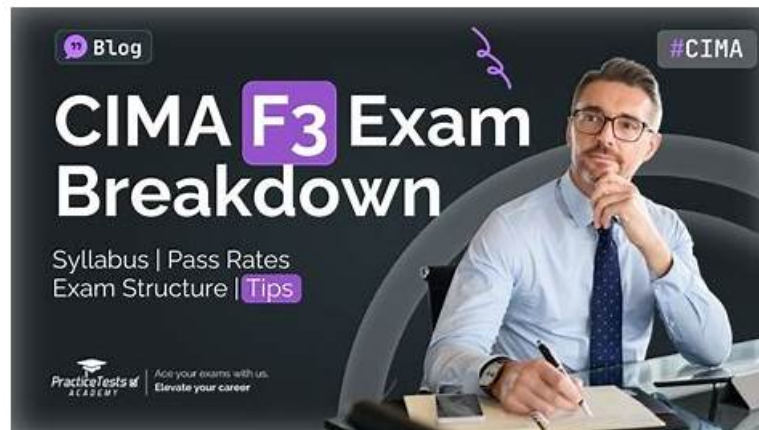


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CIMA F3 Financial Strategy Sample Questions (Q197-Q202):

NEW QUESTION # 197

A new company was set up two years ago using the personal financial resources of the founders.

These funds were used to acquire suitable premises.

The company has entered into a long-term lease on the premises which are not yet fully fitted out.

The founders are considering requesting loan finance from the company's bank to fund the purchase of custom-made advanced technology equipment.

No other companies are using this type of equipment.

The company expects to continue to be profitable for the foreseeable future.

It re-invests some of its surplus cash in on-going essential research and development.

Which THREE of the following features are likely to be considered negatives by the bank when assessing the company's credit-worthiness?

- A. The founders invested their personal financial resources in the company.

- B. The equipment is advanced technology custom-made equipment.
- C. The company premises are on a long-term lease but are not yet fully fitted out.
- D. The company will continue to remain profitable and to generate net cash.
- E. Essential on-going research and development expenditure is required.

Answer: B,C,E

Explanation:

Negatives for the bank:

- A). Advanced, custom-made tech equipment - poor resale value and high obsolescence risk, weak security.
- C). Premises on a long-term lease and not fully fitted out - limited asset security; further capital outlay still needed.
- E). Essential ongoing R&D - continuing cash demands and uncertainty of returns.

Positives, so not negatives:

- B). Continuing profitability and net cash generation - good for servicing debt.
- D). Founders' personal investment - shows commitment and loss-sharing; strengthens equity base.

NEW QUESTION # 198

Company ABC's management has noticed that Company BCD has quickly built up a 20% stake by buying shares in Company ABC and are concerned that this is the start of a hostile bid.

This build-up of shares triggers the poison pill provision which automatically converts the rights to buy future preference shares previously issued to existing shareholders in Company ABC to full ordinary shares. What is the most likely impact of the triggering of a poison pill strategy at this stage in the bidding process?

- A. Company BCD loses value on its shareholding and has to sell at a loss before losing more value
- B. It is too late for a poison pill strategy to have any impact on a hostile takeover because Company BCD has already built up a significant stake in Company ABC.
- C. The threat of a hostile takeover is reduced because Company ABC becomes more expensive to buy.
- D. Company ABC becomes less attractive due to a fall in value of the shares as a result of the discount.

Answer: C

NEW QUESTION # 199

The table below shows the forecast for a company's next financial year:

□ The forecast incorporates the following assumptions:

- * 25% of operating costs are variable
- * Debt finance comprises a \$400 million fixed rate loan at 5%
- * Corporate income tax is paid at 25%

The company plans to do the following next year from the forecast earnings on the assumption that earnings will be equivalent to free cash flow:

- * Pay a total dividend of \$20 million
- * Invest \$40 million in new projects

What is the maximum % reduction in operating activity that could occur next year before the company's dividend and investment plans are affected?

Give your answer to the nearest 0.1%.

- A. 4.8, 4.7, 4.9, 5.0, 4.6, 4.80, 4.70, 4.90, 5.00, 4.60%
Current forecast profit after tax = \$75m
Planned uses of cash next year: Dividends = \$20m
Investment = \$40m
Total required = \$60m
So profit (and cash) can fall by at most 75 - 60 = \$15m before these plans are affected.
Let xxx = proportionate reduction in operating activity (and hence in revenue and variable costs).
Revenue = 520(1 - x)
Operating costs: fixed = 75% of 400 = 300; variable = 25% of 400 = 100(1 - x)
Profit from operations = 520(1 - x) - 100(1 - x) - 300 = 420(1 - x) - 300 = 120 - 420x
Profit before tax = (120 - 420x) - 20 = 100 - 420x
Profit after tax = (100 - 420x) × (1 - 0.25) = 0.75(100 - 420x) = 75 - 315x
Set this equal to the minimum acceptable profit (60):
75 - 315x = 60
15x = 15 / 315 = 1 / 21
0.0476x = 15 / 315 = 1 / 21
0.0476
So the maximum reduction in operating activity is about 4.8%.
- B. 4.8%

Answer: A,B

NEW QUESTION # 200

Company J plans to acquire Company K, an unlisted company whose equity is to be valued using a P/E ratio approach.

A listed company has been identified which is very similar to Company K and which can be used as a proxy.

However, the growth prospects of Company K are higher than those of the proxy.

The Directors of Company J are aware that certain adjustments will be necessary to the proxy company's P/E ratio in order to obtain a more reliable valuation.

The following adjustments have been agreed:

* 20% due to Company K being unlisted.

* 15% to allow for the growth rate difference.

The total adjustment to the proxy p/e ratio is:

- A. 35% decrease
- B. 5% increase
- C. 5% decrease
- D. 35% increase

Answer: C

NEW QUESTION # 201

Three companies are quoted on the New York Stock Exchange. The following data applies:

Which of the following statements is TRUE?

- A. Companies A and B have the same capital structure
- B. Companies A and B have the same business risk
- C. Companies A and C have the same business risk
- D. Company A has the greatest business risk

Answer: B

NEW QUESTION # 202

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