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CHAPTER

Valuation of Real Options

Multiple Choice Questions

1. In the valuation of multi -business companies, it is advisable not to allocate charitable contributions to various business units:
(a) True (b) False

2. In SOTP valuation, the value per share of a listed subsidiary company may best be taken at the average of its quoted price over the immediately preceding 26 weeks:
(a) True (b) False

3. Cyclical companies are seen to invest massively when the prices are high:
(a) True (b) False

4. The principal driver of profitability of an airline company is the volatility in consumer demand:
(a) True (b) False

5. Herding behavior sends a pessimistic signal to the stock market before the business cycle turns up:
(a) True (b) False

6. Enterprise DCF model is the model of choice for valuing a banking company:
(a) True (b) False

7. A bank earns a spread by operating on different parts of the yield curve:
(a) True (b) False

8. Due to persistent efforts by RBI, the quality of banks' loan portfolios have now become very transparent:
(a) True (b) False

9. Working capital typically represents only a small portion of a bank's assets:
(a) True (b) False

10. Meeting the claims of policyholders is usually the largest expense for an insurance company:
(a) True (b) False

11. You are likely to find 'separate account' assets in the balance sheets of commercial banks with high leverage:
(a) True (b) False

12. 'Separate account' assets are exactly matched by 'separate account' liabilities:
(a) True (b) False

13. In valuing an Indian MNC, it is advisable to measure the market risk premium based on S & P 500 rather than the Nifty:
(a) True (b) False

14. When valuing a company in emerging markets, experts develop the financial projections only on real terms:
(a) True (b) False

15. As long as global investors can invest locally, local prices will be based on an international cost of capital:
(a) True (b) False

16. Much better alternatives than the CAPM are now available to estimate the cost of equity in emerging markets:
(a) True (b) False

17. Thanks to their much smaller size, the quality of past information available on private companies is typically more reliable than that on publicly traded companies:
(a) True (b) False

18. Shareholders in a private company usually expect a premium for bearing unsystematic risk:
(a) True (b) False

19. Like mutual funds, private equity investors generally play a passive role in the management of investee companies except during very tough periods:
(a) True (b) False

20. In private equity investment, 'post-money investment value' refers to the implied current value of the equity of the invested firm:
(a) True (b) False

21. Transaction costs can be used to measure liquidity:
(a) True (b) False

22. The value of tax benefits in mergers is mostly in terms of calibrated utilisation of tax-shields:
(a) True (b) False

23. Simulation analysis enables an analyst to explicitly deal with distress:
(a) True (b) False

24. In multi-business companies, corporate overheads like CEO compensation should be allocated to the various business units based on;
(a) Profit of the business unit
(b) Assets of the business unit
(c) Balance sheet size of the business unit
(d) A least-cost basis
(e) None of the above

25. For calculating the invested capital of an individual business unit , intercompany receivables should be treated as:
(a) Intercompany equity
(b) Intercompany working capital
(c) Intercompany deferred loan

(d) Deferred loan credit
(e) None of the above

26. A financial business should be valued by discounting its cash flow to equity at the:
(a) Cost of capital
(b) Cost of equity
(c) Marginal cost of capital
(d) Weighted average cost of capital
(e) None of the above

27. It is not advisable to value each business unit at its own cost of capital:
(a) True (b) False

28. In valuing a nascent high-growth company it is advisable to begin with the future and work backwards:
(a) True (b) False

29. A company in which of the following industries is typically characterised by cyclicality?
(a) Paper
(b) Chemicals
(c) Steel
(d) All the above
(e) None of the above.

30. For valuing a cyclical company it is better to use:
(a) Multiple-scenario probabilistic approach
(b) Simulation analysis under multiple scenarios
(c) Sensitivity cum probabilistic approach
(d) Either (a) or (b)
(e) None of the above

31. New trend line scenario is usually developed in valuation of:
(a) Multinational companies
(b) Multi-business companies
(c) Cyclical companies
(d) High growth intangible companies.
(e) None of the above

32. High leverage is a common feature among:
(a) Finance companies
(b) Manufacturing companies
(c) Trading companies
(d) IT companies
(e) None of the above

33. For banks, the risk-adjusted maturity mismatch income is typically value-creating:
(a) True (b) False

34. It is difficult to measure an insurer's true profitability because their cash flows extend over long periods:
(a) True (b) False

35. In insurance industry, combined ratio is the proportion of total costs to:
(a) Total income
(b) Premium income
(c) Combined income of loan interest received and premium receipts
(d) Long-term income
(e) None of the above

36. Funds entrusted to the insurer to be invested on behalf of customers are held in:
(a) "Typical assets"
(b) "Separate assets account"
(c) "Deferred policy acquisition cost asset account"
(d) "Third party funds received account"
(e) None of the above

37. The major liability for any insurer is its:
(a) "Acquisition cost"
(b) Debt financing cost
(c) Equity financing cost
(d) Reserves
(e) None of the above

38. Valuation of a foreign company, when done using forward rate method usually tends to give slightly higher values than when done using spot rates:
(a) True (b) False

39. The weighted average cost of capital used in valuing a firm in foreign currency should include:
(a) An allowance for the domestic savings rate
(b) An allowance for the foreign lending rate
(c) An additional risk premium for perceived currency risk.
(d) All the above
(e) None of the above

40. CAPM usually underestimates the real cost of equity of a:
(a) Utility company
(b) IT company
(c) Private company
(d) Public company
(e) None of the above

41. As compared to public equity investing, private equity investing:
(a) Has no active role
(b) Has no high return expectation
(c) Is illiquid
(d) All the above
(e) None of the above

42. Pre-money investment value in a PE investment is:
(a) The amount by which the funds provided by the PE exceeds the post-money investment value of the firm's equity
(b) The amount by which the post-money investment value of the firm's equity exceeds the funds provided by the PE
(c) Proportion of the funds provided by the PE to the PE's ownership interest
(d) The risk-adjusted value of the funds provided by the PE
(e) None of the above

43. According to SEBI Guidelines on Employee Stock Option Scheme, the accounting value of options should be written off as employee cost in a linearly declining order over the vesting period:
(a) True (b) False

44. Excess cash lying in a checking account is:
(a) Idle cash
(b) Wasting cash
(c) Brooding cash
(d) Non remunerative cash

45. Which of the following is not a transaction component cost?
(a) Price impact
(b) Opportunity cost of waiting
(c) Spread
(d) Commission
(e) None of the above