

Preview Test: CCACCT7106 Semester One Final Examination 2020

Test Information

Description ACCT7106 Financial Statement Analysis

Semester One 2020 Final Exam

This is an open book exam - all materials permitted

Instructions **Instructions to students:**

- Answer all questions. There are 52 questions in total worth 60 marks
- All multiple-choice and numeric questions are worth 1 mark. All short answer questions are worth 5 marks
- Please have a calculator available, as there will be calculation-based questions
- Unless otherwise stated, assume Australian Accounting Standards apply to all companies in all questions
- Unless otherwise stated, answer questions based on the methods/theories taught in lectures
- For multiple choice questions, select the best or closest answer
- For numeric questions, answer to one decimal place, unless otherwise stated. Do not include units, dollar signs or percentage signs. Do not include workings
- F **your own words** . Do

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- Contact the Library AskUs service for [.uq.edu.au/contact-us](https://www.uq.edu.au/contact-us)
- Request an email from AskUs docum so you can forward it to your course coordinator
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Timed Test This test has a time limit of 2 hours and 30 minutes. This test will save and submit automatically when the time expires.

Warnings appear when **half the time, 5 minutes, 1 minute, and 30 seconds** remain.
[The timer does not appear when previewing this test]

Multiple Attempts Not allowed. This test can only be taken once.

Force Completion This test can be saved and resumed at any point until time has expired. The timer will continue to run if you leave the test.

QUESTION 1**1 points**

Save Answer

Many companies use Microsoft Office programs (such as Word and Excel) on all of their computers and have all of their documents stored in Microsoft Office formats. From the office software industry's perspective, this is mainly an example of which barrier to entry?

- ☐ A. Demand-side benefits of scale
- ☐ B. Capital requirements
- ☐ C. Restrictive government policy
- ☐ D. Supply-side economies of scale
- ☐ E. Customer switching costs

QUESTION 2**1 points**

Save Answer

Which of the following pieces of information is NOT required to implement the residual operating income model?

- ☐ A. Forecasts
- ☐ B. The company's current net financial obligations
- ☐ C. The company's current net financial obligations and assets
- ☐ D. Forecasts of the company's operating income
- ☐ E. Forecasts of the company's net transactions with shareholders

QUESTION 3**1 points**

Save Answer

Where should dividends payable be classified in the reformulated Balance Sheet?

- ☐ A. Financial assets
- ☐ B. Operating liabilities
- ☐ C. Operating assets
- ☐ D. Financial obligations
- ☐ E. Common shareholders' equity

QUESTION 4**1 points**

Save Answer

Which of the following is NOT accurate about preparing a reformulated Balance Sheet?

- ☐ A. Deferred tax asset should be classified as an operating asset
- ☐ B. Every asset can be clearly classified as an operating asset or financial asset. There is no judgement or uncertainty involved
- ☐ C. A reformulated balance sheet separates operating and financing activities
- ☐ D. Bank loans should be classified as a financial obligation
- ☐ E. Cash and cash equivalents should be divided into operating cash and financial cash

QUESTION 5**1 points**

Save Answer

The capital asset price model (CAPM) implies that a firm can have lower cost of equity capital if:

- ☐ A. It has high
- ☐ B. Its share p
- ☐ C. It has higher dividends
- ☐ D. It reports higher earnings
- ☐ E. Its share price reflects all publicly available information

QUESTION 6**1 points**

Save Answer

Which of the following is an unlevered figure?

- ☐ A. Net transactions with shareholders
- ☐ B. Comprehensive income
- ☐ C. Retained earnings
- ☐ D. Common shareholders' equity
- ☐ E. Sales

QUESTION 7**1 points**

Save Answer

Which of the following was NOT true about the Harnischfeger case study?

- ☐ A. Harnischfeger reduced its provision for doubtful debts
- ☐ B. Harnischfeger consolidated all its wholly-owned subsidiaries
- ☐ C. Harnischfeger had recently appointed new senior executives
- ☐ D. Harnischfeger had a long-term agreement with Kobe Steel
- ☐ E. Harnischfeger had a defined benefit pension plan for its employees

QUESTION 8**1 points**

Save Answer

Which of the following was NOT true about the Harnischfeger case study?

