ED/ICAI VS- 103/2026-2027/03

Exposure Draft
of
ICAI Valuation Standard 103
Valuation Approaches and Methods



Issued by Insolvency, Bankruptcy and Valuation Standards Board

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up under an Act of Parliament)

Exposure Draft

ICAI Valuation Standard 103 *Valuation Approaches and Methods*

Following is the Exposure Draft of the ICAI Valuation Standard 103 Valuation Approaches and Methods issued by the Insolvency, Bankruptcy and Valuation Standards Board of the Institute of Chartered Accountants of India, for comments.

The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide suggestions for alternative wording.

Comments can be submitted using one of the following methods, to be received not later than ***22nd November 2026.***

1. *Electronically: Click on* ***https://forms.gle/UuFbon18ESoB2Wp76*** *to submit comments online. (Preferred method)*
2. *Email: Comments can be sent to* ***commentsvsb@icai.in***
3. *Postal: Secretary, Insolvency, Bankruptcy and Valuation Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, A- 29, Sector- 62, Noida - 201309.*

Further clarifications on any aspect of this Exposure Draft may be sought by e-mail to ivsb@icai.in.

Draft

ICAI Valuation Standard-103
Valuation Approaches and Methods

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*(The ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards)*

Objective

1. **The objective of this Standard is to :**

   (a) **define the approaches and methods for valuing an asset; and**

   (b) **provide guidance on selection and application of appropriate valuation approaches and methods.**

2. The Standard recognizes that no single valuation approach or valuation method is appropriate for every valuation engagement. The appropriateness of an approach depends upon the characteristics of the subject asset, the valuation objective, the basis of value adopted, the availability and reliability of information, prevailing market conditions and the assumptions that market participants would reasonably make.

Scope

3. **Subject to paragraph [7], this Standard shall be applied in selecting the appropriate valuation approaches and methodologies in determining the value of the subject asset.**

4. This Standard applies to valuation of assets or liabilities capable of being valued; including inter alia:
   (a) businesses and business interests;
   (b) equity and other securities;
   (c) financial instruments;
   (d) intangible assets;
   (e) land and buildings;
   (f) plant, machinery and equipment;
   (g) infrastructure assets;
   (h) inventories;
   (i) biological assets.

5. The Standard shall apply for different purposes of valuation including inter alia:
   (a) financial reporting, including impairment testing;
   (b) corporate reorganisation, including mergers, demerger, buyback, capital reduction, acquisitions;
   (c) regulatory and tax requirements;
   (d) insolvency and bankruptcy;
   (e) purchase price allocation;
   (f) dispute resolution, arbitration and litigation;
   (g) insurance;
   (h) lending, including collateral evaluation;
   (i) strategic planning, including capital raising;
   (j) succession and estate planning
   (k) internal management purposes.

6. This Standard does not provide an exhaustive list of all the valuation methods. For example, methods applicable for valuation of tangible assets, intangible assets and financial instruments have been covered briefly in this Standard and detailed guidance has been provided in the relevant Standards.

7. This Standard does not apply in cases where a valuer is required to adopt valuation bases/ premise/ approach/ method that are prescribed by a law, regulation, notification, judicial order, contractual provision or other binding requirement. In such cases, the prescribed valuation base/ premise shall apply and the valuer shall adopt specific valuation method(s) or formula(e) as have been laid down under such law, regulation, notification, judicial order, contractual provision or other binding requirement. In such cases, the valuer make an appropriate disclosure of such requirement and explain the valuation bases / premise / approach/ method so applied.

8. This Standard shall be read together with Framework for the Preparation of Valuation Report and other applicable ICAI Valuation Standards.

Valuation Approaches

9. **This Standard provides guidance for following three main valuation approaches:**
   (a) Market approach;
   (b) Income approach; and
   (c) Cost approach.

10. A *valuer* can make use of one or more valuation method(s) available for each approach.

11. The appropriateness of a valuation approach(es) and valuation method(s) for determining the value of an asset would depend on valuation bases and premises. In addition, some of the key factors that a *valuer* shall consider while determining the appropriateness of a specific valuation approach and method are:
    (a) the purpose of valuation;
    (b) the nature and characteristics of the subject asset;
    (c) availability of adequate inputs or information and its reliability;
    (d) strengths and weakness of each valuation approach and method; and
    (e) valuation approach/method considered by market participants.

12. A *valuer* shall be responsible to select the appropriate valuation approach(es) and method(s) as there may not be a single approach/ method that is best suited for valuation in every situation.

13. A valuer shall consider all valuation approaches and shall select and apply one or more valuation approach(es) and valuation method(s), based on his professional judgment, nature of engagement and the information available, to produce a reliable conclusion. The valuation approach(es) and method(s) shall generally be selected in a manner which would increase the use of relevant observable inputs.

