Question #1 of 140

The Farmer Co. has a payout ratio of 70% and a return on equity (ROE) of 14%. What will be the appropriate price-to-book value (PBV) based on fundamentals if the expected growth rate in dividends is 4.2% and the required rate of return is 11%?

A) 1.50.

B) 0.64.

C) 1.44.

Question #2 of 140

An analyst gathered the following data for TRK Construction [all amounts in Swiss francs (Sf)]:

Recent share price	Sf 30.00
Shares outstanding	Sf 40 million
Market value of debt	Sf 120 million
Cash and marketable securities	Sf 75 million
Investments	Sf 200 million
Net income	Sf 160 million
Interest expense	Sf 9 million
Depreciation and amortization	Sf 12 million
Taxes	Sf 48 million

The EV/EBITDA multiple for TRK Construction is *closest* to:

A) 5.21x.

B) 4.56x.

C) 3.47x.

Question #3 of 140

Which of the following is NOT a common momentum valuation indicator?

A) Relative strength.

B) Earnings surprise.

C) Dividend yield.

Question #4 of 140

An analyst is valuing a company with a dividend payout ratio of 0.55, a beta of 0.92, and an expected earnings growth rate of 0.07. A regression on comparable companies produces the following equation:

Predicted price to earnings (P/E) = 7.65 + (3.75 × dividend payout) + (15.35 × growth) − (0.70 × beta)

What is the predicted P/E using the above regression?

A) 7.65.

B) 11.43.

C) 10.14.

Question #5 of 140

A method commonly used to normalize earnings is the method of:

A) average return on assets.

B) comparables.

C) historical average earnings per share (EPS).

Question #6 of 140

Shares of TKR Construction (TKR) are selling for $50. Earnings for the last 12 months were $4.00 per share. The average trailing P/E ratio for firms in TKR's industry is 15. The appropriate WACC is 12%, and the risk-free rate is 8%. Assume a growth rate of 0%. Using the method of comparables, what price is indicated for TKR?

A) $50.00.

B) $60.00.

C) $33.33.

Question #7 of 140

A common price to earnings (P/E) based method for estimating terminal value in multi-stage models is the:

A) P/E to growth (PEG) approach.

B) dividend yield approach.

C) fundamentals approach.

Question #8 of 140

An increase in return on equity (ROE) will cause a price-to-book (P/B) multiple to:

A) increase.

B) there is insufficient information to tell.

C) decrease.

Question #9 of 140

Which of the following factors is a source of differences in cross-border valuation comparisons?

A) Accounting methods.

B) Intra-country market indicators.

C) Comparative advantage.

Question #10 of 140

Which of the following statements about the method of comparables in price multiple valuation is CORRECT?

A) It values an asset relative to a benchmark value of the multiple.

B) It relates multiples to company fundamentals using a discounted cash flow (DCF) model.

C) It assumes that cash flows are related to fundamentals.

Question #11 of 140

Which of the following are advantages of using EV/EBITDA?

A) EBITDA is useful for valuing capital-intensive businesses with high levels of depreciation and amortization.

B) EV/EBITDA ignores how different revenue recognition policies affect CFO.

C) If working capital is growing, EBITDA will be larger than CFO.

Question #12 of 140

Which of the following is a disadvantage of using price-to-sales (P/S) multiples in stock valuations?

A) The use of P/S multiples can miss problems associated with cost control.

B) It is difficult to capture the effects of changes in pricing policies using P/S ratios.

C) P/S multiples are more volatile than price-to-earnings (P/E) multiples.

Question #13 of 140

Margin and Sales Trade-off for CVR, Inc. and Home, Inc., for Next Year				
Firm	**Strategy**	**Retention Rate**	**Profit Margin**	**Sales/Book Value of Equity**
CVR, Inc.	High Margin / Low Volume	20%	8%	1.25
CVR, Inc.	Low Margin / High Volume	20%	2%	4.00
Home, Inc.	High Margin / Low Volume	40%	9%	2.00
Home, Inc.	Low Margin / High Volume	40%	1%	20.0

(Note: CVR, Inc., has a book value of equity of $80 and a required rate of return of 10%. Home, Inc., has a book value of equity of $100 and a required rate of return of 11%.)

If CVR, Inc., has a required return for shareholders of 10%, what is its appropriate leading price-to-sales (P/S) multiple if the firm undertakes the high margin/low volume strategy?

A) 1.46.

B) 0.20.

C) 0.80.

Question #14 of 140

The relative valuation model known as the PEG ratio is equal to:

A) P/E × earnings.

B) price-to-earnings (P/E) / earnings per share (EPS) growth rate.

C) earnings per share growth rate / price-to-earnings.

Question #15 of 140

Proprietary Technologies, Inc., (PTI) has a leading price-to-earnings (P/E) ratio of 28 while the median leading P/E of a peer group of companies within the industry is 38. Based on the method of comparables, an analyst would *most likely* conclude that PTI should be:

A) bought as an undervalued stock.

B) sold short as an overvalued stock.

C) sold as an overvalued stock.

Robin Alberts, CFA, is the head of research for Worth Brothers, a large investment company based in New York. Next week, a group of analysts who have just completed the Worth Brothers' management training program will begin rotating throughout the various departments and trading desks at the firm. The trainees will be split into small groups, and each group will spend four weeks in each area to learn the basic operations of each department through "hands on" experience. Also, in that time period, each department head is expected to fully evaluate each candidate in order to determine their future placement within the firm.

Alberts decides that she should begin every rotation in the research department by giving each candidate a brief review exam to test their knowledge of the general principles of credit analysis. She asks each candidate to analyze the following three scenarios and to answer two questions on each scenario.

Scenario One				
	Firm A	**Firm B**	**Firm C**	**Firm D**
Payout Ratio	75%	--	--	--
Required Rate of Return	12%	12%	12%	12%
Return on Equity (ROE)	20%	15%	30%	14%
Price-to-book Value (PBV) Ratio	--	3.00	0.70	3.50

Scenario Two Cost of Capital Measures for Brown, Inc.	
Risk-Free Rate	5%
Expected Return on the Market	12%
Beta	1.5
Tax Rate	40%
Cost of Debt	10%
Proportion of the Firm Financed with Debt	20%
Proportion of the Firm Financed with Equity	80%

Scenario Three The Donner Company as of December 31, 2003 (in $ millions)				
Cash	38		Current Liabilities	52
Accounts Receivable	120		Long-term Bonds	123
Inventory	57		Common Stock	75
Property, Plant & Equip.	218		Retained Earnings	183

Total Assets	433	Total Liabilities & Equity	433

	2001	2002	2003
Operating Profit (EBIT)	42	38	43
Interest Expense	16	17	20
Relevant Industry Ratios			
Long-term Debt-to-equity Ratio: 0.52			
Current Ratio: 3.20			
Interest Coverage Ratio: 2.10			

Question #16 of 140

Using the information in scenario one which of the following items would *increase* firm A's PBV?

