Learning Module 5: Company Analysis: Past and Present

Q.4239 Which of the following information is *most likely* contained in the analysis of new information section of subsequent company research reports?

A. Analysts updated recommendations.

B. Adjustments to prior forecasts based on new data.

C. Disclosures, disclaimers, and other legal requirements.

The correct answer is **B.**

The analysis of the new information section of subsequent company research reports contains the following information:

- Comparison of quarterly results to projections
- Interpretation of new data
- Adjustments to prior forecasts based on new data

A is incorrect. Analysts updated recommendation is contained in the recommendation section of the subsequent company research reports, together with the summary of changes from the prior recommendation and supporting explanations for any changes.

C is incorrect. A. Disclosures, disclaimers, and other legal requirements are contained in the front matter of the subsequent company research reports. Other items found in this section include the analysts' names, issuer names, security and exchange identifiers, analysts' recommendations, current security prices, and analysts' target prices.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (a): Describe the elements that should be covered in a thorough company research report.

Q.4240 The structure, content, and tone of a company research report depend on the analyst's setting. Which of the following is *most likely* the typical structure of a "sell-side report"?

A. An extensive initial report followed by shorter reports on specific topics or updates

B. A short initial report followed by extensive reports on specific topics or updates

C. A single extensive report covering all topics and updates

The correct answer is **A.**

The typical structure of a "sell-side report" is an extensive initial report followed by shorter reports on specific topics or updates. Sell-side analysts work for brokerage firms, and their reports are typically distributed to the firm's clients. The initial report is usually extensive and provides a comprehensive analysis of the company, including its business model, industry position, financial performance, and valuation. This report serves as a foundation for understanding the company and its investment potential.

Following the initial report, sell-side analysts provide shorter reports that focus on specific topics or updates. These updates could be related to recent company news, earnings releases, changes in the industry, or any other factors that could impact the company's performance and valuation. The purpose of these updates is to keep investors informed about any significant changes that could affect their investment decisions.

B is incorrect. A short initial report followed by extensive reports on specific topics or updates is not the typical structure of a sell-side report. While sell-side analysts do provide updates on specific topics, these updates are usually shorter and more focused than the initial report. The initial report is the most comprehensive and provides the foundation for understanding the company and its investment potential.

C is incorrect. A single extensive report covering all topics and updates is not the typical structure of a sell-side report. While the initial report is usually extensive, it is not intended to cover all topics and updates. Sell-side analysts provide regular updates to keep investors informed about any significant changes that could affect their investment decisions. These updates are typically shorter and more focused than the initial report.

CFA Level I, Equity, Learning Module 5: Company Analysis: Past and Present. LOS (a): Describe the elements that should be covered in a thorough company research report.

Q.4241 Which of the following is *most likely* the primary audience for analysts' reports solely for internal distribution?

A. Those who are unfamiliar with the issuer or security.

B. Those who are already familiar with the issuer or security.

C. External clients.

The correct answer is **B.**

The primary audience for analysts' reports solely for internal distribution is those who are already familiar with the issuer or security. These reports are typically prepared by analysts within a company or organization and are intended for internal use only. Analysts' reports that are intended just for internal distribution to an audience that is already familiar with the issuer may be much shorter and given verbally or through a few presentation slides.

A is incorrect. While analysts' reports can certainly be useful for those who are unfamiliar with the issuer or security, the primary audience for reports solely for internal distribution is not those who are unfamiliar. These reports are typically more detailed and technical and are intended for those who already have a certain level of knowledge and understanding of the issuer or security.

C is incorrect. Analysts' reports are solely for internal distribution and are not intended for external clients. These reports are typically confidential and are intended to inform decision-making within the organization. They are not typically shared with external clients, who would instead receive reports intended for external distribution.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company's business model.

Q.4242 Which of the following is *most likely* the term for an extensive initial report when an analyst begins covering a security?

A. Initiating coverage report.

B. Initial analysis report.

C. Primary coverage report

The correct answer is **A.**

The term for an extensive initial report, when an analyst begins covering a security, is called an Initiating Coverage Report. This is the first report that an analyst or a brokerage firm produces when they start following a new company or security. The initiating coverage report provides a comprehensive analysis of the company or security, including its business model, industry position, financial health, and future prospects.

It also includes a recommendation on whether to buy, sell, or hold the security. The initiating coverage report is a crucial tool for investors as it provides them with an in-depth understanding of the company or security and helps them make informed investment decisions. It is also a way for the analyst or brokerage firm to establish their expertise and credibility in the market.

B is incorrect. An Initial Analysis Report is not a standard term used in the financial industry. While it could theoretically refer to a first-time analysis of a company or security, it is not the specific term used when an analyst begins covering a new security.

C is incorrect. A Primary Coverage Report is also not a standard term used in the financial industry. It could be confused with the term 'primary research', which refers to the process of collecting data directly from the source, as opposed to analyzing data collected by someone else (secondary research). However, it is not the term used for the initial report produced by an analyst when they start covering a new security.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company's business model.

Q.4243 Which of the following is *most likely* the nature of updates after the "initiating coverage" report?

A. They are typically longer and more detailed than the initial report

B. They are typically shorter and focus on specific topics or updates

C. They are typically the same length as the initial report

The correct answer is **B.**

Updates after the "initiating coverage" report are typically shorter and focus on specific topics or updates. The initiating coverage report is a comprehensive document that provides a detailed analysis of a company, including its business model, industry position, financial performance, and future prospects. It is intended to provide a thorough understanding of the company and its potential investment value.

