

Unravelling the tapestry of royalty rates: a comprehensive study of intellectual property rates in India

Exploring trends, challenges, and
comparisons in the Indian royalty
landscape over the last decade

Coverage Period: FY2014 to FY2023

Issue month: July 2024

Foreword

In the dynamic landscape of global business, the pursuit of intellectual property rights and the associated royalty rates have emerged as crucial determinants of value creation and commercial success. As an advisory firm specialising in valuation, financial analysis and research, we are pleased to present the 2nd edition of our thought paper that delves into the realm of royalty rates observed in India over the past decade, across both listed and private spaces. Royalty rates for the purpose of this paper are based on the license cost as a percentage of sales, a common approach used in business valuations.

This thought paper aims to shed light on the nuances of royalty rates in India and enable a reader to draw insightful comparisons with the US market. The exploration of these two distinct economies allows us to grasp the divergent factors influencing royalty rates and their implications on innovation, intellectual property, and business strategies.

Comparing the Indian and US Markets: The Indian and US markets, while both influential and robust, exhibit significant variations in their economic landscapes and industrial priorities. Over the last decade, India has steadily emerged as a burgeoning hub for innovation and technology, attracting a diverse array of industries seeking growth opportunities. In contrast, the US has long been known for its emphasis on research and development (R&D), fostering a culture of cutting-edge discoveries and pioneering advancements. These divergent orientations play a pivotal role in shaping royalty rates in the two geographies.

The Elusive Nature of License Contracts in India: Throughout our research, we encountered a key challenge that has invariably influenced our analysis: the scarcity of available license contracts in India. Unlike the US, where comprehensive data on license agreements is more readily accessible, India's regulatory framework and business practices have often kept these contractual details non-public. As a result, our efforts have been devoted to navigating through limited data sources, exercising caution while interpreting findings, and striving for a comprehensive understanding of the Indian market's royalty landscape.

The Lower Royalty Rates in India: One of the central themes that have surfaced during our research is the tendency for generally lower royalty rates in India compared to developed economies. This trend can be attributed to several factors, including the prevailing emphasis on cost optimisation, the evolving intellectual property framework, and the varying stages of industry maturity. Additionally, the concentration of entities in India focusing on R&D is not as pronounced as in the developed economies, leading to contrasting approaches to royalty negotiations.

Regulatory Restriction: The regulatory restrictions concerning the repatriation of funds are also one of the reasons for the disparity. In India, remittances under technical collaboration agreements necessitate the approval of the Ministry of Commerce and Industry if the royalty payment exceeds 5% on local sales and 8% on exports, or if lump-sum payments exceed USD 2 million.

Our Path Forward: With these comparative points in mind, we present this thought paper as a foundation for further exploration. Through rigorous analysis and comparison, we aim to provide practitioners, stakeholders, and investors with valuable insights into the factors shaping royalty rates in India, the challenges encountered in the valuation process, and the implications these rates hold for businesses and investors alike.

We sincerely thank all contributors, researchers, and industry experts whose invaluable insights and support have made this endeavour possible. We hope this thought paper will serve as a catalyst for deeper analyses and foster a greater understanding of royalty rates in India.

Happy reading!

Sincerely,

Team Incwert



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Co-founder
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About Authors

Punit brings with him over two decades of experience in sell-side and buy-side advisory across equity and fixed income. He has worked on several bespoke valuations and lent research support to dozens of asset managers/investment bankers/brokers/consulting firms across the globe.

In the fixed-income segment, he worked as a fundamental analyst across the capital structure: leveraged loans, distressed debt, insolvency/bankruptcy situations and high-yield asset classes. He has also helped sell-side & consulting firms increase their market presence by coming up with thematic and white-label papers.

He started his career as an analyst with Zacks Investment Research, was part of a UK-based CLO manager's research team, and then moved on to set up research practices for a couple of startups before becoming the Global Head of Research at one of the largest BPO/KPO globally and finally co-founded Incwert.

He won 40 under 40 Alternative Professionals Awards 2020 by AIWMI.

Sunit has nearly two decades of experience in valuation, transaction, and M&A advisory.

As a valuation professional, Sunit has undertaken valuations of businesses for transactions, fundraising, strategic decision-making, and corporate restructuring. He has also undertaken valuations of intangible assets, financial instruments, option valuation, litigation support, private equity portfolio valuation and valuation for reporting purposes such as purchase price allocation and impairment test under IFRS and Indian GAAP.

In past, he has worked with KPMG India (as Associate Director), BDO, Grant Thornton, KPMG UK, and DBDBS a boutique M&A advisory firm.

In the past, Sunit has also been an active speaker on valuation at the National Institute of Finance Management (NIFM).

Professor Divya Aggarwal holds a Ph.D. in Finance from XLRI – Xavier School of Management. She has completed The Fellow Programme in Management from XLRI which is a full-time, residential doctoral programme. She is a Company Secretary (the Institute of Company Secretaries of India) and has done her Bachelors in Finance & Investment Analysis from the Delhi University. Her corporate work stints include working in corporate finance roles with McKinsey Knowledge Centre, KPMG, and investing banking roles with Avendus Capital. Before embarking on an academic career, she was working as an AVP in the financial planning team at SwissRe, a leading reinsurance firm.

