TREASURY, RISK
AND FINANCE
PROFESSIONALS
ACT

The Association of Corporate Treasurers

Examination Paper, Solutions and Examiners Report

MCT ADVANCED DIPLOMA

CASE EXAMINATION

April 2012

This examination is based on Micasa plc

QUESTION 1

Required:

a) **Analyse Micasa's current business environment using the PEST model, highlighting the main positive and negative aspects.**
(5 marks)

b) **Analyse Micasa's current business using the Market Environments Matrix and decide which environmental type best fits Micasa. Identify the main non-financial characteristics influencing your choice and the main implications for managing a business of that type.**

(5 marks)

(Total 10 marks)

QUESTION 2

Required:

Demonstrate how the financial profile supports the conclusion you reached in answer to Question 1b. As appropriate, identify any changes in the company's financial performance that indicate a management responding to that market environment.

(8 marks)

QUESTION 3

Required:

Given your responses to Questions 1 and 2, what in your opinion are the five most important treasury/finance issues confronting Micasa in 2012? Briefly justify your choices.
(5 marks)

QUESTION 4

You are asked to value Micasa as at end-January 2011, based on your estimate of the sustainable cash flow for 2012, appropriately defined, and the company's medium-term weighted average cost of capital. NB. For the purposes of this question operating leases should be ignored.

Required:

a) **Estimate the sustainable cash flow for the current year (2011-12) based on the most recent cash-flow performance and using the latest profit figures and forecasts. Present your workings and arguments for each item of the sustainable cash flow calculation.**

(**5 marks)**

b) **Calculate a medium-term WACC for Micasa that will hold good for financial valuations and decisions over the next five years, allowing for the company's cash balances. Explain and justify all your assumptions.**

(**5 marks)**

c) **Calculate an Enterprise Value, and the resulting share price, based on your figures for sustainable cash flow and WACC. Comment on your results.**

(**5 marks)**

(Total 15 marks)

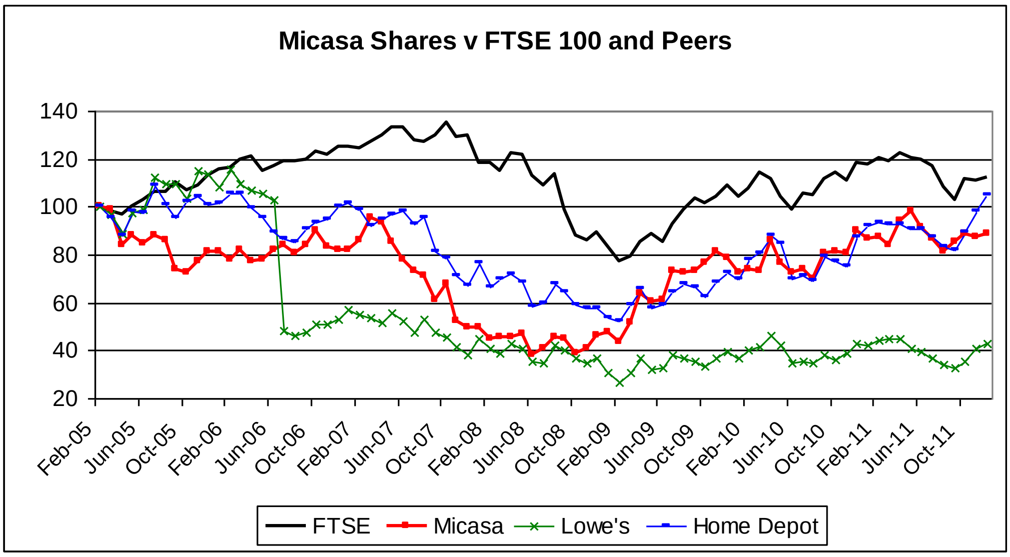
QUESTION 5

You have details in the table of Micasa's share price, the FTSE Index and market Price / Earnings ratios over the last six years. You also have summary financial information on the two global market leaders. Refer also to your analysis of the company's financial performance in your answers to Questions 1 and 2 and to the various multiples given in the case study financial exhibits. Between November 2011 and the announcement of the Third Quarter results in mid-February the shares rose from 256p to 280p. Over the same period the FTSE 100 Index rose from 5503 to 5880.

	Feb 05	Feb 06	Feb 07	Feb 08	Feb 09	Feb 10	Feb 11	Nov 11
Micasa plc share price	291	228	252	131	127	215	254	256
FTSE 100 Index	4969	5792	6172	5884	3830	5355	5994	5503
Micasa shares indexed	100	78.4	86.6	45.0	43.6	73.9	87.3	88.0
FTSE 100 indexed	100	116.6	124.2	118.4	77.1	107.8	120.6	110.7
FTSE 100 P/E Ratio	14.7	14.0	13.4	11.8	8.9	17.8	12.1	13.0

Summary Peer Group Information

	Home Depot	Lowes Companies
P/E at mid-February 2012	19.2	19.7
5-year average P/E	16.6	16.1
5-year P/E high/low range	22.9/10.0	20.2/10.6
Price/Book (Equity)	4.11	2.1
Gross profit margin	34.60%	35.00%
EBIT margin	9.20%	6.60%
Return on invested capital	13.00%	7.90%
Total Debt/Equity	0.61	0.39
EBITDA Leverage	2.3	2



Required:

In your opinion why has EV fallen over the period from February 2005 to mid-February 2012?

(10 marks)

QUESTION 6

Micasa is moving towards integrated global sourcing. The elements of this strategy are:

- common ranging
- own brand
- global sourcing footprint for MSO (Micasa Sourcing Organisation)
- direct-supplier relationships

This value chain strategy is driven by commercial considerations, eg scale/buyer power, brand recognition, product innovation and quality control. It also has major implications for treasury.

Required:

a) What treasury/finance issues would you require your commercial colleagues to keep in mind and agree with you when they are taking strategic decisions about integrated global sourcing?

(10 marks)

b) Devise a currency risk policy for Micasa to support the integrated global sourcing initiative, covering transaction, pre-transaction and strategic risks, making selective use of the template below:

Policy Objective
Policy Direction
KRIs (Key Risk Indicators)
Benchmarking
Oversight
Procedures/controls
Decision Making
KPIs and KCIs (Key Performance/Control Indicators)
Reporting
Continuous Improvement

To help focus on your answer you may find it helpful to make and state assumptions about the future shape of integrated global sourcing if the initiative is implemented as planned.

(20 marks)

c) What are the broad internal implications of the 'Delivering Value' and 'Creating the Leader' programmes for the management and organisation of treasury?

(4 marks)

(Total 34 marks)

QUESTION 7

Micasa operates in Turkey via a 50/50 joint venture (Mi-Mu AS) with the Mugla Group, one of Turkey's biggest companies. The Mugla Group is 70% owned by the Osman family and the third generation still manages the business. The Mugla Group is one of Turkey's largest conglomerates, (£20 billion turnover, £700 million profit and regarded as financially very strong), with activities in energy, automotives, consumer durables and finance, owning as it does one of Turkey's largest banks. 14 of its 113 companies are publicly-quoted and comprise 14% of the Istanbul Stock Exchange.

The Mi-Mu JV is the number one DIY retailer in Turkey - with £300 million turnover and £30 million profit it is "currently self-financing". The objective is to double the business over the next 5 years, by increasing the total DIY market in Turkey and Mi-Mu's market share. The Chief Executive "sees no reason why we can't have 100 stores in Turkey", which compares with the current 35. In the longer term the Turkish operation is seen as the main source of continuing growth for the group, being the spring-board for expansion into Eastern Europe and the republics of the former Soviet Union.

In 2011 Micasa's share of post-tax profit from the Mi-Mu joint venture and one other associate was £31 million in total, on a balance sheet investment of £259 million. Cash dividends received were £6 million.

Required:

Make an estimate of the amount of additional finance that might be required to support Mi-Mu's 5-year growth objective and make recommendations as to how any potential deficit might be funded. Give your reasoning for the various assumptions that you have to make.

(10 marks)

QUESTION 8

Required:

Looking ahead, what strategy should Micasa adopt regarding its financial service providers, given its own strategic goals and the long term restructuring currently underway in the financial services sector?

(8 marks)

MCT ADVANCED DIPLOMA
CASE STUDY
BACKGROUND INFORMATION

Micasa plc

1.0 INTRODUCTION

1.1 Overview

Micasa plc is Europe's leading home improvement retail group and the third largest in the world, with over 900 stores in eight countries in Europe and Asia. Its main retail brands are Myway, Mamaison, FaireFacile, and FastFix. Micasa also has a 50% joint venture business, (MiMu) in Turkey with Mugla Group, and a 21% interest in, and strategic alliance with, Hausmann, Germany's leading large format DIY retailer.

Worldwide it ranks third in size behind Home Depot (US) and Lowe's Companies (US) and ahead of Group Adeo (Fr), which ranks fourth.

Micasa grew out of Shepherds Group, a high street economy retailer, which in the 1980s had a small home improvement business called Myway. In the 1990s the Group acquired a pharmacy chain and a household electrical goods chain while meantime Myway expanded rapidly using warehouse style stores domestically and expanding overseas by acquisition. In 2001 the Group decided to focus solely on home improvement and expanded overseas in Europe and Asia. By end of the 2011 financial year the Group has 856 stores in eight markets employing 80,000 staff (approximately 65,000 on a full-time equivalent basis).

Summary Financials

	2010 £m	2011 £m
Turnover	10,503	10,450
EBIT	623	698
PAT	385	491
Gross Debt	1530	773
Net Debt	270	42
Shareholders' Funds	4955	5460
Market Cap	4273	5515

1.2 Purpose and goals

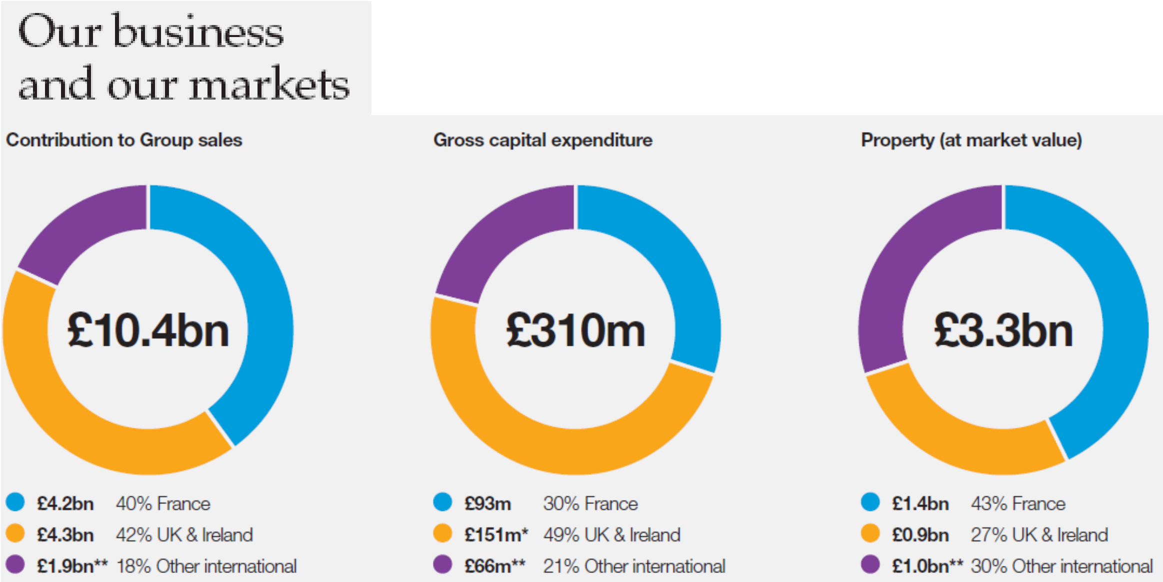
In 2008 the Group initiated a "Delivering Value" programme, aimed at realising performance improvement by "self-help", ie internally, rather than relying on any help from the Group's markets. This programme is still in progress and should complete in 2012.

The next initiative is "Creating the Leader", ie making home improvement easier for the customer ("easy"), developing a world class core common range ("common") and accelerating expansion ("expand"). Two new teams have been created to this end: a 50-strong Innovation team in France and the Micasa Brands Network to implement the best-in-class group-wide common range.

The goal is to become the leading global expert in making home improvement easier for customers.

2.0 BUSINESS PROFILE

2.1 Extract from 2010/2011 annual report and accounts



*** Includes central allocation**
**** JV not consolidated**

Country	Households (m)	Market size ($bn)	Market position	Market share	GDP growth 2011 estimated (%)	Market brands	Store numbers	Selling space (000s sq m)	Employees (full time equivalent)
France	27	20	1	21	+2.3	Mamaison	102	1,035	11,779
						FaireFacile	101	557	5,969
UK & Ireland									
UK	27	31	1	14	+2.3	Myway	330	2,480	23,669
						FastFix	162	14	3,006
Ireland	1.5	2	-	5	+1.0				
Other International									
Poland	15	10	1	11	+4.0	Mamaison	53	411	8,919
						FaireFacile	6	28	413
China	425	36	1	1	+9.2	Myway	41	339	5,929
Spain	16	5	2	4	+1.2	FaireFacile	17	100	898
Russia	53	13	3	2	+4.7	Mamaison	14	126	2,340
Turkey	18	6	1	5	+4.8	MiMu	30	160	2,512
						Total	856	5,250	65,434

2.2 A conversation with the executive team

Having transformed Micasa into a stronger business, we are now much better placed to accelerate our development and create a truly world-class leader in home improvement retailing.

Q Delivering Value has worked, so what's the next big idea?

A John Warwick responds:

“Yes it has gone well due to a relentless focus on our self-help initiatives rather than any help from our markets, which have all suffered in the global downturn one way or the other. So it's a big thanks to an incredible effort by our 80,000 colleagues. But before I tell you about our next phase of development let me remind you that we still have a very busy year ahead of us to finish the Delivering Value programme.

Having transformed Micasa into a stronger business, we are now much better placed to accelerate our development and create a truly world-class leader in home improvement retailing. We operate in an attractive market which is ripe for faster growth but it will take real leadership to unlock it. We intend to be that leader, accelerating away from the pack by becoming the world's expert at making home improvement easier for our customers. By introducing a core common range across Micasa for the first time, we will make better use of our unrivalled scale to develop innovative new products that make home projects easier and more affordable. This will boost growth in our existing markets and enable us to expand faster and more efficiently into new territories at the right time”.

Q Micasa has been an international, scale player for years. So what's different now?

