SS 10 Corporate Finance: Corporate Governance, Capital Budgeting, and Cost of Capital

Question #1 of 165

Question ID: 434330

A company has the following data associated with it:

- A target capital structure of 10% preferred stock, 50% common equity and 40% debt.
- Outstanding 20-year annual pay 6% coupon bonds selling for $894.
- Common stock selling for $45 per share that is expected to grow at 8% and expected to pay a $2 dividend one year from today.
- Their $100 par preferred stock currently sells for $90 and is earning 5%.
- The company's tax rate is 40%.

What is the after-tax cost of debt capital and after-tax cost of preferred stock?

	Debt capital	Preferred stock
A)	4.5%	3.3%
B)	4.2%	5.6%
C)	4.2%	3.3%

Question #2 of 165

Question ID: 683889

Which of the following environmental factors is *least likely* to arise from inadequate internal controls and safety standards?

A) Stranded assets.

B) Local resource depletion.

C) Waste contamination.

Question #3 of 165

Question ID: 414785

The expected dividend one year from today is $2.50 for a share of stock priced at $22.50. The long-term growth in dividends is projected at 8%. The cost of common equity is *closest* to:

A) 18.0%.

B) 19.1%.

C) 15.6%.

Question #4 of 165

Question ID: 414737

Which of the following statements about the internal rate of return (IRR) for a project with the following cash flow pattern is CORRECT?

- Year 0: -$ 2,000
- Year 1: $10,000
- Year 2: -$ 10,000

A) It has a single IRR of approximately 38%.

B) No IRRs can be calculated.

C) It has two IRRs of approximately 38% and 260%.

Question #5 of 165

Question ID: 683887

To judge whether management's incentives are aligned with a firm's stated goals, an analyst should examine the firm's:

A) share class structure.

B) remuneration programs.

C) cross-shareholdings.

Question #6 of 165

Question ID: 467819

The 6% semiannual coupon, 7-year notes of Woodbine Transportation, Inc. trade for a price of 94.54. What is the company's after-tax cost of debt capital if its marginal tax rate is 30%?

A) 4.9%.

B) 2.1%.

C) 4.2%.

Question #7 of 165

Question ID: 434325

An analyst has gathered the following data about a company with a 12% cost of capital:

	Project P	*Project Q*
Cost	\$15,000	\$25,000
Life	5 years	5 years
Cash inflows	\$5,000/year	\$7,500/year

If Projects P and Q are mutually exclusive, what should the company do?

A) Accept Project Q and reject Project P.

B) Reject both Project P and Project Q.

C) Accept Project P and reject Project Q.

Question #8 of 165

Question ID: 598675

A company has the following data associated with it:

- A target capital structure of 10% preferred stock, 50% common equity and 40% debt.
- Outstanding 20-year annual pay 6% coupon bonds selling for \$894.
- Common stock selling for \$45 per share that is expected to grow at 8% and expected to pay a \$2 dividend one year from today.
- Their 5%, \$100 par preferred stock currently sells for \$90.
- The company's tax rate is 40%.

What is the weighted average cost of capital (WACC)?

A) 8.5%.

B) 10.3%.

C) 9.2%.

Question #9 of 165

Question ID: 414791

Julius, Inc., is in a 40% marginal tax bracket. The firm can raise as much capital as needed in the bond market at a cost of 10%. The preferred stock has a fixed dividend of \$4.00. The price of preferred stock is \$31.50. The after-tax costs of debt and preferred stock are *closest* to:

	Debt	Preferred stock
A)	6.0%	7.6%
B)	10.0%	7.6%

C)	6.0%	12.7%

Question #10 of 165

Question ID: 414726

Which of the following statements about NPV and IRR is NOT correct?

A) The NPV will be positive if the IRR is less than the cost of capital.

B) The IRR can be positive even if the NPV is negative.

C) When the IRR is equal to the cost of capital, the NPV equals zero.

Question #11 of 165

Question ID: 414751

When calculating the weighted average cost of capital (WACC) an adjustment is made for taxes because:

A) equity is risky.

B) the interest on debt is tax deductible.

C) equity earns higher return than debt.

Question #12 of 165

Question ID: 485786

An analyst gathered the following information for ABC Company, which has a target capital structure of 70% common equity and 30% debt:

Dividend yield	3.50%
Expected market return	9.00%
Risk-free rate	4.00%
Tax rate	40%
Beta	0.90
Bond yield-to-maturity	8.00%

ABC's weighted-average cost of capital is *closest to*:

A) 6.9%.

B) 7.4%.

C) 8.4%.

Question #13 of 165

Question ID: 414767

Levenworth Industries has the following capital structure on December 31, 2006:

	Book Value	Market Value
Debt outstanding	$8 million	$10.5 million
Preferred stock outstanding	$2 million	$1.5 million
Common stock outstanding	$10 million	$13.7 million
Total capital	$20 million	$25.7 million

What is the firm's target debt and preferred stock portion of the capital structure based on existing capital structure?

	Debt	Preferred Stock
A)	0.40	0.10
B)	0.41	0.10
C)	0.41	0.06

Question #14 of 165

Question ID: 683886

Risks that may arise from ineffective corporate governance *least likely* include:

A) reduced default risk.

B) less effective decision making.

C) weaker financial performance.

Question #15 of 165

Question ID: 414812

Meredith Suresh, an analyst with Torch Electric, is evaluating two capital projects. Project 1 has an initial cost of $200,000 and is expected to produce cash flows of $55,000 per year for the next eight years. Project 2 has an initial cost of $100,000 and is expected to produce cash flows of $40,000 per year for the next four years. Both projects should be financed at Torch's weighted average cost of capital. Torch's current stock price is $40 per share, and next year's expected dividend is $1.80. The firm's growth rate is 5%, the current tax rate is 30%, and the pre-tax cost of debt is 8%. Torch has a target capital structure of 50% equity and 50% debt. If Torch takes on either project, it will need to be financed with externally generated equity which has flotation costs of 4%.

Suresh is aware that there are two common methods for accounting for flotation costs. The first method, commonly used in textbooks, is to incorporate flotation costs directly into the cost of equity. The second, and more correct approach, is to subtract the dollar value of the flotation costs from the project NPV. If Suresh uses the cost of equity adjustment approach to account for flotation costs rather than the correct cash flow adjustment approach, will the NPV for each project be overstated or understated?

	Project 1 NPV	Project 2 NPV
A)	Understated	Overstated
B)	Understated	Understated
C)	Overstated	Overstated

Question #16 of 165

Question ID: 414743

Polington Aircraft Co. just announced a sale of 30 aircraft to Cuba, a project with a net present value of $10 million. Investors did not anticipate the sale because government approval to sell to Cuba had never before been granted. The share price of Polington should:

A) increase by the project NPV divided by the number of common shares outstanding.

B) increase by the NPV × (1 - corporate tax rate) divided by the number of common shares outstanding.

C) not necessarily change because new contract announcements are made all the time.

Question #17 of 165

Question ID: 460667

To finance a proposed project, Youngham Corporation would need to issue £25 million in common equity. Youngham would receive £23 million in net proceeds from the equity issuance. When analyzing the project, analysts at Youngham should:

A) add the £2 million flotation cost to the project's initial cash outflow.

B) increase the cost of equity capital to account for the 8% flotation cost.

C) not consider the flotation cost because it is a sunk cost.

Question #18 of 165

Question ID: 414768

The marginal cost of capital is:

A) equal to the firm's weighted cost of funds.

B) tied solely to the specific source of financing.

C) the cost of the last dollar raised by the firm.

Question #19 of 165

Question ID: 414703

Rosalie Woischke is an executive with ColaCo, a nationally known beverage company. Woischke is trying to determine the firm's optimal capital budget. First, Woischke is analyzing projects Sparkle and Fizz. She has determined that both Sparkle and Fizz are profitable and is planning on having ColaCo accept both projects. Woischke is particularly excited about Sparkle because if Sparkle is profitable over the next year, ColaCo will have the opportunity to decide whether or not to invest in a third project, Bubble. Which of the following terms *best* describes the type of projects represented by Sparkle and Fizz as well as the opportunity to invest in Bubble?

