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Asad Munir

Vu Askari Team

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FIN622 Finalterm Papers....8 Papers Solved nearly

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By Asad Munir...

FINALTERM EXAMINATION

Fall 2009

FIN622- Corporate Finance (Session - 3)

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

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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**

In the stable dividend policy, management maintains a fixed dividend per share each year. In the constant payout ratio situation, management maintains a fixed percentage dividend payout ratio

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

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- ▶ 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 than liquidation
- ▶ **The parent company wants liquidation**

The existing parent company of the victim firm may wish to dispose of it. The parent company may be caught up in financial distress and is in acute need of cash and liquidity

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

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- ▶ Borrowing base currency

An effective interest rate can be fixed on future short-term borrowing by buying an FRA. Alternatively, an effective interest rate can be fixed on short-term deposit or investment by selling FRA.

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 h

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

Which one of the following statements is CORRECT regarding Options Contracts?

- ▶ **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

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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

<http://www.cengage.co.uk/meggison/students/mcqs/ch17mcq.htm>

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

How much debt financing is used by a firm whose beta is un-g 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?

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- ▶ 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

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**

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High risk, and often high return, the aggressive working capital policy sees the company keep a really low amount of current assets. The idea here is very simple. Collect payments on time, leaving no debtors and invest that amount in the business. And pay the creditors as late as possible. This means that the business uses very little of its own cash, paying the creditors as late as it possibly can.

<http://web.utk.edu/~jwachowi/tfquiz/tf8.html>

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?

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- ▶ 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 Page 119**
- ▶ Hybrid method
- ▶ None of the given

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

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

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► **Shareholders**

► **Stock Brokers**

Predator company appoints experts – legal consultants, banks, accountants and 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**

A management buyout occurs when incumbent management takes ownership of a firm by purchasing a sufficient amount of the firm's common stock. These transactions vary due to the conditions under which the firm is offered for sale and the method of financing employed by the managers

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 the 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**

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► **Purchasing Power Parity theory**

- Fisher effect theory
- Interest rate risk theory

Question No: 45 (Marks: 3)

How firms analyze their credit policies? Explain briefly.

First, allowing credit to customers means that the revenues to the firm will be delayed. A firm may charge higher prices to the customers for allowing them on credit and this will result in increased sales. Total revenues may increase but still the company will receive it late. Secondly, if the company allows credit to customers and then offers cash discounts for early payment from debtors it will incur cost of discount. In other words, it is reducing its profits. After allowing credit to parties the firm must arrange some loans to finance its short term operations. Such finances do carry a handsome interest rate and this need to be considered. Increasing sales by allowing generous credit to customers also increased the probability of default and thus may incur bad debts.

Question No: 46 (Marks: 5)

How Economic Order Quantity (EOQ) Model is helpful in the reduction of total inventory costs?

EOQ only applies where the demand for a product is constant over the year and that each new order is delivered in full when the inventory reaches zero. There is a fixed cost charged for each order placed, regardless of the number of units ordered. There is also a holding or storage cost for each unit held in storage (sometimes expressed as a percentage of the purchase cost of the item).

We want to determine the optimal number of units of the product to order so that we minimize the total cost associated with the purchase, delivery and storage of the product. The required parameters to the solution are the total demand for the year, the purchase cost for each item, the fixed cost to place the order and the storage cost for each item per year. Note that the number of times an order is placed will also affect the total cost, however, this number can be determined from the other parameters

Question No: 47 (Marks: 5)

Differentiate between Spot Rates and Forward Rates of currencies. Why forward rates are higher than spot rates?

Forward Rate: The agreed-upon exchange rate for a forward contract on a currency.

When a forward contract is made, the parties agree to buy/sell the underlying currency at a certain point in the future at a certain exchange rate. The rate is negotiated directly between the parties, unlike a futures contract, which trades on an exchange. Partly because there is little secondary market for forward contracts, determining the forward foreign exchange rate is a zero-sum game: one party will gain on the contract and one will lose, depending on the movements of the relevant currencies between the formation of the contract and its maturity

The current exchange rate at which a currency pair can be bought or sold. The spot forex

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rate differs from the forward rate in that it prices the value of currencies compared to foreign currencies today, rather than at some time in the future. The spot rate in forex currency trading, is the rate that most traders use when trading with an online retail forex broker.

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

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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.

FINAL TERM EXAMINATION

Fall 2009

FIN622- Corporate Finance (Session - 1)

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

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

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

Question No: 2 (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: 3 (Marks: 1) - Please choose one

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

- ▶ WACC of a levered firm is greater than that of an un-levered firm
- ▶ **WACC of a levered firm is lesser than that of an un-levered firm (100% Sure)**
- ▶ WACC of a levered firm is equal to that of an un-levered firm
- ▶ An Un-levered firm has zero WACC.

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

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

- ▶ Financial risk
- ▶ **Systematic risk**
- ▶ Business risk
- ▶ Total risk

Question

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

- ▶ **Stock Dividend**
- ▶ Cum Dividend
- ▶ Ex Dividend
- ▶ Extra Dividend

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

In which of the following situations, a company has the ability to pay off its short-term obligations easily?

- ▶ **If the company has a positive working capital**
- ▶ If the company has a negative working capital
- ▶ If the company has a zero working capital
- ▶ None of the given option

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

In the formula $Q = \frac{I}{T}$, "T" denotes which of the following?

- ▶ Initial cash out flow
- ▶ **Interest cost of holding cash**
- ▶ Investment required
- ▶ Initial investment

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

Keeping all other things constant, an increase in storage cost will result _____ in the EOQ (Economic Order Quantity).

- ▶ **A decrease**
- ▶ No change
- ▶ An increase
- ▶ Cannot be told without additional information

Question No: 9 (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: 10 (Marks: 1) - Please choose one

All of the following could be an outcome of financial distress of a firm **EXCEPT**:

- ▶ Employees are leaving the firm
- ▶ Suppliers refuse to supply on credit

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► Banks do not provide loans

► **Financial markets become instable**

Question No: 11 (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: 12 (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: 13 (Marks: 1) - Please choose one

Which of the following formulas can be used to calculate the value of the firm while considering merger/acquisition?

► Value of all-equity financed firm + FV of tax benefits + Expected Bankruptcy Costs

► **Value of all-equity financed firm + PV of tax benefits + Expected Bankruptcy Costs [page 116]**

► Value of all-equity financed firm + tax benefits + Expected Bankruptcy Costs

► Value of all-equity financed firm + Expected Bankruptcy Costs

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

Which of the following effects should be considered by a firm if it allows credit to its customers?

► Cost of discount

► Arrange loans to finance short term operations

► Prices of goods

► **All of the given options**

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

Which of the following is generally the objective of the firms behind offering discount to customers?

► **To improve the cash flow [page 106]**

► To increase the bad debts

► To improve return on equity

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- ▶ To improve the PE ratio

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

Which of the following types of dividend policies results in the most volatile dividend payments and stockholder discomfort?

- ▶ Target dividend-payout policy
- ▶ Low-regular-and-extra dividend policy
- ▶ Regular dividend policy
- ▶ **Constant payout-ratio dividend policy**

<http://wps.aw.com/wps/grader>

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

How much debt financing is used by a firm whose beta is un-gearred?

- ▶ 100% debt financed
- ▶ **100% equity financed**
- ▶ 50% equity and 50% debt financed
- ▶ 60% equity and 40% debt financed

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

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

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

Question No: 19 (Marks: 1) - 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
- ▶ New common stock issue is sold and equipment purchased

Quick Ratio = (Current Assets – Inventory) / Current Liabilities

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

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

- ▶ Rs. 82,168.44
- ▶ Rs. 71,450.82
- ▶ **Rs. 768,901.12**
- ▶ Rs. 668,609.67

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

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A 30-year corporate bond issued in 1985 would now be traded in which of the following markets?

- ▶ Primary capital market
- ▶ Primary money market
- ▶ Secondary money market
- ▶ **Secondary capital market**

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

Which of the following is reflected by the price of a share of common stock?

- ▶ **Earnings after tax divided by the number of shares outstanding**
- ▶ The board of directors' assessment of the intrinsic value of the firm
- ▶ The book value of the firm's assets less the book value of its liabilities
- ▶ The market's evaluation of a firm's present and future performance

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

You are considering buying common stock in Sumi Inc. The firm yesterday paid a dividend of Rs.7.80. You have projected that dividends will grow at a rate of 9% per year indefinitely. If you want an annual return of 24, what should you pay for the stock now?

- ▶ Rs.52.00
- ▶ **Rs.56.68**
- ▶ Rs.32.50
- ▶ Rs.35.43

Solution:-

$$P_0 = D_1(1+g) / (r - g)$$

$$P_0 = 7.8(1.09) / (0.24 - 0.09)$$

$$P_0 = 8.502 / 0.15$$

$$P_0 = 56.68$$

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

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

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

[http://highered.mcgraw-](http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html)

[hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html](http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html)

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

In deciding the optimal level of current assets for the firm, management is confronted with _____.

- ▶ **A trade-off between profitability and risk**
- ▶ A trade-off between liquidity and risk
- ▶ A trade-off between equity and debt

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- ▶ A trade-off between short-term versus long-term borrowing

http://wps.pearsoned.co.uk/ema_uk_he_wachowicz_fundfinman_12/26/6679/1709921.cw/content/index.html

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

Mr. Joseph Steve has changed the working capital policy of his company recently. As a result, the liquidity for the company has decreased but an increase in profitability has been observed alongside. From this information we can conclude that the company must have changed his working capital policy from _____ to _____.

▶ **Conservative; Aggressive**

- ▶ Aggressive; Moderate
- ▶ Aggressive; Conservative
- ▶ None of the given options

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

When the firm considers working capital management, the trade-off between risk and return is affected by all of the following **EXCEPT**:

- ▶ The pattern of cash borrowing needs of the firm
- ▶ The difference between long-term and short-term interest rates

▶ **The ratio of cash to marketable securities**

- ▶ The debt maturity schedule

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

Cash management involves all of the following **EXCEPT**:

- ▶ Efficient disbursement of cash
- ▶ Efficient collection of cash
- ▶ Wise investment of temporarily surplus cash

▶ **Raising cash through the sale of new stock and bonds**

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

Which of the following type of customers enjoy comparatively longer credit periods?

▶ **Corporate customers**

- ▶ Individual customers
- ▶ Both corporate and individual customers
- ▶ Neither corporate nor individual customers

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

Total credit cost curve consists of which of the following?

- ▶ Total of ordering cost and the opportunity cost of credit policy
- ▶ **Total of carrying cost and the opportunity cost of credit policy**
- ▶ Total of opportunity cost of credit policy and the bad debts
- ▶ Total of production cost and the cost of credit policy

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

A firm has 30 days collection period and it is offering terms of 2/10, net 30. The estimations shows that around 70% customers will avail this opportunity by paying within 10 days whereas remaining will pay after 30 days. What would be the Average Collection Period (ACP) of the firm?

▶ 10 days

▶ 12 days

▶ **16 days**

▶ 18 days

$70\% \times 10 \text{ days} + 30\% \times 30 \text{ days}$

$= 7 + 9 = 16 \text{ days}$

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

Which of the following statement is CORRECT regarding Conglomerate mergers?

▶ A firm acquires another firm that is in the same industry but at another stage in the production cycle.

▶ It occurs when one firm purchases other firms that produce similar or competing products.

▶ **It occurs when unrelated businesses merge.**

▶ None of the given options

A merger between firms that are involved in totally unrelated business activities. There are two types of conglomerate mergers: pure and mixed. Pure conglomerate mergers involve firms with nothing in common, while mixed conglomerate mergers involve firms that are looking for product extensions or market extensions

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

Which of the following is(are) reason(s) for determining shares value in mergers and acquisitions?

▶ To set up the terms of takeovers

▶ To value the company for stock exchange listing

▶ To value shares – for establishing value of share of retiring directors

▶ **All of the given options [page 114]**

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

Value of firm = _____

▶ **Value of all equity financed firm + PV of tax benefits + Expected Bankruptcy Costs**

▶ Value of all equity financed firm – PV of tax benefits + Expected Bankruptcy Costs

▶ Value of all equity financed firm + PV of tax benefits – Expected Bankruptcy Costs

▶ Value of all equity financed firm – PV of tax benefits – Expected Bankruptcy Costs

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

Which of the following statements is TRUE regarding the LBO (Leverage Buyout)?

