
Answers

- 1 (a) A management buy-out (MBO) involves the purchase of a company by the management running that company. Hence Burgut Co's current management team would be buying Burgut Co from Opao Co. A management buy-in (MBI) involves selling Burgut Co to a management team brought in from outside the company.

Opao Co may have sold Burgut Co through a MBI for the following reasons. Opao Co's BoD may have felt that Burgut Co's current management team lacked fresh ideas and strategies which could have driven Burgut Co forward successfully. Instead, it may have felt that a fresh team, with skills and expertise gained externally, would have had the required innovative ideas and skills. It may be that the external team of managers may have had the finance available to move quickly, whereas the internal team of managers may not have had the finance in place to purchase Burgut Co at that time. It is also possible that the management teams within Burgut Co and Opao Co had disagreements in the past, and Opao Co's BoD may have believed the two management teams would not be able to work together in the future, if needed. Thus, the BoD may have felt that a fresh management team was the better option going forwards.

- (b) Portfolio restructuring involves the acquisition of companies, or disposals of assets, business units and/or subsidiary companies through divestments, demergers, spin-offs, MBOs and MBIs. Organisational restructuring involves changing the way a company is organised. This may involve changing the structure of divisions in a business, business processes and other changes such as corporate governance.

The aim of either type of restructuring is to increase the performance and value of the business.

Opao Co, in going from a conglomerate business to one focusing on just two business areas, can be seen as restructuring its portfolio, as businesses and assets which are not part of financial services and food manufacturing are disposed of, and businesses focusing on these areas are acquired. Financial markets may take the view that focusing on food manufacturing and financial services has enabled Opao Co's senior management to concentrate on areas in which they have expertise. Whereas other businesses in which the senior management are not experts are disposed of. This activity leads to the maximisation of business value.

Shareholders are interested in maximising returns from their investments, which companies achieve through maximising business value, whilst minimising the risks inherent in their investment activity. Shareholders who are closely linked to a particular business do not hold diversified investment portfolios, and therefore benefit from diversification of risk undertaken by a company, investing in many different areas. On the other hand, institutional shareholders and other shareholders, who hold diversified portfolios, would not benefit from a company undertaking risk management through diversification by becoming a conglomerate. Instead, such companies would increase value by focusing on areas in which they have relative expertise, as Opao Co seems to do. So Opao Co's changing owner clientele has forced it to change its overall strategy. This strategy change was implemented through portfolio restructuring.

- (c) **Report to the board of directors (BoD), Opao Co**

Introduction

This report provides an estimate of the additional value created if Opao Co were to acquire Tai Co, and the gain for each company's shareholders based on a cash offer, a share-for-share offer and a mixed offer. It evaluates the likely reaction of the two companies' shareholders to each payment method.

Summary of the estimates from the appendices

From appendix 1

Opao Co equity value pre-acquisition: \$5,000m

Tai Co equity value pre-acquisition: \$1,000m

Combined company equity value post-acquisition: \$6,720m

From appendix 2

Therefore, additional value based on synergy benefits is \$720m or 12% (\$720m/\$6,000m)

Estimated percentage gain in value

	Opao Co	Tai Co
Cash offer	11.2%	15.8%
Share-for-share offer	6.4%	40.0%
Mixed offer	9.7%	23.4%

Likely reactions

Tai Co's shareholders are likely to consider all the offers made, because they all fall within the range of premiums paid in previous acquisitions of 15% to 40%. The cash offer is at the lower end of the range, the share-for-share offer at the top end of the range and the mixed offer in between. It is likely that Tai Co's shareholders will be more attracted to the share-for-share offer as it maximises their return. However, this offer is reliant on the fact that the expected synergy benefits will be realised and Tai Co will probably need to analyse the likelihood of this. Cash payment, although much lower, gives a certainty of return. The mixed offer provides some of the certainty of a cash payment, but also offers a higher return compared to the cash offer. This return is roughly in the middle of the premium range. It may therefore prove to be the better option for Tai Co's shareholders.

Opao Co's shareholders benefit less from the acquisition compared to Tai Co's shareholders. In each case, they get less than the additional value created of 12%, with the cash payment offering the highest return of 11.2%, which is just below the 12% overall return. The share-for-share offer gives the least return at just over half (6.4%) of the overall return of 12%. Nevertheless, with this option, cash is retained within Opao Co and can be used for other value creating projects. Opao Co's shareholders may also prefer the mixed offer, because the return they are expecting to receive is between the cash and share-for-share offers. Also, less cash resources are used compared to the cash offer, and they still benefit from a significant proportion of the additional value created.

