AP/ADMS 3530 3.00 Finance

Midterm Exam Solutions

Fall 2012

1. (Q. 15 in Type B) How much interest will be earned in the fourth year if $7,000 is deposited today that earns 6% interest compounded semiannually?

A) $509.02
B) $534.48
C) $568.86
D) $609.36
E) $652.75

Answer A

Semiannual period rate = 6% / 2 = 3%
Effective annual rate = $(1.03)^2 - 1 = 6.09\%$
The deposit grows to $\$7{,}000 \times (1.0609)^3 = \$8{,}358.3661$ at the end of the third year and $\$7{,}000 \times (1.0609)^4 = \$8{,}867.3906$ at the end of the fourth year. So the interest earned in Year 4 is the difference of the two future values, $8,867.3906 - $8,358.3661 = $509.02.

2. (Q. 16 in Type B) How much more is a perpetuity of $2,500 (annual payments) worth than an annuity of the same amount for 25 years? Assume an annual 6% interest rate and cash flows at the end of each year.

A) $3,293
B) $4,768
C) $5,486
D) $9,708
E) $12,327

Answer D

The perpetuity is worth $2,500 / 0.06 = $41,666.67
Annuity: *I/Y* = 6; *N* = 25; *PMT* = -2,500; *FV* = 0; CPT *PV* = $31,958.39
Difference = $41,666.67 - $31,958.39 = $9,708.

3. (Q. 17 in Type B) A cash flow stream has a present value of $2,500 today and is based on a $400 investment today, a $500 investment at the end of Year 1, $*X* investment at the end of Year 2, and a $700 investment at the end of Year 3. Given that the prevailing return on similar investments was 6% compounded annually then what is $*X*?

A) $650.31
B) $910.30
C) $954.37
D) $1,040.57
E) $1,169.18

Answer E

Bring all cash flows to time 0 (i.e., today):
$2,500 = $400 + $500 / (1.06) + $*X* / $(1.06)^2$ + $700 / $(1.06)^3$. Solving for *X* = $1,169.18.

4. (Q. 18 in Type B) A home mortgage of $400,000 is to be repaid monthly at a 5.2% APR semiannually compounded over 25 years. How much interest is paid over the life of the mortgage loan?

A) $270,846
B) $273,800
C) $281,350
D) $311,642
E) $342,391

Answer D

The mortgage rate is an APR 5.2% or a semiannual 2.6%. The monthly rate is given by: $(1 + 0.026)^{2/12} = 0.4287\%$

The monthly payment is obtained as: *I/Y* = 0.4287; *N* = 300; *PV* = -400,000; *FV* = 0; CPT *PMT* = $2,372.14.

The total amount of interest paid is: Interest = 300 × $2,372.14 – $400,000 = $311,642.

5. (Q. 19 in Type B) Approximately how long will it take to accumulate $2 million with annual payments of $12,000 with the first payment made today if the annual interest rate is 6%?

A) 32 years
B) 40 years
C) 48 years
D) 72 years
E) 85 years

Answer B

The number of years must be solved for using your financial calculator with the following inputs (first set your calculator to the BGN mode): *I/Y* = 6; *PMT* = -12,000; *FV* = 2,000,000; *PV* = 0; CPT *N* = 40.25 years, or about 40 years after rounding.

6. (Q. 20 in Type B) Robert wishes to have $1,000,000 in his retirement fund in 30 years. If he contributes $1,500 monthly at the end of each month for 30 years starting in one month from now, what must he also deposit today to achieve his retirement goal? The fund pays an APR of 6% compounded monthly.

A) $84,145
B) $85,396
C) $416,229
D) $417,480
E) $525,611

Answer A

Step 1: Find i_m = 6% / 12 = 0.50%
Step 2: Using your financial calculator (*watch your signs*):
(i.e., PV + PMT = FV)
I/Y = .50; *N* = 360; *PMT* = -1,500; *FV* = 1,000,000; CPT *PV* = $84,145.49.

7. (Q. 21 in Type B) Rita had purchased a new $30,000 eco-friendly car through a 60 month financing plan, with payments due at the end of each month. The interest rate was 9% APR compounded monthly. At the end of Year 4, Rita earned a large bonus from her job and wanted to pay off the outstanding balance. How much did Rita still owe at the end of Year 4?

