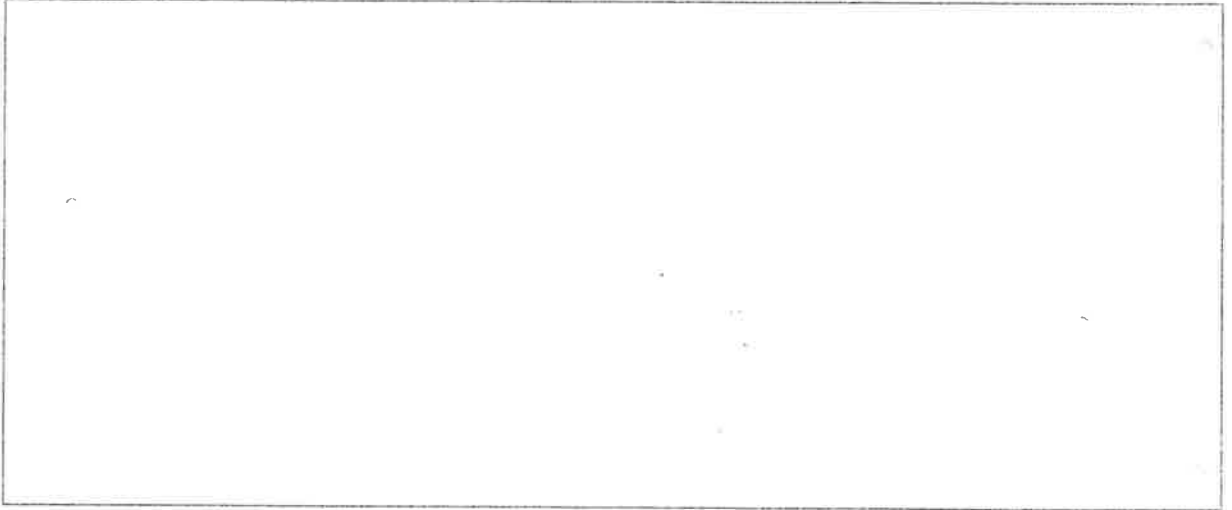


16**For the following questions, calculate the answers.**

Marks: 3

You are evaluating common stock for a firm. The current market price is \$30 and the dividend at the end of the year is expected to be \$1.50. Dividends and earnings are growing at 12% annual rate. What is the expected rate of return for this stock? Include the formula you would use to determine this.

Answer:

**17**

Marks: 3

Calculate the Discounted Payback, NPV and PI for the following Project. The initial outlay for the project is \$20,000 and the return is \$10,000 for each of the next 5 years. The required rate of return for the company is 8%. State how you calculate each and what it means.

Answer:

18

Marks: 3

You expect to receive \$5,000 each year for 5 years. You estimate that the proper discount rate for this investment is only 4% because there is not much risk. What is this investment worth to you in today's dollars? What is it worth if the discount rate increases to 6% because of some risk? Show your calculation. What are the implications of a higher interest rate?

Answer:

19

Marks: 3

Calculate the Degree of Operating leverage for a firm that has sales and Expenses as follows for 2006 and 2007. How do you interpret the result?

	Base Sales Level t	Forecast Sales Level t+1
Sales	\$400,000	\$540,000
- total variable costs	320,000	432,000
Revenue before fixed costs	80,000	108,000
- total fixed costs	30,000	30,000
EBIT	\$50,000	\$78,000
Unit Sales Price	\$25	\$25
Unit Variable Cost	10	10

Answer:

20

Marks: 3

Calculate the debt ratio, acid test ratio and the average collection period, based on the following income statement and balance sheet, and interpret the result for each.

