AFF 210 Tip Sheet

Financial Management: Theory and Practice (2016), Third Canadian Edition, Brigham, Ehrhardt, Gessaroli, Nason, Nelson Education

Key concepts for Valuations

- When calculating questions related to payments, need to know these items
  - PMT = the payment amount or interest amount at each period
  - PV = the present value of the loan/bond
  - FV = the future value of the loan (0) or bond (the face value)
  - N = the number of payments
  - I = interest rate

- Stock Valuation
  - Constant Dividend (Zero Growth)
    - P0= Dividend / Discount rate
  - Constant Dividend Growth
    - P0 = Dividend1/ (Discount rate – Growth rate)
  - Supernormal Growth
    - P0 = Dx/(1+r)^x
      - Dx = Dx-1 x (1+rate)

- Bond Valuation
  - PV = PV of coupons + PV face value
  - When valuing the bond, the market rate is used to discount, and the coupon rate is used to determine the payment

- Inverse relationship between bond prices and the interest rate:
  - if market interest rate **>** the coupon rate, bonds sell for **less than its face value**; at a **discount.**
  - if market interest rate **=** the coupon rate, bonds sell for **exactly the par value**; at **PAR**.
  - If market interest rate **<** the coupon rate, bonds sell for **more than its face value**; at a **premium**.

- To value an investment there are several investment criteria that are used to determine if an investment is a good or bad option
  - NPV (the most dominant one)
  - Internal rate of return
  - Modified rate of return
  - Profitability index
  - Payback and Discounted payback methods

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- NPV the most dominant one helps
    - Determine if an asset should be purchased
    - To determine if a new product line should be launched
        - These capital budgeting tools are used to determine the success of a business over a long period
- The APR is the interest rate expressed in terms of annual rate
- Whereas, EAR is when the annual rate is compounded
    - EAR = (1+APR/m))^m - 1

- The beta is the sensitivity of a stock's return to the return of the market
- The portfolio beta is the weighted average of the betas of the stocks in the portfolio
- What beta means
    - Beta of less than 1 means the stock has less systematic risk than the overall market
    - Beta of 1 means the stock has the same systematic risk as the overall market
    - Beta of greater than 1 means the stock has more systematic risk than the overall market

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