FIN 423 - Fall 2012
Answers to Exam 1(Chapters 1 to 6)

Part 1- Multiple Choice Theory questions (4 points each)

Answers are in bold. Other references may exist.

1. The current yield of a coupon bond is the
   A. annual interest payment divided by the par value.
   B. yield to maturity.
   C. annual interest payment divided by the current market price.
   D. internal rate of return.
   E. none of the above.

Refer to page 121 and Exam 1 Practice #1

2. The yield to maturity is the
   A. rate you will earn if your bond is called on the earliest possible date.
   B. rate computed by dividing the annual interest by the par value.
   C. rate used to compute the amount of each interest payment.
   D. rate computed as the annual interest divided by the market value.
   E. discount rate that equates a bond's price with the present value of the bond's future cash flows.

Refer to page 121.

3. A discount bond
   A. pays a variable coupon payment.
   B. has a market price in excess of face value.
   C. has a coupon rate that is higher than that required yield.
   D. has a par value that is less than $1,000.
   E. has a face value that exceeds the market value.

Refer to page26.

4. Which one of the following does a bond issuer pay to redeem a bond prior to maturity?
   A. par value
   B. face value
   C. put price
   D. call price
   E. discounted price

Refer to pages 59 and 60. Other references exist.

5. Which one of the following is the risk that market interest rates may increase causing the price of a bond to decline?
   A. inflation risk
   B. reinvestment risk
   C. yield risk
   D. interest rate risk
   E. default risk

Refer to page 7 and Quiz 1.

6. The dirty price of a coupon bond is the
   A. invoice price.
   B. quoted price.
   C. issue price.
   D. average of the bid and asked prices.
   E. dealer purchase price.

Refer to pages 32, Homework Set 1 #10, and Exam 1 Practice #14

7. Which of the following will increase if the coupon rate increases?
   I. face value
   II. market value
   III. yield-to-maturity
   IV. current yield
   A. I and II only
   B. III and IV only
   C. I, II, and III only
   D. II, III, and IV only
   E. I, II, III, and IV

Refer to the formulas or definitions for market value (=current price), Yield to maturity, and Current Yield. Note that if the coupon rate increases, the annual coupon payment increases.

8. A bullet loan
   A. is a debt that cannot be called prior to the maturity date.
   B. cannot have a long-term maturity.
   C. is a debt in which no repayment of the principal is made until the maturity date.
   D. is an amortized debt.
   E. is a fallen angel.

Note: A bullet loan is different from a bullet bond. Refer to pages 62 and 83.

9. If a corporate security can be exchanged for a fixed number of shares of the issuer's stock, the security is said to be
   A. putable.
   B. callable.
   C. exchangeable.
   D. convertible.
   E. refundable.

Refer to Quiz 1 and page 6.

10. A commercial paper is essentially
   A. another term for a junk bond.
   B. a short-term unsecured corporate IOU.
   C. an intermediate-term corporate bond.
   D. a contract between a corporation and a commercial bank.
   E. a certificate that may be exchanged for a share of common stock at a specified future date.

Refer to pages 79 and 102.

11. Which one of the following statements about Medium-Term Notes (MTNs) is true?
   A. MTNs are securities with a maturity of more than one year but no more than ten years issued by the U.S. Treasury.
   B. MTNs cannot have a maturity of more than 20 years.
   C. MTNs are corporate debt instruments that are offered continuously to investors by an agent of the issuer.
   D. Borrowers do not have flexibility in designing MTNs.
   E. A corporation that wants an MTN program does not need to file a shelf-registration with the SEC.

Refer to page 76 and Quiz 2.

12. The interest income generated from reinvestment of a bond's coupons is referred as
   A. the capital gain from investing in the bond.
   B. the periodic interest payments made by the issuer.
   C. the interest-on-interest component of the bond's total dollar return.
   D. the interest income from reinvesting the bond's par value.
   E. the bond's total dollar return.

Refer to page 128.

<u>Part 2- Quantitative questions</u>

13. A 5.5% bond with a $1,000 par value matures in 7 years, pays interest semiannually, and has a required yield of 6.23%. What is the current market price of this bond? *(4 points)*

PMT = ½(0.055 × 1000) = 27.5; FV=1000; N=14; I/Y = 3.115; CPT PV

Current market Price = **$959.09**

Refer to pages 21 to 24 for the formula, Homework Set 1 #13, and Exam 1 Practice #7.

14. A 6.5% coupon bond has a face value of $1,000 and a current yield of 6.61%. What is the current market price of this bond? *(2 points)*

$$Current\ Yield = \frac{Annual\ coupon\ payment}{Current\ price}$$