

# CFAspace

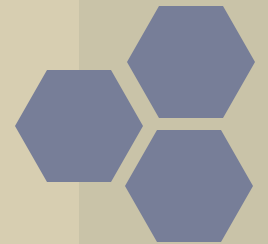
**Provided by APF**

**Academy of Professional Finance 专业金融学院**

## CFA Level II

**Equity Valuation: Applications and Processes**

**CFA Lecturer: Jiahao Gu**





# Content

## **Equity Valuation:**

### **Applications and Processes**

**(Los a - h)**

Valuation, Intrinsic value, Perceived mispricing

Going concern assumption

Value definition relevant to public company

Applications of equity valuation

Industry and competitive analysis considerations

Absolute and relative valuation models

Sum-of-the-parts valuation, Conglomerate discounts

Criteria for appropriate valuation approach



# Equity Valuation: Applications and Processes

## Valuation

**Valuation** – the process of determining the PV of an asset

*Apply valuation conclusion*

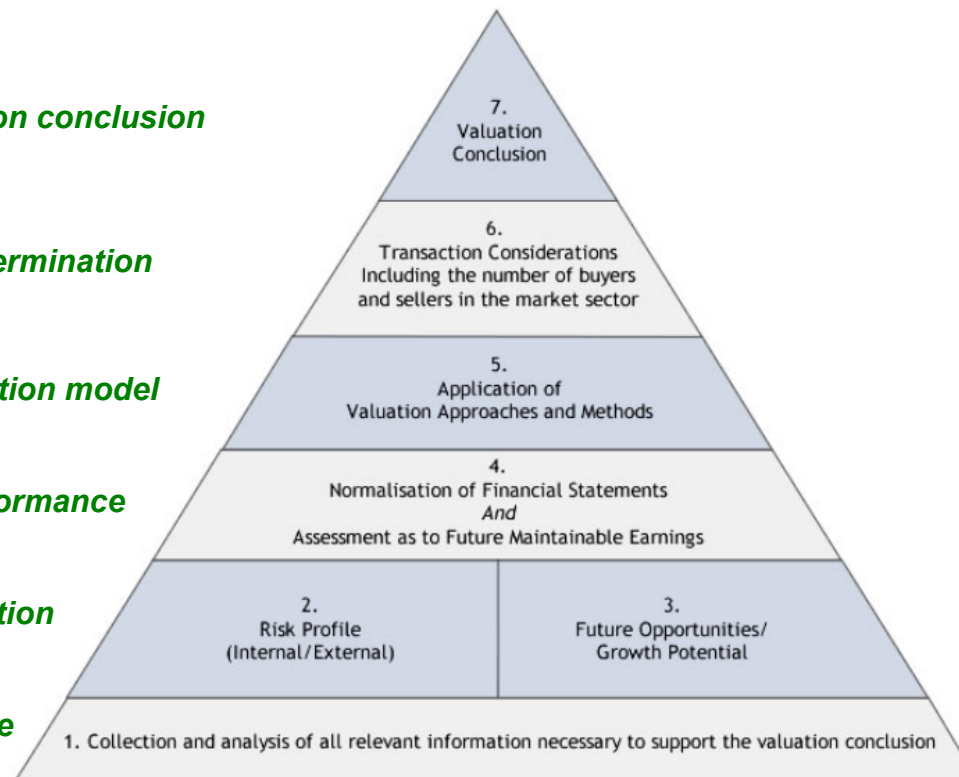
*Valuation determination*

*Choose valuation model*

*Forecast performance*

*Inputs estimation*

*History, nature*

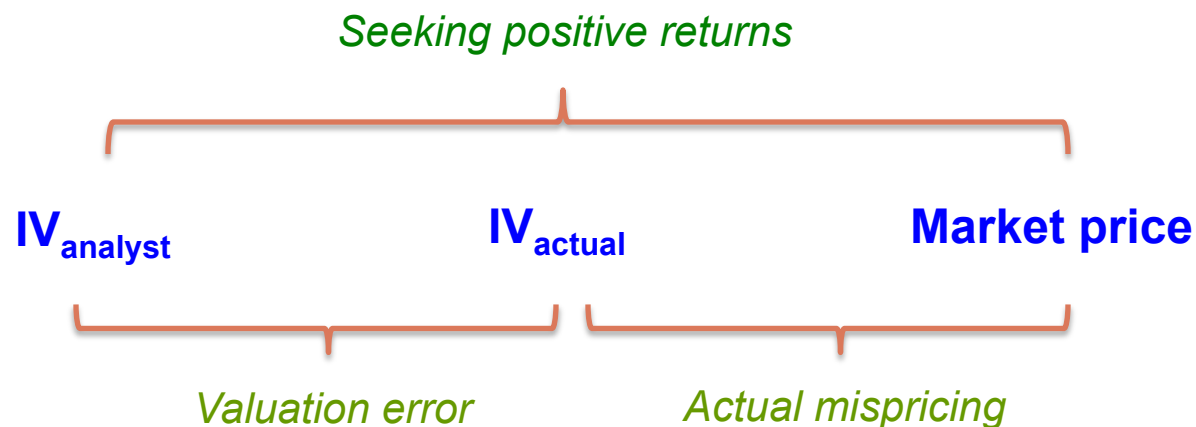




# Equity Valuation: Applications and Processes

## Intrinsic value, Perceived mispricing

Intrinsic value -- the value determined **through fundamental analysis** without reference to the asset's market value





# Equity Valuation: Applications and Processes

## Going concern assumption

### **Going concern assumption**

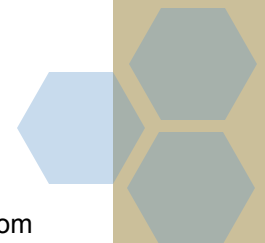
-- the company will continue in business in the foreseeable future

### **Going concern value**

-- the value of a company under the going concern assumption

### **Liquidation value**

-- the value of a company under the assumption that the company is going out of business





