STEPS INVOLVED IN THE PROCESS OF STRATEGIC DISINVESTMENT

The procedure followed by Government of India for strategic disinvestment seeks to promote administrative simplicity and speed of decision-making without compromising on transparency and fair play. The process is as follows:

Step-1

(i) **Selection of CPSEs for disinvestment:**

a) **Identification of CPSEs for Disinvestment:** NITI Aayog identifies the CPSEs for strategic disinvestment and advises the government on mode of sale, the percentage of shares to be sold and suggests methods for valuation of the CPSE. The Administrative Department coordinates with Niti Aayog for identification of CPSE for strategic disinvestment.

[Action: NITI Aayog and Administrative Deptt.]

b) **Recommendation for Strategic Disinvestment of CPSE by Core Group of Secretaries on Disinvestment (CGD):** Recommendation of NITI Aayog is examined by CGD in accordance with the extant policy of the Government. The CGD makes its recommendations to the CCEA.

[Action: DIPAM and CGD]

c) **Approval of CCEA:** Proposal for strategic disinvestment of any CPSE or a subsidiary or a unit of the CPSE, based on the recommendations of CGD, after due process of Inter-Ministerial consultation, are placed for consideration and approval of the Cabinet Committee on Economic Affairs (CCEA).

[Action: DIPAM and CCEA]

Step-2

(ii) **Selection of Intermediaries:** After CCEA clears the disinvestment proposal; selection and appointment of the Advisor(s) viz. Transaction Advisor (TA), Legal Advisor (LA) and Asset Valuer (AV) is done through a competitive bidding process, in terms of Procurement Guidelines of the Department of Expenditure.

[Action: DIPAM, Administrative Deptt. (AD) & CPSE]

a) Disinvestment of GoI shareholding in CPSE

a) Transaction Advisor(s) and Legal Advisor(s) are selected in the light of pre-announced criteria/requirements, by an Inter-ministerial Group (IMG) headed by the Secretary (DIPAM) constituted for this purpose **[Action: DIPAM]**.

b) The Asset Valuer(s) is/are selected in the light of pre-announced criteria/requirement by a Selection Committee constituted by the respective Administrative Departments under the Financial Adviser of Administrative Department/Ministry. **[Action: AD/AM]**.

b) **Disinvestment of a subsidiary or a unit of a CPSE:** In case of strategic disinvestment of a subsidiary or a unit of a CPSE, the selection of Transaction Advisor and Legal Advisor is done by the IMG headed by the Secretary of the Administrative Department concerned. The Asset Valuer in such cases is appointed by the respective CPSEs.

[Action: AD & CPSE].

Step-3

(iii) **Preliminary Information Memorandum (PIM) and Expression of Interest (EoI):**

a) To invite 'Expression of Interest', the Transaction Advisor carries out due diligence of the CPSE and in consultation with the CPSE and the Administrative Department, prepares a 'Preliminary Information Memorandum' (PIM); the terms & conditions including the 'Eligibility Criteria'; & the format/list of documents to be furnished by the interested bidders at the time of expressing interest. **[Action: TA & LA in consultation with CPSE & AD].**

b) The document comprising of PIM, Eligibility Criteria, other terms & conditions of EoI, are recommended by Administrative Department to the Evaluation Committee (EC), constituted under the chairmanship of Financial Advisor, DIPAM. The EC, in turn, make recommendations to CGD through DIPAM. The recommendations of the CGD are placed before the Alternative Mechanism for approval.**[Action: AD, EC, DIPAM and AM]**.

c) After approval by the Alternative Mechanism, 'Expression of Interest' is invited from prospective bidders through publication of advertisements in the newspapers/website. The EoIs are to be submitted to the Transaction Advisor, who maintains secrecy with regard to the name and number of prospective bidders. **[Action: AD & TA]**.

d) Clarification on EoI is given in the form of FAQs by the TA after taking approval from the Administrative Department. The clarifications are placed on website of the concerned Administrative Department/Administrative Ministry for the benefit of all prospective bidders,. **[Action: TA & AD]**.

Step-4

(iv) **Selection of the Bidders:**

a) **Acquisition by 'similarly placed' CPSEs:** On receiving EoIs from prospective bidders; the Transaction Advisor examines the eligibility of the prospective bidders, based on the terms & conditions of EoI and other available material. The Transaction Advisor compiles the relevant facts and figures of the business operation and the financial information relating to various activities of the CPSE, under disinvestment, as well as the CPSEs who have responded to the EoI and submits it to the Administrative Department. The Administrative Deptt., in turn, submits it to DIPAM for placing it before the CGD for deciding the 'similarly placed' CPSEs. **[Action: TA, AD, and DIPAM and CGD].**

b) **Disinvestment to a Strategic Partner:** On receiving EoIs from prospective bidders, the Transaction Advisor examines the eligibility of the prospective bidders based on the terms & conditions of EoI and other available material & shortlists them for participating in subsequent stages of bidding. In case of any prospective bidder being found ineligible, the Transaction Advisor furnishes specified reasons thereof in writing to the Administrative Ministry while keeping the identity of the potential bidders masked. The Administrative Ministry after consideration of the TA's report, presents it before EC for approval. In case EC is, for some specific reason, of the view that the matter requires approval of CGD, the EC may refer the matter to CGD through DIPAM. The Transaction Advisor is required to act as per the direction/decision of the EC / CGD. **[Action: TA, AD, and EC]**.

Step-5

(v) **Valuation:**

a) Concurrently with step-3, the task of valuation of the CPSE is undertaken in accordance with the standard national and international practices by the Asset Valuer and the Transaction Advisor, separately. The Asset Valuer undertakes the valuation of tangible assets & liabilities.

b) The Transaction Advisor, who carries out business valuations, may also consider valuations, based on assets & liabilities, as one of the methods of valuation.

Note: The Administrative Department facilitates the process of valuation of assets, liabilities etc. with respect to the CPSE being considered for strategic disinvestment & also facilitates addressing the issues relating to clarity of the title deeds, pending litigation, etc. on the advice of the Advisors.**[Action: AV & TA** in consultation with the **AD]**

c) **Asset Valuers Report:** The Inception Report of Asset Valuer includes all tangible assets as per updated 'Fixed Assets Register' maintained by the CPSE and any other record maintained by it. This report shall provide the basis eg. methodologies/ approach and assumptions etc. for arriving at proposed valuation in respect of assets. However, at this stage the report **shall not assign** any value of such assets.

