**Multiple Choice Questions (Chapter 8):**

1. Assets are listed on the balance sheet in order of:

I) decreasing liquidity;
II) decreasing size;
III) increasing size;
IV) relative life

|  |  |
| --- | --- |
| **A**.  | I only |

|  |  |
| --- | --- |
| B.  | III and IV only |

|  |  |
| --- | --- |
| C.  | II only |

|  |  |
| --- | --- |
| D.  | IV only |

2. The following are known as current assets:

I) cash; II) marketable securities; III) receivables; IV) inventories; V) payables

|  |  |
| --- | --- |
| A.  | I, II, and III only |

|  |  |
| --- | --- |
| **B**.  | I, II, III, and IV only |

|  |  |
| --- | --- |
| C.  | II, III, IV, and V only |

|  |  |
| --- | --- |
| D.  | III, IV, and V only |

3. The difference between current assets of a firm and its current liabilities is called:

|  |  |
| --- | --- |
| A.  | net tangible fixed assets. |

|  |  |
| --- | --- |
| **B**.  | net working capital. |

|  |  |
| --- | --- |
| C.  | gross working capital. |

|  |  |
| --- | --- |
| D.  | net worth. |

4.Earnings before interest and taxes is calculated as:

|  |  |
| --- | --- |
| A.  | total revenues - costs. |

|  |  |
| --- | --- |
| **B**.  | total revenues - costs - depreciation. |

|  |  |
| --- | --- |
| C.  | total revenues - costs + depreciation - taxes. |

|  |  |
| --- | --- |
| D.  | total revenues - costs - depreciation - taxes. |

5. Equity investors have contributed $250,000 to your start-up business, while creditors provided a loan of $300,000. You have calculated your firm's WACC at 10%. The annual interest payment is $25,000 and the marginal corporate tax rate is 35%. How much profit will your equityholders need to earn in order to break even in economic terms (i.e., EVA of zero)?

|  |  |
| --- | --- |
| A.  | $25,000 |

|  |  |
| --- | --- |
| **B**.  | $38,750 |

|  |  |
| --- | --- |
| C.  | $30,000 |

|  |  |
| --- | --- |
| D.  | $13,075 |

Total capital = 550,000.

EVA = 0 => Net Income + (1 – τ) X Interest – Total capital X cost of capital = 0 => Net Income + (1 – 0.35) X 25,000 – 550,000 X 0.1 = 0 => Net Income = 38,750

6. Which of the following is an example of a leverage ratio?

|  |  |
| --- | --- |
| **A**.  | Debt-equity ratio |

|  |  |
| --- | --- |
| B.  | Quick ratio |

|  |  |
| --- | --- |
| C.  | Payout ratio |

|  |  |
| --- | --- |
| D.  | Return on equity |

7. Assume the following data: Long-term debt = 100; Value of leases = 20; Book value of equity = 80; Market value of equity = 100. Calculate the debt-equity ratio.

|  |  |
| --- | --- |
| A.  | 0.50 |

|  |  |
| --- | --- |
| B.  | 0.60 |

|  |  |
| --- | --- |
| C.  | 1.00 |

|  |  |
| --- | --- |
| **D**.  | 1.50 |

D/E = (100 + 20)/80 = 1.5

8. Assume the following data: EBIT = 140; Interest = 20; Dividends = 10. Calculate the times interest earned (TIE) ratio.

|  |  |
| --- | --- |
| **A**.  | 7.0 |

|  |  |
| --- | --- |
| B.  | 5.0 |

|  |  |
| --- | --- |
| C.  | 4.7 |

|  |  |
| --- | --- |
| D.  | 14.0 |

TIE = 140/20 = 7.0

9. Assume the following data: Current assets = 500; Current liabilities = 250; Inventory = 200; Account receivables = 200. Calculate the current ratio.

|  |  |
| --- | --- |
| **A**.  | 2.0 |

|  |  |
| --- | --- |
| B.  | 1.5 |

|  |  |
| --- | --- |
| C.  | 1.0 |

|  |  |
| --- | --- |
| D.  | 2.5 |

Current ratio = 500/250 = 2.0

10. Assume the following data: Sales = 3200; Cost of goods sold = 1600; total assets = 1600; inventory = 200. Calculate the asset turnover ratio.

|  |  |
| --- | --- |
| **A**.  | 2.0 |

|  |  |
| --- | --- |
| B.  | 0.94 |

|  |  |
| --- | --- |
| C.  | 1.33 |

|  |  |
| --- | --- |
| D.  | 1.0 |

Asset turnover ratio = 3200/1600 = 2.0

11. Operating profit margin is calculated as:

|  |  |
| --- | --- |
| **A**.  | (after-tax interest plus net income)/sales. |

|  |  |
| --- | --- |
| B.  | net income/sales. |

|  |  |
| --- | --- |
| C.  | net income/cost of goods sold. |

|  |  |
| --- | --- |
| D.  | none of these answers. |

12. Assume the following data: EBIT = 400; Net income = 100; book value of equity = 1000. Calculate the ROE (return on equity).

|  |  |
| --- | --- |
| **A**.  | 10% |

|  |  |
| --- | --- |
| B.  | 12% |

|  |  |
| --- | --- |
| C.  | 7.5% |

|  |  |
| --- | --- |
| D.  | 30% |

ROE = 100/1000 = 0.1

13. Efficiency ratios indicate:

I) whether the firm is using its assets productively;
II) whether the firm is liquid;
III) whether the firm is profitable;
IV) how highly the firm is valued by investors

|  |  |
| --- | --- |
| **A**.  | I only |

|  |  |
| --- | --- |
| B.  | II only |

|  |  |
| --- | --- |
| C.  | III only |

|  |  |
| --- | --- |
| D.  | III and IV only |

14. Profitability ratios indicate:

I) whether the firm is using its assets productively;
II) whether the firm is liquid;
III) whether the firm is profitable;
IV) how highly the firm is valued by investors

|  |  |
| --- | --- |
| A.  | I only |

|  |  |
| --- | --- |
| B.  | II only |

|  |  |
| --- | --- |
| **C**.  | III only |

|  |  |
| --- | --- |
| D.  | III and IV only |