	Sparkle and Fizz	Opportunity to invest in Bubble
A)	Independent projects	Project sequencing
B)	Mutually exclusive projects	Project sequencing
C)	Independent projects	Add-on project

Question #20 of 165

Question ID: 414758

A firm has $100 in equity and $300 in debt. The firm recently issued bonds at the market required rate of 9%. The firm's beta is 1.125, the risk-free rate is 6%, and the expected return in the market is 14%. Assume the firm is at their optimal capital structure and the firm's tax rate is 40%. What is the firm's weighted average cost of capital (WACC)?

A) 5.4%.

B) 8.6%.

C) 7.8%.

Question #21 of 165

Question ID: 414745

Assume a firm uses a constant WACC to select investment projects rather than adjusting the projects for risk. If so, the firm will tend to:

A) reject profitable, low-risk projects and accept unprofitable, high-risk projects.

B) accept profitable, low-risk projects and reject unprofitable, high-risk projects.

C) accept profitable, low-risk projects and accept unprofitable, high-risk projects.

Question #22 of 165

Question ID: 414727

The underlying cause of ranking conflicts between the net present value (NPV) and internal rate of return (IRR) methods is the underlying assumption related to the:

A) initial cost.

B) cash flow timing.

C) reinvestment rate.

Question #23 of 165

Question ID: 414793

The following information applies to a corporation:

- The company has $200 million of equity and $100 million of debt.
- The company recently issued bonds at 9%.
- The corporate tax rate is 30%.
- The company's beta is 1.125.

If the risk-free rate is 6% and the expected return on the market portfolio is 14%, the company's after-tax weighted average cost of capital is *closest to*:

A) 12.1%.

B) 11.2%.

C) 10.5%.

Question #24 of 165

Question ID: 500869

One of the primary limitations of using beta in calculating the cost of equity in a developing country is:

A) beta does not capture inflation risk.

B) beta does not capture country risk.

C) the market portfolio in developing countries is often not well diversified.

Question #25 of 165

Question ID: 434335

A publicly traded company has a beta of 1.2, a debt/equity ratio of 1.5, ROE of 8.1%, and a marginal tax rate of 40%. The unlevered beta for this company is *closest to*:

A) 1.071.

B) 0.832.

C) 0.632.

Question #26 of 165

Question ID: 683880

A conflict of interest between corporate stakeholders is *least likely* to be mitigated by:

A) issuing stock dividends.

B) including stock options as part of manager compensation.

C) covenants in debt indentures.

Question #27 of 165

Question ID: 434331

A company has a target capital structure of 40% debt and 60% equity. The company is a constant growth firm that just paid a dividend of $2.00, sells for $27.00 per share, and has a growth rate of 8%.

- The company's bonds pay 10% coupon (semi-annual payout), mature in 20 years, and sell for $849.54.
- The company's stock beta is 1.2.
- The company's marginal tax rate is 40%.
- The risk-free rate is 10%.
- The market risk premium is 5%.

The cost of equity using the capital asset pricing model (CAPM) approach and the discounted cash flow approach is:

	CAPM	Discounted cash flow
A)	16.0%	16.0%
B)	16.0%	15.4%
C)	16.6%	15.4%

Question #28 of 165

Question ID: 414766

Carlos Rodriquez, CFA, and Regine Davis, CFA, were recently discussing the relationships between capital structure, capital budgets, and net present value (NPV) analysis. Which of the following comments made by these two individuals is *least* accurate?

A) "The optimal capital budget is determined by the intersection of a firm's marginal cost of capital curve and its investment opportunity schedule."

B) "For projects with more risk than the average firm project, NPV computations should be based on the marginal cost of capital instead of the weighted average cost of capital."

C) "A break point occurs at a level of capital expenditure where one of the component costs of capital increases."

Question #29 of 165

Question ID: 414769

Enamel Manufacturing (EM) is considering investing in a new vehicle. EM finances new projects using retained earnings and bank loans. This new vehicle is expected to have the same level of risk as the typical investment made by EM. Which one of the following should the firm use in making its decision?

A) Cost of retained earnings.

B) After-tax cost of debt.

C) Marginal cost of capital.

Question #30 of 165

Question ID: 414792

If central bank actions caused the risk-free rate to increase, what is the *most* likely change to cost of debt and equity capital?

A) Both decrease.

B) One increase and one decrease.

C) Both increase.

Question #31 of 165

Question ID: 414735

Which of the following statements regarding the internal rate of return (IRR) is *most* accurate? The IRR:

A) can lead to multiple IRR rates if the cash flows extend past the payback period.

B) assumes that the reinvestment rate of the cash flows is the cost of capital.

C) and the net present value (NPV) method lead to the same accept/reject decision for independent projects.

Question #32 of 165

Question ID: 683876

A principal-agent relationship *most likely* exists between a company's:

A) shareholders and managers.

B) customers and suppliers.

C) directors and regulators.

Question #33 of 165

Question ID: 414810

Which of the following is used to illustrate a firm's weighted average cost of capital (WACC) at different levels of capital?

A) Marginal cost of capital schedule.

B) Cost of capital component schedule.

C) Schedule of marginal capital break points.

Question #34 of 165

Question ID: 434326

An analyst has gathered the following data about a company with a 12% cost of capital:

	Project P	*Project Q*
Cost	$15,000	$25,000
Life	5 years	5 years
Cash inflows	$5,000/year	$7,500/year

If the projects are independent, what should the company do?

A) Reject both Project P and Project Q.

B) Accept both Project P and Project Q.

C) Accept Project P and reject Project Q.

Question #35 of 165

Question ID: 414710

Landen, Inc. uses several methods to evaluate capital projects. An appropriate decision rule for Landen would be to invest in a project if it has a positive:

A) net present value (NPV).

B) internal rate of return (IRR).

C) profitability index (PI).

Question #36 of 165

Question ID: 414717

Tapley Acquisition, Inc., is considering the purchase of Tangent Company. The acquisition would require an initial investment of $190,000, but Tapley's after-tax net cash flows would increase by $30,000 per year and remain at this new level forever. Assume a cost of capital of 15%. Should Tapley buy Tangent?

A) Yes, because the NPV = $10,000.

B) No, because k > IRR.

C) Yes, because the NPV = $30,000.

Question #37 of 165

Question ID: 414718

A firm is reviewing an investment opportunity that requires an initial cash outlay of $336,875 and promises to return the following irregular payments:

> Year 1: $100,000
> Year 2: $82,000
> Year 3: $76,000
> Year 4: $111,000
> Year 5: $142,000

If the required rate of return for the firm is 8%, what is the net present value of the investment? (You'll need to use your financial calculator.)

A) $64,582.

B) $99,860.

C) $86,133.

Question #38 of 165

Question ID: 414730

Which of the following statements about the internal rate of return (IRR) and net present value (NPV) is *least* accurate?

A) The IRR is the discount rate that equates the present value of the cash inflows with the present value of the outflows.

B) For mutually exclusive projects, if the NPV rankings and the IRR rankings give conflicting signals, you should select the project with the higher IRR.

C) The discount rate that causes the project's NPV to be equal to zero is the project's IRR.

Question #39 of 165

Question ID: 414779

Which of the following is *least likely* to be useful to an analyst when estimating the cost of raising capital through the issuance of non-callable, nonconvertible preferred stock?

A) The firm's corporate tax rate.

B) The stated par value of the preferred issue.

C) The preferred stock's dividend rate.

Question #40 of 165

Question ID: 414781

Justin Lopez, CFA, is the Chief Financial Officer of Waterbury Corporation. Lopez has just been informed that the U.S. Internal Revenue Code may be revised such that the maximum marginal corporate tax rate will be increased. Since Waterbury's taxable income is routinely in the highest marginal tax bracket, Lopez is concerned about the potential impact of the proposed change. Assuming that Waterbury maintains its target capital structure, which of the following is *least likely* to be affected by the proposed tax change?

A) Waterbury's after-tax cost of corporate debt.

B) Waterbury's after-tax cost of noncallable, nonconvertible preferred stock.

C) Waterbury's return on equity (ROE).

Question #41 of 165

Question ID: 414786

The cost of preferred stock is equal to the preferred stock dividend:

A) multiplied by the market price.

B) divided by the market price.

C) divided by its par value.

Question #42 of 165

Question ID: 460665

The Garden and Home Store recently issued preferred stock paying $2 annual dividends. The price of its preferred stock is $20. The after-tax cost of fixed-rate debt capital is 6% and the cost of common stock equity is 12%. The cost of preferred stock is *closest to*:

A) 10%.