[Action: Asset Valuer in consultation with **AD and CPSE].**

e) **Business Valuation Report**: The Transaction Advisor undertakes Business Valuation exercise by adopting various prevailing valuation approaches as per national and international standards. At this stage, the Business Valuation Report does not contain any valuation numbers.

[**Action: TA** in consultation with **AD and CPSE].**

Note:

(i) The Inception Report (by the Asset Valuer) & the Business Valuation Report (by the Transaction Advisor) [both without numbers] is examined and recommended by the Administrative Department for approval of the EC. Any discrepancy/inconsistency in the methodology/assumptions and their implications on the respective valuation reports is sorted out at this stage.

(ii) The finalized report(s) [without valuation numbers], as above, forms the basis of final valuation of the CPSE at the time of determining the 'Reserve Price' at a later stage. The TA & AV, shall submit the final report when required. [See: Step 10].

Step-6

(vi) **Preparation of Request for Proposal (RFP) - Confidential Information Memorandum (CIM), Share Purchase Agreement (SPA)/ Share Holders Agreement (SHA):**

a) Simultaneously with Step-3, the TA & LA prepare the RFP to be given to the Qualified Interested Bidders (QIBs) [shortlisted bidders]. The RFP comprises of Confidential Information Memorandum (CIM), Non-disclosure Agreement or Confidentiality Agreement, Share Holders Agreement (SHA), Share Purchase Agreement (SPA), the terms and conditions of bidding and submission of other documents, bid security etc. **[Action: TA, LA** in consultation with **AD]**.

b) SHA, SPA and Terms and Conditions of the RFP are prepared by the TA with the help of LA. The terms and conditions shall also provide mechanism for securing the certainty of closing the transaction e.g. seeking an EMD as partial consideration. **[Action: TA, LA** in consultation with **AD]**.

c) The draft SPA, SHA and Terms & Conditions of RFP is provided to the Administrative Department (AD) by the TA for seeking approval of appropriate authorities. The AD recommends the same to EC. The EC co-opts an officer from the Ministry of Law, as special invitee, for examination of the Agreements. The documents are, thereafter, placed for consideration of the CGD. **[Action: TA, LA, AD, EC, DIPAM, CGD]**

d) SHA/ SPA and RFP, approved by the CGD, are provided to each QIBs by the TA. **[Action: TA]**.

Step-7

(vii) **Preparation of Data Room:** Simultaneously with Step-3, a data room is also set up by the CPSE which may require engaging professional agencies under the supervision of the Transaction Advisor. The data room may be on e-platform or on physical platform (to be decided by the Admn Deptt. in consultation with the CPSE & TA). The TA will lay down rules for due diligence through data room. The identity of the QIBs must not be disclosed at any stage. All relevant documents pertaining to the CPSE are uploaded/made available through the Data Room. In case of e-data room, the TA provides 'user-id' and password to the QIBs. The cost of the data room is to be borne by the CPSE. The TA maintains logs of the documents made available to the QIBs. **[Action: TA and CPSE]**.

Step-8

(viii) **Due Diligence by QIBs:** The QIBs undertake due diligence after signing confidentiality agreement with the TA. QIBs hold discussions with the Transaction Advisor for any clarifications, who is required to maintain confidentiality of QIBs. The Transaction Advisor maintains a log of meetings, discussions, e-mails, key issues and pending issues, if any. Log of access to Data Room and uploaded documents is also suitably maintained by the Transaction Advisor. The Transaction Advisor also allots 'codes' to the respective QIBs to facilitate site visits, etc. while maintaining confidentiality about the identity of the QIBs. A record of documents/clarification sought by the QIBs and whether the same were provided or not and time of such activities are to be maintained by the TA. If any document is not provided, the reasons thereof are duly recorded by TA. **[Action: TA]**.

Step-9

(ix) Firming up the clauses of SHA & SPA, Terms and Conditions of RFP:

a) Based on the feedback from the QIBs, in case any changes are required, the SHA/SPA are finalized by the Transaction Advisor with the help of Legal Advisor and in consultation with the Administrative Department.**[Action: TA, LA** in consultation with **AD]**.

b) The Admn. Deptt. recommends the draft SPA, SHA and Terms & Conditions of RFP documents to EC. The Evaluation Committee co-opts an officer from the Ministry of Law, as special invitee, for examination of Agreements. The documents, recommended by EC, are placed for consideration of the CGD. Thereafter the documents are referred to the Ministry of Law by the Administrative Department. The vetted documents are placed for consideration of the Alternative Mechanism. **[Action: TA, LA, AD, EC, DIPAM, CGD & AM]**

c) SHA & SPA and RFP approved by the Alternative Mechanism are given to the QIBs by the TA and based on that the financial bids are invited. [**Action: TA**].

Step-10

(x) Bidding Procedure and Fixation of Reserve Price: The transparent bidding and bid evaluation processes is undertaken as per the detailed bidding procedure outlined in the Guidance Note- IV- on Bidding Procedure.

(xi) Security Clearance of highest bidder: The CGD decides whether a security clearance is required on case to case basis.

In case, security clearance of the bidder is required, the Administrative Ministry shall approach the Security Committee on Strategic Disinvestment set up for that purpose for seeking requisite clearance.

(Action: AD, respective Security Agencies)

Step-11

(xii) **Consideration and Approval of the bid by the CCEA**

After the security clearance is received, all relevant facts i.e. name of the highest bidder, price quoted by the highest bidder and the terms & conditions of strategic sale, as entered in SHA/SPA are placed before the CGD. The CGD makes appropriate recommendations to the CCEA. [**Action: DIPAM, CGD & CCEA**]

Step-12

(xiv) **Completion of the Transaction:**

a) After, the approval of the CCEA, the successful bidder is invited to complete the formalities & the SHA/SPA are executed.

b) After execution of SHA and SPA, the bidder shall comply with all the conditions precedent mentioned in SPA, including obtaining applicable approvals for the transaction, deposit of the sale proceeds; and to complete 'closure' requirements mentioned in the SPA. **[Action: TA, LA, Strategic Partner, CPSE and AD]**.

c) In case of listed CPSEs, all formalities as per SEBI regulations, including an 'open offer', if any, are to be satisfied by the Strategic Partner. **[Action: Strategic Partner]**.