A) $4,975
B) $6,000
C) $7,121
D) $8,525
E) $9,111

Answer C

The amount still owing at the end of Year 4 was the PV of the payments still outstanding at that point in time, i.e., the PV of the payments to be made in Year 5 (from months 49 to 60):

Using your financial calculator:
Step 1: Find the monthly payment (note: i_m = 9% / 12 = 0.75%):
PV = 30,000; *N* = 60; *I/Y* = 0.75; *FV* = 0; CPY *PMT* = -$622.75

Step 2: Find PV of payments still outstanding at end of Year 4 (i.e., N = 12): PMT = -622.75; N = 12; I/Y = 0.75; FV = 0; CPT PV = $7,121.09.

8. (Q. 22 in Type B) You want to buy a house that costs $500,000. You make a 15% down payment and finance the rest with a 20-year mortgage. The mortgage has a five year renewal term for which the annual mortgage rate is 6.25% compounded semiannually. What will be your monthly payment?

A) $1,858
B) $2,783
C) $2,967
D) $3,087
E) $3,631

Answer D

The semiannual rate = 6.25 / 2 = 3.125%
EAR = $(1.03125)^2$ - 1 = 6.348%

The monthly interest rate is given by:
$i_m = (1.06348)^{1/12} - 1 = 0.5142\%$

The monthly payment for the 20-year mortgage loan:
PV = 425,000 (= 85% × $500,000); N = 20 × 12 = 240; I/Y = .5142; FV = 0; CPT PMT = -$3,086.76.

9. (Q. 23 in Type B) What is the present value of a six payment annuity of $3,500 per year that begins four years from today if the annual discount rate is 6 percent?

A) $12,250.00
B) $13,632.44
C) $14,450.39
D) $16,388.97
E) $17,210.64

Answer C

Step 1: PV of an ordinary annuity:
PMT = -3,500; N = 6; I/Y = 6, FV = 0, CPT PV = $17,210.64, but the first payment is in four years!

Step 2: If payments begin in 4 years from today, then discount back 3 more periods/years (since an ordinary annuity already assumes 1 period out): PV delayed = $17,210.64 / $(1.06)^3$ = $14,450.39.

10. (Q. 24 in Type B) In order to assist your retired parents with additional income, you are now planning to establish a 15-year trust fund that will pay out $12,000 at the end of the first year and then increase by 3% per year. You expect that the trust fund can earn a 7% annual rate of return. How much should you invest today in order to maintain this fund? (Please ignore any tax implications.)

A) $33,158
B) $84,504
C) $106,508
D) $130,596
E) $300,000

Answer D

Dealing with a PV of a growing annuity:

$PV_{\text{growing annuity}} = C / (r - g) \times [1 - [\{(1 + g) / (1 + r)\}^{t}]]$

C = $12,000; r = 7%; g = 3%; and t = 15
= $12,000 / (.07 - .03) $\times$ [1 – {1.03/1.07}^{15}] = $300,000 $\times$ [1 – 0.564679]
= $300,000 $\times$ .435321 = $130,596.

11. (Q. 25 in Type B) You've won a local lottery and the cash prize is $3,000. Alternatively you've been offered $125 a month over the next 3 years with payments beginning today. Based on the above what is the EAR of the monthly alternative, assuming that both options have the same present value today?

A) 25.14%
B) 32.61%
C) 35.15%
D) 42.24%
E) 45.56%

Answer C

BGN
PV = -$3,000
PMT = $125
N = 3 $\times$ 12 = 36
FV = 0
CPT *I* / *Y* = 0.025416 (interest rate for 1 month)
EAR = (1 + 0.025416)^{12} – 1 = 0.3515, or 35.15%.

12. (Q. 26 in Type B) You are deciding between two loans over the same time frame and want to apply the knowledge that you've learned in ADMS 3530 in

choosing the cheapest loan option. Option 1 offers a 10.20% rate per annum compounded weekly. (There are 52 weeks in a year.) Option 2 offers a 10.25% rate per annum compounded quarterly. Which option would you choose?

A) Option 1.
B) Option 2.
C) You would be indifferent as the rates are exactly the same.
D) Option 1 because it is half the EAR of option 2.
E) Option 2 because it is half the EAR of option 1.

Answer B

Option 1 EAR = $(1 + 0.1020 / 52)^{52} - 1 = 10.73\%$
Option 2 EAR = $(1 + 0.1025 / 4)^{4} - 1 = 10.65\%$
So Option 2 would be the cheapest.

