Final Term Papers

Fall 2009 (Session 03a)

MGT201

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

Which of the following type of lease is a long-term lease that is not cancelable and its life often matches the useful life of the asset?

- **A financial**
- An operating
- Both financial & operating lease
- None of the given options

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

Which of the following would cause the gross profit margin to remain unchanged, but the net profit margin declined over the same period?

- Cost Cost of goods sold increased relative to sales
- Sales increased relative to expenses
- **Govt. increased the tax rate**
- Di DiDividends were decreased

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

The accounting statement of cash flows reports a firm's cash flows segregated into which of the following categorical order?

- **Operating, investing, and financing**
- Investing, operating, and financing
- Financing, operating and investing
- Financing, investing, and operating

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

Managers prefer IRR over net present value because they evaluate investments:

- In terms of dollars
- **In terms of Percentages**
- Intuitively
- Logically

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

From which of the following category would be the cash flow received from sales revenue and other income during the life of the project?

- ► Cash flow from financing activity
- ► Cash flow from operating activity
- ► Cash flow from investing activity
- ► **All of the given options**

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

Bond is a type of Direct Claim Security whose value is **NOT** secured by _____.

- ► Tangible assets
- ► **Intangible assets**
- ► Fixed assets
- ► Real assets

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

Which one of the following is the right of the issuer to call back or retire the bond by paying off the bondholders before the maturity date?

- ► Call in
- ► Call option
- ► **Call provision**
- ► Put option

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

Which of the following is designated by the individual investor's optimal portfolio?

- ► The point of tangency with the opportunity set and the capital allocation line
- ► The point of highest reward to variability ratio in the opportunity set
- ► **The point of tangency with the indifference curve and the capital allocation line**
- ► The point of the highest reward to variability ratio in the indifference curve

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

Which of the following is **NOT** the form of cash flow generated by the investments of the shareholders?

- ► Income
- ► Capital loss
- ► Capital gain
- ► **Operating income**

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

You wish to earn a return of 13% on each of two stocks, X and Y. Stock X is expected to pay a dividend of Rs. 3 in the upcoming year while Stock Y is expected to pay a dividend of Rs. 4 in the upcoming year. The expected growth rate of dividends for both stocks is 7%. The intrinsic value of stock X:

- ► Will be greater than the intrinsic value of stock Y
- ► Will be the same as the intrinsic value of stock Y
- ► **Will be less than the intrinsic value of stock Y**
- ► Cannot be calculated without knowing the market rate of return

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

Which of the following is **CORRECT**, if a firm has a required rate of return equal to the ROE?

- ► The firm can increase market price and P/E by retaining more earnings
- ► The firm can increase market price and P/E by increasing the growth rate
- ► **The amount of earnings retained by the firm does not affect market price or the P/E**
- ► None of the given options

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

Which of the following is **NOT** a major cause of unsystematic risk.

- ► New competitors
- ► New product management
- ► **Worldwide inflation**
- ► Strikes

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

Assume that the expected returns of the portfolios are the same but their standard deviations are given in the options given below, which of the option represent the most risky portfolio according to standard deviation?

- ► 1.5%
- ► 2.0%
- ► 3.0%
- ► **4.0%**

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

The logic behind _____ is that instead of looking at net cash flows you look at cash inflows and outflows separately for each point in time.

- ► IRR
- ► **MIRR**
- ► PV
- ► NPV

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

In which of the following approach you need to bring all the projects to the same length in time?

- ► MIRR approach
- ► Going concern approach
- ► **Common life approach**
- ► Equivalent annual approach

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

Which of the following is equal to the market risk, beta, of a security?

► **The covariance between the security's return and the market return divided by the variance of the market's returns**

► The covariance between the security and market returns divided by the standard deviation of the market's returns

► The variance of the security's returns divided by the covariance between the security and market returns

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► The variance of the security's returns divided by the variance of the market's returns

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

If you become more aggressive with your investments, which one of the following is likely to occur?

► Your risk will decrease
► **Your risk will increase**
► Your risk will stay the same
► Your return will be lower

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

In efficient market the stock price depends upon the required return which depends upon _____.

