



Fin622 MID TERM 8

Fin622 PAPERS

Solved by

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MIDTERM EXAMINATION

Fall 2009

FIN622- Corporate Finance (Session - 4)

Time: 60 min

Marks: 50

Question No: 1 (Marks: 1) - Please choose one

Which of the following statements is TRUE regarding Profitability Index?

- ▶ It ignores time value of money
- ▶ It ignores future cash flows
- ▶ **It ignores the scale of investment** (page 36)
- ▶ It ignores return on investment

Question No: 2 (Marks: 1) - Please choose one

A company can improve (lower) its debt-to-total assets ratio by doing which of the following?

- ▶ By increasing the amount of borrowings
- ▶ By shifting short-term to long-term debt
- ▶ By shifting long-term to short-term debt
- ▶ **By selling the common stock**

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

Question No: 3 (Marks: 1) - Please choose one

A public limited Company had sales of Rs.2 million this year. The marketing manager expects sales to grow at a 10 percent compound annual rate over the next 10 years. On this basis, which of the following is the closest amount of sales in 10 years?

- ▶ **Rs.5,187,485.**
- ▶ Rs.2,593,722.
- ▶ Rs.4,622,885.
- ▶ Rs.5,081,309

$$2000000 (1.10)^{10} = 5,187,485$$

Question No: 4 (Marks: 1) - Please choose one

Suppose you wish to set aside Rs.2,000 at the beginning of each of the next 10 years (the first Rs.2,000 deposit would be made now) in an account paying 12 percent compounded annually. Approximately how much will you accumulate at the end of 10 years?

- ▶ Rs.22,863
- ▶ Rs.35,097
- ▶ **Rs.39,310**
- ▶ Rs.25,151

Question No: 5 (Marks: 1) - Please choose one

Which of the following terms refers to the process of systematic investigation of the effects on estimates or outcomes of changes in data or parameter inputs or assumptions to evaluate a capital project?

- ▶ **Sensitivity Analysis** (page 36)
- ▶ Fundamental Analysis
- ▶ Technical Analysis
- ▶ Trend Analysis

Question No: 6 (Marks: 1) - Please choose one

The percentage change in a firm's operating profit (EBIT) resulting from a 1% change in output (sales) is known as the _____.

- ▶ **Degree of operating leverage**
- ▶ Degree of profit leverage
- ▶ Degree of total leverage
- ▶ Degree of financial leverage

Question No: 7 (Marks: 1) - Please choose one

A project would be financially feasible in which of the following situations?

- ▶ If Internal Rate of Return of a project is greater than zero
- ▶ If Net Present Value of a project is less than zero
- ▶ If the project has Profitability Index less than one
- ▶ **If the project has Profitability Index greater than one**

Question No: 8 (Marks: 1) - Please choose one

Which of the following is determined by variance of an investment's returns?

- ▶ **Volatility of the rates of return.**

- ▶ Probability of a negative return.
- ▶ Historic return over long periods.
- ▶ Average value of the investment.

Question No: 9 (Marks: 1) - Please choose one

Which of the following conditions, if exist, will make the diversification of stocks more effective?

- ▶ Securities contained in a portfolio are positively correlated
- ▶ **Securities contained in a portfolio are negatively correlated**
- ▶ Securities contained in a portfolio have high market values
- ▶ Securities contained in a portfolio have low market values

Question No: 10 (Marks: 1) - Please choose one

Which one of the following terms refers to the variability of return on stocks or portfolios not explained by general market movements, and is avoidable through proper diversification?

- ▶ Total risk
- ▶ Systematic risk
- ▶ **Unsystematic risk**
- ▶ Market risk

http://webcache.googleusercontent.com/search?q=cache:HgwIY_x4B_oJ:wps.pearsoned.co.uk/wps/media/objects/1669/1709809/0273685988_ch05.ppt+Which+one+of+the+following+terms+refers+to+the+variability+of+return+on+stocks+or+portfolios+not+explained+by+general+market+movements,+and+is+avoidable+through+proper+diversification%3F&cd=3&hl=en&ct=clnk&gl=pk

Systematic Risk is the **variability** of **return** on **stocks** or **portfolios** associated with changes in **return** on the **market** as a whole.

Unsystematic Risk is the **variability** of **return** on **stocks** or **portfolios** **not explained** by **general market movements**. It is **avoidable** through **diversification**.

Total risk = Systematic Risk + Unsystematic Risk

Question No: 11 (Marks: 1) - Please choose one

Suppose a stock is selling today for Rs.40 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.44.00. what is the rate of return on this stock?

- ▶ 12%
- ▶ 13%
- ▶ 14%
- ▶ **15%**

SOLUTION

2/40*100 = 5%

4/ 40 *100= 10%

ANOTHER SOLUTION

6 / 40 = 15%

Question No: 12 (Marks: 1) - Please choose one

If the common stocks of a company have beta value less than 1, then such stocks refer to which of the following?

- ▶ Normal stocks
- ▶ Aggressive stocks
- ▶ **Defensive stocks**
- ▶ Income stocks

<http://www.investopedia.com/terms/d/defensivestock.asp>

Question No: 13 (Marks: 1) - Please choose one

What will be the risk premium if the market portfolio has an expected return of 10% and the risk free rate is 4%?

- ▶ 4%
- ▶ 5%
- ▶ **6%**
- ▶ 7%

Market risk premium, (Erm – Rf)
10% - 4%
= 6%

Question No: 14 (Marks: 1) - Please choose one

A firm had an interest expense of Rs.400,000 on its outstanding debt during the financial year 2006-2007. If the firm marginal tax rate is 40%, what was the total tax savings of the firm during the period 2006-2007?

- ▶ Rs.150,000
- ▶ **Rs.160,000**

- ▶ Rs.170,000
- ▶ Rs.180,000

400,000 *40/100 = 160,000

Question No: 15 (Marks: 1) - Please choose one

In which of the following dividend policies, the amount of dividend is relatively fixed?

▶ **Constant payout ratio policy** (page 73)

- ▶ Hybrid dividend policy
- ▶ Residual dividend policy
- ▶ Stable dividend policy

Question No: 16 (Marks: 1) - Please choose one

Which of the following is a proposition of Miller and Modigliani theory of Capital structure?

▶ **Value of a firm is independent of its capital structure**

- ▶ Value of a firm is independent of its level of debt
- ▶ Value of a firm is dependent of its cost of capital
- ▶ Value of a firm is independent on its level of equity finances

Question No: 17 (Marks: 1) - Please choose one

Which of the following companies may be considered as a Pure Play in the beverages industry in Pakistan?

▶ **Coca Cola**

- ▶ Pepsi
- ▶ Shezan
- ▶ Nestlé

Question No: 18 (Marks: 1) - Please choose one

Which of the following is a disadvantage of Capital Asset Pricing Model?

- ▶ It considers market risk
- ▶ It can be used for listed companies
- ▶ It can be used for non-listed companies

▶ **It is based on past data** (page 52)

Question No: 19 (Marks: 1) - Please choose one

Which of the following methods would be most suitable for calculating the return on stocks of a non-listed company?

▶ **Dividend Growth Model**

- ▶ Capital Asset Pricing Model
- ▶ Security Market Line
- ▶ Characteristics Line

$r = \text{Div1} / P_0 + g$

Question No: 20 (Marks: 1) - Please choose one

What will be the effect of reduction in the cost of capital on the accounting break-even level of revenues?

- ▶ It raises the break-even level.
- ▶ It reduces the break-even level.
- ▶ **It has no effect on the break-even level** (repeated)

▶ This cannot be determined without knowing the length of the investment horizon.

Question No: 21 (Marks: 1) - Please choose one

Which of the following statements is **TRUE** regarding Balance Sheet of a firm?

- ▶ It reports how much of the firm's earnings were retained in the business rather than paid out in dividends.
- ▶ It reports the impact of a firm's operating, investing, and financing activities on cash flows over an accounting period.

▶ **It shows the firm's financial position at a specific point in time.**

▶ It summarizes the firm's revenues and expenses over an accounting period.

Question No: 22 (Marks: 1) - Please choose one

Which of the following would be a consequence of a high Inventory Turnover Ratio?

▶ **Low level of inventory and frequent stock-outs**

- ▶ Seasonal elements peculiar to the business
- ▶ Efficient inventory management
- ▶ Any of the given option

Question No: 23 (Marks: 1) - Please choose one

Short-term creditors would be most interested in which of the following ratios of a firm?

▶ Coverage ratios

▶ **Liquidity ratios**

- ▶ Profitability ratios
- ▶ Debt ratios

<http://www.docstoc.com/docs/1036816/Current-Cash-Debt-Coverage-Ratio>

Question No: 24 (Marks: 1) - Please choose one

What are the earnings per share (EPS) for a company that earned Rs.100,000 last year in after-tax profits, has 200,000 common shares outstanding, and Rs.1.2 million in retained earnings at the year end?

- ▶ Rs. 6.50
- ▶ Rs. 6
- ▶ Rs. 100,000

▶ **Rs. 0.50**

Question No: 25 (Marks: 1) - Please choose one

Which of the following statements is **CORRECT** with respect to common-size income and balance sheet statements?

▶ They show how total sales change over time, but not total assets.

▶ **They show how both total sales and total assets change over time.**

▶ They provide no information about how total assets or total sales change over time.

▶ They show how total assets change over time, but not total sales.

<http://www.netmba.com/finance/statements/common-size/>

Question No: 26 (Marks: 1) - Please choose one

Which one of the following statements is **TRUE** regarding Present Value of an amount

to be received at some future date?

- ▶ It increases as the years to receipt increases
- ▶ It remains unaffected as the years to receipt increases
- ▶ **It decreases as the years to receipt increases**
- ▶ None of the given options

Question No: 27 (Marks: 1) - Please choose one

How many years will it take for Rs.152,000 to grow to be Rs. 405,000 if it is invested in an account with an annual interest rate of 10%?

- ▶ 13.68
- ▶ 8.23
- ▶ **10.28**
- ▶ Cannot be calculated from the given data

<http://webcache.googleusercontent.com/search?q=cache:wZYpkI18Q4EJ:www.pageout.net/user/www/r/k/rkiss/cquest6.%28A%29.doc+If+you+deposit+Rs.+12,000+per+year+for+16+years+%28each+deposit+is+made+at+the+beginning+of+each+year%29+in+an+account+that+pays+an+annual+interest+rate+of+15%25,+what+will+your+account+be+worth+at+the+end+of+16+years%3F&cd=9&hl=en&ct=clnk&gl=pk>

Question No: 28 (Marks: 1) - Please choose one

If you deposit Rs. 12,000 per year for 16 years (each deposit is made at the beginning of each year) in an account that pays an annual interest rate of 15%, what will your account be worth at the end of 16 years?

