Finance 300 Exam 3 Spring 1999 Joe Smolira

Multiple Choice – 4 points each – 80 points total – Put all answers on the answer page

1. When a cash payment is made to shareholders as it has been at the end of each quarter for the past 20 years, it is called _____.

A) a homemade dividend
B) a special dividend
C) a residual dividend
D) a regular dividend
E) a liquidating dividend

2. Which of the following is the correct chronology of a dividend payment?

A) Declaration date, Date of record, Ex-dividend date, Date of payment
B) Declaration date, Ex-dividend date, Date of record, Date of payment
C) Declaration date, Date of record, Date of payment, Ex-dividend date
D) Declaration date, Date of payment, Date of record, Ex-dividend date
E) Declaration date, Ex-dividend date, Date of payment, Date of record

3. SweepDeep Enterprises announced the payment of a $1.50 per share cash dividend to "holders of record" on Wednesday, June 22. In order to receive the dividend, you must, therefore, purchase the stock no later than

A) Wednesday, June 22
B) Tuesday, June 21
C) Monday, June 20
D) Friday, June 17
E) Thursday, June 16

4. Suppose a firm wishes to have its stock listed on an exchange but its share price is not high enough to meet the minimum price level specified by the exchange. How might the firm remedy this situation and reduce the number of shares outstanding at the same time?

A) Pay a liquidating dividend
B) Pay a stock dividend
C) Pay a regular cash dividend
D) Execute a reverse stock split
E) Execute a stock split

5. You purchase 100 shares of stock for $20.00 per share just before the market closes on Thursday. The ex dividend date is Friday and the dividend is $1.50 per share. Assuming there are no taxes, just after the market opens on Friday morning your total wealth (all else equal) _____.

A) will fall from the previous day's wealth by $300
B) will still be equal to $2,000
C) will fall from the previous day's wealth by $150
D) will increase by the amount of the dividend since you can now sell the stock for $18.50 per share and keep the dividend
E) will increase by the amount of the dividend received

6. _____ usually a long-term loan provided directly by a limited number of investors.

A) A red herring is
B) A private placement is
C) Venture capital is
D) An IPO is
E) A shelf registration

7. All of the following terms EXCEPT _____could be associated with an initial public offering of common stock.

A) tombstone
B) red herring
C) preliminary prospectus
D) holder-of-record date
E) underpricing

8. The option giving the underwriter the ability to purchase additional shares of stock at the offer price is called _____.

A) a shelf registration
B) a Green Shoe provision
C) dilution
D) standby underwriting
E) a firm commitment offering

9. If a firm plans a public issue of new securities but needs the money at different stages over the coming two years, the firm may be a candidate for _____.

A) a shelf registration
B) a private placement
C) a rights offering
D) firm commitment underwriting
E) a multiplex cash offering

10. Recently, an underwriter completed a sale of stock in an under-subscribed IPO. Since then, the stock's price has dropped 10%. If the stock is still in the _____, the principal underwriter may buy shares to support the market price.

A) Red Herring
B) aftermarket
C) shelf registration
D) registration period
E) moratorium

11. _____, the underwriter agrees to purchase the entire issue of a public offering, and then attempts to resell the issue.

A) In standby underwriting
B) In firm commitment underwriting
C) In best efforts underwriting
D) By exercising a Green Shoe provision
E) By exercising an oversubscription privilege

12. Which of the following is likely to be associated with the highest level of risk?

A) Long-term corporate bonds
B) U.S. Treasury bills
C) Long-term government bonds
D) Common stock of the largest companies in the U.S.
E) Common stock of the smallest companies listed on NYSE

13. An asset's undiversifiable risk is measured by its

A) total return
B) expected return
C) variance of returns
D) unexpected component of returns
E) beta coefficient

14. Assume that markets are semi-strong form efficient. Suppose, then, that during a trading day, important new information is released for the first time concerning a certain company. This information indicates that one of the firm's oil fields, previously thought to be very promising, just came up dry. How would you expect the price of a share of stock to react to this information?

