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THE STUDY OF VALUATION OF SHARES BY FAIR MARKET VALUE METHOD AND YIELD METHOD FOR FOUR UNLISTED COMPANIES IN NASHIK DISTRICT.

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Abstract :

The present research paper focuses on the method of valuation of shares based on the Yield Method of Valuation of shares. In the research paper an analysis of four companies balance sheet is done to calculate the value of shares by fair market value method and yield method.

Introduction:

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 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 scenario analysis, value adjustments, documentation and reporting.

Valuation is the process of determining the "Economic Worth" of an Asset or Liability under certain "Assumptions and Limiting Conditions" and subject to the "Data" available on the "Valuation Date".

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.

Purpose of Valuation:

Sections	Provisions
Sec 62 (1) (c)	For Valuing further Issue of Shares
Sec 192(2)	For Valuing Assets involved in Arrangement of Non Cash transactions involving Directors
Sec 230(2) (c) (v)	For Valuing Shares, Property and Assets of the company under a Scheme of Corporate Debt Restructuring
Section 230 (3) and 232 (2) (d)	For Valuation including Share swap ratio under a Scheme of Compromise/Arrangement, a copy of Valuation Report by Expert, if any shall be accompanied
Section 232 (3) (h)	Where under a Scheme of Compromise/Arrangement the transferor company is a listed company and the transferee company is an unlisted company, for exit opportunity to the shareholders of transferor company, valuation may be required to be made by the Tribunal
Section 236 (2)	For Valuing Equity Shares held by Minority Shareholders.
Section 260 (2) c)	For preparing Valuation report in respect of Shares and Assets to arrive at the Reserve Price or Lease rent or Share Exchange Ratio for Company Administrator.
Section 281 (1) a)	For Valuing Assets for submission of report by Company Liquidator
Section 305 (2) d)	For report on the Assets of the company for preparation of declaration of solvency under voluntary winding up
Section 319 (3) b)	For Valuing the interest of any dissenting member of the transferor company who did not vote in favour of the special resolution, as may be required by the Company Liquidator
Section 325 (1) b)	For valuation of annuities and future and contingent liabilities in winding up of insolvent company

Literature Review:

1) Dr. Pankaj Kumar- IMPACT OF EARNING PER SHARE AND PRICE EARNINGS RATIO ON MARKET PRICE OF SHARE: A STUDY ON AUTO SECTOR IN INDIA- The purpose of this study is to examine the impact of earning per share and price earnings ratio on the market price of share of company, therefore in this study market price of share is dependent variable, while earning per share and price earnings ratio are dependent variables and study is exploratory in nature. The study was carried out for a sample of eight companies of auto sector based on Nifty auto index and for a period of five consecutive financial years from 2011- 12 to 2015-16. Multiple regression analysis was employed to predict the impact of earning per share and price earnings ratio on market price of share of select companies of auto sector. The result of the study concludes that earning per share has found to be a very strong forecaster of market price of share, while price earnings ratio impact significantly on the prediction of market price of share of select companies of auto sector as whole. The implications and limitations of study are also discussed.

2) M Haritha, Ravi V & Dr. O Ravisankar- Intrinsic Value A Base to Pick Scrip- IOSR Journal of Business and Management (IOSR-JBM)- Investment means sacrificing some money value in the present with the expectation of making gains in the future. Every investor is interested in knowing the appropriate timing for investment, as well as the best avenue for investment. For investing the surplus money, the investor should be willing to pay the certain value for the stock. To know about the real value of the stock is not easy for the investor. At a same time, it is not so easy to find out the real worth for the company stock. Certain analysis can be used to select the stock for investment, like Fundamental analysis and Technical analysis. Thus, this research work is done for facilitating the investor to know about the worth able value of the stock for investment. This research paper is aims to arrive at the intrinsic value of shares.

3) Amin Akbari- The Study and Evaluation of Stocks' Valuation Models in Tehran Stock Exchange- In today's world, with the expansion of privatization and turning toward the purchase and sale of shares, the need to extensive research is felt in the field of accounting and finance. One of these important areas refers to the studies relevant to stocks valuation and specifying effective variables in determining the price of shares. This study is done with the aim of testing different valuation models of stocks based on basic variables in the economic environment of Iran and tries to identify basic variables as well as introducing a model for pricing stock through testing several stocks valuation models which has the most important role in explaining the stock prices of Iranian companies. The regression was used to test the stocks valuation models. The results obtained from this study indicated that the model of price to book value ratio (P/B) has the highest adjusted coefficient of determination and is determined as the best stocks' valuation model among the models tested.

