

# Financial analysis

Catherine  
Clement Chabas

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*# 3*



## INSPIRING EDUCATION INSPIRING LIFE

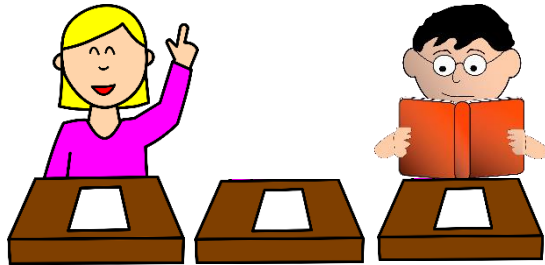
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# Students in class



Speak  
loud to  
the class



Keep  
safety  
distance

# Students online



Connect on  
zoom from  
your agenda  
link



Activate  
your  
camera



Mute your  
microphone



Be connected  
with a  
headset/mic



Pin the screen  
Use Side-by-  
side mode

Case NameVa	Time in class	reminder	Areas of financial analysis
Balance sheet detective	3 hrs	Balance sheet structure	Common size balance sheet matching
Financial Analysis Identifying the industry	3 hrs with time to search for industry information online	P&I structure Main Financial ratio	Common size + ratios industry wise matching
What value for ThermoCompact?	6 hrs (initial time to elaborate valuation methods)	Valuations method	Financial diagnosis; valuation method choice; value of firm
Yestudent	2 hrs	Context analysis	Valuation startup ; Seed financing ; Fundraising ; DCF Method ; Comparables Method

**Analyze the different dimensions of the performance of a company in all types of activities (services, production or projects)**

**Balance sheet analysis**

**Profit and Loss analysis**

**Performance ratios**

**Present in writing and orally the results of a performance study and recommendations for decision-making.**

**Develop a first approach of valuation methods**

- Cases are released on C@mpus
- The final exam will last 1 hour at the end of the last session.
  - it will consist of 20 multiple-choice questionnaire.



# Financial statements analysis

## Case 3

What value for  
ThermoCompact?

## Purpose :

**The aim of this case is to evaluate a medium size company (78 millions € revenues) in using different methods including comparables and discounted cash flows**

**Discussing different valuation methods and their relevance**

**Building a business plan and cash-flows according to different hypothesis**

# Main features

- Financial diagnostic
- Valuation methods
- Business plan
- Working capital requirement
- WACC : weighted average cost of capital
- Adjusted beta
- Sensitivity analysis



## Historical data analysis

**Analysis of available figures is a prerequisite of the initial work to be conducted before the valuation process begins.**

**Indeed, the figures are the raw data that the assessments are based on.**

Prepare (or review) a statement of financial position

Prepare (or review) a statement of profit or loss

Measure and analyze financial performance

Evaluate value creation

### Add complementary information

Clearly identify ALL assets used in business (including intangible assets)

