FINALTERM EXAMINATION
Spring 2009
FIN622 Corporate Finance
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Marks: 81

Question No: 1 (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**
- Dividends were decreased

Question No: 2 (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: 3 (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%

rate of return = dividend yield +capital gain yield
0.07 * 4 = 0.28 +.30 = 0.58

0.58 / 3 =19.3

Question No: 4 (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: 5 (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: 6 (Marks: 1) - Please choose one

Which of the following statements is correct for a project with a positive Net Present Value (NPV)?

- **Internal rate of return (IRR) exceeds the cost of capital.**
- Accepting the project has an indeterminate effect on shareholders.
- The discount rate exceeds the cost of capital.
- The profitability index equals one.

Question No: 7 (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**

Sales	**3,000,000**
Variable cost 60% of sales (3000000*60%)	**(1,800,000)**
Fixed cost	**(1,500,000)**
Deprecation	**(500,000)**
loss	**800,000**

Question No: 8 (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 / 35
= 5%

Question No: 9 (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%**

Capital gain = 6 / 60
= 10%

Question No: 10 (Marks: 1) - Please choose one
Which of the following shows the reward to risk ratio of a Security A?

- ☐ **Expected return of A (rA)- Risk free return / Beta of A**
- ☐ Expected return of A (rA) -Risk free return / required return of A
- ☐ Expected return of A (rA) -Beta of A / Risk free return
- ☐ Risk free return - Expected return of A (rA)/ Beta of A

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Question No: 11 (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

Question No: 12 (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
- ☐ Nestle

Question No: 13 (Marks: 1) - Please choose one
With respect to a Cash flow statement, Decrease in current assets would be considered as a:

- Cash outflow
- **Cash inflow**
- Sometimes considered as cash outflow and sometime as cash inflow
- Can not be determined

Question No: 14 (Marks: 1) - Please choose one
In which of the following situations, a company has the ability to pay off its short-term obligations easily?

- **If the company has a positive working capital**
- If the company has a negative working capital
- If the company has a zero working capital
- None of the given option

Question No: 15 (Marks: 1) - Please choose one
Which of the following describes the hedging approach to financing?

- Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion.
- **Each asset is offset with a financing instrument of the same approximate maturity.**
- Each asset is offset with a put or call option.
- The firm takes out insurance to protect itself against uneven cash flows.

Current Assets Financing – Hedging Approach
Under this approach each asset would be offset with a financing instrument of the same maturity. Short term seasonal investment requirements should be financed through short term loans and permanent current asset and all fixed assets should be financed through long term loan and equity.

Question No: 16 (Marks: 1) - Please choose one
Which of the following illustrates the use of a hedging (maturity matching) approach to financing?

Permanent working capital financed with long-term liabilities.
Short-term assets financed with equity.
All assets financed with 50 percent equity, 50 percent long-term debt mixture.
Short-term assets financed with long-term liabilities.

Question No: 17 (Marks: 1) - Please choose one
Financial data for three firms is presented below. Each differs only with respect to philosophy on an aggressive vs. a conservative approach to current asset management.
------------------------FIRM A --------------------FIRM B ---------------------FIRM C
Sales ------------Rs.2,000,000 -----------------Rs.2,000,000------------ Rs.2,000,000
EBIT ------------------200,000---------------------- 200,000 ------------------
200,000
Current Assets ------600,000 ----------------------500,000------------------ 400,000
Fixed Assets---------- 500,000 ---------------------500,000-------------------
500,000
Total Assets --------1,100,000 ------------------1,000,000 -------------------
900,000
What will be the rate for the firm with the most aggressive philosophy?
- 18.2 percent.
- 33.3 percent.
- 25.5 percent.
- **22.2 percent.**

Question No: 18 (Marks: 1) - Please choose one
According to the Miller Model, upper limit for cash balance is equal to which of the following?
- **Lower limit + Spread**
- Spread-Lower limit
- Optimal limit + Lower limit
- Lower limit-Spread

Question No: 19 (Marks: 1) - Please choose one
Which of the following is equal to Stock out cost?
- Carrying cost*Safety stock
- Holding cost*Carrying cost
- **Reordering cost*Safety stock**
- Carrying cost *Reordering cost

Question No: 20 (Marks: 1) - Please choose one
A merger results in a reduction of average production costs. In this case, which of the following is CORRECT?
- The merger must have been conglomerate
- **Economies of scale exist**
- The merger must have been vertical
- The acquired firm had net operating losses

Question No: 21 (Marks: 1) - Please choose one
A firm wants to acquire another firm by purchasing its assets. Which of the

following methods firm can use to evaluate the financial aspects of this deal?

- **Replacement cost method**
- Dividend valuation method
- Present value method
- Price earning ratio method

Question No: 22 (Marks: 1) - Please choose one
Employees buyout occurs through which of the following?

- **Employee stock ownership plan**
- Employees dividend scheme
- Employee empowerment scheme
- Employee long-term benefit scheme

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The official way an employee buyout occurs is through an employee stock ownership plan (ESOP).