# Equity Valuation: Applications and Processes

## Value definition relevant to public company

### **Intrinsic value**

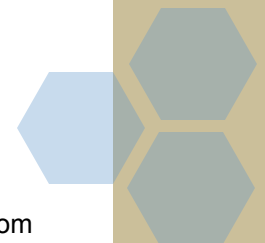
-- the value determined through fundamental analysis without reference to the asset's market value

### **Fair market value**

-- an estimation of the market value that a person willing to buy from a person willing to sell. Fair market value differs from the intrinsic value that fair market value is based on investor's own preferences

### **Investment value**

-- the value of an asset based on investor's expectations or specific needs. It is mostly often used in acquisitions.





# Equity Valuation: Applications and Processes

## Applications of equity valuation

### **Stock selection**

-- buy / hold / sell recommendation, find mispriced stocks

### **Reading the market**

-- understand the market expectations from the market price

### **Forecast the value of corporate actions**

-- determine the value of M&A, MBO, etc

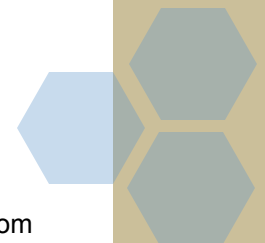
### **Fairness opinions**

### **Planning and consulting**

### **Communication with analysts and investors**

### **Valuation of private business**

### **Portfolio management**





# Equity Valuation: Applications and Processes

## Industry and competitive analysis considerations

### Porter's Five Forces Model of Competition

#### Threat of New Entry

- Time and cost of entry
- Specialist knowledge
- Economies of scale
- Cost advantages
- Technology protection
- Barriers to entry

Threat of  
New Entry

#### Competitive Rivalry

- Number of competitors
- Quality differences
- Other differences
- Switching costs
- Customer loyalty