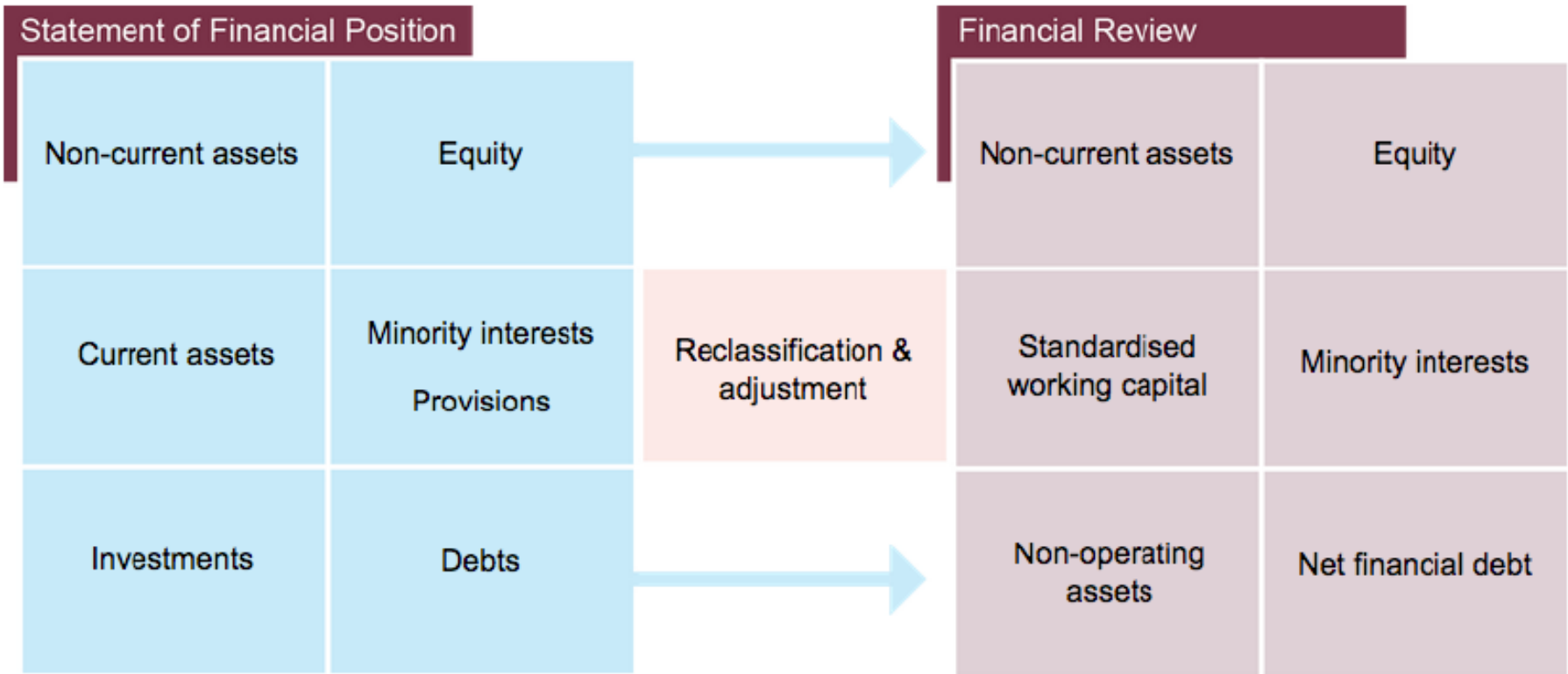
Estimate standardized working capital ratios and establish net financial debt on the day of valuation

Evaluate the environment

Validate financial forecasts by comparing them with past results (revenue, profit margin) and competitors

- Develop a validation or modelling tool for future investments.

From statement of financial position to financial review



The aim is to normalise the financial position and performance and eliminate accounting distortions.

### Example of adjustment to P&L

The enterprise to be valued is privately owned. The director pays himself a salary of 250 000 € per year including social charges.

A normal salary for a director of this kind would be €100 000 €.

Corporation tax is 20%.

Overall enterprise profit before tax and interest is €10 000 € after these payments.

The adjusted “normal” profit after tax should be?

# Example of adjustment to P&L

The adjusted “normal” profit after tax is :

Profit before adjustment : 10 000

Part of salary considered as distribution and not « normal salary » :  $250\,000 - 100\,000 = 150\,000$

Adjusted Result :  $10\,000 + 150\,000 = 160\,000$

Tax 20% : 32 000

Adjusted result after tax : 128 000



# Evaluation methods

Context

**Valuation is carried out in a variety of contexts and for different reasons.**

**Every valuation is different**, and the aim of any valuation is to provide a value that is **as objective as possible** in an environment of uncertainty.

This **contextual background is crucial** to consider as it will determine both :

- the assumptions made in the valuation process
- and also the methods used,
- and hence the validity of any resulting valuation.

### **Internal valuation - access to the organization, its management and its records**

Tax / accounting valuation

Divorce / probate valuation

Internal reward systems (stock option-Executive's compensation)

Sale of all / part of equity (vendor)

### **External valuation tool – Based on externally available information**

Investment decision – purchase all / part of equity

Comparative analysis.



## A. Introduction

1. Contexte et objectif
2. Diligences et sources d'information
3. Limites

## B. Présentation générale

1. Présentation [redacted] et du marché
2. Éléments financiers historiques
3. Hypothèses générales du plan d'affaires

## C. Approche d'évaluation retenues

1. Présentation de l'approche DCF
2. Présentation des approches analogiques
3. Présentation de l'approche par l'actif net réévalué (ANR)

## D. Estimation de la valeur des titres [redacted]

1. Approche DCF - Paramètres d'évaluation
2. Approche DCF - Hypothèses retenues
3. Approche DCF - Scénario Prudent
  - 3.1. Valeur consolidée Distribution + Edition
  - 3.2. Valeur Distribution seule
  - 3.3. Conclusions intermédiaires
4. Approche DCF - Scénario Volontariste
  - 4.1. Valeur consolidée Distribution + Edition
  - 4.2. Valeur Distribution seule
  - 4.3. Conclusions intermédiaires
5. Approche analogique - Transactions comparables
6. Synthèse

## E. Annexe

1. Approche par l'actif net réévalué
  - 1.1. Identification des actifs incorporels
  - 1.2. Évaluation des actifs incorporels

## Challenging hypothesis

**Although ultimately the valuation will employ some calculations what is critical is to ensure that the inputs to the calculations and the assumptions being made are as good as they can be.**

**Identify the key drivers of the business plan  
be critical about the assumptions in the business plan.**

## Understanding the context

**Every enterprise is different, and a thorough understanding of the strategic position of the enterprise is essential in the valuation process.**

## General background information

Story – management-

Sector / market analysis : An evaluation of the current market position and development of the enterprise.

