Suggested Example Problems
Investment Valuation – Damodaran

Lecture 6 – Relative Valuation

Lecture 6 deals with relative valuation. We will start with a basic discussion of multiples and how to interpret them. This discussion is related to chapter 17 in the text and to the McKinsey article on the use of multiples. We will then describe specific multiples in more detail focusing on their definitions, their distributions, and the fundamental characteristics that drive variation in the multiple across firms. Earnings multiples, such as P/E ratios, PEG ratios, and Value/EBITDA ratios are described in chapter 18.

We will not have time to cover chapters 19 and 20. These chapters provide a discussion of book value multiples and revenue multiples.

Suggested Problems (Do Not Turn In):

The following suggested problems will give you a basic idea of the topics that I want to emphasize from the text. The solutions to these problems are available on the class web site.

Chapter	Topic	Suggested Problems
17	An Overview of Relative Valuation	1, 2, 3, 4
18	Earnings Multiples	6, 7
19	Book Value Multiples	Not covered
20	Revenue Multiples	Not covered

Consider the following additional questions related to P/E Ratio Fundamentals:

1. Starting from the Gordon Growth Model (the Dividend Discount Model with constant growth), show how the P/E ratio is related to the fundamentals of the firm.

2. Based on your answer to (1), estimate the expected P/E ratio for a firm that has long-term expected growth of 6%, an ROE of 13%, and a cost of equity of 8.5%. If the company has a current P/E ratio of 19.5, would you analysis suggest that the company is over- or under-valued?