CHULALONGKORN BUSINESS SCHOOL

FLAGSHIP FOR LIFE

Practical Corporate Financial Modeling

Valuation

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Value: book versus market

Invested Capital	Capital Employed
Net Operating Working Capital	**Debt** - ***Short-term*** - ***Long-term***
Net Long-Term Assets	**Equity** - ***Long-term***

Enterprise Value	**Debt** - ***Short-term*** - ***Long-term***
	Equity - ***Market Cap***

Three approaches to valuation

This is generally true for all asset classes.

- How much does it cost to make it rather than buy it?
  → **Cost approach**

pricing

- How much are other people paying for it?
  → **Comparable approach**

- What benefits am I getting from owning it?
  → **Income approach**

most informative way
↳ gives intrinsic value for owning it

- Why are we doing the valuation? Who is doing the valuation?

Comp = scaling problem.

→ pricing approach

What would you compare "value" to?

Typical EV multiples

mismatch

~~EV / net income~~

includes FX gain/loss

only shdr have access on this

EV / invested capital

EV / sales

~~EV / market cap~~

EV / EBITDA ~ close to cash

EV / free cash flow

Enterprise Value	Debt - *Short-term* - *Long-term*
	Equity - *Market Cap*

Typical equity multiples

MV / net income
= (P x N) / (EPS x N) = P/E
→ E/P = earnings yield

MV / book value of equity
= P/ BV
→ B/M (book to market ratio)

~~MV / sales~~

~~MV / EBITDA~~

MV / dividend
→ DPS/P = dividend yield

Income approach can be done with both profits and cash flows.

Enterprise value
= PV(FCF, WACC)

period-by-period basis   same result

= PV(EVA, WACC)
+ invested capital

Enterprise Value	Debt - ***Short-term*** - ***Long-term***
	Equity - ***Market Cap***

Bond value
= PV(promised bond cash flow, yield to maturity [promised yield])

= PV(expected bond cash flow, "cost of debt")

Market capitalization
= PV(dividend, cost of equity)

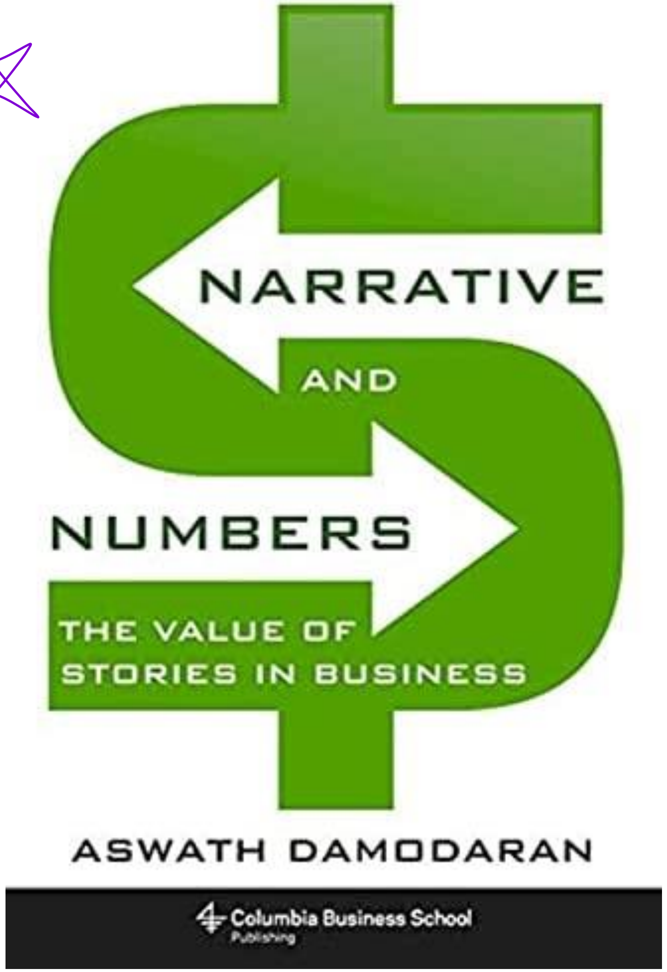
= PV(FCFE, cost of equity)

