PRIFYSGOL ABERYSTWYTH UNIVERSITY

SEMESTER TWO 2026

ABERYSTWYTH BUSINESS SCHOOL

AB31720: FINANCIAL STRATEGY

Time allowed: **2 HOURS**

Answer ANY THREE questions

Total marks available: 100

This paper contributes 60% of the overall module mark

All questions carry 33 and 1/3 marks

STUDENTS MAY SUBMIT ANSWERS TO THIS PAPER IN EITHER WELSH OR ENGLISH

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A Present Value Table is included at the back of the exam paper.
A formula sheet is included at the back of the exam paper.

CALCULATORS ARE PERMITTED (Casio FX991 FX83 or FX85 models only)

Workings should be submitted for all questions requiring calculations

Any necessary assumptions introduced in answering a question are to be stated

Once seated, students may complete the front cover of the answer book(s) and the attendance slip ONLY.

DO NOT TURN THE EXAMINATION QUESTION PAPER OVER UNTIL INSTRUCTED TO DO SO.

Question 1: Answer BOTH PARTS (a) AND (b)

(a) CwmVale Ltd is considering an investment project which requires an initial outlay of £75,000, payable immediately.

The expected net cash flows from the project are as follows:

Year	Cash Flow (£)
1	18,000
2	22,000
3	28,000
4	24,000
5	17,000

The firm's current cost of capital for investment appraisal purposes is 14%.

Required:

i. Calculate the Payback Period for the project.
ii. Calculate the Net Present Value (NPV) of the project.
iii. Calculate the Internal Rate of Return (IRR) of the project.
iv. Based on your calculations, advise whether CwmVale Ltd should undertake the project. Justify your recommendation.

[25 and 1/3 marks]

(b) Identify and explain other factors, apart from the appraisal techniques used above, that management should consider when making this decision.

[8 marks]
[Total 33 and 1/3 marks]

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Question 2: Answer ALL PARTS (a), (b) and (c)

The following information relates to the possible capital structures of Dovey plc:

Proportion of Debt	Proportion of Equity	Cost of Debt (%)	Cost of Equity (%)
0.15	0.85	4	14
0.25	0.75	5	15
0.35	0.65	6	17
0.45	0.55	7	19
0.55	0.45	8	21
0.65	0.35	9	24
0.75	0.25	11	28
0.85	0.15	14	34

Required:

(a) Calculate the Weighted Average Cost of Capital (WACC) for each capital structure and identify the optimal financing mix. [10 marks]

(b) Critically evaluate the company's decision to increase its gearing ratio, making reference to both theoretical and practical considerations. [13 and 1/3 marks]

(c) Tarren plc has an equity beta of 1.1. The expected market return is 9%, and the risk-free rate is 3.5%.

i. Calculate the cost of equity using the Capital Asset Pricing Model (CAPM).
ii. Explain other methods that can be used to estimate the cost of equity, highlighting their strengths and weaknesses.

[10 marks]

[Total 33 and 1/3 marks]

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Question 3: Answer ALL PARTS (a), (b) and (c)

(a) Define horizontal, vertical, and conglomerate mergers. Explain the key differences between them. [10 marks]

(b) Discuss the financial and strategic motives for mergers and acquisitions. Your answer should consider both value-creating and non-value-creating motives. [13 and 1/3 marks]

(c) Explain the key theoretical and practical issues a company should consider when determining its dividend policy. [10 marks]

[Total 33 and 1/3 marks]

Question 4: Answer ALL PARTS (a), (b) and (c)

LlynCo Ltd is reviewing its working capital management policies. The following information applies:

LlynCo Ltd expects annual credit sales of £90 million.