A) A larger spread between ROE and the required rate of return (r).

B) Decrease ROE.

C) Increase r.

Question #17 of 140

Using the information from scenario one which of the following changes is *most likely* to increase Firm A's P/B ratio?

A) Increase r.

B) Increase the spread between ROE and r

C) Decrease the spread between ROE and r.

Question #18 of 140

Using the information in scenario two, what is the cost of equity capital of Brown, Inc.?

A) 10.5%.

B) 15.5%.

C) 12.0%.

Question #19 of 140

Using the information in scenario two, what is the weighted-average cost of capital (WACC) of Brown, Inc.?

A) 14.40%.

B) 13.60%.

C) 9.86%.

Question #20 of 140

Using the information in scenario three, what should Mansted observe about Donner's solvency and debt capitalization?

A) Both Donner's solvency and debt capitalization ratios are better than the industry average.

B) Donner's solvency ratio is worse but its debt capitalization is better than the industry average.

C) Donner's solvency ratio is better but its debt capitalization is worse than the industry average.

Question #21 of 140

Using the information in scenario three, what should Mansted observe about Donner's ability to make its interest payments? Donner's interest coverage ratio is:

A) rising (improving) over time and is above the industry average.

B) declining (worsening) over time but is still above the industry average.

C) declining (worsening) over time and is below the industry average.

Question #22 of 140

An analyst begins an equity analysis of Company A by noting the following ratios from three companies in the same industry:

	EPS	PE
Company A	$1.60	10.0
Company B	$2.10	12.5
Company C	$5.80	13.0

This analyst is *most likely* using:

A) technical analysis.

B) the method of comparables.

C) the method of forecasted fundamentals.

Question #23 of 140

A decrease in the earnings retention rate will cause a price-to-sales (P/S) multiple to:

A) remain the same.

B) decrease.

C) increase.

Question #24 of 140

Enhanced Systems, Inc., (ESI) has a price to book value (P/B) of four while the median P/B of the stock market overall is three, and the median P/B of companies within the industry is six. Based on the method of comparables, an analyst would *most likely* conclude that ESI:

A) should be purchased because it is an undervalued stock.

B) is of indeterminate relative value, due to conflicting metrics.

C) should be sold because it is an overvalued stock.

Question #25 of 140

The trailing price-to-earnings (P/E) ratio is defined as:

A) price to most recent earnings.

B) price to next period's expected earnings.

C) the average P/E over the last five years.

An analyst has gathered the following fundamental data:

	Firm A	Firm A	Firm B	Firm B
Strategy	High Margin Low Volume	Low Margin High Volume	High Margin Low Volume	Low Margin High Volume
Payout Ratio	40%	40%	40%	40%
Required Rate of Return	11%	11%	11%	11%
Growth Rate in Dividends	9%	5%	5%	7%
Sales/Book Value of Equity	1.5	4.5	1.0	3

Profit Margin	10%	2%	9%	4%
Book Value	$150	$150	$125	$125

Question #26 of 140

What is the price-to-sales (P/S) multiple for Firm A in the high-margin, low-volume strategy?

A) 2.18.

B) 2.00.

C) 0.13.

Question #27 of 140

What is the P/S multiple for Firm B in the low-margin, high-volume strategy?

A) 2.00.

B) 0.60.

C) 0.43.

Question #28 of 140

One disadvantage of using the price/sales (P/S) multiple for stock valuation is that:

A) P/S multiple does not provide a framework to evaluate the effects of corporate policy decisions and price changes.

B) profit margins are not consistent across firms within an industry.

C) sales are relatively stable and might not change even though earnings and value might change significantly.

Question #29 of 140

An increase in growth will cause a price-to-earnings (P/E) multiple to:

A) there is insufficient information to tell.

B) decrease.

C) increase.

Question #30 of 140

A firm has a return on equity (ROE) of 18%, an estimated growth rate of 13%, and its shareholders require a return of 17% on their investment. Based on these fundamentals, a reasonable estimate of the appropriate price-to-book value ratio for the firm is:

A) 1.25.

B) 2.42.

C) 1.58.

Question #31 of 140

At a CFA society function, Andrew Caza comments to Nanda Dhople that the expected dividend growth rate (*g*) for Zeron Enterprises Inc (ZEI) is expected increase 0.5% from 6% to 6.5%. Caza claims that since ZEI will maintain their historic dividend payout ratio (*g*) of 50% and cost of equity (*k*) of 10%, ZEI's P/E ratio will also increase by 0.5%. Is Caza *correct*?

A) No, ZEI's P/E ratio will decrease by approximately 14.32%.

B) Yes, ZEI's P/E ratio will increase by approximately 0.5%.

C) No, ZEI's P/E ratio will increase by approximately 14.32%.

Question #32 of 140

Which of the following factors is NOT a source of differences in cross-border valuation comparisons?

A) Growth opportunities.

B) Intra-country market indicators.

C) Cultures.

Question #33 of 140

An analyst focusing mostly on financial stocks is likely to prefer valuing stocks via the:

A) dividend yield.

B) price/book ratio.

C) price/sales ratio.

Question #34 of 140

The value of a firm, calculated using the discounted cash flow (DCF) method, will be closest to the valuation using P/E multiples when P/E multiples are estimated using:

A) P/E multiples of comparable firms.

B) historical P/E multiples.

C) fundamental data.

Question #35 of 140

The multiple indicated by applying the discounted cash flow (DCF) model to a firm's fundamentals is necessarily the:

A) result of calculating retention/(required rate of return - growth) for the overall market.

B) same as the average industry multiple.

C) justified price multiple.

Question #36 of 140

An analyst has gathered the following fundamental data:

	Firm A	Firm B	Firm C	Firm D
Payout Ratio	75%			
Required Rate of Return	12%	12%	12%	12%
Return on Equity (ROE)	20%	15%	30%	14%
Price/Book Value (PBV) Ratio		3.00	0.70	3.50

What is the PBV ratio for Firm A?

A) 0.71.

B) 2.14.

C) 1.25.

Question #37 of 140

A justified price multiple is the:

A) warranted or intrinsic price multiple.

B) multiple implied by historical growth.

C) multiple implied by the market price.

Question #38 of 140

What is the appropriate price-to-sales (P/S) multiple of a stock that has a retention ratio of 45%, a return on equity (ROE) of 14%, an earnings per share (EPS) of $5.25, sales per share of $245.54, an expected growth rate in dividends and earnings of 6.5%, and shareholders require a return of 11% on their investment?

A) 0.278.

B) 0.158.

C) 0.227.

Question #39 of 140

Underlying earnings may be defined as earnings:

A) net of capital expenditures needed to keep the business productive.

B) that include non-recurring components.

