

## Seminar 5

### A. Multiple Choice Questions

**A1.** An Investor buys shares in MSF Ltd at the end of year 2003 for \$25.00 and sells it for \$30.00 at the end of 2007. MSF Ltd did not pay any dividends over this period. The mean geometric rate of return (per annum) on the investment is closest to:

- a. 4.7%      b. 5.0%      c. 6.3%      d. 20.0%

**A2.** Daniel Singh, the owner of a major recording studio, is a strictly buy-and-hold type of investor. You have the following information on Daniel's portfolio during 2005-2007

Year	End of Year	Total Portfolio Income
2005	\$100,000	---
2006	\$125,000	5,000
2007	\$70,000	\$5,000

\*The end of the year value does not include total portfolio income which is assumed to be paid at the end of each year.

Based on discrete returns over this period, the average geometric return (per annum) Dan has earned on his investment is closest to:

- a. -16.3%      b. -11.7%      c. -9.5%      d. -5.0%

**A3.** Leigh Ping bought a one year Treasury bond and stock in GD Ltd at the end of 2006. The investment returns and values at the end of 2007 are shown below.

	End of 2006	Interest/Dividends Paid	End of 2007
T-bond	\$12,000	\$500	\$10,000
GD Ltd	\$10,000	\$300	\$14,200

Leigh wants you to tell her the return she made on the investments over the year. Assuming year-end cash flows, her one-year rate of return is closest to:

- a. -12.5%      b. 10.0%      c. 11.4%      d. 13.6%

**A4.** The shares DBY Ltd are currently selling for \$8.00 per share. You have developed the following probability distribution of the price and dividend one year from now.

State of the Market	Probability	Price	Dividend
Bearish	0.3	\$6.80	\$0.40
Normal	0.4	\$7.60	\$0.40
Bullish	0.3	\$9.60	\$0.80

Assume year end cash flows. The standard deviation of the rate of returns for DBY Ltd shares is closest to:

- a. 2.6%      b. 12.7%      c. 16.3%      d. 25.4%

**A5.** The shares CBC Ltd are currently selling for \$25.00 per share. You have developed the following probability distribution of the price and dividend one year from now.

State of the Market	Probability	Price
Awful	0.3	\$32.50
Normal	0.4	\$30.00
Awesome	0.3	\$25.00

The variance of the returns for CBC Ltd shares is closest to:

- a) 0.0054      b) 0.0141      c) 0.0737      d) 0.1187

**A6.** Compared to government bills and bonds, global equity securities have:

- a. higher return and higher risk
- b. higher return and equal risk
- c. equal return and lower risk

**A7.** Which of the following *best* describes the benefit of cumulative voting?

- a. It provides significant minority shareholders with proportional representation on the board.
- b. It prevents minority shareholders from exercising excessive control.
- c. If cumulative dividends are not paid, preferred shareholders are given voting rights.

**A8.** The advantage of participating preferred shares, versus non-participating preferred shares, is that participating shares can:

- a. obtain voting rights
- b. receive extra dividends
- c. be converted into common stock

**A9.** Compared to public equity, which of the following is least likely to characterize private equity?

- a. Lower reporting costs
- b. Potentially weaker corporate governance
- c. Lower returns because of its less liquid market

**A10.** Global depository receipts are most often denominated in:

- a. the currency of the country where they trade and issued outside the United States
- b. U.S. dollars and issued in the United States
- c. U.S. dollars and issued outside the United States

**A11.** Which of the following types of preferred shares has the *most* risk for investors?

- a. Puttable shares
- b. Callable shares
- c. Non-puttable, non-callable shares.

**A12.** Which of the following best describes the book value of equity?

- a. Management should attempt to maximize book value of equity.
- b. Book value of equity decreases when retained earnings increase.
- c. Book value of equity reflects investors' perceptions of the firm's future

**A13.** Which of the following causes of an increase in return on equity is *most likely* a positive sign for a firm's equity investors?

- a. A firm issues debt to repurchase equity
- b. Net income is increasing at a faster rate than book value of equity
- c. Net income is decreasing at a slower rate than book value of equity.

## **B. Short Answer Questions**

**B1** You are given the following information in three stocks

Stock A offers an expected return of 8.0% p.a. with a standard deviation of 15.0% p.a.

Stock B offers an expected return of 10.0% p.a. with a standard deviation of 20.0% p.a.

Stock C offers an expected return of 10.0% p.a. with a standard deviation of 15.0% p.a.

For each of the following statements indicate whether the statement is true or false and explain why?

- a. A risk neutral investor will be indifferent between stocks B and C.
- b. A risk-averse investor would prefer to invest in stock B rather than the stock C
- c. A risk-averse investor would prefer to invest in stock C rather than stock A
- d. a risk seeking investor would be indifferent between stocks B and C

**B2.**

Why might discounted cash flow valuation be difficult to do for the following types of firms?

- a. A private firm, where the owner is planning to sell the firm.
- b. A biotechnology firm, with no current products or sales, but with several promising product patents in the pipeline.
- c. A cyclical firm, during a recession.
- d. A troubled firm, which has made significant losses and is not expected to get out of trouble for a few years.
- e. A firm, which is in the process of restructuring, where it is selling some of its assets and changing its financial mix.
- f. A firm which owns a lot of valuable land that is currently unutilized.

## **C. Long Answer Questions**

**C1.** Discuss the importance and relative performance of equity securities in global financial markets

**2.** Discuss the characteristics of various types of equity securities

**C3.** Distinguish between public and private equity securities

- C4.** Discuss the differences in voting rights and other ownership characteristics among various equity classes.
- C5.** Discuss the methods for investing in non-domestic equity securities
- C6.** Compare and contrast the risk and return characteristics of various types of equity securities.
- C7.** Explain the role of equity securities in the financing of a company's assets and creating company value.
- C8.** Distinguish between the market value and book value of equity securities.
- C9.** Compare and contrast a company's cost of equity, its (accounting) return on equity, and investors' required rates of return.