IRELAND

STRATEGIC CORPORATE FINANCE

PROFESSIONAL 2 EXAMINATION - AUGUST 2019

NOTES:
Section A - Answer Question 1; **and**
Section B - Answer **any two** from Questions 2,3 and 4.
Should you provide answers to more questions than required in Section B, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first two answers provided will be marked.

STRATEGIC CORPORATE FINANCE TABLES ARE PROVIDED

Time Allowed
3.5 hours plus **20 minutes** to read the paper.

Examination Format
This is an open book examination. Hard copy material may be consulted during this examination subject to the limitations advised on the Institute's website.

Reading Time
During the reading time you may write notes on the examination paper, but you may not commence writing in your answer booklet.

Marks
Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Answers
Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills. Care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which the answers are supported with relevant legislation, case law or examples, where appropriate.

Answer Booklets
List on the cover of each answer booklet, in the space provided, the number of each question attempted. Additional instructions are shown on the front cover of each answer booklet.

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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Case Study – VP Primer

Victoria Vanslyperkin is listening to the car radio on a crisp May morning while on her way to meet her accountant, Josh Moloney, CPA. She is not really concentrating on the discussion of the latest machinations at Westminster pertaining to the ongoing Brexit saga. Rather, she is reflecting on the surprise offer from PMD Plc (PMD), a large UK chemical company which specialises in the production of paints and varnishes, to take-over VP Primer, the business of which she is joint CEO. The offer is a pure cash offer. PMD is listed on the main market of the London Stock Exchange and its shares are very widely held. The offer from PMD came out of the blue yesterday afternoon. Victoria was scheduled to meet with Josh today to discuss the strategy of floating VP Primer on the Euronext Growth Market in Dublin. This market which is part of a pan-European Euronext market is designed for fast growing companies. The disclosure and governance regulations for this market are not as stringent as those of the main Euronext Dublin Market. Victoria ultimately plans to list on the main Euronext Market in Dublin (formerly the main Market of the Irish Stock Exchange). As an initial step Josh has been advising Victoria to float VP Primer and join companies from the former Enterprise Securities Market (ESM) on the Euronext Growth Market (Dublin).

The story really begins ten years ago when Victoria, her late father Frankie, and her brother Paul founded VP Primer. Paul, who is the other joint CEO of VP Primer looks after production and internal operations. Victoria's main focus is on strategy and financing and together with Jeremiah Cole (Marketing Manager), the marketing of the company's products. The company was set up originally to manufacture an extremely quick drying primer which can also be used to prepare wood which has been French-polished, before painting. Indeed the company takes its name from this product. It is because of its quick-drying nature that this the primer became extremely popular with painters and was soon the market leader in the Republic of Ireland. There are some sales into Northern Ireland but these amount to only £5,000 per annum. VP Primer subsequently added a number of additional lines comprising varnishes and paints which are designed for a range of woods and other surfaces. The company has been considering expansion into the UK market particularly for its eponymous primer. Victoria and Josh decided that additional capital is required to finance this expansion. The Initial Public Offering (IPO) of VP Primer on the Euronext Growth market in Dublin is planned to raise an additional €60 million in 2020 to help finance the expansion into the UK.

Another reason that Josh is keen for VP Primer to raise additional capital is so that his clients, Victoria and Paul, will have some financial capital that is not dependent on the success of the company. On his advice VP Primer has recently started paying dividends and has adopted a generous payout policy. His expectation is that the equity injection will help facilitate a generous dividend policy. Josh feels that it is necessary for Victoria and Paul to extract some of their wealth from the company at this point. Both are in their early fifties so will be expecting to retire in about 10 to 12 years' time. At present, virtually all of their wealth is in VP Primer and neither sibling has financial assets of any consequence apart from the shares that they own in VP Primer.

