FEEDBACK TUTORIAL LETTER

2nd SEMESTER 2019

QUIZ 1, 2 & 3

MANAGERIAL FINANCE 320 (MFN710S)
Quiz 1

1. Financial managers evaluating decision alternatives or potential actions must consider ________.
   a) only risk
   b) only return
   c) either risk or return
   d) risk, return, and the impact on share price

2. Which of the following is an example of a firm's stakeholder?
   a) suppliers
   b) Federal Reserve
   c) media
   d) competitors

3. A financial manager must choose between four alternative Assets: 1, 2, 3, and 4. Each asset costs $35,000 and is expected to provide earnings over a three-year period as described below.

<table>
<thead>
<tr>
<th>Asset</th>
<th>Year 1 ($)</th>
<th>Year 2 ($)</th>
<th>Year 3 ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>21 000</td>
<td>15 000</td>
<td>6 000</td>
</tr>
<tr>
<td>2</td>
<td>9 000</td>
<td>15 000</td>
<td>21 000</td>
</tr>
<tr>
<td>3</td>
<td>3 000</td>
<td>20 000</td>
<td>19 000</td>
</tr>
<tr>
<td>4</td>
<td>6 000</td>
<td>12 000</td>
<td>12 000</td>
</tr>
</tbody>
</table>

   Based on the wealth maximization goal, the financial manager would choose ________.
   a) Asset 1
   b) Asset 2
4. Which of the following is true of stakeholders?
   a) They are the owners of a firm.
   b) They are groups to whom a firm has financial obligations.
   c) **They are groups having a direct economic link to a firm.**
   d) They include only the bondholders, common stockholders, and preferred stockholders.

5. Which of the following is true regarding cash flow?
   a) **Profits do not necessarily result in cash flows available to the stockholders.**
   b) It is guaranteed that the board of directors will increase dividends when net cash flows increase.
   c) A firm's income statement will never show a positive profit when its cash outflows exceed its cash inflows.
   d) An increase in revenue will always result in an increase in cash flow.

6. The primary goal of a financial manager is _______.
   a) minimizing risk
   b) maximizing profit
   c) **maximizing wealth**
   d) minimizing return
7. Corporate owners earn a return ________.

a) by realizing gains through increases in share price and interest earnings

b) by realizing gains through increases in share price and cash dividends

c) through capital appreciation and retained earnings

d) through interest earnings and earnings per share
8. The wealth of the owners of a corporation is represented by ________.
   a) profits
   b) earnings per share
   c) **share value**
   d) cash flow

9. Wealth maximization as the goal of a firm implies enhancing the wealth of ________.
   a) the auditors
   b) the creditors
   c) the federal reserve
   d) **the firm's stockholders**

10. Which of the following is **NOT** a reason that a firm that maximizes profits may fail to maximize shareholder wealth?
    a) The timing of profits matters. Shareholders might prefer lower profits that arrive sooner.
    b) **Risk matters. Shareholders are risk averse, so they prefer less risky investments that generate lower profits.**
    c) Shareholder wealth depends on cash flow which is not the same as profit.
    d) If a firm maximizes profits by engaging in unethical business practices, its stock price may be adversely affected.

11. Which of the following is true of risk?
    a) Risk and return are inversely proportionate to each other.
b) Higher the risk associated with a security the lower is its return.

c) **Risk is a measure of the uncertainty surrounding the return that an investment will earn.**

d) Riskier investments tend to have lower returns as compared to T-bills which are risk free.

12. Nico bought 100 shares of Cisco Systems stock for $30.00 per share on January 1, 2018. He received a dividend of $2.00 per share at the end of 2018 and $3.00 per share at the end of 2019. At the end of 2020, Nico collected a dividend of $4.00 per share and sold his stock for $33.00 per share. What was Nico's realized holding period return?

a) -40%

b) +40%

c) -36.36%

d) +36.36%

13. The total rate of return on an investment over a given period of time is calculated by ________.

a) dividing the asset's cash distributions during the period, plus change in value, by its beginning-of period investment value

b) dividing the asset's cash distributions during the period, plus change in value, by its ending-of period investment value

c) dividing the asset's cash distributions during the period, minus change in value, by its ending-of period investment value

d) dividing the asset's cash distributions during the period, minus change in value, by its beginning-of period investment value
14. Last year, Mike bought 100 shares of Dallas Corporation common stock for $53 per share. During the year he received dividends of $1.45 per share. The stock is currently selling for $60 per share. What rate of return did Mike earn over the year?

