

Session 2: Post Class tests

1. Which of the following assets is best suited for intrinsic valuation?
 - a. A finite life asset with no cash flows associated with it
 - b. An infinite life asset with no cash flows associated with it
 - c. An asset with uncertain cash flows over any life period
 - d. An asset with cash flows contingent on an event happening
 - e. None of the above
2. Which of the following approaches can be used to estimate the risk adjusted value of an asset in an intrinsic valuation (more than one answer can apply)?
 - a. Discounting the certainty equivalent cash flows at a risk adjusted discount rate
 - b. Discounting the expected cash flows at a risk free rate
 - c. Discounting the expected cash flows at a risk-adjusted discount rate
 - d. Discounting the certainty equivalent cash flows at a risk free rate
3. Which of the following would you do if you were valuing the equity in a business?
 - a. Discount cash flows before debt payments at the cost of equity
 - b. Discount cash flows after debt payments at the cost of equity
 - c. Discount cash flows before debt payments at the cost of capital
 - d. Discount cash flows after debt payments at the cost of capital
4. Which of the following would you do if you were valuing the entire business?
 - a. Discount cash flows before debt payments at the cost of equity
 - b. Discount cash flows after debt payments at the cost of equity
 - c. Discount cash flows before debt payments at the cost of capital
 - d. Discount cash flows after debt payments at the cost of capital
5. You have been asked to value the chemical division of a multi business conglomerate and have been provided with the cash flows for the division. What discount rate would you use to discount this cash flow?

	Year 1	Year 2	Year 3
Earnings before interest and taxes (1- tax rate)	\$100	\$105	\$110
- Reinvestment in chemical business	\$20	\$22	\$25
Cash flow	\$80	\$83	\$85

- a. The cost of equity of the company
- b. The cost of capital of the company
- c. The cost of equity for the chemical business
- d. The cost of capital for the chemical business
- e. None of the above

Session 2: Post Class tests (Solutions)

1. c. An asset with uncertain cash flows over any time period. You cannot do intrinsic valuation on non-cash flow generating assets (collectibles, paintings, gold). An asset with contingent cash flows is best valued as an option.
2. c. & d. You can either adjust the cash flows for risk or the discount rate, not both.
3. b. Discount cash flows after debt payments at the cost of equity
4. c. Discount cash flows before debt payments at the cost of capital
5. **d. The cost of capital for the chemical business.** The cash flows are computed using operating income (rather than net income) and have no debt flows (repayments of debt or new debt issues). They are also for the chemical business.