVS 101 ,2020, section 20.3, points a) to n). A valuer must communicate the scope of work to its client prior to completion of the assignment.
Scenario Based Method	The modelling of multiple scenarios for possible future cash flows. This is often used for the valuation of non-financial liabilities.
Self-Skepticism	The challenge of one's own assumptions and conclusions. This is of special importance when undertaking valuations frequently for the same client or in the same industry. See Back-testing.
Seller's Discretionary Earnings or Cash Flow	The earnings or cash flows of a business before making any allowance for the costs of the Seller. Such costs include the remuneration and benefits paid to the Seller and possibly to family members. This is a valuation metric often used for the valuation of small businesses.
Share or Stock	A share is a fractional interest in a company. If there are 100 shares in issue each share represents an interest of 1%. It is possible for there to be different classes of share: as an example one class of share may be non-voting and may have restricted rights to dividends.
Shareholders' Agreement	An arrangement among the company's shareholders designed to minimize disputes when more than one shareholder is present in a corporation. The Shareholders' Agreement describes shareholders rights and obligations in matters such as transferring shares, representation on board, protection of shareholders, etc.

Should — The word "should" indicates responsibilities that are presumptively mandatory. The Valuer must comply with requirements of this type unless the Valuer demonstrates that alternative actions, which were followed under the circumstances were significant to achieve the objectives of the standards.[42] In the rare circumstances in which the Valuer believes the objectives of the standard can be met by alternative means, the Valuer must document why the indicated action was not deemed necessary and/ or appropriate.

Significant or Material — Inputs and assumptions are Material or Significant if the impact on the valuation could reasonably be expected to influence the decisions of users of the valuation. This is a similar concept to the use of the word "material" in the context of the truth and fairness of financial statements.

Special Assumption — An assumed fact that differs from those existing at the date of the valuation.

Special Interest Purchasers — acquirers who consider that they can enjoy post-acquisition benefits not available to other Market Participants. Examples of such benefits are economies of scale, synergies with their existing business or strategic advantages.

Standalone Value — the value of a business interest determined without reference to prices that might be paid by special interest purchasers.

Strengths, Weaknesses, Opportunities and Threats (SWOT) — A structured planning method that evaluates a business' competitive analysis and elements in the environment it can exploit or should be concerned about.

Strike Price — the amount payable when an option is exercised. This is also known as the exercise price.

Summation Method — the main method under the Cost Approach for the valuation of a business. It involves the valuation of each of the component Assets of a business and the deduction of the amounts payable in respect of liabilities. It is commonly used for businesses such as real estate companies, in which the value is in the individual Assets, with little or no intangible asset value.

42 IVS 2020, Glossary, section 20.10

Synergy	The concept that the combined value and cash flows of two or more businesses combined will be greater than the total of the separate businesses. This will arise as a result of greater revenues, lower costs or reduced cost of capital.
Synergistic Value	The result of a combination of two or more Assets or interests where the combined value is more than the sum of the separate values.[43] This is one of the six IVS bases of value.
Systematic Risk	The risk that is common to all securities in the market that cannot be diversified. Also known as Market Risk or Undiversifiable Risk. The extent of the systematic risk between different sectors is measured by Beta.
Tadawul	The primary stock exchange in the Kingdom of Saudi Arabia.
Tax Amortization Benefit (TAB)	An adjustment made when valuing Intangible Assets using the Income Approach to reflect the tax relief available on the amortization of certain Intangible Assets.
Terminal Growth Rate	A constant rate, which assumes that a firm's expected income or cash flows, will grow in perpetuity. It is used to compute the terminal value of a company.
Terminal Value	The value as at the end of the discrete projection period in a discounted future earning model. Also known as Residual Value.
Top-Down Method	a method under the market approach for the valuation of certain non-financial liabilities.
Unlevered Beta	the levered Beta as adjusted to reflect a capital structure without Debt. Also known as Asset Beta.
Unobservable Inputs	inputs for which market data are not available and that are developed using the best information available. Unobservable inputs relate to third tier evidence in IFRS 13.

43 IVS, 104 ,2020, section 70.1

Unsystematic Risk	the risk specific to an individual security that can be minimized through diversification.
Valuation	The act or process of determining an estimate of value of an asset or liability.
Valuation Approach	The principal valuation approaches are: (a) Market Approach, (b) Income Approach, and (c) Cost Approach. They are all based on the economic principle of price equilibrium, anticipation of benefits or substitution.
Valuation Date	The relevant date to which the valuer's conclusion of value applies.
Valuation Method	The particular detailed procedure within each Approach used by the Valuer to obtain the value of a company.
Valuation Model	The quantitative methods, systems, techniques and qualitative judgements used to estimate and document value.[44]
Valuation Purpose	The reason(s) a valuation is performed. Common purposes include (but are not limited to) financial reporting, tax reporting, litigation support, transaction support, and to support secured lending decisions.
Valuation Subject	The business or Equity stake in a business that is to be valued.
Valuation Technique	A specific analytical process of data treatment, conducted within a valuation method.
Valuer	An individual, group of individuals or a firm who are accredited by Taqeem and possess ability and experience to execute a valuation in an objective, unbiased and competent manner. In Saudi Arabia, licensing from Taqeem is required before one can act as a Valuer.[45]
Waterfall	the allocations of cash flows returned to various Debt and Equity instruments in a business, reflecting the seniority of each claim.
Weight	The amount of reliance placed on a particular indication of value in reaching a conclusion of value (e.g., when a single method is used, it is afforded 100% weight).[46]

44 IVS, 105 ,2020, section 90.1
45 IVS, 2020,20 Glossary, section 20.17 (amended)
46 IVS, 2020, Glossary, section 20.18

Weighted Average Cost of Capital (WACC):	The cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in a Business Capital Structure.
Weighted Average Return on Assets (WARA)	The weighted average, at market value, of the cost of financing each of the tangible and intangible fixed Assets and the working capital. Conceptually, the WARA should equal the WACC. As discount rates for many Assets are known, reconciliation of the WARA for all asset categories to the WACC is a means of confirming the reasonableness of asset-specific discount rates.
With and Without Method	With and Without Method: Projections are prepared for two scenarios: in one the business uses the relevant intangible asset; in the other the business does not use the relevant intangible asset. This is sometimes known as the “Premium Profit Method” and is normally used for the valuation of non-competition agreements. This is one of the five income approach methods advocated by IVS for the valuation of intangible Assets.
Workforce in Place	Also known as the Assembled Workforce. The team of employees who work in a Business. This is a concept that is used when calculating Contributory Asset Charges in the valuation of Intangible Assets. The Workforce in Place is an Intangible Asset but one which is nor recognized for financial reporting purposes.
Zakat	Companies owned by Saudi and GCC investors are liable for Zakat, a religious obligation. Zakat is charged on the company’s Zakat base at 2.5%; zakat base represents the net worth of the entity as calculated for Zakat purposes

Notes:

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Introduction

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2.1 Glossary

2.1.1 There is a comprehensive Glossary at the start of this manual. Glossary terms are stated with the first letter in capitals. When a Glossary term first appears in this manual it is also defined in the text.

2.2 The Need for Professional Business Valuation

2.2.1 Valuations of businesses, business ownership interests, securities (referred to in this manual as Business Valuation) is the practice of determining the economic value of a company or business or ownership interest in a business.

2.2.2 Business Valuation may be performed for various reasons including the following:

2.2.2.1 Mergers and Acquisitions;
2.2.2.2 Tax related valuations;
2.2.2.3 IPOs/Sukuks;
2.2.2.4 Portfolio company valuations;
2.2.2.5 Internal management analysis for future decision-making;
2.2.2.6 Dispute and litigation purposes;
2.2.2.7 Accessing external sources of funding;
2.2.2.8 Employee options / Stock plans;
2.2.2.9 Regulatory compliance; and
2.2.2.10 Financial Reporting

2.2.3 Consistency, objectivity and transparency are fundamental to building and sustaining public confidence and trust in Business Valuation. This requires business Valuers to possess and to use the appropriate skills, knowledge, experience and ethical behavior. Business Valuers must form sound judgments and report opinions of value clearly and unambiguously to Clients and other valuation users.

2.2.3.1 A Client is the person, persons, or entity for whom the valuation is performed. This may include external Clients (i.e., when a Valuer is engaged by a third-party Client) as well as internal Clients (i.e., valuations performed for an employer). A valuation for an employer should be consistent, objective and transparent.

2.3 Code of Ethics and Professional Conduct

2.3.1 Valuation practitioners must comply with the Saudi Authority for Accredited Valuers (Taqeem) Code of Ethics and Professional Conduct for Valuers.

2.3.2 The Code of Ethics is included as Appendix A of this manual. Paragraph 2.1 of the Code of Ethics states "all valuers licensed by the Authority to practice valuation…..must comply with this Code."

2.3.3 The Code of Ethics requires all members to:

2.3.3.1 Always act in a way that upholds the public interest;

2.3.3.2 Strive relentlessly to gain and maintain public trust;

2.3.3.3 Provide high quality valuation services demonstrating full commitment to the professional level that is consistent with the fundamental principles of the Code.

2.3.4 Valuers must comply with the following ethical principles:

2.3.4.1 Integrity

2.3.4.2 Independence

2.3.4.3 Competence

2.3.4.4 Professional Behavior and avoiding any actions that discredit the profession:

(A) Accepting assignments;

(1) Check for threats to the Code of Ethics;

(B) Use of external sources;

(1) Third parties recruited by the Valuer are subject to the Code of Ethics;

(2) Approval of Client for the use of third parties;

(C) Efficiency and Diligence;

(1) Taking care to execute the client's instructions;

(2) Thoroughness;

(3) On a timely basis;

(4) Keep clients informed;

(5) Courtesy and to respond quickly to reasonable instructions

(D) Maintain confidentiality of client's information and not gain personally from the confidential informationprovided;

(E) Disclosure;

(1) Ensure the valuation report is not misleading and disclose when required by the client, by law or by regulations

(F) Information and documentation

(1) Verify the data;

(2) Check its reliability;

(3) Keep valuation file records for at least ten years

2.3.5 The above points summarize some of the more important points. However, Valuers must make themselves aware of the Code of Ethics.

Refer to **Appendix A** for TAQEEM's Code of Ethics and Professional Conduct for Valuers

2.3.6 Taqeem has written this manual to provide practical guidance on the conduct of a business valuation assignment in accordance with the principles in the Code of Ethics. The manual covers the various nuances of business valuation and the complete engagement life cycle, and is prepared to improve the consistency and quality of the practice among Taqeem members performing Business Valuation.

2.3.7 The manual also includes some specialist topics dealing with the valuation of:

2.3.7.1 Intangible Assets;

(A) An Intangible Asset is a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and/or economic benefits to its owner. (IVS 210.20.1 2020)

2.3.7.2 Complex share classes;

2.3.7.3 Non-Financial Liabilities.

(A) Non-Financial Liabilities are those liabilities requiring a non-cash performance obligation to provide goods or services. (IVS 220.10.2 2020)

2.4 The Valuation Process

2.4.1 The manual was prepared on the basis that every valuation engagement would need to go through a four phase process, as illustrated below

2.5 Aims of this Manual

2.5.1 This manual aims to serve as a practical guide for valuation practitioners (Valuers) on the business valuation process, from beginning to completion. The manual lays out various steps that the Valuers should undertake and describes the different Valuation Approaches, Bases, Methods and Premises that need to be considered in order to deliver a robust Valuation.

(A) A Valuation Method is the particular detailed procedure within each Approach used by the Valuer to obtain the value of a company.

(B) There are three Valuation Approaches in International Valuation Standards 2020 (IVS 105.10.1 2020), namely, Income, Market and Cost Approaches.

(C) Bases of Value (sometimes called Standards of Value) describe the fundamental measurement assumption on which the reported values will be based. There are six IVS Bases of Value and other Bases of Value defined by other valuation or regulatory bodies.

(D) A Premise of Value describes the circumstances of how an asset or liability is used. IVS describe four premises of value. These are highest and best use; current use/existing use; orderly Liquidation; forced sale. The first two are going concern Premises and the second two are Liquidation Premises.

2.5.2 For Clients and other valuation users these professional standards and valuation practice statements ensure:

2.5.2.1 The application of the Code of Ethics to business valuation;

2.5.2.2 Consistency in technique, aiding understanding of the valuation process and hence of the value reported;

2.5.2.3 Credible and consistent valuation opinions by suitably trained Valuers with appropriate qualifications and adequate experience for the task;

2.5.2.4 Objectivity and transparency in the Valuer's work;

2.5.2.5 Clarity regarding the terms of engagement and the purpose of engagement, including matters to be addressed and disclosures to be made;

2.5.2.6 Clarity regarding the Basis of Value, including any Assumptions or material considerations to be taken into account.

(A) Assumptions are assumed facts that are consistent with, or could be consistent with, those existing at the date of the valuation. Assumptions are necessary to clarify either the state of the asset in the hypothetical exchange or the circumstances under which the asset is assumed to be exchanged. (IVS 104.200.1 2020). Special Assumptions are assumed facts that differ from those existing at the date of valuation.

2.5.2.7 Clarity in reporting, including proper and adequate disclosure of relevant matters where valuations may be relied on by a third party;

2.5.2.8 Clarity on valuation standards complied with. This manual has been written to be consistent with IVS 2020.

2.5.2.9 Limitations on the distribution of the report and permission required to distribute beyond the contracting party;

2.5.2.10 The information relied upon in arriving at the valuation conclusion;

2.5.2.11 The strength of the Valuer's opinion of value;

2.5.2.12 Clarification that the value conclusion does not reflect the "price" and that there may be many "prices" for a particular business depending on such matters as negotiating strength, potential buyer synergies, and many other factors.

Notes:

3

Engagement

3.1 Engagement Acceptance

3.1.1 Engagement acceptance is an important process: the Valuer determines whether to accept a new Client and to undertake an engagement with that Client. This will be subject to both external factors (For example, the Code of Ethics, other Government regulations) and internal factors (For example, commercial decisions, policies and competencies).

3.1.2 In addition to the normal commercial considerations, the Valuer should be guided by ethical, moral and legal policies of his/ her company when deciding whether to accept the engagement with any Client.

3.1.3 Article 1(8) “Integrity” of the Code of Ethics states: “A valuer shall not be involved in providing valuation services that the majority of valuers refuse for logical reasons.”

3.1.4 Article 2(10) “Independence” states: “A valuer shall not accept a valuation assignment or prepare any valuation that involves a predetermined or pre-planned opinions or views.”

3.1.5 Understanding the purpose of valuation, the intended users of the report and what they intend to use the valuation for is critical before acceptance of the Client. The Valuer should gather information on the engagement, the competencies required for the Scope of Work, the size and pricing of the engagement, the engaging Client’s background, reputation, and any potential risks. The Valuer should also take into consideration the likelihood that the valuation could lead to litigation and/or public scrutiny before accepting the Client and engagement.

3.1.6 The Valuer should conduct background checks of the engagement Client, valuation subject and counter parties or potential users to assess the engagement risk, the financial and reputation risk, and any potential impairment to the Valuer’s name by associating with the engaging Client, the Valuation Subject or the counter-parties. In addition to these background checks, the Valuer should also check if there are any independence issues, perceived conflicts of interest, unrealistic time limitations or absence of reliable information to complete the engagement.

(A) The Valuation Subject is the business or Equity stake in a business that is to be valued

3.1.7 The Valuer should only undertake that work for which he considers himself/herself to be competent. It is perfectly acceptable for a Valuer to decline an engagement which is outside their range of expertise. It is not acceptable to undertake a valuation if the Valuer knows that it is outside his or her area of knowledge and abilities.

3.1.8 This point is made in paragraph 4.8 of the Code of Ethics: “The valuer shall be knowledgeable about the characteristics of the subject, aware of the rules and procedures of valuation, and has no direct or indirect interest in the subject asset.”

3.1.9 In Article (3) paragraph 8 of the Code of Ethics the point is made again:" If the valuer does not have sufficient professional knowledge and experience to carry out the valuation service, or does not have the ability to acquire it before the job is done, he must require the assistance of someone experienced in this type of assignment or to withdraw from the assignment altogether."

3.1.10 Objectivity is a central requirement of IVS. The IVS Framework paragraph 40 states: "The process of valuation requires the valuer to make impartial judgements as to the reliability of inputs and assumptions. Judgement used in a valuation must be applied objectively to avoid biased analysis, opinion and conclusions." The Valuer will not be seen to be objective if the fee for the assignment is contingent on the valuation outcome.

3.1.11 Based on all the considerations above, the Valuer may decide to decline the engagement.

Refer to **Appendix B** for Implementing Regulations of Accredited Valuers Law;
Refer to **Appendix C** for Sample Client and Engagement acceptance form;

3.1.12 The Valuer should also comply with TAQEEM's requirement on the qualification of the team working on the valuation engagement.

3.1.13 Article 3(7) of the Code of Ethics states: "A valuer shall take reasonable steps to ensure that those working under his authority in a professional capacity have appropriate training and supervision."

3.2 What, Why, When and Basis

3.2.1 As part of accepting the engagement, there are four fundamental matters that must be addressed:

3.2.1.1 What is the Valuer required to value? Is it the entire business, a Controlling Interest or a Non-Controlling Interest?

3.2.1.2 Why is the Valuer required to undertake the valuation? Is it in connection with a dispute, for financial reporting, planning for a sale or for some other reason?

3.2.1.3 When is the valuation date for which the Business Valuation is required? This can either be a specific date in the past, or it can be as at the date of the report.

3.2.1.4 What is the Basis of Value? This may be Market Value, Equitable Value or Investment Value, as defined by IVS. Alternatively, it may be Fair Value as defined by IFRS 13 for financial reporting purposes. The reason why the valuation is being undertaken may determine the Basis of Value that is to be applied. The Basis of Value must be appropriate to the terms and purpose of the valuation assignment. The Bases of Value may influence or dictate the valuer's selection of methods, inputs and assumptions, and the ultimate opinion of value. (IVS 2020 104.10.1)

3.2.2 These are the four fundamentals to be defined before the valuation work is undertaken. We consider these four points further below.

3.3 "What": The Valuation Subject

3.3.1 The actual Asset or Liability to be valued is described as the Valuation Subject in this manual.

3.3.2 Sometimes, the Client requires only a part of the overall business to be valued – this could be a subsidiary, a particular project, a joint venture of the Client, an investee company, a business division or a specific carved-out component of the business. Alternatively, only certain of the Assets of a business could require valuation – these could be the Intangible Assets as part of Purchase Price Allocation.

3.3.3 It is also possible that the Valuation Subject is a Controlling Interest or a Non-Controlling Interest in a company. In these circumstances it is necessary to consider the Levels of Value. This is discussed further below.

(A) A Controlling Interest is a shareholding which gives the power to control the Business.

(B) A Minority Interest, also known as a Non-Controlling Interest, is an ownership interest which does not have control. This is often an interest of less than 50% of the voting interest in a business, but this depends on the distribution of other shareholders.

3.3.4 The Valuation Subject may be a special class of Shares in the company. In these circumstances the Valuer must obtain full information on the various rights between the different stockholders and the rights relating to different classes of Share or Stock.

3.3.4.1 There is a chapter in this manual dealing with the valuation of special share classes.

3.3.5 It is not only important to know the Valuation Subject but also to understand it in detail, as that forms the foundation for the entire engagement.

3.3.6 A few important questions to ask to understand and define the Valuation Subject in greater detail are listed below:

3.3.6.1 Is the Valuation Subject a public/listed company or a private/unlisted company?

3.3.6.2 If a private company, it is important to identify the following:

(A) Who are the shareholders?

(B) What are the terms of the Articles of Association?

(C) Are there different classes of Shares?

(D) Is there a Shareholder's Agreement and what are the rights of the shareholders subject to the agreement?

(E) What are the rights of the shareholders? and

(F) What is the degree of Marketability/Liquidity of their interest in the Valuation Subject?

3.3.6.3 The Valuation Subject may not be of the whole Company:

(A) Does the company own entities that need to be valued such as subsidiaries, associates, joint ventures, special-purpose vehicles (SPVs) that are set up for executing projects, investee companies, etc.?

(B) Does the company have business divisions that need to be valued separately? For instance, a conglomerate could have various businesses – each may not be under a different subsidiary, but they may still have independent operational management and Management Information System (MIS) structures and financial statements. It may be necessary to consider these divisions individually since considering the whole company together may not appropriately capture their true value;

(C) Are there Intangible Assets or tangible Assets that need to be valued separately? Are these assets recognized on the balance sheet of the company? Do these assets have large embedded gains?

(D) Does the engagement involve valuation of one entity or multiple entities? For example, in the case of a merger or a share swap, both entities will need to be valued;

3.3.7 A clear understanding of the Valuation Subject that needs to be valued is critical to ensure there is no uncertainty regarding the Scope of Work and to prevent misunderstanding from arising, subsequently, during the engagement.

(A) Articles of Association are a document that contains the constitution of a company with regard to matters such as the powers of directors and members, the holding of meetings and votes, etc. It also provides guidelines for a company's operations.

(B) A Shareholders' Agreement is an arrangement among the company's current shareholders designed to minimize disputes when more than one shareholder is present in a corporation. The Shareholders' Agreement describes shareholders rights and obligations in matters such as transferring shares, representation on board, protection of shareholders, etc

(C) Marketability is the relative ability to transfer an asset or liability.

(D) Liquidity is the ability to convert an asset into cash rapidly, for a known price, without the transaction affecting that price, with a modest bid-offer spread and with modest dealing costs. In the case of financial instruments liquidity relates to market activity and volume of trading at a point in time.

(E) A Bid-Offer Spread or Bid-Ask Spread is the difference between the price at which an investor can purchase (the ask or offer price) and at which it can sell (the bid price) of a security.

3.4 "Why": The Valuation Purpose

3.4.1 Understanding the Purpose of the Valuation, the intended users of the report and why they require the valuation is critical before acceptance of the Client. IVS 2020 101.20.1 notes that all valuation advice and the work undertaken in its preparation must be appropriate to the intended purpose.

3.4.2 Understanding the role the Client plays in relation to the Valuation Subject helps to understand their perspective and take into account any lack of objectivity they may have when preparing the business plan for the Valuation Subject. For example, an existing shareholder may look at maximizing value in a sales transaction whereas a potential investor may prefer a lower value so that their price of investment is reduced; such considerations will need to be addressed in the course of the valuation engagement.

3.4.3 Evidential Skepticism is the exercise of due professional care by challenging information provided with an appropriate level of enquiry. The Valuer must apply Evidential Skepticism throughout an assignment; this begins during the engagement process.

3.4.4 Valuations are sometimes undertaken during a transaction or M&A process. If the Valuer and the Engaging Client want valuations to be seen to be Objective, the Valuer or Engaging Client should separate the deal/valuation analysis from the deal making team to reduce any perceived or actual bias.

(A) Objectivity is making impartial judgements as to the reliability of inputs and Assumptions. (IVS 2020 Framework 40.1)Such judgements need to be made in a way that promotes transparency and minimizes the influence of any subjective factors.

3.4.5 The Valuer or Engaging Client can mitigate the effect of any perceived or actual loss of Objectivity through the following:

(A) Reducing institutional pressures: Institutions that want reliable/credible sell-side Equity research should protect their Equity research analysts who issue sell recommendations on companies, not only from companies but also from their own sales people and portfolio managers;

(B) De-linking valuations from reward: Any valuation analysis where the reward is conditional on the outcome of the valuation conclusion will result in a valuation that is perceived to lack Objectivity;

(C) No pre-commitments: Decision makers should avoid taking strong public positions on the value of a firm before the valuation work is complete;

(D) Self-Skepticism: Self-Skepticism is the challenging of one's own Assumptions. If a valuation assignment is relatively close to a subsequent sale, this can be achieved after the valuation has been completed by Back-Testing. This is the comparison of the valuation metrics used by the Valuer in an earlier valuation with the actual metrics achieved in an exit. This is of no assistance to the completed valuation but may help to inform later work. This does require an understanding of the motives of the buyer. Other forms of challenge are the review of a valuation by another qualified Valuer;

(E) Linking inputs to reliable market evidence where possible;

(F) Applying judgements with Objectivity.

3.4.6 In addition, knowing the Client and their role in relation to the Valuation Subject helps in making certain key decisions relating to the Valuation Approach and the Valuation Methods. The knowledge of the Valuation Purpose ensures that the valuation meets the requirements of the users.

3.4.7 Some key questions that help to identify the role of the Client in relation to the Valuation Subject are listed below:

3.4.7.1 Is the client an existing provider of finance (Equity or Debt, as the case may be)? These could be individuals, corporates, private Equity funds, venture capitalists, banks, financial institutions, sovereign funds, or any party that has a financial interest in the company;

3.4.7.2 Are they third parties wishing to acquire a stake in the Valuation Subject – will they be investing in terms of Equity or Debt?

3.4.7.3 Is the client responsible for the management of the Valuation Subject (For example, key officials such as CFO, CEO, finance and strategy heads responsible for major decision-making in the organization)?

3.4.7.4 Is the Client in a position to provide the information required for the valuation engagement?

3.4.7.5 Do they have sufficient understanding of the industry to provide meaningful input to the valuation process?

3.4.7.6 Is the client a government or regulatory authority? – there could be various reasons why such authorities would require a valuation, such as:

(A) Tax authorities may need to ensure that capital gains tax has been calculated on the right Basis of Value;

(B) Government or the courts may order valuations in cases where they suspect frauds or misappropriation of funds; and

(C) Stock exchanges such as the Saudi Stock Exchange (Tadawul and Nomu – Parallel Market), also require valuation reports to be filed with them in cases where listed company valuations are undertaken – however, they are usually not the appointing Client.

3.4.8 Knowing the Valuation Purpose is an important first stage to a valuation engagement: understanding the valuation context will ensure the advice is not used out of context or for a purpose that was not intended. The purpose of the valuation may also influence the Bases of Value used.

3.4.9 It is important to be clear on the intended users of the valuation report and the Valuation Purpose to ensure the context of the report and the analysis is sufficient in accordance with that Valuation Purpose. For example, valuation analysis and results for the Valuation Purpose of financial reporting may be different from a valuation for the Valuation Purpose of helping management in an investment decision. Hence, it is critical to focus the intended use of the report to the specific Valuation Purpose and to ensure that its content and format meets the needs of the user.

3.4.10 The following details the various Valuation Purposes for which a valuation may be required. The list is not exhaustive as there may be other reasons to conduct business valuations:

3.4.10.1 **Deal/Transaction related valuation:** to provide negotiation support for any on-going or potential transaction which includes sale, private financing / venture capital funding, IPOs/Sukuks, mergers and acquisitions, bankruptcy, joint venture contributions, capital (Debt/Equity) infusion, Fairness Opinion;

(A) An IPO is an Initial Public Offering in which the shares of a private company are offered to the public for the first time, when the company becomes a public company

3.4.10.2 **Strategic related valuation:** to support internal analysis for any on-going or potential transaction, capital structure assessment and/or structural business changes such as mergers & acquisitions, divestitures, IPOs/Sukuks;

(A) An Acquisition is the purchase of one corporate entity or business or Assets by another, with the acquiring company's shareholders gaining control.

(B) A Merger or Amalgamation is the joining or merging of two or more previously separate corporate entities on the basis of equality of interest. In an amalgamation or merger the acquiring company's stockholders do not gain control of the enlarged entity.

3.4.10.3 **Liquidation:** to estimate the amount to be realized from selling off or liquidating the Assets in the company on a piecemeal basis.

(A) A Liquidation is the process of converting Assets into cash and settling obligations with creditors.

3.4.10.4 **Compliance related valuation:** to comply with financial accounting standards and tax/zakat reporting. Compliance related valuations include the following:

(A) Financial reporting

(1) Valuations for financial reporting provide valuation estimates relating to tangible Assets, Intangible Assets, liabilities and Equity interests acquired in a business acquisition. This is likely to be governed by the requirements of International Financial Reporting Standard (IFRS) 3. This is known as Purchase Price Allocation.

(B) Purchase Price Allocation is the allocation of the price paid for a business among the Assets acquired and liabilities assumed. Under a Purchase Price Allocation the values of tangible assets e.g. real estate and plant and equipment are stated at their fair values. The fair values of Intangible Assets are also estimated. The residual figure is accounted for as goodwill.

(1) The calculation of the Fair Value of the consideration transferred in a transaction includes:

(a) The Fair Value of assets transferred by the acquiree;

(b) Liabilities incurred by the acquirer to the former owners; and

(c) Equity interests issued by the acquirer.

(2) The valuation of Contingent Consideration may also be required.

(C) Contingent Consideration is Consideration that varies according to results achieved after Completion if specific future conditions are met. Usually contingent consideration is an obligation of the acquirer to transfer additional assets or equity interests to the former owners as part of an exchange of control. The contingent consideration may also give the acquirer the right to the return of previously transferred consideration if specified conditions are not met. For example, a purchase transaction may be structured so that the amount which is paid is based on revenues achieved or profits realized in the two or three years after Completion.

(1) Valuations for Impairment testing provide valuation estimates relating to the annual or periodic impairment of Goodwill, as well as the annual or periodic testing of certain fair-value accounting estimates;

(D) Impairment is a loss in value of an asset due to unexpected declines in expected future economic benefits.

(E) Tax reporting

(1) Valuations for tax reporting involve the preparation of valuations for various tax requirements including share reorganizations and taxable capital gains, non-arm's length transfers of assets where the proceeds of disposal are expected to be market value.

3.4.10.5 **Dispute related valuations:** valuations for dispute resolution and litigation support include the following:

(A) Expert Determination: this is a means of settling a dispute by appointing an Expert who will determine the matter in dispute in accordance with the instructions given to him or her.

(B) An Expert is a a specialist who provides opinions in respect of his area of specialism. Such Experts are often appointed as part of litigation; they are different from factual witnesses in that they are able to give their opinions in Court

(1) Independent valuations of corporations in accordance with the Articles of Association, Shareholders' Agreements, or Joint Venture Agreements;

(C) A Joint Venture is a joint arrangement where two parties have joint control of the arrangement and rights to the net Assets of the arrangement. It normally involves sharing of resources, which could include capital, personnel, physical equipment, facilities or intellectual property such as patents

(1) If the Valuer is instructed as an Expert in a Determination, independence, Objectivity and fairness to both sides are paramount.

(D) Expert Witness

(1) Either as an independent Expert witness or as an advisor to one of the parties in the context of litigation, arbitration, or mediation where there are valuation issues to be resolved.

(2) These may relate to a breach of warranty claim, a business interruption claim, a stockholder dispute or a claim for professional negligence.

(3) If the Valuer is an independent Expert Witness, independence and duty to the court or tribunal is paramount.

(E) Regulatory purposes:

(1) These are performed to comply with legal requirements or other regulations of a jurisdiction.

(2) When undertaking valuations for Mergers and Acquisitions, differences could arise depending on whether the engaging entity is on the buy-side acquirer or the sell-side vendor of the business. Disputes may arise as the buyer may have a different business plan as compared to the seller. In this respect, the Valuer needs to be capable of assessing any potential Synergies from a merger/ acquisition that may result in realizing a higher value.

(F) A Synergy is the concept that the combined value and cash flows of two or more businesses combined will be greater than the total of the separate businesses. This will arise as a result of greater revenues, lower costs or reduced cost of capital.

(1) Valuations for regulatory compliance are usually related to filings with General Authority of Zakat and Tax (GAZT) (i.e. tax authorities), Saudi Arabian Monetary Authority (SAMA), Capital Market Authority (CMA) or the Court. The valuation in such cases may need to take account of restrictions, guidelines and any specific requirements outlined by the respective regulators in performing the valuation and arriving at a value conclusion.

(2) Valuations for creditors/financial institutions are usually required from the perspective of assessing whether the collateral offered is commensurate with the loan funds being disbursed by the institution.

(3) Lastly, when a valuation is required for internal decision making such as organizational restructuring, strategic planning and similar situations, the Valuer may need to consider various possible alternative plans, scenarios or assumptions which could give rise to complexities in the valuation exercise. As compared to regulatory or financial reporting valuations, carrying out such engagements may take a longer period depending on the depth of the review and result in multiple iterations. This needs to be identified and acknowledged while scoping the project and negotiating timelines and fees so that appropriate decisions can be taken regarding the likely time and costs involved.

3.5 “When”: The Effective Date of the Valuation

3.5.1 The Valuation Date is the specific date at which the Valuer determines the value of the Valuation Subject.

3.5.2 Defining the Valuation Date in advance is important as the date defines what information is considered in the analysis. Markets and market conditions may change and the valuation amount should reflect the market state and circumstances as at the valuation date, not other dates. (IVS 2020 104.30.2 (c))

3.5.3 The Valuation Date may either be as of the date of the report or some date in the past. The Valuation date cannot be a future date.

3.5.4 The Valuation Date must always be stated in the report (IVS 2020 101.20.3 (h)). Company, industry, general economic and capital market conditions are constantly changing, and the valuation must be linked to a precise measurement date. The valuation should be developed without the benefit of hindsight.

3.5.5 This can be a difficult concept for many who are new to valuation. It seems odd to ignore events which may occur shortly after a valuation date, which are known to the valuer and which may have a very material bearing on the valuation conclusions. The reason is simple: the Valuer must consider that he is undertaking a valuation as at the Valuation Date. Events that happen after that date would not be known by the Valuer at that date.

3.5.6 Valuation relies to a great degree on company financial statements and management information. The availability of reliable financial statements for periods prior to the Valuation Date is extremely important. For example, if a Client approaches the Valuer for a valuation as at 31 January of a particular year, the latest available financial statements to the previous 31 December together with subsequent management information, should be considered in the analysis.

3.5.7 The information that can be used can include conditions that are reasonably foreseeable. As an example, if the business has a large number of repeat customers, and the loss of such customers has in the past been between 4% and 6% a year, it may be reasonable to assume that this rate of loss will be likely to continue.

3.5.8 In contrast to this, if a single large customer is lost after the Valuation Date that loss should not be reflected in the valuation unless the loss of that customer was reasonably foreseeable. The loss of that customer might be reasonably foreseeable if there is correspondence or other evidence prior to the valuation date giving a strong indication that the customer was very likely to transfer his business elsewhere or terminate his relationship with the company.

3.5.9 Projections that have been produced prior to the valuation date but that relate to periods after the valuation date are included as relevant information. It is the date that the projections were prepared that is relevant, not the period that they cover.

3.5.10 As noted above, events after the Valuation Date should generally not be considered, unless they were reasonably foreseeable. This applies even if the unexpected subsequent events can change the relative value of a company significantly. Examples of unexpected subsequent events includes changes in customer/product concentrations, changes in dividend or distribution policies, market crashes or surges, unexpected failure of a competitor, unexpected loss of a key supplier or manager, unexpected regulatory change, and natural disaster unknown to the Valuation Subject as at the Valuation Date.

3.6 Bases of Value

3.6.1 The Basis of Value (the plural is Bases of Value) describes the fundamental measurement Assumptions on which the reported values will be based. There are six IVS Bases of Value and there are other relevant Bases of Value defined by other bodies.

3.6.2 The Valuer should be specific about the Basis of Value that will be used when valuing the Valuation Subject. The Basis of Value used must be stated in the valuation report and it must be the Basis of Value as required by the assignment. (IVS 2020 103.10.2)

3.6.3 The Bases of Value are considered in more detail in the next chapter of this manual.

3.6.4 The Bases of Value need to be considered together with the Levels of Value when valuing fractional interests in private companies.

3.7 Information Gathering

3.7.1 Information gathering is likely to take place throughout the valuation assignment.

3.7.2 The initial information requirements must be stated clearly in the Engagement Letter, contract, or following correspondence. Most of the information can be easily requested at the initial contact.

3.7.3 Another step to be undertaken at this stage is to prepare an information requirement list (IRL), listing the information required for the valuation. Providing this to the Client early helps expedite the engagement and gives an opportunity to discuss the extent of data that would be available for the valuation. The IRL highlights limitations, if any, arising due to data gaps. Such a list is given in Appendix E.

3.7.4 The IRL will depend on the nature of the valuation assurance provided and the company being valued, which would typically cover the following aspects:

3.7.4.1 Qualitative aspects pertaining to the business:

(A) Corporate profile:

(1) Various business segments, products and services;

(2) Organization chart;

(3) History of company and significant corporate events;

(4) Minutes of board of directors' meetings;

(5) Industry and competition data and industry trends;

(6) Recent merger and acquisition transactions in the industry; and

(7) Stockholder information, holdings, buy/sell or repurchase agreements.

(B) Strategic plans of the company for the projected period;

(C) Strengths Weakness Opportunities Threats (SWOT) analysis; and

(D) Market positioning and company's view on who they see as competitors, industry landscape, market size and market share.

3.7.4.2 Quantitative aspects:

(A) Audited or unaudited historical financial statements (Profit & loss accounts, Balance sheets, Cash flow statements along with all notes) for at least 4-5 years and the annual reports prepared for the same purpose (including Directors' report, Strategic Reports, management discussions and analysis, auditors' reports and all other associated sections of the annual report);

(B) Latest management prepared financial statements for the period closest to the Valuation Date;

(C) Quarterly Management Information Systems data to assess seasonality and to compare quarterly performance;

(D) Detailed projected or prospective financial information (profit and loss accounts, balance sheets and cash flow statements) along with underlying schedules showing the drivers for the projected numbers;

(E) All Assumptions made by management to prepare the projected or prospective financial information;

(F) Projected capital expenditure and working capital requirements;

(G) Any term sheets, letters of intent, investment agreements, loan documents, depending

Example: Information checklist for a company operating diagnostic centers

1. Background of the Company – Qualitative information such as goods/services offered
   a. A note on the milestones of the company e.g. when established, addition to the service offerings, registration/acquisition of processes, any other milestones
   b. Brief write-up on the prospective business plans that the company has including plans for setting up new diagnostic centers, expansion plans, diversification plans (new services or processes), etc.
   c. Strength, Weakness, Opportunity and Threat (SWOT) analysis of the Company
   d. Data on number of diagnostic centers opened each year
   e. The cost to set up a typical center
   f. How long does it take for a typical center to become profitable?
   g. Number of diagnostic centers as at the valuation date
   h. A brief write-up on key Intangible Assets such as brand, long-term relationship with corporate, suppliers, doctors, etc.
2. Industry Information – Overview of the industry, main competitors and positioning of the Company
3. Financial Information – Historical and projected financial statements, key ratios
   a. Analysis of revenues and EBITDA for the last 3 years for each Diagnostic Center.
   b. Key Performance Indicators for the Company (by Diagnostic Center and in total)
   c. Consolidated and standalone audited financials for the past 5 years, Year-To-Date financials with schedules as at the Valuation Date
   d. Quarterly financials for the last eight quarters.
   e. Shareholder ownership as at the Valuation Date
   f. Contingent or “off balance sheet” liabilities/Assets, surplus Assets as at the Valuation Date

on whether the Valuation Subject is an Equity instrument or a Debt instrument;

(H) Any recent valuation reports for property, plant and equipment or specific Assets that can be relied upon for the valuation at the measurement date; and

(I) Any other specific factor that could be expected to impact the valuation, for example, Industry outlook and competitors’ activities, change in government regulations, etc.

3.7.4.3 An example of information is given in the box above. A detailed sample information requirement list can be referred to in Appendix E.

3.7.5 It is important for the Valuer to set out the nature, extent and sources of information that should be made available to the Valuer for the purpose of the valuation exercise.

3.7.6 Information received from the Client is firstly the responsibility of the Client. However, the Valuer has must apply Evidential Skepticism to such information. It is not sufficient to state that such information is solely the responsibility of the Client. For example, the IVSC's Code of Ethical Principles for Professional Valuers indicates at Appendix 2 A2.2 that, "a professional valuer should not knowingly be associated with a valuation, a report containing a valuation, a reference to a valuation or any other communication about a valuation if they believe that it either: (a) contains statements or information that are materially false or misleading or that are made recklessly, or (b) omits or obscures information required to be included where such omission or obscurity would be misleading."

3.7.7 Evidential Skepticism is the exercise of due professional care by challenging information provided with an appropriate level of enquiry. The level of skepticism should be based on the possible lack of Objectivity within the information provided.

3.7.8 The Code of Ethics Article 4(D) states:

(1)"A valuer must verify the data used in the valuation and identify the extent of its reliability.

(2)When the valuer receives information from the client, he must reasonably verify and document the extent of the client's confidence in this information and ensure its accuracy.

(3)A valuer shall not rely on information presented by the client or any other party without verification of their eligibility or source, unless the valuer specifies the nature and extent of the information as a restriction, i.e. a limit imposed on the valuation."

3.7.9 It should be explicitly documented if the unavailability of any data would impose limitations on the valuation process. Any such gaps in information should also be stated in the valuation report if the impact could be Material or Significant. For example, at the outset of the engagement, if it is known that the company would not be able to provide a business plan and projections, this should be mentioned clearly to support the valuation methodology used. Under such circumstances the Valuer will not be able to use the Discounted Cash Flow Method under the Income Approach even if this is otherwise thought to be the most suitable method.

(A) Inputs and Assumptions are Material or Significant if the impact on the valuation could reasonably be expected to influence the decisions of users of the valuation. This is a similar concept to the use of the word "material" in the context of the truth and fairness of financial statements

3.8 Preparation of Projections

3.8.1 Valuers are sometimes required to work with clients to prepare projections or prospective financial information. The preparation of such projections has two separate components:

3.8.1.1 The various Assumptions that are made before the projections are prepared, such as the rates of growth of the business in each year of the forecast period, business operating margins, the effect of growth on the levels of working capital, the levels of capital expenditure, and other Assumptions;

3.8.1.2 The preparation of detailed projections based on those Assumptions.

3.8.2 The underlying Assumptions must come from the Client. They are responsible for managing and running the business. However, the Valuer then has the responsibility to challenge each of the Assumptions as part of the Evidential Skepticism that is required as part of the role of being a business Valuer.

3.8.3 There is no loss of Objectivity if the Valuer prepares a list of the necessary Assumptions and seeks the input of the Client in respect of reasonable assumptions for each one.

3.8.4 There is no loss of Objectivity if the Valuers prepare the detailed projections based on the Assumptions provided by the Client. In this situation the Valuer is undertaking a mechanical financial modelling exercise that turns the Client's assumptions and judgements into prospective financial information;

3.8.5 There is however some risk that the Valuer may make some errors in the calculations and that these errors may not be identified. This is a self-review threat. In such circumstances it is advisable for the calculations to be independently checked.

3.9 Risk Management

3.9.1 One of the most important things to be taken into consideration at all stages of an engagement is to identify, evaluate, mitigate and manage engagement risks. This is especially important at the planning stage. The key questions around risk management are set out below.

3.9.1.1 what is the purpose of the valuation report?

3.9.1.2 based on the above, who are the intended users of the valuation report and what reliance will the users place on the valuation report?