- ☐ A. Harnischfeger's auditor raised concerns about earnings management
- ☐ B. Harnischfeger launched a corporate recovery
- ☐ C. Harnischfeger altered its depreciation policy
- ☐ D. Harnischfeger used LIFO for inventory costing
- ☐ E. Harnischfeger used LIFO for inventory costing

QUESTION 9**1 points**

Save Answer

Under Australian accounting standards, interest received can appear in which section/s of the Statement of Cash Flows?

- ☐ A. Cash Flow from Operations
- ☐ B. Cash Flow from Operations or Cash Flow from Investing or Cash Flow from Financing
- ☐ C. Cash Flow from Investing
- ☐ D. Cash Flow from Operations or Cash Flow from Investing
- ☐ E. Cash Flow from Financing

QUESTION 10**1 points**

Save Answer

Suppose you have been given the following financial information for a company:

	2019	2020
Sales	5,000	6,500
Operating assets:		
Accounts receivable	2,500	3,250
Inventory	3,000	4,000
PPE	1,000	1,500
Operating liabilities:		
Accounts payable	2,000	2,000
Provisions	1,500	3,000

You suspect the company might be deliberately **understating** its 2020 profit, because it is trying to convince the government it needs assistance by appearing to have a small return on common shareholders' equity (ROCE).

Using account-level asset turnover as a diagnostic to detect earnings management, which account is the most suspicious?

- ☐ A. Inventory
- ☐ B. Accounts r
- ☐ C. Accounts payable
- ☐ D. Provisions
- ☐ E. PPE

QUESTION 11**1 points**

Save Answer

Which of the following is NOT true about accrual accounting?

- ☐ A. Accruals changing the timing of when transactions are recognised
- ☐ B. Prepaid expenses is an accrual account
- ☐ C. Accruals usually involve estimates
- ☐ D. Accruals ensure perfect matching of revenues and expenses
- ☐ E. Provision for warranty expenses is an accrual account

QUESTION 12**1 points**

Save Answer

You value a company using the discounted free cash flow model and the residual operating income model. You are surprised that the valuations are different. Which of the following could be the cause?

- ☐ A. You have forecasted that the company's leverage will stay constant
- ☐ B. You have forecasted sales growth to converge to the long-run economic growth rate
- ☐ C. You have assumed that weighted-average cost of capital (WACC) will be constant in the future
- ☐ D. Your forecast horizon is too short
- ☐ E. Your steady state forecast has net operating assets growing at the terminal growth rate

QUESTION 13**1 points**

Save Answer

You are trying to analysis. There a Blue Co and Red securities on its loss. You are worried that the company has overest these securities. You suspect that Red Co might be warranty and pension expenses. These are your to the companies' accounting.

Given your concerns about Blue Co and Red Co, which of the following multiples would be safest to use?

- ☐ A. P/B
- ☐ B. P/S
- ☐ C. P/E
- ☐ D. P/E or P/S
- ☐ E. P/B or P/S

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QUESTION 14**1 points**[Save Answer](#)

Which of the following statements about earnings management is FALSE?

- ☐ A. If accruals are overstated by earnings management this year, they will be understated in future periods
 - ☐ B. A decline in total asset turnover always means accrual-based earnings management is occurring
 - ☐ C. Accrual-based earnings management is reflected in unusual changes in net operating assets
 - ☐ D. Accruals are generally easier to manipulate than cash flows
 - ☐ E. Fear of violating a debt covenant can motivate earnings management
-

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QUESTION 15**1 points**

Save Answer

Suppose you are given the following reformulated Balance Sheet for an ordinary industrial company:

	\$m		\$m
Operating assets		Financial assets	
Operating cash	20	Financial cash	50
Accounts receivable	100	Short-term investments	100
Inventory	100		150
Leased assets	150		
PPE	370	Financial obligations	
Intangibles	100	Borrowings	100
Other assets	30	Bonds payable	200
	870	Preferred equity	80
		Derivative financial liabilities	20
			400
Operating liabilities		Net financial obligation	250
Accounts payable	100		
Lease liability			
Deferred tax liability			
Provisions	50	Retained earnings	
	370	Non-controlling interest	
Net operating assets	500	CSE+NFO	500

Which account has NOT been reclassified correctly?

