Practice Script B

Question 1

A	B	C	D	E	F	G	H	I

Practice Script B

Mumbai operation (e2)

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Financial Benefits

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Proceeds from sale can be invested in the business towards more modern equipment that is deemed required for improved perfromance by the board.

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By selling the mumbai operations and withdrawing from indian market removes the exchange rate risk assosciated with fluctuations in the rupee.

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Should allow a more focused supply chain to fulfill strategy. Can reduce transport costs of supply to UK if factory based in UK.

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Reduce any export or tariff or red tape assosciated with indian market

Financial Risks

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Of the 180,000 cooling components produced by the Mumbai operation, half of these (90,000) were sold to companies in India. By selling the mumbai operation and withdraw from the indian market lose out on this business to indian based companies.

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Despite exchange rate fluctuations the price of the average cooling component in £ terms was 120 per until. 120 x 90,000 = 10.8m revenue revenue recieved from the indian sales. Risk of loss of revenue.

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Likely to have paid cheaper labour in Mumbai factor.

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As the operation was advetised immediately in Aug and has not yet sold, risk that may not be enough demand. Risk will be forced to sell it for less than they has hoped.

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The longer it takes to sell the more costs Kitch will incur running the operation. Likely to incur exit costs which have not been accoutned for.

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Fv risk - The carrying amounts and FV of the ppe are decreasing as time goes on. Fv and interest rate are inversly related.

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Fair valuie less costs to sale is substaintally less than the carrying amount of the assets.

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Costs relating to short tem supply contract. May not be easy to find a long term source of cooling components.

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Mumbai operation supllied 90,000 units to UK factory, this will need to be fulfilled or could hinder UK operatins. Risk of not beingf able to meet this supply to UK factory.

1 -

If going to close at short notice may be reputational damange from staff losign their jobs and poor staff managemenr. This could have an impact of reputation of Kitch and lose customers.

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FR implications

IFRS 5 deals with the treatment of assets held for sale and discontinued operations. It requires certain conditions to met before the mumbai operation can be classified as held for sale.

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This includes that sale of the operation is highly probable and therefore this has been satisfied from the date it was advertised. However it also requires it to be available for immediate sale in its present condition. This would need to be investigated as production is still continuing therefore unlikely to be able to classify as held for sale.

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Upon classfifcation of held for sale when the conditions are met the whole mumbai operatin would be valued at the lower of its carrying amount and FV less costs to sell. Depreciation on assets would also cease.

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As the mumbai operation is a substantial and seperate divisiion it can be recgonised as a discontionued operation.

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Profit or loss attributable to the mumbai operation should therefore be calculated and shown seprately in the Kitch P+L and OCI.

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If being sold as a going concern appropraite disclosures are required in the financial staments.

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PPE and inventoey should be valued in relation to IFRS 13. Fv less costs to sale at y/e = 30,000 - 1620
=28,380
Carrying amount = 59,350
Therefore to be measured at lower amount = 28,380

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Possible provision required for the restucturing and redundancy costs. IAS 37 requires that Provisions requires a detailed formal plan and cajn only provide for redudncany costs once a formal announcemnt has been made.

