Advisory Report on Exchange Ratio of Shares upon amalgamation of Cheslind Textiles Limited with RSWM Limited

(Based on issue of Optionally Convertible Redeemable Preference Shares)

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List of Abbreviation

Abbreviation	Description
AoA	Articles of Association
CAPM	Capital Asset Pricing Model
CCI	Controller of Capital Issue
CDR	Corporate Debt Restructuring
CTL	Cheslind Textiles Ltd.
DCF	Discounted Cash Flows
EBIT	Earnings Before Interest & Tax
EBITDA	Earnings Before Interest, Tax, Depreciation & Amortisation
EPS	Earnings Per Share
EV	Enterprise Value
FCFF	Free Cash Flow to Firm
MoA	Memorandum of Association
NPV	Net Present Value
OCRPS	Optionally Convertible Redeemable Preference Shares
PAT	Profit After Tax
RSWM	RSWM Limited
"Scheme" or "Scheme of Amalgamation" or "Scheme or Arrangement" or "Scheme of Arrangement and Amalgamation"	Scheme of Arrangement and Amalgamation between CTL and RSWM
SSKM	S.S. Kothari Mehta & Co.
TOL	Total Outside Liabilities
TNW	Tangible Networth
WACC	Weighted Average Cost of Capital

Chapter 1: Introduction

1. Introduction

1.1. A Valuation Report dated 02nd April 2014 on Exchange Ratio was based on the issue of Redeemable Cumulative Preference Shares with no conversion rights to the shareholders of CTL. This Report is based on a new financial instrument as recommended by the Audit Committee vide its meeting on 9th April, 2014 viz issue of Optionally Convertible Redeemable Preference shares ("OCRPS") by RSWM Limited ("RSWM"), the transferee company, to the shareholders of Cheslind Textiles Ltd., ("CTL"), the transferor Company.

The audit committee has also directed S.S. Kothari Mehta & Co. ("SSKM") to prepare and submit a fresh Valuation Report.

Accordingly this Report is the relevant report for the Scheme of Amalgamation of the Transferor Company with the Transferee Company to be considered by the Audit committee and Board of Directors of RSWM and CTL.

Further SSKM were instructed on the following points:-

1. To arrive at price for conversion of OCRPS based on the business value of CTL and RSWM as on the Appointed Date.
2. Shareholder holding OCRPS shall get an option to apply for conversion of OCRPS of RSWM into Equity Shares of RSWM before the expiry of six months from the Allotment Date.
3. RSWM shall have an option to redeem such shares by giving not less than 3 months notice to the shareholders of all the outstanding OCRPS at par any time after the expiry of the conversion option period and before the expiry of 5 years from the Allotment Date.
4. The dividend rate would be decided by the Board of Directors of RSWM. The Dividend would be cumulative.

1.2. Disclaimer

The Valuation Advisory Report on Exchange Ratio of shares upon amalgamation of CTL with RSWM ("Report") has been prepared by SSKM from information extracted from desk research, published reports and other data supplied by the management of RSWM and CTL and other sources believed to be reliable and true. The Report cannot be distributed, published, reproduced or used, without the prior express written consent of SSKM.

RSWM and CTL have provided the factual data, business details, and projected financial statements on which SSKM has relied. While the information provided herein is believed to be true and reliable to the best of our knowledge and belief, we do not make any representations or warranties, express or implied, as to the accuracy or completeness of such information.

In furnishing the Report, SSKM reserves the right to amend or replace the Report at any time. The information contained herein is based on certain assumptions and analysis of information provided by the management of CTL and RSWM, available at the time the Report was prepared. SSKM does not purport to give any representation, warranty or other assurance in relation to this Report.

The Report highlights the alternative approaches to valuation, identifies various factors affecting the valuation, summarizes the methodology adopted keeping in view the circumstances of CTL and RSWM, and arrives at the value of the CTL and RSWM.

The purpose of this Report is to value CTL and RSWM for the purpose of arriving at the Share Exchange Ratio pursuant to the amalgamation of CTL with RSWM as on 1st April, 2013 ("Appointed Date").

1.3. Scope of Work

We have been mandated by RSWM for determining the Share Exchange Ratio, upon amalgamation of CTL with RSWM. For determining the Exchange Ratio, CTL and RSWM have to be valued on standalone basis.

Our Report is based on factual data, business details, and financial projections as provided to us by the management of CTL and RSWM.

Our scope of work does not include verification of data submitted by the management of CTL and RSWM and we have relied upon the data so submitted. We have prima facie analysed the data and formed our views. It is not an audit of Financial Statements or other financial information including financial projections and, therefore, cannot give the same level of assurance as an audit.

Limitation

It may be noted that valuation is a highly subjective exercise and the opinion on valuation may differ from valuer to valuer depending on the individual perception of the attendant circumstances. At best, it is an expression of opinion or a recommendation based on certain assumptions.

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As specified by Page 64 of ICAI Technical Guide on Valuation, 2009 Edition, we are to state that:-

a) Valuation does not include the Auditing of Financial Data provided by management, and therefore we do not take any responsibility for its accuracy and completeness.

b) Valuation should not be considered as an opinion on the achievability of Financial Projections either mentioned in, or relied upon for this Report.

This Report is to be considered only for the purpose of determining the Exchange Ratio of equity shares of CTL and OCRPS of RSWM to be issued pursuant to CTL's amalgamation with RSWM.

While all reasonable care has been taken to ensure that the advise given in the Report is fair and equitable, neither SSKM nor its constituents including its Partners & others shall in any way be responsible for any inadvertent error or any such inaccuracies in this Report that may have crept in or for any error in advising on the Exchange Ratio pursuant to data provided by management of CTL and RSWM.

