CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

ICAEW

Diploma in Corporate Finance

Corporate Finance Techniques & Theory

Date of exam	Tuesday 23 June 2015
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. Red plc (Red) has expanded organically in the past and has now decided to expand by acquisition. Your firm has been asked to make a presentation to the board of Red regarding the acquisition, by way of a takeover offer, of the ordinary shares of a listed public company.

Requirements

Prepare a briefing paper explaining:

(a) The impact of acquiring the following percentages in potential target companies:

(i) 3 per cent.	(1 mark)
(ii) 10 per cent.	(2 marks)
(iii) 30 per cent.	(1 mark)
(iv) 53 per cent.	(2 marks)
(v) 75 per cent.	(1 marks)

(b) The implications for the minimum price to be paid for the target company's shares assuming that the finance director of Red had bought some of its shares for his own account:

(i) Two months ago.	(1 mark)
(ii) Six months ago.	(2 marks)

2. At a recent meeting of the board of King plc (King) it was resolved that the company should make an offer for Lion plc (Lion). It is the intention of the board of King that the finance for the acquisition of Lion would be raised by borrowing from King's bankers. At the meeting the board were discussing how they could ensure that the funds are going to be

available at the appropriate time to satisfy the offer consideration. The finance director stated “We already have substantial borrowings and our bankers may want to secure the loans on Lion’s assets, I am worried about the financial assistance provisions of the Companies Act 2006” The CEO of King stated “No need to worry about financial assistance, I have read that it does not now apply to private companies, we can secure our loans on Lion’s private subsidiary companies”.

Your firm has been asked to give advice to the board of King on how any loans used to acquire Lion can be secured

Requirements

Give advice to the board of King on:

(a) Discuss whether the CEO’s assertion that financial assistance does not apply is correct. (3 marks)

(b) How King can arrange for its bankers to be able to secure the borrowings for the purchase of Lion on Lion’s assets. You should outline a typical approach to the problem including details of any formal meetings and special resolutions needed. (7 marks)

Exam paper continues over page

3. Orion Biotech Ltd., (Orion) is a successful, closely held, private company that operates in a very specialist area of biotechnology and it is considering an initial public offering (IPO) on the main market of the London Stock Exchange. The intention is for the shareholders of Orion to realise a large part of their investment and to raise funds for expansion of the business through continued research and development. You have been asked to make a presentation to the board of Orion on the key stages of an IPO and the methods of bringing its securities to listing.

Requirements

Prepare notes for your presentation which include:

(a) Outline the stages of an IPO process, including indicative timing and the documentation required. (3 marks)

(b) A brief description of the following methods for bringing Orion's securities to listing, you should include the relative advantages of each method.

- Offer for sale
- Placing
- Intermediaries offer

(6 marks)

(c) Your advice, with supporting assumptions, on which of the methods in (b) above is likely to be most appropriate in Orion's circumstances.

(1 mark)

4. Caspian plc (Caspian) wishes to increase the number of sources from which it obtains its funding and is considering a bond issue to raise £100 million. The bonds would be tradable. The company has approached your firm for advice on bonds generally and the procedures necessary to issue them.

After initial talks with Caspian you have established that the bonds would be issued with a maturity of seven years and have a coupon of 6% paid annually. After consultation with colleagues, you have also established that the issue price is likely to be £110 per £100 nominal value.

Requirements

(a) Calculate the yield to maturity of the bonds. (2 marks)

(b) State what the coupon rate would have to be if the bonds were to be issued at par value and discuss the implications of this for the take up of the issue and for Caspian’s cash flow. (5 marks)

(c) Advise Caspian on what public documentation is necessary for the issue of the bonds and give a brief description of its contents. (3 marks)

Exam paper continues over page

5. On 2 February 2015 an announcement was made that Grizdale plc (Grizdale) was in talks with Track plc (Track) regarding a possible offer for its ordinary shares. However on 2 March 2015 Grizdale made a statement that it does not now intend to make an offer for the ordinary shares of Track.

It is now 22 June 2015 and there has been a firm intention by a third party to make an offer for the ordinary shares of Track. The third party announcement was made before Grizdale made its statement that it did not intend to make an offer for Track.
Grizdale would now like to make a further approach to Track with a view to making an offer.

Requirements

Discuss whether Grizdale can make single confidential approach, or a second confidential approach, to Track in the following circumstances:

(a) The board of Track agrees to a single confidential approach.
(3 marks)

(b) There is no agreement from the board of Track to a single confidential approach. (1 mark)

(c) If the third party offer is by way of a scheme of arrangement and this has now been changed to a contractual offer. (2 marks)

(d) If the third party offer is by way of a public recommended offer and this has now been changed to an offer by way of a scheme of arrangement. (2 marks)

(e) Track rejected Grizdale's single confidential approach, but Grizdale would now like to make a second confidential approach to Track.
(2 marks)

6. Northern Hotels Ltd., (Northern) is a private company that operates hotels in the north of England and has been trading for ten years. Northern made a profit before tax of £200,000 for the year ended 31 May 2015. The company is owned by the Jones family who are the sole shareholders and directors.

The Jones family would like to expand by buying a hotel in Asturias, which is on the Atlantic coast of Spain. The cost of the hotel is likely to be €2 million and the spot exchange rate is €1.37 = £1. The Jones's would like to complete the purchase of the hotel in three months' time.

