SECURITIES VALUATION IN THE PRIMARY MARKET IN NIGERIA: (A CASE STUDY OF UNION MERCHANT BANK LIMITED) (An investment-banking subsidiary of Union Bank of Nigeria Plc.)

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Certification

We certify that this research project has been carefully read and approved as adequate in scope and quality in partial fulfillment of the requirements for the award of Master of Business Administration (MBA) of the Ahmadu Bello University, Zaria.

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Declaration

I, **Taofik Olanrewaju Abina**, hereby declare that this research report has been written by me and that it is a record of my own research work under the supervision of Hajiya M. Larai Shafi'I of the Department of Business Administration, Faculty of Administration, Ahmadu Bello University, Zaria.

All other sources of information, where applicable, have been duly acknowledged in form of references and bibliography.

_____ _____

Taofik O. Abina **Signature & Date**
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Dedication

This research study is dedicated to the memory of my late parents Pa Yaya Adisa Abina and Alhaja Aduke Abina for making my education in life possible. Education is the best legacy that a parent can pass on to his child.

This dedication also goes to my late elder brother, Major Tajudeen Babatunde Abina, who died along with other senior military officers in the Hercules C-130 aircrash at Ejigbo near Lagos on 26th September, 1992.

Only Allah knows best!

ACKNOWLEDGMENT

I would like to acknowledge the assistance and support given to me in the course of the study.

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In same manner, my appreciation goes to the management of the Union Merchant Bank Limited, Nigerian Stock Exchange, and Securities and Exchange Commission for giving me vital information on this research study.

Of great importance to me is the diverse contribution made towards the success of this study by my MBA classmates, friends as well as well-wishers. There is limited space to include all your names, still I appreciate you all, and your assistance morally, spiritually and physically cannot be ignored.

Zaria, Nigeria **Taofik Olanrewaju Abina**
July 2004.

Abstract

The capital market is a market for mobilizing long-term funds thus, playing a very vital role in the process of economic development through the mobilization of funds and its provision for productive investment.

Valuation of securities in the capital market, i.e. primary market and the methods adopted by Issuing Houses for securities valuation are fully discussed in this study. The methods are net asset basis, maintainable earnings basis, earnings approach, P/E valuation and Peer Company's price.

Furthermore, the results of all the methods were compared with current market price to determine a more realistic approach. The net asset basis was found more effective in securities valuation.

This research study employed the primary and secondary media of data collection. The primary data were personal interviews and observations, while the secondary data used were the pricing memorandum, annual reports and accounts of selected companies, the daily official list of the Nigeria Stock Exchange.

Also it was discovered that existing literature on valuation of securities have propounded many models which tend to be too theoretical and difficult for a perfect market operation. The net asset basis has been applauded as a more realistic valuation method than the maintainable earnings approach as it takes into consideration the effect of inflation on the economy through its revaluation process and methods.

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

According to Lewis Mandell (1992), investment may be defined "as the purchase of an asset to produce a return. It may also be defined as the sacrifice of current consumption possibly in the hope of realizing increase consumption possibilities in the future."

P. Pandian (2003) defined investment "as the employment of funds on assets with the aim of earning income or capital appreciation."

The overall return that an investor may realize depends upon a number of factors. These include:

- the amount of money available for investment;
- degree of risk the investor is willing to take;
- amount of immediate income that is needed;
- the degree of liquidity that is needed;
- the intelligence and knowledge that the investor possesses.

Purposes of investment

- Return: return refers to the reward that an investor receives for his investment. This may include dividends, rents, capital gains or losses, sale of investment.
- Liquidity: liquidity of an investment refers to the marketability i.e. the case of conversion of a security or a portion of it into cash without waste of time.
- Hedge against inflation: the rate of return from investment is expected to be higher than the rate of inflation if it is to be profitable. This is why prudent investors are cautious of nominal rate of return.
- Safety: the selected investment should be made in an environment in which there is reliable, legal and regulatory framework operating.
- Finally is the risk of holding security. It is generally accepted in the investment theory that the higher the risk, the higher the return.

Types of investment

Equity: Equity represents ownership in a business. If the equities represent joint ownership in a company by a number of investors, then the equities are called shares of stock. Common shareholders are paid cash dividends. Preferred shareholders are entitled to a fixed dividend.

- Debt: If you lend someone money, the amount lent is your investment and such investments are rewarded with interests e.g. deposit (fixed) in a bank, bonds, debentures etc.
- Real estate: Real estate is an important investment, both in one's home and in other real estate investments.
- Precious metals and other intangibles like gold, antiques, cows etc.
- Foreign currencies: e.g. US Dollars, Pound Sterling, Euro etc.
- Portfolio: combination of different investments.

Risks and Types

For most investments, one does not know exactly the rate of return one is going to get. Sometimes, this uncertainty is alluring and offers an opportunity of large returns. At other times, the uncertainty is viewed more as the potential loss of capital. For this reason, the uncertainty is continuously referred to as risk.

The following are some known risks:

- Market risk: This is risk associated with fluctuations in market prices.
- Industry risk: This is the risk associated with the activities of a particular industry. For instance, the stock prices of oil companies in Nigeria may drop drastically if terrorists destroy major oil installations.
- Specific risk: This includes management risk, financial risk, default risk, credit risk, prepayment risk, call risk, information risk, liquidity risk etc.
- Tax rate risk: Risk associated with a sudden increase in tax rate.

Securities are financial assets with certificate evidencing ownership on the part of the holder. It represents a claim on future income streams of the issuer of the security. As an investment, it constitutes a commitment of funds for a period of time to derive a rate of return that compensates the investor for the time during which the funds are invested and the uncertainty involved.

Essentially, valuation of securities deals with the pricing mechanism at both the primary and secondary markets. Pricing of securities in the primary market concerns with determining the shares value of companies that are approaching the capital market for the first time and also for companies whose shares are already quoted on The Stock Exchange but which are assessing the capital market for fresh funds for expansion and diversification programmes.

The newly issued shares are classified under the Initial Public Offer (IPO) and already existing securities are classified under Already Quoted Companies (AQCs).

However, the pricing of securities in the secondary market happens when there is a movement on shares that have gone through initial public offer. The usual practice is to list all shares on the daily official list on the stock market at the initial offer price. Thereafter, many factors will affect the value of the securities. These factors are:

- Influences of supply and demand.
- Performance of a company.
- Industry related factors.
- Regulatory constraints on pricing.
- Public perception.
- Information on management.
- Government fiscal/monetary policies.
- Actions and perceptions of stockbrokers.
- Defaults of statutory requirements of the Securities and Exchange Commission by stock or security holders.

Prior to the deregulation of the capital market in 1993, pricing of securities in the primary market involved Issuing Houses determining the value of security and submitting it for approval to the Securities and Exchange Commission (SEC). But after the deregulation, pricing of security is now the responsibility of both the issuing house and the issuer. The current practice is one in which the issuing house prepares a pricing memorandum containing the valuation techniques considered appropriate with assumptions. The price arrived at by the issuing house is discussed with the issuing company after which the mutually agreed price is then attached to the shares to be sold. But the pricing of securities in the secondary market has always been the responsibility of stockbrokers since trading began on the exchange floor of the market in 1961. This role is performed by appraising daily the fortunes of quoted companies in order to make intelligent price.

Here, it is worth mentioning that more attention is given to the valuation of securities at the capital market than the valuation of debt instruments because the volume of trading or transaction engaged in with ordinary shares (common stock) is quite higher when compared with that of fixed interest capital (debt capital).

1.1 Statement of the problems

Risk capital and debt capital securities valuation have their peculiar problems spanning from complex valuation models, determination of unrealistic value, inability to practically apply these theoretical

methods and to the overall effect of the economic situation of the country in under valuing securities at the capital market.

The valuation of securities is based on the present value of its expected future earning and all we may make use of will be estimates. Therefore for this project study, it is of importance to examine the appropriateness of the various methods used in the valuation of securities in the capital market. The two commonly methods being used are:

- net assets valuation method.
- maintainable annual profit or earnings method.

The maintainable earnings method has the tendency of giving an undervalued figure when being used is the process of valuation and this will make the price of shares look unattractive. In estimating the maintainable earnings, this historical profit of the company will be used and as we know, situations and events in the country are so unreliable where appropriate projections cannot be made.

The net assets method has been widely applauded because when used it give a high price tag to potential investor who wishes to acquire the shares of such companies based on the price. The reason for its attractive price is that the assets of the company are being revalued to reflect the true and current situation of the economy against the historical basis of the previous method.

Also, the pricing of debt securities in Nigeria has for a long time been on a steady decline. This is due to the fact that the minimum rediscount rate (MRR) of the Central Bank of Nigeria, which is currently 15%, has always been used as the basis of pricing the debt instruments and this minimum rediscount rate is just low when analyzing the present value of bond or debenture.

Furthermore, bad dividend policies of some firms aimed at maximizing the wealth of shareholders expense of affect the value of securities in the stock market.

Securities have been defined as financial assets, which constitute a claim on future interest/dividend streams from the borrower. The uncertainty attached to this gives rise to a multiplicity of valuation methods based on various assumptions. These methods and their assumptions are highly theoretical.

The valuation of securities in the secondary market is determined by many factors of which government policies and legislations are one. This particular factor is much more dared in some sectors, where adverse effect of such policy will nearly bring their business to a standstill.

Again, another problem is the scarcity of securities on the trading floors, which is as a result of the buy-hold attitude amongst investors who consider their investment worthwhile (blue chip) to be traded on the floors and the continuous inactivity of company's shares in the secondary market.

1.2 Objectives of the study

This research study has the following objectives:

- To analyse the mechanisms of stock valuation in the Nigerian capital market with particular reference to Union Merchant Bank Limited.
- To establish the relevance of Issuing Houses in the valuation of securities.
- To ascertain the intrinsic and market values of securities in the Nigeria capital market.
- To aid future researchers on this or related topic of research.

