IAQS | INSTITUTE OF ACTUARIAL & QUANTITATIVE STUDIES

Subject: Portfolio Theory & Security Analysis

Chapter: 9, 10 (Unit 4)

Category: PRACTICE QUESTIONS

1 Which of the following is *not* a characteristic of common equity?
A It represents an ownership interest in the company.
B Shareholders participate in the decision-making process.
C The company is obligated to make periodic dividend payments.
2 The type of equity voting right that grants one vote for each share of equity owned is referred to as:
A proxy voting.
B statutory voting.
C cumulative voting.
3 All of the following are characteristics of preference shares *except*:
A They are either callable or putable.
B They generally do not have voting rights.
C They do not share in the operating performance of the company.
4 Participating preference shares entitle shareholders to:
A participate in the decision-making process of the company.
B convert their shares into a specified number of common shares.
C receive an additional dividend if the company's profits exceed a pre-determined level.
5 Which of the following statements about private equity securities is *incorrect*?
A They cannot be sold on secondary markets.
B They have market-determined quoted prices.
C They are primarily issued to institutional investors.
6 Venture capital investments:
A can be publicly traded.
B do not require a long-term commitment of funds.
C provide mezzanine financing to early-stage companies.

7 Which of the following statements *most accurately* describes one difference between private and public equity firms?
A Private equity firms are focused more on short-term results than public firms.
B Private equity firms' regulatory and investor relations operations are less costly than those of public firms.
C Private equity firms are incentivized to be more open with investors about governance and compensation than public firms.
8 Emerging markets have benefited from recent trends in international markets. Which of the following has *not* been a benefit of these trends?
A Emerging market companies do not have to worry about a lack of liquidity

in their home equity markets.
B Emerging market companies have found it easier to raise capital in the markets of developed countries.
C Emerging market companies have benefited from the stability of foreign exchange markets.
9 When investing in unsponsored depository receipts, the voting rights to the shares in the trust belong to:
A the depository bank.
B the investors in the depository receipts.
C the issuer of the shares held in the trust.
10 With respect to Level III sponsored ADRs, which of the following is *least likely* to be accurate? They:
A have low listing fees.
B are traded on the NYSE, NASDAQ, and AMEX.
C are used to raise equity capital in US markets.
11 A basket of listed depository receipts, or an exchange-traded fund, would *most likely* be used for:
A gaining exposure to a single equity.
B hedging exposure to a single equity.
C gaining exposure to multiple equities.
12 Calculate the total return on a share of equity using the following data:
Purchase price: $50
Sale price: $42
Dividend paid during holding period: $2
A –12.0%
B –14.3%
C –16.0%

13 From an investor's point of view, which of the following equity securities is the *least* risky?
A Putable preference shares.
B Callable preference shares.
C Non-callable
14 Which of the following is *least likely* to be a reason for a company to issue equity securities on the primary market?
A To raise capital.
B To increase liquidity.
C To increase return on equity

15 Which of the following is *not* a primary goal of raising equity capital?
A To finance the purchase of long-lived assets.
B To finance the company's revenue-generating

activities.
C To ensure that the company continues as a going concern.
16 Which of the following statements is *most accurate* in describing a company's book value?
A Book value increases when a company retains its net income.
B Book value is usually equal to the company's market value.
C The ultimate goal of management is to maximize book value.
preference shares.

17 Hideki Corporation has just paid a dividend of \450 per share. Annual dividends are expected to grow at the rate of 4 percent per year over the next four years. At the end of four years, shares of Hideki Corporation are expected to sell for \9000. If the required rate of return is 12 percent, the intrinsic value of a share of Hideki Corporation is *closest* to:
A \5,850.
B \7,220.
C \7,670.
18 The Gordon growth model can be used to value dividend-paying companies
that are:
A expected to grow very fast.
B in a mature phase of growth.
C very sensitive to the business cycle.
19 The best model to use when valuing a young dividend-paying company that is
just entering the growth phase is *most likely* the:
A Gordon growth model.
B two-stage
dividend discount model.
C three-stage
dividend discount model.

20 An analyst has gathered the following information for the Oudin Corporation:
Expected earnings per share = €5.70
Expected dividends per share = €2.70
Dividends are expected to grow at 2.75 percent per year indefinitely
The required rate of return is 8.35 percent
Based on the information provided, the price/earnings multiple for Oudin is *closest* to:
A 5.7.
B 8.5.
C 9.4.
21 The market value of equity for a company can be calculated as enterprise value:

A minus market value of debt, preferred stock, and short-term
investments.
B plus market value of debt and preferred stock minus short-term
investments.
C minus market value of debt and preferred stock plus short-term
investments.
22 Which of the following statements regarding the calculation of the enterprise value multiple is *most likely* correct?
A Operating income may be used instead of EBITDA.
B EBITDA may not be used if company earnings are negative.
C Book value of debt may be used instead of market value of debt.
23 An analyst has determined that the appropriate EV/EBITDA for Rainbow Company is 10.2. The analyst has also collected the following forecasted information for Rainbow Company:
EBITDA = $22,000,000
Market value of debt = $56,000,000
Cash = $1,500,000
The value of equity for Rainbow Company is *closest* to:
A $169 million.
B $224 million.
C $281 million.
24 Enterprise value is most often determined as market capitalization of common equity and preferred stock minus the value of cash equivalents plus the:

A book value of debt.
B market value of debt.
C market value of long-term
debt.
25 Asset-based
valuation models are best suited to companies where the capital
structure does not have a high proportion of:
A debt.
B intangible assets.
C current assets and liabilities.
26 Which of the following is *most likely* a reason for using asset-based
valuation?
A The analyst is valuing a privately held company.
B The company has a relatively high level of intangible assets.
C The market values of assets and liabilities are different from the balance
sheet values.
27 A disadvantage of the EV method for valuing equity is that the following
information
may be difficult to obtain:
A Operating income.

B Market value of debt.
C Market value of equity.
28 Which type of equity valuation model is *most likely* to be preferable when one is comparing similar companies?
A A multiplier model.
B A present value model.
C An asset-based valuation model.
29 Which of the following is *most likely* considered a weakness of present value models?
A Present value models cannot be used for companies that do not pay dividends.
B Small changes in model assumptions and inputs can result in large changes in the computed intrinsic value of the security.
C The value of the security depends on the investor's holding period; thus, comparing

ANSWERS:

1. C
2. B
3. A
4. C
5. B
6. C
7. B
8. C
9. A
10. A
11. C
12. A
13. A
14. C
15. C
16. A
17. B
18. B
19. C
20. B
21. C

22. A
23. A
24. B
25. B
26. A
27. B
28. A
29. B