14. When evaluating a value resulting from use of multiple valuation approach(es)/ method(s), a *valuer* shall consider the reasonableness of the range of values. Where divergent values are obtained from multiple approaches or methods, the valuer shall not merely average or weight these indications without investigating the cause of the divergence. The *valuer* shall use his professional judgement considering the factors given in paragraph [12] to determine whether the chosen approaches and methodologies are appropriate or not.

15. The valuer shall document the rationale for the non-selection of any valuation approach.

16. Employing multiple approaches or methods provides a cross-check from different economic perspectives, thereby strengthening the reliability of the valuation.

17. The availability of multiple valuation approaches/ valuation methods does not imply that every available approach/ valuation method must be applied.

18. The valuer shall avoid unnecessary application of valuation approaches/ methods that do not provide meaningful valuation analysis.

19. Where the valuer has carried out valuation of the subject asset in the past 12 months, the valuer shall document the rationale for any material change in the valuation approach(es)/ method(s) as compared to such previous valuation.

Market Approach

20. **Market approach is a valuation approach that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) asset.**

21. The Market Approach is based on the principle that prices established through arm's length transactions between knowledgeable, willing and independent parties generally provide a sound indication of value where such information is reliable, relevant and sufficiently comparable.

22. The following are some of the instances where a *valuer* applies the market approach:
    (a) where the subject asset or a comparable or identical asset is traded in the active market;
    (b) there is a recent, orderly transaction in the subject asset; or
    (c) there are recent comparable orderly transactions in identical or comparable asset(s) and information for the same is available and reliable.

23. In some instances, a v*aluer* may consider using other valuation approaches instead of Market approach or in combination with Market approach, such as:
    (a) where the asset has fewer identical or comparable assets (market comparable);
    (b) the subject asset or its market comparables are not traded in the active market;
    (c) sufficient information on the comparable transaction(s) is not available;
    (d) there is no recent transaction either in the asset or in the market comparables; or
    (e) there are material differences between the subject asset and the market comparables, which require significant adjustments.

24. Sources of Market Information

Based on the nature of the subject asset, market information may be obtained from various sources including, inter alia:

(a) securities markets;

(b) subscribed / free databases;

(c) regulatory filings;

(d) financial statements / annual reports;

(e) website of the company;

(f) industry publications;

(g) insolvency transactions, where appropriate;

(h) auction results, where appropriate;

(i) broker information; and

(j) any other reliable market source.

Where multiple sources are available, preference shall ordinarily be given to information capable of independent verification.

25. The following valuation methods are commonly used under the market approach:
(a) Market Price Method (see paragraphs 26 - 28);

(b) Comparable Companies Multiple (CCM) Method (see paragraphs 29 - 36); and

(c) Comparable Transaction Multiple (CTM) Method (see paragraphs 37 - 48).

Market Price Method

26. A *valuer* shall consider the traded price observed over a reasonable period while valuing assets which are traded in the active market.

27. A *valuer* should generally consider the market where the trading volume of asset is the highest when such asset is traded in more than one active market.

28. A *valuer* shall use average price of the asset over a reasonable period. The *valuer* should consider using weighted average or volume weighted average to reduce the impact of volatility or any one time event in the asset.

Comparable Companies Multiple (CCM) Method

29. ***Comparable Companies Multiple Method*, also known as *Guideline Public Company Method*, involves valuing an asset based on market multiples derived from prices of market comparables traded on active market.**

30. The following are the major steps in deriving value using the CCM method:
(a) identify the publicly traded market comparables considering the key parameters listed in para [31]

(b) select and calculate the appropriate market multiples of the identified market comparables;

(c) compare the subject asset with the market comparables to understand material differences; and make necessary adjustments to the market multiple to account for such differences, if any;

(d) apply the adjusted market multiple to the relevant metrics of the subject asset to arrive at the value of such asset; and

(e) if value of the asset is derived by using market multiples based on different metrics, the *valuer* shall consider the reasonableness of the range of values.

31. While identifying and selecting the market comparables, a *valuer* shall consider the factors such as-

(a) industry to which the asset belongs;

(b) geographic area of operations;

(c) similar line of business, or similar economic forces that affect the asset being valued;

(d) other parameters such as size (for example - revenue, assets, etc), product category, stage of life-cycle of the asset, profitability, diversification, etc.

This list is not an exhaustive list, there may be certain other factors which a *valuer* may consider while identifying and selecting the market comparables.

32. The market multiples are generally computed on the basis of following inputs:

(a) trading prices of market comparables in an active market; and

(b) financial metrics such as Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA), Earnings Before Interest, Tax (EBIT), Profit After Tax (PAT), Revenue, Book Value of assets, etc.

Examples of market multiples – Enterprise Value / EBITDA multiple, Enterprise Value / EBIT multiple, Enterprise Value / Revenue multiple, Price earning multiple, Price to Book Value multiple etc.

