1. Which of the following should NOT influence a firm's dividend policy decision?   
  
a. The firm's ability to accelerate or delay investment projects.   
b. A strong preference by most shareholders for current cash income versus capital gains.   
c. Constraints imposed by the firm's bond indenture.   
d. The fact that much of the firm's equipment has been leased rather than bought and owned.   
e. The fact that Congress is considering changes in the tax law regarding the taxation of dividends versus capital gains

**Ans:d. The fact that much of the firm's equipment has been leased rather than bought and owned.**

2. Which of the following statements about dividend policies is CORRECT?   
  
a. Modigliani and Miller argue that investors prefer dividends to capital gains because dividends are more certain than capital gains. They call this the "bird-in-the hand" effect.   
b. One reason that companies tend to avoid stock repurchases is that dividend payments are taxed at a lower rate than gains on stock repurchases.   
c. One advantage of dividend reinvestment plans is that they allow shareholders to avoid paying taxes on the dividends that they choose to reinvest.   
d. One key advantage of a residual dividend policy is that it enables a company to follow a stable dividend policy.   
e. The clientele effect suggests that companies should follow a stable dividend policy.

**Ans: e. The clientele effect suggests that companies should follow a stable dividend policy**

3. Trenton Publishing follows a strict residual dividend policy. All else equal, which of the following factors would be most likely to lead to an increase in the firm's dividend per share?   
  
a. The firm's net income increases.   
b. The company increases the percentage of equity in its target capital structure.   
c. The number of profitable potential projects increases.   
d. Congress lowers the tax rate on capital gains. The remainder of the tax code is not changed.   
e. Earnings are unchanged, but the firm issues new shares of common stock

**Ans: a. The firm's net income increases.**

4. If a firm adheres strictly to the residual dividend policy, then if its optimal capital budget requires the use of all earnings for a given year (along with new debt according to the optimal debt/total assets ratio), then the firm should pay  
  
a. no dividends to common stockholders.  
b. dividends only out of funds raised by the sale of new common stock.  
c. dividends only out of funds raised by borrowing money (i.e., issue debt).  
d. dividends only out of funds raised by selling off fixed assets.  
e. no dividends except out of past retained earnings.

**Ans: a. no dividends to common stockholders.**

5. Which of the following statements is correct?  
  
a. Under the tax laws as they existed in 2008, a dollar received for repurchased stock must be taxed at the same rate as a dollar received as dividends.   
b. One nice feature of dividend reinvestment plans (DRIPs) is that they reduce the taxes investors would have to pay if they received cash dividends.   
c. Empirical research indicates that, in general, companies send a negative signal to the marketplace when they announce an increase in the dividend, and as a result share prices fall when dividend increases are announced. The reason is that investors interpret the increase as a signal that the firm has relatively few good investment opportunities.   
d. If a company wants to raise new equity capital rather steadily over time, a new stock dividend reinvestment plan would make sense. However, if the firm does not want or need new equity, then an open market purchase dividend reinvestment plan would probably make more sense.   
e. Dividend reinvestment plans have not caught on in most industries, and today about

**Ans: d. If a company wants to raise new equity capital rather steadily over time, a new stock dividend reinvestment plan would make sense. firm does not want or need new equity, then an open market purchase dividend reinvestment plan would probably make more sense**

6. Firm M is a mature firm in a mature industry. Its annual net income and net cash flows are both consistently high and stable. However, M's growth prospects are quite limited, so its capital budget is small relative to its net income. Firm N is a relatively new firm in a new and growing industry. Its markets and products have not stabilized, so its annual operating income fluctuates considerably. However, N has substantial growth opportunities, and its capital budget is expected to be large relative to its net income for the foreseeable future. Which of the following statements is correct?  
  
a. Firm M probably has a higher dividend payout ratio than Firm N.  
b. If the corporate tax rate increases, the debt ratio of both firms is likely to decline.  
c. The two firms are equally likely to pay high dividends.  
d. Firm N is likely to have a clientele of shareholders who want to receive consistent, stable dividend income.  
e. Firm M probably has a lower debt ratio than Firm N

**Ans: a. Firm M probably has a higher dividend payout ratio than Firm N**

7. Which of the following actions will best enable a company to raise additional equity capital?  
  
a. Declare a stock split.  
b. Begin an open-market purchase dividend reinvestment plan.  
c. Initiate a stock repurchase program.  
d. Begin a new-stock dividend reinvestment plan.  
e. Refund long-term debt with lower cost short-term debt.

