What is the Difference between NPV and IRR?

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- It is important to understand the difference between NPV and IRR

What is the Difference between NPV and IRR?

- NPV is the value today of a stream of cash flows in the future
- The cash flows may be a mix of positive and negative cash flows
- NPV is most frequently used in valuation of assets, bonds or businesses

What is the Difference between NPV and IRR?

- IRR is the hurdle rate at which the Net Present Value of an investment is equal to zero.
- This means that it is the rate of interest that matches the present value of the investment with the future cash flow from the investment
- This is most frequently used in capital budgeting or when comparing the returns on different investment opportunities.

What is the Difference between NPV and IRR?

- The two measures have three things in common:
  - They both use the DCF method
  - They both take into account the cash flows through the life of the project
  - They both recognise the time value of money

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What is the Difference between NPV and IRR?

- Their differences are just as imporant…

What is the Difference between NPV and IRR?

- The aggregate of all the present values of an asset form the Net Present Value and it is expressed in absolute $ terms

What is the Difference between NPV and IRR?

- The IRR is the rate of return at which the NPV = 0
- The IRR is expressed in percentage terms

What is the Difference between NPV and IRR?

- The NPV helps us to identify the surplus $ returns over and above the initial investment

What is the Difference between NPV and IRR?

- The IRR represents the position of no profit and no loss
- Therefore if an IRR is greater than the WACC, the investment returns are positive and the investment should be made
- If the IRR is less than the cost of capital, the investment should not be made.

What is the Difference between NPV and IRR?

- When calculating the Net Present Value, we separately calculate the appropriate discount rate using the CAPM and WACC

What is the Difference between NPV and IRR?

- When calculating the IRR, we fix the NPV to zero - there is no profit or loss from the investment
- From this we are able to derive the rate which fulfils this condition - the internal rate of return (IRR)

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