### Group considerations

Develop an understanding of the factors which may need to be considered if the valuation is for part of a group of companies.

### Resources

resources currently owned and used by the enterprise and also its resource requirements for the future.

### Legal – societal- environmental issues

To gain an understanding of any issues which may affect the valuation.

**And any other issues which may be relevant to the valuation.**

**identify areas and levels of risk and opportunity**

**Location-ownership-management-**

**Prospects and trends in the sector concerned**

**enterprise's production tools and expertise**

**competitors**

**product lines**

**main suppliers**

**clients and market share**

**advances in technology, concentration**

**changes in legislation, breaches of contract, etc...)**



**Identify any reasons to justify a difference between price and value.**

## Understanding context

Market

Competitors

Business model

Governance

Social climate

Environmental issues

Positive

Negative

**Strengths**

**Weaknesses**

Internal

**Opportunities**

**Threats**

External

**It is important to analyze all assets of the enterprise, not just those appearing on the statement of financial position**

**Some intangible assets as created trademark are not in the balance sheet**

- **Every enterprise is different and it is important to carry out a full analysis of all relevant factors :**

## **Environmental**

**People (training, quantity or quality of personnel to do their job, key figure, stability, external staff, legal compliance, retirement plans, Collective agreements, bonus agreements, ...Insurance policies**

**Internal control, outcome of recent internal or external audits**

**Governance : Statute - Share holder agreement-minutes of meetings...**

**Legal : main sales and service contract (maintenance –IT)...**

### Financial analysis : Main ratios

Profitability : Turnover, EBITDA growth , margin ..

Assets management : WCR

Financial structure : gearing liquidity



# Thermocompact : Financial analysis

QUESTIONS ?





# Evaluation methods

Choice of methodology

**Valuation will be the result of a series of calculations which give any result a sense of objectivity**

**The choice of method may make a significant difference to the result of the calculation**

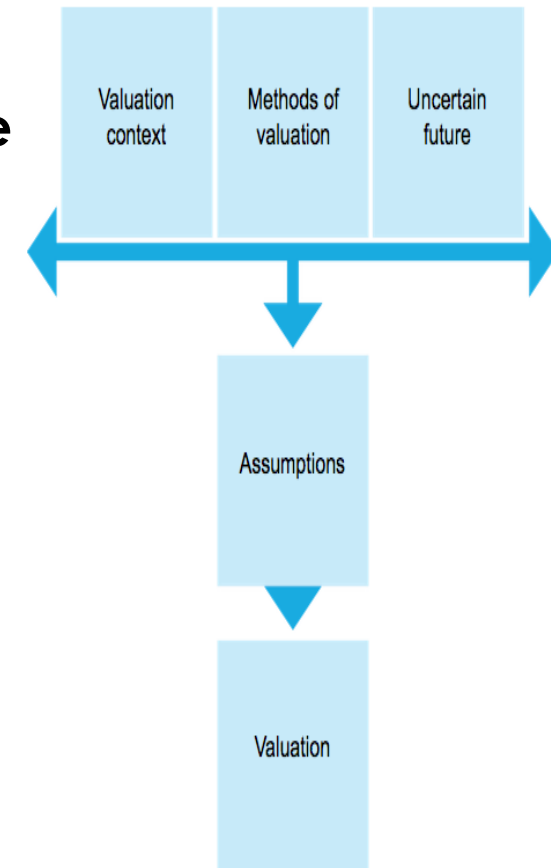
**In most instances valuation is about the future value of a business**

The future is by definition uncertain

Any valuation is based on a series of assumptions

Historical and comparative information is very useful in terms of making and justifying assumptions needed to conclude a valuation.

**Any valuation should cover a range of possible values**



In order to successfully value an enterprise it is important to understand the choice of methods available and when it is appropriate to use which method.

It is also important to understand the strengths and weaknesses of each method.

**Methods can be split into 3 categories:**

- **Asset based valuations**
- **Multiples based valuations**
- **Cash flow based valuations.**

## Net assets based valuation method

Value the assets and liabilities of the enterprise at their current fair market value and, thus, determine an adjusted net asset value

additional calculation of goodwill to value the entire enterprise.

