Accountant

CIMA-F3
Financial Strategy

Questions And Answers PDF Format:

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Question: 1

A company generates operating profit of $17.2 million, and incurs finance costs of $5.7 million.
It plans to increase interest cover to a multiple of 5-to-1 by raising funds from shareholders to repay some existing debt. The pre-tax cost of debt is fixed at 5%, and the refinancing will not affect this.
Assuming no change in operating profit, what amount must be raised from shareholders?
Give your answer in $ millions to the nearest one decimal place.
$?

Answer: 45.2

Question: 2

A company has a covenant on its 5% long-term bond, stipulating that its retained earnings must not fall below $2 million.
The company has 100 million shares in issue.
Its most recent dividend was $0.045 per share. It has committed to grow the dividend per share by 4% each year.
The nominal value of the bond is $60 million. It is currently trading at 80% of its nominal value.
Next year's earnings before interest and taxation are projected to be $11.25 million.
The rate of corporate tax is 20%.
If the company increases the dividend by 4%, advise the Board of Directors if the level of retained earnings will comply with the covenant?

A. Covenant is not breached as retained earnings = $2.40 million.
B. Covenant is not breached as retained earnings = $2.10 million.
C. Covenant is breached as retained earnings = $1.92 million.
D. The covenant is not breached as retained earnings = $4.68 million.

Answer: C

Question: 3

A company's gearing is well below its optimal level and therefore it is considering implementing a share re-purchase programme.
This programme will be funded from the proceeds of a planned new long-term bond issue.
Its financial projections show no change to next year's expected earnings.
As a result, the company plans to pay the same total dividend in future years.
If the share re-purchase is implemented, which THREE of the following measures are most likely to decrease?

A. The Weighted Average Cost of Capital
B. The cost of equity
C. The interest cover
D. Next year's dividend per share
E. The gearing, based on book value (debt ÷ (debt + equity))
F. The number of shares in issue

Answer: A, C, F

Question: 4

A profit-seeking company intends to acquire another company for a variety of reasons, primarily to enhance shareholder wealth.
Which THREE of the following offer the greatest potential for enhancing shareholder wealth?

A. Achieving more press coverage for the company.
B. Creating new opportunities for employees.
C. Achieving greater cultural diversity.
D. Acquiring Intellectual Property assets.
E. Exploiting production synergies.
F. Elimination of existing competition.

Answer: D, E, F

Question: 5

A company's Board of Directors is considering raising a long-term bank loan incorporating a number of covenants.
The Board members are unsure what loan covenants involve.
Which THREE of the following statements regarding loan covenants are true?

A. A positive loan covenant would require the company to undertake specific actions.
B. A loan covenant has no contractually binding obligations.
C. A restrictive covenant prohibits the company from conducting certain actions without the approval of the lending institution.
D. A covenant gives the financial institution the right but not the obligation to convert debt into equity in a case of non-compliance.
E. A financial covenant usually requires the company to adhere to specific financial conditions or targets.

Answer: A, C, E

Question: 6

Company A is identical in all operating and risk characteristics to Company B, but their capital structures differ.
Company B is all-equity financed. Its cost of equity is 17%.
Company A has a gearing ratio (debt:equity) of 1:2. Its pre-tax cost of debt is 7%.
Company A and Company B both pay corporate income tax at 30%.
What is the cost of equity for Company A?

A. 20.5%
B. 21.2%
C. 22.0%
D. 17.0%

Answer: A

Question: 7

A company wishes to raise new finance using a rights issue. The following data applies:
- There are 10 million shares in issue with a market value of $4 each
- The terms of the rights will be 1 new share for 4 existing shares held
- After the rights issue, the theoretical ex-rights price (TERP) will be $3.80

Assuming all shareholders take up their rights, how much new finance will be raised ?
Give your answer to one decimal place.
$? million

Answer: 7.5, 7.50

Question: 8

A company wishes to raise new finance using a rights issue to invest in a new project offering an IRR of 10%
The following data applies:
- There are currently 1 million shares in issue at a current market value of $4 each.
- The terms of the rights issue will be $3.50 for 1 new share for 5 existing shares.
- The company's WACC is currently 8%.

What is the yield-adjusted theoretical ex-rights price (TERP)?
Give your answer to 2 decimal places.
$?

Answer: 4.06, 4.060

Question: 9

A company plans to cut its dividend but is concerned that the share price will fall. This demonstrates the ______________ effect

Answer: clientele

Question: 10

A company enters into a floating rate borrowing with interest due every 12 months over the five year life of the borrowing.
At the same time, the company arranges an interest rate swap to swap the interest profile on the borrowing from floating to fixed rate.
These transactions are designated as a hedge for hedge accounting purposes under IAS 39 Financial Instruments: Recognition and Measurement.
Assuming the hedge is considered to be effective, how would the swap be accounted for 12 months later?

A. The swap would be shown at nominal value in the statement of financial position and the change in value posted to other comprehensive income.
B. The swap would be shown at nominal value in the statement of financial position and the change in value posted to profit or loss.
C. The swap would be shown at fair value the statement of financial position and the change in value posted to other comprehensive income.
D. The swap would be shown at fair value the statement of financial position and the change in value posted to profit or loss.

Answer: C