**Chapter 02 Test Bank**

1. An inventory turnover ratio of 10 means that, on average, items are held in inventory for 10 days.

**FALSE**

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*Difficulty: 1 Easy*

*Gradable: automatic*

2. All else equal, an increase in a company’s asset turnover will decrease its ROE.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

3. A company’s return on assets will always equal or exceed its profit margin.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

4. A company’s price-to-earnings ratio is always equal to one minus its earnings yield.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

5. Return on assets can be calculated as profit margin times asset turnover.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

6. All else equal, a firm would prefer to have a higher gross margin.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

7. The times-interest-earned ratio always equals or exceeds the times-burden-covered ratio.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

8. If a firm increases its accounts payable period, other things equal, it increases the cash conversion cycle.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

9. Across companies, ROA and financial leverage tend to be inversely related.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

10. One advantage of ROE is that it is a risk-adjusted measure of performance.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

11. The most popular yardstick of financial performance among investors and senior managers is the

A. profit margin.

**B.** return on equity.

C. return on assets.

D. times-burden-covered ratio.

E. earnings yield.

F. None of the options are correct.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

12. Which of these ratios, or levers of performance, are the determinants of ROE?

I. profit margin

II. financial leverage

III. times interest earned

IV. asset turnover

A. I and IV only

B. II and IV only

**C.** I, II, and IV only

D. I, II, and III only

E. I, III, and IV only

F. I, II, III, and IV

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

13. Ratios that measure how efficiently a firm manages its assets and operations to generate net income are referred to as \_\_\_\_\_ ratios.

**A.** asset turnover and control

B. financial leverage

C. coverage

D. profitability

E. None of the options are correct.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

14. Which of the following ratios are measures of a firm’s liquidity?

I. fixed asset turnover ratio

II. current ratio

III. debt-equity ratio IV. acid test

A. I and III only

**B.** II and IV only

C. III and IV only

D. I, II, and III only

E. I, III, and IV only

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

15. Ptarmigan Travelers had sales of $420,000 in 2016 and $480,000 in 2017. The firm’s current asset accounts remained constant. Given this information, which one of the following statements must be true?

A. The total asset turnover rate increased.

B. The days’ sales in receivables increased.

C. The inventory turnover rate increased.

D. The fixed asset turnover decreased.

**E.** The collection period decreased.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

16. In comparison to industry averages, Okra Corp. has a low inventory turnover, a high current ratio, and an average quick ratio. Which of the following would be the most reasonable inference about Okra Corp.?

A. Its current liabilities are too low.

B. Its cost of goods sold is too low.

C. Its cash and securities balance is too low.

**D.** Its inventory level is too high.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

17. Which one of the following ratios identifies the amount of sales a firm generates for every $1 in assets?

A. current ratio

B. debt-to-equity

C. retention

**D.** asset turnover

E. return on assets

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

18. A times-interest-earned ratio of 3.5 indicates that the firm

A. pays 3.5 times its earnings in interest expense.

B. has interest expense equal to 3.5% of EBIT.

C. has interest expense equal to 3.5% of net income.

**D.** has EBIT equal to 3.5 times its interest expense.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

19.At the end of 2017, Stacky Corp. had $500,000 in liabilities and a debt-to-assets ratio of 0.5. For 2017, Stacky had an asset turnover of 3.0. What were annual sales for Stacky in 2017?

A. $333,333

B. $1,200,000

C. $1,800,000

**D.** $3,000,000

Liabilities/Assets = 0.5 = $500,000/$1,000,000 So Assets = $1,000,000

Then, Sales/$1,000,000 = 3 So sales = $3,000,000

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

20. Klamath Corporation has asset turnover of 3.5, a profit margin of 5.2%, and a current ratio of 0.5. What is Klamath Corporation’s return on equity?

