



The Institute of
Chartered Accountants
of Pakistan

Multi Subject Assessment Stage

4 December 2018
3 hours and 30 minutes – 100 marks
Additional reading time – 15 minutes

Management Professional Competence

CRN:

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Name:

INSTRUCTIONS

Read the instructions carefully before answering the questions:

1. Answer all **THREE** questions.
2. Write your Name and Roll Number on the top perforated portion of the **MAIN ANSWER SCRIPT ONLY**. Do not write your Name, Roll Number or any other identification mark on any other portion of the main or supplementary answer script.
3. Answer to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your main and supplementary answer scripts.
4. Answer each question in black pen only.
5. You are allowed to write notes/comments on the question paper. However, you must write your CRN and name on the question paper at the space provided above before starting to write any notes/comments.
6. The questions in this paper have been prepared on the assumption that candidates do not have a detailed knowledge of the types of organisations to which they relate. No additional mark will be given to candidates displaying such knowledge.
7. Only **FIVE** original books duly bound are allowed.

QUESTION 1

It is 1 December 2018 and you are a trainee accountant of Derawal & Sahi, a Lahore-based accountancy firm, who have been engaged by Lahore World Travel Ltd (LWT) to provide business consultancy advice regarding possible acquisition of a UK-based company, Safari Adventure plc, listed on London Stock Exchange.

LWT is a long established, large and successful travel company based in Lahore and is listed on the Pakistan Stock Exchange. LWT provides travel services to different sectors of the travel and holiday market including:

- corporate travel services;
- low cost travel packages to destinations in Pakistan, Europe and Asia; and
- travel solutions for the luxury travel market, such as arranging bespoke travel and holiday requirements, world cruises and guided adventure tours.

LWT provides a personal service by assigning a personal travel advisor to each customer and also arranges adventure tours such as trekking in the Himalayas Mountains. LWT has sales and customer service centres in Pakistan's main cities so customers can book in person as well as over the telephone.

Zahid Bashir is the Chief Executive Officer of LWT. He considers LWT's approach to customer service and creative travel solutions as the two principal reasons why LWT has achieved continual growth and profitability over the past thirty years to become one of the best known travel companies in Pakistan.

Zahid believes growth and shareholder value can be achieved by applying its core competencies and unique resources to other types of travel businesses. LWT has recently been approached by the directors of Safari Adventure plc with an offer for sale. The LWT Board of Directors has requested your assistance in valuing the potential acquisition of Safari Adventure plc and advising on how it should proceed.

Requirements

- (a) Critically evaluate the potential acquisition of Safari Adventure plc by LWT (Appendix 1 and Appendix 2). Your evaluation should include a performance analysis and pros and cons of the potential acquisition. **(10 marks)**
- (b) Determine the value of the new combined group after the acquisition and the maximum price that LWT may pay. Also advise the Board of Directors of LWT whether or not to proceed with the offer price of Rs. 9,000 million (Appendix 3).
Note: All workings should be done to the nearest Rs. in million. State and explain any assumptions. **(13 marks)**
- (c) Assuming the offer of Rs. 9,000 million is accepted, determine the impact on control, gearing and earnings per share if the acquisition is funded with new debt or by issuance of shares and give appropriate recommendations to the LWT's Board of Directors. **(10 marks)**
Note: Ignore tax

- (d) Explain the key areas which a due diligence exercise should include prior to finalizing the agreement to acquire Safari Adventure plc. **(07 marks)**
- (e) In the last board meeting, while discussing the potential acquisition of Safari Adventure plc, Shahbaz Karim, one of the directors of LWT apprised that through Finance Act 2018, a concept of Controlled Foreign Company (CFC) has been introduced. Accordingly, the income of Safari Adventure plc would be considered as income received from CFC. He also stated that LWT may also opt to be taxed as one fiscal unit.

Draft a note for the board of directors covering the tax implications of the following matters:

- Views expressed by Shahbaz Karim
- Treatment of dividends to be received from Safari Adventure plc
- Each financing option being considered by LWT

(10 marks)

Total: 50 marks

APPENDIX 1 – STRATEGY AND ACQUISITION OPPORTUNITY

Four years ago, LWT acquired a competitor travel company in Pakistan, Lux Travel, which was very successful in providing luxury travel arrangements to many of Pakistan's wealthiest people. This acquisition has been largely successful, however it was expensive and financed with loans which are repayable in 2024. The acquisition has occupied a great deal of management time over the past few years. A key focus has been to resolve integration issues with LWT's own travel booking processes and computer systems.

