CIMA

CIMAPRA19-F03-1-ENG

F3 Financial Strategy (Online)

QUESTION & ANSWERS

Question: 1

A company's Board of Directors is assessing the likely impact of financing future new projects using either equity or debt.
The directors are uncertain of the effects on key variables.
Which THREE of the following statements are true?

A. The choice between using either equity or debt will have no impact on the amount of corporate income tax payable.

B. Retained earnings has no cost, and is therefore the cheapest form of equity finance.

C. Debt finance is always preferable to equity finance.

D. Debt finance will increase the cost of equity.

E. Equity finance will reduce the overall financial risk.

F. Equity finance will increase pressure to pay a higher total future dividend.

Answer: D,E,F

Question: 2

A wholly equity financed company has the following objectives:
1. Increase in profit before interest and tax by at least 10% per year.
2. Maintain a dividend payout ratio of 40% of earnings per year.
Relevant data:

- There are 2 million shares in issue.
- Profit before interest and tax in the last financial year was $5 million.
- The corporate income tax rate is 30%.

At the beginning of the current financial year, the company raised long term debt of $2 million at 10% interest each year.
Calculate the dividend per share that will be announced this year assuming the company achieves its objective of increasing profit before interest and tax by 10%.

A. $0.74

B. $0.67

C. $1.11

D. $1.01

Answer: A

Question: 3

An unlisted company operates in a niche market, exploring the west coast of Africa for new oil reservoirs.
The oil exploration program has been successful in recent years and t now has a substantial amount of oil reserves with a high level of certainty of being recoverable Under financial reporting regulations, oil still in the ground is not recognised as an asset unit is extracted.
The expense of the exploration program has used up all the company’s available cash resources.
The company has denied to list or a stock market and raise finds through an initial public offering to finance its drilling program.
Which of the following valuation methods in the appropriate to use in calculating an initial listing price for this company?

A. Market capitalisation.

B. Framings valuation using the ratio of a multinational oil exploration company

C. Net asset valuation based on book values.

D. Discounted cash flow valuation

Answer: D

Question: 4

Company W has received an unwelcome takeover bid from Company B. The offer is a share exchange of 3 shares in Company B for 5 shares in Company W or a cash alternative of $5.70 for each Company W share.
Company B is approximately twice the size of Company W based on market capitalisation. Although the two companies have some common business interested the main aim of the bid is diversification for Company B.
Company W has substantial cash balances which the directors were planning to use to fund an acquisition.
These plans have not been announced to the market.
The following share price information is relevant.

	Company B	Company W
	$	$
3 months ago	11.40	4.50
1 month ago	10.20	4.90
Today	9.30	5.40

Which of the following would be the most appropriate action by Company W's directors following receipt of this hostile bid?

A. Change the Articles of Association to increase the percentage of shareholder votes required to approve atakeover.

B. Refer the bid to the country's competition authorities.

C. Write to shareholders explaining fully why the company's share price is under valued.

D. Pay a one-off special dividend.

Answer: C

Question: 5

A company based in Country D, whose currency is the D$, has an objective of maintaining an operating profit margin of at least 10?ch year.
Relevant data:
- The company makes sales to Country E whose currency is the E$. It also makes sales to Country F whose currency is the F$.
- All purchases are from Country G whose currency is the G$.
- The settlement of all transactions is in the currency of the customer or supplier.

Which of the following changes would be most likely to help the company achieve its objective?

A. The D$ strengthens against the E$ over time.

B. The F$ weakens against the D$ over time.

C. The D$ strengthens against the G$ over time.

D. The D$ weakens against the G$ over time.

Answer: C

Question: 6

A listed company plans to raise $350 million to finance a major expansion programme.
The cash flow projections for the programme are subject to considerable variability.
Brief details of the programme have been public knowledge for a few weeks.
The directors are considering two financing options, either a rights issue at a 20% discount to current share price or a long term bond.
The following data is relevant: