DCF VALUATION II: TEST

A Corporate Governance Discount

You are valuing a company with extremely poor corporate governance. The firm is badly managed and badly run and you have estimated a DCF value of $ 100 million for the firm. Should you discount this value for poor corporate governance

a. Yes
b. No

The R&D Effect

You have just finished a DCF valuation of a pharmaceutical company and arrived at a value per share of $ 20. However, you used the conventional accounting numbers in arriving at your cash flows and discount rates. You decide to capitalize R&D and revalue the firm. What will happen to your value per share?

a. It should remain unchanged. Money spent is money spent.

b. It should go up. Earnings will increase when you capitalize R&D

c. It should go down. Reinvestment will increase when you capitalize R&D

d. Any of the above, depending on the company.

The Distress Factor

You are valuing a distressed company, with negative earnings and a significant debt overhang. You estimate expected cash flows, making realistic assumptions about improving margins, and a high cost of capital that reflects the high risk and compute a value of $ 1 billion for the equity in the firm. Given your assumptions, which of the following it likely to be true about your valuation:

a. It will be too low

b. It will be a reasonable estimate

c. It will be too high