An Intrinsic Calculation For Koninklijke BAM Groep nv (AMS:BAMNB) Suggests It's 36% Undervalued

In this article we are going to estimate the intrinsic value of Koninklijke BAM Groep nv (AMS:BAMNB) by taking the foreast future cash flows of the company and discounting them back to today's value. I will use the Discounted Cash Flow (DCF) model. Don't get put off by the jargon, the math behind it is actually quite straightforward.

Companies can be valued in a lot of ways, so we would point out that a DCF is not perfect for every situation. If you want to learn more about discounted cash flow, the rationale behind this calculation can be read in detail in the Simply Wall St analysis model.

Check out our latest analysis for Koninklijke BAM Groep

Step by step through 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. To begin with, we have to get estimates of the next ten years of cash flows. 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.

Generally we assume that a dollar today is more valuable than a dollar in the future, and so the sum of these future cash flows is then discounted to today's value:

10-year free cash flow (FCF) forecast

	2020	2021	2022	2023	2024
Levered FCF (€, Millions)	€28.9m	€42.4m	€56.4m	€69.4m	€80.7n
Growth Rate Estimate Source	Analyst x1	Est @ 46.81%	Est @ 32.88%	Est @ 23.13%	Est @ 16.3%
Present					

Value (€, Millions) Discounted @ 9.2%	€26.5	€35.6	€43.3	€48.9	€52.0

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

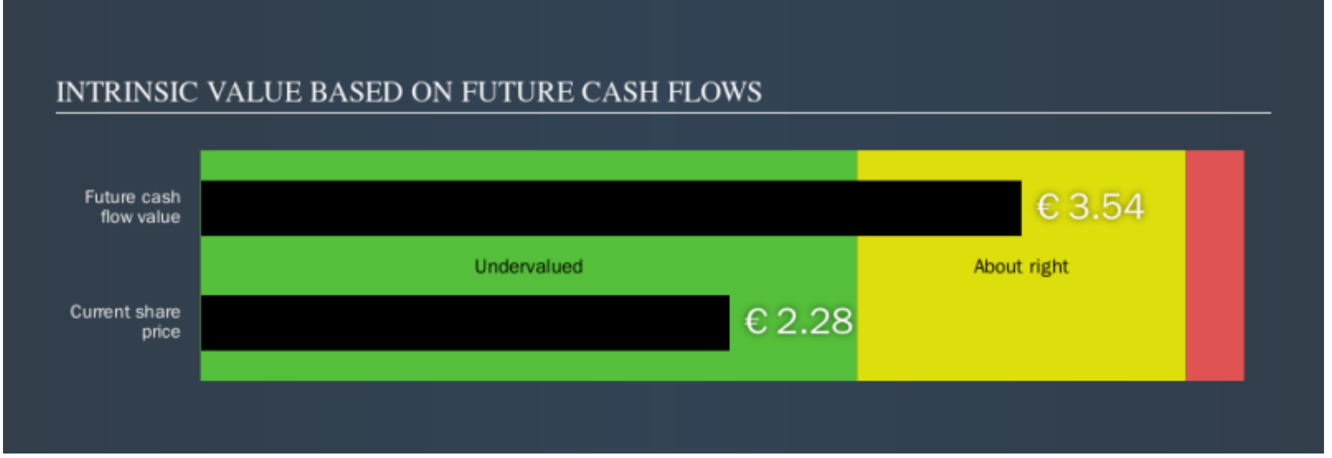
Present Value of 10-year Cash Flow (PVCF) = €457m

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 10-year government bond rate of 0.4%. We discount the terminal cash flows to today's value at a cost of equity of 9.2%.

Terminal Value (TV)= FCF_{2019} × (1 + g) ÷ (r – g) = €111m× (1 + 0.4%) ÷ 9.2%– 0.4%) = €1.3b

Present Value of Terminal Value (PVTV)= TV / $(1 + r)^{10}$= €1.3b÷ $(1 + 9.2\%)^{10}$= €524m

The total value is the sum of cash flows for the next ten years plus the discounted terminal value, which results in the Total Equity Value, which in this case is €981m. The last step is to then divide the equity value by the number of shares outstanding. Compared to the current share price of €2.3, the company appears quite undervalued at a 36% discount to where the stock price trades currently. Remember though, that this is just an approximate valuation, and like any complex formula - garbage in, garbage out.



ENXTAM:BAMNB Intrinsic value, September 28th 2019

Important assumptions

Now the most important inputs to a discounted cash flow are the discount rate, and of course, the actual cash flows. You don't have to agree with these inputs, I recommend redoing the calculations yourself and playing with them. The DCF also does not consider the possible cyclicality 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 Koninklijke BAM Groep 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 9.2%, which is based on a levered beta of 1.478. 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, DCF calculation shouldn’t be the only metric you look at when researching a company. The DCF model is not a perfect stock valuation tool. Rather it should be seen as a guide to "what assumptions need to be true for this stock to be under/overvalued?" If a company grows at a different rate, or if its cost of equity or risk free rate changes sharply, the output can look very different. What is the reason for the share price to differ from the intrinsic value? For Koninklijke BAM Groep, I've compiled three further aspects you should further research:

1. **Financial Health**: Does BAMNB 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 BAMNB'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**: Are there other high quality stocks you could be holding instead of BAMNB? Explore our interactive list of high quality stocks to get an idea of what else is out there you may be missing!

PS. Simply Wall St updates its DCF calculation for every NL stock every day, so if you want to find the intrinsic value of any other stock just search here.

We aim to bring you long-term focused research analysis driven by fundamental data. Note that our analysis may not factor in the latest price-sensitive company announcements or qualitative material.

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