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QUESTION 1

In general, it is more expensive for a company to finance with equity capital than with debt capital because

A. Long-term bonds have a maturity date and must therefore be repaid in the future

B. Investors are exposed to greater risk with equity capital.

C. Equity capital is in greater demand than debt capital

D. Dividends fluctuate to a greater extent than interest rates

Correct Answer: B

Providers of equity capital are exposed to more risk than are lenders because the firm is not obligated to pay them a return. Also, in case of liquidation, creditors are paid before equity investors. Thus, equity financing is more expensive than debt because equity investors require a higher return to compensate for the greater risk assumed

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QUESTION 2

A characteristic of the payback method (before taxes) is that it

A. Incorporates the time value of money.

B. Neglects total project profitability.

C. Uses accrual accounting inflows in the numerator of the calculation.

D. Uses the estimated expected life of the asset in the denominator of the calculation.

Correct Answer: B

The payback method calculates the number of years required to complete the return of the original investment. This measure is computed by dividing the net investment required by the average expected cash flow to be generated, resulting in the number of years required to recover the original investment. Payback is easy to calculate but has two principal problems: it ignores the time value of money, and it gives no consideration to returns after the payback period. Thus, it ignores total project profitability.

QUESTION 3

Presented below are partial year-end financial statement data for companies A and B.

	Company A	Company B		Company A	Company B
Cash	$100	$200	Sales	$600	$5,800
Accounts Receivable	unknown	100	Cost of Goods Sold	300	5,000
Inventories	unknown	100	Administrative Expenses	100	500
Net Fixed Assets	200	100	Depreciation Expense	100	100
Accounts Payable	100	50	Interest Expense	20	10
Long-Term Debt	200	50	Income Tax Expense	40	95
Common Stock	100	200	Net Income	40	95
Retained Earnings	150	100			

If Company A has 60 common shares outstanding, then it has a book value per share, to the nearest cent, of

A. $1.67

B. $2.50

C. $4.17

D. $5.00

Correct Answer: C

The book value per share for Company A equals the sum of common stock and retained earnings, divided by the number of shares, or $4.17 [($100 + $150) ?60].

QUESTION 4

Henderson, Inc. has purchased a new fleet of trucks to deliver its merchandise. The trucks have a useful life of 8 years and cost a total of $500.000. Henderson expects its net increase in after-tax cash flow to be $150,000 in Year 1, $175,000 in Year 2, $125,000 in Year 3, and $100,000 in each of the remaining years. Ignoring the time value of money, how long will it take Henderson to recover the amount of investment?

A. 3.5 years.

B. 4.0 years.

C. 4.2 years.

D. 5 years.

Correct Answer: A

The payback period for an investment, ignoring the time value of money, can be found by accumulating each year\\'s net cash flows until the initial investment is recovered. The amount accumulated after 3 years is $450,000. Thus, 50% ofYear4 cash flows is needed to recover the initial investment. The payback period is 3.5 years.

QUESTION 5

A strategic group analysis does all but which of the following?

A. Determines what mobility barriers exist

B. Forecasts future group actions and trends

C. Considers how the firm compares with the competitors within the chosen strategic group

D. Predicts reaction patterns to events such as competitive attacks

Correct Answer: C

An overall industry analysis, not a strategic group analysis, considers how the firm compares with the competitors within the chosen strategic group, e.g., on the basis of its scale of operations, the intensity of group rivalry, and the differences in the ability of the group members to implement their strategies.

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