MOCK B

SECTION A

Question#1:

Which of the following financial instruments will NOT be traded on a money market?

A. Commercial paper
B. Convertible loan notes
C. Treasury bills
D. Certificates of deposit

Question#2:

Which TWO of the following are descriptions of basis risk?

A. It is the difference between the spot exchange rate and currency futures exchange rate.
B. It is the possibility that the movements in the currency futures price and spot price will be different.
C. It is the difference between fixed and floating interest rates.
D. It is one of the reasons for an imperfect currency futures hedge.

Question#3:

Crag Co has sales of $200m per year and the gross profit margin is 40%. Finished goods inventory days vary throughout the year within the following range:

	Maximum	Minimum
Inventory (days)	120	90

All purchases and sales are made on a cash basis and no inventory of raw materials or work in progress is carried.

Crag Co intends to finance permanent current assets with equity and fluctuating current assets with its overdraft.

In relation to finished goods inventory and assuming a 360-day year, how much finance will be needed from the overdraft $_______ m?

Question#4:

The owners of a private company wish to dispose of their entire investment in the company. The company has an issued share capital of $1m of $0.50 nominal value ordinary shares.

The owners have made the following valuations of the company's assets and liabilities.

Non-current assets (book value)	$30m
Current assets	$18m
Non-current liabilities	$12m
Current liabilities	$10m

The net realisable value of the non-current assets exceeds their book value by $4m. The current assets include $2m of accounts receivable which are thought to be irrecoverable.

What is the minimum price per share which the owners should accept for the company_______$? (to the nearest $)

Question#5:

The home currency of ACB Co is the dollar ($) and it trades with a company in a foreign country whose home currency is the Dinar. The following information is available:

	Home country	Foreign country
Spot rate	20.00 Dinar per	$
Interest rate	3% per year	7% per year
Inflation rate	2% per year	5% per year

What is the six-month forward exchange rate?

A. 20.39 Dinar per $
B. 20.30 Dinar per $
C. 20.59 Dinar per $
D. 20.78 Dinar per $

Question#6:

The management of Lamara Co has annual credit sales of $20m and accounts receivable of $4m. Working capital is financed by an overdraft at 12% interest per year. Assume 365 days in a year.

What is the annual finance cost saving if the management reduces the collection period to 60 days $_______? (to the nearest $)

Question#7:

The following information has been calculated for A Co:

Trade receivables collection period:	52 days
Raw material inventory turnover period:	42 days
Work in progress inventory turnover period:	30 days
Trade payables payment period:	66 days
Finished goods inventory turnover period:	45 days

What is the length of the working capital cycle _____days?

Question#8:

Which of the following is/are usually seen as benefits of financial intermediation?

(1)Interest rate fixing
(2)Risk pooling
(3)Maturity transformation

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

Question#9:

Which TWO of the following statements concerning working capital management are correct?

A. The twin objectives of working capital management are profitability and liquidity.
B. A conservative approach to working capital investment will increase profitability.
C. Working capital management is a key factor in a company's long-term success.
D. The current ratio is a measure of profitability

Question#10:

Which of the following statements in relation to business valuation, are true or false?

	True	False
1. The earnings yield method and the dividend growth model should give similar values for a company.		
2. Market capitalisation represents the maximum value for a company.		
3. The price/earnings ratio is the reciprocal of the earnings yield.		
4.The price/earnings ratio should be increased if the company being valued is riskier than the valuing company.		

Question#11:

The following data is available:

Country Y currency	Dollar
Country X currency	Peso
Country Y interest rate	1% per year
Country X interest rate	3% per year
Country X expected inflation rate	2% per year
Spot exchange rate in Country Y	1.60 peso per $1

What is the current six-month forward exchange rate in Country Y_______? (to two decimal places)

Question#12:

Swap Co is due to receive goods costing $2,500. The terms of trade state that payment must be received within three months. However, a discount of 1.5% will be given for payment within one month.

Which of the following is the annual percentage cost of ignoring the discount and paying in three months?

A. 6.23%
B. 9.34%
C. 6.14%
D. 9.49%

Question#13:

Which of the following would lengthen the working capital cycle?

A. Delaying payments made to suppliers
B. Reducing raw material inventory
C. Increasing the turnover of finished goods inventory
D. Increasing credit given to customers

Question#14:

In decision-making, costs which need to be considered are said to be relevant costs.

Which of the following are characteristics associated with relevant costs?

1. Future costs
2. Unavoidable costs
3. Incremental costs
4. Cash costs

A. 1 and 3 only
B. 1 and 2 only
C. 1, 3 and 4 only
D. All of them

Question#15:

The following statements refer to Islamic financial instruments.

