LOYOLA COLLEGE (AUTONOMOUS), CHENNAI – 600 034

B.Com. DEGREE EXAMINATION – **ACCOUNTING AND FINANCE**

THIRD SEMESTER – **NOVEMBER 2022**

UAF 3502 – STRATEGIC FINANCIAL MANAGEMENT - I

Date: 24-11-2022 Dept. No. Max. : 100 Marks

Time: 09:00 AM - 12:00 NOON

PART – A

Q. No **Answer ALL Multiple Choice Questions** **(70 x 1 = 70 Marks)**

1 If a company has a current ratio of 2.1 and pays off a portion of its accounts payable with cash, the current ratio will

A	Decrease
B	Increase
C	Remain unchanged
D	Move closer to the quick ratio

2 The following data is collected for the year ended March 31 of City Corporation: Net sales \$300,000 Net income 75,000 Total assets, January 1 1,000,000 Total assets, December 31 2,000,000 What was City's rate of return on assets for the year?

A	5%
B	3.75%
C	7.50%
D	20%

3 Last year, a company made \$9,300,000 in net credit sales (of which 10 percent were instalment sales). It also had a \$690,000 average accounts receivable balance. The terms of credit are 2/10 net 30. Last year's average collecting period, based on a 360-day year, was?

A	26.71 days.
B	26.2 days.
C	27.2 days.
D	33.4 days.

4 A company is currently reviewing the most recent fiscal year's results of operations and noted an increase in the return on assets ratio when compared to the prior year. Which one of the following could have caused the increase?

A	Sales decreased by the same dollar amount that expenses increased
B	Sales increased by the same dollar amount as expenses and total assets
C	Sales remained the same and expenses and total assets decreased.
D	Sales remained the same and ending inventory decreased

5 Jen Co. had 200,000 shares of common stock and 20,000 shares of 10%, \$100 par value cumulative preferred stock. No dividends on common stock were declared during the year. Net income was \$2,000,000. What was Jen's basic earnings per share?

A	\$9.00
B	\$9.09
C	\$10.00
D	\$11.11

6 A business organization is having following details: a growth rate of 18%, return on assets of 24%, debt-ratio is 40% market price of the stock is \$76 per share what is the return on equity?

A	26%
B	18%
C	24%
D	40%

7 Return on investment ratio of a company may be improved by

A	Increasing sales.
B	Reducing operating expenses.
C	Increasing capital utilization.
D	All of above.

8 Shown below are components of a company's financial statements.

Sales revenue	$600,000
Cost of goods sold	300,000
Total assets	2,400,000
Total equity	1,500,000
Net income	120,000

What percentage value would net income be on a common size financial statement?

A	5%.
B	8%.
C	20%
D	40%.

9 All of the following are included when calculating the acid test ratio except

A	six-month treasury bills
B	prepaid insurance
C	Accounts receivable
D	60-day certificates of deposit

10 The characteristics of venture capital include all of the following except

A	Initial private placement for the majority of issues.
B	A minimum holding period of 5 years for new securities.
C	The use of common stock for most placements.
D	A lack of liquidity for a period of time.

11 ABC Corporation is evaluating a lease that takes effect on April1. The company must make eight equal payments, with the first payment due on April 1. The concept most relevant to the evaluation of the lease is

A	The future value of an annuity due.
B	The present value of an annuity due.
C	The present value of an ordinary annuity.
D	The future value of an ordinary annuity.

12 Which one of the following statements about trade credit is correct? Trade credit is

A	not an important source of financing for small firms.
B	a source of long-term financing to the seller.
C	subject to risk of buyer default.
D	usually an inexpensive source of external financing.

13 Guru Corporation is considering borrowing $200,000 from a bank for 1 year at a stated interest rate of 6%. What is the effective interest rate to Elan if this borrowing is in the form of a discounted note?

A	5.38%
B	6.38%
C	7.38%
D	8.38%

14 Southern Corp. has a debt-to-equity ratio of 1.75, and total assets of $275 million. Southern is considering issuing another $60 million of debt and another $10 million of equity. What will be Southern's debt-to-equity ratio after the issuance?

A	1.46
B	1.63
C	1.75
D	2.14

15 ____ is the benchmark reference rate that is generally used when the borrower and lender are in different countries.

A	Prime rate.
B	LIBOR.
C	Repo rate.
D	Reverse repo rate.

