

Answer on Question #85377 - Economics – Finance

Question:

ABC company is expected to generate post tax earnings of sh 200,000 p.a and companies in the same trade will generally have a price earning (P/E) ratio of 8. On account of company ABC limited size a ratio of 6 is considered more appropriate. The issued share capital is 1,000,000 ordinary shares of sh 50 each. Determine the value of shares and the value of business.

Answer

$$\text{Price of share} = \text{Earnings per share} \times (P/E)$$

$$\text{Price of share} = \frac{200,000}{1,000,000} \times 6 = 1.2$$

To calculate the value of business we will use the multiplier coefficient and total year earnings:

$$\text{Business value} = \text{Multiplier} \times \text{Annual revenues}$$

$$\text{Business value} = \frac{6}{8} \times 200,000 = 150,000$$

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