CHAPTER 8
Stock Valuation

I. DEFINITIONS

GROWING PERPETUITY

a 1. An asset characterized by cash flows that increase at a constant rate forever is called a:
   a. growing perpetuity.
   b. growing annuity.
   c. common annuity.
   d. perpetuity due.
   e. preferred stock.

DIVIDEND GROWTH MODEL

b 2. The stock valuation model that determines the current stock price by dividing the next annual dividend amount by the excess of the discount rate less the dividend growth rate is called the _____ model.
   a. zero growth
   b. dividend growth
   c. capital pricing
   d. earnings capitalization
   e. discounted dividend

DIVIDEND YIELD

c 3. Next year's annual dividend divided by the current stock price is called the:
   a. yield to maturity.
   b. total yield.
   c. dividend yield.
   d. capital gains yield.
   e. earnings yield.

CAPITAL GAINS YIELD

d 4. The rate at which a stock's price is expected to appreciate (or depreciate) is called the _____ yield.
   a. current
   b. total
   c. dividend
   d. capital gains
   e. earnings

PREFERRED STOCK

d 5. A form of equity which receives preferential treatment in the payment of dividends is called _____ stock.
   a. dual class
   b. cumulative
   c. deferred
   d. preferred
   e. common

PREFERRED STOCK

e 6. A _____ is a form of equity security that has a stated liquidating value.
- a. bond
- b. debenture
- c. proxy
- d. common stock
- e. preferred stock

COMMON STOCK

e 7. A form of equity which receives no preferential treatment in either the payment of dividends or in bankruptcy distributions is called _____ stock.
- a. dual class
- b. cumulative
- c. deferred
- d. preferred
- e. common

CUMULATIVE VOTING

b 8. The voting procedure whereby shareholders may cast all of their votes for one member of the board is called _____ voting.
- a. democratic
- b. cumulative
- c. straight
- d. deferred
- e. proxy

STRAIGHT VOTING

c 9. The voting procedure where you must own 50 percent plus one of the outstanding shares of stock to guarantee that you will win a seat on the board of directors is called _____ voting.
- a. democratic
- b. cumulative
- c. straight
- d. deferred
- e. proxy

PROXY VOTING

e 10. The voting procedure where a shareholder grants authority to another individual to vote his/her shares is called _____ voting.
- a. democratic
- b. cumulative
- c. straight
- d. deferred
- e. proxy

PREEMPTIVE RIGHTS

b 11. Preemptive rights refer to the right of shareholders to:
- a. share proportionately in dividends paid.
- b. share proportionately in any new stock issues sold.
- c. share proportionately in liquidated assets.
- d. vote at annual shareholder meetings.
- e. override the votes of other shareholders.

DIVIDENDS

c 12. Payments made by a corporation to its shareholders, in the form of either cash, stock or payments in kind, are called:
- a. retained earnings.
- b. net income.
- c. dividends.
- d. redistributions.
- e. infused equity.

PRIMARY MARKET

e 13. The market in which new securities are originally sold to investors is called the _____ market.
- a. dealer
- b. auction
- c. over-the-counter
- d. secondary
- e. primary

SECONDARY MARKET

d 14. The market in which previously issued securities are traded among investors is called the _____ market.
- a. dealer
- b. auction
- c. over-the-counter
- d. secondary
- e. primary

DEALER

e 15. An agent who buys and sells securities from inventory is called a:
- a. broker.
- b. trader.
- c. capitalist.
- d. principal.
- e. dealer.

BROKER

a 16. An agent who arranges security transactions among investors is called a:
a. broker.
b. trader.
c. capitalist.
d. principal.
e. dealer.

NYSE MEMBER

b 17. The owner of a seat on the New York Stock Exchange is called a(n) _____ of the exchange.
a. friend
b. member
c. agent
d. trustee
e. dealer

SPECIALIST

c 18. A member of the New York Stock Exchange acting as a dealer in one or more securities on the exchange floor is called a:
a. floor trader.
b. floor post.
c. specialist.
d. floor broker.
e. commission broker.

FLOOR BROKER

d 19. A member of the New York Stock Exchange who executes orders for commission brokers on a fee basis is a:
a. floor trader.
b. dealer.
c. specialist.
d. floor broker.
e. floor agent.

COMMISSION BROKER

e 20. A member of the New York Stock Exchange who executes buy and sell orders from customers once transmitted to the exchange floor is called a:
a. floor trader.
b. dealer.
c. specialist.
d. floor broker.
e. commission broker.

FLOOR TRADER

a 21. A member of the New York Stock Exchange who trades for his or her own account, trying to anticipate temporary price fluctuations, is called a(n):

a. floor trader.
b. exchange customer.
c. specialist.
d. floor broker.
e. commission broker.

