MBAC 813 Assignments 2020 **(Individual and Group Assignments)**

Good Luck

Individual Assignment **[40 Marks]**

Bavarian Motor Works (BMW) is a Germany registered plc that has a plant situated in Port Elizabeth, South Africa. The plant manufactures expensive, built to order, right hand drive (BMW) luxury cars for the African commonwealth market. The plant has been in operation for over 40 years. The company has seen an unprecedented year on year growth in revenues and profits over the past 25 years. This growth has been attributed largely to South African companies being exposed to international markets since the advent of democracy in 1994. The quality of South African products has taken international markets by storm. All the right hand drive BMW cars for the African commonwealth markets are manufactured by the plant in Port Elizabeth.

The BMW plant in Port Elizabeth has been supplying all other commonwealth African Markets with expensive, built to order, right hand drive luxury BMW cars except for the Botswana market. Currently, the Batswana customers have been ordering directly from South Africa. The management of the South African division of BMW is considering extending the distribution network into Botswana.

The financial manager has carried out a detailed assessment of costs and revenues of opening a distribution network in Botswana. These are given below as follows:

Initial outlay needed: 9 million Botswana Pulas

The expected cash inflows in Botswana Pulas, net of tax are given below:

Year	1	2	3	4
Cash Flow (millions of Pulas)	3.5	5.9	5.0	7.0

The following information has also been made available:

- Expected inflation rate in Botswana 3% per year
- Due to the fact that South Africa and Botswana are in the same customs union, the real interest rates are expected to be the same.
- Assume the current spot rate is: Botswana Pula 1.3 per 1 ZAR
- The treasury bonds in Botswana carry an interest rate of 4 percent per annum and in South Africa they carry 5 percent per annum.
- The company's current WACC is 14 percent. This is used to evaluate all investment decisions.
- The company's current capital structure is composed of R20 million in shareholder's funds and R4 million long term debt. The debt is redeemable in 2 years' time

According to the presentation made by the financial manager to the board of directors part of the investment can be financed from the cash flow, but since it is also expanding operations in South Africa, the Chief Executive officer prefers external finance if it can be found on favourable terms. The financial manager has noted that the borrowing rates Euro-debt market is favourable. At 3% the rates are below those in both South Africa and Botswana.

Required:

a) Determine the Rand net present value of the project using the following methods:
   I. By discounting annual cash flows in Rands **[8 marks]**
   II. By discounting annual cash flows in Pulas **[7 marks]**

b) Discuss the following: **[25 Marks]**
   1. Discuss both in general terms and as it applies to [BMW] the use of WACC as a discount rate in international operations
   2. The risks faced by BMW when it moves into an international market and how it might manage these risks
   3. The methods of financing international operations and the factors that the company needs to consider before deciding to borrowing in Euro debt

Group Assignment

Mzanzi plc **[50 Marks]**

Background Information

30 Mzanzi plc operates in the oil and gas industries. Its shares are listed on the Johannesburg Stock Exchange (JSE). It operates a number of retail outlets throughout in South Africa. In the past few years the price of petrol has been sky rocketing. As a result the company found it difficult to compete on the price of petrol alone. They decided to concentrate on providing high quality services and facilities at service stations. It provides car wash and retail services at the convenience stores throughout the country. About 60 % of its revenue and 50% of its profits comes from petrol and diesel sales. The remaining sales and profits come from other services provided at its convenience stores which are at its service stations.

Sasol plc has been the major supplier of Mzanzi plc's petroleum products. Some of the products are bought on the open market. Over the past few years Sasol plc has experienced an increase in production costs because of environmental regulations compliance costs. The profit margins of Mzanzi plc have also come under pressure because of increased prices from Sasol plc and increased competition in the market. Mzanzi plc has short term supplier agreements with Sasol plc.

Future strategy

The company is considering possible ways of increasing its profit margins and non-petroleum revenues. The management is considering three possible acquisitions to alleviate the current situation.

Case 1: Vaal oil and Gas owns thirty service stations around Gauteng. The service are of poor image. In the past the company attempted to sell diesel and petrol at the lowest possible prices. As a result little was left in the way of other services. The sites are however in good locations and they are suitable for development and renovations. Institutional investors in Vaal oil and Gas are dissatisfied with the recent performances of the company. As a result they can support the bid if the terms are favourable. The service stations of Vaal oil and Gas are considered too small for major petroleum companies to want to buy. This means that Vaal oil and Gas is unlikely to face a lot of competition from alternative buyers. Sasol plc has indicated to Mzanzi that it will be willing to finance 50 % of the acquisition cost at 9 % interest per annum. The loan will be repaid over 10 years. This would mean that Vaal oil and Gas would enter into a long term supply agreement with Sasol plc for all the thirty service stations.

