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FINALTERM EXAMINATION

Spring 2010

MGT201- Financial Management (Session - 3)

Time: 90 min

Marks: 69

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

Which of the following financial market is referred to the market for short-term government and corporate debt securities?

► **Money market**

► Capital market

► Primary market

► Secondary market

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Question No: 2 (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: 3 (Marks: 1) - Please choose one

In finance, we refer to the market where new securities are bought and sold for the first time as the _____ market.

► Money market

► Capital market

► **Primary market**

► Secondary market

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

Felton Farm Supplies, Inc., has an 8 percent return on total assets of Rs.300,000 and a net profit margin of 5 percent. What are its sales?

► 750,0Rs.3, 750,000

► **Rs.48Rs.480, 000**

► Rs.30Rs.300, 000

► Rs.1, Rs.1, 500,000

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

An investment proposal should be judged in whether or not it provides:

□

► A return equal to the return require by the investor

► A return more than required by investor

► A return less than required by investor

► **A return equal to or more than required by investor**

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

The value of a bond is directly derived from which of the following?

► Cash flows

► Coupon receipts

► Par recovery at maturity

► **All of the given options**

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

A statistical measure of the variability of a distribution around its mean is referred

to as _____.

► A probability distribution

► The expected return

► The standard deviation

► Coefficient of variation

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

A well-diversified portfolio is defined as:

► One that is diversified over a large enough number of securities that the nonsystematic variance is essentially zero

► One that contains securities from at least three different industry sectors

► A portfolio whose factor beta equals 1.0

► A portfolio that is equally weighted

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

What will happen to the expected return on a stock with a beta of 1.5 and a market risk premium of 9% if the Treasury bill yield increases from 3% to 5%?

► The expected return will increase by 2.0%

► The expected return will remain unchanged

► The expected return will increase by 1.0%

► The expected return will increase by 3.0%

Question No: 10 (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

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

Why markets and market returns fluctuate?

► Because of political factors

► Because of social factors

► Because of socio-political factors

► **Because of macro systematic factors**

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

The use of personal borrowing to change the overall amount of financial leverage to which the individual is exposed is called:

► Dividend recapture

► Financial leverage

► Private debt placement

► **Homemade leverage**

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

Which of the following best describes the statement; "The value of an asset is preserved regardless of the nature of the claims against it"?

► Law of diminishing marginal returns

► **Law of conservation of value**

► Law of return on equity

► Law of return on assets

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

The amount of current assets that varies with seasonal requirements is referred to as _____ working capital.

► Permanent

► Net

► Temporary

► **Gross**

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

Which of the following is an example of a natural hedge?

► **The prices and costs are both determined in the global market place.**

► The prices are determined in the global market place and costs are determined in the domestic market place.

► The costs are determined in the global market place and prices are determined in the domestic market place.

► None of the given options is correct

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

How should a successful acquisition be evaluated in the long-run?

► The acquisition is successful if the acquirer is able to increase its earnings per share (EPS), relative to what it would have been without the acquisition.

► The acquisition is successful if the acquirer is able to reduce its debt-tototal asset ratio, and hence risk, relative to what it would have been without the acquisition.

► The acquisition is successful if the acquirer is able to diversify its asset base and reduce its overall risk.

► **The acquisition is successful if the market price of the acquirer's stock increases over what it would have been without the acquisition.**

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

Which of the following term is used when the firm can independently control considerable assets with a very limited amount of equity?

► Joint venture

► **Leveraged buyout (LBO)**

► Spin-off

► Consolidation

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

Which of the following would **NOT** be included in inventory carrying cost?

► Insurance expense for the inventory

► Opportunity cost of capital for inventory investment

► **Cost of inventory**

► Cost of shelf space

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

What would you expect to happen to the price of a share of stock on the day it goes ex-dividend?

► The price should increase by the amount of the dividend

► **The price should decrease by the amount of the dividend**

► The price should decrease by one-half the amount of the dividend

► The price should remain constant

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

Which of the following is the suggestion of Trade-off theory of capital structure?

