ON ONE PAGE

Terminal Value

Gordon growth vs exit multiple: the biggest number in a DCF, and the one you control least.

IN ONE LINE

Terminal value is usually most of a DCF's value yet the least scrutinized. Respect the Gordon growth formula, cap growth at GDP, fade smoothly, and test it against an exit multiple.

$$TV = FCF \times (1 + g) / (WACC - g)$$

FCF: free cash flow in the final explicit year · g: terminal growth · WACC: cost of capital

Five rules

1. **Scrutinize it most.** It is often well over half the value: 74% of Ravelstone's enterprise value.
2. **g is not a free lever.** It sits in the denominator, so half a point can swing most of the value.
3. **Cap g at the economy.** No business outgrows long-run nominal GDP forever.
4. **Fade, don't jump.** Reach steady state before the terminal value takes over.
5. **Test it with a multiple.** An exit multiple is a price at the end of the forecast: ask what growth it assumes.

One point of g

Ravelstone Foods, $m: FY10 free cash flow 859.5, WACC 6.9%

g	Terminal value	Change
2%	17,894	Base
3%	22,703	+27%
4%	30,829	+72%

Gordon growth vs exit multiple

Value driver at 3% growth and a 20% return: **22,072**. Gordon on FY10 free cash flow: **22,703**, implying a 23.9% return on new capital. 14x trailing EBITDA: **25,252**, which needs **3.6% growth forever**.

Before you sign it off

- [ ] g at or below long-run nominal GDP
- [ ] Same inflation in g, cash flows and WACC
- [ ] Growth and returns faded by the final year
- [ ] Implied return on new capital you can defend
- [ ] Implied EV/EBITDA checked against comparables



GO DEEPER

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