16 What is the annual financing cost of foregoing the cash discount for trade credit with the term: 6/15 net 45, assuming year of 360 days?

A	56.5%
B	66.5%
C	76.5%
D	86.5%

17 A company is having a checking account in which $50,000 minimum balance was maintained. It took a loan from the same bank for $600,000 at 12% interest for which 10% compensating balance needs to be maintained. What is the effective cost of the loan, if interest on the checking account is 6%?

A	10.1%
B	11.1%
C	12.1%
D	13.1**%**

18 The best reason corporations issue Eurobonds rather than domestic bonds is that:

A	These bonds are denominated in the currency of the country in which they are issued.
B	These bonds are normally a less expensive form of financing because of the absence of government regulation.
C	Foreign buyers more readily accept the issues of both large and small U.S. corporations than do domestic investors.
D	Eurobonds carry no foreign exchange risk.

19 A company plans to issue new bonds. Which one of the following characteristics of the bond would cause it to have a higher coupon rate?

A	A call provision.
B	A conversion feature.
C	Attaching of warrants
D	More restrictive debt covenants.

20 A company's average total assets were $900 million, its average total liabilities were $300 million, and its net income was $270 million at the end of Year 1. Due to the planned purchase of a new production plant, the company's management expects average total assets to expand by $100 million in Year 2. At the beginning of Year 2, the company will issue $60 million in new debt. During the first year, no debt was paid off. How much does the company's return on total assets increase between Year 1 and Year 2 if management forecasts a 25% increase in net income in Year 2?

A	11%
B	17%
C	13%
D	20%

21 A corporation has a 30% return on equity, a 20% return on assets, and 40% dividend payout ratio. The sustainable growth rate of corporation is

A	12.0%.
B	70.0%.
C	8%.
D	18.0%.

22 Earnings per share disclosure is required by:

A	Banking companies.
B	Public and private companies other than non-for-profit organizations.

	C	Companies whose shares and potential shares are publicly traded.
	D	All companies.

23 The current ratio of a firm is 2.0. Cash makes up 20% of total current assets, accounts receivable makes up 40%, and inventory makes up 40%. What is the company's acid-test ratio?

A	1.6.
B	1.2.
C	0.8.
D	2.0.

24 According to its public financial statements, a company's gross profit margin decreased by 5% while its operating profit margin increased by 3%. Which one of the following factors could cause both of these changes?

A	An increase in the cost per unit of the goods purchased from a supplier.
B	A change to the variable costing income statement format
C	A lowered selling price to increase quantities sold
D	Sale of fully-depreciated production machinery at a gain and replacement of the machines with newer models.

25 Duckworth Toys had $8 million in sales, $6 million in cost of goods sold, and $0.5 million in selling and administrative expenses during the last fiscal year. If the company's income tax rate was 25%, what was the company's gross profit margin percentage?

A	50%
B	30%
C	40%
D	25%

26 In determining earnings per share, interest expense, net of applicable income taxes, on convertible debt that is dilutive should be

A	Added back to weighted-average common shares outstanding for diluted earnings per share.
B	Added back to net income for diluted earnings per share.
C	Deducted from net income for diluted earnings per share.
D	Deducted from weighted-average common shares outstanding for diluted earnings per share.

27 The return on assets of two companies is the same. The majority of Company X's assets were purchased at a modest price several years ago. The majority of Company Y's assets were obtained at a time when prices were rather high. Both corporations have the same amount of debt and list their assets at their historical value. The return on assets (ROA) ratio is most likely to be high.

A	Overstated for Company X.
B	Overstated for both companies.
C	Accurate for both companies.
D	Overstated for Company Y.

28 James Corporation has 500,000 shares of ordinary stock with a par value of $20 on the market. James paid a cash dividend of $7 per share this year and generated earnings per share of $8.40. James 's stock is now trading at $60 per share. The price-to-earnings ratio for James is

A	8.57.
B	2.38.
C	2.85.
D	7.14.

29 Sam Corporation had $1,000,000 in sales, a 10% profit margin, and $1,250,000 in assets. Sam Corporation opted to lower its debt ratio from 0.50 to 0.40 by selling new common stock and utilising the revenues to pay down some outstanding long-term debt principal. What is Sam Corporation's return on equity (ROE) after the refinancing?

