MORE SAMPLE MCQs

These Questions only give you an example of the <u>style</u> of questions asked and not necessarily the exact material or questions to be considered.

Use the following information to answer Q1 and Q2.

Stock P just paid a dividend of $2, while Stock Q just paid a dividend of $4. Stock P's dividend is expected to grow at a constant rate of 5 percent a year, while Stock Q's dividend is expected to grow at a constant rate of 3 percent. Stock P has a required return of 12 percent, while Stock Q has a required return of 10 percent. Assume that the market is in equilibrium and expected returns equal required returns.

1. Which of the following statements below is correct?

   a) Stock P has a higher dividend yield than Stock Q.
   b) Stock Q has a higher capital gains yield than Stock P.
   c) Stock Q has a higher beta than Stock P.
   d) All of the statements are correct.
   e) None of the statements are correct.

Answer: E

2. What is the market price of Stock P?

   a) $25.00
   b) $28.57
   c) $30.00
   d) $40.00
   e) $42.00

Answer: C

E Stock P has dividend yield of 7% and capital gains yield of 5%.
Stock Q has dividend yield of 7% and capital gains yield of 3%.
Stock P has higher beta since it has the higher required return, given the same risk free return & market return.

C

D_1 for Stock P	$2.10
dividend yield for Stock P	7.00%
	$30.0
Market price for Stock P	0

3. Barnes Company currently does not pay any dividends and it does not plan to pay dividends for the next 2 years. Starting from the end of Year 3, it will start to pay a dividend of $2. The dividend is then expected to grow at a constant rate of 4% forever. The risk-free rate is 2% and the market return is 12%. Barnes Company stock has a beta of 0.8. How much would you pay for Barnes Company stock today?

   a) $30.30
   b) $25.04
   c) $27.55
   d) $33.33
   e) None of the above

Answer: C

rf	2%
MRP	10%
Beta	0.8
Re	10.000%
D_3	$2.00
constant growth rate, g	4.00%
D_4	$2.08
P_3	$34.67
P0	**$27.55**

4. Jerzy Company has announced that it will be reducing its annual dividend by 20% a year for the next two years. After that (from year 3), it will maintain a constant dividend of $1.75 a share. The company just paid a dividend of $2.50 per share. What is this stock worth if you require a 15% rate of return?

   a) $14.27
   b) $13.13
   c) $12.48
   d) $11.77
   e) $10.62

Answer: D

D	dividend growth rate	-20%
	Constant dividend	$1.75
	D_0	$2.50
	Required Return	15%
	P_0	**$11.77**

5. Sami Company has a 4-year, 7% annual payments coupon bond with a $1,000 par value. Henchoz Inc. has an 8-year, 7% semi-annual payments coupon bond with a $1,000 par value. Both bonds are priced at par. Which of the following statements is correct if the market yield decreases to 5%?

   a) Sami Company's bond will have a higher percentage increase in its price than Henchoz Inc.'s bond.
   b) The current yield of Henchoz Inc.'s bond will fall by more than that of Sami Company's bond.
   c) Both bonds will have the same percentage increase in price.
   d) Both bonds will reduce coupon rate to 5%.
   e) For both bonds, YTM > Current Yield > Coupon rate.

Answer: B

B	Current price of Sami	$1,000.00	
	Current price of Henchoz	$1,000.00	
	Current yield of Sami	7.000%	
	Current yield of Henchoz	7.000%	
	New price of Sami	$1,070.92	
	New price of Henchoz	$1,130.55	
	Change in price of Sami	$70.92	7.09%
	Change in price of Henchoz	$130.55	13.06%
	New Current yield of Sami	6.536%	
	New Current yield of Henchoz	6.192%	

Use the following information to answer Q6 and Q7.

Didi Company is preparing an 8-year par bond offering with a 5 percent semiannual coupon and a face value of $1,000. Alonso Inc., with the same credit rating as Didi Company, has an outstanding bond with 8 years to maturity and a 6 percent annual coupon.

6. Which of the following statements below about Didi Company's bond is correct?

   a) The final payment will be in the amount of $1,050.
   b) Next year, if rates stay the same, the price of the bond will be higher than now.
   c) The bond has a current yield of 5%.
   d) Didi Company's bond price is higher than Alonso, Inc.'s bond price.
   e) None of the above statements are correct.

Answer: C

7. What is the market price of Alonso, Inc.'s bond?

   a) $963.14
   b) $1,000.00
   c) $1,064.63
   d) $1,065.28
   e) Insufficient information to derive.