Supplier  
Power

Competitive  
Rivalry

Buyer  
Power

#### Supplier Power

- Number of suppliers
- Size of suppliers
- Uniqueness of service
- Your ability to substitute
- Cost of changing

Threat of  
Substitution

#### Threat of Substitution

- Substitute performance
- Cost of change

#### Buyer Power

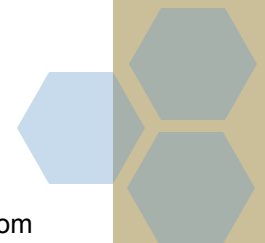
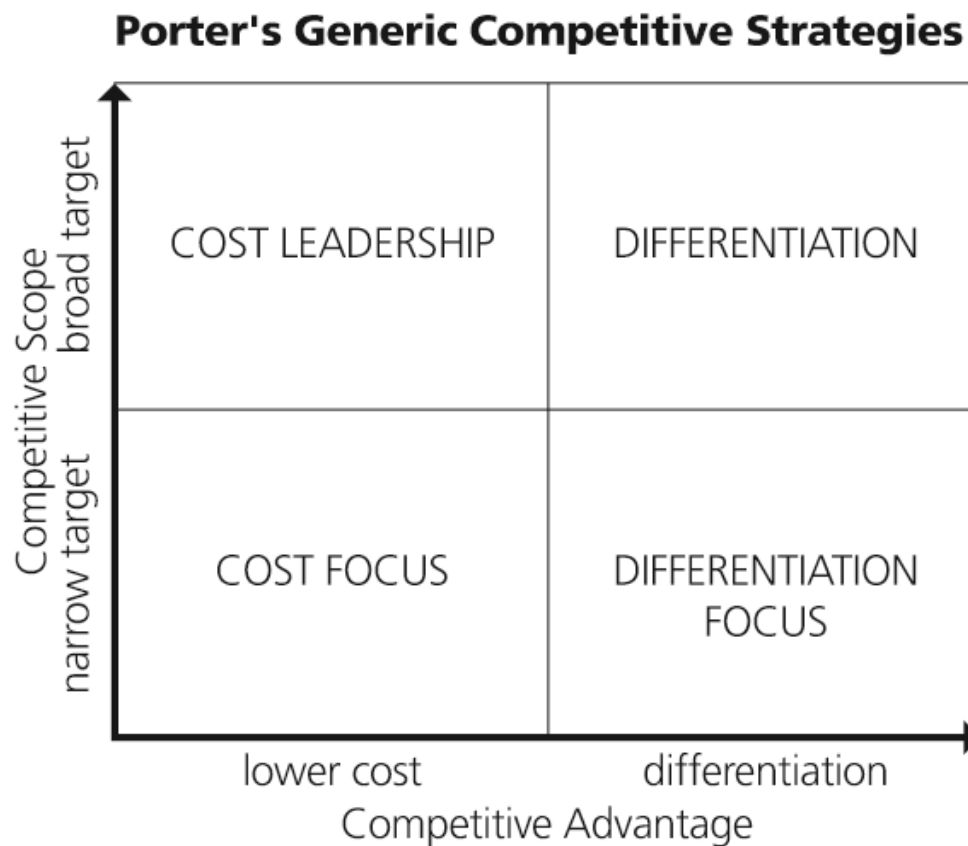
- Number of customers
- Size of each order
- Differences between competitors
- Price sensitivity
- Ability to substitute
- Cost of changing





# Equity Valuation: Applications and Processes

## Industry and competitive analysis considerations



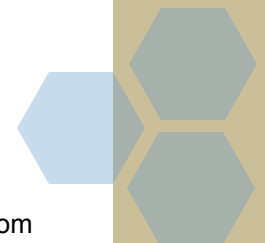


# Equity Valuation: Applications and Processes

## Industry and competitive analysis considerations

### Quality of financial statement information

- accelerating or premature recognition of income
- reclassifying gains and nonoperating income
- expense recognition and losses
- amortization, depreciation, and discount rates
- off-balance-sheet issues





# Equity Valuation: Applications and Processes

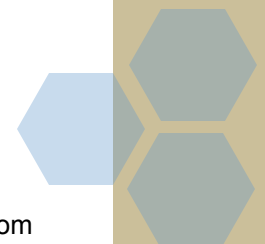
## Absolute and relative valuation models

### **Absolute valuation model**

- estimate the intrinsic value based on the projected cash flows
- dividend discount model
- free cash flow model
- residual income
- asset-based model (oil, mineral, coal, etc.)

