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QUESTION 1

A contractual arrangement that gives the owner the right to buy or sail an asset at a hexed price at any moment in time before r on a specified date is a (n)

A. European option.

B. Foreign option,

C. Future option.

D. American option.

Correct Answer: D

An American upon is a contractual arrangement that gives the owner the right to buy or sell an asset at a axed price at any moment in time before or on a specified date.

QUESTION 2

A proposed investment is not expected to have any salvage value at the end of its 5-year life. Because of realistic depreciation practices, the net carrying amount and the salvage value are equal at the end of each year. For present value purposes, cash flows are assumed to occur at the end of each year. The company uses a 12% after-tax target rate of return.

Year	Purchase Cost and Carrying Amount	Annual Net After-Tax Cash Flows	Annual Net Income
0	$500,000	$ 0	$ 0
1	336,000	240,000	70,000
2	200,000	216,000	78,000
3	100,000	192,000	86,000
4	36,000	168,000	94,000
5	0	144,000	102,000

Discount Factors for a 12% Rate of Return		
Year	Present Value of $1 at the End of Each Period	Present Value of an Annuity of $1 at the End of Each Period
1	.89	.89
2	.80	1.69
3	.71	2.40
4	.64	3.04
5	.57	3.61

The profitability index is

A. .61

B. .42

C. .86

D. 1425

Correct Answer: D

QUESTION 3

A firm\\'s current ratio is 2to 1. Its bond indenture states that its current ratio cannot fall below 1.5 to 1.11 current liabilities are $200,000, the maximum amount of new short- term debt the firm can assume in or deer to finance invent Tory with out defaulting is

A. $200,000

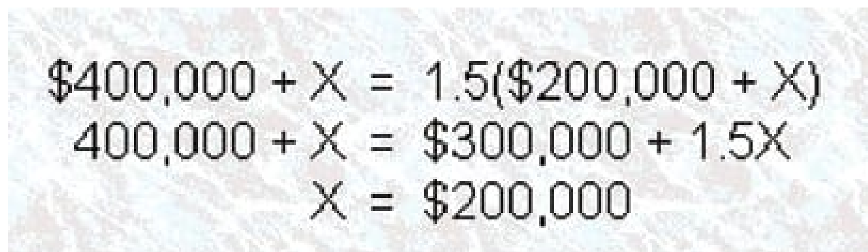
B. $66,667

C. $266,667

D. $150,000

Correct Answer: A

If current liabilities are $200,000 and the current ratio (current assets/current liabilities) is 2.0, current assets must be $400,000. If short-term debt is used to finance new inventory, current assets and current liabilities will increase by the same amount. The amount of new debt corresponding to a current ratio of 1.5 maybe determined from the following formula equating current assets and current liabilities (let X= new inventory and new debt):



QUESTION 4

Which of the following qualitative factors favors the buy choice in an insourcing vs. outsourcing decision?

A. Maintaining a long-run relationship with suppliers is desirable.

B. Quality control is critical.

C. Idle capacity is available.

D. All of the answers are correct.

Correct Answer: A

The maintenance of long-run relationships with suppliers may become paramount in a make-or-buy decision. Abandoning long-run supplier relationships may cause difficulty in obtaining needed parts when terminated suppliers find it advantageous not to supply parts in the future.

QUESTION 5

A U.S. company currently has domestic operations only. It is considering an equal-size investment in either Canada or Britain. The data on expected rate of return and the risk associated with each of these proposed investments are given below.

Proposed Investment	Mean Return	Standard Deviation
British Investment	22%	10%
Canadian Investment	28%	15%

The mean return on the company\\'s current, domestic only, business is 20% with a standard deviation of 15%. Using the above data and the correlation coefficients, the company calculated the following portfolio risk and return (based on a ratio of 50% U.S. domestic operations and 50% international operations).

Proposed Investment	Mean Return	Standard Deviation
U.S. and Britain	21%	3%
U.S. and Canada	24%	15%

The company plans to select the optimal combination of countries based on risk and return for the domestic and international investments taken together. Because the company is new to the international business environment, it is relatively risk averse. Based on the above data, which one of the following alternatives provides the best risk- adjusted return to the firm?

A. Undertake the British investment

B. Undertake the Canadian investment

C. Do not undertake either investment.

D. Unable to determine based on data given.

Correct Answer: A

A risk-averse company will select the investment with the lesser risk. Thus, by choosing to invest in Britain, the overall rate of return will increase from 20% to 21%, and risk, based on the standard deviation, will decline from 15% to 3%. This gives a better return per unit of risk as compared to the Canadian investment.

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