Multiple choice questions on Business Valuation

1. Which one of the following is covered in the valuation report?

A Proposed Transaction

B Related Parties

C Share Holding Pattern

D Valuation Methodologies

Answer: D

2. An asset is officially appraised and priced on _____.

A verification date

B valuation date

C report date

D effective date

Answer: B

3. Which of the following would most likely be useful for performing sensitivity analysis of business valuation?

A Standard of Value

B Understanding of Business

C Premise of Value

D Audit Opinion

Answer: B

4. Valuation report will depict the value of a firm is usually based on ________.

A the value of debt and equity

B the value of assets and liabilities

C the value of debt

D the value of equity

Answer: D

5. In a valuation exercise, which of the following methods is included in 'Asset based approach' (cost-based approach)?

A Comparable Companies' Multiple Method

B Replacement Method

C Earnings Capitalization Method

D Discounted Cash Flow Method

Answer: B

6. In case of valuation of firms for takeovers, which of the following provides a better estimate of value?

A Cash flows

B Free cash flows

C Future cash flows

D Free cash flow to equity

Answer: D

7. Principle of time value of money is applicable for

A Discounting future cash flow method

B Relative valuation method

C Net Asset value method

D None of the above

Answer: A

8. Synergistic value is

A The historical value of combined operations

B The net present value of expected future cash flows of the acquirer

C The net present value of expected future cash flows for the combined operations and additional benefits expected to accrue.

D. None of the above.

Answer C

9. The price paid to acquire an asset or received to assume a liability in an exchange transaction is represented by:

A Entry price

B Exit price

C Both entry and exit price

D None of the above

Answer: A

10. The price that would be received to sell an asset or paid to transfer a liability is represented by,

A Entry price

B Exit price

C Both entry and exit price

D None of the above

Answer: B

11. The premise of value of a business enterprise that is expected to continue to operate in the future is considered as,

A Liquidation basis of valuation

B Going concern basis of valuation

C As is where is basis of valuation

D None of the above

Answer: B

12. Basis of valuation of a non-financial asset by market participants that would maximize the value of the asset or the group of assets (e.g., a business) within which the asset would be used is considered as.

A Replacement basis

B Going concern basis

C Highest and Best Use basis

D None of the above

Answer: C

13. Net present value of expected future cash flows completely independent of any acquisition is considered as

A Synergy value

B Intrinsic value

C Market value

D None of the above

Answer: B

14. The valuation principle of risk and return considers the following assumptions

A an investor is risk averse,

B given two portfolio investments have similar risk profile, one with the higher expected return will always be preferred by the investor as it drives higher wealth and higher consumption value.

C Both the above

D None of the above

Answer: C

15. In order to faithfully represent the value, the valuation report needs to be evaluated in valuation assignment in accordance with their

A substance

B legal form

C Both (A) and (B) above

D None of (A) and (B) above

Answer: A

16. Faithful representation in a valuation report needs to have three characteristics, namely,

A error-free,

B neutrality

C completeness

D All of the above

Answer: D

17. An asset is defined as

A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity

B resource controlled by the entity as a result of future events and from which past economic benefits are expected to flow to the entity

C resource controlled by the entity as a result of past events and from which past economic benefits are expected to flow to the entity

D None of the above

Answer: A

18. A liability is defined as

A A future obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

B A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

C A present obligation of the entity arising from future events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

D None of the above

Answer: B

19. Which of the following methods is included in 'Asset based approach' (cost-based approach)?

A Comparable Companies' Multiple Method

B Replacement Method

C Earnings Capitalization Method

D Discounted Cash Flow Method

Answer: B

20. What adjustment is made while using the Discounted Cash Flow method to value cyclical companies?

A Normalize earnings

B Use high discount rate

C Use bank rate for discounting

D Use high growth rate

Answer: D

21. An investment entity evaluates the performance of its investments on __________value basis.

A fair

B book

C market

D use

Answer: A

22. The term "capital structure" refers to:

A Long-term debt, preferred stock, and common stock equity.

B Current assets and current liabilities.

C Total assets minus liabilities.

D Shareholders' equity.

Answer: A

23. A critical assumption of the net operating income (NOI) approach to valuation is:

A That debt and equity levels remain unchanged.

B That dividends increase at a constant rate.

C That ko remains constant regardless of changes in leverage.

D That interest expense and taxes are included in the calculation.

Answer: C

24. The traditional approach towards the valuation of a company assumes:

A That the overall capitalization rate holds constant with changes in financial leverage.

B That there is an optimum capital structure.

C That total risk is not altered by changes in the capital structure.

D That markets are perfect.

Answer: B

25. Two firms that are virtually identical except for their capital structure are selling in the market at different values. According to M&M

A One will be at greater risk of bankruptcy.

B The firm with greater financial leverage will have the higher value.

C This proves that markets cannot be efficient.

D This will not continue because arbitrage will eventually cause the firms to sell at the same value.

Answer: D

26. What is the model called that determines the present value of a stock based on its next annual dividend, the dividend growth rate, and the applicable discount rate?

A. zero growth

B. dividend growth

C. capital pricing

D. earnings capitalization

E. discounted dividend

Answer: B

27. Which one of the following is computed by dividing next year's annual dividend by the current stock price?

A. yield to maturity

B. total yield

C. dividend yield

D. capital gains yield

E. growth rate

Answer: C

28. Which one of the following is a type of equity security that has a fixed dividend and a priority status over other equity securities?

A. senior bond

B. debenture

C. warrant

D. common stock

E. preferred stock

Answer: E

29. Belpahari Enterprises stock is listed on Dalal Street. The firm is planning to issue some new equity shares for sale to the general public. This sale will occur in which one of the following markets?

A. private

B. auction

C. exchange floor

D. secondary

E. primary

Answer: E

30. The secondary market is best defined by which one of the following?

A. market in which subordinated shares are issued and resold

B. market conducted solely by brokers

C. market dominated by dealers

D. market where outstanding shares of stock are resold

E. market where warrants are offered and sold

Answer: D

31. An increase in which of the following will increase the current value of a stock according to the dividend growth model?

I. dividend amount

II. number of future dividends, provided the current number is less than infinite

III. discount rate

IV. dividend growth rate

A. I and II only

B. III and IV only

C. I, II, and III only

D. I, II, and IV only

E. I, II, III, and IV

Answer: D

32. The dividend growth model:

I. assumes that dividends increase at a constant rate forever.

II. can be used to compute a stock price at any point in time.

III. can be used to value zero-growth stocks.

IV. requires the growth rate to be less than the required return.

A. I and III only

B. II and IV only

C. I, III, and IV only

D. I, II, and IV only

E. I, II, III, and IV

Answer: E

33. Which one of the following is an underlying assumption of the dividend growth model?

A. A stock has the same value to every investor.

B. A stock's value is equal to the discounted present value of the future cash flows which it generates.

C. A stock's value changes in direct relation to the required return.

D. Stocks that pay the same annual dividend have equal market values.

E. The dividend growth rate is inversely related to a stock's market price.

Answer: B

34. Akshay Industries has a dividend policy whereby the firm pays a constant annual dividend of Rs. 2.40 per share of common stock. The firm has 1,000 shares of stock outstanding. The company:

A. must always show a current liability of Rs.2,400, (Rs.2.40 $\times$ 1,000), for dividends payable.

B. must still declare each dividend before it becomes an actual company liability.

C. is obligated to pay Rs. 2.40 per share each year in perpetuity.

D. will be declared in default if it does not pay at least Rs. 2.40 per share per year on a timely basis.

E. has a liability that must be paid at a later date should the company miss paying an annual dividend payment.

Answer: B

35. Which one of these statements related to preferred stock is correct?

A. Preferred shareholders normally receive one vote per share of stock owned.

B. Preferred shareholders determine the outcome of any election that involves a proxy fight.

C. Preferred shareholders are considered to be the residual owners of a corporation.

D. Preferred stock normally has a stated liquidating value of Rs.1,000 per share.

E. Cumulative preferred shares are more valuable than comparable non- cumulative shares.

Answer: E

36. Which of the following features do preferred shareholders and bondholders frequently have in common?

I. lack of voting rights

II. conversion option into common stock

III. annuity payments

IV. fixed liquidation value

A. I and II only

B. III and IV only

C. II, III, and IV only

D. I, III, and IV only

E. I, II, III, and IV

Answer: E

37. **Asha Brothers Hardware paid an annual dividend of Rs.1.15 per share last month. Today, the company announced that future dividends will be increasing by 2.6 percent annually. If you require a 12 percent rate of return, how much are you willing to pay to purchase one share of this stock today?**

A. Rs.12.23

B. Rs.12.55

C. Rs.12.67

D. Rs.12.72

E. Rs.12.88

Answer: B

$$P0 = \frac{Rs.1.15 \times (1 + 0.026)}{0.12 - 0.026} = Rs.12.55$$

38. Seismic Manufacturers made two announcements concerning its common stock today. First, the company announced that the next annual dividend will be Rs.1.75 a share. Secondly, all dividends after that will decrease by 1.5 percent annually. What is the maximum amount you should pay to purchase a share of this stock today if you require a 14 percent rate of return?

A. Rs.11.29

B. Rs.12.64

C. Rs.13.27

D. Rs.14.00

E. Rs.14.21

Answer: A

$$P0 = \frac{Rs.1.75}{0.14 - (-0.015)} = Rs.11.29$$

39. The common stock of Auto Deliveries sells for $28.16 a share. The stock is expected to pay Rs.1.35 per share next year when the annual dividend is distributed. The firm has established a pattern of increasing its dividends by 3 percent annually and expects to continue doing so. What is the market rate of return on this stock?

A. 7.42 percent

B. 7.79 percent

C. 19.67 percent

D. 20.14 percent

E. 20.86 percent

Answer: B

$$Rs.28.16 = \frac{Rs.1.35}{R - 0.03}$$

Where, R = 7.79 percent

40. Electronics Ltd. common stock returned a nifty 22.68 percent rate of return last year. The dividend amount was Rs.0.25 a share which equated to a dividend yield of 0.84 percent. What was the rate of price appreciation for the year?

A. 21.84 percent

B. 22.38 percent

C. 22.60 percent

D. 22.87 percent

E. 23.52 percent

Answer: A

g = 0.2268 - 0.0084 = 21.84 percent

41. Atlas Mines has adopted a policy of increasing the annual dividend on its common stock at a constant rate of 2.75 percent annually. The firm just paid an annual dividend of Rs.1.67. What will the dividend be six years from now?

