

Course No: ACC 2304, MAN 3304

Course Title:

Advance Financial

Management

Date: 16/09/2014

No. of Questions: (3)

Time: 2.25 hours

Using Calculator (Yes)

University of Palestine



Final Exam

Summer Semester

2013/2014

Total Grade:

Instructor Name: Miss Laila Aldoor

Student No.: _____

Student Name: _____

College Name: Business and Finance

Dep. / Specialist: Accounting-English

Using Dictionary (No)

Kindly empty all of your answers in the answer booklet.

Question One:

(15 Marks)

Tick true or false:

1. "Risk aversion" implies that investors require higher expected returns on riskier than on less risky securities.
2. Diversification will normally reduce the riskiness of a portfolio of stocks.
3. An individual stock's diversifiable risk, which is measured by its beta, can be lowered by adding more stocks to the portfolio in which the stock is held.
4. A stock with a beta equal to -1.0 has zero systematic (or market) risk.
5. As a firm's sales grow, its current assets also tend to increase. For instance, as sales increase, the firm's inventories generally increase, and purchases of inventories result in more accounts payable. Thus, spontaneous liabilities that reduce AFN arise from transactions brought on by sales increases.
6. To determine the amount of additional funds needed (AFN), you may subtract the expected increase in liabilities, which represents a source of funds, from the sum of the expected increases in retained earnings and assets, both of which are uses of funds.
7. The capital intensity ratio is the amount of assets required per dollar of sales and it has a major impact on a firm's capital requirements.
8. The minimum growth rate that a firm can achieve with no access to external capital is called the firm's sustainable growth rate. It can be calculated by using the AFN equation with AFN equal to zero and solving for g .
9. The optimal distribution policy strikes that balance between current dividends and capital gains that maximizes the firm's stock price.
10. The announcement of an increase in the cash dividend should, according to MM, lead to an increase in the price of the firm's stock.
11. Stock dividends and stock splits should, at least conceptually, have the same effect on shareholders' wealth.
12. Provided a firm does not use an extreme amount of debt, financial leverage typically affects both EPS and EBIT, while operating leverage only affects EBIT.
13. If Miller and Modigliani had incorporated the costs of bankruptcy into their model, it is unlikely that they would have concluded that 100% debt financing is optimal.
14. If a firm utilizes debt financing, an $X\%$ decline in earnings before interest and taxes (EBIT) will result in a decline in earnings per share that is larger than X .
15. A firm's capital structure does not affect its calculated free cash flows, because FCF reflects only operating cash flows.

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Question Two:

(45 Marks)

Multiple Choice Questions:

16. Which is the best measure of risk for a single asset held in isolation, and which is the best measure for an asset held in a diversified portfolio?
- a. Variance; correlation coefficient. b. Standard deviation; correlation coefficient.
c. Beta; variance. d. Coefficient of variation; beta. e. Beta; beta.
17. Preston Inc.'s stock has a 25% chance of producing a 30% return, a 50% chance of producing a 12% return, and a 25% chance of producing a -18% return. What is the firm's expected rate of return?
- a. 7.72% b. 8.12% c. 8.55% d. 9.00% e. 9.50%
18. Levine Inc. is considering an investment that has an expected return of 15% and a standard deviation of 10%. What is the investment's coefficient of variation?
- a. 0.67 b. 0.73 c. 0.81 d. 0.89 e. 0.98
19. Bill Dukes has \$100,000 invested in a 2-stock portfolio. \$35,000 is invested in Stock X and the remainder is invested in Stock Y. X's beta is 1.50 and Y's beta is 0.70. What is the portfolio's beta?
- a. 0.65 b. 0.72 c. 0.80 d. 0.89 e. 0.98
20. Moerdyk Company's stock has a beta of 1.40, the risk-free rate is 4.25%, and the market risk premium is 5.50%. What is the firm's required rate of return?
- a. 11.36% b. 11.65% c. 11.95% d. 12.25% e. 12.55%
21. Desreumaux Inc's stock has an expected return of 12.25%, a beta of 1.25, and is in equilibrium. If the risk-free rate is 5.00%, what is the market risk premium?
- a. 5.80% b. 5.95% c. 6.09% d. 6.25% e. 6.40%
22. Last year Emery Industries had \$450 million of sales and \$225 million of fixed assets, so its FA/Sales ratio was 50%. However, its fixed assets were used at only 65% of capacity. If the company had been able to sell off enough of its fixed assets at book value so that it was operating at full capacity, with sales held constant at \$450 million, how much cash (in millions) would it have generated?
- a. \$74.81 b. \$78.75 c. \$82.69 d. \$86.82 e. \$91.16
23. Howton & Howton Worldwide (HHW) is planning its operations for the coming year, and the CEO wants you to forecast the firm's additional funds needed (AFN). The firm is operating at full capacity. Data for use in the forecast are shown below. However, the CEO is concerned about the impact of a change in the

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27. Based on the information below, what is Ezzel Enterprises' optimal capital structure?

- a. Debt = 40%; Equity = 60%; EPS = \$2.95; Stock price = \$26.50.
- b. Debt = 50%; Equity = 50%; EPS = \$3.05; Stock price = \$28.90.
- c. Debt = 60%; Equity = 40%; EPS = \$3.18; Stock price = \$31.20.
- d. Debt = 80%; Equity = 20%; EPS = \$3.42; Stock price = \$30.40.
- e. Debt = 70%; Equity = 30%; EPS = \$3.31; Stock price = \$30.00.

28. The firm's target capital structure should be consistent with which of the following statements?

- a. Maximize the earnings per share (EPS).
- b. Minimize the cost of debt (r_d).
- c. Obtain the highest possible bond rating.
- d. Minimize the cost of equity (r_s).
- e. Minimize the weighted average cost of capital (WACC).

29. Ting Technology has a capital budget of \$850,000, it wants to maintain a target capital structure of 35% debt and 65% equity, and it also wants to pay a dividend of \$400,000. If the company follows a residual dividend policy, how much net income must it earn to meet its capital budgeting requirements and pay the dividend, all while keeping its capital structure in balance?

- a. \$904,875 b. \$952,500 c. \$1,000,125
- d. \$1,050,131 e. \$1,102,638

30. Dentaltech Inc. projects the following data for the coming year. If the firm follows the residual dividend policy and also maintains its target capital structure, what will its payout ratio be?

EBIT	\$2,000,000	Capital budget	\$850,000
Interest rate	10%	% Debt	40%
Debt outstanding	\$5,000,000	% Equity	60%
Shares outstanding	\$5,000,000	Tax rate	40%

- a. 37.2% b. 39.1% c. 41.2% d. 43.3%

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Question Three:

(20 Marks)

Kindly attempt both parts of this question:

1. The financial management literature developed three main theories for dividends preferences of shareholders. Briefly explain these three theories and compare their implications for managers as to which are the best.
2. Discuss trade-off theory as well as signalling theory and compare both of them with the M-M theories.

End of Questions

Good Luck