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CFA® Program Level I

Equities: 47 Free Practice Questions

2027 curriculum · 12 readings · answers and full explanations

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Version v2027.3 · October 2026

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CredGuild · CFA® Program Level I · Equities: 47 Free Practice Questions
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How to use these questions

The 47 free questions on credguild.com for Equities, 2027 CFA® Program Level I curriculum, each with its answer and full explanation.

- The questions are grouped by topic and reading, in curriculum order. Answers and explanations follow each topic, on a new page, so you can work a topic before you check it.
- Each explanation says why the right answer is right and why each other option is wrong, and names the reading, with a link to its notes.
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If these questions help you, pass the file on to someone else who is studying.

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CFA® PROGRAM LEVEL I · FREE PRACTICE QUESTIONS

Equities

Questions 1–47 · 12 readings

39 Common Stock vs Preferred Stock

Question 1

A trainee asks how an equity instrument differs from the other securities a company may issue. An equity instrument is *best* described as a security that:

A establishes a creditor relationship with a company.

B represents an ownership interest in a company.

C can represent either an ownership interest or a creditor position, depending on its terms.

Question 2

Under the terms in its equity prospectus, holders of Qarth Energy's shares will be offered any new shares the company issues before those shares are offered to other investors. This feature is known as:

A conversion rights.

B preemptive rights.

C split, subdivision, or combination rights.

Question 3

Brackley Utilities has three series of preference shares outstanding, identical apart from the features below. For the investors who hold them, which series is the *most* risky?

A Putable, cumulative preference shares.

B Noncallable, cumulative preference shares.

C Callable, noncumulative preference shares.

Question 4

An analyst is preparing a briefing on the main categories of private equity investment. Which of her statements is *most accurate*?

A Buyout equity concentrates on companies at the start-up and early stages of their development.

B Venture capital stakes can readily be sold in active, liquid secondary markets.

C Growth equity is capital a company raises during its growth stage, for example to finance expansion.

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40 Equity Jurisdictions, Classes, and the Voting Process

Question 5

A Chilean pension fund opens a brokerage account in Tokyo and buys the shares of a Japanese manufacturer on that company's home stock exchange. This is an example of:

A indirect investing.

B direct investing.

C dual listing.

Question 6

The founders of Veridian Apps own 15% of its shares but control a majority of the votes, because each of their shares carries ten votes while every other share carries one. This arrangement is an example of a:

A cumulative preference share issue.

B participating preference share issue.

C dual-class share structure.

Question 7

Kavanagh Dairy set the record date for voting at its annual meeting 35 days before the meeting. Ingrid Solheim, who owned 800 Kavanagh shares on the record date, sells them to Paulo Mendes 5 days before the meeting. Who is entitled to vote those 800 shares at the meeting?

A Mendes, because he owns the shares on the meeting date.

B Solheim, because she was the shareholder of record on the record date.

C Neither of them, because the shares changed hands after the record date.

41 Equity Issuance and Trading

Question 8

An analyst lists three recent transactions. Which one took place in the primary market?

A Two pension funds trade a block of listed shares directly with each other.

B A bank buys investment-grade corporate bonds from a dealer's inventory.

C A utility sells newly issued common shares to investors to fund a new plant.

Question 9

An analyst makes three statements about methods of issuing equity. Which statement is *least accurate*?

A A private company can obtain listed status through either a back-door listing or a direct listing.

B A SPAC shareholder can end up owning part of an acquired company even after voting against that target.

C Every seasoned equity offering reduces the proportional ownership of the company's current shareholders.

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Question 10

Owen Achebe owns 2,000 shares of Kilnsey Water and enters a limit order to sell all of them at 27.35. Just before his order arrives, the limit order book looks like this:

Limit order book for Kilnsey Water shares

Bid size (shares)	Limit price	Offer size (shares)
	27.60	800
	27.55	1,200
900	27.45	
600	27.40	
1,100	27.30	

Any shares that cannot be sold at once remain in the book as an offer. The average price of the shares he sells immediately is *closest* to:

A 27.35.

B 27.40.

C 27.43.

Question 11

An index provider designing a broad-based equity index for a national stock market would *most typically* weight the constituent stocks:

A by float-adjusted market capitalization.

B in proportion to their share prices.

C equally, regardless of company size.

42 Sources of Equity Returns

Question 12

Torvald Steel's profits rise and fall with the business cycle. After an exceptionally profitable year, its board wants to share the windfall with shareholders without committing to larger payments in future years. The type of distribution the board is *most likely* to declare is a:

A special dividend.

B regular dividend.

C stock dividend.

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Question 13

Galloway Brewing pays a dividend of $0.90 per share. Its shares close at $48.00 on the day before the ex-dividend date and at $45.60 on the ex-dividend date. Assume Galloway has the same risk as the overall market and there is no company news. The fraction of Galloway's ex-dividend-date price drop that is attributable to the market is *closest* to:

A 62.5%.

B 37.5%.

C 3.3%.

Question 14

An analyst expects shares of Marlow Utilities to trade at $66.00 one year from now and to pay a dividend of $2.20 per share at the end of the year. Investors' required rate of return on Marlow's equity is 11%. The value of a Marlow share today is *closest* to:

A $59.46.

B $61.44.

C $61.66.

43 Introduction to Equity Valuation

Question 15

Shares of Delvin Pharmacy trade at 14.0 times analysts' consensus forecast of next year's EPS, which is $3.20. Last year Delvin earned $2.90 per share. Using her own models, an analyst estimates the intrinsic value of a Delvin share at $40.00. From her point of view, Delvin shares are:

A undervalued by $4.80.

B overvalued by $0.60.

C overvalued by $4.80.

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Question 16

An analyst gathers the following market and financial data for Tamsin Ridge Appliances (amounts in millions except the share price).

Tamsin Ridge Appliances: selected data

Item	Value
Share price	$28.50
Common shares outstanding	12.0 million
Market value of preferred stock	$18 million
Market value of debt	$95 million
Cash and short-term investments	$31 million
EBITDA	$52 million

Tamsin Ridge's EV/EBITDA multiple is *closest* to:

A 7.8×.

B 8.2×.

C 8.8×.

Question 17

An analyst compares Tolliver Freight's ratio of enterprise value to EBITDA with the average ratio for other trucking companies. The analyst is using which type of valuation model?

A A multiplier model.

B An asset-based model.

C A discounted cash flow model.

44 Discounted Cash Flow (DCF) and Growth Models

Question 18

Which of the following statements *most accurately* contrasts a dividend discount model (DDM) with a free cash flow to equity (FCFE) model?

A A DDM reflects the firm's capacity to pay dividends, while an FCFE model uses the cash shareholders actually receive.

B A DDM takes the view of a minority shareholder, while an FCFE model takes the view of a controlling shareholder.

C A DDM assumes a volatile capital structure, while an FCFE model assumes the firm borrows aggressively.

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Question 19

Maren Solberg has concluded that both free cash flow measures for Halden Robotics are negative and are unlikely to turn positive for several years, so she will value the company's equity with a residual income model. Which condition must hold for her to use Halden's reported book value of equity without adjustment?

A The company follows clean surplus accounting.

B The company holds its debt-to-assets ratio constant.

C The company adjusts earnings for depreciation tax savings.

Question 20

Colm Brennan projects that shares of Ardent Furnishings will trade at $63.00 one year from now and that Ardent will pay a $1.80 dividend per share at the end of the year. Brennan discounts Ardent's cash flows at 9%. Ardent currently trades at $60.00. Based on Brennan's analysis, Ardent's shares are:

A Overvalued.

B Fairly priced.

C Undervalued.