In 2020 she got featured in the AIWMI list of "India's top 100 women in finance 2020" under the progressing category. She is a recipient of many awards and scholarships including "Peter Drucker essay competition 2014", "The Case Centre scholarship" and best paper awards at several national conferences.

Her research work has been published in international journals like the Journal of Behavioural and Experimental Finance, Research in Economics and Qualitative Research in Financial Markets. She has presented her research work in several national conferences like Pan-IIM, ISDSI, etc. along with international conferences such as biannual meetings of SPUDM.

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ABOUT INCWERT

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Business valuation
Purchase price allocation
Impairment testing



Complex valuations which includes the following:

Contingent consideration



Convertible securities

Expected credit loss (ECL)



Cross-country interest rate swaps

Financial Guarantee Contracts



Embedded derivatives

Hybrid securities



Forward agreements

Non-controlling interests



Loan portfolios

Swaps



Right of Use (ROUs)

Commodities



Warrants

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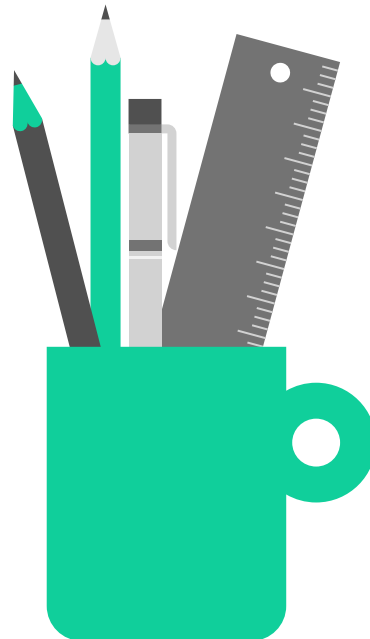
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1 Licensing rates

The graphs below provide an overview of licensing rates observed in India, encompassing both public and private entities. Our study analysed data from 1,978 entities over 10-year period, with the cutoff being 2023. Among the entities analysed, approximately 74% were unlisted, while the remaining 26% were listed on the Indian stock exchanges.

A total of 9,507 transactions spanning 16 industries were meticulously analysed. However, due to the absence of regulations mandating disclosure of license agreement terms, precise categorisation of royalty rates into technology, brand/trademark, or content-related licensing is challenging.

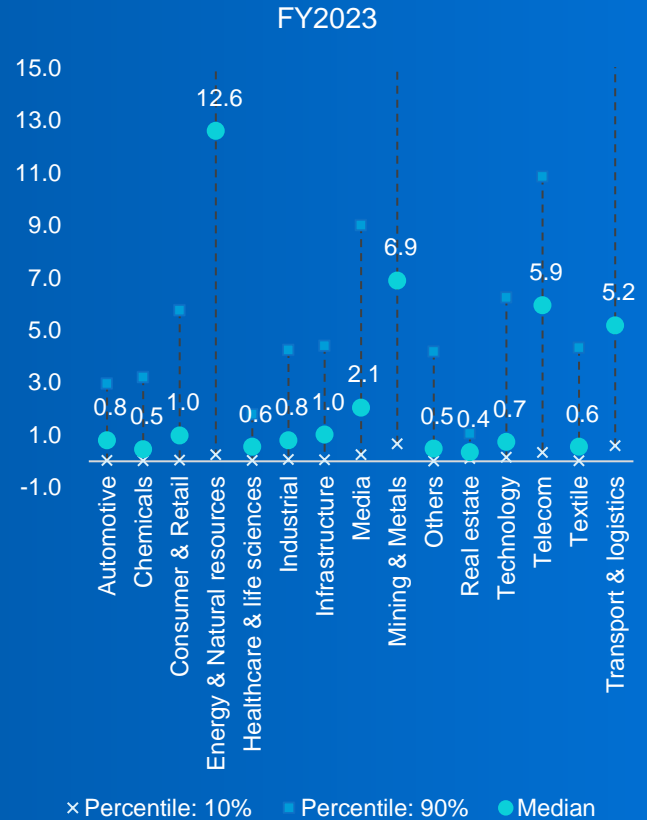
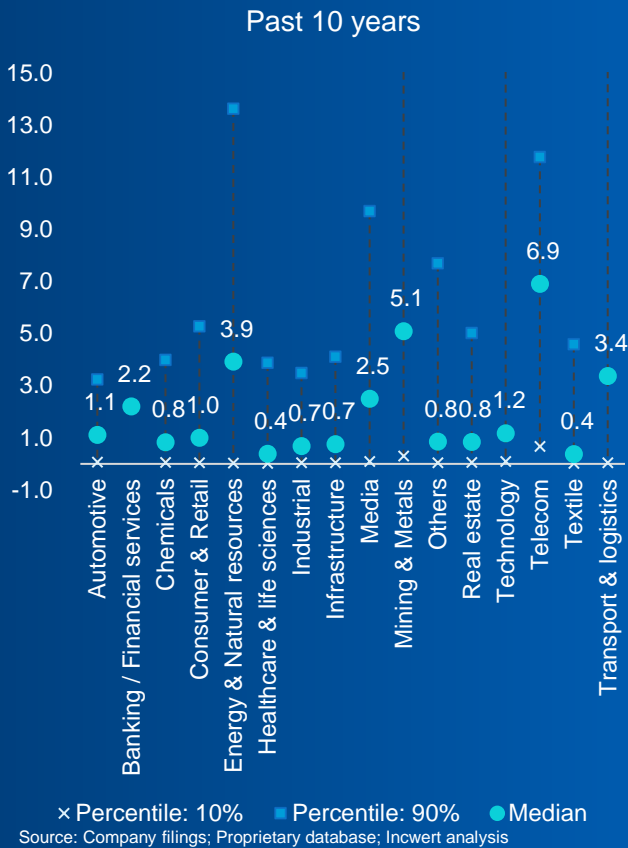
Furthermore, certain sectors in India operate under regulatory frameworks that require entities to pay license fees to the government. Consequently, royalty rates in these industries tend to be higher compared to others. For instance, entities operating in industries such as energy & natural resources, mining, telecom, and airports and ports are subject to government-specified license rates.