A John Warwick responds:

“A good question. We have been big for a while but our 'conglomerate' legacy has seen us operate for too long in country silos, re-inventing the wheel wherever we go and not fully capitalising on our scale and diversity. That said, a lot has changed in recent years and we now have a much more unified and aligned leadership team, and a fast-developing new approach to cross-Group working. Internally we call this the 'One Team' culture, a network of colleagues working across countries and businesses. Our unique asset is our international diversity and expertise, and we are now beginning to really leverage it. Today you will see great products selling under our Group-wide own brand names in multi-lingual packaging – the result of buyers networking as one team. This is just the beginning: I am very excited about how much scope we have”.

Q The French business is clearly outperforming, what's the secret?

A Henri Dupont responds:

“Good retailing is no secret but it's very hard to do consistently well. We have been working very hard for some years now to re-position ourselves as the true leader in France, not just by size for size's sake, but the leader for customers. We have modernised our stores and introduced innovative own brand products designed to make home improvement simpler and easier to do. This is now paying dividends and we are growing ahead of the market, especially at Mamaison where these initiatives are further advanced”.

Q With 203 stores, is this the end of the road for growth in France?

A Henri Dupont responds:

“Not at all, I can see plenty of opportunity to add more store space in France, whether that's through extending or relocating existing Mamaison stores, or adding new Mamaison and FaireFacile stores in regions where we still have a limited presence. I believe we are only about 80% of the way through our space expansion programme but the last 20% will take quite a long time to deliver organically. So we are keeping a good look-out for opportunities to accelerate”.

Q Great job on profits, but sales densities are still low. Do we need a booming economy to see like – for – like sales growth in the UK?

A Owen Galloway responds:

“No we don't, but we've clearly been battling a strong headwind in recent years and our market is smaller today than it was in 2004, the height of the last home improvement boom. Myway is a great British retail brand but you can never sit still in retail and so we have done a lot over the last few years to keep raising our game. Our stores are more modern, our operating standards are now much sharper and consistent, and we have trained 21,000 colleagues in product knowledge to improve our service in store. We do a great job for our 'everyday DIY-er' customer and have really improved our offer for the 'do it for me' customer. This year we introduced a whole new concept, Service Centre, into Micasa stores, which vastly improves our offer for our 'trade professional' customers. We have also recently launched a new customer promise of 'making it easier' to improve your home and this is where I think we can really differentiate ourselves and grow our market share. To this end I recruited Annette Massie who led the successful product development programme at Mamaison in France, to be our new Commercial Director. I also recruited Pippa Wright, previously the Marketing Director of Priceways, to lead our new 'making it easier' marketing campaign. So I think we have a very exciting time ahead of us, building on strong foundations, creating a true market leader”.

Q We've heard about common ranging before, why will it work this time round?

A Owen Galloway responds:

“As John said earlier, introducing common ranges is a huge growth opportunity for Micasa, both for driving sales and margin. I think the new 'One Team' approach is the key to properly harnessing our scale and talent this time round. The really good news is it's no longer just a strategy or a dream, it's happening today in stores. On shelf right now in Myway are outdoor products under a new group-wide own brand in multi-lingual packaging. And they are on shelf in France and Poland too! That's a huge breakthrough for Micasa and it's only just beginning. One day I want 50% of everything in store to be common to all our businesses”.

Q Eastern Europe is growing fast, but is it just a flash in the pan?

A Paul Butcher responds:

“Absolutely not, these markets are still in their infancy. There are 86 million homes in our market in Poland, Turkey and Russia, and, as wealth levels grow, a high priority for people is to improve their existing homes, catching up with the more developed markets in western Europe. The markets are under-developed in a retail sense with much of the sales still going to generalists and open air markets. We have opened 41 stores in the past three years but there is scope to more than double our stores and establish a multi-channel approach. So I see many years of good growth to come over the longer term. But these things are never an entirely smooth road, you have to be ready for some speed bumps along the way and build flexibility into your plans”.

Q China – stay or leave?

A Paul Butcher responds:

“To be honest I think we need another 12 months before we can know for sure. We now have a terrific local team in place and they have transformed the business from a large loss maker and cash user into one that is capable of making a profit and generating cash. But there is more to be done in China and we will need time to prove our store format is a success with customers to be sure that we have a winning formula. We have learned some important lessons from our experiences and we're determined to get that 'stay or leave' decision right. After all, you don't walk away from a market-leading position in the world's second largest economy, nor commit more shareholder funds lightly”.

Q Micasa with no debt, is it time to give back cash to shareholders?

A Sean Timmins responds:

“I'm delighted that our efforts right across the businesses have eliminated the £1.6bn of financial net debt that we started this journey with. It's true we have a much stronger balance sheet now which means we have options going forward – a nice place to be relative to the depths of the credit crisis barely two years ago. But it's not true we are debt free. We lease over 600 of our 856 stores and using a long-term property yield this equates to additional finance lease debt of £5.8 billion. Under today's accounting rules these can't be shown on the balance sheet but we do include this liability when thinking about our balance sheet and funding.

Our aim is to retain financial flexibility whilst investing in improving and growing our business for the longer term. We are also keen to share our cash generation with shareholders and that's why we have increased our full year dividend by 29% this year, ahead of our earnings growth. And I would expect us to continue to grow our dividends ahead of earnings for the next few years so that our dividend cover gently reduces from 3 times last year to around 2.7 over the medium term, a level at which we can invest in the business, return cash through dividends and maintain an appropriate balance sheet gearing”.

Q Last year you hinted at acquisitions, are you still in the market?

A Sean Timmins responds:

“First and foremost our investment will be targeted at expanding the store and digital channels for our existing businesses. We are planning to increase our organic investment in areas where high returns are already proven. If we see any opportunities to accelerate this by acquiring small parcels of stores at the right price, we will act. As regards anything more meaningful, you can 'never say never', but we set the hurdles very high indeed when it comes to creating value for shareholders via acquisition, so it would need to be a great deal”.

+41
new stores opened in Poland, Russia and Turkey since 2008

£1.6bn
amount of debt eliminated over the past three years

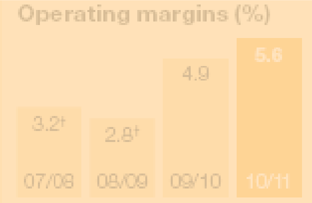
2.3 Delivering value

The financial year 2011/12 will be a year of transition as we complete the final milestones for the Delivering Value phase and mobilise the activities that will drive the next phase of our development. A summary of progress to date since 2007/08 for each of the seven key Delivering Value steps is set out overleaf along with detailed milestones for the final year.

THIS PAGE AND FOLLOWING PAGE TO BE READ SIDE BY SIDE

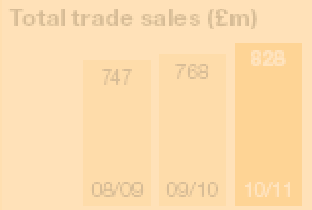
Driving up MYWAY UK & Ireland's profit

Self-help measures have rebuilt Myways retail market to 5.6% despite weak markets. Myway is on track to achieve a sustainable 7% operating margin



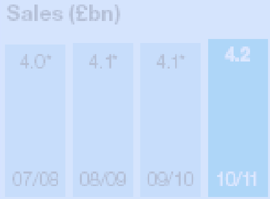
Exploring our UK Trade opportunity

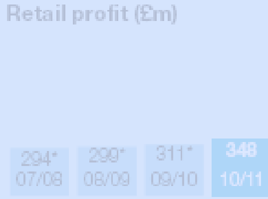
Sales to the trade have increased significantly. Over 415,000 professional Trades are now registered with Service Centre and 2.4m registered with FastFix



Expanding our total French business

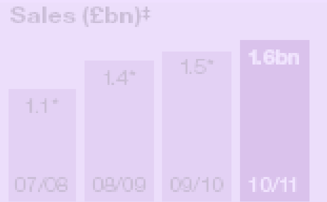
10% new space is added and profits up 18% in constant currencies since 2007/08, supported by buying optimisation and more direct sourcing





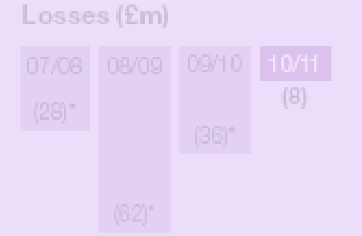
Rolling out in Eastern Europe

59% space added with sales growth in Poland, Turkey and Russia, profit up 43% in constant currencies since 2007/08



Turning around Myway China

Repositioning plan on track. Annual losses have been reduced with the Business now positioned for potential Break even in 2011/12



Growing Group Sourcing

Direct sourcing through Micasa Sourcing Organisation (MSO) is up over 60% since 2007/08 with 90% of this value being channelled through common suppliers

Reducing working Capital

Net working capital reduced by over £500m million since 2007/08 excluding around £180 million negative impact French LME

Cumulative reductions in working capital (£m)
Before the impact of the LME legislation in France

Progress to date (2008-2011)	2011/12 milestones
• 66 full store revamps, 140 kitchen and bathroom area revamps • Stringent store operating standards implemented • Self-service checkout rolled out nationally • 21,000 staff achieved retail NVQs or City & Guilds qualifications • 'Reserve and Collect' introduced • Created the successful Brookes premium own brand • Gross Margin ahead 300bps, costs percentage to sales held flat	• Open 1 new medium sized store, revamp 37 stores • Roll out new storage range nationally • Create 200 'how to' videos available in-store and on diy.com • 4,000 staff to receive NVQ or City & Guilds qualification training • Direct sourcing shipments to rise by 15% • Open new distribution centre in Swindon (as part of the supply chain efficiency project previously announced)
• Service Centre was successfully added to 124 Micasa stores and a further 194 have a Service Centre 'order & collect' next day service • Opened 69 new FastFix outlets (taking the total to 162) • Added specialist plumber and electrician counters within 110 Fast Fix outlets and launched plumbing and electrical specialist catalogues	• Add new services for the Trade professional including improved credit and insurance, bulky goods delivery and a smart phone transactional application to allow easier online shopping • Open 20 further FastFix outlets • Launch specialist websites for both plumbers and electricians
• Opened 16 net new stores, 3 relocations and 21 revamps adding 10% new space • Mamaison modernisation accelerated, innovative advertising and products introduced • Gross Margin improvement of 260bps, supported by buying optimisation benefits	• Open 2 net new stores, 4 relocations and 2 revamps, adding 2% space • Continue upweighted new product launches across both businesses • Re-launch of the FaireFacile pocket-sized catalogue • Extend buying optimisation programme, to include FaireFacile Spain • Roll out common incentive schemes to all store staff across both businesses incorporating new operational measures
• Opened 41 net new stores, 17 in Poland, 15 in Turkey and 9 in Russia with total sales up 52%* to £1.6 billion (including MiMu¸ JV 100%) • Opened new central distribution facilities in Poland and Turkey to unlock future direct sourcing and distribution benefits	• Open a further 16 new stores, 6 in Poland, 6 in Turkey and 4 in Russia, adding around 17% new space • Direct sourcing shipments in Poland and Turkey to increase by 50% • Open new format smaller 'city store' in Moscow
• Appointed a new and highly experienced management team • Store portfolio rationalised from 63 to 41 of which 16 stores were downsized and space successfully sub-let • 16 of the remaining stores retro-fitted to offer an improved shopping experience • 30% of ranges have been re-engineered from the previous supplier-led model to a more typical European customer-led retail model with encouraging results • Introduced direct sourced Group own brands • Central costs reduced by 30%	• Continue the new format trial • Continue the work started in 2009 on re-engineering ranges, including more direct sourced Group own brands • Overall break-even target, subject to a stable Chinese home improvement market
• Extended the sourcing network to Brazil, Israel, Turkey and Vietnam taking the total network to 10 locations sourcing from 32 countries (25% of direct sourced suppliers being located outside of China) • Created core range catalogues to facilitate more cross-Group common sourcing • Established 10 'superbrands' to replace 150+ local own brands. This is a critical first step in enabling the development and roll out of Group-wide common ranges in multi-lingual packaging	• Create a new Group commercial organisation aligning our sourcing, own brand and innovation capabilities more closely • Finalise common range planning and range review alignment between Myway UK and Mamaison France • Commence roll-out of Group-wide common ranges of 'superbrands' • Invest in an innovation and design team to increase product creation capability • Increase volume of direct sourced shipments by almost 15% to US$1.5 billion
• Reduced moving annual average stock by 11 days • Average payment terms on direct sourced product extended by 51 days (to 85 days)	• 'Like for like' working capital to remain constant. Overall balance will increase due to further negative effects of French LME and investment required for new stores • Further extend average payment terms on direct sourced product by another 5 days (to 90 days)

2.4 Delivering more value – creating the leader

Aim – to deliver faster growth and higher returns by working together to become the world's expert at making home improvement easier for customers.

The next phase of our development builds on the success of 'Delivering Value' which has repositioned Micasa as a strong business in the attractive home improvement market.

We currently operate in eight countries, spanning over 500 million households. Around £120 billion is spent per year on repairing, maintaining and improving these households. Spending in developed markets has tended to reflect underlying consumption patterns whilst in the developing markets rising wealth is fuelling accelerated growth as home owners catch up with developed country standards. As well as growth potential, the home improvement market is also attractive to retailers because of the relatively small number of well known manufacturer brands. This means a specialist home improvement retailer provides a vital role for the consumer by offering a wide product choice and expert advice. They can offer a high proportion of 'own brand' product, achieve economies of buying scale and have a more defensible position against online or generalist operators when compared with other retail segments.

However, the lack of sizeable, global manufacturer brands in our sector has meant there has been relatively limited product innovation in recent years to make home improvement easier and more accessible for the consumer. As a result demand has not been stimulated to its full potential.

This is particularly true in the more developed markets such as the UK and France where householders generally have a list of work needed to be done but their repair, maintenance or improvement jobs are thought to be too complicated or too costly. We believe there is a big opportunity for a real retail leader to emerge to address this opportunity and unlock the latent demand in these markets.

We aim to capitalise on the attractive characteristics of our market and to use our unrivalled international scale and experience to develop products, services and channels for our customers that make their household jobs easier to do. By doing this we will create the leader in our industry and 'accelerate away from the pack', delivering faster, sustainable growth and higher returns. Over the coming years we will focus on three themes:

1 Easier

"We believe we can stimulate the overall market, grow our like-for-like sales and our market share by becoming the world's expert at making home improvement easier for our customers."

