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FINALTERM EXAMINATION
Fall 2009
MGT201- Financial Management (Session - 4)

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

Among the pairs given below select a(n) example of a principal and a(n) example of an agent respectively.

- ► Shareholder; manager
- ► Manager; owner
- ► Accountant; bondholder
- ► Shareholder; bondholder

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

Who determines the market price of a share of common stock?

- ► Individuals buying and selling the stock
- ► The board of directors of the firm
- ► The stock exchange on which the stock is listed
- ► The president of the company

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

Which of the following would be deductible as an expense on the corporation's income statement?

- ► Interest paid on outstanding bonds
- ► Cash dividends paid on outstanding common stock

► Cash dividends paid on outstanding preferred stock

► All of the given options

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

How a company can improve (lower) its debt-to-total asset ratio?

► By borrowing more

► By shifting short-term to long-term debt

► By shifting long-term to short-term debt

► By selling common stock

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

Which of the following statement is most accurate?

► Coverage ratios also shed light on the "liquidity" of current ratios

► Receivable- and inventory-based activity ratios also shed light on the "liquidity" of current assets

► Receivable- and inventory-based activity ratios also shed light on the firm's use of financial leverage

► Liquidity ratios also shed light on the firm's use of financial leverage

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

Which of the following statements is most correct?

► The future value of an annuity due is greater than an otherwise identical ordinary annuity

► A reduction in the discount rate will increase the future value of an otherwise identical cash flow stream

► Continuous compounding will result in a higher present value relative to an otherwise identical investment that is compounded monthly at the same nominal rate

► The FVIFA (i%, N periods) equals the sum of the PVIF(i%, n) for n=1 to N periods

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

The estimated benefits from a capital budgeting project are expected as cash flows rather than income flows because _____.

► It is more difficult to calculate income flows than cash flows

► It is cash, not accounting income that is central to the firm's capital budgeting decision

► This is required by the accounting profession

► This is required by the Internal Revenue Service (IRS) and enforced through filings with the Securities and Exchange Commission (SEC)

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

Which of the following technique would be used for a project that has non-normal cash flows?

► Internal rate of return

► Multiple internal rate of return

► Modified internal rate of return

► Net present value

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

Which one of the following is **NOT** the disadvantage of the asset with very short life?

► Money has to be reinvested in some other project with uncertain NPV

► Money has to be reinvested in some other project with certain NPV

► Money has to be reinvested in some other project with return so risky

► None of the given options

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

When a bond will sell at a discount?

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► The coupon rate is greater than the current yield and the current yield is greater than yield to maturity

► The coupon rate is greater than yield to maturity

► The coupon rate is less than the current yield and the current yield is greater than the yield to maturity

► The coupon rate is less than the current yield and the current yield is less than yield to maturity

Question No: 11 (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

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

Which of the following statement about portfolio statistics is **CORRECT**?

► A portfolio's expected return is a simple weighted average of expected returns of the individual securities comprising the portfolio.

► A portfolio's standard deviation of return is a simple weighted average of individual security return standard deviations.

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► The square root of a portfolio's standard deviation of return equals its variance.

► The square root of a portfolio's standard deviation of return equals its coefficient of variation.

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

Which of the following is simply the weighted average of the possible returns, with the weights being the probabilities of occurrence?

► A probability distribution

► The expected return

► The standard deviation

► Coefficient of variation

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

The objective of financial management is to maximize _____ wealth.

- ► Stakeholders
- ► Shareholders
- ► Bondholders
- ► Directors

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

How can you limit company-specific risks?

- ► Invest in that company's bonds
- ► Invest in a variety of stocks
- ► Invest in securities that do well in a recession
- ► Invest in securities that do well in a boom

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

To limit volatility what should be the appropriate action?

- ► To diversify
- ► To check the stocks prices daily
- ► To own just a few securities
- ► Not to invest in risky securities

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

If risk and return combination of any stock is above the SML, what does it mean?

- ► It is offering lower rate of return as compared to the efficient stock
- ► It is offering higher rate of return as compared to the efficient stock
- ► Its rate of return is zero as compared to the efficient stock
- ► It is offering rate of return equal to the efficient stock

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

What is the meaning of the term "arbitrage"?

- ► Buying low and selling high
- ► Earning risk-free economic profits
- ► Negotiating for favorable brokerage fees
- ► Hedging your portfolio through the use of options

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

The ABC Company relies on preferred stock, bonds, and common stock for its long-term financing. Rank in ascending order (i.e., 1 = lowest, while 3 = highest) the likely after-tax component costs of the ABC's long-term financing.