C) that exclude non-recurring components.

Question #40 of 140

An analyst is preparing a presentation on "Interpreting PE ratios" and has the following data:

	Portfolio %	***Stock PE***
Stock AAA	60%	10
Stock BBB	40%	15

Which of the following is the *most appropriate* measure for calculating the portfolio P/E?

A) Arithmetic average of the P/E's.

B) Weighted harmonic mean of the P/E's.

C) Geometric mean of the P/E's.

Question #41 of 140

The goal of normalizing earnings is to adjust for:

A) non-cash charges.

B) cyclical elements.

C) seasonal elements.

Question #42 of 140

A common pitfall in interpreting earnings yields in valuation is:

A) look-ahead bias.

B) using underlying earnings.

C) using negative earnings.

Question #43 of 140

Which of the following valuation approaches is based on the rationale that stock values differ due to differences in the expected values of variables such as sales, earnings, or related growth rates?

A) Free cash flow to the firm.

B) Method of comparables.

C) Method of forecasted fundamentals.

Question #44 of 140

Leslie Singer comments to Robert Chan that Dreamtime Industries' expected dividend growth rate is 5.0%, ROE is 14%, and required return on equity (*r*) is 10%. Based on a justified P/B ratio compared to a P/B ratio (based on market price per share) of 1.60, Dreamtime Industries is *most likely*:

A) correctly valued.

B) undervalued.

C) overvalued.

Question #45 of 140

Herb McClain tells Cammy Oren that Kline Industries' expected dividend growth rate is 4.0%, ROE is 14%, and required return on equity (*r*) is 10%. Based on a justified P/B ratio compared to a P/B ratio (based on market price per share) of 1.55, Kline Industries is *most likely*:

A) undervalued.

B) overvalued.

C) correctly valued.

Question #46 of 140

Earnings before interest, taxes, depreciation, and amortization (EBITDA) is *best* suited as a measure of:

A) debt capacity.

B) equity value.

C) total company value.

Question #47 of 140

At a CFA society function, Robert Chan comments to Li Chiao that the expected dividend growth rate for Xanedu Industries has decreased 0.5% from 6.0% to 5.5%. Chan claims that since Xanedu will maintain their historic dividend payout ratio of 40% and required return on equity (*r*) of 12%, Xanedu's justified leading P/E ratio based on forecasted fundamentals will also decrease by 0.5%. Is Chan correct?

A) No, Xanedu's justified leading P/E ratio will decrease by approximately 7.8%.

B) Yes, Xanedu's justified leading P/E ratio will increase by approximately 0.5%.

C) No, Xanedu's justified leading P/E ratio will increase by approximately 7.8%.

Question #48 of 140

Which of the following statements regarding the P/E to growth (PEG) valuation approach is *least* accurate? The P/E to growth (PEG) valuation approach assumes that:

A) there is a linear relationship between price to earnings (P/E) and growth.

B) stocks with higher PEGs are more attractive than stocks with lower PEGs.

C) there are no risk differences among stocks.

Question #49 of 140

A common justification for using earnings yields in valuation is that:

A) earnings are usually greater than free cash flows.

B) negative earnings render P/E ratios meaningless and prices are never negative.

C) earnings are more stable than dividends.

Question #50 of 140

An analyst gathered the following data for TRK Construction [all amounts in Swiss francs (Sf)]:

Recent share price	Sf 25.00
Shares outstanding	40 million
Market value of debt	Sf 130 million
Cash and marketable securities	Sf 65 million
Investments	Sf 250 million
Net income	Sf 150 million
Interest expense	Sf 8 million
Depreciation and amortization	Sf 11 million
Taxes	Sf 52 million

The EV/EBITDA multiple for TRK Construction is *closest* to:

A) 4.12x.

B) 3.69x.

C) 2.47x.

Question #51 of 140

Which of the following is a disadvantage to using EV/EBITDA?

A) EBITDA is usually positive even when EPS is not.

B) Since FCFF captures the amount of capital expenditures, it is more strongly linked with valuation theory than EBITDA.

C) EBITDA is useful for valuing capital-intensive businesses with high levels of depreciation and amortization.

Question #52 of 140

An analyst has gathered the following data about Jackson, Inc.:

- Payout ratio = 60%.
- Expected growth rate in dividends = 6.7%.
- Required rate of return = 12.5%.

What will be the appropriate price-to-book value (PBV) ratio for Jackson, based on fundamentals?

A) 0.58.

B) 1.38.

C) 1.73.

Question #53 of 140

All other variables held constant, the justified price-to-book multiple will *decrease* with a decrease in:

A) payout ratio.

B) expected growth rate.

C) required rate of return.

Question #54 of 140

Which of the following is NOT an advantage of using price-to-book value (PBV) multiples in stock valuation?

A) Book value is often positive, even when earnings are negative.

B) Book values are very meaningful for firms in service industries.

C) PBV ratios can be compared across similar firms if accounting standards are consistent.

Question #55 of 140

Industrial Light had earnings per share (EPS) of $5.00 past year, a dividend per share of $2.50, a cost of equity of 12%, and a long-term expected growth rate of 5%. What is the trailing price-to-earnings (P/E) ratio?

A) 7.14.

B) 7.50.

C) 3.75.

Question #56 of 140

The price-to-book value (PBV) ratio for a high-growth firm will:

A) increase as the growth rate in either the high-growth or stable-growth period increases.

B) increase as the growth rate in the high-growth period increases and decrease as the growth rate in the stable-growth period increases.

C) increase as the growth rate in either the high-growth or stable-growth period decreases.

Question #57 of 140

P/E multiples are often computed using the average of the multiples of comparable firms, because:

A) it provides the most accurate results.

B) it is conceptually very straightforward.

C) it is very easy to find comparable firms that have the same business mix and risk and growth profiles.

Question #58 of 140

The warranted or intrinsic price multiple is called the:

A) justified price multiple.

B) multiple implied by the market price.

C) multiple implied by historical growth.

Question #59 of 140

The Farmer Co. has a payout ratio of 65% and a return on equity (ROE) of 16% (assume that this is expected ROE for the upcoming year). What will be the appropriate price-to-book value (PBV) based on return differential if the expected growth rate in dividends is 5.6% and the required rate of return is 13%?

A) 1.41.

B) 0.71.

C) 1.48.

Question #60 of 140

The definition of a PEG ratio is price to earnings (P/E):

A) divided by average historical earnings growth rate.

B) divided by the expected earnings growth rate.

C) divided by the average growth rate of the peer group.

Question #61 of 140

Which of the following statements about the method of forecasted fundamentals in price multiple valuation is *most* accurate?

A) It relates multiples to company fundamentals using a discounted cash flow (DCF) model.

B) It relies on the Law of One Price.

C) It values an asset relative to a benchmark value of the multiple.

Question #62 of 140

Which of the following price multiples is *most* severely damaged by international accounting differences?

