BEAM032

UNIVERSITY OF EXETER

SCHOOL OF BUSINESS AND ECONOMICS

January 2009

INVESTMENT ANALYSIS I

Duration: 2 HOURS

Module Convenor – Dr Christina Dargenidou

You are to answer ONE question from section A and any TWO questions from section B.

Approved calculators permitted.

This is a Closed Note exam.

All questions carry a maximum of 100 marks. Total marks awarded out of 300 are scaled to 100 per cent.

SECTION A
You must answer EITHER Question 1 OR Question 2 in this section.

Question 1

Airlines
The Group's principal activity is providing airline services on short-haul and medium-haul point-to-point routes within Europe. It operates through 77 airport networks spread across 21 countries. The Group's aircraft fleet consist of 55 owned and 82 under operating lease, comprising 107 Airbus A319 and 30 Boeing 737-700.

a) Calculate the basic financial ratios required to determine the financial performance and position of the company for the years 2006 and 2007. You are expected to estimate the following ratios:
Performance: (Return On Equity and its decomposition to Net Profit Margin, Asset Turnover, Financial Leverage); **efficiency** (Days' accounts receivable, Days' inventory, Days' accounts payable, Property Plant & Equipment turnover);**liquidity** (Current ratio, Quick ratio, Cash ratio, Operating cash flow ratio, Cash cycle) and **solvency** (Debt to equity and Interest coverage).

[50 marks]

b) Interpret the ratios you have calculated in part (a) and, on the basis of this information and any other information you feel to be relevant, comment upon the financial position and performance of the company. The information provided here is summarised; if you believe that you need more detailed information to interpret your ratios, state what this is and how this would improve your interpretation.

[50 marks]

[Total = 100 marks]

AIRLINE	BALANCE SHEET DATA	2007	2006	2005
OP	Property,Plant and Equipment(Gross)	1,022	752	464
OP	Minus: Accum. Depreciation	87	56	38
OP	Property,Plant and Equipment (Net)	936	696	426
OP	Investments	33	27	0
OP	Other non-current assets	381	314	295
	Total non-current assets	**1,350**	**1,036**	**721**
FIN	Cash and Equivalents	943	874	696
OP	Receivables net	193	167	135
OP	Inventories	0	0	0
OP	Other current assets	30	47	60
	Total current assets	**1,166**	**1,087**	**890**
	Total assets	**2,516**	**2,123**	**1,611**
FIN	Short Term Debt & Current Portion Due Long Term Debt	41	33	16
OP	Accounts payable	40	32	7
OP	Income taxes payable	90	47	39
OP	Other current liabilities	452	398	336
	Total current liabilities	**621**	**509**	**398**
FIN	Long term debt	479	447	201
FIN	Provisions	136	73	70
OP	Deferred taxes	35	32	28
OP	Other non-current liabilities	93	80	75
	Total non-current liabilities	**742**	**631**	**374**
EQ	Shareholders' equity	1,152	983	840
EQ	Reserves	0	0	0
EQ	Preferred equity	0	0	0
	Total equity	**1,152**	**983**	**840**
OP	Minority interest	0	0	0
	Total liabilities and equity	**2,516**	**2,123**	**1,611**
	Cash flow from operating activities	271	225	196

Turn over/…

AIRLINES: INCOME STATEMENT DATA	**2007**	**2006**
Sales	1,797	1,620
Cost of goods/services sold	1,495	1,392
Depreciation/amortisation expense	34	28
Gross income	268	200
Selling General Administrating expenses	0	0
Other operating expense(+)/income(-)	84	83
Profit before interest and taxes	**184**	**116**
Interest income	53	35
Interest expense	35	23
Net interest expense	**-18**	**-13**
Other expenses(+)/income(-)	0	0
Profit before tax	**202**	**129**
Tax	50	35
Profit after tax	**152**	**94**
Discontinued operations	0	0
Minority interest	0	0
Net profit	**152**	**94**

Question 2

Food retail
The Group's principal activity is providing grocery and related retailing services. The Group's supermarket operations has a range of own brand products such as fresh produce, food and grocery products. In addition many stores provide delicatessen, meat and fish counters, pharmacies, coffee shops, restaurants and petrol stations. The Group serves through 823 stores throughout the United Kingdom, comprising 504 supermarkets and 319 convenience stores.

a) Calculate the basic financial ratios required to determine the financial performance and position of the company for the years 2006 and 2007. You are expected to estimate the following ratios: **Performance**: (Return On Equity and its decomposition to Net Profit Margin, Asset Turnover, Financial Leverage); **efficiency** (Days' accounts receivable, Days' inventory, Days' accounts payable, Property Plant & Equipment turnover);**liquidity** (current ratio, quick ratio, cash ratio, operating cash flow ratio, cash cycle) and **solvency** (Debt to equity and interest coverage).

