

Review for Exam #2

Exam #2

▸ *Don't Forget:*

- Scan Sheet
- Calculator
- Pencil
- Picture ID
- Cheat Sheet

Things To Do...

- ▶ Study both the notes and the book.
- ▶ Remember the Panopto Recordings in Canvas.
- ▶ Do suggested problems.
- ▶ Do more problems!
- ▶ Be comfortable with calculator, but understand concepts (e.g., timeline).
- ▶ Get help if you are having problems.

HELP!

▶ Office Hours

▶ _____

▶ _____

or by appointment

Things NOT To Do...

- ▶ Study solutions and not do problems.
- ▶ Memorize all the formulas.
- ▶ Miss the exam.
- ▶ Forget your calculator.
- ▶ Cheat.
- ▶ Think bad thoughts about me between now and the exam.

Warning

The following may not contain everything we covered, and therefore, may not contain all testable material.

Discounted Cash Flow Valuation

- ▶ *Chapter 6*
- ▶ PV and FV of Single and Multiple CFs
- ▶ Perpetuities and Growing Perpetuities
- ▶ Annuities and Annuities Due
- ▶ APR vs. EAR
 - ▶ What is the difference? Which do I use?
- ▶ Amortization Schedule

Bonds

- ▶ *Chapter 7*
- ▶ What are they?
- ▶ How do we price them?
 - ▶ Zero coupon and coupon bonds
 - ▶ Find price, YTM, time-to-maturity, coupon rate, current yield
- ▶ What are their characteristics?
- ▶ Interest Rate Risk
- ▶ Price Reporting

Stocks

- ▶ *Chapter 8*
- ▶ What are they?
- ▶ How do we price them?
 - ▶ 3 types + multiples
 - ▶ Find price, dividends, discount rate, growth rate
 - ▶ Calculating dividends (just paid or will pay next year)
- ▶ What are their characteristics?
 - ▶ Common versus preferred
- ▶ Stock Markets
- ▶ Price Reporting

Practice Problem #1

True or False:

- A. _____ Shareholders with smaller proportions of the firm's stock have a stronger voice when the firm practices straight (or majority) voting, rather than cumulative voting.
- B. _____ The seniority of a bond issue indicates whether those bondholders will get paid before or after preferred shareholders in the event of default.

Practice Problem #2

Which one of the following statements is TRUE?

- A. If a bond is trading at a premium, the current yield will always be greater than the coupon rate.
- B. A stock's required rate of return is equal to the capital gains yield minus the dividend yield.
- C. During periods of inflation and expected future inflation, the yield curve will be upward sloping.
- D. Both zero coupon bonds and common stock represent ownership in a corporation.
- E. A U.S. Treasury Bond will always have a higher expected yield to maturity than a corporate bond with the same time to maturity, face value, and coupon rate.

Practice Problem #3

If dividends on a common stock are expected to grow at a constant rate forever, and if you are told the most recent dividend paid, the dividend growth rate, and the appropriate discount rate today, you can calculate _____.

- I. the price of the stock today
 - II. the dividend that is expected to be paid ten years from now
 - III. the appropriate discount rate ten years from now
-
- A. I Only
 - B. II Only
 - C. Both I and II
 - D. I, II, and III
 - E. None of the Above

Practice Problem #4

A stream of payments is converted from an ordinary annuity to an annuity due. The annual payments are still the same size. As a result of this, the present value of the annuity will _____ and the future value of the annuity will _____.

- A. increase, increase
- B. increase, decrease
- C. decrease, increase
- D. decrease, decrease
- E. be unchanged, be unchanged

Practice Problem #5

Assume interest rates (and discount rates) have increased. As a result of this, the present value of an ordinary annuity will _____ and the future value of the annuity will _____.

- A. increase, increase
- B. increase, decrease
- C. decrease, increase
- D. decrease, decrease
- E. be unchanged, be unchanged

Practice Problem #6

TriCounty, Inc., just paid a \$2.50 dividend yesterday. Analysts anticipate dividends will grow at 16 percent for each of the next 3 years, followed by growth of 5 percent per year indefinitely. If analysts estimate the required rate of return on stocks of this risk is 12 percent, how much would you expect to pay today for a share of TriCounty, Inc.?

Practice Problem #7

Yost Corp. does not currently pay any dividends. However, the firm expects to begin paying dividends in 25 years with a \$5 payout per share, after which dividends will grow at 6 percent forever. If the market requires a 16 percent rate of return on stocks of this risk, what is the current stock price of Yost Corp.?

Practice Problem #8

Granny Mae has been helping her favorite grandchild save. She has given you \$1 each year on your birthday, starting when you turned one, and taken you to deposit it in your bank account, which earns 4 percent each year. You have not deposited or withdrawn any other money. You just turned 21. However, Granny Mae is forgetful, and she forgot to give you money on your 10th and 20th birthdays. How much is in your account today?

Practice Problem #8

Practice Problem #9

Your firm just issued \$1,000 par value bonds that mature in 30 years. The bonds pay semiannual coupons and have a coupon rate of 8.5 percent.

- A. If the yield to maturity is 8 percent, what is the current price of these bonds?

Practice Problem #9

- B. If the price of the bonds is \$948.25 right now, what is the yield to maturity?

Practice Problem #10

- ▶ You decide to go car shopping and have your eye on a very nice convertible on which you talk the salesman down to \$34,495. You decide to finance the entire price of the vehicle with a 60 month loan from the dealership at an 8 percent APR compounded monthly. How much interest do you pay in the sixth month?

Answers

- | | | | |
|----|----------------------|-----|---------------------------|
| 1. | A. False
B. False | 6. | \$49.71 |
| 2. | C | 7. | \$1.42 |
| 3. | I and II | 8. | \$29.39 |
| 4. | A | 9. | A. \$1,056.56
B. 9.00% |
| 5. | C | 10. | \$214.11 |