Terminology

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- Beta: a measure of a stock's volatility relative to the overall market (typically the S&P500 index is used as a proxy for the "overall market"). The higher the beta, the more volatile the stock price. By construction, the overall market has a beta of 1.

- Cost of capital: cost of capital is actually an interest rate (e.g. 7%).
    - Equity cost of capital: the rate of return that investors expect (and demand) when purchasing that equity.
    - Debt cost of capital: the rate of return on the company's bonds (debt).

- Coverage ratios: the company's ability to cover interest payments, e.g.
    - EBIT/Interest Expense or EBITDA/Interest expense

- Current Ratio: Current Assets / Current Liabilities. Measure of whether company has enough cash to cover immediate expenses

- Discounted Cash Flow model (DCF): a valuation model that explicitly estimates the company's future cash flows, year by year, for the next several years, and then calculates the present value of all of those cash flows as a way to put a single value on the company.

Debt financing: Raising money by issuing debt (e.g. corporate bonds)

Diluted Shares outstanding: the total number of shares outstanding plus those that could be exercised by employee stock option holders

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- Dividend yield: Dividend / Share price

- Earnings estimates: Earnings are equivalent to Net Income, but on a forward-looking basis (typically next twelve months). Net Income is an accounting value from an existing Income Statement—i.e. a measure of previous earnings. Earnings estimates are available from:
    - IBES (a company that provides earnings estimates on publicly listed equities)
    - Bloomberg (an online information service used extensively in the financial markets)
    - "Sell side" research (investment bank equity research reports)

- Earnings Multiple: Equity Market Cap / Earnings. Earnings are calculated net of interest payments on debt, and are therefore of interest to equity holders, but not debt holders. Hence the earnings multiple is estimated using equity market cap, not levered market cap.

- Earnings per share (EPS): divide total company earnings by # shares outstanding. EPS represents the proportion of a company's net earnings (equivalently net income, i.e., profit) allocated to each share of common stock.

- EBIT: Earnings before Interest and Taxes (also called Operating Profit & Operating Income)

- EBITDA: Earnings before Interest, Taxes, Depreciation and Amortization.

    - EBITDA/Interest: level of earnings relative to interest payments on debt. The greater the ratio, the more financially secure the company (because it is generating adequate earnings to cover its required interest payments).

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- EBITDA Multiple: Levered Market Cap / EBITDA. Similar interpretation to P/E ratio, but based on cash flow rather than earnings.

- Equity Financing: raising funds by issuing equity

- Equity market capitalization: Diluted shares outstanding x share price

- IPO (Initial Public Offering): An equity financing—previously privately-held company issues equity to the public market for the first time

- LTM: Last Twelve Months

- Leverage: The amount of debt a company has. Typical leverage ratios include:
  - Debt / Equity Ratio
  - Debt / Assets Ratio

- Levered market capitalization (equiv: Enterprise Value): equity market capital plus net debt, where
  - Net debt = short term debt + long term debt – cash + minority interest preferred stock

- Long-term debt: Debt maturing in more than one year's time.

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- Margins: Ratios (denominator = revenue) that help to evaluate a company relative to its peers
  - Gross Profit Margin = (Revenue – COGS) / Revenue
  - Operating Income Margin = (Revenue – COGS – Operating Expenses) / Revenue
  - Net Income Margin = Net Income / Revenue

- "Multiples" analysis: multiples such as EBITDA multiple, Revenue multiple, etc. are calculated with either Equity Market Cap or Levered Market Cap as the numerator. These multiples are used as a measure of the company's value, especially relative to other companies in the same industry.
  - Levered market cap is used for line items prior to interest payments (e.g. revenue multiple, EBITDA multiple.)
  - Equity market cap is used for line items that appear after the interest payments have been made (e.g. Earnings multiple)

- Net Income: The firm's profit in a given year. Net Income is measured as revenues less all costs (operating, financial, and tax-related) of running the business. Estimates of future net income are usually called Earnings estimates.

- Operating Income / Operating Profit: see EBIT

- Options: Equity stock options are a form of compensation that is dependent on the company's share price.

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- P/E Ratio (sometimes called P/E multiple): Share price / estimated EPS. The higher the P/E, the more earnings growth the company is expected to show. Effectively, share holders are paying a high price, relative to current earnings, because they expect *future* earnings to be much higher

- P/E to Growth Ratio (PEG ratio): P/E ratio / long-term estimated growth rate. The *lower* the PEG ratio, the stronger the company's future performance is expected to be.
    - A PEG of 1 is generally accepted to be approximately "fair." (Think about why.)
    - A PEG of higher than 2 is considered "expensive"

- Pro Forma adjustments: adjustments to existing accounting numbers based on an anticipated change in financing (e.g. an equity or debt issuance).

- Return on Assets (ROA): Net Income / Assets. Higher ROA indicates higher efficiency

- Return on Equity (ROE): Net Income / Equity – indicates rate of return to equity holders

- Revenues (or Sales): The positive inflow of money generated by sales of the company's product or service.

Terminology

- Revenue Multiple: Levered Market Cap / Revenues. Note that we use *levered* MCAP for this multiple, because revenue is a line item prior to debt payments—hence revenue is an important number for both equity and debt holders. The revenue multiple (also called Sales Multiple) gives a sense of the financial strength of the company.

- Risk-free rate: Interest rate on US Treasury bonds

- Sales: see Revenues

- Terminal value: the residual value of a business at the end of an investment time horizon. When estimating a discounted cash flow model, for example, we might create the model over 5 – 7 years, and then use the Terminal Value as an estimate of the PV of all future income after that point.
  - Forecasting further in the future, on an annual basis, is an increasingly inaccurate proposition—who knows what will happen more than 7 years down the road.
  - However, it is important to to account for the anticipated infinite stream of cash flows from the corporation, beyond the number of years explicitly modeled in the DCF.