

FIN622- Corporate Finance

FINAL TERM EXAMINATION Spring 2010

PAPER # 1 (Session - 1)

Q# 1

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** P # 36 Like IRR it is a percentage and therefore ignores the scale of investment.
- ☐ It ignores return on investment

Q# 2

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

- ☒ **SWOT Analysis** P # 1
- ☐ Trend Analysis
- ☐ Fundamental Analysis
- ☐ Technical Analysis

Q# 3

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.**

Q# 4

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

- ☐ Financial leverage
- ☐ Volume discounting
- ☒ **Operating leverage** Slide # 13
- ☐ Covariance

Q# 5

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

Q# 6

What will be the taxable income of an Un-levered firm, if it has Earnings 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** *Earnings before Taxes (EBT) = Taxable Income = Accounting Income (Economic Income)*
- ☐ Rs. 60,000

Q# 7

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

- ☒ **Temporary working capital varies with seasonal requirements** P # 90
- ☐ 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

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

The temporary or varying working capital varies with the volume of operations. It fluctuates with the scale of operations. This is the additional working capital required from time to time over and above the permanent or fixed working capital. During seasons, more production/sales take place resulting in larger working capital needs. The reverse is true during off-seasons. As seasons vary, temporary working capital requirement moves up and down.

Temporary working capital can be financed through short term funds like current liabilities.

When the level of temporary working capital moves up, the business might use short-term funds and when the level for temporary working capital recedes, the business may retire its short-term loans

Q# 8

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.

Q# 9

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

- **Lower limit + Spread** P # 96
- Spread – Lower limit
- Optimal limit + Lower limit
- Lower limit – Spread

Q# 10

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

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

Q# 11

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** P # 118
- Dividend valuation method
- Present value method
- Price earnings ratio method

Replacement cost, where you evaluate what it would cost you to replace all of the assets that a firm has today.

Q# 12

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

- Management Buy-In
- **Management buyout** P # 123
- Consolidation
- Amalgamation

Q# 13

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** P # 139
- 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

Strike or exercise price - The price mentioned in option at which the holder exercises his right is known as exercise or strike price.

Q# 14

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** P # 139
- 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

Put option gives its holder a right (not obligation) to sell underlying item at specified price.

Q# 15

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** P # 143
- Greater than market rate
- Equal to the market rate
- Zero

Interest Expense: by the loan amount. This effective interest rate is less than the rate prevailing in the market.

Q# 16

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

- Spin-off
- **Hive-down** P # 114

- Hubris
- Off-shoot

There is a technique called hive down which can reduce the risks and disadvantages of share purchase method.

Q# 17

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

- Cash
- **Assets P # 114**
- Share – ordinary or preference
- Debt

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

1. Cash; 2. Share – ordinary or preferences & 3. Debt

Q# 18

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 P# 74**

Constant dividend payout (div per share/EPS)

A fixed %age is paid out as dividend. Under this policy the dividend amount will vary because the net income is not constant. Thus results in variability of return to investors. The dividends may drop to nil in case of loss. Market price of share will lower. http://wps.aw.com/aw_gitman_pmf_12/85/21795/5579564.cw/content/index.html

Q# 19

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 P#13**
- Rs. 10,880
- Rs. 9,624

Q# 20

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

$$Fv = p \times (((1 + i) ^ n - 1) / i) \times (1 + i)$$

$$P = 12000$$

$$i = 15\%$$

$$n = 16$$

$$Fv = p \times (1 + 0.15) ^ 16 - 1 / 0.15 \times (1 + 0.15)$$

$$12,000 \times (1.15) ^ 16 - 1 / 0.15 \times (1.15)$$

$$12,000 \times (9.357620873 - 1) / 0.15 \times (1.15)$$

$$12,000 \times (8.357620873) / 0.15 \times (1.15)$$

$$12,000 \times (55.71747249) \times (1.15)$$

$$12,000 \times (64.07509336)$$

$$768,901$$

<http://www.vustudents.net>

Q# 21

Which of the following statements would be CORRECT regarding nominal interest rate when inflations are 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 P #20**
- Nominal interest rate would be half of real interest rate
- Nominal interest rate would be less than the real interest rate

If inflation in the economy has been 10% in the year, then the \$110 in the account at the end of the year buys the same amount as the \$100 did a year ago. The real interest rate, in this case, is zero. Real interest rate moves in the opposite direction of both nominal interest rate and inflation.