A. 8.7%

B. 9.1%

C. 18.2%

**D.** Insufficient information to find ROE

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

21.Assume you are a banker who has loaned money to a firm, but that firm is now facing increased competition and reduced cash flows. Which one of the following ratios would you most closely monitor to evaluate the firm’s ability to repay its loan?

A. current ratio

B. debt-to-equity ratio

C. times-interest-earned ratio

**D.** times-burden-covered ratio

E. None of the options are correct.

The times-burden-covered ratio is the best answer, as it indicates how well the firm’s cash flows cover both debt principal and interest payments. The times-interest-earned ratio applies most appropriately when we are confident the firm can roll over existing debt; this is not the case here.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

22. Breakers Bay Inc. has succeeded in increasing the amount of goods it sells while holding the amount of inventory on hand at a constant level. Assume that both the cost per unit and the selling price per unit also remained constant. All else held constant, how will this accomplishment be reflected in the firm’s financial ratios?

A. decrease in the fixed asset turnover rate

B. decrease in the financial leverage ratio

**C.** increase in the inventory turnover rate

D. increase in the days’ sales in inventory

E. decrease in the total asset turnover rate

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

23. Which one of the following statements is correct?

A. If the debt-to-assets ratio is greater than 0.50, then the debt-to-equity ratio must be less than 1.0.

B. Long-term creditors would prefer the times-interest-earned ratio be 1.4 rather than 1.5.

**C.** The assets-to-equity ratio can be computed as 1 plus the debt-to-equity ratio.

D. To realize the best risk and reward profile, financial leverage should be maximized.

E. None of the options are correct.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

24. On a common-size balance sheet, all accounts are expressed as a percentage of

A. sales.

B. profits.

C. equity.

**D.** total assets.

E. None of the options are correct.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

25.Primavera Holdings has a profit margin of 25%, an asset turnover of 0.5, and financial leverage (assets to equity) of 1.5. Primavera has $20 billion in assets, of which half, is in cash and marketable securities. Assume that Primavera earns a 3 percent after-tax return on cash and securities. What would Primavera’s return on equity be if it paid out 90% of its cash and marketable securities as a dividend to shareholders?

A. Negative

B. Between 0% and 20%

C. Between 20% and 40%

**D.** between 40% and 60%

E. Greater than 60%

Currently, equity = $13.33 billion (20/13.33 = 1.5), sales = 10 (10/20 = 0.5) and net income = 2.5 (2.5/10 = 25%).

Paying a $9 billion dividend would reduce assets to $11 billion and equity to $4.33 billion. Net income would fall by 3% × $9 billion = $0.27 billion, to $2.23 billion.

ROE would then be 2.23/4.33 = 51.50%

*Accessibility: Keyboard Navigation*

*Difficulty: 3 Hard*

*Gradable: automatic*

26. Which one of the following statements does NOT describe a problem with using ROE as a performance measure?

A. ROE measures return on accounting book value, and this problem is not solved by using market value.

**B.** ROE is a forward-looking, one-period measure, while business decisions span the past and present.

C. ROE measures only return, while financial decisions involve balancing risk against return.

D. None of these describe problems with ROE.

E. All of these describe problems with ROE.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

*[The following information applies to the questions displayed below.]*

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | Link, Inc. |  |  |  |  |  |  |
|  | Selected financial data ($ thousands) |  |  | 2017 |  |  |
|  | Income statement and related items | 2016 |  |  |  |  |
|  | $160,835 | $ | 274,219 |  |  |
|  | Sales |  |  |
|  | Cost of goods sold | 141,829 |  |  | 209,628 |  |  |
|  | Net income | (91,432) |  |  | (257,981) |  |  |
|  | Cash flow from operations | (35,831) |  |  | (12,538) |  |  |
|  | Balance sheet items | $236,307 | $ | 164,952 |  |  |
|  | Cash |  |  |
|  | Marketable securities | 209,670 |  |  | 22,638 |  |  |
|  | Accounts receivable | 12,645 |  |  | 21,655 |  |  |
|  | Inventory | 3,971 |  |  | 40,556 |  |  |
|  | Total current assets | 462,593 |  |  | 249,801 |  |  |
|  | Accounts payable | 17,735 |  |  | 13,962 |  |  |
|  | Accrued liabilities | 27,184 |  |  | 76,596 |  |  |
|  | Total current liabilities | 44,919 |  |  | 90,558 |  |  |

