

CFA® SAMPLE QUESTION – LEVEL I Equity Investments

Q: An analyst gathered the following information about an industry.

Industry Beta	0.9
Industry Profit Margin	8%
Total Asset Turnover Ratio	1.5
Leverage Multiplier	2
Dividend Payout Ratio of the industry	60%
Risk Free Rate	7%
Expected Market Return	15%

The industry P/E is around:

CORRECT ANSWER:

d 13.04

First, remember under CAPM setting k = risk free rate return + beta x (Expected Market Return -Risk Free rate return) so k = 7% + 0.9 (15% - 7%) = 14.2%

Then by using the DuPont equation: ROE = Profit Margin x Asset Turnover x Leverage Multiplier so ROE = $8\% \times 1.5 \times 2 = 24\%$



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g = retention ratio × ROE = 0.40 × 24% = 9.6%

Finally P/E ratio = Payout Ratio / (k -g) = 0.6/ (14.2% - 9.6%) = 13.04



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