2. In the strategic disinvestment process, the role of each of the entities has been defined by CCEA and is available online at www.dipam.gov.in.

3. A Three-member Independent External Monitor (IEM) comprising Ex-Chief Justice of India, Ex- Comptroller and Auditor General of India, Ex- Chief Vigilance Commissioner, has also been put in place. Members are apprised of the process and procedure followed in strategic disinvestment transactions

by DIPAM from time to time. The advice and guidance of IEM is duly considered and adopted on an on-going basis. The grievances, representations, with regard to the process for Strategic Disinvestment, if any, received are flagged to the IEM from time to time. **[Action: DIPAM]**

Please note: Erstwhile Department of Disinvestment had published a Manual on Disinvestment in 2003 explaining, in details, the policy & procedures involved in the Strategic Disinvestment exercise. The above process flow has been updated based on the latest process approvals & learnings from earlier disinvestment exercise. However, it is advised that the said document (available online at www.dipam.gov.in) may also be referred to.

GUIDANCE NOTE - III

VALUATION FOR STRATEGIC DISINVESTMENT

CONTENTS

I. Introduction

1.1 In any sales process, the sale will materialize only when the seller is satisfied that the price given by the buyer is not less than the value of the object being sold. Determination of that threshold amount or the **'Reserve Price'**, which the seller considers adequate, therefore, is the first pre-requisite for conducting any sale. 'Reserve Price', in case of a company, is determined by carrying out valuation of the company.

1.2 In companies that are listed on the stock exchanges, generally market price of the shares serves as a good benchmark for assessing the fair value of the company, though the market price is usually characterized with significant short-term variance due to investor sentiments being influenced by short-term events and environmental aspects. In the case of the PSUs that are either not listed on the Stock Exchanges or command extremely limited traded float, the value discerning of optimal value is more subjective. Thus, deciding the worth of a PSU is indeed a challenging task.

1.3 The valuation of a company is different from establishing the price for which it can be sold. Experts are of the opinion that valuation must be differentiated from price. While the **fair value of an asset** is based on the assessment of intrinsic value accruing from fundamentals on a stand-alone basis, varying return expectation and underlying strategic aspects for different bidders could influence the price. A purchase and sale would be possible only when two parties while forming different views as to the value of an asset, are eventually able to reach agreement on the same price. It would be better appreciated by recognition of the fact that Government can only realize what a buyer is willing to pay for the PSU, as the purchase price ultimately agreed reflects its value to the buyer.

1.4 Valuation is a subjective figure arrived at by the bidder by leveraging his strengths with the potential of the company. Depending on the level of business synergy with the target company, perception of specific value realization and varying assessment regarding productivity, capex, etc., this figure may vary from bidder to bidder.

1.5 The guidelines on valuation, to be followed for all disinvestment transactions in the CPSUs, have been described in Chapter 18 of the manual titled "DISINVESTMENT: POLICY & PROCEDURES", published by the Ministry of Disinvestment in 2001. In its 30th Report presented to the Lok Saba/Rajya Sabha on 23.4.2002, the Standing Committee on Finance (13th Lok Sabha), inter alia, recommended that the Government should "improve and modify the guidelines for evaluation of the assets of the PSUs under consideration for disinvestment which would take value of the land invariably into consideration".

1.5 The **Handbook on valuation** was published by the Ministry of Disinvestment in February 2003 in line with the recommendations of the Standing Committee on Finance. This outlined self-contained write up on valuation methodologies and procedures to be followed for disinvestment in CPSUs. Subsequently in 2006, the **Comptroller & Auditor General submitted its Report # 17 of 2006 summarizing audit observations in respect of disinvestment of Government shareholding in selected PSU during 1999-2003.** Further, in **May 2016, NITI Aayog,** in its recommendations for first tranche of Strategic Disinvestment of the CPSEs, has given its observations on the valuation while recommending methodologies & the approach that can be adopted.

1.6 This note flags some of the areas keeping the above documents in perspective, with an intent that the relevant Advisors/ committees are aware of any gaps observed in the past, and are able to duly address the same while undertaking the valuation exercise. The relevant entities are, however, advised to refer to the relevant documents while undertaking the valuation exercise.

Recommendations of the Disinvestment Commission

2.1 The Disinvestment Commission, in its First Report, has discussed the issues & sensitivities involved in the valuation exercise. They have opined that 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.

2.2 A gist of recommendations/ observations of the Disinvestment Commission are discussed in the Handbook on Valuations, referred above.

II. Recommendations of NITI Aayog (May 2016)

3.1 Valuation is necessary to determine the 'Reserve Price' as a benchmark, which is not the market price, when a CPSE is considered for outright sale. There are three main methods of equity valuation: (i) Discounted Cash Flow (DCF) method, (ii) Relative valuation, and (iii) Asset-based Valuation. While the DCF method for valuing equity typically relies on projections of dividends and/or Free Cash Flow of a firm, Relative Valuation is based on benchmarking with equity transactions involving similar firms. Asset-based Valuation approach would involve valuation of individual assets of a firm. Since book value of assets is often different from their market value, Asset-based Valuation methods typically involve revaluing their assets based on their market value, and drawing up a balance sheet based on these values. One of the ways in which this can be done is by considering the replacement cost of assets, which involves calculating the market value of assets currently in use. There are many variations on these three methods of valuation.

3.2 Sometimes, there is a sense that these methods are scientific process that can arrive at the right value of an asset, perhaps comparable with a thorough engineering analysis that leads to the right design for a bridge. While valuation exercise have a role, it is important to underline the fragility of the answers that are obtained. The first main barrier is that while there is technique to valuation, e.g. the procedure for doing a Discounted Cash Flow, there are also an enormous number of assumptions that go into the calculations. Reasonable persons can disagree on the numerical values that are used in the assumptions.

