# Learning Module 7: Company Analysis: Forecasting

Q.4291 An analyst is preparing a financial forecast for a company. The analyst has access to a wealth of information and is planning to build a highly detailed model with a long-term perspective. This scenario is *most likely* to occur in which of the following situations?

A. The analyst is an investor with a controlling position in a private company.

B. The analyst is preparing a forecast for a public issuer with a straightforward business model.

C. The analyst is publishing company research for external distribution and is focusing on quarterly forecasts of revenue and earnings per share.

The correct answer is **A.**

An analyst preparing a financial forecast for a company with a wealth of information and planning to build a highly detailed model with a long-term perspective is most likely to occur when the analyst is an investor with a controlling position in a private company. In this situation, the analyst has access to detailed internal information and has a vested interest in the long-term performance of the company.

The analyst can use this information to build a comprehensive financial model that takes into account the company's specific business operations, financial condition, and strategic plans. This level of detail and long-term perspective is particularly important for an investor with a controlling position, as their investment decisions can have a significant impact on the company's future.

**A is incorrect**. While an analyst publishing company research for external distribution may have access to a wealth of information, they are typically focused on short-term forecasts of revenue and earnings per share. These forecasts are often based on publicly available information and are intended to provide guidance to investors and other external stakeholders. They do not typically involve the level of detail and long-term perspective described in the question.

**C is incorrect.** An analyst preparing a forecast for a public issuer with a straightforward business model may not need to build a highly detailed model with a long-term perspective. While they may have access to a wealth of information, the straightforward nature of the business model may not require the level of detail described in the question. Furthermore, public issuers are subject to regulatory requirements that limit the amount of non-public information that can be used in financial forecasts, which may further limit the level of detail and long-term perspective that can be incorporated into the model.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (a): Explain principles and approaches to forecasting a company’s financial results and position.***

---

Q.4292 An analyst is preparing a financial forecast for a company. The analyst needs to consider the company's business model as it can significantly influence the structure of the forecast. This is particularly important when comparing companies from different industries. Which of the following industries is *most likely* to require a different approach to forecasting due to its unique financial structure and revenue streams?

A. A company operating in the retail industry.

B. A company operating in the online marketplace industry.

C. A company operating in the oil and gas production industry.

The correct answer is **C.**

A company operating in the oil and gas production industry is likely to require a different approach to forecasting due to its unique financial structure and revenue streams. The oil and gas industry is characterized by high capital expenditure, long project timelines, and revenues that are highly dependent on commodity prices. This makes the financial structure of oil and gas companies significantly different from companies in other industries.

**A is incorrect.** While the retail industry has its own unique characteristics, such as inventory management and seasonality, these do not significantly alter the basic structure of a financial forecast. The main revenue streams for a retail company, such as sales of goods, are similar to those of many other industries. Therefore, the approach to forecasting for a retail company would not be significantly different from that for companies in many other industries.

**B is incorrect.** While the online marketplace industry has unique characteristics, such as network effects and scalability, these do not significantly alter the basic structure of a financial forecast. The main revenue streams for an online marketplace company, such as transaction fees, are similar to those of many other industries. Therefore, the approach to forecasting for an online marketplace company would not be significantly different from that for companies in many other industries.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (d): Explain approaches to forecasting a company's capital investments and capital structure.***

---

Q.4293 An analyst is preparing a forecast for a company's financial health and future prospects. He decides to focus on the average number of stores open and the average net sales per store to predict the company's net sales. He also plans to forecast gross margin and SG&A expenses as percentages of net sales. Which forecast object is the analyst *most likely* using in this scenario?

A. Summary Measures.

B. Drivers of Financial Statement Lines.

C. Individual Financial Statement Lines.

The correct answer is **B.**

The analyst is primarily using Drivers of Financial Statement Lines as the forecast object in this scenario. In financial forecasting, drivers are the operational and financial variables that influence the financial performance of a company. In this case, the analyst is using the average number of stores open and the average net sales per store as drivers to predict the company's net sales.

These are operational drivers that directly influence the company's revenue. Similarly, the analyst is forecasting gross margin and SG&A expenses as percentages of net sales, which are financial drivers that influence the company's profitability. By focusing on these drivers, the analyst is able to create a more accurate and detailed forecast of the company's financial health and future prospects.

**A is incorrect.** Summary Measures refer to aggregate measures of a company's financial performance, such as total revenue or net income. While these measures are important, they are not the primary focus of the analyst's forecast in this scenario. The analyst is focusing on the underlying drivers that influence these summary measures, not the measures themselves.

**C is incorrect.** Individual Financial Statement Lines refer to the individual line items in a company's financial statements, such as revenue, cost of goods sold, or net income. While the analyst is indeed forecasting some of these line items, he is doing so by focusing on the underlying drivers, not the line items themselves.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

---

Q.4294 A company has recently announced a material legal proceeding that could potentially impact its financial health. An analyst decides to forecast the potential loss or gain and its timing to make an investment decision. This forecast is not based on historical financial statements. Which type of forecast object is the analyst *most likely* using in this case?

A. Ad Hoc Objects.

B. Summary Measures.

C. Individual Financial Statement Lines.

The correct answer is **A.**

The analyst is using Ad Hoc Objects for the forecast. Ad Hoc Objects are used when the analyst needs to forecast an event that is not based on historical financial statements and is not a regular occurrence. In this case, the analyst is trying to forecast the potential impact of a legal proceeding on the company's financial health. This is not a regular occurrence and is not something that can be predicted based on historical financial statements.