SUPERDOT SYSTEM

b 22. The electronic system used by the New York Stock Exchange which enables orders to be transmitted directly to a specialist is called the _____ system.

a. NASDAQ
b. SuperDOT
c. Instinet
d. Internet
e. brokerage

ORDER FLOW

c 23. The stream of customer buy and sell orders for securities is referred to as the:

a. paper trail.
b. trading volume.
c. order flow.
d. bid-ask spread.
e. commission trail.

OVER-THE-COUNTER MARKET

c 24. A securities market primarily comprised of dealers who buy and sell for their own inventories is generally referred to as a(n) ___ market.

a. auction
b. private
c. over-the-counter
d. regional
e. electronic network

INSIDE QUOTES

c 25. The inside quotes for a security are the:

a. first posted bid and ask quotes of the trading day.
b. price quotes which apply only on the floor of the exchange.
c. highest bid quote and the lowest ask quote.
d. lowest bid quote and the highest ask quote.
e. averages of all the bid and ask quotes listed in the specialist's order book.

II. CONCEPTS

VALUATION OF ZERO GROWTH STOCK

c 26. The James River Co. pays an annual dividend of $1.50 per share on its common stock. This dividend amount has been constant for the past 15 years and is expected to remain constant. Given this, one share of James River Co. stock:

a. is basically worthless as it offers no growth potential.
b. has a market value equal to the present value of $1.50 paid one year from today.
c. is valued as if the dividend paid is a perpetuity.
d. is valued with an assumed growth rate of 3 percent.
e. has a market value of $15.00.

VALUATION OF ZERO GROWTH STOCK

e 27. The common stock of the Kenwith Co. pays a constant annual dividend. Thus, the market price of Kenwith stock will:

a. also remain constant.
b. increase over time.
c. decrease over time.
d. increase when the market rate of return increases.
e. decrease when the market rate of return increases.

DIVIDEND YIELD VS. CAPITAL GAINS YIELD

c 28. The Koster Co. currently pays an annual dividend of $1.00 and plans on increasing that amount by 5 percent each year. The Keyser Co. currently pays an annual dividend of $1.00 and plans on increasing their dividend by 3 percent annually. Given this, it can be stated with certainty that the _____ of the Koster Co. stock is greater than the _____ of the Keyser Co. stock.

a. market price; market price
b. dividend yield; dividend yield
c. rate of capital gain; rate of capital gain
d. total return; total return
e. capital gains; dividend yield

DIVIDEND GROWTH MODEL

d 29. The dividend growth model:

I. assumes that dividends increase at a constant rate forever.
II. can be used to compute a stock price at any point of time.
III. states that the market price of a stock is only affected by the amount of the dividend.
IV. considers capital gains but ignores the dividend yield.

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

DIVIDEND GROWTH MODEL

b 30. The underlying assumption of the dividend growth model is that a stock is worth:
- a. the same amount to every investor regardless of their desired rate of return.
- b. the present value of the future income which the stock generates.
- c. an amount computed as the next annual dividend divided by the market rate of return.
- d. the same amount as any other stock that pays the same current dividend and has the same required rate of return.
- e. an amount computed as the next annual dividend divided by the required rate of return.

DIVIDEND GROWTH MODEL

c 31. Assume that you are using the dividend growth model to value stocks. If you expect the market rate of return to increase across the board on all equity securities, then you should also expect the:
- a. market values of all stocks to increase, all else constant.
- b. market values of all stocks to remain constant as the dividend growth will offset the increase in the market rate.
- c. market values of all stocks to decrease, all else constant.
- d. stocks that do not pay dividends to decrease in price while the dividend-paying stocks maintain a constant price.
- e. dividend growth rates to increase to offset this change.

NONCONSTANT GROWTH

c 32. Latcher's Inc. is a relatively new firm that is still in a period of rapid development. The company plans on retaining all of its earnings for the next six years. Seven years from now, the company projects paying an annual dividend of $.25 a share and then increasing that amount by 3 percent annually thereafter. To value this stock as of today, you would most likely determine the value of the stock _____ years from today before determining today's value.
- a. 4
- b. 5
- c. 6
- d. 7
- e. 8

NONCONSTANT GROWTH

d 33. The Robert Phillips Co. currently pays no dividend. The company is anticipating dividends of $0, $0, $0, $.10, $.20, and $.30 over the next 6 years, respectively. After that, the company anticipates increasing the dividend by 4 percent annually. The first step in computing the value of this stock today, is to compute the value of the stock in year:
- a. 3.
- b. 4.
- c. 5.
- d. 6.
- e. 7.

