Investment Banking Basics Practice Test (Sample)

Study Guide

Everything you need from our exam experts!

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Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- **Practice answering questions under realistic conditions,**
- **Improve accuracy and speed,**
- **Review explanations to strengthen weak areas, and**
- **Approach the exam with greater confidence.**

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

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How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here’s how to get the most out of your Examzify study guide:

1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Your goal is to identify knowledge gaps early.

2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 – 45 minutes). Review a handful of questions, reflect on the explanations.

3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

6. Repeat and Review

Don’t just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning. Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There’s no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly, adapt the tips above to fit your pace and learning style. You've got this!

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Questions

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1. **Which value is typically higher for healthy companies: Equity Value or Shareholders' Equity?**
   - A. Equity Value
   - B. Shareholders' Equity
   - C. They are usually equal
   - D. Neither is inherently higher

2. **When would you use a Liquidation Valuation?**
   - A. In bankruptcy scenarios to see whether equity shareholders will receive any capital after debts paid; often used to advise asset sales versus a whole company.
   - B. When valuing a growth company with strong cash flows.
   - C. To forecast future revenue growth.
   - D. To determine the company's cost of capital.

3. **After a dividend recap, which statement about the financial statements is true?**
   - A. Income statement shows a higher interest expense.
   - B. Cash flow statement shows a large cash outflow from investing activities.
   - C. There is no effect on any financial statement.
   - D. Balance sheet: debt rises and equity falls; cash flow from financing rises, net zero change in cash.

4. **What is a dividend recapitalization?**
   - A. The company takes on new debt solely to pay a special dividend to the PE firm.
   - B. The company pays a dividend using existing cash reserves.
   - C. The PE firm sells the company.
   - D. The company issues stock.

5. **How is goodwill defined in an acquisition?**
   - A. The purchase price minus the seller's book value
   - B. The seller's cash on hand
   - C. The market cap of the buyer
   - D. The tax basis of the assets

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6. **In an LBO, how is the target purchase price determined, and why is it called a floor valuation?**
    - A. By using a fixed EBITDA multiple derived from comps; this approach sets the floor
    - B. By setting a targeted IRR and back-solving to determine the purchase price; floor valuation because PE firms want to pay the least
    - C. By projecting cash flows and selecting the lowest exit multiple
    - D. By aligning with a strategic acquirer’s offer

7. **Which rate is typically used to discount cash flows in a DCF?**
    - A. WACC
    - B. Cost of debt
    - C. Cost of equity
    - D. Hurdle rate

8. **Which item would typically be capitalized?**
    - A. Factory equipment
    - B. Salaries
    - C. Advertising expense
    - D. COGS (cost of goods sold)

9. **Which statement about the list of common valuation multiples is accurate?**
    - A. The listed common multiples are EV/Revenue, EV/EBITDA, EV/EBIT, P/E, and P/BV.
    - B. The listed common multiples include P/S and EV/FCF.
    - C. P/BV is not a common multiple.
    - D. P/E is not a common multiple in the list.

10. **In Sum of the Parts analysis, what is the recommended approach for divisions?**
    - A. Value each division separately and add them together.
    - B. Value the company as a single unit.
    - C. Ignore smaller divisions.
    - D. Use the same set of comps for all divisions.

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Answers

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

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Explanations

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1. Which value is typically higher for healthy companies: Equity Value or Shareholders' Equity?

A. Equity Value

B. Shareholders' Equity

C. They are usually equal

D. Neither is inherently higher

Equity Value is the market value of the company's equity, i.e., the market cap calculated as share price times shares outstanding. Shareholders' Equity is the accounting net asset value shown on the balance sheet (Assets minus Liabilities). For healthy companies, investors price in future growth, profitability, and intangible assets like brands, customer relationships, and proprietary technology—assets aren't fully captured on the balance sheet. That expected future value makes the market value of equity typically higher than the book value of shareholders' equity. In other words, the market assigns a higher value to the equity than its recorded net asset value because of anticipated cash flows and intangible benefits.

2. When would you use a Liquidation Valuation?

A. In bankruptcy scenarios to see whether equity shareholders will receive any capital after debts paid; often used to advise asset sales versus a whole company.

B. When valuing a growth company with strong cash flows.

C. To forecast future revenue growth.

D. To determine the company's cost of capital.

Liquidation valuation estimates what a company's assets would fetch if the business were wound down and assets sold off individually, usually under forced-sale conditions. This approach is used to determine recoveries for creditors and to decide whether it makes more sense to liquidate assets or sell the company as a whole in bankruptcy or insolvency scenarios. It directly answers how much, if anything, would be left for equity shareholders after debts are satisfied, and it often influences the decision to pursue asset sales rather than a sale of the entire company. This isn't the method you'd use for valuing a healthy growth company with strong cash flows, which would rely on going-concern approaches like discounted cash flows or market multiples. It also isn't about forecasting future revenue growth or calculating the cost of capital, which serve different purposes in valuation and financial analysis.

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3. After a dividend recap, which statement about the financial statements is true?

A. Income statement shows a higher interest expense.

B. Cash flow statement shows a large cash outflow from investing activities.

C. There is no effect on any financial statement.

D. Balance sheet: debt rises and equity falls; cash flow from financing rises, net zero change in cash.

Dividend recapitalization is about raising new debt to pay a large dividend to shareholders. This changes the balance sheet and cash flow in specific ways that align with the financing activity nature of the move. On the balance sheet, the company takes on more debt, and the dividend reduces shareholders' equity (retained earnings) because cash is sent to owners. Cash on hand can drop due to the dividend, but the new debt provides cash inflow that offsets this in the financing section. In the cash flow statement, the financing Activities section shows the debt proceeds as a cash inflow and the dividend payout as a cash outflow. If the amount borrowed exactly funds the dividend, the net change in cash for the period is zero, even though financing cash flow contains both an inflow and an outflow. Interest expense would appear on the income statement due to the new debt in future periods, but the statement that best captures the overall effect across statements is the one describing higher debt, lower equity, a financing cash inflow and outflow, and no net cash change.

4. What is a dividend recapitalization?

A. The company takes on new debt solely to pay a special dividend to the PE firm.

B. The company pays a dividend using existing cash reserves.

C. The PE firm sells the company.

D. The company issues stock.

Divident recapitalization is when a company borrows new funds and uses that money to pay a large, one-time dividend to its shareholders—typically the private equity sponsor that owns the business. The idea is to extract value from the company by loading it up with debt, then distributing the cash to owners, rather than selling the company or issuing new equity. This leaves the business with higher debt and higher interest costs, potentially altering risk and financial flexibility, but it provides a quick return to the investors. This differs from paying a regular dividend out of existing cash, which wouldn't involve new debt; from selling the company, which is an exit for the owners; and from issuing stock, which would bring in new equity rather than debt.

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5. How is goodwill defined in an acquisition?

A. The purchase price minus the seller's book value

B. The seller's cash on hand

C. The market cap of the buyer

D. The tax basis of the assets

Goodwill in an acquisition represents the premium paid over the value of the acquired company's net assets. It captures intangible value like brand, customer relationships, and expected synergies that aren't separately reflected on the balance sheet. To measure it, you take the purchase price and subtract the seller's net assets (assets minus liabilities) as shown on their books. This is why the option describing purchase price minus the seller's book value is the best representation: it directly reflects the premium above the net asset base being acquired. The seller's cash on hand is just liquidity, the buyer's market cap is unrelated to the target's value, and the tax basis of the assets is a historical cost used for tax purposes, not the premium paid in the deal. In practice, goodwill equals the purchase price minus the fair value of identifiable net assets; the idea remains the same—the extra you're paying over what the business's net assets are worth.

6. In an LBO, how is the target purchase price determined, and why is it called a floor valuation?

A. By using a fixed EBITDA multiple derived from comps; this approach sets the floor

B. By setting a targeted IRR and back-solving to determine the purchase price; floor valuation because PE firms want to pay the least

C. By projecting cash flows and selecting the lowest exit multiple

D. By aligning with a strategic acquirer's offer

The main idea is that the purchase price in an LBO is set by the sponsor's required return, not by a market price. You build a model of the target's cash flows, financing with debt and equity, and an assumed exit at a chosen multiple. Then you back-solve for the entry price that makes the equity investors' internal rate of return hit the target IRR. That entry price is called a floor valuation because it's the minimum price at which the deal can still meet the sponsor's hurdle return given the financing structure and the exit assumptions; paying more would push returns below the target, while paying less would push them above the target. This approach reflects how leverage and financing terms make IRR highly sensitive to the purchase price, so the floor price sets the least amount you'd effectively be willing to pay to achieve the desired return.

