

SECTION- A

- 1** XYZ Co has forecast sales in January of \$200,000 and predicts that sales will increase by 5% each month. All sales are on credit, and 60% of customers pay after one month, the rest paying after two months.

What cash receipt from customers will be budgeted for in May? Give your answer to the nearest dollar.

\$_____

- 2 Which TWO of the following statements are correct?**

- A Economic risk, in the exchange rate risk context, is related to the problems of government changing the macroeconomic environment (inflation, GDP growth etc).
- B Foreign exchange transaction risk in overseas trading relates to the problems of counterparties failing to fulfil obligations.
- C The forward foreign exchange market is one in which a deal is arranged to exchange currencies at some future date at a price agreed now.
- D The spot market is one in which transactions take place and delivery (fulfilment of the agreement) always occurs within a few days.
- E Translation risk occurs when the reported performance of an overseas subsidiary is distorted in the consolidated financial statements due to a change in exchange rates.

- 3** A company has agreed to lease a machine for a period of eight years, with equal annual payments payable at the start of each year. The NPV of the agreement, at a discount rate of 10%, is \$52,000. Ignore taxation.

What is the annual lease payment (to the nearest \$)?

- A \$8,208
- B \$8,862
- C \$9,747
- D \$13,444

- 4 A government funded fire service uses the 3E approach to assessing performance. Match the following measures to the element of the 3E approach it relates to.

The average number of minutes taken to arrive at a fire.	Economy
The cost of maintaining the fire equipment.	Effectiveness
The number of fires attended per member of staff.	Efficiency

- 5 A company is considering using a debt factor.

Which of the following services may the debt factor be able to provide?

- (1) Management of the receivables ledger
 - (2) Insurance against irrecoverable debts
 - (3) Collection of debts
 - (4) Processing customer orders
 - (5) Advancing of credit
- A (2), (3) and (4)
- B (1), (3) and (5)
- C (1), (2), (3) and (5)
- D (1), (2), (4) and (5)
- 6 QPR Co has 10 million \$0.60 par value shares in issue. It generated free cash flow of \$1.6 million this year and expects this figure to grow by 6% per annum in the future.
- QPR Co has a WACC of 10%. It has \$600,000 of bonds in issue, trading at \$60 per \$100.
- Calculate the estimated value of a QPR Co share to the nearest cent.**
- A \$1.66
- B \$1.70
- C \$4.20
- D \$4.24
- 7 TR Co has a gearing level of 1:3 debt:equity. TR is considering diversifying into a new market. B Co is already operating in the new market. B Co has an equity beta of 1.05 and a gearing level of 1:4 debt:equity. Both companies pay 30% corporation tax. Assume debt is risk-free.

What is the asset beta relevant to TR for the new market?

- A 0.89
- B 0.84
- C 0.28
- D 0.75

8 Complete the following sentences regarding currency appreciation/depreciation.

When the US dollar appreciates, US import prices will increase/decrease and US export prices will increase/decrease.

When the EURO depreciates, it would benefit European exporters/importers.

- A (2), (3) and (4)
- B (1), (3) and (5)
- C (1), (2), (3) and (5)
- D (1), (2), (4) and (5)

9 Which TWO of the following are features of overtrading?

- A Producing less than demand
- B Suffering greater risk due to frequent trading in stocks and shares
- C Suffering liquidity problems due to growing too rapidly
- D Producing more than demand
- E A rapid increase in current assets mostly financed by credit

10 Red Co is based in country H, where the functional currency is the H\$.

The spot rate for the H\$ to the euro (EUR) is EUR 5.550 = H\$1.

The expected interest rates in the eurozone and country H respectively are 2.5% and 6.5% over the next year.

What is the forecast forward rate of exchange in one year's time using the interest rate parity theory?

- A EUR 5.342 = H\$1
- B EUR 2.083 = H\$1
- C EUR 5.767 = H\$1
- D EUR 18.750 = H\$1

11 Match the following descriptions to the sources of funding in Islamic finance?

A special kind of partnership where the investment comes from one partner and the management and work is the exclusive responsibility of the other partner.	ijara
A form of trade credit, or loan, where the bank will take ownership of the asset.	mudaraba
The equivalent of lease finance, where the use of the underlying asset or service is transferred for consideration	musharaka
A relationship between two or more parties, who contribute capital to a business, and divide the net profit and loss pro-rata.	murabaha

12 Which of the following is a difference between primary and secondary capital markets?

- A Both primary and secondary markets relate to where shares and bonds trade after their initial offering.
- B Secondary capital markets relate to the sale of new issues of bonds, preference shares, and ordinary shares, while primary capital markets are where securities trade after their initial offering.
- C Primary capital markets relate to the sale of new issues of bonds, preference shares, and ordinary shares, while secondary capital markets are where securities trade after their initial offering.
- D Primary markets are where shares trade while secondary markets are where bonds trade.

13 A Co has an interest cover greater than one and gearing (debt / debt + equity) of 50%.

Complete the following sentences to explain the impact on interest cover and gearing of issuing shares to repay half the debt.

