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| SIMPLY WALL ST Testata: | Data: 17 giugno 2022 |
| Frequenza: Online | Pagina: // |

<https://simplywall.st/stocks/it/telecom/bit-ud/unidata-shares/news/a-look-at-the-intrinsic-value-of-unidata-spa-bitud>

A Look At The Intrinsic Value Of Unidata S.p.A.



Today we'll do a simple run through of a valuation method used to estimate the attractiveness of Unidata S.p.A. ([BIT:UD](#)) as an investment opportunity by taking the forecast future cash flows of the company and discounting them back to today's value. Our analysis will employ the Discounted Cash Flow (DCF) model. Before you think you won't be able to understand it, just read on! It's actually much less complex than you'd imagine.

We generally believe that a company's value is the present value of all of the cash it will generate in the future. However, a DCF is just one valuation metric among many, and it is not without flaws. For those who are keen learners of equity analysis, the [Simply Wall St analysis model here](#) may be something of interest to you.

The calculation

We use what is known as a 2-stage model, which simply means we have two different periods of growth rates for the company's cash flows. Generally the first stage is higher growth, and the second stage is a lower growth phase. In the first stage we need to estimate the cash flows to the business over the next ten years. Where possible we use analyst estimates, but when these aren't available we extrapolate the previous free cash flow (FCF) from the last estimate or reported value. We assume companies with shrinking free cash flow will slow their rate of shrinkage, and that companies with growing free cash flow will see their growth rate slow, over this period. We do this to reflect that growth tends to slow more in the early years than it does in later years.

A DCF is all about the idea that a dollar in the future is less valuable than a dollar today, so we need to discount the sum of these future cash flows to arrive at a present value estimate:

10-year free cash flow (FCF) estimate

| | 2022 | 2023 | 2024 |
|--|------------|------------|---------|
| Levered FCF (€, Millions) | €1.90m | €1.50m | €2.80 |
| Growth Rate Estimate Source | Analyst x1 | Analyst x1 | Analyst |
| Present Value (€, Millions) Discounted @ 6.8% | €1.8 | €1.3 | €2.3 |

("Est" = FCF growth rate estimated by Simply Wall St)

Present Value of 10-year Cash Flow (PVCF) = €33m

The second stage is also known as Terminal Value, this is the business's cash flow after the first stage. The Gordon Growth formula is used to calculate Terminal Value at a future annual growth rate equal to the 5-year average of the 10-year government bond yield of 1.7%. We discount the terminal cash flows to today's value at a cost of equity of 6.8%.

Terminal Value (TV) = $FCF_{2031} \times (1 + g) \div (r - g) = €8.7m \times (1 + 1.7\%) \div (6.8\% - 1.7\%) = €173m$

Present Value of Terminal Value (PVTV) = $TV / (1 + r)^{10} = €173m \div (1 + 6.8\%)^{10} = €89m$

The total value, or equity value, is then the sum of the present value of the future cash flows, which in this case is €122m. In the final step we divide the equity value by the number of shares outstanding. Relative to the current share price of €43.8, the company appears about fair value at a 13% discount to where the stock price trades currently. The assumptions in any calculation have a big impact on the valuation, so it is better to view this as a rough estimate, not precise down to the last cent.



Important assumptions

We would point out that the most important inputs to a discounted cash flow are the discount rate and of course the actual cash flows. If you don't agree with these result, have a go at the calculation yourself and play with the assumptions. The DCF also does not consider the possible cyclicity of an industry, or a company's future capital requirements, so it does not give a full picture of a company's potential performance. Given that we are looking at Unidata as potential shareholders, the cost of equity is used as the discount rate, rather than the cost of capital (or weighted average cost of capital, WACC) which accounts for debt. In this calculation we've used 6.8%, which is based on a levered beta of 0.800. Beta is a measure of a stock's volatility, compared to the market as a whole. We get our beta from the industry average beta of globally comparable companies, with an imposed limit between 0.8 and 2.0, which is a reasonable range for a stable business.

Next Steps:

Whilst important, the DCF calculation ideally won't be the sole piece of analysis you scrutinize for a company. DCF models are not the be-all and end-all of investment valuation. Rather it should be seen as a guide to "what assumptions need to be true for this stock to be under/overvalued?" For instance, if the terminal value growth rate is adjusted slightly, it can dramatically alter the overall result. For Unidata, we've compiled three pertinent aspects you should explore:

1. **Financial Health:** Does UD have a healthy balance sheet? Take a look at our [free balance sheet analysis with six simple checks](#) on key factors like leverage and risk.
2. **Future Earnings:** How does UD's growth rate compare to its peers and the wider market? Dig deeper into the analyst consensus number for the upcoming years by interacting with our [free analyst growth expectation chart](#).
3. **Other High Quality Alternatives:** Do you like a good all-rounder? Explore [our interactive list of high quality stocks](#) to get an idea of what else is out there you may be missing!