

CFIN Unit II Review Packet

THINK QUICK

Please respond to the questions below in the space provided

1. What is working capital? What does this number tell you?
2. What is the difference between direct materials, work in process, and finished goods? Give an example of each.
3. Briefly explain the difference between wages and salary.
4. Don Lemmedown has invested \$200,000 in a company and would be disappointed with profits of less than \$10,000. What is Don's cost of equity, expressed as a percentage? Show your work.
5. Something Myth Inc. has 30 percent debt at a cost of 7% and 70 percent equity at a cost of 10%. Find the WACC. Show your work.
6. Wuzzup Widgets has 30 percent debt at a cost of 6% and 70 percent equity at a cost of 10%. Find the WACC. Show your work.
7. Flatazz TVs has a new project that costs \$200,000 and the payback is eight years. How much does the project bring in each year (Assume an equal amount for each year)? Show your work.
8. Mammoth Ventures spends \$36,000 on a huge new machine that will result in the massive annual savings shown below. Find the payback in years. Show your work.

Year	Cash flows
1	\$12,000
2	\$10,000
3	\$8,000
4	\$7,000
5	\$5,000
9. Explain the difference between an income statement and a balance sheet. What information is found on each form and who might find this information useful?
10. What is ratio analysis and why is it important? How might managers, investors, and creditors use ratio analysis differently?

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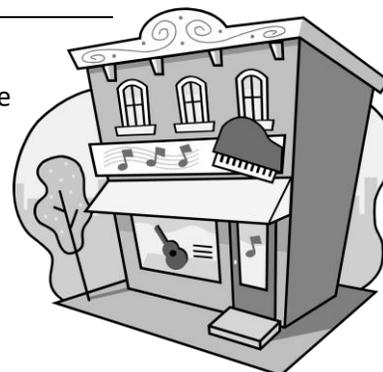
IN DEPTH

Please respond to the questions below thoughtfully and completely on a separate sheet of paper. 100 word minimum each.

1. Explain the difference between an income statement and a balance sheet. What information is found on each form and who might find this information useful?
2. What is ratio analysis and why is it important? How might managers, investors, and creditors use ratio analysis differently?

CASE STUDY: Groovy Music

You just purchased a music store and have all sorts of plans for changing the business and making it better. You are in the process of applying for a bank loan to pay for all these exciting improvements. As part of the application process, the bank is asking you to calculate several financial ratios for them. Use the attached financial information (and your knowledge of ratio analysis) to calculate the ratios below and answer the questions that follow.



Part 1: Ratio Analysis

Use the financial statements on the next page to calculate the ratios below.

Liquidity Ratios

1. Current Ratio: _____
2. Quick Ratio: _____

Debt Management Ratios

6. Debt Ratio: _____
7. Times Interest Earned: _____

Asset Management Ratios

3. Inventory Turnover: _____
4. Asset Turnover: _____
5. Accounts Receivable Turnover: _____

Profitability Ratios

8. Profit Margin: _____
9. Return On Total Assets: _____
10. Return On Equity: _____

Part 2: Industry Comparison

Based on the ratios that you just calculated and the industry averages shown below, respond to the following question thoughtfully and completely on a separate sheet of paper. Your answer should be approximately 100 words.

1. The average ratios for other music stores are shown below. Write a paragraph stating whether your company is better or worse than each of the industry averages (note: this requires that you understand whether each ratio should be a higher or lower number).

Liquidity Ratios

Current Ratio 1.70
Quick Ratio 1.03

Debt Management Ratios

Debt Ratio..... 0.42
Times Interest Earned 4.57

Asset Management Ratios

Inventory Turnover..... 7.55
Asset Turnover 1.00
Accounts Receivable Turnover 8.33

Profitability Ratios

Profit Margin 16.10%
Return on Total Assets 12.40%
Return on Equity..... 44.30%

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Part 3: Conclusions

Based on all of the information in this case, respond to the following question thoughtfully and completely on a separate sheet of paper. Your answer should be approximately 100 words.

1. Write a paragraph that provides your justifications for why the bank should lend you the money. Highlight the ratios that you feel are most important for their decision. You might want to discuss how you will work to improve these ratios if they are weak, or how you will maintain them if they are strong. Feel free to be a little creative!
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Groovy Music Financial Statements

INCOME STATEMENT		BALANCE SHEET	
Total Revenues	30,000	ASSETS	
Cost of Revenues	5,000	Cash and Cash Equivalents	6,000
Gross Profit	25,000	Accounts Receivable	4,000
Operating Expenses	9,000	Inventory	7,000
Operating Income (or Loss)	16,000	Other Current Assets	1,000
Interest Expense	1,500	Total Current Assets	18,000
Income Tax Expense	500	Property, Plant, and Equip.	12,000
Net Income	14,000	Other Assets	500
		Total Assets	30,500
		LIABILITIES	
		Accounts Payable	2,000
		Short-Term Debt	2,000
		Other Current Liabilities	200
		Total Current Liabilities	10,200
		Long-Term Debt	9,000
		Other Liabilities	1,300
		Total Liabilities	20,500
		STOCKHOLDERS' EQUITY	
		Total Stockholder's Equity	10,000