

Financial Management Quiz 1

Spring Semester 2009

**Solution File**

**Total Marks 20**

**Choose the correct option among the choices given below:**

1. Who determine the market price of a share of common stock?
  - a. The board of directors of the firm
  - b. The stock exchange on which the stock is listed
  - c. The president of the company
  - d. **Individuals buying and selling the stock**
2. What should be the focal point of financial management in a firm?
  - a. The number and types of products or services provided by the firm
  - b. The minimization of the amount of taxes paid by the firm
  - c. **The creation of value for shareholders**
  - d. The dollars profits earned by the firm
3. Which of the following would generally have unlimited liability?
  - a. A limited partner in a partnership
  - b. A shareholder in a corporation
  - c. **The owner of a sole proprietorship**
  - d. A member in a limited liability company (LLC)
4. Which of the following is equal to the average tax rate?
  - a. **Total tax liability divided by taxable income**
  - b. Rate that will be paid on the next dollar of taxable income
  - c. Median marginal tax rate
  - d. Percentage increase in taxable income from the previous period

Financial Management Quiz 1

Spring Semester 2009

5. Felton Farm Supplies, Inc., has an 8 percent return on total assets of Rs.300,000 and a net profit margin of 5 percent. What are its sales?

- a. Rs.3, 750,000
- b. **Rs.480, 000**
- c. Rs.300, 000
- d. Rs.1, 500,000

*Since  $ROI=8\%$  on  $\$300,000$  of assets, then net profit is Rs.24,000 ( $8\% \times Rs.300,000$ ). Using the net profit and given that the  $NPM=5\%$ , sales equals Rs.480,000 ( $Rs.24,000 / 5\%$ ).*

6. Which of the following would not improve the current ratio?
- a. **Borrow short term to finance additional fixed assets**
  - b. Issue long-term debt to buy inventory
  - c. Sell common stock to reduce current liabilities
  - d. Sell fixed assets to reduce accounts payable
7. With continuous compounding at 8 percent for 20 years, what is the approximate future value of a Rs.20,000 initial investment?
- a. Rs.52,000
  - b. Rs.93,219
  - c. **Rs.99,061**

d. Rs.915,240

$Rs.20,000[e^{(.08 \times 20)}] = Rs.20,000(4.9530324) = Rs.99,061.$

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

a. Fall

b. Rise

c. Remain unchanged

d. Incomplete information

### Financial Management Quiz 1

#### Spring Semester 2009

9. Cash budgets are prepared from past:

a. Balance sheets

b. Income statements

c. Income tax and depreciation data

d. None of the given options

10. Which of the following is part of an examination of the sources and uses of funds?

a. A forecasting technique

b. A funds flow analysis

c. A ratio analysis

d. Calculations for preparing the balance sheet

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

a. Less than

b. More than

c. Equal to

d. Can not be found

12. As interest rates go up, the present value of a stream of fixed cash flows \_\_\_\_\_.

a. Goes down

b. Goes up

c. Stays the same

d. Can not be found

13. ABC company is expected to generate Rs.125 million per year over the next three years in free cash flow. Assuming a discount rate of 10%, what is the present value of that cash flow stream?

a. Rs.375 million

b. Rs.338 million

c. Rs.311 million

d. Rs. 211 million

$\$311 \text{ million. The cash flow stream would look like this: } 125.00 \times 0.9090 =$

$113.63; 125.00 \times 0.8264 = 103.30; 125.00 \times 0.7513 = 93.91. \text{ The sum of the three is}$

$\$310.84, \text{ or } \$311 \text{ million.}$

### Financial Management Quiz 1

#### Spring Semester 2009

14. If we were to increase ABC company cost of equity assumption, what would we expect to happen to the present value of all future cash flows?

a. An increase

b. A decrease

- c. No change
- d. Incomplete information
- 15. In proper capital budgeting analysis we evaluate incremental \_\_\_\_\_ cash flows.
  - a. Accounting
  - b. Operating**
  - c. Before-tax
  - d. Financing
- 16. A capital budgeting technique through which discount rate equates the present value of the future net cash flows from an investment project with the project's initial cash outflow is known as:
  - a. Payback period
  - b. Internal rate of return**
  - c. Net present value
  - d. Profitability index
- 17. Discounted cash flow methods provide a more objective basis for evaluating and selecting an investment project. These methods take into account:
  - a. Magnitude of expected cash flows
  - b. Timing of expected cash flows
  - c. Both timing and magnitude of cash flows**
  - d. None of the given options
- 18. Which of the followings make the calculation of NPV difficult?
  - a. Estimated cash flows
  - b. Discount rate
  - c. Anticipated life of the business
  - d. All of the given options**