After the initial report, subsequent updates are usually shorter and focus on specific topics or updates, such as quarterly earnings results, changes in management, or significant business developments. These updates are intended to keep investors informed about any significant changes that may affect the company's investment value. They are not intended to reiterate the comprehensive analysis provided in the initiating coverage report, but rather to supplement it with timely and relevant information.

A is incorrect. Updates after the "initiating coverage" report are not typically longer and more detailed than the initial report. The initial report is usually the most comprehensive document, providing a detailed analysis of the company. Subsequent updates are typically shorter and focus on specific topics or updates.

C is incorrect. Updates after the "initiating coverage" report are not typically the same length as the initial report. The initial report is usually a comprehensive document, while subsequent updates are typically shorter and focus on specific topics or updates.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (a): Describe the elements that should be covered in a thorough company research report.

Q.4244 Which of the following is *most likely* the primary purpose of company and industry analysis in forming a view of an issuer's future financial results?

A. To predict the exact future earnings and cash flows.

B. To provide a mathematical model for future financial results.

C. To support and justify the analyst's forward-looking views.

The correct answer is **C.**

The primary purpose of company and industry analysis in forming a view of an issuer's future financial results is to support and justify the analyst's forward-looking views. Company and industry analysis involves a detailed examination of a company's financial statements, its competitive position in the industry, and the overall health of the industry. This analysis helps an analyst to form an opinion about the company's future financial performance.

The analyst uses this information to make predictions about the company's future earnings, cash flows, and other financial results. These predictions are not exact, but they are based on the analyst's understanding of the company and its industry. The analysis provides the evidence and reasoning that support these predictions. Therefore, the main purpose of company and industry analysis is to provide a solid foundation for the analyst's forward-looking views about a company's financial future.

A is incorrect. While company and industry analysis does involve making predictions about a company's future earnings and cash flows, the purpose of this analysis is not to predict the exact future earnings and cash flows. Predicting exact future financial results is impossible due to the inherent uncertainty in business and economic conditions.

B is incorrect. Company and industry analysis does not provide a mathematical model for future financial results. While quantitative methods are used in the analysis, the purpose of the analysis is not to create a mathematical model but to understand the company's financial condition and prospects. The analysis involves a combination of quantitative and qualitative methods, and the results are interpreted in the context of the company's specific situation and the conditions in its industry.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): determine a company's business model.

Q.4245 Which of the following is *most likely* the primary difference between “sell-side reports” and reports for internal distribution?

A. The audience they are intended for

B. The financial models they use

C. The companies they cover

The correct answer is **A.**

The primary difference between “sell-side reports” and reports for internal distribution is the audience they are intended for. Sell-side reports are produced by analysts working for brokerage firms, investment banks, and other financial institutions that sell securities and other investment products to investors. These reports are intended for external distribution to clients and potential clients of the firm, with the aim of persuading them to buy or sell certain securities.

Reports for internal distribution are intended for use within the organization that produces them. These reports are used for decision-making purposes by the management of the organization and are not intended for external distribution. The content of these reports may be similar to that of sell-side reports, but the audience and purpose are different.

B is incorrect. Both sell-side reports and reports for internal distribution may use similar financial models. The choice of financial models depends on the purpose of the analysis and the nature of the securities or companies being analyzed, not on whether the report is intended for external or internal distribution.

C is incorrect. Both sell-side reports and reports for internal distribution can cover any company, sector, or market, depending on the needs and interests of the audience. The choice of companies to cover is not a primary difference between these types of reports.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company’s business model.

Q.4246 Which of the following is *most likely* is the primary purpose of updates to a recommendation after the analyst receives new information or conducts additional analyses?

A. To provide a new mathematical model

B. To provide an update based on new information and analyses or a change in the analyst's recommendation

C. To provide a new initiating coverage report

The correct answer is **B.**

The primary purpose of updates to a recommendation after the analyst receives new information or conducts additional analyses is to provide an update based on new information and analyses or a change in the analyst's recommendation. In the dynamic world of finance, new information can significantly impact the valuation and prospects of a company. Therefore, it is crucial for analysts to update their recommendations when they receive new information or conduct additional analyses.

This ensures that investors have the most current and accurate information to base their investment decisions on. The updated recommendation can either confirm the previous recommendation or suggest a change, depending on the impact of the new information or analysis. This process is a key part of the analyst's role and is essential for maintaining the credibility and usefulness of their research.

A is incorrect. While a new mathematical model may be part of an update to a recommendation, it is not the primary purpose of such updates. The main aim is to provide updated information and analysis to investors, which may or may not involve a new mathematical model.

C is incorrect. An initiating coverage report is a detailed report that an analyst writes when they start covering a new company. While this report may be updated as new information becomes available, the primary purpose of updates to a recommendation is not to provide a new initiating coverage report. Instead, it is to provide updated information and analysis based on new information or additional analyses.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company's business model.

Q.4247 The initial step in industry and company analysis is determining a company's business model. This process helps in summarizing the key drivers of a company's financial results and position. What else does determining a company's business model *most likely* assist in:

A. focusing on areas that require further investigation and setting the analyst's expectations for the issuer.

B. determining the company's stock price.

C. determining the company's market share.

The correct answer is **A.**

Determining a company's business model is indeed the initial step in industry and company analysis. It helps in summarizing the key drivers of a company's financial results and position. Additionally, it assists in focusing on areas that require further investigation and sets the analyst's expectations for the issuer. Understanding a company's business model allows an analyst to identify the key revenue and cost drivers, which in turn helps in forecasting future financial performance.

It also helps in identifying the key risks and opportunities that the company faces, which can guide the analyst in identifying areas that require further investigation. Furthermore, understanding the business model can help set the analyst's expectations for the issuer, as it provides a framework for understanding how the company generates its revenues and profits and how it is likely to perform in the future.

