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

Welcome to our next lesson in the technical guide section of this interview guide. This brief tutorial will be all about how to use this guide to equity value, enterprise value, and valuation metrics and multiples most effectively.

So, along with this PDF, there are also several Excel files here: one on the actual calculations for Target, Vivendi, and Zendesk; one that has a comparison table for various different valuation metrics; one that shows you how equity value, enterprise value, and the key multiples change when a company issues debt, or issues dividends, or issues preferred stock, or some of its working capital line items change; and then there's one last one here on WACC and its impact on implied enterprise value and why capital structure does, in fact, affect enterprise value, at least implied enterprise value, to some extent.

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So, how do you use all of these most effectively? I would suggest starting out by reading Key Rule #1 here on the basic meaning and definitions of equity value and enterprise value. Even if you think you know these concepts, chances are you do not know them as well as you think. We present them a bit differently from other sources.

And if you've just relied on Wikipedia, or Investopedia, or sources like that up to this point, you really need to learn the actual definitions here and some of the subtleties that those sources miss. So, I would start by doing that before you jump into anything Excel-related.

Now, Key Rule #2 here is how events impact equity value and enterprise value. For this one, what I recommend doing is going here, reading the intro and the two key rules that you should use about common shareholders' equity and net operating assets, and then going through the questions and examples here, pulling up the Excel file on how equity value and enterprise value change, and trying these scenarios yourself until you understand the concept.

We've tried to make this as simple as humanly possible. And if you want, you can simplify it even more. For example, you can delete all the stuff here about the book versus cash taxes and the tax schedule. It's not necessary and it just clutters up a lot of these walkthroughs.

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Once you've done that, you can try your own scenarios. So, you can try seeing what happens when deferred revenue goes up, and then goes down, and how that impacts equity value and enterprise value, for example.

And you can go through many of those accounting scenarios that you learned about in the Accounting and Three Statement Lesson and the very similar model that we had there, and translate them and see how these scenarios work in this model and how they affect equity value and enterprise value.

Once you've done that, you can move on to Key Rule #3 on why the concept of enterprise value doesn't hold up in real life. The corresponding Excel file here is the one with WACC and how the debt-to-equity ratio <u>does</u> make an impact on a company's implied enterprise value.

And this just shows you why a lot of these concepts that we present about equity value and enterprise value in the first two key rules are true, to some extent, but they're still theoretical.

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Key Rule #3 takes you into the real world and shows why, yes, these concepts are useful, but they don't hold up 100% as classical sources or the first two key rules describe them.

Now, once you've done all that, Key Rules #4 through #10 don't exactly correspond to one single Excel file here, but generally speaking, they correspond to the one on Target, Vivendi, and Zendesk and how we've calculated equity value and enterprise value for these companies, and also what their comparable companies look like and how we can use multiples to value each of the companies here. And you can look at the reference table Excel file as well for all these.

These parts, I would say, are actually a bit less important for purposes of interviews. Yes, you still need to know them. You still need to know how to calculate equity value with the treasury stock method, the different valuation multiples, things like that. But if you understand the first few key rules here on what equity value and enterprise value mean and how events impact them, then the rest of this should be pretty simple to pick up and get your head around.

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Once you go beyond that, Key Rules #11 through #14 are strictly in the optional category. You don't need to know these in-depth. You just need to have a basic idea of the fact that these items can also factor into enterprise value.

Of these, the most important one is probably the one on operating leases and capital leases in enterprise value because the rules for this have changed more so than the rules for the others over time. So, if you decide to spend time on anything here, I would say Key Rule #13 will be the highest ROI area to focus on.

Now, once you've done that, and you've been through all these, and you've gone through the corresponding Excel files, you've tested your own understanding with the file that lets you modify items and see how equity value and enterprise value change, the last thing I would recommend here is looking at the interview questions.

None of these sections is “optional.” They're all pretty important, but you don't need to answer every single question in all these. For example, if you just go to one section and you look at, say, the first 5 or 10 questions just to see generally how much you know, that's a very good way to test yourself.

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You can do the same thing for the valuation multiple section. Just go through the first few questions, see how well you're understanding it, and if you don't get something here, then just go back to the part of the guide that covered this particular topic.

And if you want more practice with all of these, of course, take a look at the interactive quiz questions in Module 5 of this interview guide. Take a look at the equity-value-and enterprise-value-focused case study example in Module 6 as well. But that's what I would say, overall, for this guide and these Excel files.

To summarize, the first three key rules here are the most important because these really teach you the concepts and why equity value and enterprise value matter so much. The Excel files that correspond to these are the ones on the changes on the financial statements and how they affect equity value and enterprise value, and then the one on how capital structure can affect a company's implied enterprise value.

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Once you go beyond that, yes, you do need to know the calculations and how to use the multiples in real life, and the Excel files corresponding to them, the comparison table, and then the one for Target, Vivendi, and Zendesk. But you don't need to know these quite as in-depth. They're not going to ask you every single nuance of every single calculation here, so just make sure you get the main ideas.

And then the last four key rules are optional. Of these, the one on leases is the most important one.

Once you've done that, you can test your understanding with the interview questions and then move on to the quiz questions in Module 5 and the case studies in Module 6.

That's it for this quick tutorial. Coming up next, I'll be going over our guide and the Excel files for the valuation and DCF analysis lesson.