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## CIMA F3 Financial Strategy Sample Questions (Q83-Q88):

NEW QUESTION # 83

Company Z has identified four potential acquisition targets: companies A, B, C and D.  
 Company Z has a current equity market value of \$580 million.  
 The price it would have to pay for the equity of each company is as follows:

	Z+A	Z+B	Z+C	Z+D
Equity market value (\$ million)	625	643	640	655

Only one of the target companies can be acquired and the consideration will be paid in cash.  
 The following estimations of the new combined value of Company Z have been prepared for each acquisition before deduction of the cash consideration:

Ignoring any premium paid on acquisition, which acquisition should the directors pursue?

- A. A
- B. D
- C. C
- D. B

**Answer: C**

#### NEW QUESTION # 84

A company is about to announce a new project that has a positive NPV.  
 If the market is semi-strong form efficient, which of the following statements is most likely to be true?  
 The value of the company will.

- A. increase only on completion of the project.
- B. Increase by the NPV of the project once the information has been announced
- C. already include the value of the project.
- D. only change to incorporate historical information.

**Answer: B**

Explanation:

In a semi-strong form efficient market, share prices instantly adjust to all publicly available information.  
 When the positive-NPV project is announced, its NPV is immediately reflected in the company's value.  
 Answer Q35: B. Increase by the NPV of the project once the information has been announced

#### NEW QUESTION # 85

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

**Answer: B,C,E**

Explanation:

Explanation  
 Discursive\_F0

#### NEW QUESTION # 86

Company A is based in country A with the AS as its functional currency. It expects to receive BS20 million from Company B in settlement of an export invoice.

The current exchange rate is AS1 = BS2 and the daily standard deviation of this exchange rate = 0.5% What is the one-day 95% VaR in AS?

- A. A\$164,500
- B. A\$82,250
- C. A\$822,500
- D. A\$50,000

**Answer: B**

Explanation:

Exposure: Company A will receive BS20 million.

Spot rate: AS1 = BS2 # 1 BS = AS0.5

Current AS value of the receipt:

$$20,000,000 \times 0.5 = \text{A\$}10,000,000$$

$$5 = \text{A\$}10,000,000$$

Daily standard deviation of the exchange rate = 0.5% = 0.005

1-day 95% VaR uses Z # 1.645

VaR:

$$\text{VaR} = Z \times \sigma \times \text{exposure} = 1.645 \times 0.005 \times 10,000,000$$

$$= 1.645 \times 0.005 \times 10,000,000 = 82,250$$

$$= 82,250$$

$$1.645 \times 50,000 = 82,250$$

So the 1-day 95% VaR is A\$82,250 # Option C.

#### NEW QUESTION # 87

Company M is a geared company whose equity has a market value of \$1,500 million and debt has a market value of \$300 million.

The company plans to issue \$200 million of new shares and use the funds raised to pay off some of the debt Company M currently has a cost of equity of 13% and a WACC of 10% It pays corporate tax at the rate of

30% Company B, an ungeared company operating in the same business sector as Company M, has a cost of equity of 12% Assume Modigliani and Miller's theory of capital structure with tax applies Which calculation below shows the correct approach to calculating the new WACC following the planned changes in capital structure?

- A.  $12.8\% = 13\% \times \left[ 1 - \left( \frac{0.30 \times 100}{1,600} \right) \right]$
- B.  $11.8\% = 12\% \times \left[ 1 - \left( \frac{0.30 \times 100}{1,600} \right) \right]$
- C.  $11.8\% = 12\% \times \left[ 1 - \left( \frac{0.30 \times 100}{1,800} \right) \right]$
- D.  $12.8\% = 13\% \times \left[ 1 - \left( \frac{0.30 \times 100}{1,800} \right) \right]$

**Answer: C**

Explanation:

To get the new WACC using Modigliani & Miller with tax: Find the ungeared (asset) cost of capital,  $K_u$ . Company B is

ungeared and in the same business, so its cost of equity = asset return:  $K_u = 12\%$   
 $= 12\%$  Work out the new capital structure after the refinancing. Current equity = \$1,500m  
 Current debt = \$300m  
 New equity issue = \$200m (used to repay debt)  
 New equity  $E_1 = 1,500 + 200 = 1,700$   
 $E_1 = 1,500 + 200 = 1,700$   
 New debt  $D_1 = 300 - 200 = 100$   
 $D_1 = 300 - 200 = 100$   
 Total value (using market values)  $V_1 = D_1 + E_1 = 100 + 1,700 = 1,800$   
 $V_1 = D_1 + E_1 = 100 + 1,700 = 1,800$   
 Apply MM with tax for WACC:  $WACC = K_u [1 - T \frac{D}{V}]$   
 $WACC = K_u [1 - T \frac{D}{V}]$   
 $WACC_1 = 12\% [1 - 0.30 \times \frac{100}{1,800}]$   
 $WACC_1 = 12\% [1 - 0.30 \times \frac{100}{1,800}]$   
 This gives approximately:  $12\% \times (1 - 0.0167) = 12\% \times 0.9833 = 11.8\%$   
 $12\% \times (1 - 0.0167) \approx 12\% \times 0.9833 \approx 11.8\%$   
 This matches option B:  $11.8\% = 12\% \times [1 - (0.30 \times 100 / 1,800)]$   
 $11.8\% = 12\% \times [1 - (0.30 \times 100 / 1,800)]$

## NEW QUESTION # 88

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