TREASURY, RISK AND FINANCE PROFESSIONALS

ACT

The Association of Corporate Treasurers

Examination Paper, Solutions and Examiner's report

Paper: MCT Case Study Exam

OCTOBER 2010

You are required to answer ALL 7 questions.

All questions relate to the Leisure Tours plc Case Study. Note that the financial summary and analysis in the Case Study Background Information include figures from a broker's simplified projections for 2010, as well as the audited figures for 2007 to 2009.

QUESTION 1

Required:

(a) Given that Leisure Tours plc, in its present form, was created by merger relatively recently, what do you think are the broad strategic objectives of the group?

(3 marks)

(b) Given that the key financial objectives will no doubt cover, inter alia, sales growth, margins, costs and cash flow, what are the main non-financial characteristics of the company's business environment and its position within the industry that will drive or influence financial performance?

(7 marks)

[Total 10 marks]

QUESTION 2

Required:

Write a summary highlighting which you consider to be the most important features of the company's financial performance and its recent evolution, based on the Income Statements, Balance Sheets and Cash Flow Statements for 2007 to 2009.

[Total 10 marks]

QUESTION 3

Required:

(a) Given your responses to Questions 1 and 2, identify five major finance/treasury risks facing Leisure Tours plc in the medium term, with a brief one-line justification for each risk identified.

(5 marks)

(b) What assumptions would you make about the extent of each risk in order to stress test business plan forecasts?

(10 marks)

Reverse stress testing involves imagining a disaster scenario for the business, working back to what might have caused it and judging whether this reveals risks to your business which have been overlooked in the past, possibly through lack of imagination or creative challenge e.g. collapse of the commercial paper market or triple A sovereign downgrades.

(c) Suggest a disaster scenario reverse stress test for Leisure Tours plc involving one of the five finance/treasury risks which you identified above.

(3 marks)

[Total 18 marks]

QUESTION 4

Required:

(a) **The gross interest cost is very high in relation to the 2009 year-end balance sheet debt, for a UK-based company. What are the causal factors driving this seasonal fluctuation in debt, given the nature of the business? Based on your estimate of the likely interest rate on the company's debt, estimate the company's average and peak debt in 2009? Focus on gross debt rather than net debt for the purposes of this question.**

(4 marks)

(b) **Compare (i) the gross value of aircraft on the balance sheet that have been purchased outright with (ii) the value of aircraft on finance leases and (iii) the capital value of aircraft operating leases.**

Use S&P's methodology for estimating the capital value of operating leases i.e. the NPV of all future operating lease payments, discounted at the effective interest rate of the company's total on-balance-sheet debt.

(5 marks)

(c) **Using your work on 4a) and 4b) quantify the impact of the off-balance sheet debt plus the peak seasonal on-balance sheet debt on the following credit ratios to reflect the "worst point" in 2009: what was the company's maximum ratio of on-and-off-balance-sheet debt to (i) shareholders' funds and (ii) EBITDA. Contrast these with the year-end on-balance-sheet ratios.**

(4 marks)

(d) **In light of your analysis comment briefly on the company's aircraft funding policy.**

(1 mark)

[Total 14 Marks]

QUESTION 5

The stock market is concerned that companies in this sector seem unable to translate earnings into cash flow. In addition Leisure Tours plc seems to be on low valuation multiples. In order to shed some light on these issues you are asked to investigate the free-cash-flow growth rate implied by the average EV for 2010. Various brokers assume the company's nominal WACC currently to be in the range 7% to 9%.

Required:

(a) Estimate the sustainable cash flow (Free Cash Flow to the Firm) as at 2011 basing your assumption about the steady-state growth rate achievable on your previous analysis of the industry and the company's market position within it, the likely rate of inflation medium-term and the sales forecast for the company 2010.

(7 marks)

(b) What long-term growth rate is implied by the 2010 EV of £2,692m, given your estimate of sustainable cash flow and a WACC in the specified range of 7% to 9% (use this range - do not calculate a WACC yourself)? For the purposes of this question exclude off-balance-sheet debt in your calculation of EV.

(5 marks)

(c) What do you conclude about the market's view of the company? What are the main "non-financial" factors that might be depressing the share price?

(3 marks)

[Total 15 marks]

QUESTION 6

Leisure Tours plc is exposed to several typical treasury risks including:

(1) fuel price risk
(2) currency pre-transaction risk

Required:

For each of (1) and (2)

(a) **Explain how the risk arises in Leisure Tours plc.**
(1 mark per risk = 2 marks)

(b) **How material is each type of risk for Leisure Tours plc? Quantify and indicate the level of sensitivity, noting any assumptions made.**

(4 marks per risk = 8 marks)

(c) **Identify the key policy parameters for the management of each of these risks within Leisure Tours plc.**
(5 marks per risk = 10 marks)

[Total 20 marks]

QUESTION 7

Some information is provided in the case study about the treasury/finance policies of Leisure Tours AG (LTAG) and Monroe plc prior to the merger.

Required:

(a) **On the Treasury Organisation Matrix provided create a profile for each party to the merger before the event by ticking the cell in the top left hand corner of the appropriate box.**

(2 marks)

(b) **Create a profile for where you believe the merged entity should be after the merger integration process by ticking the cell in the bottom right hand corner of the appropriate box. Give reasons for your choice.**

(4 marks)

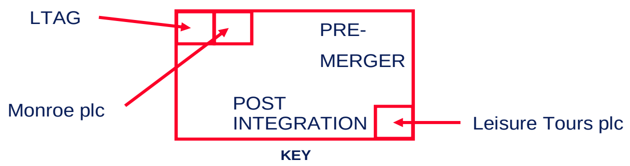
(c) **What actions would you need to take to accomplish the integration of the two treasuries and the profile you created in your answer to b)?**

(7 marks)

[Total 13 marks]

Treasury Organisation Profile

ROLE	**Advisory**	**Agency**	**In-House Bank**
AUTHORITIES	**Decentralised**	**Centralised**	**Dynamic Balance**
RESPONSE TO RISK	**Cost Centre**	**Cost-Saving Centre**	**Profit Centre**
ORGANISATION	**Elementary**	Intermediate	**Advanced**



Background information on Leisure Tours

1.0 INTRODUCTION

Leisure Tours (LT) and Worldwise plc (WW) are the two major tour operators in the UK. Both companies are the result of mergers in 2007: Leisure Tours AG with Monroe plc and Worldwise plc with Primera plc.

LT summary financials at year-end 30 September 2009 were:

	£m
Sales revenue	9269
Operating profit pre exceptionals	419
Exceptionals (mainly merger-related)	216
Operating profit	203
EBIT	160
PBT	56
PAT	18
Market capitalisation	1823
Net debt (Debt 1225m - Cash 550m)	675

Note that the September year-end more-or-less reflects the “completion” of one year’s cash cycle and the start of the next.

LT had a syndicated committed bank debt facility of £1.6bn contracted in 2008. The company is not rated currently [but is committed to acquire a rating by 2011 as a condition of two bond issues in H1 2010].

In 2009 LT had 22.1m customers and employed 31,000. It operates in five geographic segments (21 countries) with a network of 3,400 owned and franchised travel stores and a fleet of 95 aircraft.

2.0 TOUR OPERATING SECTOR [1]

In the purest form tour operators are holiday organisers that arrange flights, accommodation, transfers and car hire, put them into packages and sell them for a commission. The model has become more complex over the years as companies have expanded vertically into owning the airline and the travel agent – covering most parts of the value chain excluding hotels. There are five main components of a tour operator:

- **Hotels** – usually arranged rather than owned – treated as a pass through cost with no margin.
- **Airline** – the large operators own the airline and make good margins.
- **Distribution** – the large operators run both high street and online travel agencies – with small margins.
- **Tour operator** – the key administration centre putting packages together.
- **Destination services** – often in resort services are controlled by the tour operator – and make good margins.

It is quite difficult to get an accurate breakdown of the costs and revenues associated with each part of the tour operating business. Worldwise plc has provided targets for its planned cost of distribution and admin that we show below (and in Figure 1):

- GP1 – 20% - gross profit after accommodation, destination and airline costs
- GP2 – 10% - includes selling and distribution costs of c10%
- GP3 – 5% - after admin – ie tour operator 5%

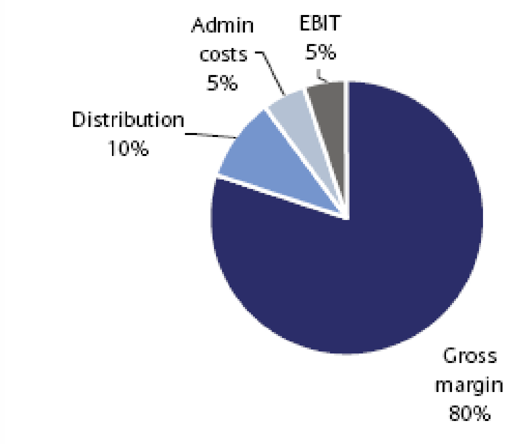
While at the last results presentations Leisure Tours showed its breakdown of gross margin:

- **Accommodation** – 33% of sales
- **Aviation** - 37% (includes fuel at 8%) of sales
- **Other cost of sales** – 7% - mainly destination services
- **Selling and administration costs** – 18%

We show these in figures 1 and 2.

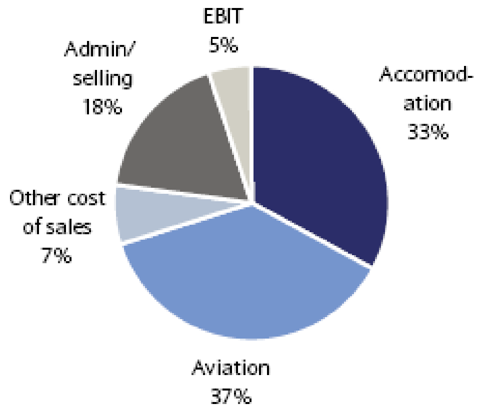
[1] Note 1: Section 2.0 data and opinions are drawn largely from a Bank Equity Analyst's Report.

Figure 1: Worldwise plc plc margin breakdown target



Source: Worldwise plc

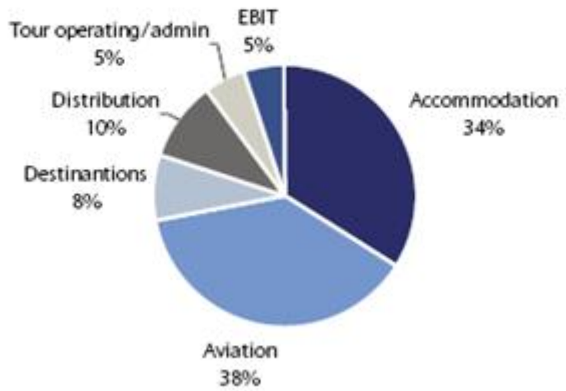
Figure 2: Leisure Tours margin breakdown 2008



Source: Leisure Tours plc

If we assume that the two companies are fairly similar – we can put both of these parts together to get a reasonable view on the split of the cost base as a percentage of sales that we show in figure 3.

Figure 3: Estimated breakdown of costs - % sales, 2008



Source: Barclays Capital

Hotels - c34% of revenue

The hotel cost for both Worldwise plc and Leisure Tours plc is mainly a pass-through cost. Very few hotels are owned or leased by either group - although they can manage hotels. In exceptional circumstances they may have to guarantee rooms in an important location. Some hotels are branded for exclusive use of an individual tour operator that would have some guarantees in place. Guarantees account for 20% of Worldwise plc travel's bed requirements whilst just 10% of Leisure Tours. These beds tend to be filled first in the booking system to help minimise the risk. Ironically, hotels have the largest margin in the value chain with tourism units enjoying a 30-35% EBIT margin.

The tour operators have tried - with varying degrees of success - to invest in hotels to monetise this part of the value chain.

- Monroe plc - tried it five years ago with some significant hotel purchases but had to sell them when they hit financial problems.
- Worldwise AG - still owns some hotels that were part of the tour operating division but were not consolidated into Worldwise plc at the merger. However, Worldwise AG has arms length agreements with Worldwise plc to fill the rooms.
- Primera plc - negotiated an option with a Spanish Hotelier to acquire hotels but the option expired.

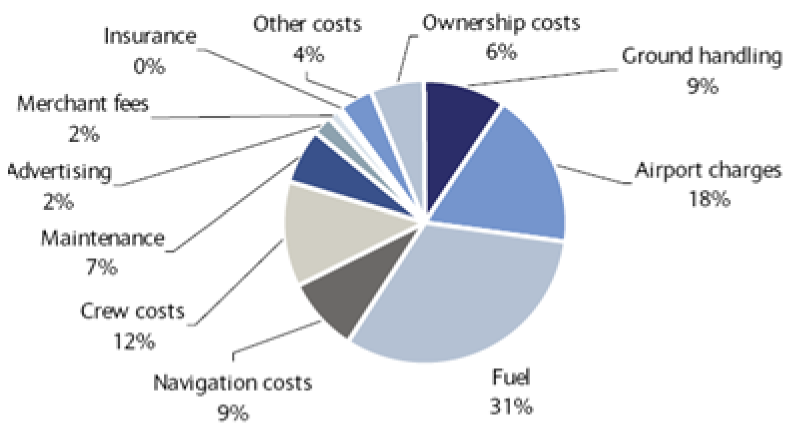
Some believe that it has never really worked with the high capital cost being one issue and the lack of flexibility being another. Committing to hotel beds significantly increases the risks in the business - especially if the beds are in places that go out of fashion. This was probably one of the factors that triggered Monroe plc's capital restructuring debt for equity swap.

