# Chapter 12 - Test Bank

### Multiple-choice questions

[Go to ⇨ Multiple choice questions - Memorandum](#AC12MCQ)

*Answer the following questions by selecting the appropriate answer from the list below.*

**Market capitalisation can be defined as which ONE of the following?**

1. The total number of authorised shares multiplied by the current share price
2. The total number of authorised shares multiplied by the fair value share price
3. The total number of issued shares multiplied by the book value share price
4. The total number of issued shares multiplied by the current share price

**Which ONE of the following types of preference share can be exchanged for ordinary shares on specified terms?**

1. Redeemable preference shares
2. Convertible preference shares
3. Participating preference shares
4. Cumulative preference shares

Which ONE of the following is the key difference between ordinary and preference shares?

1. The tax treatment of dividends received by the shareholder
2. Priority in terms of rights to distribution of earnings
3. The tax treatment of dividends paid by the issuing company
4. Shareholder liability in the event of liquidation of the issuing company

**Tandiwe (Pty) Ltd is registered as a trading services provider (TSP) with the JSE. Which ONE of the following actions is this JSE member company allowed to perform?**

1. Buying and selling of equity securities for own account and on behalf of clients
2. Exercising discretion in the management of JSE-authorised investments on behalf of clients
3. Exercising control over dematerialised JSE-listed securities traded on the JSE equity division
4. Safeguarding funds intended for the purchase of equity securities on behalf of clients

**Which of the following statements with regard to the general principles on which the listing requirements of the JSE are built are correct?**

1. The public must be satisfied that it is appropriate for the securities of the issuing company to be listed.
2. Collective investment schemes holding shares should receive preferential treatment in terms of voting rights.
3. All material activities of the issuing company should be disclosed to the shareholders and the public.
4. The listing requirements and the continuing obligations should promote investor confidence in the market.
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
8. (i), (iii) and (iv) only

#### 

**The minimum share capital requirement for listing on the AltX board of the JSE is**

1. R0,5 million
2. R1 million
3. R2 million
4. R5 million

**The issuing of shares by a company for the attainment of assets not already listed is called**

1. a capitalisation issue
2. a rights offer
3. a claw-back offer
4. an acquisition issue

#### 

**According to the relative valuation method, the intrinsic value of a share is derived by**

1. determining the share’s co-movement with the market
2. calculating the present value of future cash flows
3. estimating the expected return and variability of return for the share
4. expressing the current price of the share as a multiple of earnings

**Calculate the estimated price of a share, using relative valuation, given the following:**

* Expected earnings per share = R5,50
* Expected book value per share = R45,50
* Price/earnings (PE) ratio = 7

1. R6,50
2. R38,50
3. R45,50
4. R55,48

**Which ONE of the following is a limitation of the single-stage Gordon growth model?**

1. Its sensitivity to growth rate input
2. Not defined when rate of return reaches infinity
3. Its unrealistic inflation assumptions
4. Difficult to use in practice

### Written questions

[Go to ⇨ Written questions - Memorandum](#AC12WQ)

*Answer the following questions.*

**The pre-emptive rights of shareholders are a characteristic of ordinary shares. Explain this concept by way of an example.**

**New Bank issued 10 000 preference shares at a par value of R25 each and a dividend of 80 per cent of the prime rate. The current share price of New Bank is R28,50 and the prime rate is 11 per cent. Calculate the total preference dividend pay-out for the year.**

**Discuss the characteristics of private equity.**

**Define depository receipts, and discuss the advantages of issuing them.**

#### 

**List the two JSE boards on which new share issues can currently be issued.**

#### 

**Given the following published share information for T-Max, how long would it take an investor to earn the equivalent of the total value of the current share price if earnings remain unchanged?**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Company** | **Close**  **(cents)** | **Day move (cents)** | **Day move**  **(%)** | **High** | **Low** | **Volume traded** | **12-month**  **high** | **12-month**  **low** | **Market cap**  **(R mil)** | **DY** | **PE ratio** |
| T-Max | 9 864 | + 428 | + 4,5 | 10 002 | 9 745 | 1 099 | 10 300 | 7 946 | 78 436,7 | 3,28 | 8,28 |

