ACCA

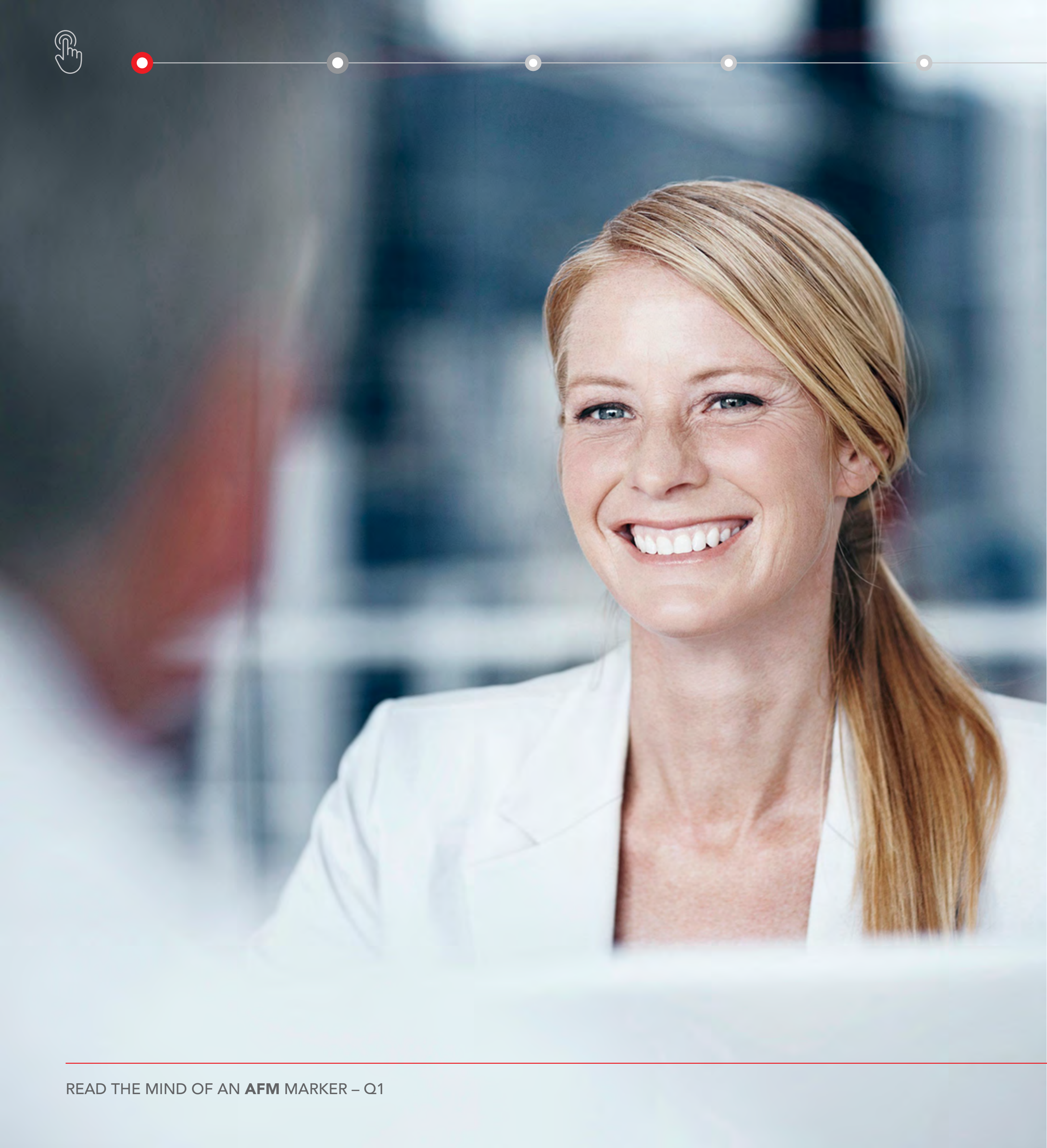
ADVANCED FINANCIAL MANAGEMENT (AFM)

Read the mind of an AFM marker

SPECIMEN EXAM Q1

Think Ahead

Contents



Introduction

I am a member of the team who marks Advanced Financial Management. This article is designed to give you, the candidate, an insight into my mind, so that you can better understand what a marker will be looking for when it comes to marking your Advanced Financial Management script.

Insight into a marker's thinking – appreciating what we are trained to look for, what we award marks for, the reasons why marks may not be awarded – will help you fulfil your potential and gain the necessary marks to pass. It will help you appreciate the points that will attract marks so that you can better assess your answers when practicing questions.