a) 11.7 percent
b) 13.2 percent
c) 14.1 percent
d) 15.9 percent

15. A common approach of estimating the variability of returns involving the forecast of pessimistic, most likely, and optimistic returns associated with an asset is called ________.

a) marginal analysis
b) scenario analysis
c) break-even analysis
d) DuPont analysis

16. The expected value and the standard deviation of returns for asset A is ________. (See below.)

<table>
<thead>
<tr>
<th>Asset A</th>
<th>Possible outcomes</th>
<th>Probability</th>
<th>Returns (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pessimistic</td>
<td>0.25</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Most likely</td>
<td>0.45</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>Optimistic</td>
<td>0.30</td>
<td>16</td>
</tr>
</tbody>
</table>

a) 12 percent and 4 percent

b) **12.7 percent and 2.3 percent**

c) 12.7 percent and 4 percent
d) 12 percent and 2.3 percent

17. The ________ the coefficient of variation, the ________ the risk.

a) lower; lower
b) higher; lower
c) lower; higher
d) more stable; higher

18. Given the following expected returns and standard deviations of assets B, M, Q, and D, which asset has the most favorable coefficient of variation?

<table>
<thead>
<tr>
<th>Asset</th>
<th>Expected Return</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>M</td>
<td>16%</td>
<td>10%</td>
</tr>
<tr>
<td>Q</td>
<td>14%</td>
<td>9%</td>
</tr>
<tr>
<td>D</td>
<td>12%</td>
<td>8%</td>
</tr>
</tbody>
</table>

a) Asset B
b) Asset M
c) Asset Q
d) Asset D

19. The expected return, standard deviation, and coefficient of variation for asset A are ________.

| Asset A
<table>
<thead>
<tr>
<th>Possible outcomes</th>
<th>Probability</th>
<th>Returns (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pessimistic</td>
<td>0.25</td>
<td>5</td>
</tr>
<tr>
<td>Most likely</td>
<td>0.45</td>
<td>10</td>
</tr>
<tr>
<td>Optimistic</td>
<td>0.30</td>
<td>13</td>
</tr>
</tbody>
</table>
a) 10 percent, 8 percent, and 1.25, respectively

b) 9.33 percent, 8 percent, and 2.15, respectively

c) 9.35 percent, 4.68 percent, and 2.00, respectively

d) 9.35 percent, 2.76 percent, and 0.295, respectively

20. Given the following limited information about the two assets A and B, which asset seems preferable?

<table>
<thead>
<tr>
<th></th>
<th>Asset A</th>
<th>Asset B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Investment</td>
<td>$5 000</td>
<td>$5 000</td>
</tr>
<tr>
<td>Annual rate of return</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pessimistic</td>
<td>9%</td>
<td>7%</td>
</tr>
<tr>
<td>Most likely</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td>Optimistic</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>Range</td>
<td>4</td>
<td>8</td>
</tr>
</tbody>
</table>

a) Asset A

b) Asset B

c) Both A and B

d) None of the above

21. The main idea behind the time value of money is that a dollar today is worth more than a dollar in the future because ________.

a) inflation erodes the value of money over time

b) investors can earn a return on money they have today and thereby have more money in the future

c) the future is more uncertain than the present

d) investors are impatient
22. You invest a certain amount of money today. The process of determining how much money that investment will produce in the future is called ________.

a) discounting
b) compounding
c) present value
d) annuitizing the cash flow

23. ________ is the amount earned on a deposit that has become the part of the principal at the end of a specified time period.

a) Discount interest
b) Compound interest
c) Primary interest
d) Future value

24. The future value of a dollar ________ as the interest rate increases and ________ the longer the money remains invested.

a) decreases; decreases
b) decreases; increases
c) increases; increases
d) increases; decreases

25. The present value of $100 to be received 10 years from today, assuming
an opportunity cost of 9 percent, is approximately ________.

a) $237
b) $190
c) $42
d) $10

26. Your current income is $50,000 per year, and you would like to maintain your current standard of living (i.e., your purchasing power) when you retire. If you expect to retire in 30 years and expect inflation to average 3% over the next 30 years, what amount of annual income will you need to live at the same comfort level in 30 years?

a) $121,363
b) $95,000
c) $20,599
d) $51,500

27. How long does it take for $5,000 to grow into $6,724.44 at 10% compounded quarterly?

a) 2 years.
b) 3 years.
c) 4 years.
d) 30 months.

