

## How to get the Gordon Growth Model from the Generalized Dividend Valuation Model?

The Generalized Dividend Valuation Model:

$$P_0 = \frac{D_0 \times (1 + g)}{(1 + k_e)} + \frac{D_0 \times (1 + g)^2}{(1 + k_e)^2} + \dots + \frac{D_0 \times (1 + g)^\infty}{(1 + k_e)^\infty}$$

If we multiply both side by  $\frac{1+k_e}{1+g}$ , we get:

$$P_0 \times \frac{1 + k_e}{1 + g} = D_0 + \frac{D_0 \times (1 + g)}{(1 + k_e)} + \dots + \frac{D_0 \times (1 + g)^{\infty-1}}{(1 + k_e)^{\infty-1}}$$

Subtract equation 1 from equation 2, we get:

$$P_0 \times \frac{1 + k_e}{1 + g} - P_0 = D_0 - \frac{D_0 \times (1 + g)^\infty}{(1 + k_e)^\infty}$$

If we assume that growth rate  $g$  is smaller than the required return on equity  $k_e$ , then we know:

$$\frac{(1 + g)^\infty}{(1 + k_e)^\infty} \rightarrow 0$$

Hence:

$$P_0 \times \left( \frac{1 + k_e}{1 + g} - 1 \right) = D_0$$
$$P_0 = \frac{D_0 \times (1 + g)}{(k_e - g)} = \frac{D_1}{(k_e - g)}$$