Question #1 of 33

Question ID: 1573974

With which of the following types of equity shares does the investor typically have the greatest voting power?

A) Common shares. ✓

B) Participating preference shares. ✗

C) Unsponsored depository receipts. ✗

Explanation

While common shares have voting rights, preference shares typically do not. With unsponsored depository receipts, the depository bank retains the right to vote the shares.

(Module 44.1, LOS 44.b)

Question #2 of 33

Question ID: 1573996

The book value of equity is equal to a firm's assets:

A) plus its accumulated other comprehensive income. ✗

B) plus its retained earnings. ✗

C) minus its liabilities. ✓

Explanation

The book value of equity is the balance sheet value of a firm's assets minus its liabilities.

(Module 44.2, LOS 44.g)

Question #3 of 33

Question ID: 1573983

A basket of listed depository receipts (BLDR) is *best* described as a(n):

A) exchange traded fund of depository receipts. ✓

B) index of global depository receipts that trade on a specific exchange. ✗

C) special purpose vehicle for issuing depository receipts in multiple countries.

Explanation

A basket of listed depository receipts (BLDR) is an exchange traded fund that represents a portfolio of depository receipts.

(Module 44.2, LOS 44.d)

Question #4 of 33

Question ID: 1573972

Which of the following is *least accurate* regarding a firm's common shareholders?

A) Typically, they can vote for the board of directors and on other important corporate matters.

B) They have an interest in the profitability and growth of the firm.

C) They have a claim against the assets of the corporation before liabilities are paid.

Explanation

Shareholders have a residual interest in the corporation in that they have a claim to the net assets of the corporation after all liabilities have been settled. They have an interest in the profitability and growth of the firm. Common shares typically have voting rights.

(Module 44.1, LOS 44.a)

Question #5 of 33

Question ID: 1573985

Preference shares will have the *most* risk for the investor if the shares are:

A) callable and cumulative.

B) callable and non-cumulative.

C) non-callable and non-cumulative.

Explanation

Preference shares (preferred stock) has more risk for the investor if they are non-cumulative than if they are cumulative, because with cumulative preference shares the firm must pay the holder any omitted dividends before it can pay any dividends to common shareholders. Callable shares have more risk for the investor than non-callable shares because the call option limits their potential for price appreciation.

(Module 44.2, LOS 44.e)

Question #6 of 33

Question ID: 1573982

Global depository receipts are *most likely* issued:

A) in the United States and denominated in U.S. dollars.

B) outside the issuer's home country and denominated in the exchange's home currency.

C) outside the issuer's home country and denominated in U.S. dollars.

Explanation

Global depository receipts are issued outside the U.S. and the issuer's home country and are most often denominated in U.S. dollars. Depository receipts issued in the United States and denominated in U.S. dollars are called American depository receipts. Global registered shares are denominated in the home currencies of the exchanges on which they trade.

(Module 44.2, LOS 44.d)

Question #7 of 33

Question ID: 1573977

Compared to a publicly traded firm, a private equity firm is *most likely* to:

A) disclose less financial information.

B) exhibit stronger corporate governance.

C) be more concerned with short-term results.

Explanation

Private equity firms are not held to the same financial reporting requirements as publicly traded firms. Less public scrutiny and limited financial disclosure may lead to weaker corporate governance. However, with less pressure from public shareholders, a private equity firm is typically more able to focus on long-term performance.

(Module 44.1, LOS 44.c)

Question #8 of 33

Question ID: 1573978

Private equity securities *most likely*:

A) are illiquid and do not have quoted prices.

B) trade in over-the-counter dealer markets.

C) are issued to individual investors.

Explanation

Private equity securities are illiquid and do not trade in public securities markets. Holders of private equity must negotiate with other investors to sell the securities. Private equity securities are typically issued to qualified institutional investors.

(Module 44.1, LOS 44.c)

Question #9 of 33

Question ID: 1573991

The primary reason for a firm to issue equity securities is to:

A) acquire the assets necessary to carry out its operations.

B) improve its solvency ratios.

C) increase publicity for the firm’s products.

Explanation

While issuing equity securities can improve a company's solvency ratios and increase the firm's visibility with the public, the primary reason to issue equity is to raise the capital needed to acquire operating assets.

(Module 44.2, LOS 44.f)

Question #10 of 33

Question ID: 1573979

Hodges Fund provides mezzanine stage financing to private companies. In which type of private equity investing is Hodges Fund most likely involved?

