

## I . ABSTRACT

Predict the stock price accurately must be the dream of all investors. They eager to identify if stocks that are undervalued should be purchased; stocks that are overpriced should be sold or even shorted. Nevertheless, "Prediction is Difficult, Especially of the Future." (Niels Bohr) Therefore, several models have been introduced to identify whether a stock is mispriced under certain assumptions. These models fall into two categories: Dividend Discount Model (DDM) and Factor-based Model. This study is to apply Dividend Discount Model for measuring the market price of a specify company- Esprit Holdings Limited. This is valuating the present true share price of Esprit in Hong Kong Stock Market by using 10-year historical data with the DDM which employing 27.4312% as discount rate (required rate of return) and 27.9050% and 14.6693% as the abnormal growth rate at first stage and the long-term constant growth rate at second stage respectively.

At the first part, the objectives of this paper and the reasons of using DDM to value Esprit will be introduced. Further, the background information of Fashion Retailing Industry and History of Esprit and SWOT Analysis will be conducted.

At the middle part of this paper, some literatures about the valuation of common stock, especially the Dividend Discount Model (DDM) will be reviewed and discussed. Furthermore, the data of Esprit which is required for DDM measurement inputs will be generated mainly from financial databases of Internet and 10-year Annual Reports of Esprit. Some other information will also be found in the publications and by the websites.

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After all, the empirical findings will be computed and measure the appropriate market price of Esprit. At the last part, final conclusion and recommendations will be conducted.

By applying the Dividend Discount Model, it is necessary to determine the growth rate ( $g$ ) and required rate of return ( $r$ ). As known, there are usually three different patterns about the growth rate of a company's expected dividends, namely, Zero Growth, Constant Growth and Supernormal Growth. In order to better reflect the future cash flow and development potential of Esprit which with near-term differential dividend growth prospects, we applied the Supernormal Growth Pattern in this study. Thus, we divided Esprit's growth rate into abnormal-stage and stable-stage. By using different methods and employing two proxy companies, Giordano and H & M, we find that the average growth rates of abnormal-stage ( $g_1$ ) and stable-stage ( $g_2$ ) are 27.9050% and 14.6693% respectively.

Then, the required rate of return ( $r$ ), which represents the minimum rate of return of investors require to their invested products, is calculated by different methods and it is estimated to be 27.4312%. Moreover, it should be pointed out that Esprit's dividend in the FY2002/03 was HK\$0.7 which represents the current annual dividend ( $D_0$ ).

Eventually, we got 100 possible outcomes of the expected stock price ranges from HK\$19.6895 to HK\$130.6478 by using different mixture calculations of selected methods for the calculation of growth rates ( $g_1$  and  $g_2$ ) and required rate of return ( $r$ ). After considering the theories underlying different methods, together with the business nature and the characteristics of Esprit, we decide to use the average abnormal- and

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stable-stage growth rates and required rate of return in the computation of the expected stock price. Our estimated expected stock price of Esprit is HK\$55.9484.

As this study is calculating the 10-year financial data of Esprit before the FY2002/03, it seems quite attractive to the investors if this result is comparing to the stock price of Esprit at the early 2004 which was only slightly over HK\$30.00. In such case, the market price of Esprit is undervalued and its shares should be purchased or hold. However, the stock price of Esprit is rising to over HK\$85.00 at the end of 2006. It is far from the final anticipated stock price in this study. It implies that the current market price of Esprit maybe over-valued and its shares should be sold or even shorted.