Unit IV — Equity, Bond & Derivative Analysis

Investment and Portfolio Management | BMB FM 01 / KMBN FM 01

Unit IV: Bond, Equity and Derivative Analysis

Syllabus: Valuation of equity — discounted cash flow techniques, balance sheet valuation, dividend discount models, intrinsic value and market price, earnings multiplier approach, P/E ratio, Price/Book value, Price/Sales ratio, Economic Value Added (EVA). Valuation of debentures/bonds — nature of bonds, valuation, bond theorems, term structure of interest rates. Derivatives — meaning, features and types; role and significance; participants (hedgers, speculators, arbitrageurs); regulatory framework.

Exam Blueprint (2022–2025 papers)

Topic	Years asked	Marks
Dividend Discount Models	2025	7
Derivatives — meaning, features, types	2025 (twice)	2 & 7
Discounted cash flow technique	2022	10
Intrinsic value	2025	2
Balance sheet valuation	2024	2
Price/Book value, Price/Sales ratio	2022, 2024	2
Bonds — definition and valuation	2022	2 & 10

YE QUESTION BAAR-BAAR AAYA HAI

Dividend Discount Model (Gordon's model) aur **derivatives** — ye do lagbhag pakke hain. DDM ka formula aur uske teen cases (zero growth, constant growth, multi-stage) ratt lo, aur numerical practice kar lo.

PART A — EQUITY VALUATION

1. Intrinsic Value and Market Price

DEFINITION - RATTA MAARO

Intrinsic value is the **true, fair or theoretically correct value** of a security, based on the **present value of all future cash flows** it is expected to generate. It is what the security is *actually worth*, independent of what the market is currently quoting.

(A 2-mark question in 2025-26.)

The decision rule — the whole point of valuation:

Comparison	Meaning	Action
Intrinsic value **>** Market price	The share is **undervalued**	**BUY**
Intrinsic value **=** Market price	Correctly priced	**HOLD**
Intrinsic value **<** Market price	The share is **overvalued**	**SELL**

EXAM TIP - AISE LIKHO

Ek line jo har valuation answer me fit hoti hai: *"Price is what you pay; value is what you get."* — Warren Buffett. Aur fundamental analysis ka poora maksad in dono ke beech ka farak dhundhna hai.

1.1 Approaches to Equity Valuation

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                 EQUITY VALUATION APPROACHES
                            |
     +----------------+-----+------------+---------------+
     |                |                  |               |
  BALANCE SHEET   DISCOUNTED         RELATIVE /      ECONOMIC
   VALUATION      CASH FLOW          MULTIPLIER     VALUE ADDED
   (asset-based)   (DCF/DDM)         (P/E, P/B,        (EVA)
                                      P/S ratios)
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2. Balance Sheet Valuation (Asset-Based)

(A 2-mark question in 2024-25: "Summarize balance sheet valuation.")

DEFINITION - RATTA MAARO

Balance sheet valuation estimates the value of a share from the **assets shown in the company's balance sheet**, rather than from its future earnings. It answers: *what would the shareholders receive if the company's assets were realised and liabilities paid off?*

2.1 The Three Measures

A. Book Value per Share

$$\text{Book value per share} = \frac{\text{Net worth (Equity capital + Reserves − Fictitious assets)}}{\text{Number of equity shares}}$$

$$\text{or} = (\text{Total assets − Total liabilities − Preference capital}) \div \text{No. of equity shares}$$

Example: Net worth Rs. 50,00,000; 2,00,000 equity shares. Book value = **Rs. 25 per share**.

B. Liquidation Value per Share

$$\text{Liquidation value} = \frac{\text{(Realisable value of assets − Amount payable to all creditors and preference shareholders)}}{\text{Number of equity shares}}$$

Uses **realisable market value**, not book value. This is a **floor value** — a share should not normally trade below it.

C. Replacement Cost and Tobin's Q