PART A
INSTRUCTIONS: 1. THERE ARE TWO (2) QUESTIONS IN THIS PART.
2. ANSWER BOTH QUESTIONS.

Question 1
a. In determining the level of risk for financial assets, when is the coefficient of variation preferred over the standard deviation? Provide an example to support your answer. [3 marks]

b. To reap the benefit of diversification, how should one select and combine the different financial assets in his or her portfolio? Why? [4 marks]

c. What is the Security Market Line (SML) and explain its importance in describing the risk-return relationship. Name TWO (2) factors and illustrate how they can affect the SML. [4 marks]

d. You have formed a portfolio consist of assets X, Y and Z.

<table>
<thead>
<tr>
<th>Asset</th>
<th>Annual Return</th>
<th>Probability</th>
<th>Beta</th>
<th>Proportion in Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>X</td>
<td>10%</td>
<td>0.50</td>
<td>1.2</td>
<td>0.333</td>
</tr>
<tr>
<td>Y</td>
<td>8%</td>
<td>0.25</td>
<td>1.6</td>
<td>0.333</td>
</tr>
<tr>
<td>Z</td>
<td>16%</td>
<td>0.25</td>
<td>2.0</td>
<td>0.333</td>
</tr>
</tbody>
</table>

i) What is the expected annual return of this portfolio?

ii) Calculate the beta of the portfolio.

iii) What can you say about the level of risk of that portfolio as compared to the market risk? [6 marks]

e. What is the market risk premium if the risk free rate is 5 percent and the expected market return is given as follows?

<table>
<thead>
<tr>
<th>State of Nature</th>
<th>Probability</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boom</td>
<td>20%</td>
<td>30%</td>
</tr>
<tr>
<td>Average</td>
<td>70%</td>
<td>15%</td>
</tr>
<tr>
<td>Recession</td>
<td>10%</td>
<td>~5%</td>
</tr>
</tbody>
</table>

[3 marks]

[TOTAL: 20 MARKS]
Question 2

a. A firm is evaluating two projects that are mutually exclusive with initial investments and cash flows as follows:

<table>
<thead>
<tr>
<th></th>
<th>Project A</th>
<th>Project B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial</td>
<td>Investment</td>
<td>Initial</td>
</tr>
<tr>
<td>End-of-Year</td>
<td>Cash Flows</td>
<td>Investment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>End-of-Year</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cash Flows</td>
</tr>
<tr>
<td>RM40,000</td>
<td>RM20,000</td>
<td>RM90,000</td>
</tr>
<tr>
<td>20,000</td>
<td>40,000</td>
<td>20,000</td>
</tr>
<tr>
<td>20,000</td>
<td>80,000</td>
<td></td>
</tr>
</tbody>
</table>

i) Which project should the firm choose if it has a required payback period of two years? Explain your answer.  
[2 marks]

ii) If the firm’s required rate of return is 15 percent, which project should be chosen? Why?  
[3 marks]

b. A firm is evaluating two independent projects utilising the internal rate of return technique. Project X has an initial investment of RM80,000 and cash inflows of RM25,000 at the end of each of the next five years. Project Z has a initial investment of RM120,000 and cash inflows of RM40,000 at the end of each of the next four years. If cost of capital is 15 percent, should the firm accept both projects? Why or why not?  
[5 marks]

c. Theoretically why NPV is a better approach than IRR in evaluating projects?  
[3 marks]

d. In capital budgeting, why only the incremental cash flows is considered relevant cash flows for a project evaluation? Elaborate by giving an example.  
[3 marks]

e. Using appropriate examples, describe what sunk costs and opportunity costs are. Are these costs, relevant costs in capital budgeting?  
[4 marks]

[TOTAL: 20 MARKS]
PART B

INSTRUCTIONS:  1. THERE ARE FIVE (5) QUESTIONS IN THIS PART.
    2. ANSWER THREE (3) QUESTIONS ONLY.

Question 1

a. Why do financial managers prefer to use the present value than the future value in making financial decisions? [3 marks]

b. As a borrower, which rate do you prefer to pay your loan in – nominal annual rate or effective rate? Why? [3 marks]

c. Jamilah has just graduated from high school and has received an award of RM5,000. She would like to deposit the money in an interest earning account until she graduates from college (i.e., four years from now). In her search for the highest interest earning account, she has narrowed the list down to the following two accounts:
   i) bank A pays 9 percent interest compounded annually, and
   ii) bank B pays 8 percent interest compounded semi-annually.
Which bank offers a better rate, and how much will Jamilah have upon graduation from college? [5 marks]

d. To expand its operation, Dayang Corp. has applied to the International Mercantile Bank for a 3-year, RM3,500,000 loan. Prepare a loan amortization table assuming 10 percent rate of interest. [4 marks]

e. A beach chalet in Morib now costs RM250,000. Inflation is expected to cause this price to increase at 5 percent per year over the next 10 years before Bibah and Puad retire from successful investment banking careers. How large an equal annual end-of-year deposit must be made into an account paying an annual rate of interest of 13 percent in order to buy the chalet upon their retirement? [5 marks]

[TOTAL: 20 MARKS]
Question 2

a. The goal of a firm is said to be maximising the shareholders’ wealth. Why the focus is only on the pursuant of the shareholders’ interest?