Wilcox Company Income Statement		
5 Thousands		2005
Sales		\$8,000
- Cost of goods sold		6,300
Gross Profit		1,700
Selling, G&A expenses		500
Depreciation Expense		200
Total Operating Expenses		700
Operating profit		1,000
Interest expense		40
Earnings before Taxes		960
Provision for Income Taxes		288
Net Income		\$672
Balance Sheet		
12/31/2005		
Assets		
Cash		1,000
Accounts Receivable		700
Inventories		200
Other Current Assets		50
Total Current Assets		1,950
Plant and Equipment		3,000
- Accumulated Depreciation		800
Net Plant and Equipment		2,200
Other		400
Total Assets		4,550
Liabilities and Equities		
Accounts Payable		300
Accrued Expenses		300
Income Taxes Payable		75
Short-term Notes		400
Other		65
Total Current Liabilities		1,120
Long-term Debt		2,000
Total Liabilities		3,120
Common Equity		
Common Stock (par value)		500
Paid-in Capital		610
Retained Earnings		1,000
- Treasury stock		680
Total Common Equity		1,430
Total Liabilities and Equity		4,550

Answer:

Final Exam Part A

1 For the following questions, select the best answers from the choices provided.

Marks: 1

The CEO of JLI Corp. decided to expand into a new market in 2004. At the end of 2004, JLI's stock price had decreased 5% since the beginning of the year. Which of the following statements is most correct?

Choose one answer.

- ☐ a. The CEO made a poor decision to expand because the stock price decreased during the year.
- ☐ b. The CEO made a poor decision to expand because the company's profits for the year obviously decreased, causing the drop in stock price.
- ☐ c. The CEO's decision may have been optimal, keeping the stock price from falling more than 5%.
- ☒ d. CEO decisions are irrelevant because the efficient market determines the value of a company's stock.

2

Marks: 1

The CEO of High Tech International decides to change an accounting method at the end of the current year. The change results in reported profits increasing by 5%, but the company's cash flows are not changed. If capital markets are efficient, then the stock price will _____.

Choose one answer.

- ☒ a. not be affected by the accounting change
- ☐ b. increase due to higher profits
- ☐ c. increase only if the accounting change will also result in higher profits in the next year
- ☐ d. decrease because accounting method changes are not permitted under generally accepted accounting principles

3

If an investor is said to be "risk averse," then that investor _____.

Marks: 1

Choose one answer.

- ☐ a. will not be induced to take on any risk
- ☐ b. will only take on the least risk possible
- ☒ c. will only take on additional risk if they expect to be compensated in the form of additional return
- ☐ d. is not behaving in a typical manner

4 Which of the following is an advantage of the sole proprietorship?

Marks: 1

Choose one answer.

- ☐ a. Limited liability for its owners
- ☐ b. Double taxation for its owners
- ☒ c. No significant legal requirements for starting the business
- ☐ d. Easily transferred ownership

5 Based on the information in the table, what is the after tax cash flow from operations for 2004 (no assets were disposed of during the year, and there was no change in interest payable or taxes payable)?

Marks: 1

Jones Company Financial Information		
	December 2003	December 2004
Net income	\$1,500	\$3,000
Accounts receivable	750	750
Accumulated depreciation	1,125	1,500
Common stock	4,500	5,250
Paid-in capital	7,500	8,250
Retained earnings	1,500	2,250
Accounts payable	750	750

Choose one answer.

- ☐ a. \$3,750
- ☐ b. \$3,375
- ☐ c. \$3,000
- ☐ d. \$2,250

6 Based on the information above, calculate the dividends paid in 2004 (no assets were disposed of during the year, and there was no change in interest payable or taxes payable).

Marks: 1

Choose one answer.

- ☐ a. \$3,750
- ☐ b. \$3,000
- ☐ c. \$750
- ☐ d. \$2,250

7 Based on the information above, assuming that no assets were disposed of during 2004, the amount of depreciation expense was _____.

Marks: 1

Choose one answer.

- ☐ a. \$375
- ☐ b. \$1,500

☐ c. \$2,625

☐ d. \$750

8 Based on the information above, assuming that no common stock was repurchased during the year, the firm issued how much new common stock during 2004?

Marks: 1

Choose one answer.

☐ a. \$750

☐ b. \$5,250

☐ c. \$1,500

☐ d. \$3,000

9 All of the following measure liquidity EXCEPT _____.

Marks: 1

Choose one answer.

☐ a. ~~current~~ ratio

☒ b. debt ratio

☐ c. ~~acid-test~~ ratio

☐ ~~d.~~ accounts receivable turnover



10 Company A has a higher days sales outstanding ratio than Company B. Therefore, _____.

Marks: 1

Choose one answer.