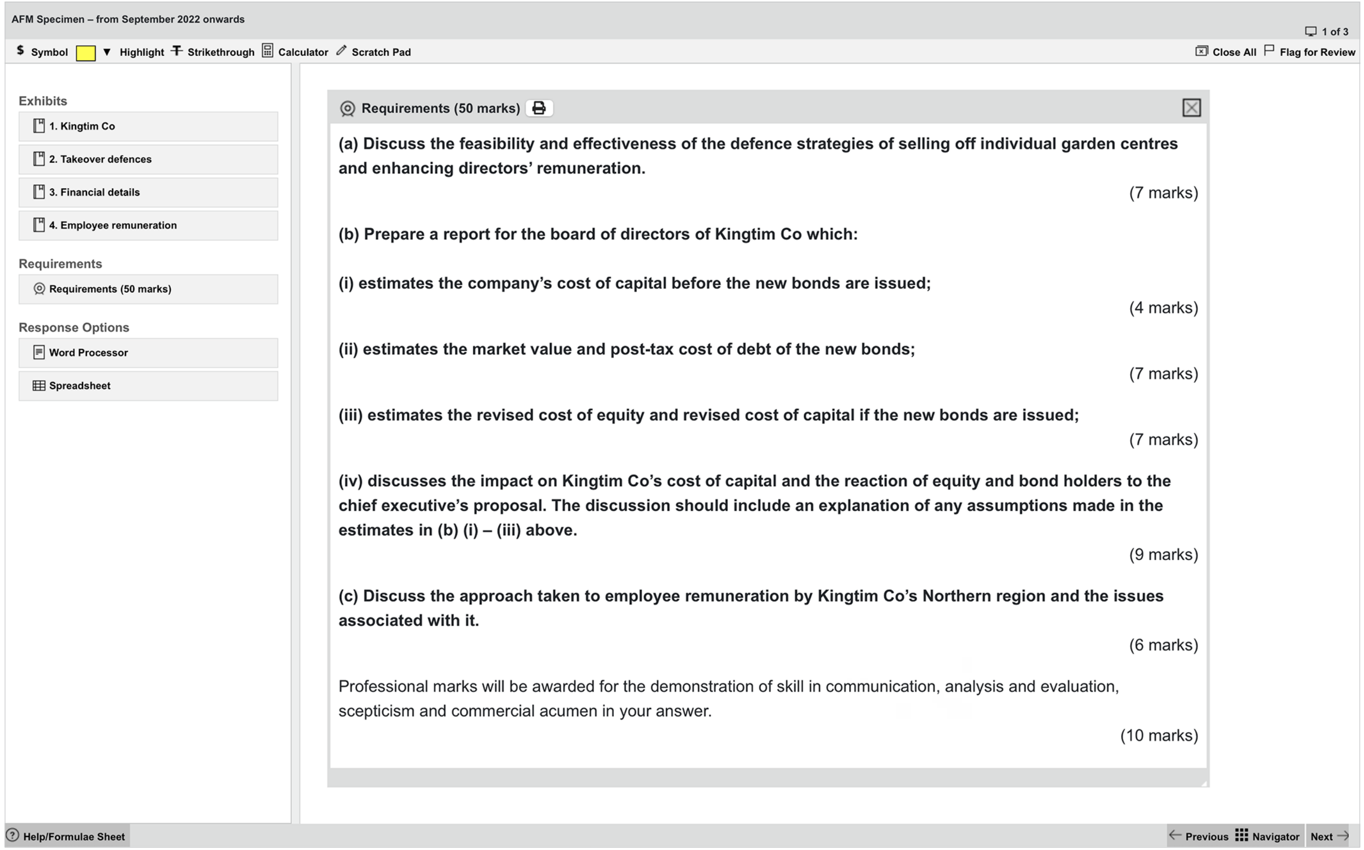
This article uses three candidates' answers to Question 1 from the AFM specimen exam. To support your reading of this article, you should refer to the specimen exam on the *ACCA Practice Platform*.

You may also find it interesting to refer to the published answers for the specimen exam, noting the differences and comparing the length and style to the candidates' answers seen in this article. It's important to remember that you don't need to replicate the published answer to achieve a pass. You can access the answers on the *ACCA Practice Platform*.

ACCESS THE **ACCA PRACTICE PLATFORM** HERE

Question 1

Observations on the requirement


AFM Specimen – from September 2022 onwards

1 of 3

Symbol | Highlight | Strikethrough | Calculator | Scratch Pad | Close All | Flag for Review

Exhibits
- 1. Kingtim Co
- 2. Takeover defences
- 3. Financial details
- 4. Employee remuneration

Requirements
- Requirements (50 marks)

Response Options
- Word Processor
- Spreadsheet

Requirements (50 marks)

(a) Discuss the feasibility and effectiveness of the defence strategies of selling off individual garden centres and enhancing directors' remuneration.

