Session 3: Post class test solutions

1. **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.
2. **c. Estimate a default spread for the US government and reduce the T. bond rate by that spread.** You could obtain the spread for the US sovereign CDS and net it out from the US treasury bond rate. You cannot use as short term rate or a rate from a bond denominated in a different currency.
3. **c. The lowest of the 10-year, euro denominated government bond rates (probably ECB or German 10-year).** The Spanish 10-year bond rate is not risk free and the Swiss government bond is in a different currency.
4. **d. The rate on a US T.Bond.** If the valuation is done in dollars, the Sol rate is not the right riskfree rate. The Peruvian dollar bond rate has default risk in it (it is trading at a higher rate than the T.Bond)
5. **c. The rate on the Peruvian Sol bond, net of the CDS spread (6%-1% = 5%).** There is a small mismatching problem since the CDS spread is in US$ terms, but there is no easy way to get the default spread in Sol.