Question No: 23 (Marks: 1) - Please choose one
Which of the following is an example of a management Buy In?

- Management of a Firm-A purchases majority shares from the shareholders
- **Management of a Firm-A acquires majority shares in another Firm-B**
- Management sale out some assets of the firm
- Management buy some new plants and machinery

Question No: 24 (Marks: 1) - Please choose one
Which of the following could be a major reason of financial distress for a firm?

- High dividend payout to shareholders
- Majority shares are being controlled by management
- Majority shares are being controlled by employees
- **Rivalry from competing firms**

Question No: 25 (Marks: 1) - Please choose one
All of the following could be an outcome of financial distress of a firm EXCEPT:

- Employees are leaving the firm
- Suppliers refuse to supply on credit
- Banks do not provide loans
- **Financial markets become instable**

Question No: 26 (Marks: 1) - Please choose one
Which one of the following statements is CORRECT regarding Option?

- An option creates an obligation for the holder

- **An option creates a right and not the obligation for the holder**
- Option seller is the option holder
- Option writer is the option holder

Question No: 27 (Marks: 1) - Please choose one
An option is termed as in the money if:

- **The exercise price mentioned in the option is favorable than the market price of the underlying commodity**
- The exercise price mentioned in the option is not favorable than the market price of the underlying commodity
- The exercise price mentioned in the option is equal to the market price of the underlying commodity
- The exercise price mentioned in the option is above the option cost

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Question No: 28 (Marks: 1) - Please choose one
Which of the following would be the net gain for the investor if the market price of underlying shares in an equity option is greater than the strike price and the investor exercise the option?

- **The difference between the market price on underlying shares and the strike price less option cost**
- The difference between exercise price and the market price of the underlying shares plus option cost
- The difference between option cost and strike price
- The difference between exercise price and market price

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Question No: 29 (Marks: 1) - Please choose one
Which one of the following statements is CORRECT regarding currency options?

- In a currency option, the seller has the right to sell currency
- **In a currency option, the holder has the right to sell/buy currency**
- In a currency option, the seller has the right to buy currency
- In a currency option, the holder has the obligation to buy

http://books.google.com/books?id=-xRaY8VvfXQC&pg=PA9&lpg=PA9&dq=Which+one+of+the+following+statements+is+CORRECT+regarding+currency+options?+%E2%80%A2%09In+a+currency+option,+the+seller+has+the+right+to+sell+currency+%E2%80%A2%09In+a+currency+option,+the+holder+has+the+right+to+sell/buy+currency+%E2%80%A2%09In+a+currency+option,+the+seller+has+the+right+to+buy+currency+%E2%80%A2%09In+a+currency+option,+the+holder+has+the+obligation+to+buy&source=bl&ots=ZlAk1W8TsP&sig=1x85AhnzEmUi5uHhW2jNMWxDEF0&hl=en&ei=aHc5Tbe6FYit8gOpg6jnCA&sa=X&oi=book_result&ct=result&resnum=7&ved=0CDwQ6AEwBg#v=onepage&q&f=false

Question No: 30 (Marks: 1) - Please choose one
A currency option will NOT be exercised if:
- The exchange rate is above the agreed rate
- **The exchange rate is below the agreed rate**
- The exchange rate is equal to the agreed rate
- The exchange rate is equal to the option cost

Question No: 31 (Marks: 1) - Please choose one
Which one of the following statements is CORRECT regarding option cost?
- Option cost is paid by the option writer to option seller
- Option cost is paid by the option writer to option holder
- **Option cost is paid by the option holder to option seller**
- Option cost is paid by the option seller to option writer

Question No: 32 (Marks: 1) - Please choose one
Which of the following is a potential risk associated with a SWAP?
- **The parties involved in a SWAP may default**
- SWAP may change floating rates into fixed rates
- SWAP provide access to the market
- SWAP may change fixed rates into floating rates

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However, there are some risks associated with swaps as well. There may be some probability of default by either party before the swap expiry.

Question No: 33 (Marks: 1) - Please choose one
Which of the following situations would result in weakening the local currency against a foreign currency?
- Demand for foreign currency decreases
- Supply of local currency decreases
- Demand & Supply are in balance
- **Demand for foreign currency increases**

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. Demand for foreign currencies will rise resulting in weakening of our local currency.