33. If market participants are using market multiple based on non-financial metrics for valuing an asset, such multiples may also be considered by the *valuer* in addition to market multiple based on the financial metrics. For example, Enterprise Value (EV) / subscriber in case of telecom companies, EV/Tonne in case of cement industry, etc.

34. A *valuer* shall preferably use several market comparables rather than relying on a single comparable.

35. A v*aluer* shall exercise professional judgement while selecting the multiple in case where the market multiple computed for each comparable is significantly different from the other.

36. The following are some of the differences between the subject asset and market comparable that the *valuer* may consider while making adjustments to the market multiple:

(a) size of the asset;

(b) geographic location;

(c) profitability;

(d) stage of life-cycle of the asset;

(e) diversification;

(f) historical and expected growth;

(g) management profile;

(h) Competitive position;

(i) Marketability

(j) Control Premium;

(k) Customer / product concentration;

The valuer shall document the key factors considered for adjustments made to the market multiple.

Comparable Transaction Multiple (CTM) Method

37. **Comparable *Transaction Multiple Method*, also known as '*Guideline Transaction Method',* involves valuing an asset based on transaction multiples derived from prices paid in transactions of the subject asset / comparables' asset (comparable transactions**).

38. CTM considers the price(s) observed in a comparable transaction(s) for the subject/ similar asset(s). Where the comparable transaction involves the subject asset, the method is also known as Price of Recent Transaction/ Price of Recent Investment.

39. Price(s) paid in previous comparable transaction(s) may provide relevant evidence of value of the underlying asset. Before relying upon such transaction, the valuer should assess whether the transaction(s) were undertaken on an arm's-length basis between willing market participants.

40. The CTM process involves:
(a) selecting relevant precedent transactions;

(b) computing the applicable multiples;

(c) comparing the subject asset to the transaction assets and adjusting the multiples;

(d) applying the adjusted multiples to the subject asset's metrics; and

(e) reconciling the results if multiple metrics are used.

41. While identifying and selecting the comparable transaction(s), a *valuer* may consider the factors such as-
(a) transactions that have been consummated closer to the valuation date are generally more representative of the market conditions prevailing during that time;

(b) the selected comparable is an orderly transaction;

(c) transaction structure / transaction size;

(d) distressed transaction;

(e) geographic area of operations;

(f) similar line of business, or similar economic forces that affect the subject asset;

(g) other parameters such as size (for example - revenue, assets, etc), stage of life-cycle of the asset, profitability, diversification, etc.

(h) availability of sufficient information on the transactions to enable the *valuer* to reasonably understand the market comparable and derive the transaction multiple;

(i) availability of information on transaction from reliable sources such as regulatory filings, Merger & Acquisition databases, etc.

This list is not an exhaustive list, there may be certain other factors which a *valuer* may consider while identifying and selecting the comparable transaction.

42. The transaction multiples are generally computed based on the following two inputs:
(a) price paid in the comparable transaction; and

(b) financial metrics such as EBITDA, PAT, Sales, Book Value, etc of the comparable asset.

Even multiples based on non-financial metrics (such as EV/ room for hotels, EV/Bed for hospitals) can be considered.

43. A *valuer* shall preferably use multiple comparable transactions of recent past rather than relying on a single transaction.

44. The following are some of the differences between the subject asset and comparable transaction(s) that the *valuer* may consider while making adjustments to the transaction multiple(s), based on the information available and professional judgment:
(a) size of the asset;

(b) geographic location;

(c) profitability;

(d) stage of life-cycle of the asset;'

(e) diversification;

(f) historical and expected growth;

(g) management profile;

(h) differential rights;

(i) distressed circumstances or orderly transactions

(j) strategy or synergistic consideration

(k) control and level of interest acquired;

(l) transaction size;

(m) other material contractual conditions, if any, governing the subject asset/ comparable transaction such as deferred payment of consideration, contingent on achievement of certain milestones, etc.).

45. Transactions completed under compulsion, liquidation, insolvency, forced sale or exceptional circumstances shall not ordinarily be regarded as reliable comparable transactions.

46. Where distressed transactions are used, appropriate adjustments shall be made after considering the extent of distress and prevailing market conditions.

47. The price paid in comparable transactions generally include control premium, except where transaction involves acquisition of non-controlling/minority stake.

48. Where a recent transaction price of the subject asset is used as a reference point, the valuer should evaluate whether events or changes occurring between the transaction date and the valuation date indicate a material change in fair value. Such assessment should be based on the professional judgment of the valuer and may include, inter alia the following factors:

    (a) changes in the financial performance or prospects of the entity;

    (b) changes in industry, regulatory or capital-market conditions;

    (c) changes in valuation multiples or other relevant market parameters;

    (d) any other entity-specific or market-related developments that may have a material impact on value.

