FINALTERM EXAMINATION
Fall 2009
FIN622- Corporate Finance (Session - 3)

Time: 120 min
Marks: 82

Question No: 1 (Marks: 1) - Please choose one
Which of the following is an expected rate of return on a bond if bought at its current market price and held to maturity?
► **Yield to maturity**
► Current yield
► Coupon yield
► Capital gains yield

Question No: 2 (Marks: 1) - Please choose one
A firm can lower its breakeven level by doing which of the following actions?
► Lowering direct cost
► Increasing variable cost
► Increasing direct cost
► Lowering sales price

Question No: 3 (Marks: 1) - Please choose one
Which one of the following statements applies to Dividend Growth Model?
► It is difficult to understand and use
► It is used for non-listed companies
► It is used for debt securities also
► **It do not consider risk level of a security**

Question No: 4 (Marks: 1) - Please choose one
Which of the following refers to a stock issuance process where a company offers its shares to a limited number of investor?
► Initial Public Offering
► **Private Placement**
► Direct Public Offering
► Primary Offering

Question No: 5 (Marks: 1) - Please choose one
Which of the following is the principal advantage of high debt financing?
► **Tax savings**
► Low Bankruptcy costs
► Minimum financial risk
► Low financial leverage

Question No: 6 (Marks: 1) - 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: 7 (Marks: 1) - 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

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

Which of the following serves as a starting point for preparing functional budgets of a firm?

► **Sales budget**
► Master budget
► Production cost budget
► Cash budget

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

A company is holding cash as a buffer in case of an unexpected need with operations. This is an example of the ________ motive for holding cash.

► Precautionary
► Speculative
► Transactions
► Capital needs

Question No: 10 (Marks: 1) - Please choose one

Which of the following is an "income based method" for share valuation of a target firm?

► Replacement cost method
► Break up value method
► **Dividend valuation method**
► Accumulated depreciation method

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

Which of the following is a re-structuring strategy in which employees buy a majority share in their own firm?

► Employee Dividend Scheme
► **Employee Buyout**
► Employee Empowerment
► Leverage Buyout

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

All of the following could be the reasons for a subsidiary buyout EXCEPT:

► The parent company is in financial distress
► The parent company needs cash
► **The parent company prefers to sell the firm rather that liquidation**
► The parent company wants liquidation

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

A firm has to pay $10,000 to an American company after three months. The firm enters into a contract with a foreign exchange dealer to buy $10,000 after three months at Rs.61/US$. This contract would be beneficial for the firm if:

► **After three months the exchange rate is Rs.60/US$**
► After three months the exchange rate is Rs.61/US$
► After three months the exchange rate is Rs.62/US$
► After three months the exchange rate is Rs.59/US$

Question No: 14 (Marks: 1) - Please choose one
A firm can fix effective interest rate on short-term borrowings by doing which of the following?
► Buying a forward rate agreement
► **Selling a forward rate agreement**
► Borrowing local currency
► Borrowing base currency
Question No: 15 (Marks: 1) - Please choose one
A firm can fix effective interest rate on its short-term investment to be made at some future date by doing which of the following?
► Borrowing local currency
► Borrowing base currency
► Selling a forward rate agreement
► **Buying an forward rate agreement**
Question No: 16 (Marks: 1) - Please choose one
A company may create a hedge through interest rate futures if it intends to make some investment for a short-term at some future date, because of:
► Fall in short-term interest rates
► Fall in short-term deposit rates
► **Increase in short-term interest rates**
► Increase in short-term deposit rates
Question No: 17 (Marks: 1) - Please choose one
Which one of the following statements is CORRECT regarding Option?
► An option creates an obligation for the holder
► **An option creates a right and not the obligation for the holder**
► Option seller is the option holder
► Option writer is the option holder
Question No: 18 (Marks: 1) - Please choose one
Which one of the following statements is CORRECT regarding Options Contacts?
► **A put option gives the holder a right to sell underlying item at a specified price**
► A put option gives its writer the right to sell underlying item at a specified price
► A call option gives its writer a right to sell underlying item
► A call option gives its holder a right to sell underlying item
Question No: 19 (Marks: 1) - Please choose one
Which of the following could be used as a hedging tool against unfavorable movement in interest rate?
► Currency option
► Currency futures
► Interest rate option
► **Currency SWAP**
Question No: 20 (Marks: 1) - Please choose one
The credit policy of a public company is 1/10, net 30. At present 25% of the customers take the discount. What would accounts receivable be if all customers took the cash discount?

