FIN500 - Critical Thinking - Module 4

1. *(Preferred stock valuation)* What is the value of a preferred stock when the dividend rate is 14 percent on a $100 par value? The appropriate discount rate for a stock of this risk level is 12 percent.

2. *(Preferred stock valuation)* Pioneer preferred stock is selling for $33 per share in the market and pays a $3.60 annual dividend.
   a. What is the expected rate of return on the stock?
   b. If an investor's required rate of return is 10 percent, what is the value of the stock for that investor?
   c. Should the investor acquire the stock?

3. *(Preferred stock valuation)* Calculate the value of a preferred stock that pays a dividend of $6 per share if your required rate of return is 12 percent.

4. *(Measuring growth)* The Fisayo Corporation wants to achieve a steady 7 percent growth rate. If it can achieve a 12 percent return on equity, what percentage of earnings must Fisayo retain for investment purposes?

5. *(Common stock valuation)* Dalton Inc. has an 11.5 percent return on equity and retains 55 percent of its earnings for reinvestment purposes. It recently paid a dividend of $3.25 and the stock is currently selling for $40.
   a. What is the growth rate for Dalton Inc.?
   b. What is the expected return for Dalton's stock?
   c. If you require a 13 percent return, should you invest in the firm?

6. *(Common stock valuation)* Bates Inc. pays a dividend of $1 and is currently selling for $32.50. If investors require a 12 percent return on their investment from buying Bates stock, what growth rate would Bates Inc. have to provide the investors?

7. *(Common stock valuation)* You intend to purchase Marigo common stock at $50 per share, hold it 1 year, and then sell it after a dividend of $6 is paid. How much will the stock price have to appreciate for you to satisfy your required rate of return of 15 percent?

8. *(Common stock valuation)* Header Motor Inc. paid a $3.50 dividend last year. At a constant growth rate of 5 percent, what is the value of the common stock if the investors require a 20 percent rate of return?

9. *(Measuring growth)* Given that a firm's return on equity is 18 percent and management plans to retain 40 percent of earnings for investment purposes, what will be the firm's growth rate?

10. *(Common stock valuation)* Honeywag common stock is expected to pay $1.85 in dividends next year, and the market price is projected to be $42.50 per share by year-end. If investors require a rate of return of 11 percent, what is the current value of the stock?

11. *(Common stock valuation)* The common stock of NCP paid $1.32 in dividends last year. Dividends are expected to grow at an 8 percent annual rate for an indefinite number of years.
    a. If NCP's current market price is $23.50 per share, what is the stock's expected rate of return?
    b. If your required rate of return is 10.5 percent, what is the value of the stock for you?
    c. Should you make the investment?

12. *(Preferred stock expected return)* You are planning to purchase 100 shares of preferred stock and must choose between Stock A and Stock B. Stock A pays an annual dividend of $4.50 and is currently selling for $35. Stock B pays an annual dividend of $4.25 and is selling for $36. If your required return is 12 percent, which stock should you choose?

13. *(Preferred stockholder expected return)* Solitron preferred stock is selling for $42.16 per share and pays $1.95 in dividends. What is your expected rate of return if you purchase the security at the market price?

14. *(Preferred stockholder expected return)* You own 200 shares of Somner Resources preferred which currently sells for $40 per share and pays annual dividends of $3.40 per share.
    a. What is your expected return?
    b. If you require an 8 percent return, given the current price, should you sell or buy more stock?

15. *(Common stockholder expected return)* Made-It common stock currently sells for $22.50 per share. The company's executives anticipate a constant growth rate of 10 percent and an end-of-year dividend of $2.
    a. What is your expected rate of return if you buy the stock for $22.50?
    b. If you require a 17 percent return, should you purchase the stock?

16. *(Common stockholder expected return)* The common stock of Zaldi Co. is selling for $32.84 per share. The stock recently paid dividends of $2.94 per share and has a projected constant growth rate of 9.5 percent. If you purchase the stock at the market price, what is your expected rate of return?

17. *(Common stockholder expected return)* The market price for Hobart common stock is $43 per share. The price at the end of 1 year is expected to be $48, and dividends for next year should be $2.84. What is the expected rate of return?