DISCOUNTED CASH FLOW STEPS:

1. Forecast The Free Cash Flow: for typical 5-10 year period > using a set of assumptions based on historical data to be able to project how much a company is going to be generating in cash in next 5-10 years.

2. Calculate the Weighted Average Cost of Capital: Also know as the WACC> this is the discount rate you use to bring back all the future cash flows back to the present to year zero> reason to do this is because of the time value of money: means a sum of money today is more than a sum of money in the future due to things like being able to invest and grow that money today

3. Calculate The Terminal Value: After the forcasted period of e.g. 5-10 years the company will not just disintegrate after that there is life after that. >Means after that forecasted period you need to assume a value for it which is known as a terminal value

4. Discount the Free Cash Flows and Terminal Value: back to the present > essentially bring back to year 0

5. get to A Valuation / Calculate Enterprise Value / Calculate Implied Share Price:

FREE CASH FLOW: cash flow available to both debt and equity holders after the business pays for everything it needs to continue operating (more free cash flow a company has the more attractive it is for investors)

Free Cash Flow Formula:

[FCF = EBIT\*(1 - TAX RATE) + DEPRECIATION & AMORTIZATION - Capital expenditure - Increase in Non Cash Working Capital]

-EBIT (Earnings Before Interest & Taxes) & -TAX RATE (Tax % Essentially)

-cap ex (like buying a new factory > a cash outflow)

-Non cash Working Capital Formula: Current Assets - Cash - Current Liabilities

**SHEET NOTES:**

A screenshot of a calculator

AI-generated content may be incorrect.**FCF**

**WACC**

THE cost of financing for a company & comes in the form of debt or equity. however both have a cost >

cost of DEBT (interest payments) &

cost of Equity (expectation that the market has for owning your shares and the risk of owning your shares> usually calculated using the

**Capital Asset Pricing Model Formula (CAPM):**

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E(Ri) = Expected return

Rf = Risk-free rate

Bi = Beta

E(Rm)= Expected market return

**Expected rates = Risk free Rate + beta \* (Annual return of the market – risk free rate)**

**Formula for the Weighted Average Cost of Capital**

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E = Equity D = Debt Re = Cost of Equity (the CAPM) Rd = Cost of Debt

**WACC = Equity / Equity + Debt \* Cost of Equity + Debt / Equity + Debt \* cost of debt \* (1 – Tax rate)**

Cost of Equity = 10y Treasury + Beta \* (Market Return – 10y Treasury)

**Terminal Value**

Value of the business after the forecasted period: 2 methods

**Perpetuity Growth Method:**

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-Assumes cash flows will grow at a steady state forever

FCFn = FCF final year forecasting e.g. year 5 for instance

g = Growth Rate ( g should be based on the GDP of the country or based on industry growth)

**Perpetuity TV = [ FCF Final year forecasted \* (1 + Growth Rate)] / (WACC – g)**

**Exit Multiple**

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Assumes the company is sold using a multiple of a metric and in this case that EBITDA and the Multiple being the Enterprise Value / EBITDA

Financial Metric Example = EBITDA

Trading Multiple Example = Enterprise Value / EBITDA

This multiple is usually calculated by looking at other similar companies