

## DIPLOMA WINTER 2010 EXAMINATION

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### INVESTMENT ANALYSIS

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<b>DATE OF EXAM</b>	Tuesday 7 December 2010
<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.

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**PLEASE TURN OVER WHEN INSTRUCTED**

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

**Question 1**

- a) Briefly describe the main activities of Renishaw plc in the year ended 30 June 2010. *(2 marks)*
  
- b) Calculate and comment upon the operating profit margin of Renishaw plc for the years ended 30 June 2009 and 30 June 2010 by each of its major business activities. *(4 marks)*
  
- c) Calculate and comment upon the following ratios for Renishaw plc for the years 2009 and 2010:
  - i) Payables turnover. *(2 marks)*
  - ii) Receivables turnover. *(2 marks)*
  
- d) Analyse and comment upon the changing liquidity position of Renishaw plc over the years ended 30 June 2009 and 30 June 2010. *(5 marks)*
  
- e) Identify the key stakeholders highlighted by Renishaw plc in its Corporate Social Responsibility review and explain how the company seeks to address their needs. *(2 marks)*
  
- f) Identify and explain what you consider to be the four most important issues discussed in the Financial Review, and describe how they are likely to impact on the value of Renishaw plc. *(5 marks)*
  
- g) Prepare forecasts of profit before and after tax and earnings per share for Renishaw plc for the year ending 30 June 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 Renishaw 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 *deep-discount bond* and why an investor might be interested in investing in such bonds. (2 marks)
- 3 Explain, with the aid of a graphical illustration, the meaning of the *Capital Market Line*. (4 marks)
- 4 a) The current risk-free rate is 3% while the anticipated annual market rate of return is 5%. Calculate the required return on shares in XYZ plc if the historic beta value is 1.1. (2 marks)
- b) If the current price of shares in XYZ plc (above) is £4.00 and the anticipated dividend in one year is 10p per share, calculate the implied growth rate, using the Constant Growth Dividend valuation model. (2 marks)
- 5 a) Explain the difference between *CPI* and *RPI*. (2 marks)
- b) What is the current medium term inflation target for the UK economy? (1 mark)
- 6 a) If  $r_{\text{nominal}}$  is the nominal rate of interest,  $r_{\text{real}}$  is the real interest rate, and  $i$  is the inflation rate, show a mathematical formula that expresses  $r_{\text{nominal}}$  as a function of  $r_{\text{real}}$  and  $i$ . (1 mark)
- b) The yield on a one-year government bond with par value of £100 is 7% and inflation next year is expected to be 4%. What is the real value of the total payoff on the government bond and the real interest rate on the bond? (2 marks)
- 7 Explain the macroeconomic terms *narrow money* and *broad money*. (4 marks)
- 8 You are a US investor looking to invest \$650,000 for one year. All other things being equal, you have the opportunity to obtain a one year UK bond (in pounds sterling) at 3.55% or a one year US bond (in dollars) at 2.75%. The spot rate is \$1.6501:£1. The one year forward rate is \$1.6175:£1. Which bond will you prefer to invest in and why? You should ignore transaction costs. (5 marks)

**PLEASE TURN OVER**

- 9 Chadwick plc proposes to make a rights issue at £4.75 of one new share for each three shares held. The money raised will enable it to invest in a new business segment. The company currently has outstanding 500,000 shares priced at £14.25 a share. Assuming that the new money is invested to earn a fair return, calculate:
- a) The total value of the company after the issue. (2 marks)
  - b) The share price after the issue. (2 marks)
  - c) The intrinsic value of the right to buy one new share. (1 mark)

## SECTION C

**TOTAL 30 MARKS**

**Answer TWO questions in this section.**

**All questions carry 15 marks each.**

- 10 Explain what is meant by *contractionary fiscal policy* and give examples of this policy within the context of the UK economy.
- 11 Discuss the proposition that an investment analyst's company report is far more useful and objective than the annual report when considering investment in a company's shares.
- 12 Since the start of 2010, government bond yields in the US, UK and Germany have fallen sharply, despite a continued rise in government debt levels. What might this indicate as to the future direction of these economies, and the outlook that it implies for both bond and equity investors?
- 13 State and explain the assumptions that are used in Modern Portfolio Theory and discuss their relevance in the light of the recent financial crisis.
- 14 Describe what you understand by the term *alternative assets*, and what type of investment areas might be covered by such assets. Explain how they might contribute to, or detract from, overall portfolio performance.