3.3 Consider DCF valuation using dividends. One would typically need at least 10 years of projections about the dividends of a firm. However, the dividends, which depend on profits, are quite unpredictable. While the net sales of a firm is a relatively stable number, the net profit of a firm is a much more variable number. One could say that if the net sales today is Rs. 100, then it is reasonably likely that 10 years later, the sales would lie between Rs. 25 and 400. However, if the net profit today is Rs. 100, then within 10 years, it can range between Rs. (-) 200 to 2000. The heart of the valuation exercise lies in taking a stand on a trajectory of future profits. This is inherently a speculative view about the future. Each person forms a speculative view about how profits will evolve in the next decade. Once that is done, this is summarized into a present value. The apparent presence of a mathematical formula (for present value) does not change the fact that this is primarily about a speculative view about future profits. As an example, consider BHEL. In 2014-15, the net sale was Rs, 31,588 crore. The net profit was Rs. 1419 crore and the dividend payout was Rs. 284 crore. The valuation of the stock in the market was Rs 30,901 crore. The net profit is 4.5% of the sales, and the dividend payout is 0.9% of sales. However, the entire valuation rides on projects about future dividends. Reasonable men will have relatively small divergence in their views about the growth of net sales over the next decade. But reasonable men can disagree in small ways about future profitability and future dividend payout rates which can have a dramatic effect on the overall answer.

3.4 These very differences of opinion of valuation are found in the financial markets. Every careful investor undertakes a thorough valuation exercise in order to choose what price he is willing to put to the shares. But every investor has a different speculative view about the future. Eg. Investors who are more optimistic about BHEL's future tend to buy the shares, and those who are less optimistic tend to sell the share. The market price is some kind of average of the speculative view of many participants in the market. As no formula can assess the speculative views of the diverse participants in the market, there are no water-tight formulae which can come up with an estimate on the market price.

3.5 Similar problems can be seen in Asset-based Valuation, as perfectly reliable information on the value of specific assets is difficult to obtain, given the limitations of substitutability of assets. The valuation would, therefore, often involve speculation about the productive use of the assets in the future. Different firms may have different plans about the possible uses of the assets, and most of these views are not available to the government or its appointed intermediaries. These views are discovered through the bidding process.

3.6 Relative valuation methods are useful for checking the robustness of valuation obtained by other methods, but relying only on relative valuation is risky unless a perfectly comparable set of firms is available on which recent transactions have taken place. Given the list of CPSEs and the effects of public ownership, typically it would be difficult to find comparable transactions that can help arrive reliable valuations using relative valuation methods.

3.7 This is not to say that the government should not undertake valuation of firms that it is putting up for sale/disinvestment. However, the above discussed limitations of valuation methods have important implications for the government taking up disinvestment of its CPSEs.

(i) The price obtained by the government, when selling the asset, will be the H1 price out of those bid by the investors.

(ii) Each investor will conduct a valuation exercise which will embed his considered views about the future of the asset.

(iii) There is no valuation exercise which can estimate what the speculative view of investors in India will be.

(iv) The expectations of the government are not important as it has no role in the process of determining the market price of assets.

(v) The strategy of the government should thus be to give out copious information and put it in the public domain through which the investors can take informed decisions after due diligence.

III. Valuation Methodologies

4.1 Subject to the suggestions as per section II above, NITI Aayog has recommended specific valuation methodologies in the context of respective CPSEs. The Administrative Ministries and Advisers are advised to keep the same in mind while undertaking valuation exercise.

4.2 Making a valuation requires an examination of several aspects of a company's activities, including analyzing its historical performance, analyzing its competitive positioning in the industry, analyzing inherent strengths/weaknesses of the business & the opportunities/threats presented by the environment, forecasting operating performance, estimating the cost of capital, estimating the continuing value, calculating and interpreting results, analyzing the impact of prevailing regulatory frame work, the global industry outlook, impact of technology and several other environmental factors.

IV. Relevant areas relating to valuations

The **Booklet on Valuations,** available at www.dipam.gov.in discusses various valuation methodologies alongwith their respective attributes. It is advised that the same may be referred to by all the entities/stakeholders involved in undertaking valuation exercise.

The suggestions below are, *interalia*, based on the observations recorded in the documents pertaining to the disinvestment exercise done in the past. The documents include Report # 17 of 2006 – Comptroller & Auditor General – in respect of Disinvestment of CPSEs done between 1999 & 2003. It may, however, be clarified that the suggestions below are only illustrative in nature and not exhaustive. The stakeholders are, therefore, advised to undertake due diligence exercise, in respect of the valuations, based on various factors that may be specific to a CPSE.

A. Consistency in Assumptions and Figures:

(i) **Justification of assumptions:** Valuation assumptions ought to be validated alongwith justifications especially in cases involving difference in opinion as regards projections, production parameters, business plan, etc;

(ii) Consistency between reports of Advisors:

(a) **On revenue account:** Consistency in facts & figures may be ascertained in the valuation report of Transaction Advisor, Asset Valuer e g. production figures, sales, expenses, net debt, net cash flow, projections period, tax rates and any parameter that has a bearing on the projections & valuations, etc.

(b) **On capital account:** Maintain consistency with the overall recommendations/assumptions as regards life of plant & machinery, associated expenditure on modernization that may have been considered in cash flow calculations including DCF method. Estimate the economic useful life of the plant & Machinery keeping in view the utility/usefulness of the plant, its potential use in overall production process, technology up-gradation & the residual value.

(c) **Maintain consistency in the dates** of valuation of assets in reports of Transaction Advisor and the Asset Valuer.

(d) Consistency as regards parameters to be adopted in valuation calculations: Maintain consistency in adoption of the Weighted Average Cost of Capital (WACC) while discounting Free Cash Flow as adoption of a higher WACC rate impacts depressing the business valuation of the entity. May also consider cost of debt while working out WACC.

B. Fixed Assets – Core & Non-core

(i) **Update Fixed Assets Register:** Value of assets ought to include assets reflected in the updated 'Fixed Asset Register' as on a particular valuation date rather than different dates.

- The CPSEs ought to also follow the instructions issued on 30 June 2006 by the Department of Public Enterprises in respect of assets.

