Valuation of Shares

Course objective of Unit No. 1

- Given the excert of Balance sheet , Profit and Loss account, dividend and earning history a student will able to apply asset backing method, dividend vlauuation Method or earning capitalization method to estimate the fair value of share.

Learning Objectives of Valuation of share and Bond

- After Studying this Chapter students should able to
- Appreciate the need of valuation of share
- Value Shares by intrinsic Value method, Yield Method and fair value method.
- Value Bonds by Current Yield, YTM and YTC Method.

SESSION OBJECTIVE

- How do we evaluate shares?

Net Asset Method or Intrinsic Value Method

- Add all the assets at market value.
- Deduct: All liabilities (Including debenture and Preference shares)
- Result= Net Asset
- Divided Net Asset by No. of equity shares
- Ascertain the value of shares = (Net Value of Asset – Liabilities- Pref. Shareholding claim)/No. of equity shares

Factors should be consider while evaluating assets

- Goodwill should be values at current cost and book value should be eliminated.
- Inventory:- Raw material, WIP & stock should be valued at cost price. Finished goods should be valued at market Price.
- Fictitious assets should be eliminated e.g. debit balance of P&L a/c, preliminary expenses, discount on issue of shares and debentures.
- Non Trading assets should be valued at market Price.
- Book debts should be valued after earmarking provisions for bad and doubtful debts.
- Fixed assets should be valued at market Price
- All other assets should be valued at book value.

Factors should be consider while evaluating liabilities

- Share Capital: - Both equity and preference share capital should be deducted from assets.
- Provisions: - Taxation and dividend provision should be included in liabilities.
- O/S Expenses: - Adequate Provision should be made.
- Contingent Liabilities: - Adequate Provision should be made for all contingent liabilities.

Yield Basis

- Future maintained Profit are ascertained.
- The normal rate of return is computed.
- The multiplier or the capitalization factor is to be ascertained – (100/ Normal rate of Return)
- Capitalized value of maintainable Profit= Future maintained Profit * Capitalization factor.
- Finally the yield value of the share is compared by dividing the capitalized value of maintainable profit by No. of equity share

Market Value

- Given Profit (PAT) – Preference Dividend
- Capitalization Factor = 100/Normal rate of return
- Capitalization Profit = Profit * Capitalization factor
- Value of equity Shares = Capitalization factor / No. of equity shares

Fair Value Method.

- Intrinsic Value + Yield Value OR Market Value /2

P/E ratio

- P/E ratio = Market Price of Shares/ Earning per share
- Market price of shares = P/E ratio* EPS
- Normal rate of return is the earning rate of return of the company which is determined using the following formula
- Earning rate = (EPS/ Market Price of Shares) * 100
- Studying this formula we can understand that P/E ratio is the reciprocal of normal rate of return.
- PE ratio = 1/ NRR
- Normal rate of return is expresses in percentage
- P/E ratio = (1*100)/ NRR

Valuation of Bond

- Definition of Bond and Bond
- valuation
- Features of Bond
- Types of Bonds
- Reasons for Issuing Bonds
- Risk in Bonds
- Measuring Bond Yield

Definition of 'Bond'

- A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate. Bonds are used by companies, municipalities, states and foreign governments to finance a variety of projects and activities.

Definition of 'Bond'

- A technique for determining the fair value of a particular bond. Bond valuation includes calculating the present value of the bond's future interest payments, also known as its cash flow, and the bond's value upon maturity, also known as its face value or par value..

Definition

- **Par or Face Value -**
- The amount of money that is paid to the bondholders at maturity.
- For most bonds this amount is $1,000. It also generally
- represents the amount of money borrowed by the bond issuer.
- **Coupon Rate -**
- The coupon rate, which is generally fixed, determines the
- periodic coupon or interest payments. It is expressed as a
- percentage of the bond's face value. It also represents the
- interest cost of the bond to the issuer

FEATURES OF BONDS

- A Sealed agreement
- Repayment of principles
- Specified time period
- Interest payment
- Call

TYPES OF BONDS

- Government Bonds
- Municipal Bonds
- Corporate Bonds
- Zero-Coupon Bonds

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REASONS FOR ISSUING BOND

- Reduce the cost of capital
- Effective Tax saving
- Widen the sources of funds
- Preserve and control

RISK IN BONDS

- Interest rate risk
- Default risk
- Marketability Risk
- Callability Risk
- Reinvestment Risk

MEASURING BOND YIELD

- Current Yield
- Yield To Maturity
- Yield To Call

CURRENT YIELD

- The current Yield relates the annual
- coupon interest to the market price. It is
- expressed as: Current Yield =Annual interest/Price

CURRENT YIELD

- When you purchase a bond, you are
- not quoted a promised rate of return.
- Using the information on Bond price,
- maturity date, and coupon payments,
- you figure out the rate of return offered
- by the bond over its life.

YIELD TO CALL

- Some bonds carry a call feature that entitles the issuer to call(buy back) the bond prior to the stated maturity date in accordance with a call schedule for
- such bonds.

Reference

- Security Analysis and Portfolio Management By Punithavathy Pandian
- Security Analysis and Portfolio Management By S.Kevin
- Investment Management By Bhalla