for equity part

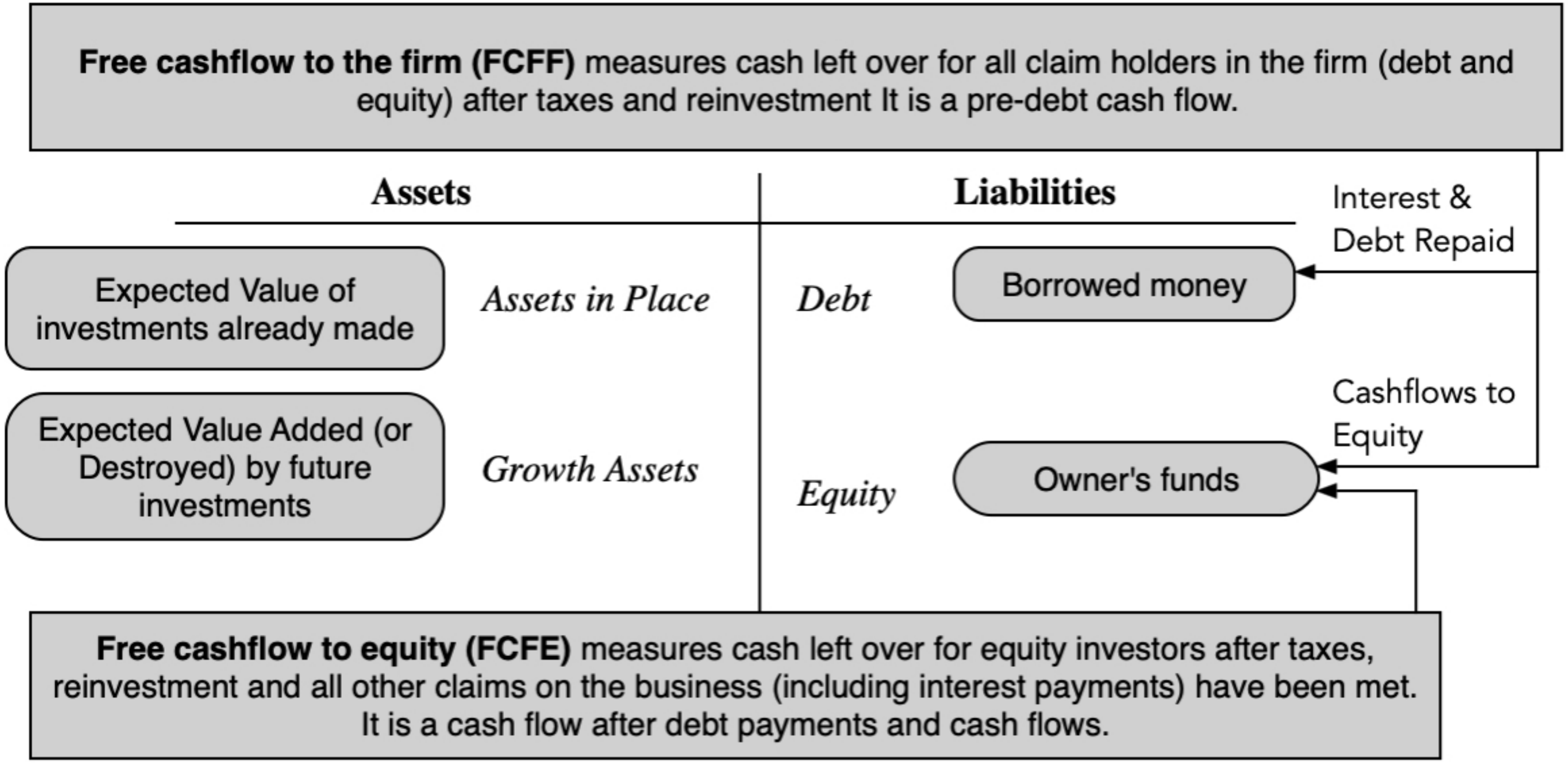
= PV(residual income, cost of equity)
+ book value of equity

"Every valuation tells a story."