## Discounted future net cash flows (DCF) method

Discounting a detailed future cash flow at an appropriate cost of capital

Dividend discounting – assuming either a constant dividend or a constant growth rate in dividends.

### **Multiples based methods**

**analogous methods or comparative methods**

**determined by referring to other comparable enterprises or transactions**

**The key is to establish the appropriate variables and enterprises in this process.**

•

### Other methods

These apply in special contexts :

**the use of professional scales**

- Restaurant
- Audit firm

**Information on Public web site :**

- Real estate : Price are released on public web site

**Repayment ability of the enterprise :** used particularly in leveraged buyout (LBO) transactions.

**These valuation methods are not suitable in every context or for each enterprise being valued**

Therefore, it is up to the professional to decide which method to adopt by considering available, usable data and to explain the process

As a general rule, not rely on only one method,

Compare values from several approaches (multi-criteria method)

**Comparison between values may highlight significant discrepancies in the values obtained and question the relevance of the parameters used or the consistency of the assumptions adopted in each method**

**The professional must justify the methods used and also those not used. They must conduct sensitivity analysis.**

Method	Advantages	Disadvantages
DCF	<ul style="list-style-type: none"> <li>• Intrinsic valuation</li> <li>• Takes different options into account (going concern, profitability)</li> </ul>	<ul style="list-style-type: none"> <li>• Sensitive to different assumptions</li> <li>• Final value and discount rate need to be precisely defined</li> </ul>
Multiples	<ul style="list-style-type: none"> <li>• Simple and widespread</li> <li>• A useful reference point in negotiations</li> <li>• Sectoral information available</li> <li>• Often based on real world market data, or transactions</li> </ul>	<ul style="list-style-type: none"> <li>• Comparable samples unreliable</li> <li>• Stock market prices assumed to be an accurate reflection of value</li> <li>• Transaction price used often without understanding of the context</li> </ul>
Adjusted net assets and other asset-based methods	<ul style="list-style-type: none"> <li>• Simple process</li> <li>• Adapted for certain sectors</li> </ul>	<ul style="list-style-type: none"> <li>• Accounting approach</li> <li>• Limited</li> <li>• Challenging to value goodwill</li> </ul>



### Question the pertinence of Experts' choice of valuation method

For example :

- Elimination of net assets methods and the method using discounting future dividends
- Used of recent transaction concerning the company's capital DCF



Evaluation methods

Recent transaction

**Is the transaction significant ?**

**Does it happened in a specific context ?**

Capital increase dedicated to salaries, to managers ....

**Premium or discount ?**

Controlling premium ?

Liquidity discount ?

**Mandatory for listed companies :**

The average stock market price of the share for the 30 days prior an event is very frequently mentioned.

**Could be used in evaluation of stock options in non listed companies when a recent transaction has occurred**

- Is the recent transaction price relevant ?

**Volume**

**Price**

**Parties**



Evaluation methods

Business plan

Which forecasting tools the enterprise use ?

How directors are involved in the forecasting process,

which may make it more credible

or less credible if they have a vested interest in a high valuation : **bonus policy** ?

If the enterprise has a reliable organization system that enables it to define and quantify assumptions

Was the forecast conservative or proactive, pessimistic or optimistic? (comparison between last budget and real data)

How were inflation and the growth rates determined?

<b>Revenue</b>
<b>Profit margin</b>
<b>Tax cost</b>
<b>Working capital requirements</b>
<b>Investment requirements</b>
<b>Funding methods and requirements</b>
<b>Forecast horizon</b>

### Revenue growth and “product-mix” used,

in line with the reasonable nature of expected contracts or proposed developments

Consistent with the strategic analysis

### Changes in costs

Consistent with revenue growth

### Change in the margin,

In line to what is currently obtained by the enterprise and in its line of business

consistent with what could be expected in the sector over the same period as the valuation



## Term of payment – working capital growth

Consistent with business growth

Client ,supplier negotiation

Changes in investments required to support the turnover growth ( new technical equipment...)

and how they are funded ?

