

THE STUDY OF VALUATION OF SHARES BY NET ASSETS METHOD FOR TWO UNLISTED COMPANIES IN NASHIK

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Abstract :

The paper deals with the valuation of shares of the unlisted companies located in the Nashik region. The study primarily focuses on the Net Assets Method of valuation of shares of the companies.

Introduction

In the cases of shares quoted in the recognised Stock Exchanges, the prices quoted in the Stock Exchanges are generally taken as the basis of valuation of those shares. However, the Stock Exchange prices are determined generally on the demand-supply position of the shares and on business cycle.¹ Credible valuations are critical to the efficient working of the capital markets, businesses, government and all its stakeholders. With growing shareholder activism, importance of independent valuations is arising all over the world including India. These actions and options are the result of fear, guesswork, intelligent or otherwise, good or bad investment policy and many other considerations. The quotations what result definitely do not represent valuation of a company by reference to its assets and its earning potential. Therefore, the accountants are called upon to value the shares by following the other methods

“Price is what you pay, Value is what you get” – Warren Buffet

The valuation of the shares of a company involves use of judgment, experience and knowledge. The accountant undertaking this work should possess knowledge of the analysis and interpretation of financial statements backed by a practical appreciation of business affairs and investments. A valuation based on quantitative information alone will not be adequate for a real valuation. It should also be recognised that the method of valuation of shares would vary, depending on the purpose for which it is to be used. Valuation of Securities or Financial Assets is critical for strategic business decisions including fund raising, M&A, Sale of businesses, Strategic business decisions like Family or Shareholders disputes, Voluntary value assessment or may be just to comply with certain regulatory or accounting requirements in India under RBI, Income Tax, Companies Act, SEBI Laws, etc. Better Corporate Governance is also leading to requirement of independent Business Valuations.

In the economical markets, the tradable assets pricing play a fundamental role in resource allocation. Therefore, there is the essential need to understand important factors describing the price of these assets. Financial theories suggest that the value of a share is equal to its present value of expected earnings. The

¹ Financial accounting II- Himalaya Publication- Rajiv S. Mishra, Asif Baig & Rajendra B. Vare- 2017.

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desire to understand the stock pricing in the absence of the uniform and same set of variables that is a representative for expected future results lead to the rapid emergence of the stocks' valuation models, while almost all stocks pricing models and frameworks have a theoretical basis.

Many legislations in India have prescribed valuation methodologies to be applied in specific situations for a particular purpose but more recently, a few legislations have prescribed valuation as per internationally accepted valuation guidelines. Though there are International valuation standards, however not much guidance is available in India on the manner in which specific valuation methodologies are to be applied and different valuer take different assumptions leading to difference in value conclusion. In many cases the valuation also lacks uniformity and generally accepted global valuation practices. Thus, in the absence of standards of business valuation in India, the valuation is more of an art based on the professional experience and exposure of the valuer rather than science based on empirical studies and logics.

Role of a valuer is to consider the facts of each case, understand purpose of valuation and applicable regulatory norms for such transaction. Validation of the inherent assumptions of a business model is critical in any business valuation engagement.

The valuation of securities or financial assets is done best when the complete process is followed beginning with understanding the purpose of valuation, making information requisition to company considering the purpose of valuation, doing financial analysis and normalisation adjustments, understanding industry characteristics and trends, forecasting and validating company performance, considering and applying appropriate valuation approach and performing

- In valuation of goodwill, consideration of the following factors will have a bearing:
 - a) Nature of the industry, its history and the risks to which it is subject to.
 - b) The ratio of liabilities to capital. (f) The nature of management and the chance for its continuation.
 - c) Prospects of the industry in the future.
 - d) The incidence of taxation. (j) The number of shareholders
 - e) The company's history — its past performance and its record of past profits and dividends.
 - f) The basis of valuation of asset of the company and their value.
 - g) Capital structure or gearing.
 - h) Size, location and reputation of the company's products.

Valuation has some important characteristics which are explained below-

In valuation, the objective is to determine the economic worth of an asset or liability. Non-economic considerations do not play a role in value assessment. For example a person may have a liking for some particular Asset due to emotional reasons but these aspects cannot be factored in the Valuation. This could be one reason for difference in the valuation derived and price offered for an asset reconfirming that Price is not same as Value.