1.4. <u>Information Relied Upon</u>

Management of CTL and RSWM provided, inter alia, the following information to SSKM:

- Audited Financial Statements of CTL and RSWM for the years ending 31st March, 2011, 31st March, 2012 and 31st March, 2013.
- Financial projections for 5 years from 2013-14 to 2017-18 of CTL and RSWM.
- Shareholding Pattern of CTL and RSWM as on 31st March, 2013
- Incorporation documents of CTL and RSWM - MoA and AoA.
- CDR documents of CTL.

Wherever required, all the accounts, projections and documents listed above have been certified by the management or by Company Secretary of the respective companies.

We have also relied upon verbal explanations and information given to us by the management of these companies during the course of our exercise and meetings held.

Some of the data required for the purpose of this exercise has been taken from Prowess Software (CMIE), Bombay Stock Exchange's website (www.bseindia.com), National Stock Exchange's website (www.nseindia.com) and other databases.

1.5. <u>Appointed Date</u>

It is proposed to keep the commencement of business hours on 1st April, 2013 as the Appointed Date as Audited Accounts upto close of business hours on 31st March, 2013 are available. Thus, for the purpose of this Report, Valuation Date is close of business on 31st March, 2013.

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Chapter 2: Background

2. BACKGROUND

2.1. CHESLIND TEXTILES LTD. ("CTL")

2.1.1. Company Profile

- CTL, listed on NSE and BSE, is a 1989 Public Limited Company; for manufacturing of Cotton Yarn.
- During 2007 RSWM Ltd acquired 66.46% (now 69.85%) Equity Shares; and CTL became its subsidiary company.
- The Company has its registered office and manufacturing unit in Bagalur, Hosur, Tamil Nadu with corporate office at Bangalore.
- The Company has a revenue of Rs.1,05.58 crores with an EBIDTA of Rs.14.31 crores (EBIDTA Margin 14%) and PAT of Rs. 4.64 crores (PAT Margin 4%) as per the Audited Financials of 2012-13 (1st October, 2012 to 31st March, 2013); the past has seen deficits/ low profits.
- During 2002 CTL set up a yarn doubling unit at Thirubuvanai, Pondicherry with installed capacity of 1800 MT.
- The Company has 64,704 spindles, currently manufactures about 10,200 MT of cotton yarn per annum. The cotton yarn manufactured includes single, double yarns which are used for both knitting and weaving.

2.1.2. Capital Structure

The capital structure of the Company as on 31st March, 2013 was as under:

Capital Structure – CTL

Particulars	Amount (in Rupees)
Authorized Share Capital 5,00,00,000 Equity shares of Rs. 10/- each	50,00,00,000
Subscribed and Paid up Share Capital 4,53,23,335 Equity shares of Rs.10/- each	45,32,33,350

2.1.3. Shareholding Pattern

The shareholding pattern of the Company as on 31st March, 2013 was as under:

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Shareholding Pattern – CTL

Name	No. of Shares	Shareholding %
Promoters		
RSWM Ltd.	3,16,57,900	69.85%
TIDCO	20,62,500	4.55%
Total Promoter's holding	3,37,20,400	74.40%
Non Promoters		
Institutional	58,38,400	12.88%
Non Institutional	57,64,535	12.72%
Total Non-Promoter's holding	1,16,02,935	25.60%
Total	4,53,23,335	100.00%

2.1.4. Financial Performance

A summary of the audited Statements of Profit and Loss and Balance Sheets of CTL for last 3 financial years is given hereunder:

Summary of Profit and Loss Account – CTL ***(In Rs. Crores)***

Particulars	2010-11 (12M)	2011-12 (18M)	2012-13 (6M)
Total Income	1,85.44	2,49.37	1,05.58
Total Operating Cost	1,53.53	2,49.43	91.27
EBITDA	**31.91**	**(-).06**	**14.31**
Interest	10.83	18.86	6.24
Profits Before Depreciation and Tax	**21.08**	**(-)18.92**	**8.07**
Depreciation	9.35	12.27	3.43
Profit before tax	**11.73**	**-31.19**	**4.64**
Tax	0	(-).33	0
Profit After Tax	**11.73**	**-30.86**	**4.64**
Cash Profits	21.08	-18.59	8.07

Summary of Balancesheet – CTL ***(in Rs. Crores)***

Particulars	31-Mar-11	30-Sep-12	31-Mar-13
Share capital	23.09	45.32	45.32
Reserves and surplus	8.42	(22.45)	(17.81)
Net Worth	**31.51**	**22.87**	**27.51**
Non-Current Liabilities	67.65	62.29	60.67
Current Liabilities	54.43	29.97	38.55
TOTAL LIABILITIES	**1,53.59**	**1,15.13**	**1,26.73**
Net Block	82.95	71.69	73.53
Other Non-current Assets	1.85	10.58	10.26
Current Assets	68.79	32.86	42.94
TOTAL ASSETS	**1,53.59**	**1,15.13**	**1,26.73**

CTL has suffered from:

(i) High cost of Power

(ii) High interest cost due to adverse ratios which is likely to go up further as per the CDR sanction. This also affected its operational costs. CDR authorities have placed certain restrictions and have specified that interest costs will go up from 1st April, 2014.

2.1.5. CDR Impact on CTL

Company had run into financial difficulties, and therefore, went for CDR scheme with its bankers. Inter-alia:-

a) CTL shall not incur any capital expenditure, except capital expenditure as permitted in terms of the CDR Package, without the prior recommendation of monitoring committee and without prior approval of CDR EG,

b) Interest rates prescribed are the floor rates for 2 years and can then go up, and

c) Other conditions and limitations regarding fund raising.