B is incorrect. While the business model can influence a company's stock price, it does not directly determine it. The stock price is determined by the market and is influenced by a variety of factors, including the company's financial performance, the economic environment, and investor sentiment. Therefore, while understanding the business model can help an analyst make informed predictions about a company's future financial performance, it does not directly determine the stock price.

C is incorrect. The business model does not directly determine a company's market share. Market share is determined by the company's sales relative to the total sales in its industry. While the business model can influence a company's ability to generate sales, it is not the only factor that determines market share. Other factors, such as the company's marketing strategy, product quality, and customer service, can also play a significant role.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company’s business model.

Q.4248 A business model describes a company's operations and includes several elements. Analysts investigate these elements by answering key questions. What is most likely the nature of these key questions? They are:

A. company-specific.

B. industry-specific.

C. common across industries and companies.

The correct answer is **C.**

The nature of the key questions that analysts investigate when examining a company's business model is that they are common across industries and companies. These questions typically revolve around understanding the company's value proposition, its target customer segment, its key resources and activities, its cost structure, and its revenue streams, among other things. These are fundamental aspects of any business, regardless of the industry or the specific company.

By asking these questions, analysts can gain a comprehensive understanding of how a company operates, how it creates value, and how it generates profits. This information is crucial for making informed investment decisions. While the specific details of a company's business model may vary depending on the industry and the company, the underlying questions that need to be answered remain the same.

A is incorrect. While it is true that some aspects of a company's business model may be unique to that company, the key questions that analysts need to answer when investigating a business model are not company-specific. They are applicable to any company, regardless of its size, industry, or geographical location.

B is incorrect. Although certain elements of a business model may be influenced by industry-specific factors, the key questions that analysts need to answer are not industry-specific. They are relevant to any company in any industry. Understanding the industry context can certainly help in answering these questions, but it does not change the nature of the questions themselves.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company’s business model.

Q.4249 "Analysts often focus their analysis on the differences in a company's business model from a conventional model or those of its competitors". What does this *most likely* imply?

A. Analysts are interested in the uniqueness of a company's business model.

B. Analysts are interested in the similarities between business models.

C. Analysts are interested in the complexity of a company's business model.

The correct answer is **A.**

When analysts focus their analysis on the differences in a company's business model from a conventional model or those of its competitors, it implies that they are interested in the uniqueness of a company's business model. A unique business model can provide a company with a competitive advantage, which can lead to superior financial performance. Analysts are interested in understanding how a company creates, delivers, and captures value and how these processes differ from those of other companies.

By focusing on the differences, analysts can identify unique strategies, resources, or capabilities that may contribute to a company's competitive advantage. This can help them make more accurate predictions about the company's future performance and make better investment decisions. Therefore, the uniqueness of a business model is a key area of focus for analysts.

B is incorrect. While analysts may also be interested in the similarities between business models, this is not what is implied by the focus on differences. Similarities can provide useful benchmarks for comparison, but they do not provide insights into a company's unique strategies or competitive advantages. Therefore, while similarities are important, they are not the primary focus of analysis.

C is incorrect. The complexity of a company's business model is not necessarily a focus of analysis. While a complex business model may require more detailed analysis, it does not necessarily provide a competitive advantage. In fact, a complex business model can sometimes be a disadvantage, as it may be more difficult to implement and manage. Therefore, complexity is not the primary focus of analysis.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company’s business model.

Q.4250 Analysts use various information sources to answer key questions about a company's business model. Which of the following is *most likely* an example of an issuer source of information?

A. Free industry white papers or analyst reports from a consultancy.

B. Reports and data from platforms such as Bloomberg and FactSet.

C. Quarterly or semi-annual earnings conference calls.

The correct answer is **C.**

Issuer sources are those that originate directly from the company or entity being analyzed. These sources include financial statements, press releases, annual reports, and conference calls. Quarterly or semi-annual earnings conference calls are an example of an issuer source. During these calls, company executives discuss the company's financial performance, business strategy, and future outlook.

Analysts can gain valuable insights from these calls, which can help them understand the company's business model and make informed investment decisions. The information provided during these calls is considered to be reliable as it comes directly from the company's management. However, analysts should also consider other sources of information to get a comprehensive view of the company's performance and prospects.

A is incorrect. Free industry white papers or analyst reports from a consultancy are examples of public third-party sources. These sources provide information about the industry or market in which the company operates, but they do not originate from the company itself.

B is incorrect. Reports and data from platforms such as Bloomberg and FactSet are examples of proprietary third-party sources. These platforms provide a wide range of financial data and analysis, but again, this information does not originate from the company being analyzed.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company's business model.

Q.4251 Which of the following is *most likely* an example of an issuer source of information about a company's business model?

A. Company website.

B. General news outlets.

C. Surveys, conversations, and product comparisons.

The correct answer is **A.**

A company's website or properties that an analyst may be able to visit as either a customer or an investor is a public third-party source that analysts use to determine a company's business model. Company websites often provide a wealth of information about a company's business model, including its products and services, target market, competitive advantages, and strategies for growth.

In addition, visiting a company's properties can provide valuable insights into its operations, customer base, and market positioning. For example, an analyst might visit a retailer's stores to observe customer traffic, product selection, pricing strategies, and service quality. These observations can help the analyst understand the company's business model and assess its potential for success.

B is incorrect. General news outlets are not considered a direct source of information. While they can provide useful information about a company's activities and performance, they do not typically provide detailed insights into a company's business model. They often focus on recent events and developments rather than the underlying business model that drives a company's long-term performance. They are considered public third-party sources.