13. (Q. 27 in Type B) You are advising your friend on two alternative forms of financing for the purchase of his used car. Option 1: Put down a $1,000 deposit today and make 4 annual payments of $2,000 each, with the first payment starting in 2 years from today. Option 2: Pay $7,000 cash today. If the dealership is charging an EAR of 8%, which option should you choose?

A) Option 1: as its present value is $6,134.
B) Option 1: as its present value is $7,624.
C) Option 2: as its present value is $7,000.
D) Option 1: as its present value is $6,624.
E) Option 1: as its present value is $6,766.

Answer C

Option 1: The PV in Year 1 of the annuity payment of $2,000 for 4 years is $6,624.25. So PV today (i.e., time 0) = $6,624.25 / 1.08 = $6,133.57.
Finally add the initial payment $1,000 today to the PV of the annuity at time 0, $(6,133.57 + 1,000) = $7,133.57, or $7,134.
Therefore Option 2, i.e., paying $7,000 cash today, is the cheaper option.

14. (Q. 1 in Type B) The Government of Italy's 12% coupon bond has 5 years remaining to maturity. The bond pays annual coupons and the next coupon is due in one year. The face value of the bond is $1,000. The bond is currently yielding at 50% of its coupon rate. If you buy the bond today and hold it to maturity, then how much interest do you earn on the reinvested coupons, assuming coupons are reinvested at the yield to maturity?

A) $600.00
B) $762.34
C) $76.45

D) $60.00
E) $87.19

Answer C

Yield to maturity = 50% of coupon rate, or 12% × 50% = 6%

Total coupons = $120 × 5 = $600

Interest earned on reinvested coupons = FV of coupons including reinvestment income - total coupons

Use a financial calculator and recognize that the coupons are a 5-year annuity:

PV = 0; *N* = 5; *PMT* = -120; *I*/*Y* = 6; CPT *FV* = $676.4512.

Therefore, interest earned on reinvested coupons = $676.4512 - $600 = $76.4512.

15. (Q. 2 in Type B) The Government of Canada has a bond that matures in 22 years and has a face value of $1,000. The bond has a coupon rate of 3.2%, paid semiannually. The yield to maturity on the bond is 7%. If coupons are reinvested at 3.7% per annum semiannually compounded, then how much interest is earned on reinvested coupons over the life of the bond? In your answer please calculate the interest as a percentage of the total cash flows received by the bondholder.

A) 16%
B) 18%
C) 21%
D) 29%
E) 11%

Answer B

First, determine how much interest was earned on reinvesting the coupons at 3.7% annually. You will be getting a total of 44 coupons at $16 each. These coupons are an annuity

Interest earned on reinvested coupons is: FV of coupons - coupons received

By using a financial calculator:

PV = 0; *N* = 44; *PMT* = -16; *I*/*Y* = 3.7/2 = 1.85; CPT *FV* = $1,072.5995

Thus interest earned on reinvested coupons is: \$1,072.5995 – 44 × \$16 = \$368.5995.

As a percentage of the total cash flows from the bond (coupon income plus principal), the interest earned on coupons is: \$368.5995 / (\$1,000 + \$1,072.5995) = 18%.

16. (Q. 3 in Type B) To raise funds for software development for the gun registry, the Federal Government of Canada has issued bonds on behalf of the Department of Justice. The bonds, called "Gun Bonds", have a face value of \$1,000, two years to maturity and a 6% coupon rate (semiannual coupons). The bonds are priced at \$1,018.86. What is the yield to maturity on the Gun Bonds?

A) 2.99%
B) 2.49%
C) 3.99%
D) 4.99%
E) 5.99%

Answer D

By using a financial calculator:

PV = -1,018.86; *N* = 4; *PMT* = 30; *FV* = 1,000; CPT *I/Y* = 2.4987. Therefore, the YTM = 2.4987 × 2 = 4.9974%.

17. (Q. 4 in Type B) J&J Enterprises wants to issue a 20-year, \$1,000 zero-coupon bond. If each bond is to yield 9% annually, how much will J&J receive (ignoring issuance costs) when the bond is first sold?

A) \$150.16
B) \$167.55
C) \$178.43
D) \$199.11
E) \$165.22

Answer C

Investors will receive \$1,000 dollars for each bond. Discount this amount for 20 years at the interest rate of 9% per year, PV = \$1,000 / (1.09^{20}) = \$178.43

Alternatively, by using a financial calculator: *N* = 20; *PMT* = 0; *I/Y* = 9; *FV* = 1,000; CPT *PV* = -\$178.43.

