

Are Investors Undervaluing InMode Ltd. (NASDAQ:INMD) By 21%?

How far off is InMode Ltd. ([NASDAQ:INMD](#)) from its intrinsic value? Using the most recent financial data, we'll take a look at whether the stock is fairly priced 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. There's really not all that much to it, even though it might appear quite complex.

Remember though, that there are many ways to estimate a company's value, and a DCF is just one method. Anyone interested in learning a bit more about intrinsic value should have a read of the [Simply Wall St analysis model](#).

The model

We're using the 2-stage growth model, which simply means we take in account two stages of company's growth. In the initial period the company may have a higher growth rate and the second stage is usually assumed to have a stable growth rate. 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, and so the sum of these future cash flows is then discounted to today's value:

10-year free cash flow (FCF) estimate

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Levered FCF (\$, Millions)	US\$135.0m	US\$163.0m	US\$183.7m	US\$201.1m	US\$215.6m	US\$227.8m	US\$238.2m	US\$247.2m	US\$255.2m	US\$262.6m
Growth Rate Estimate Source	Analyst x2	Analyst x1	Est @ 12.68%	Est @ 9.47%	Est @ 7.23%	Est @ 5.66%	Est @ 4.56%	Est @ 3.79%	Est @ 3.25%	Est @ 2.87%
Present Value (\$, Millions) Discounted @ 6.7%	US\$127	US\$143	US\$151	US\$155	US\$156	US\$154	US\$151	US\$147	US\$142	US\$137

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

Present Value of 10-year Cash Flow (PVCF) = US\$1.5b

After calculating the present value of future cash flows in the initial 10-year period, we need to calculate the Terminal Value, which accounts for all future cash flows beyond 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 2.0%. We discount the terminal cash flows to today's value at a cost of equity of 6.7%.

Terminal Value (TV) = $FCF \times (1 + g) \div (r - g) = US\$263m \times (1 + 2.0\%) \div (6.7\% - 2.0\%) = US\$5.7b$

Present Value of Terminal Value (PVTV) = $TV / (1 + r) = US\$5.7b \div (1 + 6.7\%) = US\$3.0b$

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 US\$4.4b. To get the intrinsic value per share, we divide this by the total number of shares outstanding. Compared to the current share price of US\$91.7, the company appears a touch undervalued at a 21% 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.



Important assumptions

Now 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 InMode 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 6.7%, which is based on a levered beta of 0.876. 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. Instead the best use for a DCF model is to test certain assumptions and theories to see if they would lead to the company being undervalued or overvalued. For example, changes in the company's cost of equity or the risk free rate can significantly impact the valuation. Why is the intrinsic value higher than the current share price? For InMode, we've put together three fundamental elements you should explore:

1. **Risks:** Case in point, we've spotted [2 warning signs for InMode](#) you should be aware of.
2. **Future Earnings:** How does INMD'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!