In modern finance, the objective of an enterprise is to maximize shareholders' wealth. This was a stark shift from traditional profit maximization theory. Ever since then, the topic of valuation has gained more importance in business parlance. As a follow on, regulatory attention to the subject has also been increasing. Business Valuation is subjective, biased, and at times, speculative. A transaction - in other words, a deal - assumes weight to intuition over rationale. Often so, a rationale adjustment is made as a postmortem to the deal, justifying the value. Market forces of demand and supply, coupled with numerous other factors, mark the closure of a deal. Hence, it is not possible to come up with an absolute "value" of a security; for it is always relative. Two valuers may have two different values for the same security or asset class. And, this may happen even if both of them used the same valuation methods or approaches. Valuers often make up reasons, facts, and assumptions, to substantiate their results.

Valuation is neither a science nor an art. Disclaimers and caveats provide relief to valuers, helping them wash their hands off easily at times of trouble. A valuer runs through a number of facts and assumptions during a valuation work. But, there are only a handful of valuation methods that are generally accepted. The valuer's task is to bring in the various facts and assumptions to the model making appropriate insertions to the method he chooses. But valuation has less to do with valuers. The real stakeholders are the parties themselves, the regulators, and in some cases, the public too. In developed financial markets, there are mechanisms by which stakeholders have legal protection to valuation related differences. Concepts such as fairness opinion or fair value protect the interest of minority shareholders, other stakeholders, lenders, etc. There are law firms that operate only in this area. They provide litigation support to government, investors, minority shareholders, holders of other classes of shares/securities, lenders and creditors, by a specialized engagement called class.

Unlisted means it is not listed on any stock exchanges in India. Public Company is a Company having registration under the Companies Act, 2013/1956 with minimum 3 Directors and 7 lack Paid up capital, which is the one not listed in any Stock Exchange is known as unlisted public company.

Valuation is pivotal in strategic, long term or short term decision making process in cases like reorganization of company, merger and acquisition, extension or diversification, or for launching new schemes or projects. As the application area of valuation moves from financial accounting to financial management, the role of accountant also undergoes a transition. One can also define valuation as Measurement of value in monetary terms.

Measurement of income and valuation of wealth are two interdependent core aspects of financial accounting and reporting. Wealth comprises of assets and liabilities. Valuation of assets and liabilities are made to portray the wealth position of a firm through a balance sheet and to supply logistics to the measure of the periodical income of the firm through a profit and loss account. Again valuation of business and valuation of share are made through financial statement analysis for management appraisal and investment decisions.

Valuation is a process used to determine what a business is worth. Determining a private company's worth and knowing what drives its value is a prerequisite for deciding on the appropriate price to pay or receive in an acquisition, merger transaction, corporate restructuring, sale of securities, and other taxable events. Private companies may include small family-owned enterprises, divisions/subsidiaries of larger private companies, or large corporations.

Valuing a company is at the best of times a tricky and complex business. In case of listed companies the market provides an instant valuation, which changes from minute to minute.

Which is why in case of takeovers an average price, say, over a six-month period, is considered? It gets even more complicated in case of unlisted companies. The price band for an IPO is often a best guess by investment bankers of what the market will bear and is also intended to leave something on the table.

There is, of course, no 'correct' valuation. In the case of unlisted companies the valuations discovered during a bidding process is the best approximation of correctness. In the case of the battle for Corus the valuation went up during the bidding process far above what the stock market was valuing the company. Ultimately valuation is a function of the buyer's expectations about the future.

Given the inherent uncertainties involved, the media should be exceptionally careful while speculating on valuations. Indian newspapers and magazines often value unlisted companies and then use these to estimate the net worth of promoters. These valuations are usually arrived at by assigning multiples to EBITA or the net profit. Often this is with reference to listed companies in the same sector.

Such exercises could be fraught with pitfalls. For one thing the company can hold stakes in other companies which may not be taken into account. Also, the exercise could hurt the company because the 'guesstimate' valuation may put a ceiling on what the unlisted company can expect if it were to tap the market that would be unfair to the owners of the unlisted company. On the other hand an excessively generous valuation can be unfair to potential future investors, who may end up overpaying. Valuation is best left to the market or informed private equity/strategic investors.