Conclusion

Based on the benefits accruing to both sets of shareholders, it is not possible to conclusively say that one method of acquisition payment would be acceptable to both sets of shareholders. However, both sets of shareholders may be persuaded that the mixed offer provides a reasonable compromise between the wholly cash and the wholly share-for-share prices. Given that synergy benefits are shared (even if not equally), both companies' share prices should increase if the acquisition proceeds, as long as the estimates when estimating the valuations are reasonably accurate.

Report compiled by:

Date

APPENDICES:

Appendix 1 (Part (c) (i)):

Equity value of Opao Co prior to acquisition

$\$2.50/\text{share} \times 2,000\text{m shares} = \$5,000\text{m}$

Equity value of Tai Co prior to acquisition

Free cash flows to firm = $\$132.0\text{m} + \$27.4\text{m} - \$24.3\text{m} - (\$132.0\text{m} \times 0.2) = \108.7m

Company value = $\$108.7\text{m} \times 1.03 / (0.11 - 0.03) = \$1,399.5\text{m}$, say $\$1,400\text{m}$

Equity value = $\$1,400\text{m} - \$400\text{m} = \$1,000\text{m}$

Equity value of combined company post acquisition

All amounts in \$ millions

Year	1	2	3	4
Sales revenue (5.02% growth, yrs 2 to 4)	7,351	7,720	8,108	8,515
Pre-tax profit (15.4% of sales revenue)	1,132	1,189	1,249	1,311
Less: Tax (20%)	(226)	(238)	(250)	(262)
Less: Additional investment (\$0.31 per \$1, yrs 2 to 4)	(109)	(114)	(120)	(126)
Free cash flows	797	837	879	923
Present value of free cash flows (10%)	724	691	660	630

Combined company value: years 1 to 4 = $\$2,705\text{m}$

Combined company value: after year 4 = $923 \times 1.024 / (0.1 - 0.024) \times 1.1^{-4} = \$8,494\text{m}$

Total combined company value = $\$11,199\text{m}$

Equity value (60% x $\$11,199\text{m}$) = $\$6,719.4\text{m}$, say $\$6,720\text{m}$

Appendix 2 (Part (c) (ii): Percentage gains for Tai Co and Opao Co shareholders under each payment method

Estimate of additional value created from acquisition due to synergy benefits

$\$6,720\text{m} - (\$5,000\text{m} + \$1,000\text{m}) = \720m

Tai Co, value per share = $\$1,000\text{m} / 263\text{m shares} = \$3.80/\text{share}$ approx.

Cash offer

Tai Co shareholders, percentage gain

$(\$4.40 - \$3.80) / \$3.80 = \$0.60 / \$3.80 = 15.8\%$

Opao Co shareholders, percentage gain

Amount of additional value created going to Tai Co shareholders = $\$0.60 \times 263\text{m shares} = \157.8m

Amount of additional value created going to Opao Co shareholders = $\$720\text{m} - \$157.8\text{m} = \$562.2\text{m}$

As a percentage = $(\$562.2\text{m} / 2,000\text{m shares}) / \$2.50 = 11.2\%$

Share-for-share offer

Share of additional value to Tai Co shareholders = $\$720\text{m} \times 0.555 = \399.6m

Share of additional value to Opao Co shareholders = $\$720\text{m} \times 0.445 = \320.4m

Opao Co equity value after acquisition = $\$5,320.4\text{m}$

Opao Co, estimated share price after acquisition = $\$5,320.4\text{m} / 2,000\text{m shares} = \$2.66/\text{share}$

Opao Co shares to be allocated to Tai Co shareholders = $(\$1,000\text{m} + \$399.6\text{m}) / \$2.66 = 526\text{m shares}$ approximately

Therefore, share-for-share offer will be 2 Opao Co shares for 1 Tai Co share [$526 / 263 = 2$]

Tai Co shareholders, percentage gain

$$(\$2.66 \times 2 \text{ shares} - \$3.80 \times 1 \text{ share}) / (\$3.80 \times 1 \text{ share}) = 40\%$$

Opao Co shareholders, percentage gain

$$(\$2.66 - \$2.50) / \$2.50 = 6.4\%$$

Mixed offer**Tai Co shareholders, percentage gain**

$$((\$2.60 + \$2.09) - \$3.80) / \$3.80 = \$0.89 / \$3.80 = 23.4\%$$

Opao Co shareholders, percentage gain

$$\text{Amount of additional value going to Tai Co shareholders} = \$0.89 \times 263\text{m} = \$234.1\text{m}$$

$$\text{Amount of additional value created going to Opao Co shareholders} = \$720\text{m} - \$234.1\text{m} = \$485.9\text{m}$$

$$\text{As a percentage} = (\$485.9\text{m} / 2,000\text{m shares}) / \$2.50 = 9.7\%$$

- (d) The initial public offering (IPO) is the conventional way to obtain a listing where a company issues and offers shares to the public. When doing this, the company will follow the normal procedures and processes required by the stock exchange regarding a new issue of shares and will comply with the regulatory requirements.