The median license fee paid by most of the companies is under 2% of sales, which is lower compared to rates observed in the US (typically 4-5% of sales).

Save for the regulated sectors, license rates in most industries display positive skewness.

Licensing rates (in %)



Caveats:

- The royalty rates presented above may reflect the net royalty rates which may not sync with the gross royalty rates observed in the license agreement.
- The above royalty rates do not assess the comparability of the bundle of rights transferred considering the non-availability of licensing agreements in the public domain in India.
- The relationship between observed market royalty rates as derived above cannot be tested with its commercial rights that are transferred.
- The above-observed royalty rate cannot be analysed to determine whether it compensates the licensor for all functions (ownership rights and responsibilities) associated with the asset or not.
- The data presented above is only a representative of license royalty rates observed in India and there may be several other transactions which we cannot fully identify/analyse.

Royalty rates and the 25 percent rule across industries

The table-1 below presents the comparison between *The Classic 25% Rule*, which is usually used for estimating a baseline royalty based on credible profitability or cost savings to the licensee and the average/median license rates as determined using the financials of the companies. For the purpose of our analysis, the royalty rates implied by the 25% rule are calculated using gross profit margin, EBITDA margin, EBIT margin and PBT margin.

Table-1: Rates From The 25 Percent Rule, & Royalty Rates (past 10 years)

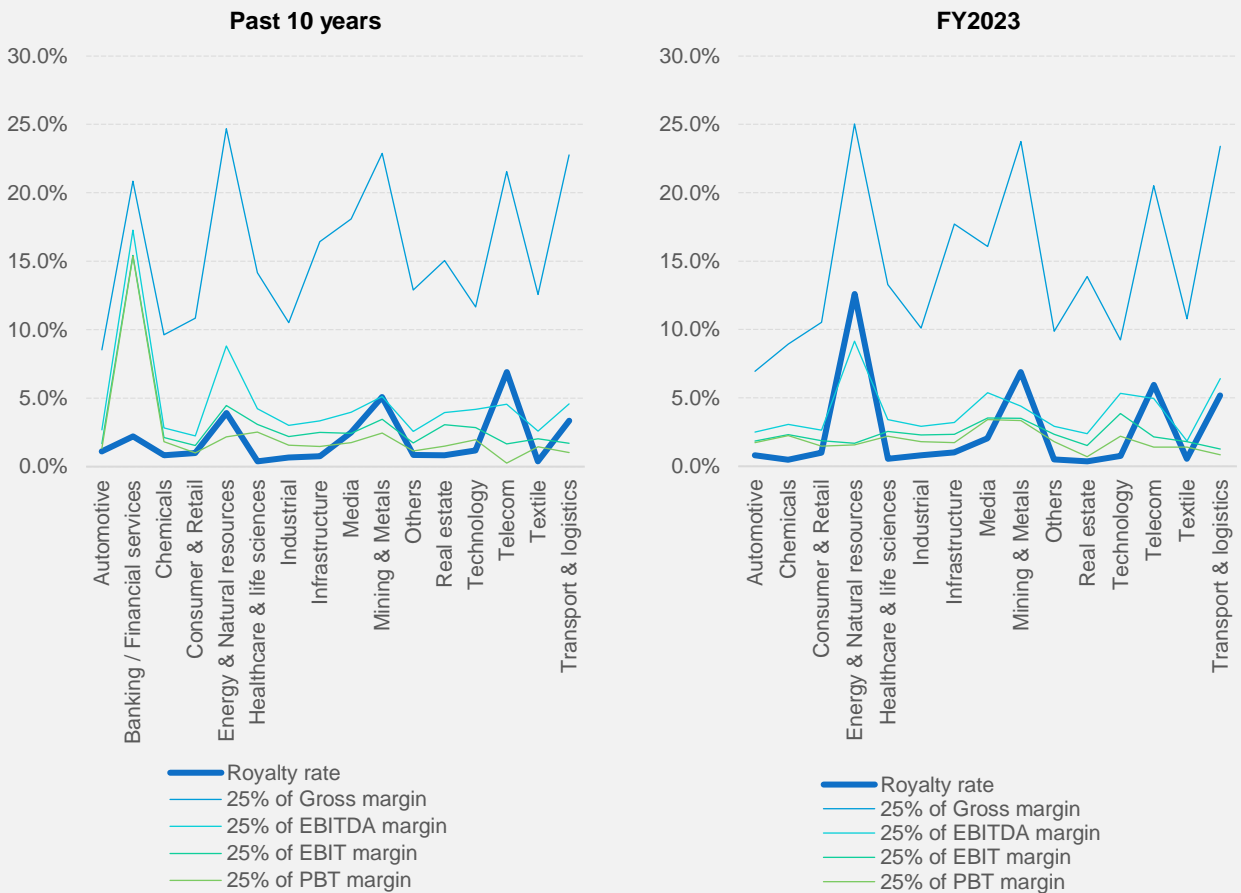
	Gross profit margin	EBITDA margin	EBIT margin	PBT margin
Average profit margin				
- 25% of the average profit margin	16.4%	8.1%	7.5%	4.1%
- Average royalty rates	3.7%	3.7%	3.7%	3.7%
Median profit margin				
- 25% of the median profit margin	11.5%	3.2%	2.4%	2.0%
- Median royalty rates	1.0%	1.0%	1.0%	1.0%