A) Price to free cash flow to equity (P/FCFE).

B) Price to cash flow from operations (P/CFO).

C) Enterprise value to earnings before interest, taxes, depreciation, and amortization (EV/EBITDA).

Question #63 of 140

At a CFA society function, Robert Chan comments to Li Chiao that Xanedu Industries' expected dividend growth rate is 5.5%, dividend payout ratio (g) is 40%, and required return on equity (r) is 12%. Based on a justified leading P/E ratio compared to an actual P/E ratio of 8.0, Xanedu Industries is *most likely*:

A) undervalued.

B) overvalued.

C) correctly valued.

Question #64 of 140

Proprietary Technologies, Inc., (PTI) has a leading price-to-earnings (P/E) ratio of 38 while the median leading P/E of a peer group of companies within the industry is 28. Based on the method of comparables, an analyst would *most likely* conclude that PTI should be:

A) viewed as a properly valued stock.

B) sold or sold short as an overvalued stock.

C) bought as an undervalued stock.

Question #65 of 140

The net impact of an *increase* in payout ratio on price-to-book value (PBV) ratio cannot be determined because it might also:

A) decrease expected growth.

B) decrease the market value of the firm.

C) decrease required rate of return.

Question #66 of 140

Which of the following measures of cash flow is *most closely* linked with valuation theory?

A) Earnings before interest, taxes, depreciation, and amortization (EBITDA).

B) Free cash flow to equity (FCFE).

C) Cash flow from operations (CFO).

Question #67 of 140

Robert Chan comments to Leslie Singer that Converted Industries' expected dividend growth rate is 5.0%, dividend payout ratio (*g*) is 45%, and required return on equity (*r*) is 10%. Based on a justified trailing P/E ratio compared to the stock's trailing P/E ratio at market of 9.0, Converted Industries is *most likely*:

A) undervalued.

B) overvalued.

C) correctly valued.

Question #68 of 140

An argument against using the price-to-sales (P/S) valuation approach is that:

A) P/S ratios do not express differences in cost structures across companies.

B) P/S ratios are not as volatile as price-to-earnings (P/E) multiples.

C) sales figures are not as easy to manipulate or distort as earnings per share (EPS) and book value.

Question #69 of 140

Alpha Software (AS) recently reported annual earnings per share (EPS) of $1.75, which included an extraordinary loss of $0.19 and an expense of $0.10 related to acquisition costs during the accounting period, neither of which are expected to recur. Given that the most recent share price is $65.00, what is a useful AS's trailing price to earnings (P/E) for valuation purposes?

A) 44.52.

B) 31.86.

C) 37.14.

Question #70 of 140

Glad Tidings Gifts (GTG) recently reported annual earnings per share (EPS) of $2.25, which included an extraordinary loss of $0.17 and an expense of $0.12 related to acquisition costs during the accounting period, neither of which are expected to recur. Given that the most recent share price is $50.00, what is a useful GTG's trailing price to earnings (P/E) for valuation purposes?

A) 22.22.

B) 19.69.

C) 25.51.

Question #71 of 140

An analyst has gathered the following data about the Garber Company:

- Payout Ratio = 60%.
- Expected Return on Equity = 16.75%.
- Required rate of return = 12.5%.

What will be the appropriate price-to-book value (PBV) ratio for the Garber Company based on return differential?

A) 1.73.

B) 1.38.

C) 0.58.

Question #72 of 140

Which of the following is a common momentum valuation indicator?

A) Relative strength.

B) Dividend yield (D/P).

C) Price to free cash flow to equity (P/FCFE).

Question #73 of 140

Analyst Ariel Cunningham likes using the price/earnings ratio for valuation purposes because studies have shown it is very effective at identifying undervalued stocks. However, she has one main problem with the statistic – it doesn't work when a company loses money. So Cunningham is considering switching to a different core valuation metric. Given Cunningham's rationale for using the price/earnings ratio, which option would be her *best* alternative?

A) Price/book.

B) Price/cash flow.

C) Price/sales.

Question #74 of 140

A firm is better valued using the discounted cash flow approach than the P/E multiples approach when:

A) earnings per share are negative.

B) expected growth rate is very high.

C) dividend payout is low.

Question #75 of 140

An analyst is preparing a presentation on "Interpreting PE ratios" and has the following data:

	Portfolio %	***Stock PE***
Stock AAA	60%	10
Stock BBB	40%	15

Which of the following is *closest* to the weighted harmonic mean of these two PE ratios?

A) 11.54.

B) 11.98.

C) 12.49.

Question #76 of 140

What is the justified leading price-to-earnings (P/E) multiple of a stock that has a retention ratio of 60% if the shareholders require a return of 16% on their investment and the expected growth rate in dividends is 6%?

A) 4.24.

B) 4.00.

C) 6.36.

Question #77 of 140

An increase in growth will cause a price to cash flow multiple to:

A) there is insufficient information to tell.

B) decrease.

C) increase.

Question #78 of 140

An argument against using the price-to-earnings (P/E) valuation approach is that:

A) research shows that P/E differences are significantly related to long-run average stock returns.

B) earnings power is the primary determinant of investment value.

C) earnings can be negative.

Question #79 of 140

The following data was available for Morris, Inc., for the year ending December 31, 2001:

- Sales per share = $150.
- Earnings per share = $1.75.
- Return on Equity (ROE) = 16%.
- Required rate of return = 12%.

If the expected growth rate in dividends and earning is 4%, what will the appropriate price-to-sales (P/S) multiple be for Morris?

A) 0.037.

B) 0.114.

C) 0.109.

Beachwood Builders merged with Country Point Homes on December 31, 2003. Both companies were builders of mid-scale and luxury homes in their respective markets. On December 31, 2013, because of tax considerations and the need to segment the businesses between mid-scale and luxury homes, Beachwood decided to spin-off Country Point, its luxury home subsidiary, to its common shareholders. Beachwood retained Bernheim Securities to value the spin-off of Country Point to its shareholders.

The following information is available to Bernheim's investment bankers:

- Country Point's allocated common equity was $55.6 million as of December 31, 2013.
- Beachwood paid no dividends and has no preferred shareholders.
- Country Point's free cash flow (FCF) is expected to grow 7% after 2017.
- The current risk-free rate is 6%. The market risk premium is 11%.
- Beachwood Builders had 5 million common shares as of December 31, 2013.
- Country Point's cost of capital is equal to its return on equity at year-end (rounded to the nearest percentage point).
- Country Point did not have any long-term debt allocated from Beachwood.

The following data for Country Point is also available for analysis:

$ (in millions)	2013	2014(E)	2015(E)	2016(E)	2017(E)
Net Income	10	15	20	25	30
Depreciation	5	6	5	6	5
Change in Capital Expenditures	7	8	9	10	12
Change in Working Capital	0	0	0	0	0

There are three comparable companies in Country Point's peer group: Upscale Homes, Custom Estates and Chateau One.