27. Please refer to the financial data for Link, Inc. above. The current ratio for Link at the end of 2017 is

A. 10.21.

B. 2.31.

**C.** 2.76.

D. 10.30.

E. None of the options are correct.

249,801/90,558 = 2.76

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

28. Please refer to the financial data for Link, Inc. above. Which of the following statements best describes how the Link's short-term liquidity changed from 2016 to 2017?

A. Link’s short-term liquidity has improved modestly.

B. Link’s short-term liquidity has deteriorated very little, but from a low initial base.

C. Link’s short-term liquidity has improved considerably, but from a low initial base.

**D.** Link’s short-term liquidity has deteriorated considerably, but from a high initial base.

E. None of the options are correct.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

29. Please refer to the financial data for Link, Inc. above. Assume a 365-day year for your calculations. Link’s collection period in days, based on sales, at the end of 2017 is

A. 24.3.

B. 219.6.

C. 35.7.

**D.** 28.8.

E. None of the options are correct.

21,655/(274,219/365) = 28.8

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

30. Please refer to the financial data for Link, Inc. above. Assume a 365-day year for your calculations. Link’s inventory turnover, based on cost of goods sold, at the end of 2017 is

**A.** 5.2.

B. 24.3.

C. 28.8.

D. 35.7.

E. None of the options are correct.

209,628/40,556 = 5.2

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

31. Please refer to the financial data for Link, Inc. above. Assume a 365-day year for your calculations. Link’s payables period in days, based on cost of goods sold, at the end of 2017 is

A. 5.2.

**B.** 24.3.

C. 28.8.

D. 35.7.

E. None of the options are correct.

13,962/(209,620/365) = 24.3

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

32. Please refer to the financial data for Link, Inc. above. Assume a 365-day year for your calculations. Link’s days’ sales in cash at the end of 2017 is:

A. 24.3

B. 28.8

C. 219.6

**D.** 249.7

E. None of the options are correct.

(164,952 + 22,638)/(274,219/365) = 249.7

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

33. Please refer to the financial data for Link, Inc. above. Link’s gross margin for 2017 is

A. −94%.

B. 13%.

C. 26%.

D. 31%.

**E.** None of the options are correct.

(274,219 − 209,628)/274,219 = 23.6%

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

34. Please refer to the financial data for Link, Inc. above. Link’s profit margin for 2017 is

**A.** −94%.

B. −57%.

C. 13%.

D. 31%.

E. None of the options are correct.

−257,981/274,219 = −94%

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

35. Please refer to the income statement for VGA Associates below. Assuming that cost of goods sold are variable and operating expenses are fixed, what was VGA Associates’ breakeven sales volume in 2017?

VGA Associates

Income statement for 2017

|  |  |  |
| --- | --- | --- |
| Sales | $ | 200,000 |
| Cost of goods sold |  | 150,000 |
| Gross profit |  | 50,000 |
| Operating expenses |  | 20,000 |
| Operating income |  | 30,000 |
| Interest expense |  | 5,000 |
| Pre-tax income |  | 25,000 |
| Taxes |  | 5,000 |
| Net income | $ | 20,000 |



A. $20,000

**B.** $80,000

C. $150,000

D. $180,000

E. None of the options are correct.

Gross margin = 50,000/200,000 = 25%.

Breakeven sales volume = Operating expenses/Gross margin = $20,000/0.25 = $80,000.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

36. Please refer to the income statement for VGA Associates below. If VGA had a principal repayment of $8,000 due in 2017, what was its times-burden-covered ratio in 2017?

