3. No. Math problem, weighted average of two fractions is not equal to the sum of numerators divided by sum of denominators.

Ref: CH15 P407

4. No. Same as No. 3.

Ref: CH15 P407

5. The major advantage of NPV relative to Comps is that if you can get reasonable future cash flows and discounted rate of return, you know your valuation is accurate, and you don’t have to search comparable companies and choose attributes. The disadvantages are input estimates can be far off from true value, and there is no objective standards for your estimates.

NPV works better to value a project which you know the expected cash flows, while Comps are used more often in valuation of the whole firms and you know the valuation of your comparable firms are accurate.

Ref: CH15 P399

6. It’s a common measure but not good. TA includes FD, EQ and NFL. No financial liability is also a liability but not considered in the numerator. Therefore this is not a good measure.

Ref: Class Note

7. The debt part seldom change year to year compared to equity. It only changed drastically when issuing or retiring a debt. Thus, the biggest determinant of market-based leverage ratio changes is equity.

Ref: Q 16.15

8. No, such a firm will go bankruptcy.

9. Yes, it could be. Negative equity means shareholders owe money.

10. No. Public companies will be delisted if stock price approaches zero.

11. Zero

12. It depends on whether it’s in the money or out of the money.

13. No.

14. Apparently, there is 1/X domain problem. We have four methods to deal with this issue.

1) Ignore nonpositive earnings firms.

P/E = (80/0.3 + 500/3)/2 = 216.6667

2) Use the median.

P/E = 166.6667

3) Average E/P yields and invert

P/E = 1/((-0.3/100 + 0.3/80 + 3/500)/3) = 444.4444

4) Work with sums

P/E = (100 + 80 + 500)/(-0.3 + 0.3 + 3) = 226.6667

Here, I prefer working with sums because it’s not suitable to use first two methods when there are only three firms.

Ref: CH15 P407

21. vi

22 i

23 ii