A) The value of a share will fall over an extended period of time as investors begin to sell shares in the company
B) The value of a share will drop immediately to a price that reflects the value of the new information
C) The value of a share will fall below what is considered appropriate because of the decreased demand for the shares, eventually the price will rise to the correct level
D) The value of a share will rise over a long period of time as investors sell the stock
E) The stock price will not change since this type of information has no impact in markets that are semi-strong form efficient

15. The excess return required from an investment in a risky asset over a risk-free investment is called the _____.

A) risk-free rate of interest
B) market rate of interest
C) risk premium
D) real rate of interest
E) holding-period return

16. You purchased a bond for $900 one year ago. Today, you receive your only interest payment for the year of $100. The bond could be sold for $975 today. Your percentage return on your investment is _____. (Ignore taxes)

A) 8.3%
B) 11.1%
C) 18.0%
D) 19.4%
E) 23.8%

17. The stock price of a gold-mining firm drops when it is discovered the firm's chairman has overstated minable gold reserves. This is an example of a(n) _____ risk factor.

A) systematic
B) nondiversifiable
C) unsystematic
D) market
E) anticipated

18. The CAPM shows that the expected return for a particular asset depends on

I. the amount of unsystematic risk
II. the reward for bearing systematic risk
III. the pure time value of money

A) I only
B) I and II only
C) III only
D) II and III only
E) I, II and III

19. You are considering an investment project. You know that the cost of capital associated with the project depends on _____.

A) the total risk of the firm's equity
B) the type of security to be issued to finance the project
C) the type of assets needed for the project, that is, whether they are long-term or short-term assets
D) the risk associated with the project
E) the interest rate on the firm's existing long term bonds

20. In using the _____ approach to estimating the cost of capital for a division, an analyst proceeds by observing the returns for a firm whose operations are in the same risk class as the division.

A) pure play
B) conglomerate
C) market specialist
D) correspondent division
E) parallel risk class

Partial Credit Problems – Show All Work – 20 points total

(10 points) The stock of a company has the following returns for different states of the economy in the coming year:

State of the economy	Probability	ABC
Excellent	.30	23%
Average	.40	18%
Poor	.20	5%
Recession	.10	-7%

A) Calculate the expected return.

B) Calculate the standard deviation.

C) Calculate the coefficient of variation.

(10 points) You are given the following information concerning:

Debt:	1,000 7 percent coupon bonds outstanding, 20 years to maturity, and a quoted price of 90 1/8.
Preferred Stock:	1,100 shares of 8% preferred outstanding selling at $83 per share.
Common Stock:	50,000 shares of common stock selling for $35 per share. The stock has a Beta of 1.3 and will pay a dividend of $3.25 next year. The dividend is expected to grow by 5% per year indefinitely.
Market:	A 12% expected return and a 4% risk free rate.

Calculate the WACC. Assume the tax rate is 35%.

Answer Key **Spring 1999** **Exam 3**

1	D
2	B
3	D
4	D
5	B
6	B
7	D
8	B
9	A
10	B
11	B
12	E
13	E
14	B
15	C
16	D
17	C
18	D
19	D
20	A

Problem #1

P	R	P*R	E(R)	R-E(R)	(R-E(R))^2	P*(R-E(R))^2
0.3	23	6.9	14.4	8.6	73.96	22.188
0.4	18	7.2	14.4	3.6	12.96	5.184
0.2	5	1	14.4	-9.4	88.36	17.672
0.1	-7	-0.7	14.4	-21.4	457.96	45.796
	E(R)	14.4			Variance	90.84
					SD	9.53

Coefficient of Variation = .662

Problem #2

Debt: 1000FV 40N 35PMT 901.25 +/-PV CPT I/Y 7.997 * 2 = 8.00%
K_d = 8.00 (1-.35) = 5.2%

Preferred Stock: K_p = 8 / 83 = 9.6%

Common Stock: K_e = (3.25/35) + .05 = 14.29%
E(R) = 4 + 1.3 (12-4) = 14.4 %
K_e = (14.29 + 14.4) / 2 = 14.35%

Debt:	1,000	×	$901.25	=	$901,250	=	0.329
Pref:	1,100	×	$83.00	=	$91,300	=	0.033
CS:	50,000	×	$35.00	=	$1,750,000	=	0.638
					$2,742,550		

WACC = (5.2 × .329) + (9.6 × .033) + (14.35 × .638)
= 11.19%