The valuation of the shares of the units to be disinvested, the methods to be adopted for disinvestment and also, the procedures to be applied for the disinvestment are very important for the prospective investor to make the appropriate decision. So the present chapter has been devoted for analyzing them from the angle of an investor.

VALUATION

In any sale process, the sale materializes only when the seller is satisfied that the price given by the buyer is not less than the value of the object being sold, which in his perception is adequate.

Determination of that threshold amount, which the seller considers adequate, therefore, is the first pre-requisite for conducting any sale. This threshold amount is called the Reserve Price. Thus Reserve Price is the threshold amount below which the seller generally perceives any offer or bid inadequate.

Reserve Price in case of sale of a company is determined by carrying out valuation of the company. In companies, which are listed on the Stock Exchanges, market price of the shares is a good indicator of the value of the company. However most of the PSUs are either not listed on the Stock Exchanges or their shares are highly undervalued. Therefore, deciding the worth of a PSU is indeed a challenging task.
Another point worth mentioning is that valuation of a PSU is different from establishing the price for which it can be sold. Experts are of the opinion that valuation must be differentiated from price.

A purchase and sale would be possible only when two parties form different views as to the value of an asset but are able to reach agreement on the same price. It would be better appreciated by all that the Government can only realise what a buyer is willing to pay for the PSU, as the purchase price ultimately agreed reflects its value to the buyer.

In the literature on valuation of shares for disinvestment decisions, reference is made to the following methods.

1. MARKET VALUE METHOD (MV)

In this method, the market value acts as the guiding factor valuation of shares for the purpose of disinvestment. The underline principle is that the market present a genuine assessment of the managerial and economic strength of the enterprises through pricing of its scrips on day to day basis. The market value method can be used only in such cases where the companies are listed on one or more stock exchanges. There have been some case of both the central and state enterprises being listed on the stock exchanges.
2. Net Tangible Assets Methods (NTAV)

The net tangible asset value is computed with the help of the latest audited balance sheet of the concerned company. Under this method the figure for total assets is worked out as a first step. Secondly, the balances in respect of current liabilities, long term debt, intangible assets including goodwill and assets to written of are than deducted from the total assets.

At the third stage, the assets are revalued and any increase or decrease on account of this has to be affected. The ultimate figure arrived at gives the value of the net tangible assets.

The net tangible asset per share is arrived at by dividing net tangible assets by the number of shares with the company.

3. Profit Earning Capacity Value Method (PECV)

This method suggests the valuation of the company by capitalising the average of profits after tax. According to the guidelines issued by the Controller of Capital Issues of India, the capitalisation of profits for industries in various lines of operation could be done on the following basis:-

15% on capital employed in the case of manufacturing concern.
20% in case of trading companies.
17.5% in case of intermediate companies.*

* Intermediate company is one wherein the turnover from trading activities is more than 40% but less than 60% of its total turnover.
In the case of manufacturing enterprises exceptions may have to be made to the capitalisation rate of 15%. If there is staggering difference between the market piece and the price arrived at 15% of capitalisation rate. Normally, a period of 3 years is taken to average out the profits. If the profits of the last three years are stable, they may be averaged out on the basis of the simple arithmetic mean. However, the profit are rising year after year steadily, it is useful to take the help of weighted average method. It is very easy to apply this method. However, the only difficulty with the profit earning capacity value method is selecting and appropriates capitalisation rate.

4. Fair Market Value Method (FV)

The average of NTAV and the PSCB (with the 15% capitalisation rate) is called fair value or value based on best reasonable judgement. Hence fair market value method is depend on share valuation. Though, market value will not be taken as a direct input in calculating fair value, how ever, it will be used as a guiding factor for reworking the capitalisation rate or readjusting PECB. The Controller of Capital Issues of India's guidelines provide for such readjustment if the fair value is less than market value by over 20%. However, it is clarified that the capitalisation rate should not be reduced below 8%.

Fair value does not provide the maximum value of shares as it is based on the principal of averages. PEs with the low profile or having the net asset value below the face value of share may be valued with the help of fair value method.
5. Face Value Plus Interest Method (FI)

As per this method the valuation of shares of a company is done by taking into consideration its total investment at the time of acquisition and by adding to the same an equivalent of 15% rate interest every year.

From the total sum so computed, total amount of dividends paid to shareholders from the date of acquisition stretching to the date of valuation has to be calculated. The remainder is divided by total number of shares to the compute the value per share of the company. This method is suitable for the valuation companies which have a non-volatile assured income stream.

This method turn out to be very useful even for such companies which make capital additions now and then. It is not useful in the case of enterprises having a negative net-worth.