Product

- We will establish for the first time a product innovation function to design new, easier to use products under the banner of our 10 new own 'superbrands'. These products will be exclusive to Micasa businesses
- We will use our scale and global sourcing expertise to bring these products first to market and at great value for money
- We will expand our direct sourcing network across the world to find the best sources of quality and affordability

Multi-channel

- We will add new digital channels for the convenience of our customers

Advice

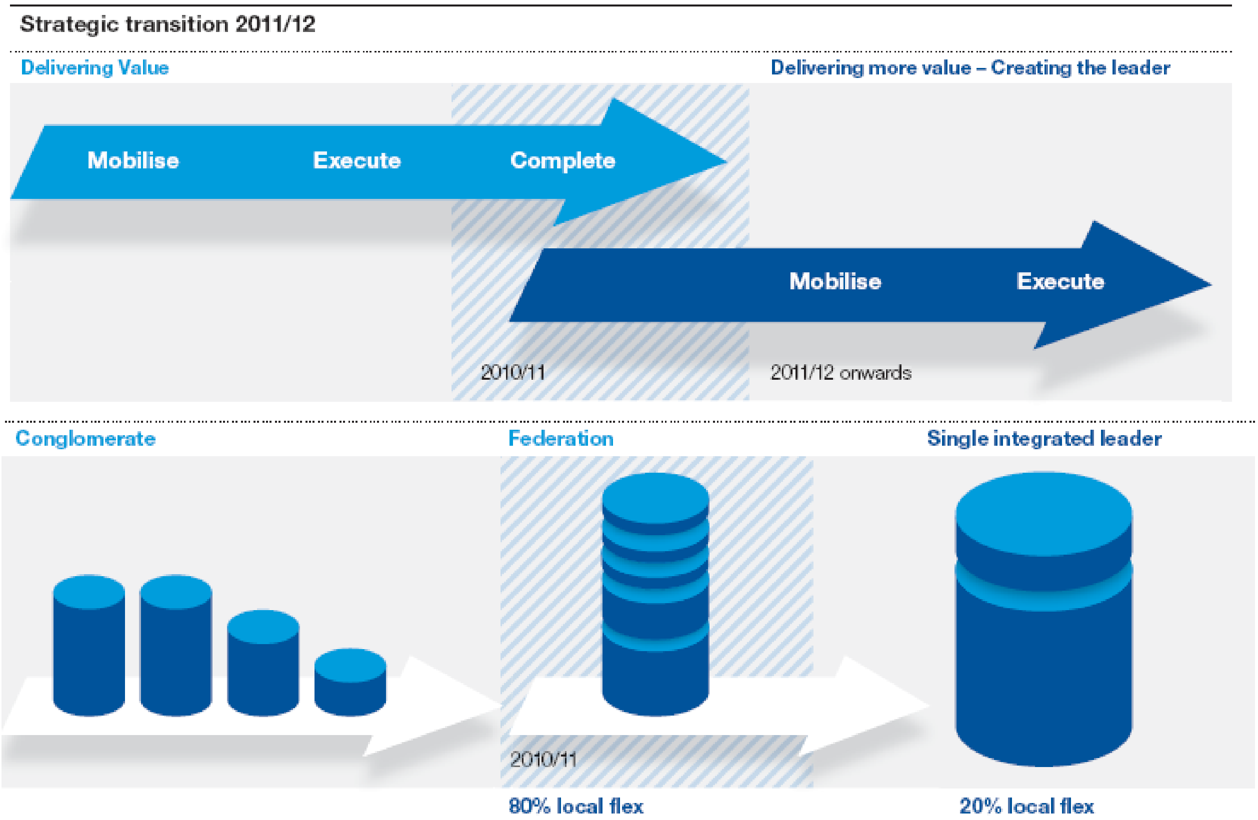
- We will be the best at offering advice and demonstration whether that is in store, online or through social media
- We will de-mystify 'Eco' to make this important trend more accessible

2 Common

"By having a 50% core common range across all our businesses we will use our scale to accelerate innovation, stimulating overall market demand and growing our like-for-like sales and our market share. Our scale will also make home improvement more affordable for our customers whilst boosting our margins."

This is possible because tastes across our markets are increasingly similar as customers travel more and buy products produced from international sources. We already sell the same categories in our stores, such as building & repair materials and tools, gardening and seasonal products, decoration products, kitchens and bathrooms. However, less than 5% of individual products on sale across Micasa's businesses are common to more than one business and sourced from a common supplier, reflecting our previous conglomerate organisation. As we progress towards a more integrated organisational approach we will increase the proportion of products that form a core common range to around 50%. Much of this will be our own brands, sourced direct through the global Micasa Sourcing Organisation.

Greater commonality will result in greater convergence of our operating models around the Group, enabling operating efficiency and cost productivity gains.



3 Expand

"By becoming the best at making home improvement easier and developing a core common range we will be able to accelerate and improve our expansion, thereby growing total sales and market share."

Having strengthened the businesses and established stringent capital disciplines, Micasa is now in a better position to successfully accelerate its expansion. There is potential to grow our current store network from 856 to over 1,100 in our existing markets over the long-term, and also establish a multi-channel presence in each one. Over time we would expect participation of sales from the three geographic operating divisions to be broadly equivalent (UK & Ireland, France and Other International).

'Proven' territories

- We will expand faster and deeper into existing markets where returns are proven

'Early phase' territories

- We will continue to develop in China and Russia and determine suitability for eventual expansion against challenging return hurdle rates

New territories

- We will identify and enter new markets with stores and other channels, leveraging our core common range and more common operating model

Organisational development

Successful delivery of the next phase will require us to complete the journey from our origins as a retail conglomerate to a single, unified retailer. Much progress has been made in recent years and the organisation is now ready to complete the final steps in our journey, thereby unlocking the full potential of our unique international talent and scale.

At the same time it is also very important that we retain the value of our local diversity and closeness to the local customer. Rather than adopting a fully centralised model we will retain our existing country management structures whilst in addition creating a series of teams that work across traditional country and business boundaries. A number of these multinational, multi-operating company teams are already established, are well resourced and empowered to manage key projects, such as common ranging and multi-channel development, under the direction of the Group Executive. Known internally as 'One Team', this new approach will enable us to move from the existing 20:80 (common:local) business model towards an 80:20 model.

Challenging goals

A key element of the success of the Delivering Value programme has been setting clear and challenging medium-term goals linked to share-based incentives. As we start to enter the next phase of Micasa’s development a revision to the existing Performance Share Plan, covering the three years to January 2014, will be proposed for approval by shareholders at the Annual General Meeting in June 2011.

Under the proposals, share awards will be made for reaching stretching earnings and returns targets. The maximum potential share award will vest as follows:

- Earnings: 50% for achieving a compound average growth rate (CAGR) of 15% in adjusted EPS over the three years. EPS in 2013/14 will need to be 31.2p to achieve maximum vesting. Returns: 50% for generating a cumulative Micasa economic profit target over the three years.

Micasa economic profit differs from other reported profit figures because it takes into account a charge for the capital employed in the business. In doing this the calculation treats leases as though they were owned assets within capital employed, capitalising them using long-term property yield methodology. For the purposes of the calculation, reported adjusted post-tax profit is used, but interest and lease costs are added back. A charge for the cost of capital employed is then deducted by applying the Group's lease adjusted WACC to its lease and pension adjusted capital employed.

These share-based incentives will cover the two Executive Directors and the top 50 senior managers with plans to extend elements of this scheme to the next 150 senior managers. Further share incentives for store managers will also be rolled out next year.

2.5 Group buying programmes

Major growth in direct sourcing

In recent years Micasa has worked hard to create an infrastructure through which our Group businesses can source greater volumes of products directly from suppliers. The advantages of such an approach are clear: it gives more control of the sourcing process, reduces time to market and – crucially – enables our businesses to share ranges that offer the greatest value and purchasing appeal to our customers.

Last year saw a genuine step-change in our Group buying performance, with the value of direct shipments reaching $1.3 billion, up 66% on the previous year and significantly ahead of our $1 billion target. Growth was seen across all Group businesses with notably strong results achieved by FaireFacile France, which more than doubled its direct shipments, while Mamaison Poland achieved an increase of 88%, Mamaison France 60% and Myway UK 49%.

From a product perspective the ranges that saw biggest increases in direct shipments were bathroom and kitchen (94%), electrical products (86%), lighting (100%) and garden tools (72%).

The Micasa Sourcing Organisation (MSO) has further enlarged its global footprint, with a new sourcing presence now established in Israel. Elsewhere, the MSO's Vietnamese office, which opened in 2009, continues to extend its reach into South East Asia, while the Warsaw office is sourcing from other eastern European territories including Ukraine, Turkey, Romania and the Czech Republic. Products manufactured outside Poland now generate 45% of the Warsaw team's total buying volumes, which are up 150% year-on-year.

Optimising our supplier base

We recognise that our suppliers hold the key to us achieving our future Group sourcing ambitions. Finding the best manufacturers to meet our exacting standards for quality, innovation, exclusivity and value, then developing strong and mutually beneficial relationships with them, is a prerequisite if we are to make the most of our combined buying scale.

Last year 86% of the $1.3bn we spent on direct shipments was placed with vendors who supply at least two Micasa businesses. In addition, while China remains our most important sourcing market we have worked to establish a truly global supplier base: 25% of our direct sourcing vendors are now located outside China across 32 different countries.

Developing an outstanding portfolio of global Group brands

The more efficiently we can source and market own-brand products to our customers, the greater the benefits we can drive from our Group buying strategy. During the past year a project has been completed to create a streamlined portfolio of 10 exclusive Micasa own-brands covering our key product categories. Some are established names; others have been newly created to meet a particular need.

Each brand is available to all our home improvement formats, with multi-lingual packaging as standard to minimise production lead times. The first common ranges to be delivered under this new strategy were seasonal garden products which went on sale in Myway UK, FaireFacile France, Mamaison Poland, Mamaison Russia and MiMu in early 2011.

Taking common ranging to the next level

Our two largest Group businesses, Myway UK and Mamaison France, are now aligning their product sourcing strategies more closely than ever before.

In the seasonal category, a product roadshow was held in Hong Kong in March 2010 where the buying teams worked together on creating more common ranges of barbecues and garden furniture. This resulted in 60% of this season's barbecue range and 35% of the garden furniture range being common between Myway UK and Mamaison France. We now place 80% of our total garden leisure purchasing through common suppliers. By working together with our suppliers, our combined scale allows us to achieve better commercial terms as well as enabling us to create better designed products which will help us drive sales. To facilitate more cross-Group common sourcing, we have recently created core range catalogues containing 3,000 best selling direct sourced products. This core range is available across the Group, helping us drive more volume through common products.

Ethical sourcing

Micasa continues to work with suppliers to improve labour and environmental conditions throughout its supply chain and monitor compliance with the Micasa Code of Conduct for Factory Working Conditions. Over 1,000 supplier/factory ethical assessments were conducted during the year.

The Micasa Sourcing Organisation works in collaboration with factories to improve standards through factory action plans, partnership projects and training, such as ethical sourcing workshops for factories in India.

2.6 Corporate responsibility – future homes

Micasa's corporate responsibility strategy, which we call Future Homes, has two principal aims. The first is to make sustainable living easier and more affordable for our customers; the second is to embed sustainability into all aspects of our own operations.

1 Sustainable living

We have been working with Forum for the Future, the independent sustainability experts, to develop a new 2020 Future Homes vision which highlights four key priorities where we can make a real and sustainable difference. During the past year we have made significant progress, giving us a strong platform from which to work towards our longer-term goals.

Product innovation

In 2010/11 sales of eco products totalled £1.1 billion - accounting for nearly 11% of total retail sales across the Group. Every item sold in our stores which we highlight as an eco product has been independently assessed by the sustainability experts BioRegional to ensure it meets our rigorous criteria. We have also created Group eco design guidelines to help our buying teams incorporate sustainability principles into their sourcing strategies.

During the year Myway UK launched the first 'best in class' products. Myway customers can now choose loft insulation made from recycled plastic or sheep's wool and carpet underlay made of 100% recycled clothing, while in some stores recycled paint products have been made available on a trial basis. Mamaison France encourages innovation among suppliers through its annual eco product award, now in its third year.

Energy-efficient homes

Our two largest businesses, Myway UK and Mamaison France, now stock around 10,000 products within their respective eco ranges. During 2010 Myway UK enhanced its in-store customer support by introducing trained eco advisers across all stores. Mamaison France has introduced a new logo to highlight its eco product ranges in stores. FaireFacile Spain broke new ground by launching a low-cost solar panel kit priced at €79.

Selling good wood

We exceeded our target to source 75% of timber volume from proven well managed forests or recycled sources. In the UK, Myway has now achieved 100% responsible timber sourcing, with Myway offering the largest range of 'good wood' on the market - more than 16,000 products made from or containing sustainable timber. Myway China has pioneered the introduction of FSC-certified timber in its local market, continuing this work in January 2011 with the launch of a new FSC-certified flooring range.

At Group level Micasa has been instrumental in establishing the Timber Retail Coalition (TRC) alongside other major retailers. The TRC aims to support EU legislation to curb illegally harvested timber.

	2009/10	2010/11	Progress
Timber – reported volume from proven well managed forests or recycled sources (%)	77%	81%	+4% points

Local communities

We are committed to supporting local communities everywhere we operate and increased our community investment by 70% during 2010/11. Micasa has a number of strategic charity partnerships and our operating companies also support a range of projects. For example, at MiMu head office staff mentor local students as part of an employee volunteering programme, while Mamaison Russia has developed a partnership with a charity called 'To Children With Love', which provides support for orphaned children.

	2009/10	2010/11	Progress
Total community investment (£)	£0.94m	£1.60m	+70%

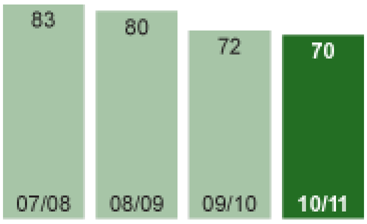
2 Making our operations more sustainable

We have reduced our total CO_2 equivalent emissions (from energy and transport) per £m retail sales by 25% since 2006/07, exceeding our target of a 20% reduction. This year, Myway UK achieved a 9% reduction in CO_2 from electricity, driven by an investment of £2.3 million to improve the energy efficiency of lighting. Micasa continues to work with the Carbon Trust to further reduce the carbon footprint of its stores. During 2010/11, we significantly cut total store waste disposed. For example, FaireFacile France achieved a significant reduction in waste by setting specific waste targets for every store manager.

	2006/07	2010/11	Progress
Total CO_2 equivalent emissions from energy and transport (tonnes per £m retail sales)	59.6	44.5	-25%

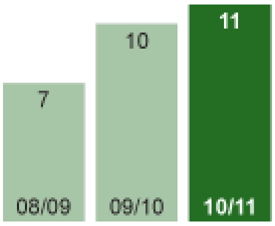
For several years Micasa has been included in the FTSE4Good and Dow Jones Sustainability Indices. In 2010 we also gained inclusion into the Carbon Performance Leadership Index (CPLI) compiled by the Carbon Disclosure Project (CDP).