Note: 1) Royalty rate is computed based on the license fee and sales.
 2) Negative values have been discarded in the calculation of the average or median margins.
 Source: Company filings; Proprietary database; Incwert analysis

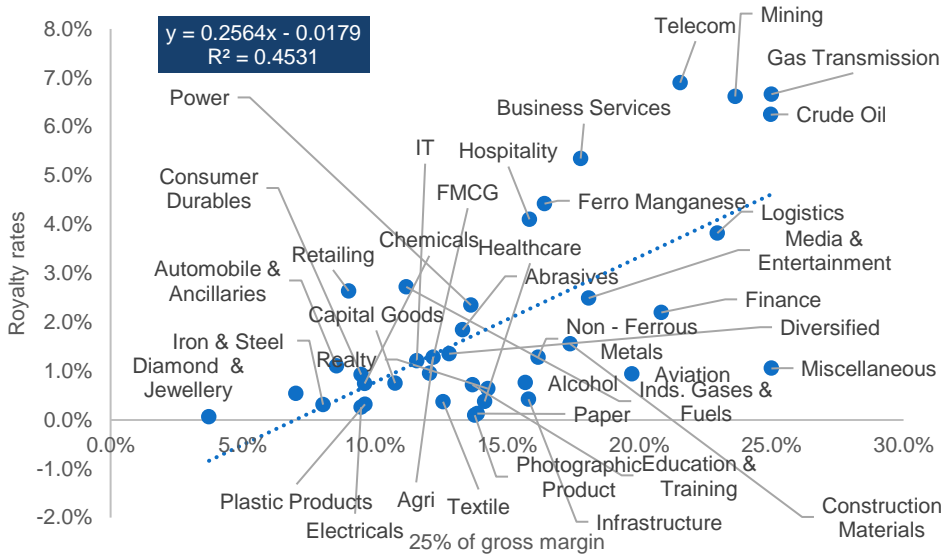
The observed median licensing royalty rates are lower than the 25% Rule values

Possible reasons for such singularities... what we think

Profit Margins and Cost Structure: factors like intense competition and cost-sensitiveness often force licensee companies to be more cautious about royalty expenditure and ensure that profit margin is not unduly dented.
Market Competition: In high-growth markets, companies may negotiate lower royalty rates to reduce their operational costs and stay competitive.
Stage of Commercialisation Cycle: access to intellectual property license early on in the commercialisation stage may lead to lower rates as the licensee company will need to make requisite investments to develop the market.
Technology Maturity and Innovation: lower rates could be because of different focuses in terms of industries and technology maturity.
Legal and Regulatory Factors: As mentioned in the preface, regulatory restrictions on repatriation and the approval process for technical collaboration agreements may affect royalty rates in India. These requirements may impact licensor decisions and contribute to lower rates.



Gross margins explain about 1/2 of the variations across the sub-sectors



	Coefficients	P-value	R-square
Intercept	(0.018)	0.02	0.45
X variable	0.256	0.00	

Source: Company filings; Proprietary database; Incwert analysis

We attempted to establish a linear relationship between the gross margin and the license royalty rates. The regression analysis indicates that the gross margin explains almost 45% of the variations across the sub-sectors. The coefficient for the intercept and the predictor are significant since their P-value is less than 0.05.

