|  |
| --- |
| Beranek Corp. has $410,000 of assets, and it uses no debt--it is financed only with common equity.  The new CFO wants to employ enough debt to bring the debt/assets ratio to 40%, using the proceeds from the borrowing to buy back common stock at its book value.  How much must the firm borrow to achieve the target debt ratio?  |
| Question 15 answers

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| --- | --- | --- |
|  | A. | $155,800  |
|  | B. | $164,000  |
|  | C. | $172,200  |
|  | D. | $180,810  |
|  | E. | $189,851  |

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| Question 16 text**Question 16**  |     | Save    |
|   | Bonner Corp.'s sales last year were $415,000, and its year-end total assets were $355,000.  The average firm in the industry has a total assets turnover ratio (TATO) of 2.4.  Bonner's new CFO believes the firm has excess assets that can be sold so as to bring the TATO down to the industry average without affecting sales.  By how much must the assets be reduced to bring the TATO to the industry average, holding sales constant?  |  |  |  |  |
| Question 16 answers

|  |  |  |
| --- | --- | --- |
|  | A. | $164,330  |
|  | B. | $172,979  |
|  | C. | $182,083  |
|  | D. | $191,188  |
|  | E. | $200,747  |

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| Question 17 text**Question 17**  |    | Save    |
|   | Last year Urbana Corp. had $197,500 of assets, $307,500 of sales, $19,575 of net income, and a debt-to-total-assets ratio of 37.5%.  The new CFO believes a new computer program will enable it to reduce costs and thus raise net income to $33,000.  Assets, sales, and the debt ratio would not be affected.  By how much would the cost reduction improve the ROE?  |  |  |  |  |
| Question 17 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 9.32%  |
|  | B. | 9.82%  |
|  | C. | 10.33%  |
|  | D. | 10.88%  |
|  | E. | 11.42%  |

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| Question 18 text**Question 18**  |     | Save    |
|   | D. J. Masson Inc. recently issued noncallable bonds that mature in 10 years.  They have a par value of $1,000 and an annual coupon of 5.5%.  If the current market interest rate is 7.0%, at what price should the bonds sell?  |  |  |  |  |
| Question 18 answers

|  |  |  |
| --- | --- | --- |
|  | A. | $829.21  |
|  | B. | $850.47  |
|  | C. | $872.28  |
|  | D. | $894.65  |
|  | E. | $917.01  |

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| Question 19 text**Question 19**  |     | Save    |
|   | Ezzell Enterprises’ noncallable bonds currently sell for $1,165.  They have a 15-year maturity, an annual coupon of $95, and a par value of $1,000.  What is their yield to maturity?   |  |  |  |  |
| Question 19 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 6.20%  |
|  | B. | 6.53%  |
|  | C. | 6.87%  |
|  | D. | 7.24%  |
|  | E. | 7.62%  |

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| Question 20 text**Question 20**  |     | Save    |
|   | 5-year Treasury bonds yield 5.5%.  The inflation premium (IP) is 1.9%, and the maturity risk premium (MRP) on 5-year bonds is 0.4%.  What is the real risk-free rate, r\*?  |  |  |  |  |
| Question 20 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 2.59%  |
|  | B. | 2.88%  |
|  | C. | 3.20%  |
|  | D. | 3.52%  |
|  | E. | 3.87%  |

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| Question 21 text**Question 21**  |     | Save    |
|   | A stock is expected to pay a year-end dividend of $2.00, i.e., D1 = $2.00.  The dividend is expected to decline at a rate of 5% a year forever (g = -5%).  If the company’s expected and required rate of return is 15%, which of the following statements is CORRECT?  |  |  |  |  |
| Question 21 answers

|  |  |  |
| --- | --- | --- |
|  | A. | The company’s current stock price is $20.  |
|  | B. | The company’s dividend yield 5 years from now is expected to be 10%.  |
|  | C. | The constant growth model cannot be used because the growth rate is negative.  |
|  | D. | The company’s expected capital gains yield is 5%.  |
|  | E. | The company’s stock price next year is expected to be $9.50.  |