SUPERNORMAL GROWTH

b 34. Supernormal growth refers to a firm that increases its dividend by:
- a. three or more percent per year.
- b. a rate which is most likely not sustainable over an extended period of time.
- c. a constant rate of 2 or more percent per year.
- d. $.10 or more per year.
- e. an amount in excess of $.10 a year.

DIVIDEND YIELD AND CAPITAL GAINS

e 35. The total rate of return earned on a stock is comprised of which two of the following?
- I. current yield
- II. yield to maturity
- III. dividend yield
- IV. capital gains yield
- a. I and II only
- b. I and IV only
- c. II and III only
- d. II and IV only
- e. III and IV only

DIVIDEND YIELD

c 36. The total rate of return on a stock can be positive even when the price of the stock depreciates because of the:
- a. capital appreciation.
- b. interest yield.
- c. dividend yield.
- d. supernormal growth.
- e. real rate of return.

DIVIDEND YIELD AND CAPITAL GAINS

c 37. Fred Flintlock wants to earn a total of 10 percent on his investments. He recently purchased shares of ABC stock at a price of $20 a share. The stock pays a $1 a year dividend. The price of ABC stock needs to _____ if Fred is to achieve his 10 percent rate of return.
- a. remain constant
- b. decrease by 5 percent
- c. increase by 5 percent
- d. increase by 10 percent
- e. increase by 15 percent

DIVIDEND GROWTH MODEL

d 38. Which one of the following correctly defines the dividend growth model?
- a. $P_0 = D_0 \div (R-g)$
- b. $D = P_0 \times (R-g)$
- c. $R = (P_0 \div D_0) + g$
- d. $R = (D_1 \div P_0) + g$
- e. $P_0 = (D_1 \div R) + g$

SHAREHOLDER RIGHTS

a 39. Shareholders generally have the right to:
- I. elect the corporate directors.
- II. select the senior management of the firm.
- III. elect the chief executive officer (CEO).
- IV. elect the chief operating officer (COO).
- a. I only
- b. I and III only
- c. II only
- d. I and II only
- e. III and IV only

CUMULATIVE VOTING

c 40. Jack owns 35 shares of stock in Beta, Inc. and wants to exercise as much control as possible over the company. Beta, Inc. has a total of 100 shares of stock outstanding. Each share receives one vote. Presently, the company is voting to elect two new directors. Which one of the following statements must be true given this information?
- a. If straight voting applies, Jack is assured one seat on the board.
- b. If straight voting applies, Jack can control both open seats.
- c. If cumulative voting applies, Jack is assured one seat on the board.
- d. If cumulative voting applies, Jack can control both open seats.
- e. Regardless of the type of voting employed, Jack does not own enough shares to control any of the seats.

STRAIGHT VOTING

a 41. ABC Co. is owned by a group of shareholders who all vote independently and who all want personal control over the firm. If straight voting is utilized, a shareholder:
- a. must either own enough shares to totally control the elections or else he/she has no control whatsoever.
- b. will be able to elect at least one director as long as there are at least three open positions and the shareholder owns at least 25 percent plus one of the outstanding shares.
- c. must own at least two-thirds of the shares, plus one, to exercise control over the elections.
- d. is only permitted to elect one director, regardless of the number of shares owned.
- e. who owns more shares than anyone else, regardless of the number of shares owned, will control the elections.

PROXY VOTING

e 42. The Zilo Corp. has 1,000 shareholders and is preparing to elect three new board members. You do not own enough shares to control the elections but are determined to oust the current leadership. The most likely result of this situation is a:
- a. negotiated settlement where you are granted control over one of the three open positions.
- b. legal battle for control of the firm based on your discontent as an individual shareholder.
- c. arbitrated settlement whereby you are granted control over one of the three open positions.
- d. total loss of power for you since you are a minority shareholder.
- e. proxy fight for control of the firm.

SHAREHOLDER RIGHTS

e 43. Common stock shareholders are generally granted rights which include the right to:
- I. share in company profits.
- II. vote for company directors.
- III. vote on proposed mergers.
- IV. residual assets in a liquidation.
- a. I and II only
- b. II and III only
- c. I and IV only
- d. I, II, and IV only
- e. I, II, III, and IV

DIVIDENDS

e 44. The Scott Co. has a general dividend policy whereby they pay a constant annual dividend of $1 per share of common stock. The firm has 1,000 shares of stock outstanding. The company:
- a. must always show a current liability of $1,000 for dividends payable.
- b. is obligated to continue paying $1 per share per year.
- c. will be declared in default and can face bankruptcy if they do not pay $1 per year to each shareholder on a timely basis.
- d. has a liability which must be paid at a later date should the company miss paying an annual dividend payment.
- e. must still declare each dividend before it becomes an actual company liability.

