

MIDTERM EXAMINATION
Fall 2009
FIN622- Corporate Finance (Session - 4)

Question No: 1 -- Please choose one

Which of the following statements is TRUE regarding Profitability Index?

- ▶ It ignores time value of money
- ▶ It ignores future cash flows
- ▶ **It ignores the scale of investment - (page 36)**
- ▶ It ignores return on investment

Question No: 2 -- Please choose one

A company can improve (lower) its debt-to-total assets ratio by doing which of the following?

- ▶ By increasing the amount of borrowings
- ▶ By shifting short-term to long-term debt
- ▶ By shifting long-term to short-term debt
- ▶ **By selling the common stock -**

Question No: 3 -- Please choose one

A public limited Company had sales of Rs.2 million this year. The marketing manager expects sales to grow at a 10 percent compound annual rate over the next 10 years. On this basis, which of the following is the closest amount of sales in 10 years?

- ▶ **Rs.5,187,485. -**
 $2000000 (1.10)^{10} = 5,187,485$
- ▶ Rs.2,593,722.
- ▶ Rs.4,622,885.
- ▶ Rs.5,081,309

Question No: 4 -- Please choose one

Suppose you wish to set aside Rs.2,000 at the beginning of each of the next 10 years (the first Rs.2,000 deposit would be made now) in an account paying 12 percent compounded annually. Approximately how much will you accumulate at the end of 10 years?

- ▶ Rs.22,863
- ▶ **Rs.35,097 - Doubtful**
- ▶ Rs.39,310
- ▶ Rs.25,151

Question No: 5 -- Please choose one

Which of the following terms refers to the process of systematic investigation of the effects on estimates or outcomes of changes in data or parameter inputs or assumptions to evaluate a capital project?

► **Sensitivity Analysis -**
(page 36)

- Fundamental Analysis
- Technical Analysis
- Trend Analysis

Question No: 6 -- Please choose one

The percentage change in a firm's operating profit (EBIT) resulting from a 1% change in output (sales) is known as the _____.

► **Degree of operating leverage -**

- Degree of profit leverage
- Degree of total leverage
- Degree of financial leverage

Question No: 7 -- Please choose one

A project would be financially feasible in which of the following situations?

- If Internal Rate of Return of a project is greater than zero
- If Net Present Value of a project is less than zero
- If the project has Profitability Index less than one
- **If the project has Profitability Index greater than one -**

Question No: 8 -- Please choose one

Which of the following is determined by variance of an investment's returns?

- Volatility of the rates of return.
- Probability of a negative return.
- Historic return over long periods.
- **Average value of the investment. -**

Question No: 9 -- Please choose one

Which of the following conditions, if exist, will make the diversification of stocks more effective?

- Securities contained in a portfolio are positively correlated
- **Securities contained in a portfolio are negatively correlated -**
- Securities contained in a portfolio have high market values
- Securities contained in a portfolio have low market values

Question No: 10 -- Please choose one

Which one of the following terms refers to the variability of return on stocks or portfolios not explained by general market movements, and is avoidable through proper diversification?

- Total risk
- Systematic risk
- **Unsystematic risk -**
- Market risk

Question No: 11 -- Please choose one

Suppose a stock is selling today for Rs.40 per share. At the end of the year, it pays a

dividend of Rs.2.00 per share and sells for Rs.44.00. what is the rate of return on this stock?

- ▶ 12%
- ▶ 13%
- ▶ 14%
- ▶ **15% -**

$$2/40 * 100 = 5\%$$

$$4/40 * 100 = 10\%$$

$$5\% + 10\% + 15\%$$

Question No: 12 -- Please choose one

If the common stocks of a company have beta value less than 1, then such stocks refer to which of the following?

- ▶ Normal stocks
- ▶ Aggressive stocks
- ▶ **Defensive stocks -**
- ▶ Income stocks

Question No: 13 -- Please choose one

What will be the risk premium if the market portfolio has an expected return of 10% and the risk free rate is 4%?