► Firms should add leverage whenever interest rates are low

► **Firms with higher operating risk should use less debt**

► Firms should use 50% debt and 50% equity

► Firms should use debt to overcome high par values of stock

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

What is the basic purpose of financial management?

► **Finding the best opportunities for the use of finance**

► Maintaining the books of accounts of the organization

► Helping managers in managing the employees

► Assessing the nature of employees and motivating them

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

"Value line" is an agency in America which performs which of the following functions?

► Calculates the NPVs

► Calculates the Correlation coefficients

► Calculates the Annuities

► **Calculates the stock Betas**

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

In NPV (Net Present Value) calculations, which of the following is used?

► Excepted rate of return

► **Required rate of return**

► Both expected rate of return and Required rate of return

► None of the given options

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

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

► **Risk lover**

► Risk averse

► Gamblers

► None of the given options

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

If an asset B has steeper SML (security market line) than another asset A, which of the following statements is TRUE?

► Asset A is more risky than asset B

► **Asset B is more risky than asset A**

► Asset B is as risky as Asset A

► None of the given options

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

Which of the following shows ALL possible risk–return combinations of all stocks

in a portfolio, whether these are efficient or not?

□

► Security market line

► Capital market line

► Parachute graph

► **All of the given options**

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

According to Traditionalist Theory, when a 100% Equity Firm takes on more and more debt, which of the following phenomenon is observed?

► Share Price first falls, then reaches minimum and finally rises

► Share Price first rises, then reaches minimum and finally falls

► **Share Price first rises, then reaches maximum and finally falls**

► None of the given options

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

Which of the following formula represents the yield to maturity?

► Interest yield + Market price

► Capital gain yield + Book value

► **Interest yield + Capital gain yield**

► Market price + Capital gain yield

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

In the WACC equation (rDxD + rExE + rPxP), **xP** represents which of the following?

► Weight or Fraction of Total Capital value raised from common stock

► **Weight or Fraction of Total Capital value raised from bonds**

► Weight or Fraction of Total Capital value raised from preferred stock

► Weight or Fraction of Total Capital value raised from retained earnings

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

The date on which the firm's directors issue a statement about the announcement of dividend is known as:

► **Declaration Date**

► Holder-of-record Date

► Ex-Dividend Date

► Payment Date

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

You own 150 shares of ABC Company and it offers you the stock splits 2-for-1. How many additional shares will you receive after stock splits?

► 100

► 150

► 200

.

► 300

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

The decisions regarding working capital management of a firm are mainly concerned with which of the following?

► Current assets & long-term liabilities of balance sheet

► Current assets & current liabilities of balance sheet

► Fixed assets & current liabilities of balance sheet

► Fixed assets & long-term liabilities of balance sheet

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

ABC Company wants to use hedging approach to financing assets. How can the firm use this approach?

► Finance temporary current assets with long-term liabilities

► Finance short-term assets with equity

► Finance permanent working capital with long-term liabilities

► Finance all assets financed with a mixture of 50% equity and 50% longterm

debt

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

Which of the following is true regarding financial leverage?

► Whenever a firm's equity increases faster than its debt, financial leverage increases

► Investors can undo the effects of the firm's capital structure by using home-made leverage

► Increasing financial leverage will always increase the EPS for stockholders

► The level of financial leverage that produces the minimum firm value is the most beneficial to stockholders

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

Suppose that there is no personal or corporate income tax and that the firm's WACC is not affected by its capital structure, then which of the following statements is true?

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► A firm's cost of equity depends on the firm's business and financial risks

► The value of the firm is dependent on its capital structure

► The cost of equity increases as the firm's leverage decreases

► The greater the financial leverage, the more valuable is the firm

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

Which of the following is **NOT** a source of spontaneous financing?

► Trade credits

□

► Short term loans

► Accrued taxes

► Wages payable

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

Which of the following statements depicts the trade-off theory in a better way?