B) 11%.

C) 9%.

Question #43 of 165

Question ID: 414805

Arlington Machinery currently has assets on its balance sheet of $300 million that is financed with 70% equity and 30% debt. The executive management team at Arlington is considering a major expansion that would require raising additional capital. Jeffery Marian, an analyst with Arlington Machinery, has put together the following schedule for the costs of debt and equity:

Amount of New Debt (in millions)	*After-tax Cost of Debt*	*Amount of New Equity (in millions)*	*Cost of Equity*
$0 to $49	4.0%	$0 to $99	7.0%

$50 to $99	4.2%	$100 to $199	8.0%
$100 to $149	4.5%	$200 to $299	9.0%

In a presentation to Arlington's executive management team, Marian makes the following statements:

Statement 1: If we maintain our target capital structure of 70% equity and 30% debt, the breakpoint at which our cost of equity will increase to 9.0% is approximately $286 million in new capital.

Statement 2: If we want to finance total assets of $600 million, our weighted average cost of capital (WACC) for the additional financing needed will be 7.56%.

Marian's statements are:

	Statement 1	Statement 2
A)	Incorrect	Incorrect
B)	Correct	Incorrect
C)	Correct	Correct

Question #44 of 165

Question ID: 414704

The Chief Financial Officer of Large Closeouts Inc. (LCI) determines that the firm must engage in capital rationing for its capital budgeting projects. Which of the following describes the *most likely* reason for LCI to use capital rationing? LCI:

A) would like to arrange projects so that investing in a project today provides the option to accept or reject certain future projects.

B) has a limited amount of funds to invest.

C) must choose between projects that compete with one another.

Question #45 of 165

Question ID: 414794

A company's outstanding 20-year, annual-pay 6% coupon bonds are selling for $894. At a tax rate of 40%, the company's after-tax cost of debt capital is *closest* to:

A) 5.1%

B) 4.2%.

C) 7.0%

Question #46 of 165

Question ID: 414698

Ashlyn Lutz makes the following statements to her supervisor, Paul Ulring, regarding the basic principles of capital budgeting:

Statement 1: The timing of expected cash flows is crucial for determining the profitability of a capital budgeting project.

Statement 2: Capital budgeting decisions should be based on the after-tax net income produced by the capital project.

Which of the following regarding Lutz's statements is *most* accurate?

	Statement 1	Statement 2
A)	Correct	Incorrect
B)	Correct	Correct
C)	Incorrect	Correct

Question #47 of 165

Question ID: 414752

An analyst gathered the following data about a company:

Capital Structure	*Required Rate of Return*
30% debt	10% for debt
20% preferred stock	11% for preferred stock
50% common stock	18% for common stock

Assuming a 40% tax rate, what after-tax rate of return must the company earn on its investments?

A) 13.0%.

B) 10.0%.

C) 14.2%.

Question #48 of 165

Question ID: 414748

Which of the following events will *reduce* a company's weighted average cost of capital (WACC)?

A) A reduction in the company's bond rating.

B) A reduction in the market risk premium.

C) An increase in expected inflation.

Question #49 of 165

Question ID: 683872

The stakeholders of a company that prefer a relatively riskier company strategy that has the potential for superior company performance are:

A) creditors.

B) suppliers.

C) shareholders.

Question #50 of 165

Question ID: 414777

The debt of Savanna Equipment, Inc. has an average maturity of ten years and a BBB rating. A market yield to maturity is not available because the debt is not publicly traded, but the market yield on debt with similar characteristics is 8.33%. Savanna is planning to issue new ten-year notes that would be subordinate to the firm's existing debt. The company's marginal tax rate is 40%. The *most* appropriate estimate of the after-tax cost of this new debt is:

A) Between 3.3% and 5.0%.

B) 5.0%.

C) More than 5.0%.

Question #51 of 165

Question ID: 487759

A company primarily engaged in the production of cement has the following characteristics:

- Beta = 0.8.
- Market value debt = $180 million.
- Market value equity = $540 million.
- Effective tax rate = 25%.
- Marginal tax rate = 34%.

The asset beta that should be used by a company considering entering into cement production is *closest to*:

A) 0.725.

B) 0.656.

C) 0.640.

Question #52 of 165

Question ID: 414719

A company is considering the purchase of a copier that costs $5,000. Assume a cost of capital of 10 percent and the following cash flow schedule:

- Year 1: $3,000
- Year 2: $2,000
- Year 3: $2,000

Determine the project's payback period and discounted payback period.

	Payback Period	Discounted Payback Period
A)	2.0 years	1.6 years
B)	2.0 years	2.4 years
C)	2.4 years	1.6 years

Question #53 of 165

Question ID: 414712

A company is considering the purchase of a copier that costs $5,000. Assume a cost of capital of 10 percent and the following cash flow schedule:

- Year 1: $3,000
- Year 2: $2,000
- Year 3: $2,000

Determine the project's NPV and IRR.

	NPV	IRR
A)	$243	20%
B)	$883	20%
C)	$883	15%

Question #54 of 165

Question ID: 414761

At a recent Haggerty Semiconductors Board of Directors meeting, Merle Haggerty was asked to discuss the topic of the company's weighted average cost of capital (WACC).

At the meeting Haggerty made the following statements about the company's WACC:

Statement 1: A company creates value by producing a higher return on its assets than the cost of financing those assets. As such, the WACC is the cost of financing a firm's assets and can be viewed as the firm's opportunity cost of financing its assets.

Statement 2: Since a firm's WACC reflects the average risk of the projects that make up the firm, it is not appropriate for evaluating all new projects. It should be adjusted upward for projects with greater-than-average risk and downward for projects with less-than-average risk.

Are Statement 1 and Statement 2, as made by Haggerty CORRECT?

	Statement 1	Statement 2
A)	Correct	Correct
B)	Incorrect	Correct
C)	Correct	Incorrect

Question #55 of 165

Question ID: 414725

Which of the following projects would have multiple internal rates of return (IRRs)? The cost of capital for all projects is 9.75%.

Cash Flows	*Blackjack*	*Roulette*	*Keno*
T_0	-10,000	-12,000	-8,000
T_1	10,000	7,000	4,000
T_2	15,000	2,000	0
T_3	-10,000	2,000	6,000

A) Projects Roulette and Keno.

B) Projects Blackjack and Keno.

C) Project Blackjack only.

Question #56 of 165

Question ID: 414711

Which of the following statements about the payback period is NOT correct?

A) The payback period is the number of years it takes to recover the original cost of the investment.

B) The payback method considers all cash flows throughout the entire life of a project.

C) The payback period provides a rough measure of a project's liquidity and risk.

Question #57 of 165

Question ID: 683883

A company director's duty of loyalty is *most accurately* described as requiring a director to:

A) perform his or her duties in good faith and with due diligence.

B) carry out the duties assigned by the managers of the company.

C) act in the interests of the company and its shareholders.

Question #58 of 165

Question ID: 414750

Helmut Humm, manager at a large U.S. firm, has just been assigned to the capital budgeting area to replace a person who left suddenly. One of Humm's first tasks is to calculate the company's weighted average cost of capital (WACC) - and fast! The CEO is scheduled to present to the board in half an hour and needs the WACC - now! Luckily, Humm finds clear notes on the target capital component weights. Unfortunately, all he can find for the cost of capital components is some handwritten notes. He can make out the numbers, but not the corresponding capital component. As time runs out, he has to guess.

Here is what Humm deciphered:

- Target weights: w_d = 30%, w_{ps} = 20%, w_{ce} = 50%, where w_d, w_{ps}, and w_{ce} are the weights used for debt, preferred stock, and common equity.
- Cost of components (in no particular order): 6.0%, 15.0%, and 8.5%.
- The cost of debt is the after-tax cost.

If Humm guesses correctly, the WACC is:

A) 9.2%.

B) 9.0%.

C) 11.0%.

Question #59 of 165

Question ID: 434337

The before-tax cost of debt for Hardcastle Industries, Inc. is currently 8.0%, but it will increase to 8.25% when debt levels reach $600 million. The debt-to-total assets ratio for Hardcastle is 40% and its capital structure is composed of debt and common equity only. If Hardcastle changes its target capital structure to 50% debt / 50% equity, which of the following describes the effect on the level of new investment at which the cost of debt will increase? The level will:

A) change, but can either increase or decrease.

