FIN 360: PRINCIPLES OF FINANCIAL MANAGEMENT
STOCK VALUATION
CRITICAL THINKING & CONCEPTUAL QUESTIONS

1. What is a stock's "intrinsic" value?
2. Explain the concept of a required rate of return, and why we are willing to pay *less* for riskier securities (given some future payoff) – which results in them offering potentially greater returns.
3. Explain why we use the required rate of return as our discount rate.
4. Looking at the dividend discount model formula for stock valuation, what happens to the price of a share of stock if (all else equal):
    a. The dividends we forecast the stock to pay increase? What if the dividends we forecasted are too high and we revise our model with lower dividends?
    b. The discount rate *k* rises? What if it falls?
    c. A stock's beta rises? What if it falls?
    d. The FED raises interest rates (Hint: think about the risk-free rate)? What if the FED lowers rates?
5. Explain how valuing common stock is similar to valuing bonds. How is it different?
6. Explain why market efficiency implies that the price of a share of stock equals the intrinsic value of the share.
7. How is the value of a share the "sum of an infinite stream of dividends"? Doesn't the price you sell the stock for in the future matter?
8. If you determine that a share is "undervalued" by the dividend discount model, what should you do? What if it is "overvalued"?
9. How should investors value stocks if they do not pay dividends?
10. Why is it important that we use an industry or "comparable company" PE ratio when finding a stock's implied price?
11. Why might a price lower than the implied price be desirable for an investor looking to buy the stock?
12. How is it possible for different investors to reach different conclusions when calculating a stock's intrinsic value if they use the same formulas?
13. Describe, in words, the CAPM and where you obtain its components.
14. Explain how a stock's beta represents risk.
15. If you know, with certainty, that the markets are going to rise significantly today, would you prefer to be holding a high or low beta stock?
16. Explain why markets *require* different investors to reach slightly different conclusions about whether a stock is under- or over- valued.