- ▶ 4%
- ▶ 5%
- ▶ **6% -**

Market risk premium, (Erm – Rf)

$$10\% - 4\% = 6\%$$

- ▶ 7%

Question No: 14 -- Please choose one

A firm had an interest expense of Rs.400,000 on its outstanding debt during the financial year 2006-2007. If the firm marginal tax rate is 40%, what was the total tax savings of the firm during the period 2006-2007?

- ▶ Rs.150,000
- ▶ **Rs.160,000 -**
- $$400,000 * 40/100 = 160,000$$
- ▶ Rs.170,000
- ▶ Rs.180,000

Question No: 15 -- Please choose one

In which of the following dividend policies, the amount of dividend is relatively fixed?

- ▶ **Constant payout ratio policy -**
- (page 73)**
- ▶ Hybrid dividend policy
- ▶ Residual dividend policy
- ▶ Stable dividend policy

Question No: 16 -- Please choose one

Which of the following is a proposition of Miller and Modigliani theory of Capital structure?

- ▶ **Value of a firm is independent of its capital structure -**

- ▶ Value of a firm is independent of its level of debt
- ▶ Value of a firm is dependent of its cost of capital
- ▶ Value of a firm is independent on its level of equity finances

Question No: 17 -- Please choose one

Which of the following companies may be considered as a Pure Play in the beverages industry in Pakistan?

- ▶ Coca Cola
- ▶ Pepsi
- ▶ Shezan
- ▶ **Nestlé -**

Question No: 18 -- Please choose one

Which of the following is a disadvantage of Capital Asset Pricing Model?

- ▶ It considers market risk
- ▶ It can be used for listed companies
- ▶ It can be used for non-listed companies
- ▶ **It is based on past data -**
(page 52)

Question No: 19 -- Please choose one

Which of the following methods would be most suitable for calculating the return on stocks of a non-listed company?

- ▶ **Dividend Growth Model -**
 $r = \text{Div1} / \text{Po} + g$
- ▶ Capital Asset Pricing Model
- ▶ Security Market Line
- ▶ Characteristics Line

Question No: 20 -- Please choose one

What will be the effect of reduction in the cost of capital on the accounting break-even level of revenues?

- ▶ It raises the break-even level.
- ▶ It reduces the break-even level.
- ▶ **It has no effect on the break-even level. -**
- ▶ This cannot be determined without knowing the length of the investment horizon.

Question No: 21 -- Please choose one

Which of the following statements is **TRUE** regarding Balance Sheet of a firm?

- ▶ It reports how much of the firm's earnings were retained in the business rather than paid out in dividends.
- ▶ It reports the impact of a firm's operating, investing, and financing activities on cash flows over an accounting period.
- ▶ **It shows the firm's financial position at a specific point in time. -**
- ▶ It summarizes the firm's revenues and expenses over an accounting period.

Question No: 22 -- Please choose one

Which of the following would be a consequence of a high Inventory Turnover Ratio?

- ▶ Low level of inventory and frequent stock-outs
- ▶ Seasonal elements peculiar to the business
- ▶ **Efficient inventory management -**
- ▶ Any of the given option

Question No: 23 -- Please choose one

Short-term creditors would be most interested in which of the following ratios of a firm?

- ▶ Coverage ratios
- ▶ **Liquidity ratios -**
- ▶ Profitability ratios
- ▶ Debt ratios

Question No: 24 -- Please choose one

What are the earnings per share (EPS) for a company that earned Rs.100,000 last year in after-tax profits, has 200,000 common shares outstanding, and Rs.1.2 million in retained earnings at the year end?

- ▶ Rs. 6.50
- ▶ Rs. 6
- ▶ Rs. 100,000
- ▶ **Rs. 0.50 - $100,000/200,000 = 0.50$**

Question No: 25 -- Please choose one

Which of the following statements is **CORRECT** with respect to common-size income and balance sheet statements?

- ▶ They show how total sales change over time, but not total assets.
- ▶ **They show how both total sales and total assets change over time. -**
- ▶ They provide no information about how total assets or total sales change over time.
- ▶ They show how total assets change over time, but not total sales.

Question No: 26 -- Please choose one

Which one of the following statements is **TRUE** regarding Present Value of an amount to be received at some future date?