Victoria and Josh agree that PMD is attracted to VP Primer because the eponymous primer could, with PMD's marketing and distribution behind it, also become the leading primer brand in the UK. PMD Plc have explained to Victoria that after the take-over they plan to use their own facilities in Chesire to produce the primer that started the VP Primer success story. It will maintain the Irish plant to supply the Irish Market. While not being too specific, PMD has suggested an offer in the region of €700 million for the equity in VP Primer. Another option being considered is the purchase of a controlling interest and allowing Victoria and Paul to continue to work with VP Primer which would then become a subsidiary, but not a wholly-owned one of PMD. In this scenario, PMD would purchase 60%-70% of the equity shares for €420 million - €490 million. Also, should VP Primer accept this offer PMD would like for Victoria and Paul to remain on and manage the Irish operation as well as assist in the integration of VP Primer into the PMD group.

Victoria explains to Josh that, in her opinion, the PMD plan must be to do what VP Primer plans to do itself: expand sales of the product VP Primer into the UK. However, she is unsettled by the offer from PMD. Until the PMD offer was made, Paul and she had a relatively straightforward choice to make - continue as previously or float the company on the Euronext Growth Market in Dublin. Now, in addition to the above decision, they have to consider the two alternatives offered by PMD Plc. This involves either selling the entire share capital of VP Primer to PMD or alternatively selling it a controlling interest. The meeting between Josh and Victoria is far different to that which they had planned. They agree that they cannot make a decision immediately and commence consideration of the pros and cons of the alternative proposals.

However, in the meeting, Josh does manage to cover one or two of the issues that need to be dealt with regarding the IPO. He impresses on Victoria that the corporate governance of VP Primer must change radically, perhaps in advance of the IPO on the Euronext Growth Market but most certainly in advance of an Initial Public Offering on the main Dublin market, Euronext Dublin.

The current ownership structure of VP primer is that Victoria, Paul and their mother, who is 80 years old, each own one-third of the shares in the company. The company's board comprises the three shareholders above and Jeremiah Cole, the Marketing Manager of VP Primer who has been with the company since it was founded. Victoria's mother has not attended a board meeting in the past two years.

Josh mentions to Victoria that VP Primer will have to issue shares at a discount. There is some discussion on the size of the discount although no decision on this matter is made. Josh points out that the company currently has 54 million shares in issue. The plan is to issue 6 million new shares to the public but the price at which these new shares will be issued is not yet decided upon.

Josh brings Victoria through some projections that he and his staff have prepared for the IPO (see Table 1) . The first column of Table 1 outlines the actual financial statements for the year ended 30 June 2019. The remaining columns contain the projected accounts from 2020-2023, inclusive. Josh explains that if €60 million is raised from the Euronext Market the net debt balance will not rise to €217,189,000 (€250,585,000 less cash of €33,396,00) as projected in 2020. That said, both Victoria and he consider that the projections are realistic and form a reasonable basis for extracting projected cash flows for use in a valuation of VP Primer. The projections assume a long-run growth rate of 2% from 2023 on.

Other Information:

- VP Primer can borrow additional funds at 3% per annum
- The risk free rate is 0.5%
- The Australian paint manufacturer, Dulux, is the public company whose area of business has the closest resemblance with VP Primer. Dulux has a Debt to equity ratio of 1.1
- The beta of the paint manufacturer Dulux is 1.06
- The market risk premium is 6.5%
- The corporate tax rate is 12.5% in Ireland and is 30% in Australia
- The beta of Dulux's debt is 0.1. VP Primer's Debt can be assumed to have the same beta as that of Dulux
- VP Primer has 54 million shares in issue and plans to issue 6 million shares to the new shareholders that take up the initial public offering on the Euronext Growth Market.