DIVIDENDS

b 45. The dividends paid by a corporation:
- I. to an individual become taxable income of that individual.
- II. reduce the taxable income of the corporation.
- III. are declared by the chief financial officer of the corporation.
- IV. to another corporation may or may not represent taxable income to the recipient.
- a. I only
- b. I and IV only
- c. II and III only
- d. I, II, and IV only
- e. I, III, and IV only

PREFERRED STOCK

a 46. The owner of preferred stock:
- a. is entitled to a distribution of income prior to the common shareholders.
- b. has the right to veto the outcome of an election held by the common shareholders.
- c. has the right to declare the company bankrupt whenever there are insufficient funds to pay dividends to the common shareholders.
- d. receives tax-free dividends if they are an individual and own more than 20 percent of the outstanding preferred shares.
- e. has the right to collect payment on any unpaid dividends as long as the stock is noncumulative preferred.

PREFERRED STOCK

b 47. A 6 percent preferred stock pays _____ a year in dividends per share.

a. $3
b. $6
c. $12
d. $30
e. $60

PREFERRED STOCK

e 48. Which one of the following statements concerning preferred stock is correct?

a. Unpaid preferred dividends are a liability of the firm.
b. Preferred dividends must be paid quarterly provided the firm has net income that exceeds the amount of the quarterly dividend.
c. Preferred dividends must be paid timely each quarter or the unpaid dividends start accruing interest.
d. All unpaid dividends on preferred stock, regardless of the type of preferred, must be paid before any income can be distributed to common shareholders.
e. Preferred shareholders may be granted voting rights and seats on the board if preferred dividend payments remain unpaid.

PREFERRED STOCK

e 49. In a liquidation, each share of 5 percent preferred stock is generally entitled to a liquidation payment of _____ as long as there are sufficient funds available.

a. $1
b. $5
c. $10
d. $50
e. $100

QUARTERLY INCOME PREFERRED SECURITIES

b 50. Quarterly income preferred securities distribute payments to investors which are:

I. taxed like interest income for tax purposes if the income recipient is an individual.
II. excluded from the taxable income of any individual recipient.
III. distributed from the after-tax income of the corporation.
IV. tax deductible to the corporation.

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

PRIMARY MARKET

d 51. Which one of the following transactions occurs in the primary market?

a. the sale of ABC stock by Fred Jones to Mary Smith
b. the tax-free gift of DEF stock to Heather by Jennifer
c. the repurchase of GHI stock from Tim by GHI
d. the initial sale of JKL stock by JKL to Jamie
e. the transfer of MNO stock from Tom to his son, Jon

DEALERS AND BROKERS

d 52. Which one of the following statements concerning dealers and brokers is correct?
- a. A dealer in market securities arranges sales between buyers and sellers for a fee.
- b. A dealer in market securities pays the asked price when purchasing securities.
- c. A broker in market securities earns income in the form of a bid-ask spread.
- d. A broker does not take ownership of the securities being traded.
- e. A broker deals solely in the primary market.

NEW YORK STOCK EXHANGE

a 53. Technically, the actual owners of the New York Stock Exchange are its:
- a. members.
- b. specialists.
- c. dealers.
- d. floor brokers.
- e. commission brokers.

FLOOR BROKERS

d 54. Which one of the following players on the floor of the New York Stock Exchange can be likened to part-time help in that they are called to duty only when others are fully employed?
- a. floor trader
- b. specialist
- c. dealer
- d. floor broker
- e. commission broker

SPECIALIST'S POST

b 55. The post is a stationary position on the floor of the New York Stock Exchange where a _____ is assigned to work.
- a. floor trader
- b. specialist
- c. dealer
- d. floor broker
- e. commission broker

STOCK MARKET REPORTING

d 56. The closing price of a stock is quoted at 22.87, with a P/E of 26 and a net change of 1.42. Based on this information, which one of the following statements is correct?
- a. The closing price on the previous day was $1.42 higher than today's closing price.
- b. A dealer will buy the stock at $22.87 and sell it at $26 a share.
- c. The stock increased in value between yesterday's close and today's close by $.0142.
- d. The earnings per share are equal to $1/26^{th}$ of $22.87.
- e. The earnings per share have increased by $1.42 this year.

STOCK QUOTE

b 57. A stock listing contains the following information: P/E 17.5, closing price 33.10, dividend .80, YTD % chg 3.4, and a net chg of -.50. Which of the following statements are correct given this information?

I. The stock price has increased by 3.4 percent during the current year.
II. The closing price on the previous trading day was $32.60.
III. The earnings per share are approximately $1.89.
IV. The current yield is 17.5 percent.

