Fundamental Valuation: Analyzing Projections

EQUITY VALUATION IN R

Cliff Ang

Senior Vice President, Compass Lexecon

Analyzing Projections

- Projections are critical input in discounted cash flow analysis

- Garbage-In → Garbage-Out

- Approaches to Analyzing Projections
  - Visual Inspection

  - Regression Analysis

Let's practice!

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Fundamental Valuation

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Fundamental Valuation techniques

- Free Cash Flow to Equity (FCFE)

- Dividend Discount Model (DDM)

Free Cash Flow to Equity Model Recap

Value of Firm's Equity equals Present Value of Free Cash Flows to Equity discounted at the Cost of Equity

$$V = \sum_{t=1}^{T} FCFE_t/(1+k_e)^t + [(FCFE_T(1+g)/(k_e-g)]/(1+k_e)^T$$

Steps:

- FCFE during projection period

- Terminal Value

- Add the two together to get Equity Value

Dividend Discount Model Recap

- Value = PV of Projected Dividend Payments

- Shortcut for dividends growing at a constant rate:

$$V = \frac{div_t(1 + g)}{(k_e - g)}$$

Let's practice!

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Relative Valuation

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Valuation Using Multiples

- Relative Valuation is based on the *law of one price*

- Identifying comparable companies is crucial

- P/E and P/B Ratios are two of the most common valuation multiples

- Resulting valuation is "implied"

Let's practice!

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Congratulations!

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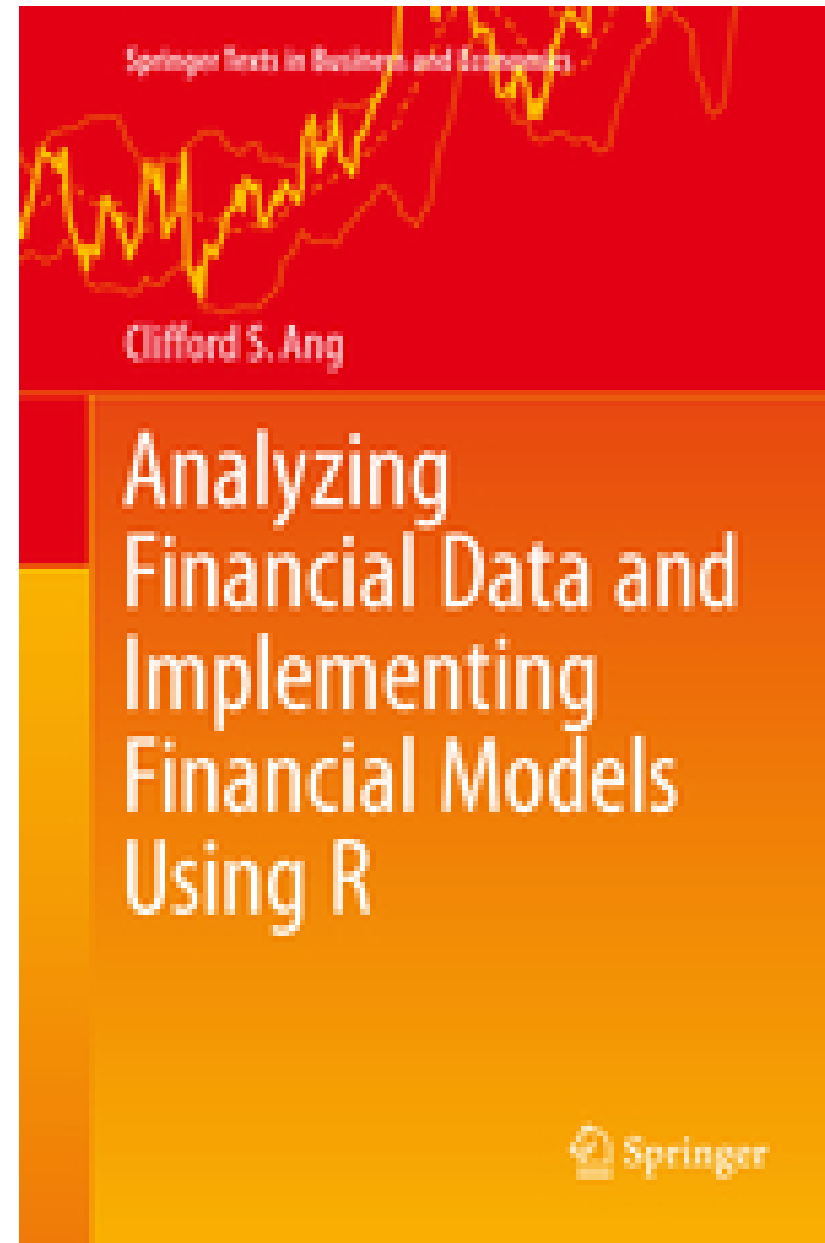Ssenior Vice President, Compass Lexecon

For further studies ...

Good luck!

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