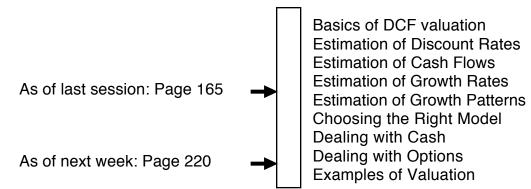
Equity Instruments: Newsletter – March 8, 2014

Where we are in class...





Where you should be in the project...

DCF Valuation portion of Project

	Item
	1. Pick a firm
	2. Obtain its financials
	3. Find out the businesses that your firm operates in
	4. Obtain a riskfree rate
	5. Estimate a market risk premium
	6. Estimate a bottom-up unlevered beta
	7. Estimate the market value of equity and debt
	8. Estimate a bottom-up levered beta
	9. Estimate a pre-tax cost of debt (using actual or synthetic ratings)
	10. Convert operating leases into debt
	11. Estimate a tax rate
	11. Estimate a cost of capital
	12. Capitalize R&D expenses
	13. Estimate an adjusted operating income
	14. Estimate net capital expenditures
	15. Estimate non-cash working capital
	16. Estimate Free Cash Flow to Firm
	17. Estimate Free Cash Flow to Equity
	18. Estimate a historical growth rate in earnings
	19. Obtain analyst forecasts of growth in earnings for your firm
	20. Estimate growth in earnings from fundamentals
	21. Choose a length for the high growth period
	22. Choose a DCF model
_	23 Value the firm/stock

23. Value the firm/stock

Data Notes...

Now that you have the fundamental inputs for valuing your firm - the cash flows, the growth rate, the discount rate - you have to pick a valuation model. You can download a spreadsheet that will help in making this choice by going to

http://www.stern.nyu.edu/~adamodar/New_Home_Page/spreadsh.htm

To download any of the valuations that we will be doing in class in the next weeks, you can check out company valuations at

http://www.stern.nyu.edu/~adamodar/New_Home_Page/covals.htm

Miscellaneous FAQs

How do I decide on whether to use a stable growth, 2-stage or 3-stage model? The choice is ultimately a subjective one. While historical growth is one input, you should also look at the growth of the market your firm serves and your firm's market share.

How do I know whether I should estimate FCFF or FCFE?

You do not, until you have picked a DCF model that fits your firm. I would estimate both. Once you have picked a DCF model, you can decide which one is more appropriate. *My company has negative earnings. Which stage model should I use?*

If your firm has negative earnings, you first have to decide how you are going to normalize earnings. If you can normalize earnings instantaneously, you can then pick a stable growth or 2-stage model. If you cannot, you will have to forecast revenue growth over a period and an expected operating margin at the end; you would use these then to project free cash flows to the firm.