**AMS Ltd paid a R0,75 annual dividend in the CURRENT year. Assuming dividends are expected to grow at a constant rate of 8 per cent and a required rate of return of 11 per cent, calculate the intrinsic value.**

**What does the free cash flow to equity (FCFE) of a company indicate?**

**A broker enters a fill-or-kill market order to buy 5200 Protel shares. The following orders are already on the order book waiting to be executed during continuous trading. How will the new order be managed in the order book?**

|  |  |  |
| --- | --- | --- |
| **Sell orders** | | |
|  | **Price** | **Size** |
| Order A | 208 | 1 200 |
| Order B | 207 | 1 400 |
| Order C | 205 | 1 800 |

**Distinguish between covered and naked short sales.**

### True or false questions

[Go to ⇨ True/False questions - Memorandum](#AC12TFQ)

*Read the statements below and indicate whether they are true or false.*

**The shares of private limited companies may be listed and sold to the general public via stock exchanges.**

**Preference shareholders have the right to choose directors and vote on matters of importance to the company.**

**The prices of exchange-traded funds (ETFs) fluctuate at once in response to changes in their underlying portfolios, thereby offering the same intraday liquidity as other shares traded on exchange.**

**The listing requirements of the JSE stipulate that the CEO of an issuing company may not hold the position of chairman of the board.**

**The earnings yield is the annual earnings per share divided by the market price, which is also equal to the inverse of the dividend yield.**

### Choose the correct term

[Go to ⇨ Choose the correct term - Memorandum](#AC12CTCT)

*Select the correct term to make the statement accurate.*

#### 

**South African American Depository Receipts (ADRs) are USD-/ZAR-denominated depository receipts representing ownership in South African shares issued by a US/ZAR depository bank.**

**Investment banks/venture capitalists invest medium- and long-term funds in new and young firms.**

**An offer for sale/placing is a share-issuing method that involves offering the shares to a selected base of investors following private negotiations.**

**A market/limit order is an order to buy or a sell a specified number of shares to be executed immediately at any price but at a stipulated volume.**

**If an investor enters into a short sale, he or she believes that the price of the share will fall/rise.**

# Chapter 12 - Memorandum

### Multiple-choice questions

[Go back to ⇦ Multiple choice questions](#C12MCQ)

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**According to the relative valuation method, the intrinsic value of a share is derived by**

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1. Its sensitivity to growth rate input
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### Written questions

[Go back to ⇦Written questions](#C12WQ)

*Answer the following questions.*

**The pre-emptive rights of shareholders are a characteristic of ordinary shares. Explain this concept by way of an example.**

**Shareholders have the first option to buy new shares in proportion to their existing shareholding, thus their voting rights and claim to earnings cannot be diluted without their consent. For example, Rex Ltd owns 10 per cent or 100 of the 1000 shares of Jurassic Ltd. If Jurassic Ltd decides to issue an additional 100 shares, Rex Ltd has the right to purchase 10 per cent or 10 of the new shares issued to maintain its 10 per cent interest in Jurassic Ltd.**

**New Bank issued 10 000 preference shares at a par value of R25 each and a dividend of 80 per cent of the prime rate. The current share price of New Bank is R28,50 and the prime rate is 11 per cent. Calculate the total preference dividend pay-out for the year.**

**10 000 × R25 × 0,8 × 0,11 = R22 000**

**Discuss the characteristics of private equity.**

* **Private equity is privately held as opposed to publicly traded.**
* **Private equity investment entails active involvement in identifying the investment, negotiating and structuring the transaction, and monitoring the company once the investment is made. This often requires an investor to serve as a board member of the company.**
* **Private equity investments are not intended to be held indefinitely. Generally, alternative exit strategies are evaluated at the time the initial investment in the company is made. One such strategy would be to list the company on a stock exchange and sell the shares to the public.**
* **Private equity investments are high risk and high reward. Private equity investors seek a high return on their capital when the company prospers as they risk losing most, if not all, of their investment if the company fails.**

**Define depository receipts, and discuss the advantages of issuing them.**

**Depository receipts are certiﬁcates representing ownership in the ordinary shares of a company but that are traded and marketed outside of the company’s home country (i.e. in a host country). Depository receipts are quoted in the host country’s currency and treated in the same way as host country shares for trading, clearance, settlement, transfer and ownership purposes.**

