

EQUITY ASSET VALUATION

John D. Stowe, CFA

Thomas R. Robinson, CFA

Jerald E. Pinto, CFA

Dennis W. McLeavey, CFA

HOCHSCHULE
LIECHTENSTEIN
Bibliothek



John Wiley & Sons, Inc.

CONTENTS

Foreword	xi
Acknowledgments	xv
Introduction	xvii
CHAPTER 1	
The Equity Valuation Process	1
Learning Outcomes	1
1 Introduction	2
2 The Scope of Equity Valuation	3
2.1 Valuation and Portfolio Management	5
3 Valuation Concepts and Models	6
3.1 The Valuation Process	6
3.2 Understanding the Business	7
3.3 Forecasting Company Performance	9
3.4 Selecting the Appropriate Valuation Model	15
4 Performing Valuations: The Analyst's Role and Responsibilities	23
5 Communicating Valuation Results: The Research Report	26
5.1 Contents of a Research Report	26
5.2 Format of a Research Report	28
5.3 Research Reporting Responsibilities	30
6 Summary	30
Problems	33
CHAPTER 2	
Discounted Dividend Valuation	37
Learning Outcomes	37
1 Introduction	38
2 Present Value Models	39
2.1 Valuation Based on the Present Value of Future Cash Flows	39
2.2 Streams of Expected Cash Flows	42
2.3 Discount Rate Determination	47

3	The Dividend Discount Model	56
3.1	The Expression for a Single Holding Period	56
3.2	The Expression for Multiple Holding Periods	58
4	The Gordon Growth Model	61
4.1	The Gordon Growth Model Equation	61
4.2	The Implied Dividend Growth Rate	67
4.3	Estimating the Expected Rate of Return with the Gordon Growth Model	68
4.4	The Present Value of Growth Opportunities	70
4.5	Gordon Growth Model and the Price—Earnings Ratio	71
4.6	Strengths and Weaknesses of the Gordon Growth Model	73
5	Multistage Dividend Discount Models ^{^^}	74
5.1	Two-Stage Dividend Discount Model	75
5.2	Valuing a Non-Dividend-Paying Company (First-Stage Dividend = 0)	78
5.3	The H-Model	79
5.4	Three-Stage Dividend Discount Models	80
5.5	Spreadsheet Modeling	83
5.6	Finding Rates of Return for Any DDM	84
5.7	Strengths and Weaknesses of Multistage DDMs	86
6	The Financial Determinants of Growth Rates	87
6.1	Sustainable Growth Rate ^r	87
6.2	Dividend Growth Rate, Retention Rate, and ROE Analysis	89
6.3	Financial Models and Dividends	92
6.4	Investment Management and DDMs	94
7	Summary	95
	Problems	98
CHAPTER 3		
	Free Cash Flow Valuation	107
	Learning Outcomes	107
1	Introduction to Free Cash Flows	108
2	FCFF and FCFE Valuation Approaches	109
2.1	Defining Free Cash Flow	109
2.2	Present Value of Free Cash Flow	110
2.3	Single-Stage FCFF and FCFE Growth Models	112
3	Forecasting Free Cash Flow	113
3.1	Computing FCFF from Net Income	113
3.2	Computing FCFF from the Statement of Cash Flows	117
3.3	Noncash Charges	118
3.4	Computing FCFE from FCFF	122
3.5	Finding FCFF and FCFE from EBIT or EBITDA	127
3.6	Forecasting FCFF and FCFE	130
3.7	Other Issues with Free Cash Flow Analysis	134
4	Free Cash Flow Model Variations	140
4.1	An International Application of the Single-Stage Model	140
4.2	Sensitivity Analysis of FCFF and FCFE Valuations	141

4.3 Two-Stage Free Cash Flow Models	143
4.4 Three-Stage Growth Models	149
5 Non-Operating Assets and Firm Value	151
6 Summary	152
Problems	154

CHAPTER 4

Market-Based Valuation: Price Multiples 165

Learning Outcomes	165
1 Introduction	166
2 Price Multiples in Valuation	167
3 Price to Earnings	169
3.1 Determining Earnings	170
3.2 Valuation Based on Forecasted Fundamentals	178
3.3 Valuation Using Comparables	181
4 Price to Book Value	194
4.1 Determining Book Value	197
4.2 Valuation Based on Forecasted Fundamentals	201
4.3 Valuation Using Comparables	202
5 Price to Sales	204
5.1 Determining Sales	205
5.2 Valuation Based on Forecasted Fundamentals	207
5.3 Valuation Using Comparables	209
6 Price to Cash Flow	210
6.1 Determining Cash Flow	212
6.2 Valuation Based on Forecasted Fundamentals	217
6.3 Valuation Using Comparables	218
7 Enterprise Value to EBITDA	218
7.1 Determining EBITDA	219
7.2 Valuation Based on Forecasted Fundamentals	224
7.3 Valuation Using Comparables	224
8 Dividend Yield	224
8.1 Calculation of Dividend Yield	224
8.2 Valuation Based on Forecasted Fundamentals	225
8.3 Valuation Using Comparables	225
9 International Valuation Considerations	226
10 Momentum Valuation Indicators	227
11 Valuation Indicators and Investment Management	231
12 Summary	233
Problems	236

CHAPTER 5

Residual Income Valuation 243

Learning Outcomes	243
1 Introduction	243
2 Residual Income	244
2.1 Commercial Implementations	247

3	The Residual Income Valuation Model	248
3.1	The General Residual Income Model	253
3.2	Fundamental Determinants of Residual Income	257
3.3	Residual Income Valuation in Relation to Other Approaches	258
4	Accounting and International Considerations	259
4.1	Violations of the Clean Surplus Relationship	261
4.2	Balance Sheet Adjustments for Fair Value	262
4.3	Intangible Assets	263
4.4	Nonrecurring Items	265
4.5	Other Aggressive Accounting Practices	266
4.6	International Considerations	266
5	Single-Stage Residual Income Valuation $\leq sp^{\wedge}$	267
6	Multistage Residual Income Valuation	269
7	Summary	274
	Problems	276
	References	281
	Glossary	287
	About the CFA Program	293
	About the Authors	295
	Index	297