Glossary of Business Valuation Terms

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the below identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion, in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner that materially departs from the enclosed definitions, it is recommended that the term be defined as used within the valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

American Institute of Certified Public Accountants
American Society of Appraisers
Canadian Institute of Chartered Business Valuators
National Association of Certified Valuators and Analysts
The Institute of Business Appraisers

Adjusted Book Value Method: A method, within the asset approach, whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values. (NOTE: In Canada on a going concern basis.)

Adjusted Net Asset Method: See **Adjusted Book Value Method**.

Appraisal: See **Valuation**.

Appraisal Approach: See **Valuation Approach**.

Appraisal Date: See **Valuation Date**.

Appraisal Method: See **Valuation Method**.

Appraisal Procedure: See **Valuation Procedure**.

Arbitrage Pricing Theory: A multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

Asset (Asset-Based) Approach: A general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Beta: A measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Blockage Discount: An amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

Book Value: See **Net Book Value**.

Business: See **Business Enterprise**.

Business Enterprise: A commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Business Risk: The degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.

Business Valuation: The act or process of determining the value of a business enterprise or ownership interest therein.

Capital Asset Pricing Model (CAPM): A model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization: A conversion of a single period of economic benefits into value.

Capitalization Factor: Any multiple or divisor used to convert anticipated economic benefits of a single period into value.

Capitalization of Earnings Method: A method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

Capitalization Rate: Any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure: The composition of the invested capital of a business enterprise, the mix of debt and equity financing.

Cash Flow: Cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

Common Size Statements: Financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control: The power to direct the management and policies of a business enterprise.

Control Premium: An amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rate value of a non-controlling interest in a business enterprise to reflect the power of control.

Cost Approach: A general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital: The expected rate of return that the market requires in order to attract funds to a particular investment.

Debt-Free: ***We discourage the use of this term.*** See **Invested Capital**.

Discount for Lack of Control: An amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability: An amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights: An amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

Discount Rate: A rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method: A method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Discounted Future Earnings Method: A method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

Economic Benefits: Inflows such as revenues, net income, net cash flows, etc.

Economic Life: The period of time over which property may generate economic benefits.

Effective Date: See **Valuation Date**.

Enterprise: See **Business Enterprise**.

Equity: The owner's interest in property after deduction of all liabilities.

Equity Net Cash Flows: Those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

Equity Risk Premium: A rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings: That amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method: A specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings, and b) the value of the selected asset base. Also frequently used to value intangible assets. See also **Excess Earnings**.

Fair Market Value: The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. (NOTE: in Canada, the term "price" should be replaced with the term "highest price.")

Fairness Opinion: An opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

Financial Risk: The degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.

Forced Liquidation Value: Liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Free Cash Flow: ***We discourage the use of this term.*** See **Net Cash Flow**.

Going Concern: An ongoing operating business enterprise.

Going Concern Value: The value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems and procedures in place.

Goodwill: That intangible asset arising as a result of name, reputation, customer loyalty, location, products and similar factors not separately identified.

Goodwill Value: The value attributable to goodwill.

Guideline Public Company Method: A method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

Income (Income-Based) Approach: A general way of determining a value indication of a business, business ownership interest, security or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets: Non-physical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

Internal Rate of Return: A discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value: The value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price or strike price of an option and the market value of the underlying security.

Invested Capital: The sum of equity and debt in a business enterprise. Debt is typically a) all interest-bearing debt, or b) long-term interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

Invested Capital Net Cash Flows: Those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

Investment Risk: The degree of uncertainty as to the realization of expected returns.

Investment Value: The value to a particular investor based on individual investment requirements and expectations. (NOTE: in Canada, the term used is "Value to the Owner.")

Key Person Discount: An amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta: The beta reflecting a capital structure that includes debt.

Limited Appraisal: The act or process of determining the value of a business, business ownership interest, security or intangible asset with limitations in analyses, procedures or scope.

Liquidity: The ability to quickly convert property to cash or pay a liability.