B) increase.

C) decrease.

Question #60 of 165

Question ID: 460661

A firm is evaluating two mutually exclusive projects of the same risk class, Project X and Project Y. Both have the same initial cash outlay and both have positive NPVs. Which of the following is a sufficient reason to choose Project X over Project Y?

A) Project Y has a lower internal rate of return than Project X.

B) Project Y has a lower profitability index than Project X.

C) Project X has both a shorter payback period and a shorter discounted payback period compared to Project Y.

Question #61 of 165

Question ID: 414771

Which of the following statements is *least* accurate regarding the marginal cost of capital's role in determining the net present value (NPV) of a project?

A) Projects for which the present value of the after-tax cash inflows is greater than the present value of the after-tax cash outflows should be undertaken by the firm.

B) When using a firm's marginal cost of capital to evaluate a specific project, there is an implicit assumption that the capital structure of the firm will remain at the target capital structure over the life of the project.

C) The NPVs of potential projects of above-average risk should be calculated using the marginal cost of capital for the firm.

Question #62 of 165

Question ID: 414802

In order to more accurately estimate the cost of equity for a company situated in a developing market, an analyst should:

A) use the yield on the sovereign debt of the developing country instead of the risk free rate when using the capital asset pricing model (CAPM).

B) add a country risk premium to the risk-free rate when using the capital asset pricing model (CAPM).

C) add a country risk premium to the market risk premium when using the capital asset pricing model (CAPM).

Question #63 of 165

Question ID: 414772

Which of the following statements about the role of the marginal cost of capital in determining the net present value of a project is *most* accurate? The marginal cost of capital should be used to discount the cash flows:

A) if the firm's capital structure is expected to change during the project's life.

B) of all projects the firm is considering.

C) for potential projects that have a level of risk near that of the firm's average project.

Question #64 of 165

Question ID: 414734

If the calculated net present value (NPV) is negative, which of the following must be CORRECT. The discount rate used is:

A) greater than the internal rate of return (IRR).

B) less than the internal rate of return (IRR).

C) equal to the internal rate of return (IRR).

Question #65 of 165

Question ID: 414720

Edelman Enginenering is considering including an overhead pulley system in this year's capital budget. The cash outlay for the pully system is $22,430. The firm's cost of capital is 14%. After-tax cash flows, including depreciation are $7,500 for each of the next 5 years.

Calculate the internal rate of return (IRR) and the net present value (NPV) for the project, and indicate the correct accept/reject decision.

	NPV	IRR	Accept/Reject
A)	$15,070	14%	Reject
B)	$3,318	20%	Accept
C)	$15,070	14%	Accept

Question #66 of 165

Question ID: 414811

The *most* accurate way to account for flotation costs when issuing new equity to finance a project is to:

A) increase the cost of equity capital by dividing it by (1 - flotation cost).

B) adjust cash flows in the computation of the project NPV by the dollar amount of the flotation costs.

C) increase the cost of equity capital by multiplying it by (1 + flotation cost).

Question #67 of 165

Question ID: 414715

Which of the following statements about NPV and IRR is *least* accurate?

A) For independent projects if the IRR is > the cost of capital accept the project.

B) The NPV method assumes that all cash flows are reinvested at the cost of capital.

C) For mutually exclusive projects you should use the IRR to rank and select projects.

Question #68 of 165

Question ID: 485788

The following is a schedule of Tiger Company's new debt and equity capital costs ($ millions):

Amount of New Debt	After-tax Cost of Debt	Amount of New Equity	Cost of Equity
< $30	3.5%	< $60	8.5%
$30 - $60	4.0%	$60 - $90	10.3%
> $60	4.7%	> $90	12.5%

The company has a target capital structure of 30% debt and 70% equity. Tiger needs to raise an additional $135.0 million of capital for a new project while maintaining its target capital structure. The company's second debt break point and its marginal cost of capital (MCC) are *closest to*:

	Debt Break Point #2	MCC
A)	$100 million	8.4%
B)	$200 million	10.0%
C)	$200 million	8.4%

Question #69 of 165

Question ID: 414699

One of the basic principles of capital budgeting is that:

A) cash flows should be analyzed on a pre-tax basis.

B) decisions are based on cash flows, not accounting income.

C) opportunity costs should be excluded from the analysis of a project.

Question #70 of 165

Question ID: 414728

Which of the following statements regarding the net present value (NPV) and internal rate of return (IRR) is *least* accurate?

A) The NPV tells how much the value of the firm will increase if you accept the project.

B) For independent projects, the internal rate of return IRR and the NPV methods always yield the same accept/reject decisions.

C) For mutually exclusive projects, you must accept the project with the highest NPV regardless of the sign of the NPV calculation.

Question #71 of 165

Question ID: 414722

A firm is considering a $5,000 project that will generate an annual cash flow of $1,000 for the next 8 years. The firm has the following financial data:

- Debt/equity ratio is 50%.
- Cost of equity capital is 15%.
- Cost of new debt is 9%.
- Tax rate is 33%.

Determine the project's net present value (NPV) and whether or not to accept it.

	NPV	Accept / Reject
A)	+$4,968	Accept
B)	-$33	Reject
C)	+$33	Accept

Question #72 of 165

Question ID: 414738

Which of the following projects would *most likely* have multiple internal rates of return (IRRs)? The cost of capital for all projects is 10.0%.

Cash Flows	*South*	*East*	*West*
CF_0	-15,000	-12,000	-8,000
CF_1	10,000	7,000	4,000
CF_2	-1,000	2,000	0
CF_3	15,000	2,000	6,000

A) Projects East and West.

B) Project South only.

C) Projects South and West.

Question #73 of 165

Question ID: 414807

A North American investment society held a panel discussion on the topics of capital costs and capital budgeting. Which of the following comments made during this discussion is the *least* accurate?

A) Any given project's NPV will decline when a breakpoint is reached.

B) An increase in the after-tax cost of debt may occur at a break point.

C) A project's internal rate of return decreases when a breakpoint is reached.

Question #74 of 165

Question ID: 414705

Project sequencing is *best* described as:

A) arranging projects in an order such that cash flows from the first project fund subsequent projects.

B) an investment in a project today that creates the opportunity to invest in other projects in the future.

C) prioritizing funds to achieve the maximum value for shareholders, given capital limitations.

Question #75 of 165

Question ID: 414706

The Seattle Corporation has been presented with an investment opportunity which will yield cash flows of $30,000 per year in years 1 through 4, $35,000 per year in years 5 through 9, and $40,000 in year 10. This investment will cost the firm $150,000 today, and the firm's cost of capital is 10%. The payback period for this investment is *closest* to:

A) 5.23 years.

B) 6.12 years.

C) 4.86 years.

Question #76 of 165

Question ID: 683869

The interests of community groups affected by a company's operations are *most likely* to be considered in corporate governance under:

A) stakeholder theory.

B) special interest theory.

C) shareholder theory.

Question #77 of 165

Question ID: 414755

Assume that a company has equal amounts of debt, common stock, and preferred stock. An increase in the corporate tax rate of a firm will cause its weighted average cost of capital (WACC) to:

A) fall.

B) rise.

C) more information is needed.

Question #78 of 165

Question ID: 414783

Axle Corporation earned £3.00 per share and paid a dividend of £2.40 on its common stock last year. Its common stock is trading at £40 per share. Axle is expected to have a return on equity of 15%, an effective tax rate of 34%, and to maintain its historic payout ratio going forward. In estimating Axle's after-tax cost of capital, an analyst's estimate of Axle's cost of common equity would be *closest* to:

A) 8.8%.

B) 9.2%.

C) 9.0%.

Question #79 of 165

Question ID: 460663

Elenore Rice, CFA, is asked to determine the appropriate weighted average cost of capital for Samson Brick Company. Rice is provided with the following data:

- Debt outstanding, market value $10 million
- Common stock outstanding, market value $30 million
- Marginal tax rate 40%
- Cost of common equity 12%
- Cost of debt 8%

Samson has no preferred stock. Assuming Samson's ratios reflect the firm's target capital structure, Samson's weighted average cost of capital is *closest to*:

A) 9.8%.

