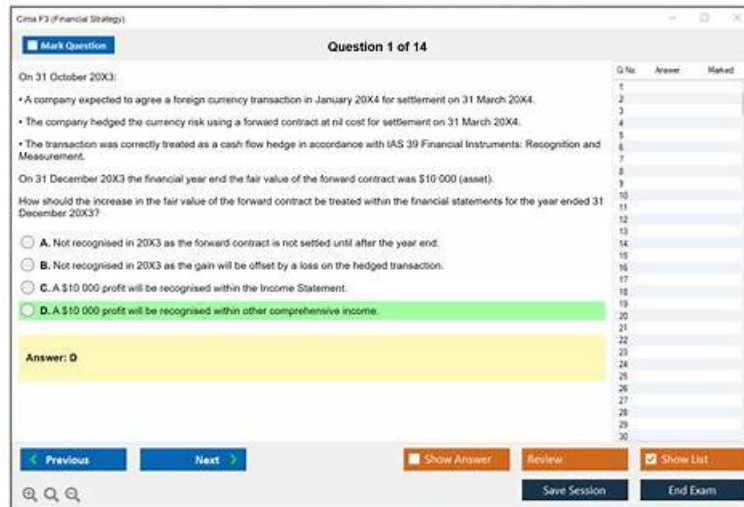


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## CIMA F3 Financial Strategy Sample Questions (Q109-Q114):

### NEW QUESTION # 109

Which of the following would be a reason for a company to adopt a low dividend pay-out policy?

- A. A lack of alternative sources of finance
- B. High profitability

- C. A lack of investment opportunities
- D. Using dividends to give a signal to the stock market

**Answer: D**

#### NEW QUESTION # 110

Company A is subject to a takeover bid from Company B, both companies operate in the same industry and each of them demand a significant market share. Company B has made an offer of \$5 per share to the shareholders of Company A. The directors of Company A do not believe the takeover would be in the best interests of the stakeholders and other stakeholders of Company A due to the following reasons:

1. Company B has recently taken over several other companies resulting in them breaking up the company and selling on the assets.  
 2. The directors of Company A believe the offer of \$5 per share undervalues the company. The directors of Company A are therefore keen to prevent the bid from going ahead. Which THREE of the following defence strategies could be used by the directors of Company A in this situation?

- A. Refer the bid to the Competition Authority because of the risk of a large number of employee redundancies if Company B's bid were to be successful
- B. Appeal to their own shareholders that the company should not be broken up because it has strong growth prospects.
- C. Offer the company to an alternative White Knight bidder.
- D. Inform shareholders of the potential current value of the non-current assets including intangibles, to show that their true value is higher than the bid value.
- E. Give existing shareholders the right to buy bonds in the future.

**Answer: A,B,C**

#### NEW QUESTION # 111

Company A is planning to acquire Company B. Both companies are listed and are of similar size based on market capitalisation. No approach has yet been made to Company B's shareholders as the directors of Company A are undecided about the most suitable method of financing the offer. Two methods are under consideration: a share exchange or a cash offer financed by debt.

Company A currently has a gearing ratio (debt to debt plus equity) of 30% based on market values. The average gearing ratio (debt to debt plus equity) for the industry is 50%. Although no formal offer has been made, there have been market rumours of the proposed bid, which is seen as favorable to Company A. As a consequence, Company A's share price has risen over the past few weeks while Company B's share price has fallen.

Which THREE of the following statements are most likely to be correct?

- A. The method of finance chosen will not affect the post-acquisition earnings per share of the combined business
- B. Company A's gearing will increase following a share exchange.
- C. Based on current share price movements, a share exchange would mean Company A has to issue fewer shares to acquire Company B than it would have done a few weeks ago
- D. Company B's shareholders will be able to participate in the future growth of the combined business if it is a share exchange
- E. Company A's weighted average cost of capital will fall if financing is with debt

**Answer: C,E**

#### NEW QUESTION # 112

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

**Answer: C**

### NEW QUESTION # 113

An all equity financed company plans an issue of new ordinary shares to the general public to raise finance for a new project The following data applies:

- \* 10 million ordinary shares are currently in issue with a market value of \$3 each share
- \* The new project will cost \$2.88 million and is expected to give a positive NPV of \$1 million
- \* The issue will be priced at a 40% discount to the current share price.

What gain or loss per share will accrue to the existing shareholders?

- **A. Loss of \$0.08**
- B. Gain of \$0.08
- C. Gain of 0.18
- D. Loss of \$0.18

**Answer: A**

Explanation:

Current equity value =  $10m \times \$3 = \$30m$

Issue price at a 40% discount:  $3 \times (1 - 0.40) = \$1.80$

New shares issued =  $2.88 / 1.80 = 1.6m$

Total shares after issue =  $10 + 1.6 = 11.6m$

Total value after project and issue (exam approach):

$30 + 2.88$  (cash raised) + 1 (NPV) = \$33.88m

Ex-issue price =  $33.88 / 11.6 = \$2.92$































































Gain/loss per existing share =  $2.92 - 3.00 = -\$0.08$

### NEW QUESTION # 114

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