

Valuation of shares

In case of shares which are quoted on the stock exchange, the value of the share can be obtained from the daily list of prices published by stock exchanges. Although in some cases the stock exchange prices do not reflect the true value of shares, in many cases the prices of shares are not related directly to the value of a company's assets or to the amount of its profits and consequently, these quotations cannot form a fair and basis for valuation of shares. So, share of such a company are to be sold or pledged, the value of such share will have to be ascertained.

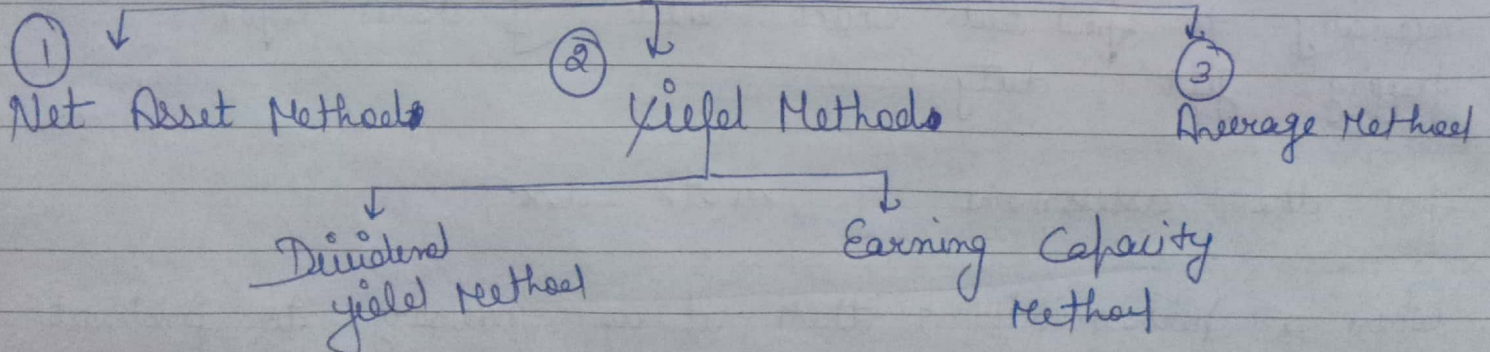
Need of valuation of shares There are following needs for the valuation of shares

- ① When shares are received as a gift, it may be necessary to find out ^{the} exact value of shares for paying gift duty.
- ② for the assessment of wealth tax.
- ③ When a person dies, then it is necessary to find out

the value of shares for paying death duties.

- ④ for purchase and sale of shares in private companies
- ⑤ for formulating amalgamation and internal reconstruction schemes
- ⑥ for compensating the shareholders when the company is nationalised.
- ⑦ when shares of one class are to be converted into shares of another class.
- ⑧ when shares are pledged as a security for a loan.

Methods of Valuation of shares



① Net Asset \Rightarrow This Method is known as Break up value Method, Intrinsic Value Method, Assets valuation or Assets backing Method.

$$\text{Value of Shares} \Rightarrow \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

1st Method

Net Assets \Rightarrow To calculate net Assets
 \rightarrow All Assets (~~including~~ ^{Excluding} fictitious Assets)
at Market value.

dem Outside liabilities (whether long term or short term)

dem Preference share Capital \rightarrow or Preference dividend

2nd Method \Rightarrow To calculate net Assets

Net Assets \Rightarrow Equity share Capital + Reserve & surplus +
Accumulated Profits + Profit on Revaluation of
Assets - Accumulated losses - Preliminary Expenses.

Suitability: ① where a scheme of amalgamation is to be formulated
② when it is intended to liquidate the company
③ where reliable information about Earning Capacity of the Company is not available. As in the case of newly established Co.

②

Yield Method :- This method is divided into two parts :-

(a) Dividend yield Method :- Under this Method, the value of the shares is calculated by comparing the expected rate of dividend of this concern with the normal rate of dividend as prevailing in that Industry :-

$$\text{Value of Share} = \frac{\text{Expected Rate of Dividend} \times \text{paid up Value of Share}}{\text{Normal Rate of Dividend}}$$

There are two elements to be ascertained in order to calculate the value of a share :-

① Ascertaining the Expected Rate of Dividend

② Ascertaining the Normal Rate of Dividend

One would expect a higher normal rate of return for investing in business which are riskier.

ERD \Rightarrow Profit of the Company

(less) Income Tax

Transfer to Reserve

Transfer to Debenture sinking fund

Preference Dividend

X 100

Final value of Equity Share Capital

Suitability! ① This method is appropriate for an investor who wishes to hold the shares for a short term.

- ② when there are no past losses and the firm is declaring regular dividends.
③ where there are no plans to liquidate the Co. in near future.

② Earning Capacity Method → This Method is ~~ap~~ appropriate to find out the value of shares on the basis of Earnings of the Company. In this Method, the rate of earning of the Company is compared to the normal rate of return prevailing in the Industry. The formula is :-

$$\text{Value of Shares} = \frac{\text{Rate of Earnings}}{\text{Normal Rate of Return}} \times \text{Paid up value of Share.}$$

There are two elements to be ascertained in order to calculate the value of a share :-

① Rate of Earnings

Normal Rate of Returns

one would expect a higher normal rate of return for Industry in Business

$$\text{① Rate of Earning} = \frac{\text{Estimated future Earning}}{\text{Capital Employed}} \times 100$$

Estimated future Earning \rightarrow Profit of Company after Tax but before the following \rightarrow

- (a) Interest on Debenture
- (b) Preference Dividend
- (c) transfer to General Reserve

Capital Employed

$\times 100$

Here Capital Employed = All Assets (excepting all fictitious Assets) - Current Liabilities

Suitability :-

This Method is appropriate when the earning of Company is stable, ~~more~~.