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2.2. RSWM LIMITED ("RSWM")

2.2.1 Company Profile

RSWM Limited, incorporated in 1960, is the flagship company of the LNJ Bhilwara group headed by Shri L.N. Jhunjhunwala. The Company is one of the leading textile units in Rajasthan and has positioned itself as one of the largest textile units of the country. The activities of the company comprise manufacturing of synthetic yarn, cotton mélange yarn, synthetic yarn, cotton yarn, suiting, shirting's and Denim fabrics. The Company set up its first plant at Bhilwara and subsequently set up another plant, a composite textile mill, at Kharigram (Bhilwara) in 1973. The original Bhilwara Mill was later spun off as an independent company in the name of Bhilwara Spinners Limited.

The company set up another spinning unit at Banswara in the year 1989-90, with the objective of manufacturing export quality yarn and started export of PV yarn in a big way. The Company also set up a Cotton Yarn Mélange Project at Bhilwara, which started commercial production in 1994. In 2003-04 it acquired Rishabhdev unit from HEG Ltd., which is engaged in manufacturing of synthetic blended yarn.

The company acquired Jaipur Polyspin Ltd. and Mordi Textiles & Processors Ltd. and subsequently these were merged with the company in 2005-06, which are engaged in the same business.

The Company has completed an ambitious expansion plan in 2006-07 & 2007-08 which increased the company's capacities substantially. The expansion plan has been implemented at all the existing locations as well as a new unit for manufacturing of Denim fabrics was set-up at Mordi, Banswara. The Denim plant with a capacity of producing 14 million meter fabrics per annum having latest state of art machinery and a composite plant right from feeding raw cotton to finished denim fabrics. The capacity of denim plant expanded in 2011-12 by 2.7 million meter per annum and the plant now have a total capacity of 16.7 million meter denim fabrics per annum.

The company has set up a 46 MW Thermal Power Plant (coal based) at Mordi (Banswara) in 2006-07. Commercial production has started in the year 2007-08. This plant provides captive power to existing operations of the company at Banswara, Bhilwara, Rishabhdev, Kharigram, Ringas, Mordi and denim project at Mordi.

In this way, the company now has 4,02,680 spindles and 3,120 Rotors for manufacturing of Synthetic Blended, Cotton Mélange, Cotton blended Grey/Dyed yarn in the count range of 6 to 60. Similarly, the company's brand "Mayur

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Suitings" is well recognized brand amongst Mill sector having 104 looms including Toyoda and Sulzer looms and In-house processing facilities. Denim Plant with manufacturing capacity of 16.7 million meter Denim fabrics and 46 MW Captive Coal based Thermal Power Plant to cater the energy needs of the Company.

2.2.2 Capital Structure

The capital structure of the Company as on 31st March, 2013 was as under:

Capital Structure - RSWM

Particulars	Amount (in Rupees)
Authorized Share Capital	
• 4,75,00,000 equity shares of Rs. 10/- each	• 47,50,00,000
• 25,00,000 Optional Convertible Redeemable Preference Shares of Rs. 150/- each	• 37,50,00,000
Issued, Subscribed and Paid up Capital	
• 2,31,48,689 equity shares of Rs. 10/- each	23,14,86,890

2.2.3 Shareholding Pattern

The shareholding pattern of the Company as on 31st March, 2013 was as under:

Shareholding Pattern - RSWM

Name	No. of Shares	Shareholding %
Shareholding of Promoters	**1,19,06,654**	**51.44%**
Indian	69,71,884	30.12%
Foreign	49,34,770	21.32%
Public Shareholding	**1,12,42,035**	**48.56%**
Institutions	24,32,793	10.51%
Non-Institutions	88,09,242	38.06%
Total	**2,31,48,689**	**100.00%**

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2.2.4 Financial Performance

A summary of the audited profit and loss account and balance sheets of RSWM for last 3 financial years is given hereunder:

Summary of Profit and Loss Account – RSWM ***(In Rs. Crores)***

For the year ending 31st March	2011	2012	2013
Total Income	19,73.98	20,09.33	24,76.13
Total Operating Cost	16,25.61	18,48.35	21,44.96
EBITDA	3,48.37	**1,60.98**	**3,31.17**
Interest	72.57	1,04.04	1,21.29
PBDT	2,75.8	**56.94**	**2,09.88**
Depreciation	80.14	89.1	1,08.45
Profit Before Tax and Exceptional Items	**1,95.66**	**-32.16**	**1,01.43**
Exceptional Items	14.42	0.00	0.00
Profit Before Tax	**1,81.24**	**-32.16**	**1,01.43**
Tax	58.26	-10.36	33.56
Profit After Tax	**1,22.98**	**-21.8**	**67.87**
Cash Profits	2,26.99	60.79	1,89.62

Summary of Balance Sheet – RSWM ***(In Rs. Crores)***

For the year ending 31st March	2011	2012	2013
Share Capital	23.15	23.15	23.15
Reserves and Surplus	287.64	263.75	305.42
Net Worth	**3,10.79**	**2,86.90**	**3,28.58**
Non-Current Liabilities	6,58.85	8,72.66	7,84.08
Current Liabilities	6,91.53	5,73.64	7,37.81
TOTAL LIABILITIES	**16,61.17**	**17,33.20**	**18,50.46**
Net Block	8,07.44	10,30.84	9,76.95
Other Non-current Assets	104.44	1,03.55	1,35.87
Current Assets	7,49.28	5,98.81	7,37.64
TOTAL ASSETS	**16,61.17**	**17,33.20**	**18,50.46**

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Chapter 3: Objective and Rationale of Valuation

3.1 Objective of this Report:

The objective of this Report is to value, for the purpose of advising on the Exchange Ratio of shares, both the Transferor and the Transferee Companies. It is based on the fair valuation of the business of the Transferor Company and the Transferee Company.