Review the Equity/debt ratio and the WACC

New funding needed for working capital requirements and investment  
rate changes observed on the market,

Better or Worst ability of the enterprise to borrow money



# Thermocompact : business plan

- Up to you : Prepare expected cash flows



# Evaluation methods

DCF

**This method assumes that an asset is worth the cash flows it can bring in the future**

**The value is determined in 3 steps**

**determining future cash flows (free cash flow) attributable to all fund providers (shareholders and financial creditors)**

**and discounting them at a rate that represent the requirement of fund provider in terms of profitability**

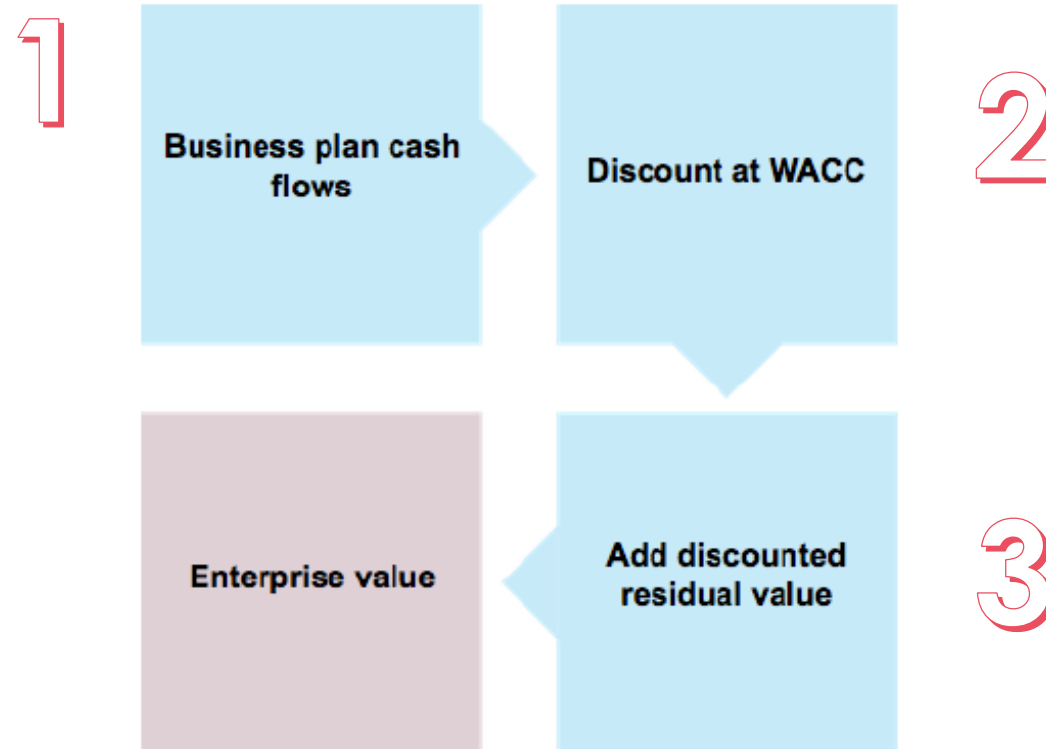
**It is often considered the most relevant part of the valuation**

**because it includes,**

**The specific risk (strategic and economic components) of the valued enterprise through the cash flow projection**

**And the profitability requirement of fund providers, given the level of risk associated with their investment (market risk)**

# Discounting cash flow : 3 steps methodology



- **Cash flows over the period relevant to the business plan "explicit forecast period"**

le : For very capital-intensive companies like EDF, the business plan can be established over a period of 20 years

- **Residual value corresponding to the funding of a standard cash flow at the end of the period relevant to the qualified business plan**
- **The Weighted Average Cost of Capital (WACC), from which the cash flow and residual value will be discounted.**

It takes into consideration the notions of risk and time.

**DCF allows to determine the value of the enterprise**

**To obtain a value of its equity**

Long term liabilities have to be subtracted to the value calculated by DCF

**Non operating assets has to be added to the DCF value :**

**Since the cash flows included are those generated by the operations of the enterprise it does not affect the estimate of non- operating assets (which must, therefore, be valued separately) and added to the DCF Value**

= rate that reflects current market assessments of:



Time value of money



Risks specific to the asset

Rate of return that investors **would require** if they were to choose an investment that would generate cash-flows equivalent to those expected from the asset

=> *WACC or incremental borrowing rate*



# The discount rate usually adopted is the weighted average cost of capital (WACC).

To calculate WACC, multiply the cost of each « founders 'component » by its proportional weight and take the sum of the results.

$$WACC = \frac{E}{V} * Re + \frac{D}{V} * Rd * (1 - Tc)$$

### Shareholder remuneration

Re = cost of equity

E = market value of the firm's equity

E/V = percentage of financing that is equity

### Bank remuneration (after tax impact)

Rd = cost of debt

D = market value of the firm's debt

D/V = percentage of financing that is debt

Tc = corporate tax rate

V = E + D = total market value of the firm's  
financing (equity and debt)

**Should be adopted the current financial structure or a target structure ?**

**Do we apply the same WACC rate for the entire forecast period, regardless of the flows to be discounted and change in financial structure ?**

**Current practices do not appear to be unanimous**

**Current account : debt or equity ?**

**In some cases, it may be necessary to determine which items to include in the equity or liability.**

**Therefore, if the current accounts of the partners in a partnership are considered “frozen”, they are treated as equity, whereas, if they are not “frozen”, they are added to debt**

Shareholders will expect to receive a certain return on their investments in a company,

**the equity holders' required rate of return is a cost from the company's perspective,**

because if the company fails to deliver this expected return, shareholders will simply sell off their shares, which leads to a decrease in share price and in the company's value.