Question 21

Brookmere Clinics is expected to generate free cash flow to the firm (FCFF) of $50 million in Year 1, $62 million in Year 2 and $80 million in Year 3. After Year 3, FCFF is expected to grow at 4% a year. Brookmere's weighted average cost of capital (WACC) is 8.5%. The value of the firm today is *closest* to:

A $1,609 million.

B $1,553 million.

C $1,495 million.

Question 22

Compared with an otherwise identical option-free preferred stock, a preferred stock with an embedded option *most likely* has a lower intrinsic value when the right to exercise the option is held by:

A the investor, as with a conversion feature.

B either party, because an embedded option always lowers value.

C the issuer, as with a call feature.

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45 Relative Value Equity Valuation Approaches

Question 23

Beatriz Almeida is valuing Penhallow Instruments with the method of comparables. The leading P/E ratios of the five companies in her peer group are 13.5, 14.5, 16.0, 20.0 and 48.0. The 48.0 multiple belongs to a peer whose earnings next year are expected to be temporarily depressed by a plant refit. Penhallow earned $2.60 per share over the last 12 months, and the consensus forecast of its EPS for next year is $2.95. Almeida's estimate of Penhallow's value per share is *closest* to:

A $41.60.

B $47.20.

C $66.08.

Question 24

Over its most recent business cycle, Dunmore Engineering earned an average return on equity of 16%. Its current book value per share is $31.50, its expected EPS for next year is $4.80, and its EPS averaged $4.35 over the same cycle. Using the average ROE method, Dunmore's normalized EPS is *closest* to:

A $4.35.

B $4.80.

C $5.04.

Question 25

Which of the following is *most likely* a limitation of relying on an industry-based peer group?

A Industry peers are assumed to carry the same financial leverage.

B Some companies operate across several distinct industries and markets.

C The law of one price requires factor models for firms operating abroad.

Question 26

Carys Morgan forecasts that Norrland Timber will earn $6.00 per share in Year 7. From then on she expects earnings and dividends to grow at 5% a year indefinitely, with 40% of earnings paid out, and she requires a 10% return. Using a justified leading P/E ratio, Norrland's terminal value per share at the end of Year 7 is *closest* to:

A $48.00.

B $50.40.

C $75.60.

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46 Financial Statement Forecasting in Equity Valuation

Question 27

Compared with a present value model that applies one or two growth rates to a single cash flow measure, the *main* benefit of a disaggregated valuation model built on forecast financial statements is that it:

A eliminates the need to estimate a terminal value.

B lets each statement component follow its own growth path.

C produces a more precise estimate of the discount rate.

Question 28

Tomasz Wilk is building a forecast for Halvorsen Aluminum. Halvorsen has just signed a four-year energy supply contract that fixes the electricity price for its smelters at a level well above what it paid in the past. Wilk wants his expense forecast to reflect the new contract terms. Which approach to forecasting expenses is *most* appropriate?

A Itemizing expenses.

B A historical approach.

C A direct profit margin approach.

Question 29

A venture capital fund targets an ROI multiple of 5x on a start-up investment that it expects to exit after six years. The annual required rate of return implied by this target is *closest* to:

A 30.8%.

B 34.8%.

C 66.7%.

Question 30

An investor estimates that Wexcombe Textiles has an 85% probability of surviving as a going concern, in which case its equity would be worth $46 million. If it does not survive, the investor expects a distress sale to leave shareholders $10 million after all creditor claims and sale costs are paid. The value of Wexcombe's equity is *closest* to:

A $46.0 million.

B $40.6 million.

C $15.4 million.

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Question 31

An analyst's forecast for Carrow Retail assumes that revenue will grow 3% a year, while most of Carrow's operating expenses, including SG&A and depreciation, will grow 5% to 6% a year. Based only on this information, which of the following is *most likely*?

A The gross profit margin is expected to remain steady.

B The net profit margin is expected to increase.

C The operating profit margin is expected to decrease.

47 Industry and Competitive Analysis

Question 32

Kalinda Osei is studying how carbon-pricing rules, changing attitudes toward home exercise, and higher interest rates could affect the fitness-equipment industry. She organizes these factors using the PESTLE framework. In the industry and competitive analysis process, this work is best described as:

A examining external influences.

B analyzing the industry structure.

C defining the industry.

Question 33

Rosalind Achebe wants to size the market for gluten-free infant cereal. She plans to use a national statistics agency's revenue figures for the packaged-food industry. The main drawback of this approach is *most likely* that:

A it is unsuitable when an industry contains many private firms.

B the data may not be detailed enough for a narrow product niche.

C revenue is hard to isolate for companies with several product lines.

Question 34

The residential elevator industry in a country has five manufacturers with market shares of 50%, 20%, 15%, 10% and 5%. Based on its Herfindahl-Hirschman Index (HHI), the industry's concentration is best described as:

A low.

B moderate.

C high.

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Question 35

Fennick Labs is exploring home diagnostics within the clearly defined medical-testing domain. The exact customer problem is not yet distinct, but its new testing model could create a new market or redefine the existing diagnostics market. This strategy is most characteristic of:

A disruptive innovation.

B breakthrough innovation.

C sustaining innovation.

48 Company Analysis: Past, Present, and Future

Question 36

Having finished her assessment of the competitive forces in the packaged-foods industry, an analyst now turns to one particular company in that industry. Which of the following is she *most likely* to examine next?

A The threat of substitute products.

B The bargaining power of suppliers.

C The company's competitive strategy.

Question 37

Fennwick Pumps makes solar-powered irrigation pumps. Across its home continent, annual demand for such pumps (the total addressable market) is estimated at $2.4 billion. Fennwick's pumps are certified only for the voltage standard used in 70% of that demand, and within the certified segment it holds sales licenses in countries representing 55% of that segment's demand. Its factory can supply at most $300 million of pumps a year. Fennwick's serviceable market is *closest* to:

A $924 million.

B $1,320 million.

C $1,680 million.

Question 38

An analyst is deciding whether to rely on net income when assessing a company's operating profitability. Which statement about net income is *most accurate*?

A It can be difficult to use for tracking a company's profitability over time.

B It is well suited to start-ups and to companies in highly cyclical industries.

C It is not recognized as a profitability measure under US GAAP or IFRS.

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Question 39

An analyst gathers the data in the exhibit for Pellworth Logistics.

Pellworth Logistics: selected data for the year ($ millions)

Item	Amount ($ millions)
Net income	54
Depreciation and amortization	18
Increase in noncash working capital	9
Capital expenditures (gross investment in long-term assets)	40
New long-term borrowing	25
Repayment of existing debt	10

Pellworth's free cash flow to equity (FCFE) for the year is *closest* to:

A $56 million.

B $48 million.

C $38 million.

Question 40

A long-established, capital-intensive electric utility with steady, predictable cash flows is *most likely* to finance its operations mainly by issuing:

A common stock.

B preferred stock.

C public bonds.

49 Equity Analyst Research Reports

Question 41

Which of the following statements about the front page of a report initiating coverage of a company is *most accurate*?

A It is written last, even though it is the first page investors read.

B It leaves out the recommendation so readers study the analysis first.

C It contains the full financial statement analysis behind the target.

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Question 42

Compared with a report initiating coverage, a subsequent company research report is *most likely* to emphasize:

A variance analysis comparing forecast and actual results.

B a full introduction to the company's revenue and expense drivers.

C a detailed overview of the industry and competitive positioning.

Question 43

Which of the following is more characteristic of sell-side analysts than of buy-side analysts? Sell-side analysts tend to:

A keep their final investment conclusions confidential.

B specialize in activist short-selling strategies.

C issue recommendations in line with the market consensus.