(7 marks)

(b) Prepare a report for the board of directors of Kingtim Co which:

(i) estimates the company's cost of capital before the new bonds are issued;

(4 marks)

(ii) estimates the market value and post-tax cost of debt of the new bonds;

(7 marks)

(iii) estimates the revised cost of equity and revised cost of capital if the new bonds are issued;

(7 marks)

(iv) discusses the impact on Kingtim Co's cost of capital and the reaction of equity and bond holders to the chief executive's proposal. The discussion should include an explanation of any assumptions made in the estimates in (b) (i) – (iii) above.

(9 marks)

(c) Discuss the approach taken to employee remuneration by Kingtim Co's Northern region and the issues associated with it.

(6 marks)

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, scepticism and commercial acumen in your answer.

(10 marks)

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ACCESS THE ACCA PRACTICE PLATFORM HERE

Question 1 contains a number of requirements, as is usually the case with a 50-mark question, and requires the preparation of a report to the board of directors. It also requires the use of numerical techniques to calculate costs of capital and to discuss the findings from these calculations.

For the discussion elements, each relevant point will generally be awarded 1 mark, although a well-discussed point can be worth 2 marks. Remember, however, that to discuss means to consider the pros and cons of an issue.

For the calculations in part (b), each part of the calculation will generally be awarded 1 or 2 marks, depending on complexity.

A good answer to part (a) would look at each defence strategy in turn and separately consider the feasibility and the effectiveness of such a strategy.

A good answer to parts (b)(i)-(iii) would take a methodical approach with clear and easy to follow workings.

A good answer to part (b)(iv) would discuss the outcome of the calculations in (b)(i)-(iii) and what this would mean for both the shareholders and the bond holders. It should also include the key assumptions made in the earlier calculations.

A good answer to part (c) would include the arguments for and against the approach taken to employee remuneration and the possible issues arising from it.

Professional marks would be obtained from producing answers which fully address the requirements.

Specimen exam marked answers

Question 1 candidate one

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Word Processor

Paragraph

(a) Feasibility and effectiveness of the defence strategies of selling off individual garden centres and enhancing directors' remuneration

Kingtim Co (the Company) is a nationwide chain of garden centres, selling products such as plants, fertilisers, tools and garden furniture. Potential acquirers are looking to diversify their business into the profitable garden centre sector. As long as the Company is a position to protect itself from takeover there are a number of safeguards that could be put in place.

One of these safeguards is to sell individual garden centres. It is believed that disposal of these centre would make Kingtim Co less attractive purchase. In the light that no potential acquirer has approached the Company to buy the whole chain, but there are parties interested in the individual purchase of the garden centres, the measure might be a proper defence strategy. By divestment, the directors will face less stress over the unpredictable future for their wellbeing, and will be able to focus on other parts of the business. 1 Such sale may take some time to be arranged. Also detailed analyses are to prepared whether the garden centre are crucial for the future development, even survival, of the business. If those centres are crucial for the business, and steps for selling the garden centres will only lead to potential bankruptcy. 2

Another safeguard is enhancing directors' remuneration. Such a defence approach is more common for post-offers stage, while the divestment is more common for pre-acquisition stage. Pay the directors higher remuneration and change their contract so that they receive much higher compensation for loss of office is a probable safeguard that will bring desirable compensation for the directors, established and running the Company for the past 20 years. Due to the fact that the same have been involved in the business since its incorporation, the directors may feel attached to it. Due to this fact paying them a higher compensation may not be in line with their desires. Also under some legislation these increased remunerations, also known as 'golden parachutes' are not permitted. Further analyses are to be made in these regards on whether the executive directors would be satisfied by the compensation, and whether such defence is in line with local regulations. Moreover, regarding the feasibility of the measure, it should be taken under consideration whether there is a potential for the whole company to be purchased, and not just the garden centres, which may bring no effect over the executive directors' positions. 3 4

Besides the above stated considerations, it should also be taken in mind the fact that the executive directors hold 25% of the shares of the Company. In the light of a potential take-over they would probably be not in the position to be forced to dispose of their holding (in some legislations the threshold for a forced sale is 10% shareholding in the light that the rest is acquired by a purchaser). Also the control exercised over the Company is to be taken under considerations. 5

(b) Report

Prepared by: Financial Consultant

To: Board of directors of Kingtim Co which

Date: 01.01.20X0

Introduction:

Kingtim Co (the Company) is in the position to analyse further development by establishment of chain of outdoor shops. The same would be finance through debt. This report is prepared to estimate the company's cost of capital before the new bonds are issued, the market value and yield to maturity of the new bonds, the revised cost of equity and revised cost of capital if the new bonds are issued, the impact of the chief executive's proposal on forecast after-tax earnings for the coming year, and to list considerations on the impact on Kingtim Co's cost of capital and the reaction of equity and bond holders to the chief executive's proposal.

Company's cost of capital before the new bonds are issued

The company's cost of capital (as per Appendix 1) is 10%.

Market value and yield to maturity of the new bonds

The market value of the new bond is 109.91 (as per Appendix 2), and the yield to maturity is 9.92% (as seen in appendix 2)

Revised cost of equity and revised cost of capital if the new bonds are issued

Revised cost of equity is 9.73% (Appendix 3) and the revised cost of capital is 7.378% (Appendix 3).

