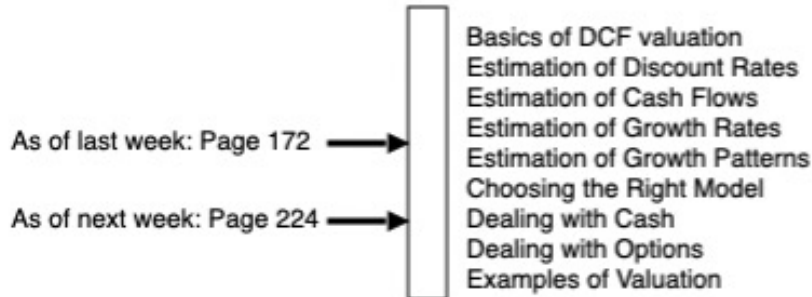


Valuation: Newsletter – March 2, 2024

Where we are in class...

Lecture Notes Packet 1 (pdf)



Where you should be in the project...

DCF Valuation portion of Project

- | <i>Item</i> |
|--|
| 1. Find a group & 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...

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. The models below are the most adaptable, one for non-financial service firms and one for financial service firms (a dividend discount model):

Non-financial service: <https://pages.stern.nyu.edu/~adamodar/pc/fcffsimpleginzu.xlsx>

Financial service: <https://pages.stern.nyu.edu/~adamodar/pc/divginzu.xlsx>

I had also promised you links to a couple of forensic accounting books. Here they are:

1. http://www.amazon.com/Financial-Shenanigans-Accounting-Gimmicks-Reports/dp/0071703071/ref=pd_sim_b_8
2. http://www.amazon.com/Creative-Cash-Flow-Reporting-Sustainable/dp/0471469181/ref=pd_sim_b_2

There are denser books on the topics but those are for forensic accountants. These books work for the rest of us.

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.