B) 10.4%.

C) 10.2%.

Question #80 of 165

Question ID: 683878

In the context of stakeholder management, organizational infrastructure is *most accurately* described as:

A) a framework for defining the rights and responsibilities of stakeholders.

B) contractual arrangements a company enters into with its stakeholders.

C) a company's internal procedures for addressing stakeholder relationships.

Question #81 of 165

Question ID: 683884

With a one-tier board structure:

A) senior managers determine corporate strategy.

B) independent directors determine company strategy.

C) both executives and non-executives can serve on the board of directors.

Question #82 of 165

Question ID: 683877

The relationship between a company's shareholders and its senior managers is *best* described as a(n):

A) agency relationship.

B) working partnership.

C) principal relationship.

Question #83 of 165

Question ID: 434336

Affluence Inc. is considering whether to expand its recreational sports division by embarking on a new project. Affluence's capital structure consists of 75% debt and 25% equity and its marginal tax rate is 30%. Aspire Brands is a publicly traded firm that specializes in recreational sports products. Aspire has a debt-to-equity ratio of 1.7, a beta of 0.8, and a marginal tax rate of 35%. Using the pure-play method with Aspire as the comparable firm, the project beta Affluence should use to calculate the cost of equity capital for this project is *closest to*:

A) 0.38.

B) 0.58.

C) 1.18.

Question #84 of 165

Question ID: 414697

Financing costs for a capital project are:

A) subtracted from the net present value of a project.

B) captured in the project's required rate of return.

C) subtracted from estimates of a project's future cash flows.

Question #85 of 165

Question ID: 485785

A company is considering two mutually exclusive investment projects. The firm's cost of capital is 12%. Each project costs $7 million and the after-tax cash flows for each are as follows:

	Project One	Project Two
Year 1	$6.6 million	$3.0 million
Year 2	$1.5 million	$3.0 million
Year 3	$0.1 million	$3.0 million

Indicate which project should be accepted and whether the IRR and NPV methods would lead to the same decision.

	Project accepted?	Same decision?
A)	Project One	No
B)	Project Two	No
C)	Project Two	Yes

Question #86 of 165

Question ID: 414746

In calculating the weighted average cost of capital (WACC), which of the following statements is *least accurate*?

A) The cost of debt is equal to one minus the marginal tax rate multiplied by the coupon rate on outstanding debt.

B) Different methods for estimating the cost of common equity might produce different results.

C) The cost of preferred equity capital is the preferred dividend divided by the price of preferred shares.

Question #87 of 165

Question ID: 414707

The process of evaluating and selecting profitable long-term investments consistent with the firm's goal of shareholder wealth maximization is known as:

A) monitoring.

B) capital budgeting.

C) financial restructuring.

Question #88 of 165

Question ID: 414701

The CFO of Axis Manufacturing is evaluating the introduction of a new product. The costs of a recently completed marketing study for the new product and the possible increase in the sales of a related product made by Axis are best described (respectively) as:

A) externality; cannibalization.

B) sunk cost; externality.

C) opportunity cost; externality.

Question #89 of 165

Question ID: 414733

When a company is evaluating two mutually exclusive projects that are both profitable but have conflicting NPV and IRR project rankings, the company should:

A) use a third method of evaluation such as discounted payback period.

B) accept the project with the higher internal rate of return.

C) accept the project with the higher net present value.

Question #90 of 165

Question ID: 414729

Apple Industries, a firm with unlimited funds, is evaluating five projects. Projects A and B are independent and Projects C, D, and E are mutually exclusive. The projects are listed with their rate of return and NPV. Assume that the applicable discount rate is 10%.

Project	*Status*	*Rate of Return*	*Net Present Value*
A	Independent	14%	$10,500
B	Independent	12%	$13,400
C	Mutually Exclusive	11%	$16,000
D	Mutually Exclusive	15%	$14,000
E	Mutually Exclusive	12%	$11,500

Rank the projects the firm should select.

A) Project A, Project B, and Project C.

B) All projects should be selected.

C) Project A, Project B, and Project D.

Question #91 of 165

Question ID: 434338

Cullen Casket Company is considering a project that requires a $175,000 cash outlay and is expected to produce cash flows of $65,000 per year for the next four years. Cullen's tax rate is 40% and the before-tax cost of debt is 9%. The current share price for Cullen stock is $32 per share and the expected dividend next year is $1.50 per share. Cullen's expected growth rate is 5%. Cullen finances the project with 70% newly issued equity and 30% debt, and the flotation costs for equity are 4.5%. What is the dollar amount of the flotation costs attributable to the project, and that is the NPV for the project, assuming that flotation costs are accounted for correctly?

	Dollar amount of floatation costs	NPV of project
A)	$7,875	$30,510
B)	$5,513	$30,510
C)	$5,513	$32,872

Question #92 of 165

Question ID: 414782

Which of the following statements is *most* accurate regarding a firm's cost of preferred shares? A firm's cost of preferred stock is:

A) the dividend yield on the firm's newly-issued preferred stock.

B) approximately equal to the market price of the firm's debt as a percentage of the market price of its common shares.

C) the market price of the preferred shares as a percentage of its issuance price.

Question #93 of 165

Question ID: 414790

A firm has $3 million in outstanding 10-year bonds, with a fixed rate of 8% (assume annual payments). The bonds trade at a price of $92 per $100 par in the open market. The firm's marginal tax rate is 35%. What is the after-tax component cost of debt to be used in the weighted average cost of capital (WACC) calculations?

A) 6.02%.

B) 9.26%.

C) 5.40%.

Question #94 of 165

Question ID: 460664

Hanson Aluminum, Inc. is considering whether to build a mill based around a new rolling technology the company has been developing. Management views this project as being riskier than the average project the company undertakes. Based on their analysis of the projected cash flows, management determines that the project's internal rate of return is equal to the company's marginal cost of capital. If the project goes forward, the company will finance it with newly issued debt with an after-tax cost less than the project's IRR. Should management accept or reject this project?

A) Accept, because the marginal cost of the new debt is less than the project's internal rate of return.

B) Accept, because the project returns the company's cost of capital.

C) Reject, because the project reduces the value of the company when its risk is taken into account.

Question #95 of 165

Question ID: 683882

Smith Company's board of directors assigns responsibilities to three committees. The committee that is *most likely* to be responsible for establishing the chief executive officer's compensation package is Smith's:

A) nominations and remuneration committee.

B) audit and governance committee.

C) investment and risk committee.

Question #96 of 165

Question ID: 414731

Two projects being considered by a firm are mutually exclusive and have the following projected cash flows:

Year	*Project 1 Cash Flow*	*Project 2 Cash Flow*
0	−\$4.0	?
1	\$3.0	\$1.7
2	\$5.0	\$3.2
3	\$2.0	\$5.8

The crossover rate of the two projects' NPV profiles is 9%. What is the initial cash flow for Project 2?

A) −\$4.51.

B) −\$5.70.

C) −\$4.22.

Question #97 of 165

Question ID: 683881

Minority shareholder groups are *most likely* to have influence over corporate strategy when board elections:

A) use cumulative voting.

B) are staggered.

C) use majority voting.

Question #98 of 165

Question ID: 414778

Which of the following is *least likely* to be useful to an analyst who is estimating the pretax cost of a firm's fixed-rate debt?

A) Seniority and any special covenants of the firm's anticipated debt.

B) The coupon rate on the firm's existing debt.

C) The yield to maturity of the firm's existing debt.

Question #99 of 165

Question ID: 414760

Which of the following choices *best* describes the role of taxes on the after-tax cost of capital in the U.S. from the different capital sources?

	Common equity	Preferred equity	Debt
A)	No effect	Decrease	Decrease
B)	Decrease	Decrease	No effect
C)	No effect	No effect	Decrease

Question #100 of 165

Question ID: 414744

A company is planning a $50 million expansion. The expansion is to be financed by selling $20 million in new debt and $30 million in new common stock. The before-tax required return on debt is 9% and the required return for equity is 14%. If the company is in the 40% tax bracket, the marginal weighted average cost of capital is *closest* to:

A) 9.0%.

B) 10.0%

C) 10.6%.