Airline - c38% of revenue

Both Worldwise plc and Leisure Tours plc own an airline. The costs of this are mainly fixed once the decision to fly the plane has been made. We show the breakdown of easyJet's cost base in figure 4. With the exception of merchant fees (credit card payment fees) and advertising, all the costs would have to be paid if the aircraft is flown empty. The key to a variable cost base is the ability to be flexible on capacity, as we describe later in the note. The tour operators have been successful in ensuring flexibility on the airline fleet. This has been achieved from two areas in the airline:

- Staggered annual lease expiry.
- Non-committed seats on third-party carriers - Worldwise plc has 30% from third-party flying in the mainstream operations across its operations with both companies having c10% in the UK.

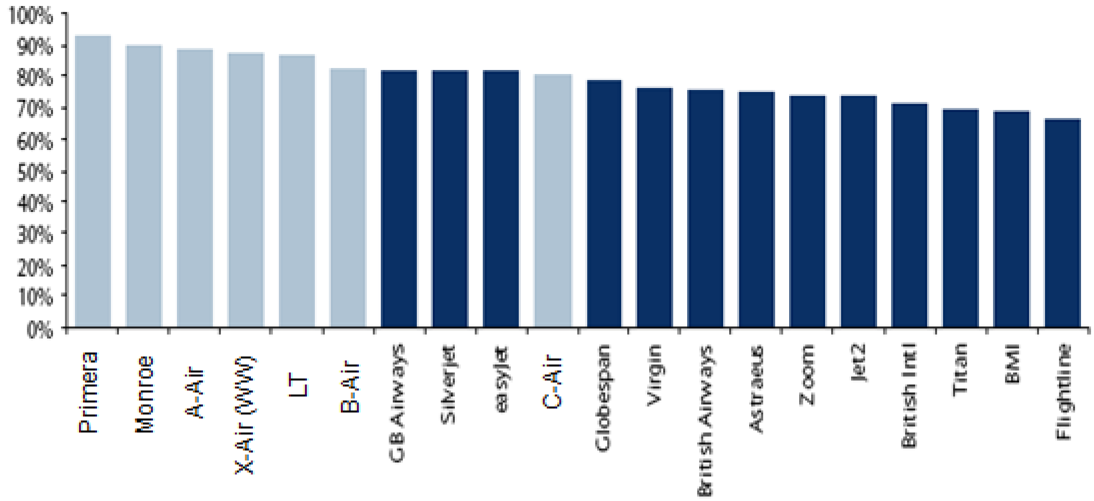
Figure 4: easyJet cost base of its airline



Source: easyJet report & accounts, 2008

In general – the tour operators are good operators. Load factors are high due to extensive distribution offered by the retail travel agents and tour operating function that is designed to ensure that the planes are flown full. This high utilisation of the aircraft is depicted in figure 5. The data comes from CAA data for 2007, which shows the average utilisation of the top 20 based airlines. The charter operators are highlighted in a lighter colour – but it is clear that they have very high load factors relative to the scheduled operators.

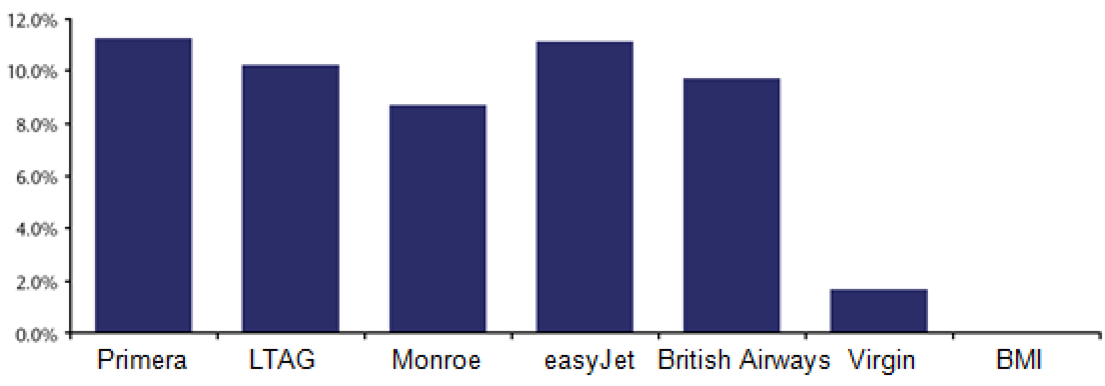
Figure 5: Load factors of the top 20 UK airlines



Source: CAA

The high load factors also produce good EBIT margins as we show in figure 6. In 2007, the margin of the charter airlines were very similar to the top UK scheduled carriers of British Airways and easyJet - and substantially ahead of Virgin and BMI. X-Air (WW) is not included in the data as it had major losses from its scheduled operation and exceptionals that cannot be split from the CAA data.

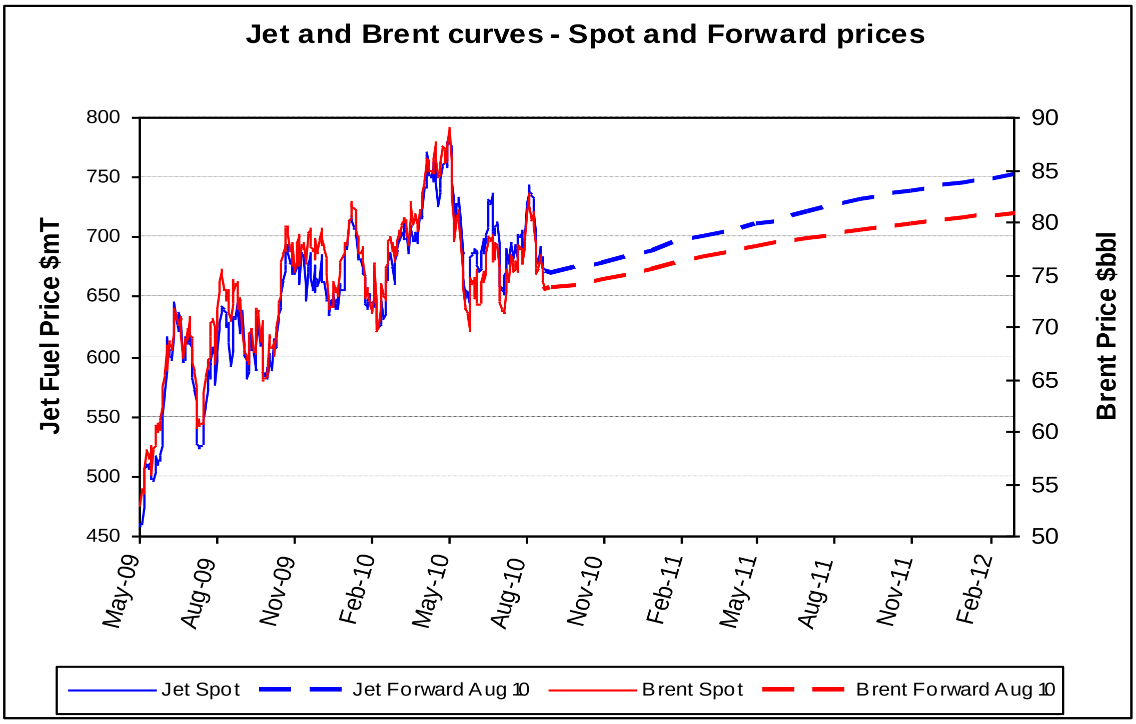
Figure 6: EBIT margin of the major UK airlines, 2007



Source: CAA data

Fuel is a very significant element of airline costs because of its size and volatility. The graph below shows spot prices over the past year to August 2010 and forward prices out to February 2012.

Figure 7: Jet and Brent spot and forward prices



Jet and Brent are quoted in different units.

Destination services - c8% of costs

Destination Services is an important part of the product differential from a modular package. This includes in resort representatives that provide entertainment as well as support and help sales on trips in the resort. X-Air (part of Worldwise Travel) adopted a policy of ensuring that all reps covered their costs with sales of in resort services.

Distribution costs - c10% of costs

Distribution costs are an area that differentiates the tour operators' business model from an airline. The easyJet split of costs in figure 4 shows that merchant fees (ie credit card costs etc) together with advertising totalled 4% of costs, which accounts for most of the distribution costs of the group. This is significantly smaller than 10% for the tour operators - and in fact it would be nearer 15% if the cost of hotels is excluded to put it on more of a like-for-like basis with the airlines. This is not surprising given that easyJet's only real form of distribution is from online bookings. Tour operators own a large number of travel agents in the high street, which materially increases the cost of distribution, although arguably they have proved to be more successful at filling the planes as we showed in the load factors. The travel agent has a similar cost profile to a retailer with rent and staff costs accounting for more than 50% of the costs. Most of the high street shops are leased with both Worldwise plc and Leisure Tours plc having a staggered lease expiry guaranteeing some flexibility. Increasing the percentage of bookings from both owned distribution and the online percentage is a major focus of both Worldwise plc and Leisure Tours plc.

Tour operating costs - c5% of costs

The tour operator is effectively an administration cost. This part of the operation puts itineraries together, decides where the planes would be best utilised and in which resorts. It makes agreements with hotels and controls pricing of the packages to ensure they are sold at the maximum margin. For doing all of this the margins are typically very low as it actually takes on very little risk and requires limited capital.

Margin depends on the level of integration

The level of margin for a tour operator varies geographically due mainly to the different degree of vertical integration. The more parts of the value chain that they keep - the higher the margin. Not surprisingly this increases the level of risk in the group too. A good way of demonstrating this is with Leisure Tours that showed the margin targets for each of its main geographical areas that we show in the table below.

Margin range determined by business type		
Type	**Leisure Tours segment**	**Industry margin %**
Fully integrated (TO*, Shops, Airline & Hotels)	Northern Europe	7 - 9
Highly integrated (TO*, Shops & Airline)	UK Belgium	5 - 8
Less integrated (TO* & Retail)	Netherlands France Canada	3 - 5
Emerging markets	Eastern Europe	2 - 4
Tour operators only	Germany	2 - 3
Airline	LT (Germany)	4 - 6
Germany combined		3 - 5

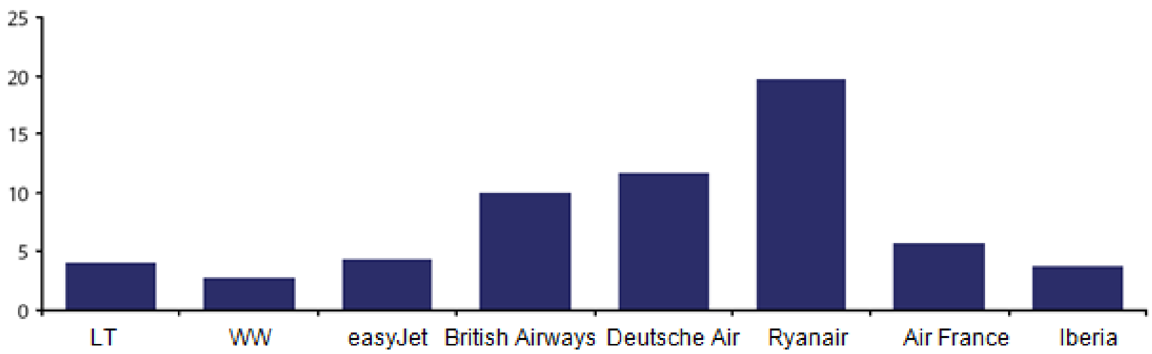
*** Tour operators (TO)**
Source: Leisure Tours

- **Fully integrated** – 7% to 9% – the group's Scandinavian operation included some hotel participants together with the tour operating, retail and airline operations. This enables the group to target a margin of 7-9% (the largest of all geographical regions) – and actually achieved 8.9% in 2008.
- **Highly integrated** – 5% to 8% – the UK and Belgium operations include the tour operator, airline and travel agencies giving a 5-8% margin opportunity.

- **Less integrated** – 3% to 5% – the groups' operations in Netherlands, France and Canada only include the retail travel agent and tour operator – hence a lower margin.
- **Emerging market** – 2% to 4% – small and in development.
- **Tour operators only** – 2% to 3% – the German operation has limited vertical integration and makes a low but relatively low risk margin.
- **German airline** – 4% to 6% – due to competition in Germany – the airline has modest margin targets.

The tour operator groups look to have worse margins than the airline operators – although this is distorted by the pass-through cost of the hotels. Taking the distribution and selling costs on top of the airline margin we showed earlier, the tour operators made a 5.5% to 6.5% margin last year. While this is below the better airline operators, we believe the additional costs of distribution make the groups more resilient to the downturn.

Figure 8: Airlines' margins against the tour operators, 2007

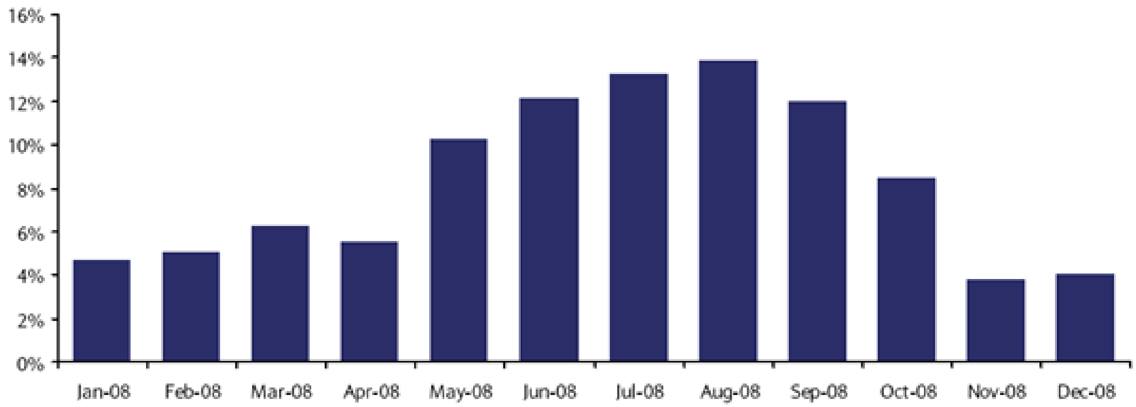


Source: Barclays capital

Seasonality

Tour operating is a highly seasonal business with a substantial focus on school holidays – especially over the summer months. This is reflected in the number of charter flights, which we show from the CAA statistics in the following chart.

