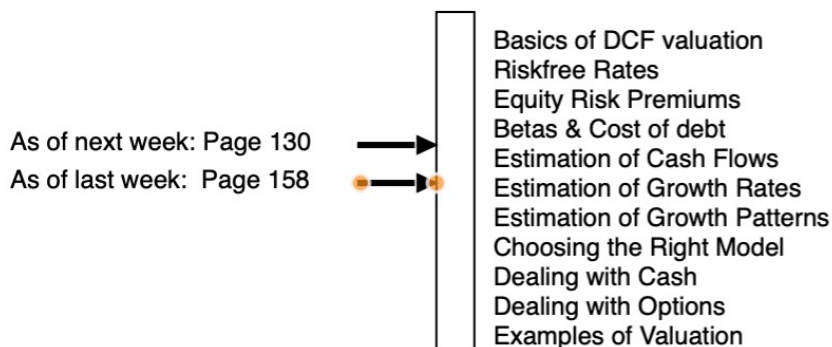


Equity Instruments: Newsletter – February 17, 2024

Where we are in class...

Lecture Notes Packet 1 (pdf)



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 |

Data Notes...

In the next two weeks, we will start on the discussion of growth and how best to estimate growth for a company. You can get analyst estimates of growth in earnings for your firm by visiting the Zacks web site:

<http://www.zacks.com>

If you want to look at historical growth rates in revenues and earnings for your firms, check under updated data on my web site. Since we also link growth to fundamentals, you can also get a measure of the fundamentals that drive growth (retention ratio, reinvestment rates, return on equity and return on capital) for different sectors under the updated data site as well.

Miscellaneous FAQs

Which earnings should I compute growth in? Net income? Operating Income? Earnings per share?

At this stage in the process it is probably best to do all of the above. The differences will tell you a great deal about how this firm is growing and may affect your estimates for the future.

What happens if my firm is not followed by analysts, or I cannot get analyst projections of growth?

Given how little information there is in these forecasts, it is not the end of the world. Work with fundamental growth rates.

I am having trouble estimating historical growth. What should I do?

See answer to last question.