UNIT -4

Valuation of Shares

Introduction:

There are many circumstances where value of share are required for various accounting purpose. In such cases the value that is taken is not the par value, but the marker value. The market value of a share is nothing but the value quoted in Stock Exchange. However, when the share is not listed in any stock exchange, the market value must be ascertained. Such ascertainment of value of shares is discussed in this chapter.

The various circumstance necessitating valuation of shares are:

- When amalgamation or absorption of companies take place.
- When a block of shares are purchase or sold
- When one class of shares are converted into another class.
- When a company is nationalized
- When shares are to be provided as security for loans and advances
- When shares are to be sold in the absence of a Stock exchange
- When the assets of Finance or Investment Companies are to be valued.

Meaning of Valuation of Shares:

The term valuation of shares refers to the process of ascertaining the intrinsic value or the market value or the value of the shares of a company.

Factors to be considered while valuing the Shares:

- The nature of business of the company
- The stability of earnings of the company
- The earning capacity of the company
- The capacity of management of company
- The demand for and the supply of shares of the company
- The economic and political conditions in the country
- The value of goodwill of the company
- The progress of the company

- The nature of competition

Methods of Valuation of Shares

1. Net Asset Method or Intrinsic Value Method
2. Yield Method
3. Earning Capacity Method

1. Net Assets Method or Intrinsic Value Method:

- Under this method, the value of shares is determined by adding the market values of all assets including unrecorded assets, Goodwill and Investments and deducting from that, the total liabilities payable to outsiders i ,e , Secured loans, unsecured loans and current liabilities. The amt arrived is called ***net value of assets available for share holders.***
- From the value of net assets available to share holders, the total paid up, Preference Share Capital and arrears of preference dividend, if any must be deducted. The resulting balance is the net value of assets available for Equity Shareholders.
- The intrinsic value of each Equity Share is calculated by dividing the net assets available for Equity Shareholders by number of Equity Shares.

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1. Problems on Net Asset Method or Intrinsic Value Method
2. Problems on Yield method
3. Problems on Earning Capacity Method
4. Problems Including Net Asset Method, Yield Method, Fair value Method and Earning Capacity Method
5. 5-Marks Problems

Key points to be remembered:

1. The asset must be considered at their Market values at the time of valuation but not at book value.
2. When there are both fully paid and partly paid shares, the following procedure must be adopted in calculating their market values.

a. Calculate the total value of net assets using the following formula

(Market value of Assets – Total liabilities)+Notional calls on partly paid Equity shares.

b. Deduct the above Total value of Net Assets, the claims of preference shareholders

c. Divide the balance by the total number of Equity shares i , e fully paid shares and partly paid shares.

d. From the value per share obtained, deduct the notional call per share in case of partly paid shares.

e. The value in (c) represents Intrinsic value of fully paid share and the value in (d) represents value of partly paid share.

3. When preference shareholders does not have any preferential right either on capital or on capital or on arrears of dividend. Then the Intrinsic value must be calculated in the following order:

i. Find the Net value of Assets as per format available to both shareholders i ,e, preference and equity.

ii. Apportion the Net value of Asset to preference shareholders and equity shareholders in proportion of their respective capitals.

iii. Divide the "Proportional Net value of Assets "by respective number of shares.

iv. While, calculating the market value of Asset, the fictitious assets like preliminary expenses, underwriting commission, discount of issue on shares and debentures, profit and loss account debit balance etc. must be ignored.

Calculation of Intrinsic value per Share

Particulars	Rs	Rs
Market Value of Assets		
Good will	XXX	
Land & Buildings	XXX	
Plant & Machinery	XXX	
Furniture	XXX	
Patents & Trade Marks	XXX	
Motor vehicles	XXX	
Investments	XXX	
Cash in hand	XXX	
Cash at Bank	XXX	
Sundry debtors	XXX	
Bill Receivable	XXX	
Stock in Trade	XXX	
Prepaid expences	XXX	XXX
Less Total Libailities		
Debentures	XXX	
Mortgage loans	XXX	
Loans	XXX	
Fixed deposits from public	XXX	
Sundry Creditors	XXX	
Bills payable	XXX	
Bank overdraft	XXX	
Unclaimed dividend	XXX	
Provision for taxation	XXX	
Proposed dividend	XXX	
Employees provident Fund	XXX	
Workmen’s Saving Bank	XXX	
Depreciation Fund	XXX	XXX
Net value of Assets available to share holders		XXX
Less Amounts payable to Preference shareholders		
Arrears of preference share dividend	XXX	
Preference Share Capital	XXX	
Net Value of Assets available for Equity Share holders		XXXX

