

- 1) DYI Construction Co. is considering a new inventory system that will cost \$750,000. The system is expected to generate positive cash flows over the next four years in the amounts of \$350,000 in year one, \$325,000 in year two, \$150,000 in year three, and \$180,000 in year four. DYI's required rate of return is 8%. What is the internal rate of return of this project? 1) _____
- A) 11.57% B) 10.87% C) 15.13% D) 13.68%

- 2) What is the net present value of the following cash flows if the relevant discount rate is 11.4 percent? 2) _____

Year	Cash Flow
0	-\$32,400
1	10,620
2	15,800
3	-3,110
4	26,600

- A) \$18,519.71 B) \$4,887.26 C) \$13,058.39 D) \$8,215.46

- 3) You are considering an investment for which you require a rate of return of 8.5 percent. The investment costs \$67,400 and will produce cash inflows of \$25,720 for three years. Should you accept this project based on its internal rate of return? Why or why not? 3) _____
- A) Yes; because the IRR is 9.51 percent B) No; because the IRR is 7.08 percent
 C) Yes; because the IRR is 7.08 percent D) No'; because the IRR is 9.51 percent

- 4) A project has the following cash flows. What is the payback period? 4) _____

Year	Cash Flow
0	-\$14,500
1	2,200
2	4,800
3	6,500
4	7,500

- A) 3.24 years B) 3.04 years C) 3.13 years D) 2.96 years

- 5) A firm is reviewing a project that has an initial cost of \$67,000. The project will produce annual cash inflows, starting with Year 1, of \$8,000, \$13,400, \$18,600, \$24,100, and finally in Year 5, \$37,900. What is the profitability index if the discount rate is 11 percent? 5) _____
- A) 1.05 B) .98 C) 1.02 D) .92 E) 1.09

6) Consider the following two mutually exclusive projects:

6) _____

<u>Year</u>	<u>Cash Flow</u> (A)	<u>Cash</u> <u>Flow(B)</u>
0	-\$54,000	-\$23,000
1	12,700	11,600
2	23,200	11,200
3	27,600	12,500
4	46,500	6,000

Whichever project you choose, if any, you require a rate of return of 14 percent on your investment. If you apply the payback criterion, you will choose Project _____; if you apply the NPV criterion, you will choose Project _____; if you apply the IRR criterion, you will choose Project _____; if you choose the profitability index criterion, you will choose Project _____. Based on your first four answers, which project will you finally choose?

- A) A; A; B; B; A
 B) B; A; B; B; A
 C) B; A; B; A; A
 D) A; B; A; A; B

7) Corner Restaurant is considering a project with an initial cost of \$211,600. The project will not produce any cash flows for the first three years. Starting in Year 4, the project will produce cash inflows of \$151,000 a year for three years. This project is risky, so the firm has assigned it a discount rate of 18.6 percent. What is the project's net present value?

7) _____

- A) \$113,585.57 B) -\$16,670.67 C) -\$4,591.11 D) \$2,255.56

8) What is the IRR for the following project if its initial after-tax cost is \$5,000,000 and it is expected to provide after-tax operating cash flows of (\$1,800,000) in year 1, \$2,900,000 in year 2, \$2,700,000 in year 3, and \$2,300,000 in year 4?

8) _____

- A) 11.44% B) 6.85% C) 5.83% D) 9.67%

9) Your firm is considering an investment that will cost \$920,000 today. The investment will produce cash flows of \$450,000 in year 1, \$270,000 in years 2 through 4, and \$200,000 in year 5. The discount rate that your firm uses for projects of this type is 11.25%. What is the investment's profitability index?

9) _____

- A) 1.43 B) 1.69 C) 1.26 D) 1.21

10) Your company is considering a project with the following cash flows:
 Initial Outlay = \$3,000,000
 Cash Flows Year 1-8 = \$547,000

10) _____

Compute the internal rate of return on the project.

