# CRC Sample Questions

1. Pretty Pets operates a chain of pet shops in suburban malls throughout the country. The company is experiencing rapid sales growth through new store openings. Pretty Pets opens 3 to 5 new stores every two years and it takes three years for each new store to reach profitability. In reviewing the company's direct cash flow statement, which of the following would most likely occur?

    a. Decrease in working capital assets.
    b. A financing surplus.
    c. A decrease in net cash after operations.
    d. Increase in miscellaneous income.

2. Mountain Candies is a regional manufacturer of chocolates. The following is a summary of the company's Year 1 performance and the relevant RMA Statement Studies statistics for the industry.

    **RMA Statement Studies:**

    | | |
    |---|---|
    | Net sales | 100% |
    | Gross profit | 47.4% |
    | Operating expenses | 43.1% |
    | Operating profit | 4.3% |
    | All other expenses (net) | 1.3% |
    | Profit before taxes | 3.0% |

    **Mountain Candies:**

    | | |
    |---|---|
    | Net sales | $10,500 |
    | Gross profit | 3,885 |
    | Operating expenses | 3,430 |
    | Operating profit | 455 |
    | All other expenses (net) | 85 |
    | Profit before taxes | $260 |

    Which of the following best describes the company's performance in comparison to its industry peers?

    a. Operating profit margin meets industry standard despite higher operating expenses.

b. Operating profit margin meets industry standard despite lower gross profit margin.
c. Net profit margin is better than industry standards due to lower operating expenses.
d. Net profit margin is better than industry standards due to higher gross profit margin.

3. Pretty Pets operates a chain of pet shops in suburban malls throughout the country. The company is experiencing rapid sales growth through new store openings. Pretty Pets opens 3 to 5 new stores every two years and it takes three years for each new store to reach profitability. The company has requested long-term financing from Your Bank to fund the leasehold improvements and inventory growth required for opening its new stores. Which of the following will you most likely require to mitigate the risk that the company will be unable to repay debt from cash flow?

   a. Personal guarantees from the owners of Pretty Pets.
   b. First security interest in the assets of the company.
   c. Landlord waiver.
   d. Limitations on new store openings.

4. Dr. Roberta Bryant is offering her personal guarantee to support a $3 MM commercial real estate loan to her company, Bryant Medical, a physicians group specializing in plastic surgery. The company is purchasing and renovating a new facility in the major suburban area. In addition, the bank will be providing a $1 MM line of credit to support accounts receivables for the firm. Bryant's personal financial statement is detailed below.

| | | |
|---|---|---|
| Cash | $108 | |
| Stocks/shares | 314 | |
| Personal residence | 450 | |
| Residential rental property | 185 | |
| Ownership in Bryant Law | 5,000 | |
| Autos & other personal | 175 | |
| **Total assets** | **6,232** | |
| | | |
| Home equity loan | $212 | |
| Credit cards | 25 | |
| Residential mortgage | 295 | |
| Mortgage on rental property | 53 | |
| Total liabilities | 585 | |
| Net worth | 5,647 | |
| **Total liabilities & net worth** | | **6,232** |

Which of the following questions would be most important to ask in making an assessment as to the value of Bryant's guarantee?

a. How long have you owned the business?
b. How long have you lived in your residence?
c. What are the details of your contingent liabilities?
d. How did you arrive at the value of your company?

5. JR Manufacturing built up its inventory in Year X2 to meet the anticipated demand of its customers. Based on the below information, which of the following is the best estimate of how much less inventory would have been required if the company had performed at the same level of inventory efficiency as Year X1?

| | X1 | X2 |
|---|---|---|
| Sales | $85 | $100 |
| Cost of goods sold | 60 | 70 |
| Inventory | 8 | 15 |
| Inventory days on hand | 49 days | 78 days |

a. $ 5.6
b. $ 7.0
c. $ 7.9
d. $ 9.3

**6. Sources**

| | |
|---|---|
| Funds from operations | 1,509 |
| Long-term debt | 574 |
| Short-term debt | 1,728 |
| Cash | 60 |
| Accounts payable | 109 |

**Uses**

| | |
|---|---|
| Change in working capital | 2,747 |
| Current maturities | 135 |
| Interest | 195 |
| Dividends | 113 |
| Capital expenditures | 790 |

Based on the above information, which of the following best describes the company's sources and uses of cash?

a. The company used its profits to make capital expenditures and finance the increase in working capital.
b. The company borrowed short-term financing to pay its interest and principal payments on debt.
c. The company borrowed long-term debt to make equipment and short-term debt to finance working capital.
d. The company generated sufficient funds from operations to pay its debt, interest, dividends, and capital expenditures.