A) Leveraged buyout.

B) Private investment in public equity.

C) Venture capital.

Explanation

Venture capital providers invest in firms that are early in their life cycles. Stages of venture capital financing include seed stage, early stage, and mezzanine financing. In a leveraged buyout, an investor purchases all of a public firm's equity, taking the firm private. In a private investment in public equity (PIPE), an investor purchases private equity issued by a public firm.

(Module 44.1, LOS 44.c)

Question #11 of 33

Question ID: 1573970

Participating preference shares *most likely*:

A) give the shareholder the right to sell the shares back to the firm at a specific price.

B) can be exchanged for common stock at a ratio determined at issuance.

C) receive extra dividends if firm profits exceed a predetermined threshold.

Explanation

Participating preference shares receive extra dividends if firm profits exceed a predetermined threshold. Convertible preference shares can be exchanged for common stock at a conversion ratio determined at issuance. Putable common shares give the shareholder the right to sell the shares back to the firm at a specific price.

(Module 44.1, LOS 44.a)

Question #12 of 33

Question ID: 1573969

Dividends on non-participating preference shares are typically:

A) a contractual obligation of the company.

B) a fixed percentage of par value.

C) lower than the dividends on common shares.

Explanation

Similar to the interest payments on a debt security, dividends on non-participating preference shares (preferred stock) are typically fixed. Unlike the interest payments on a debt security, the company is not contractually obligated to pay preferred dividends. Preferred dividends are typically higher than a firm's common dividends.

(Module 44.1, LOS 44.a)

Question #13 of 33

Question ID: 1573987

Other things equal, preference shares have the *most* risk for the investor when they are:

A) callable and non-cumulative.

B) putable and cumulative.

C) non-callable and non-cumulative.

Explanation

Callable shares have more risk than otherwise equivalent non-callable shares because the possibility of the shares being called limits their potential price gains. Putable shares have less risk than otherwise equivalent non-putable shares because the option to put the shares back to the issuer for a predetermined price effectively places a floor under their price. Cumulative preference shares have less risk than otherwise equivalent non-cumulative preference shares because any scheduled dividends the issuer misses are still owed to the preferred shareholder.

(Module 44.2, LOS 44.e)

Question #14 of 33

Question ID: 1573988

In a period when U.S. equity prices are increasing and the U.S. dollar is depreciating, which of the following investors in U.S. equities is *most likely* to earn the highest return in the investor's local currency?

A) Non-U.S. investor who does not reinvest dividends.

B) Non-U.S. investor who reinvests dividends.

C) U.S. investor who reinvests dividends.

Explanation

Sources of return on equity securities include price appreciation or depreciation, dividend income, and foreign exchange gains or losses for investors outside the country. In an increasing equity market, reinvesting dividends is likely to increase returns compared to not reinvesting dividends. If the currency is depreciating, investors from outside the country will experience foreign exchange losses that decrease their returns.

(Module 44.2, LOS 44.e)

Question #15 of 33

Question ID: 1573999

When analyzing an industry characterized by increasing book values of equity, return on equity for a period is *most* appropriately calculated based on:

A) average book value.

B) ending book value.

C) beginning book value.

Explanation

When book values are not stable, analysts should calculate ROE based on the average book value for the period. When book values are more stable, beginning book value is appropriate.

(Module 44.2, LOS 44.h)

Question #16 of 33

Question ID: 1573995

For a non-dividend paying firm, an increase in net income must increase:

A) book value of equity.

B) both book value and market value of equity.

C) market value of equity.

Explanation

Book value of equity is the company's assets minus its liabilities. For a non-dividend paying firm, positive net income will increase the book value of equity. An increase in book value of equity may or may not increase the market value of equity. An increase in net income that does not meet investors' prior expectations may decrease the market value of equity.

(Module 44.2, LOS 44.g)

Question #17 of 33

Question ID: 1573992

Equity securities are *least likely* issued to finance:

A) research and development.

B) inventories.

C) equipment.

Explanation

Equity securities are typically issued to finance a firm's long-lived assets, such as equipment, and long-term projects such as research and development.

(Module 44.2, LOS 44.f)

Question #18 of 33

Question ID: 1573993

Which of the following statements about the role of equities in financing a company's assets is *most accurate*?

A) Equity capital is typically used for the purchase of long-term assets and expansion into new areas.

