

**CHIEF GENERAL MANAGER
MUTUAL FUNDS DEPARTMENT**

MFD/CIR/03/526/2002
May 9, 2002

All Mutual Funds Registered with SEBI
Unit Trust of India
Association of Mutual Funds in India

Dear Sirs,

Investment in Unlisted Equity Shares

With a view to bringing about uniformity in calculation of NAVs of mutual funds schemes, the following guidelines are being issued for valuation of unlisted equity shares in consultation with Association of Mutual Funds in India (AMFI). The guidelines also prescribe exercise of due diligence while making such investments and review of their performance so as to protect the interests of investors.

Methodology for Valuation

Unlisted equity shares of a company shall be valued "in good faith" on the basis of the valuation principles laid down below:

- a. Based on the latest available audited balance sheet, net worth shall be calculated as lower of (i) and (ii) below:
 - i. Net worth per share = [share capital plus free reserves (excluding revaluation reserves) minus Miscellaneous expenditure not written off or deferred revenue expenditure, intangible assets and accumulated losses] divided by Number of Paid up Shares.
 - ii. After taking into account the outstanding warrants and options, Net worth per share shall again be calculated and shall be = [share capital plus consideration on exercise of Option/Warrants received/receivable by the Company plus free reserves(excluding revaluation reserves) minus Miscellaneous expenditure not written off or deferred revenue expenditure, intangible assets and accumulated losses] divided by {Number of Paid up Shares plus Number of Shares that would be obtained on conversion/exercise of Outstanding Warrants and Options}

The lower of (i) and (ii) above shall be used for calculation of net worth per share and for further calculation in (c) below.

(b) Average capitalisation rate (P/E ratio) for the industry based upon either BSE or NSE data (which should be followed consistently and changes, if any, noted with proper justification thereof) shall be taken and discounted by 75% i.e. only 25% of the Industry average P/E shall be taken as capitalisation rate (P/E ratio). Earnings per share of the latest audited annual accounts will be considered for this purpose.

(c) The value as per the net worth value per share and the capital earning value calculated as above shall be averaged and further discounted by 15% for illiquidity so as to arrive at the fair value per share.

The above methodology for valuation shall be subject to the following conditions:

- i. All calculations as aforesaid shall be based on audited accounts.
- ii. In case where the latest balance sheet of the company is not available within nine months from the close of the year, unless the accounting year is changed, the shares of such companies shall be valued at zero.
- iii. If the net worth of the company is negative, the share would be marked down to zero.
- iv. In case the EPS is negative, EPS value for that year shall be taken as zero for arriving at capitalised earning.

- v. In case an individual security accounts for more than 5% of the total assets of the scheme, an independent valuer shall be appointed for the valuation of the said security. To determine if a security accounts for more than 5% of the total assets of the scheme, it should be valued in accordance with the procedure as mentioned above on the date of valuation.

At the discretion of the AMC and with the approval of the trustees, an unlisted equity share may be valued at a price lower than the value derived using the aforesaid methodology.

Due Diligence

The mutual funds shall not make investment in unlisted equity shares at a price higher than the price obtained by using the aforesaid methodology. However, it is clarified that this will not be applicable for investment made in the initial public offers of the companies (IPOs) or firm allotment in public issues where all the regulatory requirements and formalities pertaining to public issues have been complied with by the companies and where the mutual funds are required to pay just before the date of public issue.

The boards of AMCs and trustees of mutual funds shall lay down the parameters for investing in unlisted equity shares. They shall pay specific attention that due diligence was exercised while making such investments and shall review their performance in their periodical meetings as advised in SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000.

Reporting of Compliance

The AMCs and trustees shall offer their comments on the compliance of these guidelines in their quarterly and half-yearly reports filed with SEBI.

These guidelines effective immediately are being issued in accordance with the provisions of Regulation 77 of SEBI (Mutual Funds) Regulations, 1996.

Yours faithfully,

P.K.NAGPAL