I. **True or False (30%)**

1 A bond is said to sell at a premium when the required return and the bond value fall below the coupon interest rate and the par, respectively.

2. Accounting figures and cash flows are not necessarily the same, due to the presence of certain noncash expenditures on the firm's income statement.

3. In capital budgeting, risk refers to the chance that a project has a high degree of variability of the initial investment

4. Using the Capital Asset Pricing Model (CAPM), the cost of common stock equity is the return required by investors as compensation for the firm's nondiversifiable risk.

5. The cost of equity is greater than the cost of debt and increases with increasing financial leverage, but generally less rapidly than the cost of debt.

6. Since the putable bonds give its holder the right to "put the bond" at specified times or actions by the firm, the bond's yield is lower than that of a non-putable bond.

7. One disadvantage of the common stock financing is that market participants perceive the sale of common stock by the firm to reflect management's belief that the stock is "overvalued"; as a result, the stock price declines.

8. Operating lease are noncancelable and obligates the lessee to make payments for the use of an asset over a predefined period of time

9. The actual ratio of exchange in a stock-exchange acquisition is the ratio of the amount paid per share of the target company to the per-share market price of the acquiring.

10 A multi-national corporation (MNC) can give some protection to international cash flows by reducing its liabilities if the currency is appreciating or by reducing its financial assets if currency is depreciating.

II. **Multiple Choice** (**only one** answer out of four possible answers, 30%)

1. A common stock currently has a beta of 1.7, the risk-free rate is 7% annually, and the market return is 12% annually. The stock is expected to generate per share benefits of $6.70 during the coming period. A pending lawsuit has just been dismissed and the beta of the stock drops to 1.4. The new equilibrium price of the stock
(A) will be $55.83
(B) will be $43.23
(C) will be $47.86
(D) cannot be determined from the information given.

(背面仍有題目,請繼續作答)

2. A corporation is considering expanding operations to meet growing demand. With the capital expansion, the current accounts are expected to change. Management expects cash to increase by \$20,000, accounts receivable by \$40,000, and inventories by \$60,000. At the same time, accounts payable will increase by \$50,000, accruals by \$10,0000 and long-term debt by \$100,000. The change in net working capital is
(A)an increase of \$120,000
(B)a decrease of \$40,000
(C)a decrease of \$120,000
(D)an increase of \$60,000

3. A firm is evaluating two independent projects utilizing the internal rate of return technique. Project X has an initial investment of \$80,000 and cash inflows at the end of each of the next five years of \$25,000. Project Z has a initial investment of \$120,000 and cash inflows at the end of each of the next four years of \$40,000. The firm should
(A)Accept both if their cost of capital is 15% at the maximum.
(B)Accept only Z if their cost of capital is 15% at the maximum.
(C)Accept only X if their cost of capital is 15% at the maximum.
(D)Reject both if their cost of capital is 12% at the maximum.

4. If a corporation has an average tax rate of 40%, the approximate, annual, after-tax cost of debt for a 15-year, 12%, \$1,000 par value bond, selling at \$950 is
(A)10%
(B)10.6%
(C)7.6%
(D)6.0%

5. As debt is substituted for equity in the capital structure and the debt ratio increases, the behavior of the overall cost of capital is partially explained by
(A)the tax-deductibility of interest payments
(B)the increase in the number of common shares understanding
(C)the reduction in risk as perceived by the common shareholders.
(D)The decrease in the cost of equity.

6. To compensate for the uncertainty of future interest rates and the fact that the longer the term of a loan the higher the probability that the borrower will default, the lender typically
(A)charges a higher interest rate on long-term loans
(B)reserves the right to change the terms of the loan at any time.
(C)Includes excessively restrictive debt provisions
(D)Reserves the right to demand immediate payment at any time.

7. The problem with a constant-payout-ratio dividend policy form the shareholder's perspective is that
(A)it bores the shareholders
(B)if the firm's earnings drop, so does the dividend payment
(C)even when earnings are low, the company must pay a fixed dividend.
(D)There is no informational content.