**Ans: d. Begin a new-stock dividend reinvestment plan**

8. Which of the following statements is correct?   
  
a. If a company has a 2-for-1 stock split, its stock price should roughly double.   
b. Capital gains earned in a share repurchase are taxed less favourably than dividends; this explains why companies typically pay dividends and avoid share repurchases.   
c. Very often, a company's stock price will rise when it announces that it plans to commence a share repurchase program. Such an announcement could lead to a stock price decline, but this does not normally happen.   
d. The clientele effect is the best explanation for why companies tend to vary their dividend payments from quarter to quarter

**Ans:c. Very often, a company's stock price will rise when it announces that it plans to commence a share repurchase program. Such an announcement could lead to a stock price decline, but this does not normally happen.**

9. Which of the following statements is correct?   
  
a. One advantage of dividend reinvestment plans is that they enable investors to avoid paying taxes on the dividends they receive.   
b. If a company has an established clientele of investors who prefer a high dividend payout, and if management wants to keep stockholders happy, it should NOT follow the strict residual dividend policy.   
c. If a firm follows a strict residual dividend policy, then, holding all else constant, its divi-dend payout ratio will tend to rise whenever the firm's investment opportunities improve.   
d. Despite its drawbacks, following the residual dividend policy will tend to stabilize actual cash dividends, and this will make it easier for firms to attract a clientele that prefers high dividends, such as retirees

**Ans: b. If a company has an established clientele of investors who prefer a high dividend payout, and if management wants to keep stockholders happy, it should NOT follow the strict residual dividend policy.**

10. Myron Gordon and John Lintner believe that the required return on equity increases as the dividend payout ratio is decreased. Their argument is based on the assumption that  
  
a. Investors are indifferent between dividends and capital gains.   
b. Investors require that the dividend yield and capital gains yield equal a constant.   
c. Capital gains are taxed at a higher rate than dividends.   
d. Investors view dividends as being less risky than potential future capital gains.   
e. Investors value a dollar of expected capital gains more highly than a dollar of expected dividends because of the lower tax rate on capital gains.

**Ans: d. investors view dividends as being less risky than potential future capital gains.**

11. Other things held constant, which of the following events is most likely to encourage a firm to increase the amount of debt in its capital structure?  
  
a. Its sales become less stable over time.   
b. The costs that would be incurred in the event of bankruptcy increase.   
c. Management believes that the firm's stock has become overvalued.   
d. Its degree of operating leverage increases.   
e. The corporate tax rate increases

**Ans:e. The corporate tax rate increases**

12. The firm's target capital structure should be consistent with which of the following statements?  
  
a. Minimize the cost of debt (rd).  
b. Obtain the highest possible bond rating.  
c. Minimize the cost of equity (rs).  
d. Minimize the weighted average cost of capital (WACC).  
e. Maximize the earnings per share (EPS).