1/2

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate one

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Word Processor

Paragraph

Impact on Kingtim Co's cost of capital and the reaction of equity and bond holders to the chief executive's proposal.
Further gearing may be beneficial to the shareholders, as the same will bring tax reliefs and will ultimately boost the company cost of capital. This statement is suggested by M&M. The theory faces limitation that such effect would be achieved in perfect market environment. 6

As per the calculations in the appendixes and the stated statements in this report, the WACC (weighted average cost of capital) decreases from 10% to 7.38%. This is in line with M&M theory. This decrease will benefit the shareholders.

The issue of new debt may bring, however, some further risk to the current and future debt holders, and to the shareholders, as well. 7

The increase in risk may be unnecessary to the shareholders, as they may have already diversified their portfolio of investments by taking shares in different companies.

The increased risk is relevant to incapability of the company to repay its interest obligations, and the principal amount upon maturity. This in long term may bring negative effects to the investors willingness to invest into the company and eventually lead to bankruptcy. 8

The calculations shown above are made upon a number of assumptions. The same include:

- Bd is assumed to be 0 for all relevant calculations; 9
- Equity beta of the garden centres is assumed to be the same as the equity beta of the company before the bond issue; 10
- For revised cost of equity calculations it is assumed that the similar companies are appropriately selected, and that the gearing level is the same as the company in question. Also it is assumed that beta can be reasonably established; 11
- It is assumed that the return of the newly issued bond is equal to the interest payable each year;
- It assumed that there will be no change in tax legislation for the near future.

Conclusion:
Given the limitations of the assumptions made, and the effect over the stakeholders, it should be further analysed what is the best decision for the company.
However, based on the numbers, it is reasonable to undertake the project and further invest, as suggested above.

(c) Approach taken to employee remuneration by Kingtim Co's Northern region and the issues associated with it.

Kingtim Co's annual report contains a general commitment to act with social responsibility, in line with society's expectations. This brings some responsibility for the company to act in line with their core principles. 12

The annual report also commits to paying the staff fairly in accordance with their responsibilities.

A newspaper investigation has revealed revealed that some staff in Kingtim Co's garden centres are paid up to 15% less per hour than the recommended by the Government minimum wage. This issue may not be illegal, however, puts the company into the public eye. Such negative press may reflect the company's future operations. Nowadays, entities 13 are becoming much more concerned regarding the social principle adopted by the companies. This negative press may lead to decline in client base, to decline in investors' interest, 14 and even to staff redundancies.

The fact that the company is not acting in line with its policies and representations bring into question the whole integrity of the management. By questioning the integrity of the management, all the stakeholders may lost faith in the company, especially the current and potential investors and the shareholders. 15

The managers states that the company had obligations to its shareholders to control staff costs. Lower pay levels are claimed to be necessary to differentiate between staff.
This brings agency problem, when the managers might not be seen as acting in the best interest of the shareholders.

The approach taken, however, might be seen as in line with social and shareholders' expectations, if the same is in line with legislation, internal policies, best practises, and is designed to serve the company in long term. As long as lower remuneration is paid to staff working part-time than to those full-time, the same might not be considered as inequal and unethical treatment. 16

See spreadsheet.

2/2

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate one

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.
Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet

Edit Format

	A	B	C
1			
2	**b i)**		
3	**Appendix 1**		
4			
5	*This appendix is prepared to support the report to the Board of Directors*		
6			
7	**Company's cost of capital before the new bonds are issued**		
8			
9	Shares	25,000,000.00	
10	Ve 17	139,000,000.00	
11	Bonds 6.5%	450,000.00	
12	Vd 18	46,800,000.00	
13	premium	2%	
14	Kd (after tax)	4.10%	
15	Be (garden centers)	0.9	*Bd is assumed to be 0; Equity beta of the garden centers is assumed to be the same as the equity beta ot the company before the bond issue*
16	Rf	4%	
17	T	25%	
18	Market risk premium	9%	
19	Ba (company)	0.718552556	*Ba=Ve((Ve+Vd(1-T))*Be*
20	E(ri) 19	0.121	*E(ri) = Rf +Be*MarketRiskPremium*
21	WACC	0.1008493	*WACC = (Ve/(Ve+Vd)Ke + (Vd/(Ve+Vd)Kd(1-T)*
22	WACC in % 20	**10%**	
23			

Sheet1

1/3

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate one

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.
Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet

Edit Format

	A	B	C	D	E	F
24						
25	**b ii)**					
26	**Appendix 2**					
27						
28	*This appendix is prepared to support the report to the Board of Directors*					
29						
30	**Market value and yield to maturity of the new bonds**					
31						
32	new bond	900000				
33	interest	7.50%				
34	redemption	4 years				
35	premium	8%				
36						
37	Working for bond value:					
38	Time	1	2	3	4	21
39	Return	4.56	5.08	5.76	6.55	*Return = Market Spread+Credit Rating*
40	1+Return	1.0456	1.0508	1.0576	1.0655	
41	Premium	7.5	7.5	7.5	7.5	
42	Redemprion				108	
43	CF	7.5	7.5	7.5	115.5	
44	CF*(1+r)^-n	7.172915073	6.792367	6.340112	89.61241	
45	Value	109.9178063	22			*the sum of discounted CF*
46						
47	Valuer of all bonds	**98,926,025.65**				
48	Yiled	**9.92%**	23			
49						

Sheet1

2/3

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate one

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.
Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet

	A	B	C
49			
50	**b iii)**		
51	**Appendix 3**		
52			
53	*This appendix is prepared to support the report to the Board of Directors*		
54			
55	**Revised cost of equity**		
56			
57	Ba (similar companies)	0.88	Assumption is made that the similar companies are appropriately selected, and that the gearing level is the same as the company in question. Also it is assumed that beta can be reasonably established.
58	Be	0.636158003	*Ba=Ve((Ve+Vd1(1-T)+Vd2(1-T))*Be*
59			
60	Ve	139000000	
61	Vd1	46800000	
62	Kd1 (after tax)	0.041	
63	Vd2	98926025.65	
64	Kd2	0.075	*It is assumed that the return of the newly issued bond is equal to the interest payable each year.*
65			
66	E(ri) 24	**9.73%**	*E(ri) = Rf +Be*MarketRiskPremium*
67			
68			
69			
70	**Revised cost of capital if the new bonds are issued;**		
71			
72	Ve+Vd1+Vd2	284,726,025.65	
73			
74	WACC 25	**7.38%**	*WACC = (Ve/(Ve+Vd1+Vd2)Ke + (Vd1/(Ve+Vd1+Vd2)Kd1(1-T) + (Vd2/(Ve+Vd1+Vd2)Kd2(1-T)*
75			

Sheet1

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Marks awarded and comments:

OFR = own figure rule. This is when credit is awarded where a previous error has been carried forward correctly in subsequent calculations.

Notes on **candidate one's** answer to **Q1**

Summary of marks:

TECHNICAL:	
(a)	5
(b)(i)	4
(b)(ii)	4
(b)(iii)	3
(b)(iv)	6
(c)	5
TOTAL technical marks	**27**
PROFESSIONAL:	
Communication	5
Analysis and evaluation	4
Scepticism	0
Commercial acumen	2
TOTAL professional marks	**10**
OVERALL TOTAL	**37/50**

SEE CANDIDATE ONE'S ANSWER TO Q1 HERE

How could this answer have been improved?

Professional skills summary

This candidate has demonstrated very good communication skills and has obtained the available 5 marks here. This is because the format and structure of the report have been met, the style, language and clarity of the report are very good. The report is effective because the answer is specific and relevant and it also adheres to chief executive's proposal.

For analysis and evaluation there has been good use of the data to determine suitable calculations, good use of the data to support discussions and also to draw appropriate conclusions. In this instance this answer would obtain 4 marks for analysis and evaluation.

For scepticism, there is no real focus on scepticism in this answer and so there are no marks awarded for this.

In terms of commercial acumen, there are a number of examples of using the information from the scenario and also practical considerations to make commercial points, such as the timing of the sales of individual centres and consideration of the need to repay the loan principal. All together this shows a reasonable demonstration of the skill and would be worth 2 marks for commercial acumen.

This gives a total of 11 marks, but as there is a maximum of 10 marks available, this is capped at 10 marks.

Specimen exam marked answers

Question 1 candidate two

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Word Processor

Paragraph

(a) Defence strategies

As Kingtim Co is fearful of the takeovers in the sector the company is looking to protect itself from the bid. They revealed two proposals for defence – Selling the key assets "Crown jewels" strategy and "Golden parachutes".

Selling the individual garden centres – This strategy represents selling the major or key assets/business of the company and to not be so attractive to the bidder. It has Pros and Cons:

Pros - The Amount of money that will be received can be invested in other beneficial projects and earn additional money. 1

Cons - The sell off of the assets can lead to loss of competitive position in the market. As per the scenario this is not the case with Kingtim. 2

Enhancing directors' remuneration – This represents defence strategy "golden parachutes". The large amount of money will be distributed to the managers as large amounts.

Pros - The Company will leave the cash balances reduced and this will not be attractive to the bidder. 3

Cons - Maybe the directors only want to get the money and are not interested anymore for the future of the company. 4

(b) **Report to board of directors, Kingtim Co:**

Introduction

This report estimates and discusses the impact of the proposed bond issue from the Financial director on the capital structure and on the bond holders value. Also it estimates the impact on the after-tax earnings and discuss the assumptions made in the estimates.

