Given the current annualized yields on the following securities:
- 15-year Treasury Bond: 4.1 percent
- 15-year AAA-rated Corporate Bond: 4.8 percent
- 15-year BBB-rated Corporate Bond: 6.0 percent

To what can the differences between these rates be primarily attributed?
- Inflation differences
- Differences in the real interest rate
- Tax effects
- **d. Default risk differences**
- Maturity risk differences

2. The major difference between semidirect finance (investment banking house) and indirect finance (financial intermediation) is that:
- Semidirect finance involves a financial institution where indirect finance does not.
- Secondary securities are created with semidirect finance.
- Time intermediation occurs with semidirect finance.
- Indirect finance involves a financial institution where semidirect finance does not.
- **e. Secondary securities are created with indirect finance.**

3. What can be concluded from the following Fixed Asset Turnover (FATO) and Total Asset Turnover (TATO) ratios for the Franco Company and its industry?
<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>FATO</td>
<td>5.6x</td>
<td>5.8x</td>
<td>6.0x</td>
<td>7.0x</td>
</tr>
<tr>
<td>TATO</td>
<td>3.0x</td>
<td>3.1x</td>
<td>3.3x</td>
<td>3.6x</td>
</tr>
</tbody>
</table>

- The firm uses its assets less effectively than does the industry on average and it is getting worse.
- The firm uses its assets more effectively than does the industry on average but it is approaching the industry average.
- **c. The firm uses its assets less effectively than does the industry on average and it is improving.**
- The firm uses its assets more effectively than does the industry on average and it is improving.

4. Given the information in the question 3 above, which actions should a manager consider to improve the firm’s overall performance?
   - **a. Sell obsolete and unused facilities to reduce manufacturing overhead.**
   - Seek greater manufacturing efficiencies to improve lower COGS.
   - Increase the firm’s debt level to increase its financial leverage.
   - Tighten credit policy by imposing higher credit standards.
   - Cut product prices to increase the level of revenue.
5. The liquidity preference theory of the term structure of interest rates suggests:
   a. That the rate of interest for a particular maturity is determined solely by the supply and demand for securities with that particular maturity.
   b. That the term structure is determined by investor’s expectations about future interest rates.
   c. That investors require additional compensation in the form of higher yields for buying securities with longer maturities.
   d. That investors prefer securities that are more liquid that other securities and will pay more for that additional liquidity.
   e. That the yield curve can and will be inverted from time to time.

6. A firm has a days-sales-outstanding ratio (DSO) of 58.1; the industry average is 42.0. As a financial analyst, what conclusions could you draw from this situation?
   a. The firm collects its credit sales more quickly than the industry on average.
   b. The firm’s cost of goods sold exceeds the industry’s average.
   c. The firm is less profitable than the industry on average.
   d. The firm may have too much inventory.
   e. The firm’s credit policy may be too lenient or lax.

7. Given the information in the question 6 above, which actions should a manager consider to improve the firm’s overall performance?
   a. Raise product prices to improve gross margins.
   b. Loosen the firm’s credit terms to generate more sales.
   c. Offer customers a cash discount make payments within 15 days of purchase.
   d. Increase the firm’s debt level to increase its financial leverage.
   e. Loosen credit policy by imposing lower credit standards.

8. A friend is disappointed the return that she is receiving on her bank savings deposits. She asks you to recommend an investment that earns a higher return. Which of the following changes would she make and receive a higher rate of return (given today’s investment environment)?
   a. Invest in more liquid securities.
   b. Invest in securities that are more marketable.
   c. Invest in securities with a lower inflation premium.
   e. Invest in less risky securities.

9. Assume that on February 8, 2004 Standard and Poor lowered the rating on Ford Motor Company’s long-term debt from A to BBB. Which of the following statements BEST describes the effect that this announcement would have on the yields of Ford’s long-term debt?
   a. The yield on Ford’s long-term debt should increase due to an increase in the liquidity premium.
   b. The yield on Ford’s long-term debt should decline due to a decline in the maturity premium
   c. The yield on Ford’s long-term debt should decline due to a decline in the default risk premium.
   d. The yield on Ford’s long-term debt should increase due to an increase in the default risk premium.
10. In normal or average market circumstances, which of the following securities should have the highest yield (or current market interest rate)?
   a. 90-day US Treasury bills
   b. AAA-rated corporate bonds with 5 years remaining until maturity
   c. A-rated corporate bonds with 10 years remaining until maturity.
   d. **BBB-rated corporate bonds with 25 years remaining until maturity**
   e. 30 year US Treasury bonds

11. What can you conclude given the following information about a firm's inventory turnover?

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>15</td>
<td>18</td>
<td>21</td>
<td>25</td>
<td>28</td>
</tr>
</tbody>
</table>

   a. The firm is using its inventory less efficiently.
   b. The firm's sales are increasing rapidly.
   c. The firm’s inventory has decreased significantly.
   d. The firm's current assets have decreased.
   e. The firm has reduced its profitability on sales.