LWT's recent strategy has been to focus on growing its corporate travel services division. However, the board of directors has become increasingly concerned about a forecast decline in LWT growth. In response, the CEO, Zahid Bashir believes it is time to consider further acquisitions to help LWT achieve its strategic objective of being the market leader in the package, corporate and luxury travel markets.

As a result, the board of directors is considering purchasing two safari parks in Malawi (an East African country) and one safari park in Botswana (a South African country) operated by a UK company, Safari Adventure plc (Safari). It is unclear why Safari is looking to sell, however, Zahid believes this is an opportunity to buy a company at a low price and create new revenue opportunities by selling luxury safari holidays to LWT's extensive wealthy client base.

This acquisition represents a diversification from its current operations as LWT has no previous expertise in running hotels or safari parks, but the board understands that the existing management of Safari is talented and the employees operating the safari parks have significant expertise. None of the LWT directors has yet visited Safari's head office in London or any of the three safari parks in Malawi and Botswana.

LWT's share capital consists of 40 million shares which are currently trading at Rs. 500 per share. Additionally, LWT has outstanding loans of Rs. 10,000 million which are due for repayment in December 2024.

The directors of Safari have submitted a letter to the LWT Board of Directors stating that their shareholders are likely to accept an offer of Rs. 9,000 million for 100% equity in Safari Adventure plc. This offer price represents a 20% premium on Safari's current London Stock Exchange share price of £2.50 per share.

Safari is currently ungeared and its paid up capital consists of 20 million shares.

APPENDIX 2 – COMPANY PERFORMANCE DATA PROVIDED BY USMAN SARBANI, LWT'S OPERATIONS DIRECTOR

Dear colleagues at Derawal & Sahi,

As you know, LWT hasn't extensively advertised in the past ten years as our policy has been to rely on our reputation, returning customers and word-of-mouth recommendations.

Each customer enquiry is assigned to a travel executive who deals with all of the customer's booking needs. Returning customers who wish to make another travel booking contact the company's general telephone number or their previously assigned travel executive. Once a travel booking is complete, it is filed with a transaction reference number. However, there is rarely a need to access a past travel booking unless there is a customer complaint. This has never been too much of a problem for LWT.

Historically, LWT has avoided expensive, detailed management reporting as we have focused on customer service. However, here is the recent performance data of the companies from our management accounts and from information emailed to me by Safari Adventure plc.

	Lahore World Travel		Safari Adventure plc	
	Year to 30 June 2018	Year to 30 June 2017	Year to 30 June 2018	Year to 30 June 2017
	----- Rs. in million -----		----- £ in million -----	
Revenue	11,892	11,458	21.5	20.0
Profit after tax	2,200	2,160	4.4	4.1

I've also included the following useful extracts from the October 2018 LWT board minutes which will help with your evaluation.

The Finance Director, Adeena Malik, explained that LWT's failure to meet its 2018 revenue target of Rs. 12.5 billion was attributable to challenging economic conditions affecting the travel market. Recent growth has been predominantly in the corporate sector by winning tenders to exclusively supply corporate travel services.

The Commercial Director said that growth at Safari Adventure plc is impressive, with an 8% increase in customers in 2018 and 7% increase in customers in 2017. This information was included in their recent letter offering the company for sale for Rs. 9,000 million. LWT's own research indicates that popularity of safari holidays has increased over the past five years as wealthy travellers seek a different vacation experience and are particularly attracted by the opportunity of observing a wide variety of African wildlife such as lions, giraffes and elephants in their natural environment. He expects this growth trend to continue. He informed that the three Safari Adventure plc sites are vast wildernesses of many hundred square kilometres and are often booked up during high season at least one year in advance. Expansion of the Botswana site in 2017 increased the number of available rooms by one third.