VGA Associates

|  |  |
| --- | --- |
| Income statement for 2017 |  |
| Sales | $ | 200,000 |
| Cost of goods sold |  | 150,000 |
| Gross profit |  | 50,000 |
| Operating expenses |  | 20,000 |
| Operating income |  | 30,000 |
| Interest expense |  | 5,000 |
| Pre-tax income |  | 25,000 |
| Taxes |  | 5,000 |
| Net income | $ | 20,000 |



A. 0.67

B. 1.33

C. 2.31

D. 6.00

**E.** None of the options are correct.

|  |  |  |
| --- | --- | --- |
| *TBC* | = | *EBIT* |
| *Int.Exp.* | + | *Prin.Repay.* |
|   |   | *1* − *t* |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| *TBC* | = | *30,000* | = | *2* |
| *5,000* | + | *8,000* |
|   |   | *1* − *0.2* |   |   |

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

37.Ellsbury Corporation has a goal to reduce its cash conversion cycle. Which of the following actions, holding all else equal, is likely to accomplish this goal?

A. Ellsbury changes the credit terms it offers to customers, allowing them to pay in 45 days instead of 30 days.

**B.** Ellsbury increases the efficiency of its production process, reducing by 10% the average time it takes to convert raw materials to finished products.

C. Ellsbury starts paying off all outstanding invoices to suppliers twice a month instead of once a month.

D. Ellsbury increases its cash/assets ratio from 12% to 15%.

A would increase CCC, because A/R would increase.

B would reduce CCC, because inventory would decrease.

C would increase CCC, because A/P would decrease.

D would not affect CCC.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

38.What is the length of the cash conversion cycle for a firm with $3 million in inventory, $1.5 million in accounts payable, a collection period of 40 days, and an annual cost of goods sold of $18 million?

A. 34.0 days

B. 51.2 days

**C.** 70.4 days

D. 131.2 days

E. None of the options are correct.

CCC = Days Inventory Outstanding + Collection Period − Payables Period

= Inventory/(COGS/365) + Receivables/(Sales/365) − Payables/(COGS/365)

= 3/(18/365) + 40 − 1.5/(18/365)

= 60.8 + 40 − 30.4 = 70.4 days

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

39. Answer the questions below based on the following information. The tax rate is 35%, and all dollars are in millions. Assume that the companies have no liabilities other than the debt shown below.

|  |  |  |
| --- | --- | --- |
|  | Suunto Inc. | Runrun Corp. |
| Earnings before interest and taxes | $ | 280 |  | $ | 294 |  |
| Debt (at 10% interest) | $ | 140 |  | $ | 840 |  |
| Equity | $ | 560 |  | $ | 210 |  |

a. Calculate each company’s ROE, ROA, and ROIC.

b. Why is Runrun’s ROE so much higher than Suunto’s? Does this mean Runrun is a better company? Why or why not?

c. Why is Suunto’s ROA higher than Runrun’s? What does this tell you about the two companies?

d. How do the two companies’ ROICs compare? What does this suggest about the two companies?

a.

|  |  |  |
| --- | --- | --- |
|  | Suunto Inc. | Runrun Corp. |
| Net income |  | 172.9 |  |  | 136.5 |  |
| ROE |  | 31 | % |  | 65 | % |
| ROA |  | 25 | % |  | 13 | % |
| ROIC |  | 26 | % |  | 18 | % |

b. Runrun’s higher ROE is a natural reflection of its higher financial leverage. It does not mean that Runrun is the better company.

c. This is also due to Runrun’s higher leverage. ROA penalizes levered companies by comparing the net income available to equity to the capital provided by owners and creditors. It does not mean that Runrun is a worse company than Suunto.