    Where such changes are significant, appropriate adjustments should be made, or an alternative valuation approach(es) or valuation method(s) should be applied.

Selection of Market / Transaction Multiples

49. Where the Market Approach is applied using market multiples / transaction multiples, the valuer shall not mechanically apply average or median multiples without analysing comparability.

50. Where an individual comparable is assigned greater weight, the reasons shall be documented.

51. The multiple shall represent a relationship between enterprise value/ equity value and a relevant financial, operational or non-financial measure. An enterprise value multiple shall generally be applied to an enterprise-level measure (such as EV/EBITDA, EV/EBIT, EV/Tonne, etc) and not directly to equity-level measure.

Discounts and Control Premium

52. A *valuer* shall evaluate and make adjustments for differences between the subject asset and market comparables/comparable transactions. The most common adjustment under CCM method and CTM method pertain to 'Discounts' and 'Control Premium'.

53. 'Discounts' include Discount for Lack of Marketability (DLOM) and Discount for Lack of Control (DLOC).

Discount for Lack of Marketability (DLOM)

54. **The concept of DLOM recognises that investors pay a premium for liquidity; thus, an asset lacking a ready market (such as securities of an unlisted entity) or subject to selling restrictions (such as securities under lock-in-period or regulatory restrictions) is valued lower than an otherwise identical liquid asset. .**

55. Generally, restrictions on marketability that are only inherent in the subject asset shall be considered while valuing the asset. Marketability restrictions that are specific to a particular owner of the asset are not generally considered for discount adjustment.

56. Determining an appropriate level of DLOM can be a complex and subjective process. Accordingly, the specific nature and characteristics of the asset and the facts and circumstances surrounding the valuation should be considered.

57. A *valuer* shall use his professional judgement while applying DLOM and consider the relevant factors including but not limited to-
    (a) size and nature of the asset;
    (b) time and costs associated with marketing or for making a public offer;
    (c) probability and timing of an IPO, sale or other liquidity event;
    (d) restrictions on transferability;
    (e) history of past transactions;
    (f) exit rights; or
    (g) lack of or limitation to access to information.

58. The valuer shall document the rationale for the DLOM applied.

Control Premium and Discount for Lack of Control (DLOC)

59. ***Control Premium generally represents the amount paid by acquirer for the benefits it would derive by controlling the acquiree's assets and cash flows.***

60. **Control Premium is an amount that a buyer is willing to pay over the current market price of a publicly-traded company to acquire a controlling interest in an asset. It is opposite of discount for lack of control to be applied in case of valuation of a non-controlling/minority interest.**

61. Generally, on acquisition an acquirer can derive benefits from the following:
    (a) potential synergies as a result of merger/combination; and
    (b) ability to influence acquiree's operating, financial, or corporate governance policies relating to appointment of board members, declaration of dividends, etc.

62. Under the CCM method, the value of the asset is on a minority interest/ non-controlling interest as the market multiples of market comparables are derived from their respective traded price in the active market.
    The traded price of such comparables may not include the benefit derived from controlling the market comparable's assets and cash flows. Therefore, while applying the CCM method to value the asset for a controlling interest, a control premium may be considered.

63. Under the CTM method, the transaction price generally includes price paid for control premium (except where transaction involves acquisition of non-controlling/minority stake). Therefore, while valuing the asset for a non-controlling/minority interest, DLOC may be considered.

64. Determining an appropriate level of Control Premium and DLOC can be a complex and subjective process. Accordingly, the specific nature and characteristics of the asset and the facts and circumstances surrounding the valuation should be considered.

65. A *valuer* shall use his professional judgement while applying control premiums and DLOC, considering the factors, including but not limited to
    (a) amount/ extent of control in the subject asset;
    (b) nature and size of the interest;
    (c) distribution of the remaining ownership interests;
    (d) presence of other controlling shareholders;
    (e) ability to determine or materially influence key business decisions, including, appointment or removal of directors, corporate reorganisation, acquire/ sell business/ assets, etc. ;
    (f) statutory provision relating to protection of minority shareholders;
    (g) the shareholder protection restrictions contained in the articles of incorporation, the byelaws and/or the shareholders' agreement

66. The valuer shall document the rationale for the Control premium/ DLOC applied.

67. The valuer shall avoid double counting or double adjustment. Where control premium or marketability factors, have already been reflected in the selected multiple, a further separate adjustment should not be made unless supported by information.

Income Approach

68. **Income approach is a valuation approach that converts future free cashflows or maintainable metrics (e.g., cash flows or earnings) to a single current (i.e., discounted or capitalised) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future free cashflows/ maintainable metrics.**

69. This approach involves discounting future free cashflows/ capitalizing maintainable metrics (eg. cash flows or earnings) to a single present value.

70. The application of the Income Approach requires analysis of:
    (a) expected future free cash flows/ maintainable metric;
    (b) expected growth;
    (c) duration of economic benefits;
    (d) key risks associated with achieving expected benefits; and
    (e) appropriate discounting or capitalisation factors.

