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## CIMA F3 Financial Strategy Sample Questions (Q425-Q430):

### NEW QUESTION # 425

A company has borrowings of \$5 million on which it pays interest at 8%. It has an operating profit margin of 20%.

The company plans to increase borrowings by \$2 million. Interest on additional borrowings would be 10% and the operating profit margin would remain unchanged. A debt covenant attached to the new borrowings requires interest cover to be at least 4 times throughout the period of the borrowing. Interest cover is defined in the loan documentation as being based on operating profit. What is the minimum sales value required each year to avoid a breach of the interest cover covenant?

- A. \$12.00 million

- B. \$2.88 million
- C. \$3.00 million
- D. \$2.40 million

**Answer: A**

Explanation:

Current debt interest:

Existing:  $5m \times 8\% = 0.40m$

New:  $2m \times 10\% = 0.20m$

Total interest = 0.60m

Let annual sales = S.

Operating profit margin = 20% #  $OP = 0.20 S$ .

Interest cover covenant:

$\frac{0.20 S}{0.60} \geq 2.4 \Rightarrow 0.20 S \geq 1.44$

$\Rightarrow S \geq \frac{1.44}{0.20} = 7.2 \text{ million}$

\$7.20 million

#### NEW QUESTION # 426

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 # 427

The ex div share price of Company A's shares is \$3.50

An investor in Company A currently holds 2,000 shares.

Company A plans to issue a scrip dividend of 1 new share for every 10 shares currently held.

After the scrip dividend, what will be the total wealth of the shareholder?

Give your answer to the nearest whole \$.

□

- A. 0
- B. 1

**Answer: B**

Explanation:

□

#### NEW QUESTION # 428

A profitable company wishes to dispose of a loss-making division that generated negative free cashflow in the last financial year.

The division requires significant new investment to return it to profitability.

Which of the following valuation approaches is likely to be the most useful to the company when negotiating the sales price?

- A. P/E ratio applied to forecast earnings next year
- **B. Asset basis**
- C. Dividend growth model
- D. Discounted forecast free cashflow

**Answer: B**

Explanation:

The division is:

Currently loss-making

Has generated negative free cash flow

Requires significant new investment to return to profitability

Under CIMA F3 valuation principles:

Dividend growth model (A) - not suitable: the division does not pay dividends and may not be a standalone listed entity.

P/E ratio on forecast earnings (D) - inappropriate where current earnings are negative and future earnings highly uncertain.

Discounted forecast free cash flow (C) is theoretically strong, but here forecasts are likely to be very uncertain because profitability depends on substantial new investment by the buyer.

In such cases, the asset-based valuation (B) is often most useful as a negotiation tool: it provides a defensible view of what the business is worth in terms of its underlying net assets and sets a floor for acceptable sale price.

So the most useful approach in negotiations is B. Asset basis.

#### NEW QUESTION # 429

XYZ has a variable rate loan of \$200 million on which it is paying interest of Libor + 3%.

XYZ entered into a swap with AG bank to convert this to a fixed rate 8% loan. AB bank charges an annual commission of 0.4% for making this arrangement

Calculate the net payment from XYZ to AB bank at the end of the first year if Libor was 2% throughout the year.

Give your answer in \$ million, to one decimal place.

- A. 22.9
- **B. 22.8**

**Answer: B**


Explanation:

#### NEW QUESTION # 430

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