Financial results by proposal:

After issuing the second bond as per the proposal of the finance director the change in the capital structure is marginal and despite the increase in debt due to the tax shield relief the overall structure of the capital is not changed. There is slight decrease by 0.05%. 5

Please see the Appendixes i - iii.

	Before Bond issue and investment	After Bond issue and investment
Cost of capital	12.06 %	12.01 %

1/2

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate two

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Word Processor

Paragraph

Non-Financial aspects

The political situation is not stable. There can be a problem in the remittances from the subsidiary.

Assumptions

All the calculations in the appendixes considers that the figures are accurate. The models used consists of lots of variables that can change and the result of the predictions can be different. The revised cost of the debt is based on the required yield based on different bonds and credit spreads as per the BBB rating. As the debt is rising and the industry specifics may the credit agencies consider that the ratings need to be adjusted and debt market value will change. Also the tax rate can change. It will be better to perform sensitivity analysis and simulation models to see the outcomes if there is change in some of the variables. 6 7 8

Debt Holders

Debt holders are likely to happy with new bond issued as the interest of 7.5 % is bigger.

Equity Holders

Equity holders might be happy due the increase in the after tax profit due to the investment in the non-current assets which could impact the dividends positively. 9
There is also increased in the earnings per share could impact the share price positively and capital gains could be realised.

Conclusion

Based this report and taking the into account the almost immaterial in the overall change in the cost of capital, the increased earnings after tax and the assumptions made the proposals made by the finance director should be accepted.

Report compiled by:

Date:

(c) Remuneration issues

If the wages of the employees do not increase there is possibility of the reputation risk for Kingtim co. Also the morale and loyalty will decrease as well. 10 11
This will increase the cost and decrease the profits.

See spreadsheet.

2/2

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate two

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.
Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet

Edit Format

	A	B	C	D	E	F
1	**Appendixes**					
2	**I) Cost of the capital before the bond issue**					
3						
4	Market value of equity	139	m 12			
5	Market value of debt	0.468	m 13			
6	Cost of debt	4.10%				
7	Cost of Equity					
8						
9	Asset beta	0.9				
10	Cost of equity using CAPM	12.1	% 14			
11						
12	**WACC**	**12.06**	% 15			
13						
14						
15	ii) Estimate market value of the bond and yield to maturity of the new Bond					
16						
17	Yield to Maturity					
18						
19	Year	Annual Yield	BBB Rating	Yield to maturity		1
20	1	4	0.56	4.56	0.0456	1.0456
21	2	4.3	0.78	5.08	0.0508	1.0508
22	3	4.7	1.06	5.76	0.0576	1.0576
23	4	5.2	1.35	6.55	16 0.0655	1.0655
24						
25	Market value					
26	annual interest	4.5				
27	4th year	107.5				
28		7.5				
29	17 103.710886	per 100$				

Sheet1

1/2

Marks awarded and comments:

OFR = own figure rule. This is when credit is awarded where a previous error has been carried forward correctly in subsequent calculations.

Specimen exam marked answers

Question 1 candidate two

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.
Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet

Edit Format

	A	B	C	D
30				
31	iii) Revised cost of capital			
32	Market value of the new debt	0.62	m 18	
33	Market value of debt	0.468	m	
34	Total debt	1.09		
35	Premium	8%		
36	Revised cost of capital	**12.01**	% 19	
37				
38	There is a slight decrease in the revised WACC			
39				

Sheet1

2/2

Marks awarded and comments:

OFR = own figure rule. This is when credit is awarded where a previous error has been carried forward correctly in subsequent calculations.

Notes on **candidate two's** answer to **Q1**

Summary of marks:

TECHNICAL:	
(a)	4
(b)(i)	3
(b)(ii)	4
(b)(iii)	1
(b)(iv)	5
(c)	2
TOTAL technical marks	**19**
PROFESSIONAL:	
Communication	4
Analysis and evaluation	2
Scepticism	1
Commercial acumen	0
TOTAL professional marks	**7**
OVERALL TOTAL	**26/50**

SEE CANDIDATE TWO'S ANSWER TO Q1 HERE

How could this answer have been improved?

Professional skills summary

This candidate has demonstrated good communication skills and has obtained 4 marks here. This is because the format and structure of the report have been met, the style, language and clarity of the report are reasonable. The report is effective because the answer is specific and relevant and it also adheres to chief executive's proposal.

For analysis and evaluation there has been reasonable use of the data to determine suitable calculations, although there are some omissions in the analysis. There is good use of the data to draw appropriate conclusions, although not much support for the discussion and no clear demonstration of the judgement of key matters and so this answer would obtain 2 marks for analysis and evaluation.

For scepticism, there is an effective challenge of some of the information supplied and 1 mark would be awarded for scepticism.

In terms of commercial acumen, there is no clear application or explanation of commercial points in this answer, so there are no marks awarded for this.