Question 44

Selin Arslan covers a company with revenue of $48 million and operating costs of $30 million, an operating profit margin of 37.5%. She forecasts revenue growth of 4% for next year and assumes the company will benefit from economies of scale. The operating profit margin Arslan forecasts for next year will *most likely*:

A stay at 37.5%, because operating costs are expected to grow in line with revenue.

B decline, because new capital investment will be charged immediately against operating profit.

C increase, because operating costs are expected to grow more slowly than revenue.

50 The Capital Asset Pricing Model, Market Model, and Other Factor-Based Equity Models

Question 45

Eighteen months ago, Galloway Industries sold its stable consumer division and financed a large acquisition mostly with new debt. An analyst estimating Galloway's beta with the market model decides to lengthen the lookback period from 2 years to 8 years. This change will *most likely*:

A make the beta a better estimate of Galloway's future systematic risk, because a larger sample lowers statistical noise.

B increase the amount of mean reversion built into the adjusted beta.

C produce a beta that reflects a risk profile Galloway no longer has.

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Question 46

A broad equity index currently offers a dividend yield of 2.2%, and its earnings and dividends are expected to grow at 5.5% a year over the long term. The risk-free rate is 3.1%. A forward-looking estimate of the market risk premium is *closest* to:

A 4.6%.

B 7.7%.

C 10.8%.

Question 47

An analyst estimates the following four-factor model betas for Tidewater Logistics:

Four-factor model betas for Tidewater Logistics

Factor	Beta
Market	0.90
Size (SMB)	−0.30
Value (HML)	0.42
Momentum (UMD)	−0.15

Based on these betas, Tidewater is *most appropriately* characterized as a:

A small-cap value stock.

B large-cap growth stock.

C large-cap value stock.

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EQUITIES

Answers and explanations

Answer key: 1. B · 2. B · 3. C · 4. C · 5. B · 6. C · 7. B · 8. C · 9. C · 10. C · 11. A · 12. A · 13. A · 14. B · 15. C · 16. B · 17. A · 18. B · 19. A · 20. A · 21. A · 22. C · 23. B · 24. C · 25. B · 26. B · 27. B · 28. A · 29. A · 30. B · 31. C · 32. A · 33. B · 34. C · 35. A · 36. C · 37. A · 38. A · 39. C · 40. C · 41. A · 42. A · 43. C · 44. C · 45. C · 46. A · 47. C

Question 1 **Answer: B**

An equity instrument gives its holder ownership of a portion of a corporation. Debt instruments such as loans and bonds, by contrast, create a creditor relationship between the investor and the company.

Why the other options are wrong

- **A.** Loans, bonds and other debt instruments create a creditor relationship.
- **C.** An equity instrument is by definition an ownership interest; it does not switch between ownership and creditor status.

Key takeaway Equity is ownership; debt is a creditor relationship.

Reading 39: Equity Instrument Features. Notes: credguild.com/cfa/level-1/notes/equities/common-stock-vs-preferred-stock/

Question 2 **Answer: B**

Preemptive rights let current holders buy newly issued shares before anyone else is offered them, so they can keep their proportional stake in the company. Without preemptive rights, a new share issue sold to other investors would dilute existing holders' percentage ownership; the right is one of the features disclosed in the equity prospectus.

Why the other options are wrong

- **A.** Conversion rights allow a holder to change the security into another type, such as from preferred shares into common shares.
- **C.** Split, subdivision, or combination rights set out how a holder's proportional ownership is treated if shares are split, subdivided or combined.

Key takeaway A first right to buy newly issued shares is a preemptive right.

Reading 39: Equity Instrument Features. Notes: credguild.com/cfa/level-1/notes/equities/common-stock-vs-preferred-stock/

Question 3 **Answer: C**

A call feature is the issuer's right to repurchase the shares at the call price, which caps the holder's gains and is likely to be used when the holder would prefer to keep the shares. A noncumulative dividend that is skipped is lost, whereas skipped cumulative dividends must be made up before common shareholders receive anything. The callable noncumulative series carries both disadvantages, so it is the riskiest for the holder.

Compare the features from the holder's side:

- Callable: the issuer holds the option, which adds risk for the holder. Putable: the holder can sell the shares back at the put contingency price, which reduces risk. Noncallable: neither side holds an option.

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- Cumulative: missed dividends accumulate and rank ahead of common dividends. Noncumulative: missed dividends are gone.

Only the callable noncumulative series has a feature against the holder on both counts.

Why the other options are wrong

- **A.** This is the least risky series. The put limits the holder's losses, and skipped dividends accumulate.
- **B.** Without a call, the issuer cannot take the shares away when their value rises, and skipped dividends still accumulate. This series is less risky than the callable noncumulative one.

Key takeaway From the holder's side, putable and cumulative features reduce risk; callable and noncumulative features add it.

Reading 39: Equity Instrument Features. Notes: credguild.com/cfa/level-1/notes/equities/common-stock-vs-preferred-stock/

Question 4 **Answer: C**

Growth equity is the capital a company raises while it is in the growth phase of its life cycle; the money is often used to expand the business. Raising it can also reduce the concentrated ownership left over from the venture capital stage.

Why the other options are wrong

- **A.** Buyout equity is aimed at mature-stage companies that investors think are underperforming. Start-up and early-stage financing is venture capital.
- **B.** Venture capital investments are illiquid: there is no active market for the shares, and investors usually have to keep their money committed for several years before they can exit.

Key takeaway Each private equity type matches a life-cycle stage: venture capital funds start-up and early-stage firms, growth equity funds growing firms, buyout equity targets mature firms, and special situations covers distressed or restructuring firms.

Reading 39: Equity Instrument Features. Notes: credguild.com/cfa/level-1/notes/equities/common-stock-vs-preferred-stock/

Question 5 **Answer: B**

Direct investing in foreign companies means buying the foreign firm's securities in its own (foreign) market. The pension fund does this when it buys on the Tokyo exchange.

Why the other options are wrong

- **A.** Indirect investing means holding an instrument that represents the company's shares, such as a depository receipt, instead of buying the shares on their home exchange.
- **C.** Dual listing is something a company arranges: its shares trade on one or more foreign exchanges in addition to its home exchange. The pension fund is simply buying the shares on the company's home exchange, which is direct investing.

Key takeaway Buying foreign shares on their home exchange is direct investing; buying DRs is indirect investing; dual listing is a company's decision to list its shares abroad.

Reading 40: Equity Jurisdictions, Classes, and the Voting Process. Notes: credguild.com/cfa/level-1/notes/equities/equity-jurisdictions-classes-and-the-voting-process/

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Question 6 **Answer: C**

In a dual-class share structure, some classes of common stock carry more votes than others. This can give a group such as the founders effective control while they own less than a majority of the shares.

Why the other options are wrong

- **A.** Cumulative preference shares concern dividends in arrears and typically carry no voting rights.
- **B.** Participating preference shares concern extra dividends and typically carry no voting rights.

Key takeaway Unequal votes across classes of common stock indicate a dual-class share structure, often used to keep founder control.

Reading 40: Equity Jurisdictions, Classes, and the Voting Process. Notes: credguild.com/cfa/level-1/notes/equities/equity-jurisdictions-classes-and-the-voting-process/

Question 7 **Answer: B**

Eligibility to vote is fixed on the record date: the custodian identifies the shareholder of record as of that date. A shareholder who sells after the record date but before the meeting remains eligible to vote the shares, so Solheim votes them.

Why the other options are wrong

- **A.** Mendes bought after the record date, so he is not the shareholder of record for this meeting and cannot vote these shares at it.
- **C.** A sale after the record date does not cancel the votes; the seller who held the shares on the record date keeps the right to vote them.

