

Valuation Analysis

.....

For Fair Value of Employee Stock Options, Accounting & Disclosures

....., 20.....

Strictly Private & Confidential



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The Board of Directors

.....

.....

New Delhi,

For the Kind attention of Mr.

Dear Sir,

Sub: Fair Value of Options granted under Employee Stock Option Plan 20.... of M/s Pvt. Ltd

We refer to the discussion held with your good self for carrying out the fair value of options issued under “Employee Stock Option Scheme 20....” of Pvt. Ltd (here-in-after referred as “Company”) for the purpose of issue of Stock Options. We are enclosing our report along with this letter. In attached report, we have summarized our Valuation Analysis of the Stock Options of granted by the Company out of total options of in the month of ..., 20... together with the description of methodologies used and limitation on our Scope of Work.

This Valuation Analysis is confidential and has been prepared exclusively for the Management of Company. It should not be used, reproduced or circulated to any other person, in whole or in part, without the prior consent of Corporate Professionals Capital Private Limited. Such consent will only be given after full consideration of the circumstance at the time. We are however aware that the conclusion in this report may be used for the purpose of certain statutory disclosures and we provide consent for the same.

Trust the above meets your requirements.

Please feel free to contact us in case you require any additional information or clarifications.

Yours Faithfully,

For Corporate Professionals Capital Private Limited

Chander Sawhney
[Asst. Vice President]

Maneesh Srivastava
[Manager]

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EXECUTIVE SUMMARY

... Pvt. Ltd. is a company engaged in manufacturing of pharmaceutical ... and other pharmaceutical packing products .The Company was founded in by who have rich & vast experiences in this particular domain. The Company adapts as ISO 9001-2000 quality management system and has an installed capacity to produceMillion per day adapting ISO 9001-2000 system of quality management. It supplies to major pharmaceutical companies in India and also exports all over the world.

We are being told by the management that the Company has introduced “Employee Stock Option Scheme 20....” and shall be granting options to its employees and consultants. Therefore, the company needs to ascertain its employee ESOP compensation cost based on the Intrinsic Value of Accounting. In this respect, we as a SEBI Registered (Category I) Merchant Banker have been appointed by the Company to determine the intrinsic value of the equity shares of the company.

It is pertinent to mention herein that the valuation of stock option is not an exact science and ultimately depends upon a number of factors like the efficiency of market, interest rate factor, volatility of stock, liquidity of market, dividend yield etc. In the international arena the fair value of the stock options of company is guided by the IFRS-2 which suggests black scholes and other binomial method to be applied. In the Indian context there is no mandatory guideline to find the fair value of company for stock Options, however Institute of Chartered Accountants of India (ICAI) has issued recommendatory guidelines which suggests fair value of stock options can be calculated as per Black Scholes option pricing model or any other binomial model, therefore we have used the Black Scholes model for the purpose of our calculations and value recommendation.

Fair value of stock options granted by the company in the month of 20.... presented in table below:-

Grant Dates	Fair Value (Amount in Rs)

PURPOSE OF VALUATION

ABOUT THE TRANSACTION

Based on the discussions held with the Management and Key Managerial Personnel (KMP's), we understand that the Company has adopted Employee Stock Option Plan-20..... and accordingly grantedoptions out of a total of options to its employees in the month of 20...., with the purpose to retain and reward the employees as stakeholders in the growth and success of the Company as they are the key catalyst in progress of the company.

SCOPE OF SERVICES

This valuation report has been prepared by **M/s Corporate Professionals Capital Private Limited, SEBI Registered (Category – I), Merchant Banker** to ascertain the Fair Value of options of the Company and for the said purpose we have used Black Scholes Model as the valuation methodology.

LIMITATION OF REPORT

This valuation report has been prepared as per Black scholes model and which takes into consideration the key components like Historical Volatility, Exercise Price and Expected Dividends Yield which in turn calculated as per the documents provided by the key management of the company like “ESOP-20..... scheme and Financial Data” .Although, we have reviewed such data for consistency and reasonableness, we have not independently investigated or otherwise verified the data provided to us.