(1)Sukuk (debt finance) holders have little influence over the actions of the Sukuk manager

(2)Under a Musharaka contract (venture capital) profits are shared between partners according to ratios in the contract

(3)An Ijara transaction is the Islamic equivalent of a lease

Which of these statements is/are correct?

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

Question#16:

A company from Northland is expecting to receive Southland Krone in one year's time. The spot rate is Northland dollar 3.4670 per 1 Krone. The company could borrow in Krone at 8% or in Northland dollars at 13%. There is no forward rate for one year's time.

What would interest rate parity predict the exchange rate to be in one year?

A. 0.1734
B. 3.3136
C. 3.6275
D. 5.2251

Question#17:

The following statements relate to currency risk.

1. Transaction risk is the risk that the organisation will make exchange losses when the accounting results of its foreign branches are shown in the home currency.
2. Economic risk is the effect on the present value of longer-term cash flows.

Are the statements true or false?

A. Both statements are true
B. Both statements are false
C. Statement 1 is true and statement 2 is false
D. Statement 2 is true and statement 1 is false

SECTION B

1)

Herd Co is based in a country whose currency is the dollar ($). The company expects to receive €1,500,000 in 6 months' time from Find Co, a foreign customer. The finance director of Herd Co is concerned that the euro (€) may depreciate against the dollar before the foreign customer makes payment and she is looking at hedging the receipt.

Herd Co has in issue loan notes with a total nominal value of $4m which can be redeemed in 10 years' time. The interest paid on the loan notes is at a variable rate linked to LIBOR. The finance director of Herd Co believes that interest rates may increase in the near future.

The spot exchange rate is €1.543 per $1. The domestic short-term interest rate is 2% per year, while the foreign short-term interest rate is 5% per year.

1. What is the six-month forward exchange rate predicted by interest rate parity______$? (to 3 decimal places)

2. As regards the euro receipt, what is the primary nature of the risk faced by Herd Co?

A. Transaction risk
B. Economic risk
C. Translation risk
D. Business risk

3. Which of the following hedging methods will NOT be suitable for hedging the euro receipt?

A. Forward exchange contract
B. Money market hedge
C. Currency futures
D. Currency swap

4. Which of the following statements support the finance director's belief that the euro will depreciate against the dollar?

	Supports the director's belief	Does not support the director's belief
1. The dollar inflation rate is greater than the euro inflation rate		
2. The dollar nominal interest rate is less than the euro nominal interest rate		

5. As regards the interest rate risk faced by Herd Co, which of the following statements is correct?

A. In exchange for a premium, Herd Co could hedge its interest rate risk by buying interest rate options.
B. Buying a floor will give Herd Co a hedge against interest rate increases.
C. Herd Co can hedge its interest rate risk by buying interest rate futures now in order to sell them at a future date.
D. Taking out a variable rate overdraft will allow Herd Co to hedge the interest rate risk through matching.

2)

Mathilda Co is a listed company which is seen as a potential target for acquisition by financial analysts. The value of the company has therefore been a matter of public debate in recent weeks and the following financial information is available:

Year	20X4	20X3	20X2	20X1
Profit after tax ($m)	25.3	24.3	22.3	21.3
Total dividends ($m)	15.0	14.0	13.0	12.5

Statement of financial position information for 20X4:

	$m	$m
Non-current assets		227.5
Current assets		
Inventory	9.5	
Trade receivables	11.3	20.8
Total assets		248.3
Equity finance		
Ordinary shares	50.0	
Reserves	118.0	168.0
Non-current liabilities		
8% bonds		62.5
Current liabilities		17.8
Total liabilities		248.3

The shares of Mathilda Co have a nominal value of 50c per share and a market value of $10.00 per share. The business sector of Mathilda Co has an average price/earnings ratio of 16 times.

The expected net realisable values of the non-current assets and the inventory are $215.0m and $10.5m, respectively. In the event of liquidation, only 90% of the trade receivables are expected to be collectible.