3.2 Rationale of Amalgamation

a) Both Transferor Company and Transferee Company are engaged in the similar business of spinners, doublers, weavers, bleachers, dyers, printers, mercers and hosiers in cotton, wool, jute, silk, teryline, terrycotton, linen and all other synthetic and other fibrous materials and to purchase, comb, prepare, spin, weave, bleach, dye, print, mercerise or otherwise manufacture and deal in wool, cotton, silk and all other goods, yarn, cotton and other goods, fabrics whether textiles, trebled, knotted or looped, kapas, hemp, jute, rags, yarns, necessary or useful in processes for treatment of any or all of the above purposes.

b) The amalgamation will enable pooling of resources of the companies involved in amalgamation to their common advantage, resulting in more productive utilization of the said resources, cost & operational efficiencies, which would be beneficial for all stakeholders.

c) The proposed amalgamation will provide a stronger and consolidated financial structure to the businesses of the companies besides synergy of operations and making a more profitable organization with a greater potential for growth.

d) The amalgamation would result in the creation of a company with much larger asset base and a net worth with strong financials enabling further growth and development of the businesses of the said companies and also enable the resultant Transferee Company to withstand all kinds of risks associated with global business and the growing competition in the international scenario.

c) The proposed amalgamation will result in reduction in overheads and other expenses, economies of scale, reduction in administrative and procedural work and eliminate duplication of work and will enable the undertakings concerned to effect internal economies and optimize productivity.

f) The Transferee Company post amalgamation will have better financial and business prospects. The Scheme shall be beneficial and in the best interests of the shareholders, creditors, employees of the Transferor Company and the Transferee Company and all concerned. The Scheme shall provide strength to the Transferor Company on its amalgamation with the Transferee Company.

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Chapter 4: Valuation Methodology

The valuation methodology to be adopted varies from case to case depending upon different factors affecting valuation. The basis of valuation would depend on the purpose of valuation, nature of business, future prospects of the company & industry and other attendant circumstances.

Different methodologies are adopted for valuation of manufacturing, investment, property and trading companies. Investment and property companies are valued based on the market value or fair value of their underlying assets while manufacturing companies are valued in relation to profits from business and relative value of assets. Different methodologies used for the purpose of valuation are explained subsequently:

4.1 ASSET APPROACH:

This methodology is likely to be appropriate for a business whose value derives mainly from the underlying value of its assets rather than its earnings, such as property holding and investment business.

Net asset values, which are of great relevance in industries such as utilities, manufacturing and transport that are dependent on physical infrastructure and assets, may not have particular significance in industries such as information technology, pharmaceutical that are driven by intangibles not recorded in the books. The asset valuation is a good indicator of the entry barrier that exists in a business.

Some of the most common techniques of valuation considered under this approach are to value a business enterprise on the basis of book value of the assets or at Adjusted book value of the assets or at Replacement value.

i. **Book value:** This is simply a value based upon the accounting books of the business. In simple term, Assets less liabilities equals the owners' equity, which is the "Book Value" of the business. For mature firms with predominantly fixed assets, little or no growth opportunities and no potential for excess returns, the book value of the assets may yield a reasonable measure of the true value of these firms. For firms with significant growth opportunities in businesses where they can generate excess returns, book values will be very different from true value.

ii. **Adjusted book value:** This method involves reviewing each and every assets and liabilities on the company's balance sheet and adjusting it to reflect its estimated market value. Depending on the mix of assets owned by the company, other types of appraisers (e.g., real estate, machinery and equipment) might need to be consulted as part of the valuation process. In addition, it is important to consider intangible items that might not necessarily be reflected on the balance sheet, but which might have considerable value to a user, such as trade names, patents, etc. The unrecorded and contingent liabilities are also considered at their fairly estimated value.

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iii. **Replacement value:** This method is mainly used with asset-heavy businesses such as hotels/motels and natural resources (mining) businesses. The asset valuation methodology essentially estimates the cost of replacing 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 a new business is set, this methodology may not be relevant in a going concern.

4.2 INCOME APPROACH

The Income Approach derives an estimation of value based on the sum of the present value of expected economic benefits associated with the asset or business (Economic benefits have two components: cash flow (or dividends) and capital appreciation). Under the Income Approach, the appraiser may select a single period capitalization method (Profit earning capacity value method) or a multi-period discounted future income method.

a) **Profit earning capacity value method:**

- The basic of this approach is to find the normalized earning capacity of the business and to capitalize it on the basis of appropriate rate considering the business fundamentals of business cycle, safety, return and time. In this method, future maintainable profit of the company is calculated. Alternately, an appropriate multiple can be used with the normalized earnings to arrive at fair estimation of business value (Market Price per Share "MPS")
- The important task is to determine two factors:
    i. normalized Profit After Tax (PAT) and
    ii. rate of capitalization or multiple for capitalization
- The average annual maintainable PAT should be representative and is generally determined based on average past earnings, or future projected earnings where the past earnings are not representative of the future earning potential of the business.
- The capitalization rate is taken based at P/E Multiple (MPS/EPS) of the industry on the rate of return expected by the equity shareholders of the company.

b) **Discounted Free Cash Flow Method (DCF)**

- 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. It recognizes that money has a time value by discounting future cash flows at an appropriate discount factor.

