Question #1 of 71

Analyst Charlie Howell, CFA, has constructed two models for determining the required return on equity for Yazz Jazz, a saxophone maker. One takes the company's size into account, the other takes the shares' liquidity into account. Which of the following pairs of equity-return models require the use of:

	Size	Liquidity
A)	Build-up	Pastor-Stambaugh
B)	Build-up	Fama-French
C)	Capital asset pricing model	Fama-French

Question #2 of 71

There is a multistep process used to estimate the beta of nonpublic companies. What extra step must be taken to use the process on thinly traded public companies?

A) Beta must be adjusted to reflect debt and equity levels.

B) Beta must be reduced using a liquidity factor.

C) No extra step must be taken.

Question #3 of 71

Which of the following would cause an analyst to have concern about a firm's quality of earnings?

A) The gain on the sale of a plant was included in operating earnings.

B) A firm books sales when orders are shipped.

C) The firm took a write off for a recently impaired asset.

Question #4 of 71

If an analyst uses a build-up model to estimate a stock's return rather than using a multifactor model or the capital asset pricing model, the analyst is probably *least* concerned about:

A) timeliness.

B) simplicity.

C) accuracy.

Question #5 of 71

A valuation of a firm based on the comparison of the firm with the market value of other firms is known as a:

A) relative valuation.

B) comparison valuation.

C) peer group valuation.

Question #6 of 71

Disclosures of accounting practices and basis are most likely to be made in which part of a firm's financial reports?

A) The audit report.

B) Management's discussion and analysis (MD&A).

C) Footnotes.

Joe Dentice has an opportunity to buy 5% of Gold Star Oil, Inc., a closely held oil company. He wants to value the company so as to make a decision on a fair price to pay for the investment.

Question #7 of 71

Consider the steps in the top down valuation approach as it is applicable for Gold Star. Dentice should forecast the growth of:

A) the overall economy, growth of the industry, and the growth rate of Gold Star.

B) each firm in the oil industry, the growth rate of the oil industry, and the growth rate of the economy.

C) Gold Star, the growth of the oil industry, and then the growth of the overall economy.

Question #8 of 71

Which of the following models would be *most* suitable to value Gold Star?

A) Absolute valuation.

B) Relative valuation.

C) Liquidation value.

Question #9 of 71

Which discounts must be taken into account while valuing the investment opportunity? Joe should take into account the:

A) marketability, liquidity, and minority discounts in the valuation.

B) marketability, liquidity, and control premium in the valuation.

C) marketability, liquidity, and majority discounts in the valuation.

Question #10 of 71

Juliann Kellmann, CFA, wants to quickly and simply calculate the expected return of equity in a company with few shares outstanding. She should use:

A) a build-up model.

B) a multifactor model.

C) the capital asset pricing model.

Question #11 of 71

Junior analyst Quentin Haggard is struggling with a required return calculation. His main concern is compensating for exchange rate fluctuations between the country where his company is based and the home country of a portfolio of stocks he is analyzing. Haggard should calculate the return in his home country's currency, then adjust:

A) for expected changes in the foreign country's inflation rate.

B) the beta to account for exchange-rate fluctuations.

C) for expected changes in the foreign country's currency value.

Question #12 of 71

Valuation models for equities contain estimates of required returns and:

A) expected future cash flows.

B) an assumed continuation of past cash flows.

C) known future cash flows.

Question #13 of 71

Which of the following two ratios are likely to be used for determining value as a function of company peer benchmarks?

A) Price-to-sales and debt/equity.

B) Price-to-earnings and price-to-book.

C) Return on equity and net profit margin.

Question #14 of 71

Ben Jacobs, CFA, is attempting to calculate a historical equity risk premium. His first estimate uses geometric mean equity returns and long-term bond yields. His second estimate uses arithmetic mean returns and short-term bond yields. The effect of the changes in methodology in the second estimate, relative to the first, will:

A) both increase the size of the risk premium.

B) have offsetting effects.

C) both decrease the size of the risk premium.

Question #15 of 71

Morgan Bondillo, CFA, is attempting to calculate the value of Smith Sprockets. She is using a supply-side model to estimate the equity risk premium and a build-up model to estimate returns.

Based on the strategies Bondillo is using, Smith Sprockets is *least likely* to:

A) be closely held.

B) need its beta adjusted for drift.

C) be located in a developed market.

Question #16 of 71

To determine which rate of return to use as a discount rate, an analyst should consider the:

A) likely return of the stock market over the next year.

B) nature of the cash flows being discounted.

C) length of the holding period.

