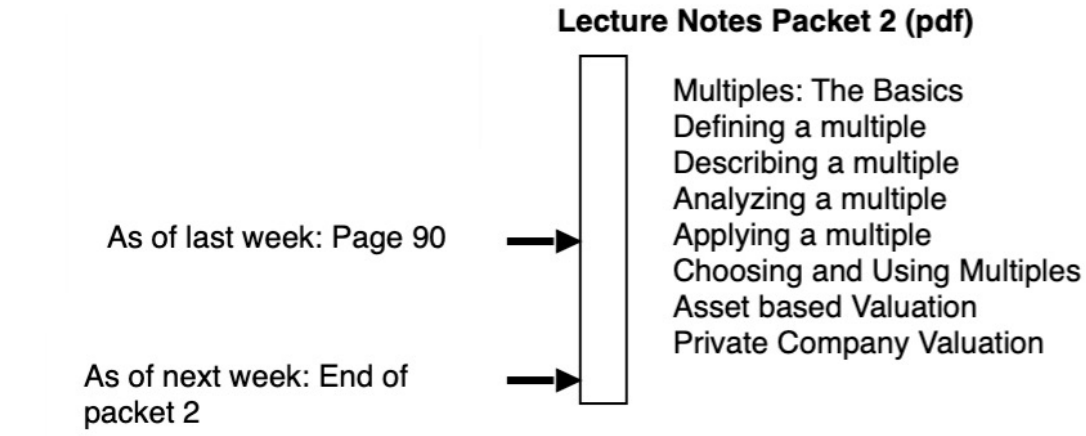
Valuation: Newsletter – April 13, 2024

Where we are in class…



Where you should be in the project…

Rest of Project

Item
1. 1. Complete your DCF valuation
2. Find comparable firms
3. Pick a multiple
4. Collect information on the multiple and variables that determine that multiple for comparable firms
5. Develop as subjective estimate of what the multiple should be for your firm
6. Run a regression for your multiple across comparable firms
7. Use the market regression to estimate the multiple for your firm
→ 8. Based upon (5), (6) and (7), decide which one you believe best represents the relative value.
9. Apply the option pricing model to value equity in your firm
10. Calculate the face value of the debt and the weighted duration.
11. Estimate the variance in firm value
11. Value equity as an option
12. Value control at one of the firms in your group.
13. Estimate EVA at each of your firms
14. Make a recommendation.

Data Notes…

Most data sites allow you to screen for multiples and fundamentals, though they constrain you in two ways. First, they define the multiple using their version of the multiple, which may not match up to yours. Second, they report only the fundamentals that they think are important.

If you truly want to use multiples, you have to access the raw data (market and accounting). You should then define the multiples, using what you feel is the best measure of that multiple and the fundamentals that you believe should matter. Then, it is a question of finding mismatches.

Miscellaneous FAQs

Why do we do the intrinsic value equations for multiples?

As I went through each multiple, I tried using a discounted cash flow model to derive that multiple. With equity multiples the model was a dividend discount model and with firm multiples, the model is a firm valuation model. While the equation that emerges looks daunting, it is just a DCF presented as a multiple. You should never use this multiple to price a company because you are doing valuation, with this multiple, not pricing. What you get out of the DCF set up is the list of variables that drive that multiple, i.e., the variable that you should be controlling for, when using that multiple in pricing.

What is a "cheap" stock, on pricing basis?

A cheap stock is one that trades at a low multiple, without any of the fundamental reasons for trading at that low a multiple. Thus, a low PE stock with high growth, low risk and high ROE is a cheap stock