**Topic 12 Knowledge Check**

|  |  |
| --- | --- |
| Points: | 31 |

Started on Jun 27 at 15:09

Your Submission:

Top of Form

1. Bookmark question for later

A firm has sales of $101 million, variable costs of $74 million, fixed costs of $9 million, depreciation of $6 million, interest expense $3 million and taxes of $.5 million.  What is the degree of combined leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Castanias (1983) shows that industries with more firm bankruptcies generally have firms that have lower debt-to-equity ratios.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

Jensen and Meckling (1976) suggest that agency costs can affect the value of the firm.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

Which of the following is NOT a benefit of using debt to finance investment projects?

|  |
| --- |
| * + Greater solvency risk   + Less costly than using equity financing   + Lower overall tax bill   + Retains control and ownership |
|  |

1. Bookmark question for later

A firm has EBIT of $14 million and interest expense of $5 million.  What is the firm’s degree of financial leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Jensen and Meckling (1976) suggest that a firm’s capital structure cannot affect the level of agency costs.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

A firm has sales of $150 million, variable costs of $61 million, EBIT of $44 million, and interest expense of $22 million.  What is the degree of combined leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Suppose a firm has variable costs of $14 million, fixed costs of $15 million, depreciation of $3 million, and EBIT of $25 million.  Given this information, what is the degree of operating leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

The tax benefits associated with debt are higher when corporate tax rates are lower.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

Suppose a firm has sales of $15 million, variable costs of $4 million, fixed costs of $5 million, and EBIT of $5 million.  Given this information, what is the degree of operating leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

A company has a degree of operating leverage of 1.5 and a degree financial leverage of 2.2.  What is the company’s degree of combined leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Jensen and Meckling (1976) show that shareholders prefer stock issuance to bond issuance because stock holders will be able to monitor management better than bond holders.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

A firm has EBIT of $138 million and interest expense of $77 million.  What is the firm’s degree of financial leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Suppose a firm has sales of $102 million, fixed costs of $45 million, depreciation of $13 million, and EBIT of $35 million.  Given this information, what is the degree of operating leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Masulis (1980) finds that tax shields affect the change in stock prices surrounding changes in capital structure.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

While theory in Miller and Modigliani (1958, 1963) assumes that firms do not face bankruptcy risk, Castanias (1983) shows that firms that do face bankruptcy risks generally carry less debt.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

An example of nationalization is the U.S. government purchase of the majority equity stake in U.S. automakers.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

A company has a degree of operating leverage of 2.1 and a degree financial leverage of 2.5.  What is the company’s degree of combined leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

A firm has EBIT of $56 million and earnings before taxes (EBT) of $34 million. What is the firms degree of financial leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

A firm has EBIT of $126 million and earnings before taxes (EBT) of $101 million. What is the firms degree of financial leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Suppose a firm has sales of $56 million, variable costs of $20 million, fixed costs of $16 million, and depreciation of $5 million.  Given this information, what is the degree of operating leverage? (Round to the nearest hundredth: .00)



1. Bookmark question for later

Nationalization is a type of recapitalization that allows individuals in a particular nation to purchase shares of a company.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

On an income statement, interest payments are deducted before taxes are calculated.

|  |
| --- |
| TrueFalse |
|  |

1. Bookmark question for later

When a company uses more leverage as evidenced by a higher degree of either financial or operating leverage, what effect does it have on changes in profitability?

|  |
| --- |
| * + Higher leverage leads to lower risk.   + When leverage goes up liquidity goes down.   + Lower leverage results in higher income to shareholders.   + Higher leverage leads to higher profitability for a given sales level. |
|  |

1. Bookmark question for later

Company A has an EBIT of $700,000 and interest expense of $30,000. Company B has EBIT of $1,500,000 and interest expense of $30,000. Which company has a higher degree of financial leverage?

|  |
| --- |
| * + Companies A and B have the same leverage   + Insufficient data to make a determination   + Company A   + Company B |
|  |

1. Bookmark question for later

What is the operating leverage of Company Y? How will that affect profits compared with Company Z, which has an operating leverage of 5.25?  Company Y has an EBIT of $3,000,000, sales of $25,000,000, and variable expenses of $18,000,000.

|  |
| --- |
| * + Operating leverage of .43 As sales increase, Company Y's profits will rise faster than Company Z's.   + Operating leverage of 2.33 As sales increase, Company Y's profits will rise slower than Company Z's.   + Operating leverage of 2.33 As sales increase, the profits of both companies will stay the same.   + Operating leverage of .43 As sales increase, Company Y's profits will rise slower than Company Z's. |
|  |

1. Bookmark question for later

What is the financial leverage of Company A? How will that leverage affect profits compared to Company B if sales decrease?  For Company A, EBIT is $500,000, interest expense is $50,000, sales are $4,500,000, and variable costs are $3,000,000.

|  |
| --- |
| * + Degree of financial leverage: 1.11 Interest costs rise as sales decrease.   + Degree of financial leverage: 1.11 Profits decrease with higher leverage.   + Degree of financial leverage: 3.33 Profits increase as interest expense increases.   + Degree of financial leverage: 3.00 Profits increase as sales decrease. |
|  |

1. Bookmark question for later

What is the degree of combined leverage when EBIT is $700,000, interest expense is $100,000, sales are $3,500,000, and variable costs are $1,200,000?

|  |
| --- |
| * + 0.462   + 3.833   + 5.000   + 2.917 |
|  |

1. Bookmark question for later

What is the degree of operating leverage given sales of $100,000, variable costs of $75,000, and EBIT of $10,000?

|  |
| --- |
| * + 2.50   + 10.00   + 2.05   + 1.00 |
|  |

1. Bookmark question for later

What does the degree of financial leverage indicate?

|  |
| --- |
| * + The firm's cash balance   + The reliance on assets   + The reliance on debt   + The cost of financed assets |
|  |

1. Bookmark question for later

If a company has a high degree of financial leverage, what does that tell about the firm's risk profile?

|  |
| --- |
| * + Low risk   + Appropriate risk   + Higher ability to pay debt   + Higher profits to shareholders |

Bottom of Form