The Valuation exercise was carried out under the following limitations:

- Our Valuation & Analysis and the conclusions drawn there are based on number of factors which are largely dependent upon the prevailing business and Industry conditions as on the respective valuation dates and the data and explanations/representations provided by the Management. We presume that the Board of the Company has taken reasonable care to ensure that all relevant information which could have an impact over the Valuation has been duly disclosed & made available to us.
- The scope of our work has been limited both in terms of the areas of the business and operations which we have reviewed and the extent to which we have reviewed them. There may be matters, other than those noted in this Report, which might be relevant in the context of the transaction and which a wider scope might uncover.

COMPANY ASSESSMENT

BASIC INFORMATION:

... Pvt. Ltd. was incorporated on The company engaged in manufacturing of pharmaceutical ... and other pharmaceutical packing products .The Company was founded in by who have rich & vast experiences in this particular domain. The Company adapts as ISO 9001-2000 quality management system and has an installed capacity to produceMillion per day adapting ISO 9001-2000 system of quality management. It supplies to major pharmaceutical companies in India and also exports all over the world.



VALUATION METHODOLOGY, APPROACH AND ANALYSIS













METHODOLOGIES CONSIDERED FOR BLACK SCHOLES VALUATION:

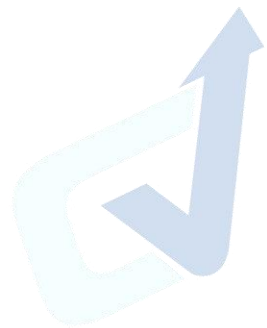
The following is the summary with respect to use of Black Scholes method which we had considered for estimating the Fair Value of the stock options.

Some of the basic assumptions used in the Black-Scholes model are –

- **Markets are efficient** - This assumption suggests that people cannot consistently predict the direction of the market or an individual stock. The Black-Scholes model assumes stocks move in a manner referred to as a random walk. Random walk means that at any given moment in time, the price of the underlying stock can go up or down with the same probability. The price of a stock in time $t+1$ is independent from the price in time
- **Interest rates remain constant and known** - The Black-Scholes model uses the risk-free rate to represent this constant and known rate.
- **Returns are normally distributed** – This assumption suggests returns on the underlying stock are normally distributed.
- **Constant volatility**- The most significant assumption is that volatility, a measure of how much a stock can be expected to move in the near-term, is a constant over time. While volatility can be relatively constant in very short term, it is never constant in longer term. Some advanced option valuation models substitute Black-Scholes constant volatility with stochastic-process generated estimates.
- **Liquidity**- The Black-Scholes model assumes that markets are perfectly liquid and it is possible to purchase or sell any amount of stock or options or their fractions at any given time.

The variables that influence the Fair value of the option and the impact of changes in those underlying variables on the option value are presented below

Underlying Variable	Change in Variable	Change in Option Value
Exercise Price		
Market Price		
Current Expected dividend yield		
Risk free rate of return		
Expected option Life		
Volatility of the stock		



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We have used the Black & Scholes model for estimating the fair value of option.

Black Scholes Formula

$$C = P_s [e^{-YT}] N(x) - P_e [e^{-RT}] N(y)$$

$$d1 = \{ \ln (P_s/P_e) + [R - Y + .5 \text{ Var} (r)] T \} / [\text{Var} (r)]^{1/2} T^{1/2}$$

$$d2 = d1 - [\text{Var} (r)]^{1/2} T^{1/2}$$

where

C = Price of a call option

P_s = Market price of the optioned stock;

P_e = Exercise price

ln = Natural logarithm

e = Exponential number (2.7183)

