Final Term Papers

Fall 2009 (Session 03d)

MGT201

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

ABC's and XYZ's debt-to-total assets ratio is 0.4. What is its debt-to-equity ratio?

- 0 .2
- 0 .77
- **0.667**
- 0.333

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

As interest rates go up, the present value of a stream of fixed cash flows _____

- **Goes down**
- Goes up
- Stays the same
- Can not be found

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

A 5-year ordinary annuity has a future value of Rs.1,000. If the interest rate is 8 percent, the amount of each annuity payment is closest to which of the following?

- Rs.231.91
- Rs.184.08
- Rs.181.62
- **Rs.170.44**

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

When there is single period capital rationing, what would be the most sensible way of making investment decisions?

- ► Choose all projects with a positive NPV
- ► **Group projects together to allocate the funds available and select the group of projects with the highest NPV**
- ► Choose the project with the highest NPV
- ► Calculate IRR and select the projects with the highest IRRs

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

Which of the following is the value of bond that we expect the bond to be?

- ► Intrinsic value
- ► Fair value
- ► **Both intrinsic and fair value**
- ► Market price

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

An investment opportunity set formed with two securities that are perfectly negatively correlated. What will be standard deviation in the global minimum variance portfolio?

- ► **Equal to zero**
- ► Greater than zero
- ► Equal to the sum of the securities' standard deviations
- ► Equal to -1

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

Which of the following value of the shares changes with investor's perception about the company's future and supply and demand situation?

- ► Par value
- ► **Market value**
- ► Intrinsic value
- ► Face value

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

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

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► **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.

► 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: 10 (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: 11 (Marks: 1) - Please choose one

The ratio of the standard deviation of a distribution to the mean of that distribution is referred to as _____.

► A probability distribution

► The expected return

► The standard deviation

► **Coefficient of variation**

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

The Higher the Risk of a Share, the _____ its Rate of Return and the _____ its Market Price.

► **Higher; Lower**

► Lower; Higher

► Higher; Higher

► Lower; Lower

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

If a company intends to start a new project, _____ technique are employed to assess the financial viability of the project.

- ► Financial planning
- ► Financial forecasting
- ► **Capital budgeting**
- ► Capital rationing

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

Expected Portfolio Return = _____

- ► **rP * = xA rA + xB rB**
- ► rP * = xA rA - xB rB
- ► rP * = xA rA / xB rB
- ► rP * = xA rA * xB rB

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

Market risk is measured in terms of the _____ of the market portfolio or index.

- ► Variance
- ► Covariance
- ► **Standard deviation**
- ► Correlation coefficient

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Question No: 17 (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: 18 (Marks: 1) - Please choose one

Generally companies want to keep the balance in the form of:

- **Debt**
- Equity
- Hybrid security
- Both debt and equity

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

A firm has a DFL of 3.5 at X dollars. What does this tell us about the firm?

- If sales rise by 3.5% at the firm, then EBIT will rise by 1%
- If EBIT rises by 3.5% at the firm, then EPS will rise by 1%
- **If EBIT rises by 1% at the firm, then EPS will rise by 3.5%**
- If sales rise by 1% at the firm, then EBIT will rise by 3.5%

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

Which of the following is the maximum amount of debt (and other fixed-charge financing) that a firm can adequately service?

- **Debt capacity**
- Debt-service burden
- Adequacy capacity
- Fixed-charge burden

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

Which of the following represents financial leverage?

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- **Use of more debt capital to increase profit**
- Debt is not used in capital to increase profit
- High degree of solvency
- Low degree of solvency

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

Which of the following statements regarding leverage is true?

- **The ultimate effect of leverage depends on the firm's EBIT**
- If things go poorly for the firm, increased leverage provides greater returns to shareholders.
- As a firm lever up, shareholders are exposed to less risk
- The benefits of leverage always outweigh the costs of financial distress

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

Your firm has a philosophy that is analogous to the hedging (maturity matching) approach. Which of the following is the most appropriate form for financing a new capital investment in plant and equipment?

- 6-month bank notes
- Accounts payable
- **Common stock equity**
- Trade credit

Question No: 24 (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

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

Which of the following is **NOT** a form of short-term, spontaneous credit?

- Accrued wages

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- Trade credit
- **Commercial paper**
- Accrued taxes

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

What would be the result when there is an increase in the number of shares outstanding by reducing the par value of stock?

- **Stock split**
- Stock dividend
- Extra dividend
- Regular dividend

Question No: 28 (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: 29 (Marks: 1) - Please choose one

Which of the following add up to the costs of financial distress?