► **Market risk**
► Total risk
► Diversified risk
► Non- Systematic risk

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

How much return would be offered by the stock whose (risk and return) pair lies above the SML?

► No return
► Lower return
► Average return
► **Excessive return**

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

Find the Expected Return on the Market Portfolio given that the Expected Return on Stock is 17%, the Risk-Free Rate is 1.1%, and the Beta for Stock is 1.5.

► **11.7%**
► 12.14%
► 13.23%

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► 13.82%

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

Which of the following represent all Risk –Return Combinations for the efficient portfolios in the capital market?

► Parachute graph
► **CML straight line equation**
► Security market line
► All of the given options

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

Assume the nominal interest rates (annual) in the country of Freedonia and the United States are 6% and 12% respectively. What is the implied 90-day forward rate if the current spot rate is 5 Freedonian marks (FM) per U.S. dollar?

► 4.732
► **4.927**
► 5.074
► 5.283

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

Which of the following statements is most correct as it relates to the recording of a capital lease?

► The capital lease is shown on the lessee's balance sheet as an asset and amortized over the asset's useful life.
► **The capital lease is listed as an asset on the lessor's balance sheet and amortized over lease term.**
► A capital lease is listed as an asset on the lessee's balance sheet and must be amortized over the lease period.
► A capital lease is listed as an asset on the lessee's balance sheet and must be amortized over the asset's useful life.

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

The trade terms "1/10, net 45" indicate that _____.

► **A 45% discount is permitted if payment is made within 10 days**

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- A 1% discount is permitted if payment is made within 10 days
- A 10% discount is permitted if payment is made within 45 days
- A 1% discount is permitted if payment is made within 45 days

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

When the buyer purchases securities through a brokerage house, it is called as:

- Dutch-auction operation
- **Fixed-price operation**
- Open-market operation
- Fair-warning operation

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

The presence of which of the following costs is **NOT** used as a major argument against the M&M arbitrage process?

- Transaction costs
- **Insurance costs**
- Bankruptcy costs
- Agency costs

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

An implicit cost of adding debt to the capital structure is that it:

- Adds interest expense to the operating statement
- **Increases the required return on equity**
- Reduces the expected return on assets
- Decreases the firm's beta

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

When financial disaster is looming, why management may borrow to invest in projects having a negative expected NPV?

- The firm's beta is now negative
- Taxes are no longer a concern
- The interest tax shield will cover the loan costs

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► **The lender bears all the risk**

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

What is difference between shares and bonds?

► Bonds represent ownership whereas shares do not
► **Shares represent ownership whereas bonds do not**
► Shares and bonds both represent equity
► Bonds represent equity whereas shares do not

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

What is the present value of Rs.53,000 to be paid at the end of 15 years if the interest rate is 9% compounded annually?

► Rs.25,300
► Rs.34,122
► **Rs.14,549**
► Rs.11,989

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

Market portion of risk can be represented through which of the following?

► **Standard deviation**
► Beta coefficient
► Correlation coefficient
► Variance

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

The KSE (Karachi Stock Exchange) 100 Index represents what?

► **The value of Portfolio of Highest volume stocks**
► The value of Portfolio of all Stocks
► The value of Portfolio of lowest volume stocks
► None of the given options

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

All of the following are used in calculation of required return on a particular stock using SML equation **EXCEPT**:

- Risk free rate
- Market risk premium
- Stock's beta
- **Stock's price**

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

What will be the Stock Y's risk premium if the average share of stock Y has a required return of 20% and beta for that stock is 1.0? In addition, treasury bonds yield is 10%?

- 5%
- **10%**
- 20%
- 30%

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

Which of the following represents the tax shield?

- **Interest on capital**
- Dividends to shareholders
- Retained earnings
- Establishment expenses

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

Which of the following theory suggests that shareholder wealth is maximized by a low Dividend Payout?

- MM Irrelevance Theory
- Bird in the Hand Theory
- **Tax Preference Theory**
- Signaling Theory

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

In residual dividend model, what does the term 'Conservatism' refer?

- ► Overvaluation of free cash flows
- ► **Underestimation of free cash flows**
- ► Overestimation of free cash flows
- ► None of the given option

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

Which of the following states that dividends can not exceed retained earnings which are shown in balance sheet?

