The Valuation Standard

The Valuation Standard is a framework of principles and methods I've developed for my own investment approach. I believe it is an alternative to conventional investing and valuation techniques. While many of the principles align with industry standards, certain metrics and valuation methods intentionally deviate based on my personal understanding of how investing should function and how companies should truly be valued. If you choose to read my analysis and valuations, please note that I do not always adhere strictly to traditional standards.

Main principle

$$\frac{\text{Free Cash Flow Yield + Intrinsic Value Growth}}{\text{Cost of Equity}}$$

The first formula illustrates the root of what I believe a company's value truly lies: The rate of ***tangible cash return*** *an investor may realistically realize. The objective of investing is to have access to a company's cash flows therefore its value is attained by the free cash flow yield it offers. The value of the yield may be perceived acceptable by deriving the value of return an investor may ask for relative to the risk-free rate, average market returns and risk. Therefore, the most suitable yield to apply as a benchmark for optimal returns is the* ***cost of equity.*** *It fully encapsulates the returns an investor should look for in a company relative to its risk, market performance and the risk-free returns.*

However, in auction based markets where company valuation changes over time, a company must be valued accordingly based on its performance. As the free cash flow yield grows, the market capitalization of the company must also grow in proportion with its FCF yield growth. Since both the yield and the growth of the market cap are tangible cash returns, they can be used to fulfil the rate of return required by the cost of equity.

My own principle

$$\frac{\text{Free Cash Flow Yield + Intrinsic Value Growth}}{\text{15\%}}$$

I, however believed that the current and traditional way of deriving the cost of equity to be significantly uncompetitive, especially so taking into consideration of inflation and currency fluctuations. I also would like my investments to double every 5 years. And so, I choose a flat 15% rate as my cost of equity, not because I have sophisticated calculations laid out to justify this but simply out of my own personal objective. With this, I also theoretically may consistently outperform any indices the world could come up with consistently over the long term.

Intrinsic Value

$$\frac{\textbf{Free Cash Flow}}{\textbf{Required FCF Yield}}$$

The intrinsic value in this context is the minimum amount of yield a security can provide that is required by the investor. Note that the yield used is free cash flow yield and not dividends yield because FCF yield is real, tangible, practical yield. The yield may be derived from the risk-free rate plus a premium of the investor's choice. This will result in the intrinsic value of a company. This way every year, the market cap may grow or shrink based on the yield it generates.

Intrinsic Value Growth

(Final Year Intrinsic Value/Base Year Market Cap)^(1/n)-1

The growth of intrinsic value is the growth of market cap under the condition that it retains the FCF yield. This hypothesis would benefit both dividend seeking investors and growth investors to invest in a company that is both growing and has the capacity to distribute FCF.