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- ▶ New common stocks are issued to acquire the firm
- ▶ Shareholders' dividend is used to acquire the firm
- ▶ Company's reserves are used to acquire the firm
- ▶ **Borrowed money is used to acquire the firm**

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

Which of the following terms refer to the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition?

- ▶ Management Buyout
- ▶ Management Buy-In
- ▶ **Leverage Buyout**
- ▶ None of the given options

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

Which of the following statements is **INCORRECT** regarding currency future?

- ▶ Reversal of currency future is simple.
- ▶ Parties have to put an initial margin in currency future.
- ▶ The size is pre-determined or fixed in currency future.
- ▶ **Reversing of currency future requires original parties.**

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

An option is termed as "out of money" if:

- ▶ **The exercise price of an option is not favorable than the market price of the underlying item**
- ▶ The exercise price mentioned in the option is favorable than the market price of the underlying commodity
- ▶ The exercise price mentioned in the option is equal to the market price of the underlying commodity
- ▶ The exercise price mentioned in the option is above the option cost

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

Short-term Interest Futures (STIRs) are settled through which of the following?

- ▶ **Cash [page 136]**
- ▶ Physical delivery
- ▶ Both cash and physical delivery
- ▶ Neither cash nor physical delivery

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

An option is termed as "at the money" if:

- ▶ **The strike price and current market price are equal**
- ▶ The strike price is higher than current market price
- ▶ The strike price is lower than current market price
- ▶ None of the given options

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Question No: 41 (Marks: 1) - Please choose one

Which of the following is the CORRECT statement regarding the Law of One Price?

▶ **The law of one price applies to only tradable goods**

- ▶ The law of one price applies to all goods
- ▶ The law of one price applies to immovable goods
- ▶ The law of one price applies to services only

The law of one price only applies to tradable goods; immobile goods such as houses, and many services that are local, are of course not traded between countries

Question No: 42 (Marks: 1) - Please choose one

“Companies may be stretching to other countries in search and import to the home country cheap raw materials.” This statement depicts which of the following strategic motives of multinational companies for foreign investment?

- ▶ Market development
- ▶ **Backward integration**
- ▶ Political safety
- ▶ None of the given options

Question No: 43 (Marks: 1) - Please choose one

Which of the following is a mutually controlled entity by two or more business enterprisers having a shared motive?

- ▶ Subsidiary
- ▶ Branch
- ▶ **Joint Venture**
- ▶ Licensing branch

Question No: 44 (Marks: 1) - Please choose one

Between 1870 and 1914, the globally fixed exchange rate was accepted in which the currencies were linked to which of the following?

- ▶ Any commodity
- ▶ Diamond
- ▶ **Gold**
- ▶ Wheat

Question No: 45 (Marks: 3)

Give at least three sources of synergies and explain each of them briefly.

Question No: 46 (Marks: 5)

How would you expect the firm's cash balance to respond to the following changes?

- a) Interest rates increase.
- b) The volatility of daily cash flow decreases
- c) The transaction cost of buying or selling marketable securities goes up

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Question No: 47 (Marks: 5)

The Inventory Manager of a firm has given the following data:

Consumption per Period = $S = 4000$ Units

Economic Order Quantity = $EOQ = 80$ Units

Lead Time = $L = 1$ Month

Stock out Acceptance Factor = $F = 1.10$

Requirement:

Determine the Economic Order Point for the firm.

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?

Question No: 49 (Marks: 10)

Describe in detail the major steps in short term financial planning process of a firm.

Question No: 50 (Marks: 10)

Explain the process of re-organization of a firm in a financial distress

stage before bankruptcy where a company's creditors are not being paid or are paid with significant difficulty. While a company can avoid moving from financial distress to bankruptcy, it can be very difficult. Often, financial distress can come with its own costs, such as fees paid to lawyers or the costs of extra interest for late payments.

Asset Restructuring:

Selling major assets.

Merging with another firm.

Reducing capital spending and R&D spending.

Financial Restructuring:

Issuing new securities.

Negotiating with banks and other creditors.

Exchanging debt for equity.

Filing for bankruptcy

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

Which of the following statements is TRUE regarding Profitability Index?

- ▶ It ignores time value of money
- ▶ It ignores future cash flows
- ▶ It ignores the scale of investment

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► It ignores return on investment

Reference:

Rechecking Midterm Paper 3rd Option is wrong in VU server. 1 and 2 option are suitable only 4 left.

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

Which of the following is a tool that identifies the strengths, weaknesses, opportunities and threats of an organization?

► **SWOT Analysis**

- Trend Analysis
- Fundamental Analysis
- Technical Analysis



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

If sensitivity analysis concludes that the largest impact on profits would come from changes in the sales level, then which of the following recommendations should be considered?

- Fixed costs should be traded for variable costs
- Variable costs should be traded for fixed costs.
- The project should not be undertaken.

► **Additional marketing analysis may be beneficial before proceeding.**

<http://www1.shift.edu.cn/jrxy/jpkc/html/quizzes/Chpt07.htm?As25=1>

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

The employment of fixed costs associated with the actual production of goods or services is known as:

- Financial leverage
- Volume discounting
- **Operating leverage**

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- Covariance

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

Which one of the following terms refers to the variability of return on stocks or portfolios, associated with changes in return on the market as a whole?

- Unsystematic risk
- Unique risk
- **Systematic risk**
- Company specific risk

Reference: slide # 38 on following link
http://www.slideshare.net/ami_goel/risk-and-return-943136

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

What will be the taxable income of an Un-levered firm, if it has Earning Before Interest and Tax (EBIT) equal to Rs.50,000, and its tax rate is 35%?

- Rs.25,000
- Rs.45,000
- **Rs.50,000**
- Rs.60,000

Earnings Before Taxes (EBT) = Taxable Income = Accounting Income (Economic Income)
<http://www.turkelektrik.com/yon-Mali-Unlevered.htm>

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

Which of the following statements is **TRUE** regarding temporary working capital?

- **Temporary working capital varies with seasonal requirements.**
- Temporary working capital is the constant component of working capital.
- Temporary working capital excludes inventories.

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- ▶ Temporary working capital should be financed with bonds or common stock

Reference: PAGE 90

Temporary working capital is the amount of investment in current assets that varies according to the seasonal requirements.

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

Which of the following describes the hedging approach to financing?

- ▶ Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion.

▶ Each asset is offset with a financing instrument of the same approximate maturity.

- ▶ Each asset is offset with a put or call option.
- ▶ The firm takes out insurance to protect itself against uneven cash flows.

Slide#17

http://wps.pearsoned.co.uk/wps/media/objects/1669/1709919/0273685988_ch08.ppt

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

According to the Miller Model, upper limit for cash balance is equal to which of the following?

▶ Lower limit + Spread [page 96]

- ▶ Spread – Lower limit
- ▶ Optimal limit + Lower limit
- ▶ Lower limit – Spread

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

Suppose that the sale (usage rate) on an item gets doubled. The EOQ (Economic Order Quantity) for that item should be:

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- ▶ Halved
- ▶ Unaffected
- ▶ Decreased
- ▶ **Increased**

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

A firm wants to acquire another firm by purchasing its assets. Which of the following methods firm can use to evaluate the financial aspects of this deal?

- ▶ **Replacement cost method**
- ▶ Dividend valuation method
- ▶ Present value method
- ▶ Price earning ratio method

Ref: PAGE # 118

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

In which of the following acquisition strategies, a purchaser has complete knowledge of the acquiring firm?

- ▶ Management Buy-In
- ▶ **Management buyout**
- ▶ Consolidation
- ▶ Amalgamation

Reference: PAGE # 123

Management Buyouts

Management buyouts are similar in all major legal aspects to any other acquisition of a company. The particular nature of the MBO lies in the position of the buyers as managers of the company and the practical consequences that follow from that. In particular, the due diligence process is likely to be limited as the buyers already have full knowledge of the company available to them. The seller is also unlikely to give any but the most basic

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warranties to the management, on the basis that the management knows more about the company than the sellers do and the Reference ore the sellers should not have to warrant the state of the company. In many cases, the company will already be a private company, but if it is public then the management will take it private.

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

Which one of the following statements is CORRECT regarding exercise price?

- ▶ **Exercise price is the price mentioned in the option at which the holder exercises his right**
- ▶ Exercise price is the price mentioned in the option at which the holder exercises his obligation
- ▶ Exercise price is the price mentioned in the option at which the option seller exercises his right
- ▶ Exercise price is the price mentioned in the option at which the option writer exercises his right

Ref: PAGE # 139

Question No: 14 (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: 15 (Marks: 1) - Please choose one

If market interest rate increases above the agreed rate in an interest rate option, the effective interest rate for the option holder would be:

- ▶ **Less than the market rate [page 143]**
- ▶ Greater than market rate

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► Equal to the market rate

► Zero

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

Which one of the following techniques can reduce the risks and disadvantages of share purchase method in mergers and acquisitions?

► Spin-off

► **Hive-down [page 114]**

► Hubris

► Off-shoot

There is a technique called hivedown which can reduce the risks and disadvantages of share purchase method. This is applied when only part of the business is being taken over by the purchaser. The part is transferred to a new entity of the vendor without raising any tax adverse consequences

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

The financial consideration to be paid to target company in mergers can be classified in to the following categories EXCEPT:

► Cash

► **Assets [page 114]**

► Share – ordinary or preference

► Debt

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

Which of the following types of dividend policies results in the most volatile dividend payments and stockholder discomfort?

► Target dividend-payout policy

► Low-regular-and-extra dividend policy

► Regular dividend policy

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► **Constant payout-ratio dividend policy [page 74]**

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

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

► Rs.10,208

► **Rs.9,728 = $8000(1-.05)^4$**

► Rs.10,880

► Rs.9,624

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

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

► Rs. 82,168.44

► Rs. 71,450.82

► **Rs. 768,901.12**

► Rs. 668,609.67

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

Which of the following statements would be **CORRECT** regarding nominal interest rate when inflations is expected to occur over the foreseeable future?

► Nominal interest rate would be equal to real interest rate

► **Nominal interest rate would be more than real interest rate**

► Nominal interest rate would be half of real interest rate

► Nominal interest rate would be less than the real interest rate

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Real interest rate moves in the opposite direction of both nominal interest rate and inflation

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

Which of the following is a method of evaluating securities by analyzing statistics generated by market activity, such as past prices and volume?

► **Technical analysis**

- Fundamental analysis
- Common size analysis
- Ratio analysis

Technical analysis is the method of evaluating traded products by analyzing statistics generated by market activity, such as past prices and volume. Technical analysts believe that the price contains all known information and therefore technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity.

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

Which of the following statements best describes the term Market Correction?

► **Market Correction refers to the situation where equilibrium of supply & demand of shares occurs in the market**

- Market correction refers to the situation where shares' intrinsic values becomes equal to face values
- Market Correction refers to the situation when there is a boom in the economy
- Market Correction refers to the situation where inflation rate is above the market interest rate

A technical correction is a drop in stock or market prices when there is no fundamental reason for a decrease. After a steady increase in value, investors may become more cautious buyers at the higher prices and look to reevaluate the market, resulting in a decrease in purchases. The drop in purchase volume will stop the upward price trend from continuing while the market re-evaluates the short-term direction.

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

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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

fundamental information that is analyzed can include a company's financial reports, and non-financial information such as estimates of the growth of demand for competing products, industry comparisons, analysis of the effects of new regulations or demographic changes, and economy-wide changes.

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

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

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

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

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

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

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

Which of the following IAS (International Accounting Standard) deals with cash flow statement?

- ▶ IAS 1
- ▶ **IAS 7**
- ▶ IAS 16
- ▶ IAS 28

Cash flows must be analyzed between operating, investing and financing activities. [IAS 7]

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

Mr. Joseph Steve has changed the working capital policy of his company recently. As a result, the liquidity for the company has decreased but an increase in profitability has been observed alongside. From this information we can conclude that the company must have changed his working capital policy from _____ to _____.