- ► Irrelevance theory
- ► **Impairment of Capital Rule**
- ► Bird-in-the-hand rule
- ► Tax preference theory

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

Mr. X is going to purchase the stock of ABC Company. Mr. X should purchase the stock on which date so that he can be entitled to receive the dividend, keeping in mind the ex-dividend date is December 7?

- ► **December 6**
- ► December 7
- ► December 8
- ► December 9

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

Which of the following statement shows the total stand alone risk of a firm?

- ► Unique risk + Market risk
- ► Diversified risk + Financial risk
- ► **Business risk + Financial risk**
- ► Business risk + Market risk

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

Which of the following best matches this statement: "A policy under which relatively large amount of cash, marketable securities, and inventories are carried and under which sales are stimulated by a liberal credit policy, resulting in a high level of receivable"?

- ► **Fat cat working capital policy**
- ► Lean & Mean working capital policy
- ► Moderate working capital policy
- ► None of the given options

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

Calculate the return on equity (ROE) of ABC Company using Du Pont equation and the data given below:

Profit Margin= 30%

Asset Turnover= 50%

Leverage Factor = 60%

- ► 3.6%
- ► **9%**
- ► 14%
- ► 33%

Question No: 43 (Marks: 1) - Please choose one

Which of the following is the total cost formula?

- ► Fixed cost * Quantity + Variable cost
- ► Variable cost * Quantity - Fixed cost
- ► **Variable cost * Quantity + Fixed cost**
- ► Fixed cost * Quantity - Variable cost

Question No: 44 (Marks: 1) - Please choose one

Capital structure theory is presented by which of the following?

- ► Robert Alan Hill
- ► **Modigliani & Miller**
- ► Brigham & Houston
- ► Van Horne & Gittman

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Question No: 45 (Marks: 1) - Please choose one

Which of the following statements is correct regarding an aggressive financing policy for a firm relative to a previous conservative policy?

- ► The firm will use long-term financing to finance all fixed and current assets
- ► **The firm will see an increase in its expected profits than before**
- ► The firm will see a decline in its overall risk profile
- ► The firm will need to issue additional common stock this period to finance the assets

Question No: 46 (Marks: 1) - Please choose one

Under which of the following conditions, suppliers may refuse to supply the raw material?

- ► **When there is rumor of bankruptcy of the firm**
- ► When firms are financed through debt
- ► When firms are financed through equity
- ► Under uncertain market conditions

Question No: 47 (Marks: 1) - Please choose one

Which of the following is also known as service lease?

- ► Capital Lease
- ► Financial Lease
- ► **Operating Lease**
- ► Sale & Lease-Back

Question No: 48 (Marks: 1) - Please choose one

Company A has to purchase another company. How do Company A pay for buying the other company?

- ► In Cash
- ► In Shares
- ► Bank Borrowing
- ► **All of the given options**

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Question No: 49 (Marks: 1) - Please choose one

Two businesses at the same level of production are merging together. It is referred as:

- **Horizontal Merger**
- Vertical Merger
- Congeneric Merger
- Conglomerate Merger

Question No: 50 (Marks: 1) - Please choose one

Under pure M&M theory, WACC does not change with _____.

- **Change of debt in capital structure**
- Change in EPS
- Change financial expenses
- Change in business risk

Question No: 51 (Marks: 1) - Please choose one

According to the trade off theory, value of the firm rises as a result of _____.

- **Tax saving**
- Increase in EPS
- Increase in EBIT
- Saving in cost of debt

Question No: 52 (Marks: 1) - Please choose one

From which of the following equations, net income can be calculated?

- **NI = (EBIT - x_D r_D) (1 - Tc)**
- NI = (EAT - x_D r_D) (1 - Tc)
- NI = (EBIT + x_D r_D) (1 - Tc)
- NI = (EBIT - x_D r_D) / (1 - Tc)

Question No: 53 (Marks: 1) - Please choose one

Calculate the Forward Rate for Rupee using Interest Rate Parity if the interest on 1 Year Maturity in Pakistan is 10% and on Euro is 6% and the forward rate is Rs.124/ EUR.