28. How much will an ordinary annuity of N$650 per year be worth in eight years at an annual interest rate of 6 percent?

a) $8,975.38
29. What annual interest rate would you need in order to have an ordinary annuity of $7,500 per year accumulate to $279,600 in 15 years?

   a) 8.75%
   b) 10.2%
   c) 12%
   d) 14%

30. What would you be willing to pay for a $1,000 bond paying $70 interest at the end of each year and maturing in 25 years if you wanted the bond to yield an annual interest rate of 7 percent? (Note: At maturity, the bond will be retired and the holder will receive $1,000 in cash).

   a) $1,100
   b) $958
   c) $1,000
   d) $979
1. The firm of Sun and Moon purchased a share of Acme.com common stock exactly one year ago for $45. During the past year the common stock paid an annual dividend of $2.40. The firm sold the security today for $85. What is the rate of return the firm has earned?
   a. 5.3%
   b. 194.2%
   c. 88.9%
   d. 94.2%

2. A set of possible values that a random variable can assume and their associated probabilities of occurrence are referred to as _________.
   a. probability distribution
   b. the expected return
   c. the standard deviation
   d. coefficient of variation

3. A statistical measure of the variability of a distribution around its mean is referred to as _________.
   a. a probability distribution
   b. the expected return
   c. the standard deviation
   d. coefficient of variation

4. The ratio of the standard deviation of a distribution to the mean of that distribution is referred to as _________.
   a. a probability distribution
   b. the expected return
   c. the standard deviation
   d. coefficient of variation

5. The weighted average of possible returns, with the weights being the probabilities of occurrence is referred to as _________.
   a. a probability distribution
   b. the expected return
   c. the standard deviation
   d. coefficient of variation
6. Clive Rodney Megabucks offers your friend, Melanie, an interesting gamble involving giving her the choice of the contents in one of two sealed, identical-looking boxes. One box has $20,000 in cash and the second has nothing inside. There is an equal probability that the chosen box contains cash versus nothing. Melanie states that she would not call off the gamble if you offered her a certain $10,999 instead of her choice of box. However, she would be indifferent if $11,000 was offered in place of the risky gamble; and she would definitely take $11,001 to call off the gamble. We would describe Melanie as __________ in this instance.
   a. being risk averse
   b. being risk indifferent
   c. having a risk preference

7. Clive Rodney Megabucks offers your friend, Yunyoung, an interesting gamble involving giving her the choice of the contents in one of two sealed, identical-looking boxes. One box has $20,000 in cash and the second has nothing inside. There is an equal probability that the chosen box contains cash versus nothing. Yunyoung states that she would not call off the gamble if you offered her a certain $4,999 instead of her choice of box. However, she would be indifferent if $5,000 was offered in place of the risky gamble; and she would definitely take $5,001 to call off the gamble. We would describe Yunyoung as __________ in this instance.
   a. being risk averse
   b. being risk indifferent
   c. having a risk preference

8. Which of the following statements regarding covariance is correct?
   a. Covariance always lies in the range -1 to +1.
   b. Covariance, because it involves a squared value, must always be a positive number (or zero).
   c. Low covariances among returns for different securities leads to high portfolio risk.
   d. Covariances can take on positive, negative, or zero values.

9. Which of the following portfolio statistics statements is correct?
   a. A portfolio's expected return is a simple weighted average of expected returns of the individual securities comprising the portfolio.
   b. A portfolio’s standard deviation of return is a simple weighted average of individual security return standard deviations.
   c. The square root of a portfolio’s standard deviation of return equals its variance.
d. The square root of a portfolio's standard deviation of return equals its coefficient of variation.

10. Total portfolio risk is __________.
   a. equal to systematic risk plus non-diversifiable risk
   b. **equal to avoidable risk plus diversifiable risk**
   c. equal to systematic risk plus unavoidable risk
   d. equal to systematic risk plus diversifiable risk

11. __________ is the variability of return on stocks or portfolios not explained by general market movements. It is avoidable through diversification.
   a. Systematic risk
   b. Standard deviation.
   c. **Unsystematic risk**
   d. Coefficient of variation.

12. __________ is the variability of return on stocks or portfolios associated with changes in return on the market as a whole.
   a. **Systematic risk**
   b. Standard deviation
   c. Unsystematic risk
   d. Coefficient of variation

13. Which of the following indexes would be most the appropriate proxy to measure the return of the market portfolio in the CAPM?
   a. Dow Jones Industrial Index.
   b. **Standard & Poor's 500.**
   c. Solomon Brothers Bond Index.
   d. Wilshire Gold Index.

