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Question 1

Question Type: MultipleChoice

The directors of the following four entities have been discussing dividend policy:

Entity name	Description of entity
A	A government-owned (public sector) entity.
B	A large company whose shares are traded on a major stock exchange.
C	A small company whose shares are traded on a small company stock exchange and are owned by investors seeking maximum capital growth on their investment.
D	A small family-owned private company whose shareholders rely on their dividend income as their main source of income.

Which of these four entities is most likely to have a residual dividend policy?

Options:

A- A

B- B

C- C

D- D

Answer:

B

Question 2

Question Type: MultipleChoice

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 S3 each share

* The new project will cost S2.88 million and is expected to give a positive NPV of S1 million

* The issue will be priced at a AaA discount to the current share price.

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

Options:

A- Gain of 0.18

B- Loss of $0.08

C- Gain of $0.08

D- Loss of $0.18

Answer:

C

Question 3

Question Type: **MultipleChoice**

A company has borrowings of S5 million on which it pays interest at 8%. It has an operating profit margin of 20%.

The company plans to increase borrowings by S2 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'

Options:

A- S12.00 million

B- S3.00 million

C- TS2.40 million

D- S2.88 million

Answer:

C

Question 4

Question Type: MultipleChoice

RR has agreed to sell goods to XX for S20.000 XX will pay when the goods are delivered in 6 months time. RR's home currency is the - The current exchange rate is 4.3 /S. The projected inflation rate for the S is 2.8%, and for the E 4 6%.

When RR receives payment for its goods, what will the value be to the nearest pound?

Options:

A- 87.506

B- 85,243

C- 86 760

D- 84.520

Answer:

A

Question 5

Question Type: MultipleChoice

An unlisted company.

* Is owned by the original founders and members of their families

* Pays annual dividends each year depending on the cash requirements of the dominant shareholders.

* Has earnings that are highly sensitive to underlying economic conditions.

* Is a small business in a large Industry where there are listed companies with comparable capital structures

Which of the following methods is likely to give the most accurate equity value for this unlisted company?

Options:

A- Dividend valuation model.

B- Net asset valuation

C- P/E based valuation using the P/E of a similar company.

D- Discounted cash flow analysis at WACC (based on cash flows after tax but before financing) plus the market value of debt.

Answer:

A

Question 6

Question Type: **MultipleChoice**

WW is a quoted manufacturing company. The Finance Director has addressed the shareholders during WW's annual general meeting- She has told the shareholders that WW raised equity during the year and used the funds to repay a large loan that was maturing, thereby reducing WW's gearing ratio

At the conclusion of the Finance Director's speech one of the shareholders complained that it had been foolish for WW to have used equity to repay debt The shareholder argued that the Modigliani and Miller model (with tax) offers proof that debt is cheaper than equity when companies pay tax on their profits.

Which THREE arguments could the Finance Director have used in response to the shareholder?

Options:

A- A lower gearing ratio will result in an increase in the value of the company

B- WW was approaching a debt covenant limit and it was therefore important to reduce gearing.

C- A lower gearing ratio creates greater flexibility for WW in the future

D- The shareholder was confusing the cost of capital with shareholder wealth

E- Reducing the gearing ratio has reduced the financial risk of WW which will benefit shareholders

F- The Modigliani and Miller model would only be valid in practice if WW's shareholders were aware of the model and believed in its validity

Answer:

A, B, E

Question 7

Question Type: **MultipleChoice**

A company with a market capitalisation of S50million is considering raising $1 million debt to fund a new 10-year capital investment protect

The value of this issue is considered to be small in comparison to the company's market capitalisation

The company is considering whether to raise the debt finance by either a ''bond private placing' or a 'public bond issue.

Which THREE of the following statements are correct?

Options:

A- An initial public bond issue will be administratively complex and relatively expensive for the relatively small amount of debt being raised whereas a bond private placing will be relatively less complex

B- An average investor is made aware of a potential initial public bond issue whereas the average investor is only made aware of a bond private placing after it has occurred.

C- The company's credit rating will be a key element in determining the interest rate payable and the potential success of either the public bond issue or the bond private placing

D- An initial public bond issue does not need to be underwritten whereas a bond private placing must be underwritten.

E- An initial public bond issue can be arranged relatively quickly whereas a bond private placing can take up to a year to arrange.

Answer:

A, E

Question 8

Question Type: **MultipleChoice**

Company W is a manufacturing company with three divisions, all of which are making profits:

* Division A which manufactures cars

* Division B which manufactures trucks

* Division C which manufactures agricultural machinery

Company W is facing severe competitive pressure in all of its markets, and is currently operating with a high level of gearing Company W's latest forecasts suggest that it needs to raise cash to avoid breaching loan covenants on its existing debt finance in 6 months' time

In a recent strategy review. Divisions A and B were identified as being the core divisions of Company W

The management of Division C is known to be interested in the possibility of a management buy-out. Company Z is known to be interested in making a takeover bid for Company W's truck manufacturing division

A rival to Company W has recently successfully demerged its business, this was well received by the Financial markets

Which of the following exit strategies will be most suitable for company W?

Options:

A- Sale of Division B to Company Z

B- Closure of Division

C- Management buy-out of Division C

D- Demerger of Division C

Answer:

C

Question 9

Question Type: MultipleChoice

Listed Company A has prepared a valuation of an unlisted company. Company B. to achieve vertical integration Company A is intending to acquire a controlling interest in the equity of Company B and therefore wants to value only the equity of Company B.

The assistant accountant of Company A has prepared the following valuation of Company B's equity using the dividend valuation model (DVM):

Where:

* S2 million is Company B's most recent dividend

* 5% is Company B's average dividend growth rate over the last 5 years

* 10% is a cost of equity calculated using the capital asset pricing model (CAPM), based on the industry average beta factor

$$\text{Valuation of Company B's equity} = \frac{\$2\,million \times 1.05}{0.10 - 0.05} = \$42\,million$$

Where:

Which THREE of the following are valid criticisms of the valuation of Company B's equity prepared by the assistant accountant?

Options:

A- The DVM calculation should use Company A's cost of equity rather than Company B's cost of equity

B- It is better to use the present value of earnings rather than present value of dividends to value a controlling interest

C- The 5% growth rate may not reflect the future growth of Company B.

D- The beta factor used may not reflect Company B's financial risk.

E- An unlisted company cannot use the capital asset pricing model to calculate its cost of equity

Answer:

A, C, D

Question 10

Question Type: MultipleChoice

The primary objective of a public sector entity is to ensure value for money is generated.

Value for money is defined as performing an activity so as to simultaneously achieve economy, efficiency and effectiveness

Efficiency is defined as:

Options:

A- spending funds so as to achieve the objectives of the entity.

B- performing activities in the least amount of time possible

C- obtaining maximum output from minimum inputs

D- obtaining quality inputs at minimum cost.

Answer:

B