

Valuation of shares

SOL.1. Calculation of Average Capital Employed

	Rs.	Rs.
Fixed Assets		4,50,000
Current Assets Rs.(5,20,000 – 10,000)		5,10,000
	Rs.	9,60,000
Less: Bank overdraft	10,000	
Creditors	60,000	
Provision for taxation	1,10,000	1,80,000
Capital employed		7,80,000
Less: Half of the profit after tax of the current year		1,09,200
Average capital employed		6,70,800
Calculation of Average Adjusted Profits		
Total profits for last 3 years		9,70,000
Less: Provision for bad debts		10,000
		9,60,000
Average Profit		3,20,000
Less : Depreciation on revaluation of fixed assets 10% (Rs.(4,50,000 – 3,70,000))		(8,000)
		3,12,000
Less : Income Tax @ 30%		(93,600)
Average maintainable profit		2,18,400
Less: Normal Profit 10% of 6,70,800		(67,080)
Super Profit		1,51,320

Goodwill at 3 years purchases = Super profit x No. of years
 = Rs.1,51,320 x 3
 = Rs.4,53,960

Goodwill as per Capitalization Method = Capitalized value – Actual capital employed
 Capitalized value = (Average maintainable profit x 100) / Normal rate of profit
 = Rs.(2,18,400 x 100) / 10
 = Rs.21,84,000

Goodwill = Rs.21,84,000 – Rs.7,80,000 = **Rs.14,04,000**

Ans.2.

Valuation of Equity Share

	Chelsi Ltd.	Nensi Ltd.
Profit after tax (Rs.)	10,00,000	10,00,000
Less : Pref. Dividend (Rs.)	1,20,000	2,40,000
Profits available to equity shareholders (Rs.)	8,80,000	7,60,000
No. of equity shares	5,00,000	4,00,000
Earning per share	8,80,000 5,00,000 = 1.76	7,60,000 4,00,000 = 1.90
Profit to be distributed	80%	80%
Dividend per share	80% of 1.76 = Rs. 1.408	80% of 1.90 = Rs. 1.52
(i) When controlling shares are sold :	1,408/15 x 100 = Rs.9,39	152/15 x 100 = Rs.10.13
(ii) When controlling shares are sold : Value of share	1.76/15 x 100 Rs.11.73	1.90/15 x 100 = Rs.12.67

In the given problem, no separate market expectation rate is given for preference shares. Since preference shares are fixed-dividend bearing shares, they have a slightly lesser capitalization rate say 13% in this case. Further, Chelsi Ltd., has better preference dividend coverage of 8.83 (10,00,000 / 1,20,000) as compared to Nensi Ltd., 's coverage of 4.17 (10,00,000 / 2,40,000). Accordingly, market expectation rate for Nensi Ltd., should be slightly more say by 0.50%. Thus market expectation rate for Chelsi Ltd. and Nensi Ltd. have been taken as 13% and 13.5% respectively (This rate is subjective).

	Chelsi Ltd.	Nensi Ltd.
Rate of Dividend	12%	12%
Market Expectation Rate	13%	13.5%
Value of a Preference Share	12 / 13 x 100 = Rs.92.31	12 / 13.5 x 100 = Rs.88.99

