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**Kashif Imran.**

**MIDTERM EXAMINATION**

**Fall 2009**

**MGT201- Financial Management (Session - 4)**

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

Among the pairs given below select a(n) example of a principal and a(n) example of an agent respectively.

▶ **Shareholder; manager**

- ▶ Manager; owner
- ▶ Accountant; bondholder
- ▶ Shareholder; bondholder

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

What should be the focal point of financial management in a firm?

- ▶ The number and types of products or services provided by the firm
- ▶ The minimization of the amount of taxes paid by the firm
- ▶ **The creation of value for shareholders**
- ▶ The dollars profits earned by the firm

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

Which of the following financial market is referred to the market for short-term

government and corporate debt securities?

▶ **Money market**

- ▶ Capital market
- ▶ Primary market
- ▶ Secondary market

Reference: Page 7

**Money Markets**

Money market generally is a market where there is buying and selling of short term liquid debt instruments. (Short term means one year or less). Liquid means something which is easily en-cashable; an instrument that can be easily exchanged for cash. Following financial instruments are traded in money markets

**Question No: 4 ( Marks: 1 ) - Please choose one**

Which of the following would generally have unlimited liability?

- ▶ A limited partner in a partnership
- ▶ A shareholder in a corporation
- ▶ **The owner of a sole proprietorship**
- ▶ A member in a limited liability company (LLC)

**Question No: 5 ( Marks: 1 ) - Please choose one**

Which of the following is a major disadvantage of the corporate form of organization?

- ▶ **Double taxation of dividends**
- ▶ Inability of the firm to raise large sums of additional
- ▶ Limited liability of shareholders
- ▶ Limited life of the corporate form

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

Which of the following statement is most accurate?

► Coverage ratios also shed light on the "liquidity" of current ratios

► **Receivable- and inventory-based activity ratios also shed light on the "liquidity" of current assets**

► Receivable- and inventory-based activity ratios also shed light on the firm's use of financial leverage

► Liquidity ratios also shed light on the firm's use of financial leverage

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

In 2 years you are to receive Rs.10,000. If the interest rate were to suddenly decrease, the present value of that future amount to you would \_\_\_\_\_.

► Incomplete information

► Fall

► **Rise**

► Remain unchanged

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

You are going to invest Rs.12,500 into a certificate of deposit (CD) at a 6% annual rate (compounded annually) with a maturity of 30 months. How much money will you receive when the CD matures?

► Rs.14,491

► Rs.14,518

► Incomplete information

► **Rs.14,460**

Reference:

$$FV = PV * (1+i)^n$$

$$FV = 12500(1.06)^{2.5}$$

$$FV = 14460$$

Where 30 months divided by 12 we get 2.5 years

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

Which of the following would be considered a cash-flow item from a "financing" activity?

- ▶ A cash outflow to the government for taxes
- ▶ **A cash outflow to repurchase the firm's own common stock**
- ▶ A cash outflow to lenders as interest
- ▶ A cash outflow to purchase bonds issued by another company

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

In estimating "after-tax incremental operating cash flows" for a project, you should include all of the following EXCEPT \_\_\_\_\_.

- ▶ Changes in costs due to a general appreciation in those costs
- ▶ The amount (net of taxes) that we could realize from selling a currently unused building of ours that we intend to use for our project
- ▶ Changes in working capital resulting from the project, net of spontaneous changes in current liabilities
- ▶ **Costs that have previously been incurred that are unrecoverable**

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

The basic capital budgeting principles involved in determining relevant after-tax incremental operating cash flows require us to \_\_\_\_\_.

- ▶ Include sunk costs, but ignore opportunity costs
- ▶ **Include opportunity costs, but ignore sunk costs**
- ▶ Ignore both opportunity costs and sunk costs
- ▶ Include both opportunity and sunk costs

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

Interest payments, principal payments, and cash dividends are \_\_\_\_\_ the typical budgeting cash-flow analysis because they are \_\_\_\_\_ cash flows.

- ▶ Included in; financing
- ▶ **Excluded from; financing**
- ▶ Included in; operating
- ▶ Excluded from; operating

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

Why Payback period is a poor gauge of profitability?

- ▶ It ignores the time value of money
- ▶ It gives rough indication to the liquidity of the project
- ▶ It does not consider cash flows after expiration of the payback period
- ▶ **All of the given options**

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

To estimate an unknown number that lies between two known numbers is known as \_\_\_\_\_.

- ▶ Capital rationing
- ▶ Capital budgeting
- ▶ **Interpolation**
- ▶ Amortization

Reference:

In the mathematical subfield of numerical analysis, interpolation is a method of

constructing new data points within the range of a discrete set of known data points.

**Question No: 15 ( Marks: 1 ) - Please choose one**

Which of the following make the calculation of NPV difficult?

- ▶ Estimated cash flows
- ▶ Discount rate
- ▶ Anticipated life of the business

▶ **All of the given options**

Reference:

Page 41 & 42

**Question No: 16 ( 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: 17 ( Marks: 1 ) - Please choose one**

The sinking fund retirement of a bond issue takes \_\_\_\_\_.

▶ Only one form -- the corporation purchases bonds in the open market and delivers

a given number of bonds to the trustee

▶ Only one form -- the corporation pays cash to the trustee, who in turn calls the  
for redemption

▶ Only one form -- bonds mature periodically and the corporation retires them in  
the order that they mature

► Two forms -- (1) the corporation purchases bonds in the open market and delivers a given number of bonds to the trustee; or (2) the corporation pays cash to the trustee, who in turn calls the bonds for redemption

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

Which of the following statements is correct in distinguishing between serial bonds and sinking-fund bonds?

► Serial bonds mature at a variety of dates, but sinking-fund bonds mature at a single date

► Serial bonds provide for the deliberate retirement of bonds prior to maturity, but sinking-fund bonds do not provide for the deliberate retirement of bonds prior to maturity

► Serial bonds do not provide for the deliberate retirement of bonds prior to maturity, but sinking-fund bonds do provide for the deliberate retirement of bonds prior to maturity

► None of the above are correct since a serial bond is identical to a sinking fund bond

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

\_\_\_\_\_ is a long-term, unsecured debt instrument with a lower claim on assets and income than other classes of debt.

► **subordinated debenture**

► A debenture

► A junk bond

► An income bond

Reference:

Subordinated Debenture -- A long-term, unsecured debt instrument with a lower claim on assets and income than other classes of debt; known as junior debt.

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

Bond is a type of Direct Claim Security whose value is NOT secured by \_\_\_\_\_.

▶ Tangible assets

▶ **Intangible assets**

▶ Fixed assets

▶ Real assets

Reference:

Value of Direct Claim Security is directly will be determined by the value of the underlying Real Asset.

Real assets include tangible assets and tangible assets include fixed assets, so answer is intangible assets

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

Which of the following is NOT the present value of the bond?