The primary objective of this report was to critically investigate valuation procedures for unlisted companies in INDIA. A further objective was to theoretically and empirically investigate existing valuation models and which of these models were currently used by valuers.

It was found during the investigation that the unlisted sector was more complex to value than the listed sector because of the difference in overall regulation between the two sectors. All the models researched in the literature were evaluated and those suitable for this sector were selected for in-depth research.

Literature review:

Literature Review

1) CMA MRITYUNJAY ACHARJEE Associate Vice President, Tax and Chief Internal Auditor, Balmer Lawrie Ltd.- VALUATION OF UNQUOTED SHARES - CBDT ISSUED AMENDED RULE - 11UA - UNDERSTANDING THE IMPACT: the author opines that Valuation of Shares is not a science

and hence determining the fair market value (FMV) of shares can be challenging particularly in case of unquoted equity shares. To deal with these issue, the Income-tax Department had prescribed a specific formula based on “Net Asset Value Approach” under rule 11UA of the Income Tax Rules, 1962. For the basis of valuation of shares the author the book values may be taken into consideration as the current market price of the assets may not be available. the Finance Act, 2017 inserted Section 56(2) (x) so as to widen the scope of taxability of receipt of sum of money or property. Specific Anti-Avoidance Provisions (‘SAAR’) is section 50CA was introduced by the Finance Act, 2017 for tackling with the transfer without adequate consideration. This amendment has been introduced for the purpose of taxing the “indirect” sale Considering the context and–of immovable property. Objective of section 56(2)(x) and section 50CA, the CBDT had come out with Draft Rules earlier (May 2017)

2) Dr. Biraj K Mohanty Rabindra Kr. Singh- "Impact of "Buy back of shares" on Share Prices of the Companies Listed on NSE& BSE"- INSTITUTE OF MANAGEMENT J. K .LAKSHMIPAT UNIVERSITY JAIPUR (RAJ.): the articles concentrates on the fact that Share capital represents owner's contribution in the business. It is rthe life line of an company. The owners are at a wide diasporas. After the share of a company has been allotted to the subscriber, the subscriber has no right over the money gone as proceeds of the shares subscribed. All that the shareholder has is the right to vote at the general meeting of the company but are away from its management. The only option left with the shareholder in order to realize the price of the share is to transfer the share to some other person. But there are certain provisions in the Companies Act which allow the shareholders to sell their shares directly to the company and such provisions are termed as "buy back of shares". Buy back of shares can be understood as the process by which a company buys its share back from its shareholder or a resort a shareholder can take in order to sell the share back to the company. Its an option available to shareholder to exit from the company business.

3) Dr. Vinay Kandpa & Prof P C Kavidayal- A Study Of Dividend Policy And Its Effect On Market Value Of Shares Of Selected Banks In India- IOSR Journal of Business and Management (IOSR-JBM): the author opines that dividend policy is a maneuvering techniques in order to determine the amount and timing of dividend payments. The best suitable dividend policy framed by an organization is one of the crucial issues in corporate finance since it may have an impact on the firm's value and shareholder wealth. The researcher attempts to analyze the effect of dividend policy on shareholder wealth of thirty selected Indian banks listed and traded in Bombay Stock Exchange (BSE).

4) The Validity of Company Valuation Using Discounted Cash Flow Methods Florian Steigerl Seminar Paper Fall 2008: the author used discounted cash flow method of valuation of shares. A special emphasize is being put on the valuation of companies using the DCF method. The author finds that the discounted cash flow method is a powerful tool to analyze even complex situations. However, the DCF method is subject to massive assumption bias and even slight changes in the underlying assumptions of an analysis can drastically alter the valuation results.

Statement of the problem:

The valuation of the shares of a company involves use of judgment, experience and knowledge. The accountant undertaking this work should possess knowledge of the analysis and interpretation of financial statements backed by a practical appreciation of business affairs and investments. A valuation based on quantitative information alone will not be adequate for a real valuation. It should also be recognised that the method of valuation of shares would vary, depending on the purpose for which it is to be used.

A clear understanding of the purpose of valuation is undoubtedly important, but an equally important imperative is to have a full appreciation of the 'value' emanating from common principles. This 'general purpose value' may be suitably modified for the special purpose for which the valuation is done. The factors affecting that value with reference to the special purpose must be judged and brought into final assessment in a sound and reasonable manner.

