Course Title: A.Financial Management Date: 22 /11 /2014 No. of Questions: (3) Time: 1.5 hour Using Calculator (Yes)	University of Palestine Midterm Exam. First Semester 2014 Total Grade: 20	Instructor Name: Yousef El-Mudallal Student Name: _______________ College Name: _______________ Dep. / Specialist: _____________ Using Dictionary (No)

Answer the following three questions:

Q.1 : True or False **6 marks**

1- Capital can be defined as the funds supplied by investors ( )
2- Diversifiable risk, which is measured by beta, can be lowered by adding more stocks to a portfolio ( )
3- A firm cannot change its beta through any managerial decision because betas are completely market determined ( )
4- If investors become more averse to risk, the slope of the Security Market Line (SML) will increase ( )
5- Risk aversion implies that some securities will go unpurchased in the market even if a large risk premium is paid to investors. ( )
6- We will generally find that the beta of a diversified portfolio is more stable over time than the beta of a single security( )
7- Funds acquired by the firm through retaining earnings have no cost because there are no dividend or interest payments associated with them, but capital raised by selling new stock or bonds does have a cost ( )
8- The lower the firm's tax rate, the lower will be the firm's after-tax cost of debt and WACC, other things held constant ( )

Q.2: Choose the correct answer **4.5 marks**

1- Inflation, recession, and high interest rates are economic events which are characterized as
   a. Company-specific risk that can be diversified away.
   b. Market risk.
   c. Systematic risk that can be diversified away.
   d. Diversifiable risk.
2- Which is the best measure of risk for an asset held in a well-diversified portfolio?
   a. Variance
   b. Standard deviation
   c. Expected value
   d. Beta
3- You observe the following information regarding Company X and Company Y:
   - Company X has a higher expected mean return than Company Y.
   - Company X has a lower standard deviation than Company Y.
   - Company X has a higher beta than Company Y.

   Given this information, which of the following statements is most correct?
   a. Company X has a lower coefficient of variation.
   b. Company Y has a lower coefficient of variation.
   c. Company X is a better stock to buy.
   d. Statements a and b and c are incorrect.

Q.3: Mini cases: Answer the following questions **11 marks**

1. A money manager is holding the following portfolio:

Stock	Amount Invested	Beta
1	$300,000	0.6
2	300,000	1.0
3	500,000	1.4
4	500,000	1.8

The risk-free rate is 6 percent and the portfolio's required rate of return is 12.5 percent.

   a. What is the Funds required rate of return?
   b. If the manager would like to sell all of her holdings of Stock 1 and use the proceeds to purchase more shares of Stock 4. What would be the portfolio's required rate of return following this change?

2. Rollins Corporation is estimating its WACC. Its target capital structure is 20 percent debt, 20 percent preferred stock, and 60 percent common equity. Its bonds have a 12 percent yield to maturity. The firm could sell, at par, $100 preferred stock which pays a 12 percent annual dividend, but flotation costs of 5 percent would be incurred. Rollins' beta is 1.2, the risk-free rate is 10 percent, and the market risk premium is 5 percent. Rollins is a constant-growth firm which just paid a dividend of $2.00, sells for $27.00 per share, and has a growth rate of 8 percent. The firm's policy is to use a risk premium of 4 percentage points when using the bond-yield-plus-risk-premium method to find r_s. The firm's marginal tax rate is 40 percent.

   1- What is Rollins' component cost of debt?
   2- What is Rollins' cost of preferred stock?
   3- What is Rollins' cost of common stock (r_s) using the CAPM approach?
   4- What is the firm's cost of common stock (r_s) using the DCF approach?
   5- What is Rollins' cost of common stock using the bond-yield-plus-risk-premium approach?

Good Luck