3

Comparison of alternatives
- new UK factory
- Use UK based third party supplier

Using the intial cost outlay for the new factory and teh assumed 5million annual saving compared to using the thirs party supplier. An incremental saving of 7.35m has been calculated for using the proposal of teh new factory as apose to using a third party supllier. See calc below
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However the new factory would require a signifacnt intial investment of 50million, howver as Kitch has surplus cash it is in a healthy position to be making this significant investment.
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Also has not considered the contract cost rising from the third party.
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However this calculation is based on assumptions. It is assumed that this cash saving will grow by 1% over the 20 years of the factory this may not be case in reality and if were not to maintain this growth would be less of a cost saving. 1 % increase in cost savings fro 20 years may be optimistic.
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It also assumed the discount rate is 7% which is the WACC this may change ovet time therefore having an impact on this calculation.
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The choice for a new factory gives kitch more control over their supply than with outsourcing it. By outsouricng placing reliance on the third party, risky if they were raise prices or go into liquidatioon.
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However by outsourcing to a third party supplier, the suppleir may be better equiped to produce these cooling components. May have been technology to do so more efficiently and therefore may be able to meet demand easier.
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Therefreo could allow Kitch to focus more so on what they produce in their other factory
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By outsouricng allows flexibilty to switch outsourer every few years. The factory is assumed to be in use for 20 years. Disadvantge of the factory is that will need to look for another suitable factory in 20 years.
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Should consider the data portection risks of cutomer infromation assosciated with using an outsourced supplier.
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May also be difficult to coordinate the supply of the cooling components with the other componenets for teh air conditining systems is using 3rd party. This could create operatiional porblems with the rest of the busness.
-
Harder to guarantee the timing and quality and risk of delays or hidden costs such as disruptions from the thirs party.
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Therefore in conclusion would recommend the purchase of own factory as potential for 7.35m cost savings and kicth can benefit from having more control over its supply management.

Incremental NPV

	T0 - 1/10/2019	T1 - 31/9/2020 (grow 1%) for 20 years	
cash outlay	(50,000)		
cash benefit		5,000	
	(50,000)	5,000	
df @ 7%	1	1-(1 + 6 %)^-20/ 7%-1%	
	(50,000)	57,350	7,350
NPV	7,350		

Proposed share buy-back (e3)

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Factors to determine price per share

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Risk of underselling the shares .

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Need to consider a price that the individual shareholders are likely accept.

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Should incporate the loss of future dividends expected from the shares. £10million in dividends were paid out each year, 10p dividen per share.

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Should consider the signalling effect, may choose to sell back on AIM market instead of accepting offer. This could result in a fall in the share price.

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Would reduce number of share in issue by 20million therefore total being 80million.

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Would leave 5million shares to individual shareholders. This in theory would increase the price of the shares as suplly has fallen

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Should consider the type of indiivdual shareholders, whether they were looking for dividends or capital gains. This should be considered in the price choosen.

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if bought at the current price would cost 2.30 x 20million = 46million. This likely to the least the shareholders would eb willing to accpt and likely to be higher. Average share price in prior year was 2.68. Therefore at this price would cost 53.6m

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Would need to consider the price/time at which current shareholders bought their shares, this will impact on their price they will accept as will determine the capital gain on thei investment.

Benefits and problems for each stakeholder

Rohit and katy

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Proceeds should increase cash for investment back into the business.
Rohit and Katy's shareholding would increase to 37.5% (30m/80m). They would between them have 75% of control.
However do not have the majority vote in decisions so this would giving them more power in decision makiing.
If maintain the dividend level of total 10million payout this will be spread amoungst fewer shares therefore more dividend payout for remianing shareholders.
Catherine sue and zoe could stop the buy back from happening if they do not agree as need 75% approval.

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catherine, sue, zoe

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Without considering the individal shareholders who own less than 1% each for the share buy back to go ahead, would need 75% approval. This would likely require all three (catehrine, sue and zoe) to agree to this. This gives them a degree of power in the matter.
Shareholding increases from 5% to 6.25%. Equal holding amount the three of them. They will now have equally highest voting power /sharing above the individual holders who will only yhave 5%
May access to hhigher dividend
Unwilling to sell their own shares, may feel pressured that they want to also be bought back.

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Individual

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20 out of 25million of the shares will be bought back leaving only 5million sharess to individual holders. Liekly to increase the share price as reduced supply for those with remianign shares.
Those who sell their shares may be able to achieve a good price. The prior year share price was 2,68 likely to expect more than this.
As Ketch is going through reorgamnsing the business could potentially fail and therefore this provides a way out. However potential for the business to suceed and share price increase in future
If bought last year will only accept if higher than 2.68 or else would make a capital loss.
provides and opportunity to put shares elsewher potenitally less riskier investment.

