FUNDAMENTALS OF FINANCE

Equity Valuation

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Chapter Description

- Synopsis

  This chapter explain definition of stocks, its types, features and its valuation.

- Expected Outcomes

  Students should be able to:

  1. Understand preferred stocks and common stocks and its features
  2. Evaluate preferred stocks and common stocks

Content

- Definition of Preferred Stocks
- Features of Preferred Stocks
- Valuation of Preferred Stocks

- Definition of Common Stocks
- Features of Common Stocks
- Valuation of Common Stocks

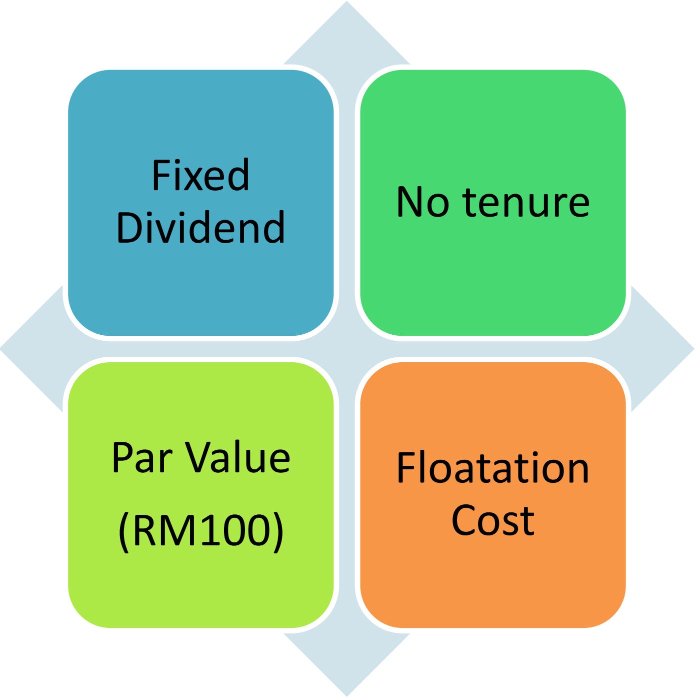
Definition of Preferred Stocks

- Preferred stocks is an equity instrument.

- It is an alternative of financial instrument that could fulfill capital needs of a firm.

Features of Preferred Stocks

- Preferred Stocks has its own features that make it unique from Common Stocks. Among its features are:



Valuation of Preferred Stocks

- **Cost of preferred stocks:**

$$\text{Kps} = \frac{\text{Fixed Dividend}}{\text{(Price of ps – Floatation Cost)}}$$

- **Value of preferred stocks:**

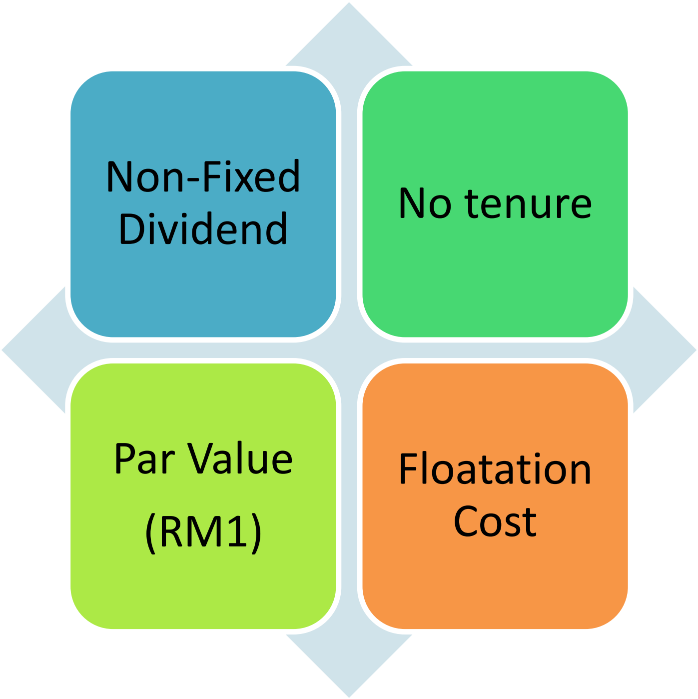
$$\text{Vps} = \frac{\text{Fixed Dividend}}{\text{Cost of ps}}$$

Definition of Common Stocks

- Common stocks is an equity instrument.
- It is also known as shares.
- It is an alternative of financial instrument that could fulfill capital needs of a firm.
- Investors who bought shares is called as shareholders and holding voting and voice rights in the firm.

Features of Common Stocks

- Common Stocks has its own features. Among its features are:



Valuation of Common Stocks

- **Cost of common stocks:**

$$Kcs = \frac{\text{Future Dividend}}{(\text{Price of cs} - \text{Floatation Cost})} + \text{growth}$$

- **Value of common stocks (Constant Growth):**

$$Vps = \frac{\text{Future Dividend}}{(\text{Cost of cs} - \text{Growth})}$$

Valuation of Common Stocks

- **Cost of common stocks:**

$$P_o = D1\,(PVIF_{k,1}) + D2\,(PVIF_{k,2}) + \ldots.\ Dn\,(PVIF_{k,n}) + SPn\,(PVIF_{k,n})$$

Conclusion of The Chapter

- Conclusion
  - Preferred Stock and Common Stock are equity security and an alternative for a firm to raise capital.
  - Issuing Preferred Stock will incurred fixed cost (Fixed Dividend).
  - Issuing Common Stock will leverage the firm’s ownership.
  - No maturity date for the instrument, hence, no principal return on the capital raised.

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