The analyst is using an Ad Hoc Object for the forecast. Ad Hoc Objects are often used in situations where there is a significant event or change in the company's operations that could potentially have a significant impact on the company's financial performance. These forecasts are often more subjective and require a higher level of judgment and expertise from the analyst.

**B is incorrect.** Summary Measures are used when the analyst is forecasting a summary measure of the company's financial performance, such as earnings per share or return on equity. This is not the case here, as the analyst is not forecasting a summary measure but rather the potential impact of a legal proceeding.

**C is incorrect**. Individual Financial Statement Lines are used when the analyst is forecasting specific line items on the financial statements based on historical trends and other relevant factors. This is not the case here, as the analyst is not forecasting a specific line item on the financial statements but rather the potential impact of a legal proceeding.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (e): Describe the use of scenario analysis in forecasting.***

---

Q.4295 An analyst is preparing a forecast for a company's sales and gross margin. The company discloses its gross margin only on a consolidated basis. The analyst is considering forecasting sales and gross margin by individual product line. However, the analyst is aware that if the company's reported gross margin results differ from the gross margin estimates, it will be challenging to verify the product-line gross margin estimates. In this scenario, what is the *most likely* issue the analyst will face?

A. The analyst will be able to easily verify the product-line gross margin estimates.

B. The analyst will not be able to determine if the forecast is off on individual product lines.

C. The analyst will not face any issues as the company discloses its gross margin on a consolidated basis.

The correct answer is **B.**

When a company only discloses its gross margin on a consolidated basis, it becomes challenging to verify the gross margin estimates for individual product lines. This is because the consolidated gross margin is a weighted average of the gross margins of all the product lines, and it does not provide information about the gross margin of each individual product line. If the company's reported gross margin results differ from the gross margin estimates, the analyst will not be able to identify which product line's gross margin estimate is off.

This could lead to inaccuracies in the forecast and could potentially mislead the analyst's understanding of the company's profitability by product line. Therefore, it is crucial for analysts to consider the limitations of using consolidated gross margin data when forecasting sales and gross margin by individual product lines.

**A is incorrect.** The analyst will not be able to easily verify the product-line gross margin estimates if the company only discloses its gross margin on a consolidated basis. The consolidated gross margin does not provide information about the gross margin of each individual product line, making it difficult to verify the gross margin estimates for individual product lines.

**C is incorrect.** The analyst will indeed face issues even though the company discloses its gross margin on a consolidated basis. The issue is that the consolidated gross margin does not provide information about the gross margin of each individual product line, making it difficult to verify the gross margin estimates for individual product lines.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

Q.4296 An analyst is considering creating a complex model to forecast the revenues of Novartis AG, a Swiss pharmaceutical company, by forecasting sales for each of its individual drugs by illness and geography. The analyst is aware that such a model would take months to create and weeks to update every quarter. Moreover, the forecasts by illness are not verifiable over time based on the company's disclosures. In this scenario, what would *most likely* be the most advisable course of action for the analyst?

A. The analyst should create the complex model but only update it annually to save time.

B. The analyst should proceed with creating the complex model as it will provide the most accurate forecast.

C. The analyst should not create a complex model and instead focus on the most important drivers and use aggregations and shortcuts where the value-added of discrete forecasting is low.

The correct answer is **C.**

The analyst should not create a complex model and instead focus on the most important drivers and use aggregations and shortcuts where the value-added of discrete forecasting is low. In financial analysis, it is important to balance the complexity of a model with its practicality and usefulness. While a highly detailed model may theoretically provide more accurate forecasts, it may also be time-consuming to create and update and may not necessarily provide significantly better results than a simpler model.

**A is incorrect.** Updating the model only annually would not provide timely and relevant information for decision-making. In a fast-paced industry like pharmaceuticals, conditions can change rapidly, and outdated information could lead to inaccurate forecasts and poor decisions.

**B is incorrect.** While creating a complex model might seem like it would provide the most accurate forecast, it is not always the best course of action. The time and resources required to create and maintain such a model may not be justified by the potential increase in forecast accuracy. Moreover, if the forecasts by illness are not verifiable, the model could be based on inaccurate assumptions, leading to inaccurate forecasts.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

---

Q.4297 Assume you are an analyst working for a financial firm. You are tasked with forecasting the future performance of a company that operates in a cyclical industry and is currently undergoing a major restructuring process, including a large acquisition. Given the circumstances, you are considering the Historical Results Forecast Approach. Is this approach suitable for your task?

A. Yes, because the Historical Results Forecast Approach is the easiest and often the default method due to its simplicity.

B. No, because the Historical Results Forecast Approach is less suitable for companies in cyclical industries and those undergoing major restructuring.

C. Yes, because the Historical Results Forecast Approach is commonly used for forecast objects that are not material or that the analyst does not hold an opinion on.

The correct answer is **B.**

The Historical Results Forecast Approach is less suitable for companies in cyclical industries and those undergoing major restructuring. This approach relies on the assumption that past performance is a reliable indicator of future performance. However, in cyclical industries, performance can vary significantly from one period to another due to changes in the business cycle. Therefore, using historical results to forecast future performance can lead to inaccurate predictions.

**A is incorrect.** While the Historical Results Forecast Approach is indeed often the default method due to its simplicity, this does not mean it is suitable for all situations. As explained above, it is less suitable for companies in cyclical industries and those undergoing major restructuring.

