40 Introduction to Financial Statement Modeling

1. An analyst trying to mitigate representativeness bias would most likely:
   (A) perform scenario analysis.
   (B) consider both inside and outside views to generate forecasts.
   (C) use flexible models with few independent variables.

2. The earnings forecast of a firm is most likely to be optimistic if the industry has:
   (A) a high threat of substitute products.
   (B) low bargaining power of suppliers.
   (C) low barriers to entry.

3. What is the most likely impact on revenue if a firm increases the selling price of a product with elastic demand?
   (A) Revenue will increase.
   (B) Revenue will decrease.
   (C) Revenue will be unaffected.

J.K. SHAH® CLASSES a Veranda Enterprise

4. An analyst who wants to create a sales-based pro forma model for a company is most likely to begin by:
   (A) modeling the company's working capital items.
   (B) estimating the company's revenue growth trend.
   (C) forecasting the company's capital spending.

5. By including only variables with known explanatory power in a forecast, an analyst may be trying to mitigate the:
   (A) illusion of control bias.
   (B) overconfidence bias.
   (C) confirmation bias.

6. A company is most likely to have pricing power if it operates in an industry that exhibits high:
   (A) bargaining power of customers.
   (B) barriers to entry.
   (C) intensity of industry rivalry.

7. In preparing a set of sales-based pro forma financial statements, which of the following steps would most likely be completed first?
   (A) Construct the pro forma cash flow statement.
   (B) Estimate future capital expenditures.
   (C) Estimate the financing costs.

8. An analyst is forecasting performance of a firm and trying to incorporate inflection points. Which of the following is most likely to signal an inflection point?
   (A) A new marketing campaign with celebrity endorsement.
   (B) A new chairman being hired.
   (C) A new export tariff being imposed on the company's products.

9. For a highly cyclical company, which of the following would be the most appropriate forecast time horizon?
   (A) Until the middle of the business cycle.
   (B) Until two full business cycles have been included.
   (C) One year only.

J.K. SHAH CLASSES a Veranda Enterprise

10. An analyst has forecast earnings for the next year for a particular investment. Since the forecast was completed, the firm has made some announcements regarding new products and structural changes. A few of these were expected by the analyst and incorporated into the original forecast, and some were excluded. The analyst is reluctant to make any changes to the forecast. This analyst is most likely exhibiting which of the following biases?
    (A) Confirmation bias.
    (B) Conservatism bias.
    (C) Representativeness bias.

11. A firm has experienced an increase in some of its input costs and has decided to cut its advertising expenses to help maintain operating margins. This strategy is most appropriate if the input cost increases are deemed to be:
    (A) either short term or long term.
    (B) short term only.
    (C) long term only.

12. An analyst who makes only a small change to a previous forecast, even when new information suggests a large change is needed, is most likely exhibiting:
    (A) conservatism bias.
    (B) confirmation bias.
    (C) base-rate neglect.

13. An analyst is developing a forecast for a firm and expects the units sold to be reduced by 5% in the next reporting period. Which of the following balance sheet current assets is this most likely to affect?
    (A) Accounts receivable, inventory, and prepayments.
    (B) Accounts receivable and prepayments.
    (C) Accounts receivable and inventory.

14. When forecasting the value of a stock using the discounted cash flow approach, a small change in which of the following estimates will most likely have the largest impact on the forecast value?
    (A) Annual depreciation.
    (B) Long-term growth rate.
    (C) Statutory tax rate.

15. An analyst is developing a set of sales-based pro forma financial statements and states the following:
    Statement 1: COGS will grow at the same rate as sales.
    Statement 2: SG&A grows with sales.
    Which of his statements are most likely correct?
    (A) Both Statement 1 and Statement 2.
    (B) Statement 1 only.
    (C) Statement 2 only.

J.K. SHAH® CLASSES a Veranda Enterprise

16. Fresh Farm Foods (FFF) achieved the following performance for the year ended December 31, 20X8, based on sales of 140,000 units.

    Income Statement for Year Ended 20X8

Revenue	$800,000
COGS	($570,000)
Gross profit	$230,000
SG&A	($96,000)
Operating profit	$134,000

    An analyst forecasts that FFF will be forced to increase its unit price by 8%, and this will result in a decrease in demand of 3,000 units. In percentage terms, which of the following will most likely see the biggest decrease?
    (A) Operating profit.
    (B) Revenue.
    (C) Gross profit.

17. An analyst is looking at the impact of sales and cost price changes for a multinational firm. Which of the following would least likely be helpful to be included in her analysis?
    (A) Hedging activities.
    (B) Capital structure.
    (C) Vertical structure.

18. Which of the following elements of Porter's five forces model is most likely to have the largest impact on elasticity of demand, assuming a competitive industry?
    (A) Availability of substitute products.
    (B) Bargaining power of customers.
    (C) Bargaining power of suppliers.

19. Which of the following would most likely lead to a company having high pricing power?
    (A) Low threat of substitute products.
    (B) High bargaining power of customers.
    (C) High intensity of industry rivalry.

20. A portfolio has a 17% annual turnover. For a buy-side analyst, what would be an appropriate time horizon to use when forecasting performance?
    (A) 10 years.
    (B) 1 year.
    (C) 6 years.

J.K. SHAH CLASSES a Veranda Enterprise

21. An analyst is trying to compare the returns of two different firms, both operating in Europe. Why would the analyst most likely choose to use return on invested capital (ROIC) over return on equity (ROE)?
    (A) The two firms operate in different industries.
    (B) The two firms have differing capital structures.
    (C) The two firms operate in different countries.