7. Diva Doughnuts sells its goods to restaurants, schools, and colleges. Your Bank provides a line of credit to the company to finance receivables. In reviewing this month's receivable report you note that Dave's Diner has several accounts receivable to Diva. Of the 5 items, 3 are current and 2 are over 90 days. The two accounts over 90 days represent ~ 25% of total receivables due from Dave's. In calculating Diva's availability on the line of credit, which of the following best describes how to account for Dave's Diner's accounts receivable?

    a. Allow all of the accounts because the majority are current.
    b. Exclude the accounts that are overdue, but include the current accounts.
    c. Exclude all of Dave's Diner's accounts receivable.
    d. Reduce the availability on the accounts by 10%.

8. Snow and Ice is a manufacturer of ice scrapers, shovels, and plows for use in snow removal. The company's manufacturing cycle and financing needs mirror its season, beginning in November and ending in March. The company would like to move to year-round production to save on labor costs and increase capacity. It is expected that the financing needs of the company will be year-round with seasonal peaks. Which of the following best describes the type of loan that Snow and Ice will need?

    a. Seasonal line of credit with a provision to reduce the line to zero for a specified period of time annually (a clean-up provision).
    b. Seasonal line of credit with a provision to reduce the line to an agreed upon limit for a specified period of time annually (a clean-down provision).
    c. Permanent working capital facility.
    d. Reducing revolving working capital facility.

9. Your Bank provides working capital financing to ABC Telecom Holding Company. The company down streams the funds to its 12 subsidiaries as needed. The borrower on the loan is ABC Telecom Holding Company and the loan is secured by ABC Holdings shares in its subsidiaries. Which of the following will most likely result if the loan defaults?

    a. The bank will have first rights to the collateral of the subsidiaries.
    b. The bank will have no right to the company's assets because the Bank is secured by shares.
    c. The bank will be an unsecured creditor to the Holding Company.
    d. The bank will become an equity stakeholder in the subsidiaries.

10. Murray's Mowers is a manufacturer of garden equipment including lawn mowers and hedge trimmers. The company has been a borrower of the bank for 10 years and during that time has always been in compliance with the terms and conditions of its debt. This year was very profitable, but the company is showing

an uncharacteristically high level of finished goods at the end of July financed by Your Bank's seasonal line of credit.  Which of the following best describes Your Bank's response to this scenario?

a. Call the loan because the company's inventory did not sell this season and are unlikely to sell in the upcoming winter months.
b. Term out the outstanding balance of the line of credit.
c. Liquidate the company's collateral in an orderly onsite liquidation.
d. Provide a permanent working capital facility anticipating the sale of the goods next spring/summer.

## Answers

1. C is the best answer. With the growth in the company's stores, working capital needs will increase causing a decrease in, and possibly a negative, net cash after operations.
2. B is the best answer. The company's operating margin meets industry standards due to decreased operating expenses despite its lower gross profit margin. The company's gross and net margins are lower than industry standards.
3. D is the best answer. Although all the above are important, it is most critical to stop new store openings so that the cash flow from the existing stores can repay the debt rather than fund new store openings.
4. C is the best answer. All the questions would provide helpful information about the guarantor. The unknown component of future liability is in contingent risks that the guarantor faces including other debt that Bryant may guarantee as well as possible outstanding litigation as a doctor.
5. A is the best answer. (78 – 49) / 365 x 70 = 5.6.
6. C is the best answer. To evaluate the company's cash flows, match short-term debt to short-term assets and long-term debt to long-term assets.
7. C is the best answer. Cross-aging is the practice of making all of the accounts receivable from a single account ineligible if a specified proportion of the total accounts receivable from that party is delinquent. While some financial institutions will allow 10% of receivables to be in excess of 90 days before deducting the entire receivable, Dave's delinquency percentage is well above 10%.
8. B is the best answer. The company's sales and accounts receivable will continue to reflect a seasonal pattern, but the consistent manufacturing of inventory will create a permanent working capital layer in the seasonal line of credit.
9. D is the best answer. With shares as security, in default, the bank becomes an owner.
10. D is the best answer. Because these goods are not perishable or fashionable, it is likely that the company will be able to sell them in the next season.