Corporate responsibility key performance indicators (KPIs) minimising our impact on the environment



i) Climate change

CO_2 emissions from store energy (kg CO_2 equivalent per m^2 total sales area)



ii) Eco-product sales

(% contribution to total retail sales)

2.7 Global integrated sourcing

Micasa is moving towards integrated global sourcing.

The components of this strategy are:

- common ranging: creating products which are common to all Micasa outlets worldwide

- own brand: creating a limited number of own brand lines (currently 10, reduced from 150) available worldwide

- global footprint for MSO (Micasa Sourcing Organisation) which currently has 10 locations overseas from which it operates

- direct sourcing: manufacturers which supply direct to the company

The medium-term goal is to achieve 50% of in-store offerings as own brand direct - sourced. The Brookes range is an example. It is supplied by a US-based multinational which specialise in own brands, manufactured in Europe for the UK market and delivered direct to customers' homes.

Linking the global sourcing strategy to the initiative to make home improvement easier means developing a close working relationship between suppliers, MSO, the Innovation team and Micasa Brands.

This strategy has significant implications for treasury. In simple terms it represents a move from local sourcing on a country by country basis at one extreme to, at the other, a sourcing matrix with worldwide suppliers on one axis and worldwide stores/buyers on the other axis.

3.0 SECTOR OVERVIEW

3.1 Extract from Moodys Global Retail Industry

There is considerable diversity in the general retail sector so broad sector reviews may not catch the subtleties of specific sub-sectors.

In the UK Home-base and to some extent Travis Perkins and Wickes are seen as peer group.

Internationally, Home Depot and Lowe's Companies (both US) are peer group as are the German (Hausmann) and Turkish (Mugla Group) firms, with both of which Micasa already has involvement. Groupe Adeo (French), number 4 globally with 24 companies in 11 countries, is number 2 in Europe and would also be peer group.

The Moody's extract below is from "Rating Methodology: Global Retail Industry", (30.06.2011), pp2-5.

About the Rated Universe

Moody's rates 109 companies covered by the Global Retail Methodology as of October 2010. In the aggregate, these issuers have approximately $330 billion of outstanding debt. The global rated retail universe is very diverse, covering a large number of segments (e.g. grocery store retailers, specialty apparel stores, or department stores), different business models (e.g. direct marketers, vertically integrated manufacturers versus pure distributers) and a wide range of formats (e.g. "big box" retailers or internet- or catalog-based direct-sale operators). Accordingly, retailers globally exhibit very diverse operational and financial dynamics.

The published ratings of the issuers are also very diverse: The corporate family rating (CFR) or senior unsecured ratings of the covered speculative grade or investment grade issuers (respectively) range from Aa2 to Caa3 with a concentration in the B rating category. As of October 2010, 79 companies had stable outlooks, 13 had positive outlooks, 13 had a negative outlooks, three were on review for possible downgrade, and one was on review for possible upgrade.

The rated population consists of 85 retailers in the Americas (primarily in the U.S.), 16 retailers in the Asian-Pacific region, and 8 retailers in EMEA.

Exhibit 1 below shows a list of some of the rated retail issuers as of June 10, 2011.

EXHIBIT 1

Sample Global Retail Rating Methodology Universe

Representative Sample of the Global Retail Industry Rating Universe as of June 10, 2011

	Company	Rating*	Outlook
1	Carrefour S.A.	Baa1	Stable
2	Carsa S.A.	B3	Stable
3	Claire's Stores, Inc.	Caa2	Positive
4	Costco Wholesale Corporation	A2	Positive
5	Dillard's, Inc.	B2	Positive
6	Dollar General Corporation	Ba3	Positive
7	General Nutrition Centers, Inc.	B2	Stable
8	Kroger Co. (The)	Baa2	Stable
9	Lowe's Companies, Inc.	A1	Stable
10	Macy's, Inc.	Ba1	Positive
11	Marks & Spencer p.l.c.	Baa3	Stable
12	Metro AG	Baa2	Stable
13	Nordstrom, Inc.	Baa1	Stable
14	Pep Boys -- Manny, Moe & Jack (The)	B1	Stable
15	Rite Aid Corporation	Caa2	Stable
16	Seven & i Holdings Co., Ltd.	Aa3	Review for possible downgrade
17	SUGI Holdings Co., Ltd.	A2	Stable
18	SUPERVALU INC.	B1	Stable
19	Target Corporation	A2	Stable
20	Tesco Plc	A3	Negative
21	Wal-Mart Stores, Inc.	Aa2	Stable
22	Walgreen Co.	A2	Stable
23	Woolworths Limited	A3	Stable
24	X5 Retail Group N.V.	B2	Stable

*Rating represents the Corporate Family Rating or senior unsecured rating

Note: Of the top four global DIY firms only Lowe's Companies Inc is listed above.

Industry Definition and Characteristics

For the purposes of this methodology, we have defined retailers as companies whose principal business is to act as the final sales point to end-consumers for wholesalers and manufacturers of food and non-food products. Companies that fall within the retail industry typically exhibit the following characteristics:

- » The purchaser of the retailer's goods is a private individual or small trader. Cash-and-carry operators which supply retail channels are included within the scope of this methodology.
- » The goods being purchased are principally physical goods or media content, although we note that some retailers sell services (e.g. financial services / service contracts) as a secondary component of their merchandise offering.
- » Purchasing frequency of goods can vary significantly, ranging from near-daily food purchases to less-than-annual purchases of large consumer electronics or home goods.
- » Selling channel: A retailer could sell its products via physical brick-and-mortar stores and/or direct channel (catalog / Internet).
- » Some retailers solely focus on retailing while others may also be manufacturers that self-retail. [1]

1 Some companies with retail operations may have business segments that may be better evaluated under other industry methodologies. For example, some apparel or vitamins, minerals and nutritional supplements retailers may have a significant wholesale business. As such, we may occasionally evaluate retailers using other Moody's industry methodologies including the "Global Apparel Industry" (May 2010), the "Global Packaged Goods Industry" (July 2009) or the "Global Business & Consumer Service Industry Rating Methodology" (October 2010).

Key Industry Characteristics

The retail industry is highly competitive, faces a wide range of business, logistical and execution risks, and is significantly affected by macroeconomic factors such as unemployment and consumer spending. The following general points summarize the key characteristics of the global retail industry:

- » **Wide range of business risks:** As discussed further in this report, business risk is largely a function of the products which a retailer sells, the market segment in which the retailer operates, the overall competitive environment, and the retailer's positioning within its product and geographic markets. A further complicating factor is the variability of the regulatory and geographic environments in determining new store openings.

  For example, companies which focus on products with less demand variability (e.g. food and basic consumables) will generally exhibit lower business risk. Conversely, we view specialty retailers as having higher business risk due to cyclicality and seasonal volatility, product obsolescence and fashion risk. The positioning of a retailer within its segment, and the rise or fall of entire segments of retailing relative to others, add additional dimensions of risk. Discounters, for example, have globally taken meaningful share in numerous product categories over the past decade. For instance, Wal-Mart has become a key player in the grocery and apparel segments.

- » **High standards of execution, including tight logistics and customer service, are key success factors:** Ultimately, a successful retail business should have demonstrated its ability to efficiently provide customers with the right product at the right time, and at the right price. Competition is often fierce, and customer loyalty can shift rapidly – most rapidly to the negative - if the value proposition of the retailer changes. As a result, a retailer that is unable to provide and maintain satisfactory value to customers will likely see an impact on its operating and financial performance. A successful retailer needs to be flexible in managing its inventory.

- **<u>High fixed cost:</u>** Retailers typically require significant investments in fixed cost, including rent for retail outlets and employment costs. In addition, as a retailer grows it may become more capital intensive due to the need to invest in warehouses, distribution infrastructure and high-tech inventory management systems. These fixed assets need to be updated, refurbished and relocated on an ongoing basis to provide optimal returns. Retailers have a number of financing options at their disposal, including outright asset purchases or lease contracts.
- **<u>Multiple growth models:</u>** The growth strategy for most operators remains based on organic growth, consisting of either new stores or growth in existing stores. We may observe acquisition activities when organic growth is limited, or when there is an advantage in acquiring rather than developing a new technology advance. Growth models evolve over time, as demonstrated by trends towards franchising. Some retailers have expanded internationally to find new sources of growth. Retail formats, however, do not always travel well. International expansions typically take time and multiple iterations before being deemed a success or failure, and can lead to substantial write-offs if unsuccessful. In addition, overseas infrastructure requires significant upfront investment, limiting some of the benefits of size.
- **<u>Relevant markets are likely to be local or regional in nature:</u>** While a few large retailers can show significant geographic diversification, most retailers remain predominantly local or regional businesses. As we rate retailers throughout the world, it is important to understand the regional context in which a company operates to properly evaluate its business model.
- **<u>Significant seasonality and fashion risk:</u>** Non-food retailers in general face significant seasonality, with a high concentration of cash flow during holiday seasons. Severe seasonality can result in a make-or-break period for a retailer, magnifying the financial impact if the retailer misses the trend, carries obsolete inventory, or cannot price its products at a competitive advantage during a key season.
- **<u>Directly influenced by consumer spending, unemployment, and mall traffic:</u>** The retail industry is often severely affected by macroeconomic factors, including unemployment, housing prices, and consumer spending. Retailers that focus on selling non-discretionary products tend to better weather economic downturns – however, no retailer is immune from such downturns. Many retailers sell discretionary items, which the consumers may forego during a recession. Such retailers may be forced to lower prices, reduce margins, and write-off inventory during an economic downturn. Mall traffic, on which many retailers are dependent, may vary for reasons such as changing consumer preferences or changes in local demographics. The price of gas and rise of competing formats are two factors that can affect consumers' decisions to change shopping patterns.

4.0 BORROWINGS AND OPERATING LEASES

4.1 Borrowings

£ millions	2010/11	2009/10
Current		
Bank overdrafts	**95**	125
Bank loans	**89**	136
Medium Term Notes and other fixed term debt	**–**	374
Finance leases	**12**	12
	196	647
Non-current		
Bank loans	**15**	18
Medium Term Notes and other fixed term debt	**504**	812
Finance leases	**58**	53
	577	883
Borrowings	**773**	1,530

Bank overdrafts and loans

Bank overdrafts are repayable on demand and current bank loans mature within the next 12 months. Bank overdrafts are arranged at floating rates of interest. Current bank loans include Chinese Renminbi loans drawn under committed and uncommitted facilities expiring in July 2013 and July 2011 respectively. These loans bear interest based on the People's Bank of China reference rate and are fixed for periods of up to six months. At the year end the effective borrowing rate on the drawn amounts was 4.8%. Other current bank loans are arranged at floating rates of interest.

Non-current bank loans have an average maturity of two years (2009/10: two years) and are arranged at fixed rates of interest with an effective interest rate of 4.3% (2009/10: 6.1%).

There has been a reduction in the level of bank loans in China during the year.

Medium Term Notes and other fixed term debt

Medium Term Notes ('MTNs') were issued in prior years under the Group's €2,500m MTN programme and further notes issued as a US Private Placement ('USPP').

£ millions	Principal outstanding	Maturity date	Coupon	Effective interest rate	2010/11 Carrying amount	2009/10 Carrying amount
Sterling MTN	–	23/03/10[1]	6.88%	7.0%	**–**	85
Euro MTN	–	21/10/10[2]	4.50%	4.6%	**–**	289
Euro MTN	€200m	23/11/12[3]	4.13%	4.3%	**178**	217
US Dollar USPP	$50m	24/05/13[4]	6.14%	6.1%	**35**	144
Sterling MTN	£101m	15/12/14[5]	5.63%	5.8%	**110**	270
US Dollar USPP	$68m	24/05/16[4]	6.30%	6.3%	**49**	57
US Dollar USPP	$179m	24/05/18[4]	6.40%	6.4%	**132**	124
					504	1,186

1 Swapped to floating rate Sterling based on 3 month LIBOR plus a margin using an interest rate swap. £85m was repaid at maturity in March 2010.
2 €200m swapped to floating rate Euro based on 3 month EURIBOR plus a margin using an interest rate swap. €329m was repaid at maturity in October 2010.
3 Swapped to floating rate Euro based on 3 month EURIBOR plus a margin using an interest rate swap. €43m was repurchased in the year.
4 $297m swapped to floating rate Sterling based on 6 month LIBOR plus a margin using a cross-currency interest rate swap. $170m was repurchased in the year.
5 Swapped to floating rate Euro based on 3 month EURIBOR plus a margin using a cross-currency interest rate swap. £149m was repurchased in the year.

Finance leases

The Group leases certain of its buildings and fixtures and equipment under finance leases. The average lease term maturity for buildings is seven years (2009/10: seven years) and for fixtures and equipment is two years (2009/10: two years). Certain building leases include a clause to enable upward revision of the rental charge to prevailing market conditions.

Future minimum lease payments under finance leases, together with the present value of minimum lease payments, are as follows:

	2010/11		2009/10	
£ millions	Present value of payments	Minimum payments	Present value of payments	Minimum payments
Less than one year	12	16	12	16
One to five years	30	42	27	36
More than five years	28	41	26	43
Total	70	99	65	95
Less amounts representing finance charges		(29)		(30)
Present value of minimum lease payments		70		65

The interest rates inherent in the finance leases are fixed at the contract date for the lease term. The weighted average effective interest rate on the Group's finance leases is 8.4% (2009/10: 8.2%).

