

Share Valuation

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Knowing the true value of a share is crucial to make investment decisions.

Market Value of a Share

The market value or price is the value determined by the consensus of market participants (i.e. sellers and buyers). The price we observe in share markets result from the interaction between the demand for shares and the supply of shares.

Intrinsic (True) Value of a Share

The intrinsic value is the true or fundamental value of a share. This value is not observed, and has to be estimated using share valuation methods. The intrinsic value represents the maximum price that the investor should pay to purchase a share. This may not be equal to the current market price.

Investments Decisions

The investment decision depends on the relationship between the market value and the intrinsic value of a share.

The prevailing market price is equal to the intrinsic value when the share is properly valued. If the market value is less than the intrinsic value, the share is under-valued or under-priced. An undervalued share is considered a good share to buy. An investor can expect to earn a return in excess of the normal return expected in the market.

When the share is overvalued, the market price is greater than the intrinsic value. An overvalued share should be sold if the investor already owns that stock and should not be bought if the investor is evaluating the share as a possible investment.

It is important to know the true value of a share before buying or selling a share. However, picking the right shares is not an easy task. It is difficult to identify a share in a bullish market, when the positive sentiments are already factored in the share price. **However it is easier to identify under-priced shares in a bearish market where the prices have plummeted.**

The investors can determine the intrinsic value of the share using a number of share valuation methods. Share valuation methods will be discussed next week.