The Association of Corporate Treasurers

Examiners Paper, Solutions and Examiners Report

MCT ADVANCED DIPLOMA GENERAL EXAMINATION

April 2015

Questions 1, 2 and 3 relate to the proposed merger of Build plc and Construct plc as described below.

Construct plc initiated merger talks with Build plc on July 25 2014, a move that was generally welcomed by the market. The two UK-based companies have different mixes of business within the broad construction sector, including construction, consultancy and investments.

Industry experts have estimated likely merger synergies of anywhere between GBP 75m and 250m, with a median figure of 160m. They are convinced that real synergies are available, for example in supply chain and IT. Build was considering selective disposal of businesses that were too small to be viable or which did not fit group strategy. One analyst is quoted as saying that “the merger would create a huge industry leader with reduced costs and enough fire-power to take on the world”. It is also estimated that the current re-valuation of Build’s portfolio of publicly funded infrastructure projects could be GBP 500m higher than the book value of GBP 700m.

Build shares had fallen to a 6-year low in May 2014 after its third profit warning in two years, due to a general down-turn in some activities and contract losses in others. This led to the departure of the Chief Executive Officer. This was followed by a “further worsening” of the picture on July 3 and the current forecast for pre-tax profits for 2014 is between GBP 145m and 160m.

Analysts’ forecasts of Construct’s 2014 eps vary between 32p and 36p.

Build walked away from the first proposal and also from a second more-favourable proposal on August 11. This second proposal would have given Build shareholders 56.5% of the equity (worth 1,886m) in the combined group. The current, third and final, proposal, announced on August 18, would give Build shareholders 58.268% of the merged group, a stake valued at GBP 2,086m, plus a final dividend of 8.5p.

Figure 1 gives share prices of Build and Construct, weekly for the last three months and monthly for the last year, to allow insights into the comparative recent and longer-term share-price performance of the two companies.

Figure 2 presents comparative 2013 financial information for the two companies, together with 2012 figures for Build plc which are perhaps more indicative of underlying performance. Given the unusual pattern of tax payments in recent years assume a tax rate of 20% applies to both companies if required.

It is now August 20 2014.

Figure 1

Share Price History

	Weekly, June 2014 to date			
	Construct plc		**Buid plc**	
Date	High	Low	High	Low
18/08/2014	340.2	331.4	248.8	240.7
11/08/2014	351.0	316.7	245.4	235.7
04/08/2014	333.4	314.4	247.7	232.6
28/07/2014	366.8	326.5	256.2	232.9
21/07/2014	386.6	329.2	263.0	229.4
14/07/2014	339.2	322.9	232.9	218.3
07/07/2014	347.1	321.4	230.0	212.2
30/06/2014	350.1	329.4	238.5	192.6
23/06/2014	338.3	326.2	239.8	225.0
16/06/2014	350.6	328.1	244.1	231.1
09/06/2014	363.7	340.8	244.2	235.5
02/06/2014	363.7	352.8	239.0	232.7

	Monthly, August 2013 to date			
	Construct plc		**Buid plc**	
Date	High	Low	High	Low
01/08/2014	351.0	314.4	248.8	232.6
01/07/2014	386.6	321.4	263.0	192.6
02/06/2014	363.7	326.2	244.2	225.0
01/05/2014	379.8	331.8	288.4	218.0
01/04/2014	385.7	354.7	309.5	278.1
03/03/2014	396.5	342.1	322.2	276.2
03/02/2014	379.5	329.5	319.2	280.6
01/01/2014	358.7	321.5	302.3	283.9
02/12/2013	333.0	269.1	297.3	255.9
01/11/2013	312.5	289.0	287.0	259.1
01/10/2013	319.8	297.7	287.9	262.4
02/09/2013	330.5	283.0	286.4	247.1
19/08/2013	299.9	283.0	257.4	242.6

Figure 2

Build/Construct Financials			
	Construct plc	Build plc	Build plc
GBP million	31.12.2013	31.12.2013	31.12.2012
Income Statement			
Sales	**3,332.6**	**8,745.0**	**8,656.0**
Gross profit	348.0	863.0	989.0
EBITDA	**194.5**	**139.0**	**245.0**
Operating profit	150.2	48.0	154.0
Financial income	7.7	65.0	62.0
Financial expense	(47.3)	(81.0)	(69.0)
Profit before tax	**110.6**	**32.0**	**147.0**
Profit attributable to shareholders	**100.2**	(35.0)	**35.0**
Earnings per share (p)	23.3	(5.1)	5.3
Dividends per share (p)	17.5	14.1	14.1
Assets			
Intangible assets	1,552.8	1,252.0	1,372.0
Property, plant & equipment	128.2	208.0	247.0
Investments	163.1	1,216.0	1,362.0
Deferred tax assets	112.6	235.0	216.0
Total non-current assets	**1,956.7**	**2,911.0**	**3,197.0**
Receivables & inventories	1,260.9	1,956.0	2,047.0
Financial instruments & investments	8.6	241.0	5.0
Cash	413.7	604.0	542.0
Total non-current assets	**1,683.2**	**2,801.0**	**2,594.0**
Total assets	**3,639.9**	**5,712.0**	**5,791.0**
Liabilities			
Current borrowing	22.5	179.0	489.0
Trade payables	1588.5	2406.0	2596.0
Tax & other provisions	50.6	371.0	178.0
Total current liabilities	**1661.6**	**2956.0**	**3263.0**
Non-current borrowing	606.4	845.0	386.0
Retirement benefits	373.9	434.0	333.0
Tax & other provisions	14.4	442.0	496.0
Total non-current liabilities	**994.7**	**1721.0**	**1215.0**
Net assets	**983.6**	**1035.0**	**1313.0**
Equity attributable to shareholders	**967.2**	**1033.0**	**1310.0**
Non-controlling interests	**16.4**	**2.0**	**3.0**
Number of ordinary shares (m)	**430.1**	**685.0**	
Share price - current (pence)	338.90	242.40	
Share price - 12 months high (pence)	396.54	322.20	
Share price - 12 months low (pence)	269.07	192.60	
Forecast pre-tax profit range (GBP m)	-	145-160	

QUESTION 1

Assume that the merger goes ahead on the latest terms.

