# Module 4 Practice Quiz 2

**8/8** points earned (100%)

Excellent!

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Correct  
1 / 1 points

1. Consider the example of sensitivity analysis that we discussed in class (in the spreadsheet[Sensitivity.xls](https://d396qusza40orc.cloudfront.net/corporatefinance/resources/Sensitivity.xls)).

What happens to the NPV and the IRR of the project when the discount rate goes from 8% to 9%?

1. The IRR goes to 14.25%, and the NPV goes to $10,949.16.
2. The IRR goes to 12.25%, and the NPV goes to $10,949.16.
3. **The IRR is unchanged, and the NPV goes to $10,949.16.**
4. The IRR is unchanged, and the NPV goes to $12,245.50.

Correct  
1 / 1 points

2. The marketing department just reported additional information about the market price. Given the uncertainty about the state of the economy and competition in the industry, there is a 33.33% chance that the price will be equal to 3 dollars, a 33.33% chance that the price will be equal to 4 dollars, and a 33.33% chance that the price will be equal to 5 dollars. The discount rate is still equal to 8%.

What is the expected market price given this information?

1. 3 dollars
2. 5 dollars
3. **4 dollars**
4. You do not have sufficient information to answer the question.

Correct  
1 / 1 points

3. The marketing department just reported additional information about the market price. Given the uncertainty about the state of the economy and competition in the industry, there is a 33.33% chance that the price will be equal to 3 dollars, a 33.33% chance that the price will be equal to 4 dollars, and a 33.33% chance that the price will be equal to 5 dollars. The discount rate is still equal to 8%.

How would this information change your decision to invest in the project?

1. You no longer recommend investing in the project because there is a significant chance that the NPV will be negative.
2. You are even more optimistic about the project since there is a significant chance that you will be able to charge more for the product.
3. This information is irrelevant since the expected price is still 4 dollars.
4. **This information does not necessarily change your decision to invest in the project, but given the large degree of uncertainty, you may ask the marketing department to do more research about market prices.**

Correct  
1 / 1 points

4. Suppose the current yield on a 30-year government bond jumps to 3.5%. Which of the following statements is most likely to be incorrect?

1. It would still be reasonable to use a market risk premium of 4% to 5% to estimate the required return on equity for all companies.
2. **Since the market risk premium is the difference between market returns and government bond returns, the market risk premium should go down by 0.5%.**
3. This increase does not necessarily change the risk premium on the stock market.
4. This increase in government yields will increase the required return on equity by all companies by 0.5%.

Correct  
1 / 1 points

5. Suppose a company has a required return on equity equal to 10%. Calculate the company’s Beta if the 30-year government bond yield is 3% and the market risk premium is 5%.

1. **1.4**
2. 1.2
3. 0.7
4. 1

Correct  
1 / 1 points

6. Your company’s required return on debt is 4.25%, its tax rate is 30%, and its required return on equity is 8%. The company has 10 billion dollars of debt, and book equity is 20 billion dollars. The stock price is 20 dollars a share and the company has 4 billion shares outstanding. The company’s WACC is \_\_\_\_\_\_\_\_.

1. You don't have sufficient information to estimate WACC
2. 8.1%
3. **7.4%**
4. 6.3%

Correct  
1 / 1 points

7. You estimated your company’s WACC to be between 10% and 12%, and you are trying to decide whether to undertake a new investment that has similar risks as the overall company. The IRR of this project is 10%.

Should you take the project?

1. The WACC is not relevant for this decision because you need to estimate the WACC for the project.
2. Yes since 10% is a nice return and there is a lot of uncertainty about WACC.
3. **No, because the WACC is greater than the IRR, and the project has similar risks as the overall company.**
4. You need to know the company’s discount rate to make a decision about this investment.

Correct  
1 / 1 points

8. The company’s CEO is not happy about your recommendation in question 7. She is arguing that since the company has a lot of cash in the balance sheet and cash is earning a paltry 2% a year (the cash is invested in safe government bonds), the company should in fact take the investment because the 10% return on the investment is much larger than 2%.

Which of the following statements is incorrect?

1. The return on cash is not relevant for the decision about this new investment project.
2. The company’s WACC is greater than 2% because investing in the company is riskier than investing in a government bond.
3. **The company should still not take the project because it may not have sufficient cash to pay for the entire required investment.**
4. Cash has a low return because it is invested in safe securities. The low return on cash is thus not a problem for the company.