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7. Which rate is typically used to discount cash flows in a DCF?

A. WACC

B. Cost of debt

C. Cost of equity

D. Hurdle rate

In a DCF, the discount rate should reflect the opportunity cost of capital for the entire firm, i.e., the return that both debt and equity investors require given the company's risk. The standard measure for this is the Weighted Average Cost of Capital (WACC), which combines the cost of equity and the after-tax cost of debt in proportion to their share of the capital structure. Using WACC to discount unlevered cash flows (free cash flow to the firm) ensures the present value accounts for both financing sources and the risk of the overall business. Using the cost of debt would ignore equity holders' required return, and using the cost of equity would ignore the debt component; a hurdle rate is a target for project approval, not the typical discount rate for a full firm DCF.

8. Which item would typically be capitalized?

A. Factory equipment

B. Salaries

C. Advertising expense

D. COGS (cost of goods sold)

Capitalization means recording an expenditure as an asset on the balance sheet when it will provide benefits beyond the current year. Factory equipment fits this, because it's a long-lived asset used in production over many years and is shown as part of property, plant, and equipment. It is not expensed all at once; instead, its cost is depreciated over its useful life, spreading the expense over the periods that benefit from it. Salaries, advertising expense, and COGS are typically recognized as expenses in the period they are incurred or incurred events occur. Salaries are day-to-day operating costs; advertising expense is the cost of marketing efforts for the current period; and COGS represents the costs directly tied to goods sold and is expensed when those goods are sold.

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9. Which statement about the list of common valuation multiples is accurate?

A. The listed common multiples are EV/Revenue, EV/EBITDA, EV/EBIT, P/E, and P/BV.

B. The listed common multiples include P/S and EV/FCF.

C. P/BV is not a common multiple.

D. P/E is not a common multiple in the list.

Understanding valuation multiples: some look at the whole firm’s value (enterprise-value multiples) and others look at the equity value per share (equity multiples). The set EV/Revenue, EV/EBITDA, and EV/EBIT are enterprise-value multiples that relate the company’s total value to its revenue or operating earnings, giving a sense of how the market prices the firm as a whole. P/E and P/BV are equity multiples that relate stock price to per-share earnings or to book value, reflecting what investors are willing to pay for each unit of earnings or book value. This combination—EV/Revenue, EV/EBITDA, EV/EBIT, P/E, and P/BV—is widely used, so listing them together is accurate. Other common measures like P/S and EV/FCF are indeed used in practice, but they are not part of this specific listed set, which is why the statement that those belong to the listed group would be false.

10. In Sum of the Parts analysis, what is the recommended approach for divisions?

A. Value each division separately and add them together.

B. Value the company as a single unit.

C. Ignore smaller divisions.

D. Use the same set of comps for all divisions.

Sum of the parts analysis rests on valuing each division on its own terms and then adding those values to get the total. Different divisions live in different industries with distinct growth rates, margins, capital needs, and risk profiles. If you forced one valuation method or set of comparables across all units, you’d distort what each part is really worth and either understate or overstate the overall value. So the recommended approach is to value each division separately—using the most appropriate method for that business (such as relevant multiples from its industry, or a stand-alone DCF plan)—and then sum the results to obtain the company’s total value. Looking at the other options, valuing the entire company as a single unit ignores the heterogeneity across divisions, which can misprice the parts. Ignoring smaller divisions leaves out material value contributions. Using the same set of comps for all divisions fails to reflect differing industries and risk levels, leading to inaccurate valuations.

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Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at hello@examzify.com.

Or visit your dedicated course page for more study tools and resources:

https://investmentbankingbasics.examzify.com

We wish you the very best on your exam journey. You've got this!

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