Annual Costs:

	£m
Raw materials	36
Direct labour	14
Overheads	20

Additional information:
– Raw materials are held in stock for 5 weeks
– Work in progress takes 6 weeks, and is 70% complete
– Finished goods are held in stock for 4 weeks
– Customers are allowed 12 weeks' credit
– Suppliers provide 7 weeks' credit
– Overheads and production costs occur evenly throughout the year
– Short-term finance costs are 10% per annum

LlynCo Ltd is considering two alternative debtor management strategies:

Option 1: Factoring
– Factor fee of 2% of annual sales
– Advances 75% of invoices
– Interest charged at 17%
– Expected reduction in bad debts of £1.1m
– Reduces credit period to 9 weeks

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Option 2: Early Payment Discount
– Offer a 2% discount
– 65% of customers expected to take up the discount
– Credit period reduced to 9 weeks
– Sales volume remains unchanged

Required:
(a) Calculate the company's cash conversion cycle and total working capital requirement. [15 marks]

(b) Evaluate whether the early payment discount proposal is financially worthwhile and calculate the maximum discount LlynCo Ltd could offer while remaining financially indifferent. [10 marks]

(c) Evaluate whether the factoring proposal should be accepted. [8 and 1/3 marks]

[Total 33 and 1/3 marks]

END OF PAPER

FORMULA SHEET AND PRESENT VALUE FACTOR TABLE FOLLOW

Present value and future value

$PV = FV/ (1+r)^t$ OR $PV = FV(1+r)^{-t}$

$FV = PV(1+r)^t$

$FV_n = PV_0(1 + [r/m])^{mn}$

$PV_n = FV_0/(1 + [r/m])^{mn}$ OR $PV_n = FV_0/(1 + [r/m])^{-mn}$

Perpetuity

$$PV = \frac{C}{r}$$

Annuity

$$FV_A = C_1 \times \frac{(1+r)^t-1}{r}$$

$$FV_A = C_0(1+r) \times \frac{(1+r)^t-1}{r}$$

Continuous Compounding and Discounting

$FV = PV \times e^{r \times n}$ $PV = FV \times e^{-r \times n}$

Time

$$t = \frac{\log (FV/PV)}{\log (1+r)}$$

(AER) APR

$$\text{(AER) APR} = \frac{(1 + r)^m - 1}{m}$$

Implicit rate of return

$$r = \left(\frac{FV}{PV}\right)^{1/n} - 1$$

Table 1: Present value of 1 unit received *n* periods in the future assuming a constant discount rate of r per annu

n \ *r*	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026
21	0.811	0.660	0.538	0.439	0.359	0.294	0.242	0.199	0.164	0.135	0.112	0.093	0.077	0.064	0.053	0.044	0.037	0.031	0.026	0.022
22	0.803	0.647	0.522	0.422	0.342	0.278	0.226	0.184	0.150	0.123	0.101	0.083	0.068	0.056	0.046	0.038	0.032	0.026	0.022	0.018
23	0.795	0.634	0.507	0.406	0.326	0.262	0.211	0.170	0.138	0.112	0.091	0.074	0.060	0.049	0.040	0.033	0.027	0.022	0.018	0.015
24	0.788	0.622	0.492	0.390	0.310	0.247	0.197	0.158	0.126	0.102	0.082	0.066	0.053	0.043	0.035	0.028	0.023	0.019	0.015	0.013
25	0.780	0.610	0.478	0.375	0.295	0.233	0.184	0.146	0.116	0.092	0.074	0.059	0.047	0.038	0.030	0.024	0.020	0.016	0.013	0.010
26	0.772	0.598	0.464	0.361	0.281	0.220	0.172	0.135	0.106	0.084	0.066	0.053	0.042	0.033	0.026	0.021	0.017	0.014	0.011	0.009
27	0.764	0.586	0.450	0.347	0.268	0.207	0.161	0.125	0.098	0.076	0.060	0.047	0.037	0.029	0.023	0.018	0.014	0.011	0.009	0.007
28	0.757	0.574	0.437	0.333	0.255	0.196	0.150	0.116	0.090	0.069	0.054	0.042	0.033	0.026	0.020	0.016	0.012	0.010	0.008	0.006
29	0.749	0.563	0.424	0.321	0.243	0.185	0.141	0.107	0.082	0.063	0.048	0.037	0.029	0.022	0.017	0.014	0.011	0.008	0.006	0.005
30	0.742	0.552	0.412	0.308	0.231	0.174	0.131	0.099	0.075	0.057	0.044	0.033	0.026	0.020	0.015	0.012	0.009	0.007	0.005	0.004