APPENDIX 3 – EMAIL FROM ADEENA MALIK, THE FINANCE DIRECTOR OF LWT

To: Derawal & Sahi Partners
Date: 4 December 2018
Subject: Valuation of Safari Adventure

As we discussed, LWT is considering an offer to purchase Safari Adventure plc for Rs. 9,000 million. This acquisition could represent good value for our shareholders and an opportunity for LWT to diversify within the travel sector and apply our focus on customer service to add value.

We would like Derawal & Sahi to determine the combined value of LWT and Safari Adventure plc. Here are our forecast of free cash flows (FCF) which are stated after all taxes for both companies based on our own projections for LWT, and from information supplied by Safari Adventure plc in their offer for sale.

		Year to 30-Jun-19	Year to 30-Jun-20	Year to 30-Jun-21	Year to 30-Jun-22	Year to 30-Jun-23
Lahore World Travel	Rs. in million	2,500	2,700	2,900	3,000	3,100
Safari	£ in million	5.0	5.2	5.4	5.5	5.5

Here is some additional forecast financial information which I have compiled for you to assist with your valuation:

- Additional profit after tax of Rs. 150 million per annum will be generated from 2019 onwards by selling luxury safari holidays to LWT's existing customer base although this revenue synergy could be much higher.
- Surplus land at one of the Malawi safari parks can be sold to a local housing developer for equivalent to Rs. 500 million at the end of 2019 without impacting on the forecasted free cash flows. This land is not currently used by the guests of the Safari park.
- To be prudent I would like you to assume combined group cash flows for 2024 and beyond are forecast as remaining the same as 2023.
- LWT's post-tax weighted average cost of capital will remain at 9% following the acquisition of Safari Adventure plc so this can be used to value the new combined entity.
- The existing exchange rate of £1 : Rs. 150 is not expected to change significantly.

There are two possible financing options.

Option 1 – Borrow and acquire with cash

We could finance the acquisition with a further bank loan at a post-tax interest rate of 6% which is comparable to our existing bank loans.

The directors of LWT have expressed some concern about the current level of gearing, however Zahid and myself believe that the additional operating profit generated by the safari parks will far exceed the cash required to service the additional debt finance.

Option 2 – Acquire with a share for share exchange

An alternative is to acquire Safari Adventure plc by offering new LWT shares instead of cash. An investment bank has initially advised that based on current equity values, an offer of 1 new LWT share for each existing Safari Adventure plc share would be acceptable to the shareholders of Safari Adventure plc.

Kindest regards,
Adeena Malik

Question 2

The Fresh Food Company is based in Karachi and is a very large corporation in the Pakistan food industry. It owns many food processing companies and its Board of Directors is currently considering the strategic value of its fishing subsidiary, the Fresh Fish Company (FFC). FFC has three operating divisions as follows:

- (i) **The Fishing Division:** This division operates a large fishing fleet operating off the coast of Karachi for catching of fish and shellfish. The catch is transferred to FFC's processing and restaurant divisions as well as local fish markets, other local fish processors and restaurants. This division also owns and operates four fish farms in various coastal areas in Pakistan.
- (ii) **The Fish Processing Division:** This division is concerned with processing and canning fish, which is sold and transported to other external fish markets and to Karachi-based restaurants. This division operates its own fleet of trucks to transport fish directly from the Fishing Division and fish canning plants to the restaurants managed by Fish Restaurant Division and external customers (including wholesalers, supermarkets and fish markets.)
- (iii) **The Fish Restaurant Division:** This division operates the 'Karachi Fish Diner' chain of twenty restaurants across Pakistan's major cities.

The Fishing Division

Fishing is a significant industry in Pakistan due to the 1046 km coastline along the Arabian Sea. Karachi Fish Harbour is the largest fishing harbour in Pakistan and can accommodate almost all modern commercial fishing vessels.

Fishing provides a large amount of employment along these coastal areas and is a major contributor to Pakistan's exports. 90% of fish and other seafood caught in Pakistan pass through the Karachi Fish Harbour. The popularity and the price of fish has risen in recent years due to increasing affluence driven by economic growth in Pakistan.

The Pakistan fishing industry is regulated by the Fisheries Development Board which is part of the Ministry of National Food Security & Research. The Fisheries Development Board sets the rules and policies regulating the fishing industry in Pakistan and ensures its waters are not over-fished.