Question #101 of 165

Question ID: 434332

Genoa Corp. pays 40% of its earnings out in dividends. The return on equity (ROE) is 15%. Last year's earnings were $5.00 per share and the dividend was just paid to shareholders. The current price of shares is $42.00. The firm's tax rate is 30%. The cost of common equity is *closest* to:

A) 14.2%.

B) 16.1%.

C) 13.8%.

Question #102 of 165

Question ID: 414716

As the director of capital budgeting for Denver Corporation, an analyst is evaluating two mutually exclusive projects with the following net cash flows:

Year	*Project X*	*Project Z*
0	-$100,000	-$100,000
1	$50,000	$10,000
2	$40,000	$30,000
3	$30,000	$40,000
4	$10,000	$60,000

If Denver's cost of capital is 15%, which project should be chosen?

A) Neither project.

B) Project X, since it has the higher IRR.

C) Project X, since it has the higher net present value (NPV).

Question #103 of 165

Question ID: 414739

The NPV profile is a graphical representation of the change in net present value relative to a change in the:

A) internal rate of return.

B) discount rate.

C) prime rate.

Question #104 of 165

Question ID: 414762

A financial analyst is estimating the effect on the cost of capital for a company of a decrease in the marginal tax rate. The company is financed with debt and common equity. A decrease in the firm's marginal tax rate would:

A) decrease the cost of capital because of a lower after-tax cost of debt and equity.

B) increase the cost of capital because of a higher after-tax cost of debt and equity.

C) increase the cost of capital because of a higher after-tax cost of debt.

Question #105 of 165

Question ID: 434328

A company has a target capital structure of 40% debt and 60% equity. The company is a constant growth firm that just paid a dividend of $2.00, sells for $27.00 per share, and has a growth rate of 8%.

- The company's bonds pay 10% coupon (semi-annual payout), mature in 20 years, and sell for $849.54.
- The company's stock beta is 1.2.
- The company's marginal tax rate is 40%.
- The risk-free rate is 10%.
- The market risk premium is 5%.

The company's after-tax cost of debt is:

A) 4.8%.

B) 12.0%.

C) 7.2%.

Question #106 of 165

Question ID: 414808

BPM Ltd. has the following capital structure: 40% debt and 60% equity. The cost of equity is 16%. Its before tax cost of debt is 8%, and its corporate tax rate is 40%. BPM is considering between two mutually exclusive projects that have the following cash flows:

	Today	*Year 1*	*Year 2*	*Year 3*
Project X	Cost = 100 million	+ 50 million	+ 30 million	+ 50 million
Project Y	Cost = 150 million	+ 50 million	+ 60 million	+ 80 million

Which project should BPM choose?

A) Project X because its NPV is $5 million.

B) Project Y because its NPV is $22 million.

C) Project X because its NPV is $16 million.

Question #107 of 165

Question ID: 414784

A $100 par, 8% preferred stock is currently selling for $80. What is the cost of preferred equity?

A) 10.8%.

B) 10.0%.

C) 8.0%.

Question #108 of 165

Question ID: 683874

Which of the following stakeholders are *most likely* to benefit from a company's growth and excellent financial performance?

A) Creditors.

B) Customers.

C) Governments.

Question #109 of 165

Question ID: 496831

A company is considering a $10,000 project that will last 5 years.

- Annual after tax cash flows are expected to be $3,000
- Cost of capital = 9.7%

What is the project's net present value (NPV)?

A) +$1,460.

B) +$11,460.

C) -$1,460.

Question #110 of 165

Question ID: 414749

The following data is regarding the Link Company:

- A target debt/equity ratio of 0.5
- Bonds are currently yielding 10%
- Link is a constant growth firm that just paid a dividend of $3.00
- Stock sells for $31.50 per share, and has a growth rate of 5%
- Marginal tax rate is 40%

What is Link's after-tax cost of capital?

A) 10.5%.

B) 12.5%.

C) 12.0%.

Question #111 of 165

Question ID: 460657

The greatest amount of detailed capital budgeting analysis is typically required when deciding whether to:

A) introduce a new product or develop a new market.

B) replace a functioning machine with a newer model to reduce costs.

C) expand production capacity.

Question #112 of 165

Question ID: 460658

The effects that the acceptance of a project may have on other firm cash flows are *best* described as:

A) pure plays.

B) externalities.

C) opportunity costs.

Question #113 of 165

Question ID: 412846

Jack Smith, CFA, is analyzing independent investment projects X and Y. Smith has calculated the net present value (NPV) and internal rate of return (IRR) for each project:

> Project X: NPV = $250; IRR = 15%
>
> Project Y: NPV = $5,000; IRR = 8%

Smith should make which of the following recommendations concerning the two projects?

A) Accept Project X only.

B) Accept both projects.

C) Accept Project Y only.

Question #114 of 165

Question ID: 414736

If a project has a negative cash flow during its life or at the end of its life, the project *most likely* has:

A) more than one internal rate of return.

B) a negative internal rate of return.

C) multiple net present values.

Question #115 of 165

Question ID: 414804

Simcox Financial is considering raising additional capital to finance a takeover of one of the firm's major competitors. Reuben Mellum, an analyst with Simcox, has put together the following schedule of costs related to raising new capital:

Amount of New Debt (in millions)	*After-tax Cost of Debt*	*Amount of New Equity (in millions)*	*Cost of Equity*
$0 to $149	4.2%	$0 to $399	7.5%
$150 to $349	5.0%	$400 to $799	8.5%

Assuming that Simcox has a target debt to equity ratio of 65% equity and 35% debt, what are the marginal cost of capital schedule breakpoints for raising additional debt capital and equity capital, respectively?

	Breakpoint for new debt capital	Breakpoint for new equity capital
A)	$375.0 million	$615.4 million
B)	$428.6 million	$533.3 million
C)	$428.6 million	$615.4 million

Question #116 of 165

Question ID: 683890

Thematic investing is *most accurately* described as:

A) considering a single environmental or social factor when selecting investments.

B) identifying the best companies in each sector with respect to environmental and social factors.

C) excluding companies or sectors from consideration for investment based on environmental and social factors.

Question #117 of 165

Question ID: 414713

A firm is considering a $200,000 project that will last 3 years and has the following financial data:

- Annual after-tax cash flows are expected to be $90,000.
- Target debt/equity ratio is 0.4.

- Cost of equity is 14%.
- Cost of debt is 7%.
- Tax rate is 34%.

Determine the project's payback period and net present value (NPV).

	Payback Period	NPV
A)	2.43 years	$18,716
B)	2.22 years	$18,716
C)	2.22 years	$21,872

Question #118 of 165

Question ID: 414789

A firm has $4 million in outstanding bonds that mature in four years, with a fixed rate of 7.5% (assume annual payments). The bonds trade at a price of $98 in the open market. The firm's marginal tax rate is 35%. Using the bond-yield plus method, what is the firm's cost of equity risk assuming an add-on of 4%?

A) 11.50%.

B) 12.11%.

C) 13.34%.

Question #119 of 165

Question ID: 414700

Mason Webb makes the following statements to his boss, Laine DeWalt about the principles of capital budgeting.

Statement 1: Opportunity costs are not true cash outflows and should not be considered in a capital budgeting analysis.

Statement 2: Cash flows should be analyzed on an after-tax basis.

Should DeWalt agree or disagree with Webb's statements?

	Statement 1	Statement 2
A)	Disagree	Agree
B)	Agree	Agree
C)	Disagree	Disagree

Question #120 of 165

Question ID: 414754

A company has the following capital structure:

- Target weightings: 30% debt, 20% preferred stock, 50% common equity.
- Tax Rate: 35%.
- The firm can issue $1,000 face value, 7% semi-annual coupon debt with a 15-year maturity for a price of $1,047.46.
- A preferred stock issue that pays a dividend of $2.80 has a value of $35 per share.
- The company's growth rate is estimated at 6%.
- The company's common shares have a value of $40 and a dividend in year 0 of D_0 = $3.00.

The company's weighted average cost of capital is *closest* to:

A) 9.84%.

B) 9.28%.

C) 10.53%.

Question #121 of 165

Question ID: 683875

The stakeholders *most likely* to be concerned with their legal liabilities are:

A) regulators.

B) creditors.

C) directors.

Question #122 of 165

Question ID: 414773

A new project is expected to be less risky than the average risk of existing projects. The appropriate discount rate to use when evaluating this project is:

A) the firm's marginal cost of capital.