Q# 22

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

Q# 23

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.

http://www.investopedia.com/terms/t/technical_correction.asp

Q# 24

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 P # 24**

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.

Q# 25

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

Q# 26

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

Q# 27

Which of the following IAS deals with cash flow statement?

- IAS 1
- IAS 7 P # 82**
- IAS 16
- IAS 28

Q# 28

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 P # 89**
- Aggressive; Moderate
- Aggressive; Conservative
- None of the given options

Q# 29

"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 P # 88**
- Conservative working capital policy
- Moderate working capital policy
- The statement is not related to any of the working capital policies

Q# 30

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

- Permanent

- ☐ Net
- ☒ **Temporary P # 90**
- ☐ Gross

Q# 31

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 P # 90**
- ☐ Baumol Model

Under this approach each asset would be offset with a financing instrument of the same maturity.

Q# 32

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

- ☒ **Personal Motives P # 94**
- ☐ Safety Motives
- ☐ Transactions Motives
- ☐ Speculative Motives

A motive for Cash holding - Transactions Motive ensures that the firm has enough funds to transact its routine, day-to-day business affairs. Safety Motive protects the firm against being unable to meet unexpected demands for cash. Speculative Motive allows the firm to take advantage of unexpected opportunities that may arise.

Q# 33

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

Q# 34

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 P # 100**

Q# 35

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

- ☐ Stock-out
- ☐ Buffer Stock
- ☐ Holding Stock
- ☒ **Safety Stock P # 100**

Q# 36

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

- ☐ To increase the productivity
- ☒ **To increase the inventories P # 100**
- ☐ To increase the quality
- ☐ To increase the flexibility

Q# 37

"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 P # 111**
- ☐ Talent departure
- ☐ All of the given options

Q# 38

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 P # 120**

Q# 39

Corporate restructuring involves the restructuring of:

- ☒ **All of the given options P # 121**

- The assets and liabilities of the company
- The debt to equity structures of the company
- Cost minimization by the company

Corporate Restructuring

Corporate restructuring and improved corporate governance are essential parts of economic reform programs under way in many countries. How can corporations be restructured to promote growth and reduce excessive debt without placing undue burdens on taxpayers? What framework is needed to promote better corporate governance? Corporate Restructuring involves restructuring the assets and liabilities of corporations, including their debt-to-equity structures, in line with their cash flow needs to promote efficiency, restore growth, and minimize the cost to taxpayers.

Q# 40

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** P # 124
- None of the given options

Leveraged Buyout – LBO

The acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition.

Q# 41

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

- Transaction exposure
- Translation exposure
- **Local exposure** P # 130
- Economic exposure

Q# 42

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

- **Invoicing in home currency** P # 131
- Money market hedges
- Currency futures
- Currency swaps

Q# 43

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** P # 136

Forward Rate Agreements – FRA

This is a contract and a financial instrument that is used to hedge against interest rate adverse fluctuations on deposit or loans starting in near future. This resembles to forward exchange rate agreements to fix the exchange rates.

Q# 44

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.** P # 136
- No size restriction is placed in forward contract.
- Forward contract is made between parties and each party needs to confirm the creditworthiness of each other.

Q# 45

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** P # 139
- At the money
- None of the given options

Options pricing:

"If the strike price is not favorable than the current market price of underlying asset or item, the option is called "out-of-money."

Q# 46

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 / 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. 2,5000

Q# 47

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
- Rs. 25,000

Total share is $5 \times 100 = 500$

Total cost of option is $500 \times 52 = 26,000$

Total Sale Value = $500 \times 55 = 27,500$

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

Q# 48

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

- The law of one price applies to only tradable goods** P # 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

FINALTERM EXAMINATION Fall 2009 PAPER # 02

Q# 1

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** P # 18
- Current yield
- Coupon yield
- Capital gains yield

The yield to maturity (YTM) is the discount rate which returns the market price of the bond. It is thus the internal rate of return of an investment in the bond made at the observed price. YTM can also be used to price a bond, where it is used as the required return on the bond.

Q# 2

A firm can lower its breakeven level by doing which of the following actions?