The share valuation of some Public Sector Enterprises is shown in Table 3.1.
<table>
<thead>
<tr>
<th>S. no.</th>
<th>Name of company</th>
<th>Divested shares</th>
<th>Paid up value per share (Rs.)</th>
<th>NA method</th>
<th>PECV method</th>
<th>FV method</th>
<th>face value</th>
<th>Best Value</th>
<th>Amount realisable</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Andrew Yule</td>
<td>13.57</td>
<td>1.58</td>
<td>18.88</td>
<td>41.38</td>
<td>22.23</td>
<td>25.12</td>
<td>35.58</td>
<td>41.38 NA</td>
</tr>
<tr>
<td>2</td>
<td>Bharat Earth Mover</td>
<td>28.88</td>
<td>6.88</td>
<td>188.88</td>
<td>11666.67</td>
<td>8849</td>
<td>8728.38</td>
<td>5858.88</td>
<td>11666.67 NA</td>
</tr>
<tr>
<td>3</td>
<td>Bh Electronic</td>
<td>28.88</td>
<td>16.88</td>
<td>188.88</td>
<td>3265.58</td>
<td>2249</td>
<td>2378.89</td>
<td>6558.88</td>
<td>35.58 NA</td>
</tr>
<tr>
<td>4</td>
<td>BHEL</td>
<td>28.88</td>
<td>46.96</td>
<td>188.88</td>
<td>3418.96</td>
<td>1866</td>
<td>438.58</td>
<td>16858.6</td>
<td>16858.68 NA</td>
</tr>
<tr>
<td>5</td>
<td>BPCL</td>
<td>28.88</td>
<td>18.88</td>
<td>188.88</td>
<td>13288.28</td>
<td>1129</td>
<td>1268.3</td>
<td>5588.88</td>
<td>11786.44 PECSV</td>
</tr>
<tr>
<td>6</td>
<td>BRPL</td>
<td>28.88</td>
<td>39.96</td>
<td>188.88</td>
<td>1682.86</td>
<td>1129</td>
<td>1268.3</td>
<td>3588.88</td>
<td>3588.88 FI</td>
</tr>
<tr>
<td>7</td>
<td>Computer Mt Corp</td>
<td>18.69</td>
<td>2.53</td>
<td>188.88</td>
<td>1168.48</td>
<td>-795.8</td>
<td>-1328.18</td>
<td>3488.88</td>
<td>3488.88 FI</td>
</tr>
<tr>
<td>8</td>
<td>Cochin Ref</td>
<td>18.81</td>
<td>6.98</td>
<td>188.88</td>
<td>366.47</td>
<td>537.55</td>
<td>5658.88</td>
<td>5658.88</td>
<td>5658.88 FI</td>
</tr>
<tr>
<td>9</td>
<td>Dredging</td>
<td>1.44</td>
<td>8.48</td>
<td>1888.88</td>
<td>3651.87</td>
<td>2292.87</td>
<td>3258.88</td>
<td>3258.88</td>
<td>3258.88 FI</td>
</tr>
<tr>
<td>10</td>
<td>Fertilizer. Chem. (T)</td>
<td>1.54</td>
<td>5.28</td>
<td>18.88</td>
<td>11.41</td>
<td>2.81</td>
<td>53.58</td>
<td>53.58</td>
<td>53.58 FI</td>
</tr>
<tr>
<td>11</td>
<td>H. M. T.</td>
<td>5.43</td>
<td>4.27</td>
<td>1888.88</td>
<td>3218.29</td>
<td>488.8</td>
<td>711.81</td>
<td>6788.88</td>
<td>6788.88 FI</td>
</tr>
<tr>
<td>12</td>
<td>H. cables</td>
<td>3.64</td>
<td>1.67</td>
<td>1888.88</td>
<td>2735.58</td>
<td>1823</td>
<td>1138.3</td>
<td>6888.88</td>
<td>6888.88 FI</td>
</tr>
<tr>
<td>13</td>
<td>H.P.C.L.</td>
<td>28.88</td>
<td>12.77</td>
<td>188.88</td>
<td>13286.87</td>
<td>15938</td>
<td>15938.8</td>
<td>3588.88</td>
<td>3588.88 FI</td>
</tr>
<tr>
<td>14</td>
<td>H. photo firm Co.</td>
<td>16.85</td>
<td>19.18</td>
<td>1888.88</td>
<td>3455.68</td>
<td>287.12</td>
<td>287.12</td>
<td>7458.88</td>
<td>7458.88 FI</td>
</tr>
<tr>
<td>15</td>
<td>H. O.C.L.</td>
<td>28.88</td>
<td>9.87</td>
<td>1888.88</td>
<td>1457.55</td>
<td>357.5</td>
<td>9658.88</td>
<td>9658.88</td>
<td>9658.88 FI</td>
</tr>
<tr>
<td>16</td>
<td>H. Z. L.</td>
<td>28.88</td>
<td>88.75</td>
<td>188.88</td>
<td>1569.85</td>
<td>1258</td>
<td>1379.54</td>
<td>4758.88</td>
<td>4758.88 FI</td>
</tr>
<tr>
<td>17</td>
<td>I.P.C.L.</td>
<td>28.88</td>
<td>37.28</td>
<td>1888.88</td>
<td>3745.27</td>
<td>287.72</td>
<td>4358.88</td>
<td>4358.88</td>
<td>4358.88 FI</td>
</tr>
<tr>
<td>18</td>
<td>Ind. Railway Const</td>
<td>8.27</td>
<td>8.81</td>
<td>1888.88</td>
<td>37393.94</td>
<td>1124.6</td>
<td>3258.88</td>
<td>3258.88</td>
<td>3258.88 FI</td>
</tr>
<tr>
<td>19</td>
<td>ITI</td>
<td>28.88</td>
<td>17.68</td>
<td>188.88</td>
<td>345.89</td>
<td>252</td>
<td>252.49</td>
<td>745.88</td>
<td>745.88 FI</td>
</tr>
<tr>
<td>20</td>
<td>Madras Ref.</td>
<td>28.88</td>
<td>22.83</td>
<td>1888.88</td>
<td>2328.48</td>
<td>2967</td>
<td>2964.65</td>
<td>4968.88</td>
<td>4968.88 FI</td>
</tr>
<tr>
<td>21</td>
<td>MTNL</td>
<td>28.88</td>
<td>128.88</td>
<td>1888.88</td>
<td>1766.18</td>
<td>28682</td>
<td>1711.41</td>
<td>16588.9</td>
<td>16588.9 FI</td>
</tr>
<tr>
<td>22</td>
<td>Maruti</td>
<td>9.88</td>
<td>9.92</td>
<td>188.88</td>
<td>217.19</td>
<td>286.4</td>
<td>223.27</td>
<td>223.27</td>
<td>223.27 FI</td>
</tr>
<tr>
<td>23</td>
<td>MMTC</td>
<td>8.67</td>
<td>1.34</td>
<td>188.88</td>
<td>788.14</td>
<td>636.9</td>
<td>241.31</td>
<td>241.31</td>
<td>241.31 NA</td>
</tr>
<tr>
<td>24</td>
<td>Nalco</td>
<td>2.72</td>
<td>35.85</td>
<td>1888.88</td>
<td>1156.25</td>
<td>456.9</td>
<td>514.64</td>
<td>2588.88</td>
<td>2588.88 FI</td>
</tr>
<tr>
<td>25</td>
<td>NFL</td>
<td>2.18</td>
<td>11.19</td>
<td>1888.88</td>
<td>1455.58</td>
<td>289.5</td>
<td>265.72</td>
<td>355.88</td>
<td>355.88 FI</td>
</tr>
<tr>
<td>26</td>
<td>Neyveli</td>
<td>5.88</td>
<td>71.79</td>
<td>188.88</td>
<td>147.33</td>
<td>41.84</td>
<td>42.43</td>
<td>625.88</td>
<td>625.88 FI</td>
</tr>
<tr>
<td>27</td>
<td>Ras. C. F. L.</td>
<td>56.43</td>
<td>31.12</td>
<td>1888.88</td>
<td>1592.52</td>
<td>644.1</td>
<td>578.22</td>
<td>295.88</td>
<td>295.88 FI</td>
</tr>
<tr>
<td>28</td>
<td>S.C.I.L.</td>
<td>38.88</td>
<td>52.25</td>
<td>188.88</td>
<td>217.91</td>
<td>197.5</td>
<td>222.88</td>
<td>658.88</td>
<td>658.88 FI</td>
</tr>
<tr>
<td>29</td>
<td>SAIL</td>
<td>7.93</td>
<td>2.38</td>
<td>1888.88</td>
<td>1896.13</td>
<td>836.9</td>
<td>859.74</td>
<td>625.88</td>
<td>625.88 FI</td>
</tr>
<tr>
<td>30</td>
<td>STC</td>
<td>5.88</td>
<td>199.29</td>
<td>1888.88</td>
<td>1839.49</td>
<td>371.6</td>
<td>351.15</td>
<td>4759.88</td>
<td>4759.88 FI</td>
</tr>
<tr>
<td>31</td>
<td>VSNL</td>
<td>29.88</td>
<td>12.88</td>
<td>1888.88</td>
<td>5753.88</td>
<td>7233</td>
<td>7487.97</td>
<td>7688.88</td>
<td>7688.88 FI</td>
</tr>
</tbody>
</table>

Total: 8898.88

6156.28

Source: Compiled on the basis of data contained in a Statistical Review of Central Public Enterprises (Centre for Monitoring Indian Economy), Bombay, April 1992

Method: NA = net asset value, PSEV = profit earning value method, FV = face value + interest method, S = simple average, W = weighted average
Which method is most suited for share valuation of PEs for disinvestment. The special features of the various techniques point out that no 'one' method could meet the requirement of the situation.

Multiple techniques need to be use to arrive at a fairly reliable estimate. For instance, for PEs listed on the stock exchanges, the market value method would be right choice. For PEs with staggering investments but low profit-making, the net worth method would be appropriate although it would need to be modified to provide 'inflation' factor. For medium / high profit making PEs / dividend paying PEs profit earning capacity value method would be an ideal choice or PEs with stable operations and moderate growth, the face value plus interest method could provide genuine estimates.

Disinvestment Commission’s Recommendations

Keeping in view the above problems regarding valuation, specific to a PSU, the issue was discussed in detail by the Disinvestment Commission in its 1st Report. Underlining the importance of valuation, the Commission felt that the valuation of equity of a firm gains importance in case of disinvestment of companies which are not listed or in cases where capital markets may not fully reflect the intrinsic worth of a share disinvested earlier.

Disinvestment Commission while emphasizing that valuation should be independent, transparent and free from bias has recommended three methods of valuation:
1. The discounted cash flow relates the value of an asset to the present value of expected future cash flows of the asset.

2. The relative valuation is used to estimate the value of an asset by looking at the pricing of comparable assets relative to a common variable like earnings, cash flows, book value or sales.

3. The net asset value of the shares is used as a basis for valuation.

   Regarding the application of Valuation Methods, Disinvestment Commission felt that the use of a particular method of valuation will depend on the health of the company being evaluated, the nature of industry in which it operates and the company's intrinsic strengths. The depth of capital markets will also have an impact on the valuation. For example, in the United Kingdom, the London Stock Exchange has helped in creating markets by enabling credible price discovery for the shares of privatized companies listed on the exchange. Although valuation methods will indicate a range of valuations, Disinvestment Commission felt that some discounts might need to be applied for arriving at the final value depending on the liquidity of the stock and the extent of disinvestment.

   a) Lack of marketability discount takes into account the degree of marketability (or the lack of it) of the stocks being valued. This is applicable especially to cases, which had been disinvested earlier and have been referred for disinvestment again. Discount on this consideration stems from the fact that investor will probably pay more for a liquid stock than for a less liquid one.