B) less than the firm's marginal cost of capital.

C) greater than the firm's marginal cost of capital.

Question #123 of 165

Question ID: 414774

Which of the following is *most* accurate regarding the component costs and component weights in a firm's weighted average cost of capital (WACC)?

A) Taxes reduce the cost of debt for firms in countries in which interest payments are tax deductible.

B) The weights in the WACC should be based on the book values of the individual capital components.

C) The appropriate pre-tax cost of a firm's new debt is the average coupon rate on the firm's existing debt.

Question #124 of 165

Question ID: 414696

Which of the following types of capital budgeting projects are *most likely* to generate little to no revenue?

A) New product or market development.

B) Replacement projects to maintain the business.

C) Regulatory projects.

Question #125 of 165

Question ID: 434329

DeSoto Corp. 8% coupon bonds have a yield to maturity of 7.5%. The firm's tax rate is 30%. The after-tax cost of debt is *closest* to:

A) 5.3%.

B) 5.6%.

C) 7.5%.

Question #126 of 165

Question ID: 460662

An analyst gathered the following information about a capital budgeting project:

- The proposed project cost $10,000.
- The project is expected to increase pretax net income and cash flow by $3,000 in each of the next eight years.
- The company has 50% of its capital in equity at a cost of 12%.
- The pretax cost of debt capital is 6%.
- The company's tax rate is 33%.

The project's net present value is *closest to*:

A) $7,240.

B) $6,604.

C) $1,551.

Question #127 of 165

Question ID: 414788

A company has $5 million in debt outstanding with a coupon rate of 12%. Currently the YTM on these bonds is 14%. If the tax rate is 40%, what is the after tax cost of debt?

A) 7.2%.

B) 8.4%.

C) 5.6%.

Question #128 of 165

Question ID: 460659

A single independent project with a negative net present value has an initial cost of $2.5 million and would generate cash inflows of $1 million in each of the next three years. The discount rate the company used when evaluating this project is *closest* to:

A) 9%.

B) 8%.

C) 10%.

Question #129 of 165

Question ID: 434334

Utilitarian Co. is looking to expand its appliances division. It currently has a beta of 0.9, a D/E ratio of 2.5, a marginal tax rate of 30%, and its debt is currently yielding 7%. JF Black, Inc. is a publicly traded appliance firm with a beta of 0.7, a D/E ratio of 3, a marginal tax rate of 40%, and its debt is currently yielding 6.8%. The risk-free rate is currently 5% and the expected return on the market portfolio is 9%. Using this data, calculate Utilitarian's weighted average cost of capital for this potential expansion.

A) 4.2%.

B) 7.1%.

C) 5.7%.

Question #130 of 165

Question ID: 460666

The following information applies to World Turn Company:

- 10% rate of interest on newly issued bonds.
- 7% growth rate in earnings and dividends.
- The last dividend paid was $0.93.
- Shares sell for $16.
- Stock's beta is 1.5.
- Market risk premium is 6%.
- Risk-free rate of interest is 5%.

- The firm is in a 40% marginal tax bracket.

If the appropriate risk premium relative to the bond yield is 4%, World Turn's equity cost of capital using the dividend discount model is *closest to*:

A) 12.8%.

B) 14.0%.

C) 13.2%.

Question #131 of 165

Question ID: 684025

Which of the following statements about corporate governance is most accurate? Corporate governance:

A) best practices are essentially the same in developed economies.

B) is defined in the same way in most countries.

C) may be focused only on shareholder interests.

Question #132 of 165

Question ID: 414732

For a project with cash outflows during its life, the least preferred capital budgeting tool would be:

A) net present value.

B) internal rate of return.

C) profitability index.

Question #133 of 165

Question ID: 414814

Nippon Post Corporation (NPC), a Japanese software development firm, has a capital structure that is comprised of 60% common equity and 40% debt. In order to finance several capital projects, NPC will raise USD1.6 million by issuing common equity and debt in proportion to its current capital structure. The debt will be issued at par with a 9% coupon and flotation costs on the equity issue will be 3.5%. NPC's common stock is currently selling for USD21.40 per share, and its last dividend was USD1.80 and is expected to grow at 7% forever. The company's tax rate is 40%. NPC's WACC based on the cost of new capital is *closest* to:

A) 9.6%.

B) 13.1%.

C) 11.8%.

Question #134 of 165

Question ID: 414753

A company has the following information:

- A target capital structure of 40% debt and 60% equity.
- $1,000 par value bonds pay 10% coupon (semi-annual payments), mature in 20 years, and sell for $849.54.
- The company stock beta is 1.2.
- Risk-free rate is 10%, and market risk premium is 5%.
- The company's marginal tax rate is 40%.

The weighted average cost of capital (WACC) is closest to:

A) 13.5%.

B) 13.0%.

C) 12.5%.

Question #135 of 165

Question ID: 683879

A company's internal systems and practices for managing stakeholder relationships are *most accurately* described as its:

A) contractual infrastructure.

B) organizational infrastructure.

C) governance infrastructure.

Question #136 of 165

Question ID: 414757

Hatch Corporation's target capital structure is 40% debt, 50% common stock, and 10% preferred stock. Information regarding the company's cost of capital can be summarized as follows:

- The company's bonds have a nominal yield to maturity of 7%.
- The company's preferred stock sells for $40 a share and pays an annual dividend of $4 a share.
- The company's common stock sells for $25 a share and is expected to pay a dividend of $2 a share at the end of the year (i.e., D_1 = $2.00). The dividend is expected to grow at a constant rate of 7% a year.
- The company has no retained earnings.
- The company's tax rate is 40%.

What is the company's weighted average cost of capital (WACC)?

A) 10.59%.

B) 10.18%.

C) 10.03%.

Question #137 of 165

Question ID: 414747

Given the following information about capital structure, compute the WACC. The marginal tax rate is 40%.

Type of Capital	*Percent of Capital Structure*	*Before-Tax Component Cost*
Bonds	40%	7.5%
Preferred Stock	5%	11.0%
Common Stock	55%	15.0%

A) 7.1%.

B) 10.6%.

C) 13.3%.

Question #138 of 165

Question ID: 414741

Garner Corporation is investing $30 million in new capital equipment. The present value of future after-tax cash flows generated by the equipment is estimated to be $50 million. Currently, Garner has a stock price of $28.00 per share with 8 million shares outstanding. Assuming that this project represents new information and is independent of other expectations about the company, what should the effect of the project be on the firm's stock price?

A) The stock price will increase to $34.25.

B) The stock price will remain unchanged.

C) The stock price will increase to $30.50.

Question #139 of 165

Question ID: 414695

Which of the following steps is *least likely* to be an administrative step in the capital budgeting process?

A) Forecasting cash flows and analyzing project profitability.

B) Conducting a post-audit to identify errors in the forecasting process.

C) Arranging financing for capital projects.

Question #140 of 165

Question ID: 414708

Lincoln Coal is planning a new coal mine, which will cost $430,000 to build, with the expenditure occurring next year. The mine will bring cash inflows of $200,000 annually over the subsequent seven years. It will then cost $170,000 to close down the mine over the following year. Assume all cash flows occur at the end of the year. Alternatively, Lincoln Coal may choose to sell the site today. What minimum price should Lincoln set on the property, given a 16% required rate of return?

A) $280,913.

B) $325,859.

C) $376,872.

Question #141 of 165

Question ID: 414763

Deighton Industries has 200,000 bonds outstanding. The par value of each corporate bond is $1,000, and the current market price of the bonds is $965. Deighton also has 6 million common shares outstanding, with a book value of $35 per share and a market price of $28 per share. At a recent board of directors meeting, Deighton board members decided not to change the company's capital structure in a material way for the future. To calculate the weighted average cost of Deighton's capital, what weights should be assigned to debt and to equity?

	Debt	Equity
A)	56.55%	43.45%
B)	48.85%	51.15%
C)	53.46%	46.54%

Question #142 of 165

Question ID: 414775

Ferryville Radar Technologies has five-year, 7.5% notes outstanding that trade at a yield to maturity of 6.8%. The company's marginal tax rate is 35%. Ferryville plans to issue new five-year notes to finance an expansion. Ferryville's cost of debt capital is *closest* to:

A) 2.4%.

B) 4.4%.