**Ans: d. Minimize the weighted average cost of capital**

13. Which of the following statements is CORRECT? As a firm increases the operating leverage used to produce a given quantity of output, this will  
  
a. normally lead to a decrease in its business risk.  
b. normally lead to a decrease in the standard deviation of its expected EBIT.  
c. normally lead to a decrease in the variability of its expected EPS.  
d. normally lead to a reduction in its fixed assets turnover ratio.  
e. normally lead to an increase in its fixed assets turnover ratio.

d. normally lead to a reduction in its fixed assets turnover ratio

14. Which of the following statements is CORRECT?  
  
a. As a rule, the optimal capital structure is found by determining the debt-equity mix that maximizes expected EPS.   
b. The optimal capital structure simultaneously maximizes EPS and minimizes the WACC.   
c. The optimal capital structure minimizes the cost of equity, which is a necessary condition for maximizing the stock price.   
d. The optimal capital structure simultaneously minimizes the cost of debt, the cost of equity, and the WACC.   
e. The optimal capital structure simultaneously maximizes stock price and minimizes the WACC

e. The optimal capital structure simultaneously maximizes stock price and minimizes the WACC

15. Which of the following statements is CORRECT?  
  
a. Since debt financing is cheaper than equity financing, raising a company's debt ratio will always reduce its WACC.  
b. Increasing a company's debt ratio will typically reduce the marginal cost of both debt and equity financing. However, this action still may raise the company's WACC.  
c. Increasing a company's debt ratio will typically increase the marginal cost of both debt and equity financing. However, this action still may lower the company's WACC.  
d. Since a firm's beta coefficient it not affected by its use of financial leverage, leverage does not affect the cost of equity.  
e. Since debt financing raises the firm's financial risk, increasing a company's debt ratio will always increase its WACC.

c. Increasing a company's debt ratio will typically increase the marginal cost of both debt and equity financing. the company's WACC

16. You own 100 shares of Troll Brothers' stock, which currently sells for $120 a share. The company is contemplating a 2-for-1 stock split. Which of the following best describes what your position will be after such a split takes place?  
  
a. You will have 200 shares of stock, and the stock will trade at or near $120 a share.   
b. You will have 200 shares of stock, and the stock will trade at or near $60 a share.   
c. You will have 100 shares of stock, and the stock will trade at or near $60 a share.   
d. You will have 50 shares of stock, and the stock will trade at or near $120 a share.   
e. You will have 50 shares of stock, and the stock will trade at or near $60 a share

b. You will have 200 shares of stock, and the stock will trade at or near $60 a share.

17. Grandin Inc. is evaluating its dividend policy. It has a capital budget of $625,000, and it wants to maintain a target capital structure of 60% debt and 40% equity. The company forecasts a net income of $475,000. If it follows the residual dividend policy, what is its forecasted dividend payout ratio  
  
a. 40.61%  
b. 42.75%  
c. 45.00%  
d. 47.37%  
e. 49.74%

d. 47.37%

18. In recent years Constable Inc. has suffered losses, and its stock currently sells for only $0.50 per share. Management wants to use a reverse split to get the price up to a more "reasonable" level, which it thinks is $25 per share. How many of the old shares must be given up for one new share to achieve the $25 price, assuming this transaction has no effect on total market value?  
  
a. 47.50  
b. 49.88  
c. 50.00  
d. 52.50  
e. 55.13

c. 50.00

19. In the real world, dividends  
  
a. are usually more stable than earnings.   
b. fluctuate more widely than earnings.   
c. tend to be a lower percentage of earnings for mature firms.   
d. are usually changed every year to reflect earnings changes, and these changes are randomly higher or lower, depending on whether earnings increased or decreased.   
e. are usually set as a fixed percentage of earnings, e.g., at 40% of earnings, so if EPS = $2.00, then DPS will equal $0.80. Once the percentage is set, then dividend policy is on "automatic pilot" and the actual dividend depends strictly on earnings

a. are usually more stable than earnings

20. Kenny Electric Company's noncallable bonds were issued several years ago and now have 20 years to maturity. These bonds have a 9.25% annual coupon, paid semiannually, sells at a price of $1,075, and has a par value of $1,000. If the firm's tax rate is 40%, what is the component cost of debt for use in the WACC calculation?  
  