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| Question 22 text**Question 22**  |     | Save    |
|   | If D1 = $1.75, g (which is constant) = 4.5%, and P0 = $46, what is the stock’s expected dividend yield for the coming year?  |  |  |  |  |
| Question 22 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 3.26%  |
|  | B. | 3.43%  |
|  | C. | 3.61%  |
|  | D. | 3.80%  |
|  | E. | 3.99%  |

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| Question 23 text**Question 23**  |    | Save    |
|   | If D1 = $1.25, g (which is constant) = 5.5%, and P0 = $44, what is the stock’s expected total return for the coming year?  |  |  |  |  |
| Question 23 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 7.54%  |
|  | B. | 7.73%  |
|  | C. | 7.93%  |
|  | D. | 8.13%  |
|  | E. | 8.34%  |

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| Question 24 text**Question 24**  |     | Save    |
|   | The Zumwalt Company is expected to pay a dividend of $2.25 per share at the end of the year, and that dividend is expected to grow at a constant rate of 5.00% per year in the future.  The company's beta is 1.15, the market risk premium is 5.50%, and the risk-free rate is 4.00%.  What is the company's current stock price?  |  |  |  |  |
| Question 24 answers

|  |  |  |
| --- | --- | --- |
|  | A. | $42.25  |
|  | B. | $43.31  |
|  | C. | $44.39  |
|  | D. | $45.50  |
|  | E. | $46.64  |

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| Question 25 text**Question 25**  |    | Save    |
|   | Bankston Corporation forecasts that if all of its existing financial policies are adhered to, its proposed capital budget would be so large that it would have to issue new common stock.  Since new stock has a higher cost than retained earnings, Bankston would like to avoid issuing new stock.  Which of the following actions would reduce its need to issue new common stock?  |  |  |  |  |
| Question 25 answers

|  |  |  |  |
| --- | --- | --- | --- |
|  | A. | Increase the percentage of debt in the target capital structure.

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|  | B. | Increase the dividend payout ratio for the upcoming year.  |
|  | C. | Increase the proposed capital budget.

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|  | D. | Reduce the amount of short-term bank debt in order to increase the current ratio.

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|  | E. | Reduce the percentage of debt in the target capital structure.  |

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| Question 26 text**Question 26**  |     | Save    |
|   | Jackson Inc. uses only equity capital, and it has 2 equally-sized divisions. Division A’s cost of capital is 10.0%, Division B’s cost is 14.0%, and the composite WACC is 12.0%.  All of Division A’s projects have the same risk, as do all of Division B's projects.  However, the projects in Division A have less risk than those in Division B.  Which of the following projects should Jackson accept?  |  |  |  |  |
| Question 26 answers

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| --- | --- | --- |
|  | A. | A Division B project with a 13% return.  |
|  | B. | A Division B project with a 12% return.

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|  | C. | A Division A project with an 11% return.

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|  | D. | A Division A project with a 9% return.

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|  | E. | A Division B project with an 11% return.  |

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| Question 27 text**Question 27**  |     | Save    |
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| A company’s perpetual preferred stock currently trades at $87.50 per share, and it pays an $8.00 annual dividend.  If the company were to sell a new preferred issue, it would incur a flotation cost of 5.00% of the issue price.  What is the firm's cost of preferred stock? |

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| Question 27 answers

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| --- | --- | --- |
|  | A. | 8.25%  |
|  | B. | 8.69%  |
|  | C. | 9.14%  |
|  | D. | 9.62%  |
|  | E. | 10.11%  |

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| Question 28 text**Question 28**  |     | Save    |
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| P. Lange Inc. hired your consulting firm to help them estimate the cost of equity.  The yield on Lange's bonds is 7.25%, and your firm's economists believe that the cost of equity can be estimated using a risk premium of 3.50% over a firm's own cost of debt.  What is an estimate of Lange's cost of equity from retained earnings? |

