**Module 2 - Home**

**STOCK AND BOND VALUATION**

**Modular Learning Outcomes**

Upon successful completion of this module, the student will be able to satisfy the following outcomes:

* Case
  + Identify and explain the distinction between stocks and bonds.
  + Apply discounted cash flow models to value stocks.
  + Apply discounted cash flow models to value bonds.
* SLP
  + Apply P/E ratios to assess and value stock investments.
  + Apply the concept of liquidation value for stock investments.
  + Evaluate the investment potential of a given company.
* Discussion
  + Evaluate the investment potential of a given company.

**Module Overview**



What exactly are you buying when you purchase stock in a company? There are really two main benefits of owning shares in a company.

The first is that when a company is profitable, it pays dividends to investors. A share in a company is a share in profits. The simplest way to estimate the value of a stock is by how much dividends it pays. We will be using the tools of present value that you learned in Module 1, and apply them to estimating the present value of future dividends to be paid by a company. Specific tools include the zero growth **dividend valuation method** and the **dividend growth model.**

The second benefit is that shares in a company typically come with voting rights and a say in how management runs the company. You have probably heard the term “hostile takeover.” This refers to investors purchasing shares of a company in order to gain control of the company and oust the existing management team. Purchase enough shares of a company and get some existing shareholders to take your side and you can gain 51% of the company and vote to oust management.

Another way corporations raise money is by selling bonds. Bonds are different from stocks in that they don’t come with voting rights. However, bonds pay a set amount every year and also come with the promise that your investment will eventually be returned in the future. While bonds don’t come with voting rights or any say in management, if the company is unable to make its payments on your bonds or pay you back, then bondholders can force the company into bankruptcy. In bankruptcy, the assets of the company are sold and given to bondholders. While stock shares give voting rights, bondholders get preference when a company goes into bankruptcy. Shareholders are paid only after bondholders are paid. If there is no money left to pay shareholders, then shareholders get nothing. Overall, stocks are riskier than bonds, but on average give a higher rate of return. As you have probably guessed, we will also be applying the concept of present value to value bonds in this module.