▶ Intrinsic value

▶ **Market price**

▶ Fair price

▶ Theoretical price

Reference:

**PV** = Intrinsic Value of Bond or Fair Price (in rupees) paid to invest in the bond. It is the Expected or Theoretical Price and NOT the actual Market Price.

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

A coupon bond pays annual interest, has a par value of Rs.1,000, matures in 4 years, has



a coupon rate of 10%, and has a yield to maturity of 12%. What is the current yield on this bond?

► **10.65%**

► 10.45%

► 10.95%

► 10.52%

Reference:

Price of Bond =  $100 \times (1 + 0.12)^{-1} + 100 \times (1 + 0.12)^{-2} + 100 \times (1 + 0.12)^{-3} +$

$1100 \times (1.12)^{-4} = 939.25$

Current Yield = Coupon / Market Price

Current Yield =  $100 / 939.35$

Coupon payment 4 year @ 10% =  $100 \times 4 = 400$

Current yield =  $400 / 1000 = .1064 = 10.64\%$

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

A coupon bond that pays interest annually is selling at par value of Rs.1,000, matures in

5 years, and has a coupon rate of 9%. What is the yield to maturity on this bond?

► 8.0%

► 8.3%

► **9.0%**

► 10.0%

**Question No: 24 ( Marks: 1 ) - Please choose one**

What is yield to maturity on a bond?

► It is below the coupon rate when the bond sells at a discount, and equal to the

coupon rate when the bond sells at a premium

► **The discount rate that will set the present value of the payments equal to the bond price**

- ▶ It is based on the assumption that any payments received are reinvested at the coupon rate
- ▶ None of the given options

Reference:

The most common way to compare the Overall Rate of Return of different Bonds is to compare their YTM's

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**Question No: 25 ( 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

Reference:

Another thing about the shares is to remember that par value is the value when they are issued the market value of the shares changes with investor's perception about the company's future and supply and demand situation.

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

The value of direct claim security is derived from which of the following?

- ▶ Fundamental analysis
- ▶ **Underlying real asset**

- ▶ Supply and demand of securities in the market
- ▶ All of the given options

Reference:

Value of Direct Claim Security is directly will be determined by the value of the underlying Real Asset.

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

Low Tech Company has an expected ROE of 10%. The dividend growth rate will be \_\_\_\_\_ if the firm follows a policy of paying 40% of earnings in the form of dividends.

- ▶ **6.0%**
- ▶ 4.8%
- ▶ 7.2%
- ▶ 3.0%

Reference:

$G = \text{plowback ratio} \times \text{ROE}$ .

40% earning retained

60% remaining

$G = 0.60 \times 0.10 = 0.06 \times 100 = 6\%$

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

How dividend yield on a stock is similar to the current yield on a bond?

▶ Both represent how much each security's price will increase in a year

▶ **Both represent the security's annual income divided by its price**

▶ Both are an accurate representation of the total annual return an investor can expect to earn by owning the security

- ▶ Both incorporate the par value in their calculation

Reference:

$$\text{Current Yield} = \text{Coupon} / \text{Market Price}$$

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

In the dividend discount model, which of the following is (are) NOT incorporated into the discount rate?

- ▶ Real risk-free rate
- ▶ Risk premium for stocks
- ▶ **Return on assets**
- ▶ Expected inflation rate

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

Total portfolio risk is \_\_\_\_\_.

- ▶ Equal to systematic risk plus non-diversifiable risk
- ▶ Equal to avoidable risk plus diversifiable risk
- ▶ Equal to systematic risk plus unavoidable risk
- ▶ **Equal to systematic risk plus diversifiable risk**

**Question No: 31 ( 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: 32 ( Marks: 1 ) - Please choose one**

A well-diversified portfolio is defined as:

- ▶ **One that is diversified over a large enough number of securities that the nonsystematic variance is essentially zero**

- ▶ One that contains securities from at least three different industry sectors
- ▶ A portfolio whose factor beta equals 1.0
- ▶ A portfolio that is equally weighted

Reference:

A **well-diversified portfolio** is **one** that contains a **large number** of **securities**, each having a small (but not necessarily equal) weight, so that **nonsystematic variance** is negligible

**Question No: 33 ( 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

Reference:

Moreover, if a company intends to start a new project, Capital Budgeting techniques are employed to assess the financial viability of the project.

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

Capital budgeting is a decentralized function assigned to:

- ▶ Individuals
- ▶ Departments
- ▶ Teams
- ▶ **All of the given options**

Reference:

Capital budgeting is a decentralized function. In big corporations, this function is not an individual's job, rather, different departments and teams are assigned to work on different aspects of capital budgeting.

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

The biggest challenge in capital budgeting is to keep finding:

► Valuable projects

► Sources of funds

► Blue chips

► Fixed assets

Reference: Page 39

The biggest challenge in capital budgeting is to keep finding the valuable projects, i.e., projects that may add to the value of the firm. You must be familiar with the basic objective of financial management by now, which is to maximize shareholders' wealth. This is possible only by investing in the projects, which have positive net present value, which in effect will increase the shareholders' wealth.

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

The objective of financial management is to maximize \_\_\_\_\_ wealth.

► Stakeholders

► Shareholders

► Bondholders

► Directors

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

Information that goes into \_\_\_\_\_ can be used to prepare \_\_\_\_\_.

► A forecast balance sheet; a forecast income statement

► Forecast financial statements; a cash budget

► **Cash budget; forecast financial statements**

► A forecast income statement; a cash budget

Reference:

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

A proposal is accepted if payback period falls within the time period of 3 years.

According to the given criteria which of the following project will be accepted?

Payback period

Project A 1.66

Project B 2.66

Project C 3.66

► Project A

► Project B

► Project C

► **Project A & B**

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

What is the present value of Rs.1,000 to be paid at the end of 5 years if the interest rate is 8% compounded annually?

► **Rs.680.58**

► Rs.1,462.23

► Rs.322.69

► Rs.401.98

Reference:

$$PV = FV / (1+i)^n$$

$$PV = 1000 / (1+0.08)^5$$

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

What is the present value of Rs.6,500 to be paid at the end of 8 years if the interest rate is 10% compounded annually?

► **Rs.3,032**

► Rs.3,890

► Rs.3,190

► Rs.4,301

Reference:

$$PV = FV / (1+i)^n$$

$$PV = 6500 / (1+.10)^8$$

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## MIDTERM EXAMINATION

Fall 2009

### MGT201- Financial Management (Session - 3)

#### **Question No: 1 ( Marks: 1 ) - 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 earning at the year end?

► Rs.1.00

► Rs. 6.00

► **Rs. 0.50**

► Rs. 6.50

Reference:

#### **Earning Per Share (EPS):**

= Net Income / Average Number of Common Shares Outstanding

$$= 100000 / 200000$$

$$= 0.50$$



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

Who determines the market price of a share of common stock?

► **Individuals buying and selling the stock**

- The board of directors of the firm
- The stock exchange on which the stock is listed
- The president of the company

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

Which of the following statements is correct for a sole proprietorship?

