

Accountancy@UJ



Department of Accountancy

Financial Strategy

FIS8X00 / FST8X00 / FNB15X7

LAST ASSESSMENT OPPORTUNITY

05 November 2018

Time: 3 Hours 20 minutes (200 Minutes)

Marks: 100

Assessor: Mr K Thomas

Internal Moderator:

Mr B Mogapi

External Moderator:

Ms S Jooste

INSTRUCTIONS:

- Question 2 of the assessment consists of **6** pages (including the cover page).
- Remove the password from all the files (File / Protect Document / Encrypt with Password).
- Answer question 2 in the MS Word and MS Excel **answer templates** provided. Show all calculations and workings clearly.
- The question 1 objective test questions (OTQ's) are available separately on uLink. The OTQ's are not printed in the question paper and **MUST** be answered electronically.
- Silent, non-programmable financial calculators may be used.
- Where applicable, round all calculations to two decimal places, unless stipulated otherwise.
- You are allowed 15 minutes reading time during the assessment. The purpose of the reading time is to allow you an opportunity to read through the question paper and, if you wish, make annotations on the question paper as well as to plan your answers.
- You are allocated 5 minutes to upload your answers into uLink.
- Do not use a tick mark ✓ as a bullet when answering the required.
- **The printed question paper MUST be handed in at the end of the assessment.**
- Good Luck!

| Question | Topic | Marks | Time |
|----------|--|------------|--------------------|
| 1 | Reading and Uploading Answer Templates | --- | 20 minutes |
| | Objective Test Questions – Various Topics (See uLink) | 50 | 90 minutes |
| 2 | Case Study Question – Objectives, Mergers & Financing Decision | 50 | 90 minutes |
| | | 100 | 200 minutes |

QUESTION 2

[50 marks]

You are provided with the unseen case material below. This unseen case material should be read in conjunction with the pre-seen material in answering the required for question two.

Assume today is 01 January 2017 (as the financial information in the pre-seen is for the period up to 31 December 2016).

Introduction

Evestar is a large, listed company in Teeland. Evestar is quoted (listed) on the Teeland Stock Exchange, reports using International Financial Reporting Standards (IFRS) and has the T\$ as its currency.

Evestar is Teeland's largest producer of "reality" television, when measured by revenue from programme sales. Reality television is a generic title for programmes that are largely unscripted and put participants in "real-life" situations that may be simulated.

Possible acquisition

At a recent board of directors meeting, the directors discussed the need to expand the number of "reality" television shows that Evestar currently produces. Ed Lanson (Finance Director) has indicated to the Board that he believes Evestar should acquire one of Evestar's competitors rather than start producing their own new reality shows as it will enable Evestar to expand far quicker.

Planned bid for Bonchant

Denny White, the Chief Executive Officer (CEO) and Chairman, has identified Bonchant, Evestar's closest competitor, as a possible takeover target (refer to the pre-seen material on pages 14 as well as 20 – 22 for additional information relating to Bonchant). Bonchant is a quoted (listed) company.

No official announcement has been made to the market concerning the possible acquisition. However, in recent weeks there has been significant movement in the share price of both Evestar and Bonchant, which is considered to be largely due to the leaking of information on the proposed bid into the public domain. There has been an 8% decrease in Evestar's share price and a 10% decrease in Bonchant's share price during this period.

Evestar is planning to make a cash offer for Bonchant.

Financial information for Bonchant

A relevant extract of Bonchant's financial statements for the year ended 31 December 2016 is provided below (refer to the pre-seen material on pages 20 – 21 for the financial extracts relating to Bonchant):

THE UNSEEN SCENARIO FOR QUESTION 2 CONTINUES ON PAGE 3

QUESTION 2 (CONTINUED)

[50 marks]

Financial information for Bonchant (Continued)

Statement of Profit and Loss of Bonchant for the year ended 31 December

| | 2016 T\$m | 2015 T\$m |
|---------------------------|--------------|--------------|
| Revenue | 175 | 158 |
| Cost of sales | (68) | (54) |
| Gross profit | 107 | 104 |
| Administrative expenses | (11) | (11) |
| Advertising and promotion | (19) | (19) |
| Operating profit | 77 | 74 |
| Finance charges | (8) | (8) |
| Profit before tax | 69 | 66 |
| Tax expense | (17) | (15) |
| Profit for the year | 52 | 51 |

Statement of Financial Position of Bonchant as at 31 December

| | 2016 T\$m | 2015 T\$m |
|--|--------------|--------------|
| ASSETS | | |
| Non-current assets | 387 | 370 |
| Property | 155 | 143 |
| Plant and equipment | 149 | 140 |
| Intangibles – programme development | 83 | 87 |
| Current assets | 51 | 45 |
| Trade receivables | 19 | 17 |
| Cash and cash equivalents | 32 | 28 |
| TOTAL ASSETS | 438 | 415 |
| EQUITY AND LIABILITIES | | |
| Equity attributable to equity holders | 311 | 292 |
| Ordinary share capital and share premium | 100 | 100 |
| Retained earnings | 211 | 192 |
| Non-current liabilities | 100 | 100 |
| Bonds | 100 | 100 |
| Current liabilities | 27 | 23 |
| Trade payables | 8 | 6 |
| Tax payable | 19 | 17 |
| TOTAL EQUITY AND LIABILITIES | 438 | 415 |