Required:

a) **Calculate the estimated market capitalisation value of the merged companies, and hence the implied new value of Construct equity, based on the details of the final offer to Build shareholders.**

(1 mark)

b) **Compare the equity market capitalisation and the EV values of Build, Construct and the merged entity with the current market values and comment.**

(4 marks)

c) **From the partial information given, estimate the likely earnings, pre-tax profit, operating profit and EBITDA for both companies for the full year 2014. Use your forecasts to obtain the figures for the merged entity.**

(7 marks)

d) **Based on the terms of the final offer, compare and evaluate the values of the two original companies plus the merged entity, with reference to both the historical results, your forecast results and the estimated synergies.**

(7 marks)

e) **Compare the relative attractiveness of the proposed deal for the two sets of shareholders and state whether or not each should agree the proposed deal.**

(2 marks)

(Total 21 marks)

QUESTION 2

Assume that the merger is not agreed but Construct launches an aggressive takeover bid for Build at £3 per share. After extensive analysis Construct has concluded that all existing cash is required for current operational requirements.

Required:

With due consideration to the issues of gearing and eps dilution, propose an appropriate mix of debt and equity to enable Construct to fund the acquisition. Quantify the impact on gearing, interest cover and eps for the post-acquisition group to support your choice of funding mix.

(16 marks)

QUESTION 3

Build has been considering a GBP 200m bid for a small, private Belgian company, Zuidag, which specialises in road-building projects. Assume that Construct's takeover bid for Build is successful, based on the offer terms and on the funding mix in your answer to Question 2, and that Construct decides to evaluate the Belgian proposal.

Prior to the acquisition the quoted beta for Build's equity was 0.79 and Construct's was 0.84. Zuidag's cash flows (before interest but after tax) have been forecast at EUR 8m for 2015, with growth in the following three years of 50%, 30% and 15% respectively, before falling to a residual growth rate of 1%.

Required:

a) **Calculate an appropriate discount rate for the enlarged Construct, post the Build acquisition, based on reasoned assumptions about capital structure, associated beta and borrowing costs, and using all relevant information on the company.**

(9 marks)

b) **Carry out a DCF valuation of the proposed acquisition as at December 2014.**

(4 marks)

c) **Give your recommendation as to whether Construct should proceed with the Belgian acquisition. Justify your recommendation.**

(4 marks)

(Total 17 marks)

QUESTION 4

Your German-based company produces innovative high-precision, high value process-monitoring and control devices. This includes a new product range which can operate remotely via satellite over a wide area and are attractive for petro-chemical and mining applications in countries with less developed communications infrastructure. Customers are typically plant construction engineers or operating companies and all sales are invoiced in EUR.

Annual revenue is EUR 1bn, the company is profitable with above average earnings for its sector but with some volatility reflecting the nature of its customers' markets.

Your company has just established a new subsidiary, its first overseas, in a less developed country (LDC) with a rapidly developing commodity-based economy in order to provide "on the ground" technical support for several longstanding global customers. All devices will be sourced from Germany and invoiced to the local subsidiary in EUR. However all domestic sales must be invoiced in local currency which is pegged to the USD.

It turns out that the import procedures for goods and for the related documents required for payment purposes can be complex and lengthy. Your local Managing Director, a senior development engineer transferred from Group Head Office, has informed you that a local logistics company has proposed a contract under which the logistics company will clear all incoming goods, remit the EUR payments back to the parent company in Germany (forecast at EUR 10m in year 1) and pass on the cost of these EUR remittances to the subsidiary in local currency.

The Managing Director requests your permission to proceed with this arrangement as it makes the import process more efficient and removes the local foreign exchange risk.

Required:

As Group Treasurer, draft a response to the local Managing Director explaining the issues which the logistics company's contract raises and proposing a way forward.

(10 marks)

QUESTION 5

Your company is a long established A+ rated innovative manufacturer of electric generators used in power stations and by companies with operating units large enough to justify generating their own power.

You have in excess of 1,000 component suppliers, two thirds domestic/one third overseas. The majority of suppliers are mid-size engineering sector manufacturers, including some which would be difficult to replace because of their specialist expertise.

A large international commercial bank, not an existing relationship bank, has approached your Finance Director about providing a Buyer Driven Receivables Programme (BDRP), a type of Supply Chain Finance (SCF) sometimes referred to as Reverse Factoring. The Bank explains that BDRP is designed to facilitate both buyer working capital finance and supplier receivables finance and, quoting the Bank, means that "it is a win-win for both parties."

The BDRP Bank's product literature summarises the key features of the arrangement:

- The supplier finance process is triggered by the buyer's (i.e. your company's) approval of the payable rather than by the shipment of the goods. This enables both your company and BDRP Bank to eliminate the performance risk of the supplier because your company's obligations to pay has already been established prior to the purchase of the supplier's receivable – on a non-recourse to the supplier basis – by BDRP Bank.
- BDRP Bank is now providing receivables finance to your supplier at a rate based on your company's investment grade status and ahead of the historical payment terms. This opens up the possibility for your company to negotiate an extension of the historical supplier payment terms, with the agreement of BDRP Bank to finance the additional days.
- Assuming that a significant proportion of suppliers agree to participate, the BDRP Bank's information systems will provide the buyer with much enhanced visibility of supplier performance.

Required:

a) Your Finance Director asks you to prepare a note identifying the pros and cons of initiating a BDRP from both your company's and your suppliers' perspectives.

(9 marks)

b) Comment on how such an arrangement might impact on existing banking relationships.

(3 marks)

(Total 12 marks)

QUESTION 6

Your company, with operations predominantly in Western Europe and North America, has an annual turnover of £2bn, profit after tax of £400m and cash holdings of £200m, mostly invested in money market funds.

Your Finance Director wishes to diversify cash holdings. One of your relationship banks has suggested tri-party repos.

Current cash holdings are invested in:

INSTRUMENT	ENTITY		AVERAGE BALANCE £m	TOTAL £m
Money Market Funds	5 x Large Int'l Banks		30	150
Bank Deposits	2 x Large Int'l Banks		10	20
Bank Balances	10 x Mix Local Banks		3	30
Total				200

The distinguishing feature of a tri-party repo is that an international central securities depositor such as Euroclear or a custodian bank such as JP Morgan Chase acts as the Tri-party Agent ("TPA"). The TPA is the intermediary between the two principal counterparties to the repo, ie the corporate investor of cash/repo buyer and the security owner/repo seller.

TPAs administer trillions of US dollars worth of collateral. They can therefore enable a corporate investor to define in detail an "eligible collateral profile" reflecting the investor's risk appetite, eg in terms of asset type, issuer Standard Industrial Classification ("SIC"), named issuers, credit rating, issue size, and average daily traded volumes.

The repo buyer, repo sellers and the TPA agree to a collateral management service agreement (CMSA) whereby the TPA assumes responsibility for all administration including trading against a predefined basket of collateral, daily valuation/margin call/reporting, settlement and accounting.

Tri-party repos are suitable only for relatively large amounts of cash invested on a repeat basis (eg overnight USD 20-40m, 3 month USD 5-10m) because of set-up costs.

