IB Interview Guide: Technical Questions – Equity Value and Enterprise Value and Valuation Metrics and Multiples

Hello, and welcome to our next lesson in the technical questions and section of this interview guide. This time around, I'm going to be walking you through our document on Equity Value, Enterprise Value, and valuation metrics and multiples, as well as some of the accompanying Excel files that we provide here, mostly to help you answer interview questions and understand the concepts.

Now in the lesson on accounting, I recommended that you start, in some cases, by looking at the Excel file and playing around with it and then testing yourself with the interview questions, especially if you have an accounting background. With this topic, though, I recommend a bit of a different approach because Equity Value and Enterprise Value seem very easy, in theory. And if you Google these terms and look at Investopedia, and Wikipedia, and other sites, you will come across definitions that seem very straight forward.

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The problem is that a lot of what's out there on these topics is misleading and sometimes, is completely wrong. In my experience, almost no students and almost no professional bankers actually understand what these concepts mean in-depth. So I recommend actually going through all the key rules here, certainly at least the first five key rules. Even if you *think* you know exactly what Enterprise Value and Equity Value mean, and how to calculate them, chances are you're going to find some things here that you don't know about and that you haven't thought about before.

So just as one example, going down here, in the very first page of the section I point out that most of the Google search results for these terms are actually completely wrong. And for some reason, the actual correct definition of Enterprise Value is nowhere to be found. Or, you can find it in some books, and I've seen it in some textbooks, for example, but a lot of what's out there is wrong and doesn't contain the real definition of this term.

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So definitely take a look at the first section on implied value and market value, or current value, Equity Value, Enterprise Value, a few simple examples of how to calculate them, our real world analogy for what it means in terms of buying a house, which is a common analogy used to describe these terms, but we present it and look at it in a bit of a different light. And, it is something you probably haven't seen before, unless you've already been through our modeling courses as well.

Then we go to our real company here. So I recommend just reading through all of this to start with. Don't even look at the Excel files at this stage. It's actually really important to read and understand these concepts. In my experience, the most difficult questions on these concepts are actually conceptual in nature and don't have anything to do with calculations, or Excel, or anything like that. I would read through at least the first five key rules here.

Now after that, when you get to key rules numbers 6 through 10, these you may know more about if you've worked in finance, or you've done a previous internship, or something like that.

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These are a little bit more straightforward and more traditional in terms of what they cover because we go through how to calculate diluted shares outstanding using the treasury stock method, how to calculate diluted shares from convertibles, and a lot of that isn't vastly different from what you'll see in other sources.

The parts about how to move from Equity Value to Enterprise Value and how to calculate valuation metrics and multiples and different types of cash flows, similarly, are not quite as different as the first five key rules here, but they're still important to understand. And then this one on Other Metrics and Multiples I would say is optional. It's useful if you're going in to interview with a specific industry group and you want to learn a little bit about it beforehand and how some of the metrics and multiples differ, but it's not as essential as the other topics.

Now, with the interview questions here, really you should be testing yourself with all of these. So the conceptual questions are quite important. What do Equity Value and Enterprise Value mean? A lot of people answer that question by explaining how to *calculate* Enterprise Value and Equity Value, but that's not what the question is asking. The question is asking what the concepts actually mean.

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So I would recommend going through this and testing yourself on all these concepts and making sure you can answer all these questions. Now, some of these questions will deal with slightly more advanced topics like Equity Investments and Noncontrolling Interests, and those might be a little bit less important. But again, in my experience, a very high percentage of interviewees and candidates get tripped up on these types of questions, which is why I view this as one of the most important technical sections in the guide.

In terms of the Excel files here, one of them on the Debt and Equity mix and how it affects a company's implied Enterprise Value if you project its cash flow or free cash flow, is mostly here to illustrate this concept. It's not really about answering interview questions so much as it is about explaining why the whole concept behind Enterprise Value and the theory doesn't exactly hold up in real life. So this will be useful, but more for understanding that concept, not quite as much for testing yourself with interview questions.

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This other Excel file on how Equity Value and Enterprise Value and multiples change after specific events like issuing debt, issuing equity, repurchasing stock, repaying debt, and issuing dividends will be very helpful because it's specifically designed to help you answer these types of interview questions. So play around with it, see how it works, make sure you understand the scenarios here. I would compare this one to the three-statement model in the accounting section and in the accounting lessons and guides. The concept is very similar, it's a little bit simpler because there aren't quite as many things that could happen, but this is probably the single most helpful Excel file if you want to test yourself and prepare for interview questions.

And then some of the other Excel files here on how to calculate diluted Equity Value and Enterprise Value for Vivendi, and how to calculate some of their valuation metrics and multiples and things like that are there mostly for your reference.

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In a real interview, you're not going to get numbers this ugly and this complicated because they're not going to give you real companies. In an interview, if you get asked to calculate any of this, it's going to be very similar to the questions in our guide towards the end where they give you simplified and easier-to-calculate numbers. So many of these Excel files in this section are there to teach you the concepts and for your reference, if you want to see how it's done in real life and Excel. Really, the most helpful one for actually practicing is this one about how Equity Value, Enterprise Value, and multiples change when a company's capital structure changes.

So that's what I'd say overall. Again, I'd really emphasize that even if you *think* you know these concepts, chances are you don't know them as well as you think you do. Even if you've been through our modeling courses, even if you've been through other modeling courses, there is quite a lot to these concepts. And if you really want to understand valuation and DCF analysis in depth, you have to understand these concepts first, or else none of that material will make any sense.

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So that's it for this lesson. Coming up next, I'll be getting into that next topic, valuation and DCF analysis, and I'll be going through the guide, the Excel files, and what you should pay attention to.