- ☐ A. Lease liability
- ☐ B. Preferred equity
- ☐ C. Deferred tax liability
- ☐ D. Non-controlling interest
- ☐ E. Derivative financial liabilities

QUESTION 16**1 points**

Save Answer

An equity analyst has proposed the following ratio: CI/Average NOA (comprehensive income over average net operating assets). What is the main problem with this ratio?

- ☐ A. It does not reflect profitability
- ☐ B. It mixes levered and unlevered figures
- ☐ C. There is no problem with the ratio
- ☐ D. It reflects accrual accounting not cash accounting
- ☐ E. It uses the average of net operating assets in the denominator

QUESTION 17**1 points**

Save Answer

A company is involved in a lawsuit at the end of the reporting period. It expects to win the case and receive a substantial amount of cash from the other party to the lawsuit as damages next period. The company does not record an asset but provides details about the lawsuit in its annual issue?

- ☐ A. Accrual accounting
- ☐ B. Recognition vs. disclosure
- ☐ C. Classification
- ☐ D. Clean vs. dirty surplus accounting
- ☐ E. Fair value vs. historical cost

QUESTION 18**1 points**

Save Answer

Suppose you are valuing an Australian company using the residual income model. The company only operates in Australia and you expect it to remain that way. What can we say about a sensible terminal growth rate for valuing the company?

- ☐ A. The terminal growth rate should be not be greater than the expected long-run Australian real GDP growth
- ☐ B. The terminal growth rate must be greater than the cost of equity
- ☐ C. The terminal growth rate must be positive
- ☐ D. We can't say anything. The terminal growth rate could be anything
- ☐ E. The terminal growth rate should be not be greater than the expected long-run Australian nominal GDP growth

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QUESTION 19**1 points**

Save Answer

Which of the following is a red flag that a company might be manipulating its accruals to inflate earnings?

- ☐ A. The industry's products become obsolete rapidly
- ☐ B. Fixed costs in the industry are low
- ☐ C. Most customers are more concerned about quality than price
- ☐ D. Customers face substantial costs in changing from one supplier to another
- ☐ E. Companies in the industry offer products with unique features

QUESTION 20**1 points**

Save Answer

Which of the following would be a red flag that a company might be manipulating its accruals to inflate earnings?

- ☐ A. An unusual decrease in inventories
- ☐ B. An unusual increase in provision for doubtful debts
- ☐ C. An unusual decrease in deferred revenue
- ☐ D. An unusual increase in financial obligations
- ☐ E. An unusual increase in provision for employee benefits

QUESTION 21**1 points**[Save Answer](#)

Which of the following is FALSE about valuation?

- ☐ A. In a 'Scenario 1' valuation the terminal value is zero
 - ☐ B. The CAPM can be difficult to practically implement
 - ☐ C. Asset-based valuation usually undervalues a company
 - ☐ D. Valuation is only useful if the market is not semi-strong form efficient
 - ☐ E. We must know a company's current common shareholders' equity to implement a residual income model
-

QUESTION 22**1 points**[Save Answer](#)

Harnischfeger was able to increase earnings in the year that the case is set (1984) by selling down inventory to a low level. Why did this work?

- ☐ A. Harnischf inventory
 - ☐ B. Harnischf inventory had increased over time
 - ☐ C. Harnischfeger used LIFO inventory costing and inventory had decreased over time
 - ☐ D. Harnischfeger used FIFO inventory costing and the cost of its inventory had decreased over time
 - ☐ E. Harnischfeger impaired its inventory to lower of cost and net realisable value
-

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QUESTION 23**1 points**[Save Answer](#)

Australia is a geographically large country with major cities that are far apart. From the perspective of the Australian domestic passenger airline industry, this results in which of Porter's Five Forces being especially weak?

