Session 1: Post class test (solutions)

1. F. All of the listed are corporate finance decisions, since they all require financial resources. The one that comes closest to not making it is the accounting reevaluation because it really is cosmetic. The only reason I include it is because you have to pay the accountants to do this cosmetic restatement.
2. **c. That the firm is funded with primarily equity and pays little out to its stockholders.** If you are a firm that derives your value from growth assets, you cannot afford debt (since you don't have much in existing assets & cash flows) and you need all your cash to go back into the firm to generate future growth (and thus cannot return cash to stockholders).
3. **e. Firms should take investments that earn returns greater than the risk adjusted hurdle rate.** It is not enough that the investments are profitable & increase growth or that they earn more than the risk free rate. The projects earning the highest returns may not be good enough, if they are very risky.
4. e. Debt in the same currency that your cash flows are in. Using the cheapest debt, the longest term debt or the shortest term debt may not make sense if the debt is not matched up to the cash flows on the assets. Mismatching debt to assets increases default risk.
5. c. Firms that have high earnings and low growth potential will return more cash to stockholders. It is a combination of having lots of earnings (cash flows) and not that much to invest those cash flows in that creates the opportunity to return more cash.