A. Rs.1.88

B. Rs.1.92

C. Rs.1.97

D. Rs.2.02

E. Rs.2.05

Answer: C

D6 = Rs.1.67 × (1.0275)6 = Rs.1.97

42. Home Canning Products common stock sells for Rs.44.96 a share and has a market rate of return of 12.8 percent. The company just paid an annual dividend of Rs.1.04 per share. What is the dividend growth rate?

A. 8.29 percent

B. 8.45 percent

C. 9.23 percent

D. 9.67 percent

E. 10.25 percent

Answer: E

$$\text{Rs.}44.96 = \frac{\text{Rs.}1.04 \times (1+g)}{0.128 - g} = 10.25 \text{ percent}$$

43. Summer Home Ltd is going to pay an annual dividend of Rs.2.86 a share on its common stock next year. This year, the company paid a dividend of Rs.2.75 a share. The company adheres to a constant rate of growth dividend policy. What will one share of this common stock be worth five years from now if the applicable discount rate is 11.7 percent?

A. Rs.43.45

B. Rs.43.87

C. Rs.44.15

D. Rs.45.19

E. Rs.47.00

Answer: D

$$g = \frac{\text{Rs.}2.86 - \text{Rs.}2.75}{\text{Rs.}2.75} = 0.04$$

$$P5 = \frac{\text{Rs.}2.86 \times (1 + 0.04)5}{0.117 - 0,04} = \text{Rs.}45.19$$

44. Use the following information to answer the three questions below:

A firm has an opportunity cost of capital of 15%, it can borrow long term debt at a cost of 10%, its marginal tax rate is 50% and it has an expected cash flow to the firm of 150 (in perpetuity). The market value of its equity and debt are 900 and 600, respectively.

What is the firm's WACC? Choose the closest number (unless you think it cannot be determined).

A. 10.19%

B. 10.87%

C. 9.82%

D. 11.55%

E. It cannot be determined from the data.

Answer: B (true value is 11%).

45. What is the value of the firm's equity estimated from cash flows to the firm? Choose the closest number (unless you think it cannot be determined).

A. 1364

B. 1090

C. 800

D. 764

E. It cannot be determined from the data.

Answer: D

46. What is the value of the firm's equity estimated from cash flows to the equity holders? Choose the closest number (unless you think it cannot be determined).

A. 1364

B. 1090

C. 800

D. 764

E. It cannot be determined from the data.

Answer: C.

47. For most firms, P/E ratios and risk

A. will be directly related.

B. will have an inverse relationship.

C. will be unrelated.

D. will both increase as inflation increases.

E. None of these is correct.

Answer: B

In the context of the constant growth model, the higher the risk of the firm the lower its P/E ratio.

48. A firm has a return on equity of 14% and a dividend payout ratio of 60%. The firm's anticipated growth rate is ________.

A. 5.6%

B. 10%

C. 14%

D. 20%

E. None of these is correct

Answer: A

14% X 0.40 = 5.6%.

49. A firm has a return on equity of 20% and a dividend payout ratio of 30%. The firm's anticipated growth rate is ________.

A. 6%

B. 10%

C. 14%

D. 20%

E. None of these is correct

Answer: C

20% X 0.70 = 14%.

50. Sales Company paid a Rs.1.00 dividend per share last year and is expected to continue to pay out 40% of earnings as dividends for the foreseeable future. If the firm is expected to generate a 10% return on equity in the future, and if you require a 12% return on the stock, the value of the stock is _______.

A. Rs.17.67

B. Rs.13.00

C. Rs.16.67

D. Rs.18.67

E. None of these is correct

Answer: A

g = 10% X 0.6 = 6%; P = 1 (1.06)/(.12 − .06) = Rs.17.67.

51. A firm's earnings per share increased from Rs.10 to Rs.12, dividends increased from Rs.4.00 to Rs.4.80, and the share price increased from Rs.80 to Rs.90. Given this information, it follows that _______.

A. the stock experienced a drop in the P/E ratio

B. the firm had a decrease in dividend payout ratio

C. the firm increased the number of shares outstanding

D. the required rate of return decreased

E. None of these is correct

Answer: A

Rs.80/Rs.10 = 8; Rs.90/Rs.12 = 7.5.

52. 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

E. None of these is correct

Answer: C

A, B, and D are incorporated into the discount rate used in the dividend discount model.

53. Riskpro Ltd is expected to pay a dividend of Rs.3.50 in the coming year. Dividends are expected to grow at a rate of 10% per year. The risk-free rate of return is 5% and the expected return on the market portfolio is 13%. The stock is trading in the market today at a price of Rs.90.00.

What is the market capitalization rate for Riskpro Ltd?

A. 13.6%

B. 13.9%

C. 15.6%

D. 16.9%

E. None of these is correct

Answer: B

k = 3.50/90 + .10; k = 13.9%

54. What is the approximate beta of Riskpro's stock?

A. 0.8

B. 1.0

C. 1.1

D. 1.4

E. None of these is correct

Answer: C

k = 13.9%; 13.9 = 5% + b (13% − 5%) = 1.11.

55. Old Quartz Gold Mining Company is expected to pay a dividend of Rs.8 in the coming year. Dividends are expected to decline at the rate of 2% per year. The risk-free rate of return is 6% and the expected return on the market portfolio is 14%. The stock of Old Quartz Gold Mining Company has a beta of -0.25. The intrinsic value of the stock is _____.

A. Rs.80.00

B. Rs.133.33

C. Rs.200.00

D. Rs.400.00

E. None of these is correct

Answer: B

k = 6% + [−0.25(14% − 6%)] = 4%; P = 8/[.04 − (−.02)] = Rs.133.33.

56. An analyst has determined that the intrinsic value of IBM stock is Rs.80 per share using the capitalized earnings model. If the typical P/E ratio in the computer industry is 22, then it would be reasonable to assume the expected EPS of IBM in the coming year is _____.

A. Rs.3.64

B. Rs.4.44

C. Rs.14.40

D. Rs.22.50

E. None of these is correct

Answer: A

Rs.80(1/22) = Rs.3.64.

57. Torque Corporation is expected to pay a dividend of Rs.1.00 in the upcoming year. Dividends are expected to grow at the rate of 6% per year. The risk-free rate of return is 5% and the expected return on the market portfolio is 13%. The stock of Torque Corporation has a beta of 1.2.

What is the return you should require on Torque's stock?

A. 12.0%

B. 14.6%

C. 15.6%

D. 20%

E. None of these is correct

Answer: B. Working - 5% + 1.2(13% − 5%) = 14.6%.

58. What is the intrinsic value of Torque's stock?

A. Rs.14.29

B. Rs.14.60

C. Rs.12.33

D. Rs.11.62

E. None of these is correct

Answer: D

Working: k = 5% + 1.2(13% − 5%) = 14.6%; P = 1 / (.146 − .06) = Rs.11.62.

59. The most popular approach to forecasting the overall stock market is to use

A. the dividend multiplier.

B. the aggregate return on assets.

C. the historical ratio of book value to market value.

D. the aggregate earnings multiplier.

E. Tobin's Q.

Answer: D

The earnings multiplier approach is the most popular approach to forecasting the overall stock market.

60. Paper Express Company has a balance sheet which lists Rs.85 million in assets, Rs.40 million in liabilities and Rs.45 million in common shareholders' equity. It has 1,400,000 common shares outstanding. The replacement cost of the assets is Rs.115 million. The market share price is Rs.90.

What is Paper Express's book value per share?

A. Rs.1.68

B. Rs.2.60

C. Rs.32.14

D. Rs.60.71

E. None of these is correct

Answer: C

Rs.45M/1.4M = Rs.32.14.

61. What is Paper Express's market value per share?

A. Rs.1.68

B. Rs.2.60

C. Rs.32.14

D. Rs.60.71

E. None of these is correct

Answer: E

The price of Rs.90.

62. A preferred stock will pay a dividend of Rs.6.00 in the upcoming year, and every year thereafter, i.e., dividends are not expected to grow. You require a return of 10% on this stock. Use the constant growth DDM to calculate the intrinsic value of this preferred stock.

A. Rs.0.60

B. Rs.6.00

C. Rs. 600

D. Rs. 60.00

E. None of these is correct

Answer: D

6.00/.10 = 60.00

63. A preferred stock will pay a dividend of Rs.7.50 in the upcoming year, and every year thereafter, i.e., dividends are not expected to grow. You require a return of 10% on this stock. Use the constant growth DDM to calculate the intrinsic value of this preferred stock.

A. Rs.0.75

B. Rs.7.50

C. Rs.64.12

D. Rs.56.25

E. None of these is correct

Answer: E

7.50/.10 = 75.00

64. A preferred stock will pay a dividend of Rs.2.75 in the upcoming year, and every year thereafter, i.e., dividends are not expected to grow. You require a return of 10% on this stock. Use the constant growth DDM to calculate the intrinsic value of this preferred stock.

A. Rs.0.275

B. Rs.27.50

C. Rs.31.82

D. Rs.56.25

E. None of these is correct

Answer: B

2.75/.10 = 27.50

65. Each of two stocks, C and D, are expected to pay a dividend of Rs.3 in the upcoming year. The expected growth rate of dividends is 9% for both stocks. You require a rate of return of 10% on stock C and a return of 13% on stock D. The intrinsic value of stock C ____.

A. will be greater than the intrinsic value of stock D

B. will be the same as the intrinsic value of stock D

C. will be less than the intrinsic value of stock D

D. cannot be calculated without knowing the market rate of return

E. None of these is correct.

Answer: A

PV0 = D1/ (k − g); given that dividends are equal, the stock with the larger required return will have the lower value.

66. If the expected ROE on reinvested earnings is equal to k, the multistage DDM reduces to

A. V0= (Expected Dividend Per Share in Year 1)/k

B. V0= (Expected EPS in Year 1)/k

C. V0= (Treasury Bond Yield in Year 1)/k

D. V0= (Market return in Year 1)/k

E. None of these is correct

Answer: B

If ROE = k, no growth is occurring; b = 0; EPS = DPS

67. The Gordon model

A. is a generalization of the perpetuity formula to cover the case of a growing perpetuity.

B. is valid only when g is less than k.

C. is valid only when k is less than g.

D. is a generalization of the perpetuity formula to cover the case of a growing perpetuity and is valid only when g is less than k.

