1

The current price of a stock is $65.88. If dividends are expected to be $1 per share for the next five years ,and the required return is 10%, then what should be the price of the stock be in 5 years when you plan to sell it? If the dividend and the required return the same, and the stock price is expected to increase by $1, why or why not?

2

A company has just announced a 3-for 1 stock split, effective immediately .prior to the split, the company had a market value of $5 billion with $100 million shares outstanding. Assuming that the split conveys no new information about the company, what is the value of the company, the number of shares outstanding and price per share after the split? If the actual market price immediately following the split is $17 per share, what does this tell us about market efficiency?

3

You wish to hire Ron to manage your Dallas operations .The profits from the operations depend partially on how hard Ron works, as follows

|  |
| --- |
|  |
|  | Profit=$10,000 | Profit=$50,000 |
| Lazy | 60% | 40% |
| Hard Worker | 20% | 80% |
|  |  |  |

If Ron is lazy ,he will surf the internet all day, and he views this as a zero cost opportunity .However ,Ron would view working hard as a personal cost. Valued at $100 .What fixed percentage of the profits should you offer Ron? Assume Ron cares only about his expected payment less any personal cost

4

You own a car worth 400,000 that is located on a river. If the river floods moderately, the house will be completely destroyed .This happens about once every 50 years .If you build a seawall, the river would have to flood heavily to destroy your house .Which happens only about once every 200 years.

What Is the annual premium for an insurance policy that offers full insurance? For a policy that pays only 75% of the home value. What are you expected costs with and without a seawall? Do the different policies provide an incentive to be safer (i.e , to build the several)