- ► 1 = bonds; 2 = common stock; 3 = preferred stock
- ► 1 = bonds; 2 = preferred stock; 3 = common stock
- ► 1 = common stock; 2 = preferred stock; 3 = bonds
- ► 1 = preferred stock; 2 = common stock; 3 = bonds

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

Which of the following is **NOT** a recognized approach for determining the cost of equity?

- ► Dividend discount model approach
- ► Before-tax cost of preferred stock plus risk premium approach
- ► Capital-asset pricing model approach
- ► Before-tax cost of debt plus risk premium approach

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

The overall (weighted average) cost of capital is composed of weighted averages of which of the following?

- ► The cost of common equity and the cost of debt
- ► The cost of common equity and the cost of preferred stock
- ► The cost of preferred stock and the cost of debt
- ► The cost of common equity, the cost of preferred stock, and the cost of debt

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

Which of the following is related to the use Lower financial leverage?

- ► Fixed cost
- ► Variable cost
- ► Debt financing

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► Common equity financing

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

Which of the following is the cash required during a specific period to meet interest expenses and principal payments?

► Debt capacity

► Debt-service burden

► Adequacy capacity

► Fixed-charge burden

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

Suppose that the Euro is selling at a forward discount in the forward-exchange market. This implies that most likely _____.

► The Euro has low exchange-rate risk

► The Euro is gaining strength in relation to the dollar

► Interest rates are higher in Euroland than in the United States

► Interest rates are declining in Europe

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

Which of the following is a reason suggested by the authors for a divestiture, such as a sell-off or spin-off?

► Synergy

► Reverse synergy

- Hubris
- Economies of scale

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

Which of the following refers to a policy of dividend "smoothing"?

- Maintaining a constant dividend payout ratio
- Keeping the regular dividend at the same level indefinitely
- Maintaining a steady progression of dividend increase over time
- Alternating cash dividends with stock dividends

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

Why Investors may prefer lower dividends to higher dividends?

- The low dividends are more predictable
- Capital gains may be taxed less heavily than dividends
- Of the "bird in the hand" logic

► Low dividends indicate heavy investment for the future

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

Which of the following is **NOT** correct regarding issuing company's repurchase of their shares?

► Companies pay out money to shareholders by repurchasing their shares

► Stock repurchases have grown slowly but gradually in recent years; however they do not substitute for dividends

► Instead, repurchases are generally used to make major one-off changes to the firm's capital structure, particularly when cash resources have outrun good investment opportunities

► Repurchases can be like bumper dividends; they cause large amounts of cash to be paid to investors when the firm buys back their shares

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

According to MM II, what happens when a firm's debt-to-equity ratio increases?

► Its financial risk increases

► Its operating risk increases

► The expected return on equity increases

► The expected return on equity decreases

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

If the following are the balance sheet changes, which one of them would **NOT** represent use of funds by a company?

► Rs. 8,950 decrease in net fixed assets

- Rs. 5,005 decrease in accounts receivable
- Rs. 10,001 increase in accounts payable
- Rs. 12,012 decrease in notes payable

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

Assume a company had Rs.1 billion in free cash flow last year, and it is expected to grow that cash flow at 3% into perpetuity. Assuming a 9% cost of equity, what is the present value of the company?

- Rs.12.08 billion
- Rs.18.15 billion
- Rs.14.16 billion
- Rs.16.67 billion

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

While calculating the stock Beta graphically, y-intercept is known as:

- Alpha
- Beta
- Gamma
- None of the given options

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

In a market where the SML (Security Market Line) has low slope, most of the investors are:

- Risk lover

- Risk averse
- Professional investors
- None of the given options

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

What is the assumed value of risk free rate of return in Pakistan?

- 5%
- 8%
- 10%
- 12%

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

In term of diversification, the efficient portfolios must lie on which of the following?

- Capital market line
- Money market line
- Security market line
- None of the given options

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

Which of the following is/are ideal source(s) of capital for profitable firms because of no transaction costs?

- Sizeable Cash

► Retained Earnings

► Both Sizeable Cash and Retained Earnings

► None of the given options

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

Which of the following is/are the assumption(s) of MM's (Miller Modigliani) Theory?