14. The __________ describes the linear relationship between expected rates of return for individual securities (or portfolios) and __________.
   a. characteristic line; standard deviation
   b. characteristic line; beta
   c. security market line; standard deviation
   d. **security market line; beta**

15. The __________ describes the relationship between an individual security's returns and returns on the market portfolio. The slope of this line is __________.
   a. security market line; beta
b. characteristic line; beta

c. security market line; equal to +1.

d. characteristic line; equal to +1

16. Which of the following items describes an index measure of systematic risk?
   a. Beta.
   b. Standard deviation.
   c. Coefficient of variation.
   d. Variance.

17. Which of the following items is a model that describes the relationship between risk and expected return (in this model the expected return is equal to the risk-free return plus a premium based on the systematic risk of the security)?
   a. Beta.
   b. Characteristic line.
   c. Capital asset pricing model.
   d. Efficient markets model.

18. What is the beta for an average risk security? What is the beta for a Treasury bill?
   a. 1; 0.
   b. 0; 1.
   c. Greater than 1; 1.
   d. 1; Greater than 1.

19. Assume that a firm's common stock can be valued using the constant dividend growth model. As an analyst you expect that the return on the market will be 15% and the risk-free rate is 7%. You have estimated that the dividend next period will be $1.50, the firm will grow at a constant 6%, and the firm beta is 0.50. The common stock is currently selling for $30.00 in the market place. Which of the following statements is correct?
   a. The firm's stock is over-priced.
   b. The firm's stock is fairly-priced.
   c. The firm's stock is under-priced.
   d. The firm's stock cannot be valued because of missing information.

20. Which form of market efficiency states that current security prices fully reflect all information, both public and private?
   a. Weak.
   b. Semi-strong.
   c. Strong.
21. Which form of market efficiency states that current prices fully reflect the historical sequence of prices?
   a. Weak.
   b. Semi-strong.
   c. Strong.

22. Which form of market efficiency states that current prices fully reflect all publicly available information?
   a. Weak.
   b. Semi-strong.
   c. Strong.

23. Two alternative expected returns are compared with help of
   a. coefficient of variation
   b. coefficient of deviation
   c. coefficient of standard
   d. coefficient of return

24. Dollar return is divided by invested amount which is used for calculating the
   a. rate of return
   b. return amount
   c. investment rate
   d. received amount

25. An analysis of decision making of investors and managers is classified as
   a. riskier finance
   b. behavioural finance
   c. premium finance
   d. buying finance

26. Yield on bond is 7% and market required return is 14% then market risk premium would be
   a. 0.02
   b. 0.21
   c. 0.005
   d. 0.07

27. This type of risk is avoidable through proper diversification.
   a. portfolio risk
   b. systematic risk
c. unsystematic risk
d. total risk

28. A statistical measure of the degree to which two variables (e.g., securities' returns) move together.
   a. coefficient of variation
   b. variance
   c. covariance
   d. certainty equivalent

29. Plaid Pants, Inc. common stock has a beta of 0.90, while Acme Dynamite Company common stock has a beta of 1.80. The expected return on the market is 10 percent, and the risk-free rate is 6 percent. According to the capital-asset pricing model (CAPM) and making use of the information above, the required return on Plaid Pants' common stock should be, and the required return on Acme's common stock should be.
   a. 3.6 percent; 7.2 percent
   b. 9.6 percent; 13.2 percent
   c. 9.0 percent; 18.0 percent
   d. 14.0 percent; 23.0 percent

30. Espinosa Coffee & Trading, Inc.'s common stock measured beta is calculated to be 0.75. The market beta is, of course, 1.00 and the beta of the industry of which the company is a part is 1.10. If Merrill Lych were to calculate an "adjusted beta" for Espinosa's common stock, that adjusted beta would most likely be.
   a. less than 0.75
   b. more than 0.75, but less than 1.10
   c. equal to 1.10
   d. equal to 0.95 (i.e., (1/3) x (0.75 + 1.00 + 1.10))
Quiz 3

1. The discount rate used to determine the present value of a stream of expected future cash flows is referred to as the __________.
   a) net operating income
   b) capitalization rate
   c) capital structure
   d) yield on the company's market value of common equity

2. The traditional approach towards the valuation of a company assumes that __________.
   a) the cost of capital is independent of the capital structure of the firm
   b) the firm maintains constant risk regardless of the type of financing employed
   c) there exists no optimal capital structure
   d) that management can increase the total value of the firm through the judicious use of financial leverage

3. The presence of which one of the following costs is not used as a major argument against the M&M arbitrage process?
   a) Bankruptcy costs.
   b) Agency costs.
   c) Transactions costs.
   d) Insurance costs.