71. The reliability of the Income Approach depends upon:
    (a) reasonableness of forecasts/ maintainable metric;
    (b) consistency of key assumptions;
    (c) appropriateness of discount rates or capitalisation factors;

(d) relevance and reliability of information available.

72. The following are some of the instances where a *valuer* may apply the income approach:
(a) where the asset does not have any market comparable or comparable transaction;
(b) where the asset has fewer relevant market comparables; or
(c) where the asset is an income generating asset for which the future cash flows are available and can reasonably be projected.

73. In some instances, a *valuer* may consider using other valuation approaches instead of income approach or in combination with income approach, such as, where -
(a) the asset has not yet started generating income or cash flows, e.g., projects under development;
(b) there is significant uncertainty on the amount and timing of income/future cash flows, e.g., start-up companies; or
(c) the client does not have access to the information relating to the asset being valued, e.g., minority shareholder may not have access to projections/budgets or growth expectations specific to the business.
(d) historical performance is not representative or highly volatile;
(e) business continuity is uncertain;
(f) economic environment is highly volatile;

74. Some of the common valuation methods under income approach are as follows:
(a) Discounted Cash Flow (DCF) Method (see paragraphs 75- 96);
(b) Capitalisation Method
(c) Option pricing models such as Black-Scholes-Merton formula or binomial (lattice) model or Monte Carlo stimulation model (see paragraphs 117- 118)

Discounted Cash Flow ('DCF') Method

75. **The DCF method values the asset by discounting the free cash flows expected to be generated by the subject asset for the explicit forecast period and also the perpetuity value (or terminal value) in case of assets with indefinite life**.

76. The DCF method is one of the most common methods for valuing various assets such as shares, businesses, real estate projects, debt instruments, etc.

77. This method involves discounting of future free cash flows expected to be generated by the subject asset over its life using an appropriate discount rate to arrive at the present value.

78. The following are the major steps in deriving a value using the DCF method:
(a) Consider the projections to determine the future operating free cash flows expected to be generated by the asset;
(b) analyse the projections and its underlying assumptions to assess the reasonableness of the free cash flows;
(c) choose the most appropriate type of cash flows for the asset, *viz*., pre-tax or post-tax cash flows,

free cash flows to equity or free cash flows to firm;

(d) determine the discount rate;

(e) determine growth rate beyond explicit forecast period; and

(f) apply the discount rate to arrive at the present value of the explicit period cash flows and for arriving at the terminal value.

79. While using the DCF method, it may also be necessary to make adjustments to the valuation to reflect matters that are not captured in either the cash flow forecasts or the discount rate adopted. eg. where the future cash flows include only the operating business, value of non-operating assets/ liabilities or investments shall be adjusted to arrive at the equity value.

80. In case of the DCF method, projected cash flows usually reflect the benefits of control and accordingly the value of asset arrived under this method is generally not grossed up for control premium.

81. A *valuer* shall use his professional judgement while applying the DLOM / DLOC. It may include adjustments for discount for the marketability of the interest being valued or whether the interest being valued is non-controlling interest in the business.

82. The following are important inputs for the DCF method:

(a) Cash flows;

(b) Discount rate; and

(c) Terminal value

Cash Flows

83. In most cases, the projections shall comprise the statement of profit & loss, balance sheet, cash flow statement, along with the underlying key assumptions. However, in certain cases, if balance sheet and cash flow statement are not available, details of future capital expenditure and working capital requirements may also suffice.

84. The projections reflect the accrual based accounting income and expenses. For arriving at the cash flows, non-cash expenses, such as depreciation and amortisation, shall be added back. Further, cash outflows relating to capital expenditure and incremental working capital requirements, if any shall be deducted.

85. Generally, historical financial statements are used as the base for preparation of projections. If in future, changes in circumstances are anticipated the assumptions underlying the projections shall reflect differences on account of such differences *vis-à-vis* the historical financial statements.

86. The valuer shall evaluate whether forecast cash flows represent reasonable expectations of future performance considering *inter-alia* the analysis of the following:

(a) historical performance;
(b) industry outlook;
(c) management strategy; and
(d) capital expenditure and working capital requirements.

87. A *valuer* shall carry out procedures such as ratio analysis, trend analysis to determine historical trends, as considered appropriate, to gather necessary information to assess risks inherent in the achievability of the projections.

88. The fact that the *valuer* considers the projections in estimating the value of the asset shall not be construed as the *valuer* being associated with or being a party to such projections.