QUESTION 2 (CONTINUED)

[50 marks]

Financial information

Additional financial information as at 31 December 2016 is provided below:

| | Evestar | Bonchant |
|--|----------------|-----------------|
| Corporate income tax rate | 25% | 25% |
| Published equity beta | 1.0 | 1.2 |
| Forecast earnings growth (in perpetuity) | 3% | 5% |
| Ordinary shares in issue (millions) | 500 m | 400 m |
| Share price (today) | T\$1.30 | T\$1.10 |
| Forward price/earnings (P/E) ratio | 9 | 10 |
| Book value gearing ratio (<i>non-current liabilities ÷ (non-current liabilities + equity)</i>) | 59% | 24% |

Additional information

- You may assume a risk free rate of 6% and a market risk premium of 5%.
- You may assume that the debt betas are all zero.
- The market value of Bonchant's property was recently valued by a professional valuer at T\$200 million.
- It may be assumed that Bonchant's bondholders would accept the change of ownership of Bonchant's business and would reassign Bonchant's bonds to Evestar.
- Bonchant's historical ordinary dividend policy (up to 31 December 2016) has been to pay a stable growing dividend that increases by 4% per annum. This dividend growth is expected to continue in the future.

Financing of acquisition

Despite Evestar's board of directors' refusal to introduce additional equity to date, the downgrading of Evestar's bond rating by credit rating agencies has resulted in a rethink of this policy.

The following two alternative sources of finance are currently being considered by the directors of Evestar to raise T\$487.5 million for the acquisition of Bonchant:

1. Issue additional ordinary shares on 01 January 2017 by means of a rights issue at a 25% discount to the current share price; or
2. Issue 9% redeemable debentures. The debentures will be issued on 01 January 2017 at a discount of 5%. The debentures would be redeemable in six years' time at a premium of 10% per R100 nominal value bond. Interest would be payable semi-annually in arrears on 30 June and 31 December each year.

THE REQUIRED FOR QUESTION 2 STARTS ON PAGE 5

QUESTION 2 (CONTINUED)

[50 marks]

PART A

REQUIRED:

- 2.1 With reference to Teeland's television industry (refer to the pre-seen material on pages 2 – 4) **compare and contrast** the objectives of National Television (NT) **and** IndTV in Teeland. Consider the needs of each of their main stakeholder groups as well as the consequences of each entity failing to meet its stated objectives. **(8)**
- 2.2 **Calculate** a range of values (in total **and** per share) for Bonchant as at 01 January 2017 using the following valuation methods:
- (a) Assets;
 - (b) Dividends; **and**
 - (c) Earnings. **(9)**
- 2.3 **Advise** the directors of Evestar of the strategic advantages **and** disadvantages of acquiring Bonchant. **(8)**

NOTE:

- Show all workings clearly.
- Round answers to 2 decimal places, where applicable.
- State any assumptions you consider necessary.
- You **MAY** answer 2.2, in either MS Word or you can use the attached MS Excel template.
- Please ensure that you upload the MS Excel template into uLink if you make use of it.
- You **MUST** answer 2.1 and 2.3 in MS Word.

(Total for question 2 Part A = 25 marks)

QUESTION 2 (CONTINUED)

[50 marks]

PART B

REQUIRED:

- 2.4 For the rights issue for Evestar on 01 January 2017, **calculate** the: (2)
- (a) Number of ordinary shares to be issued in the rights issue; (2)
 - (b) Theoretical ex-rights price (TERP) of one share; (2)
 - (c) Expected trading price for the rights; **and** (2)
 - (d) Yield-adjusted ex-rights price of one share if the rate of return on the additional financing is assumed to be 15%, versus 12% on the existing financing. (2)
- 2.5 **Calculate** the yield to maturity of the 9% redeemable debentures for Evestar on 01 January 2017. (4)
- 2.6 Assume you are a senior manager at Evestar. **Prepare** an e-mail addressed to the board of directors that:
- (a) **Evaluates** the two proposed methods of financing (i.e. rights issue and redeemable debentures). Base your **evaluation** on your calculations above and any other relevant information. Marks will be awarded for additional, relevant calculations. Your evaluation should also include a **discussion** of the advantages **and** disadvantages of the two methods of financing being considered above; **and** (8)
 - (b) **Recommends** (with reason/s) an initial cash offer price for Bonchant (assuming the directors decide to acquire Bonchant). (2)

NOTE:

- You **MAY** answer 2.4 and 2.5, in either MS Word or you can use the attached MS Excel template.
- Please ensure that you upload the MS Excel template into uLink if you make use of it.
- You **MUST** answer 2.6 in MS Word.
- Marks will be awarded for structure and presentation in 2.6. (3)

(Total for question 2 Part B = 25 marks)

(Total for question 2 = 50 marks)

Total = 100