Valuation

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Valuation

- Goodwill
- Shares
- Business

Valuation of Goodwill

Goodwill means advantage which arises due to past efforts/purchased efforts/locational efforts. We will value Goodwill due to past/purchased efforts in this chapter.

Methods of Goodwill Valuation

i. **Average Profit Method** = Future Maintainable Profit X No. of yrs purchased

ii. **Super Profit Method** = (FMP – NRR X Capital Employed) X No. of yrs purchased

= Super Profit X NYP

iii. **Capitalisation Method** = $\frac{\text{Super Profit}}{\text{NRR}}$

*Use closing capital employed

iv. **Capitalisation of Super Profit Method** = $\frac{\text{Super Profit}}{\text{NRR}}$

*Use average capital employed

v. **Annuity Method** = Super Prft/FMP X P.V. of annuity factor

How to calculate FMP?

FMP represents profits of future periods based on certain assumptions

1. Projection Method (1st preference)
2. Past Profit Method (2nd preference)

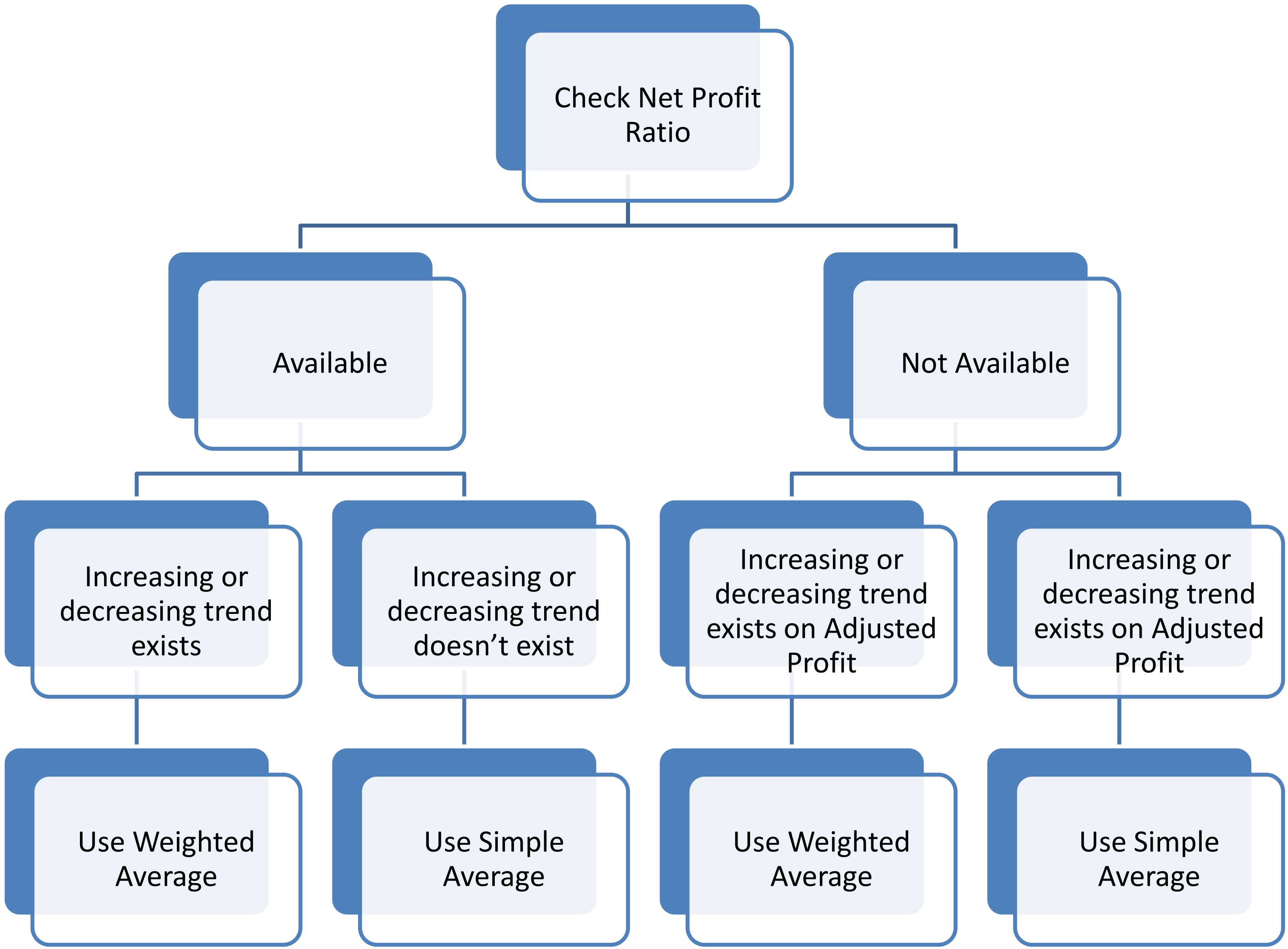
Projection Method Sales, CGS and expenses are projected based upon expectation

Past Profit Method

Particulars	Years		
	1	2	3
Profit after Tax	XXX	XXX	XXX
+ Tax Expense	XXX	XXX	XXX
Profit Before Tax	XXX	XXX	XXX
± Abnormal Items	-	+XXX loss	(XXX) gain
± Non-reccurring Item (Profit on sale of machinery)	(XXX)	-	-
± Rectification of Errors	-	XXX	XXX
± Effects of changes in A/cing Policies	XXX	XXX	XXX
± Revaluation of CA/CL	XXX	XXX	XXX
+ Goodwill Amortisation	XXX	XXX	XXX
- Non operating/trade Income	(XXX)	(XXX)	(XXX)
Adjusted Profits	XXX	XXX	XXX
Average Adjusted Profits		XXX	
± Future Income/Expense		XXX	
FMPBT		XXX	
- Future Tax		XXX	
FMP		XXX	

Notes

1. Future tax rate will be either given or previous year rates or average of previous years
2. Whenever abnormal item exists, but can’t be valued, ignore such year.
3. All investments will be assumed as Non – Trade if question is silent.
4. Average can be
   i. Simple Average
   ii. Weighted Average
   iii. Trend Line Average


Check Net Profit Ratio
Available
Not Available
Increasing or decreasing trend exists
Increasing or decreasing trend doesn’t exist
Increasing or decreasing trend exists on Adjusted Profit
Increasing or decreasing trend exists on Adjusted Profit
Use Weighted Average
Use Simple Average
Use Weighted Average
Use Simple Average

Trend line average is to be applied if question specifies

$y = a + bx$

Where,

y = Income

a = Simple Average

b = Growth = $\sum xy / \sum x^2$

x = Variable from median

How to calculate Capital Employed?

S. Assets	XXX
(-) S Liabilities	XXX
Capital Employed	XXX
(S.H. Funds)	

Notes:

1. All assets and liabilities should be after revaluation
2. After rectification
3. After change in a/cing policies
4. S. Assets should not include
   - Goodwill
   - Preliminary Expense
   - Non Trade Investments

5. S. Liabilities does not include proposed dividend (it is treated as part of Reserve/Surplus)
6. Tangible capital employed means closing capital employed
7. Capital employed should be average capital employed (preferred)

   $$\text{Average capital employed} = \frac{\text{Op CE} + \text{Cl CE}}{2}$$

   Average capital employed = Cl CE – ½ Rectified PAT
8. Whenever we use weighted average in FMP, use closing CE

   whereas, whenever we use simple average in FMP, use average CE