

# Valuation Project

Finance 40610 – Fall Semester 2011  
Professor Shane A. Corwin

## Objectives:

The purpose of this project is for you to apply the valuation techniques learned in class, while becoming an expert on a particular firm. In the end, I do not care whether you give the stock a buy, hold, or sell recommendation. I will be grading your project based on the quality of your analysis, on how well you support your assumptions/methods, and on the professionalism of your presentation. My goal is for you to create a valuation model and analyst presentation that you would be comfortable sharing with a potential employer.

## Details:

- To complete this project you will work in groups of 3-5 students. All students are equally responsible for the work that is turned in. In completing the project, you should not collaborate with any students outside your own group.
- Each group may select the company they wish to value, so long as that company has not already been selected by another group. The only restriction is that the firm be a publicly-traded non-financial U.S. company, with at least three identifiable comparable firms.
- This project will require you to make use of numerous outside resources, including company web pages, annual reports, analyst reports, etc. Be sure to appropriately cite relevant resources.
- The valuation project consists of three related components which will all count toward the final project grade. Each of these components is described in more detail below.

## Project Components:

### I. Project-related assignments, readings, and discussions

During the semester, you will complete several assignments and readings related to the valuation project. These assignments are designed to guide your analysis throughout the semester and will allow me to provide feedback on your initial analysis prior to the completion of your final valuation. The timely completion of these assignments is an important component of your project grade.

### II. Spreadsheet model of your valuation

In order to complete the valuation project, you will be required to develop a detailed spreadsheet model. This model will incorporate all of your quantitative analysis and provide the justification for your recommendation. The model must include all of the necessary components we discuss in class, as illustrated in my example Home Depot valuation. Within the spreadsheet or on a separate page, you should explain all assumptions made regarding key variables. Failure to include the required components or to explain your assumptions may result in a significant grade reduction. The spreadsheet will be graded based on the quality and clarity of your analysis, and on the appropriateness of your assumptions. The completed spreadsheet model will be submitted to me electronically and is due on Thursday, December 8<sup>th</sup> at 5:00 p.m. In addition, a preliminary (but complete) version of your spreadsheet must be turned in prior to your group presentation.

### **III. Final Group Presentation**

#### ***A. Presentation***

Group presentations will be held during the last week of class. The purpose of your group presentation is to summarize your valuation of the firm and to both explain and support your buy/sell/hold recommendation. Think of this as a presentation to an institutional investor who has hired you to analyze the stock. The presentation will be no longer than 15 minutes and must be accompanied by a PowerPoint presentation. A copy of the presentation slides must be provided to me prior to the presentation. Each group member must participate in the group presentation.

Your presentation grade will be determined based on both content and the quality of your presentation. Keep in mind that your time is limited, so you should spend the most time on information that is most relevant to support your valuation and recommendation. At a minimum, the presentation should cover the following items:

- A summary of your recommendation and the key points supporting your recommendation.
- A detailed discussion of the key value drivers for this firm. This section should explain the most important sources of value for this firm. Depending on their importance, this may include descriptions of key product lines, competitive advantages, key competitors, acquisition strategies, etc. If it is important for your valuation, you may also wish to discuss the outlook for the firm's industry. Be sure to be specific about how these items affect value.
- A detailed discussion of the key risk factors for the firm. This section should explain the most important risks that could damage firm value. Depending on their importance, this may include descriptions of key product lines or product development, retention of key personnel, economic or cost forecasts. Be sure to be specific about how these items affect value.
- A detailed discussion of the valuation method used and key assumptions. This section should explain and justify those assumptions that are most important to your analysis. Examples include forecasts for cost of capital and its components, free cash flow and its components (working capital, capital expenditures, after-tax income, etc.), margins, growth forecasts and drivers of growth, etc. You should also discuss any sensitivity analysis that is important for the interpretation of your valuation.

