[Q89-Q103 CIMAPRA19-F03-1 Certification - The Ultimate Guide [Updated 2023

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QUESTION 89

Company B is an all equity financed company with a cost of equity of 10%.

It is considering issuing bonds in order to achieve a gearing level of 20% debt and 80% equity.

These bonds will pay a coupon rate of 5% and have an interest yield of 6%.

Company B pays corporate tax at the rate of 25%.

According to Modigliani and Miller’s theory of capital structure with tax, what will be Company B’s new cost of equity?

* $11.25\% = 10\% + [(10\% - 5\%) \times (20/80)]$
* $10.75\% = 10\% + [(10\% - 6\%) \times (15/80)]$
* $10.94\% = 10\% + [(10\% - 5\%) \times (15/80)]$
* $11.00\% = 10\% + [(10\% - 6\%) \times ($

QUESTION 90

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’
* S12.00 million
* S3.00 million
* TS2.40 million
* S2.88 million

QUESTION 91

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	9

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.
* 3,150
* 1,890
* 4,500
* 2,700

QUESTION 92

A company is financed as follows:

* 400 million $1 shares quoted at $3.00 each.

* $800 million 5% bonds quoted at par.

The company plans to raise $200 million long term debt to finance a project with a net present value of

$100 million.

The bank that is providing the debt is insisting on a maximum gearing level covenant.

Gearing will be based on market values and calculated as debt/(debt + equity).

What is the lowest figure for the gearing covenant that the bank could impose without the company breaching the agreement?
* 43%
* 44%
* 45%
* 46%

QUESTION 93

A company has in a 5% corporate bond in issue on which there are two loan covenants.

* Interest cover must not fall below 3 times

* Retained earnings for the year must not fall below $3.5 million

The Company has 200 million shares in issue.

The most recent dividend per share was $0.04.

The Company intends increasing dividends by 10% next year.

Financial projections for next year are as follows:

	$ million
Profit before interest and taxation	20.0
Interest ($100 million @ 5%)	5.0
Profit before taxation	15.0
Taxation @ 20%	3.0
Earnings	12.0

Advise the Board of Directors which of the following will be the status of compliance with the loan covenants next year?
* The company will be in compliance with both covenants.
* The company will be in breach of both covenants.
* The company will breach the covenant in respect of retained earnings only.
* The company will be in breach of the covenant in respect of interest cover only.

QUESTION 94

M is an accountant who wishes to take out a forward rate agreement as a hedging instrument but the company treasurer has advised that a short-term interest rate future would be a better option.

Which of the following is true of a short-term interest rate future?
* It can be tailored to the exact reeds of the company.
* It interest rates have gone down the price of the future will have fallen.
* It must be kept for ne whole duration of the contract
* The date is flexible and the position can be closed quickly and easily.

QUESTION 95

A listed company is planning a share repurchase.

Research into different offer prices has given the following data with regards acceptance by the shareholders at different prices:

Offer price	% take up
$8.50	10%
$9.00	20%
$9.50	30%
$10.00	40%

What price should be offered to shareholders if the retained earnings of the company are to remain unchanged?
* $8.50
* $9.00
* $9.50
* $10.00

QUESTION 96

A company is planning to repurchase some of its shares. Relevant details are as follows:

* 100 million shares in issue

* Current share price $5

* 5 million shares to be repurchased

* 10% repurchase premium

* Repurchased shares to be cancelled

What would you expect the share price after the repurchase to be?

Give your answer to two decimal places.
$?

4.97, 4.98

QUESTION 97

The following information relates to Company A’s current capital structure:

Company A is considering a change in the capital structure that will increase gearing to 30:70 (Debt:Equity).

The risk -free rate is 3% and the return on the market portfolio is expected to be 10%.

The rate of corporate tax is 25%

Using the Capital Asset Pricing Model, calculate the cost of equity resulting from the proposed change to the capital structure.
* 11.4%
* 12.3%
* 9.3%
* 10.1%

QUESTION 98

Which THREE of the following long term changes are most likely to increase the credit rating of a company?
* An increase in the interest cover ratio.
* A decrease in the (Net debt) / (Earnings before interest, tax, depreciation and amortisation) ratio.
* An increase in the free cashflow generated from operations.
* A decrease in the (Book value of debt) / (Book value of equity) ratio.
* A decrease in the dividend cover ratio.

QUESTION 99

Company A is located in Country A, where the currency is the A$.

It is listed on the local stock market which was set up 10 years ago.

It plans a takeover of Company B, which is located in Country B where the currency is the B$, and where the stock market has been operating for over 100 years.

Company A is considering how to finance the acquisition, and how the shareholders of Company B might respond to a share exchange or cash (paid in B$).

Which of the following is likely to explain why the shareholders of Company B would prefer a share exchange as opposed to a cash offer?
* It would allow them to realise their investment and make a capital gain.
* It would avoid them being exposed to foreign currency risk.
* They would receive shares in a market that is likely to be more efficient.
* It would enable them to benefit from the future performance of the combined entity.

QUESTION 100

A company’s annual dividend has grown steadily at an annual rate of 3% for many years. It has a cost of equity of 11%. The share price is presently $64.38.

The company is about to announce its latest dividend, which is expected to be $5.00 per share.

The Board of Directors is considering an attractive investment opportunity that would have to be funded by reducing the dividend to $4.50 per share. The board expects the project to enable future dividends to grow by

5% every year and the cost of equity to remain unchanged.

Calculate the change in share price, assuming that the directors announce their intention to proceed with this investment opportunity.

Give your answer to 2 decimal places.

$?
14.37

QUESTION 101

Company U has made a bid for the entire share capital of Company B.

Company U is offering the shareholders in Company B the option of either a share exchange or a cash alternative.

Advise the shareholders in Company B which THREE of the following would be considered disadvantages of accepting the cash consideration?
* Cash consideration is certain whereas Company U’s future share price performance is uncertain.
* Interest rates on deposit accounts are currently at a historic low and are expected to remain low.
* Company U is not expected to change its dividend policy post-acquisition.
* Taxation is payable on realised capital gains.
* There will be no opportunity to participate in the future economic success of Company U.

QUESTION 102

Company A is identical in all operating and risk characteristics to Company B, but their capital structures differ.

Company B is all-equity financed. Its cost of equity is 17%.

Company A has a gearing ratio (debt:equity) of 1:2. Its pre-tax cost of debt is 7%.

Company A and Company B both pay corporate income tax at 30%.

What is the cost of equity for Company A?
* 20.5%
* 21.2%
* 22.0%
* 17.0%

QUESTION 103

Company T is a listed company in the retail sector.

Its current profit before interest and taxation is $5 million.

This level of profit is forecast to be maintainable in future.

Company T has a 10% corporate bond in issue with a nominal value of $10 million.

This currently trades at 90% of its nominal value.

Corporate tax is paid at 20%.

The following information is available:

	The Overall Stock Market	The Retail Sector	Recent Takeovers in the Retail Sector
P/E multiples	20.0 times	10.0 times	13.0 times

Which of the following is a reasonable expectation of the equity value in the event of an attempted takeover?
* $32.0 million
* $41.6 million
* $65.0 million
* $50.2 million

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