- ▶ Rs. 82,168.44
- ▶ Rs. 71,450.82
- ▶ **Rs. 768,901.12**
- ▶ Rs. 668,609.67

Question No: 29 (Marks: 1) - Please choose one

Which of the following types of bonds pays no annual interest to the holder, but is sold at discount below the par value?

- ▶ An original maturity bond
- ▶ A floating rate bond
- ▶ A fixed maturity date bond

▶ **A zero coupon bond**

Question No: 30 (Marks: 1) - Please choose one

Which of the following is the rate of return earned on a bond if held till maturity?

- ▶ Yield-to-call
- ▶ Coupon payment
- ▶ **Yield-to-maturity**
- ▶ Sinking fund yield

<http://www.allbusiness.com/glossaries/yield-to-maturity-ytm/4944151-1.html>

Question No: 31 (Marks: 1) - Please choose one

Which one of the following statements best describes the relationship between market interest rates and bond prices?

- ▶ Market interest rates and bond prices move in the same direction
- ▶ **Market interest rates and bond prices move in opposite directions**
- ▶ Sometimes move in the same direction, sometimes in opposite directions
- ▶ Market interest rate and bond prices have no relationship with each other

Question No: 32 (Marks: 1) - Please choose one

When the market's required rate of return for a particular bond is much less than its coupon rate, the bond will be selling at which one of the following?

- ▶ **At premium**
- ▶ At discount
- ▶ At par
- ▶ Cannot be determined without more information

<http://web.utk.edu/~jwachowi/mcquiz/mc4.html>

Question No: 33 (Marks: 1) - Please choose one

Which of the following techniques of stock evaluation considers quantitative factors as well as qualitative factors for valuation?

- ▶ Technical Analysis
- ▶ **Fundamental Analysis**
- ▶ Constant Growth Model
- ▶ No Growth Model

http://www.indianmoney.com/moneyschool/money-gyan-articles.php?cat_id=1&sub_id=12&aid=869&acat=&page_id=3&ahead=Stock%20Valuation%20Technique.....!!!%20%28Fundamental%20Analysis%29&subcat=2

Question No: 34 (Marks: 1) - Please choose one

In which of the following situations market price of a security will move down?

- ▶ **When market price of the security is above the intrinsic value of the security**
- ▶ When market price of the security is equal to the intrinsic value of the security
- ▶ When market value of the security is equal to the face value of the security
- ▶ When market price of the security is below the intrinsic value of the security

Question No: 35 (Marks: 1) - Please choose one

Which of the following could be used to calculate the cost of common equity?

- ▶ Interpolation method
- ▶ Dividend discount model
- ▶ YTM (Yield-to-Maturity) method
- ▶ **Capital structure valuation**

Question No: 36 (Marks: 1) - Please choose one

Which of the following is a long-term source of financing for a firm?

- ▶ **Corporate bonds**
- ▶ Money market instruments
- ▶ Trade credit
- ▶ Accounts payables

Question No: 37 (Marks: 1) - Please choose one

Which of the following focuses on long-term investment decision-making process?

- ▶ Working Capital Management
- ▶ **Capital Budgeting**
- ▶ Cash Budgeting
- ▶ None of the given options

Question No: 38 (Marks: 1) - Please choose one

Since the capital budgeting techniques use cash flows instead of accounting flows, therefore, the financial manager must add back which one of the following to the analysis?

- ▶ The cost of fixed assets
- ▶ The cost of accounts payable
- ▶ Investments
- ▶ **Depreciation**

http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html

Question No: 39 (Marks: 1) - Please choose one

Which of the following capital budgeting methods focuses on firm's liquidity?

- ▶ Internal Rate of Return
- ▶ **Payback method**
- ▶ Net Present Value
- ▶ None of the given options

http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html

Question No: 40 (Marks: 1) - Please choose one

When faced with mutually exclusive options, which project should be accepted under the 'Payback Method'?

- ▶ The one with the longest payback period
- ▶ The one with the shortest Payback period
- ▶ **It doesn't matter because the payback method is not theoretically correct**
- ▶ None of the given options

http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html

MIDTERM EXAMINATION

Spring 2009

FIN622- Corporate Finance (Session - 1)

Question No: 1 (Marks: 1) - Please choose one

Which of the following statements is TRUE regarding Profitability Index?

It ignores time value of money
It ignores future cash flows

It ignores the scale of investment

It ignores return on investment

Question No: 2 (Marks: 1) - Please choose one

Which one of the following is an offering in which the shares of a company are offered to a limited number of investors?

Initial Public Offering

Private Placement

Direct Public Offering

Primary Offering

Question No: 3 (Marks: 1) - Please choose one

Following are the disadvantages of the Corporate Form of an organization EXCEPT

Reduction of double taxation.

Limited owner liability.

Legal restrictions.

Ease of organization.

<http://web.utk.edu/~jwachowi/mcquiz/mc2.html>

Question No: 4 (Marks: 1) - Please choose one

Suppose that a corporation of which you are a shareholder has just gone bankrupt. Its liabilities are far in excess of its assets. How much of your investment would you get back?

A proportionate share of bondholder claims based on the number of common shares that you own.

A proportional share of all creditor claims based on the number of common shares that you own.

An amount that could, at most, equal what you originally paid for the shares of common stock in the corporation.

Nothing

<http://web.utk.edu/~jwachowi/mcquiz/mc2.html>

Question No: 5 (Marks: 1) - Please choose one

Which of the following is a limitation of the Times Interest Earned Ratio?

It does not consider earnings of the company

It does not consider fixed financial payments other than interest

It uses earnings before interest and taxes which does not represent all of the cash flow available to service debt

It does not consider interest expense of the company

<http://webcache.googleusercontent.com/search?q=cache:4H0qiGpEtHQJ:www.pageout.net/user/www/r/k/rkiss/Brigham%2520chapter3.doc+Which+of+the+following+is+a+limitation+of+the+Times+Interest+Earned+Ratio%3F+It+does+not+consider+earnings+of+the+company+It+does+not+consider+fixed+financial+payments+other+than+interest+It+uses+earnings+before+interest+and+taxes+which+does+not+represent+all+of+the+cash+flow+available+to+service+debt+It+does+not+consider+interest+expense+of+the+company&cd=1&hl=en&ct=clnk&gl=pk>

Question No: 6 (Marks: 1) - Please choose one

If a creditor wants to know about the bill payment status of a potential customer, the creditor could look at which one of the following ratios?

Current ratio.

Acid ratio.

Average age of accounts payable.

Average age of accounts receivable

Question No: 7 (Marks: 1) - Please choose one

For financial statement purposes, the accounting value of fixed assets is based upon which of the following?

It is based on their estimated liquidation value.

It is based on their relative importance to the company.

It is based on their actual purchase price.

It is based on their current market price.

Question No: 8 (Marks: 1) - Please choose one

Which of the following transactions affects the acid-test ratio?

Receivables are collected.

Inventory is liquidated for cash. PAGE # 11

New common stock is sold and used to retire a debt issue.

A new common stock issue is sold and equipment purchased.

Reference:

Two frequently-used liquidity ratios are the current ratio (or working capital ratio) and the quick ratio.

The current ratio is the ratio of current assets to current liabilities:

Current Ratio = Current Assets/Current Liabilities

One drawback of the current ratio is that **inventory may include many items that are difficult to liquidate quickly and that have uncertain liquidation values. The quick ratio is an alternative measure of liquidity** that does not include inventory in the current assets. The quick ratio is defined as follows:

Quick Ratio = (Current Assets – Inventory)/ Current Liabilities

Question No: 9 (Marks: 1) - Please choose one

Which of the following refers to the value at which an asset is carried on a balance sheet?

Book Value

Market Value

Fair Value

Liquidation Value

Question No: 10 (Marks: 1) - Please choose one

Suppose you invested Rs. 8,000 in a savings account paying 5 percent interest a year, compounded annually. How much amount you r account will have at the end of four years?

Rs.9,624.

Rs.10,208.

Rs.9,728.

Rs.10,880

$8000(1.05)^4=9724$

Question No: 11 (Marks: 1) - Please choose one

What approximate annual interest rate would you have to earn in order to double your money in six years? (please choose the nearest figure)

16 percent

7 percent

10 percent

12 percent

Example

$5000(1.12)^6=9869$

Question No: 12 (Marks: 1) - Please choose one

If you invest Rs.400 today in a savings account paying 8 percent interest per year, how much will you have in the account at the end of three years if the interest is compounded annually?

Rs.325

Rs.1,299

Rs.504

Rs.609

$400(1.08)^3=504$

Question No: 13 (Marks: 1) - Please choose one

The present value of Rs.100 per year received for 10 years discounted at 8 percent is closest to which of the following amounts?

Rs.177.

Rs.362.

Rs.425.

Rs.671.

Calculation

$100/1.08+100/(1.18)^2+100/(1.08)^3+100/(1.08)^4+100/(1.08)^5+100/(1.08)^6+100/(1.08)^7+100(1.08)^8+100/(1.08)^9+100/(1.08)^{10}$
 $92+85+79+73+68+63+58+54+50+46$
 668

Question No: 14 (Marks: 1) - Please choose one

When the market's required rate of return for a particular bond is much less than its coupon rate, the bond will be selling at which one of the following?

At premium.

At discount.

Cannot be determined without more information.

At face value.

Question No: 15 (Marks: 1) - Please choose one

If a bond sells at a high premium, then which of the following relationships hold true?

(P0 represents the price of a bond and YTM is the bond's yield to maturity.)

P0 < par and YTM > the coupon rate.

P0 > par and YTM > the coupon rate.

P0 > par and YTM < the coupon rate.

P0 < par and YTM < the coupon rate.

<http://web.utk.edu/~jwachowi/mcquiz/mc4.html>

Question No: 16 (Marks: 1) - Please choose one

An investor would be exposed to which of the following risks, if he may have to sell a bond prior to maturity and interest rates have risen since the bond was purchased?

