

A Sample Engagement Letter

[The following letter is for use as a guide to the Valuer and will need to be varied according to individual requirements and circumstances relevant to the engagement.]

The Board of Directors

XXX Private Limited/ Public Limited

Address

Date

For the kind attention of: Mr A– Managing Director

Dear Sirs

BUSINESS VALUATION ANALYSIS

With reference to our recent discussions to value the company XXX Private Limited/ Public Limited, we are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

1. INTRODUCTION

Based on discussions with the Management, we understand that the Company is engaged in the [Business of the company]. Headquartered in theand XXX is ayears old company.

2. SCOPE OF WORK

Based on discussions with the Management, we understand that the promoters of the Company are evaluating the possibility of selling their stake in XXX. In this context, you require our assistance to carry out the Valuation of the Company.

Valuation of a company is not an exact science and ultimately depends upon what it is worth to a serious investor or buyer who for his or her own reasons may be prepared to pay substantial goodwill.

This exercise may be carried out using various methodologies, the relative emphasis of each often varying with:

- i) industry to which the company belongs
- ii) ease with which the growth rate in cash flows to perpetuity can be

estimated

- iii) extent to which industry and comparable company information is available
- iv) Need for an independent fixed asset valuation/ revaluation.

Having arrived at an assessment of fair value, some adjustments that are typically considered in such an exercise are:

- i) Whether there is change of control and therefore a control premium is justified for a particular purchaser, if any.
- ii) Whether the shares are marketable and frequently traded or there is a case for discounting on account of illiquidity, if applicable.

Our assessment of the valuation of the Company will be on the basic assumption of a going concern entity and would be based on some or all of these popular methodologies:

Income Approach

The Income Approach indicates the value of a business based on the value of the cash flows that a business is expected to generate in future. This approach is appropriate in most going concern situations as the worth of a business is generally a function of its ability to earn income/cash flow and to provide an appropriate return on investment.

Market Approach

Compared to the Income Approach that incorporates company-specific estimates to arrive at the firm's intrinsic value, the Market Approach relies on relative valuation to arrive at the value of a business, based upon how similar assets are priced in the market.

The Market Approach provides a reasonable basis for valuation and is relatively a quick approach in its application, but it suffers from a number of limitations

Cost Approach

Valuation on Net Assets is computed by taking the net value of a business's assets, subtracting therefrom the amount of the liabilities and preferred shareholders' claims and dividing the remainder among the equity shareholders according to their individual rights.

It is generally used as the minimum break-up value for the transaction since

A Sample Engagement Letter

this methodology ignores the future return the assets can produce and is calculated using historical accounting data that does not reflect how much the business is worth to someone who may buy it as a going concern.

Maintainable Profit Method or Discounted Cash Flows Method ('DCF')

DCF uses the future free cash flows of the company discounted by the firm's weighted average cost of capital (the average cost of all the capital used in the business, including debt and equity), plus a risk factor measured by beta. Beta is an adjustment that uses historic data to measure the sensitivity of the company's cash flow, for example, through business cycles. This means that companies in highly cyclical businesses will have a high beta to reflect the volatile nature of their cash flow. The DCF method is a strong valuation tool, as it concentrates on cash generation potential of a business.

Comparable Company Market Multiple

Under this methodology, market multiples of comparable listed companies are computed and applied to the Company being valued to arrive at a multiple based valuation. The difficulty here is in the selection of a comparable company, since it is rare to find two or more companies with the same product portfolio, size, capital structure, business strategy, profitability and accounting practices.

Price/Earnings multiple

This is a popular method due to its simplicity. However, it has limited acceptability due to the results being influenced by differences in accounting methods (i.e. treatment of intangible assets) or an artificially boosted PE ratio due to an atypical drop in earnings. Earnings before interest, depreciation and tax is usually preferred over net earnings in order to even out differences caused by capital structure, tax benefits, etc.

Market Cap/Sales Multiple

This method is sometimes used to value the SME sector by multiplying a year's gross/net profit or sales by a certain number, determined as the appropriate multiple for the type of business. This approach particularly with the small and medium sized business has little or no scientific methodology behind it, as it assumes automatically that what has gone before will continue in the future.