…continued overleaf

Required:

Prepare a note for the Finance Director:

a) Critically assessing the potential benefits and drawbacks of Tri-party repos compared to the current instruments used by the company for investing short term cash.

(8 marks)

b) List and justify your recommendation about alternate investment instruments which you consider suitable.

(4 marks)

(Total 12 marks)

QUESTION 7

As traditional banks' credit capacity dwindled during the financial crisis, some of the resulting shortfall in credit capacity was picked up by non-bank financial institutions, causing concern among regulators about unregulated shadow banks. As it becomes clearer that some of the crisis-driven shortfall in bank credit capacity may not be transitory, regulators have had to shift ground. In a speech in mid-2014 a leading European Central Banker states:

"I think 'shadow banking' is an unhelpful and misleading description. To be clear, we want to see more diversity in the way credit is provided in the economy – more players in the banking sector and more non-bank market-based finance. . . .I suspect one of the reasons the US recovered more quickly from the crisis was because it had greater diversity of credit channels in the economy. For instance, it is for this reason that our Central Bank is working with the European Central Bank ("ECB") and others to encourage the revival of a robust, simple and transparent securitisation market in Europe. But – and this is an important 'but' – it is important that the bank-like activity does not migrate outside of the regular banking system in an uncontrolled manner that presents equally important systemic risks."

Recently some insurance companies in the UK which traditionally funded corporates at arm's length through the bond market, and then moved closer to end users via bilateral private placements, have moved even closer still to full scale origination by building in an end-user specific draw-down schedule.

Required:

a) **Identify the implications for corporate treasurers of this rebalancing of credit sources for treasurer/bank relationship management.**

(6 marks)

And as the post-crisis regulatory framework for banks continues to develop and crystallise, it is becoming clear that governments and regulators want the traditional deposit-taking and lending banks to focus scarce resources on supporting the retail and smaller corporate end of their domestic "real economy". This could well be at the expense of providing larger scale corporate and international services which could encourage banks to become "too big to fail" again. Vickers ring fencing in the UK, the Liikanen recommendations in Europe and the Volker rules in the USA are examples of this trend.

b) **For international companies, explain the implications of this trend for choosing whether to source banking services locally at subsidiary level rather than centrally via the Group Treasury function.**

(3 marks)

c) **For a typical overseas manufacturing subsidiary, explain which bank services should be sourced locally, which centrally and which require senior level sign off?**

(3 marks)

(Total 12 marks)

ADVANCED DIPLOMA

GENERAL EXAMINATION - NOTE FORM ANSWERS

APRIL 2015

QUESTION 1 **[37.8 mins] (21 marks)**

Q1.a. **[1.8 mins] (1 mark)**
[Marking scheme: ½ mark for each good point].

Total market cap. = 2,086/0.58268 = £3,580m
Therefore Construct value = 3,580 – 2,086 = 1,494 = 41.732%

Q1.b **[7.2 mins] (4 marks)**
[Marking scheme: ⅓ mark for each good point].

Current market values of equity

Build 1,660.4 (685 x 2.424)
Construct 1,457.6 (430.1 x 3.389)
Combined 3,118.

Implied Combined added equity value = (£3,580 - £3,118) = £462m (14.8% increase), Build up 25.6%, Construct up 2.5%.

Build bid value looks high – final bid price = 2,086/685 = 345p, (12-month range 218-322p).

Construct bid value looks low – final bid price = 1,494/430.1 = 347p, (12-month range 269-397p.

Build net debt = 604-179-845 = (420)
Construct net debt = 413.7-22.5-606.4 = (215.2)

EVs - based on bid terms; ;
Build = 2,086 + 420 = 2,506
Construct = 1,494 + 215.2 = 1,709.2
Combined = 3,580 + 635 = 4,215

EVs – current market
Build = 1,660.4 + 420 = 2,080.4
Construct 1,457.6 + 215.2 = 1,672.8
Combined 3,118 + 635.2 = 3,753.2
EV increases; Combined 12.3%, Build 20.5%, Construct 2.2%.

Q1.c **[12.6 mins] (7 marks)**
[Marking scheme: 0.4 mark for each good point].

Build pre-tax profit = 145 to 160m given.
Construct eps = 32p to 36p given

Construct's EBITDA is forecast to increase by between 31% and 43%, Build's by between 3% and 9% based on 2012 numbers not 2013. Construct's earnings is forecast to increase by 37% to 55%, Build's by between 219% and 250% (2012 base).

Build/Construct Financials	Forecasts							
	Construct	Construct	Build plc	Build plc	combined	combined	wth synergies	
	low	high	low	high	low	high	low	high
GBP million	2014	2014	2014	2014	2014	2014	2014	2014
EBITDA	**255.9**	**277.4**	**252.0**	**267.0**	**507.9**	**544.4**	**582.9**	**794.4**
Depr. & amort.	44.3	44.3	91.0	91.0	135.3	135.3	135.3	135.3
Operating profit	**211.6**	**233.1**	**161.0**	**176.0**	**372.6**	**409.1**	**447.6**	**659.1**
Financial income	7.7	7.7	65.0	65.0	72.7	72.7	72.7	72.7
Financial expense	(47.3)	(47.3)	(81.0)	(81.0)	(128.3)	(128.3)	(128.3)	(128.3)
Profit before tax	**172.0**	**193.5**	***145.0***	***160.0***	**317.0**	**353.5**	**392.0**	**603.5**
Earnings (Profit attrib.)	**137.6**	**154.8**	**116.0**	**128.0**	**253.6**	**282.8**	**313.6**	**482.8**
Earnings per share (p)	***32.0***	***36.0***	**16.9**	**18.7**				
Number of shares	430.1	430.1	685.0	685.0				

N.B. Marks 3 to 13 for numbers highlighted thus
N.N.B. Marks 14 and 15 for a range of values.

Q1.d. **[12.6 mins] (7 marks)**
[Marking scheme: ⅓ mark for each good point].

N.B. a full analysis is given here for future teaching/learning purposes.

Pre-bid historical;
P/E ratios not comparable because of Build's disastrous, erratic performance – value not supported by current profits.
EV/EBITDA multiples much more consistent at around 8.5 times.

Pre-bid prospective;
Based on the prospective profits and pre-bid prices Construct's multiples look low (P/E 10, EV/EBITDA 6.3) and are much lower than Build's. Is Construct's price under-valuing the forecast improvement in eps and Build's over-valuing its recovery?

Final bid prospective;

The combined P/E at 13.3 and EV/EBITDA of 8.0 are a little lower than Construct's 2014 historical figures but in the ball-park.

In relation to average forecast earnings and EBITDA Construct suffers a drop in its valuation multiples of between 25% and 30%, with a smaller increase in its value compared with pre-bid.

