THE UNIVERSITY OF MELBOURNE

## Module 4 - Introduction

# The Language and Tools of Financial Analysis

## Value Measurement Using Discounted Cash Flow Analysis

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## Breaking through the accounting barrier

Accounting information has its limits for corporate financial analysis.

The difference between market value and book value suggests that we need to look elsewhere.

$$EnterpriseValue = MV(Equity) + Debt - Cash$$

Maximizing shareholder wealth requires forward-looking information and the tools to bring it back to the present decision point.

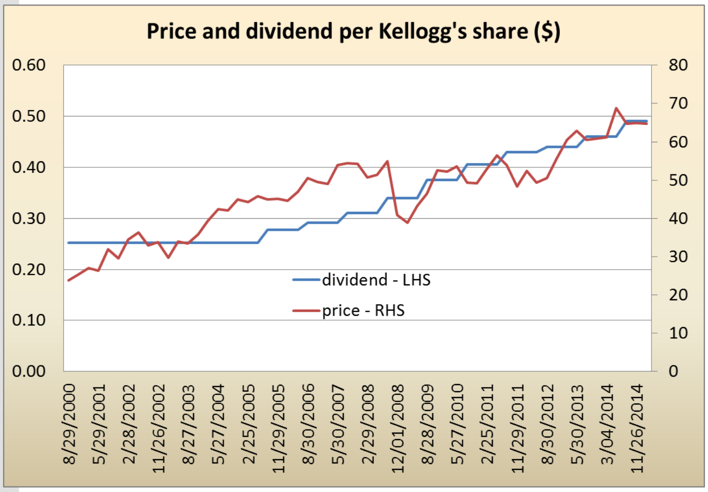
## Looking forward

Buying a share in Kellogg's today entitles the investor to Kellogg's future cash flows.

To help an investor decide whether to buy Kellogg's shares today:

- what are the expectations of future cash flows?
- are they guaranteed or risky?
- does money lose value over time?
- are there alternative investments?

## Some cash flows are predictable…




## But others not so much…

Future sales and expenses are uncertain due to various risk factors:

- competition
- labor cost
- raw material prices
- external factors (health recommendations), etc.

There are other risks:

- inflation
- opportunity cost.

## The gold standard in finance…

**Discounted Cash Flow (DCF)** methodology is the standard forward-looking valuation technique in finance, providing ‘absolute’ valuation of the investment opportunity.

But is often supplemented by multiples (ratio) valuation, providing relative valuation of the investment opportunity.

## Source List

- Slide 5: Price and dividend per Kellogg’s share ($) © the University of Melbourne. Created from data sourced at Yahoo!7 Finance (https://au.finance.yahoo.com/q/hp?s=K)
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