a. 4.35%   
b. 4.58%   
c. 4.83%   
d. 5.08%   
e. 5.33%

d. 5.08%

21. The president and CFO of Spellman Transportation are having a disagreement about whether to use market value or book value weights in calculating the WACC. Spellman's balance sheet shows a total of noncallable $45 million long-term debt with a coupon rate of 7.00% and a yield to maturity of 6.00%. This debt currently has a market value of $50 million. The company has 10 million shares of common stock, and the book value of the common equity (common stock plus retained earnings) is $65 million. The current stock price is $22.50 per share; stockholders' required return, r s , is 14.00%; and the firm's tax rate is 40%. The CFO thinks the WACC should be based on market value weights, but the president thinks book weights are more appropriate. What is the difference between these two WACCs?  
  
a. 1.55%  
b. 1.72%  
c. 1.91%  
d. 2.13%  
e. 2.36%

e. 2.36%

22. The projected capital budget of Kandell Corporation is $1,000,000, its target capital structure is 60% debt and 40% equity, and its forecasted net income is $550,000. If the company follows a residual dividend policy, what total dividends, if any, will it pay out?  
  
a. $122,176  
b. $128,606  
c. $135,375  
d. $142,500  
e. $150,000

e. $150,000

23. Reynolds Resorts is currently 100% equity financed. The CFO is considering a recapitalization plan under which the firm would issue long-term debt with a yield of 9% and use the proceeds to repurchase common stock. The recapitalization would not change the company's total assets, nor would it affect the firm's basic earning power, which is currently 15%. The CFO believes that this recapitalization would reduce the WACC and increase stock price. Which of the following would also be likely to occur if the company goes ahead with the recapitalization plan?  
  
a. The company's net income would increase.   
b. The company's earnings per share would decline.   
c. The company's cost of equity would increase.   
d. The company's ROA would increase

c. The company's cost of equity would increase

24. Business risk is affected by a firm's operations. Which of the following is NOT associated with (or does not contribute to) business risk?  
  
a. Demand variability   
b. Sales price variability   
c. The extent to which operating costs are fixed   
d. The extent to which interest rates on the firm's debt fluctuate  
e. Input price variability.

d. The extent to which interest rates on the firm's debt fluctuate.

25. If debt financing is used, which of the following is CORRECT?  
  
a. The percentage change in net operating income will be greater than a given percentage change in net income.   
b. The percentage change in net operating income will be equal to a given percentage change in net income.   
c. The percentage change in net income relative to the percentage change in net operating income will depend on the interest rate charged on debt.   
d. The percentage change in net income will be greater than the percentage change in net operating income.   
e. The percentage change in sales will be greater than the percentage change in EBIT, which in turn will be greater than the percentage change in net income.

d. The percentage change in net income will be greater than the percentage change in net operating income.

26. Which of the following statements is CORRECT?  
  
a. Increasing financial leverage is one way to increase a firm's basic earning power (BEP).   
b. If a firm lowered its fixed costs while increasing its variable costs, holding total costs at the present level of sales constant, this would decrease its operating leverage.   
c. The debt ratio that maximizes EPS generally exceeds the debt ratio that maximizes share price.   
d. If a company were to issue debt and use the money to repurchase common stock, this action would have no impact on its basic earning power ratio. (Assume that the repurchase has no impact on the company's operating income.)   
e. If changes in the bankruptcy code made bankruptcy less costly to corporations, this would likely reduce the average corporation's debt ratio.

c. The debt ratio that maximizes EPS generally exceeds the debt ratio that maximizes share price

27. Which of the following statements is CORRECT, holding other things constant?   
  
a. Firms whose assets are relatively liquid tend to have relatively low bankruptcy costs, hence they tend to use relatively little debt.   
b. An increase in the personal tax rate is likely to increase the debt ratio of the average corporation.   
c. If changes in the bankruptcy code make bankruptcy less costly to corporations, then this would likely reduce the debt ratio of the average corporation.   
d. An increase in the company's degree of operating leverage is likely to encourage a company to use more debt in its capital structure.   
e. An increase in the corporate tax rate is likely to encourage a company to use more debt in its capital structure.

e. An increase in the corporate tax rate is likely to encourage a company to use more debt in its capital structure.

