Corporate Finance, Module 1: “Present Values and Opportunity Cost of Capital”

Practice Problems

(The attached PDF file has better formatting.)

Exercise 1.1: Shopping Mall Present Values and Returns

An investor can buy land this year for $12 million, build a shopping mall for an additional $12 million, and sell the land and the mall for $30 million in one year. Investors building similar projects expect to receive 15% returns.

A. What is the expected return from the mall-building venture?
B. What is the present value of the land plus mall?
C. What is the net present value of the project?

Solution 1.1:

Part A: The total investment is $12 million + $12 million = $24 million. The profit is $30 million – $24 million = $6 million. The expected return is $6 million / $24 million = 25%.

Part B: The present value of the land plus mall is $30 million / 1.15 = $26.087 million.

Part C: The net present value is the present value minus the cost, or $26.087 million – $24 million = $2.087 million.