Interest cover will rise / fall.

Gearing will rise / fall.

14 Which TWO of the following statements regarding dividend policy are true?

- A All public companies are able to distribute up to 100% of retained earnings in the form of dividends.
- B A dividend that is different to investor expectations signals information about the business to the investors.
- C The dividend irrelevancy theory states that shareholders prefer capital growth to cash dividend.
- D Residual theory argues that dividends are important but the pattern of them is not.
- E A bonus share issue can be used as an alternative to cash dividends.

15 Which of the following statements are true?

- (1) Monetary policy is exercised by a government by control over interest rates only.
 - (2) An increase in interest rates will reduce consumer spending.
 - (3) An economic policy goal of full employment could lead to excessive inflation.
- A (1) and (2)
B (2) and (3)
C (1) and (3)
D (1), (2) and (3)

SECTION-B

Brecon Co is planning to introduce a new product, DV, to its range next year.

The marketing department has estimated that demand for the DV will be 8,000 per year for the life of the project. The following information relating to the investment proposal has now been prepared

Initial investment (first day of accounting period)	\$250,000
Selling price	\$45 per unit
Variable operating costs	\$28 per unit
Fixed operating costs	\$36,000 per year

No machinery scrap value is expected at the end of four years, when production of DV is planned to end. For investment appraisal purposes, Brecon uses a cost of capital of 10% per year and has a target return on capital employed of 20% per year. Ignore taxation.

16 What is the net present value for the investment proposal?

- A \$317,000
B -\$181,000
C \$67,000
D -\$150,000

17 Calculate the return on capital employed (accounting rate of return) based on average investment for the investment proposal. Show answer to the nearest whole number.

_____ %

- 18 If taxation is introduced at a rate of 30% and tax-allowable depreciation is available on a reducing balance basis of 25%, which figure is the present value of the tax savings on the tax-allowable depreciation closest to? Assume that tax is paid a year in arrears.

- A \$75,001
- B \$63,947
- C \$56,445
- D \$52,902

- 19 Select the correct words to complete the following sentences.

The discounted payback period for a project will be longer / shorter than the non-discounted payback period.

If the payback period calculated is longer / shorter than the company's target payback period, the project should be accepted.

- 20 If the cost of capital of 10% is the money discount rate and the general inflation rate is 2%, calculate the real discount rate.

- A 7.8%
- B 8%
- C 12%
- D 12.2%

The following scenario relates to questions 21–25.

Hulsta Co, a UK company, is in the process of negotiating an order worth \$1.4m with a large US retailer on six months' credit. If successful, this will be the first time that Hulsta has sold goods into the highly competitive US market.

The company's treasury department has provided the following:

The current spot rate is \$1.8960 – \$1.8970 = £1

The six-month forward rate is \$1.8840 – \$1.8860 = £1

	UK	USA
Annual borrowing rate	4%	8%
Annual deposit rate	3%	6%

- 21 Working to the nearest £000, how much would Hulsta receive in £ in six months if they used a money market hedge?
- A £735,000
 - B £724,000
 - C £745,000
 - D £720,000
- 22 Calculate (to the nearest £) the sterling receipt for Hulsta if they invoiced in dollars and used a forward exchange contract.
- £_____
- 23 If the exchange rate were to move to \$1.8870 – \$1.8900 = £1 in six months' time, what would be the exchange gain or loss compared to today if the company did not hedge the transaction?
- A £2,734 loss
 - B £2,734 gain
 - C £3,521 loss
 - D £3,521 gain
- 24 Which TWO of the following statements are correct about methods of dealing with foreign currency risk?
- A Future contracts and forward contracts can be traded.
 - B Currency options give the right but not the obligation to buy or sell currency at some point in the future at a predetermined rate.
 - C When using a money market hedge to hedge a future payment you borrow the present value of the foreign currency amount today, translate this into your home currency and place this on deposit.
 - D A forward exchange contract allows flexibility with regard to the amount to be covered and the settlement date.
 - E If an importer expects the currency it is due to pay in will depreciate, it may decide to settle early.
- 25 Select the correct words to complete the following sentences.
- Hulsta, a UK exporter trading with the USA and invoicing in US\$ would prefer £ sterling to be strong/weak.
- Hulsta's US customer would prefer the US dollar to be strong/weak if Hulsta were to invoice in £ sterling.

The following scenario relates to questions 26–30.

The directors of Park Co are considering making an offer to buy 100% of the shares in Ride Co, a competitor company. Extracts from the most recent financial statements of Ride Co are as follows:

Statement of profit or loss for the year ended 31 December 20X5

	\$000
Profit before tax	2,200
Tax @ 30%	(660)
	<hr/>
Profit after tax	1,540
	<hr/>
Dividends declared	250
	<hr/>

Statement of financial position at 31 December 20X5

Freehold land and buildings	8,500
Plant and machinery	5,800
Current assets	4,300
Share capital (50c ordinary shares)	500
Retained earnings	7,900
6% irredeemable debentures	8,000
Current liabilities	2,200

Additional information

A recent independent valuation of some of the company's assets showed that the land and buildings were worth \$9.6m and the plant and machinery \$3.2m. The current asset balance includes a receivable of \$0.2m from a company in liquidation and some inventory worth \$0.4m less than its carrying value.