C is incorrect. Surveys, conversations, product comparisons, and other studies commissioned by the analyst or conducted directly are classified as proprietary primary research. These are primary research methods that analysts use to gather information directly from the company, its customers, competitors, or other stakeholders.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company’s business model.

Q.4252 Analysts in an institutional investment setting are often able to conduct initial research quickly. What is *most likely* the reason for this?

A. They have access to proprietary third-party sources, industry knowledge and experience, and prior analyses of the company

B. They have a large team of analysts working toget

C. They have access to advanced technology and software.

The correct answer is **A.**

Analysts in an institutional investment setting are often able to conduct initial research quickly because they have broad access to a variety of proprietary third-party sources, industry knowledge and experience, prior analyses of the company or industry, and access to the issuer investor relations personnel and management. These resources provide a wealth of information that can be used to quickly assess a company or industry.

Proprietary third-party sources can provide detailed data and analysis that may not be readily available to the public. Industry knowledge and experience can help analysts quickly understand the context and implications of new information. Prior analyses can provide a baseline for comparison and a framework for understanding new data. Access to issuer investor relations personnel and management can provide insights into the company’s strategy and outlook that may not be apparent from public information.

B is incorrect. While having a large team of analysts can certainly help in conducting research quickly, it is not the primary reason. A large team without access to the right resources or without the necessary industry knowledge and experience may not be able to conduct research effectively or efficiently.

C is incorrect. Access to advanced technology and software can certainly aid in the research process, but it is not the primary reason why analysts in an institutional investment setting are able to conduct initial research quickly. Technology and software are tools that can help analysts process and analyze data more efficiently, but they are not a substitute for the knowledge, experience, and resources mentioned in Choice A.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company’s business model.

Q.4253 Which of the following is *most likely* the primary purpose of determining a company's business model in the context of industry and company analysis?

A. Predict the company's future stock price.

B. Summarize the key drivers of a company's financial results and position.

C. Determine the company's market share.

The correct answer is **B.**

The primary purpose of determining a company's business model in the context of industry and company analysis is to summarize the key drivers of a company's financial results and position. Understanding a company's business model is crucial for analysts as it provides a clear picture of how the company generates its revenue, what its cost structures are, and how it creates value for its shareholders.

The business model outlines the company's strategic approach to achieving its financial objectives and provides insights into its competitive positioning within the industry. It helps analysts to understand the company's operational efficiency, profitability, and growth potential. By identifying the key drivers of a company's financial results, analysts can make more accurate forecasts and provide more reliable investment recommendations.

A is incorrect. While predicting the company's future stock price is an important aspect of financial analysis, it is not the primary purpose of determining a company's business model. The business model provides insights into the company's operations and financial performance, which can be used to estimate its future earnings and cash flows. However, the stock price is influenced by a variety of factors, including market sentiment, economic conditions, and investor expectations, which are not directly related to the business model.

C is incorrect. Determining a company's market share is an important part of industry analysis, but it is not the primary purpose of understanding the company's business model. The business model provides insights into how the company competes in the market and generates revenue, but it does not directly determine the company's market share. Market share is determined by comparing the company's sales to the total sales of the industry.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company's business model.

Q.4254 Which of the following is *most likely* the role of proprietary primary research in determining a company's business model? It provides:

A. information about the company's competitors.

B. information about the company's stock price.

C. information through surveys, conversations, product comparisons, and other commissioned studies

The correct answer is **C.**

Proprietary primary research plays a crucial role in determining a company's business model as it provides information through surveys, conversations, product comparisons, and other studies commissioned by the analyst or conducted directly. This type of research is unique and exclusive to the analyst or the firm conducting it, providing them with a competitive edge.

It allows analysts to gain a deep understanding of the company's operations, its products or services, its competitive positioning, and its market environment. This information is vital in assessing the company's business model and its sustainability. Proprietary primary research can reveal insights that are not available through secondary sources or public information, thereby enabling more accurate and informed investment decisions.

A is incorrect. While proprietary primary research can provide information about a company's competitors, this is not its primary role in determining a company's business model. Understanding the competitive landscape is just one aspect of the overall analysis of a company's business model.

B is incorrect. Proprietary primary research does not directly provide information about a company's stock price. While the insights gained from this research can influence an analyst's view on the company's valuation and hence its stock price, the research itself does not provide information about the stock price. The stock price is determined by the market and reflects the collective views of all market participants, not just the views of a single analyst or firm.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company's business model.

Q.4255 Which of the following is *most likely* the significance of proprietary third-party sources of informaton in determining a company’s business model? They provide information:

A. about the company’s internal operations.

B. through analyst reports and communications, including from “sell-side” or “Wall Street” analysts and credit rating agencies.

C. about the company’s market share.

The correct answer is **B.**

Proprietary third-party sources are significant in determining a company’s business model because they provide information through analyst reports and communications, including from “sell-side” or “Wall Street” analysts and credit rating agencies. These sources offer valuable insights into a company’s financial health, competitive position, and future prospects. Analyst reports often include a detailed analysis of a company’s business model, including its revenue streams, cost structure, and key value drivers.

They also provide forecasts of future financial performance and recommendations on whether to buy, hold, or sell the company’s stock. Credit rating agencies assess a company’s creditworthiness, which can provide insights into its financial stability and risk of default. These sources can therefore play a crucial role in helping investors, lenders, and other stakeholders understand a company’s business model and make informed decisions.

A is incorrect. Proprietary third-party sources do not typically provide information about a company’s internal operations. This type of information is usually confidential and not publicly available. It is typically obtained through internal company reports, management discussions, and other internal sources.