The Fishing Division was formed in 1992 when the company bought three small fishing fleets and consolidated them into a single fleet. The Fishing Division has over 200 fishing vessels of different sizes and ages and accounts for just over 10% of the total number of fishing boats operating in Pakistan's waters. The main catch is shrimp, tuna, snapper, grouper and sardines. The Fishing Division has recorded consistent profits since its formation but it is operating in an increasingly competitive market place with new competition each year fishing in the same Pakistan waters.

Since the Arabian Sea has suffered from over-fishing in recent years, the Pakistan government introduced quotas several years ago in an attempt to conserve fish stocks. In response, four saltwater fish farms were acquired six years ago by the Fishing Division. These are in areas of the ocean close to land where fish are protected from both fishermen and natural prey. Fish stocks can be built up quickly in these fish farms. FFC originally saw this acquisition as a way of ensuring supply to its other divisions.

40% of fish caught or farmed by the Fishing Division is currently processed by the Fish Processing Division and 10% is sold to the Fish Restaurant Division. The rest of the catch is sold to other fish processors in Pakistan, wholesalers and restaurants.

The Fish Processing Division

The Fish Processing Division was acquired nearly 20 years ago when FFC bought the assets of the Karachi Canning Company. Government grants were made available to the Fish Processing Division to develop industry in an attempt to address the economic decline and high unemployment in the area resulting in the largest major fish processing and canning capability in the area.

The Fish Processing Division is situated near the Karachi Fish Harbour and its relatively low prices have made it attractive to many fishing companies. Fish processing is manually intensive as the processing machinery, which continues to operate well, has been unchanged since the division was acquired. The division has its own fleet of trucks which it uses to collect fish from the Fishing Division and deliver processed fish products to wholesalers, supermarkets, the Fish Restaurant Division and other restaurants in Pakistan.

The Fish Restaurant Division

The 'Karachi Fish Diner' chain of restaurants was founded nearly eight years ago. The chain enjoyed early success as it quickly became a fashionable place to eat with its range of high quality, healthy fish meals in a modern setting. Much of Karachi Fish Diner's success was built on the quality of its food and service. There are now 20 large Karachi Fish Diner restaurants across Pakistan. The menus contain a wide range of dishes which haven't changed and have remained popular since the restaurants were first launched.

In the past two years, the financial performance of Karachi Fish Diners has declined although the reasons for this are not yet fully understood by the management. At a recent meeting one of the employees called for new restaurant managers who can change with the times and effectively manage staff.

The Fish Restaurant Division currently buys half of its fish products from the other two divisions and the rest from local wholesalers. The Board of FFC want to see a significant change at the Fish Restaurant Division so that it can return to profitability as soon as possible.

Recent divisional performance in the year to September

Fishing Division	2018	2017
Turnover of market sector (Rs. in million)	24,950	23,750
Turnover of the Fishing Division (Rs. in million)	2,940	2,688
*Divisional gross profit (Rs. in million)	138	131
Divisional volume of fish caught and farmed (tonnes)	53,400	52,125
Number of divisional fishing vessels	202	200
Fish Processing Division		
Turnover of market sector (Rs. in million)	5,580	5,100
Turnover of the Fish Processing Division (Rs. in million)	2,212	2,065
*Divisional gross profit (Rs. in million)	194	218
Divisional volume of fish processed (tonnes)	32,040	31,850
Restaurant Division		
Divisional turnover (Rs. in million)	7,388	7,677
*Divisional gross profit (loss) (Rs. in million)	(700)	(628)
No. of divisional restaurants	20	20
Average number of meals served by the Restaurant Division per day	7,768	8,340

**All inter-divisional sales are made at arm's length*

Requirements

- (a) Assess the performance of the three divisions in FFC. Your assessment should include a strategic recommendation for each division. **(15 marks)**
- (b) Advise on the required actions necessary to achieve a turnaround of the Fish Restaurant division. **(05 marks)**
- (c) Advise how value can be added at FFC in the following areas:
- (i) Use of new technology
 - (ii) Customer relationship management
 - (iii) Use of specific key performance indicators
 - (iv) Creation of a shared service centre

(10 marks)
Total: 30 marks

Question 3

Techcon Limited (Techcon) is a listed Karachi based company which manufactures a small portfolio of leading-edge technology products. It was founded in 2003 by Salman Umar, who started his career with a large technology company but quickly became impatient with their processes and wanted to start up on his own. The company grew rapidly. It quickly became admired for its innovation and dynamism, and it floated on the Pakistan Stock Exchange in 2014. The company is now mostly owned by financial institutions, although Salman still owns 15% of the company and other employees own approximately 10%. Salman continues to be CEO and Chairman of the company. Financial results have been improving, but the company has not yet made a profit and some shareholders are becoming impatient.