E. is a generalization of the perpetuity formula to cover the case of a growing perpetuity and is valid only when k is less than g.

Answer: D

68. The ______ is a common term for the market consensus value of the required return on a stock.

A. dividend payout ratio

B. intrinsic value

C. market capitalization rate

D. plowback rate

E. None of these is correct

Answer: C

The market capitalization rate, which consists of the risk-free rate, the systematic risk of the stock and the market risk premium, is the rate at which a stock's cash flows are discounted in order to determine intrinsic value.

69. _______ is the amount of money per common share that could be realized by breaking up the firm, selling the assets, repaying the debt, and distributing the remainder to shareholders.

A. Book value per share

B. Liquidation value per share

C. Market value per share

D. Tobin's Q

E. None of these is correct

Answer: B

Book value per share is assets minus liabilities divided by number of shares. Liquidation value per share is the amount a shareholder would receive in the event of bankruptcy. Market value per share is the market price of the stock.

70. KL Airlines paid an annual dividend of Rs.1.42 a share last month. The company is planning on paying Rs.1.50, Rs.1.75, and Rs.1.80 a share over the next 3 years, respectively. After that, the dividend will be constant at Rs.2 per share per year. What is the market price of this stock if the market rate of return is 10.5 percent?

A. Rs.15.98

B. Rs.16.07

C. Rs.18.24

D. Rs.21.16

E. Rs.24.10

Answer: C

$$P1 = \frac{Rs.2}{0.105} = Rs.19.05$$

$$P0 = \frac{1.50}{(1+0.105)^1} + \frac{Rs.1.75}{(1+0.105)^2} + \frac{Rs.1.80 + Rs.19.05}{(1+0.105)^3} = Rs.18.24$$

71. Paradip Metals paid its first annual dividend yesterday in the amount of Rs.0.18 a share. The company plans to double each annual dividend payment for the next 3 years. After that time, it plans to pay Rs.1.25 a share for 2 years than then pay a constant dividend of Rs.1.60 per share indefinitely. What is one share of this stock worth today if the market rate of return on similar securities is 10.24 percent?

A. Rs.12.32

B. Rs.12.77

C. Rs.13.20

D. Rs.14.26

E. Rs.14.79

Answer: C

$$P5 = \frac{Rs.1.60}{0.1024} = Rs.15.625$$

$$P0 = \frac{Rs.0.36}{(1+0.1024)^1} + \frac{Rs.0.72}{(1+0.1024)^2} + \frac{Ra.1.44}{(1+0.1024)^3} + \frac{Rs.1.25}{(1+0.1024)^4} + \frac{Rs1.25 + Rs.15.625}{(1+0.1024)^5}$$
$$= Rs.13.20$$

72. The preferred stock of Malabar Industries Ltd, pays an annual dividend of Rs.7.50 and sells for Rs.59.70 a share. What is the rate of return on this security?

A. 10.38 percent

B. 11.63 percent

C. 12.56 percent

D. 12.72 percent

E. 12.84 percent

Answer: C

R = Rs.7.50/Rs.59.70 = 12.56 percent

73. Beacon Software Ltd is expecting a period of intense growth and has decided to retain more of its earnings to help finance that growth. As a result, it is going to reduce its annual dividend by 30 percent a year for the next 2 years. After that, it will maintain a constant dividend of Rs.2.50 a share. Last year, the company paid Rs.3.60 as the annual dividend per share. What is the market value of this stock if the required rate of return is 14.5 percent?

A. Rs.14.63

B. Rs.16.70

C. Rs.18.08

D. Rs.19.61

E. Rs.21.23

Answer: B

$$P2 = \frac{Rs.2.50}{0.145} = Rs.17.24$$

$$P0 = \frac{Rs.3.60 \times (1-0.30)}{(1+0.145)^1} + \frac{Rs.3.60 \times (1-0.30)^2 + Rs.17.24}{(1+0.145)^2} = Rs.16.70$$

74. Value of a firm is usually based on ________.

A the value of debt and equity

B the value of assets and liabilities

C the value of debt

D the value of equity

Answer: D

75. An asset is officially appraised and priced on _____.

A verification date

B valuation date

C report date

D effective date

Answer: B

76. Which one of the following is covered in the valuation report?

A Proposed Transaction

B Related Parties

C Share Holding Pattern

D Valuation Methodologies

Answer: D

77. Which of the following valuation methods would most likely not be used for business valuation?

A Discounted Cash Flow

B Net Assets Method

C Multi-period Excess Earning Method

D Industry Price Earnings Ratio

Answer: C

78. When attempting to build a risk premium into the required returns of stocks in a developing country, an analyst should use the ________.

A country spread model

B country's weighted average cost of capital

C modified Gordon growth model

D dividend discount model

Answer: A

79. A disadvantage of the Enterprise Value method for valuing equity is that it may be difficult to obtain the information about _______.

A operating income

B market value of debt

C market value of equity

D cash and cash equivalent

Answer: B

80. An analyst is valuing a firm's equity using the 'Enterprise Value to Revenue Ratio' of similar firms. Which of the following is not a factor that the analyst should use?

A Revenue growth

B EBITDA margins

C Expected return

D Debt Equity ratio

Answer: D

81. Which of the following would most likely be useful for performing sensitivity analysis of business valuation?

A Standard of Value

B Understanding of Business

C Premise of Value

D Audit Opinion

Answer: B

82. What do 'Cash Cows' symbolize in The Boston Consulting Group's product portfolio matrix?

A Remain Invested

B Problem Child

C Stable Cash Flow

D Cash Traps

Answer: C

83. 'Economies of Scale' arises from _______ synergy in Merger and Acquisitions.

A operating

B financial

C managerial

D market

Answer: A

84. Which of the following represent the three major categories of risks faced by a business organization?

A Business risks, personnel risks, budget risks

B Project risks, technical risks, business risks

C Planning risks, technical risks, personnel risks

D Management risks, technical risks, design risks

Answer: B

85. In time-series analysis, which source of variation can be estimated by the ratio-to-trend method?

A Cyclical

B Trend

C Seasonal

D Irregular

Answer: C

86. In case of valuation of firms for takeovers, which of the following provides a better estimate of value?

A Cash flows

B Free cash flows

C Future cash flows

D Free cash flow to equity

Answer: D

87. During a merger and acquisition transaction, the ability to find and use good comparable data for a valuation is relatively ____________.

A easy because each successful company within an industry uses the same ratios

B easy because public stock price fluctuation is not sufficient or erratic enough to make a difference

C difficult because book value is adjusted in small companies as FIFO is the method of choice and in public companies' book value is static due to LIFO

D difficult because size differential, management depth, product diversity and access to lines of credit seldom match the company being valued

Answer: D

88. One is entitled to initiate insolvency resolution of a corporate debtor when the corporate debtor __________.

A does not have enough liquid cash to continue operations as a going concern

B has failed to repay a debt when due and payable

C has ceased to be a going concern

D has negative net worth

Answer: B

89. XYZ company has 50 lakh shares outstanding and plans to raise Rs.20 lakh by offering 10 lakh shares at Rs.2 per share. What is XYZ's post-money valuation?

A Rs.1.20 crore

B Rs.1 crore

C Rs.50 lakh

D Rs.2 crore

Answer: A

90. A single, overall cost of capital is often used to evaluate projects because:

A It avoids the problem of computing the required rate of return for each investment proposal.

B It is the only way to measure a firm's required return.

C It acknowledges that most new investment projects have about the same degree of risk.

D It acknowledges that most new investment projects offer about the same expected return.

Answer: A

91. The weighted average cost of capital for a firm is the:

A Discount rate which the firm should apply to all of the projects it undertakes.

B Rate of return a firm must earn on its existing assets to maintain the current value of its stock.

C Coupon rate the firm should expect to pay on its next bond issue.

D Maximum rate which the firm should require on any projects it undertakes.

E Required rate which every project's internal rate of return must exceed.

Answer: B

92. Peter's Audio Shop has a cost of debt of 7%, a cost of equity of 11%, and a cost of preferred stock of 8%. The firm has 104,000 shares of common stock outstanding at a market price of Rs.20 a share. There are 40,000 shares of preferred stock outstanding at a market price of Rs.34 a share. The bond issue has a total face value of Rs.500,000 and sells at 102% of face value. The tax rate is 34%. What is the weighted average cost of capital for Peter's Audio Shop?

A 6.14%

B 6.54%

C 8.60%

D 9.14%

E 9.45%

Answer: D

93. If the CAPM is used to estimate the cost of equity capital, the expected excess market return is equal to the:

A Return on the stock minus the risk-free rate.

B Difference between the return on the market and the risk-free rate.

C Beta times the market risk premium.

D Beta times the risk-free rate.

E Market rate of return.

Answer: B

94. The weighted average cost of capital for a firm is the:

A Discount rate which the firm should apply to all of the projects it undertakes.

B Overall rate which the firm must earn on its existing assets to maintain the value of its stock.

C Rate the firm should expect to pay on its next bond issue.

D Maximum rate which the firm should require on any projects it undertakes.

E Rate of return that the firm's preferred stockholders should expect to earn over the long term.

Answer: B

95. Using the CAPM to calculate the cost of capital for a risky project assumes that:

A using the firm's beta is the same measure of risk as the project.

B the firm is all-equity financed.

C the financial risk is equal to business risk.

D Both A and B.

E Both A and C.

Answer: D

96. If the project beta and IRR coordinates plot above the SML the project should be:

A accepted.

B rejected.

C It is impossible to tell.

D It will depend on the NPV.

E None of the above.

Answer: A

97. Betas may vary substantially across an industry. The decision to use the industry or firm beta: to estimate the cost of capital depends on

A how small the estimation errors are of all betas across industries.

B how similar the firm's operations are to the operations of all other firms in the industry.

C whether the company is a leader or follower.

D the size of the company's public float.

E None of the above.

Answer: B

98. Comparing two otherwise equal firms, the beta of the common stock of a levered firm is………..than the beta of the common stock of an unlevered firm.

A equal to

B significantly less

C slightly less

D greater

E None of the above.

Answer: D

99. A firm with high operating leverage has:

A low fixed costs in its production process.

B high variable costs in its production process.

C high fixed costs in its production process.

D high price per unit.