4.2 Operating leases

Operating lease payments	£ millions	2010/11	2009/10
Minimum lease payments Sublease Income		436 (24)	419 (17)
		412	402

Operating lease commitments

Undiscounted total future minimum rentals payable under non-cancellable operating leases are as follows:

	2010/11		2009/10	
£ millions	Land and buildings	Plant and equipment	Land and buildings	Plant and equipment
Less than one year	390	21	402	22
One to five years	1,458	33	1,509	32
More than five years	2,973	2	3,206	1
	4,821	56	5,117	55

5.0 LATEST RESULTS AND FORECASTS

5.1 Micasa interim statements 2011/2012

MICASA PLC

2011/12 INTERIM CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED INCOME STATEMENT

	Half year ended 30 July 2011			Half year ended 31 July 2010		
£ millions	Before exceptional items	Exceptional items	Total	Before exceptional items	Exceptional items	Total
Sales	**5,662**	-	**5,662**	5,454	-	5,454
Cost of sales	**(3,559)**	-	**(3,559)**	(3,455)	-	(3,455)
Gross profit	**2,103**	-	**2,103**	1,999	-	1,999
Selling and distribution expenses	**(1,407)**	-	**(1,407)**	(1,390)	(9)	(1,399)
Administrative expenses	**(282)**	-	**(282)**	(260)	-	(260)
Other income	**16**	-	**16**	14	2	16
Share of post-tax results of joint ventures and associates	**13**	-	**13**	11	-	11
Operating profit	**443**	-	**443**	374	(7)	367
Analysed as:						
Retail profit	**473**	-	**473**	402	(7)	395
Central costs	**(21)**	-	**(21)**	(20)	-	(20)
Share of interest and tax of joint ventures and associates	**(9)**	-	**(9)**	(8)	-	(8)
Finance costs	**(12)**	-	**(12)**	(22)	-	(22)
Finance income	**7**	-	**7**	6	-	6
Net finance costs	**(5)**	-	**(5)**	(16)	-	(16)
Profit before taxation	**438**	-	**438**	358	(7)	351
Income tax expense	**(118)**	-	**(118)**	(107)	4	(103)
Profit for the period	**320**	-	**320**	251	(3)	248
Attributable to:						
Equity shareholders of the Company			**321**			250
Non-controlling interests			**(1)**			(2)
			320			248
Earnings per share						
Basic			**13.7p**			10.6p
Diluted			**13.5p**			10.5p
Adjusted basic			**13.5p**			10.6p
Adjusted diluted			**13.2p**			10.5p

The proposed interim dividend for the period ended 30 July 2011 is 2.47p per share.

MICASA PLC

2011/12 INTERIM CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED CASH FLOW STATEMENT

£ millions	Half year ended 30 July 2011	Half year ended 31 July 2010	Year ended 29 January 2011
Operating activities			
Cash generated by operations	**375**	492	763
Income tax paid	**(68)**	(51)	(133)
Net cash flows from operating activities	**307**	441	630
Investing activities			
Purchase of businesses and non-controlling interests	**(9)**	-	-
Purchase of property, plant and equipment, investment property and intangible assets	**(263)**	(127)	(310)
Disposal of property, plant and equipment, investment property and intangible assets	**-**	73	87
Interest received	6	6	19
Dividends received from joint ventures and associates	9	7	6
Net cash flows from investing activities	**(257)**	(41)	(198)
Financing activities			
Interest paid	**(9)**	(15)	(33)
Interest element of finance lease rental payments	**(2)**	(3)	(5)
Repayment of bank loans	**(8)**	(37)	(57)
Repayment of Medium Term Notes and other fixed term debt	**(10)**	(124)	(696)
(Payment)/receipt on financing derivatives	**(3)**	2	6
Capital element of finance lease rental payments	**(6)**	(7)	(12)
Issue of share capital under share schemes	**1**	-	3
Purchase of own shares	**(117)**	-	-
Disposal of own shares	**1**	-	1
Dividends paid to equity shareholders of the Company	**(121)**	(84)	(129)
Net cash flows from financing activities	**(274)**	(268)	(922)
Net (decrease)/increase in cash and cash equivalents and bank overdrafts	**(224)**	132	(490)
Cash and cash equivalents and bank overdrafts at beginning of period	636	1,135	1,135
Exchange differences	**22**	(69)	(9)
Cash and cash equivalents and bank overdrafts at end of period	**434**	1,198	636

Cash generated by operations

£ millions	Half year ended 30 July 2011	Half year ended 31 July 2010	Year ended 29 January 2011
Operating profit	**443**	367	698
Share of post-tax results of joint ventures and associates	**(13)**	(11)	(31)
Depreciation and amortisation	**115**	118	238
Impairment losses	-	-	14
Loss on disposal of property, plant and equipment, investment property and intangible assets	**1**	-	4
Share-based compensation charge	**17**	12	21
Increase in inventories	**(155)**	(227)	(238)
Increase in trade and other receivables	**(63)**	(17)	(10)
Increase in trade and other payables	**50**	269	107
Movement in provisions	**(11)**	(10)	(21)
Movement in post employment benefits	**(9)**	(9)	(19)
Cash generated by operations	375	492	763

5.2 Note on third quarter results and latest profit forecasts for 2011/2012

Micasa reported a 14% increase in third quarter earnings; the third quarter retail profit of £273 million compares with the average analysts' forecast of £263 million. Challenging market conditions in Britain and France were offset by market share gains and the drive to improve margins by buying more goods centrally and direct from cheaper manufacturing centres like China.

The Chief Executive Officer said that the likely profit for the full year was in line with the current consensus of analysts' forecasts, namely £799 million adjusted pre-tax profit, compared with last year's outcome of £671 million, an improvement of around 20%.

The latest estimates for eps are:

	2012	2013
high	25.07p	27.63p
average	24.22p	26.36p
low	22.70p	25.14p
last year	20.20p	24.22p

And for sales:

	2012	2013
high	11.04 bn	11.60 bn
average	10.83 bn	11.14 bn
low	10.58 bn	10.85 bn
last year	10.45 bn (+ 3.6%)	10.83 bn (+ 2.9%)

Other information:

Sales growth over the next 5 years	10.32%	10.49%
P/E comparable	13.92	14.23

Between November 2011 and the announcement of the third quarter results in mid-February the shares rose from 256p to 280p. Over the same period the FTSE 100 Index rose from 5503 to 5880.

6.0 FINANCIALS

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

Equity Analysis Model
Micasa plc
Income Statement

		Historical Data						
	Accounts date	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
	Currency / units	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**
	Audit / man / fcst	**audited**	**audited**	**audited**	**audited**	**audited**	**audited**	**unaudited**
	Number of months	**12**	**12**	**12**	**12**	**12**	**12**	**6**
	Sales Revenue	**8,010**	**8,676**	**9,050**	**10,026**	**10,503**	**10,450**	**5,662**
a	(Cost of Sales)	(5,173)	(5,624)	(5,905)	(6,504)	(6,706)	(6,545)	(3,559)
a	**Gross Profit**	**2,837**	**3,052**	**3,145**	**3,522**	**3,797**	**3,905**	**2,103**
a	(Total Overheads)	(2,622)	(2,641)	(2,762)	(3,120)	(3,248)	(3,266)	(1,689)
a	Other Operating (Costs) & Revenues	43	24	22	22	31	34	16
a	Exceptionals etc. +/-	-	50	4	(273)	17	(6)	
b	Cost of Materials, Other External Purchases	-						
b	**Value Added**							
b	(Personnel Costs)	(1,106)	(1,176)	(1,270)	(1,420)	(1,453)	(1,500)	
b	(Depreciation & Impairment of Tangible Assets)	(190)	(175)	(190)	(231)	(230)	(226)	(115)
b	(Amortisation of Intangibles excluding Goodwill)	(340)	(379)	(36)	(34)	(34)	(26)	
b	(R&D Costs)							
b	Other Operating (Costs) & Revenues							
b	Exceptionals etc. +/-							
	Operating Profit	**252**	**492**	**409**	**275**	**609**	**672**	**430**
	Non-operating Income & Expenditure							
	Exceptionals etc.							
	(Amortisation & Impairment of Goodwill)	6	(8)	-	(124)	(12)	(5)	
	Financial Income							
	Income from Investments, Participations etc	11	17	19	22	26	31	13
	Other Financial Income & Expenditure							
	EBIT	**270**	**501**	**428**	**173**	**623**	**698**	**443**
	Interest Received & Paid							
	Interest Received	14	25	33	36	19	19	7
	(Gross Interest Paid)	(52)	(76)	(95)	(119)	(76)	(46)	(12)
	Profit before Tax	**232**	**451**	**366**	**90**	**566**	**671**	**438**
	(Current tax)	(93)	(112)	(114)	(88)	(181)	(180)	(118)
	(Deferred tax)							
	Profit after Tax	**139**	**338**	**252**	**2**	**385**	**491**	**320**
	Extraordinaries, (amortisation of goodwill) etc			20	204			
	Minority Interests	1	(2)	2	3	3	3	1
	(Preference Dividends)							
	Net Income / Earnings for Ordinary Shareholders	**140**	**337**	**274**	**209**	**388**	**494**	**321**
	(Ordinary Dividends)					(125)	(129)	
	Retained Profit for Year	**140**	**337**	**274**	**209**	**263**	**365**	**321**
	Statement of Gains and Losses	11	(12)	265	(22)	(119)	118	4
	Income after gains and Losses	150	327	537	184	266	609	324
	EBITA (before exceptionals & Goodwill Amort.)	**263**	**459**	**424**	**570**	**618**	**709**	**443**
	EBITDA (before Exceps. Deprn, & all Amortisn.)	**793**	**1,014**	**650**	**835**	**882**	**961**	**558**
	Cash Earnings (Before Goodwill, Exceps.& Extraords)	**133**	**295**	**250**	**402**	**383**	**505**	**321**
	Cash Retained Profit (Before Goodwill, Exceps & Extraords)	**133**	**295**	**250**	**402**	**258**	**376**	**321**

Equity Analysis Model

Micasa plc

Balance Sheet

	Historical Data						
Accounts date	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Currency / units	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**
ASSETS							
Fixed Assets							
Intangible Fixed Assets	2,661	2,641	2,617	2,469	2,465	2,481	2,496
Property, Land & Buildings, Forestry Assets - net	2,424	2,286	2,660	2,676	2,673	2,680	2,754
Other Fixed Assets - net	841	924	1,038	1,023	939	952	1,000
Financial Investments, Tax & Pension Assets & Derivatives	200	245	434	449	366	380	405
Medium-term Trade-related Assets	52	47	13	17	22	15	
Total Fixed Assets	**6,178**	**6,143**	**6,762**	**6,634**	**6,465**	**6,508**	**6,655**
Current Assets							
Stocks, Inventories, Work in Progress	1,355	1,531	1,873	1,792	1,545	1,791	1,956
Debtors, Prepayments, Receivables etc.	571	505	533	508	494	513	574
Cash and Short-term Investments	234	395	218	1,157	1,260	731	594
Tax Assets, Derivatives & Other Current Assets	21	43	17	140	82	60	49
Total Current Assets	**2,181**	**2,474**	**2,641**	**3,597**	**3,381**	**3,095**	**3,173**
Total Assets	**8,358**	**8,617**	**9,403**	**10,231**	**9,846**	**9,603**	**9,828**
LIABILITIES							
Current Liabilities (Creditors < 1 Year)							
Creditors, Accruals, Advance Payments etc.	1,751	1,958	2,238	2,362	2,374	2,519	2,558
Short-term Debt	347	241	191	389	647	196	253
Corporation Tax Payable	77	87	89	206	348	372	386
Provisions, Derivatives & Other Current Liabilities	47	56	57	107	61	38	45
Total Current Liabilities	**2,221**	**2,343**	**2,575**	**3,064**	**3,430**	**3,125**	**3,242**
Non-current Liabilities (Creditors > 1 Year)							
Medium & Long-term Debt	1,256	1,432	1,620	1,907	883	577	563
Medium-term Trade-related Liabilities	6	51	32	33	74	76	79
Deferred Tax, Pension & Other Long-term Provisions	555	371	452	429	504	365	386
Total Non-current Liabilities	**1,817**	**1,853**	**2,104**	**2,369**	**1,461**	**1,018**	**1,028**
Share Capital & Reserves							
Issued Share Capital	370	371	371	371	371	371	372
Share Premium Account, Treasury Shares	2,175	2,185	2,188	2,188	2,191	2,194	2,194
Revaluation Reserve							
Other Reserves	(95)	(81)	(66)	(57)	462	497	418
Retained Earnings / Profit and Loss	1,861	1,940	2,220	2,281	1,921	2,390	2,567
Total Capital and Reserves	**4,311**	**4,415**	**4,713**	**4,783**	**4,945**	**5,452**	**5,551**
Minority Interests	9	7	11	15	10	8	7
Total Shareholders' Funds	**4,320**	**4,421**	**4,724**	**4,798**	**4,955**	**5,460**	**5,558**
Balance Check	-	-	-	-	-	-	-

Accumulated depreciation	762	821	1,016	1,320	1,428	1,603	1,833
Average Cost of Debt %	5.05%	4.10%	4.60%	5.50%	5.50%	4.50%	4.50%

Equity Analysis Model

Micasa plc

UK-Style Cash Flow Statement

	Historical Data						
Accounts date	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Currency / units	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**
Number of months	**12**	**12**	**12**	**12**	**12**	**12**	**6**
CASH FLOW FROM OPERATING ACTIVITIES							
Operating Profit	270	501	428	173	623	698	443
Tangible Asset Depreciation	190	175	190	231	230	226	115
Dec(Inc) in Stock / Inventories	(33)	(215)	(216)	169	234	(238)	(155)
Dec(Inc) in Debtors / Receivables	(97)	44	4	69	(18)	(10)	(63)
Inc(Dec) in Creditors / Payables & Advance Payments	27	295	178	(23)	102	107	50
All other non-cash adjustments & Exceptionals	68	(143)	(65)	243	(41)	(20)	(15)
Cash Generated from Operations	**424**	**658**	**519**	**862**	**1,130**	**763**	**375**
Dividends Received from Associates							
Tax Paid	(120)	(98)	(69)	(77)	(3)	(133)	(68)
Net Cash from Operating Activities	**304**	**559**	**450**	**785**	**1,127**	**630**	**307**
CASH FLOW FROM INVESTING ACTIVITIES							
Dividends Received from Investments	5	5	6	3	5	6	9
Interest Received	11	19	22	22	14	19	6
(Purchase of Tangible Fixed Assets)	(435)	(439)	(513)	(390)	(221)	(310)	(263)
Disposal of Tangible Fixed Assets	111	251	117	62	59	87	
(Purchase of Subs, Intang., Financial & Forestry Assets)	(235)	(60)	(1)	(7)	(35)		(9)
Disposal of Subsidiaries, Intangibles & Financial Assets	4	0	71	12			
Net Cash from Investing Activities	**(539)**	**(223)**	**(298)**	**(298)**	**(178)**	**(198)**	**(257)**
CASH FLOW FROM FINANCING ACTIVITIES							
(Total Interest Paid)	(46)	(76)	(95)	(116)	(77)	(38)	(11)
New Shares Issued	14	19	5	1		4	2
(Repurchase / Redemption of Shares)					(7)		(117)
(Costs of Issuing / Redeeming Equity)							
Total Increase in Debt	524	252	136				
(Total Decrease in Debt)	(8)	(145)	(8)	(49)	(644)	(765)	(121)
(Dividends Paid on Ordinary Shares)	(247)	(248)	(249)	(126)	(125)	(129)	(24)
(Preference and Minority Dividends Paid)		(2)	(4)				
Movements Relating to Derivative Instruments					78	6	(3)
Net Cash from Financing Activities	**237**	**(200)**	**(215)**	**(290)**	**(775)**	**(922)**	**(274)**
Net Cash Flow from Ops. Investing & Funding	2	136	(63)	197	174	(490)	(224)
Balance check	(0)	(0)	0	-	-	-	-
Change in Cash	-	160.4	(176.5)	939.0	103.0	(426.0)	(666.0)
Change in Overdraft	1.8	(24.7)	113.5	(742.0)	71.0	(64.0)	442.0

