HEC Paris **Financial Markets** **Practice Quiz 1**

ANSWER KEY

Your answers must be based on the CAPM and the Constant Growth Dividend Discount Model.

1) If the expected dividends for company A are larger than the expected dividends for company B, then the share price of A is larger than the share price of B.

- ☐ always true
- ☐ <u>impossible to tell without knowing the risk of the two companies</u>

<u>Questions 2 to 5</u>: Company ABC current price (at t=0) is € 50 per share. The dividend policy for this company is to distribute 80% of earnings to shareholders in the form of dividends. What remains of the earnings is reinvested at a ROE of 10%. The cost of capital for Company X is 10%.

2) What is the growth rate of dividends for company ABC?

☐ 1%	☐ <u>2%</u>
☐ 3%	☐ 4%
☐ 5%	☐ 7%

3) What is the next year's expected dividend?

☐ € 1.0	☐ € 2.5
☐ € 1.5	☐ € 3.0
☐ € 2.0	☐ <u>€ 4.0</u>

4) What is next year's expected stock price (at t=1) for company ABC?

☐ € 10	☐ <u>€ 51</u>
☐ € 26	☐ € 120
☐ € 36	☐ € + ∞

5) If the covariance between company ABC's returns and the market portfolio decreases what happens to the stock price of company ABC holding everything else constant?

- ☐ <u>it increases</u>
- ☐ it decreases
- ☐ it does not change