**The cost of equity, then, is essentially the amount that a company must spend in order to maintain a share price that will satisfy its investors.**

## Using the capital asset pricing model (CAPM)

$$k_e = r_f + \beta \times (r_m - r_f)$$

- **$r_f$ :** Risk-free rate. In reality, this will be the rates on government bonds, the rate of a state investment, normally considered the least risky. In practice, the risk-free rate in five years is adopted (as it fits with the business plan period), even if the theory presupposes retaining a maturity spread over the term of the business plan. It would be more appropriate to use the rate in 30 years, as this time is the closest to the infinite forecast period of a discounted cash flow (DCF)
- **$r_m$ :** Profitability of the market portfolio. This measures the expected profitability of the market in its entirety. Consider the risk premium of expected market shares (in the market of the target country)
- **$\beta$ :** Measures the sensitivity of a stock relative to the evolution of the market as a whole = systematic risk assessment (not diversifiable risk) It is assigned a "beta" coefficient related to the company itself in its sector
- For a non-quoted enterprise we may use comparable quoted companies to calculate  $\beta$  and the cost of equity.

## Cost of debt

$k_d$ : Profitability rate demanded by creditors taking account of:

- Financial structure of the enterprise being valued or
- Financial structure of target enterprise (longer term) consistent with the forecast period and the tax “rate at which the enterprise could refinance its debt, taking into account its economic situation”
- Always a cost after tax.

Tax. Corporation tax. Beware rates will vary by country, so an average effective rate for a company is generally used.

The market related content ( $r_f$ ,  $r_m$ ,  $\beta$ ) can be found via various financial websites (Bloomberg, Yahoo, FT etc.)

In any event, it is advisable to ensure that the same risk is not taken into account twice:

- Once in the business plan
- And again in the discount rate used.



Thermocompact : WACC

Up to you : Calculate WACC

## Calculating discounted residual value

It is represented by the Gordon-Shapiro formula:

$$\text{Discounted residual value} = \frac{\text{S.C.F}}{(i - g)} \frac{1}{(1 + i)^n}$$

S.C.F is the standardised cash flow (after the business plan period)

i is the discount rate

g is the perpetual growth rate

n is the last year of the business plan

**Future standard cash flow** should be calculated independently of the last flow of the business plan since, for example, depreciation to infinity is mostly equal to the asset investment. It should be consistent with the profitability levels observed in the type of business studied, which can be analysed using ROCE: Return on Capital Employed, determined by dividing the net operating income before tax by the amount of capital used.

Capital used is also defined as the sum of the non-current assets and working capital.

**The growth rate to infinity** to be adopted is a growth rate of net flow and not revenue. It is also an inflated rate. A number of items can be considered to help estimate it:

- Long-term growth prospects of the economy
- Long-term growth prospects of the line of business of the enterprise being valued
- Organic growth in recent years; possibly the last ten
- Sustainable growth by the enterprise, assessed in terms of capital, productivity and market prospects.

In practice, the growth rate to infinity is usually between 1 and 3%.

**It is also possible to determine residual value** on the basis of a multiple of a suitable aggregate, such as Gross Operating Surplus, based on the last year of the business plan.

In any event, it is advisable to assess the likelihood of this value by determining the multiple brought about by the residual value, on the basis of the main financial aggregates of the business concerned (GOS, operating income, net income, revenue, etc.) by comparing them with financial aggregates today and finally, by analysing the importance of the residual value in the overall value.



**The cash flow method enables you to determine enterprise value, from which net liabilities are deducted (or net cash added) in order to get equity value.**

**Pension liabilities and certain non-recurring provisions** for risks and expenses, if disbursement is not included in the cash flow forecast operating cash flow

**Financial assets, including equity securities** for which it is advisable to adopt the actual value

**Financial instruments** whose fair value must also be taken into account if it has not contributed to the determination of net liabilities (rate or currency swap)

**Assets and deferred tax liabilities** that have not been identified through the use of an effective tax rate in the cash flow (losses carried forward before business plan...)