- Lowering direct cost** P # 39
- Increasing variable cost
- Increasing direct cost
- Lowering sales price

1. Lower direct costs, which will raise the gross margin. Be more diligent about purchasing material, controlling inventory, or increasing the productivity of your labor by more cost effective scheduling or adding more efficient technology.

Q# 3

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** P#60

Q# 4

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

Q# 5

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

- Tax savings** P # 72
- Low Bankruptcy costs
- Minimum financial risk
- Low financial leverage

Q# 6

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** P#67

The more debt in capital structure, there is greater financial leverage. P#12

The debt-to-equity ratio is total debt divided by total equity:

Debt-to-Equity Ratio = Total Debt/Total Equity

Debt = 60 and Equity = 40

Q# 7

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**

Q# 8

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

Q# 9

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** P # 94
- ☐ Transactions
- ☐ Capital needs

Q# 10

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

- ☐ Replacement cost method
- ☐ Breakup value method
- ☒ **Dividend valuation method** P#115
- ☐ Accumulated depreciation method

Q# 11

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** P # 124
- ☐ Employee Empowerment
- ☐ Leverage Buyout

Q# 12

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** P#124

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.

Q# 13

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\$

Q# 14

A firm can fix effective interest rate on short-term borrowings by doing which of the following?

- ☒ **Buying a forward rate agreement** P # 137
- ☐ Selling a forward rate agreement
- ☐ Borrowing local currency
- ☐ Borrowing base currency

Q# 15

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 P#137**
- ⊙ Buying an forward rate agreement

Q# 16

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 P#139**
- ⊙ Fall in short-term deposit rates
- ⊙ Increase in short-term interest rates
- ⊙ Increase in short-term deposit rates

Q# 17

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 P#139**
- ⊙ Option seller is the option holder
- ⊙ Option writer is the option holder

An option is a contract that confers a right to buy or sell a specific quantity or asset – but not the obligation – at agreed price on or before the specified future date.

Q# 19

Which of the following could be used as a hedging tool against unfavorable movement in interest rate?

- ⊙ Currency option
- ⊙ Currency futures
- ⊙ **Interest rate option P#143**
- ⊙ Currency SWAP

When borrowing on variable interest rates, a firm may want to utilize option as hedging tool against the unfavorable interest rate movements over the full term of loan or deposit

Q# 20

The credit policy of a public company is 1/10, net 30. At present 25% of the customers take the discount. What would accounts receivable be if all customers took the cash discount?

- ⊙ **Account receivable would be lower than the present level**
- ⊙ No change from the present level
- ⊙ Account receivable would be higher than the present level
- ⊙ Unable to determine without more information

Q# 21

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

Q# 22

The efficiency enhancing effect resulting from a strategic merger is called which of the following?

- ⊙ Merger effect
- ⊙ Acquisition effect
- ⊙ **Synergy effect P # 108**
- ⊙ Efficiency effect

Synergy is the magic force that allows for enhanced cost efficiencies of the new business. Synergy takes the form of revenue enhancement and cost savings

Q# 23

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

- 100% debt financed
- 100% equity financed P # 66**
- 50% equity and 50% debt financed
- 60% equity and 40% debt financed

Q# 24

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 P # 15**

⦿ Nominal Interest Rate

The Effective Annual Rate (EAR) is the interest rate that is annualized using compound interest. The EAR is the annualized equivalent of interest with shorter compounding periods.

Q# 25

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** P # 136
- ⦿ Inflation risk
- ⦿ Unique risk

Examples of interest rate risk – short term investments, investment in bonds, borrowings in short term – variation in short term interest rate.

Q# 26

Which of the following focuses on long-term investment decision-making process?

Working Capital Management

Capital Budgeting P # 24

Cash Budgeting

None of the

Capital Budgeting is the planning process used to determine a firm's long term investments such as new machinery, replacement machinery, new plants, new products, and research and development projects.

Q# 27

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

Q# 28

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** P # 29
- ⦿ Accepting the project has an indeterminate effect on shareholders
- ⦿ The discount rate exceeds the cost of capital
- ⦿ The profitability index equals one

Q# 29

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** P #49
- ⦿ deducted from; deducted from

Q# 30

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** P#89

Q# 31

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

- ⦿ High liquidity; high profitability; high risk
- ⦿ **High liquidity; low profitability; low risk** P # 89
- ⦿ Low liquidity; low profitability; high risk
- ⦿ Low liquidity; high profitability; high risk

Q# 33

"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** P#88
- ⦿ Moderate working capital policy
- ⦿ The statement is not related to any of the working capital

Q# 34

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 | 2,000,000 | 2,000,000 | 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**

Firm A = EBIT / total assets = 2000000/1100000 = 18.2

Firm B = EBIT / total assets = 200000/1000000 = 20

Firm C = EBIT / total assets = 200000 / 900000 = 22.2

Q# 37

Which of the following type of mergers occurs when one firm purchases other firms that produce similar or competing products?