- The sole proprietor has limited liability
- The sole proprietor can easily dispose of their ownership position relative to a shareholder in a corporation

► **The sole proprietorship can be created more quickly than a corporation**

- The owner of a sole proprietorship faces double taxation unlike the partners in a partnership

**Question No: 4 ( Marks: 1 ) - Please choose one**

Which of the following market refers to the market for relatively long-term financial instruments?

- Secondary market
- Primary market
- Money market
- **Capital market**

Reference:

**Capital Markets:**

These are the markets for the long term debt & corporate stocks.

The maturity of debt

should be more than one year to qualify it as a capital market instrument.

**Question No: 5 ( Marks: 1 ) - 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 percent. What are its sales?

► 750,0Rs.3, 750,000

► **Rs.48Rs.480, 000**

► Rs.30Rs.300, 000

► Rs.1, Rs.1, 500,000

Reference:

Since  $ROI=8\%$  on \$300,000 of assets,  
then net profit is \$24,000 ( $8\% \times \$300,000$ ).

Using the net profit and  
given that the  $NPM=5\%$ , sales equals \$480,000 ( $\$24,000 / 5\%$ ).

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

The DuPont Approach breaks down the earning power on shareholders' book value (ROE) as follows:  $ROE =$  \_\_\_\_\_.

► **Net profit margin  $\times$  Total asset turnover  $\times$  Equity multiplier**

► Total asset turnover  $\times$  Gross profit margin  $\times$  Debt ratio

► Total asset turnover  $\times$  Net profit margin

► Total asset turnover  $\times$  Gross profit margin  $\times$  Equity multiplier

Reference:

• DuPont = Profit Margin  $\times$  Asset Turnover  $\times$  (Assets/Equity),

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

In conducting an index analysis every balance sheet item is divided by \_\_\_\_\_ and  
every income statement is divided by \_\_\_\_\_ respectively.

► **Its corresponding base year balance sheet item; its corresponding base year income statement item**

- ▶ Its corresponding base year income statement item; its corresponding base year balance sheet item
- ▶ Net sales or revenues; total assets
- ▶ Total assets; net sales or revenues

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

Which group of ratios shows the extent to which the firm is financed with debt?

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

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

Which of the following would be considered a cash-flow item from an "operating activity"?

- ▶ **Cash outflow to the government for taxes**
- ▶ Cash outflow to shareholders as dividends
- ▶ Cash inflow to the firm from selling new common equity shares
- ▶ Cash outflow to purchase bonds issued by another company

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

An annuity due is always worth \_\_\_\_\_ a comparable annuity.

- ▶ Less than
- ▶ **More than**
- ▶ Equal to
- ▶ Can not be found

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

A capital budgeting technique through which discount rate equates the present value of the future net cash flows from an investment project with the project's initial cash outflow is known as:

► Payback period

► **Internal rate of return**

► Net present value

► Profitability index

Reference:

Page 43 & 44

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

If the cash flow stream for a project is **NOT** a uniform series of inflows and initial

outflow occur at time 0. 15% discount rate produces a resulting present value of Rs.

104,000 that is greater than the initial cash outflow of Rs. 100,000.

Now if we want to

calculate the best discount rate:

► **We need to try a higher discount rate**

► We need to try a lower discount rate

► 15% is the best discount rate

► Interpolation is not required here

**Question No: 13 ( 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

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

Which of the following make the calculation of NPV difficult?

- ▶ Estimated cash flows
- ▶ Discount rate
- ▶ Anticipated life of the business
- ▶ **All of the given options**

Reference:

Page 41 & 42

**Question No: 15 ( 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 with the highest NPV**
- ▶ Choose the project with the highest NPV
- ▶ Calculate IRR and select the projects with the highest IRRs

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

You are selecting a project from a mix of projects, what would be your first selection in descending order to give yourself the best chance to add most to the firm value, when operating under a single-period capital-rationing constraint?

- ▶ **Profitability index (PI)**
- ▶ Net present value (NPV)
- ▶ Internal rate of return (IRR)
- ▶ Payback period (PBP)

Reference:

Reference:

1. Pay back period (ascending order)
2. Return on investment (ROI)
3. Net Present Value (NPV)
4. Profitability Index (PI) (Descending order)
5. Internal Rate of Return (IRR)

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

Due to timing difference problem, a good project might suffer from \_\_\_\_\_ IRR even though its NPV is \_\_\_\_\_.

- ▶ Higher; Lower
- ▶ Lower; Lower
- ▶ **Lower; Higher**
- ▶ Higher; Higher

Reference:

A good project might suffer from a lower IRR even though its NPV is higher

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

What type of long-term financing most likely has the following features: 1) it has an infinite life, 2) it pays dividends, and 3) its cash flows are expected to be a constant annuity stream?

- ▶ Long-term debt
- ▶ **Preferred stock**
- ▶ Common stock
- ▶ None of the given option

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

Market price of the bond changes according to which of the following reasons?

- ▶ Market price changes due to the supply –demand of the bond in the market
- ▶ Market price changes due to Investor's perception
- ▶ Market price changes due to change in the interest rate
- ▶ **All of the given options**

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

Which one of the following is the right of the issuer to call back or retire the bond by paying off the bondholders before the maturity date?

- ▶ Call in
- ▶ Call option
- ▶ **Call provision**
- ▶ Put option

Reference:

**Call Provision:**

The right (or option) of the Issuer to call back (redeem) or retire the bond by paying-off the Bondholders before the Maturity Date.

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

The value of a bond is directly derived from which of the following?

- ▶ Cash flows
- ▶ Coupon receipts
- ▶ Par recovery at maturity
- ▶ **All of the given options**

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

When the bond approaches its maturity, the market value of the bond approaches to which of the following?

- ▶ \_ Intrinsic value
- ▶ Book value
- ▶ **Par value**
- ▶ Historic cost

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

What is yield to maturity on a bond?

- ▶ It is below the coupon rate when the bond sells at a discount, and equal to the

coupon rate when the bond sells at a premium

► **The discount rate that will set the present value of the payments equal to the bond price**

► It is based on the assumption that any payments received are reinvested at the coupon rate

► None of the given options

Reference:

The most common way to compare the Overall Rate of Return of different Bonds is to compare Their **YTM's**

**Question No: 24 ( Marks: 1 ) - Please choose one**

Consider a 5-year bond with a 10% coupon that has a present yield to maturity of 8%. If interest rates remain constant, one year from now, what will be the price of this bond?

► Higher

► **Lower**

► The same

► Rs. 1,000

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

If all things equal, when diversification is most effective?

► Securities' returns are positively correlated

► Securities' returns are uncorrelated

► Securities' returns are high

► **Securities' returns are negatively correlated**

Reference:

If  $R_o = -1.0$ , it means that Investments are Perfectly Negatively Correlated and the

Returns (or Prices or Values) of the 2 Investments move in Exactly Opposite directions.



In this Ideal Case, All Risk can be diversified away. For example, if the price of one stock increases by 50% then the price of another stock goes down by 50%.

**Question No: 26 ( 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

Reference:

Another thing about the shares is to remember that par value is the value when they are issued the market value of the shares changes with investor's perception about the company's future and supply and demand situation.

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

Which of the following has **NO** effect when the financial health (cash flows and income) of the company changes with time?

- ▶ Market value
- ▶ Price of the share
- ▶ **Par value**
- ▶ None of the given options

Reference:

As the financial health (cash flows and income) of the company changes with time, the Market Value (or Price) of the Share changes (even though it's Par Value is fixed).

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

The value of dividend is derived from which of the following?

► **Cash flow streams**

- Capital gain /loss
- Difference between buying & selling price
- All of the given options

**Reference:**

The Dividend Value derived from Dividend Cash Stream and Capital Gain /Loss from Difference between Buying & Selling Price

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

You wish to earn a return of 13% on each of two stocks, X and Y. Stock X is expected to pay a dividend of Rs. 3 in the upcoming year while Stock Y is expected to pay dividend of Rs. 4 in the upcoming year. The expected growth rate of dividends for both stocks is 7%. The intrinsic value of stock X:

- Will be greater than the intrinsic value of stock Y
- Will be the same as the intrinsic value of stock Y
- **Will be less than the intrinsic value of stock Y**
- Cannot be calculated without knowing the market rate of return

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

Total portfolio risk is \_\_\_\_\_.

- Equal to systematic risk plus non-diversifiable risk
- Equal to avoidable risk plus diversifiable risk
- Equal to systematic risk plus unavoidable risk
- **Equal to systematic risk plus diversifiable risk**

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

The wider the range of possible outcomes i.e. \_\_\_\_\_.

- **The greater the variability in potential Returns that can occur, the greater the**

## **Risk**

- ▶ The greater the variability in potential Returns that can occur, the lesser the Risk
- ▶ The greater the variability in potential Returns that can occur, the level of risk remain constant
- ▶ None of the given options

Reference:

The wider the range of Possible Outcomes that can occur, the greater the Risk

### **Question No: 32 ( 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

Reference:

**Average Formula** and Probabilities (what we have been calculating so far). It is basically the weighted average or mean of the expected return of the individual investments in the portfolio

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

Which of the following statements regarding covariance is

**CORRECT?**

- ▶ Covariance always lies in the range -1 to +1
- ▶ Covariance, because it involves a squared value, must always be a positive number (or zero)
- ▶ Low covariance's among returns for different securities leads to high portfolio risk
- ▶ **Covariance can take on positive, negative, or zero values**

Reference:

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

Which of the following is **NOT** a major cause of systematic risk.

- ▶ A worldwide recession
- ▶ A world war
- ▶ World energy supply
- ▶ **Company management change**

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

Finance consists of three interrelated areas:

- ▶ Money and capital market
- ▶ Investment
- ▶ Financial management
- ▶ **All of the given options**

Reference:

Page 1

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

Mutually exclusive means that you can invest in \_\_\_\_\_ project(s) and having chosen \_\_\_\_\_ you cannot choose another.

- ▶ **One; one**
- ▶ Two; two
- ▶ Two; one
- ▶ Three; one

Reference:

**Mutually Exclusive:** means that you can invest in ONE of the investment choices and having chosen one you cannot choose another.

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

At the termination of the project we need to take into account:

- ▶ **Salvage value**
- ▶ Book value

- ▶ Intrinsic value
- ▶ Fair value

Reference:

Termination of the project refers to the period when the project life ends. At this time, we need to take into account the salvage value of the project assets,

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

In which of the following approach you need to bring all the projects to the same length in time?

- ▶ MIRR approach
- ▶ Going concern approach
- ▶ **Common life approach**
- ▶ Equivalent annual approach

Reference:

Page 54

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

Assume a company had Rs.1 billion in free cash flow last year, and it is expected to grow that cash flow at 3% into perpetuity.

Assuming a 9% cost of equity, what is the present value of the company?

- ▶ **Rs.12.08 billion**
- ▶ Rs.18.15 billion
- ▶ Rs.14.16 billion
- ▶ Rs.16.67 billion

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

What is the most important criteria in capital budgeting?

- ▶ Profitability index

► **Net present value**

► Pay back period

► Return on investment

**MIDTERM EXAMINATION**

**Spring 2009**

**MGT201- Financial Management (Session - 2)**

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

Why companies invest in projects with negative NPV?

► **Because there is hidden value in each project**

► Because they have chance of rapid growth

► Because they have invested a lot

► All of the given options

Reference:

Companies invest in projects with negative NPV because there is a hidden value in each project. This hidden value is an opportunity, which is known as an option.

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

Mutually exclusive means that you can invest in \_\_\_\_\_ project(s) and having chosen \_\_\_\_\_ you cannot choose another.

► **One; one**

► Two; two

► Two; one

► Three; one

Reference:

**Mutually Exclusive:** means that you can invest in ONE of the investment choices and having chosen one you cannot choose another.

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

The weighted average of possible returns, with the weights being the probabilities of occurrence is referred to as \_\_\_\_\_.

► A probability distribution

► **The expected return**

► The standard deviation

► Coefficient of variation

Reference:

**Average Formula** and Probabilities (what we have been calculating so far). It is basically the weighted average or mean of the expected return of the individual investments in the portfolio.

**Question No: 4 ( Marks: 1 ) - Please choose one**

A set of possible values that a random variable can assume and their associated probabilities of occurrence are referred to as \_\_\_\_\_.

► **Probability distribution**

► The expected return

► The standard deviation

► Coefficient of variation

Reference:

**Average Formula** and Probabilities (what we have been calculating so far). It is basically the weighted average or mean of the expected return of the individual investments in the portfolio.

**Question No: 5 ( Marks: 1 ) - Please choose one**

The present value of growth opportunities (PVGO) is equal to  
I) The difference between a stock's price and its no-growth value per share

II) The stock's price

III) Zero if its return on equity equals the discount rate

IV) The net present value of favorable investment opportunities

► I and IV

► II and IV

► **I, III, and IV**

► II, III, and IV

Reference:

All are correct except II the stock's price equals the no-growth value per share plus the PVGO

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

Which of the following is **CORRECT**, if a firm has a required rate of return equal to the ROE?

► The firm can increase market price and P/E by retaining more earnings

► The firm can increase market price and P/E by increasing the growth rate

► **The amount of earnings retained by the firm does not affect market price or the P/E**

► None of the given options

Reference:

If required return and ROE are equal, investors are indifferent as to whether the **firm**

Retains more earnings or increases dividends. Thus, retention rates and growth rates do not affect **market price** and P/E .

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

Which of the following would tend to reduce a firm's P/E ratio?