► There are no brokerage costs

► There are no taxes

► There are no bankruptcy costs

► All of the given options

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

How many approaches are used to calculate the required rate of return for common equity?

► 1

► 2

► 3

► 5

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

Which of the following allows to by-pass the errors of forecasting?

- Capital asset pricing model
- Gordon's formula
- Share valuation formula
- Standard deviation

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

The Impairment of Capital Rule refers to what?

- Cash Dividends can only be paid from cash
- Dividends can not exceed Retained Earnings
- Restricting the dividend payout if earnings are too low to pay interest
- Investors buy stocks whose dividend policy they like

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

Tax Preference Theory suggests that shareholder wealth is maximized by low dividend payout because of which of the following reasons?

- Marginal tax rate on dividends is lower than on capital gains
- Marginal tax rate on dividends is higher than on capital gains
- Marginal tax rate on dividends is equal to capital gains
- None of the given options

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

Company ABC offers its stockholders 10 % stock dividends and Mr. S is one of

its stockholders being the owner of 250 stocks. How many shares Mr. S has after availing the stock dividend?

- ► 25
- ► 50
- ► 275
- ► 250

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

All of the following are considered while computing the working capital of a firm **EXCEPT:**

- ► Inventory
- ► Accounts Receivables
- ► Accrued expenses
- ► Marketable Securities

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

Firms increase financial leverage because of the increase in which of the following?

- ► Assets
- ► Debt
- ► Equity
- ► Expenses

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

Which of the following is called the father of corporate finance?

- ► Prasanna Chandra
- ► Modigliani & Miller
- ► Van Horne & Gittman
- ► Robert Alan Hill

Question No: 47 (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: 48 (Marks: 1) - Please choose one

If selling price per unit falls and all other factors remain constant, the operating break-even points (units) will _____.

- ► Fall
- ► Rise
- ► Remain the same
- ► None of the given options

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

A car manufacturing company purchases radiators, axles and other parts to be

used in manufacturing the car from suppliers rather than making them itself. This refers to which of the following?

- ► Outsourcing
- ► Just in time
- ► Aggressive approach
- ► Conservative approach

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

From which of the following, negative net worth of the company is expressed?

- ► Experiencing a project failure
- ► Competitor's insolvency
- ► Experiencing technical insolvency
- ► Experiencing accounting insolvency

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Question No: 51 (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: 52 (Marks: 1) - Please choose one

Which of the following is not one of the types of merger?

- ► Horizontal Merger
- ► Vertical Merger
- ► Diagonal Merger
- ► Conglomerate Merger

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

In which of the following theory the value of the firm increases gradually because of tax savings but with excessive leverage the value starts declining?

- ► M&M theory
- ► Trade off theory
- ► Law of diminishing returns
- ► Signaling theory

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

Which of the following statements is true about business risk?

- ► The financial risk of a firm decreases when it takes on a risky project
- ► The financial risk of a firm increases when it takes on more equity
- ► The business risk of a firm increases when it takes on a risky project
- ► The business risk of a firm increases when it takes on more debt

Question No: 55 (Marks: 3)

Suppose that the risk free rate is 8%, if the market rate is expected to be 10%, what would be the expected return on the stock with a beta of 1.2?

Question No: 56 (Marks: 5)

How working capital affects performance of a business?

Question No: 57 (Marks: 5)

ABC industries have a beta of 1.5. The risk free rate is 8% and the expected return on the market portfolio is 13 %. The company presently pays a dividend of $5 a share, and investors expect it to experience a growth in dividends of 10 percent per annum for many years to come.

a. What is the stock's required rate of return according to the CAPM?

b. What is the stock's present market price per share, assuming this required return?

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Question No: 58 (Marks: 10)

Stock L and the "market" has the following rates of returns over the past four years.

Year	Stock L	Market
2005---	12.00%-----	14.00%
2006---	5.00% ---	2.00%
2007---	11.00%------	14.00%
2008---	-7.00% ------	-3.00%

Additional Information:

60% of your portfolio is invested in Stock L and the remaining 40% is invested in Stock Y. The risk-free rate is 6% and the market risk premium is also 6%. You estimated that 14% is the required rate of return on your portfolio. While Stock L has the beta of 0.9484.

Required:

You are required to calculate the beta of Stock Y?

Question No: 59 (Marks: 10)

Elaborate the drawbacks of the capital structure theory presented by the Miller & Modigliani. And what changes were made to this theory.

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