1.3 Significance of the study

The research study must be seen to be significant or relevant as enumerated below:

1.3.1 Capital market operation

The capital market operators will find this study useful, as it will afford them another opportunity for a detailed research and expository essay on the valuation of securities in the primary and secondary market. This includes the jobbers, brokers, issuing house etc.

1.3.2 Company's accountant

This study will make the accountant to see another importance of keeping proper books of accounts as their financial statement forms the basis of securities valuation.

1.3.3 Direction/management

The management of a business are interested in seeing the relevance of their decision making and policy formulation as it affects the value of a company's securities e.g. the declaration or non-declaration of dividend.

1.3.4 Private investors/general public

This study will enable the potential investors and the general public to know that constitutes security prices in the capital market.

1.3.5 Researchers

This study will be a guide to a researcher who intends to conduct further research on the valuation of securities in the capital market.

1.3.6 Existing shareholders

This study will expose the various methods of valuing securities, hence existing shareholders will be in a better position to value and know the worth of their investment for necessary portfolio review.

1.3.7 **Financial reporters**

The financial analysts and reporters will find this research work useful for better business analysis and accurate reporting.

1.4 **Scope of the study**

This research study focuses on selected parameters as included in the pricing memorandum, financial statement, daily official list as used by the Union Merchant Bank Limited for the valuation of securities in the primary market.

1.5 **Limitations of the study**

This study is limited by the problems associated with secondary data and other off-the-shelf information pertaining to the companies being examined.

There is a time limit within which the study must be completed, coupled with limited financial resources at the disposal of the researcher.

1.6 **Brief historical background of Union Merchant Bank Limited**

- The Bank's registered name is UNION MERCHANT BANK LIMITED.
- The Bank's registered office address is 4, Davies Street, Off Marina, Lagos.

Union Merchant Bank Limited is the Investment banking subsidiary of Union Bank of Nigeria Plc. It was established in 1995 with the acquisition of controlling interest in the former Citi-Trust Merchant Bank Limited. The present ownership structure of the Bank is as follows:

		%
Union Bank of Nigeria Plc	=	80.7
Other Private Nigerians	=	19.3
		100.0

The Bank is licensed by the Central Bank of Nigeria to carry out merchant banking services in the country. The Securities and Exchange Commission (SEC) gave approval to the bank to carry out the following services:

- Issuing House.
- Financial/Investment Advisors.
- Portfolio/Fund Managers.

In addition to the above, the Bank has a fully owned stockbroking subsidiary company – Union Stockbrokers Limited that is licensed and trades on the floors of The Nigerian Stock Exchange.

Since acquisition, the Bank's Authorised, Issued and fully Paid-up Share Capital have increased steadily to the present level of N2 billion and N1.25 billion respectively.

1.7 Definition of terms

Capital market: This is the market whose funds are bought and sold for long period exceeding one year.

Nigerian stock exchange (NSE): This is the hub of the market. It is the regulator that ensures that there is law and order in all transactions in the market.

Securities and exchange commission (SEC): This is the apex regulator of the entire capital market.

Primary market: This is the market where new issues of securities are floated.

Secondary market: This is the market for already existing securities.

Market capitalisation: This is the market value of a company's issued share capital. It is the product of the current quoted price of shares and number of shares outstanding. The term is also used as performance indicator of the capital market.

Debentures: These are fixed interest-bearing securities. They are of types: debentures with floating charges and the ones with fixed charges. Debenture holders are creditors to the company.

Right Issues: These are shares offered to company's existing shareholders in proportion to the number of shares held by them and are usually at below market price to make the offer attractive.

1.8 Chapter organisation

This study is divided into five chapters with the following highlights:

Chapter one introduces the topic as well as gives a background to the process that evolved the topic of study. This chapter also outlines the need for the study, the objectives as well as the scope and limitation.

Chapter two reviews past studies on the study. An overview of the business economic and financial environment would be made. The views and findings of various experts on the topic and tools used would be discussed in an attempt to justify the selection of prepared tools and methods. Relevant theories would be evaluated to know how they apply to the Nigerian companies.

Chapter three discusses the methodology. It explains the nature and source of information, the sample size as well as data analytical procedure.

Chapter four analyses the data and interprets the results of the findings.

Chapter five summaries the findings, points out obvious conclusions and makes recommendations for further study in relation to the topic.

This is followed by the bibliography.

CHAPTER TWO

LITERATURE REVIEW AND CONCEPTUAL FRAMEWORK

2.0 Introduction

Financial intermediation is a popular concept in the theory of the role of the financial institutions in economic growth and development. The development of the financial system goes a long way in the measurement of the capital market growth and development in the modern economy.

For this reason, financial market especially the capital market itself continues to attract research attention both in the developed and developing economies.

In Nigeria, the capital market became an indispensable issue in 1959, the year before independence. The discussion of the Nigeria capital market or the financial system in general cannot be overemphasized without taking cognizance of the year 1959. The year 1959 featured the establishment of some key financial institutions like the Central Bank of Nigeria, the Nigerian Industrial Development Bank and the Lagos Stock Exchange later renamed Nigerian Stock Exchange.

2A Literature review

The review of literature serves two purposes in this research study:

- To set the theoretical base for the research; and
- To set the current research into perspective to show "the state of the art".

This review would be dealt with later in this chapter. It is also set to survey the research previously done on the problem and evaluate what this research has and has not accomplished in solving the problem currently under study.

2B Conceptual framework

2.B1 Importance of securities valuation

The securities valuation is important in a number of ways:

- It serves as a legal obligation of the issuer to the intending investors;
- The document (pricing memorandum) contains matters relating to the issue.
- The various methods including assumptions used in the valuation are disclosed.
- The investor's perception and level of confidence in the proposed issue and market acceptance is further strengthened.
- The Issuing House optimism that the proposed issue would be substantially subscribed.

- The basis for determining the appropriate selling price is stated in the pricing memorandum.

2.B2 **Techniques of securities valuation**

In carrying out the valuation exercise, we are guided by the following understanding:

- The desirability of a company converting to a public company and issuing its securities to the public through an Initial Public Offer (IPO).
- The company does not have any reference price for the issue of the securities.
- An under-pricing will deprive the company of any premium cash proceeds that is inherent in the company and thus transfer the excess value to the prospective investors.
- An under-pricing will also lead to a dilution of future earnings per security of the company. In order to raise the proposed fund, the number of securities to be issued will be more than otherwise needed if the securities are sold at less than the optimum price of the security.
- Over-pricing will make the company unattractive to the investors, which ultimately can result in under-subscription or failed offer.

There are many methods for valuing business, due to

- The unique nature of each business, and
- The purpose of the valuation.

Here is a run down of the most common approaches for security valuation:

- net asset basis.
- average maintainable earnings basis.
- earnings approach.
- P/E valuation.
- peer company's market price.

Net asset basis

This method values securities of a company based on the book value of its assets at a specific point in time. The use of this method of valuation is premised on the assumption that the assets are employed to create wealth for the company; therefore the value of a company can be derived from the value of its assets.

The limitation is that the assets or shareholders' fund is the book value as at the Balance Sheet date or any other cut-off date that may be chosen. To avoid under-valuation, it is acceptable to use the market value of the assets rather than the book value. This method provides a fair benchmark value.

Another limitation of the use of this method is that the value of the assets is not a reflection of the profit potential, a key factor, of the company.

Average maintainable earnings

This method averages a company's earnings for five years (or the number of years in operation, if less than five (5) years) and capitalizes the amount by the traditional capitalization rate applicable to the company's industry/sector. The capitalization ratio is a reflection of the payback period being sought by the investor. A capitalization rate of 20% and 25% translates to a payback period of 5 and 4 years respectively.

To arrive at the value per security, the capitalized earnings are divided by the number of ordinary shares in issue and fully paid-up.

Earnings approach

Valuation under this approach is determined by establishing the earnings per share (EPS) and applying the expected growth rate to arrive at the assumed sustainable EPS. The sustainable EPS is capitalized with the expected returns by the investor.

To ensure an adoption of an objective expected return, rates or sovereign risk instruments are usually used as benchmark with mark-up to reflect the perceived risk of the investment. Reference indices such as MRR and Treasury bill are generally used with an additional mark-up of between 1-5% depending on the perceived industry and business risk of the company.

In applying this method, the average P/E multiple of the identified companies is then multiplied by the earnings of the company being valued to arrive at its value.

Peer companies market price

This method derives its valuation from the stock market price or in the event that the security is not quoted on the stock exchange, its price is derived by making inferences to the market prices of peer companies in the same industry that are listed on the stock exchange in the country.

P/E valuation

Price earnings ratio is the relationship between earnings potential of any company and its security market price. Thus, the value of a company is represented by a price, which is given multiple of the earnings per share.

The price earnings (P/E) ratio represents the number of a current year's earnings it would take to earn the equivalent of the entities current market prices. A high P/E ratio generally

indicates that the market considers that its earnings are likely to grow quickly, and a low P/E ratio indicates that earnings are expected to stagnate.

However, the results obtained from the P/E method in relation to the company's financials may require some refinements. In so doing, the company's projected earnings/cash flows and those of their peers would be considered for a number of reasons.

In identifying the P/E multiple, it is necessary to identify quoted companies in the same line of business with similar capital/financial outlook for comparison.

P/E multiple is generally viewed in relation to the growth prospects in the industry/company, level of risk of investment, whether low or high and the nature of the business sector whether growing, stagnant, mature, etc.

2.B3 **Security valuation models**

Security is basically made up of risk capital and fixed interest or debt capital. For risk capital, otherwise known as ordinary share capital. There have been two schools of thought from the literatures available on its mode of pricing or valuation. These existing literatures are classified into the dividend relevance and the dividend irrelevance schools.

Gordon, Walter, William and others propounded the dividend relevance school. They believe that dividend is the main factor in the determination of the price of a share capital or stock while the dividend irrelevance school of thought, propounded by Modigliani and Miller, believe that earnings rather than dividends are far more important in the valuation of securities.

The valuation of debt security has not and cannot gain the type of prominence being enjoyed by the equity capital. Yet it has its own valuation techniques, which are accepted and recognized anywhere.

These are:

- valuation model for bonds or debenture at maturity.
- valuation model for bonds or debenture in perpetuity.