► **Account receivable would be lower than the present level**
► No change from the present level
► Account receivable would be higher than the present level
► Unable to determine without more information
Question No: 21 (Marks: 1) - Please choose one
In the long run, a successful acquisition is one that:
► Enables the acquirer to make an all-equity purchase, thereby avoiding additional financial leverage
► Enables the acquirer to diversify its asset base
► **Increases the market price of the acquirer's stock over what it would have been without the acquisition**
► Increases the financial leverage of the firm
Question No: 22 (Marks: 1) - Please choose one
The efficiency enhancing effect resulting from a strategic merger is called which of the following?
► Merger effect
► Acquisition effect
► **Synergy effect**
► Efficiency effect
Question No: 23 (Marks: 1) - Please choose one
How much debt financing is used by a firm whose beta is un-geared?
► 100% debt financed
► **100% equity financed**
► 50% equity and 50% debt financed
► 60% equity and 40% debt financed
Question No: 24 (Marks: 1) - Please choose one
Which of the following is more appropriate to use while comparing investment alternatives with different compounding periods?
► Quoted Interest Rate
► Annual Percentage Rate
► **Effective Annual Interest Rate**
► Nominal Interest Rate
Question No: 25 (Marks: 1) - Please choose one
An investor would be exposed to which of the following risks, if he may have to sell a bond prior to maturity and interest rates have risen since the bond was purchased?
► The coupon effect risk
► **Interest rate risk**
► Inflation risk
► Unique risk
Question No: 26 (Marks: 1) - 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: 27 (Marks: 1) - Please choose one

According to the reinvestment rate assumption, which method of capital budgeting assumes that the cash flows are reinvested at the project's rate of return?

► Payback period

► **Net present value**

► Internal rate of return

► None of the given options

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

Which of the following statements is correct for a project with a positive Net Present Value (NPV)?

► **Internal rate of return (IRR) exceeds the cost of capital**

► Accepting the project has an indeterminate effect on shareholders

► The discount rate exceeds the cost of capital

► The profitability index equals one

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

While calculating cash flow from operating activities through indirect method, an increase in current assets is __________ whereas an increase in current liabilities is ___________ net income?

► added to; added to

► added to; deducted from

► **deducted from; added to**

► deducted from; deducted from

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

Which of the following holds true regarding aggressive working capital policy?

► **High liquidity; high profitability; high risk**

► High liquidity; low profitability; low risk

► Low liquidity; low profitability; high risk

► Low liquidity; high profitability; high risk

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

Which of the following holds TRUE regarding conservative working capital policy?

► High liquidity; high profitability; high risk

► **High liquidity; low profitability; low risk**

► Low liquidity; low profitability; high risk

► Low liquidity; high profitability; high risk

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

“The firm has very little net working capital sometimes even negative net working capital that can be very risky.”

The above statement belongs to:

► **Aggressive working capital policy**

► Conservative working capital policy

► Moderate working capital policy

► The statement is not related to any of the working capital policies

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

“The firm has a reasonable amount of net working capital that leads to a low-risk position”.
The above statement belongs to:
► Aggressive working capital policy
► **Conservative working capital policy**
► Moderate working capital policy
► The statement is not related to any of the working capital policies

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

Financial data for three firms is presented below. Each differs only with respect to philosophy on an aggressive vs. a conservative approach to current asset management.

	FIRM A	FIRM B	FIRM C
Sales	Rs.2,000,000	Rs.2,000,000	Rs.2,000,000
EBIT	200,000	200,000	200,000
Current Assets	600,000	500,000	400,000
Fixed Assets	500,000	500,000	500,000
Total Assets	1,100,000	1,000,000	900,000

What will be the rate for the firm with the most aggressive philosophy?
► 18.2 percent
► 33.3 percent
► 25.5 percent
► 22.2 percent

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

Which of the following is equal to Stock out cost?
► Carrying cost Safety stock
► Holding cost Carrying cost
► Reordering cost Safety stock
► Carrying cost Reordering cost

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

Which of the following statement is INCORRECT regarding Just-In-Time (JIT)?
► The inventories are kept near zero level.
► The inventory is acquired in such quantity on daily basis that can support the daily production level.
► The entire inventory acquired move to the production hall.
► **Inventory level is necessarily kept at zero level.**

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

Which of the following type of mergers occurs when one firm purchases other firms that produce similar or competing products?
► **Horizontal**
► Vertical
► Financial
► Conglomerate

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

Which of the following valuation approach allows for specific and direct estimation of future benefits to the owners, which is consistent with the theory of value?