Undertaking a reverse takeover enables a company to obtain a listing without going through the IPO process. The BoD of Burgut Co would initially take control of a 'shell' listed company by buying some shares in that company and taking over as its BoD. The 'shell' listed company was probably a normal listed company previously, but is no longer trading. New equity shares in the listed company would then be exchanged for Burgut Co's shares, with the external appearance that the listed company has taken over Burgut Co. But in reality Burgut Co has now effectively got a listing, having taken control of the listed company previously. Normally, the name of the original listed company would then be changed to Burgut Co.

Compared with an IPO, the main benefits of undertaking a reverse takeover are that it is cheaper, takes less time and ensures that Burgut Co will obtain a listing on a stock exchange. An IPO can cost between 3% and 5% of the capital being raised because it involves investment banks, lawyers, and other experts. A marketing campaign and issuing a prospectus are also needed to make the offering attractive and ensure shares to the public do get sold. A reverse takeover does not need any of these and therefore avoids the related costs. The IPO process can typically take one or two years to complete due to hiring the experts, the marketing process and the need to obtain a value for the shares. Additionally, the regulatory process and procedures of the stock exchange need to be complied with. With a reverse takeover, none of these are required and therefore the process is quicker. Finally, there is no guarantee that an IPO will be successful. In times of uncertainty, economic downturn or recession, it may not attract the attention of investors and a listing may not be obtained. With reverse takeover, because the transaction is an internal one, between two parties, it will happen and Burgut Co will be listed.

However, obtaining a listing through a reverse takeover can have issues attached to it. The listed 'shell' company may have potential liabilities which are not transparent at the outset, such as potential litigation action. A full due diligence of the listed company should be conducted before the reverse takeover process is started. The IPO process is probably better at helping provide the senior management of Burgut Co with knowledge of the stock exchange and its regulatory environment. The involvement of experts and the time senior management need to devote to the listing process will help in this regard. Due to the marketing effort involved with an IPO launch, it will probably have an investor following, which a reverse takeover would not. Therefore, a company which has gone through an IPO would probably find it easier to raise extra funds, whilst a company which has gone through a reverse takeover may find it more difficult to raise new funding.

Overall, neither option of obtaining a listing has a clear advantage over the other. The choice of listing method depends on the company undertaking the listing and the purpose for which it is doing so.

(Note: Credit will be given for alternative valid areas of discussion)

- 2 (a) Nutourne Co will have a Swiss Franc receipt in six months' time and needs to hedge against the dollar strengthening.

Futures

Sell Swiss futures and use June futures contracts.

$$\text{No. of contracts} = \text{CHF}12,300,000 / 125,000 = 98.4, \text{ say } 98, \text{ hedging } \text{CHF}12,250,000$$

$$\text{Remainder to be hedged on the forward market is } \text{CHF}12,300,000 - \text{CHF}12,250,000 = \text{CHF } 50,000$$

$$\text{Receipt} = \text{CHF}50,000 \times 1.0358 = \$51,790$$

Calculation of futures price

Assume that basis reduces to zero at contract maturity in a linear fashion.

Estimate from March and June futures contract rates.

$$\text{Predicted futures rate at the end of May} = 1.0345 + ((1.0369 - 1.0345) \times 2/3) = 1.0361$$

$$\text{Expected receipt} = \text{CHF}12,250,000 \times 1.0361 = \$12,692,225$$

Outcome

	\$
Futures	12,692,225
Remainder on forward market	51,790
	<u>12,744,015</u>

Or

Calculation of futures price

Alternatively, use spot rate = 1.0292

Predicted futures rate at the end of May = $1.0292 + (6/7 \times (1.0369 - 1.0292)) = 1.0358$ (when the June futures contract is closed out in May).

Expected receipt = CHF12,250,000 x 1.0358 = \$12,688,550

Outcome

	\$
Futures	12,688,550
Remainder on forward market	51,790
	<u>12,740,340</u>

Options contract

Nutourne Co would purchase CHF June put options.

