

## DIPLOMA SUMMER 2011 EXAMINATION

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### INVESTMENT ANALYSIS

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<b>DATE OF EXAM</b>	Tuesday 21 June 2011
<b>3 Hrs 15 mins</b>	2.00 pm – 5.15 pm
<b>RUBRIC</b>	SECTION A - <b><i>ALL</i></b> parts of the question in this section are to be answered  SECTION B – <b><i>ALL</i></b> questions in this section are to be answered  SECTION C – <b><i>TWO</i></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.

**Answer ALL parts of the question in this section. All parts refer to Victrex plc.**

**Question 1**

- a) Briefly describe the main activities of Victrex plc in the year ending 30 September 2010. *(2 marks)*
- b) Calculate and comment upon the operating profit margin of Victrex plc for the years ending 30 September 2009 and 30 September 2010 by each of its major business activities. *(4 marks)*
- c) Compute two profitability ratios other than the operating profit margin to enable you to comment upon the performance of Victrex plc in 2009 and 2010. *(4 marks)*
- d) Referring to the risks, trends, factors and uncertainties discussed in the Annual Report, identify the three which you believe to be most pertinent to Victrex Group plc and explain why. *(5 marks)*
- e) Briefly summarise and evaluate the Victrex plc's Group strategy. *(2 marks)*
- f) With reference to the Group's financial statements, comment upon the changing financial position of Victrex plc and the Board's strategy for shareholder remuneration. *(5 marks)*
- g) Prepare forecasts of profit before and after tax and earnings per share for Victrex plc for the year ended 30 September 2011. 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 Victrex 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 is meant by “geared” and “ungeared” equity betas? How are they related? (4 marks)

- 3 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?

Share return if market return is:		
Share	-10%	+10%
A	+20	-20
B	-10	+10
C	0	+10

(2 marks)

- 4 What are Real Estate Investment Trusts (REITs) and what are their main distinguishing features? (3 marks)

- 5 Explain what is meant by the macroeconomic term “the Output Gap”. (3 marks)

- 6 a) A bond has an annual coupon rate of 7%, makes coupon payments semi-annually, and has a par value of £1,000. The bond matures in 6 years time. Investors discount its cash flows at 9% per annum. What is the value of the bond? (3 marks)

b) Does this bond currently sell at par, at a discount or at a premium? Explain your answer. (1 mark)

- 7 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)

- 8 a) What is an interest rate swap? (1 mark)

b) Company A can borrow at 6% fixed rate or at a variable rate equal to LIBOR, but would prefer a variable rate. Company B can borrow at 7.5% fixed rate or at a variable rate of LIBOR+0.5%, but would prefer a fixed rate. LIBOR is currently 6%. If A borrows at fixed rate and B borrows at variable rate, and A pays B variable rate interest at LIBOR whilst B pays A fixed rate interest at 6.5%, show the net interest cost to both parties. (2 marks)

- 9 DEF plc, a purely equity-financed food retailing company, has a firm beta of 0.6. The risk free rate is 4 per cent and the market risk premium is 5 per cent. It is considering adding two new divisions: a clothing retailing division with a beta of 1.2 and a petrol retailing division with a beta of 0.9.
- a) Calculate the cost of equity for the food retailing, clothing retailing and petrol retailing divisions using the Capital Asset Pricing Model. (2 marks)
  - b) Calculate the new beta of DEF plc if it decides to go ahead with the two new divisions. The new company's value would be 85 per cent in the food retailing, 10 per cent in the clothing retailing, and 5 per cent in the petrol retailing divisions. (1 mark)
  - c) DEF plc is considering a fourth division, financial services, which has a beta of 0.7 and offers an expected rate of return of 6 per cent. Should the firm engage in this new line of business? (2 marks)

## SECTION C

**TOTAL 30 MARKS**

**Answer TWO questions in this section.**

**All questions carry 15 marks each.**

- 10 "Inflation is the one form of taxation that can be imposed without legislation"  
(Milton Friedman, 1912-2006).

Discuss the implications of this statement, and in particular explain what strategies investors might pursue to protect investment portfolios against the impact of high inflation.

- 11 Explain the nature of, and critically appraise, the role of Credit Rating Agencies and their importance to financial markets.
- 12 Discuss the nature of "mutual funds"(in particular UK-based Open-Ended Investment Companies and Unit Trusts) and identify their relative merits.
- 13 Explain the phenomenon of "stagflation" in the context of the UK economy and how it might be addressed.
- 14 Discuss frameworks or models appropriate for analysing the industry to which a company belongs.