Intrinsic value of equity share =

Problems on Net asset Method or Intrinsic Value Method:

1. From the following information, find out the value of each share:

Balance Sheet of Varun Company

Liabilities	Rs	Assets	Rs
20,000 equity shares of Rs. 10 each	2,00,000	Good will	1,90,000
		Investments	3,00,000
Reserves	2,50,000	Current assets	50,000
Profit and Loss A/c	30,000	Loan and advances	30,000
Unsecured Loans	80,000	Preliminary Expenses	5,000
Current Liabilities	20,000	Discount on Debtors	5,000
Total	5,80,000	Total	5,80,000

For the purpose of valuation of shares goodwill shall be taken at two year's purchase of the average profit of the last five years. The profits for the last five years: Rs. 60,000, Rs. 70,000, Rs. 40,000, Rs. 50,000 and Rs. 50,000

2. Following is the balance sheet of Kavya Ltd as on 31-3-2010

Liabilities	Rs	Assets	Rs
1,000, 8% Preference Shares of Rs. 100 each	1,00,000	Fixed Assets	4,00,000
		Current Assets	2,50,000
30,000 Equity shares of Rs. 10 each	3,00,000	Miscellaneous expenses	20,000
		Discount on Debenture	5,000
Debenture Redemption Fund	50,000	Profit and loss A/c	45,000
6% Debentures	1,00,000		
Depreciation Fund	1,00,000		
Sundry Creditors	70,000		
Total	7,20,000	Total	7,20,000

Calculate the value of the Equity share under net assets method after considering the following information:

1.. Debenture interest is due for 1 Year

2. Current assets include Book Debts of which Rs. 12,000 which were doubtful for which no provision has been made.

Yield Method:

This method assumes that the company would continue to exist and would not dispose of its assets. Under this method the profit available for equity dividend are taken into account while calculating the value of equity share.

Steps to be followed while calculating the value of each Equity Share

Step-1: Calculate the average profits on the basis of available data

Step-2 Calculate the profits available for dividends after deducting provision for tax and various appropriations towards reserves

Step-3: Calculate the profits available for equity dividends by deducting the dicidends payable to preference share holders

Step:4: Calculate the Capitalised profit by using the formula:

Stip-5: Calculate the market Value or yield value of each Equity Share by using the formula

Alternative Method:

An alternative method can be followed to find out the value of equity shares under yield method

Following steps to be followed

Step-1: Calculate the average profits on the basis of available data

Step-2 Calculate the profits available for dividends after deducting provision for tax and various appropriations towards reserves

Step-3: Calculate the profits available for equity share holders

Step -4: Calculate expected rate of return by using the following equation

Step-5: Calculate yield value of share by the following equation;

3. From the following information, calculate the value of an equity share under yield method;
    - The paid up share capital of a company consists of 4000, 15% preference shares of Rs. 100 each and 80,000 equity shares of Rs. 10 each
    - The average annual profit of the company, after providing for depreciation and taxation amounted to Rs. 3,00,000. It is considered necessary to transfer Rs. 40,000 to General Reserve before declaring dicidend
    - The normal return expected by investors on equity shares form the type of business carried on by the company is 10%

4. From the following information, calculate the value of an equity share under yield method;
    - The paid up share capital of a company consists of 2000, 15% preference shares of Rs. 100 each and 40,000 equity shares of Rs. 10 each
    - The average annual profit of the company, after providing for depreciation and taxation (I,e 5000 and 15.000) amounted to Rs. 1,70,000. It is considered necessary to transfer Rs. 20,000 to General Reserve before declaring dividend
    - The normal return expected by investors on equity shares form the type of business carried on by the company is 10%

Earning Capacity Method:

Sometimes, the rate of dividend by a company is much less than the rate of earnings of the company because of writing off of accumulated losses and also retention of profits.

