PMIR BFM Quiz 3 (A) Solution

Time: 10 mins

Please (✓) against the nearest correct answer. For each correct answer you get +1 mark & for each wrong answer -1.

1) The ABC company has two bonds outstanding that are the same except for the maturity date. Bond D matures in 4 years, while Bond E matures in 7 years. If the required return changes by 15 percent

a) Bond D will have a greater change in price.
b) Bond E will have a greater change in price.
c) the price of the bonds will be constant.
d) the price change for the bonds will be equal.
e) none of the above

2) Assume that XYZ firm has accurately calculated the net cash flows relating to an investment proposal. If the net present value of this proposal is greater than zero and the firm is not under the constraint of capital rationing, then the firm should:

a) Calculate the IRR of this investment to be certain that the IRR is greater than the cost of capital
b) Compare the profitability index of the investment to those of other possible investments
c) Calculate the payback period to make certain that the initial cash outlay can be recovered within an appropriate period of time
d) Accept the proposal, since the acceptance of value-creating investments should increase shareholder wealth
e) None of the above

3) PQR has estimated that a proposed project's 10-year annual net cash benefit, received each year end, will be Rs.2,500 with an additional terminal benefit of Rs.5,000 at the end of the tenth year. Assuming that these cash inflows satisfy exactly PQR's required rate of return of 8 percent, calculate the initial cash outlay.

a) Rs.16,775
b) Rs.19,090
c) Rs.25,650
d) Rs.30,600
e) none of the above

4) A firm has fixed operating costs of $175,000, total sales revenue of $3,000,000 and total variable costs of $2,250,000. The firm's degree of operating leverage is ______.

a) 0.77
b) 1.30
c) 0.81
d) 4.29
e) none of the above

5) If the intrinsic value of a stock is greater than its market value, which of the following is a reasonable conclusion?

a) The stock has a low level of risk
b) The stock offers a high dividend payout ratio
c) The market is overvaluing the stock
d) All of the above
e) None of the above

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6) Which of the following statements is correct?

a) If the NPV of a project is greater than 0, its PI will equal 0
b) If the IRR of a project is 0%, its NPV, using a discount rate, k, greater than 0, will be 0
c) If the PI of a project is less than 1, its NPV should be less than 0
d) If the IRR of a project is greater than the discount rate, k, its PI will be less than 1 and its NPV will be greater than 0
e) None of the above

7) You are considering two mutually exclusive investment proposals, project A and project B. B's expected value of net present value is $1,000 less than that for A; and A has less dispersion. On the basis of risk and return, you would say that

a) Project A dominates project B
b) Project B dominates project A
c) Project A is more risky and should offer greater expected value.
d) Each project is high on one variable, so the two are basically equal
e) None of the above

8) If capital is to be rationed for only the current period, a firm should probably first consider selecting projects by descending order of ____.

a) net present value
b) payback period
c) internal rate of return
d) profitability index
e) none of the above

9) RST airlines paid Rs.4 as dividend last year on its equity shares, which is currently selling at Rs.100 per share. What is the market's required return on this investment if the dividend is expected to grow at 5% forever?

a) 9.0 percent
b) 9.2 percent
c) 9.4 percent
d) 9.6 percent
e) none of the above

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10) A firm has determined it can issue preferred stock at $115 per share par value. The stock will pay a $12 annual dividend. The cost of issuing and selling the stock is $3 per share. The cost of the preferred stock is

a) 6.4 percent.
b) 10.4 percent.
c) 10.7 percent.
d) 12 percent.
e) none of the above

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