1. **What is the value of Mathilda Co using market capitalisation (equity market value)?**

A. $50m
B. $250m
C. $500m
D. $1,000m

2. **What is the value of Mathilda Co using the net asset value (liquidation basis)?**

A. $147.20m
B. $155.37m
C. $217.87m
D. $248.30m

3. **What is the value of Mathilda Co using the price/earnings ratio method (business sector average price/earnings ratio)?**

A. $269.87m
B. $404.8m
C. $155.37m
D. $240m

4. **What is the average historic dividend growth rate for Mathilda Co?**

A. 4.66%
B. 5.90%
C. 6.27%
D. 35.72%

5. **Which of the following statements are problems in using the price/earnings ratio to value a company?**

1. It can be difficult to find a quoted company with a similar range of activities.
2. A single year's P/E ratio may not be representative
3. It is the reciprocal of the earnings yield
4. It combines stock market information with corporate information

A. 1 and 2 only
B. 3 and 4 only
C. 1, 3 and 4 only
D. 1, 2, 3 and 4

MOCK C

Question#1:

The equity shares of Nice plc have a beta value of 0.70. The risk free rate of return is 8% and the market risk premium is 5%. Corporation tax is 30%.

What is the required return on the shares of Nice plc_______ (to one decimal place)?

Question#2:

Apple Co latest results are as follows:

	$'000
Profit before interest and taxation	2,500
Profit before taxation	2,250
Profit after tax	1,400

In addition, extracts from its latest statement of financial position are as follows:

	$'000
Equity	10,000
Non-current liabilities	2,500

What is Apple Co's return on capital employed (ROCE)?

A. 14%
B. 18%
C. 20%
D. 25%

Question#3:

Which of the following is NOT an advantage of withholding a dividend as a source of finance?

Retained profits are a free source of finance.

A. Investment plans need less justification.
B. Issue costs are lower.
C. It is quick.

Question#4:

Which of the following statements about investment appraisal methods is correct?

A. The return on capital employed method considers the time value of money.
B. Return on capital employed must be greater than the cost of equity if a project is to be accepted.
C. Riskier projects should be evaluated with longer payback periods.
D. Payback period ignores the timing of cash flows within the payback period.

Question#5:

Which of the following statements concerning capital structure theory is correct?

A. In the traditional view, there is a linear relationship between the cost of equity and financial risk.
B. Modigliani and Miller said that, in the absence of tax, the cost of equity would remain constant.
C. Pecking order theory indicates that preference shares are preferred to convertible debt as a source of finance.
D. Business risk is assumed to be constant as the capital structure changes

Question#6:

SKV Co has paid the following dividends per share in recent years:

Year	20X4	20X3	20X2	20X1
Dividend ($ per share)	0.360	0.338	0.328	0.311

The dividend for 20X4 has just been paid and SKV Co has a cost of equity of 12%.

Using the geometric average historical dividend growth rate and the dividend growth model, what is the market price of SKV Co shares on an ex dividend basis?

A. $4.67
B. $5.14
C. $5.40
D. $6.97

Question#7:

Carp Co has announced that it will pay an annual dividend equal to 55% of earnings. Its earnings per share is $0.80, and it has 10 million shares in issue. The return on equity of Carp Co is 20% and its current cum dividend share price is $4.60.

What is the cost of equity of Carp Co?

A. 19.4%

B. 20.5%

C. 28.0%

D.22.7%

Question#8:

Which of the following is/are relevant costs for investment appraisal of a new machine?

1. Depreciation of the machine
2. Research into different types of machine
3. Annual maintenance costs for the machine

A. 1 and 2 only

B. 2 only

C. 3 only

D.1 and 3 only

Question#9:

Which of the following is/are true of the payback method of investment appraisal?

1. It tends to maximise financial and business risk
2. It's a fairly complex technique and not easy to understand
3. It cannot be used when there is a capital rationing situation

A. None of these

B. All of these

C. 1 only

D. 2 and 3 only

Question#10:

Using a discount rate of 10% per year the net present value (NPV) of a project has been correctly calculated as $50. If the discount rate is increased by 1% the NPV of the project falls by $20.

What is the internal rate of return (IRR) of the project?

A. 7.5%

B. 11.7%

C. 12.5%

D. 20.0%

Question#11:

TS operates a fleet of vehicles and is considering whether to replace the vehicles on a 1, 2 or 3 year cycle. Each vehicle costs $25,000. The operating costs per vehicle for each year and the resale value at the end of each year are as follows.

	Year 1	Year 2	Year 3
	$	$	$
Operating costs	5,000	8,000	11,000
Resale value	18,000	15,000	5,000

The cost of capital is 6% per annum.

You should assume that the initial investment is incurred at the beginning of year 1 and that all other cash flows arise at the end of the year.

What is the equivalent annual cost of replacing the vehicles every two years?

A. $11,743

B. $12,812

C. $13,511

D. $15,666

Question#12:

The following statements relate to dividend policy.

1. According to Modigliani and Miller, in a perfect capital market, shareholders are indifferent between dividends and capital gains.
2. Residual theory states that dividends should be paid ahead of investing in positive NPV projects.