Question No: 34 (Marks: 1) - Please choose one
Which of the following would be consistent with an aggressive approach to financing working capital?
- Financing short-term needs with short-term funds
- Financing permanent inventory buildup with long-term debt
- Financing seasonal needs with short-term funds
- **Financing some long-term needs with short-term funds**

http://web.utk.edu/~jwachowi/mcquiz/mc8.html

Question No: 35 (Marks: 1) - Please choose one
Identify the INCORRECT statement in connection with working capital management.
- The objectives of working capital management are profitability and liquidity
- **Long-term funds are more expensive than short-term funds but also riskier**
- Aggressive financing policies increase profitability at the cost of higher risk
- Conservative financing policies use short-term funds to finance only part of fluctuating current asset

http://wps.pearsoned.co.uk/ema_uk_he_watson_corpfin_3/16/4209/1077746.cw/index.ht ml

Question No: 36 (Marks: 1) - Please choose one
All of the following are TRUE regarding the investing activity section of the cash flow statement EXCEPT:

- Investing activities include the purchase and sale of income-producing assets
- Selling off capital assets may be good news if the company is getting rid of unprofitable divisions
- **Large purchases of capital assets may signal an emergency**
- Investing activities require analysis of long-term asset accounts

http://cwx.prenhall.com/bookbind/pubbooks/horngren_ca/chapter17/multiple1/deluxe-content.html

Question No: 37 (Marks: 1) - Please choose one
Which of the following is a reason for high P/E ratio of a company?

- Low profit & losses mix in recent past
- Expected future losses
- Low security
- **High Share prices due to a takeover bid.**

http://free-books-online.org/finance-2/corporate-finance/acquisitions/

High P/E ratio may be due to:

-The company may be experiencing consistent growth over the recent past years.

-Based on some future expectations

-Share price may have gone up in wake of takeover bid.

-High security shares

Question No: 38 (Marks: 1) - Please choose one
Which of the following formulas can be used to calculate the value of the firm while considering merger/acquisition?

- Value of all-equity financed firm + FV of tax benefits + Expected Bankruptcy Costs
- **Value of all-equity financed firm + PV of tax benefits + Expected Bankruptcy Costs**
- Value of all-equity financed firm + tax benefits + Expected Bankruptcy Costs
- Value of all-equity financed firm + Expected Bankruptcy Costs

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Question No: 39 (Marks: 1) - Please choose one
Suppose that a firm sells goods on terms of 2/10, net 20. On March 1, 2008 you buy goods from the company with an invoice value of Rs.50, 000. How much discount would you get, if you took the cash discount?

- **Rs. 1,000**

- Rs. 2,000
- Rs. 4,000
- Rs. 5,000

50,000 *2/100 = 1000

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

All of the following are the methods to evaluate the credit worthiness in business EXCEPT:

- Market reputation
- Previous payment record
- **Production plant capacity**
- Financial strength

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The following methods to evaluate the credit worthiness are widely used in business:

Financial statements of vendor
Market reputation
Banks
Previous payment record
Financial strength
Capacity
General economic conditions in vendors industry

Question No: 41 (Marks: 1) - Please choose one

Total credit cost curve consists of which of the following?

- Total of ordering cost and the opportunity cost of credit policy
- **Total of carrying cost and the opportunity cost of credit policy**
- Total of opportunity cost of credit policy and the bad debts
- Total of production cost and the cost of credit policy

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The total of carrying cost and the opportunity cost of credit policy is called the total credit cost curve.

Question No: 42 (Marks: 1) - Please choose one

Which of the following is the most common reason for a capital expenditure?

- Safety device installation
- **Expansion**
- Renewal
- Replacement

Expansion

The most common motive for a capital expenditure is to expand the level of operations – usually through acquisition of fixed assets. A growing firm often needs to acquire new fixed assets rapidly, such as the purchase of property and plant

http://www.google.com/#sclient=psy&hl=en&q=Which+of+the+following+is+the+most+common+reason+for+a+capital+expenditure%3F+%E2%80%A2%09Safety+device+installation+%E2%80%A2%09Expansion+%E2%80%A2%09Renewal+%E2%80%A2%09Replacement&aq=f&aqi=&aql=&oq=&fp=e832639d1dbb91d3

3RD link ppt

Question No: 43 (Marks: 3)

How the following shall effect the size of the firm s optimal investment in current assets?

a. The interest rate rises from 6% to 8%.
b. A just in time inventory system is introduced that reduces the risk of inventory shortages.
c. Customers pressure the firm for a more lenient credit sales policy.
Question No: 44 (Marks: 3)
Give at least three reasons of merger failure and explain each of them briefly.

Question No: 45 (Marks: 3)
An American exporter sold goods worth $1,000,000 to a Pakistani importer. What type of
currency risk would American exporter face, if Pakistani importer promises to pay the
amount after three months? Explain.

Question No: 46 (Marks: 5)
How are dividends paid and how do companies decide on dividend payments?

Question No: 47 (Marks: 5)
What do you understand by leverage buy outs? Explain briefly

Question No: 48 (Marks: 10)
The Green Company has developed the following estimates (in millions) of its current
and fixed asset investment for each of the next four quarters:
QUARTER FIXED ASSETS CURRENT ASSETS
1 Rs.30 Rs.20
2 30 24
3 30 28
4 32 16
Green Co. has found that payables and accruals equal 25 percent of the current assets. It
currently has Rs.20 million in equity with the balance of its long-term funds

coming from
debt. Devise a financing plan for Green based on the hedging approach.

Question No: 49 (Marks: 10)
Describe in detail the various ways of commencing international operations by Multinational corporations.