18. (Q. 5 in Type B) Jay Z became the first heavy-hip hop artist to sell bonds when he arranged a $30 million deal with Linkin Park in February 2005. The collateral on the bonds (and a source of cash flows for interest and principal payments) consisted of future royalties from the artist's albums like "Encore". Each bond in the issue had a face value of $1,000, a ten-year maturity and paid a coupon rate of 4% payable semiannually. The market rate of interest on equivalent securities was 7% per year. What price did each of the bonds sell for?

A) $789.81
B) $768.81
C) $803.47
D) $798.29
E) $786.81

Answer E

By using a financial calculator:

N = 20; *PMT* = 20; *I/Y* = 3.5; *FV* = 1,000; CPT *PV* = -$786.81

Therefore, each bond sold for $786.81.

19. (Q. 6 in Type B) Jumanji Inc. issues semiannual coupon bonds that have a 5.25% coupon rate. The bonds are currently selling at a premium of 1.25% of the par value of $1,000 and are scheduled to mature in 7 years. What is the yield to maturity on these bonds?

A) 5.25%
B) 5.04%
C) 5.33%
D) 5.49%
E) 5.19%

Answer B

Current selling price (PV) = $1,000 × 1.0125 = $1,012.50
Number of periods to maturity (N) = 7 × 2 = 14
Face value (FV) = $1,000
Semi annual coupon (PMT) = 5.25% × 1,000 / 2 = $26.25
Using your calculator to solve for the yield to maturity (I/Y) = 2.518 × 2 = 5.04%.

20. (Q. 7 in Type B) Sirriwalia bought an 8.5% coupon payable annually bond at a face value of $1,000. A year later he sold it at a 2% discount on face value. During the year, the consumer price index that represents the inflation rate rose

by 3%. What was the real rate of return that Sirriwalia has earned on his investment?

A) 4.4%
B) 3.4%
C) 6.7%
D) 3.6%
E) 6.5%

Answer B

Purchase price (PV) = $1,000
Selling price = $1,000 × (1 – 0.02) = $980
Coupon = $85
Rate of return (nominal) = (Selling price – purchase price + coupon) / Purchase price = ($980 - $1,000 + $85) / $1,000 = 0.065, or 6.5%
Real rate of return = [(1 + Nominal rate) / (1 + Inflation rate)] – 1 = (1.065 / 1.03) – 1 = 0.033981, or 3.4%.

21. (Q. 8 in Type B) What is the expected annual constant growth rate of dividends for a stock currently selling at $50, that has just paid a dividend per share of $2, and has an expected rate of return of 11% per year?

A) 6.21%
B) 6.43%
C) 6.73%
D) 7.00%
E) 7.25%

Answer C

From the constant-growth DDM: $P_0 = DIV_1 / (r - g)$ and $DIV_1 = DIV_0 \times (1 + g) \Rightarrow \$50 = \$2 \times (1 + g) / (0.11 – g) \Rightarrow g = 6.7308\%$, or 6.73%.

22. (Q. 9 in Type B) A firm expects to have earnings per share of $3 in next year. Until now the firm has paid out all the earnings as dividends. With the expectation of no growth, the current share price is $20. The firm is considering a proposal to cut the dividend payout ratio to 45% and to reinvest the rest of the earnings on a new investment project. The ROE on the new investment would be 22% annually. Assuming the firm's required rate of return is unchanged, what would happen to the firm's share price if the proposal is approved?

A) The stock price should be the same.
B) The stock price should drop from $20 to $15.65.
C) The stock price should drop from $20 to $17.45.
D) The stock price should rise from $20 to $43.85.

E) The stock price should rise from $20 to $46.55.

Answer E

Without the proposal, the firm's required rate of return is: $r = DIV_1 / P_0 + g = \$3 / \$20 + 0\% = 15\%$. If the proposal is approved, $P_{new} = DIV_1 / (r - g)$, where $DIV_1 = \$3 \times 45\% = \$1.35$, $g = ROE \times$ plowback ratio $= 22\% \times (1 - 45\%) = 12.1\%$, $\therefore P_{new} = \$1.35 / (0.15 - 0.121) = \$46.55$.

23. (Q. 10 in Type B) The earnings of a firm in this past year were $4 per share and are expected to grow at 16% annually over the next three years. In Year 4 the growth rate will slow to a constant rate of 4% and continues at this level forever. No dividends are expected to be paid until the end of Year 4 when the firm will begin paying out 70% of its earnings as dividends. If the firm's required rate of return is 12% per year, what is its share price today?

