

Report on valuation of Phantom Stock of Hero FinCorp Limited

Valuation
Investment Banking
Restructuring
Transaction Tax
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Transaction Services

Private and Confidential

Mr. Jayesh Jain,
Chief Financial Officer
Hero FinCorp Limited
09, Basant Lok, Vasant Vihar,
New Delhi -110057

Dear Sir,

In accordance with our engagement letter dated September 14, 2022, we enclose our report on the valuation of phantom stock granted by Hero FinCorp Limited (hereinafter referred as “HFCL” or the “Company” or the “Client) as of September 01, 2022 (‘Valuation Date’) for financial reporting purpose.

HFCL was incorporated in December 1991 as Hero Finlease Limited and is currently engaged in consumer finance business and commercial lending. Consumer Finance includes financing Hero MotoCorp Two-Wheeler, Loyalty Customer Loans (top up loans for existing customers) and providing Loans against property. On the commercial lending side, it provides corporates with a wide portfolio of financing products which include working capital loans, machine loans, among others.

HFCL has issued phantom stocks to its employees under Phantom Stock Units Plan 2022 (“PSU”) on September 1, 2022 (‘Grant Date’). Each of the Phantom Stock Unit confers a right upon the employee to receive sum of money equal to appreciation in accordance with the terms and conditions as stated in the plan. In this context the Management wants to understand value of PSU as of the Grant Date for the purposes of accounting the same in its books of accounts.

We have carried out the valuation for PSU as of the Grant Date considering the data/information provided by the Management, current market analysis, discussion with Management and other factors set out in the Report. While our work has involved analysis of financial and other information, it has not included an audit in accordance with generally accepted auditing standards. Moreover, except where otherwise stated in the Report, we have not subjected the financial and other pertinent information in the Report to inspections/ investigations/ verification validation / diligence procedures.

We have worked out the value of phantom stock using Black Scholes Option Pricing Model. As of the Grant Date, we have considering the fair value per share of HFCL at INR 550 per share. The value of Phantom Stock Option as of September 01, 2022 is estimated as under,

Tranche	Estimated Life of Option	Per Employee Stock Option Value (INR)
Tranche 1	3.0 Years	548.13
Tranche 2	4.0 Years	546.50
Tranche 3	5.0 Years	545.10

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This Report forms an integral whole and cannot be split in parts. The outcome of the Value Analysis can only lead to proper conclusions if the Report as a whole is taken into account.

For RBSA Valuation Advisors LLP
RVE No. : IBBI/RV-E/05/2019/110

Samir Dinesh Shah
Partner
Asset Class : Securities or Financial Assets
RV No. : IBBI/RV/06/2019/12263

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COMPANY OVERVIEW

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1. COMPANY OVERVIEW



HFCL is a public company domiciled in India and incorporated under the provisions of the Companies Act, 1956 on December 16, 1991. The Company is registered as a Non-Banking financial (Non deposit accepting) Company, engaged in the business of financing, leasing, bill discounting and related financial services, with the Reserve Bank of India (Registration No. 14.00266).

HFCL provides various financial products including used Car Financing, Loyalty Personal Loan, Inventory Funding, Loan Against Property, Loans to SMEs and Emerging Corporates and has a wholly owned subsidiary 'Hero Housing Finance Limited' ('HHFL') to cater the housing needs. HFCL caters to Retail, SME & Corporate business.

The Company is holding company of Hero Housing Finance Limited.

In June 2022, HFCL issued compulsorily convertible preference shares to AHVF II Holdings Singapore II Pte. Ltd., an affiliate of Apollo Global Management at a price of INR 550 per share.

SCOPE ASSUMPTIONS & LIMITING CONDITIONS

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2. SCOPE ASSUMPTIONS & LIMITING CONDITIONS