Build's ratios increase much more; prospective P/E is 67% higher than Construct's and its EV/EBITDA multiple is 50% above Construct's. Compared to the ex-ante EV/EBITDA of about 8.5 Construct is below and Build above, again suggesting the deal favour Build more than Construct.

Valuation Multiples					
	C	D	E		
	Construct	Build plc	Build plc	combined	
Historical	2013	2013	2012		
Net debt	215.2	420.0	333.0	635.2	C+D
Market capitalisation (pre final bid)	1,457.6	1,660.4	1,712.5	3,118.0	C+D
EV (pre final bid)	1,672.8	2,080.4	2,045.5	3,753.2	C+D
Earnings (Profit attrib.) (historcial)	100.2	(35.0)	35.0	135.2	C+E
EBITDA (historical)	194.5	139.0	245.0	439.5	C+E
P/E Ratio (historical)	**14.5**	**n.a.**	**48.9**	**23.1**	
EV/EBITDA (historical)	**8.6**	**14.97**	**8.3**	**8.5**	
Prospective; Pre- Bid Values					
Market capitalisation (pre final bid)	1,457.6	1,660.4		3,118.0	
EV (pre final bid)	1,672.8	2,080.4		3,753.2	
Earnings (Profit attrib.) (forecast)	146.2	122.0		268.2	
EBITDA (forecast)	266.7	259.5		526.2	
P/E Ratio (prospective)	**10.0**	**13.6**		**11.6**	
EV/EBITDA (prospective)	**6.3**	**8.0**		**7.1**	
Prospective; Final Bid values					+ synergies
Market capitalisation (final bid values)	1,494.0	2,086.0		3,580.0	3,580.0
EV (final bid values)	1,709.2	2,506.0		4,215.2	4,215.2
Earnings (Profit attrib.) (forecast)	146.2	122.0		268.2	398.2
EBITDA (forecast)	266.7	259.5		526.2	688.7
P/E Ratio (prospective)	**10.2**	**17.1**		**13.3**	**9.0**
EV/EBITDA (prospective)	**6.4**	**9.7**		**8.0**	**6.1**
N.B. Marks 1 to 10 for numbers highlighted thus					

With average synergies;
A P/E of 9.0 and EV/EBITDA of 6.1, both low-ish, suggest the synergies will be lower than expected or take time to realise.

Q1.e. [3.6 mins] (2 marks)
[Marking scheme: ⅓ mark for each good point].

From the analysis of price increases and profit multiples above, the deal favours Build shareholders. Looking at premia over the recent year's low share prices the offer for Build is up 79%, Construct's only 5%. And this is a merger not an acquisition.

Using 8.5 as a typical EV/EBITDA multiple for the companies, the multiple of 9.7 implies EBITDA of 295m, 14% above our (recovery) forecast.

Build has been in crisis for over a year, with a record of repeated profit warnings and the loss of the CEO (is there worse still to come?), Build's shareholders should ACCEPT [6] this generous rescue bid while it is on offer.

Synergies, which would sweeten the deal for Construct shareholders, look dubious at best - Construct's should REJECT.

QUESTION 2 **[28.8 mins] (16 marks)**
[Marking scheme: ½ mark for each good point].

<u>Fundamentals</u>
Value of bid = 3.00 x 685 = 2,055m plus net debt of 420m, gives total EV 2,475m. If no value addition (theoretically correct), actual pre-bid combined EV =3,753m so Construct EV = 1,278, less debt of 215m gives market cap. of 1,063m. So this is a big, if not impossible acquisition, twice as big as Construct.

If Construct's pre-bid value holds, on basis of expected value-adding synergies, Construct EV is 1,672.8, market cap. 1,457.6m.
Post-merger EV = 4,147.8. We use this (more optimistic) assumption in subsequent calculations.

Construct prospective P/E = 10.0, earnings yield 10.0%,
Construct's post-tax cost of debt = 47.3/628.9 x 0.8 = 6.0%
Therefore buying with shares is dilutive.

Build's prospective exit P/E = 2,055/122 (based on average of earnings of 116 and 128) = 16.8, [11] earnings yield 5.9%.
Therefore buying with debt is also marginally dilutive.

<u>For Information and in case of use.</u>
An <u>all-share acquisition</u> would mean number of new shares required = 2,055/338.9 = 606.4m shares (a 141% increase), total shares now 1,036.5.
Using forecast combined earnings of 268.2m (before synergies can be achieved) give eps of 25.9p (was 23.3p in 2013, forecast 32-36p).
Eps dilution of 19-28% - unacceptable, and dividend cover (of 17.5p) very thin at 1.48 (68%pay-out).
Debt/EV = 635/4,148 = 15% - absolutely no problem.

Consider implausible <u>all debt finance;</u>
Total net debt= 215+420+2,055 = 2,690m.
Total EV = 2,475 + 1,673 = 4,148m
Debt/EV = 64%, or 7.94 times forecast EBITDA of 526.2m without synergies – both too high.
Total net interest payable = 55.6+ (7.5% x 2,055) = 210m. Against forecast operating profit of 391 gives cover of 1.86, EBITDA cover of 2.521 – too low.

<u>Debt/equity mix.</u>
<u>Assume maximum Debt/EBITDA of 3.0 times</u>.

Maximum debt = 3 x 526.2 (based on average of 507.9 and 544.4)= 1,579
Less existing debt of both companies of 635 = 944m new debt = 46% of the bid cost.
Debt/EV = 1,579/4,148 = 38% - acceptable?
Extra interest = 944x7.5% = 70.8m, total interest 70.8+55.6 = 126.4m
Operating profit/Interest = 390.9/126.4 = 3.09.
EBITDA/Interest = 526.2/126.4 = 4.16 – so far, so good.

Extra shares needed = (2,055-944)/3.389 = 1,111/3.389 = 328
Total shares = 430+328 = 758, an increase of 76% - big.
Earnings = 268.2 less extra interest after tax (70.8 x 0.8 = 56.6m), gives 211.6.
Eps = 211.6/758 = 27.9p – eps dilution of 13% to 23% - still not acceptable.
With average synergies of 130m after tax (worth 17.2p per share) eps = 341/758 = 45.0p, i.e. 25-41% enhancement.
So, avoiding dilution all depends on synergies, but question mark over size and timing of synergies.

QUESTION 3 **[30.6 mins] (17 marks)**

Q3.a. **[16.2 mins] (9 marks)**
[Marking scheme: 0.4 mark for each good point].

We calculate a parent company GBP WACC based on UK market data.
We assume the level of business risk is comparable to that of existing Build and Construct businesses, so no additional equity premium.
From answers to Q2 we use net debt of 1,579m, which is 38% of EV (4,148 from above). Equity 62%.
With cash at 1,018 (25% of EV) gross debt is 2,597, being 63% of EV.
We use these gearing figures although debt may well reduce over the next few years since it is high for a plc.

