

Chapter Assignments:**Required:** See Chapter Assignments Handout (10 points)**Bonus:** See Chapter Bonus Assignment Handout (10 points)**Due: TueThur Mar 26th; Online Mar 28th****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