- ▶ It increases as the years to receipt increases
- ▶ It remains unaffected as the years to receipt increases
- ▶ **It decreases as the years to receipt increases -**
- ▶ None of the given options

Question No: 27 -- Please choose one

How many years will it take for Rs.152,000 to grow to be Rs.

405,000 if it is invested in an account with an annual interest rate of 10%?

- ▶ 13.68
- ▶ 8.23
- ▶ **10.28 -**
- ▶ Cannot be calculated from the given data

Question No: 28 -- Please choose one

If you deposit Rs. 12,000 per year for 16 years (each deposit is made at the beginning of each year) in an account that pays an annual interest rate of 15%, what will your account be worth at the end of 16 years?

- ▶ Rs. 82,168.44
- ▶ Rs. 71,450.82
- ▶ **Rs. 768,901.12 -**

- ▶ Rs. 668,609.67

Question No: 29 -- Please choose one

Which of the following types of bonds pays no annual interest to the holder, but is sold at discount below the par value?

- ▶ An original maturity bond
- ▶ A floating rate bond
- ▶ A fixed maturity date bond
- ▶ **A zero coupon bond -**

Question No: 30 -- Please choose one

Which of the following is the rate of return earned on a bond if held till maturity?

- ▶ Yield-to-call
- ▶ Coupon payment
- ▶ **Yield-to-maturity -**
- ▶ Sinking fund yield

Question No: 31 -- Please choose one

Which one of the following statements best describes the relationship between market interest rates and bond prices?

- ▶ Market interest rates and bond prices move in the same direction
- ▶ **Market interest rates and bond prices move in opposite directions -**

- ▶ Sometimes move in the same direction, sometimes in opposite directions
- ▶ Market interest rate and bond prices have no relationship with each other

Question No: 32 -- Please choose one

When the market's required rate of return for a particular bond is much less than its coupon rate, the bond will be selling at which one of the following?

- ▶ **At premium -**
- ▶ At discount
- ▶ At par
- ▶ Cannot be determined without more information

Question No: 33 -- Please choose one

Which of the following techniques of stock evaluation considers quantitative factors as well as qualitative factors for valuation?

- ▶ Technical Analysis
- ▶ **Fundamental Analysis -**
- ▶ Constant Growth Model
- ▶ No Growth Model

Question No: 34 -- Please choose one

In which of the following situations market price of a security will move down?

- ▶ **When market price of the security is above the intrinsic value of the security**
- ▶ When market price of the security is equal to the intrinsic value of the security
- ▶ When market value of the security is equal to the face value of the security
- ▶ **When market price of the security is below the intrinsic value of the security**

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Question No: 35 -- Please choose one

Which of the following could be used to calculate the cost of common equity?

- ▶ Interpolation method
- ▶ Dividend discount model
- ▶ **YTM (Yield-to-Maturity) method**
- ▶ **Capital structure valuation -**

Question No: 36 -- Please choose one

Which of the following is a long-term source of financing for a

firm?

- ▶ **Corporate bonds -**
- ▶ Money market instruments
- ▶ Trade credit
- ▶ Accounts payables

Question No: 37 -- Please choose one

Which of the following focuses on long-term investment decision-making process?

- ▶ Working Capital Management
- ▶ **Capital Budgeting -**
- ▶ Cash Budgeting
- ▶ None of the given options

Question No: 38 -- Please choose one

Since the capital budgeting techniques use cash flows instead of accounting flows, therefore, the financial manager must add back which one of the following to the analysis?

- ▶ The cost of fixed assets
- ▶ The cost of accounts payable
- ▶ Investments
- ▶ **Depreciation –**

Question No: 39 -- Please choose one

Which of the following capital budgeting methods focuses on firm's liquidity?

- ▶ Internal Rate of Return
- ▶ **Payback method -**
- ▶ Net Present Value
- ▶ None of the given options

Question No: 40 -- Please choose one

When faced with mutually exclusive options, which project should be accepted under the 'Payback Method'?

- ▶ The one with the longest payback period
- ▶ **The one with the shortest Payback period**
- ▶ **It doesn't matter because the payback method is not theoretically correct**
- ▶ None of the given options