C is incorrect. While proprietary third-party sources may provide some information about a company’s market share, this is not their primary function or significance in determining a company’s business model. Market share information is typically obtained through market research reports, industry publications, and other sources that specialize in market data.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company’s business model.

Q.4256 When analyzing a company’s financial position and historical results, the first step is to understand the business model. This understanding forms the foundation for forecasting a financial statement model that aids in security valuation. Which of the following is *most likely* the primary focus of this analysis?

A. Revenues.

B. Expenses.

C. Balance sheet analysis.

The correct answer is **A.**

The primary focus of the analysis when forecasting a financial statement model for security valuation is usually the company’s revenues. Understanding the company’s revenue streams is crucial as it provides insight into the company’s business model, its market position, and its potential for growth. Revenue is the top line of the income statement and is often considered the most important financial metric for a company.

It reflects the total amount of money a company generates from its operations before any expenses are deducted. A thorough analysis of a company’s revenues can provide valuable information about its business operations, competitive position, and potential for future growth. It can also help identify trends and patterns that may not be immediately apparent from a cursory review of the financial statements.

B is incorrect. While the company’s expenses are an important aspect of financial analysis, they are not usually the primary focus when forecasting a financial statement model for security valuation. Expenses are deducted from revenues to calculate net income, which is a measure of profitability. However, without a thorough understanding of the company’s revenues, it would be difficult to accurately forecast expenses and, consequently, net income.

C is incorrect. The company’s balance sheet provides a snapshot of the company’s financial position at a specific point in time, including its assets, liabilities, and shareholders’ equity. While it is an important part of financial analysis, it is not usually the primary focus when forecasting a financial statement model for security valuation. The balance sheet does not provide information about the company’s revenues or expenses, which are crucial for forecasting future financial performance.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (c): Evaluate a company’s revenue and revenue drivers, including pricing power.

Q.4257 Which of the following approaches of determining revenue drivers *most likely* breaks down revenues into drivers such as sales volume and price or revenues by product line, segment, or geography?

A. Bottom-up approach.

B. Top-down approach.

C. Both bottom-up and top-down approach

The correct answer is **A.**

The Bottom-Up approach involves breaking down revenues into drivers such as sales volume and price or revenues by product line, segment, or geography. This approach starts with the smallest base elements and then builds up to the larger aggregate data. It is a detailed and granular approach that allows for a more precise and accurate analysis of revenue drivers.

It is often used in financial analysis, budgeting, and forecasting because it provides a more detailed understanding of the underlying factors that drive revenue. It allows analysts to identify specific areas of strength or weakness in a company's revenue generation and provides a basis for making strategic decisions to improve performance.

B is incorrect. The Top-Down approach starts with the aggregate data and then breaks it down into smaller components. While it can provide a broad overview of revenue trends, it does not provide the same level of detail as the Bottom-Up approach. The Top-Down approach is more suitable for macroeconomic analysis or for understanding the overall market or industry trends rather than the specific drivers of a company's revenue.

C is incorrect. This level of detail is specific to the Bottom-Up approach. The Top-Down approach starts with the total market or industry and then breaks it down into segments or individual companies. Therefore, it does not provide the same level of detail on the specific drivers of a company's revenue.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (c): Evaluate a company's revenue and revenue drivers, including pricing power.

Q.4258 Which of the following statements *most likely* correctly defines pricing power?

A. A company's ability to set prices and other economic terms without affecting its sales volumes

B. A company's ability to increase its market share

C. A company's ability to increase its sales volume

The correct answer is **A.**

Pricing power refers to a company's ability to set prices and other economic terms with customers without affecting its sales volumes. This is a crucial aspect of a company's competitive advantage and profitability. Companies with strong pricing power can increase prices without losing customers, which can lead to higher profit margins.

Pricing power is often a result of strong brand recognition, product differentiation, or a lack of competition. It is a key factor to consider in a top-down approach to revenue forecasting, as it can significantly impact a company's revenue growth. A company with strong pricing power can maintain or increase its revenues even in a challenging economic environment, making it a potentially attractive investment.

B is incorrect. While a company's ability to increase its market share can contribute to its revenue growth, it is not what is referred to as pricing power. Market share refers to the percentage of an industry's total sales that is earned by a particular company over a specified time period. A company can increase its market share by outperforming its competitors or by expanding into new markets, but this does not necessarily mean it has strong pricing power.

C is incorrect. A company's ability to increase its sales volume can also contribute to its revenue growth, but it is not what is referred to as pricing power. Sales volume refers to the number of units of a product or service that a company sells. A company can increase its sales volume by attracting new customers or by selling more to existing customers, but this does not necessarily mean it has strong pricing power.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (c): Evaluate a company's revenue and revenue drivers, including pricing power.

Q.4259 Analysts evaluate pricing power not just by examining a firm's prices over time or relative to competitors but also by comparing a firm's prices with its costs. Which of the following is most likely an important sign of pricing power?

A. Rising profitability over time.

B. Decreasing profitability over time.

C. Stable profitability over time.

The correct answer is **A.**

Rising profitability over time is an important sign of pricing power. Pricing power refers to a company's ability to raise prices without losing customers to competitors. Firms with strong pricing power can increase prices over time, leading to higher profit margins and thus, rising profitability. This is because these firms have unique products, strong brand recognition, or high customer switching costs that make their customers less sensitive to price increases.

B is incorrect. Decreasing profitability over time is not a sign of pricing power. On the contrary, it suggests that a firm is unable to pass on cost increases to its customers, which indicates a lack of pricing power. This could be due to intense competition, commoditization of the firm's products, or price sensitivity of the firm's customers.

