Chapter 12
Cash Flow Estimation and Risk Analysis

LEARNING OBJECTIVES

After reading this chapter, students should be able to:

- Discuss difficulties and relevant considerations in estimating net cash flows, and explain the four major ways that project cash flow differs from accounting income.
- Define the following terms: relevant cash flow, incremental cash flow, sunk cost, opportunity cost, externalities, and cannibalization.
- Identify the three categories to which incremental cash flows can be classified.
- Analyze an expansion project and make a decision whether the project should be accepted on the basis of standard capital budgeting techniques.
- Incorporate inflationary expectation into cash flow estimation when considering capital budgeting decisions.
- Explain three reasons why corporate risk is important even if a firm's stockholders are well diversified.
- Identify two reasons why stand-alone risk is important.
- Demonstrate sensitivity and scenario analyses and explain Monte Carlo simulation.
- Discuss the two methods used to incorporate risk into capital budgeting decisions.