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

III. PROBLEMS

STOCK VALUE

d 58. Michael’s, Inc. just paid $1.40 to their shareholders as the annual dividend. Simultaneously, the company announced that future dividends will be increasing by 4.5 percent. If you require an 8 percent rate of return, how much are you willing to pay to purchase one share of Michael’s stock?

a. $31.11
b. $32.51
c. $40.00
d. $41.80
e. $43.68

STOCK VALUE

e 59. Angelina’s made two announcements concerning their common stock today. First, the company announced that their next annual dividend has been set at $2.16 a share. Secondly, the company announced that all future dividends will increase by 4 percent annually. What is the maximum amount you should pay to purchase a share of Angelina’s stock if your goal is to earn a 10 percent rate of return?

a. $21.60
b. $22.46
c. $27.44
d. $34.62
e. $36.00

STOCK VALUE

d 60. How much are you willing to pay for one share of stock if the company just paid an $.80 annual dividend, the dividends increase by 4 percent annually and you require an 8 percent rate of return?

a. $19.23
b. $20.00
c. $20.40
d. $20.80
e. $21.63

STOCK VALUE

d 61. Lee Hong Imports paid a $1.00 per share annual dividend last week. Dividends are expected to increase by 5 percent annually. What is one share of this stock worth to you today if the appropriate discount rate is 14 percent?

a. $7.14
b. $7.50
c. $11.11
d. $11.67
e. $12.25

STOCK VALUE

c 62. Majestic Homes stock traditionally provides an 8 percent rate of return. The company just paid a $2 a year dividend which is expected to increase by 5 percent per year. If you are planning on buying 1,000 shares of this stock next year, how much should you expect to pay per share if the market rate of return for this type of security is 9 percent at the time of your purchase?

a. $48.60
b. $52.50
c. $55.13
d. $57.89
e. $70.00

STOCK VALUE

c 63. Leslie's Unique Clothing Stores offers a common stock that pays an annual dividend of $2.00 a share. The company has promised to maintain a constant dividend. How much are you willing to pay for one share of this stock if you want to earn 12 percent return on your equity investments?

a. $10.00
b. $13.33
c. $16.67
d. $18.88
e. $20.00

STOCK VALUE

b 64. Martin's Yachts has paid annual dividends of $1.40, $1.75, and $2.00 a share over the past three years, respectively. The company now predicts that it will maintain a constant dividend since its business has leveled off and sales are expected to remain relatively constant. Given the lack of future growth, you will only buy this stock if you can earn at least a 15 percent rate of return. What is the maximum amount you are willing to pay to buy one share of this stock today?

a. $10.00
b. $13.33
c. $16.67
d. $18.88
e. $20.00

REQUIRED RETURN

c 65. The common stock of Eddie's Engines, Inc. sells for $25.71 a share. The stock is expected to pay $1.80 per share next month when the annual dividend is distributed. Eddie's has established a pattern of increasing their dividends by 4 percent annually and expects to continue doing so. What is the market rate of return on this stock?

a. 7 percent
b. 9 percent
c. 11 percent
d. 13 percent
e. 15 percent

REQUIRED RETURN

a 66. The current yield on Alpha's common stock is 4.8 percent. The company just paid a $2.10 dividend. The rumor is that the dividend will be $2.205 next year. The dividend growth rate is expected to remain constant at the current level. What is the required rate of return on Alpha's stock?

a. 10.04 percent
b. 16.07 percent
c. 21.88 percent
d. 43.75 percent
e. 45.94 percent

REQUIRED RETURN

e 67. Martha's Vineyard recently paid a $3.60 annual dividend on their common stock. This dividend increases at an average rate of 3.5 percent per year. The stock is currently selling for $62.10 a share. What is the market rate of return?

a. 2.5 percent
b. 3.5 percent
c. 5.5 percent
d. 6.0 percent
e. 9.5 percent

REQUIRED RETURN

d 68. Bet'R Bilt Bikes just announced that their annual dividend for this coming year will be $2.42 a share and that all future dividends are expected to increase by 2.5 percent annually. What is the market rate of return if this stock is currently selling for $22 a share?

a. 9.5 percent
b. 11.0 percent
c. 12.5 percent
d. 13.5 percent
e. 15.0 percent

DIVIDEND YIELD VS. CAPITAL GAINS YIELD

b 69. Shares of common stock of the Samson Co. offer an expected total return of 12 percent. The dividend is increasing at a constant 8 percent per year. The dividend yield must be:
a. - 4 percent.
b. 4 percent.
c. 8 percent.
d. 12 percent.
e. 20 percent.

