## Module 4 – Chapter 5 – Valuation Techniques

Valuation techniques are used by investors to determine the worth of a company. The two most common methods are discounted cash flow (DCF) analysis and comparable company analysis (CCA).

Both methods require careful consideration of various factors that contribute to the company's value, such as its financial performance, market trends, industry analysis, and more.

## **Discounted Cash Flow Analysis**

The discounted cash flow (DCF) analysis is a valuation method that calculates the present value of a company's future cash flows. It's based on the assumption that a company's value is determined by the future cash flows it generates. DCF is widely used in valuing companies because it takes into account the time value of money and the expected growth rate of the company.

The process of DCF analysis involves several steps. First, you need to project the company's future cash flows for a certain number of years. These projections are usually based on the company's historical financial performance, market trends, and industry analysis. Then, you need to calculate the company's terminal value, which is the value of the company at the end of the projection period. Finally, you need to discount the projected cash flows and the terminal value to their present value, using a discount rate that reflects the risk associated with the investment.

The main advantage of DCF analysis is that it's based on the company's future cash flows, which are directly linked to its operations and growth potential. However, DCF analysis requires a lot of assumptions and estimates, which can be subjective and difficult to predict. The accuracy of the valuation heavily depends on the quality of the projections and the discount rate used.

## **Comparable Company Analysis**

The comparable company analysis (CCA) is a valuation method that compares the company to similar companies in the same industry. It's based on the assumption that companies in the same industry share similar characteristics and that their valuations can be compared to each other. CCA is often used as a complementary method to DCF analysis.

The process of CCA involves identifying similar companies in the same industry and collecting financial and operating data for each company. The data collected can include revenue, EBITDA, net income, and multiples such as price-to-earnings ratio (P/E ratio), price-to-sales ratio (P/S ratio), and enterprise value-to-EBITDA ratio (EV/EBITDA ratio). Then, you need to calculate the average multiples of the similar companies and apply them to the company being valued.

The main advantage of CCA is that it's relatively simple and easy to use. It also provides a market-based valuation, which is less subjective than DCF analysis. However, CCA has its limitations. It assumes that the similar companies have similar growth rates, risk profiles, and business models. It also doesn't take into account the company's unique characteristics and future growth potential.

Valuation techniques are essential tools for investors to determine the worth of a company. Both DCF analysis and CCA have their advantages and limitations. DCF analysis is more suitable for valuing companies with unique characteristics and growth potential, while CCA is more suitable for valuing companies in mature industries. A comprehensive valuation requires a combination of both methods and careful consideration of various factors that contribute to the company's value.

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