Statement of Problem:

The following is an illustrative list of the circumstances which call for a value to be placed upon shares in companies:

- Sale of shares by a person to another within an unlisted companies.
- Merger of two or more companies or the absorption of one company by another or in a capital restructuring exercise.
- Tax purposes.
- Acquisition/ transfer of shares in an Indian company by a non-resident.
- Ascertainment of the premium at which shares are to be issued.
- Acquisition or transfer of shares by certain bodies corporate – under Sections 108A & 108B of the Companies Act, 1956.

Need of the study:

SOME REASONS TO GET BUSINESS VALUATION

Transactions	Regulatory	Accounting	Dispute Resolution	Value Creation
Merger IPO Acquisition/ Investment/ Sale Voluntary Assessment	RBI I ncome Tax SEBI Companies Act IBC	ESOP Purchase Price Allocation Impairment/ Diminution Fair Value (Ind AS)	NCLT / Courts Arbitration Mediation	Equity Research Credit Rating Corporate Planning

1) Relevance and Importance of the Study:

It is a correct phenomenon that the the stock exchange is the barometer of the market conditions. The companies which trade their shsres on the recoganised share market are called as listed companies. Their market price are market based but does not differ from the conventional method of vakuation of shares. Apart from these recoganised stock exchange there are various parties that deal with the valuation of the shares of these listed companies. Whereas non listed companies play a dormant role as they lack the recognition of stock exchanges. The researcher thus tries to establish a methodological approach to deal with the issues of valuation of shares.

Main Methods of valuation:

a) income based: Yield Method

b) assets based: intrinsic value method.

c) assets and profits based:

d) market price approach method:

i) price earning method.

ii) Book value method.

iii) other: discounted cash flow approach method

Assumptions:

1) Only two methods of valuations are compared viz the yield method and market value method.

2) As the study entails ten unlisted companies valuation of shares, the study is restricted to one financial year only.

3) The valuation of shares would imply valuation of shares of a non-listed companies.

Objectives of the study:

1) To study the process of valuation of shares of unlisted companies.

2) To study the yield method and market value method of valuation of shares for unlisted companies.

3) To understand why an independent value of equity is required.

4) To contemporarily analyse the paradigm shift in the method of valuation of shares as envisaged by resorting to the various techniques of valuation for an unlisted companies.

5) To study the different factors responsible for making the valuation of shares imperative.

6) To study the effect of potential earning power as a paramount factor in the valuation of shares.

Hypothesis:

1) Yield method of valuation gives a higher value of shares as compared to the market vale method of valuation of shares.

Working definition used:

1) Capital Market: a financial instrument for raising capital. A place where shares, bonds are traded.

2) Financial leverage: Financial leverage is the degree to which a company uses fixed-income securities such as debt and preferred equity. The more debt financing a company uses, the higher its financial leverage. A high degree of financial leverage means high interest payments, which negatively affect the company's bottom-line earnings per share.

3) 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.

4) Yield: Yield refers to the earnings generated and realized on an investment over a particular period of time, and is expressed in terms of percentage based on the invested amount or on the current market value or on the face value of the security. It includes the interest earned or dividends received from holding a particular security. Depending on the nature and valuation (fixed/fluctuating) of the security, yields may be classified as known or anticipated.

5) Intrinsic value: Yield refers to the earnings generated and realized on an investment over a particular period of time, and is expressed in terms of percentage based on the invested amount or on the current market value or on the face value of the security. It includes the interest earned or dividends received from holding a particular security. Depending on the nature and valuation (fixed/fluctuating) of the security, yields may be classified as known or anticipated.

6) Fair market value: The value which is fetched in the Open Market when Buyers and Sellers are dealing in arms strength.

7) Intrinsic Value: Intrinsic Value is the perceived or Calculated Value, including tangible and intangible factors. The intrinsic value may or may not be the same as market value.