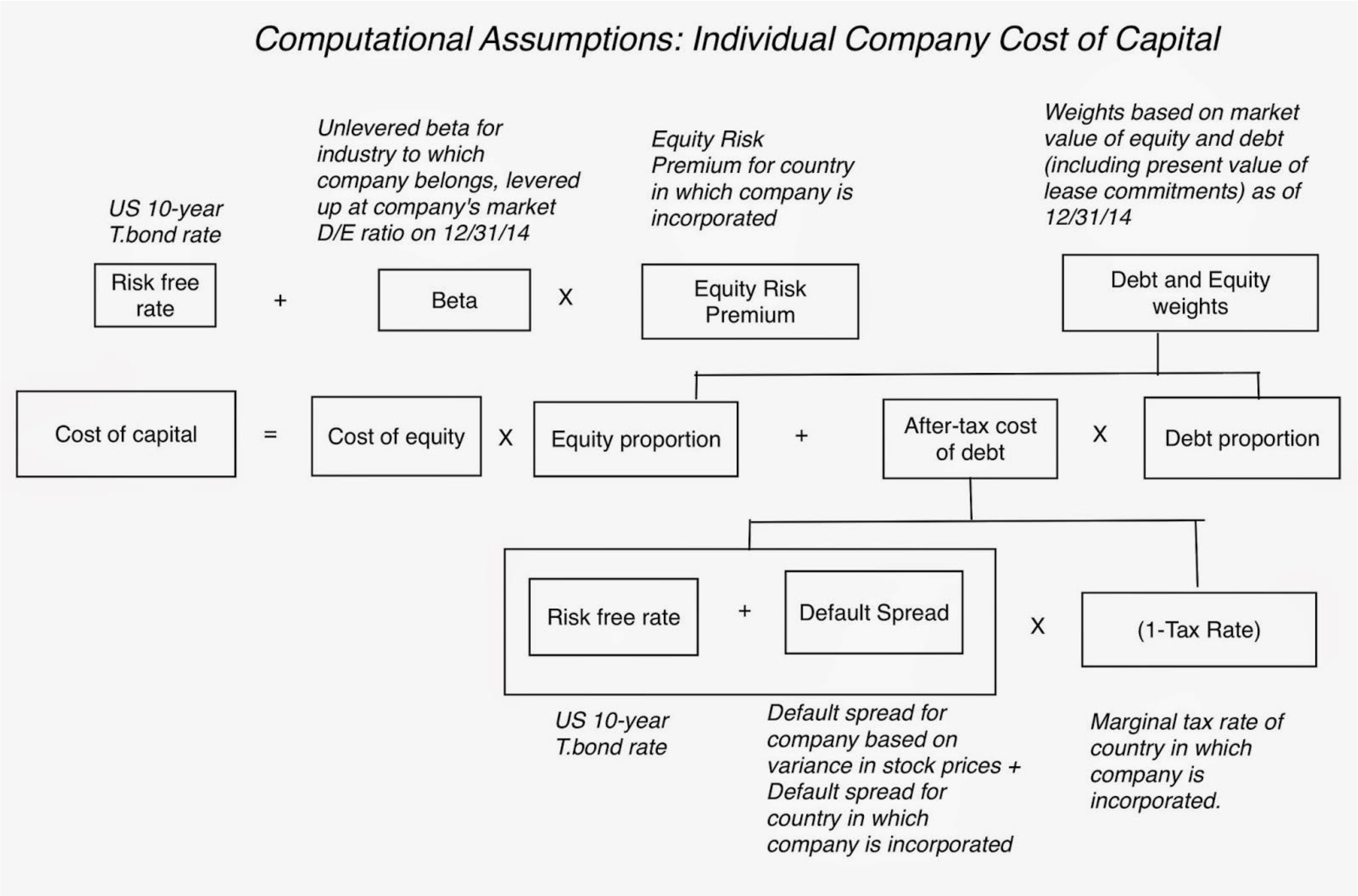
Prof. Aswath Damodaran, the "Dean of Valuation"