12. Given the information in the question 11 above, which of the following actions would a manager take to improve the firm’s overall performance?
   a. Eliminate obsolete or slow-selling items from the firm’s inventory.
   b. Increase the size of the inventory to eliminate lost sales.
   c. Increase the firm’s other current assets such as cash and accounts receivable.
   d. Increase the firm’s profit margin by increasing prices.
   e. Slow the growth of the firm’s sales.

13. A financial analyst is given the following ratios for a firm and its industry.

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Firm</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>TIE</td>
<td>3.4</td>
<td>5.0</td>
</tr>
<tr>
<td>EBITDA Coverage</td>
<td>2.0</td>
<td>4.6</td>
</tr>
</tbody>
</table>

   Which of the following statements best represent the conclusion that the analyst could draw from these ratios?
   a. The firm leases too many of its assets.
   b. The firm covers its fixed charges at a higher rate than the industry on average.
   c. **The firm has a lower margin of safety than the industry on average.**
   d. The firm’s interest charges are smaller than the industry on average.
   e. The firm is more profitable than the industry.

14. Given the information in the question 13 above, which actions should a manager consider in order to improve the firm’s overall performance?
   a. Cut product prices to reduce gross margins.
   b. **Issue new equity and repay existing debt issues to reduce financing costs.**
   c. Sell existing fixed assets to reduce depreciation charges.
   d. Invest marketable securities in higher return assets.
   e. Increase the firm’s debt level to increase its financial leverage.
15. A firm's operating income (EBIT) was $500 million, their depreciation expense was $60 million, and their increase in net investment in operating capital was $40 million. Assuming that the firm is in the 40% tax bracket, what was their free cash flow?
   a. $300.0 million  d. $260.0 million
   b. $160.0 million  e. $220.0 million
   c. $320.0 million

16. In its recent income statement, Smith Software Inc. reported paying $45 million in dividends to common shareholders, and in its year-end balance sheet, Smith reported $360 million of retained earnings. The previous year, its balance sheet showed $315 million of retained earnings. What was the firm’s net income during the most recent year?
   a. $45.0 million  d. $85.0 million
   b. $80.0 million  e. $75.0 million
   c. $90.0 million

17. One-year Treasury securities yield 2.1 percent, 2-year Treasury securities yield 2.35 percent, and 3-year Treasury securities yield 2.6 percent. Assume that the expectations theory holds. What does the market expect will be the yield on 1-year Treasury securities two years from now?
   a. 3.70 percent  d. 2.80 percent
   b. 3.60 percent  e. 2.90 percent
   c. 3.10 percent

18. The real risk-free rate is 2.75 percent. Inflation is expected to be 2.8 percent this year, 3.0 percent next year, and then 3.3 percent thereafter. The maturity risk premium is estimated to be 0.0005 X (t-1), where t = number of years to maturity, what is the nominal interest rate on a 3-year Treasury note?
   a. 5.933 percent  d. 5.286 percent
   b. 5.883 percent  e. 8.083 percent
   c. 8.133 percent
19. Interest rates on 4-year Treasury securities are currently 4 percent, while interest rates on 12-year Treasury securities are currently 5.8 percent. If the pure expectations theory is correct, what does the market believe that 8-year securities will be yielding 4 years from now?

   a. 6.70 percent  
   b. 13.40 percent  
   c. 3.10 percent  
   d. 6.40 percent  
   e. 7.00 percent

20. Casey Motors recently reported net income of $25 million. The firm's tax rate was 40.0% and interest expense was $5 million. The company's after-tax cost of capital is 16.0% and the firm's total investor supplied operating capital employed equals $100 million. What is the company's EVA?

   a. $24.5 million  
   b. $9.0 million  
   c. $11.0 million  
   d. $12.0 million  
   e. $30.7 million

21. Cleveland Corporation has 50 million shares of common stock outstanding, its net income is $250 million, and its P/E ratio is 18.3. What is the company’s stock price?

