Old Exam Questions
Equity Valuation

READ FIRST: The following questions are reproduced from my previous exams. Exam formats have differed over time, so you may notice some differences in formatting or question style. The intent is that these questions will help you to practice, but it is ***NOT*** intended to replace your own study habits.

1. You are analyzing IndiCo's stock. The company expects to begin paying dividends one year from today, and they will pay them annually from that point. You see a Morningstar report that estimates this dividend at $5 per share and sets a price target of $50 one year from today. You estimate a 10% required rate of return if you were to invest in IndiCo. What would you expect the price to be today?
   A. $40
   B. $45
   C. $50
   D. $55
   E. $60

2. Cookbook Solutions is a firm that retains approximately 50% of its earnings each year. The firm is currently growing at a rate of 5% per year, and the market demands a 15% return on its equity. What would you estimate is the justified price-to-earnings ratio for the stock?
   A. 3.33
   B. 5
   C. 6.67
   D. 10
   E. A different value

3. Yup Brands just paid a $1 per share dividend. You expect the firm to grow at a 20% rate for the forseeable future, while the market demands a 40% return from the firm. What would you estimate the share price should be?
   A. $3
   B. $5
   C. $6
   D. $8
   E. A different value

4. Check Printers R Us is dominant in their industry, but they find themselves with limited growth opportunities. They have decided to pay out all of their earnings as a dividend. By doing so, they realize that they will likely eliminate any ability for the firm to grow. The dividend is expected to be $5 per share this year. If the market expects a 10% return on the stock, what would you estimate the stock price to be?
    A. $5
    B. $10
    C. $45
    D. $50
    E. $55

5. Word United has been focusing on growing quickly. The firm retains 75% of its earnings each year in order to grow at a rate of 10% per year. At the same time, investors demand a return on the stock of 20%. What would you estimate is the firm's justified price to earnings ratio?
    A. 1
    B. 2.50
    C. 5
    D. 7.50
    E. A different value

6. You read the Morningstar report on Excel Industries. They gave a 1 year price target of $40, along with an expected dividend of $2 per share in 1 year. If you require a 5% return on the stock, what would you expect the stock price to be right now?
    A. $38
    B. $40
    C. $42
    D. $45
    E. A different value

7. Lame Duck Enterprises is no longer growing. They generate approximately $2 in earnings per year, which they pay out to shareholders. If the market demands a 5% return on this stock, what is the firm's share price?
    A. $10
    B. $20
    C. $30
    D. $40
    E. A different value

8. Business is booming for Bamsung Electronics. The firm just paid a $1 dividend, and you expect the firm to grow at a 10% rate for the forseeable future. If investors demand an 11% return from the stock, what would you estimate the price of the stock to be?
   A. $10
   B. $11
   C. $100
   D. $110
   E. A different value

9. You are looking to invest in TerryCo. You see that the firm just paid a $2, and you expect the stock to grow at a 5% rate going forward. Meanwhile, you believe that the firm should return 15% to justify you bearing its risk. What would you pay for this stock?
   A. $15
   B. $18
   C. $20
   D. $21
   E. A different value

10. You are considering an investment in DawgCorp. The stock currently trades for $20 per share, and analysts predict that the stock will hit $30 at the end of the year. You expect that the stock will pay a $3 dividend. You've estimated that DawgCorp's beta is 0.8. Further, you see that the expected market risk premium is 10%, while the expected T-bill rate is 2%. What would you estimate the true value of the stock to be?
    A. $20
    B. $23
    C. $27
    D. $30
    E. A different value

11. You are looking to invest in Aubie Industries. The firm is pretty hopeless, and they have limited growth opportunities going forward. However, the firm's board realizes this and pays out 100% of its earnings each period. This year, the firm earned $1 per share. You figure that the firm is risky enough that you should earn a 12.5% return for holding it. What would you figure the price of the firm's shares should be?
    A. $7.14
    B. $8
    C. $8.33
    D. $10
    E. A different value

Use the following information for the next two questions:

AshCo has little room for growth under their current management. Knowing this, the firm pays out 100% of its $2 earnings as dividends each year. Willow Holdings plans to acquire AshCo, believing that new management will allow the firm to grow at a 10% rate each year. To accomplish this, the firm would have to start retaining a large portion of its earnings. Thus, Willow projects a dividend of $0.50 next year, growing at 16% thereafter. Investors currently demand a 20% return on AshCo's stock. Assume that this return will remain the same after the acquisition.