E low price per unit

Answer: C

100. If a firm has low fixed costs relative to all other firms in the same industry, a large change in sales volume (either up or down) would have:

A a smaller change in EBIT for the firm versus the other firms.

B no effect in any way on the firms as volume does not effect fixed costs.

C a decreasing effect on the cyclical nature of the business.

D a larger change in EBIT for the firm versus the other firms.

E None of the above.

Answer: A

101. A firm with high operating leverage is characterized by while one with high financial leverage is characterized by __________.

A low fixed cost of production; low fixed financial costs

B high variable cost of production; high variable financial costs

C high fixed costs of production; high fixed financial costs

D low costs of production; high fixed financial costs

E high fixed costs of production; low variable financial costs

Answer: C

102. Which one of the following statements is correct concerning the weighted average cost of capital (WACC)?

A The WACC may decrease as a firm's debt-equity ratio increases.

B When computing the WACC, the weight assigned to the preferred stock is based on the coupon rate multiplied by the par value of the stock.

C A firm's WACC will decrease as the corporate tax rate decreases.

D The weight of the common stock used in the computation of the WACC is based on the number of shares outstanding multiplied by the book value per share.

E The WACC will remain constant unless a firm retires some of its debt.

Answer: A

103. Flotation costs should:

A Be ignored when analyzing a project because flotation costs are not an actual cost of the project.

B Be averaged over the life of the project thereby reducing the cash flows for each year of the project.

C Only be considered when two projects have the same net present value.

D Be included in the initial cost of a project before the net present value of the project is computed.

E Be ignored totally when internal equity funding is utilized.

Answer: D

104. Cameron Industries is expected to pay an annual dividend of Rs.1.30 a share next month. The market price of the stock is Rs.24.80 and the growth rate is 3 percent. What is the firm's cost of equity?

A 7.58 percent

B 7.91 percent

C 8.24 percent

D 8.40 percent

E 8.76 percent

Answer: C

105. The Sealing Company has 1,500 bonds outstanding that are selling for Rs.1,060 each. The company also has 5,000 shares of preferred stock at a market price of Rs.32 each. The common stock is priced at Rs.26 a share and there are 36,000 shares outstanding. What is the weight of the common stock as it relates to the firm's weighted average cost of capital?

A 6 percent

B 35 percent

C 41 percent

D 54 percent

E 60 percent

Answer: C

106. In calculating the proportional amount of equity financing employed by a firm, we should use:

A The common stock equity account on the firm's balance sheet.

B The sum of common stock and preferred stock on the balance sheet.

C The book value of the firm.

D The current market price per share of common stock times the number of shares outstanding.

Answer: D

107. To compute the required rate of return for equity in a company using the CAPM, it is necessary to know all of the following EXCEPT:

A The risk-free rate.

B The beta for the firm.

C The earnings for the next time period.

D The market return expected for the time period.

Answer: C

108. A quick approximation of the typical firm's cost of equity may be calculated by

A Adding a 5 percent risk premium to the firm's before-tax cost of debt.

B Adding a 5 percent risk premium to the firm's after-tax cost of debt.

C Subtracting a 5 percent risk discount from the firm's before-tax cost of debt.

D Subtracting a 5 percent risk discount from the firm's after-tax cost of debt.

Answer: A

109. Market values are often used in computing the weighted average cost of capital because

A This is the simplest way to do the calculation.

B This is consistent with the goal of maximizing shareholder value.

C This is required in the U.S. by the Securities and Exchange Commission.

D This is a very common mistake.

Answer: B

110. Some projects that a firm accepts will undoubtedly result in zero or negative returns. In light of this fact, it is best if the firm

A Adjusts its hurdle rate (i.e., cost of capital) upward to compensate for this fact.

B Adjusts its hurdle rate (i.e., cost of capital) downward to compensate for this fact.

C Does not adjust its hurdle rate up or down regardless of this fact.

D Raises its prices to compensate for this fact.

Answer: B

111. The Knick-Knack Company relies on preferred stock, bonds, and common stock for its long-term financing. Rank in ascending order (i.e., 1 = lowest, while 3 = highest) the likely after-tax component costs of the Tchotchke Company's long-term financing.

A 1 = bonds; 2 = common stock; 3 = preferred stock.

B 1 = bonds; 2 = preferred stock; 3 = common stock.

C 1 = common stock; 2 = preferred stock; 3 = bonds.

D 1 = preferred stock; 2 = common stock; 3 = bonds.

Answer: B

112. David King is evaluating two conventional, independent capital budgeting projects (X and Y) by making use of the risk-adjusted discount rate (RADR) method of analysis. Projects X and Y have internal rates of return of 16 percent and 12 percent, respectively. The RADR appropriate to Project X is 18 percent, while Project Y's RADR is only 10 percent. The company's overall, weighted-average cost of capital is 14 percent. David King should:

A Accept Project X and accept Project Y.

B Accept Project X and reject Project Y. [IRR of pro X (16%) is less than RADR (18%) so, reject the IRR of pro Y is greater than RADR (10%) so accept]

C Reject Project X and accept Project Y.

D Reject Project X and reject Project Y.

Answer: C

113. QWC Ltd. has cash of Rs.100,000 that will be invested in an equity investment that has a beta of 2.25. The current risk-free rate in the market is 2.5%, and the market requires an 8% risk premium for equity securities. What return should QWC Ltd. expect to earn?

A Rs.8,000

B Rs.18,000

C Rs.23,625

D Rs.20,500

Answer: D

114. XYZ company recently issued rights to raise financing. The shares are currently trading for Rs.18 per share on the stock exchange. The subscription price for the rights offering is Rs.14 per share, and an investor will require 3 rights to purchase 1 share. The value of one right is

A Rs.12.00.

B Rs.2.33.

C Rs.1.00.

D Rs.0.

Answer: C

115. LPY Ltd. has cash of Rs.500,000 that will be used to create an investment portfolio. The portfolio will be invested evenly in two assets: an equity investment that has a beta of 1.70 and a one-year risk-free interest-bearing certificate. The current risk-free rate in the market is 3% and the market requires a 6% risk premium for equity securities. What one year return should LPY Ltd. expect to earn on its portfolio?

A Rs.7,500

B Rs.30,000

C Rs.33,000

D Rs.40,500

Answer: D

116. According to the Efficient Market Hypothesis, what effect would a higher-than expected earnings report have on a firm's share price?

A A gradual increase in the share price over several days.

B An immediate decrease in the share price, with no later adjustments.

C An immediate increase in the share price, followed by a decrease the following day.

D An immediate increase in the share price, with no later adjustments.

Answer: D

117. XYZ Ltd. has the following financial information:

Current liabilities Rs.900,000

Long-term debt Rs.1,300,000

Total liabilities Rs.2,200,000

Preferred shares Rs.3,500,000

Common equity Rs.6,200,000

The long-term debt consists of a single bond issue paying 6% interest annually. These bonds currently yield 7.5% in the market. The current cost of the preferred shares is 8%.

The current cost of the common shares is 12%. The company's tax rate is 40%. What is XYZ Ltd's weighted average cost of capital (rounded to the nearest tenth of a percent)?

A 9.4%

B 10.2%

C 9.8%

D 9.2%

Answer: C

118. Given the following two stocks A and B

	Expected rate of return	Beta
A	0.12	1.2
B	0.14	1.8

If the expected market rate of return is 0.09 and the risk-free rate is 0.05, which security would be considered the better buy and why?

A A because it offers an expected excess return of 1.2%.

B B because it offers an expected excess return of 1.8%.

C A because it offers an expected excess return of 2.2%.

D B because it offers an expected return of 14%.

E B because it has a higher beta.

Answer: C

119. The risk-free security has a beta equal to, while the market portfolio's beta equal to

A One; more than one.

B One; less than one.

C Zero; one.

D Less than zero; more than zero.

Answer: C

120. The greater the beta, the…………………of the security involved.

A Greater the unavoidable risk

B Greater the avoidable risk

C Less the unavoidable risk

D Less the avoidable risk

Answer: A

121. Arizona Ltd. common stock has a beta of 0.90, while Acme Dynamite Ltd. common stock has a beta of 1.80. The expected return on the market is 10 percent, and the risk-free rate is 6 percent. According to the capital-asset pricing model (CAPM) and making use of the information above, the required return on Plaid Pants' common stock should be , and the required return on Acme's common stock should be .

A 3.6 percent; 7.2 percent

B 9.6 percent; 13.2 percent [Arizona required return=0.06+ [(0.90) (0.10-0.06)] =0.096]

C 9.0 percent; 18.0 percent acme required return=0.06+ [(1.8) (0.10-0.06)] =0.132

D 14.0 percent; 23.0 percent

Answer: B

122. Alpha Coffee & Trading Ltd's common stock measured beta is calculated to be 0.75. The market beta is, of course, 1.00 and the beta of the industry of which the company is a part is 1.10. If Merrill Lynch were to calculate an "adjusted beta" for Alpha Coffee's common stock, that adjusted beta would most likely be.

A Less than 0.75

B More than 0.75, but less than 1.10

C Equal to 1.10

D Equal to 0.95 {i.e., (1/3) x (0.75 + 1.00 + 1.10)}

Answer: B

123. Mehta Brothers' stock is currently selling for Rs.40 a share. The stock is expected to pay a Rs.2 dividend at the end of the year. The stock's dividend is expected to grow at a constant rate of 7 percent a year forever. The risk-free rate (kRF) is 6 percent and the market risk premium (kM - kRF) is also 6 percent. What is the stock's beta?

A 1.06

B 1.00

C 2.00

D 0.83

E 1.08

Answer: B

124. A project has an up-front cost of Rs.100,000. The project's WACC is 12 percent and its net present value is Rs.10,000. Which of the following statements is most correct?

A The project should be rejected since its return is less than the WACC.

B The project's internal rate of return is greater than 12 percent.

C The project's modified internal rate of return is less than 12 percent.

D All of the statements above are correct.

E None of the statements above is correct.

Answer: B

125. Manila Corporation is expected have EBIT of Rs. 2.3M this year. Manila Corporation is in the 30% tax bracket, will report Rs.175,000 in depreciation, will make Rs.175,000 in capital expenditures, and have no change in net working capital this year. What is Manila's FCFF?