In order to meet up with the rising level of inflation, there has also been the development of models to take care of the effect of inflation on bonds or debenture pricing or valuation.

2.B4 **Dividend relevance based models**

Dividend relevance models believe that dividend declaration is the main factor in security valuation. One of the first exponents of this school of thought was William's who in 1938 postulated that only dividends could be discounted in the determination of value.

Also, Petite in 1972 studied a total of 625 companies in the New York Exchange and concluded "dividend announcements convey substantial information to market participants that caused them to revalue their security". Also Professor James E. Walter argues that "the choice of dividend policies almost always affect the value of the enterprises".

Finally, Jahnke (1975) concluded, "earnings growth is actually a substitute for what really matters. These are the dividend growth trends, and that as the investment horizon grows, the realized investment growth in dividend becomes the dominant factor".

Generally, we have noted that dividends are important and relevant in security valuation. Each model is now enumerated below:

1. **The general / common model**

   The formula is $Vj = \sum_{t=1}^{} Dt\,(I+k)^{t}$

   where Vj = the value of the common stock.

   Dt = dividend during period 't'

   K = required rate of return on stock j

2. **The constant dividend model**

   A widely used version of the common model expatiated above is the constant dividend model. Given certain assumptions and according to Reilly (1989), it states that:

   $$Vj = \frac{D1}{k - g}$$

   where

   Vj = the value of the common stock.

   Di = the next period's dividend payment, estimated easily as current dividend D times (I+g)

   K = the required rate of return.

   NOTE: For the model to be consistent, it is assumed that the required return K is greater than the expected dividend growth rate g.

   Reilly (1989) used the constant dividend valuation model to demonstrate how security can compete against inflation.

3. **Walter's model**

Professor James E. Walter argued, "that the choice of dividend policy almost always affects the value of the enterprise". His model, which is one of the earliest theoretical works, shows clearly the importance of the relationship between a firm's internal rate of return and its cost of capital. Walter's dividend policy that will maximize the wealth of shareholders is based on the followings assumptions:

- The firm finances all investors through retained earnings.
- The firm's internal rate of return and its cost of capital are constant.

4. **Myron Gordon's model**

The bird-in-the-hand argument has put it more convincingly that uncertainty moves with futurity, that is, the more uncertain the dividend becomes. That means that the future had certainly become dicy or unpredictable.

Accordingly, when dividend policy is considered in the context of uncertainty, the appropriate discount rate cannot be assumed to be constant. In fact, it increases with uncertainty. Investors prefer to avoid securities that pay the greater current dividend, all other things being equal.

2.B5 **Dividend irrelevance model**

According to Modiglani and Miller (M-M), the dividend policy of a firm is irrelevant, as it does not affect the wealth of the shareholders. They argued that the value of a firm depends on the firm's earnings, which results from its investment policy.

Thus, when the investment decision of the firm is given, the dividend decision is of no significance in determining the value of the firm. The M-M hypothesis of dividend irrelevance is based on the following assumptions:

- The firm operates in a perfect capital market.
- Taxes do not exist.
- The firm has a fixed investment policy.
- Risk of uncertainty does not exist.

2.B6 **Capital asset pricing model** (CAPM)

This model is used for the purpose of determining the appropriate discount rate for each project so as to be able to compute the present value of each security.

This rate is the risk-free cost of capital plus a risk premium where the premium is determined according to the degree of risk attached to the project in the context of it's addition to an existing portfolio. By portfolio, we mean a collection or set of investments.

The existing portfolio has a rate of return, which is regarded as being a risk free rate of return plus a risk premium appropriate to that portfolio. It can be expressed thus:

Rs = Rf + B(Rm – Rf).

Rj = Minimum required rate of return or cost of capital.

Rf = The expected return on a risk free investment (e.g. government stocks).

Rm = The expected return for the market as a whole.

B = Beta factor (a measure of the riskiness of the share).

Capital asset pricing model (CAPM) is based on the following assumptions:

- Investors are rational and risk averse.
- Investors seek to maximize utility, which is a function of risk and expected return.
- Risk is measured by standard deviation.
- There is a linear relationship between the returns obtained from an individual security and average rate of return from all the securities in the market.
- The stock market is efficient i.e. security values reflect all known information, which is available to all investors at low cost.
- All investors view security in the same way with respect to return risk and correlation with other securities.

2.B7 **Chartist (Technical theory)**

This theory was essentially based on the past performance. The theorists believed that previous security price would be represented in future price. They were of the opinion that prices can be placed on the security price data and extending same to the future.

They also propounded that the price of a security is not dependent only on the intrinsic value (market demand and supply), but also on intangible market forces such as emotions. Sometimes it is argued that actions and emotions of suppliers would change the prices of security. They recorded historical price changes and financial data on charts and graph.

They also argued that certain patterns and movements tend to repeat themselves and they tried to identify these patterns and recorded them as they appear. Prediction is therefore possible and appropriate action is taken to buy or hold these securities according to the pattern of movement.

2.B8 **The random walk theory**

These theorists were in agreement with the traditionalists that the price of the security of a company depends on its future receipts capitalized with an appropriate rate (cost of capital). They criticized the fundamentalists on security price having a single intrinsic value. They argued that though securities prices are based on future cash flows discounted at an expected rate of return but that securities are bound to exhibit different values since expectation differs from one shareholder to another.

They opined that these values would take a random walk around the so-called intrinsic value of the fundamentalist if supported by the efficient market hypothesis.

2.B9 **Fundamentalist analysis**

This is based on the idea that every business has an intrinsic long-term worth quite apart from the transitory value that is placed on it currently by the market. It is believed that this intrinsic value can be discovered through an analysis of financial information derived from its annual accounts where the intrinsic value is above the current market value. This is to be taken as a sign to buy the shares. But where it is below the current market value, it is a sign not to buy or to sell if already held.

The fundamental analysis is based on a number of assumptions and these are:

- That a business has an intrinsic value.
- That this can be determined by analysis of the company's generated data.
- That this value may go unrecognized by the market in the short term.
- The market will eventually recognize that it in the long term.

2.B10 **Efficient market hypothesis** (EMH)

An efficient capital market is one that possesses the following characteristics:

- Large number of buyers and sellers operating in the market such that no single group dominates the market.
- Freedom of entry and exit in the market.

- Transaction costs in the market are not high as to significantly discourage trading in the market.
- Participants in the market are expected to be willing investors.
- The prices of securities bought and sold reflect all the relevant information, which is available and therefore known to the buyers and sellers.
- No investor will consistently be able to obtain above normal returns since security price will be based on information obtained.

The efficient market hypothesis argues that the future price of a security can be predicted given today's set of information. This is equal to today's price compounded at an appropriate rate of return with commensurable risk of the security. This means that today's price, which reflects current information is an estimation of tomorrow's present value price.

According to the efficient market hypothesis, there are three degrees of efficiency viz:

- The weak form.
- The semi-strong form.
- The strong form.

The weak form

This assumes that the current market price of a security reflects only historical price and earnings. In other words, securities prices only change when new information about a company and its profits become available. Security prices do not change in anticipation of new information being obtained.

The semi-strong form

Security prices does not only reflect all relevant information about price movement and their implications but also all knowledge which is available publicly and relevant to the valuation of the security. For example, if two companies plan a merger, security prices of the companies will inevitably change once the merger plans are formally announced.

The strong form

Security prices reflect all information available from past price changes, from 'Public' knowledge/anticipation and also from "Insider" knowledge available to specialists or

experts. All these hypotheses testing are rare to come by because they suggest a perfect capital market.

2.B11 **Valuation approaches for debt securities**

It is relatively easy to determine the intrinsic value of debt. If there is no risk of default, there is no difficulty in estimating the cashflow associated with a debt. The expected cashflow consists of the annual interest payments plus the principal amount to be recovered at maturity or sooner.

The appropriate capitalization or discount rate to be applied will depend upon the riskiness of the debt. The risk in holding a government bond is less than the risk associated with a debenture issued by a company, consequently a lower rate would be applied to the cashflow of the government bond and a higher rate to the cash flow of the debenture.

- **A debt security with a maturity period**

  When a bond or debenture has a finite maturity to determine its value, we shall consider the annual interest payments plus its terminal or maturity value.

- **A debt security in perpetuity**

  The bonds, which will never mature, are known as 'Perpetual Bonds or debentures. After the Napoleonic wars, England issued three types of bonds to pay off many smaller issues that had been floated in previous years to pay for the wars. In the case of the perpetual bonds, as there is no maturity or terminal value, the value of the bonds would be the discount value of the infinite stream of interest flows.

- **Valuation of debt security in an inflationary period**

  For fixed income securities (Treasury bills and certificates, government development stocks and debenture stocks) the value of the security would decline if K increases as inflation increases.

  Infact, Malkiel (1962) demonstrated that the following relationship (theorems) exists between yield (required rate of return) changes and bond price (value) behaviour.

- Bond prices move inversely to bond yields.

- For a given change in market yield, changes in bond prices are greater for long-term maturities. Thus, bond price volatility is directly related to maturity.
- The degree of maturity-derived price volatility i.e. percentage of price change increases at a diminishing rate as term to maturity increase.
- Price movements resulting from increase or decrease in yield is not systematical, since a decrease in yield raises bond prices by more than a corresponding increase in yield lower prices.
- The higher the coupon of the issue, the smaller the percentage of price fluctuation for given changes in yield thus bond price volatility is inversely related to coupon.

In summary, increase (decrease) in inflation will increase (decrease) the required rate of return and this will mean a decrease (increase) in the value of a fixed-increase security.

2.B12 **Deregulation in the capital market**

Prior to the deregulation of the capital market, pricing became the responsibility of both the issuing house and issuer. The current practice therefore is one in which the issuing house prepares a pricing memorandum containing the evaluation techniques considered appropriate with assumptions. The price arrived at by the issuing house is discussed with the issuer whose agreement has to be obtained.

The mutually agreed price is then attached to the securities to be sold. This price is however communicated to Securities and Exchange Commission (SEC) for information purposes only along with other details for the issue.