[50 marks]

b) Interpret the ratios you have calculated in part (a) and, on the basis of this information and any other information you feel to be relevant, comment upon the financial position and performance of the company. The information provided here is summarised; if you believe that you need more detailed information to interpret your ratios, state what this is and how this would improve your interpretation.

[50 marks]

[Total = 100 marks]

Turn over/…

FOOD RETAIL:	BALANCE SHEET DATA	2007	2006	2005
OP	Property Plant & Equipment (Gross)	11,745	11,199	10,741
OP	Minus: Accum. Depreciation	4,321	4,023	3,681
OP	Property Plant & Equipment (Net)	7,424	7,176	7,060
OP	Investments	254	235	123
OP	Other non-current assets	715	225	1,664
	Total non-current assets	**8,393**	**7,636**	**8,847**
FIN	Cash and Equivalents	723	1,128	1,080
OP	Receivables net	115	95	1,975
OP	Inventories	681	590	576
OP	Other current assets	203	127	214
	Total current assets	**1,722**	**1,940**	**3,845**
	Total assets	**10,115**	**9,576**	**12,692**
FIN	Short Term Debt & Current Portion Due Long Term Debt	118	363	241
OP	Accounts payable	1,703	1,706	1,419
OP	Income taxes payable	0	0	63
OP	Other current liabilities	784	642	3,075
	Total current liabilities	**2,605**	**2,711**	**4,798**
FIN	Long term debt	2,084	2,090	2,178
FIN	Provisions	63	172	753
OP	Deferred taxes	321	168	-55
OP	Other non-current liabilities	107	76	1,041
	Total non-current liabilities	**2,575**	**2,506**	**3,917**
EQ	Shareholders' equity	4,935	4,349	3,886
EQ	Reserves	0	0	0
EQ	Preferred equity	0	10	12
	Total equity	**4,935**	**4,359**	**3,898**
OP	Minority interest	0	0	79
	Total liabilities and equity	**10,115**	**9,576**	**12,692**
	Cash flow from operating activites	**837**	**756**	**627**

FOOD RETAIL: INCOME STATEMENT DATA	**2007**	**2006**
Sales	17,837	17,151
Cost of goods/services sold	16,354	15,551
Depreciation/amortisation expense	481	500
Gross income	1,002	1,100
Selling General Administrating expenses	470	574
Other operating expense(-)/income(+)	48	43
Profit before interest and taxes	**580**	**569**
Interest income	29	15
Interest expense	128	107
Net interest expense	**99**	**92**
Other expenses(-)/income(+)	-2	0
Profit before tax	**479**	**477**
Tax	150	153
Profit after tax	**329**	**324**
Discontinued operations	0	0
Minority interest	0	-1
Net profit	**329**	**325**

Turn over/…

SECTION B

You must answer ANY TWO questions from this section.

Question 3

a) Discuss the general limitations of the widely accepted and popular Return On Equity decomposition into Net Profit Margin, Asset Turnover, Financial Leverage.

[20 marks]

b) Apply an "advanced" Return On Equity decomposition that takes into account the distinction between operating and financing activities. Use the data in **EITHER** Question 1 **OR** Question 2. The operating (OP), financial (FIN) assets and liabilities and equity (EQ) are clearly indicated.

[30 marks]

c) In the light of your discussion in 3a, assess this part of performance that is due to the operating decisions of the firm as reflected by the Operating Return on Assets and the part of the performance that is attributed to the financial decisions of the firm (Financial leverage gain or loss). Is your assessment of the ROE different now than under the earlier ROE decomposition into Net Profit Margin, Asset Turnover, Financial Leverage? Why?

[50 marks]

[Total = 100 marks]

Question 4

Discuss the implications of the following items with respect to the strength of the financial position (or how the following may signal a "weak balance-sheet") of the firm:

- Operating leases [35 marks]
- Under-funded pensions [35 marks]
- Unearned revenues [30 marks]

[Total = 100 marks]

Question 5

- Discuss the challenges for the analyst arising from acco8unting rules prohibiting the capitalisation of expenditures related to intangibles (e.g. building a customer base by marketing campaigns, research outlays).

[50 marks]

- Explain the impact of managerial discretion on the balance sheet and the income statement with respect to Impairments in non-current assets. Give examples of warning signals of Impairments.

[50 marks]

[Total = 100 marks]

Question 6

Discuss the concepts of

- High quality accounting standards [35 marks]
- External auditing [35 marks]
- Legal liability [15 marks]
- Public enforcement [15 marks]

as factors enhancing accounting quality, giving examples where appropriate.

[Total = 100 marks]

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