<u>Section One</u>

<u>Answer ALL questions</u>

<u>Multiple choice questions</u>

(Each question is worth two marks)

<u>First Section:</u>

1- **Hawaii co. has just paid a dividend of 21 cent per share and its share price is $3.5 per share. One year ago its share price was $3.6 per share.**
   What is the total shareholder return over the period?
   - **A.** 8.9%
   - **B.** 8.6%
   - **C.** 3.1%
   - **D.** 0.9%

2- **Managerial reward schemes should help ensure managers take decisions which are consistent with the objective of shareholders.**
   Which of the following is <u>not</u> a characteristic of carefully designed remuneration package?
   - **A.** Linking awards to changes in shareholders wealth.
   - **B.** Matching of manager's time horizon's to shareholders time horizons.
   - **C.** Possibility of manipulation by managers.
   - **D.** Encouragement for managers to adept the same attitudes to risk as shareholders.

3- **Which of the following is a disadvantage of having a centralised treasury department in a large international group of companies?**
   - **A.** No need for treasury skills to be duplicated throughout the group.
   - **B.** Necessary borrowings can be arranged is bulk, at keener interest rates than for small amounts.
   - **C.** The group's foreign currency risk can be managed much more effectively since they can appreciate the total exposure situation.
   - **D.** Local operating units should have a better feel for local conditions than head office and can response more quickly to local developments.

4- **Although cash needs to be invested to earn returns, businesses need to keep a certain amount readily available for other needs.**
   Which of the following is <u>not</u> a reason for holding cash?
   - **A.** Movement motive.
   - **B.** Transactions motive.
   - **C.** Precautionary motive.
   - **D.** Investment motive.

5- **When considering investment appraisal under un certainty, a simulation exercise;**
   - **A.** Considers the effect of changing one variable at a time.
   - **B.** Considers the impact of many variables changing at the same time.
   - **C.** Points directly to the correct investment decision.
   - **D.** Assess the likelihood of a variable changing.

6- **A company issued its 12% irredeemable loan notes at $95 price. The current market price is $92. The company is paying corporation tax at a rate of 30%.**
What is the cost of capital per annum of the loan notes?
A. 8.8%
B. 9.1%
C. 12.6%
D. 13%

7- **An all equity company issues some irredeemable loan notes to finance project that has the same risk as existing projects. If the company operates in a tax free environment under conditions of perfect capital markets, what is the validity of the following statements?**
Statement1: the cost of equity will fall.
Statement2: the weighted average cost of capital will rise.

	Statment1	**stetment2**
A.	True	True
B.	False	True
C.	True	False
D.	False	False

8- **Compared to ordinary secured loan notes, convertible secured loan notes are; (choose the right answer).**
A. Likely to be more expensive to service because of their equity component.
B. Likely to be less expensive to service because of their equity component.
C. Likely to be more expensive to service because of converting to equity requires the holders to make additional payments.
D. Likely to be less expensive to service because they must rank under ordinary secured loan stock.

9- **In relation to preference shares as a source of capital for a company, which of the following statement is correct?**
A. Preference shares are a form of loan capital which curry lower risk than ordinary shares.
B. Preference shares are a form of equity capital which curry higher risk than ordinary shares.
C. Preference shares are a form of loan capital which curry higher risk than ordinary shares.
D. Preference shares are a form of equity capital which curry lower risk than ordinary shares.

10- What does the term "matching" refer to?

- **A.** The coupling of two simple financial instruments to great a more complex one.
- **B.** The mechanism whereby a company balances its foreign currency inflows and outflows.
- **C.** The adjustment of credit terms between companies.
- **D.** Contracts not yet offsets by future contracts or fulfilled by delivery.

11- Government have a number of economic targets as part of their monetary policy. Which of the following targets relates predominantly to monetary policy?

1. Increasing tax revenue.
2. Controlling the growth in the size of the money supply.
3. Reducing public expenditure.
4. Keeping interest rates low.