Table 1:

Statement of Profit or Loss and Other Comprehensive Income (Extracts) for the year ending:
VP Primer - Accounts in Thousands of Euro

			Income Statement	**€'000**	
	Actual 2019	**2020**	**2021**	**2022**	**2023**
Sales	1,311,000	1,442,100	1,658,415	1,824,257	1,860,742
Operating Expenses	1,250,000	1,387,500	1,623,375	1,785,713	1,821,427
Operating Income	61,000	54,600	35,040	38,544	39,315
Interest	4,500	4,500	6,388	7,799	7,195
PBT	56,500	50,100	28,652	30,745	32,120
Taxation	7,063	6,262	3,581	3,843	4,015
Net Profit After Tax	49,437	43,838	25,071	26,902	28,105
Dividends	25,000	25,000	25,000	25,000	25,000
Addition to Equity	24,437	18,838	71	1,902	3,105

			Balance Sheet	**€'000**	
	2019	**2020**	**2021**	**2022**	**2023**
Fixed Assets	196,650	259,578	265,346	291,881	297,719
Net Current Assets	39,330	57,684	66,337	36,485	37,215
Operating Assets	235,980	317,262	331,683	328,366	334,933
Cash	0	500	33,168	18,243	18,607
Net Assets	235,980	317,762	364,851	346,609	353,541
Shareholders' Equity	85,980	104,818	104,888	106,790	109,895
Debt	150,000	212,944	259,963	239,819	243,646
Total Financing	235,980	317,762	364,851	346,609	353,541

END OF CASE STUDY

SECTION A - Compulsory Question

1.

(a) Critically evaluate the plan to float VP Primer on the Euronext Growth market in Dublin and estimate its value for the Initial Public Offering.

Your answer may assume that the projections of Josh and Victoria are good estimates of how its future profitability and financial position will evolve as a stand-alone company into the future.

(30 Marks)

(b) Critically evaluate the use of debt capital in comparison to raising equity as a method of financing the expansion of VP Primer into the UK market. Your answer should outline at least one alternative method of financing (more if you can) the organic expansion of VP Primer into the UK market.

(10 Marks)

(c) Assuming VP Primer needs to raise €60 million by issuing 6 million new shares, reccommend with reasons, a price per share it should set for the Initial Public Offering (IPO).

(5 Marks)

(d) There are alternative ways of structuring the IPO on the Euronext Market. Recommend, giving reasons, an appropriate format for the VP Primer IPO.

(5 Marks)

[Total: 50 Marks]

SECTION B – Answer only 2 questions

2.

(a) Outline and justify the corporate governance changes that will have to take place at VP Primer in order for it to ultimately list on the Euronext market in Dublin (the main Dublin market).

(10 Marks)

(b) Critically evaluate PMD's decision to continue with VP Primer's Irish operations while producing the product of the same name at its facility in the UK. Your answer should discuss reasons why PMD should move production of VP Primer entirely to the UK as well as reasons for maintaining production in Ireland.

(10 Marks)

(c) PMD have given the shareholders of VP Primer the option to sell all or part of their company to it. If the shareholders of VP Primer decide to opt for the sale of the controlling interest in the company, propose additional conditions that PMD might consider imposing on the sale.

(5 Marks)

[Total: 25 Marks]

3.

(a) Discuss the key benefits for Victoria and Paul in selling a controlling stake in VP Primer to PMD Plc.

(10 Marks)

(b) Justify the price being offered by PMD Plc for VP Primer. Your answer should outline and explain any differences between the €700 million price being offered by PMD and your valuation as computed in Question 1 (a). You should also discuss any differences between the price per share of €12.96 (€700m/52m) implied by PMD's offer with the price you recommend for the IPO in Question 1 (c).

(10 Marks)

(c) Assuming VP Primer is to accept PMD's offer, recommend to the Vanslyperkins which one they should accept (the 100% buy out, or the purchase of the majority stake). Justify your answer.

(5 Marks)

[Total: 25 Marks]

4.

(a) Critically evaluate the foreign exchange risks that VP Primer would be exposed to if it does not sell to PMD and instead expands into the UK market itself.

For each type of risk, discuss how VP Primer would be exposed to it and propose steps that should be taken to mitigate it.

