

PROBLEM SET: Terminal Value

Exercise 1. *Terminal Value* [1]

The terminal value in a capital budgeting project is generally much lower than the initial investment. The terminal price in a stock valuation is generally much higher than the initial investment. How would you explain the difference?

Solutions

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A capital budgeting project generally has a finite life. Consequently it loses value over time. A stock has an infinite life. It generally increases in value over time, both as a consequence of inflation and real growth.