Company	Forward P/E	Five-Year EPS Growth Forecast	Forward PEG
Upscale Homes	10.0	12.5%	0.80
Custom Estates	15.0	15.0%	1.00
Chateau One	20.0	17.5%	1.14

Question #80 of 140

Bernheim's investment bankers have determined the value of Country Point to be $162.6 million. As part of the spin-off, Beachwood issued to its common shareholders two shares in Country Point for each Beachwood share that its current shareholders held. The appropriate initial offering price per share of the shares that Beachwood's shareholders receive is *closest* to:

A) $32.50.

B) $14.45.

C) $16.26.

Question #81 of 140

Immediately after the spin-off, Country Point's book value per share is *closest* to:

A) $11.12.

B) $5.56.

C) $16.25.

Question #82 of 140

Assume for this question that the initial offering price per share of the Country Point shares is $16.26. Based on this initial offering price of the spin-off, the estimated price-to-book (P/B) ratio of Country Point is *closest* to:

A) 2.00 times.

B) 1.46 times.

C) 2.92 times.

Question #83 of 140

Based on Bernheim's careful analysis, firms comparable to Country Point trade at a P/B ratio of 3.5 times. The expected price per share of the spin-off based on this P/B ratio and assuming a liquid and efficient market for Country Point's common shares is *closest* to:

A) $56.88.

B) $19.46.

C) $38.92.

Question #84 of 140

Imagine that the current market price of Country Point at December 31, 2013 is $20.00 per share. If the average trailing P/E for luxury home builders is 15x, Country Point is *most* accurately described as:

A) overvalued.

B) undervalued.

C) fairly valued.

Question #85 of 140

Imagine that the current market price for Country Point is $20.00 and the firm's estimated five-year earnings growth rate is 15.0%. The two most attractive companies among the four peer companies based on price-earnings-growth ratio (PEG) as of December 31, 2013 are:

A) Chateau One and Country Point.

B) Upscale Homes and Country Point.

C) Custom Estates and Chateau One.

Question #86 of 140

An increase in financial leverage will cause the trailing price-to-earnings (P/E) multiple to:

A) there is insufficient information to tell.

B) increase.

C) decrease.

Lucas Davenport, CFA, has been assigned the task of doing a valuation analysis of Sanford Systems Inc. Sanford is currently trading at $15 per share. Exhibit 1 and Exhibit 2 present a summary of Sanford's financial statements for 2007 and 2008.

Davenport has previously completed a FCFE valuation, which yielded a value of $11.18 per share based on FCFE per common share in 2008 of $0.85.

Exhibit 1: Sanford Systems Balance Sheets as of 12/31/2008 (in US$ millions)

	2007	2008
Cash and equivalents	$325	450
Accounts receivable	850	870
Inventory	1,000	1,050
Total current assets	$2,175	$2,370
Gross fixed assets	13,600	15,900
Accumulated depreciation	2,300	2,900
Net fixed assets	11,300	13,000
Total assets	$13,475	$15,370
Accounts payable	$1,500	$1,520
Notes payable	300	550
Accrued taxes and expenses		

Total current liabilities	$1,800	$2,070
Long-term debt	$5,575	$6,111
Common stock	100	100
Additional paid-in capital		
Retained earnings	6,000	7,089
Total shareholders' equity	$6,100	$7,189
Total liabilities and shareholders' equity	$13,475	$15,370

Exhibit 2: Sanford Systems Income Statements for 2007 and 2008 (in US$ millions)

	2007	2008
Total revenues	$12,000	$13,100
Operating costs and expenses	9,400	9,600
EBITDA	$2,600	$3,500
Depreciation and amortization	500	600
EBIT	$2,100	$2,900
Interest expense	500	585
Income before taxes	$1,600	$2,315
Taxes (40%)	640	926
Net income	$960	$1,389
Dividends	$280	$300
Change in retained earnings	$680	$1,089
EPS	$1.92	$2.78
DPS	$0.56	$0.60
# of shares outstanding (millions)	500	500

Davenport determines that the company follows IFRS rules, and compiles the following industry price-to-adjusted (per share) CFO data, where adjusted CFO is equal to cash flow from operations from the statement of cash flows plus after-tax cash interest expense.

Exhibit 3: Industry Data

	TrailingP/Adjusted CFO per share	Beta	Consensus 5-Year Earnings Growth
Industry Median	2.0x	1.20	9.9%
Sanford		1.25	9.2%

Davenport would also like to make international price multiple comparisons and is contemplating using one or more of the following ratios: price-to-sales, price-to-earnings, price-to-book, price-to-adjusted cash flow from operations, and enterprise value-to-EBITDA.

Davenport decides to use a single-stage residual income model to estimate the value of Sanford, in addition to the FCFE framework he used earlier. He estimates Sanford's long-term perpetual growth rate in residual income at 5 percent, its return on equity to be 20 percent going forward, weighted average cost of capital to be 10.4 percent based on the target debt-to-asset ratio, and the required return on equity to be 14 percent.

Finally, Davenport solves the following equation for T, given the other inputs (where the index is the S&P 500), and determines that T = 3.6.

$$\ln\left(\frac{\text{Sanford P/E}}{\text{Index P/E}}\right) = \text{T} \times \ln\left(\frac{1 + \text{Sanford short-term growth rate} + \text{Sanford dividend yield}}{1 + \text{Index growth rate} + \text{Index dividend yield}}\right)$$

Question #87 of 140

Sanford's economic value added (EVA®) for 2008 is *closest* to:

A) \$525.80

B) \$567.80

C) \$1,383.20

Question #88 of 140

Based on a comparison of the actual trailing P/FCFE ratio compared to the justified trailing P/FCFE ratio (based on Davenport's FCFE valuation model) for 2008, Sanford is:

A) correctly valued because the actual P/FCFE ratio is equal to the justified P/FCFE ratio for 2008.

B) overvalued because the actual P/FCFE ratio is greater than the justified P/FCFE ratio for 2008.

C) undervalued because the actual P/FCFE ratio is less than the justified P/FCFE ratio for 2008.

Question #89 of 140

Based on a comparison of the actual trailing P/adjusted CFO ratio compared to the industry median trailing P/adjusted CFO per share ratio for 2008, Sanford:

A) is overvalued relative to the industry benchmark because Sanford's P/adjusted CFO ratio is higher than the industry median, despite slightly higher systematic risk and lower 5-year earnings growth.

B) may be undervalued relative to the industry benchmark because Sanford's P/adjusted CFO ratio is higher than the industry median, despite slightly higher systematic risk and lower 5-year earnings growth.

C) is correctly valued relative to the industry benchmark because Sanford's P/adjusted CFO ratio is equal to the industry median, despite slightly higher systematic risk and lower 5-year earnings growth.

