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CIMA F3 Financial Strategy Sample Questions (Q24-Q29):

NEW QUESTION # 24

A Venture Capital Fund currently holds a significant shareholding in a large private company as a result of funding a recent management buyout. It plans to exit this investment in 5 years time at a significant profit.

Which THREE of the following exit mechanisms are most likely to be preferred by the Venture Capital Fund?

- A. The Venture Capital Fund has an option to sell its shareholding to the company at twice its original cost which can be exercised in 5 years time.
- B. The Venture Capital Fund has a legal entitlement to sell its shareholding to any third party investor if the company has not obtained a stock market listing within 5 years.
- C. The private company obtains a stock market listing on a recognised exchange within the next 5 years.
- D. The management team has an option to buy the Venture Capital Fund's shares for their nominal value which can be exercised in 5 years time.
- E. The management team agrees to buy back the Venture Capital Funds shareholding in 5 years time at its original cost.

Answer: A,B,C

Explanation:

VC wants to exit in 5 years at a significant profit.

A: Buyback at original cost # no profit # not preferred.

B: IPO within 5 years # creates market to sell at premium # preferred.

C: Put option to sell back to company at twice cost # guarantees profit # preferred.

D: Right to sell to any third party if no listing # provides liquidity / exit route # preferred.

E: Management can buy at nominal value # would likely be a loss # not preferred.

NEW QUESTION # 25

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

Answer:

Explanation:

effect

Signalling effect (information content of dividends) In CIMA F3, dividend policy is closely linked to information asymmetry between a company's management and its shareholders.

Managers typically have better information about the firm's future prospects than external investors. As a result, investors often interpret changes in dividends as signals about management's expectations of future earnings and cash flows.

The concern that cutting dividends will cause the share price to fall illustrates the signalling effect (also known as dividend signalling theory). According to this theory, a dividend cut is interpreted by the market as a negative signal, suggesting that management expects lower future profits or cash flow difficulties. Investors react by revising their expectations downward, leading to a fall in the share price. CIMA F3 study guidance contrasts this with Modigliani and Miller's dividend irrelevance theory, which assumes perfect markets and no information asymmetry. In reality, markets are imperfect, and dividends convey information. Therefore, companies are often reluctant to reduce dividends even when it may be financially prudent, due to fear of adverse market reactions. This behaviour is also linked to dividend stability, another key concept in F3, where firms prefer stable or gradually increasing dividends to avoid sending negative signals to investors.

NEW QUESTION # 26

A listed company follows a policy of paying a constant dividend. The following information is available:

* Issued share capital (nominal value \$0.50) \$60 million

* Current market capitalisation \$480 million

The shareholders are requesting an increased dividend this year as earnings have been growing. However, the directors wish to retain as much cash as possible to fund new investments. They therefore plan to announce a

1-for-10 scrip dividend to replace the usual cash dividend.

Assuming no other influence on share price, what is the expected share price following the scrip dividend?

Give your answer to 2 decimal places.

Answer:

Explanation:

\$?

3.64, 3.63, 3.65

NEW QUESTION # 27

A company has:

* \$6 million market value of equity

* \$4 million market value of debt

* WACC of 11.04%

* Corporate income tax rate of 20%

According to Modigliani and Miller's theory of capital structure with tax, what is the ungeared cost of equity?

- A. 10.16%
- B. 16.24%
- C. 12.54%
- D. 12.00%

Answer: D

NEW QUESTION # 28

Extracts from a company's profit forecast for the next financial year as follows:

Since preparing the forecast, the company has decided to return surplus cash to shareholders by a share repurchase arrangement.

The share repurchase would result in the company purchasing 20% of the 1,250 million ordinary shares currently in issue and canceling them.

Assuming the share repurchase went ahead, the impact on the company's forecast earnings per share will be an increase of:

- A. \$0.200
- B. \$0.100
- C. \$0.125
- D. \$0.175

Answer: B

NEW QUESTION # 29

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