- ▶ **Conservative; Aggressive**
- ▶ Aggressive; Moderate
- ▶ Aggressive; Conservative
- ▶ None of the given options

Question No: 29 (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 [page 88]**
- ▶ Conservative working capital policy
- ▶ Moderate working capital policy
- ▶ The statement is not related to any of the working capital policies

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

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The amount of current assets that varies with seasonal requirements is referred to as _____ working capital.

▶ Permanent

▶ Net

▶ **Temporary [page 90]**

▶ Gross

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

Under which of the following concepts, each asset is offset with a financing instrument of the same maturity?

▶ M&M proposition

▶ Clientele effect

▶ **Hedging approach [page 90]**

▶ Baumol Model

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

Which of the following is NOT one of the common motives of holding cash?

▶ **Personal Motives [page 94]**

▶ Safety Motives

▶ Transactions Motives

▶ Speculative Motives

Question No: 33 (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

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Question No: 34 (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. [page 100]**

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

Which of the following term refers to the minimum inventory amount needed for an item?

- ▶ Stock-out
- ▶ Buffer Stock
- ▶ Holding Stock

▶ **Safety Stock [page 100]**

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

Which of the following is NOT an objective of Just-In-Time (JIT)?

- ▶ To increase the productivity
- ▶ **To increase the inventories [page 100]**
- ▶ To increase the quality
- ▶ To increase the flexibility

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

“If the people are not able to work together, the merger will not succeed.” Which of the following cause(s) of failure is(are) being depicted in this statement?

- ▶ Lack of planning
- ▶ **Corporate culture [page 111]**

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- ▶ Talent departure
- ▶ All of the given options

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

Which of the following is an anti takeover strategy in which the target company make significant efforts to resist a takeover bid e.g. by a major acquisition, issue new shares?

- ▶ Shark repellent
- ▶ Pac-man
- ▶ Poison pill

▶ **Political pressure [page 120]**

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

Corporate restructuring involves the restructuring of:

- ▶ **All of the given options [page 121]**
- ▶ The assets and liabilities of the company
- ▶ The debt to equity structures of the company
- ▶ Cost minimization by the company

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

Which of the following terms refer to the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition?

- ▶ Management Buyout
- ▶ Management Buy-In

▶ **Leverage Buyout [page 124]**

- ▶ None of the given options

Question No: 41 (Marks: 1) - Please choose one

Which of the following is NOT among the categories of foreign risk?

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▶ Transaction exposure

▶ Translation exposure

▶ **Local exposure [page 130]**

▶ Economic exposure

Question No: 42 (Marks: 1) - Please choose one

Which of the following is **NOT** an external method to reduce the transaction exposure?

▶ **Invoicing in home currency [page 131]**

▶ Money market hedges

▶ Currency futures

▶ Currency swaps

Question No: 43 (Marks: 1) - Please choose one

Which of the following is the purpose of a Forward Interest Rate Agreement?

▶ **To fix the interest rate**

▶ To estimate the exchange rate

▶ To estimate the interest rate

▶ To fix the foreign exchange rate

Question No: 44 (Marks: 1) - Please choose one

Which of the following statements is **INCORRECT** regarding forward contracts?

▶ Reversing forward contract is difficult.

▶ **Parties have to put an initial margin in forward contracts. [page 136]**

▶ No size restriction is placed in forward contract.

▶ Forward contract is made between parties and each party needs to confirm the credit worthiness of each other.

Question No: 45 (Marks: 1) - Please choose one

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If the exercise price of an option is not favorable than the market price of the underlying item, an option would be termed as:

- ▶ In the money
- ▶ **Out of money [page 139]**
- ▶ At the money
- ▶ None of the given options

Question No: 46 (Marks: 1) - Please choose one

An investor buys 5 options on shares of at a price of Rs 50 per share. Each option consists of 100 shares and premium paid is Rs. 2 per share. What would be the total option cost for investor if the share price is Rs. 55 at the expiry of option?

▶ **Rs. 1,000**

- ▶ Rs. 1,500
- ▶ Rs. 2,500
- ▶ Rs. 25,000

One options contract represents one hundred shares in the underlying stock. The quoted price of an option is per share. The quoted price of a stock option must be multiplied by 100 to get the cost per contract

total share is $5 * 100 = 500$

total cost of option is $500 * 2 = 1,000$

Question No: 47 (Marks: 1) - Please choose one

An investor buys 5 options on shares at a price of Rs 50 per share. Each option consists of 100 shares and premium paid is Rs. 2 per share. What would be the net gain for investor if the share price is Rs. 55 at the expiry of option?

▶ **Rs. 1,500**

- ▶ Rs. 2,500
- ▶ Rs. 1,000

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► Rs. 25,000

total share is $5 * 100 = 500$

total cost of option is $500 * 52 = 26,000$

Total Sale Value = $500 * 55 = 27,500$

Net Gain = $27,500 - 26,000 = 1,500$

Question No: 48 (Marks: 1) - Please choose one

Which of the following is the CORRECT statement regarding the Law of One Price?

► **The law of one price applies to only tradable goods [page 145]**

- The law of one price applies to all goods
- The law of one price applies to immovable goods
- The law of one price applies to services only

Question No: 49 (Marks: 3)

Explain the main features of a forward rate agreement.

A. Features of FRAs:

- It is in between bank and client for fixing future interest rate on notional amount of loan. The loan is for an affirmed period starting on a particular time in future.
- The size of the notional loan or deposit is decided between the bank and the client.
- FRAs are cash settled.
- On settlement date buyer and seller must settle the agreement.
- The FRA rate for three months loan/deposit starting in a 6 months' time is normally expressed as 6v9 FRA.
- The buyer of a FRA agrees to pay fixed interest rate on notional loan. At the same buyer will receive interest on notional loan at standard rate of interest. On the other side, seller of FRA agrees to pay interest on the notional amount at benchmark rate and receives interest at a fixed rate.

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Question No: 50 (Marks: 3)

Differentiate between Management Buyout and Management Buy-In.

Management Buyouts

Management buyouts are similar in all major legal aspects to any other acquisition of a company. The particular nature of the MBO lies in the position of the buyers as managers of the company and the practical consequences that follow from that. In particular, the due diligence process is likely to be limited as the buyers already have full knowledge of the company available to them. The seller is also unlikely to give any but the most basic warranties to the management, on the basis that the management knows more about the company than the sellers do and therefore the sellers should not have to warrant the state of the company. In many cases, the company will already be a private company, but if it is public then the management will take it private.

Management Buy In (MBI):

Management Buy in (MBI) occurs when a manager or a management team from **outside** the company raises the necessary finance buys it and becomes the company's new management. A management buy-in team often competes with other purchasers in the search for a suitable business. Usually, a manager will lead the team with significant experience at managing director level. The difference to a management buy-out is in the position of the purchaser: in the case of a buy-out, they are already working for the company. In the case of a buy-in, however, the manager or management team is from another source.

Question No: 51 (Marks: 5)

Assume that a bookstore uses up cash at a steady rate of Rs.300,000 per year. The interest rate is 3% and each sale of securities costs Rs.20. Determine the optimal cash balance for the bookstore.

Optimal level of cash = $\sqrt{(2FT / I)}$

$$= \sqrt{[(2 \times 20 \times 300,000) / 0.03]}$$

$$= \sqrt{[12000000 / 0.03]}$$

$$= \sqrt{400000000}$$

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= Rs. 20000

Question No: 52 (Marks: 5)

Firm A wants to acquire a private limited company operating in the same industry. What procedure would be followed by the **Firm A** to acquire the target company?

Question No: 53 (Marks: 5)

Why exchange rates of two currencies fluctuate? Explain briefly

Following are some factors for fluctuation:

Relative interest rates: One factor that affects exchange rates is the size of the differential between the real interest rates available to investors in the respective countries. The real interest rate is simply the nominal interest rate available to an investor in a high quality short-term investment subtracted by the country's inflation rate.

Trade imbalances: The size of any trade deficit between two countries will also affect those countries' currency exchange rates. This is because they result in an imbalance of currency reserves among the trading partners.

Political stability: If a country's government becomes unstable due to political gridlock, votes of no confidence, revolution or civil war, confidence can quickly be lost. People become less willing to accept paper currency in exchange for their goods and services, primarily because they're unsure whether they'll be able to pass the paper along to the next person.

Government involvement: The relative value of a country's currency is of great importance to its government. The value of a country's currency affects the wealth of its citizens, the competitiveness of domestically produced goods, the relative cost of the country's labor, and the country's ability to compete. As a result, governments often try to influence the relative value of their country's currencies in a number of different ways, including altering their monetary and fiscal policies, and by directly intervening in the currency markets.

Investors: Perhaps the most powerful factor that can influence exchange rates over short time frames is the role that speculators play. Investors typically have tremendous amounts of capital that they can use to either buy or sell any currency. Consequently, their actions can cause the value of such currency to fluctuate, sometimes quite

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significantly.

FINAL TERM EXAMINATION

Fall 2009

FIN622- Corporate Finance (Session - 1)

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

In 3 years you are to receive Rs.5,000. What will be the effect on the present value of that future amount to you if the interest rates increase suddenly?

- ▶ Remain unchanged
- ▶ Rise
- ▶ **Fall**
- ▶ Can not be determined

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

If you invest Rs.400 today in a savings account paying 8 percent interest per year, how much will you have in the account at the end of three years if the interest is compounded annually?

- ▶ Rs.325
- ▶ Rs.1,299
- ▶ **$Rs.504 = 400 \times 1.08^3$**
- ▶ Rs.609

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

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

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

If the correlation between different stocks is negative or Zero then risk and return profile graph takes on a hook shaped curve and this hook shaped curve is important to understand because it means that it is possible for certain combinations of the portfolio to both reduce risk and increase return.

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

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

- ▶ **Government T-bills**
- ▶ Junk bonds
- ▶ Preferred stock
- ▶ Secured bonds

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

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

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

the betas of neutral stocks (betas close to one) do seem to be invariant to the length of the horizon, the betas of defensive stocks (betas less than one) decline significantly, while those of aggressive stocks (betas greater than one) increase significantly.

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

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

- ▶ **Stock Dividend**
- ▶ Cum Dividend
- ▶ Ex Dividend
- ▶ Extra Dividend

Question No: 7 (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: 8 (Marks: 1) - Please choose one

The National Co. is holding cash to meet the cash needs on a day-to-day basis for normal operations. This is an example of the _____ motive for holding cash.

- ▶ Capital needs
- ▶ **Transactions [page 94]**
- ▶ Precautionary
- ▶ Speculative

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

Currency futures do not provide a clean hedge because:

- ▶ **Contract size is standardized**
- ▶ Settlement date is fixed
- ▶ Currency futures are cash settled
- ▶ Currency futures are available in US\$

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The reason is that **contract size** normally does not equalize the FCY involved. The first step, in establishing hedge, would be to work out the contracts needed to hedge the **currency** exposure. This can be computed by dividing **currency** involved by the **contract size**.

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

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Which of the following is a potential risk associated with a SWAP?

- ▶ **The parties involved in a SWAP may default**
- ▶ SWAP may change floating rates into fixed rates
- ▶ SWAP provide access to the market
- ▶ SWAP may change fixed rates into floating rates

There may be some probability of default by either party before the swap expiry. This can be reduced by transacting with bank or using financial institution as an intermediary.

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

Which of the following is the basis of Purchasing Power Parity Theory?

- ▶ **The Law of one price [page 146]**

- ▶ The Law of demand & supply
- ▶ Efficient market theory
- ▶ Efficient portfolio theory

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

Which of the following will improve a company's working capital management position?

- ▶ **An increase in the credit period allowed by suppliers**

- ▶ An increased level of bad debts
- ▶ An increased debtor collection period
- ▶ An increase in the length of the production process

Question No: 13 (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: 14 (Marks: 1) - Please choose one

How should a successful acquisition be evaluated in the long-run?

- ▶ The acquisition is successful if the acquirer is able to increase its earnings per share (EPS), relative to what it would have been without the acquisition

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- ▶ The acquisition is successful if the acquirer is able to reduce its debt-to-total asset ratio, and hence risk, relative to what it would have been without the acquisition
- ▶ The acquisition is successful if the acquirer is able to diversify its asset base and reduce its overall risk
- ▶ **The acquisition is successful if the market price of the acquirer's stock increases over what it would have been without the acquisition**

Question No: 15 (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: 16 (Marks: 1) - Please choose one

According to the _____ theory of dividends, if the available retained earnings are in excess of the need, the surplus should be distributed as dividends.