Figure 9: Charter – percentage of airport movements per month



Source: CAA

With costs more evenly spread over the year - it makes EBIT highly seasonal where all of the profits are made in the July to September quarter. We show in the following charts the quarterly profits and losses for Worldwise plc and Leisure Tours plc in 2008 by quarter. This clearly demonstrates the seasonality. Both companies have a September year end so the July-September quarter is the Q4 figures.

Figure 10: Quarterly revenue, 2008

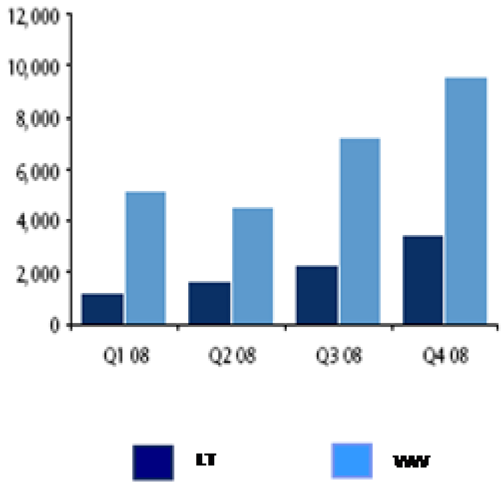
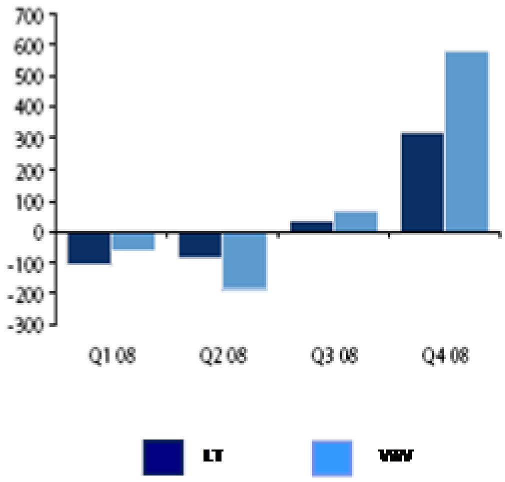


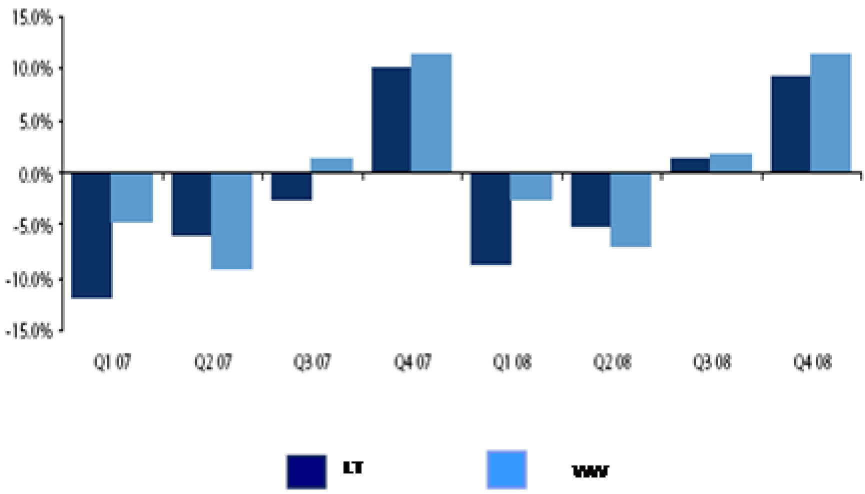
Figure 11: Quarterly EBIT, 2008



Source: Company reports

The problem with this level of seasonality is that the late booking market in the final quarter is critical for profitability. While the groups can manage capacity – 40% of holidays are still booked within six weeks of departure. Small changes in prices at this stage with so many holidays taking place can result in some quite significant profit volatility both on the upside and the downside. The quarterly margins are very volatile as we show in figure 12.

Figure 12: Quarterly margins, 2007 and 2008

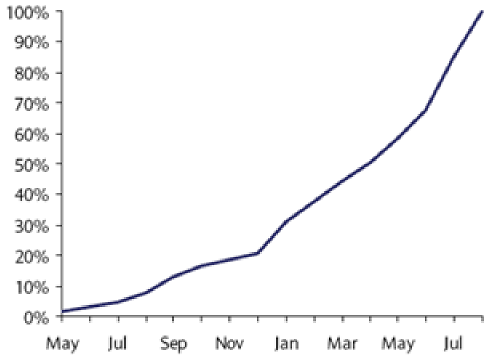


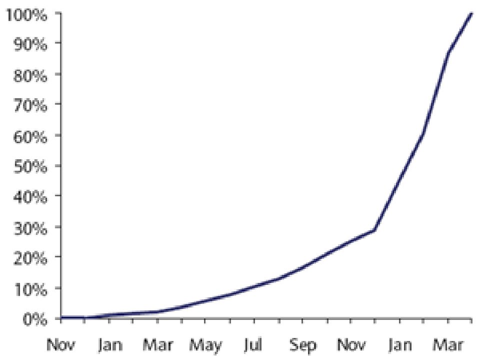
Source: Company reports

Yield management is key

The emphasis and importance on systems cannot be underestimated in tour operating. With enormous revenue and slightly less-than-enormous costs – small changes in either can make a large difference to EBIT. The key issue for the groups is the development of the booking curve. There is a similar pattern each year where the groups aim to sell a certain percentage of the packages by a certain date. We show the data for the industry from 2006 for both winter bookings and summer bookings. For summer – typically 20% of the packages are sold by December – there is an acceleration in bookings in January – 50% are sold by May with 30-40% in the lates market (six weeks before departure).

Figure 13: Summer booking pattern, 2006 **Figure 14: Winter booking pattern, 2006**



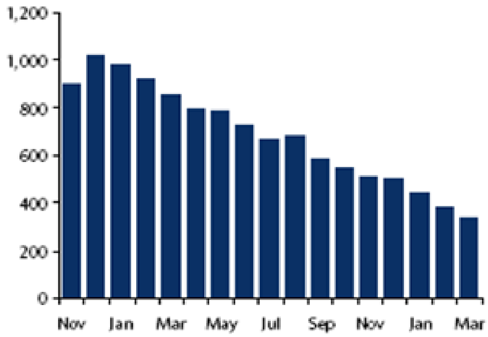


Source: Barclays Capital

The yield curve is managed by pricing. As we show in figures 15 and 16, prices tend to fall as the industry approaches departure date. Part of the reason for this is that the company sells the premium holidays first and therefore higher-priced packages earlier, but some of it is due to the yield management system that results in the stock that is not selling well being discounted.

Figure 15: Summer pricing, 2006

Figure 16: Winter pricing, 2006



Source: Barclays Capital

The tour operators have a different pricing curve from the low cost carriers that increases as you approach departure. This is a potential disadvantage for the tour operators in competing routes as visible pricing would automatically lead to a later booking cycle for the tour operators. This provides further incentive to move away from competitive routes.

3.0 LEISURE TOURS PLC PROFILE

3.1 Merger in 2007

In 2006, prior to the merger, the Leisure Tours and Monroe businesses looked like this:

- Leisure Tours AG: German owned, 13.2m customers, 19,775 employees, 60 aircraft, operating in mainstream and independent sectors and in travel-related financial services.

- Monroe plc: UK owned, 5.5m customers, 12,947 employees, 31 leased aircraft operating principally in the mainstream sector.

Leisure Tours AG was jointly owned by KQ AG (a major German retailer) and Deutsche Air.

The new merged company, Leisure Tours Group, would be owned 52% by KQ AG and 48% by existing Monroe shareholders.

3.1.1 Background to and Reasons for the Merger

The combination of Monroe and Leisure Tours is expected to create significant shareholder value for both Monroe and KQ shareholders through substantial cost savings, particularly in the UK. In addition, the combination provides both sets of shareholders with certainty that they will benefit from consolidation.
In particular, the Enlarged Group will benefit from:

- Leading positions in the UK & Ireland, Germany, Scandinavia, Benelux, France and Canada;
- A strong portfolio of complementary and industry leading brands, coupled with broader distribution reach to serve all segments of the travel market from budget to premium customers; and
- Greater earnings stability through the increased geographic spread of the Enlarged Group.

In addition, the Merger is achieved without the Enlarged Group incurring any additional financial leverage, thereby reducing the operating risk of the group as well as retaining financial flexibility going forward.

3.1.2 Strategy for the Enlarged Group

The Enlarged Group will be uniquely positioned to provide its customers with outstanding holiday experiences and its shareholders with industry leading profitability.

Going forward, the key strategic focus of the Enlarged Group will be on:

- Integrating the businesses and delivering significant synergies;
- Strengthening the Mainstream tour operating model through continued operational improvements and quality product delivery;
- Growing its independent travel segment through an asset-light business model; and
- Extending the Enlarged Group's financial services offering, leveraging Leisure Tours' strengths in this area.

3.1.3 Synergy Benefits

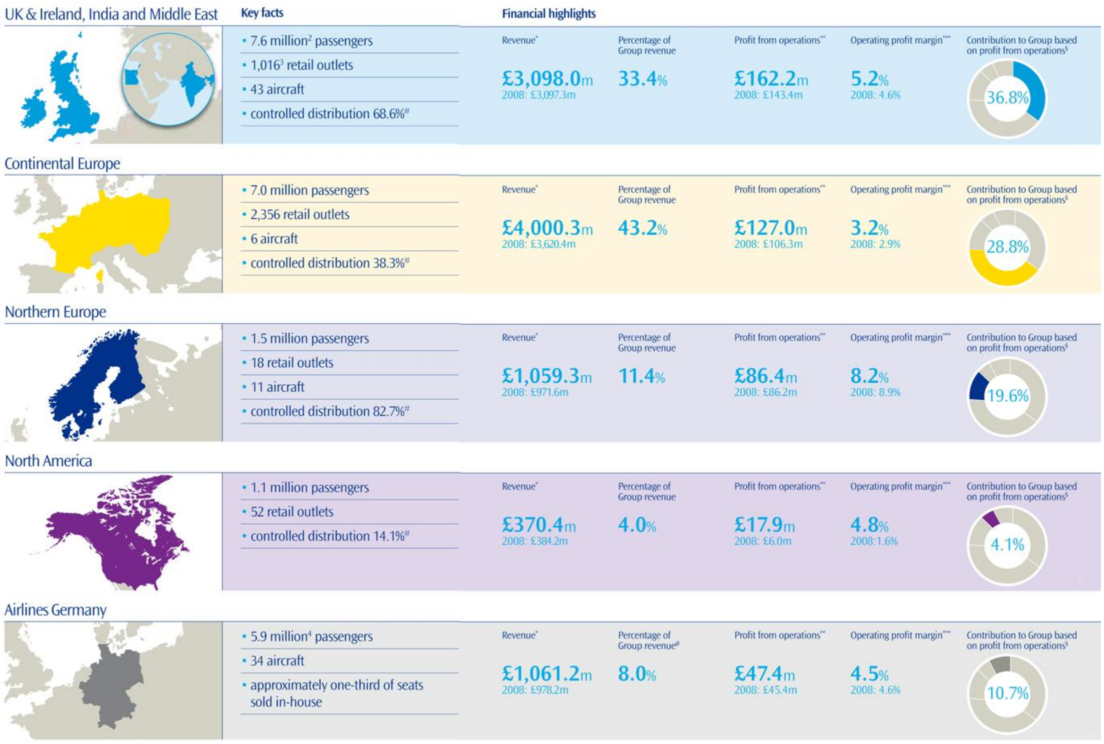
The boards of Monroe and Leisure Tours believe that the annualised pre-tax cost benefits arising from a combination of the businesses will be at least £75 million per annum once the full benefits of the Merger are realised. It is expected that the full synergies will be realised within 24-30 months of Completion.

The synergies are expected to be derived from the following key areas:

- Organisational consolidation;
- Cost reductions;
- Leveraging of economies of scale; and
- Realisation of operational efficiencies.

3.2 GROUP OVERVIEW 2009

Leisure Tours plc is one of the world's leading leisure travel groups with sales of £9.3 billion and 22.1 million customers. LT operates under five geographic segments in 21 countries, and is number one or number two in its core markets. The business is supported by 31,000 employees, a fleet of 95 aircraft and a network of over 3,400 owned and franchised travel stores.



Segment	Key facts	Revenue*	Percentage of Group revenue	Profit from operations**	Operating profit margin***	Contribution to Group based on profit from operations$
UK & Ireland, India and Middle East	• 7.6 million[2] passengers • 1,016[3] retail outlets • 43 aircraft • controlled distribution 68.6%#	£3,098.0m 2008: £3,097.3m	33.4%	£162.2m 2008: £143.4m	5.2% 2008: 4.6%	36.8%
Continental Europe	• 7.0 million passengers • 2,356 retail outlets • 6 aircraft • controlled distribution 38.3%#	£4,000.3m 2008: £3,620.4m	43.2%	£127.0m 2008: £106.3m	3.2% 2008: 2.9%	28.8%
Northern Europe	• 1.5 million passengers • 18 retail outlets • 11 aircraft • controlled distribution 82.7%#	£1,059.3m 2008: £971.6m	11.4%	£86.4m 2008: £86.2m	8.2% 2008: 8.9%	19.6%
North America	• 1.1 million passengers • 52 retail outlets • controlled distribution 14.1%#	£370.4m 2008: £384.2m	4.0%	£17.9m 2008: £6.0m	4.8% 2008:1.6%	4.1%
Airlines Germany	• 5.9 million[4] passengers • 34 aircraft • approximately one-third of seats sold in-house	£1,061.2m 2008: £978.2m	8.0% (Percentage of Group revenue@)	£47.4m 2008: £45.4m	4.5% 2008: 4.6%	10.7%

3.3 SEGMENTAL INFORMATION

For management purposes, the Group is currently organised into five geographic operating divisions: UK and Ireland, Continental Europe, Northern Europe, North America and Airlines Germany. These divisions are the basis on which the Group reports its primary segment information. Certain residual businesses and corporate functions are not allocated to these divisions and are shown separately as Corporate.