Question #17 of 71

A valuation of a firm based on the assumption that the firm will continue to operate is referred to as its:

A) operating value.

B) going-concern value.

C) status quo value.

Question #18 of 71

Laura's Chocolates, is a maker of nut-based toffees. The company holds shares in one of its suppliers, and wants to know what the holding period return was last year.

January 1 (purchase date)	$40
December 31	$45
Dividend paid (December 31)	$5
Cost of equity	11%
Cost of debt	8%
Debt : equity	1:3

What is the holding period return (ignore taxes)?

A) 12.50%.

B) 25.00%.

C) 22.50%.

Question #19 of 71

Notes to financial statements contain:

A) a description of the firm’s financial condition and future prospects.

B) important information about the firm's accounting practices and basis of presentation.

C) discussion of the firm's accounting practices and basis of presentation.

Question #20 of 71

The goal of asset valuation, based on the expected future cash flows of an asset, is to establish an asset's:

A) relative value.

B) market value.

C) intrinsic value.

Question #21 of 71

The present value of expected future cash flows is the firm's:

A) terminal value.

B) going-concern value.

C) liquidation value.

Question #22 of 71

For an analyst seeking to value an entire company, the *best* tool is the:

A) weighted average cost of capital.

B) capital asset pricing model.

C) Pastor-Stambaugh model.

Question #23 of 71

The country risk rating model:

A) depends on forecasts of exchange rates.

B) determines a risk premium for an emerging market.

C) determines a risk premium for any foreign market.

Question #24 of 71

Minority shareholders often do not have control of the price at which the firm will be sold or merged with another firm. In order to safeguard their interests, minority shareholders will often seek an analyst's opinion of the value of the firm. This opinion is referred to as a:

A) second opinion.

B) fairness opinion.

C) minority opinion.

Question #25 of 71

Overestimating the growth rate of a firm in using a valuation model would result in a value that is likely to be:

A) too low.

B) can't tell from this information.

C) too high.

Question #26 of 71

Which of the following is *least likely* a use of equity valuation?

A) Projecting the value of corporate actions.

B) Issuing fairness opinions.

C) Assessing Corporate governance.

Question #27 of 71

If an investor had determined that an asset's market price was too high, (implying that it will soon fall) the expected holding period return (HPR) would be:

A) lower than the required return.

B) higher than the required return.

C) equal to the required return.

Question #28 of 71

In an efficient market, a mutual fund's required return is the same as the:

A) net asset value return.

B) holding period return.

C) internal rate of return.

Question #29 of 71

A wise analyst will examine a valuation to determine:

A) how well it will be received by the firm's management.

B) its sensitivity to changes in expectations.

C) ways to enhance a client's valuation.

Question #30 of 71

Equity analyst Yasmine Cordova of Substantial Securities is trying to determine the investment appeal of shares of Maxwell Mincemeat, a small food company. Cordova has assembled the following data about the company:

- Internal rate of return: 9.4%.
- Maxwell's 20-year bond yield to maturity: 7.9%.
- Maxwell's two-year bond yield to maturity: 6.1%.
- Treasury bill yield: 3.4%.
- Maxwell's estimated beta: 2.1.
- Maxwell's 20-year bonds are priced at $102.65.
- Maxwell's two-year bonds are priced at $101.47.
- Estimated return of Russell 2000 Index: 12.3%.
- Substantial's credit analyst estimates that Maxwell's equity warrants a premium of 4.9% over its bonds.

Cordova wants to make sure her estimates are accurate, so she decides to calculate the estimated required return in two ways. She opts for the bond-yield plus risk premium method and the capital asset pricing model. To check her work, she wants to compare the estimates derived under each method. The difference between the required returns is *closest* to:

A) 5.30%.

B) 5.89%.

C) 9.29%.

Question #31 of 71

To determine the present value of an investment based on a future estimate of the investment's value, an analyst should use the:

A) discount rate.

B) internal rate of return.

C) required return.

Question #32 of 71

When an analyst scrutinizes a firm's financial statements to try to discern how accurately the reported information reflects economic reality, and to evaluate the sustainability of the company's performance, the process is most likely to be referred to as a:

A) quality of earnings analysis.

B) reasonable assurance analysis.

C) comprehensive basis of accounting analysis.

Question #33 of 71

Candace Elwince is attempting to calculate the required return of Skeun Inc., a machine-tool manufacturer in a small Eastern European country. Elwince has solid data from the German market but is not sure how to account for the exchange-rate risk Skeun investors would face. Her *best* choice for creating a risk premium is the:

A) difference between the inflation rates of both markets.