(ii) **Core assets**: Value core assets including plant and machinery, leasehold and freehold land, office buildings, staff colony, guest houses, branch offices and so on depending on the direct contribution to the core activities such as manufacture, production or operations of the business or otherwise.

(iii) **Non-core assets:** In case non–core assets are proposed to be transferred in Strategic sale of the CPSE, that may be identified and their value added to the DCF valuation to arrive at final valuation.

(iv) **Valuation of specific assets:** In case of any assets e.g mines, that have inherent value that is ascertainable by a specialist in the field, the valuation may be done accordingly.

C. Valuation of Immovable Properties:

(i) **Nature of ownership rights:** Conditions of lease including conditions for its transfer, lease rent and provisions for revision, total period of lease remaining period of lease, conditions for renewals etc may be considered while valuing the property apart from encumbrances, if any and land usage restrictions.

(ii) **Realizable value based on covenants:** The realizable market value of 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 may be assessed after taking into account any defects/restrictions/encumbrances on the use/lease/sublease/ sales etc. of the properties or in the title deeds, etc.

(iii) **Capital works-in-progress:** Capital works-in-progress should be taken into consideration for valuation of assets.

D. Business Plan, Intangibles & Contingent Liabilities

(i) **Business Plans:** Draw up a business plan to undertake valuations through Discounted Cash Flow Method. In case of any deviation from the Business Plan, grounds should be justified and recorded in the valuation report.

(ii) **Joint ventures:** Evaluate the joint ventures of the CPSEs & suitable factor in valuations.

(iii) **Intangibles:** Valuation of intangible assets may be suitably factored while undertaking valuation exercise.

(iv) **Date of Valuation:** The facts & figures that form the basis of valuation report should be of a date that is close to the date of submission of financial bids. The rationale is for choosing such date may be specified.

(v) **Contingent Liabilities:** The extent of contingent liability may be disclosed in the financial statement & may not be considered for deduction from in any methodology of valuation.

E. General

(i) **Record maintenance for future reference:** Maintain records of deliberations by Advisors alongwith working sheets, supporting documents (in paper & electronics form). Such documents should provide basis for assumptions & various calculations, valuations and analysis done for arriving at financial evaluation for future reference. The Administrative Ministry, being the Secretariat of the Evaluation Committee, has to ensure that such records are kept.

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GUIDANCE NOTE-IV

SALIENT FEATURES IN SHARE PURCHASE AGREEMENT/SHARE HOLDERS AGREEMENT (SPA/SHA)

The Share Holders Agreement (SHA) or/and Share Purchase Agreement(SPA) contain clauses, specific to the transaction, taking into account unique features in respective transactions.

2. **'Understanding the Strategic Sale Agreement'**, published by the then Department of Disinvestment & available online at www.dipam.gov.in, provides a detailed note on the salient features required to be incorporated in the requisite agreements viz. SHA/SPA etc. All the stakeholders are **advised to go through the document** while firming up the agreements.

3. Without prejudice to the above, some of the issues that may be, *interalia*, specifically kept in mind while drafting the said agreements include:

i. **Protection against Asset Stripping:** The SHA/SPA may include clause on affirmative rights of the Government in case of sale of assets or other modes of disposal/transfer of assets after takeover.

ii. **Protection to employees post disinvestment:** Suitable clauses may be incorporated in the SPA/SHA for the benefit of existing employees of the Company and to protect such employees post disinvestment.

iii. **Lock In Period :** A reasonable period may be mentioned in the agreement for which the Strategic Partner may not exit the Company ('Lock-in' period). Typically, this is 3/5 years .

iv. **Exit options for the balance shares held by Government of India**: During Strategic Disinvestment of the CPSE, management control is being transferred to the Strategic Partner (SP). To this extent, SPs right to manage the CPSE merits protection without having additional restrictions on the right of the Government to disinvest its residual stake in the CPSE through various means. Suitable exit options should be provided for exiting the residual shareholding of the Government including put option, tag along right or disinvestment of the Govt. stake through any other mode.

v. **<u>Breach and its Consequences:</u>** Breach takes place when the Strategic Partner breaches any of the R&Ws (Representation & Warranties) or other covenants in the Agreement. In case of breach/default, remedies shall be provided. For example,

   a. The Government may have a 'call' option for major breaches at say 50% of Fair Market Value (FMV) or purchase price, whichever is lower and 75% for minor breaches.(Figures are only for illustration)

   b. Major breaches could be asset stripping, employee related etc. In case of breach, the Government typically may also have a 'put' option apart from the 'call' option. For major breaches at say 150% of FMV or purchase price, whichever is higher and 125% for minor breaches. (Figures are only for illustration)

vi. **<u>Arbitration</u>**: Arbitration clauses to take care of disputes concerning interpretation of the agreement or application or rights and obligations should be provided in the Agreement. Indian Arbitration and Conciliation Act, 1996, should govern arbitration. Seat and venue of arbitration shall be Delhi, India.

vii. **<u>Post Closing Adjustments and other adjustments to purchase price</u>**: It may be noted that it is in Government's interest not to have a 'post closing adjustments'. Therefore, the agreement may be structured in a manner that such adjustments are avoided.

viii. **<u>R & W Claim Period:</u>** A suitable period for which the representation and warranties shall survive may be mentioned in the agreement.

ix. **<u>Parent Guarantee</u>**: In case of a consortium or in any other case if an SPV is formed then the persons who form the SPV shall undertake that each principal jointly and severally, irrevocably and unconditionally guarantees to the Government that the SPV shall, at all times, fully and faithfully perform and discharge all its obligations under the SPA/SHA.

x. **<u>Change in Articles:</u>** The Articles of the Company may have to be amended to reflect the provisions of the SPA/SHA.

xi. **Limitation of liability:** There should be limitation on the liability of the government. Clauses such as threshold on the total amount, di minimus , insurance, double claim, time period etc may be provided.

xii. **Board of Directors:** Suitable decision on the constitution of the Board of the Company post disinvestment may be taken and mentioned in the agreement.