Key takeaway Voting eligibility follows the record date (often 30 or more days before the meeting). Ownership on the meeting day does not matter.

Reading 40: Equity Jurisdictions, Classes, and the Voting Process. Notes: credguild.com/cfa/level-1/notes/equities/equity-jurisdictions-classes-and-the-voting-process/

Question 8 **Answer: C**

The primary market is the market for new issues: the securities are sold for the first time and the issuer receives the proceeds. The utility's sale of newly issued shares to finance a plant is a primary market transaction.

Why the other options are wrong

- **A.** Institutions trading existing listed shares with each other is a secondary market trade; the issuer receives nothing.
- **B.** Buying bonds that already sit in a dealer's inventory is a secondary market purchase. Credit quality (investment grade or not) has nothing to do with whether a market is primary or secondary.

Key takeaway A primary market sale is the first sale of a new security, with proceeds going to the issuer.

Reading 41: Equity Issuance and Trading. Notes: credguild.com/cfa/level-1/notes/equities/equity-issuance-and-trading/

Question 9 **Answer: C**

A seasoned equity offering is dilutive only when the company sells newly created shares (a primary follow-on offering). When the shares sold are existing shares held by founders or other private investors (a secondary follow-on offering), no new shares are created and existing proportional ownership is unchanged, so the

statement that every seasoned offering dilutes current holders is false.

Why the other options are wrong

- **A.** This is accurate. In a back-door listing a private company buys a listed company and uses its listing; in a direct listing a private company has its existing shares admitted to trading. Both give a private company the benefits of listed status.
- **B.** This is accurate. SPAC shareholders vote to approve the acquisition target, but the vote need not be unanimous, so an investor who opposed the target can still become a shareholder of the acquired business after the de-SPAC transaction.

Key takeaway A primary follow-on sells new shares and is dilutive; a secondary follow-on sells existing shares and is nondilutive. The word "seasoned" alone does not say which.

Reading 41: Equity Issuance and Trading. Notes: credguild.com/cfa/level-1/notes/equities/equity-issuance-and-trading/

Question 10 **Answer: C**

A sell limit order trades against the bids in order from the highest price downward, but never at a price below its limit. The bids at 27.45 and 27.40 are within the 27.35 limit; the bid at 27.30 is not. The order therefore sells 1,500 shares at once, and the average price is the volume-weighted average of those two fills.

Bids at or above 27.35: 900 shares at 27.45 and 600 shares at 27.40, a total of 1,500 shares.

$$\text{average price} = \frac{900 \times 27.45 + 600 \times 27.40}{1{,}500} = \frac{24{,}705 + 16{,}440}{1{,}500} = \frac{41{,}145}{1{,}500} = 27.43$$

The other 500 shares stay in the book as an offer at 27.35, which becomes the new lowest offer.

Calculator: `[(] 900 [×] 27.45 [)] [+] [(] 600 [×] 27.40 [)] [=] [÷] 1500 [=]` 27.43

Why the other options are wrong

- **A.** 27.35 is the limit price, the least the order may accept. The fills take place at the bid prices in the book, which are higher.
- **B.** 27.40 sells the last 500 shares at 27.30: $(41{,}145 + 500 \times 27.30)/2{,}000 = 27.3975$. That bid is below the 27.35 limit, so those shares cannot be sold.

Key takeaway A marketable sell limit order works down through the bids from the highest price and stops at its limit; weight the fill prices by the shares actually sold.

Reading 41: Equity Issuance and Trading. Notes: credguild.com/cfa/level-1/notes/equities/equity-issuance-and-trading/

Question 11 **Answer: A**

Broad-based equity indexes include the largest listed firms and are calculated on a market-capitalization-weighted basis, adjusted for market float. Larger companies therefore carry larger weights.

Why the other options are wrong

- **B.** Price weighting is not the typical method for broad-based equity indexes.
- **C.** Equal weighting is an alternative weighting method used to reduce the dominance of the largest companies in a broad-based equity index; it is not the standard approach.

Key takeaway Broad-based equity indexes are float-adjusted and cap-weighted; equal-weighted and factor-weighted versions are the alternatives.

Reading 41: Equity Issuance and Trading. Notes: credguild.com/cfa/level-1/notes/equities/equity-issuance-and-trading/

Question 12 Answer: A

A special (extraordinary) cash dividend is a one-time payment made when favorable circumstances allow, in addition to any regular dividend. Many cyclical companies use special dividends to share profits in good years while keeping the flexibility to conserve cash when profits fall.

Why the other options are wrong

- **B.** Raising the regular dividend creates an expectation that the higher payment will continue; cutting it later would send an adverse signal, and the board wants to avoid both.
- **C.** A stock dividend distributes new shares rather than cash and does not share any profits: total equity and shareholder wealth are unchanged.

Key takeaway A cyclical firm that wants to share a good year without a lasting commitment pays a special dividend.

Reading 42: Sources of Equity Returns. Notes: credguild.com/cfa/level-1/notes/equities/sources-of-equity-returns/

Question 13 Answer: A

Other things equal, the price should fall by the dividend on the ex-dividend date. Any decline beyond the dividend is attributed to the market, given that the stock has market-level risk and no company-specific news is mentioned.

Total decline $= 48.00 - 45.60 = \$2.40$.

Due to the dividend: $\$0.90$. Due to the market: $2.40 - 0.90 = \$1.50$.

$$\text{market share of decline} = \frac{1.50}{2.40} = 62.5\%$$

Why the other options are wrong

- **B.** 37.5% $(0.90/2.40)$ is the part of the decline caused by the dividend. The question asks for the market's part.
- **C.** 3.3% $(1.50/45.60)$ expresses the market-driven dollar decline as a percentage of the share price. The question asks what fraction of the *decline* is due to the market.

Key takeaway Split the ex-date price drop into dividend and market pieces in dollars first, then express each as a share of the total drop.

Reading 42: Sources of Equity Returns. Notes: credguild.com/cfa/level-1/notes/equities/sources-of-equity-returns/

Question 14 Answer: B

The value of an equity security today is the present value of the cash flows the investor expects to receive, discounted at the required rate of return. Over one period, those cash flows are the expected dividend and the expected ending price, both received at the end of the year.

$$P_0 = \frac{E(P_1) + E(D_1)}{1 + r_E} = \frac{66.00 + 2.20}{1.11} = \frac{68.20}{1.11} = \$61.44$$

Why the other options are wrong

- **A.** \$59.46 $(66.00/1.11)$ discounts only the expected price and leaves out the expected dividend.
- **C.** \$61.66 $(66.00/1.11 + 2.20)$ discounts the expected price but adds the dividend undiscounted, even though it is also received a year from now.

Key takeaway $P_0 = [E(P_1) + E(D_1)]/(1 + r_E)$: discount every future cash flow, including the dividend.

Reading 42: Sources of Equity Returns. Notes: credguild.com/cfa/level-1/notes/equities/sources-of-equity-returns/

Question 15 **Answer: C**

The market price follows from the multiple and the earnings figure it is based on, here next year's forecast EPS. A stock whose market price is above the investor's estimate of intrinsic value is overvalued from that investor's point of view. The analyst's \$40.00 is below the \$44.80 price.

$$P_0 = 14.0 \times 3.20 = \$44.80$$

$$\text{intrinsic value} - \text{price} = 40.00 - 44.80 = -\$4.80$$

The shares are overvalued by \$4.80.

Why the other options are wrong

- **A.** The size of the gap is right, but the direction is reversed. Undervalued would require intrinsic value above the market price.
- **B.** \$0.60 applies the multiple to the EPS of the year just ended, $14.0 \times 2.90 = 40.60$. The multiple is stated on next year's forecast, so the price is 14.0×3.20.