28. Which of the following statements best describes the optimal capital structure? The optimal capital structure is the mix of debt, equity, and preferred stock that maximizes the company's \_\_\_\_  
  
a. stock price.  
b. cost of equity.  
c. cost of debt.  
d. cost of preferred stock.  
e. earnings per share (EPS).

a. stock price

29. Daylight Solutions is considering a recapitalization that would increase its debt ratio and increase its interest expense. The company would issue new bonds and use the proceeds to buy back shares of its common stock. The company's CFO thinks the plan will not change total assets or operating income, but that it will increase earnings per share (EPS). Assuming the CFO's estimates are correct, which of the following statements is CORRECT?  
  
a. If the plan reduces the WACC, the stock price is also likely to decline.  
b. Since the plan is expected to increase EPS, this implies that net income is also expected to increase.  
c. If the plan does increase the EPS, the stock price will automatically increase at the same rate.  
d. Under the plan there will be more bonds outstanding, and that will increase their liquidity and thus lower the interest rate on the currently outstanding bonds.  
e. Since the proposed plan increases Daylight's financial risk, the company's stock price still might fall even if EPS increases.

e. Since the proposed plan increases Daylight's financial risk, the company's stock price still might fall even if EPS increases

30. Which of the following is NOT associated with (or does not contribute to) business risk? Recall that business risk is affected by a firm's operations  
  
a. Sales price variability.  
b. The extent to which operating costs are fixed.  
c. The extent to which interest rates on the firm's debt fluctuate.  
d. Input price variability.  
e. Demand variability.

c. The extent to which interest rates on the firm's debt fluctuate

31. An all-equity firm with 200,000 shares outstanding, Antwerther Inc., has $2,000,000 of EBIT, which is expected to remain constant in the future. The company pays out all of its earnings, so earnings per share (EPS) equal dividends per shares (DPS). Its tax rate is 40%. The company is considering issuing $5,000,000 of 10.0% bonds and using the proceeds to repurchase stock. The risk-free rate is 6.5%, the market risk premium is 5.0%, and the beta is currently 0.90, but the CFO believes beta would rise to 1.10 if the recapitalization occurs. Assuming that the shares can be repurchased at the price that existed prior to the recapitalization, what would the price be following the recapitalization?   
  
a. $65.77   
b. $69.23   
c. $72.69   
d. $76.33   
e. $80.14

b. $69.23

32. Morales Publishing's tax rate is 40%, its beta is 1.10, and it uses no debt. However, the CFO is considering moving to a capital structure with 30% debt and 70% equity. If the risk-free rate is 5.0% and the market risk premium is 6.0%, by how much would the capital structure shift change the firm's cost of equity?   
  
a. 1.53%   
b. 1.70%   
c. 1.87%   
d. 2.05%   
e. 2.26%

b. 1.70%

33. Cartwright Communications is considering making a change to its capital structure to reduce its cost of capital and increase firm value. Right now, Cartwright has a capital structure that consists of 20% debt and 80% equity, based on market values. (Its D/S ratio is 0.25.) The risk-free rate is 6% and the market risk premium, r M - r RF , is 5%. Currently the company's cost of equity, which is based on the CAPM, is 12% and its tax rate is 40%. What would be Cartwright's estimated cost of equity if it were to change its capital structure to 50% debt and 50% equity?  
  
a. 13.00%   
b. 13.64%   
c. 14.35%   
d. 14.72%   
e. 15.60%

c. 14.35%

34. The major contribution of the Miller Model is that it demonstrates that  
  
a. personal taxes increase the value of using corporate debt  
b. personal taxes decrease the value of using corporate debt  
c. financial distress and agency costs reduce the value of using corporate debt  
d. equity costs increase with financial leverage  
e. debt costs increase with financial leverage

b. personal taxes decrease the value of using corporate debt

35. Which of the following statements concerning the MM extension with growth is NOT CORRECT?   
  
a. The value of a growing tax shield is greater than the value of a constant tax shield.   
b. For a given D/S, the levered cost of equity is greater than the levered cost of equity under MM's original (with tax) assumptions.   
c. For a given D/S, the WACC is less than the WACC under MM's original (with tax) assumptions.   
d. The total value of the firm increases with the amount of debt.   
e. The tax shields should be discounted at the cost of debt.

e. The tax shields should be discounted at the cost of debt.

