



DIPLOMA SUMMER 2009 EXAMINATION

INVESTMENT ANALYSIS

DATE OF EXAM	Tuesday 23 June 2009
3 Hrs 15 mins	2.00 pm – 5.15 pm
RUBRIC	SECTION A - <i>ALL</i> parts of the question in this section are to be answered SECTION B – <i>ALL</i> questions in this section are to be answered SECTION C – <i>TWO</i> questions in this section are to be answered

Candidates are reminded that no marks will be awarded for illegible work

NOTES TO CANDIDATES

1. Please insert your Candidate Number on the cover of your Answer Book. *Do not insert your name.*
2. Show *all* workings in your Answer Book.
3. Candidates may attempt the sections in any order. Please indicate clearly in your Answer Book which questions you are answering.
4. Please insert in the box provided on the cover of your Answer Book the numbers of the questions you have attempted in the order in which they appear in the Answer Book.
5. You may use the calculator provided or one approved by the Securities & Investment Institute.
6. You must hand your Answer Book to an invigilator before you leave the Examination Hall. *Failure to do so will result in disqualification.*
7. Once submitted, the examination scripts become the property of the Securities & Investment Institute and will not be returned to candidates.

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PLEASE TURN OVER WHEN INSTRUCTED

Answer ALL parts of the question in this section. All parts refer to Marston's plc.

Question 1

- a) Briefly describe the main activities of Marston's plc in the year ending 4 October 2008. *(2 marks)*
- b) Calculate and comment upon the operating profit margin of Marston's plc for the years ending 29 September 2007 and 4 October 2008 by each of its major business activities. *(4 marks)*
- c) With reference to the Group balance sheet, comment upon the changing financial position of Marston's plc. *(5 marks)*
- d) Briefly explain within the context of the business model, the key strengths and weaknesses of Marston's plc. *(4 marks)*
- e) Calculate and comment upon the following ratios for Marston's plc for the years ending 29 September 2007 and 4 October 2008:
- i) Interest cover;
 - ii) Return on Capital Employed.
- (4 marks)*
- f) Briefly summarise and explain Marston's plc's approach to corporate and social responsibility. *(3 marks)*
- g) Prepare forecasts of profit before and after tax and earnings per share for Marston's plc for the year ended 3 October 2009. Explain the basis of your computation and of any assumptions that you have made. *(10 marks)*
- h) Advise on the desirability of investment in the shares of Marston's plc at the price shown on page 1 of the Information Pack. Explain the reasons behind the advice given. *(8 marks)*

Answer ALL questions in this section

2 What are the advantages and disadvantages of *convertible bonds* to the investor? (3 marks)

3 The market index yielded 10% in recent years and you predict that it will offer a risk premium of 6% in the future. The standard deviation of market returns is 7% and the risk-free rate of return is 4%.

a) Draw a diagram to show the Capital Market Line. (1 mark)

b) Which of the following three shares is over-valued given the base data in part a) and each share's current returns performance and beta?

Share	Current rate of return on share	Share beta
X	6%	0.5
Y	10%	1.1
Z	15%	1.5

(3 marks)

4 West plc grows at 6% per annum though it is expected that growth will stop after year 5. Indeed, in year 6 and thereafter it intends to pay out all of its earnings as dividends. If next year's earnings per share is 75p, next year's dividend is 50p, and the cost of equity capital is 9%, what is the share price for West plc? (4 marks)

5 Explain what is meant by the expression 'term structure of interest rates'. Briefly outline two of the theories that attempt to explain this expression. (4 marks)

6 a) Define Macaulay duration. (1 mark)

b) A four year 8 per cent annual coupon bond redeemable at £100 trades with a gross redemption yield of 7 per cent. Calculate the Macaulay duration of the bond. (3 marks)

7 QRS plc has borrowed at the floating rate of LIBOR plus 1.0% with a three month rollover. QRS's treasurer is worried that interest rates may move adversely and is therefore considering hedging the interest rate from the next rollover date. He has been offered a forward interest rate agreement (FRA) by his bank at 8% interest or a cap at 8% interest for a premium of 1.5% a year. What is the effective interest rate that QRS plc will pay if it:

- a) Decides not to hedge
- b) Arranges the FRA
- c) Buys the cap

under each of the following interest rate conditions: LIBOR moves to:

- i) 4.0%
- ii) 6.0%
- iii) 9.0%

(5 marks)

8 a) Define Tobin's Q *(2 marks)*

b) Briefly explain how Tobin's Q might be employed by the investment analyst
(1 mark)

9 a) Explain what is meant by the term "GDP deflator" and why this concept should be of interest to the investor. *(2 marks)*

b) The nominal GDP of a country in 2009 is £50bn and the GDP deflator for that year is 156. The base year for the deflator is 1995 at which time it was 100. Calculate real GDP in 2009. *(1 mark)*

Answer TWO questions in this section.

All questions carry 15 marks each.

- 10 Explain what is meant by an economic recession and discuss the impact of the current UK recession on economic agents.
- 11 a) Discuss how price multiples may be used in the valuation of a company's shares and the relative merits of the price multiples model.
- 12 Explain two multi-factor asset pricing models and discuss how they represent an important extension of the Capital Asset Pricing Model (CAPM).
- 13 Explain the nature of quantitative easing and how it differs from the conventional tools of monetary policy.
- 14 With reference to the current problems in the international financial sector, together with your own knowledge, discuss the implications of the proposition that some companies are "too big to fail".