This study session provides insights on issues that affect security valuation internationally. Analyzing industries in a global context and evaluating competitive forces that will affect returns provide a foundation for security valuation decisions. Discounted dividend models are examined in detail.

### READING ASSIGNMENTS

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### LEARNING OUTCOMES

**READING 30. THE FIVE COMPETITIVE FORCES THAT SHAPE STRATEGY**

The candidate should be able to:

- distinguish among the five competitive forces and explain how they drive industry profitability in the medium and long run;
b describe why industry growth rate, technology and innovation, government, and complementary products and services are fleeting factors rather than forces shaping industry structure;

c identify changes in industry structure, and forecast their effects on the industry’s profit potential;

d explain how positioning a company, exploiting industry change, and shaping industry structure may be used to achieve a competitive advantage.

READING 31. YOUR STRATEGY NEEDS A STRATEGY

The candidate should be able to:

a describe predictability and malleability as factors in assessing an industry;

b describe how an industry’s predictability and malleability are expected to affect the choice of an appropriate corporate strategy (classical, adaptive, visionary, or shaping);

c evaluate the predictability and malleability of an industry and select an appropriate strategy.

READING 32. INDUSTRY AND COMPANY ANALYSIS

The candidate should be able to:

a compare top-down, bottom-up, and hybrid approaches for developing inputs to equity valuation models;

b compare “growth relative to GDP growth” and “market growth and market share” approaches to forecasting revenue;

c evaluate whether economies of scale are present in an industry by analyzing operating margins and sales levels;

d forecast the following costs: cost of goods sold, selling general and administrative costs, financing costs, and income taxes;

e describe approaches to balance sheet modeling;

f describe the relationship between return on invested capital and competitive advantage;

g explain how competitive factors affect prices and costs;

h judge the competitive position of a company based on a Porter’s five forces analysis;

i explain how to forecast industry and company sales and costs when they are subject to price inflation or deflation;

j evaluate the effects of technological developments on demand, selling prices, costs, and margins;

k explain considerations in the choice of an explicit forecast horizon;

l explain an analyst’s choices in developing projections beyond the short-term forecast horizon;

m demonstrate the development of a sales-based pro forma company model.
READING 33. DISCOUNTED DIVIDEND VALUATION

The candidate should be able to:

a compare dividends, free cash flow, and residual income as inputs to discounted cash flow models, and identify investment situations for which each measure is suitable;

b calculate and interpret the value of a common stock using the dividend discount model (DDM) for single and multiple holding periods;

c calculate the value of a common stock using the Gordon growth model, and explain the model's underlying assumptions;

d calculate and interpret the implied growth rate of dividends using the Gordon growth model and current stock price;

e calculate and interpret the present value of growth opportunities (PVGO) and the component of the leading price-to-earnings ratio (P/E) related to PVGO;

f calculate and interpret the justified leading and trailing P/Es using the Gordon growth model;

g calculate the value of noncallable fixed-rate perpetual preferred stock;

h describe strengths and limitations of the Gordon growth model, and justify its selection to value a company's common shares;

i explain the assumptions and justify the selection of the two-stage DDM, the H-model, the three-stage DDM, or spreadsheet modeling to value a company's common shares;

j explain the growth phase, transitional phase, and maturity phase of a business;

k describe terminal value, and explain alternative approaches to determining the terminal value in a DDM;

l calculate and interpret the value of common shares using the two-stage DDM, the H-model, and the three-stage DDM;

m estimate a required return based on any DDM, including the Gordon growth model and the H-model;

n explain the use of spreadsheet modeling to forecast dividends and to value common shares;

o calculate and interpret the sustainable growth rate of a company, and demonstrate the use of DuPont analysis to estimate a company's sustainable growth rate;

p evaluate whether a stock is overvalued, fairly valued, or undervalued by the market based on a DDM estimate of value.