1) Need of the study:

SOME REASONS TO GET BUSINESS VALUATION (table 3)

a) **Transaction:** A business may grow over time as the utility of its products and services is recognized. It may also grow through an inorganic process, symbolized by an instantaneous expansion in work force, customers, infrastructure resources and thereby an overall increase in the revenues and profits of the entity. Mergers and acquisitions are manifestations of an inorganic growth process. While mergers can be defined to mean unification of two players into a single entity, acquisitions are situations where one player buys out the other to combine the bought entity with itself. It may be in form of a purchase, where one business buys another or a management buy out, where the management buys the business from its owners. Further, de-mergers, i.e., division of a single entity into two or more entities also require being recognized and treated on par with mergers and acquisitions regime as recommended below, and accordingly references below to mergers and acquisitions also is intended to cover de-mergers (with the law & Rules as framed duly catering to the same).

1) **Accounting:** IND AS 113: A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

2) With the extraordinary rise in deal volumes, there runs a risk of disputes and fallouts and the need for a subsequent robust valuation. To explore the principles of conducting a healthy valuation and methodologies commonly used by Experts in dispute resolutions, along with their associated strengths and weaknesses.

3) To create the value of shares for the shareholders.

Relevance and Importance of the Study:

Share valuation is carried out by financial experts/analysts in the stock market. The value they compute is usually called Theoretical/Intrinsic/real value. Theoretical value is different from market value/price of a share as quoted on the stock exchange. The comparison of the two values (market and theoretical) form

the basis of stating whether a share is under valued or overvalued. Prices quoted by the stock exchange are treated for many purposes as gospel pronouncements on shares worth but the prices may not be directly related to the value of companies' assets or amounts of their profits and consequently these prices no matter what dates may be chosen for reference, cannot form a fair and equitable or rational basis for compensation. The quoted price is determined by the demand and supply mechanism in the stock market

Assumptions:

- 1) As the study entails two unlisted companies valuation of shares, the study is restricted to one financial year only.
- 2) The valuation of shares would imply valuation of shares of a non-listed companies.
- 3) For the purpose of simplicity the value of shares is done by Net assets Value method only.

Objectives of the study:

- 1) To study the process of valuation of shares of unlisted companies.
- 2) To study the Net Assets Value Method of valuation of shares for unlisted companies.
- 3) To understand why an independent value of equity is required.
- 4) To study the legal framework affecting the valuation of shares.

2) Hypothesis:

The value of Aaditi- Hitech Textile is more than Nayan Jute Indus. Ltd.

3) Working definition used:

- 1) Unlisted company: An unlisted company means a company whose shares are not available to general public for trading and not listed to stock exchanges. An unlisted company can be private limited company or public limited company.
- 2) Capital Market: a financial instrument for raising capital. A place where shares, bonds are traded.
- 3) SEBI: SEBI means the securities and exchange board of india.
- 4) Value: estimate the monetary worth of of shares of an unlisted companies.
- 5) Taxation: The term taxation, tax system, system of taxation etc. is used interchangeably in several places in the study. The above term signify the set of laws, rules and procedure related to income tax assessment, investigation and related administrative activities.

Scope of the Study:

- 1) The study covers two unlisted companies valuation of shares.
- 2) The study covers one financial year of an unlisted company.
- 3) The study relates to the Net Assets method of Valuation of shares terms of accounting viz. yield method, intrinsic method and cash flow method.

Research design:

The research begins with a through literature survey. The large data would be gathered by secondary method. For the application aspect of taxation information would be collected by way of structured

questionnaire from the high level accountants of the companies. After collecting the raw data it would be cleansed and arranged by various statistical techniques viz: Classification, Tabulation, Graph, Diagrams. The hypothesis testing would be done by evaluating various methods of valuation of shares.

Methods of Valuation: As the shares are not quoted the first two methods can't be used. So the research focuses upon the following methods:

Net Assets Value Method:

Data Collection and Interpretation

The data, after collection, has to be processed and analysed in accordance with the outline laid down for the purpose at the time of developing the research plan. This is essential for a scientific study and for ensuring that we have all relevant data for making contemplated comparisons and analysis. Technically speaking, processing implies editing, coding, classification and tabulation of collected data so that they are amenable to analysis.

