## *Book review*

# Aswath Damodaran, *Investment Valuation, University Edition: Tools and Techniques for Determining the Value of Any Asset*, 4th Edition. John Wiley & Sons Inc (2025)

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The term valuation comes from Latin "valitus", past participle of "valeo", "valére": being strong, having value. In the etymological profile, the concept of valuation is linked to the determination and attribution of value to an asset. Despite its apparent simplicity, "*[p]erhaps one subject more than any other has been the subject of debates among accounting theorists in the last decade is the valuation of assets. And so it should, for this is one area of great importance*" (Penman, 1970, p. 333). "*Valuation can be considered the heart of finance. […]. Given the centrality of its role, you would think that the question of how best to value a business, private or public, would have been well researched. […] The research into valuation models and metrics in finance is surprisingly spotty, with some aspects of valuation, such as risk assessment, being deeply analyzed and others, such as how best to estimate cash flows and reconciling different versions of models, not receiving the attention that they deserve*" (Damodaran, 2007, p. 694).

To bridge this gap, sustained by a large corpus of research, Aswath Damodaran has synthesized pre-existing theories, broadening their conceptual boundaries and clarifying their operational implications in the applied field, making his contributions among the most authoritative links between the academic and professional worlds. Among the author's best-known works, it is worth mentioning *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset*, a true milestone, now in its 4th edition, and the subject of this book review.

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Doi: 10.3280/fr202622731

The purpose of the book is clear: any type of asset, financial or otherwise, from the most complex (businesses, start-ups, and patents) to the simplest, can be valued. To this end, it is necessary to understand not only which valuation model best suits the type of asset being valued, but above all, what its sources of value are.

The work presents a thorough and wide-ranging analysis of the field, divided into 34 chapters. Despite the breadth of coverage, we can identify four clearly defined macro-thematic areas, whose transitions are guided by an overall vision that never loses the unity of the topic: this narrative thread is evident in the first two and the final chapters, expertly tying the work together.

In the first chapter, the Author lays out a theoretical basis for valuation, along with how valuation is used or can be used across a variety of frameworks, from portfolio management to corporate finance. From the first page, a key concept emerges that will guide the rest of the discussion: although the words price and value are used interchangeably and can sometimes converge, there is a difference between "valuation" and "pricing" (Damodaran, 2025). Prices are data expressed by the market, arising from the meeting of supply and demand; the value (i.e., *intrinsic value*) of an asset is the present value of the future cash flows it will generate, adjusted for timing and risk. When prices and values coexist, they may not coincide at all (Guatri & Bini, 2007). This occurs for several reasons, both internal and external. Since value and price are different concepts, influenced by different factors, different tools are therefore needed to estimate them: tools that will be introduced in the second chapter and then explored in greater depth in the remainder of the discussion.

The second chapter is probably the most important for understanding the entire book because it defines and explains the three possible approaches to asset valuation (i.e., intrinsic valuation, pricing or relative valuation, contingent claim valuation) and how the outcomes change depending on the method used. Furthermore, the possible paths that can be taken after choosing the approach are specified, depending on the perspective of the stakeholders being evaluated: asset-side valuation (leading to the estimation of firm value) or equity-side valuation (leading to the estimation of equity value). Although the two evaluation procedures lead to different outcomes, the result of the first path can be traced back to that of the second via the relationship *Equity Value = Firm Value – Net Debt*. Defining the path is essential, as the nature of the inputs depends on the choice (e.g., the discount rates to be used and, depending on the approach, the cash flows or multiples).

Chapters three through six lay the foundations upon which the models will be based: the financial statement and its analysis (chapter three); the concept of risk and the models used to estimate it (chapter four); option pricing theory and models (chapter five); and market efficiency (chapter six). This last topic is

essential for fully understanding the difference between price and value and the implications for the chosen valuation approach.

The seventh and eighth chapters address a cross-cutting topic in valuation: the estimation of risk-return rates. Starting from theoretical assumptions, the author defines the proper determination of the risk-free rate, approaches for estimating the equity risk premium and beta to derive the cost of equity, and the additional components necessary to quantify the weighted average cost of capital (WACC). All this while maintaining a common thread: the choice of rate must always align with the valuation approach chosen, so use the WACC for the asset-side approach and the cost of equity for the equity-side approach.

