RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: BBA (DM)

SUBJECT: SECURITY AND PORTFOLIO MANAGEMENT

SUBJECT CODE:BBA (DM) 602

LECTURE: 8

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Equity Valuation

- **Equity Valuation** is a method of deriving the fair value of a firm or its **equity** stock. 2. For the stock market, value is the price that someone is willing to pay for owning the company. 3. There are two types of **valuation** methods – absolute **valuation** model and relative **valuation** model.
- Or we can say that valuation is a process of determining the fair market value of an asset. Equity valuation therefore refers to the process of determining the fair market value of equity securities.

Importance of Equity Valuation

Systemic

The whole system of stock markets is based upon the idea of equity valuation. The stock markets have a wide variety of stocks on offer, whose perceived market value changed every minute because of the change in information that the market receives on a real time basis.

Equity valuation therefore is the backbone of the modern financial system. It enables companies with sound business models to command a premium in the market. On the other hand, it ensures that companies whose fundamentals are weak witness a drop in their valuation. The art and science of equity valuation therefore enables the modern economic system to efficiently allocate scare capital resources amongst various

Importance of Equity Valuation

Individual

- On a micro level, equity valuation is beneficial for the entire stock market ecosystem. However, how does it benefit an individual to study and apply the principles of equity valuation?
- Well, markets receive information every moment and make an attempt to factor the financial effect of this information in the stock price. Individual estimates of the effect vary and as such different people may come up with different stock prices. Therefore, there can be a difference between the market value of a company and what investors call its true or “intrinsic value”
- Investors, stand to gain a lot of money if they are able to correctly identify this difference. The second richest person in the world, Warren Buffett has made his fortune correcting and applying the art of equity valuation. In fact, the theory of equity valuation has been heavily influenced by the work of Warren Buffett and his mentor.

Process of Conducting Equity Valuation

- Equity valuation is followed differently by different individuals. As such, there is no set pre-defined standard process. Instead, equity valuation consists of 4 or 5 broad categories of steps that need to be followed. The procedures maybe different but the objectives are always the same. Every person conducting equity valuation, must in one way or another account for these parameters:
- **Understand the macroeconomic factors and the industry**
- **Make a reasonable forecast of the company's performance**
- **Select the appropriate valuation model**
- **Arrive at a valuation figure based on the forecast**
- **Take action based on the arrived valuation**

Process of Conducting Equity Valuation..........

- **Arrive at a valuation figure based on the forecast:**

The next step is to apply the valuation model and come up with an exact numerical value which according to the analyst defines the worth of the business. It may be a single estimated amount or it could be a range. Investors prefer a range so that they clearly know what their lower and upper bounds for bidding should be.

Process of Conducting Equity Valuation……….

- **Take action based on the arrived valuation**: Finally, the analyst has to give a buy, sell or hold recommendation based on the current market price and what analysis shows is the intrinsic worth of the company.

Conclusion

- SECURITY ANALYSIS: Classification of securities(shares, debentures, bonds etc..), examining the risk-return characteristics of individual securities, fundamental and technical analysis.
- PORTFOLIO ANALYSIS: Identification of range of possible portfolio from a different set and ascertaining risk and return.
- PORTFOLIO SELECTION: Efficient portfolio is identified and optimal portfolio is selected.
- PORTFOLIO REVISION: Addition or deletion of securities due to change in availability of additional funds, change in risk, need for cash etc.
- PORTFOLIO EVALUATION : Comparison of objective norms with relative performance. Provides feedback mechanism for improving the entire portfolio management process.