**C is incorrect.** The Historical Results Forecast Approach is not only used for forecast objects that are not material or that the analyst does not hold an opinion on. It can also be used for material forecast objects and when the analyst does hold an opinion. However, its suitability depends on the specific circumstances, as explained above.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (e): Describe the use of scenario analysis in forecasting.***

---

Q.4298 You are a financial analyst, and you are asked to predict the future outcomes for a company operating in an industry where you do not anticipate any changes in the industry structure. The company also has a low sensitivity to changes in the business cycle. Why would the historical forecast approach forecasting approach *most likely* be most suitable in this scenario?

A. It is less appropriate for companies in cyclical industries and those undergoing major restructuring.

B. It is commonly used to forecast objects that are not material or that the analyst does not hold an opinion on.

C. It is suitable for companies operating in industries where the analyst does not anticipate any changes in the industry structure and for companies that have a low sensitivity to changes in the business cycle.

The correct answer is **C.**

The Historical Results Forecast Approach is most suitable in this scenario because it is ideal for companies operating in industries where the analyst does not anticipate any changes in the industry structure and for companies that have a low sensitivity to changes in the business cycle. This approach uses historical data as a basis for estimating future outcomes. It assumes that the past performance of a company is a good indicator of its future performance.

**A is incorrect.** While it is true that the Historical Results Forecast Approach is less appropriate for companies in cyclical industries and those undergoing major restructuring, this statement does not accurately describe why it would be the most suitable approach in this particular scenario. The key factor in this scenario is not that the company is not in a cyclical industry or undergoing restructuring, but that the industry is stable and the company has a low sensitivity to changes in the business cycle.

**B is incorrect.** The Historical Results Forecast Approach is not just used for forecast objects that are not material or that the analyst does not hold an opinion on. It can be used for any company or industry, provided that the conditions are suitable, as they are in this scenario. This choice misrepresents the scope and applicability of the Historical Results Forecast Approach.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (a): Explain principles and approaches to forecasting a company's financial results and position.***

---

Q.4299 In which of the following scenarios would the historical base rates and convergence forecast approach be *most likely* suitable?

A. A company in a new and rapidly changing industry where calculating a base rate is difficult.

B. A leading tech company that accounts for a substantial proportion of the industry base rate.

C. A biotechnology company that recently launched its first drug and is expected to scale its operations.

The correct answer is **C.**

The Historical Base Rates and Convergence forecast Approach would be most suitable for a biotechnology company that recently launched its first drug and is expected to scale its operations. This is because the company is in a phase where it is expected to grow and stabilize its operations, and hence, it is reasonable to expect that its performance will converge to the industry average over time. The base rate, in this case, would be the average or median performance of similar biotechnology companies that have launched their first drug and scaled their operations.

**A is incorrect.** A company in a new and rapidly changing industry where calculating a base rate is difficult would not be a suitable candidate for the Historical Base Rates and Convergence forecast Approach. This is because the lack of historical data and the rapid changes in the industry make it difficult to calculate a reliable base rate, and hence, the forecast based on this approach would be highly uncertain and potentially misleading.

**B is incorrect**. A leading tech company that accounts for a substantial proportion of the industry base rate would not be a suitable candidate for the Historical Base Rates and Convergence forecast Approach. This is because the company's performance is likely to have a significant impact on the industry average, and hence, using the industry average as a base rate for forecasting the company's performance would be circular and potentially misleading.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (a): Explain principles and approaches to forecasting a company’s financial results and position.***

Q.4300 Which of the following is *most likely* explains why the Historical Base Rates and Convergence forecast Approach is not suitable for companies in highly cyclical industries?

> A. It requires a longer-term base rate and smooth convergence to it, which would obscure year-to-year volatility.
>
> B. It requires a short-term base rate and rapid convergence it, which would highlight year-to-year volatility.
>
> C. It requires a medium-term base rate and moderate convergence to it, which would neither obscure nor highlight year-to-year volatility.

The correct answer is **A.**

The Historical Base Rates and Convergence Forecast Approach is not suitable for companies in highly cyclical industries because it requires a longer-term base rate and smooth convergence to it, which would obscure year-to-year volatility. Highly cyclical industries are characterized by significant fluctuations in performance and profitability due to economic cycles. These industries can experience periods of rapid growth followed by periods of contraction.

**B is incorrect.** The Historical Base Rates and Convergence forecast Approach does not require a short-term base rate and rapid convergence to it. This would highlight year-to-year volatility, which is not the objective of this approach. This approach is designed to provide a long-term perspective and smooth out short-term fluctuations, not to highlight them.

**C is incorrect.** The Historical Base Rates and Convergence forecast Approach does not require a medium-term base rate and moderate convergence to it. This would neither obscure nor highlight year-to-year volatility, which is not the objective of this approach. This approach is designed to provide a long-term perspective and smooth out short-term fluctuations, not to maintain a balance between obscuring and highlighting volatility.

***CFA Level I, Equity, Learning Module 7: Company Analysis: Forecasting. LOS (a): Explain principles and approaches to forecasting a company's financial results and position.***

---

Q.4301 A public company's management has provided a guidance range for their sales growth as 2%–4%. As an investor, you are trying to understand the management's true expectations. Based on the characteristics of guidance and management expectations, how should you most likely interpret this range?

A. The midpoint of the range, 3%, represents the management's true expectations.

B. The lower bound of the range, 2%, represents the management's true expectations.

C. The upper bound of the range, 4%, represents the management's true expectations.

The correct answer is **C.**

When a company's management provides a guidance range for their sales growth, interpreting the upper bound of the range as the management's true expectations is often a prudent approach for investors. This interpretation is grounded in the understanding that management teams typically offer guidance ranges to encapsulate potential uncertainties and risks that could affect the company's performance. The upper end of this range is not just an optimistic target but rather a calculated estimate that management believes is achievable, even in the face of some anticipated challenges.