- ☒ **Horizontal** P # 109
- ☐ Vertical
- ☐ Financial
- ☐ Conglomerate

Q# 38

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** P# 119
- ☐ Hybrid method
- ☐ None of the given

Q# 39

The experts hired in evaluation stage of a public take over process DO NOT include which of the following?

- ☐ Legal consultants
- ☐ Accountants
- ☒ **Shareholders** P#119
- ☐ Stock Brokers

Q# 40

In which of the following forms of acquisition, a company's existing managers acquire a large part or all of the company?

- ☒ **Management Buyout** P # 123
- ☐ Management Buy-In
- ☐ Leverage Buyout
- ☐ None of the given options

Q# 41

Recession in economy is related to which of the following levels of financial distress of a firm?

- ☐ Firm Level
- ☐ Industry Level
- ☒ **Macro-Level** P # 127
- ☐ All of the given options

Q# 42

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.** P # 137
- ☐ 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.

Q# 43

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** P#140

- None of the given options

Q# 44

Which of the following theories states that exchange rates between currencies are in equilibrium when their purchasing power is the same in each of the two countries?

- M&M theory
- Purchasing Power Parity theory P # 145**
- Fisher effect theory
- Interest rate risk theory

FINALTERM EXAMINATION Fall PAPER # 03 (Session - 1)

Q# 1

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 FM P # 42**

Q# 2

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 P #60**

Finally, this approach does not take into account the risk level. There is no direct adjustment for the riskiness of the investment. For instance, there is no adjustment for the degree of certainty or uncertainty in estimated growth rate for dividends

Q# 3

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 P # 71**
- 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.

Q# 4

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

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

Q# 5

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

- Stock Dividend P# 75**
- Cum Dividend
- Ex-Dividend
- Extra Dividend

Q# 6

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

Q# 7

In the formula $Q =$, "I" denotes which of the following?

- Initial cash out flow
- Interest cost of holding cash P#95**
- Investment required
- Initial investment

Q# 8

Keeping all other things constant, an increase in storage cost will result _____ in the EOQ

- A decrease**
- No change
- An increase

- Cannot be told without additional information

Q# 9

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 P# 124**
- Employee Empowerment
- Leverage Buyout

Q# 10

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**

Q# 13

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

P#116

Q# 14

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 P #103**

Q# 15

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

- **To improve the cash flow P#106**
- To increase the bad debts
- To improve return on equity
- To improve the PE ratio

Q# 18

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 P#55**
- 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

$\text{Reward to Risk} = (ER_A - ER_{RF}) / \text{BETA}_A$

Q# 19

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

Q# 21

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**

Q# 22

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

Q# 23

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** $P_0 = D_1(1+g) / (r - g) = 7.8(1.09) / (0.24 - 0.09) = 8.502 / 0.15 = 56.68$
- Ⓒ Rs. 32.50
- Ⓓ Rs. 35.43

Q# 24

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

Q# 25

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

- Ⓐ **A trade-off between profitability and risk** P # 101
- Ⓑ A trade-off between liquidity and risk
- Ⓒ A trade-off between equity and debt
- Ⓓ A trade-off between short-term versus long-term borrowing

There are significant funds invested in accounts receivables and there must be some tradeoff between the profitability and risk. The optimal level of investment should be based on the benefit resulting from a specific level of investment in debtors.

Q# 27

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

Q# 28

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**

Q# 29

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

- Ⓐ **Corporate customers** P#102
- Ⓑ Individual customers
- Ⓒ Both corporate and individual customers
- Ⓓ Neither corporate nor individual customers

Q# 30

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** P#105
- Ⓒ Total of opportunity cost of credit policy and the bad debts
- Ⓓ Total of production cost and the cost of credit policy

The total of carrying cost and the opportunity cost of credit policy is called the total credit cost curve.

