

Unit – II Valuation of Shares

necessary to value the shares in the following circumstances. Purpose

Need (i) When unquoted shares are to be sold by the shareholders.
 (ii) For Estate Duty purpose.
 (iii) At the time of amalgamation, absorption and reconstruction.
 (iv) If loan is to be raised on the security of shares.
 (v) Conversion of one class of shares into another class.

There are three methods of valuation of shares viz.
 (1) Net Assets Method, (2) Yield Method, (3) Fair Value

This method is also called balance-sheet method or asset backing method, or intrinsic or break-up value method. Under this method, an attempt is made to determine as to how much amount per share a shareholder will receive on the date of determination of the value of shares. For this purpose, it is necessary to determine the net assets of the business as on that date. Net assets mean the total of **realisable** assets including non-trading investments and goodwill less the total of third party liabilities. As only realisable assets are to be taken, the items such as preliminary expenses, discount on debentures/shares, underwriting commission, Profit & Loss A/c (debit balance) etc. appearing under the heading "Miscellaneous Expenditure & Losses" are not to be taken into consideration. Similarly, realisable values and not the book-values are to be considered.

The intrinsic value per share is arrived at by dividing the value of net assets by the number of shares issued and subscribed.

3. Realisable Values : If realisable values of any assets are not mentioned, their book-values are to be taken as realisable values.

This method is generally not recommended for going concerns as yield or earning is the main factor in their case. However, it is suitable for investment companies and the companies having highly uneven past results.

(i) Intrinsic Value per Equity Share is arrived at as under : format

Present or Market Value i.e. Realisable	—
Value of all tangible Assets	—
Value of Goodwill	—
Less : Third party liabilities	—
Contingent liabilities, including arrears of Preference Shares dividend	—
Preference Share Capital (Provided they have Preference over Equity Shares for repayment of capital.)	—
= Amount available for Equity Shareholders	—

$$\text{Intrinsic Value per share} = \frac{\text{Amount Available}}{\text{Number of Equity Shares Issued \& subscribed}}$$



3. Fair value of share method

Most of the accountants feel that the net asset method and yield value method for valuing the shares are defective. Each method has certain limitation e.g. In case of yield method the normal rate of return in similar business is taken but it varies depending upon general factors like the bank rate, economical and political condition of the nation, period of investment & so on. Hence fair value is preferred by these people as it is an average of the two method of valuation of shares.

$$\text{Fair value of share} = \frac{\text{Intrinsic value of share} + \text{Yield/market value of share}}{2}$$

2. Yield value method or Market value method

Under this method the valuation of shares depends upon the comparison of the company's earning capacity and the normal rate of return or dividend that is current in outside investment. To ascertain the value of shares based on earning capacity of the business, the future maintainable profit and normal rate of return at which the profits are to be capitalized must be fixed. The yield value of share is calculated by applying the following formula.

$$\text{Yield value of share} = \frac{\text{Expected rate of dividend}}{\text{Normal rate of return}} \times \text{Paid-up value of share}$$

OR

$$= \frac{\text{Rate of dividend per share in peps}}{\text{Normal rate of return}} \times 100$$

For the calculation of expected rate of dividend the average profit is ascertained. From the average profit the amount of provision for taxation, transfer to general reserves and the dividend on preference shares are deducted. Thus, the profit remained is known as 'adjusted profit' or 'profit available for dividend to equity shareholder' or 'Expected profit for dividend'.

$$\text{Expected rate of dividend} = \frac{\text{Expected profit for dividend}}{\text{Paid-up share capital}} \times 100$$

Thank u