Question #1 of 39

Given the following information on the annual operating results for ArtFrames, a producer of quality metal picture frames:

- Sales of $3,500,000.
- Variable costs at 45% of sales.
- Fixed costs of $1,050,000.
- Debt interest payments on $750,000 issued at par with an annual 9.0% coupon; market yield is currently 7.0%.

ArtFrames's degree of operating leverage (DOL) and degree of financial leverage (DFL) are *closest to*:

	DOL	DFL
A)	3.00	1.50
B)	2.20	1.08
C)	2.20	1.50

Question #2 of 39

Variability in a firm's operating income is *most closely* related to its:

A) financial risk.

B) business risk.

C) internal risk.

Question #3 of 39

Which of the following statements about business risk and financial risk is *least* accurate?

A) The greater a company's business risk, the higher its optimal debt ratio.

B) Factors that affect business risk are demand, sales price, and input price variability.

C) Business risk is the riskiness of the company's assets if it uses no debt.

Question #4 of 39

Annah Korotkin is the sole proprietor of CoverMeUp, a business that designs and sews outdoor clothing for dogs. Each year, she rents a booth at the regional Pet Expo and sells only blankets. Korotkin views the Expo as primarily a marketing tool and is happy to breakeven (that is, cover her booth rental). For the last 3 years, she has sold exactly enough blankets to cover the $750 booth rental fee. This year, she decided to make all blankets for the Expo out of high-tech waterproof/breathable material that is more expensive to produce, but that she believes she can sell for a higher profit margin. Information on the two types of blankets is as follows:

Per Unit	Last Year's (Basic) Blanket	This Year's (New) Blanket
Sales Price	$25	$40
Variable Cost	$20	$33

Assuming that Korotkin remains most interested in covering the booth cost (which has increased to $840), how many more or fewer blankets (new style) does she need to sell to cover the booth cost? To cover this year's booth costs, Korotkin needs to sell:

A) 42 more blankets than last year.

B) 42 fewer blankets than last year.

C) 30 fewer blankets than last year.

Question #5 of 39

Which of the following factors is *least likely* to affect business risk?

A) Demand variability.

B) Operating leverage.

C) Interest rate variability.

Question #6 of 39

A company's use of financial leverage:

A) decreases default risk and decreases potential return on equity.

B) increases default risk and increases potential return on equity.

C) increases default risk and decreases potential return on equity.

Question #7 of 39

Hughes Continental is assessing its business risk. Which of the following factors would *least likely* be considered in the analysis?

A) Input price variability.

B) Debt-equity ratio.

C) Unit sales levels.

Question #8 of 39

Which of the following *best* describes a firm with low operating leverage? A large change in:

A) the number of units a firm produces and sells result in a similar change in the firm's earnings before interest and taxes.

B) sales result in a small change in net income.

C) earnings before interest and taxes result in a small change in net income.

Question #9 of 39

FCO, Inc. (FCO) is comparing EBIT forecasts to help determine the impact its capital structure has on net income.

	Expected EBIT	**EBIT + 10%**
EBIT	$80,000	$88,000
Interest expense	15,000	15,000
EBT	65,000	73,000
Taxes	26,000	29,200
Net income	39,000	43,800
Liabilities	200,000	
Shareholder equity	250,000	
Return on equity	15.60%	

FCO's degree of financial leverage is *closest* to:

A) 1.25.

B) 0.60.

C) 0.80.

Question #10 of 39

Which of the following statements regarding leverage is *most* accurate?

A) High levels of financial leverage increase business risk while high levels of operating leverage will decrease business risk.

B) A firm with high business risk is more likely to increase its use of financial leverage than a firm with low business risk.

C) A firm with low operating leverage has a small proportion of its total costs in fixed costs.

Question #11 of 39

Additional debt should be used in the firm's capital structure if it increases:

A) the value of the firm.

B) firm earnings.

C) earnings per share.

Question #12 of 39

All else equal, a firm's business risk is higher when:

A) fixed costs are the highest portion of its expense.

B) the firm has low operating leverage.

C) variable costs are the highest portion of its expense.