Equity Analysis Model
Micasa plc

Share Price Data

	Historical Data						
Accounts date	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Currency / units	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**
Number of months	**12**	**12**	**12**	**12**	**12**	**12**	**6**
Number of Shares & Eps							
Adjusted Earnings per Share (pence or equivalent)	8.60	9.60	10.60	11.00	16.40	20.50	13.50
Dividends Per Share (pence or equivalent)	7.25	7.25	7.25	5.33	5.50	7.07	5.50
Average number of common shares	2,324.7	2,333.0	2,342.0	2,345.0	2,347.0	2,349.0	2,347.0
Average number of preference shares							
Share Prices							
Common Share Price - Low (pounds or equivalent)	1.97	2.17	1.15	0.89	1.15	1.97	1.15
Common Share Price - High (pounds or equivalent)	3.03	2.76	2.87	1.61	2.49	2.73	2.49
Common Share Price - Average	2.50	2.46	2.01	1.25	1.82	2.35	1.82
Preference Share Price - Low (pounds or equivalent)							
Preference Share Price - High (pounds or equivalent)							
Preference Share Price - Average							
Risk rating							
Variability %	28	24	25	27	31	32	31
Beta (actual or estimate)	1.07	1.02	1.22	0.90	0.95	0.97	0.95
Assumed Market Risk premium	**4.50**	**4.50**	**4.50**	**4.50**	**4.50**	**4.50**	**4.50**
Actual / Assumed 10-year Gilt Yield	**1.83**	**2.83**	**3.83**	**4.35**	**3.73**	**3.40**	**3.73**
LIBOR or equivalent	**4.63**	**5.32**	**5.89**	**2.71**	**0.61**	**0.76**	**0.76**
Market Capitalisation							
Market Capitalisation - Common Stock	5,803	5,748	4,702	2,930	4,273	5,515	4,273
Market Capitalisation - Preference Stock	-	-	-	-	-	-	-
Market Capitalisation - Total	5,803	5,748	4,702	2,930	4,273	5,515	4,273
Minorities	9	7	11	15	10	8	7
Net Debt	1,368	1,278	1,593	1,139	270	42	222
Enterprise value [EV]	**7,181**	**7,033**	**6,306**	**4,084**	**4,553**	**5,565**	**4,502**

Equity Analysis

Equity Ratios							
Eps Growth %		11.6%	10.4%	3.8%	49.1%	25.0%	28.6%
P/E Ratio	29.0	25.7	18.9	11.4	11.1	11.5	27.0
Market / Book Ratio of Equity	1.35	1.30	1.00	0.61	0.86	1.01	0.77
Dividend Cover	1.19	1.32	1.46	2.07	2.98	2.90	2.45
Dividend Yield %	2.9%	2.9%	3.6%	4.3%	3.0%	3.0%	6.0%
Total Return to Shareholders %		1.6%	(14.9%)	(33.5%)	48.7%	32.0%	(38.9%)
EV Valuation Multiples							
EV / Sales	0.90	0.81	0.70	0.41	0.43	0.53	0.40
EV / Book Capital Employed	1.26	1.23	1.00	0.69	0.87	1.01	0.78
EV / EBITA	27.3	15.3	14.9	7.2	7.4	7.8	5.1
EV / EBITDA	9.05	6.94	9.70	4.89	5.16	5.79	4.03

Equity Analysis Model

Micasa plc

Cash Flow Analysis

	Historical Data							
Accounts date	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**Period**
Currency / units	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**£mill**	**Total**
Cash Flow Summary	**audited**	**audited**	**audited**	**audited**	**audited**	**audited**	**unaudited**	**2006-2011**
Number of months	**12**	**12**	**12**	**12**	**12**	**12**	**6**	
CASH FLOW FROM OPERATIONS								
Operating Profit	270	501	428	173	623	698	443	3,136
Other Non-cash & Exceptional Items	68	(143)	(65)	243	37	(14)	(18)	108
Investment Income	5	5	6	3	5	6	9	39
"Cash Profit"	**343**	**364**	**369**	**419**	**665**	**690**	**434**	**3,283**
(Increase) / Decrease in Net Working Assets	(103)	124	(34)	215	318	(141)	(168)	211
Tangible Asset Depreciation	190	175	190	231	230	226	115	1,357
Net Capital Expenditure	(324)	(188)	(396)	(328)	(162)	(223)	(263)	(1,884)
(Tax Paid)	(120)	(98)	(69)	(77)	(3)	(133)	(68)	(568)
(Dividends Paid)	(247)	(251)	(253)	(126)	(125)	(129)	(24)	(1,155)
Free Cash Flow before Interest	**(263)**	**126**	**(193)**	**334**	**923**	**290**	**26**	**1,244**
(Net Interest Paid)	(35)	(58)	(73)	(94)	(63)	(19)	(5)	(347)
Internal Cash Flow	**(298)**	**69**	**(266)**	**240**	**860**	**271**	**21**	**897**
ACQUISITION & FINANCING CASH FLOWS								
(Acquisitions),Disposals,(Investments)	(231)	(59)	70	5	(35)		(9)	(259)
Increase / (Decrease) in Share Capital	14	19	5	1	(7)	4	(115)	(79)
Increase / (Decrease) in Debt	514	132	15	693	(715)	(701)	(563)	(625)
(Increase) / Decrease in Cash		(160)	177	(939)	(103)	426	666	66
Net Financing Cash Flow	**298**	**(69)**	**266**	**(240)**	**(860)**	**(271)**	**(21)**	**(897)**

Equity Analysis Model
Micasa plc

Financial Profile

	Historical Data						
Accounts date	**2007**	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
Number of months	***12***	***12***	***12***	***12***	***12***	***12***	***6***
Annual % Growth Rates							
Sales Growth	4.7%	8.3%	4.3%	10.8%	4.8%	(0.5%)	8.4%
Profitability and Cost Structure							
Gross Profit % Sales	35.4%	35.2%	34.8%	35.1%	36.2%	37.4%	37.1%
Overheads % Sales	32.1%	29.4%	30.0%	33.4%	30.2%	30.7%	29.3%
Exceptional & Other Financial Items % Sales (+/-)		0.6%	0.0%	(2.7%)	0.2%	(0.1%)	
EBIT % Sales	3.4%	5.8%	4.7%	1.7%	5.9%	6.7%	7.8%
Personnel Costs % Sales	13.8%	13.6%	14.0%	14.2%	13.8%	14.4%	
Depreciation % Sales	2.4%	2.0%	2.1%	2.3%	2.2%	2.2%	2.0%
EBITA % Capital Employed (pre-exceptionals)	4.6%	8.1%	6.7%	9.6%	11.8%	12.9%	15.3%
Pre-tax Target Rate of Return 0n Book Value	10.9%	11.7%	11.1%	7.6%	10.4%	11.5%	8.9%
Pre-tax Target Rate of Return on Market Value	8.7%	9.5%	11.1%	11.1%	11.9%	11.4%	11.4%
EBITA % Market Enterprise Value	3.7%	6.5%	6.7%	14.0%	13.6%	12.7%	19.7%
Asset Utilisation / Capital Intensity							
Sales / Total Assets	0.96	1.01	0.96	0.98	1.07	1.09	1.15
Stocks % Sales	16.9%	17.6%	20.7%	17.9%	14.7%	17.1%	17.3%
Debtors % Sales	7.8%	6.4%	6.0%	5.2%	4.9%	5.1%	5.1%
Creditors & Advance Payments % Sales	21.9%	23.2%	25.1%	23.9%	23.3%	24.8%	23.3%
Net Working Assets % Sales	2.8%	0.9%	1.6%	(0.8%)	(3.7%)	(2.6%)	(0.9%)
Tangible Fixed Assets % Sales	41%	37%	41%	37%	34%	35%	33%
Depreciable Assets % Sales	10%	11%	11%	10%	9%	9%	9%
Net Capex % Annual Depreciation	171%	107%	208%	142%	70%	99%	229%
Average Age of Depreciable Assets (years)	4.0	4.7	5.3	5.7	6.2	7.1	8.0
Tax Ratios							
Effective Interest Rate [P&L] %	3.2%	4.6%	5.5%	5.8%	4.0%	4.0%	2.0%
Effective Tax Rate [P&L] %	40.0%	24.9%	31.1%	97.8%	32.0%	26.8%	26.9%
Cash Tax Rate [Cash Flow] %	51.8%	21.8%	18.9%	85.6%	0.5%	19.8%	15.5%

Capital Structure & Credit Status

	2007	2008	2009	2010	2011	2011	2012
Balance Sheet Gearing & Leverage							
Leverage: (Net Debt % Capital Employed)	24%	22%	25%	19%	5%	1%	4%
Net Debt % Enterprise Value	19%	18%	25%	28%	6%	1%	5%
Interest Cover Ratios							
Interest Cover: (EBITA / Net Interest Paid)	7.0	9.0	6.8	6.9	10.8	26.3	88.6
Interest Cover: (EBITDA / Net Interest Paid)	21.0	20.0	10.5	10.1	15.5	35.6	111.6
Cash Flow before Interest / Cash Net Interest	(7.5)	2.2	(2.6)	3.6	14.7	15.3	5.2
Income Leverage (Debt Repayment Ability)							
Gross Debt / Cash Retained Profit	12.0	5.7	7.2	5.7	5.9	2.1	1.3
Net Debt / EBITDA	1.7	1.3	2.5	1.4	0.3	0.0	0.2

ADVANCED DIPLOMA

CASE STUDY EXAMINATION - NOTE FORM ANSWERS

APRIL 2012

QUESTION 1 **[Total 10 marks, 18 mins]**

1a PEST analysis **(5 marks, 9 mins)**

[Marking scheme – I have 20 points so ⅓ mark for each good point]

<u>Political</u>
- tax, regulatory planning etc [1] regimes in UK, Europe, China, Asia, etc have impact.
- very variable country to country and over time [2]
- some very stable, some [3] potentially unstable ? [4]

<u>Economic</u>
- mature market in [19] Europe, still developing elsewhere and faster growing
- sales closely linked to GDP [5] in countries of sale, therefore cyclical. [6] Oil and commodity prices important [7] cost item - products and transportation. Also cost of leasing premises (also cyclical) [8]
- seasonal business eg susceptible to weather [9]

<u>Socio-cultural</u>
- life-style [10] trends <u>very</u> important re “DIY hobby” very different [11] in different countries. “Environmental/green” trends help product sales. [12]
- differing and changing DIY skill base in population [13]
- globalisation of buying habits/tastes

<u>Technological</u>
- affects products, increasing features, [14] reducing cost. Not such a big impact on business itself (retail), but transportation and storage progressively re-shaped to suit store presentation[15] and transport cost.
- Impact of internet? [20]

Tentative conclusions - no big threats, [16] no very big [17] opportunities with economic [18] factors probably the most important, because largely discretionary purchases therefore cyclical tendencies.

1b Market Environments Matrix (5 marks, 9 mins)

"Volume" type market **(1 whole mark)**

[Marking scheme for detailed points – I have 12 points so ⅓ mark for each good point]

Cost-price [1] competition but product range closely tailored to customer [2] needs
Economies of scale [3] e.g. standardisation of products & stores, product range rationalisation [4]
Mass market, relatively stable demand [5] – global market share crucial
Four large global players with dominant, [6] stable market shares
Increasingly centralised control of all operations [7]
Supply & distribution channels [8] important for costs and continuity e.g. global sourcing strategy, logistics [9]
Big marketing spend – brand & image [10] building and re-inforcement
"Systems and resources productivity" [11] - maximising economies of scale globally via products, stores, branding, sourcing, logistical. [12]
Overhead control crucial.

QUESTION 2 Financial Evidence for "Volume" Market Environment

[Total 8 marks, 14.4 mins]

[Marking scheme – I have 16 points so ½ mark for each good point <u>relevant to the questions</u>]

- 5.5% CAGR in sales [1] – low growth rate even with acquisitions, geographical expansion
- Gross margins - slow but steady [2] improvement 35.4 → 37.4% - economies of scale re. external costs. [3]
- Similarly, steady continuing downwards [4] pressure on overheads – economies of scale re. internal costs. [5]
- Low EBIT margin [6] on sales margins but steady improvement to 6.7%
- Sales / asset turnover has [7] increased from .96 to 1.15
- NWA % Sales from plus 2.8% to minus 2.6% (2011) [8] – debtor and creditor management, reflecting bargaining power of a volume business. [9]
- Depreciable fixed assets tightly controlled [10] (capex reduced last 2 years but average still 1.3 [11] times depreciation) and non-depreciable assets reduced by 5% of sales
- Consequent improvement in ROCE, [12] 4.6% (poor) → 12.9% (good) - against stable target of about 11
- Result is EBITA up 170%, EBITDA up 21%, [13] earnings up 253% - operating leverage benefits of a volume business [14]

- NB Tax charge down from 40% to 27% - benefits of scale, [15] centralisation and geographical spread?
- Tight cash flow management [16] has resulted in de-leveraging from 24% to 1% of capital employed and from 1.7 x EBITDA to zero.

QUESTION 3 Treasury/Finance Key Issues [Total 5 marks, 9 mins]

3a 5 most important treasury/finance issues at 2012 (5 marks, 9 mins)

[Marking scheme: 5 credible issues and narrative for clear pass; extra marks for quality and depth of discussion and for adding extra credible issues]

- 1. Currency risks around the sourcing and common range logistics
- 2. Working capital gains and possible adoption elsewhere of France's enforcement of shorter payment terms and in future from sourcing and common range logistics
- 3. Capex criteria for store investment, for business disposal (eg China) and for acquisitions (small and big)
- 4. Managing capital structure (net debt) efficiently while retaining flexibility and satisfying shareholders' expectations
- 5. Protecting investment grade rating

These are arguably the top five and all got several mentions except possibly working capital.

Other important issues mentioned were:

- 6. Currency translation risk re. overseas growth (stores and sourcing)
- 7. Counterparty risk including added complexity of supply chain developments
- 8. Cash management, pooling
- 9. Treasury organisation in response to overseas growth and increasing complexity, to increase visibility of global operations, eg of cashflows
- 10. Eurozone eg contingency plans

In fact (see Q6) several of the above 10 issues can be related to the developing MSO and supply chain function eg 6, 7, 9 + 1, 2, 3 (+ 10).

This question had the highest pass rate (9/9) and the second highest average mark (62%).