3.9.2 The foremost goal of risk management in valuation engagements is to ensure that:

3.9.2.1 the assignment is within the competency of the Valuer;

3.9.2.2 the timetable is sufficient for the valuaiton work to be undertaken;

3.9.2.3 the Client will respect the Objectivity of the Valuer. This means that the Client should not aim to influence the Valuer as to the valuation conclusions expected or required;

3.9.2.4 the Basis of Value to be applied is consistent with the purpose of the valuation;

3.9.2.5 the valuation engagement does not expose the Valuer/valuation firm to self-review risk (i.e. does not put the firm in a position of reviewing its own work). For example, if the firm provides audit/assurance services to a company, then the audit firm should not undertake the independent valuation analysis of investments owned by that company. This is not allowed in view of the requirement for an audit to be an independent examination. Accordingly, for audit firms who also undertake valuations, the Valuer needs to check at the outset of the engagement whether the Engaging Client or the Valuation Subject is also an audit Client.

3.9.2.6 There is no lack of Objectivity in arriving at the valuation. This implies that the value conclusion should be fair and representative of the true value of the business interest.

3.9.3 The Valuer should define and cap the liability that the firm / Valuer should have to bear. This can provide some protection if the Client makes a successful claim against the Valuer.

3.9.4 This is important because keeping the liability uncapped exposes the firm to liabilities without limit. Such limits are usually explicitly defined in the engagement contracts.

3.10 Risk Classification of an Engagement

3.10.1 It may be useful if each prospective engagement is classified according to its risk profile as being low, moderate or high risk.

3.10.2 Indicators of high risk valuation assignments include:

3.10.2.1 where work is being performed without limitation of liability or at a limit in excess of that normally applied by the Valuer;

3.10.2.2 where the engagement involves public reporting in an investment circular;

3.10.2.3 other valuation work for public companies where the users of the valuation are public and unknown;

3.10.2.4 where there is significant public interest element in the work (e.g., certain government work).

3.10.2.5 valuation for litigation where the Court relies on the opinion of the Valuer in arriving at a decision.

3.10.3 Engagements may be classified as high risk even in the absence of any of the above criteria; the Valuer may still decide that the engagement should be classified as high risk based on a combination of other factors identified during the engagement acceptance.

3.10.4 General considerations affecting the risk profile include:

3.10.4.1 The size and complexity of the engagement (e.g., use of cross-border and multi-functional teams);

3.10.4.2 The nature of the Client involved (experience, sophistication, history of Client relationship, litigation history of Client);

3.10.4.3 The Client's intended use of the Valuer's work or report (e.g., public reporting, reporting, regulatory compliance);

3.10.4.4 Any project restrictions imposed (e.g., timeline, access to information, fee);

3.10.5 Additional risk mitigation actions on high risk assignments might include any of the following;

3.10.5.1 independent review of the valuation report and conclusions before the report is finalized and issued;

3.10.5.2 identification of specific technical resources to be brought in on the engagement;

3.10.5.3 use of more senior team members;

3.10.5.4 more time allowed within the work timetable for the self-review of all calculations and conclusions;

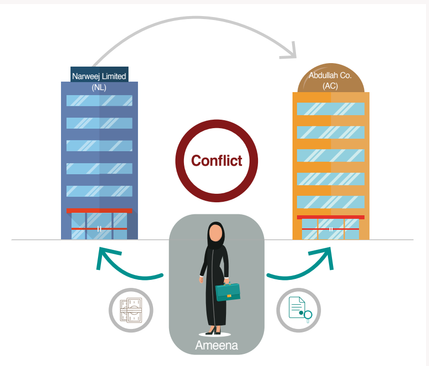
3.10.5.5 fee retainer arrangements;

3.10.5.6 firms with a wide range of resources can include internal reviews of the work files, the valuation conclusions and the draft reports before the report is finalized.

3.11 Conflicts of interest and Objectivity

3.11.1 A conflict of interest is an existing situation where a Valuer could potentially benefit from the value conclusion on a particular engagement, directly or indirectly. Simple instances of conflicts of interest are:

Example 1: Actual Conflict of Interest



Consider a situation where, Narweej Limited (NL) is buying majority stake in Abdullah Co. (AC) and Ameena, the Valuer for AC holds shares in NL. In this case, if the transaction is a favorable one, the acquisition may push prices of NL upwards and Ameena would stand to benefit. Further, Ameena may have access to material, price-sensitive information giving her an advantage over other market participants. Since the price at which NL would buy the shares of AC may be influenced by on Ameena's valuation of AC, she is in a position to influence which way the transaction goes and hence, benefit from it. This is an inherent conflict of interest as well as an independence issue since Ameena, who should ideally have only the best interests of her client in mind, could in this circumstance, be somewhat biased to her personal interests. While Ameena may be an objective Valuer and keep her personal interests aside of her professional engagements, this actual conflict of interest is sufficient risk to prevent staffing Ameena on the valuation or requiring her to dispose of her holdings prior to accepting the engagement or refrain from trading on the account for a certain cool-off period.

Example 2: Conflict of Interest

Another situation which presents a conflict of interest is when a Valuer (whether in his/her individual capacity or the firm as a whole) has access to classified information on both sides of a transaction or valuation event. For instance, if Narweej Limited (NL) is contemplating an investment in Abdullah Co (AC) and the Valuer, Juhaina Advisory Services Company (JAS) was to advise both NL as well as AC, there is an inherent conflict of interest.

In this case, the engagement team at JAS is automatically forced into a position of prioritizing the interests of one client over another. In another situation, JAS accepts the valuation engagement from AC. While at the time of accepting the engagement, JAS is not representing NL but NL is a long-time client of JAS. Now at the time of taking on the engagement, JAS should anticipate the conflict and decide which client it wants to represent on a particular engagement. Client relationships are very important in the services industry and accordingly, if JAS wants to accept the engagement from NL, it should decline the engagement with AC. AC would need to engage their own objective valuation expert.

3.11.2 At the very outset of a valuation engagement, it is important to be aware of existing and/or potential conflicts of interest and outline measures to address them appropriately. If there is an actual or potential conflict, the Valuer (or valuation firm) should not engage in the valuation assignment. Whatever decision is made, it is not acceptable for a Valuer (or valuation firm) to be seen as compromising its Objectivity. IVSC's Fundamental Principles in its Code of Ethics note that objectivity is making sure that professional or business judgement is not overridden by conflicts of interest, undue influence or bias.

3.11.3 The Taqeem Code of Ethics states in Article 2(1):

(1) "The valuer shall not compromise his professional or business judgment because of bias, conflict of interest or the undue influence of others.

(2) A valuer shall not to act for two or more parties in the same matter without the written consent of both parties.

(3) A valuer must take all necessary precautions to prevent the emergence of conflict of interests between the interests of his clients."

3.11.4 A useful tool to acknowledge this risk is to have the engagement team disclose internally all existing and potential interests prior to accepting the valuation engagement. Depending on the nature of the conflict of interest the decision can be taken whether or not to accept the assignment.

3.11.5 The Code of Ethics states in paragraph 4.9: "A valuer shall refrain immediately from any valuation process or advice for public or private entities, especially judicial authorities and financial institutions for any asset in which the valuer has a direct or indirect interest, and to disclose clearly the state of his ownership or the ownership of his relatives (to the third degree) of any Assets associated with or affected by the value of subject Assets."

3.11.6 Valuers who are employed by their Clients are able to comply with International Valuation Standards provided that their Objectivity is protected. In such circumstances the Valuer must ensure that there are governance controls put in place by their employer. These controls should mean that the Valuer is free from management pressures so that the Valuer is able to undertake valuations with Objectivity.

3.11.7 The Objectivity of the Valuer can also be questioned by the acceptance of gifts, favors and special privileges from the Client.

3.11.8 There are many instances where the lack of Objectivity of Valuers has been questioned by the regulatory authorities. A robust paper trail is the only strong evidence that the authorities rely on to establish that the Valuer has retained objectivity.

3.11.9 Objectivity is a state of mind. In addition to undertaking work with Objectivity, it is also necessary that the Valuer is seen by others to be Objective.

> Refer to **Appendix F** for Independence Confirmation;
> Refer to **Appendix G** for Sample Conflict of Check conditions and Sample Internal approval letter for potential conflict of **interest;**

3.12 Confidentiality

3.12.1 As mentioned earlier, Valuers deal with confidential information in their engagements. It is a fundamental ethical requirement that such information should remain confidential. Therefore, such information should not be disclosed to others without the prior consent of the Client, or as required by Government authorities. The valuer should not use that information for the personal advantage of the professional valuer or third parties.

3.12.2 The Code of Ethics states in Article 4(C):

(1) "A valuer must handle the client's information sensitively all times and must not disclose confidential information or results relevant to an assignment for, or would be beneficial to, another party or person.

(2) The valuer shall not use confidential information gained as a result of professional relationships for the personal advantage of the valuer or third parties.

(3) A valuer shall maintain confidentiality of information disclosed by a prospective client or employer.

(4) A valuer shall maintain the confidentiality of information within the firm or employing organization."

(5) A valuer should take reasonable steps to ensure that staff under the professional valuer's control and persons from whom advice and assistance is obtained respect the professional valuer's duty of confidentiality.

(6) The need to comply with the principle of confidentiality continues even after the end of a relationship between a professional valuer and a client or employer. When a professional valuer changes employment or acquires a new client, the professional valuer is entitled to use prior experience. The professional valuer should not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.

3.12.3 In using confidential information, the Valuer owes a responsibility to the Client that there are precautions in place to maintain the confidentiality of information provided by the Client. Engagement agreements and contracts should have a confidentiality clause that describes the Valuer's responsibility to keep information confidential.

3.12.4 Clients may insist on a Non-disclosure Agreement (NDA) to impress upon the Valuer the importance of maintaining confidentiality. However, such an agreement is not strictly required: the Valuer has a professional duty not to disclose information without the consent of the Client in any event.

3.12.5 Some of the rules to follow for maintaining Client confidentiality are listed below:

3.12.5.1 Valuers should ensure workplace security such as maintaining proper firewall and security on the firm's server and computers;

3.12.5.2 Valuers should consider the use of code words for key Client entities involved in the valuation and for the project as a whole;

3.12.5.3 Valuers should discuss confidential information within closed meeting rooms or designated project rooms and not in the common areas in the presence of co-workers or passers-by;

3.12.5.4 Confidential information must never be left lying on tables, loosely in drawers or even flashing on the mobile screen.

Refer to **Appendix** H for Sample Non-Disclosure Agreement

3.13 Limitations of Liability

3.13.1 The Valuer should define the cap on the liability that the firm / Valuer should have to bear. This can provide some protection if the Client makes a successful claim against the Valuer.

3.13.2 This is important because keeping the liability uncapped exposes the firm to liabilities without limit. Such limits are usually explicitly defined in the engagement contracts.

3.14 Planning the work

3.14.1 An effective plan requires the following:

3.14.1.1 An understanding of the Client's instructions;

3.14.1.2 The identification of relevant matters from initial meetings with the Client and the subject company; and

3.14.1.3 Assessment of other available information sources, which are likely to assist the planning process.

3.14.2 At the planning stage, the Valuer will have time to conduct only limited research. However, subject to confidentiality requirements, the following preliminary research procedures may be considered at the planning stage:

3.14.2.1 Request the Client to provide any information that may be useful to the initial planning;

3.14.2.2 Perform a media search;

3.14.2.3 Review the website of the company for information as to how it presents itself to the market in terms of services provided;

3.14.2.4 Review market or industry reports, brokers' reports (if a public company) and competitor information.

3.14.3 The preliminary research at the planning stage should build upon initial research performed to support engagement acceptance. Additional research may be performed during the engagement and the key findings should be documented. Obtaining and analyzing information takes place throughout the valuation assignment.

3.14.4 The Valuer must consider the following matters at the beginning of the planning stage:

3.14.4.1 Preparing a written plan is not a mandatory requirement for every engagement. However, a written plan is an effective method of communicating the planned approach to the engagement team and serves as a checklist of steps to be performed;

3.14.4.2 The information obtained before the start of the assignment should be recorded in note form. These are an appropriate starting point for the planning document These may be added to as further information is obtained;

3.14.4.3 The planning document should state the four fundamentals of valuation:

(A) **Why** is the valuation being undertaken?

(B) **What** is the asset being valued?

(C) **When** is the valuation date?

(D) the **Basis of Value**.

3.14.5 The extent and detail of a written plan will depend on the size and complexity of the engagement; for a small and less complex engagement, the plan might be communicated in a short e-mail to the engagement team.

3.14.6 Where a written plan is prepared, it may be supplemented by a team briefing to provide additional information including communicating project roles and responsibilities to team members and allowing team discussions and questions to be raised by the engagement team.

3.14.7 A written plan may include the following elements:

3.14.7.1 Project background including key findings from the preliminary research;

3.14.7.2 Confirmation of the Scope of Work and listing of the work required;

3.14.7.3 Identification of the engagement team and their respective roles and responsibilities for each work stream;

3.14.7.4 Timetable for completing the engagement including key milestone dates for each work stream;

3.14.7.5 Estimation of time/cost budget for each work stream;

3.14.7.6 Areas of key risk and sensitivity related to the project; and

3.14.7.7 Useful administrative information (e.g., Client contact details, engagement team contact details, etc.).

3.15 Scope of Work

3.15.1 The Scope of Work describes the fundamental terms of a valuation engagement, such as the Assets being valued, the purpose of the valuation and the responsibilities of parties involved in the valuation. IVS 2020 101 provides the standard and general requirements for scope of work, as well as changes to scope of work over time.

3.15.2 The Scope of Work should be agreed in writing in an engagement agreement or Engagement Letter. All of the steps needed for the valuation assignment should be listed at the planning stage.

3.15.3 The Scope of Work should be communicated to the engaging Client as early as possible and prior to completion of the engagement. IVS 2020 requires that the Scope of Work should include the following if the assignment is to be compliant with IVS:

(a) Identity of the Valuer;
(b) Identity of the Client(s);
(c) Identity of the intended users;
(d) Company or interest in company being valued; (What)
(e) The valuation currency
(f) Purpose of the valuation; (Why)
(g) Basis or Bases of value used; (Basis of Value)
(h) Valuation Date; (When)
(i) The nature and extent of the Valuer's work and limitations thereon;
(j) The nature and sources of information upon which the Valuer relies;
(k) Significant Assumptions and/or Special Assumptions (assumed facts that differ from those existing at the date of valuation);
(l) Type of report being prepared;
(m) Restrictions on use, distribution and publication of the report
(n) That the valuation will be prepared in compliance with IVS and that the Valuer will assess the appropriateness of all significant inputs.

3.15.4 If the above points are not communicated to the Client near the beginning of the assignment (and updated if necessary as it proceeds) then the valuation and the related report cannot be stated to be compliant with IVS.

3.15.5 The nature of any departure from IVS must be explained. A departure is a circumstance where specific legislative, regulatory or other authoritative requirement must be followed that differ from the requirement of IVS and take precedence over IVS requirements.

3.16 Materiality (or Significance) and risk areas

3.16.1 Inputs and Assumptions are Material or Significant if the impact on the valuation could reasonably be expected to influence the decisions of users of the valuation. Judgements about materiality are made in light of the overall valuation engagement and are influenced by the size and nature of the subject asset.

3.16.2 At the planning stage the Valuer should identify those aspects of the work which are likely to be the most Material or Significant due to their financial magnitude, complexity or inherent uncertainty.

3.16.3 The Valuer should then focus their resources on these areas of the work as these will be likely to have the biggest impact on the valuation conclusions.

3.16.4 The risks within a valuation assignment are that a valuation conclusion is Materially or Significantly above or below the appropriate valuation. The Valuer should document steps taken to mitigate the risks of Material mis-statement. The steps to take include:

3.16.4.1 Prioritize those matters which are likely to require detailed consideration or discussion, so that key issues are brought to light earlier and there is sufficient time to resolve complex matters;

3.16.4.2 In order to assist the Valuer to form his own view, the Valuer may decide to discuss the project with the Client to establish their view about which aspects of the work are likely to be the most challenging or Significant;

3.16.4.3 Ensure adequate skilled and experienced staff are dedicated to the highest areas of risk.

3.16.5 Determining Materiality or Significance will vary according to the Valuer's views and the nature of the work. In this context it is important to remember the definition of what is Material or Significant.

3.17 Work Requirements, Reporting and Timetable

3.17.1 At the planning stage, the Valuer should understand the manner in which the Client expects the Valuer to report the findings and/or issue the work product (including progress reports on interim findings and the final reports);

3.17.2 It may be appropriate to prepare outline template reports or work product at an earlier stage to confirm the Client's requirements or to assist the Valuer to ensure that they meet all Scope of Work requirements; and

3.17.3 At the planning stage, the Valuer should understand the anticipated timetable for receiving information required for completing each stage of the work.

3.17.4 It can be very helpful to Clients to give them a regular update as to the progress being made. Clients can be concerned that the timetable may not be met if they are not kept informed of progress.

3.17.5 It is advisable to issue a final draft of the valuation report to the Client before finalizing to allow them to review the analysis and ensure that all facts and assumptions made are understood by the Client and any input they wish to offer may be considered.

3.17.5.1 This is not for the purpose of seeking the approval of the Client to the valuation conclusions – the judgements within the report are ultimately those of the Valuer.

3.17.5.2 The purpose of a client review is to ensure that there are no factual inaccuracies in the information that is provided in the report.

3.17.6 Due to this requirement the timetable should allow time for the Client to review the report for its factual accuracy.

3.18 Forming the Plan

3.18.1 The Valuer should establish a clear understanding of what is required for the valuation engagement, taking account of the results of any preliminary research performed and the other matters considered during planning. This planning process should determine:

3.18.1.1 The nature and timing of the work product including the timetable for progress reports on interim findings and the final reports;

3.18.1.2 The nature and timing of the processes and procedures that will be performed (and the resources required to undertake these activities);

3.18.1.3 The nature and timing of information to be provided by the Client or third parties;

3.18.1.4 A budget estimate for costs; and

3.18.1.5 For larger valuation projects, assigning experts and valuation professionals to be involved in the project.

3.18.2 Often the planning process will break the overall engagement into a number of separate (but related) work streams. The planned approach should be communicated to all team members so that they understand the context of the work as well as the significance of the findings.

3.18.3 The procedures that would be performed by the Valuer should be outlined under the scope. If there are additional service elements that are required by the Client (such as scenario analysis or valuations at multiple Valuation Dates or any other special requirements), these need to be specifically referred to in the scope. They should also be considered in any negotiations around timelines and fees.

3.19 Exclusions

3.19.1 While it is important to outline the Valuer's responsibility, it is also essential to indicate the exclusions from the Scope of Work in addition to caveats, limitations, terms and conditions that would govern the overall execution of the engagement. Some of the typical exclusions that the Valuer should consider indicating to their Clients are:

3.19.1.1 Preparation of Projections (unless expressly anticipated in the Scope of Work);

3.19.1.2 Provision of accounting, tax, environmental, regulatory or legal advice in relation to the valuation subject.

3.20 Assumptions

3.20.1 There may be specific Assumptions pertaining to the subject of valuation that need to be borne in mind by the Valuer

3.20.1.1 For example, when valuing a company with various divisions or segments, certain items such as fixed Assets or corporate overheads may not be explicitly allocated to the divisions in the business plan. If these divisions are required to be valued separately (and not on a consolidated basis), then the Client would need to provide a basis for the allocation which may not actually be incorporated in the business plan.

Example:

"We have been engaged to value Akbar Company Limited (ACL) as at 31 December 2019 (Valuation Date) based on the financial statements for ACL as at the Valuation Date. We understand that we would be provided with historical financial information for ACL for 4 years and forecast financial statements for 5 years from the Valuation Date. ACL operates in four business divisions, namely – manufacturing of garments; trading of accessories, bags and shoes; operation of retail stores; and provision of boutique tailoring services. We understand that the forecast financial statements have been prepared on a consolidated basis for ACL as a whole. Divisional profit & loss statements for the specified historical and forecast period have been prepared; however, the allocation of common Assets and costs were not been carried out. The basis for this allocation as required for the valuation would be provided to us by ACL."

3.20.2 Assumptions are an inevitable part of undertaking valuation of a Business. The Valuer will need to make Assumptions on the likely future cash flows of the Business, on the likely category of Market Participants who would be prepared to buy the relevant asset, and various other matters.

3.20.3 Special Assumptions are different to Assumptions:

(A) A Special Assumption is an assumed fact that differs from those existing at the date of the valuation.

3.20.4 An example of a Special Assumption is given later in this manual.

3.21 The Report or Other Deliverable

3.21.1 The deliverable that is expected from the engagement, including the format in which it would be prepared and the manner in which it will be communicated needs to be agreed with the Client.

3.21.2 The Scope of Work should clearly indicate the final valuation reporting on the engagement that is expected from the Valuer. It should also mention the format in which the deliverable would be prepared and the manner in which it is to be shared with the Client.

3.21.3 Typically, the deliverable on a business valuation engagement is a report on the valuation of the subject as at the Valuation Date. It should be indicated whether the report will be shared in printed hard or soft electronic format, or both.

3.21.4 Usually, the valuation calculations and Excel work products are the working papers and intellectual property of the Valuer. These working papers and Excel models are not shared with the Client unless otherwise agreed. Accordingly, it is better to mention that the editable files prepared by the Valuer to arrive at the valuation are not to be shared with the Client.

3.21.5 Although the various file documents of the Valuer belong to the Valuer, the Valuer should include sufficient information in the report so that an independent Valuer, with access only to the report, would be able to review the report and the various calculations made in arriving at a final conclusion.

3.21.6 The valuation report should include reference to any regulatory or accounting standards, guidelines or rules that apply to the valuation exercise and confirmation that the valuation will comply with such stipulated guidelines.

3.21.7 If there are any regulatory guidelines, accounting standards or other rules that apply to the valuation, these should be clearly identified in the Scope of Work so that the approach and limitations are clear to both the Client and the Valuer.

3.21.8 For example, Purchase Price Allocations are prepared following an acquisition as per IFRS 3 when a company acquires another business. It is therefore, advisable to mention as part of the scope that the purpose of valuation is to comply with this financial reporting standard;

3.21.9 Similarly, regulators may issue notices, circulars or guidelines to govern when valuations are required and if any specific approach is to be followed. Reference should be made to such circulars or notices to identify the basis that would be followed for the valuation.

3.21.10 In addition to all the above parameters, any special feature applicable to the valuation known at the time of entering the engagement should also form part of the scope document. Hence, the Scope of Work document becomes the starting point for documenting all engagement administration and execution.

3.22 Timelines

3.22.1 Once the Scope of Work has been clearly outlined, the next engagement parameter to agree upon is the timeline. This can be very challenging since valuation may be perceived by some people to be formulaic and the time, efforts and analysis that go into arriving at a robust valuation are often underestimated.

3.22.2 It is important to set timelines that are realistic, achievable and commensurate with the extent of work involved. For this purpose, preparing a work-plan is always a good place to start. This involves identifying workflow streams and activities, assigning team members and resources who will be responsible for preparing the work, estimating time required for each activity, setting milestones and providing for delays at each level.

3.22.3 In estimating the time required, the Valuer should consider the skills, expertise and number of people to be engaged in a particular activity since the time estimate should represent total 'man-hours'.

3.22.4 It is also important to note that the timeframe required to carry out a valuation of the Valuation Subject depends on the complexity, level of detail, extent of information available and the availability of management of the company. For example, research and analysis for a public limited company would / may take less time than a private limited company as most essential information would be readily available. Therefore, the timeline is not a template and needs to be customized on a case-by-case basis.

3.22.5 Once the total hours required have been estimated, the timeline should be discussed and agreed upon.

3.22.6 Depending on the Client's requirements regarding the timeline, the Valuer may choose to have more senior, mid-level or junior team members on the engagement as there is a trade-off between the skills and experience vs. cost of deploying more senior team members.

3.22.7 As noted earlier, the Client should be given time to review the draft report to ensure that the facts are correctly stated according to their understanding. Time therefore needs to be included in the plan for this step.

Sample indicative work-plan:

Activity	Workstream	Total # of man-hours	Day1	Day2	Day3	Day4	Day5	Day6	Day7	Day8	Day9	Day10	Day11	Day12	Day13	Day14	Day15
Kick-off & receipt of data	Kick-off	35.0															
Research & peer-group analysis	Reserch	42.0															
Analysis of data, identification of data gaps	Reserch	20.0															
Receipt of additional data/clarifications	Reserch	18.0															
Further analysis & draft valuation	Reserch	24.0															
Internal revies	Reviews	16.0															
Discussion of draft valuation with client	Reviews	12.0															
Receipt of additional data/clarifications	Changes	20.0															
Changes & finalisation of valuation	Changes	30.0															
Discussion & closure of valuation numbers	Changes	15.0															
Report Preparation & delivery	Delivery	40.0															
Total		272.0															

3.23 Calculation of Fees

3.23.1 While there is no standard approach for the calculation of fees, the final fees agreed between the Valuer and the Client should be based on various rounds of discussions and negotiations. The starting point for the negotiations is based on an effort estimate, and an hourly billing rate.

3.23.2 Once the approximate effort required on the engagement is estimated, the work needs to be allocated to various levels since the billing rate for a junior team member would be less than that of a senior member.

3.23.3 Often, engagements are won on competitive bids where the lowest bidder or the Valuer with the lowest fee quote wins the engagement. In such cases, for a Valuer to be successful in winning the engagement, the Valuer should ensure that the proposed fee is sufficient to complete the work with an adequate margin for the efforts expended. The price quote must be realistic and commensurate with the Scope of Work agreed. The estimation of efforts and fees should consider realistic timelines without compromising on quality.

3.23.4 Any form of fee that is contingent on a transaction taking place or some other event should not be conisdered. Such fees can damage the Objectivity of the Valuer or the way that the Objectivity of the Valuer is viewed by other parties.

3.23.5 Billing of fees may be milestone-based rather than on engagement completion. Part of the fee may be requested in advance.

3.23.6 The fee proposal should also clarify who will bear any incidental and out-of-pocket expenses – whether these would be borne by the Valuer or by the Client. Details of any applicable taxes/zakat, charges, and levies must also be clearly outlined so the Client is aware of the all-inclusive fee quote.

3.24 Proposal

3.24.1 Proposals are initiated by the Client; they are generally required as part of a process to award valuation engagements, possibly under a competitive bidding process;

3.24.2 Proposals are prepared in response to a request from a potential Client.

3.24.3 Proposals may provide for a prescribed format that all bidding Valuers need to follow.

3.24.4 With Proposals, the Client usually dictates the key terms of the engagement with little or no flexibility afforded to the Valuer to customize the same.

3.24.5 The process of competitive bidding for the valuation of a business or project may start with a Request for Proposal ("RFP"). Government agencies or contracting companies invite Valuers to put forward their proposal for valuation. Following this a Valuer is finalized and selected. The RFP usually requires submission of the following:

3.24.5.1 A letter of intent which communicates the Valuer's intention or interest in providing the required services; and

3.24.5.2 Technical and financial proposals as part of the bidding process.

3.24.6 Technical Proposal

3.24.6.1 The technical proposal outlines and expands on the technical competencies that the team possesses, which highlight how the Valuer is a competent candidate for the valuation;

3.24.6.2 The technical proposal should include the following:

(A) A scope document that outlines the key steps that the Valuer will perform as part of the valuation, key inclusions and exclusions and the deliverables under the engagement;

(B) A professional résumé of the engagement team members highlighting their educational background, qualifications, experience and proposed role in the engagement; and

(C) Information on recent and past credentials and case studies of successful engagements (and references upon request).

3.24.7 Financial Proposal

3.24.7.1 The financial proposal should include a break-down between staff level, time and cost;

3.24.7.2 If the engagement is comprised of various activities, the financial proposal may require a separate pricing for each activity. In some cases, the Client may decide to award parts of an engagement to various Valuers depending on technical competency and time constraints;

3.24.7.3 The financial proposal would need to outline the following:

(A) Billing plan with various milestones defined clearly, if the RFP does not already specify the same; and

(B) The mechanism for reimbursement (if applicable) of any incidental and out-of-pocket expenses on the engagement, all applicable taxes/zakat and rates and any other charges that the Client would be liable to pay.

3.24.8 A proposal would comprise all the elements described above. However, it may not need to be prepared and submitted separately or to follow a standard format. The Valuer may prepare one comprehensive proposal which comprises all the following details:

3.24.8.1 Value proposition highlighting industry expertise;

3.24.8.2 Technical competency;

3.24.8.3 Proposed scope of services;

3.24.8.4 Key deliverables;

3.24.8.5 Steps to be performed and valuation process to be followed;

3.24.8.6 Team highlights – experience and key skills;

3.24.8.7 Past credentials and case studies; and

3.24.8.8 Fee proposal.

3.24.9 While the above details represent a broad structure for a proposal, there is no standard format or template for a proposal. By its nature a proposal is a marketing document and each organization has customized documents prepared based on internal branding and marketing conventions.

3.25 Engagement Letter

3.25.1 Introduction

3.25.1.1 The Engagement Letter is a formal agreement between the Client and the Valuer, which should be signed by both parties before the formal commencement of the engagement.

3.25.1.2 It states the terms and conditions of engagement, mainly focusing on the scope of the engagement, Client information requirements and timing, Valuation Date, compensation estimates to the Valuer for the services performed and the responsibilities and obligations of each of the parties involved.

3.25.1.3 The letter of engagement should define all the terms and conditions, to avoid any misunderstandings, which may lead to legal/operational/financial disputes later during the course of engagement.

3.25.2 Contents

3.25.2.1 The contents of a standard Engagement Letter include:

(A) Addressee: The letter is typically addressed to Client/senior management member of Client firm;

(B) Service to be rendered: This describes the nature of service to be rendered (i.e. valuation);

(C) Valuation Purpose: Stating why the Client needs the valuation.

(D) Background: A brief description of the entity/subject to be valued and relationship to the Client;

(E) Scope of Work: This lays down specifications of work to be performed by Valuer in regard to the engagement.

(F) Why, What, When and Basis of Value:

(G) Limitation of scope: Any limitations or restrictions on the inspection, enquiry and analysis of the valuation must be identified. This helps ensure that there is no ambiguity later, during or after the engagement about work undertaken and not undertaken;

(H) Circulation of report: This states the parties to which the valuation report would be circulated;

(I) Deadlines/Timeline: This section states the estimated date of completion and release of draft and final reports. The section also states limitations upon completion being contingent on the release of data from the Client's side;

(J) Responsibilities of Valuer: This lays out the responsibility of the Valuer to provide the valuation, to the best of his abilities. It limits the scope of accuracy of the valuation to the accuracy of data and proper representation of factors relevant to valuation (i.e. which may affect the value).

(K) Fees: This section lays out the agreed compensation between the Client and the Valuer. This will include any additional expenses and applicable taxes, which have to be covered by the Client and the terms and conditions related to the same. It may also state the terms, schedule and method of payment;

(L) Responsibilities of the Valuer: This lays out the responsibility of the Valuer to their Clients to ensure reasonable skill, care and delivery in a timely manner;

(M) Responsibilities of Client: This lays out the responsibility of the Client to ensure the timely delivery of information and timely access to assistance of management personnel.

(N) Presentation of results: This lays out the report format and medium through which the Valuer would deliver its valuation report and the broad contents of the report;

(O) Limitations on usage/Confidentiality: This lays out that the report may not be disclosed by the Client to external third parties.,

(P) Limitations on liability: This lays out restrictions on the liabilities to be paid by Valuer to Client or third parties due to legal disputes arising out of the engagement. It also limits the value of liability to be paid, as well as the period for which liability exists. The limitations on liability section needs to specify the Client indemnity provisions related to the engagement in case the Valuer is drawn into legal disputes; and

(Q) Governing law/Dispute resolution: This lays out the mechanism for resolution of any dispute, which may arise between the Client and the Valuer. In case of judicial recourse, it states the legal jurisdiction under which the case shall be resolved.

Refer to **Appendix** I for Sample Engagement Letter

3.26 Consortium Agreement

3.26.1 Sometimes, the valuation services are provided by the Valuer, as part of a consortium to the Client.

3.26.2 The agreement between the consortium and the Client should meet the minimum standards for Engagement Letters defined in the applicable policy and in particular contain the provisions indicated below. The level of risk that each consortium member would be willing to take is a management/strategic decision that the licensed Valuer should take. Hence, the engagement agreement should include provisions around the indemnity and risks associated with the consortium arrangement, when applicable. Such provisions should be included based on the legal counsel's advice.

3.26.2.1 Scope and work products: The scope of services and the work products should be defined for every Consortium member;

3.26.2.2 Fees: The agreement should define what share of the total fees each Consortium member is entitled to as well as the timings and the other terms of payment;

3.26.2.3 Liability limitation: The agreement should contain limits on the liability of the Consortium members. If possible, the Valuer should avoid joint and several liability, in particular where Valuer does not have the expertise to supervise the other Consortium members' work;

3.26.2.4 Sole recourse: To the extent the member firm of the Valuer incurs liability under the Consortium arrangement, the Client should agree to bring claims arising out of the services performed only against the member firm of the Valuer that is part of the Consortium and acknowledge that there is no agency relationship between such member firm of the Valuer and any other Valuer entity;

3.26.2.5 Notification of termination/exclusion: In case the remedies described below, i.e., termination of the Consortium or exclusion of a member, are exercised, there should be a procedure for notifying the Client;

3.26.2.6 Governing law and jurisdiction: Particularly in case of a cross border consortium, the laws of the contracting Valuer member firm's country should govern. The courts of that country should have exclusive jurisdiction or, alternatively, the Valuer's member firm may prefer to employ alternative dispute resolution procedures;

3.26.2.7 The agreement between the Consortium members should contain the following provisions:

(A) Subject matter and purpose: The subject matter and the purpose of the Consortium need to be precisely defined;

(B) Scope, work product and timing: Both the scope of services and the work product as well as the timetable for delivery for every Consortium member need to be defined;

(C) Cooperation: Consortium members agree to provide each other with the data, information and/or documents required for each of them to meet their obligations to the Client in a timely manner, including notification of any delay in performance or of any event that may impact the engagement;

(D) Remedies for the event of a breach of contract by a Consortium member, e.g., exclusion from the Consortium and liability to pay increased costs, should also be included;

(E) Lead firm: It needs to be agreed whether one Consortium member should represent the Consortium as the lead member and what authority the lead member has, e.g., whether it is authorized to represent the other Consortium members or whether it only manages and coordinates the Consortium;

(F) Quality: Consortium members should agree to provide services with professional care. For quality assurance purposes, the Valuer should be granted access to work papers, deliverables and other documents to ensure the quality and consistency in the deliverables;

(G) Decision making of the Consortium: It needs to be agreed whether internal decisions of the Consortium need to be made unanimously or by a majority and what is the process to deal with decisions where there are fundamental disagreements among the Consortium members;

(H) IP covenant: It needs to be acknowledged that there shall be no transfer of pre-existing intellectual property rights between the members of the Consortium. Consideration needs to be given as to who will own IP rights created during the course of the engagement;

(I) Payment terms: Consortium members must agree on specific fee and billing arrangements. Billing can be made by each member separately or by the lead member. If made by the lead member, what is the payment process to Consortium members? Can the lead member charge a premium on their Consortium member's fees?

(J) Indemnity: Each Consortium member should indemnify the other members against any physical injury and any other losses, damages or liabilities, including a liability to the Client under a joint and several liability obligation, which arises out of indemnifying Consortium member's acts or omissions in connection with the engagement;

(J) Indemnity: Each Consortium member should indemnify the other members against any physical injury and any other losses, damages or liabilities, including a liability to the Client under a joint and several liability obligation, which arises out of indemnifying Consortium member's acts or omissions in connection with the engagement;

(K) Confidentiality: Consortium members agree not to disclose confidential information of the Client or other Consortium members and Circulation or use of report among Consortium members;

(L) No agent/no partnership: Consortium members are independent contractors and not agents of one another;

(M) Independence: The Consortium member represents that amounts expected to be earned under the business relationship shall not exceed %5 of the Consortium member's total annual revenues;

(N) Exclusivity / non-compete provision: Including an exclusivity/non-compete provision should be considered;

(O) Termination: Reasons for immediate termination by a Consortium member need to be defined, including any Consortium member's bankruptcy, change in independence status of a consortium member or inability to perform;

(P) An end date and or trigger event for ending the Consortium agreement should be defined; and

(Q) Governing law and jurisdiction: Particularly in case of a cross border consortium, the laws of the Valuer member firm's country should govern. The courts of that country should have exclusive jurisdiction or, alternatively, the member firm may prefer dispute resolution by arbitration.

(R) Insurance: Identify how the insurance for the Consortium will be put in place and who will be managing the insurance related activities.

4

Bases and Levels of Value

4.1 Bases of Value

4.1.1 Assets may have a different value, depending on the Basis of Value used. The choice of the Basis of Value may also influence or dictate the Valuer's selection of methods, inputs and Assumptions, and the ultimate opinion of value.

4.1.2 The Basis of Value used for financial reporting under IFRS 13 is Fair Value. The definition is: "The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between Market Participants at the measurement date."

4.1.3 The six IVS Bases of Value follow. They are also defined in the Glossary:

4.1.4 **Market Value:** The estimated amount for which an asset or liability should exchange on the Valuation Date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

4.1.4.1 Market Value is the most common Basis of Value within IVS. IVS 2020 analyses the above words and provides further explanation as to the meaning of the various phrases in the definition.

4.1.4.2 The concepts within Market Value as a Basis of Value are very similar to the Fair Value definition within IFRS 13.

4.1.4.3 In order to determine Market Value a notional transaction has to be imagined. That transaction takes place between two unknown parties. The realities of any actual buyers and sellers are ignored.

4.1.4.4 Market Value does not include value that is available to a specific owner or purchaser if that value is not available to other Market Participants. Market Participants are all individuals or other entities that are potential buyers of the asset. The Assumption is that there is a willing purchaser, not a particular willing purchaser.

4.1.4.5 Market value is consistent with the premise of the highest and best use for the Market Participants. Again this excludes the highest and best use only available to a specific owner or purchaser.

4.1.5 **Market Rent:** The estimated amount for which an interest in real property should be leased on the Valuation Date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

4.1.5.1 This Basis of Value is of main relevance for real estate Valuers. It is however useful for Business Valuers to be aware of this basis.

4.1.6 **Equitable Value:** The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties. It requires the assessment of the price that is fair between two specific, identified parties considering the respective

advantages and disadvantages that each will gain from the transaction; hence, the price that is equitable between them is different from the price that might be obtainable in the market.

4.1.6.1 This Basis of Value does not assume unknown parties as buyer and seller. Equitable Value refers to the value between two known parties.

4.1.6.2 A common example of the possible use of Equitable Value is the valuation of stock that is to be transferred between two existing stockholders in a company. An example is the purchaser who has %76 of the stock and the seller who has 24% of the stock, Equitable Value is above the Market Value of a holding of 24%; Equitable Value is below the Market Value of 24/100 of a 100% holding.

4.1.6.3 Equitable Value reflects the interests of the two parties. It does not reflect the negotiating abilities of the two parties. Some Valuers assume equal negotiating abilities and arrive at an Equitable Value as the average of the above two values.

4.1.7 **Investment Value:** The value of an asset to a particular owner or prospective owner for individual investment or operational objectives.

4.1.7.1 Investment Value is an entity-specific Basis of Value and may be higher than Market Value depending on the owner or potential buyer.

4.1.7.2 Investment Value includes possible synergies, goodwill from brand recognition and other owner specific factors.

4.1.7.3 Investment Value is another Basis of Value which does not assume an exchange between two unidentified parties.

4.1.8 **Synergistic Value:** Synergistic value is the result of a combination of two or more Assets or interests where the combined value is more than the sum of the separate values.

4.1.8.1 If the synergies are only available to one specific buyer then Synergistic value will differ from Market Value.

4.1.9 **Liquidation Value:** The amount that would be realised when an asset or group of Assets are sold on a piecemeal basis. Liquidation Value should take into account the costs of getting the Assets into a saleable condition as well as those of the disposal activity.

4.1.9.1 Unlike Market Value and the other Bases of Value, Liquidation Value assumes a disposal of the Assets by the business.

4.1.9.2 If the Basis of Value is Market Value using the Cost Approach, the Highest and Best Use Premise and the Summation Method, the costs of getting the Assets into a saleable condition and the costs of disposal are not deducted.

4.1.9.3 If the Basis of Value is Liquidation Value, using the Cost Approach, the Highest and Best Use Premise and the Summation Method, the costs of getting the Assets into a saleable condition and the costs of disposal are deducted.

4.2 Levels of Value

4.2.1 When considering "What" is being valued, we need to consider the Levels of Value. Levels of Value are the relationships between holdings of stocks in the public markets with Controlling Interests and Non-Controlling Interests in private companies.

4.2.2 The Valuer should be specific about the Level of Value that will be used when valuing the interest in the Valuation Subject; the specific ownership interest characteristics such as Control (or lack of control) and Marketability (or lack of Marketability) should be taken into consideration on or before the terms of the engagement are finalised.

4.2.3 The Levels of Value can be influenced by the purpose of the valuation. As an example, if the valuation relates to an exit in the form of a sale of the entire Equity of a private business, the Controlling non-Liquid value and the Non-Controlling non-Liquid value will reflect the same value per share. If the Purpose is for a Standalone Value of a Non-Controlling Interest, the valuation may be very different.

4.2.4 We can consider the Levels of Value in term of the characteristics of Control: these levels are summarised in the following chart:

Synergistic Value

• Bid Premiums

Synergistic Value

• Discount for Lack of Liquidity

Controlling Non-Liquid

• Greater Illiquidity
• No benefit of control

Non-controlling Non-Liquid

4.2.4.1 Synergistic Value or strategic value: the value assigned, above Market Value, when the holder has the benefit of Synergies not available to other Market Participants.

(A) When takeovers of public companies take place, some %92 of such transactions are at a premium above the previous market price. This is known as the Acquisition Premium or the Market Participant Acquisition Premium (MPAP).

(1) It used to be considered that the premiums paid or offered in the takeover of public companies were premiums for Control. This evidence was then used to calculate the difference between a Controlling Holding and a Non-Controlling Holding in a private company.

(2) The underlying Assumption was therefore that all listed companies had a value above their Market Capitalization. (This is the total Equity value of a public company, calculated as the share price multiplied by the number of shares outstanding.)

(3) However only some 3% of public companies are taken over each year. There is little logic in applying the attributes of the 3% of companies taken over to the 97% which remain independent.

(4) It is now recognized that there is only value in a public company above its Market Capitalization if it is possible either to increase the cash flows or to reduce the risks in achieving those cash flows.

(5) It is now considered that such premiums very largely reflect the interests of Special Interest Purchasers; they are prepared to pay a premium over the prevailing market price as they can enjoy post-acquisition benefits not available to other Market Participants.