► The firm significantly decreases financial leverage

► The firm increases return on equity for the long term

► **The level of inflation is expected to increase to double-digit levels**

► The rate of return on Treasury bills decreases

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



A company whose stock is selling at a P/E ratio greater than the P/E ratio of a market index, most likely has \_\_\_\_\_.

- ▶ An anticipated earnings growth rate which is less than that of the average firm
- ▶ **A dividend yield which is less than that of the average firm**
- ▶ Less predictable earnings growth than that of the average firm
- ▶ Greater cyclical growth of earnings than that of the average firm

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

In the dividend discount model, which of the following is (are) **NOT** incorporated into the discount rate?

- ▶ Real risk-free rate
- ▶ Risk premium for stocks
- ▶ **Return on assets**
- ▶ Expected inflation rate

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

The market capitalization rate on the stock of Steel Company is 12%. The expected ROE is 13% and the expected EPS are Rs. 3.60. If the firm's plowback ratio is 50%, what will be the P/E ratio?

- ▶ 7.69
- ▶ 8.33
- ▶ **9.09**
- ▶ 11.11

Reference:

$$P/E = (1-b)/K-G$$

$$K=12\%=.12$$

$G = \text{plowback ratio} \times \text{ROE}$

$$G=0.5 \times 0.13 = 0.065$$

Put the values in formula.

$$P/E=(1-.05)/0.12-0.065$$

$$P/E=0.5/0.055$$

$$P/E=9.09$$

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

How dividend yield on a stock is similar to the current yield on a bond?

► Both represent how much each security's price will increase in a year

► Both represent the security's annual income divided by its price

► Both are an accurate representation of the total annual return an investor can expect to earn by owning the security

► Both incorporate the par value in their calculation

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

Low Tech Company has an expected ROE of 10%. The dividend growth rate will be \_\_\_\_\_ if the firm follows a policy of paying 40% of earnings in the form of dividends.

► 6.0%

► 4.8%

► 7.2%

► 3.0%

Reference:

$G = \text{plowback ratio} \times \text{ROE}$

40% earning retained

60% remaining

$$G=0.60 \times 0.10 = 0.06 \times 100 = 6\%$$

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

The value of direct claim security is derived from which of the following?

► Fundamental analysis

► **Underlying real asset**

► Supply and demand of securities in the market

► All of the given options

Reference:

Value of Direct Claim Security is directly will be determined by the value of the underlying Real Asset.

**Question No: 14 ( 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

Reference:

Another thing about the shares is to remember that par value is the value when they are issued the market value of the shares changes with investor's perception about the company's future and supply and demand situation.

**Question No: 15 ( Marks: 1 ) - Please choose one**

How efficient portfolios of "N" risky securities are formed?

► These are formed with the securities that have the highest rates of return

of their standard deviations

► They have the highest risk and rates of return and the highest standard deviations

► They are selected from those securities with the lowest standard deviations

of their returns

► **They have the highest rates of return for a given level of risk**

Reference:

Portfolios that are efficient are those that provide the highest expected return for a given level of risk.

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

When a bond will sell at a discount?

► The coupon rate is greater than the current yield and the current yield is greater than yield to maturity

► The coupon rate is greater than yield to maturity

► The coupon rate is less than the current yield and the current yield is greater than yield to maturity

► **The coupon rate is less than the current yield and the current yield is less than yield to maturity**

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

Which of the following is a characteristic of a coupon bond?

► **Pays interest on a regular basis (typically every six months)**

► Does not pay interest on a regular basis but pays a lump sum at maturity

► Can always be converted into a specific number of shares of common stock in the issuing company

► Always sells at par

Reference:

A bond that yields a certain amount (the "coupon"), usually paid semi-annually. Coupon bonds provide cash flow at predictable intervals and a capital repayment of the face value at maturity, unless the issuer defaults.

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

A coupon bond pays annual interest, has a par value of Rs.1,000, matures in 4 years, has a coupon rate of 10%, and has a yield to maturity of 12%. What is the current yield on this bond?

▶ 10.65%

▶ 10.45%

▶ 10.95%

▶ 10.52%

Reference:

Price of Bond =  $100 \times (1 + 0.12)^{-1} + 100 \times (1 + 0.12)^{-2} + 100 \times (1 + 0.12)^{-3} +$

$1100 \times (1.12)^{-4} = 939.25$

Current Yield = Coupon / Market Price

Current Yield =  $100 / 939.35$

Coupon payment 4 year @ 10% =  $100 \times 4 = 400$

Current yield =  $400 / 1000 = .1064 = 10.64\%$

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

If a 7% coupon bond is trading for Rs. 975 it has a current yield of \_\_\_\_\_ percent.

▶ 7.00

▶ 6.53

▶ 8.53

▶ 7.18

Reference:

Current Yield = Coupon / Market Price

Current Yield =  $7\% \times 1000 / 975$

Current Yield =  $70 / 975$

Current Yield =  $0.071 \times 100$

Current Yield = 7.18

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

Interest rate risk for long term bonds is more than the interest rate risk for short term bonds provided the \_\_\_\_\_ for the bonds is similar.

- ▶ Interest rate risk
- ▶ Market rate
- ▶ **Coupon rate**
- ▶ Inflation rate

Reference:

Interest Rate Risk for Long Term Bonds (i.e. 10 year bonds) is more than the Interest Rate Risk for Short Term Bonds (i.e. 1 year bonds) provided the coupon rate for the bonds is similar.

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

When market is offering lower rate of return than the bond, the bond becomes valuable, with respect to the given scenario which of the following is correct?

▶ **Market interest rate < coupon interest rate, market value of bond is > par value**

- ▶ Market interest rate > coupon interest rate, market value of bond is > par value
- ▶ Market interest rate < coupon interest rate, market value of bond is < par value
- ▶ Market interest rate = coupon interest rate, market value of bond is > par value

Reference:

So, When Market Interest Rate < Coupon Interest Rate, Market Value (or Price) of Bond > Par Value

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

Which of the following affects the price of the bond?

- ▶ Market interest rate
- ▶ Required rate of return
- ▶ Interest rate risk
- ▶ **All of the given options**

Reference:

Lesson 14

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

Bond is a type of Direct Claim Security whose value is **NOT** secured by \_\_\_\_\_.

- ▶ Tangible assets
- ▶ **Intangible assets**
- ▶ Fixed assets
- ▶ Real assets

Reference:

Value of Direct Claim Security is directly will be determined by the value of the underlying Real Asset. Real assets include tangible assets and tangible assets include fixed assets, so answer is intangible assets.

**Question No: 24 ( Marks: 1 ) - Please choose one**

\_\_\_\_\_ is a long-term, unsecured debt instrument with a lower claim on assets and income than other classes of debt.

- ▶ **A subordinated debenture**
- ▶ A debenture
- ▶ A junk bond
- ▶ An income bond

Reference:

Subordinated Debenture -- A long-term, unsecured debt instrument with a lower claim on assets and income than other classes of debt; known as junior debt.