   However, the concern of overhand of supply may adversely affect valuation even for liquid stocks.
b) Disinvestment Commission felt that the extent of disinvestment in core, non-strategic & non-core PSUs will have a bearing on the valuation process. The transfer of a controlling block may help to reduce the discount that has to be applied. If all the businesses of a PSU are not equally profitable, it may be necessary to restructure the business before disinvestment. However, if this is not possible, a minority discount may have to be applied.

Disinvestment Commission also sought to correct some erroneous perceptions about valuation. There is a general perception that since valuation models are quantitative, valuation is objective. The Commission felt that though it is true that valuation does make use of quantitative models, yet the inputs leave plenty of room for subjective judgments. At the same time, there may be no such thing as a precise estimate of a value. Even after the end of the most careful and detailed valuation of a company, there could be uncertainty about the final numbers, as they are shaped by assumptions about the future of the company.

Another wrong perception sought to be corrected, by the Commission was the relationship attributed between valuation and market price. The benchmark for most valuations remains the market price (either its own price, if it is listed or that of a comparable company). When the value from a valuation analysis is significantly different from the market price, the two possibilities are that either one of the valuations could be incorrect. The Commission felt that the valuation done before listing takes into account anticipated factors, whereas market price reflects realized events that are influenced by unanticipated factors. However, a specific valuation itself may not be valid over a period of time. It is a function of the competitive position of the company, the nature of market in which it operates and Government policies. Therefore, it may be appropriate to update or revise valuations.
In cases where strategic sale is done with transfer of management control, the Commission felt that asset valuation should also be done. The views of the Commission in this regard are as follows:

"Strategic sale implies sale of a substantial block of Government holdings to a single party which would not only acquire substantial equity holdings of up to 50% but also bring in the necessary technology for making the PSU viable and competitive in the global market. It should be noted that the valuation of the share will depend on the extent of disinvestment and the nature of shareholder interest in the management of the company. Where Government continues to hold 51% or more of the share holding, the valuation will relate mainly to the shares of the companies and not to the assets of the company. On the other hand, where shares are sold through strategic sale and management is transferred to the strategic partner, the valuation of the enterprise would be different, as the strategic partner will have control of the management. In such cases, the valuation of land and other physical assets should also be computed at current market values in order to fix the reserve price for the strategic sale.

To get best value through strategic sales, it would be necessary to have a transparent and competitive procedure and encourage enough competition among viable parties."

Method of Valuation being followed in India:

Making a valuation requires an examination of several aspects of a company's activities, such as analysing its historical performance, comparisons with the other players in the industry, forecasting performance, estimating the cost of capital, estimating the continuing value, calculating and interpreting results, the
Based on the recommendations of the Disinvestment Commission and in keeping with the best market practices the following four methodologies are being used for valuation of PSUs:

a) DCF Method.

b) Balance Sheet Method.

c) Transaction Multiple Method.

d) Asset Valuation Method.

While the first three are business valuation methodologies generally used for valuation of a going concern, the last methodology would be relevant only for valuation of assets in case of liquidation of a company.

**Discounted Cash Flow (DCF) method**

The Discounted Cash Flow (DCF) methodology expresses the present value of a business as a function of its future cash earnings capacity. This methodology works on the premise that the value of a business is measured in terms of future cash flow streams, discounted to the present time at an appropriate discount rate.

The DCF methodology is the most appropriate methodology in the following cases:

Where the business is being transferred / acquired on a going concern basis;
Where the business possesses substantial intangibles like brand, goodwill, marketing and distribution network, etc;

Where the business is not being valued for the substantial undisclosed assets it possesses.

The DCF methodology is considered to be the best methodology for valuation the world over because it takes into account all the factors relevant for valuation:

1. It takes care of all the free cash flows available to stakeholders of a firm. The free cash flows are calculated taking into account the average cost of capital, cost of debt, cost of equity and market returns.

2. It also takes into account the risk factor to which the enterprise is exposed. The discount rate is based on the risk perception of the business.

3. It also takes into account the value of the core assets of the company. Any business has two kinds of assets - core assets that are a part of the business and non-core assets that are not directly a part of the business. The asset value of core assets is reflected in the cash flows of the company and therefore should not be added separately to it. However non-core assets are not reflected in the cash flows. Therefore asset valuation of non-core assets should be done separately and should be added to DCF valuation.

4. A prudent DCF valuation should also capture the capital costs for renovation and modernization of plant and machinery. The age and condition of assets like plant and machinery and their replacement value would be relevant for estimating expenditure on their replacement whenever necessary. This expenditure will reduce cash flows and DCF value. Valuation of plant and machinery would be a
relevant item that would influence the DCF valuation. For example, a person acquiring a company operating a fleet of taxis would examine the conditions of vehicles for valuation of the company. If the vehicles need replacement of a low cost item like hub caps the impact on DCF will be less than if they need to replace gear boxes in a high proportion of vehicles. The person would also calculate DCF with reference to the demand for taxis, the average mileage, cost of maintenance etc. Valuation of plant and machinery is not a simple addition to DCF, but a factor to be taken into account while calculating DCF. In such calculation, plant and machinery may be a net negative factor in the DCF if replacement costs are high. Where surplus land would be sold this would be a positive factor. If the sale of land can cover the cost of plant replacement the net effect would be neutral on DCF.

5. For a going Concern, various intangibles like market share, competition, etc have a significant bearing on the valuation of the company. One cannot place a money value for these factors. They have no financial value of their own that can be merely in money terms. Hence, there is no way of evaluating them in any other methodology. DCF is the only methodology, which takes into account these factors by incorporating them in various cash flows. In calculating DCF different assumptions will be made of market share, competition from imports etc, which are translated into financial terms. Sensitivity analysis can also be made for different assumptions. The Financial Advisor and the Seller should exercise the judgment on the most likely financial values for the market share etc. and also on the discount rate to be applied while arriving at the optimum DCF value.

6. In a strategic sale the bidders take into account not only DCF valuation, but also a premium for management control. Premium for management control would be a subjective item for each bidder and will be reflected in the competitive bids.
Therefore, this premium need not be incorporated in the valuation amount separately.

7. In DCF method, while computing the cash flows, cash out flows for renovation and modernization of plant and machinery need to be discounted for arriving at realistic figures. Since non-core assets are not reflected in the cash flows, the non-core assets need to be separately valued by the Asset Valuation method and added to the valuation figure arrived at by the DCF method.

**Balance Sheet method**

The Balance sheet or the Net Asset Value (NAV) methodology values a business on the basis of the value of its underlying assets. This is relevant where the value of the business is fairly represented by its underlying assets. The NAV method is normally used to determine the minimum price a seller would be willing to accept and, thus serves to establish the floor for the value of the business. This method is pertinent where:

The value of intangibles is not significant;

The business has been recently set up.

This method takes into account the value of the assets of a business or the net-worth as represented in the financial statements. Hence, this method takes into account the amount that is historically spent and earned from the business. This method does not, however, consider the earnings potential of the assets and is, therefore, seldom used for valuing a going concern. The above method is not considered appropriate, particularly in the following cases:
When the financial statement sheets do not reflect the true value of assets, being either too high on account of possible losses not reflected in the balance sheet or too low because of initial losses which may not continue in future;

Where intangibles such as brand, goodwill, marketing infrastructure, and product development capabilities, etc., form a major part of the value of the company.

Transaction Multiple method

This method takes into account the value paid for similar transactions in the industry and benchmarks it against certain parameters, like earnings or sales. Two such parameters are:

- Earnings Before Interest, Taxes, Depreciation & Amortisations (EBITDA)
- SALES

Although the Transaction Multiples method captures most value elements of a business, it does not properly reflect the cash flows generated by a business, or take into account the time value of money. However, it is considered as a useful rule of thumb, in valuing businesses by various valuation experts. Accordingly, one may have to review a series of comparable transactions to determine a range of appropriate capitalisation factors to value a company as per this methodology.

a) EBITDA multiple

The EBITDA multiple or the earnings method is based on the premise that the value of a business is directly related to the quantum of its profits. The adjusted maintainable profits are capitalised by an appropriate factor
("capitalisation factor") to arrive at the business value. The profits are adjusted to reflect the operating recurring profits of the business on a standalone basis (i.e. after deducting extraordinary or unusual items, or items of a non-recurring nature). As a further refinement, the profits may be adjusted for non-cash items (including depreciation and amortisation) and other factors, such as interest and taxation (which vary from business to business) to derive EBITDA (Earnings Before Interest, Taxation, Depreciation and Amortisations).

