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CIMA F3 Financial Strategy Sample Questions (Q339-Q344):

NEW QUESTION # 339
Company A is a listed company that produces pottery goods which it sells throughout Europe. The pottery is then delivered to a network of self employed artists who are contracted to paint the pottery in their own homes. Finished goods are distributed by network of sales agents.The directors of Company A are now considering acquiring one or more smaller companies by means of vertical integration to improve profit margins.
Advise the Board of Company A which of the following acquisitions is most likely to achieve the stated aim of vertical integration?

- A. A company that produces accessories.
- B. A company in a similar market to Company A.
- C. A pottery factory in the Middle East.
- D. A listed international logistics firm.

Answer: D

NEW QUESTION # 340

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 Wora 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.
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 a takeover.
- B. Pay a one-off special dividend.
- C. Refer the bid to the country's competition authorities.
- D. Write to shareholders explaining fully why the company's share price is under valued.

Answer: D

NEW QUESTION # 341

Providers of debt finance often insist on covenants being entered into when providing debt finance for companies.
Agreement and adherence to the specific covenants is often a condition of the loan provided by the lender.
Which THREE of the following statements are true in respect of covenants?

- A. Covenants are entered into to eliminate the tax liability of the company.
- B. Covenants are entered into to penalise the company.
- C. Covenants are entered into to impose financial discipline on the company.
- D. Covenants enable the lender to demand immediate repayment or to renegotiate terms if it is breached.
- E. Covenants are entered into to give the lender added protection on the loan extended to the company.

Answer: C,D,E

Explanation:
Covenants are mainly there to protect the lender (B),
to impose financial discipline on the borrower (C), and
if breached, they usually give the lender rights to call in the loan or renegotiate (D).
They are not designed simply to penalise the company (A) or eliminate tax (E).
Discursive_F0

NEW QUESTION # 342

A company is owned by its five directors who want to sell the business.
Current profit after tax is $750,000.
The directors are currently paid minimal salaries, taking most of their incomes as dividends.
After the company is sold, directors' salaries will need to be increased by $50,000 each year in total.
A suitable Price/Earnings (P/E) ratio is 7, and the rate of corporate tax is 20%.
What is the value of the company using a P/E valuation?

- A. $4,900,000
- B. $5,250,000
- C. $4,970,000
- D. $5,530,000

Answer: C

NEW QUESTION # 343
It is now 1 January 20X0.
Company V, a private equity company, is considering the acquisition of 40% of the equity of Company A for a total amount of $15 million.
Company A has been established to develop a new type of engine which will be launched at the end of 20X1.
Company A is forecasting that the new engine will result in free cash flows to equity of $2m in its first year of operation and that this will rise by 8% per year for the foreseeable future.
The new engine is the only commercial activity that Company A is involved in.
Company V intends to sell its stake in Company A when the new engine is launched.
Company A has a cost of equity of 12%.
Assuming that Company V receives an amount that reflects the present value of their shares in company A.
what is the estimated annual rate of return to Company V from this investment? (To the nearest %)

- A. 33%
- B. 10%
- C. 16%
- D. 3%

Answer: C

Explanation:
Company A's equity value at the launch date (end of 20X1) is the PV of a growing perpetuity of FCFE:
First FCFE (end of first year of operation, 20X2): $2m
Growth: 8%
Cost of equity: 12%
Value of Company A at end-20X1:
V=20.12#0.08=20.04=50 millionV = \frac{2}{0.12 - 0.08} = \frac{2}{0.04} = 50 \text{ million}V=0.12#0.082=0.042=50 million
Company V owns 40%:
Value of stake at sale=0.4×50=20 million\text{Value of stake at sale} = 0.4 \times 50 = 20 \text{ million} Value of stake at sale=0.4×50=20 million It invests $15m at 1 Jan 20X0 and gets $20m at end-20X1 (# 2 years):
15(1+r)2=20#(1+r)2=2015=4315(1 + r)