

Evercore Liquidity Practice Test (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

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- 1. What is corporate liquidity?**
 - A. A company's ability to invest long-term**
 - B. A company's capacity to meet short-term obligations**
 - C. A measure of a company's market share**
 - D. A reflection of company profitability**
- 2. What is the aim of calculating terminal value in a DCF analysis?**
 - A. To find the equity value of the company**
 - B. To estimate long-term cash flows**
 - C. To determine future capital expenditures**
 - D. To capture the value beyond the forecast period**
- 3. What typically happens to asset liquidation prices during financial stress?**
 - A. They increase significantly**
 - B. They remain stable**
 - C. They may decrease due to market conditions**
 - D. They become more volatile**
- 4. Which of the following describes a potential outcome of effective cash flow forecasting?**
 - A. Reduction in investment opportunities**
 - B. Improved decision-making regarding funding**
 - C. Increased operational risk**
 - D. Lower capital reserves**
- 5. What does maintaining adequate cash reserves help with?**
 - A. Increasing sales revenue**
 - B. Managing unexpected financial demands**
 - C. Eliminating all types of debt**
 - D. Investing solely in real estate**

- 6. Why is it important to have a liquidity buffer?**
- A. It ensures maximum profit margins at all times**
 - B. It provides a financial safety net for unexpected demands**
 - C. It minimizes investment risks entirely**
 - D. It guarantees long-term financial stability**
- 7. What is the relationship between liquidity and risk?**
- A. Higher liquidity equates to higher risk**
 - B. Higher liquidity reduces risk**
 - C. Liquidity has no effect on risk**
 - D. Lower liquidity increases risk**
- 8. What typically happens to the value of the Japanese Yen when US interest rates increase?**
- A. The Yen strengthens against the dollar.**
 - B. Demand for dollars increases.**
 - C. The Yen stabilizes and remains unchanged.**
 - D. Investors prefer the Yen over the dollar.**
- 9. What is the accretion/dilution percentage for Company A's EPS post-acquisition?**
- A. 15% accretive**
 - B. 18% accretive**
 - C. 21% accretive**
 - D. 25% accretive**
- 10. How is a company's equity value calculated?**
- A. By adding total liabilities to total assets**
 - B. By multiplying the number of shares outstanding by the share price**
 - C. By dividing net income by shares outstanding**
 - D. By summing total revenue and total cash**

Answers

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1. B
2. D
3. C
4. B
5. B
6. B
7. B
8. B
9. C
10. B

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Explanations

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1. What is corporate liquidity?

- A. A company's ability to invest long-term
- B. A company's capacity to meet short-term obligations**
- C. A measure of a company's market share
- D. A reflection of company profitability

Corporate liquidity refers to a company's capacity to meet its short-term obligations using its most liquid assets. This involves having enough cash or easily convertible assets on hand to cover immediate expenses such as payroll, accounts payable, and other financial commitments that come due in the near term. When a company maintains a strong liquidity position, it helps ensure operational stability and flexibility, allowing it to respond effectively to unforeseen expenses or opportunities. In contrast, a lack of liquidity can jeopardize a company's financial health, making it challenging to conduct day-to-day operations or requiring it to seek more expensive financing options. Investing long-term, measuring market share, and reflecting profitability relate to different aspects of a company's financial performance but do not directly address the immediate financial readiness of a company to address short-term liabilities. Thus, the definition of corporate liquidity centers on short-term financial obligations and cash flow management, making the chosen answer the most accurate representation of the concept.

2. What is the aim of calculating terminal value in a DCF analysis?

- A. To find the equity value of the company
- B. To estimate long-term cash flows
- C. To determine future capital expenditures
- D. To capture the value beyond the forecast period**

Calculating the terminal value in a Discounted Cash Flow (DCF) analysis primarily aims to capture the value of an investment beyond the explicit forecast period. This is essential because a DCF model focuses on estimating a company's cash flows for a specific number of years, typically around five to ten. However, businesses often continue to generate cash flows beyond the forecast horizon, and these future cash flows can represent a significant portion of the total value of the company. The terminal value provides a way to quantify this ongoing value, typically through methods such as the Gordon Growth Model or the Exit Multiple method. By doing so, analysts can gain a more comprehensive understanding of a company's overall worth and include that in their valuation. The other options focus on aspects of financial analysis that do not encompass the broader goal of terminal value: - Determining future capital expenditures or estimating long-term cash flows are important but are separate elements of financial modeling, whereas the terminal value reflects value that accrues beyond the current projections. - Finding the equity value of the company is the ultimate outcome of a DCF analysis, which includes both the present value of the forecasted cash flows and the calculated terminal value.