The earning capacity method is an improvement over the yield method and it gives the proper value of Equity Shares;

Steps to be followed to calculate the value of shares:

Step-1: Calculate the rate of earnings of the company by using the formula

Step- 2: Calculation of market value per shareL

5. Following is the summarized Balance Sheet of Vijay lakshmi Ltd:

Liabilities	Rs	Assets	Rs
40,000 Shares of Rs. 10 each	4,00,000	Good will	40,000
Reserve Fund	90,000	Fixed Assets	5,00,000
Profit & Loss A/c	35,000	Current Assets	2,00,000
9% Debentures	1,00,000		
Current liabilities	1,30,000		
Total	7,40,000	Total	7,40,000

On March 31, 2002, the fixed assets were independently valued at Rs. 3,50,000 and the good will at Rs. 50,000, The Net profits for the three years were; Rs. 51,600, Rs. 52,000, Rs. 51,650 of which 20% was placed under reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%.

Compute the value of each equity share by assets method and yield method and also in earning capacity method.

Problems on Net asset method and yield method:

6. Following is the Balance Sheet of Prarthana Ltd as on 31/3/2006

Liabilities	Rs	Assets	Rs
Equity share capital of Rs 10 each	16,00,000	Good will	2,00,000
		Other fixed Assets	24,00,000
Reserves & Surplus	3,00,000	Current Assets	4,00,000
10% Debentures	4,00,000		
Creditors	4,00,000		
Provision for tax	3,00,000		

Total	30,00,000	Total	30,00,000

On the above date, an independent valuation of goodwill and other fixed assets was made at Rs. 3,00,000 and Rs, 30,00,000 respectively. Current assets include Debtors Rs. 2,00,000 out of which 15% is bad. The net profits of the company for the past 3 years were Rs. 2,40,000, Rs. 2,80,000 and Rs. 3,05,000 of which 20% was placed to reserve. The normal rate of return is 10%. Calculate the value of share net asset method and yield method.

7. From the given Balance Sheet and other information you are required to ascertain the value of equity shares under:

- Intrinsic value method
- Yield method and
- Fair value method. Ignore taxation

Balance Sheet of Lakshmi Ltd as at 31-3-2007

Liabilities	Rs	Assets	Rs
2,000 shares of Rs. 100 each	2,00,000	Land & Buildings	1,10,000
General Reserve	40,000	Plant & Machinery	1,30,000
P&L A.c	32,000	Patents and trade marks	20,000
Creditors	1,28,000	Stock	48,000
Bills payable	60,000	Debtors	88,000
		Cash at Bank	52,000
		Preliminary expenses	12,000
Total	4,60,000	Total	4,60,000

An Independent valuer valued the assets of the company as under:

Land and Buildings Rs. 2,40,000, Goodwill Rs. 1,60,000 and Plant and Machinery Rs, 1,20,000. The other assets are worth their book value

The profits of the company have been as follows:

2004-2005 – Rs. 80,000

2005-2006 – Rs. 90,000

2006-20007 – Rs. 1,06,000

The Company follows the practice of transferring 25% of profits to general reserve. Normal rate of return is 12%.

8. The following details are obtained from the books of Nitya Ltd as on 30th June 2008

a.	Share Capital	
	5,000 equity shares of Rs. 10 each fully paid up	50,000
	5,000 equity shares of Rsl 10 each Rs. 7.50 per share paid up	37,500
	5,000 equity shares of Rs. 10 each Rs. 5 Per share paid up	25,000
b	General Reserve	25,000
	Liabilities	62,500
	Fixed Assets	90,000
	Current Assets	1,00,000
	Normal average profit (less tax)	15,000
	Estimated rate for capitalization purpose is 10%	
	Transfer 20% of profits after tax to General Reserve	

Calculate the value of each type of shares by

A/ Assets – backing method, and B. Yield method.