- Direct bankruptcy costs, primarily legal and administrative costs
- Indirect bankruptcy costs, reflecting the difficulty of managing a company when it is in bankruptcy proceedings

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► Costs of the threat of bankruptcy, such as poor investment decisions resulting from conflicts of interest between debt holders and stockholders

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

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

A technique that tells us the number of years required to recover our initial cash investment based on the project's expected cash flows is:

► **Pay back period**
► Internal rate of return
► Net present value
► Profitability index

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

Which is the best measure of risk for a single asset held in isolation, and which is the best measure for an asset held in a diversified portfolio?

► Variance, correlation coefficient
► Standard deviation, correlation coefficient
► Beta, variance
► **Coefficient of variation, beta**

Question No: 32 (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: 33 (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%**

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► 20%
► 30%

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

What should be used to calculate the proportional amount of equity financing employed by a firm?

► The book value of the firm
► The sum of common stock and preferred stock on the balance sheet
► **The current market price per share of common stock times the number of shares outstanding**
► The common stock equity account on the firm's balance sheet

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

According to Traditionalist Theory, when an un-leveraged firm takes on more and more debt, which of the following phenomenon is observed?

► Cost of Capital increases, reaches a minimum point, and then falls
► **Cost of Capital decreases, reaches a minimum point, and then rises**
► Cost of Capital increases, reaches a maximum point, and then rises
► None of the given options

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

In the WACC equation ($r_D x_D + r_E x_E + r_P x_P$), $\mathbf{x_D}$ represents which of the following?

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

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

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

The date on which the names of stockholders in the Stock Transfer Register of firm are documented is referred as:

- ► Declaration Date
- ► **Holder-of-record Date**
- ► Ex-Dividend Date
- ► Payment Date

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

XYZ Corporation has offered its shareholders the option that their dividends will be used to purchase additional shares of this corporation. This offer of XYZ Corporation is referred as:

- ► Stock repurchases
- ► **Dividend reinvestment**
- ► Stock dividends
- ► Stock splits

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

When IRR < WACC it means that:

- ► Investment is acceptable as required rate of return is less then cost of capital
- ► **Investment is not acceptable as required rate of return is less then cost of capital**
- ► Investment is acceptable as required rate of return is equal to the cost of capital
- ► None of the given options is true

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

Which of the following statement depicts the advantage of raising capital through debt?

- ► Debt adds to company specific risk
- ► If company does not pay interest it can be close down
- ► **It can improve the return on equity**
- ► Not required to pay fixed amount of interest

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

Which of the following can be defined as "additional risk faced by common stockholders if firms take debt."?

- Unsystematic risk
- Systematic risk
- Business risk
- **Financial risk**

Question No: 43 (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

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

If Current assets = Rs. 16,000,

Current liabilities= Rs. 10,000

Inventory= Rs. 2500

Calculate quick ratio for the firm?

- **1.35**
- 6.0
- 1.60
- 0.25

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

Which of the following states that "Cash is King and only Cash can pay the bills"?

- Fat cat working capital policy
- Lean & Mean perspective
- **Balance Sheet Perspective**
- Moderate working capital policy

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

Which of the following depicts the break even point in best way?

- **EBIT = 0**
- EBIT < 0
- EBIT > 0
- None of the given options

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

Financial leverage is considered good in which of the following?

- Earning after interest & tax / Total asset > Interest cost
- Earning after interest & tax / Total asset < Interest cost
- Earning before interest & tax / Total asset < Interest cost
- **Earning before interest & tax / Total asset > Interest cost**

Question No: 48 (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?

- **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: 49 (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: 50 (Marks: 1) - Please choose one

A car manufacturing firm buys steel from a steel mill. Both these entities combined together to form a new firm. It is referred to which of the following?

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

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

Under efficient market, the effect of debt on WACC can be represented with the help of which of the following?

- ► **Straight line**
- ► U shaped curve
- ► Concave
- ► Time to time fluctuation

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

What is the effect on WACC if debt increases under pure M&M theory model?

- ► It will increase
- ► It will decrease
- ► **It remains unchanged**
- ► None of the given options

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

Most of the firms wish to maintain their capital structure in the form of which of the following?

- ► 100% equity
- ► **100% debt**
- ► Mix of debt and equity
- ► 100% from the personal savings

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

Under Net income approach, which of the following is a correct sequence of calculating cost of capital?

- Net income – Total firm's market value – WACC
- Net income – WACC – total firm's market value
- WACC – Net income – market value of equity
- **Market value of firm – WACC – Net income**

Question No: 55 (Marks: 3)

If capital structure changes from equity to debt then what will be the effect on capital structure.

Question No: 56 (Marks: 5)

How are dividends paid, and how do companies decide on dividend payments?

Question No: 57 (Marks: 5)

Write a note on capital structure of organizations and cost of capital.

Question No: 58 (Marks: 10)

Why is stock price volatility more likely to imply risk than earnings volatility? Explain with the help of some examples.

Question No: 59 (Marks: 10)

Explain the following conditions:

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

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