The EBITDA multiple method takes into account the value or consideration paid by acquirers of similar businesses, and is computed by dividing the total consideration paid (after adjusting for any debt assumed) by the EBITDA to derive a multiple, which can be applied to the EBITDA figure of the business being valued.

\[\text{EBITDA multiple} = \frac{\text{Enterprise Value}}{\text{EBITDA}}\]

Where:
\[\text{Enterprise Value} = \text{Market value of Equity} + \text{Market value of Debt}\]
\[\text{EBITDA} = \text{Earnings Before Interest, Tax, Depreciation and Amortization}\]

b) Sales multiple

The sales multiple technique is based on a similar analysis of relevant acquisitions and is the ratio of Enterprise Value to the current sales. It is calculated as follows:

\[\text{Sales multiple} = \frac{\text{Enterprises Value}}{\text{Net sales of the current year}}\]

The Transaction Multiple methodology suffers from the following drawbacks:
Actual monies required to earn the maintainable profits / sales of the business as a going concern (for instance, future capital expenditure) are not reflected.

This methodology does not take into account the time value of money. Notwithstanding these limitations, these multiples are widely used by investors to arrive at benchmark values for a company.

**ASSET VALUATION METHODOLOGY**

The asset valuation methodology essentially estimates the cost of replicating the tangible assets of the business. The replacement cost takes into account the market value of various assets or the expenditure required to create the infrastructure exactly similar to that of a company being valued. Since the replacement methodology assumes the value of business as if we were setting a new business, this methodology may not be relevant in a going concern. Instead it will be more realistic if asset valuation is done on the basis of the new book value of the assets. The asset valuation is a good indicator of the entry barrier that exists in a business. Alternatively, this methodology can also assume the amount which can be realized by liquidating the business by selling off all the tangible assets of a company and paying off the liabilities.

The asset valuation methodology is useful in case of liquidation/closure of the business.

In a strategic sale process, the proposal is normally to transfer management control of an on-going concern to a strategic partner and restrictions are imposed on the SP. The land and property of the business cannot be sold or put to alternate use by the strategic partner. Moreover, its value is already reflected in the cash flows from the business, which are valued in other
methodologies of valuation. Therefore, asset valuation method is not the correct reflection of the value of the enterprise. However, it has been used so far in the valuation of CPSUs under disinvestment because the Disinvestment Commission had recommended that this method should also be followed for valuation in the case of strategic sale. The asset valuation methodology also fails to factor in some important aspects for a running business such as the following and is normally not favoured for pricing equity: • Value of intangibles like brands, goodwill, marketing, distribution, development and research capabilities, etc.; • Profit or cash generating ability of a business; • Opportunity loss during the period before a business is fully operational.

The asset valuation methodology is particularly questionable in the following circumstances:

Where it is impossible to replicate a business intended to be transferred on account of a complete change in technology;

Where a business was set up several years before its competitors and has a real cost advantage reflected in a higher return on invested capital;

Where a business set-up several years ago had witnessed a significant appreciation in the value of real estate, which is not reflected in the earnings capacity of a business.

The Asset Valuation would be more realistic, if we compute the value of only the realizable amount, after discounting the non-realizable portions. The realizable market value of all real estate assets either owned by the company as freehold properties or on a lease/rental basis may be determined, assuming a non-distress sale scenario. The value would be assessed after taking into account any
defects/restrictions/encumbrances on the use/lease/sublease/sale etc. of the properties or in the title deeds etc.

Since Asset Valuation normally reflects the amount which may need to be spent to create a similar infrastructure as that of a business to be valued or the value which may be realized by liquidation of a company through the sale of all its tangible assets and repayment of all liabilities, adjustments for an assumed capital gains tax consequent to the (hypothetical) outright sale of these assets as also adjustments to reflect realization of working capital, settlement of all liabilities including VRS to all the employees will have to be made.

METHODS OF DISINVESTMENT: -

The various methodologies available for disinvestment are: -

(1) CAPITAL MARKETS
   a) Offer for sale to public at a fixed price
   b) Offer for sale to public through book building
   c) Secondary market operations
   d) International offering
   e) Private placement
   f) Auction

(2) STRATEGIC SALE

(3) WAREHOUSING

(4) REDUCTION IN EQUITY
   a) Buy-back of equity
   b) Conversion of equity into debt exchangeable into capital market instruments.

(5) TRADE SALE

(6) ASSET SALE / WINDING UP
The strategic sale method being the preferred option in the finance Minister's Budget Speech and also in the recommendations of the Disinvestment Commission and earlier the Rangarajan Committee, is described in detail in this Chapter.

Stage I - Qualification of Companies/Consortia

a) Issue of advertisement inviting EOIs (Expression of Interest)
b) Submission of EOIs and supporting documentation
c) Despatch of RFQ, (Request for Qualification) background information and PIM (Preliminary Information Memorandum) to interested parties.
d) Qualification of companies/consortia.

Stage II - Request for Proposals and submission of Bids

a) Notification of qualified companies/consortia and issue of "Bid pack" containing a detail Information Memorandum (IM), Annual Reports of the company, Request for Proposal (RFP) and further information to qualified parties.
b) Due Diligence (including interaction with management, access to data room and site visits)
c) Negotiations and finalisation of contractual documents
d) Submission of final bid.
Stage III - Completion


Normally it would take 6 months to 9 months for a simple privatisation operation. However, the time period can vary depending on the complexity of the process.

Stage I
Issue of Advertisement inviting EOIs

A public announcement of a privatisation transaction assures the people of the transparency of the transaction. A typical advertisement in this category usually provides a short description of government policy on privatisation, profile of the enterprise being privatised, the bidding procedure, deadline for submission of expression of interest or bids, and the address for further information. Advertisement is normally given in three major national newspapers and one international newspaper besides industry/trade journals. A copy of the advertisement is put on the internet on the websites of the PSU, administrative ministry, Department of Disinvestment, and Ministry of External Affairs.

Submission of EOIs & Supporting Documents

Any company / consortium, participating in a privatization transaction has to submit an Expression of Interest. It is normally submitted along with a statement of legal capacity; and a litigation impact statement. It is the responsibility of applicant to ensure that EOI is delivered at the prescribed address by the stated deadline. The covering envelope of all EOIs submitted should be clearly marked "Private and Confidential - Expression of Interest for the Strategic
Sale". Responses received after the deadline or not accompanied by the required documentation are not considered. A company /consortium may be disqualified for any misrepresentation, failure to provide the required information or if any member has already submitted a separate EOI.

Contents of EOIs

All EOIs generally include the following information:

1. Executive Summary

   This provides a brief description of the company and (where appropriate) of each member in the consortium, containing details like ownership structure, write up on business history and growth, business areas / activities, respective revenue details, etc. It includes a brief commentary on the capability of the company / consortium, as demonstrated, inter alia, in its past track record, to run its own business.

2. Background Information

   a) The Applicant

   The full name, address, telephone and facsimile numbers, e-mail address of the company or of each member of the consortium and the names and the titles of the persons who are the principal points of contact.

   b) Basic Information

   This contains the details of the place of incorporation, registered office, current directors, key management personnel and principal shareholders of the company/companies in the consortium. It also contains a copy of its current
Memorandum and Articles of Association and copies of audited accounts for the last three years of the company / companies in the consortium.

3. Management Organization

i) An overview of the applicant's senior management and organization structure and in the case of a consortium, that of each member; and

ii) Summaries of the roles and responsibilities of the directors, key management personnel of the applicant and, in case of a consortium, those of each member

4. International Operations / Joint Ventures / Alliances

Brief write up of the company's or, in the case of a consortium, of the members, of their international operations, joint ventures / alliances (whether international or domestic), nature and size of such operations, equity ownership, if applicable, copies of the audited accounts for the last one year of such companies.