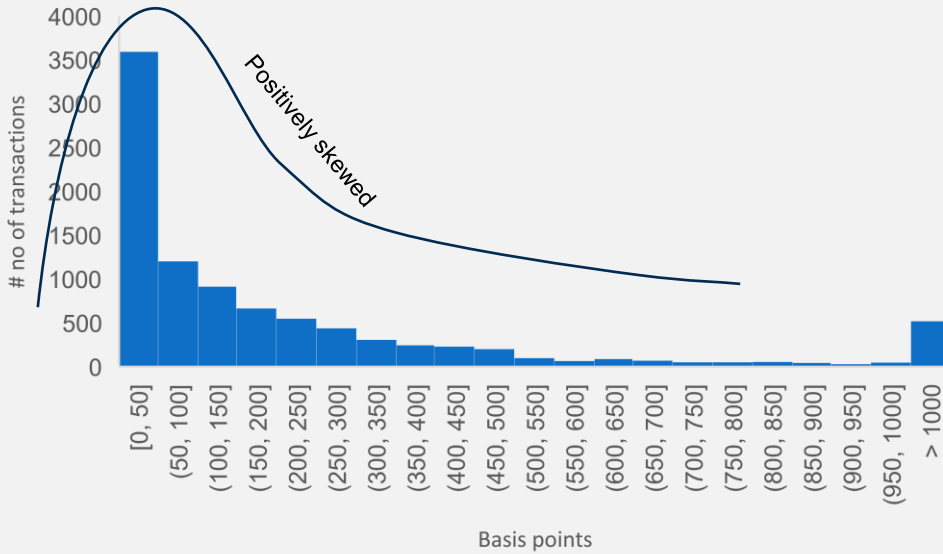
The right-side group largely comprises regulated sectors wherein license rates are government specified.

Sub-sectors	Real estate	Healthcare & life sciences	Consumer & Retail	Industrial	Infrastruct	Chemicals	Others	Mining & Metals	Media	Energy & Natural resources	Technology	Automotive	Textile	Transport & logistics	Telecom	Banking / Financial services	# of data-points
Mining	-	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	306
Diversified	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	58
Construction Materials	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	254
Textile	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	225
Logistics	-	-	-	-	-	-	-	-	-	-	-	-	-	Included	-	-	197
Retailing	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	225
FMCG	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	713
Automobile & Ancillaries	-	-	-	-	-	-	-	-	-	-	-	Included	-	-	-	-	1,768
Chemicals	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	-	616
Capital Goods	-	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	1,510
Paper	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	17
Consumer Durables	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	202
Infrastructure	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	356
Realty	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	225
Iron & Steel	-	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	211
Healthcare	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	-	413
Alcohol	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	71
Plastic Products	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	109
Miscellaneous	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	327
Media & Entertainment	-	-	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	359
Agri	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	199
Electricals	-	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	58
Crude Oil	-	-	-	-	-	-	-	-	-	Included	-	-	-	-	-	-	105
Telecom	-	-	-	-	-	-	-	-	-	-	-	-	-	-	Included	-	221
Trading	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	291
Diamond & Jewellery	-	-	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	38
Ferro Manganese	-	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	17
IT	-	-	-	-	-	-	-	-	-	-	Included	-	-	-	-	-	201
Inds. Gases & Fuels	-	-	-	-	-	-	-	-	-	Included	Included	-	-	-	-	-	25
Education & Training	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	21
Aviation	-	-	-	-	-	-	-	-	-	-	-	-	-	Included	-	-	19
Abrasives	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	-	18
Non-Ferrous Metals	-	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	65
Business Services	-	-	-	-	-	-	Included	-	-	-	-	-	-	-	-	-	7
Photographic Product	-	-	-	-	-	-	-	-	-	-	Included	-	-	-	-	-	7
Power	-	-	-	-	-	-	-	-	-	-	Included	-	-	-	-	-	10
Hospitality	Included	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	38
Gas Transmission	-	-	-	-	-	-	-	-	-	Included	-	-	-	-	-	-	3
Finance	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	Included	2
# of data-points	263	413	1,249	1,779	610	634	1,029	388	359	143	208	1,768	225	216	221	2	9,507

Our findings highlight the importance of the financial health and profitability of businesses in determining the license royalty rates. A higher gross margin could imply a company's ability to invest more in innovation and technology, leading to a greater willingness to pay for valuable licenses. On the other hand, companies with lower gross margins might be more cost-sensitive and, therefore, seek to negotiate lower royalty rates. Understanding this relationship can aid both licensors and licensees in making informed decisions during licensing agreements and negotiations.