A) $31.78
B) $34.80
C) $37.62
D) $40.44
E) $43.26

Answer D

g_1, g_2, and $g_3 = 16\%$, while $g_4 = 4\%$
$EPS_1 = \$4 \times 1.16 = \$4.64$ $DIV_1 = 0$
$EPS_2 = \$4.64 \times 1.16 = \$5.3824$ $DIV_2 = 0$
$EPS_3 = \$5.3824 \times 1.16 = \$6.2436$ $DIV_3 = 0$
$EPS_4 = \$6.2436 \times 1.04 = \$6.4933$ $DIV_4 = \$6.4933 \times 70\% = \$4.5453$
$P_3 = DIV_4 / (r - g) = \$4.5453 / (0.12 - 0.04) = \$56.8163$
$P_0 = \$56.8163 / (1.12)^3 = \$40.4407$, or $40.44.

24. (Q. 11 in Type B) A company expects its earnings and dividends to grow at 14% annually during the next 2 years and at 12% in the third year and then at a constant rate of 6% annually infinitely. The last dividend paid was $1.5 and the required rate of return is 9% every year. What should be the company's share price now?

A) $59.62
B) $61.78
C) $62.94
D) $64.46
E) $66.20

Answer D

The share price today is the present value of all the future dividends. $DIV_1 = \$1.5 \times 1.14 = \$1.71$, $DIV_2 = \$1.71 \times 1.14 = \$1.9494$, $DIV_3 = \$1.9494 \times 1.12 = \$2.1833$, and $DIV_4 = \$2.1833 \times 1.06 = \$2.3143$. Expected rate of return: $r = 9\%$. $P_3 = DIV_4 / (r - g) = \$2.3143 / (0.09 - 0.06) = \$77.1433$. Therefore the price of the stock today is the present value of DIV_1, DIV_2, DIV_3, and P_3: $P_0 = \$1.71 / (1.09)^1 + \$1.9494 / (1.09)^2 + \$2.1833 / (1.09)^3 + \$77.1433 / (1.09)^3 = \$(1.5688 + 1.6408 + 1.6859 + 59.5688) = \$64.4643$, or \$64.46.

25. (Q. 12 in Type B) A stock currently sells for \$48 per share. The market requires a 13% rate of return on the firm's stock. If the company maintains a 7% growth rate in dividends, what was the most recent annual dividend per share?

A) \$2.43
B) \$2.52
C) \$2.69
D) \$2.88
E) \$2.97

Answer C

The expected dividend DIV_1 in next year is given by: $P_0 = DIV_1 / (r - g)$, rearranging the formula to solve for $DIV_1 = P_0 \times (r - g) = \$48 \times (0.13 - 0.07) = \$2.88$. Since $DIV_0 = DIV_1 / (1 + g) \Rightarrow DIV_0 = \$2.88 / (1 + 0.07) = \$2.6916$, or \$2.69 per share.

26. (Q. 13 in Type B) A stock paying \$2.5 in annual dividends sells now for \$105 and has an expected rate of return of 15% annually. What might investors expect to pay for this stock one year from now?

A) \$120.15
B) \$114.55
C) \$115.75
D) \$116.85
E) \$118.25

Answer E

$$\textbf{Expected rate of return} = \frac{DIV_1 + P_1 - P_0}{P_0}$$

$$\therefore 15\% = \frac{\$2.5 + P_1 - \$105}{\$105}$$

$$\Rightarrow \$15.75 = P_1 - \$102.5 \Rightarrow P_1 = \$118.25.$$

27. (Q. 14 in Type B) What is the annual expected rate of return on a stock that has a 3.4% constant growth rate, a current price of $32, and an expected dividend of $1.36 per share for next year, and a P/E ratio of 18?

A) 7.43%
B) 7.65%
C) 7.81%
D) 8.07%
E) 8.25%

Answer B

$$\$32 = \frac{\$1.36}{r - 0.034} \Rightarrow \$32 \times r = \$1.36 + \$32 \times 0.034 \Rightarrow r = \frac{\$2.448}{\$32} = 7.65\%.$$

28. (Q. 35 in Type B) The agency problem is:

A) the conflict between regulators and an incorporated company.
B) the conflict between the company and the elected legislators in the province of the company's head office.
C) the conflict of interest between the shareholders and the managers.
D) the problem insurance companies have in keeping their agents from leaving to join another company.
E) None of the above.