Key takeaway Intrinsic value above price means undervalued; below price means overvalued. Pair each multiple with the earnings figure it is based on.

Reading 43: Introduction to Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/introduction-to-equity-valuation/

Question 16 **Answer: B**

Enterprise value is the market value of common and preferred stock plus the market value of debt, minus cash and short-term investments (an acquirer assumes the debt but also receives the cash). Dividing EV by EBITDA gives the multiple used for relative valuation.

Market value of common stock $= \$28.50 \times 12.0 = \$342$ million.

$$\text{EV} = 342 + 18 + 95 - 31 = \$424 \text{ million}$$

$$\text{EV/EBITDA} = \frac{424}{52} = 8.15 \approx 8.2\times$$

Why the other options are wrong

- **A.** 7.8× $(342 + 95 - 31)/52$ leaves out the \$18 million of preferred stock, which is part of the firm's equity capital.
- **C.** 8.8× $(342 + 18 + 95)/52$ forgets to subtract cash and short-term investments.

Key takeaway EV = common + preferred + debt − cash; then divide by EBITDA.

Reading 43: Introduction to Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/introduction-to-equity-valuation/

Question 17 Answer: A

An enterprise value multiple expresses enterprise value relative to EBITDA, EBIT or revenue, and the analyst compares it across a peer group. That makes it a relative valuation (multiplier) model.

Why the other options are wrong

- **B.** An asset-based model values equity as the fair value of assets minus liabilities and preferred stock; it does not use a ratio compared with peers.
- **C.** A discounted cash flow model estimates value as the present value of forecast cash flows. It does not use a multiple of a current fundamental.

Key takeaway EV/EBITDA, P/E and P/B are all multiplier (relative valuation) models.

Reading 43: Introduction to Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/introduction-to-equity-valuation/

Question 18 Answer: B

Dividends are what every shareholder receives and reflect the position of an investor who cannot influence dividend policy, which is a **minority shareholder** perspective. An FCFE valuation reflects a **controlling shareholder**, who can decide how much of the free cash flow is paid out.

Why the other options are wrong

- **A.** This reverses the two models: the DDM uses the cash actually received (dividends), while FCFE represents the firm's theoretical capacity to pay dividends.
- **C.** Neither model assumes a volatile capital structure or heavy borrowing; each is built on the premise that the firm's financing mix stays steady. When the mix is volatile, FCFF is the preferred measure.

Key takeaway A DDM takes the minority view of cash actually paid; FCFE takes the controlling view of cash that could be paid. Both assume a stable capital structure.

Reading 44: Discounted Cash Flow (DCF) and Growth Models. Notes: credguild.com/cfa/level-1/notes/equities/discounted-cash-flow-dcf-and-growth-models/

Question 19 Answer: A

A residual income model is built on book values, so it requires **clean surplus accounting**: the book value of equity may change only through the income statement (retained earnings) and through transactions with shareholders (dividends, share issuance and buybacks). Any item that bypasses the income statement, such as a foreign currency translation gain or loss, breaks this link and must be adjusted for by the analyst before the model is applied.

Why the other options are wrong

- **B.** A constant debt-to-assets ratio is an assumption used to forecast net borrowing when estimating FCFE ($FCFE = \text{net income} - (1 - DR)(\text{net investment})$); it is not a requirement of the residual income model.
- **C.** Adding back the tax savings on depreciation is part of converting EBITDA into FCFF. It has nothing to do with whether book values are usable in a residual income model.

Key takeaway The residual income model requires clean surplus accounting. A constant debt ratio belongs to FCFE forecasting, and the depreciation tax shield to the EBITDA-to-FCFF bridge.

Reading 44: Discounted Cash Flow (DCF) and Growth Models. Notes: credguild.com/cfa/level-1/notes/equities/discounted-cash-flow-dcf-and-growth-models/

Question 20 **Answer: A**

Compare the market price with the value implied by the analyst's forecasts. The one-period value is the present value of the year-end dividend plus the projected price.

$$V_0 = \frac{D_1 + P_1}{1 + r} = \frac{1.80 + 63.00}{1.09} = \frac{64.80}{1.09} = \$59.45$$

The market price of $60.00 is above the estimated value of $59.45, so the shares are overvalued.

Why the other options are wrong

- **B.** Fairly priced would require the market price to equal the $59.45 value; it is $0.55 higher.
- **C.** Undervalued would require the price to be below the estimated value. Comparing $60.00 with the undiscounted $64.80 might suggest this, but the cash flows arrive in one year and must be discounted.

Key takeaway A price above estimated value means the shares are overvalued; a price below it means they are undervalued.

Reading 44: Discounted Cash Flow (DCF) and Growth Models. Notes: credguild.com/cfa/level-1/notes/equities/discounted-cash-flow-dcf-and-growth-models/

Question 21 **Answer: A**

FCFF is discounted at the WACC to give firm value. The terminal value at the end of Year 3 uses the Year 4 cash flow, $FCFF_3(1 + g)$.

$$TV_3 = \frac{FCFF_3(1 + g)}{WACC - g} = \frac{80(1.04)}{0.085 - 0.04} = \frac{83.2}{0.045} = 1{,}848.89$$

$$V_0 = \frac{50}{1.085} + \frac{62}{1.085^2} + \frac{80 + 1{,}848.89}{1.085^3} = 46.08 + 52.67 + 1{,}510.14 = \$1{,}609 \text{ million}$$

Calculator: CF0 = 0; C01 = 50; C02 = 62; C03 = 1,928.89; [NPV] I = 8.5, [↓] [CPT] = 1,608.9.

Why the other options are wrong

- **B.** $1,553 million builds the terminal value from the Year 3 cash flow ($80/0.045 = 1{,}777.78$) instead of the Year 4 cash flow.
- **C.** $1,495 million discounts the Year 3 terminal value four periods instead of three.

Key takeaway Terminal value at time n uses the cash flow of period n + 1 and is discounted n periods.

Reading 44: Discounted Cash Flow (DCF) and Growth Models. Notes: credguild.com/cfa/level-1/notes/equities/discounted-cash-flow-dcf-and-growth-models/

Question 22 **Answer: C**

An embedded option is a right, not an obligation, so it has a non-negative value to the party that holds it. When the issuer holds the right, its value is subtracted from the option-free value of the preferred stock. A call feature lets the issuer redeem the shares at a predetermined price, so a callable preferred is worth less than a comparable non-callable preferred.

Why the other options are wrong

- **A.** When the investor holds the right, the option's value is added to the option-free value. A conversion feature lets the investor exchange the preferred for common shares at a set ratio, so a convertible preferred is worth more, not less.
- **B.** The effect depends on who holds the right. An option held by the issuer lowers the preferred's value; one held by the investor, such as a put or a conversion right, raises it.

Key takeaway Embedded option held by the issuer (call): subtract its value. Held by the investor (put, conversion): add its value.

Reading 44: Discounted Cash Flow (DCF) and Growth Models. Notes: credguild.com/cfa/level-1/notes/equities/discounted-cash-flow-dcf-and-growth-models/

Question 23 **Answer: B**

The method of comparables values a stock at the benchmark multiple of its peer group, applied to the stock's own value driver. One peer's multiple is inflated by temporarily depressed earnings, so the median, which a single extreme value does not pull, is the appropriate benchmark. A leading P/E has next year's forecast EPS in its denominator, so the benchmark is applied to Penhallow's forecast EPS of $2.95. Its trailing EPS would pair with a trailing multiple.

