

The Valuation School



MASTERCLASS
VALUATION
Part - 2/30

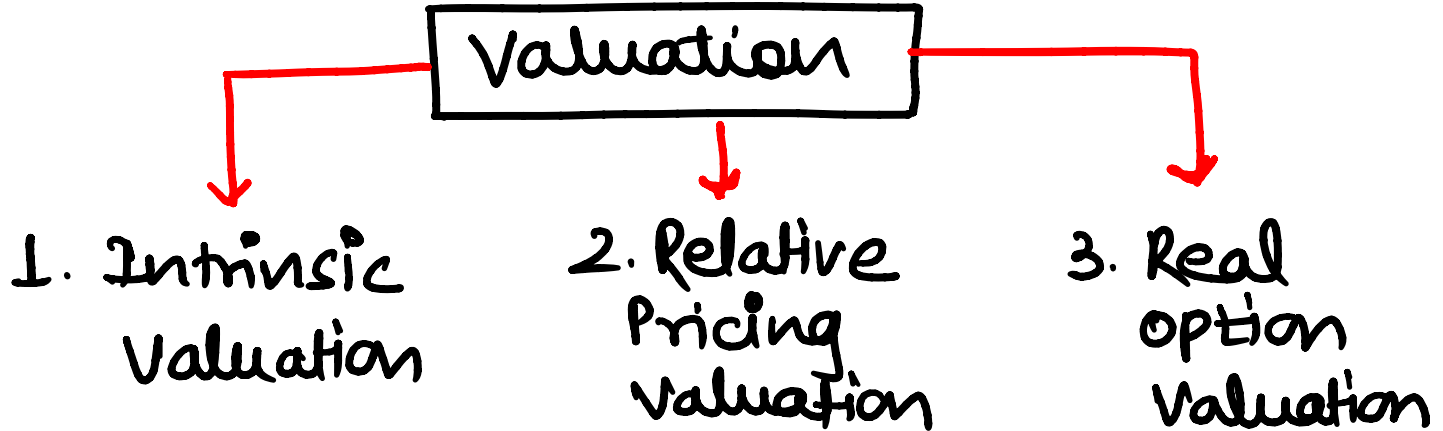
3 Pillars of DCF

Heylos!



- 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 →



Let's first understand each of them

I. 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

$$\text{value} = \frac{cf_1}{(1+r)^1} + \frac{cf_2}{(1+r)^2} + \dots + \frac{cf_n}{(1+r)^n}$$

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.

Cash + Growth + Risk

- If you are able to control these 3 parameters; DCF is yours forever ♥

Let's understand this →



I. cash

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

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?



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 generic 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
section on risk free rate.