CEO behaviour

Salman is a visionary businessman and known for pushing himself and his employees to excel. He has a high media profile, spending his wealth on luxury cars, yachts and homes. He uses social media extensively and has over 500,000 followers on Twitter and Instagram. He regularly posts personal information, business updates and opinions about current issues.

In recent months, the board of directors and shareholders have become increasingly concerned about Salman's erratic behaviour, including his criticism of celebrities and a meeting he held with key shareholders where he lost his temper and walked out after a shareholder criticised the performance of the company. At one point he was criticised for arriving late to an awards ceremony and commented on social media:

'I was using my own satnav (navigation device), so of course I got lost and was late! Ha-ha!'

He later insisted it was intended as a joke, but he was heavily criticised by employees, shareholders and the public on social media for damaging the reputation of Techcon's products.

A week later, on 22 October 2018, there was a traffic accident in Lahore and the driver, who was injured, blamed his Techcon satnav for directing him into a one-way street the wrong way. Following on from Salman's earlier flippant social media remark, the driver's claim received extensive publicity – Appendix 1 is an example of media report. An extract from the board minutes following the accident is provided in Appendix 2.

Requirements

Assume the date today is 30 October 2018.

- (a) Explain the ethical and commercial implications of the CEO's behaviour and the accident (Appendix 1). **(06 marks)**
- (b) Using the information above and board minutes (Appendix 2), advise the board of directors on specific improvements that should be made to the governance of Techcon Limited. **(05 marks)**

Subsequent developments

Two months after the traffic accident, Techcon announced that Salman Umar would be stepping down as their CEO and Chairman, although he would remain on the Board of Directors as he is a key shareholder. A new interim Chairman was appointed and his first task was to oversee the recruitment of a new CEO. The Nomination Committee drew up a draft person specification (summarised in Appendix 3) and began to review the Curriculum Vitae (CVs) of potential candidates (two CVs are provided in Appendix 4).

You are a consultant in GFD & Company. Following the traffic accident, your manager has asked you to draft sections of a report to the client.

Requirement

- (c) Identify any additional requirements that should be included in the person specification for the CEO's role (Appendix 3). Provide a preliminary recommendation, with reasons, as to which of the two candidates (Appendix 4) you would recommend to be the new CEO.

(09 marks)

Total: 20 marks

APPENDIX 1 – 'DAILY NEWS' REPORT

Techcon boss in further trouble after accident

Not so long ago, Techcon was one of the fastest rising shares in the market and its founder and CEO, Salman Umar, is a high-profile figure in Pakistan. However, several recent incidents have called into question his professional judgement, especially that famous remark on social media about his own satnav products. He protests that it was a joke, but staff and customers didn't find it at all humorous.

And now it's only getting worse. Last night in Lahore a man named Adeel Iqbal was involved in a collision with a lorry as he was going the wrong way down a one-way street, breaking his arm and collarbone. No one else was hurt in the incident. From hospital, Adeel told our reporter that his Techcon satnav had clearly directed him to turn into the road and travel down it the wrong way, commenting 'Even the CEO admits the Techcon satnav doesn't work and now it has caused real injuries to me.'

APPENDIX 2 – EXTRACTS FROM TECHCON LIMITED BOARD MINUTES**Date:** 29 October 2018**Attending:**

Executive Board	Non-executive Board
Salman Umar (SU, CEO and Chairman) Finance Director (FD) Marketing & Sales Director (MSD) IT Director (ITD) (taking minutes in the absence of the Company Secretary)	Non-executive Director 1 (NED1), representing Techcon's largest external shareholder. Non-executive Director 2 (NED2), CEO of a well-established oil company. Non-executive Director 3 (NED3), Salman's brother, a major shareholder in Techcon and CEO of a large retailer.
Apologies for absence: Company Secretary (CS), Operations Director (OD), HR Director (HRD).	

