Summarizing ‘Corporate Valuation’ …

Ram Kumar Kakani
SPJCM Singapore

Basic FCF Model

- Value of Firm
  - Use CF of Firm and WACC as discounting rate
- Value of Equity
  - Use CF to Firm's Equity and Cost of Equity as discounting rate
- Modifications for …
- Firms in trouble
  - Estimate cash flow until they turn positive
- Cyclical Firms
  - FCF are usually smoothened out
- Firms with unutilized assets
  - Get the value of these assets externally and add

FCF Model … Complications

- Firms with patents and product options
  - As above [or] real options pricing model
- Firms in the process of restructuring
  - Adjust CF to reflect business restructuring and discount rate to reflect financial restructuring
- Firms involved in acquisitions
  - (a) incorporate in FCF's; and (b) incorporate in risk
- Private firms:
  - Take riskiness of comparable firms that are publicly traded [or] relate the measure of risk to accounting variables

Why Estimates Usually Go Wrong?

Sources of uncertainty (by Aswath Damodaran)

- Our estimates of value can be wrong for a number of reasons (divided into three groups):
  1. <u>Estimation uncertainty</u>: Errors while converting raw information into inputs and use these inputs in models (common in valuing young technology company)
  2. <u>Firm-specific uncertainty</u>: The path that we envision for the firm can prove to be hopelessly wrong. (common in situations of information asymmetry for us vis-à-vis market participants)
  3. <u>Macroeconomic uncertainty</u>: Macroeconomic environment can change in unpredictable ways (common in mature cyclical or commodity company)

Good Responses to Uncertainty

Healthy responses to uncertainty would include:

- Better valuation models
- Valuation ranges
- Probabilistic statements
- The principle of parsimony helps

Unhealthy responses to uncertainty would include:

- Passing the buck
- Giving up on fundamentals (and going for day dreaming or technical analysis)

Limitations of Valuation

- Valuing alternate assets
- Valuing control
- While one can always state that … in the long run market always prices assets based on their intrinsic value
- … finally, it is also a question of Demand and Supply
- And hence there can be temporary asset mis-pricing due to liquidity issues
- Also slightly longer time frame mis-pricing is created by a few market participants (using information asymmetry and large complexity) → typically you make things opaque) → RIL
- Finally, Corporate Valuation is very successful over the long-run

Corporate Valuation

- How much of Corporate Valuation did we cover?
- Our focus was on connecting theoretical knowledge to practical aspects through … Comprehensive Assignment, Case Studies, etc.
- Why was this course tailored so differently? … albeit in such a non-student friendly way
- Say, in terms of, rigor, toughness, pressure
- Help Students remains my goal … but …
- I interpret it differently
- Evaluation Fairness? Value Addition?

- I take back all the prejudice against any person(s) or communities conveyed during the teaching?
- I apologize if anyone is hurt/upset by the same … it was to drive home a point
- In fact, every community (including varied business communities) do bring different perspective to the society (and of course add to the society)
- Feedback for improving the course and its delivery are welcome
- Acknowledgements to my School Teachers, Parents, and to all others who added value to me OR helped me OR blessed me …