13 INTEGRATION OF FIN...EMENT ANALYSIS TECHNIQUES

1. Cash generated from operations (CGO) is least appropriately calculated as:
   (A) EBIT + non-cash charges – increase in working capital.
   (B) operating cash flow + cash interest paid + cash taxes paid.
   (C) net income – cash flow from operations – cash flow from investing.

2. Holdall Corporation recently reclassified many of their assets such that the average useful life of their depreciable assets was reduced. Which of the following is the most likely result from this change on net income and inventory turnover? (Assume everything else remains constant.) Net income will:
   (A) increase and inventory turnover will not change.
   (B) decrease and inventory turnover may or may not change.
   (C) decrease and inventory turnover will rise.

3. Express Delivery Inc. (EDI) reported the following year-end data:

Depreciation expense	$30 million
Net income	$30 million
Total assets	$535 million
Shareholder's equity	$150 million
Effective tax rate	35 percent

Last year EDI purchased a fleet of delivery vehicles for $140 million. For the first year, straight-line depreciation was used assuming a depreciable life of 7 years with no salvage value. However, at year-end EDI's management determined that assumptions of a useful life of 5 years with a salvage value of 10 percent of the original value were more appropriate. How would the return on assets (ROA) and return on equity (ROE) for last year change due to the change in depreciation assumptions? ROA and ROE would be closed to:
   (A) ROA 5.7% and ROE 19.5%.
   (B) ROA 5.0% and ROE 18.2%.
   (C) ROA 5.3% and ROE 20.5%.

4. An investor relations spokesperson for the Square Door Corporation was quoted as saying that Square Door shares were a bargain, selling at a price-to-earnings (P/E) ratio of 12, relative to the S&P 500 average P/E of 15.3. The financial statements reported net earnings of $126 million, or $4.00 per share. The notes to the financial statements included a statement that income for the year included a $31.5 million (after-tax) gain from the reclassification of certain assets from its investment portfolio to its trading portfolio. What would be the normalized P/E?
(A) 13
(B) 16
(C) 15

5. A firm has reported net income of $136 million, but the notes to financial statements includes a statement that the results "include a $27 million charge for non-insured earthquake damage" and a "gain on the sale of certain assets during restructuring of $16 million." If we assume that both of these items are given on a pre-tax basis and the effective tax rate is 36%, what would be the "normal income"?
(A) $94.08 million.
(B) $147.00 million.
(C) $143.04 million.

6. An analyst is developing a framework for financial statement analysis for his firm. The primary goal of financial statement analysis is to:
(A) document portfolio changes for purposes of the Prudent Investor Rule.
(B) facilitate an economic decision.
(C) justify trading decisions for purposes of the Statement of Code and Standards.

7. Star Chemical Inc. (SCI) reported the following year-end data:

Depreciation expense	$25 million
Net income	$35 million
Dividends	$10 million
Total assets	$250 million
Shareholder's equity	$195 million
Effective tax rate	35 percent

SCI also reported that is changed from an accelerated depreciation method to straight line depreciation. The change resulted in a decrease in depreciation expense of $5 million. Management felt that the change "would not have a material effect on financial performance measures. "Ignoring deferred taxes, what are the return on assets (ROA) and return on equity (ROE) measures under the old depreciation methods?
(A) ROA is 13.30% and ROE is 17.05%.
(B) ROA is 12.96% and ROE is 16.56%.
(C) ROA is 13.50% and ROE is 17.51%.

8. Recently, Galaxy Corporation lowered its allowance for doubtful accounts by reducing bad debt expense from 2 percent of sales to 1 percent of sales. Ignoring taxes, what are the immediate effects on Galaxy's operating income and operating cash flow?

	Operating income	Operating cash flow
(A)	Higher	No effect
(B)	No effect	Higher
(C)	Lower	Lower

9. Endrun Company reported net income of \$4.7 million in 1999, and \$4.3 million in 2000. In reviewing the annual report an analyst notices that the Endrun took a charge of \$2.4 million in 1999 for the costs of relocating its main office, and in 2000 booked a gain of \$900,000 on the sale of its previous office building. What would "normalized earnings" be for 1999 and 2000 if we assume a tax rate of 36% for both years?
   (A) \$3.99 million and \$2.54 million.
   (B) \$7.1 million and \$5.2 million.
   (C) \$6.236 million and \$3.724 million.

10. An analyst is analyzing TRK Construction (TRK) for possible recommendation to his firm's clients. He wants to use TRK's financial statements to answer such questions as "Is TRK suitable for firm clients?", "Is TRK priced properly relative to peers?", "What is TRK's earnings quality?" The analyst is most likely to begin with:
   (A) analysts adjustments to the financial statements.
   (B) a review of his firm's framework for analysis of financial statements.
   (C) a DuPont analysis.