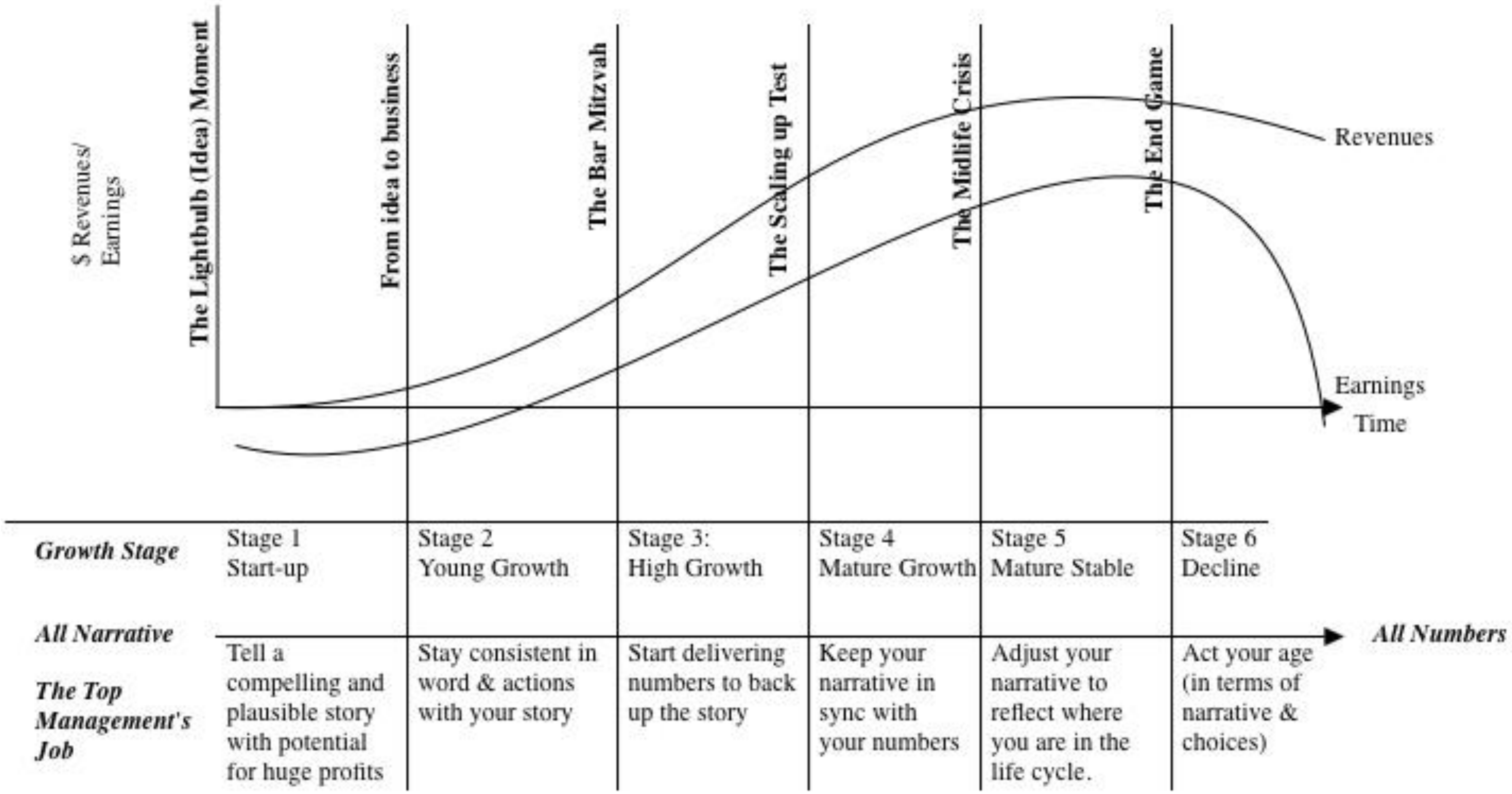
FCFF versus FCFE



Source: https://aswathdamodaran.blogspot.com/2022/11/meta-lesson-1-corporate-governance.html



Source: https://aswathdamodaran.blogspot.com/2015/01/putting-d-in-dcf-cost-of-capital.html?m=1



Source: https://aswathdamodaran.blogspot.com/2022/10/earnings-and-cash-flows-primer-on-free.html

Challenges associated with financial decision making.

How private equity construct financial model
target return based model → next week

- What are the implicit assumptions in the valuation method?
  - Capital structure?
  - Frictions that may affect firm value?
- How do we evaluate "success" when we make decision?
  - Merger and acquisition
  - Private equity and venture capital
- Valuation versus pricing
  - Different parties may not agree on the valuation.
  - Value is unobservable.
  - Negotiation will determine the price, which is the only outcome you'll see.

Valuation ingredients

- How many assumptions do we want to make?
  - **FCF = NOPAT – reinvestment**
  - Revenue / cost drivers
  - Investment decisions

- How long should we forecast cash flows for?
  - Growth rate
  - Operating / financial metrics
  - Cost of capital
  - Each year and then “steady state”

- Equity value = enterprise value
  + other adjustments (e.g., investment in subsidiaries)
  – debt + excess cash (net debt)
  + equity raised (only in new equity issuance)