

Mid term paper 2009 session 4 Fin 622(Corporate Finance)

Question No: 1 -- Please choose one

Following are amongst the three main areas of Finance EXCEPT:

- ▶ Financial institutions
- ▶ Investments

▶ Accounting -

BASIC AREA OF FINANCE

(1)corporate finance

(2)investment

(3)financial institution

(4)international finance

- ▶ Financial management

Question No: 2 -- Please choose one

Which one of the following is an offering in which the shares of a company are offered to a limited number of investors?

- ▶ Initial Public Offering

▶ Private Placement -

Corporation engage two type of primary market transaction

(1)public transaction

(2)private transaction

Public offering, as the name suggests, involves securities to general public.

Private placement is a negotiated sale involving a specific buyer

- ▶ Direct Public Offering

- ▶ Primary Offering

Question No: 3 -- Please choose one

If you want to earn 8 percent, approximately how much should you pay for a security which matures in one year at Rs. 1,000?

- ▶ Rs. 1,080

- ▶ Rs. 940

- ▶ Rs. 920

- ▶ Rs. 926 -

Using present value formula

$$Pv = fv / (1+i)^n$$

$$1000 / 1.08 = 926 \text{ or } 1000 * 0.9259 = 926$$

Divide 1000 on future value factor against one year under 8% or multiply 1000 on present value factor against one year under 8%

Question No: 4 -- Please choose one

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

- ▶ At discount

- ▶ At premium -

(page 18)

- ▶ At par value

- ▶ At indeterminate price

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

www.vchowk.com

Question No: 6 -- Please choose one

For a firm with a Degree of Operating Leverage of 3.5, an increase in sales of 6% will:

- Increase pre-tax profits by 3.5%
- Decrease pre-tax profits by 3.5%.
- Increase pre-tax profits by 21.0%. -
- Increase pre-tax profits by 1.71%.

Question No: 7 -- 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 operation leverage=
Percentage change in EBIT/ percentage
change in sales
OR

Sales – variable costs / EBIT

OR

Contribution / EBIT

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

Question No: 8 -- Please choose one

Suppose a stock is selling today for Rs.60 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.66.00. what is the capital gain yield on the stock?

- ▶ 7%
- ▶ 8%
- ▶ 9%
- ▶ 10% -

Capital Gain Yield = $(P_n - P_o) / P_o$

Question No: 9 -- Please choose one

Which of the following is considered as a risk free financial asset?

- ▶ Government T-bills -

(page 50)

<http://www.investopedia.com/terms/r/riskfreeasset.asp>

- ▶ Junk bonds
- ▶ Preferred stock
- ▶ Secured bonds

Question No: 10 -- 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: 11 -- Please choose one

Which of the following is known as market portfolio?

- ▶ A portfolio consists of all risk free securities available in the market
- ▶ A portfolio consists of securities of the same industry
- ▶ A portfolio consists of all aggressive securities available in the market
- ▶ A portfolio consists of all securities available in the market -

<http://pages.cs.brandeis.edu/~magnus/stocks/node7.html>

Question No: 12 -- 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% -

$10 - 4 = 6$

Risk Premium = Expected Return – Risk Free Assets

= $10\% - 4\%$

= 6%

▶ 7%

Question No: 13 -- Please choose one

Which of the following statements is true regarding Weighted Average Cost of Capital (WACC)?

▶ WACC of a levered firm is greater than that of an un-levered firm

▶ WACC of a levered firm is lesser than that of an un-levered firm

▶ WACC of a levered firm is equal to that of an un-levered firm

-

▶ An Un-levered firm has zero WACC.

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

XYZ Airlines will pay a Rs.4.00 dividend next year on its common stock, which is currently selling at Rs.100 per share. What is the market's required return on this investment if the dividend is expected to grow at 5% forever?

▶ 9% -

$K_e = D_1 / P_0 + g$ and $P_0 = D_1 / K_e - g$

= $4/100 + 5\%$

= 9%

▶ 4%

▶ 5%

▶ 7%

Question No: 15 -- Please choose one

A Pure Play method of selecting a discount rate is most suitable in which of the following situations?

▶ When the intended investment project has a Non-conventional stream of cash flows

▶ When the intended investment project is a replacement project

▶ When the intended investment project belongs to industry other than the firms operating in -

(page 66)

▶ When the intended investment project has a conventional stream of cash flows

Question No: 16 -- Please choose one

A Levered firm has a lower weighted average cost of capital as compared to an Un-levered firm because of which of the following?

▶ Interest tax shield -

▶ Low level of financial risk

▶ Low level of business risk

▶ Low level of systematic risk

Question No: 17 -- Please choose one

ABC Corporation declared 10% dividend on its shares. A person purchased some shares of this corporation after the dividend was announced. If he is entitled to receive the declared dividend, his shares would be categorized as which of the following?