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

A 12% coupon rate, Rs.1,000 par bond currently trades at 90 one year after issuance.

Which of the following is the most likely call price?

- ▶ Rs. 87
- ▶ **Rs. 90**
- ▶ Rs. 102
- ▶ Rs. 112

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

Which of the following is a legal agreement between the corporation issuing bonds and the bondholders that establish the terms of the bond issue?

- ▶ **Indenture**
- ▶ Debenture
- ▶ Bond
- ▶ Bond trustee

Reference:

Indenture -- The legal agreement, also called the deed of trust, between the corporation issuing bonds and the bondholders, establishing the terms of the bond issue and naming ,the trustee.

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

Companies and individuals running different types of businesses have to make the choices of the asset according to which of the following?



► **Life span of the project**

- Validity of the project
- Cost of the capital
- Return on asset

Reference:

Lesson 12

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

Which of the following technique would be used for a project that has non-normal cash flows?

- Internal rate of return
- **Multiple internal rate of return**
- Modified internal rate of return
- Net present value

Reference:

Page 53

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

Why net present value is the most important criteria for selecting the project in capital budgeting?

- Because it has a direct link with the shareholders dividends maximization
- **Because it has direct link with shareholders wealth maximization**
- Because it helps in quick judgment regarding the investment in real assets
- Because we have a simple formula to calculate the cash flows

Reference:

The NPV is the most important because it has a direct link with shareholders wealth maximization. Page 55

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

From which of the following category would be the cash flow received from sales

revenue and other income during the life of the project?

- ▶ Cash flow from financing activity
- ▶ Cash flow from operating activity
- ▶ Cash flow from investing activity

▶ **All of the given options**

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

An investment proposal should be judged in whether or not it provides:

- ▶ A return equal to the return require by the investor
- ▶ A return more than required by investor
- ▶ A return less than required by investor

▶ **A return equal to or more than required by investor**

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

ABC Co. will earn Rs. 350 million in cash flow in four years from now. Assuming an 8.5% weighted average cost of capital, what is that cash flow worth today?

▶ **Rs.253 million**

- ▶ Rs.323 million
- ▶ Rs.380 million
- ▶ Rs.180 million

Reference:

$$PV = FV / (1+i)^n$$

$$PV = 350 / (1+0.085)^4$$

$$PV = 253$$

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

An 8-year annuity due has a future value of Rs.1,000. If the interest rate is 5 percent, the

amount of each annuity payment is closest to which of the following?

- ▶ Rs.109.39
- ▶ Rs.147.36
- ▶ Rs.154.73
- ▶ **Rs.99.74**

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**Question No: 34 ( 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

Reference:

For Example

$$PV = FV / (1+i)^n$$

$$PV = 1000 / (1+.08)^5$$

$$PV = 680.58$$

$$PV = FV / (1+i)^n$$

$$PV = 1000 / (1+.09)^5$$

$$PV = 650$$

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

An annuity due is always worth \_\_\_\_\_ a comparable annuity.

- ▶ Less than
- ▶ **More than**
- ▶ Equal to
- ▶ Can not be found

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

What is the present value of an annuity that pays 100 per year for 10 years if the required rate of return is 7%?

- ▶ Rs.1000
- ▶ **Rs.702.40**
- ▶ Rs.545.45
- ▶ Rs.13,816

Reference:

$$PV=100\{1-(1+.07)^{-10}/.07\}$$

$$PV=100\{1-(1.07)^{-10}/.07\}$$

$$PV=100\{1-0.5083/.07\}$$

$$PV=100(0.4916/.07)$$

$$PV=100(7.024)$$

$$PV= \text{Rs.}702.40$$

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

Which of the following would be considered a cash-flow item from a "financing" activity?

- ▶ A cash outflow to the government for taxes
- ▶ **A cash outflow to repurchase the firm's own common stock**
- ▶ A cash outflow to lenders as interest
- ▶ A cash outflow to purchase bonds issued by another company

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

Which group of ratios relates profits to sales and investment?

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

Reference:

**PROFITABILITY RATIOS:**

The profitability ratios show the combine effects of liquidity, asset management, and debt management on operating result.

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

Which of the following statements is the least likely to be correct?

- ▶ A firm that has a high degree of business risk is less likely to want to incur financial risk
- ▶ **There exists little or no negotiation with suppliers of capital regarding the financing needs of the firm**
- ▶ Financial ratios are relevant for making internal comparisons
- ▶ It is important to make external comparisons or financial ratios

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

Which of the following statement (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 weaker ROI
- ▶ The higher the tax rate for a firm, the lower the interest coverage ratio

Reference:

The firm has a preference for a high receivables turnover as it is more quickly turning receivables into cash that the firm can use.

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## MIDTERM EXAMINATION

Spring 2009

MGT201- Financial Management (Session - 4)

Time: 60 min

Marks: 50

### Question No: 1 ( Marks: 1 ) - 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 earning at the year end?

- ▶ Rs.1.00
- ▶ Rs. 6.00
- ▶ **Rs. 0.50**
- ▶ Rs. 6.50

Reference:

**Earning Per Share (EPS):**

= Net Income / Average Number of Common Shares Outstanding

=100000/200000

=0.50

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

Among the pairs given below select a(n) example of a principal and a(n) example of an agent respectively.

► **Shareholder; manager**

- Manager; owner
- Accountant; bondholder
- Shareholder; bondholder

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

Which of the following is equal to the average tax rate?

► **Total tax liability divided by taxable income**

- Rate that will be paid on the next dollar of taxable income
- Median marginal tax rate
- Percentage increase in taxable income from the previous period

**Question No: 4 ( Marks: 1 ) - Please choose one**

Which of the following would be deductible as an expense on the corporation's income statement?

► **Interest paid on outstanding bonds**

- Cash dividends paid on outstanding common stock
- Cash dividends paid on outstanding preferred stock
- All of the given options

**Question No: 5 ( Marks: 1 ) - Please choose one**

In conducting an index analysis every balance sheet item is divided by \_\_\_\_\_ and every income statement is divided by \_\_\_\_\_ respectively.

► **Its corresponding base year balance sheet item; its corresponding base year income statement item**

- Its corresponding base year income statement item; its corresponding base year balance sheet item
- Net sales or revenues; total assets
- Total assets; net sales or revenues

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

Which group of ratios measures a firm's ability to meet short-term obligations?

► **Liquidity ratios**

- Debt ratios
- Coverage ratios
- Profitability ratios

Reference:

Keep enough Liquidity to meet maturing short term obligations (i.e. Accounts Payable, Interest, etc) on time.

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

Which group of ratios relates profits to sales and investment?

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

Reference:

**PROFITABILITY RATIOS:**

The profitability ratios show the combine effects of liquidity, asset management, and debt management on operating result.

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

Interest paid on the original principal borrowed is often referred to as \_\_\_\_\_.

