EQUITY VALUATION IN R

Fundamental Valuation: Analyzing Projections

Cliff Ang
Vice President, Compass Lexecon

Analyzing Projections

- Projections are critical input in discounted cash flow analysis
- Garbage-In $\rightarrow$ Garbage-Out
- Approaches to Analyzing Projections
  - Visual Inspection
  - Regression Analysis

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Let's practice!

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Fundamental Valuation

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Fundamental Valuation techniques

- Free Cash Flow to Equity (FCFE)
- Dividend Discount Model (DDM)

Free Cash Flow to Equity Model Recap

Value of Firm's Equity equals Present Value of Free Cash Flows to Equity discounted at the Cost of Equity

$$V = \sum_{t=1}^{T} FCFE_t/(1+k_e)^t + [(FCFE_T(1+g)/(k_e-g)]/(1+k_e)^T$$

Steps:

- FCFE during projection period
- Terminal Value
- Add the two together to get Equity Value

Dividend Discount Model Recap

- Value = PV of Projected Dividend Payments
- Shortcut for dividends growing at a constant rate:

$$V = \frac{div_t(1+g)}{(k_e - g)}$$

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Relative Valuation

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Valuation Using Multiples

- Relative Valuation is based on the *law of one price*
- Identifying comparable companies is crucial
- P/E and P/B Ratios are two of the most common valuation multiples
- Resulting valuation is "implied"

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Congratulations!

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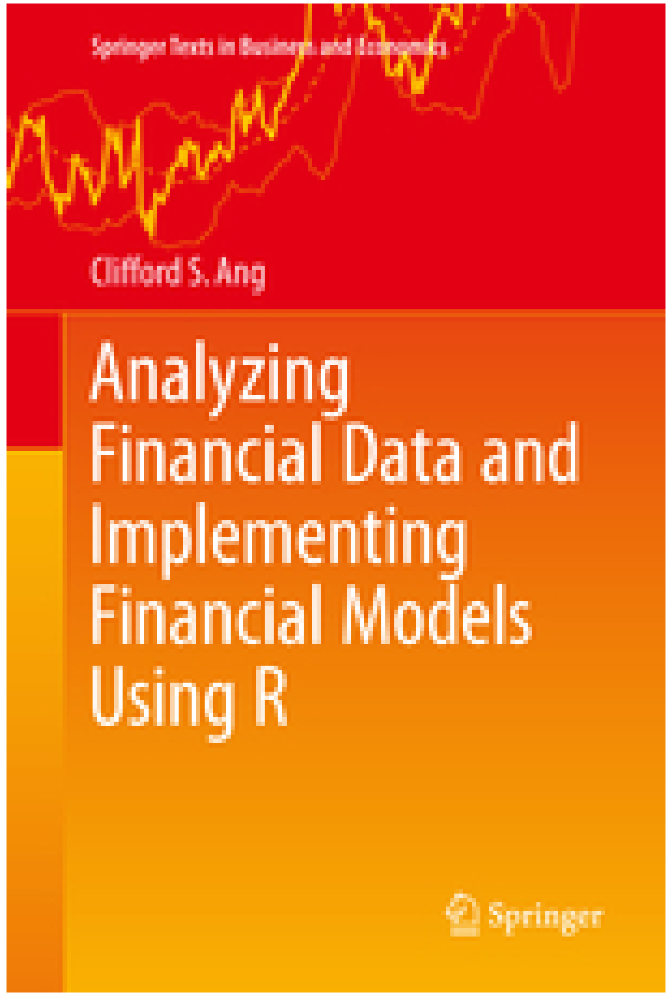
For further studies ...



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Good luck!