Sort the peers' leading P/Es: 13.5, 14.5, 16.0, 20.0, 48.0. With five values, the median is the third one:

$$\text{median leading } P/E = 16.0$$

Apply the benchmark to next year's EPS:

$$V_0 = \text{benchmark } \frac{P_0}{E_1} \times E_1 = 16.0 \times \$2.95 = \$47.20$$

Dropping the 48.0 outlier and averaging the other four peers gives the same benchmark: $(13.5 + 14.5 + 16.0 + 20.0)/4 = 64.0/4 = 16.0$. The mean of all five, $(13.5 + 14.5 + 16.0 + 20.0 + 48.0)/5 = 112.0/5 = 22.4$, is higher than four of the five peers because of the single 48.0 value.

Why the other options are wrong

- **A.** $16.0 \times \$2.60 = \$41.60$ applies a leading multiple to trailing EPS. The peer multiple and the subject's earnings must cover the same period, so a leading P/E is paired with forecast EPS.
- **C.** $22.4 \times \$2.95 = \$66.08$ uses the mean leading P/E of all five peers. The 48.0 multiple reflects one peer's temporarily depressed earnings and drags the mean well above the typical peer, so the median is the better benchmark.

Key takeaway Comparables-based value = benchmark multiple × the subject company's own value driver. Match the timing (a leading multiple with forecast EPS, a trailing multiple with trailing EPS), and use the

median when a few extreme multiples skew the peer group.

Reading 45: Relative Value Equity Valuation Approaches. Notes: credguild.com/cfa/level-1/notes/equities/relative-value-equity-valuation-approaches/

Question 24 **Answer: C**

Normalized earnings estimate mid-cycle EPS for a cyclical company. Under the average ROE method, normalized EPS equals the average ROE over the most recent cycle multiplied by the current book value per share.

$$\text{Normalized EPS} = \overline{ROE} \times BVPS_{\text{current}} = 0.16 \times 31.50 = \$5.04$$

Why the other options are wrong

- **A.** $4.35 is normalized EPS under the method of historical average EPS. That method does not reflect changes in firm size as well as the average ROE method does.
- **B.** $4.80 is simply next year's expected EPS, which is not adjusted for where the firm is in the business cycle.

Key takeaway Average ROE method uses current BVPS, so it captures growth in the firm's size; historical average EPS does not.

Reading 45: Relative Value Equity Valuation Approaches. Notes: credguild.com/cfa/level-1/notes/equities/relative-value-equity-valuation-approaches/

Question 25 **Answer: B**

Multi-industry companies are a recognized problem for industry-based peer groups. A conglomerate's mix of businesses gives it a blended risk and growth profile, and a single set of industry peers is unlikely to match that profile.

Why the other options are wrong

- **A.** Industry-based peer groups make no automatic assumption that all members have identical leverage. Analysts are told to check leverage differences among industry peers.
- **C.** The law of one price is the rationale for comparables. It does not require factor models for firms with international operations.

Key takeaway Industry-peer problems: unique firms, mixed life cycle stages, different tax/regulatory jurisdictions, and multi-industry companies.

Reading 45: Relative Value Equity Valuation Approaches. Notes: credguild.com/cfa/level-1/notes/equities/relative-value-equity-valuation-approaches/

Question 26 **Answer: B**

A forecast multiple can be applied to a forecast metric to estimate a terminal value. A justified leading P/E at the end of Year 7 must be multiplied by earnings expected for the following year (Year 8).

$$\text{Justified leading P/E} = \frac{0.40}{0.10 - 0.05} = 8.0$$

$E_8 = 6.00 \times 1.05 = 6.30$

$$TV_7 = 8.0 \times 6.30 = \$50.40$$

Check: trailing P/E $= 8.0 \times 1.05 = 8.4$; $8.4 \times 6.00 = \$50.40$.

Why the other options are wrong

- **A.** \$48.00 applies the leading P/E of 8.0 to Year 7 earnings (8.0×6.00) instead of Year 8 earnings.
- **C.** \$75.60 uses the retention ratio (0.60) in place of the payout ratio, giving a P/E of 12.0.

Key takeaway Leading P/E × next-year earnings (or, equivalently, trailing P/E × current earnings) gives the terminal value.

Reading 45: Relative Value Equity Valuation Approaches. Notes: credguild.com/cfa/level-1/notes/equities/relative-value-equity-valuation-approaches/

Question 27 **Answer: B**

A disaggregated model forecasts revenues, expenses, assets and financing separately, each with its own assumptions. That flexibility lets the analyst reflect industry projections, competition and company-specific information, which improves the cash flow forecast.

Why the other options are wrong

- **A.** A forecast model still covers only a finite horizon, so a terminal value is still needed to capture value beyond it.
- **C.** The model refines the cash flow estimates. The required return is estimated separately.

Key takeaway Disaggregated models improve the numerator (cash flows). They leave the denominator (discount rate) to be estimated separately, and they still need a terminal value.

Reading 46: Financial Statement Forecasting in Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/financial-statement-forecasting-in-equity-valuation/

Question 28 **Answer: A**

Itemizing forecasts economically significant expense lines individually, so new information, such as the terms of a new supply contract, can be built directly into the affected line. Wilk can raise the energy cost line to reflect the contracted price while forecasting other costs separately.

Why the other options are wrong

- **B.** A historical approach (for example, a regression of each expense on revenue) assumes the past relationship between expenses and revenue will continue. The new contract breaks that relationship for energy costs, so history would misstate them.
- **C.** A direct profit margin approach assumes a margin without breaking costs into components, which makes it hard to capture the effect of one specific contract on one cost line.

Key takeaway New, specific information about a cost, such as a labor agreement, supplier terms or a lease, calls for itemizing.

Reading 46: Financial Statement Forecasting in Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/financial-statement-forecasting-in-equity-valuation/

Question 29 **Answer: A**

The ROI multiple compounds the annual required return over the investment horizon: ROI multiple $= (1 + r)^n$. Solve for r.

$$5 = (1 + r)^6 \;\Rightarrow\; r = 5^{1/6} - 1 = 1.3077 - 1 = 30.8\%$$

Calculator: 5 [y^x] 6 [1/x] [=] gives 1.3077.

Why the other options are wrong

- **B.** 34.8% treats a 5x multiple as a 500% profit, i.e., a multiple of 6x: $6^{1/6} - 1$. A 5x multiple is a 400% profit.
- **C.** 66.7% divides the 400% total profit by six years ($(5 - 1)/6$), ignoring compounding.

Key takeaway $r = (\text{ROI multiple})^{1/n} - 1$. A multiple of M means a total profit of $M - 1$.

Reading 46: Financial Statement Forecasting in Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/financial-statement-forecasting-in-equity-valuation/

Question 30 **Answer: B**

For a firm whose going-concern assumption is in doubt, equity value is the probability-weighted average of the going-concern equity value and the distress value to shareholders (here $10 million, already net of creditor claims).

$$\text{value} = 0.85 \times 46 + 0.15 \times 10 = 39.1 + 1.5 = \$40.6 \text{ million}$$

Why the other options are wrong

- **A.** $46.0 million is the going-concern value alone; it ignores the 15% probability of distress.
- **C.** $15.4 million swaps the probabilities, weighting the going-concern value by 15% and the distress value by 85%: $0.15 \times 46 + 0.85 \times 10$.

Key takeaway value = P(going concern) × going-concern value + P(distress) × distress sale value; the two probabilities sum to 1.

Reading 46: Financial Statement Forecasting in Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/financial-statement-forecasting-in-equity-valuation/

Question 31 **Answer: C**

When most operating expenses grow faster than revenue, operating expenses take a larger share of each dollar of sales, so the operating profit margin is expected to fall. No calculation is needed.

Why the other options are wrong

- **A.** Gross profit margin depends only on revenue and COGS, and the other operating costs listed do not affect it. The stem does not say how fast COGS will grow, so a steady gross margin cannot be concluded.
- **B.** Net profit margin also depends on non-operating items such as interest income and expense, which are not given. A falling operating margin, if anything, pushes it down.