Question #13 of 39

Jayco, Inc., sells blue ink for $4.00 a bottle. The ink's variable cost per bottle is $2.00. Ink has fixed cost of $10,000. What is Jayco's breakeven point in units?

A) 6,000.

B) 5,000.

C) 2,500.

Question #14 of 39

Steven's Bakery produces snack cakes and bread. Listed below are the operating costs for the snack cakes division and the bread division.

	Snack cakes	**Bread**
Price per package	$2.00	$2.50
Variable cost per package	$1.00	$1.30
Fixed operating costs	$25,000	$30,000
Fixed financing costs	$10,000	$10,000

Compared to the snack cakes division, the operating breakeven quantity for the bread division is:

A) less.

B) greater.

C) the same.

Question #15 of 39

Financial leverage magnifies:

A) operating income variability.

B) taxes.

C) earnings per share variability.

Question #16 of 39

Nelson, Inc. has fixed financing costs of $3 million, fixed operating costs of $5 million, and variable costs of $2.00 per unit. If the price of Nelson's product is $4.00, Nelson's operating breakeven quantity of sales is:

A) 4.0 million units.

B) 1.0 million units.

C) 2.5 million units.

Question #17 of 39

The additional risk a firm's common shareholders must bear when a firm uses fixed cost financing is *best* described as:

A) operating risk.

B) financial risk.

C) business risk.

Question #18 of 39

Which of the following sources of financing is *least likely* to increase a firm's financial risk?

A) Operating leases.

B) Common equity.

C) Fixed-rate debt.

Question #19 of 39

If a 10% increase in sales causes EPS to increase from $1.00 to $1.50, and if the firm uses no debt, then what is its degree of operating leverage?

A) 5.0.

B) 4.2.

C) 4.7.

Question #20 of 39

All else equal, which of the following statements about operating leverage is *least* accurate?

A) Operating leverage reflects the tradeoff between variable costs and fixed costs.

B) Lower operating leverage generally results in a higher expected rate of return.

C) Firms with high operating leverage experience greater variance in operating income.

Question #21 of 39

Wanton's San Y'isidro Co. manufactures custom door knobs for international clients. Average Revenue is $35 per unit, variable costs are $15 per unit, and total costs are $200,000. If sales are 10,000 units, what is the firm's breakeven sales quantity?

A) 2,500 units.

B) 1,750 units.

C) 3,000 units.

Question #22 of 39

Myron Jackson is a private equity fund manager specializing in distressed companies. His investment philosophy is based on the principle that capital structure problems can be fixed, but industry characteristics dictate business models. Jackson would *most likely* be interested in distressed firms with which of the following characteristics?

A) High operating risk and high financial risk.

B) High operating risk and low financial risk.

C) High financial risk and low operating risk.

Question #23 of 39

During a period of expansion in the economy, compared to firms with lower operating expense levels, earnings growth for firms with high operating leverage will be:

A) higher.

B) unaffected.

C) lower.

Question #24 of 39

Given the following information on the annual operating results for ArtFrames, a producer of quality metal picture frames, what is the degree of operating leverage (DOL) and the degree of financial leverage (DFL)?

- Sales of $3.5 million
- Variable Costs at 45% of sales
- Fixed Costs of $1.05 million
- Debt interest payments on $750,000 issued at par with an annual 9.0% coupon (current yield is 7.0%)

Which of the following choices is *closest* to the correct answer? ArtFrame's DOL and DFL are:

	DOL	DFL
A)	2.20	1.08
B)	3.00	1.50
C)	2.20	1.50

Question #25 of 39

The two major types of risk affecting a firm are:

A) business risk and financial risk.

B) financial risk and cash flow risk.

C) business risk and collection risk.

Question #26 of 39

As financial leverage increases, what will be the impact on the expected rate of return and financial risk?

A) Both will fall.

B) One will rise while the other falls.

C) Both will rise.

Question #27 of 39

The combination of operating risk and sales risk is known as:

A) business risk.

B) gearing risk.

C) financial risk.

Question #28 of 39

Jayco, Inc. sells 10,000 units at a price of $5 per unit. Jayco's fixed costs are $8,000, interest expense is $2,000, variable costs are $3 per unit, and earnings before interest and taxes (EBIT) is $12,000. What is Jayco's degree of financial leverage (DFL) and total leverage (DTL)?

