

Table of Content

TABLE OF CONTENT	5
LIST OF TABLES	8
TABLE OF FIGURES	9
TABLE OF ABBREVIATIONS	10
1 SCOPE OF THE THESIS	13
1.1 Problem Statement	13
1.2 Objective.....	15
1.3 Layout.....	15
1.4 Selection of sector and companies	16
1.5 Characteristics of the technology sector	17
2 APPLICATION OF EQUITY VALUATION MODELS	21
2.1 Free Cash Flow to Equity Model (FCFE)	21
2.1.1 Free Cash Flow to Equity Model Theory	21
2.1.1.1 Definition and characteristics of the Free Cash Flow to Equity Model... ..	21
2.1.1.2 Constant Growth FCFE Model.....	22
2.1.1.3 Two-Stage FCFE Model	23
2.1.1.4 Three-Stage FCFE Model	24
2.1.1.5 Input variables	24
2.1.1.5.1 Free Cash Flow to Equity (FCFE)	25
2.1.1.5.2 Cost of equity	25
2.1.1.5.2.1 Risk-free rate r_f	25
2.1.1.5.2.2 Beta	26
2.1.1.5.2.3 Risk premium.....	27
2.1.1.5.3 Growth	28
2.1.1.5.4 Terminal Value	28
2.1.2 Input variables decisions.....	29

2.1.2.1 Free Cash Flow to Equity (FCFE).....	29
2.1.2.2 Cost of equity	29
2.1.2.2.1 Risk-free rate r_f	29
2.1.2.2.2 Beta	29
2.1.2.2.3 Risk premium.....	31
2.1.2.3 Growth.....	32
2.1.2.4 Terminal Value.....	33
2.1.3 Assumptions.....	33
2.1.4 Determining the present value of equity with the Free Cash Flow to Equity Model.....	42
2.1.5 Evaluation of the forecasting capability of the FCFE Model.....	44
2.2 Dividend Discount Model (DDM).....	48
2.2.1 Dividend Discount Model Theory	48
2.2.1.1 Definition and characteristics of the Dividend Discount Model.....	48
2.2.1.2 Gordon Growth Model	48
2.2.1.3 Two-Stage Dividend Discount Model	49
2.2.1.4 Three-Stage Dividend Discount Model	50
2.2.1.5 Input variables	51
2.2.1.5.1 Dividends	51
2.2.1.5.2 Cost of equity.....	52
2.2.1.5.3 Growth	52
2.2.1.5.4 Terminal value	52
2.2.2 JPMorgan Fleming's implementation of the Dividend Discount Model	52
2.2.3 Input variables decisions.....	56
2.2.3.1 Dividends.....	56
2.2.3.2 Cost of equity	56
2.2.3.3 Growth.....	56
2.2.3.4 Terminal value.....	56
2.2.3.5 Value of the stock.....	56
2.2.4 Assumptions.....	57

2.2.5 Determining the Dividend Discount Rate (DDR) with the DDM.....	62
2.2.6 Evaluation of the forecasting capability of the Dividend Discount Model....	68
3 DISCUSSION AND CONCLUSIONS	71
3.1 Comparison of the equity valuation models.....	71
3.2 Comparison of the forecasting capability of the equity valuation models	73
3.3 Analysis of the input decisions	74
3.3.1 Cost of equity in the initial growth period.....	74
3.3.2 Growth rate in the initial growth period	75
3.3.3 Negative reinvestment and growth rates in the initial growth period	76
3.3.4 ROE in the stable growth period.....	77
3.4 Stock pricing.....	77
3.5 Market environment & sector characteristics	80
3.5.1 Dynamic market environment	81
3.5.2 “Irrational Exuberance”	82
3.5.3 Stock price volatility & CAPM	82
3.6 Limitations.....	85
3.7 Summary	85
3.8 Conclusions and Recommendations	86
APPENDIX	89
TABLE OF REFERENCES.....	113
ACKNOWLEDGEMENT	115