- ☐ A. Threat of new entry
 - ☐ B. Threat of substitutes
 - ☐ C. Bargaining power of suppliers
 - ☐ D. Rivalry between existing competitors
 - ☐ E. Bargaining power of buyers
-

QUESTION 24**1 points**[Save Answer](#)

A company has a cost of equity of 10%, which is expected to remain constant. The company generated a return on common shareholders' equity (ROCE) of 15% in its most recent financial year. The market does not expect
Assuming market
the company's market

- ☐ A. Its market capitalisation will be 1.5 times its shareholders' equity
 - ☐ B. Its market capitalisation will be 1.5 times its shareholders' equity
 - ☐ C. Its market capitalisation will equal its current common shareholders' equity
 - ☐ D. We cannot say anything
 - ☐ E. Its market capitalisation will be greater than its current common shareholders' equity
-

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QUESTION 25**1 points**

Save Answer

A company XYZ owns 90% of a subsidiary ABC. ABC issues additional shares to shareholders other than XYZ. What effect does this have on reformulated financial statements?

- ☐ A. It will reduce common shareholders' equity
- ☐ B. It will reduce operating income (after-tax)
- ☐ C. It will decrease net transactions with shareholders
- ☐ D. It will increase financial obligations
- ☐ E. It will have no effect

QUESTION 26**1 points**

Save Answer

A company conducts an incremental (i.e. upwards) revaluation of PPE carried under the fair value model. The PPE is used in day-to-day operations. The incremental revaluation is not a reversal of a previous revaluation decrement or impairment. Which of the following is a correct financial statement effect?

- ☐ A. Increase in operating income
- ☐ B. Increase in common shareholders' equity and increase in operating OCI
- ☐ C. Increase in common shareholders' equity and increase in net transactions with shareholders
- ☐ D. Increase in common shareholders' equity and increase in core other operating income
- ☐ E. Increase in operating assets and increase in operating cash flow

QUESTION 27**1 points**

Save Answer

A company records a 'Gain on bargain purchase' as a result of buying another company in the same industry for less than the fair value of its net assets. What would be the best classification in the reformulated Income Statement?

- ☐ A. Core operating income from sales
- ☐ B. Financing OCI
- ☐ C. Core other operating income
- ☐ D. Unusual operating income
- ☐ E. Financial income

QUESTION 28**1 points**

Save Answer

Suppose you have been given the following extract from a Statement of Cash Flows prepared under IAS standards:

2020

Proceeds from sale of government bonds
Investment in marketable securities
Interest received
Interest paid
Acquisition of operating subsidiary
Cash Flow from Investing

The company is an ordinary industrial company.

Which of the following would NOT have to be adjusted for when preparing the reformulated Statement of Cash Flows?

- ☐ A. Proceeds from sale of government bonds
- ☐ B. Interest paid
- ☐ C. Acquisition of operating subsidiary
- ☐ D. Investment in marketable securities
- ☐ E. Interest received

QUESTION 29**1 points**

Save Answer

Which of the following types of companies is most likely to have a high asset turnover (ATO) and low profit margin (PM)?

- ☐ A. A hospital
- ☐ B. A utility company (e.g. an electricity generation company)
- ☐ C. A supermarket
- ☐ D. A transportation company
- ☐ E. A mining company

QUESTION 30**1 points**

Save Answer

Which of the following relations must hold to mathematically derive the residual income model from the dividend discount model?

- ☐ A. $FCF = \Delta$
- ☐ B. Change in
- ☐ C. $FCF = OI(a)$
- ☐ D. Book value of NOA = market value of NOA
- ☐ E. Assets = Liabilities + Equity

QUESTION 31**1 points**

Save Answer

The Australian company Treasury Wine Estates (TWE) generates revenue by growing and selling wine. It owns vines which grow grapes that are used to produce wine. TWE reports an account 'Agricultural Assets' relating to these vines on its Balance Sheet. What is the best classification of this account in the reformulated Balance Sheet?

- ☐ A. Non-current asset
- ☐ B. Common shareholders' equity
- ☐ C. Operating asset
- ☐ D. Operating liability
- ☐ E. Financial asset

QUESTION 32**1 points**

Save Answer

Which of the following is NOT an objective of reformulating the financial statements?

- ☐ A. Separate operating income based on whether it is recurring and whether it is driven by sales
- ☐ B. Alter the classification of some items
- ☐ C. Separate current and non-current operating assets
- ☐ D. Separate operating and financing activities
- ☐ E. Show how free cash flow is generated and used on the cash flow statement

QUESTION 33**1 points**

Save Answer

Harnischfeger may have reduced its research and development expense to inflate earnings. This is an example of which form of earnings management?