Number of contracts 98, as before.

Amount not hedged, hedged by forward contract CHF translated as \$51,790 as before.

Assuming the options are exercised:

	\$
Receipt (W1)	12,709,375
Premium (W2)	(105,350)
Forward contract	51,790
	<u>12,655,815</u>

Workings

1 Receipt

$$\text{CHF}125,000 \times 98 \times 1.0375 = \$12,709,375$$

2 Premium

$$1.0375 \text{ options} = 98 \times 125,000 \times 0.0086 = \$105,350$$

The options would give the higher receipt if they were not exercised and the spot rate moved sufficiently in Nutourne Co's favour. If Nutourne Co allowed the option to lapse, it would obtain the same receipt as under the futures if the US\$/CHF spot rate was x, such that:

$$12,692,225 = 12,250,000x - 105,350$$

$$12,250,000x = 12,692,225 + 105,350$$

so that x is US\$1.0447 = CHF1.

Or

$$12,688,550 = 12,250,000x - 105,350$$

$$12,250,000x = 12,688,550 + 105,350$$

so that x is US\$1.0444 = CHF1.

Comments

If the options are exercised, the futures would give the higher receipt. The options give a lower receipt because of the premium which Nutourne Co has to pay. The futures will be subject to the risk that basis (the difference between the futures price and the spot price) may not decrease linearly as the futures approach maturity as assumed in the above calculations. This will mean that the hedge of the CHF 12,250,000 is imperfect, and the receipt may be unpredictable despite a futures hedge being taken out.

The options can also be allowed to lapse if for some reason the contract is not completed. If this happens, Nutourne Co will only have to settle the forward contract.

(b) Benefits of a forward contract

A forward contract would not involve payment of a large premium upfront to the counterparty.

A forward contract is a simple arrangement to understand, whereas the basis of calculation of the premium for an over-the-counter (OTC) option may be unclear.

A forward contract gives a certain receipt for the purposes of budgeting.

Drawbacks of a forward contract

A forward contract has to be fulfilled, even if the transaction which led to the forward contract being purchased is cancelled. Exchange rate movements may mean that the contract has to be fulfilled at an unfavourable rate. An OTC option can be allowed to lapse if it is not needed.

A forward contract does not allow the holder to take advantage of favourable exchange rate movements. An OTC option need not be exercised if the exchange rate moves in the holder's favour.

A forward contract may only be available for a short time period, depending on what currencies are involved. An OTC option may be purchased for a longer time period, over a year.

The rate offered on a forward contract will be determined by a prediction based on expected interest rates. The rate offered on an OTC option may be more flexible. This may suit a holder who is prepared to tolerate the risk of some loss in order to have the opportunity to take advantage of favourable exchange rate movements, but who wishes to use the option to set a limit to possible losses.

Reasons why exchange-traded derivatives are used

One of the main reasons why the treasury function uses exchange-traded derivatives is that the contracts can be bought and sold as required. Also, because the markets are regulated by an exchange, counterparty risk (the risk of the other party to the transaction defaulting) should be minimised.

- (c)** The mark-to-market process begins with Nutourne Co having to deposit an amount (the initial margin) in a margin account with the futures exchange when it takes out the futures. The margin account will remain open as long as the futures are open. The profit or loss on the futures is calculated daily and the margin account is adjusted for the profit or loss.

The maintenance margin is the minimum balance which has to be maintained on the margin account.

If the losses on the futures are so large that the balance on the margin account is less than the maintenance margin, then the futures exchange will make a demand (a margin call) for an extra payment (the variation margin) to increase the balance on the account back to the maintenance margin.

In the example, initial margin = \$1,450 x 98 = \$142,100

Maintenance margin = \$1,360 x 98 = \$133,280

Loss in ticks = 0.0011/0.0001 = 11

Total loss = 11 ticks x \$12.50 x 98 = \$13,475

Balance on margin account = \$142,100 - \$13,475 = \$128,625

This is less than the maintenance margin, so Nutourne Co would have to deposit an extra (\$133,280 - \$128,625) = \$4,655 (the variation margin) to bring the balance on the margin account up to the maintenance margin.

Alternative solution

In some exchanges, a variation margin may be required to increase the balance on the account back to its initial margin level. Therefore, in this case, the variation margin amount would be \$13,475 (i.e. \$142,100 - \$128,625).