#### ***B. Tear Sheet***

As an overview of your presentation, you must create a one-page analyst report summary (or tear sheet). The tear sheet must be turned in by 5:00 p.m. on the day prior to your presentation. The summary page should give the reader a basic understanding of the firm, its past performance, its expected future performance, and the justification for your recommendation. This page should be able to stand alone as a summary of your valuation and recommendation. Several example tear sheets are attached. At a minimum, the summary page should include the following items:

- Buy/sell/hold recommendation and 52-week price target
- A chart of past stock price and trading volume
- Current statistics such as price, beta, dividend yield, market capitalization, shares outstanding, institutional holdings, valuation multiples (P/E, P/Sales, etc.), sector/industry
- Key financial ratios, balance sheet items, and income statement items based on annual data for the past five years and based on quarterly data for the most recent quarter
- A short business summary
- A short summary of recent developments
- A short summary of key future prospects that provide a rationale for your recommendation

# Home Depot Inc. (The)

**S&P Recommendation** **HOLD** ★★☆☆☆

**Price**  
\$30.58 (as of Aug 12, 2011)

**12-Mo. Target Price**  
\$36.00

**Investment Style**  
Large-Cap Blend

**UPDATE: PLEASE SEE THE ANALYST'S LATEST RESEARCH NOTE IN THE COMPANY NEWS SECTION**

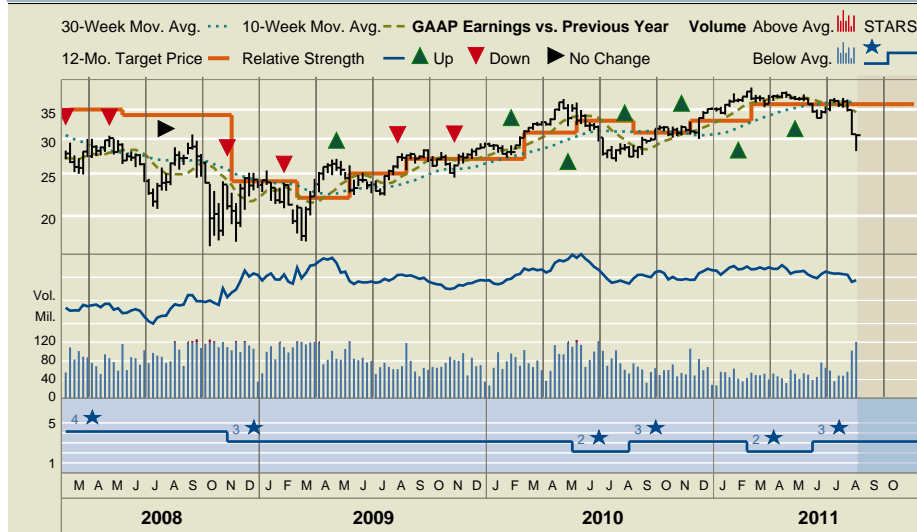
**GICS Sector** Consumer Discretionary  
**Sub-Industry** Home Improvement Retail

**Summary** HD operates a chain of over 2,200 retail warehouse-type stores, selling a wide variety of home improvement products for the do-it-yourself and home remodeling markets.

**Key Stock Statistics** (Source S&P, Vickers, company reports)

52-Wk Range	<b>\$39.38–27.10</b>	S&P Oper. EPS 2012E	<b>2.28</b>	Market Capitalization(B)	<b>\$48.691</b>	Beta	<b>0.78</b>
Trailing 12-Month EPS	<b>\$2.08</b>	S&P Oper. EPS 2013E	<b>2.58</b>	Yield (%)	<b>3.27</b>	S&P 3-Yr. Proj. EPS CAGR(%)	<b>12</b>
Trailing 12-Month P/E	<b>14.7</b>	P/E on S&P Oper. EPS 2012E	<b>13.4</b>	Dividend Rate/Share	<b>\$1.00</b>	S&P Credit Rating	<b>BBB+</b>
\$10K Invested 5 Yrs Ago	<b>\$10,714</b>	Common Shares Outstg. (M)	<b>1,592.2</b>	Institutional Ownership (%)	<b>71</b>		

**Price Performance**



**Qualitative Risk Assessment**

**LOW** **MEDIUM** **HIGH**

Our risk assessment for Home Depot reflects our view of ample opportunities for growth in the professional market domestically and the retail business overseas, and an S&P Quality Ranking of A. This is partially offset by the cyclical nature of the home improvement retail industry, which is reliant on economic growth.