2.B13 **The stock pricing function of the Union Merchant Bank**

A company that wishes to come to the capital market either through Initial Public Offer (IPO) or further listing must subject itself to the guidelines of the Securities and Exchange Commission. The information that would be required to enable the bank determine the price are as follows:

- The company must be registered a Public Limited Company (Plc).
- Audited accounts for five years immediately preceding the issue or sale.
- Brief history of the business including particulars of products, goods or services.

- Capital structure and changes over the years.
- Particulars of the top management staff.
- Major features of the memorandum and articles of association.
- Pending litigations (if any).
- Assets, especially landed property or plant.
- Future development plans.
- Major contracts entered into affecting the business in material terms.

The activity of the bank especially in the area of security pricing has been the cause of some controversy. Before the deregulation of the capital market, critics felt that the pricing of new securities was not scientific enough and that judgment was significantly subjective but after the deregulation, the one-time critics of the market had given support to the market's policy by exhibiting confidence in their pricing strategy.

The scale of rates approved by the Securities and Exchange Commission for the purpose of capitalization is as follows:

Table 2.1 Capitalization range per sector

Sector	Capitalisation rate (%)
Agriculture/Agro-Allied	10 – 12.5
Property	12.5 – 15
Banking and Finance	15 – 17.5
Manufacturing	17.5 – 20
Commercial	20 – 25
Service	25 – 30

Source: Securities and Exchange Commission

Once a company's security is listed and quoted on the stock exchange subsequent market forces, that is, the forces of demand and supply, will determine prices. This is determined on the floor of the stock exchange.

2C SUMMARY

The literature review and conceptual framework has dealt extensively with the views on the research study. The various techniques used in the valuation of securities have also been enumerated.

The researcher is of the view that care must be taken in the valuation process so as to have the investors' confidence in the proposed issue. The various indices for the valuation have to be evaluated in order to have a suitable value price.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter will examine the method of collecting the data, the sources and the nature of such data. The data analytical procedure will be examined as well as the limitation to acquiring the relevant data.

3.1 Research methodology selected for the study

Many different methods can be used in exploring a problem situation, helping to solve a problem or establishing acceptability or otherwise of hypotheses. Some of these methods can compliment each other.

We shall, therefore, briefly consider the different types of research designs. These include the historical, case study, survey and experimental. They all have varying degrees of scientific respectability.

3.1.1 Historical Research

The historical method of research is concerned with being able to understand and explain the present and predicts the future, through an evaluation of available records of past events. It involves the systematic search for documents and other sources that contain facts relating to the researcher's question about the past to have better understanding of the present and perhaps to predict the future situation. It may take one of two forms. It may be concerned with an historical problem in management or it may be an historical approach to a current management problem.

Historical research also helps solve current problems by examining what has happened in the past. For example, we are interested at development of a company; we look at the problems it has faced in the past and the current situation in order to suggest future directions and strategies the company might adopt or through literature review.

The methodology of historical research is similar to that of science because it follows these steps:

- Identifying the problem.
- Formulating probable hyphotheses.
- Identifying and collecting relevant data.

- Analysing of data.
- Interpreting and reporting findings.

Historical research can be very useful in the following ways:

- Aids in avoiding past mistakes.
- Builds on what is already known.
- Assists in predicting the future.
- Refreshes memory on what is known and unfolds what is not known.
- Records cultural development of a people.

3.1.2 Case study method

The term “case study” usually refers to a fairly intensive examination of a single unit, such as a person, a small group of people or indeed a single company. Case studies involve measuring and studying what is there and how it got there. In this sense, it is historical. It can enable us to explore, unravel and understand problems, issues and relationships. It cannot however, allow us to generalize, i.e. to argue that from one case study the results, findings or theory developed apply to other similar case studies. The case study may be unique and therefore not representative of other instances. Case studies may be used for exploratory studies or testing of hypotheses.

The case study method has four steps:

- Determination of the present situation.
- Gathering of background information about the past and the key variables.
- Testing of hypotheses. The background information would have been analysed for possible hypotheses.
- Taking remedial action. The aim is to check that the hypotheses actually work out in practice.

3.1.3 Survey method

This is the most widely used method in the social sciences. Survey consists of methods of gathering data from usually a large number of respondents who themselves constitute a sample by asking them questions.

The purpose of a survey is not the collection of data per se, but the discovering of meaning in the data collected, so that facts and events can be better understood, interpreted and explained. In other words, surveys can be used to explore relationships between different

variables. Surveys are based on a very simple procedure: If we wish to know what people think about certain things, we must ask them, i.e. it involves collecting data through asking people questions-either in self administered questionnaires or through interviews. For example, if we want to know students' perception of BUAD 765 lecturer, how they feel about the MBA programme, etc. we ask them.

Survey may be used for descriptive, explanatory and exploratory purposes. They are chiefly used in studies that have individual people as the units of analysis, such as method can be used for other units of analysis, such as groups or interactions, it is necessary that some individual persons are used as respondents or informants. Survey research is probably the best method available to the social scientist in collecting original data for describing a population too large to observe directly using research instruments like questionnaires, interviews, etc.

3.1.4 **Experimental method**

The classical method of the physical sciences is the experiment. Most physical science researchers aim to set up a situation in which all the variables can be controlled or varied at will. By varying this one in an experiment involves monitoring changes in the "output". The relationship between (1) taking action and (2) observing the consequences of variables can be carefully studied and documented. In essence, the researcher seeks to vary one of several independent variables, whilst measuring the effect on the dependent variable(s), keeping intervening variables constant.

Experiments are especially well suited to research projects involving relatively limited and well defined concepts and propositions. Experimentation is a particularly desirable method where research question take the form of hypotheses which state that "if (a) and (b) follows" rather than those hypotheses that seek to describe a phenomenon or where the primary aim of the research is to develop or verify theory. It is appropriate for hypotheses testing. It is better used for explanatory than descriptive purposes.

An example of true experimentation, which can be used to study human behaviour, and particularly in social sciences is the pre-test and post-test control design. In the simplest experimental design, subjects are measured in terms of a dependent variable (pre-tested), exposed to a stimulus representing an independent variable, and then measured in terms of the dependent variable (post-tested). Differences are noted in the first and last measurements on the dependent variable are then attributed to the influence of the

independent variable. Also the design may be made up of experimental and control groups. The experimental group is that which is exposed to the experimental stimulus of interest, while the control group is not exposed to the stimulus.

The methodology selected for the study would be personal interview and observation on the chosen case study. Also reference to books, research works written by notable authors would also be explored.

3.2 Techniques of data collected adopted for the study

The data collected would be analyzed by computing values for securities as contained in the pricing memorandum prepared by the Issuing House. Comprehensive securities values of similar businesses in the industry would also be examined. The essence is to have a fair security value for any offer made to the public. It is important to note that security value is computed based on the information supplied by the issuer.

3.3 Research design for the study

It is important in any research that the researcher explains the way and manner the study is carried out. The research process usually involves the description of the population and the sample of the study, their characteristics, the source of data intended for use in the study and research instruments to be employed in the analysis of data to reach a conclusion.

A research design is essentially a model that guides the researcher in the process of collecting, analyzing and interpreting data. It attempts to provide solutions to crucial research questions, like what is the objective or study, what is the researcher expected to observe, when should these observations be made, how will the researcher access his data and what technique should be employed in analyzing the research data and variable.

3.4 Population and sample for the study

Selecting research subjects is an important matter in social research. One important decision that must be made in any research has to do with WHO and WHAT to study i.e. study population. The choice of respondents is a critical aspect of social research because it influences reliability and validity of data that are ultimately collected. Data from wrong respondents would misguide research thought and distort social reality. The process of sampling consists of three phases:

- Definition of the population of study.
- Drawing of sample from the population; and
- Making statistical inference.

The population of study is that group (usually of people) or set of individuals, objects or measurements about whom we want to be able to draw conclusions. Study population is that aggregation of elements from which the sample is actually selected. At times, we may not be able to study all the members of the population that interest us because of large size and you may need to limit the population e.g. census of National Population hence the need to drawn a sample.

A sample is therefore a subset of the population. Resources and circumstances may make it humanly impossible to cover the whole population of study, hence the essence of sampling. Sampling is the process of selecting a sample of respondents who are representative of the population study.

Sampling can be divided into four stages:

- Identifying suitable sampling frame based on your research question(s).
- Deciding on a suitable sample size.
- Selecting the most appropriate sampling technique and select the sample.
- Checking that the sample is representative of the population.

Once the researcher has successfully formulated a problem and operationalised the concepts, data on which the research is based must be collected. Data are recorded observation. It is a method of getting information about the world around us.

The principal instruments or methods available to the researcher for data collection include observations, questionnaires, interviews and published documents. Each of these methods must be valid and reliable for the purpose intended.

The main objective behind sampling is to enable the researcher obtain a subset of a population. The samples selected are contained in the pricing memorandum prepared by the Issuing House (Union Merchant Bank Limited) on the various initial public offers and rights issue made.

The population, as contained in the capital issues handled by Union Merchant Bank Limited as Financial Advisers/Issuing House in recent times, is enumerated below:

ORGANISATION	**ASSIGNMENT**
Hallmark Bank Plc:	Public Offer for Subscription of 400 million Ordinary Shares of 50k each at N1.50 per share.
A.G. Leventis (Nig.) Plc:	Rights Issue of 526 million Ordinary Shares of 50k each at N10.00 per share.

