BUS-123 Spring 2014 | Common Stock Valuation | Name: ________________
Instr: F. Paiano | Chap 6 Assignments / Notes

Chapter Assignments:
Required: See Chapter Assignments Handout (10 points)
Bonus: See Chapter Bonus Assignment Handout (10 points)
Due: Tue/Thu Mar 27th, Online: Mar 29th

Chapter Sections:
Security Analysis: Be Careful Out There
The Dividend Discount Model
The Two-Stage Dividend Growth Model
The Residual Income Model
The Free Cash Flow Model
Price Ratio Analysis
An Analysis of the McGraw-Hill Company

Chapter Terms:
stock valuation
security analysis
fundamental analysis
financial ratios
Price-to-Earning ratio (a.k.a. price-earnings ratio, P/E ratio, P/E, PE) = market price / earnings per share (EPS)
earnings yield (inverse of P/E) = earnings per share (EPS) / market price
growth stocks – term often used to describe high-P/E stocks
value stocks – term often used to describe low-P/E stocks
Price-to-Cash Flow ratio = market price / cash flow per share (CFPS)
Price-to-Sales ratio = market price / sales per share (SPS)
Price-to-Book ratio = market price / book value per share
application of price ratio analysis – predicting future stock price using Price Ratio Models
Required Rate of Return
Dividend Discount Models (a.k.a. DDMs, Dividend Valuation Models, DVMs, discounted cash flow models)
Dividend Discount Model (pure form):
  value of stock = present value of expected future dividends (i.e. the cash flows from the stock)
Zero Growth DDM – dividends continued at a current rate
  value = annual dividends / required rate of return
Constant Perpetual Growth DDM – dividends grow at a constant growth rate perpetually into the future
  value = annual dividends * (1 + dividend growth rate) / (required rate of return - dividend growth rate)
Constant Growth DDM: – dividends grow at a constant growth rate for a specified number of years
  value = look in the book (we will not use this model)
Two-stage DDM (a.k.a. Variable Growth DDM): – dividends grow at two different rates, one fast, one constant
  value = look in the book (we will not use this model)
Discounted Cash Flow Model (pure form of DDM above *plus* the present value of the expected price of the stock):
  (a.k.a. DDM, Dividends & Earnings Model – but does not use the company's earnings?)
  value = present value of expected future dividends + present value of price of stock when you plan to sell
present value
present value table
present value multipliers
Internal Rate of Return =IRR(values,approximate-rate-of-return)
Residual Income Model (similar to Constant Perpetual Growth Model, covered in 4th, 5th, and 6th editions, but not in 3rd edition)
Free Cash Flow Model
The Value Line