Diploma in Corporate Finance

Corporate Finance Techniques & Theory

Date of exam	Tuesday 2 December 2014
3 hours	2.00 pm – 5.00 pm
Rubric	Section A – answer **five** questions in this section
	Section B – answer **both** questions in this section

Candidates are reminded that no marks will be awarded for illegible work

Notes to candidates

1. Please insert your candidate number on the cover of your answer book. **Do not insert your name.**
2. Show **all** workings in your answer book.
3. Candidates may attempt the sections in any order. Please indicate clearly in your answer book which questions you are answering.
4. Please insert the numbers of the questions which you have attempted, in the order in which they appear in the answer book, in the box provided on the cover of your answer book.
5. You may use the calculator provided or a model approved by the CISI.
6. You must hand your answer book to an invigilator before you leave the examination hall. **Failure to do so will result in disqualification.**
7. The decision of the exam panel is final and no correspondence will be entered into concerning the grade awarded.
8. Once submitted, the examination scripts become the property of the CISI. They are not returned to candidates.

Please turn over when instructed

SECTION A **TOTAL 50 MARKS**

All companies designated as a plc should be assumed to be UK-based, premium listed companies, unless otherwise indicated.

Answer FIVE questions in this section

1. Lightspeed plc (Lightspeed) has its central management in Austria. Lightspeed has been approached, in confidence, by a private equity company that intends to make an offer for its ordinary shares. The Board of Lightspeed is minded to oppose the offer and, as part of a takeover defence strategy, intends to issue a profit forecast. Neither the Board or the private equity company hold shares in Lightspeed.

At a recent Board board meeting, where the takeover defence strategy was discussed, the chairman of Lightspeed stated that: "Since the company's central management is in Austria we do not need to worry about the City Code rules concerning profit forecasts." The company secretary said that: "There certainly is no need to worry about the City Code because I have read that it is not necessary to obtain a report on a profit forecast from an independent accountant or financial advisor. So we can just issue a profits forecast showing the best case scenario."

Requirements

(a) Discuss the accuracy of the chairman's statement. (3 marks)

(b) Discuss the accuracy of the company secretary's statement. (5 marks)

(c) In relation to your answer in (b), discuss whether it would make a difference if the offer for Lightspeed was from a management buy-out team, rather than from a third party. (2 marks)

(Note: In your answers you must make reference to the relevant rules of the Code)

2. A secretary at Oakwood Products plc (Oakwood) overheard two directors of the company talking about an announcement that it intends to make next week concerning a major new contract. Oakwood has secured an order to supply furniture to a large hotel chain, which operates throughout Europe. The secretary subsequently made a phone call to her partner encouraging him to immediately buy call options on Oakwood shares.

Requirements

(a) Briefly describe the various offences of market abuse. (6 marks)

(b) Discuss whether the secretary, her partner or both are guilty of any of the offences of market abuse. (4 marks)

3. Dragon Construction plc (Dragon) is considering a project in a foreign country which will require an investment of the foreign currency equivalent of £200 million. The project will be financed by debt and the finance director of Dragon is considering how and where to raise the loan. He has asked your firm to brief him on the use of currency swaps in these circumstances.

Requirements

(a) Describe the mechanics of a currency swap. (4 marks)

(b) Discuss three advantages and three disadvantages of using a currency swap in Dragon's circumstances. (6 marks)

Exam paper continues over page

4. You have been asked to prepare briefing notes on the topic of Economic Value Added (EVA®) for a presentation to one of your firm's listed clients. To illustrate your notes you have the following information available for the Volkswagen Group for the years ended 31 December 2012 and 2013:

	2013 € million	**2012 € million**
Operating profit after tax	10,536	10,904
Invested capital (average)	72,749	65,749
Cost of capital	8.3%	7.8%

Requirements

Prepare briefing notes that should include:

(a) The EVA® of the Volkswagen Group for the two years ended 31 December 2012 and 2013 and your comments on the use of the operating profit after tax. (2 marks)

(b) An explanation of what the EVA® of the Volkswagen Group represents for its ordinary shareholders. (3 marks)

(c) The problems in using EVA® as a value-added measure. (5 marks)

5. ABC plc (ABC) is seeking a premium listing. A major shareholder in ABC is Andrew Price who holds 20% of the ordinary shares of ABC and he is also the controlling shareholder of XYZ plc, which owns a further 12% of the ordinary shares of ABC.

Amongst other concerns, the Board of ABC would like more information regarding controlling shareholder agreements.

Requirements

Provide advice to the Board of ABC on:

(a) Whether and why ABC might or might not be required to put in place a controlling shareholder agreement.

(2 marks)

(b) The undertakings that must be contained in such an agreement.

