FINAL EXAM—REVIEW SHEET

This sheet, while not all inclusive, should give you a good idea as to the topics that will be included on the final exam. The exam will include multiple choice questions and problems. If you have worked and understand the end-of-chapter problems that were assigned, you should be able to solve the problems on the exam.

Part 1—Chapters 9 – 11 & 14

<u>Chapter 9: Capital Budgeting Techniques</u>

- What are the various types of capital budgeting decisions? What does it mean for projects to be independent? Mutually exclusive?
- Be able to compute the payback period (both traditional and discounted), net present value (NPV), and internal rate of return (IRR) for a capital budgeting project. Understand what the result for each computation means. For example, what does it mean if you find a project has an IRR equal to 14 percent? If NPV > 0, what is the relationship between the firm's required rate of return and the project's IRR, and what is the project's discounted payback period relative to its life?
- How do capital budgeting decisions differ from general asset valuation? Are they based on the same concepts?

<u>Chapter 10: Project Cash Flows and Risk</u>

- Understand and be able to identify the different cash flows that are relevant for making capital budgeting decisions. For example, what would be included as part of the initial investment outlay, supplemental operating cash flows, and terminal cash flow? How does the identification of these cash flows differ if the project is a replacement asset rather than an expansion asset?
- Be able to compute relevant cash flows mentioned in the lecture and contained in the problems assigned from the book.
- Why should the risk associated with a project be considered when making a capital budgeting decision? What incorrect decisions could be made if risk is not considered in capital budgeting analysis?
- Understand how risk is incorporated into capital budgeting decisions. What techniques are used?
- Depreciation is not a cash flow; it is a noncash expense. So, why is depreciation considered when determining incremental cash flows?

<u>Chapter 11: The Cost of Capital</u>

- Understand the concept of weighted average cost of capital (WACC)—that is, the definition and the use. Remember that the WACC is simply the average cost of all the funds used to finance the firm's assets based on the proportion of each type of funds used; thus, it is the minimum rate of return the firm must earn when investing those funds.
- Be able to compute each of the component costs of capital as well as the WACC. Why is the cost of debt adjusted for taxes whereas the costs of equity, whether preferred stock or common equity, are not? Understand why there is a cost associated with retained earnings. Why is the cost of retained earnings *always* less than the cost of issuing new (external) equity?

- Understand what causes the WACC to change—that is, understand what break points are. Be able to compute break points. What is one break point that a firm always faces? (Think about retained earnings.)
- How is the WACC used to make capital budgeting decisions?

Chapter 14: Managing Short-Term Financing

- Understand what working capital management entails.
- What is the cash conversion cycle? How do firms use information from the cash conversion cycle to help achieve the goal of wealth maximization? Be able to compute the cash conversion cycle for a firm.
- Understand the current asset financing policies discussed in class. Which one is riskiest? Which one is most profitable?
- What are the general characteristics of short-term financing? What are some of the different types of short-term financing firms use (e.g., accruals, trade credit, and so forth)?
- Be able to compute the cost of different types of short-term financing. Be able to compute the amount a firm must borrow to end up with a particular amount it can use.

Part 2—Chapters 1 - 8

Chapter 1: An Overview of Managerial Finance

- Understand the different forms of business organizations and the major differences among them.
- Know what the primary goal of the firm should be, and why it should be the firm's primary goal.
- Know how foreign firms differ from U.S. firms and how multinational finance differs from finance in purely domestic companies.

Chapter 2: Analysis of Financial Statements

- DO NOT MEMORIZE ANY OF THE RATIOS; all the equations you need to answer questions on the exam are given on the formula sheet that is posted on the course web page at http://sbesley.myweb.usf.edu/FIN3403/eqn.html
- Understand which financial statements are generated by corporations.
- Know what information each of the five categories of ratios mentioned in the text provides to those who interpret the ratios?
- Know the uses and limitations of ratio analysis.

Chapter 3: The Financial Environment: Markets, Institutions, and Investment Banking

- Know what a financial market is and what types of financial markets exist.
- Understand what a financial intermediary is and what some of the more common financial intermediaries are.
- Understand what an investment banker is and the services investment banking houses provide.

Chapter 4: Time Value of Money

- Understand the concept of the time value of money.
- Be able to compute the future value and the present value of different cash flow patterns.
- Understand and be able to compute the effective annual rate (EAR = r_{EAR}) and the APR. What is the difference between r_{EAR} and APR?

Chapter 5: The Cost of Money (Interest Rates)

- Understand how interest rates are determined in general and what factors affect interest rates.
- Understand the basic risks that are included in the risk premium associated with a debt instrument (i.e., DRP, LP, and MRP)
- Be able to compute expected interest rates. (If you are given a problem, it will be fairly short and relatively simple.)

Chapter 6: Bonds (Debt)—Characteristics and Valuation

- Know the general characteristics/features of bonds.
- Understand the basic concept of valuation.
- Be able to compute the value and the yield to maturity (YTM) of a bond. Understand what the YTM of a bond represents.
- Understand the relationship between YTM and the coupon rate and the market value of a bond. For example, if a bond is selling at a premium, is the bond's YTM equal to, greater than, or less than its coupon rate of interest?
- How is the coupon rate of a bond determined? When is it determined?

Chapter 7: Stocks (Equity)—Characteristics and Valuation

- Know the general characteristics/features of stocks.
- Be able to compute the value of a stock when there is constant growth.
- Understand the components that make up the required return earned on a stock—that is, dividend yield and capital gains.

Chapter 8: Risk and Rates of Return

- Understand what investment risk is and how it is measured.
- Understand the difference between the risk associated with holding an investment in isolation (i.e., by itself or alone) and the risk associated with holding the same investment in a well-diversified portfolio.
- What is the expected rate of return of an investment and how is it measured?
- Understand what the relevant risk of an investment is and how it is measured (β).
- Be able to compute expected rates of return using the CAPM.