3 (a) Year	0 \$m	1 \$m	2 \$m	3 \$m	4 \$m
Post-tax operating cash flows		28.50	36.70	44.40	50.90
Investment	(150.00)				
Realisable value					45.00
Working capital (W1)	(6.00)	(0.48)	(0.39)	(0.34)	7.21
Cash flows	(156.00)	28.02	36.31	44.06	103.11
Discount factor 12% (W2)	1.000	0.893	0.797	0.712	0.636
Present value	(156.00)	25.02	28.94	31.37	65.58
Base case net present value		(5.09)			

Base case net present value is approximately (\$5.09 million) and on this basis, the investment should be rejected.

Workings

1 Working capital

Year	0	1	2	3	4
	\$m	\$m	\$m	\$m	\$m
Working capital		6.00	6.48	6.87	7.21
Required/(released)	6.00	0.48	0.39	0.34	(7.21)

2 Discount rate

Using asset beta

All-equity financed discount rate = $4\% + (11\% - 4\%) 1.14 = 12\%$

3 Issue costs

$\$80 \text{ million} / 0.97 = \$82,474,227$

Issue costs = $3\% \times \$82,474,227 = \$2,474,227$

There will be no issue costs for the bank loan.

4 Tax shield on subsidised loan

Use PV of an annuity (PVA) years 1 to 4 at 8% (normal borrowing rate)

$\$80\text{m} \times 0.031 \times 30\% \times 3.312 = \$2,464,128$

Note to markers

Full credit should be given if tax shield is discounted at the government interest rate of 3.1% rather than the normal borrowing rate of 8%.

5 Tax shield on bank loan

Annual repayment = $(\$70\text{m}/\text{PVA } 8\% \text{ Yr } 1 - 4) = (\$70\text{m}/3.312) = \$21,135,266$

Year	1	2	3	4
	\$000	\$000	\$000	\$000
Opening balance	70,000	54,465	37,687	19,567
Interest at 8%	5,600	4,357	3,015	1,565
Repayment	(21,135)	(21,135)	(21,135)	(21,135)
Closing balance	<u>54,465</u>	<u>37,687</u>	<u>19,567</u>	<u>(3)</u>

Year	1	2	3	4
	\$000	\$000	\$000	\$000
Interest cost	<u>5,600</u>	<u>4,357</u>	<u>3,015</u>	<u>1,565</u>
Tax relief at 30%	1,680	1,307	905	470
Discount factor 8%	0.926	0.857	0.794	0.735
Present value	1,556	1,120	719	345
Net present value	3,740			

6 Subsidy benefit

Benefit = $\$80\text{m} \times (0.08 - 0.031) \times 70\% \times 3.312 = \$9,088,128$

7 Financing side effects

	\$000
Issue costs (W3)	(2,474)
Tax shield on subsidised loan (W4)	2,464
Tax shield on bank loan (W5)	3,740
Subsidy benefit (W6)	<u>9,088</u>
Total benefit of financing side effects	<u>12,818</u>

Financing the project in this way would add around \$12.82 million to the value of the project.

The adjusted present value of the project is around \$7.73 million and so the project should be accepted. Sensitivity analysis should be undertaken on all the significant variables. Further analysis may be needed, particularly of the assumptions which lie behind the post-tax cash flows, such as sales and the tax rate. The realisable value of \$45 million may be questionable. On the other hand, the time horizon of four years seems low and analysis should be done of potential cash flows beyond that time.

- (b) Amberle Co's board can use various principles to determine its long-term finance mix. The directors may aim to follow consistent long-term policies, or they may have preferences which change as circumstances change.

Long-term policy factors

At present Amberle Co is using a mix of finance, raising the question of whether the directors are aiming for an optimal level of gearing, or there is a level which they do not wish gearing to exceed. If the board wishes to maintain gearing at an optimal level, this is likely to be determined by a balance of risks and advantages. The main risks are not being able to maintain the required level of payment to finance providers, interest to debt providers or required level of dividend to shareholders. Advantages may include lower costs of debt, tax relief on finance costs as shown in the APV calculation or, on the other hand, not being legally required to pay dividends in a particular year.

Another issue is whether Amberle Co's board has preferences about what source of finance should be used and in what order. One example of this is following the pecking order of retained earnings, then debt, then equity. The board may prefer this pecking order on the grounds that avoiding a new equity issue means that the composition of shareholdings is unchanged, or because retained earnings and longer term debt are judged low risk, or because the market will assume that an equity issue is being made because directors want to take advantage of Amberle Co's shares being over-priced. Other specific sources of finance may have benefits which attract the directors or drawbacks which deter them.