### **Relative valuation model**

- estimate the firm's value based on the value of its competitors
- use price as a multiple of financial indicators (P/E, P/B, P/S, etc.)
- EV multiple





# Equity Valuation: Applications and Processes

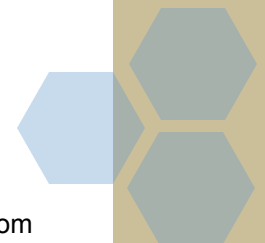
## Sum-of-the-parts valuation, Conglomerate discounts

### **Sum-of-the-parts value**

-- estimate the intrinsic value of each part of the business and sum them up

### **Conglomerate discount**

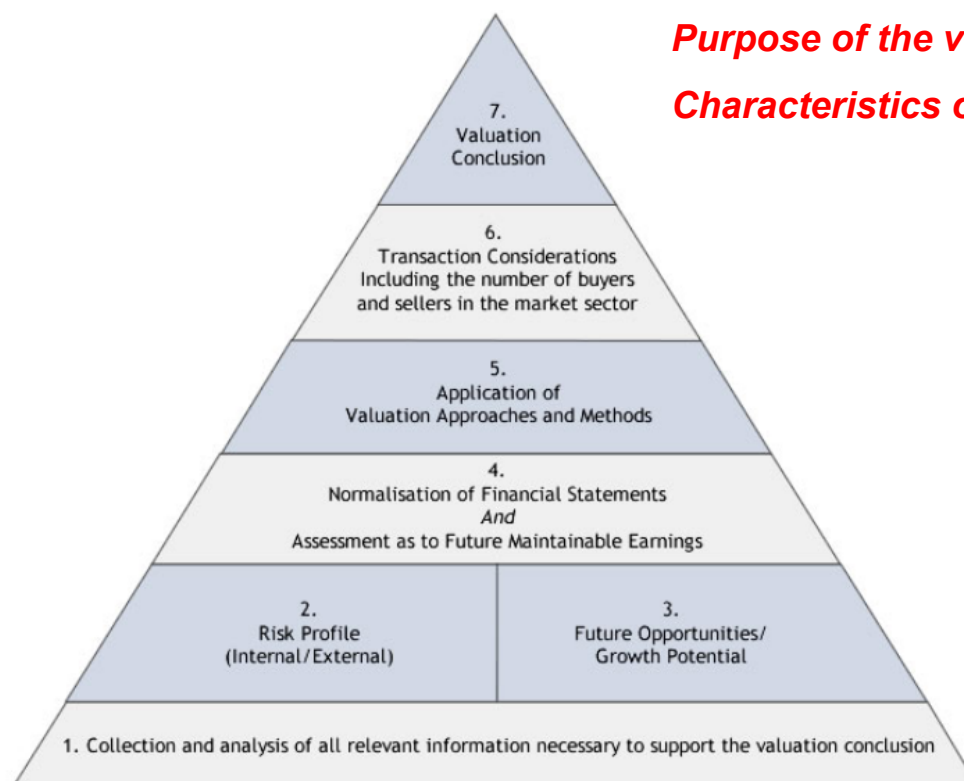
-- markdown to the value of a company that has multiple business  
-- internal capital inefficiency  
-- internal factors (e.g. hide poor performance)  
-- incorrect measurement





# Equity Valuation: Applications and Processes

## Criteria for appropriate valuation approach



*Model inputs*

*Purpose of the valuation*

*Characteristics of the company*

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**Thank You!**