GUIDANCE NOTE -V

DETERMINATION OF RESERVE PRICE &
BIDDING PROCEDURE FOR STRATEGIC DISINVESTMENT

I. **Role & Responsibilities:** DIPAM has, vide its OMs dated 29th February, 2016, published instructions as regards role of various entities involved in the process of Strategic Disinvestment. In the context of processing of Bids, the following have been inter alia notified:

(i) The **Administrative Department** will prepare the Transaction and Bid documents with the help of the Transaction Advisor for putting it up to the Evaluation Committee.

(ii) The **Evaluation Committee** shall consider the recommendation of Administrative Department on valuation & recommend to CGD the Reserve Price as per guidelines laid down by CGD. The Evaluation Committee shall also process documents for inviting bids, open and evaluate financial bids received from bidder. It shall recommend to CGD for approval of the competent authority the final price and/or strategic partner(s).

(iii) The **CGD** shall lay down guidelines for evaluation by the Evaluation Committee based on the recommendation of NITI Aayog. The CGD shall recommend to the CCEA, the terms and conditions of sale (entered in the transaction documents), the price of sale and recommend the strategic partner.

II. **Guiding Principles underlying bidding process:**

The bidding process is guided by the principles of transparency, fair play, promoting competition and ensuring highest degree of integrity and probity. It is recommended that the bids are received in electronic form through a secure e-platform. However, keeping in view peculiarity of the nature of transaction involved, bids can also be received in physical form. The decision to choose one of the two modes i.e. physical mode or on e-platform, would be taken by the Competent Authority and would be intimated in the respective RFP.

The bidding process ought to satisfy the following:

(i) **Reserve Price** shall not be fixed by the Government before the process of tender/ auction is initiated and the financial bids are finalized and frozen on the secure e-platform or otherwise. This would eliminate the possibility of any of the bidder knowing about the Reserve Price fixed by Government, before bidding.

(ii) The Government, while fixing the Reserve Price, will not have knowledge about the number of participating bidders and the details of the financial bids, (received on the e-platform or otherwise). This will ensure that the fixing of the Reserve Price is not influenced by such knowledge.

(iii) The Advisors are not privy to finalizing Reserve Price. This will eliminate conflict of interest with them to keep a low Reserve Price.

(iv) The functionality of E-platform (as compare to physical mode) provide full comfort to the bidders with regard to integrity of their bids, which once submitted, can in no way be tampered with by any agency.

III. **Process of Financial bidding**

Step 1: Before the bidding process is initiated, the Transaction Advisor & the Asset Valuer shall submit the respective 'Business Valuation Report' & the 'Asset Valuation Report' [both having requisite valuation numbers] to the Administrative Ministry in separate sealed envelopes in a confidential manner. The date and time of receipt of such envelopes is duly mentioned on the envelopes itself alongwith the signature of receiving officer of the Administrative Ministry (member of the Evaluation Committee) & the respective Advisor/valuer. These envelopes are kept in the custody of the Administrative Ministry till step E-6 or P-6 as the case may be.

The process of processing the bids either in physical or e-platform is explained below:

(A) The process for receiving the bids in e-bidding format:

The process for receiving the bids in electronic form on e-platform shall be through a combination of **e-forward auction** & **e-tender** process:

System Requirements:

- All users, viz., System Administrator, Government Officers, Transaction Advisors, Bidders and any other user (either participating in bidding process or otherwise) shall access the database only through the front-end application using requisite authentication mechanism including user i.d., password, digital signature and/or e-signature through Adhaar, OTP, etc.
- The information stored in the database shall be encrypted at all times and not accessible to any user, except on **authentication of at least two individuals**.
- The Systems shall maintain **audit log** of all the activities impacting the database including reading, extraction of data, writing, deleting and alteration, etc. The audit log shall include information about date, time, place, IP address, user i.d. mode and type of acquisition/ queries, etc.
- The System Administrator shall preserve the data in encrypted form along with the audit logs till such time as the Government notifies.
- No participant, including System Administrator shall access the system through backend queries.

Broad contours of e-bid process:

A two Member Committee consisting of JS&FA(DIPAM) and AS&FA/ JS&FA, (Administrative Ministry) will supervise the Auction process. They will decide the auction/ bidding date, time, duration and rules for auction etc. and issue instruction to the Transaction Advisor and System Administrator at different stages of the process.

Activity-E-I: Receiving Financial Bids and Fixation of Reserve Price

Step E-1: The System Administrator allots user id., password, to the **Transaction Advisor** after comprehensive KYC. The KYC documents are uploaded on the System by the System Administrator

Step E-2: The Transaction Advisors allots User ID and password to **Qualified Interested Bidders (QIBs)** after comprehensive KYC. The KYC documents are uploaded on the System by the Transaction Advisor. In case of 'Employees bidder', the TA mentions this fact against the corresponding code.

Step E-3: All QIBs to register on the e-platform and get system generated Code for future use.

Step E-4: QIBs to upload the requisite documents including Board authorizations, Bank guarantee, Copy of the SHA / SPA authenticated by the bidder& such other documents as prescribed under the extant laws or as required in the RFP documents. The original version of the documents is retained by the QIBs for verification at a future date.

Step E-5: **E-auction:**

Auction to start at the appointed date, time on the e-platform. The system will permit QIBs to participate in the auction after verifying that the QIB has **certified online** that all the requisite documents have been submitted. E-auction followed by e-tender process shall ensure that information about number of participating bidders, quantum of bids, highest bid, reserve price, etc. is masked.

Step E-6: **E-tender:**

At the appointed date, and after completion of Step E-5, only a specified number of bidders who have quoted the higher bids (say H1, H2, H3) are allowed to tender one last financial bid (e-tender) on the e-platform. This is to invoke competition even if number of bidders in the e-auction process is less.

Step E-7: After the System confirms that the e-bidding process (Step E-5 & Step E-6) has been completed, the Administrative Department has to recommend the valuation to the Evaluation Committee. The Administrative Department will open the reports of the Transaction Advisor and the Asset Valuer (Refer **Step 1** mentioned above). The date & time of opening of the reports is marked in the records. Further, the Transaction Advisor will take the inputs from the report of the Asset

Valuer for incorporation in their report for the purpose of arriving at valuation based on 'Asset Valuation Method'. The Transaction Advisor makes a detailed presentation to the Department and gives recommendation on valuation. The Asset Valuer is present during the discussions to answer any queries and to examine the discrepancies, if any, in the two reports.

