

Stock Pricing

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17 November 2022

1 Summary

Equity - Ownership right - Claim on future dividends

Stock Value: Generally, Stock price P present value of future dividends D

$$P_0 = \sum_{t=1}^{\infty} \frac{D_t}{(1+r)^t}$$

Special case: with constant growth g :

$$P_0 = \frac{D_1}{r-g}$$

Use above to estimate returns from dividend yield and assumed growth:

$$r = \frac{E[D_1]}{P_0} + g$$

Expected future price:

$$E[P_t] = P_0(1+g)^t$$

Cost of equity capital: Risk adjustment.

What is the riskiness of the stock (company)?

Possible method: CAPM – What is the beta of the stock – measure of riskiness.

To estimate growth: Can use historical growth