(20 Marks)

(b) Suppose PMD offered its own shares rather than cash as consideration for VP Primer shares for the full or partial takeover. Would this improve or dis-improve the offer from the Vanslyperkins perspective? Fully explain your answer.

(5 Marks)

[Total: 25 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

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SOLUTION 1

(a) The plan to issue some of VPP's equity on the Euronext Growth Market and ultimately on Euronext Dublin Main Market is sensible since Victoria and Paul and very undiversified and their entire personal wealth is tied up with VPP. The cash from the flotation while it will directly replace debt in VPP it will allow the company to continue with its relatively high dividend payout ratio. This should ensure that Victoria and Paul have the funds to build up a portfolio of financial assets outside of VPP. In this vein some serious consideration should be given to increasing the portion of the company to be sold off so that all of the Vanslyperkins' wealth is no longer tied to the fortunes of VP Primer.

Since VPP is going to issue shares on the Euronext Market it will have access to a potential pan-European investor base. Accordingly we can use the CAPM to estimate the cost of equity since the investors of VPP will now be well diversified. Attracting in such well diversified investors while at the same time becoming more diversified themselves will mean that all owners (with the possible exception of Victoria's mother) will be diversified shareholders and this will reduce the cost of capital to VPP.

We must first estimate the capital structure of VPP. This should be in market value terms.

Given that PMD have offered €700 million for the company's equity we can use this as an estimate of the equity value. Clearly the PMD offer would mean that the equity issue on the Euronext Market in Dublin would not go ahead so we can take the company's borrowings to be €150 million. This would give an enterprise value €850 (700 + 150) . The debt to value ratio is 150/850 and the debt to equity ratio is 150/700.

The equity beta of Dulux is 1.06. The D/E ratio of Dulux is 1.1 (or 1.1/1 if you like) so the debt to value (D/(D+E)) ratio is 1.1/(1 +1.1) = 1.1/2.1 or 0.524.

From the above we can compute the asset beta of Dulux to be

$\beta_a = \beta_e \frac{E}{V} + \beta_d \frac{D}{V}(1\text{-}T)$

$\beta_a = 1.06(.476) + 0.1(.524)(.7) = .505 + .037 = .54$

Note that since Dulux is an Australian company paying Australian Tax we use the Australian tax rate to adjust the cost of debt here.

We must relever this asset beta using VP Primer's capital structure to get its equity beta. We know that the debt beta is 0.1, the asset beta is .54 and the Irish Tax rate is 12.5%

For VP Primer $\beta_a = \beta_e \frac{E}{V} + \beta_d \frac{D}{V}(1\text{-}T)$ so we solved for β_e.

$.54 = \beta_e\frac{70}{85} + \beta_d\frac{15}{85}(1 - .125) = \beta_e\frac{70}{85} = .54 - .015$ and $\beta_e = \frac{85}{70}(.53) = .64$

The equity beta of VP Primer is .64.

The cost of equity for VP Primer once it lists on the Euronext Market is

E(R) = k_e = 0.5 + 6.5(.64) = 0.5+ 4.55 = 4.66% say 5%

The weighted average cost of capital (WACC) is $k_e \frac{E}{V} + k_d \frac{D}{V}(1-T)$ $= 5.0\frac{700}{850} + 3(1-.125)\frac{150}{850}$ = 4.12 + .46 = 4.6

Therefore we will estimate the WACC at 5%.

Rounding up the WACC to 5% can also be justified on the basis that betas mean revert – this means that betas that are lower than 1 will tend to rise toward their mean or 1.0 and betas that are higher than this mean will tend to fall toward one. The cost of equity which increases in beta and is likely to be higher than 5.0% which will increase the WACC. Remember that the cost of equity and the WACC are estimates so using a precise discount rate of 4.6 shows a lack of appreciation of this.

We then use the discount rate of 5% to discount the FCF of the company to get the enterprise value and then subtract the value of debt €150 from this to give the value of equity.

