

VALUATION OF GOODWILL

• goodwill is the excess revenue earning capacity of the business/enterprise

Methods of goodwill valuation

Average Profit

$$= FMP \times n$$

(full profit)

Super Profit

$$= S.P \times n$$

$$S.P = FMP - \text{Normal P}$$

$$\text{normal p} = \text{NRR} \times \text{CE}$$

excess profit

avg CE

Annuity method

$$= SP \times \text{annuity factor for } n \text{ years}$$

PV of excess profit

Capitalisation Yield method

$$= \frac{\text{exp CE}}{\text{Normal CE}} - \frac{\text{act CE}}{\text{CE}}$$

$$\text{exp CE} = \frac{FMP}{\text{NRR}}$$

excess capital

using CE

n - no. of years purchase

• no of years for which profit is expected to be received

profit trend	n
↑	5
↓	3

Normal rate of return (NRR)

• std, industry, expected ROR

$$\text{NRR} = \text{expected NRR} \pm \text{Risk Impact}$$

$$\text{NRR} = \text{earning yield} = \text{PE} = \frac{\text{EPS}}{\text{MPS}} = \frac{\text{DPS}}{\text{MPS}}$$

Risk Impact ↑ risk ↑ return as compared to Ind conservatism = ignore ↓ in NRR

$$\text{Avg CE} = \frac{OP^n + CP^n}{2}$$

Avg CE = closing CE

(-) 1/2 profit earned

(-) 1/2 addn capital

(+) 1/2 draw

$$= CP^n - \frac{1}{2}P - \frac{1}{2} \text{ add} - \frac{1}{2}$$

Future maintainable profit (FMP)

• trend
↓ ↑ = wtd avg

no = simple avg

Past profit

Avg past profit
± past / future adj
± non trading / recurring item (fnc)
± acc policy Δ

FMP

current profit

use when past profit not avail or not comparable

Avg P by tax

$$\text{FMP} = \frac{\text{PAT}}{\text{tax @ future rate (tax)}}$$

trend equation

$$y = mx + c$$

$$c = \frac{\sum y}{n} \quad m = \frac{\sum xy}{\sum x^2}$$

avg past profit

y = each year p
x = slope

• FMP always before dividend (kef + equity) & after tax

• in case of mismatch = make abnormal year normal or ignore

ignore all the time inc or exp which will x these inputs

dividend

• prop div = part of reserves
• never a liability
• Include in FMP

Investments

Inv Income in P/L

Yes	NO
Non trade Invest	trade invest "asset"
(part of CE)	*

* Invest in subsidiary = always trade if silent

Format

Assumption method
Calc of G/W
WN
(1st do CE)

Leverage effect on G

Impact of debt on G/W
= G/W as SH fund - G/W as per LT fund

Capital employed

Shareholders funds (& silent)

ESC
(+) PSC
(+) R&S + prop div
(-) ME
(-) non trade inv
q/w

FA
(+) trade inv
(+) CA
(-) CL
(-) Long term loan
(-) Short term loan
q/w

• existing q/w in B/s ignored.
• Always take "current values"
not mention then take "BV"

long term funds

ESC
(+) PSC
(+) R&S + prop div
(-) ME
(-) non trade inv
(+) long term loan
q/w

FA
(+) trade inv
(+) CA
(-) CL
(-) ST. loan
q/w

• Every item must be comparable. (3 aspects)

Par in R

CE

FMP
(always after tax)

NRR
(also after tax)

1) silent or shareholders fund

shareholders fund

Profit b4 div (P&E) after tax

NRR for SH

2) For ESH or ESH funds

shareholders fund (exclude PSC)

Profit after pref div after tax

NRR for ESH

3) Type 3 (LT) 4) cash

long term fund SH fund

PBIT but after tax (profit b4 int after tax) (cash FMP / cash flow)

NRR for LT fund

• profit earned (for AVG CE = $\frac{1}{2}(C_1 - C_2) \times \frac{1}{2} \text{ profit}$) = $\uparrow$ PL $\uparrow$ GR (don't forget to consider prop div) full amt (x Δ)

• -ve q/w then q/w = 0

• Facex: consider P/L for current value (CE) and also adj to FMP.

• non trade inv: don't forget to deduct income from FMP (non trade inc)

• future tax: always consider future tax for FMP.

• addn expenses, direct remuneration: will impact tax provision + CL for CE

• tax provision: $[\text{inc} - \text{exp}] \times \text{tr} [\text{addn}] - \text{debit prov w/b, expens prov, FA remain}$

• FMP (SH) $\rightarrow$ FMP (LT): $\text{FMP (after tax)} + \text{int. net of tax} = \text{Profit b4 int after tax}$

• debn redeemed: (+) debn int to FMP (as no longer payable) + ignore disc on redemption (just one time, won't come in future)

ignore one time adj

• revaluation of FA: impact current value of FA, P&L (FMP (+) (-) opp), tax prov.

• disputed items: they are x abnormal eg: bonus disp (share) from FMP

• fresh issue: $\text{NA} \div \text{NOS} = \text{existing} + \text{new (x)} \text{ of } C_x - \text{if not known}$. $1 \cdot p = \text{money raised} / x$ $x = \text{new shares}$
NA = for includes trade & non trade both.

• no. of shares: always pd up (x authorised) + consider potential eq share [convertible debn, share sub, share]

• interco holding: shares (asset) valued @ VPS of CoA @ BV value + also included prop div if any

• VPS (ex div) = $\text{VPS (cum div)} - \text{dividend per share}$