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GOVT. COLLEGE FOR GIRLS, LUDHIANA

ADVANCED ACCOUNTING VALUATION OF SHARES

Methods of Valuation

1) Net Asset Method/Intrinsic Value Method/Book Value Method

$$= \frac{\text{Net Assets}}{\text{Number of equity shares}}$$

Net Assets= Fixed Assets (Revised Value) + Investment (Revised Value) + Current Asset (RV) ----Outside liabilities ---Preference share capital ---Preference Share dividend (if arrears)

Outside liabilities = Sundry creditors + B/P + o/s Expenses + Provision for Tax + Proposed Dividend + Bank O/D + Bank Loan + Debentures + Mortgage + Deposits from public etc.etc.

Note—Fictitious asset will not be considered.

Or

= Equity Share capital + Reserve and surplus + Profit on revaluation of asset – Loss on revaluation of asset & Liabilities –Fictitious assets

2) Yield Basis/Market Value Method

$$= \frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} \times \text{Paid up value of share}$$

Expected Rate of Return = $\frac{\text{Expected Profit for equity}}{\text{Equity Share capital (Paid up)}} \times 100$

Expected Profit—

Average Profit after tax	= xx
Less: Preference Share Dividend	= (--)
Less: Transfer to Reserve Fund	= (--)
	xx

3) Fair Value Method/ Dual Price Method

$$= \frac{\text{Value of share by Net Asset Method + Value of Share by Yield Basis}}{2}$$

Question 1 (05 S) From the following information, you are required to value the equity shares:

Assets at book value	Rs 6,00,000
2000, 6% preference shares of Rs 100 each	Rs 2,00,000
30000 equity shares of Rs 10 each	Rs 3,00,000
Sundry liabilities	Rs 1,00,000

To market value of ½ of the assets is considered at 10% more than the book values and that of remaining at 5% less than the book values. There was a liability off Rs 5000 which remained unrecorded. Assume preference shares have no priority as to repayment of capital or dividend.

Answer—

Sundry Assets (3,00,000 + 10% + 3,00,000 ---5%)		= 6,15,000
Less: Liabilities		
Sundry Liabilities	1,00,000	
Unrecorded Liabilities	5,000	(105000)
Net Assets		5,10,000

Value of Share = $\frac{\text{Net Assets}}{\text{No of shares}}$ = 5,10,000/50,000 = 10.20

Total Shares = 30000 equity shares of Rs 10 + 20000 Preference shares of Rs 10 = 50000 shares

OR

Net Assets divided among equity and Preference shares in 3:2

Therefore, share of equity in Net Asset = 510000 X 3/5 = 306000

Value of Share = 306000 /30000 = 10.20

Question 2 (04 A)--

Answer—

Particular	**Amount**
Expected Profit for the year before Tax **Less:** Tax 50%	2,18,000 (1,09,000)
Expected profit after tax **Less**: Transfer to General Reserve (20%)	1,09,000 (21,800)
 Less: Preference Share Dividend (2,00,000 X 9 %)	87,200 (18,000)
Expected Profit for equity	69,200

Expected Rate of Return = $\frac{\text{Expected Profit for equity}}{\text{Equity Share Capital}}$ X 100

Expected Rate of Return = $\frac{69,200}{4,00,000}$ X 100 = 17.3%

Value of share = $\frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}}$ X Paid up value of share

= $\frac{17.3}{15}$ X 8 = 9.23

Question 3 (13)

Answer—

Intrinsic Value Method

Value of Share = $\frac{\text{Net Asset}}{\text{No of equity Shares}}$ = $\frac{5,32000}{2000}$ = 266

Net Assets= L & B + Goodwill + Plant + Patent + Stock + Debtor + Bank – Sundry Creditors – Income Tax Provision= 240000 + 160000 + 120000 + 20000 + 48000 + (88000 –8000) 80000 + 52000 –128000 – 60000 = 532000

Yield Method

Value of Share = $\frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}}$ X Paid up Value of Share

Average Profits = $\frac{80000 + 90000 + (1,06,000 - 8000)}{3}$ = 89,333.33

Average Profits = 89333.33

Less: Transfer to Reserve (25%) = (22,333.33)