d. ROIC abstracts from differences in leverage to provide a direct comparison of the earning power of the two companies’ assets. On this metric, Suunto is the superior performer. Before drawing any firm conclusions, however, it is important to ask how the business risks faced by the companies compare and whether the observed ratios reflect long-run capabilities or transitory events.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: manual*

*[The following information applies to the questions displayed below.]*

The financial statements for Limited Brands, Inc. follow (fiscal years ending January):

|  |
| --- |
| Limited Brands, Inc. |
| Balance Sheets ($ Millions) |
|  | 2007 |  | 2006 |  | 2005 |
| Total Assets | 7,093.00 |  |  | 6,346.00 |  |  | 6,089.00 |  |
|  |  |  |  |  |  |  |  |  |
| Liabilities |  |  |  |  |  |  |  |  |
| Long-Term Debt Due In One Year | 8 |  |  | 7 |  |  | 0 |  |
| Payables and Accrued Expenses | 1,701.00 |   |  | 1,568.00 |   |  | 1,451.00 |   |
| Total Current Liabilities | 1,709.00 |  |  | 1,575.00 |  |  | 1,451.00 |  |
| Long-Term Debt | 1,665.00 |  |  | 1,669.00 |  |  | 1,646.00 |  |
| Deferred Taxes | 173 |  |  | 146 |  |  | 177 |  |
| Minority Interest | 71 |  |  | 33 |  |  | 33 |  |
| Other Liabilities | 520 |   |  | 452 |   |  | 447 |   |
| Total Liabilities | 4,138.00 |  |  | 3,875.00 |  |  | 3,754.00 |  |
|  |  |  |  |  |  |  |  |  |
| Total Equity | 2,955.00 |   |  | 2,471.00 |   |  | 2,335.00 |   |
| Total Liabilities & Equity | 7,093.00 |  |  | 6,346.00 |  |  | 6,089.00 |  |
|  |  |  |  |  |  |  |  |  |
| Common Shares Outstanding | 398 |   |  | 395 |   |  | 407 |   |

|  |
| --- |
| Income Statements ($ MILLIONS) |
|  | 2007 |  | 2006 |
| Sales |  | 10,671.00 |  |  |  | 9,669.00 |  |
| Cost of Goods Sold |   | 6,342.00 |   |  |   | 5,920.00 |   |
| Gross Profit |  | 4,329.00 |  |  |  | 3,749.00 |  |
| Selling, General, & Administrative Exp. |   | 2,837.00 |   |  |   | 2,502.50 |   |
| Operating Income Before Deprec. |  | 1,492.00 |  |  |  | 1,246.50 |  |
| Depreciation, Depletion, & Amortization |   | 316 |   |  |   | 299 |   |
| Operating Profit |  | 1,176.00 |  |  |  | 947.5 |  |
| Interest Expense |  | 102 |  |  |  | 94 |  |
| Non-Operating Income/Expense |  | 23 |  |  |  | 25 |  |
| Special Items |   | 0 |   |  |   | 78.5 |   |
| Pretax Income |  | 1,097.00 |  |  |  | 957 |  |
| Total Income Taxes |   | 422 |   |  |   | 291 |   |
| Adjusted Available for Common |  | 675 |  |  |  | 666 |  |
| Extraordinary Items |   | 1 |   |  |   | 17 |   |
| Adjusted Net Income |   | 676 |   |  |   | 683 |   |
|  |  |  |  |  |  |  |  |
| Dividends per share | $ | 0.6 |  |  | $ | 0 |  |

40. Please refer to Limited Brands, Inc.’s financial statements above. Use the company’s operating profit as an approximation of its EBIT, and assume a 40% tax rate for your calculations. For the fiscal years ending in January of 2006 and 2007, calculate:

a. Debt-to-equity ratio

b. Times-interest-earned ratio

c. Times burden covered

|  |  |  |
| --- | --- | --- |
|  |  | Fiscal Year Ending |
|  |  | Jan. 2007 | Jan. 2006 |
| a. | Debt-to-equity ratio | 1.4 |  | 1.57 |  |
| b. | Times-interest-earned ratio | 11.53 |  | 10.08 |  |
| c. | Times burden covered | 10.35 |  | 10.08 |  |

(Note that principal payment in year t equals current portion of long-term debt in year t -1.)