(a) There can be other reasons: as an example, a Public Company which is poorly managed may be bought at an Acquisition Premium on the basis that cash flows can be increased under better management. However, we cannot reasonably assume that all Public Companies could improve cash flows under different management.

(B) Levels of MPAP are commonly in the range from 30% to 40%. It is generally accepted that such levels of MPAP only make economic sense if there are similar economic benefits for the bidder. The company bidding to take over a public company should be able to increase the cash flows by the amount of the MPAP or reduce the risks of those cash flows.

4.2.4.2 Controlling Interest: The value assigned when the holder of stocks has control over the company's business activities by virtue of their ability to direct the management and policies of a business.

(A) It is recognised that there must be value in Control as it is generally considered to be better to have Control than not to have it. However, unless Control enables cash flows to be increased or risks reduced, its value in the context of public companies is likely to be modest. There is no evidence from the public stock markets as to what that value might be. Its value in the context of private companies can be very great.

4.2.4.3 Liquid Value: The value assigned when owners can sell the investment quickly for a known price, with the transaction not moving that price, with a relatively small Bid-Ask Spread and with modest dealing costs.

(A) This is the Level of Value which is published as the market prices of public companies on stock markets throughout the world.

(B) These prices relate to the transfers of relatively small holdings in the shares of public companies. The prices are therefore for Non-Controlling Interests.

(C) There is however only significant value above those prices if a Controlling Interest can increase the cash flows of the public company or reduce the risk of those cash flows.

(D) We cannot reasonably assume that the performance of all public companies can be improved under new management. It is therefore reasonable to assume that there is no significant adjustment for Control when comparing the metrics of a Comparable Public Company with a Controlling Interest in a private Company. There may be however a need for a Liquidity adjustment;

4.2.4.4 Controlling Non-Liquid Interest: the value assigned for a Control holding in a private company.

(A) Such a holding is not Liquid. It will take several months to achieve a sale; the price at which that sales transaction will take place is not known; there are likely to be significant dealing costs in achieving a sale. However, the Controlling Non-Liquid Interest does generally have the power to take the company to market at a time of his choosing. This means that the holding is Marketable. Non-Controlling Interests in the company will almost certainly have no objections to a sale as this gives them the opportunity to obtain an exit without a discount.

(B) When moving from the Liquid Interest to the Controlling Non-Liquid Interest there is a need for a Discount for Lack of Liquidity. This is sometimes referred to as the Discount for Lack of Marketability or DLOM.

4.2.4.5 Non-Controlling, non-Liquid value: the value assigned for a non-Controlling interest in a private company.

(A) Such a holding is not Marketable (as the holder does not have the choice to market the interest for sale). It is also not Liquid. It is even less Liquid than a Controlling Non-Liquid Interest. There is no ready market for Non-Controlling stockholdings in private companies.

(B) There are two discounts that need to be considered when moving from the Controlling Non-Liquid Interest to a Non-Controlling Non-Liquid Interest:

(1) The Discount for Lack of Control (DLOC) to reflect the absence of some or all of the powers of Control;

(2) A further Discount for Lack of Liquidity as the Non-Controlling Non-Liquid Interest is less liquid than the Controlling Interest.

4.2.5 The point has been made above that there is little value in the Control of a public company unless there is the prospect of either increasing the cash flows or reducing the risks of achieving those cash flows. The Assumption is that public companies are subject to rules regarding their governance:

4.2.5.1 The compensation for the officers should be determined independently and not by the officers themselves;

4.2.5.2 Decisions as to the appointment of family members and their compensation should be made independently of the officer concerned.

4.2.5.3 Any other transactions between the officers and the company should be subject to strict rules to ensure that they take place at Arm's Length.

(A) An Arm's Length transaction is one between parties who do not have a particular or special relationship and who are each acting independently.

4.2.5.4 In some jurisdictions such transactions may require stockholder approval;

4.2.5.5 Those officers have a responsibility to act in the best interests of all stockholders.

4.2.6 There can be significant value in the Control of a private company. This is because private companies are unlikely to have the same rules regarding their governance:

4.2.6.1 The compensation for the officers will be determined by the majority stockholder. The majority stockholder is commonly an officer and he can therefore decide on his own compensation;

4.2.6.2 Decisions as to the appointment of family members and their compensation can be made by the controlling stockholder.

4.2.6.3 Any other transactions between the officers and the company may not be at Arm's Length.

4.2.6.4 The controlling stockholder will often act in his own best interests rather than the interests of all stockholders.

4.2.7 There can be limitations on the powers of controlling stockholders in private companies:

4.2.7.1 In some countries minority stockholders can take action in the Courts if the controlling stockholder abuses his position – however this can be a very costly exercise with no guarantee of success;

4.2.7.2 In some countries the tax authorities will take action if there are transactions that are not at Arm's Length (in order to protect the tax position, not to protect minority stockholders).

4.2.8 Despite these limitations, it is recognised that a controlling stockholder in a private company is in a very powerful position.

4.3 The Implications for Valuation Work

4.3.1 When using the Market Approach and the Comparable Public Company (or Guideline Public Company) Method, the prices stated in the financial press are those of liquid minority interests.

(A) The Comparable Pubic Company Method is a valuation method under the Market Approach, which uses the market multiples derived from the market prices of the securities of public traded companies in an open actively traded market in the same or similar line of business as the private company being valued.

4.3.2 The Valuation of Controlling Interests in Private Companies

4.3.2.1 If valuing a Controlling Interest in a private company, it is not appropriate to add a premium for control by using Acquisition Premiums as a source for the premium for control.

4.3.2.2 It may be appropriate to apply a Discount for Lack of Liquidity to reflect the absence of Liquidity in the stock as the controlling interest cannot be sold quickly for a known price;

4.3.2.3 We recognize that there are major benefits in control of a private company. These benefits are built into the valuation by using Controlling Interest cash flows.

(A) Controlling Interest cash flows are adjusted for the various financial benefits of control, that is excess compensation of Controlling stockholder, excess compensation of family members and transactions not at Arm's Length.

(B) The adjusted cash flows or earnings are called Normalized Earnings: these are economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

4.3.3 The Valuation of Non-Controlling Interests in Private Companies

4.3.3.1 If valuing a Non-Controlling Interest in a private company, the starting point may be the prices stated in the financial press for Comparable Public Companies. These are also the prices of Non-Controlling Interests.

4.3.3.2 It is not appropriate to apply a Discount for Lack of Control (DLOC) to these market prices.

4.3.3.3 It is appropriate to apply a Discount for Lack of Liquidity to reflect the absence of liquidity in the stock. as the Non-Controlling interest cannot be sold quickly for a known price. This Discount for Lack of Liquidity should be greater than for a Controlling Interest as there is no open market for such holdings;

4.3.3.4 We recognize that there are major potential disadvantages in a Non-Controlling stake in a private company. These disadvantages are built into the valuation by using Non-Controlling Interest cash flows. It may also be appropriate to apply a discount to reflect the prospect of further unfair actions by the Controlling Stockholder.

(A) Non-Controlling cash flows are the cash flows as reported by the company in its financial statements. There is no adjustment for the financial benefits of Control as those benefits are not available to the Non-Controlling Interest.

4.3.4 It is normally relatively easy to calculate the Controlling Interest cash flows: the starting point are the financial statements; the profits and cash flows in those financial statements are then increased by the various non-arm's Length transactions. The result are the cash flows available to the Controlling Interest.

4.3.5 It can be considerably more difficult to calculate the Non-Controlling Interest cash flows: this is best illustrated by an example:

4.3.5.1 A company is owned by four family members, each with %25 of the issued stock;

4.3.5.2 The four family members each work in the business and receive rewards in the form of earnings compensation and dividends;

4.3.5.3 It is necessary to determine the Market Value of one holding of %25;

4.3.5.4 Market Value is based on a notional transaction in the market-place between two anonymous Market Participants;

4.3.5.5 If a %25 stockholding is held outside the family, how will the remaining family members react?

(A) It is quite possible that they will increase their salaries and will reduce or stop the payment of dividends;

(B) How would Market Participants estimate the Non-Controlling cash flows? Should the valuer anticipate this possible reaction or should the valuer assume that the past practice of paying dividends will continue?

4.3.5.6 In these circumstances it may be necessary to value %100 of the stock, but without the benefit of the cash flows that come from control. Discounts should then be applied in order to reflect both the lack of Liquidity and the risks arising from the absence of control.

5

The Valuation Work

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5.1 Introduction

5.1.1 This chapter defines the fundamental steps that a Valuer should undertake during the valuation engagement. Our objective is to guide Valuers, as well as the relevant stakeholders (e.g. lawyers, accountants, business owners, users, etc.) to gain an understanding of the Approaches, Methods, Bases of Value, Premises and procedures that should be followed in the valuation engagement.

5.2 Valuation Process

5.2.1 For any valuation engagement, the Valuer should perform the following:

5.2.1.1 Define the engagement which includes understanding the purpose of valuation, the valuation subject being valued, the Valuation Date and the Basis of Value ("why", "what", "when" and "basis")

5.2.1.2 Collect qualitative and quantitative information about the Valuation Subject and the market it operates in;

5.2.1.3 Analyze information in relation to the following:

(A) The Valuation Subject

(B) The economic environment, which includes economic and industry growth, Risk Free Rate, interest rates and Equity Risk Premium;

(C) (The Equity Risk Premium, also known as the Market Risk Premium, is the additional rate of return required by investors over the risk-free return to reflect the additional risk of investing in Equity instruments compared to risk free instruments.)

(D) (The Risk Free Rate is the rate of return available in the market on an investment free of default risk.)

(E) The market the Valuation Subject operates in, which includes market size, outlook, historical growth rates, outlook, competitive tension, key risks, etc.;

(F) Historical and prospective financial performance

5.2.1.4 Identify any excess Assets owned by the business;

5.2.1.5 Analyze competitors and their performance in relation to Valuation Subject.

5.2.2 Work towards a valuation conclusion through undertaking the following:

5.2.2.1 Selecting appropriate valuation Approaches and Methods.

5.2.2.2 Carrying out the valuation analysis using one or two of the three Approaches and different Methods under those Approaches. It is often useful to perform a reasonableness check through the use of another Approach or Method to test the valuation conclusions reached;

5.2.2.3 Conducting other reasonableness checks on the analysis and conclusion.

5.2.3 Prepare the valuation report.

5.2.3.1 The general requirements of the report clearly detail the Purpose of the Valuation, the company and interest being valued, the valuation date, the intended users, Scope of Work, the analyses performed and the valuation conclusion;

5.2.3.2 The format of the report should be agreed as part of the Scope of Work.

5.2.3.3 IVS 2020 103.10.1 states: "It is essential that the valuation report communicates the information necessary for proper understanding of the valuation or valuation review. A report must provide the intended users with a clear understanding of the valuation."

(A) Clarity and simplicity of language is important. It can be very tempting for a Business Valuer to make his report (and therefore his work) appear complex by using language which is more technical than is necessary.

5.2.3.4 The report should also be sufficient for an appropriately experienced valuation professional with no prior involvement with the valuation engagement to review the report and understand the essential components, including the Approaches, Methods, the key inputs and the Assumptions made.

5.3 Data Collection

5.3.1 Valuation involves an initial process of collecting and analyzing information. Accordingly, at the beginning of the engagement the Valuer should obtain the relevant information to get a good understanding of the Valuation Subject and the market dynamics around it.

5.3.2 The following is a non-exhaustive list of information the Valuer should obtain to carry out the required analysis.

5.3.2.1 Qualitative background information, which includes the Valuation Subject's background, ownership structure, details on products/ services offered, SWOT analysis of the company, discussion on past performance and future trends/prospects of the company;

5.3.2.2 Audited or unaudited financial statements, annual reports, and quarterly management accounts (preferably for the past three to five years) as well as detailed Information on Intangible Assets.

5.3.2.3 Details of Non-Operating Assets.

(A) Non-Operating Assets are Assets which are not required for use in the income-producing operations of the Business.

5.3.2.4 Contingent Assets and liabilities;

5.3.2.5 fixed Assets register as at the Valuation Date or the nearest available date;

5.3.2.6 Business plan including prospective financial information and key Assumptions on which they are based;

5.3.2.7 Key Agreements such as Articles of Association, Shareholders' Agreements, franchise agreements, etc.

5.3.2.8 Other information including independent reports on the company or the industry; and

5.3.2.9 Balance sheet at the Valuation Date or close to that date.

5.3.3 During the execution phase, if the Client is unable to provide any of the information requested, the Valuer should assess the importance of the outstanding data for the valuation analysis and conclusion and proceed accordingly. For example, in the absence of an audited balance sheet as at the Valuation Date, the Valuer can use the latest available balance sheet based on the provisional statements or management accounts. The information used should be included in the report.

Refer to **Appendix** E for comprehensive list of requisite information for business valuation.

5.4 Analysis of the Valuation Subject

5.4.1 During this phase, the Valuer should analyze the following:

5.4.1.1 The Company's key historical development, including the date on which the Company was incorporated, legal structure, organization structure, shareholders, management, major events in the history of the Company, etc.;

5.4.1.2 Current operations of the Company including products and services, key suppliers and customers, the markets it operates in, the supply chain, and the numbers and categories of employees;

5.4.1.3 The ways in which the Company seeks to gain new customers;

5.4.1.4 Any unique selling points of the Company: in other words why it retains its existing customers and gains new customers;

5.4.1.5 The overall operations and business plan; and

5.4.1.6 The historical performance in relation to the competitors.

5.5 Analysis of the business environment

5.5.1 The Valuer should analyze the size, growth rate, and dynamics of the market in which the Valuation Subject is operating. This includes analyzing the following:

5.5.1.1 Current and expected state of the economy and industry;

5.5.1.2 Key supply and demand characteristics, historical and projected trends, main drivers/ trends underpinning market growth in the product categories; and

5.5.1.3 The Market's competitive intensity and critical success factors.

5.5.2 The analysis should be based on information available in market research databases (i.e. Bloomberg, Capital IQ, Capitaline, Thomson Reuters, etc.) and the public domain. In the absence of such information, primary research may be undertaken to gather market data. However, the Valuer can only work with the information he/she can access.

5.6 Historical Financial Analysis

5.6.1 To develop a conclusion about the Company's future prospects, the Valuer is required to carry out a comprehensive analysis of the Valuation Subject's financial statements covering a historical period (preferably from 3-5 five years). The historical financial information analysis should include analyzing the following:

5.6.1.1 Revenues, gross profits, operating costs, operating profits and financing and other costs;

5.6.1.2 Ratio analysis, which includes liquidity analysis, coverage ratios, and operating ratios (i.e. turnover statistics, expense to revenue ratios, etc.) For further details, refer to Appendix 6.5;

5.6.1.3 Historical trends and calculating key performance metrics which include revenue growth each year, Compounded Annual Growth Rate (CAGR), profitability margins, return on Assets, dividend cover, Return on Invested Capital, Return on Equity, net Debt and EBITDA;

5.6.1.4 Balance sheets at both the latest available date and the latest audited position.

5.6.2 In addition to the figures disclosed on the balance sheets, the Valuer should consider:

5.6.2.1 contingent and off-balance sheet Assets or liabilities;

5.6.2.2 Non-Operating Assets:

5.6.2.3 That the balance sheet figures are largely based on historic cost and may not include a very significant group of Assets, namely the Intangible Assets which the Company has created and maintained.

5.6.3 Capital expenditure incurred during the historical period and whether capital expenditures are allocated for maintenance or expansion plans;

5.6.4 Historical trends in free cash flow generated by the Company to identify and understand the underlying drivers;

5.6.5 Cash conversion rate and working capital requirements. The Cash conversion rate is the percentage of Earnings which are reflected in increased cash balances.

5.6.6 the relationship of the Compounded Annual Growth Rate (CAGR) of the revenues with the CAGR of the total Assets;

5.6.7 Consider whether Normalized Earnings should be computed by making adjustments to historical figures if relevant to Market Participants.

5.6.8 Common methods of historical financial information analysis include the following:

5.6.8.1 Common-size analysis displays line items in financial statements as a percentage of one selected or common figure. On the income statement, each line item is expressed as a percentage of sales. On the balance sheet each line item is expressed as a percentage of total Assets. Using common-size analysis helps investors and Valuers to identify changes in a firm's financial statements.

5.6.8.2 Trend-analysis compares historical financial statements, on an annual and quarterly basis. The Valuer should look for variations in sales growth, gross margin, EBITDA margin and asset utilization.

5.6.8.3 Financial ratios analysis, which typically covers five major categories; namely, profitability ratios, liquidity ratios, activity (asset utilization) ratios, leverage/coverage ratios and Du Pont Formula.

5.6.8.4 Comparative financial analysis compares the Valuation Subject's financial performance against different companies in the same industry, to get an idea of comparative performance and possible impact on the valuation.

Refer to **Appendix** J for Key Financial ratios

5.6.9 During the analysis, the Valuer should adjust the earnings for transactions not at -Arm's Length, unusual or non-recurring transactions and for the effect of Non-Operating Assets, where appropriate. The aim is to calculate the Normalized Earnings.

5.6.10 The following is a list of types of adjustments that may be applied to the historical financial statements:

(A) transactions not at Arm's Length which may be at above or below market values;

(B) One-off / non-recurring items including one off income, costs and expenses;

(C) Acquisitions / disposals;

(D) New operations or discontinued operations;

(E) Impairment charges.

(F) Exceptional foreign exchange effects

(G) Changes in accounting policies

(H) The means (and consistency) of allocation of costs between divisions;

(I) Contribution from non-consolidated

6

Valuation Premises, Approaches and Methods

6.1 Premises of Value

6.1.1 The selection of the Basis of Value will be largely decided by the nature of the instructions provided and the Valuation Purpose. The next matter for the Valuer to address is the Premise of Value.

6.1.2 A Premise of Value describes the circumstances of how an asset or liability is used. IVS describe four Premises of Value. These are:

(A) Highest and Best Use;

(B) Current Use/existing use;

(C) Orderly Liquidation;

(D) Forced Sale.

6.1.3 The first two are going concern premises and the second two are Liquidation premises.

6.1.4 The distinction between Highest and Best Use and Current Use is generally of concern for the real estate Valuer. If a business is a Going Concern, the Business Valuer normally values the operating Assets of a Business on the basis that they are being used at the Highest and Best Use.

6.1.5 The Business Valuer therefore has to decide, probably at a relatively early stage, whether the Business is likely to be valued on the going concern Premises or on the Liquidation Premises. This decision must be revisited before the Report is finalized. If the Business does not generate a sufficient return on the operating Assets, it may be worth more dead than alive. In that circumstance the Valuer has to decide on whether the Orderly Liquidation Premise or the Forced Sale Premise is the appropriate Premise.

6.1.6 If the Valuer decides that the business is not a going concern, this is a situation in which the Basis of Value then needs to change; instead of using Market Value or one of the other Bases of Value, Liquidation Value should be chosen as the Basis of Value. This is because Liquidation Value includes the costs of getting the Assets into saleable condition as well as those of the disposal activity.

6.2 Income Approach

6.2.1 There are three approaches to estimate the value of the Valuation Subject that are covered in IVS 2020, one of which is the Income Approach.

6.2.2 The Income Approach provides an indication of value by converting future cash flow to a single current value. Under the Income Approach, the value of an asset is determined by reference to the value of income, cash flow or cost savings generated by the asset. (IVS 2020 105.40.1)

6.2.3 Within the Income Approach, there are many Methods of converting expected benefit streams into value. Although there are many ways to implement the Income Approach, all methods under the Income Approach are effectively based on discounting future amounts of cash flow to present value. They are variations of the Discounted Cash Flow (DCF) method.

6.2.4 Two common Methods under the Income Approach are:

6.2.4.1 Discounted Cash Flow (DCF) Method;

6.2.4.2 Single period capitalization methods

6.2.5 There are various other specific methods under the Income Approach used for the valuation of Intangible Assets. These are covered in the relevant chapter of this manual.

6.2.6 The DCF Method is dependent on the preparation of realistic prospective financial information. The DCF Method is the most appropriate Method when reliable forecasts are provided by management.

6.2.7 The Capitalization of Cash Flows Method is one of the Methods within the Capitalization of Earnings Methods. If the cash flows are considered to increase at a constant rate in perpetuity from the valuation date this has an identical outcome to the DCF Method

6.3 Market Approach

6.3.1 The Market Approach provides an indication of value by comparing the asset with identical or comparable (that is similar) Assets for which price information is available. (IVS 2020 105.20.1)

6.3.2 Under the Market Approach, there are several recognized methods:

6.3.2.1 the pricing multiples of publicly traded stocks of comparable companies (Comparable Public Company Method or Guideline Public Company Method) or

6.3.2.2 the pricing multiples of actual acquisitions of comparable companies (Comparable Transaction Method or Guideline Transaction Method.).

6.3.2.3 Calibration to a previous transaction in the stock of the Company; Calibration is the use of relevant inputs as of the date that an earlier investment in an entity was made; updated inputs as of a subsequent measurement date are then used in order to generate the current value.

6.3.2.4 Calibration to a previous offer for the stock of the Business, if that offer was an offer made in good faith with the intention of buying at that price;

6.3.2.5 Rules of Thumb. Rules of Thumb are sector-specific valuation benchmarks. They are common in certain retail sectors with small businesses. They are sometimes based on multiples of revenue or the volume sales of specific goods or services. IVS 2020 state that Rules of Thumb should not be given substantial weight unless it can be shown that buyers and sellers place significant reliance on them.

6.4 Cost Approach:

6.4.1 The Cost Approach provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility. (IVS 2020 105.60.1).

6.4.2 It is a valuation method based on the underlying principle of substitution.

6.4.3 Within the Cost Approach, there are three primary methods:

6.4.3.1 Summation Method

6.4.3.2 Reproduction Cost Method

6.4.3.3 Replacement Cost Method

6.4.4 The Summation Method is the main method under the Cost Approach for the valuation of a Business. It involves the valuation of each of the component Assets of a Business and the deduction of the amounts payable in respect of liabilities. It is commonly used for Businesses such as real estate companies or Real Estate Investment Trusts, in which the value is in the individual Assets, with little or no Intangible Asset value.

(A) A Real Estate Investment Trust (REIT) is a corporation or trust that invests in real estate. The rules relating to REITs vary according to jurisdiction. They are commonly public companies which are not subject to corporate taxation, provided that substantially all of the income is distributed to stockholders.

6.4.5 The Reproduction Cost Method indicates value by calculating the cost to recreating a replica of an asset. This is a Method of main interest to plant Valuers.

6.4.6 The Replacement Cost Method indicates value by calculating the cost of a similar asset offering equivalent utility. This is used by Business Valuers in the valuation of certain Intangible Assets. It is also a Method of interest to plant Valuers.

6.5 Valuation Methods and Approaches Selection

6.5.1 When selecting the appropriate valuation Approach and Methods, the Valuer should consider the following factors:

6.5.1.1 The nature and size of the Business:

(A) If the Valuation Subject is a small trading company, the Comparable Public Company Method under the Market Approach is unlikely to be suitable as the main Method. IVS 2020 states that the Method should only be used when the subject business is sufficiently similar to the Comparable Public Companies. The use of the Comparable Transactions Method may provide pricing data that is more suited to the small size of the Valuation Subject.

(B) If the Valuation Subject is a Real Estate Investment Trust or a Closed End Investment Company, the Summation Method under the Cost Approach with the Highest and Best Use Premise will almost certainly be the main Method and Premise.

(C) (Closed End Investment Company (CEICs) or Investment Trusts are investment companies listed on a stock exchange that raise a fixed amount of capital through an IPO. The CEIC invests its capital in the stock of other public or private companies.

6.5.1.2 The information available:

(A) If reliable cash flow projections are not available, the DCF Method under the Income Approach cannot be used. If the Valuation Subject has historic results of modest but consistent growth over the previous few years, and the owners anticipate that this will continue, a Capitalization of Earnings Method may be appropriate.

6.5.1.3 The life cycle stage:

(A) If the Valuation Subject is a start-up with little or no revenues and negative earnings, the Summation Method under the Cost Approach is likely to be the main Method with the Highest and Best Use Premise.

(B) If the business is in its early stages of its operations but no longer a start-up and reliable forecasts are available, then using the DCF Method under the Income Approach may be more appropriate.

(C) For a mature large company, the Comparable Public Company Method under the Market Approach may be one main Method.

(D) In general, the DCF Method under the Income Approach is appropriate for businesses that are planning to experience growth or decline over the short term, before reaching a steady/stable state. It can only be used provided that reliable forecasts are available.

(E) For a larger cyclical company (such as an auto dealer or retailer of discretionary products such as large kitchen appliances) or asset management companies, which typically have a high degree of uncertainty, then using the Comparable Public Company Method under the Market Approach may be more appropriate. This is primarily because such types of companies are very subject to the economic cycle and market factors are immediately reflected in the Comparable Public Companies.

(F) For a distressed company, then using the Liquidation Value basis, the Summation Method and the Forced Sale Premise under the Cost Approach will be appropriate.

6.5.2 The Valuer should weigh the valuation results developed under different valuation Approaches to arrive at an overall valuation conclusion. The Valuer should always attempt to reconcile the valuation under the primary Approach with a secondary Approach and Method as a means of testing the conclusions reached and modifying if appropriate.

Notes:

7

Income Approach Methods – DCF

7.1 The Discounted Cash Flow Method

7.1.1 This method uses the present value concept where the value of any Asset is the present value of expected future cash flows that the asset generates.

(A) An Asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

7.1.2 If an asset is going to yield 100 in one year's time the present value is determined by discounting. This is the opposite of compounding. The formula is:

$$\frac{100}{(1+r)}$$

7.1.3 Therefore, if r, the required return, is 8%, the formula is 100/1.08 and the present value of 100 to be received in one year's time is 92.59.

7.1.4 If the asset is going to yield 100 at the end of years, 1 ,2 and 3, the formula is based on the above and is very similar. It is

$$\frac{100}{(1.08)^1} + \frac{100}{(1.08)^2} + \frac{100}{(1.08)^3}$$

7.1.5 This is 92.59 + 85.73 + 79.38 = 257.70

7.1.6 If the asset continues to yield 100 every year for a finite period, the above formula can be extended for the number of years in that finite period. However, rather than continue the work of valuing each year individually and then adding up the values for each year, the standard annuity formula would be used as a quicker way of calculating the net present value.

7.1.7 If the asset is going to yield 100 in perpetuity, then the formula is far simpler. The simplest formula, and one of the most important in understanding Business valuation is the formula for the receipt of a fixed sum in perpetuity. The formula is: $\frac{1}{r}$

7.1.8 If we use the example of 100 to be received in perpetuity and a required rate of return of %8 the formula gives a value of 100/0.08 = 1,250 for that asset.

7.1.9 The next point to make is that the above formulas apply to investments which yield a constant return. When we value Equity instruments, there is normally an expectation of growth. Although it is almost certain that the rate of growth will not be constant, the best Assumption that we can make is that, at some stage, the average rate of growth in the future can be represented by a single rate.

7.1.9 The next point to make is that the above formulas apply to investments which yield a constant return. When we value Equity instruments, there is normally an expectation of growth. Although it is almost certain that the rate of growth will not be constant, the best Assumption that we can make is that, at some stage, the average rate of growth in the future can be represented by a single rate.

7.1.10 If we assume a rate of growth of 3% and that the investment is expected to yield 200 in year 0 (that is the 12 months up to the Valuation Date) and 206 in year 1 (the 12 months after the Valuation Date), the amounts received in years 2 and 3 will be 212.18 and 218.55. If the Discount Rate is 9%, the discount factors are 0.9174 ,0.84168 and 0.77218. the net present value of those sums will be:

$$188.99 + 178.59 + 168.76 = 536.34$$

7.1.11 For most Equity instruments the Assumption is that the income will continue in perpetuity. The perpetuity formula is the Gordon Growth Model. This is based on the standard formula for an increasing annuity. The formula simplifies considerably when dealing with a perpetuity period and becomes:

$$\frac{CF_0\,(1+g)}{(K_e - g)}$$

(A) The Gordon Growth Model is a valuation tool which determines value, based on the economic benefit of a single period. That economic benefit is expected to grow at a constant average annual compound rate of growth into perpetuity.

7.1.12 In the above formula CF_0 is the cash flow in the year before the projections begin, g is the rate of growth and K_e is the standard description used for the cost of Equity.

7.1.13 We can see that r which is used when dealing with fixed returns is replaced by Ke when dealing with Equity returns. This is just a change of symbol and has no deeper relevance.

7.1.14 If we continue with the above example and consider that at the end of year 3 the income will continue in perpetuity, we can calculate the value of that perpetuity, using the Gordon Growth Model. This is known as the Terminal Value:

$$\frac{218.55 \times (1+0.03)}{(0.09 - 0.03)}$$

The product of the above formula is 3,751.70

7.1.15 The figure of 3,751.70 above is the Terminal Value at the end of year 3. That Terminal Value also needs to be discounted to the net present value. We use the year 3 discount factor of 0.77218 as used above. This gives a net present value of the Terminal Value of 2,897.00.

(A) The Terminal Value is defined as the value as at the end of the discrete projection period in a discounted future earning model. Also known as Residual Value.

7.1.16 The net present values of years 1 to 3 are added to the net present value of the Terminal Value at the end of year 3. The result is a value of 3,433.33.

7.1.17 Instead of calculating the individual figures for years 1 to 3, we can simplify the calculations. As the growth is assumed to be constant from the Valuation Date, we can just apply the Gordon Growth Model to the cash flows of the year ended on that date. The calculation is then:

$$\frac{CF_0 \times (1+g)}{(k_e - g)} = \frac{200 \times 1.03}{0.09 - 0.03} = 3{,}433.33$$

7.1.18 This demonstrates the point that is made in IVS 2020 105.50.1 that Methods under the Income Approach are effectively based on discounting future amounts of cash flow to present value.

7.1.19 Single period Capitalization at the Valuation Date can be appropriate if the Business has shown relatively stable rates of growth over several years, with those rates of growth being considered as sustainable in the future. This means that the rates of growth should not normally exceed the rate of growth in the economy in which the Business operates.

7.1.20 DCF for several years after the Valuation Date, followed by the calculation of the Terminal Value, can be appropriate if the Business is experiencing relatively high rates of growth and if reliable projections are available.

7.1.21 The value of the Valuation Subject using this approach is based on the following formula:

Formula 1: Equity Value Calculation based on the DCF Method

$$\text{Equity Value} = \sum_{t=0}^{t=n} \frac{FCFE_t}{(1+K_e)^t} + TV$$

Where; FCFE = Free cash flow to equity

K_e = Cost of equity

g = Growth rate

TV = Terminal Value

7.2 Equity Value and Enterprise Value

7.2.1 A Business can be funded by two types of financing:

7.2.1.1 Equity, being the capital provided by the owners and the profits made and retained in the Business as a result of profitable trading.

(A) Equity is defined as the owner's interest in a business after deducting all liabilities;

7.2.1.2 Borrowed funds, being funds provided by banks and other financial institutions. These funds are known as Debt. In business valuation this conventionally relates to interest-bearing Debt. This can be all interest-bearing Debt or long-term interest-bearing Debt.

7.2.2 The composition of the Equity financing and Debt financing of a business is known as the Capital Structure.

7.2.3 Equity holders expect to receive dividends when cash flow permits. They also expect that the profits made and retained will result in the value of their investment increasing over time.

7.2.4 Debt holders expect to receive interest on the Debt. They also expect the Debt to be repaid in accordance with the agreed terms.

7.2.5 The mix of Equity and Debt can vary significantly between different companies. Different owners can decide to fund their businesses in different ways.

7.2.6 There are two implications from this:

7.2.6.1 Businesses should not be valued differently just by reference to the way that they are funded;

7.2.6.2 The Market Value of the Equity of a Business should in theory be based on the optimum Capital Structure of Equity and Debt. It is normally assumed that the Capital Structure of public companies in the same sector represent the optimal Capital Structure.

7.2.7 As noted above, Businesses should not be valued differently just by reference to the way that they are funded. It is therefore very common for Valuers to value the aggregate of the Equity and the Debt. The Market Value of the Debt is then deducted in order to give the value of the Equity.

7.2.8 It is therefore possible to undertake valuations under the Income Approach either directly or indirectly:

7.2.8.1 A direct valuation of the Equity, using Free Cash Flow to Equity and an Equity cost of capital.

(A) The Free Cash Flow to Equity is the cash flow available to the Equity holders of the company after all operating expenses (including taxes, zakat), interest, principal payments and necessary investments in working and fixed capital have been paid/ made

7.2.8.2 A valuation of the Enterprise, using Free Cash Flow to the Firm and a Weighted Average Cost of Capital or WACC.

(A) The WACC is the cost of capital (Discount Rate) determined by the weighted average, at market value, of the cost of all financing sources in a Business Capital Structure.

(B) For this purpose the Enterprise is the Equity in a business plus its Debt and less any cash or cash equivalents available to repay the Debt and less any non-operating Assets in the business.

(C) For this purpose, the Firm has the same meaning as Enterprise.

7.2.9 There are various concepts introduced in the above. In the text that follows we look at the DCF Method. We will then look at the calculation of the Cost of Equity, the Cost of Debt and the Weighted Average Cost of Capital.

7.2.10 When carrying out the valuation using the DCF method, the Valuer should:

7.2.10.1 Review and analyze the Prospective Financial Information;

7.2.10.2 Choose an appropriate type of cash flow based on the nature of the Valuation Subject (i.e. Free Cash Flow to the Firm or Free Cash Flow to Equity);

7.2.10.3 Determine the appropriate Discount Rate to apply to the projected free cash flows. If the Valuer considers Free Cash Flows to Equity, the Discount Rate is the Cost of Equity. For Free Cash Flows to Firm, the Discount Rate is the Weighted Average Cost of Capital (WACC);

7.2.10.4 Calculate the Terminal Value based on the appropriate technique;

7.2.10.5 Calculate the present value of the free cash flows for each year for which separate projections have been prepared; calculate the present value of the Terminal Value. The discounting to present value should use the appropriate Discount Rate to arrive at the Equity value or the Enterprise Value.

7.2.10.6 If using Free Cash Flow to the Firm, deduct the Debt from the Enterprise Value as at the Valuation Date in order to calculate the value of the Equity.

7.3 Prospective Financial Information Review

7.3.1 Prospective Financial Information (PFI) are forecasts of financial performance used to estimate future cash flows for use in a discounted cash flow analysis. The review of Prospective Financial Information includes an entity's financial position, results of operations and cash flows for one or more future dates or periods.

7.3.2 As the PFI are based on a mixture of best-estimate and hypothetical Assumptions of future events and possible or expected management actions, they are highly subjective in nature. In this respect, the Valuer should have a clear understanding of the performance drivers and conduct reasonableness checks on the financial projections and underlying Assumptions for consistency with identified and expected trends from two perspectives:

7.3.2.1 the market outlook in which the company operates; and

7.3.2.2 the Valuation Subject's own operating characteristics and historic financial performance.

7.3.3 As part of the review process, the Valuer should carry out the following:

7.3.3.1 Review the Valuation Subject's financial model and conclude on its logical integrity and arithmetical accuracy;

7.3.3.2 Assess the reasonableness of the Assumptions used. This includes the following:

(A) Assess the projected revenue growth rates taking into consideration the size of market, the Company's size, historical growth rate, operating model, growth plans, market outlook and magnitude and sustainability of competitive advantage;

(B) Assess the gross margins and operating margins based on the Company's historical performance and margins achieved by the comparable companies. The Valuer may get access to competitors' information through annual reports, investor presentations and analyst reports of comparable companies;

(C) Assess whether the capital expenditure estimates appear to be sufficient to sustain the future growth rates the company has projected;

(D) Validate if there is enough workforce to achieve the forecasted growth rates and what will be the increase in direct costs and fixed expenses to achieve the projected revenues;

(E) Understand how the Business manages its working capital and accordingly assess the reasonableness of working capital Assumptions; and

(F) Validate if the company can access adequate funding (Equity or Debt) for the increase in both fixed Assets and working capital.

7.3.3.3 Examples relating to the above assessment are:

(A) if a Business has historically made an operating margin of 9% of revenue, strong evidence is needed if the projections show operating margins of 12% of revenue: if it is anticipated that the gross profit margin will improve, this needs to be understood; if the administrative expenses are a reducing percentage of sales revenues, it needs to be established if this is realistic or whether more administrative support will be needed;

(B) if the Business has been growing at a relatively consistent rate of 3% a year in the past, convincing explanations are needed as to a higher rate of growth in the projections. If this is the result of new products or new customers, the Client should be able to explain how such growth is to be achieved.

(C) If the Business has had 55 to 60 days in receivables in previous years, the projections would normally assume the same in the future.

7.3.3.4 assess the appropriate Discount Rate that would capture the risks associated with achieving these projections;

7.3.3.5 If applicable, validate the first year's projection based on the year to date performance and the pipelined projects or signed order book with the company.

7.3.4 In the absence of detailed projections, the Valuer may support the Valuation Subject's management with the preparation of projections:

7.3.4.1 The Valuer can provide an excel-sheet financial model for the Company based on the identified cost and revenue drivers for the agreed-upon projection period;

7.3.4.2 the Valuer can only support the Company's Management in developing their forecasts. The Assumptions on which the projections are based must be those of management.

7.3.4.3 As noted earlier, if the Valuer carries out the role of converting the Client's Assumptions into projections, it is very important that there is a separate check of the calculations within the projections.

7.4 Equity Cash Flows and Enterprise Cash Flows

7.4.1 As noted previously, the Valuer may select from one of the two conventional valuation techniques; these are "Free Cash Flows to Equity (FCFE)" and "Free Cash Flows to the Firm (FCFF)", where:

7.4.1.1 Free Cash Flow to Equity (FCFE) is the cash flow available to the firm's Equity (the common stockholders) once operating expenses, interest and taxes, expenditures needed to sustain the firm's productive capacity, and payments to (and receipts from) Debt Holders are accounted for.

7.4.1.2 Free Cash Flow to the Firm (FCFF) is the cash flow available to the firm's Equity Holders and Debt Holders once operating expenses and taxes, and expenditures needed to sustain the firm's productive capacity are accounted for.

7.4.2 The differences between the two types of cash flow are:

7.4.2.1 The Free Cash Flow to Equity is after interest paid on the Debt and is after the repayment of Debt and any receipts of further Debt. The tax is the tax payable on the profits of the Business;

7.4.3 FCFF is considered to be the more appropriate valuation technique in most situations if the Capital Structure includes Debt.

7.4.4 The Free Cash Flow to Equity and Free Cash Flow to the Firm are computed as follows:

Free Cash Flow to Equity	Free Cash Flow to the Firm
Operating profit	Operating profit
Less: interest expense	
Equals earnings before tax	
Less: tax expense	Less tax on operating profits
Equals Net Income After Tax	Equals Net Operating Profit After Tax
Add depreciation/amortization	Add depreciation/amortization
Less: capital expenditures	Less: capital expenditures
Less: increase in working capital	Less: increase in working capital
Less: Debt repayments	
Add: New Debt received	
Equals FCFE	Equals FCFF

7.4.5 Both FCFF and FCFE can be computed from Net Income After Tax, cash flow from operations, EBIT or EBITDA, as detailed below:

Formula 2: Free Cash Flow Calculation

Determining FCFF from Net Income:

FCFF=Net Income+Depreciation expenses+interest expense*

(1— tax rate)—Change in working capital—Investment in fixed assets

Determining FCFF from EBIT:

FCFF=EBIT*(1—Tax rate)+Depreciation expense —

Change in working capital—Investment in fixed assets

Determining FCFF from EBITDA:

FCFF=EBITDA*(1—tax rate)+Depreciation expense*tax rate—

Change in working capital—Investment in fixed assets

Determining FCFE from FCFF:

FCFE=FCFF—Interest expense*(1—tax rate)+increase in net borrowing

7.4.6 The above information includes an add-back for depreciation/amortization. This is because they both represent a non-cash expense. There are some other similar non-cash expenses which also need to be added back to compute the cash flows:

7.4.6.1 Losses on disposal of fixed Assets (profits on disposal are deducted);

7.4.6.2 Impairment provisions made;

7.4.6.3 Other provisions made (such as provisions for the closure of a business segment).

7.4.7 Other adjustments include:

7.4.7.1 Changes in working capital, which includes inventory, current Assets, advances, trade receivables and payables, etc. As a Business increases in size, even if that increase is only as a result of inflation, there is normally an increase in working capital. This means that more funds are invested in working capital and the free cash flows therefore reduce.

7.4.7.2 Investment in fixed Assets; these represent the cash outflow made to purchase fixed Assets necessary to support the company's current and future operations. Accordingly, the free cash flows are reduced by such investment. Even if growth is modest, there is an expectation that the capital expenditures in the projections will be somewhat greater than the depreciation charges.

7.5 Calculating The Discount Rate

7.5.1 The application of the DCF method requires the determination of an appropriate Discount Rate at which future cash flows are discounted to their present value as at the Valuation Date.

7.5.2 The Discount Rate reflects the perceived risk associated with the projected future cash flows. It is based on the Valuer's assessment of the returns on capital expected by Market Participants to match the risks involved.

7.5.3 The Cost of Equity (COE) is the rate for discounting FCFE. The Weighted Average Cost of Capital (WACC) is the appropriate rate for discounting FCFF.

(A) The Cost of Equity is the rate of return Equity holders expect in return for investing in the Equity securities of company i.e. compensation for undertaking the risk of owning Equity interests.

(B) The Cost of Debt is the effective rate a company pays on its Debt obligations

(C) The Weighted Average Cost of Capital is the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in a Business Capital Structure.

Formula: CAPM

$K_e = rƒ + β χ (rm - rƒ) +α)$

Where,

K_e = Cost of Equity

rf =Risk-free rate of return.

rm= Market risk premium

α= Unsystematic (company-specific) risk factor

7.6 Cost of Equity

7.6 Cost of Equity

7.6.1 There are many methods to determine COE: a non-exhaustive list of common methods includes the Capital Asset Pricing Model (CAPM), the Arbitrage Pricing Theory Model, the Build-up Model and multi-factor models. However, CAPM is the most common method used to calculate the COE.

(A) The Capital Asset Pricing Model is an asset pricing model used to determine the expected rate of return of a security by adding a risk premium to the rate on a risk-free security. The risk premium is comprised of the Equity (or Market) Risk Premium adjusted by the Systematic Risk (or Beta) of the security.

(B) The Arbitrage Pricing Theory Model is a multi-factor asset-pricing model, which predicts an asset's returns using the relationship between the asset and macroeconomic risk factors. It incorporates several systematic risk factors.