Computation of Free Cash Flow

Operting Income After Tax		48,337	31,459	34,701	35,300
ΔNOA		81,282	14,421	(3,317)	6,567
Free Cash Flow		(32,945)	17,038	38,018	28,733
Cash Flow Statement					
Dividends		25,000	25,000	25,000	25,000
Increase (Reduction)in Cash		500	32,668	(14,926)	365
Reduction (Increase) in Debt		(62,945)	(47,019)	20,145	(3,827)
Interest on Debt		4,500	6,388	7,799	7,195
FCF		(32,945)	17,038	38,018	28,733
FCF		(32,945)	17,038	38,018	28,733
Discount Factor		1.050	1.103	1.158	1.216
DFCF		(31,376)	15,454	32,841	23,638
Terminal Value					976,906
PVDFCF to 2019	40,557				
PVTV	803,703				
Enterprise Value	844,260				
Value of Debt	150,000				
Value of Equity	694,260				

Operating Income Aft Tax		48,337	31,459	34,701	35,300
Capital Charge		11,799	15,863	16,584	16,418
ReOI		36,538	15,595	18,117	18,882
Discount Factor		1.050	1.103	1.158	1.216
Discounted ReOI		34,799	14,146	15,650	15,534
TV					641,972
PV of ReOI to 2019	80,128				
PV of TV	528,152				
Book Value	85,980				
Value of Equity	694,260				

It could be argued, with a lot of justification that as VP Primer plans to issue €60m worth of shares to replace debt that this should be taken into account when valuing it. Indeed, the valuation presented above could be considered more appropriate when considering the offer of PMD plc to purchase all or a majority stake in VP Primer.

The next part of my solution to Q1 (a) is not part of the suggested solution. Rather it just serves to illustrate the effect of raising an additional €60 million on the Euronext Exchange and retiring the equivalent amount of debt.

If we assume that the €60 million in equity is issued to replace debt at the end of the financial year 2020 (June 2010) the increase in debt in that year becomes only €2,945,000 and not €62,945,000 as in the above cash flow statement. However, dividends net of the equity injection decline and equivalent €60 million leaving FCF increases 2020 unchanged. Subsequent interest payments and profitability change marginally. However, assuming that the cost of capital does not change the valuation declines marginally. This is outlined below.

Cash Flow Statement					
Dividends		(35,000)	25,000	25,000	25,000
Increase (Reduction)in Cash	500	32,668	(14,926)	365	
Reduction (Increase) in Debt	(2,945)	(45,444)	21,761	(2,168)	
Interest on Debt		4,500	4,588	5,952	5,299
FCF		(32,945)	16,813	37,787	28,496
FCF		(32,945)	16,813	37,787	28,496
Discount Factor		1.050	1.103	1.158	1.216
DFCF		(31,376)	15,249	32,642	23,443
Terminal Value					968,849
PVDFCF to 2019	39,959				
PVTV	797,074				
Enterprise Value	837,033				
Value of Debt	150,000				
Value of Equity	687,033				

Operating Income Aft Tax	48,337	31,234	34,470	35,063	
Capital Charge		11,799	15,863	16,584	16,418
ReOI		36,538	15,370	17,886	18,645
Discount Factor		1.050	1.103	1.158	1.216
Discounted ReOI		34,799	13,941	15,450	15,339
TV					633,915
PV of ReOI to 2019	79,529				
PV of TV	521,524				
Book Value	85,980				
Value of Equity	687,033				

It could be argued that since equity is a more costly source of finance that the cost of capital increases. However, if we take the debt to value ratio to be 90/850 instead of 150/850 we will not change our estimate of the cost of capital from 5%.

WACC is $k_e \frac{E}{V} + k_d \frac{D}{V} = 5.0\frac{760}{850} + 3(1-.125)\frac{90}{850} = 4.5 + .28 = 4.8$

(30 marks)

(b) An obvious alternative method of financing the expansion into the UK would be to borrow the funds.

