Session 8: Post Class tests

1. When you invest in the equity in a business, you are entitled to the residual cash flows. Which of the following is the best description of what that residual cash flow is?
    a. Net Income
    b. The cash flow before debt payments and reinvestment
    c. The cash flow after debt payments and reinvestment
    d. The cash flow after debt payments but before reinvestment
    e. None of the above
2. Some investors use dividends as their measure of cash flows to equity, and value equity based upon expected dividends. For this approach to yield reasonable values for equity, which of the following assumptions have to hold?
    a. Earnings have to be positive
    b. The company must be paying dividends currently
    c. Dividends cannot exceed earnings
    d. Dividends have to be expected to increase over time
    e. Dividends should approximate potential dividends (free cash flows to equity)
3. You are valuing a company that reported $3.00 in earnings per share in the most recent year, on which it paid dividends of $2.00 per share. If you expect these dividends to grow at 2% a year in perpetuity and the cost of equity is 10%, estimate the value of equity per share.
    a. $20.00/share
    b. $20.40/share
    c. $25.00/share
    d. $25.50/share
    e. $37.50/share
    f. $38.25/share
4. Assume that the shares of the company (described in the example above) are trading at $40.80/share. If your estimate of growth in dividends is correct, estimate the cost of equity that the market is attaching to the company.
    a. 4.9%
    b. 5.0%
    c. 6.9%
    d. 7.0%
    e. None of the above