[3 marks]

b. What are rights issues and why these issues are sold to the existing shareholders of a company?

[3 marks]

c. The stock beta of Dragon King Bhd is 1.50. The risk-free rate of interest is currently 12 percent and the required rate of return of market portfolio is 18 percent. The company plans to pay a dividend of RM2.45 per share next year and anticipates that its future dividends will increase at an annual rate consistent with that experienced over the 2009–2011 period.

<table>
<thead>
<tr>
<th>Year</th>
<th>Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>2.32</td>
</tr>
<tr>
<td>2010</td>
<td>2.21</td>
</tr>
<tr>
<td>2009</td>
<td>2.10</td>
</tr>
</tbody>
</table>

Based on the above information, estimate the stock value of Dragon King Bhd.

[4 marks]

d. The National Broadcasting Company paid RM2.00 dividend last year for its common stock per share. It is expected that its dividend will grow at the rate of 5 percent for the next 4 years and then to 3 percent per year thereafter. What is the current value of the stock if the required rate of return is 8 percent?

[6 marks]

e. Briefly discuss the similarities and differences between the rights of the debt-holders and the rights of equity holders of a company.

[4 marks]

[TOTAL: 20 MARKS]
Question 3

a. Current and quick ratios measure the liquidity of a company. When is the quick ratio a better measure of liquidity than the current ratio? Give an example to support your answer. [3 marks]

b. Which financial ratio would be of great interest to the shareholders of a company? Why? [3 marks]

c. A firm had the following accounts and financial data for 2010:

<table>
<thead>
<tr>
<th>Sales revenue</th>
<th>RM3,060</th>
<th>Cost of goods sold</th>
<th>RM1,800</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>500</td>
<td>Preferred stock dividends</td>
<td>18</td>
</tr>
<tr>
<td>Interest expense</td>
<td>126</td>
<td>Tax rate</td>
<td>40%</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>600</td>
<td>Number of common shares</td>
<td>1,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>240</td>
<td>outstanding</td>
<td></td>
</tr>
</tbody>
</table>

Calculate the firm’s earnings per share, rounded to the nearest cent. [5 marks]

d. In an effort to analyse Cendana Company finances, Joey realised that the company’s net profits after taxes for the current year is missing. Based on the following information determine the company’s net profits after taxes using the following information:

Return on total assets = 2%
Total Asset Turnover = 0.5
Cost of Goods Sold = RM105,000
Gross Profit Margin = 0.30

[6 marks]

e. What is the return on equity (ROE) for a firm with sales of RM1,000,000, net profits after taxes of RM30,000, total assets of RM1,500,000, and total liabilities of RM750,000? [3 marks]

[TOTAL: 20 MARKS]
Question 4

a. What are discount, premium and par bonds? What will happen to their prices as the bonds approach the maturity date? [4 marks]

b. What are the risks associated to bond? Elaborate. [4 marks]

c. Jamieson Enterprises wants to issue sixty 20-year, RM1,000 par value, zero-coupon bonds. If each bond is priced to yield 7 percent, how much will Jamieson receive (ignoring issuance costs) when the bonds are first sold? [4 marks]

d. Mahligai Industries has issued a bond which has a RM1,000 par value and a 15 percent annual coupon interest rate. The bond will mature in ten years and currently sells for RM1,250. Using this information, determine the yield to maturity of the bond. [5 marks]

e. The Alpha Corp. has two bonds outstanding that are the same except for the maturity date. Bond Delta matures in 4 years while Bond Epsilon matures in 7 years. If the investor’s required rate return changes, which bond will experience greater price change? Why? (Hint: You only need to explain your answer) [3 marks]

[TOTAL: 20 MARKS]
Question 5

a. Briefly discuss the relationship between risk and return as postulated by the Capital Asset Pricing Model (CAPM).

[5 marks]

b. Within the framework of the Efficient Market Hypothesis (EMH), briefly describe how the financial securities are being priced.

[5 marks]

c. Using an example, briefly describe the process of valuation and explain why it is important for a financial manager to understand this process.

[5 marks]

d. Brief explain why wealth maximisation is a preferred goal for an organisation as opposed to profit maximisation?

[5 marks]

[TOTAL: 20 MARKS]