16

Investment in Corporate Bonds (Ex3 - propsal 3 - use phloom and ghlast)
-
Risks and benefits of using corporate bonds
-
Risk of company not ebing able to pay interest or redemption and investment loss
usually less riskier than investment in equity
inverse relationship between interest rates and bond prices. The price of some bonds are more sensitive to changes in interest rate
Volatilty of the bonds value,
exchange rate risak for those bonds denominated in foreign currency
recived 3% interest of every 100 bond they buy each year from Ploome
eailty liquid to be sold

How risks could be mitigated
- invest in bobnds of high credit ratings
- can use the macauley duration to compare the volatilty of the two bonds. Ghlast plc is longer until maturirty therefore would increase volatity. However Ploome has a high coupon rate of 3%.
- monitor the value of the bonds throughout the life to see if value is falling
- hedge investm,ent

Evaluation of Zoe and Sues views
- Ploome has a higher credit rating than Ghlast therefore should be less risk.
- Get 3% of 100n bond each year, this is steady annual cash inflow
- The bond yeild is based on the credit rating and time to maturity. As Ghlast has longer time to maturity and a lower credit rating the bond yeilf required will be much higher. Therefore would potentially expect a lower bond price than 95
- agree with Zoe that is it better to match with the time period of 4 years and therefore less risky.
- plan to ninvest after 4 years
- also has a better credit rating
- Ploome gives us more time to make be able to pay the redemption back, however liquidy is not an issue for Ketch therefore this is not too risky
- Ploome are redeemable at a very high premium
- Would need to caluclate the implicit intrest rate of both to compare the cost of issuing the bonds
- Ghlast gioves us 45% back on our investment after 10years, likely to be more than Ploome.

18	Recommendation of 3 proposals - Recommend to use the surplus cash to go ahead with proposal 1 and the first option of purchasing a new factory. Provides potential cost savings of 7.35m as apose to outsourcing and will be need to fulfill the 90,000 cooling components made by mumbai operation. - Gives more control that the outsourcing option - Share buy back is not in best option of the board, may result in divisions in management and risk that they do not accurately price the shares. Would giv voting power back to R and K and their integrity has come into question from hannahs recording. - Although the bonds to provide good return on invetsment, they are not in very good risk rated comapnies therefore risk that company would not be able t pay teh interest on redemption. Also the UK factory is more of an operational neccisity assosciated with the actuall trading of the business and tehrefore better choice.
19	
20	Ethical implications for r and k - Corporate governance issues, unfettered power by R+K. Could face legal procedings for unfair dissimisal Reputational damage if news of R+K character comes to light, alegations of intimidation Potential insider trading of Katy reslling her sahres Implications for GRC (advisors) The means by which Hannah has received this information could be deemed unethical. She has overheard information and then proceeded to record it. this could be seen as evesdropping on confidentail information and could put Hannah's integrity into question. - As advisors the managements integrity has come into question. There is a intimidation threat from Rohit onto both GRC and the other directors. Katy implies she is not in a position to be making appropraite decsions for the business as does not want what is best for the business. - Rohit is implying that they will be able to use GRC to support this option. This could be deemd as adovacy threat as GRC must remain independant on their advice rather than what Rohit would like them to advise. May be threatening GRC - Must remain objective in their advisory role. - Reputational damage for GRC must ensure they do not agree to anything unethical or not best for the business. Actions - Establish the facts as may have misheard - Seek legal advice - Should remain sceptical of information from R+K, be sure not to be forced to do anything - Consult ethics partner at firm for advice - Consider resignation from the adivsory role

Question 2

Analyse and evaluate financial perfromance

Revenue change	2017	2018	% change
- stores	24200	22300	(7.85%)
- online	7100	8600	21.2%
- golf	20,000	18600	(7%)
- skiing	113000	11300	0
total	31,300	30,900	(1.27%)
Revenue Mix			
Stores : online			
Golf : Skliing			
Gross Profit margin			
- golf	25%	28%	
--skiimng	30%	22%	