Using Hamada:
Un-geared beta for Build is 0.79/ (1+(0.8 x 20.2 / 79.8)) = 0.66
Un-geared beta for Construct is 0.84/ (1+(0.8 x 12.9 / 87.1)) = 0.75
A weighted average would give 0.70

Re-geared beta = 0.70 x (1+(0.8 x 38 / 62)) = 1.04
Then using reasonable assumptions for the risk free rate and the equity premium:
Required return on equity = e.g. 3.5 +(1.04 x 4.0) = 7.66
Previous weighted cost of debt = 7.6% pre-tax, 6.08% after tax.
Might be higher because of higher leverage after Build acquisition, say 9%, after-tax 7.2%. Note that this cost is higher than the cost of equity, which seems unrealistic.
Assume after-tax return on cash = 0.8 x 2.0% = 1.6%.

2-part WACC = (7.62 x 0.66) + (7.2 x 0.38) = 7.48%
3-part WACC = (7.66 x 0.62) + (7.2 x 0.63) – (1.6 x 0.25) = 8.88% - more appropriate because of the large cash balances.
We use 8.86% in the DCF Table below.

This could rise to about 9.9% if gearing is reduced quickly to about 20/80 D/E.

Q3.b. [7.2 mins] (4 marks)
[Marking scheme: 0.4 mark for each good point].

We calculate NPV in Euro terms then convert it to GBP (same as converting cash flows to sterling then discounting. Rate used was 0.73.

Zuidag Acquisition DCF								
		0	1	2	3	4	5	
WACC	**8.86%**	2014	2015	2016	2017	2018	2019	
				50%	30%	15%	1.0%	
cash flows (EUR)			8.0	12.0	15.6	17.9	18.12	**3**
discount rate		1.000	0.919	0.844	0.775	0.712	**4**	
discounted c.f.		0.0	7.3	10.1	12.1	12.8	**5**	
discounted terminal value						164.15	**6**	
PV cash flows (EUR)		**206.5**	**8**					
PV cash flows (GBP) @	**0.73**	**150.7**	**9**			undiscounted TV		
Cost (GBP)		**(200.0)**				230.53	**7**	
NPV (GBP)		**(49.3)**	**10**					
	N.B. Marks indicated as follows				**1**			

Q3.c. [7.2 mins] (4 marks)
[Marking scheme: 0.4 mark for each good point].

A negative NPV so "not worth doing" financially.
The assumed growth rate is strong and the pattern unusual – a lot depends on the first two years' growth in particular. And if WACC rises with expected de-gearing (e.g. 9.9% as above), or the exchange rate moves adversely (we assumed 0.73) it could look even worse (on these figures IRR is about 7.0%).
This is Build's target – how well does Construct know this private company and does it have Belgian experience?
Given the undoubted problems of digesting
Build probably better to let this one go – small so hardly worth the hassle.

QUESTION 4 [18 mins, 10 marks]
[Marking Scheme: FX – clear explanation that the logistics company is NOT hedging FX risk and a credible solution to pass. Pegged currency is NOT a necessary part of the Solution. Extra marks for the potential counterparty risk on the logistics firm and for commenting on the subsidiary organisation]

Context

EUR is the firm's domestic currency. All sales, domestic and overseas, are invoiced in EUR.

The LDC subsidiary is the firm's first overseas subsidiary. The firm intends to treat it like any other overseas buyer and so will invoice the subsidiary in EUR.

The LDC is developing fast on the back of a commodity based economy. The local currency LX is pegged to the USD. The subsidiary must invoice all local sales in local currency LX.

The subsidiary's Managing Director is a development engineer, so has no fx skills.

There are delays in clearing imported goods and perfecting related documents.

Issues

There are two issues:

(i) - delays due to bureaucracy in clearing imported goods and releasing documents necessary for payment

(ii) - fx transaction risk ie EUR-LX on the exports to the subsidiary

- fx transaction risk on the dividend remittances to the parent.

(i) Import delays:

- Delays at the import stage in many countries are commonplace. In time, if the subsidiary prospers, it may be worthwhile to hire someone local who can facilitate matters – as part of a broader role

- Meantime, it might be advisable to retain the services of a local agent. The risk here is that the agency may do something in the course of facilitating imports which compromises the firm

- So due diligence necessary on the agent and alternatives to be explored for cost purposes

(ii) EUR-LX exposure

- The Agent will settle at the spot rate whenever payment documents are released. This is transferring the fx risk straight back to the subsidiary, not managing it.

- "Managing the fx risk" involves the consideration of pricing power and ability to increase prices on the basis of increases in exchange rate, then projecting expected import costs (a function of local subsidiary sales) ahead, say, 12 months, estimating the profit remittances to the parent (timing and amounts) and deciding how much of the net exposure to hedge (between 100% - 0%) and how far ahead to hedge it.

- The Agent may not negotiate the best rate and/or may add a commission %.
- So potential loss of value to parent and/or increased cost of sales locally.
- Significance of peg to USD: if the pegged exchange rate for EUR-LX overstates the value of LX when compared with the rate implied by the interest rate differential between the two currencies, then locking into a forward rate derived from the interest rate differential will always mean paying more for EUR than just taking the spot rate. For example:

TIME	EUR	MANAGED LX	INTEREST DIFFERENTIAL
NOW	1.00	= 1.00	= 1.00
INTEREST	5% Actual	3% Implied by 0.98%	10% Actual
1 YEAR	1.00	= 0.98	= 1.10

The 1 year forward would be EUR/LX = 1.10

The 1 year actual would be EUR/LX = 0.98

So buying 1EUR a year ahead costs 1.10 LX

And buying 1EUR a year from now spot costs 0.98 LX
. . . . . if the peg holds

So, out of ignorance or intuition the Agent may have been right!

The Way Forward

The simplest solution for this Scenario, given all the circumstances, would be for the parent to invoice the subsidiary in LX and manage the EUR-LX risk at Group level, eg deciding whether or not the peg will hold and for how long.

What is needed then from the subsidiary is an update of the sales forecast and remittance back to Group forecast on a monthly basis until a pattern is established.

Other issues

Other issues not discussed above are legal ownership of goods/counterparty risk on Agent, local government view of Agent’s activities, is he “netting” client flows to his advantage?