National Oil & Chemical Marketing Co. Plc:	Privatization of Federal Government shares and divestment by Shell of its 40% equity holdings in National Oil & Chemical Marketing Plc (NOLCHEM) (now CONOIL).
Edo State Government:	Offer for subscription of N500 million Edo State 21% Floating Rate Revenue Bond (oversubscribed and increased to N1 billion which was equally oversubscribed).
New Nigeria Bank Plc:	Offer for Subscription of 1,260,000,000 ordinary shares of 50k each at 60k per share and offer for sale of 1,5660,000,000 ordinary shares of 50k each at 60k per share.
Trans International Bank Plc:	Offer for Subscription of 234,903,398 ordinary shares of 50k each and Rights Issue of 353,019,320 ordinary shares of 50k each at N1.50 per share.
Union Bank of Nigeria Plc:	Rights Issue of 838,950,000 ordinary shares of 50k each at N18 per share.
Hallmark Bank Plc:	Offer for subscription of 1,300,000,000 ordinary shares of 50k each and Rights Issue of 700,000,000 ordinary shares of 50k each.
Gulf Bank of Nigeria Plc:	Offer for subscription of 1,500,000,000 ordinary shares of 50k each at N2.00 per share.
Albarka Airline Plc:	Offer for subscription of 1,500,000,000 ordinary shares of 50k each at N1.00 per share.
IMB International Bank Plc:	Offer for subscription of 5,800,000,000 ordinary shares of 50k each at 53k per share.
African Petroleum Plc:	Rights Issue of 216,000,000 ordinary shares of 50k each at N40 per share. (In progress).
Afribank Nigeria Plc:	Offer for subscription of 1,500,000,000 ordinary shares of 50k each at N6.00 per share. (In progress).
NEM Insurance Plc:	Rights Issue of 526,500,000 ordinary shares of 50k each at 55k per share. (In progress).
Akwa Ibom State Govt.:	Offer for subscription of N6 Billion Revenue Bond. (In progress).

Niger Insurance Plc:	Rights Issue of 200,000,000 ordinary shares of 50k each at N3.30 per share. (In progress).
African Express Bank Plc:	Rights issue of 750,000,000 ordinary shares of 50k each at N1.50 per share.
Linkage Assurance Plc:	Initial Public Offer of 1,400,000,000 ordinary shares of 50k each at 90k per share.

From a population of 18 issues handled by the bank, in recent times a sample size of 7 issues mainly Initial Public Offers and Rights issue were selected, while work is in progress in 5 different issues. The issues selected are as follows:

	ORGANISATION	ASSIGNMENT
i.	Gulf Bank of Nigeria Plc:	Offer for subscription of 1,500,000 ordinary shares of 50k each at N2.00 per share.
ii.	Trade Bank Plc:	Offer for subscription of 1 billion ordinary shares of 50k each at N1.00 per share.
iii.	African Express Bank Plc:	Rights Issue of 750,000,000 ordinary shares of 50k each at N1.20 per share.
iv.	Trans International Bank Plc:	Offer for subscription of 234,903,338 ordinary shares of 50k each and Rights Issue of 353,019,320 ordinary shares of 50k each at N1.50 per share.
v.	Linkage Assurance Plc:	Initial Public Offer of 1,400,000,000 ordinary shares of 50k each at 90k per share.
vi.	Niger Insurance Plc:	Rights Issue of 200,000,000 ordinary shares of 50k each at N3.30 per share. (In progress).
vii.	Union Bank of Nigeria Plc:	Rights Issue of 839,950,000 ordinary shares of 50k each at N18.00 per share.

3.5 **Research techniques for the study**

The critical point in any research endeavour is the data collection stage. Data collection helps to lend empirical support to the research study in question. In most research efforts, two major sources of data collection exist, and these are:

- Primary sources
- Secondary sources

Primary sources

In a developing society like Nigeria, there are several constraints to accessing relevant published or unpublished works. Given the relevance of data to research effort the researcher may be compelled to collect necessary data himself. The data collected from such first hand sources is called primary data.

The major procedure involved in such data collected is through the use of questionnaires, personal observation and interview method. The researcher employed for this research study observation and personal interview methods for the primary source of information.

Secondary sources

Secondary data sources refer to any previous research documents or works. The secondary source of data was equally used in this research. The daily official list of the stock exchange, journals, textbooks, annual reports and accounts of 7 selected companies, newspapers and periodicals were thoroughly examined.

3.6 Research instruments

The methods of valuing securities being currently used in the capital market were adopted. They are net asset basis, average maintainable earnings basis, earnings approach, P/E valuation and Peer company's market price while the determination of the present worth of the debt security is less cumbersome as it just requires the application of already defined formulae.

3.6.1 The maintainable earnings method

This refers to the level of return to equity, which are likely to be achieved in the future by a company. Since the entire profit after tax belongs to the equity owners, the market value of the security will then become the discounted value of the whole profit using the capitalization rate devised by Securities and Exchange Commission as illustrated in Table 2.1.

In estimating the maintainable earnings, the historical performance of the company may be used and the practice is to take an average of the profits for the preceding five years.

3.6.2 The net asset basis

This approach looks at the net assets or shareholders' fund of a Company which, when divided by the number of shares in issue as at a particular balance sheet date should give the value for the security.

Net asset approach is used to determine the efficiency of the use of assets, and also the proportion of the net asset owned by each shareholder. It also shows the net worth of the business and the agreed price based on this valuation method makes the investor to believe

that he is buying an asset of a company that would be used to generate the future income or revenue of the company from which its dividend will be paid. A very good aspect of this method is that it is futuristic and not historical, and incorporation the inflationary procedure through its revaluation of asset to reflect the current situation.

3.6.3 **Analysis of variance**

This research study will also make use of analysis of variance to test the computed figures derived from using net asset and maintainable earnings bases amongst others with the current market price to ascertain how reliable each of the method used for the valuation.

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CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.0 **Introduction**

This chapter deals with the presentation of data and data analysis and interpretation of data collection from the secondary data obtained from Union Merchant Bank Limited, the Nigerian Stock Exchange and the Securities and Exchange Commission.

4.1 **Presentation and analysis of data**

Seven (7) companies were chosen for the purpose of analyzing how security prices were arrived at using the net asset basis, weighted average annual maintainable earnings basis, earnings approach, price earnings (P/E) valuation and the peer company's market price.

4.2 **Analysis of share prices valuation techniques employed by Union Merchant Bank Limited**

Security prices are market indicators of the value of securities. High security prices indicate a high level of investors' confidence and demand for the companies' securities in the capital market. Two factors usually influence the behaviour of investors and these are:

- their perception of the risk involved in the investment.
- their estimation of the returns expected from the investment.

Let us take a look at the methods used by the bank in valuing the securities of the seven (7) carefully selected companies chosen for this study.

1.	**Gulf Bank of Nigeria Plc**	-	Offer for subscription of 1,500,000,000 ordinary share of 50k each at N2.00 per share
	Authorised Capital:		N2,000,000,000 divided into 2,000,000,000 Ordinary shares of N1 each.
	Issued and fully paid-up Share capital:		N1,000,000,00 ordinary shares of N1 each.
	Proposed Issues:		1,000,000,000 ordinary shares of N1 each.
	Method of Issue:		Offer for subscription.

COMPUTATION OF SHARE PRICE

1.1 **Net assets valuation method**

$$\text{Price per share} = \frac{\text{Total Net Assets}}{\text{No of shares in issue}}$$

$$\frac{2,408,976,000}{1,000,000,000}$$

$$= \underline{N2.41k}$$

1.2 **Maintainable profit valuation method**

Year	PAT N'm	Weight	Weight x PAT N'm
1998	105,727	1	105,727
1999	159,605	2	319,210
2000	358,436	3	1,075,308
2001	596,418	4	2,385,672
2002	930,332	5	4,651,660
	2,150,518	15	8,537,577
	========	==	========

1.2.1 Simple average profit valuation

Simple Average Profit $= \frac{2,150,518,000}{5}$

$= N430,103,600$

Capitalized at 17.5% $= 2,457,734,857$

Value per share $= \frac{2,457,734,857}{1,000,000,000}$

$= \underline{N2.48k}$

Capitalized at 12.5% $= 3,440,878,800$

Value per share $= \frac{3,440,828,800}{1,000,000,000}$

$= \underline{N3.44k}$

Average price $= \frac{2.48 + 3.44}{2}$

$= \frac{5.92}{2}$

$= \underline{N2.96k}$

1.2.2 **Weighted average profit valuation**

Weighted average profit $= \frac{8,537,577,000}{15}$

$= 569,171,800$

Capitalised at 17.5% $= 3,252,410,286$

Value per share $= \frac{3,252,410,286}{1,000,000,000}$

$= \underline{\mathbf{N3.25k}}$

Capitalised at 12.5%	=	4,553,374,400
Value per share	=	$\frac{4,553,374,400}{1,000,000,000}$
	=	**N4.55k**
Average price	=	$\frac{(3.25+4.55)}{2}$
	=	$\frac{7.80}{2}$
	=	**N3.90k**

AVERAGE EARNINGS AFTER TAX PER N1 ORDINARY SHARE = **0.54k**
====

YEAR	EARNING PER SHARE
1998	0.20
1999	0.30
2000	0.68
2001	0.60
2002	0.08
	2.71 divided by 5 = 0.542

EARNINGS YIELD AT VARIOUS PRICES

Prices	Earnings yield %	P/E RATIO	Remarks
1.00	54	1.85	Nominal price
1.50	36	2.77	
2.00	27	3.7	
2.41	22.41	4.48	Net asset price
2.96	18.24	5.48	Simple average price
3.00	18	5.56	
3.90	13.85	7.22	Weighted average price

2. **Trade Bank Plc** - Offer for subscription of 1 billion ordinary shares of 50k each at N1.00 per share.

SHARE VALUATION

The valuation of the shares of the Bank has been carried out on the basis of maintainable annual profit for the five and half (5.5) years ended 30th September

2003 using the applicable capitalization rates of 15% and 17.5% on a simple average approach.

The **Net Asset Basis** of valuation, using the Net Asset figure and the issued share capital of the Bank as at 30th September 2004 was also carried out.

From the schedule, a value of **57 kobo** per share was arrived at on the basis of 15% capitalization rate while the rate of 17.5% yielded a value of **49 kobo** per share. The average of the two capitalization rates yielded a value of **53 kobo** per share.

On the other hand, the valuation carried out through the **Net Asset Basis** resulted in a value of **88 kobo** per share.

The summation of the maintainable annual profit (53 kobo) and the net assets (88 kobo) valuation bases product a figure of **141 kobo** and an average value of **70.5 kobo** per share.