Since the purpose of the new funds is to finance the expansion of VPP into the UK an alternative approach would be to borrow the equivalent of €60 in sterling.

This would convey a number of advantages.

First if the loan is at a variable rate it will be PPP neutral. If sterling appreciates the interest rate on the loan will decline which will should hedge the loan itself. A fixed rate loan would also be useful in that it will help match the receipts and payment in sterling as a hedge but would not be PPP neutral.

Also the loan will be a natural long term hedge for the sterling receipts that VPP will receive from the new sales in the UK while all its production costs are in Euro.

There will be no costly changes in corporate governance or loss of control.
There will be a tax shield from the interest. It will be allowable at a tax rate of about 18% if a UK subsidiary is set up which is about 50% more than the Irish rate. The problem is the UK subsidiary would have to pay tax at 18% also.

From the projected accounts the debt rises to approximately €260m with the market value of equity in the region of €690 this is a D/E of about 38% which is not high. At its worst the interest cover provided by profits before tax is over 4 times so the borrowing is affordable.

A disadvantage of debt is that it's repayments would consume cash flow and might restrict dividend payments in the future. The size of debt being contemplated is probably too small to adversely affect the risk of VP Primer.

The advantage of raising equity capital is that it will bring VPP further down the road toward a full listing and a chance for Victoria and Paul to extract some of their wealth from the company.

VPP could consider raising equity capital in the AIM of the LSE which would give the hedging benefits and benefits of equity capital combined.

(10 marks)

(c) It is clear from the valuation above that PMD have got the valuation of approximately €700 million for the equity of VP Primer just about correct. Sixty million euro would buy 8.57 percent of this equity value. However, to ensure the success of the issue VP Primer is going to have to issue the shares at a discount. In other words the €60 million will buy more than 8.57 percent of the company. A relatively simple scheme is outlined below. We assume that €60 million buys 10% of the share capital and not just 8.57%

6 Million new shares are to be issued.

The existing shareholders continue to hold 54 million shares. This 54 million is 90% of the shares so will account for 90% of the value of the company.

The 6 million other shares will be issued to new shareholders for the remaining 10% of the company.

So the new shares can be prices at a nominal value €1 each.

A reasonable estimate of their value is about 690m/60m = €11.5 or so the shares issues are worth €69 million but they only cost €60m a discount of about 13%. The issue price per share is €60/6m = €10 this is a discount of €1.50 or 13% from the €11.50 value of the shares.

(5 marks)

(d) The obvious alternative method pertains the amount raised. It would seem more efficient in terms of a diversification of their financial assets if the Vanslyperkins sold more of VP Primer in the IPO and kept some of the cash for themselves rather than reduce debt. Thus from a finance perspective it is clearly a better option. It is likely that the Vanslyperkins might pay less tax that using dividends also. It would be worthwhile getting a tax expert to check on the tax efficiency of the alternative methods of extracting their wealth from VP Primer.

Other considerations are whether an offer for sale which would need to be under-written is used or if the shares are placed with institutions.

(5 marks)
[Total: 50 Marks]

SOLUTION 2

(a) To list on the main market in Dublin VPP will have to comply with the UK Corporate Governance Code (2018) and the Irish Corporate Governance Annex.

The fundamental Corporate Governance change that will have to be made before VPP can become a listed company on the main market is that it must create an independent board that is capable of representing all of its shareholders not just Victoria, Paul and their mother.

This will involve recruiting independent non-executive directors who are capable of (a) monitoring the executives and (b) bring skills and resources to the company that will help with the formulation of a sound strategy for the development of the company.

A non-executive chairman will have to be recruited to run the board as distinct from running the company which will remain the responsibility of Victoria and Paul.

The code states that the majority of the directors (excluding the chair) should be independent.
The definition of independence is clearly set out in the code and precludes conflicts of interest that might arise due to familial ties, length of time on the board, business ties and cross-director ships.