5. Professional Advisors

The names and addresses of those companies and the professional firms, if any, who are (or will be) advising the applicant/consortium, together with the names of the principal individual advisors at those companies and firms.
6. Legal Capacity of the Company/Accuracy of Information

Every company and each member of a consortium must provide with the EOI a representation, duly executed by its authorised official/representative that it has the requisite corporate authorisation to submit the EOI and that all information provided in the EOI is complete and accurate in all material respects to the best of their knowledge. If, at a subsequent date, it is discovered that the company or any consortium member did not either possess the requisite authorisation or that any part of the information provided in the EOI was not complete or accurate in any material respect, the Government reserves the right to disqualify such company or consortium or member of the consortium from the process.

7. Outstanding Litigation

Each company, and each member of a consortium must provide with the EOI a statement litigations of pending.

Despatch of RFQ, background information and Preliminary Information Memorandum (PIM)

After the expression of interest is published, the investors are interested in knowing details about the company. The purpose of Preliminary Information Memorandum is to assist the investors in deciding whether they should proceed ahead with the proposed disinvestment.

Structure Of PIM

A typical Preliminary Information Memorandum includes the following information:
1. Introduction

This gives a brief of the government decision regarding disinvestment in the company, the extent of equity held by the Government, the extent of equity to be the disinvested, the contact person, the relevant telephone numbers and fax nos.

2. Information about the Company

This contains the information about the company, its history, activities, the location, management, human resources, quality, control, markets and marketing arrangements, capital structure, various assets and other details about the company. It also gives the strengths and opportunities of the company.

3. Financial Details

The Preliminary Information Memorandum gives the profit and loss account and balance sheet of the company for the last five years.

4. Formats

The preliminary information memorandum contains the formats for submitting Expression of Interest, statement of legal capacity and RFQ.

Qualification of Companies/Consortia

The advertisement of the transaction indicates the broad qualifications of the prospective bidders.

Based on the criteria mentioned in the advertisement, the bidders are shortlisted.
A common way to create a shortlist is to introduce another stage between announcement and short listing. This stage is referred to as Request for Qualification (RFQ). This is normally done to discourage non-serious bidders.

In the announcement for the transaction, the potential bidders can be directed to apply for prequalification by submitting detailed information in response to an RFQ document. Potential bidders send a letter asking for the RFQ package. They fill out the forms, supplying the requested information in the desired format. The government then uses this information to shortlist potential bidders.

Request For Qualification (RFQ)

A typical RFQ consists of the following three main sections:

1. **Introduction & Description Of The Strategic Sale Process**

   This section contains: Govt's Strategic Sale Objectives, Background Information, Questions/Clarifications, Strategic Sale Timetable, Overview of the Qualification Process, and overview of the future process.

2. **General Requirements & Instructions For EOIs**

   This section contains Eligibility Conditions, Notification of Due Date, Number of Companies and Filing Requirements, Conditions for Consortium and Disqualifications.

3. **Contents of EOIs**

   This Section contains basic information to be provided in Expressions of Interest about the bidders, like the executive summary, background information, management, organization, international operations / joint ventures / alliances, operational ability, details about professional advisors of the bidders, legal capacity of the company and outstanding litigation as explained in Sub Para (b) above.

   Based on the information submitted in EOIs, the Ministry and the advisors will carry out an evaluation of the qualifications of the companies/consortia and...
subsequently notify in writing those companies / consortia which qualify to participate in the next stage of the process.

**Stage II**

**RFP & Bid Process**

The proposed Strategic Sale process, consequent to the submission of EOI, involves a detailed due diligence exercise to be undertaken by the Bidder followed by submission of a Technical Bid and a Financial Bid.

The due diligence phase involves providing a Bid Pack containing various documents to the Bidder. Besides, visits to the Data Room, site visits to the units of the company form a part of the due diligence phase. At the end of this phase, the Bidder is expected to submit his Technical Bid and the Financial Bid. Details of form and content of the Bids and the proposed due diligence process are given in RFP.

**Notification to qualified / short listed parties & issue of Bid Packs**

A Bid Pack containing the following documents is made available to the qualified / shortlisted bidders, along with RFP after getting a confidentiality undertaking signed by them:

i) Information Memorandum;

ii) Previous 3 years' audited annual accounts of the company, and

iii) Data Room Rules.
The following documents (which may or may not form a part of the Bid Pack) are also made available to the qualified / shortlisted bidders in due course:

i) Draft Share Purchase Agreement;
ii) Draft Shareholders' Agreement, and
iii) Provisional results for the Financial year

Where the EOI has been submitted by a Consortium, it is expected that there shall not be any changes in the Members of the Consortium consequent to the submission of EOI.

However, if a change is desired by some or all the Members prior to the submission of the Technical and Financial Bid, such change shall have to be approved by GoI. Similarly, consequent to the submission of EOI, if the Bidder desires to form a Consortium by inducting new Member(s), it shall have to seek an approval from GoI.

Where the Bidder is a Consortium, the stake in the ordinary share capital of the company can be acquired and held either through an investment vehicle ("Consortium Vehicle") or through direct holding in the company by each Member or through any Group Company (ies).

Confidentiality Undertaking

The IM being a much more detailed document, it is customary to send it only to those who have given a Confidentiality Undertaking. Typically, this undertaking requires that the potential bidders do not misuse this wealth of
information. It is not uncommon for competitors to send a bogus team to discover the trade secrets of the other parties.

It is an undertaking made by the bidder in favour of President of India (acting through Joint Secretary of the administrative ministry), the company and advisors to treat all the confidential information in Confidence and not to disclose to any person, the fact that he has been provided the Confidential information or has inspected any confidential documents or the discussion/negotiation regarding the transaction.

Confidential information means all information, concerning the business, operations, prospects, finances, or other affairs of the company. It includes documents delivered in connection with a due diligence investigation, information concerning business activities, products, specifications, data know-how, compositions, designs, sketches, photographs graphs, drawings, research and development, marketing or distribution methods and processes, customer lists, customer requirements, price lists, market studies, computer software and programs, database technologies, systems structures and architectures, historical financial projects and budgets, historical and projected sales, capital spending budgets and plans, current or prospective financing sources, the names and background of personnel, personnel training techniques and materials.

It also includes information memorandum, request for proposal, draft of shareholders and share purchase agreements or other materials prepared in connection with the transaction.
Confidentiality undertaking also provides that the bidder shall not deal with any officer, Director or employee of the Govt. or Company, regarding the business, operations, prospects or financing of the company without advisor's express written consent.

The confidentiality undertaking contains an indemnity clause, whereby the bidder agrees to indemnify the advisor, the Govt. and the company any damages, loss, cost or liability arising out of any unauthorised use or disclosure by the bidder.

**Request For Proposals (RFP):**

A typical RFP consists of the following three main sections:

1. **Background and General Information:**
   This section describes the goals of the privatization transaction and provides information on the company that is being privatized.

2. **Conditions of Agreement:**
   In this section of the RFP, a summary of contractual obligations is provided in simple, non-legalistic language.

3. **Proposals and Selection Process:**
   This section describes the entire privatization procedure including the process of evaluation of bids.

**Information Memorandum (IM)**

After obtaining the confidentiality undertaking, Advisors send out an Information Memorandum (IM) along with the RFP. An Information
Memorandum is a much more in-depth description of the company to be privatized than that suggested by the RFP.

This reduces the cost of preliminary due diligence for all potential bidders, thereby increasing the chances of attracting quality players who are in great demand.

A typical information memorandum usually has the following sections:

1. **Executive Summary**: This is a brief chapter containing introduction of the company, investment considerations, business overview, objectives of Government of India and the role of the strategic partner. Business overview will include information on business activities, infrastructure, marketing and distribution, land and summary financial performance.

2. **General Information on India** includes introduction about India, its institutional framework, demography, language and literacy, international relations, economic and financial indicators, foreign trade, balance of payments, economic indicators and PSU reforms.

3. **Sector Scenario** generally contains an overview of the industry, its segmentation, regulatory environment governing the sector in India, and policy initiatives in the sector. Industry segmentation would include various segments of the industry in India. Regulatory environment governing the sector in India would include compulsory legislation, voluntary standards, policy relating to small scale undertakings, policy related to foreign investments in the sector and
laws pertaining to employer-employee relations. Policy initiatives would include regulation and control, fiscal policy and taxation.