STEPS	1) AADITI -HITECH TEXTILES P.Ltd.:	2) NAYAN Jute Inds.Ltd.:
<u>CALCULATION OF GOOD WILL</u>		
1 FUTURE PROFIT	18439235	2808390
2 NORMAL PROFITS	17690729	2738723
3 SUPER PROFITS (1-2)	748506	69668
GOODWILL	1497012	139335
<u>NET ASSEST FOR EQUITY SHARE HOLDERS</u>		
1 CLOSING CAPITAL EMPLOYED	235876386	36516305
2 ADD GOODWILL AS PER VALUATION	1497012	139335
NET ASSETS FOR EQUITY VALUE PER SHARE =	237373398	36655640
NET ASSETS FOR EQUITY / NO. OF EQUITY SHARES	237373398/ 1443000	36655640/ 1125000
VALUE PER SHARE	164.5	32.58

Notes

Calculation of Future Maintainable Profit:

NAME OF THE COMPANY	2014-15	2013-14	2012-13	2011-12	2010-11	Avg. Profit	Adjustment	Future Maintainable Profit
AADITI - HITECH TEXTILES P.Ltd	170363007	-114262138.5	-783165	0	0	18439235	0	18439235
NAYAN Jute Inds.Ltd	2645885	2506791	3259292	2868258	2761727	2808390	0	2808390

3) 1.2. CALCULATION OF NORMAL PROFIT

ASSETS	AADITI -HITECH TEXTILES P.Ltd.	NAYAN Jute Inds.Ltd.,
I) FIXED ASSETS		
A) TANGIBLE ASSETS (INCL WIP).	584395923	35755312.5
B) INTANGIBLE ASSETS	1078972.5	0
II) NON CURRENT INVESTMENTS	4522500	0
III) DEFERRED TAX ASSET	41501842.5	
IV) LONG TERM LOANS & ADVANCES	1124445134	
V) OTHER NON CURRENT ASSETS	12887550	
VI) CURRENT ASSETS		
A) TRADE RECIVABLES	0	28880157
B) INVENTORIES INC. STORES	1318069119	31097472
C) CASH & CASH EQUIVALENTS	25775325	8393031
D) SHORT TERM LOANS & ADV.		
E) OTHER CURRENT ASSETS	43124287.5	2116998
TOTAL ASSETS	3155800653	106242971
LIABILITIES		
NON CURRENT LIABILITIES		
A) LONG TERM BORROWINGS	1759508846	22364863.5
B) OTHER LONG TERM TERM BORROWINGS	1691961	
C) DEFERRED TAX LIABILITIES		1906489.5
CURRENT LIABILITIES		
A) SHORT TERM BORROWINGS	610810707	42197046
B) TRADE PAYABLES	360135732	
C) OTHER CURRENT LIABILITIES	184874218.5	1621111.5
D) SHORT TERM PROVISIONS	2902804.5	1637155.5
TOTAL LIABILITIES	2919924269	69726666
CLOSING CAPITAL EMPLOYED	235876384.5	36516304.5
NRR/ EXPECTED RATE OF RETURN	7.50%	7.50%
NORMAL PROFITS	17690729	2738723

Interpretation of data:

Particulars	AADITI -HITECH TEXTILES P.Ltd.:	NAYAN Jute Inds.Ltd.:
Value per equity shares (Rs)	164.5	32.58

It is clearly evident that the Aaditi Hitech Textile value is more than Nayan Jute.

SUGGESTIONS & CONCLUSIONS

- 1) The common accounting standard will not only provide convenience to the valuation of shares but also foster the ease in comparability by the investors at large.
- 2) As the acquisition and mergers are on a very large scale the proper valuation will help the investors and the common shareholders of this unlisted company to arrive at their true worth.

Conclusion:

1. There are various methods of computing of the value of shares. The most common method is Net Assets Value Method.
2. The valuation of shares requires additional information from the companies. Which the private parties in order to avoid competition may not willingly disclose. Plus for a few methodologies market value of assets is required. It can only be ascertained by professional valuers valuing each and every assets. Thus making an additional burden of cost for the organization interested in valuing their companies worth.

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- 2) R. L. Gupta & M. Radhaswamy-Sultan Chand & Sons,
- 3) Module of Chartered Accountant-Final Year. Module of Institute of Company Secretary