A	2.50%
B	4.30%
C	1.33%
D	13.33%

30 The credit manager should be particularly concerned about the applicant's credit history while considering a credit application is

A	working capital and return on equity.
B	working capital and current ratio.
C	price-earnings ratio and current ratio.
D	profit margin and return on assets.

31 Newman Limited is effectively using leverage. The company has been profitable for years now. Which of the following ratios would be the largest?

A	Return on preferred equity.
B	Return on common equity.
C	Return on assets.
D	Return on total equity.

32 Which of the following items would best enable Driver Co. to determine whether the fair value of its investment in Favre Corp. is properly stated in the balance sheet?

A	Discounted cash flow of Favre's operations.
B	Quoted market prices available from a business broker for a similar asset.
C	Quoted market prices on a stock exchange for an identical asset.
D	Historical performance and return on Driver's investment in Favre.

33 The slope of a Security Market Line is

A	The market risk premium.
B	The graphical representation of the security's risk.
C	The graphical representation of the security's returns.
D	The beta

34 If Dexter Industries has a beta value of 1.0, then its

A	Volatility is low.
B	Expected return should approximate the overall market's expected return.
C	Price is relatively stable.
D	Return should equal the risk-free rate.

35 Systematic risk is

A	The possibility that an investment cannot be sold (converted into cash) for its market value.
B	Risk that cannot be diversified away by holding securities in a diversified portfolio.
C	Risk that can be diversified away by holding securities in a diversified portfolio.
D	Risk that can be quantified.

36 Hathaway Co's share price is $3·50 per share. One year ago its share price was $3·60 per share. The total shareholder return over the period is 3.1%. Working to one decimal place, what is dividend per share that the company paid? $

A	A 0.21
B	B 1.26
C	C 0.89
D	D 0.06

37 Kent Co had sales growth of 10% over the past year. EBIT grew by 15% and earnings per share (EPS) grew by 25% over the same period. Which of the following statements regarding Kent Co's gearing is correct?

A	Total gearing is equal to 0.9
B	B Total gearing is equal to 2.1
C	C Financial gearing is equal to 0.6
D	D Operating gearing is equal to 1.5

38 Using the capital asset pricing model, an analyst has calculated an expected risk adjusted return of 17% for the common stock of a company. The company's stock has a beta of 2, and the overall expected market return for equities is 10%. The risk-free return is 3%. All else being equal, the expected risk-adjusted return for the company's stock would increase if the

A	Overall expected market return for equities decreases.

	B	Volatility of the company's stock decreases.
	C	Risk-free return decreases.
	D	Beta of the company's stock decreases.

39 The U.S. Treasury Bill rate is 2%. The expected return on the market is 11%. OPQ Corp.'s common stock has a beta of 1.2, and its dividends have an expected growth rate of 2%. What is the stock's expected risk premium?

A	13.2%
B	10.8%
C	11%
D	9%

40 What kind of risk can be eliminated by diversification in a portfolio?

A	Market risk
B	Portfolio risk
C	Unsystematic risk
D	Systematic risk

41 All of the following are true about the beta coefficient except

A	The beta coefficient of an investment measures how sensitive the stock's return is to changes in the market's return.
B	The beta coefficient is the slope of the regression line that relates the return of an individual security to the return of its benchmark index.
C	The beta coefficient measures non-market risk.
D	The beta coefficient is used to measure a stock's market risk.

42 What type of risk cannot be eliminated through diversification?

A	Business risk
B	Unsystematic risk
C	Financial risk
D	Systematic risk

43 What correlation between returns on shares held will best reduce risk?

A	Perfect positive correlation
B	No correlation
C	Perfect negative correlation
D	Weak correlation

44 What is a major advantage of issuing long-term debt?

A	Increased financial flexibility
B	The reduction in profit before tax
C	Decreased financial risk
D	The reduction of shareholders' control over the company

45 P Co has just paid a dividend of 10c. Shareholders expect dividends to grow at 7% pa. P Co's cost of equity is 12.2%. What is P Co's per share value? $

A	1.85
B	2.05
C	2.15
D	2.25

46 A company has in issue 9% redeemable debt with 10 years to redemption. Redemption will be at par of $100. The investors require a return of 15%. What is the market value of the debt?