A. 2,300,000

B. 1,785,000

C. 1,960,000

D. 1,610,000

E. 1,435,000

Answer: D

FCFF = EBIT (1 − T) + depreciation − capital expenditures − increase in NWC or 2,300,000(.7) + 175,000 − 175,000 − 0 = 1,610,000

126. Lotto Corporation is expected have EBIT of Rs.6.2M this year. Lotto Corporation is in the 40% tax bracket, will report Rs.1.2M in depreciation, will make Rs.1.4M in capital expenditures, and have a Rs.160,000 increase in net working capital this year. What is Lotto's FCFF?

A. 6,200,000

B. 6,160,000

C. 3,360,000

D. 3,680,000

E. 4,625,000

Answer: C

FCFF = EBIT (1 – T) + depreciation – capital expenditures – increase in NWC or 6,200,000(.6) + 1,200,000 – 1,400,000 – 160,000 = 3,360,000

127. Stingy Ltd is expected have EBIT of Rs. 1.2M this year. Stingy Ltd is in the 30% tax bracket, will report Rs.133,000 in depreciation, will make Rs.76,000 in capital expenditures, and have a Rs.24,000 increase in net working capital this year. What is Stingy's FCFF?

A. 1,139,000

B. 1,200,000

C. 1,025,000

D. 921,000

E. 873,000

Answer: E

FCFF = EBIT (1 – T) + depreciation – capital expenditures – increase in NWC or 1,200,000(.7) + 133,000 – 76,000 – 24,000 = 873,000.

128. Manali Flying Club Ltd is expected have EBIT of Rs.800k this year. Manali Flying Club Ltd is in the 30% tax bracket, will report Rs.52,000 in depreciation, will make Rs.86,000 in capital expenditures, and have a Rs. 16,000 increase in net working capital this year. What is Manali Flying Club's FCFF?

A. 510,000

B. 406,000

C. 542,000

D. 596,000

E. 682,000

Answer: A

FCFF = EBIT(1-T) + depreciation – capital expenditures – increase in NWC or 800,000(.7) + 52,000 – 86,000 – 16,000 = 510,000.

129. Boatman Ltd had a FCFE of Rs.4.6 Billion last year and has 113.2M shares outstanding. Boatman's required return on equity is 11.6% and WACC is 10.4%. If FCFE is expected to grow at 5% forever, the intrinsic value of Boatman's shares are ___________.

A. Rs.646.48

B. Rs.64.66

C. Rs.6,464.8

D. Rs.6.46

E. None of these is correct

Answer: A

Rs.4.6 B/113.2M = Rs 40.636 FCFE per share; 40.636*1.05 = 42.6678; 42.6678/(0.116 – 0.05) = 646.48.

130. Max Ltd had a FCFE of Rs.1.6M last year and has 3.2M shares outstanding. Max's required return on equity is 12% and WACC is 9.8%. If FCFE is expected to grow at 9% forever, the intrinsic value of Max's shares are ___________.

A. Rs.68.13

B. Rs.18.17

C. Rs.26.35

D. Rs.14.76

E. None of these is correct

Answer: B

Rs1.6M/3.2M = Rs.0.50 FCFE per share; .50*1.09 = .545; .545/(.12 − .09) = 18.17

131. Zero Ltd had a FCFE of Rs.4.5M last year and has 2.25M shares outstanding. Zero's required return on equity is 10% and WACC is 8.2%. If FCFE is expected to grow at 8% forever, the intrinsic value of Zero's shares are ___________.

A. $108.00

B. $1080.00

C. $26.35

D. $14.76

E. None of these is correct

Answer: A

Rs.4.5M/2.25M = Rs.2.00 FCFE per share; 2.00*1.08 = 2.16; 2.16/(.10 − .08) = 108

132. See had a FCFE of Rs.6.1M last year and has 2.32M shares outstanding. See's required return on equity is 10.6% and WACC is 9.3%. If FCFE is expected to grow at 6.5% forever, the intrinsic value of See's shares are:

A. $108.00

B. $68.29

C. $26.35

D. $14.76

E. None of these is correct

Answer: B

Rs.6.1M/2.32M = $2.6293 FCFE per share; 2.6293*1.065 = 2.800; 2.80/(.106 − .065) = 68.29

133. The most appropriate discount rate to use when applying a FCFF valuation model is the __________.

A. required rate of return on equity

B. WACC

C. risk-free rate

D. required rate of return on equity or risk-free rate depending on the debt level of the firm

E. None of these is correct

Answer: B

The most appropriate discount rate to use when applying a FCFF valuation model is the WACC.

134. The required rate of return on equity is the most appropriate discount rate to use when applying a……….valuation model.

A. FCFE

B. FCEF

C. DDM

D. FCEF or DDM

E. P/E

Answer: A

The most appropriate discount rate to use when applying a FCFE valuation model is the required rate of return on equity.

135. FCF and DDM valuations should be if the assumptions used are consistent.

A. very different for all firms

B. similar for all firms

C. similar only for unlevered firms

D. similar only for levered firms

E. None of these is correct

Answer: B

FCF and DDM valuations should be similar for all firms if the assumptions used are consistent.

136. Low P/E ratios tend to indicate that a company will, ceteris paribus.

A. grow quickly

B. grow at the same speed as the average company

C. grow slowly

D. P/E ratios are unrelated to growth

E. None of these is correct

Answer: C

Investors pay for growth; hence a relatively high P/E ratio for growth firms.

137. The dividend discount model

A. ignores capital gains.

B. incorporates the after-tax value of capital gains.

C. includes capital gains implicitly.

D. restricts capital gains to a minimum.

E. None of these is correct.

Answer: C

The DDM includes capital gains implicitly, as the selling price at any point is based on the forecast of future dividends.

138. Which method is preferred to determine cost of debt for the WACC calculation if the target company's debt is not traded?

A. Historical average interest expense
B. Spread between CAPM and risk-free rate
C. Calculate by determining implied credit rating based on target capital structure
D. None of the above

Answer (C) In these instances, preferred approach is to approximate a company's cost of debt based on its current (or implied) credit ratings at the target capital structure and cost of debt for comparable credits.

139. Which of the following is considered a weakness of the DCF?

A. Market independent
B. Terminal value represents a large portion of the total value
C. Can handle multiple financial performance scenarios
D. Minimal reliance on comparable companies or transactions

Answer (B) The use of terminal value is considered a potential weakness.

140. Which of the following is a long-term asset?

A. Goodwill
B. Prepaid expenses
C. Accounts payable
D. Accounts receivable

Answer (A)

141. Which of the following is the correct order of the steps to complete a DCF analysis?

1. Determine terminal value
2. Study the target and determine key performance drivers
3. Calculate present value and determine valuation
4. Calculate weighted average cost of capital

A. 2, 5,4,3 and 1
B. 2,4,5,1 and 3
C. 3,4,5,1 and 2
D. 3,4,5,2 and 1

Answer (B)

142. The CAPM is based on the premise that equity investors need to be compensated for their assumption of:

A. Systematic risk
B. Unsystematic risk
C. Default risk
D. Risk of financial distress

Answer (A) CAPM is based on the premise that equity investors need to be compensated for their assumption of systematic risk in the form of a risk premium, or the delta between market return and the risk-free rate.

143. Which of the following are relevant for creating assumptions when projecting FCF in a DCF?

I. Historical interest expense
II. Historical growth rates
III. Classes of debt securities
IV. Historical EBIT margins
A.I and II
B. I and III
C. II and IV
D. I, II, III and IV
Answer (C)

144. A stock with a beta greater than 1.0 has

A. Lower systematic risk than the market
B. Higher systematic risk than the market
C. Lower unsystematic risk than the market
D. Higher unsystematic risk than the market

Answer (B)

145. Calculate unlevered beta using the information below:

Levered beta	1.25
Debt to equity ratio	40%
Marginal tax rate	25%

A. 0.96
B. 1.00
C. 1.12
D. 1.35

Answer (A) Unlevered beta = Levered beta / (1+ D/E X (1 – t)

= 1.25 / (1 + 0.4 x (1-0.25)
= 1.25 / 1.30
= 0.96

146. Calculate levered beta using the information below:

Unlevered beta	1.00
Debt to equity ratio	45%
Marginal tax rate	25%

A. 1.01
B. 1.25
C. 1.34
D. 1.42

Answer (C) Levered beta = Unlevered beta x (1 + D/E) X (1-t)

= 1.00 x (1 + 0.45 x (1 – 0.25)

= 1.34

147. A company with no debt in its capital structure would have a WACC equal to its

A. Risk-free rate
B. Cost of equity
C. Cost of debt
D. Tax effected cost of equity

Answer (D)

148. Which methodology is used to capture the value of a company beyond its projection period?

A. Long term value
B. Long term adjusted value
C. Terminal value
D. Projected value

Answer (C)

149. What method is used to calculate cost of equity?

A. CAPM
B. WACC
C.NWC
D.YTW

Answer (A)

150. Calculate cost of equity using the information below:

Levered beta	1.25
Risk free rate	3.0%
Market rate premium	6.6 %
Cost of debt	9.0%

A 11.3%
B 12.0%
C. 13.1%
D. 14.4%

Answer (A)

Cost of equity = Risk free rate + Levered beta x market risk premium

= 3.0% +1.25 x 6.6%

= 11.3%

151. Which of the following is an acceptable proxy for the risk-free rate in the CAPM?

A. After tax cost of debt
B. Government securities
C. The LIBOR
D. None of the above

Answer (B)

152. Calculate terminal value using the parameters mentioned below.

Year five FCF	**Rs.250 million**
Growth rate	**3.0%**
WACC	**12.0%**

A. Rs. 2800.2 million
B. Rs. 2861.1 million
C. Rs. 3111.5 million
D. Rs. 3215.2 million

Answer (B) FCF = Unlevered free cash flow

n = terminal year of the projection period

g = perpetuity growth rate

r = WACC

Hence, Terminal value = (FCF X (1+g))/(r-g)

= (250 x (1+3%))/(12% - 3%)

= Rs.2861.1 million

153. Calculate FCF using the information below.

Calculate FCF using the following information below.