Q# 31

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** $ACP = 70\% \times 10 \text{ days} + 30\% \times 30 \text{ days} = 7 + 9 = 16 \text{ days}$
- Ⓓ 18 days

Q# 32

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.** P # 110 - Two companies that have no common business areas.

- None of the given options

Q# 33

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** P #114

Q# 34

Value of firm = _____

- Value of all equity financed firm + PV of tax benefits + Expected Bankruptcy Costs** P#116

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

Q# 35

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

- 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** P#124

Leveraged Buyout – LBO

The acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition. Often, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital.

Q# 37

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.** P#136

Q# 38

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** P#140

If the strike price is not favorable than the current market price of underlying asset or item, the option is called "out-of-money."

- 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

Q# 39

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

- Cash** P#138
- Physical delivery
- Both cash and physical delivery
- Neither cash nor physical delivery

Q# 40

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

- The strike price and current market price are equal** P#140
- The strike price is higher than current market price
- The strike price is lower than current market price
- None of the given options

Q# 41

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

- The law of one price applies to only tradable goods** P#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

(3) 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

Q# 42

"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** P#149

Q# 43

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

- ☐ Subsidiary
- ☐ Branch
- ☒ **Joint Venture** P#150
- ☐ Licensing branch

Q# 44

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** P #147

Between 1870 and 1914, there was a global fixed exchange rate. Currencies were linked to gold, meaning that the value of a local currency was fixed at a set exchange rate to gold ounces. This was known as the gold standard.

FINAL TERM EXAMINATION

Fall 2009 (Session - 1)

Q# 1

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**
- ☐ Cannot be determined

Q# 2

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** $= 400 \times (1 + 0.08)^3 = 504$
- ☐ Rs. 609

Q# 3

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

Q# 4

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

- ☒ **Government T-bills** P # 51
- ☐ Junk bonds
- ☐ Preferred stock
- ☐ Secured bonds

Q# 5

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

- ☐ Normal stocks
- ☒ **Aggressive stocks**
- ☐ Defensive stocks
- ☐ Income stocks

Q# 8

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** P #94
- Precautionary
- Speculative

Q# 9

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\$

Q# 10

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

The parties involved in a SWAP may default P #144

- SWAP may change floating rates into fixed rates
- SWAP provide access to the market
- SWAP may change fixed rates into floating rates

Q# 11

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

- **The Law of one price** P #146

Purchasing power parity (PPP) is in economics the method of using the long-run equilibrium exchange rate of two currencies to equalize the currencies' purchasing power. It is based on the law of one price, the idea that, in an efficient market, identical goods must have only one price.

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

Q# 12

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

Q# 14

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
- 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**

Q# 16

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

Q# 17

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

- **Dividend Growth Model**

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

- Capital Asset Pricing Model
- Security Market Line
- Characteristics Line

Q# 18

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**
- It helps improve accounting policies of the company
- It helps improve purchasing policies of the company

Q# 19

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

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

Q# 20

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?

- Rs. 560
- Rs. 1,000
- Rs. 903
- **Rs. 1,104** = $100 \times (1 - [1 / (1 + 0.08)^7]) / 0.08 + 1000 / (1 + 0.08)^7 = 100 \times 5.2063 + 583.50 = 1,104$

Q# 21

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** P # 18

For a bond selling above the face value is said to sell at premium. It means investor who buys it at a premium face a capital loss over the life of bond. So return on bond will be less than the current yield.

- At discount
- At par
- Cannot be determined without more information

Q# 22

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 $\text{YTM} < \text{the coupon rate}$**

Q# 23

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

- Technical Analysis
- **Fundamental Analysis**

The biggest part of fundamental analysis involves delving into the financial statements. Also known as quantitative analysis

- Constant Growth Model
- No Growth Model

Q# 24

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** P #75

The term 'Valuation' implies the task of estimating the worth / value of an asset, a security or a business / firm.

Q# 25

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** P# 78

The Financial Planning Process consists of the Following five Steps

1. Establishing and defining the client-planner relationship.

The financial planner should clearly explain or document the services to be provided to you and define both his and your responsibilities.