- **A.** (1) only
- **B.** (1) and (3) only
- **C.** (2) and (4) only
- **D.** (2) , (3) and (4)

12- A put option gives?

- **A.** The right to sell an asset at a fixed price.
- **B.** An obligation to sell an asset at a fixed price.
- **C.** The right to buy an asset at a fixed price.
- **D.** An obligation to buy an asset at a fixed price.

13- Which of the following best describes commercial paper?

- **A.** Secured long-term loan notes issued by companies.
- **B.** Secured short-term loan notes issued by companies.
- **C.** Un secured long-term loan notes issued by companies
- **D.** Un secured short-term loan notes issued by companies

14- Haney co. is evaluating a capital investment proposal with the following information:

Initial cost	**500,000 dollars**
Life	**10 years**
Annual operating cash inflow	**200,000 dollars**
Scrap value	**100,000 dollars**

The investment will depreciated using the straight line method.

What is the payback period for this investment?

- **A.** 3.25 years
- **B.** 2.67 years
- **C.** 3.5 years
- **D.** 2 years

15- Which of the following types of bonds is most likely to maintain a constant market value?

- **A.** Zero-coupon.
- **B.** Floating rate.
- **C.** Irredeemable.
- **D.** Convertible.

16- **Which of following may be regarded us an advantage to existing shareholders of listing the ferin on a major stock market ?**

 A. Reduced disclosure requirements.
 B. Larger dividends can be paid.
 C. Shares become more marketable.
 D. Reduced risk takeover.

17- **Which of the following is the correct definition of a warrant?**

 A. Security or collateral provide for a debit.
 B. Shares issued in line of a cash dividend.
 C. Restrictive covenants written into debt contracts.
 D. Shares option attached to a debt issue.

18- **Which of three elements from the following that needed to estimate the cost of equity using the dividend growth model?**

 A. Current dividends per share, expected growth rate in earnings per share and current market price per shares.
 B. Current earnings per share, expected growth rate in dividends per share and current market price per shares.
 C. Current earnings per share, expected growth rate in dividends per share and current value per shares.
 D. Current dividends per share, expected growth rate in dividends per share and current market price per shares.

19- **Which of the following statement concerning working capital management are correct?**

1. The two objectives of working capital management are profitability and liquidity.
2. A conservative approach to working capital investment will increase profit ability.
3. Working capital management is a key factor in a company's long term success.

 A. 1 and 2 only
 B. 1 and 3 only
 C. 2 and 3 only
 D. 1,2 and 3

20- **Which of the following is an example of a connected stakeholder of a company?**

 A. The community at large.
 B. Pressure groups.
 C. Customers.
 D. Government.

(Total marks 40)

Second Section
Answer all questions in this section

Question one:

The following financial information relates to Hagar Co:

Statement of financial position at the current date (extracts)

	$000	$000	$000
Non-current assets			48,965
Current assets:			
Inventory		8,160	
Accounts receivable		8,775	

Total Current assets		16,935	
Current liabilities			
Overdraft	3,800		
Accounts payable	10,200		

Total Current liabilities		14,000	

Net current assets			2,935

Total assets less current liabilities			51,900

Cash flow forecasts from the current date are as follows:

	Month 1	**Month 2**	**Month 3**
Cash operating receipts ($000)	4,220	4,350	3,808
Cash operating payments ($000)	3,950	4,100	3,750
Six-monthly interest on traded bonds ($000)		200	
Capital investment ($000)			2,000

The finance director has completed a review of accounts receivable management and has proposed staff training and operating procedure improvements, which he believes will reduce accounts receivable days to the average sector value of 53 days. This reduction would take six months to achieve from the current date, with an equal reduction in each month. He has also proposed changes to inventory management methods, which he hopes will reduce inventory days by two days per month each month over a three-month period from the current date. He does not expect any change in the current level of accounts payable.

