A. MULTIPLE CHOICE QUESTIONS (40%)

1. Lowell Corporation has decided to include certain financial ratios in its year-end annual report to shareholders. Selected information relating to its most recent fiscal year is provided next.

Cash	$ 10,000
Accounts receivable (end of year)	20,000
Accounts receivable (beginning of year)	24,000
Inventory (end of year)	30,000
Inventory (beginning of year)	26,000
Notes payable (due in 90 days)	25,000
Bonds payable (due in 10 years)	35,000
Net credit sales for year	220,000
Cost of goods sold	140,000

Using a 365-day year, compute Lowell's accounts receivable turnover in days.

a. 26.1 days
b. 33.2days
c. 36.5 days
d. 39.8days

2. Cornwall Corporation's net accounts receivable were $68,000 and $47,000 at the beginning and end of the year, respectively. Cornwall's condensed income statement is shown next.

Sales	$900,000
Cost of goods sold	527,000
Operating expenses	175,000
Operating income	198,000
Income tax	79,000
Net income	$119,000

Cornwall's average number of days' sales in accounts receivable (using a 365-day year) is

a. 8days.
b. 13days.
c. 19days.
d. 23days

3. The following information concerning Arnold Company's common stock was included in the company's financial reports for the last two years.

	Year 2	Year 1
Market price per share on December 31	$60	$50
Par value per share	10	10
Earnings per share	3	3
Dividends per share	1	1
Book value per share on December 31	36	34

Based on the price/earnings information, investors would **most likely** consider Arnold's common stock to

a. be overvalued at the end of year 2
b. indicate inferior investment decisions by management in year 2
c. show a positive trend in growth opportunities in year 2 compared to year 1
d. Show a decline in growth opportunities in year2 compared to year 1

4. **Devlin Inc. has 250,000 shares of $10 par value common stock outstanding. For the current year, Devlin paid a cash dividend of $3.50 per share and had earnings per share of $4.80. The market price of Devlin's stock is $34 per share. Devlin's price/earnings ratio is:**

a. 2.08
b. 2.85
c. 7.08
d. 9.71

5. **For the year just ended, Beechwood Corporation had income from operations of $198,000 and net income of $96,000. Additional financial information is given next.**

	January 1	December 31
7% bonds payable	$95,000	$77,000
Common Stock ($10 par value)	300,000	300,000
Reserve for bond retirement	12,000	28,000
Retained earnings	155,000	206,000

Beechwood has no other equity issues outstanding. Beechwood's return on shareholders' equity for the year just ended is:

a. 19.2%.
b. 19.9%.
c. 32.0%.
d. 39.5%.

6. **In the last fiscal year, LMO Company had net sales of $7,000,000, a gross profit margin of 40%, and a net profit margin of 10%. What is its cost of goods sold?**

a. $4,200,000
b. $6,300,000
c. $2,800,000
d. $700,000

7. **BDU Company has net income of $500,000 and average assets of $2,000,000 for the current year. If its asset turnover is 1.25 times, what is its profit margin?**

a. 0.25
b. 0.31
c. 0.36
d. 0.2

8. **All of the following are risks specific to foreign investment except**
   a. political risk.
   b. foreign currency fluctuation risk.
   c. interest rate risk.
   d. potential nationalization of businesses by the foreign country.

9. **The Hatch Sausage Company is projecting an annual dividend growth rate for the foreseeable future of 9%. The most recent dividend paid was $3.00 per share. New common stock can be issued at $36 per share. Using the constant growth model, what is the approximate cost of capital for retained earnings?**
   a. 9.08%
   b. 17.33%
   c. 18.08%
   d. 19.88%

10. **Shown next are selected data from Fortune Company's most recent financial statements.**

marketable securities	$10,000
Accounts receivable	60,000
Inventory	25,000
Supplies	5,000
Accounts payable	40,000
Short-term debt payable	10,000
Accruals	5,000

What is Fortune's net working capital?
   a. $35,000
   b. $45,000
   c. $50,000
   d. $80,000

11. **Which of the following statements about supply and demand is (are) true?**
   I. There is a direct relationship between shifts in the demand curve and the equilibrium price and equilibrium quantity.
   II. An increase in supply with an increase in demand will result in an increase in equilibrium price and quantity.
   III. A perfectly elastic demand would be shown in a graph as a vertical line, while a perfectly inelastic demand is shown as a horizontal line.
   IV. A price elasticity of demand value greater than 1 is considered elastic or relatively elastic.
   a. I
   b. I and II
   c. I and IV
   d. I, II, III, and IV

12. Which of the following statements about supply and demand are true?

I. When demand increases, the price of complementary products will increase.
II. The substitution effect states that when the price of a product decreases, consumers will buy a substitute product.
III. The law of diminishing marginal utility states that consumers will buy more of a product only if the price decreases.
IV. An increase in the quantity supplied without a change in demand will result in a decrease in price.

a. I and II
b. I, II, and III
c. I, III, and IV
d. I, II, III, and IV

13. Given fixed costs of $8,000, variable costs of $100, and a unit contribution margin of $200, how many units must be sold to reach a target operating income of $34,000?

a. 130
b. 140
c. 210
d. 260

14. The enterprise risk management model looks at:

a. financial risk.
b. operating risk.
c. compliance risk.
d. all of the above.

15. The risk identification framework considers

a. only external threats.
b. both external and internal threats.
c. only internal threats.
d. risk priorities.

