

Net Present Value (NPV) – An initial cash outlay is compared to the present value of future cash flows that were generated by the cash outlay using a predetermined discount rate. It is computed by subtracting the initial cash outlay from the present value of the future cash flows.

Net Present Value Rule – An investment (project) is accepted if its net present value is positive and rejected if its net present value is negative.

Nominal Interest Rate – This is the stated or quoted interest rate not taking into account compounding or inflation. The interest rate often quoted by financial lenders and others.

Opportunity Cost of Capital – The return that could be received by investing money elsewhere (alternative investment). The opportunity cost of capital is often used as the discount rate or the threshold rate of return. If the investment will not generate a return sufficient to equal or exceed the opportunity cost of capital, then the money should be invested in the alternative investment.

Perpetuity – Series of equal and periodic future cash flows that continue on forever.

Present Value (PV) – Current cash amount. It is computed by discounting future cash flows back in time to its equivalent current value now.

Profitability Index – The present Value of future cash inflows divided by the present value of future cash outflows.

Profitability Index Rule – A project is accepted if the index is greater than one. If it is less than one, the project is rejected.

Quoted Interest Rate – It is the annual interest rate not taking into account compounding within the year. It is also called the stated or nominal interest rate.

Reinvestment Rate of Return – The rate of return received from an alternative investment or the rate of return savings from reducing debt.

Semiannual Compounding – The process of determining the final value of a cash amount when the interest is added twice a year.

Stated Interest Rate – It is the annual interest rate, not taking into account compounding within the year.

Statement of Cash Flows – A statement showing the cash flow operating, investing and financing activities.

Threshold (Required) Rate of Return (TRR) – It is the required rate of return in order for an investment alternative to be accepted.

Time Line – It is a graphic representation showing the timing of current and future cash flows.

Time Value of Money – Time impacts the value of money by an individual. For example, a dollar received today is of more value than a dollar received at some future point in time. This difference in value is equalized by the use of an interest rate.

Uniform Annual Series – A series of payments, uniform in amount and uniformly spaced such as a payment every year.

Valuation – Process of capitalizing future net cash flows that are provided by an asset.

Yield to Maturity – The rate of return that is earned if a bond is purchased at its market price and held until maturity. It is the internal rate of return created by discounting the future value (maturity value) back to its present value (market price). As market price changes and the length of time until maturity changes, the internal rate of return will change.

... and justice for all

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