### Review of the valuation achieved

Compare the results obtained with those obtained using other valuation methods, analyze the differences

### Sensitivity analysis

The cash flow method is based on numerous assumptions (worst –medium –best cases):

**conduct the calculations under several alternative assumptions**

**Several scenarios can then be built** using data from the business plan, especially when some achievements are related to external factors.

This model is sensitive to changes in actuarial data. Therefore you should simulate the impact of changes in the discount rate or the growth rate to infinity.

**Adjustment to the overall value or to the assumptions about required returns (and therefore the value) could be made depending on these factors.**

### Value in whose hands:

The value of an enterprise will vary depending on who owns it :

- Family business-LBO-
- The value to a buyer or a seller may be different (value versus price)

### Size of equity stake:

We would expect to see a premium for a controlling stake or a discount for a minority in practice

But not in theory

### Liquidity of the equity:

The value of equity will be increased if it is liquid

equity shares in a stock-exchange-listed company will have a premium in value versus an identical company which isn't listed.

## When to apply

- Enterprises likely to establish sufficiently reliable medium-term business plans

In most cases, this means enterprises of a certain size that can make forecasts with sufficient outlook on their future

Businesses of an industrial nature or with significant investments

- **With great prudence** the method can be applied **to start ups**,

which by their nature (high fixed costs, weak or no revenue, significant losses as a result of the latter and often with negative equity) make it difficult to apply another method, unless consistent forecasts can be established.

## When not to apply

- small enterprises with no reliable budget planning process.



## Question

**The DCF method is effective when the company to be valued is :**

1. An enterprises likely to establish sufficiently reliable medium-term business plans
2. A start-up
3. A small enterprises with no reliable budget planning process
4. A real estate company



Thermocompact : DCF

Up to you : Finalize the DCF  
valuation



# Evaluation methods

## Multiple based evaluation

## Defining the performance measure

- The first thing to do is to define the aggregate that you want to use which, from the sample of comparable companies, will determine a "multiple" which, when applied to the aggregate of the enterprise to value, will enable you to calculate its value

it is possible to choose an aggregate which will either value the entire enterprise or just the owners' equity

It is critical to ensure that the numerator and denominator match the aim of the valuation.

## The most common aggregates used are:

- Revenue , EBITDA , EBIT, Net income
- Operating cash flow



Revenue, EBITDA, and EBIT are used to determine the enterprise value because they correspond to flows which cover remuneration from all fund providers. They are independent of the company's financial structure.

## Revenue

This is the simplest information

Its relevance to valuation is conditional on other features of the companies included in the sample, such as the level of margin generated or their size and how capital-intensive they are

It is most often used for professional service companies such as lawyers and accountants.

## EBITDA

- This introduces the concept of profitability while avoiding distortions associated with the depreciation or funding policy of the comparative enterprises.

This aggregate does not take into account capital intensity

It may be necessary, if appropriate, to make adjustments to ensure comparability.

lease classification : include or exclude from EBITDA

Analysis of charges and revenues highlights specificities :

Choice of compensation: salary or dividends

Grant : in France for example : presentation of CICE advantage

## EBIT

- Similar to EBITDA but caution must be exercised to ensure consistency of depreciation approaches.



## Question

The enterprise to be valued is privately owned.

The director pays himself a salary of 250 000 €, A normal salary for a director of this kind would be €100 000 €.

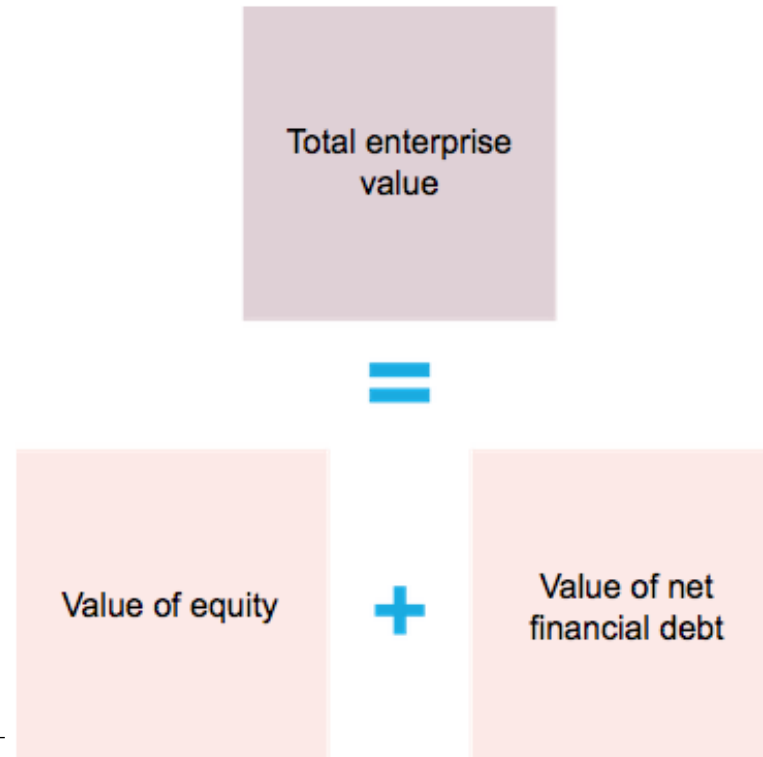
Corporation tax is 20%.

