



EQUITY SECURITIES

CHAPTER EXAM

1.

If interest rates fall, issuers most likely will call:

- I low dividend rate preferred issues
 - II high dividend rate preferred issues
 - III preferred issues trading at a premium
 - IV preferred issues trading at a discount
- a. I and III
 - b. I and IV
 - c. II and III
 - d. II and IV

2.

Which of the following terms describes common stock?

- a. negotiable
- b. redeemable
- c. non-negotiable
- d. callable

3.

Which security of the same issuer is likely to give the highest current yield?

- a. warrant
- b. common stock
- c. convertible preferred stock
- d. non-convertible preferred stock

4.

The definition of Treasury Stock is:

- a. issued shares which are outstanding
- b. issued shares which are no longer outstanding
- c. unissued shares which are outstanding
- d. unissued shares which are no longer outstanding

5.

PDQ Company \$1 par common stock currently trading at \$55. PDQ is currently paying a quarterly common dividend of \$1.10 per share. The current yield of PDQ stock is:

- a. 2.0%
- b. 4.4%
- c. 8.0%
- d. 44.0%

6.

A customer gives a power of attorney to a caretaker to vote his shares on his behalf at the company's annual meeting. Which statements are **TRUE**?

- I This is known as a proxy
 - II This is known as a voting trust
 - III Once given, the power of attorney cannot be revoked
 - IV The power of attorney can be revoked prior to the annual meeting
- a. I and III
 - b. I and IV
 - c. II and III
 - d. II and IV

7.

All of the following statements are true regarding the effect of the purchase of Treasury Stock **EXCEPT**:

- a. the number of outstanding shares is reduced
- b. the earnings per share is increased
- c. the market price of the stock will increase
- d. the number of authorized shares will be reduced

8.

Which of the following statements are **TRUE** regarding the rights agent?

- I The rights agent usually handles the mechanics of a rights offering
 - II The rights agent is usually the existing transfer agent of the issuer
 - III The rights agent issues the additional shares upon presentation of the rights certificates with payment
- a. I only
 - b. I and II
 - c. II and III
 - d. I, II, III

9.

The transfer agent will typically perform which of the following functions?

- I Canceling old stock certificates
 - II Issuing new stock certificates
 - III Acting as disbursement agent for the corporation
 - IV Maintaining the integrity of the record of all shareholder names and addresses
- a. I and II only
 - b. III and IV only
 - c. I, II, III
 - d. I, II, III, IV

10.

In a corporate liquidation, common stockholders are paid:

- a. first
- b. after creditors but before preferred stockholders
- c. after bondholders but before preferred stockholders
- d. last

11.

A customer buys 100 shares of preferred at \$51 per share. The par value is \$50. The dividend rate is 8%. Each dividend payment would be:

- a. \$200
- b. \$400
- c. \$600
- d. \$800

**12.**

ABC Corporation has declared a cash dividend to stockholders of record on Monday, November 21st. The last day to buy ABC shares **BEFORE** they go ex dividend is?

- a. Wednesday, November 16th
- b. Thursday, November 17th
- c. Friday, November 18th
- d. Sunday, November 20th

13.

Which of the following do **NOT** pay dividends?

- I Preferred Stock
- II ADRs
- III Warrants
- IV Real Estate Investment Trust Shares

- a. I only
- b. III only
- c. III and IV
- d. II and IV

14.

All of the following statements about warrants are true **EXCEPT**:

- a. warrants have a longer term than rights
- b. warrants are issued to make corporate senior securities offerings more attractive to investors
- c. warrants give the holder a perpetual interest in the issuer's underlying common stock
- d. warrants trade separately from the stock of the company

15.

As interest rates fall, preferred stock prices will:

- a. remain unaffected
- b. rise
- c. fall
- d. fluctuate

16.

A company's common stock is selling in the market at a "multiple of 10". If the market price of the common stock is currently \$10, which statement is **TRUE**?

- a. The company has paid dividends of \$1 per share this year
- b. The company has earnings per share of \$1 this year
- c. The company has paid dividends of \$100 per share this year
- d. The company has earnings per share of \$100 this year

17.

A customer owns 210 shares of ABC common stock. ABC declares a rights offering, with the terms being that for every 20 rights tendered, a shareholder may purchase one additional share at \$20 per share. Any fractional rights holding may be rounded up to buy an additional share. If this shareholder wishes to subscribe, which statement is **TRUE**?

- a. The shareholder can buy a maximum of 10 shares by paying \$20
- b. The shareholder can buy a maximum of 11 shares by paying \$220
- c. The shareholder can buy a maximum of 11 shares by paying \$420
- d. The shareholder can buy a maximum of 110 shares by paying \$2,200

18.

All of the following are methods of dividend payment **EXCEPT**:

- a. cash
- b. stock
- c. rights
- d. product

19.

Which of the following statements are **TRUE** about preferred stock?

- I Dividends are paid before common
- II Dividends are paid monthly
- III Dividends are based on corporate earnings
- IV Preferred shareholders have a prior claim to common shareholders

- a. I and II
- b. I and IV
- c. II, III, IV
- d. I, II, III, IV

20.