The coupon effect risk.

Interest rate risk. Page # 136

Inflation risk.

Unique risk

Reference:

If a company is planning to borrow at variable rate of interest, the interest amount charged each time varying according to whether short-term interest rates have risen or fallen since the previous payment. To quote another example how interest rate fluctuations affect the financials of the company, a company may have invested in bonds and any change in interest rate will affect the value of

investment in balance sheet.
Examples of **interest rate risk** – short term investments, investment in bonds, borrowings in short term – variation in short term interest rate.

Question No: 17 (Marks: 1) - Please choose one
Which of the following is reflected by the price of a share of common stock?
Earnings after tax divided by the number of shares outstanding.
The board of directors' assessment of the intrinsic value of the firm.
The book value of the firm's assets less the book value of its liabilities.
The market's evaluation of a firm's present and future performance

Question No: 18 (Marks: 1) - Please choose one
You are considering buying common stock in Grow On, Inc. The firm yesterday paid a dividend of \$7.80. You have projected that dividends will grow at a rate of 9.0% per year indefinitely. If you want an annual return of 24.0%, what is the most you should pay for the stock now?
\$52.00
\$56.68
\$32.50
\$35.43
Calculation
7.8(1+.09) = 8.5
po = 8.5/ .24-.09 = 56.67

Question No: 19 (Marks: 1) - Please choose one
A company has a dividend yield of 8%. If its dividend is expected to grow at a constant rate of 5%, what must be the expected rate of return on the company's stock?
14%
13%
12%
10%

Question No: 20 (Marks: 1) - Please choose one
Which one of the following costs should be ignored, while evaluating the financial viability of a project?
Initial cost
Equipment cost
Cost of capital
Sunk cost

Question No: 21 (Marks: 1) - Please choose one
When faced with mutually exclusive option, which project should be accepted under the 'Payback Method'?
The one with the longest payback period.
The one with the shortest Payback period.
It doesn't matter because the payback method is not theoretically correct.
None of the given options.
http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html

Question No: 22 (Marks: 1) - Please choose one
Which of the following capital budgeting methods states the project return as a percentage?
Payback period
Net present value
Internal Rate of Return
None of the given options

Question No: 23 (Marks: 1) - Please choose one
Which of the following terms refers to the process of systematic investigation of the effects on estimates or outcomes of changes in data or parameter inputs or assumptions to evaluate a capital project?
Sensitivity Analysis
Fundamental Analysis
Technical Analysis
Trend Analysis

Question No: 24 (Marks: 1) - Please choose one
A firm with 60% of sales going to variable costs, \$1.5 million fixed costs, and \$500,000 depreciation would show what accounting profit with sales of \$3 million?
(Ignore taxes)
Zero loss
\$370,000 loss
\$666,667 loss
\$800,000 loss
Feedback:

revenues	3000000
variable cost	- 1800000 (60% of sales)
fixed cost	- 1500000
depreccation	- 500000
loss	800000

Question No: 25 (Marks: 1) - Please choose one
Which of the following best illustrates the problem imposed by capital rationing?
Accepting projects with the highest NPVs first
Accepting projects with the highest IRRs first
Bypassing projects that have positive NPVs
Bypassing projects that have positive IRRs

Question No: 26 (Marks: 1) - Please choose one
Which of the following statements applies to Security Market Line (SML)?
Security Market Line (SML) shows the relationship between expected rate of return and required rate of return of a security.
Security Market Line (SML) shows the relationship between Beta and market value of a security.
Security Market Line (SML) shows the relationship between required rate of return and beta coefficient of a security.
Security Market Line (SML) shows the relationship between Market value and face value of a security.

Question No: 27 (Marks: 1) - Please choose one

Which of the following refers to a stock issuance process where a company offers its shares to a limited number of investor?

Initial Public Offering

Private Placement

Direct Public Offering

Primary Offering

Question No: 28 (Marks: 1) - Please choose one

A Pure Play method of selecting a discount rate is most suitable in which of the following situations?

When the intended investment project has a Non-conventional stream of cash flows

When the intended investment project is a replacement project

When the intended investment project belongs to industry other than the firms operating in

When the intended investment project has a conventional stream of cash flows

- **Pure play** approach involves finding the beta of a company that operates almost exclusively (i.e., **pure play**) in the industry associated with the project under consideration and adjusting this company's beta for the leverage associated with that company.

Question No: 29 (Marks: 1) - Please choose one

Which of the following is a dividend that is paid in the form of additional shares, rather than a cash payout?

Stock Dividend

Cum Dividend

Ex Dividend

Extra Dividend

Question No: 30 (Marks: 1) - Please choose one

Which of the following transactions would occur in a primary financial market?

Initial public offering

Buying mutual funds certificates

Selling old shares

Buying bonds issued in previous year

MIDTERM EXAMINATION

Spring 2009

FIN622- Corporate Finance (Session - 1)

Question No: 1 (Marks: 1) - Please choose one

In which one of the following markets the bonds of a Corporation shall be traded now who were issued 10 years back?

Primary market

Secondary market

Money Market

All of the above

Question No: 2 (Marks: 1) - Please choose one

Palo Alto Industries has a debt-to-equity ratio of 1.6 compared with the industry average of 1.4. What do these ratios tell about this company?

The company will not experience any difficulty with its creditors

The company has less liquidity than other firms in the industry

The company will be viewed as having high creditworthiness

The company has greater than average financial risk when compared to other firms in its industry

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

Question No: 3 (Marks: 1) - Please choose one

A company can improve (lower) its debt-to-total assets ratio by doing which of the following?

By increasing the amount of borrowings

By shifting short-term to long-term debt

By shifting long-term to short-term debt

By selling the common stock

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

Question No: 4 (Marks: 1) - Please choose one

If a creditor wants to know about the bill payment status of a potential customer, the creditor could look at which one of the following ratios?

Current ratio.

Acid ratio.

Average age of accounts payable.

Average age of accounts receivable

Question No: 5 (Marks: 1) - Please choose one

Which one of the following values refers to the amount of money that could be realized if an asset or group of assets is sold separately from its operating organization?

Book value

Market value

Liquidation value

Intrinsic value

http://wps.pearsoned.co.uk/ema_uk_he_wachowicz_fundfinman_12/26/6678/1709775.cw/content/index.html

Question No: 6 (Marks: 1) - Please choose one

The present value of Rs.100 per year received for 10 years discounted at 8 percent is

closest to which of the following amounts?

Rs.177.

Rs.362.

Rs.425.

Rs.671. (repeated)

Question No: 7 (Marks: 1) - Please choose one

Which one of the following is a long-term contract under which a borrower agrees to make payments of interest and principal on specific dates?

Common stock.

Preferred stock

Equity contract.

Bond.

Question No: 8 (Marks: 1) - Please choose one

Which of the following is the main source of income for the buyer of a zero-coupon bond?

Price appreciation.

A rate of return equal to zero over the life of the bond.

Variable dividends instead of a fixed interest payment annually.

All interest payments in one lump sum at maturity.

<http://www.sec.gov/answers/zero.htm>

Question No: 9 (Marks: 1) - Please choose one

If the intrinsic value of a stock is greater than its market value, then which of the following is a reasonable conclusion?

The stock has a low level of risk.

The stock offers a high dividend payout ratio.

The market is undervaluing the stock.

The market is overvaluing the stock.

<http://web.utk.edu/~jwachowi/mcquiz/mc4.html>

Question No: 10 (Marks: 1) - Please choose one

If a bond sells at a high premium, then which of the following relationships hold true?

(P0 represents the price of a bond and YTM is the bond's yield to maturity.)

P0 < par and YTM > the coupon rate.

P0 > par and YTM > the coupon rate.

P0 > par and YTM < the coupon rate.

P0 < par and YTM < the coupon rate.

Question No: 11 (Marks: 1) - Please choose one

A company has a dividend yield of 8%. If its dividend is expected to grow at a constant rate of 5%, what must be the expected rate of return on the company's stock?

14%

13%

12%

10%

Question No: 12 (Marks: 1) - Please choose one

Which of the following statements best describes the term Market Correction?

Market Correction refers to the situation where equilibrium of supply & demand of shares occurs in the market

Market correction refers to the situation where shares' intrinsic values becomes equal to face values

Market Correction refers to the situation when there is a boom in the economy

Market Correction refers to the situation where inflation rate is above the market interest rate

Question No: 13 (Marks: 1) - Please choose one

Which of the following statements is Correct regarding the fundamental analysis?

Fundamental analysts use only Economic indicators to evaluate a stock

Fundamental analysts use only financial information to evaluate a company's stocks

Fundamental analysts use financial and non -financial information to evaluate a company's stocks

Fundamental analysts use only non -financial information to evaluate a company's stocks

Question No: 14 (Marks: 1) - Please choose one

Which of the following statements is applied to weighted average cost of capital (WACC)?

It is used as an evaluation tool

It is based on the present cost obligation's of the firm

It is the cost of long-term investment

It is the cost of maintaining optimal level of current assets

Question No: 15 (Marks: 1) - Please choose one

In which of the following situations a project is acceptable?

When a project has conventional cash flows patterns

When a project has a non-conventional cash flow pattern

When a project has a discounted rate higher than the inflation rate

When a project has a positive net present value

Question No: 16 (Marks: 1) - Please choose one

Which of the following capital budgeting methods focuses on firm's liquidity?

Payback method

Net Present Value

Internal Rate of Return

None of the given options

Question No: 17 (Marks: 1) - Please choose one

When faced with mutually exclusive option, which project should be accepted under the 'Payback Method'?

The one with the longest payback period.

The one with the shortest Payback period.

It doesn't matter because the payback method is not theoretically correct.

None of the given options.

Question No: 18 (Marks: 1) - Please choose one

According to the reinvestment rate assumption, which method of capital budgeting

assumes that the cash flows are reinvested at the project's rate of return?

Payback period

Net present value

Internal rate of return

None of the given options

Question No: 19 (Marks: 1) - Please choose one

Which of the following would lower a firm's operating break- even point?

An increase in the cost of goods sold

An increase in selling price

An increase in wages paid to employees

An increase in total sales

<http://web.utk.edu/~jwachowi/mcquiz/mc16.html>

Question No: 20 (Marks: 1) - Please choose one

A project would be financially feasible in which of the following situations?