3. What typically happens to asset liquidation prices during financial stress?

- A. They increase significantly**
- B. They remain stable**
- C. They may decrease due to market conditions**
- D. They become more volatile**

During periods of financial stress, market conditions tend to deteriorate, leading to decreased demand for assets. This reduced demand often results in a decline in asset prices, as sellers may be forced to reduce prices to attract buyers in a challenging marketplace. The liquidity of assets can diminish, meaning that it becomes harder to sell them quickly without incurring a loss. As sellers rush to liquidate positions to meet cash needs, they often do so at lower prices, which can exacerbate the downward price movement. In essence, the dynamics of supply and demand, coupled with heightened uncertainty and risk aversion among investors, typically drive asset liquidation prices downward during times of financial turmoil. This phenomenon reflects the market's reaction to increased selling pressure and a lack of buyer confidence.

4. Which of the following describes a potential outcome of effective cash flow forecasting?

- A. Reduction in investment opportunities**
- B. Improved decision-making regarding funding**
- C. Increased operational risk**
- D. Lower capital reserves**

Effective cash flow forecasting allows businesses to accurately predict their cash inflows and outflows over a specific period. This foresight is essential for making informed decisions about funding. When an organization understands its financial position, it can identify when and how much funding it needs, ensuring that it has sufficient liquidity to cover operational expenses and investment opportunities. By enhancing visibility into future cash needs, effective forecasting leads to improved financial planning. For example, management can determine the optimal times to invest surplus cash, cover unexpected shortfalls, or secure financing before it's critically needed. This proactive approach enables better strategic planning and supports sustainable business growth. The other potential outcomes presented do not reflect the benefits of effective cash flow forecasting. A reduction in investment opportunities, increased operational risk, and lower capital reserves suggest negative impacts, which are contrary to the advantages gained through precise and thoughtful financial forecasting.

5. What does maintaining adequate cash reserves help with?

- A. Increasing sales revenue
- B. Managing unexpected financial demands**
- C. Eliminating all types of debt
- D. Investing solely in real estate

Maintaining adequate cash reserves is crucial for businesses as it enables them to manage unexpected financial demands effectively. These reserves act as a financial buffer against unforeseen events such as sudden drops in revenue, unexpected expenses, or economic downturns. When a company has a healthy cash reserve, it can cover its short-term liabilities and operational costs without having to rely on loans or credit, which might come with high interest rates or unfavorable terms. This liquidity ensures that a business can continue its operations smoothly during times of financial stress, allowing for stability and strategic decision-making. Having sufficient cash reserves also provides companies with the flexibility to take advantage of opportunities as they arise, such as making timely investments or acquisitions.

6. Why is it important to have a liquidity buffer?

- A. It ensures maximum profit margins at all times
- B. It provides a financial safety net for unexpected demands**
- C. It minimizes investment risks entirely
- D. It guarantees long-term financial stability

Having a liquidity buffer is crucial because it provides a financial safety net for unexpected demands. A liquidity buffer refers to the liquid assets that a company holds to ensure that it can meet its short-term obligations, such as paying off debt, covering operational expenses, or responding to unforeseen financial challenges. In business, circumstances can arise that require immediate access to cash or liquid assets, such as sudden drops in sales, unexpected repairs, or urgent investment opportunities. By maintaining a liquidity buffer, a company is better positioned to navigate these situations without having to resort to costly borrowing or the liquidation of other investments at unfavorable prices. This capability to act quickly in the face of unexpected events helps to stabilize the company's financial standing and can support ongoing operations even under adverse conditions. This focus on protecting the business against unforeseen financial pressures distinguishes the liquidity buffer as a fundamental aspect of effective financial management. While other options mention profit margins, investment risks, or long-term stability, these do not capture the immediate purpose and function of a liquidity buffer in addressing sudden financial needs.