**Quantitative Evaluations**

**S&P Quality Ranking** **A**

D C B- B B+ A- **A** A+

**Relative Strength Rank** **MODERATE**

39

LOWEST = 1 HIGHEST = 99

**Revenue/Earnings Data**

Revenue (Million \$)	1Q	2Q	3Q	4Q	Year
2012	16,823	--	--	--	--
2011	16,863	19,410	16,598	15,126	67,997
2010	16,175	19,071	16,361	14,569	66,176
2009	17,907	20,990	17,784	14,607	71,288
2008	21,585	22,184	18,961	17,659	77,349
2007	21,461	26,026	23,085	20,265	90,837

Earnings Per Share (\$)	1Q	2Q	3Q	4Q	Year
2012	0.50	E0.81	E0.57	E0.40	E2.28
2011	0.43	0.72	0.51	0.36	2.01
2010	0.30	0.66	0.41	0.18	1.55
2009	0.21	0.71	0.45	-0.03	1.37
2008	0.53	0.71	0.59	0.40	2.27
2007	0.70	0.90	0.73	0.46	2.79

Fiscal year ended Jan. 31. Next earnings report expected: Mid August. EPS Estimates based on S&P Operating Earnings; historical GAAP earnings are as reported.

**Dividend Data** (Dates: mm/dd Payment Date: mm/dd/yy)

Amount (\$)	Date Decl.	Ex-Div. Date	Stk. of Record	Payment Date
0.236	08/19	08/31	09/02	09/16/10
0.236	11/18	11/30	12/02	12/16/10
0.250	02/22	03/08	03/10	03/24/11
0.250	06/01	06/14	06/16	06/30/11

Dividends have been paid since 1987. Source: Company reports.

Analysis prepared by Equity Analyst **Michael Souers** on Jun 07, 2011, when the stock traded at **\$34.29**.

**Highlights**

- ▶ We expect retail sales to increase 2.3% in FY 12 (Jan.), following a 2.8% advance in FY 11. We see this rise reflecting a handful of net new retail store additions, including international store openings, and a 2% to 3% increase in same-store sales. We project a continued slow recovery in the housing market in calendar 2011, and expect tight consumer credit to also adversely affect near-term sales for home improvement retailers, particularly on big-ticket remodeling projects.
- ▶ We see FY 12 operating margins widening 40 basis points, driven by a rational pricing environment, continued tight expense control, supply chain benefits from the recent investment in rapid deployment centers, and an improving mix. We also expect the projected increase in same-store sales to leverage fixed expenses slightly, given HD's stringent cost controls.
- ▶ After a slight decline in net interest expense, taxes at an effective rate of 36.9%, and a 3% reduction in the diluted share count, we see FY 12 EPS of \$2.28. This would be a 12% improvement from the \$2.03 the company earned in FY 11, excluding a \$0.02 charge due to a revaluation of a loan. We see EPS of \$2.58 in FY 13.

**Investment Rationale/Risk**

- ▶ We expect the housing market to recover gradually over the coming year and believe HD will reap rewards from an accelerated focus on customer service. Favorable demographic trends, such as the aging of houses and low interest rates, should help support home remodeling efforts over the long term. However, although we view HD's balance sheet and free cash flow generation as strong, we remain concerned that the recovery in housing will take much longer than widely anticipated. Following a recent decline in price, we think the shares are fairly valued, trading at approximately 15X our FY 12 EPS estimate, a slight premium to both the S&P 500 and to key peer Lowe's (LOW 23, Hold).
- ▶ Risks to our recommendation and target price include a renewed slowdown in consumer spending; a slower-than-expected improvement or weakening of the housing market; and unfavorable currency movements.
- ▶ Our 12-month target price of \$36, which is equal to about 16X our FY 12 EPS estimate, is derived from our DCF model, which assumes a weighted average cost of capital of 9.8% and a terminal growth rate of 3.0%.

Please read the Required Disclosures and Analyst Certification on the last page of this report.

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