Minutes:

1. The board approved the minutes of last meeting of the board held on 4 April 2018.
2. NED1 requested an update on the incident where a driver blamed his Techcon satnav for a collision. SU assured the Board that no technical problems had ever occurred with satnavs in use and he was certain the driver's claim was without foundation. He intended to vigorously resist any legal claim resulting from the accident.

MSD expressed the view that recent incidents may cause some damage to the Techcon brand, and this was discussed. SU strongly disagreed with this view, saying that he believed the brand was stronger than ever, and helped by his growing profile in the press and on social media. This was partly due to the work of a branding consultancy, which has been hired a month ago to improve the profile of the business. MSD said that she was not aware of these consultants being retained and SU explained that the consultants were not expensive and therefore, to avoid delays, he himself had taken the decision to hire them.

NED2 was concerned about the allegation that Techcon products may be faulty and in some cases this may endanger safety. As Chairman of the audit committee, he expressed the view that the internal audit function should review the controls around quality and safety testing as a matter of urgency. SU said that as the allegations were without foundation this was not necessary and that it was a higher priority for internal audit to review the product development process, as product innovation was the most critical area of focus for the company as a whole.

APPENDIX 3 – DRAFT PERSON SPECIFICATION FOR CHIEF EXECUTIVE OFFICER**Essential attributes**

- Significant experience at senior management level, ideally as a CEO, including strategic planning and financial management
- Experience of managing in a fast-growing environment
- Experience of managing relationships with shareholders, suppliers and other key stakeholders
- Understanding of the technology industry and leading-edge technology developments
- Experience of representing an organisation publicly to the media
- Strong presentation and communication skills
- Educated to degree level or equivalent

Desirable attributes

- Advanced degree in a technology-related field and/or management
- Senior management experience within the technology industry

APPENDIX 4 – SUMMARISED CVS OF TWO CANDIDATES

Candidate A	Candidate B
<p>Professional Qualifications and Experience</p> <ul style="list-style-type: none"> ▪ Chief Executive Officer of DYJ, the largest provider of IT strategies and solutions in Pakistan, 2015–present ▪ Finance Director of DYJ, 2010–2015 ▪ Qualified accountant and MBA 	<p>Professional Qualifications and Experience</p> <ul style="list-style-type: none"> ▪ Chief Executive Officer of Ama.pk, a fast-growing e-commerce business, 2013–present ▪ Chief Operating Officer of Ama.pk, 2010–2013 ▪ Senior Vice-President for Strategic Planning of DB Limited, a media company, 2005–2010
<p>Experience and duties</p> <ul style="list-style-type: none"> ▪ Developing and executing strategy to maximise financial returns for DYJ's private equity owners ▪ Developing new talent management strategy and processes focused on attracting and retaining the best staff ▪ Leading the development of new and improved services to offer to corporate clients ▪ Producing regular presentations to Board members to keep them updated and fostering critical discussions 	<p>Experience and duties</p> <ul style="list-style-type: none"> ▪ Driving strategy and vision in a fast-changing market ▪ As CEO, led growth of 300% in turnover and successful floatation on the Stock Exchange in 2015 ▪ Improving focus on controls and efficiency in a fast-growing business ▪ Identifying and hiring a strong senior management team ▪ Managing relationships with shareholders, the media and other key stakeholders
<p>Key skills and competencies</p> <ul style="list-style-type: none"> ▪ Inspiring and leading a talented team to deliver excellent service and innovative solutions to a range of corporate clients ▪ Strong vision and strategic capability ▪ Ability to develop strong relationships with key clients and influencers ▪ Experience of managing complex projects in a changing organisation ▪ Highly effective interpersonal and communication skills ▪ Excellent financial and commercial management skills 	<p>Key skills and competencies</p> <ul style="list-style-type: none"> ▪ Commitment to put the customer at the centre of everything and driving world-class service ▪ Proven record of managing a successful, fast-growing business ▪ Successfully managed the cultural, operational and management changes required in taking a business public ▪ A charismatic leader able to inspire confidence and communicate direction to a range of stakeholders ▪ Enterprising and creative thinker, with a talent for seeing and exploiting commercial opportunities

(THE END)