If Internal Rate of Return of a project is greater than zero

If Net Present Value of a project is less than zero

If the project has Profitability Index less than one

If the project has Profitability Index greater than one

Question No: 21 (Marks: 1) - Please choose one

Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on this stock?

2%

3%

4%

5%

$2/39 \times 100 = 5\%$

Question No: 22 (Marks: 1) - Please choose one

If the common stocks of a company have beta value less than 1, then such stocks refer to which of the following?

Normal stocks

Aggressive stocks

Defensive stocks

Income stocks

Question No: 23 (Marks: 1) - Please choose one

What will be the risk premium if the market portfolio has an expected return of 10% and the risk free rate is 4%?

4%

5%

6%

7%

Market Risk Premium = 10%-4% = 6%

Question No: 24 (Marks: 1) - Please choose one

In which of the following conditions a stock is said to be undervalued?

If the stock has market value less than the expected value

If the stock has market value more than the expected value

If the stock has market value equal to the expect value

If the stock has market value more that intrinsic value

Question No: 25 (Marks: 1) - Please choose one

Which of the following is included in the cost of capital of a firm?

Cost of sales

Depreciation cost

Depletion cost

Cost of retained earnings

Question No: 26 (Marks: 1) - Please choose one

Suppose a firm has weighted average cost of capital (WACC) of 15% based on the market values of Debt and equity. Which of the following is the suitable discount rate to be used by the firm to evaluate financial viability of its investment projects?

10%

12%

13%

15%

Question No: 27 (Marks: 1) - Please choose one

Which of the following statements is TRUE regarding a firm that is totally (100%) financed by equity?

Its Return on Equity (ROE) is equal to its Return on Assets (ROA)

Its Return on Equity (ROE) is less than its Return on Assets (ROA)

Its Return on Equity (ROE) is greater than its Return on Assets (ROA)

Its Return on Equity (ROE) and Return on Assets (ROA) are zero

Question No: 28 (Marks: 1) - Please choose one

A Levered firm has a lower weighted average cost of capital as compare to an Un-levered firm because of which of the following?

Interest tax shield

Low level of financial risk

Low level of business risk

Low level of systematic risk

Question No: 29 (Marks: 1) - Please choose one

Which of the following is a dividend that is paid in the form of additional shares, rather than a cash payout?

Stock Dividend

Cum Dividend

Ex Dividend

Extra Dividend

Question No: 30 (Marks: 1) - Please choose one

Which of the following is a long-term source of financing for a firm?

Corporate bonds

Money market instruments

Trade credit

Accounts payables

MIDTERM EXAMINATION
Spring 2009
FIN622- Corporate Finance (Session - 2)

Question No: 1 (Marks: 1) - Please choose one

In which one of the following markets the bonds of a Corporation shall be traded now who were issued 10 years back?

Primary market

Secondary market

Money Market

All of the above

Question No: 2 (Marks: 1) - Please choose one

Following are amongst the three main areas of Finance EXCEPT:

Financial institutions

Investments

Accounting

Financial management

Question No: 3 (Marks: 1) - Please choose one

Which one of the following types of companies enjoys the 'Limited Liability'?

A general partnership.

A corporation.

A sole proprietorship.

None of the given options.

Question No: 4 (Marks: 1) - Please choose one

A company can improve (lower) its debt-to-total assets ratio by doing which of the following?

By increasing the amount of borrowings

By shifting short-term to long-term debt

By shifting long-term to short-term debt

By selling the common stock

Question No: 5 (Marks: 1) - Please choose one

What are the earnings per share (EPS) for a company that earned Rs.100,000 last year in after-tax profits, has 200,000 common shares outstanding, and Rs.1.2 million in retained earnings at the year end?

Rs. 6.50

Rs. 6

Rs. 100,000

Rs. 0.50

100000/200000 = .50

Question No: 6 (Marks: 1) - Please choose one

Which of the following refers to the value at which an asset is carried on a balance sheet?

Book Value

Market Value

Fair Value

Liquidation Value

Question No: 7 (Marks: 1) - Please choose one

In 3 years you are to receive Rs.5,000. What will be the effect on the present value of that future amount to you if the interest rates increase suddenly?

Remain unchanged

Rise

Fall

Can not be determined

<http://www.wiziq.com/online-tests/77-financial-management-1>

Question No: 8 (Marks: 1) - Please choose one

Which of the following change will occur if a bond's yield-to-maturity increases, keeping other factors constant?

Its price will rise

Its price will remain unchanged

Its price will fall.

Can not be determined

Question No: 9 (Marks: 1) - Please choose one

A 30-year corporate bond issued in 1985 would now be traded in which of the following markets?

Primary capital market.

Primary money market.

Secondary money market.

Secondary capital market.

Question No: 10 (Marks: 1) - Please choose one

When the market's nominal annual required rate of return for a particular bond is less than its coupon rate, the bond will be selling at which of the following?

At discount

At premium

At par value

At indeterminate price

Question No: 11 (Marks: 1) - Please choose one

If the intrinsic value of a stock is greater than its market value, then which of the following is a reasonable conclusion?

The stock has a low level of risk.

The stock offers a high dividend payout ratio.

The market is undervaluing the stock.

The market is overvaluing the stock.

<http://web.utk.edu/~jwachowi/mcquiz/mc4.html>

Question No: 12 (Marks: 1) - Please choose one

A person has invested some of its personal spare funds in the common stocks of a public

limited company. Which of the following would be the total return for this person on his common stocks?

Dividend per share and market interest rate.

Dividend yield and capital gains yield.

Earning per share and dividend per share

Market interest rate and dividend yield.

Question No: 13 (Marks: 1) - Please choose one

Which one of the following costs should be ignored, while evaluating the financial viability of a project?

Initial cost

Equipment cost

Cost of capital

Sunk cost

Question No: 14 (Marks: 1) - Please choose one

Which of the following statements best describes the term Market Correction?

Market Correction refers to the situation where equilibrium of supply & demand of shares occurs in the market

Market correction refers to the situation where shares' intrinsic values becomes equal to face values

Market Correction refers to the situation when there is a boom in the economy

Market Correction refers to the situation where inflation rate is above the market interest rate

Question No: 15 (Marks: 1) - Please choose one

Which of the following statements is Correct regarding the fundamental analysis?

Fundamental analysts use only Economic indicators to evaluate a stock

Fundamental analysts use only financial information to evaluate a company's stocks

Fundamental analysts use financial and non -financial information to evaluate a company's stocks

Fundamental analysts use only non -financial information to evaluate a company's stocks

Question No: 16 (Marks: 1) - Please choose one

Since the capital budgeting techniques use cash flows instead of accounting flows, therefore, the financial manager must add back which one of the following to the analysis?

The cost of fixed assets

The cost of accounts payable

Investments

Depreciation

Question No: 17 (Marks: 1) - Please choose one

According to the reinvestment rate assumption, which method of capital budgeting assumes that the cash flows are reinvested at the project's rate of return?

Payback period

Net present value

Internal rate of return

None of the given options

<http://www.wiziq.com/online-tests/111-financial-management>

Question No: 18 (Marks: 1) - Please choose one

What is the Net Present Value (NPV) of a project that costs \$100,000 and returns \$45,000 annually for three years if the opportunity cost of capital is 14%?

\$3,397.57

\$4,473.44

\$16,100.00

\$35,000.00

$45000/(1.14) + 45000/(1.14)^2 + 45000/(1.14)^3$

Question No: 19 (Marks: 1) - Please choose one

Market demand allowed a company, to raise its price by 20% to \$60. What is the new level of break-even revenues if fixed charges including depreciation are \$1 million and variable costs were 70% of the old price?

\$2,000,000

\$2,400,000

\$2,857,143

\$3,333,333

$60/120 * 100 = 50$

$50 * .7 = 35$

$35/60 * 100 = 58.33$

$100 - 58.33 = 41.67\%$

$1000000/.4167 = 2399808$

Question No: 20 (Marks: 1) - Please choose one

Which of the following best illustrates the problem imposed by capital rationing?

Accepting projects with the highest NPVs first

Accepting projects with the highest IRRs first

Bypassing projects that have positive NPVs

Bypassing projects that have positive IRRs

Question No: 21 (Marks: 1) - Please choose one

Which of the following is determined by variance of an investment's returns?

Volatility of the rates of return.

Probability of a negative return.

Historic return over long periods.

Average value of the investment.

Question No: 22 (Marks: 1) - Please choose one

Which one of the following terms refers to the variability of return on stocks or portfolios, associated with changes in return on the market as a whole?

Unsystematic risk

Unique risk

Systematic risk

Company specific risk

http://www.slideshare.net/ami_goel/risk-and-return-943136

Question No: 23 (Marks: 1) - Please choose one

Suppose a stock is selling today for Rs.40 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.44.00. what is the rate of return on this stock?

12%

13%

14%

15%

$$2/40 \times 100 = 5\%$$

$$4/40 \times 100 = 10\%$$

$$5\% + 10\% = 15\%$$

Question No: 24 (Marks: 1) - Please choose one

Suppose a stock is selling today for Rs.60 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.66.00. What is the capital gain yield on the stock?

7%
8%
9%

10%

$$6/60 \times 100 = 10\%$$

Question No: 25 (Marks: 1) - Please choose one

If the common stocks of a company have a beta value less than 1, then such stocks refer to which of the following?

Normal stocks

Aggressive stocks

Defensive stocks

Income stocks

Question No: 26 (Marks: 1) - Please choose one

Which of the following statements applies to the Capital Asset Pricing Model?

It tells us about the changes in the stock market index

It tells us about specific risk of a security

It tells us about specific risk of a portfolio

It tells us that how risk is rewarded in the market

Question No: 27 (Marks: 1) - Please choose one

Which of the following is included in the cost of capital of a firm?

Cost of sales

Depreciation cost

Depletion cost

Cost of retained earnings

Question No: 28 (Marks: 1) - Please choose one

Suppose a firm has a weighted average cost of capital (WACC) of 15% based on the market values of Debt and equity. Which of the following is the suitable discount rate to be used by the firm to evaluate the financial viability of its investment projects?

10%
12%
13%

15%

Question No: 29 (Marks: 1) - Please choose one

Which of the following best defines the term 'Capital Structure'?

The proportion of debt and equity capital used by a firm

The proportion of long-term liabilities used by a firm

The proportion of equity used by a firm

The proportion of short-term bank loan used by a firm

Question No: 30 (Marks: 1) - Please choose one

In which of the following dividend policies, the amount of dividend is relatively fixed?

