ST MARY’S UNIVERSITY

TWICKENHAM, LONDON

BA/BA (ITT) Degree Examination students registered for

Level **FIVE**

Title: **Corporate Finance**

Code: **MGT5015**

Semester: **ONE**

Date: **January 7th 2019**

Time: **9:30 – 11:30AM**

TIME ALLOWED: **TWO** HOURS

Section A - Please answer **ALL** questions (30 marks)

Section B - Please answer **TWO** questions (70 marks)

Section A (30 marks)

1. Shareholders of a corporation may be, among others (choose the best answer),

A. individuals.

B. individuals and pension funds.

C. individuals, pension funds, and insurance companies.

D. pension funds and insurance companies

1. A firm's investment decision is also called its:

A. capital budgeting decision

B. financial input decision

C. liquidity decision

D. leasing decision

1. In the principal–agent framework (choose the best answer),

A. shareholders are the agents

B. managers are the principals and shareholders are the agents

C. shareholders are the principals and managers are the agents

D. managers are the agents

1. The present value of $100 expected two years from today at a discount rate of 7 percent is:

A. $82.04

B. $87.34

C. $95.39

D. $101.00

1. An initial investment of $440,000 is expected to produce an end-of-year cash flow of $480,000. What is the NPV of the project at a discount rate of 20 percent?

A. -$40,000

B. $24,000

C. $50,000

D. $67,600

1. Which of the following statements regarding the NPV rule and the rate of return rule is false?

A. Accept a project if its NPV > 0

B. Reject a project if its opportunity cost > 0

C. Reject a project if the NPV < 0

D. Accept a project if its rate of return > opportunity cost of capital

1. What is the present value of $10,000 per year in perpetuity at an annual interest rate of 8 percent? Assume the perpetuity starts in one year.

A. $30,000

B. $77,500

C. $125,000

D. $250,000

1. The opportunity cost of capital for a risky project is:

A. the expected rate of return on a government security having the same maturity as the project.

B. the expected rate of return on a typical equity portfolio.

C. the expected rate of return on a typical bond portfolio.

D. the expected rate of return on a security of similar risk as the project.

1. A government bond issued in Germany has a coupon rate of 5 percent, a face value of 100 euros, and matures in five years. The bond pays annual interest payments. Calculate the price of the bond (in euros) if the yield to maturity is 3 percent.

A. 112.01

B. 109.16

C. 106.33

D. 105.00

1. Generally, a bond can be valued as a package of

A. coupon and perpetuity only

B. perpetuity and single payment only

C. annuity, single payment and coupon

D. annuity and single payment only

1. If the nominal interest rate per year is 10 percent and the inflation rate is 6 percent, what is the real rate of interest?

A. 3.1 percent

B. 3.8 percent

C. 4.0 percent

D. 16.0 percent

12. Assume General Electric (GE) has about 10.3 billion shares outstanding and the stock price is $39.10. Also, assume the P/E ratio is about 18.3. Calculate the approximate market capitalization for GE.

A. $679 billion

B. $403 billion

C. $384 billion

D. $109 billion

13. Futuristic Computer Company's stock is selling for $100 per share today. It is expected that, at the end of one year, it will pay a dividend of $3 per share and then be sold for $107 per share. Calculate the expected rate of return for the shareholders.

A. 10 percent

B. 20 percent

C. 20 percent

D. 25 percent

14. One can estimate the dividend growth rate for a stable firm as:

A. plow-back rate / the return on equity (ROE)

B. plow-back rate × the return on equity (ROE)

C. the return on equity (ROE) / plow-back rate

D. plow-back rate + the return on equity (ROE)

15. Happy Co. is expected to pay a dividend of $2 per share at the end of year 1, and the dividends are expected to grow at a constant rate of 4 percent forever. If the current price of the stock is $40 per share, calculate the expected return or the cost of equity capital for the firm.

A. 9 percent

B. 11 percent

C. 14 percent

D. 20 percent

Section B (70 marks)

Answer **TWO** questions.

1. Explain how one calculates the expected return and the standard deviation of a portfolio consisting of two stocks, and draw the resultant risk-return profile. How does the size of the correlation coefficient between the two stock prices affect the profile, and why is this a surprising result?
2. Describe the Dividend Irrelevance theorem of Modigliani and Miller, and assess its realism and applicability.
3. Describe the shareholder and stakeholder approaches to corporate mission and identity. What does the empirical evidence suggest with the regards to the relationship between financial performance and corporate social responsibility?
4. Define the concept of market efficiency and describe the three different forms of market efficiency identified by researchers. To what extent do markets display efficiency in real life?
5. Define call and put options, and explain the concept of put-call parity. How realistic is this concept in real life?
6. Identify and describe the different types of mergers. What are the typical difficulties associated with mergers? What additional difficulties do international mergers involve compared to those taking place within individual countries?

**END OF EXAMINATION**