Some research into listed companies in the publishing industry shows the following:

Average PE ratio	11
Average dividend yield	3%

- 26 Calculate the total equity value of Ride Co at 31 December 20X5 using the net asset basis (revalued).
- A \$8,400,000
- B \$6,300,000
- C \$14,300,000
- D \$6,900,000
- 27 Calculate the value per share of Ride Co at 31 December 20X5 using dividend yield method. Show your answer to the nearest cent.

\$_____

28 Which of the following statements is correct about valuation methods?

- A The net asset (revalued) method would tend to over value a business such as Ride.
- B The dividend valuation model is usually only used to value a minority interest.
- C Income based valuation methods, such as the PE ratio method, are particularly good for valuing minority shareholdings.
- D When using the PE ratio method for valuing a private company with fewer internal controls, the PE ratio of a similar public company could be used and adjusted upwards.

29 Drag the level of market efficiency to the statement to which it relates.

Inefficient	Weak form	Semi-strong form	Strong form
With this form of efficiency there would be no need to ban insider dealing as insiders cannot benefit from trading before information is published.			
Share prices follow a random walk so future price movements cannot be predicted from past price movements.			
With this form of efficiency the share price is not always an accurate reflection of the available information.			
The only way to beat the market would be to trade in the first few minutes of news about the company being published.			

30 If the return required by the debt holders of Ride is 7.5%, calculate the market value of the irredeemable debt. Show your answer to the nearest dollar.

- A \$80.00
- B \$125.00
- C \$56.00
- D \$87.50

SECTION-C

- 31** KC Co is a small owner-managed manufacturing company which manufactures one product. Each unit of their product requires two main input materials, F2 and H7. These materials are purchased from KC Co's two main suppliers.

KC Co is currently facing cash flow difficulties. It has gradually extended its overdraft over the past three years to its current level of \$1m. The company also has a loan from the bank for \$1.5m, which is due for repayment in 2 years' time. The loan is secured on the business premises.

KC Co pays interest on its overdraft at a rate of 15%.

KC Co's bank has suffered recently as a result of the banking crisis and has now tightened its lending policies. It has therefore asked KC Co to reduce the level of its overdraft by half within the next year.

The Finance Director (FD) is understandably concerned and considers that better management of working capital could release some much needed cash.

Two proposals are being considered:

Proposal 1: KC Co currently purchases all of its F2 from supplier A and obtains a 1.5% discount for settling invoices within 10 days. Standard payment terms are 45 days. The FD is proposing that KC Co revert to the standard payment terms with supplier A. Total purchases from supplier A in the year are \$6m.

Proposal 2: KC Co requires 10,000 units of material H7 each month and this is purchased from supplier B. Supplier B offers a discount of 5% on the normal purchase price of \$0.50 for orders of 20,000 or above and KC have always taken advantage of this discount by ordering 20,000 units at a time. The cost of placing an order with supplier B has been calculated as \$45 and the holding cost of H7 is \$1.20 per unit. The FD is proposing to reduce the quantity of H7 ordered each time to the economic order quantity level to reduce the holding costs, although this would mean losing the bulk discount.

Required:

- (a) Calculate the net cost or saving for KC Co of implementing proposal 1 and recommend if KC Co should go ahead with the proposal. (6 marks)
- (b) Calculate the net cost or saving for KC Co of implementing proposal 2 and recommend if KC Co should go ahead with the proposal. (8 marks)
- (c) Identify and discuss three techniques that could be used to monitor and manage cash resources in the future. (6 marks)

(Total: 20 marks)

- 32** March Co operates and manages a number of theme parks. The capital structure of March Co as at 1st January 2016 is as follows:

	\$m
Issued ordinary shares (25c shares)	250
10% preference shares (50c shares)	100
Bank term loan	200
8% irredeemable loan notes	400

The ordinary shares have a current market price of \$2 each. Dividends per share (in cents) in the five preceding years were as follows:

2011	2012	2013	2014	2015
6.9	7.2	8.8	9.6	10.5

The ordinary dividend for 2015 has just been paid. The bank is currently charging 10% on the term loan. The preference shares are currently priced in the market at \$0.70 per share and the dividend is just about to be paid. The loan stock has an ex interest market price of \$75 (against a nominal value of \$100). The company pays corporation tax at a rate of 30%.

Required:

- (a) Calculate a suitable discount rate that March Co could use when appraising new theme park projects. (10 marks)
- (b) Discuss the fundamental assumptions that are made whenever the weighted average cost of capital of a company is used as the discount rate in net present value calculations. (5 marks)
- (c) Discuss whether March Co could increase shareholder wealth by reducing its weighted average cost of capital to a minimum level. (ignore tax in any model discussed) (5 marks)

(Total: 20 marks)