36. Which of the following statements concerning the MM extension with growth is false ?  
  
a. The tax shields should be discounted at the unlevered cost of equity.   
b. The value of a growing tax shield is greater than the value of a constant tax shield.   
c. For a given D/S, the levered cost of equity is greater than the levered cost of equity under MM's original (with tax) assumptions.   
d. For a given D/S, the WACC is greater than the WACC under MM's original (with tax) assumptions.   
e. The total value of the firm is independent of the amount of debt.

e. The total value of the firm is independent of the amount of debt.

37. The market value of Firm L's debt is $200,000 and its yield is 9%. The firm's equity has a market value of $300,000, its earnings are growing at a rate of 5%, and its tax rate is 40%. A similar firm with no debt has a cost of equity of 12%. Under the MM extension with growth, what would Firm L's total value be if it had no debt?  
  
a. 358421  
b. 377286  
c. 397143  
d. 417000  
e. 437850

c. 397143

38. The market value of Firm L's debt is $200,000 and its yield is 9%. The firm's equity has a market value of $300,000, its earnings are growing at a rate of 5%, and its tax rate is 40%. A similar firm with no debt has a cost of equity of 12%. Under the MM extension with growth, what is the value of your firm's tax shield?  
  
a. 92571  
b. 102857  
c. 113143  
d. 124457  
e. 136903

b. 102857

39. The Kimberly corporation is a zero growth firm with an expected EBIT of $100,000 and a corporate tax rate of 30%. Kimberly uses $500,000 of 12.0% debt, and the cost of equity to an unlevered firm in the same risk class is 16%. What is the value of the firm according to MM with corporate taxes?  
  
a. 475875  
b. 528750  
c. 587500  
d. 646250  
e. 710875

c. 587500

40. The Kimberly corporation is a zero growth firm with an expected EBIT of $100,000 and a corporate tax rate of 30%. Kimberly uses $500,000 of 12.0% debt, and the cost of equity to an unlevered firm in the same risk class is 16%. What is the firm's cost of equity?  
  
a. 21.0%  
b. 23.3%  
c. 25.9%  
d. 28.8%  
e. 32.0%

e. 32.0%

41. In the lease versus buy decision, leasing is often preferable   
  
a. because it has no effect on the firm's ability to borrow to make other investments.   
b. because, generally, no down payment is required, and there are no indirect interest costs.   
c. because lease obligations do not affect the firm's risk as seen by investors.   
d. because the lessee owns the property at the end of the least term.   
e. because the lessee may have greater flexibility in abandoning the project in which the leased property is used than if the lessee bought and owned the asset.

e. because the lessee may have greater flexibility in abandoning the project in which the leased property is used than if the lessee bought and owned the asset.

42. Sutton Corporation, which has a zero tax rate due to tax loss carry-forwards, is considering a 5-year, $6,000,000 bank loan to finance service equipment. The loan has an interest rate of 10% and would be amortized over 5 years, with 5 end-of-year payments. Sutton can also lease the equipment for 5 end-of-year payments of $1,790,000 each. How much larger or smaller is the bank loan payment than the lease payment? Note: Subtract the loan payment from the lease payment.   
  