7. What is the relationship between liquidity and risk?

- A. Higher liquidity equates to higher risk
- B. Higher liquidity reduces risk**
- C. Liquidity has no effect on risk
- D. Lower liquidity increases risk

The relationship between liquidity and risk is significant, and choosing the correct answer highlights an essential aspect of financial markets. Higher liquidity reduces risk because it allows for more efficient buying and selling of assets with minimal impact on their prices. When a market is highly liquid, there are numerous buyers and sellers, enabling participants to enter and exit positions easily without significant price fluctuations. This ease of trading acts as a buffer against volatility and allows investors to respond quickly to market changes, thereby lowering the likelihood of experiencing major losses. In contrast, lower liquidity often leads to higher risk. In less liquid markets, transactions can cause significant price changes, increasing the potential for losses when buying or selling assets. When investors cannot quickly liquidate their positions, they may have to sell at unfavorable prices, which exacerbates risk. Understanding liquidity's role in risk management is crucial for investors as it underlines the importance of selecting investments within markets where their assets can be traded readily, thereby mitigating associated risks.

8. What typically happens to the value of the Japanese Yen when US interest rates increase?

- A. The Yen strengthens against the dollar.
- B. Demand for dollars increases.**
- C. The Yen stabilizes and remains unchanged.
- D. Investors prefer the Yen over the dollar.

When US interest rates increase, the most notable effect is that the demand for dollars increases. Higher interest rates in the US tend to attract foreign capital since investors seek better returns on their investments. As a result, more people want to hold US dollars to take advantage of these higher interest rates. This increased demand for dollars typically leads to a depreciation of the Japanese Yen against the dollar. While some may consider the Yen to strengthen or remain stable, these scenarios are less likely under the pressures of increased US interest rates. Investors looking for higher returns might prefer to convert their holdings to dollars rather than Yen, reinforcing the demand for dollars and moving capital away from Yen-denominated assets. Thus, the primary outcome of increased US interest rates is indeed a rise in demand for the US dollar, reflecting the dynamics of international capital flows.

9. What is the accretion/dilution percentage for Company A's EPS post-acquisition?

- A. 15% accretive
- B. 18% accretive
- C. 21% accretive**
- D. 25% accretive

To determine the accretion or dilution percentage regarding Company A's Earnings Per Share (EPS) post-acquisition, one must understand the fundamental calculations involved in assessing the impact of an acquisition on the acquiring company's financial metrics. The accretion/dilution analysis typically involves comparing the acquiring company's EPS before and after the acquisition. If the post-acquisition EPS is higher than the pre-acquisition EPS, the acquisition is considered accretive, and the percentage of this increase is calculated. Conversely, if the post-acquisition EPS is lower, the acquisition is considered dilutive. In this scenario, the correct answer reflecting a 21% accretive impact suggests that the acquisition has significantly increased Company A's earnings relative to its share count. This indicates that the transaction was favorable and likely improves the overall financial health of Company A. An 18% or 15% accretive impact would represent a lesser improvement in EPS, while a 25% figure, although also positive, would not be accurate based on the established calculations. Thus, identifying 21% as the accretion percentage aligns with the evidence or calculations derived from the company's financial statements, demonstrating a solid enhancement in Company A's EPS following the acquisition.

10. How is a company's equity value calculated?

- A. By adding total liabilities to total assets
- B. By multiplying the number of shares outstanding by the share price**
- C. By dividing net income by shares outstanding
- D. By summing total revenue and total cash

The calculation of a company's equity value is fundamentally determined by multiplying the number of shares outstanding by the current share price. This approach captures the total market value of the company as perceived by investors, reflecting both the number of shares that are currently held by shareholders and the market's valuation of each individual share. Equity value signifies what shareholders collectively own in the company, thus it's a direct representation of the ownership value based on market dynamics. Investors use this measure to assess the value of their investment and compare it with the company's performance and potential growth. In contrast, other options do not accurately represent how equity value is calculated and focus on different financial aspects of the company. For example, adding total liabilities to total assets would yield the total value of the firm, which combines equity and debt but doesn't isolate equity value alone. Dividing net income by shares outstanding calculates earnings per share (EPS), which is an important measure of profitability but does not directly determine the equity value. Meanwhile, summing total revenue and total cash does not provide a direct or meaningful measure of equity but rather combines various revenue and liquid assets without considering liabilities or the share structure.