[Frequently Asked Questions]

Market Efficiency (Part-2)

Subject:	Business Economics
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Paper No. & Title:	Paper – 511 Investment Management
Unit No. & Title:	Unit – 2 Market Efficiency
Lecture No. & Title:	Lecture – 2 Market Efficiency (Part-2)

Frequently Asked Questions

Q.1. What is the meaning of Dividend Discount Model?

Ans. The Dividend Discount Model (DDM) is a procedure for valuing the price of a stock by using the predicted dividends and discounting them back to the present value.

Q.2. Define the meaning of Multi Stage Dividend Discount Model.

Ans. Multi-stage dividend discount model is a technique used to calculate intrinsic value of a stock by identifying different growth phases of a stock; projecting dividends per share for each of the periods in the high growth phase and discounting them to valuation date, finding terminal value at the start of the stable growth phase using the Gordon growth model, discounting it back to the valuation date and adding it to the present value of the high-growth phase dividends.

Q.3. What is the meaning of Two Stage Dividend Discount Model?

Ans. This method of equity valuation is not a model based on two cash flows but is a two-stage model where the first stage may have a high growth rate and the second stage is usually assumed to have a stable growth rate.

Q.4. What is the meaning of P/E Ratio?

Ans. It is a useful metric for evaluating the relative attractiveness of a company's stock price.

$$\text{Price/Earnings Ratio} = \frac{\text{Stock Price per Share}}{\text{Earnings per Share (EPS)}}$$

Q.5. Define the various forms of Variable Growth Rate Model.

Ans. The most common form is one that assumes 3 different rates of growth: an initial high rate of growth, a transition to slower growth, and lastly, a sustainable, steady rate of growth.

Q.6. Write formula for Intrinsic Value.

Ans. The formula is as follows:

PV of High Growth Phase Dividend + PV of Stable Growth Phase dividends

$$\frac{D1}{(1+r)^1} + \frac{D2}{(1+r)^2} + \cdots + \frac{Dn}{(1+r)^n} + \frac{1}{(1+r)^n} * \frac{Dn+1}{r-g}$$

Q.7. What is Zero or Negative P/E Ratio?

Ans. When companies don’t make profit or make loss, it is zero or negative P/E ratio.

Q.8. How many types of P/E Ratios are there?

Ans. They are as follows:

- Trailing or Current P/E
- Projected Or Forward P/E
- Combined Or Mixed P/E

Q.9. What does a low P/E indicates?

Ans. A low P/E can mean that a company's worth is undervalued by the market in the short-term and represents a buying opportunity for an investor

Q.10. Write the formula for Valuation of any Stock.

Ans. The formula is as follows:

$$\text{Value of Stock} = \frac{\textbf{Dividend per share}}{\textbf{Discount Rate - Dividend growth rate}}$$