Market price

The share of Trade Bank stood at a price of **N1.35**k at the close of trading on 1st April, 2004.

PROPOSED OFFER PRICE

The Bank and the Issuing House have agreed to offer the shares at a price of **N1.00** per share. The price was considered appropriate given its current share's price of **N1.35k**, which, to all intent, is a better reflection of the investor's perception and level of confidence of Trade Bank and its shares in the market. Trade Bank easily comes up as one of the most patronized banks in the country in terms of customer base.

Trade Bank Board can easily pass as one of the most stable in the industry as it has not for once, since inception, witness the slightest form of crisis either covertly or overtly.

Besides, the anticipated positive impact that the investment of the proceed of the offer on Branch Network expansion, Information Technology and additional working capital would have on the rating and performance indices of the Bank further strengthened the justification for an offer price of N1.00 per share,

Furthermore, in view of the impressive forecast indices, the Issuing House is quite optimistic and confident that the shares would be substantially subscribed at the proposed offer price of N1.00 by the investors.

Maintainable earnings method

Year	Simple Average N'000
1998 (15 Months)	86,800
2000	62,675
2001	178,305
2002	370,368
2003	399,829
2003 (Half-year)	141,443
	1,239,420

Average PAT (1,239,420/5.75) 215,555

(a) Capitalization of average PAT @ 15%

= 1,437,007

Valuation based on
2,500,000,000 shares
as at 31/09/03 (kobo) = 57

(b) Capitalisation of average PAT @ 17.5%

= 1,231,720

Valuation based on
2,500,000,000, shares
as at 31/09/03 (kobo) = **49**

Average value (a+b) = **53**

Net assets basis

Net assets as at September 30, 2003 = 2,207,002,000

Net asset per share = 2,207,002,000 / 2,500,000,000

Net asset per share (kobo) = **88**

QUOTED SHARE's PRICE
AS AT APRIL 1, 2004 = **N1.35k**

3. **African Express Bank Plc** - Rights issue of 750,000,000 ordinary shares of 50k each at N1.20 per share.

1. **Net assets valuation method**

Net assets at 31/12/01 - 626,036,000

Number of Issued Shares - 1,500,000,000

Price per share (N) - **0.42**

The net assets value method is used particularly for banks where the bulk of the units are in cash or near cash, and in situation where the sale is to result in a change of ownership and control of the enterprises being valued, especially in mergers and acquisition. The net assets value method gave a price of 42 kobo per share because of the substantial losses recorded by the company in the last three years have severely eroded the shareholders funds.

2. **Maintainable profit**

Year	PAT/(LOSS) N'm	Weight	WEIGHT X PAT N'm
1997	(44,887)	1	(44,887)
1998	(271,767)	2	(543,534)
1999	(143,302)	3	(426,906)
2000	1,649	4	6,596
2001	(248,716)	5	1,243,580
	(208,591)	15	234,849

2.1 Simple average profit/(loss) = (208,591,000) / 5

= (41,718,200)

Capitalised @ 12.5% = (333,745,600)

Value per share = (0.22)

Capitalised at 17.5% = (238,389,714)

Value per share = (0.16)

Average price = (0.38) / 2

= (0.19)

2.2 Weighted average profit = 234,849,000 / 15

= 15,656,600

Capitalised @ 12.5% = 125,252,800

Value per share = 0.08

Capitalised @ 17.5% = 89,466,286

Value per share = 0.06

Average price = 0.06 / 2

= **0.03**

The maintainable annual profit method deals with the number of years it would take for an investor to recoup his investment in a company. It utilizes the average of five years after the profits to arrive at the "maintainable annual profit". The maintainable annual profit is capitalized using an expected rate of return depending on the industry type. The Securities & Exchange Commission (SEC) has categorized industries into expected rates of return, and for finance activities, (the most appropriate categorization for Afex Bank) applicable expected rate of return of 12.5% to 17.5% implies that an investment in the sector is expected to be realized between 8 and 5 years.

The simple average method gave a negative price of 0.19 per share and the weighted average method gave a price of 0.07k, both prices are not acceptable.

From the above, a particular trend becomes obvious: the company's historical earnings were very poor, current earnings are better and projected earnings are expected to grow rapidly. For instance the Bank's profit for 2001 before provision for losses b/f was N248m, which its profit for 9 months to September 2001 unaudited was N330m.

The market price for the share as at 31/10/02 was N1.50. However the bank had now built up some goodwill and things have started moving up for the Bank.

We, therefore, recommend that the price of N1.20 being proposed by the company will represent a discount of 20% on the value of the shares as at 31/10/02 of 150 kobo.

4. **Trans International Bank Plc** - Offer for subscription of 234,903,338 ordinary shares of 50k each and Right Issues or 353,019,320 ordinary shares of 50k each at N1.50k per share.

Net assets basis

Net Assets as at 31st December, 2000 = N1,022,754,000

Divide Net Asset by number of paid up capital of 1,176,731,094 ordinary shares

Value per share: N1,022,754,000/1,176,731,094

= **0.84k**

Maintainable annual profit

Year	Adjusted Profit After Tax
	N'000
2000	225,553,000
1999	24,269,000
1998	51,270,000
1997	32,494,000
1996	27,918,000
	361,504,000

Simple average: 361,504,000/5 = N72,300,000

1. Capitalise N72,300,000 at 17.5%* = N413,147,429
   Value per share: N413,147,429/1,176,731,094 = **N0.35k**
   Capitalise N72,300,000 at 12.5% = N578,406,400
   Value per share: N578,406,400/1,176,731,094 = **N0.50k**
   Average price = 35k + 50k/2 = **43k**

*Indicative rate for banks by Securities & Exchange Commission.

Maintainable annual profit-incorporating profit forecasts

Year	Adjusted Profit After Tax
	N'000
2003	763,061,000
2002	686,572,000
2001	485,516,000
2000	225,553,000
1999	24,269,000
	2,174,971,000

Simple Average: N2,174,971,000/5 = N434,994,200

Capitalise N434,994,200 at 17.5% = N2,485,681,140

Value per share: N2,485,681,140/2,000,000,000 = **N1.24k**

Capitalize N434,994,200 at 12.5% = N3,479,953,600

Value per share: N3,479,953,600/2,000,000,000 = **N1.74k**

Average price = 1.24 + 1.74/92 = **N1.49k**

Weighted annual profit

Year	Adjusted Profit After Tax	Weighting	Weighted Profit
2000	225,553,000	5	1,127,765,000
1999	24,269,000	4	97,076,000
1998	51,270,000	3	153,810,000

1997	32,494,000	2	64,988,000
1996	27,918,000	1	27,918,000
	361,504,000	15	1,417,557,000
	==========	==	==========

Weighted average: N1,417,557,000/15 = N98,103,800

Capitalise N98,103,800 at 17.5% = N560,59,143

Value per share: N560,593,143/1,176,731,094 = **N0.48k**

Capitalise N98,103,800 at 12.5% = N784,830,400

Value per share: N784,830,400/1,176,731,094 = **N0.67k**

Average price = 48k + 67k/2 = **58k**

Weighted average –incorporating profit forecasts

Year	Adjusted Profit After Tax	Weighting	Weighted Profit
2003	753,061,000	5	3,765,305,000
2002	686,572,000	4	2,746,288,000
2001	485,516,000	3	1,456,548,000
2000	225,553,000	2	451,106,000
1999	24,269,000	1	24,269,000
	2,174,971,000	15	8,443,516,000
	==========	==	==========

N8,443,516,000/15 = N562,901,000,000

Capitalised at 17.5% = N3,216,577,000

Value per share: N3,216,577,000/2,000,000,000 = **N1.61k**

Capitalised at 12.5% = N4,503,208,000

Value per share: N4,503,208,000/2,000,000,000 = **N2.25k**

Average price = N1.61 + N2.25/2 = **N1.93k**

Earnings yield at various prices

Price – N	Earnings Yield %	P/E Ratio
2.00	8.72	11.47
1.93	9.03	11.07
1.90	9.17	10.90
1.85	9.42	10.61
1.80	9.68	10.33
1.70	10.25	9.75
1.60	10.89	9.18
1.50	11.62	8.61
1.49	11.70	8.55
1.40	12.45	8.03
1.20	14.53	6.88
1.00	17.43	5.74

0.84	20.73	4.59
0.70	24.90	4.02
0.60	29.05	3.44
0.58	30.05	3.33

Average EPS

Simple average	10k
Simple average + forecast	21.75k
Weighted average	10k
Weighted average + forecast	28k
	69.75k

Average EPS 69.75k/4 = **N17.43k**

Observation

i. Valuation of the shares using the net asset valuation method an employing the total asset of the bank as at 31st December, 2000 gives a value per 50 kobo share at 87 kobo.

ii. Valuation of the share using simple average or earnings for the four years period (1996 – 2000) gives a value per 50 kobo share of 43 kobo. Capitalizing the Simple Average profit with 17.5% and 12.5% respectively and dividing the value by 2 arrived at this amount.

iii. Valuation of the shares using weighted average of earnings for the five years period (1996 – 2000) gives a value per 50 kobo share of 58 kobo. The figure of 58 kobo was arrived at with the same method above in 2.

iv. The average of the three valuations is 63 kobo. (87k + 43k + 58k) divided by 3.

v. The result obtained from the maintainable profit valuation method would have been higher had the bank maintained a track of increasing its profit. Particularly, that PAT of N24.2 million of 1999 weakened the outcome of the share valuation, when compared with other years i.e. 1996, 1997, 1998 & 2000.

vi. The funds being raised by the bank will boost its operations thereby enhancing its future profitability.

vii. We note that MRR is 20.5% per annum currently and TB is 19.5% per annum currently.

viii. We observed that Trade Bank Plc. a comparable company with TIB Plc did a Public Offer in March 2001 at a price of 80 kobo per share.

ix. The highest dividend paid by TIB Plc during the proceeding five years is 5 kobo per share, which was paid in 1997.

x. Given the forecast average EPS of 32 kobo, TIB Plc may not be able to pay more than 20k per share as dividend after making provision for statutory reserves and SSI. This translates to a proposed dividend yield of 20% at an offer price of N1.00 and 16.67% at an offer price of N1.20. The 20% proposed dividend yield is therefore within the acceptance region if compared with the prevailing MRR and TB rates.

