Study Guide for Exit Exam for Finance Majors

The exit exam is given in the Advanced Financial Management (FINA40153) class. The exit exam counts as 10% of the course grade.

Students graduating with a Bachelors degree in Finance should be knowledgeable of the following:

Time Value of Money

* Calculate the present value or future value of a lump (single) sum.
* Find number of periods or interest rate for lump sum cash flow if given PV and FV
* Calculate PV or FV of an annuity and of an annuity due
* Find PMT, interest rate, or number of payments in annuity or annuity due problem with annual or non-annual payments
* Find the PV, PMT, or interest rate for a perpetuity
* Calculate the effective annual rate for an interest rate compounded more than one time per year
* Prepare a loan amortization table
* Understand the effect of time and interest rate on present and future values of a cash flow

Asset Valuation

* Calculate the price of a bond
* Calculate the yield to maturity of a bond
* Understand the impact of time to maturity on changes in bond prices as yield changes
* Explain bond duration
* Calculate the price of preferred stock
* Calculate the expected return of preferred stock
* Calculate the value of common stock using the dividend discount model, earnings model, and firm’s free cash flows.
* Calculate the expected return of common stock
* Calculate the current yield (dividend yield) of stock
* Explain relative riskiness of bonds, preferred stock, common stock relative to claims on assets and claims on income
* Understand the effect of changes in discount rate on price of asset
* Calculate the value of a merger using free cash flows, cash flows to equity, and adjusted present value approach
* Understand derivative terminology, pricing models, and investment strategies.
* Explain the Efficient Market Hypothesis
* Explain the three different types of market efficiency and its implications to abnormal returns.
* Calculate the beta and alpha of a common stock based on historical stock price data
* Explain the benefits of diversification
* Understand the difference between systematic and unsystematic risk.
* Calculate the Sharpe ratio and explain its relation to risk-benefit tradeoff
* Explain the role of an investment banker regarding security issues, capital structure analysis, and merger and acquisitions
* Explain financial leverage and operating leverage and how they impact firm performance
* Understand the ‘random walk’ of stock prices
* Understand primary and secondary security market transactions

Capital Budgeting

* Calculate the cost of debt with and without flotation costs
* Calculate the cost of preferred stock with and without flotation costs
* Calculate the cost of common stock using the dividend growth model with and without flotation costs
* Calculate the cost of equity using the Capital Asset Pricing Model
* Understand what a stock’s beta measures and how it is calculated
* Understand how a firm’s level of debt affects the cost of common equity
* Calculate the firm’s capital structure weights
* Calculate the firm’s weighted average cost of capital
* Understand marginal cost of capital
* Be able to evaluate a project’s cash flows using payback period, discounted payback period, net present value, internal rate of return, and modified internal rate of return
* Be able to select between projects of different life length and different size (initial outlay)
* Be able to develop a project’s cash flows
* Understand why the WACC curve is u-shaped

Financial Statement Analysis

* Understand the uses of financial statement analysis
* Understand the use of profitability ratios, liquidity ratios, asset utilization ratios, and debt utilization ratios
* Calculate the following ratios: profit margin, return on equity, return on assets, debt ratio, times interest earned, receivables turnover, average collection period, total asset turnover, current ratio
* Use the DuPont system of analysis
* Understand the limitations of ratio analysis

Corporate Governance

* Understand agency theory, agency problem, and ways firms can minimize the agency problem
* Explain the goal of a firm and how corporate governance policies influence management’s actions to achieve the goal

Capital Structure

* Understand the effects of debt on firm value, cost of debt, and cost of equity
* Explain and calculate interest tax shields
* Discuss the effect of debt on the cost of financial distress

Money and Banking

* Understand how market interest rates are determined
* Explain the term structure of interest rates
* Understand foreign-exchange markets and exchange rates
* Understand the functions of financial institutions
* Explain the money supply process
* Explain the organization of central banks, monetary policy tools, and the conduct of monetary policy
* Explain the IS-LM-FE model
* Understand aggregate demand and aggregate supply
* Explain the causes and consequences of inflation
* Discuss the implications of the moral hazard problem
* Explain the adverse selection problem