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Scenario: Currently a stock pays a dividend per share of \$9.64. A security analyst projects the future dividend growth rate over the next five years to be 12.0%, 13.0%, 15.0%, 9.0%, 8.0% and then 7.0% each year thereafter to infinity. The levered cost of equity capital for the firm is 12.0% per year. What is the stock's value / share?

Solution Strategy. Construct a two-stage discounted dividend model. In stage one, explicitly forecast the firm's dividend over a five-year horizon. In stage two, forecast the firm's dividend from year six to infinity and calculate its continuation value as the present value of this infinitely growing annuity. Then, discount the future dividends and the date 5 continuation value back to the present to get the stock's value.

Stock Valuation - DIVIDEND DISCOUNT MODELS Two Stage

Inputs

Levered Cost of Equity Capital

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Dividend Discount Model	First Stage: Finite Horizon						2nd Stage:
	Year 0	1	2	3	4	5	Infin Horiz 6
Dividend Growth Rate		12.0%	13.0%	15.0%	9.0%	8.0%	7.0%
Dividend	\$9.64	\$10.80	\$12.20	\$14.03	\$15.29	\$16.52	\$17.67
Continuation Value						\$353.46	
Dividend + Continuation Value		\$10.80	\$12.20	\$14.03	\$15.29	\$369.97	\$17.67
PV of Dividend + Contin. Value		\$9.64	\$9.73	\$9.99	\$9.72	\$209.93	\$8.95
Stock Value	\$249.00						

