1. A bond has a coupon rate of 10% and it is currently traded at its par value of $1000. Which of the following must be true?

- **A.** The current market interest rate for this bond is 10%.
- **B.** One cannot compute this bond’s yield to maturity without a financial calculator.
- **C.** Both A and B
- **D.** Neither A nor B
- **E.**

2. You are evaluating the purchase of Cool Toys, Inc. common stock that just paid a dividend of $1.80. You expect the dividend to grow at a rate of 12%, indefinitely. You estimate that a required rate of return of 17.5% will be adequate compensation for this investment. Assuming that your analysis is correct, what is the most that you would be willing to pay for the common stock if you were to purchase it today? Round to the nearest $.01.

- **A.** $74.82
- **B.** $51.55
- **C.** $36.65
- **D.** $91.23

3. You are considering the purchase of Miller Manufacturing, Inc.’s common stock. The stock is selling for $21.00 per share. The next dividend is expected to be $2.10, and you expect the dividend to keep growing at a constant rate. If the stock is returning 15%, calculate the growth rate of dividends.

- **A.** 10%
- **B.** 3%
- **C.** 8%
- **D.** 5%
4. Which of the following best describes a firm's cost of capital?

- A. The average yield to maturity on debt
- B. The average cost of the firm's assets
- C. The rate of return that must be earned on its investments in order to satisfy the firm's investors
- D. The coupon rate on preferred stock

5. Green Company's common stock is currently selling at $24.00 per share. The company recently paid dividends of $1.92 per share and projects growth at a rate of 4%. At this rate, what is the stock's expected rate of return?

- A. 8.80%
- B. 8.00%
- C. 12.32%
- D. 12.00%

6. The yield to maturity on a bond:

- A. is fixed in the indenture.
- B. is the required return on the bond.
- C. is lower for higher – risk bonds.
- D. is generally equal to the coupon interest rate.
7. A firm currently has the following capital structure which it intends to maintain. Debt: $3,000,000 par value of 9% bonds outstanding with an annual before-tax yield to maturity of 7.67% on a new issue. The bonds currently sell for $115 per $100 par value. Common stock: 46,000 shares outstanding currently selling for $50 per share. The firm expects to pay a $5.50 dividend per share one year from now and is experiencing a 3.67% growth rate in dividends, which it expects to continue indefinitely. The firm's marginal tax rate is 40%. The company has no plans to issue new securities. The firm's weighted average cost of capital is:

- [ ] A. 8.63%.
- [ ] B. 7.71%.
- [ ] C. 10.47%.
- [ ] D. 9.29%.

8. The retail analyst at Morgan – Sachs values stock of the GAP at $28.00 per share. They are using the average industry P/E ratio of 15. Their forecasted earnings per share for next year is:

- [ ] A. $1.50.
- [ ] B. $1.87.
- [ ] C. $0.54.
- [ ] D. There is not enough information to calculate earnings per share.

9. Company A is expected to have an earnings per share (EPS) of $2 for next year, with full payout (dividends = earnings). The current riskfree rate is 5%. The stock has a beta of 2. If we assume that the company's earnings will be growing at a constant rate and that the expected risk premium on the company's stock is equal to its earnings growth rate, do we have enough information to value the company's stock?

- [ ] A. No. We do not have enough information to value the stock.
- [ ] B. Yes. The stock is worth $40 per share.
- [ ] C. Yes. The stock is worth $2 per share.
- [ ] D. Yes. The stock is worth $20 per share.
10. Acme Consolidated has a return on equity of 12%. If Acme distributes 60% of earnings as dividends, then we would expect the common shareholders' investment in the firm and the value of the common stock to grow by:

- [ ] A. 7.20%.
- [ ] B. 6%.
- [ ] C. 4.80%.
- [ ] D. 12%.

11. Bond ratings are usually not affected by:

- [ ] A. variability in earnings.
- [ ] B. firm size.
- [ ] C. the company's fiscal year end.
- [ ] D. profitable operations.

12. An issue of common stock currently sells for $40.00 per share, has an expected dividend to be paid at the end of the year of $2.00 per share, and has an expected growth rate to infinity of 5% per year. The expected rate of return on this security is:

- [ ] A. 5%.
- [ ] B. 13.11%.
- [ ] C. 10.25%.
- [ ] D. 10%.
13. Quirk Drugs sold an issue of 30-year, $1,000 par value bonds to the public that carry a 10.85% coupon rate, payable semiannually. It is now 10 years later, and the current market rate of interest is 9.00%. If interest rates remain at 9.00% until Quirk's bonds mature, what will happen to the value of the bonds over time?

☐ A. The bonds will sell at a discount and rise in value until maturity.
☐ B. The bonds will sell at a premium and rise in value until maturity.
☐ C. The bonds will sell at a premium and decline in value until maturity.
☐ D. The bonds will sell at a discount and fall in value until maturity.

14. The George Company, Inc., has two issues of debt. Issue A has a maturity value of 8 million dollars, a coupon rate of 8%, paid annually, and is selling at par. Issue B was issued as a 15-year bond 5 years ago. Its coupon rate is 9%, paid annually. Investors demand a pre-tax return of 9.3% on this bond. The current market value of Issue B is 6 million dollars. The George company has a marginal tax rate of 35%. What is the company's after tax cost of debt?

☐ A. 8.47%
☐ B. 5.56%
☐ C. 4.73%
☐ D. 7.36%

15. Sonderson is undertaking a capital budgeting analysis. The firm's beta is 1.5. The riskfree rate is 5%, and the expected market risk premium is 12%. What is the appropriate cost of common equity in determining the firm's cost of capital?

☐ A. 17.7%
☐ B. 19.9%
☐ C. 23.0%
☐ D. 15.5%
16. Fris B. Corporation stock is currently selling for $42.86. It is expected to pay a dividend of $3.00 at the end of the year. Dividends are expected to grow at a constant rate of 3% indefinitely. Compute the required rate of return on FBC stock.

   ○ A. 7%
   ○ B. 10%
   ○ C. 33%
   ○ D. 4.3%

17. KDP's most recent dividend was $2.00 per share and is selling today in the market for $70. The dividend is expected to grow at a rate of 7% per year for the foreseeable future. If the market return is 10% on investments with comparable risk, should you purchase the stock?

   ○ A. No, because the stock is overpriced $1.33.
   ○ B. No, because the stock is overpriced $3.33.
   ○ C. Yes, because the stock is underpriced $1.33.
   ○ D. Yes, because the stock is underpriced $3.33.

18. White Sink, Inc. just paid a dividend of $5.55 per share on its common stock, and the firm is expected to generate constant growth of 12.25% over the foreseeable future. The common stock is currently selling for $73.75 per share. The firm's dividend payout ratio is 40%, and White's marginal tax rate is 40%. What is the rate of return that common stockholders expect? Round to the nearest 0.1%.

   ○ A. 8.5%
   ○ B. 15.5%
   ○ C. 4.8%
   ○ D. 20.7%
19. A $1,000 par value 10-year bond with a 10% coupon rate recently sold for $900. The yield to maturity:

☐ A. is greater than 10%.
☐ B. is less than 10%.
☐ C. is 10%.
☐ D. cannot be determined.

20. Which of the following is generally NOT a characteristic of a bond?

☐ A. Par value
☐ B. Claims on assets and income
☐ C. Voting rights
☐ D. Indenture
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