Fundamentals Level – Skills Module

Financial Management

September/December 2017 – Sample Questions

Time allowed: 3 hours 15 minutes

This question paper is divided into three sections:

Section A – ALL 15 questions are compulsory and MUST be attempted

Section B – ALL 15 questions are compulsory and MUST be attempted

Section C – BOTH questions are compulsory and MUST be attempted

Formulae Sheet, Present Value and Annuity Tables are on pages 4–6.

Do NOT open this question paper until instructed by the supervisor.

Do NOT record any of your answers on the question paper.

This question paper must not be removed from the examination hall.

Paper F9

Think Ahead ACCA

The Association of Chartered Certified Accountants

Section C – BOTH questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

31 The following statement of financial position information relates to Tufa Co, a company listed on a large stock market which pays corporation tax at a rate of 30%.

	$m	$m
Equity and liabilities		
Share capital	17	
Retained earnings	15	
Total equity		32
Non-current liabilities		
Long-term borrowings	13	
Current liabilities	21	
Total liabilities		34
Total equity and liabilities		66

The share capital of Tufa Co consists of $12m of ordinary shares and $5m of irredeemable preference shares.

The ordinary shares of Tufa Co have a nominal value of $0·50 per share, an ex dividend market price of $7·07 per share and a cum dividend market price of $7·52 per share. The dividend for 20X7 will be paid in the near future. Dividends paid in recent years have been as follows:

Year	20X6	20X5	20X4	20X3
Dividend ($/share)	0·43	0·41	0·39	0·37

The 5% preference shares of Tufa Co have a nominal value of $0·50 per share and an ex dividend market price of $0·31 per share.

The long-term borrowings of Tufa Co consist of $10m of loan notes and a $3m bank loan. The bank loan has a variable interest rate.

The 7% loan notes have a nominal value of $100 per loan note and a market price of $102·34 per loan note. Annual interest has just been paid and the loan notes are redeemable in four years' time at a 5% premium to nominal value.

Required:

(a) Calculate the after-tax weighted average cost of capital of Tufa Co on a market value basis. (11 marks)

(b) Discuss the circumstances under which it is appropriate to use the current WACC of Tufa Co in appraising an investment project. (3 marks)

(c) Discuss THREE advantages to Tufa Co of using convertible loan notes as a source of long-term finance. (6 marks)

(20 marks)

32 The directors of Pelta Co are considering a planned investment project costing $25m, payable at the start of the first year of operation. The following information relates to the investment project:

	Year 1	Year 2	Year 3	Year 4
Sales volume (units/year)	520,000	624,000	717,000	788,000
Selling price ($/unit)	30·00	30·00	30·00	30·00
Variable costs ($/unit)	10·00	10·20	10·61	10·93
Fixed costs ($/year)	700,000	735,000	779,000	841,000

This information needs adjusting to take account of selling price inflation of 4% per year and variable cost inflation of 3% per year. The fixed costs, which are incremental and related to the investment project, are in nominal terms. The year 4 sales volume is expected to continue for the foreseeable future.

Pelta Co pays corporation tax of 30% one year in arrears. The company can claim tax-allowable depreciation on a 25% reducing balance basis.

The views of the directors of Pelta Co are that all investment projects must be evaluated over four years of operations, with an assumed terminal value at the end of the fourth year of 5% of the initial investment cost. Both net present value and discounted payback must be used, with a maximum discounted payback period of two years. The real after-tax cost of capital of Pelta Co is 7% and its nominal after-tax cost of capital is 12%.

Required:

(a) (i) Calculate the net present value of the planned investment project. (9 marks)

(ii) Calculate the discounted payback period of the planned investment project. (2 marks)

(b) Discuss the financial acceptability of the investment project. (3 marks)

(c) Critically discuss the views of the directors on Pelta Co's investment appraisal. (6 marks)

(20 marks)