UNIVERSITY INVESTMENT CLUB

2.0 Equity Value & Enterprise Value Guide

Definitions, Bridges & Multiple Selection

Guide 2 of 6 | IB & PE Interview Prep Series

Compiled for internal club use. Questions are illustrative and drawn from commonly tested technical themes in IB and PE recruiting — not affiliated with, or sourced verbatim from, any bank or recruiting firm.

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These questions test whether you understand what you're actually buying in a transaction and why bankers move between Equity Value and Enterprise Value depending on the metric being used.

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1. Core Definitions

Q1.1 What's the difference between Equity Value and Enterprise Value?

Equity Value (market cap) is the value of everything the company owns, belonging only to shareholders — it's what's left after all debt and other claims are settled. **Enterprise Value** is the value of the company's core operating business, available to *all* capital providers (equity and debt holders alike), independent of how it's financed.

Equity Value = Share Price × Diluted Shares Outstanding.

Enterprise Value = Equity Value + Debt + Preferred Stock + Noncontrolling Interest – Cash & Cash Equivalents.

Q1.2 Why do we subtract cash when moving from Equity Value to Enterprise Value?

Because cash is a non-operating asset that reduces the effective cost of acquiring the business — a buyer could use the target's own cash to help pay for the deal. Enterprise Value represents the value of operations only, so excess cash is netted out.

Q1.3 Can Enterprise Value be negative? Can Equity Value?

Enterprise Value *can* be negative if a company holds far more cash than its Debt and Equity Value combined (rare, but seen in some net-cash-rich, low-multiple businesses). Equity Value (market cap) can *never* be negative — share price and share count are both non-negative by definition.

Q1.4 Why do we add minority interest / noncontrolling interest to get to Enterprise Value?

Because when a company owns >50% of another company, it consolidates 100% of that subsidiary's revenue, EBITDA, and other operating metrics into its own financials — even though it doesn't own 100% of the underlying equity. Adding back Noncontrolling Interest keeps EV consistent with those fully-consolidated operating metrics.

2. Adjustments & Edge Cases

Q2.1 How do you treat preferred stock in the Enterprise Value formula?

Preferred stock is added to Enterprise Value, similar to Debt — it represents a claim on the company senior to common equity, with fixed dividend obligations. It's treated as a form of financing rather than part of core operations.

Q2.2 How would you treat operating leases when calculating Enterprise Value?

Under current accounting rules, most operating leases are capitalized on the Balance Sheet as a Right-of-Use Asset and a corresponding lease Liability. Many practitioners now add the lease liability to Enterprise Value (similar to Debt), though conventions vary by bank and by whether you're comparing to historical, pre-capitalization periods.

Q2.3 A company has $500 of Debt and $600 of Cash. What does that imply for Enterprise Value?

Net Debt is negative ($500 – $600 = –$100), so Enterprise Value will be $100 *lower* than Equity Value. This is common for cash-rich, low-leverage companies (e.g., some large-cap tech names).

Q2.4 How do options and convertible securities affect Equity Value?

You use **diluted** shares outstanding, typically via the Treasury Stock Method for in-the-money options/warrants (assume exercise, add the shares, then assume the proceeds are used to repurchase shares at the current price) and as-converted or net-share-settlement treatment for convertible debt, depending on its terms.

3. Multiples & Practical Application

Q3.1 Why do we use EV/EBITDA rather than Equity Value/EBITDA?

Because EBITDA is a **pre-interest** metric that is available to all capital providers — it doesn't reflect a company's capital structure. Pairing it with Enterprise Value (also capital-structure-neutral) keeps the numerator and denominator consistent. Pairing EBITDA with Equity Value would understate value for companies that carry leverage.

Q3.2 Why do we use the P/E ratio (Equity Value multiple) instead of EV/Net Income?

Net Income is **after** interest expense — it already reflects the company's capital structure and only accrues to equity holders. So it's paired with Equity Value, which is also an equity-holder-only metric. Mixing Net Income with Enterprise Value would double-count the effect of leverage.

Q3.3 Give an example of each type of multiple: Enterprise Value-based and Equity Value-based.

- **Enterprise Value-based:** EV/Revenue, EV/EBITDA, EV/EBIT.
- **Equity Value-based:** P/E (Price/Earnings), Price/Book Value, Dividend Yield.

Q3.4 Rank Enterprise Value, Equity Value, and Purchase Price / Transaction Value from largest to smallest for a typical premium acquisition.

Transaction/Purchase Value is usually the largest, since it reflects Equity Value plus the control premium paid to shareholders. Enterprise Value and Equity Value can rank either way relative to each other depending on the target's Net Debt position — there's no universal ordering between those two.