Answer: C

Alonso Inc price	$1,064.63

8. Cisse Company has a 5 percent, semiannual coupon bond outstanding with a current market price of $921.37. The bond has a par value of $1,000 and a yield to maturity of 8 percent. How many years is it until this bond matures?

a) 3.0 years
b) 4.0 years
c) 5.0 years
d) 6.0 years
e) Insufficient information to derive

Answer: A **N** **3.00** **years**

9. Which of the following statements about the term structure of interest rates is/are correct?

I. The real rate of return causes the slope of the term structure of interest rates to change.
II. The term structure of interest rates includes an inflation premium, an interest rate risk premium and a liquidity risk premium.
III. The slope of the term structure of interest rates is independent of the health of the economy.

a) I and II only
b) I and III only
c) III only
d) II and III only
e) None of the above statements are correct.

Answer: E

10. Which of the following statement/s is/are **CORRECT**?

I. For conventional cash flow streams, IRR will always equal MIRR.
II. Independent projects with conventional cash flow streams will always give the same decision for NPV and IRR.
III. A negative NPV project with conventional cashflows can not have a payback period.
IV. It is possible for cash flow streams to not have any IRR at all.

a) I and II only.
b) II and IV only.
c) I, II and III only.
d) II, III and IV only.
e) I, III and IV only.

Answer: B

Use the following information to answer Q11 and Q12.

A project will produce operating cash flows of $120,000 a year for four years. During the life of the project, inventory will be increased by $30,000 and accounts receivable will increase by $25,000. Accounts payable will increase by $65,000. The project requires the purchase of equipment at an initial cost of $325,000. The equipment will be depreciated straight-line to a zero book value over the life of the project. The equipment will be salvaged at the end of the project creating a $10,000 after-tax cash flow. At the end of the project, net working capital will return to its normal level. Assume a marginal tax rate of 34%.

11. What is the net present value of this project given a required return of 18%?

a) - $2,169
b) $3,862
c) $7,807
d) $11,156
e) $14,078

Answer: C

12. What is the IRR of this project?

a) 16.9%
b) 17.2%
c) 18.5%
d) 19.3%
e) 20.4%

Answer: D

Initial Cost	-$325,000.00
Change in Inventory	$30,000.00
Change in A/R	$25,000.00
Change in A/P	$65,000.00
Change in NOWC	-$10,000.00
CF0	-$315,000.00
OCF	$120,000.00
NSV	$10,000.00
Terminal CF	$0.00
Discount Rate	18%

0	-$315,000.00
1	$120,000.00
2	$120,000.00
3	$120,000.00
4	$120,000.00
NPV	**$7,807.42**
IRR	**19.3%**

13. Igor is considering a project for his business. If he starts the project today, the initial cost is $50,000 and he will receive cash inflows of $80,000 a year for three years. If he waits one year to start the project, the initial cost will increase to $75,000 but the cash flows will also increase to $X a year for three years. The cost of capital is 12%. Find X that would make Igor indifferent between doing the project now and waiting till next year.

a) $90,409
b) $97,511
c) $102,165
d) $106,732
e) $115,084

Answer: B

B	discount rate	12%
	Start now	
	CF0	-$50,000.00
	CF1-3	$80,000.00
	NPV	$142,146.50
	Start 1 year later	
	CF0	-$75,000.00
	CF1-3	$X
	PV of CF0	-$66,964.29
	PV0 of 3-year annuity	$209,110.79
	PV1 of 3-year annuity	$234,204.08
	X	**$97,510.63**

Use the following information to answer Q14 and Q15.

Becker is planning to use a lockbox system to speed up collections from his customers. The bank charges a one-time set-up fee of $250,000 for the lockbox system. Each day, the bank will charge $0.10 for each cheque collected. The estimated reduction in collection and processing time is 2 days. Every day, X customers use this lockbox and the average amount of each cheque is $1,000. Treasury bills are currently yielding an effective rate of 3 percent per year. Assume a year has 365 days.

14. What is the minimum number of customers, X, that would make this lockbox service a sensible investment for Becker?

a) 239
b) 251
c) 295
d) 327
e) 358

Answer: D

15. Suppose that 920 customers deposit cheques into the lockbox every day. The bank is looking to increase the collection charge per cheque from the current $0.10. How high can the bank charge before this lockbox service becomes insensible for Becker?

a) $0.26
b) $0.23
c) $0.20
d) $0.17
e) $0.14

Answer: E

N	X		327
no. of days improved	2		2
amt of each check	1000		1000
increased bank balance	2000X		654000
daily interest rate	0.00008100	1234.567901	0.00008100
total costs	$0.1X/0.000081 + $250,000		653703.7037
X	**326.6129032**		296.2962963

N	920		
no. of days improved	2		
amt of each check	1000		
increased bank balance	$1,840,000.00		
daily interest rate	0.00008100		
total costs	$920X/0.000081 + $250,000		$1,840,000.00000000
X	**$0.1400**		$0.00000000