Business valuation glossary

Referring to terms used in the course business valuation fundamentals:

Term	**Definition**
Alpha	See firm-specific risk.
Beta	The Beta (β) of a stock or portfolio is a number describing the correlated volatility of an asset in relation to the volatility of the benchmark that the asset is being compared to. This benchmark is generally the overall financial market and is often estimated via the use of representative indices, such as the S&P 500.
Capital asset pricing model (CAPM)	The capital asset pricing model is the most widely used risk / return model used to calculate the equity cost of capital.
Comparable company analysis	Comps or comparable company analysis involves identifying valuation multiples from comparable listed companies and applying these to the financials of the company to be valued.
Compounding	The ability of an asset to generate earnings, which are then reinvested in order to generate their own earnings. In other words, compounding refers to generating earnings from previous earnings.
Comps	See comparable company analysis.
Constant perpetuity	A constant stream of identical cash flows without end.
Covariance	A statistical measure of the variance of two random variables that are observed or measured in the same mean time period.
Covenants	The promises made by the borrowing company in a loan agreement to adhere to certain limits in it's operations.
Debt financing	Raising money for a business through loans or by issuing bonds.
Discount rate	The percentage rate required to calculate the present value of a future cash flow.
Discounted cash flow (DCF) valuation approach	Discounted cash flow (DCF) valuation is a method of valuing a company using the concept of the time value of money. All future cash flows are estimated and discounted to give their present values. The sum of all future cash flows, both incoming and outgoing, is the net present value (NPV), which is taken as the value or price of the cash flows in question.
Discounting	The process of determining the present value of a payment or a stream of payments that is to be received in the future.

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Diversifiable risk	See firm-specific risk.
Dividends	A share of a company's net profits distributed by the company to a class of its shareholders.
EBIT	Earnings before interest and tax. Sometimes referred to as operating profit.
EBITDA	Earnings before interest, taxation, depreciation, and amortization.
Enterprise value	Enterprise value (EV), also known as total enterprise value (TEV), entity value, or firm value (FV) is a measure reflecting the market value of a whole business. It is the sum of claims of all the security-holders: debt holders, preferred shareholders, minority interest, common equity holders, and others.
Enterprise value multiples	A ratio used to determine the value of a company. The enterprise value multiple looks at a company as a potential acquirer would, because it takes debt into account - an item which other multiples like the P/E ratio do not include. An example of an enterprise value multiple is EV/EBITDA.
Entity value	See enterprise value.
Equity	Total assets less total liabilities. Also called total shareholders' equity or net worth.
Equity financing	The money acquired from the business owners themselves or from other investors.
Equity multiples	A ratio used to determine the value of a company's equity. An example of an equity multiple is price to earnings.
Equity risk premium	See risk premium.
Equity value	Equity value is the value of a company available to shareholders. It is the enterprise value plus all cash and cash equivalents, short and long-term investments, and less all short-term debt, long-term debt and minority interests.
EV/Capital Employed	The EV to capital employed multiple is defined as the enterprise value divided by capital employed where capital employed is the book value of all funding (e.g. debt and equity).
EV/EBIT	The EV to EBIT multiple is defined as the enterprise value divided by earnings before interest and tax.
EV/EBITDA	The EV to EBITDA multiple is defined as the enterprise value divided by earnings before interest, tax, depreciation and amortization.
EV/Free cash flows	The EV to free cash flows multiple is defined as the enterprise value divided by free cash flows to the firm.
EV/Sales	The EV to sales multiple is defined as the enterprise value divided by sales (also called revenue or turnover).
Firm value	See enterprise value.

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Firm-specific risk	Firm specific risk is sometimes called unsystematic risk, specific risk, diversifiable risk or alpha. This category includes risks associated with a firm's management team, operations, projects, products, profits, and so on.
Free cash flows to equity	This is the cash flow available for distribution to equity holders. If net borrowings remain unchanged, the formula is free cash flows to the firm – Interest Expense x (1 – Tax Rate).
Free cash flows to the firm	This is the cash flow available for distribution among all the securities holders of an organization (i.e. debt holders, equity holders, etc.). The standard definition is EBIT x (1 – Tax Rate) + Depreciation & Amortization +/- Changes in Working Capital – Capital Expenditure.
Gross debt	All interest bearing debt (both current and long term).
Growing perpetuity	A constant stream of cash flows without end that is expected to rise indefinitely.
Market cap	See market capitalization.
Market capitalization	The share prices times the number of shares outstanding for a publicly traded company.
Market risk	Market risk is often referred to as systematic risk, non-specific risk, non-diversifiable risk or beta. This category includes risks such as interest rates, the economic cycle, inflation, legislation and socio-economic developments.
Multiples valuation approach	A valuation theory based on the idea that similar assets sell at similar prices. This assumes that a ratio comparing value to some firm-specific variable (operating margins, cash flow, etc.) is the same across similar firms.
Net debt	Net debt is all interest bearing debt (often referred to as gross debt) less cash, cash equivalents and marketable securities. Net debt assumes that cash and marketable securities are "surplus" or "redundant" and can be used to pay down debt. In practice, It is important to assess whether all cash, cash equivalents and marketable securities truly are "redundant" or readily disposable.
Net operating profit after tax (NOPAT)	Net operating profit after tax (NOPAT) is a company's after-tax operating profit for all investors, including shareholders and debt holders. It is typically defined as EBIT x (1 – effective tax rate).
Net present value	The sum of the present values of a time series of future cash flows.
Non-diversifiable risk	See market risk.
Non-specific risk	See market risk
Normalized earnings	Earnings adjusted for non-recurring items, over/under depreciation, profit/loss on sale of assets, etc. so that earnings reflect the on-going performance of the company.

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Precedent transaction analysis	Precedents or precedent transaction analysis involves identifying recent acquisitions in the same sector and applying the multiples from these transactions to the financials of the company to be valued.
Price to book	The price to book multiple is defined as the market capitalization (or equity value of common shares) divided by the book value of equity which is total common shareholders' equity excluding preference shares and minority interest.
Price to cash flow	The price to cash flow multiple is defined as the market capitalization (or equity value of common shares) divided by free cash flows to equity. Free cash flows to equity is typically defined as cash flows from operations less capital expenditures.
Price to earnings	The price to earnings multiple is defined as the market capitalization (or equity value of common shares) divided by the earnings belonging to common shareholders.
Risk free rate	Most analysts use the yield on government bonds to determine the risk free rate even though they are not entirely risk free. This is because it is virtually impossible to get a truly risk free rate.
Risk premium	The excess return that the overall stock market provides over the risk free rate.
Single stage DCF valuation	A DCF valuation technique that solely uses a DCF perpetuity formula to value a company. It should only be used for companies with stable cash flows that are expected to grow in a predictable manner.
Specific risk	See firm-specific risk.
Standard deviation	A measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Standard deviation is calculated as the square root of variance.
Systematic risk	See market risk.
Total shareholder return	Total shareholder return (TSR) is the total return of a stock to an investor including both dividends and capital gains.
Two stage DCF valuation	A DCF valuation technique that is made up of a finite forecast period and a post-forecast period. The post-forecast period is commonly referred to as the continuing value, terminal value or TV.
Unsystematic risk	See firm-specific risk.
Variance	A measure of the dispersion of a set of data points around their mean value. Variance is a mathematical expectation of the average squared deviations from the mean.
Weighted average cost of capital (WACC)	The weighted average cost of capital (WACC) incorporates the individual costs of capital for each provider of finance (e.g. debt and equity), weighted by the relative size of their contribution to the overall pool of finance.