B) Management can directly increase the market value of equity by increasing net income.

C) The book value and market value of equities is usually the same.

Explanation

Equity capital is used for the purchase of long-term assets, equipment, research and development and expansion into new businesses or geographic areas. Book value and market value of equities are almost always valued differently. Management can only indirectly affect the market value of equity.

(Module 44.2, LOS 44.f)

Question #19 of 33

Question ID: 1573989

Compared to preferred stock, common stock is *most likely* to:

A) exhibit a lower standard deviation of returns. ✗

B) pay more frequent dividends. ✗

C) provide a higher average return. ✓

Explanation

Common stock is more risky than preferred stock and is expected to provide higher average returns. Preferred stock promises fixed periodic dividends. Common stock can be dividend-paying or non-dividend paying and the dividends are at management's discretion.

(Module 44.2, LOS 44.e)

Question #20 of 33

Question ID: 1573971

Securities that can be sold back to the issuing firm at a specific price are *best* described as:

A) putable. ✓

B) convertible. ✗

C) callable. ✗

Explanation

Putable securities give the investor the right to sell the securities back to the firm at a predetermined price. Callable securities give the issuer the right to buy the securities back at a predetermined price. Convertible securities give the investor the right to exchange the securities for a predetermined number of the firm's common shares.

(Module 44.1, LOS 44.a)

Question #21 of 33

Question ID: 1573976

Two investors, Craig Tower and Erin Gray, own 100 shares each of the same company. Tower receives a quarterly dividend while Gray does not. This is *most likely* because Tower:

A) purchased his shares after Gray purchased her shares.

B) owns a different class of stock than Gray.

C) owns common shares while Gray owns preferred shares.

Explanation

Different classes of common stocks can have different features with respect to dividends, stock splits, voting power and seniority if the firm's assets are liquidated. If Gray owns preferred shares, she would be more likely to receive a dividend than Tower's common shares. If Gray had purchased shares before an ex-dividend date and Tower purchased the same class of shares after that ex-dividend date, Gray would receive a dividend that Tower did not.

(Module 44.1, LOS 44.b)

Question #22 of 33

Question ID: 1573990

Common equity share types ranked from least risky to most risky are:

A) callable, putable, option-free.

B) option-free, putable, callable.

C) putable, option-free, callable.

Explanation

Putable shares are the least risky because the investor can sell the shares back to the issuer at a predetermined price. Callable shares are the most risky because the issuer can buy the securities back at a predetermined price, which limits the upside for the investor.

(Module 44.2, LOS 44.e)

Question #23 of 33

Question ID: 1573973

Johnson Company shuts down and is liquidated. Bob Smith owns 100 common shares of Johnson, but has a lower priority of claims than Al Jones, who also owns 100 common shares. Smith *most likely* owns:

A) Class B shares.

B) non-cumulative shares.

C) non-participating shares.

Explanation

Some firms have different classes of common stock (e.g., Class A and Class B shares). These classes may be distinguished by factors such as voting rights and priority in the event of liquidation. Participating and non-participating, cumulative and non-cumulative refer to characteristics of preferred stock.

(Module 44.1, LOS 44.b)

Question #24 of 33

Question ID: 1573967

Two seats on a board of directors are to be elected. A voting system in which the owner of 100 shares may cast 100 votes in each of the board elections is a:

A) cumulative voting system.

B) proportional voting system.

C) statutory voting system.

Explanation

In a statutory voting system, a shareholder can vote in each separate board election based on the number of shares she owns. Under cumulative voting, the shareholder may choose to cast her total number of votes (200 in this example) for a candidate in one of the elections.

(Module 44.1, LOS 44.a)

Question #25 of 33

Question ID: 1573998

Which of the following changes would *most likely* cause a firm's return on equity to increase?

A) Net income decreases by 5% and average book value of equity decreases by 10%.

B) Net income increases by 5% and average book value of equity increases by 10%.

C) Net income increases by 5% and average book value of equity increases by 5%.

Explanation

Return on equity is net income divided by average book value of equity. If the book value of equity decreases relatively more than net income decreases, return on equity will increase. This illustrates that an increase in ROE is not necessarily positive for the firm. An analyst must examine the reasons for changes in ROE.

(Module 44.2, LOS 44.h)

Question #26 of 33

Question ID: 1573968

Requiring the firm to pay any scheduled dividends that have been missed, before paying any dividends to common equity holders, is a feature of:

A) all preference shares.