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| Question 28 answers

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| --- | --- | --- |
|  | A. | 10.75%  |
|  | B. | 11.18%  |
|  | C. | 11.63%  |
|  | D. | 12.09%  |
|  | E. | 12.58%  |

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| Question 29 text**Question 29**  |    |    |
|   | To help finance a major expansion, Delano Development Company sold a noncallable bond several years ago that now has 15 years to maturity.  This bond has a 10.25% annual coupon, paid annually, it sells at a price of $1,025, and it has a par value of $1,000.  If Delano’s tax rate is 40%, what component cost of debt should be used in the WACC calculation?  |  |  |  |  |
| Question 29 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 5.11%  |
|  | B. | 5.37%  |
|  | C. | 5.66%  |
|  | D. | 5.96%  |
|  | E. | 6.25%  |

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| Question 30 text**Question 30**  |     |    |
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| Which of the following statements is CORRECT? |

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| Question 30 answers

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| --- | --- | --- |
|  | A. | Perhaps the most important step when developing pro forma financial statements is to determine the breakdown of common equity between common stock and retained earnings.  |
|  | B. | The first, and perhaps the most critical, step in forecasting financial requirements is to forecast future sales.  |
|  | C. | Pro forma financial statements, as discussed in the text, are used primarily as a part of the managerial compensation program, where management's historical performance is evaluated.  |
|  | D. | The capital intensity ratio gives us an idea of the physical condition of the firm’s fixed assets.  |
|  | E. | The AFN equation method produces more accurate forecasts than the forecasted financial statement method, especially if fixed assets are lumpy and economies of scale exist.

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| Question 31 text**Question 31**  |     |    |
|   | You own 100 shares of Troll Brothers’ stock, which currently sells for $120 a share.  The company is contemplating a 2-for-1 stock split.  Which of the following best describes what your position will be after such a split takes place? |  |  |  |  |
| Question 31 answers

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| --- | --- | --- |
|  | A. | You will have 200 shares of stock, and the stock will trade at or near $120 a share. |
|  | B. | You will have 200 shares of stock, and the stock will trade at or near $60 a share. |
|  | C. | You will have 100 shares of stock, and the stock will trade at or near $60 a share. |
|  | D. | You will have 50 shares of stock, and the stock will trade at or near $120 a share. |
|  | E. | You will have 50 shares of stock, and the stock will trade at or near $60 a share. |

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| Question 32 text**Question 32**  |     | Save    |
|   | In the lease versus buy decision, leasing is often preferable  |  |  |  |  |
| Question 32 answers

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| --- | --- | --- |
|  | A. |                   because it has no effect on the firm's ability to borrow to make other investments. |
|  | B. | because        because, generally, no down payment is required, and there are no indirect interest costs. |
|  | C. | because lease obligations do not affect the firm's risk as seen by investors. |
|  | D. | because the lessee owns the property at the end of the lease term. |
|  | E. | because the lessee may have greater flexibility in abandoning the project in which the leased property is used than if the lessee bought and owned the asset. |

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| Question 33 text**Question 33**  |     | Save    |
|   | If easing a firm's credit policy lengthens the collection period and results in a worsening of the aging schedule, then whymight a firm take this action?  |  |  |  |  |
| Question 33 answers

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| --- | --- | --- |
|  | A. | To slow down an unsustainable growth in sales.  |
|  | B. | To meet competitive pressure.  |
|  | C. | To increase the payments deferral period.  |
|  | D. | To shorten the cash collection cycle.  |
|  | E. | To increase the current ratio and make the firm look stronger.  |

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| Question 34 text**Question 34**  |    | Save    |
|   | SchadA Systems is expected to pay a $3.50 dividend at year end (D1 = $3.50), the dividend is expected to grow at a constant rate of 6.50% a year, and the common stock currently sells for $62.50 a share.  The before-tax cost of debt is 7.50%, and the tax rate is 40%.  The target capital structure consists of 40% debt and 60% common equity.  What is the company’s WACC if all equity is from retained earnings? |  |  |  |  |
| Question 34 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 8.35%  |
|  | B. | 8.70%  |
|  | C. | 9.06%  |
|  | D. | 9.42%  |
|  | E. | 9.80%  |

