

# **D P VIPRA COLLEGE BILASPUR CG**



**DEPARTMENT OF COMMERCE**

**VALUATION OF SHARES**

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# Valuation of shares

## Need for valuation:

1. At the time of amalgamation.
2. When loan is granted on the security of shares.
3. When preference shares or debentures are converted into equity shares.
4. When equity shareholders are to be compensated on acquisition of their shares by the govt. under a scheme of nationalisation.

# Factors affecting valuation of shares

- Nature of the business
- Demand and supply for shares
- Govt. policy
- Past performance of the company
- Growth prospectus of the company
- The management of the company
- The economic climate
- Accumulated reserves
- Prospects of bonus or rights issue
- Dividend declared etc.

# Methods for valuation

- Net assets basis (or intrinsic value) method
- Yield basis method
- Dual (or fair value) method

# Net assets basis method

## 1. Net tangible assets basis (excluding goodwill)

Under this method, net tangible assets are estimated in order to value the shares.

Net tangible assets = Assets – Liabilities

Assets are taken at their actual values (market values) and not at book values. Fictitious assets like preliminary expenses are excluded. All the liabilities (whether in books or not) are deducted. Non trading assets are also included in the assets. Amount payable to preference shareholders is also deducted.

value of share = net tangible assets/no. of equity shares

## 2. Net assets (including goodwill)

In this method, goodwill is included with other tangible assets for the valuation of shares. Goodwill is taken at its actual value which maybe equal to, more than or less than the book value. There maybe some value of goodwill even if it is not shown in the books.

Example:

Assests = Rs.10,00,000

Liabilities= Rs. 2,00,000

No. of shares= 50,000

Value of share=  $(10,00,000 - 2,00,000) / 50,000 = \text{Rs. } 16$

# Yield method

Following steps are taken for calculating the value of shares under this method:

1. Calculation of average expected future profits (profit available for equity shareholders).
2. Calculation of expected return.

Expected return =  $\frac{\text{expected profits}}{\text{equity share capital}} \times 100$

3. Value of share =  $\frac{\text{Expected rate}}{\text{normal rate}} \times \text{paid up value of one share}$

## Example:

2000, 9% preference shares of Rs. 100 each: Rs. 2,00,000

50,000 equity shares of Rs. 10 each, Rs. 8 per share paid up: Rs. 4,00,000

Expected profit per year before tax: Rs. 2,18,000

Rate of tax: 40%

Transfer to general reserve every year: 20% of profit

Normal rate of earning: 15%



Solution:

(i) Calculation of profit availability to equity shareholders:

	Rs.
Expected profit before tax	2,18,000
Less: tax@40%	<u>87,200</u>
Profit after tax	1,30,800
Less: transfer to general reserve@20%	<u>26,160</u>
Profit after tax and transfer to general reserve	1,04,640
Less: preference dividend @9% on Rs. 2,00,000	<u>18,000</u>
	86,640

(ii) Calculation of expected rate of earnings

Expected rate = profit available / total paid-up equity  
share capital \* 100 =  $86,640 / 4,00,000 * 100 = 21.66\%$

(iii) Calculation of value of an equity share

Value per share - expected rate / normal rate \* paid up  
value of shares =  $21.66\% / 15.0\% * \text{Rs. } 8 = \text{Rs. } 11.55$

# Dual or fair value method

It is simply a combination of the previous two methods.

According to this method,

Value of share =  $\frac{\text{net asset method value} + \text{yield method value}}{2}$

For eg:

Net asset method value: Rs. 10

Yield method value: Rs. 12

Fair value:  $\text{Rs. } 10 + \text{Rs. } 12 / 2 = \text{Rs. } 11$