29 SOURCES OF CAPITAL

1. Quixote Co. and Sisyphus Co., two similar-sized competitors, have had stable operating cycles of 180 days and cash conversion cycles of 140 days over the past several years. Sisyphus' operating and cash conversion cycles remained at these levels in the most recent year, but Quixote's cash conversion cycle contracted to 120 days while its operating cycle remained at 180 days. Relative to Sisyphus, Quixote has *most likely begun:*
   (A) taking more time to pay its suppliers.
   (B) operating with less inventory on hand.
   (C) offering easier credit terms to its customers.

2. An example of a secondary source of liquidity is:
   (A) negotiating debt contracts.
   (B) cash flow management.
   (C) trade credit and bank lines of credit.

3. Which of the following most accurately represents the cash conversion cycle?
   (A) average days of receivables + average days of inventory - average days of payables.
   (B) average days of payables + average days of inventory - average days of receivables.
   (C) average days of receivables + average days of inventory + average days of payables.

4. An analyst who is evaluating a firm's liquidity position would be least likely to be concerned if the firm's:
   (A) number of days of inventory is higher than that of its peers.
   (B) total asset turnover is lower than its industry average.
   (C) operating cycle is shorter than that of its peers.

5. The average number of days that it takes to turn raw materials into cash proceeds is a firm's:
   (A) inventory turnover cycle.
   (B) receivables cycle.
   (C) operating cycle.

6. Pierce Motor Company has an operating cycle of 150 days and a cash conversion cycle of 120 days, while Dunhill Motor, Inc. has an operating cycle of 140 days and a cash conversion cycle of 125 days. Based on these figures it is most likely that:
   (A) average days of payables for Dunhill is less than for Pierce.
   (B) average days of inventory for Dunhill is less than for Pierce.
   (C) average days of receivables for Dunhill is less than for Pierce.

7. Which of the following sources of liquidity is the *most* reliable?
   (A) Uncommitted line of credit.
   (B) Revolving line of credit.
   (C) Committed line of credit.

8. Which of the following sources of credit would an analyst most likely associate with a borrower of the lowest credit quality?
   (A) Uncommitted line of credit.
   (B) Revolving line of credit.
   (C) Committed line of credit.

9. Which of the following is NOT a limitation to financial ratio analysis?
   (A) A firm that operates in only one industry.
   (B) The need to use judgment.
   (C) Differences in international accounting practices.

10. In reviewing the effectiveness of a company's liquidity, an analyst has calculated operating cycle and cash conversion cycle measures for the past three years.

	20X6	20X7	20X8
Operating cycle (number of days)	55	60	62
Cash conversion cycle (number of days)	27	30	32

The trends in the operating cycle and cash conversion cycle *most likely indicate:*
   (A) slower collections of receivables.
   (B) improving liquidity.
   (C) stretching of payables.

11. The condition that occurs when a company disburses cash too quickly, stretching the company's cash reserves, is best described as a:
   (A) pull on liquidity.
   (B) drag on liquidity.
   (C) liquidity premium.

12. Which of the following sources of short-term liquidity is considered reliable enough that it can be listed in the footnotes to a firm's financial statements as a source of liquidity?
   (A) Revolving line of credit.
   (B) Factoring agreement.
   (C) Uncommitted line of credit.

13. An analyst has calculated the following statistics for Company X and Company Y.
Company X Company Y

	Company X		Company Y	
	Year 1	Year 2	Year 3	Year 4
Number of days of inventory	18	22	33	24
Number of days of receivables	14	16	14	12
Number of days of payables	19	20	18	20

The net operating cycle for:
(A) Company Y was 36 days in year 2, a decline in liquidity compared to year 1.
(B) Company X was 18 days in year 2, an improvement in liquidity compared to year 1.
(C) Company Y was 16 days in year 2, an improvement in liquidity compared to year 1.

14. A high cash conversion cycle suggests that a company's investment in working capital is:
(A) appropriate.
(B) too low.
(C) too high.

15. A company is most likely to have a longer operating cycle than its peers if it:
(A) has a higher payables turnover ratio than its peers.
(B) has a higher inventory turnover ratio than its peers.
(C) grants more lenient credit terms to its customers than its peers.

16. A large, creditworthy manufacturing firm would most likely get short-term financing by:
(A) Issuing commercial paper.
(B) Factoring its receivables.
(C) Entering into an agreement for a committed line of credit

17. Which of the following is least likely an indicator of a firm's liquidity?
(A) Inventory turnover.
(B) Amount of credit sales.
(C) Cash as a percentage of sales.

18. A firm has average days of receivables outstanding of 22 compared to an industry average of 29 days. An analyst would most likely conclude that the firm:
(A) Has a lower cash conversion cycle than its peer companies.
(B) Has better credit controls than its peer companies.
(C) May have credit policies that are too strict.

19. Alton Industries will have better liquidity than its peer group of companies if its:
(A) quick ratio is lower.
(B) average trade payables are lower.
(C) receivables turnover is higher.

20. Which of the following factors is most likely to cause a firm to need short-term financing?
    (A) Operating cash inflows that fluctuate seasonally.
    (B) Return of principal from maturing investments.
    (C) Shorter cash conversion cycle than the industry average.

21. The quick ratio is considered a more conservative measure of liquidity than the current ratio because the quick ratio excludes:
    (A) Inventories.
    (B) Marketable securities.
    (C) accounts receivable.

22. An analyst computes the following ratios for Iridescent Carpeting Inc. and compares the results to the industry averages:

Financial Ratio	Iridescent Carpeting	Industry Average
Current Ratio	2.3	1.8
Net Profit Margin	22%	24%
Return on Equity	17%	20%
Total Debt / Total Capital	35%	56%
Interest Coverage Ratio	4.7	4.1

Based on the above data, which of the following can the analyst conclude? Compared to its competitors, Iridescent Carpeting is more:
    (A) Leveraged.
    (B) Liquid.
    (C) Profitable.

23. Liquidating short-term assets and renegotiating debt agreements are best described as a firm's:
    (A) Primary sources of liquidity.
    (B) Pulls and drags on liquidity.
    (C) Secondary sources of liquidity.

24. An example of a primary source of liquidity is:
    (A) Renegotiating debt agreements.
    (B) Filing for bankruptcy.
    (C) Using trade credit from vendors.