**Depository receipts increase the company’s visibility in markets outside its home country, and allow the company access to capital in other countries.**

#### 

**List the JSE boards on which new share issues can currently be issued.**

* **The main board, which includes the Africa Board**
* **The Venture Capital Market (VCM)**
* **The Development Capital Market (DCM(**
* **AltX**

#### 

**Given the following published share information for T-Max, how long would it take an investor to earn the equivalent of the total value of the current share price if earnings remain unchanged?**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Company** | **Close**  **(cents)** | **Day move (cents)** | **Day move**  **(%)** | **High** | **Low** | **Volume traded** | **12-month**  **high** | **12-month**  **low** | **Market cap**  **(R mil)** | **DY** | **PE ratio** |
| T-Max | 9 864 | + 428 | + 4,5 | 10 002 | 9 745 | 1 099 | 10 300 | 7 946 | 78 436,7 | 3,28 | 8,28 |

**8,28 years (according to PE ratio)**

**AMS Ltd paid a R0,75 annual dividend in the CURRENT year. Assuming dividends are expected to grow at a constant rate of 8 per cent and a required rate of return of 11 per cent, calculate the intrinsic value.**

**DPS1 = R0,75 × (1 + 0,08) = R0,81**

**Value of share = R0,81/(0,11 – 0,08) = R27,00**

**What does the free cash flow to equity (FCFE) of a company indicate?**

**FCFE indicates what the company can afford to pay as dividends.**

**A broker enters a fill-or-kill market order to buy 5200 Protel shares. The following orders are already on the order book waiting to be executed during continuous trading. How will the new order be managed in the order book?**

|  |  |  |
| --- | --- | --- |
| **Sell orders** | | |
|  | **Price** | **Size** |
| Order A | 208 | 1 200 |
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**The order will not execute at all and the complete order will be deleted from the JSE central order book.**

**Distinguish between covered and naked short sales.**

**A short sale is a sale of a share that the seller does not own.**

**In a covered short sale transaction, the seller borrows shares and delivers them to the buyer within the standard settlement period (currently five business days). When it is time to exit the short position at some point in the future, the short seller will purchase equivalent shares in the market. These shares are then returned to the lender – that is, the original holder of the shares.**

**A naked short sale occurs when the seller does not borrow shares to make delivery to the buyer. JSE equities rules prohibit naked short selling.**

### True or false questions

[Go back to ⇦ True/False questions](#C12TFQ)

*Read the statements below and indicate whether they are true or false.*

**The shares of private limited companies may be listed and sold to the general public via stock exchanges.**

**False – the shares of private limited companies may not be offered for sale to the public. Transferability of shares is also restricted.**

**Preference shareholders have the right to choose directors and vote on matters of importance to the company.**

**False – preference shareholders only have limited voting rights and these usually do not concern important matters of the company.**

**The prices of exchange-traded funds (ETFs) fluctuate at once in response to changes in their underlying portfolios, thereby offering the same intraday liquidity as other shares traded on exchange.**

**True**

**The listing requirements of the JSE stipulate that the CEO of an issuing company may not hold the position of chairman of the board.**

**True**

**The earnings yield is the annual earnings per share divided by the market price, which is also equal to the inverse of the dividend yield.**

**False – the earnings yield is the inverse of the price/earnings ratio.**

### Choose the correct term

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*Select the correct term to make the statement accurate.*

#### 

**South African American Depository Receipts (ADRs) are USD-/ZAR-denominated depository receipts representing ownership in South African shares issued by a US/ZAR depository bank.**

**USD-; US**

**Investment banks/venture capitalists invest medium- and long-term funds in new and young firms.**

**Venture capitalists**

**An offer for sale/placing is a share-issuing method that involves offering the shares to a selected base of investors following private negotiations.**

**placing**

**A market/limit order is an order to buy or a sell a specified number of shares to be executed immediately at any price but at a stipulated volume.**

**market**

**If an investor enters into a short sale, he or she believes that the price of the share will fall/rise.**

**fall**