16. Which of the following statements about using the payback method in capital budgeting is false?
The payback method:

a. represents the break-even point for an investment.
b. provides a rough measure of project liquidity.
c. takes into account the time value of money.
d. provides a rough measure of project risk.

17. What is the payback period for a capital budgeting project in which the total initial capital investment is $900,000 and the expected annual net cash flow is $150,000 each year for 8 years?

a. 3 years
b. 5 years
c. 6 years
d. 7 years

18. Which of the following statements accurately compares the discounted payback and payback methods?

a. Both methods provide simple measures of project profitability.
b. Discounted payback uses the present values of net cash inflows; payback does not.
c. Discounted payback ignores cash flows after the payback period expiration; payback does not.
d. Both methods distinguish between types of cash inflows.

19. Which method is best suited to comparing the net present values for two mutually exclusive capital investment projects when the cash flows vary?

a. Sensitivity analysis
b. Expected value approach
c. Capital asset pricing model
d. Computer simulations

20. All of the following are similarities between the internal rate of return (IRR) and the net present value (NPV) methods except:

a. both NPV and IRR require the calculation of the incremental operating cash flows.
b. both NPV and IRR require the calculation of a discount rate, or hurdle rate.
c. both NPV and IRR require the calculation of the initial investment.
d. both NPV and IRR can be used to rank independent projects.

B. PROBLEM SOLVING

Problem # 1 (18%)

Khoury Travel Agency specializes in flights between Los Angeles and London. It books passengers on United Airlines at $900 per round trip ticket. Until last month, United paid Khoury a commission of 10% of the ticket price paid by each passenger. This commission was Khoury's only source of revenues. Khoury's fixed costs are $14,000 per month (for salaries, rent, and so on), and its variable costs, such as sales commissions and bonuses, are $20 per ticket purchased for a passenger.

United Airlines has just announced a revised payment schedule for all travel agents. It will now pay travel agents a 10% commission per ticket up to a maximum of $50. Any ticket costing more than $500 generates only $50 commission, regardless of the ticket price. Khoury's managers are concerned about how United's new payment schedule will affect its breakeven point and profitability.

Required:

1. Under the old 10% commission structure, how many round-trip tickets must Khoury sell each month to:

    a. break even

    b. earn an operating income of $7,000?

2. How does United's revised payment schedule affect your answers to (a) and (b) in requirement 1?

Problem # 2 (12%)

Motor Co's financial statements appear below:

Motor Co Balance Sheet December 31, N		
Assets:		
Current Assets		
Cash	$100,000	
Marketable Securities	200,000	
Inventory	300,000	
Total Current Assets		$ 600,000
Noncurrent Assets		
Fixed Assets		500,000
Total Assets		$1,100,000
Liabilities and Stockholders' Equity:		
Current liabilities	$200,000	
Long-Term liabilities	100,000	
Total liabilities		$ 300,000
Stockholders' Equity		
Common stock, $1 par value, 100,000 shares	$100,000	
Preferred Stock	50,000	
Premium on Common Stock	500,000	
Retained Earnings	150,000	
Total Stockholders' Equity		800,000
Total Liabilities and Stockholders' Equity		$1,100,000

Motors Co Income Statement For the year Ended December 31, N	
Net Sales	$10,000,000
Cost of Goods Sold	6,000,000
Operating Expenses	1,000,000
Income Taxes (50% rate)	To determine

Additional information available is a market price of $150 per share of common stock and total dividends of $600,000 for common shareholders for the year 'N', and $250,000 of inventory as of December 31, 'N – 1'.

Required:

Compute the following ratios:

(a) Current ratio
(b) Quick ratio
(c) Inventory turnover
(d) Average age of inventory (Days sales in Inventory)
(e) Debt-equity ratio
(f) Earnings per share (EPS)
(g) Common Dividends per share (DPS)
(h) Common Dividend payout ratio (DPR)

Problem # 3 (15%)

Adam's Shop is considering the purchase of a new machine. Adam, the owner of the shop, has compiled the following estimates in trying to determine whether the machine should be purchased:

Cost of the machine	$20,000
Annual net cash flows	4,500
Salvage value	4,000
Estimated useful life	5 years
Cost of capital	11%
Present value of an annuity of $1 for 5 years	3.70
Present value of $1 for year 5	0.59

Adam's assistant manager is trying to convince Adam that the machine has other benefits that he hasn't considered in the initial estimates. These additional benefits, including savings in costs, are expected to increase net cash flows by $600 each year.

Required:

1. Calculate the net present value of the machine, based on the initial estimates. Should the machine be purchased? Justify your answer
2. Calculate the net present value, incorporating the additional benefits suggested by the assistant manager. Should the machine be purchased? Justify your answer
3. Calculate the payback period (in years) taking into account the additional benefits highlighted by the assistant manager.

Problem # 4 (15%)

ABC Corp paid an annual cash dividend of 5$ per share last year. The required rate of return is 13%. Hania expects no change in the policy of dividend distribution (5$ per share per year): she does not expect any growth in dividends at all. Nader expects dividends to grow at constant growth rate of 5%. Mosbah expects dividends to grow at an annual rate of 10% for the next 3 years and then to a normal growth rate of 5%.

Required:

1. Based on Hania expectation, calculate the price of the common stock today
2. Based on Nader expectation, calculate the price of the common stock today
3. Based on Mosbah expectation, calculate the price of the common stock today

Good Work!!