Review for Exam #1

Exam #1

• Don’t Forget:
  ○ Scan Sheet
  ○ Calculator
  ○ Pencil
  ○ Picture ID
  ○ Cheat Sheet
Things To Do...

- Study both the notes and the book.
- Do suggested problems.
- Do more problems!
- Be comfortable with calculator, but understand concepts (e.g., timeline).
- Get help if you are having problems.

HELP!

- Office Hours
  - ______________________
  - ______________________
  or by appointment
Things NOT To Do...

- Study solutions and not do problems.
- Memorize all the formulas.
- Miss the exam.
- Forget your calculator.
- Cheat.
- Think bad thoughts about me between now and the exam.

Conceptual Exercise

Which of the following is a great reason to take Yost’s 3610 class?

I. It is the easiest class in the College.
II. He’s the best looking professor at AU.
III. His outstanding use of colors and diagrams cannot be duplicated.

A) I only  
B) I and II  
C) I and III  
D) II and III  
E) I, II, and III
Warning

The following may not contain everything we covered, and therefore, may not contain all testable material.

Introduction to Corporate Finance

- Chapter 1
- What is corporate finance? What are the three functions?
- What is the goal of the firm?
- What are the benefits/drawbacks of sole proprietorships, general and limited partnerships, and corporations?
- What are agency costs and how do we mitigate them?
Financial Statements and Cash Flow

- Chapter 2 and section 3.1 of Chapter 3
- Balance Sheet
  - Book Values versus Market Values
- Income Statement
  - Accounting Numbers versus Cash Flows
- Statement of Cash Flows
  - Sources and Uses of Cash
- Taxes
  - Average versus Marginal

Financial Statement Analysis

- Chapter 3
- Ratios
  - How to calculate them.
  - What they tell us.
  - DuPont Identity
- Common size balance sheets and income statements
- Potential Problems for Ratio Analysis
The Time Value of Money

• Chapter 5

• Present and Future Values of Single Cash Flows (and multiple cash flows by adding them up)
• Calculate N, I/Y, PV, and FV.
• Cannot compare cash flows across periods.
• Moving along time line.
• Understand concepts.

Practice Problem #1

Which of the following actions are likely to reduce the agency problem between stockholders and managers?

a. Congress passes a law that severely restricts hostile takeovers.
b. A manager receives a lower salary but receives additional shares of the company’s stock.
c. The board of directors has become more vigilant in its oversight of the company’s management.
d. Statements b and c are correct.
e. All of the statements above are correct.
Practice Problem #2

Information on the Statement of Cash Flows comes from...

a. The Income Statement.
b. The Balance Sheet.
c. Both the Income Statement and the Balance Sheet.
d. Market values not found on the Income Statement or Balance Sheet.
e. Both c and d.

Practice Problem #3

Which of the following statements is most correct?

a. Many large firms operate different divisions in different industries, and this makes it hard to develop a meaningful set of industry benchmarks for these types of firms.
b. Financial ratios should be interpreted with caution because there exist seasonal and accounting differences that can reduce their comparability.
c. Financial ratios should be interpreted with caution because it may be difficult to say with certainty what is a “good” value. For example, in the case of the current ratio, a “good” value is neither high nor low.
d. Ratio analysis facilitates comparisons by standardizing numbers.
e. All of the statements above are correct.
Practice Problem #4

Other things equal, present value...

a. Increases as the number of periods increases.
b. Increases as the rate of interest increases.
c. Increases as the future value increases.
d. Decreases as the rate of interest decreases.
e. None of the above.

Practice Problem #5

The goal of the company is generally presumed to be...

a. Sales maximization.
b. Profit maximization.
c. Shareholder wealth maximization.
d. Cost minimization.
e. Profit stabilization.
Practice Problem #6

On the Statement of Cash Flows, depreciation will be found in the section entitled...

a. Cash Flow from Operating Activities.
b. Cash Flow from Investing Activities.
c. Cash Flow from Financing Activities.
d. Cash Flow from Non-cash Adjustments.
e. None of the above.

Practice Problem #7

Which of the following statements is most correct?

a. A firm with financial leverage has a larger equity multiplier than an otherwise identical firm with no debt in its capital structure.
b. The use of debt in a company’s capital structure results in tax benefits to the investors who purchase the company's bonds.
c. All else equal, a firm with a higher debt ratio will have a lower return on equity.
d. All of the answers above are correct.
e. Answers a and c are correct.
Practice Problem #8

Your dentist mentions that if you earn 15% for two years, you will have more money than if you earn 10% for one year and 20% for the other year. What do you think about your dentist’s statement?

a. The dentist is correct.
b. The dentist is incorrect. Both sets of returns result in the same value.
c. The dentist is incorrect. You will actually have more money if you earn 20% in the first year and 10% in the second year.
d. The dentist is incorrect. You will actually have more money if you earn 10% in the first year and 20% in the second year.
e. The dentist is incorrect. You will have more money if you earn 10% in one year and 20% in the other year, and it makes no difference what order the two returns occur in.

Practice Problem #9

Which of the following is not a significant advantage of the corporate form of organization over the partnership or proprietorship forms?

a. Limited liability
b. Double taxation
c. Ease of transferring ownership
d. Unlimited life
e. Ability to raise funds
Practice Problem #10

The current Federal income tax system gives corporate financial managers the incentive to use _____ financial leverage and to _____ a higher proportion of corporate earnings.

a. more; retain
b. more; pay out
c. less; retain
d. less; pay out
e. None of the above

Practice Problem #11

You observe that a firm’s profit margin is below the industry average, its debt ratio is below the industry average, and its return on equity exceeds the industry average. What can you conclude?

a. Inventory turnover is above the industry average.
b. Total assets turnover is above the industry average.
c. Total assets turnover is below the industry average.
d. Both statements a and b are correct.
e. None of the statements above is correct.
Practice Problem #12

Compute the present value of $1,910 received after three years if the appropriate discount rate is 6.3%.

a. $1,431
b. $1,272
c. $1,590
d. $1,113
e. Not enough information.

Answers

1. D 7. A
2. C 8. A
4. C 10. A
5. C 11. B
6. A 12. C