8) Extrinsic Value: It is the difference between an option's price and the intrinsic value. For example, an option that has a premium price of ` 10 and an intrinsic value of ` 5 would have an extrinsic value of ` 5. Denoting the amount that the option's price is greater than the intrinsic value, the extrinsic or time value of the option declines as the expiration date of an option draws closer.

Scope of the Study:

1) The study covers four unlisted companies valuation of shares.
2) The study covers one financial year of an unlisted company.
3) The study relates to the terms of accounting viz. yield method and market value method of valuation of shares.
4) The research touches various section of the Income Tax Act for example section 50CA and section 56 (2) (x).
5) The study is restricted to valuation of shares of unlisted companies only situated in nashik district only.

Factors Influencing Valuation: The valuation of shares of a company is based, inter alia, on the following factors:

1) Current stock market price of the shares.
2) Profits earned and dividend paid over the years:
3) Availability of reserves and future prospects of the company.
4) Realisable value of the net assets of the company.
5) Current and deferred liabilities for the company.
6) Age and status of plant and machinery of the company.
7) Net worth of the company.
8) Record of efficiency, integrity and honesty of Board of Directors and other managerial personnel of the company.
9) Quality of top and middle management of the company and their professional competence.
10) Record of performance of the company in financial terms.

Method of valuation:

11) Yield Method The valuation of shares under the Yield Method may be done under two categories: (a) Return on capital employed method: This method is applied for the purpose of valuation of the shares of majority shareholding. A big investor is more interested in what the company earns and not simply in what the company distributes. Even if the company does not distribute 100% of its earning among its shareholders, it, as a matter of fact, strengthens the financial position of the company. The value of the share under this method is calculated by the formula:

Return on Capital Employed = Normal Rate of Return Return of Capital Employed × Paid-up Value of Shares

(b) Valuation on the basis of dividend: This method is more suitable for valuation of small block of shares. The method of calculation is:

Normal Rate of Dividend Expected Rate of Dividend × Paid-up Value of Shares

12) Fair Value of a Share The fair value of a share is the average of the value obtained by the net asset method and the yield method.

Fair Value = $\frac{\text{Yield Value+Intrinsic Value}}{2}$

STEPS	SARIKA Papers Pvt.Ltd.,	Karnik Oxygen Co.Ltd.	Sai Bevrages Pvt.Ltd.	Anushka Engineering Works Ltd
CALCULATION OF GOOD WILL				
1 FUTURE PROFIT	3707741	1270885	1057121	23988
2 NORMAL PROIFTS	2989392	708211	923161.3	21130
3 SUPER PROFITS (1-2)	**718349**	**562674**	**133960**	**2858**
GOODWILL	**1436697**	**1125348**	**267920**	**5715**
NET ASSEST FOR EQUITY SHARE HOLDERS				
1 CLOSING CAPITAL EMPLOYED	24911606	9442811	9231608	1408700
2 ADD GOODWILL AS PER VALUATION	1436697	1125348	267920	5715
NET ASSETS FOR EQUITY	**26348303**	**10568159**	**9499528**	**1414415**
VALUE PER SHARE =				
NET ASSETS FOR EQUITY / NO. OF EQUITY SHARES	26348303/ 183324	10568159 / 75000	9499528/ 15000	1414415/ 165750
VALUE PER SHARE	143.73	140.91	633.30	8.53

NOTES

1.1) CALCULATIHON OFFUTURE MAINTAINAMBLE PROFIT

NAME OF THE COMPANY	2014-5	2013-4	2012-3	2011-2	2010-1	Avg. Profit	Adjustment	Future Maintainable Profit
SARIKA Papers Pvt.Ltd.,	1052242.5	4249597.5	6233905.5	4461824	2541131	3707740	0	3707740
Karnik Oxygen Co.Ltd.	-2079575	2225655	1672980	2965980	2840270	1525062	0	1525062
Sai Bevrages Pvt.Ltd.	11058138	-126459	-1428750	-4428750	0	1268545	0	1268545
Anushka Engineering Works Ltd	22709	12926	27828	51678	0	28785		28785

ASSUMPTION

1) GOOD WILL IS ASSUMED TO BE 2 YEARS PURCHASE OF SUPER PROFITS, AS THE COMPANIES HAVE STARTED STABLISE EARNINGI N THE PREVIOUS TWO YEARS, WHICH COMPANY IS EARINING DUE TO ITS GOOD WILL.IN CASE OF NEW COMPANIES GOODWILL IS ASSUMED TO BE EQUAL TO SUPER PROFIT.
2) NORMAL RATE OF RETURN/ EXPECTED RATE OF RETURN IS TAKEN AS PER EXPECTED RETUNRS OF LIMITED COMPANIES IN SIMILAR BUSINESSES GIVEN ON GURU FOUCS WEBSITE.