**Financial Management Quiz 1**  
**Spring Semester 2009**

- 19. From which of the following category would be the cash flow received from sales revenue and other income during the life of the project?
  - a. Financing activity
  - b. Operating activity**
  - c. Investing activity
  - d. All of the given options
- 20. Which of the following technique would be used for a project that has non –normal cash flows?
  - a. Multiple internal rate of return**
  - b. Modified internal rate of return
  - c. Net present value
  - d. Internal rate of return

**Financial Management Quiz 2**  
**Spring Semester 2009**

**Total Marks 20**

**Choose the correct option among the choices given below:**

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

- a. Because it has a direct link with the shareholders dividends maximization
  - b. Because it helps in quick judgment regarding the investment in real assets
  - c. Because we have a simple formula to calculate the cash flows
  - d. Because it has direct link with shareholders wealth maximization**
2. In which of the following situations you can expect multiple answers of IRR?
- a. More than one sign change taking place in cash flow diagram
  - b. There are two adjacent arrows one of them is downward pointing & the other one is upward pointing
  - c. During the life of project if you have any net cash outflow
  - d. All of the given options**
3. Which one of the following selects the combination of investment proposals that will provide the greatest increase in the value of the firm within the budget ceiling constraint?
- a. Cash budgeting
  - b. Capital budgeting
  - c. Capital expenditure
  - d. Capital rationing**
4. Who is responsible for the decisions relating capital budgeting and capital rationing?
- a. Chief executive officer
  - b. Junior management
  - c. Division heads
  - d. All of the given option**
- Financial Management Quiz 2**  
**Spring Semester 2009**
5. What is a legal agreement, also called the deed of trust, between the corporation issuing bonds and the bondholders that establish the terms of the bond issue?
- a. Indenture**
  - b. Debenture
  - c. Bond
  - d. Bond trustee
6. \_\_\_\_\_ is a high-risk, high-yield bond rated below investment grade; while a/ (an) \_\_\_\_\_ bond has its interest payment contingent on sufficient earnings of the firm.
- a. A junk bond; income**
  - b. A subordinated debenture; mortgage
  - c. A debenture; subordinated debenture
  - d. An income bond; mortgage
7. \_\_\_\_\_ is a long-term, unsecured debt instrument with a lower claim on assets and income than other classes of debt; while a/(an) \_\_\_\_\_ bond issue is secured by the issuer's property.
- a. A subordinated debenture; mortgage**
  - b. A debenture; subordinated debenture
  - c. A junk bond; income
  - d. An income bond; junk
8. The value of the bond is NOT directly tied to the value of which of the following

assets?

- a. **Liquid assets of the business**
- b. Fixed assets of the business
- c. Long term assets of the business
- d. Real assets of the business

**Financial Management Quiz 2**

**Spring Semester 2009**

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

- a. Cash flows
- b. Coupon receipts
- c. Par recovery at maturity
- d. **All of the given options**

10. Which of the following is not the present value of the bond?

- a. Intrinsic value
- b. Fair price
- c. Theoretical price
- d. **Market price**

11. The current yield on a bond is equal to \_\_\_\_\_.

- a. The yield to maturity
- b. Annual interest divided by the par value
- c. **Annual interest divided by the current market price**
- d. The internal rate of return

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

- a. 10.45%
- b. 10.95%
- c. **10.65%**
- d. 10.52%

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

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

**Financial Management Quiz 2**

**Spring Semester 2009**

14. Which of the following value of the shares changes with investor's perception about the company's future and supply and demand situation? (Comprehension)

- a. Par value
- b. Intrinsic value
- c. **Market value**
- d. Face value

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

- a. Fundamental analysis
- b. **Underlying real asset**

- c. Supply and demand of securities in the market
- d. All of the given options
- 16. \_\_\_\_\_ is equal to (common shareholders' equity/common shares outstanding).
- a. Liquidation value per share
- b. Book value per share**
- c. Market value per share
- d. None of the above
- 17. Low Tech Company has an expected ROE of 10%. The dividend growth rate will be \_\_\_\_\_ if the firm follows a policy of paying 40% of earnings in the form of dividends.
- a. 4.8%
- b. 6.0%**
- c. 7.2%
- d. 3.0%

**Financial Management Quiz 2**  
**Spring Semester 2009**

- 18. High Tech Chip Company is expected to have EPS in the coming year of Rs. 2.50. The expected ROE is 12.5%. An appropriate required return on the stock is 11%. If the firm has a plowback ratio of 70%, what would be the growth rate of dividends?
- a. 6.25%
- b. 8.75%**
- c. 6.60%
- d. 7.50%
- 19. In the dividend discount model, \_\_\_\_\_ which of the following are **not** incorporated into the discount rate?
- a. Real risk-free rate
- b. Risk premium for stocks
- c. Return on assets**
- d. Expected inflation rate
- 20. Bond is a type of Direct Claim Security whose value is **NOT** secured by \_\_\_\_\_.
- a. Tangible assets
- b. Fixed assets
- c. Intangible assets**
- d. Real assets