Expected Profit for Equity = 67,000

Expected Rate of Return = $\frac{67000}{2,00,000}$ X 100 = 33.5

Value of Share = $\frac{33.5}{10}$ X 100 = 335

Fair Value Method

Value of Share = $\frac{\text{Value of Share by Net Assets + Value of Yield basis}}{2} = \frac{266 + 335}{2} = 301$

Question 4 (07 S)— From the following information relating to MKP Ltd., calculate the value per equity share:

Issued equity share capital	10,000 shares of Rs 10 per share
Paid up equity share capital	10,000 shares of Rs 10 per share, Rs 8 paid up
6% Preference share capital	1,00,000 shares of Rs 10 per share fully paid up
Annual transfer to general reserve	20% of the profit after tax
Rate of Tax	50%
Expected profit before tax	Rs 2,00,000
Normal rate of return	20%

Answer—

Profit before tax	2,00,000
Less: 50% Tax	(1,00,000)
Profit after tax	1,00,000
Less: Transfer to General Reserve (20%)	(20,000)
Less: Preference Share Dividend	(6000)
Expected Profit for equity	74,000

Expected Rate of Return = $\frac{74000}{80,000} \times 100 = 92.50\%$

Value of Share = $\frac{92.50}{20} \times 8 = 37$

Question 5 (08 S)- You have been given the following information regarding X Ltd. and Y Ltd.

Share capital of X Ltd. is Rs 8,00,000 and Y Ltd. is also Rs 8,00,000. X Ltd. distributes 50% of its profits as dividend while Y Ltd. distributes 60% of its profits as dividend.

Annual profits of X Ltd. is Rs 2,00,000 and of Y Ltd. is also Rs 2,00,000. Find out the value of shares of each of X Ltd. and Y Ltd. Normal rate of return is 10% p.a. Each share of both the companies is of Rs 100 paid up value.

Answer--

	X Ltd.	**Y Ltd.**
Annual Profit	2,00,000	2,00,000
Less: Transfer to Reserve Fund	(1,00,000)(50%)	(80,000) (40%)
Expected Profit for equity	1,00,000	1,20,000
Expected Rate of Return=	100000/800000X100 = 12.5%	120000/800000 X 100 = 15%
Value of Share	12.5/10 X 100 = 125	15/10 X 100 = 150

Question 6 (09 A) The capital of C Ltd. consist of 1000, 6% preference shares (Participating) of Rs 100 each and 4000 equity shares of Rs 100 each, all fully paid. The preference shares are entitled to participate in the surplus profit upto 4% after payment of equity dividend of 10%. The profit after taxation Rs 70,000. The normal return expected on equity shares at 10% and on preference share is 8%. Compute the value of preference share and equity share.

Answer-

Average Profit	70,000
Less: Preference Share Dividend 6000	

Less: Equity Share Dividend 40000	(46000)
	24000
Less: Preference Share Dividend (Participating 4%)	(4000)
Profit for equity	20,000

Total Profit available for equity (20,000 + 40,000) = 60,000

Expected Rate of Return (Equity) = $\frac{60,000}{4,00,000} \times 100 = 15\%$

VOS (Equity) = $\frac{15}{10} \times 100 = 150$

VOS (Preference) = $\frac{10,000}{1,00,000} \times 100 = 10\%$

VOS = 10/8 X 100 = 125

Question 7 (10 S)— From the following information, calculate the value of an equity share.

(i) The paid up share capital of a company consists of 1000 15% preference shares of Rs 100 each and 20000 equity shares of Rs 10 each.

(ii) The average annual profits after taxation amounted to Rs 75000. It is considered necessary to transfer Rs 10000 to general reserve before declaring any dividend.

(iii) The normal return expected by investors of equity shares from the type of business carried on by the company is 10%.

Answer—

Average Profit	75,000
Less: General Reserve	(10,000)
Less: Preference Share Dividend	(15000)
Profit for equity	50,000

Expected Rate of Return = $\frac{\text{Profit For Equity}}{\text{Equity Share Capital (Paid up)}} \times 100$

$= \frac{50000}{2,00,000} \times 100 = 25\%$

Value of share = $\frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} \times \text{Paid up value of share}$

$= 25/10 \times 10 = 25$

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