The primary business of all of these operating divisions is the provision of leisure travel services and, accordingly, no separate secondary segmental information is provided.

Segmental information for these activities is presented below:

Primary segments – management structure

Year ended 30 September 2009	UK and Ireland £m	Continental Europe £m	Northern Europe £m	North America £m	Airlines Germany £m	Corporate £m	Total £m
Revenue							
Segment sales	3,117.2	4,014.6	1,061.6	370.4	1,061.2	–	9,625.0
Inter-segment sales	(19.2)	(14.3)	(2.3)	–	(320.4)	–	(356.2)
Total revenue	3,098.0	4,000.3	1,059.3	370.4	740.8	–	9,268.8
Result							
Profit/(loss) from operations before exceptional items and amortisation of business combination intangibles	162.2	127.0	86.4	17.9	47.4	(26.0)	414.9
Exceptional items	(88.8)	(64.6)	(7.3)	(22.8)	(3.4)	(29.0)	(215.9)
Amortisation of business combination intangibles	(14.2)	(0.5)	(18.9)	(1.2)	–	–	(34.8)
Segment result	59.2	61.9	60.2	(6.1)	44.0	(55.0)	164.2
Share of results of associates and joint ventures							(3.8)
Loss on disposal of associate							(2.2)
Net investment income							1.4
Finance income							51.2
Finance costs							(154.7)
Profit before tax							56.1
Tax							(37.8)
Profit for the year							18.3
Other information							
Capital additions	63.4	22.8	10.3	5.0	63.1	33.4	198.0
Depreciation	47.7	11.1	9.2	1.0	74.8	1.4	145.2
Amortisation of intangible assets	24.3	5.3	19.5	2.0	0.3	5.8	57.2
Impairment of intangible assets	–	0.8	–	–	–	17.2	18.0

Balance sheet							
Assets							
Segment assets	3,833.0	1,869.3	1,659.2	318.8	876.9	3,763.3	12,320.5
Inter-segment eliminations							(5,761.2)
							6,559.3
Investments in associates and joint ventures							36.0
Tax and deferred tax assets							476.0
Total assets							7,071.3
Liabilities							
Segment liabilities	2,643.6	1,289.2	917.3	270.1	617.6	2,939.1	8,676.9
Inter-segment eliminations							(4,750.7)
							3,926.2
Tax and deferred tax liabilities							192.4
Borrowings and obligations under finance leases							1,225.5
Total liabilities							5,344.1

Inter-segment sales are charged at prevailing market prices.

Segment assets consist primarily of goodwill, other intangible assets, property, plant and equipment, trade and other receivables and cash and cash equivalents.

Segment liabilities comprise trade and other payables, revenue received in advance and provisions.

Capital additions comprise additions to property, plant and equipment and other intangible assets.

3.4 GROWTH DRIVERS

LT has identified four strategic objectives to drive growth:

3.4.1. Maximise value of Mainstream

Our core business remains our Mainstream business which is primarily the sale of charter packages where two or more components of travel such as flights, hotels, transfers and rep services are bundled together in advance and sold to customers through brochures and agents in stores, online through various websites or over the phone from our call centres. The charter package holiday remains very popular as customers appreciate the value for money it provides, the ease of choice and selection, and the security offered. However, in the longer term, growth is expected to be moderate in established economies. Our strategy, therefore, is to maximise the value of our mainstream business through cost efficiencies and through increasing the proportion of higher value products such as all inclusive board basis, four and five star properties and medium haul destinations. To this aim we will accelerate many of the activities started this year.

In mainstream travel, we are reorganising our purchasing and destination management activities into a more centralised structure to maximise the benefits of our size and scale, whilst retaining our local market expertise. We will also continue to grow the proportion of products sold online, making the most of the efficiencies offered by this distribution channel, as well as continuing to improve product and destination mix.

In our airlines business we have made a number of strategic developments. These in part were the result of our decision to retain our German airline, LT AG, as part of the Group. Given this decision, we have made significant progress in identifying synergies between our various airlines and have begun to deliver significant cost savings.

Performance Highlights 2009

Mainstream travel currently represents 74% of total revenue. Revenue increased 5% in the year with improved average selling prices and foreign exchange translation benefits being partly offset by capacity cuts. Margins were also helped by a strong focus on cost control.

3.4.2. Become a Leading Independent Travel Provider

Become a leading independent travel provider, where consumers build their own trip on their own or with the help of an agent, has gained in popularity boosted by greater online penetration and new technologies that allow consumers to create their own packages (dynamic packaging). This area of travel also includes scheduled tours where consumers either tailor-make their trips or buy pre-packaged itineraries. It also includes our wholesale business, where we operate as an intermediary between suppliers and other agents providing them with the ability to build holidays for their customers.

In independent travel we plan to make further changes and investment in our e-commerce capabilities so strengthen our position as an online travel agent, leveraging our brands, inventory, buying organisation and multi-channel model. We also continue to invest in our dynamic packaging capabilities and our independent product portfolio in general.

Independent travel will continue to grow helped by technology improvements and continued consumer demand. Our strategy is to take advantage of that growth, in particular the increase in on-line penetration. We plan to significantly grow both sales of our in-house inventory on-line and sales of third party products, performing the role of an online travel agent.

Performance Highlights 2009

Independent travel currently represents 23% of total revenue. Revenue increased 10% in the year as a result of continued investment in our dynamic packaging capabilities and products as well as improved online operations. Revenue growth was also achieved through expansion of our product offering and favourable foreign exchange translation.

3.4.3. Become a Leading Travel Related Financial Services Provider

Travel-related financial services broadly fall into the categories of travel money, which are products that help customers pay for goods and services whilst travelling such as pre-paid foreign exchange, travel assurance, which are products that cover the various risks associated with travel such as insurance for accidents and thefts; and travel finance which are products that allow customers to finance their travel such as credit cards. These are typically high margin products, and are naturally sold alongside other holiday components. Our strategy is to make the most of our brands and distribution capabilities to continue to grow this important part of our business.

In travel-related financial services we are looking both to maximise cross-sell opportunities and to grow our direct to consumer sales within existing markets. We are also planning to launch a number of innovative new products across the Group and are looking at opportunities to use the Leisure Tours brand to expand into new source markets.

Performance Highlights 2009

Financial services performance continued to be strong helped by share gain in the UK foreign exchange market, and continued initiatives to improve insurance cross-sell rates.

3.4.4. Capture Growth and Value Through M&A and Partnerships

To support our growth drivers, we are constantly open to opportunities to bolster our business through mergers, acquisitions or partnerships. As developed markets mature, we are focused on the one hand on ways to consolidate these markets and maximise the value from them, and on the other on the new growth areas of emerging markets, in particular, large fast growing markets such as India (where we are already a leading player), Russia, China and parts of South America. We are in advanced stages of discussions with both Russian and Chinese travel providers and aim to complete at least one of these early in 2010. In addition, we are always on the look out for smaller deals that enable us to maintain our competitive advantage.

Performance Highlights 2009

A number of acquisitions were completed, notably Gold Medal and Med Hotels in the UK, adding to our independent businesses. Progress was also made in evaluating opportunities in China and Russia.

3.5 TREASURY AND FINANCE

Prior to the merger the two components of Leisure Travel were quite different, LT being older, larger and more diversified.

The differences extend to the treasury functions in the two companies pre-merger. Edited extracts from related documents are reproduced below:

3.5.1 Leisure Tours AG

- **Financial Constitution**

The Financial Constitution defines the goals, principles, basic conditions as well as the tasks and responsibilities for the group-wide financial management within the Leisure Tours Group. The Financial Constitution is superior to all other financial guidelines and sets a framework for the financial management within the Leisure Tours Group. The purpose of this Financial Constitution is to ensure that all financial transactions are conducted according to the principles authorized by the management board of Leisure Tours AG.

- **Functional Financial Guidelines (FFG)**

The Functional Financial Guidelines outline the goals and principles laid down in the Financial Constitution in more detail. The tasks within financial management are governed by the Functional Financial Guidelines for:

- Cash Management
- Financial Risk Management
- Financial Risk Control
- Financing

- **FFG : Cash Management**

The main goal of Cash Management is to optimize the costs of short-term financing and the profits of short-term financial investments within the Leisure Tours Group. Cash Management is also responsible for liquidity planning up to one year, payment transactions, the concentration of liquid funds via Cash Pooling and the daily disposition. The investment of surplus / borrowing of liquid funds on the money market is executed by Financial Risk Management with the information provided by Cash Management.

- **FFG : Financial Risk Management (FRM)**

The main goal of Financial Risk Management is to control financial risks (e.g. Interest and FX Risks) and to minimize any negative impact on the Balance Sheet and the Profit and Loss Statement of Leisure Tours AG.

Deutsche Air manages the fuel hedging for Leisure Tours AG.

- **FFG : Financial Risk Control**

Financial Risk Controlling aims at measuring all financial risks and reporting them in an appropriate way. A comprehensive system of limits and lines should be developed, continuously monitored and updated.

Financial Risk Controlling should be separated from Risk Management in order to provide Risk Controlling with the opportunity to fulfil its monitoring role.

- **FFG : Financing**

Financing is the provision of sufficient funds for maintaining the business operations and for securing the future growth of the Leisure Tours Group at all times, eg:

- Management of banking relations (incl. negotiations of credit lines)
- Corporate Finance Activities
- Working Capital Management
- Risk (Asset and Liability) Management
- Planning and Financing of large investments (e.g. aircrafts, hotels)
- Medium- / Long-Term Financial Planning (exceeding a horizon of one year)
- Development of Financing Strategies
- Management of Loan- and other Guarantees
- Customer Protection Programmes

3.5.2 Monroe

- **Banking**

The Group policy is to maintain close banking relations with a selected number of banks in order to achieve equitable pricing, preferential service and sufficient access to funding. Strong emphasis is placed on relationships with banks providing a range of financing services to the Group and credit support for example BP are a key provider of both jet fuel and hedging.

- **Cash Management**

Monroe divisions operate a 3 stage procedure to cash flow forecasting, namely;

i) Short term
ii) Medium term
iii) Strategic Plan

All Subsidiaries must report their liquidity requirements on a weekly basis using the standard documentation. Completed forms must be submitted to Group Treasury by email by 11am on Monday morning.

- **Investment Management**

The overall objective of Group Treasury cash and investment policy is to maximise the yield on cash investments within the Board approved guidelines, (documented in the schedule) and to ensure that the maximum of cash is held by Group Treasury for investment or repayment of group debt as appropriate.

All subsidiaries must minimise cash held and all surplus funds should be placed with Group Treasury. Any exceptions for technical reasons or other operational reasons must be agreed in advance by Group Treasury.

Deposits will be made by the business units with Group Treasury at an agreed rate the term of which should reflect the subsidiaries cash flow requirements as forecast.

- **Borrowings**

No borrowings are permitted without the prior sign off from the Group Treasurer, Director of Corporate Finance, or the Group Finance Director, as the entering into of a borrowing, the provision of a letter of credit or guarantee may breach Group financial covenants or other conditions. Any borrowings with a maturity greater than 6 months requires the approval of the GFD.

Under no circumstances should assets be pledged or mortgaged, covenants be entered into or financial ratios agreed as part of any borrowing facilities, without the prior written agreement of the Group Treasurer. The Group Treasurer must inform the GFD and Director of Corporate Finance prior to agreement.

- **Foreign Exchange & Fuel Exposure**

Exposure management is broken down into:-

- Transaction Exposure - applicable for Foreign Exchange and Fuel
- Economic Exposure - applicable for Foreign Exchange and Fuel
- Translation Exposure - applicable for Foreign Exchange only

All transactional foreign exchange, fuel and interest rate exposure should be hedged as soon as the exposure becomes known; speculative hedging is strictly prohibited. Hedging must be in accordance with the Monroe Group Plc Treasury Hedging Policy.

- **Interest Rate Exposure Management**

Interest risk exposures are managed and undertaken solely by Group Treasury.

The objective is to minimise the risk to the Group's interest charge and investment income caused by movements in interest rates by seeking to manage the debt and cash portfolios with an appropriate mix of fixed and floating interest rates in the short, medium and long term.

- **Bonding & Guarantees (Including Letters Of Credit, Promissory Notes)**

All Bonding and Guarantee requirements must be sourced through Group Treasury (unless dispensation is given). (Bonding refers to the provision of bank guarantees to regulatory authorities and other bodies in order to retain licences or membership from these bodies or to comply with local laws.)

Promissory Notes which are not to be discounted i.e. not incurring a cost may be issued by subsidiaries upon agreement with Group Treasury. Promissory Notes may be issued and discounted by beneficiaries at their cost. All Promissory Notes which are to be discounted at a cost to the subsidiary must be sourced through Group Treasury.

3.5.3 Detail of FX Hedging

To exemplify the policies of each party prior to the merger, some detail about FX hedging is reproduced below.

3.5.3.1. Leisure Tours AG FX Management

For the adequate presentation of its inherent risks the foreign currency position of Leisure Tours Group is divided into the following portfolios:

- Operational Business - Tour Operator
  - Carrier
  - FX-Exchange

- Investments and Special Transactions
- Strategic Hedging
- Active Management

Portfolio “Tour Operator”

The portfolio "Tour Operator" relates to the active management of foreign currency risks which derive from the ongoing catalogue-business of the tour operator division. The foreign currency positions are generally "short", meaning foreign currencies have to be acquired to pay invoices.

Portfolio "Carrier"

The portfolio "Carrier" manages among others those foreign currency risks which derive form the procurement of fuel per planning period. Hedging of the foreign currency demands is performed exclusively by Financial Risk Management (FRM).