Distribution frequency of licensing rates

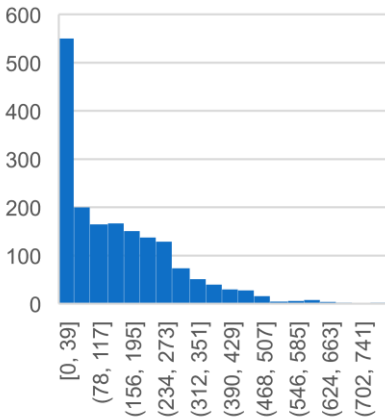
Past 10 years



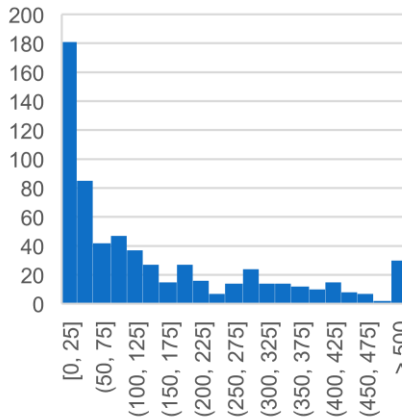
38%, 51% and 68% of the occurrences of royalty rates are lower than equal to 0.5%, 1.0% and 2.0% of sales respectively

The number of occurrences with license royalty between 4-5% is under 5% of the select transactions