Overall revenue fell by 1.27% in 2018 from 31,300 to 30,900. This was mostly driven by a fall of 7% in golfing revenue. Revenue relating to skiing did not chnage in the year. store sales fell by 8% and online sales increased by 21%. However online sales still makes up a lot less of total sales. Invetsment shoudl be driven towards increasigng online sales.
Gross profit margins on golf increased by 3% which indicates able to obtain cheaper purchasest. However gross profit margin from skiing fell signifacntly by 8%. This may have been caused by unfavourable exchange rate fluctautions of suppies. Gold products are now more profitable than skiing so potent8ially7 should focus groeth on this area or look to alternative suppliers for skiing.

19

Benefits of digital marketing strategy, rev, lt value and brand
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very little use has been made of the data helf on cutomers. Bid data helps to break down this information and identify trends in cusomter behaviour.
Digital marketing can be used as part of CRM.
- can be used to identify peak seasons and help for inventory management
Can be usaed to sttract bnew customers
-
digital marketing can be used as a cost effective way to advertise through social media
-
can use personalised emails to offer promotions to target those who are buying golf products and those who are buying skiing products as most buy one or the other and therefore uinlikely to be interested in prmotionals for the other.
-
Can identify want customer want ie eitehr golf or skiing promotions and targfet these to certain custoemr
-
As 75% of zetas sales come from 20% of its customers and 84% of zetas sales from previos customer, customer rention is key for repeat purchasers, therefore could implement online loyalty schemes.
-
Customers have already shown a degree of brand loyalty therefore could use the information they store to reward certain loyal customers.
-
Can build a profile on the type of customer they atrract and use this for social media purposes. ccould team up with related golf and skiing events to impriove their overall brand
-
Allows them to better place their stragteic marketing and pricign stratgies . Can use segmentation strategy to divide customers.
-
Must also consider the secrity and data protection risks assoscaited wuith storing data

Possible valuation methods
-
IFRS 13 requires brands acquired to be valued at fair value. This however is subjective.
The ski gear brand will currently not be recognised on Ski gears FS as it is internally genrated. As it is just breaking evemn ay suggest the brand is not entirely poepular however this would need to be invetsgiated.
IFRS 13 requires the FV to be determine on its higeghst and best use.
Level 1 inputs are the quited prices in an active market therefire the priceZeta would be prepared to pay. Could use level inputs which internal ski gears uinternal company dATTA.
3 possible techniques
1, makret basis - however difficult therefore could use income basis which is PV of incremental income generated by the brand or cost basis which is the reoplacemnt cost of the band.
Cost basis would inlove estimating the PV of the costs that would need to be incurred to develop a comparable brand from scratch,. ie r+D costs and advertising cotss/

Income basis probably most apptropriate. However woyuld be highly judgem,ental.

FR teatmnent
-
If OSC acquired would represtn control and therefreo would need to prepare consolidated financial statments. If the ski brand could be seperateable and identifable price it could then be recgonised on the financial statments as an intangible asset. This is because the transaction of the acquauiton would represent a valualtion on the brand.
CoFP would add up the asset so would be recgonsied as Non currrent asset.
Would not be recognised on Ski gears individal FS as to them it is ibnterna;lly generated
If only the ski brand was to be recognised it would be recognised on the Financial sdtatment as an inatingible non cureent asset under IAS 38. It would need to be reviewede for impairmetn annualyy recognised at its fair value

Due diligence
The fair value of the brand is highly subjective and therefore would rewuire due diligence to ensure it is not being over priced.
This due diligence could inlcude use of an external experts opinion
Depenign on the valualtion method used, for example income basis would have to review the PV caclulation and the workign asummptions reviewed fro reasonableness. for example the discount rate
If cost basis used would have to test the inputs for example reasonableness of

perfrom market research on the perception of the brand and its quality