- a) RBSA has been appointed by HFCL to work out the value of PSU as of the Grant Date for financial reporting purpose.
- b) Valuation is carried out in accordance with the Valuation Standards issued by the Institute of Chartered Accountants of India ("ICAI Valuation Standards"). The basis of value for the analyses is fair value, which is defined as *"The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction."* Valuation is carried out on an 'as is where is' premise.
- c) This Report, its contents and the results herein are specific to (i) the purpose of valuation agreed as per the terms of our engagement; (ii) the date of Valuation; (iii) Information provided by the Management, and information obtained from public domain.
- d) RBSA has relied on the valuation report provided by the Management of an external valuer, K R A Chartered Accountants dt. May 31, 2022, who have concluded that the fair value per share of HFCL is INR 550 as of April 30, 2022. Further the Company, in June 2022, has issued compulsorily convertible preference shares to certain PE Investor at a price of INR 550 per share which is convertible into one equity share. Basis this, for the purpose of our valuation, as of Grant Date, we have considered the fair value of equity share of HFCL to be INR 550 per share as of Grant Date..
- e) While our work has involved an analysis information provided by/ on behalf of the Management, our engagement does not include an audit in accordance with generally accepted auditing standards of the Company's business records. We have not carried out any independent technical evaluation or appraisal or due diligence of the assets or liabilities of the Company. Accordingly, we assume no responsibility and make no representations with respect to the accuracy or completeness of any information provided by/ on behalf of the Management. Our Report is subject to the scope, assumptions and limitations detailed hereinafter. As such the Report is to be read in totality, and not in parts, in conjunction with the relevant documents referred to herein and in the context of the purpose for which it is made.
- f) Valuation is not a precise science and the conclusions arrived at in many cases will be subjective and dependent on the exercise of individual judgment.
- g) A valuation of this nature is necessarily based on stock market, financial, economic, and other conditions in general and industry trends in particular prevailing as on the Valuation Date and the information made available to us as of the date hereof. Events occurring after the Valuation date may affect this Report and the assumptions used in preparing it, and we do not assume any obligation to update, revise or reaffirm this Report.

2. SCOPE ASSUMPTIONS & LIMITING CONDITIONS



- g) In the course of valuation, we were provided with both written and verbal information. We have analyzed the information provided to us by the Management through broad inquiry, analysis and review but have not carried out a due diligence or audit of the information provided for the purpose of this engagement. Our conclusions are based on the assumptions, and other information provided by the Management.
- h) The scope of work has been limited both in terms of the areas of the business and operations which have been reviewed for the purposes of this options valuation.
- i) RBSA is not aware of any contingent, commitment or material issue, which could materially affect the Company's economic environment and future performance and therefore, the equity value. No responsibility is assumed for matters of a legal nature
- j) A draft of this report along with the valuation workings was provided to the Management for confirmation of facts and management representations. The Management has represented to us that the information provided to us was complete, accurate and true and correct to the best of their knowledge. We have relied upon the representations of the Management in respect of the information provided by the Management. We shall not be liable for any loss, damages, cost or expenses arising from fraudulent acts, misrepresentations, or willful default on part of the Management, their directors, employee or agents.
- k) This Report forms an integral whole and cannot be split in parts. The outcome of the valuation can lead to proper conclusions only if the Report as a whole is taken into account.

SOURCES OF INFORMATION AND PROCEDURES

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3. SOURCES OF INFORMATION AND PROCEDURES



Sources of Information

This Report is prepared based on the following sources of information as provided to us by the Management:

- a. Valuation Report of external valuer dt. May 31, 2022;
- b. Management representation on issuance of compulsorily convertible preference shares ("CCPS") to certain PE Investor at a price of INR 550;
- c. Phantom Stock Plan, 2022;
- d. Information obtained from public domain and subscribed databases in respect of comparable companies
- e. Such other information and explanation that we believed necessary for the purpose of valuation which was provided by the Management.

Procedures

The procedures used in our valuation included such substantive steps as we considered necessary under the circumstances, including, the following:

- a) Pursued the valuation report of external valuer;
- b) Considered Management representation on issuance of CCPS to PE Investor;
- c) Considered information available in public domain in respect of comparable companies; and
- d) Such other analyses, reviews and inquiries, as we considered necessary.

VALUE ANALYSIS – BLACK-SCHOLES OPTION PRICING MODEL

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4.1. VALUE ANALYSIS – OPTION PRICING MODEL



HFCL has granted phantom stocks under Hero Fincorp Phantom Stock Plan, 2022 (hereinafter referred to as “PSU 2022” or “Scheme”). Each of the Phantom Stock Unit confers a right upon the employee to receive sum of money equal to appreciation in accordance with the terms and conditions as stated in the plan.

