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PRACTICE EXERCISES LECTURE 1

- Q1.** Who reads financial statements? List at least three different categories of people. For each category, provide an example of the type of information they might be interested in and discuss why.
- Q2.** Consider the following potential events that might have taken place at Global Conglomerate on December 30, 2018. For each one, indicate which line items in Global's balance sheet would be affected and by how much. Also indicate the change to Global's book value of equity. (In all cases, ignore any tax consequences for simplicity.)
- a. Global used \$20 million of its available cash to repay \$20 million of its long-term debt.
 - b. A warehouse fire destroyed \$5 million worth of uninsured inventory.
 - c. Global used \$5 million in cash and \$5 million in new long-term debt to purchase a \$10 million building.
 - d. A large customer owing \$3 million for products it already received declared bankruptcy, leaving no possibility that Global would ever receive payment.
 - e. Global's engineers discover a new manufacturing process that will cut the cost of its flagship product by over 50%.
 - f. A key competitor announces a radical new pricing policy that will drastically undercut Global's prices.
- Q3.** Global Conglomerate's book value of equity increased by \$1 million from 2017 to 2018 according to Table 2.1 in the textbook. Does this imply that the market price of Global's shares increased in 2018? Explain.
- Q4.** In early 2018, Abercrombie & Fitch (ANF) had a book equity of \$1390 million, a price per share of \$25.52, and 69.35 million shares outstanding. At the same time, The Gap (GPS) had a book equity of \$2983 million, a share price of \$41.19, and 421 million shares outstanding.
- a. What is the market-to-book ratio of each of these clothing retailers?
 - b. What conclusions can you draw by comparing the two ratios?
- Q5.** In early 2015, Ford Motor (F) had a book value of equity of \$24.8 billion, 4.0 billion shares outstanding, and a market price of \$16 per share. Ford also had cash of \$21.7 billion, and total debt of \$119.2 billion. Three years later, in early 2018, Ford had a book value of equity of \$35.0 billion, 4.0 billion shares outstanding with a market price of \$11 per share, cash of \$26.5 billion, and total debt of \$154.3 billion. Over this period, what was the change in Ford's:
- a. market capitalization?
 - b. market-to-book ratio?
 - c. enterprise value?

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Q6. At the end of 2015, Apple had cash and short-term investments of \$41.60 billion, accounts receivable of \$35.89 billion, current assets of \$89.38 billion, and current liabilities of \$80.61 billion.

- a. What was Apple's current ratio?
- b. What was Apple's quick ratio?
- c. What is Apple's cash ratio?
- d. At the end of 2015, HPQ had a cash ratio of 0.35, a quick ratio of 0.73 and a current ratio of 1.15. What can you say about the asset liquidity of Apple relative to HPQ?

Q7. You are analyzing the leverage of two firms and you note the following (all values in millions of dollars):

	Debt	Book Equity	Market Equity	EBIT	Interest Expense
Firm A	495.8	297.7	401.1	106.8	45.2
Firm B	83.8	38.3	35.9	8.4	7.5

- a. What is the market debt-to-equity ratio of each firm?
- b. What is the book debt-to-equity ratio of each firm?
- c. What is the interest coverage ratio of each firm?
- d. Which firm may have more difficulty meeting its debt obligations? Explain.

Q8. For fiscal year 2018, Tesco had total revenues of \$485.65 billion, had total revenues of 485.65, net income of \$16.36 billion, total assets of \$203.49 billion, and total shareholder's equity of \$81.39 billion.

- a. Calculate Tesco's ROE directly, and using the DuPont Identity.
- b. Now compare Tesco with Aeon Group: For fiscal year 2018, Aeon Group had a net profit margin of 2.05%, asset turnover of 3.48, and a book equity multiplier of 3.15. Use the DuPont Identity to understand the difference between the two firms' ROEs.

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