Question #90 of 140

Which of the following market multiples is *most* appropriate for Davenport to use in international valuation comparisons?

A) Price-to-adjusted CFO.

B) Enterprise value-to-EBITDA.

C) Price-to-sales.

Question #91 of 140

The value per share of Sanford's common equity, based on a single-stage residual income model, is *closest* to:

A) $22.44.

B) $23.96.

C) $21.24.

Question #92 of 140

For purposes of this question only, assume Sanford's ROE is 20%, its current market price is $25, and the cost of equity is 14%. Sanford's implied growth rate in residual income is *closest* to:

A) 5.88%.

B) 5.23%.

C) 5.11%.

Question #93 of 140

An *increase* in which of the following variables will *least likley* result in a corresponding *increase* in the price-to-book value (PBV) ratio for a high-growth firm?

A) Required rate of return

B) Growth rates in earnings.

C) Payout ratios.

Question #94 of 140

An increase in profit margin will cause a price-to-sales (P/S) multiple to increase if:

A) the required rate of return increases.

B) the growth rate in sales does not decrease proportionately.

C) there is insufficient information to tell.

Question #95 of 140

Precision Tools is expected to have earnings per share (EPS) of $5.00 per share in five years, a dividend per share of $2.00, a cost of equity of 12%, and a long-term expected growth rate of 5%. What is the terminal trailing price-to-earnings (P/E) ratio in five years?

A) 7.14.

B) 6.00.

C) 9.00.

Question #96 of 140

Bill Whelan and Chad Delft are arguing about the relative merits of valuation metrics.

Whelan: "My ratio is less volatile than most, and it works particularly well when I look at stocks in cyclical industries."

Delft: "The problem with your ratio is that it doesn't reflect differences in the cost structures of companies in different industries. I like to use a metric that strips out all the fluff that distorts true company performance."

Whelan: "People can't even agree how to calculate your ratio."

Which valuation metric do the analysts *most likely* prefer?

	Whelan	Delft
A)	Price/sales	Price/cash flow
B)	Price/cash flow	Price/book
C)	Price/book	EV/EBITDA

Question #97 of 140

Two security analysts, Ramon Long and Sri Beujeau, disagree about certain aspects of the PEG ratio. Long argues that: "unlike typical valuation metrics that incorporate dividend discounting, the PEG ratio is unique because it generates meaningful results for firms with negative expected earnings-growth." Is Long correct?

A) No, because the PEG ratio generates meaningless results for negative earnings-growth companies.

B) Yes, because the expected earnings-growth rate is cancelled out in the computation of the PEG ratio.

C) Yes, because the computation of the PEG ratio does not use the rate of expected earnings growth.

Question #98 of 140

An analyst is valuing a company with a dividend payout ratio of 0.65, a beta of 0.72, and an expected earnings growth rate of 0.05. A regression on comparable companies produces the following equation:

Predicted price to earnings (P/E) = 7.65 + (3.75 × dividend payout) + (15.35 × growth) − (0.70 × beta)

What is the predicted P/E using the above regression?

A) 10.35.

B) 7.65.

C) 11.39.

Question #99 of 140

Enhanced Systems, Inc., has a price to book value (P/B) of five while the median P/B of a peer group of companies within the industry is five. Based on the method of comparables, an analyst would *most likely* conclude that ESI should be:

A) sold or sold short as an overvalued stock.

B) viewed as a properly valued stock.

C) bought as an undervalued stock.

Question #100 of 140

A firm has a payout ratio of 40%, a profit margin of 7%, an estimated growth rate of 10%, and its shareholders require a return of 14% on their investment. Based on these fundamentals, a reasonable estimate of the appropriate price-to-sales ratio for the firm (based on trailing sales) is:

A) 0.70.

B) 0.56.

C) 0.77.

Question #101 of 140

Proprietary Technologies, Inc., (PTI) has a leading price-to-earnings (P/E) ratio of 28 while the median leading P/E of a peer group of companies within the industry is 28. Based on the method of comparables, an analyst would *most likely* conclude that PTI should be:

A) bought as an undervalued stock.

B) sold or sold short as an overvalued stock.

C) viewed as a properly valued stock.

Question #102 of 140

A firm's return on equity (ROE) is 14%, its required rate of return is 10%, and its expected growth rate is 8%. What is the firm's justified price-to-book value (P/B) based on these fundamentals?

A) 2.00.

B) 3.00.

C) 2.75.

Question #103 of 140

What is the justified trailing price-to-earnings (P/E) multiple of a stock that has a payout ratio of 65% if the shareholders require a return of 10% on their investment and the expected growth rate in dividends is 6%?

A) 16.25.

B) 17.23.

C) 9.28.

Question #104 of 140

An analyst begins an equity analysis of Company A by estimating future cash flows, discounting them back to the present, and dividing the result by the outstanding number of shares. This analyst is *most likely* using the:

A) technical analysis.

B) the method of forecasted fundamentals.

C) the method of comparables.

Question #105 of 140

An argument for using the price-to-earnings (P/E) valuation approach is that:

A) management discretion increases the reliability of the ratio.

B) earnings power is the primary determinant of investment value.

C) earnings can be negative.

Question #106 of 140

An analyst is calculating the weighted harmonic mean P/E ratio of a 2-stock portfolio. Stocks AAA and BBB have prices of $12 and $15, respectively, and EPS of $1 and $2, respectively. Which of the following is the weighted harmonic mean P/E of the portfolio *closest* to?

A) 9

B) 9.23

C) 9.75

Question #107 of 140

The observation that negative price to earnings (P/E) ratios are meaningless and prices are never negative is used to justify which valuation approach?

A) Dividend discount model.

B) Dividend yield.

C) Earnings yield.

Question #108 of 140

The Lewis Corp. had revenue per share of $300 in 2001, earnings per share of $4.50, and paid out 60% of its earnings as dividends. If the return on equity (ROE) and required rate of return of Lewis are 20% and 13% respectively, what is the appropriate price/sales (P/S) multiple for Lewis?

A) 0.18.

B) 0.12.

C) 0.19.

Question #109 of 140

A firm's return on equity (ROE) is 15%, its required rate of return is 12%, and its expected growth rate is 7%. What is the firm's justified price to book value (P/B) based on these fundamentals?

A) 1.60.

B) 0.63.

C) 1.71.

Question #110 of 140

For which of the following firms is the Price/Earnings to Growth (PEG) ratio *most* appropriate for identifying undervalued or overvalued equities?

Firm A: Expected dividend growth = 6%; Cost of equity = 12%; price-to-earnings (P/E) = 12.

Firm B: Expected dividend growth = −6%; Cost of equity = 12%; price-to-earnings (P/E) = 12.

Firm C: Expected dividend growth = 1%; Cost of equity = 12%; price-to-earnings (P/E) = 12.