Portfolio “Currency Exchange”

Leisure Tours Group is also in the business of currency exchange and offers its customers the exchange of currencies, Traveller Cheques and Traveller Cards.

Portfolio "Investments and Special Transactions"

Foreign exchange risks resulting from individual contracts are allocated to the portfolio "Investments and Special Transactions". These contracts differ in structure, maturity and amount from the ongoing day-to-day business, which is managed in the portfolios "Tour Operator" and "Carrier". The portfolio includes i.e. foreign exchange risks resulting from financing airplanes and hotels.

Portfolio “Strategic Hedging”

Strategic hedging constitutes a special kind of hedging methodology and is exclusively applied when special circumstances arise (i.e. historically low market prices).

A strategic hedge has to be authorized by the CFO, acting upon a proposal by Financial Risk Management (FRM). The design of the strategic hedge has to take into account its effects on the other portfolios.

The authorization for the execution of strategic hedges is limited to FRM.

Portfolio “Active Management”

To take advantage of market situations and to manage opportunity risks it may be necessary to deviate to a certain degree from the regular hedging strategies described above. These deviations are called active management.

Active management is performed exclusively by FRM.

Foreign exchange transactions destined for the portfolio "Active Management" have to be clearly labelled as such at the conclusion of the transaction. A rededication of transactions executed as part of Active Management to other portfolios is not permissible.

3.5.3.2. Monroe FX and Fuel Hedging Policy

Purpose

The Group Hedging Policy is designed to accommodate the commercial requirements of the business and ensure that there is minimal exposure to fluctuating exchange rates and adverse price movements in physical jet fuel markets once budget rates have been agreed.

The Group operates a rolling 12-18 month hedging programme for both fuel and foreign exchange, which results in a target level of hedging being in place 6 months prior to the commencement of the relevant season.

The *budget cycle* for winter commences in February/March, and ends in May/June, at which point Summer commences, ending in September/October.

Commercial/Geographical considerations

These vary between the divisions, but approximate to the *budget cycle*.

- Monroe (Northern Europe) look to achieve certainty over hedge rates and hence budget costs per the detailed hedger timetable below. The objective of this re timetabling is to align the cost to the business (through exchange rate fixing) with that of brochure pricing.

- Monroe (North America). The North America timeline lags that of both the UK and Northern Europe, hence the hedge process commences up to 10 months in advance of the season.

- Monroe (UK). Brochure pricing and sales commence up to 18 months in advance of the season start accumulating at 7.5% of total exposure per month up to a period of 6 months in advance of the season.

3.6 DEBT AND LEASING

3.6.1 Borrowings

21. Borrowings

	2009 £m	2008 £m
Short-term borrowings		
Unsecured bank loans and other borrowings	401.8	198.8
Unsecured bank overdrafts	43.2	13.8
	445.0	212.6
Current portion of long-term borrowings	174.1	143.4
	619.1	356.0
Long-term borrowings		
Bank loans – repayable within one year	174.1	143.4
– repayable between one and five years	305.4	399.1
– repayable after five years	15.5	17.0
	495.0	559.5
Less: amounts due for settlement within one year shown under current liabilities	(174.1)	(143.4)
Amount due for settlement after one year	320.9	416.1

Borrowings by class

	2009		2008	
	Current £m	Non-current £m	Current £m	Non-current £m
Group committed credit facility	498.6	227.9	218.1	338.4
Aircraft related bank loans	55.3	37.8	69.9	43.8
Other bank borrowings	65.2	55.2	68.0	33.9
	619.1	320.9	356.0	416.1

In May 2008, the Group entered into a €1.8bn committed facility maturing in May 2011. The facility comprises term loan, revolving credit and bonding facilities. €320m of the revolving credit facilities were originally made available for the Group in respect of the proposed transaction between LT Germany and Air Berlin. During the year, the Group entered into an agreement with its lenders to change the designation of this portion of the facility to enable it to be used to meet the aircraft refinancing needs of the Group. This re-designation became effective on 1 October 2009 and the facilities were fully available to the group from this date.

Amounts are repayable under the term loan facility at fixed intervals with a final bullet payment at maturity. As at 30 September 2009, the Group had repaid a total of €75m of term loans.

The Directors consider that the fair value of the Group's borrowings with a carrying value of £940.0m is £943.9m (2008 : carrying value £772.1m; fair value £770.0m). The fair values quoted were determined on the basis of the interest rates for the corresponding terms to maturity or repayment as at the period end. For items maturing in less than one year, the Directors feel that the fair value is equal to the carrying amount.

Borrowing facilities
As at 30 September 2009, the Group had undrawn committed debt, guarantee and bonding facilities of £463.2m 2008 : £558.7m).

3.6.2 Obligations under Finance Leases

	Minimum lease payments 2009 £m	Minimum lease payments 2008 £m	Present value of minimum lease payments 2009 £m	Present value of minimum lease payments 2008 £m
Amounts payable under finance leases:				
Within one year	**246.7**	197.7	**237.8**	182.6
Between one and five years	**37.1**	229.1	**33.0**	215.1
After five years	**23.7**	22.6	**14.7**	13.2
	307.5	449.4	**285.5**	410.9
Less: future finance charges	**(22.0)**	(38.5)	**–**	–
Present value of lease obligations	**285.5**	410.9	**285.5**	410.9
Less: amount due for settlement within 12 months (shown under current liabilities)			**(237.8)**	(182.6)
Amount due for settlement after 12 months			**47.7**	228.3

3.6.3 Operating Leases

The Group as lessee

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	Property and other 2009 £m	Aircraft and aircraft spares 2009 £m	Total 2009 £m	Property and other 2008 £m	Aircraft and aircraft spares 2008 £m	Total 2008 £m
Within one year	**111.8**	**128.4**	**240.2**	98.1	117.3	215.4
Later than one and less than five years	**290.4**	**267.2**	**557.6**	276.2	302.3	578.5
After five years	**153.4**	**10.7**	**164.1**	185.0	31.5	216.5
	555.6	**406.3**	**961.9**	559.3	451.1	1,010.4

3.6.4 The Currency

The currency analysis of amounts payable under finance leases is:

	2009 £m	2008 £m
Euro	**193.4**	302.5
US dollar	**92.0**	108.4
Indian rupee	**0.1**	–
	285.5	410.9

Finance leases principally relate to aircraft and aircraft spares.

No arrangements have been entered into for contingent rental payments.

The Directors consider that the fair value of the Group's finance lease obligations with a carrying value of £285.5m was £294.5m at 30 September 2009 (2008: carrying value £410.9m; fair value £409.1m). The fair values quoted were determined on the basis of the interest rates for the corresponding terms to repayment as at the period end.

The Group's obligations under finance leases are secured by the lessors' rights over the leased assets.

4.0 FINANCIALS

- Income Statement
- Balance Sheet
- UK-Style Cash Flow Statement
- Share Price Data & Equity Analysis
- Cash Flow Analysis
- Financial Profile

Equity Analysis Model
Leisure Tours plc
Income Statement

		Historical Data			
	Accounts date	30/09/7	30/09/8	30/09/9	30/09/10
	Currency / units	£mill	£mill	£mill	£mill
	Audit / man / fcst	audited	audited	audited	broker est
	Number of months	12	12	12	12
	Sales Revenue	**6,404.5**	**8,848.9**	**9,268.8**	**9,538.0**
a	(Cost of Sales)	(4,879.1)	(6,807.2)	(7,076.5)	(7,327.0)
a	**Gross Profit**	**1,525.4**	**2,041.7**	**2,192.3**	**2,211.0**
a	(Total Overheads)	(480.3)	(526.0)	(519.1)	(520.0)
a	Other Operating (Costs) & Revenues	37.8			
a	Exceptionals etc. +/-	-			
b	Cost of Materials, Other External Purchases	-			
b	**Value Added**				
b	(Personnel Costs)	(670.7)	(977.8)	(1,086.8)	(1,100.0)
b	(Depreciation & Impairment of Tangible Assets)	(89.3)	(122.2)	(145.2)	(146.0)
b	(Amortisation of Intangibles excl. Goodwill)	(14.0)	(17.5)	(22.4)	(13.0)
b	(R&D Costs)	-	-		
b	Other Operating (Costs) & Revenues	-	-		
b	Exceptionals etc. +/-	(127.0)	(195.9)	(215.9)	(100.0)
	Operating Profit	**181.9**	**202.4**	**202.9**	**332.0**
	Non-operating Income & Expenditure	-			
	Exceptionals etc.	35.5	(1.9)	(6.1)	
	(Amortisation of Goodwill)	(30.1)	(53.6)	(34.8)	
	Financial Income				
	Income from Investments, Participations etc	1.8	(1.7)	(3.8)	-
	Other Financial Income & Expenditure	1.7	0.5	1.4	
	EBIT	**190.8**	**145.7**	**159.6**	**332.0**
	Interest Received & Paid				
	Interest Received	74.1	74.6	51.2	
	(Gross Interest Paid)	(74.7)	(167.6)	(154.7)	(102.0)
	Profit before Tax	**190.2**	**52.8**	**56.1**	**230.0**
	(Current tax)	(39.5)	(5.2)	(37.8)	(62.0)
	(Deferred tax)	-			
	Profit after Tax	**150.7**	**47.6**	**18.3**	**168.0**
	Extraordinaries, (amortisation of goodwill) etc	-			
	Minority Interests	(0.9)	0.34	(2.5)	(3.0)
	(Preference Dividends)	-			
	Net Income / Earnings for Ordinary Shareholders	**149.8**	**47.90**	**15.8**	**165.0**
	(Ordinary Dividends)	(48.8)	(85.2)	(91.7)	(98.6)
	Retained Profit for Year	**101.0**	**(37.3)**	**(75.9)**	**66.4**

EBITA (before exceptionals & Goodwill Amort.)	**312**	**397**	**416**	**432**
EBITDA (before Exceps. Deprn, & all Amortisn.)	**416**	**537**	**584**	**591**
Cash Earnings (Before Goodwill, Exceps.& Extraords)	**271**	**299**	**273**	**265**
Cash Retained Profit (Before Goodwill, Exceps & Extraords)	**223**	**214**	**181**	**166**

Equity Analysis Model
Leisure Tours plc
Balance Sheet

	Historical Data			
Accounts date	30/09/7	30/09/8	30/09/9	30/09/10
Currency / units	£mill	£mill	£mill	£mill
ASSETS				
Fixed Assets				
Intangible Fixed Assets	2,883.5	3,438.1	3,775.1	3,775.1
Property, Land & Buildings - net	197.7	238.4	261.2	261.2
Other Fixed Assets - net	637.6	674.4	732.2	733.8
Financial Investments, Tax & Pension Assets & Derivatives	381.6	466.0	498.6	473.0
Medium-term Trade-related Assets	98.8	126.4	113.8	
Total Fixed Assets	**4,199.2**	**4,943.3**	**5,380.9**	**5,243.1**
Current Assets				
Stocks, Inventories, Work in Progress	19.1	24.2	27.0	27.0
Debtors, Prepayments, Receivables etc.	864.4	1,016.0	931.6	931.6
Cash and Short-term Investments	622.3	761.3	550.2	550.2
Tax Assets, Derivatives & Other Current Assets	112.4	276.7	181.6	
Total Current Assets	**1,618.2**	**2,078.2**	**1,690.4**	**1,508.8**
Total Assets	**5,817.4**	**7,021.5**	**7,071.3**	**6,751.9**
LIABILITIES				
Current Liabilities (Creditors < 1 Year)				
Creditors, Accruals, Advance Payments etc.	2,100.6	2,773.5	2,766.5	2,987.6
Short-term Debt	133.1	538.6	856.9	673.0
Corporation Tax Payable	76.2	69.4	80.9	
Provisions, Derivatives & Other Current Liabilities	312.2	368.3	462.0	459.0
Total Current Liabilities	**2,622.1**	**3,749.8**	**4,166.3**	**4,119.6**
Non-current Liabilities (Creditors > 1 Year)				
Medium & Long-term Debt	489.6	644.4	368.6	550.2
Medium-term Trade-related Liabilities	124.5	37.0	18.3	
Deferred Tax, Pension & Other Long-term Provisions	460.6	577.9	790.9	350.1
Total Non-current Liabilities	**1,074.7**	**1,259.3**	**1,177.8**	**900.3**
Share Capital & Reserves				
Issued Share Capital	66.1	59.8	57.7	
Share Premium Account / Paid-in Surplus / Tresury Shares	6.8	8.9	8.9	
Revaluation Reserve				
Other Reserves	1,995.2	2,192.4	2,115.7	
Retained Earnings / Profit and Loss	44.2	(261.4)	(474.0)	
Total Capital and Reserves	**2,112.3**	**1,999.7**	**1,708.3**	**1,712.0**
Minority Interests	8.3	12.7	18.9	20.0
Total Shareholders' Funds	**2,120.6**	**2,012.4**	**1,727.2**	**1,732.0**
	-			
Accumulated depreciation	252	301	344	344

