Chapter 6: Valuing levered projects

Answers to self test questions

1. (a) The risk of the cash flows generated by the firm's assets

2. (c) The additional risk that investors accept by giving other investors a claim with a higher priority than their own

3. (b) The expected return of all equity financed assets with the same risk

4. Correct answers are:

(a)	The market price of business risk	True
(b)	The weighted average cost of capital (WACC)	False
(c)	The expected return of all equity financed assets with the same risk	True
(d)	The weighted average return on shares of companies in the same business	False

5. (c) Because business risk is transferred from the equity holders to the debt holders

6. (a) 'unlevered' after tax cash flows ('as if' all equity financed)

7. (d) The OCC or r_d, cannot say which without more information

8. (b) Rebalanced debt

9. (b) Various different side effects can be included

10. (c) The cost of debt, r_d

11. (a) The OCC

12. (b) $(1 + r_a)(1 + r_d)$

13. (c) The OCC remains the same

14. (d) Cannot say without more information

15. (c) Predetermined debt

16. (b) Periodically rebalanced debt

17. Correct answers are:

(a)	The unlever-relever procedure	True
(b)	The Modigliani-Miller formula	True
(c)	The Miles-Ezzell formula	False
(d)	Adjusted present value	True

18. Correct answers are:

(a)	The unlever-relever procedure	False
(b)	The Modigliani-Miller formula	False
(c)	The Miles-Ezzell formula	True
(d)	Adjusted present value	True

19. Correct answers are:

(a)	The unlever-relever procedure	True
(b)	The Modigliani-Miller formula	False
(c)	The Miles-Ezzell formula	False
(d)	Adjusted present value	True

20. (c) With the pure play method

21. (d) None of the above
    Under the Modigliani-Miller assumptions, the proper formula is:
    $\beta_a = \beta_d(1-\tau)\frac{D}{V-\tau D} + \beta_e \frac{E}{V-\tau D}$

22. (a) To discount the after tax cash flow to equity with the required return on equity