CFA-LEVEL-1 Q&As

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QUESTION 1

Net profit margin for a market series is difficult to estimate because it is very ________.

A. stable

B. costly

C. volatile

D. inaccurate

Correct Answer: C

Net profit margin for a market series is difficult to estimate because it is highly volatile, a result of changes in depreciation, interest and tax rate over time.

QUESTION 2

An investor purchased 100 shares of a stock two years ago for $50 per share after deciding the stock would be a good value investment. Since the initial purchase, the stock price has fallen to $35 per share after several of the company\\'s major customers canceled contracts. The investor has decided to purchase another 50 shares at the lower price. Which of the following behavioral biases best characterizes the investor\\'s actions?

A. Escalation bias.

B. Momentum bias.

C. Overconfidence bias.

Correct Answer: A

QUESTION 3

Given that the expected dividend payout ratio on a common stock is 0.7, the required rate of return is 19%, the dividend and earnings growth rate is 15%, and current earnings are $1.38, using the earnings multiplier model, what is the estimated value of the stock?

A. Not enough information

B. $27.83

C. $43.71

D. $29.68

E. $25.53

Correct Answer: B

The earnings multiplier model postulates that P/E = (D1/E)/(k -g), where P/E is the price to earnings ratio, D1 is next

year\\'s expected dividends, E is next year\\'s earnings, k is the required rate of return, and g is the growth rate in dividends. D1/ E is also known as the dividend payout ratio. In this question, the P/E is

(0.7) / (0.19 - 0.15) = 17.5. Next year\\'s earnings are equal to current earnings multiplied by the earnings (and dividend) growth rate (1.38 x 1.15 = $1.59). We can multiply P/E by next year\\'s earnings to arrive at our expected stock value ((P/E) x E = P) In this question, the estimated value is 17.5 x 1.59 = $27.83.

QUESTION 4

Assume the following information about an international telecommunications company.

Retention rate = 0.91 Net income / sales = 0.21 Total assets / common equity = 3.125 Sales / total assets = 0.33

What is the expected annual growth rate of this firm\\'s dividends?

A. 23.63%

B. 1.77%

C. The answer cannot be determined from the information provided.

D. None of these answers is correct.

E. 28.71%

F. 19.71%

Correct Answer: F

A popular model for determining the growth rate of dividends is the following: g = RR * ROE

Where: g = the expected growth rate of dividends, RR = the retention rate (this is equal to 1 - dividend

payout ratio), and ROE = the return on equity.

Although it may at first appear otherwise, all of the necessary information has been provided. Remember

the Du Pont decomposition process for ROE, which breaks down the ROE figure into the following:

ROE = (Net Income / Sales) * (Sales / Total Assets) * (Total Assets * Common Equity)

Mathematically, this will break down into (Net Income / Common Equity), the ROE figure. The calculation

of the return on equity for this company is as follows:

ROE = [0.21 * 0.33 * 3.125] = 0.216563, or 21.66%.

Now that the ROE figure has been determined, the calculation of the growth rate of dividends is as follows:

g = [(0.91) * 0.2166] = 0.197072, or 19.71%.

QUESTION 5

An increase in accounts payable would be considered ________.

A. a non-cash charge to income

B. an adjusting entry

C. a use of cash

D. a source of cash

Correct Answer: D

An increase in accounts payable shows a decrease in the outflow of cash.

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