A) Firm B.

B) Firm C.

C) Firm A.

Question #111 of 140

In interpreting the standardized unexpected earnings (SUE) momentum measure, it can be concluded that a given size forecast error is:

A) more meaningful the larger the historical size of forecast errors.

B) more meaningful the smaller the historical size of forecast errors.

C) scaled by the earnings surprise.

Question #112 of 140

An analyst gathers the following information for ABC Industries:

Market Value of Debt	$110 million
Market Value of Equity	$90 million
Book Value of Debt	$100 million
Book Value of Equity	$50 million
EBITDA	$75 million

The EV/EBITDA is *closest* to:

A) 2.67.

B) 2.00.

C) 2.13.

Question #113 of 140

Which of the following statements about cyclical firms is *least* accurate?

A) The price-to-earnings (P/E) multiple of a cyclical firm normally peaks at the depths of recession and bottoms out at the peak of economic boom.

B) The problems encountered when using the price-to-earnings (P/E) multiples of cyclical firms can be completely eliminated by using average or normalized earnings.

C) Cyclical firms have volatile earnings, and their price-to-earnings (P/E) multiple is not very useful for valuation.

Question #114 of 140

Enhanced Systems, Inc., (ESI) has a leading price to sales (P/S) of 0.18 while the median leading P/S of a peer group of companies within the industry is 0.10. Based on the method of comparables, an analyst would *most likely* conclude that ESI should be:

A) bought on margin as an undervalued stock.

B) bought as an undervalued stock.

C) sold or sold short as an overvalued stock.

Question #115 of 140

An analyst is valuing a company with a dividend payout ratio of 0.35, a beta of 1.45, and an expected earnings growth rate of 0.08. A regression on comparable companies produces the following equation:

Predicted price to earnings (P/E) = 7.65 + (3.75 × dividend payout) + (15.35 × growth) − (0.70 × beta)

What is the predicted P/E using the above regression?

A) 9.18.

B) 7.65.

C) 11.21.

Question #116 of 140

What is the appropriate leading price-to-earnings (P/E) multiple of a stock that has a projected payout ratio of 40% if shareholders require a return of 15% on their investment and the expected growth rate in dividends is 5%?

A) 4.00.

B) 13.20.

C) 6.30.

Question #117 of 140

Consider the statement: "Unlike many valuation metrics that incorporate dividend discounting, the PEG ratio may be used to value firms with zero expected dividend growth prospects." Is this statement correct?

A) Yes, because the expected dividend growth rate is cancelled out in the computation of the PEG ratio.

B) No, because the PEG ratio is undefined for zero-growth companies.

C) Yes, because the computation of the PEG ratio does not use the rate of expected dividend growth.

Question #118 of 140

An increase in return on equity (ROE) will cause a price-to-earnings (P/E) multiple to:

A) there is insufficient information to tell.

B) decrease.

C) increase.

Question #119 of 140

At a regional security analysts conference, Sandeep Singh made the following comment: "A PEG ratio is a very useful valuation metric because it generates meaningful results for all equities, regardless of the rate of dividend growth." Is Singh correct?

A) No, because the PEG ratio generates highly questionable results for low-growth companies.

B) Yes, because the expected dividend growth rate is cancelled out in the computation of the PEG ratio.

C) Yes, because the computation of the PEG ratio does include the rate of expected dividend growth.

Question #120 of 140

What is the appropriate justified trailing price-to-earnings (P/E) multiple of a stock that has a payout ratio of 40% if shareholders require a return of 15% on their investment and the expected growth rate in dividends is 5%?

A) 6.30.

B) 4.20.

C) 3.80.

Question #121 of 140

An argument for using the price-to-earnings (P/E) valuation approach is that:

A) research shows that P/E differences are significantly related to long-run average stock returns.

B) earnings can be negative.

C) earnings volatility facilitates interpretation.

Question #122 of 140

Which of the following is a *disadvantage* of using the price-to-book value (PBV) ratio?

A) Book values are affected by accounting standards, which may vary across firms and countries.

B) Firms with negative earnings cannot be evaluated with the PBV ratios.

C) Book value may not mean much for manufacturing firms with significant fixed costs.

Question #123 of 140

Margin and Sales Trade-off for CVR, Inc. and Home, Inc., for Next Year				
Firm	**Strategy**	**Retention Rate**	**Profit Margin**	**Sales/Book Value (SBV) of Equity**
CVR, Inc.	High Margin / Low Volume	20%	8%	1.25
CVR, Inc.	Low Margin / High Volume	20%	2%	4.00
Home, Inc.	High Margin / Low Volume	40%	9%	2.00
Home, Inc.	Low Margin / High Volume	40%	1%	20.0

Note: CVR, Inc., has a book value of equity of $80 and a required rate of return of 10%. Home, Inc., has a book value of equity of $100 and a required rate of return of 11%.

If Home, Inc., has a required return for shareholders of 11%, what is its appropriate leading price-to-sales (P_0 / S_1) multiple if the firm undertakes the low margin/high volume strategy?

A) 0.80.

B) 0.20.

C) 1.00.

Question #124 of 140

What is the justified trailing price-to-earnings (P/E) multiple of a stock that has a payout ratio of 40% if the shareholders require a return of 16% on their investment and the expected growth rate in dividends is 6%?

A) 4.00.

B) 4.24.

C) 6.36.

Question #125 of 140

The average return on equity (ROE) earnings normalization method relies on:

A) average earnings per share (EPS) over the most recent cycle.

B) average ROE over the most recent cycle.

C) the earnings yield.

Question #126 of 140

Good Sports, Inc., (GSI) has a leading price-to-earnings (P/E) ratio of 12.75 and a 5-year consensus growth rate forecast of 8.5%. What is the firm's P/E to growth (PEG) ratio?

A) 150.00.

B) 0.67.

C) 1.50.

Analysts and portfolio managers at Big Picture Investments are having their weekly investment meeting. CEO Bob Powell, CFA, believes the firm's portfolios are too heavily weighted toward growth stocks. "I expect value to make a comeback over the next 12 months. We need to get more value stocks in the Big Picture portfolios." Four of Powell's analysts, all of whom hold the CFA charter, were at the meeting – Laura Barnes, Chester Lincoln, Zelda Marks, and Thaddeus Bosley. Powell suggested Big Picture should start selecting stocks with the lowest price-to-earnings (P/E) multiples. Here are the analysts' comments:

- Barnes said numerous academic studies have shown that low P/E stocks tend to outperform those with high P/Es. She uses the P/E ratio as the basis of most of her valuation analysis. "I prefer to use the justified P/E ratio because it is inversely related to the required rate of return."
- Lincoln warned against using P/E ratios to evaluate technology stocks. He suggests using price-to-book (P/B) ratios instead, because they are useful for explaining long-term stock returns. "Book value is a good measure of value for companies with a lot of liquid assets, and it is easier to calculate than the P/E because you rarely have to adjust book value."
- Bosley prefers the price/sales (P/S) ratio and the earnings yield. "The P/S ratio is particularly useful for valuing companies in cyclical industries because it isn't affected by sharp changes in profitability caused by economic cycles."
- Marks acknowledges that the P/E ratio is a useful valuation measurement. However, she prefers using the price/free-cash-flow ratio. "Free cash flow (FCF) is more difficult to manipulate than earnings, and it has proven value as a predictor of stock returns."