- ☐ A. Manipulation
- ☐ B. Transaction
- ☐ C. Manipulation of accrual estimates
- ☐ D. Changing the timing of transactions
- ☐ E. Manipulation of fair value estimates

QUESTION 34**1 points**

Save Answer

Under Australian accounting standards, for what types of investments is the 'equity method' of accounting used?

- ☐ A. Investments in subsidiaries
- ☐ B. Investments in associates and investments in joint ventures
- ☐ C. Investments in joint ventures
- ☐ D. Investments in marketable securities held for trading
- ☐ E. Investments in associates

QUESTION 35**1 points**

Save Answer

A company is trading at a market price per share of \$12. The company has a cost of equity of 10% and current CSE of \$1 per share. The market expects the company to generate residual income of \$0.55 per share next year ($t+1$) and \$0.75 per share the year after ($t+2$). The company's residual income will then grow at a constant terminal growth rate forever after year $t+2$.

To one decimal place, what is the terminal growth rate of residual income that the market must be using?

QUESTION 36**1 points**

Save Answer

Suppose you have been given the following turnovers for individual operating assets and liabilities:

	Turnover
Accounts receivable turnover	4.0
Inventory turnover	10.0
PPE turnover	2.0
Accounts payable	
Provisions turnov	
Deferred revenue	

To one decimal place, what is the company's overa

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QUESTION 37**1 points**

Save Answer

A company reports the following financial statements:

Balance Sheet

	2019	2020		2019	2020
Operating assets	232.4	245.8	Operating liabilities	58.2	34.6
Financial assets	12.3	10.0	Financial obligations	135.0	140.5
			Total liabilities	193.2	175.1
			Common shareholders' equity	51.5	80.7
Total assets	244.7	255.8	Total liabilities and equity	244.7	255.8

Income Statement

	2019	2020
Operating revenue		
Operating expenses		
Operating income		
Financial revenue		2.0
Financial expense		(1.5)
Comprehensive income		233.7

The company pays no tax. To one decimal place, what is free cash flow for 2020?

QUESTION 38**1 points**

Save Answer

A company's draft financial statements show an operating income (after tax) of 600. The company calculates return on net operating assets (RNOA) using the opening balance of net operating assets (NOA) in the denominator. The CFO finds that the RNOA is 8%. The CEO complains that she needs to achieve a 10% RNOA to receive a bonus. The CFO decides to use accrual-based earnings management to meet the 10% RNOA goal.

To one decimal place, how much accruals must the CFO add to achieve the CEO's goal?

QUESTION 39**1 points**

Save Answer

Suppose you have been given the following reformulated financials:

Reformulated Balance Sheet

	2019	2020		2019	2020
Operating assets	300	350	Financial obligations	200	200
Operating liabilities	100	80	Financial assets	40	40
Net operating assets	200	280	Net financial obligations	160	160
			Common shareholders' equity	40	120
			NFO + CSE	200	280

You have also been told that Operating income (after tax) for 2020 is 60 and the company's net borrowing cost is 10%.

Using averages of balance sheet figures when calculating ratios, what is the company's ROCE for 2020 to one decimal place?

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QUESTION 40**1 points**

Save Answer

Suppose you have been given the following reformulated financial information:

	2019	2020
Income Statement		
Sales	1,500	2,000
Operating expenses (including tax and operating OCI)	(800)	(900)
Operating income (after tax and including operating OCI)	700	1,100
Net financial expense (after tax and including financing OCI)	(100)	(150)
Comprehensive income	600	950
Balance Sheet		
Operating assets	500	600
Operating liabilities	(200)	(200)
Net operating assets	300	400
Financial assets		
Financial obligations		
Net financial obligations		
Common shareholders' equity	20	

The company has a normal asset turnover (ATO) of decimal place, what is normal change in NOA for 2020?

QUESTION 41**1 points**

Save Answer

Suppose you have following financial information about a company:

	2019	2020
CSE	352.3	323.5
Cash dividends	50.0	20.4
Share repurchases	0.0	45.0
Share issues	14.0	60.0

The company has no financial obligations or financial assets in both years. To one decimal place, what is free cash flow for 2020?