- Gathering client data, including goals
- Analyzing and evaluating financial data
- Developing and presenting financial planning recommendations and/or alternatives

Q# 26

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

- Ⓐ **Direct method** P # 83

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

- Ⓑ Indirect method
- Ⓒ Both direct and indirect method
- Ⓓ Neither direct nor indirect method

Q# 27

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

- Ⓐ Same; inverse
- Ⓑ **Inverse; same** P# 89

- Profitability varies inversely with liquidity; increased liquidity can be achieved at the expense of (decreased) profitability
- Profitability & risk have same direction; in order to have greater profitability, we need to take greater risk.

- Ⓒ Inverse; opposite
- Ⓓ Same; opposite

Q# 28

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

Q# 29

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

- Ⓐ **The difference between upper limit and lower limit of cash balances** P #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

Q# 30

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**

Q# 31

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** P #96

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

Q# 32

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** P #104

The following methods to evaluate the credit worthiness are widely used in business:

- Financial statements of vendor
- Market reputation
- Banks
- Previous payment record
- Financial strength
- Capacity
- General economic conditions in vendors industry

Q# 33

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** P #110

Vertical merger - A customer and company or a supplier and company Think of a cone supplier merging with an ice cream maker.

- Ⓒ Financial
- Ⓓ Conglomerate

Q# 34

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

- **Market-extension merger** P #110

Market-extension merger - Two companies that sell the same products in different markets

- Product-extension merger
- Conglomeration
- None of the given options

Q# 36

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** P #120

White knight (business)

In business, a white knight may be a corporation, a private company, or a person that intends to help another firm. There are many types of white knights.

Q# 37

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

- **Transaction exposure** P #130

Transaction Exposure:

In real world, a single transaction (sales and receipt) may take some period of time. For example, you sold goods to a foreign customer on 15 December 2005, and customer promised payment after two months.

Now during these two months the exchange rate may fluctuate on either side and this will result in exchange gain or loss. These transactions may include import or export of goods on credit terms, borrowing or investing in foreign currency, receipt of dividend from foreign subsidiary. This type of exposure can be safeguarded by using hedging instruments.

- Translation exposure
- Economic exposure
- None of the given options

Q# 38

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** P#140

"If the strike price is not favorable than the current market price of underlying asset or item, the option is called "out-of-money."

- At the money
- None of the given options

Q# 39

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** P #138

Interest Rate Future:

Interest rate futures are also contracts, which have following features:

- These contracts are similar to currency futures. These are traded in standardized form on future exchanges.
 - Settlement dates on future exchanges are calendar quarters.
 - Each future contract is for standardized quantity of underlying security.
 - Price of the future is expressed in terms of underlying item.
 - Interest rate future, like currency futures may be settled before the maturity date.
 - Short Term Interest Rate futures – STIRs are cash settled.
- Interest rate future, like currency futures may be settled before the maturity date.

Q# 41

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**

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

Premium = $1000 \times 5 = 5,000$

Total cost = 105,000.00

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

Gain = $110,000 - 105,000 = 5,000$

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

Q# 42

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** P#143

The next step will be to calculate the effective interest expense, which can be computed by dividing Net Interest Expense by the loan amount.

Q# 43

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** P# 150

1) Confiscation risk

The risk of loss of control, business may be taken over by the local govt. or intervention and interference by the local authorities.

- Commercial risk

Q# 44

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

- High P# 146**
Countries with high interest rate will register capital inflow and will result in appreciation in exchange rate.
- Low
- Moderate
- None of the given options

FINAL TERM EXAMINATION Fall 2009 (Session - 1)

Q# 1

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

Q# 3

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%**

$(\text{Dividend} + \text{capital Gain}) / \text{Old price} = 0.07 \times 4 + 0.28 + 0.30 = 0.58$ $0.58 / 3 = 0.1933 = 19.33\%$

- 10.0%
- 11.0%

Q# 4

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**

Q# 5

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

Q# 6

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

Q# 7

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

- Ⓐ 4%
- Ⓑ 5%
- Ⓒ **6% $10\% - 4\% = 6\%$**
- Ⓓ 7%

Q# 9

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 $400,000 \times 40\% = 160,000$**
- Ⓒ Rs. 170,00
- Ⓓ Rs. 180,000

Q# 12

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

- Ⓐ Liquidity
- Ⓑ Safety
- Ⓒ Profitability
- Ⓓ **Inventory**

Q# 13

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**

Q# 15

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**

Q# 16

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

Q# 17

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

- Ⓐ **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

Q# 18

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. P # 117**

High P/E ratio may be due to:

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

Q# 19

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 P # 106**

Expansion of credit involves two types of risks – additional cost of funds and bad debts.