   a. $36.60  
   b. $91.50  
   c. $68.31  
   d. $27.32  
   e. $95.00

22. Yohe Inc. has an ROA of 18.0 percent and a 15 percent profit margin. The company has sales equal to $60 million. What are the company's total assets?

   a. $50.0 million  
   b. $20.0 million  
   c. $60.0 million  
   d. $30.0 million  
   e. $40.0 million
23. Given the following information, calculate the market price per share of WAM, Inc.:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings after interest and taxes</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Earnings per share</td>
<td>$2.50</td>
</tr>
<tr>
<td>Stockholders' equity</td>
<td>$25,000,000</td>
</tr>
<tr>
<td>Market/Book ratio</td>
<td>1.40</td>
</tr>
</tbody>
</table>

a. $ 4.46  
b. $ 3.60  
c. $16.56  
d. $ 6.25  
e. $ 8.75

24. Coastal Packaging’s ROE last year was only 3 percent, but its management has developed a new operating plan designed to improve things. The new plan calls for a total debt ratio of 25 percent, which will result in interest charges of $600,000 per year. Management projects an EBIT of $1,200,000 on sales of $10,000,000, and it expects to have a total asset turnover ratio of 8.0. Under these conditions, the average tax rate will be 40 percent. If the changes are made, what return on equity will Coastal earn?

a. 86.62 percent  
b. **38.40 percent**  
c. 19.25 percent  
d. 57.74 percent  
e. 44.81 percent

25. If a firm has total interest charges of $200,000 per year, sales of $5 million, a tax rate of 40%, and a net profit margin of 10%, what is the firm's times interest earned ratio?

a. 3.5 times  
b. 6.3 times  
c. **5.2 times**  
d. 4.2 times  
e. 7.3 times
FORMULA SHEET

PM = \frac{Net\ Income}{Sales} \hspace{1cm} \text{Current Ratio} = \frac{Current\ Assets}{Current\ Liabilities}

TATO = \frac{Sales}{Assets} \hspace{1cm} \text{Quick Ratio} = \frac{Current\ Assets - Inventory}{Current\ Liabilities}

ROA = \frac{Net\ Income}{Total\ Assets} \hspace{1cm} EM = \frac{\text{Assets}}{\text{Equity}} = \frac{1}{1-D/A}

ROE = \frac{Net\ Income}{Total\ Equity} \hspace{1cm} ACP = \frac{Accounts\ Receivable}{\text{Credit Sales/360}}

\text{Inventory Turnover} = \frac{Sales}{Inventory} \hspace{1cm} \text{Times Interest Earned} = \frac{\text{EBIT}}{\text{Interest Charges}}

\text{Capital Intensity ratio} = \frac{\text{Assets}}{\text{Sales}} = \frac{1}{TATO}

\text{BEP} = \frac{\text{EBIT}}{\text{Total\ Assets}} \hspace{1cm} \text{EVA} = \text{NOPAT} - \left[\text{Capital Cost x Assets}\right]

\text{Net Operating Working Capital} = \text{All current assets} - \text{All non-interest charging current liabilities}

\text{NOPAT} = \text{EBIT(1-Tax Rate)} \hspace{1cm} \text{FCF} = \text{NOPAT} - \text{Net Investment in Operating Capital}

\text{MVA} = \text{Market Value of Stock} - \text{Equity Capital Supplied by Shareholders}

\text{EVA} = \text{NOPAT} - \text{After-tax Dollar Cost of Operating Capital}

\text{Total Operating Capital} = \text{Net Operating Working Capital} + \text{Net Fixed Assets}

\text{Net Cash Flow} = \text{Net Income} + \text{Depreciation and Amortization}

\begin{align*}
\text{EBIT} & - \text{Int} \\
\text{EBT} & \times (1-\text{tax}) \\
\text{NI} & \\
\end{align*}

\textbf{ANSWER SHEET}

1. \hspace{1cm} 11. \hspace{1cm} 21. \hspace{1cm}

2. \hspace{1cm} 12. \hspace{1cm} 22. \hspace{1cm}

3. \hspace{1cm} 13. \hspace{1cm} 23. \hspace{1cm}

4. \hspace{1cm} 14. \hspace{1cm} 24. \hspace{1cm}

5. \hspace{1cm} 15. \hspace{1cm} 25. \hspace{1cm}

6. \hspace{1cm} 16. \hspace{1cm}

7. \hspace{1cm} 17. \hspace{1cm}

8. \hspace{1cm} 18. \hspace{1cm}

9. \hspace{1cm} 19. \hspace{1cm}

10. \hspace{1cm} 20. \hspace{1cm}