Financial terminology

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Terminology

- What I intend to cover
- Simple Valuation – a worked example
- Return on Investment – a worked example

A few of the basics

Assets = Liabilities + Equity

Or

Assets- Liabilities= Equity

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EBITDA

Earnings before interest, tax, depreciation and amortisation

Approximate indicator of operating cashflow.

Start up balance sheet

ASSETS	EQUITY
INTANGIBLE Your great business idea	If 5 of you, you might agree equal 20% shares
Your particular skills	
No liabilities at this point	

Assets – Liabilities = Equity

Forecast future maintainable earnings of 1 million per year

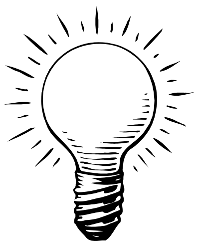
Industry p/e is 5, discount to (2.5*1million) = 2.5 million valuation

Valuation

ASSETS	EQUITY
INTANGIBLE Your great business idea Your particular skills No liabilities at this point Cash \$2.5m	If you give up 50% of the company to the new investor(s) for their \$2.5m you will each halve your percentage share of the company. This is called dilution. The new investor has 50% and each of you have 10%. Each 10% is worth \$500k at the post money valuation so the dilution has had a neutral effect on the initial shareholders holdings valuations. New investor(s) shares (50%)

How to estimate what the value might be in 5 years

Valuation of Company = Cash generated x Company Price Earning Ratio (P/E Ratio)



Industry sector P/E Ratio = 5
Discount = 20% of Industry sector P/E Ratio = (20/100) x 5 = 1
Company P/E Ratio = (Industry sector P/E Ratio – Discount) = 5 – 1 = 4
Cash generated (in 5th year) = $6.25m

Valuation of Company (in 5th year) = Cash generated (in 5th year)

x

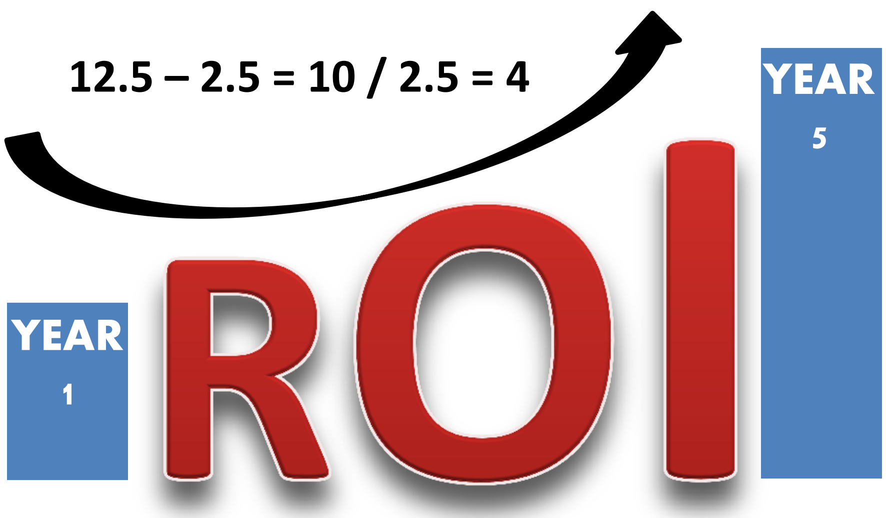
Company P/E Ratio = $6.25m x 4

= $25m

V A L U E

Return on investment

Return on investment (ROI) = $\dfrac{\text{(Gains less cost of investment)}}{\text{cost of investment}}$



= 400%

Cost	$2.5m	$2.5m
Company Value	$5m	$25m
Investor 50% Value	$2.5m	$12.5m

Return on investment

(Benefit less cost of investment)/ cost of investment

Forecasting “benefits” may be problematic

Your turn

I have handed out a sheet of definitions

I have also handed out a sheet of financial terms which I will also leave displayed here

When you are finished, let us know by putting your hand in the air.

Your task is to match the correct term with its definition. Write the term in the box to the right of the definition

There will be a prize for the first team with a correct answer

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Financial terms	Financial terms
Balance sheet	Cash breakeven
Cashflow statement	EBITDA
Depreciation	Profit and loss account
Gross margin	Variable costs
Working capital	Return on investment

Thank you

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