Constant payout ratio policy

Hybrid dividend policy

Residual dividend policy

Stable dividend policy

MIDTERM EXAMINATION

Fall 2009

FIN622- Corporate Finance (Session - 4)

Question No: 1 (Marks: 1) - Please choose one

Following are amongst the three main areas of Finance EXCEPT:

- ▶ Financial institutions
- ▶ Investments
- ▶ **Accounting**
- ▶ Financial management

BASIC AREA OF FINANCE

- (1) corporate finance
- (2) investment
- (3) financial institution
- (4) international finance

Question No: 2 (Marks: 1) - Please choose one

Which one of the following is an offering in which the shares of a company are offered to a limited number of investors?

- ▶ Initial Public Offering
- ▶ **Private Placement**
- ▶ Direct Public Offering
- ▶ Primary Offering

Corporation engages two types of primary market transactions

- (1) public transaction
- (2) private transaction

Public offering, as the name suggests, involves securities to the general public.

Private placement is a negotiated sale involving a specific buyer

Question No: 3 (Marks: 1) - Please choose one

If you want to earn 8 percent, approximately how much should you pay for a security which matures in one year at Rs. 1,000?

- ▶ Rs. 1,080
- ▶ Rs. 940
- ▶ Rs. 920
- ▶ **Rs. 926**

$$1000 / 1.08 = 926 \text{ or } 1000 \times 0.9259 = 926$$

Divide 1000 on future value factor against one year under 8% or multiply 1000 on present value factor against one year under 8%

Question No: 4 (Marks: 1) - Please choose one

When the market's nominal annual required rate of return for a particular bond is less than its coupon rate, the bond will be selling at which of the following?

- ▶ At discount
- ▶ **At premium (page 18)**
- ▶ At par value
- ▶ At indeterminate price

Question No: 5 (Marks: 1) - Please choose one

Which of the following terms refers to the process of systematic investigation of the effects on estimates or outcomes of changes in data or parameter inputs or assumptions to evaluate a capital project?

- ▶ **Sensitivity Analysis (page 36)**
- ▶ Fundamental Analysis
- ▶ Technical Analysis
- ▶ Trend Analysis

Question No: 6 (Marks: 1) - Please choose one

For a firm with a Degree of Operating Leverage of 3.5, an increase in sales of 6% will:

- ▶ Increase pre-tax profits by 3.5%
- ▶ Decrease pre-tax profits by 3.5%.
- ▶ **Increase pre-tax profits by 21.0%.**
- ▶ Increase pre-tax profits by 1.71%.

solution with example

sales	10500	6% increase	11130	630
vc	6500		6500	----
CM	4000		4630	630
FC	1000		1000	-----
profit	3000		3630	630

630 / 3000 = .21

.21*100 = 21%

Simple Solution

Operation leverage = 3.5

Increase sales = 6% = 0.06

3.5*0.06 = 0.21

0.21*100 = 21%

Question No: 7 (Marks: 1) - Please choose one

The percentage change in a firm's operating profit (EBIT) resulting from a 1% change in output (sales) is known as the _____.

- ▶ **Degree of operating leverage**
- ▶ Degree of profit leverage
- ▶ Degree of total leverage
- ▶ Degree of financial leverage

Degree of operation leverage=

Percentage change in EBIT/ percentage change in sales

OR

Sales – variable costs /EBIT

OR

Contribution / EBIT

Question No: 8 (Marks: 1) - Please choose one

Suppose a stock is selling today for Rs.60 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.66.00. what is the capital gain yield on the stock?

- ▶ 7%
- ▶ 8%
- ▶ 9%
- ▶ **10%**

solution

6/60*100=10%

Question No: 9 (Marks: 1) - Please choose one

Which of the following is considered as a risk free financial asset?

- ▶ **Government T-bills (page 50)**
- ▶ Junk bonds
- ▶ Preferred stock
- ▶ Secured bonds

Ref: <http://www.investopedia.com/terms/r/riskfreeasset.asp>

Question No: 10 (Marks: 1) - Please choose one

If the common stocks of a company have beta value less than 1, then such stocks refer to which of the following?

- ▶ Normal stocks
- ▶ Aggressive stocks
- ▶ **Defensive stocks**
- ▶ Income stocks

Question No: 11 (Marks: 1) - Please choose one

Which of the following is known as market portfolio?

- ▶ A portfolio consists of all risk free securities available in the market
- ▶ A portfolio consists of securities of the same industry
- ▶ A portfolio consists of all aggressive securities available in the market

- ▶ **A portfolio consists of all securities available in the market**

<http://pages.cs.brandeis.edu/~magnus/stocks/node7.html>

Question No: 12 (Marks: 1) - Please choose one

What will be the risk premium if the market portfolio has an expected return of 10% and the risk free rate is 4%?

- ▶ 4%
- ▶ 5%
- ▶ **6%**
- ▶ 7%

Risk Premium = Expected Return – Risk Free Assets

$$= 10\% - 4\%$$

$$= 6\%$$

Question No: 13 (Marks: 1) - Please choose one

Which of the following statements is true regarding Weighted Average Cost of Capital (WACC)?

- ▶ WACC of a levered firm is greater than that of an un-levered firm
- ▶ WACC of a levered firm is lesser than that of an un-levered firm
- ▶ **WACC of a levered firm is equal to that of an un-levered firm**
- ▶ An Un-levered firm has zero WACC.

Question No: 14 (Marks: 1) - Please choose one

XYZ Airlines will pay a Rs.4.00 dividend next year on its common stock, which is currently selling at Rs.100 per share. What is the market's required return on this investment if the dividend is expected to grow at 5% forever?

- ▶ **9%**
- ▶ 4%
- ▶ 5%
- ▶ 7%

$$\begin{aligned} K_e &= D_1 / P_0 + g & \text{and } p_0 &= D_1 / K_e - g \\ &= 4/100 + 5\% \\ &= 9\% \end{aligned}$$

Question No: 15 (Marks: 1) - Please choose one

A Pure Play method of selecting a discount rate is most suitable in which of the following situations?

- ▶ When the intended investment project has a Non-conventional stream of cash flows
- ▶ When the intended investment project is a replacement project
- ▶ **When the intended investment project belongs to industry other than the firms operating in** (page66)
- ▶ When the intended investment project has a conventional stream of cash flows

Question No: 16 (Marks: 1) - Please choose one

A Levered firm has a lower weighted average cost of capital as compare to an Un-levered firm because of which of the following?

- ▶ **Interest tax shield** (general question)
- ▶ Low level of financial risk
- ▶ Low level of business risk
- ▶ Low level of systematic risk

Question No: 17 (Marks: 1) - Please choose one

ABC Corporation declared 10% dividend on its shares. A person purchased some shares of this corporation after the dividend was announced. If he is entitled to receive the declared dividend, his shares would be categorized as which of the following?

- ▶ **Ex-Dividend** (page 73)
- ▶ Cum-Dividend
- ▶ Stock- Dividend
- ▶ Cash Dividend

Question No: 18 (Marks: 1) - Please choose one

Which of the following is a dividend that is paid in the form of additional shares, rather than a cash payout?

- ▶ **Stock Dividend**
- ▶ Cum Dividend
- ▶ Ex Dividend
- ▶ Extra Dividend

When cash is insufficient then stock dividend paid to shareholders

Question No: 19 (Marks: 1) - Please choose one

Which of the following firms would have the highest financial leverage?

- ▶ A firm having debt-to-equity ratio of 30:70
- ▶ A firm having debt-to-equity ratio of 40:60
- ▶ A firm having debt-to-equity ratio of 50:50
- ▶ **A firm having debt-to-equity ratio of 60:40**

Question No: 20 (Marks: 1) - Please choose one

Which of the following is the principal advantage of high debt financing?

- ▶ **Tax savings** (page 71)
- ▶ Low Bankruptcy costs
- ▶ Minimum financial risk
- ▶ Low financial leverage

Question No: 21 (Marks: 1) - Please choose one

Which of the following is a proposition of Miller and Modigliani theory of Capital structure?

- ▶ **Value of a firm is independent of its capital structure** (page 68)
- ▶ Value of a firm is independent of its level of debt
- ▶ Value of a firm is dependent of its cost of capital
- ▶ Value of a firm is independent on its level of equity finances

Question No: 22 (Marks: 1) - Please choose one

Which of the following is a disadvantage of Capital Asset Pricing Model?

- ▶ It considers market risk
- ▶ It can be used for listed companies
- ▶ It can be used for non-listed companies
- ▶ **It is based on past data (page 51)**

Question No: 23 (Marks: 1) - Please choose one

Which of the following shows the reward to risk ratio of a Security A?

- ▶ **Expected return of A (r_A) – risk free return / beta of A (page 55)**
- ▶ Expected return of A (r_A) – risk free return / required return of A
- ▶ Expected return of A (r_A) – beta of A / risk free return
- ▶ Risk free return - expected return of A (r_A)/ beta of A

Question No: 24 (Marks: 1) - Please choose one

In Capital Assets Pricing Model, which of the following shows time value of money?

- ▶ Beta of the security
- ▶ **Risk free rate of return (page 57)**
- ▶ Risk premium
- ▶ Market rate of return

Question No: 25 (Marks: 1) - Please choose one

Which of the following statements is **TRUE** regarding Balance Sheet of a firm?

- ▶ It reports how much of the firm's earnings were retained in the business rather than paid out in dividends.
- ▶ It reports the impact of a firm's operating, investing, and financing activities on cash flows over an accounting period.
- ▶ **It shows the firm's financial position at a specific point in time.**
- ▶ It summarizes the firm's revenues and expenses over an accounting period.

Question No: 26 (Marks: 1) - Please choose one

Suppose that a corporation of which you are a shareholder has just gone bankrupt. Its liabilities are far in excess of its assets. How much of your investment would you get back?

- ▶ A proportionate share of bondholder claims based on the number of common shares that you own
- ▶ A proportional share of all creditor claims based on the number of common shares that you own
- ▶ An amount that could, at most, equal what you originally paid for the shares of common stock in the corporation
- ▶ **Nothing at all**

Question No: 27 (Marks: 1) - Please choose one

The gross profit margin is unchanged, but the net profit margin declined over same period. This could have happened due to which one of the following reasons?