1.2. CALCULATION OF NORMAL PROFIT

ASSETS	SARIKA Papers Pvt.Ltd.,	Karnik Oxygen Co.Ltd.	Sai Bevrages Pvt.Ltd.	Anushka Engineering Works Ltd
I) FIXED ASSETS				
A) TANGIBLE ASSETS (INCL WIP).	9707553	4954644	3022618	561091.3
B) INTANGIBLE ASSETS			67568.75	
II) NON CURRENT INVESMENTS	328218			
III) DEFFERED TAX ASSETS		379500		
IV) LONG TERM LOANS & ADVANCES		78826.5	87500	10200
V) OTHER NON CURRENT ASSETS		2413773	31935759	
VI) CURRENT ASSETS				
A) TRADE RECIVABLES	7879037	11232293	18100000	
B) INVENTORIES INC. STORES	10538100	16112517	1447615	553041.3
C) CASH & CASH EQUIVALENTS	12308849	597891	2287983	2364029
D) SHORT TERM LOANS & ADV.	1024368	1433382		624550
E)OTHER CURRENT ASSETS	3495320	1357670		13070
TOTAL ASSETS	**45281444**	**38560496**	**56949043**	**4125981**
LIABILITES				
NON CURRENT LIABILITIES				
A) LONG TERM BORROWINGS	9216254	1963190	5698847	1280550
B) OTHER LONG TERM TERM BORROWINGS	325752			
C) DEFFERED TAX LIABILITIES	1513940	7463715		
CURRENT LIABILITIES	7622232	16061817	43719687	
A) SHORT TERM BORROWINGS				
B) TRADE PAYABLES	1691663			1655681
C) OTHER CURRENT LIABILITIES			5742509	
D) SHORT TERM PROVISIONS		1740401	2099880	324505.5
TOTAL LIABILITIES	**20369840**	**27229122**	**57260922**	**3260736**
CLOSING CAPITAL EMPLOYED	24911604	11331374	-11879.5	865245.3
NRR/ EXPECTED RATE OF RETURS	12.00%	7.50%	10.00%	1.50%
NORMAL PROFITS	1868370	849853	-23391	64893

VALUATION OF SHARES OF UNLISTED COMPANIES

2) VALUATION BY EARNING YIELD METHOD

STEPS	SARIKA Papers Pvt.Ltd.,	Karnik Oxygen Co.Ltd.	Sai Bevrages Pvt.Ltd.	Anushka Engineering Works Ltd
ACTUAL YIELD				
1 FUTURE MAINTAINABLE PROFIT FOR EQUITY SHARE HOLDERS (NOTE 1)	3707741	1525062	1268546	28785.12
2 PAID UP EQUITY CAPITAL	1833240	750000	150000	1657500
ACTUAL YIELD = **FMP FOR ESH*100** / **PAID UP EQUITY CAPITAL**	**202.25**	**203.34**	**845.70**	**1.74**
OR				
CAPITALIZED VALUE OF F.M.P.				
1 F.M.P. FOR EQ. SHARE (NOTE 1)	3707741	1525062	1268546	28785.12
2 EXPECTED YIELD	12	7.5	10	1.5
CAPITALIZED VALUE OF FMP= FPM FOR ESH *100 / EXPECTED YIELD	**30897833**	**20334164**	**12685449**	**1919009**
VALUE PER SHARE				
1 IF EARNING BASIS ACT. YIELD* PAID UP VALUE /	2022.51	2033.416	8456.966	17.36659
EXPECTED YIELD	12	7.5	10	1.5
VALUE PER SHARES	168.54	271.12	845.70	11.58
2 IF CAPITALIZED VALUE OF FMP	30897833	20334164	12685449	1919009
CAP. VALUE OF FMP / NO. OF EQUITY SHARES	183324	75000	15000	165750
VALUE PER SHARES	168.54	271.12	845.70	11.58

