Multiple Choice Questions (20 Points):

1. Which of the following is an advantage for a firm to issue common stock over long-term debt?

A) the cost of equity financing being less than the cost of debt financing
B) the primary claim of equityholders on income and assets in the event of liquidation
C) no maturity date on which the par value of the issue must be repaid
D) the tax deductibility of dividends which lowers the cost of equity financing

2. Which of the following typically applies to common stock but not to preferred stock?

A) par value
B) dividend yield
C) legally considered as equity in the firm
D) voting rights

3. Equity capital can be raised through ________.

A) the money market
B) the NYSE bond market
C) the stock market
D) a private placement with an insurance company

4. Dividends in arrears that must be paid to the preferred stockholders before payment of dividends to common stockholders are ________.

A) cumulative
B) nonparticipating
C) participating
D) convertible

5. Preferred stock is valued as if it were a ________.

A) fixed-income obligation
B) bond
C) perpetuity
D) common stock

6. A firm has an issue of preferred stock outstanding that has a stated annual dividend of $4. The required return on the preferred stock is 16 percent. The value of the preferred stock is ________.

A) $64
B) $16
C) $25
D) $50

7. In the Gordon model, the value of a common stock is the ________.

A) net value of all assets which are liquidated for their exact accounting value
B) actual amount each common stockholder would expect to receive if the firm's assets are sold
C) present value of a non-growing dividend stream
D) present value of a dividend stream that grows at a constant rate forever

8. Emmy Lou, Inc. has an expected dividend next year of $5.60 per share, a growth rate of dividends of 10 percent, and a required return of 20 percent. The value of a share of Emmy Lou, Inc.'s common stock is ________.
A) $28.00
B) $56.00
C) $22.40
D) $18.67

9. Although no investment is truly risk free, ________ are generally viewed as the closest thing we can come to in the real world to a risk-free investment.
A) U.S. Treasury securities
B) AAA-rated corporate bonds
C) secured bonds
D) zero-coupon bonds

10. The ________ is the compound annual rate of interest earned on a debt security purchased on a given date and held to maturity.
A) risk premium
B) yield curve
C) risk-free rate
D) yield to maturity

11. The purpose of the debt covenant that requires maintaining a minimum level of net working capital is to ________.
A) protect the lender by controlling the risk and marketability of the borrower's security investment alternatives
B) limit the amount of fixed-payment obligations
C) ensure a cash shortage does not cause an inability to meet current obligations
D) limit the annual cash dividends paid by the firm

12. A $1,000, 8% bond sells for 980. $1,000 is called the ________.
A) current value
B) market value
C) par value
D) auction value

13. A(n) ________ gives purchasers inflation protection.
A) zero-coupon bond
B) junk bond
C) floating rate bond
D) income bond

14. A deeply discounted bond that pays no coupon interest is a ________.
A) junk bond
B) floating rate bond
C) zero coupon bond
D) subordinated debenture

15. A(n) ________ is secured by real estate.
A) income bond
B) debenture
C) mortgage bond
D) subordinated debenture

16. In the basic valuation model, risk is generally incorporated into the ________.
A) cash flows
B) timing
C) discount rate
D) total value

17. Corporate bonds usually have a ________.
A) face value of $5,000
B) market price of $1,000
C) specified coupon rate paid annually
D) par value of $1,000

18. The value of a bond is the present value of its interest payments plus ________.
A) the future value of its par value
B) the present value of its par value
C) its face value
D) $1,000

19. Bonds that sell at less than face value are priced at a ________, while bonds which sell at greater than face value sell at a ________.
A) par; premium
B) discount; par
C) discount; premium
D) coupon; premium

20. Hewitt Packing Company has an issue of $1,000 par value bonds with a 14 percent annual coupon interest rate. The issue has ten years remaining to the maturity date. Bonds of similar risk are currently selling to yield a 12 percent rate of return. The current value of each Hewitt bond is ________.
A) $791.00
B) $1,000
C) $1,052.24
D) $1,113.00

True/False Questions (20 Points):

1. Unlike equity holders, creditors are owners of the firm.
2. Holders of equity have claims on both income and assets that are secondary to the claims of creditors.
3. Interest paid to bondholders is tax deductible.
4. Dividends paid to stockholders are tax deductible.
5. Common stock can be either privately owned by private investors or publicly owned by public investors.
6. Preemptive rights allow common stockholders to maintain their proportionate ownership in the corporation when when the firm sells new shares of stock.
7. Investors with a speculative motive for trading purchase a stock when they believe that it is undervalued and sell when they feel that it is overvalued.
8. The constant growth model is an approach to dividend valuation that assumes a constant future dividend.
9. If the risk-free rate decreases due to a shift in government policy, the required return goes up.
10. The possibility that the issuer of a bond will not pay the contractual interest or principal payments as scheduled is called credit (default) risk.
11. The conversion feature of a bond is a feature that is included in nearly all corporate bond issues that gives the issuer the opportunity to repurchase bonds at a stated price prior to maturity.
12. To sell a callable bond, the issuer must pay a higher interest rate than on an otherwise equivalent noncallable bond.
13. High-quality (high-rated) bonds provide lower returns than lower-quality (low-rated) bonds.
14. A Eurobond bond is a bond denominated in Euros.
15. The value of an asset depends on the historical cash flow(s) up to the present time.
16. Interest rate risk is the risk that results from the changes in interest rates that impact bond prices.
17. A bond will sell at a premium when its required return rises above its coupon interest rate.
18. The ask price is the highest price offered by a dealer to purchase a given security.
19. A prospectus is another term for a firm's annual report showing the firm's prospects for the coming year.
20. The initial public offering (IPO) offer price is the price at which a newly public firm's shares begin trading in the secondary market.