

DIPLOMA SUMMER 2009 EXAMINATION

INTERPRETATION OF FINANCIAL STATEMENTS

DATE OF EXAM	Wednesday 24 June
3 HOURS	2.00 pm – 5.00 pm
RUBRIC	SECTION A – <i>ALL</i> parts of the question in this section are to be answered SECTION B – Question 2 <i>AND EITHER</i> Question 3 <i>OR</i> Question 4 are to be answered SECTION C – <i>ALL</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 this question

This question is based on the Annual Report and Accounts of Stagecoach Group plc for the year ending 30 April 2008.

- a) Present a numeric and discursive overview of Stagecoach and its development over the last year. *(6 marks)*
- b) Carry out a ratio analysis of Stagecoach's group accounts, discussing the meaning and interpretation of the ratios calculated. Focus on the following ratio categories:
- i) Trading performance *(10 marks)*
 - ii) Liquidity and solvency *(6 marks)*
- c) Analyse the performance of Stagecoach's UK Bus, North America and UK Rail segments in 2007 and 2008. Comment on the relative performance of each segment. *(12 marks)*
- d) The report makes numerous references to the 63.0 pence per share return of value to shareholders in May/June 2007. Explain the impact of this on the group's finances. You do not need to explain the details of the transactions. *(5 marks)*
- e) On pages 5 to 7 of Stagecoach's annual report, the company lists five areas to focus on in evaluating its performance. Using paragraph 3.5.2.2 of the Operating and Financial Review, discuss the advantages and disadvantages of using adjusted earnings per share as a performance measure.

On page 36 of the Stagecoach report, it is stated that the exercise of executive share options is dependent upon the outperformance of earnings per share over inflation. Also comment on this feature of the remuneration of executives. *(6 marks)*

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PROCEED TO SECTION B OVERLEAF

Answer question 2 AND EITHER question 3 OR question 4

Question 2

Below are key numbers taken from the recently published accounts for Orca Orchids plc:

For the year ending 31 December	2008	2007
Turnover	55000	44000
Cost of Sales	-48500	-38500
Gross profit	6500	5500
Administrative costs	-3200	-2800
Operating profit	3300	2700
Net finance costs	-1200	-1200
Tax	-625	-375
Profit for the year	1475	1125
Note above figures include:		
Depreciation	2050	1875
Amortisation	425	400
Impairment	200	0

As at 31 December	2008	2007
Non-current assets	18500	21000
Current assets		
Inventory 6750	4563	
Debtors 7670	5525	
Cash 492	300	
	14912	10388
Current liabilities		
Trade creditors	3425	3076
Long term liabilities		
Long term debt	17000	17000
Provisions	500	300
	12487	11012
Shareholders' fund	12487	11012

- a) Calculate EBITDA for Orca for both 2007 and 2008. Explain why this statistic is often used for assessing performance instead of, or alongside, operating profit. (6 marks)
- b) Calculate the net change in the operating working capital position of the business, showing your workings. Discuss the magnitude of this change in the light of the increase in sales turnover. (8 marks)

- c) Calculate the Cashflow from Operations for 2008. (3 marks)
- d) What factors other than the Cashflow from Operations explain the change in the cash position of Orca in 2008 compared to 2007? (3 marks)

Question 3

You receive an email from a friend who has been considering investing in a company with a wide range of operations. He asks you:

“The annual accounts are 150 pages long. Which parts are really important? Should I bother with the segmental reporting note, for example? And anyway isn’t it about to change?”

Write the email in reply to your friend, including the following:

- a) An explanation of the logic and required disclosure of the segmental reporting note.
- b) An explanation of primary and secondary segment disclosure.
- c) A discussion of the key changes in moving to the new standard.
- d) A discussion of the potential value of utilising the segmental reporting when assessing company value. (15 marks)

Question 4

“Accounting policy choice complicates the task of the financial analyst.”

You work for a firm of analysts and receive a request from a client asking for an explanation of the above quote from a prestigious business daily.

Write a short report replying to the client, including:

- a) An explanation of the relationship between accounting standards and accounting policy choices.
- b) An explanation of the reasons for allowing companies some choice in accounting policies.
- c) A brief explanation of two areas of accounting policy choice and their potential impact on analysis.
- d) A discussion of the problems accounting policy choice presents to the analyst. (15 marks)

Answer ALL FIVE questions in this section.

Question 5

You are analysing two companies in the same sector. Their financial performance over the last year was identical; however the historic Price-Earnings ratio of one is 25 and that of the other is 20. Briefly outline the potential reasons for this difference. (4 marks)

Question 6

An investor is comparing the performance of two customers, both food retailers. Both have a return on net assets (RONA) of 18%, but one has a sales margin of 6% and the other 3%. He does not understand how RONA can be the same and sales margin so different. Briefly explain this apparent anomaly and the potentially different business models that this implies. (4 marks)

Question 7

In order to gain market share, company Z has offered longer credit terms to customers in 2008. Comparative figures for 2007 and 2008 are shown below:

	2008	2007
Sales for the year	£6,000 million	£5,000 million
Operating profit for the year	£280 million	£200 million
Year end trade debtors	£900 million	£500 million

- Work out the debtor days for 2007 and 2008. (2 marks)
- The policy has succeeded in expanding turnover and profit. Explain the likely impact on cash flow performance. (2 marks)

Question 8

The table below shows information on company Y for the last three years:

	2008	2007	2006
Earnings	£240,000	£220,000	£200,000
Dividends per share (pence)	22	16	12
Number of shares	1,150,000	1,150,000	1,150,000

Work out the dividend cover for each of the last three years. Comment on the prospects for continuing dividend growth. *(4 marks)*

Question 9

The report from a recent impairment review shows that the values of a number of brands purchased in recent years by company x have fallen considerably over the last twelve months.

How should the company account for this change? Briefly discuss how an analyst should treat this disclosure. *(4 marks)*