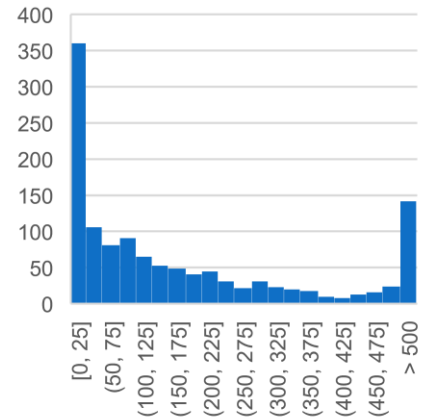
Automotive



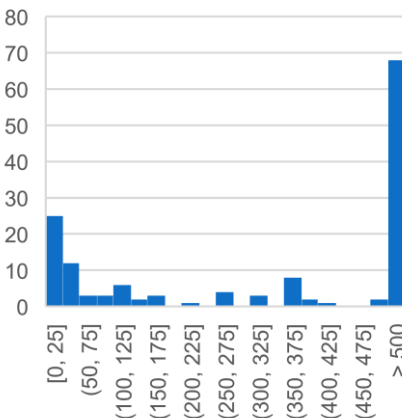
Chemicals



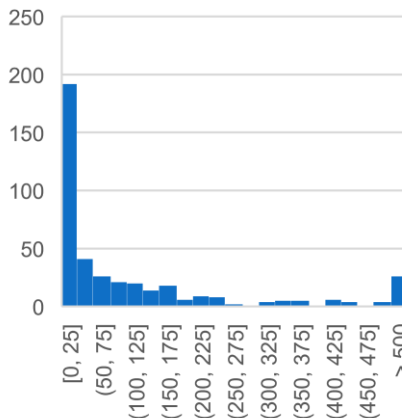
Consumer & Retail



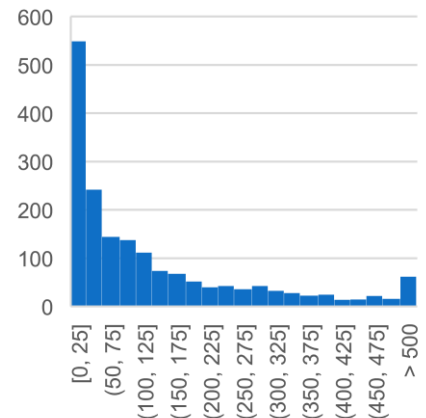
Energy & Natural resources



Healthcare & life sciences

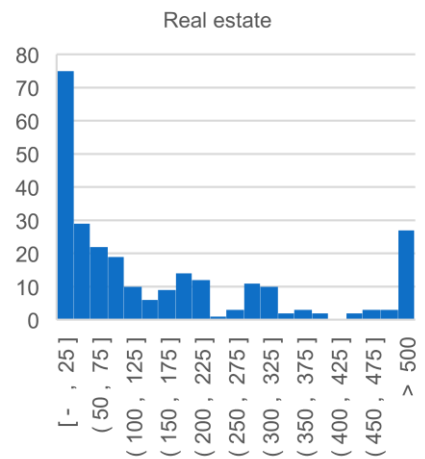
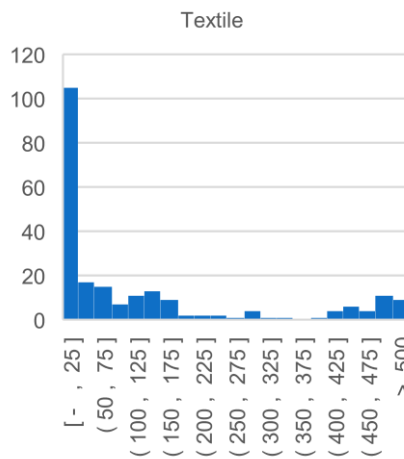
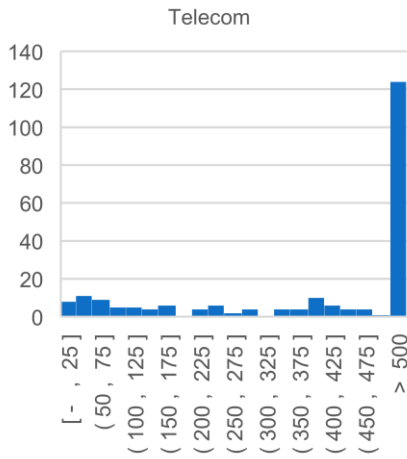
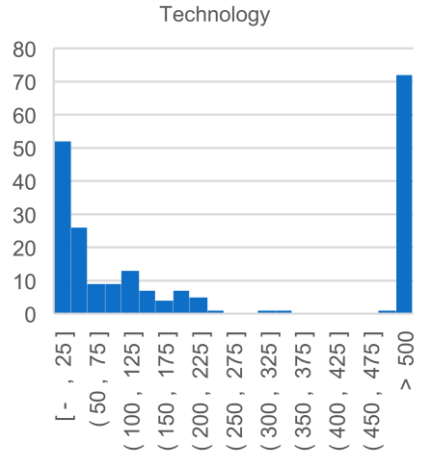
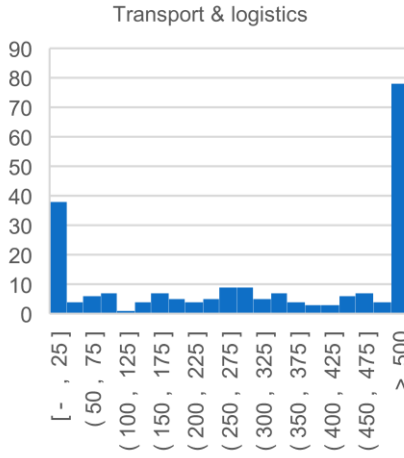
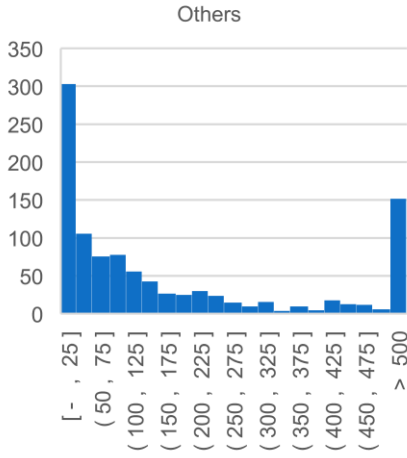
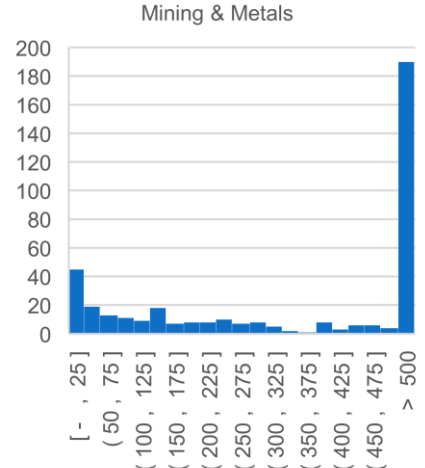
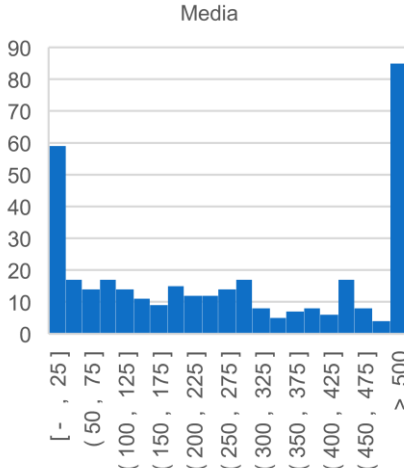
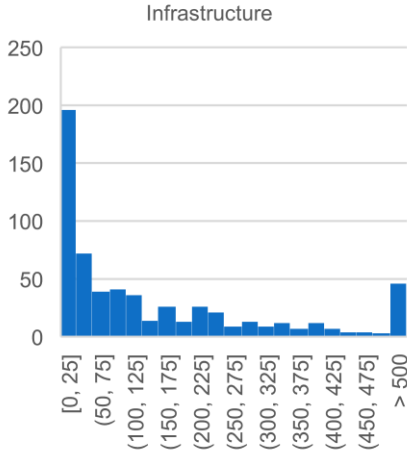


Industrial



Note: 1) The vertical axis shows the number of transactions and the horizontal axis represents the royalty rates in basis points (100 basis points = 1 per cent).
Source: Company filings; Proprietary database; Incwert analysis

Distribution frequency of licensing rates



Note: 1) The vertical axis shows the number of transactions and the horizontal axis represents the royalty rates in basis points (100 basis points = 1 per cent).
 Source: Company filings; Proprietary database; Incwert analysis

Conclusion

There are five particular observations of the study:

- The average and median license royalty rates are lower than the rates observed in the US market. This could possibly be due to various factors discussed in the paper earlier, though actual royalty rates are the result of complex interactions between multiple elements in a specific business and industry context.
- License royalty rates display considerable variation across industries, contingent upon several key license characteristics. These factors include whether the license is bundled or pertains to a single asset, its designated term, exclusivity offered, operating territory, stage of commercialisation, market demand, and payment structure. One illustrative example of this variance lies in the presence of tiered royalty payment structures within license agreements, wherein the actual royalty payments are determined based on the extent of intellectual property (IP) utilisation. As such, an in-depth analysis of these multifaceted elements is imperative to gain a comprehensive understanding of the dynamics influencing royalty rate negotiations and agreements.
- Role of the underlying intangible asset in influencing license royalty rates. Licensing rates may vary significantly based on whether the asset is a routine or pivotal asset.
 - Routine intangible assets are those for which functional substitutes or alternatives are readily available in the marketplace. In such cases, licensors may face greater competition, leading to relatively lower royalty rates. Since potential licensees have multiple options to choose from, licensors must offer competitive rates to attract partners.
 - On the other hand, pivotal intangible assets are those that hold a unique and strategic position in the market, often providing a significant competitive advantage to the licensee. These assets may be groundbreaking technologies, proprietary methodologies, or exclusive rights to critical intellectual property. Given their rarity and value, licensors can command higher royalty rates for the licensing of pivotal assets.
- The regression analysis, with a 45% explanatory power of gross margin on the variations across sub-sectors, suggests a discernible connection between the profitability of businesses (as indicated by the gross margin) and the royalty rates businesses are willing to pay or charge for licensing agreements. The observation, where we attempted to establish a linear relationship between the gross margin and license royalty rates, holds valuable implications for our conclusion. The significance of the coefficients for both the intercept and the predictor (gross margin) - indicated by their P-values being less than 0.05 - further strengthens the credibility of the regression model.

- High occurrence rate of the license royalty rate lower than the Classic 25% Rule suggests that significant licenses in the sample pool may relate to routine intangibles. For example, a large conglomerate offering the use of business names and marks to its affiliated entities for a fee of 0.25% of the annual net income.

It is essential to note that while the gross margin explains a significant portion of the variation in royalty rates, there are other key factors at play that contribute to the remaining variations. We hope that our current findings serve as a strong foundation for future research and provide valuable insights for stakeholders in the realm of licensing and intangible asset valuation.

Keynotes for valuers

Selection of the right comparable royalty rate in valuation will require researching and identifying arm's-length license transactions involving intangible assets that are sufficiently comparable to the subject asset.

For details of license rates in the US, commercial intellectual property license databases such as RoyaltySource and ktMINE are usually relied upon.

Client footprints across India and outside



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Equity Risk Premium
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- Mar 2024



Purchase Price Allocation Study
- January 2024



India Size Premium Study
- November 2023



Control Premium Study-India
- Aug 2023



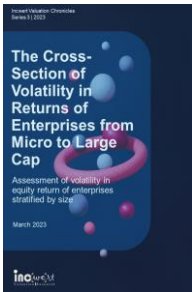
Royalty rates in India
- July 2023



Equity Risk Premium Volatility study
- May 2023



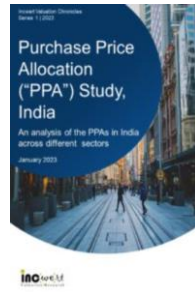
Holdco Discount
- February 2023



Holdco Discount
- February 2023



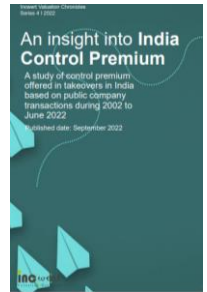
Purchase Price Allocation Study, India
- January 2023



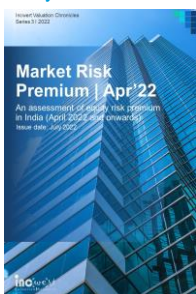
India Size Premium Study
- November 2022



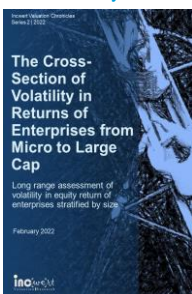
Control Premium Study-India
- Sept 2022



Equity Risk Premium
- July 2022



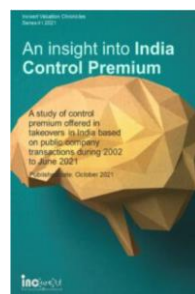
Volatility in returns
- February 2022



Holdco Discount
- January 2022



India control premium study
- October 2021



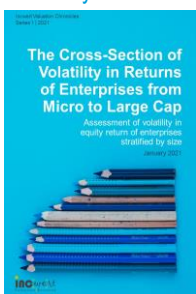
India size premium study
- August 2021



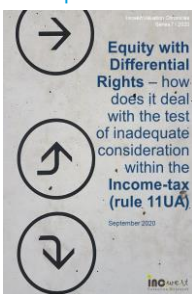
Equity Risk Premium
- May 2021



Volatility in returns
- January 2021



DVR and Rule 11UA
- September 2020



India Control Premium
- August 2020



PPA study (BFSI)
- July 2020



Equity Risk Premium
- June 2020



Holdco Discount
- Mar 2020





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