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- **This method is used to determine the present value of a business on a going concern assumption.** The DCF methodology depends on the projection of the future cash flows and the selection of an appropriate discount factor.
- When valuing a business on a DCF basis, the objective is to determine a net present value of the cash flows ("CF") arising from the business over a future select period of time (say 5 years), which period is called the explicit forecast period. Free cash flows are defined to include all inflows and outflows associated with the project prior to debt service, such as taxes, amount invested in working capital and capital expenditure. Under the DCF methodology, value must be placed both on the explicit cash flows as stated above, and the ongoing cash flows a company will generate after the explicit forecast period. The latter value, also known as terminal value, is also to be estimated.
- The future cash flows can be projected, the less sensitive the valuation is to inaccuracies in the assumed terminal value. Therefore, the longer the period covered by the projection, the less reliable the projections are likely to be. For this reason, the approach is used to value businesses, where the future cash flows can be projected with a reasonable degree of reliability. For example, in a fast changing market like telecom or even automobile, the explicit period typically cannot be more than at least 5 years. Any projection beyond that would be mostly speculation.
- The discount rate applied to estimate the present value of explicit forecast period free cash flows as also continuing value, is taken at the "Weighted Average Cost of Capital" (WACC). One of the advantages of the DCF approach is that it permits the various elements that make up the discount factor to be considered separately, and thus, the effect of the variations in the assumptions can be modelled more easily. The principal elements of WACC are cost of equity (which is the desired rate of return for an equity investor given the risk profile of the company and associated cash flows), the post-tax cost of debt and the target capital structure of the company (a function of debt to equity ratio). In turn, cost of equity is derived, on the basis of capital asset pricing model (CAPM), as a function of risk-free rate, Beta (an estimate of risk profile of the company relative to equity market) and equity risk premium assigned to the subject equity market.
- Value obtained by using DCF method gives us the Enterprise Value; and adjustment for the loans as on the valuation date gives us the Equity Value.

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This method is generally used when there is reasonable certainty on the timing, quantum and quality of the cash flows, which has its close coupling with the underlying assets (e.g. in case of a manufacturing company). It is the most commonly used valuation technique,

and is widely accepted by valuers because of its intrinsic merits, some of which are given below:

(a) It is a very sound model because it is based up on expected future cash flows of a company that will determine an investor's actual return.

(b) It is based on the expectations of performance specific to the business, and is not influenced by short-term market conditions or non-economic indicators.

(c) It is not as vulnerable to accounting conventions like depreciation, inventory valuation in comparison with the other techniques/approaches since it is based on cash flows rather than accounting profits.

4.3 VALUATION OF SURPLUS ASSETS

In case company holds any asset which is surplus to its business and expansion plans, and they are material in quantum, then such assets are to be valued at its estimated net realizable value instead of book value.

Value of such surplus assets are then added to the overall valuation of the company.

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Chapter 5-Methodology adopted for Valuation of CTL and RSWM

5.1. Methods adopted for valuation of CTL:

The valuation of CTL has been done on the basis of Weighted Average of DCF, on Net Asset Value method, PECV method ("PE" Multiple) and Market Price Method with weightage as per Para 5.3 of this report.

5.1.1 DCF Method

Based on the assumptions and business plans provided by the management, CTL is valued on **Discounted Cash flow (DCF) basis** as given below:

i. Free Cash Flow

Explicit Period: FY 2013-14 to FY 2017-18 (5 years).

ii. Period considered for projections

We have considered a period of 5 operating years starting from FY 2013-14 for the purpose of valuation so as to cover a business cycle.

It is substantiated from the quotation from *Page 7 & 8 of "Technical guide on Share Valuation, by The Institute of Chartered Accountants of India, Published in Year 2009)*

"Cash flow should reasonably capture the growth prospects and earnings capability of a company. The forecasted period should necessarily cover the entire business cycle of a company"

Moreover, the longer the period covered by the projection, the less reliable the projections are likely to be. For this reason, the approach is used to value businesses, where the future cash flows can be projected with a reasonable degree of reliability. For example, in a fast changing market like automobile or manufacturing, the explicit period typically cannot be more than 5 years.

iii. Discounting Factor

In determining the present value of the cash flows that are available to firm, the discount rate used is Cost of Capital of the entity, i.e. Weighted Average Cost of Capital (WACC). This reflects the opportunity cost of the Company.

WACC is arrived at by using the following formula:

*= (Cost of Equity * Shareholders Funds/ Total Funds) + (Cost of Debt * Debt/ Total Funds)*

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a. *Cost of Equity*

The cost of equity has been determined by using Capital Asset Pricing model (CAPM). This has been computed as follows:

Cost of equity = Rf + [Rm – Rf] (Beta)

Where; Rf denotes risk free rate of return

Rm denotes return on diversified market portfolio return

Rm-Rf is the market premium risk

Beta is the systematic risk factor

Following are the factors used for the calculation of cost of equity:

- Risk Free Return (Rf) is considered at **7.99%** which is based on 10 years zero coupon Indian Government bond yield as per the *latest available "Public Debt Management Quarterly Report" for the quarter: January-March, 2013, issued in the month of May, 2013.*

- Beta is used to calculate the cost of equity (i.e. expected rate of return by the equity shareholders). It is assumed that for shareholders the substitute opportunity for investment would be investment in SENSEX. Hence, we have assumed the shareholders' expectation equal to the market return (based on the return on BSE from 1979 till date).

- Accordingly, in order to calculate the cost of equity, we have considered the Beta = 0.91 i.e. equal to the beta (of textile industry) for market return.