Equity Analysis Model

Leisure Tours plc

UK-Style Cash Flow Statement

	Historical Data			
Accounts date	30/09/7	30/09/8	30/09/9	30/09/10
Currency / units	£mill	£mill	£mill	£mill
Number of months	12	12	12	12
CASH FLOW FROM OPERATING ACTIVITIES				
Operating Profit	181.9	202.4	202.9	332.0
Tangible Asset Depreciation	89.3	122.2	145.2	146.0
Dec(Inc) in Stock / Inventories	(2.7)	(4.7)	(1.1)	
Dec(Inc) in Debtors / Receivables	84.0	(121.6)	110.0	
Inc(Dec) in Creditors / Payables & Advance Payments	(239.9)	245.8	(263.3)	(10.0)
All other non-cash adjustments & Exceptionals	77.8	3.9	11.0	22.0
Cash Generated from Operations	**190.4**	**447.9**	**204.7**	**490.0**
Dividends Received from Associates	-			
Tax Paid	(29.8)	(63.7)	(26.6)	(46.0)
Net Cash from Operating Activities	**160.6**	**384.2**	**178.1**	**444.0**
CASH FLOW FROM INVESTING ACTIVITIES	-			
Dividends Received from Investments	-			
Interest Received	-			
(Purchase of Tangible Fixed Assets)	(24.7)	(82.2)	(131.0)	(160.0)
Disposal of Tangible Fixed Assets	53.3	13.2	12.3	
(Purchase of Subsidiaries, Intangibles & Financial Assets)				
Disposal of Subsidiaries, Intangibles & Financial Assets	5.6	(222.5)	(11.3)	(100.0)
Net Cash from Investing Activities	**34.2**	**(291.5)**	**(130.0)**	**(260.0)**
CASH FLOW FROM FINANCING ACTIVITIES	-			
(Total Interest Paid)	(32.1)	(55.2)	(102.6)	(88.0)
New Shares Issued	(5.0)	2.2		
(Repurchase / Redemption of Shares)	(5.0)	(247.8)	(47.1)	
(Costs of Issuing / Redeeming Equity)				
Total Increase in Debt		732.3	181.9	
(Total Decrease in Debt)	(61.5)	(340.0)	(303.3)	(3.0)
(Dividends Paid on Ordinary Shares)		(78.2)	(87.4)	(93.0)
(Preference and Minority Dividends Paid)		(1.9)		
Movements Relating to Derivative Instruments				
Net Cash from Financing Activities	**(103.6)**	**11.4**	**(358.5)**	**(184.0)**
Net Cash Flow from Ops. Investing & Funding	91.2	104.1	(310.4)	-
Change in Cash	-	139.0	(211.1)	-
Change in Overdraft	91.2	(34.9)	(99.3)	-

Equity Analysis Model
Leisure Tours plc

Share Price Data

	Historical Data			
Accounts date	**30/09/7**	**30/09/8**	**30/09/9**	**30/09/10**
Currency / units	**£mill**	**£mill**	**£mill**	**£mill**
Number of Shares & Eps				
Adjusted Earnings per Share (pence or equivalent)	22.00	4.60	1.90	19.19
Dividends Per Share (pence or equivalent)	5.00	9.75	10.75	11.55
Average number of common shares	681.1	947.6	853.7	853.7
Average number of preference shares				
Share Prices				
Common Share Price - Low (pounds or equivalent)	1.75	1.71	1.24	1.91
Common Share Price - High (pounds or equivalent)	3.28	3.10	3.04	2.77
Common Share Price - Average	2.51	2.40	2.14	2.34
Preference Share Price - Low (pounds or equivalent)				
Preference Share Price - High (pounds or equivalent)				
Preference Share Price - Average				
Risk rating				
Variability %	78	52	44	46
Beta (actual or estimate)	1.12	0.93	0.92	0.96
Assumed Market Risk premium	**4.50**	**4.50**	**4.50**	**4.50**
Actual / Assumed 10-year Gilt Yield	**5.01**	**4.00**	**3.50**	**3.50**
10-year Gilt spread over LIBOR	**(0.66)**	**(1.92)**	**1.30**	**2.71**
EV Calculation				
Market Capitalisation - Common Stock	1,711	2,278	1,823	1,999
Market Capitalisation - Preference Stock	-	-	-	-
Market Capitalisation - Total	1,711	2,278	1,823	1,999
Minorities	8	13	19	20
Net Debt	0	422	675	673
Enterprise value [EV]	**1,720**	**2,712**	**2,517**	**2,692**

Equity Analysis

Equity Ratios				
Eps Growth %		(79.1%)	(58.7%)	910.0%
P/E Ratio	11.4	52.3	112.4	12.2
Market / Book Ratio	0.81	1.14	1.07	1.17
Dividend Cover	4.40	0.47	0.18	1.66
Dividend Yield %	2.0%	4.1%	5.0%	4.9%
Total Return to Shareholders %		(0.3%)	(6.1%)	14.6%
EV Valuation Multiples				
EV / Sales	0.27	0.31	0.27	0.28
EV / Total Assets	0.30	0.39	0.36	0.40
EV / EBITA	5.51	6.83	6.05	6.23
EV / EBITDA	4.14	5.05	4.31	4.56
EV / Staff Costs	2.6	2.8	2.3	2.4

Equity Analysis Model
Leisure Tours plc
Cash Flow Analysis

	Historical Data				
Accounts date	**30/09/7**	**30/09/8**	**30/09/9**	**30/09/10**	**Period**
Currency / units	**£mill**	**£mill**	**£mill**	**£mill**	**Total**
Cash Flow Summary	**audited**	**audited**	**audited**	**broker est**	
Number of months	**12**	**12**	**12**	**12**	
CASH FLOW FROM OPERATIONS					
Operating Profit	182	202	203	332	919
Other Non-cash & Exceptional Items	78	4	11	22	115
Investment Income					
"Cash Profit"	**260**	**206**	**214**	**354**	**1,034**
(Increase) / Decrease in Net Working Assets	(159)	120	(154)	(10)	(204)
Tangible Asset Depreciation	89	122	145	146	503
Net Capital Expenditure	29	(69)	(119)	(160)	(319)
(Tax Paid	(30)	(64)	(27)	(46)	(166)
(Dividends Paid)		(80)	(87)	(93)	(261)
Free Cash Flow before Interest	**189**	**235**	**(28)**	**191**	**587**
(Net Interest Paid)	(32)	(55)	(103)	(88)	(278)
Internal Cash Flow	**157**	**180**	**(131)**	**103**	**309**
ACQUISITION & FINANCING CASH FLOWS					
(Acquisitions),Disposals,(Investments)	6	(223)	(11)	(100)	(328)
Increase / (Decrease) in Share Capital	(10)	(246)	(47)		(303)
Increase / (Decrease) in Debt	(153)	427	(22)	(3)	249
(Increase) / Decrease in Cash		(139)	211		72
Net Financing Cash Flow	**(157)**	**(180)**	**131**	**(103)**	**(309)**

Equity Analysis Model
Leisure Tours plc

Financial Profile

	Historical Data			
Accounts date	30/09/7	30/09/8	30/09/9	30/09/10
Number of months	*12*	*12*	*12*	*12*
Annual % Growth Rates				
Sales Growth		38.2%	4.7%	2.9%
Operating Profit Growth		11.2%	0.3%	63.6%
Net Income / Earnings Growth (pre Goodwill)		10.3%	(8.9%)	(2.8%)
Profitability and Cost Structure				
Gross Profit % Sales	23.8%	23.1%	23.7%	23.2%
Overheads % Sales	7.5%	5.9%	5.6%	5.5%
Operating Profit % Sales	2.8%	2.3%	2.2%	3.5%
Personnel Costs % Sales	10.5%	11.0%	11.7%	11.5%
Depreciation % Sales	1.4%	1.4%	1.6%	1.5%
R&D Costs% Sales				
EBITA % Capital Employed (pre-exceptionals)	14.7%	16.3%	17.3%	18.0%
Pre-tax Target Rate of Return (market values)	14.3%	11.4%	9.5%	9.1%
EBITA % Market Enterprise Value	18.2%	14.6%	16.5%	16.0%
Asset Utilisation / Capital Intensity				
Sales / Total Assets	1.10	1.26	1.31	1.41
Stocks % Sales	0.3%	0.3%	0.3%	0.3%
Debtors % Sales	15.0%	12.9%	11.3%	9.8%
Creditors & Advance Payments % Sales	34.7%	31.8%	30.0%	31.3%
Net Working Assets % Sales	(19.4%)	(18.6%)	(18.5%)	(21.3%)
Tangible Fixed Assets % Sales	13%	10%	11%	10%
Depreciable Assets % Sales	10%	8%	8%	8%
Net Capex % Annual Depreciation	(32%)	56%	82%	110%
Average Age of Depreciable Assets (years)	2.82	2.46	2.37	2.36
Tax Ratios				
Effective Interest Rate [P&L] %	12.0%	18.6%	12.8%	8.3%
Effective Tax Rate [P&L] %	20.8%	9.9%	67.4%	27.0%
Cash Tax Rate [Cash Flow] %	15.7%	120.6%	47.4%	20.0%

5.0 MISCELLANEOUS ACCOUNTING INFORMATION & NOTES

- Group Statement of Recognised Income and Expense
- Detail of Non-Current Assets and Liabilities
- Note on Intangible Assets
- Note on Property, Plant & Equipment
- Note on Deferred Tax Assets & Liabilities

Group Statement of Recognised Income and Expense

For the year ended 30 September 2009

	notes	Year ended 30 September 2009 £m	11 months ended 30 September 2008 Restated £m
(Losses)/ gains on cash flow hedges	31	**(213.7)**	281.4
Losses on available-for-sale investments	31	**(1.1)**	(0.9)
Exchange differences on translation of foreign operations	31	**86.4**	121.6
Actuarial losses on defined benefit pension schemes	37	**(170.1)**	(16.3)
Movement in asset cap on defined benefit pension schemes	37	**0.7**	–
Tax on items taken directly to equity	10	**113.3**	(74.5)
Net (expense)/income recognised directly in equity		**(184.5)**	311.3
Transfers			
Transferred to profit or loss on cash flow hedges	31	**(24.6)**	(177.8)
Transfer of translation losses to profit or loss on disposal	31	**4.5**	–
Tax on items transferred from equity	10	**7.0**	53.3
		(13.1)	(124.5)
Profit for the period		**18.3**	43.6
Total recognised (expense)/income for the period	29	**(179.3)**	230.4
Attributable to:			
Equity holders of the parent	29	**(181.8)**	230.7
Minority interests	29	**2.5**	(0.3)
		(179.3)	230.4

Detail of Non-Current Assets and Liabilities

At 30 September 2009

	notes	30 September 2009 £m	30 September 2008 Restated £m
Non-current assets			
Intangible assets	13	**3,775.1**	3,438.1
Property, plant and equipment – aircraft and aircraft spares	14	**628.3**	584.8
– investment property	14	**18.0**	15.7
– other	14	**347.1**	312.3
Investments in associates and joint ventures	15	**36.0**	42.7
Other investments	15	**20.3**	29.4
Deferred tax assets	26	**431.8**	328.0
Tax assets		**5.6**	9.9
Trade and other receivables	18	**113.8**	126.4
Pension assets	37	**–**	0.4
Derivative financial instruments	23	**4.9**	55.6
		5,380.9	4,943.3

	notes	30 September 2009 £m	30 September 2008 Restated £m
Non-current liabilities			
Retirement benefit obligations	37	**(366.3)**	(181.6)
Trade and other payables	20	**(17.1)**	(36.1)
Long-term borrowings	21	**(320.9)**	(416.1)
Obligations under finance leases	22	**(47.7)**	(228.3)
Revenue received in advance		**(1.2)**	(0.9)
Deferred tax liabilities	26	**(111.5)**	(99.3)
Long-term provisions	27	**(294.3)**	(234.1)
Derivative financial instruments	23	**(18.8)**	(66.9)
		(1,177.8)	(1,263.3)
Total liabilities		**(5,344.1)**	(5,013.1)
Net assets		**1,727.2**	2,008.4
Equity			
Called-up share capital	29/30	**57.7**	59.8
Share premium account	29	**8.9**	8.9
Merger reserve	29	**1,984.2**	1,984.2
Hedging and translation reserves	29/31	**136.1**	214.8
Capital redemption reserve	29	**8.5**	6.4
Retained earnings deficit	29	**(474.0)**	(265.4)
Investment in own shares	29	**(13.1)**	(13.0)
Equity attributable to equity holders of the parent		**1,708.3**	1,995.7
Minority interests	29	**18.9**	12.7
Total equity	29	**1,727.2**	2,008.4

These financial statements were approved by the Board of Directors on 29 November 2009.

Signed on behalf of the Board

Note on Intangible Assets

Intangible assets

	2009 £m	2008 restated £m
Goodwill	**3,187.9**	2,931.5
Business combination intangible assets	**409.3**	372.7
Other	**177.9**	133.9
	3,775.1	3,438.1

Goodwill

Cost	£m
At 1 November 2007	2,569.4
Additions (restated)	302.3
Exchange differences	161.1
At 30 September 2008	3,032.8
Additions (note 16)	48.0
Exchange differences	224.4
At 30 September 2009	**3,305.2**
Accumulated impairment losses	
At 1 November 2007	88.0
Exchange differences	13.3
At 30 September 2008	101.3
Exchange differences	16.0
At 30 September 2009	**117.3**
Carrying amount	
At 30 September 2009	**3,187.9**
At 30 September 2008	**2,931.5**

	Brands and customer relationships £m	Order backlog £m	Computer software £m	Other £m	Total £m
Cost					
At 1 November 2007	304.8	34.0	12.5	–	351.3
Additions (restated)	83.2	3.5	–	3.3	90.0
Exchange differences	13.4	3.0	0.9	(0.2)	17.1
At 30 September 2008	401.4	40.5	13.4	3.1	458.4
Additions (note 16)	47.4	0.2	–	–	47.6
Disposal of subsidiaries	(2.4)	–	–	–	(2.4)
Exchange differences	29.1	0.4	1.4	–	30.9
At 30 September 2009	**475.5**	**41.1**	**14.8**	**3.1**	**534.5**
Amortisation					
At 1 November 2007	9.5	19.6	1.0	–	30.1
Charge for the period (restated)	28.6	17.4	3.1	–	49.1
Impairment losses	3.5	–	–	–	3.5
Exchange differences	0.6	2.3	0.1	–	3.0
At 30 September 2008	42.2	39.3	4.2	–	85.7
Charge for the year	30.0	1.4	3.4	–	34.8
Exchange differences	3.7	0.3	0.7	–	4.7
At 30 September 2009	**75.9**	**41.0**	**8.3**	**–**	**125.2**
Carrying amount					
At 30 September 2009	**399.6**	**0.1**	**6.5**	**3.1**	**409.3**
At 30 September 2008	359.2	1.2	9.2	3.1	372.7