- ▶ "Bird-in-the hand"
- ▶ **Residual**
- ▶ Clientele effect
- ▶ Dividend irrelevancy

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

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

- ▶ **Dividend Growth Model**
- ▶ Capital Asset Pricing Model
- ▶ Security Market Line
- ▶ Characteristics Line

Dividend growth model is a valuation method which takes into consideration dividend per share and its expected growth. This model assumes that dividends grow at a constant rate in perpetuity. Thus, it is usually employed during the valuation of companies belonging to for mature and stable industries, having steady dividend growth

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

Which of the following reasons justifies the need for Financial Statement Analysis ?

- ▶ It improves capital budgeting process of the company
- ▶ **It helps improve future planning [doubted]**
- ▶ It helps improve accounting policies of the company
- ▶ It helps improve purchasing policies of the company

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

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The long-term creditors are likely to be least interested in which of the following ratios of a firm?

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

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

How much should you pay for a bond with Rs.1,000 face value, a 10 percent coupon rate, and seven years to maturity if your appropriate discount rate is 8 percent and interest is paid annually?

(Answers are rounded to the nearest dollar)

- ▶ Rs.560
- ▶ Rs.1,000
- ▶ Rs.903
- ▶ **Rs.1,104**

$$\begin{aligned} &= 100 * \{ 1 - [1 / (1 + 0.08)^7] \} / 0.08 + 1000 / (1 + 0.08)^7 \\ &= 100 * 5.2063 + 583.50 \\ &= 1,104 \end{aligned}$$

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

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

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

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

If a bond sells at a high premium, then which of the following relationships holds true? (P represents the price of a bond and YTM is the bond's yield to maturity.)

- ▶ $P < \text{par}$ and $\text{YTM} < \text{the coupon rate}$.
- ▶ $P < \text{par}$ and $\text{YTM} > \text{the coupon rate}$.
- ▶ $P > \text{par}$ and $\text{YTM} > \text{the coupon rate}$.
- ▶ **$P > \text{par}$ and $\text{YTM} < \text{the coupon rate}$.**

Discount Coupon Rate < Current Yield < YTM

Premium Coupon Rate > Current Yield > YTM

Par Value Coupon Rate = Current Yield = YTM

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

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

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

The biggest part of fundamental analysis involves delving into the financial statements. Also known as quantitative analysis, this involves looking at revenue, expenses, assets, liabilities and all the other financial aspects of a company. Fundamental analysts look at this information to gain insight on a company's future performance. But there is more than just number crunching when it comes to analyzing a company. This is where qualitative analysis comes in - the breakdown of all the intangible, difficult-to-measure aspects of a company.

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

The term "Valuation" covers which of the following tasks?

- ▶ Estimating the worth of an asset
- ▶ Estimating the value of a security
- ▶ Estimating the worth of a business
- ▶ **All of the given options [page 75]**

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

In which of the following stage of financial planning process, the financial planner should clearly explain or document the services to be provided ?

- ▶ **Establishing and defining the client-planner relationship [page 78]**
- ▶ Gathering client data, including goals
- ▶ Analyzing and evaluating financial data
- ▶ Developing and presenting financial planning recommendations and/or alternatives

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

Which of the following methods show(s) each major class of gross cash receipts and gross cash payments?

- ▶ **Direct method [page 83]**
- ▶ Indirect method
- ▶ Both direct and indirect method
- ▶ Neither direct nor indirect method

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

Profitability and liquidity move in _____ direction whereas risk and profitability and risk move in _____ direction.

- ▶ Same; inverse
- ▶ **Inverse; same [page 89]**
- ▶ Inverse; opposite

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- ▶ Same; opposite

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

Which of the following illustrates the use of a hedging (maturity matching) approach to financing?

- ▶ **Permanent working capital financed with long-term liabilities**

- ▶ Short-term assets financed with equity
- ▶ All assets financed with 50 percent equity, 50 percent long-term debt mixture
- ▶ Short-term assets financed with long-term liabilities

<http://web.utk.edu/~jwachowi/mcquiz/mc8.html>

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

Which of the following is the correct definition for "spread" in cash management?

- ▶ **The difference between upper limit and lower limit of cash balances [page 96]**

- ▶ The difference between optimal cash balance and Nominal Cash balance
- ▶ The difference between opening cash balance and ending cash balance
- ▶ The difference between optimal cash balance and ending cash balance

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

If the EOQ (Economic Order Quantity) for an item decreases, the average level of inventory will:

- ▶ Increase
- ▶ Remain the same
- ▶ There is no relationship between the EOQ and inventory levels

- ▶ **Decrease**

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

According to Miller-Orr Model for cash management, the upper limits and lower limits of cash balances depends upon:

- ▶ Variance of cash flow
- ▶ Transaction cost
- ▶ Interest rate

- ▶ **All of the given options**

Spread = $3(0.75 \times \text{transaction cost} \times \text{variance of daily cash flows} / \text{daily interest rate})^{1/3}$

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

Which of the following is(are) the way(s) to evaluate the credit worthiness of customer?

- ▶ Financial statement
- ▶ Market reputation
- ▶ Previous payment record
- ▶ **All of the given options [page 104]**

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

In which of the following type of mergers, one firm acquires another firm that is in the same industry but at another stage in the production cycle?

- ▶ Horizontal
- ▶ **Vertical [page 110]**
- ▶ Financial
- ▶ Conglomerate

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

A merger between two companies that sell the same products in different markets, would be known as:

- ▶ **Market-extension merger [page 110]**
- ▶ Product-extension merger
- ▶ Conglomeration
- ▶ None of the given options

Question No: 35 (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: 36 (Marks: 1) - Please choose one

Who among the following can perform as a “white knight” in an antitakeover measure?

- ▶ A corporation
- ▶ A private company
- ▶ A person
- ▶ **All of the given options [page 120]**

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

Which of the following type of exposures can be safeguarded by using hedging instruments?

- ▶ **Transaction exposure [page 130]**
- ▶ Translation exposure
- ▶ Economic exposure
- ▶ None of the given options

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

If the exercise price of an option is not favorable than the market price of the underlying item, an option would be termed as:

- ▶ In the money

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► **Out of money [page 140]**

- At the money
- None of the given options

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

Which of the following statement is INCORRECT regarding Interest Rate Futures?

- These contracts are similar to currency futures.
- These are traded in standardized form on future exchanges.
- **Short Term Interest Rate futures are settled through physical delivery. [page 138]**
- Interest rate future, like currency futures may be settled before the maturity date.

Question No: 40 (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 [page 140]**
- None of the given options

Question No: 41 (Marks: 1) - Please choose one

An investor buys 10 options on shares of at a price of Rs 100 per share. Each option consists of

100 shares and premium paid is Rs. 5 per share. What would be the total gain for investor if the share price is Rs. 110 at the expiry of option?

- **Rs. 5,000**
- Rs. 8,000
- Rs. 10,000
- Rs. 100,000

Price of option = $10 \times 100 \times 100 = 100,000.00$

Premium = $1000 \times 5 = 5000$

Total cost = $105,000.00$

Share price at expiry $1000 \times 110 = 110,000.00$

Gain = $110,000 - 105,000 = 5000.00$

Question No: 42 (Marks: 1) - Please choose one

In the calculations of Interest Rate Option, effective interest is computed by:

- Adding net interest expense and loan amount
- Subtracting loan amount from net interest expense
- Multiplying loan amount from net interest expense
- **Dividing net interest expense by the loan amount**

$(\text{Interest Expense}) + (\text{Cost of Options}) - (\text{Receipt from Option}) = \text{Net Interest Expense.}$

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The next step will be to calculate the effective interest expense, which can be computed by dividing Net Interest Expense by the loan amount. This effective interest rate is less than the rate prevailing in the market

Question No: 43 (Marks: 1) - Please choose one

Which of the following is the risk of loss of control, business may be taken over by the local government or intervention and interference by the local authorities?

- ▶ Interest rate risk
- ▶ Financial risk
- ▶ **Confiscation risk [page 150]**
- ▶ Commercial risk

Question No: 44 (Marks: 1) - Please choose one

Countries with _____ interest rate register capital inflow and result in appreciation in exchange rate.

- ▶ **High**
- ▶ Low
- ▶ Moderate
- ▶ None of the given options

Countries with high interest rate will register capital inflow and will result in appreciation in exchange rate.

Question No: 45 (Marks: 3)

How Discount offers to the customers help in managing the cash by the firms?

Question No: 46 (Marks: 5)

How are dividends paid and how do companies decide on dividend payments?

Question No: 47 (Marks: 5)

The Inventory Manager of a firm has given the following data:

Consumption per Period = $S = 4000$ Units

Economic Order Quantity = $EOQ = 80$ Units

Lead Time = $L = 1$ Month

Stock out Acceptance Factor = $F = 1.10$

Requirement:

Determine the Economic Order Point for the firm.

$EOP = SL + F \sqrt{S \times EOQ \times L}$

Where

S = Consumption per Period

L = Lead Time

F = Stock out Acceptance Factor

EOQ = Economic Order Quantity

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$$EOP = 4000 \times 1 + 1.10 \sqrt{4000 \times 80 \times 1}$$

$$EOP = 4000 + 1.10 \sqrt{320,000}$$

$$EOP = 4000 + 1.10 (565.68)$$

$$EOP = 4000 + 622.25$$

$$EOP = 4622.25$$

Question No: 48 (Marks: 5)

How forward rates are determined in the foreign currency market? Explain briefly

Question No: 49 (Marks: 10)

Exercise Date	Exercise Price	Call Price	Put Price
October 2005	Rs.45	55	65
	Rs.11.45	4.90	1.45
	Rs.1.82	5.30	11.90
January 2006	Rs.45	55	65
	Rs.12.60	6.50	2.78
	Rs.2.70	6.55	12.75
January 2007	Rs.45	55	65
	Rs.16.75	11.35	7.25
	Rs.5.40	9.65	15.45

Refer to the above table determine the following:

a) What will be proceeds and net profits to an investor who sells the October maturity call options

with exercise price of Rs.55 if the stock price at maturity is Rs.40?

b) What will be proceeds and net profits to an investor who sells the October maturity call options

with exercise price of Rs.55 if the stock price at maturity is Rs.70?

c) What will be proceeds and net profits to an investor who sells the October maturity put options

with exercise price of Rs.55 if the stock price at maturity is Rs.40?

Question No: 50 (Marks: 10)

Describe in detail the following anti-takeover tools:

- Poison pill
- Pac-man
- Shark repellent
- Targeted Repurchase

FINAL TERM EXAMINATION

Fall 2008

FIN622- Corporate Finance (Session - 1)

Marks: 81

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

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

- Cost of goods sold increased relative to sales
- Sales increased relative to expenses
- **The tax rate has been increased**
- Dividends were decreased

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

A 30-year corporate bond issued in 1985 would now be traded in which of the following markets?

- Primary capital market.
- Primary money market.
- Secondary money market.
- **Secondary capital market.**

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

A Company's common stock is currently selling at Rs.3.00 per share, its quarterly dividend is Rs.0.07, and the stock is expected to rise to Rs.3.30 in a year. What is its expected rate of return?

- 9.3%
- **19.3%**
- 10.0%
- 11.0%

{Dividend + capital Gain} / Old price

.07 * 4 = .28 + .30 = .58

.58/3 = .1933 = 19.33%

Question No: 4 (Marks: 1) - 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%**
- 12%
- 10%

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

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

- The cost of fixed assets
- The cost of accounts payable

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- Investments
- **Depreciation**

Question No: 6 (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.

Projects with a positive NPV have a return that exceeds the cost of capital

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

A firm with 60% of sales going to variable costs, \$1.5 million fixed costs, and \$500,000 depreciation would show what accounting profit with sales of \$3 million? (Ignore taxes)

- Zero loss
- \$370,000 loss
- \$666,667 loss
- **\$800,000 loss**

Net loss $3,000,000 - (1,800,000 + 1,500,000 + 500,000) = 800,000$

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

Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on this stock?

