DIPLOMA WINTER 2008 EXAMINATION

INVESTMENT ANALYSIS

DATE OF EXAM	Tuesday 2 December 2008
3 Hrs 15 mins	2.00 pm – 5.15 pm
RUBRIC	SECTION A - ***ALL*** parts of the question in this section are to be answered
	SECTION B – ***ALL*** questions in this section are to be answered
	SECTION C – ***TWO*** 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. The decision of the Securities & Investment Institute is final and no correspondence will be entered into concerning the grade awarded.
8. Once submitted, the examination scripts become the property of the Securities & Investment Institute and will not be returned to candidates.

PLEASE TURN OVER WHEN INSTRUCTED

SECTION A TOTAL 40 MARKS

Answer ALL parts of the question in this section. All parts refer to BSS Group plc.

Question 1

a) Briefly describe the main activities of BSS Group plc in the year ending 31st March 2008.

(2 marks)

b) Calculate and comment upon the operating profit margin of BSS Group plc for the years ending 31st March 2007 and March 2008 by each of its major business activities.

(4 marks)

c) Analyse and briefly comment upon BSS Group plc's Consolidated Cash Flow Statement, comparing the years ending 31st March 2007 and March 2008. *(5 marks)*

d) Briefly comment upon the compliance of BSS Group plc with the Combined Code on Corporate Governance 2006. *(3 marks)*

e) Calculate and comment upon the following ratios for BBS Group plc for the years ending 31st March 2007 and March 2008:

i) Sales to capital employed

ii) Return on equity

(6 marks)

f) Briefly summarise the main components of the directors' compensation at BSS Group plc. *(2 marks)*

g) Prepare forecasts of profit before and after tax and earnings per share for BSS Group plc for the year ended 31st March 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 BSS Group plc at the price shown on page 1 of the Information Pack. Explain the reasons behind the advice given. *(8 marks)*

SECTION B — TOTAL 30 MARKS

Answer ALL questions in this section

2 a) Briefly explain the meaning of the beta coefficient in the Capital Asset Pricing Model (CAPM). *(2 marks)*

b) What is the beta of each of the shares shown in the table below? *(2 marks)*

Share return if market return is:

Share	-10%	+10%
A	0	+10
B	-10	+10
C	+10	+10
D	+20	-20

3 Briefly explain the distinction between the terms *disinflation* and *deflation* and suggest what forces may give rise to such phenomena. *(3 marks)*

4 Company XYZ plc is a UK listed food retailer. The market value of its capital structure components is £8 billion for equity and £6 billion for debt. Its beta coefficient computed by a reputable financial data agency is 0.95. The UK 3 month Treasury bill rate is 4.5% and you estimate that the market risk premium over and above this rate is 4.7%. The UK corporation tax rate is 30% and the rate paid by the company on its 10 year bonds is 6.0%. Calculate XYZ plc's weighted average cost of capital (WACC). *(4 marks)*

5 PQR plc issues a bond with a 9% coupon rate and a 5 year maturity. Its debtholders expect an 8% return for bonds of its risk class. If the bond's value at maturity is £1,000, calculate the current value of the bond showing your workings:

a) By discounting the individual cash flows

b) By applying the annuity formula. *(4 marks)*

6 Describe the main distinctions between *unit trusts* and *investment trusts*. *(4 marks)*

7 You are charged with the task of valuing an as yet unlisted company, DEF, using the comparable companies approach. You assume that this approach uses industry market multiples in relation to key financial statement figures to arrive at an indicative market value for a company.

Your research reveals that DEF has three key industry competitors: A, B and C. The market/sales multiples for companies A, B and C are 2.0, 2.2 and 1.7 respectively. The market/book equity multiples for companies A, B and C are 2.5, 2.5 and 2.3 respectively. Finally, the market/net profit multiples for companies A, B and C are 20, 18 and 17 respectively. What is the market value of DEF, if its sales are £12 million, its book value of equity is £9 million, and its net profit is £1.5 million?

(3 marks)

8 Explain the relationship between a *call option price* and the following, and give a brief reason to support your answer:

a) Share price

b) Exercise price

c) Interest rate

d) Time to expiration

e) Volatility of share price

(5 marks)

9 a) Explain the term *savings ratio* for a particular country. *(2 marks)*

b) Give one reason for a possible change in the savings ratio. *(1 mark)*

SECTION C TOTAL 30 MARKS

Answer TWO questions in this section.

All questions carry 15 marks each.

10 Compare and comment upon the roles of the following in the UK financial system:

a) The Bank of England

b) The Financial Services Authority

11 Explain the nature of Credit Default Swaps (CDSs) and explain why the CDS market has grown so rapidly in recent years.

12 "Free cash flow models are always and everywhere superior to dividend models in the valuation of shares."

Discuss this statement with reference to the basis for, and relative merits of, these two competing equity valuation models.

13 Explain the nature of Exchange Traded Funds (ETFs) and their relative merits and demerits.

14 Discuss the series of events which have given rise to the current "global credit crunch" and the implications for the global economy.