**Securities Analysis  
Homework 2**

**Chapters 10 and 11**

**Following are 20 questions, worth five points each.**

**Chapter 10: Analysis of Financial Statements**

1. Discuss briefly two decisions that require the analysis of financial statements.

2. Why do analysts use financial ratios rather than the absolute numbers? Give an example.

3. Besides comparing a company’s performance to its total industry, discuss what other comparisons should be considered within the industry.

4. How might a jewellery store and a grocery store differ in terms of asset turnover and profit margin? Would you expect their return on total assets to differ assuming equal business risk? Discuss.

5. Describe the components of business risk, and discuss how the components affect the variability of operating earnings (EBIT).

6. Would you expect a steel company or a retail food chain to have greater business risk? Discuss this expectation in terms of the components of business risk.

7. When examining a firm’s financial structure, would you be concerned with the firm’s business risk? Why or why not?

8. Give an example of how a cash flow ratio might differ from a proportion of debt ratio. Assuming these ratios differ for a firm (e.g., the cash flow ratios indicate high financial risk, while the proportion of debt ratio indicates low risk), which ratios would you follow? Justify your choice.

9. Why is the analysis of growth potential important to the common stockholder? Why is it important to the debt investor?

11. A firm is earning 24 percent on equity and has low business and financial risk. Discuss why you would expect it to have a high or low retention rate.

**Chapter 11: An Introduction to Security Valuation**

1. Discuss the difference between the top-down and bottom-up approaches. What is the major assumption that causes the difference in these two approaches?

2. What is the benefit of analysing the market and alternative industries before individual securities?

3. Discuss why you would not expect all industries to have a similar relationship to the economy. Give an example of two industries that have different relationships to the economy.

4. Discuss why estimating the value for a bond is easier than estimating the value for common stock.

5. Would you expect the required rate of return for a U.S. investor in U.S. common stocks to be the same as the required rate of return on Japanese common stocks? What factors would determine the required rate of return for stocks in the United States versus Japan?

6. Would you expect the nominal RFR in the United States to be the same as in Germany? Discuss your reasoning in detail.

7. Would you expect the risk premium for an investment in an Indonesian stock to be the same as that for a stock from the United Kingdom? Discuss your specific reasoning.

8. Would you expect the risk premium for an investment in a stock from Singapore to be the same as that for a stock from the United States? Discuss your specific reasoning.

11. Under what conditions will it be ideal to use one or several of the relative valuation ratios to evaluate a stock?

12. Discuss a scenario where it would be appropriate to use one of the present value of cash flow techniques for the valuation.