(C) The Build Up Model is a model used to calculate the required rate of return on a security by adding various risk premiums to the risk-free rate. For example, the build-up model may comprise risk free rate, Equity risk premium, size premium and company specific risk premium. It differs from CAPM as Beta is not used to adjust the Equity risk premium.

7.6.2 CAPM estimates the rate of return required by investors taking into consideration the Valuation Subject's risk profile. The formula is given below.

$$K_e = rf + \beta \chi (r_m - r_f) + \alpha$$

7.6.3 In the formula above K_e is the Cost of Equity, rf is the risk free rate, β is Beta, r_m is the return expected by the Market and α is the Company Specific Risk Premium.

(A) Beta is a measure used to assess the systematic risk or relative volatility of a single security or portfolio, relative to the overall market. It is computed as the volatility of a security (as measured by standard deviation) relative to the volatility of the market, multiplied by the correlation of the security with the market.

(B) The Company Specific Risk Premium is the additional risk arising from factors other than those factors correlated with the investment market. The investor requires an additional return to compensate for the additional risk.

7.6.4 In the modified CAPM Model the required return is a function of five variables, which are:

7.6.4.1 the Risk Free Rate;

7.6.4.2 the Beta for the Valuation Subject's business sector;

7.6.4.3 the moderation of the Beta for the relative amount of Debt in the Valuation Subject

7.6.4.4 the Equity risk premium; and

7.6.4.5 The additional Company-Specific Risk Premium,

7.6.5 The Risk-Free Rate of return is typically obtainable from a government security of equivalent maturity to the projection period and consistent with the currency considered in the projections. The Valuer may use the yields on the 30-year US treasury bonds, and if the forecast currency is in Saudi Riyal, adjust for the inflation differential between US and Saudi Arabia. Alternatively, the Valuer could directly use the yields on the Saudi government long term bonds.

7.6.6 Beta is a measure used to assess the systematic risk or relative volatility of a single security or portfolio, relative to the overall market.

7.6.7 As noted above, it is computed as the volatility of a security (as measured by standard deviation) relative to the volatility of the market. The second stage in the calculation is to multiply the result of the first stage by the correlation of the security with the market. It is common to compute Beta based on data on the public companies for three years or for five years. There is therefore another Assumption: that future volatility is likely to be consistent with the volatility of the past.

7.6.8 The Assumption is that volatility is a proxy for risk: a stock which increases and decreases in value by more than the movements in the market is more volatile than the market; Market Participants then require higher returns in order to compensate for that higher volatility.

7.6.9 Sectors with relatively stable demand, such as water companies, power generation and other utilities will normally have a Beta of less than one: they are expected to deliver stable returns and are not greatly affected by short-term economic factors.

7.6.10 Sectors which are subject to great uncertainty, such as high – technology companies developing new products, will tend to be more volatile and to have Betas of more than one.

7.6.11 Betas reported in public sources are leveraged, which means that the additional risk to a stockholder due to the Debt financing of the company is incorporated in the corresponding Beta. In this respect, when calculating the Cost of Equity for the Valuation Subject, the industry Beta needs to be unlevered and re-levered to take into consideration the differences in capital structure, using the following formulas.

Formula: Un-levering and Re-levering Beta

$$B_u = \frac{B_L}{[1 + ((1 - T_c) \times (\frac{D}{E}))]}$$

$$B_L = B_u \times [1 + ((1 - T_c) \times (\frac{D}{E}))]$$

where; B_u=Unlevered beta

B_L=Levered beta

T_c=Tax rate

D/E=Debt to equity

7.6.12 Market Risk is the risk that is present in the entire market and that cannot be diversified. This is also known as Systematic Risk. The Equity Risk Premium is defined as the additional rate of return required by investors over the risk-free return to reflect the additional risk of investing in Equity instruments compared to risk free instruments. It is the premium that investors demand for investing in risky investments relative to risk-free ones. This is primarily attributed to three main factors:

7.6.12.1 The lowest risk investment in the currency of any country is lending to the government of that country. Higher returns are required to compensate for the additional risk of investing in Debt securities issued by public companies. Those Debt securities are, in turn, more certain in respect of

returns and the repayment of the capital than investing in the Equity securities of public companies. Equities therefore require a return which is higher than government Debt and which is also higher than corporate Debt. If Equity securities did not generate higher returns than both government bonds and corporate bonds, modern free market economies could no longer function.

7.6.12.2 The results of long-term empirical studies conducted, which indicate that investments in shares have historically yielded higher returns than investments in government bonds;

7.6.12.3 the comparison of current market prices with consensus earnings estimates for public companies also indicate higher returns for Equities.

7.6.13 There are three sources of data for the Equity Risk Premium:

7.6.13.1 Analysis of historic Equity Risk Premiums over many years;

7.6.13.2 Forward looking Risk Premiums, computed on the basis of Analysts' consensus views on future returns of public companies;

7.6.13.3 Surveys of Market Participants.

7.6.14 Dimson Marsh and Staunton of the London Business School analyze average Equity Risk Premiums over many countries for the period from 1900 to date;

7.6.15 Aswath Damodaran undertakes forward looking calculations of Equity Risk Premiums for USA stocks. His website is an extremely useful resource on many aspects of the USA market and of Business valuation generally.

7.6.16 Pablo Fernando of the University of Navarre undertakes an annual survey of the views of Market Participants as to the Equity Risk Premiums in different countries.

7.6.17 A reliable source for extracting and quantifying the Equity Risk Premium is Duff & Phelps international cost of capital resources.

7.6.18 It is important to recognize that the theory behind the CAPM model relates to the pricing of a single security which is held as part of a fully diversified portfolio. When a security is a small part of a large diversified portfolio the Unsystematic Risk within that individual business is almost entirely removed by diversification.

(A) Unsystematic Risk is defined as the risk specific to an individual security that can be minimized through diversification.

7.6.19 Many small Business owners do not diversify their risk in this way. This is one justification for the inclusion of a Company Specific Risk Premium (see below).

7.7 Equity Size Premium (Small Stock Premium)

7.7.1 In some Business Valuation firms, an Equity size premium (also known as the small stock premium) is added to CAPM calculations to capture additional return expectations on small companies. The theory is that the investors demand a higher rate of return on small companies than they do on large companies due to the increased risk associated with investments in small companies.

7.7.2 The Size Premium was first identified in the USA markets in 1980 in an academic article by Ralf Banz. He calculated that smaller stocks had delivered higher returns in the periods from 1926 to that date.

7.7.3 The Size Premium needs to be treated with extreme caution:

7.7.3.1 It has not been a feature of the USA markets since 1981. The study by Ralf Banz led to the creation of many small stock funds. It is possible that these removed the market inefficiency which had led to the small stock premium

7.7.3.2 Valuers who include a size premium are therefore relying on excess returns made prior to 1981;

7.7.3.3 There are many other factors which have to be removed from the data:

(A) smaller companies often have a higher Beta;

(B) they are subject to a larger Bid-Ask Spread; a Bid-Ask Spread or Bid-Offer Spread is the difference between the price at which an investor can purchase (the ask or offer price) and at which it can sell (the bid price) of a security. Less liquid stocks and smaller stocks have a larger spread between the purchase and the selling price;

(C) some companies are not risky because they are small – they have lower market capitalizations as they are risky;

(D) some of the smaller companies are distressed;

(E) others are not yet generating revenues;

(F) part of the premium may be due to the reduced liquidity of the stock.

7.7.4 Therefore, any analysis of the data needs to control for a significant number of variables apart from size.

7.7.5 Aswath Damodaran, a highly regarded American academic, who undertakes forward looking studies of Equity Risk Premiums as referred to above, has stated that his studies do not show a small stock premium.

7.8 Company Specific Risk Premium

7.8.1 The Company Specific Risk Premium is the additional risk arising from factors other than those factors correlated with the investment market. The investor requires an additional return to compensate for the additional risk. A Company Specific Risk Premium is added in the CAPM calculation to capture the inherent operational and financial risk the business is exposed to, such as:

7.8.1.1 The absence of diversification for many Market Participants in the small Business market;

7.8.1.2 Product/service offering risk: a lower Discount Rate would be applied where a product or service is protected by patent, exclusive agencies or copyright, or has brand name recognition than if no such protection existed.

7.8.1.3 Type of contractual arrangement. The Valuer should apply a lower Discount Rate if the Valuation Subject has long-term contracts or exclusive franchise agreement in place.

7.8.1.4 Customer concentration risk; a higher discount would be applied if the company is highly dependent on a few customers.

7.8.1.5 Product or service concentration: a Business with few product or service lines would normally require a higher Discount Rate than one with a wider offering;

7.8.1.6 Depth of management and management succession. Many smaller Businesses have one or two excellent managers and leaders. However, the Business may be very dependent upon them continuing in post.

7.8.1.7 The Company Specific Risk Premium is mostly judgmental and subjective. The above factors are only some of the considerations to be taken into account.

7.9 CAPM Application and the Build-Up Model

7.9.1 If we assume a Risk Free Rate of 3%, a relevered Beta of 1.2, an Equity Risk Premium of 5% and a Company Specific Risk Premium of 4%, the calculation of the cost of Equity capital is:

$$3\% + (1.2 \times 5\%) + 4\% = 13\%$$

7.9.2 Some practitioners prefer to use the Build-Up Model in order to derive the cost of Equity capital. The Build-Up Model is a model used to calculate the required rate of return on a security by adding various risk premiums to the Risk Free Rate. For example, the build-up model may comprise the Risk Free Rate, an Equity Risk Premium, a size premium and a Company Specific Risk Premium. It differs from CAPM as Beta is not used to adjust the Equity Risk Premium.

7.9.3 If we use the same inputs above, and calculate the cost of capital using the Build-Up Model, we derive a slightly lower cost of capital:

$$3\% + 5\% + 4\% = 12\%$$

7.9.4 This illustrates that in the Build-Up Model a further adjustment is needed to take account of the sector in which the business operates. If the Valuer decided that the business sector justified a specific addition to the Equity Risk Premium of 1%, the two models would result in the same cost of Equity capital.

7.10 Cost of Debt

7.10.1 The Cost of Debt (COD) is the expected return that Debt holders would accept when investing in a security that has a default risk. A default risk is the risk of not receiving the promised payments in the form of interest payments and principal repayment.

7.10.2 COD is a function of the Risk Free Rate and a default spread. The largest and most profitable companies will have a small default spread when compared to risk free securities. Smaller and less stable companies will have a larger default spread.

Formula: Cost of Debt Formula

$$COD = R_d \times (1 - T_c)$$

where; COD=Cost of Debt

R_d=Cost of Debt

T_c=Effective tax and zakat rate

7.10.3 The Cost of Equity is stated on an after-tax basis. This is because Business profits are generally subject to tax or zakat.

7.10.4 The Cost of Debt is treated differently: as the interest payments are an allowable deductible expense as per the Saudi tax and zakat regulations, the Cost of Debt needs to be adjusted for such benefit. Hence, the Valuer should consider the Cost of Debt after the benefit of relief from tax and zakat.

7.10.5 As an example, if the pre-tax interest on the Debt is 4% and the zakat rate is 25% the calculation of the Cost of Debt is:

$$4\% \times (1 - 25\%) = 3\%$$

7.11 Weighted Average Cost of Capital (WACC)

7.11.1 To calculate the Valuation Subject's WACC, the Cost of Equity, the Cost of Debt and the optimum Capital Structure are determined. The next stage is to input the Cost of Equity and the Cost of Debt. These two costs have to be weighted according to the Capital Structure. The formula for the WACC looks rather challenging. However, it is far simpler than it appears.

Formula: WACC Formula

$$WACC= \frac{E}{E+D} * K_e + \frac{D}{E+D} * R_d + (1 - Tc)$$

where; WACC=Weighted Average Cost of Capital

K_e=Cost of equity

R_d=Cost of debt

E=Market value of equity

D=Market value of interest bearing debt

T_c=Effective tax and zakat rate

7.11.2 From previous examples we have a Cost of Equity under CAPM of 13%; the Cost of Debt, after tax relief, is 3%. If we assume that the Capital Structure comprises 75 million Equity at Market Value and 25 million of Debt, again at Market Value, the calculation of the Weighted Average Cost of Capital or WACC is:

$$(13\% \times \frac{75}{100})+(3\% \times \frac{25}{100}) = 9.75\% + 0.75\% = 10.5\%$$

7.12 Discounting Future Cash Flows

7.12.1 If undertaking a direct valuation of the Equity, the Free Cash Flow to Equity should be calculated. An Equity Discount Rate (that is the Cost of Equity) should be used.

7.12.2 If undertaking an indirect valuation of the Equity (through calculation of the Enterprise Value and deducting the value of the Debt) the Free Cash Flow to the Firm should be calculated. A Weighted Average Cost of Capital (WACC) should be used as the Discount Rate.

7.12.3 Future free cash flows should be discounted using the Discount Rate determined on the following basis:
Cash Flow / (1 + Discount Rate) ^ (Year-Valuation Date)

7.12.4 We can apply this formula in practice: if we assume cash flows of 100 (year 1) and 105 (year 2) , a Discount Rate of 11%, and discounting the first and second year after the valuation date, the calculations are:

$$\frac{100}{(1+.11)^{1}} \text{ and } \frac{105}{(1+.11)^{2}} = \frac{100}{1.11} + \frac{105}{1.2321} = 90.09 + 85.22 = 175.31$$

7.12.5 The above technique assumes that the free cash flows for a given year come at the end of that year. However, this may be inaccurate if the cash is generated throughout the year.

7.12.6 To account for this, Mid-Year Discounting may be used.

(A) Mid-Year Discounting is a convention used in the discounted future earnings method that reflects economic benefits all being generated at the middle of the year. It is also known as the Mid-Year Convention.

7.12.7 Hence, the following formula may be used:
Cash Flow / (1 + Discount Rate) ^ ((Year-Valuation Date)-0.5)

7.12.8 Using Mid-Year Discounting factor is considered by many to be best practice for discounting free cash flows as the cash flows to the Business typically occur throughout the year. If we continue the above example, but use Mid-Year Discounting, the calculations are:

$$\frac{100}{1.11^{0.5}} + \frac{105}{1.11^{1.5}} = \frac{100}{1.0536} + \frac{105}{1.169} = 94.91 + 89.79 = 184.70$$

7.12.9 With the above inputs the use of Mid-Year Discounting has increased the value by 5.4% over the year end Discounting.

7.12.10 For complete years there is a short-cut way of obtaining the same result: if the year-end discounting value is multiplied by $(1 + \text{Discount Rate})^{0.5}$ the Mid-Year Discounting result is obtained:

$$175.31 \times 1.11^{0.5} = 175.31 \times 1.0536 = 184.70$$

7.12.11 However, where the cash flows of the Valuation Subject are not earned evenly throughout the year, a year-end discounting period can be applied based on the economic reality of the Valuation Subject. The Valuer needs to assess whether a mid-year or year-end discounting is appropriate.

7.13 Terminal Value

7.13.1 The final component of DCF is the Terminal Value.

(A) Terminal Value is the value as at the end of the discrete projection period in a discounted future earning model. Also known as Residual Value.

7.13.2 The Terminal Value should be discounted back to the present value using the final year's Discount Rate to arrive at the present value of the Terminal Value.

7.13.3 If the Income Approach is continued, the Gordon Growth model should be used to determine the perpetuity value at the end of the explicit forecast period. As a reminder, the Gordon Growth Model formula is:

$$\frac{CF_0 \times (1 + g)}{K - g}$$

7.13.4 In the above formula CF_0 is the cash flow in the final year of the explicit forecasts, g is the perpetual rate of growth and K is the cost of capital (the cost of Equity if using Free Cash Flows to Equity and WACC if using Free Cash Flows to the Firm).

7.13.5 However, there is a choice to the Valuer in computing the Terminal Value; there are the following three models.

7.13.5.1 Gordon Growth Model – Income Approach

(A) This model assumes the company will generate free cash flows at a normalized rate in perpetuity, which is known as the Terminal Growth Rate (TGR). This rate is usually assumed to be in line with the inflation with the GDP growth rate as a ceiling rate.

(B) The TGR could be zero or negative if the Business is not growing in line with inflation.

Formula: Terminal Value calculation based on Gordon Growth Model

$$\text{Present Value of Terminal Value (TV)} = \frac{FCF_n (1 + g)}{(k - g)} \times \frac{1}{(1 + k)^n}$$

Where;FCF=Free cash flow

K=Cost of Equity or WACC

g=Growth rate

n = number of years in explicit forecast period

7.13.5.2 Exit multiple – Market Approach

(A) The exit multiple, also referred to as terminal multiple, assumes that the business will be valued at the end of the projection period, based on market multiples.

(B) The Terminal Value is computed by applying an appropriate multiple (of earnings, revenue or book value, etc) to the relevant statistic projected for the terminal year.

(C) Care is needed when applying this technique:

(1) The switch from the Income Approach can lead to inconsistencies – the Capitalization Rate in the Market Approach should be compared to the Discount Rate in the Income Approach to ensure that the implied rate of growth is reasonable;

(2) The Business may be being valued at the start of a period of high growth – and that is why explicit projections have been prepared for several years. The Terminal Value is at the end of such a period of high growth; therefore, different valuation metrics are appropriate from those applying at the start of the period of rapid growth. If the exit multiple is derived from the entry multiple, the Terminal Value may be overstated.

7.13.5.3 The calculation and application of valuation multiples is discussed in detail in the Market Approach section.

Formula: Terminal Value calculation based on P/E multiple

$$\text{Terminal Value in year t} = \text{earnings in year t} \times \text{Trailing} \frac{P}{E}$$

$$\text{Terminal Value in year t} = \text{earnings in year (t + 1)} \times \text{Leading} \frac{P}{E}$$

Where, $\frac{P}{E}$ = Price to earnings ratio

Trailing $\frac{P}{E}$ uses the current share price and divides by the total earnings per share over the past 12 months.

Leading $\frac{P}{E}$ uses the current share price and divides by the total earnings per share forecast over the next 12 months.

Terminal Value calculation based EV/EBITDA multiple

$$\text{Terminal Value in year t} = \text{EBITDA in year t} \times \text{trailing} \frac{EV}{EBITDA}$$

$$\text{Terminal Value in year t} = \text{EBITDA in year (t + 1)} \times \text{leading} \frac{EV}{EBITDA}$$

Where, $\frac{EV}{EBITDA}$ = Enterprise value to EBITDA ratio

Trailing $\frac{EV}{EBITDA}$ uses the enterprise value divided by EBITDA per share over the past 12 months.

Leading $\frac{EV}{EBITDA}$ uses the enterprise value divided by EBITDA forecast over the next 12 months.

7.13.5.4 Salvage value – Cost Approach

(A) The Salvage Value is the Terminal Value of an asset computed under the Cost Approach. The Salvage Value is the proceeds of sale less all the costs of disposal

(B) This normally only applies when a Business is expected to have a finite life (i.e. the operation of open cast mineral extraction or an oil well). The expectation is that there will be a limited number of years of revenue generation. At the end of that period there may be a Salvage Value. The Salvage Value may be less than the costs of site clearance and land remediation.

(C) The DCF forecast would probably be based on the actual life of the Valuation Subject. If the Business operations were expected to decline at a consistent rate the formula for a changing annuity could be used as an alternative.

(D) As an example, if an oil well had a life of 25 years, following which the facility would need to be dismantled, the projections would cover the 25 year life of the well. The Salvage Value would then be calculated.

(E) While Terminal Value may be computed either by the constant growth model or exit value or Salvage Value, the resulting Terminal Value should be crosschecked using other methods. For example, if the Valuer used the Gordon Growth Model to arrive at the Terminal Value, the implied multiple should be computed and compared with the industry multiples. Likewise, if the Valuer considered the exit multiple to arrive at the Terminal Value, the implied terminal growth rate should be computed to ensure that it is not significantly far from the economy's growth rate.

Example: Terminal Value calculation based on P/E multiple

Abdullah & Co. will generate SAR 60 Mn of revenues 10 years from now and the exit price to sales multiple for the industry at the terminal year is 2.0x. The Terminal Value at the end of 10th year would be 60x2 = SAR 120 Mn.

Formula 9: Implied Terminal Value

$$\text{Implied terminal EBITDA multiple} = \frac{\text{Terminal value}}{\text{EBITDA terminal year}}$$

Implied terminal growth rate=

(Terminal value*WACC — EBITDA terminal year) / Terminal Value + EBITDA terminal year)

where,terminal value=

value of valuation subject beyond explicit forecast period

EBITDA terminal year = EBITDA during the terminal year

WACC=Weighted Average Cost of Capital

Notes:

8

Income Approach Methods - Capitalized Earnings and Other Methods

8.1 Capitalized Earnings

8.1.1 This method is also known as Capitalization of Cash Flow Method and is typically used when stable growth is a reasonable Assumption.

8.1.2 Under this method, free cash flow for the first year after the Valuation Date is divided by a Capitalization Rate to arrive at the Equity Value or the Enterprise Value.

8.1.3 This is simply the use of the Gordon Growth Model as at the Valuation Date, rather than at the end of a discrete projection period.

8.1.4 As an example, a health supplies business has shown a rate of growth which has

Formula: Enterprise and Equity Valuation based on Capitalized Cash Flow Method

$$\text{Enterprise value} = \frac{FCFF}{WACC - g}$$

$$\text{Equity value} = \frac{FCFF}{WACC - g}$$

Where;FCFF=Free cash flow to firm

FCFE=Free Cash Flow to Equity

g=Growth rate

COE = Cost of Equity

averaged 3.5% a year over the last ten years. Management consider that growth will be at a similar rate in the future. The business has no borrowings. The Free Cash Flows to Equity for the last 12 months were 1 million. The discount rate is 12%. The calculation of the Value of the Equity, using the Gordon Growth Model are:

$$\frac{1{,}000{,}000 \times 1.035}{12\% - 3.5\%} = 12{,}176{,}000$$

8.2 Dividend Discount Method

8.2.1 The dividend discount method is a technique of valuing a company, on the basis that the price of stock is equivalent to the sum of all of its future dividends, discounted to present value. This technique can be used to value minority interests in a company.

8.2.2 This is an alternative means of valuing a Business, if the dividends are anticipated to remain as a constant percentage of the earnings of the Business.

8.2.3 The model uses dividend payments and a dividend yield to calculate the value of stock. The dividend yield is a Capitalization Rate.

8.2.4 Assuming stable growth for the company's dividends (which is usually true for mature companies), this can be rewritten as

$$\text{Equity value} = \frac{\text{Dividend}}{\text{dividend yield}}$$

8.2.5 This is just a variation on the Capitalization of Earnings Method, using the dividends as the relevant cash flows rather than the Free Cash Flows to Equity.

8.2.6 It is important to recognize that a public company can be valued based on a Capitalization Rate of Earnings (the price earnings ratio) or based on a different Capitalization Rate of dividends (the dividend yield). Both techniques refer to the same value of the Public company's shares.

8.3 Excess Earnings Method

8.3.1 Excess earnings are the company earnings less the required return on working capital and fixed Assets.

8.3.2 This is a Method which is used for the valuation of Intangible Assets. This is the Multi-Period Excess Earnings Method for the valuation of the most important Intangible Asset. It is covered in the relevant chapter.

8.3.3 It was for some years a conventional means of valuing trading businesses. However, it is not now in general use for the purpose. It is included here for completeness.

8.3.4 This method can be used for small firms where their Intangible Assets are significant and the tangible net Assets are very small.

8.3.5 Under the excess earning method or residual income method, enterprise value will be as follows:

> **Formula:** Enterprise Value based on excess earnings method
>
> **Enterprise Value =** Working Capital + Fixed Assets + value of Intangible Assets
>
> **Present value of Value of Intangible Assets=** Present value of excess operating profits

8.3.6 Steps in applying the excess earning method are:

8.3.6.1 Estimate fair value of working capital and fixed Assets;

8.3.6.2 Determine the normalized net operating profit after tax (NOPAT) of the company;

8.3.6.3 Develop costs of capital for working capital and fixed Assets. Working capital is viewed as the lowest risk and most liquid asset with lowest rate of return. Fixed Assets require a higher rate of return compared to working capital;

8.3.6.4 Calculated required return for working capital and fixed Assets and deduct this from normalized NOPAT to determine excess earning of the company;

8.3.6.5 The excess earnings are capitalized using a capitalization rate to estimate the value of Intangible Assets; and

8.3.6.6 Calculate the value of Firm: the value of Firm is the sum of working capital, fixed Assets, and Intangible Assets.

Notes:

9

Market Approach Methods

9.1 Introduction

9.1.1 The Market Approach provides an indication of value by comparing the asset with identical or comparable (that is similar) Assets for which price information is available. It is based on what other purchasers in the market have paid for companies that can be considered reasonably similar to the Valuation Subject.

9.1.2 Two frequently used valuation methods under the Market Approach are the Comparable Public Companies Method and the Comparable Transactions Method.

9.1.3 Valuation under both Methods are typically carried out using Price Multiples and Enterprise multiples from trade data for public companies and public and private transactions, where:

9.1.3.1 Price multiples are ratios of a company's market price per share to some fundamental value of the company per share. Listed below are some of the more common price multiples.

(A) Price / Earnings (P/E) ratio: There are two versions of the P/E ratio: trailing and leading P/E. The P/E multiple is a reasonable multiple if the Valuation Subject has a similar capital structure to comparable companies. If not, it can deliver misleading results as it is a relatively unsophisticated tool (but is in wide general use in the financial press).

$$\text{Trailing } \frac{P}{E} = \frac{\text{market price per share}}{\text{EPS over previous 12 months}}$$

$$\text{Leading } \frac{P}{E} = \frac{\text{market price per share}}{\text{Earnings Per Share over next 12 months}}$$

(B) P/B multiple: price to book multiple is defined as

$$\frac{P}{B} = \frac{\text{market price of equity}}{\text{Book value of equity}}$$

(C) P/S multiple: price to sales multiple is defined as

$$\frac{P}{S} = \frac{\text{market price of equity}}{\text{total sales}}$$

(1) The Price to sales multiple is an Enterprise Value measure. It should only be used as an Equity measure if there is no Debt in the Capital Structure

9.1.3.2 Enterprise multiples are ratios of the Enterprise Value of a company to some relevant measure of fundamental value of the company. Listed below are some of Enterprise multiples.

(A) EV/EBITDA multiple: EV to EBITDA multiple is a widely used Enterprise Value multiple. It can only be used between businesses in the same sector with similar levels of fixed Assets. A major advantage of this multiple is that the amortization of intangibles is ignored. A major disadvantage is that capital intensive companies cannot be compared with those with only modest tangible fixed Assets.

(B) EV/Earnings Before Interest, Tax and Amortization (EV/EBITA). This is less common than EV/EBITDA. However, it is a multiple that recognizes that depreciation of tangible Assets is a real, consistent economic cost. This is not the case with the amortization of intangibles.

(C) EV/sales multiple: EV/sales is only appropriate if the Valuation Subject and Comparable Public Companies have similar profit margins.

(D) EV/Earnings Before Interest and Tax (EBIT) multiple: This multiple can be used, as an alternative to EV/EBITA, if there is no significant amortization of Intangible Assets.

(E) EV/Net Operating Profits After Tax (NOPAT): this is the post-tax equivalent to the EV/EBIT multiple. It is useful, as NOPAT is the starting point for computing the Free Cash Flows to the Firm.

(F) In limited situations, alternative multiples based on non-financial data can provide useful insights, especially for new companies with unstable revenues or negative profitability. The non-financial multiple must be a reasonable predictor of future value creation and correlated with the growth and Return on Invested Capital metrics. For example, to value internet start-ups, the Valuer may use Enterprise Value to website hits, Enterprise Value to number of subscribers or Enterprise Value to unique customers. The Valuer should consider the Cost Approach as a check to ensure that the valuation conclusion is reasonable, given the state of the business. The check to the Cost Approach allows the indicated value of the Intangible Assets to be identified.

9.1.4 The Market Approach requires valid transactions and valid reporting of such transactions. For the Comparable Public Companies Method, this is in the form of regular and free trades in the stock of public companies in a liquid market. There is then a need for reliable data on such trades. For Comparable Transactions there needs to be a database which gives information on the companies purchased, the prices paid and the financial results of such companies.

9.1.5 Another requirement is that the Comparable Public Companies and the Comparable Transactions should be similar in terms of size (i.e., revenues, net income, etc.), product/services offering, industry, growth prospects etc.

9.1.6 IVS 2020 states the following: “There must be a reasonable basis for comparison with, and reliance upon, similar businesses in the Market Approach. These similar businesses should be in the same industry as the subject business or in an industry that responds to the same economic variables.”

9.2 Comparable Public Companies Method’

9.2.1 This is also known as the Guideline Public Company Method. It is a valuation method under the Market Approach, which uses the market multiples derived from the market prices of the securities of public traded companies. There needs to be an open actively traded market for stocks. The Comparable Public Company should be in the same or a similar line of business as the private company being valued.

9.2.2 This Method can be used to value both publicly listed companies and large privately owned companies.

9.2.3 The Valuer should follow the steps outlined below when using the Comparable Public Companies Method to value a company:

9.2.3.1 Identify the multiple that is relevant for the industry, the financial performance of Valuation Subject and purpose of the valuation. EV/EBITDA is one of the most commonly used valuation multiples, since EBITDA is considered as a proxy for operating cash flow available to the firm; however, other multiples are used when the Valuation Subject has negative EBITDA and/or when the company holds a large number of liquid Assets such as finance, banking and insurance companies. Also, certain industries have preferred multiples; for example, the Price to Assets Under Management multiple is frequently used for asset management businesses and Price to Book multiple for banking, some financial services and real estate sectors.

9.2.3.2 Identify the Comparable Public Companies that are similar to the Valuation Subject. This includes examining the companies in a similar industry to the Valuation Subject. Potential resources include annual reports, market research reports, and/or standard industry classification codes;

9.2.3.3 Perform a comparative analysis of qualitative and quantitative similarities and differences between the identified Comparable Public Companies and the Valuation Subject. The analysis should highlight the following areas:

(A) Growth and profitability metrics (E.g., Return on Invested Capital, revenue CAGR, EBITDA CAGR).

(B) Valuation metrics taking into consideration the growth trajectory, capital structure, etc. For example, enterprise value multiples are less susceptible to distortions caused by the company’s Debt-to-Equity ratio; however, P/E ratio will be impacted by different Capital Structures.

9.2.3.4 Review the trading volumes of the stock of the Comparable Public Companies to check that the published prices reflect a liquid market;

9.2.3.5 Calculate the mean, median or weighted average of multiples of all the relevant Comparable Public Companies in the peer group. The median is typically more representative of the dataset since it is not affected by outliers.

9.2.3.6 If there is sufficient data consider calculating the coefficient of variation. This is a means of assessing how tightly data is grouped. It can be useful in deciding on the most appropriate multiple to use.

9.2.3.7 Apply appropriate discounts/ premiums, if any, to the multiple to reflect differences between the Valuation Subject and the Comparable Public Companies.

9.2.3.8 Apply the adjusted multiple to the Valuation Subject's financial metrics;

(A) If using an Enterprise Value metric, deduct Debt from the Enterprise Value. If using an Equity metric no such adjustment is required.

9.2.4 Add the value of Non-Operating Assets to arrive at the Equity Value.

Capital IQ Transaction Screening Report

Company Name	Industry	Geographic Locations	Revenue (SARmm)	EBITDA (SARmm)	(SARmm)	(X)
Raja Investors Ltd	Commercial Banks (Primary)	Middle East (Primary)	415.2	124.6	196.2	3.4
Smithsin Participation SA	Commercial Banks (Primary)	Middle East (Primary)	850.4	255.1	424.9	2.7
Bank Hap B.M.	Commercial Banks (Primary)	Middle East (Primary)	357.4	107.2	178.0	8.0
Coperfield Turk	Commercial Banks (Primary)	Middle East (Primary)	781.2	234.4	393.7	3.1
Kevin Sekerbank	Commercial Banks (Primary)	Middle East (Primary)	680.1	204.0	349.6	5.3
BTA Securities JSC	Commercial Banks (Primary)	Middle East (Primary)	296.9	89.1	129.1	6.3
Mean						4.8
Median						4.2
Minimun						2.7
Maximum						8.0

9.2.5 In the above example there are 6 Comparable Public Companies. The valuation metric that has been selected to value the Enterprise is EV/EBITDA.

9.2.6 Bank Hap BM appears to be an outlier. The mean or average of all six companies is 4.8. The mean excluding Bank Hap BM is 4.2. The median has been computed as 4.2. As noted above, the median is normally a better measure of central tendency than the mean.

9.2.7 In this case the Valuer used the median EV/EBITDA multiple of 4.2. It was applied to the Valuation Subject EBITDA of 303.5 million to give an Enterprise Value of 1,274.7 million. Net Debt of 738 million was deducted to give an Equity value of 536.7 million before consideration of discounts for liquidity and any other factors.

9.3 Comparable Transaction Method

9.3.1 The Comparable Transaction Method, also known as the Guideline Transaction Method, considers deal multiples of transactions involving Assets that are similar to the Valuation Subject to arrive at the value.

9.3.2 The key steps in the Comparable Transaction Method are:

9.3.2.1 Identify the relevant Comparable Transactions and calculate the key valuation multiple/ deal multiple for those transactions;

9.3.2.2 Identify the valuation multiples that are used by participants in the industry of the Valuation Subject;

9.3.2.3 Identify whether the transaction is for a Noncontrolling or Controlling stake;

9.3.2.4 Perform a comparative analysis of qualitative and quantitative similarities and differences between the comparable Assets and the Valuation Subject.

9.3.2.5 Select suitable transaction multiples from the data set.

9.3.2.6 Apply appropriate discounts/ premiums, if any, to the multiple to reflect differences between the current transaction and the Comparable Transactions. For example, it is possible that the price of a Comparable Transaction includes the benefits of synergies and is therefore higher than Market Value.

9.3.3 Some transactions involve consideration which is variable, based on the continuing performance of the Business. In this circumstance the Valuer may adjust the comparable multiple to take into consideration the large portion of contingent consideration in its purchase price. Apply the adjusted valuation multiple to the financial metric of Valuation Subject (if applicable).

9.3.4 If using an Enterprise Value technique, adjust the Enterprise value by net Debt. If using a direct Equity Value technique, no such adjustment is required.

9.3.5 Adjust for surplus cash and non-operating Assets. to arrive at the Equity Value. Apply appropriate discounts (e.g. discount for lack of liquidity and/or control), if any, to the valuation multiple to reflect differences between the percentage interest of the Valuation Subject being valued and the comparable transactions. The Valuer decides whether a liquidity discount is appropriate depending on the purpose of valuation (e.g., even if the Valuation Subject is a private company, it may not be appropriate to consider a liquidity discount if the purpose of the valuation is for immediate liquidity event).

Example: Valuation based comparable transaction method

Calculate Equity value of Fazan Finance Co. using comparable transaction under the Market Approach method based on the data below:

- Fazan Finance Co. is a financing company in Saudi Arabia with operations across the middle East;
- The size of Abdullah & Co is very small in terms of revenues and no of clinics compared to comparable companies in the industry;
- EBITDA of Abdullah & Co for the year ended 31 December 2016 is SAR 303.5 Mn; and
- Market value of Debt for the year ended 31 December 2016 is SAR 903.2 Mn

Solution:

Methodology:

The following transactions have taken place in the last 2 years:

Capital IQ Transaction Screening Report

All Transactions Announced Date	Target/Issuer	Transaction Value ($ USDmm, Historicalrate)	Buyers/Investors	Sellers	Geographic Locations (Target/Issuer)	EV/EBITDA (x)	P/BV (x)
01/10/2015	Ahli Qatar Bank	615.95	Beirut Foundation, Endow ment Arm	Ahli United Bank B.S.C.	Middle East (primary)	16.39	2.22
06/08/2016	Denizbank Anonim Hono	379.59	Sberbank	Dexia Participation Belgique SA	Middle East (primary)	9.82	1.41
04/09/2016	Burgan Bank Anonim Sirketi	355.66	Burgan Bank S.A.K.	Eurobank Ergasias S.A.	Middle East (primary)	15.22	0.92
06/20/2015	Bank Hap B.m.	68.62	-	Salt of The Earth Ltd.	Middle East (primary)	9.07	0.833
04/03/2015	First Interational Bank	73.93	-	FIB Holdings Ltd.	Middle East (primary)	8.92	0.785

10

The Cost Approach

10.1 Introduction

10.1.1 The Cost Approach provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility. This is one of the three valuation approaches in IVS

10.1.2 Within the Cost Approach there are three Methods:

10.1.2.1 Replacement Cost Method

10.1.2.2 Reproduction Cost Method

10.1.2.3 Summation Method

10.1.3 As noted previously, the Replacement Cost Method and the Reproduction Cost Method are mainly of relevance to plant Valuers. Business valuation is almost always undertaken using the Summation Method.

10.2 Premises of Value

10.2.1 The Premises of Value must be carefully considered when using the Cost Approach. There are four Premises of Value within IVS:

10.2.1.1 Current Use – a going concern Premise;

10.2.1.2 Highest and Best Use – a going concern Premise;

10.2.1.3 Orderly Liquidation – a Liquidation Premise;

10.2.1.4 Forced Sale or Forced Liquidation – a Liquidation Premise.

10.2.2 If using one of the going concern Premises, Market Value is often the Basis of Value to be used. If using one of the Liquidation Premises, Liquidation Value will be the appropriate Basis of Value.

10.3 Use of Cost Approach

10.3.1 Valuation using the Cost Approach can often result in a lower value as it does not consider some Intangible Assets. If a Business is not generating an adequate return on the Capital Employed, the Cost Approach can result in a higher valuation than using other Approaches.

10.3.2 It is appropriate to consider the Cost Approach when valuing:

10.3.2.1 A holding company such as real estate investment trusts (REITs) and Closed End Investment Companies (CEICs). The underlying Assets typically consist of real estate or securities that should be valued by a real estate appraiser, using one of the three Valuation Approaches. Using the Cost Approach, the Market Value Basis of Value, the Summation Method and the Highest and Best Use Premise will normally be appropriate.

10.3.2.2 A trading company, not earning adequate returns on its capital. In such situations the company may be worth more dead than alive. The Cost Approach, the Liquidation Value Basis of Value, the Summation Method and the Orderly Liquidation Premise may be appropriate

10.3.2.3 Losses are continually generated by the Business and the Business is no longer able to meet its financial obligations. In this circumstance, the Cost Approach, the Liquidation Value Basis of Value, the Summation Method and the Forced Sale Premise will almost certainly be appropriate.

10.3.2.4 The Business is profitable but those profits are wholly dependent upon the skills of the owner; the classic example is a specialist surgeon working through his own Business. In that circumstance there is no goodwill within the Business. Using the Cost Approach, the Market Value Basis of Value, the Summation Method and the Highest and Best Use Premise will normally be appropriate. The valuation will therefore relate to the net tangible Assets within the Business.

10.4 Adjusted Net Asset Value Method

10.4.1 This is now more commonly known as the Summation Method under the Cost Approach. Under this Method, if the Business is a going concern, the Company's Assets and liabilities are adjusted to their current market value.

10.4.2 The Valuer should carry out the following steps when valuing the Valuation Subject using the Adjusted NAV Method:

10.4.2.1 Analyze the balance sheet of the Valuation Subject as at the Valuation Date;

10.4.2.2 Restate the Assets and liabilities to their market values;

10.4.2.3 Identify the unrecorded Assets and liabilities and their impact on the valuation; these can be unrecorded Intangible Assets, off-balance sheet commitments or contingent Assets that are not on the balance sheet.

10.4.3 There is no requirement to compute taxes/zakat that may be payable on a realization of the Assets under the going concern Premises as no disposal of the Assets is anticipated.

10.5 Liquidation Value

10.5.1 Liquidation Value is one of the six IVS Bases of Value. Liquidation value is the amount that would be realized when an asset or group of Assets are sold on a piecemeal basis. Liquidation value should take into account the costs of getting the Assets into saleable condition as well as those of the disposal activity.

10.5.2 As noted above, there are two different Liquidation Premises, Orderly Liquidation and Forced Sale.

10.5.2.1 Forced Sale assumes that the Assets of a business are sold as quickly as possible; often at distressed prices.

10.5.2.2 Orderly Liquidation assumes that the Assets of a business are sold over a relatively longer timeframe, to maximize the proceeds.

10.5.3 The Liquidation Value Basis of Value and the Liquidation Premises are used in the following situations:

10.5.3.1 If the Valuation Subject's earnings are low, on a sustainable basis, to the extent that the application of an appropriate Capitalization Rate to those earnings results in a value lower than the Liquidation Value.

10.5.3.2 Where the Company is not a going concern and is not able to meet its financial obligations and therefore should be liquidated.

10.5.4 Liquidation Value differs from Market Value in that it takes account of the costs of getting the Assets into a saleable condition as well as those of the disposal activity. The Summation Method and one of the Liquidation Premises, using Liquidation Value as the Basis of Value, requires the following steps:

10.5.4.1 Determining the book value of the shareholder Equity as at the Valuation Date.

10.5.4.2 Restating Assets and liabilities to the realizable value. As Liquidation Value is based on net realizable values, Assets and liabilities should be analyzed and any required restatement should be undertaken. Please refer to appendix for a non-exhaustive list of adjustments. Furthermore, the Valuer may require the opinion of a Subject Matter expert such as property and equipment appraisal, if required.

10.5.4.3 Calculating the costs of disposal of Assets;

10.5.4.4 Calculating the taxes payable upon disposal of the Assets, if any.

10.6 Tangible Asset Backing

10.6.1 Tangible asset backing represents the total Market Value of all tangible Assets determined on a going concern basis, less all liabilities. No deduction is made for disposal costs or liquidation costs and deferred income taxes are generally ignored depending on the circumstances.

Example: Liquidation value calculation

Calculate the Liquidation value of Hassan Co. as at 31 December 2016 based on the following information.

Liquidation Value

Currency: SAR mn			**LV**
Share capital and retained earnings			110.0
Market Value of assets		75.0	
Net book value of assets		(25.0)	
Adjustment to assets	1		50.00
Less: Disposal Costs			
Commissions			(5.0)
Corporate taxe (if any)			(15.0)
Less: Distribution costs			(10.0)
Liquidation Value	2		**130.0**

1 **Adjustment to assets =**

Market value of assets - Net book value of assets

2 **Liquidation Value =**

Share capital and retained earnings + Adjustment to assets - Commission - Corprate taxes - Distribution Costs

10.6.2 If using the Income or Market Approaches to Valuation it can often be a useful cross check to establish the tangible asset backing using the Cost Approach, the Market Value Basis of Value, the Summation Method and a going concern Premise.

10.6.3 The difference between the tangible asset backing and the valuations under the Income or Market Approaches represents the implied value of the Intangible Assets including goodwill. Some transactions involving small Businesses may not take place if the Intangible Assets component of the Valuation is too high, due to the additional risk involved: if the business fails there may be some value recovery from tangible Assets; the value in the Intangible Assets may be entirely lost.