4. **Business Review** contains introduction of the company, chronology of its growth, overview of its business, its operations. Operations include facilities, land, marketing and distribution, manufacturing plants and process, raw materials and research and development (R & D).

5. **Structure, Responsibilities and Systems** contains structure of the company, structure of the manufacturing units and financial and management information systems. Structure of the company means finance, marketing, operations, human resources development and administration. Financial and Management Information Systems contains financial accounting, management accounting and budgeting.

6. **Directors, Management and Employees** contains description of the Directors, Senior Management and Employees. It contains information on the remuneration, employee entitlements, recruitment, retirement and dismissal, training and development, pension and welfare obligations and industrial relations. Employee entitlements generally means basic salary, dearness allowance (DA), residential accommodation/house rent allowance (HRA), conveyance, provident fund (PF) and gratuity, bonus, productivity linked scheme, overtime, annual increments, accident insurance, medical reimbursement scheme, health scheme, loans/advances, other benefits and perquisites, leave, holidays and leave travel concession benefits.
7. **Financial Statements** of the company include profit and loss data, balance sheet data and operational results normally for the last 5 years.

**Share Purchase Agreement**

The bidders put in their bid based on the last audited balance sheet information made available to them. However, the company is transferred to them at a later stage. There could be either an increase or decrease in working capital and debt during this period. Share Purchase Agreement fixes the closing date on which the company is handed over to the buyer so that the difference between the closing date and the date of last audited balance sheet can be arrived at and accounted for. It describes the purchase price, the mode of payment and the actions at closing time. It also lays down representations and warranties given by both the parties.

Share Purchase Agreement is entered into among the President of India (acting through the Joint Secretary of the Administrative Ministry), the company, the strategic partner and other principals as applicable.

It contains the following sections:

1. **Definitions and principles of interpretation**: This section deals with the definitions contained in the agreement, certain rules of implementation and the summary of the entire agreement along with the schedules.

2. **Purchase and sale**: It describes the actions at closing time, other actions and the place of closing along with other documents relevant for the above transaction.
3. **Purchase price:** It describes the purchase price and the mode of payment.

4. **Representations and Warranties of the Government:** It describes the right to sell, due authorization, enforceability of obligations, regulatory approvals, incorporation, due authorization, enforceability of obligations, absence of conflicting agreements, litigation, regulatory approvals, foreign participation, strategic partner review; access to information, investment intent, source of funds, technical proposals and shareholding structure.

5. **Agreements on Representations and Warranties:** It describes the various representations and warranties given by both the parties.

6. **Covenants of the parties:** It describes the actions to satisfy closing conditions, the requirements of preserving records and of making public announcements.

7. **Conditions precedent:** It lays down that the representations at the closing time be true and accurate. It also lays down the performance of obligations, receipt of closing documentation, consents, authorizations and registrations.

8. **Indemnification:** It lays down the conditions for the indemnification by the strategic partner.
9. **Termination** : It lays down the conditions for termination of the contract and effect of this termination.

10. **Waiver/Survival** : The waiver/survival clause is added at the end of the agreement.

11. **General**: The general section includes the various provisions regarding expenses, notices, assignment, further assurances, dispute resolution /submission to jurisdiction, amendments, governing law, appointment of agent and severability.

**Shareholders' Agreement**

Shareholders' Agreement is a very important agreement. It defines the rights and obligations of both the parties. Concerns of Government on protection of employees' rights, future investment/business plans and the precautions against assets stripping are generally reflected in it. It lays down the conditions for indemnification of purchaser losses after ignoring the De-Minimis figures, the survival period after which the claims become time barred and the indemnification limit to which a purchaser can be indemnified. It also lays down the terms and conditions of indemnification for any disputed tax liabilities, litigation liabilities and environmental liabilities. It lays down the procedure for management of the company after disinvestment. It also includes various representations and warranties given by both the parties. It lays down the dispute resolution mechanism for both the parties.
Shareholders' Agreement is entered into among the President of India (acting through the Joint Secretary of the Administrative Ministry), the company, the strategic partner and other principals as applicable.

It contains the following sections:

1. **Definitions and principles of interpretation**: It contains the various definitions and rules of interpretation given in the agreement.

2. **Purpose and scope**: It defines the purpose and the scope of the agreement. It lays down the conditions for compliance with the agreement. It lays down the various conditions to be complied by the company.

3. **Equity participation and financial support**: It lays down the conditions for equity participation, additional capital and dilution of Government Equity Interest.

4. **Management of the company**: It describes the constitution of the Board of Directors, procedure for removal and replacement of nominees, procedure for calling meetings of Board, quorum, procedure for approval of matters, deemed consent, casual vacancies and filling the post of alternate Director and Managing Director.

5. **Shareholder meetings**: It describes the procedure for general meeting of shareholders, notice of shareholder meetings, quorum and voting requirements.

6. **Transfer of equity shares**: It lays down the conditions for general restriction on transfer, rights of first refusal, change in control, event of default, government's right to sell, Strategic Partner's right to buy, determination of fair
market value, procedure for call and put options, permitted transfers and compliance with legal requirements.

7. **Representations and Warranties**: It describes the various representations and warranties given by the company, the strategic partner and the government. It also includes a survival clause.

8. **Indemnification and confidentiality**: It lays down the various indemnifications given by all the parties in case of breach of contract. It also includes a confidentiality clause. It lays down the various equitable remedies and costs in the event of a breach of contract.

9. **Miscellaneous**: It includes clauses on arbitration, application of this agreement, assurances, benefit of the agreement, amendments and waivers, assignment, severability, notices, governing law and expenses.

**Due Diligence**

The purpose of the due diligence programme is to provide the Bidder an overview of the Strategic Sale programme and a detailed information on the company's businesses. In order to enable the Bidder to obtain the required information, the programme provides for data room visit followed by site visit.

The following is a summarised, indicative list of types of documents and information required.
Financial Documents

All annual reports.
Quarterly reports.
All accountants’ and auditors’ reports and opinions.

Management financial reports, capital expenditure budgets, projections and reports for last five years.

Operating budgets, projections, and reports for last five years. Any financial information presented to Gol in last five years. Operating revenue accounts for last five years. Operations and maintenance accounts for last five years.

Accounts and Investments

List of all bank accounts and investments, including account balances and value of investments.

Loan Documents

A chart setting forth loan amortisation and interest payments (with the company both as borrower and, if applicable, lender).

A chart showing other debt-like obligations of the company (letter of credit repayment obligations, installment sales obligations, capitalized lease obligations).
All loan agreement in which the company is a borrower (together with related promissory notes, security documents, and ancillary agreements).

All loan agreements in which the company is a lender (together with related promissory note, security documents and ancillary agreements).

All documents relating to debt-like obligations of the company (letter of credit repayment obligations, installment sales obligations, capitalised lease obligations).

**Equity Documents**

A chart setting forth all capital contributions of the company and share issuances by the company; share issuance and transfer ledger.

All equity subscription agreements, option agreements, etc.

**Corporate Documents**

Memorandum and articles of association.

**By-laws.**

Minutes of shareholders’ and board meetings’ for the last five years.

**Licenses and Permits**

List of all required licenses and permits.

All licenses/permits.

All correspondence relating to revocation, modification, or non-issuance of any license or permit.
All laws and regulations applicable to the company (including any laws relating to environmental and safety matters).

All environmental and safety permits.

All tariffs applicable to the company in last five years. All environmental and safety reports prepared in last five years.

Litigation
Status report of all litigation, disputes, etc., pending or concluded in last five years.

Litigation files relating to pending matters.

Employee Matters
List of all employees indicating name, years of service, position, and salary (employees below a particular grade could be classified in groups).

List of all welfare, pension, and health plans, together with a brief description of each and a financial summary relating to each (i.e., the company’s assets and liabilities).

List of unionised workers and unions. All unions and collective bargaining agreements.

Employment agreements.

Description of bonus and profit sharing arrangements, together with any related documents.
Tax Matters (including Income tax, Sales tax, Excise duty, and Other taxes)

List of tax liabilities and payments during last five years.
Tax filings and notices for last five years.
All disputes relating to tax matters.

Real Estate

List of all owned and leased real property, together with schedule of annual lease payments and lease expiry dates.
Title documents relating to owned real property.
Leases relating to leased real property.

