

CFA® SAMPLE QUESTION – LEVEL I

Equity Investments

Q: Stock ABC paid a dividend of \$0.5 per share last year from an EPS of \$0.90 per share. The firm's earnings and dividend are expected to growth at 7% per year constantly.

Shareholders of ABC require a return of 14% on their investment. As a result, the justified trailing and leading P/E multiples are closet to:

CORRECT ANSWER:

Trailing P/E

8.49

Leading P/E

7.94

Ⓒ

First let us find out the Price 0 of the stock first.

Then we have $P_0 = 0.5 * 1.07 / (0.14 - 0.07)$
 $P_0 = 7.64$

Remember $P_0 = D_1 / (r - g)$
D1 = Dividend at the end of year 1
r = required rate of return
g = growth rate

Justified Trailing P/E = $P_0 / E_0 = 7.64 / 0.9 = 8.49$
Leading P/E = $P_0 / E_1 = 7.64 / (0.9 * 1.07) = 7.93$



CFA Society Hong Kong
Candidate Services