FINALTERM EXAMINATION
Fall 2009
FIN622- Corporate Finance

Time: 120 min

Question No: 1 (Marks: 1) - Please choose one
Which of the following is an expected rate of return on a bond if bought at its current market price and held to maturity?
- **Yield to maturity**
- Current yield
- Coupon yield
- Capital gains yield

Question No: 2 (Marks: 1) - Please choose one
A firm can lower its breakeven level by doing which of the following actions?
- **Lowering direct cost**
- Increasing variable cost
- Increasing direct cost
- Lowering sales price

Question No: 3 (Marks: 1) - Please choose one
Which one of the following statements applies to Dividend Growth Model?
- It is difficult to understand and use
- It is used for non-listed companies
- It is used for debt securities also
- **It do not consider risk level of a security**

Question No: 4 (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: 5 (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: 6 (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: 7 (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

Question No: 8 (Marks: 1) - Please choose one
Which of the following serves as a starting point for preparing functional budgets of a firm?

- Sales budget
- Master budget
- Production cost budget
- **Cash budget**

Question No: 9 (Marks: 1) - Please choose one
A company is holding cash as a buffer in case of an unexpected need with operations. This is an example of the _________ motive for holding cash.

- **Precautionary**
- Speculative
- Transactions
- Capital needs

Question No: 10 (Marks: 1) - Please choose one
Which of the following is an "income based method" for share valuation of a target firm?

- Replacement cost method
- Break up value method
- **Dividend valuation method**
- Accumulated depreciation method

Question No: 11 (Marks: 1) - Please choose one
Which of the following is a re-structuring strategy in which employees buy a majority share in their own firm?

- Employee Dividend Scheme
- **Employee Buyout**
- Employee Empowerment
- Leverage Buyout

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

All of the following could be the reasons for a subsidiary buyout EXCEPT:
- The parent company is in financial distress
- The parent company needs cash
- **The parent company prefers to sell the firm rather that liquidation**
- The parent company wants liquidation

Question No: 13 (Marks: 1) - Please choose one
A firm has to pay $10,000 to an American company after three months. The firm enters into a contract with a foreign exchange dealer to buy $10,000 after three months at Rs.61/US$. This contract would be beneficial for the firm if:
- After three months the exchange rate is Rs.60/US$
- After three months the exchange rate is Rs.61/US$
- **After three months the exchange rate is Rs.62/US$**
- After three months the exchange rate is Rs.59/US$

Question No: 14 (Marks: 1) - Please choose one
A firm can fix effective interest rate on short-term borrowings by doing which of the following?
- **Buying a forward rate agreement**
- Selling a forward rate agreement
- Borrowing local currency
- Borrowing base currency

Question No: 15 (Marks: 1) - Please choose one
A firm can fix effective interest rate on its short-term investment to be made at some future date by doing which of the following?
- Borrowing local currency
- Borrowing base currency
- **Selling a forward rate agreement**
- Buying an forward rate agreement

Question No: 16 (Marks: 1) - Please choose one
A company may create a hedge through interest rate futures if it intends to make some
investment for a short-term at some future date, because of:
- **Fall in short-term interest rates**
- Fall in short-term deposit rates
- Increase in short-term interest rates
- Increase in short-term deposit rates

Question No: 17 (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: 18 (Marks: 1) - Please choose one
Which one of the following statements is CORRECT regarding Options Contacts?
□ □ **A put option gives the holder a right to sell underlying item at a specified price**
□ □ A put option gives its writer the right to sell underlying item at a specified price
□ □ A call option gives its writer a right to sell underlying item
□ □ A call option gives its holder a right to sell underlying item

Question No: 19 (Marks: 1) - Please choose one
Which of the following could be used as a hedging tool against unfavorable movement in interest rate?
□ □ Currency option
□ □ Currency futures
□ □ **Interest rate option**
□ □ Currency SWAP

Question No: 20 (Marks: 1) - Please choose one
The credit policy of a public company is 1/10, net 30. At present 25% of the customers take the discount. What would accounts receivable be if all customers took the cash discount?
□ □ **Account receivable would be lower than the present level**
□ □ No change from the present level
□ □ Account receivable would be higher than the present level
□ □ Unable to determine without more information

Question No: 21 (Marks: 1) - Please choose one
In the long run, a successful acquisition is one that:
□ □ Enables the acquirer to make an all-equity purchase, thereby avoiding additional financial leverage
□ □ Enables the acquirer to diversify its asset base
□ □ **Increases the market price of the acquirer's stock over what it would have been without the acquisition**
□ □ Increases the financial leverage of the firm

Question No: 22 (Marks: 1) - Please choose one
The efficiency enhancing effect resulting from a strategic merger is called which of the following?
□ □ Merger effect
□ □ Acquisition effect
□ □ **Synergy effect**
□ □ Efficiency effect

Question No: 23 (Marks: 1) - Please choose one
How much debt financing is used by a firm whose beta is un-geared?
□ □ 100% debt financed
□ □ **100% equity financed**

☐ 50% equity and 50% debt financed
☐ ☐ 60% equity and 40% debt financed

Question No: 24 (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: 25 (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**
☐ ☐ Inflation risk
☐ ☐ Unique risk

Question No: 26 (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: 27 (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: 28 (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: 29 (Marks: 1) - Please choose one
While calculating cash flow from operating activities through indirect method, an

increase in current assets is ___________ whereas an increase in current liabilities is ____________ net income?