This gives a total of 7 marks out of 10 for the professional skills.

Specimen exam marked answers

Question 1 candidate three

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Word Processor

Paragraph

Part a

Executive directors were among founder of the company and spend many years to make it successful. Also currently they are main shareholders of company. Therefore they felt extremely connected with Company and fear losing company and their influence there. Kingtim Co has agency issues when Executive Directors more concentrate on their own interest rather than company wealth. 1

Obviously Directors try to make company less attractive for potential investors and avoid possible take overs how it happened with their competitors.

Selling individual garden centres for sure bring that result Directors looking for. From other side Kingtim Co will lose it's competitive advantages as chain of Garden centres. Company is known under it's brand and separating individual centres and selling them to supermarkets or other potential investors may create a kind of Internal competition but under different brands. 2

Changing Directors contracts also covered mainly their own needs. Directors much more concentrating on own benefits then company good future. Kingtim Co want to develop their own chain and need more investments for it. Changes in Directors contracts may have negative influence for investors who wishes to invest into Kingtim Co. and it may affect the whole finance position of company. To have a solution between company needs and Agent problems some additional discussion and negotiation should be done. 3

Part b

This report prepared to evaluate the possible impact of issuing new bonds to finance future Development of company. It takes under consideration interest of existing and new investors as well as equity owners. Calculation for supporting this report present in Appendixes (Excel spreadsheet).

To start evaluating new possible debts issuing, the current estimated cost of capital was calculated (Appendix i) and it's value is 12.28%.

If company take a decision to issue new bonds their estimated Market Value will be 106.65 USD (Appendix ii) which is higher than the existing ones the company have. It can have negative influence for existing bond holders due to fact that price of current bonds is not changed. From other side higher market value of new bond should increase interest from potential investors and it help company faster receive additional funds to grow company.

Issuing new bond in generally will change the structure of Capital (Appendix iii) and it can give a negative feeling of Directors who is an equity owner that they lose control on the company. In such situation it can demotivate them to continue put maximum effort into further company development. From other side such changes increase company gearing rate that should bring additional benefit from Tax shield of paid interest. Such changes should have a positive effect since such level of gearing company has bring advantages but not put company in dangerous situation of luck of future possible debt issued or loan taken. 4 5

Also new capital structure should attract new investors who will feel more involved in company decision making and have more influence on it.

As it shown in Appendix iii the cost of capital will increase to 13.702% compare to initial 12.28% due to the new bond issuing. So Company shall moderate it carefully to be able to pay their liabilities on-time.

Proposal of new extra investment to outdoor activity unfortunately will not bring positive impact. Based on cost of capital similar company and return expected from such investment it will give negative effect in amount 2.65 m USD. So it is suggested to postpone such investment until better market condition appear. 6

c) It seems that Kingtim company only values the permanent "old" staff who are loyal to the company. Low level remuneration provides negative motivation for the new staff. Based on assumption company wants to grow they should invest more to the new staff. Since company declares itself as socially responsible company it should be fair to it's employee and pay them at least minimum required salary. It helps the company to keep positive image of it s brand and help attract new customers and investors. 7 8 9