11. Wanda Brunner, CFA, is analyzing Straight Elements, Inc., (SE). SE is a discount manufacturer of parts and supplies for the railroad industry. She has followed her firm's suggested financial analysis framework, and has assembled output from processing data. When applying the financial analysis framework, which of the following is the best example of output from processing data?
   (A) Audited financial statements.
   (B) Common-size financial statements.
   (C) A written list of questions to be answered by the analysis.

12. An analyst finds return-on-equity (ROE) (based on beginning of the year equity) a good measure of management performance and wants to compare two firms: Firm A and Firm B. Firm A reports net income of \$3.2 million and has a ROE of 18. Firm B reports income of \$16 million and has an ROE of 16.

    A review of the notes to the financial statements for Firm A, shows that the earnings include a loss from smelting operations of \$400,000 and that the firm has exited this business. In addition, the firm sold the smelting equipment and had a gain on the sale of \$300,000.

A similar review of the notes for Firm B discloses that the $16 million in net income includes $2.6 million gain on the sale of no longer needed office property. Assume that the tax rate for both firms is 36%, and that the notes describe pre-tax amounts. Which of the following is closest to the "normalized" ROE for Firm A and for Firm B, respectively?

(A) 18.4 and 14.3.

(B) 17.1 and 16.9

(C) 16.0 and 18.0.

13. If segmental cash flow data has not been reported, we can most appropriately approximate cash flow as:

(A) EBIT + non-cash charges + increase in working capital.

(B) EBIT +depreciation + amortization.

(C) operating cash flow – cash interest – cash taxes.

14. Which of the following statements is CORRECT when inventory prices are falling?

(A) LIFO results in higher COGS, lower earnings, higher taxes, and higher cash flows.

(B) LIFO results in lower COGS, lower earnings, lower taxes, and higher cash flows.

(C) LIFO results in lower COGS, higher earnings, higher taxes, and lower cash flows.

15. MKF Consolidated reports $500 million in goodwill on its balance sheet. The market consensus indicates that the value of MKF's intangible assets is $300 million. How should an analyst adjust MKF's balance sheet? Reduce goodwill and:

(A) increase liabilities by $200 million.

(B) equity by $200 million.

(C) equity by $500 million while increasing liabilities by $300 million.

16. Inventories are listed on the balance sheet at $600,000, retained earnings are $1.9 Million. In the notes to financial statements, you find a LIFO reserve of $125,000. Also, the probability of a LIFO liquidation is high. Assuming a tax rate of 36%, what will be the adjusted value of retained earnings?

(A) $1,820,000.00.

(B) $1,980,000.00.

(C) $1,855,000.00.

17. A firm seeking to lower current tax liability may elect to use which method of inventory valuation during an inflationary period?

(A) Average cost.

(B) FIFO.

(C) LIFO.

18. In order to compare companies using a common size statement, the various line items in a company's income statement are most likely to be divided by the company's:

(A) total assets.

(B) revenues.

(C) net earnings.

19. ABC Tie Company reports income for the year 2009 as $450,000. The notes to its financial statements state that the firm uses the last in, first out (LIFO) convention to value its inventories, and that had it used first in, first out (FIFO) instead, inventories would have been $62,000 greater for the year 2008 and $78,000 greater for the year 2009. If earnings were restated using FIFO to determine the cost of goods sold (COGS), what would the net income be for the year 2009? Assume a tax rate of 36%. Net income would have been:
    (A) $455,760.
    (B) $439,760.
    (C) $460,240.

20. An analyst is developing a framework for financial statement analysis for his firm. This framework is most likely to include:
    (A) Maintain integrity of capital markets, perform duties to clients and employers, and avoid conflicts of interest.
    (B) Determine the allocation of firm fees, interpret processed data, and communicate conclusions.
    (C) Define the purpose of the analysis, process input data, and follow up.

21. An analyst is analyzing a discount manufacturer of parts and supplies. She has followed her firm's suggested financial analysis framework and has communicated with company suppliers, customers, and competitors. This is an input that occurs while:
    (A) processing data.
    (B) collecting data.
    (C) establishing the objective of the analysis.

22. Coastal Drilling Corp (CDC) reported the following year-end data:

EBIT	$23 million
EBT	$20 million
Effective tax rate	40 percent

CDC reported in the footnotes to its financial statements that it had increased the expected return on pension plan assets assumption which resulted in an increase of EBIT of $2 million. Analyst Wanda Brunner, CFA, thinks this change in assumptions is unfounded and removes the $2 million increase in EBIT. Which of the following is closest to the tax burden ratio after adjustment?
    (A) 55.6%.
    (B) 60.0%.
    (C) 61.9%.