► Asset-based method
► Income-based method
► **Hybrid method**
► None of the given options
Question No: 39 (Marks: 1) - Please choose one
The experts hired in evaluation stage of a public take over process DO NOT include which of the following?
► Legal consultants
► Accountants
► **Shareholders**
► Stock Brokers
Question No: 40 (Marks: 1) - Please choose one
In which of the following forms of acquisition, a company's existing managers acquire a large part or all of the company?
► **Management Buyout**
► Management Buy-In
► Leverage Buyout
► None of the given options
Question No: 41 (Marks: 1) - Please choose one
Recession in economy is related to which of the following levels of financial distress of a firm?
► Firm Level
► Industry Level
► Macro-Level
► **All of the given options**
Question No: 42 (Marks: 1) - Please choose one
Which of the following would be the outcome if the fixed rate in the forward rate agreement (FRA) is lower than the reference rate?
► **The seller of the FRA makes a cash payment to the buyer.**
► Both buyer and seller make payments to each other.
► The buyer of the FRA makes a cash payment to the seller.
► Neither buyer nor seller makes any payment to each other.
Question No: 43 (Marks: 1) - Please choose one
If the strike price and current market price are equal, an option would be termed as:
► In the money
► Out of money
► **At the money**
► None of the given options
Question No: 44 (Marks: 1) - Please choose one
Which of the following theories states that exchange rates between currencies are in equilibrium when their purchasing power is the same in each of the two countries?
► M&M theory
► **Purchasing Power Parity theory**
► Fisher effect theory

► Interest rate risk theory
Question No: 45 (Marks: 3)
How firms analyze their credit policies? Explain briefly.
Question No: 46 (Marks: 5)
How Economic Order Quantity (EOQ) Model is helpful in the reduction of total inventory costs?
Question No: 47 (Marks: 5)
Differentiate between Spot Rates and Forward Rates of currencies. Why forward rates are higher than spot rates?
Question No: 48 (Marks: 5)
How a firm can create a money market hedge against transaction exposure, when the firm has to make a payment at some future date?
Answer: Money Market Hedge
A similar approach will be taken to create the hedge when a firm is expecting to pay in FCY in future. In this scenario, a hedge can be created by exchanging local currency for FCY now using spot rates and putting the currency on deposit until the future payment is to be made. The amount borrowed and the interest earned on the deposit should be equal to the FCY. If it is not the case then it will not be a clean hedge. The cash flows are fixed because the cost in local currency is the cost of buying FCY on spot rates that was put under a deposit.
Mechanism:
Step 1: determine the FCY (assume US $) amount to be put to a deposit that will grow exactly to equalize the future payment in dollars. You need to calculate this using the available spot rates and interest rate on dollar deposit.
Step 2: in order to deposit dollars in interest bearing account, the company will buy dollars at spot rates.
Step 3: the company will borrow local currency for the period of hedge.
These steps will ensure that the hedge created a definite cash flow regardless of exchange rate or interest rate fluctuations. The exchange rate has been fixed.
Question No: 49 (Marks: 10)
A Firm sales 200,000 units per year of a particular Product, order size is for 5000 units and stock out is 3000 units. The stock out probability acceptance level is set to 5% and per unit stock out cost is Rs.7/-. Holding cost is estimated at Rs.3/- per unit. Being an inventory manager, determine stock out cost and amount of safety stock to be kept in hand.
Question No: 50 (Marks: 10)
Why firms do business internationally? Explain in detail.
Faster growth: Firms that have operate internationally tend to develop at a much quicker pace than those operating locally
Access to cheaper inputs: Operating internationally may enable the firm to source raw materials or labor at lower prices
Increased quality and efficiency: Exposure to foreign competition will encourage increased efficiency. Doing business in the international market allows firms to improve the quality of their product in order to gain a competitive advantage.
New market opportunities: International business presents firms with new market opportunities. These new markets provide more opportunities for

expansion, growth, and income. A bigger market means more customers, increased revenue, a larger profit margin, and allows the business to realize economies of scale.
Diversification: As the firm diversifies its market, it becomes less vulnerable to changes in local demand. This reduces wild swings in a company's sales and profits.