Recommendation

We therefore recommend that both offers be made at N1.00 per share.

5. **Linkage Assurance Plc** - Initial Public Offer of 1,400,000,000 Ordinary shares of 50k each at 90k per share.

Approach

In arriving at the valuation under the different options, we have been guided and relied on the following information:

- Annual reports & accounts of the company for the 5 years up to December 31, 2001.
- The four-year financial projection of the company.
- The prices of shares of Insurance Companies listed on the Nigerian Stock Exchange, other stock market information and indices.
- The guidelines of the Securities & Exchange Commission ("SEC") on share valuation.
- Our knowledge and industry practice in valuation of shares.

Net asset basis

This method values the shares of a company based on the book value of its assets at a specific point in time. The use of this method of valuation is premised on the assumption that the assets are employed to create wealth for the company; therefore the value of a company can be derived from the value of its assets.

This method of share valuation is normally adopted in the following cases:

- Majority acquisition of the shareholding of a company.

- Mergers and acquisitions where the assets of one company would be transferred to another company.
- Asset striping.
- Privatization of state owned enterprises where the level of profitability has not justified the level of investments in assets.

In arriving at the value of the company per share, the net asset value is divided by the company's total number of issued and paid up share capital.

Using the net asset basis, the valuation of Linkage based on its Balance Sheet as at 31st December 2001, is as shown hereunder:

Net asset per accounts	312,259,058
Nos. of shares in Issue	241,663,751
Value per share	**N1.29k per 1 share**

Average maintainable earnings

This method averages a company's earnings for five years (or the number of years in operation, if less than 5 years) and capitalizes the amount by the traditional capitalization rate applicable to the company's industry/sector. The capitalization ratio is a reflection of the payback period being sought by the investor. A capitalization rate of 20% and 5% translates to a payback period of 5 and 4 years respectively.

To arrive at the value per share, the capitalized earnings are divided by the number of ordinary shares in issue and fully paid-up.

Using the Average Maintainable Earnings, the valuation of Linkage based on its Balance Sheet as at 31st December 2001, is as shown hereunder. We have assumed a payback period of 5 years or capitalization rate of 20%.

	1997	1998	1999	2000	2001	TOTAL
	₦	₦	₦	₦	₦	₦
Net Earning as per accounts	13,633,323	20,412,564	30,766,182	45,882,368	63,401,891	174,096,328
Provisions no longer required	0.00	0.00	0.00	0.00	0.00	0.00
Adjusted earnings weighting	13,633,323	20,412,564	30,766,182	45,882,368	63,401,891	174,096,328
Weighting	1	2	3	4	5	
Weighting Earnings	13,633,323	40,825,128	92,298,546	183,529,472	317,009,455	647,295,924
Average Earnings						43,153,061
Capitalized Earnings @ 20.0%						215,765,305
Number of shares in issue						241,663,751
Value per share						**0.89k per N1 Share**

Earnings approach

Valuation under this approach is determined by establishing the earnings per share (EPS) and applying the expected growth rate to arrive at the assumed sustainable EPS. The sustainable EPS is capitalized with the expected returns by the investor.

To ensure an adoption of an objective expected return, rates of sovereign risk instruments are usually used as benchmark with mark up to reflect the perceived risk of the investment. Reference indices such as MRR and Treasury bill are generally used with an additional mark-up of between 1.5% depending of the perceived industry and business risk of the company. Using the current MRR of 16.5% as index and taking an assumed mark-up of 3.5%, the expected rate of return is 20.0%. The ERR agrees with an assumption of a payback period of 5 years earlier adopted under the average maintainable earnings basis.

In applying this method, the average P/E multiple of the identified companies is then multiplied by the earnings of the company being valued to arrive at its value.

The valuation of linkage under the P/E valuation is as shown below:

Projected EPS of Linkage	=	N0.45
Average Industry P/E ratio	=	6.82
Projected price of Linkage	=	EPS x P/E ratio
	=	N0.45 x 6.82
	=	**N3.07k**

Peer company's market price

This method derives its valuation from the stock market price or in the event that the stock is not quoted on the exchange, its price is derived by making inferences to the market prices of peer companies in the same industry that are listed on the exchange in the company.

Insurance companies listed on The Nigerian Stock Exchange and their prices as at November 4, 2002 are as stated in the table below.

It is on this note that we recommend a conservative pricing approach in the valuation of the shares to be traded.

Average EPS of peer companies	=	N0.21
Average Industry P/E ratio	=	7.43
Projected price of linkage	=	EPS x P/E ratio
	=	N0.21 x 7.43
	=	**N1.56k**

Based on statistics from the capital market, we have assumed a growth rate of 2.5% in the Insurance Industry.

Using the Gordon growth model, under the earnings approach, the valuation of Linkage is as shown hereunder: EPS oo (1+g)/k-g; where;

G :	growth rate	=	2.5%
K :	expected rate of return	=	20.0%
EPS :	earnings per share	=	0.34 (derived from projections for 2002)

Thus, price per share is 0.3(1+0.025)/(0.02-0.025)

= **N1.99 per N1 share**

P/E valuation

Price earnings ratio is the relationship between earnings potential of any company and its stock market price. Thus, the value of a company is represented by a price, which is a given multiple of the earnings per share.

The price/earnings (P/E) ratio represents the number of current year's earnings it would take to earn the equivalent of the entities' current market prices. A high P/E ratio generally indicates that the market considers that its earnings are likely to grow quickly, and a low P/E ratio indicates that earnings are expected to stagnate.

However, the results obtained from the P/E method in relation to the company's financials may require some refinements. In so doing, the company's projected earnings/cashflows and those of their peers would be considered for a number of reasons.

In identifying the P/E multiple, it is necessary to identify quoted companies in the same line of business with similar capital/financial outlook for comparison.

P/E multiple is generally viewed in relation to the growth prospects in the industry/company, level of risk of investment, whether low or high and the nature of the business sector whether growing, stagnant, mature, etc.

Name of Insurance companies	Market price on November 4, 2002 N	EPS	P/E
AIICO	1.65	0.51	3.24
Niger Insurance	2.09	0.25	8.36
Prestige Assurance	2.43	0.36	6.75
Royal Exchange Assurance	3.42	0.36	6.75
Unic Insurance	0.57	0.00	0.00
CORE-CONTEMPORARIES OF LINKAGE			
Cornerstone Insurance	1.39	0.39	3.56
Crusader Insurance	0.99	0.13	7.62
Lasaco Assurance	1.12	0.17	6.59
Wapic Insurance Plc	1.79	0.15	11.93
Peer Average		0.21	7.43
Amicable Assurance Plc	0.64	0.00	0.00
Baico Insurance Plc	0.67	0.00	0.00
Confidence Insurance Plc	0.57	0.00	0.00
Guinea Insurance Plc	0.60	0.00	0.00
Law Union and Rock Ins Plc	1.02	0.16	6.38
Mutual Benefits	0.85	0.00	0.00
NEM Insurance	0.50	0.06	8.33
Security Assurance Plc	0.75	0.00	0.00
Sun Insurance Nigeria Plc	0.60	0.11	5.45
Security Assurance Plc	0.75	0.00	0.00
	22.40		
Industry average	**1.12**		**6.82**

Summary valuation

The result of the above seven methods give the price of the company's share as follows:

	N
Net assets basis	1.29 per N1.00 share
Average maintainable earnings basis	0.89 per N1.00 share
Earnings approach	1.99 per N1.00 share
P/E valuation basis	3.07 per N1.00 share
Peer company's market price	1.56 per N1.00 share

The average of all the foregoing approaches give a number of N1.76k per N1.00 share.

Commentary

In all methods of share valuation, there is an element of subjectivity. Thus, it is always appropriate to use the results of the different methods as a guide to arrive at a realistic, reasonable and acceptable value.

None of the valuation methods give a conclusive basis for valuation of the shares because of the inherent deficiencies of each method. Our final recommendation of price will take cognizance of the figures generated under the different basis but supremely on an objective analysis of market receptiveness to the stock of Linkage Assurance and the selling price.

As mentioned earlier the market offers the most credible place to determine the price of stock. Our independent review has revealed that The NSE stock index is on downward slide with the tendency to worsen because of the depleting purchasing power in the Nigerian economy. The capital market is also currently awash with several public offers of shares that will pose competition for the proposed investment in shares of Linkage. Beyond these, the pricing of shares insurance companies is noted to be generally low. It is our researched opinion that the market will spurn an attempt to price above the traditional price range unless the company is perceived to offer top of the range returns above the industry levels.

To however add and retain the current values of the company as reflected in the valuation generated under the various bases, it is advisable that stock split should be carried out for the existing shareholders to convert one stock of N1 to two stocks of 50k each. Selling a N1.00 stock at N1.50k is the same as selling two stocks of 50k par at 75k each.

Conclusion

Based on the foregoing analysis, it is our strong opinion that the price of the stock should be N0.80k per 50k share.

6. **Niger Insurance Plc** - Rights Issue of 200,000,000 Ordinary shares of 50k each at N3.30 per share. (In progress).

Authorised capital: N500,000,000 divided into 1,000,000,000 Ordinary shares of 50 kobo each.

Issued and paid up capital: N400,000,000 divided into 800,000,000 Ordinary shares of 50 .kobo each

Proposed issue: 200,000,000 ordinary shares of 50 kobo each.