- ▶ Cost of goods sold increased relative to sales
- ▶ Sales increased relative to expenses
- ▶ **The tax rate has been increased (general question)**
- ▶ Dividends were decreased

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

Question No: 28 (Marks: 1) - Please choose one

Palo Alto Industries has a debt-to-equity ratio of 1.6 compared with the industry average of 1.4. What do these ratios tell about this company?

- ▶ The company will be viewed as having high creditworthiness
- ▶ **The company has greater than average financial risk when compared to other firms in its industry**
- ▶ The company will not experience any difficulty with its creditors
- ▶ The company has less liquidity than other firms in the industry

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

Question No: 29 (Marks: 1) - Please choose one

If a creditor wants to know about the bill payment status of a potential customer, the creditor could look at which one of the following ratios?

- ▶ Current ratio
- ▶ Acid ratio
- ▶ **Average age of accounts payable**
- ▶ Average age of accounts receivable

Question No: 30 (Marks: 1) - Please choose one

Suppose you invested Rs. 8,000 in a savings account paying 5 percent interest a year, compounded annually. How much amount your account will have at the end the end of four years?

- ▶ Rs.9,624
- ▶ Rs.10,208
- ▶ **Rs.9,728**
- ▶ Rs.10,880

solution

$$8000*(1.05)^4=9724.05$$

Question No: 31 (Marks: 1) - Please choose one

The present value of Rs.100 per year received for 10 years discounted at 8 percent is closest to which of the following amounts?

- ▶ Rs.177
- ▶ Rs.362
- ▶ Rs.425
- ▶ **Rs.671**

$$\begin{aligned}fv &= pv(1+i)^n \\ &= 100 (1.08)^{10} \\ &= 100 * 6.710 \\ &= 671\end{aligned}$$

Question No: 32 (Marks: 1) - Please choose one

How many years will it take for Rs.152,000 to grow to be Rs. 405,000 if it is invested in an account with an annual interest rate of 10%?

- ▶ 13.68
- ▶ 8.23
- ▶ **10.28**
- ▶ Cannot be calculated from the given data

http://webcache.googleusercontent.com/search?q=cache:wZYpkI18Q4EJ:www.pageout.net/user/www/r/k/rkiss/cq_uest6.%28A%29.doc+How+many+years+will+it+take+for+Rs.152,000+to+grow+to+be+Rs.+405,000+if+it+is+invested+in+an+account+with+an+annual+interest+rate+of+10%25%3F&cd=6&hl=en&ct=clnk&gl=pk

Question No: 33 (Marks: 1) - Please choose one

Which of the following types of bonds pays no annual interest to the holder, but is sold at discount below the par value?

- ▶ An original maturity bond
- ▶ A floating rate bond
- ▶ A fixed maturity date bond
- ▶ **A zero coupon bond**

<http://www.appuonline.com/appu/investment/bond.html>

Question No: 34 (Marks: 1) - Please choose one

Which of the following is a financial asset?

- ▶ A building
- ▶ **Bonds**
- ▶ Inventories
- ▶ Equipments

Question No: 35 (Marks: 1) - Please choose one

An investor buys a bond that will pay the interest amount of Rs.60 annually, forever. Which of the following would be the present value of the bond if there is exactly one year remaining until the next interest payment and the investor's required annual return is 5 percent?

- ▶ **Rs. 1,200**
- ▶ Rs. 800
- ▶ Rs. 600
- ▶ Rs. 1,000

$$60 / .05 = 1200$$

Question No: 36 (Marks: 1) - Please choose one

How much should you pay for a bond with Rs.1,000 face value, a 10 percent coupon rate, and seven years to maturity if your appropriate discount rate is 8 percent and interest is paid annually? (*Answers are rounded to the nearest dollar*)

- ▶ Rs.560
- ▶ Rs.1,000
- ▶ Rs.903
- ▶

MIDTERM EXAMINATION
Spring 2009
FIN622- Corporate Finance (Session - 5)

Question No: 1 (Marks: 1) - Please choose one

Which of the following could be used to calculate the cost of common equity?

- ▶ Interpolation method
- ▶ Dividend discount model
- ▶ YTM method
- ▶ **Capital structure valuation**

$$k_e = D1 / p_o$$

Question No: 2 (Marks: 1) - Please choose one

What will be the effect of reduction in the cost of capital on the accounting break-even level of revenues?

- ▶ It raises the break-even level.
- ▶ It reduces the break-even level.
- ▶ **It has no effect on the break-even level.**
- ▶ This cannot be determined without knowing the length of the investment horizon.

http://highered.mcgraw-hill.com/sites/0073382302/student_view0/chapter10/chapter_quiz.html

Question No: 3 (Marks: 1) - Please choose one

In Capital Assets Pricing Model, which of the following shows time value of money?

- ▶ Beta of the security
- ▶ **Risk free rate of return** (page 57)
- ▶ Risk premium
- ▶ Market rate of return

Question No: 4 (Marks: 1) - Please choose one

Which of the following is a proposition of Miller and Modigliani theory of Capital structure?

- ▶ **Value of a firm is independent of its capital structure** (page 69)
- ▶ Value of a firm is independent of its level of debt
- ▶ Value of a firm is dependent of its cost of capital
- ▶ Value of a firm is independent on its level of equity finances

Question No: 5 (Marks: 1) - Please choose one

In which of the following dividend policies, the amount of dividend is relatively fixed?

- ▶ **Constant payout ratio policy** (page 73)
- ▶ Hybrid dividend policy
- ▶ Residual dividend policy
- ▶ Stable dividend policy

☐ A **constant payout ratio policy** is a **policy** of paying a **FIXED** percentage of a firm's earnings as dividends in each period. Such a **policy** is likely to result in wildly fluctuating dividends. As a result, only a small percentage of **dividend** paying firms follow such a **policy**.

Question No: 6 (Marks: 1) - Please choose one

Which of the following risks increases as the debt level of a business increases?

- ▶ **financial risk**
- ▶ Operating risk
- ▶ Business risk
- ▶ Investment risk

Question No: 7 (Marks: 1) - Please choose one

Which of the following risks is independent of capital structure of a firm?

- ▶ Financial risk
- ▶ Systematic risk
- ▶ **Business risk**
- ▶ Total risk

Question No: 8 (Marks: 1) - Please choose one

Which of the following *best* define the term 'Capital Structure'?

- ▶ The proportion of equity used by a firm
- ▶ **The proportion of debt and equity capital used by a firm**
- ▶ The proportion of long-term liabilities used by a firm
- ▶ The proportion of short-term bank loan used by a firm

<http://www.quickmba.com/finance/cf/>

Question No: 9 (Marks: 1) - Please choose one

Which of the following is tax deductible?

- ▶ Dividend on preferred shares
- ▶ Dividend on common stocks
- ▶ **Coupon payments on bonds**
- ▶ Capital gain on common stocks

Question No: 10 (Marks: 1) - Please choose one

Suppose a stock is selling today for Rs.40 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.44.00. what is the rate of return on this stock?

- ▶ 12%
- ▶ 13%
- ▶ 14%
- ▶ **15%**

PO = 40

Div = 2

Sales = 44

D0+g =D1

2+4 = 6

D1 / P0

6/40

0.15 OR 15%

Question No: 11 (Marks: 1) - Please choose one

Which of the following is determined by variance of an investment's returns?

- ▶ **Volatility of the rates of return.**
- ▶ Probability of a negative return.
- ▶ Historic return over long periods.
- ▶ Average value of the investment

http://webcache.googleusercontent.com/search?q=cache:bGL5ERYKpL0J:83.143.248.39/faculty/mmatee/Investment%2520and%2520Portfolio%2520Management%2520BUS%2520415/docs/Chapter%252005_Hand-out%25204.doc+Which+of+the+following+is+determined+by+variance+of+an+investment's+returns%3F+%E2%96%BA+Volatility+of+the+rates+of+return. +%E2%96%BA+Probability+of+a+negative+return. +%E2%96%BA+Historic+return+over+long+periods. +%E2%96%BA+Average+value+of+the+investment.&cd=10&hl=en&ct=clnk&gl=pk

Question No: 12 (Marks: 1) - Please choose one

Which of the following best illustrates the problem imposed by capital rationing?

- ▶ Accepting projects with the highest NPVs first
- ▶ Accepting projects with the highest IRRs first
- ▶ **Bypassing projects that have positive NPVs**
- ▶ Bypassing projects that have positive IRRs

http://highered.mcgraw-hill.com/sites/0073382302/student_view0/chapter8/chapter_quiz.html

Question No: 13 (Marks: 1) - Please choose one

Market demand allowed a company, to raise its price by 20% to \$60. What is the new level of break-even revenues if fixed charges including depreciation are \$1 million and variable costs were 70% of the old price?

- ▶ \$2,000,000
- ▶ **\$2,400,000**
- ▶ \$2,857,143
- ▶ \$3,333,333

OLD PRICE = 60/ 1.2 =50

VC= 50*.7=35 WHICH EQUALS = 58.33%

NEW BREAK EVEN = 1 MILLION/ .4167 = 2400000

ANOTHER SOLUTION

NEW PRICE 60/ 120 * 100 = 50

VARIABLE 50*.7 = 35

35/60*100 = 58.33

100 – 58.33 = 41.67

100000/.4167 = 239980

http://highered.mcgraw-hill.com/sites/0073382302/student_view0/chapter10/chapter_quiz.html

Question No: 14 (Marks: 1) - Please choose one

Which of the following capital budgeting methods states the project return as a percentage?

- ▶ Payback period
- ▶ Net present value
- ▶ **Internal Rate of Return**
- ▶ None of the given options

is always quoted in terms of percentage,

which makes it comparable to the other market interest rates or the inflation rate

Question No: 15 (Marks: 1) - Please choose one

Which of the following capital budgeting methods focuses on firm's liquidity?

- ▶ None of the given options
- ▶ **Payback method**
- ▶ Net Present Value
- ▶ Internal Rate of Return

http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html

Question No: 16 (Marks: 1) - Please choose one

In which of the following situations a project is acceptable?

- ▶ When a project has conventional cash flows patterns
- ▶ When a project has a non-conventional cash flow pattern
- ▶ When a project has a discounted rate higher than the inflation rate
- ▶ **When a project has a positive net present value**

Question No: 17 (Marks: 1) - Please choose one

Which of the following statements is Correct regarding the fundamental analysis?