Step-E-8 At this stage, the Transaction Advisor& Asset Valuer withdraw from the meeting and the Administrative Department thereafter deliberates on the issue, if necessary in more than one session sometimes spreading over more than one day, and makes recommendation on valuation to the Evaluation Committee.

Note: The Transaction Advisor/Asset Valuer are not involved in the process of making the final recommendation on valuation to the Evaluation Committee. Their contribution is only to provide the business valuation/asset valuation report, making a presentation and furnishing any further details/clarification that may be sought.

Step-E-9 The valuation, recommended by the Administrative Department is forwarded confidentially to the Evaluation Committee alongwith the reports of Transaction Advisor & the Asset Valuer.

Step-E10: **T**he Evaluation Committee considers the report of the Administrative Department & the reports of the Transaction Advisor/Asset Valuer. The Transaction Advisor & the Asset Valuer are present during the discussions to answer any queries and to examine the discrepancies, if any, in the two reports.

Step-E11: **The** deliberations in Evaluation Committee may spread over more than one session spanning more than one day(s).**T**he members of the EC arrive at an agreed 'Reserve Price' without disclosing the same to the Transaction Advisor and the Asset Valuer. The recommendations of the EC as regards 'Reserve Price' are put in a sealed envelope in which date and time are marked. The sealed envelope containing Reserve Price is handed over to DIPAM for consideration of the CGD.

Step-E12 DIPAM presents the recommendation of the Evaluation Committee with regard to the Reserve Price alongwith relevant documents to the CGD for its consideration;

Step-E13 The CGD approves the 'Reserve Price' and sends confidential communication to DIPAM who in turn submits the same to the Chairman, Evaluation Committee;

Step-E14 The Chairman, Evaluation Committee uploads the Reserve Price into the e-platform system.

Step E-15: If the reserve price is above the highest bid, the system notifies the participating bidders about this fact without revealing the identity of H1 bidder or the number of bidders or the quantum of bid or the reserve price. The system opens window for upward revision of the bid as the last opportunity, to be availed by pre-selected highest bidders within specified time.

Activity- E-II Opening of Financial Bids

Step E-16: After the window, as per Step E-15, is closed, the Transaction Advisor scrutinizes the documents available online as submitted by the QIBs. The Transaction Advisor marks on the e-platform system itself whether the documents of the respective bidder are complete.

Step E-17 The Transaction Advisor confirms on the system that documents of all the bidders have been checked.

Note: The system at this stage displays a prompt that the results of the bidding process are now available for display. The display would be available through the User-Id of the Chairperson, Evaluation Committee.

Step E-18: The bidding process also follows the guidelines notified vide circular dated 25th April 2003 in the context of Employee bids.

Step E-19: E-platform system will display the result of the bids and whether the same are above the Reserve Price. The price value of the bid is **not*** displayed at this stage. The bidders and Advisors are not allowed to be present during this proceeding. The Evaluation Committee makes a record of proceedings and prepares a report for the consideration of the CGD.

***Note:** Price bid is not displayed if the said bid is higher than the Reserve Price. However, it may have to be displayed in certain situations viz. a) When H1 is less than the Reserve Price; or b) In case of employee bid being within 10% band of H1 or c) When H1 bidder does not get security clearance or d) any other reasons. In such cases, the price bid may be displayed after recording reasons on the system.

Activity E-III Consideration of the bid by the Core Group of Secretaries on Disinvestment

Step E-20 The report as per Step –E19 is forwarded by the Evaluation Committee to DIPAM confidentially for consideration of the CGD. DIPAM shall present it for consideration of the CGD.

Step-E-21 The CGD would consider the report and give appropriate recommendations alongwith the decision about the requirement for obtaining security clearance.

Step-E-22 In case security clearance of H1 is required, the Administrative Ministry shall approach the Security Committee on Strategic Disinvestment for that purpose for seeking requisite clearance.

Step-E-23 If the security report provides clearance to the bidder, the price bid is opened on the system by the Evaluation Committee who recommends the case to the CGD for its consideration

Step-P-24 If H1 is not clear from security perspective, CGD will return the matter to EC for giving option to the next highest bidder for matching the price of H1.

Step-P-25 **If the** next highest bidder agrees to match the price of H1, Step- P-20 to Step-P-23 will be followed.

Step-E26 The CGD considers the security clearance report alongwith the price bid & the Reserve Price and makes its recommendation to the CCEA

Activity-IV Consideration and Approval of the bid by the CCEA

Step-E-27 Recommendations of the CGD are thereafter placed before the CCEA for final approval.

(B) The process for receiving the bids in physical format:

Step 1:

Activity P-I- Receiving the bids

In this case, there is no auction involved. The financial bids are processed following tender protocols.

StepP-1: Bids are received by the Transaction Advisor from the bidders in a sealed envelope (referred as 'cover envelop') that contains two separate sealed envelopes upto specified date, time and venue. The 'cover envelop' is signed by the bidder and the Transaction Advisor alongwith the date and time of receipt of the documents. The 'cover envelop' does not indicate the name of Bidder. However, the Transaction Advisor can put a 'code number' for identification. The Transaction Advisor gives an acknowledgement number to the bidder as token of receiving the documents. The acknowledgement number is also mentioned on the 'cover envelop'.

First sealed envelope contains only the price bids(marked 'Price Bid').

Second sealed envelope (marked 'Important Supporting Documents') contains documents including Board authorizations, Bank guarantee, Copy of the SHA / SPA authenticated by the bidder & such other documents as prescribed under the extant laws or as required in the RFP documents.

Step P-2: On appointed date and time, the Transaction Advisor presents the documents as per Step P-1 with the seals of 'cover envelop' intact to the Financial Advisor (DIPAM) and Financial Advisor (Administrative Ministry)[Chairperson & Member of the Evaluation Committee respectively] who receive the bids. The Transaction Advisors and Legal

Advisors are present. Bidders who were allowed to submit financial bids will also be invited by TA to be present in this meeting.