4. What is the present value of the net tax-shield of debt if the current market value of the firm is $10 million, its value if unlevered would be $8 million, and the present value of bankruptcy and agency costs is $500,000?
   a) $1,500,000
   b) $2,000,000
   c) $2,500,000
   d) None of the above are correct.

5. What is the market value of common equity under the NOI approach? The firm has an expected net operating income of $5,000 with $4,000 of debt (market value). Assume that the overall capitalization rate is 20%.
   a) $5,000
   b) $20,000
   c) $21,000
   d) $25,000
6. Which of the following statements regarding the net operating income approach is incorrect?
   a) The overall capitalization rate, kO, is constant.
   b) The cost of debt funds, ki, is constant.
   c) The required return on equity, ke, is constant.
   d) The total value of the firm is unaffected by changes in financial leverage.

7. Which of the following statements regarding the total value principle is incorrect?
   a) The total value principle allows for corporate borrowing and excludes personal borrowings via arbitrage.
   b) The total value principle must hold or else arbitrage will take place and then its presence will cause the value to remain constant regardless of the capital structure.
   c) The total value does not change because the underlying profit and risk of the firm are with its operations, which do not change when the financing changes.
   d) Modigliani and Miller, in their original position, advocate that the total value of the firm is identical regardless of the financing mix.

8. Two identical firms exist except that Firm A uses no debt and Firm B uses some debt. The total value of Firm A is less than the total value of Firm B, but you own 2% of Firm B. Based on the arguments by Modigliani and Miller regarding the total value principle, what should you do?
   a) Buy 2% of Firm A with funds from "shorting" your shares in Firm B. Submit a press release that the two firms should be worth identical values. This will cause Firm A to rise in value and leave you extra funds for investment.
   b) You should borrow enough funds to equal the difference in firm value, purchase shares of Firm A with these funds, and sell your shares in Firm B. This will leave extra funds for an investment of your choice.
   c) Sell your shares, personally borrow 2% of the quantity of firm debt, and purchase 2% of Firm A. This will leave extra funds for an investment of your choice.
   d) Sell enough of your shares (Firm B) to purchase 2% of Firm A. This will leave extra funds for an investment of your choice.

9. Allowing for bankruptcy costs and an increasing probability of bankruptcy with increasing financial leverage, we should expect __________ than would be the case without bankruptcy costs.
a) the premium for business risk to be higher
b) the premium for business risk to be lower
c) the premium for financial risk should rise by less
d) the premium for financial risk should rise by more

10. The existence of __________ on the balance sheet generates tax advantages that directly influence the capital structure of the firm.
   a) a large proportion of fixed assets
   b) long-term debt
   c) retained earnings
   d) All of the above answers are

11. As the amount of __________ increases the present value of __________.
   a) debt; net tax-shield benefits of debt increases
   b) common equity; bankruptcy and agency costs increase
   c) debt; net tax-shield benefits of debt decrease
   d) common equity; net tax-shield benefits of debt decrease.

12. When the manager of a firm uses capital structure changes to convey information about the profitability and risk of the firm, then the manager is engaging in __________.
   a) financial signaling
   b) informational symmetry
   c) the net operating income approach to capital structure
   d) the traditional approach to capital structure

13. In an M&M world -- but, with taxes -- and where r is the interest rate, B is the value of perpetual debt, and tc is the corporate tax rate, the present value of tax-shield benefits of debt would be equal to __________.
   a) \(( r ) \times ( B ) \times ( tc )\)
   b) \(( r ) \times ( B )\)
   c) \(( B ) \times ( tc )\)
   d) \(( r ) \times ( B ) \times ( tc ) / ( 1 + r )\)

14. __________ costs are associated with monitoring management to ensure that it behaves properly.
   a) Agency
   b) Behavioral
   c) Bankruptcy
   d) Managerial
15. ________ costs are those associated with engaging in various business transactions that may cause the firm to not have the exact optimal capital structure.
   a) Agency
   b) Transaction
   c) Bankruptcy
   d) Managerial

16. Assume that the market imperfection of taxes exists. If the corporate tax rate were increased under new legislation, the use of debt would ________.
   a) rise
   b) fall
   c) not be impacted
   d) There is not sufficient information provided to determine the impact.

