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# The Advantages and Disadvantages of Using Discounted Cash Flow (DCF) Valuation

# Advantages of DCF

- Theoretically, it is one of the most sound methods of valuation.
- It focuses on cash which is the key driver of value
- Since the emphasis is on cash, there should not be accounting issues that can distort measures such as P/Es
- It does gives you a rough gauge to get started if you have absolutely no idea how to determine a fair value of the stock price.

# Disadvantages of DCF

- The accuracy of the valuation is very much dependent on the assumptions made regarding the free cash flow, discount rate etc.
- It is challenging to predict the company's growth for the next 5-10 years. Past performance does not guarantee future results.
- The complexity of the calculation is putting off many retail investors (the use of our given spreadsheet make it much easier though)

# Best Practices On DCF Valuation

1. The company has consistent track record of cashflow, EPS (earnings per share) and ROE (return on equity)

2. Min. 5 years of financial record; best with 10 years history

3. Credible Management

4. Strong Economic Moat

5. The company's business revenue is somewhat predictable (Coca-Cola, Visa, Starhub, Breadtalk, Vicom etc)

6. It is only roughly right BUT it is better than precisely wrong

7. Need to calculate DCF yearly to go inline with economy

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