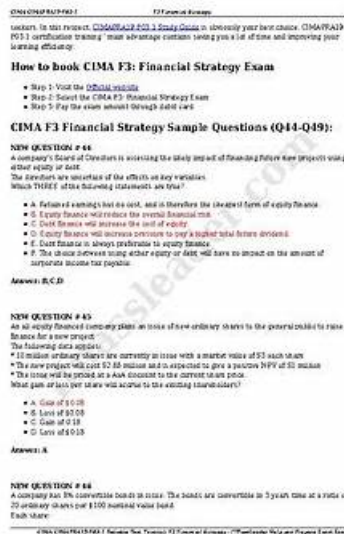


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CIMA F3 Financial Strategy Sample Questions (Q161-Q166):

NEW QUESTION # 161

Company A is a large well-established listed entertainment company and Company B is a small unlisted company specializing in providing online media streaming.

Company A has a gearing ratio of 60% (using book values) and interest cover of 2.

Company A is considering making an offer for Company B, either a cash offer financed by raising additional debt finance or a share-for-share exchange.

Which of the following is most likely to occur if Company A offers a share-for exchange rather than offering cash finance by raising debt?

- A. There would be no dilution of control.
- **B. Gearing would be lower.**
- C. Earnings per share would be higher.
- D. Dividend per share would be higher.

Answer: B

Explanation:

Two options for Company A buying B:

Cash offer financed by new debt # increases debt, so gearing goes up.

Share-for-share exchange # issues new shares (equity) instead of increasing debt.

So, relative to a debt-financed cash bid, a share-for-share offer leads to lower gearing (or at least avoids increasing gearing further).

The others are unlikely:

A & B: Using shares instead of (usually cheaper) debt doesn't generally make EPS or DPS higher.

D: Issuing new shares dilutes control, so there is dilution, not "no dilution".

NEW QUESTION # 162

A company intends to sell one of its business units, Company R by a management buyout (MBO).

A selling price of \$100 million has been agreed.

The managers are discussing with a bank and a venture capital company (VCC) the following financing proposal:

□ The VCC requires a minimum return on its equity investment in the MBO of 30% a year on a compound basis over 5 years.

What is the minimum TOTAL equity value of Company R in 5 years time in order to meet the VCC's required return?

Give your answer to one decimal place.

\$? million

- **A. 111.4, 111, 111.0, 111.1, 111.2, 111.3, 111.5, 111.6, 111.7** VCC equity investment = \$25m, required return = 30% p.a. for 5 years. Future value of VCC equity needed: $25 \times 1.35 = 25 \times 3.71293 = 92.823$ times 1.3

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