12. Using the information above, what is the value of AshCo's stock once they are acquired?
    A. $10
    B. $12.50
    C. $14.50
    D. $50
    E. A different value

13. Using the above information, what is the present value of growth opportunities for AshCo if the acquisition goes through?
    A. $2.50
    B. $4.50
    C. $40
    D. $48
    E. A different value

14. You are evaluating an investment in Smoke Productions. The firm recently paid out $2 million in dividends on $10 million in earnings. You expect this payout ratio to continue going forward. You believe that you need to earn at least 25% on the firm's stock for it to be worthwhile for you to invest in the company, and you think that the firm will grow at a 15% rate going forward. What do you estimate the justified price-to-earnings ratio of the company to be?
    A. 2
    B. 4
    C. 6
    D. 8
    E. A different value

15. FinEx is considering its payout structure. The firm currently pays a fraction of its earnings out in order to spur growth. It just paid a dividend of $0.25, and it expects to grow at 10%. Alternatively, they could choose to pay out all of their earnings as a dividend each period and cease any growth. Their earnings this period were $1 per share. Investors in the firm demand a 12.5% return, and this is expected to be the same regardless of which path the firm chooses. What is the present value of the firm's growth opportunities?
    A. $3
    B. $8
    C. $10
    D. $11
    E. A different value

16. [Quantitative] Gator Suction Solutions has paid out a dividend of $2 per share every year for several years. You see no reason to expect this to change in the future. If you require a return on the stock of 10%, what is the value of the stock?
    A. $10
    B. $12
    C. $20
    D. $22
    E. A different value

17. [Quantitative] Gua Kennel Co. just paid a dividend of $1.50 per share. It expects to grow at a rate of 10% going forward, and investors demand a return of 25% from the stock. What is the value of the firm's stock?
    A. $6.60
    B. $10
    C. $11
    D. $16.50
    E. A different value

18. [Quantitative] Big Box, Inc. is re-evaluating its payout policy. It just posted earnings of $2 per share. Currently, the firm pays out 100% of its earnings as a dividend each year. It has done so for a long period of time. However, executives believe that market conditions might be favorable for the firm to reduce this payout in order to spur future growth. They believe that the firm could grow at a 5% rate each year if they retain and reinvest 25% of earnings each period starting now. Assuming that the firm's required return would be 15% in either case, what is the present value of these growth opportunities?
    F. $1.67
    G. $2.42
    H. $3.33
    I. $5
    J. A different value

19. [Quantitative] The Blue Dog Corporation pays out 20% of its earnings as a dividend each period. Investors currently demand a return of 24% on the firm's shares, while the firm grows at a rate of approximately 8% per year. What is the price to earnings ratio for the firm?
    A. 0.75
    B. 1
    C. 1.25
    D. 1.50
    E. A different value

20. [Quantitative] Zoozle recently took its market by storm! The firm has been growing extremely quickly over the past few years. It expects to continue growing at 40% over the next year. At the end of this year, its growth will slow to 10% going forward. The firm's market capitalization rate is 12%. If the firm will pay a dividend of $2 at the end of this year, what would be the value of the stock today?
    A. $98.21
    B. $100
    C. $110
    D. $111.79
    E. A different value

21. [Quantitative] You put a price target on Aivitca shares of $60 next year. You estimate that the firm will pay a dividend at the same time of $4.50 per share. If the market capitalization rate for the firm is 12%, what should the share price be today?
    A. $55.45
    B. $56.34
    C. $57.03
    D. $57.59
    E. A different value

22. [Conceptual] The ability of firms to engage in earnings management presents a problem with what process?
    A. Calculating the price-to-earnings ratio
    B. Identifying the abnormal return
    C. Parsing our trading strengths and weaknesses
    D. Testing market efficiency

