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QUESTION 1

Projecting a firm's net profit margin should include an analysis of:

- A. all of these answers
- B. the firm's relationship with its industry, which should indicate whether the company's past performance is attributable to its industry or if it is unique to the firm
- C. the firm's specific competitive strategy, either low cost or differentiation
- D. the firm's internal performance, including general company trends and consideration of any problems that might affect its future performance

Correct Answer: A

These three examinations help in understanding the firm's past performance and provide the background to make meaningful estimates for the future.

QUESTION 2

Consider the following information:

Borrowing Rate 10%

Marginal Tax Rate 40%

Preferred Stock Par Price \$100

Preferred Dividend \$10

Preferred Stock floatation cost 2.5%

Cost of common equity 12.0%

Preferred Stock issued at Par

The Optimal Capital Structure is 40% debt, 50% common equity, and 10% preferred stock. Credit Rating

BB+ What is the firm's Weighted Average Cost of Capital (WACC)?

- A. 12.62%
- B. 7.42%
- C. 9.0%
- D. 8.0%
- E. 2.5%
- F. 9.42%



Correct Answer: F

The firm's Weighted Average Cost of Capital (WACC) is a weighted average of the component cost of capital. In this case $10\%(\text{borrowing rate}) \times (1 - .4)\text{Tax savings} = 6\%$ is the component cost of debt. $\$10 (\text{preferred dividend}) / 97.5(\text{Par minus floatation cost}) = 10.25\%$ is the component cost of preferred stock. Thus the $\text{WACC} = .4(6\%) + .5(12\%) + .1(10.25\%) = 9.42\%$

QUESTION 3

A company is analyzing two mutually exclusive projects, S and L, whose cash flows are shown below: Years 0 1 2 3
S -1,100 1,000 350 50
L -1,100 0 300 1,500
The company's cost of capital is 12 percent, and it can get an unlimited amount of capital at that cost. What is the regular IRR (not MIRR) of the better project, i.e., the project which the company should choose if it wants to maximize its stock price?

- A. 12.00%
- B. 18.62%
- C. 20.46%
- D. 19.08%
- E. 15.53%

Correct Answer: D

Because the two projects are mutually exclusive, the project with the higher positive NPV is the "better" project.

S -1,100 1,000 350 50

NPV(S) = \$107.46

IRR(S) = 20.46%

L -1,100 0 300 1,500

NPV(L) = \$206.83

IRR(L) = 19.08%

Project L is the "better" project: its IRR = 19.08%.

QUESTION 4

Standard I deals with _____.

- A. Use of Professional Designation
- B. Duty to Employer
- C. Obligation to Inform Employer of Code and Standards



- D. Professional Misconduct
- E. Plagiarism
- F. Fundamental Responsibilities
- G. Disclosure of Conflicts to Employer
- H. None of these answers

Correct Answer: F

Standard I deals with Fundamental Responsibilities. Standard II (A) deals with Use of Professional Designation. Standard II (B) deals with Professional Misconduct. Standard II (C) deals with Plagiarism. Standard III (A) deals with the Obligation to Inform Employer of Codes and Standards. Standard III (B) deals with the Duty to Employer. Standard III (C) deals with Disclosure of Conflicts to Employer.

QUESTION 5

Given that the risk-free rate of return is 6%, what is the value of a riskless zero-coupon bond with which the principal payment is \$10,000 in 15 years?

- A. \$5,733
- B. \$4,173
- C. \$5,929
- D. \$6,841
- E. \$7,126
- F. Not enough information

Correct Answer: B

The value of a zero-coupon bond is equal to the present value of its principal payment. The required rate of return on a riskless bond is the risk-free rate of return. Using appendix C in the book by Reilly and Brown, the present value of the bond is $\$10,000 \times 0.4173 = \$4,173$, or $\$10,000 / (1.06^{15})$.

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