The Irish CG annex requires that companies *"1.1 Outline the rationale for the current board size and structure, explaining why the company believes it to be appropriate and provide details of any planned or anticipated changes to the board size or structure"*

There should be formal and rigorous evaluation of the performance of the boards.

The board must have a Nomination Committee.

The majority of members of all of the above committee should be independent.

The board must also establish and Audit committee made up entirely of independent NEDs. In addition for the audit committee at least one of its independent members must have recent relevant financial experience.

The board should also have a remuneration committee which again must be entirely composed of NEDs.

Clearly to fulfil the above requirements VPP will have to recruit at least four independent directors.

One NED will have be the chair. This will leave three other NEDs and Victoria and Paul as the remaining members of the board.

The minimum size the audit committee can have is two and one of the new directors must have relevant and recent financial experience.

Note that not all of these changes need to be done immediately since VPP is only going for a quotation on the Euronext Growth market initially but it will have to address this issue before it obtains a listing on the main Irish Euronext Market.

While not part of the answer it is worth noting some of the provisions of the Irish Annex:

1.1 Outline the rationale for the current board size and structure, explaining why the company believes it to be appropriate and provide details of any planned or anticipated changes to the board size or structure;

1.2 Where the requirements of provision B.1.2 of the UK Code have been met, explain why the company regards the number of nonexecutive directors appointed to the board as sufficient;

1.3 Set out how the specific skills, expertise and experience of the board are harnessed to best effect in addressing the major challenges for the company;

1.4 Where a company has diverged from the requirements of provision B.1.2 of the UK Code, give a reasoned explanation for the departure; The section of the Annual Report including the Directors' biographies should include:

1.5 The date of appointment of each director, the length of service of each director as a director and, where applicable, the length of service of each director on a board committee;

1.6 A detailed description of the skills, expertise and experience that each of the directors brings to the board;

1.7 Where a company has directors who have been nominated by shareholders or government, a reasoned explanation for such appointments including a description of the skills and expertise these directors bring to the board as provided by the shareholders or government (as applicable) or a statement that no such description has been provided to the company.

(10 marks)

(b) It would seem that PMD's plans to produce VP Primer in Chesire makes sense. The UK market is much larger than that of Ireland so an expansion of the Irish plant would be needed anyway. It would make sense from the point of view of PMD that they match their sterling inflows and outflows so it is logical to produce in the same currency that they will be selling in. The same rationale applies to keeping the Irish plant open. It might make sense in terms of economies of scale to produce in the UK but this must be balanced with the proximity to market and foreign currency hedging provided by producing in the UK for the UK market and in Ireland for the Irish Market. Also having the Irish facility is useful for future expansion of VP Primer sales into the Eurozone and there is likely to be some flexibility to switch some production from one plant to the other depending on the strength of the respective currencies. For example at the moment with £1 sterling worth about 90 cent it would makes sense to produce as much as possible in Ireland. This is an example of maintaining flexibility so as not to suffer from long-term economic foreign currency exposure.

(10 marks)

(c) If the Vanslyperkins do not sell all of their shares in VP Primer to PMD the latter should insist on pre-emptive rights to the Vanslyperkins remaining shares. There should be a clearly defined metric for the computation of the price of these shares perhaps based on the prevailing share price of PMD and the profitability of VP Primer. In the event of a dispute pertaining to the price of these shares a method of arbitration should be put in place

(5 marks)

[Total: 25 Marks]

SOLUTION 3

(a) First, it essentially releases the wealth that Victoria and Paul have tied up in VPP. This will allow them to develop a more diversified portfolio of financial assets at a time when their human capital is depleting (in their early fifties).

The price offered is very fair. It is marginally higher than the calculated value in 1 (a). Further, Victoria and Paul don't have to undertake the journey of and IPO in the Euronext Growth Market possibly followed by an SEO in the main Dublin Euronext market with all the uncertainty and risks associated with these endeavours. If they sell now they get the full value of the company without the hassle of an IPO. All in all it is a very good deal.