**A is incorrect.** Suggesting that the midpoint of the range, 3%, represents management's true expectations oversimplifies the strategic purpose behind providing a range. While the midpoint might seem like a reasonable estimate, it does not fully account for the optimism that management might have about its strategies and market conditions. The midpoint could be seen as a conservative estimate, potentially underestimating the company's capabilities and market opportunities.

**B is incorrect.** Interpreting the lower bound of the range, 2%, as the management's true expectations is overly pessimistic. This figure likely represents a threshold that management is confident it can exceed, barring any unforeseen major disruptions. It is a conservative figure that ensures the company can meet its guidance even under less favorable conditions. Relying solely on the lower end of the guidance range might lead investors to undervalue the company's potential for growth and overlook the strategic initiatives in place to achieve higher sales growth.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

---

Q.4302 You are an analyst considering the use of a company's guidance for your forecasts. The company in question is highly sensitive to the business cycle. Based on the principles of using guidance for forecasts, should you rely on the company's guidance for your forecasts?

A. Yes, because guidance accounts for a majority of the quarterly financial reporting information used by investors.

B. Yes, because guidance is forward-looking, and management has an abundance of industry and company information that investors do not.

C. No, because management does not have an informational advantage over investors in forecasting macroeconomic variables like GDP or the prices of commodities.

The correct answer is **C.**

When considering the use of a company's guidance for forecasts, especially for a company that is highly sensitive to the business cycle, it is important to understand the limitations of management's ability to predict future outcomes. While management does have access to a wealth of industry and company-specific information, they do not have an informational advantage over investors when it comes to forecasting macroeconomic variables like GDP or the prices of commodities.

**A is incorrect.** While the guidance does account for a significant portion of the quarterly financial reporting information used by investors, this does not mean that it should be the sole source of information for forecasts. Guidance is just one of many tools that investors can use to predict future performance. Other sources of information, such as economic indicators, industry trends, and independent research, should also be considered when making forecasts.

**B is incorrect.** While it is true that management has access to a wealth of industry and company-specific information, this does not necessarily translate into an ability to accurately predict future macroeconomic conditions. As mentioned above, management does not have an informational advantage over investors when it comes to forecasting macroeconomic variables. Relying solely on the company's guidance for forecasts could lead to inaccurate predictions.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (a): Explain principles and approaches to forecasting a company's financial results and position.***

Q.4304 A financial analyst is preparing a revenue forecast for a company that discloses the volumes and prices of its products. The analyst plans to prepare individual forecasts for these quantities and then multiply them to arrive at a revenue forecast. This approach is *most likely* an example of which type of forecast object?

A. Top-Down Forecast Object.

B. Bottom-Up Forecast Object.

C. Market Growth and Market Share Forecast Object

The correct answer is **B.**

This approach is an example of a Bottom-Up Forecast Object. In a bottom-up forecasting approach, the analyst starts with the smallest, most basic elements of the business and then combines them to create a larger, overall forecast. In this case, the analyst starts with the individual volumes and prices of the company's products, which are the basic elements of the company's revenue.

**A is incorrect.** A top-down forecast object would involve starting with a larger, overall forecast (such as total market size or total company revenue) and then breaking it down into smaller components. This is the opposite of the approach described in the question.

**C is incorrect.** A market growth and market share forecast object would involve forecasting the growth of the overall market and the company's share of that market. This is a different approach than the one described in the question, which involves forecasting individual volumes and prices of the company's products.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company’s revenues.***

---

Q.4305 A retail company is forecasting its revenues based on the number of stores and sales per store, or same-store sales growth and sales related to new-store openings. This approach is *most likely* an example of which type of forecast object?

A. Capacity-based Measures Forecast Object.

B. Return- or Yield-based Measures Forecast Object.

C. Market Growth and Market Share Forecast Object.

The correct answer is **A.**

This approach is an example of a Capacity-based Measures Forecast Object. The capacity is the number of stores that the retail company operates. The company is forecasting its revenues based on two factors: the sales per store (same-store sales growth) and the sales related to new-store openings. This approach is a capacity-based measure because it is based on the company's capacity to generate sales, which is determined by the number of stores it operates.

The company is forecasting its revenues based on its ability to utilize its capacity (i.e., its stores) to generate sales. This approach is commonly used in industries where capacity is a key determinant of revenues, such as retail, manufacturing, and hospitality.

**B is incorrect.** Return- or Yield-based Measures Forecast Object refers to a forecasting approach that is based on the returns or yields that a company expects to generate. This approach is typically used in financial industries, such as banking and investment. In this case, the company is not forecasting its revenues based on returns or yields but rather on its own capacity to generate sales.

**C is incorrect.** Market Growth and Market Share Forecast Object refers to a forecasting approach that is based on the growth of the overall market and the company's share of that market. In this case, the company is not forecasting its revenues based on market growth or market share but rather on its own capacity to generate sales.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company’s revenues.***

---

Q.4306 A retail company is forecasting its revenues based on the number of stores and sales per store, or same-store sales growth and sales related to new-store openings. This approach is *most likely* an example of which type of forecast object?

A. Capacity-based Measures Forecast Object.

B. Return- or Yield-based Measures Forecast Object.

C. Market Growth and Market Share Forecast Object.

The correct answer is **A.**

This approach is an example of a Capacity-based Measures Forecast Object. In this case, the capacity is the number of stores that the retail company operates. The company is forecasting its revenues based on two factors: the sales per store (same-store sales growth) and the sales related to new-store openings. This approach is a capacity-based measure because it is based on the company's capacity to generate sales, which is determined by the number of stores it operates.