10.7 Net Debt

10.7.1 Net Debt is the company's total Debt minus its free cash and cash equivalent balances.

10.7.2 When carrying out the valuation analysis based on the Income Approach or Market Approach using the Enterprise Value multiples, the Valuer needs to calculate the net Debt of the Company to arrive at the Equity Value as at the Valuation Date.

10.7.3 When calculating net Debt, the Valuer should include Debt and "Debt like" items in calculating the total Debt levels of the Company.

10.7.4 While Debt owed to banks and other financial institutions can easily be determined, "Debt like items" can be open to interpretation.

10.7.5 The important test is to ask how the Business is financed, and what is its Capital Structure. Some Debt may be short-term and seasonal whereas other short-term Debt may be constantly rolled over so that it is part of the Capital Structure.

10.7.6 "Debt like" items may include capital expenditure payables, contingent liabilities, deferred revenue and potential litigation payments amongst others. A list of items to consider Debt and "Debt like" items are as follows:

10.7.6.1 InDebtedness for borrowed money;

10.7.6.2 Obligations backed by a note, bond, debenture and similar instruments;

10.7.6.3 Capital finance lease obligations;

10.7.6.4 All-interest bearing Debt owed to financial institutions;

10.7.6.5 All Debt owing to shareholders or their associates, including accrued interest thereon (excluding trade related);

(A) Such balances are normally included as Debt, whether interest is charged or not; they represent part of the Capital Structure unless they are short term trade payables on normal Arm's Length terms.

10.7.6.6 All recourse liabilities and other liabilities arising from any transaction such as the assignment of receivables for financing purposes;

10.7.6.7 Accrued interest; and

10.7.6.8 Shareholders/associates current accounts

10.7.7 Cash items may include the following:

10.7.7.1 Cash and Cash Equivalents; and

10.7.7.2 Non-revolving deposits.

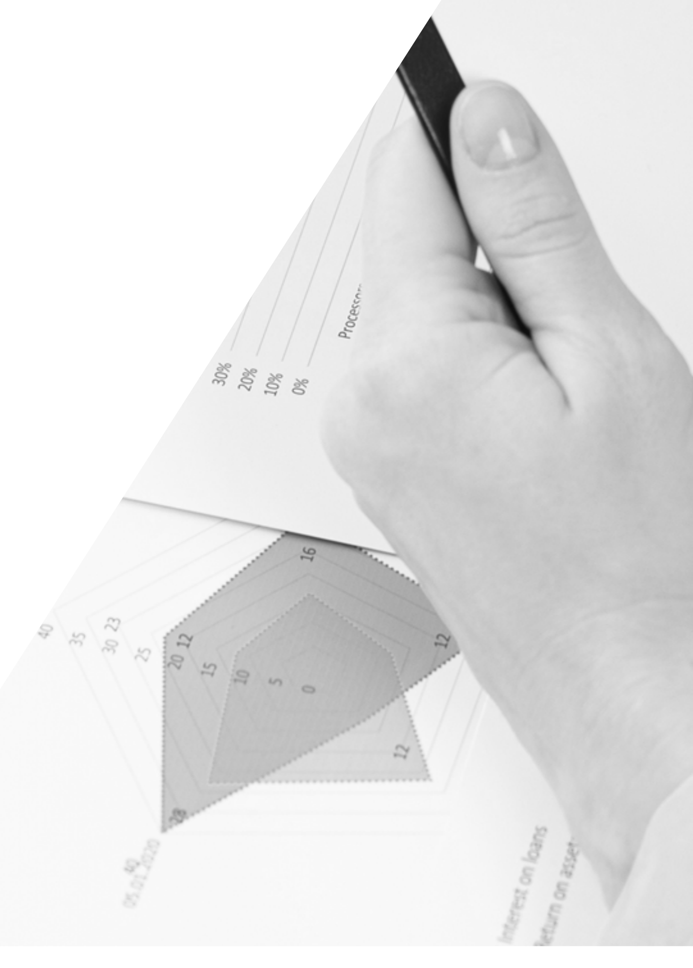
10.7.8 Cash Equivalents are Assets in a business that can be converted into cash. Examples are realizable investments, amounts due from officers and amounts due from other related parties.

10.7.9 It is also important to note that a "negative net Debt" implies that the company has more cash than Debt.

Notes:

11

Non-Operating Assets



30
20
10
0
01.01.2019
Minimum price
01.01.2020
Closing price
Sales
3,2
2,6
1,4
1,2
First quarter
Second quarter
Third quarter
Fourth quarter
Performance level
Payback
Interest rate
5
4,5
4
3,5
3
2,5
2
1,5
1
0,5
0
Название оси
2017
2018
2019
2020
Power consumption levels
Product 1
Balance sheet profit
Retained earnings

11.1 Introduction

11.1.1 Non-Operating Assets are Assets which are not required for use in the income-producing operations of the business.

11.1.2 The Valuer must be aware of the possibility of the presence of Non-Operating Assets and that their existence may significantly affect the value of the Valuation Subject. In this respect, during the analysis, the Valuer should carefully review the financial statements over several years to:

11.1.2.1 Identify and analyze any Non-Operating Assets;

11.1.2.2 Establish the revenues generated from Non-Operating Assets:

(A) They are typically reported as "other income" (e.g. rental income in a trading business, interest on term deposits or portfolio dividends) and can normally be easily confirmed. The Valuer needs to confirm their nature and amounts with Management.

11.1.2.3 Estimate the associated expenditure. A more detailed examination of the Company's records may be required to assess the associated expenditure. The Valuer also needs to confirm the facts with Management.

(A) As an example, if a trading business receives rental income on a warehouse that is not needed for the trade, there may be associated utility costs for that warehouse included in general administrative costs.

11.2 Impact on Valuation

11.2.1 It is necessary to exclude these amounts in the Valuation of a business on a going-concern basis, if using either the Income Approach or the Market Approach. They then need to be added to the Valuation once the going concern business has been valued. The revenues and expenditures relating to Non-Operating Assets must be eliminated from maintainable earnings in a going concern valuation.

11.2.2 When valuing the Valuation Subject using the Cost Approach, separate consideration of Non-Operating Assets is not critical other than in respect of the degree to which zakat and income taxes underlying these Assets may be recognized.

11.2.3 The important test is to establish if the value of the Asset has been included within the Valuation Method used.

11.3 Types of Non-Operating Assets

11.3.1 Non-Operating Assets are those Assets not needed for the operations of the Business in its main activity. A list of Non-Operating Assets is given below:

11.3.1.1 Portfolio investments;

11.3.1.2 Other investments and loans;

11.3.1.3 Excess land, buildings or equipment (e.g. real estate not required for future business expansion; a property capable of subdivision; unused warehouse (if capable of leasing to outsiders); or investment in unused machinery);

11.3.1.4 Assets held for the use of the owners, such as holiday homes, private jets and other non-essential Assets.

11.3.2 Excess Working Capital

11.3.2.1 Excess working capital can be estimated through comparing the working capital of the Valuation Subject by:

(A) Industry averages, as reported by various industry association publications and/or annual reports of public companies;

(B) The historical Current and Acid Test ratios as at the Valuation Date. However, the Valuation Subject's management or an independent banker can advise the Valuer the degree of excess working capital required and confirm that funds are not required to finance an increase volume of business and/or secure financing that cannot otherwise be obtained.

11.3.2.2 This area needs to be treated with considerable caution. It is important to establish if the working capital could be reduced under different management, without affecting profitability.

(A) As an example, if the Business grants extended credit to customers, this may be part of the business model. Shortening of the credit terms may result in the loss of profitable trading with those customers.

11.3.3 Excess Fixed Assets

11.3.3.1 The Valuer may identify excess/surplus fixed Assets through discussions with management based on a detailed analysis of the fixed Assets register.

(A) If the surplus fixed Assets are used as security for borrowings, the full effects of disposal will need to be addressed.

11.3.3.2 Such Non-Operating Assets should be valued at Liquidation Value. If the asset is a Non-Operating Asset its value is the net proceeds after disposal costs.

11.4 Valuation of Non-Operating Assets

11.4.1 Once the Non-Operating Assets are identified, the Valuer needs to value them. However, if the Valuer is not a real estate or plant appraiser, such valuation specialists will be required.

11.4.2 The Valuer can compute the value of some Non-Operating Assets, such as a portfolio of publicly listed investments by the stock trading prices reported in the financial newspapers.

12

Reporting

12.1 General

12.1.1 A valuation report is a document which must effectively and clearly convey to the Client an understanding of the valuation, as determined by the Valuer. It must give a precise, accurate and clear description of:

12.1.1.1 the purpose and intended use of the Valuation ("Why");

12.1.1.2 the Valuation Subject ("What");

12.1.1.3 The Valuation Date ("When")

12.1.1.4 The Basis of Value applied ("Basis")

12.1.1.5 As noted at the planning stage, IVs 2020 includes a list of points which must be communicated to the Client near the start of the assignment. These may be communicated in a separate document or in the valuation report. These are:

(A) Identity of the Valuer;

(B) Identity of the Client(s);

(C) Identity of the intended users;

(D) Company or interest in company being valued; (What)

(E) The valuation currency;

(F) Purpose of the valuation; (Why)

(G) Basis or Bases of value used; (Basis of Value)

(H) Valuation Date; (When)

(I) The nature and extent of the Valuer's work and limitations thereon;

(J) The nature and sources of information upon which the Valuer relies;

(K) Significant Assumptions and/or special Assumptions;

(L) Type of report being prepared;

(M) Restrictions on use, distribution and publication of the report

(N) That the valuation will be prepared in compliance with IVS and that the Valuer will assess the appropriateness of all significant inputs.

12.1.2 Objectivity, clarity and logical reasoning in the valuation report is essential, as important decisions maybe taken based on it. The Valuer should express any strong opinions about strengths or weaknesses of the Valuation Subject in a reasoned way, ensuring that conclusions reached are understandable by the reader.

12.2 Forms of report

12.2.1 IVS 2020 describes two types of reports:

12.2.1.1 Valuation reports

12.2.1.2 Valuation review reports.

12.2.2 For valuation reports, the IVS requires details about the Scope of Work, the valuation approach or approaches adopted, the valuation method or methods applied, the key inputs and Assumptions used, along with the conclusion and the principal reasons for any conclusion reached.

12.2.3 For valuation review reports, the IVS requires details about the scope of the review, the valuation report being reviewed and its inputs and Assumptions as well as reviewer's conclusion and the reasons supporting it,

12.3 Types of valuation report

12.3.1 Reports can be delivered in 'long form' or 'short form'. The type of report required should be stated in the Engagement Letter.

12.3.2 In some jurisdictions short form reports are called non-speaking reports. This is because they provide no support for their reasoning. The wording of a non-speaking report is as brief as stating:

12.3.2.1 "This valuation has been prepared for the following Valuation Purpose….. In my opinion the value of 15,000 ordinary shares in XYZ, representing 7.5% of the issued capital of that company, is 2 million at the present time.

12.3.3 These non-speaking reports are commonly produced when a Valuer has been appointed by the parties to determine the value of the relevant shares, with both parties agreeing to be bound by the valuation conclusion. Such a report would not be compliant with IVS 2020.

12.3.4 If a report is to be compliant with IVS 2020 it is necessary for it to provide sufficient information that another Valuer can review the report and understand all of the conclusions reached.

12.3.5 Draft reports should be provided to Clients, before issuance of a final report. The purpose of this stage is to allow the Client to confirm the factual content. The draft report is not issued to the Client so that the Client is able to give his opinions on the valuation conclusions.

12.3.6 A letter of representation from the Client should be obtained prior to arriving at a conclusion and issuance of the final report to the Client. This letter is to confirm that the facts are fairly stated and to ensure that there are no Material or Significant facts that have not been provided to the Valuer.

8 The International Valuation Standards (IVSC), 2020
9 European Valuation Standards, Blue Book (TEGOVA, 2016) Pg. 67-77
10 Statement of Standards for Valuation Services – issued by AICPA (June 2017) Pg.22-35
11Guidance on type of valuation reports – Issued by CICBV,

12.4 Contents of a valuation report

12.4.1 The valuation report should provide sufficient information about the Valuation Analysis, so that intended users can clearly understand the data, the analysis and the conclusions from that analysis, the Basis of Value and the valuation conclusion.

12.4.2 The Valuation Analysis report should contain the following sections, as applicable:

12.4.2.1 Letter of transmittal;

12.4.2.2 Table of Contents;

12.4.2.3 Introduction/Valuation Summary;

12.4.2.4 Representation of Valuer/Statement of Limiting Conditions;

12.4.2.5 Valuation Analysis;

12.4.2.6 Valuation Conclusions;

12.4.2.7 Abbreviations/Appendix and Exhibits.

12.4.3 The report must contain following information to comply with IVS 103.30.1 2020:

(A) The Scope of Work, as detailed above;

(B) The intended use of the report;

(C) The Valuation Approach or Approaches adopted;

(D) The Method or Methods applied;

(E) The key inputs used;

(F) The Assumptions made;

(G) The conclusions of value and the principal reasons for the conclusions;

(H) The date of the report

12.4.4 The report should normally contain the following information:

(A) Appendices and exhibits, which include relevant workings;

(B) Background information of Valuation Subject; and

(C) Discussion of economic and industry outlook, especially which may affect valuation

12.4.5 A brief description of the content in some of the sections of the report is detailed below:

12.4.5.1 Introduction/Valuation Summary

(A) This section provides a detailed summary of valuation, which can be broken down into various sub sections as follows:

(1) The engagement and Company Background provides a detailed explanation about the identity of the Client, and any relevant non-financial information about its relationship with the subject entity of valuation. It also gives a description of the Valuation Subject.

(2) The Purpose of Valuation gives details about the stated usage and intended users of report, which may include regulatory and legal purposes.

(3) The sources of Information subsection provides details about the relevant sources of information, which were utilized in performing the valuation. It may identify information provided by management, which may be in written form or oral, such as audited/ unaudited financial statements, financial projections, background information, and any other information, which is provided through discussions, emails or documents. It should further contain sources utilized for finding relevant industry and economic conditions, including publicly available information and proprietary databases.

(4) Valuation results comprise a brief overview of the valuation analysis and provide results of the valuation. It may also include tables/data to depict the same. It should contain the Scope of Work, a summary of valuation tables and a statement providing a conclusion of value, in a range or a single value, clearly mentioning the currency.

(5) Matters of Emphasis gives information about any major factors that guided the Valuer's work during the engagement. It also contains major Assumptions and the valuation Methods. If the Valuation is based on Special Assumptions, these must be clearly stated.

Example:

As informed by Management or the Client, there are no contingent liabilities or contingent Assets relevant to the subject entity, as at the Valuation Date.

12.4.5.2 Representation of Valuer/Statement of Limiting Conditions

(A) This section provides representation by the Valuer of the extent of the report. If the Valuer relies on financial statements provided by management, the report should include a disclosure, which highlights that the Valuer has not carried out an audit of this information. The Valuer has however a duty to review the data and to challenge the information provided when necessary as part of the application of Evidential Skepticism. The report might also state that any changes after the Valuation Date have not been taken into account for the purpose of valuation.

(B) It also sets out the extent of liability to third parties, be it of a legal nature or otherwise.

(C) It states whether the Valuer is obligated to update the report.

(D) It should clearly state that the Valuer will have no responsibility or liability for any losses incurred as a result of the circulation or distribution of the report contrary to the report's provisions.

12.4.6 Valuation Analysis

12.4.6.1 This section provides details about the actual work done in relation to valuation, which can be broken down into the following subsections:

(A) Details are provided of the Valuation Approaches and Methods used. The Valuer should explain the weights assigned to each Method used and should provide the reasons behind the applicability of the Methods.

(B) Financial Statement/Information Analysis provides description about the Valuation Subject being valued, and Assumptions made. Key historical and Prospective Financial Information and analysis for the Valuation Subject should be provided;

(1) profit and loss/ income statements for 3 to 5 years; and explanation for the movement in the more important ratios such as gross margin and operating margin;

(2) balance sheet/statement of Assets and explanation of major balance sheet movements;

(3) Cash flow statements for historic periods showing the relationship between profits and cash generation;

(4) Graphs related to important business variables, etc.

(5) Projected financial information if available, including underlying Assumptions. The report might also include subsidiary information such as tax calculations, Debt amortization schedules, capital expenditure schedule, etc., movements in working capital, as applicable.

12.4.6.2 The valuation analysis section should provide the workings relating to the Valuation Method/s performed. For each Valuation Approach, the following information should be provided:

(A) For the Income Approach and Discounted Cash Flow Method:

(1) the composition of the revenue stream if there are different business segments;

(2) the main Assumptions and explanation of variation from historic metrics,

(3) Calculation of the effect of changes to the main Assumptions, such as rate of sales growth or the operating margins projected;

(4) the risk factors considered in selecting appropriate discount rate

(5) and other relevant factors should be included;

(B) For the Income Approach and Capitalization of Earnings Method:

(1) The reasons for considering that the earnings or cash flows are stable and that this method is preferable to the Discounted Cash Flow Method;

(C) For the Cost Approach: adjustments made by Valuer to the balance sheet, and how the Asset values have been calculated;

(D) For the Market Approach and Comparable Public Company Method:

(1) the Comparable Companies selected,

(2) the process used in their selection and reasons for exclusion of companies

(3) rationale for the pricing multiples used and how they are used and if adjusted, the rationale for the same should be given.

(E) For the Income Approach and Comparable Transaction Method:,

(1) rationale for selecting transactions;

(2) associated pricing multiples used and, if adjusted, rationale for the same.

12.4.6.3 The section should contain exhibits of the workings, including data sheets, calculations etc. for each Method used, for each entity/interest being valued.

12.4.6.4 The Conclusion of Value section should contain final workings on the valuation, summarizing all the values by various Methods used, and adjusting them, if required along with the explanation for the adjustments.

Refer to **Appendix K** for the sample of contents in a detailed report

12.5 Short Form Report

12.5.1 This section does not apply to a “non-speaking valuation report” as this is covered above.

12.5.2 A short form report should primarily provide a summary of key information included in a detailed report. It should include the key terms of valuation (including the Valuation Date, Valuation Subject, the Valuation Purpose and the Basis of Value). The second section should express the Valuer’s opinion of the Value.

12.5.3 This report is primarily prepared for the use of senior executives (Chief Executive Officer, Chief Financial Officer, etc.) and accordingly includes key insights about the Company, historical performance and value conclusion; any required information may be included in appendices such as representation of Valuer, Assumptions, etc.)

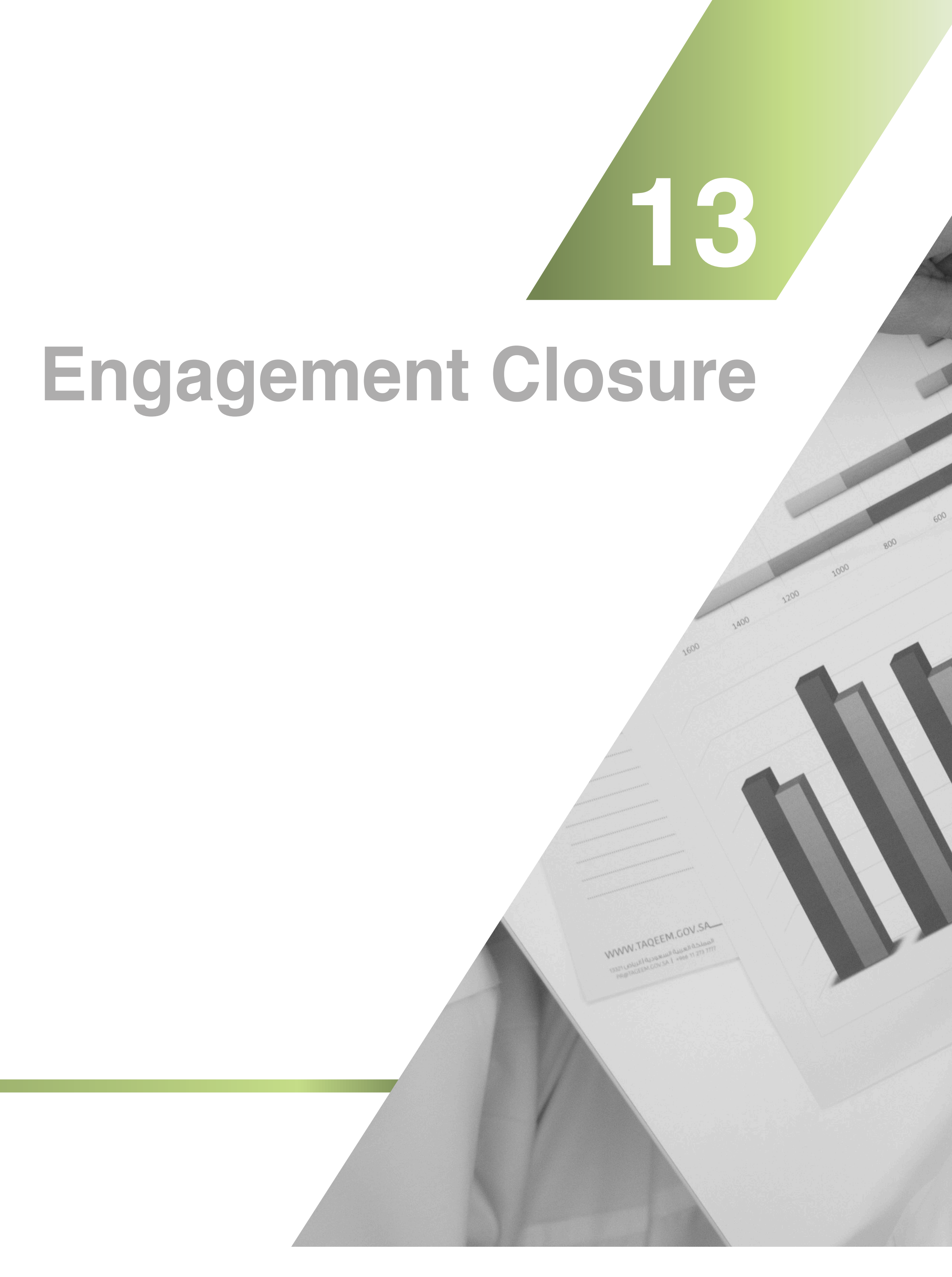
12.5.4 A short form report does not mean that less detailed valuation analysis is undertaken, or the value is different from a detailed report. The amount of information may be less, and sections (i.e. market overview) may be excluded, depending on requirement of the Client. A short form report may be issued as a standalone or can be a deliverable with a full detailed report.

12.5.5 The risk/liability/responsibility of the Valuer does not change with the type of report.

Refer to **Appendix L** for an example of a short form report

13

Engagement Closure



13.1 Filing and archiving

13.1.1 During the course of the valuation, the engagement team will receive records, most of which have to be retained by the Valuer to comply with business, legal, regulatory and financial requirements and/or for referencing purposes.

13.1.2 The Valuer must maintain a principal record of information received from the Client, the procedures performed, and valuation Approaches considered and used, and the value concluded. Some of this information will be in the report but some will only be recorded in the working records.

13.1.3 Page 14 of the Code of Ethics states that a "valuer must prepare a work file for each assignment. The file shall contain a hard or soft copy of every written report, correspondence, note, and document in addition to the information, data and procedures adequate to support the valuer's opinion such as inquiries, inspections, sources, methods, analyses, and calculations."

13.1.4 The Code also states that

13.1.4.1 "every file shall contain supporting information for the valuer's work, even when the valuer only provides a brief report to the client.

13.1.4.2 The work file must be prepared in a way that someone who does not have any previous relationship with the assignment can determine the stages underpinning the valuation process up until the conclusions, and this is the main purpose of the work file."

13.1.5 The Valuer should dedicate a section on the sources of information to list all the information obtained and analyzed in arriving at the valuation conclusion.

13.1.6 A list should be produced of all information received and used for the assignment. The records could be in multiple forms i.e. emails, work papers, reports, faxes, letters, plans, correspondence and data from multiple sources including photographs, videos, audio recordings, paper, electronic, etc. The records can reside in filing cabinets, computers, databases, portable media (USB pen drive, DVD, smartphones), network servers, etc.

13.1.7 In valuation practice, records normally comprise Engagement Letters, correspondence for information, information provided by the Client and other sources, workings, models, drafts, final reports, documentation, forms for initiation and completion of engagements, etc.

13.1.8 To ensure proper compliance and best standards, a comprehensive record retention policy should be enacted. The policy should state a minimum retention period, where the records have to be retained. A period of not less than ten years is required by the Code of Ethics.

13.1.9 Once the retention period has expired, and no applicable preservation notices exist in relation to the records, the records can be deleted. Records maintained after this should be periodically reviewed and the need to retain them should be re-examined.

13.1.10 However, exceptions can occur to the minimum period, and records must be retained if the Valuer is made aware of any anticipated or actual claim, litigation, investigation, proceedings, government subpoenas, or formal or informal request which involve the valuation practice. Such records must not be altered or revised without advice from legal counsel.

13.1.11 Security and confidentiality of all forms of information, related to the valuation, is essential. Appropriate measures must be taken to ensure that information remains confidential; Paper records should be stored in secured locations with limited and defined access and records in electronic form need to be maintained as per the Valuer's/valuation firm's information retention policy. Records may be kept on-site or off-site (but there is a need to ensure that Valuer is able to access the records if required); however, in case of third party offsite storage, adequate measures should be in place to ensure that the documents are secured.

13.2 Closing instructions

13.2.1 At the completion of the engagement process, the following steps should be followed:

13.2.1.1 A small summary/overview of the engagement should be created which can be used as a reference in the future internally (or externally on an anonymous basis), which in an M&A transaction may be forwarded to external agencies (such as Bloomberg, Thomson Reuters, etc.) where the valuation team/practice gets the credit for the advisory/transaction undertaken. This also helps in pitching to new Clients for a similar engagement profile.

13.2.1.2 The entire engagement including pitches, proposals, deliverables, workings, etc. should be reviewed to identify best practices during the engagement. Such identified practices should be shared within the firm, to enhance the quality of future work.

13.2.1.3 Clients should be asked about their satisfaction with regard to the work undertaken and a system should be in place for receiving and processing any feedback given by Client.

13.2.2 The engagement team should ensure that they have followed all the steps for engagement closure and a record of the same must be kept. These include declarations that appropriate policies/laws were followed and that the engagement has been carried out properly.

13.2.3 A completion letter may also be enclosed with the final deliverable. This letter is primarily used as a formal communication on longer duration, phased engagements that may or may not include a formal report; and

13.2.4 The engagement team can take advantage of this as an opportunity to propose actions for follow-on services, meetings or events for continued Client interaction and where value addition is provided.

Refer to **Appendix M** and N for sample Completion Letter and sample Engagement Completion Checklist

13.3 Managing repeat instructions

13.3.1 The following procedures should be enacted, if the Client asks for an extension in the Scope of Work after the report has been delivered:

13.3.1.1 If the Client requires the report to be made available for other intended users, a release letter should be created. This letter should state the new intended users and the purpose for which it is intended, The report is then cleared for dissemination to additional members.

13.3.1.2 The Valuer should ensure that the report is appropriate for the new users, by assessing the required usage, and should not permit the distribution of the report if its usage is contrary to the valuation undertaken.

13.3.1.3 The Valuer should add a key clause stating that there will be no responsibility or liability for losses occurred as the result of circulation or distribution of the report contrary to the report's provisions.

13.3.1.4 While signing the release letter, care should be taken that it does not expose the firm to any additional legal or risk liabilities or obligations.

Refer to **Appendix O** for sample Release Letter

13.4 Complaints handling procedure

13.4.1 For any complaints arising, consistent procedures need to be implemented.

13.4.2 After closure, if there are complaints about the valuation analysis then it may be possible to resolve such issues amicably; however, if this is not possible, both parties should comply with the dispute resolution procedures as per the Valuer's dispute resolution handling procedures

Notes:

14

Intangible Assets

14.1 Introduction

14.1.1 Intangible Assets are of increasing importance, both in the economy and for Business Valuers: as economies move away from the extractive industries and heavy manufacturing towards more diversification into other sectors, particularly the knowledge sectors, Intangible Assets become increasingly large components of value.

14.1.1 An Intangible Asset, is defined as "a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and / or economic benefits to its owner."

14.1.2 Intangible Assets can be valued for different purposes; in practice, financial reporting is one of the most common reasons (Purchase Price Allocation, Impairment testing, asset acquisitions and sales). Other purposes are:

14.1.2.1 for tax reporting purposes for transfer pricing analysis; and

14.1.2.2 for the purposes of litigation, such as an infringement of Intellectual Property.

(A) Intellectual Property comprises Intangible Assets that enjoy special legal recognition and protection, often by statutory authorities. IP is often thought of as "creations of the mind". Examples are trademarks, trade names, patents and copyright

14.1.3 When valuing Intangible Assets, the Valuer must understand specifically what needs to be valued and the purpose of the valuation.

14.1.4 Intangible Assets are generally classified within one of the following categories :

(A) Marketing related (e.g. trademarks, trade names, internet domains, etc.)

(B) Customer related (e.g. customer lists, customer contracts, order backlog, etc.)

(C) Artistic related (e.g. books, films, plays, music, etc.)

(D) Contract related (e.g. licensing, Royalty agreements, etc.)

(E) Technology based (e.g. patented & unpatented technology, database, internally developed software, etc.)

14.1.5 Brands may represent a combination of categories of Intangible Assets that are marketing-related.

14.1.6 The three approaches of Market, Cost and Income are all potentially applicable to the valuation of certain Intangible Assets. IVS 210 recognizes that the Market Approach is of limited application. There are several specific Methods under the Income Approach.

14.1.6.1 Intangible Assets, with some notable exceptions, seldom transact separately from the business enterprise that uses them in its operations. There are relatively few separate transactions for intangible assets; there are concerns regarding comparability of different intangible assets; there

is often little in the way of public information on transactions that have taken place. The result is that it is rarely possible to find reliable market evidence. Examples of Intangible Assets which may be valued using the Market Approach and the Guideline Transaction Method are:

(A) Broadcast spectrum;

(B) Internet domain names;

(C) Taxi medallions.

14.1.6.2 It is also recognised that the Income Approach Method of Relief from Royalty is something of a hybrid method under both the Market and Income Approaches as Royalty rates are normally obtained from the markets.

(A) The Relief from Royalty Method means that the value of an intangible asset is estimated by considering the hypothetical Royalty payments that are saved through ownership of the asset.

14.1.6.3 The Cost Approach and Replacement Cost Method is commonly used for the following types of Intangible Assets:

(A) Acquired third-party software;

(B) Internally developed and internally used non-marketable software;

(C) Assembled workforce – also known as workforce in place.

(D) (The Workforce in Place is the team of employees who work in a Business. This is a concept that is used when calculating Contributory Asset Charges in the valuation of Intangible Assets. The Workforce in Place is an Intangible Asset but one which is not recognized for financial reporting purposes.)

14.1.6.4 If using the Cost Approach, Valuers are asked to consider the following:

(A) The direct and indirect costs of replacing the utility of the asset;

(B) Possible adjustments for functional and economic obsolescence;

(C) Whether it is appropriate to include a profit mark-up. Such a mark-up may be appropriate;

(D) Opportunity costs (reflecting costs associated with not having the subject Intangible Asset in place for some period during its creation) may also be included.

14.1.7 There are various methods under the Income Approach as advocated by IVS. Guidance is included in IVS 210 relating to these methods. The various methods under the Income Approach covered by IVS are:

(A) Excess Earnings:

(B) Relief from Royalty;

(C) Premium profit, or with and without;

(D) Greenfield;

(E) Distributor.

14.1.8 Later sections of this chapter summarize the guidance provided for each of these methods.

14.2 Goodwill

14.2.1 Goodwill is any future economic benefit arising from a business which has not been separately recognized in another Asset. It is typically measured as the residual after all other Assets and Liabilities have been identified.

14.2.2 IVS recognize that in a business combination under IFRS and US GAAP an Intangible Asset can only be recognized if it is separable or arising from contractual or other rights. The amount of goodwill therefore can vary according to the rules that apply relating to the recognition of other Assets.

14.2.3 Goodwill frequently includes within it certain specific categories such as the benefit of an Assembled Workforce (as this cannot be recognized as a separate Intangible Asset under accounting rules).

14.3 Intangible Asset Economic Lives

14.3.1 Due to legal, technological, functional or economic factors, Intangible Assets usually have limited economic lives. In most cases when valuing Intangible Assets under the Income Approach, the Valuer must consider the impact of technological, functional or economic factors.

14.3.2 For customer related Intangible Assets the loss of existing customer relationships is referred to as Attrition.

(A) Attrition is the rate of loss of existing customers, a group of contracts, Workforce or other Assets or the rate of decay of existing technology.

14.3.3 IVS 210.100.6, includes guidance on how to measure Attrition, such as on customer lists. It allows for a number of different ways of modelling Attrition:

14.3.3.1 A constant rate of loss of say 10% of the prior year balance;

14.3.3.2 A variable rate if customer loss is dependent on the longevity of the customer relationship;

14.3.3.3 Stratification of customers into subgroups may be appropriate if there are different customer groups with different levels of profitability, attrition or other key attributes.

14.4 Tax Amortization Benefit (TAB)

(A) The Tax Amortization Benefit (TAB) is an adjustment made when valuing Intangible Assets using the Income Approach to reflect the tax relief available on the amortization of certain Intangible Assets.

14.4.2 The TAB recognizes that in many jurisdictions Intangible Assets can be amortized for tax purposes. This tax amortization has the effect of reducing tax costs and increasing cash flows .

14.4.3 It may be appropriate to include the TAB in the valuation of the intangible if using the Income Approach.

14.4.4 The TAB applies only when using the Income Approach and when the Cost Approach uses after-tax costs to value an asset (in the Market Approach the price paid to create or purchase the asset would already reflect the ability to amortize the asset).

14.4.5 The TAB also only applies if the notional transaction used for the valuation of the Intangible Asset assumes an uplift in the asset for tax purposes. This would normally be expected if the notional transaction was the sale of the individual asset. It may not apply if the notional transaction was the sale of an entire business unit.

14.5 Discount rates

14.5.1 Observable market evidence for Intangible Asset-related discounts rates is limited, hence significant professional judgment is generally required.

14.5.1.1 Intangible Assets often have higher risks than Tangible Assets;

14.5.1.2 Some intangibles, such as backlog, have more predictable cash flows and therefore lower risk than other Intangible Assets, such as those related to research and development.

14.5.2 Benchmark rates to consider include the following:

14.5.2.1 Risk Free rates with similar maturities to the life of the subject Intangible Asset;

14.5.2.2 Cost of Debt borrowing rates with similar maturities to the life of the subject Intangible Asset;

14.5.2.3 Cost of Equity or rates of return for participants for the subject Intangible Assets;

14.5.2.4 WACC of participants for subject Intangible Assets or of the company owning/using the subject Intangible Asset;

14.5.2.5 Internal Rate of Return if the context is that of a recent business acquisition;

(A) The Internal Rate of Return (IRR) is a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment

14.5.2.6 Weighted Average Rate of Return (WARA) analysis.

(A) The Weighted Average Rate of Return is the weighted average, at market value, of the cost of financing each of the tangible and intangible Assets and the working capital.

14.6 Excess Earnings Method

14.6.1 "estimates the value of an Intangible Asset as the present value of the cash flows attributable to the subject Intangible Asset after excluding the proportion of the cash flows that are attributable to other Assets required to generate the cash flows (Contributory Assets)."

(A) Contributory Assets are the required working capital and any tangible or intangible Assets required for the generation of the cash flows associated with the valuation of intangible Assets.

14.6.2 The most common application under this method is the Multi-Period Excess Earnings Method or MPEEM.

(A) The Multi-Period Excess Earnings Method is a Method which values an Intangible Asset as the present value of the cash flows attributable to the subject Intangible Asset after excluding the proportion of the cash flows which are attributable to other Assets required to generate the cash flows ("Contributory Assets").

14.6.3 This Method should be applied only to one Intangible Asset, generally the most important and central of the Intangible Assets.

14.6.4 The Contributory Assets most commonly encountered are:

14.6.4.1 Working capital;

14.6.4.2 Fixed Assets;

14.6.4.3 Other identified Intangible Assets;

14.6.4.4 Assembled workforce (workforce in place). Although the assembled workforce is not recognized as a separate Intangible Asset, it is still treated as a Contributory Asset requiring a rate of return, as a component of the goodwill figure. (The other components of the goodwill figure are not treated as Contributory Assets.)

14.6.5 The required returns on the Contributory Assets, known as Contributory Asset Charges or CACs, should normally be computed on an after-tax basis.

14.6.6 Care is required in considering two aspects relating to the Contributory Assets:

14.6.6.1 The return of the Asset – that is the recovery of the initial investment in that Asset.

14.6.6.2 The return on the Asset – that is the return on the capital invested in that Asset;

14.6.7 This can be illustrated by example:

14.6.7.1 if there is an adequate depreciation or amortization charge for the Contributory Asset, this is the return of the Asset. This reflects the general consumption of the Asset within the Business. It is then necessary to consider only the return on the Asset. That return is based on the return required from the funding structure of the Business;

14.6.7.2 If the profits are shown without any depreciation or amortization charge and the Contributory Asset is a wasting asset, adjustment will be necessary to allow for a return of the Asset in addition to the return on the Asset.

14.7 Relief from Royalty Method

14.7.1 "the value of an Intangible Asset is determined by reference to the value of the hypothetical Royalty payments that would be saved through owning the asset, as compared with licensing the Intangible Asset from a third party".

(A) A Royalty is a payment made for the use of an asset, especially an Intangible Asset or a natural resource, such as the right to extract minerals.

14.7.2 Most Royalties are paid as a percentage of revenue. The Royalties which have been saved through ownership of the asset are therefore most commonly related to those expected revenues.

14.7.3 There are two means of determining an appropriate Royalty rate:

14.7.3.1 The market Royalty rates for similar Assets; or

14.7.3.2 A split of the profits that might be paid to the notional licensor.

14.7.4 Some Royalty rates are gross, meaning that the costs relating to the asset remain with the licensor; other Royalty rates are net, with those costs being borne by the licensee.

14.8 With-and-Without Method (Premium profit method)

14.8.1 “indicates the value of an Intangible Asset by comparing two scenarios: one in which the business uses the subject Intangible Asset and one in which the business does not use the subject Intangible Asset”.

(A) In the With and Without Method projections are prepared for two scenarios: in one the business uses the relevant Intangible Asset; in the other the business does not use the relevant Intangible Asset.

14.8.2 This method is commonly used in the valuation of non-competition agreements. It may be used for other Intangible Assets if appropriate.

14.8.3 With this method the profits under the two different scenarios are projected. The value of the non-compete agreement then reflects the difference between those two scenarios.

14.9 Greenfield Method

14.9.1 “the value of the subject Intangible Asset is determined using cash flow projections that assume the only asset of the business at the valuation date is the subject Intangible Asset. All other tangible and Intangible Assets must be bought, built or rented”.

(A) The Greenfield Method is an alternative method for the valuation of the most important Intangible Asset. It is assumed that the only Asset of the business is that Intangible Asset. All other tangible and Intangible Assets must be bought, built or rented.

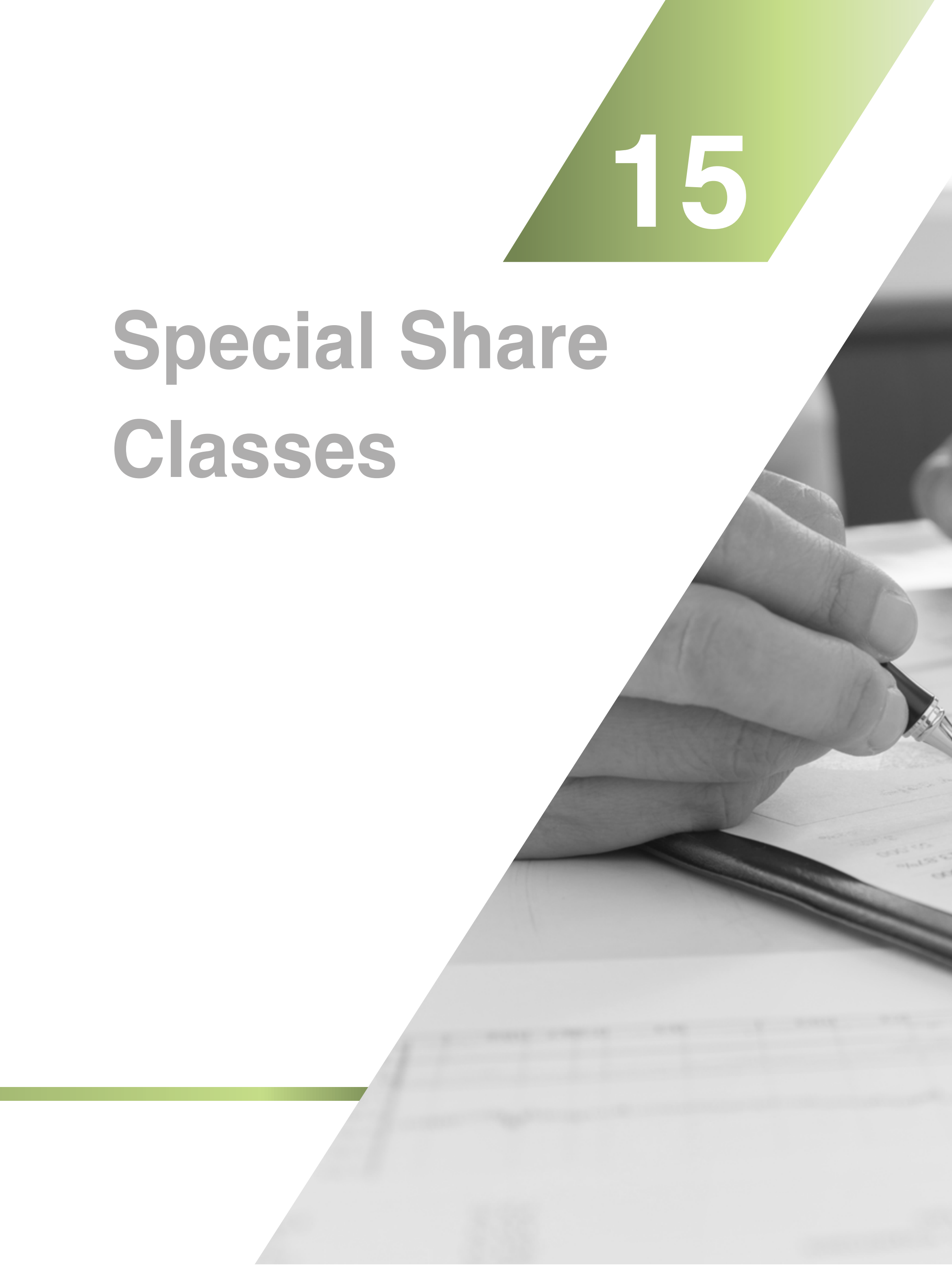
14.9.2 This is conceptually similar to the excess earnings method. Instead of subtracting Contributory Asset Charges from the cash flow, the Valuer is required to assume the costs of having to build, buy or rent the Contributory Assets.