QUESTION 4 **[Total 15 marks, 27 mins]**

4a Sustainable Cash Flow 2011-12 (5 marks, 9 mins)

[Marking scheme – I have 15 detailed points so ⅓ mark for each good point]

NB Interim sales up 3.8% [1] on last year. Interim operating profits up 20.8%. Profit forecasts up 15% to 20%. [2]

Operating profit	3	800
Other income, non-cash adjustments	4	(18)
Change in NWA	5	6
Depreciation	6	230
Net capital expenditure	7	(299)
Tax on operating profit	8	(231)
Sustainable cash flow to the firm	9	488

Notes;
Profit pro-rata increase in line with forecast and Interim [10] (15/16% on £698)
Other income less non-cash adjustments – double Interim [11] figures
NWA at 29/1/11 was minus 2.6% of sales x sales of 10,450 x sustainable growth of 3.0% ?
Depreciation very stable over last 3½ years so use [12] £230m.
Fixed asset age = 7.1 years, gives inflation multiplier for capex of 125%, [13] and average actual capex / depreciation ratio = 130%, so use 130% of £230m. [14]
Cash tax on cash profit less excepting also less interest averages 29.5% so use 30% times £772 (800 - 18 - 10) [15]

4b Medium-term WACC Calculation (5 marks, 9 mins)

[Marking scheme – I have 20 points so ⅓ mark for each good point]

Capital structure as at	Interim 2011-12		Final 2010-11		
Cash	(594)	(9.8%)	(731)	(13.1%)	1
Total debt	816	13.6%	773	13.9%	2
Net debt	222	3.7%	42	0.8%	
Market capitalisation (average)	5,788	96.2%	5,515	99.1%	3
Minorities	7	0.1%	8	0.1%	
EV	**6,017**	100.0%	5,565	100.0%	4

NB. Deliberately ignores operating leases – relevant for thinking about gearing and financial risk but not relevant to cost of capital funding.

Assume continuing [5] high levels of cash at 10%, low levels of debt at [6] 13% and equity at 97%. [7] (I assume low balance sheet debt reflects high level of operating leases plus associated risk, which is equivalent to about 33% leverage, but ignore for current purposes.) It seems unlikely [8] that the capital structure will change dramatically over the next 5 years since the company is more profitable and anticipated growth seems to be self [9] funding. A higher dividend policy or share buy-backs could change that position.

Estimated cost of equity = 4.5 + (0.95 x 4.5) = 8.775% [10]

> Gilt yields currently very low (2012) – on a 5-year view use 4.5 [11] which is closer to the last ten years' average rate. Beta at 0.95 is the average [12] for the last 4 years, reflecting recent strategy and results (much higher before that). 4.5 for a typical recent market risk premium. [13]

Currently company debt mainly costs 4.3% to 4.8% but with finance loans at 8.4% - weighted average about 4.8%. ?

Estimated cost of debt = 5.0 x 0.70 = 3.5% [14]

> Interest rates exceptionally low recently but increases are forecast [15] within next 2 years, so use [16] 5.0% to 6% as approximate average of last 5 years being more indicative of likely medium-term cost post-banking crisis. Tax rate approx 29.5% historically. [17]

Estimated return on cash = 2.0 x 0.7 = 1.4% [18]

> Assume 3% below borrowing rate.

WACC = (0.97 x 8.775) + (0.13 x 3.5) - (0.10 x 1.4) = 8.83% [19]

Based simply on net debt WACC would be (0.97 x 8.775) + (0.03 x 3.5) = 8.62% [20]

4c Enterprise Value and Share Price (5 marks, 9 mins)

[Marking scheme – I have 14 points so 0.4 mark for each good point because answers on interpretation of the value are more important than the simple EV calculation]

EV = 488 / 0.0883 – g

Try sustainable growth rate = inflationary growth of between -2% and =+3%

EV plus capitalised leases =

4,506 -2%
4,964 -1%
5,527 0%
6,232 +1%
Current EV = 6,778 [1]
7,145 +2%
8,370 +3% [2]

Assuming 3% sustainable growth rate (inflation 2% plus real growth [3] 1% long term);
Equity value = 8,370 minus minorities of 7 minus net debt of 222 = £8,141 [4] mill.
Share price = £8,141 / 2,339 [5] x 100 = **348 pence per share** [6]

But current EV is £6,778 [7] and share price is around 280 [8] pence (a 20% discount)!
WACC minus growth = SCF / EV = 488 / 6,778 = 7.20%, therefore implied [9] growth is 1.63% (8.83% - 7.20%) – checks with table above.

Shares still look well [10] under-valued at **280p.** Has the strength of the profit growth and strong cash-flow performance not yet been [11] factored in? Does the market think that the recent growth rate of Micasa via acquisitions and investment cannot [12] be supported by market growth / development into the longer term? Or does the sector [13] attract negative ratings?

Because of the large operating leases [14] Micasa is effectively quite highly leveraged operationally so any increase or decrease in profits and cash flow or growth rate has a larger than [15] average impact on the share price. Extra market discount because of this?

QUESTION 5 **[10 marks, 18 mins]**

[Marking scheme – I have 23 points so 0.4 mark for each good point on a difficult question and with messy data]

Average share price is down 6%, market cap down 5%, EV down 23% (2006 – 2011) [1]

Possible reasons for the fall in EV: [2]

1. Because the whole market is down
2. Fall in profitability
3. Lower valuation multiples despite maintained or increased profits

3a Poorer growth prospects or increased risks for the sector or company
3b Unpopular or risky company strategy

1. FTSE up 18.3% to Feb 2012, up 10.7% to March 2011 [3]
   Micasa shares down 3.8% to 2012, down 12.0% to Nov 2011 [4]
   Micasa EV down 5.6% 2006 to November 2011

So this is not the reason [5]

The whole market fell 20% to June 2009 while Micasa and peers fell 40% to 60%, but have since largely recovered in line with the market (except Lowe's) [6]

To February 2012 Micasa shares are down 4% but the FTSE up 18%. [7]

2. On virtually every measure Micasa's profit is up [8] eg EBITDA 21%, earnings 253%, eps 138% [9] to 2011, and even better is forecast to [10] 2012.

   So this is not the reason [11]

3. From the above it follows that multiples must have fallen [12] eg over the same period (2006-2011):

   Market/book down 25% (1.35 to 1.01)
   EV/EBITDA down 36 (9.05 to 5.79)
   P/E down 60% (29 to 11.5) [13]

   While P/E of FTSE down only 14% (14.0 to 12.1) [14]

   Was the company "overvalued" in 2006 or "undervalued" now? [15]

   Probably more of the former rather than the latter.

On the latest share price of 280p, historical eps of 20.50p and prospective eps of 24.22p, historical P/E is 13.7 times and prospective P/E is 11.56 [16] times, low compared to (normal) historical range and averages for Micasa and sector, also FTSE.

3a The average 5-year P/E for Micasa and its peers is 15.7 to 16.1, probably near the average for the whole market. [17] At February 2012 Micasa is at 13.7 (historical P/E) versus peers at 19.2/19.7, so looking relatively undervalued [18] - but in lower growth, Western European markets on average. [19]

3b The recent performance seems to vindicate recent and current strategy [20] so is the reliance on expansion in Eastern Europe (and China) for growth seen as too risky [21] , leaving Micasa in low-growth Western European markets.

Tentative conclusions – shares look relatively undervalued [22] (by 20%) because of market doubts about whether the 2012 improved performance can be maintained or increased in the face of continuing economic recession in Europe and risky growth strategy. [23]

NB. Test question
If EV = market cap plus net debt, does a reduction in debt lead to a reduction in EV? – quoted in quite a few answers.

QUESTION 6 Treasury Implications of Integrated Global Sourcing (IGS)

[Total 34 marks, 61.2 mins]

6a IGS: Treasury issues to keep in mind (10 marks, 18 mins)

[Marking scheme: 10 marks (18 mins) requires a thoughtful answer eg 5 major points with good quality narrative or, say, 10 more specific bullets with some narrative for a pass]

Here is a list of issues in no particular order:

- Potential for reducing stock holding (working capital) by shortening delivery times, sharing stock inter-store, delivering some items direct to customer

- Supplier financial strength assessment

- Business continuity contingency plans, insurance

- Terms of trade which help to secure supply continuity eg lc's for smaller suppliers

- Transport and shipping: pricing and related hedging (fuel), insurance, road transport contracts based on maintaining stock levels versus tonnage and kilometres travelled

- Currency risk management:
  - supplier or buyer risk?
  - level: country, region, central
  - "price list" issue
  - "transfer pricing" issue
  - sourcing JV

Here is an alternative approach with a structure to help determine and classify issues under Supplier, MSO and Branch Buyer.

Supplier of Product	**MSO**	**Branch Buyer**
	• Functional currency	
• Financial strength • Reliability	• L.C. to help finance? • **Continuity risk**	
• Terms of trade • Finance • Currency	• Transfer pricing • Working capital • **Currency risk** - transaction - price list - strategic	• Terms of trade • Finance • Currency
• Transport	• **Cost, term contract** • **Fuel price risk** • **Insurance**	• Transport
	• **IHC (intermediate holding company)** • Tax	
	• Sourcing JVs	• All above

Key: = **Risks**

6b Currency risk policies (20 marks, 36 mins)

This part asks for transaction, pre-transaction and strategic currency risk policies. The structure immediately above, suggested for part 6.a., is the basis for the table of policies below.

The policies are designed for the MSO's integrated global sourcing of core products. The assumption is that MSO acts as an "intermediary" between the product supplier and the branch product buyer. MSO operates within a periodically reviewed sourcing strategy (guided by Strategic Currency Risk policy considerations), negotiates contracts with core product suppliers (guided by a Transactions Currency Risk policy) and sells to Micasa branches (guided by a Pre-Transaction Currency Risk policy).

This approach and the policies suggested below, in their entirety, go beyond what could reasonably be expected for 20 marks (36 mins).

So the marking scheme used was:

[Marking scheme:

- **look for focus on and coverage of one of the three types of risk, eg transaction**
- **look for some understanding of how global integrated sourcing gives rise to the three risks and of MSOs potential role as intermediary]**

The template suggested in the question and exemplified below [MCT 6.4.2] was used by relatively few candidates but worked well for those who did use it.

MSO : CURRENCY POLICIES			
Policy Name	• Strategic currency risk policy for core product sourcing	• Currency transaction risk policy for core suppliers	• Pre transaction currency risk policy for supplying Micasa branches
Policy Objective	• To source in countries and currencies which enable firm to: - maintain medium-term price competitiveness - provides optimum opportunities for internal structural fx hedging	• To achieve budgeted product cost over the financial planning time horizon, while maintaining some flexibility and, if feasible, some upside potential	• To eliminate currency risk at local level • To provide locally competitive and stable product pricing • To facilitate periodic “sales”, “special offers”
Policy Direction	• Review in step with key supplier contract renewals (annually?)	• Work closely with core product sourcing team on terms of trade, eg break clauses, volume discounts, currency pricing (which party takes the risk)	• Work closely with local retail and trade marketing teams to form a forward-looking view about pricing and competitiveness

MSO : CURRENCY POLICIES			
Risk Measures (KRIs)	• Global competitor reviews by core product price • Product quality/price • Delivery reliability	• Unhedged local currency cost volatility • Demand volatility	• Unhedged local currency product price (spot if possible, ie bought off the shelf)
Benchmarking	• Price ranking against local competitors	• Product cost performance against budget	• Local currency product price ranking against competition last year/rolling 12 months
Responsibility/ Oversight	• Board	• Group Treasurer	• Marketing Director
Procedures	• Routine Board report against benchmark	• MSO monthly, prices against budget • Routine report to marketing Director & Group Treasurer • Routine summary to Board	• MSO monthly - price to branch against budget - competitive local price ranking • Routine summary to Board
Decision-making	• Board on recommendation of Marketing Director & group Treasurer	• MSO	• MSO and Marketing Director
Key Performance Indicators (KPIs)	• Local/regional price ranking for core products (in local/regional currency) • Customer satisfaction • Volume of structural hedging	• Product cost against budget	• Improvement on competitive product price ranking a year ago
Reporting/Feedback	• 6 monthly	• 1 monthly	• 6 monthly
Continuous Improvement	• Cross-functional Away-day + Board Review	←	←

6c Implications for Treasury Organisation (4 marks, 7.2 mins)

In broad terms treasury needs to move closer to the business. Executives comment on “conglomerate legacy” and “country sales” as barriers to group-wide common range and innovation initiatives.

So, the treasury needs to position itself as adding value during the pursuit of these goals.

More specifically, treasury needs to be able to:

- centralise activities where conditions permit
- ensure visibility for all transactions
- so as to net cash balances and currency exposures where feasible
- this probably means an upgraded TMS
- and a network of banks which can interface with it

Some responses referred to the Treasury Organisation Profile. What they proposed in terms of the future is summarised below. Micasa might perhaps wish to migrate further to the right, particularly for Role.

Treasury Organisation Profile

Role	**advisory**	**agency** 2	**in-house bank** 2
Authorities	**decentralised**	**centralised** 6	**balanced**
Response to risk	**cost centre**	**cost-saving centre** 2	**profit centre** 1
Organisation	**elementary**	**intermediate** 2	**advanced** 1

QUESTION 7 **[Total 10 marks, 18 mins]**

[Marking scheme – I have 31 points so ⅓ mark for each good point]

Calculations will be based on total cash and finance required then, at the end, will be factored to 50% to reflect Micasa's share.