- Ⓒ Additional cost of advertising
- Ⓓ Additional cost of business

Q# 20

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**

$$\begin{aligned}PVoa &= PMT [(1 - (1 / (1 + i)^n)) / i] \\PVoa &= 100 [(1 - (1 / (1 + 0.08)^{10})) / 0.08] \\PVoa &= 100 [(1 - (1 / (1.08)^{10})) / 0.08] \\PVoa &= 100 [(1 - (1 / (2.158924997))) / 0.08] \\PVoa &= 100 [(1 - 0.463193488) / 0.08] \\PVoa &= 100 [0.536806512 / 0.08] \\PVoa &= 100 [6.7100] \\PVoa &= 671\end{aligned}$$

Q# 21

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

Q# 22

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

- ☒ **Corporate bonds**
- ☐ Money market instruments
- ☐ Trade credit
- ☐ Accounts payables

Q# 23

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** P # 75

Q# 24

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

- ☐ Planning
- ☒ **Control** P # 78

Control -- defined as monitoring, comparing information to a standard and taking corrective action. For a budget to serve this function well it must have four characteristics:

- ☐ Management
- ☐ None of the given options

Q# 26

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

- ☐ Direct method
- ☒ **Indirect method** P # 83

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

- ☐ Both direct and indirect method
- ☐ Neither direct nor indirect method

Q# 27

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**

Q# 28

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

Q# 32

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

Q# 35

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

Q# 36

"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** P # 110

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.

- ☐ New mergers
- ☐ Brand mergers

Q# 37

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** P # 114

Acquisition Consideration

The predator and target will need to agree on following basis issues surrounding the consideration:

- i. Whether shares or assets to be purchased.*
- ii. Type of consideration*
- iii. Valuation issues*

Q# 38

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

- ☒ **Replacement cost method** P # 118
- ☐ Dividend valuation method
- ☐ Present value method
- ☐ Price earning ration method

Q# 39

"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** P # 124

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

- ☐ Leverage Buyout
- ☐ None of the given options

Q# 40

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
- ☐ Conversion of debt from one class to another
- ☒ **All of the given options** P # 128

Types of reorganization:

The following are the types of reorganizations:

- i. Conversion of debt to equity or vice versa*
- ii. Conversion of equity from one class to other*
- iii. Conversion of debt from one class to another*

Q# 41

Which of the following statements is CORRECT regarding currency futures?

- ☒ **Currency futures are forward contracts traded on future and option exchanges** P # 133

Futures are forward contracts traded on future and option exchanges.

- ☐ Currency future is a money market hedging techniques

- Currency futures are traded in the stock market
- Currency futures are regularized by mutual funds

Q# 43

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** P # 139
- Out of money
- At the money
- None of the given options

FINALTERM EXAMINATION Fall 2009 (Session - 5)

Q# 1

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 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**

$$\begin{aligned} ROA &= NI/TA \\ 0.14 &= (NI)/(15,000,000) \\ (0.14)(15,000,000) &= NI \\ NI &= 2,100,000 \\ NPM &= NI/Sales \\ 0.09 &= (2,100,000)/Sales \\ 0.09Sales &= 2,100,000 \\ Sales &= (2,100,000)/(0.09) = 23,333,333 \end{aligned}$$

Q# 2

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

$$\begin{aligned} ROI / NPM &= TAT \\ 0.08 / 0.05 &= 1.6 \\ TAT \times TA &= SALES \\ 1.6 \times 300,000 &= 480,000 \end{aligned}$$

Q# 3

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

Q# 4

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

Q# 5

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

Q# 6

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.

Q# 7

Which of the following is closely related to a sales budget?

- ☐ Miscellaneous income
- ☐ Future profits
- ☐ Cash outflow
- ☒ **Cash inflow**

Q# 9

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

Horizontal merger - Two companies that are in direct competition and share the same product lines and markets

- ☐ Monopolistic merger
- ☐ Conglomerate merger
- ☐ Vertical merger

Q# 10

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**

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

- ☐ Employees buy shares of a competing firm

Q# 11

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** P # 127

Q# 17

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**

Taking under root of $2 \times \text{arxco} / \text{cc}$; Taking under root of $2 \times 100,000 \times 180 / 1 = 6000$

- ☐ 4,243 units
- ☐ 556 units
- ☐ 4,000 units

Q# 20

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-hill.com/sites/007353062x/student_view0/chapter8/self_test_quiz.html

Q# 21

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

Q# 22

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

- ☒ **Coca Cola**
- ☐ Pepsi
- ☐ Shezan
- ☐ Nestlé

Q# 23

Which one of the following types of business enjoys the advantage of 'Limited Liability'?