☐ a. Company A must be managing its accounting receivable better than Company B

☐ b. Company A may have a more lenient credit policy than Company B

☐ c. on average, Company A must be collecting its accounts receivables faster than Company B

☐ d. Company A must have higher sales than Company B

11 Operating return on assets is equal to _____.

Marks: 1

Choose one answer.

☐ a. operating profit margin times sales

☐ b. return on equity times total assets

☐ c. return on assets times earnings before interest and taxes (EBIT)

☐ d. operating profit margin times total asset turnover

12

Marks: 1

HighLev Inc. borrows heavily and uses the leverage to boost its return on equity to 30%, nearly 10% higher than the industry average. However, HighLev's stock price decreases relative to its industry counterparts. How is this possible?

Choose one answer.

- ☐ a. Markets are inefficient and fail to recognize the benefits of leverage.
- ☐ b. The increased debt resulted in interest payments that made HighLev's operating income drop even though return on equity increased.
- ☐ c. Shareholders are not interested in return on equity.
- ☐ d. The high levels of debt increased the riskiness of HighLev are relative to its competitors.

13 The current ratio of a firm would be decreased by which of the following?

Marks: 1

Choose one answer.

- ☐ a. Land held for investment is sold for cash.
- ☐ b. Equipment is purchased, financed by a long-term debt issue.
- ☐ c. Inventories are sold for cash.
- ☐ d. Inventories are sold on a short-term credit basis.

14 When forecasting fixed asset requirements, the projected fixed asset balance will _____.

Marks: 1

Choose one answer.

- ☐ a. not increase proportionally with sales if the existing level of fixed assets is sufficient to support current sales
- ☐ b. not increase proportionally if excess capacity exists
- ☐ c. remain the same since the balance is fixed
- ☐ d. always increase proportionally with sales

15 Which of the following will most likely result in an increase in discretionary funding needed?

Marks: 1

Choose one answer.

- ☐ a. The company's profit margin increases.
- ☐ b. The company's dividend payout ratio decreases.
- ☐ c. The company's assets are only operating at 50% of capacity.
- ☐ d. The company pays its accounts payable in 30 days, down from 45 days.

16 JR Textiles, a highly profitable company, is considering two growth strategies, one that will achieve sales growth of 20% in one year, and the other that will achieve 20% growth in sales, but over a 4-year time frame. Assuming JR Textiles uses the percent of sales method, which of the following statements is TRUE?

Marks: 1

☐

Choose one answer.

- ☐ a. Discretionary financing needed will be much greater for the 4-year growth strategy.
- ☐ b. Discretionary financing needed could be much less for the 4-year growth strategy due to retained earnings.
- ☐ c. The asset balances at the end of 4 years for strategy two will be much greater than the asset balances required at the end of year one for strategy one.
- ☐ d. Discretionary financing needed could be much greater for the slow growth strategy because interest charges will accumulate on the company's debt.

17 The first step involved in predicting financing needs is ____.

Marks: 1

Choose one answer.

- ☐ a. project the firm's sales revenues and expenses over the planning period
- ☐ b. estimating the levels of investment in current and fixed assets that are necessary to support the projected sales
- ☐ c. determining the firm's financing needs throughout the planning period
- ☐ d. estimating the cost of debt

18 Spontaneous sources of funds refers to all of the below EXCEPT ____.

Marks: 1

Choose one answer.

- ☐ a. accruals *SP*
- ☒ b. ~~a bank loan~~
- ☒ c. ~~accounts payable~~ *SP*
- ☐ d. ~~common stock~~ *SP*

19 Current assets would NOT usually include ____.

Marks: 1

Choose one answer.

- ☒ a. plant and equipment
 - ☐ b. marketable ~~securities~~
 - ☐ c. ~~accounts receivable~~
 - ☐ d. ~~inventories~~
- V*

20 JoLi Corp. purchases a new delivery van, which is expected to increase cash flows for the next 10 years. JoLi can finance the purchase with a standard 48-month vehicle loan, or by getting a 10 year loan from the bank. According to the hedging principle, JoLi should ____.

Marks: 1

Choose one answer.

- ☐ a. use the 10-year financing in order to match the cash flow stream from the asset with the financing repayments

- ☐ b. use the 48-month loan since it matches the type of asset with the type of loan
- ☐ c. use either type of financing, but hedge the risk in the options market
- ☐ d. avoid using either loan and finance the truck with current cash reserves to avoid interest expense

21 All of the following are likely to increase the cost of a company's short-term financing EXCEPT

Marks: 1

Choose one answer.