	DFL	DTL
A)	1.33	2.00
B)	1.20	2.00
C)	1.33	1.75

Question #29 of 39

Jayco, Inc. has a division that makes red ink for the accounting industry. The unit has fixed costs of $10,000 per month, and is expected to sell 40,000 bottles of ink per month. If the variable cost per bottle is $2.00 what price must the division charge in order to breakeven?

A) $2.50.

B) $2.25.

C) $2.75.

Question #30 of 39

Which of the following statements regarding the impact of financial leverage on a company's net income and return on equity (ROE) is *most* accurate?

A) Using financial leverage increases the volatility of ROE for a level of volatility in operating income.

B) Increasing financial leverage increases both risk and potential return of existing bondholders.

C) If a firm has a positive operating profit margin, using financial leverage will always increase ROE.

Question #31 of 39

Yangtze Delta High Technology produces multimedia-enabled wireless phones. The factory incurs rent, depreciation, salary, and other fixed costs totaling RMB 10 million per year. Also, the company incurs annual interest of RMB 3 million on debt. Each phone sold by Yangtze Delta sells for RMB 200. The variable cost per phone is RMB 150. Yangtze Delta's operating breakeven quantity of sales is *closest to*:

A) 260,000.

B) 65,000.

C) 200,000.

Question #32 of 39

Which of the following is a key determinant of operating leverage?

A) The competitive nature of the business.

B) Level and cost of debt.

C) The tradeoff between fixed and variable costs.

Question #33 of 39

The uncertainty in return on assets due to the nature of a firm's operations is known as:

A) financial leverage.

B) tax efficiency.

C) business risk.

Question #34 of 39

An analyst has gathered the following expenditure information for three different firms, each of which has a sales level of $4 million.

Costs for firms under consideration (in millions)			
	Firm A	**Firm B**	**Firm C**
Variable Costs	$2.00	$2.60	$2.40
Fixed Costs	$1.00	$1.30	$1.40
Interest Expense	$0.20	$0.00	$0.20

Which firm has the *highest* degree of operating leverage (DOL)?

A) Firm C.

B) Firm B.

C) Firm A.

Question #35 of 39

The following information reflects the projected operating results for Opstalan, a catalog printer.

- Sales of $5.0 million.
- Variable Costs at 40% of sales.
- Fixed Costs of $1.0 million.
- Debt interest payments on $1.5 million issued with an annual 7.0% coupon (current yield is 8.0%).
- Tax Rate of 0.0%.

Opstalan's degree of total leverage (DTL) is *closest* to:

A) 2.58.

B) 1.41.

C) 1.59.

Question #36 of 39

Annual fixed costs at King Mattress amount to $325,000. The variable cost of raw materials and labor is $120 for the typical mattress. Sales prices for mattresses average $160. How many units must King Mattress sell to break even?

A) 8,125.

B) 40.

C) 2,708.

Question #37 of 39

Which of the following statements about leverage is *most* accurate?

A) An increase in fixed costs (holding sales and variable costs constant) will reduce the company's degree of operating leverage.

B) If the company has no debt outstanding, then its degree of total leverage equals its degree of operating leverage.

C) A decrease in interest expense will increase the company's degree of total leverage.

Question #38 of 39

Stromburg Corporation's sales are $75,000,000. Fixed costs, including research and development, are $40,000,000, while variable costs amount to 30% of sales. Stromburg plans an expansion which will generate additional fixed costs of $15,000,000, decrease variable costs to 25% of sales, and permit sales to increase to $100,000,000. What is Stromburg's degree of operating leverage at the new projected sales level?

A) 3.75.

B) 4.20.

C) 3.50.

Question #39 of 39

A firm expects to produce 200,000 units of flour that can be sold for $3.00 per bag. The variable costs per unit are $2.00, the fixed costs are $75,000, and interest expense is $25,000. The degree of operating leverage (DOL) and the degree of total leverage (DTL) is *closest* to:

	DOL	DTL
A)	1.6	1.3
B)	1.3	1.3
C)	1.6	2.0