3) **FAIR VALUE METHOD**

STEPS	SARIKA Papers Pvt.Ltd.,	Karnik Oxygen Co.Ltd.	Sai Bevrages Pvt.Ltd.	Anushka Engineering Works Ltd
VPS AS PER FAIR VALUE METHOD				
INTRINSIC VALUE	143.73	140.91	633.30	8.53
YIELD VALUE	168.54	271.12	845.70	11.58
FAIR VALUE = NAV+EYV / 2	**156.13**	**206.02**	**739.50**	**10.06**

Interpretation:

1) **SARIKA Papers Pvt.Ltd.,**

Particulars	**EYV**	**Fair value**
Value per equity shares (Rs)	**168.54**	**156.13**

The face value is Rs 10 per shares but the value is the highest when computed by yield method of valuation of shares.

2) **Karnik Oxygen Co.Ltd.:**

Particulars	**EYV**	**Fair value**
Value per equity shares (Rs)	**271.12**	**206.02**

It is clearly evident that from all the three methods of valuation the yield method return the highest value pr shares. The face value per share for the said company is Rs. 10.

3) **Sai Bevrages Pvt.Ltd.**

Particulars	**EYV**	**Fair value**
Value per equity shares (Rs)	**845.70**	**739.5**

The value per share by yield method is the highest and the vsalue per share by NAV method is the lowest. Face value of the said share is Rs. 10.

4) **Anushka Engineering Works Ltd**

Particulars	**EYV**	**Fair value**
Value per equity shares (Rs)	**11.58**	**10.06**

Yield method of valuation shows the highest value of Rs. 11.58. The Net assets value shows the lowest and the fair value is at the average level.

Suggestions:

1) The main emphasis at the end of the project would be on the area of standardization in the process of valuation. As the forces of market are not operative in the cases of unlisted companies a common harmonized method of valuation is deeply felt. A uniformly accepted accounting standard should be promulgated in order to limit the methods of valuation of shares whether the company is listed or unlisted. 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. So a proper mechanism and investor's education about the valuation of shares must be promoted.

3) A formal mechanism or body must be promulgated to value the shares of the unlisted companies so that their credit worthiness can be judged by the bank and other investors. If such companies properly manage their payables and receivables they would stand in a better position in respect of earnings. The proper utilization of credit facility will reduce the chances of unnecessary revenue loss on payment of interest to the taxation authorizes. It will also reduce the chances on hearings & assessments.

4) The Indian capital market are is in its infant stage more ever all companies are not listed on the share market. A huge amount of capital is floated up outside the formal share market. The securities and exchange board should promulgate guidelines in this arena.

CONCLUSION

1) There is a morbid fear among a layman about investing in an unlisted company. The valuation of shares is still a perplex issue. How do you go about valuing a Unlisted company? It's a simple question with a complex answer. While there are numerous valuation methodologies that can be utilized to establish value, not all methodologies would be appropriate in all situations.

2) A reasonably high amount of expertise and accurate judgement in involved in the valuation of shares along with the prevalent market condition.

3) There are various methods of computating odf the value of shares. The most comman methods are Net Assets Value Method, Yield Method and discounted cash flow method. Even when the compay is being taken over by another company the method of valuation will make a significant differencc. As its highly probable that each party dealing in the arms strength will entice upon the method best suited for each of them.

4) As there are many methods in valuation of shares there is always an element of doubt as to one method best suited to all. Each valuation approach has its own particular use and should be used in that respect. However it is likely that more than one method be used to have a reasonable safe guard as to the value of shares. For some each method of valuation will provide additional inputs as to the correct value

of the shares based upon their expectations. Evaluating the results of numerous methods provides a better understanding of a business' true worth. It is also important to note that different people will have different ideas on the value of a company depending on various factors.

5) 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.

6) The results from this study show that the suggested equity valuation models serve as good indicators for unlisted equity. This is because the companies' multiples for earnings and book values produced regression models with overall high goodness-of fit measures. Thus it can be concluded that the suggested models, studied in this study are appropriate for valuing unlisted equity.

7) A fair amount of experience, judgment and corporate finance and equity market knowledge is required. In each case, seemingly straightforward tools contain several hidden layers of complexity and restraints.

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