89. The length of the period of projections (explicit forecast period) shall be determined based on the following factors:
    (a) *Nature of the asset*- where the business is of cyclical nature, explicit forecast period should ordinarily consider one entire cycle (for example commodity business).
    (b) *Life of the asset*- In case of asset with definite life, explicit period should be for the entire life of the asset (for example, debt instruments, Build Operate Transfer (BOT) road projects).
    (c) *Sufficient period*- The forecast period should have a length of time that is sufficient for the asset to achieve stable level of operating performance.
    (d) *Reliable data*- The data that are used for projecting the cash flows, should be reliable.

90. The following are the types of cash flows which are generally used for valuation under DCF Method*:*
    (a) Free Cash Flows to Firm (FCFF): FCFF refers to cash flows that are available to all the providers of capital, i.e. equity shareholders, preference shareholders and lenders. Therefore, cash flows required to service lenders and preference shareholders such as interest, dividend, repayment of principal amount and even additional fund raising are not considered in the calculation of FCFF.
    (b) Free Cash Flows to Equity (FCFE): FCFE refers to cash flows available to equity shareholders and therefore, cash flows after interest, dividend to preference shareholders, principal repayment and additional funds raised from lenders / preference shareholders are considered.

    Asset value is independent of the manner of finance, hence, FCFF is more commonly used to arrive at an asset value.

91. The valuer shall clearly identify the cash flows adopted and ensure that the basis of computation of discount rate is consistent with such cash flows.

Discount Rate

92. ***Discount rate*** **represents the market's required rate of return for the investment, incorporating both the time value of money and the specific risks associated with the asset's expected cash flows."**

93. The following discount rates are most commonly used depending upon the type of the cash flows:
    (a) weighted average cost of capital;
    (b) cost of equity;
    (c) Internal Rate of Return ('IRR');
    (d) cost of debt; or
    (e) yield.

94. Different methods are used for determining the discount rate. The most commonly used methods are as follows:
    (a) Capital Asset Pricing Model (CAPM) for determining the cost of equity.
    (b) Weighted Average Cost of Capital (WACC) is the combination of cost of equity and cost of debt weighted for their relative funding in the asset.
    (c) Build-up method (generally used only in absence of market inputs).

95. A *valuer* may consider the following factors while determining the discount rate:
    (a) type of asset being valued such as debt, preference shares, business, real estate, intangibles, etc.;
    (b) life of the asset such as the risk-free rate used for determining the cost of equity in the CAPM model differs for an asset with a one-year life *vs* an indefinite life;
    (c) geographic location of the asset;
    (d) currency in which the projections have been prepared;
    (e) risk in achieving the projected cash flows;
    (f) type of cash flows used for the projections, for eg, FCFE needs to be discounted by Cost of Equity whereas FCFF to be discounted using WACC;
    (g) discount the cash flows in the functional currency using a discount rate appropriate for that functional currency; and
    (h) pre-tax cash flows need to be discounted by pre-tax discount rate and post-tax cash flows to be discounted by post-tax discount rate;

96. *A valuer* shall include, where appropriate, risk adjustments that a market participant shall expect as compensation for uncertainty inherent in the cash flows.

Terminal Value

97. ***Terminal value*** **represents the present value at the end of explicit forecast period of all subsequent cash flows to the end of the life of the asset or into perpetuity if the asset has an indefinite life.**

98. In case of assets having indefinite or very long useful life, it is not practical to project the cash flows for such indefinite or long periods. Therefore, the *valuer* needs to determine the terminal value to capture the value of the asset at the end of explicit forecast period.

99. Terminal value assumptions shall be estimated considering *inter-alia* the following:
    (a) expected operating performance;
    (b) long term inflation;
    (c) expected competitive conditions; and
    (d) reinvestment requirements;

100. There are different methods for estimating the terminal value. The commonly used methods are:
    (a) Constant Growth Model;
    (b) Variable Growth Model;

(c) Exit Multiple; and

(d) Salvage / Liquidation value

Constant Growth Model

101. The terminal value under this method is computed by dividing the perpetuity maintainable free cash flows with the discount rate as reduced by the stable growth rate.

102. The estimation of stable growth rate is of significance because even a minor change in stable growth rate can have an impact on the terminal value and the value of the asset.

Variable Growth Model

103. The Constant Growth Model assumes that the asset grows (or declines) at a constant rate beyond the explicit forecast period whereas the Variable Growth Model assumes that the asset grows (or declines) at variable rate beyond the explicit forecast period.

Exit Multiple

104. The estimation of terminal value under this method involves capitalising the final year's earnings or cash flow using a market-derived multiple (for example, Enterprise Value (EV) / Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA), EV / Sales) to the perpetuity earnings / income.

105. The multiple needs to be estimated based on multiples of comparable assets and hence, the principles laid down under the market approach section of this standard should be complied with.

106. The Exit multiple shall be estimated by the valuer on the basis of professional judgement and may consider inter-alia the following factors:
    - current market multiples;
    - projected financial performance;
    - business maturity and expected industry conditions;

107. Where the Exit Multiple Method is used, the selected multiple should reflect expected market conditions at the end of the forecast period and the valuer should make appropriate adjustments for factors including, normalization of growth rates at the end of the projection period.

