Q. 1 Multiple Choice

Three individuals are considering starting a new business. They have the following considerations:

- They want to protect themselves from personal liability to pay any debts owed in the event of the business becoming bankrupt.
- Initially, they intend to raise £200 million from a combination of debt and equity financing.
- They expect at least 40% of the funding to come from equity raised through a Stock Exchange.

Select the most appropriate capital structure for the business.

A. Limited Liability Partnership

B. Private Limited Company

C. Sole Trader

D. Public Limited Company

Q. 2 Multiple Choice – with data

Question:

The following information relates to Company X:

- Equity Market Value: £6,000,000
- Debt Market Value: £4,000,000
- Risk Free Rate of Return: 2%
- Market Return: 7%
- Company Beta: 1.2
- Company Cost of Debt: 8%
- Tax Rate: 25%

Calculate company X's weighted average cost of capital (WACC).

A. 8.00

B. 7.44

C. 7.20

D. 6.80

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Q. 3 Numerical Entry

Instructions to candidates:

Calculate the following, in pence, to 2 decimal places.

Question:

A company has 100 million shares. The current market price per share is 100pence.

The company undertakes a rights issue of one (1) new share for every ten shares currently held. The issue price is 80pence per share.

Calculate the theoretical ex-rights price in pence to two decimal places.

Q. 4 Numerical Entry

Question:

The following information relates to Company Q:

Profit before interest and tax	**220,000**
Interest on loan capital	(22,000)
Profit before tax	198,000
Tax (10%)	(19,800)
Profit after interest and tax	178,200

Calculate Company Q's interest cover to the nearest whole number.

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Q. 5 Multiple Response

Question:

Country Y government has significantly increased its company tax rates.

In response, companies are adapting their behaviour to reduce their tax.

Which **TWO** of the following is Country Y likely to see an increase of?

A. More companies raising funds through preferred stock.

B. More companies raising funds through long-term loans.

C. More companies attracting foreign investors from countries with low tax rates.

D. More companies selling and leasing back properties as a form of borrowing.

E. More companies using retained earnings to fund new projects.

Q. 6 Multiple Response

Question:

Company U is a chemical manufacturer that has its Head Office in Northland.

Company U's factories are located overseas in host countries that offer access to raw materials and low employment costs.

Company U has a comprehensive risk management system in place.

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

A. U's Board can be blamed for accidents in its factories by host governments.

B. U's directors can only be held responsible for factory safety if they are chemists.

C. U's Board should close all factories that manufacture hazardous chemicals.

D. U's Board can delegate oversight of specific safety risks to designated managers.

E. U's Board should rely on host governments to check safety in factories.

Q. 7 True/False

Question:

Company D is based in the country of Actuaria.

The table below shows the impact of different capital structures on the total value of Company D's debt + equity:

Debt Allocation .(%)	Equity Allocation (%)	D's cost of equity capital	Weighted Average Cost of Capital (%p.a.)	Company Value (Debt + equity) ($'000)
0	100	6%	6%	450
20	80	6%	4%	500
30	70	8%	7%	400
50	50	9%	9%	360

Which of the statements is/are true?

i. The results in the table contradict Modigliani and Miller's first irrelevance proposition.

ii. The results in the table are consistent with Modigliani and Miller' second irrelevance proposition.

iii. Company D's optimal capital structure is 20% debt and 80% equity.

A. (i) and (ii) only

B. (ii) and (iii) only

C. (i) and (iii) only

D. (iii) only

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Q. 8 Drop down/Fill in the blank

Question:

The following information relates to Company Y:

- Capital structure: 50% equity and 50% debt.
- Return on equity: 7.0%
- Risk free rate: 3.0%
- Gross cost of debt: 4.5%
- Net cost of debt:3.8%

Select the correct options to complete the following sentences:

Company Y’s weighted average capital structure (WACC) is

If Company Y’s beta increases then its WACC will

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Q. 9 Drop down/Fill in the blank

Select the correct options to complete the following sentences:

Company H manufactures electronic components. H has a very short inventory turnover period (in days).

Such a short period is a favourable sign.

H's Board should be careful not to by carrying inventory.

The optimal inventory turnover

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Q. 10 Matching/Drag & Drop

Question:

Company C is heavily geared with loans secured on valuable land and buildings.

The company is facing severe cash flow problems because of the need to service its borrowings.

Company C's Board believes that the company can only survive for a year unless remedial action is taken.

The Board is considering four courses of action.

Match the proposed course of action by dragging its likely outcome next to it.

ACTION	OUTCOME
Enter into a high risk, but potentially profitable, investment.	This is likely to be rejected.
Seek support from the lenders.	The lenders will object and may take legal action.
Announce a large dividend payment using C's remaining cash.	Only the shareholders will benefit from the upside.
Undertake a large rights issue.	This could benefit both shareholders and lenders

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Q. 11 Matching/Drag & Drop

Question:

Draw a line between the following accounting ratios and the users of financial statements who are most likely to be interested in them.

RATIO	USER
Return on capital employed	Wholesale customers
Gross profit %	Suppliers
Gearing	Shareholders
Quick asset ratio	Lenders

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Q. 12 Assertion/Reasoning

Instructions to candidates:

1. You are given an assertion followed by a reason.
2. Consider the assertion and decide whether it is a true statement.
3. Consider the reason and consider whether that is a true statement.
4. If you decide that both the assertion and the reason are true, decide whether the reason provides a true explanation of the assertion.

Question:

You have been provided with the following information about Company A and Company B:

	Company A	Company B
Inventory Turnover Period	45 days	30 days
Trade Receivables Period	50 days	40 days
Trade Payables Turnover Period	40 days	35 days
Revenue	$120,000	$150,000
Cost of sales	$100,000	$125,000

Assertion	because	Reason
Company A has a greater need for an injection of cash compared to Company B		Company A has a lower operating profit compared to Company B

	Assertion	Reason	because
A.	True	True	Reason explains Assertion
B.	True	True	Reason does not explain Assertion
C.	True	False	
D.	False	True	
E.	False	False	

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Answers

Q1. **D**

Q2. **C**

Q3. **98.18 pence**

Q4. **10**

Q5. **B&D**

Q6. **A&D**

Q7. **C**

Q8.
Drop down1: **5.4**%
Drop down 2: **rise**

Q9.
Drop down 1: **possibly**
Drop down 2: **lose sales**
Drop down 3: **insufficient**
Drop down 4: **depends on the industry**

Q10.

Enter into a high risk, but potentially profitable, investment.	Only the shareholders will benefit from the upside.
Seek support from the lenders.	This is likely to be rejected.
Announce a large dividend payment using C's remaining cash.	The lenders will object and may take legal action.
Undertake a large rights issue.	This could benefit both shareholders and lenders

Q11.

Return on capital employed = **Shareholders**

Gross profit % = **Wholesale customers**

Gearing = **Lenders**

Quick asset ratio = **Suppliers**

Q12. **B**

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