□ □

□ □

□ □ **deducted from; added to**

□ □ deducted from; deducted from

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

Which of the following holds true regarding aggressive working capital policy?

□ □

□ □

□ □ Low liquidity; low profitability; high risk

□ □ **Low liquidity; high profitability; high risk**

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

Which of the following holds TRUE regarding conservative working capital policy?

□ □ ; high risk

□ □ **High liquidity; low profitability; low risk**

□ □

□ □

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

"The firm has very little net working capital sometimes even negative net working capital that can be very risky."

The above statement belongs to:

□ □ **Aggressive working capital policy**

□ □ Conservative working capital policy

□ □ Moderate working capital policy

□ □ The statement is not related to any of the working capital policies

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

"The firm has a reasonable amount of net working capital that leads to a low -risk position".

The above statement belongs to:

□ □ Aggressive working capital policy

□ □ **Conservative working capital policy**

□ Moderate working capital policy

□ □ The statement is not related to any of the working capital policies

Question No: 35 (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: 36 (Marks: 1) - Please choose one
Which of the following statement is INCORRECT regarding Just-In-Time (JIT)?
□ □ The inventories are kept near zero level.
□ □ The inventory is acquired in such quantity on daily basis that can support the daily production level.
□ □ The entire inventory acquired move to the production hall.
□ □ **Inventory level is necessarily kept at zero level.**

Question No: 37 (Marks: 1) - Please choose one
Which of the following type of mergers occurs when one firm purchases other firms that produce similar or competing products?
□ □ **Horizontal**
□ □ Vertical
□ □ Financial
□ □ Conglomerate

Question No: 38 (Marks: 1) - Please choose one
Which of the following valuation approach allows for specific and direct estimation of future
benefits to the owners, which is consistent with the theory of value?
□ □ Asset-based method
□ □ Income-based method
□ □ **Hybrid method**
□ □ None of the given options

Question No: 39 (Marks: 1) - Please choose one
The experts hired in evaluation stage of a public take over process DO NOT include which of the following?
□ □ Legal consultants
□ □ Accountants
□ □ **Shareholders**
□ □ Stock Brokers

Question No: 40 (Marks: 1) - Please choose one
In which of the following forms of acquisition, a company's existing managers acquire a large part or all of the company?
□ □ **Management Buyout**
□ □ Management Buy-In
□ □ Leverage Buyout
□ □ None of the given options

Question No: 41 (Marks: 1) - Please choose one
Recession in economy is related to which of the following levels of financial distress

of a firm?

- Firm Level
- Industry Level
- Macro-Level
- **All of the given options**

Question No: 42 (Marks: 1) - Please choose one
Which of the following would be the outcome if the fixed rate in the forward rate agreement (FRA) is lower than the reference rate?

- **The seller of the FRA makes a cash payment to the buyer.**
- Both buyer and seller make payments to each other.
- The buyer of the FRA makes a cash payment to the seller.
- Neither buyer nor seller makes any payment to each other.

Question No: 43 (Marks: 1) - Please choose one
If the strike price and current market price are equal, an option would be termed as:

- In the money
- Out of money
- **At the money**
- None of the given options

Question No: 44 (Marks: 1) - Please choose one
Which of the following theories states that exchange rates between currencies are in equilibrium when their purchasing power is the same in each of the two countries?

- M&M theory
- **Purchasing Power Parity theory**
- Fisher effect theory
- Interest rate risk theory

Question No: 45 (Marks: 3)
How firms analyze their credit policies? Explain briefly.

Question No: 46 (Marks: 5)
How Economic Order Quantity (EOQ) Model is helpful in the reduction of total inventory costs?
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Question No: 47 (Marks: 5)
Differentiate between Spot Rates and Forward Rates of currencies. Why forward rates are higher than spot rates?

Question No: 48 (Marks: 5)
How a firm can create a money market hedge against transaction exposure, when the firm has to make a payment at some future date?

Question No: 49 (Marks: 10)
A Firm sales 200,000 units per year of a particular Product, order size is for 5000 units and stock out is 3000 units. The stock out probability acceptance level is set to 5% and per unit stock out cost is Rs.7/-. Holding cost is estimated at Rs.3/- per unit. Being an inventory manager, determine stock out cost and amount of safety stock to be kept in hand.

Question No: 50 (Marks: 10)
Why firms do business internationally? Explain in detail.