Industry Valuation Benchmarks

A number of industries have industry-specific valuation benchmarks such as

'EV per MW' for power generation companies, 'EV per subscriber' for telecom companies, etc. which can be applied as rule of thumb for business valuation. Other industries where long term contracts are a key feature, multiples of revenues can be used as a valuation benchmark. These industry norms are based on the assumption that investors are willing to pay for turnover or market share and that the normal profitability of businesses in the industry does not vary much. This methodology is more useful as a sense-check of values produced using other methodologies.

As a result of the work set out above, should you wish us to act for you in any other aspects concerning the future strategy of the Company, or adopt any other method of valuation we would be pleased to discuss your requirements. Clearly, any additional work will be the subject of a separate fee arrangement.

Please note that the Services described above do not constitute an audit of the books and records of the Company under the Companies Act. Further, in carrying out our work we shall rely upon the information and clarifications provided to us by the Management of the Company. We will not accept any responsibility for the accuracy or authenticity of the records or information provided to us.

3. DURATION OF THE ASSIGNMENT

Based on our initial estimate of the time required to complete our engagement fieldwork relating to scope of work detailed in this letter, we expect to deliver our draft report within days of commencement of fieldwork. Fieldwork would be commenced after receiving your confirmation to start the work and after receiving the basic information relating to the Company. The final report shall be issued subsequent to clearance of your comments on the draft report.

4. CONFIDENTIALITY

Our report will be addressed to XXX. We stress that our reports and letters are confidential and prepared for the addressees only. They should not be used, reproduced or circulated for any other purpose, whether in whole or in part without our prior written consent, which consent will only be given after full consideration of the circumstances at the time.

6. FEES

Our fees will be based on the degree of skill involved, the seniority of the

A Sample Engagement Letter

staff engaged and the time necessarily occupied on the work. Our fees will be paid by XXX as and when due and it will be due as follows:

- XX% on acceptance of this engagement letter
- XX% on submission of draft report

The fee for the engagement would include:

- INR XXXX (Indian Rupees XXXX only) plus taxes as applicable for the Valuation Analysis of the Company. This fee does not include any other services such as post valuation follow up, negotiation, valuation justification, updating and other support services for the valuation engagement. Such services can be taken up separately based on mutually agreeable terms.
- In case of any unforeseen event or circumstances arise which require us to do more work, it would be charged in addition of above as may be decided in writing.
- In addition, expenses incurred directly in connection with the assignment would be reimbursable.

Please note that payment is due on submission of our invoice. Invoices outstanding for more than X days post the invoice date shall attract a simple interest of XX% per month.

7. TERMINATION

After commencement of engagement and before the final report is issued, if at any stage the assignment is called off by the company, then the company will be liable to pay a compensation of ...% of the fee quoted above or(Some another basis), whichever is higher.

8. LIMITATION OF LIABILITY

Our liability in respect of this assignment will be limited to that part of any loss suffered which is proportional to our responsibility or due to negligence at our part and at no time shall exceed the fee that we have received from this assignment.

9. ADDITIONAL TERMS AND CONDITIONS OF ENGAGEMENT

The additional terms and conditions included in *ANNEXURE 1* to this letter apply to this engagement as if they were set out in this letter. They should be read and understood in conjunction with this letter as they form an important and integral part of the overall terms of engagement.

10. ACCEPTANCE OF TERMS

We would be grateful if you would confirm our understanding of your instructions and your agreement to the terms of this letter, including those contained in *Appendix I*, by signing and returning the enclosed copy of this letter.

We are keen to work with you and look forward to your confirmation. Meanwhile, please feel free to contact us for any clarifications.

Yours faithfully

ABC VALUER

For and on behalf of **XXX Private Limited/ Public Limited**

Terms of engagement acknowledged and agreed by-

NAME..... REGISTRATION No

SIGNATURE DATE.....

A Sample Engagement Letter

ANNEXURE I: ADDITIONAL TERMS AND CONDITIONS OF ENGAGEMENT

These additional terms and conditions of engagement should be read together with the accompanying engagement letter from ABC Valuer which identifies the engagement to which they relate (the 'engagement letter').