- 2%
- 3%
- 4%
- **5%**

The dividend yield or the dividend-price ratio on a company stock is the company's annual dividend payments divided by its market cap, or the dividend per share, divided by the price per share. It is often expressed as a percentage

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

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

- 7%
- 8%
- 9%
- **10%**

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$$\text{Capital Gains Yield} = \frac{P_1 - P_0}{P_0}$$

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

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

- **Expected return of A (rA) - Risk free return / Beta of A**
- Expected return of A (rA) Risk free return / required return of A
- Expected return of A (rA) Beta of A / Risk free return
- Risk free return - Expected return of A (rA)/ Beta of A

Reward to Risk = (ER a - ER rf) / BETA a

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

Which of the following transactions would occur in a primary financial market?

- **Initial Public Offering**
- Buying Mutual Funds Certificates
- Selling old shares
- Buying Bonds issued in previous year

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

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

- **Coca Cola**
- PEPSI
- Shezan
- Nestle

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

With respect to a Cash flow statement, Decrease in current assets would be considered as a:

- Cash outflow
- **Cash inflow**
- Sometimes considered as cash outflow and sometime as cash inflow
- Can not be determined

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

In which of the following situations, a company has the ability to pay off its short-term obligations easily?

- **If the company has a positive working capital**
- If the company has a negative working capital
- If the company has a zero working capital
- None of the given option

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

Which of the following describes the hedging approach to financing?

- Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion.
- **Each asset is offset with a financing instrument of the same approximate maturity.**
- Each asset is offset with a put or call option.
- The firm takes out insurance to protect itself against uneven cash flows.

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

Which of the following illustrates the use of a hedging (maturity matching) approach to financing?

- **Permanent working capital financed with long-term liabilities.**
- Short-term assets financed with equity.
- All assets financed with 50 percent equity, 50 percent long-term debt mixture.
- Short-term assets financed with long-term liabilities.

Question No: 17 (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: 18 (Marks: 1) - Please choose one

According to the Miller Model, upper limit for cash balance is equal to which of the following?

- **Lower limit + Spread**
- Spread Lower limit
- Optimal limit + Lower limit
- Lower limit Spread

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

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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: 20 (Marks: 1) - Please choose one

A merger results in a reduction of average production costs. In this case, which of the following is CORRECT?

- The merger must have been conglomerate
- **Economies of scale exist**
- The merger must have been vertical
- The acquired firm had net operating losses

[http://highered.mcgraw-](http://highered.mcgraw-hill.com/sites/0070897824/student_view0/chapter30/multiple_choice_quiz.html)

[hill.com/sites/0070897824/student_view0/chapter30/multiple_choice_quiz.html](http://highered.mcgraw-hill.com/sites/0070897824/student_view0/chapter30/multiple_choice_quiz.html)

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

A firm wants to acquire another firm by purchasing its assets. Which of the following methods firm can use to evaluate the financial aspects of this deal?

- **Replacement cost method**
- Dividend valuation method
- Present value method
- Price earning ratio method

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

Employees buyout occurs through which of the following?

- **Employee stock ownership plan [page 124]**
- Employees dividend scheme
- Employee empowerment scheme
- Employee long-term benefit scheme

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

Which of the following is an example of a management Buy In?

- Management of a Firm-A purchases majority shares from the shareholders
- **Management of a Firm-A acquires majority shares in another Firm-B [page125]**
- Management sale out some assets of the firm
- Management buy some new plants and machinery

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

Which of the following could be a major reason of financial distress for a firm?

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- High dividend payout to shareholders
- Majority shares are being controlled by management
- Majority shares are being controlled by employees
- **Rivalry from competing firms**

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

All of the following could be an outcome of financial distress of a firm **EXCEPT**:

- Employees are leaving the firm
- Suppliers refuse to supply on credit
- Banks do not provide loans
- **Financial markets become instable**

Question No: 26 (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: 27 (Marks: 1) - Please choose one

An option is termed as *in the money* if:

- **The exercise price mentioned in the option is favorable than the market price of the underlying commodity**
 - The exercise price mentioned in the option is not favorable than the market price of the underlying commodity
 - The exercise price mentioned in the option is equal to the market price of the underlying commodity
 - The exercise price mentioned in the option is above the option cost
- If the strike price is more favorable than the current market price of underlying asset or item, the option is termed as "in-the-money."

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

Which of the following would be the net gain for the investor if the market price of underlying shares in an equity option is greater than the strike price and the investor exercise the option?

- **The difference between the market price on underlying shares and the strike price less option cost**
- The difference between exercise price and the market price of the underlying shares plus option cost
- The difference between option cost and strike price
- The difference between exercise price and market price

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

Which one of the following statements is CORRECT regarding currency options?

- In a currency option, the seller has the right to sell currency
- **In a currency option, the holder has the right to sell/buy currency [page 142]**
- In a currency option, the seller has the right to buy currency
- In a currency option, the holder has the obligation to buy

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

A currency option will NOT be exercised if:

- The exchange rate is above the agreed rate
- **The exchange rate is below the agreed rate**
- The exchange rate is equal to the agreed rate
- The exchange rate is equal to the option cost

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

Which one of the following statements is CORRECT regarding option cost?

- Option cost is paid by the option writer to option seller
- Option cost is paid by the option writer to option holder
- **Option cost is paid by the option holder to option seller**
- Option cost is paid by the option seller to option writer

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

Which of the following is a potential risk associated with a SWAP?

- **The parties involved in a SWAP may default [page 144]**
- SWAP may change floating rates into fixed rates
- SWAP provide access to the market
- SWAP may change fixed rates into floating rates

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

Which of the following situations would result in weakening the local currency against a foreign currency?

- Demand for foreign currency decreases
- Supply of local currency decreases
- Demand & Supply are in balance
- **Demand for foreign currency increases**

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

Which of the following would be consistent with an aggressive approach to financing working capital?

- Financing short-term needs with short-term funds
- Financing permanent inventory buildup with long-term debt
- Financing seasonal needs with short-term funds

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- **Financing some long-term needs with short-term funds**

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

Identify the INCORRECT statement in connection with working capital management.

- The objectives of working capital management are profitability and liquidity
- **Long-term funds are more expensive than short-term funds but also riskier**
- Aggressive financing policies increase profitability at the cost of higher risk
- Conservative financing policies use short-term funds to finance only part of fluctuating current assets

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

All of the following are TRUE regarding the investing activity section of the cash flow statement **EXCEPT**:

- Investing activities include the purchase and sale of income-producing assets
- Selling off capital assets may be good news if the company is getting rid of unprofitable divisions
- **Large purchases of capital assets may signal an emergency**
- Investing activities require analysis of long-term asset accounts

http://cwx.prenhall.com/bookbind/pubbooks/horngren_ca/chapter17/multiple1/deluxe-content.html

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

Which of the following is a reason for high P/E ratio of a company?

- Low profit & losses mix in recent past
- Expected future losses
- Low security
- **High Share prices due to a takeover bid. [page 117]**

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

Which of the following formulas can be used to calculate the value of the firm while considering merger/acquisition?

- Value of all-equity financed firm + FV of tax benefits + Expected Bankruptcy Costs
- **Value of all-equity financed firm + PV of tax benefits + Expected Bankruptcy Costs [page 116]**
- Value of all-equity financed firm + tax benefits + Expected Bankruptcy Costs
- Value of all-equity financed firm + Expected Bankruptcy Costs

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

Suppose that a firm sells goods on terms of 2/10, net 20. On March 1, 2008 you buy goods from the company with an invoice value of Rs.50, 000. How much discount would

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you get, if you took the cash discount?

- **Rs. 1,000**
- Rs. 2,000
- Rs. 4,000
- Rs. 5,000

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

All of the following are the methods to evaluate the credit worthiness in business

EXCEPT:

- Market reputation
- Previous payment record
- **Production plant capacity [page 104]**
- Financial strength

Question No: 41 (Marks: 1) - Please choose one

Total credit cost curve consists of which of the following?

- Total of ordering cost and the opportunity cost of credit policy
- **Total of carrying cost and the opportunity cost of credit policy [page 105]**
- Total of opportunity cost of credit policy and the bad debts
- Total of production cost and the cost of credit policy

Question No: 42 (Marks: 1) - Please choose one

Which of the following is the most common reason for a capital expenditure?

- Safety device installation
- **Expansion**
- Renewal
- Replacement

Question No: 43 (Marks: 3)

How the following shall effect the size of the firm s optimal investment in current assets?

- a. The interest rate rises from 6% to 8%.
- b. A just in time inventory system is introduced that reduces the risk of inventory shortages.
- c. Customers pressure the firm for a more lenient credit sales policy.

Question No: 44 (Marks: 3)

Give at least three reasons of merger failure and explain each of them briefly.

Question No: 45 (Marks: 3)

An American exporter sold goods worth \$1,000,000 to a Pakistani importer. What type of currency risk would American exporter face, if Pakistani importer promises to pay the amount after three months? Explain.

Question No: 46 (Marks: 5)

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How are dividends paid and how do companies decide on dividend payments?

Question No: 47 (Marks: 5)

What do you understand by leverage buy outs? Explain briefly

Question No: 48 (Marks: 10)

The Green Company has developed the following estimates (in millions) of its current and fixed asset investment for each of the next four quarters:

QUARTER FIXED ASSETS CURRENT ASSETS

1 Rs.30 Rs.20

2 30 24

3 30 28

4 32 16

Green Co. has found that payables and accruals equal 25 percent of the current assets. It currently has Rs.20 million in equity with the balance of its long-term funds coming from debt. Devise a financing plan for Green based on the hedging approach.

Question No: 49 (Marks: 10)

Describe in detail the various ways of commencing international operations by Multinational corporations.

If EOQ = 1,000 units, order costs are Rs.200 per order, and sales total 5,000 units, what is the carrying cost per unit?

► **Rs.2**

► Rs.10

► Rs.100

► Rs.1000

$EOQ = \sqrt{2(O)(S)/C}$

$1,000 = \sqrt{2(\$200)(5,000)/C}$

$1,000,000 = 2(\$200)(5,000)/C$

$1,000,000/C$. Thus,

$C = 2M / 1M = \$2$.

What would happen to the debt equity ratio if a company does not pay all the profit to shareholders in the form of dividend ?

► It will remain unchanged

► **It will change**

► Debt equity ratio has no relation with the payment of dividends

► None of the given options

Residual Dividend Policy

If a company does not pay all the profit to shareholders in the form of dividend then the debt equity ratio will change. In this section we will assume that company do have some potential opportunities and will finance these opportunities first and any remainder profit will be paid as dividend and the debt equity ratio will be held constant.

An approach that suggests that a firm pay dividends only if there are no potential

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opportunities for expansion or there's some profit left after financing the potential opportunities, represents residual dividend policy.

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

ROI / NPM = TAT

.08 / .05 = 1.6

TAT * TA = SALES

1.6 * 300,000 = 480,000

FINAL TERM EXAMINATION

Fall 2009

FIN622- Corporate Finance (Session - 1)

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

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

► Initial Public Offering

► **Private Placement**

► Direct Public Offering

► Primary Offering

Question No: 2 (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

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

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

A Company's common stock is currently selling at Rs.3.00 per share, its quarterly dividend is Rs.0.07, and the stock is expected to rise to Rs.3.30 in a year. What is its expected rate of return?

► 9.3%

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► 19.3%

► 10.0%

► 11.0%

{Dividend + capital Gain} / Old price

.07 * 4 = .28 + .30 = .58

.58/3 = .1933 = 19.33%

http://worldacademyonline.com/article/24/345/what_is_the_expected_return_on_common_stock_.html

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

Which of the following is a main purpose of the Sensitivity Analysis?

- To find out the optimal level of capital budget.
- To find out that how price changes affect break-even volume.
- To find out the seasonal variation in product demand.
- **To find out that how variables in a project affect profitability**

[http://highered.mcgraw-](http://highered.mcgraw-hill.com/sites/0073382302/student_view0/chapter10/chapter_quiz.html)

[hill.com/sites/0073382302/student_view0/chapter10/chapter_quiz.html](http://highered.mcgraw-hill.com/sites/0073382302/student_view0/chapter10/chapter_quiz.html)

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

Which of the following refers to the budgetary constraint placed by a firm on its investment projects?