Are the statements true or false?

A Both statements are true

B Both statements are false

C Statement 1 is true and statement 2 is false

D Statement 2 is true and statement 1 is false

Question#13:

CTF Co has the following information relating to its ordinary shares.

Dividend cover	5
Earnings per share	150
Published dividend yield	3.75%

What is the price of CTF Co's ordinary shares?

A 30c

B 113c

C 563c

D 800c

Question#14:

The equity shares of HF Co have a beta value of 0.90. This risk-free rate of return is 6% and the market risk premium is 4%. Tax is 30%.

What is the return on shares of HF Co?

A 6.6%

B 6.7%

C 9.4%

D 9.6%

Question#15:

The following statements relate to capital structure theory.

1. The traditional view is that, in the absence of tax, a company's capital structure would have no impact on its weighted cost of capital (WACC).
2. The net operating income approach (MM) assumes that debt is risk free.

Are the statements true or false?

A. Both statements are true

B. Both statements are false

C. Statement 1 is true and statement 2 is false

D. Statement 2 is true and statement 1 is false

Question#16:

Sparrow Co has just paid an ordinary dividend of 30c per share. The shares are now trading at 480c.

If dividend growth is expected to be 3% per annum, what is the company's cost of equity to the nearest whole number?

A. 6%

B. 7%

C. 8%

D. 9%

The finance director of Coral Co has been asked to provide values for the company's equity and loan notes. Coral Co is a listed company and has the following long-term finance:

	$m
Ordinary shares	7.8
7% convertible loan notes	8.0
	15.8

The ordinary shares of Coral Co have a nominal value of $0.25 per share and are currently trading on an ex dividend basis at $7.10 per share. An economic recovery has been forecast and so share prices are expected to grow by 8% per year for the foreseeable future.

The loan notes are redeemable after 6 years at their nominal value of $100 per loan note, or can be converted after 6 years into 10 ordinary shares of Coral Co per loan note. The loan notes are traded on the capital market.

The before-tax cost of debt of Coral Co is 5% and the company pays corporation tax of 20% per year.

1. **What is the equity market value of Coral Co $_______m?**(to two decimal place)
2. **Assuming conversion, what is the market value of each loan note of Coral Co______?**

A. $110.13
B. $112.67
C. $119.58
D. $125.70

3. **Which of the following statements about the equity market value of Coral Co is/are true?**

(1)The equity market value will change frequently due to capital market forces.
(2)If the capital market is semi-strong form efficient, the equity market value will not be affected by the release to the public of insider information.
(3)Over time, the equity market value of Coral Co will follow a random walk.

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

4. **Indicate whether the following are assumptions made by the dividend growth model.**

		Yes	No
1	Investors make rational decisions.		
2	Dividends show either constant growth or zero growth.		
3	The dividend growth rate is less than the cost of equity.		

5. **Why might valuations of the equity and loan notes of Coral Co be necessary?**

(1) The company is planning to go to the market for additional finance.
(2) The securities need to be valued for corporate taxation purposes.
(3) The company has received a takeover bid from a rival company.

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

2)

A company is considering two capital expenditure proposals. Both proposals are for similar products and both are expected to operate for four years. Only one proposal can be accepted.
The following information is available.

	Profit/(loss)	
	Proposal A	Proposal B
	$	$
Initial investment	46,000	46,000
Year 1	6,500	4,500
Year 2	3,500	2,500
Year 3	13,500	4,500
Year 4	(1,500)	14,500
Estimated scrap value at the end of year 4	4,000	4,000

Depreciation is charged on the straight line basis.

1. What is the annual cash flow for year 4 for Proposal A?

A$2,500
B$9,000
C$13,000
D$15,000

2. What is the payback period for Proposal B?

A. 2.6 years
B. 3.1 years
C. 4.0 years
D. It doesn't pay back

3. What is the return on capital employed on average investment for Proposal A?

A. 4.5%
B. 22.0%
C. 26.0%
D. 26.2%

4. Which of the following are true of the payback period?

1. It is a measure used by external analysts
2. It reduces risk
3. It looks at the entire project life
4. It may lead to excessive investment in short-term projects

A. 2 and 4 only
B. 1, 2 and 3 only
C. 1 and 4 only
D. 1, 2, 3 and 4

5. Which of the following are true of ROCE?

1. It can be used to compare two investment options
2. It takes account of the length of a project
3. It ignores the time value of money
4. It is subject to the company's accounting treatment

A. 1 and 2 only
B. 1, 3 and 4 only
C. 2 and 3 only
D. 4 only