- Market Return (Rm) is considered **16.64%** which has been the market rate of return on Bombay Stock Exchange from April 1, 1979 to March 31st, 2013. ***(Source: BSE Website)***

Based on the above, cost of equity (ke) comes out to be 15.88 % on the basis of data for the period ended 31st March, 2013.

b. *Cost of Debt*

The cost of debt has been computed considering the Interest rate post CDR at 14.50% and an effective MAT rate has been taken. **Based on these assumptions, effective cost of debt works out to 11.60 % on the basis of data for the period ended 31st March, 2013.**

c. ***Cost of Capital***

The weighted average cost of capital has been worked out taking the initial Debt- Equity ratio at **2.77 : 1**. At this Debt-Equity ratio, the Cost of capital has worked out to be **12.73% on the basis of data for the period ended 31st March, 2013.**

Therefore, on the basis of above mentioned factors, the Equity valuation of CTL as per DCF Method is Rs. 34.03 crores or Rs. 7.51 per share based on 4,53,23,335 equity shares of Rs. 10/- each.

5.1.2 NAV Method

The NAV of CTL is computed by subtracting Current and Non-Current Liabilities from the Total Assets of CTL. The said value is also known as shareholders' fund. However, we have excluded non-strategic investment from the business value as substantiated from the quotation from Page 48 of "Technical guide on Share Valuation, by The Institute of Chartered Accountants of India (Published in Year 2009), Para 6.19 and Para 6.20, which states:

Para 6.19 "All the assets of a business which are not used in the normal operations of the business such as investments, surplus land .... should be identified and segregated separately from the operating assets.

Para 6.20 "Surplus Assets should be valued at their current net market value and added to the value of a business."

Therefore, on the basis of above mentioned factors, the Equity valuation of CTL (based on operating assets) as per NAV Method is Rs. 21.01 crores or Rs. 4.63 per share based on 4,53,23,335 equity shares of Rs. 10/- each.

5.1.3 PECV Method

Based on the assumptions and business plans provided by the management, CTL is valued on **Profit Earning Capacity Value ("PECV") basis** as given below:

- Profit After Tax

  Explicit Period: FY 2013-14 to FY 2017-18 (5 years).

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- <u>Period considered for projections</u>

  We have considered a period of 5 operating years starting from FY 2013-14 for the purpose of valuation so as to cover a business cycle of the textile industry.

It is substantiated from the quotation from *Page 7 & 8 of "Technical guide on Share Valuation, by The Institute of Chartered Accountants of India, Published in Year 2009)*

"Cash flow should reasonably capture the growth prospects and earnings capability of a company. The forecasted period should necessarily cover the entire business cycle of a company"

Moreover, the longer the period covered by the projection, the less reliable the projections are likely to be. For this reason, the approach is used to value businesses, where the future cash flows can be projected with a reasonable degree of reliability. For example, in a fast changing market like automobile or manufacturing, the explicit period typically cannot be more than 5 years.

- <u>Capitalisation Factor</u>

  In determining the Equity value of the firm the capitalisation factor taken is the PE (MPS/EPS) multiple of the comparable companies plying in the same sector and having same line of business with growth potentials and risk class similar to the CTL.

Therefore, on the basis of above mentioned factors, the Equity valuation of CTL as per PECV Method is Rs. 29.48 crores or Rs. 6.51 per share based on 4,53,23,335 equity shares of Rs. 10/- each.

5.1.4 <u>Market Price Method</u>

Equity shares of CTL are listed and traded on BSE and NSE, hence this may also be considered. This is the value of the aggregate subscribed Equity share capital of CTL. The subscribed and paid up equity capital of the CTL stands at Rs. 45.32 crores as on 31st March, 2013. It has not issued any preference share capital.

The value of CTL is evaluated considering the volume-weighted average market price shares of CTL for a period of sixty trading days immediately preceding the appointed date as traded on the stock exchange where the maximum volume of trading in the shares of CTL are recorded during such period, and multiplying the same with the number of equity shares of CTL.

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Therefore, on the basis of above mentioned factors, the Equity valuation of CTL is done as per data available at B.S.E., thereby the Equity valuation of 4,53,23,335 equity shares of Rs. 10/- each of CTL as per Weighted Market Price of Rs. 7.41 is Rs. 33.60 Crores.

5.1.5 **Valuation of Investments:**

Company has investments in following companies:

- Indo Wind Power Pvt. Ltd.
- Ind Eco Ventures Ltd.
- Asian Energy Ltd.
- Shree Rengaraj Ispat Industries Pvt. Ltd.

As informed to us by the management of CTL and RSWM, these investments are valued at respective book values appearing in the book of accounts i.e. at Rs. 3.17 Crores.

5.2. Methods adopted for valuation of RSWM:

The valuation of RSWM has been done on the basis of Weighted Average of DCF, on Net Asset Value method, PECV method ("PE" Multiple) and Market Price Method with weightage as per Para 5.3 of this report.

5.2.1 **DCF Method**

Based on the assumptions and business plans provided by the management, RSWM is valued on **Discounted Cash flow (DCF) basis** as given below:

i. Free Cash Flow

Explicit Period: FY 2013-14 to FY 2017-18 (5 years).

ii. Period considered for projections

We have considered a period of 5 operating years starting from FY 2013-14 for the purpose of valuation so as to cover a business cycle.