- Compound interest
- Present value
- **Simple interest**
- Future value

Reference:

Simple interest incurs only on the principal. While calculating simple interest we keep the interest and principal separately, i.e.,



the interest incurred in one year is not added to the principal while calculating interest of the next period. Simple interest can be calculated using the following formula.

$$FV = PV + (PV \times i \times n)$$

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

If the following are the balance sheet changes, which one of them would represent use of funds by a company?

- ▶ Rs. 8,950 decrease in net fixed assets
- ▶ Rs. 5,005 decrease in accounts receivable
- ▶ Rs. 10,001 increase in accounts payable
- ▶ **Rs. 12,012 decrease in notes payable**

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

In preparing a forecast balance sheet, it is likely that either cash or \_\_\_\_\_ will serve as a "plug figure" or balancing factor to ensure that assets equal liabilities plus shareholders' equity.

- ▶ Retained earnings
- ▶ Accounts receivable
- ▶ Shareholders' equity
- ▶ **Notes payable (short-term borrowings)**

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

What is the present value of Rs.8,000 to be paid at the end of three years if the interest rate is 11%?

- ▶ **Rs.5,850**
- ▶ Rs.4,872
- ▶ Rs.6,725
- ▶ Rs.1,842

Reference:

$$PV = FV / (1+i)^3$$

$$PV = 8000 / (1+.11)^3$$

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

What is the present value of Rs.1,000 to be paid at the end of 5 years if the interest rate is 8%.

► **Rs.680.58**

► Rs.1,462.23

► Rs.322.69

► Rs.401.98

Reference:

$$PV = FV / (1+i)^n$$

$$PV = 1000 / (1+.08)^5$$

**Question No: 13 ( 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

Reference:

For Example

$$PV = FV / (1+i)^n$$

$$PV = 1000 / (1+.08)^5$$

$$PV = 680.58$$

$$PV = FV / (1+i)^n$$

$$PV = 1000 / (1+.09)^5$$

$$PV = 650$$

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

The benefit we expect from a project is expressed in terms of:

▶ **Cash in flows**

▶ Cash out flows

▶ Cash flows

▶ None of the given options

Reference:

Capital Budgeting Topic

**Question No: 15 ( Marks: 1 ) - Please choose one**

A proposal is accepted if payback period falls within the time period of 3 years.

According to the given criteria which of the following project will be accepted?

**Payback period**

Project A 1.66

Project B 2.66

Project C 3.66

▶ Project A

▶ Project B

▶ Project C

▶ **Project A & B**

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

If a project's initial cash outflow of Rs. 100,000 is followed by four annual receipts of 36,000 we can get the nearest discount factor by:

▶ Interpolation

▶ **Dividing 100,000 by 36,000**

▶ Dividing 36,000 by 100,000

▶ Insufficient information

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

In which of the following situations you can expect multiple answers of IRR?

- ▶ More than one sign change taking place in cash flow diagram
- ▶ There are two adjacent arrows one of them is downward pointing & the other one is upward pointing
- ▶ During the life of project if you have any net cash outflow
- ▶ **All of the given options**

Reference:

Page 43

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

Which of the following technique would be used for a project that has non-normal cash flows?

- ▶ Internal rate of return
- ▶ **Multiple internal rate of return**
- ▶ Modified internal rate of return
- ▶ Net present value

Reference:

Page 53

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

What is the advantage of a longer life of the asset?

- ▶ Cash flows from the asset becomes non-predictable
- ▶ **Cash flows from the asset becomes more predictable**
- ▶ Cash inflows from the asset becomes more predictable
- ▶ Cash outflows from the asset becomes more predictable

Reference:

**Advantages of asset with a long life:**

The advantage of a longer asset life is that the cash flows from the project become more predictable, since there are lesser cash outflows occurring during the life of the project.

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

Which one of the following is **NOT** the disadvantage of the asset with very short life?

► Money has to be reinvested in some other project with uncertain NPV

► **Money has to be reinvested in some other project with certain NPV**

► Money has to be reinvested in some other project with return so risky

► None of the given options

Reference:

**Disadvantage of assets with very short life:**

The disadvantage is that the money will have to be reinvested in some other project with an uncertain NPV and return so it is risky. If a good project is not available, the money will earn only a minimal return at the risk free interest rate.

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

You are selecting a project from a mix of projects, what would be your first selection in descending order to give yourself the best chance to add most to the firm value, when operating under a single-period capital-rationing constraint?

► **Profitability index (PI)**

► Net present value (NPV)

► Internal rate of return (IRR)

► Payback period (PBP)

Reference:

1. Pay back period (ascending order)

2. Return on investment (ROI)
3. Net Present Value (NPV)
4. Profitability Index (PI) (Descending order)
5. Internal Rate of Return (IRR)

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

Which one of the following is the right of the issuer to call back or retire the bond by paying off the bondholders before the maturity date?

- ▶ Call in
- ▶ Call option
- ▶ **Call provision**
- ▶ Put option

Reference:

**Call Provision:**

The right (or option) of the Issuer to call back (redeem) or retire the bond by paying-off the Bondholders before the Maturity Date.

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

Which of the following is a characteristic of a coupon bond?

- ▶ **Pays interest on a regular basis (typically every six months)**
- ▶ Does not pay interest on a regular basis but pays a lump sum at maturity
- ▶ Can always be converted into a specific number of shares of common stock the issuing company
- ▶ Always sells at par

Reference:

A bond that yields a certain amount (the "coupon"), usually paid semi-annually. Coupon bonds provide cash flow at predictable intervals and a capital repayment of the face value at maturity, unless the issuer defaults.

**Question No: 24 ( Marks: 1 ) - Please choose one**

When a bond will sell at a discount?

- ▶ The coupon rate is greater than the current yield and the current yield is greater than yield to maturity
- ▶ The coupon rate is greater than yield to maturity
- ▶ The coupon rate is less than the current yield and the current yield is greater than the yield to maturity
- ▶ **The coupon rate is less than the current yield and the current yield is less than yield to maturity**

**Question No: 25 ( 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**

Reference:

**Correlation Coefficient (  $\rho$  or “ $\rho$ ”):**

Risk of a Portfolio of only 2 Stocks A & B depends on the Correlation between those 2 stocks. The value of  $\rho$  is between -1.0 and +1.0

If  $\rho = 0$  then Investments are Uncorrelated & Risk Formula simplifies to Weighted Average Formula. If  $\rho = + 1.0$  then Investments are Perfectly Positively Correlated and this means that Diversification does not reduce Risk.

If  $\rho = - 1.0$ , it means that Investments are Perfectly Negatively Correlated and the Returns (or Prices or Values) of the 2 Investments move in Exactly Opposite directions

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

How efficient portfolios of "N" risky securities are formed?

- ▶ These are formed with the securities that have the highest rates of return
- ▶ They have the highest risk and rates of return and the highest standard deviations
- ▶ They are selected from those securities with the lowest standard deviations regardless of their returns

▶ **They have the highest rates of return for a given level of risk**

Reference:

Portfolios that are efficient are those that provide the highest expected return for a given level of risk.