a. $177,169   
b. $196,854   
c. $207,215   
d. $217,576   
e. $228,455

c. $207,215

43. Kohers Inc. is considering a leasing arrangement to finance some manufacturing tools that it needs for the next 3 years. The tools will be obsolete and worthless after 3 years. The firm will depreciate the cost of the tools on a straight-line basis over their 3-year life. It can borrow $4,800,000, the purchase price, at 10% and buy the tools, or it can make 3 equal end-of-year lease payments of $2,100,000 each and lease them. The loan obtained from the bank is a 3-year simple interest loan, with interest paid at the end of the year. The firm's tax rate is 40%. Annual maintenance costs associated with ownership are estimated at $240,000, but this cost would be borne by the lessor if it leases. What is the net advantage to leasing (NAL), in thousands? (Suggestion: Delete 3 zeros from dollars and work in thousands.)   
  
a. $96   
b. $106   
c. $112   
d. $117   
e. $123

b. $106

44. Which of the following statements is most correct?  
  
a. Firms that use "off balance sheet" financing, such as leasing, will show lower debt ratios once the effects of their leases are reflected in their financial statements. b. Capitalizing a lease means that the firm issues equity capital in proportion to its current capital structure, in an amount sufficient to support the lease payment obligation.   
c. The fixed charges associated with a lease can be as high as, but never greater than, the fixed payments associated with a loan.   
d. Capital, or financial, leases generally provide for maintenance service on the part of the lessor and can be refinanced at the discretion of the lessee.   
e. A key difference between a capital lease and an operating lease is that with a capital lease, the total lease payments on the asset are roughly equal to the full price of the asset plus a return on the investment in the asset.

e. A key difference between a capital lease and an operating lease is that with a capital lease, the total lease payments on the asset are roughly equal to the full price of the asset plus a return on the investment in the asset.

45. Which of the following statements is most correct?   
  
a. Financial leases are fully amortized.   
b. Financial leases can be canceled.   
c. Financial leases provide for maintenance services.   
d. Operating leases can never be canceled.   
e. All of the statements above are correct.

a. Financial leases are fully amortized.

46. Heavy use of off-balance sheet lease financing will tend to   
  
a. Make a company appear more risky than it actually is because its stated debt ratio will appear higher.   
b. Make a company appear less risky than it actually is because its stated debt ratio will appear lower.   
c. Affect a company's cash flows but not its degree of risk.   
d. Have no effect on either cash flows or risk because the cash flows are already reflected in the income statement.   
e. None of the statements above is correct.

b. Make a company appear less risky than it actually is because its stated debt ratio will appear lower.

47. The lease analysis should compare the cost of leasing to the   
  
a. Cost of owning using debt.   
b. Cost of owning using equity.   
c. After-tax cost of debt to measure the effect of leasing on the cost of equity.   
d. Average cost of all fixed charges.   
e. Cost of owning using the weighted average cost of capital for the firm.

a. Cost of owning using debt.

48. From the lessee viewpoint, the riskiness of the cash flows, with the possible exception of the residual value, is about the same as the riskiness of the lessee's   
  
a. equity cash flows.   
b. capital budgeting project cash flows.   
c. debt cash flows.   
d. pension fund cash flows.   
e. sales

c. debt cash flows.

49. Operating leases often have terms that include   
  
a. maintenance of the equipment by the lessor.   
b. full amortization over the life of the lease.   
c. very high penalties if the lease is cancelled.   
d. restrictions on how much the leased property can be used.   
e. much longer lease periods than for most financial leases.

a. maintenance of the equipment by the lessor.

50. A lease versus purchase analysis should compare the cost of leasing to the cost of owning, assuming that the asset purchased   
  
a. is financed with short-term debt.   
b. is financed with long-term debt.   
c. is financed with debt whose maturity matches the term of the lease.   
d. is financed with a mix of debt and equity based on the firm's target capital structure, i.e., at the WACC.   
e. is financed with retained earnings.

c. is financed with debt whose maturity matches the term of the lease.