- ▶ Fundamental analysts use only Economic indicators to evaluate a stock
- ▶ Fundamental analysts use only financial information to evaluate a company's stocks
- ▶ **Fundamental analysts use financial and non-financial information to evaluate a company's stocks**
- ▶ Fundamental analysts use only non-financial information to evaluate a company's stocks

Question No: 18 (Marks: 1) - Please choose one

A company has a dividend yield of 8%. If its dividend is expected to grow at a constant rate of 5%, what must be the expected rate of return on the company's stock?

- ▶ 14%
- ▶ **13%**
- ▶ 12%
- ▶ 10%

Question No: 19 (Marks: 1) - Please choose one

You are considering buying common stock in Grow On, Inc. The firm yesterday paid a dividend of \$7.80. You have projected that dividends will grow at a rate of 9.0% per year indefinitely. If you want an annual return of 24.0%, what is the most you should pay for the stock now?

- ▶ \$52.00
- ▶ **\$56.68**
- ▶ \$32.50
- ▶ \$35.43

$$7.8(1+.09)=8.50$$

$$P_0 = D_1 / R - G$$

$$= 8.5 / .24-.09$$

$$56.67$$

Question No: 20 (Marks: 1) - Please choose one

If a bond sells at a high premium, then which of the following relationships hold true? (P0 represents the price of a bond and YTM is the bond's yield to maturity.)

- ▶ P0 < par and YTM < the coupon rate.
- ▶ P0 < par and YTM > the coupon rate.
- ▶ P0 > par and YTM > the coupon rate.
- ▶ **P0 > par and YTM < the coupon rate.**

<http://web.utk.edu/~jwachowi/mcquiz/mc4.html>

Question No: 21 (Marks: 1) - Please choose one

An investor buys a bond that will pay the interest amount of Rs.60 annually, forever. If there is exactly one year remaining until the next interest payment and the investor's required annual return is 5 percent, the present value of this bond is closest to which one of the following?

- ▶ **Rs.1,200.**
- ▶ Rs.800.
- ▶ Rs.600.
- ▶ Rs.1,000.

$$60 / .05 = 1200$$

Question No: 22 (Marks: 1) - Please choose one

Which one of the following is a long-term contract under which a borrower agrees to make payments of interest and principal on specific dates?

- ▶ Common stock.
- ▶ Preferred stock
- ▶ Equity contract.
- ▶ **Bond.**

Question No: 23 (Marks: 1) - Please choose one

If you deposit \$12,000 per year for 16 years (each deposit is made at the beginning of each year) in an account that pays an annual interest rate of 15%, what will your account be worth at the end of 16 years?

- ▶ \$82,168.44
- ▶ \$71,450.82
- ▶ **\$768,901.12**
- ▶ \$668,609.67

Question No: 24 (Marks: 1) - Please choose one

Suppose you wish to set aside Rs.2,000 at the beginning of each of the next 10 years (the first Rs.2,000 deposit would be made now) in an account paying 12 percent compounded annually. Approximately how much will you accumulate at the end of 10 years?

- ▶ Rs.22,863
- ▶ Rs.35,097
- ▶ **Rs.39,310**
- ▶ Rs.25,151

Question No: 25 (Marks: 1) - Please choose one

Which of the following transactions affects the acid-test ratio?

- ▶ Receivables are collected.
- ▶ **Inventory is liquidated for cash.**
- ▶ New common stock is sold and used to retire a debt issue.
- ▶ A new common stock issue is sold and equipment purchased.

Question No: 26 (Marks: 1) - Please choose one

Which of the following would be a consequence of a high Inventory Turnover Ratio?

- ▶ **Too low a level of inventory and frequent stock-outs.**
- ▶ Seasonal elements peculiar to the business.
- ▶ Efficient inventory management.
- ▶ Any of the given option.

http://books.google.com.pk/books?id=zb0cItqvLJUC&pg=PT445&dq=Efficient+inventory+management&hl=en&ei=sN_nTO_yFdO7jAeRkLyGAw&sa=X&oi=book_result&ct=result&resnum=3&ved=0CDAQ6AEwAg#v=onepage&q=Efficient%20inventory%20management&f=false

Question No: 27 (Marks: 1) - Please choose one

Which of the following statements (in general) is correct?

- ▶ A low receivables turnover is desirable.
- ▶ **The lower the total debt-to-equity ratio, the lower the financial risk for a firm.**
- ▶ An increase in net profit margin with no change in sales or assets means a poor ROI.
- ▶ The higher the tax rate for a firm, the lower the interest coverage ratio

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

Question No: 28 (Marks: 1) - Please choose one

Palo Alto Industries has a debt-to-equity ratio of 1.6 compared with the industry average of 1.4. What do these ratios tell about this company?

- ▶ The company will be viewed as having high creditworthiness
- ▶ **The company has greater than average financial risk when compared to other firms in its industry**
- ▶ The company will not experience any difficulty with its creditors
- ▶ The company has less liquidity than other firms in the industry

Question No: 29 (Marks: 1) - Please choose one

Felton Farm Supplies, Inc., has an 8 percent return on total assets of Rs.300,000 and a net profit margin of 5%. What are its sales?

- ▶ Rs.3,750,000
- ▶ **Rs.480,000**
- ▶ Rs.300,000
- ▶ Rs.1,500,000

300000*.08 = 24000

net income = 24000

sales = net income / net profit margin

= 24000 / .05

= 480,000

OR

PROFIT MARGIN = NET PROFIT / SALES

.05 = 24000 / SALES

SALES = 24000/.05

= 480000

Question No: 30 (Marks: 1) - Please choose one

In which one of the following markets the bonds of a Corporation shall be traded now who were issued 10 years back?

- ▶ Primary market
- ▶ **Secondary market**
- ▶ Money Market
- ▶ All of the above

MIDTERM EXAMINATION

Spring 2010

FIN622- Corporate Finance (Session - 3

Question No: 1 (Marks: 1) - Please choose one

Which of the following is a transaction of a primary financial market?

▶ **Initial Public Offering**

- ▶ Buying Mutual Funds Certificates
- ▶ Selling old shares
- ▶ Buying Bonds issued in previous years

The methods by which the primary market transactions carried out are -

1. Purchasing Initial Public Offer 2.Purchasing Preferential Issue 3.Purchasing Rights Issue
2. <http://finance.mapsofworld.com/capital-market/primary/transactions.html>

Question No: 2 (Marks: 1) - Please choose one

Last year ABC Company had a 9.00% net profit margin based on Rs.22,000,000 in sales and Rs.15,000,000 of total assets. During the coming year, the president has set a goal of attaining a 14% return on total assets. How much must firm sales equal, other things being the same, for the goal to be achieved?

▶ **Rs.23,333,333**

▶ Rs.22,000,000

▶ Rs.26,722,967

► Rs.25,603,667

net income = $22000000 \times 9\% = 1980000$

return on total assets = net income / total assets

= $1980000 / 15000000$

= 0.132

$2200000 / 0.132 \times .14 = 23,333,333$

Question No: 3 (Marks: 1) - Please choose one

If you want to earn 8 percent, approximately how much should you pay for a security which matures in one year at Rs. 1,000?

► Rs. 1,080

► Rs. 940

► Rs. 920

► **Rs. 926**

Fv= pv (1+i)ⁿ

1000 = (1+0.08)¹

PV = 1000/ 1.08

= 925.9 = 926

Question No: 4 (Marks: 1) - Please choose one

Which of the following statements describes the term structure of interest rates?

► Term structure of interest rates refers to the relationship between yield and rating, for securities with the same maturity.

► Term structure of interest rates refers to the relationship between yield and marketability, for securities with the same tax status.

► **Term structure of interest rates refers to the relationship between yield and maturity, for the same security class.**

► Term structure of interest rates refers to the relationship between yield and risk, for securities with the same maturity.

Ref: http://www.pimco.com/LeftNav/Bond+Basics/2006/Yield_Curve_Basics.htm

A yield curve depicts yield differences, or yield spreads, that are due solely to differences in maturity. It therefore conveys the overall relationship that prevails at a given time in the marketplace between bond interest rates and maturities. **This relationship between yields and maturities is known as the term structure of interest rates.**

Question No: 5 (Marks: 1) - Please choose one

A Company's common stock is currently selling at Rs.3.00 per share, its quarterly dividend is Rs.0.07, and the stock is expected to rise to Rs.3.30 in a year. What is its expected rate of return?

► 9.3%

► **19.3%**

► 10.0%

► 11.0%

.07*4 = .28 + .30 = .58

58 / 3 = .1933= 19.33%

Question No: 6 (Marks: 1) - Please choose one

For a firm with a Degree of Operating Leverage of 3.5, an increase in sales of 6% will:

► Increase pre-tax profits by 3.5%

► Decrease pre-tax profits by 3.5%.

► **Increase pre-tax profits by 21.0%.**

► Increase pre-tax profits by 1.71%.

3.5 * 6% = 21.0%

Question No: 7 (Marks: 1) - Please choose one

Which of the following best illustrates the problem imposed by capital rationing?

▶ Accepting projects with the highest NPVs first

▶ Accepting projects with the highest IRRs first

▶ **By passing projects that have positive NPVs**

▶ Bypassing projects that have positive IRRs

Question No: 8 (Marks: 1) - Please choose one

Which of the following is determined by variance of an investment's returns?

▶ **Volatility of the rates of return.**

▶ Probability of a negative return.

▶ Historic return over long periods.

▶ Average value of the investment.

Page 48 The variance essentially measures the average squared difference between the actual returns and the average return.

Question No: 9 (Marks: 1) - Please choose one

Which of the following conditions, if exist, will make the diversification of stocks more effective?

▶ Securities contained in a portfolio are positively correlated

▶ **Securities contained in a portfolio are negatively correlated**

▶ Securities contained in a portfolio have high market values

▶ Securities contained in a portfolio have low market values

Page 50 Diversification will allow for the same portfolio return with reduced risk. For diversification to work the component assets must not be perfectly correlated, i.e. correlation coefficient not equal to 1.

Question No: 10 (Marks: 1) - Please choose one

Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on this stock?

▶ 2%

▶ 3%

▶ 4%

▶ **5%**

Dividend yield = Annual dividends per share / market price per share

= 2 / 39 = 0.057 = 5%

Question No: 11 (Marks: 1) - Please choose one

Which of the following statements applies to Security Market Line (SML)?