This investment highlights the aspect of whether the board prefers to match sources of finance with specific investments. Matching arguably gives greater flexibility and avoids committing Amberle Co to a long-term interest burden. However, to adopt this approach, the board will need assurance either that the investment will be able to meet finance costs and ultimately repayment burdens, or these can be met from surpluses from other operations.

Changing long-term financing policy

As well as deciding what financing mix or sources of finance they desire to use, the directors will also need to consider what factors would cause this decision to change.

A major change in the scope of the operations, with investment requirements being paramount, may cause a change in financing policy. Here the \$150 million investment has been financed entirely by medium-term debt. Amberle Co may have chosen solely to use debt if it has made a recent equity issue and does not feel it can make another one so soon afterwards. In addition, if Amberle Co expands its manufacture of electric cars, it may decide to sell off its motorbike or cycles divisions if they are performing less well. If part of the business is sold, the sale proceeds could help finance new investment in the cars division.

The board may also be flexible at times and take advantage of whatever source of finance seems to be offering the best terms for Amberle Co. Here the board is taking advantage of loan finance being available at a low cost, thanks to the government loan scheme.

A change in the business or economic environment may also lead to the board rethinking how the company is financed. An economic recession, leading to falling share prices, may mean that the results of a share issue are uncertain. On the other hand, an increase in economic or business risk may mean that lenders are less likely to lend at acceptable rates or will impose greater restrictions. If the directors are risk-averse, they may not seek new finance during a recession but instead rely on retained earnings to finance any expansion.

		<i>Marks</i>	
1	(a) Distinguishing between MBO and MBI Discussion of choice of MBI	1–2	
		2–3	
		Max <u>4</u>	
	(b) Explanation of portfolio restructuring and organisational restructuring Discussion of reason(s) for change in business focus	2	
		3	
		<u>5</u>	
	(c)	(i) (Appendix 1)	
		Equity value of Opao Co	1
		Tai Co, free cash flow to firm	2
		Estimate of value of Tai Co	1
Estimate of equity value of Tai Co		1	
Combined company, free cash flows		2	
Value of combined company, years 1 to 4		1	
Value of combined company, after year 4		1	
Equity value of combined company		1	
		<u>10</u>	
(ii) (Appendix 2)			
Cash offer, percentage gain, Tai Co		1	
Cash offer, percentage gain, Opao Co		2	
Share-for-share offer, share of additional value		1	
Share-for-share offer, Opao Co share value		1	
Share-for-share offer, total shares allocated to Tai Co		1	
Share-for-share offer, 2 Opao Co shares for 1 Tai Co share		1	
Share-for-share offer, percentage gain, Tai Co		1	
Share-for-share offer, percentage gain, Opao Co		1	
Mixed offer, percentage gain, Tai Co	1		
Mixed offer, percentage gain, Opao Co	2		
	<u>12</u>		
(iii) (Report on proposed acquisition)			
Evaluation: Opao Co	3–4		
Evaluation: Tai Co	3–4		
	Max <u>7</u>		
Professional marks for part (c)			
Report format	1		
Structure and presentation of the report	3		
	<u>4</u>		
(d) Explanation of difference between an IPO and reverse takeover Discussion of using an IPO or reverse takeover to obtain a listing	3		
	5		
	<u>8</u>		
	Total <u>50</u>		

		<i>Marks</i>
2	(a) Futures	
	Sell futures now	1
	Number of contracts	1
	Forward hedge	1
	Predicted futures rate using basis	1
	Overall expected receipt	1
	Options	
	Purchase June put	1
	Premium	1
	Overall expected receipt	1
	Calculation of when option is a better choice	2
	Comments	2
		<hr/> 12
	(b) Advantages of forward contract	2–3
	Disadvantages of forward contract	2–3
	Reasons for using exchange-traded derivatives	1–2
		<hr/> Max 7
	(c) Significance of initial and maintenance margins	2
	Mark-to-market explanation	1
	Numerical illustration using Nutourne Co's figures	3
		<hr/> 6
	Total	<hr/> 25
3	(a) Working capital	2
	Discount rate	1
	Base case net present value	2
	Issue costs	1
	Tax shield benefit – subsidised loan	1
	Tax shield benefit – bank loan	4
	Subsidy benefit	1
	Adjusted present value	1
	Comments and conclusion	2
		<hr/> 15
	(b) Factors determining long-term finance policy	5–6
	Factors which cause policy to change	5–6
		<hr/> Max 10
	Total	<hr/> 25