23. [Conceptual] You are looking to value a firm relative to its industry peers. Unfortunately, you know that the companies in this industry have significantly different capital structures—some have low leverage and others have high leverage. What multiple would be best suited to this situation?
    A. Enterprise Value / EBITDA
    B. Price / Book Value
    C. Price / Cash Flow
    D. Price / Earnings
    E. Price / Sales

24. [Quantitative] Indy Corp just posted earnings of $1.50 per share. You see that the firm paid a dividend of $0.30 per share. You expect the company to grow at a 6% rate going forward, while you expect a 14% return on its stock. What is the firm's trailing P/E ratio?
    A. 2.5
    B. 2.57
    C. 2.65
    D. 2.73
    E. A different value

25. [Quantitative] Roof Hunters, Inc. just paid a $3 per share dividend. You don't expect the firm grow, thinking it will remain at its current size. What would you expect its share price to be today if you require a 15% return on the stock?
    A. $15
    B. $17
    C. $18
    D. $20
    E. A different value

26. [Quantitative] You are evaluating an investment in Arch Finishing. The stock currently costs $60. Based on your analysis, you have set a price target of $68 for 1 year from today. You also predict a dividend 1 year from today of $1.30 per share. You also figure that investors should earn a 10% return on the stock. What is the intrinsic value of the stock today?
    A. $60
    B. $61
    C. $62
    D. $63
    E. A different value

27. [Conceptual] Which of the following is ***NOT*** an assumption that we made for one of the forms of the dividend discount model?
    A. Dividends don't grow
    B. Dividends grow at a constant rate
    C. Dividends grow at a faster rate followed by a slower rate
    D. One discount rate for all cash flows
    E. We used all of these

28. [Quantitative] You are interested in Dawg Productions. The firm just paid a $2 dividend. You believe that the firm will grow at 25% for the next 2 years, before its growth drops to a long term rate of 10%. If the required return on the stock is 20%, what should the stock price be today? (NOTE: Potentially significant rounding needed. If you get an answer within +/- $0.01 of an answer choice, choose that answer.)
   A. $23.87
   B. $25.33
   C. $26.91
   D. $28.13
   E. A different value

29. [Quantitative] Fuse Corp currently isn't growing. The firm pays out 100% of its $0.50 per share earnings each period. The firm's new CEO argues that the firm could retain 50% of its earnings starting this year and grow at a 10% rate. If investors demand a 15% return on the stock regardless of this decision, what is the present value of growth opportunities for Fuse Corp?
   A. $2
   B. $2.17
   C. $2.33
   D. $2.50
   E. A different value

30. [Conceptual] A higher P/E ratio implies higher expected __________.
   A. Growth
   B. Price
   C. Probabilities
   D. Returns
   E. None of these

31. [Quantitative] You are analyzing Irma Demolitions. You see that the firm just paid a dividend of $1 per share. You figure that the firm will grow at a rate of 5% going forward. If you require a 10% return on the firm's stock, what should the firm's stock price be today?
   A. $18
   B. $19
   C. $20
   D. $21
   E. A different value

32. [Conceptual] Which of the following is ***NOT*** a reason we might use free cash flow to the firm to value a company?
    A. Firm doesn't pay dividends
    B. Firm's dividends don't match its cash flows
    C. Intend to buy out the company
    D. Stable capital structure
    E. All of these are reasons to use free cash flow to the firm

33. [Conceptual] Two manufacturing firms are competitors. One firm primarily uses machinery, leading to high fixed costs and low variable costs. The other primarily relies on human labor, leading to low fixed costs and high variable costs. Which multiple might we wish to avoid when comparing the two firms?
    A. Enterprise Value / EBITDA
    B. Price / Book Value
    C. Price / Cash Flow
    D. Price / Earnings
    E. Price / Sales

34. [Quantitative] You are analyzing Tech Demolitions. You observed that the firm just posted earnings of $3 per share. You see that the firm's dividends consistently grow at a 4% rate each year, and it routinely pays out 30% of its earnings as a dividend. If you require a 12% return on the stock, what is the justified P/E ratio for the stock?
    A. 3.6
    B. 3.75
    C. 3.9
    D. 4.1
    E. A different value