

FIN 534 – Homework Chapter 2

1. Which of the following statements is CORRECT?

- a. Typically, a firm's DPS should exceed its EPS.
- b. Typically, a firm's EBIT should exceed its EBITDA.

C(correct). If a firm is more profitable than average (e.g., Google), we would normally expect to see its stock price exceed its book value per share.

- d. If a firm is more profitable than most other firms, we would normally expect to see its book value per share exceed its stock price, especially after several years of high inflation.
- e. The more depreciation a firm has in a given year, the higher its EPS, other things held constant.

2. Which of the following statements is CORRECT?

- a. The statement of cash flows reflects cash flows from operations, but it does not reflect the effects of buying or selling fixed assets.
- b. The statement of cash flows shows where the firm's cash is located; indeed, it provides a listing of all banks and brokerage houses where cash is on deposit.
- c. The statement of cash flows reflects cash flows from continuing operations, but it does not reflect the effects of changes in working capital.
- d. The statement of cash flows reflects cash flows from operations and from borrowings, but it does not reflect cash obtained by selling new common stock.

E(correct) The statement of cash flows shows how much the firm's cash--the total of currency, bank deposits, and short-term liquid securities (or cash equivalents)--increased or decreased during a given year.

3. Which of the following statements is CORRECT?

- a. Dividends paid reduce the net income that is reported on a company's income statement.
- b. If a company uses some of its bank deposits to buy short-term, highly liquid marketable securities, this will cause a decline in its current assets as shown on the balance sheet.
- c. If a company issues new long-term bonds during the current year, this will increase its reported current liabilities at the end of the year.
- d. Accounts receivable are reported as a current liability on the balance sheet.

E(correct) If a company pays more in dividends than it generates in net income, its retained earnings as reported on the balance sheet will decline from the previous year's balance.

4. Last year Roussakis Company's operations provided a negative net cash flow, yet the cash shown on its balance sheet increased. Which of the following statements could explain the increase in cash, assuming the company's financial statements were prepared under generally accepted accounting principles?

D(correct)The company repurchased some of its common stock.

- b. The company dramatically increased its capital expenditures.
- c. The company retired a large amount of its long-term debt.
- d. The company sold some of its fixed assets.
- e. The company had high depreciation expenses.

5. Bartling Energy Systems recently reported \$9,250 of sales, \$5,750 of operating costs other than depreciation, and \$700 of depreciation. The company had no amortization charges, it had \$3,200 of outstanding bonds that carry a 5% interest rate, and its federal-plus-state income tax rate was 35%. In order to sustain its operations and thus generate sales and cash flows in the future, the firm was required to make \$1,250 of capital expenditures on new fixed assets and to invest \$300 in net operating working capital. By how much did the firm's net income exceed its free cash flow?

- a. \$673.27
- b. \$708.70
- c. \$746.00**
- d. \$783.30
- e. \$822.47