

# Finance midterm

Finance



1) Which of the following statements is CORRECT?

1. The New York Stock Exchange is an auction market, and it has a physical location.
2. Home mortgage loans are traded in the money market.
3. If an investor sells shares of stock through a broker, then it would be a primary market transaction.
4. Capital markets deal only with common stocks and other equity securities.
5. While the distinctions are blurring, investment banks generally specialize in lending money, whereas commercial banks generally help companies raise capital from other parties.

2) Which of the following statements is CORRECT?

1. A hostile takeover is the main method of transferring ownership interest in a corporation.
2. A corporation is a legal entity created by a state, and it has a life and existence that is separate from the lives and existence of its owners and managers.
3. Unlimited liability and limited life are two key advantages of the corporate form over other forms of business organization.
4. Limited liability is an advantage of the corporate form of organization to its owners (stockholders), but corporations have more trouble raising money in financial markets because of the complexity of this form of organization.
5. Although the stockholders of the corporation are insulated by limited legal liability, the legal status of the corporation does not protect the

firm's managers in the same way, i. e. , bondholders can sue its managers if the firm defaults on its debt.

3) The retained earnings account on the balance sheet does not represent cash. Rather, it represents part of the stockholders' claim against the firm's existing assets. Put another way retained earnings are stockholders' reinvested earnings.

1. True
2. False

4) In finance, we are generally more interested in cash flows than in accounting profits. Free cash flow (FCF) is calculated as after-tax operating income plus depreciation less than the sum of capital expenditures and changes in networking capital.

1. True
2. False

5) Other things held constant, which of the following actions would increase the amount of cash on a company's balance sheet?

1. The company repurchases common stock.
2. The company pays a dividend.
3. The company issues new common stock.
4. The company gives customers more time to pay their bills.
5. The company purchases a new piece of equipment.

6) Ryngard Corp's sales last year were \$38, 000, and its total assets were \$16, 000. What was its total assets turnover ratio (TATO)?

1. 2. 04

2. 2. 14

3. 2. 26

4. 2. 38

5. 2. 49

7) A new firm is developing its business plan. It will require \$615, 000 of assets, and it projects \$450, 000 of sales and \$355, 000 of operating costs for the first year. Management is reasonably sure of these numbers because of contracts with its customers and suppliers. It can borrow at a rate of 7.5%, but the bank requires it to have a TIE of at least 4. 0, and if the TIE falls below this level the bank will call in the loan and the firm will go bankrupt. What is the maximum debt ratio the firm can use? (Hint: Find the maximum dollars of interest, then the debt that produces that interest, and then the related debt ratio.)

1. 41. 94%

2. 44. 15%

3. 46. 47%

4. 48. 92%

5. 51. 49%

8) Which of the following could explain why a business might choose to operate as a corporation rather than as a sole proprietorship or a partnership?

1. Corporations generally face fewer regulations.

2. Less of a corporation's income is generally subject to federal taxes.

3. Corporate shareholders are exposed to unlimited liability, but this factor is offset by the tax advantages of incorporation.
4. Corporate investors are exposed to unlimited liability.
5. Corporations generally find it easier to raise large amounts of capital.

9) You recently sold 200 shares of Disney stock, and the transfer was made through a broker. This is an example of:

1. A money market transaction.
2. A primary market transaction.
3. A secondary market transaction.
4. A futures market transaction.
5. An over-the-counter market transaction

10) Below are the 2007 and 2008 year-end balance sheets for Tran Enterprises:

| Assets:              | 2008             | 2007             |
|----------------------|------------------|------------------|
| Cash                 | \$ 200, 000      | \$ 170, 000      |
| Accounts receivable  | 864, 000         | 700, 000         |
| Inventories          | 2, 000,<br>000   | 1, 400, 000      |
| Total current assets | \$3, 064,<br>000 | \$2, 270,<br>000 |

|                           |                  |                  |
|---------------------------|------------------|------------------|
| Net fixed assets          | 6, 000,<br>000   | 5, 600, 000      |
| Total assets              | \$9, 064,<br>000 | \$7, 870,<br>000 |
| Liabilities and equity:   | -                | -                |
| Accounts payable          | \$1, 400,<br>000 | \$1, 090,<br>000 |
| Notes payable             | 1, 600,<br>000   | 1, 800, 000      |
| Total current liabilities | \$3, 000,<br>000 | \$2, 890,<br>000 |
| Long-term debt            | 2, 400,<br>000   | 2, 400, 000      |
| Common stock              | 3, 000,<br>000   | 2, 000, 000      |
| Retained earnings         | 664, 000         | 580, 000         |
| Total common equity       | \$3, 664,<br>000 | \$2, 580,<br>000 |

|                              |               |               |
|------------------------------|---------------|---------------|
|                              | 000           | 000           |
| Total liabilities and equity | \$9, 064, 000 | \$7, 870, 000 |

The firm has never paid a dividend on its common stock, and it issued \$2, 400, 000 of 10-year, non-callable, long-term debt in 2007. As of the end of 2008, none of the principal on this debt had been repaid. Assume that the company's sales in 2007 and 2008 were the same. Which of the following statements must be CORRECT?

1. The firm increased its short-term bank debt in 2008.
2. The firm issued long-term debt in 2008.
3. The firm issued new common stock in 2008.
4. The firm repurchased some common stock in 2008.
5. The firm had a negative net income in 2008.

11) Chang Corp. has \$375, 000 of assets, and it uses only common equity capital (zero debt). Its sales for the last year were \$595, 000, and its net income was \$25, 000. Stockholders recently voted in a new management team that has promised to lower costs and get the return on equity up to 15.0%. What profit margin would the firm need in order to achieve the 15% ROE, holding everything else constant?

1. 9.45%
2. 0.93%
3. 10.42%
4. 10.94%

5. 11. 49%

12) Which of the following statements is CORRECT?

1. Most rapidly growing companies have positive free cash flows because cash flows from existing operations generally exceed fixed asset purchases and changes to net working capital.
2. Changes in working capital have no effect on free cash flow.
3. Free cash flow (FCF) is defined as follows:  $FCF = EBIT(1 - T) + Depreciation - Capital\ expenditures\ required\ to\ sustain\ operations - Required\ changes\ in\ net\ working\ capital.$
4. Free cash flow (FCF) is defined as follows:  $FCF = EBIT(1 - T) + Capital\ expenditures.$  e. Managers should be less concerned with free cash flow than with accounting net income. Accounting net income is the "bottom line" and represents how much the firm can distribute to all its investors- both creditors and stockholders.

13) Last year Harrington Inc. had sales of \$325, 000 and a net income of \$19, 000, and its year-end assets were \$250, 000. The firm's total-debt-to-total-assets ratio was 45. 0%. Based on the DuPont equation, what was the ROE?

1. 13. 82%
2. 14. 51%
3. 15. 23%
4. 16. 00%
5. 16. 80%