14.10 Distributor Method

14.10.1 "a variation of the multi-period excess earnings method sometimes used to value customer-related Intangible Assets".

(A) The Distributor Method is a valuation method under the income approach for the valuation of certain customer-related Intangible Assets. The margins made by Businesses which act solely as distributors can be used to determine the proportion of profits which relate to customer-related Intangible Assets.

14.10.2 The underpinning concept is that businesses comprise various functions, each of which is due a proportion of the profits made by the business. There are standalone businesses which act solely as distributors of products to customers; the margins made by such businesses indicate the proportion of profits attributable to customer-related Intangible Assets.



15

Special Share Classes

15.1 Introduction

15.1.1 The Capital Structure of a Company may be relatively complex due to different classes of shares. The situations which can result in such complexity can be illustrated by example:

15.1.1.1 A Business owner owns the entire Equity of a company that has a current value of 50 million. He decides to provide incentives to members of the senior management team. This is so that they are motivated to grow the Business and increase its value. He therefore arranges for shares of a different class to be issued to those managers. The main terms of these management shares are:

(A) If there is a sale of the Company in the future the management shares do not receive any part of the proceeds up to 50 million;

(B) The management shares are entitled to receive 25% of the proceeds greater than 50 million. Therefore, if the Company is sold in the future for 70 million the management shares receive 5 million of the proceeds with 65 million going to the existing shares.

15.1.2 The challenge for Valuers is to address the value that exists above the current value. The current value is agreed at 50 million; the management shares do not share in that current value. The valuation Methods which have been covered in previous chapters in this manual are not able to answer that question. Therefore, further valuation Methods are needed to deal with these complex Capital Structures

15.2 Pre - Money and Post – Money Value

15.2.1 Pre-Money value is the value of a business immediately before its most recent round of financing.

15.2.2 A Post-Money Value is the value of a business immediately following its most recent round of financing.

15.2.3 This can be explained by example:

15.2.3.1 A business is valued on a Pre-Money basis at SR 50 million. There is a funding round, with an investor putting SR 10 million into the business in exchange for an interest of %16.67. The Post-Money Value is SR 60 million. The business has additional cash resources of SR 10 million; these can be used to help to fund its continuing development.

15.2.4 IVS 2020 states that the Valuer should consider any potential differences arising from the increased funds in the Business:

15.2.4.1 An infusion of cash may impact the overall risk profile of the Enterprise as well as the relative value allocation between the share classes.

15.2.5 A Valuer should also consider recent transactions in the subject Equity. This is consistent with International Private Equity Valuation (IPEV) Guidelines which emphasize the importance of Calibrating the current valuation by reference to a preceding transaction. The process of Calibration should take account of changes in the entity and in market conditions. As an example:

15.2.5.1 The last funding round was based on the Business having an Enterprise Valuation based on a multiple of 5 times the EBITDA for the previous 12 months;

15.2.5.2 Since that funding round the Business has exceeded its growth targets and has revised future projections. That sector of the market is also transacting at higher EBITDA multiples than previously;

15.2.5.3 These two factors are reflected in a higher EBITDA multiple for the valuation.

15.3 The Three Methods

15.3.1 For complex capital structures, being those that include a form of Equity other than just common stock, IVS 2020 states that Valuers may use any reasonable method to determine the value of a particular class of Equity.

15.3.2 Three methods are stated in IVS 2020:

15.3.2.1 Current Value Method (CVM);

15.3.2.2 Option Pricing Method (OPM);

15.3.2.3 Probability-Weighted Expected Return Method (PWERM).

15.3.3 These are covered in more detail below.

15.4 Current Value Method (CVM)

15.4.1 The CVM is an allocation of the Enterprise value or total Equity value to the various securities assuming a sale of the business on the valuation date.

15.4.2 The obligations to Debt holders are the first to be deducted from the Enterprise Value;

15.4.3 The remainder, if any, is allocated to the classes of preferred stock based on their Liquidation preferences or conversion values;

15.4.4 The residue is then allocated to any common Equity.

15.4.5 Any share classes which only have a payoff above the current Enterprise Value are considered to have a value of nil under the CVM.

15.4.6 The CVM should only be used in the following circumstances:

(A) A liquidity event of the enterprise is imminent;

(B) An early-stage enterprise has developed no Equity value above that of the Liquidation preference on the preferred Equity;

(C) No material progress has been made on the company's business plan;

(D) No reasonable basis exists for estimating the amount and timing of any such value above the Liquidation preference that might be created in the future.

15.5 The Limitation of CVM

15.5.1 A limitation of the CVM is that it is not forward looking. It is strongly arguable that there is a forward-looking value in such shares: this can be tested by continuing the above example:

15.5.1.1 It is highly unlikely that the current Business owner would be prepared to give away any part of the value above 50 million. He may however be prepared to sell such an interest:

(A) If he sells such an interest, he is locking in part of the future growth in value that is anticipated but is not certain. He is receiving funds and is reducing the risk within his shareholding with this partial realization of his interest.

15.5.2 The CVM fails to consider the values within the payoffs of some share classes. These payoffs have very similar attributes to options:

15.5.2.1 Share classes may have a nil value under CVM as they only participate in value above the current value;

15.5.2.2 These share classes can be described as "under water" or "out of the money". In some countries these are known as "growth stocks".

15.5.2.3 the price paid for such stock will likely be relatively modest, as they do not participate in some or all of the current value – this can be related to the price paid for a Call Option in the markets.

(A) A Call Option is an option contract giving the holder of the option the choice to buy stock in the future at a stated price.

15.5.2.4 There is a value attributable to a Call Option over public securities, even when the option Strike Price is above the current market value of the listed securities.

(A) The Strike Price is the amount payable when an option is exercised. This is also known as the Exercise Price.

15.5.2.5 This is explained by an example:

(A) A stock is trading at 100 per share in the markets. An option contract gives the option holder the option to buy stock in two years' time at 120 per share. The option holder pays 11 for this option contract.

(1) This is a Call Option as it is an opportunity, but not an obligation, to buy stock;

(2) (An Option to sell stock is known as a Put Option);

(3) The Strike Price or Exercise Price is 120;

(4) If the stock is above 120 in two years' time the option holder can exercise the option and buy the stock for 120.

(5) If the stock is at 120 or below the option holder will not exercise the Option and will incur a loss of 11.

(6) The Option Holder only makes a profit if the stock price is above 131 in two years' time.

15.5.2.6 The value within a Call Option when it is issued varies in inverse proportion to the extent to which the Strike Price exceeds the current market value (together with other variables).

15.5.2.7 If the company does increase in value to a sufficient extent, there will be value in the relevant share classes. This is similar to there being value in an Option.

15.5.2.8 If the company does not increase in value, the relatively modest price paid for the stock will be lost in the same way that the cost of the call option will be lost.

15.5.3 There is, in broad terms, a degree of symmetry in most Equity securities:

15.5.3.1 there is a near equal possibility of the stock increasing or decreasing in value;

15.5.3.2 the stockholder may therefore either lose or gain say 20% in the value of his investment;

15.5.3.3 the downside risk and the upside potential are therefore relatively equal.

15.5.4 For stocks with little or no share in the current value, the same symmetry does not exist:

15.5.4.1 there is upside potential which is greater than the downside;

15.5.4.2 this is due to the participation in the upside;

15.5.4.3 the downside risk is modest as there is a relatively low current value for such stocks;

15.5.4.4 the low current value is due to the stocks not being entitled to the value currently within the business.

15.5.5 The same absence of symmetry applies to the purchase of a Call Option in the markets.

15.6 Option Pricing Method (OPM)

15.6.1 The OPM values the different share classes by treating each share class as an option on the cash flows from the enterprise.

15.6.2 The OPM may be performed on the Enterprise Value, thereby including any Debt in the OPM, or on an Equity basis after separate consideration of the Debt.

15.6.3 The starting point for the OPM is the value of the total Equity. The OPM is then applied to allocate the total Equity value among the different classes of Equity.

15.6.4 The OPM most frequently uses the Black Scholes Option Model. This has been extended by the inclusion of a dividend Assumption and is known as the Black Scholes Merton model.

(A) The Black Scholes Option Model is a model, with the status of a mathematical proof, devised for the pricing of Option contracts in the markets.

15.6.5 The inputs into the model are:

(A) The Risk-Free rate for the relevant period;
(B) The time period of the option;
(C) The current stock price;
(D) The Strike Price, that is the price payable on exercise of the option;
(E) The volatility;
(F) The continuously compounding dividend.

15.6.6 The most significant variables in the above are likely to be the level of volatility that should be assumed and the anticipated time period to a liquidity event.

15.6.7 The various layers of Equity value are calculated by setting the current stock price as the present value of the entire Equity; the strike price is then set at the different breakpoints at which the various share classes begin to participate.

15.6.8 As noted above, the volatility is likely to be a significant input. It is challenging to determine an appropriate level of volatility for shares that are not regularly traded in a very liquid market. In determining volatility Valuers should consider:

15.6.8.1 The development stage of the asset and the relative impact to the volatility when compared to that observed by the comparable companies;

15.6.8.2 The relative financial leverage of the asset.

15.6.9 In addition to the above method, the OPM can be used to back solve for the value of the total Equity, and the value of the different classes of shares, if the value of one type of Equity is known.

15.7 Probability Weighted Expected Return Method (PWERM)

15.7.1 Under PWERM the share value is based on the probability-weighted present value of expected future investment returns, considering each of the possible future outcomes available to the asset and the rights and preferences of the share classes.

15.7.2 This is a method that may be used when a company is close to an exit and various different outcomes are considered.

15.7.3 PWERM therefore requires the production of a number of different scenarios; each projection then has to be weighted in terms of probability.

15.7.4 The scenarios may be a range of different profit outcomes; it will also consider alternatives such as staying private, IPO, or a trade sale to another company.

15.7.5 The various outcomes are then allocated over the various classes of equity, so that the potential value of each type of stock can be determined.

15.7.6 Valuers should reconcile the probability-weighted present values of the future exit values to the overall asset value to make sure that the overall valuation of the enterprise or the equity is reasonable.

15.7.7 Valuers can use a hybrid method, with PWERM being used to determine the total value and OPM being used to allocate that total value over the various share classes.

16

Non-Financial Liabilities

16.1 General

16.1.1 IVS 220 is a new addition to IVS, being included for the first time in IVS 2020.

16.1.2 Non-Financial Liabilities are defined as:

(A) "those liabilities requiring a non-cash Performance Obligation to provide goods or services."

(B) A Performance Obligation is the obligation contained within a liability. For a financial liability the performance obligation is settlement in cash, known as Fulfilment. For a Non-Financial Liability the Performance Obligation is the provision of goods or services, and this requires a fulfilment effort.

(C) Fulfilment is the discharge of a performance obligation of a liability.

16.1.3 Examples of Non-Financial Liabilities are:

(A) Deferred revenue, also referred to as contract liabilities;

(B) Warranties;

(C) Environmental obligations;

(D) Loyalty programmes;

(E) Power purchase agreements;

(F) Certain litigation provisions;

(G) Product guarantees.

16.1.4 The essential quality of Non-Financial Liabilities is given in IVS 220.20.4:
"The party assuming a Non-Financial Liability typically requires a profit margin on the Fulfilment effort to compensate for the effort incurred and risk borne for the delivery of goods or services."

16.1.5 The measurement of Non-Financial Liabilities is based on a deemed transfer of the obligation to a third party. In IVS 220 the risk is therefore considered to be non-performance risk – the credit risk of the counterparty obligated to fulfil the liability.

16.1.6 For financial liabilities, cash fulfilment is typically the only performance obligation. There is therefore an Asset-Liability Symmetry. This means that the liability can be valued by reference to the value of the asset. There is often no such symmetry with Non-Financial Liabilities.

(A) Asset-Liability Symmetry is the concept that financial liabilities can be valued at the same amount as the related asset.

16.1.7 Non-Financial Liabilities are valued for various purposes, including:

(A) Financial reporting;

(B) Tax purposes;

(C) Litigation;

(D) Advice on transactions.

16.2 Asset-Liability Symmetry

16.2.1 Non-Financial Liabilities often do not have a corresponding asset recognized by the counterparty. The example provided is that of environmental liabilities.

16.2.2 Other Non-Financial Liabilities are reflected in a corresponding asset but one which is not separable and capable of measurement as an asset, such as a product warranty.

16.2.3 The market for Non-Financial Assets and Liabilities is often highly illiquid. This means that there is no symmetry in the information. This then results in high Bid-Offer spreads and asymmetric asset and liability values.

16.3 Bases, Approaches and Methods

16.3.1 The bases of value applicable will often be defined by organizations other than the IVSC in accordance with the purpose – financial reporting, taxation, etc.

16.3.2 There are several places in IVS 220 in which the IVSC recognizes that valuation techniques may be determined by external organizations rather than by the requirements and guidance in IVS 220.

16.3.3 The three valuation Approaches may all be applicable in accordance with the applicable basis.

16.3.4 Non-Financial Liabilities are only infrequently transacted on their own and this therefore hampers the use of the Market Approach. It is rarely possible to find direct market evidence. Such market evidence will normally be in the form of Guideline / Comparable Transactions. Qualitative adjustments will often be required if using market data. However, the use of market-based inputs should be maximized. Three of the examples given are:

- 16.3.4.1 Pricing from third parties to fulfil obligations such as in respect of deferred revenue;
- 16.3.4.2 Pricing for warranty policies issued by third parties for similar obligations;
- 16.3.4.3 The monetary conversion amounts for certain loyalty reward programmes.

16.3.5 Two methods to value Non-Financial Liabilities are the Top-Down Method (Market Approach) and the Bottom-Up Method (Income Approach).

16.3.6 The Top-Down Method requires reliable market evidence for the performance obligation:

16.3.6.1 The example given is of deferred revenue: the concept is that a Market Participant could consider the market price of an obligation, such as unfulfilled orders;

16.3.6.2 The costs of obtaining those orders will be sales and marketing costs that have already been incurred;

16.3.6.3 Those costs, together with an appropriate profit margin, should be deducted from the market price. The result is the remaining amount of the deferred revenue obligation that needs to be fulfilled.

16.3.7 The use of the Income Approach normally requires the value of a Non-Financial Liability to be considered as the present value of the future cash outflows plus a profit margin that would be required to assume the liability. This is the essence of the Bottom-Up Method.

16.3.7.1 The costs required to fulfil the Performance Obligation are computed.

(A) These costs will include both the direct costs and also any indirect charges such as charges for the use of Contributory Assets.

(B) Costs incurred as part of the selling activities before the acquisition date should be excluded from the Fulfilment effort.

(C) It may occasionally be appropriate to include opportunity costs:

(1) The example given is of the licensing of symbolic intellectual property. If the obligation reduces the scope to monetize the underlying Asset (as the licence grants exclusivity) there may be opportunity costs associated with such an arrangement.

16.3.7.2 A reasonable mark-up is applied to the Fulfilment effort. This may be a lump sum or an assumed reasonable margin.

16.3.7.3 Determine the timing of the cash outflows and discount to net present value.

(A) This needs to be done with care: if the Fulfilment costs are derived through a percentage of revenue, that revenue will be likely to reflect the timing of its receipt. For example the cash flow benefit of payment in advance may already been reflected in the amount of the revenues when compared to revenues received during or after Fulfilment.

16.3.8 The Cost Approach is stated by IVS 2020 to have limited application. The reason is given near the beginning of this chapter: the party assuming a Non-Financial Liability will normally require a profit margin on the Fulfilment effort. (There is scope under the Cost Approach to include either mark-ups or opportunity costs so as to include such a profit margin.

16.4 Discount Rates, Cash Flows and Risk Margins

16.4.1 In the Income Approach investors expect to receive a return on their investments: that return will vary in accordance with the risks involved.

16.4.2 As noted earlier, IVS 220 requires that the discount rate should account for the time value of money and the non-performance risk of the counterparty.

16.4.3 IVS 220 recognizes that other regulatory bodies may require the discount rate to be related to the risks within the liability. If so, such requirements must be followed.

16.4.4 Certain Non-Financial Liabilities are long term: an example is an environmental obligation to restore land after mineral extraction has taken place. The Valuer must ensure that the discount rate and the cash flow estimates are prepared on a consistent basis in respect of inflation.

16.4.5 There can be considerable difficulty in determining future cash flows. Different methods are suggested:

16.4.5.1 The modelling of multiple scenarios to derive a probability-weighted cash flow, known as the Scenario-Based Method or SBM;

16.4.5.2 The use of Monte Carlo simulation;

16.4.5.3 Option pricing models.

(A) The Scenario Based Method involves the modelling of multiple scenarios for possible future cash flows. This is often used for the valuation of Non-Financial Liabilities

16.4.6 Due to these uncertainties an appropriate risk margin should be included in the cash outflows. The Valuer must:

(A) Document the method used for developing the risk margin;

(B) Provide evidence for its derivation;

(C) Consider the time periods involved;

(D) Consider geographic locations;

(E) Consider the relevant currency;

(F) Consider whether the cash flows are probability-weighted, most likely or contractual.

16.4.7 IVS 220 states that the risk margin should increase in proportion to the uncertainty in the cash flows. There may be a high “tail risk” or there may be a wide distribution of likely outcomes. These should impact on the risk margin required.

16.4.8 There is an inverse relationship between the discount rate and value;

16.4.8.1 For Non-Financial Liabilities it is counter-intuitive that the discount rate should be decreased to reflect the additional risk due to uncertainties as to the amount and timing of cash outflows. This should only be done if it is not feasible to include a risk margin in the cash outflows.

16.4.9 There may be restrictions on transfer of Non-Financial Liabilities. These may be contractual in nature or may reflect an illiquid market for the relevant Non-Financial Liability.

16.4.10 When using market evidence, the Valuer should consider whether adjustments to reflect the transfer restrictions should be included.

16.4.10.1 The IVS definition of the Market Value basis assumes that an asset or liability is freely transferable for the purposes of considering its market value. However, the fact that there may be restrictions on transfer in any future transaction is an aspect of that Asset or liability which is reflected in that Market Value.

16.5 Taxes

16.5.1 Valuers should use pre-tax cash flows and a pre-tax discount rate for the valuation of Non-Financial Liabilities.

16.5.2 The way that a similar requirement in International Accounting Standard 36 (Impairment of Assets) is implemented is that calculations are prepared on a post-tax basis. A back solve method is then used in order to state the applicable pre-tax discount rate.

Notes:

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Code of Ethics and Professional Conduct for Valuers

17.1 Introduction

The Saudi Authority for Accredited Valuers "Taqeem" is the entity responsible for setting standards and controls necessary for valuation activities of real estate, economic entities, equipment, movable properties and the like in accordance with the Accredited Valuers Law issued pursuant to Royal Decree no. (m/43), dated (1433/07/09H). Taqeem aims to promote the valuation profession, improve the proficiency of valuers, set the general provisions for memberships, and organize continuous professional education courses to raise its members to the highest level of practice and international standards. Taqeem is a non-profit corporate personality that has an independent budget and operates under the supervision of the Ministry of Commerce and Industry.

The Saudi Authority for Accredited Valuers emphasizes the importance of professional conduct on valuation and is committed to set and maintain (the Code of Ethics and Professional Conduct for Valuers) which contributes to the development of the valuation profession and consolidates the public trust.

17.2 Scope of Code

17.2.1 Compliance with laws and regulations and the application of standards is achieved by the adherence to this Code. Therefore, all valuers licensed by the Authority to practice valuation whether temporarily until their approval or accredited members, natural or corporate persons must comply with this Code. The valuer shall also require the compliance with this Code from his subordinates or associates in the valuation process.

17.2.2 When conducting any valuation service, this Code applies to all internal and external valuers as well as valuers excluded from the Law. The Code also applies to all valuation, review and consultation services and to all sectors of valuation included in the Law which are; real estate, economic entities, equipment, movable properties and the like. Furthermore, the Code applies to all active, associate, honorary and student members once they join the membership of the Authority as specified by the Law and implementing regulations.

17.2.3 All valuers shall comply with the general provisions of this Code and pursue its aims and objectives, realize the scope of its application and the dimensions of the process and related parties of the valuation profession. Valuers shall meet the valuation and valuer's requirements, as well as follow the fundamental principles and ethical behavior of the Code at all times and in all transactions with related parties. Valuers shall conform to understanding the Guidance for this Code; including the issued General Concepts and the subsequent further guidance, as well as the disciplinary actions for Code violation.

Sample

17.3 The Aim of this Code

Developing the valuation profession and maintaining continuous and constant improvement:
This Code does not only positively affect the clients and other beneficiaries trust in valuation services only, but also extends it effect to include the public trust in the valuation profession. To achieve such result, this requires all members to work to achieve the following objectives:

17.3.1 Uphold public interest:

(A) Always act in a way that upholds the public interest.

17.3.2 Gain Public Trust:

(A) Striving relentlessly to gain and maintain public trust.

(B) Members of the Authority must realize that acting in the public interest involves having regard to the legitimate interests of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the valuation profession to support the public interest and orderly functioning of the market.

(C) The public interest includes reasonable and informed professional decisions which have greater influence on third parties.

17.3.3 Pride in the profession and quality of performance:

(A) Achieving these aims requires all members of the Authority to provide high quality valuation services demonstrating full commitment to the professional level that is consistent with the fundamental principles of the Code.

17.4 General Provisions

17.4.1 All members of the Authority must comply with all laws and regulations applicable in the Kingdom of Saudi Arabia.

17.4.2 Valuation practitioners shall acknowledge and recognize this Code and all its aims, principles and provisions set forth therein and commit to it as soon as they join the Authority's membership.

17.4.3 The valuer shall be responsible for his associates, advisers or employees' commitment to all principles, provisions and requirements of this Code.

Sample

17.4.4 Members shall not prepare or participate in a valuation service that violates the laws, regulations or complementary decisions of this Code.

17.4.5 The valuer shall report any unprofessional or unethical behavior or any breach of the provisions of this Code.

17.4.6 When a member is exposed to any suspicious situations or conditions not stated explicitly in the provisions of this Code, the valuer must refer the matter to the Authority to determine the procedures to be followed.

17.4.7 A valuation practitioner must meet the requirements of the Accredited Valuers Law and its implementing regulations and be an active member in the Saudi Authority for Accredited Valuers. The valuer shall employ approved methods accurately to provide credible services, continue training in continuous professional education courses, and follow all the requirements of this Code. It is necessary to ensure the integrity of the valuation process by providing the users of valuation services with valuers that have the right experience, skill and judgment.

17.4.8 The valuer shall comply with the ethical and professional principles. These include, fairness, impartial judgments that are not subject to any pressure, and experience in the valuation of the subject asset. The valuer shall be knowledgeable about the characteristics of the subject, aware of the rules and procedures of valuation, and has no direct or indirect interest in the subject asset. A valuer shall refrain immediately from any valuation process or advice for public or private entities, especially judicial authorities and financial institutions for any asset in which the valuer has a direct or indirect interest, and to disclose clearly the state of his ownership or the ownership of his relatives (to the third degree) of any Assets associated with or affected by the value of subject Assets.

17.4.9 The valuer shall refrain from using undeserved titles to promote himself such as the titles of "accredited valuer" or "licensed valuer" unless granted by the Authority. The valuer shall conduct services with the licensed title granted by the Authority as displayed in the membership card. The valuer must sign valuation reports issued by his office or his company himself. The valuer shall not assign anyone to sign the valuation report on his behalf unless he is a provisional or accredited member.

17.4.10 The valuer shall comply with professional and ethical principles, especially the following:

Sample

17.4.10.1 Ethical Principles:

(A) Integrity: Provide honesty, fairness and clarity in all professional relationships and business dealings.

(B) Independency: Ensure the complete absence of any real or potential conflict of interest. The valuer shall not let personal bias, external pressures or interests influence his professional judgment.

17.4.10.2 Professional Principles:

(A) Competence: To maintain the necessary skills and knowledge required to provide the client with the best service competent with recent developments in practice, legislation and valuation techniques.

(B) Professional Behavior: The valuer shall commit to act diligently, carefully, thoroughly and on a timely basis in accordance with the regulatory requirements and applicable technical and professional standards and avoid any action that may discredit the profession. This includes;

(1) Accepting assignments: Before a valuer decides to accept any assignment, he must determine the scope of work and ensure that the assignment does not pose threats to the fundamental principles of this Code, if there is any, the valuer must use safeguards to eliminate these threats or reduce them.

(2) External sources: When recruiting the help of third parties to complete the set of skills needed in the valuation assignment, the valuer must conform that the required skills and ethical principles are applicable as well as obtain the consent of the client. The third party should disclose the identity of the assistants and their role in the preparation of the valuation report.

(3) Efficiency and Diligence: The valuer must act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis. The valuer must work diligently at client service and inform the clients regularly of the assignment developments. The valuer must treat clients and the public with courtesy and respond quickly and effectively to reasonable instructions and complaints.

(4) Confidentiality: The valuer shall always undertake his work in full confidentiality and shall abstain from disclosing any special information about any client except for legal reasons (an order from the court or the Authority).

(5) Disclosure: Transparency is essential for valuation users to understand major valuation issues and ensure that the valuation report is not misleading. A valuer may, without breaching confidentiality, disclose confidential information to third parties, when obliged to do so by law or regulations.

Sample

(6) Information and Documentation: The valuer must verify the data used in valuation and check its reliability as well as keep the work file of each assignment for at least ten years after the assignment is completed.

17.4.11 Valuers who breach the provisions provided in this Code shall be referred to the Accredited Valuers Violation Review Committee.

17.5 Fundamental Principles:

17.5.1 Article (1): Integrity:

17.5.1.1 A valuer shall be straightforward and honest in all professional and business relationships.

17.5.1.2 A valuer shall not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

17.5.1.3 A valuer must be content and abstain from self-desires and avoid doubtful matters, as he must "give up what is doubtful for that which is not doubtful". The valuer might hold for something permissible for fear of falling into that which is prohibited.

17.5.1.4 A valuer shall not knowingly be associated with reports, returns, communications or other information where the valuer believes that the information:

(A) contains false, misleading or biased information, analyses or results.

(B) Withhold or omit required information that might lead to misleading results.

17.5.1.5 When a valuer becomes aware that he has been associated with such information, he shall take necessary steps to be disassociated from that information. For example, issue a modified version of the valuation or report.

17.5.1.6 In marketing and promoting themselves and their work, valuers shall be honest and truthful and not:

(A) Make exaggerated claims about the qualifications they possess, experience they have gained, or neglect the correction of such claims.

(B) Use incorrect or misleading information or exaggerated declarations for the services they provide.

(C) Make disparaging references or unsubstantiated comparisons to the work of others.

17.5.1.7 A valuer shall not conduct his job in a way that leads to error.

17.5.1.8 A valuer shall not be involved in providing valuation services that the majority of valuers refuse for logical reasons.

17.5.1.9 A valuer must act consistently in a way that emphasizes his compliance with applicable and related regulations and legislation.

Sample

17.5.1.10 The valuer must avoid any action that a reasonable and informed third party would likely to conclude that it adversely affects the valuer's integrity and compromises his professionalism.

17.5.1.11 A valuer shall not accept gifts, donations or unusual exceptions before accepting the valuation assignment, during the assignment or after its completion based on the result of his work.

17.5.2 Article (2): Independency:

17.5.2.1 The valuer shall not compromise his professional or business judgment because of bias, conflict of interest or the undue influence of others.

17.5.2.2 A valuer shall not to act for two or more parties in the same matter without the written consent of both parties.

17.5.2.3 A valuer must take all necessary precautions to prevent the emergence of conflict of interests between the interests of his clients.

17.5.2.4 When valuating a subject, the valuer shall take all necessary precautions to ensure there is no direct or indirect interest for him, his company, his relatives, his friends or his partners in the subject asset. Indirect interest includes everything that the subject asset affects. When there is such a conflict, the valuer must disclose this information.

17.5.2.5 The valuer must disclose his state as an internal or external Independent valuer.

17.5.2.6 The valuer must disclose potential conflicts in writing before accepting the assignment, or later conflicts that the valuer discovers at a later date.

17.5.2.7 The valuer must disclose conflicts discovered after the completion of the valuation immediately after the discovery of those conflicts.

17.5.2.8 The valuer shall execute each assignment independently and impartiality without regard to personal interests.

17.5.2.9 When valuing a subject, a valuer must not let personal preferences affect the valuation.

17.5.2.10 A valuer shall not accept a valuation assignment or prepare any valuation that involves a predetermined or pre-planned opinions or views.

17.5.2.11 Valuation fees must not depend on the results. For example, the fee is a percentage of the value or the fee will be paid after the execution of the transaction.

17.5.2.12 A valuer shall not accept an assignment based on assumptions unlikely to be achieved in a time span logically consistent with those assumptions.

17.5.2.13 Assumptions must be logical, for example, valuing a land as decontaminated, provided that the assumption is accompanied by a study on its possibility and the value if it cannot be achieved.

Sample

17.5.2.14 A valuer shall not use or rely on unsubstantiated conclusions or conclusions built on basis of prejudice of any kind or conclusions that reflect a prejudiced opinion the report relies on or increases its value.

17.5.2.15 A valuer must work with various clients and not depend totally on a limited number of clients which threatens his objectivity.

17.5.2.16 When a valuer reviews a report prepared by another valuer, as in security lending or other purposes, the valuer must always be impartial, make fair judgments and justify the reasons for his agreement or disagreement with the report's conclusions.

17.5.3 Article (3): Competence:

17.5.3.1 The valuer must ensure that clients or employers receive competent professional service.

17.5.3.2 Valuation shall not be practiced by persons who do not apply to the definition of "valuer" contained in this Code and those who do not meet the conditions and requirements.

17.5.3.3 The valuer must be certain that he possess the professional knowledge and skill required to ensure competent professional service.

17.5.3.4 Valuers must act diligently in accordance with applicable technical and professional standards when providing professional services.

17.5.3.5 The valuer must exercise sound judgment and skill in applying professional knowledge and performing such service.

17.5.3.6 The maintenance of professional competence requires continuous awareness and understanding of relevant technical, professional and business developments. Continuing professional development enables the valuer to develop and maintain the capabilities to perform work competently.

17.5.3.7 A valuer shall take reasonable steps to ensure that those working under his authority in a professional capacity have appropriate training and supervision.

17.5.3.8 Where appropriate, a valuer must be aware of his limitations. If the valuer does not have sufficient professional knowledge and experience to carry out the valuation service, or does not have the ability to acquire it before the job is done, he must require the assistance of someone experienced in this type of assignment or to withdraw from the assignment altogether.

17.5.4 Article (4): Professional Behavior:

The valuer shall commit to working with professionalism and diligence and present work in a timely manner in accordance with the regulatory requirements and applicable technical and professional standards, and avoid any actions that discredit the profession. These includes;

Sample

17.5.4.1 Accepting Assignments: Before accepting any assignments or engagements, a valuer must:

(A) Understand the dimensions of the required assignment; this includes identifying the parties involved in the assignment, the subject asset, the purpose of the assignment and the basis of value, to agree with the client on the scope of work.

(B) Ensure that the scope of work is sufficient to achieve credible results.

(C) Ensure that the assignment does not pose any threats to compliance with this Code, if any, the valuer must use safeguards to eliminate the threats or reduce them.

(D) Receive precise instructions from the client and document it in writing in accordance with the International Valuation Standards before engagement to avoid any misinterpretation of meanings or scope of work.

17.5.4.2 The valuer shall refuse any assignments that do not meet the previous points. If the valuer accepts an assignment then later discovers a threat to compliance with the principles of this Code, he shall disclose this to the client, and determine how to deal with the assignment. There might be cases when the valuer withdraws from the assignment after accepting it.

The valuer must not accept an assignment if the circumstances do not permit the achievement of accurate and reliable high quality results. This usually leads to the disappointment of the client and valuer alike and affects the reputation of the profession.

External sources:

(A) When recruiting the help of third parties to complete the set of skills needed in the valuation assignment, the valuer must conform that the required skills and ethical principles are applicable.

(B) The valuer must obtain the consent of the client when requiring the help of external sources. The third party should disclose the identity of the assistants and their role in the preparation of the valuation report.

(C) The contributions of each person shall be mentioned in the report as well as how the valuer used the information they have provided in the valuation report. This helps the client to understand the role of each person and reduce confusion.

17.5.4.3 Efficiency and Diligence:

(A) The valuer must work effectively to execute the clients instructions and notify them regularly of the assignment developments.

(B) The valuer must work according to the requirements of the assignment carefully, diligently and in a timely manner.

Sample

(C) The valuer must work hard to provide the best services for clients and exercise due care to ensure that the provided service is in accordance with all applicable professional and technical regulations and standards of the valuation subject, the purpose of the valuation or both.

(D) The valuer must treat clients and the public with courtesy and respond quickly and effectively to reasonable instructions and complaints.

17.5.4.4 Confidentiality:

(A) A valuer must handle the client's information sensitively all times and must not disclose confidential information or results relevant to an assignment for, or would be beneficial to, another party or person.

(B) The valuer shall not use confidential information gained as a result of professional relationships for the personal advantage of the valuer or third parties.

(C) A valuer shall maintain confidentiality of information disclosed by a prospective client or employer.

(D) A valuer shall maintain the confidentiality of information within the firm or employing organization.

(E) A valuer shall maintain confidentiality, including in a social environment, being alert to the possibility of inadvertent disclosure, particularly to business colleagues or family members.

(F) A valuer shall take reasonable steps to ensure that staff under his control and persons from whom advice and assistance is obtained respect the duty of confidentiality.

(G) The valuer shall comply with the principle of confidentiality even after the end of relationships between the valuer and a client or employer.

(H) The valuer is entitled to use prior experience when the valuer changes employment or acquires a new client. The valuer shall not, however, use or disclose any confidential information either acquired or received as a result of a previous professional or business relationship.

17.5.4.5 Disclosure:

Disclosure is essential for valuation users to understand the major issues, and ensure that the valuation report is not misleading. However, disclosure alone is not sufficient to meet ethical standards. Without prejudice to the principle of confidentiality, the following are circumstances where valuers are or may be required to disclose confidential information or when such disclosure may be appropriate:

(A) Disclosure is permitted or authorized by the client or the employer;

(B) Disclosure is permitted by law.

(C) Disclosure is required by law, for example:

Sample

(1) Production of documents or other provision of evidence in the course of legal proceedings; or

(2) Disclosure to the appropriate public authorities of infringements of the law that come to light; and

(D) There is a professional duty or right to disclose:

(1) To comply with the quality review of the Saudi Authority for Accredited Valuers,

(2) To respond to an inquiry or investigation by the Authority,

(3) To respond to the regulatory procedures in accordance with the Authority such as to disclose to the Violation Commission,

(4) To protect the professional interests of a valuer in legal proceedings; or

(5) To comply with technical standards and ethical requirements.

(E) In deciding whether to disclose confidential information, relevant factors to consider include:

(1) Whether the interests of all parties, including third parties whose interests may be affected, could be harmed if the client or employer consents to the disclosure of information by the valuer;

(2) Whether all the relevant information is known and substantiated, when the situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgment shall be used in determining the type of disclosure to be made, if any; and

(3) The type of communication that is expected, to whom it is addressed and whether it is appropriate.

(F) Information and Documentation:

(1) A valuer must verify the data used in the valuation and identify the extent of its reliability.

(2) When the valuer receives information from the client, he must reasonably verify and document the extent of the client's confidence in this information and ensure its accuracy.

(3) A valuer shall not rely on information presented by the client or any other party without verification of their eligibility or source, unless the valuer specifies the nature and extent of the information as a restriction, i.e. a limit imposed on the valuation.

(4) A valuer must prepare a work file for each assignment. The file shall contain a hard or soft copy of every written report, correspondence, note, and document in addition to the information, data and procedures adequate to support the valuer's opinion such as inquiries, inspections, sources, methods, analyses, and calculations.

Sample

(5) Every file shall contain supporting information for the valuer's work, even when the valuer only provides a brief report to the client.

(6) The work file must be prepared in a way that someone who does not have any previous relationship with the assignment can determine the stages underpinning the valuation process up until the conclusions, and this is the main purpose of the work file.

(7) The valuer shall keep the work file of each assignment for at least ten years after the assignment is completed. If the assignment includes litigation, the year count starts after the end of the litigation, including appeals.

17.6 Guidance:

17.6.1 Further guidance shall be issued as appendices to this Code. The guidance shall provide assistance to the valuer and explain some of the general concepts or provide examples of threats to complying with the Code. The guidance will address these threats because of the wide range of relationships, circumstances, and safeguards to be taken into consideration to eliminate these threats or reduce them to an acceptable level. Guidance on complaints or disciplinary action for the violation of this Code shall be provided, or further guidance in response to any new requirements for the valuers, market or clients.

Sample

Implementing Regulations of Accredited Valuers Law

Chapter I: Definitions

Article (1):

The following terms shall have the meanings set forth below, unless the context requires otherwise:

1. Ministry: The Ministry of Commerce and Investment.
2. Minister: The Minister of Commerce and Investment.
3. Taqeem: The Saudi Authority for Accredited Valuers
4. Council: Taqeem's board of directors.
5. Profession: Business valuation.
6. Law: Accredited Valuers Law, issued by the Royal Decree Number M/43 and dated 1433/07/9.
7. Regulations: Implementing Regulations for the Accredited Valuers Law (Business sector).
8. Code: Taqeem's Code of Ethics and Conduct for the Valuation Profession.
9. Registry: The Registry where Taqeem-accredited valuers in the Business sector are registered at the Ministry.
10. Valuation standards: The standards approved by Taqeem.
11. Guidebook: Business valuation guidance that Taqeem issues for enhancing the quality of valuation and raising the professional competence of valuers.
12. Business: Business entities or interests regardless of their size, weather personal or corporate including Assets and liabilities, and intangible Assets such as patents, trademarks, goodwill and intellectual property.
13. Business Valuation: The act or process of determining the value of various business entities or interests according to a purpose and basis of value.
14. Accredited Valuer: Natural or legal persons authorized to practice the valuation profession.
15. Subscriptions: The predetermined amount of money required for membership designations, Firm Account and other services provided by Taqeem.
16. Valuation firm: A place the Accredited Valuer takes as headquarter for valuation operations and meets the regulatory requirements whether it is an individual office or a professional company.
17. Experience hours: The acquired hours of professional valuation practice. The Guidebook shall determine the process of calculating the hours. Equivalent hours shall be allocated to attend seminars, conferences, workshops and other related valuation events.
18. Firm account: An online account created by an Accredited Valuer in Taqeem's Electronic System where the valuer uploads a summary of valuation reports issued by the Valuation Firm. This Account allows the user to calculate Experience Hours for the Accredited Valuer and other valuers, associate and student members affiliated to the Firm.
19. Valuation report: The document issued by an Accredited Valuer to the Client, which includes conclusion of value, adheres to the Accredited Valuer requirements in the Law and Regulations and complies with the adopted valuation standards.

Sample

20. Valuation summary: Online forms in Qima Portal the Accredited Valuer uses to summarize valuation reports issued by the Valuation Firm, it includes valuation information such as who participated in the valuation assignment and the nature of their participation.

21. Client: The beneficiary of the valuation assignment whether a natural or legal person.

22. Electronic systems: The online systems Taqeem utilizes to regulate valuation practice, and it includes:

a) Qima Portal: An online portal that provides services to Taqeem members where they can organize and document their work as well as register their experience hours.

b) Any other system or means adopted by Taqeem to regulate the profession.

Chapter II: Memberships in Business Valuation Sector

Article (2):

2.1 Taqeem Business Valuation memberships shall be categorized as follows:

A. Basic Membership:

First: Those exempted under Article 40 of the Law, and they include the following designations:

1. Provisional member
2. Accredited member

Second: Holders of a university degree in any discipline, provided they obtain the fellowship certification. This category includes the following designation:

- Fellow Member

Third: Those exempted under Article (40) of the Law and passed Taqeem's qualification exams without obtaining the fellowship certification. This category includes the following designations:

- Practitioner Member.

B. Associate Membership.

C. Student Membership.

D. Honorary Membership.

2.2 The requirements for Memberships are as follows:

A. Basic Membership:

1. Provisional Member: A person who has met the following requirements:

a) Presented evidence of Business valuation experience before the Law came into effect.

b) Passed Taqeem courses, which include:

- BV 201-200.
- BV 202.

c) Met the requirements for the membership form and completed all required documents.

d) Passed the interview.

e) Paid the membership subscription fee.

2. **Accredited Member:** A person who has met the following requirements:

   a) Acquired the Provisional Member designation

   b) Passed Taqeem courses, which include:

      • BV 203.

      • BV 204.

   c) Gained at least (1000) hours of verifiable experience registered in the Firm Account, of which at least (500) hours has been worked as a Provisional Valuer.

   d) Paid the membership subscription fee.

3. **Fellow Member:** a person who has met the following requirements:

   a) Acquired the Accredited Member designation, or the Associate membership.

   b) Passed the exams of Taqeem courses which include:

      • BV 205 for Accredited Members.

      • BV 205 & 204 ,203 for Associate Members.

   c) Gained at least (1000) hours of verifiable experience registered in the Firm Account, after acquiring the Accredited Member designation. Associate members are required to gain at least (2000) hours of verifiable experience registered at the Firm Account -while being registered as a student or an associate member- of which at least (1000) hours gained after passing (BV 204 & 203) courses, and another (500) after passing (BV 205).

   d) Has a bachelor's degree or its equivalent in accounting, economics, finance, or similar scientific specializations at an accredited university, unless exempted under article (40) of the Law.

   e) Paid the membership subscription fee.

4. **Practitioner member:** a person who has met the following requirements:

   a) Presented an evidence of (20) years of valuation experience before the Law came into effect.

   b) Passed Taqeem exams -except Fellow exams- to qualify the member for accreditation.

   c) Paid the membership subscription fee.

Sample

B. Associate Membership:

Associate Member: a person who has met the following requirements:

1. Has a bachelor's degree or its equivalent in accounting, economics, finance, or similar scientific specializations at an accredited university.
2. Passed the exams of Taqeem courses which include:
   - BV 201-200 courses.
   - BV 202.
3. Paid the membership subscription fee.

C. Student Membership:

A Student Member designation will be granted to an applicant who is:

1. Pursuing a Bachelor's degree or its equivalent in accounting, economics, finance, or a similar scientific specialization at an accredited university.
2. Paid the membership subscription fee.