C is incorrect. Stable profitability over time does not necessarily indicate pricing power. While it suggests that a firm is able to maintain its profit margins, it does not show whether the firm has the ability to increase prices and improve its profitability. A firm with pricing power should be able to increase its profitability over time, not just maintain it.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (c): Evaluate a company's revenue and revenue drivers, including pricing power.

Q.4260 Which of the following options *most likely* includes revenue drivers of a company?

A. Market size, product line, and pricing power.

B. Market size, expenses, and pricing power.

C. Market size, profit margins, and a company’s share of that market.

The correct answer is **A.**

Revenue drivers are indeed factors that have a significant impact on a company’s revenue. Using the bottom-up approach, these include sales volume and price or revenues by product line, segment, or geography.

Using the top-down approach, these include market share, the addressable market or market size, and GDP growth. Understanding these drivers is crucial for investors, as it can help them predict future revenue trends and make informed investment decisions.

B is incorrect. While market size and pricing power are indeed important revenue drivers, expenses are not a revenue driver. Expenses are costs incurred by a company in the process of generating revenue.

C is incorrect. Though the market size and a company’s share of the market are considered revenue drivers, profit margin is not a revenue driver. Profit margin is a financial metric that measures a company’s profitability and is calculated as a percentage of a company’s net profit relative to its total revenue. It is an indicator of how efficiently a company is able to convert its sales into profits.

CFA Level I, Equity, Learning Module 5: Company Analysis: Past and Present. LOS (c): Evaluate a company’s revenue and revenue drivers, including pricing power.

Q.4261 Which of the following *most likely* defines what top-down approach to revenue analysis?

A. Looking at the overall market size, sales volume, and price.

B. Looking at the overall market size and the company's share of that market.

C. Looking at the company's share of that market and product line revenue.

The correct answer is **B.**

The top-down approach to analyzing revenue involves looking at the overall market size and the company's share of that market. This approach starts with a broad view of the entire market or industry and then narrows down to the specific company. It involves understanding the total market size, the company's position within that market, and the company's market share.

A is incorrect. Though looking at the overall market size is an aspect of top top-down approach, the use of sales volume and price is not part of the top-down approach. Decomposing revenue into sales volume and price is an aspect of the bottom-up approach.

C is incorrect. Looking at the company's share of the market is an aspect of top-down approach. However, examining the product line revenue is a bottom-up approach activity.

CFA Level I, Equity, Learning Module 5: Company Analysis: Past and Present. LOS (c): Evaluate a company's revenue and revenue drivers, including pricing power.

Q.4262 Which of the following *most likely* describes company's operating costs?

A. Expenses related to the acquisition and production of long-term assets.

B. Payments to debt and equity investors as a return on their investment

C. Expenses related to the generation of current period revenue.

The correct answer is **C.**

Operating costs, also known as operating expenses, are the costs that a company incurs as a result of day-to-day business operations. They are the expenses related to the generation of current period revenue. These costs include rent, utilities, salaries, raw materials, and other expenses that are directly tied to the production and delivery of goods and services.

Operating costs are typically recurring and are necessary for the company to conduct its business. They are deducted from a company’s gross income to determine its operating income, which is a measure of profitability before interest and taxes. Understanding operating costs is crucial for managers, investors, and creditors as it helps them assess the company’s efficiency and profitability.

A is incorrect. Expenses related to the acquisition and production of long-term assets are not operating costs. These are capital expenditures, which are used to acquire, upgrade, and maintain physical assets such as property, buildings, and equipment. Capital expenditures are not considered operating costs because they are not tied to the company’s day-to-day operations and are not recurring in nature.

B is incorrect. Payments to debt and equity investors as a return on their investment are not operating costs. These are financial costs, specifically interest expenses and dividends, which are related to the company’s financing activities. While these costs are important for a company’s financial health, they are not directly tied to the production and delivery of goods and services and are, therefore, not considered operating costs.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (d): Evaluate a company’s operating profitability and working capital using key measures.

Q.4263 Which of the following is *most likely* an example of a variable cost?

A. Insurance costs.

B. Depreciation and amortization.

C. Materials and direct labor costs for a manufacturer.

The correct answer is **C.**

Materials and direct labor costs for a manufacturer are examples of variable costs. Variable costs are those costs that change in direct proportion to the volume of output. In other words, when production increases, variable costs increase, and when production decreases, variable costs decrease. For a manufacturer, the cost of materials and direct labor are directly tied to the number of units produced. If more units are produced, more materials and labor are needed, and thus the cost increases.

A is incorrect. Insurance costs are also an example of fixed costs. These costs are typically set for a certain period (e.g., annually) and do not change with the level of production or sales. Therefore, they are not variable costs.

B is incorrect. Depreciation and amortization are examples of fixed costs, not variable costs. These costs are incurred regardless of the level of production or sales. Depreciation is the systematic allocation of the cost of a tangible asset over its useful life, while amortization is the systematic allocation of the cost of an intangible asset over its useful life. They do not change with the level of output or sales and thus are considered fixed costs.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (d): Evaluate a company's operating profitability and working capital using key measures.

Q.4264 Which of the following will *most likely* increase the degree of operating leverage (DOL) of a company?

A. increasing both the fixed and variable costs in its cost base.

B. increasing the fixed costs and decreasing the variable costs in its cost base.

C. decreasing the fixed costs and increasing the variable costs in its cost base.

The correct answer is **B.**

A firm can increase its Degree of Operating Leverage (DOL) by increasing the fixed costs and decreasing the variable costs in its cost base. The DOL is a measure of how a percentage change in sales volume will affect operating profit. It is calculated as the percentage change in operating profit divided by the percentage change in sales. Firms with a high DOL have a high proportion of fixed costs in their cost structure.