B) difference between the bond yields of both markets.

C) Gordon Growth model.

Question #34 of 71

Currently the market index stands at 1,190.45. Firms in the index are expected to pay cumulative dividends of 35.71 over the coming year. The consensus 5-year earnings growth forecast for these firms is expected to increase to 6.2% up from last year's forecast of 4.5%. The long-term government bond is yielding 5.0%. According to the Gordon growth model, what is the equity risk premium?

A) 4.2%.

B) 2.5%.

C) 1.2%.

Question #35 of 71

An analyst performing an asset valuation to detect investor's expectations about the future value of the variables that affect a stock's price is *most likely* using the valuation for:

A) reading the market.

B) generating a fairness opinion.

C) projecting the value of corporate actions.

Question #36 of 71

Adjusted beta for public companies compensates for:

A) leverage.

B) drift.

C) changes in the market’s growth rate.

Question #37 of 71

A valuation of a firm based on a review of other firms' price to earnings, price to sales, and price to return on investment ratios is an example of a:

A) fundamental valuation.

B) relative valuation.

C) broad-based valuation.

Question #38 of 71

Liquidation value is the:

A) cash generated by terminating a business, selling its assets, and repaying liabilities.

B) market value of the total assets less the market value of the total liabilities.

C) present value of future cash flow less the possible liquidation cost.

Question #39 of 71

A valuation of a firm based on the intrinsic value of the firm's investment characteristics is known as an:

A) absolution valuation.

B) absolute valuation.

C) asset based valuation.

Question #40 of 71

What are three factors that would make a firm's accounting earnings less of a gauge of future economic performance? Late filings, unusually:

A) high amounts of loans to company insiders, and long tenure of senior management.

B) high amounts of loans to company insiders, and short tenure of senior management.

C) low amounts of loans to company insiders, and short tenure of senior management.

Question #41 of 71

Which of the following *least* accurately represents one of the primary steps of the equity valuation process described by Pinto, Henry, Robinson, and Stowe?

A) Decision making.

B) Selecting a valuation model.

C) Assessing corporate governance.

Question #42 of 71

In order to calculate the value of a firm's equity, the firm's FCFE should be discounted at the firm's:

A) cost of capital as determined by the capital asset pricing model.

B) required return on equity.

C) weighted average cost of capital (WACC).

Question #43 of 71

An analyst is *most likely* to review the footnotes to a firm's financial statements to find information about the firm's:

A) cash flow activities.

B) operation.

C) accounting practices.

Question #44 of 71

The equity risk premium is the difference between:

A) the required equity return and the risk-free return.

B) the estimated equity return and the risk-free return.

C) estimated equity returns and estimated bond returns.

Question #45 of 71

An analyst attempting to derive the equity risk premium for a stock starting from the required return for that stock would find which of the following statistics *least* useful?

A) The stock's beta.

B) The stock's estimated return.

C) Historical 10-year Treasury bond rates.

Question #46 of 71

For an analyst valuing public equities, the relevant concept of value is *most likely* to be:

A) fair market value.

B) intrinsic value.

C) orderly liquidation value.

Question #47 of 71

When attempting to build a risk premium into the required returns of stocks in a developing country, an analyst should use the:

A) country spread model.

B) country's weighted average cost of capital.

C) modified Gordon Growth model.

Question #48 of 71

Equity analyst Mason Kramer wants to calculate the return on equity for a number of stocks. Kramer values predictive power over all other factors and is in no hurry to finish the work. Which model is Kramer's *best* option?

A) Capital asset pricing.

B) Build-up.

C) Multifactor.

Question #49 of 71

Jaime Moreno, a new hire at the venture-capital fund Burkhart Partners, has been tasked with assessing the appeal of various potential equity investments. Moreno has been given the weighted average cost of capital (WACC) for each company. To determine the value of each company's equity, Moreno should:

A) calculate the firm value using the WACC, then strip out the value of debt.

B) strip the effects of debt out of the WACC, then calculate the value of equity.

C) calculate the equity value using the WACC, then incorporate the value of debt.

Question #50 of 71

Analyst Charlie Howell, CFA, is trying to calculate the required return on equity for Yazz Jazz, a maker of saxophones. However, Yazz Jazz operates in a country with rapidly changing inflation rates. Which method should Howell use?

A) A multifactor model.

B) Bond-yield plus risk premium.

C) Build-up.

Question #51 of 71

How can we account for different valuations for the same firm from several analysts even if they use the same required returns?

A) Valuation models contain random errors.

B) The analysts may be biased with personal opinions about management.