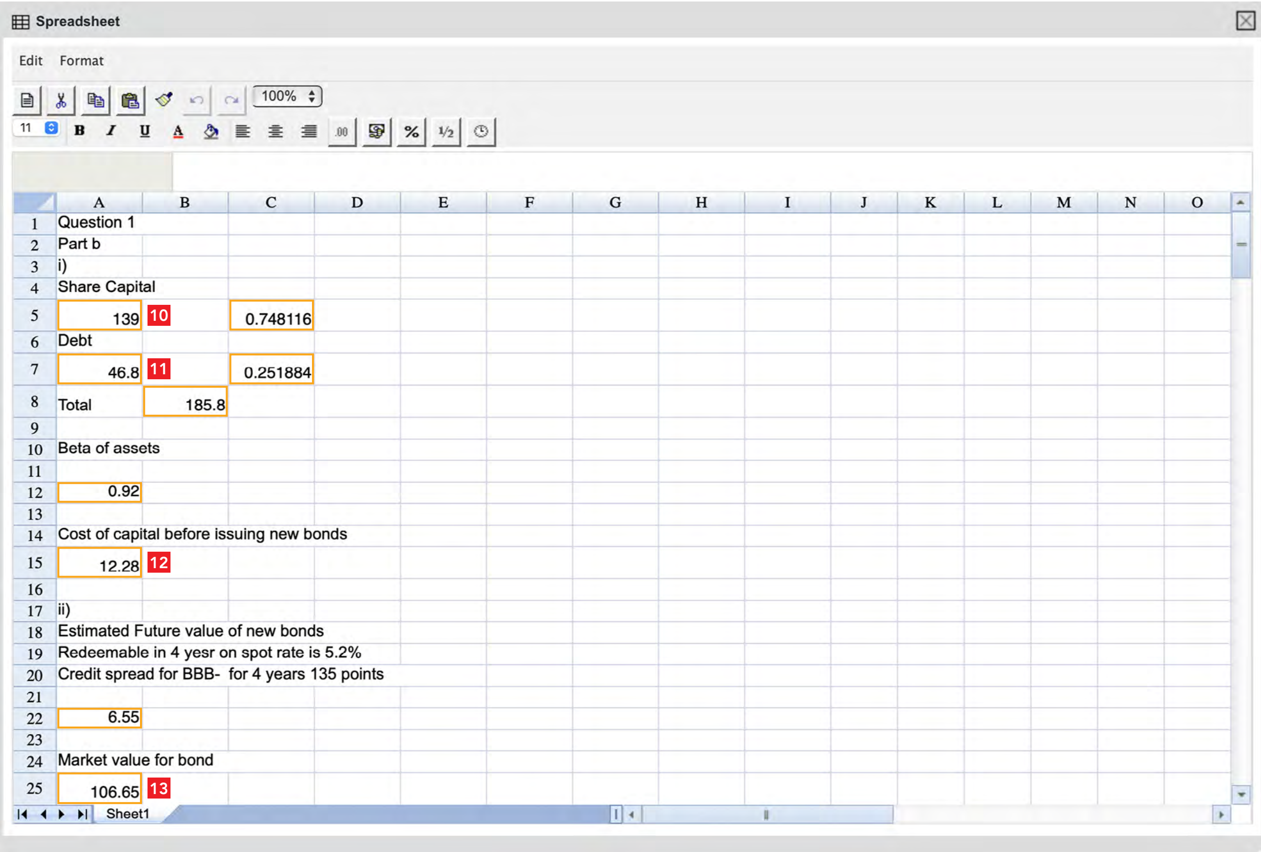
See spreadsheet.

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate three

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.
Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:



	A	B	C
1	Question 1		
2	Part b		
3	i)		
4	Share Capital		
5	139	10	0.748116
6	Debt		
7	46.8	11	0.251884
8	Total	185.8	
9			
10	Beta of assets		
11			
12	0.92		
13			
14	Cost of capital before issuing new bonds		
15	12.28	12	
16			
17	ii)		
18	Estimated Future value of new bonds		
19	Redeemable in 4 yesr on spot rate is 5.2%		
20	Credit spread for BBB- for 4 years 135 points		
21			
22	6.55		
23			
24	Market value for bond		
25	106.65	13	

1/2

Marks awarded and comments:

Specimen exam marked answers

Question 1 candidate three

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.
Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet

Edit Format

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
28	iii)	Revised cost of equity													
29															
30	Share Capital				Cost of debt		0.045								
31	139		0.556467		Premium	1	2	3	4						
32	Debt				@8%	48	48	48	48						
33	110.79	14	0.443533		NPV	158.9821									
34	Total														
35		249.79													
36															
37	Ungeared equity beta														
38															
39	1.125														
40															
41	Cost of equity before new bond														
42	14.125														
43	Revised														
44															
45	22.17898														
46															
47	Cost of capital														
48															
49	Asset beta														
50															
51	1.077465														
52															
53	Cost of capital														
54	13.702	15													

Sheet1

2/2

Marks awarded and comments:

OFR = own figure rule. This is when credit is awarded where a previous error has been carried forward correctly in subsequent calculations.

Notes on **candidate three's** answer to **Q1**

Summary of marks:

TECHNICAL:	
(a)	3
(b)(i)	2
(b)(ii)	1
(b)(iii)	1
(b)(iv)	3
(c)	3
TOTAL technical marks	**13**
PROFESSIONAL:	
Communication	3
Analysis and evaluation	1
Scepticism	0
Commercial acumen	1
TOTAL professional marks	**5**
OVERALL TOTAL	**18/50**

SEE CANDIDATE THREE'S ANSWER TO Q1 HERE

How could this answer have been improved?

Professional skills summary

This candidate has demonstrated some communication skills and has obtained 3 marks here. This is because the format and structure of the report have not been fully adopted, however the style, language and clarity of the answer are reasonable. The report is effective because the answer is specific and relevant and it also adheres to chief executive's proposal.

For analysis and evaluation there is insufficient use of the data to determine suitable calculations. However there is use of the data to draw an appropriate conclusion, although not much support for the discussion and no clear demonstration of the judgement of key matters and so this answer would obtain 1 mark for analysis and evaluation.

For scepticism, there is no real focus on scepticism in this answer and no challenge to the information supplied so there are no marks awarded for this.

In terms of commercial acumen, there are examples of using practical considerations to make commercial points, particularly in the answer to part (c). All together this shows some demonstration of the skill and would be worth 1 mark for commercial acumen.

This gives a total of 5 marks out of 10 for the professional skills.

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