Case 2: Blue Diamonds specializes in oil distribution. It transports oils from the depots of major oil companies in South Africa. It has been listed on the Johannesburg stock exchange (JSE) since two years ago. It operates a well maintained and managed fleet of oil tankers. Some of these tankers are owned and others are leased. Mzanzi plc has used the services of blue diamonds in the past. 40% of the shares of Blue diamonds are owned by directors and their families. Consequently a successful bid is not assured as it might be considered hostile.

Case 3: Maemo Motors owns and operates 15 car showrooms in upmarket areas in Gauteng. It operates the Mercedes Benz franchise. Maemo motors is a family owned business. It is not listed on a stock exchange. The major shareholder is planning to retire in the near future. His family is showing no interest in taking over the business. The major shareholder has approached the Mzanzi plc management, asking if they would be interested in buying Maemo Motors.

The financial managers of Mzanzi plc have produced the following estimates of expected Net present values (NPV) and post-merger earnings for a full year of Mzanzi with each of the acquisition targets.

	Estimated earnings 1 year after meger	**Estimated NPV of combined entity**
	Rands (millions)	Rand (millions)
Mzanzi plus Vaal oil and Gas	64	1024
Mzanzi plus Blue Diamonds	70	1190
Mzanzi plus Maemo motors	46	736

Financial and other information for Mzanzi and the possible acquisitions targets are given below as follows:

Extract from the statement of financial position of Mzanzi plc as at 31 December 2019

	Rands (millions)	Rand (millions)
Long term assets (NBV)		280
Current assets:		
Inventory	80	
Debtors	160	
Cash and cash equivalents	<u>160</u>	
		<u>400</u>
		<u>680</u>

Ordinary Share Capital (R1 each): Authorised 60million

Issued	40
Retained income	360
8% 8 year Bonds (long term loan redeemable in 8 years)	100
Short term liabilities	180
	680

Summary of financial indicators

	Mzanzi	Vaal oil & Gas	Blue Diamond	Maemo
Year ended	**31 /12/ 2019**	**31 /12/ 2019**	**31 /12/ 2019**	**31 /12/ 2019**
Issued Share Capital (millions)	40	20	24	1
EPS (cents)	206	150	170	360
DPS (cents)	62	110	84	224
Share price (cents)	3296	1350	3060	N/A
NAV (Rand millions)	500	120	130	12
Debt ratio (%)	7%	15%	8%	0
Expected Annual growth rate%	12%	6%	15%	10%
Beta co-efficient	1.4	0.8	1.5	1.45

Additional information:

1. The beta coefficient provided for Maemo motors is an equity beta of a larger quoted company. The company conducts business which is in the same line as Maemo. The larger quoted company has a gearing ratio (debt: debt +equity) of 20%. Assume that the debt has a beta coefficient of zero
2. The forecasted growth rates are based on publicly available information.
3. Ignore taxation issues when answering this question
4. Assume that the return on the market is 12%, and the risk free rate is 6%

Required:

Question 1:

a) Calculate, where relevant, the current market value and the P/E ratio for Mzanzi, and for each of the three acquisition targets **(3 marks)**
b) Use the capital asset pricing model, where relevant, to determine the cost of equity for Mzanzi, and for each of the three acquisition targets **(3 marks)**
c) Use the constant growth dividend valuation model, where relevant, to determine the prospective market value for Mzanzi, and for each of the three acquisition targets **(4 marks)**

Question 2:

In question 1 you calculated the current market values and the prospective market values using the constant growth dividend valuation model. You are also given the net asset value in the scenario. Discuss the limitations and usefulness of each of these three company valuation methods to Mzanzi's acquisition decision. **(12 marks)**

Question 3:

Suppose you are working as the financial manager for Mzanzi plc. Write a report to the managing director; In this report you must discuss the following issues that are pertinent to the acquisition decision:

I. The price that may be offered to the shareholders of the target company. Please note that you must also recommend a range of terms that Mzanzi is prepared to negotiate.
II. The most appropriate method of financing the bid
III. The implications on the business

State any assumptions you make in offering credible advice. There is no single correct answer. **[28 marks]**