Y = Dividend yield on the stock

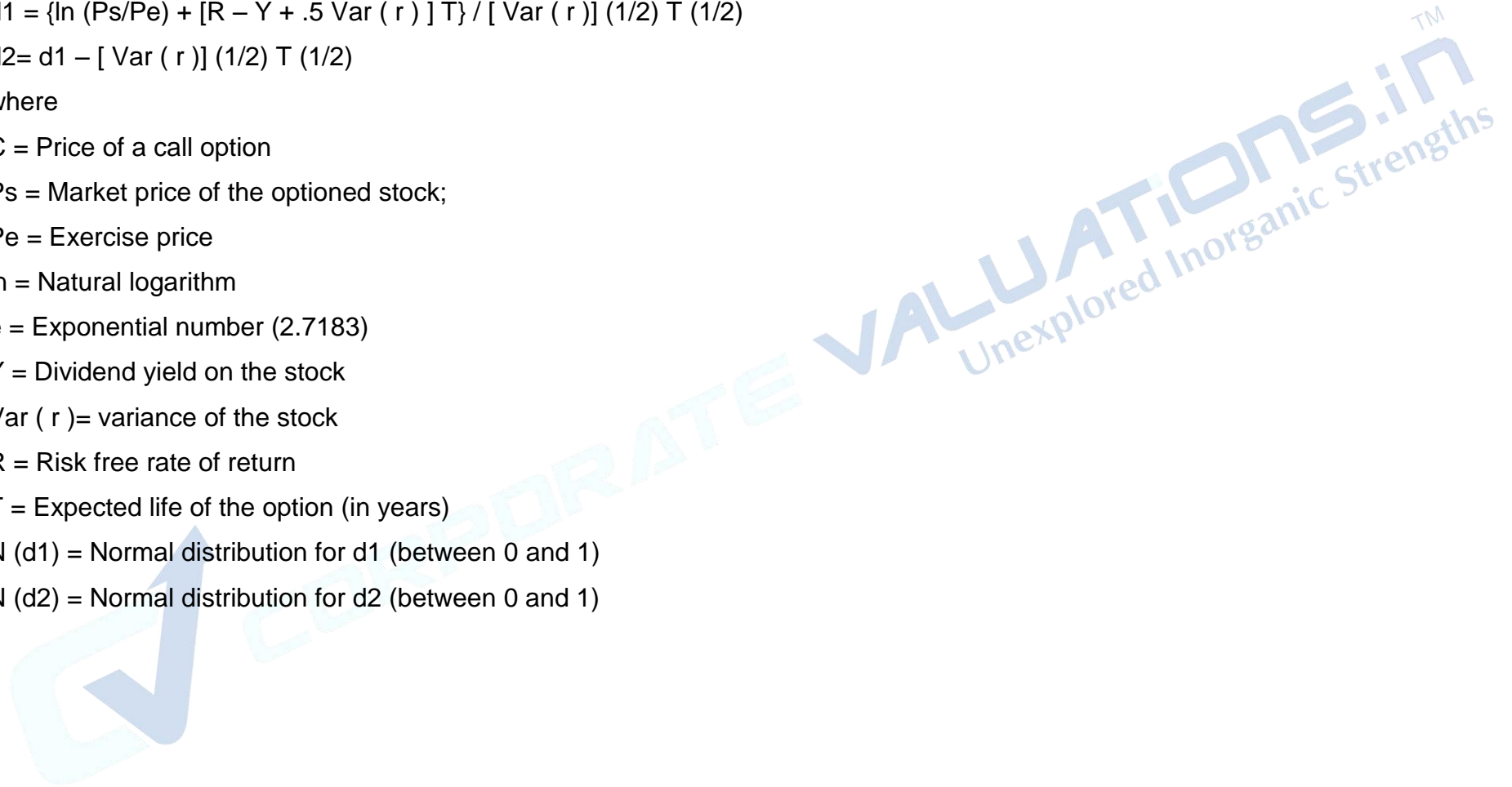
Var (r) = variance of the stock

R = Risk free rate of return

T = Expected life of the option (in years)

N (d1) = Normal distribution for d1 (between 0 and 1)

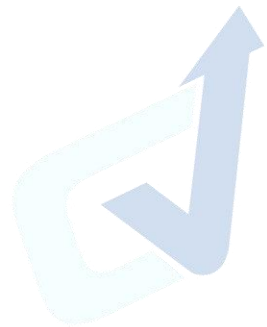
N (d2) = Normal distribution for d2 (between 0 and 1)



The variables used for calculating the Fair Value and their rationale are as follows:

- **Stock price** As there is no readily available market price for the shares of the company so, we have analyzed the value of the company as per Comparable Companies Multiple Approach (CCM) and Net Asset Value Approach (NAV) and assigned equal weights to both the methodologies. Hence we are of the view that the value per share of the company is the stock price of the company Rs. which was calculated as per the separate valuation done as on 31st March 20.... and this valuation holds good for our Black scholes Fair Valuation analysis for the grants made by the company in the month of, 20....because its being represented by the management that there is not any significant event taken place between these dates.
- **Exercise price** The price at which a specific derivative contract can be exercised. ***The exercise price per option in our case as represented by the management is Rs. per option.***
- **Time to Maturity/Expected Life of the Options** It is the period for which the Company expects the options to be alive. The minimum life of stock option is the minimum period before which the options cannot be exercised and the maximum life is the period after which the option cannot be exercised. ***The min time period is taken asyear and the maximum time period as years as per the ESOP Scheme and in our calculation we have taken the Average of it i.e. Years.***
- **Historical Volatility** is a measure of the amount by which a price has fluctuated or is expected to fluctuate during the period. The measure volatility is used in the Black Scholes option- pricing model is the annualized standard deviation of the continuously compounded rate of the return of the stock over a period of time.
The period to be considered for volatility has to be adequate to represent a consistent trend in the price movements and the movement due to abnormal events if any gets evened out. There is no research that demonstrates conclusively how long the historical period used to estimate expected long-term future volatility should be. However, informal tests and preliminary research tends to confirm that estimates of expected future long term volatility should be based on historical volatility for a period that approximates the expected life of the options being valued. ***In our case as the Company is unlisted one and there are no matured listed Companies in the industry of a comparable size are available so, we have taken the volatility of the Company tending to Zero.***

- **Risk Free Rate** The Risk free rate being considered for the calculation is the interest rate applicable for a maturity equal to the expected life of the options based on the zero-coupon yield curve for Government Securities or 10 years Government bonds. ***We have taken as on the date of valuation***
- **Dividend Yield** The dividend yield for the year is derived by dividing the dividend for the period with the current market price. ***The company is running into losses so no question of dividend.***

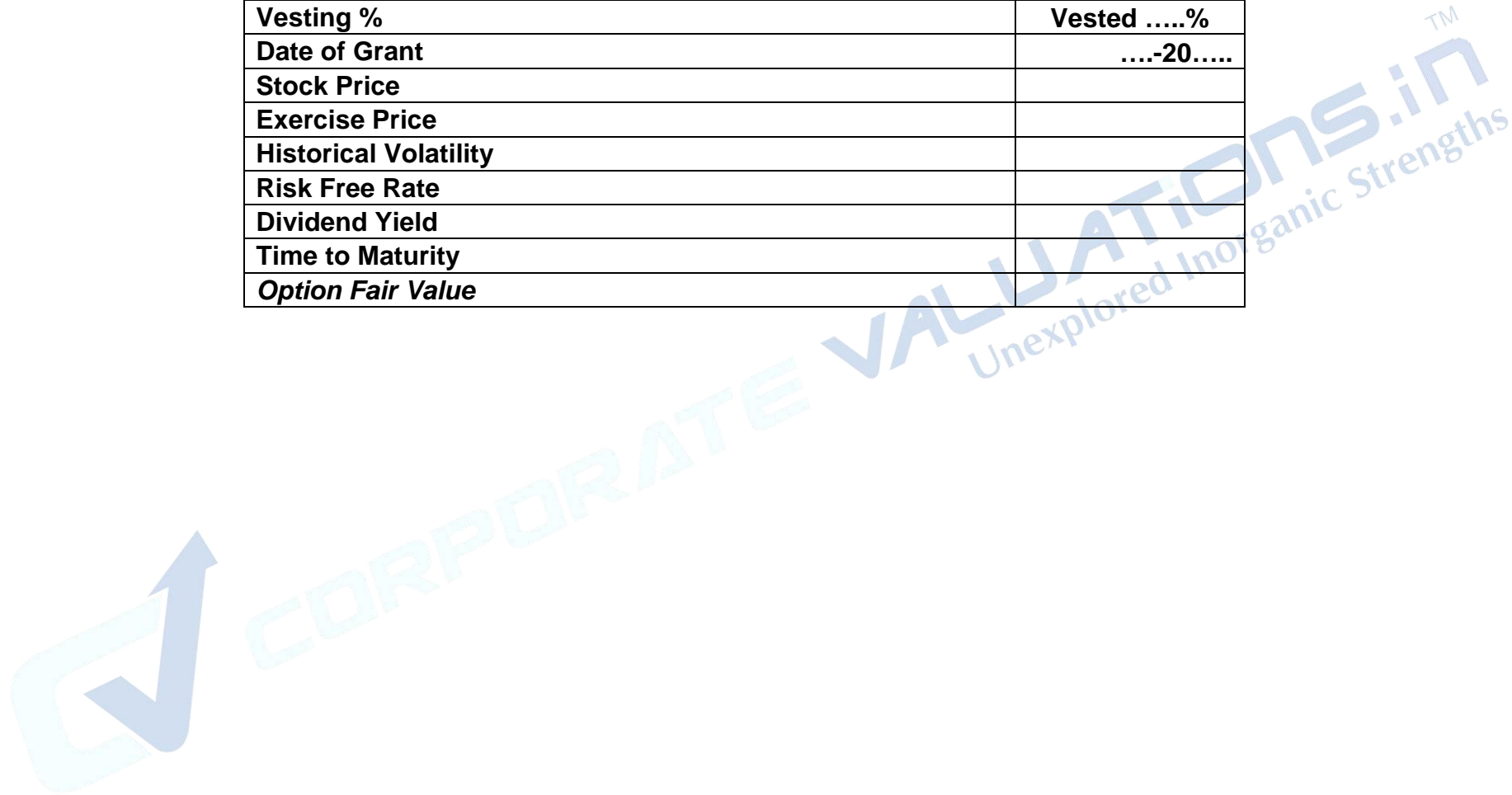


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FAIR VALUE COMPUTATION

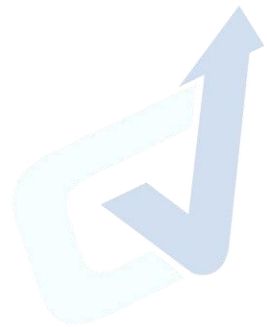
All Amount in Rs.

Grant Month 20....	
Vesting %	Vested%
Date of Grant-20.....
Stock Price	
Exercise Price	
Historical Volatility	
Risk Free Rate	
Dividend Yield	
Time to Maturity	
<i>Option Fair Value</i>	



CAVEATS

- This Valuation Report has been issued on the specific request of Pvt. Ltd for the fair value of the stock options issued under Employee Stock Option Plan. This Report is prepared exclusively for the above stated purpose and must not be copied, disclosed or circulated or referred to in correspondence or discussion with any other party. Neither this report nor its content may be used for any other purpose without prior written consent of M/s Corporate Professionals Capital Private Limited.
- We have summarized the Valuation Analysis of the stock option of the Company based on the information as was provided to us and other publically available information. We do not assume any responsibility for the accuracy or reliability of such documents on which we have relied upon in forming our opinion. However, we would like to state that in the process of evaluation, nothing has come to our attention to indicate that the information provided was, materially mis-stated or incorrect or would not afford reasonable grounds to believes it is incorrect upon which the report is based.
- We have no present or planned future interest in Private Limited and the fee for this Valuation analysis is not contingent upon the values reported herein. The Valuation Analysis contained herein is not intended to represent the value at any time other than the date that is specifically stated in this Report.



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is a venture promoted by Corporate Professionals Capital Pvt. Ltd, SEBI Registered (Cat-I) Merchant Banker. By virtue of our Dedicated Valuation Team , Inhouse Research Wing and proven expertise in Corporate Taxation Advisory, we have attained leading edge, technical knowledge and indepth industry experience that allow us to provide Independent Valuation & Fairness Opinion across different context, Industries and Boundaries.

Our Valuation Offerings

- Business Valuation;
- Acquisition and Investment Valuation
- Valuation of shares as per Discounted Free Cash Flow Method
- Court Approved Merger & Demerger Valuation and Swap Ratio
- M & A Fairness Opinion
- ESOP Valuation
- Tax Valuation
- Valuation of Business Segments for Spin-off & Restructuring
- FOREX & Overseas Transactions Valuation
- Intangibles Valuation/Valuation for Regulatory Reporting
- Build/Review Financial Models

Contact Us

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