A is incorrect. Increasing both the fixed and variable costs in its cost base would not necessarily increase a firm's DOL. The impact on DOL would depend on the relative changes in fixed and variable costs. If the increase in fixed costs is greater than the increase in variable costs, the DOL could increase. However, if the increase in variable costs is greater than the increase in fixed costs, the DOL could decrease.

C is incorrect. Decreasing the fixed costs and increasing the variable costs in its cost base would actually decrease a firm's DOL. This is because a lower proportion of fixed costs would mean that a smaller portion of each additional dollar of sales contributes to operating profit.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (d): Evaluate a company's operating profitability and working capital using key measures.

Q.4265 Which of the following statements is *most likely* true regarding operating costs?

A. A significant amount of the cost of sales is fixed.

B. Depreciation and amortization expenses are variable.

C. Most operating expenses, such as sales and marketing, general and administrative are variable.

The correct answer is **A.**

A significant amount of the cost of sales is indeed fixed. Cost of sales or cost of goods sold (COGS), is the direct costs attributable to the production of the goods sold by a company. This amount includes the cost of the materials and labor directly used to create the goods. It excludes indirect expenses such as distribution costs and sales force costs.

B is incorrect. Depreciation and amortization expenses are not variable; they are fixed costs. Depreciation is the systematic allocation of the cost of a tangible asset over its useful life, and amortization is a similar process for intangible assets. These costs are determined at the time of acquisition of the asset and do not change with the level of production or sales.

C is incorrect. It is not accurate to say that most operating expenses, such as sales and marketing, general and administrative, and research and development costs, are variable. While some of these costs may vary with the level of sales (for example, sales commissions), many are fixed or semi-fixed in nature. For example, salaries for administrative staff, rent for office space, and research and development costs are typically incurred regardless of the level of sales.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (d): Evaluate a company's operating profitability and working capital using key measures.

Q.4266 Which of the following *most likely* describe the economies of scale?

A. A decline in costs per unit as output grows.

B. An increase in costs per unit as output grows.

C. A decline in costs per unit as the number of business lines increases.

The correct answer is **A.**

Economies of scale refer to the decline in costs per unit as output grows. This concept is based on the principle that as a company increases its production volume, the cost of producing each unit decreases. This is due to the fact that fixed costs, such as rent, salaries, and equipment, are spread over a larger number of units.

As a company grows, it can often negotiate better terms with suppliers, further reducing the cost per unit. Economies of scale can provide a significant competitive advantage, as they allow a company to produce goods or services at a lower cost than its competitors. This can lead to higher profit margins or the ability to offer lower prices to consumers, both of which can contribute to increased market share.

B is incorrect. An increase in costs per unit as output grows is the opposite of economies of scale. This situation, known as diseconomies of scale, can occur when a company grows too large and becomes inefficient, leading to increased per-unit costs. This can be due to factors such as increased complexity, communication difficulties, or bureaucratic inefficiencies.

C is incorrect. The decline in costs per unit as the number of products or business lines increases is referred to as economies of scope, not economies of scale. Economies of scope occur when a company can produce a variety of products more cheaply than if each product were produced individually. This is often due to shared resources or capabilities, such as a common distribution network or brand recognition.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (d): Evaluate a company's operating profitability and working capital using key measures.

Q.4267 Which of the following is *least likely* a method used by independent investment analysts to determine whether there have been improvements or declines in the value creation of a company?

A. Aggregated measures.

B. Company's internal reports.

C. Investors' required rates of return.

The correct answer is **C.**

Investors' required rates of return is not a method used by independent investment analysts to determine whether there have been improvements or declines in value creation. The required rate of return is a concept that represents the minimum return that an investor expects to achieve by investing in a particular asset. It is not a method of evaluating a company's capital investments or assessing the effectiveness of management in utilizing investors' capital.

A is incorrect. Aggregated measures are indeed used by independent investment analysts to determine whether there have been improvements or declines in value creation. These measures, which include ratios such as return on invested capital (ROIC) and economic value added (EVA), provide a comprehensive view of a company's performance by taking into account various factors such as profitability, efficiency, and risk.

B is incorrect. Company's internal reports are also used by analysts to assess a company's performance and value creation. These reports provide detailed information about a company's operations, financial condition, and strategic initiatives, which can be used to evaluate the effectiveness of management in utilizing investors' capital.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (b): Determine a company's business model.

Q.4268 Which of the following *most likely* indicates a high net working capital to sales ratio?

A. The company's current liabilities exceed its current assets.

B. The company is efficiently using its working capital to generate sales.

C. The company is not efficiently using its working capital to generate sales.

The correct answer is **C.**

A high net working capital to sales ratio indicates that the company is not efficiently using its working capital to generate sales. Net working capital is calculated as:

$$\begin{aligned}\text{Net Working Capital} = &(\text{Current assets, excluding cash and marketable securities}) - \\ &(\text{Current liabilities, excluding short-term and current debt})\end{aligned}$$

A high ratio suggests that a large proportion of a company's assets are tied up in working capital, which may not be generating sales or profits. This could be due to excessive inventory, slow collection of receivables, or insufficient payables.

A is incorrect. The net working capital to sales ratio does not directly indicate whether a company's current liabilities exceed its current assets. A company could have a high ratio because it has a large amount of current assets relative to its sales, not because its current liabilities exceed its current assets. If a company's current liabilities did exceed its current assets, it would have negative net working capital, but this would not necessarily result in a high net working capital to sales ratio.

