Chapter9 preview

1. Explain the purpose of a dividend-discount model.

The dividend-discount model estimates the intrinsic value of a stock by discounting expected future dividends to the present value.

2. What is the total return?

Total return is the overall return on an investment, including both dividend income and capital gains.

3. Does repurchase of stock can affect shareholder wealth?

Yes, stock repurchases can increase earnings per share (EPS) and often raise the stock price, thereby enhancing shareholder wealth.

4. What is the method of comparables?

The method of comparables estimates a firm's value by comparing it to similar companies using valuation multiples like P/E or P/B ratios.

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

By multiplying the firm's expected earnings by the industry average P/E ratio, the firm's estimated value can be determined.

6. State the efficient market hypothesis.

The efficient market hypothesis states that all publicly available information is fully reflected in stock prices, making it difficult to consistently achieve excess returns.

7. Define the following terms:

- **Dividend payout ratio:**

  The proportion of earnings paid out as dividends, calculated as Dividends ÷ Net Income.

- **Weighted average cost of capital (WACC):**

The average rate of return a company is expected to pay its investors, weighted by the proportion of debt and equity.

- **Sustainable growth rate (SGR):**

  The maximum growth rate a firm can achieve without raising additional external capital, based on reinvested earnings.

- **Enterprise value (EV):**

  The total value of a firm, calculated as market capitalization plus net debt (debt minus cash).

- **The Discounted Free Cash Flow Model (DCF Model):**

  A valuation method that estimates a firm's value by discounting its expected future free cash flows to the present.