Property, Plant and Equipment

List of all owned/leased tangible property (if appropriate by class) and inventory, together with schedule of annual lease payments and lease expiry dates.

All purchase and services contracts under which equipment and services are to be provided to the company. Plant accounts

Intellectual Property

List of all intellectual property owned or used by the company. All intellectual property ownership, license, royalty and similar documents. Description of computer systems and hardware.
Customer Documents

Standard forms, if any, of customer contracts, billing documents, etc. Customer service policies and records of service. Copies of material customer complaints. Customer statistics for each class of customer.

Technical Data

System maps.
Technical assessments and reports prepared in last five years.

Negotiations & Finalisation Of Contractual Documents

During the course of due diligence, and thereafter, the qualified bidders are also invited to offer their comments on the contracted documents (i.e. the draft Share Purchase and the Shareholders Agreement) provided to them, with a view to finalizing those and making terms and conditions thereof uniform, so that the bids are submitted by all bidders on same terms and conditions.

Details Of Technical & Financial Bids

Form and Content of the Technical Bid

In its Technical Bid, the Bidder must provide the following:-

i) The ownership structure and the investment route which the Bidder / Member proposes to adopt for its investment in the company with a diagram or corporate structure chart showing the shareholding relationship between the Bidder / Member and the Group Company through which the equity stake in the company is to be held;
ii) Confirmation whether there has been a change in the Consortium or formation of a Consortium consequent to the submission of EOI;

iii) The details, with respect to any Member who may have joined the Consortium;

iv) Evidence that the Bidder / Member has the necessary corporate authorisations to enter into and perform its obligations as per the Contractual Documentation, and

v) Response to the Technical Bid.

The Technical Bid must be signed by the Bidder / all Members of the Bidder consortium and submitted as an original version in one sealed package. The covering envelope of the Technical Bid should be clearly marked 'Private and Confidential - Technical Bid for the Strategic Sale'.

Details of Financial Bids

Form and Content of the Financial Bid

The Financial Bid must be:-

(i) In the form to be provided by GoI;

(ii) Expressed in Indian Rupees;

(iii) Made on the basis of the terms of the revised final drafts of the Contractual Documentation as may be circulated to the Bidder.
(iv) Unconditional and open for acceptance for a period of 180 days from the stipulated deadline;

(v) Must be signed by the Bidder or, where the Bidder is a Consortium by all the Members of the Bidder, and

(vi) Submitted to Gol on or prior to the stipulated deadline.

The Bidder submits to Gol one copy of its Financial Bid, contained in a separate sealed package. The covering envelope on the package containing the Financial Bid must be clearly marked 'Private and Confidential - Financial Bid for Strategic Sale' and include on the envelope the name of the contact person and address of the Bidder (to whom any unopened Financial Bid should be returned).

**Earnest Money Guarantee**

The Bidder or in the case of Consortium any of the Member of that Consortium, singly or jointly, shall be required to enter into an Earnest Money Guarantee agreement for a stipulated amount. The draft of the Earnest Money Guarantee agreement is provided to the Bidder.

All the bids have to be submitted before a stipulated deadline.

The selection of Purchaser is based on an evaluation of the Bidder's Technical Bid as well as the Financial Bid.
Principles of Evaluation of Technical Capabilities

The principles underlying the evaluation of the technical capabilities of the Bidder are twofold: -

(i) Bidder's understanding of the industry in which the company operates and of the company's existing and proposed business(es), including its strengths, weaknesses, areas of concern, future potential, etc, and

(ii) Bidder's views as expressed in its Technical Bid as to how it will use its experience and expertise in the operation and management of the company for its existing and / or proposed business activities.

A Bidder can be disqualified for any of the reasons listed below:-

(i) If a material misrepresentation is made by the Bidder / Member, whether in the Technical Bid, the Financial Bid, supporting documentation or otherwise;

(ii) If the Technical Bid submitted by the Bidder is in any material respect inconsistent with, or demonstrate any failure to comply with, the provisions of RFP;

(iii) If the Financial Bid is not submitted separately from the Technical Bid of the Bidder;

(iv) Failure to comply with any other material requirement of RFP, and failure to comply with the reasonable requests of GoI in relation to the Strategic Sale process.
Stage III-Completion

Bids are opened before an empowered committee. The Technical Bid and the Financial Bid are submitted in separate envelopes. First, only the technical bids are opened and the names of firms, who have submitted the technical bids, are recorded. The financial bids are placed in one package, the contents recorded and sealed. In reviewing a bidder's methodology, the committee looks at its business plan and its approach to fulfill the government's objectives for the transaction, qualifications and experience of permanent staff, innovative ideas, and technology proposed to carry out the objectives as outlined in the RFP. After the technical evaluations have been completed those proposals, which do not fulfill the technical criteria, are rejected. Once the technical evaluation has been done, financial bids of only those parties are opened who fulfill the technical evaluation criterion. Financial bids of those parties, who have been rejected in the technical evaluation, are not considered and they are kept aside in a sealed cover. The whole process is carefully minuted, incorporating all the details.

Post Closing Adjustments

The bidder submits his bid based on information supplied to him in the data room. This information is the last audited balance sheet. However from the date of the last audited balance sheet, till the date of handing over (called the closing date), there may be accretion or depletion in the current assets, current liabilities resulting in the change in Net working Capital and the debt position. The difference between these figures between the date of the last audited balance sheet and the closing date is called post closing adjustment and depending on whether there is an accretion or depletion of the current assets and debts, this amount is paid by the government/purchaser to the other party.
Within 90 days following the closing date, an accounting firm is jointly selected by the Government and the purchaser, from the CAG's approved panel or otherwise as mutually agreed. The firm finalizes the "Closing Date Net working Capital Amount" and the "Closing Date Debt Amount". These computations are final and binding on both the parties.

If there is accretion in the Net working capital on the closing date, the purchaser would pay the differences to the government. Conversely, if the working capital decreases on the closing date, the government would pay the difference to the purchaser.

Similarly if the closing date debt amount exceeds the amount given in the last balance sheet (which was the basis of the bid), then the government would pay the difference to the purchaser. Conversely if the closing date debt amount is less than the debt amount given in the last balance sheet, the purchaser would pay the difference to the government.

All payments are normally settled within 45 days of the date of handing over the closing date accounts by the auditors.

**Indemnification by the Government**

The Government indemnifies the purchaser from any actual losses, liabilities, damages, judgments, settlements and expenses arising out of any breach by the government of any representations and warranties contained in the agreement.

A cumulative aggregate amount of losses (called the Aggregate Liability threshold) is decided, below which all minor losses are ignored. This mutually
decided threshold is normally 3-4% of the total Purchase Price. If the losses are more than this threshold level, and arise out of some breach or violation by the government, then the purchaser is indemnified these losses by the government.

For calculations of Purchase Losses in individual events, a figure (say Rs.1 lakh in each incident) is agreed to, which is called De-Minimis Purchaser loss. All individual amounts less than this De-Minimis figure are ignored in calculating the purchaser loss. The total amount indemnified by the government is limited to an agreed limiting percentage of the purchase price. Normally, irrespective of the loss, the indemnified amount will not exceed 70% of the total purchase price. All the claims of indemnity are to be preferred within the survival period (normally 24 months) after which they become time-barred.

**Tax-liabilities**

If there is any liability at closing time of sales tax, income tax or excise duty, which is disputed, the company pays that under protest. If that dispute is resolved unfavourably against the company, the government would indemnify that amount to the company, provided the purchaser has informed the government within the stipulated period and provided that the purchaser has not been compensated for this liability earlier.

**Litigation**

If there are certain litigations, which are listed in the schedule of agreement, the government may retain all liabilities in their respect, subject to the clauses of the agreement and would make all efforts to resolve them. Subject to the conditions of agreement the government would indemnify all liabilities arising out of these litigations to the purchaser.
Environmental Liabilities

If there are any claims regarding environmental damages arising out of the acts of commission/omission on the part of government during the period prior to disinvestment, and the claim has been preferred during the survival period, then subject to the clauses of the agreement, the government would indemnify the liabilities arising out of these claims to the purchaser. It is advisable to have an environmental audit done prior to the disinvestment to benchmark the extent of such liabilities.