C) 4.9%.

Question #143 of 165

Question ID: 414787

The expected annual dividend one year from today is $2.50 for a share of stock priced at $25. What is the cost of equity if the constant long-term growth in dividends is projected to be 8%?

A) 19%.

B) 18%.

C) 15%.

Question #144 of 165

Question ID: 414765

Hans Klein, CFA, is responsible for capital projects at Vertex Corporation. Klein and his assistant, Karl Schwartz, were discussing various issues about capital budgeting and Schwartz made a comment that Klein believed to be incorrect. Which of the following is *most likely* the *incorrect* statement made by Schwartz?

A) "Net present value (NPV) and internal rate of return (IRR) result in the same rankings of potential capital projects."

B) "It is not always appropriate to use the firm's marginal cost of capital when determining the net present value of a capital project."

C) "The weighted average cost of capital (WACC) should be based on market values for the firm's outstanding securities."

Question #145 of 165

Question ID: 414723

Which of the following is the *most* appropriate decision rule for mutually exclusive projects?

A) Accept both projects if their internal rates of return exceed the firm's hurdle rate.

B) If the net present value method and the internal rate of return method give conflicting signals, select the project with the highest internal rate of return.

C) Accept the project with the highest net present value, subject to the condition that its net present value is greater than zero.

Question #146 of 165

Question ID: 414709

Which of the following statements about the discounted payback period is *least* accurate? The discounted payback:

A) period is generally shorter than the regular payback.

B) method can give conflicting results with the NPV.

C) frequently ignores terminal values.

Question #147 of 165

Question ID: 414764

Agora Systems Inc. has the following capital structure and cost of new capital:

	Book Value	Market Value	Cost of Issuing
Debt	$50 million	$58 million	5.3%
Preferred stock	$25 million	$28 million	7.2%
Common stock	$200 million	$525 million	8.0%
Total capital	$275 million	$611 million	

What is Agora's weighted-average cost of capital if its marginal tax rate is 40%?

A) 8.02%.

B) 7.50%.

C) 6.23%.

Question #148 of 165

Question ID: 414803

Stolzenbach Technologies has a target capital structure of 60% equity and 40% debt. The schedule of financing costs for the Stolzenbach is shown in the table below:

Amount of New Debt (in millions)	*After-tax Cost of Debt*	*Amount of New Equity (in millions)*	*Cost of Equity*
$0 to $199	4.5%	$0 to $299	7.5%
$200 to $399	5.0%	$300 to $699	8.5%
$400 to $599	5.5%	$700 to $999	9.5%

Stolzenbach Technologies has breakpoints for raising additional financing at both:

A) $400 million and $700 million.

B) $500 million and $700 million.

C) $500 million and $1,000 million.

Question #149 of 165

Question ID: 434333

Degen Company is considering a project in the commercial printing business. Its debt currently has a yield of 12%. Degen has a leverage ratio of 2.3 and a marginal tax rate of 30%. Hodgkins Inc., a publicly traded firm that operates only in the commercial printing business, has a marginal tax rate of 25%, a debt-to-equity ratio of 2.0, and an equity beta of 1.3. The risk-free rate is 3% and the expected return on the market portfolio is 9%. The appropriate WACC to use in evaluating Degen's project is *closest to*:

A) 8.9%.

B) 9.2%.

C) 8.6%.

Question #150 of 165

Question ID: 414759

A firm is planning a $25 million expansion project. The project will be financed with $10 million in debt and $15 million in equity stock (equal to the company's current capital structure). The before-tax required return on debt is 10% and 15% for equity. If the company is in the 35% tax bracket, what cost of capital should the firm use to determine the project's net present value (NPV)?

A) 11.6%.

B) 9.6%.

C) 12.5%.

Question #151 of 165

Question ID: 460660

In a net present value (NPV) profile, the internal rate of return is represented as the:

A) point where two NPV profiles intersect.

B) intersection of the NPV profile with the horizontal axis.

C) intersection of the NPV profile with the vertical axis.

Question #152 of 165

Question ID: 683885

Shareholders who use their share voting power or other means to pressure companies to make changes they believe will increase shareholder value are *most accurately* described as:

A) activist shareholders.

B) proxy shareholders.

C) ESG shareholders.

Question #153 of 165

Question ID: 434324

Lane Industries has a project with the following cash flows:

Year	*Cash Flow*
0	−$200,000
1	60,000
2	80,000
3	70,000
4	60,000

5	50,000

The project's cost of capital is 12%. The discounted payback period is *closest* to:

A) 3.9 years.

B) 2.9 years.

C) 3.4 years.

Question #154 of 165

Question ID: 414724

Which of the following statements about independent projects is *least* accurate?

A) The net present value indicates how much the value of the firm will change if the project is accepted.

B) If the internal rate of return is less than the cost of capital, reject the project.

C) The internal rate of return and net present value methods can yield different accept/reject decisions for independent projects.

Question #155 of 165

Question ID: 414742

The effect of a company announcement that they have begun a project with a current cost of $10 million that will generate future cash flows with a present value of $20 million is *most likely* to:

A) increase value of the firm's common shares by $10 million.

B) increase the value of the firm's common shares by $20 million.

C) only affect value of the firm's common shares if the project was unexpected.

Question #156 of 165

Question ID: 683870

The stakeholder theory of corporate governance is primarily focused on:

A) increasing the value a company.

B) resolving the competing interests of those who manage companies and other groups affected by a company's actions.

C) the interests of various stakeholders rather than the interests of shareholders.

Question #157 of 165

Question ID: 414780

The after-tax cost of preferred stock is always:

A) less than the before-tax cost of preferred stock.

B) higher than the cost of common shares.

C) equal to the before-tax cost of preferred stock.

Question #158 of 165

Question ID: 414740

When using net present value (NPV) profiles:

A) one should accept all mutually exclusive projects with positive NPVs.

B) the NPV profile's intersection with the vertical y-axis identifies the project's internal rate of return.

C) one should accept all independent projects with positive NPVs.

Question #159 of 165

Question ID: 683873

The stakeholder group that typically prefers the greatest amount of business risk is:

A) senior managers.

B) directors.

C) shareholders.

Question #160 of 165

Question ID: 683888

Sustainable investing is *most accurately* described as:

A) excluding companies in carbon production based industries from consideration for investment.

B) integrating environmental and social considerations into the investment decision making process.

C) investing only in companies that promote environmental or social initiatives favored by an investor.

Question #161 of 165

Question ID: 414799

Tony Costa, operations manager of BioChem Inc., is exploring a proposed product line expansion. Costa explains that he estimates the beta for the project by seeking out a publicly traded firm that is engaged exclusively in the same business as the proposed BioChem product line expansion. The beta of the proposed project is estimated from the beta of that firm after appropriate adjustments for capital structure differences. The method that Costa uses is known as the:

A) build-up method.

B) pure-play method.

C) accounting method.

Question #162 of 165

Question ID: 414806

Which one of the following statements about the marginal cost of capital (MCC) is *most* accurate?

A) The MCC falls as more and more capital is raised in a given period.

B) The MCC is the cost of the last dollar obtained from bondholders.

C) A breakpoint on the MCC curve occurs when one of the components in the weighted average cost of capital changes in cost.

Question #163 of 165

Question ID: 414770

The optimal capital budget is the amount of capital determined by the:

A) point of tangency between the marginal cost of capital curve and the investment opportunity schedule.

B) downward sloping marginal cost of capital curve's intersection with a upward sloping investment opportunity schedule.

C) upward sloping marginal cost of capital curve's intersection with a downward sloping investment opportunity schedule.

Question #164 of 165

Question ID: 414756

Ravencroft Supplies is estimating its weighted average cost of capital (WACC). Ravencroft's optimal capital structure includes 10% preferred stock, 30% debt, and 60% equity. They can sell additional bonds at a rate of 8%. The cost of issuing new preferred stock is 12%. The firm can issue new shares of common stock at a cost of 14.5%. The firm's marginal tax rate is 35%. Ravencroft's WACC is *closest* to:

A) 13.3%.

B) 11.5%.

C) 12.3%.

Question #165 of 165

Question ID: 414702

If two projects are mutually exclusive, a company:

A) can accept either project, but not both projects.

B) must accept both projects or reject both projects.

C) can accept one of the projects, both projects, or neither project.