▶ Ex-Dividend -

(page 73)

- ▶ Cum-Dividend
- ▶ Stock- Dividend
- ▶ Cash Dividend

Question No: 18 -- Please choose one

Which of the following is a dividend that is paid in the form of additional shares, rather than a cash payout?

- ▶ [Stock Dividend -](#)

[When cash is insufficient then stock dividend paid to shareholders](#)

- ▶ Cum Dividend
- ▶ Ex Dividend
- ▶ Extra Dividend

Question No: 19 -- Please choose one

Which of the following firms would have the highest financial leverage?

- ▶ A firm having debt-to-equity ratio of 30:70
- ▶ A firm having debt-to-equity ratio of 40:60
- ▶ A firm having debt-to-equity ratio of 50:50
- ▶ [A firm having debt-to-equity ratio of 60:40 -](#)

Question No: 20 -- Please choose one

Which of the following is the principal advantage of high debt financing?

- ▶ [Tax savings -](#)

[\(page 71\)](#)

- ▶ Low Bankruptcy costs
- ▶ Minimum financial risk
- ▶ Low financial leverage

Question No: 21 -- 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 -](#)

[\(page 68\)](#)

- ▶ 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: 22 -- 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 -](#)

[\(page 51\)](#)

Question No: 23 -- Please choose one

Which of the following shows the reward to risk ratio of a Security A?

- ▶ [Expected return of A \(\$r_A\$ \) – risk free return / beta of A -](#)

[\(page 55\)](#)

- ▶ Expected return of A (r_A) – risk free return / required return of A
- ▶ Expected return of A (r_A) – beta of A / risk free return
- ▶ Risk free return - expected return of A (r_A) / beta of A

Question No: 24 -- Please choose one

In Capital Assets Pricing Model, which of the following shows time value of money?

- ▶ Beta of the security
- ▶ Risk free rate of return - (page 57)
- ▶ Risk premium
- ▶ Market rate of return

Question No: 25 -- 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: 26 -- Please choose one

Suppose that a corporation of which you are a shareholder has just gone bankrupt. Its liabilities are far in excess of its assets. How much of your investment would you get back?

- ▶ A proportionate share of bondholder claims based on the number of common shares that you own
- ▶ A proportional share of all creditor claims based on the number of common shares that you own
- ▶ An amount that could, at most, equal what you originally paid for the shares of common stock in the corporation
- ▶ Nothing at all -

Question No: 27 -- Please choose one

The gross profit margin is unchanged, but the net profit margin declined over same period. This could have happened due to which one of the following reasons?

- ▶ Cost of goods sold increased relative to sales
- ▶ Sales increased relative to expenses
- ▶ The tax rate has been increased -

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

- ▶ Dividends were decreased

Question No: 28 -- Please choose one

Palo Alto Industries has a debt-to-equity ratio of 1.6 compared with the industry average of 1.4. What do these ratios tell about this company?

- ▶ The company will be viewed as having high creditworthiness
- ▶ The company has greater than average financial risk when compared to other firms in its industry -

<http://web.utk.edu/~jwachowi/mcquiz/mc6.html>

- ▶ The company will not experience any difficulty with its creditors

- ▶ The company has less liquidity than other firms in the industry

Question No: 29 -- Please choose one

If a creditor wants to know about the bill payment status of a potential customer, the creditor could look at which one of the following ratios?

- ▶ Current ratio
- ▶ Acid ratio
- ▶ Average age of accounts payable -
- ▶ Average age of accounts receivable

Question No: 30 -- Please choose one

Suppose you invested Rs. 8,000 in a savings account paying 5 percent interest a year, compounded annually. How much amount your account will have at the end the end of four years?

- ▶ Rs.9,624
 - ▶ Rs.10,208
 - ▶ Rs.9,728 -
- $$8000 \times (1.05)^4 = 9724.05$$
- ▶ Rs.10,880

Question No: 31 -- Please choose one

The present value of Rs.100 per year received for 10 years discounted at 8 percent is closest to which of the following amounts?

- ▶ Rs.177
 - ▶ Rs.362
 - ▶ Rs.425
 - ▶ Rs.671 -
- $$fv = pv(1+i)^n$$
- $$= 100 (1.08)^{10}$$
- $$= 100 * 6.710$$
- $$= 671$$

Question No: 32 -- 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: 33 -- 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: 34 -- Please choose one

Which of the following is a financial asset?

- A building
- [Bonds -](#)
- Inventories
- Equipments

Question No: 35 -- Please choose one

An investor buys a bond that will pay the interest amount of Rs.60 annually,

forever. Which of the following would be the present value of the bond if there is

exactly one year remaining until the next interest payment and the investor's

required annual return is 5 percent?

► [Rs. 1,200 -](#)

[60 / 0.05 = 1200](#)

- Rs. 800
- Rs. 600
- Rs. 1,000