EBIT	**Rs.300.0 million**
Depreciation	**Rs. 50.0 million**
Capital expenditure	**Rs.25.0 million**
Inc/dec of net working capital	**Rs.10.0 million**
Tax rate	**25%**

A. Rs.151.0 million
B. Rs.189.0 million
C. Rs.240.0 million
D. Rs.389.0 million

Answer (C)

Statement of free cash flows (Rs. Million)

EBIT	300.0
Depreciation	50.0
Taxes @ 25%	(75.0)
NOPAT	275.0
Less: Capex	(25.0)
Less: Net working capital change	(10.0)
Free cash flow	240.0

154. Calculate FCF using the information below.

Rs Million

Sales	**1000.0**
EBITDA Margin	**15%**
Depreciation as % of sales	**3%**
Capital expenditure as % of sales	**2.5%**
Net working capital change	**15.0**
Tax rate	**25%**

A. Rs.64.0 million
B. Rs.80.0 million
C. Rs.89.1 million
D. Rs.102.0 million

Answer (B)

Statement of Free cash flows	Rs. Million
Sales	1000.0 (A)
EBITDA (A x 15%)	150.0 (B)
Less Depreciation (A x 3%)	30.0 (C)
EBIT	120.0 (D)
Less: (D X Tax 25%)	30.0 (E)
Add: Depreciation	30.0 (C)
NOPAT	120.0 (D-E+C) = (F)
Less: Capex (2.5% of sales)	(25.0) (G)
Less: Net working capital change	(15.0) (H)
Free Cash Flow	80.0 (F-G-H=I)

155. Which of the following is an asset pricing model based on the ideas that an asset's returns can be predicted using the relationship between that asset and many common risk factors?

A Arbitrage pricing theory

B Arbitrage risk theory

C Arbitrage asset theory

D Risk pricing theory

Answer: A

156. Typical parameters used in quantitative methods to estimate discount for lack of marketability include ____________.

A duration of the restriction and risk of the investment

B return of the investment

C dividends paid

D market size

Answer: A

157. Which is a type of preferred stock that stockholders can exchange for a predetermined number of a company's common stock?

A Prior preferred stock

B Convertible preferred stock

C Participating preferred stock

D Cumulative preferred stock

Answer: B

158. Agency bonds are issued by _____________.

A local governments

B national governments

C quasi-government entities

D corporates

Answer: C

159. If interest rates are expected to increase, the coupon payment structure most likely to benefit the issuer is a ______.

A step-up coupon

B inflation-linked coupon

C put option

D cap in a floating-rate note

Answer: D

160. Which of the following bonds has the shortest duration?

A A bond with 20-year maturity, 10% coupon rate

B A bond with 20-year maturity, 6% coupon rate

C A bond with 10-year maturity, 6% coupon rate

D A bond with 10-year maturity, 10% coupon rate

Answer: A

161. ___________ is the risk that an issuer will fail to satisfy the terms of the agreement with respect to the timely payment of interest and principal.

A Default risk

B Credit spread risk

C Volatility risk

D Downgrade risk

Answer: A

162. What is the value of Three-Year 4.25% Annual Coupon Bond Puttable at Par one year from now if one year forward rates at T (0), T (1) and T (2) are 2.50%, 3% and 4.5% respectively?

A 101.54

B 101.71

C 102.67

D 102.89

Answer: C

163. The fixed-rate payer in an interest-rate swap has a position equivalent to a series of ____________.

A long interest-rate puts and short interest-rate calls

B short interest-rate puts and long interest-rate calls

C long interest-rate puts and calls

D short interest-rate puts and calls

Answer: B

164. The collar of a floating-rate bond refers to the minimum and maximum ______.

A call periods

B maturity dates

C coupon rates

D yields to maturity

Answer: C

165. A perpetual bond does not have a fixed _________.

A interest rate

B maturity period

C duration

D underlying asset

Answer: B

166. Which principle tells us that an investor will not invest in an asset if a more attractive substitute exists?

A Principle of alternative

B Principle of expectation

C Principle of substitution

D Principle of risk and return

Answer: C

167. Which of the following is an assumption on the returns distribution in Black Scholes Mode?

A Normal

B Exponential

C Standard

D Linear

Answer: A

167. Individuals hold their claims on real assets through ____________ in a well-developed economy.

A intangible assets

B tangible assets

C real estate

D financial assets

Answer: D

168. The credit default spread method of valuation of a guarantee given by a parent company on behalf of its subsidiary involves estimating the value ____________.

A using credit default spread based on the credit rating of the subsidiary

B using credit default spread based on the credit rating of the guaranto

C based on probability of default

D of the guarantee using an option pricing model

Answer: A

169. When an investor uses a derivative instrument to reduce his exposure to the price volatility of certain underlying assets, he is said to be _______.

A speculating

B squaring

C hedging

D arbitraging

Answer: C

170. The price of a Rs.1,000 par bond carrying a coupon rate of 8 percent and maturing after 5 years is Rs.1020.

The approximate Yield to Maturity is:

A 6.59%

B 7.51%

C 7.34%

D 7.45%

Answer: B

$$YTM = \frac{80 + (1000 - 1020)/5}{0.6 \times 1020 + 0.4 \times 1000} = 7.51\%$$

171. Ellie's Enterprise has a bond issue outstanding that matures in fourteen years. The bonds pay interest semi-annually. Currently, the bonds are quoted at 98 percent of face value and carry an 8 percent coupon. The firm's tax rate is 35 percent. What is the firm's after-tax cost of debt?

A 2.88 percent

B 5.36 percent

C 5.45 percent

D 8.24 percent

E 10.72 percent

Answer: B

172. In calculating the costs of the individual components of a firm's financing, the corporate tax rate is important to which of the following component cost formulae?

A Common stock.

B Debt.

C Preferred stock.

D None of the above.

Answer: B

173. The common stock of a company must provide a higher expected return than the debt of the same company because

A There is less demand for stock than for bonds.

B There is greater demand for stock than for bonds.

C There is more systematic risk involved for the common stock.

D There is a market premium required for bonds.

Answer: C

174. Lei-Feng, Inc.'s Rs.100 par value preferred stock just paid its Rs.10 per share annual dividend. The preferred stock has a current market price of Rs.96 a share. The firm's marginal tax rate (combined federal and state) is 40 percent, and the firm plans to maintain its current capital

structure relationship into the future. The component cost of preferred stock to Lei-Feng, Inc. would be closest to.

A 6 percent

B 6.25 percent 10 / 96 =.1042, remember dividends are not a tax deduct table expense, so, we do not multiply 10 by one minus the tax rate before continuing our calculation

C 10 percent

D 10.4 percent

Answer: D

175. Flower Inc. is issuing preferred shares to raise capital. Each preferred share will be issued with a par value of Rs.200 and a cumulative dividend of Rs.18. The preferred shares will result in after-tax underwriting expenses of Rs.3 per share. What is the cost of issuing the preferred shares?

A 9.14%

B 9.00%

C 7.50%

D 10.50%

Answer: A

176. The value of a bond and debenture is

A Present value of interest payments it gets

B Present value of contractual payments it gets till maturity

C Present value of redemption amount

D None of the above

Answer: B

177. Required rate of return > Coupon rate, the bond will be valued at

A Premium

B Par value

C Discount

D None of the above.

Answer: C

178. If the coupon rate is constant, the value of bond when close to maturity will be

A Issued value

B Par value

C Redemption value

D All of the above

Answer: C

179. A bond is said to be issued at premium when

A Coupon rate>Required returns

B Coupon rate=Required returns

C Coupon rate

D None of the above

Answer: A

180. Value of a bond just depends on the interest payment it offers.

A True

B False

Answer: B

181. In a variable growth model, the dividend is believed to grow at a constant pace forever after an initial growth period.

A True

B False

Answer: A

182. For a bond YTM is always equal to coupon rate.

A True

B False

Answer: B

183 For financial assets classified as bonds, how are unrealised gains and losses reflected in shareholders' equity?

A They are not recognised.

B Shown as an adjustment in paid-in capital.

C Recognised as amortized cost and measured through effective interest method.

Answer: C

184. Short Ltd issued Rs.10,000,000 worth of 8% debentures of face value Rs.100 each on par value basis on 1st Jan 2019. These debentures are redeemable at 12% premium at the end of 2014 or exchangeable for ordinary shares of Long Ltd on 1:1 basis. The interest rate for similar debentures that do not carry conversion entitlement is 12%. You are required to calculate the value of the debt portion of the above compound financial instrument. The present value of the rupee at the end of years 1 to 4 at 8% and 12% are supplied to you as:

	8%	12%
End of year 2019	0.926	0.893
End of year 2020	0.857	0.797
End of year 2021	0.794	0.712
End of year 2022	0.735	0.636

The equity component is:

A 9,500,000

B 9,553,600

C 9,450,000

D 9,550,000

Answer: B,

185. From the above example the debt component is:

A 500,000

B 446,400

C 550,000

D 450,000

Answer: B

186. Alpha Ltd has issued 10,000 convertible debentures with a face value of Rs. 100 per debenture. The interest rate on the debentures is 5%. The debenture holders have the option of converting these debentures into ordinary shares at the end of four years. The prevailing market rate for a similar debt which does not have a conversion right is 7%.

Present Value of Rs. 1 at 7% after 4 years would be 0.763.

Present Value of Annuity of Rs.1 after 4 years would be 3.387.

The carrying amount of the debt portion of convertible debentures would be:

A Rs.1,000,000.

B Rs. 932,350.

C Rs. 950,000

D None of the above.

Answer: B

187. From the above example the carrying amount of equity portion of the convertible debentures would be:

A Rs. Nil.

B Rs. 65,350.

C Rs. 67,650

D Rs. 69,650

Answer: C

188. Blackwell bonds have a face value of Rs.1,000 and are currently quoted at 98.4. The bonds have a 5 percent coupon rate. What is the current yield on these bonds?

A. 4.67 percent

B. 4.78 percent

C. 5.08 percent

D. 5.33 percent

E. 5.54 percent

Answer: C

Current yield = (0.05 x Rs.1,000)/(0.0984 x Rs.1,000)

= 5.08%

189. The outstanding bonds of The River Front Ferry carry a 6.5 percent coupon. The bonds have a face value of Rs.1,000 and are currently quoted at 101.6. What is the current yield on these bonds?

A. 1.60 percent

B. 2.37 percent

C. 6.40 percent

D. 6.49 percent

E. 6.88 percent

Answer: C

Current yield = (0.065x Rs.1,000)/(1.016 x Rs.1,000)

= 6.4%

190. The 7 percent, semi-annual coupon bonds offered by House Renovators are callable in 2 years at Rs. 1,054. What is the amount of the call premium on a Rs.1,000 par value bond?

