'common stock valuation'

Finance

Common Stock Valuation Submitted: Common Stock Valuation A stock exchange investor or a person, who invests in stocks of companies, does so with the intention of gaining a higher price for the stock and for the dividends and bonuses that the stock has to offer. His expectation of future value and dividends of stock can be identified through the value he pays or is ready to pay for a particular stock (Vallabhaneni, 2009). The actual value of the stock purchased should be equivalent to the current value of all the returns that an investor expects to receive in future. Common Stocks do not have a maturity date so whatever is the current value of the share will be the present value of all the undermined floe of cash. The dividend yielded from a particular common stock is not predetermined and is variable as compared to the fixed dividend offered in the case of preferred shares. The identification of the common stock's value becomes quite difficult as the dividend rate is not already known and is always fluctuating. The basic principle applied while stock's value is determined is that the current value of the stock is supposed to be its present value of all upcoming cash flows that is owed by the person who has invested in the stock. In simpler terms this means that an investor's return depends on what price he is paying for a stock. The current price of a stock can be identified through discounted value of future cash flows by applying the principle of time value of money (Moyer, 2012). This value of the stock is recognized as the stocks intrinsic value as this value is obtained from different information available about the stock. This value is not the exact value of the stock, but this value is near to the stocks actual value and reflects the current position of the stock.

If a particular share's dividend is fixed, the dividend yield for each share is the present price of the stock. Formula:

Po = D1/r

The above formula states that Po is the current price of the share and D1 is the dividend for that particular stock which is offered for the first time and the same dividend will be offered throughout and r is used to represent the common stock's required return rate (Mayo, 2007). If a particular stock's dividend is not constant and keeps on changing then the current value of the stock is its present value of any growing cash flows. Formula:

Do is used to indicate the dividend that is offered this time, if the dividend of that particular stock keeps on growing at a continuous rate, then the current common stock's value is value that all future dividends will have (Chisholm, 2009). The constant rate of growth of stocks is represented by " g". This model is referred as DVM or dividend valuation model. The DVM model is even recognized as Gordon Model and is one of the models that are recognized as DDM or Dividend Discount Model (Gitman, 1976).

References

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