QUESTION 5 (BDRP) [21.6 mins, 12 marks]

Q5.a. (16.2 mins, 9 marks)
[Marking Scheme: up to 1 mark for each of nine pros/cons spread fairly evenly across the Buyer (easier) and Supplier (harder) for a pass]

Traditionally, firms trading with each other either did it on "open account" at one extreme if they knew and trusted each other or by "documentary letters of credit" at the other if they didn't. Open account simply involves raising an invoice for goods supplied and receiving payment within the credit period agreed. Documentary letters of credit involve the buyer's bank providing the suppliers bank with a guarantee (l.c.) that payment will be made on receipt of the documents evidencing shipment and delivery of goods to the agreed specification. "Open account" characterised domestic trade and "letters of credit" international.

Pursuing working capital efficiencies, firms have learnt to look beyond the narrow boundaries of accounts payable and receivable to the much broader challenge of understanding how the nature of business dictates the level of accounts payable and receivable. This means identifying the drivers and trying to influence these. In the working capital area, this has become known as supply chain finance (SCF).

SCF is a general term. A Buyer Driven Receivables Programme (BDRP) is one type of formalised SCP which has evolved, with commercial banks acting as the evangelists.

A BDRP usually involves a large investment grade corporate with a large number of smaller domestic and overseas suppliers and a large commercial bank who specialises in this area acting as intermediary.

The essence of the Programme is that the supplier finance process is initiated by the approval of payables rather than by the shipment of goods:

- The buyers' approved payable is the suppliers' approved receivable
- The BDRP bank purchases the approved receivable, without recourse to the supplier
- The supplier is in effect paid in advance and pays interest on this amount at a rate which reflects the buyers credit quality
- The supplier pays interest until the buyer settles for the goods provided in accordance with the agreed terms of trade.

Buyers Advantages	**Disadvantages**
- visibility & control of payables	- stronger suppliers may see the move as exploiting buyer power
- data to standardise creditor days	- relationship bank(s) may frown on the advent of a newcomer
- power to negotiate extension of creditor days, given it has facilitated the provision of non-recourse finance	- auditors and banks may interpret the exposure to BDRP bank as having a negative impact on the balance sheet
- facilitated financing of weaker critical suppliers	
- stabilises supply chain by facilitating supplier working capital finance	

Suppliers Advantage	**Disadvantages**
- on the receivables affected, substitution of cheaper debt	- receivables term may be extended, wiping out credit margin savings
- more availability of credit for weaker suppliers because of non-recourse feature	- may disturb relationship with existing bankers

BDRP is variously referred to as Reverse Factoring and Accounts Payable Finance.

Q5.b. (5.4 mins, 3 marks)
[Marking Scheme: 0.33 mark for each plausible point made, provided all three banks involved get at least one mention]

- BDRP bank:
  - gets entry to a new large corporate customer with cross-sell opportunities
  - product service fee
  - lots of short-term revolving credit business at investment grade credit risk and the opportunity to price above that as long as it is below the suppliers' existing cost of debt (great for Basel 3!)
  - data on and access to lots of potential cross-sell suppliers' businesses
- Buyers' bank:
  - frown on new direct competition
  - lose the credit business relating to the standardisation of and extension to payables term
  - assuming BDRP bank has recourse to Buyer for suppliers failure to deliver, may review credit limits

- Suppliers' bank: - loss of working capital finance
  - new direct competition

As mentioned at the outset, Open Account and Documentary Letters of Credit were usually distinguished as being Domestic and Overseas. This distinction no longer holds.

BDRP which has obvious advantages over Documentary L.C.s also has advantages over vanilla open account as a financing device.

Two references with helpful diagrams:

"Bright Idea", John Bugeja, The Treasurer, June 2014, pp 46-47
"BPO: a solution looking for a problem", Treasury Today, February 2014, pp 18-20.
Also:
"Making a success of supplier finance", Treasury Today, April 2014, pp 48-51
More SCF articles in The Treasurer, June 2014, pp 48-51

QUESTION 6 **[21.6 mins, 12marks]**

Q6.a. **(14.4 mins, 8 marks)**
[Marking Scheme: looking for about eight features of TPRs which counterpoint the features of the three existing instruments used and enable comparisons to be made]

The main benefits are:

- Secured
- Can choose risk(s)
- Can choose diversification of risks
- Can segregate the £200m, eg short-term liquidity, holding for acquisition, and match term and risk to purpose.

Main disadvantages are:

- Set up cost
- Complex to understand and explain to Board
- Large amounts required to access product
- Illiquid during term

The main advantage over existing investments is security and the flexibility to closely prescribe risk-return.

Currently MMF is main instrument but will be subject to new regulation soon so tripartite repos are a useful alternative to know about and try out.

Main drawback is complexity and unfamiliarity – applies also to Board members who will need to sign off.

Q6.b. **(7.2 mins, 4 marks)**

[Marking Scheme: Looking for (i) a few critical comments on the major types of Instruments available (provided in tabular form!) and (ii) something that goes a bit beyond the conventional SLY]

Table below is reproduced from an ACT Briefing Note referenced at the end of this Solution. It compares features of Treasury Bills, Banks Depos, Bank CDs, Money Market Funds, Commercial Paper and Repos.

The Repo entries cover both bilateral and tripartite varieties, as does the Briefing Note text.

Table 1 High level comparison of short-term liquid investment products

	Treasury Bill	**Bank Deposit**	**Bank Cert. of Deposit (CD)**	**Money Market Mutual Funds**[3]	**Commercial Paper (CP)**	**Repo**
Counterparty risk	Exposure to one government counterparty	Exposure to one bank counterparty	Exposure to one bank counterparty	Exposure to many counterparties	Exposure to one corporate counterparty	Primary exposure to one counterparty
Secured	no[4]	no	no	no	no	yes
Default risk	Primary counterparty	Primary counterparty	Primary counterparty	Underlying assets, not asset manager	Primary counterparty	Look to collateral if primary counterparty fails
Single name counterparty exposure	100%	100%	100%	10% [5]	100%	Can be as low as 5% if asset to dispose is highly liquid and good reactivity to default

Credit risk analysis	In-house assessment	In-house assessment	In-house assessment	Ultimate exposure delegated to the Asset Manager but review of fund investment policy etc. is by in-house assessment	In-house assessment	In-house assessment on a broader asset class

	Treasury Bill	**Bank Deposit**	**Bank Cert. of Deposit (CD)**	**Money Market Mutual Funds**	**Commercial Paper (CP)**	**Repo**
Custodian required	yes	no	yes	yes	yes	yes
Secondary market	yes	no	yes	yes	yes	yes but not liquid[6]
Indicative yield[7]	0.33%	0.45%-0.65%	0.45%-0.65%	0.49%	0.49% ± 5bps	0.43% (based on 3 mth gilt repo)
Administrative cost	low	low	low	Fees netted from fund's performance	low	• Bilateral = high • Tri-party Agency costs paid by bank
Pre-trade documentation	none	none	none	none	none	• GMRA • CMSA (Tri-party)

[3] The International Organisation of Securities Commissions (IOSCO) has been consulting on Reform of Money Market Funds.