- a) For determination of phantom stock value, Black & Scholes model is applied which considers the following six basic inputs:
- the exercise price of the option;
 - the price of the underlying shares as on valuation date;
 - the life of the option;
 - the expected volatility of the share price;
 - the dividends expected on the shares; and
 - the risk-free interest rate for the life of the option.
- b) **Exercise Price:** Exercise price for the purposes of Black & Scholes model has been considered at INR 0.001.
- c) **Current Price of the Underlying Shares:** Basis Management’s representation and considering the price at which CCPS were issued to PE Investor, the price of the underlying share has been considered at **INR 550.0/- per share** as of September 01, 2022.
- d) **Life of the option:** The expected life of an option is the period of time from the date of holding of option to the date on which the option is expected to be exercised. As represented by management the life of options expected to be exercised in Tranche 1, Tranche 2 and Tranche 3 is considered at 3.0 years, 4.0 years and 5.0 years, respectively.
- **Expected Volatility:** Volatility is a measure of the amount by which the price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a given period. The volatility of a share price is the standard deviation of the continuously compounded rates of return on the share over a specified period. As HFCL is an unlisted entity, it does not have historical information upon which it can base an estimate of expected volatility. Thus, we have considered the historical volatility of listed comparable companies for which share price information is available. The historical volatility for computing the fair value of options granted is derived as a weighted average volatility for a period of 3.0 years, 4.0 years and 5.0 years of the comparable companies as stated in the report.

4.1. VALUE ANALYSIS – OPTION PRICING MODEL



- f) **Dividends:** Dividend refers to the expected dividend payouts over the life of option. We have assumed a dividend yield of 0.36% for the Scheme.

- g) **Risk Free Rate:** Risk-Free Interest Rate refers to the implied yield of zero-coupon government issues in whose currency the exercise price is expressed. We have considered the risk-free rate of return corresponding to the expected life of the options. (Source: CCIL)

4.1. VALUE ANALYSIS – OPTION PRICING MODEL



Black & Scholes Model

a) The Black Scholes formula calculates the price of put and call options. It can be obtained by solving the Black–Scholes stochastic differential equation.

b) Methodologies

The value of a Call Option for a non-dividend paying underlying stock in terms of the Black Scholes parameters is:

$$C(S, t) = N(d_1)S - N(d_2)Ke^{-r(T-t)}$$

$$d_1 = \frac{1}{\sigma\sqrt{T-t}} \left[\ln\left(\frac{S}{K}\right) + \left(r + \frac{\sigma^2}{2}\right)(T-t) \right]$$

$$d_2 = \frac{1}{\sigma\sqrt{T-t}} \left[\ln\left(\frac{S}{K}\right) + \left(r - \frac{\sigma^2}{2}\right)(T-t) \right]$$
$$= d_1 - \sigma\sqrt{T-t}$$

Where:

- $N(\cdot)$ is the cumulative distribution function of the standard normal distribution
- $T - t$ is the time to maturity
- S is the spot price of the underlying asset
- K is the strike price
- r is the risk free rate (annual rate, expressed in terms of continuous compounding)
- σ is the volatility of returns of the underlying asset

c) The model makes the following explicit assumptions:

- There is no arbitrage opportunity, i.e. there is no way to make a riskless profit
- It is possible to borrow and lend cash at a known constant risk-free interest rate.
- It is possible to buy and sell any amount, even fractional, of stock (this includes short selling)
- The above transactions do not incur any fees or costs
- The stock price follows a geometric Brownian motion with constant drift and volatility.

VALUE ANALYSIS SUMMARY

- OPTIONS

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4.2. VALUE ANALYSIS SUMMARY



Based on aforementioned, the fair Value of Phantom Stock value using Black-Scholes Option Pricing Model is worked out as under,

Inputs	3 Year	4 Year	5 Year
Spot Price	550.00	550.00	550.00
Adjusted Stock Price (S)	548.13	546.50	545.10
Strike Price (X)	0.001	0.001	0.001
Volatility (s)	54.86%	51.48%	48.15%
Risk-free Rate	6.76%	6.92%	7.02%
Average Time to expiration (T) in Years	3.0	4.00	5.00
Dividend Yield	0.36%	0.36%	0.36%
Output:			
D1	14.59	13.61	13.13
D2	13.64	12.58	12.05
N(D1)	1.00	1.00	1.00
N(D2)	1.00	1.00	1.00
Option Value as on Grant Date	548.13	546.50	545.10