A	70
B	75
C	80
D	85

47 The common stock of a beverage company has a current market price of $34. The beverage company is estimated to earn $2 per share in the next year. The average price/earnings ratio of companies in the beverage industry is 15. Using the price/earnings ratio as the comparable valuation method, the beverage company's stock is

A	$4 overvalued.

B	$2 overvalued.
C	$4 undervalued.
D	$2 undervalued.

48 The price of Investors, Inc. stock is $31.25, and its beta is 1.2. The stock's next annual dividend will be $1.25, and dividends are expected to grow at the rate of 5% per year. The risk-free rate is 3%. What is the expected return to the market?

A	8.00%
B	8.17%
C	9.00%
D	10.20%

49 Which one of the following characteristics distinguishes income bonds from other bonds?

A	By promising a return to the bondholder, an income bond is junior to preferred and common stock.
B	The bondholder is guaranteed an income over the life of the security.
C	Income bonds pay interest only if the issuing company has earned the interest.
D	Income bonds are junior to subordinated debt but senior to preferred and common stock.

50 An investor is currently holding income bonds, debentures, subordinated debentures, and first-mortgage bonds. Which of these securities traditionally is considered to have the least risk?

A	Subordinated debentures.
B	Income bonds.
C	First-mortgage bonds.
D	Debentures.

51 In practice, dividends

A	Tend to be a lower percentage of earnings for mature firms.
B	Fluctuates more widely than earnings.
C	Usually exhibit greater stability than earnings.
D	Are usually set as a fixed percentage of earnings

52 Which of the following is the correct definition of a warrant?

A	Security or collateral provided for debt
B	Shares issued in lieu of a cash dividend
C	Restrictive covenants written into debt contracts
D	Similar to Share options

53 Which of the following usually determines the optimal capital structure for an organisation?

A	Maximum degree of financial gearing
B	Maximum degree of operating gearing
C	Lowest weighted average cost of capital
D	Capital structure used by competitors

54 Jack Co owns a $1,000 face value loan note purchased at nominal value with an annual coupon of 5%. What would happen to the market value of the loan note if market interest rates later decreased to 4% and why?

A	Increase because the loan note pays a higher coupon than the current market rate
B	Stay the same since the loan note pays a fixed coupon
C	Stay the same since the firm's credit rating has not changed
D	Decrease since market interest rates have declined

55 A loan note has a fixed annual coupon of 7% and it will be repaid at its face value of $100 in one year's time. Similar loan notes have a gross redemption yield (i.e. yield to maturity) of 8%. What is the current market value of the loan note?

A	$99·07
B	$100·00
C	$100·93
D	$106·07

56 On July 14, an investor goes short on a call option for 100 shares of CDM Corporation common stock with a strike price of $70.00, expiring on August 16, at an option premium of $3.00 per share. The market price of CDM on July 14 is $68.00. On August 16, the market price of CDM is $75.00.

How much has the investor gained or lost on the option transaction? Disregard any brokerage commissions involved.

A	$200 gain.
B	Loss of $500.
C	Loss of $200.
D	Gain of $300

57 On July 14, an investor goes long on a call option for 100 shares of AMB Corporation common stock with a strike price of $27.00, expiring on August 16, at an option premium of $4.50 per share. The market price of AMB on July 14 is $31.00. On August 16, the market price of AMB is $35.00. How much has the investor gained or lost on the option transaction? Disregard any brokerage commissions involved.

A	$800 gain.
B	$350 loss.
C	$350 gain.
D	$450 loss

58 Which working capital financing policy exposes the firm to the greatest risk of being unable to meet its obligations as they fall due?

A	Financing fluctuating current assets with long-term debt
B	Financing permanent current assets with long-term debt
C	Financing permanent current assets with short-term debt
D	Financing fluctuating current assets with short-term debt

59 Which of the following might be associated with a shortening working capital cycle?

A	Lower net operating cash flow
B	B Increasing tax-allowable depreciation expenditure
C	Slower inventory turnover
D	Taking longer to pay suppliers

60 The cash operating cycle is equal to which of the following?

A	Receivables days plus inventory holding period minus payables days
B	Inventory holding period minus receivables days minus payables days
C	Receivables days plus inventory holding period plus payables days
D	Receivables days minus payables days minus inventory holding period