Intangible assets continued

Other intangible assets

	Concessions and computer software		Other	
	Purchased £m	Internally generated £m	Purchased £m	Total £m
Cost				
At 1 November 2007	164.2	29.9	0.6	194.7
Additions	44.8	15.4	–	60.2
Acquisitions (restated)	7.1	1.1	0.1	8.3
Exchange differences	15.7	4.1	–	19.8
Reclassification	(54.8)	54.8	–	–
Disposals	(1.4)	(3.5)	–	(4.9)
At 30 September 2008	175.6	101.8	0.7	278.1
Additions	36.1	30.2	2.2	68.5
Acquisitions (note 16)	–	0.5	3.8	4.3
Exchange differences	27.6	6.6	0.3	34.5
Disposals	(0.9)	(5.0)	–	(5.9)
At 30 September 2009	**238.4**	**134.1**	**7.0**	**379.5**
Amortisation				
At 1 November 2007	97.0	16.7	0.1	113.8
Charge for the period	6.9	10.0	0.4	17.3
Impairment losses	1.0	1.0	–	2.0
Exchange differences	10.9	2.6	–	13.5
Transfer from non-current assets held for sale	(36.3)	36.3	–	–
Disposals	(0.9)	(1.5)	–	(2.4)
At 30 September 2008	78.6	65.1	0.5	144.2
Charge for the year	7.4	13.4	1.6	22.4
Impairment losses	18.0	–	–	18.0
Exchange differences	14.9	3.7	–	18.6
Disposals	(0.4)	(1.2)	–	(1.6)
At 30 September 2009	**118.5**	**81.0**	**2.1**	**201.6**
Carrying amount				
At 30 September 2009	**119.9**	**53.1**	**4.9**	**177.9**
At 30 September 2008	97.0	36.7	0.2	133.9

Note on Property, Plant & Equipment

. Property, plant and equipment

	Aircraft and aircraft spares £m	Investment property £m	Other property, plant and equipment: Freehold land and buildings £m	Short leaseholds £m	Other fixed assets £m	Total £m
Cost						
At 1 November 2007	1,247.1	–	187.3	130.5	202.5	520.3
Additions	42.2	–	1.0	10.0	29.9	40.9
Acquisitions (restated)	–	–	4.1	1.3	8.3	13.7
Exchange differences	165.7	1.6	25.4	7.4	23.9	56.7
Transfer from non-current assets held for sale	–	14.1	–	–	–	–
Reclassification	8.8	–	(4.5)	35.0	(39.3)	(8.8)
Disposals	(22.1)	–	(0.1)	(12.1)	(7.4)	(19.6)
At 30 September 2008	1,441.7	15.7	213.2	172.1	217.9	603.2
Additions	86.5	–	0.9	14.8	27.3	43.0
Acquisitions (note 16)	–	–	–	0.5	1.4	1.9
Exchange differences	194.1	2.3	31.2	11.7	35.9	78.8
Disposals	(8.9)	–	(1.5)	(12.1)	(21.8)	(35.4)
At 30 September 2009	**1,713.4**	**18.0**	**243.8**	**187.0**	**260.7**	**691.5**
Accumulated depreciation and impairment						
At 1 November 2007	680.0	–	44.7	75.4	132.0	252.1
Charge for the period	78.8	–	5.9	8.8	17.2	31.9
Provision for impairment	–	–	–	–	1.3	1.3
Exchange differences	105.0	–	7.5	3.1	17.4	28.0
Reclassification	7.1	–	(3.3)	30.1	(33.9)	(7.1)
Disposals	(14.0)	–	–	(9.6)	(5.7)	(15.3)
At 30 September 2008	856.9	–	54.8	107.8	128.3	290.9
Charge for the year	105.1	–	7.2	11.1	21.8	40.1
Exchange differences	129.4	–	10.0	7.6	24.9	42.5
Disposals	(6.3)	–	(1.0)	(9.9)	(18.2)	(29.1)
At 30 September 2009	**1,085.1**	**–**	**71.0**	**116.6**	**156.8**	**344.4**
Carrying amount						
At 30 September 2009	**628.3**	**18.0**	**172.8**	**70.4**	**103.9**	**347.1**
At 30 September 2008	584.8	15.7	158.4	64.3	89.6	312.3

Freehold land with a cost of £38.7m (2008: £34.7m) has not been depreciated.

The cost of property, plant and equipment stated above does not include capitalised interest.

The net book value of aircraft and aircraft spares includes £170.5m (2008: £267.3m) in respect of assets held under finance leases.

The net book value of other property, plant and equipment includes £15.8m (2008: £13.0m) in respect of assets held under finance lease.

Capital commitments	**2009 £m**	2008 £m
Capital expenditure contracted but not provided for in the accounts	**127.8**	53.4

The 2009 capital commitments include £60.7m in relation to two aircraft that are currently held under operating leases which will come on balance sheet during 2010.

Note on Deferred Tax Assets & Liabilities

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances for financial reporting purposes:

	2009 £m	2008 £m
Deferred tax liabilities	(111.5)	(99.3)
Deferred tax assets	431.8	328.0
	320.3	228.7

At the balance sheet date, the Group had unused tax losses of £1,441.0m (2008: £1,327.9m) available for offset against future profits. Deferred tax assets have only been recognised where there is sufficient probability that there will be future taxable profits against which the assets may be recovered. The increase in recognised tax losses in the period relates to non-recurring exceptional costs. The UK and German businesses generated taxable profits before exceptional items which support the recognition of losses in these territories. No deferred tax asset has been recognised in respect of tax losses of £679.9m (2008: £531.0m) due to the unpredictability of future profit streams.

Other temporary differences on which deferred tax has been provided, primarily relate to the difference in book to tax value on qualifying tax assets, provisions for which tax relief was not originally available and fair value accounting on properties acquired as part of the merger. In addition, the Group had unused other short term timing differences in respect of which no deferred tax asset has been recognised amounting to £59.0m (2008: £34.0m), also due to the unpredictability of future profit streams.

Deferred tax liabilities were offset against the corresponding deferred tax assets where both items fell within the responsibility of the same tax authority. The deferred tax assets and liabilities at the period end, without taking into consideration the offsetting balances within the same jurisdiction are £445.4m and £125.1 respectively.

CASE STUDY EXAMINATION - NOTE FORM ANSWERS

QUESTION 1 Non-Financials Total 18 mins (10 marks)

Required:

(a) Given that Leisure Tours, in its present form, was created by merger relatively recently, what do you think are the broad strategic objectives of the group.

5.4 mins (3 marks)

Consolidate the combined business.

Rationalise organisation structure & operating locations

Achieve synergies, cost savings, rationalisation benefit

Remove excess holiday capacity, restore basis profitability

Focus on load factors

Maintain market share versus other major tour operator

Grow at same rate as the economy

Look for small acquisitions to increase market share, extend product range

(b) Given that the key financial objectives will no doubt cover, inter alia, sales growth, margins, costs and cash flow, what are the main non-financial characteristics of the company's business environment and its position within the industry that will drive or influence financial performance?

12.6 mins (7 marks)

This is a mature business, low growth but not declining, industry consolidation.

The state of the economy, fuel price and taxes, "environmental developments"

But European demand for holidays pretty resilient

One major competitor, many much smaller

Supplier power – big oil and aircraft suppliers, stronger re latter than former (fuel critical cost factor). Strong re purchase of holiday accommodation
Buyer power – the general public have strong collective buyer power because of alternative tour operators

No real threat of new entrants of significant size to threaten

Continuing threat of competitive products (e.g. DIY holiday packages) but still demand for flights and accommodation

High volume, low margin business (price elasticity important)

A “volume” business – duopoly power, big business efficiency, centralised control etc. Labour cost efficiency important component of overheads representing 50% of gross margin

QUESTION 2 Financial Profiling Total 18 mins (10 marks)

Write a summary highlighting the main features of the company’s financial profile and its recent evolution, based on the Income Statements, Balance Sheets and Cash Flow Statements for 2007 to 2009.

Total 18 mins (10 marks)

Low volume growth, post merger.

Stable gross margins, improved overheads so operating margins up from 2.8% to 3.5% (prospective 2010)

Return on capital trend still improving, well above target rate of return on book value, also on market value. Suggests company well undervalued!

Asset turnover is improving, both working and fixed. Advance payments received are a big item contributing to net working liabilities (-21%).

Fixed asset utilisation increasing (10% fixed assets to sales).

Capex has been negative to too low, now increasing – critical issue.

High effective interest rate indicates seasonal debt much higher than year-end.

All credit ratios indicate increased debt post merger but still comfortable.

Debt has doubled but cash is still at similar level and now 45% of debt at year end.

Credit rating about BB?

Dividends not covered in last two years but expected 1.66 cover in 2010. Steady and high yield of 5%, but share price up and down!

Steady cash from operations before working capital, but big swings in WC, and surprisingly a net consumer of cash in three years out of four.

Capex only 63% of depreciation, but operating leases also.

Tax, interest, divi payments modest and manageable.

Internal cash flow positive three out of four years – total of 309 same as share buy-back amount.

Net debt increase of 321 similar to acquisitions amount of 328.
All nicely balanced.

QUESTION 3 Risk Identification & Stress Testing
Total 32.4 mins (18 marks)

Required:

(a) Given your responses to Questions 1 and 2, identify five major finance/treasury risks facing LT in the medium term, with a brief one-line justification for each risk identified.
9mins (5 marks)

Fuel, given price volatility and significance for travel cost (own aircraft and third party)

FX (transaction), again given potential volatility and proportion of costs exposed to currency risk, eg for accommodation, catering.

FX (pre-transaction) ie price-list for holidays in advance of bookings.

Liquidity, given size of seasonal swings in cashflow.

Refinance risk, given tighter bank capital adequacy/liquidity rules.

Counterparty risk on cash balances and mtm on derivatives, the latter a two-way item.

Interest risk on debt and depos.

Others: pension, FX translation.

(b) What assumptions would you make about the extent of each risk in order to stress test business plan forecasts?
18mins (10 marks)

Fuel price: 20% normal; 50% abnormal: cost impact/if hedged collateral

FX:5%; 25%: impact on costs/collateral

Liquidity: Lower trough, delay/shortfall in recovery

Refinance: Need to access capital markets for 50% of refinance with a sub-investment grade rating

C'party: All banks down one notch; two bank failures

Interest: Variation 1%; 2.5%; impact on net cost/collateral

Reverse stress testing involves imagining a disaster scenario, working back to what might have caused it and judging whether this reveals risks to your business which have been overlooked in the past, possibility through lack of imagination or creative challenge eg collapse of the commercial paper market, triple A sovereign downgrades.

(c) Suggest a disaster scenario reverse stress test for LT(involving one of the five finance/treasury risks which you identified above).

5.4mins (3 marks)

Fuel supply interruption for one/two months due to political unrest at source.

QUESTION 4 Seasonal and off-balance sheet gearing
Total 25.2 mins (14 marks)

Required:

(a) The gross interest cost is very high in relation to the 2009 year-end balance sheet debt, for a UK-based company. What are the causal factors driving this seasonal fluctuation in debt, given the nature of the business? Based on your estimate of the likely interest rate on the company's debt, estimate the company's average and peak debt in 2009? Ignore the company's cash balances throughout this question.

7.2 mins (4 marks)

Big seasonal swings in working capital – cash going out until Christmas then advance payments for next year's holidays starts coming in.

2009 average debt based on year end BS = 1,204 mill, interest paid = 154.7 mill, effective rate = 12.85%.

Assume average interest rate of 7.5%, then average debt = 154.7 / 0.075 = 2,063 mill. If average = 2,063 and low is 1,204, then peak could be as high as 2,922, but this would be an unlikely spike.

Sensitivity of analysis:

5.5%; 2,813, 4,422
6.5%; 2,380, 3,556
7.5%; 2,063, 2,922
8.5%; 1,820, 2,436

(b) Compare i) the gross value of aircraft on the balance sheet that have been purchased outright with ii) the value of aircraft on finance leases and iii) the capital value of aircraft operating leases.

Use S&P's methodology for estimating the capital value of operating leases i.e. the NPV of all future operating lease payments, discounted at the effective interest rate of the company's total on-balance-sheet debt.

9 mins (5 marks)

Operating lease commitments on aircraft, from accounts:

< 1 year; 128.4 mill
1 to 4 year; 290.4, average 72.6 mill per year
5 to 10 years; 153.4, average 25.6 mill per year

Assume interest rate of 7.5%

operating lease valuation

	0	1	2	3	4	5	6	7	8	9	10
cash flow	128.4	72.6	72.6	72.6	72.6	25.6	25.6	25.6	25.6	25.6	25.6
discount factors	1.000	0.9302	0.8653	0.8050	0.7488	0.6966	0.6480	0.6028	0.5607	0.5216	0.4852
dcf	128.4	67.5349	62.8231	58.4401	54.3629	17.8319	16.5878	15.4305	14.354	13.3525	12.421
NPV	461.54										
7.50%											

Total on-balance-sheet aircraft plus spares (at cost) = 1,713.4 mill
(net 1,085.1 mill)

Aircraft on finance leases = 170.5 mill (net), estimate of gross = 170.5 / 1,085.1 * 1,713.4 = 269.2.

Summary;

aircraft on operating leases:	£461.5	(21.2%)	debt	£461.5
aircraft on finance leases:	£269.2	(12.4%)	debt	£170.5
aircraft purchases outright:	£1,444.2	(66.4%)	debt	£914.6
total aircraft:	£2,174.9	(100%)	total debt	£1,546.6

(c) Using your work on (a) and (b) what was the company's maximum ratio of total on-balance sheet and off-balance-sheet debt to shareholders' funds at the worst point in 2009? Contrast that with the year-end on-balance-sheet ratio.

7.2 mins (4 marks)

On B/S debt = £1,225.5
Shareholders' funds = £1,727.2
Debt / Equity ratio = 0.71

EBITDA = £591
Debt/ EBITDA = 2.07

Estimated peak debt plus operating leases = £2,922 + 462 = 3,384 = D/E = 1.96

Peak debt/ EBITDA = 5.73

(d) In light of your analysis comment briefly on the company aircraft funding policy.