D. Honorary membership:

An Honorary Member designation is granted by the Taqeem's Board of Directors to natural or legal persons in recognition for their achievements or their services to the Business Valuation profession.

2.3 All Basic Memberships in section (A) of paragraph 2.1 – except Practitioner Members- shall commit to meet the requirements of Fellow Members by the end of the, original or extended, period stipulated in Article (40) of the Law.

2.4 Taqeem shall develop the necessary criteria for the equivalency of expertise and other accreditation programs from local or international authorities to their counterpart membership designations in this Regulation.

Article (3):

3.1 Taqeem grants each affiliated member, who has met all membership requirements, a membership card containing the member's information, designation and expiration date.

3.2 Taqeem shall issue the necessary decisions to regulate the membership renewal process and address any delay thereof.

3.3 All members of Taqeem shall return the membership card immediately upon the decision of membership cancellation.

Sample

Chapter III: Valuation Practice and Licensing Conditions

Article (4):

An Accredited Valuer shall practice valuation according to the following:

(1) Comply with the provisions of the Law, Regulations, Code of Ethics, and Guidebook;

(2) Practice valuation though a Valuation Firm;

(3) Display the valuer's information at the Firm's main office and other subsequent branches, if any, including the name of the Accredited Member, license number, authorized sector and phone number;

(4) Indicate the authorized sector and Basic Membership designation when signing valuation reports;

(5) Create a Valuation firm account and pay the required subscription for the service;

(6) Upload a Report Summary -on the Firm Account- for every valuation issued by the Firm as well as register experience hours. The summary shall provide details of who participated in the valuation assignment and the percentage of the Accredited Valuer's, and other valuers -who have acquired Basic Memberships-, associate members and students;

(7) All valuers at the Firm shall be active Basic Members and work under the supervision and responsibility of the Accredited Member according to legal written contracts;

(8) All valuers at the Firm shall be of good behavior and conduct and has not been convicted to a penalty or punishment of a crime that is against integrity or honesty, unless rehabilitated;

(9) Taking into account the provisions, regulations and other decisions related to the Saudi Labor Law, the Accredited Valuer shall commit to have no less than %25 Saudi professionals in the Firm who have basic membership, associate membership or student membership of total valuers.

(10) Train associate and student members according to the arrangements determined by Taqeem.

(11) Renew Taqeem membership and practice license before its termination. This obligation is demanded by all partners if the Accredited Member is a legal person.

(12) Ensure that the valuers at the Firm -who have a Basic Membership- and trainees such as associate and student members shall renew their Taqeem membership before its termination;

(13) Work according to the rules and instructions provided by Taqeem;

(14) Notify Taqeem of the Firm's address within (30) days of obtaining a practice license as well as any change in the address within a period not exceeding thirty (30) days. The notification shall be via electronic systems or in writing;

(15) Use the approved electronic systems to regulate valuation practice.

Sample

A. An Accredited Member shall not accept a business valuation assignment in any condition stipulated in the Code, especially the following:

1. Valuing businesses that the valuer own, co-own, have an interest in - directly or indirectly - as an intermediary, investor or a financier for their ownership or leasehold.
2. Businesses in which the valuer is a relative, to the third degree, of the founder or a member of the Board of Directors.
3. Businesses of companies where the valuer provides services that conflict with one's valuation of either of the Assets, either directly or indirectly;
4. Businesses of organizations in which the valuer has shares of ownership during the period of valuation. If the valuer accepts to undertake such a valuation, the shares shall be disposed of before the valuation.
5. Businesses where the valuer is a partner of one the employees, a senior partner, or a partner of the company itself.
6. Businesses owned by organizations where the valuer is an administrator of an endowment or a guardian of patrimony.
7. Businesses that have commercial activities similar to the activities of the Client where the Business Valuer is a member of the Board of Directors, or the Board of Directors includes any of the Business Valuer's relatives to the third degree.

B. Before accepting the valuation assignment, the Accredited Valuer shall ensure that all valuers participating in the valuation assignment are adhering to paragraph (A) of this item and replace who cannot commit to such conditions.

(16) The following procedures shall be followed when an Accredited Valuer ceases to work, either temporarily or permanently for any reason:

A. The Ministry and Taqeem shall be notified of the reasons and the duration of the cessation within thirty (30) days following the cessation.

B. Taqeem shall be notified of the assignments affected by the cessation, as well as the procedures taken to preserve the rights of clients and staff for the thirty (30) days following the date of the cessation; and the steps to be taken to deal with the consequences of the cessation.

C. If one partner ceases to work, the remaining partners of a professional company shall amend the Company Contract in accordance with the Law of Professional Companies. Taqeem shall be notified of the steps taken to reassign the assignments supervised by the departing partner to other partners.

Article (5):

A Basic Member shall practice valuation according to the following:

(1)Comply with the provisions of the Law, Regulations, Code of Ethics, and Guidebook.

(2)Practice valuation through a Business Valuation Firm via a written contract. A Saudi Basic Member can work with more than one Valuation Firm, but not exceeding two, according to the following conditions:

a. The primary firm must consent to working for another firm.

b. Maintain confidentiality of assignments for each Firm, and refrain from valuing the same property for more than one Valuation Firm.

(3)Adhere to item (16) of Article (4) of this Regulation.

(4)Obtain a valid membership when working at the valuation Firm.

(5)Use the approved electronic systems to regulate the valuation practice.

(6)Work according to the rules and instructions provided by Taqeem;

(7)Notify Taqeem of the Firm's address within (30) days of obtaining a practice license as well as any change in the address within a period not exceeding thirty (30) days. The notification shall be via electronic systems or in writing.

Article (6):

In accordance with the provisions of paragraph (4) of Article (5) of the Law, a person whose name is registered in the registry must have practical experience in valuing Businesses as follows:

1. Certified practical experience demonstrating the skills and knowledge gained by passing BV 203 – at minimum - of Taqeem's approved qualification programs.
2. Documented practical experience gained by obtaining the Practitioner designation according to the conditions set out in this Regulation.

Article (7):

7.1 Associate and Student Members can acquire hours of experience by working at Valuation Firms.

7.2 A Student member is required to pass the qualifying course determined by Taqeem prior to joining the training at the Valuation Firm.

7.3 Associate and student members shall comply with the provisions of Basic memberships in Article (5) when working for Valuation Firms. In the case of violation of any provision, Article (14) of this Regulation shall be applied.

Chapter 4 - Membership Fees and Services

Article (8):

8.1 Taqeem shall charge a fee for memberships, examinations, training courses, course materials and other services.

sample

8.2 Student members will be eligible to a %50 discount on all abovementioned services in paragraph 8.1.

Chapter 5: Training and qualification

Article (9):

Taqeem shall develop, localize, and accredit Business valuation training curricula, as well as organize the required training courses to qualify the valuers of this sector.

Article (10):

Basic Members shall attend Continuing Professional Development (CPD) programs as required by Taqeem periodically.

Chapter 6: Control and Quality Assurance

Chapter 6: Control and Quality Assurance

Article (11):

Subject to the provisions of Article (35) of the Law, Taqeem shall establish appropriate procedures to monitor the quality of professional performance and ensure that the profession of Business valuation is conducted in accordance with the provisions of the Law and Regulations.

Article (12):

The Accredited Valuer shall commit to enable Taqeem or its representative to monitor the quality of professional performance.

Chapter 7: Violations and Penalties

Article (13):

The Accredited Valuer shall be subject to Article (32) of the Law, in case of any violation of the provisions of the Law or Regulations.

Article (14):

14.1 Without prejudice to the liability of Accredited Valuer for the valuers under their Firm who have basic memberships, Taqeem shall, in case of violation of any of the provisions of the Regulations, carry out the following:

(1) Notify the Basic Member of any breach thereof and inform the Accredited Valuer who supervises their work of such violations.

Sample

(2) If the Basic Member's violation is repeated or the act is contrary to the principle of good conduct, the Council or its representative may issue a decision to cancel their Taqeem membership.

14.2 The Basic Member shall be notified of the decisions issued via electronic systems or registered letters, and the Accredited Valuer who supervises their works shall be provided with a copy thereof via abovementioned means.

14.3 The cancellation of the Basic Membership shall result in ceasing all Business valuation activities and the Accredited Valuer who supervises the work of the valuer shall take the necessary legal measures.
14.4 The Basic Member who has cancelled his membership has the right to submit legal defenses to Taqeem within (30) thirty days from the date of the resolution.

Chapter 8: General Provisions

Article (15):
15.1 According to Article (7) of the Law, the Valuers Registration Committee shall set forth the rules governing its work, which shall be issued pursuant to a decision by the Minister.
15.2 The Committee for Disputes and Violations- as provided for in Article (34) of the Law - shall set the rules governing its work and shall be issued by a decision by the Minister.

Article (16):
Members of other professional bodies are entitled to attend specialized courses and enter exams held by Taqeem as well as obtain Taqeem memberships.

Article (17):
Taqeem shall issue the necessary decisions to regulate provisions of the Firm Account.

Article (18):
Taqeem shall interpret this Regulation and it shall be legally binding.

Chapter 9: Issuance and Effective Date

Article (19):
This Regulation shall be issued pursuant to a decision by the Minister and shall be effective on its date of issuance

Sample

Sample Client and Engagement Acceptance Form

Client Acceptance Questionnaire

1. Risk Questions

1.1. Identification

1.1.1. Is your proposed client an individual?

1.1.2. Is the client (or any of its affiliates) in any of the restricted industries?

a) Yes

b) No

1.1.3. Have we considered the Code of Ethics and Professional Conduct for Valuers and whether the acceptance of the client creates any ethical concerns?

1.1.4. Do any of the following high-profile criteria apply to your client? (Select all that apply.)

a) The client, its owners/directors/officers or its industry, are at the center of public attention and appear regularly in the media.

b) The client's industry is currently the focus of stricter regulation and / or investigation than normal.

c) Association with the client could subject Valuation Firm or our work product to an unusual level of public attention.

d) It is a government entity or other statutory body.

e) …………..

1.2. Integrity and reputation

1.2.1. Identify the current key officers, directors and significant stakeholders of the entity (i.e., of the entity being evaluated, not the parent entity).

1.2.2. What has been done to assess the client's integrity and reputation?

1.2.3. Based upon procedures performed per the preceding question, and/or upon information known to you, are you aware of any of the following risk factors? (Select all that apply.)

a) Concerns about the corporate governance of the client

b) Concerns about the management's track record in this or other business undertakings

c) Concerns about the integrity or reputation of the client or its management

d) Concerns about illegal or unethical activities of the client

e) ……………………….

2. Independence Questions

2.1. Independence Questions

2.1.1. Is Valuation Firm required to be independent of the entity being evaluated?

Engagement Acceptance Questionnaire

1. General Questions

1.1. Scoping

Sample

1.1.1. Is the output of this service likely to be used to originate or resolve a dispute with another party (other than tax authorities) that could involve litigation/arbitration?

1.1.2. Is the client or third party or counter party to the potential conflict a governmental entity or a quasi-governmental entity (including a state and local economic development organization, or a local regulator)?

1.1.3. Could the output of this service be used by the client in a hostile situation (e.g., a hostile takeover or hostile competitive situation)?

1.1.4. Does this engagement relate to an underlying acquisition or sale and is the name of the seller entity/individual known to you?

1.1.5. Could this engagement contractually limit our ability to work for other clients?

1.2. Third Party involvement

1.2.1. Are you aware of any third parties who will have access to our report or work product or will otherwise rely on the results of our engagement, and the work is branded or otherwise attributable to Valuation Firm? (Select all that apply.)

1.3. Fee Information

1.3.1. What is the estimated engagement fee in US dollars?

1.4. Risk Considerations

1.4.1. Are there any engagement risk factors or engagement acceptance issues we must consider?

1.4.2. Does the execution of this engagement involve handling of unpublished price sensitive information?

1.5. Engagement Planning

1.5.1. No of hours expected to spend on completing the engagement?

2. Independence Questions

2.1. Risk Management questions

2.1.1. Does the proposed engagement include Valuation Firm's involvement in any other services? (Applicable if the Valuation Firm offers other services like audit/advisory services)

2.1.2. Does the proposed engagement include Valuation Firm's involvement with any assurance service other than financial statement audits or reviews? (Applicable if the Valuation Firm offers other services like audit/advisory services)

does not only positively affect the clients and other beneficiaries trust in valuation services only, but also extends it effect to include the public trust in the valuation profession. To achieve such result, this requires all members to work to achieve the following objectives: principles and provisions set forth therein and commit to it as soon as they join the Authority's membership.

Sample

Cost Approach: Liquidation Value Basis of Value

Orderly Liquidation Premise or Forced Sale (Forced Liquidation) Premise

Potential Adjustments

1. If the Valuation Date coincides with the financial statement date, the unadjusted net asset value in the financial statements represents the Equity book value of the company.

2. If this is not the case, amend the financial statements for the results since the last balance sheet date.

3. Restate net current Assets to net realizable value.

I. Cash, Bank and Term Deposits, which include accrued interest on bank and term deposits. Early redemption penalties should be accounted for if a Forced Liquidation is the assumed Premise. If it is an Orderly Liquidation Premise such penalties should not be incurred.
II. Marketable Securities: Most recent or closing trading price less brokerage fees should be used. If no trades have taken place or if the investment holding represents more than a normal trading lot, in which case either a blockage discount or premium might be applicable if a Forced Sale. In an Orderly Liquidation the securities may be sold over many weeks. An investment banker should be consulted if holdings are significant.
III. Accounts and Advances Receivable should be reviewed and evaluated on the basis of the Forced Sale Premise. Accounts that would normally be collectible in full on a going concern basis may become a problem in a Forced Sale as customers have no continuing relationship to protect. There are likely to be losses on Accounts Receivable in either Premise, but the Forced Sale Premise often results in larger losses.
IV. Inventories: In a Forced Sale, the Valuer may analyze whether it is beneficial to maintain a sales force and warehouse facilities until a substantial amount of inventory is sold or to bring an auctioneer on board to dispose of the inventory. In Orderly Liquidations there is more flexibility available for these decisions.
V. Other Current Assets including prepaid expenses should be reviewed individually since many of them will have no realizable value.

4. Restate fixed Assets to fair market value.

I. Land and Buildings: Real estate appraisers determine the market value of land and buildings.
II. Machinery and Equipment: Capital Equipment appraisers should be consulted if the equipment and machinery are material in amount. Dealers representing specialized equipment may be consulted to obtain values relating to the product.

Sample

III. Furniture and Fixtures: Equipment appraisers should be consulted if the furniture and fixtures are material in amount. Used furniture and office equipment is often sold for very small amounts.
IV. Leasehold Improvements: Leasehold improvements are normally reverted to the property owner and hence, often do not have value in a Liquidation.

5. Restate other tangible and intangible Assets.

I. There may be some value in separable intangible Assets. Goodwill is the residual intangible asset and normally has little or no value in a Liquidation.
II. Inter- Corporate Investments: Inter-corporate investments should be individually valued on either a going concern or a Liquidation Value Basis of Value as applicable.
III. Copyrights, Formulae, Franchises, Licenses, Patents, Trademarks and Other Similar Contractual Rights: The Market Value must be determined for the Assets to establish if they have any value to another party. Value relates to expected stream of benefits from the Assets.
IV. Long-term Debt: Long-term Debt balances maybe at a fixed rate or at a variable rate of interest. If at a fixed rate, there may be early settlement penalties
V. Deferred Income Taxes (where applicable)
VI. These are considered a Liquidation cost and are dealt with below.

- a. Contingencies: These are evaluated and quantified. Where contingencies exist, reasonable care and effort must be taken to quantify the liability and to determine the date of settlement. The present value of the expected payment should accordingly be computed. The recognition of contingent Assets or liabilities is often determined using probabilities.

6. Liquidation costs are identified and quantified.

I. They include, amongst others:

- a. Real Estate and Other Similar Fees: A provision should be created for notional real estate commissions and related costs of clearing title. Provision should also be made for commissions that would be payable on the sale or auction of machinery, equipment, furniture and fixtures.
- b. Legal, Accounting and Other Similar Fees: Professional fees associated with the Liquidation activity, including the preparation of financial statements, tax and zakat returns, legal/governmental documents, should be estimated that are likely to be incurred if the business were liquidated.

Sample

c. Termination Benefits to Discontinued Employees: If not already accrued, holiday pay should be calculated and any potential liabilities arising from employees initiating legal proceedings for terminating them without notice.

d. Penalties for Early Termination of Long-term Commitments: Early retirement of Debt and/or leases often, result in penalties imposed. Relevant documents should be reviewed to determine whether or not potential penalties exist.

e. Net Operation Costs During Period of Liquidation: Provision must be created for overhead and operating costs during the period of Liquidation. The most common examples are rent and utilities, security and interest on Debt.

7. Taxes payable upon Liquidation are calculated (where applicable).

I. Zakat and Corporate income and/or capital gains taxes that arise on the notional disposition of Assets and Liquidation of liabilities. Items to be considered include:

II. Income gains and losses on disposition of Liquidation of current Assets. Marketable securities may also give rise to taxable capital gains or allowable capital losses.

III. Recapture, terminal losses and taxable capital gains on the disposition of fixed Assets. Real estate and other commissions reduce proceeds of disposition.

IV. Terminal losses and taxable capital gains on the disposition of other tangible and intangible Assets.

V. Contingencies to the extent they are deductible for income tax purposes (where applicable). It is assumed that payment relating to contingencies is made during the Liquidation period

Sample

Information Requirements List for a BusinessValuation

We would require as much of the following information for the purposes of our valuation of XYZ Limited, as possible. While compiling this information we request you to ensure the following:

1) All financial and qualitative background information is made available in a hard copy as well as in digital/ soft form;

2) All spreadsheet related work may be done on Microsoft Excel; and

21.1 Qualitative background information

21.1.1 Background of the Company (brief note on all major milestones);

21.1.2 A note on the products and services offered and highlights of their manufacturing and marketing processes;

21.1.3 Explanation on past performance trends in the business of the Company;

21.1.4 The reason for customers being gained and retained- does the business have a unique selling point?

21.1.5 Strength, Weakness, Opportunity and Threat (SWOT) analysis of the Company and comparison with key listed competitors;

21.1.6 A brief write-up on the key intangible Assets in the Company's business and the relative importance of these intangible Assets;

21.1.7 Details on marketing and distribution network;

21.1.8 Summary of all key contractual commitments/obligations and rights of the company; and

21.1.9 Future trends and prospects for the Company.

21.2 Industry information

21.2.1 A brief write-up on the products and a comparison of these with those of competitor's products;

21.2.2 A note on the industry, giving information about its characteristics, market size, company's market share, expected growth rate, information on major players, and other relevant information; and

21.2.3 Comparison of company's operating and financial performance with those of its key competitors.

21.3 Financial and other information

21.3.1 Historical data

21.3.1.1 Annual Reports (audited) for the all the accounting periods since inception or for the last 5 years;

Sample

21.3.1.2 Quarterly financials for the last 12 quarters (if available);

21.3.1.3 Valuation reports done in the past (fixed asset as well as business valuation);

21.3.1.4 Details of each product (both in terms of quantity and value) also including discounts and commissions and gross margins for each;

21.3.1.5 Details on other sources of income, if any;

21.3.1.6 Details of liability or contingent liability not provided for in the accounts as of the Valuation Date. With respect to contingent liabilities, pleases also provide details of all types of guarantees given by the Company - name of party, whether related party, purpose, amount as of Valuation Date, whether party is solvent and expected to continue being solvent, etc.;

21.3.1.7 Details of key customers such as - names, addresses, revenue contribution from them over past years, margins on sales to them, any material changes expected in above relationship, any addition expected in the list of key customers, etc.;

21.3.1.8 Details of the signed order book position of the Company as of current date;

21.3.1.9 Details of key suppliers such as - names, addresses, purchases from them over past years, any material changes expected in above relationship, any addition / deletion expected in the list of key suppliers, etc.;

21.3.1.10 Details of quarter wise and product wise changes (if any) in capacity of company over last 12 quarters;

21.3.1.11 Balance sheet of company as of Valuation Date and YTD financials of company from last annual report date / audited financials date to Valuation Date;

21.3.1.12 Market value of the Assets of the company (real estate, plant, etc.) as of the Valuation Date, if no recent asset valuation has been carried out then management estimates on their fair market value should be provided;

21.3.1.13 A write up on current status of capital work in progress / capital expenditure plans of the company;

21.3.1.14 Are there any idle or surplus Assets? If so, a brief description and their book value and Zakat/tax written down value as well as market value as of Valuation Date;

21.3.1.15 Age-wise analysis of receivables/sundry Debtors;

21.3.1.16 Details of any doubtful Debts, loans and advances other than those shown on the latest Balance Sheet; and

21.3.1.17 Details of transactions between the Company and other group companies (i.e. related party transactions).

21.3.2 Projections related information

21.3.2.1 Any indications suggesting that foreseeable future (2-5 years) business and financial performance will be notably different from last 1-3 years' performance;

Sample

21.3.2.2 5 years financial projections (starting from the Valuation Date) and assumptions supporting the projections (with underlying basis), such as

(A) Balance sheet, all line items;

(B) Sources of revenue – model wise sales volume and net sales realizations;

(C) Raw material consumption norms, their prices, etc.;

(D) General and administrative expenses;

(E) Marketing and sales expenses;

(F) Working capital requirements;

(G) Capital expenditure- incremental and maintenance;

(H) Miscellaneous income;

(I) Zakat/tax computation and tax calculation worksheets;

(J) Leased Assets, if any;

(K) Debt schedule with rates of interest for each line of borrowing. Any risk of lenders withdrawing these facilities post-transaction;

(L) General economic assumptions including inflation, currency depreciation vis-à-vis foreign currencies, tariff levels, etc. and how these have been considered for making projection; and

(M) An explanation of all significant and material variances in assumptions to what has historically been recorded.

21.3.3 Taxation/Zakat related information

21.3.3.1 Summary of current position as regards assessment, liability and dues towards major taxes;

21.3.3.2 If there are any brought forward losses, an analysis thereof over business losses, unabsorbed depreciation, unabsorbed investment allowance together with their year wise break-up;

21.3.3.3 Details of any appeals/case filed with respect to Zakat/tax; and

21.3.3.4 Any contingent liability because of Zakat/tax.

21.3.4 Other Information

21.3.4.1 Details of any transactions in the shares or business of the Company (as the case may be) during last 3 years other than through Tadawul, Nomu and/or recognized stock markets in similar markets; and

21.3.4.2 Any special factor that should be considered in the Valuation.

Sample

Independence Confirmation

DISCLOSURE OF INTEREST OF HOLDINGS IN RELATION TO THE RELEVANT ENGAGEMENT

Date: _______________

To

<Insert Engagement Lead Director or Partner>

Dear Sir,

I confirm that I will comply with all requirements of the Code of Ethics and Professional Conduct for Valuers as issued by Taqeem.

I shall not communicate, provide or allow access to any Unpublished Price Sensitive Information, relating to a client entity or its material affiliates or securities listed or proposed to be listed, to any person including other Insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations. I hereby declare the following particulars of listed securities or voting rights [held /change in the holding held] by me/us in the client entity to the relevant Engagement or its material affiliates along with my Relatives to the third degree.

Name of the Holder	Registered Folio/ Client's ID No.	Distinctive No's		No. of Equity Shares	Particulars of Change
		From	To		
Name of the Immediate Relatives					

I confirm that during the term of the Relevant Engagement with the Firm neither I nor my Immediate Relatives will trade in any of the above securities.

Yours faithfully,

(__________)

Sample

When Conflicts of Interest Arise

A. Types of Conflict of Interest

In conducting any part of its business, every Valuation Firm should avoid conflicts of interest and any other activity that could possibly threaten their objectivity, integrity, confidentiality or reputation. Conflicts of interest can arise in client engagements as well as any situation in which Valuation Firm enter into business relationships, including procurement, acquisitions and alliances.

Types of Potential Conflicts of Interest

	Description	Circumstances giving rise to potential conflicts of interest
Transactional Conflicts	Potential conflicts that arise from client engagements involving the sale or purchase of a business, and Valuation Firm's relationships with the counterparties.	• Valuation services
Relational Conflicts	Potential conflicts that arise from client engagements in which Valuation Firm has relationships with two or more parties with opposing interests;	• Business modelling or model review / testing • Acting as arbitrator
Advocacy conflicts	Potential conflicts that arise from client engagements involving legal or other disputes and Valuation Firm's relationships with the counterparties	• Expert Valuation • Valuation for dispute resolution
Personal Conflicts	Potential conflicts that arise from personal relationships and/or financial interests of Employees of Valuation Firm with counterparties to an Valuation Firm's business relationship.	• Management decisions and/ or advice with respect to acquisitions/ valuation services when the Employee working on the engagement or a close family member has a significant financial interest in the entity.
Competitive situations	Potential conflicts that arise from: • Valuation Firm's relationships with parties who are in competition with one another.	• Buy-side advice to the purchaser

Sample

B. Sample Internal approval letter for potential conflict of interest

Insert Office

[DATE]

To: Regional Advisory Quality Leader and the Conflicts Director

cc: [Name] - Coordinating Partner for Engaging Client
[Name] - Coordinating Partner for Other Party Client
[If consulted – Names of Others Consulted]
[If applicable - Names of Other Internal Parties]

From: [Name] - Engagement Executive in Charge for Engaging Client

Potential Conflict of Interest Memorandum
[Engaging Client]/[Other Party Client]

Prior to accepting any engagement, Firm guidance requires the completion of our assessment as to whether we have a potential conflict of interest. At the beginning of this process, we assess whether two or more clients have potentially differing, or possibly adverse, interests that may be affected directly by services the Firm has provided, or is being asked to provide, to one or more clients. In this regard, we analyze the client relationships and the nature of the services and conclude whether a potential conflict of interest exists. As a result of completing this process with respect to the potential engagement with [Engaging Client], we have noted that a potential conflict of interest may exist between [Engaging Client] and [Other Party Client] that we believe should be disclosed to [Engaging Client] and [Other Party Client]. We have concluded we can perform this engagement with objectivity as required by professional standards. Each client must acknowledge this potential conflict and consent to Valuation Firm's involvement in the engagement before we will accept this engagement for performing the [Service(s)].

[Note to Preparer: The preparer should describe the proposed service(s) in the following paragraph in sufficient detail and document the nature of the potential conflict of interest and the necessary actions to mitigate or reduce the risk to a manageable level, to enable the Regional Advisory Quality Leader to make an informed decision as to whether or not we should perform such services.]

Sample

Summary of Proposed Services and Clients:
[Engaging Client], a [specify work performed by the Valuation Firm] [public] client of the valuation firm [Practice and Local Office 1] has asked us to perform [describe the nature of the services giving rise to the potential conflict of interest] involving [Other Party Client]. [Describe how services affect Other Party Client]. The Valuation Firm has also performed [choose one or more:] [audit services] [tax services] [advisory services] [etc.] for the Engaging Client during the past three years and [name of the Coordinating Partner] is the coordinating partner.

[Other Party Client] is [public] client of the Valuation Firm's [Practice and Local Office 2] and [Other Party Client Coordinating Partner] is the coordinating partner. The Valuation Firm has performed [choose one or more:] [audit services] [tax services] [advisory services] [etc.] for [Other Party Client] during the past three years.

The _________________ services will be performed by a team led by [name of Engaging Client Engagement Executive in Charge]. None of the Engaging Client engagement team members has provided any services to [Other Party Client] during the past three years. It is our intention that [name of Engaging Client Engagement Executive in Charge] will serve as the engagement Executive in Charge and that the other primary professionals assigned to the engagement will be [name senior members of the team].

Summary of Mitigating Actions
The necessary actions to mitigate or reduce the risk to a manageable level are described herein:
[Describe the necessary actions provided by the conflicts team]
Summary of Parties Informed
[Describe any other relevant, non-confidential information relating to the transaction or engagement.]

[Engaging Client Engagement Executive in Charge] has consulted with [Engaging Client Coordinating Partner] and [Other Party Client Coordinating Partner] [and Names of Others Consulted, if any] who concurred with the Firm's undertaking of this proposed engagement for [Engaging Client] under these circumstances. These individuals are copied on this memo as evidence of their concurrence.

As part of the engagement acceptance process, we informed [Engaging Client] of the potential conflict of interest (without breaching our confidentiality obligations) and the need for notifying [Other Party Client] that a written acknowledgement and consent letter will be required documenting that management of both [Engaging Client] and [Other Party Client] are aware of, and consent to, the Valuation Firm's performance of services for both [Engaging Client] and [Other Party Client].

We also informed [Engaging Client] that such signed letter will be required before we can accept [or proceed] with the engagement. A copy of the potential conflict of interest acknowledgement and consent letter that [Engaging Client] and [Other Party Client] will be asked to sign is attached. If either [Engaging Client] or [Other Party Client] will not acknowledge and consent to the potential conflict of interest, we will not proceed and the engagement with [Engaging Client] will be declined.

Acknowledgement and Consent Letter status

There are no planned modifications to the acknowledgement and consent letter to be signed by [Engaging Client] and [Other Party Client] from our standard template [except as follows:]. Should either of our clients request modification, the Valuation Firm will be promptly brought to your attention for approval before accepting the engagement.

We will complete the internal approval process and obtain signed external acknowledgement and consent letters prior to accepting the engagement and starting fieldwork [if any exceptions are required, describe why].

Also, as part of the engagement execution process, we will establish and observe appropriate confidentiality walls and comply with other policies and requirements as set forth in the "Summary of Mitigating Actions" section above, the Conflicts of Interest Global Policy and the supplemental Advisory service line guidance.

This memorandum represents a request for your approval of our participation in this engagement for [Engaging Client]. Please indicate your approval by signing on the appropriate line below and returning a copy to me.

____

Regional Advisory Quality Leader and Date

____

Sample

Non-Disclosure Agreement Template

CONFIDENTIALITY and Non- Disclosure AGREEMENT

ABC Limited **XX XXX 20XX**

Attention: Mr. XXXX XXXX

Address

Dear Sir,

Re: Valuation of certain identified Assets / liabilities related to acquisition of shares of ABC Ltd.

We ("XYZ") write to confirm the terms of our agreement in respect of the confidentiality and non-disclosure of the information you will be making available to us.

We are bound by the Code of Ethics and Professional Conduct for Valuers of Taqeem and have an obligation to keep all information provided to us confidential unless required to release such information by appropriate regulators.

You will be providing us with access to certain information, which has been designated as confidential information, and which relates to valuation of identified Assets / liabilities related to acquisition of shares of MNO (hereinafter referred to as "MNO") by ABC Limited ("ABC"). This information may be disclosed to us either in writing, orally or by access to computer systems or data, but will be clearly designated on its face or otherwise in writing by you as being confidential ("the Information"). In consideration for you granting this access to the Information, ABC agrees that:

1. Subject to Clause 6 below, we will keep the Information strictly confidential and will not disclose it to any third party (other than our staff) without your prior written consent;

2. The Information will only be disclosed to those personnel of XYZ and members firms of the global network of XYZ firms who need to know it for the proper performance of their duties in relation to this project, and then only to the extent reasonably necessary. XYZ will take appropriate steps to ensure that all personnel to whom access to the Information is given are aware of its confidentiality;

3. The Information disclosed to us will be used solely for the purpose of valuation of identified Assets / liabilities related to acquisition of shares of MNO Ltd. (the "Purpose");

4. XYZ will comply with the confidentiality obligations set out herein for a period of twelve months from the date of disclosure;

5. On the termination of our involvement in the above project, and upon being requested to do so, XYZ will return the Information disclosed to it within a reasonable period, subject to the retention of proper professional records;

6. The obligations contained above shall not apply to any Information which:

Sample

a. is or becomes publicly available otherwise than through a breach of this agreement;

b. is already in XYZ's possession without any obligation of confidentiality;

c. is obtained by XYZ from a third party without any obligation of confidentiality;

d. is independently developed by XYZ outside the scope of this agreement;

e. XYZ is required to disclose by any legal or professional obligation or by order of a regulatory authority.

7. This Agreement shall terminate upon the earlier of (a) the expiry of twelve months from the date hereof, or (b) the execution of a definitive agreement between the parties in furtherance of the Purpose; and

8. This Agreement shall be governed by and construed in accordance with the laws of "country".

We should be grateful if you would acknowledge your agreement to these terms by signing the copy of this letter where indicated and returning to us.

Yours faithfully

For XYZ

Name

Designation

We agree to the above terms regulating the disclosure of the Information.

ABC Limited

By: ____

Mr. Client Representative

Sample

Sample of Engagement Letter

CONFIDENTIALITY and Non- Disclosure AGREEMENT

ABC Limited **XX XXX 20XX**

Attention: <<please provide>>

<<Address>>

Dear Sir,

Re: Report on Valuation of Equity shares of ABC Limited

Thank you for choosing **XYZ** ("we" or "XYZ") to perform professional services (the "Services") for **ABC Limited** ("you" or "the Client" or "the Company" or "ABC") relating to the valuation of its Equity shares as at XX XXX 20XX ("Valuation Date") for the following Purpose: We anticipate that the Basis of Value that we will be using is Market Value as defined in International Valuation Standards 2020:

"The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion."

In order to comply with International Valuation Standards 2020 we need to inform you of various matters. These are attached as an Appendix to this letter.

In all our work we will comply with the Code of Ethics for Professional Conduct for Valuers as issued by Taqeem.

We appreciate the opportunity to assist you and look forward to working with you.

The attached Statement of Work describes the scope of the Services, our fees for the Services, and any additional arrangements. The Services will be subject to the terms and conditions of this letter, together with its attachments, including the General Terms and Conditions, the applicable Statement of Work and any other Appendices (together, this "Agreement"). This Agreement supersedes all discussions we have had so far.

<<Intentionally left blank>>

Please sign this letter in the space provided below to indicate your agreement with these arrangements and return it to undersigned at your earliest convenience. If you have any questions about any of these

Sample

materials, please do not hesitate to contact undersigned so that we can address any issues you identify before we begin to provide the Services. From our side, undersigned will have the overall responsibility for the engagement. We understand that the undersigned would be the co-ordinator from your side.

Very truly yours,

XYZ

AGREED:

ABC Limited

By: ____

Authorized Signatory

Enclosed:

- Copy of this letter with all appendices for you to sign and return
- Appendix 1 - Statement of work
- Appendix 2 – Fee Proposal
- Appendix 3 - General terms and conditions
- Appendix 4 – Information Required by IVS 2020

STATEMENT OF WORK — Appendix 1

Background

Background of appointing entity.

Background of valuation subject.

Purpose of valuation

Scope of our Services

The scope of our Services is to perform a valuation of ABC as at Valuation Date for the aforementioned purpose.

Basis of valuation

For the purpose of the above valuation, the basis of value will be Market Value as defined by IVS.

Sample

Limitation of our scope

You are responsible for the data, information and explanations given to us. We will review the data and discuss with you any matters that are not consistent with our expectations. If the data includes projections into the future, we will discuss with you the assumptions upon which such projections are based. If any of the assumptions are inconsistent with the past performance of the business or appear to us to be potentially too optimistic or pessimistic, we will discuss our concerns with you.

Our duties and responsibilities shall be limited to those expressly set out in this letter and without limiting the generality of the foregoing, we shall not:

- Provide you with any accounting, legal, tax or other specialist advice or assume any responsibility for or liability in respect of any advice given to us or you by any other professional adviser;
- Provide advice on any aspects relating to legal and regulatory requirement;
- Express any independent opinion on, or take responsibility for, the achievability of any forecasts or the reasonableness of any assumptions or upon the fairness or accuracy of any financial or other information relating to the business;
- Evaluate the technical/operational product information which we are not equipped to evaluate and for which we will rely on the information provided by the management;
- Owe duty of care to any person other than you.

If you are not able to provide us with any of the information we have requested, this may affect our ability to conclude our valuation in the terms indicated above or at all. We will inform you of any restrictions to our valuation or the reliance which may be placed on it because of incomplete information.

We will not approach potential buyers of the Company to test their reaction to our valuation or, indeed, identify whether there are any potential buyers or the size of population of buyers.

In no circumstances shall we be liable, other than in the event of our bad faith or willful default, for any loss or damage, of whatsoever nature, arising from information material to our work being withheld or concealed from us or misrepresented to us by your directors, employees, or agents or any other person of whom we may make inquiries, unless detection of such withholding, concealment or misrepresentation should reasonably have been expected because the fact of such withholding, concealment or misrepresentation was evident without further inquiry from the the information provided to us or expressly required to be considered by us pursuant to the scope

Sample

of analysis agreed upon under this letter. This clause, and any assessment of our work made pursuant to it, will have regard to the limited scope of our analysis agreed under this letter. It may be noted that depending upon track record of your business and of comparable market transactions/ valuation parameters and availability of sufficient reliable information thereon in public domain; valuation analysis may be more or less subjective.

Circulation of the Report

The valuation Report will be provided to you for the above Purpose only and should not be used or relied upon for any other purpose, nor should it be disclosed to, or discussed with, any other party without our prior consent in writing.

It may be clarified that results of valuation exercise can be different if carried out for a purpose other than the Purpose for which the current exercise has been undertaken. Accordingly, we would not be liable at all for any loss arising due to use of our Report under this engagement for any other purpose.

Timetable

We will mobilize our engagement team to commence work on the date of execution of this Agreement or receipt of advance payment, whichever is later (the "Start Date"). Throughout the course of the engagement, we shall be in close discussions with you and keep you informed of the progress of our work.

We will work towards submission of our draft Report within xxx weeks from the Start Date and/ or date of receipt of majority of data/information required for the engagement, whichever is later. You acknowledge that achieving our schedule is a function of numerous factors. Our timing will also depend significantly upon the availability and the promptness with which reliable and accurate information is made available to us. We request you to review and provide us with your comments on the facts stated in the draft Report within one week of the receipt of our draft Report. We would like to issue the final Report within 15 days of issuing the draft Report. We will issue the final Report only after you have confirm that the facts in the draft report are correctly stated.

Fees

Our professional fee for the engagement is xxx.

a. In addition to the fees set out above all direct expenses and disbursements ("Out of pocket expenses" or "OPE") incurred in connection with the performance of the services, and an administrative surcharge, to be calculated as xxx% of the OPE.

Sample

b. Direct expenses include reasonable and customary out-of-pocket expenses such as travel, meals, accommodation and other expenses specifically related to the engagement. The administrative surcharge is levied towards recovery of expenses such as printing and stationery, telecommunication costs, other levies/taxes, costs that are not always identifiable to specific engagements.

c. The above fee estimate is valid for work performed up to and including issue of a draft final report, subject to minor amendments.

2B. Terms of payment

Payment is due upon receipt of XYZ's invoice. In case the payment is not made within 15 days, interest @ ___ % for the delay would become due and payable along with the fees.

2C. Method of payment

All payments should be done through electronic transfer of funds or through cheese or draft. Please intimate the details of specific invoice against which the payment is made. Billing details

Bill addressed to	
e-mail id for invoice submission (more than one email id can be given)	
Address for physical invoice submission, if required (not required in case of digitally signed invoices)	

2D. Contact information

As mentioned below we have identified our contact person at XYZ and similarly you have identified your contact person with whom we should communicate about these Services

Particulars		
Engagement manager		
Billing and collection		
TDS certificate		

Our Responsibilities

We will provide the Services (or such variations as may subsequently be agreed in writing between us) with reasonable skill and care and in a timely manner. Emphasis during our valuation analysis is usually on substance over form and on materiality than complete accuracy given the nature of the valuation discipline as well as the purpose and context of most valuation assignments. Also, it must be understood by you that you should not omit any factor relevant and material for valuation analysis and that you should check out relevance or materiality of any specific information to the present exercise with us in case of any doubt. Our conclusions are based on the information

Sample

provided by you. It must also be understood by you that any omissions, inaccuracies or misstatements on your part may materially affect our valuation analysis/results. Accordingly, we would assume no responsibility for any errors in the above information furnished by you and their impact on the present exercise. In addition, we assume no responsibility for technical information furnished by you and believed to be reliable.

The nature and content of any advice we provide will necessarily reflect the specific scope and limitations of our engagement, the amount and accuracy of information provided to us and the timescale within which the advice is required. If, at your request, we provide our advice in an abbreviated format or timescale, you acknowledge that you will not receive all the information you would have done had we provided a full written Report or had more time in which to carry out the work. Oral advice provided by anybody within XYZ with reference to this engagement is not valid and must not be relied upon by you. Written advice given by XYZ with reference to this engagement is valid only if it is given by person signing this Agreement on behalf of XYZ or by the authorized signatory of such person.

If general advice is provided, the applicability of this will depend on the particular circumstances in which it is to be used by you (of which we might not be aware) and should be viewed accordingly. In relation to any particular transaction, specific advice should always be sought, and all material information provided to us. Our advice is provided only for the Purpose of this engagement and we disclaim any responsibility for the use of our advice for a different purpose or in a different context. We shall be under no obligation to update any advice for events occurring after the advice has been provided in its final form.

Presentation of results

Our valuation analysis will be documented in a Report discussing our methodologies and opinion(s), and including supporting exhibits, e.g. the key elements of business plan to be provided by you. The opinions expressed in our Report will be based on Methods and techniques that we consider appropriate under the circumstances. The Report will contain XYZ's Disclaimers and Declarations with respect to the Services. These Disclaimers and Declarations shall form part of any written literature drawing reference to our Report.

The opinion(s) rendered in the Report shall only represent the opinion(s) of XYZ based upon information furnished by you and others on your behalf and other sources and the said opinion(s) shall be considered advisory in nature. Our opinion will however not be for advising anybody to take buy or sell decision, for which specific opinion needs to be taken from expert advisors.

You recognize that, for the purposes of carrying out our responsibilities in this engagement, we shall not be treated as having notice of information, which may have been provided to individuals within

Sample

this firm who are not involved in this engagement. We may make reference to, as a part of the brief factual description of the work done for you (transaction tombstone, etc.), your corporate/brand name, trademark, logo, etc. in our credentials, proposals, brochures and publicity materials, which may be forwarded to prospective clients or such other parties as per our needs.

Other matters

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner contact. If you prefer an alternative route, please contact [Name of Managing Partner] at <Address>.

We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you.

Information Required for IVS Compliance **Appendix 3**

a. Identity of the Valuer;
b. Identity of the client(s);
c. Identity of the intended users;
d. Company or interest in company being valued; (What)
e. The valuation currency
f. Purpose of the valuation; (Why)
g. Basis or Bases of value used; (Basis of Valuation)
h. Valuation Date; (When)
i. The nature and extent of the Valuer's work and limitations thereon;
j. The nature and sources of information upon which the Valuer relies on;
k. Significant assumptions and/or special assumptions;
l. Type of report being prepared; and
m. Restrictions on use, distribution and publication of the report
n. That the valuation will be prepared in compliance with IVS and that the valuer will assess the appropriateness of all significant inputs..