Powell has provided Barnes with a group of small-cap stocks to analyze. The stocks come from a variety of different sectors and have widely different financial structures and growth profiles. She has been asked to determine which of these stocks represent attractive values. She is considering four possible methods for the job:

- The PEG ratio, because it corrects for risk if the stocks have similar expected returns.
- Comparing P/E ratios to the average stock in the S&P 500 Index, because the benchmark should serve as a good proxy for the average small-cap stock valuation.
- Comparing P/E ratios to the median stock in the S&P 500 Index, because outliers can skew the average P/E upward.
- The P/S ratio, because it works well for companies in different stages of the business cycle.

Question #127 of 140

Which analyst's quote is *least* accurate?

A) Lincoln's.

B) Bosley's.

C) Barnes'.

Question #128 of 140

Barnes is contemplating the use of a price/earnings ratio to value a start-up medical technology firm. Which of the following is the *most* compelling reason not to use the P/E ratio?

A) The company is likely to be unprofitable.

B) Earnings per share are not a good determinant of investment value for medical-technology companies.

C) P/E ratios for medical-technology firms with different specialties are not comparable.

Question #129 of 140

Based on their responses to Powell, which of the analysts is *most likely* concerned about earnings volatility?

A) Bosley.

B) Barnes.

C) Lincoln.

Question #130 of 140

Based on their responses to Powell, which of the analysts has proposed a method that has the *best* chance to work for determining the relative value start-up companies?

A) Marks.

B) Bosley.

C) Lincoln.

Question #131 of 140

Barnes would be *least likely* to use EV/EBITDA ratio, rather than the P/E ratio, when analyzing a company that:

A) has a different capital structure than most of its peers.

B) pays a dividend, and is likely to deliver little earnings growth.

C) reports a lot of depreciation expense.

Question #132 of 140

Barnes is considering the four methods previously described to analyze the small-cap stocks provided to her by Powell. For which method does Barnes provide the *weakest* justification?

A) The mean P/E of S&P 500 companies.

B) The PEG ratio.

C) The price/sales ratio.

Question #133 of 140

An analyst gathered the following data for TRK Construction [all amounts in Swiss francs (Sf)]:

Recent share price	Sf 22.00
Shares outstanding	40 million
Market value of debt	Sf 140 million
Cash and marketable securities	Sf 55 million
Investments	Sf 300 million
Net income	Sf 140 million
Interest expense	Sf 7 million
Depreciation and amortization	Sf 10 million
Taxes	Sf 56 million

The EV/EBITDA ratio for TRK Construction is *closest* to:

A) 3.12x.

B) 3.49x.

C) 2.52x.

Carol Jenkins, CFA, works as a stock analyst for Cape Cod Partners, a money-management firm that handles private accounts for high net worth clients. Jenkins' assignment is to find attractively valued stocks for client portfolios.

Jenkins believes that recent weakness in the technology sector presents an attractive opportunity. She is looking at Massive Tech, the market leader in chipsets for laptop computers, and Mouse & Associates, a tiny software developer specializing in data-storage programs. Jenkins is considering the companies' relative values in a number of ways. Statistics for Massive and Mouse are provided below:

	Massive Tech	Mouse & Associates
Stock price	$65	$12

Trailing earnings	$4,300	$3.15
Market capitalization	$130,000	$84
Assets	$16,250	$7.0
Equity	$12,000	$5.5
Operating margin	49%	54%
Net margin	12%	22%
Depreciation	$3,500	$6
Amortization	$5,675	$1.5
Fixed investment plus borrowing	$4,200	$0.3
Dividends	$3	$0.02
Shares outstanding	2,000	7

* All figures except stock price, dividends, and percentages are in millions.

In most cases, Jenkins values her stocks relative to an equally-weighted basket of stocks in the same industry in order to avoid significant fundamental differences between companies of different types. However, her picks made based on price/earnings ratios are not doing well against the market. She fears the stocks she selects are not as cheap as she originally thought, relative to her benchmark.

Jenkins also wants to improve Cape Cod's selection of software stocks. To widen the field beyond the companies she currently follows, Jenkins wants to include Canadian software stocks in Cape Cod's research universe. Differences in accounting methodologies are not a concern, but Jenkins is still concerned about the difficulty of valuing the different stocks.

Jenkins has assembled the following data about Canadian software companies:

- Most are very small.
- Most carry little debt, but about 20% are heavily leveraged.
- These companies are more likely to be unprofitable compared to U.S. companies.
- Few pay dividends, as is the case in the U.S.
- Many of the companies are government-subsidized, which leads to drastic differences in the level of operating expenses.

Question #134 of 140

Which of the following explanations is *least likely* to explain why Jenkins' stock picks underperform?

A) She is using the mean rather than the median valuation as a benchmark.

B) Large stocks have an outsized effect on the benchmark data.

C) Many stocks in the benchmark group are mispriced.

Question #135 of 140

If she wants to compare Canadian software companies to U.S. software companies, it would be *most* appropriate for Jenkins to value the companies using the:

A) price/sales ratio.

B) price/book ratio.

C) enterprise value/EBITDA ratio.

Question #136 of 140

Which valuation ratio is *least* appropriate for comparing Massive and Mouse?

A) Price/cash flow because cash flows for small companies can be extremely volatile.

B) Price/book because Massive is larger than Mouse.

C) Enterprise value/EBITDA because Massive and Mouse have very different debt levels.

Question #137 of 140

Mouse & Associates is cheaper than Massive Tech as measured by:

A) the price/sales ratio and the price/earnings ratio.

B) the earnings yield but not the price/book.

C) the price/sales ratio and the dividend yield.

Question #138 of 140

The price/cash flow ratio of Massive Tech, where cash flow is defined as earnings plus noncash charges, is *closest* to:

A) 7.89.

B) 9.65.

C) 16.67.

Question #139 of 140

If Jenkins wants to compare foreign stocks to U.S. stocks and is concerned about differences in accounting, she should start with the:

A) price/book ratio.

B) price/FCFE ratio.

C) dividend yield.

Question #140 of 140

If cash flow from operations (CFO) embeds financing-related flows, it should be adjusted by:

A) subtracting capital expenditures.

B) adding (net interest outflow) × (1 - tax rate).

C) subtracting (net interest outflow) × (1 - tax rate).