$100 of Cash and Enterprise Value

• Question the Other Day:

• “If a CEO of a company picks up $100 of cash on the ground and puts it in the company’s bank account, what happens to the company’s Enterprise Value?”

• (In other words, does it increase, decrease, or stay the same?)
$100 of Cash and Enterprise Value

• ANSWER: Enterprise Value stays the same!

• Most common follow-up question:

• “But wait, you subtract cash in the Enterprise Value calculation. How can Enterprise Value possibly stay the same?”

• Formula: Equity Value + Debt – Cash + NCI + Preferred + Unfunded Pensions – Other Investments…
What Does Enterprise Value Mean?

- That’s how you calculate Enterprise Value, but it’s not what it means

- **Meaning**: Enterprise Value represents the value of a company’s core business operations to ALL the investors in the company

- **Equity Value**: Represents value of everything, but only to the Equity Investors
Implications of This Definition:

• So when you calculate Enterprise Value, starting with Equity Value…

• **Add Items When**: They represent *other* investors (Debt investors, Preferred Stock investors, etc.) or *long-term funding sources* (Capital Leases, Unfunded Pensions)

• **Subtract Items When**: They are not related to the company’s core business operations (side activities, cash or excess cash, investments, real estate, etc.)
Back to the $100 in Cash…

• Is it part of the company’s **core business**?

• No! Does **not** make the **core business** more valuable

• **But**… it is part of the “everything” the company has

• **Equity Value**: Increases; **Cash**: Increases

• **Enterprise Value**: The same! One part up, one down
About Equity Value…

• Why does Equity Value **increase** as cash increases?

• **Because:** Equity Value should **implicitly** reflect the company’s cash balance already

• If a company has $500 in cash, would it make **any sense** for all its shares to be worth **less** than $500?

• No! Should always be worth **at least** its cash on-hand
One Other Way to Think About This...

- **Common Analogy**: Buying a house, and Enterprise Value represents the total value of the house.

- **House**: $500K, with 50% mortgage and 50% down payment.

  - **Mortgage**: $250K
  - **Equity**: $250K
  - **Total**: $500K
One Other Way to Think About This…

- **House**: $500K, with 80% mortgage and 20% down payment

  - Mortgage = $400K
  - Equity = $100K
  - Total = $500K
One Other Way to Think About This…

- **House:** $500K, with 0% mortgage and 100% down payment

  - Mortgage = $0
  - Equity = $500K
  - Total = $500K
Question for You:

• What if you and the owner find an extra room? What happens to the home’s price?

• Answer: Total Value goes up → House is now worth more; just like Enterprise Value increasing

• But… what happens if you find some extra supplies or gardening tools that you’re going to sell anyway?
Extra Tools / Supplies:

• **Answer:** NOT core to the home’s value

• Yes, the upfront price may increase… but you’ll sell them and get the cash back anyway! No changes!

• So the home’s **Enterprise Value** stays the same

• Just like what happens when the CEO picks up $100 of cash on the ground
Moral of the Story:

• “What happens to Enterprise Value when X or Y changes?”

• Don’t think about the formula for Enterprise Value!

• **Instead:** Think about whether or not that change is related to the company’s **core business operations**

• **Test:** Will it affect revenue or EBITDA?
Moral of the Story:

• **Core Business Value Changes:** Enterprise Value will change in some way

• **Core Business Value Does Not Change:** Enterprise Value stays the same

• **Other Examples:** Cash, Debt, Preferred Stock, Share Count → None of these should impact Enterprise Value