

Problem set for seminar 6

- Q1. In analysing risk levels among industries, studies have found that
 - e) a) risk levels vary among different industries.
 - d) risk levels for ~~the~~ the same industry remain fairly constant over time.
2. Which of the following statements about the business cycle is false?
 - d) As the business cycle reaches a peak, inflation rates decrease.
3. Which of the following is not considered a structural influence on the economy and industry?
 - c) International economics
4. Which of the following is not a stage in the industrial life cycle?
 - c) Acquisition and consolidation
5. In which industrial life cycle stage do sales correlate highly with an economic series of the economy in general?
 - d) stabilisation and market maturity
6. Which of the following statements concerning the competitive environment is true?
 - d) The ability to substitute another product limits the industry's profit potential.
7. When forecasting industry sales it can be useful to
 - a) utilise the industry life cycle
 - b) use input-output analysis
 - c) use the relationship between
8. The _____ of an industry is a function of retention rate & return on equity.
 - d) expected growth rate

9. At the initial stage of an economic recovery,
b) consumer durable stocks rise on expectations of rising consumer confidence and personal income.
10. If the economic outlook was such that you expected corporate earnings to decline, consumers have excessive levels of debt, and there to be significant overcapacity in the technology sector, then an appropriate asset allocation policy would be to:
b) underweight equity especially technology stocks & overweight bonds.
11. Analysts should identify and monitor ~~a) & e)~~
a) the current & emerging trends & patterns affecting an industry
b) the indicators of trends & patterns in structural factors.
12. Which of the following is not characteristic of the 'growth' phase in the industry life cycle?
~~b) & c)~~ d) low profits
13. Which of the following statements regarding cyclical industries is true?
a) cyclical industries are affected by changes in consumer sentiment.
14. An increase in any of the following will cause the expected dividend growth rate to increase for an industry except.
d) dividend payout ratio
17. c) the momentum toward change in trends & patterns in structural factors.

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Question 2

Below are four industries and four forecasts of the macroeconomy. Match the industry to the scenario in which it is likely to be the best performer:

Industry:

1. Housing Construction (cyclical but interest-rate sensitive): **C**
2. Health Care (a noncyclical industry): **A**
3. Gold Mining (counter-cyclical): **D**
4. Steel Production (cyclical industry): **B**

Economic Forecast:

- A. Deep Recession - Falling inflation, interest rate & GDP
- B. Superheated Economy - rapidly rising GDP, increasing inflation and interest rates.
- C. Healthy Expansion - rising GDP, mild inflation, low unemployment
- D. stagflation - falling GDP, high inflation.

Question 3

In which stage of the industry lifecycle would you place the following industries?

1. Oil well equipment: **relative decline** (Environmental pressures, decline in easily developed new oil fields) (Stage 5)
2. Computer hardware: **Consolidation** (Stage 4)
3. Computer software: **Consolidation** (Stage 4)
4. Genetic engineering: **Start-up** (Stage 1)
5. Railroads: **relative decline** (Stage 5).

Question 4

- a) Assume that the industry that you are investigating is known to be in the fourth stage of its life cycle.
- How would you react/respond if your associates' analysis predicted that sales per share for the industry would increase by 20%?
 - Discuss your reasoning?
 - the industry is in 4th stage
 - sales per share \uparrow by 20%
 - The 4th stage of the industrial life cycle is stabilisation and market maturity.
 - During this stage, sales grow in line with the economy.
 - If sales per share for an industry in this stage of the life cycle were predicted to increase by 20%, this would imply a growth rate of the aggregate economy of 20%.
 - A sales growth rate of 20% is high for an industry in the 4th stage of the industrial life cycle.
- b) Discuss briefly the impact of substitute products on the steel industry's profitability.
- A substitute product for steel would limit the prices firms in that industry could charge.
 - The degree of limitation would depend on how closely the substitute product was on price and function to steel.

Question 5

6. As a securities analyst you have been asked to review a valuation of a closely held business, Wigulam Autoparts Heaven, Inc. (WAH), prepared by the Red Rocks Group (RRG). You are to give an opinion on the valuation and to support your opinion by analyzing each part of the valuation. WAH's sole business is automotive parts retailing. The RRG valuation includes a section called "Analysis of the Retail Autoparts Industry", based completely on the data in Table 17D and the following additional information:
- WAH and its principal competitors each operated more than 150 stores at year-end 2012.
 - The average number of stores operated per company engaged in the retail autoparts industry is 5.3.
 - The major customer base for autoparts sold in retail stores consists of young owners of old vehicles. These owners do their own automotive maintenance out of economic necessity.
- a) One of RRG's conclusions is that the retail autoparts industry as a whole is in the maturity stage of the industry life cycle. Discuss three relevant items of data from Table 17D that support this conclusion.
- b) Another RRG conclusion is that WAH and its principal competitors are in the consolidation stage of their life cycle.
- i) Cite three relevant items of data from Table 17D that support this conclusion.
 - ii) Explain how WAH and its principal competitors can be in a consolidation stage while their industry as a whole is in the maturity stage.

- a) - The population of 18-29 year olds, a major customer base for the industry, is gradually declining.
- The number of households with income less than \$35,000, another important consumer base, is not expanding.
 - The number of cars aged 5 to 15 year old, an important end market, has experienced low annual growth (or actual decline in some years), so the number of units that potentially need parts is not growing.
 - Automotive aftermarket industry retail sales have been growing slowly for several years.
 - Consumer expenditures on automotive parts and accessories have grown slowly for several years.
 - Average operating margins of all retail autoparts companies have steadily declined.

- b) i) • Sales growth of retail autoparts companies with 100 or more stores have been growing rapidly and at an increasing rate.
- Market share of retail autoparts stores with 100 or more stores has been increasing but is still less than 20 percent, leaving room for much more growth.
 - Average operating margins for retail autoparts companies with 100 or more stores are high and rising.

b) ii)

Because of industry fragmentation (i.e., most of the market share is distributed among many companies with only a few stores), the retail autoparts industry apparently is undergoing marketing innovation & consolidation.

The industry is moving toward the "category killer" format, in which a few major companies control large market shares through proliferation of outlets.

The evidences suggests that a new "industry within an industry" is emerging in the form of the "category killer" large chain-store company.

This industry subgroup is in its consolidation stage (i.e., rapid growth with high operating profit margins and emerging market leaders) despite the fact that the industry is in the maturity stage of its life cycle.