**B is incorrect.** Return- or Yield-based Measures Forecast Object refers to a forecasting approach that is based on the returns or yields that a company expects to generate. This approach is typically used in financial industries, such as banking and investment. The company is not forecasting its revenues based on returns or yields but rather on its own capacity to generate sales.

**C is incorrect.** Market Growth and Market Share Forecast Object refers to a forecasting approach that is based on the growth of the overall market and the company's share of that market. In this case, the company is not forecasting its revenues based on market growth or market share but rather on its own capacity to generate sales.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

Q.4307 A bank is forecasting its net interest income based on account balances and revenue yields on them. The net interest income is calculated as loans multiplied by the average interest rate minus the product of deposits and liabilities and their average interest rate. This approach is *most likely* an example of which type of forecast object?

A. Return- or Yield-based Measures Forecast Object.

B. Product-line or Segment Revenues Forecast Object.

C. Market Growth and Market Share Forecast Object.

The correct answer is **A.**

Return- or yield-based measures are forecasts based on account balances and revenue yields on them. For example, net interest income for a bank can be calculated as loans multiplied by the average interest rate minus the product of deposits and liabilities and their average interest rate.

**B is incorrect.** Product-line or segment revenues are forecasts for individual products, product or business lines, geographic areas, or reporting segments are made and then aggregated into a total revenue forecast. This approach is commonly used if a company makes such disclosures and if the objects have different economic exposures.

**C is incorrect.** In a market growth and market share technique the analyst first forecasts a growth rate for a company's product market, and then considers the company's current market share and how that share is likely to change over time.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

Q.4308 If a company experiences a sudden increase in revenue due to changes in exchange rates, additional selling days in the period, or acquisitions, how should these items *most likely* be treated in the revenue forecast? They should be:

A. included in the forecast but highlighted as potential risks.

B. included in the forecast as they contribute to the overall revenue.

C. excluded from the forecast and considered separately as they do not have the same drivers as the recurring revenue.

The correct answer is **C.**

These items should be excluded from the forecast and considered separately as they do not have the same drivers as the recurring revenue. In financial forecasting, it is crucial to distinguish between recurring and non-recurring items. Recurring items are those that are expected to continue in the future, while non-recurring items are one-time events that are not expected to repeat. A sudden increase in revenue due to changes in exchange rates, additional selling days in the period, or acquisitions are examples of non-recurring items.

**A is incorrect**. While it is important to highlight potential risks in a forecast, including these items in the forecast could lead to overestimation or underestimation of future revenues. These items are non-recurring and do not reflect the company's underlying business performance. Therefore, they should not be included in the forecast, even if they are highlighted as potential risks.

**B is incorrect.** Including these items in the forecast as they contribute to the overall revenue can lead to inaccurate forecasts. These items are non-recurring and do not reflect the company's underlying business performance. Therefore, they should not be included in the forecast.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

---

Q.4309 The COVID-19 pandemic led to a rapid increase in e-commerce sales, which later decelerated or declined in 2022. How should an analyst *most likely* interpret this trend in e-commerce sales?

A. As an indication that the e-commerce industry is in decline.

B. As a sign of the e-commerce industry's instability and unpredictability.

C. As evidence that some of the growth in e-commerce sales during the pandemic was non-recurring.

The correct answer is **C.**

The rapid increase in e-commerce sales during the COVID-19 pandemic and the subsequent deceleration or decline in 2022 should be interpreted as evidence that some of the growth in e-commerce sales during the pandemic was non-recurring. The pandemic led to a unique set of circumstances that significantly boosted e-commerce sales, including lockdowns, social distancing measures, and a general shift towards online shopping due to health concerns.

**A is incorrect.** The deceleration or decline in e-commerce sales in 2022 does not necessarily indicate that the e-commerce industry is in decline. It is more likely a return to more normal growth rates after the extraordinary surge in sales during the pandemic. The long-term trend for the e-commerce industry is still one of growth, driven by factors such as increasing internet penetration, technological advancements, and changing consumer behaviors.

**B is incorrect.** The fluctuation in e-commerce sales during and after the pandemic does not necessarily indicate the e-commerce industry's instability and unpredictability. It is more a reflection of the extraordinary circumstances created by the pandemic, which led to a temporary surge in e-commerce sales.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (e): Describe the use of scenario analysis in forecasting.***

---

Q.4310 Which of the following is *most likely* the primary reason the analyst to analysts may separate certain "one-time" revenues or gains from the main revenue forecast when forecasting revenue?

A. To make the revenue forecast appear more impressive.

B. To forecast the "underlying" revenue or growth apart from the non-recurring items.

C. To simplify the revenue forecast by removing complex elements.

The correct answer is **B.**

The primary reason for separating certain "one-time" revenues or gains from the main revenue forecast is to forecast the "underlying" revenue or growth apart from the non-recurring items. This is because one-time revenues or gains are not expected to recur in the future, and therefore, they can distort the true picture of a company's ongoing operations. By separating these items, analysts can provide a more accurate and reliable forecast of the company's future revenue growth.

**A is incorrect.** The purpose of separating one-time revenues or gains from the main revenue forecast is not to make the revenue forecast appear more impressive. While removing these items may result in a lower total revenue figure, it provides a more accurate and reliable measure of the company's ongoing operations. The goal of financial analysis is to provide accurate and reliable information, not to inflate or distort the financial results.