8. An investor is considering buying 500 shares of ABC company at \$32 per share. Analysts agree that the firm's stock price may increase to 45 per share in the next four months. As an alternative, the investor could purchase a 120-day call option at a striking price of \$30 for \$5,000. What profit would the investor realize if the stock price increased to \$42 per share?
(A)0
(B)1,000
(C)4,000
(D)6,000

9. Marketing Concepts, Inc. is considering the acquisition of Management Theories, Inc. at a cash price of \$1.5 million. Management Theories, Inc. has short-term liabilities of \$500,000. As a result of acquiring Management Theories, Inc., Marketing Concepts, Inc. would acquire the copyrights to a national best-seller which would provide an estimated cash flow of \$300,000 for the next five years. The firm ahs a cost of capital of 20%. The approximate net present value of this acquisition is
(A)\$500,000
(B)\$480,800
(C)-\$102,700
(D)-\$1,102,700

10. A short-term financial decision based on an MNC management's expectation that the local foreign currency will appreciate may be
(A) increasing local customers accounts receivable and increasing local notes payable
(B) decreasing local notes receivable and decreasing accruals
(C) increasing local inventories and increasing local notes payable
(D) increasing local accounts receivable and decreasing local accounts payable.

III. **Essay Questions (40%)**

1. David and Mary are studying *Financial Management* course for this semester. They meet together today to discuss the materials of *Financial Management*. Their dialogue is as follows:(**Notice: Your answers for the following questions should be more detailed and complete**)

Dialogue 1:

David: Mary, I am not quite comfortable about the idea that the investment decision and the market portfolio are made due to different economic reasons.

Mary: Well, I agree with you regarding this. The whole idea does not make any sense out of intuitions, really. How does this idea work?

(a) According to conversation above, could you tell and explain to us what kind of theory David and Mary are talking about? (5%)

Dialogue 2:

David: I have no clue about that. In addition, since the professor told us that the economic agents make their investment decisions through their preferences, the CAPM (capital asset pricing model) model should be related to indifference curves, right?

Mary: I am not quite sure. But, as you said, if the investment decisions have anything to do with preference idea, the CAPM got to be connected with individual preferences?

(b)According to conversation above, could you tell and explain to us whether the explanations of the CAPM Mary and David gave us are correct or not? And what are the reasons behind your reasons? (5%)

Dialogue 3:

David: Mary, the homework problem said that we are able to use the CAPM idea to evaluate a project value. Could you give me a hint how to work out this problem?

Mary: Let's see. A project has cash flow of \$320. In the meantime, the market portfolio return is 7%, the risk-free rate is 3%, and the volatility of market portfolio return is 2%. The covariance between the project cash flow and the market portfolio is 5.5. What is the present value of this project? Hey, look at the hint. "Be sure to use certainty equivalent ideà." Ho! La! La! What kind of question we have now?

(c)According to conversation above, you should provide David and Mary with an answer to their homework problem? (Don't just write down the answer. Be sure to include your solution processes) (5%)

2. The CFO in the ABC company decides to make a dividend policy for the company. He finds out that investors currently undervalue ABC stocks. Therefore, he wants to raise dividends to tell investors how well the ABC company is. However, he recently got a financial prediction report saying that the sales could go down for the following 3 years due to industry cycle and go up in the 4th year. So the CFO comes into a dilemma regarding the dividend policy. Now, you are a financial advisor and are requested by the CFO to provide him with suggestions. What kind of dividend policy you should recommend the CFO to adopt? What reasons and theories can support your idea? (15%)

3. The Tiga company made strategic alliance with ICM company a month ago. The stock market reacted to this news by pushing the stock prices of both companies to increase. Encouraged by this strategic alliance decision, the Tiga company makes a further announcement today that the Tiga company decides to merge with the UNC company to further enhance their production and design capabilities. Unfortunately, investors sell bunch of Tiga stocks in response to this merge announcement and therefore the stock price of the Tiga company plunges a lot. Could you explain how come the investors respond to news so differently regarding the Tiga company's decisions? (Be sure to include theories to back up your answers) (10%)