Terminal Value

Accounting & Finance

The two ways to calculate it, and the trap in both.

Terminal value captures all cash flows beyond the explicit forecast horizon.

$$TV = CF(n+1) \div (r - g)$$

g = 2%, r = 9% — **TV = CF ÷ 0.07**

About 14× cash flow.

g = 5%, r = 9% — **TV = CF ÷ 0.04**

25× — nearly double.

g ≥ r — **Infinite value**

The formula breaks.

THE COMMON MISTAKE

× Using an optimistic growth rate

✓ Capping g at long-run GDP growth

A firm growing faster than the economy forever would eventually become the entire economy. Small changes in g swing the answer enormously.

Sensitivity-test g and r together. A DCF with a single point estimate hides how fragile the answer is.