Method of issue: Rights Issue

Computation of share price

Data	
No. of shares in Issue:	800,000,000
Par value:	50 kobo
Total Net Assets as at 31/12/2002:	N'000
Paid up capital	350,000
Share premium	100,607
Reserve for bonus issue	50,000
Capital reserve	465,629
Contingency reserve	108,992
General reserve	106,047
	1,181,275
	========

Net assets valuation method

$$\text{Price per share} = \frac{\text{Total Net Assets}}{\text{No. of shares in Issue}}$$

$$= \frac{1,181,275}{800,000}$$

$$= \textbf{N1.48k}$$

Maintainable profit valuation method

YEAR	PROFIT AFTER TAX N'000	WEIGHT	WEIGHTED PAT N '000
1998	50,441	1	50,441
1999	71,664	2	143,328
2000	100,700	3	302,100
2001	124,210	4	496,840
2002	155,766	5	778,830
	502,781	15	1,771,539
	=======	==	========

Simple average profit valuation

Simple average profit/(loss) = $\frac{502,781}{5}$

= N100,556.20

Simple average earnings/(loss) per share = $\frac{100,556.20}{800,000}$

= N0.13

Average price/earnings ratio = 10

Value = 0.13 x 10

= **N1.30k per share**

Weighted average profit valuation

Weighted average profit/(loss) = $\frac{1,771,539}{15}$

Weighted average earnings/(loss) = $\frac{118,102.60}{800,000}$

= N0.15

Average price /earnings ratio = 10

Value = 0.15 x 10

= **N1.50 per share**

Average of the three valuations

(a)	Net asset basis (2002)	N1.48
(b)	Simple average of earnings for five years (1998 – 2002)	N1.30
(c)	Weighted average of earnings for the five years (1998 – 2002)	N1.50

		N4.28
		=====

Average price = $\frac{4.28}{3}$

= **N1.43k per share**

Observation

- The market valuation of NIGER INSURANCE PLC shares as per the Daily Official list of 23/04/2004 is N3.94. The market price of N3.94 is higher than the average price of N1.43 derived from the three valuations above.
- The maintainable profits valuations give an average price of N1.40, while the net asset value per share is N1.48.
- The highest price attained, so far, this year by the shares is N4.31, while the lowest is N3.32.
- The company runs a profitable business operation. In the last five years, the profit after taxation of the company has increased from N50.441 million in 1998 to N155.766 million in year 2002. This represents an increase of 309% or an annual growth of 33%.
- Based on the above, we are of the opinion, that the current market price of shares of the company in the secondary market is the best guide in determining the price of the shares in the proposed Rights Offer. The market valuation of Niger Insurance Plc as per the Daily Official List of 23/04/2004 is N3.94. A Rights Offer of N3.30 per share will constitute a discount of 64k per share, which is 16% of the existing price.

Recommendation

Based on the above, a price of **N3.30k** per share is considered reasonable for the Rights Offer.

7. **Union Bank of Nigeria Plc** - Rights Issue of 839,950,000 Ordinary shares of 50k each at N18.00 per share.

Net asset basis

Net Asset as at 31st March, 2001 N12,191,000,000
Divide Net Asset by number of paid up capital of 1,258,400,000 ordinary shares.

Value per share: N12,191,000,000/1,258,400,000

= **N12.07k or N12**

Maintainable annual profit

Year	Adjusted Profit After Tax
	N'000
2001	5,745,000
1999	3,249,000
1998	1,914,000
1997	1,283,000
1996	1,152,000
	13,343,000

Simple Average: N13,343,000/5 = N2,669,000

Capitalise N2,669,000 at 17.5%* = N15,251,000

Value per share: N15,251,000/1,258,400 = **N12.119k or N1**

*Indicative rate for Banks by Securities & Exchange Commission.

Maintainable annual profit-incorporating profit forecasts

Year	Adjusted Profit After Tax
	N'000
2002	7,029,000
2003	6,234,000
2002	5,020,000
2001	5,745,000
1999	3,249,000
	27,883,000

Simple Average: N27,883,000,000/5 = N5,576,600,000

Capitalise N5,576,600,000 at 17.5%* = N31,866,285,714

Value per share: N31,866,285,714/2,516,850,000

= **N12.66 or N13**

Weighted average

Year	Adjusted Profit After Tax N'000	Weighting	Weighted PAT N'000
2001	5,745,000	5	28,725,000
1999	3,249,000	4	12,996,000
1998	1,914,000	3	5,742,000
1997	1,283,000	2	2,566,000
1996	1,152,000	1	1,152,000
	13,343,000	15	51,181,000

N51,181,000/15 = N3,412,000

Capitalised at 17.5% = N17,497,000

Value per share: 19,497,000/1,258,400

= **N15.49k or N15.50k**

Weighted average – incorporating profit forecasts

Year	Adjusted Profit After Tax N'000	Weighting	Weighted PAT N'000
2004	7,029,000	5	35,145,000
2003	6,234,000	4	24,936,000
2002	5,626,000	3	16,878,000
2001	5,745,000	2	11,490,000
1999	3,249,000	1	3,249,000
		15	91,698,000
		==	=========

N91,698,000,000/15 = N6,113,200,000

Capitalised at 17.5% = N34,932,571,429

Value per share: N34,932,571,429/2,516,850,000*

= **N13.87k or N14**

*Post Bonus, Post Rights paid up capital

Earnings before and after tax per 50k ordinary share

– Year ended March 31st

Earnings yield at various prices

Price- N	Earnings Yield	P/E Ratio	Remark
20	11.8	8.51	
19	12.4	8.09	
18	13.1	7.66	Offer price
16	14.7	6.80	
15.5	16.6	6.02	Weighted average price
15	15.7	6.38	
14	16.78	5.96	Weighted average price including forecast)
13	18.12	5.52	Simple average (including forecast)
12.1	19.4	5.15	Net asset price
12	19.6	5.10	Simple average price
50k	470	0.21	Nominal price

*Average earnings after tax per 50k ordinary share is **N2.35k**

4.3 Discussion of Result

Based on the valuation methods employed by the bank on the sample selected for this study the researcher also adopted analysis of variance amongst the companies valued.

4.4 **Reasons why the current market price of shares are higher than computed figures**

The difference between prices computed and the current market price of shares could be deduced as follows:

(i) Market interplay is one of the major factors that influence the current market price of shares after the Initial Price Offer as the prices will rise

when there is an increase in the demand for that particular company's shares.

(ii) The company's dividend policies, investing public would go for shares of company that will yield constant and higher income from their investment. Therefore share price of companies that have a good dividend policy in place will experience upward movement.

(iii) Political and economic stability, most of the prices of company's security fell drastically during June 12, 1993 upheaval and since the country returned to democracy, the capital market is booming again and there is relatively price increase.

4.5 **Problems encountered by Union Merchant Bank Limited in stock valuation**

Some of the problems encountered in stock valuation process are as follows:

- Determination of the appropriate time to seek for funds from the capital market.
- Over or under pricing of the issue.
- Over or under subscription of the issue.
- Financial statements do not reflect the actual position of the issuer.
- Valuations often based on assumptions thereby ignoring realities.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter covers the summary/findings, conclusions and recommendations of the study. The suggestions prepared will form basis for further research study. There is need to continuously study the capital market by both the Issuing House and the issuer in order to increase the volume of trade, encourage foreign capital inflow and internationalize the capital market to take advantage of the globalization that is fast gaining increase.

5.1 Summary of the Study

Earlier in this research report it was stated that this research is aimed at ensuring that the general public have clear understanding of what constitutes a security and how the values are determined. In order to accomplish this objective, this work has been conducted in such a manner that justice has been done to attain this objective.

We also examine the concept of security, its classification as risk capital and fixed interest capital. Mention was made about the two types of markets that exist at the capital market and how securities are valued in the market.

Deregulation era of the capital market was also discussed. It like wise expounded the various problems associated with valuation of securities as well as the issue of under valuation of securities.

Further more, the study also highlighted the significance of the study together with consideration of the scope and limitations of the study. An extensive theoretical framework of all existing works were carried out on the valuation of securities, ranging from dividend relevance and dividend irrelevance models, to capital assets pricing model (CAPM), random walk theory, technical analysis (chartists), fundamental analysis and efficient market hypothesis.

The study gave an account of the research design, population, sample size, research techniques, research instruments and the procedures used.

Personal observations and interviews were the primary data collection instruments, while the use of journals, textbooks, annual reports, pricing memorandum, the daily official list of the stock exchange market. Secondary data used for the study was highlighted and the limitations to the research study were fully explained.

The analysis and presentation of data collected were dealt with and from the analysis it was discovered that all the models talked about in the literature review could not be used in the analysis of

data as most of the models are virtually theoretical and need a perfect market to operate in. Therefore, the researcher had to be restricted to the two methods currently used and these are:

(i) The net asset basis.

(ii) The maintainable earnings method.

However, it was discovered that the maintainable earnings method tends to undervalue securities making it incomparable with the net asset approach. The net asset basis has been applauded as an approach, which is more reasonable than the maintainable earnings approach.

5.2 Conclusions

Having examined and analysed the data obtained for the valuation of securities, the following conclusions can be drawn in the light of the research findings:

(a) The maintainable earnings approach of valuing equity shares gives a very low result as compared with the net asset basis method. It has also been observed to have the limitation of utilizing historical data as in previous years after tax because of circumstances and events change. Any attempt to forecast future earnings based on past performances will produce unrealistic and largely questionable values.

(b) The net asset approach gives a more realistic and reasonable price of securities, which reflect the true strength of the company in the ever-competitive industry. This is made possible because this method often ensures that assets are revalued to reflect the current and inflationary trend so as to make it possible for shareholders to take advantage of the higher prices.

(c) The equity share capital has gained much more prominence in terms of acceptance and transactional activities than the government securities and the industrial loans.

(d) The deregulation that has taken place in the capital market is a welcome idea as people will now fully assume responsibility for any price of security agreed by both the Issuing House and the issuer of the security.

5.3 Recommendations

One of the functions of the Securities and Exchange Commission is to ensure proper valuation of securities. In order that this function is successfully carried out in view of the findings of this research and its conclusions, the following recommendations are being made:

(i) The net asset approach should be adopted for the valuation of new shares as facts have shown that it presents a more realistic pricing of securities, in both the primary and secondary markets.

(ii) The discount rate or cost of capital used by companies to evaluate the present value of securities is too high. The lower the present value and company's cost of capital the higher the present value of its security gets thereby having investors confidence on the company.

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