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

Which of the following is NOT an example of hybrid equity?

- ▶ Convertible bonds
- ▶ Convertible debenture
- ▶ **Common shares**
- ▶ Preferred shares

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

The value of dividend is derived from which of the following?

- ▶ **Cash flow streams**
- ▶ Capital gain /loss
- ▶ Difference between buying & selling price
- ▶ All of the given options

**Reference:**



The Dividend Value derived from Dividend Cash Stream and Capital Gain /Loss from Difference between Buying & Selling Price.

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

How dividend yield on a stock is similar to the current yield on a bond?

► Both represent how much each security's price will increase in a year

► Both represent the security's annual income divided by its price

► Both are an accurate representation of the total annual return an investor can

expect to earn by owning the security

► Both incorporate the par value in their calculation

Reference:

**Current Yield = Coupon / Market Price**

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

The market capitalization rate on the stock of Fast Growing Company is 20%. The expected ROE is 22% and the expected EPS is Rs. 6.10. If the firm's plowback ratio is 90%, the P/E ratio will be \_\_\_\_\_.

► 8.33

► 50.0

► 9.09

► 7.69

Reference:

$P/E = (1-b)/K-G$

$K = 20\% = .20$

$G = \text{plowback ratio} \times \text{ROE}$

$G = 0.9 \times 0.22 = 0.198$

Put the values in formula.

$$P/E = (1 - 0.09) / 0.20 - 0.198$$

$$P/E = 0.1 / 0.002$$

$$P/E = 50$$

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

In the dividend discount model, which of the following is (are) **NOT** incorporated into the discount rate?

- ▶ Real risk-free rate
- ▶ Risk premium for stocks
- ▶ **Return on assets**
- ▶ Expected inflation rate

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

A company whose stock is selling at a P/E ratio greater than the P/E ratio of a market index, most likely has \_\_\_\_\_.

- ▶ An anticipated earnings growth rate which is less than that of the average firm
- ▶ **A dividend yield which is less than that of the average firm**
- ▶ Less predictable earnings growth than that of the average firm
- ▶ Greater cyclicality of earnings growth than that of the average firm

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

Which of the following is the variability of return on stocks or portfolios not explained by general market movements. It is avoidable through diversification?

- ▶ Systematic risk
- ▶ Standard deviation
- ▶ **Unsystematic risk**
- ▶ Financial risk

Reference:

o Systematic Risk is the variability of return on stocks or portfolios associated with changes in return on the market as a whole.

o Unsystematic Risk is the variability of return on stocks or portfolios not explained by general market movements. It is avoidable through diversification

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

When Return is being estimated in % terms, the units of Standard Deviation will be mention in \_\_\_\_\_.

- ▶ %
- ▶ Times
- ▶ Number of days
- ▶ All of the given options

Reference:

**Standard Deviation Interpretation**

What are the units of Standard Deviation?

For our example where Return is being estimated in % terms, the units of

Standard Deviation will also be %.

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

A well-diversified portfolio is defined as:

- ▶ One that is diversified over a large enough number of securities that the nonsystematic variance is essentially zero
- ▶ One that contains securities from at least three different industry sectors
- ▶ A portfolio whose factor beta equals 1.0
- ▶ A portfolio that is equally weighted

Reference:

A **well-diversified portfolio** is **one** that contains a **large number** of **securities**, each having a small (but not necessarily equal) weight, so that **nonsystematic variance** is negligible

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

Which of the following is **NOT** a major cause of unsystematic risk.

- ▶ New competitors
- ▶ New product management
- ▶ **Worldwide inflation**
- ▶ Strikes

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

You are considering two investment proposals, project A and project B. B's expected net present value is Rs. 1,000 greater than that for A and A's dispersion of net present value is less than that for B. On the basis of risk and return, what would be your conclusion?

- ▶ Project A dominates project B
- ▶ Project B dominates project A
- ▶ **Neither project dominates the other in terms of risk and return**
- ▶ Incomplete information

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

Which of the following is a drawback of percentage of sales method?

- ▶ It is a rough approximation
- ▶ There is change in fixed asset during the forecasted period
- ▶ Lumpy assets are not taken into account
- ▶ **All of the given options**

**Reference:**

**Drawback of Percent of Sales Method:**

Despite the fact that percentage of sales method is widely used method for forecasting, it has certain disadvantages. The first and

the foremost problem with this method is that it is only a rough approximation and is not very detailed. The other problem is that if there is a change in fixed assets during the forecasted period the percentage of sales method would not yield a very accurate answer. The third problem is that the lumpy assets are not taken into account while using the percentage of sales method. Here, lumpy assets refer to those assets which can only be acquired in large discrete units.

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

Which of the following need to be excluded while we calculate the incremental cash flows?

- ▶ Depreciation
- ▶ **Sunk cost**
- ▶ Opportunity cost
- ▶ Non-cash item

Reference:

Sunk costs need to be excluded while calculating the incremental cash flows. Sunk costs are the costs that have already incurred in the past.

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

Why companies invest in projects with negative NPV?

- ▶ **Because there is hidden value in each project**
- ▶ Because they have chance of rapid growth
- ▶ Because they have invested a lot
- ▶ All of the given options

Reference:

Companies invest in projects with negative NPV because there is a hidden value in each project . this hidden value is opportunity, which is known as option.

**Question No: 41 ( Marks: 10 )**

**ICO Company must decide between two mutually exclusive projects. The following information describes the cash flows of each project.**

<b>Year</b>	<b>Project "A"</b>	<b>Project "B"</b>
0	Rs. (20,000)	Rs. 24,000
1	10,000	10,000
2	8,000	10,000
3	6,000	10,000

- Assume that 15% is the appropriate required rate of return. What decision should the firm make about these two projects?
- If the firm reevaluated these projects at 10%, what decision should the firm make about these two projects?

A) We have 2 project A , B

Project A,  $I_0 = -Rs20000$ ,  $Yr\ 1 = +Rs10000$ ,  $Yr2 = Rs8000$ ,  $Yr3 = Rs6000$

Project B,  $I_0 = -Rs24000$ ,  $Yr1 = +Rs10000$ ,  $Yr2 = Rs10000$ ,  $Yr3 = Rs10000$

In simple NPV=

Project A=  $-20000 + 10000 + 8000 + 6000 / (1.15)^3$

$$Rs = 2630.19$$

$$\text{Project B} = -24000 + 10000 + 10000 + 10000 / (1.15)^3$$
$$Rs = 3945.29$$

The firm will decide to take the 2<sup>nd</sup> project B. becuz its NPV is greater tha project A.

B)

$$\text{Project A} = -20000 + 10000 + 8000 + 6000 / (1.10)^3$$
$$Rs = 3005.25$$

$$\text{Project B} = -24000 + 10000 + 10000 + 10000 / (1.10)^3$$
$$Rs = 4507.88$$

Again on 10%, project B is better than project A.

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