*Accessibility: Keyboard Navigation
Difficulty: 2 Medium
Gradable: manual*

41. Please refer to Limited Brands, Inc.’s financial statements above. Use the company’s operating profit as an approximation of its EBIT, and assume a 40% tax rate for your calculations. What percentage decline in earnings before interest and taxes could Limited Brands have sustained in fiscal years ending in January 2006 and 2007 before failing to cover:

a. Interest and principal repayment requirements?

b. Interest, principal, and common dividend payments?

a. For the fiscal year ending January 2006: Interest expense = $94 Principal repayment = $0 (long−term debt due in one year from 2005) EBIT = $947.5, so it could have fallen (947.5 − 94)/947.5 = 90.1% before failing to cover interest and principal.

For the fiscal year ending January 2007: Interest expense = $102 Principal repayment = $7 (long−term debt due in one year from 2006) EBIT = $1,176, so it could have fallen (1,176 − 102 − 7/0.6)/1,176 = 90.3% before failing to cover interest and principal.

b. For the fiscal year ending January 2006: Interest expense = $94 Principal repayment = $0 (long−term debt due in one year from 2005) Common dividends = Shares outstanding × Dividends per share = 395 × 0.61 = $241.0 EBIT = $947.5, so it could have fallen (947.5 − 94 − 241/0.6)/947.5 = 47.7% before failing to cover interest, principal, and dividends.

For the fiscal year ending January 2007: Interest expense = $102 Principal repayment = $7 (long−term debt due in one year from 2006) Common dividends = Shares outstanding × Dividends per share = 398 × 0.60 = $238.8 EBIT = $1,176, so it could have fallen (1,176 − 102 − 245.8/0.6)/1,176 = 56.5% before failing to cover interest, principal, and dividends.

*Accessibility: Keyboard Navigation
Difficulty: 2 Medium
Gradable: manual*

42. Please refer to Limited Brands, Inc.’s financial statements above. Prepare common-size financial statements for Limited Brands, Inc. for 2006–2007.

|  |
| --- |
| BALANCE SHEETS (% of Assets) |
|  | 2007 |  | 2006 |  | 2005 |
| TOTAL ASSETS | 100 | % |  | 100 | % |  | 100 | % |
| LIABILITIES |  |  |  |  |  |  |  |  |
| Long-Term Debt Due In One Year | 0.11 | % |  | 0.11 | % |  | 0 | % |
| Payables and Accrued Expenses | 23.98 | % |  | 24.71 | % |  | 23.83 | % |
| Total Current Liabilities | 24.09 | % |  | 24.82 | % |  | 23.83 | % |
| Long-Term Debt | 23.47 | % |  | 26.3 | % |  | 27.03 | % |
| Deferred Taxes | 2.44 | % |  | 2.3 | % |  | 2.91 | % |
| Minority Interest | 1 | % |  | 0.52 | % |  | 0.54 | % |
| Other Liabilities | 7.33 | % |  | 7.12 | % |  | 7.34 | % |
| TOTAL LIABILITIES | 58.34 | % |  | 61.06 | % |  | 61.65 | % |
| TOTAL EQUITY | 41.66 | % |  | 38.94 | % |  | 38.35 | % |
| TOTAL LIABILITIES & EQUITY | 100 | % |  | 100 | % |  | 100 | % |
| Common Shares Outstanding | 398 |  |  | 395 |  |  | 407 |  |

