

## DIPLOMA SUMMER 2010 EXAMINATION

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### INVESTMENT ANALYSIS

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<b>DATE OF EXAM</b>	Tuesday 22 June 2010
<b>3 Hrs 15 mins</b>	2.00 pm – 5.15 pm
<b>RUBRIC</b>	SECTION A - <b>ALL</b> parts of the question in this section are to be answered  SECTION B – <b>ALL</b> questions in this section are to be answered  SECTION C – <b>TWO</b> questions in this section are to be answered

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

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#### 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 Chartered Institute for Securities & Investment.
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 Chartered Institute for Securities & Investment 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 Dechra Pharmaceuticals plc.**

**Question 1**

- a) Briefly describe the main activities of Dechra Pharmaceuticals plc in the year ending 30 June 2010. *(2 marks)*
  
- b) Calculate and comment upon the operating profit margin of Dechra Pharmaceuticals plc for the years ending 30 June 2008 and 30 June 2009 by each of its major business activities. *(4 marks)*
  
- c) Analyse and comment upon the working capital position of Dechra Pharmaceuticals plc over the years ending 30 June 2008 and 30 June 2009. *(5 marks)*
  
- d) Calculate and comment upon the following ratios for Dechra Pharmaceuticals plc for the years 2008 and 2009 and briefly comment upon them:
  - i) Sales to capital employed; *(2 marks)*
  - ii) Operating cash flow to current liabilities. *(2 marks)*
  
- e) Briefly explain within the context of the business model, the key strengths and weaknesses of Dechra Pharmaceuticals plc and the opportunities and threats which it faces. *(4 marks)*
  
- f) Discuss the suitability of the board of directors, and how this might be improved to the benefit of shareholders. *(3 marks)*
  
- g) Prepare forecasts of profit before and after tax and earnings per share for Dechra Pharmaceuticals plc for the year ended 30 June 2010. 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 Dechra Pharmaceuticals 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 Explain what is meant by a *reverse stock split* and in what circumstances a company might be tempted to engage in one. (2 marks)
- 3 a) Give the formula for the Capital Asset Pricing Model (CAPM) and explain its meaning. (1 mark)
- b) Using the Capital Asset Pricing Model (CAPM) formula, calculate the missing values ( $r_f$ ,  $\beta$  and  $r_m$ ) in the table below:

	Expected return on share	Risk-free rate	Equity beta	Expected return on the market portfolio
Share A	8.8%	$r_f$	1.2	8.0%
Share B	13.5%	7.0%	1.3	$r_m$
Share C	6.0%	4.0%	$\beta$	8.0%

(2 marks)

- 4 Supergrow plc is experiencing rapid growth. Indeed, analysts expect both its earnings and dividends to grow at the following rates: 15 per cent over the next two years; 12 per cent in the third year; and 4 per cent thereafter. The last dividend paid by Supergrow plc was £1.50 and the required rate of return on the share is 8.5 per cent.
- a) Calculate the present value of the share, assuming it has just gone ex-dividend. (3 marks)
- b) Calculate the value of the share in one year's time, all other things being equal. (2 marks)
- 5 Discuss how government tax revenues change as personal income tax rates are varied. (4 marks)
- 6 An investor thinks that she has spotted a likely candidate company for a takeover, Lucky plc. Lucky plc's current share price is £1.75. In January she purchased through her broker a contract for 1,000 July call options at a cost of 12p each. The exercise price of the option is £1.65. Calculate her profit or loss in July if:
- a) Lucky plc is not taken over, and the share price falls to £1.50;
- b) Lucky plc is not taken over, but its share price rises to £1.76;
- c) Lucky plc is indeed taken over, and the share price rises to £2.37. (3 marks)

- 7 Briefly explain how each of the following is likely to gain or lose from *unanticipated* inflation: lenders, borrowers, taxpayers, the Government. (3 marks)
- 8 Explain the meaning of the term *Tobin tax*. (4 marks)
- 9 You are given the following base date prices and current share prices for four shares. The base index value is 100.

Share	Base date price $P_0$	Base date quantity $Q_0$	Current price $P_n$	Current quantity $Q_n$
D	3.00	12	3.70	15
E	3.50	18	3.90	8
F	2.75	11	3.20	18
G	1.20	5	1.95	10

- a) Compute the unweighted arithmetic index for the four shares. (2 marks)
- b) Compute the unweighted geometric index for the shares. (2 marks)
- c) Compute the weighted arithmetic index (Laspeyre Index) for the shares. (2 marks)

## SECTION C

**TOTAL 30 MARKS**

**Answer TWO questions in this section.**

**All questions carry 15 marks each.**

- 10 What is meant by “private equity” and what need is there for it in developed financial markets?
- 11 “Fundamental analysis is a more rigorous and therefore more meaningful approach to equity analysis than technical analysis.” Discuss.
- 12 Explain the distinction between a “top down” and “bottom up” approach to investment analysis. Describe also the main steps that would be taken in each approach and the assumptions on which each is based.
- 13 Explain what is meant by “short-selling” and discuss both the rationale for, and the risks associated with, its use.
- 14 Explain the causes and implications of the European sovereign debt crisis.