Recommendations of Disinvestment Commission:

On 23rd August 1996, the Disinvestment Commission was established as an independent, non-statutory, advisory body to make its recommendations on the PSEs referred to it. 72 public sector enterprises were referred to the Disinvestment Commission of which 8 were withdrawn. 6 public sector enterprises were BIFR cases. The Commission gave 12 reports upto Aug. 1999 in which recommendations in regard to 58 public sector enterprises were given. So far as the mode of disinvestments is concerned, the recommendations of the Disinvestment Commission can be classified into two broad categories - those involving change of ownership/management and others which do not involve any change in ownership/management. Table below gives the break up of all the recommendations of the Disinvestment Commission in respect of the mode of disinvestments.
Table 3.2
MODALITIES OF DISINVESTMENTS INVOLVING CHANGE IN OWNERSHIP/MANAGEMENT

<table>
<thead>
<tr>
<th>Mode of Disinvestment</th>
<th>Number of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Involving change in ownership/management</strong></td>
<td></td>
</tr>
<tr>
<td>1. Strategic sale</td>
<td>29</td>
</tr>
<tr>
<td>2. Trade Sale</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>37</strong></td>
</tr>
<tr>
<td><strong>B. Involving no change in ownership/management</strong></td>
<td></td>
</tr>
<tr>
<td>1. Offer of shares</td>
<td>5</td>
</tr>
<tr>
<td>2. Disinvestments deferred</td>
<td>11</td>
</tr>
<tr>
<td>3. No disinvestments</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17</strong></td>
</tr>
<tr>
<td>Closure/Sale of Assets</td>
<td>4</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>58</strong></td>
</tr>
</tbody>
</table>

**Source:** - Disinvestment Commission Report No. XII.

Thus out of 58 recommendations, in 37 cases change of ownership/management was recommended as against 17 companies where either no disinvestment was suggested or the mode was such that ownership change was not involved.

Table 3.3 disinvestment modalities recommended and action taken by Government.
### Table 3.3

**RECOMMENDED DISINVESTMENT MODALITIES**

<table>
<thead>
<tr>
<th>Recommended Modalities of Disinvestment</th>
<th>No. of units</th>
<th>Name of PSUs</th>
<th>Status of Government decision</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Accepted</td>
</tr>
<tr>
<td>TRADE Sale</td>
<td>8</td>
<td>HLC,MFCL,</td>
<td>MFCL,HCCL,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>NCL,PEL,</td>
<td>R-Ashok,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>STL,MSTC,</td>
<td>U-Ashok</td>
</tr>
<tr>
<td>STRATEGIC SALE</td>
<td>29</td>
<td>HCL,EBRPL,</td>
<td>HCL,BALCO,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>NACL,IMPCL,</td>
<td>EIL,HCCL,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>KIOCL,MFL,</td>
<td>J.BIL,HCL,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>EIL,HPPL,</td>
<td>BPCL,SCC,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>NEPA,JHCL,</td>
<td>EIL,HOCL,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>JNCL,MECON,</td>
<td>EIL,HOCL,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>RAJL,HELC.</td>
<td>EIL,HOCL,</td>
</tr>
<tr>
<td>OFFERS OF SHARES</td>
<td>5</td>
<td>GAIL,CONCOR,</td>
<td>CONCOR,MTNL,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MTL,NACLCO,</td>
<td></td>
</tr>
<tr>
<td>NODISINVESTED</td>
<td>1</td>
<td>RITES</td>
<td>RITES</td>
</tr>
<tr>
<td>DISINVESTMENT</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DEFERRED</td>
<td>11</td>
<td>OIL,ONGC,PCL</td>
<td>OIL,ONGC,PCL</td>
</tr>
<tr>
<td></td>
<td></td>
<td>NTPC,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>NBPC,NBC,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>NCL,OIL,TEL</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>NCL,TEL,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>NCL,TEL,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>NCL,TEL,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>NCL,TEL,</td>
<td></td>
</tr>
<tr>
<td>CLOSURE SALE OF ASSETS</td>
<td>4</td>
<td>EPC,ELT,TEL</td>
<td>Epil</td>
</tr>
<tr>
<td></td>
<td></td>
<td>HVOC,ELT</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>58</td>
<td>9</td>
<td>1</td>
</tr>
</tbody>
</table>
The Department of Disinvestment has also received on transfer from the Department of Heavy Industry other cases of disinvestments in public sector enterprises and the subsidiaries of the PSUs, which are being processed. In some other cases like Indian Airlines, Indian Oil Corporation and VSNL, the disinvestment is being pursued on the basis of advice of other expert bodies etc. The Government takes action for disinvestments in companies through a prescribed procedure explained below.

Procedure for Disinvestment

The apex decision-making body on disinvestments matters is the Cabinet Committee on Disinvestment headed by the Prime Minister. A Core Group of Secretaries on Disinvestment headed by the Cabinet Secretary deliberates on various aspects of disinvestments program in the following manner.

On the recommendations of the Disinvestment Commission or of the other expert bodies, or on the basis of decisions arrived at the level of an administrative ministry, the Department of Disinvestment initiates consultation with the concerned Administrative Ministries on such recommendations and places them for the consideration of the Core Group. The Secretary of the concerned administrative ministry is represented on the Core Group while deliberating upon the disinvestment plans for the concerned company.

The decisions taken by the Core Group, in the form of recommendations, are then submitted for the consideration of the Cabinet Committee on Disinvestment and a final decision is obtained.
After CCD clears the disinvestments proposal, selection of the advisor is done through a competitive bidding process.

The advisor assists the Govt. in preparation and issue of advertisement in leading newspapers inviting the Expression of Interest (EOI) offers from interested parties. In some cases, to expedite disinvestment, EOI advertisements have been issued before appointing Advisors.

After receipt of the EOIs, prospective bidders are short listed based on objective screening in the light of announced criteria/requirements.

The advisors, after due diligence of the PSU, prepare the information memorandum in consultation with the concern PSU. This is given to the short listed prospective bidders who have entered into a confidentiality agreement.

The draft share purchase agreement and the shareholder agreement are also prepared by the advisors with the help of the legal advisors.

The prospective bidders undertake due diligence of the PSU and hold discussions with the advisors/ the Govt./ the representatives of the PSU for any clarifications.

Concurrently, the task of valuation of the PSU is undertaken in accordance with the standard national and international practices.

Based on the response received from the prospective bidders, the share purchase agreement and shareholders agreement are prepared. After getting them vetted by the Ministry of Law, they are approved by the Govt. Thereafter, they are
sent to the prospective bidders for inviting the final binding bids (Technical and Financial).

After examination, analysis and evaluation, the recommendations of the Inter Ministerial Group (IMG) are placed before the CCD for a final decision regarding selection of the strategic partner, signing of the share purchase agreement and shareholder agreement, and other ancillary issues.

In the disinvestments process mentioned above, Deptt. Of Disinvestment is assisted at each stage by an IMG comprising officers from the Ministry of Finance, Deptt. Of Public Enterprises, the Administrative Ministry/Deptt. Controlling the PSU, apart from the officers of the Department of Disinvestment and the advisors.

After the transaction is completed, all papers and documents relating to it shall be turned over to the CAG of India; the CAG shall prepare an evaluation for sending to Parliament and releasing to the public.

**Implementation**

The Cabinet decisions are then implemented under the overall supervision of the Core Group in the following manner.

For each case of disinvestment an Inter Ministerial Group (IMG) is constituted to advise and assist in the process of disinvestment. These IMGs are generally headed by the Secretary (Disinvestment), Joint Secretary level officers of the administrative ministry, Department of Economic Affairs, Deptt. of Public Enterprises and the CMD of the company being the other members. As and when
needed, senior representatives of the Deptt. of Legal Affairs and of the Deptt. of Company Affairs are requested to participate in the IMG meetings. To obtain high quality professional advice, an "Advisor" is appointed for each case through a process of competitive bidding, to assist in implementing the transactions. The process involves issuing advertisements, both nationally and internationally, to appoint advisor, calling them for presentations, evaluating their performance on a predetermined selection criteria, shortlisting on the basis of such evaluation and selection of the lowest bidder among the shortlisted bidder through separate price bids.