The offer also takes the pressure off creating a dividend policy to allow Victoria and Paul extract their wealth from VPP.

(10 marks)

(b) As mentioned in part (a) of the answer to this question PMD are offering a very good deal for VPP. One reason that they can afford to make such an offer is that they have an existing or ready-made distribution channels to the paint retailer in the UK. VPP on the other hand would have to create a totally new distribution network. This would entail administrative and selling costs. The latter may include having to give discounts and promotions to get the VPP products established. Acquiring VP Power essentially provides synergies for PMD the benefits of which they can afford share in some small way with the Vanslyperkins. VP Power is probably worth more in the hands of PMD than as a stand-alone company.

The issue price of €10 computed for the IPO gives an overall value of only €600m. This is €100 m less that PMD's offer. This is because PMD is trying to get control and must pay a premium for control. VP Primer must ensure the success of its issue and must give a discount to the new shareholders to ensure all the shares are sold.

(10 marks)

(c) Ultimately this is a matter of personal preference. Essentially Victoria and Paul could continue to work for the business which they were founders of with the partial buyout. In a sense this is a type of diversification owning the business (but only part thereof) and getting a capital injection to fund their personal lives. In many ways selling part of the business would be the better option. However, whey will have to protect themselves by agreeing a metric for the computation of the value of the shares

(5 marks)

[Total: 25 Marks]

SOLUTION 4

(a) The major type of foreign exchange exposure that any firm faces is Economic exposure. This is the loss of price competitiveness due to fluctuations in the exchange rates. The best way dealing with this type of exposure is to arrange for offsetting cash inflows and outflows in the same currencies. Financial hedges will not work since they will not match the time horizon for the cash flows. Also they will not allow PPP to work properly since they essentially fix the price of the currency but the inflation rate can still differ between the UK and Ireland. If PPP held the country with the higher inflation would see its currency decline to compensate for the higher prices due to inflation. It must be admitted that PPP only holds at economy level and not at company level. During Brexit it is doubtful that PPP holds at all for the UK relative to its trading partners. For the UK expansion the economic exposure to sterling can be hedged by financing (or part financing) in sterling. The purchase price can be borrowed from a UK bank or shares issued on the UK stock market. Unless the sterling denominated shares were issued to UK investors there would be no real reduction in the exposure from the Irish shareholders perspective. To put it succinctly if VPP were to issue sterling shares to the Vanslyperkins, the latter would then have the FX exposure rather than VPP. On balance it might be best to borrow some sterling for the purchase: clearly the company has borrowing capacity and the corporate tax rate in the UK is higher than in Ireland providing an additional rationale for borrowing in the UK. VPP clearly has the borrowing capacity with leverage in terms of the debt to equity ratio in the order of 0.38. However, if an UK subsidiary was set up to take advantage of the greater value of tax shields in the UK it would have to be remembered that that subsidiary will also pay tax at a higher corporation tax rate in the UK. Of course issuing shares to new UK investors would dilute the shareholdings of existing shareholders which might not be in the latter's interest.

VPP will also be subject to transaction risk when contracts to sell at a particular price in sterling – if sterling depreciates it will not get the amount of Euro that it had expected to get.

The largest risk that needs to be mitigated is the economic risk and the best way of dealing with this is to borrow at a variable rate in sterling.

There are a plethora of methods for dealing with transactions risk such as money market hedges and forward rate agreements. Leading and lagging is not hedging it is more like speculation.

Translation risk will only arise if VPP sets up a subsidiary or branch in the UK.

(20 marks)

(b) Sometimes companies use their own shares to buy other companies when they consider these shares to be over-valued by the market. They essentially trade these over-priced shares for less over-priced assets of the target company. So the Vanslyperkins should be wary of a share offer. Companies also use shares as consideration when they want to share the risk of the take-over with the target's shareholders. However, this is unlikely to be the case for VP Primer.

An advantage of the share offer would the deferment of CGT.

(5 marks)

[Total: 25 Marks]