Cumulative voting is considered to be an advantage as it:

- I allows a proportionate voting weight
- II allows a disproportionate voting weight
- III is considered to be an advantage for the smaller investor
- IV is considered to be an advantage for the larger investor

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV



EQUITY SECURITIES - CHAPTER EXAM EXPLANATIONS

1. The best answer is **c**. If interest rates fall, issuers most likely will "call in" old high rate preferred and replace it by selling new preferred at the lower current rates. High rate preferred will sell at a premium if market interest rates are dropping.
2. The best answer is **a**. Common stock is a negotiable (transferable) security. It is not redeemable with the issuer nor is it callable by the issuer.
3. The best answer is **d**. Warrants give no yield. Common stocks give the lowest yields since there is direct growth potential in the price of the stock as reported earnings increase. Convertible preferred yields are higher than common yields but not as high as non-convertible yields. A non-convertible preferred stockholder gets a fixed rate of return without any growth potential. A convertible preferred stockholder can convert to common if the common's price rises, so growth potential is included. Because of this, yields for convertible preferred are lower than for non-convertible preferred.
4. The best answer is **b**. Treasury Stock consists of authorized shares which have been issued and subsequently repurchased, thus they are no longer outstanding.
5. The best answer is **c**. Yields are based on annual return. The formula for current yield is:

$$\frac{\text{Annual Income}}{\text{Market Price}} = \text{Current Yield}$$

$$\frac{\$4.40}{\$55} = 8\%$$

6. The best answer is **b**. When a shareholder cannot attend the annual meeting and vote, the shareholder can give a power of attorney to another individual or the management of the company to "stand in" and cast that shareholder's votes as directed. This is called a "proxy," where the individual granted the power of attorney acts as the shareholder's proxy. A power of attorney is revocable at any time as long as it is revoked in writing. The customer can revoke the power of attorney if he decides to change his vote or decides to go to the annual meeting himself.

The "caretaker" wording used in the question is a little odd, but that individual granted the proxy must act in the shareholder's interests, so this person could be viewed as a caretaker.

7. The best answer is **d**. Treasury stock is deducted from outstanding shares and since outstanding shares are reduced, earnings per share increases. As earnings per share rises, this makes the stock more attractive to investors, who will bid up the stock's price in the market. The purchase of Treasury Stock has no effect on authorized shares.
8. The best answer is **d**. A rights agent is hired to handle the mechanics of a rights offering. The rights agent is usually the existing transfer agent of the issuer. To subscribe, the existing shareholders submit their rights with the subscription dollar amount to the rights agent.

9. The best answer is **c**. It is the responsibility of the registrar to maintain the integrity of the shareholder list, and to ensure that the number of shares transferred from one shareholder to another always matches. The transfer agent will cancel old shares, issue new shares, and act as disbursement agent for the corporation.

10. The best answer is **d**. In a liquidation, common shareholders are paid last, after creditors, bondholders, and preferred stockholders.

11. The best answer is **a**. The annual rate is $8\% \times \$50 \text{ par value} = \$4 \text{ per share} \times 100 \text{ shares} = \400 . Since preferred dividends are paid semi-annually, each payment is for \$200.

12. The best answer is **a**. The regular way ex date is 2 business days prior to the record date. The record date is Monday, November 21st, therefore the ex date is Thursday, November 17th. To buy the shares before they go ex dividend, the shares must be purchased before Thursday, November 17th, meaning they must be purchased on Wednesday, November 16th.

13. The best answer is **b**. Preferred stock pays a fixed dividend rate; American Depositary Receipt holders receive dividends; and Real Estate Investment Trusts are a type of common stock that is no different from other common shares, and thus they make dividend distributions to shareholders. Holders of warrants and rights do not receive dividends on these instruments. In order to receive dividends, these must be exercised, which results in the purchase of the common shares.

14. The best answer is **c**. Warrants are long term options to buy a company's shares at a fixed price. They are typically attached to debt and preferred stock offerings (securities that are "senior" to the common stock of the issuer) to make the securities more attractive to purchasers. This is accomplished because the warrant gives growth potential to these senior security holders if the common stock price should rise in the future. Warrants typically have a fixed life of 5 years or less and then expire. Companies can issue perpetual warrants, but rarely do so.

15. The best answer is **b**. Preferred stock is a fixed income security whose prices move inversely with interest rates. As interest rates fall, preferred stock prices rise, so that the preferred will give a yield that is competitive with the current market.

16. The best answer is **b**. When a stock is selling at a "multiple" of 10, this means that the market price is 10 times the current earnings per share. The "multiple" refers to the Price/Earnings Per Share ratio.

17. The best answer is **b**. The terms of the rights offering are that fractional holdings are rounded up to buy 1 additional share. This person owns 210 shares and thus, will receive 210 rights. $210 \text{ rights} / 20 \text{ rights per share} = 10.5 \text{ shares}$, which is rounded up to 11 shares @ \$20 each = \$220 necessary to subscribe.

18. The best answer is **c**. The distribution of "rights" is not a dividend. Rather, it is the "pre-emptive" right of all shareholders to maintain proportionate ownership if the corporation wishes to issue additional shares. The corporation must distribute rights to existing shareholders if it wishes to



sell new common shares. Dividend distributions, on the other hand, are voluntary payments made by the corporation to its shareholders. The amount and form of payment are determined by the Board of Directors. Dividend payments can take the form of cash; stock dividends; or product dividends. For example, in years past, Procter and Gamble would send a "variety pack" of its products to shareholders in addition to the regular cash dividend. In recent years, product dividends have not been popular, since they are taxable to the shareholder as is any dividend, and the owner would rather receive cash.

19. The best answer is **b**. Preferred stock dividends are paid before common dividends can be paid and preferred shareholders have a prior claim to assets in a liquidation before common shareholders. Whereas common dividends are typically paid quarterly, preferred dividends are typically paid semi-annually - similar to bond interest payments (remember, both preferred and bonds are fixed income securities; common stock is not).

20. The best answer is **c**. Cumulative voting allows a disproportionate voting weight to be placed on selected directors who are up for election. This is considered to be advantageous for the smaller investor, who wishes to have a specific director (or directors) elected.



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Options

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TRADING MARKETS

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