C) Valuations are based on the analyst's expectations.

Question #52 of 71

An ownership perspective can be important for an analyst determining the value of a share position. A controlling interest suggests the *most* appropriate model is a:

A) dividend discount model.

B) cash flow model.

C) time series model.

Question #53 of 71

A comparison between a firm's going-concern valuation and its liquidation value will show that the going-concern value will always be:

A) equal to the present value of the expected continued operation of the firm.

B) less than the liquidation value.

C) greater than the liquidation value.

Question #54 of 71

Financial Analyst Davey Jarvis, CFA, is evaluating Laura's Chocolates, Inc., which processes nut-based toffee for world-wide distribution. Which of the following steps is Jarvis *most likely* to take as part of the top-down valuation process?

A) Perform momentum-based technical analysis.

B) Evaluate price performance on an ongoing basis.

C) Learn / understand the business.

Question #55 of 71

The value of a conglomerate derived using a sum-of-the-parts valuation would *least accurately* be called the:

A) liquidation value.

B) breakup value.

C) private market value.

Question #56 of 71

Important considerations for choosing an appropriate approach for valuing a given company are *least likely* to include:

A) Is the model appropriate based on the quality and availability of input data?

B) Is the model consistent with the investor's IPS?

C) Is the model suitable given the purpose of the analysis?

Question #57 of 71

One justification for using multiple models to estimate firm value is:

A) the ability to streamline and economize the development process through repeated use of the same generic baseline.

B) the ability to examine differences in estimated values can reveal how a model's assumptions and the perspective of the analysis are affecting the estimated values.

C) the ability to learn from each successive model and to make improvements.

Question #58 of 71

Which of the following is NOT a use of asset valuation?

A) Estimating inflation rates.

B) Issuing fairness opinions.

C) Projecting the value of corporate actions.

Question #59 of 71

Types of estimates of the equity risk premium are *least likely* to include:

A) macroeconomic model estimates.

B) ex-ante estimates.

C) extemporized estimates.

Question #60 of 71

Marina Syltus, chief financial officer of Worcester Water Treatment, wants to know the cost of the company's capital so it can make wiser budgeting decisions. Syltus has assembled the following data:

- Worcester's long-term debt has a market value of $230 million.
- Worcester's shares have a total market value of $782 million.
- The marginal tax rate is 37%.
- The required return on equity is 14.6%.
- Worcester's long-term debt has a weighted average interest rate of 9.4%.

To calculate the weighted average cost of capital, Syltus needs:

A) the target debt/equity ratio.

B) the required return on debt.

C) both the required return on debt and the target debt/equity ratio.

Question #61 of 71

In the process of estimating beta for a private company, unlevering the beta calculated for the publicly traded comparable company accomplishes what goal?

A) Establishing a baseline level of leverage.

B) Improving the accuracy of the estimate in the event that the private company's debt is of low quality.

C) Isolating market risk.

Question #62 of 71

Joe Bates, CFA, has prepared a schedule of real cash flows for his company's plant expansion. Bates generally uses the weighted average cost of capital to discount such cash flows, but in order to accurately determine the present value of those real cash flows, he should adjust the discount rate to reflect:

A) expected inflation.

B) the company's cost of both debt and equity.

C) expected changes in the market growth rate.

Question #63 of 71

A valuation of a firm based on the current market price of its assets - liabilities is referred to as the firm's:

A) liquidation value.

B) operating value.

C) going-concern value.

Jaden Hoyle is evaluating the MegaFood Market chain of grocery stores and Strinson Carburetors, a maker of automobile and industrial engine parts. MegaFood is publicly traded, while Strinson is a private company. Hoyle's firm, Janssen and Associates, is considering the purchase of a 50% equity stake in one or both of the companies, and may be willing to purchase the companies outright. Janssen only invests in companies with a weighted average cost of capital of less than 11%.

Hoyle has assembled the following data on the two companies:

	MegaFood Market	Strinson Carburetors
Beta	0.87	
Market value of equity	$173 million	$993 million
Market value of debt	$38 million	$567 million

Marginal tax rate	42.8%	31%
Target debt/equity ratio	35%	78%
Equity risk premium		4.6%
Required return on debt	9%	6.5%

The risk-free rate of return is 5.2%. Hoyle must make recommendations regarding both MegaFood Market and Strinson Carburetors.