51. Carmichael Cleaners needs a new steam finishing machine that costs $100,000. The company is evaluating whether it should lease or purchase the machine. The equipment falls into the MACRS 3-year class, and it would be used for 3 years and then sold, because the firm plans to move to a new facility at that time. The estimated value of the equipment after 3 years is $30,000. A maintenance contract on the equipment would cost $3,000 per year, payable at the beginning of each year. Alternatively, the firm could lease the equipment for 3 years for a lease payment of $29,000 per year, payable at the beginning of each year. The lease would include maintenance. The firm is in the 20% tax bracket, and it could obtain a 3-year simple interest loan, interest payable at the end of the year, to purchase the equipment at a before-tax cost of 10%. If there is a positive Net Advantage to Leasing the firm will lease the equipment. Otherwise, it will buy it. What is the NAL? (Note: Assume MACRS rates for Years 1 to 4 are 0.3333, 0.4445, 0.1481, and 0.0741.)  
  
a. $5,734  
b. $6,023  
c. $6,324  
d. $6,640  
e. $6,972

a. $5,734

52. Volunteer Vegetables' common stock currently sells for $33, and its 8% convertible debentures (issued at par, or $1,000) sell for $850. Each debenture can be converted into 25 shares of common stock at any time before 2017. What is the conversion value of the bond?   
  
a. $707.33   
b. $744.56   
c. $783.75   
d. $825.00   
e. $866.25

d. $825.00

53. Chocolate Factory's convertible debentures were issued at their $1,000 par value in 2007. At any time prior to maturity on February 1, 2027, a debenture holder can exchange a bond for 25 shares of common stock. What is the conversion price, P c ?  
  
a. $40.00   
b. $42.00   
c. $44.10   
d. $46.31  
e. $48.62

a. $40.00

54. A decrease in a firm's willingness to pay dividends is likely to result from an increase in its   
  
a. Earnings stability.   
b. Access to capital markets.   
c. Profitable investment opportunities.   
d. Collection of accounts receivable.   
e. Stock price.

c. Profitable investment opportunities.

55. Which of the following is likely to encourage a company to use more debt in its capital structure?   
  
a. An increase in the corporate tax rate.   
b. An increase in the personal tax rate.   
c. A decrease in the company's degree of operating leverage.   
d. Statements a and c are correct.   
e. All of the statements above are correct.

d. Statements a and c are correct.

56. Which of the following statements is most correct?   
  
a. A reduction in the corporate tax rate is likely to increase the debt ratio of the average corporation.   
b. An increase in the personal tax rate is likely to increase the debt ratio of the average corporation.   
c. If changes in the bankruptcy code make bankruptcy less costly to corporations, then this would likely reduce the debt ratio of the average corporation.   
d. All of the statements above are correct.   
e. None of the statements above is correct

e. None of the statements above is correct

57. Which of the following statements is likely to encourage a firm to increase its debt ratio in its capital structure?   
  
a. Its sales become less stable over time.   
b. Its corporate tax rate declines.   
c. Management believes that the firm's stock is overvalued.   
d. Statements a and b are correct.   
e. None of the statements above is correct.

e. None of the statements above is correct.

58. Which of the following factors is likely to encourage a corporation to increase the proportion of debt in its capital structure?   
  
a. An increase in the corporate tax rate.   
b. An increase in the personal tax rate.   
c. An increase in the company's degree of operating leverage.  
d. The company's assets become less liquid.   
e. An increase in expected bankruptcy costs.

a. An increase in the corporate tax rate.

59. Companies HD and LD have identical tax rates, total assets, and basic earning power ratios, and their basic earning power exceeds their before-tax cost of debt, r d . However, Company HD has a higher debt ratio and thus more interest expense than Company LD. Which of the following statements is CORRECT?   
  
a. Company HD has a higher net income than Company LD.   
b. Company HD has a lower ROA than Company LD.   
c. Company HD has a lower ROE than Company LD.   
d. The two companies have the same ROA.   
e. The two companies have the same ROE.

b. Company HD has a lower ROA th