- ☐ a. an increase in the bank's prime lending rate
- ☐ b. an increase in the compensating balance required
- ☐ c. taking a loan on a discount basis
- ☐ d. an increase in the company's debt rating by Moody's or Standard and Poors

22 Which of the following is NOT true regarding the use of short-term debt?

Marks: 1

Choose one answer.

- ☐ a. It must be rolled over more often than long-term debt.
- ☐ b. There is uncertainty connected with interest costs on short-term debt from year to year.
- ☐ c. The firm is subjected to greater liquidity risk when using short-term credit.
- ☐ d. Interest rates are usually higher on short-term debt.

23 For the following questions, read the information below, and then answer the questions that follow.

Marks: 1

Zelluose Corp. is considering two mutually exclusive projects, A and B. Project A costs \$50,000 and is expected to generate \$38,000 in year one and \$30,000 in year two. Project B costs \$70,000 and is expected to generate \$24,000 in year one, \$32,000 in year two, \$23,000 in year three and \$29,000 in year four. Zelluose Corp.'s required rate of return for these projects is 12%.

The net present value for Project A is _____.

Choose one answer.

- ☐ a. \$5,000
- ☐ b. \$7,844
- ☐ c. \$5,600
- ☐ d. \$8,492

24 The net present value for Project B is _____.

Marks: 1

Choose one answer.

- ☐ a. \$38,000
- ☐ b. \$33,929
- ☐ c. \$11,740
- ☐ d. \$9,873

25 The profitability index for Project A is _____.

Marks: 1

Choose one answer.

- ☐ a. 1.100
- ☐ b. 1.435
- ☐ c. 1.973
- ☐ d. 1.157

26 The profitability index for Project B is _____.

Marks: 1

Choose one answer.

- ☐ a. 1.168
- ☐ b. 1.543
- ☐ c. .098
- ☐ d. 1.741

27 The internal rate of return for Project A is _____.

Marks: 1

Choose one answer.

- ☐ a. 33.56%
- ☐ b. 24.28%
- ☐ c. 21.87%
- ☐ d. 19.84%

28 The internal rate of return for Project B is _____.

Marks: 1

Choose one answer.

- ☐ a. 29.74%
- ☐ b. 22.35%
- ☐ c. 19.64%
- ☐ d. 16.49%

29

29

Marks: 1 Taste Good Chocolates develops a new candy and plans to sell each bar for \$1. Taste Good predicts that 1 million candy bars will be sold in the first year if the new candy bar is produced and sold, and includes \$1 million of incremental revenues in its capital budgeting analysis. A senior executive in the company believes that 1 million candy bars will indeed be sold, but lowers the estimate of incremental revenue to \$700,000. What would explain the change?

- Choose one answer.
- ☐ a. Cannibalization of 300,000 of Taste Good Chocolate's other candy bars
 - ☐ b. Excessive marketing costs to sell the 1 million candy bars
 - ☐ c. A lower discount rate
 - ☐ d. A higher selling price for the new candy bars

30 Laural Inc. is a household products firm that is considering developing a new detergent. In evaluating whether to go ahead with the new detergent project, which of the following statements is MOST correct?

Marks: 1

- Choose one answer.
- ☐ a. The company will produce the detergent project in a building that they already own. The cost of the building is therefore zero and should be excluded from the analysis.
 - ☐ b. The company will need to use some equipment that it could have leased to another company. This equipment lease could have generated \$200,000 per year in after-tax income. The \$200,000 should be excluded because the equipment can no longer be leased.
 - ☐ c. The company will need to hire 10 new workers whose salaries and benefits will total \$400,000 per year. Labor costs are not part of capital budgeting and should be excluded.
 - ☐ d. The company will produce the detergent in a building that it renovated 2 years ago for \$300,000. The \$300,000 should be excluded from the analysis.