Salvage or Liquidation Value

108. For assets with depleting life spans, such as oil wells or mines, terminal value is typically estimated as the net realisable value of the asset upon disposal.

Terminal growth Rate

109. The terminal growth rate shall reflect sustainable long-term expectations.

110. Some of the factors that a *valuer* may consider while determining the terminal growth rate:
    (a) whether the level of operations beyond explicit forecast period are expected to be significantly

different from the level projected in the last year of the explicit forecast period or only a normal growth is expected;

(b) capacity utilisation at the end of explicit forecast period;

(c) functional currency in which the projections have been prepared;

(d) market share;

(e) product life cycle;

(f) geographic location of the asset;

(g) capital investment required to support the assumed growth rate;

(h) whether there is future growth potential for the asset beyond the explicit forecast period, or whether the asset is deteriorating in nature; and

(i) for cyclical assets, the terminal value should consider the cyclical nature of the asset.

Capitalisation Method

111. Capitalisation Method is a valuation method that converts future maintainable metric (e.g., cash flows or earnings) to a single current amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future maintainable metrics.

112. The Capitalisation Method involves determination of future maintainable metric (e.g., cash flows or earnings) of the subject asset from its normal operations. The future maintainable metric is then capitalised at a rate, which, in the opinion of the valuer, combines an adequate expectation of reward from enterprise and risk.

113. The Capitalisation Method may be used for valuation of:
(a) NBFCs (primarily having fund-based activities), banks; or
(b) for assets where operating earnings/ operating cash flows are relatively stable and sustainable and future growth is reasonably predictable.

114. Capitalisation Method shall not be used for assets where significant changes are expected in the business' operations, growth or capital structure.

115. For application of Capitalisation Method, the valuer shall:
(a) estimate maintainable metric;
(b) normalise earnings/ cash flows, where appropriate; and
(c) determine an appropriate capitalisation rate.

116. The capitalisation rate shall be consistent with the earnings/ cashflows measure and basis of value and shall be estimated considering inter-alia the following factors:
(a) Expected return on equity;
(b) Expected return on capital employed;
(c) Expected long term sustainable growth rate;

(d) Reinvestment requirements;

(e) Implied return expectation based on multiple(s) of comparable companies.

Option Pricing Models

117. There are several methods to value options, of which the Black-Scholes-Merton Model, Binomial Model, Monte Carlo Simulation Model are widely used. The important inputs required in these models are as under:

(a) current price of the subject asset;

(b) exercise price;

(c) life of the option;

(d) expected volatility in the price of the asset;

(e) expected dividend yield; and

(f) risk free interest rate.

118. MEEM, Relief from Royalty method, With and Without method are used only for valuation of intangible assets and Option Pricing Models are used in case of valuation of options. Specific guidance on the aforesaid valuation methods is provided in other relevant ICAI Valuation Standards.

Cost Approach

119. Cost Approach is a valuation approach that estimates value of the subject asset by reference to the cost required, as at the valuation date, to create, acquire or replace with an asset providing comparable utility, with appropriate consideration of the subject asset's condition, service capacity, remaining economic life, obsolescence and other relevant characteristics

120. The Cost Approach is based on the principle that, in appropriate circumstances, a rational purchaser would generally not pay more for an asset than the cost of obtaining an asset providing comparable utility, subject to differences in timing, risk, condition, utility, obsolescence and other relevant factors.

121. The Cost Approach may be appropriate for valuation of assets or asset classes including, but not limited to:

(a) specialised properties;

(b) industrial plants and facilities;

(c) machinery, equipment and other specialised tangible assets;

(d) buildings or other properties for which reliable market evidence is limited;

(e) assets under initial stage of construction or development;

(f) internally developed assets, where the cost incurred or required to recreate or replace the asset is a relevant indicator of value;

(g) certain intangible assets, particularly where the value of the asset is primarily attributable to the cost of creating or replacing the asset and the asset does not generate economic benefits that can be reliably isolated;

122. In certain situations, carrying value of assets and liabilities held by the subject asset may be considered by the *valuer* where it has been prescribed by the applicable regulations/law/guidelines or is appropriate considering the nature of such asset.

Adjusted Net Assets Value Method

123. Valuation of investment holding company may be carried out adopting Adjusted Net Assets Value Method considering the following:
    (a) fair value of underlying investee companies and surplus/ non-operating assets; and
    (b) fair value / carrying value of the residual assets and liabilities, as appropriate.

    In such a case, fair value of investments, non-operating or other assets shall be determined by adopting appropriate Valuation Approach(es) and Valuation Method(s) and the same shall be disclosed in the valuation report.