[4] Whilst treasury bills are not collateralised investments they are central government obligations

[5] Based on maximum allowable concentration ratio of 10% for any counterparty

[6] In addition selling repos in the secondary market, the corporate investor may rehypothecate the securities it has received as collateral. Whilst this would increase yield and provide liquidity it does so at the expense of security. The corporate would need to ensure it received the securities back before the original repo trade matured.

[7] Yields as at end of October 2012 for a 3 mth duration. Rates are dependent on the credit quality of the borrower/fund

The Association of Corporate Treasurers, London, November 2012

Of the six instruments listed, your company uses two: MMFs and bank deposits/balances. MMFs regulations are about to change and they will probably become unattractive to corporates.

Of the other four, CDs are not being issued currently by banks.

So that leaves:

- Treasuries
- Bank Depos
- CP
- Repos (bilateral)
- Repos (Tripartite)

Domestic treasuries are very low risk but also low yield

Bank depos have become more risky because of lower bank ratings and also because governments/ regulators are demonstrating a willingness to bail them in if the bank gets in serious trouble. However, big commercial banks are relatively safe again (depending on the country) and with a reasonable monitoring system it should be possible to detect signals in the market if credit quality is deteriorating.

Commercial paper: probably more difficult to monitor and more likely than a big commercial bank to fail suddenly.

Bilateral repos need a considerable amount of detailed admin. Tripartite in contrast are administered (at a cost) by the TPA.

So for this company it would make sense now to set up a tri-party repo (TPR) as a possible alternative to MMFs and test it out.

This is a situation where networking with other treasurers who have moved to TPR would be helpful, eg on the effectiveness of different TPAs.

So the recommendation could be to leave £50m with the banks and begin to shift from MMFs to TPRs, segmenting the £150m into different terms to match up with the various reasons for holding this sum.

References:

ACT Briefing Note: “Practical Steps to Investing in Repos”, November 2013, 20pp [Discusses bilateral & tripartite repos]

“Ready, Steady, Go”, The Treasurer, October 2014, pp 28-29

“Repo Cash Management: How it Works at Microsoft”, Treasury Today, January 2015, pp 14-15

“The Real Deal”, The Treasurer, July/August 2015, pp 30-31

QUESTION 7 **[21.6 mins, 12 marks]**
[Marking Scheme: looking for (a) 8 significant changes in the relationships between banks and corporates which have emerged since 2007; (b) and (c) together – another half a dozen specifically relating to international operations]

Context

Deposit taking and lending banks (DTLBs) are under pressure from regulators and government to:

(i) become smaller so that their possible failure does not threaten the national economy

(ii) structure financially with much higher level of equity capital so that if they fail they do it in a pre-planned way ensuring that the loss is borne directly by investors rather than tax payers

(iii) reduce significantly their traditional maturity transformation and credit diversification roles by reducing dependence on non-customer deposits, match funding to a much greater extent and confining their activities to vanilla lending in the “real” economy (ref the quote in the Question).

In the UK, the ring-fencing of the more basic functions of DTLBs is clear evidence of the regulatory direction of travel. (Although there are signs of increasing push-back from banks as the economy begins to strengthen).

So for corporates, the goal of creating a relationship with a few core banks which can provide a seamless service domestically and internationally across all the classic funding, risk management and payment banking services is becoming increasingly difficult to attain – even if it was in fact ever possible.

And it is a paradox that just at the time when the larger international corporates are breaking new ground by grasping the opportunities provided by new communications and data handling technology to develop global business strategies, regulators are forcing banks to be stand-alone-viable financially on a country by country basis.

Only a few banks have business models which align with the regulators' desires, eg HSBC, Santander. It will be no surprise then that the latter is one of the banks which specialises in BDRP (see Q5 Buyer Driven Receivables Programme) because BDRP address a very basic commercial requirement, it is short-term low risk finance, it requires wide international representation but the global inter-connections required is based on data systems rather than global financial cross border risk, subject by definition to at least two national regulators with a primary duty to protect their own banking system.

Q7.a. (10.8 mins, 6 marks)

So, the implications of the rebalancing of credit sources for corporate treasury relationship management include:

- diminishing capacity of DTLBs to provide classic credit risk and payments services mean that alternative sources need to be found and cultivated

- for credit, for instance, pension funds and insurance companies are an obvious source. They already provide fixed income capital market debt at arm's length by investing in corporate bonds (and of course in equities) so they are no strangers to corporate credit and equity risk

- however, when it comes to tailoring finance to individual corporate needs, then in non-bank financial institutions traditionally there has been no corporate relationship manager to talk to and negotiate with – and little or no chance of re-negotiation or waiver in the event of problems

- as well as identifying sources, the treasurer needs to learn how to work with providers who have not dealt with corporates on a case by case basis before

- and the learning needs to be a two-way process so that the treasurer educates the provider about what drives corporate treasury needs (shades of educating the board). Some insurance companies doing corporate private placements are now building in drawdown schedules agreed with the issuer

- treasurers will need to be open-minded and tap into sources of innovation. For instance, some corporates accessing fixed rate private placements but requiring a 50/50 mix of fixed and floating have done through the agency of consultants matched counterparty swaps with floating rate borrowers wanting some fixed

- cash rich companies concerned about counterparty risk as well as changes to MMF regulation are increasingly tapping into the tri-partite repo market

In summary, there is a need to engage with a broader range of financial service providers and, while being open to new ideas, a need to look through the marketing wrap at the economic reality beneath.

Q7.b. 5.4 mins, 3 marks)

It is the banks which are under pressure to keep it simple and focus on the domestic credit market – corporates are not similarly constrained.

So at least some of the international connectedness which corporates used to rely on banks to provide will need to be engineered by the corporates.

Financial markets have the flexibility to adjust to this. For example, Alchemy plc, the company which features in the Case Exam which is a companion to this Paper has two LSE-ORB EUR100m retail bonds listed on LSE, issued under UK law but targeted at the Benelux countries where the firm has most if its operations and lead-managed by KBC and Fortis.

Q7.c. (5.4 mins, 3 marks)

There is usually a presumption in favour of centralising everything financial. As for 7.b. and credit, similarly for other bank services which create cross border risks for the bank eg fx derivatives. So the pressure is again on the corporate to engineer the necessary inter-connectedness to ensure visibility and control. Overseas service centres are one option.

Services which need sign off would include bank credit and deposit relationships, hedging of any sort, payment systems giving rise to significant settlement risk - particularly international, financial market activities of any kind, issuing of guarantees.