Hagar Co has an overdraft limit of $4,000,000. Overdraft interest is payable at an annual rate of 6·17% per year, with payments being made each month based on the opening balance at the start of that month. Credit sales for the year to the current date were $49,275,000 and cost of sales was $37,230,000. These levels of credit sales and cost of sales are expected to be maintained in the coming year. Assume that there are 365 working days in each year.

__**Required:**__

(a) Discuss the working capital financing strategy of Hagar Co.

(6 marks)

(b) For Hagar Co, calculate:

(i) the bank balance in three months' time if no action is taken; and

(ii) the bank balance in three months' time if the finance director's proposals are implemented.

Comment on the forecast cash flow position of Hagar Co and recommend a suitable course of action.

(9 marks)

(Total 15 marks)

Question two:

FMY Co manufactures glass bottles for the drinks industry. It has been trading for 15 years. The company at present has no long-term debt although it does have an overdraft facility that is used for short-term financing needs.

The company is forecasting post-tax earnings of $4.5 million on revenue of $32 million for the current year. These sales and earnings levels are expected to continue unless new investment is undertaken. The Managing Director, who is also a significant shareholder, is planning a major expansion programme that will require raising $5 million of new finance for capital investment. This investment yields a positive net present value of $1.2 million when evaluated at the company's post-tax cost of capital of 12%, and is expected to increase post-tax earnings by $1million per annum (before considering the method of financing the expansion).

The Board is considering two alternative methods of financing this expansion:

(1) A 1 for 4 rights issue to existing shareholders. There are currently 10 million shares in issue, each of which is trading at $2.20.

(2) Medium-term (five years) debt, interest rate fixed at 8.6%, secured on the company's non-current assets, mainly land and buildings.

The company pays tax one year in arrears at 30%.

Required:

(a) Comment on the effect of each suggested method of financing on the valuation of the company. Your answer should refer to capital structure theories amongst other things.

(11 marks)

(b) Explain the major differences between Islamic finance and other conventional forms of finance such as those being considered by FMY Co.

(4 marks)

(Total: 15 marks)

Question three:

Jawa Co has undertaken market research at a cost of $200,000 in order to forecast the future cash flows of an investment project with an expected life of four years, as follows:

Year	*1*	*2*	*3*	*4*
Sales revenue ($000)	1,250	2,570	6,890	4,530
Costs ($000)	500	1,000	2,500	1,750

These forecast cash flows are before taking account of general inflation of 4.7% per year. The capital cost of the investment project, payable at the start of the first year, will be $2,000,000. The investment project will have zero scrap value at the end of the fourth year. The level of working capital investment at the start of each year is expected to be 10% of the sales revenue in that year.

Tax-allowable depreciation would be available on the capital cost of the investment project on a 25% reducing balance basis. Jawa Co pays tax on profits at an annual rate of 30% per year, with tax being paid one year in arrears. Jawa Co has a nominal (money terms) after tax cost of capital of 12% per year.

Required:

(a) Calculate the net present value of the investment project in nominal terms and comment on its financial acceptability.

(12 marks)

(b) Explain three ways in which the directors of Jawa Co can be motivated to achieve the objective of maximisation of shareholder wealth.

(3 marks)

(Total: 15 marks)

Question four:

Zad Co is a stock-market listed company that manufactures personal protection equipment. At a recent board meeting of Zad Co, a non-executive director suggested that the company's remuneration committee should consider scrapping the company's current share option scheme, since executive directors could be rewarded by the scheme even when they did not perform well.

A second non-executive director disagreed, saying the problem was that even when directors acted in ways which decreased the agency problem, they might not be rewarded by the share option scheme if the stock market were in decline.

Required:

(a) Explain the nature of the agency problem.

(7 marks)

(b) Discuss the use of share option schemes as a way of reducing the agency problem in a stock-market listed company such as Zad Co.

(8 marks)

(Total: 15 marks)

"End of questions paper"