

Exam 2 Spring 2003 Closed Book Answers

1. b. False
2. a. True
3. Topic not covered on this exam.
4. Topic not covered on this exam.
5. Topic not covered on this exam.
6. As discussed in the text, list three common differences between operating leases and financial leases?

Operating leases are usually short term, cancelable before the end of the lease term, are usually off-balance sheet financing, and the entire lease payment is tax-deductible.

Financial leases are long term (usually the economic life of the asset), cannot be cancelled before the end, are on-balance sheet financing similar to secured loans, and have tax treatment similar to owning an asset that is financed with debt (i.e. deduct depreciation and interest expense only).

7. This topic was not covered in this textbook, and therefore would not be on this exam.
8. b. False
9. a. True
10. Topic not covered on this exam.
11. a. True
12. Topic not covered on this exam.
13. Topic not covered on this exam.

Exam 2 Spring 2003 FINC 4532 Open Book

1. BlackRock Corporation is considering a leasing arrangement to finance some special manufacturing tools that it needs for production during the next four years. A planned change in the firm's production technology will make the tools obsolete after 4 years. The firm will depreciate the cost of the tools using the MACRS 3 year schedule. The firm can borrow \$5,700,000, the purchase price, at 12 percent on an amortized loan to buy the tools, or it can make three equal beginning-of-year lease payments of \$2,800,000. The firm's tax rate is 40 percent. Annual maintenance costs associated with ownership are estimated at \$180,000. Should the firm lease or buy the piece of equipment (1 point)? Numerical evidence that your answer is correct (12 points)

USE the Solution shown in class on the board

2. Topic not covered on this exam.
3. Topic not covered on this exam.
4. Topic not covered on this exam.

5. (3 points) Higher return is associated with higher inflation and therefore depreciating currency, thus the pound is depreciating. With a difference of 4% per year, this is 1% per quarter. Also, note you are quoted the rate for 1 pound, and in the answer we want the rate for 1 dollar.

Convert 1 pound = \$1.60 to \$1 = .625 pounds using  $1/x$  function. Since the pound is depreciating, it takes more 1% pounds to buy \$1, thus .63125 is the answer.

6. since  $1 \text{ MK} = 1234.56 \text{ CP}$ , use  $1/x$  to show  $1 \text{ CP} = .00081 \text{ MK}$

7.  $\text{SF} = 3264 \text{ US}$ ,  $\$1 = 1.58 \text{ SF}$ , answer can be either  $\$1 = \text{___ US}$  or  $1 \text{ US} = \$\text{___}$ .

To solve one way, use  $1/x$  to get  $1 \text{ SF} = \$0.632911$ . Now since each equals 1 SF, use division to solve,  $3264 / 0.632911$  or  $5157.12 \text{ US} = \$1$ .

8. Take the \$1000 to Cancun, convert to 8200 pesos, then buy 91.11 CDs ( $8200/90$ ) in Cancun. Fly to Atlanta, and sell the CDs for \$1002.22 for a profit of \$2.22.