Business 2019 FA

Assignment 1

Due Tuesday, October 1, 8:30am (beginning of class)

1. Explain what an efficient capital market is. Are North American capital markets efficient? Explain how an argument supporting market efficiency can be constructed. Explain how an argument contradicting market efficiency can be constructed.

   Hints: This is not an easy question. See, among others,

   (a) Fama, E. (1970), "Efficient Capital Markets", *Journal of Finance*, vol 25, pp 383-417;

   (b) Fama, E. (1991), "Efficient Capital Markets II", *Journal of Finance*, vol 46, pp 1575-1618;

   (c) DeBondt, W. and Thaler, R. (1985). "Does the Stock Market Overreact?", *Journal of Finance* vol 40, pp 793-805;

   (d) Chan, K.C. (1988), "On the Contrarian Investment Strategy", Journal of Business vol 61, pp 147-163.

   Links to these articles and other documents of interest will be available on the course website at
   http://foba2.lakeheadu.ca/gregoire/2019/assign.htm

2. (Internet Application Question) Canadian banks are actively involved in financing home mortgages. Describe the role played by the Canadian Mortgage and Housing

Corporation in home mortgages (www.cmhc.ca). What is the National Housing Act? Click on the *Mortgage insurance & investments* menu and then *Mortgage-Backed Securities* on the CMHC homepage and describe Mortgage Backed Securities offered by the CMHC.

3. Big Bock Brewery shows the following information on its 2000 income statement: sales $= \$70,000$; costs $= \$42,000$; other expenses $= \$1,750$; depreciation expense $= \$3,000$; interest expense $= \$7,000$; current taxes $= \$4,165$; tax rate $= 34\%$; dividends $= \$3,200$. In addition, you're told that the firm issued $1,415 in new equity during 2000 and redeemed $3,000 in outstanding long-term debt.

   (a) What is the 2000 operating cash flow?

   (b) What is the 2000 cash flow to creditors?

   (c) What is the 2000 cash flow to stockholders?

   (d) If the next fixed assets increased by $2,500 during the year, what is the addition to NWC?

4. You have the following information about some firm: sales $= \$17,000$; costs $= \$9,000$; addition to retained earnings $= \$3,000$; dividends paid $= \$400$; interest expense $= \$950$; tax rate $= 35\%$. Calculate the depreciation expense.

5. Harvest Corp. is obligated to pay its creditors $1,800 during the year. What is the value of shareholders' equity if total assets equal $2,000? What if total assets equal $1,600?

6. Prepare a balance sheet for Bean Co. as of December 31, 2001, based on the following information: cash $= \$180,000$; patents and copyrights $= \$525,000$; accounts payable $= \$500,000$; accounts receivable $= \$125,000$; tangible net fixed assets $= \$3,000,000$; inventory $= \$330,000$; notes payable $= \$120,000$; accumulated retained earnings $= \$2,750,000$; long-term debt $= \$525,000$.

7. During 2000, Mattawa Canoes Inc. has sales of \$700,000. Cost of goods sold, administrative and selling expenses, and depreciation expenses were \$400,000, \$200,000, and \$60,000, respectively. In addition, the company had an interest expense of \$55,000 and a tax rate of 35% (ignore and tax loss carry-forward or carry-forward provisions). Find Mattawa's net income for 2000. Find Mattawa's operating cash flow. Explain the discrepancy between these two values.

8. Ross, Westerfield, Jordan and Roberts, Chapter 2, Problem 25.

9. Ross, Westerfield, Jordan and Roberts, Chapter 2, Problem 29.

10. Ross, Westerfield, Jordan and Roberts, Chapter 2, Problem 30.

11. Ross, Westerfield, Jordan and Roberts, Chapter 2, Problem 31.

12. Find (recent) annual financial statements for an existing publicly traded company (copies of the statements used and their source have to be provided in appendix). For a given year, 2000, for example, calculate the cash flow from assets as we have done it in class. Compare your result with the firm's statement of cash flow for that year. How to reconcile the two values (if they differ)? For the same year, explain how the value for shareholders' equity has been computed.