QUESTION 42**1 points**

Save Answer

You have the following information about a company:

Market data

Share price	10
Shares outstanding	100
Market capitalisation	1,000
Cost of equity	9%
Cost of debt (before tax)	4%

Balance Sheet data

Net operating assets	1,000
Net financial obligations	500
CSE	500

The company's tax rate is 25%. What is the company's weighted-average cost of capital (WACC)?

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QUESTION 4**1 points**

Save Answer

A company with
in its reformulated Income Statement:

Core operating income from sales (before tax)	
Core other operating income (before tax)	300
Unusual operating income (before tax)	200
Net financial income (before tax)	150
Profit before tax	1,850
<hr/>	
Income tax expense	740

To one decimal place, what is the tax allocation to Core operating income from sales?

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QUESTION 44**1 points**

Save Answer

Suppose you have been given the following Statement of Changes in Equity:

	Share Capital	Treasury Shares	Retained Earnings	Total
Opening balance	500	0	100	600
NPAT			1,000	1,000
OCI			(200)	(200)
Cash dividends			(100)	(100)
Share-based payments	10			10
Sale of treasury shares		8		8
Purchase of treasury shares		(20)		(20)
Closing balance	510	(12)	800	1,298

What is total net transactions with shareholders?

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Save Answer

A company paid 128 in income taxes during a year. Income taxes payable at the beginning of the year was 67 and 23 at the end of the year. There were no deferred taxes and no other comprehensive income items. What was the income tax expense on its income statement for the year?

QUESTION 46**1 points**

Save Answer

Suppose you have been given the following forecasts of net transactions with shareholders (d) for 2020-2022 and the forecasted terminal value as at 2022 for a company:

	2020E	2021E	2022E
d	100	150	200
Terminal value (TV)			4,000

The company is in steady state at 2022. It has a cost of equity of 9%. To one decimal place, what is the dividend discount model valuation of the company's equity?

QUESTION 47**1 points**

Save Answer

Suppose you have been given the following forecasts of free cash flow (FCF) for a company:

Year
2021E
2022E
2023E

Suppose 2023E is the steady state year, its WACC is terminal growth rate is 3%. To the nearest dollar, what is the value of the terminal value?

QUESTION 48**1 points**

Save Answer

A company with a 30% marginal tax rate reports the following figures in its AASB Statement of Cash Flows:

	2020
Cash receipts from customers	1,000
Cash payments to suppliers and employees	(750)
Interest received	20
Interest paid	(50)
Income tax paid	(200)
Cash Flow from Operations	20

To one decimal place, what is the tax shield from net interest paid for 2020?

QUESTION 49**1 points**

Save Answer

A company is trading at a P/E ratio of 10.0. The company has a profit margin of 15%. What must be the company's P/S ratio?

QUESTION 50**1 points**

Save Answer

You are trying to value the equity of a company with total Sales of 200, Comprehensive income of 10, and Common shareholders' equity of 100. You decide to conduct a comparable companies valuation using the following three comparable companies:

	Comparable X	Comparable Y	Comparable Z
Income Statement			
Sales	500	300	400
Operating income (after tax)	100	20	60
Net financial expense (after tax)	(30)	0	(50)
Comprehensive income	70	20	10
Balance Sheet			
Operating assets	550	400	
Operating liabilities	(100)	(100)	
Net operating assets	450	300	
Financial obligations	300	0	450
Financial assets	(50)	0	(50)
Net financial obligations	250	0	400
Common shareholders' equity	200	300	100
Market Data			
Price	8	3	1
Shares outstanding	100	250	200
Market capitalisation	900	750	200

You include all three companies in your multiples calculation. What is the value of your company using the mean P/B multiple?

QUESTION 51**5 points**[Save Answer](#)

Suppose I value an Australian company at \$10 per share by using analyst-consensus forecasts of earnings per share and dividends per share for the next three years, and the company's current common shareholders' equity. I assume a cost of equity of 8% and terminal growth rate of 3% in my valuation. The market price is \$20. List and explain four different things that might have caused me to obtain a different valuation than the market.

QUESTION 52**5 points**[Save Answer](#)

The CFO of a company is proposing to boost his company's return on net operating assets (RNOA) by paying suppliers later because the CFO claims "there's no interest charged on accounts payable". Using the concept of operating leverage, explain the CFO's strategy, and discuss the factors that might cause the CFO's strategy to succeed or fail.

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