- A) 8.95% B) 6.38% C) 9.25% D) 12.34%

- 11) Southeast Compositions, Inc. is considering a project with the following cash flows: 11) _____
- Initial Outlay = \$126,000
Cash Flows: Year 1 = \$44,000
Year 2 = \$59,000
Year 3 = \$64,000
- Compute the net present value of this project if the company's discount rate is 14%.
- A) -\$138,561 B) \$725,000 C) \$239,209 D) -\$249,335
- 12) Your firm is considering an investment that will cost \$920,000 today. The investment will produce cash flows of \$450,000 in year 1, \$270,000 in years 2 through 4, and \$200,000 in year 5. The discount rate that your firm uses for projects of this type is 11.25%. What is the investment's net present value? 12) _____
- A) \$192,369 B) \$112,583 C) \$540,000 D) \$378,458
- 13) Jamie is analyzing the estimated net present value of a project under various conditions by revising the sales quantity, sales price, and the cost estimates. The type of analysis that Jamie is doing is best described as: 13) _____
- A) sensitivity analysis. B) scenario analysis.
C) opportunity evaluation. D) erosion planning.
- 14) You purchased 400 shares of KNO stock five years ago and have earned annual returns of 8.3 percent, 9.6 percent, 18.25 percent, -7.7 percent, and 1.8 percent, respectively. What is your arithmetic average return? 14) _____
- A) 6.47 percent B) 6.23 percent C) 6.05 percent D) 8.01 percent
- 15) Sensitivity analysis: 15) _____
- A) helps identify the variable within a project that presents the greatest forecasting risk.
B) looks at the most reasonably optimistic and pessimistic results for a project.
C) is used for projects that cannot be analyzed by scenario analysis because the cash flows are unconventional.
D) is generally conducted prior to scenario analysis just to determine if the range of potential outcomes is acceptable.
E) illustrates how an increase in operating cash flow caused by changing both the revenue and the costs simultaneously will change the net present value for a project.
- 16) Your portfolio has provided you with returns of 11.4 percent, 6.2 percent, -.7 percent, and 14.6 percent over the past four years, respectively. What is the geometric average return for this period? 16) _____
- A) 7.25 percent B) 7.72 percent C) 7.63 percent D) 7.57 percent

- 17) A stock has returns for five years of 14 percent, -16 percent, 12 percent, 23 percent, and 4 percent, respectively. The stock has an average return of _____ percent and a standard deviation of _____ percent. 17) _____
 A) 8.60; 16.36 B) 7.40; 13.54 C) 7.40; 14.72 D) 8.60; 14.63
- 18) Semistrong form market efficiency states that the value of a security is based on: 18) _____
 A) all public and private information.
 B) all publicly available information plus any data that can be gathered from insider trading.
 C) historical information only.
 D) random information with no clear distinction as to the source of that information.
 E) all publicly available information.
- 19) Which one of these is the best example of systematic risk? 19) _____
 A) Decrease in textile imports B) Decrease in gross domestic product
 C) Discovery of a major gas field D) Increase in agricultural exports
- 20) PL Lumber stock is expected to return 22 percent in a booming economy, 15 percent in a normal economy, and lose 2 percent in a recession. The probabilities of an economic boom, normal state, or recession are 5 percent, 92 percent, and 3 percent, respectively. What is the expected rate of return on this stock? 20) _____
 A) 15.47 percent B) 15.26 percent C) 14.84 percent D) 14.51 percent
- 21) Fiddler's Music Stores' stock has a risk premium of 8.3 percent while the inflation rate is 3.1 percent and the risk-free rate is 3.8 percent. What is the expected return on this stock? 21) _____
 A) 15.2 percent B) 9.0 percent C) 6.9 percent D) 12.1 percent
- 22) Bruno's stock should return 14 percent in a boom, 11 percent in a normal economy, and 4 percent in a recession. The probabilities of a boom, normal economy, and recession are 8 percent, 90 percent, and 2 percent, respectively. What is the variance of the returns on this stock? 22) _____
 A) .011387 B) .001538 C) .011561 D) .001506 E) .000169
- 23) A beta of 1.0 is the beta of the _____, while a beta of 0.0 is the measure for a _____. 23) _____
 A) market; single security held on its own.
 B) risk-free security; single security held on its own.
 C) risk-free security; market.
 D) market; risk-free security.

Answer Key

Testname: PRACTICEEXAM3

- 1) C
- 2) B
- 3) B
- 4) C
- 5) A
- 6) C
- 7) B
- 8) C
- 9) D
- 10) C
- 11) D
- 12) A
- 13) B
- 14) C
- 15) A
- 16) B
- 17) C
- 18) E
- 19) B
- 20) C
- 21) D
- 22) E
- 23) D