31 You have been asked by the president of your company to evaluate the proposed acquisition of a new special-purpose truck. Since you are not an expert on industrial vehicles, you hire a consulting firm to make recommendations. The consultant charged you \$1,500 and recommended the purchase of a model CP8 truck. The truck's basic price is \$40,000, and it will cost another \$10,000 to modify it for special use by your firm. The truck will be depreciated using IRS guidelines that require depreciation expense equal to 33 percent of the initial depreciable value in year one, 45 percent of the initial depreciable value in year two and 15 percent of the initial depreciable value in year three. The company expects to sell the new truck after three years for \$20,000. Use of the truck will require an increase in the company's net working capital of \$2,000, but this \$2,000 may be recovered at the end of year three. The truck will have no effect on revenues, but it is expected to save the firm \$25,000 per year in before-tax operating costs, mainly labor. The firm's marginal tax rate is 40 percent. What is the initial outlay required to fund this project?

Marks: 1

- Choose one answer.
- ☐ a. \$50,000
 - ☐ b. \$51,500
 - ☐ c. \$52,000
 - ☐ d. \$53,500

32 The recapture of net working capital at the end of a project will _____.

Marks: 1

- Choose one answer.
- ☐ a. increase terminal year free cash flow
 - ☐ b. decrease terminal year free cash flow by the change in net working capital times the corporate tax rate
 - ☐ c. increase terminal year free cash flow by the change in net working capital times the corporate tax rate
 - ☐ d. have no effect on the terminal year free cash flow because the net working capital change has already been included in a prior year

33 Acme Auto Repair developed a new diagnostic testing procedure that is expected to increase sales by \$10,000 per month. As more drivers bring in their vehicles, Acme expects to also do more oil changes and brake repairs. As a result, inventory levels of oil and brake parts must be increased by \$5,000. Revenues from oil changes and brake jobs are expected to increase by \$4,000 per month. An example of a synergistic effect from the new diagnostic testing procedure is the increase in _____.

Marks: 1

- Choose one answer.
- ☐ a. inventory levels of oil and brake parts
 - ☐ b. revenue of \$10,000 per month for the diagnostic testing
 - ☐ c. revenues from oil changes and brake jobs of \$4,000 per month
 - ☐ d. all activities totaling \$19,000 per month

34 All of the following affect the value of a bond EXCEPT _____.

Marks: 1

- Choose one answer.
- ☐ a. investor's required rate of return
 - ☒ b. the recorded value of the firm's assets
 - ☐ c. the coupon rate of interest
 - ☐ d. the maturity date of the bond

35 If the market price of a bond decreases, then _____.

Marks: 1

- Choose one answer.
- ☐ a. the yield to maturity decreases
 - ☐ b. the coupon rate increases
 - ☐ c. the yield to maturity increases
 - ☐ d. the coupon rate decreases

36 Market efficiency implies which of the following?

- Marks: 1 Choose one answer.
- ☐ a. book value = intrinsic value
 - ☒ b. market value = intrinsic value
 - ☐ c. book value = market value
 - ☐ d. liquidation value = book value

37 An example of the growth factor in common stock is _____.

- Marks: 1 Choose one answer.
- ☐ a. acquiring a loan to fund an investment in East Germany
 - ☐ b. retaining profits in order to reinvest them into the firm
 - ☐ c. issuing new stock to provide capital for future growth
 - ☐ d. two strong companies merging together to increase their economy of scale

38 Which of the following is NOT a definition of yield to maturity?

- Marks: 1 Choose one answer.
- ☐ a. Discount rate that equates present value of future cash flows with a bond's price
 - ☐ b. Investor's required rate of return on a bond investment
 - ☐ c. Return that an investor will earn if they buy the bond for its market price and hold it until maturity
 - ☐ d. Discount rate that equates present value of future cash flows with a bond's face value

39 A project for Jevon and Aaron, Inc. results in additional accounts receivable of \$200,000, additional inventory of \$120,000 and additional accounts payable of \$50,000. What is the additional investment in net working capital?

Marks: 1

- Choose one answer.
- ☐ a. \$30,000
 - ☐ b. \$130,000
 - ☐ c. \$270,000
 - ☐ d. \$370,000

40 Project XYZ requires an investment in equipment of \$500,000 to replace existing equipment. The existing equipment will produce after-tax salvage value of \$50,000. Net working capital requirements are increased by \$50,000. What is the total cash outflow at time zero?

Marks: 1

- Choose one answer.
- ☐ a. \$400,000
 - ☐ b. \$450,000
 - ☐ c. \$500,000