|  |
| --- |
| INCOME STATEMENTS (% of Sales) |
|  | 2007 |  | 2006 |
| Sales |  | 100 | % |  | 100 | % |
| Cost of Goods Sold |  | 59.4 | % |  | 61.23 | % |
| Gross Profit |  | 40.6 | % |  | 38.77 | % |
| Selling, General, & Administrative Exp. |  | 26.6 | % |  | 25.88 | % |
| Operating Income Before Deprec. |  | 14 | % |  | 12.89 | % |
| Depreciation, Depletion, & Amortization |  | 2.96 | % |  | 3.09 | % |
| Operating Profit |  | 11 | % |  | 9.8 | % |
| Interest Expense |  | 0.96 | % |  | 0.97 | % |
| Non-Operating Income/Expense |  | 0.22 | % |  | 0.26 | % |
| Special Items |  | 0 | % |  | 0.81 | % |
| Pretax Income |  | 10.3 | % |  | 9.9 | % |
| Total Income Taxes |  | 3.95 | % |  | 3.01 | % |
| Adjusted Available for Common |  | 6.33 | % |  | 6.89 | % |
| Extraordinary Items |  | 0.01 | % |  | 0.18 | % |
| Adjusted Net Income |  | 6.33 | % |  | 7.06 | % |

*Accessibility: Keyboard Navigation
Difficulty: 2 Medium
Gradable: manual*

43. Please refer to the financial statements for Roxbury Corporation. Estimate the length of Roxbury’s cash conversion cycle in 2017.

|  |
| --- |
| Roxbury Corporation |
| 2016 and 2017, ($ millions) |
| INCOME STATEMENT | BALANCE SHEET |
|  | 2016 | 2017 |  | 2016 |  | 2017 |
| Net sales | $ | 47,616 |  | $ | 52,378 |  | Cash & securities | $ | 951 |  | $ | 1,046 |  |
| Cost of goods sold |  | 40,718 |  |  | 44,790 |  | Accounts receivable |  | 6,66 |  |  | 7,333 |  |
| GS&A expense |  | 6,171 |  |  | 6,788 |  | Inventories |  | 5,236 |  |  | 5,760 |  |
| EBIT |  | 727 |  |  | 800 |  | Net fixed assets |  | 2,048 |  |  | 2,253 |  |
| Interest expense |  | 215 |  |  | 255 |  | Total assets | $ | 14,901 |  | $ | 16,392 |  |
| Earnings before tax |  | 512 |  |  | 545 |  | Bank loan | $ | 392 |  | $ | 547 |  |
| Tax |  | 154 |  |  | 164 |  | Accounts payable |  | 7,419 |  |  | 8,161 |  |
| Net income | $ | 358 |  | $ | 382 |  | Long-term debt |  | 2,148 |  |  | 2,551 |  |
|  |  |  |  |  |  |  | Total liabilities |  | 9,959 |  |  | 11,259 |  |
|  |  |  |  |  |  |  | Common stock |  | 1,293 |  |  | 1,293 |  |
|  |  |  |  |  |  |  | Retained earnings |  | 3,649 |  |  | 3,840 |  |
|  |  |  |  |  |  |  | Total equity |  | 4,942 |  |  | 5,133 |  |
|  |  |  |  |  |  |  | Total liabilities & equity | $ | 14,901 |  | $ | 16,392 |  |

CCC = Days Inventory Outstanding + Collection Period − Payables Period

= Inventory/(COGS/365) + Receivables/(Sales/365) − Payables/(COGS/365)

= 5760/(44,790/365) + 7333/(52,378/365) − 8161/(44,790/365)

= 46.9 + 51.1 − 66.5 = 31.5 days

*Accessibility: Keyboard Navigation
Difficulty: 2 Medium
Gradable: manual*

**Chapter 02 Test Bank Summary**

|  |  |
| --- | --- |
| *Category* | *# of Questions* |
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| Difficulty: 1 Easy | 20 |
| Difficulty: 2 Medium | 22 |
| Difficulty: 3 Hard | 1 |
| Gradable: automatic | 38 |
| Gradable: manual | 5 |