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- Rs. 6 per EUR
- Rs. 120 per EUR
- **Rs. 124 per EUR**
- Rs. 1240 per EUR

Question No: 54 (Marks: 1) - Please choose one

Which of the following is known as selling price for currency?

- **Bid rate**
- Ask rate
- Forward rate
- Spot rate

Question No: 55 (Marks: 3)

Write a short note on real asset markets and also give some examples.

The real asset market where the real physical asset are traded .for example, you have wheat market, cotton market, where real material change hands.

Examples: Gold Market, Property (land, house)

Question No: 56 (Marks: 5)

Company XYZ wants to issue more Common Stock of Face Value Rs 12. Next Year the Dividend is expected to be Rs. 3 per share assuming a Dividend Growth Rate of 10% pa.

The Lawyer's fee and Stock Brokers' Commissions will cost Rs 1 per share. Investors are confident about Company ABC so the Common Share is floated at a Market Price of Rs 18 (i.e. Premium of Rs 6).

If the Capital Structure of Company ABC is entirely Common Equity, then what is the Company's WACC? Use New Stock Issuance Approach to calculate the results.

DIV1 = 2

G= 10%

Lawyer fee and comm. = 1 Rs

Po = 16

Capital structure is equity base 100%

As company is 100 equity it means unlevearged company so its wacc will be required rate of return on equity.

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Required ROR for Common Stock using Gordon's Formula

r = (DIV1/Po) + g

Po = market price = 18

Div1 = Next Dividend = 3

G = growth rate = 10%

r = (3/18)+10% = 26.66%

Now If company wanted to issue the stock via new float then it has to pay the lawyer fee and broker commission which 1 Rs.

Net proceed = 18 – 1 = 17

r = (3/17)+10% = 27.64%

Question No: 57 (Marks: 5)

Why may payout decisions be used by management to signal the prospects of the firm? Give answer in bulleted form.

- If a company selected the high pay out policy without the cash flow to back it up.
- They will find that it ultimately has to either reduce the investments or turn to capital markets for additional debt or equity financing.
- As it is costly, managers will not increase dividends unless they are confident that the firm will get enough cash to pay them.
- It is main reason that we say that there is an information signal attached to dividends payout policy.
- So any change in the dividend payout policy send signals of a change in the firm's prospects.
- Investors take it positively that a company plans to repurchase its stock.
- If they are worried that the company has more cash than it can profitably employ, they may be pleased to see the cash given back to the shareholders.

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Question No: 58 (Marks: 10)

What are the factors affecting signaling theory?

(Give the answer in bulleted form only with brief description)

- This theory consider that all Investors not have equal amount of information.
- All investors are not rational.
- Insider have more information compare to general public
- A Firm's Owners & Managers (Insiders)know more about it than Ordinary outside Investors.
- When manage or owner knows that there are better chances of high cash flow or some project which can bring good profit or earning. They try to finance the capital via debt or bond. They avoid use the equity issuance. Because they don't wanted to share the profit with number share holders. They take capital via debt by paying small amount of interest by this they can earn huge profits.
- When Firm's Outlook looks bad or some risky project, then Managers will choose to raise capital by Issuing Equity by doing this they will be able to share the Likely Losses amongst more Shareholders. If they took Debt and couldn't repay it, they might Default and be forced to go Bankrupt.
- By doing this investor also get signal that if companies is financing its capital via debt then likely it will be some good prospect in the company.
- By looking at these practices by management we can so mangers are in a better position to decide about the firm.

Question No: 59 (Marks: 10)

Explain the following conditions:

- **IRR <WACC**
- **IRR >WACC> SML**
- **IRR <SML**
- **IRR <WACC< SML**

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IRR <WACC

you should not invest in this project as rate of return is less then WACC. In other words your returns are less the cost of capital.

IRR >WACC> SML

we should take this project as its rate of rerun is higher then the WACC and it offers better return then an efficient market offers. Due to IRR is higher then SML

IRR <SML

It is showing rate of return which is lower than SML we should not invest in such project because it is not giving as much return as efficient market is returns

IRR <WACC< SML

IRR lower than WACC and SML company should not invest as IRR is not enough to cover the WACC (not enough to cover the cost of capital) plus its returns are lower then returns offered by efficient market.

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