Answer C

29. (Q. 36 in Type B) The treasurer of a company:

A) prepares the financial statements.
B) manages the cash balances.
C) prepares the tax returns.
D) None of the above.
E) Each of A, B and C.

Answer B

30. (Q. 37 in Type B) Maximizing company profits is not a well-defined company objective because:

A) cost-cutting decisions that raise profit this year may reduce future profits by much more.
B) a company may raise profit by retaining dividends and investing them but it is earning such low returns that it should pay the dividends to the shareholders who can reinvest the money for higher returns.

C) the company may increase profits with actions that hurt society as a whole.
D) A and C only
E) A, B and C

Answer E

31. (Q. 38 in Type B) Which of the following is NOT an effective method of monitoring and controlling corporations and their Boards of Directors?

A) Regulations of the Ontario Securities Commission.
B) Takeovers.
C) Shareholders voting for the Board of Directors.
D) Stock options granted to the senior executives that can be sold at any time.
E) Large institutional investors who become active in monitoring the companies in which they invest.

Answer D

32. (Q. 39 in Type B) The real rate of interest is:

A) the rate we observe in the financial markets.
B) the same as the risk-free rate of return.
C) the rate of interest if there were no inflation.
D) the yield to maturity on a short-term Government of Canada bond.
E) the yield to maturity on a long-term Government of Canada bond.

Answer C

33. (Q. 40 in Type B) The amount owing on a mortgage loan on the date of renewal at a new, higher rate of interest is:

A) the present value of the old payment amount discounted for the number of periods remaining in the mortgage at the old rate of interest.
B) the future value of the payments already made, discounted at the old rate of interest to the renewal date.
C) the present value of all the future payments discounted at the new rate, minus the interest expense already paid.
D) the present value of the future payment amount discounted for the number of periods remaining in the mortgage at the old interest rate.
E) the original value of the mortgage minus the sum of all the payments made so far.

Answer A

34. (Q. 28 in Type B) Bonds, which give the issuing company the option to buy them back early, are known as:

A) zero-coupon bonds.
B) floating-rate bonds.
C) warrants.
D) strip bonds.
E) callable bonds.

Answer E

35. (Q. 29 in Type B) When pricing bonds, if a bond's coupon rate is less than the required rate of return, then:

A) the holder of the bond is assured of a profit regardless of when the bond is eventually sold.
B) The holder of the bond will realize a capital gain if the bond is held to maturity.
C) The bond sells at par because the required rate of return is adjusted to reflect the difference.
D) The bond sells at a premium if it has a long maturity, a discount if it has a short maturity.
E) The bond sells at a discount if it has a long maturity, a premium if it has a short maturity.

Answer B

36. (Q. 30 in Type B) It is more difficult to value a stock than it is to value a bond because:

A) the future cash flows of a stock are known.
B) the life of an equity security is limited.
C) the required market rate of return on a stock is known in advance.
D) equity securities have no maturity date.
E) the maturity value of a stock is known.

Answer D

37. (Q. 31 in Type B) Dividends on the common stock of Andean Inc. are expected to grow at a constant rate forever. If you are told Andean's most recent dividend paid, its dividend growth rate, and a discount rate, you can calculate _____.

I. the price today
II. the price five years from now
III. the dividend that is expected to be paid 10 years from now

A) I only
B) I and II only
C) I and III only
D) II and III only
E) I, II, and III

Answer E

38. (Q. 32 in Type B) The dividend discount model:

A) values a stock based solely on the rate of dividend growth.
B) can be used to value all common stocks.
C) considers both the dividend yield and the capital gains yield.
D) can not be used to value zero growth dividend stocks.
E) is independent of an investor's required rate of return.

Answer C

39. (Q. 33 in Type B) A dividend payment on preferred stock:

A) can never be omitted if the company is earning a profit.
B) can not be omitted even at the discretion of the board of directors.
C) is automatically omitted if the company realizes a loss.
D) can be omitted at the discretion of the board of directors.
E) increases when the company has a profit and decreases when the company has a loss.

Answer D

40. (Q. 34 in Type B) Suppose two analysts, Amanda and Bob, are evaluating a stock. Amanda assumes a higher required return on the stock than the return assumed by Bob. All other estimates are the same. The price of the stock calculated by Amanda will be _____ than the price calculated by Bob.

A) higher
B) lower
C) the same
D) lower only if the stock does not pay a dividend
E) higher only if the stock does not pay a dividend

Answer B