CAPITAL GAIN

c 70. The common stock of Grady Co. returned an 11.25 percent rate of return last year. The dividend amount was $.70 a share which equated to a dividend yield of 1.5 percent. What was the rate of price appreciation on the stock?
a. 1.50 percent
b. 8.00 percent
c. 9.75 percent
d. 11.25 percent
e. 12.75 percent

DIVIDEND AMOUNT

b 71. Weisbro and Sons common stock sells for $21 a share and pays an annual dividend that increases by 5 percent annually. The market rate of return on this stock is 9 percent. What is the amount of the last dividend paid by Weisbro and Sons?
a. $.77
b. $.80
c. $.84
d. $.87
e. $.88

DIVIDEND AMOUNT

d 72. The common stock of Energizer’s pays an annual dividend that is expected to increase by 10 percent annually. The stock commands a market rate of return of 12 percent and sells for $60.50 a share. What is the expected amount of the next dividend to be paid on Energizer’s common stock?
a. $.90
b. $1.00
c. $1.10
d. $1.21
e. $1.33

DIVIDEND AMOUNT

d 73. The Reading Co. has adopted a policy of increasing the annual dividend on their common stock at a constant rate of 3 percent annually. The last dividend they paid was $0.90 a share. What will their dividend be in six years?
a. $.90
b. $.93
c. $1.04
d. $1.07
e. $1.11

CONSTANT DIVIDEND

e 74. A stock pays a constant annual dividend and sells for $31.11 a share. If the rate of return on this stock is 9 percent, what is the dividend amount?
- a. $1.40
- b. $1.80
- c. $2.20
- d. $2.40
- e. $2.80

CONSTANT DIVIDEND

b 75. You have decided that you would like to own some shares of GH Corp. but need an expected 12 percent rate of return to compensate for the perceived risk of such ownership. What is the maximum you are willing to spend per share to buy GH stock if the company pays a constant $3.50 annual dividend per share?
- a. $26.04
- b. $29.17
- c. $32.67
- d. $34.29
- e. $36.59

GROWTH DIVIDEND

e 76. Turnips and Parsley common stock sells for $39.86 a share at a market rate of return of 9.5 percent. The company just paid their annual dividend of $1.20. What is the rate of growth of their dividend?
- a. 5.2 percent
- b. 5.5 percent
- c. 5.9 percent
- d. 6.0 percent
- e. 6.3 percent

GROWTH DIVIDEND

c 77. B&K Enterprises will pay an annual dividend of $2.08 a share on their common stock next week. Last year, the company paid a dividend of $2.00 a share. The company adheres to a constant rate of growth dividend policy. What will one share of B&K common stock be worth ten years from now if the applicable discount rate is 8 percent?
- a. $71.16
- b. $74.01
- c. $76.97
- d. $80.05
- e. $83.25

GROWTH DIVIDEND

d 78. Wilbert's Clothing Stores just paid a $1.20 annual dividend. The company has a policy whereby the dividend increases by 2.5 percent annually. You would like to purchase 100 shares of stock in this firm but realize that you will not have the funds to do so for another three years. If you desire a 10 percent rate of return, how much should you expect to pay for 100 shares when you can afford to buy this stock? Ignore trading costs.

a. $1,640
b. $1,681
c. $1,723
d. $1,766
e. $1,810

GROWTH DIVIDEND

b 79. The Merriweather Co. just announced that they are increasing their annual dividend to $1.60 and establishing a policy whereby the dividend will increase by 3.5 percent annually thereafter. How much will one share of this stock be worth five years from now if the required rate of return is 12 percent?

a. $21.60
b. $22.36
c. $23.14
d. $23.95
e. $24.79

GROWTH DIVIDEND

b 80. Shares of the Katydid Co. common stock are currently selling for $27.73. The last dividend paid was $1.60 per share. The market rate of return is 10 percent. At what rate is the dividend growing?

a. 2.50 percent
b. 4.00 percent
c. 5.98 percent
d. 13.05 percent
e. 14.91 percent

SUPERNORMAL GROWTH

c 81. The Bell Weather Co. is a new firm in a rapidly growing industry. The company is planning on increasing its annual dividend by 20 percent a year for the next four years and then decreasing the growth rate to 5 percent per year. The company just paid its annual dividend in the amount of $1.00 per share. What is the current value of one share of this stock if the required rate of return is 9.25 percent?

a. $35.63
b. $38.19
c. $41.05
d. $43.19
e. $45.81

SUPERNORMAL GROWTH

c 82. The Extreme Reaches Corp. last paid a $1.50 per share annual dividend. The company is planning on paying $3.00, $5.00, $7.50, and $10.00 a share over the next four years, respectively. After that the dividend will be a constant $2.50 per share per year. What is the market price of this stock if the market rate of return is 15 percent?

a. $17.04
b. $22.39
c. $26.57
d. $29.08
e. $33.71

SUPERNORMAL GROWTH

d 83. Can't Hold Me Back, Inc. is preparing to pay their first dividends. They are going to pay $1.00, $2.50, and $5.00 a share over the next three years, respectively. After that, the company has stated that the annual dividend will be $1.25 per share indefinitely. What is this stock worth to you per share if you demand a 7 percent rate of return?