61 Which of the following is an advantage of implementing just-in-time inventory management?

A	Quality control costs will be eliminated
B	Monthly finance costs incurred in holding inventory will be kept constant
C	The frequency of raw material deliveries is reduced
D	The amount of obsolete inventory will be minimized

62 Which of the following is/are true?

(1) A conservative working capital investment policy implies a higher proportion of permanent current assets to fluctuating current assets

(2) Long-term finance is generally cheaper than short-term finance

A	1 only is correct
B	2 only is correct
C	1 and 2 are correct
D	1 and 2 are incorrect

63 Amicable Wireless Co offers customers credit terms of 2% discount for payment within 10 days or full payment within 25 days. 60% of Amicable's customers take the 2% discount and pay on day 10. The remainder of Amicable's customers pay on day 30. What is Amicable's receivables days?

A	16
B	12
C	18
D	20

64 Which of the following transactions would increase the current ratio and decrease net profit?

A	Tax due from the previous year is paid
B	A long-term bond is redeemed

C	A scrip dividend is paid
D	Land is sold for less than the net book value

65 Will Co incurs costs of $65 every time it places an order with its raw materials supplier. It orders 300,000 units of product each year. The cost of holding one unit of inventory for a month is $30. Calculate the economic order quantity (EOQ) that will optimise the business's inventory costs is?

A	1140
B	1350
C	1220
D	890

66 Which TWO of the following would be key aspects of a company's accounts receivable credit policy?

A Assessing creditworthiness
B Checking credit limits once a year
C Invoicing promptly and collecting overdue debts
D Delaying payments to obtain a 'free' source of finance

A	A&C
B	A&B
C	A&D
D	B&C

67 Which of the following statements is consistent with an aggressive working capital funding policy?

A	Most current assets are financed with long-term funding rather than short-term funding, despite long-term funding being more expensive
B	Most current assets are funded with debt rather than equity, as it is cheaper
C	Most current assets are financed with short-term funding rather than long-term funding, despite the higher risk involved
D	Most current assets are funded by secured funding to enable the financial manager to focus on managing the working capital balances

68 The merger of ICICI Bank and Allahabad Bank is an example of:

A	Cross-border merger
B	Horizontal merger
C	Conglomerate merger
D	Vertical merger

69 Platinum Co is US-based and has a receivable due in 30 days for 30,000 euros. The treasurer is concerned that the value of the euro relative to the dollar will drop before the payment is received. What should Platinum do to reduce this risk?

A	Deposit 30,000 euros today
B	Enter into an interest rate swap contract for 30 days
C	Enter into a forward contract to sell 30,000 euros in 30 days
D	Platinum cannot effectively reduce this risk

70 Freely fluctuating exchange rates perform which of the following functions?

A	They tend to correct a lack of equilibrium between imports and exports
B	They make imports cheaper and exports more expensive
C	They impose constraints on the domestic economy
D	They eliminate the need for foreign currency hedging

Part - B **2 x 15 = 30 Marks**

71 The equity beta of Fence Co is 0.9 and the company has issued 10 million ordinary shares. The market value of each ordinary share is $7.50. The company is also financed by 5.5% bonds with a market value of $15 million. The risk-free rate of return is 4% per year and the average return on the stock market is 11% per year. Fence pay corporation tax at a rate of 20% per year.

a. Required to Calculate the current weighted average cost of capital of Fence Co. (5 marks)
b. Explain the difference between systematic and unsystematic risk in relation to portfolio theory and the capital asset pricing model. (5 marks)
c. Explain why businesses are unlikely to have high financial gearing and high operating gearing together. (5 marks)

72 Phoenix Industries, a textile manufacturer, is in contract talks with the labor organization that represents its hourly production workers. Negotiations have come to a halt, and a strike appears to be on the cards. If and when a strike occurs, the controller has summoned the general accounting manager to his office to discuss liquidity difficulties.If a strike occurs, the controller asks the accounting manager to identify actions to assess liquidity. Although some non-union employees may be able to continue working during the strike, the controller would prefer to be cautious and anticipate no shipments during this time period. Customers may seek products from other suppliers during a strike, therefore cash receipts for current outstanding amounts due by customers may not be paid in a timely manner.

a) Define liquidity and explain its importance (7.5 Marks)
b) Bring out the significance of Increasing current asset or decreasing current liability in a company (4 Marks)
c) How will you interpret the Liquidity position of the company (3.5 Marks)

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