Below are extracts from the Balance Sheet of Northern at 31 May 2015:

	£	£	£
NON-CURRENT ASSETS			
Vehicles and equipment			100,000
Freehold property (recently revalued)			6,000,000
			6,100,000
CURRENT ASSETS			
Stock	35,000		
Debtors and prepayments	60,000		
Cash	15,000	110,000	
CURRENT LIABILITIES			
Trade creditors and accruals	80,000		
Bank overdraft	500,000	580,000	
NET CURRENT LIABILITIES			(470,000)
LONG TERM LOANS			(2,250,000)
NET ASSETS			(3,380,000)

(Note: The bank overdraft is secured by a fixed and floating charge on Northern's assets and the Jones family have given personal guarantees to Northern's bank. The long-term loans are secured on Northern's property)

Exam paper continues over page

Requirements

(a) Discuss whether and how Northern can restructure its existing financing and two appropriate options that are available for it to raise the finance needed to buy the hotel in Asturias. (7 marks)

(b) Discuss the particular risks faced by Northern when expanding overseas. (3 marks)

7. Apple plc (Apple) and Pear plc (Pear) are premium-listed companies, which intend to set up a joint venture. Apple and Pear will each transfer a subsidiary to a new company (Newco) in exchange for a 50% interest in Newco.

You are giving advice to Apple regarding the Listing Rule implications of setting up the Newco.

Requirements

Prepare a briefing paper for a meeting with the board of Apple, which includes:

(a) A definition of a significant transaction and a discussion of why this is important for premium listed companies. (2 marks)

(b) An explanation of which class tests will need to be applied when transferring the subsidiary to Newco. (2 marks)

(c) An explanation of which class tests will need to be applied to taking control of 50% of Newco. (Assume that the interest in Newco will not be consolidated into Apple's accounts). (2 marks)

(d) A brief list of the contents of a class 2 circular and any additional obligations should the transaction be categorized as class 1. (4 marks)

SECTION B **TOTAL 50 MARKS**

Answer BOTH questions in this section

Both questions in this section are based on the same company, boohoo.com plc (boohoo), but each question is to be treated 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 13 March 2015.

The share price of boohoo on Friday 13 March 2015 = 29p

Boohoo was floated on AIM in March 2014 and the company enjoyed high sales growth in the six months prior to 31 August 2014. However the following three articles appeared in The Guardian and the Telegraph on 9 January 2015 and the London Evening Standard on 13 March 2015.

<u>The following articles relate to boohoo.com plc</u>

The Guardian:

"Boohoo.com, a fashion website aimed at young shoppers, has warned that profit will be more than 25% below City expectations after a pre-Christmas marketing push failed to increase sales.
Its shares crashed by more than 40% after the profits warning to 21.7p. The retailer floated on the stock market in March at 50p a share.
It said warm weather hit sales of its autumn range in the final two months of 2014. As a result, revenue for the year ending February

will be about £140m compared with a previous estimate of £157m. Earnings before interest, tax, interest and other items, forecast at £19m, will be about £14m – a 26% shortfall.

Boohoo said it increased marketing spending in late October but that sales did not increase as expected because of heavy discounting on the UK high street in response to the unusually warm autumn."

The Telegraph:

"The chairman and non-executive directors of the online fashion retailer Boohoo.com have bought more shares in the company in an apparent effort to reassure investors after a major profit warning this week.

Boohoo.com shares collapsed by 40pc on Wednesday after the company said sales growth in the UK had slowed to 25pc in the four months to December 31 and full-year results would be below market expectations.

The Manchester-based company's chairman Peter Williams and three non-executive directors all bought shares on Thursday, it disclosed on Friday.

Mr Williams increased his stake by a third to 400,000 shares, or 0.04pc of total Boohoo.com equity. David Forbes, the senior independent director, was the biggest buyer, adding 200,000 shares to the 40,000 he already owned."

The London Evening Standard:

"Could Boohoo do with a shake-up?

The online fashion retailer suffered a shock profit warning two months ago but seemed to be turning a corner yesterday when it revealed a 27% spike in full-year profits.

That's not enough for Panmure Grodon's (sic) new retail firebrand, Mike Stewart, who today started coverage of Boohoo with a call for an activist investor to take it by the scruff of the neck.
"Boohoo is a fundamentally sound business operating in an attractive trading environment, but the group's brand, marketing and IT capabilities require assistance," Stewart wrote.

He's not shy on names either: Topshop tycoon Sir Philip Green or Camden owner and technology entrepreneur Teddy Sagi are Stewart's two leading picks to shake-up the business.
Boohoo climbed 0.75p to 27.75p."

8. Your firm has a client with a substantial shareholding in boohoo. Your client is considering either selling his shares or making an offer for the remaining shares. A partner in your firm is due to meet with the client and discuss the financial health and future prospects of boohoo. You have been asked to prepare a report for the partner in advance of the meeting.

Requirements

Prepare a report for the partner in your firm that should include:

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

Exam paper continues over page

(b) A discussion on how your analysis in (a) above, making reference to the three newspaper articles, either supports or opposes the two options that your client is considering.
(Note: You should also refer to the estimates report for this section of your answer). (10 marks)

9. The joint CEOs of boohoo are concerned about the tone of the newspaper articles above and feel that the markets may be undervaluing the company. They are also concerned about potential takeover threats and how they can restore investor confidence in the company.

Your firm has been asked to produce a report addressing the joint CEO's concerns.

Requirements

Prepare a report for the joint CEOs of boohoo that should include:

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

(i) Discounted cash flow using a three year time horizon and assuming a growth rate of 2% thereafter (Note: The risk free rate may be assumed to be 1.35% and the risk premium 5%). (10 marks)

(ii) A broad range of multiples. (5 marks)

(Note: in both valuations, you should state the reasonableness of the assumptions and any reservations or further information requirements you may have)

(b) A summary and discussion of how boohoo can defend itself against a takeover and restore investor confidence in the following circumstances:

(i) Before an approach is made to the company by an offeror. You should include in your answer two strategies. (4 marks)

(ii) After an approach to the company by an offeror. You should include the responsibilities of the board of boohoo and any relevant code rules. (6 marks)

End of examination paper