Step-P-3 All the above persons present authenticate the 'cover envelop' alongwith the date and time as token of having received the same in sealed form and thereafter open the 'cover envelop'. Thereafter, each financial bid envelope, without opening it, is signed by the persons present. The signature of each bidder, present in the meeting, is also obtained on these envelopes. Any bidder, who has come to attend this meeting but does not submit a financial bid, is also permitted to be present and his signature may also be obtained on these envelopes.

Step-P-4 The sealed envelopes, containing the financial bids duly authenticated as per Step-P-3 above, are put in a third envelope, sealed and authenticated again by all the persons mentioned in Step-3 above, thus, ensuring that no tampering takes place. The Chairperson of Evaluation Committee keeps this envelop in his/her safe custody. Bidders withdraw from the meeting.

Step-P-5 The second envelope marked 'Important Supporting Documents' is now opened in the presence of the two Financial Advisors, Joint Secretary of the Administrative Ministry & DIPAM and the Transaction Advisors & the Legal Advisors. The Transaction Advisor and the Legal Advisor scrutinize these documents and certify that they are in order. EC may decide on the modalities of the verification of the documents by TA and LA.

Step-P-6 The Transaction Advisor certifies that all the activities up to Step P-5 above are completed. The certificate mentioning the date & time of completion is given to the Administrative Department and the Chairman, Evaluation Committee.

Activity-P-II- Physical Bids - Fixation of the Reserve Price

Step-P-7 Immediately after Activity -I, upon receiving the certificate as per Step P-6, the Administrative Department has to recommend the valuation to the Evaluation Committee. The Administrative Department will open the reports of the Transaction Advisor and the Asset Valuer (Refer

Step 1 mentioned above). The date & time of opening of the reports is marked in the records. Further, the Transaction Advisor will take the inputs from the report of the Asset Valuer for incorporation in their report for the purpose of arriving at valuation based on 'Asset Valuation Method'. The Transaction Advisor makes a detailed presentation to the Department and gives recommendation on valuation. The Asset Valuer is present during the discussions to answer any queries and to examine the discrepancies, if any, in the two reports.

Step-P-8 At this stage, the Transaction Advisor & Asset Valuer withdraw from the meeting and the Administrative Department thereafter deliberates on the issue, if necessary in more than one session sometimes spreading over more than one day, and makes recommendation on valuation to the Evaluation Committee.

Note: The Transaction Advisor/Asset Valuer are not involved in the process of making the final recommendation on valuation to the Evaluation Committee. Their contribution is only to provide the business valuation/asset valuation report, making a presentation and furnishing any further details/clarification that may be sought.

Step-P-9 The valuation, recommended by the Administrative Department is forwarded confidentially to the Evaluation Committee alongwith the reports of Transaction Advisor & the Asset Valuer.

Step-P10: **T**he Evaluation Committee considers the report of the Administrative Department & the reports of the Transaction Advisor/Asset Valuer. The Transaction Advisor & the Asset Valuer are present during the discussions to answer any queries and to examine the discrepancies, if any, in the two reports.

Step-P11: **The** deliberations in Evaluation Committee may spread over more than one session spanning more than one day(s).**T**he members of the EC arrive at an agreed 'Reserve Price' without disclosing the same to the Transaction Advisor and the Asset Valuer. The recommendations of the EC as regards 'Reserve Price' are put in a sealed envelope in which date and time are marked. The sealed envelope containing Reserve Price is handed over to DIPAM for consideration of the CGD.

Step-P12 DIPAM presents the recommendation of the Evaluation Committee with regard to the Reserve Price alongwith relevant documents to the CGD for its consideration;

Step-P13 The CGD approves the 'Reserve Price' and sends confidential communication to DIPAM who in turn submits the same to the Chairman, Evaluation Committee;

Activity- P-III Opening of Financial Bids

Step-P15 After the Reserve Price is decided upon by the CGD & communicated to the EC, at pre-specified date, time and venue, the third envelope containing the sealed price bids and is kept in the possession of Chairperson Evaluation Committee (on which signatures of the members of the EC and the bidders were marked (Refer. Step-P4)) is opened by the Evaluation Committee in the presence of TA and the bidders (the Advisors and the bidders are invited to be present at this point of time) to ensure that they have not been tampered with.

Step - P16 The signatures of the bidders are obtained on the reverse of the bids to give comfort to the bidders that no tampering could take place even after this stage, in the bids submitted by them. Their signatures are obtained on the reverse to ensure that none of the bidders come to know what bid the others have submitted.

Step-P17 Thereafter, the bidders and Advisors withdraw from the meeting. The Evaluation Committee opens the bids and the 'Reserve Price' envelop, makes a record of proceedings and prepares a report for the consideration of the CGD. The report *interalia* contains

- Details of the bidders,
- Respective bids,
- Status regarding submission of documents,
- Reserve price &

- Any other salient points that are worth bringing notice.
- Final price and the name of the Strategic Partner.
- Whether Security clearance of the H1 bidder required or not.

Activity-IV- Consideration of the bid by the Core Group of Secretaries on Disinvestment

Step-P18 The report as per Step –P17 is forwarded by the Evaluation Committee to DIPAM confidentially for consideration of the CGD. DIPAM shall present it for consideration of the CGD

Step-P19 The CGD would consider the report and give appropriate recommendations alongwith the decision about the requirement for obtaining security clearance

Step-P-20 In case security clearance of H1 is required, the Administrative Ministry shall approach the Security Committee on Strategic Disinvestment set up for that purpose for seeking requisite clearance.

Step-P-21 **T**he security clearance report is placed before CGD for its consideration.

Step-P-22 If H1 is not clear from security perspective, CGD will return the matter to EC for giving option to the next highest bidder for matching the price of H1.

Step-P-23 to **If the** next highest bidder agrees to match the price of H1, Step- P-18 Step-P-21 will be followed.

Activity-V Consideration and Approval of the bid by the CCEA

Step-P24 Recommendations of the CGD are thereafter placed before the CCEA for final approval.

Please note:

Erstwhile Department of Disinvestment had published a Manual on Disinvestment in 2003 explaining, in details, the policy & procedures involved in the Strategic Disinvestment exercise. The above process flow has been updated based on the e-bidding process being introduced, latest process approvals & learnings from earlier disinvestment exercise. However, it is advised that the said document (available online at www.dipam.gov.in) may also be referred to.