

Practice Test

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- The following statements regarding the NPV rule and the rate of return rule are true except:
 - Accept a project if its $NPV > 0$
 - Reject a project if its $NPV < 0$
 - Accept a project if its rate of return > 0
 - Accept a project if its rate of return $>$ opportunity cost of capital
- According to the net present value rule, an investment in a project should be made if the:
 - Net present value is greater than the cost of investment
 - Net present value is greater than the present value of cash flows
 - Net present value is positive
 - Net present value is negative
- The opportunity cost of capital for a risky project is
 - The expected rate of return on a government security having the same maturity as the project
 - The expected rate of return on a well-diversified portfolio of common stocks
 - The expected rate of return on a portfolio of securities of similar risks as the project
 - None of the above
- Mr. Bird has \$100 income this year and zero income next year. The market interest rate is 10% per year. Mr. Bird also has an investment opportunity in which he can invest \$50 today and receive \$80 next year. Suppose Mr. Bird consumes \$30 this year and invests in the project. What will be his consumption next year?
 - \$88
 - \$102
 - \$80
 - \$100
- Ms. Venus has \$100 income this year and \$110 next year. The market interest rate is 10% per year. Suppose Ms. Venus consumes \$60 this year. What will be her consumption next year?
 - \$154
 - \$170
 - \$120
 - None of the above
- Mr. Dell has \$100 income this year and zero income next year. The market interest rate is 10% per year. Mr. Dell also has an investment opportunity in which he can invest \$50 this year and receive \$80 next year. Suppose Mr. Dell consumes \$50 this year and invests in the project. What is the NPV of the investment opportunity?
 - \$5
 - \$22.73
 - \$0 (zero)
 - None of the above.
- You would like to have enough money saved to receive a growing perpetuity, growing at a rate of 5% per year, the first payment being \$50,000, after retirement so that you and your family can lead a good life. How much would you need to save in your retirement fund to achieve this goal (assume that the growing perpetuity payments start one year from the date of your retirement. The interest rate is 10%)?
 - \$1,000,000
 - \$10,000,000

- C. \$2,000,000
D. None of the above
8. If the three-year present value annuity factor is 2.673 and two-year present value annuity factor is 1.833, what is the present value of \$1 received at the end of the 3 years?
- A. \$1.1905
B. \$0.84
C. \$0.89
D. None of the above
9. After retirement, you expect to live for 25 years. You would like to have \$75,000 income each year. How much should you have saved in the retirement to receive this income, if the interest is 9% per year (assume that the payments start on the day of retirement)?
- A. \$736,693.47
B. \$802,995.88
C. \$2,043,750
D. None of the above
10. A three-year bond has 8.0% coupon rate and face value of \$1000. If the yield to maturity on the bond is 10%, calculate the price of the bond assuming that the bond makes semi-annual coupon interest payments.
- A. \$857.96
B. \$949.24
C. \$1057.54
D. \$1000.00
11. The Wall Street Journal quotation for a company has the following values: Div: 2.00, PE: 20 Close: 80.00. Calculate the dividend pay out ratio for the company.
- A. 2.5%
B. 50%
C. 20%
D. None of the above
12. The required rate of return or the market capitalization rate is estimated as follows:
- A. Dividend yield - expected rate of growth in dividends
B. Dividend yield + expected rate of growth in dividends
C. Dividend yield / expected rate of growth in dividends
D. (Dividend yield) * (expected rate of growth in dividends)
13. MJ Co. pays out 75% of its earnings as dividends. Its return on equity is 20%. What is the stable dividend growth rate for the firm?
- A. 3%
B. 5%
C. 8%
D. 12%
14. The NetTech Co. has just paid a dividend of \$1 per share. The dividends are expected to grow at 20% per year for the next three years and at the rate of 5% per year thereafter. If the required rate of return on the stock is 15%(APR), what is the current value of the stock?
- A. \$18.14
B. \$11.93
C. \$15.20
D. None of the above

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1. (p. 18) C
2. (p. 18) C
3. (p. 20) C
4. (p. 22) B
5. (p. 22) A
6. (p. 22) B
7. (p. 40) A
8. (p. 41) B
9. (p. 42) B
10. (p. 59) B
11. (p. 61) B
12. (p. 65) B
13. (p. 67) B
14. (p. 70) C