▶ Security Market Line (SML) shows the relationship between expected rate of return and required rate of return of a security.

▶ Security Market Line (SML) shows the relationship between Beta and market value of a security.

▶ **Security Market Line (SML) shows the relationship between required rate of return and beta coefficient of a security. (pg52)**

▶ Security Market Line (SML) shows the relationship between Market value and face value of a security.

Page 52 Securities Market Line

The relationship between Beta & required return is plotted on the securities market line (SML) which shows expected return as a function of β. The intercept is the risk-free rate available for the market,

Question No: 12 (Marks: 1) - Please choose one

Which of the following is known as market portfolio?

▶ A portfolio consists of all risk free securities available in the market

▶ A portfolio consists of securities of the same industry

▶ A portfolio consists of all aggressive securities available in the market

▶ **A portfolio consists of all securities available in the market (PG51)**

Question No: 13 (Marks: 1) - Please choose one

A firm had an interest expense of Rs.400,000 on its outstanding debt during the financial year 2006-2007. If the firm marginal tax rate is 40%, what was the total tax savings of the firm during the period 2006-2007?

► Rs.150, 000

► **Rs.160, 000**

► Rs.170, 000

► Rs.180, 000

400,000 *40%

= 160,000

Question No: 14 (Marks: 1) - Please choose one

A Pure Play method of selecting a discount rate is most suitable in which of the following situations?

► When the intended investment project has a Non-conventional stream of cash flows

► When the intended investment project is a replacement project

► **When the intended investment project belongs to industry other than the firms operating in**

► When the intended investment project has a conventional stream of cash flows

Question No: 15 (Marks: 1) - Please choose one

Which of the following statements is TRUE regarding an Un-levered firm?

► **Its Return on Equity is equal to Return on Assets**

► Its Return on Equity is equal to Return on Investment

► Its Return on Equity is equal to Return on Sales

► Its Return on Equity is equal to Return on Non-fixed Assets

Question No: 16 (Marks: 1) - Please choose one

Which of the following is the principal advantage of high debt financing?

► **Tax savings**

► Low Bankruptcy costs

► Minimum financial risk

► Low financial leverage

Question No: 17 (Marks: 1) - Please choose one

Which of the following is the main objective of a Residual Dividend Policy?

► **To use internal resources for investment in projects and business operations**

► To pay a fixed amount of Dividend to shareholders of the firm

► To maintain a constant payout ratio

► To stabilize Dividend per share

<http://finance.mapsofworld.com/dividend/stock/residual-policy.html>

Question No: 18 (Marks: 1) - Please choose one

Which of the following methods would be most suitable for calculating the return on stocks of a non-listed company?

► **Dividend Growth Model**

► Capital Asset Pricing Model

► Security Market Line

► Characteristics Line

Question No: 19 (Marks: 1) - Please choose one

What will be the effect of reduction in the cost of capital on the accounting break-even level of revenues?

► It raises the break-even level.

► It reduces the break-even level.

► **It has no effect on the break-even level.**

► This cannot be determined without knowing the length of the investment horizon.

Question No: 20 (Marks: 1) - Please choose one

Which of the following are the primary sources of capital to the firm?

► Net income, Retained earnings and Bank loans

► **Bonds, Preferred stock and Common stock**

- Operating profits, extraordinary gains and Dividends
- Amortization cash flow, Net income and Retained earnings

http://docs.google.com/viewer?a=v&q=cache:RBLNsg71uwkJ:info.cba.ksu.edu/tavakol/Info/Fall%25202001/450/Review%2520Problems/RP%2520December%25204.doc+primary+sources+of+capital+to+the+firm&hl=en&gl=pk&pid=bl&srcid=ADGEEShoYhgNknfGzaspSmm262PTovmCfoAsnVa0aDF9DTnKkHAAbbCwQiQcr4m00_UFg47a_0eX6dA9rvjZPOLuQQWflYLO3L1ZKASr02T0rXBgJG-V1T7Eeqe_PcJtGLmx7RkEmppv0&sig=AHIEtbTJ7f9gD09CZ0DuEj3j-VJGyiKoGA

Question No: 21 (Marks: 1) - Please choose one

Suppose you invested Rs. 8,000 in a savings account paying 5 percent interest a year, compounded annually. How much amount your account will have at the end the end of four years?

- Rs.10, 208

► **Rs.9, 728**

- Rs.10, 880
- Rs.9, 624

$8000(1.05)^4 = 9,724$

Question No: 22 (Marks: 1) - Please choose one

Which of the following refers to an analysis of financial statements where all balance sheet or income statement figures for a base year equal 100.0 and financial statement items for subsequent years are expressed as percentages of the base year values?

- Common-size analysis
- Ratio analysis

► **Index analysis**

- Technical analysis

http://books.google.com.pk/books?id=ZGGqDw3hdH0C&pg=PA33&dq=index+analysis&hl=en&ei=34bmTNqKB-CR4gbslvT4Ag&sa=X&oi=book_result&ct=result&resnum=6&ved=0CD4Q6AEwBQ#v=onepage&q=index%20analysis&f=false

Question No: 23 (Marks: 1) - Please choose one

Which of the following is more appropriate to use while comparing investment alternatives with different compounding periods?

- Quoted Interest Rate
- Annual Percentage Rate

► **Effective Annual Interest Rate**

- Nominal Interest Rate

Question No: 24 (Marks: 1) - Please choose one

ABC Company will pay a dividend of Rs.2.40 per share at the end of this year. Its dividend yield is 8%. At what price is the stock selling?

- 40
- 35
- **30**
- 25

$\text{selling price} = 2.40 / 0.08 = 30$

Question No: 25 (Marks: 1) - Please choose one

Which one of the following costs should be ignored while evaluating the financial viability of a project?

- Initial cost
- Equipment cost
- Cost of capital

► **Sunk cost**

Question No: 26 (Marks: 1) - Please choose one

In which of the following situations a project is acceptable?

- When a project has conventional cash flows patterns
- When a project has a non-conventional cash flow pattern

► When a project has a discounted rate higher than the inflation rate

► When a project has a positive net present value

Question No: 27 (Marks: 1) - Please choose one

Which of the following capital budgeting methods states the project return as a percentage?

► Payback period

► Net present value

► Internal Rate of Return

► None of the given options

Internal Rate of Return is always quoted in terms of percentage which makes it comparable to the other market interest rates or the inflation rate

Question No: 28 (Marks: 1) - Please choose one

What is the Net Present Value (NPV) of a project that costs Rs.100,000 and returns Rs.45,000 annually for three years if the opportunity cost of capital is 14%?

► Rs.16, 100.00

► Rs.35, 000.00

► Rs.3, 397.57

► Rs.4, 473.44

$$45000/1.14+45000/1.14^2 +45000/(1.14)^3$$

$$39473+ 34626 +30374$$

$$104473$$

$$104473-100000 = 4473$$

Question No: 1 (Marks: 1) - Please choose one
An analysis of percentage financial statements where all balance sheet or income statement figures for a base year equal 100.0% and subsequent financial statement items are expressed as percentages of their values in the base year is known as _____. ► Common-size analysis ► Fundamental analysis ► Index analysis ► Discriminated analysis
Question No: 2 (Marks: 1) - Please choose one
What is the future value of Rs.1.00 invested for 10 years if 12 percent annual rate of interest is compounded quarterly? ► Rs.2.30 ► Rs.3.26 ► Rs.3.25 ► Rs.2.93 $1*(1+.03)^{40}$
Question No: 3 (Marks: 1) - Please choose one
When the market's nominal annual required rate of return for a particular bond is less than its coupon rate, the bond will be selling at _____.

- ▶ Discount
- ▶ **Premium**
- ▶ Par value
- ▶ An indeterminate price

Question No: 4 (Marks: 1) - Please choose one

Which of the following is a method of evaluating securities by analyzing statistics generated by market activities, such as past prices and volumes?

- ▶ Technical analysis
- ▶ **Fundamental analysis**
- ▶ Common size analysis
- ▶ Ratio analysis

Question No: 5 (Marks: 1) - Please choose one

Which of the following capital budgeting technique ignores profitability and time value of money?

- ▶ Net present value
- ▶ Internal rate of return
- ▶ Discounted pay back period
- ▶ **Simple pay back period**

Question No: 6 (Marks: 1) - Please choose one

Which of the following method should be used to evaluate the riskiness of an investment?

- ▶ Profitability index
- ▶ **Sensitivity analysis**
- ▶ Net present value
- ▶ Internal rate of return

Question No: 7 (Marks: 1) - Please choose one

The concept of risk can be expressed quantitatively as the _____ of expected future cash flows.

- ▶ **Present value**
- ▶ Probability
- ▶ Standard deviation
- ▶ Market value

Question No: 8 (Marks: 1) - Please choose one

“A U.S Treasury bond provides a lower rate of return as compared to a Corporate bond”. Which of the following reason would justify this statement?

- ▶ **The U.S Treasury bonds have a low level of risk**
- ▶ The Corporate bonds have a low level of risk
- ▶ The U.S Treasury bonds have a high level of risk
- ▶ Corporations have high level of profits

Question No: 9 (Marks: 1) - Please choose one

Buying shares in a mutual fund can provide investors with an inexpensive source of _____.

- ▶ Investment
- ▶ Diversification
- ▶ Earnings
- ▶ **Both 1st and 3rd options are correct**

Question No: 10 (Marks: 1) - Please choose one

Weights used in calculating the weighted average cost of capital should be based on :

- ▶ Book values
- ▶ Par values
- ▶ Estimated future values
- ▶ **Market values**

Question No: 11 (Marks: 1) - Please choose one

Generally, a firm should try to maximize its overall cost of capital.

- ▶ True
- ▶ **False**

Question No: 12 (Marks: 1) - Please choose one

Capital rationing may lead to non-optimal investment decisions.

- ▶ True
- ▶ **False**

Question No: 13 (Marks: 1) - Please choose one

The expected return of a portfolio is a weighted average of the expected standard deviations of the securities in that portfolio.

- ▶ True
- ▶ **False**

Question No: 14 (Marks: 1) - Please choose one

According to Modigliani and Miller, the use of debt is only advantageous in the presence of corporate income taxes.

- ▶ **True**

▶ False

Question No: 15 (Marks: 1) - Please choose one

Security market line represents the relationship between expected return and systematic risk of holding a security.

▶ True

▶ False