

Homework and Suggested Example Problems
Investment Valuation – Damodaran

Lecture 1 – Introduction to Valuation

Lecture 1 is an introduction to valuation. This lecture is intended to give you an overview of alternative valuation models. We will discuss the properties as well as the advantages and disadvantages of three alternative valuation frameworks: discounted cash flow analysis, relative valuation, and contingent claim valuation. We will also discuss basic accounting statements and financial statement analysis.

Discussion Problems:

Complete the problems on the attached pages and be prepared to discuss your solutions in class.

Additional Suggested Problems:

The following suggested problems will serve as additional examples related to our class material and should give you a basic idea of the topics that I want to emphasize from the text. The solutions to these problems are available on the class web site.

You may not know the answers to all of the financial statement questions in chapter 3. Use the solutions as a way to review this information. We will discuss specific financial statement items in more detail throughout the semester.

Note: The balance sheet listed for Coca Cola on page 57 contains an error. The marketable securities listed as 1049 should be listed separately as marketable securities of 159 and inventories of 890.

Chapter	Topic	Suggested Problems
1	Introduction to valuation	None
2	Approaches to valuation	1, 2, 3
3	Financial Statements	1 through 10

Discussion Problems - Lecture 1

1. You are analyzing a company with the expected future cash flows shown below. Based on current market prices, the market value of the firm's equity is \$1,962.9. The outstanding debt has both a market and book value of \$800. The firm's cost of equity (k_e) is 11.0%, the firm's past and future cost of debt is 10%, and the firm's tax rate is $t=50\%$. Use this information to answer the questions below.

<u>Year</u>	<u>FCF to Firm</u>	<u>Int Exp (1-t)</u>	<u>FCF to Equity</u>
1	\$ 140.0	\$ 40	\$ 100.0
2	\$ 150.0	\$ 40	\$ 110.0
3	\$ 161.0	\$ 40	\$ 121.0
4	\$ 173.1	\$ 40	\$ 133.1
5	\$ 186.4	\$ 40	\$ 146.4
Terminal Value	\$ 3339.6		\$2562.2

- a. Calculate the value of the firm's equity by discounting the listed Free Cash Flows to Equity.
- b. Calculate the value of the overall firm by discounting the listed Free Cash Flows to the Firm. Use your solution to calculate the value of the firm's equity.
- c. Are the equity values you obtained using the two methods the same? What firm characteristics would be necessary in order for the two values to be identical?