**C is incorrect.** The purpose of separating one-time revenues or gains from the main revenue forecast is not to simplify the revenue forecast by removing complex elements. While this approach may simplify the analysis to some extent, its primary purpose is to provide a more accurate and reliable measure of the company's ongoing operations. Even with the removal of one-time items, the revenue forecast may still involve complex elements, such as the impact of changes in market conditions, competition, and company strategy.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

---

Q.4311 In the late 2010s, GPU manufacturers saw a large increase in sales, partly attributed to the use of GPUs in cryptocurrency mining. However, the companies could not or would not quantify the precise amount. How should an analyst *most likely* treat such sales in their forecast? They should:

A. ignore these sales as they are not quantified by the company.

B. include these sales in the forecast as they contribute to the overall revenue.

C. exclude these sales from the forecast and consider them separately, judging them as non-recurring.

The correct answer is **C.**

An analyst should exclude these sales from the forecast and consider them separately, judging them as non-recurring. This is because the sales attributed to the use of GPUs in cryptocurrency mining are not a regular or predictable source of revenue for the company. The demand for GPUs for cryptocurrency mining can fluctuate significantly depending on various factors such as the price of cryptocurrencies, the difficulty of mining, and regulatory changes.

**A is incorrect.** Ignoring these sales completely would not be a prudent approach either. Even though the company has not quantified the precise amount of these sales, they still represent a significant part of the company's business. Ignoring them could lead to an underestimation of the company's total revenue and could also overlook the potential risks associated with the company's exposure to the cryptocurrency market.

**B is incorrect.** While it is true that these sales contribute to the overall revenue of the company, including them in the forecast without considering their non-recurring nature could lead to inaccurate predictions. The demand for GPUs for cryptocurrency mining is highly volatile and unpredictable, and therefore, it is not a reliable source of revenue for the company.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

---

Q.4312 Which of the following is *least likely* one of the main approaches used for revenue forecasting?

A. Historical results.

B. Market speculation.

C. Management guidance.

The correct answer is **B.**

Market speculation is not one of the main approaches used for revenue forecasting. Revenue forecasting is a crucial part of financial analysis and planning, and it involves predicting the future revenues of a company based on various factors. The main approaches used for revenue forecasting include historical results, management guidance, and market research. Market speculation, is not a reliable or systematic method for forecasting revenues.

**A is incorrect.** Historical results are indeed one of the main approaches used for revenue forecasting. This method involves analyzing a company's past revenue trends to predict future revenues. It is based on the assumption that past performance is a good indicator of future performance.

**C is incorrect.** Management guidance is also a main approach used for revenue forecasting. This method involves using the revenue projections provided by a company's management team. These projections are often based on the company's strategic plans and goals, as well as its current market position and competitive environment.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (b): Explain approaches to forecasting a company's revenues.***

---

Q.4313 An analyst is reviewing the financial statements of a company. The company's disclosures about operating costs are less detailed compared to revenue disclosures. The analyst has to rely on more aggregated forecast objects. Which of the following would *most likely* be an example of such an aggregated forecast object that the analyst might rely on?

A. Costs separated by different geographic regions.

B. Detailed breakdown of costs for each product line

C. Consolidated financial statement lines such as cost of sales

The correct answer is **C.**

When a company's disclosures about operating costs are less detailed compared to revenue disclosures, an analyst might have to rely on more aggregated forecast objects. An example of such an aggregated forecast object is consolidated financial statement lines such as cost of sales. Cost of sales is a line item on a company's income statement that aggregates all the direct costs associated with producing goods sold by a company.

**A is incorrect.** Costs separated by different geographic regions would not be an aggregated forecast object. This would be a more detailed breakdown of costs, which the analyst does not have access to in this scenario.

**B is incorrect.** A detailed breakdown of costs for each product line would also not be an aggregated forecast object. This would be a more detailed level of cost information, which the analyst does not have access to in this scenario. Therefore, the analyst would not be able to rely on this information for forecasting.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (c): Explain approaches to forecasting a company’s operating expenses and working capital.***

Q.4314 An analyst is forecasting for a grocery chain that also sells higher-margin items such as alcoholic products or pharmaceutical products. The analyst expects a change in the product mix sold. What is the *most likely* reason for the analyst to forecast this change?

A. The grocery chain is planning to reduce its product range.

B. The grocery chain is planning to expand its product range.

C. Food and grocery items typically have low gross profit margins

The correct answer is **C.**

The likely reason for the analyst to forecast a change in the product mix sold by the grocery chain is that food and grocery items typically have low gross profit margins. In the retail industry, gross profit margin is a key indicator of a company's financial health. It represents the percentage of sales revenue a company retains after incurring the direct costs associated with producing the goods it sells, and the services it provides.

The higher the gross profit margin, the more capital a company retains on each dollar of sales, which it can then use to pay other costs or satisfy debt obligations. Therefore, by shifting its product mix towards higher-margin items such as alcoholic or pharmaceutical products, the grocery chain can increase its gross profit margin and improve its financial performance. This is a common strategy used by grocery chains to boost their profitability.

**A is incorrect.** Reducing the product range could also lead to a change in the product mix, but again, it is not necessarily linked to the gross profit margin. The impact on profitability would depend on which products are removed from the range and what their margins were. If the grocery chain removes low-margin products, it could potentially increase its overall gross profit margin, but if it removes high-margin products, the opposite could happen.

