The Valuation School

MASTERCLASS

VALUATION

Part-2/30

3 Pillars of DCF

Heylos!

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- Welcome to Part 2 of 30 part Series on "Valuation Masterclass"

- In this part, I have thrown light on different Methods of Valuations and 3 pillars of DCF Valuation

- If you missed the 1st part - Link is in the post above.

- Save this post to Revise again.

Different Methods of Valuation

Valuation

1. Intrinsic Valuation
2. Relative Pricing Valuation
3. Real option Valuation

Let's first understand each of them

1. Intrinsic Valuation →

- As name suggest, it is derived internally within the company.
- i.e. through the data internally generated by the company - eg free cash flow, growth, Risk etc
- Note - No Benchmarking (comparison) with the peers is being done in Intrinsic valuation.

2. Relative Pricing Valuation →

- Benchmarking/comparison with other companies is being done here.

- How our company is priced, based on other companies traded in MKt

- Similar to Real estate, if you have to sell a plot, you will first enquire about similar plot sold recently in the vicinity

3. Real option Valuation →

- You are valuing Netflix and got to know, they might get permission to enter in china.
- This could substantially increase the valuation. However, it is still uncertain.
- In Real option Valuation, we consider "Entry to china" as a call option and then perform Valuation through Black Scholes model.

3 Pillars of DCF Valuation

This is a generic DCF Model

$$\boxed{\text{Value} = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \dots \dots \frac{CF_n}{(1+r)^n}}$$

Where Value of firm today is Present value of its future cash flows.

3 pillars of Dcf Valuation

- whenever you need to perform a Dcf valuation. Be mindful of three things.

$\boxed{\text{Cash + Growth + Risk}}$

- If you are able to control these 3 parameters; Dcf is yours forever ❤

Let's understand this →

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1. cash

- what is current Earnings of the company?
- Is there any adjustment needed to purify the earnings?
- conversion of earnings to cashflows.

2. Growth

- once the current year's cashflows is established.
- we need to consider future growth in these cashflows.
- How long would be high growth period?
- what would be the terminal year growth?

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3. Risk

- In this pillar, we need to consider the Risk in growth of these cash flows
- Risk in Dcf valuation is factored through "Discount Rate".
- Therefore discount Rate should be consistent with the cashflow.

Don't worry; I will cover these in detail

What you need to do? →

- Do a genric google search
- Read about these 3 methods in detail.
- we will be having Linkedin LIVE session on Wednesday 10PM to answer all your queries and doubts.

Don't miss that.

REPOST this to help others.

SAVE this to Revise later.

FOLLOW your man Parth for premium finance content.

See you tomorrow with a detailed session on Risk free Rate.