Chapter Preview: Chapter 9

Answer the following questions briefly:

1. Explain the purpose of a dividend-discount model (DDM)

* DDM estimates the value of a stock based on the present value of its expected future dividends.

2. What is the total return?

* Total return is the overall return from an investment, including both income (dividends or interest) and capital gains.

3. Does repurchase of stock can affect shareholder wealth?

* Yes, stock repurchase can increase shareholder wealth by reducing the number of shares outstanding, often leading to higher earnings per share (EPS) and stock price.

4. What is the method of comparables?

* It is a valuation method that estimates the value of an asset by comparing it to similar assets using metrics like P/E, EV/EBITDA.

5. How the price-earnings ratio (P/E) can be used to estimate the value of a firm?

* P/E ratio allows valuation by multiplying a company's earnings by the industry-average or peer group's P/E ratio.

6. State the efficient market hypothesis (EMH).

* EMH states that all available information is already reflected in stock prices, making it impossible to consistently outperform the market.

7. Define the following terms:

* Dividend payout ratio
  + The proportion of earnings paid out as dividends to shareholders.
* Weighted average cost of capital (WACC)
  + The average rate a company is expected to pay to all its security holders to finance its assets.
* Sustainable growth rate (SGR)
  + The rate at which a company can grow its sales, earnings, and dividends without having to increase financial leverage.
* Enterprise value (EV)
  + The total value of a company, calculated as market capitalization plus debt minus cash.
* The Discounted Free Cash Flow (DFC) Model
  + A valuation method that estimates the value of an investment based on its expected future free cash flows discounted back to present value.