a. $7.20
b. $14.48
c. $18.88
d. $21.78
e. $25.06

NONCONSTANT DIVIDENDS

c 84. NU YU announced today that they will begin paying annual dividends. The first dividend will be paid next year in the amount of $.25 a share. The following dividends will be $.40, $.60, and $.75 a share annually for the following three years, respectively. After that, dividends are projected to increase by 3.5 percent per year. How much are you willing to pay to buy one share of this stock if your desired rate of return is 12 percent?

a. $1.45
b. $5.80
c. $7.25
d. $9.06
e. $10.58

NONCONSTANT DIVIDENDS

b 85. Now or Later, Inc. recently paid $1.10 as an annual dividend. Future dividends are projected at $1.14, $1.18, $1.22, and $1.25 over the next four years, respectively. Beginning five years from now, the dividend is expected to increase by 2 percent annually. What is one share of this stock worth to you if you require an 8 percent rate of return on similar investments?

a. $15.62
b. $19.57
c. $21.21
d. $23.33
e. $25.98

NONCONSTANT DIVIDENDS

b 86. The Red Bud Co. pays a constant dividend of $1.20 a share. The company announced today that they will continue to do this for another 3 years after which time they will discontinue paying dividends permanently. What is one share of this stock worth today if the required rate of return is 7 percent?

a. $2.94
b. $3.15
c. $3.23
d. $3.44
e. $3.60

NONCONSTANT DIVIDENDS

b 87. Bill Bailey and Sons pays no dividend at the present time. The company plans to start paying an annual dividend in the amount of $.30 a share for two years commencing two years from today. After that time, the company plans on paying a constant $1 a share dividend indefinitely. How much are you willing to pay to buy a share of this stock if your required return is 14 percent?

a. $4.82
b. $5.25
c. $5.39
d. $5.46
e. $5.58

NONCONSTANT DIVIDENDS

a 88. The Lighthouse Co. is in a downsizing mode. The company paid a $2.50 annual dividend last year. The company has announced plans to lower the dividend by $.50 a year. Once the dividend amount becomes zero, the company will cease all dividends permanently. You place a required rate of return of 16 percent on this particular stock given the company's situation. What is one share of this stock worth to you today?

a. $3.76
b. $4.08
c. $4.87
d. $5.13
e. $5.39

NONCONSTANT DIVIDENDS

e 89. Mother and Daughter Enterprises is a relatively new firm that appears to be on the road to great success. The company paid their first annual dividend yesterday in the amount of $.28 a share. The company plans to double each annual dividend payment for the next three years. After that time, they are planning on paying a constant $1.50 per share indefinitely. What is one share of this stock worth today if the market rate of return on similar securities is 11.5 percent?

a. $9.41
b. $11.40
c. $11.46
d. $11.93
e. $12.43

NONCONSTANT DIVIDENDS

a 90. BC ‘n D just paid their annual dividend of $.60 a share. The projected dividends for the next five years are $.30, $.50, $.75, $1.00, and $1.20, respectively. After that time, the dividends will be held constant at $1.40. What is this stock worth today at a 6 percent discount rate?

a. $20.48
b. $20.60
c. $21.02
d. $21.28
e. $21.43

NONCONSTANT DIVIDENDS

b 91. Beaksley, Inc. is a very cyclical type of business which is reflected in their dividend policy. The firm pays a $2.00 a share dividend every other year. The last dividend was paid last year. Five years from now, the company is repurchasing all of the outstanding shares at a price of $50 a share. At an 8 percent rate of return, what is this stock worth today?

a. $34.03
b. $37.21
c. $43.78
d. $48.09
e. $53.18

NEGATIVE GROWTH

a 92. Last week, Railway Cabooses paid their annual dividend of $1.20 per share. The company has been reducing the dividends by 10 percent each year. How much are you willing to pay to purchase stock in this company if your required rate of return is 14 percent?

a. $4.50
b. $7.71
c. $10.80
d. $15.60
e. $27.00

NEGATIVE GROWTH

b 93. Nu-Tek, Inc. is expecting a period of intense growth so have decided to retain more of their earnings to help finance that growth. As a result they are going to reduce their annual dividend by 10 percent a year for the next three years. After that they will maintain a constant dividend of $.70 a share. Last year, the company paid $1.80 per share. What is the market value of this stock if the required rate of return is 13 percent?

a. $6.79
b. $7.22
c. $8.22
d. $8.87
e. $9.01

NEGATIVE GROWTH

c 94. The Double Dip Co. is expecting their ice cream sales to decline due to the increased interest in healthy eating. Thus, the company has announced that they will be reducing their annual dividend by 5 percent a year for the next two years. After that, they will maintain a constant dividend of $1 a share. Last year, the company paid $1.40 per share. What is this stock worth to you if you require a 9 percent rate of return?