A. Rs. 52

B. Rs. 54

C. Rs. 72

D. Rs. 84

E. Rs. 89

Answer:B

Call premium = Rs.1,054 – Rs.1,000 = Rs.54

191. A corporate bond was quoted yesterday at 102.16 while today's quote is 102.19. What is the market price of the bond that has a face value of Rs.6,000?

A. Rs.0.30

B. Rs.1.80

C. Rs.3.00

D. Rs.18.00

E. Rs. 180.00

Answer:B

Market price = (1.0219 - 1.0216) $\times$ Rs.6,000 = Rs.1.80

192. A corporate bond is quoted at a price of 103.16 and carries a 6.50 percent coupon. The bond pays interest semi-annually. What is the current yield on one of these bonds?

A. 6.24 percent

B. 6.30 percent

C. 6.36 percent

D. 6.62 percent

Answer: B

Current yield = (0.065 $\times$ Rs.1,000)/(1.0316 $\times$ Rs.1,000) = 6.30 percent

193. A bond that pays interest annually yielded 7.47 percent last year. The inflation rate for the same period was 6.10 percent. What was the actual real rate of return on this bond for last year?

A. 1.19 percent

B. 1.25 percent

C. 1.29 percent

D. 1.36 percent

E. 1.41 percent

Answer: C

$$r = \frac{1.0747}{1.0610} - 1 = 1.29 \text{ percent}$$

194. Getty Markets has bonds outstanding that pay a 5 percent semi-annual coupon, have a 5.28 percent yield to maturity, and a face value of $1,000. The current rate of inflation is 4.1 percent. What is the real rate of return on these bonds?

A. 0.86 percent

B. 0.90 percent

C. 1.04 percent

D. 1.13 percent

E. 1.19 percent

Answer: D

$$r = \frac{1.0528}{1.041} - 1 = 1.13 \text{ percent}$$

195. The outstanding bonds of Wintertime Products provide a real rate of return of 3.03 percent. The current rate of inflation is 4.68 percent. What is the actual nominal rate of return on these bonds?

A. 7.58 percent

B. 7.33 percent

C. 7.71 percent

D. 7.76 percent

E. 7.85 percent

Answer: E

$(1 + 0.0303) \times (1 + 0.0468) - 1 = 7.85$ percent

196. The yield to maturity on a bond is currently 8.46 percent. The real rate of return is 3.22 percent. What is the rate of inflation?

A. 5.08 percent

B. 5.64 percent

C. 6.24 percent

D. 6.53 percent

E. 6.71 percent

Answer: A

$$h = \frac{1+0.0846}{1+0.0322} - 1 = 5.08\,\text{percent}$$

197. You purchased an investment which will pay you Rs.8,000, in real dollars, a year for the next three years. Each payment will be received at the end of the period with the first payment occurring one year from today. The nominal discount rate is 7.5 per cent and the inflation rate is 2.9 percent. What is the present value of these payments?

A. Rs.21,720

B. Rs.22,004

C. Rs.22,511

D. Rs.23,406

E. Rs.23,529

Answer: B

$$r = \frac{1 + 0{,}075}{1 + 0.029} - 1 = 0.0447$$

$$PV = \frac{\text{Rs.}8{,}000}{1+0.04471} + \frac{\text{Rs.}8{,}000}{1+0.04472} + \frac{\text{Rs.}8{,}000}{1+0.04473} = \text{Rs.}22{,}004$$

198. Mary just purchased a bond which pays Rs.60 a year in interest. What is this Rs. 60 called?

A. coupon

B. face value

C. discount

D. call premium

E. yield

Answer: A

199. Bert owns a bond that will pay him Rs.75 each year in interest plus a Rs.1,000 principal payment at maturity. What is the Rs.1,000 called?

A. coupon

B. face value

C. discount

D. yield

Answer: B

200. **Currently, the bond market requires a return of 11.6 percent on the 10-year bonds issued by Winston Industries. The 11.6 percent is referred to as which one of the following?**

A. coupon rate

B. face rate

C. call rate

D. yield to maturity

E. interest rate

Answer: D

201. **The current yield is defined as the annual interest on a bond divided by which one of the following?**

A. coupon

B. face value

C. market price

D. call price

Answer: C

202. **Atlas Entertainment has 15-year bonds outstanding. The interest payments on these bonds are sent directly to each of the individual bondholders. These direct payments are a clear indication that the bonds can accurately be defined as being issued:**

A. at par.

B. in registered form.

C. as debentures.

D. as callable.

Answer: B

203. **An indenture is:**

A. another name for a bond's coupon.

B. the written record of all the holders of a bond issue.

C. a bond that is past its maturity date but has yet to be repaid.

D. a bond that is secured by the inventory held by the bond's issuer.

E. the legal agreement between the bond issuer and the bondholders.

Answer: E

204. **The Leeward Company just issued 15-year, 8 percent, unsecured bonds at par. These bonds fit the definition of which one of the following terms?**

A. note

B. discounted

C. zero-coupon

D. callable

E. debenture

Answer: E

205. **Which of the following defines a Note?**

I. secured

II. unsecured

III. maturity less than 10 years

IV. maturity in excess of 10 years

A. III only

B. I and III only

C. I and IV only

D. II and III only

E. II and IV only

Answer: D

206. **A Rs.1,000 face value bond can be redeemed early at the issuer's discretion for Rs.1,030, plus any accrued interest. The additional Rs.30 is called which one of the following?**

A. dirty price

B. redemption value

C. call premium

D. original-issue discount

E. redemption discount

Answer: C

207. **A bond that can be paid off early at the issuer's discretion is referred to as being which one of the following?**

A. zero coupon

B. callable

C. senior

D. collateralized

E. unsecured

Answer: B

208. A call-protected bond is a bond that:

A. is guaranteed to be called.

B. can never be called.

C. is currently being called.

D. is callable at any time.

E. cannot be called during a certain period of time.

Answer: E

209. A deferred call provision is which one of the following?

A. requirement that a bond issuer pay the current market price, plus accrued interest, should the firm decide to call a bond

B. ability of a bond issuer to delay repaying a bond until after the maturity date should the issuer so opt

C. prohibition placed on an issuer which prevents that issuer from ever redeeming bonds prior to maturity

D. prohibition which prevents bond issuers from redeeming callable bonds prior to a specified date

E. requirement that a bond issuer pay a call premium which is equal to or greater than one year's coupon should that issuer decide to call a bond

Answer: D

210. The items included in an indenture that limit certain actions of the issuer in order to protect bondholder's interests are referred to as the:

A. trustee relationships.

B. bylaws.

C. legal bounds.

D. “plain vanilla” conditions.

E. protective covenants.

Answer: E

211. A bond that has only one payment, which occurs at maturity, defines which one of the following?

A. debenture

B. callable

C. floating-rate

D. junk

E. zero coupon

Answer: E

212. Which one of the following is the price a dealer will pay to purchase a bond?

A. call price

B. asked price

C. bid price

D. bid-ask spread

E. par value

Answer: C

213. You want to buy a bond from a dealer. Which one of the following prices will you pay?

A. call price

B. auction price

C. bid price

D. asked price

E. bid-ask spread

Answer: D

214. The difference between the price that a dealer is willing to pay and the price at which he or she will sell is called the:

A. equilibrium.

B. premium.

C. discount.

D. call price.

E. spread.

Answer: E

215. Real rates of a Bond are defined as nominal rates that have been adjusted for which of the following?

A. inflation

B. default risk

C. accrued interest

D. interest rate risk

E. both inflation and interest rate risk

Answer: A

216. The pure time value of money is known as the:

A. liquidity effect.

B. Fisher effect.

C. term structure of interest rates.

D. inflation factor.

E. interest rate factor.

Answer: C

217. The interest rate risk premium is the:

A. additional compensation paid to investors to offset rising prices.

B. compensation investors demand for accepting interest rate risk.

C. difference between the yield to maturity and the current yield.

D. difference between the market interest rate and the coupon rate.

E. difference between the coupon rate and the current yield.

Answer: B

218. A Treasury yield curve plots Treasury interest rates relative to which one of the following?

A. market rates

B. comparable corporate bond rates

C. the risk-free rate

D. inflation

E. maturity

Answer: E

219. Which one of the following risk premiums compensates for the possibility of non-payment by the bond issuer?

A. default risk

B. taxability

C. liquidity

D. inflation

E. interest rate risk

Answer: A

220. The liquidity premium is compensation to investors for:

A. purchasing a bond in the secondary market.

B. the lack of an active market wherein a bond can be sold for its actual value.

C. acquiring a bond with an unfavorable tax status.

D. redeeming a bond prior to maturity.

E. purchasing a bond that has defaulted on its coupon payments.

Answer: B

221. An 8 percent corporate bond that pays interest semi-annually was issued last year. Which two of the following most likely apply to this bond today if the current yield-to-maturity is 7 percent?

I. a structure as an interest-only loan

II. a current yield that equals the coupon rate

III. a yield-to-maturity equal to the coupon rate

IV. a market price that differs from the face value

A. I and III only

B. I and IV only

C. II and III only

D. II and IV only

E. III and IV only

Answer: B

222. A bond has a market price that exceeds its face value. Which of the following features currently apply to this bond?

I. discounted price

II. premium price

III. yield-to-maturity that exceeds the coupon rate

IV. yield-to-maturity that is less than the coupon rate

A. III only

B. I and III only

C. I and IV only

D. II and III only

E. II and IV only

Answer: E

223. Which of the following are characteristics of a premium bond?

I. coupon rate < yield-to-maturity

II. coupon rate > yield-to-maturity

III. coupon rate < current yield

IV. coupon rate > current yield

A. I only

B. I and III only

C. I and IV only

D. II and III only

E. II and IV only

Answer: E

224. Which of the following relationships apply to a par value bond?

I. coupon rate < yield-to-maturity

II. current yield = yield-to-maturity

III. market price = call price

IV. market price = face value

A. I and II only

B. I and III only

C. II and IV only

D. I, II, and III only

E. II, III, and IV only

Answer: C

225. Gamma is preparing a bond offering with a 6 percent, semi-annual coupon and a face value of Rs.1,000. The bonds will be repaid in 10 years and will be sold at par. Given this, which one of the following statements is correct?