Profit before tax and interest is €10 000 € after these payments.

The adjusted “normal” profit after tax should be ?

## Company value versus equity value

To move from the value of the company to the value of equity, you have to take into account, in particular, net liabilities (positive or negative), provisions for liabilities and disbursements and for deferred taxation.



## Homogeneous sample

- It is best determined by considering two criteria rather than just one

one being size-related

and the other profitability-related, for example.

## Databases enable you to help you go about this

## Accessing comparable financial data

It is important to know under which accounting regulations comparative data were established.

It is necessary to ensure EBITDA or net operating income are consistency between the enterprise being valued and the enterprises included in the sample,

which can result in a certain number of adjustments, e.g., inclusion of provisions for risks and charges or pension liabilities.

## Obtaining relevant data

Stock market was facing, before Covid, a financial bubble that leads to an artificial increase in quotation prices,

**From 7 EBITDA to 11 EBITDA**

Period of economic depression introducing volatility of the quoted prices

Volume of transaction

"forced" conditions

**Exclude companies too dissimilar (financial structure, business model, etc.)**

**Focus on transactions involving a significant part of the capital and which were conducted in cash**

**as transactions paid for in securities are more difficult to analyze**

**Ensure that the transaction price is not augmented by a premium justified by specific synergies**

**Verify the advertised selling price**

**It may include other factors, such as a future price supplement or commitments made by the buyer, which contribute to lowering the apparent sale price**

**Non operating assets valued at market price (building, ...)**

## Analyze the shareholder structure

Family business, subsidiary of a group

## Verify Specific situations,

regulatory constraints

or tax assets

Corporate reputation

## Take account of any discounts to be applied

for example, a minority stake in an unlisted company).

The success of identifying the correct comparable data will in part be driven by the quality of the strategic and financial analysis





Thermocompact : Multiples  
observed method

Up to you : Finalize valuation  
using the comparable

## **Adjusted net asset valuation.**

The value of net assets in the statement of financial position adjusted to reflect current market values.

## **$\beta$ (beta).**

The systematic risk (undiversifiable) of investing in a particular security. Measured by correlation of returns of the security to the market.

## **CAPM (Capital Asset Pricing Model).**

An academic model for calculating the rate of return required for investing in a given asset given its risk. Most often used to calculate the cost of equity.

## **Company value. Enterprise value.**

The value of the entire company, or the total that would need to be financed either by debt or equity.

## **DCF (discounted cash flow).**

Decision making tool based on the time value of money.

## **Discount rate.**

The factor used to convert future cash flows into today's terms. Usually the WACC.

## **Enterprise value.**

This is the same as the company value, but NOT the equity value.

## **Exceptional items.**

Items within a statement of profit or loss which are a normal part of business activity but are exceptional in terms of either size or frequency.

## Cost of debt :

The required rate of return (after tax) required for lending long term funds to the company. Often approximated to the rate of interest.

## Cost of equity :

The required rate of return, taking account of risk, required for investing in the equity of the company.

**NPV (net present value).** The summation of a DCF calculation, taking account of all future cash flows.

**Non-operating assets.** Assets owned by the company but not directly involved in the operational activity of the company.

**PV (present value).** The value in today's terms of a future cash flow, after the application of a discount rate.

## **Residual value.**

The value of the company after the period of detailed forecasts have finished. Usually 3-5 years depending on the industry.

## **The risk free rate of return.**

Generally accepted to be the return on long dated government securities.

## **The expected return of on the (stock) market.**

Hard to predict, but evidence suggests that the market risk premium (the excess of  $r_m$  over  $r_f$ ) is more consistent at between 5 and 8%.

**SWOT (Strengths, Weaknesses, Opportunities and Threats).** A tool used for strategic analysis of company position.

**WACC (Weighted Average Cost of Capital).** The average return expected for providers of finance to the company (debt and equity).

**THANK YOU!**