MIDTERM EXAMINATION
Spring 2009
FIN622- Corporate Finance (Session - 5)

Question No: 1 -- Please choose one

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

► Interpolation method
► Dividend discount model
► YTM method
► **Capital structure valuation -**

Capital structure of a typical company may consist of ordinary shares, preference stock, short term and long-term loan, bonds and leases. These components in capital structure have their own cost and if we add all the individual components cost after adjusting with the weight age of each, the resultant value is known as weighted cost of capital. In order to compute the WACC we need to calculate the individual components cost. First of all we take up the Equity part of the capital and will see how we can compute the cost of equity.

Question No: 2 -- 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: 3 -- 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 -**
► Risk premium
► Market rate of return

Question No: 4 -- 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: 5 -- Please choose one

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

► **Constant payout ratio policy -**
► Hybrid dividend policy
► Residual dividend policy
► Stable dividend policy

 A ***constant payout ratio policy*** is a **policy** of paying a FIXED percentage of a firm's earnings
as dividends in each period. Such a **policy** is likely to result in wildly fluctuating dividends. As a
result, only a small percentage of paying firms follow such a **policy**.

Question No: 6 -- Please choose one

Which of the following risks increases as the debt level of a business increases?

► **financial risk -**
► Operating risk
► Business risk
► Investment risk

Question No: 7 -- Please choose one

Which of the following risks is independent of capital structure of a firm?

► Financial risk
► Systematic risk
► Business risk
► Total risk - Doubted
Question No: 8 -- Please choose one
Which of the following *best*define the term 'Capital Structure'?
► The proportion of equity used by a firm
► The proportion of debt and equity capital used by a firm -
► The proportion of long-term liabilities used by a firm
► The proportion of short-term bank loan used by a firm
Question No: 9 -- Please choose one

Which of the following is tax deductible?
► Dividend on preferred shares
► Dividend on common stocks
► Coupon payments on bonds
► Capital gain on common stocks -
Question No: 10 -- Please choose on
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%
Question No: 11 -- 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: 12 -- Please choose one
Which of the following best illustrates the problem imposed by capital rationing?
► Accepting projects with the highest NPVs first
► Accepting projects with the highest IRRs first
► By passing projects that have positive NPVs -
► Bypassing projects that have positive IRRs
Question No: 13 -- Please choose one
Market demand allowed a company, to raise its price by 20% to $60. What is the new level of break-even revenues if fixed charges including depreciation are $1 million and variable costs were 70% of the old price?
► $2,000,000
► $2,400,000
► $2,857,143
► $3,333,333
Question No: 14 -- Please choose one
Which of the following capital budgeting methods states the project return as a percentage?
► Payback period
► Net present value
► Internal Rate of Return -
► None of the given options
is always quoted in terms of percentage,
which makes it comparable to the other market interest rates or the inflation rate
Question No: 15 -- Please choose one
Which of the following capital budgeting methods focuses on firm's liquidity?
► None of the given options
► Payback method -

► Net Present Value
► Internal Rate of Return

Question No: 16 -- Please choose one

In which of the following situations a project is acceptable?
► When a project has conventional cash flows patterns
► When a project has a non-conventional cash flow pattern
► When a project has a discounted rate higher than the inflation rate
► **When a project has a positive net present value -**

Question No: 17 -- Please choose one

Which of the following statements is Correct regarding the fundamental analysis?
► Fundamental analysts use only Economic indicators to evaluate a stock
► Fundamental analysts use only financial information to evaluate a company's stocks
► **Fundamental analysts use financial and non-financial information to evaluate a company's stocks -**
► Fundamental analysts use only non-financial information to evaluate a company's stocks

Question No: 18 -- Please choose one

A company has a dividend yield of 8%. If its dividend is expected to grow at a constant rate of 5%, what must be the expected rate of return on the company's stock?
► 14%
► **13% -**
r = DIV1/P0 + g =
8% + 5% =
13%
► 12%
► 10%

Question No: 19 -- Please choose one

You are considering buying common stock in Grow On, Inc. The firm yesterday paid a dividend of $7.80. You have projected that dividends will grow at a rate of 9.0% per year indefinitely. If you want an annual return of 24.0%, what is the most you should pay for the stock now?
► $52.00
► $56.68
► $32.50
► $35.43

Question No: 20 -- Please choose one

If a bond sells at a high premium, then which of the following relationships hold true? (P0 represents the price of a bond and YTM is the bond's yield to maturity.)
► P0 < par and YTM < the coupon rate.
► P0 < par and YTM > the coupon rate.
□ ► P0 > par and YTM > the coupon rate.
► **P0 > par and YTM < the coupon rate. -**

http://web.utk.edu/~jwachowi/mcquiz/mc4.html

Question No: 21 -- Please choose one

An investor buys a bond that will pay the interest amount of Rs.60 annually, forever. If there is exactly one year remaining until the next interest payment and the investor's required annual return is 5 percent, the present value of this bond is closest to which one of the following?

► Rs.1,200.
► Rs.800.
► Rs.600.
► Rs.1,000.

Question No: 22 -- Please choose one

Which one of the following is a long-term contract under which a borrower agrees to make payments of interest and principal on specific dates?

► Common stock.
► Preferred stock
► Equity contract.
► **Bond. -**

Question No: 23 -- Please choose one

If you deposit $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?

► $82,168.44
► $71,450.82
► **$768,901.12 -**
► $668,609.67

Question No: 24 (Marks: 1) - 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
► Rs.39,310
► Rs.25,151

Question No: 25 -- Please choose one

Which of the following transactions affects the acid-test ratio?

► Receivables are collected.
► **Inventory is liquidated for cash. -**
► New common stock is sold and used to retire a debt issue.
► A new common stock issue is sold and equipment purchased.

Question No: 26 -- Please choose one

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

► Too low a level of inventory and frequent stock-outs.
► Seasonal elements peculiar to the business.
► **Efficient inventory management. -**
► Any of the given option.

Question No: 27 -- Please choose one

Which of the following statements (in general) is correct?
► A low receivables turnover is desirable.
► The lower the total debt-to-equity ratio, the lower the financial risk for a firm. -
► An increase in net profit margin with no change in sales or assets means a poor ROI.
► The higher the tax rate for a firm, the lower the interest coverage ratio
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 -
► 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
Felton Farm Supplies, Inc., has an 8 percent return on total assets of Rs.300,000 and a net profit margin of 5%. What are its sales?
► Rs.3,750,000
► Rs.480,000 -
► Rs.300,000
► Rs.1,500,000
Question No: 30 -- Please choose one
In which one of the following markets the bonds of a Corporation shall be traded now who were issued 10 years back?
► Primary market
► Secondary market -
► Money Market
► All of the above
Question No: 31 (Marks: 5)
A Company had the following data, extracted from its financial statements for the year ending June 30, 2008:
a) Current Ratio = 2
b) Acid Ratio = 1.5
c) Current Liabilities = $500,000
d) Inventory Turnover = 5
e) Gross Profit Margin = 20 percent
What were its sales for the year?

Question No: 32 (Marks: 10)
Bank A pays 6.2% interest compounded semiannually and **Bank B** pays 6%
interest,compounded monthly. Which bank offers the higher effective annual rate?