A. The bonds will become discount bonds if the market rate of interest declines.

B. The bonds will pay 10 interest payments of Rs.60 each.

C. The bonds will sell at a premium if the market rate is 5.5 percent.

D. The bonds will initially sell for Rs.1,030 each.

E. The final payment will be in the amount of Rs.1,060.

Answer: C

226. A newly issued bond has a 7 percent coupon with semi-annual interest payments. The bonds are currently priced at par value. The effective annual rate provided by these bonds must be:

A. 3.5 percent.

B. greater than 3.5 percent but less than 7 percent.

C. 7 percent.

D. greater than 7 percent.

E. Answer cannot be determined from the information provided.

Answer: D

227. You own a bond that has a 6 percent annual coupon and matures 5 years from now. You purchased this 10-year bond at par value when it was originally issued. Which one of the following statements applies to this bond if the relevant market interest rate is now 5.8 percent?

A. The current yield-to-maturity is greater than 6 percent.

B. The current yield is 6 percent.

C. The next interest payment will be Rs.30.

D. The bond is currently valued at one-half of its issue price.

E. You will realize a capital gain on the bond if you sell it today.

Answer: E

228. A 6 percent, annual coupon bond is currently selling at a premium and matures in 7 years. The bond was originally issued 3 years ago at par. Which one of the following statements is accurate in respect to this bond today?

A. The face value of the bond today is greater than it was when the bond was issued.

B. The bond is worth less today than when it was issued.

C. The yield-to-maturity is less than the coupon rate.

D. The coupon rate is greater than the current yield.

E. The yield-to-maturity equals the current yield.

Answer: C

229. Which of the following statements concerning bonds are correct?

I. Bonds provide tax benefits to issuers.

II. The risk of a firm financially failing increases when the firm issues bonds.

III. Most long-term bond issues are referred to as unfunded debt.

IV. All bonds are treated equally in a bankruptcy proceeding.

A. II and III only

B. I and II only

C. III and IV only

D. II and IV only

E. I, II, and III only

Answer: B

230. Last year, Alpha Homes issued Rs.1 million in unsecured, non-callable debt. This debt pays an annual interest payment of Rs. 55 and matures 6 years from now. The face value is Rs.1,000 and the market price is Rs.1,020. Which one of these terms correctly describes a feature of this debt?

A. semi-annual coupon

B. discount bond

C. note

D. trust deed

E. collateralized

Answer: C

231. Which of the statements is correct? A zero-coupon bond:

A. is sold at a large premium.

B. pays interest that is tax deductible to the issuer when paid.

C. can only be issued by the U.S. Treasury.

D. has more interest rate risk than a comparable coupon bond.

E. provides no taxable income to the bondholder until the bond matures.

Answer: D

232. Phil has researched Solar Technologies and believes the firm is poised to vastly increase in value. He wants to invest in this company. Phil has decided to purchase Solar Technologies bonds so that he can have a steady stream of interest income. However, he still wishes that he could share in the firm's success along with Solar's shareholders. Which one of the following bond features will help Phil fulfill his wish?

A. put provision

B. positive covenant

C. warrant

D. crossover rating

E. call provision

Answer: C

233. Tacko Supply offers 7.5 percent coupon bonds with semi-annual payments and a yield to maturity of 7.68 percent. The bonds mature in 6 years. What is the market price per bond if the face value is Rs.1,000?

A. Rs.989.70

B. Rs.991.47

C. Rs.996.48

D. Rs.1,002.60

E. Rs.1,013.48

Answer: B

$$P = \frac{0.075 - \text{Rs.}1000}{2} \text{x} \left\{\frac{1-[1/(1+0.0768/2)6\text{x}2}{0.0768/2}\right\} + \frac{\text{Rs.}1000}{(1+0.0768/2)6\text{x}2} = \text{Rs.}991.47$$

234. Grand Properties offers a 9.5 percent coupon bond with annual payments. The yield to maturity is 11.2 percent and the maturity date is 11 years from today. What is the market price of this bond if the face value is Rs. 1,000?

A. Rs.895.43

B. Rs.896.67

C. Rs.941.20

D. Rs.946.18

E. Rs. 953.30

Answer: A

$$P = (0.095 \text{ X Rs.}1000) \text{ x } \left\{\frac{1- [1/1(1+0/112)]^{11}}{0.112}\right\} + \frac{\text{Rs.}1000}{(1+0.112)^{11}} = \text{Rs.}895.43$$

235. The zero-coupon bonds of Ivory Towers have a market price of Rs.319.24, a face value of Rs.1,000, and a yield to maturity of 9.17 percent. How many years is it until these bonds mature?

A. 11.92 years

B. 12.28 years

C. 12.73 years

D. 13.01 years

E. 13.47 years

Answer: C

$$\text{Rs.}319.24 = \frac{\text{Rs.}1000}{\left(1+\frac{0.0917}{2}\right)}; \; t = 12.73 \text{ years}$$

236. An investment offers a 10.5 percent total return over the coming year. Delta thinks the total real return on this investment will be only 4.5 percent. What does Sam believe the inflation rate will be for the next year?

A. 5.60 percent

B. 5.67 percent

C. 5.74 percent

D. 6.00 percent

E. 6.21 percent

Answer: C

$(1 + 0.105) = (1 + 0.045) \times (1 + h)$; h = 5.74 percent

237. Alpha owns 15% common stock of Delta Limited and used the fair value method to account for this investment. Delta Limited reported earnings of Rs.110,000 for 2019 and paid dividends of

Rs.60,000 on October 31, 2019. How much income should Alpha recognize on his investment in 2019?

A. Rs.16,500

B. Rs. 9,000

C. Rs.15,500

D. Rs.25,000

Answer: B

238. What is an intangible asset?

A Non-monetary asset with physical substance

B Monetary asset without physical substance

C Non-monetary asset without physical substance

D Monetary asset with physical substance

Answer: C

239. The valuation method for the cost approach include:

A Guideline pricing method

B Greenfield method

C Reproduction cost method

D None of the above

Answer: C

240. Relief-from-royalty method estimates the value an asset based on the value of the royalty payments ___________.

A from which the company is relieved due to its ownership of the asset

B made by the company to acquire ownership of the asset

C received by the company from the useful life of the asset

D over and above the internal rate of return

Answer: A

241. If the aggregate fair market value of prescribed movable property received by a taxpayer as gift during the year is Rs.1,50,000, tax will be charged on ______.

A Rs.1,00,000

B Rs.50,000

C Rs.1,50,000

D Rs.0

Answer: C

242. **Which of the following method would you consider appropriate while valuing the intangible assets?**

A Multiple

B Relative

C Consistent

D Exclusive

Answer: B

243. **X Ltd has created employee goodwill by recognizing its retirement benefit package. An independent management consultant estimated the value of the goodwill at Rs.5 million. In addition, X Ltd recently purchased a patent that was developed by a competitor. The patent has an estimated useful life of five years. Should X Ltd value and report the goodwill and patent on its Balance Sheet?**

	Goodwill	Patent
A	Yes	No
B	No	Yes
C	No	No
D	Yes	Yes

Answer: B

244. T Ltd owns a patent for an established successful drug that has a remaining life of 8 years. A firm of specialized advisors has estimated current value of patent at Rs 20 m.

However, the firm is awaiting clinical trials, which if successful would push the value upwards to Rs. 35 m. Value of patent to be considered under *IAS 38: Intangible Assets* would be:

A Rs.35 Million

B Rs.20 Million

C Rs.10 Million

D None of the above.

Answer: B

245. In Dec 2018 D Ltd paid Rs 15 million for a television advertising campaign for its products that will run for six months from 1st Jan 2019 to 30th June 2019. The directors believe that increased sales because of the publicity will continue for two years from the start of the advertisement. However, it is not clear whether the advertising campaign will generate economic benefit to flow to the entity.

A The amount of Rs.15 million to be shown under Intangible assets.

B The amount of Rs.15 million to be charged to Statement of Profit & Loss.

C The amount of Rs.15 million should be amortized for a period of two years.

D None of the above.

Answer: B

246. J Ltd hold a trademark with a carrying value of INR 3.7 million, which it uses to produce consumer goods. It is expected that the products will continue to be in demand for at least ten years and the trademark has an indefinite life. At 31st December 2018, based on a report by an independent expert, it is estimated that the recoverable amount of the trademark is only INR 2.6 million.

A The trademark will be amortized for a period of ten years.

B The trademark having indefinite life would be tested for impairment.

C The carrying value of trademark should be charged to revenue.

D None of the above.

Answer: B

247. **Alpha Ltd. produced a place of antivirus software and declared it as 'open' software. Anybody can download it for free from the internet and anyone can make changes to it. Alpha Ltd has spent Rs. 5 Million in developing the software.**

A The software will be treated as intangible asset and amortized over its usful life.

B The software will be tested for impairment depending on its recoverable value in future.

C The amount spent on the software will be capitalized under Ind AS 16.

D The software cost would be charged to revenue as it does not meet the criteria laid down under *Ind AS 38: Intangible Assets*

Answer: D

248. **Goodwill is defined as**

A Intangible asset

B Fictitious asset

C Current asset

D Liquid asset

Answer: A

249. **The excess amount which the firm can get on selling its assets over and above the saleable value of its assets is called**

A Surplus

B Super Profit

C Reserve

D Goodwill

Answer: D

250. **A firm's goodwill is not affected by**

A Location of the firm

B The reputation of the Firm

C Better Customer Service

D None of the Above

Answer: D

251. **Weighted average method of calculating goodwill is used when**

A Profits are not equal

B Profits show a trend

C Profits are Fluctuating

D None of the Above

Answer: B

252. Under the capitalization method, the formula for calculating the goodwill is

A Super profit multiplied by the rate of return

B Average profits multiplied by the rate of return

C Super profits divided by the rate of return

D Average profits divided by the rate of return

Answer: C

253. The total capital employed in the company is INR 8,00,000 a reasonable rate of return is 15% and the profit of the year is 412,00,000. The value of goodwill of the company as per the capitalization method will be

A INR 82,00,000

B INR 12,00,000

C INR 72,00,000

D INR 42,00,000

Answer: C

254. A firm earns INR 1,00,000. The normal rate of return is 10%. The assets of the company amounted to INR 11,00,000 and liabilities to INR 1,00,000. Value of goodwill by the capitalization of average actual profit will be

A INR 2,00,000

B INR 10,000

C INR 5,000

D INR 1,00,000

Answer: D