

## ACCOUNTING

Financial Statement Analysis and Valuation

Answering time 4 hours

Course number: 2163

14.1.2012

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Calculator allowed

Assuming they are the right sentences, ten sentences per question should be more than enough to answer questions one to four perfectly. To get the maximum points in question five, the answer should include calculations.

Good luck!

1. Mention five "red flags" that may point toward questionable accounting quality. (10 points)
2. What are the two main sources of competitive advantage and what ratios would you look at to determine which of these two competitive strategies a firm follows? (15 points)
3. Why is interest bearing debt usually included in a firm's optimal capital structure and state which factors influence what financial leverage –level a firm should choose? (15 points)
4. Let's assume that a firm has the option of either (1) expensing R&D outlays as occurred directly in the income statement or (2) capitalizing the R&D outlays on the balance sheet and then depreciate them during the following years. Use the discounted abnormal earnings valuation model to describe how the choice between these two options affects the value of the firm. (15 points)
5. Take a look at the beginning (year 0) and ending balance sheets (year 1) and the income statement between these two (year 1), which are given on the back of this page, and state (a) the cash flow from operating activities, (b) the cash flow from investing activities and (c) the cash flow from financing activities for year 1. (15 points)

Tables for question 5

Beginning balance sheet:

| Assets (year 0)   |       |  | Equity and liabilities (year 0) |       |
|-------------------|-------|--|---------------------------------|-------|
| Plant & Equipment | 5000  |  | Equity                          | 5000  |
| Inventory         | 2000  |  | Interest bearing debt           | 4000  |
| Receivables       | 2000  |  | Payables                        | 1000  |
| Cash              | 1000  |  |                                 |       |
| Total             | 10000 |  | Total                           | 10000 |

Income statement:

| Income statement (year 1)              |       |
|--|-------|
| Net sales                              | 20000 |
| Cost of goods sold (COGS)              | 12000 |
| Selling, general & admin. costs (SG&A) | 5000  |
| Depreciation                           | 1000  |
| Operating income                       | 2000  |
| Interest costs (net)                   | 300   |
| Net income                             | 1700  |

(There are no taxes)

Ending balance sheet:

| Assets (year 1)   |       |  | Equity and liabilities (year 1) |       |
|-------------------|-------|--|---------------------------------|-------|
| Plant & Equipment | 5500  |  | Equity                          | 6000  |
| Inventory         | 3500  |  | Interest bearing debt           | 4500  |
| Receivables       | 2300  |  | Payables                        | 2100  |
| Cash              | 1300  |  |                                 |       |
| Total             | 12600 |  | Total                           | 12600 |