124. Examples of situations where a *valuer* applies the cost approach are:
    (a) an asset can be recreated in a reasonable time with substantially the same utility as the subject asset;
    (b) the asset is under initial stage of construction or development, and significant costs are yet to be incurred

125. In some instances, the valuer may consider using other valuation approaches in combination with cost approach, such as:
    (a) the asset has not yet started generating income / cash flows (directly or indirectly);
    (b) an asset of substantially the same utility as the subject asset can be created but there are regulatory or legal restrictions and involves significant time for recreation; or
    (c) the asset was recently created.

126. The following are the two most commonly used valuation methods under the Cost approach:
    (a) Replacement Cost Method (see paragraph 127 – 130); and
    (b) Reproduction Cost Method (see paragraph 131-133).

Replacement Cost Method

127. ***Replacement Cost Method, also known as 'Depreciated Replacement Cost Method' involves valuing an asset based on the cost that a market participant shall have to incur to recreate an asset with substantially the same utility (comparable utility) as that of the subject asset, adjusted for obsolescence.***

128. The physical properties of the new asset may or may not be similar to the one under valuation, but the former asset should bear comparable utility. Obsolescence includes physical deterioration, functional

(technological) and economic obsolescence. The term obsolescence connotes a wider meaning than the term depreciation adopted for financial reporting or tax purposes.

129. Replacement Cost represents the estimated cost to create an asset providing equivalent utility using modern materials, technology, design and construction methods. Replacement Cost generally reflects the perspective of a rational market participant seeking equivalent utility rather than an identical asset

130. The following are the major steps in deriving a value using the Replacement Cost method:
(a) estimate the costs that will be incurred by a market participant for creating an asset with comparable utility as that of the subject asset;
(b) assess whether there is any loss on account of physical, functional or economic obsolescence in the subject asset; and
(c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the subject asset.

Reproduction Cost Method

131. ***Reproduction Cost Method involves valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the subject asset, adjusted for obsolescence.***

132. Reproduction Cost represents the estimated cost to create a replica of the existing asset using the same materials, specifications, design and standards and may be appropriate where:

(a) the asset has unique characteristics;
(b) historical authenticity is relevant;
(c) replacement with modern alternatives would not provide equivalent utility.

133. The following are the major steps in deriving a value using the Reproduction Cost method:
(a) estimate the costs that will be incurred by a market participant for creating a replica of the subject asset;
(b) assess whether there is any loss of value on account of physical, functional or economic obsolescence in the subject asset; and
(c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the subject asset.

Historical Cost Method

134. ***Historical Cost refers to the cost incurred at the time the asset was originally acquired, constructed or developed, including costs appropriately attributable to bringing the asset to its intended condition and location.***

135. Historical Cost is historical measure of expenditure and shall not, by themselves, be regarded as an indication of the current value of an asset. Where such costs are used as inputs to the Cost Approach, the valuer shall assess their relevance to current market conditions and make appropriate adjustments for changes in price levels, technology, capacity, specifications, location, utility, physical condition and other relevant factors.

Obsolescence

136. ***Under the Replacement Cost Method or the Reproduction Cost Method, the estimated cost of creating an asset is required to be adjusted where relevant, for physical deterioration and for functional and economic obsolescence affecting the subject asset.***

137. The following are common types of obsolescence
   (a) *Physical obsolescence* represents the loss in utility on account of age, wear and tear, usage, maintenance condition, environmental exposure or other physical factors.
   (b) *Functional (technological) obsolescence* represents the loss in utility on account of development of superior technology; whereby the utility of the subject asset declines due to availability of more efficient alternative assets.
   (c) *Economic (external) obsolescence* represents the loss in utility on account of decreased usefulness of the asset caused by external economic factors such as change in environmental or other regulations, excess supply, change in customer preferences, high interest rates, etc. Economic obsolescence shall not be confused with temporary market fluctuations unless such fluctuations affect long-term utility.

138. Cost approach is generally used in case of valuation of property, plant and equipment and certain intangible assets. ICAI Valuation Standards dealing with valuation of these assets provides specific guidance on the aforesaid valuation methods under the Cost approach.

Valuation Range and Point Estimate

139. The valuer shall determine whether a point estimate or valuation range is appropriate based on the professional judgement and may inter-alia consider the following factors:
   (a) nature and purpose of the engagement (eg. Share exchange ratio, purchase price allocation, etc.);
   (b) Regulations;
   (c) Level of uncertainty.

Benchmarking/ Reasonableness checks before Final Conclusion

140. Before finalising the valuation conclusion, the valuer shall perform appropriate Benchmarking/ reasonableness checks.

141. Benchmarking/ Reasonableness checks may include:

   (a) implied valuation multiples;
   (b) comparison with industry benchmarks;
   (c) comparison with market transactions;

Effective Date

142. ICAI Valuation Standard 103 Valuation Approaches and Methods shall be applied for the valuation reports issued on or after [].