It is substantiated from the quotation from *Page 7 & 8 of "Technical guide on Share Valuation, by The Institute of Chartered Accountants of India, Published in Year 2009)*

"Cash flow should reasonably capture the growth prospects and earnings capability of a company. The forecasted period should necessarily cover the entire business cycle of a company"

Moreover, the longer the period covered by the projection, the less reliable the projections are likely to be. For this reason, the approach is used to value businesses, where the future cash flows can be projected with a reasonable degree of reliability. For example, in a fast changing market like automobile or manufacturing, the explicit period typically cannot be more than 5 years.

iii. <u>Discounting Factor</u>

In determining the present value of the cash flows that are available to firm, the discount rate used is Cost of Capital of the entity, i.e. Weighted Average Cost of Capital (WACC). This reflects the opportunity cost of the Company.

WACC is arrived at by using the following formula:

*= (Cost of Equity * Shareholders Funds/ Total Funds) + (Cost of Debt * Debt/ Total Funds)*

a) <u>Cost of Equity</u>

The cost of equity has been determined by using Capital Asset Pricing model (CAPM). This has been computed as follows:

Cost of equity = Rf + [Rm – Rf] (Beta)

Where; Rf denotes risk free rate of return

Rm denotes return on diversified market portfolio return

Rm-Rf is the market premium risk

Beta is the systematic risk factor

Following are the factors used for the calculation of cost of equity:

- Risk Free Return (Rf) is considered at **7.99%** which is based on 10 years zero coupon Indian Government bond yield as per the *latest available "Public Debt Management Quarterly Report" for the quarter: January-March, 2013, issued in the month of May, 2013.*
- Beta is used to calculate the cost of equity (i.e. expected rate of return by the equity shareholders). It is assumed that for shareholders the substitute opportunity for investment would be investment in SENSEX. Hence, we have assumed the shareholders' expectation equal to the market return (based on the return on BSE from 1979 till date).
- Accordingly, in order to calculate the cost of equity, we have considered the Beta = 1.16 i.e. equal to the beta (of textile industry) for market return.
- Market Return (Rm) is considered 16.64% which has been the market rate of return on Bombay Stock Exchange from April 1, 1979 to March 31st, 2013. (Source: BSE Website)

Based on the above, cost of equity (ke) comes out to be 18% on the basis of data for the period ended 31st March, 2013.

b) Cost of Debt

The cost of debt has been computed considering the Interest rate at 11.50% and an effective normal tax rate has been taken. **Based on these assumptions, effective cost of debt works out to 7.77% on the basis of data for the period ended 31st March, 2013.**

c) Cost of Capital

The weighted average cost of capital has been worked out taking the initial Debt- Equity ratio at **3.99 : 1**. At this Debt-Equity ratio, the Cost of capital has worked out to be **9.82% on the basis of data for the period ended 31st March, 2013.**

Therefore, on the basis of above mentioned factors, the aggregate Equity valuation of RSWM as per DCF Method is Rs. 393.24 crores or Rs. 169.88 per Equity share of Rs. 10 each based on 2,31,48,689 equity shares of Rs. 10/- each.

5.2.2 NAV Method

The NAV of RSWM is computed by subtracting Current and Non-Current Liabilities from the Total Assets of RSWM. The said value is also known as shareholders' fund.

Therefore, on the basis of above mentioned factors, the aggregate Equity valuation of RSWM (based on operating assets) as per NAV Method is Rs. 290.66 crores or Rs. 125.56 per Equity shares of Rs. 10 each based on 2,31,48,689 equity shares of Rs. 10/- each.

5.2.3 PECV Method

Based on the assumptions and business plans provided by the management, RSWM is valued on **Profit Earning Capacity Value ("PECV") basis** as given below:

- Profit After Tax

  Explicit Period: FY 2013-14 to FY 2017-18 (5 years).

- Period considered for projections

  We have considered a period of 5 operating years starting from FY 2013-14 for the purpose of valuation so as to cover a business cycle of the textile industry.

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It is substantiated from the quotation from *Page 7 & 8 of "Technical guide on Share Valuation, by The Institute of Chartered Accountants of India, Published in Year 2009)*

"Cash flow should reasonably capture the growth prospects and earnings capability of a company. The forecasted period should necessarily cover the entire business cycle of a company"

Moreover, the longer the period covered by the projection, the less reliable the projections are likely to be. For this reason, the approach is used to value businesses, where the future cash flows can be projected with a reasonable degree of reliability. For example, in a fast changing market like automobile or manufacturing, the explicit period typically cannot be more than 5 years.

- Capitalisation Factor

  In determining the Equity value of the firm the capitalisation factor taken is the PE (MPS/EPS) multiple of the comparable companies plying in the same sector and having same line of business with growth potentials and risk class similar to the RSWM.

Therefore, on the basis of above mentioned factors, the Equity valuation of RSWM as per PECV Method is Rs. 417.83 crores or Rs. 180.50 per equity share of Rs. 10 each based on aggregate 2,31,48,689 equity shares of Rs. 10/- each.

5.2.4 Market Price Method

Equity shares of RSWM are listed and traded on BSE and NSE, hence this may also be considered. The subscribed and paid up equity capital of the RSWM stands at Rs. 23.15 crores as on 31st March, 2013. It has not issued any preference share capital.

The value of RSWM is evaluated considering the volume-weighted average market price shares of RSWM for a period of sixty trading days immediately preceding the appointed date as traded on the stock exchange where the maximum volume of trading in the shares of RSWM are recorded during such period, and multiplying the same with the number of equity shares of RSWM.

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Therefore, on the basis of above mentioned factors, the aggregate Equity valuation of RSWM as per Market Price Method is Rs. 258.94 Crores or Rs. 111.86 is per equity share of Rs. 10 each based on 2,31,48,689 equity shares of Rs. 10/- each.

