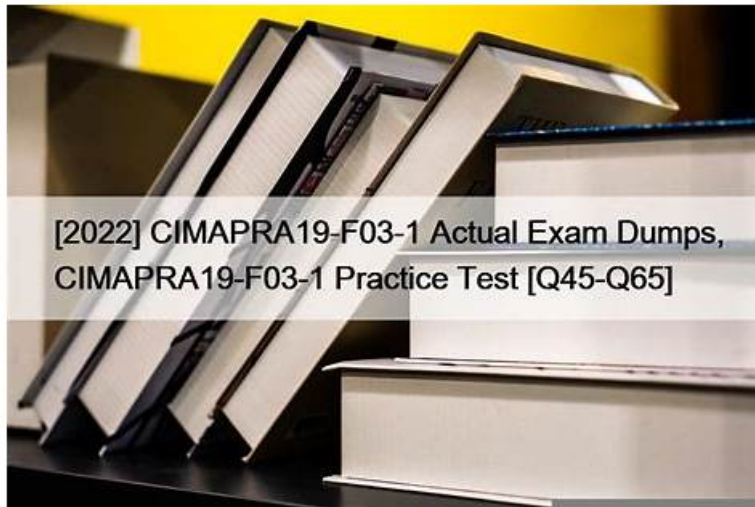


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CIMA F3 Financial Strategy Sample Questions (Q86-Q91):

NEW QUESTION # 86

Company E is a listed company. Its directors are valuing a smaller listed company, Company F, as a possible acquisition. The two companies operate in the same markets and have the same business risk. Relevant data on the two companies is as follows:

	Company E	Company F
Pre tax profits (\$million)	2,000	300
P/E ratio	15	5

Both companies are wholly equity financed and both pay corporate tax at 30%.

The directors of Company E believe they can "bootstrap" Company F's earnings to improve performance.

Calculate the maximum price that Company E should offer to Company F's shareholders to acquire the company.

Give your answer to the nearest \$million.

- A. 3,150
- B. 2,700
- C. 1,890
- D. 4,500

Answer: A

NEW QUESTION # 87

A company plans to raise finance for a new project.

It is considering either the issue of a redeemable cumulative preference share or a Eurobond.

Advise the directors which of the following statements would justify the issue of preference shares over a bond?

- A. If profits are poor, dividends do not have to be paid on the preference share - however, interest would need to be paid on the Eurobond.
- B. Preference shares are not secured against the assets of the business - however, the Eurobond would be.
- C. The issue of the preference share would reduce the company's gearing - however, the Eurobond would increase it.
- D. The company can claim tax relief on the dividend paid on the preference share at a higher rate than the interest paid on the Eurobond.

Answer: A

Explanation:

CIMA F3 compares different forms of long-term finance, including preference shares and bonds/Eurobonds, focusing on control, tax treatment, gearing impact, and flexibility.

Statement B captures a key advantage of preference shares from the company's perspective: if profits are poor, preference dividends can be omitted or deferred, especially when they are cumulative. Although unpaid dividends accumulate, non-payment does not normally constitute default in the same way as missing an interest payment on a bond. For a Eurobond, failure to pay interest when due would place the company in default, triggering legal and reputational consequences. This extra flexibility is exactly why preference shares might be favoured over bonds.

Statement A is misleading: Eurobonds are often unsecured, and security (or lack of it) is not a defining difference versus preference shares.

Statement C is incorrect in this context: redeemable cumulative preference shares are typically treated as a financial liability under IFRS (like debt), so they would generally increase gearing, not reduce it.

Statement D is clearly wrong as dividends are not tax-deductible, whereas bond interest normally is.

Therefore, the best justification for issuing preference shares rather than a Eurobond is B.

NEW QUESTION # 88

The directors of a multinational group have decided to sell off a loss-making subsidiary and are considering the following methods of divestment:

1. Trade sale to an external buyer
2. A management buyout (MBO)

The MDO team and the external buyer have both offered the same price to the parent company for the subsidiary.

Which of the following is an advantage to the parent company of opting for a MBO compared to a trade sale as the preferred method of divestment?

- A. Avoid a hostile reaction from key management.
- B. Retain the know edge of key management.
- C. Raise the cash more quickly.
- D. Focus on the core competencies of the business

Answer: A

NEW QUESTION # 89

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 divided of 1 new shares for every 10 shares currently held.

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

Give your answer to the nearest whole \$.

\$

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- A. 0
- B. 1

Answer: B

Explanation:

\$ 7000

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NEW QUESTION # 90

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

	\$ million
Revenue	520
Operating costs	(400)
Profit from operations	120
Interest	(20)
Corporate income tax	(25)
Profit after tax	75

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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 $x =$ 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 = $(100 - 420x) \times (1 - 0.25) = 0.75(100 - 420x) = 75 - 315x$ Set this equal to the minimum acceptable profit (60): $75 - 315x = 60$ $15x = 15/315 = 1/21 \approx 0.0476$ $x = 15 / 315 = 1/21 \approx 0.0476$ $x = 15/315 = 1/21 \approx 0.0476$ So the maximum reduction in operating activity is about 4.8%.
- B. 4.8%

Answer: A,B

NEW QUESTION # 91

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