B) cumulative preference shares only.

C) participating preference shares only.

Explanation

Cumulative preference shares (cumulative preferred stock) must receive any dividends in arrears before the firm may pay any dividends to common shareholders. Not all preference shares are cumulative. Participating preference shares may receive extra dividends if the firm's profits are greater than a predetermined level.

(Module 44.1, LOS 44.a)

Question #27 of 33

Question ID: 1573975

Cheryl Brower and Todd Sutter each own 100 shares of Hills Company stock. In a recent proxy vote, Brower had 100 votes but Sutter had 10 votes. The *most likely* reason for this difference in voting rights is that:

A) Brower and Sutter own different classes of stock.

B) Brower is a director of Hills Company.

C) Hills Company uses a statutory voting method.

Explanation

Companies may issue classes of stock (e.g., Class A and Class B shares) that differ in aspects such as voting rights, dividends, or priority of claims in liquidation.

(Module 44.1, LOS 44.b)

Question #28 of 33

Question ID: 1573997

A firm's cost of equity capital is *least accurately* described as the:

A) expected total return on the firm's equity shares in equilibrium.

B) minimum rate of return investors require to invest in the firm's equity securities.

C) ratio of the firm's net income to its average book value.

Explanation

The ratio of the firm's net income to its average book value is the firm's return on equity, which can be greater than, equal to, or less than the firm's cost of equity. Cost of equity for a firm can be defined as the expected equilibrium total return in the market on its equity shares, or as minimum rate of return that investors require as compensation for the risk of the firm's equity securities.

(Module 44.2, LOS 44.h)

Question #29 of 33

Question ID: 1573994

The difference between a firm's balance sheet assets and liabilities is equal to the firm's:

A) market value of equity.

B) book value of equity.

C) intrinsic value of equity.

Explanation

Book value of equity is equal to balance sheet assets minus liabilities. Market value of equity is equal to shares outstanding times the share price. Intrinsic value of equity is typically estimated using one or more valuation models.

(Module 44.2, LOS 44.g)

Question #30 of 33

Question ID: 1573984

A U.S. investor purchases ADRs of a Japanese company, while a Japanese investor purchases the same value of the company's common stock. Compared to the Japanese investor, the U.S. investor will *most likely*:

A) face the same risk.

B) benefit from greater transparency.

C) realize different returns.

Explanation

The return to the U.S. investor is affected by the return on the shares in Japanese yen and by the dollar/yen exchange rate. The U.S. investor therefore faces additional currency risk, which will most likely result in returns that differ from those a Japanese investor would realize. ADRs do not necessarily offer greater transparency to foreign investors than that which is available to domestic investors.

(Module 44.2, LOS 44.d)

Question #31 of 33

Question ID: 1573986

Other things equal, which of the following types of stock has the *most* risk from the investor's perspective?

A) Putable common share.

B) Callable preferred share.

C) Callable common share.

Explanation

Callable shares have more risk than putable shares because the issuer can exercise the call option (which limits the investor's potential gains) while the investor can exercise the put option (which limits the investor's potential losses, assuming the firm is able to meet its obligation). Preferred shares have less risk for the investor than common shares because preferred shares have a higher priority claim on the firm's assets in the event of liquidation, and because preferred dividends typically must be paid before common dividends may be paid.

(Module 44.2, LOS 44.e)

Question #32 of 33

Question ID: 1573980

Private equity investment securities are issued:

A) only by private firms.

B) by both public and private firms.

C) by public firms but not by private firms.

Explanation

Private equity securities are not registered for public trading but may be issued by firms that have issued publicly traded common stock (public firms) as well as firms that do not have any publicly traded securities (private firms). A private investment in public equity (PIPE) is an example of private equity securities issued by a public company.

(Module 44.1, LOS 44.c)

Question #33 of 33

Question ID: 1573981

A security that represents an equity share in a foreign firm and for which the voting rights are retained by the depository bank, is a(n):

A) American depository share.

B) global registered share.

C) unsponsored depository receipt.

Explanation

In an unsponsored DR, the depository bank retains the voting rights of the equity shares of the foreign firm. In a sponsored DR, the investor in the DR has the voting rights. For an American depository receipt, an American depository share is the underlying security that trades in the issuing firm's domestic market. A global registered share is an equity security that trades in the local currencies on stock exchanges around the world.

(Module 44.2, LOS 44.d)