**Multiple Choice Questions (Chapter 4):**

1. The valuation of a common stock today primarily depends on:

|  |  |
| --- | --- |
| A.  | the number of shares outstanding and the number of its shareholders. |

|  |  |
| --- | --- |
| **B**.  | its expected future dividends and its discount rate. |

|  |  |
| --- | --- |
| C.  | Wall Street analysts. |

|  |  |
| --- | --- |
| D.  | the present value of its future earnings per share and its discount rate. |

2. CK Company stockholders expect to receive a year-end dividend of $5 per share and then immediately sell their shares for $115 dollars per share. If the required rate of return for the stock is 20%, what is the current value of the stock?

|  |  |
| --- | --- |
| A.  | $132 |

|  |  |
| --- | --- |
| B.  | $122 |

|  |  |
| --- | --- |
| **C**.  | $100 |

|  |  |
| --- | --- |
| D.  | $110 |

P = (115 + 5) / (1 + 0.2) = 100

3. Casino Inc. expects to pay a dividend of $3 per share at the end of year 1 (*D*1) and these dividends are expected to grow at a constant rate of 6% per year forever. If the required rate of return on the stock is 18%, what is the current value of the stock today?

|  |  |
| --- | --- |
| **A**.  | $25 |

|  |  |
| --- | --- |
| B.  | $50 |

|  |  |
| --- | --- |
| C.  | $100 |

|  |  |
| --- | --- |
| D.  | $54 |

P = 3 / (0.18 – 0.06) = 25

4. Will Co. is expected to pay a dividend of $2 per share at the end of year 1(*D*1), and the dividends are expected to grow at a constant rate of 4% forever. If the current price of the stock is $20 per share, calculate the expected return or the cost of equity capital for the firm.

|  |  |
| --- | --- |
| A.  | 10% |

|  |  |
| --- | --- |
| B.  | 4% |

|  |  |
| --- | --- |
| **C**.  | 14% |

|  |  |
| --- | --- |
| D.  | 20% |

R = 2/20 + 0.04 = 0.14

5. One can estimate the dividend growth rate for a stable firm as:

|  |  |
| --- | --- |
| A.  | plow-back rate/the return on equity (ROE). |

|  |  |
| --- | --- |
| B.  | plow-back rate - the return on equity (ROE). |

|  |  |
| --- | --- |
| C.  | plow-back rate + the return on equity (ROE). |

|  |  |
| --- | --- |
| **D**.  | plow-back rate × the return on equity (ROE). |

6. MJ Co. pays out 60% of its earnings as dividends. Its return on equity is 15%. What is the stable dividend growth rate for the firm?

|  |  |
| --- | --- |
| A.  | 9% |

|  |  |
| --- | --- |
| B.  | 5% |

|  |  |
| --- | --- |
| **C**.  | 6% |

|  |  |
| --- | --- |
| D.  | 15% |

g = (1 – 0.6) X 0.15 = 0.06

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 7. Generally high growth stocks pay:

|  |  |
| --- | --- |
| **A**.  | low or no dividends. |

|  |  |
| --- | --- |
| B.  | high, steadily growing dividends. |

|  |  |
| --- | --- |
| C.  | erratic dividends. |

|  |  |
| --- | --- |
| D.  | decreasing dividends. |

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|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 8. A high proportion of the value of a growth stock typically comes from:

|  |  |
| --- | --- |
| A.  | past dividend payments. |

|  |  |
| --- | --- |
| B.  | past earnings. |

|  |  |
| --- | --- |
| **C**.  | PVGO (present value of growth opportunities). |

|  |  |
| --- | --- |
| D.  | both A and B. |

 |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 9. | Which of the following stocks is an income stock?

|  |  |
| --- | --- |
| **A**.  | Dow Chemicals |

|  |  |
| --- | --- |
| B.  | Starbucks |

|  |  |
| --- | --- |
| C.  | Facebook |

|  |  |
| --- | --- |
| D.  | Google |

 |

10. If capital markets are efficient, then the sale or purchase of any security at the prevailing market price is generally:

|  |  |
| --- | --- |
| A.  | a positive-NPV transaction. |

|  |  |
| --- | --- |
| **B**.  | a zero-NPV transaction. |

|  |  |
| --- | --- |
| C.  | a negative-NPV transaction. |

|  |  |
| --- | --- |
| D.  | no general trend exists for such transactions. |

11. Generally, a firm is able to find positive-NPV opportunities among its:
I) financing decisions; II) capital investment decisions; III) short-term borrowing decisions

|  |  |
| --- | --- |
| A.  | I only |

|  |  |
| --- | --- |
| B.  | I and III only |

|  |  |
| --- | --- |
| C.  | III only |

|  |  |
| --- | --- |
| **D**.  | II only |

12. Which of the following statements is(are) true if the strong-form efficient market hypothesis holds?

I) Analysts can easily forecast stock price changes.
II) Financial markets are irrational.
III) Stock returns follow a particular pattern.
IV) Stock prices reflect all available information.

|  |  |
| --- | --- |
| A.  | I only |

|  |  |
| --- | --- |
| B.  | II only |

|  |  |
| --- | --- |
| C.  | I and III only |

|  |  |
| --- | --- |
| **D**.  | IV only |

13. If the efficient market hypothesis holds, investors should expect:

I) to receive a fair price for their security
II) to earn a normal rate of return on their investments
III) to be able to pick stocks that will outperform the market

|  |  |
| --- | --- |
| A.  | I only |

|  |  |
| --- | --- |
| B.  | II only |

|  |  |
| --- | --- |
| C.  | III only |

|  |  |
| --- | --- |
| **D**.  | I and II only |