Hoyle does not have all of the data she needs and knows she will have to estimate some values using the data she does possess. To help estimate the required return on equity for Strinson Carburetors, Hoyle takes three actions:

Action A:	She selects a benchmark company, unlevers the beta of that company, then levers up the adjusted beta using Strinson's debt and equity allocation.
Action B:	She calculates a risk premium, then adds that premium to the yield to maturity of the company's long-term debt.
Action C:	She prepares a supply-side multifactor model considering expected inflation, expected GDP growth, and expected changes in P/E ratio.

Before she finishes her analysis of MegaFood Market and Strinson Carburetors, Hoyle must construct valuation models for two other companies, Halberd Hardware, a maker of hand tools, and the Jones Group, one of the world's largest consultants. She has assembled the following information about each company.

Halberd Hardware

- Gary Halberd, the founder, still owns 85% of the company, and all the rest is in the hands of company directors and friends of Halberd who bought stakes 20 years ago.
- Halberd Hardware has publicly traded debt.
- Historical data on equity returns is sparse, as there have been very few trades over the last two decades.
- Halberd Hardware is headquartered in New York City.
- The company plans to go public in the next six months, with Gary Halberd selling 30% of his ownership interest.

Jones Group

- Jones Group, one of the world's largest consulting companies, has been publicly traded for four years on the South Pittson Island stock market. Its ADR trades on the U.S. market.
- South Pittson Island is a small island nation in the Mediterranean known for its business-friendly tax code.

For her analysis of Halberd Hardware, Hoyle is considering three models to calculate the estimated return. But she has already decided to use the Gordon Growth model to calculate the equity risk premium.

As soon as Hoyle finishes determining which models are best suited to her purposes, her boss comes into the office and tells her to use the capital asset pricing model (CAPM) for all four of the companies she is reviewing. Hoyle is concerned about the effectiveness of the CAPM. With regards to Jones Group, her three main worries are:

Worry A:	The need to use the country spread model to revise the equity risk premium.
Worry B:	The CAPM's effectiveness because of Jones Group's ADR.
Worry C:	The need to create a beta estimate using an unlevered beta.

Question #64 of 71

Assuming MegaFood Market has a required return on equity (ROE) of 13.6% and Strinson Carburetors has a required ROE of 15.3%, what recommendation should Hoyle give her superiors at Janssen regarding each company?

	MegaFood Market	Strinson Carburetors
A)	Don’t buy the company	Don’t buy the company
B)	Don’t buy the company	Buy the company
C)	Buy the company	Buy the company

Question #65 of 71

Which of Hoyle's actions is *least* helpful in the calculation of required return on equity for Strinson Carburetors?

A) Action A.

B) Action B.

C) Action C.

Question #66 of 71

Which of the following is the *best* model for calculating Strinson Carburetors' required return?

A) Capital asset pricing model.

B) Fama-French model.

C) Pastor-Stambaugh model.

Question #67 of 71

Hoyle wants to calculate an expected return for Halberd Hardware and Jones Group. She has access to a variety of models, but her *best* option is:

	for Halberd	for Jones
A)	build-up method	capital asset pricing model
B)	bond-yield plus risk premium	capital asset pricing
C)	build-up method	country spread model

Question #68 of 71

Hoyle wants to use a macroeconomic model to derive equity risk premiums for both Halberd Hardware and Jones Group. Such a model is appropriate for:

A) Jones Group, but not Halberd Hardware, because macroeconomic models don't work for closely held companies.

B) both Halberd Hardware and Jones Group.

C) Halberd Hardware, but not Jones Group, because macroeconomic models don't work for nations like South Pittson Island.

Question #69 of 71

Which of Hoyle's worries about using the CAPM for Jones Group is *most* justified?

A) Worry A.

B) Worry B.

C) Worry C.

Question #70 of 71

Senior analyst James Matin is instructing a room full of new hires in the finer points of equity valuation. He makes two statements:

Statement 1:	"When the return you expect for a stock doesn't match the required return, make sure you calculate a convergence yield and build that into your valuation model."
Statement 2:	"When you estimate the equity return of a thinly traded company, the Pastor-Stambaugh model is a better option than the Fama-French model."

Do the statements represent good advice?

Statement 1 Statement 2

A)	Yes	No
B)	No	Yes
C)	Yes	Yes

Question #71 of 71

One year ago, Makato Omura purchased a 6.50% fixed coupon bond for 98.50. Recently, she sold the bond for 99.25 and calculated her return at 7.4%. Her friend, Takanino Takemiya, CFA, reminds Omura that this is the nominal return and that to calculate the real return, she needs to factor in the inflation rate over the holding period. If the price index for the current year is 118.5 and the price index one year ago was 115.9, Omura's real return is *closest* to:

A) 5.2%.

B) 6.3%.

C) 9.6%.