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| Question 35 text**Question 35**  |     | Save    |
|   |             You were hired as a consultant to Quigley Company, whose target capital structure is 40% debt, 10% preferred, and 50% common equity.  The interest rate on new debt is 6.50%, the yield on the preferred is 6.00%, the cost of retained earnings is 12.25%, and the tax rate is 40%.  The firm will not be issuing any new stock.  What is Quigley's WACC? |  |  |  |  |
| Question 35 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 8.29%  |
|  | B. | 8.62%  |
|  | C. | 8.96%  |
|  | D. | 9.32%  |
|  | E. | 9.69%  |

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| Question 36 text**Question 36**  |    | Save    |
|   | Which of the following statements is CORRECT? |  |  |  |  |
| Question 36 answers

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| --- | --- | --- |
|  | A. | T         The shorter a project's payback period, the less desirable the project is normally considered to be by this criterion. |
|  | B. |             One drawback of the payback criterion for evaluating projects is that this method does not take account of cash flows beyond the payback period. |
|  | C. |             If a project’s payback is positive, then the project should be accepted because it must have a positive NPV. |
|  | D. |             The regular payback ignores cash flows beyond the payback period, but the discounted payback method overcomes this problem.  |
|  | E. |             One drawback of the discounted payback is that this method does not consider the time value of money, while the regular payback overcomes this drawback. |

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| Question 37 text**Question 37**  |    | Save    |
|   |             Humboldt Inc. is considering a project that has the following cash flow and WACC data.  What is the project's NPV?  Note that if a project's projected NPV is negative, it should be rejected.                                                                                                WACC:           9.00%                                                              Year:               0                      1          2          3          4          5          Cash flows:     -$1,000            $300    $300    $300    $300    $300     |  |  |  |  |
| Question 37 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 135.94  |
|  | B. | 143.09  |
|  | C. | 150.62  |
|  | D. | 158.55  |
|  | E. | 166.90  |

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| Question 38 text**Question 38**  |    | Save    |
|   |             Tucker Corp. is considering a project that has the following cash flow data.  What is the project's IRR?  Note that a project's projected IRR can be negative, in which case it will be rejected.                                                                                                Year:               0                      1          2          3                                  Cash flows:           -$1,000               $450    $450    $450     |  |  |  |  |
| Question 38 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 15.82%  |
|  | B. | 16.65%  |
|  | C. | 17.48%  |
|  | D. | 18.36%  |
|  | E. | 19.27%  |

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| Question 39 text**Question 39**  |     | Save    |
|   |             Adler Enterprises is considering a project that has the following cash flow and WACC data.  What is the project's NPV?  Note that a project's projected NPV can be negative, in which case it will be rejected.WACC:           10.00%                                                Year:               0                      1          2          3          Cash flows:     -$1,000            $450    $460    $470     |  |  |  |  |
| Question 39 answers

|  |  |  |
| --- | --- | --- |
|  | A. | $142.37  |
|  | B. | $149.49  |
|  | C. | $156.97  |
|  | D. | $164.82  |
|  | E. | $173.06  |

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| Question 40 text**Question 40**  |    | Save    |
|   |             You were recently hired as CFO to improve the performance of Dennis Systems, which is highly profitable but has been experiencing cash shortages due to its high rate of growth.  As one part of your analysis, you want to determine the firm’s cash conversion cycle.  Using the following information and a 365-day year, what is your estimate of the firm’s present cash conversion cycle?            Average inventory:     $120,000            Annual sales:   $600,000Average accounts receivable:  $160,000Average accounts payable:     $25,000Total annual purchases:           $365,000Buy on net 30 days, no discounts:      30Sell on net 50 days, no discounts:      50 |  |  |  |  |
| Question 40 answers

|  |  |  |
| --- | --- | --- |
|  | A. | 118.4  |
|  | B. | 124.6  |
|  | C. | 131.2  |
|  | D. | 138.1  |
|  | E. | 145.3  |

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