- **Capital rationing**
- Working capital management
- Cash budgeting
- None of the given options

[http://highered.mcgraw-](http://highered.mcgraw-hill.com/sites/0073027200/student_view0/chapter12/multiple_choice_quiz.html)

[hill.com/sites/0073027200/student_view0/chapter12/multiple_choice_quiz.html](http://highered.mcgraw-hill.com/sites/0073027200/student_view0/chapter12/multiple_choice_quiz.html)

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

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

- **Degree of operating leverage**
- Degree of profit leverage
- Degree of total leverage
- Degree of financial leverage

DOL (Degree of Operating Leverage) is a quantitative measure of the “sensitivity” of a firm’s operating profit to a change in the firm’s sales. The closer that a firm operates to its break-even point, the higher is the absolute value of its DOL. When comparing firms, the firm with the highest DOL is the firm that will be most “sensitive” to a change in sales. The DOL percentage in change in a firm’s EBIT resulting from a 1 percent change in quantity (sales):

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

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

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- ▶ 4%
- ▶ 5%
- ▶ **6% [10-6]**
- ▶ 7%

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

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

- ▶ WACC of a levered firm is greater than that of an un-levered firm
- ▶ **WACC of a levered firm is lesser than that of an un-levered firm**
- ▶ WACC of a levered firm is equal to that of an un-levered firm
- ▶ An Un-levered firm has zero WACC.

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

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

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

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

What will be the taxable income of an Un-levered firm, if it has Earning Before Interest and Tax (EBIT) equal to Rs.50,000, and its tax rate is 35%?

- ▶ Rs.25,000
- ▶ Rs.45,000
- ▶ **Rs.50,000**
- ▶ Rs.60,000

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

Which of the following statements is **TRUE** regarding temporary working capital?

- ▶ **Temporary working capital varies with seasonal requirements.**
- ▶ Temporary working capital is the constant component of working capital.
- ▶ Temporary working capital excludes inventories.
- ▶ Temporary working capital should be financed with bonds or common stock

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

All of the following factors must be considered while making short-term investments **EXCEPT**:

- ▶ Liquidity
- ▶ Safety
- ▶ Profitability
- ▶ **Inventory**

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

All of the following can be used as hedging tool against interest rate risk **EXCEPT**:

- ▶ Forward rate agreements
- ▶ Interest rate futures
- ▶ Interest rate options
- ▶ **Currency futures**

http://books.google.com.pk/books?id=bcunXnIFfWUC&printsec=frontcover&dq=%22hedging+tool+against+interest+rate+risk%22&source=bl&ots=a9oVZzYA8K&sig=CNeO_m9kZlvhX7gIrj-RvA1lxNU&hl=en&ei=bYFRTYbwH86UOtTM_eIH&sa=X&oi=book_result&ct=result&resnum=8&ved=0CE4Q6AEwBw#v=onepage&q&f=false

Question No: 14 (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: 15 (Marks: 1) - Please choose one

Which of the following would be consistent with an aggressive approach to financing working capital?

- ▶ Financing short-term needs with short-term funds
- ▶ Financing permanent inventory buildup with long-term debt
- ▶ Financing seasonal needs with short-term funds
- ▶ **Financing some long-term needs with short-term funds**

Ref: <http://web.utk.edu/~jwachowi/mcquiz/mc8.html>

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

The restructuring of a firm should be undertaken if :

- ▶ The restructuring is expected to increase earnings per share (EPS) next year
- ▶ **The restructuring is expected to create value for shareholders**
- ▶ The restructuring is expected to increase the firm's market share power within the industry
- ▶ The current employees will receive additional stock options to align employee interest

ref: Q#3

http://wps.pearsoned.co.uk/ema_uk_he_wachowicz_fundfinman_12/26/6681/1710459.cw/-/1710461/index.html

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

Which of the following is **NOT** a reason for determining shares value in mergers and acquisitions?

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► To impede the anti takeover bid of the predator company

- To set up the terms of takeovers
- To value the company for stock exchange listing
- To value shares – for establishing value of share of retiring directors

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

Which of the following is a reason for high P/E ratio of a company?

- Low profit & losses mix in recent past
- Expected future losses
- Low security
- **High Share prices due to a takeover bid.**

Ref:

High P/E ratio may be due to:

- The company may be experiencing consistent growth over the recent past years.
- Based on some future expectations
- Share price may have gone up in wake of takeover bid.
- High security shares

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

Expansion of credit period by a firm involves which of the following types of risk?

- Additional cost of production
- **Additional cost of funds and bad debts [page 106]**
- Additional cost of advertising
- Additional cost of business

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

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

- Rs.177
- Rs.362
- Rs.425
- **Rs.671**

Reference:

$$PV_{oa} = PMT [(1 - (1 / (1 + i)^n)) / i]$$

$$PV_{oa} = 100 [(1 - (1 / (1 + 0.08)^{10})) / 0.08]$$

$$PV_{oa} = 100 [(1 - (1 / (1.08)^{10})) / 0.08]$$

$$PV_{oa} = 100 [(1 - (1 / (2.158924997))) / 0.08]$$

$$PV_{oa} = 100 [(1 - 0.463193488) / 0.08]$$

$$PV_{oa} = 100 [0.536806512 / 0.08]$$

$$PV_{oa} = 100 [6.7100]$$

$$P_{voa} = 671$$

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

Which of the following refers to the value at which an asset is carried on a balance sheet?

- ▶ **Book Value**
- ▶ Market Value
- ▶ Fair Value
- ▶ Liquidation Value

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

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

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

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

Which of the following is not one of the kinds of dividend policies in practice?

- ▶ Residual dividend policy
- ▶ Dividend growth policy
- ▶ Premium dividend policy
- ▶ **Discount dividend policy**

- residual dividend policy;
- stable or dividend growth policy;
- stable net profit/dividend payment ratio dividend policy;
- Premium dividend policy.

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

Which of the following functions behind budget activity refers to monitoring, comparing information to a standard and taking corrective action?

- ▶ Planning
- ▶ **Control [page 78]**
- ▶ Management
- ▶ None of the given options

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

Which of the following methods show(s) each major class of gross cash receipts and gross cash payments?

- ▶ **Direct method**
- ▶ Indirect method
- ▶ Both direct and indirect method
- ▶ Neither direct nor indirect method

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The **direct method** shows each major class of gross cash receipts and gross cash payments

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

Which of the following method adjust(s) accrual basis net profit or loss for the effects of non-cash transactions?

- ▶ Direct method
- ▶ **Indirect method**
- ▶ Both direct and indirect method
- ▶ Neither direct nor indirect method

The **indirect method** adjusts accrual basis net profit or loss for the effects of non-cash transactions.

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

Mr. Saleem buys inventory on credit on Jan. 01, 2009 worth Rs.10,000 settle the creditor on Mar. 01, 2009. After a month (on Apr. 01, 2009), a debtor buys finished goods Rs.14,000 and pays for that on May 15, 2009. What is the operating cycle in the given scenario?

- ▶ 60 days
- ▶ 90 days
- ▶ 120 days
- ▶ **135 days**

Operating Cycle = age of inventory + collection period.

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

In deciding the optimal level of current assets for the firm, management is confronted with _____.

- ▶ **A trade-off between profitability and risk**
- ▶ A trade-off between liquidity and risk
- ▶ A trade-off between equity and debt
- ▶ A trade-off between short-term versus long-term borrowing

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

Mr. John Smith has changed the working capital policy of his company recently. As a result, the liquidity for the company has increased but a decrease in profitability has been observed alongside. From this information, we can conclude that the company must have changed his working capital policy from _____ to _____.

- ▶ Conservative; Aggressive
- ▶ Conservative; Moderate
- ▶ **Aggressive; Conservative**
- ▶ Moderate; Aggressive

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

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

- ▶ High liquidity; high profitability; high risk
- ▶ **High liquidity; low profitability; low risk [page 89]**
- ▶ Low liquidity; low profitability; high risk
- ▶ Low liquidity; high profitability; high risk

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

Under which of the following concepts, each asset is offset with a financing instrument of the same maturity?

- ▶ M&M proposition
- ▶ Clientele effect
- ▶ **Hedging approach [page 90]**
- ▶ Baumol Model

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

Which of the following are properly managed by a good Cash Management System?

- ▶ Collections, disbursements, cash balances, and capital investment
- ▶ **Collections, disbursements, cash balances, and marketable securities investment**
- ▶ Only collections, disbursements, and cash balances
- ▶ Only collections and disbursements

With timely information reporting, a firm can generate significant income by properly managing collections, disbursements, cash balances, and marketable securities investment.

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

Which of the following is equal to Stock out cost?

- ▶ **Carrying cost \times Safety stock**
- ▶ Holding cost \times Carrying cost
- ▶ Reordering cost \times Safety stock
- ▶ Carrying cost \times Reordering cost

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

Which of the following term refers to the minimum inventory amount needed for an item?

- ▶ Stock-out
- ▶ Buffer Stock
- ▶ Holding Stock
- ▶ **Safety Stock**

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

Suppose you have made a purchase of Rs. 50,000 today on terms of 2/10, net 30. How much would you need to pay if you pay after seven days of purchase?

- ▶ **Rs. 49,000**

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- ▶ Rs. 5,000
- ▶ Rs. 10,000
- ▶ Rs. 35,000

$50,000 \times 0.02 = 1000$

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

“Two companies A & B have been acquired by a brand new company C.” This information refers to which of the following terms?

- ▶ Purchase mergers
- ▶ **Consolidation mergers**
- ▶ New mergers
- ▶ Brand mergers

Consolidation Mergers - With this merger, a brand new company is formed and both companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger.

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

Which of the following is(are) required to be decided while considering acquisition?

- ▶ Whether shares or assets to be purchased
- ▶ Type of consideration
- ▶ Share valuation issues
- ▶ **All of the given options [page 114]**

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

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

- ▶ **Replacement cost method [page 118]**
- ▶ Dividend valuation method
- ▶ Present value method
- ▶ Price earning ratio method

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

“The managers of ABC Company are going to buy majority shares of the XYZ Company.” This practice demonstrates which of the following acquisition types?

- ▶ Management Buyout
- ▶ **Management Buy-In**
- ▶ Leverage Buyout
- ▶ None of the given options

Management Buy in (MBI) occurs when a manager or a management team from outside the company raises the necessary finance buys it and becomes the company's new management

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

Which of the following is(are) the type(s) of re-organization?

- ▶ Conversion of debt to equity or vice versa
- ▶ Conversion of equity from one class to other

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- ▶ Conversion of debt from one class to another

- ▶ **All of the given options [page 128]**

Question No: 41 (Marks: 1) - Please choose one

Which of the following statements is **CORRECT** regarding currency futures?

- ▶ **Currency futures are forward contracts traded on future and option exchanges [page 133]**

- ▶ Currency future is a money market hedging techniques
- ▶ Currency futures are traded in the stock market
- ▶ Currency futures are regularized by mutual funds

Question No: 42 (Marks: 1) - Please choose one

Which of the following statements is **INCORRECT** regarding forward contracts?

- ▶ Reversing forward contract is difficult.
- ▶ **Parties have to put an initial margin in forward contracts. [page 136]**
- ▶ No size restriction is placed in forward contract.
- ▶ Forward contract is made between parties and each party needs to confirm the credit worthiness of each other.

Question No: 43 (Marks: 1) - Please choose one

If the exercise price mentioned in the option is favorable than the market price of the underlying commodity, an option would be termed as:

- ▶ **In the money [page 139]**
- ▶ Out of money
- ▶ At the money
- ▶ None of the given options

Question No: 44 (Marks: 1) - Please choose one

An investor buys 10 options on shares of at a price of Rs 100 per share. Each option consists of 100 shares and premium paid is Rs. 5 per share. What would be the net gain n for investor if the share price is Rs. 110 at the expiry of option?

