

# Valuing the Corporation

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## WHAT'S COVERED

In this lesson, you will learn about the different approaches for valuing a corporation. Specifically, this lesson will cover:

## 1. Business Valuation Approaches

There are several approaches used in business valuation:

- Income approach
- Asset-based approach
- Market approach

### 1a. Income Approach

One income approach is calculating the weighted average cost of capital, or WACC. It is the average cost of a unit of income for the company. It is calculated by using a weighted average of the cost of bonds, the after-tax yield to maturity, the required return on common stock, and preferred stock, if there is any.

The income approach also includes the capital asset pricing model, or CAPM. This expresses a required return on a company as a function of risk and a comparison of how risky the stock is compared to the risk of the market as a whole.

### 1b. Asset-Based Approach

The asset-based approach is a method based on assets to determine the value of a business. This approach estimates the cost of replacing the total assets of the business with the same economic utility.

### 1c. Market Approach

The truest way is the market approach, which tells us that the true value of a firm is what the market says it is. It is the current price of a share of common stock times the number of shares outstanding. The shares of common stock represent ownership, and in the market, price represents the true value of what each of the shares are worth.



**BIG IDEA**

For that reason, the product of these two is the fairest of estimates of the true value of the firm.



## SUMMARY

In this lesson, we learned about **income approaches**. The weighted average cost of capital (WACC) is the average of after-tax costs of bonds and the required return of common stock. We can also use the capital asset pricing model (CAPM), which is based on the risk of the company compared to the risk for the market overall.

There is also the **asset-based approach**, which estimates the cost of replacing all assets of the company with those of the same utility.

Finally, there is the **market approach**. The market price represents the true value. It is what the market says the shares of common stock ownership are worth.

Best of luck in your learning!

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