



FIN 360: PRINCIPLES OF FINANCIAL MANAGEMENT

DISCOUNTED CASH FLOW VALUATION

CRITICAL THINKING & CONCEPTUAL QUESTIONS

1. Explain why it would be better to be paid your entire annual salary on the first day of the year instead of receiving 26 bi-weekly paychecks throughout the year.
2. Explain why beginning of period payments increase *both* the present value and future value of cash flows.
3. Explain how a series of cash flows, such as cash flows from a legal settlement, can be “purchased” from another party or “sold” to another party.
4. What happens to the (i) present value and (ii) future value of a series of cash flows if (holding all else constant):
 - a. The size of the cash flows through time increase
 - b. The discount rate or compounding rate r increases
 - c. The number of cash flow payments increases
 - d. The payments shift from the end of the period to the beginning of period
 - e. The growth rate g increases
5. Where do we “get” a discount rate for a series of cash flows?
6. In what way do annuities and perpetuities differ?
7. Why can't we compute the future value of a perpetuity?
8. Is a preferred stock worth *more* or *less* today if you were to increase the rate of return you require on the preferred stock, given the stock's risk.
9. In general, how do we “assign” a “required rate of return” on a stock? Explain what factors might go into your own personal decision as to what an investment should return in order for you to invest in that investment.
10. Is it possible (given your discussion in the previous problem) that different people might have different required rates of return on the same stock or same series of cash flows?
11. Why doesn't an infinite series of cash flows cost an *infinite* number of dollars today?
12. What must we know about the relationship between a growing annuity's (or a growing perpetuity's) discount rate r and payment growth rate g ? What happens if $r = g$?
13. Explain how stocks and bonds can resemble annuities to an investor. How then might we determine what a stock or bond is “worth”?