9. The following details are obtained from the books of Shabari Ltd as on 30-6-2002

Share Capital	
10,000 Equity shares of Rs. 10 each fully paid up	1,00,000
10,000 Equity shares of Rs. 10 each Rs. 7.50 paid up	75,000
10,000 Equity shares of Rs. 10 each Rs. 5 paid up	50,000
General Reserve	50,000
Liabilities	1,25,000
Fixed Assets	1,80,000
Current Assets	2,20,000

The normal average profit (less tax) of the company is estimated at Rs. 30,000 and the estimated rate for capitalization purpose is 10, transfer to General Reserve 20%. Calculate the value of each type of shares by

- Asset Backing Method (excluding goodwill)

- Yield Method

10. On 31-3-2010 the Balance Sheet of Sanjana Ltd. Was as follows

Liabilities	Rs	Assets	Rs
5,000 shares of Rs. 100	5,00,000	Land & Building	2,20,000
Profit & Loss A,c	1,03,000	Plant and Machinery	95,000
Bank overdraft	20,000	Stock	3,50,000
Creditors	77,000	Sundry Debtors	1,55,000
Provision for tax	45,000		
Proposed Dividend	75,000		
Total	8,20,000	Total	8,20,000

The net profits of the company after deducting all working charged and providing for depreciation and taxation were as under

Financial Year

2005-2006 – Rs. 85,000

2006-2007 – Rs.96,000

2007-2008 – Rs. 90,000

209-2010 – Rs. 95,000

On 31-3-2010, Land and Building was revalued at Rs. 2,50,000, Plant and Machinery at Rs. 1,50,000 and goodwill at Rs. 1,50,000. The normal rate of return is 10%

You are required to ascertain the value of Equity Share sunder

- Intrinsic Value method
- Yield method
- Fair value method

5-Marks problems:

11. Following information relates to Deepika Ltd.,

- 4000, 10% preference share of Rs. 100 each Rs. 4,00,000
- 5,000 equity shares of Rs, 100 each Rs. 5,00,000
- Rate tax – 38%

- Transfer to be made to Reserve - 20%
- Normal Rate of return – 15%

12. Following is the Balance Sheet of Pooja Ltd, as at 31-3-2007

Liabilities	Rs	Assets	Rs
Equity shares of Rs. 10 each	8,00,000	Fixed Assets	12,00,000
Reserve Fund	1,00,000	Current Assets	3,00,000
12% Debentures	2,00,000		
Current Liabilities	4,00,000		
Total	15,00,000	Total	15,00,000

The profits of the company for the past 3 years before charging interest on debentures were Rs. 1,52,000, Rs. 1,56,000 and Rs. 1,54,000 respectively. Normal rate of return is 12%. You are required to ascertain the yield value shares assuming that 20% of the profit is transferred to reserve fund each year (ignore taxation)

13. From the following particulars of Vinod Ltd, Compute the value of shares under yield method

- Equity Shares of Rs. 10 each – Rs. 8,00,000
- Profits for the last three years – Rs. 75,000, Rs. 78,000 and Rs. 87,000
- 20% is transferred to Reserve
- Normal rate of return – 10%

14. Following are the particulars of Rachana Ltd

- Equity Shares of Rs. 10 each - 4,00,000
- 5% Debentures – 1,00,000
- Current liabilities – 1,30,000
- Current Assets – 2,00,000
- Fixed Assets – 5,50,000
- Good will – 50,000

Compute the value of shares under Net Asset Method

15. From the following details, calculate the value of each Equity shares on yield bases method:

- 5000, 9% Preference Shares of Rs. 100 each - Rs/ 5,00,000
- 1,25,000 Equity shares of rs. 10 each Rs. 8 paid up – Rs. 10,00,000
- Expected Profits per year before tax – Rs/ 5,45,000
- Rate of Taxation - 40%
- Transfer to General Reserve every year – 20% profit after tax
- Normal rate of return – 15%

2- Marks Questions:

1. What is meant by valuation of shares
2. What are the circumstances under which shares are valued?
3. How do you calculate intrinsic value of shares
4. State any two factors to be considered for valuation of shres
5. How do you calculate the value of shares under break-up method
6. What is the fair value of share
7. State any four reasons for valuation of shares
8. State the methods of valuation of shares