Liquidation Value: The net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

Majority Control: The degree of control provided by a majority position.

Majority Interest: An ownership interest great than 50% of the voting interest in a business enterprise.

Market (Market-Based) Approach: A general way of determining a value indication of a business, business ownership interest, security or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities or intangible assets that have been sold.

Market Capitalization of Equity: The share price of a publicly traded stock multiplied by the number of shares outstanding.

Market Capitalization of Invested Capital: The market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple: The market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

Marketability: The ability to quickly convert property to cash at minimal cost.

Marketability Discount: See **Discount for Lack of Marketability**.

Merger and Acquisition Method: A method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting: A convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

Minority Discount: A discount for lack of control applicable to a minority interest.

Minority Interest: An ownership interest less than 50 percent of the voting interest in a business enterprise.

Multiple: The inverse of the capitalization rate.

Net Book Value: With respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flows: When the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

Net Present Value: The value, as of the specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Net Tangible Asset Value: The value of the business enterprise's tangible assets (excluding excess assets and non-operating assets) minus the value of its liabilities.

Non-Operating Assets: Assets not necessary to ongoing operations of the business enterprise. (NOTE: in Canada, the term used is "Redundant Assets.")

Normalized Earnings: Economic benefits adjusted for nonrecurring, non-economic or other unusual items to eliminate anomalies and/or facilitate comparisons.

Normalized Financial Statements: Financial statements adjusted for non-operating assets and liabilities and/or for non-recurring, non-economic or other unusual items to eliminate anomalies and/or facilitate comparisons.

Orderly Liquidation Value: Liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

Premise of Value: An assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation (e.g., going concern, liquidation).

Present Value: The value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Portfolio Discount: An amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

Price/Earnings Multiple: The price of a share of stock divided by its earnings per share.

Rate of Return: An amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Redundant Assets: See **Non-Operating Assets**.

Report Date: The date conclusions are transmitted to the client.

Replacement Cost New: The current cost of a similar new property having the nearest equivalent utility to the property being valued.

Reproduction Cost New: The current cost of an identical new property.

Required Rate of Return: The minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

Residual Value: The value as of the end of the discrete projection period in a discounted future earnings model.

Return on Equity: The amount, expressed as a percentage, earned on a company's common equity for a given period.

Return on Investment: See **Return on Invested Capital** and **Return on Equity**.

Return on Invested Capital: The amount, expressed as a percentage, earned on a company's total capital for a given period.

Risk-Free Rate: The rate of return available in the market on an investment free of default risk.

Risk Premium: A rate of return added to a risk-free rate to reflect risk.

Rule of Thumb: A mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay or a combination of these; usually industry specific.

Special Interest Purchasers: Acquirers who believe they can enjoy post-acquisition economies of scale, synergies or strategic advantages by combining the acquired business interest with their own.

Standard of Value: The identification of the type of value being used in a specific engagement (e.g., fair market value, fair value, investment value).

Sustaining Capital Reinvestment: The periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

Systematic Risk: The risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

Tangible Assets: Physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Terminal Value: See **Residual Value**.

Transaction Method: See **Merger and Acquisition Method**.

Unlevered Beta: The beta reflecting a capital structure without debt.

Unsystematic Risk: The risk specific to an individual security that can be avoided through diversification.

Valuation: The act or process of determining the value of a business, business ownership interest, security or intangible asset.

Valuation Approach: A general way of determining a value indication of a business, business ownership interest, security or intangible asset using one or more valuation methods.

Valuation Date: The specific point in time as of which the valuator's conclusions of value applies (also referred to as "Effective Date" or "Appraisal Date").

Valuation Method: Within approaches, a specific way to determine value.

Valuation Procedure: The act, manner, and technique of performing the steps of an appraisal method.

Valuation Ratio: A fraction in which a value or price serves as the numerator and financial, operating, or physical data services as the denominator.

Value to the Owner: See **Investment Value**.

Voting Control: *De jure* control of a business enterprise.

Weighted Average Cost of Capital (WACC): The cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.