

Valuation: Newsletter – February 15, 2025

Where we are in class...

Lecture Notes Packet 1 (pdf)

As of last week: Page 78

As of next week: Page 120



Basics of DCF valuation
Riskfree Rates
Equity Risk Premiums
Betas & Cost of debt
Estimation of Cash Flows
Estimation of Growth Rates
Estimation of Growth Patterns
Choosing the Right Model
Dealing with Cash
Dealing with Options
Examples of Valuation

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...

This week, we continued our discussion of cost of capital, navigating our way through riskfree rates and equity risk premiums. For the default spreads, the best sources is the Federal Reserve Site in St. Louis (FRED), where you can find default spreads for indices, by rating. If you are interested in finding more information on country risk, Campbell Harvey at Duke maintains great country risk data on his site and you can access it by going to:

http://people.duke.edu/~charvey/Country_risk/couindex.htm

If you have \$200+ to spare, you can also buy the latest country risk scores from PRS, a service that analyzes country risk:

<http://www.prsgroup.com>

Miscellaneous FAQs

My company breaks revenues down into the US and the rest of the world. How do I assume an equity risk premium for the rest of the world?

You can use the country specific ERP that I have in my excel spreadsheet, with the GDP in that same spreadsheet to compute a weighted average for the rest of the world (or any customized region) you want.

Do I always have to use revenues to weight ERP? Can I use EBITDA or total assets instead?

Sure. Just make sure that the EBITDA for a country or region is not negative. If you believe risk exposure is a function of where your assets are and not a function of where you sell your products, you can use total assets.

If I expect my company to reduce or increase its exposure to a particular country, can I change weights over time?

I don't see why not.