5.2.5 Valuation of Surplus Assets:

Surplus assets are valued at the market price of the respective assets, at the value informed to us by the management. Thus, as informed to us by the management of RSWM, the value of surplus assets is estimated at Rs. 20 Crores.

5.3. Weightages Assigned to the Valuation Methods Adopted:

While valuing CTL and RSWM, we have assigned weights 2:2:1:1 to DCF, PECV, NAV and Market Price methods of valuation for valuing the operating business respectively.

As per ***"The valuation of company shares and business"*** by Adamson & Adamson, 6th Edition published in 1980 in McCathie's case, it was decided as under:

"A purchaser of shares in a company which is a going concern does not usually purchase them with a view to attempting to wind up the company..... The real value of the share will depend more on the profits which the company has been making and should be capable of making, having regard to its nature of business....." (Page 60)

Judicial Pronouncements and Eminent Authors' Views

Though there are no thumb rules of valuation, there are a few pointers/basis to valuation principles that may be applicable on a case depending upon the attendant circumstances relative to each case.

The erstwhile Controller of Capital Issue (C.C.I.) advocated the above methodology. There are a few major Court decisions, which throw light on the adoptable basis of valuation.

In India, the valuers generally follow the principle laid down by the Hon'ble Supreme Court of India in the landmark case of merger of *Tata Oil Mills Co. Ltd. with Hindustan Levers Limited (Hindustan Lever Employees' Union vs. Hindustan Lever Limited and others (1995) 83 Comp. Cases 30 (SC))*. It suggests that multiple methodologies are to be considered with greater weightage to income based methods. The Court noted, *"in the case of amalgamation, a combination of all or some of the methods of valuation may be adopted for the purpose of fixation of the exchange ratio of all the entities"*. It is to be noted that even in such a situation, the book value method has been described as *"more of talking point than a matter of substance"*. Hence we are giving lower weight to Asset Value.

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Chapter 6: Valuation of CTL and RSWM

Based on the valuation elucidated in the previous chapters, the valuation of CTL and RSWM as on 31st March, 2013, i.e. the Transfer Date is as follows:

"Valuation of CTL" (using weighted average)

Method	Equity Value (in Rs. Crores)	Weights	Weighted Equity Value (in Rs. Crores)
DCF Method	34.03	2.00	68.06
PECV	29.48	2.00	58.96
NAV Method	21.01	1.00	21.01
Market Price @ 31st March 2013	33.60	1.00	33.60
		6.00	**181.64**
Weighted Average Equity Value (in Rs. Crores)			**30.27**
Add: Value of Surplus Assets (in Rs. Crores)			**3.17**
Weighted Average Equity Value for 4,53,23,335 issued, subscribed & paid up shares of CTL (in Rs. Crores)			**33.44**
No. of Equity Shares (in Nos.)			**4,53,23,335**
Weighted Average Price per Equity Share of Rs 10/- each of CTL (in Rs.)			**7.38**

We advise that the value of CTL upon amalgamation of CTL with RSWM at Rs. 33.44 Crores or Rs. 7.38 per Equity Share, fully paid-up, using Discounted Cash Flow, PECV, NAV and Market Price methods of valuation would be fair and representative value of the aggregate equity capital.

"Valuation of RSWM" (using weighted average)

Method	Equity Value (in Rs. Crores)	Weights	Weighted Equity Value (in Rs. Crores)
DCF Method	393.23	2.00	786.46
PECV	417.83	2.00	835.66
NAV Method	290.66	1.00	290.66
Market Price @ 31st March 2013	258.94	1.00	258.94
		6.00	**2171.72**
Weighted Average Equity Value (in Rs. Crores)			**361.95**
Add: Value of Surplus Assets (in Rs. Crores)			**20.00**
Weighted Average Equity Value for 2,31,48,689 issued, subscribed & paid up shares of RSWM (in Rs. Crores)			**381.95**
No. of Equity Shares (in Nos.)			**2,31,48,689**
Weighted Average Price per Equity Share of Rs 10/- each of RSWM (in Rs.)			**165.00**

We advise that the value of RSWM upon amalgamation of CTL with RSWM at Rs. 381.95 Crores or Rs. 165.00 per Equity Share, fully paid-up, using Discounted Cash Flow, PECV, NAV and Market Price methods of valuation would be fair and representative value of the aggregate equity capital.

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Chapter 7: Share Exchange Ratio

Based on the valuation elucidated in Chapter 6, the Exchange Ratio pursuant to the amalgamation of CTL with RSWM as on 31st March, 2013, i.e. the Transfer Date, we recommend for consideration that the shareholders of CTL may be allotted:

1 (One) fully paid OCRPS of Rs. 7.50 (Rupee Seven and Fifty Paise) each at par of RSWM for every 1 (One) fully paid-up Equity Share of Rs. 10/- (Rupees Ten) each held in CTL which shall be convertible to Equity Share of RSWM at the option of the OCRPS holders at Rs. 165/- per equity share (conversion price) after giving due notice. The conversion will be as per the terms of issue of OCRPS as stated in the Scheme of Arrangement.

Accordingly, at the time of conversion, OCRPS holder will get 1 (One) Equity Share of Rs. 10 each fully paid-up in RSWM in lieu of 22 (Twenty Two) OCRPS of Rs. 7.50 each fully paid-up held by them in RSWM.

In our opinion, the above Exchange Ratio of shares would be fair and equitable to the shareholders of both the Companies

The report is to be read in whole.

For S.S. Kothari Mehta & Co.

Chartered Accountants

Date: 09th April 2014
Place: New Delhi

K S Mehta
Partner
Membership Number: 008883

Firm No: FRN000756N

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