The ninth chapter begins the first of the four macro-themes mentioned above (from chapter nine to chapter sixteen), which focuses on intrinsic valuation and aims to estimate intrinsic value. If intrinsic value is the present value of cash flows discounted for risk and time, intrinsic valuation methods, the most important and well-known of which is discounted cash flow (DCF), must first estimate cash flows. These cash flows will have a different configuration depending on the valuation method chosen – Free Cash Flow to the Firm (FCFF) for the asset side and Free Cash Flow to Equity (FCFE) for the equity side –. To measure cash flows, it is first necessary to update, adjust, and/or normalize the net accounting profit/net operating profit after taxes (NOPAT; chapter nine) and then "correct" it with reinvestment to arrive at cash flow (chapter ten).

Chapter eleven explains how to estimate one of the crucial inputs for valuation purposes: growth, while the twelfth chapter focuses on terminal value and how to correctly measure it while remaining consistent with its underlying assumptions.

It is worth noting that the thirteenth chapter has been deliberately omitted from each macro-theme because it is a "general framework" that can be adapted across all evaluation approaches. According to the author, valuation is the bridge that connects stories to numbers: every valuation is a story, but it is by moving from the story to the numbers with a logical five-step process (with a focus on the story or the numbers depending on the stage of the corporate life cycle) that the determined value takes on realism and defensible validity.

The fourteenth chapter discusses equity intrinsic value models, emphasizing that the equity-side DCF (whose inputs were estimated in previous chapters) is essentially a more flexible version of the dividend discount model (DDM; both augmented and non-augmented) when dividends are not distributed. It is appropriate to note that a single, generalizable valuation model is not possible; however, an optimal model exists, defined by the situational context and the company's operating maturity.

The fifteenth chapter focuses on asset-side intrinsic models, specifically the

cost of capital and adjusted present value (APV) approaches, and when it would be appropriate to use them, that is, in the case of changes in the financial structure.

Chapter sixteen explains the adjustments needed to derive per-share value from firm value and, in doing so, addresses special issues such as holdings, non-operating assets, and outstanding shares (including options).

The second identified macro-theme (from chapter seventeen to chapter twenty) is relative valuation (or pricing). The introduction to chapter seventeen clarifies the differences with intrinsic valuation: it highlights how the choice of approach is based on different visions of market efficiency (a topic that will return in chapter thirty-four). Chapter seventeen provides an overview of the construction and types of multiples, which are then analyzed in subsequent chapters: the earnings multiple (chapter eighteen), the book value multiple (chapter nineteen), the revenue multiple, and the sector-specific multiple (chapter twenty).

The narrative arc extending from chapter twenty-one to chapter twenty-seven outlines the third thematic area of the work. Although this section has been conventionally grouped under a single macro-category, it seems methodologically more rigorous to define it as a heterogeneous cluster of topics whose common denominator is to be found in the objective difficulty to estimate the value of the assets covered in the chapters and in the author's attempt to find solutions to this problem: financial service firms (chapter twenty-one), money-losing firms (chapter twenty-two), young or start-up firms (chapter twenty-three), private firms (chapter twenty-four), acquisitions and takeovers (chapter twenty-five), real estate (chapter twenty-six), and other assets (chapter twenty-seven).

Between chapters twenty-eight and thirty, we find the fourth macro-theme: cases in which the concept of valuing an asset as discounted future cash flows is not fully and/or correctly applicable due to the optionality typically embedded with such assets. Chapter twenty-eight uses option-pricing models to value assets such as patents and undeveloped land. Chapter twenty-nine addresses the valuation of whether to expand or abandon an investment. Chapter thirty applies the option pricing methodology to the valuation of equity in distressed firms.

In chapter thirty-one, the author implements a change in perspective, moving from that of a "passive" investor to that of an "active" subject involved in management, and analyzes, starting from the DCF valuation, the different paths that the manager (or owner) of the company can choose to increase its value.

In chapter thirty-two, the author analyzes valuation methods such as economic value added (EVA) and cash flow return on investment (CFROI).

Chapter thirty-three emphasizes the importance of (and offers tools for) adopting a probabilistic approach to valuation: value, by its nature, is linked to

estimates derived from assumptions about a series of key variables, and, being a prospective value, it depends largely on the future values of those variables. However, any type of quantitative variable (whether discrete or continuous) can assume n-different values and, consequently, yield n-numerical configurations of values; hence the need to incorporate a probabilistic approach in its estimation.