**B is incorrect.** While expanding the product range could potentially lead to a change in the product mix, it is not necessarily linked to the gross profit margin. The new products could have higher or lower margins than the existing ones, and their impact on the overall profitability would depend on their sales volume and the costs associated with their production and distribution.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (a): Explain principles and approaches to forecasting a company’s financial results and position.***

---

Q.4316 A company heavily relies on commodities for its production process. Recently, the input prices have increased significantly. The company has a hedging strategy in place. As an analyst, how would you *most likely* expect this situation to impact the company's gross margin?

A. The gross margin will significantly decrease due to the rise in input prices.

B. The gross margin may decline, but the company's hedging strategy will mitigate the impact.

C. The gross margin will remain the same as the hedging strategy will completely mitigate the impact of rising input prices.

The correct answer is **B.**

The gross margin may decline, but the impact will be mitigated by the company's hedging strategy. Gross margin is calculated as sales revenue minus cost of goods sold (COGS) divided by sales revenue. When input prices rise, the COGS will increase, which could potentially decrease the gross margin.

However, if the company has a hedging strategy in place, it can mitigate the impact of rising input prices. Hedging strategies are designed to protect against price fluctuations by locking in prices for inputs in advance.

**A is incorrect.** While it's true that rising input prices can lead to a decrease in gross margin, this statement ignores the fact that the company has a hedging strategy in place, which can mitigate the impact of rising input prices.

**C is incorrect.** This statement assumes that the hedging strategy will completely mitigate the impact of rising input prices, which is not always the case. The effectiveness of a hedging strategy can vary depending on various factors, and it may not always be able to completely eliminate the impact of rising input prices.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (e): Describe the use of scenario analysis in forecasting.***

---

*Q.4317 You are analyzing a company that operates as a wholesaler with franchised retail operations. When comparing this company's gross margin with a retailer that owns and operates its own stores, what would you most likely expect to find? The wholesaler will have a*

*A. higher gross margin and lower operating costs.*

*B. lower gross margin and higher operating costs.*

*C. lower gross margin but also much lower operating costs.*

*The correct answer is* ***C.***

*The wholesaler will have a much lower gross margin but also much lower operating costs. Gross margin is the difference between revenue and cost of goods sold (COGS), divided by revenue. A wholesaler typically has a lower gross margin than a retailer because it sells goods in bulk at lower prices. However, a wholesaler also has lower operating costs than a retailer. This is because a wholesaler does not have to bear the costs associated with running retail operations, such as rent, utilities, and staff salaries.*

***A is incorrect.*** *The wholesaler will not have a much higher gross margin and lower operating costs. As explained above, a wholesaler typically has a lower gross margin than a retailer because it sells goods in bulk at lower prices. While it is true that a wholesaler has lower operating costs than a retailer, this does not result in a higher gross margin.*

***B is incorrect.*** *The wholesaler will not have a much lower gross margin and higher operating costs. While it is true that a wholesaler has a lower gross margin than a retailer, its operating costs are also lower, not higher. This is because a wholesaler does not have to bear the costs associated with running retail operations, such as rent, utilities, and staff salaries.*

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (c): Explain approaches to forecasting a company's operating expenses and working capital.***

---

Q.4318 Total, a German cement and building materials company, experienced a sales growth of 6.1% from 2017 to 2018. However, the company's gross profit fell by 6.5% and its gross margin declined due to the growth of other operating costs, including SG&A expenses. Despite the increase in SG&A expenses, as a percentage of revenue, these expenses declined slightly. Based on this information, what can *most likely* be inferred about the relationship between SG&A expenses and the company's sales?

A. SG&A expenses increase in direct proportion to the company's sales.

B. SG&A expenses decrease in direct proportion to the company's sales.

C. SG&A expenses do not have a direct relationship with the company's sales.

The correct answer is **C.**

Based on the information provided, it can be inferred that SG&A (Selling, General & Administrative) expenses do not have a direct relationship with the company's sales. This is because despite the company experiencing a sales growth of 6.1% from 2017 to 2018, the SG&A expenses increased, but as a percentage of revenue, these expenses declined slightly. This indicates that the increase in SG&A expenses was not directly proportional to the increase in sales.

**A is incorrect.** SG&A expenses do not increase in direct proportion to the company's sales. If this were the case, the increase in sales would have resulted in a proportional increase in SG&A expenses as a percentage of revenue, which did not happen.

**B is incorrect.** SG&A expenses do not decrease in direct proportion to the company's sales. If this were the case, the increase in sales would have resulted in a proportional decrease in SG&A expenses as a percentage of revenue, which also did not happen.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (c): Explain approaches to forecasting a company’s operating expenses and working capital.***

---

Q.4319 Which of the following is *most likely* can be inferred about the type of information typically included in segment disclosures? Segment disclosures typically include:

A. cost items such as cost of sales, SG&A, etc., by segment.

B. operating and EBITDA margin profitability by segment.

C. both cost items and profitability measures by segment.

The correct answer is **B.**

Segment disclosures typically include operating and EBITDA margin profitability by segment. This is because these measures provide a summary view of the profitability of each segment, which is useful for investors and analysts. Operating margin is a measure of profitability that shows how much of each dollar of revenues is left over after both costs of goods sold and operating expenses are considered.

**A is incorrect.** Segment disclosures generally do not include cost items such as cost of sales, SG&A, etc., by segment. This is because these details can be sensitive and revealing them could potentially harm the company's competitive position. Furthermore, these cost items can be complex and difficult to allocate accurately to individual segments, especially in diversified companies with multiple lines of business.