17. Assume that the economy has unexpectedly and immediately gone into a recession. Which of the following firms that are in the same industry and face the same business risks would most likely see the largest increase in the present value of bankruptcy costs?
   a) A firm with the highest proportion of common equity financing.
   b) A firm with the highest proportion of debt financing.
   c) A firm with the lowest proportion of preferred stock financing.
   d) All firms will see an identical rise in the present value of bankruptcy costs since the business risk is the same.

18. In general, what would happen to the debt ratio of a firm if it always kept an optimal capital structure and if: 1) the government changed tax laws that allowed the deduction of dividend financing and 2) excluded the deduction of interest expense?
   a) The debt ratio would fall.
   b) The debt ratio would rise.
   c) The debt ratio would not change.

19. Which term would most likely be associated with the phrase "actions speak louder than words?"
   a) Incentive signaling.
   b) Shareholder wealth maximization.
   c) Financial signaling.
   d) Optimal capital structure.

20. Which of the following is not something that you would consider when evaluating the optimal capital structure?
a) Agency Costs.
b) EBIT-EPS Analysis.
c) Taxes.
d) Security Rating.
e) All of the above are considered when determining the optimal capital structure.

21. From the options below, select the optimal capital structure for Minnow Entertainment Company.

a) Debt = 40%; Equity = 60%; EPS = $2.95; Stock price = $26.50.

a) Debt = 50%; Equity = 50%; EPS = $3.05; Stock price = $28.90.

b) Debt = 60%; Equity = 40%; EPS = $3.18; Stock price = $31.20.

c) Debt = 80%; Equity = 20%; EPS = $3.42; Stock price = $30.40.

d) Debt = 70%; Equity = 30%; EPS = $3.31; Stock price = $30.00.

22. Which of the following statements best describes the optimal capital structure?

a) The optimal capital structure is the mix of debt, equity, and preferred stock that maximizes the company's earnings per share (EPS).

b) The optimal capital structure is the mix of debt, equity, and preferred stock that maximizes the company's stock price.

d) The optimal capital structure is the mix of debt, equity, and preferred stock that minimizes the company's weighted average cost of capital (WACC).

f) Statements A and B are correct.

h) Statements B and C are correct.

23. Suppose company X is levered and its degree of financial leverage is 1.25. The company has 3,000,000 common stock outstanding and the recent after tax earnings were N$14,250,000. If the EBIT of the following year increase by 10%, what would be the company’s EPS in that year?

a) N$5.94

b) N$5.34
24. If company Y has no preference shares but is a levered firm with EBIT of N$1 500 000 and annual interest of N$750 000 and current EPS of N$ 5.50, what would be the EPS of the company if EBIT rises by 12%?
   a) N$11.00
   b) N$6.16
   c) N$8.25
   d) N$6.82
   e) N$2.25

25. Which of the following factors is likely to encourage a corporation to increase the proportion of debt in its capital structure?
   a) An Increase in the corporate tax rate.
   b) An Increase in the personal tax rate.
   c) An increase in the company’s degree of operating leverage
   d) The company’s assets becoming less liquid
   e) An increase in expected bankruptcy costs

26. Brock’e Brothers wants to maintain its capital structure that consists of 30 percent debt and 70 percent equity. The company forecasts that its net income this year will be $1,000,000. The company follows a residual dividend policy and anticipates a dividend payout ratio of 40 percent. What is the size of the company’s capital budget?
   a) N$600 000
   b) N$857 143
   c) N$1 000 000
   d) N$1 428 571
   e) N$2 000 000

27. The directors intend to expand the business by issuing some debenture, with a cost of 10% a year, to the value of 40% of the existing value of the business. Making the Modigliani and Miller assumptions, including that of no taxes, what will be the cost of equity after the debenture issue?
28. Avis Holdings made during the year, Sales of N$2,500,000, cost of sales N$1,800,000, operating expenses N$300,000 and depreciation expenses were N$200,000. The firm is in the 30% tax bracket. Based on this data what was the firm’s operating cash flow?

   a) N$340,000
   b) N$200,000
   c) N$400,000
   d) N$140,000
   e) None of the above

29. Grey products has fixed operating costs of N$380,000, variable operating costs of N$16/unit and a selling price of N$63.50/unit. What is company’s degree of operating leverage at 10,000 units?

   a) 4
   b) 2.5
   c) 3
   d) 5
   e) 6

30. The term "capital structure" refers to:
   a) long-term debt, preferred stock, and common stock equity.
   b) current assets and current liabilities.
   c) total assets minus liabilities.
   d) shareholders' equity.