In the final chapter, the thirty-fourth, Damodaran (2025) ideally reconnects with the conceptual framework introduced in the second chapter and further developed throughout the work, achieving a unifying synthesis. Like a tailor, the author picks up the needle and defines a "tailor-made modulation" of models, functional to the specificities of the context, demonstrating that the effectiveness of a theoretical framework does not reside in its rigidity or universal effectiveness, but rather that the choice must be made based on the theoretical framework's ability to respond practically to situational contingencies.

Damodaran (2025) suggests innovative approaches and insights in each of the four macro-areas into which the book is divided, and beyond. Indeed, although the cost of capital is ideally addressed outside the macro-areas (as it is transversal to them) and is contained in two chapters, the author's great merit lies in introducing methodological consistency in its practical determination, focusing on each component. The author introduces numerous innovations in these two chapters, however, the main ones, starting with the components of the cost of equity, are to be found primarily in the (possible) use and estimation, using different methods, of the country risk premium[1] (as well as in the relative coherence that follows its use); secondly, in the forward-looking estimation of the equity risk premium (ERP), overcoming the critical issues presented regarding its historical calculation (Cornell, 1999), arriving at what Damodaran (2025) defines as *implied ERP*. In the two chapters on the calculation of the cost of capital, probably the greatest "step forward" introduced is the development of a model called "*bottom-up beta*", which, by using the Hamada (1969) formula, manages to reduce the standard error typical of the market betas of the CAPM (Sharpe, 1963, 1964) and thus also introduce the possibility of determining a risk-rate also for private firms. A simple approach to estimate the cost of debt, specifically its default spread component, is also defined using the interest coverage ratio (ICR). There is the development of a methodology to determine the market value of a company's debt when it is not publicly listed, with the possibility of determining, among other things, the weights of the capital structure to be used in the WACC.

[1] The use depends on the risk free used, to avoid "double counting" of the country risk.

Throughout the chapters that comprise the macro-area of intrinsic valuation, Damodaran (2025) proposes solutions to problems present in three crucial inputs for the estimation of prospective cash flows: 1) he fills various gaps regarding the adjustments to be made to economic flow to arrive at a prospective cash flow (be it asset-side or equity-side), taking into account the company's *sources of value* (e.g., how to treat R&D expenses and/or acquisitions); 2) the estimate of growth through an ingenious "relaxation" of the assumptions underlying the sustainable growth rate (SGR; Higgins, 1977), which allows us to overcome limitations related to the absence of dividend distribution and extend this growth estimation model to asset-side valuations as well; 3) how to estimate the percentage of reinvestment to be subtracted from the perpetual cash flow (if the conditions for this to be the case) without the growth rate exceeding the economy's projected inflation.

In the macro-area of pricing, the novelty lies in the four-step approach the author proposes for the use and definition of multiples: first, he understands their distribution across the market, and then, through their mathematical and financial breakdown, identifies their determinants, necessary for understanding how the multiple changes as the fundamentals change. Among these, one variable dominates in explaining each multiple: the *companion variable*, which can usually be identified by examining how multiples differ across firms in a sector or across the entire market. Thus, after identifying comparable companies (as Damodaran suggests), we can estimate the price by regressing the multiples on variables that should affect them.

For chapters twenty-one to twenty-seven, discussing the individual innovations would be impossible: each of them represents a complex asset to evaluate, and the author proposes one or more innovative approaches to estimating the value of these assets.

A major weakness in valuation has always been the calculation of the value of intangible assets (Sullivan & Sullivan, 2000): Damodaran (2025) defines various methodologies for valuing intangible assets using approaches that vary according to the intangible's ability to be (or to be able to be) an independent asset in the generation of cash flows.

In the fourth macro-area, Damodaran introduces an interesting approach to valuing the equity of firms with substantial debt, negative earnings, and significant assets. Since these firms face a real possibility of default, equity can be valued using the options methodology, in which the strike price is the face value of outstanding debt, the value of the underlying asset is the firm's liquidation value, and equity is thus the net payoff.

To conclude, Damodaran's book is a comprehensive valuation manual, with methodologies tailored to specific circumstances and asset types. It follows a unified narrative that extends from the theoretical foundations to the empirical construction of each component of the valuation methods presented, enriching the discussion with timely real-world case studies that apply the concepts. Anyone interested in learning about or practicing valuation professionally should have this volume in their library.

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