- ▶ **Rs. 5,000**
- ▶ Rs. 8,000
- ▶ Rs. 10,000
- ▶ Rs. 100,000

Price of option = $10 \times 100 \times 100 = 100,000$

Premium = $1000 \times 5 = 5000$

Total cost = 105,000

Share price at expiry $1000 \times 110 = 110,000$

Gain = $110,000 - 105,000 = 5000$

Question No: 45 (Marks: 3)

Taylor Industries needs to raise funds on a short-term basis. One alternative is to borrow

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from the bank at an 18 percent annual interest rate, while the second involves foregoing cash discounts from a supplier whose trade credit terms are 2/10, net 60. Which alternative has the lower effective interest cost (assume a 360 day year)?

Question No: 46 (Marks: 5)

Assume that a bookstore uses up cash at a steady rate of Rs.300,000 per year. The interest rate is 3% and each sale of securities costs Rs.20. Determine the optimal cash balance for the bookstore.

Question No: 47 (Marks: 5)

How a hedge could be established with a currency option? Briefly explain.

Question No: 48 (Marks: 5)

Briefly describe the role of “white knight” as an anti-takeover tool?

Question No: 49 (Marks: 10)

Thermo Products, a manufacturer of solar heating panels, is currently selling Rs.6 million annually to dealers on 30-day credit terms. Management believes that sales could be increased by changing its credit policy. The firm's present collection period is 30 days and it is presently considering the following credit policies:

Policy	Average Collection Period	Expected Annual Sales
A	45 days	Rs.6.6 million
B	60 days	7.0 million
C	90 days	7.2 million

Requirement:

If the firm's variable costs average 75 percent and its opportunity cost of funds is 20 percent, which policy should be adopted? (*Assume a 360-day year.*)

Question No: 50 (Marks: 10)

Suppose your firm is planning to issue long-term bonds in nine months. It is expected that the interest rates may increase in the meantime. To tackle with this, the company is considering using Financial Futures.

Required:

1. Describe the term ‘Hedging’.
2. Describe the mechanism of Financial Futures.
3. How Financial Futures could be helpful for your firm to hedge against general rise in interest rate? Explain.

FINAL TERM EXAMINATION

Spring 2009

FIN622 Corporate Finance

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

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

- Cost of goods sold increased relative to sales
- Sales increased relative to expenses
- **The tax rate has been increased**
- Dividends were decreased

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

A 30-year corporate bond issued in 1985 would now be traded in which of the following markets?

- Primary capital market.
- Primary money market.
- Secondary money market.
- **Secondary capital market.**

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

A Company's common stock is currently selling at Rs.3.00 per share, its quarterly dividend is Rs.0.07, and the stock is expected to rise to Rs.3.30 in a year. What is its expected rate of return?

- 9.3%
- **19.3%**
- 10.0%
- 11.0%

Question No: 4 (Marks: 1) - 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%**
- 12%
- 10%

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

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

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

Question No: 6 (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: 7 (Marks: 1) - Please choose one

A firm with 60% of sales going to variable costs, \$1.5 million fixed costs, and \$500,000 depreciation would show what accounting profit with sales of \$3 million? (Ignore taxes)

- Zero loss
- \$370,000 loss
- \$666,667 loss
- **\$800,000 loss**

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

Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on this stock?

- 2%
- 3%
- 4%
- **5%**

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

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

- 7%
- 8%
- 9%
- **10%**

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

Mr. Saleem buys inventory on credit on Jan. 01, 2009 worth Rs.10,000 settle the creditor on Mar. 01, 2009. After a month (on Apr. 01, 2009), a debtor buys finished goods Rs.14,000 and pays for that on May 15, 2009. What is the operating cycle in the given scenario?

- 60 days
- 90 days
- 120 days
- **135 days**

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

Which of the following transactions would occur in a primary financial market?

- **Initial Public Offering**
- Buying Mutual Funds Certificates
- Selling old shares
- Buying Bonds issued in previous year

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

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

- **Coca Cola**
- PEPSI
- Shezan
- Nestle

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

With respect to a Cash flow statement, Decrease in current assets would be considered as a:

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- Cash outflow
- **Cash inflow**
- Sometimes considered as cash outflow and sometime as cash inflow
- Can not be determined

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

In which of the following situations, a company has the ability to pay off its short-term obligations easily?

- **If the company has a positive working capital**
- If the company has a negative working capital
- If the company has a zero working capital
- None of the given option

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

Which of the following describes the hedging approach to financing?

- Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion.
- **Each asset is offset with a financing instrument of the same approximate maturity.**
- Each asset is offset with a put or call option.
- The firm takes out insurance to protect itself against uneven cash flows.

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

Identify the INCORRECT statement in connection with working capital management.

- The objectives of working capital management are profitability and liquidity
- **Long-term funds are more expensive than short-term funds but also riskier**
- Aggressive financing policies increase profitability at the cost of higher risk
- Conservative financing policies use short-term funds to finance only part of fluctuating current asset

Question No: 17 (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

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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: 18 (Marks: 1) - Please choose one

According to the Miller Model, upper limit for cash balance is equal to which of the following?

- **Lower limit + Spread**
- Spread-Lower limit
- Optimal limit + Lower limit
- Lower limit-Spread

Question No: 19 (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: 20 (Marks: 1) - Please choose one

A merger results in a reduction of average production costs. In this case, which of the following is CORRECT?

- The merger must have been conglomerate
- **Economies of scale exist**
- The merger must have been vertical
- The acquired firm had net operating losses

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

A firm wants to acquire another firm by purchasing its assets. Which of the following

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methods firm can use to evaluate the financial aspects of this deal?

- **Replacement cost method**
- Dividend valuation method
- Present value method
- Price earning ratio method

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

Employees buyout occurs through which of the following?

- **Employee stock ownership plan**
- Employees dividend scheme
- Employee empowerment scheme
- Employee long-term benefit scheme

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

Which of the following is an example of a management Buy In?

- Management of a Firm-A purchases majority shares from the shareholders
- **Management of a Firm-A acquires majority shares in another Firm-B**
- Management sale out some assets of the firm
- Management buy some new plants and machinery

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

Which of the following could be a major reason of financial distress for a firm?

- High dividend payout to shareholders
- Majority shares are being controlled by management
- Majority shares are being controlled by employees
- **Rivalry from competing firms**

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

All of the following could be an outcome of financial distress of a firm EXCEPT:

- Employees are leaving the firm
- Suppliers refuse to supply on credit
- Banks do not provide loans
- **Financial markets become instable**

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Question No: 26 (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: 27 (Marks: 1) - Please choose one

An option is termed as in the money if:

- **The exercise price mentioned in the option is favorable than the market price of the underlying commodity**
- The exercise price mentioned in the option is not favorable than the market price of the underlying commodity
- The exercise price mentioned in the option is equal to the market price of the underlying commodity
- The exercise price mentioned in the option is above the option cost

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

Which of the following would be the net gain for the investor if the market price of underlying shares in an equity option is greater than the strike price and the investor exercise the option?

- **The difference between the market price on underlying shares and the strike price less option cost**
- The difference between exercise price and the market price of the underlying shares plus option cost
- The difference between option cost and strike price
- The difference between exercise price and market price

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

Which one of the following statements is CORRECT regarding currency options?

- In a currency option, the seller has the right to sell currency
- **In a currency option, the holder has the right to sell/buy currency**
- In a currency option, the seller has the right to buy currency
- In a currency option, the holder has the obligation to buy

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

Suppose you have made a purchase of Rs. 50,000 today on terms of 2/10, net 30. How much would you need to pay if you pay after seven days of purchase?

- **Rs. 49,000**
- Rs. 5,000
- Rs. 10,000
- Rs. 35,000

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

Which one of the following statements is CORRECT regarding option cost?

- Option cost is paid by the option writer to option seller
- Option cost is paid by the option writer to option holder
- **Option cost is paid by the option holder to option seller**
- Option cost is paid by the option seller to option writer

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

Which of the following is a potential risk associated with a SWAP?

- **The parties involved in a SWAP may default**
- SWAP may change floating rates into fixed rates
- SWAP provide access to the market
- SWAP may change fixed rates into floating rates

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

Which of the following situations would result in weakening the local currency against a foreign currency?

- Demand for foreign currency decreases
- Supply of local currency decreases
- Demand & Supply are in balance
- **Demand for foreign currency increases**

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

What would happen to the debt equity ratio if a company does not pay all the profit to shareholders in the form of dividend ?

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- It will remain unchanged
- **It will change**
- Debt equity ratio has no relation with the payment of dividends
- None of the given options

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

Inventory between various stages of production is known as:

- Balanced goods inventory
- Raw materials inventory
- **Work in Process inventory**
- Finished goods inventory

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

All of the following are TRUE regarding the investing activity section of the cash flow statement EXCEPT:

- Investing activities include the purchase and sale of income-producing assets
- Selling off capital assets may be good news if the company is getting rid of unprofitable divisions
- **Large purchases of capital assets may signal an emergency**
- Investing activities require analysis of long-term asset accounts

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

Which one of the following will precede "FEEDBACK" in the financial planning process?

- Choosing a strategy
- Implementation of the plan
- **Comparing budgeted and actual results**
- Taking corrective measures

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

Which of the following formulas can be used to calculate the value of the firm while considering merger/acquisition?

- Value of all-equity financed firm + FV of tax benefits + Expected Bankruptcy Costs
- **Value of all-equity financed firm + PV of tax benefits + Expected Bankruptcy Costs**
- Value of all-equity financed firm + tax benefits + Expected Bankruptcy Costs
- Value of all-equity financed firm + Expected Bankruptcy Costs

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

Suppose that a firm sells goods on terms of 2/10, net 20. On March 1, 2008 you buy goods from the company with an invoice value of Rs.50, 000. How much discount would you get, if you took the cash discount?

- **Rs. 1,000 [50000x.02]**
- Rs. 2,000
- Rs. 4,000
- Rs. 5,000

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

All of the following are the methods to evaluate the credit worthiness in business EXCEPT:

- Market reputation
- Previous payment record
- **Production plant capacity**
- Financial strength

Question No: 41 (Marks: 1) - Please choose one

Total credit cost curve consists of which of the following?

- Total of ordering cost and the opportunity cost of credit policy
- **Total of carrying cost and the opportunity cost of credit policy**
- Total of opportunity cost of credit policy and the bad debts
- Total of production cost and the cost of credit policy

Question No: 42 (Marks: 1) - Please choose one

Which of the following is the most common reason for a capital expenditure?

- Safety device installation
- **Expansion**
- Renewal
- Replacement

Question No: 43 (Marks: 3)

How the following shall effect the size of the firm s optimal investment in current assets?

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- a. The interest rate rises from 6% to 8%.
- b. A just in time inventory system is introduced that reduces the risk of inventory shortages.
- c. Customers pressure the firm for a more lenient credit sales policy.

Question No: 44 (Marks: 3)

Give at least three reasons of merger failure and explain each of them briefly.

Question No: 45 (Marks: 3)

An American exporter sold goods worth \$1,000,000 to a Pakistani importer. What type of currency risk would American exporter face, if Pakistani importer promises to pay the amount after three months? Explain.

Question No: 46 (Marks: 5)

How are dividends paid and how do companies decide on dividend payments?

Question No: 47 (Marks: 5)

What do you understand by leverage buy outs? Explain briefly

Question No: 48 (Marks: 10)

The Green Company has developed the following estimates (in millions) of its current and fixed asset investment for each of the next four quarters:

QUARTER FIXED ASSETS CURRENT ASSETS

1 Rs.30 Rs.20

2 30 24

3 30 28

4 32 16

Green Co. has found that payables and accruals equal 25 percent of the current assets. It currently has Rs.20 million in equity with the balance of its long-term funds coming from debt. Devise a financing plan for Green based on the hedging approach.

Question No: 49 (Marks: 10)

Describe in detail the various ways of commencing international operations by Multinational corporations.

FINAL TERM EXAMINATION

Fall 2009

FIN622- Corporate Finance (Session - 5)

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

Last year ABC Company had a 9.00% net profit margin based on Rs.22,000,000 in sales and Rs.15,000,000 of total assets. During the coming year, the president has set a goal of attaining a 14% return on total assets. How much must firm sales equal, other things

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being the same, for the goal to be achieved?