► It states a tradeoff between the costs and benefits of debt financing

► **It states the tradeoff between the debt financing and equity financing**

► There is tradeoff between assets and liabilities of the firm

► There is tradeoff between revenues and expenses of the firm

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

Value of the firm can be calculated with the help of which of the following formulas?

► **Price of a share x No. of shares outstanding**

► Price of a share x debt / equity

► Price of a share / No. of shares outstanding

► Price of a share x earnings after tax / equity

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

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

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► In Cash

► In Shares

► Bank Borrowing

► **All of the given options**

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

Which of the following mathematical expressions depicts divestiture?

► 5-1=4

► 5-1=6

► 5+1=6

► **None of the given options**

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

What happens to the total risk when leverage increases with high rate?

► Total risk increases with slow rate than the leverage

► Total risk increases with decreasing rate

► Total risk remains the same

► Total risk increases faster than the leverage

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

From which of the followings, the stability of the firm can be judged?

□

► Financial leverage

► Weighted-average cost of capital

► Capital structure

► Business risk

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

You have 25 Indian Rupees and you want to exchange these Indian Rupees with Pakistan Rupees. You go to a money changer and he tells you the selling rate of 1 Indian Rupee is 1.8041 PKR. The rate 1.8041 PKR is referred as:

► Bid rate

► Forward rate

► Future rate

► Ask rate

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

The value at which buyers and sellers are willing to buy and sell any asset is known as:

► Liquidation value

► Book value

► Intrinsic value

► Market value

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

"Do not compare apples with oranges" is the concept in:

► **Discounting and Net present value**

► Risk & return

► Insurance management

► Time value of money

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

Which of the following statement best describes capital budgeting?

► It's a tool which is used to evaluate the projects and fixed assets of the company

► A technique used to assess the working capital requirement

► It will help the management to decide whether the new venture should be taken up or not.

► **All of the given options are correct**

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

In Pakistan which of the following is assigned to bond rating and risk?

► IMF

► Moody's

► Standard & poor

□

□

► **PACRA**

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

In Gordon's formula (rCE = DIV1 / Po + g), rCE is considered as _____ and "g" is considered as _____.

► Dividend yield, operating expenses

► Dividend yield, operating income

► Dividend yield, capital loss

► **Dividend yield, capital gain**

Question No: 49 (Marks: 3)

Where do firms invest excess funds until they are needed to pay bills?

Question No: 50 (Marks: 3)

What problems a firm can face if it faces a shortfall or surplus of inventories.

Question No: 51 (Marks: 5)

Compare aggressive working capital financing with conservative working capital financing.

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Question No: 52 (Marks: 5)

Ahmad Corporation, a small business man, provided the following information about the production level:

Fixed operating cost = Rs. 2,500, Sale price per unit is Rs.10 and its operating variable cost per unit is Rs. 5.

 You are required to calculate the breakeven quantity from the above information.

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Answer:

Sales=10/unit

VC=5/unit

CM=5/unit

FC=2,500, 250/unit

Profit=200/unit

Fixed cost/ CM unit= 25, 00/5

Breakeven quantity=500

 If variable cost has changed and it is increased up to Rs. 6 then what will be the effect of this change on Break even quantity.

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□

Answer:

Contribution Margin=10-6=4

New Breakeven quantity=25, 00/4=625

Breakeven quantity is increased by 125 units.

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Question No: 53 (Marks: 5)

ABC Corporation expects to have the following data during the coming year.

Assets Rs. 200,000 Interest rate 8%

Debt/Assets, book value 65% Tax rate 40%

EBIT Rs. 25,000

Required:

What is the firm's expected ROE?

Answer:

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ROE=NI/Equity

NI=EBIT-Tax=25,000-10,000=15,000

Assets=(200,000*65%)=130,000

130,000*8%=10,400

Profit after interest=25,000-10,400=14,600

14,600*40%=5840

Net profit after tax=8,760

ROE=(8,760/70,000)*100=12.51%

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