Reference:

- “The role of the leverage ratio and the need to monitor risks outside the regulated banking sector”, Speech, Sir Jon Cunliffe, BoE, 17 July 2014, p6 ff

- “A World of Opportunities”, The Treasurer, December 2013/January 2014, pp 24-25

Examiner's Report   Advanced Diploma - April 2015

OVERALL SUMMARY OF PERFORMANCE

	General Exam	Case Exam	Combined
Marks	36.7%	48.5%	42.5%
Questions	7	8	16
Students	6	6	12
Passes # @50%	0	3	3
Passes # @45%	0	4	4
Pass % (50%)	0%	50%	25%
Pass % (45%)	0%	67%	33%

Range of marks   31.2% to 42.6%   40.0% to 56.1%

OVERVIEW

This exam consisted 100% of re-sit candidates with two re-taking both papers. This was a disappointing set of results on all metrics, typified by the overall average mark of 42.5% with only three passes at the 50% pass-mark level.

The quality of work on the General exam was poor as it was on the Corporate Finance and Funding questions across the two papers (average mark 26%, no passes. Performance on the Risk and Treasury Management questions was better (average mark 49%, 5 passes at 45%, 2 at 50%). The detailed figures below show that an average score of 50% or more was achieved on six out of the total of fifteen questions.

General exam	marks available	passes out of 6	average mark
Q1	21	0	28%
Q2	16	2	28%
Q3	17	0	22%
Q4	10	2	43%
Q5	12	2	45%
Q6	12	5	57%
Q7	12	4	51%
Case exam	**marks available**	**passes out of 6**	**average mark**
Q1	13	6	71%
Q2	11	3	56%
Q3	12	5	61%
Q4	14	4	47%
Q5	14	0	33%
Q6	8	2	33%
Q7	12	3	52%
Q8	16	2	36%

Examiner's Report - General Examination

Question 1 Valuation and evaluation of a proposed merger.

The answers here displayed weak conceptual understanding and inadequate knowledge combined with unreliable numerical work. Many fundamental errors were made, for example in the use of different measures of profit e.g. pre-tax profit is not the same as operating profit and using EBITDA to calculate earnings per share. Some candidates are were unaware of the different usage of the term “earnings” in American versus English terminology. The second failing was conceptual – no basic understanding of corporate value additivity i.e. 1+1 = 2 unless there are positive synergies or excessive merger costs – if the numbers suggest otherwise they are probably wrong.

<u>Question 2</u> Same case as in Question 1 but funding an acquisition rather than a merger.

The standard here was poor which required a clear understanding of the methodology and a rigorous application of the numbers. A quick assessment would have shown that this was a big, if not impossible, acquisition. The best way was to choose the maximum acceptable gearing, then run the credit metrics for the extra debt, then quantify the extra shares needed and run the eps metrics through to earnings after the extra post-tax interest, allowing for the additional shares. But first remember to add the two companies together i.e. the operating profit, **the interest and the debt** but not the equity of the acquired company – that is what the acquirer is buying.

<u>Question 3</u> WACC calculation and DCF evaluation of a small acquisition.

This was a simple, straightforward question but it received the lowest mark on the paper and no passes.

<u>Question 4</u> New Subsidiary in an LDC importing product from the German parent invoiced in EUR wishes to engage a local Logistics Agent (LA) to facilitate imports, including settlement of parent invoices in EUR by LA, susequently billed on to the subsidiary in local currency.

Two of six candidates passed at 50%, five passed at 45%, average mark 43%. There were two problems confronting the M. D. of the subsidiary: clearing the goods at customs and getting the relevant documents and (ii) managing the exchange risk. The M D. recognised both but did not understand the second. The M. D. states in the Question narrative that engaging the LA removes the fx risk because the M. D's. is settling now in local currency – wrong! – at best this is just settling at spot without making any attempt to examine possible ways to hedge the risk that the local currency is depreciating. And there is a paradox here arising from the pegged currency dimension: if the peg is propping up the value of the local currency and is expected to hold in the medium term, then settling at spot is nearly always cheaper than forward cover if the latter is based on interest differential. There are other issues too about the legal position of the LA – eg, "agent" or "principal"? – and about the choice of an engineering specialist as M. D. so quite a lot to go for.

<u>Question 5</u>Advantages and disadvantages of a supply chain process known as Buyer Driven Receivables Programme (BDRP) for the buyer, its suppliers and the various banks involved.

2/6 passed at 50%, 3/6 passed at 45%, average mark 45%, Students fared worst on this Question in the Risk and Treasury Management section. Again, quite a lot of issues to understand and address. The core of BDRP is that the bank providing the service takes the investment grade buyer's recognition of its payable, ie the supplier's receivable, as the basis for purchasing that receivable without recourse to the supplier. If BDRP is adopted by a majority of suppliers – encouraged perhaps by buyer power – then the buyer has the data to justify standardising its payment terms.

If it then decides to extend the terms and if suppliers agree, it will have the BDRP Bank's cooperation in adjusting the price at which it buys the receivable from the supplier to reflect the extension in terms. So students need to understand the pros and cons for all parties – NOT necessarily a win-win for both supplier and buyeras the quote from the BDRP bank in the Question text suggests. There is also the differential impacts of the Programme on the BDRP Bank itself, on the suppliers' banks and on the buyer's bank – the latter in particular given the new cuckoo init's nest. Most students seemed to have difficulty in grasping the entirety of what was going on here. Therefore the responses were somewhat "shotgun" – pellets of wisdom scattered across the pages but a lack of connectedness.

<u>Question 6</u> Critical assessment of using Tri-Party Repos (TPRs) as an alternative to bank deposits and Money Market Funds (MMFs).

5/6 passed at 50%, 6/6 passed at 45%, average mark 57%. In contrast this Question provoked the best responses. Part (a) about positives and negatives was very well/well answered by most. Security, ability to prescribe risk were recognised as positives; set-up cost, complexity, potential illiquidity were picked up as negatives. Treatment of alternatives was a little weaker but was mostly acceptable.

Several mentioned private placements for some reason (?) and a few came up with fixed rate instruments, eg corporate bonds, covered bonds, high yield, all exposed to market risk. But overall, good responses.

<u>Question 7</u> Implications of post crisis banking regulatory changes for corporate - bank relationship management.

4/6 passed at 50%, 4/6 passed at 45%, average mark 51%. In some ways, an easier Question than the others. Four scored well and seemed aware of and in tune with the dramatic structural changes afoot in the financial sector due to new regulation - the other two were clear fails, The purpose of the new regulations is to immunise the taxpayer and the economy from any further Infectious epidemics of exuberance in the banking sector by reducing the size and scope of commercial banking activity and ensuring that the cost of any future failures is borne by investors**.**