(3 marks)

(c) The continuing obligations if a controlling shareholder agreement is not complied with. (3 marks)

(d) The disclosure requirements relating to controlling shareholder agreements. (2 marks)

Exam paper continues over page

6. Vertical Limits Ltd. (Vertical) is a European leader in specialist industrial roped access. Vertical was financed by multiple founders, including business angels. The age range of the founders is from 40 to 65 and it is becoming increasingly clear that their individual ambitions are changing. Some of the founders would like a complete exit from the company, whilst others would like to still participate in future growth.

You are employed by Zeta Financial Advisors (Zeta) and you have been asked to make a presentation to the shareholders of Vertical on the alternatives available to satisfy the differing ambitions of the founders of the company.

Requirements

Prepare a presentation that specifically covers, while addressing the differing ambitions of the founders of Vertical, the following:

(a) How a private equity or venture capital company might be able to work in partnership with Vertical.

(4 marks)

(b) Three appropriate alternatives to private equity or venture capital.

(6 marks)

7. Black plc (Black) is a mid-cap company which intends to expand by acquisition and has asked your firm to give advice on certain matters in the takeover process.

Requirements

Provide full answers to the following queries from the Board of Black in relation to acquisitions of other listed companies:

(a) What would cause an offer to be mandatory rather than voluntary? (2 marks)

(b) What are the rules relating to the acceptance condition in a voluntary offer and are they different in a mandatory offer? (2 marks)

(c) What is the minimum price to be offered to the target company's shareholders? (2 marks)

(d) What might cause the minimum price to be offered, mentioned in (c) above, to change? (1 mark)

(e) What are the rules concerning irrevocable commitments and letters of intent given by the offeree company shareholders who are also directors of the offeree company? (3 marks)

Exam paper continues over page

SECTION B **TOTAL 50 MARKS**

Answer BOTH questions in this section

Both questions in this section are based on the same company, Majestic Wine plc (Majestic), but you should treat each question separately. For both questions you are provided with an information booklet which contains financial information on the company.

For both these questions, you should assume that the current date is 31 July 2014.

The share price of Majestic on 31 July 2014 = 394.25p

8. *“Majestic Wine said a cocktail of tax increases and bad harvests had caused a sales headache for the company as it reported flat annual profits.*

   Chief executive Steve Lewis blamed rising wine prices for a small decline in like-for-like sales at the retailer but pointed to encouraging trends, such as sales of fine wine – bottles priced at £20 and above – which climbed by nearly a fifth. "We had consecutive wine duty increases and there were bad harvests in both the northern and southern hemisphere, inevitably that led to price inflation," he said.

   The wine specialist made a pre-tax profit of nearly £24m – a small increase on last year – on sales of £278m, which was in line with City expectations following a shock profits warning in March. The retailer was caught out by a slowdown in sales after Christmas, as consumers cut back spending on wine. Duty on a bottle of wine has increased from £1.81 three years ago to £2.05, the company said.”

   Source: The *Guardian* June 2014.

Your firm, Moorland Corporate Finance (MCF), has been asked by a client, which is a private equity fund, to analyse the financial health of Majestic. The analysis is to be carried out with a view to your firm, on behalf of its client, making an offer for Majestic's ordinary shares.

Requirements

(a) Prepare a financial analysis of Majestic and discuss the financial health and trends of the company. Where possible you should refer to the comparable company information. You must include a conclusion in your discussion. (15 marks)

(b) Discuss whether the financial health and trends of Majestic might cause shareholders to consider an offer (depending on the price) from your client. You must include a conclusion in your discussion. (4 marks)

(c) Discuss whether Majestic is likely to be a suitable takeover target for your client. (6 marks)

Exam paper continues over page

9. The Board of Majestic is concerned about recent rumours that the company might become a takeover target and would like an independent report on the value of its ordinary shares.

You are an analyst with Bridge Financial Advisors (BFA) and you have been asked to prepare a draft valuation report for a BFA partner who is due to meet the Board of Majestic. You have also been asked to include in your report some suggestions of how your client might encourage shareholders to retain their holdings in Majestic.

The valuation of Majestic is to be carried out using publicly available information and, since the half year results are not yet due, it should be based on 31 March 2014 financial statements and the Capital IQ estimates for future years.

Requirements

Prepare a draft report that should include:

(a) An estimate of a range of values for the ordinary shares of Majestic based on:

i) Discounted cash flow using a three-year time horizon, to 31 March 2017, and assuming a growth rate of 2% thereafter (Note: the risk free rate may be assumed to be 2% and the risk premium 5%). (10 marks)

ii) A broad range of multiples. (6 marks)

(Note: in both valuations, you should state your assumptions, reservations and any further information requirements.)

(b) A recommendation of whether the current share price of Majestic, 394.25p on 31 July 2014, represents a fair value of the company when compared to your valuation range.

(3 marks)

(c) A description of how Majestic might encourage shareholders to retain their holdings in the company. (6 marks)