1.8 mins (1 mark)

Very limited use of finance leases is maybe surprising (missed tax opportunities?)

Also very limited use of operating leases exacerbates on-balance-sheet leverage at seasonal debt peak.

Unsophisticated financing or transparent and open?

QUESTION 5 — Sustainable Cash Flow and Market Valuations

Total 27 mins (15 marks)

The stock market is concerned that companies in this sector seem unable to translate earnings into cash flow. In addition Leisure Tours seems to be on low valuation multiples. In order to shed some light on these issues you are asked to investigate the free-cash-flow growth rate implied by the average EV for 2010. Various brokers assume the company's nominal WACC currently to be in the range 7% to 9%.

Required:

(a) Estimate the sustainable cash flow (Free Cash Flow to the Firm) as at 2011 basing your assumption about the steady-state growth rate achievable on your previous analysis of the industry and the company's position within it, the likely rate of inflation medium-term and the sales forecast for the company 2010. 12.6 mins (7 marks)

Assume steady-state growth of 3% (2010 forecast and future level of inflation?)
Assume reduced exceptional costs of £50 mill (2010 – £100 mill, essentially related to merger in 2007)

		£ mill
Operating profit (332 + 50) x 1.03 =		393
Non-cash adjustments other than depreciation (average 3 years)		12
Change in working capital (9,538 x 0.03 x 0.2 =		57
Depreciation (146 x 1.03) =		150
Replacement capital expenditure (150 x 1.072)		(161)
Asset age = 344/146 = 2.36). Cum. inflation 7.2%	(1.03^2.36)	
Tax on operating profit @ 2010 cash tax rate of 46/230 = 20%		(79)
Sustainable cash flow to the firm (SFCFF)		372

(b) What growth rate is implied by the average 2010 EV, given your estimate of sustainable cash flow and a WACC in the specified range?

9 mins (5 marks)

EV (2010) = 1,223.2 – 550.2 + 20 + (853.7 x 234p) = 2,691
EV = SFCFF / WACC – Growth
WACC minus Growth = SFCFF / EV = 372 / 2,691 = 13.8%
If WACC = 7% implied growth = -6.8%
If WACC = 8% implied growth = -5.8%
If WACC = 9% implied growth = -4.8%

(c) What do you conclude about the market's view of the company? What are the main "non-financial" factors that might be depressing the share price?

5.4 marks (3 marks)

Market is either much more pessimistic about cash-generating ability or about achievable growth rate or both. NB EV / EBITDA = 4.52, P/E = 12.2, both unexciting multiples.

Reasons:

- Market unconvinced about medium-term sustainability of the business model and therefore of cash-generating ability.
- Leisure Tours under threat from DIY holidays and more specialist holiday firms.
- Accelerating effects of increasing fuel taxes on costs and sales.
- Inability to gain synergies / cost savings from merger.
- Continuing rationalisation costs.
- Destructive price war with other major player, given adverse factors above
- High operational risk eg volcanic ash event in 2010.

QUESTION 6 Fuel & Currency Pre-Transaction Risk Analysis and Policy
Total 36 mins (20 marks)

LT is exposed to several typical treasury risks including

(1) fuel price risk
(2) currency pre-transaction risk

Required:

For each of (1) and (2)

(a) Explain how the risk arises in LT.

3.6 mins (1 mark per risk total 2 marks)

Fuel: significant and volatile element of travel costs .

FX pre-transaction:
significant, volatile element of non-travel costs; to issue catalogue prices and not have to resort to last minute surcharges, LT needs to hedge these costs well ahead of the season.

(b) How material is each type of risk for LT? Quantify and indicate the level of sensitivity, noting any assumptions made.

14.4 mins (4 marks per risk total 8 marks)

Fuel: Comprises around 8% of total costs, with a recent history of increasing by as much as 50%. So very significant in this low margin business.

Note that the hedging of this risk gives rise to another, ie the potential cost of collateral calls on derivative mtm valuations.

FX: Overall, after hedging, LT 2009 a/cs state that a 5% shift in EUR and USD would impact PBT by £18.8m.

In the Case section 3.5 LTAG labelled this risk Portfolio "Tour Operator". Monroe discussed it in terms of the budget cycle and the pre-season booking period. Section 2.0 Tour Operating Sector indicates tour operator margins of 5-10%. Taking the cost breakdown of tour operators on pages 3, 4 and making assumptions about non-domestic parties:

Accommodation	34% x 0.75	= 25%
Aviation	38% x 0.50	= 19%
Destinations	8% x 1.00	= 8%
		52%

So at least 50% of costs are exposed to fx volatility and margins are as low as 10% of that number, so even minor volatility can be terminal!

As for fuel, collateral calls are a potential problem.

(c) Identify the key policy dimensions for the management of each of the risks within LT.

18 mins (5 marks per risk)

<u>Fuel</u>
Policy issues include:

Timeframe

instruments eg collar options

competitor behaviour

collateral call management

own fleet, third party carriers

hedge accounting

<u>FX</u>
Policy issues include:

attitude to fx surcharges

target % hedge

local norms for catalogue lead time re. start of season

treatment of contracted flows

treatment of forecast flows

netting

instruments

collateral calls

hedge a/cing impact on hedge timing

(Total 10 marks)

QUESTION 7 Treasury Organisation Profiles Pre/Post Merger & Action to Implement the Transition

Total 23.4 mins (13 marks)

Required:

(a) On the Treasury Organisation Matrix provided create a profile for each party to the merger before the event by ticking the cell in the top left hand corner of the appropriate box.

3.6 mins (2 marks)

LTAG treasury policies are detailed, comprehensive and sophisticated probably reflecting a more diversified, complex and mature activity.

Monroe plc treasury, again probably reflects the different character of that business.

	Monroe plc	**LTAG**
ROLE	Agency	In-house Bank
AUTHORITY	Centralised	Centralised/Dynamic Balance
RESPONSE TO RISK	Cost Centre	Profit Centre
ORGANISATION	Intermediate	Advanced

(b) Create a profile for where you believe the merged entity should be after the merger integration process by ticking the cell in the bottom right hand corner of the appropriate box. Give reasons for your choice.

7.2 mins (4 marks)

Expect the post-merger profile to level up to LTAG and move eastwards, subject to political considerations.

(c) What actions would you need to take to accomplish the integration of the two treasuries and the profile you created in your answer to 7b?

12.6 mins (7 marks)

Several big changes will be underway post merger which have a direct impact on the shape of treasury in the new business:

The Board and executive will be pressing ahead to realise synergies promised to shareholders.

The consequent integration of functions will require a view about the future treasury structure and the policies to be pursued.

The future treasury structure will involve people moves, systems integration and re-alignment of relationships with the outside world eg banks.

Meantime the various businesses have to continue to function.

So, need a high level decision on:

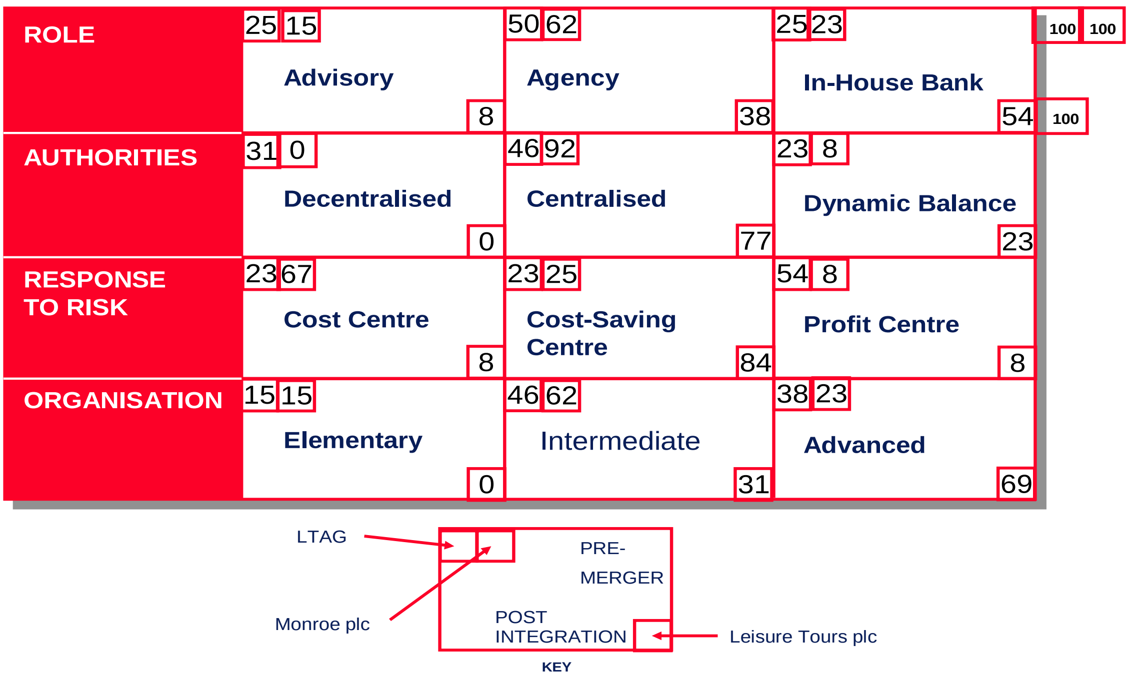
- people
- priorities
- policies
- place of business
- plan of action:
    - immediate
    - one year
    - two/three years

Obvious areas for priority attention are:

- fx hedging
- fuel hedging
- cash pooling
- bank relationship rationalisation
- consolidation of debt facilities
- systems rationalisation

The table below summarises candidate responses to 7a & 7b.

Treasury Organisation Profile (%)



Examiner's Report

OVERVIEW
It is worthwhile to note the parts of questions which carry high marks and to plan your time to respond proportionately. Questions with several parts are often so structured in order to lead candidates through the analysis and evaluation necessary to make a prescription about some important issue. Not surprisingly, the prescriptive part which is the more difficult carries the higher marks eg Case Exam Questions 3, 4, 5, & 7, General Exam Question 4.

In professional practice corporate treasurers often need to scope a problem at short notice, make assumptions about missing data which there is not time to research, make approximations to quantify the problem and propose a solution. Some questions in both exams may be designed to assess this skill eg General Exam Q5, Case Exam Q6. These questions sometimes seem to wrong foot candidates.

In the questions devoted to corporate finance and funding it is essential that candidates thoroughly understand the key concepts and can apply them appropriately to practical problems including correct numerical calculations.

Examiner's Report - Case Study Examination

<u>Question 1</u> Non-Financials **(10 marks)**

Average mark 64.4%, pass rate 85%.

Straight forward, predictable question, which no-one should fail, but still a good discriminator of the strong versus weak candidates.

Worst failing; simply repeating bullet headings from the case study, with no analysis or argument.

<u>Question 2</u> Financial Profiling **(10 marks)**

Average mark 55.7%, pass rate 46%.

Again a predictable question requiring candidates to review the totality of the company’s recent performance and summarise the key features. This was a very good discriminator because the better candidates wrote very full, rich answers whereas the answers of the weaker ones were very weak and thin.

Worst failing; failing to understand and take account of big acquisition-related exceptional items, especially relating to the ability to cover dividends.

<u>Question 3</u> Risk Identification & Stress Testing **(18 marks)**

Average mark 61.3%, pass rate 84%.

Yet again, a predictable question about identifying key finance and treasury risks but with a twist in the tail about stress testing which carried two-thirds of the marks. All students passed this question comfortably, except for two who were also clear fails overall on both the case and general exams. Worst failings: unrealistic stress test parameters.

<u>Question 4</u> Seasonal and off-balance sheet gearing **(14 marks)**

Average mark 50.0%, pass rate 54%.

This was the toughest number-crunching question in the corporate finance/funding section. This really did sort out the weaker candidates - poor on the arithmetic, weak on concepts (eg end year versus average versus peak overdraft in a seasonal business), double counting of total B/S debt and finance leases, unable to calculate capitalised operating leases. It was too difficult for some to tackle especially if left to the end.

The good candidates, however, did really well.

Worst failing; inability to handle the numerical calculations.

<u>Question 5</u> Sustainable Cash Flow and Market Valuations **(15 marks)**

Average mark 49.7%, pass rate 62%.

This should have been a fairly predictable core topic, requiring good conceptual understanding, good numerical skills and good practical judgement. The best candidates wrote extremely good answers. Two candidates left this until last and/or wrote virtually nothing. Two others were pretty much lost.

Worst failing; not understanding the concept of sustainable cash flow versus last year's actual cash flow inflated.

<u>Question 6</u> Fuel & Currency Pre-Transaction Risk Analysis and Policy **(20 marks)**

Average mark 51.9%, pass rate 62%.

A reasonably predictable question about origins and materiality of two key risks (fuel and fx) and policy parameters for their management. Candidates needed to supplement information in the case by making their own assumptions in order to quantify materiality. The ability and willingness to make such assumptions has sometimes been a weakness in previous exams, but in this instance it was well executed by most students (as was also the case in the stress testing part of Question 3).

Worst failings: misinterpreting pre-transaction risk (in this instance “price list” risk) as the more conventional “transaction risk”; lack of precision and breadth about policy parameters.

Question 7 Treasury Organisation Profiles Pre/Post Merger & Actions to Implement the Transition (13 marks)

Average mark 49.7%, pass rate 54%.

Pass rate and average marks were at the lower end of the spectrum. The first two more conventional parts of the question - profiling the present treasury organisations for the parties to the merger and proposing a profile for the combined entity - were well answered, in particular the second part. However around half of the candidates struggled with prescribing the actions required to create the proposed combined treasury organisation profile; this part of the question carried more than half of the marks so the high proportion of weak responses dragged down the pass rate on the question.

Worst failing: answers to last part of question lacking in specifics.