Very truly yours,

XYZ

AGREED:

ABC Limited

By: ____

Authorized Signator

Sample

Financial Statement Analysis-keyratios

Activity Analysis

A firm needs to invest in both short-term Assets (inventory and accounts receivable) and long term Assets (property, plant and equipment) Assets in order to carry out operations. Activity ratios are financial analysis tools used to gauge the ability of a business to convert various asset, liability and capital accounts into cash or sales (also called firm's level of operations).

A higher ratio implies efficient firm operations as relatively fewer Assets are required to maintain a given level of operations. Monitoring the trends in these ratios over time and inter firm comparison in the industry can point out potential trouble spots or opportunities. Although these ratios do not measure profitability or liquidity directly, they are, ultimately, important factors affecting those performance indicators.

A firm's capital requirements, both operating and long term, can be forecasted using activity ratios. Investments in additional Assets would be required to grow sales. Activity ratios enable the Valuer to forecast these requirements and to measure the firm's ability to purchase the Assets needed to sustain the forecasted growth.

Short-Term (Operating) Activity Ratios

i. Inventory turnover

The inventory turnover ratio provides an indicator of how efficiently the firm is managing its inventory. A higher ratio is an indicator that inventory does not deteriorate in warehouses or on the shelves but rather moves quickly from time of acquisition to sale.

$$\text{Inventory turnover} = \frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

$$\text{Day sales of inventory} = \frac{365}{\text{Inventory turnover}}$$

The inverse of this ratio can be used to calculate the average number of days inventory is held until it is sold:

ii. Receivables turnover

Sample

The receivables turnover ratio and the average number of days receivables are outstanding can be calculated as follows:

$$\text{Receivables turnover} = \frac{\text{Sales}}{\text{Average receivables}}$$

$$\text{Days receivables outstanding} = \frac{365}{\text{Receivables turnover}}$$

These ratios measure the effectiveness of the company's credit policies. A high turnover ratio may indicate that the company's collection is efficient and that the company has customers who pay off Debt quickly. When calculating receivables turnover, care should be taken to include only trade receivables, excluding receivables related to financing and investment activities.

iii. Working capital turnover

The working capital turnover ratio is defined as a summary ratio used to measure the amount of working capital needed to maintain a given level of sales. A high working capital turnover indicates that management is using the company's short-term Assets and liabilities efficiently to support sales. In contrast, a low ratio may show that the management is investing excessively in short term Assets such as inventory. Only operating items should be considered while computing this ratio. Short term Debt, marketable securities, and excess cash should be excluded.

$$\text{Working capital turnover} = \frac{\text{Sales}}{\text{Average working capital}}$$

Long Term (Investment) Activity Ratios

i. Fixed asset turnover

The fixed asset turnover ratio measures the efficiency of (long-term) capital investment. The ratio reflects the operating performance of the fixed Assets and measures how able a company is to generate net sales from fixed asset investments.

$$\text{Fixed assets turnover} = \frac{\text{Sales}}{\text{Average fixed assets}}$$

An analyst must consider changes in the ratio over time as sales and capacity increases may not be proportional. Sales growth is continuous, albeit at varying rates. Changes in capacity to meet that sales growth, however, are discrete, depending on the addition of new factories, warehouses, stores and so forth. The combination of these factors may result in a volatile turnover ratio.

The life cycle of a company or product includes a number of stages: start-up, growth, maturity (steady state), and decline. The initial turnover for start-up companies might be low, as their level of operations are below their productive capacity. However, turnover will improve gradually with growth in sales until the limits of the firm's initial capacity are reached. The increase in capital investment needed to maintain the growth would have an impact on the ratio as sales growth is a gradual process. This process will continue until the firm matures and its sales and capacity level off and will eventually decline when the firm enters its decline stage.

Problems may arise because of the timing of a firm's purchase of Assets. Two firms with similar operating efficiencies, having the same productive capacity and the same level of sales, may show differing ratios depending on when their Assets were acquired. The firm with highly depreciated Assets would show a higher turnover ratio, as the carrying value of that firm's Assets would be lower. Similarly, for any firm, the accumulation of depreciation expense may result in a biased ratio (the ratio would be higher if the firm uses accelerated depreciated methods or short depreciable lives) if actual efficiency did not change.

The productivity of Assets also depends on their acquisition date. Newer Assets operate with higher efficiency, although they are purchased at higher prices. The use of gross (before depreciation) rather than net fixed Assets would eliminate this limitation. However, due to inflation, more recently acquired Assets would be more expensive and thus distort the comparison of firms with older Assets versus those with newer Assets.

ii. Total asset turnover

The total asset turnover is an overall activity measure, which is used as an indicator of the efficiency with which a company is deploying its Assets to generate sales. This relationship provides a measure of overall investment efficiency by aggregating the joint impact of both

$$\text{Total assets turnover} = \frac{\text{Sales}}{\text{Average total assets}}$$

short and long-term Assets.

Liquidity Analysis

Liquidity analysis is used to assess the risk level and ability of a firm to meet its current obligations. Satisfying these commitments requires the use of cash resources available as at the balance sheet date and the cash to be generated through the operating cycle of the firm.

The firm purchases or manufactures inventory, which requires an outlay of cash and/or trade payables. The sale of inventory results in receivables, which when collected, are used to pay off the trade payables, and the cycle repeats. The ability to repeat this cycle on a continuous basis depends on the firm's short-term cash generating ability and liquidity.

Length of Cash Cycle

One indicator of short-term liquidity uses the activity ratios as a liquidity measure. The inverse of the inventory and accounts receivable (A/R) turnover ratios indicates the number of days it takes until inventory is sold and receivables (generated by those sales) are converted to cash, respectively. Therefore, for a trading company, the sum of the two ratios indicates the length of the firm's operating cycle, that is, the number of days it takes for inventory to be converted to cash.

Cash conversion cycle

Cash operating cycle=Accounts receivable days+Inventory days

Cash flow cycle=Cash operating cycle-Days payable outstanding

$$\text{Days payable oustanding} = \frac{365}{\text{Accounts payable turnover}}$$

$$\text{Accounts payable turnover} = \frac{\text{Total supplier purchases}}{\text{Average accounts payable}}$$

The firm's cash operating cycle is reduced when days payable outstanding are considered. The inverse of the accounts payable turnover ratio is equal to reflecting the number of days it takes until the payables are settled. Subtracting accounts payable outstanding from the time interval it takes to convert inventory to cash represents the firm's cash flow cycle, that is, the number of days a company's cash is tied up by its current cash flow cycle.

Sample

Working Capital Ratios and Defensive Intervals

The concept of working capital relies on the classification of Assets and liabilities into "current" and "non-current" categories. The traditional definition of current Assets and liabilities is based on a maturity of less than one year.

In the typical balance sheet, we find the following categories of current Assets:

a. Cash and cash equivalents;
b. Marketable securities;
c. Accounts receivable;
d. Inventories;
e. Prepaid expenses;

In addition, the following three categories of current liabilities:

a. Short-term Debt;
b. Accounts payable; and
c. Accrued liabilities.

By definition, each current asset and liability has a maturity (the expected date of conversion to cash for an asset; the expected date of use of cash for a liability) of less than one year. The ratios used in short-term liquidity analysis evaluate the adequacy of the firm's cash resources relative to its cash obligations. Its cash resources can be measured by the firm's current cash balance and potential sources of cash or its (net) cash flows from operations, whereas the firm's cash obligations can be measured by either its current obligations or the cash outflows arising from operations.

The first three ratios to be described compare different measures of the present level of cash resources with the present level of obligations. The current ratio uses all current Assets, which comprises inventory, accounts receivables and cash.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\text{Quick ratio} = \frac{\text{Cash+Marketable securities}}{\text{Current liabilities}}$$

The quick ratio is similar to the current ratio, except that it excludes inventory from current Assets, recognising that the conversion of inventory to cash is less certain both in terms of timing and amount. The other Assets, being receivables, prepayments, cash and marketable securities, are "quick Assets" because they can be more quickly converted to cash.

$$\text{Cash ratio} = \frac{\text{Cash+Marketable securities}}{\text{Current liabilities}}$$

Cash ratio is the most conservative of these measures of liquidity as it includes only actual cash and cash equivalent balances.

The use of the current (or quick) ratio implicitly assumes that the current Assets will eventually be converted to cash.

In order to maintain operations, certain levels of inventories and receivables, as well as payables and accruals (which help to finance inventories and receivables) are required. These ratios therefore measure the "margin of safety" provided by the cash resources in relation to obligations.

Liquidity analysis and activity analysis are both used interchangeably. Poor receivables or inventory turnover restricts the usefulness of the current and quick ratios, as the reported amounts of these ratios may not truly reflect the liquidity of the firm. Current Assets such as obsolete inventory or uncollectible receivables will not be easily converted to cash. Hence, short-term liquidity ratios should be examined in conjunction with turnover ratios.

$$\text{Cash flow from operations ratio} = \frac{\text{Cash flow from operations}}{\text{Current liabilities}}$$

The cash flow from operations ratio addresses the issues of actual cash generation in relation to current liabilities.

An important limitation of the preceding analysis of liquidity ratios is the lack of an economic or "real-world" interpretation of those measures.

Sample

$$\text{Cash ratio} = \frac{\text{Cash+Marketable securities}}{\text{Current liabilities}}$$

The defensive interval is one tool that provides an intuitive "feel" for a firm's liquidity, although it is the most conservative one. It compares the currently available liquid sources of cash (cash, marketable securities and accounts receivable) with the estimated expenditure required to operate the firm. There are different forms of the defensive interval as well as various methods to arrive at the projected expenditures. Only the basic form has been presented here.

Long -Term Debt and Solvency Analysis

The analysis of a firm's capital structure is essential to evaluate its long-term risk and return prospects. Leveraged firms provide excess returns to their shareholders as long as the rate of return on the investments is greater than the cost of Debt, used to finance the investments. However, financial leverage has additional risks in the form of fixed costs that adversely affect profitability if demand declines. Moreover, when adversity strikes, the priority of interest and Debt claims can have a severe negative impact on a firm. Failure to meet these obligations can lead to default and possibly bankruptcy.

Debt Covenants

Long-term creditors often impose restrictions (Debt covenants) on the borrowing company's ability to incur additional Debt as well as on dividend payments, in order to protect their claim. Debt covenants are often expressed in terms of maintaining a specific working capital, profitability and net worth. It is, therefore, important to monitor the various ratios to ensure that their levels are in compliance with the Debt covenant requirements. Violations of Debt covenants frequently trigger an "event of default" under loan agreements, making the Debt due immediately. Hence, borrowers must either repay the Debt (not usually possible) or obtain waivers from lenders, when Debt covenants are violated. Such waivers often impose additional collateral, restrictions on firm operations, or higher interest rates.

Capitalization / Debt Ratios

A firm's financing is obtained from either Equity or Debt, or a combination of both. The capitalisation or Debt ratios examine the capital structure of the firm and thereby indirectly the ability to meet current or additional Debt obligations. Debt ratios are expressed as either Debt to total capital or Debt to Equity.

Sample

$$\text{Debt to total capital} = \frac{\text{Total Debt (current and long term)}}{\text{Total capital (Debt and equity)}}$$

$$\text{Debt to equity} = \frac{\text{Total Debt}}{\text{Total equity}}$$

The definition of short-term Debt may or may not include operating (trade) Debt (accounts payable and accrued liabilities). The argument for excluding it is that operating Debt is part of the normal operations of a firm and as such, it does not reflect a firm's external financing decisions, as opposed to short-term Debt financing. However, it should be noted that many lenders use a definition of Debt that includes all liabilities.

Debt ratios measures the riskiness of a firm. A higher Debt ratio indicates that the firm is risky. However, industry factors play an important role in determining an industry wide acceptable level of Debt as well as the nature of the Debt - whether short or long term, variable or fixed, and the relative proportion of different maturities. Capital-intensive industries tend to have high levels of Debt required to finance property, plant and equipment. Moreover, the term of the Debt should match the horizon of the Assets acquired.

Defining Debt or Equity is not always a straightforward task. The existence of leases (whether capitalised or operating), other off-balance sheet transactions such as contractual obligations not accorded accounting recognition, deferred taxes, financial instruments with Debt and Equity characteristics, and various forms of innovative financing techniques must all be taken into consideration when computing and analysing the ratios.

Interest Coverage Ratios

A more direct measure of the ability to meet interest payments is the interest coverage ratio, which indicates the degree of financial flexibility, by measuring the extent to which earnings available cover the interest payments.

$$\text{Times interest earned} = \frac{\text{Earnings before interest and taxes (EBIT)}}{\text{Interest expense}}$$

Sample

A more comprehensive measure, the fixed charge coverage ratio, includes all fixed charges arising from a firm's Debt commitments. Fixed charges are defined as contractually committed periodic interest and principal payments on leases as well as funded Debt.

$$\text{Fixed charge coverage} = \frac{\text{Earnings before fixed charges and taxes}}{\text{Fixed charges}}$$

Variations of the two ratios above use adjusted operating cash flows.

$$\text{Fixed charge coverage ratio (cash basis)} = \frac{\text{Adjusted operating cash flow}}{\text{Interest expense}}$$

Capital Expenditure and Cash Flow from Operations to Debt Ratios

In addition to servicing Debt, internally generated cash flows are also required for the purpose of investment. The interest coverage ratio(s) do not consider this aspect. Cash flow from operations is calculated without any deduction for capital expenditure.. Net income, with its provision for depreciation, reflects the use of Assets. However, even with minimal inflation rates, over their relatively long service life, replacement costs of these Assets tend to be significantly higher, and historical cost depreciation cannot adequately account for their replacement. Neither net income nor cash from operations, of course, makes any provision for the capital required for growth.

A firm's long-term solvency is a function of its ability to finance the replacement and expansion of its investment in productive capacity and the amount of cash left for Debt repayment after paying for capital investments.

$$\text{Capital expenditure ratio} = \frac{\text{Cash from operations}}{\text{Capital expenditures}}$$

he capital expenditure ratio measures the relationship between the firm's cash generating ability and its investment expenditures. If the ratio exceeds one, it indicates the amount of money the firm has left for Debt after payment for capital expenditures.

The Cash Flow from Operations-to-Debt ratio similarly provides information as to the amount of principal the current CFO can cover. Low CFO-to-Debt ratios could signal a long-term solvency problem as the firm is not able to generate enough cash internally to repay its Debt.

Sample

$$\text{CFO to debt} = \frac{\text{CFO}}{\text{Total debt}}$$

Profitability Analysis

A firm's profitability can be measured in various differing but interrelated dimensions. First, there is the relationship of a firm's profits to sales, that is, what is the residual return to the firm from sales? The second type of measure, return on investment (ROI), quantified as return on total Assets (ROA), return on Capital Structure or return on Equity (ROE), relates profits to the investment required to generate them.

Return on Sales

One measure of a firm's profitability is the relationship between the firm's costs and its sales. The greater a firm's ability to control costs in relation to its revenues, the more its earnings power is enhanced. A common size income statement can provide detailed information as to the ratio of each of the component cost items to sales. In addition, five summary ratios listed next measure the relationship between different measures of profitability and sales.

i. *Gross margin:* It represents the percent of total sales revenue that the company retains after incurring direct costs associated with producing the goods and services it sells.

$$\text{Gross margin} = \frac{\text{Gross profit}}{\text{Sales}}$$

$$\text{Pre—tax margin} = \frac{\text{Earnings before tax (EBT)}}{\text{Sales}}$$

ii. *Operating margin:* It provides information about a firm's profitability from the operations of its "core" business without regard to:

a. Investment policy (e.g. income from affiliates or gains/losses arising from sale of Assets)

b. Financing policy (interest expense)

c. Tax position (if applicable)

Sample

$$\text{Operating margin} = \frac{\text{Operating income (EBIT)}}{\text{Sales}}$$

iii. *Profit margin:* It is the overall profit margin of the firm, which excludes all the expenses.

Return on Investment

ROI measures are computed with return measured either by excluding financing expenses or by excluding both financing and tax expenses. Return on Assets (ROA), measures the operating

$$\text{Profit margin} = \frac{\text{Net income}}{\text{Sales}}$$

$$\text{Return on assets} = \frac{\text{Net income+After tax interest cost (NOPAT)}}{\text{Average total assets}}$$

efficiency of the firm without regard to its financial structure. The return is defined as net income prior to the cost of financing and is computed by adding back the (after-tax) interest cost;

A variation of the ROA ratio uses pre-tax earnings as the return measure, thereby bypassing not only the firm's financing policy but its tax position as well:

$$\text{Return on assets} = \frac{\text{Earnings before interest and taxes}}{\text{Average total assets}}$$

It should be noted that the ROA measure is sometimes computed "after interest" as either net income or earning before tax over Assets. Pre-interest measures of profitability facilitate the comparison of firms with different degrees of leverage. Using post interest measures of profit negates this advantage and makes leveraged firms appear less profitable by charging earnings for payments (interest) to some capital providers (lenders) but not others (stockholders). Ratios that use total Assets in the denominator should include total earnings (before interest) in the numerator. As interest is tax deductible, interest payments must be tax affected when a post-tax measure of profits is used.

Sample

The second commonly used ROI measure focuses on the returns accruing to the residual owners of the firm i.e. common shareholders.

$$\text{Return on common equity (ROE)} = \frac{\text{Net income-Preferred dividends}}{\text{Average common equity}}$$

A more general definition of this relationship computes the return on total stockholders' Equity.

$$\text{Return on equity} = \frac{\text{Net income}}{\text{Average total equity}}$$

The relationship between ROA and ROE can be understood in terms of the firm's relationship to its creditors and shareholders. The creditors and shareholders provide the capital needed by the firm to acquire the Assets needed for the business. In return, they expect to be rewarded with their share in the firm's profits.

The ROA measure can be interpreted in two different ways. First, it is an indicator of management's operating efficiency i.e. how well management is using the Assets at its disposal to generate profits. Alternatively, it can be viewed as the total return accruing to the providers of capital, independent of the source of capital.

The ROE measures reflect returns to the firm's common shareholders and is calculated after deducting the returns paid to the creditors (interest) and other providers of Equity capital (preferred shareholders).

Ratios: An Integrated Analysis

The ratios analysed are used to measure an Enterprise's Liquidity, solvency, profitability, and efficiency of operations (activity ratios). The earlier discussion of ratios has focused on their individual characteristics. Comprehensive analysis requires a review of the interrelationships among ratios, resulting from the following factors:

i. *Economic relationships:* The underlying economics of a firm result in elements of the financial statements moving together. For example, higher sales are generally associated with higher investment in working capital components such as receivables and inventory. Ratios comprising these various elements would be correlated.

Sample

ii. Overlap of components: A cursory examination of the ratios examined indicates that the components of many ratios overlap. This overlap may result from ratios having identical terms in the numerator or denominator or because a term in one ratio is a subset of a component of another ratio.

In a similar vein, the total Assets turnover ratio is essentially a (weighted) aggregation of the individual turnover ratios. Ratios that aggregate other ratios can be expected to follow patterns over time similar to those of their components.

iii. Ratios as composites of other ratios: Some ratios are related to other ratios across categories. For example, the return on Assets ratio is a combination of a profitability and turnover ratio.

$$\text{Return on assets} = \frac{\text{Sale}}{\text{Assets}} \times \frac{\text{Net Income}}{\text{Sales}}$$

The inter-relationships among ratios have important implications for financial analysis. On the one hand, disaggregation of a ratio into its component elements provides insight into factors affecting a firm's performance. Further, ratio difference can highlight the economic characteristics and strategies of:

a. Firms in the same industry
b. The same firm over time
c. Firms in different industries

On the other hand, the relationships between ratios imply that one might be able to "ignore" some component ratios and use a composite or representative ratio to capture the information contained in other ratios. For example, in the ROA relationship earlier, the effect of the two ratios on the right side of the equation may be captured by the ROA ratio. For analytical purposes, this composite return on Assets ratio may suffice.

Analysis of Firm Performance

This section will discover some of the inter-relationships to analyse a firm's performance by focusing on disaggregation of the overall profitability measures, which include ROA and ROE.

Sample

Disaggregation of ROA

The return on Assets ratio can be disaggregated as follows:

$$\text{Return on assets} = \frac{\text{Sale}}{\text{Total Assets}} \times \frac{\text{Net Income}}{\text{Sales}}$$

Return on assets = Total asset turnover × Return on sales

This disaggregation of ROA indicates that the firm's overall profitability is the product of an activity ratio and a profitability ratio. A low ROA, for example, can reflect either low turnover, indicating poor asset management or low profit margin even when turnover is high. A combination of both is also possible.

The disaggregation can lead to analysis of a firm's performance (over time or with respect to that of other firms) in a hierarchical fashion. Changes or differences in ROA can be traced first to changes in activity and/or profitability. Note that profitability is measured by earnings before interest and taxes (EBIT). The use of EBIT rather than net income has the advantage of showing trends independent of the capital structure of the firm. This analysis can be refined further by examining individual turnover ratios and the elements of profitability.

Disaggregation of ROE and its Relationship to ROA

The next logical step involves a detailed examination of the return on Equity. From the perspective of Equity analysis, net income is the measure of profitability, as only the residual (after interest expense, income taxes etc.) belongs to the common stockholder.

Disaggregation of ROA into Basic Components

The relationship of ROE and ROA is a function of the proportion of Debt used for financing and the relationship of the cost of Debt to the ROA. This can be formally expressed as:

$$\text{Return on equity} = \text{ROA} + (\text{ROA-Cost of debt}) \times \frac{\text{Debt}}{\text{Equity}}$$

Sample

In effect, the benefits of financial leverage are a product of the excess returns earned on the firm's Assets over the cost of Debt and the proportion of Debt financing to Equity financing. If there are no excess returns (i.e. ROA < cost of Debt), then ROE will be less than ROA.

The relationship between ROA and ROE may also be expressed as

$$\text{Return on equity} = \text{Return on assets} - \frac{\text{Interest cost}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}}$$

The Assets/Equity ratio is a capital structure/financial leverage ratio indicating the degree to which Assets are internally financed. The larger the ratio the more outside financing. It is equal to one plus the Debt/Equity ratio where Debt is defined as total liabilities. Thus, when we recall the categories making up the ROA ratio, the ROE relationship can be shown to be a function of three of the four categories discussed as shown below.

The analysis of the components of ROE, which is frequently known as the "DuPont model", enables the Valuer to discern the contribution of different factors to the change in ROE.

$$\text{Return on equity} = \text{Profitability ratio} \times \text{Activity ratio} \times \text{Solvency ratio}$$

$$\text{Return on equity} = \frac{\text{Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}}$$

1. While the three-component model shown is the standard DuPont model, it can be developed further. In many cases, it is worthwhile to look at the effect of interest payments or tax payments. To do so we must disaggregate the profitability ratio further as shown below:

$$\text{Profitability ratio} = \frac{\text{Net income}}{\text{EBT}} \times \frac{\text{EBT}}{\text{EBIT}} \times \frac{\text{EBIT}}{\text{Sales}}$$

Sample

Valuation Report

Table of Contents Template

Valuation summary

1. Engagement background (identity of client, information about subject)
2. Sources of Information (information from management, etc.)
3. Valuation Results (brief overview of valuation results, etc.)
4. Matters of Emphasis (major factors/assumptions)

Statement of Limiting Conditions

5. Statement of Limiting Conditions (extent of liabilities, etc.)

Background

6. Transaction overview (if valuation is required for actual or proposed deal)
7. Business background (details about operations of subject entity)
8. Financial information (historical financial statements, etc.)

Valuation analysis

9. Summary of values (values achieved by various methods, etc.)
10. Assumptions used by the Valuer
11. Projected Financials
12. Valuation analysis: (workings of Valuation method/s performed)
11. Discount Rate

Annexure A: Valuation workings

Sample

Sample short form report

[Date]
[Name of Client and title]
[Address of Client]

Dear [name]:

Valuation of ABC Company

Introduction

In accordance with the Letter of Engagement between ABC ("client", "you", "Company" or "ABC") and XYZ ("we", "us" or "XYZ"), we have performed a valuation analysis of the market value as at 31 December 2019 of ABC Company.
The objective of our valuation was to provide recommendations to ABC Company in connection with the proposed sale of its interests in its factory to third parties. We understand that the Company will use our recommendation solely for this purpose.
The valuation in the report are based only upon the information provided to us by the company's management. We did not carry out any procedures to verify the accuracy of the information, nor do we assume responsibility for its accuracy.
Summaries of, or references to, the report that are to be presented to third parties must be reviewed by us, and that information may not be released without our prior approval.

28.1 Definition of market value

For the purpose of this analysis, Market Value is defined by International Valuation Standards as: The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion."

28.2 Statement of limiting conditions and assumptions made

Our valuation is contingent on the following limiting conditions and assumptions made by us:
1. The Company will achieve its targets in terms of capacity utilization, sale price per unit increases and net profit during the projection period.

Sample

2. The recommended value contained is intended only to represent the value of the Company as of the Valuation Date. Subsequent changes in market conditions could result in a substantially different valuation than what has been estimated.
3. Information provided to us by the Company, which forms a basis for our recommended value, is believed to be reliable but has not been verified independently unless otherwise stated.
4. The prospective financial information provided to us is based on expectations of competitive and economic environments as they may affect Company's future operations. We have reviewed with management the key assumptions for the projection period.
5. The prospective financial information provided to us by management has been prepared using assumptions that include hypothetical assumptions about future events and management's actions that may not be achieved. Even if the events anticipated under the hypothetical assumptions take place, the actual outcome is still likely to be different from the projections included in the prospective financial information since anticipated events frequently do not occur as expected..
6. Our report assumes that the Company has an unrestricted title to all the assets unless otherwise stated.
7. Our report assumes that the Company complies fully with local laws and regulations, unless otherwise stated, and that it will be managed in a competent and responsible manner.
8. This report should not be considered as investment advice. The value shown is only indicative of the ultimate price that may be agreed between a willing buyer and a willing seller after the required due diligence procedures have been undertaken.
9. Information provided to us from the management Company forms the basis upon of our valuation. Hence, omission of any material information provided to us would have a significant impact on the valuation.

28.3 Business Valuation

The valuation has been carried out on the following principles:

- Value is as of the Valuation Date.
- Value is a function of what a business expects to earn in the future as at the Valuation Date.
- Going concern values are assessed in relation to the value of the net assets viewed as a whole which are expected to generate earnings. Higher tangible asset backing supports higher going concern values.
- Liquidity of a business has a direct impact on its price.

Based on the above, we have used the Income and Cost Approaches to value the business.

Sample

28.4 Summary of valuation

1. Taking into consideration the fact that the Company has a large fixed asset base, for comparative purposes, we have also shown the adjusted net asset value of ABC at 31 December 2019. Adjusted Net Asset Value may be applied where the DCF methods provide values lower than the adjusted net asset value.

SAR (m)	Discounted cash flow	Net Asset Value
Valuation	129.8	118.7
Redundant Assets	10	-
Indicative Value	**139.8**	**118.7**

Based on our analysis the market value of ABC %100 equity interest as at 31 December 2016 is in the range of SAR 118.7m and SAR 139.8m.

This report is subject to the statement of limitation conditions and assumptions made in section 4 of this report.

Very truly yours,

XYZ

AGREED:

ABC Limited

By: ____

Authorized Signatory

Sample

Completion Letter template

[Date]
[Name of Client and title]
[Address of Client]

Dear [name]:

We have completed our engagement [or phase of engagement] to [describe the objective of our overall integrated or single competency engagement] under the Agreement, dated ________, between [legal name of XYZ firm party to the Agreement] ("we" or "XYZ") and [Client party to the Agreement /SOW] and the Statement[s] of Work dated [insert dates] (together, the "Agreement"). If we use a capitalized term in this letter, but do not define it, it has the meaning set out in the Agreement.

[Add further background here, as needed, to provide brief context of understanding of client's objectives and needs]

Scope of our work to date [amend wording as required]

[This section summarizes the scope of the work performed and any exclusions and/or significant limitations. Related activities not covered in the scope are described here if necessary to delineate the boundaries of the engagement. The nature and extent of procedures performed also are described here. Be very careful NOT to contradict the scope of services set out in the Agreement, as it may have been amended – check the original scope]

As set out in the Agreement, during the period [insert beginning and completion dates], we performed Services that included [include a brief description of the nature of the overall work performed and the time period covered]. The scope of our work included [include here summarized procedures performed approved by scope of work or make reference to an attachment]. [Also, include here a description of any significant limitations considered important to highlight].

Results of our work

During the course of performing these Services, we provided you with written and other Reports including [insert name/title/date(s) of written work product(s) and/or describe tools, templates, progress reports, presentations, schedules, information, etc. tailored to the specific engagement].

[Consider also including information about positive aspects of the client's business (for example, milestones met, processes/phases completed, and improvements since the last engagement or phase) to fairly represent the existing issues and provide perspective and balance to the work product.

Sample

Our Services, and our advice, recommendations and other Reports, were based on information provided by you or on your behalf. While we believe that the Services were substantially responsive to your request for assistance, we are not in a position to assess their sufficiency for your purposes. Please note that we are not required to update our work or perform any services after the completion date set forth above.

Although the Agreement addresses these issues, we wish to remind you that:

• You alone are responsible for any decision to implement any of our advice or recommendations, as well as for the actual implementation thereof and the results of implementation. We make no representation or warranty that you will be able to implement our advice, recommendations or strategies effectively or successfully, or with respect to your results.

• Only you (including your board) may use our Reports, and, except as expressly permitted in the Agreement, you may not disclose them to anyone else.

• We express no opinion or any other assurance on your historical or prospective financial statements, management representations or any other data included in or underlying the information we received. We take no responsibility for any of your prospective financial information or underlying assumptions, or your ability to achieve identified prospective financial results.

Next Steps

[This section could be used to:

• Discuss and/or propose next steps relating to actual and potential follow-on engagements.

• Request formal feedback or request the opportunity to schedule a client meeting to obtain performance feedback in person].

We appreciate the cooperation and assistance you provided to us during the course of our work. Thank you for the opportunity to assist you with this engagement [Further customize as needed]. If you have any questions, please call [Valuer] at [insert telephone number].

Very truly yours,

[XYZ Limited]

Sample

Engagement Completionchecklisttemplate

Client :

Engagement title :

A. To be signed by the engagement team

We confirm the following:

1. We have complied with the Taqeem Code of Ethics throughout the assignment;
2. The client/ engagement acceptance and conflict of interest procedures have been followed;
3. A detailed information checklist was shared with the client at the start of the engagement and later on followed up. Information asked but not provided by the client has been mentioned in the client deliverables;
4. We have sought appropriate industry insights;
5. All relevant telephone conversations and meetings (including presentations) have been adequately documented and considered in the valuation;
6. Any doubt / clarification required, during the course of the engagement has been highlighted / discussed with the engagement manager;
7. We have reviewed all client deliverables, including the valuation workings;
8. All casts and cross references in the report have been checked;
9. We have received the latest audited accounts of the valuation subject, read the annual report and highlighted the key information affecting valuation to the Manager;
10. We have checked the multiples calculation for correctness;
11. We have compiled the control file and completed the checklist;
12. All the information sent by the client has been appropriately considered and challenged for the valuation analysis and/or discussed with the engagement manager;
13. We have prepared the deliverables to the best of our ability and with due care; and
14. We have ensured that all the review comments of the Partner on valuation workings and report have been incorporated.

Team member name	Designation	Signatures

Sample

Example of Valuation Release Letter

Pro forma release letter to third party requesting sight of report prepared for client (with additional wording for inclusion if we are required to meet with the third party)]. This letter is to be used for buy side engagement situations.

Private and confidential
[Date]
[Addressee (Third Party)]

Dear Sir

Report on [Target]

We have been requested by [Client] to provide you with a copy of the [draft] report dated [date] we prepared, on its instructions, on [Target] ("the Report") [and meet with you to answer questions relating to the Report. Any comments made by us or information provided either at any meeting or subsequently are referred to as the "Information"]. We hereby provide a copy of the Report to you, conditioned upon each of the Client and your prior signed agreement to the terms of this letter agreement and our prior receipt of each of those signed agreements.

The Report was prepared solely for the purpose of [state purpose of our report] and addressed issues specific to [Client]. The Report was not prepared in anticipation of being provided to third parties, [similarly neither our work nor our Report contemplated a meeting with you or any other third party] and we did not have the interest of anyone other than [Client] in our contemplation when we carried out our work. Accordingly, we may not have addressed issues of relevance to you.

Our work in connection with the Report[s] was completed on [insert date of completing work, as stated in transmittal letter], which may be some time before the Report[s] [is/are] provided to [new addressee], and has not been updated for subsequent events and transactions or for any other matters which might have a material effect on the contents of the Report[s] [Insert any other relevant caveats, e.g. only providing part of report, restricted access when doing our work, no responsibility accepted for the Vendor Due Diligence (*"VDD"*) report or any other third party Due Diligence (*"DD"*) report used in our work.]

Whilst we are prepared to release a copy of the Report to you [and meet with you], it is only on the basis that you acknowledge and agree that:

1. XYZ (Valuer), including its affiliates, partners, employees, agents, and subcontractors accepts no responsibility and shall have no liability in contract, tort or otherwise to you or any other third party in relation to the contents of the Report [or the Information];
2. [Where applicable, include the exact 'hold harmless' wording required by the auditors (whether XYZ or another firm) in connection with the review of the audit or tax files.

[Auditors] have no responsibility or liability whatsoever to you in connection with their audit or any information or explanations sought by us in the course of our review of the audit working papers [or the tax papers]. We draw your attention to the Notice included on page [ ] of the Report];

3. Any use you make of the Report [or the Information] is entirely at your own risk;

Sample

4. You will not provide copies of the Report [or details of the Information] to any party (i) other than your professional advisers acting in that capacity provided that they accept the terms and conditions relating to restrictions on use and distribution of Report [or the Information], as set out herein or (ii) unless required by court order or a regulatory authority, without our prior written consent. Notwithstanding the above, you may disclose to any and all persons, without limitation of any kind, including any fact that may be relevant to understanding such valuation analysis, and all materials of any kind provided to you in relation to such value conclusion. However, because the valuation is solely for [Client's] benefit and is not to be relied upon by any other person or entity, you shall inform those to whom you disclose any such information that they may not rely upon any of it for any purpose without our prior written consent;
5. Without prejudice to other rights and remedies that XYZ may have, you shall, to the extent not prohibited by applicable law, promptly make good and indemnify XYZ, including its affiliates, partners, employees and representatives, upon express notice by XYZ, from any costs and expenses (including without limitation, attorneys' fees and time of XYZ personnel), paid or incurred by XYZ at any time, in relation to any third party claims, and which claims are finally determined in any way to have arisen out of or relating to your access to the Report;
6. Where any other member of the global network of XYZ firms has assisted us in the preparation of the Report or has provided Information (each an "XYZ Firm"), they will be entitled to benefit from and enforce the terms of this letter; and
7. This letter shall be governed by and construed in accordance with the laws of Saudi Arabia and any dispute arising out of this letter shall be subject to the exclusive jurisdiction of the courts at "jurisdiction".
We should be grateful if you would sign a copy of this letter where indicated and return it to us as soon as possible.
Yours faithfully

[ ]
Designation
XYZ

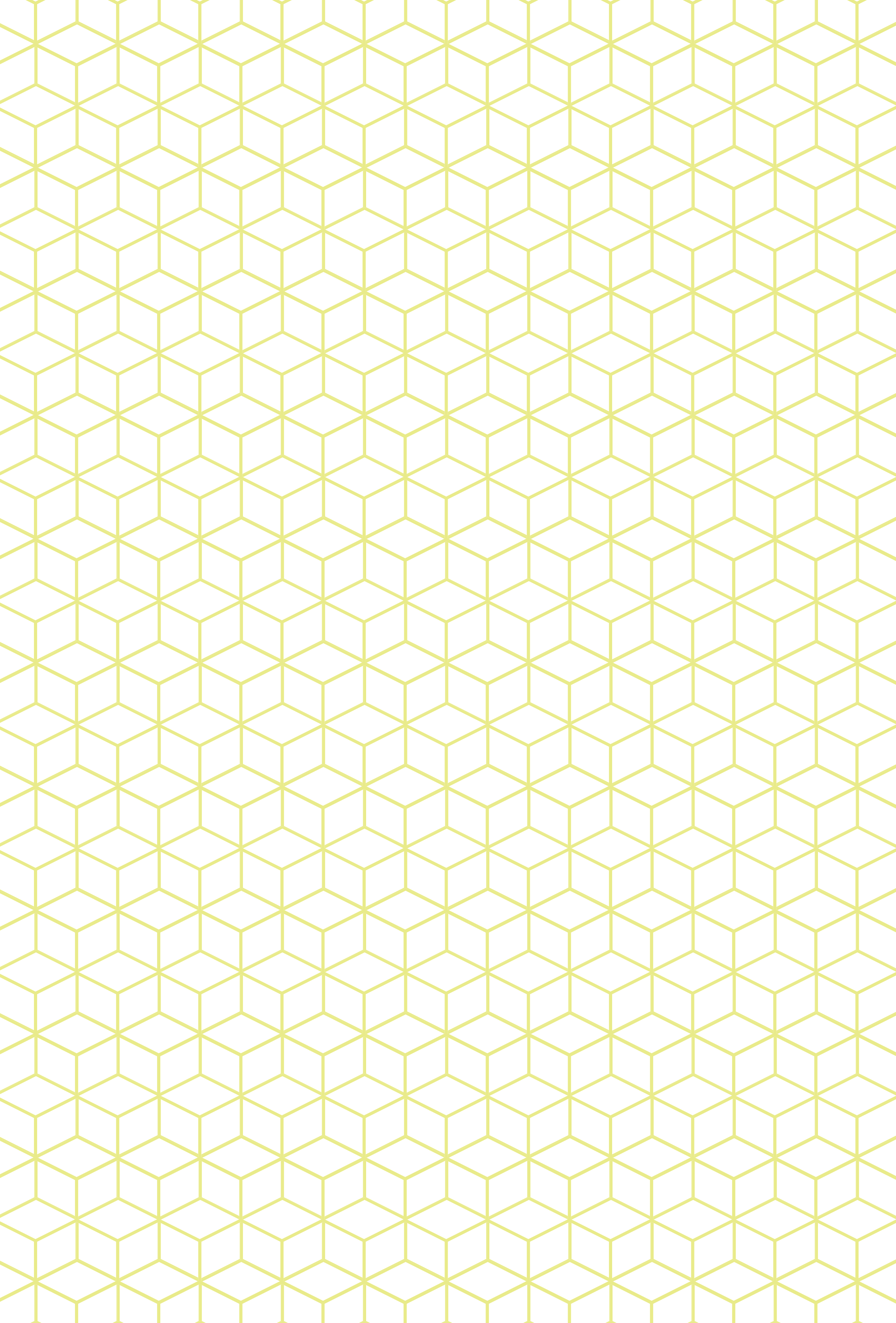
We acknowledge and agree to the terms set out in this letter.

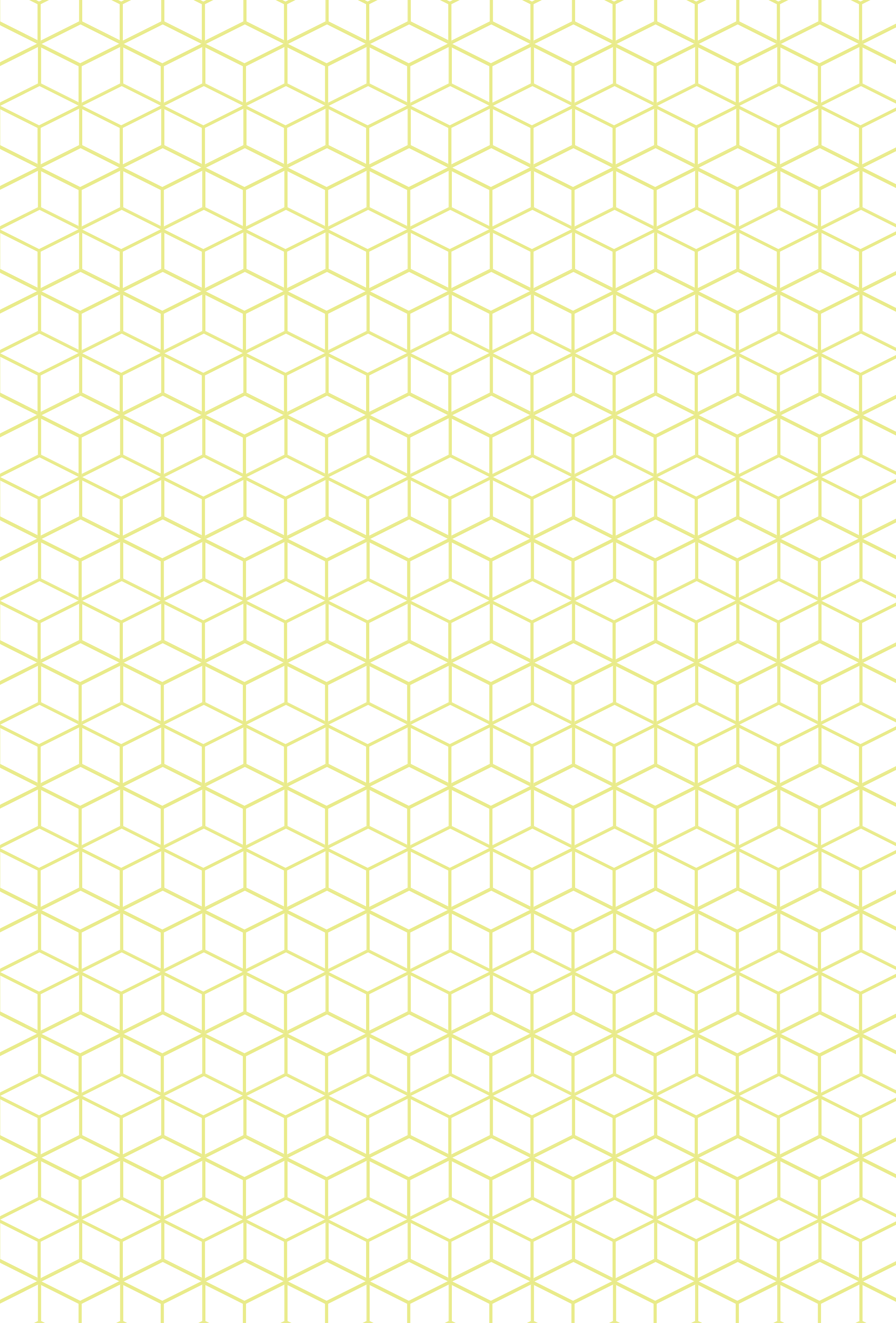
.... Date ....
for and on behalf of
[Third Party]

We acknowledge and agree to the terms set out in this letter.

.... Date ....
for and on behalf of
[Client]

Sample





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