B is incorrect. A low net working capital to sales ratio, not a high one, would indicate that the company is efficiently using its working capital to generate sales. A low ratio suggests that the company is able to generate a high volume of sales with a relatively small amount of working capital, which is generally seen as a sign of efficiency.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (d): Evaluate a company's operating profitability and working capital using key measures.

Q.4269 The risks associated with a company's capital structure can be measured using various methods. Which of the following is *least likely* a method used to assess these risks?

A. Company's market share.

B. Leverage and coverage ratios.

C. Credit ratings by third-party rating agencies

The correct answer is **A.**

The company's market share is not a method used to assess the risks associated with a company's capital structure. Capital structure risk refers to the risk associated with a company's mix of debt and equity financing. It is typically assessed using leverage and coverage ratios, which measure the company's ability to meet its debt obligations, and credit ratings, which provide an independent assessment of the company's creditworthiness.

B is incorrect. Leverage and coverage ratios are indeed used to assess the risks associated with a company's capital structure. Leverage ratios measure the proportion of debt in a company's capital structure, while coverage ratios measure the company's ability to meet its debt service obligations. High leverage and low coverage ratios indicate a higher level of capital structure risk.

C is incorrect. Credit ratings by third-party rating agencies are also used to assess capital structure risk. These ratings provide an independent assessment of a company's creditworthiness, taking into account factors such as its capital structure, financial performance, and industry conditions. Lower credit ratings indicate a higher level of capital structure risk.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (e): Evaluate a company's capital investments and capital structure.

Q.4270 Which of the following will *most likely* be consistent with an increase in the degree of financial leverage?

A. Higher interest expenses that are fixed with respect to operating income.

B. Lower interest expenses that are fixed with respect to operating income.

C. Higher interest expenses that are variable with respect to operating income.

The correct answer is **A.**

The degree of financial leverage increases with higher interest expenses that are fixed with respect to operating income. Financial leverage is a measure of how a company's operations are financed with debt versus equity. It is a measure of risk, as companies with higher leverage are more vulnerable to economic downturns due to the higher fixed costs of interest payments.

When a company has high fixed interest expenses, a change in operating income will have a larger impact on net income because the interest expenses do not change with operating income. This means that a small change in operating income can lead to a large change in net income, increasing the degree of financial leverage.

B is incorrect. Lower interest expenses that are fixed with respect to operating income would decrease the degree of financial leverage, not increase it. This is because lower fixed-interest expenses would mean that a change in operating income would have a smaller impact on net income, reducing the degree of financial leverage.

C is incorrect. Higher interest expenses that are variable with respect to operating income would not necessarily increase the degree of financial leverage. This is because variable interest expenses change with operating income, so a change in operating income would not necessarily lead to a large change in net income. Therefore, the degree of financial leverage would not necessarily be higher when the interest expenses that are variable with respect to operating income are higher.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (e): Evaluate a company's capital investments and capital structure.

Q.4271 Which of the following is *most likely* a measure of levered returns?

A. Return on equity (ROE).

B. Return on assets (ROA).

C. Return on Invested Capital (ROIC).

The correct answer is **A.**

Return on Equity (ROE) is a measure of levered returns. ROE is a financial ratio that measures the profitability of a firm in relation to the equity. It is calculated by dividing net income by shareholder's equity. The reason why ROE is a measure of levered returns is because it takes into account the financial leverage of a company.

Levered returns, often referred to as leveraged returns, are a measure of an investor's total return on an investment that involves the use of leverage or borrowed funds. Leveraged returns take into account not only the return on the investor's own capital but also the impact of borrowed funds on the overall return.

B is incorrect. Return on assets (ROA) is also not a measure of levered returns. ROA measures the profitability of a company in relation to its total assets. It is calculated by dividing net income by total assets. Like ROIC, ROA does not take into account the financial leverage of a company, and therefore, it is not a measure of levered returns.

C is incorrect. Return on Invested Capital (ROIC) is not a measure of levered returns. ROIC measures how effectively a company uses its capital to generate profits. It is calculated by dividing the net operating profit after taxes by the total invested capital. ROIC does not take into account the financial leverage of a company, and therefore, it is not a measure of levered returns.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (e): Evaluate a company's capital investments and capital structure.

Q.4272 Which of the following is *most likely* the main difference/similarity between the degree of financial leverage and the degree of operating leverage?

A. DFL and DOL are primarily determined by the company's financing costs.

B. DFL is more concerned with the variability of cash flows, while DOL with the variability of sales.

C. DFL is determined by financing costs, while DOL is determined by fixed operating cost

The correct answer is **C.**

The degree of financial leverage is determined by financing costs, while the degree of operating leverage is determined by fixed operating costs. Financial leverage refers to the use of debt to acquire additional assets. On the other hand, operating leverage refers to the proportion of fixed costs in a company's cost structure. The degree of operating leverage is a measure of how much operating income will change with a change in sales, due to changes in fixed costs.

A is incorrect. The operating profit margin is a measure of a company's profitability from its core business operations, before taking into account interest and taxes. Like the gross margin, it is not directly comparable to levered returns, which take into account the effect of financial leverage. Therefore, it is not correct to say that a company's levered returns can be significantly higher than its operating margin.

B is incorrect. The degree of financial leverage reflects the risk associated with the company's financing decisions, while the degree of operating leverage reflects the risk associated with the company's operating decisions.

CFA Level I, Topic 6 - Equity, Learning Module 5: Company Analysis: Past and Present. LOS (e): Evaluate a company's capital investments and capital structure.