Sales to double from £300 million i.e. an increase of £300 mill. [1]
Assume fixed asset utilisation is less efficient than for existing operations and/or reflects start up time lags, so 41% t0 37% [2] of sales increase i.e. **£111 to £123 mill.** [3]
Assets under operating leases are currently estimated at £3 [4] billion for the group i.e. another 29% of sales. Assume Micasa will try to replicate their [5] operating lease / finance lease / capital purchase profile but allow for only achieving 40% to 60% of operating leasing i.e. extra fixed asset investment of say 17% to 11% of £300 mill **= £33 to £51 mill.** [6]
Assume working capital management is also cannot hit the same levels of efficiency in Turkey compared with existing operations, so 5% [7] of sales increase i.e. **£15 mill.** [8]

Total period investment of £159 [9] **to £189 mill.** [10]

A crucial question is what profit margins are achievable. The group has increased EBITA margins from 4.6% [11] to 15.3%. We are told that MiMu earns £30 [12] mill profit on £300 mill sales, so assume that this 10% is an EBITA margin, in the middle of Micasa's historical range.
Sales growing from 300 to 600 means, say, 450 p.a. on average over 5 years = £2,250 total sales which, assuming a 10% to 12% margin, allowing for economies of scale, will generate £225 to £270 [13] million profit before tax.
Assume the Turkish tax rate with capital allowances might be as low as 20%, [14] after-tax profit would be £180 [15] to £216 mill.
Micasa's current associate investments generate a dividend [16] of £6 mill on profits after tax of £31 mill or about 5% [17] payout ratio, much lower than the group's 33% to 50% pay-out, as one would expect for a growing subsidiary or associate. Assuming a similar dividend policy for MiMu (hardly significant) would leave 95% of £216 mill = [18] **£171 to £205 mill.** [19]
Given our assumptions there would appear that the expansion is likely to continue to be self [20] funding and range between a **surplus of £205 - £159 = £46mill and a deficit of £171 - £189 = £18 mill.** (+ 46m to – 18m) [21] [22]

At worst the likely resulting deficit of, say, £20 mill, is insignificant [23] in relation to Micasa's total asset base of almost £10 billion, cash of almost £600 [24] mill, debt of £800 mill and annual retained profit of [25] over £400 mill. The same applies to the Mugla Group [26] with "£700 million profit". So neither would have any problem in providing additional capital of £10 mill [27] each, ideally as medium-term loans to maximise the likely tax benefits.

MiMu's balance sheet is likely to show total assets of about £600 mill by the end of the 5-year growth programme and net worth of about £350, [28] so the obvious solution to any temporary or medium-term deficits is to use local [29] Turkish bank funding. The insignificant level of gearing surely would not contravene either parent's capital structure and funding policies, and should be achievable without [30] recourse. It would also extend local banking relationships needed for the day-to-day banking requirements of a retailer. [31]

QUESTION 8 Future Bank Relationship Strategy **[Total 8 marks, 14.4 mins]**

<u>Background: Banks and Micasa</u>

Banks Post Crisis

- Individual banks – more on-going diversity/polarity in individual bank financial strength
- Individual countries – more on-going diversity/polarity in individual country financial strength
- Banks in on-going process of radical changes to business models in response to on-going changes to banking regulation (2012-2019) eg Basel III, Vickers ICB Ring-fence
- Impact on banks
    - credit: less availability
    - credit: more costly
    - credit: long maturities unattractive
    - some banks encouraging disintermediation (to capital markets) to de-risk, deleverage balance sheet
    - universal UK banks to split up retail/commercial from investment banking
    - banks will find it very difficult to continue with "integrated global banking" strategies because of stricter intra-group cross border restrictions
    - retail banks encouraged to "stand-alone" country by country (re capital, liquidity).

Micasa Likely Future Direction

- Global integrated sourcing
- Global financial services to support

  eg cash, fx, trade finance, shipping, fuel, contingency planning

  eg access to local debt markets, transmission
- Treasury organisation functions integrated to support above, TMS for visibility
- Global business development (probably, selectively) eg opportunistic acquisition funding.
- Routine financing via loan, overdraft, MTN, private placement and re-financing for existing business, as well as finance leasing – plus property leasing equating to £5.8bn of additional finance leasing as estimated by CFO.

Conclusion:

Micasa is rationalising its business operations and integrating its supply chain globally to achieve economies of scale and scope. At the same time most of the big banks which had hitherto pursued similar globally integrated strategies and could have comfortably supported the company's global services aspirations are being forced to retreat to their domestic bases to survive the aftermath of the financial crisis and comply with the new regulatory regimes.

So Micasa needs to select its financial service providers carefully to ensure a good match with its future needs.

[Marking scheme: 5 credible elements of a coherent strategy statement with supporting narrative for a pass]

<u>Strategy</u>

Broad Considerations

- Preference for stronger banks (B/S capital and liquidity) in stronger countries as core providers of commercial banking facilities
- Nurture good existing relationship banks
- Emphasis on need for flexibility
- Recognition that in some areas local banks are essential even if weaker
- Diversify: avoid dependence on one provider in any area, particularly where bank B/S strength is critical to provision of service
- Ensure access to capital markets via investment banks
- Exploit quasi-government agencies eg EIB (European Investment Bank), ECAs (export credit agencies)
- Track newer providers, eg insurance companies, non-bank financial intermediaries
- Maintain ample headroom and avoid refinancing cliffs
- Protect investment grade rating so attractive counterparty for banks
- Ensure that banking business is spread across main relationship banks so that the company remains attractive commercially to service providers

Some detailed considerations

- Banks with geographic reach which matches Micasa's footprint are important for fx, cash management, trade finance, supplier finance, point of sale credit/payment systems

- And also for populating the database of a TMS designed to give company-wide visibility

- Financial leasing is currently a major financing need

(• Insurance for stock, property and shipping/transport as well as pension fund management are other significant needs not discussed above but worthy of some marks if mentioned)

Examiner's Report
Advanced Diploma - April 2012

OVERVIEW

	General Exam	Case Exam	Combined
Marks	50.9%	49.6%	50.3%
Questions	8	8	16
Students	11	9	12
Pass #	6	4	10
Pass %	55%	44%	50%

The combined average mark is very similar to that achieved in recent sittings but the combined pass rate is better. Unusually the results for the General Examination this time are better than those for the Case Examination.

Corporate Finance and Funding Summary (both papers)

Overall the quality of answers on the nine corporate finance and funding questions across the two papers (103 marks out of 200) was good. There were 7 passes out of 11 candidates with an average mark of 53.1%. Furthermore the seven passes were clear passes, with two candidates close to distinction level. Two of the fails were marginal but the other two were bad fails. One re-sit candidate did well but one was poor.

Treasury and Risk Management Summary (both papers)

There were seven questions on treasury and risk management across the two papers (97 marks out of 200). A typically, the average mark for the eleven candidates was 48.0% compared with 53.1% for CF & F, and only 5 of the eleven candidates passed. One of the six fails was marginal but the other five were clear fails. On average, candidates found the T & RM questions on the General Exam slightly more difficult than on the Case Exam.

Examiner's Report Case Study Examination

<u>Question 1 (10 marks) average mark 72.2% passes 8/9</u>

Non-financial analysis - PEST and Market Environments Matrix

Candidates generally answered this variation on the generic non-financial first question very well, with the PEST done rather better than the MEM. Better answers were more analytical than descriptive, articulated the positive versus the negative aspects more clearly and gave an overall conclusion/summary. All but two of the candidates concluded that this was a “Volume” market on the Market Environments Matrix, which is what the examiner decided as well. Strangely, one candidate who chose differently produced all the evidence for the Volume environment!

<u>Question 2 (8 marks) average mark 51.1% passes 5/9</u>

Analysis of aspects of the financial profile and of management’s actions that evidence a “Volume” market.

Only three candidates wrote good answers to this variation on the generis finance question 2. Most answers to this question reflected two typical weaknesses of recent examination sittings, in that they were generally not well focused on the actual question set and not very analytical: simply repeating ratios that have already been included in the case study background material, without any commentary at all, is not good enough.

<u>Question 3 (5 marks) average mark 62.1% passes 9/9</u>

This is an “evergreen” question, asking candidates to identify the five most important treasury/finance issues confronting Micasa in 2012, with supporting narrative.

These issues usually become apparent to candidates as they work through Question 1 (business environment) and Question 2 (historic profile). So not surprisingly the pass rate is usually very good as it is in this case (9/9).

The more important issues identified included currency transaction and translation risk, working capital management, capex criteria, counterparty risk, treasury organisation and cash pooling. All of these would be expected to arise in a company of Micasa’s size and diversity. However in Micasa’s case, they are arising in a new guise as a result of the MSO and supply chain developments which are a crucial part of the business model and help to underline the links between business strategy and the profile of treasury functions.

<u>Question 4 (15 marks) average mark 51.5% passes 6/9</u>

Calculation of sustainable cash flow, medium-term WACC, EV and share price value, with commentary on the resulting price per share.

Again, this was a technical question requiring thorough understanding of the underlying concepts, reliable calculations and good judgement with regard to the more subjective elements of DCF valuation of companies. I have therefore given a fairly detailed commentary.

4a Sustainable cash flow (7 passes, average mark 67%). Most candidates answered this well, supported by very good technical calculations and sound logic, but there were some serious and obvious errors. Three candidates did not really understand the concept of SCF and therefore the detailed considerations involved in its estimation, also how it is used in a perpetuity calculation of company value. The most common mistakes involved simply using last year's actual cash flow figures in part or in whole. A more unusual misunderstanding was to attempt a multi-period cash-flow forecast and DCF calculation. Finally, one candidate's cash flow suffered a monumental blow which betrayed a worrying inability to spot a seriously wrong number, by including the level of working capital instead of the change in working capital.

4b WACC (6 passes out of 9, average mark 57%) Most candidates ignored the precise wording of this question, namely "medium-term", "good for …the next five years" and "explain and justify your assumptions". This is a common but potentially fatal failing – not answering the question set but one that the candidate chooses to answer because it is easier. So, most candidates just churned out a "no-brainer" of a WACC calculation which is what the examiner was deliberately trying to avoid - a purely mechanical and lazy calculation based on the 2011 data already given in the case study and using the formula also provided to candidates. We are arguably nearing the end of a period of historically low interest rates, but the likely future pattern of gilt rates, LIBOR and borrowing spreads requires discussion. The five-year pattern of beta for the company should have been discussed, also the fluctuating historical levels of debt, cash and equity should have informed a discussion about the medium-term "policy" level of gearing/leverage. Unfortunately, therefore, this question was wasted on the examination candidates - disappointing!

4C EV and share valuation plus commentary (only 1 pass, average mark 36%) Most surprising was the general inability to get the simple EV and share price calculations correct, through all kinds of errors (maybe running out of time here). Most candidates also had neither the time nor the inclination to "comment on their results", which should have been way out of line with the recent share price history if correctly calculated. It was hugely disappointing that no one answered this part well.

Question 5 (10 marks) average mark 41.7% passes 3/9

Why has EV fallen over the last 7 years?

I knew this question would be a key discriminator. This was a very practical, deceptively simple-looking, question with lots of real-life messy and partly contradictory data. So this was a tough question to answer, which did sort out the best candidates from the average ones, while the weaker ones were lost.

Most candidates were unable to cope because of a combination of poor conceptual, numerical and judgemental skills. The data provided in the question and in the case study background material did allow a systematic examination of whether the fall in EV was because of the overall stock market, the sector, US versus European markets or something to do with the company itself e.g. too recent a recovery in the financials, the change in strategy, the particular growth strategy or its geographical exposure. A few carefully chosen ratios would have eliminated most of the possible reasons in turn but indiscriminate or poor choice of ratios made for confusion. Some candidate failed to use the data on hand at all but just waffled.

Incidentally I concluded that the falling EV and "under-valuation" on the company is down to some combination of "too recent a recovery in the financials, the change in strategy, the particular growth strategy or its geographical exposure".

The worst reason for the falling EV was that since EV = Net Debt plus Market Capitalisation and Net Debt has fallen, therefore EV has fallen!
Maybe this will make a good quick revision question for future course tutors to use.

Question 6 (34 marks) average mark 46.9% passes 3/9

This question is about the treasury implications of integrated global sourcing, specifically (a) the related treasury/finance issues about which the commercial staff should be aware, (b) the related currency risk policies and (c) the implications for treasury organisation.

This was a testing question resulting in a low pass rate (part (a) 6/9, part (b) 3/9, part (c) 4/9, overall 3/9.

The six "pass" responses to part (a) displayed a good grasp of the issues, eg for suppliers/MSO/branch buyers the terms of trade, consequent working capital burden, operational currency/currency risk, supplier financial strength and operational dependability. However in part (b) the detail of currency risk policy in the particular circumstances of integrated global sourcing proved too much of a challenge for the majority: the question proposed the use of a Policy template and those who understood how to apply this fared better. Part (c) about treasury implications eg need to centralise, get visibility, net, upgrade TMS, find compatible banks to service, also caused some casualties.

This challenging question provides a very good example of how treasury skills can add value to a new strategic initiative.

<u>Question 7 (10 marks) average mark 33.0% passes 2/9</u>

Estimation of the amount of investment required to finance a 5-year growth strategy aiming to double sales in a 50/50 joint-venture company, plus thoughts on how to fund any resulting deficit.

This question required the intelligent use of "ball-park" figures, based on financial information given in the case relating to both the parent company and the joint venture, both of which were somewhat sketchy or indirect. So this was another demanding but perfectly feasible and do-able question.

Those who passed achieved their extra marks by covering the sources of funding and related issues very well, because very few candidates were able to assess the funding requirements at all well. As indicated above, the data on the j.v. were realistically a bit thin and tentative, so candidates needed to refer back to the financial fundamentals of the group business to understand; a) fixed asset requirements, b) working capital requirements, c) profit after tax and d) also have a stab at likely dividend policy for the j.v. The resulting conclusion was that the j.v. should probably be able to continue to be self-funding but, if not, the size of funding required was easily manageable given the size and strength of the two j.v. partners.

<u>Question 8 (8 marks)   average mark 50.2%   passes 4/9</u>

This question is about the strategy which Micasa should pursue in relation to its choice and management of future financial service providers, given its own strategic goals and the long-term restructuring currently afoot in the financial services sector.

Micasa is implementing an ambitious global rationalisation of the business with a view to improved performance, competitiveness and future growth. Core to this is the integrated management of the supply chain (Q6) which will require global support from the company's banks, orchestrated by group treasury. However the banking sector is currently retrenching, deleveraging and re-engineering its business models in response to the aftermath of the financial crisis and new regulation . . . . over an extended period to 2019 and possibly beyond.

So it is important that Micasa has a core of financially strong global banks which can react flexibly to the company's developing needs and which match its own global footprint and profile of financial needs. This is the focus of the question. This was a topic on which about half of the candidates had very little to say and the pass rate was low at 4/9.

Overall corporate finance and funding (5 questions, 53 marks)

Only 4 out of 9 passes, average mark for the 9 was 50.0%. This was somewhat disappointing for what was a very practical examination based on the actual finance issues of a real company. Questions 5 and 7 proved to be the undoing of many candidates, both questions requiring the skill and judgement to make the best use of messy real-life data in financial approximations and well-judged calculations. But also, candidates should have done much better than the average 51% achieved on Question 2, the generic finance question. The temptation just to "dump" a standard review or summary of the financial ratios provided in advance in the case-study material, rather than relating what one has learned about the finances of the company to the actual question set, must be avoided.

Overall treasury and risk management (3 questions, 47 marks)

The average mark for the 3 questions was 50% (similar to CF&F) with a pass rate of 6/9. The average for the 6 passes was 58%. One of the fails was marginal, the other two averaged 25%. The T&RM question which candidates found most difficult was Q6 part (b), about currency policy for integrated global sourcing.