



## UNIT-3

### FUNDAMENTAL ANALYSIS

#### 3.8 APPLIED VALUATION TECHNIQUES

Valuation techniques are essential tools used by investors, analysts, and financial professionals to estimate the intrinsic value of an asset, company, or investment. These techniques help in making informed decisions about buying, selling, or holding securities. Here are some widely applied valuation techniques:

##### **1. Discounted Cash Flow (DCF) Analysis:**

Description: DCF is a fundamental valuation method that estimates the present value of a company's future cash flows. It involves forecasting free cash flows and discounting them back to their present value using a discount rate.

Application: DCF is commonly used for valuing businesses, projects, and investments. It provides a comprehensive and forward-looking approach to valuation.

##### **2. Comparable Company Analysis (CCA) / Comparable Company Valuation (CCV):**

Description: CCA involves comparing the financial metrics (e.g., P/E ratios, EV/EBITDA) of a target company to those of similar publicly traded companies.

Application: Commonly used in the valuation of public companies, CCA relies on market multiples to estimate the value of a target company.

##### **3. Comparable Transactions Analysis (CTA) / Precedent Transactions Analysis (PTA):**

Description: CTA involves comparing the financial metrics of a target company to those of similar companies involved in recent mergers and acquisitions.

Application: PTA is particularly relevant in the context of mergers and acquisitions. It provides a basis for estimating the value of a company based on historical transaction data.



#### **4. Earnings Multiples:**

Description: Earnings multiples, such as the Price-to-Earnings (P/E) ratio, relate a company's stock price to its earnings. Similarly, EV/EBITDA is a multiple based on enterprise value and earnings before interest, taxes, depreciation, and amortization.

Application: These multiples are widely used in equity valuation, especially in the context of comparable company analysis. They provide a quick way to assess relative valuation.

#### **5. Dividend Discount Model (DDM):**

Description: DDM values a company by estimating the present value of its future dividend payments. It assumes that the value of a stock is the sum of its future dividend payments.

Application: DDM is commonly used for valuing dividend-paying stocks, especially in stable and mature industries.

#### **6. Residual Income Valuation:**

Description: Residual income is calculated by subtracting the equity charge from the net income. Equity charge is determined by multiplying the cost of equity by the beginning-of-period book value of equity.

Application: This method is often used in conjunction with other valuation techniques and focuses on the economic profit a company generates.

#### **7. Asset-Based Valuation:**

Description: This approach values a company based on the net value of its assets. It includes both tangible assets (such as real estate and equipment) and intangible assets (such as patents and trademarks).

Application: Asset-based valuation is particularly relevant when a company's market value is significantly different from the book value of its assets.

#### **8. Real Options Valuation:**



**Description:** Real options extend traditional valuation methods by considering the value of managerial flexibility and strategic options. It applies option pricing models to estimate the value of investment opportunities.

**Application:** Common in industries where flexibility and the ability to adapt to changing circumstances are critical, such as technology and pharmaceuticals.

### **9. Market Capitalization:**

**Description:** Market capitalization is a straightforward method that values a company based on its current stock price multiplied by the total number of outstanding shares.

**Application:** Widely used for publicly traded companies, market capitalization reflects the market's valuation of a company.

### **10. Enterprise Value (EV) Analysis:**

**Description:** EV is a measure of a company's total value, including both equity and debt. It is calculated by adding the market value of equity, debt, and minority interest and subtracting cash and cash equivalents.

**Application:** EV is often used in conjunction with metrics like EBITDA to assess a company's total value, making it useful for comparing companies with different capital structures.

### **CONCLUSION:**

Each valuation technique has its strengths, weaknesses, and applicability to specific situations. The choice of a particular method often depends on the nature of the business, the availability of data, and the purpose of the valuation. In practice, analysts may use a combination of these techniques to derive a comprehensive and well-supported valuation.