- ☐ Sole-proprietorship
- ☐ Partnership
- ☒ **Company**

- None of the given options

Q# 24

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

Q# 25

For financial statement purposes, the accounting value of fixed assets is based upon which of the following?

- Their estimated liquidation value
- Their relative importance to the company
- **Their actual purchase price**
- Their current market price

Q# 27

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**

Q# 28

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** $= 60/5 \times 100 = 1200$
- Rs. 800
- Rs. 600
- Rs. 1,00

Q# 29

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**

Q# 32

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

Q# 34

Which of the following is NOT a way to improve cash flow?

- Liquidating investments
- Deferring payments to creditors
- **Increasing the receipt float** P # 94
- Accelerating cash inflows which were set for recovery at a later period

No. 36

Which of the following statement is considered as the special alchemy of merges and 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.

Q# 37

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

Q# 38

Leverage risk is related to which of the following levels of financial distress of a firm?

- ☒ **Firm Level** P # 127
- ☐ Industry Level
- ☐ Macro-Level
- ☐ All of the given options

Q# 39

Which of the following is an internal method to reduce the transaction exposure?

- ☐ Forward contract
- ☒ **Multilateral netting** P # 131
- ☐ Money market hedges
- ☐ Currency futures

Q# 42

Which of the following is an economic motive of Multinational Companies for foreign investment?

- ☒ **Economies of scale** P # 149
- ☐ Market development
- ☐ Political safety
- ☐ Backward Integration

Q# 43

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** P # 150

Q# 44

"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** P # 145
- ☐ Fisher effect theory

FINAL TERM EXAMINATION Fall 2008 (Session - 1)

Q# 1

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

Q# 4

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%**

Q# 5

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**

Q# 7

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**

$\text{Sales} - (\text{Variable cost } 60\% \text{ of sales} + \text{fixed cost} + \text{Depreciation})$
 $3,000,000 - (1,800,000 + 1,500,000 + 500,000) = (800,000)$

Q# 8

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

Q# 9

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% $\text{Capital gain yield} = 66 - 60 / 60 = 10\%$

Q# 11

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

Q# 13

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
- ☐ Cannot be determined

Q# 22

Employee's buyout occurs through which of the following?

- ☒ Employee stock ownership plan P #124
The official way an employee buyout occurs is through an employee stock ownership plan (ESOP).
- ☐ Employees dividend scheme
- ☐ Employee empowerment scheme
- ☐ Employee long-term benefit scheme

Q# 23

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 P#125
- ☐ Management sale out some assets of the firm
- ☐ Management buy some new plants and machinery

Q# 24

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

Q# 27

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 P#139
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."
- ☐ 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

Q# 28

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** P#141
- 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

Q# 29

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** P#142

Currency Options:

Currency option is a contract like equity options that we have covered in previous section. This is a contract, which confers right to the buyer to buy or sell (but not obligation) a fixed amount of underlying currency at a fixed price (strike price) on a fixed date (expiry).

- In a currency option, the seller has the right to buy currency
- In a currency option, the holder has the obligation to buy

Q# 30

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

Q# 31

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

Q# 33

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** P# 145

Demand for foreign currencies will rise resulting in weakening of our local currency.

Q# 35

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**

Q# 36

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

Q# 39

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** $50,000 \times 2/100 = 1000$
- Rs. 2,000
- Rs. 4,000
- Rs. 5,000

Q# 40

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

- Ⓐ Market reputation
- Ⓑ Previous payment record
- Ⓒ **Production plant capacity** P# 104

The following methods to evaluate the credit worthiness are widely used in business:

Financial statements of vendor

Market reputation

Banks

Previous payment record

Financial strength

Capacity

General economic conditions in vendors industry

- Ⓓ Financial strength

Q# 42

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

- Ⓐ Safety device installation
- Ⓑ **Expansion**
- Ⓒ Renewal
- Ⓓ Replacement