- ▶ Rs.22,000,000
- ▶ Rs.26,722,967
- ▶ Rs.25,603,667
- ▶ **Rs.23,333,333**

$$\text{ROA} = \text{NI}/\text{TA}$$

$$0.14 = (\text{NI})/(15,000,000)$$

$$(0.14)(15,000,000) = \text{NI}$$

$$\text{NI} = 2,100,000$$

$$\text{NPM} = \text{NI}/\text{Sales}$$

$$0.09 = (2,100,000)/\text{Sales}$$

$$0.09\text{Sales} = 2,100,000$$

$$\text{Sales} = (2,100,000)/(0.09) = 23,333,333$$

Question No: 2 (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%. What are its sales?

- ▶ Rs.3,750,000
- ▶ **Rs.480,000**
- ▶ Rs.300,000
- ▶ Rs.1,500,000

$$\text{ROI} / \text{NPM} = \text{TAT}$$

$$.08 / .05 = 1.6$$

$$\text{TAT} * \text{TA} = \text{SALES}$$

$$1.6 * 300,000 = 480,000$$

Question No: 3 (Marks: 1) - 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.

[http://highereducation.mcgraw-](http://highereducation.mcgraw-hill.com/sites/0073382302/student_view0/chapter11/chapter_quiz.html)

[hill.com/sites/0073382302/student_view0/chapter11/chapter_quiz.html](http://highereducation.mcgraw-hill.com/sites/0073382302/student_view0/chapter11/chapter_quiz.html)

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

Which one of the following will precede "FEEDBACK" in the financial planning process?

- ▶ Choosing a strategy
- ▶ Implementation of the plan
- ▶ **Comparing budgeted and actual results**
- ▶ Taking corrective measures

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

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

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► **Sales budget**

- Master budget
- Production cost budget
- Cash budget

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

Which of the following is prepared by combining all the functional budgets?

- A cash budget
- A sales budget
- **A master budget**
- A production budget

Master budget is a consolidated budget prepared by combining the summaries of all the functional budgets.

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

Which of the following is closely related to a sales budget?

- Miscellaneous income
- Future profits
- Cash outflow
- **Cash inflow**

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

Which of the following describes the hedging approach to financing?

► Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion.

► **Each asset is offset with a financing instrument of the same approximate maturity.**

- Each asset is offset with a put or call option.
- The firm takes out insurance to protect itself against uneven cash flows.

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

The merger of the two computer manufacturing firms, Compaq and Dell Corporation, would be classified as which of the following types of merger?

- **Horizontal merger**
- Monopolistic merger
- Conglomerate merger
- Vertical merger

Horizontal merger - Two companies that are in direct competition and share the same product lines and markets

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

Which of the following statements applies to employees' buyout?

- Employees are promoted to the higher positions
- Employees are given more responsibilities
- **Employees buy majority shares in the firm**

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- ▶ Employees buy shares of a competing firm

A restructuring strategy in which employees buy a majority stake in their own firms. This form of buyout is often done by firms looking for an alternative to a leveraged buyout

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

Which of the following is a firm level cause of financial distress?

- ▶ Bargaining power of suppliers
- ▶ Difficulty in producing quality products
- ▶ Intensive market competition
- ▶ **Difficulty in cash flow generation [page 127]**

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

All of the following could be an outcome of financial distress of a firm **EXCEPT**:

- ▶ Employees are leaving the firm
- ▶ Suppliers refuse to supply on credit
- ▶ Banks do not provide loans
- ▶ **Financial markets become instable**

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

Currency futures do not provide a clean hedge because:

- ▶ **Contract size is standardized**
- ▶ Settlement date is fixed
- ▶ Currency futures are cash settled
- ▶ Currency futures are available in US\$

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

Which one of the following statements is CORRECT regarding Options Contracts?

▶ **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: 15 (Marks: 1) - Please choose one

Which of the following is the basis of Purchasing Power Parity Theory?

▶ **The Law of one price**

- ▶ The Law of demand & supply
- ▶ Efficient market theory
- ▶ Efficient portfolio theory

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

The amount of current assets required to meet a firm's long-term minimum needs is referred to as _____ working capital.

▶ **Permanent**

- ▶ Temporary
- ▶ Net
- ▶ Gross

Permanent working capital is the minimum investment in current assets that is required support long-term minimum need.

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

Which of the following best represents the optimal economic order quantity (EOQ), where total usage of the inventory item is 100,000 units for the planning period, the cost per order is Rs.180 and the carrying costs per unit for each period is Rs.1?

▶ **6,000 units**

- ▶ 4,243 units
- ▶ 556 units
- ▶ 4,000 units

$SQR\ 2 \times RU \times OC / CC$

$SQR\ 2 \times 100,000 \times 180 / 1 = 6000$

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

The restructuring of a firm should be undertaken if :

▶ The restructuring is expected to increase earnings per share (EPS) next year

▶ **The restructuring is expected to create value for shareholders**

▶ The restructuring is expected to increase the firm's market share power within the industry

▶ The current employees will receive additional stock options to align employee interest

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

Which of the following formulas can be used to calculate the value of the firm while considering merger/acquisition?

► Value of all-equity financed firm + FV of tax benefits + Expected Bankruptcy Costs

► Value of all-equity financed firm + PV of tax benefits + Expected Bankruptcy Costs

► Value of all-equity financed firm + tax benefits + Expected Bankruptcy Costs

► Value of all-equity financed firm + Expected Bankruptcy Costs

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

The total return on a share of common stock is comprised of which of the following?

- ▶ Capital gains yield and a dividend growth rate
- ▶ Capital gains growth rate and a dividend growth rate
- ▶ Dividend yield and a required rate of return
- ▶ **Dividend yield and a capital gains yield**

[http://highered.mcgraw-](http://highered.mcgraw-hill.com/sites/007353062x/student_view0/chapter8/self_test_quiz.html)

[hill.com/sites/007353062x/student_view0/chapter8/self_test_quiz.html](http://highered.mcgraw-hill.com/sites/007353062x/student_view0/chapter8/self_test_quiz.html)

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

A decrease in the firm's receivable turnover ratio means that _____.

- ▶ It is collecting credit sales more quickly than before
- ▶ **It is collecting credit sales more slowly than before**
- ▶ Sales have gone down
- ▶ Inventories have gone up

For example, if the firm goes from 6 turns to 3 turns, the firm is increasing the average collection period from 60 days to 120 days (assuming a 360 day year). Thus it is collecting more slowly

http://wps.pearsoned.co.uk/ema_uk_he_wachowicz_fundfinman_12/26/6679/1709995.cw/content/index.html

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

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

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

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

Which one of the following types of business enjoys the advantage of 'Limited Liability'?

- ▶ Sole-proprietorship
- ▶ Partnership
- ▶ **Company**
- ▶ None of the given options

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

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

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

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

For financial statement purposes, the accounting value of fixed assets is based upon which of the following?

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- ▶ Their estimated liquidation value
- ▶ Their relative importance to the company
- ▶ **Their actual purchase price**
- ▶ Their current market price

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

Which of the following refers to the value at which an asset is carried on a balance sheet?

- ▶ **Book Value**
- ▶ Market Value
- ▶ Fair Value
- ▶ Liquidation Value

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

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

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

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

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

- ▶ **Rs. 1,200 [60/.05]**
- ▶ Rs. 800
- ▶ Rs. 600
- ▶ Rs. 1,000

A perpetual bond pays interest yet it never matures, it provides a never ending stream of interest payments. To value the perpetual bond or to find the market price of a perpetual bond, we simply take its interest payment and divide it by the investor's required rate of return. Thus the price of a perpetual bond is nothing more than the ratio of its interest payment and the investor's required rate of return.

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

How much should you pay for a bond with Rs.1,000 face value, an 8 percent coupon rate, and seven years to maturity if your appropriate discount rate is 10 percent and interest is paid annually? (Answers are rounded to the nearest dollar)

- ▶ Rs.1,104
- ▶ Rs.560
- ▶ Rs.1,000
- ▶ **Rs.903**

$$= 80/1.1 + 80/(1.1^2) + 80/(1.1^3) + 80/(1.1^4) + 80/(1.1^5) + 80/(1.1^6) + 80/(1.1^7) + 1000/(1.1^7)$$

Question No: 30 (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

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

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

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

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

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[hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html](http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html)

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

According to IAS 7, which method(s) should be used as benchmark treatment?

- ▶ **Direct method**
- ▶ Indirect method
- ▶ Both direct and indirect method
- ▶ Neither direct nor indirect method

Question No: 33 (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: 34 (Marks: 1) - Please choose one

Which of the following is NOT a way to improve cash flow?

- ▶ Liquidating investments
- ▶ Deferring payments to creditors
- ▶ **Increasing the receipt float [page 94]**
- ▶ Accelerating cash inflows which were set for recovery at a later period

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

Which of the following is NOT one of the common motives of holding cash?

- ▶ **Personal Motives [page 94]**
- ▶ Safety Motives
- ▶ Transactions Motives
- ▶ Speculative Motives

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

Which of the following statement is considered as the special alchemy of merges and

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acquisitions?

- ▶ A bird in hand is better than two in bushes.
- ▶ Something is better than nothing.
- ▶ **One plus one makes three.**
- ▶ A dollar in your hand is worth more than a dollar to be received next year.

One plus one makes three: this equation is the special alchemy of a merger or an acquisition. The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. Two companies together are more valuable than two separate companies

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

In a public take over process, the predator company appoints experts at which stage?

- ▶ **Evaluation stage**
- ▶ Direct Bid stage
- ▶ Establishing offer stage
- ▶ None of the given options

Acquisition of private company:

- **Limited consultancy services from expert are required, internal evaluation is normally enough.**
- Detailed investigation is conducted before the transaction.
- Offer price is negotiated by both parties
- Finalization of deal by entering into a contract
- Payment of price finishes the deal.

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

Leverage risk is related to which of the following levels of financial distress of a firm?

- ▶ **Firm Level [page 127]**
- ▶ Industry Level
- ▶ Macro-Level
- ▶ All of the given options

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

Which of the following is an internal method to reduce the transaction exposure?

- ▶ Forward contract
- ▶ **Multilateral netting [page 131]**
- ▶ Money market hedges
- ▶ Currency futures

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

Which of the following statements is **INCORRECT** regarding forward contracts?

- ▶ Reversing forward contract is difficult.
- ▶ **Parties have to put an initial margin in forward contracts.**
- ▶ No size restriction is placed in forward contract.
- ▶ Forward contract is made between parties and each party needs to confirm the credit worthiness of each other.

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Question No: 41 (Marks: 1) - Please choose one

In the calculations of Interest Rate Option, effective interest is computed by:

- ▶ Adding net interest expense and loan amount
- ▶ Subtracting loan amount from net interest expense
- ▶ Multiplying loan amount from net interest expense
- ▶ **Dividing net interest expense by the loan amount**

Question No: 42 (Marks: 1) - Please choose one

Which of the following is an economic motive of Multinational Companies for foreign investment?

- ▶ **Economies of scale [page 149]**
- ▶ Market development
- ▶ Political safety
- ▶ Backward Integration

Question No: 43 (Marks: 1) - Please choose one

Which of the following is(are) the way(s) through which a multi-national firm could reduce political risk?

- ▶ High gearing
- ▶ High local finances
- ▶ Share in equity from local resources
- ▶ **All of the given options [page 150]**

Question No: 44 (Marks: 1) - Please choose one

“The exchange rate between two countries should equal the ratio of the two countries' price level of a fixed basket of goods and services.” This statement belongs to which of the following theory?

- ▶ M&M theory
- ▶ Interest rate risk theory
- ▶ **Purchasing Power Parity theory [page 145]**
- ▶ Fisher effect theory

Question No: 45 (Marks: 3)

Briefly explain the role of planning in achieving corporate objectives.

Question No: 46 (Marks: 5)

If a firm is facing cash flow problems, what steps would you suggest to the firm to overcome its cash flow problems?

Question No: 47 (Marks: 5)

Differentiate between Spot Rates and Forward Rates of currencies. Why forward rates are higher than spot rates?

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Question No: 48 (Marks: 5)

Suppose a firm is planning to borrow some amount in a short-term period. How this firm can create a hedge against rising interest rates?

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)

Describe in detail the major steps in short term financial planning process of a firm.

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