

# CHAPTER SUMMARY

- CHAPTER 6 – PRICE MULTIPLE VALUATION
- Price multiples are ratios of a stock's market price to some measure of fundamental value per share
  - Investors value the price of a share of stock, judge whether it is fairly/under/over-valued
  - By considering what a share buys in terms of per-share earnings, net assets, cash flow
- Enterprise value multiples; relate to the total market value of all sources of a company's capital to measure of fundamental value for the entire company
  - Investors evaluate the market value of an entire enterprise relative to the amount of EBIT, sales, operating cash flow

- THE METHOD OF COMPARABLES
  - Refers to valuation of an asset based on multiples of comparable assets
  - Valuation based on multiples benchmarked to the multiples of similar assets
  - Stock cannot be evaluated in isolation.
  - Refer to pages 259-260, Example 6-1 page 260
- THE METHOD BASED ON FORCASTED FUNDAMENTALS
  - Refers to the use of multiples derived from forecasted fundamentals
  - Characteristics of a business related to profitability, growth, or financial strength
  - Page 260-262

- PRICE MULTIPLES pages 262-320
- Price to Earnings
  - Rationales that support the use of P/E multiples in valuation , page 263
  - Potential drawbacks to using P/E derived from the characteristics of EPS page 263
  - Alternative definitions of P/E
  - Calculating Trailing P/E analyst must consider 4 things, refer to page 265
  - Go through page 265-272
  - Forward P/E
    - Forward looking
    - Do example 6-5 page 273

## – VALUATION BASED ON FORCASTED FUNDAMENTALS

- Forward P/E

$$\frac{P_0}{E_1} = \frac{D_1 / E_1}{r - g}$$
$$= \frac{1 - b}{r - g}$$

- Trailing P/E

$$\frac{P_0}{E_0} = \frac{D_0(1 + g) / E_0}{r - g}$$
$$= \frac{(1 - b)(1 + g)}{r - g}$$

- Example 6-7 and 6-8 and 6-9 on pages 276-278
- Using P/E to obtain the terminal value in multistage dividend discount models
  - Key condition; company reflects earnings growth that the company can sustain in the long run.
- Price to Book value
  - Rationales for using P/B pages 295-296
  - Drawbacks pages 296
  - Work through pages 295-306

- Valuation based on forecasted fundamentals (P/B)

- $$\frac{P_0}{B_0} = \frac{ROE - g}{r - g}$$

- $$\frac{P_0}{B_0} = 1 + \frac{\text{Present value of expected future residual earnings}}{B_0}$$

- » This equation makes special assumptions about growth; refer to page 305

- Refer to pages 304-305

- Price to Sales pg306-312
  - Rationales, pg 306-307
  - Drawbacks, pg 307
  - Calculating P/S, example 6-22 refer to pg307

$$\frac{P_0}{S_0} = \frac{(E_0/S_0)(1-b)(1+g)}{r-g}$$

- Price to Cash flow pages 312-317
  - Rationales page 313
  - Drawbacks page 313
  - Example 6-30 pages 316-317
- Price to Dividends and Dividend yield
  - Rationales page 318
  - Drawbacks page 318
  - Example 6-32 page 319
  - Based on forecasted fundamentals page 319

$$\frac{D_0}{P_0} = \frac{r - g}{1 + g}$$

- Go thorough the following:
  - ENTERPRISE VALUE MULTIPLES pages 320-329
  - INTERNATIONAL CONSIDERATIONS WHEN USING MULTIPLES pages 330-331
  - MOMENTUM VALUATION INDICATORS pages 332-337
  - VALUATION INDICATORS: ISSUES IN PRATICE pages 337-344
- SUMMARY pages 344-346
- ADDITIONAL QUESTIONS
  - Questions 1, 3,6-9,11-12