Key takeaway Compare growth rates. Revenue growing more slowly than operating costs means a lower operating margin; revenue growing faster means a higher one.

Reading 46: Financial Statement Forecasting in Equity Valuation. Notes: credguild.com/cfa/level-1/notes/equities/financial-statement-forecasting-in-equity-valuation/

Question 32 **Answer: A**

The PESTLE framework groups the political, economic, social, technological, legal and environmental factors that act on an industry from outside. Using it is the fourth step of industry and competitive analysis: examining external influences.

Why the other options are wrong

- **B.** Analyzing the industry structure (step 3) uses a framework such as Porter's five forces to judge competitive rivalry and profitability drivers. PESTLE belongs to a later step.
- **C.** Defining the industry (step 1) sets its scope: which products, regions and companies belong in it.

Key takeaway Porter's five forces serve step 3 (industry structure); PESTLE serves step 4 (external influences).

Reading 47: Industry and Competitive Analysis. Notes: credguild.com/cfa/level-1/notes/equities/industry-and-competitive-analysis/

Question 33 **Answer: B**

Using government or third-party data is the top-down approach. Its key limitation is that such data may lack the granularity or specific detail needed for niche analysis. Aggregate packaged-food revenue will not isolate a narrow segment such as gluten-free infant cereal.

Why the other options are wrong

- **A.** Industries with many private firms are where the top-down approach works best; being a poor fit for them is a limitation of the bottom-up approach, because private firms do not publish revenues.
- **C.** Difficulty isolating the revenue of multi-product companies is a limitation of the bottom-up approach, which adds up company revenues.

Key takeaway Top-down: good for industries of private/small firms, weak on granularity. Bottom-up: precise when large listed firms dominate, weak with multi-product or private firms.

Reading 47: Industry and Competitive Analysis. Notes: credguild.com/cfa/level-1/notes/equities/industry-and-competitive-analysis/

Question 34 **Answer: C**

The HHI is the sum of the squared market shares (in percent) of all participants. Here it is 3,250, well above the 1,800 level that is often interpreted as indicating high concentration.

$$HHI = \sum(\text{market share}_i)^2 = 50^2 + 20^2 + 15^2 + 10^2 + 5^2$$

$$= 2{,}500 + 400 + 225 + 100 + 25 = 3{,}250$$

Since $3{,}250 > 1{,}800$, the industry is highly concentrated.

Why the other options are wrong

- **A.** Low concentration would require many firms with small shares. Squaring the shares as decimals gives 0.325, which looks tiny but is simply the HHI divided by 10,000. It does not indicate low concentration.
- **B.** An HHI above 1,800 is often interpreted as high concentration, and at 3,250 the index is far above that level. Even the three largest firms alone give $50^2 + 20^2 + 15^2 = 3{,}125$, so the industry cannot be described as only moderately concentrated.

Key takeaway Square each share in percent and add. The maximum HHI is 10,000 (monopoly); an HHI above 1,800 is often interpreted as high concentration.

Reading 47: Industry and Competitive Analysis. Notes: credguild.com/cfa/level-1/notes/equities/industry-and-competitive-analysis/

Question 35 **Answer: A**

Disruptive innovation addresses an indistinct problem within a distinct domain and creates a new market or redefines an existing one. The domain here is medical testing, the exact problem is not yet distinct, and the model could reshape that market.

Why the other options are wrong

- **B.** Breakthrough innovation addresses a distinct problem across an indistinct domain and can affect many industries. This scenario stays within the distinct domain of medical testing.
- **C.** Sustaining innovation addresses a distinct problem within a distinct domain and improves existing products without redefining the market. Here the problem is indistinct and the market could be redefined.

Key takeaway Disruptive innovation = indistinct problem, distinct domain, and creation or redefinition of a market.

Reading 47: Industry and Competitive Analysis. Notes: credguild.com/cfa/level-1/notes/equities/industry-and-competitive-analysis/

Question 36 **Answer: C**

The last step of industry and competitive analysis is to evaluate the individual company's competitive strategy: its competitive advantage, position within its industry, and resources and capabilities. Company analysis therefore adds the firm's own strategy (e.g., cost leadership or differentiation), along with its products and financial condition, to the industry picture.

Why the other options are wrong

- **A.** The threat of substitutes is one of Porter's five forces and is assessed during industry analysis, which the analyst has already completed.
- **B.** The bargaining power of suppliers is also an industry-level competitive force, already covered by the industry analysis.

Key takeaway The five forces belong to industry analysis; competitive strategy belongs to company analysis.

Reading 48: Company Analysis: Past, Present, and Future. Notes: credguild.com/cfa/level-1/notes/equities/company-analysis-past-present-and-future/

Question 37 **Answer: A**

The serviceable market is the part of the total addressable market (TAM) that the company can actually reach, given its technical fit and geographic footprint. Both constraints must be applied to the TAM. Production capacity limits the obtainable market and plays no part here.

$$\text{Serviceable market} = \text{TAM} \times \text{technical fit} \times \text{geographic reach}$$

$$= \$2{,}400 \text{ million} \times 0.70 \times 0.55 = \$1{,}680 \text{ million} \times 0.55 = \$924 \text{ million}$$

The $300 million capacity cap defines the obtainable market, the share of the serviceable market Fennwick can realistically capture now.

Why the other options are wrong

- **B.** $1,320 million applies only the 55% licensing constraint ($2{,}400 \times 0.55$) and ignores that the pumps work in only 70% of the market.
- **C.** $1,680 million applies only the 70% technical fit ($2{,}400 \times 0.70$) and ignores the geographic (licensing) limit.

Key takeaway Start from the TAM, apply every reach constraint to get the serviceable market, then apply current scale to get the obtainable market. Capacity limits belong to the obtainable market.

Reading 48: Company Analysis: Past, Present, and Future. Notes: credguild.com/cfa/level-1/notes/equities/company-analysis-past-present-and-future/

Question 38 **Answer: A**

Net income is often volatile because it is affected by nonrecurring items, changes in capital structure and changing expenditures or tax rates. That makes it hard to compare across companies and to assess one company's profitability over time.

Why the other options are wrong

- **B.** Net income is less useful for start-ups and highly cyclical industries, which are often loss-making or swing widely; it is most useful in the growth, mature and decline stages.
- **C.** Net income is a standard GAAP/IFRS measure. EBITDA is the metric not recognized by these accounting standards.

Key takeaway Net income: most comprehensive but volatile and distorted by capital structure; EBITDA: not a GAAP/IFRS metric.

Reading 48: Company Analysis: Past, Present, and Future. Notes: credguild.com/cfa/level-1/notes/equities/company-analysis-past-present-and-future/

Question 39 **Answer: C**

FCFE is the cash left for shareholders after operating expenses, investment in noncash working capital and in long-term assets, and net borrowing. Because the $40 million is gross capital expenditure (before depreciation), depreciation and amortization is added back to net income as a noncash charge. Increases in noncash working capital and capital expenditures are uses of cash, and only net debt issued (new borrowing minus repayments) is a source.

$$\text{FCFE} = \text{NI} + \text{D\&A} - \text{capital expenditures} - \Delta\text{WC} + \text{net borrowing}$$

Net debt issued $= 25 - 10 = 15$.

$$\text{FCFE} = 54 + 18 - 40 - 9 + 15 = \$38 \text{ million}$$

Why the other options are wrong

- **A.** $56 million adds the $9 million increase in working capital instead of subtracting it ($54 + 18 + 9 - 40 + 15$).
- **B.** $48 million uses gross new borrowing of $25 million and ignores the $10 million repayment ($54 + 18 - 9 - 40 + 25$).