a. $10.86
b. $11.11
c. $11.64
d. $12.98
e. $14.23

PREFERRED STOCK

d 95. Butterup's 'N More wants to offer some preferred stock that pays an annual dividend of $2.00 a share. The company has determined that stocks with similar characteristics provide a 9 percent rate of return. What price should Butterup's expect to receive per share for this stock offering?

a. $18.35
b. $20.00
c. $21.80
d. $22.22
e. $24.22

PREFERRED STOCK

c 96. The preferred stock of North Coast Shoreline pays an annual dividend of $1.70 and sells for $20.24 a share. What is the rate of return on this security?

a. 5.95 percent
b. 7.08 percent
c. 8.40 percent
d. 11.90 percent
e. 14.17 percent

PREFERRED STOCK

a 97. Jim owns shares of Abco, Inc. preferred stock which he says provides him with a constant 6.58 percent rate of return. The stock is currently priced at $45.60 a share. What is the amount of the dividend per share?

a. $3.00
b. $3.15
c. $3.50
d. $3.54
e. $3.62

PREFERRED STOCK

b 98. You want to earn a 12 percent rate of return. Panco, Inc. preferred stock pays a $4.50 annual dividend. What is the maximum price you are willing to pay for one share of this stock?

a. $32.50
b. $37.50
c. $39.00
d. $40.50
e. $45.00

IV. ESSAYS

NYSE MEMBERS

99. List the four types of New York Stock Exchange members and give a brief definition of what each member does.

This is a simple listing question, the answer to which should include:

1. Commission broker: Executes customer orders to buy/sell stock as transmitted to the exchange floor
2. Specialist (market maker): Acts as a dealer in a small number of securities on the exchange floor
3. Floor broker: Executes orders for commission brokers on a fee basis
4. Floor trader: Trades for their own account in an attempt to profit on temporary price fluctuations

NASDAQ VS. NYSE

100. What are the primary differences between NASDAQ and the NYSE?

According to the basic information in the text, the NYSE has a physical location, while NASDAQ does not. NASDAQ has multiple market makers while the NYSE utilizes specialists for each security traded. Also, NASDAQ is a dealer market while the NYSE utilizes brokers.

REQUIRED RETURN

101. What are the components of the required rate of return on a share of stock? Briefly explain each component.

The two components are dividend yield, which measures the annual percentage income return on a stock, and the capital gains yield, which is the percentage of price appreciation or depreciation.

PREFERRED VS. COMMON STOCK

102. Briefly explain the differences between preferred and common stock.

Common stockholders have the right to vote on corporate matters and have the right to receive the residual value of the firm after all liabilities and preferred stockholders are paid in a liquidation. Preferred stockholders have a promised dividend, may or may not have the right to collect dividends that have been passed, and typically will be rated much like bonds. In a liquidation, preferred shareholders have a preference over common stockholders.

STOCKS VS. BONDS

103. Explain whether it is easier to find the required return on a publicly traded stock or a publicly traded bond, and explain why.

Bonds, unlike stocks, have a final maturity date and promised payments at fixed periods of time. Thus, once an appropriate discount rate is established, valuing a bond is relatively simple. For stocks, the only valuation model we have up to this point in the text is the dividend growth model which requires estimation of a dividend growth rate and also requires that certain conditions be met before the dividend growth model can be applied. Normally, all of the information required to find the yield on a publicly traded bond is publicly available while only the price and the most current dividend are available for stocks.

ZERO-DIVIDEND STOCKS

104. A number of publicly traded firms pay no dividends yet investors are willing to buy shares in these firms. How is this possible? Does this violate our basic principle of stock valuation? Explain.

Our basic principle of stock valuation is that the value of a share of stock is simply equal to the present value of all of the expected dividends on the stock. According to the dividend growth model, an asset that has no expected cash flows has a value of zero, so if investors are willing to purchase shares of stock in firms that pay no dividends, they evidently expect that the firms will begin paying dividends at some point in the future.

CLASSES OF STOCK

105. A firm has two classes of common stock outstanding: Class A, which carries voting rights of 10 votes per share but receives no dividends (ever), and Class B, which carries voting rights of 1 vote per share and pays dividends whenever they are declared by the board. Which would you be willing to pay more for and why?

This is a very open-ended question to get the students thinking about the differing interests of investors. Management of the firm would likely prefer Class A while investors interested in dividends would likely prefer Class B shares. The Class B shares with their ordinary voting rights and dividends can be valued using the dividend growth model but the Class A shares, whose value is derived completely from the voting rights, would be very difficult to value.