1. VERIFICATION OF RESPONSIBILITIES

- 1.1 The scope of our work is as set out in the engagement letter above. We will provide the services set out in the scope with reasonable skill and care, in accordance with the professional standard expected of us, and in a timely manner. We will not normally verify or check any information provided to us by you or by others on your behalf, and you acknowledge that we shall be entitled to rely on such information when performing our obligations under this engagement as it is not designed to investigate nor interrogate for fraud and/or dishonesty (actual or possible) and is not costed accordingly.
- 1.2 Our review of the affairs of the Company will not constitute an audit in accordance with Auditing Standards and we will carry out no verification work. Consequently we will not express an opinion on the financial statements and management accounts, which we may discuss in our reports, except where required by statute or regulations.
- 1.3 In relation to all our work for you, it is the responsibility of your staff to provide us with complete, accurate, timely and relevant information and to carry out any other obligations required to be undertaken by you or others under your control. In addition, you agree to keep us informed of any material developments relating to the business or operations which may have a bearing on our engagement.

2. LIMITATION OF LIABILITY

- 2.1 The aggregate liability of our firm, its partners, agents and employees or any of them (together referred to in this and subsequent clauses as the "Firm") for damage shall be limited to the fee that we have received from this assignment, as set out in our engagement letter.
- 2.2 For the purposes of this engagement letter "damage" shall mean the aggregate of all losses or damages (including interest thereon if any) and costs suffered or incurred, directly or indirectly, by the addressee of this letter ("Addressee") under or in connection with this engagement including as a result of breach of contract, breach of

statutory duty, tort (including negligence), or other act or omission by the Firm but excluding any such losses, damages or costs arising from the fraud or dishonesty of the Firm or in respect of liabilities which cannot lawfully be limited or excluded.

- 2.3 Subject always to the aggregate limit of liability specified in paragraph 2.1 above, the liability of the Firm to the addressee of this letter (the "Addressee") in connection to this engagement shall be limited to the proportion of the total damage which may justly and equitably be attributed to the Firm, after taking into account contributory negligence (if any) of the Addressee.
- 2.4 Addressee shall hold harmless the Firm, its directors and employees free from all actions, claims, proceedings, losses, damages, costs and expenses, whatsoever and however caused, incurred, sustained or arising, which Firm, its directors and employees may suffer, arising from, or in connection with, the provision of the services. This provision shall survive the termination of the engagement for any reason.

3. OWNERSHIP OF BOOKS AND PAPERS

- 3.1 All documents in whatever form, paper, electronic or otherwise such as (for example, but without being an exhaustive list) working papers, letters (including without limitation e-mails), memoranda, file notes of meetings and telephone calls, draft computations and returns etc and copies of other original documents which we create or which we receive either as principal or in our own right or as agent for you belong to ABC Valuer. For the avoidance of doubt, we do not assert such ownership rights to documents such as, for example, title documents, original invoices and other original primary accounting records, tax deduction certificates etc belonging to you, but we may retain possession of them by exercising a lien because our fees remain outstanding after becoming due for payment.
- 3.2 The valuation worksheets prepared for the exercise are proprietary to ABC Valuer and cannot be shared. Any clarifications on the workings will be provided on request, prior to finalising the report, as per the terms of our engagement.

4. CONFIDENTIALITY

- 4.1 Where we receive confidential information, our only obligation is to

A Sample Engagement Letter

take such steps as we in good faith think fit to preserve such confidential information from unauthorized disclosure or other misuse both during and after termination of this engagement. If, despite taking such steps, we disclose without authorization or otherwise misuse the confidential information, causing you loss, we shall be liable to you in accordance with law but subject to the other terms of the engagement. Subject to our duty of confidentiality, you agree we may act for your competitors or for other clients, whose interests are or may be opposed to yours.

We will not be prevented from disclosing confidential information:

- a) which is or becomes public knowledge other than by way of breach of an obligation of confidentiality;
- b) which is or becomes known from other sources without restriction on disclosure; or
- c) which is required to be disclosed by law or any professional or regulatory obligation.

5. OUR SERVICE

- 5.1 If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the services you are receiving, please let us know by contacting our, Mr B. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. If we have given you a less than satisfactory service, we undertake to do everything reasonable to put it right.

6. GOVERNING LAW

- 6.1 These terms of business shall be governed by and construed in accordance with the laws of India and any dispute arising out of this engagement or these terms shall be subject to the exclusive jurisdiction of Indian courts.