MGT201 Financial Management

Final Term Examination - February 2005

Time Allowed: 150 Minutes

INSTRUCTIONS

Please read the following instructions carefully before attempting any question:

1. This exam consists of **5** Multiple Choice Questions (MCQs), **5** short questions and **1** descriptive question.
2. Each MCQ carries 2 Marks; each short question carries 5 Marks and Descriptive Question carry 15 Marks.
3. The use of calculator is allowed.
4. The use of Financial Tables is allowed.
5. For each MCQ question, read the choices available and select the choice which you consider is the correct answer, by clicking on the appropriate check box.
6. Save your answer before proceeding to the next question.
7. Do not click the "Finish button" while solving your paper. Once you clicked the "Finish" button, you will not be able to access your paper again. Click it at the end of your paper. That means you have submitted your complete paper.
8. A clock is given in the exam software. Software will automatically be closed at the end of 90 minutes.
9. Remember not to spend too much time on any one MCQ. Since all MCQs carry equal marks, it is important to manage your time and response to test questions effectively.
10. Failure to comply with the Supervisor's directions will result in your test being cancelled. Please comply with supervisor's directions to avoid any unpleasant event.

Total Marks: 50 **Total Questions: 11**

Question No. 1	**Marks : 5**

What is advocated by the bird in hand theory regarding the dividend policy?

Question No. 2	**Marks : 5**

Why EBIT is generally considered to be independent of financial leverage?

Question No. 3	Marks : 2

Suppose you borrow $12 and promise to pay it back over twelve months in monthly installments. If the interest rate were positive, your payment would be:

1 One dollar a month.
2 Twelve dollars a month.
3 Less than one dollar a month.
4 More than one dollar a month.

Question No. 4	Marks : 15

The ABC company is currently in this situation

EBIT Rs	4 Million
Cost of equity,	15%
Shares outstanding, n	600,000
Tax rate, T (Federal plus state)	35%
Value of debt D	Rs 2 Million
Kd	10 %

The firm's Market is stable, and it expects no growth, so all the earnings are paid out as dividends. The debt consists of perpetual bonds.

a. What is the total market value of the firm's stock, S, its price per share Po and the firm's total market value?

b. What is the firm's weighted average cost of capital?

Question No. 5	Marks : 5

What is the difference between present value and net present value?

Question No. 6	Marks : 2

How can investors reduce the variability of returns in their investment portfolio?

1 By diversifying their investments.
2 By adding securities to their portfolio that are not perfectly correlated.
3 By adding some mutual funds to their portfolio.
4 All of the given options.

Question No. 7	Marks : 2

What is the definition of operating leverage?

1 Additional variability in earnings available to the firm's common shareholders.

2 Responsiveness of the firm's EBIT to fluctuations in sales.
3 Concept of financing a portion of the firm's assets with securities bearing a fixed rate of return.
4 Concept of financing a portion of the firm's assets with securities bearing a variable rate of return.

Question No. 8	Marks : 5

What is meant by Budget Constraints?

Question No. 9	Marks : 5

What is the difference between the Pure MM model and traditionalist view?

Question No. 10	Marks : 2

What financial statement measures the amount of profits generated by a firm over a given period of time?

1 Statement of cash flow
2 Balance sheet.
3 Income statement or profit and loss statement.
4 Operating Income Statement.

Question No. 11	Marks : 2

How would a firm use its calculated weighted average cost of capital of 12.5 percent?

5 As a hurdle rate for decisions related to project acceptance or rejection.
6 To determine how much of its earnings the firm should retain.
7 To calculate the weights in the capital structure.
8 To determine the expected rate of return on a potential project