Key takeaway In FCFE, add back D&A only against gross capital expenditures; an increase in noncash working capital is a use of cash, and net borrowing means new borrowing minus repayments.

Reading 48: Company Analysis: Past, Present, and Future. Notes: credguild.com/cfa/level-1/notes/equities/company-analysis-past-present-and-future/

Question 40 **Answer: C**

Mature companies with stable, predictable cash flows rely more heavily on debt, such as issues of public or private bonds. Industries that need heavy long-term capital investment, such as utilities, rely in particular on long-term debt financing, so public bonds are the most likely main source.

Why the other options are wrong

- **A.** Common stock (equity capital) is the main source of financing for early-stage and growth firms with negative cash flow. A mature utility relies more on debt.
- **B.** Preferred stock is an equity security: although it pays fixed dividends, those dividends are not a contractual obligation and the shares usually do not mature. Stable cash flows and capital intensity point to greater use of debt rather than preferred equity.

Key takeaway Stable cash flow and capital intensity point to long-term debt.

Reading 48: Company Analysis: Past, Present, and Future. Notes: credguild.com/cfa/level-1/notes/equities/company-analysis-past-present-and-future/

Question 41 **Answer: A**

Although it appears first, the front page is written last because it summarizes the whole report: the buy/hold/sell recommendation and price target, the investment thesis, the company's name, ticker, sector, market capitalization and float, recent developments, and summary financial data. Each of these is covered in more detail later in the report.

Why the other options are wrong

- **B.** The recommendation and price target are the main items the front page shows.
- **C.** The front page carries only a summary of recent and forecast financial data; the detailed analysis is in the financial analysis and valuation section.

Key takeaway The front page summarizes the recommendation, target, thesis and key data. It is the first page read and the last written.

Reading 49: Equity Analyst Research Reports. Notes: credguild.com/cfa/level-1/notes/equities/equity-analyst-research-reports/

Question 42 Answer: A

An update is shorter than the initial report and concentrates on what has changed: newly released financial statements, a comparison of forecast with actual results (variance analysis), and any revisions to the valuation, risks and recommendation.

Why the other options are wrong

- **B.** Revenue and expense drivers are covered in the business-model section of the initial report, which introduces the company.
- **C.** The industry overview and competitive positioning are also part of the initial report.

Key takeaway Updates cover what is new: variance analysis, valuation changes, risk changes and the recommendation rationale.

Reading 49: Equity Analyst Research Reports. Notes: credguild.com/cfa/level-1/notes/equities/equity-analyst-research-reports/

Question 43 Answer: C

Presenting a view contrary to the market consensus requires a high degree of certainty, so sell-side recommendations are typically in line with the consensus (which is easy to observe on data platforms).

Why the other options are wrong

- **A.** Keeping conclusions confidential is characteristic of buy-side research, which is used internally.
- **B.** Activist short selling is a branch of buy-side research.

Key takeaway Sell side: published, standardized, usually consensus-aligned, mostly buy/hold. Buy side: confidential, customized.

Reading 49: Equity Analyst Research Reports. Notes: credguild.com/cfa/level-1/notes/equities/equity-analyst-research-reports/

Question 44 Answer: C

Economies of scale mean that operating costs rise more slowly than the 4% revenue growth, so operating profit grows faster than revenue and the margin widens above 37.5%.

Next year's revenue $= 48 \times 1.04 = \$49.92$ million. If costs grew 4% as well, costs $= \$31.2$ million and the margin stays $(49.92 - 31.2)/49.92 = 37.5\%$. With economies of scale, costs grow by less than 4% (say 2%: $30 \times 1.02 = \$30.6$ million), so the margin rises to $(49.92 - 30.6)/49.92 = 38.7\%$.

Why the other options are wrong

- **A.** A constant margin requires costs to grow at the same 4% rate as revenue, which contradicts the assumption of economies of scale.
- **B.** Capital investment is capitalized rather than expensed immediately, so it does not directly reduce operating profit; economies of scale point to a rising margin.

Key takeaway With the same revenue forecast, different cost growth gives different margins. Costs growing more slowly than revenue raise the margin; costs growing faster lower it.

Reading 49: Equity Analyst Research Reports. Notes: credguild.com/cfa/level-1/notes/equities/equity-analyst-research-reports/

Question 45 Answer: C

A longer lookback period gives a larger sample and a lower standard error of beta. However, most of the extra data now come from before Galloway's restructuring, when its business mix and leverage were different. The estimate will therefore describe past conditions rather than the company's future systematic risk.

Why the other options are wrong

- **A.** The standard error does fall with more observations, but a beta built largely on data from an obsolete business model and capital structure is a poorer guide to future risk.
- **B.** The mean-reversion adjustment is applied separately to the raw beta. With the usual fixed two-thirds weight on the raw beta, it does not change with the length of the lookback period.

Key takeaway A longer lookback period means less statistical noise but more stale data. After a major change in the business or capital structure, the stale data dominate, and a peer (pure-play) beta is usually the better choice.

Reading 50: The Capital Asset Pricing Model, Market Model, and Other Factor-Based Equity Models. Notes: credguild.com/cfa/level-1/notes/equities/the-capital-asset-pricing-model-market-model-and-other-factor-based-equity-models/

Question 46 Answer: A

A forward-looking estimate is implied by current prices. Rearranging the constant growth model, the expected market return equals the dividend yield plus the long-term growth rate. Subtracting the risk-free rate gives the implied market risk premium.

$$E(R_m) = \frac{D_1}{P_0} + g = 2.2\% + 5.5\% = 7.7\%$$

$$MRP = 7.7\% - 3.1\% = 4.6\%$$

Why the other options are wrong

- **B.** 7.7% is the expected return on the market index ($2.2\% + 5.5\%$). The risk-free rate has not been subtracted.
- **C.** 10.8% adds the risk-free rate to the dividend yield and growth instead of subtracting it: $7.7\% + 3.1\%$.

Key takeaway Forward $MRP = D_1/P_0 + g - R_f$.

Reading 50: The Capital Asset Pricing Model, Market Model, and Other Factor-Based Equity Models. Notes: credguild.com/cfa/level-1/notes/equities/the-capital-asset-pricing-model-market-model-and-other-factor-based-equity-models/

Question 47 Answer: C

In the four-factor model the size factor (SMB) is the return on a zero-cost portfolio that buys small-cap stocks and shorts large-cap stocks. Tidewater's negative size beta (−0.30) means it tends to earn a negative incremental return in periods when small caps outperform large caps, which marks it as a large-cap stock. The value factor is long high book-to-market (value) stocks and short low book-to-market (growth) stocks;

Tidewater's positive value beta (0.42) means it moves with value stocks. Together the two signs describe a large-cap value stock. The market beta (0.90) and momentum beta (−0.15) do not bear on the size or style classification.

Why the other options are wrong

- **A.** A small-cap stock would show a positive beta to the size factor, because it would move with the small-cap long side of that portfolio. Tidewater's size beta is negative (−0.30), so it behaves like a large-cap stock, even though its positive value beta does point to value.
- **B.** A growth stock would show a negative beta to the value factor, because it would move with the short (low book-to-market) side of that portfolio. Tidewater's value beta is positive (0.42), so the growth label is wrong, even though the large-cap part is right.

Key takeaway Size beta sign: + small, − large. Value beta sign: + value, − growth.

Reading 50: The Capital Asset Pricing Model, Market Model, and Other Factor-Based Equity Models. Notes: credguild.com/cfa/level-1/notes/equities/the-capital-asset-pricing-model-market-model-and-other-factor-based-equity-models/

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