**C is incorrect.** While it would be ideal if segment disclosures included both cost items and profitability measures by segment, this is generally not the case. As mentioned earlier, cost items are typically not included due to their sensitive nature and the complexity involved in accurately allocating them to individual segments. Therefore, analysts usually have to rely on summary measures such as operating and EBITDA margin profitability to assess the performance of individual segments.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (c): Explain approaches to forecasting a company’s operating expenses and working capital.***

---

Q.4320 A financial analyst is preparing a working capital forecast for a business. He is considering various elements to project the future financial health of the business. In this context, which of the following elements is *least likely* typically included in a working capital forecast?

A. Inventories

B. Long-term liabilities

C. Accounts receivable

The correct answer is **B.**

Long-term liabilities are not typically included in a working capital forecast. Working capital is a measure of a company's operational liquidity and short-term financial health. It is calculated as current assets minus current liabilities. Current assets typically include cash, accounts receivable, and inventories, while current liabilities include accounts payable and short-term debt. These are all items that are expected to be used, collected, or paid within one year.

**A is incorrect.** Inventories are also typically included in a working capital forecast. Inventories represent goods that a company has on hand for sale in the ordinary course of business. They are considered a current asset because they are expected to be sold within one year. Therefore, they are relevant to a company's short-term financial health and liquidity and are typically included in a working capital forecast.

**C is incorrect.** Accounts receivable are typically included in a working capital forecast. Accounts receivable represents money owed to a company by its customers for goods or services that have been delivered or used but not yet paid for. It is considered a current asset because it is expected to be collected within one year. Therefore, it is relevant to a company's short-term financial health and liquidity and is typically included in a working capital forecast.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (c): Explain approaches to forecasting a company’s operating expenses and working capital.***

---

Q.4322 In the context of capital expenditures, which type is *most likely* needed to expand the business and is more discretionary, tied to management’s expansion plans and revenue growth?

A. Growth capital expenditures.

B. Operational capital expenditures.

C. Maintenance capital expenditures.

The correct answer is **A.**

Growth capital expenditures are the type of capital expenditures that are needed to expand the business and are more discretionary, tied to management’s expansion plans and revenue growth. These expenditures are made with the expectation that they will increase the company's capacity to generate revenue in the future. They are often associated with the purchase of long-term assets such as property, plant, and equipment or investments in new technology or research and development.

**B is incorrect.** Operational capital expenditures are the costs associated with the day-to-day operations of a business. While these expenditures are necessary for the company to continue its operations, they do not contribute to the expansion of the business. Operational capital expenditures are typically recurring and predictable and are not tied to management’s expansion plans and revenue growth.

**C is incorrect.** Maintenance capital expenditures are the costs incurred to keep the company's existing assets in good working condition. These are necessary expenditures that a company must make to maintain its current level of operations and are not discretionary. They do not contribute to the growth of the company but rather to the maintenance of its existing operations.

***CFA Level I, Equity, Learning Module 7: Company Analysis: Forecasting. LOS (d): Explain approaches to forecasting a company’s capital investments and capital structure.***

---

Q.4323 When projecting a company’s future capital structure, which of the following ratios are *most likely* used as the forecast object to project future debt and equity levels?

A. Current ratio, Quick ratio, and Cash ratio.

B. Debt to capital, Debt to equity, and Debt to EBITDA.

C. Return on assets, Return on equity, and Return on investment.

The correct answer is **B.**

When projecting a company’s future capital structure, the ratios often used as the forecast object to project future debt and equity levels are Debt to Capital, Debt to Equity, and Debt to EBITDA. These ratios are directly related to a company's capital structure and provide insights into the company's financial leverage and ability to meet its financial obligations. The Debt to Capital ratio measures the proportion of a company's funding that comes from debt.

**A is incorrect.** The Current ratio, Quick ratio, and Cash ratio are liquidity ratios, not capital structure ratios. They are used to measure a company's ability to pay off its short-term liabilities with its short-term assets. While these ratios are important in assessing a company's short-term financial health, they are not typically used to project future debt and equity levels.

**C is incorrect.** The Return on Assets (ROA), Return on Equity (ROE), and Return on Investment (ROI) are profitability ratios, not capital structure ratios. They measure the efficiency of a company in generating profits from its assets, equity, and investments, respectively. While these ratios provide valuable insights into a company's profitability, they are not typically used to project future debt and equity levels.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (d): Explain approaches to forecasting a company’s capital investments and capital structure.***

Q.4325 Which of the following might management *most likely* provide guidance on when projecting the future capital structure?

A. Company's marketing strategy and customer base.

B. Company's market share and competitive landscape.

C. Target capital structure, debt covenant ratios, and capital expenditures.

The correct answer is **C.**

When projecting the future capital structure, management might provide guidance on the target capital structure, debt covenant ratios, and capital expenditures. The target capital structure is the mix of debt, preferred stock, and common equity, which the firm plans to finance its investments. It is the proportion of debt and equity that the company aims to maintain over the long term. Debt covenant ratios are conditions that lenders put on loans to limit the actions of the borrower and reduce the lender's risk.

**A is incorrect.** While the company's marketing strategy and customer base are important aspects of the overall business strategy, they are not directly related to the projection of the future capital structure. The capital structure is more concerned with the financial aspects of the company, such as debt and equity levels, rather than marketing strategies or customer base.

**B is incorrect.** The company's market share and competitive landscape are important factors in strategic planning and can indirectly influence the capital structure. However, they are not the primary factors that management would provide guidance on when projecting the future capital structure. The capital structure is more directly influenced by financial factors such as the target capital structure, debt covenant ratios, and capital expenditures.

***CFA Level I, Topic 6 - Equity, Learning Module 7: Company Analysis: Forecasting. LOS (d): Explain approaches to forecasting a company’s capital investments and capital structure.***

---