INSTITUTE OF COST AND MANAGEMENT ACCOUNTANTS OF PAKISTAN

Fall (Winter) 2008 Examinations

Sunday, the 23rd November 2008

MANAGEMENT ACCOUNTING – BUSINESS STRATEGY – (S-603)

Stage – 6

Time Allowed – 2 Hours 45 Minutes | Maximum Marks – 90

(i) Attempt ALL questions.

(ii) Answers must be neat, relevant and brief.

(iii) In marking the question paper, the examiners take into account clarity of exposition, logic of arguments, effective presentation, language and use of clear diagram / chart, where appropriate.

(iv) Read the instructions printed on the top cover of answer script CAREFULLY before attempting the paper.

(v) Use of non-programmable scientific calculators of any model is allowed.

(vi) DO NOT write your Name, Reg. No. or Roll No. anywhere inside the answer script.

(vii) Question No.1 – "Multiple Choice Question" printed separately, is an integral part of this question paper.

Marks

Q. 2 **(a)** What is leveraged buyout (LBO)? 02

(b) Khyber Industries wishes to sell its sewer pipe division for Rs.100 million. Management of the division wishes to buy it and has arranged a leveraged buyout. Management will put up Rs.10 million in cash. A senior lender will advance Rs.70 million secured by all the assets of the company. The rate on the loan is 2% above the prime rate, which is presently 12%. The loan is payable in equal annual principal installment over five years, with interest for the year payable at the end of each year.

A junior subordinated loan of Rs.20 million has also been arranged, and this loan is due at the end of six years. The interest rate is fixed at 15%, and interest payments only are due at the end of each of the first five (5) years. Interest and the entire principal are due at the end of the sixth year. In addition, the lender has received warrants exercisable for 50% of the shares.

The sewer pipe division expects earnings before interest and taxes of Rs.34 million in each of the first three years and Rs.37 million in the last three years. The tax rate is 33.33%, and the company expects capital expenditure and investments in receivables and inventories to equal depreciation charge in each year. All debt servicing must come from profits. The company can carry forward its operational losses. (Assume also that warrants are not exercised and that there is no cash infusion as a result).

Required:

(i) If the prime rate stays at 12% throughout the six years, will the enterprise be able to service the debt properly? Illustrate your findings. 09

(ii) If the prime rate were to rise to 20% in the beginning of second year and remains unchanged for the second year to the sixth year, would the situation change? 09

PTO

Marks

Q. 3 "Porter's five-forces model of competitive analysis is a widely used approach for developing strategies in many industries". Elaborate the statement with examples. 20

Q. 4 Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation). Contrast strategy formulation with strategy implementation. 10

Q. 5 "There is no single ideal strategy evaluation system for enterprises. The unique characteristics of an organization can determine a strategy-evaluation and control system's final design. Strategy evaluation must meet several basic requirements to be effective". 20

Comment on the above statement.

Q. 6 A firm is considering to purchase a computer at a price of Rs.70,000. The availability of this machine will save an amount of Rs.20,000 per annum in office expenditure.

The computer has a useful life of seven (7) years. A 10% tax credit is available on this investment to encourage the use of computers. The firm's tax rate is 40% and required rate of return (after tax) is 13%.

Required:

(a) Using straight-line depreciation, what is the net present value of installation of computer? 04

(b) If sum-of-the-years' digits method of depreciation is used, what is its net present value? Why does the answer differ from the answer of (a) above. 09

(c) If a working capital investment is required over the life of the computer, what would be the effect on net present value (assume straight-line depreciation). 07

Present value factors

Year	*11%*	*12%*	*13%*	*14%*	*15%*
1	0.9009	0.8929	0.8850	0.8772	0.8696
2	0.8116	0.7972	0.7831	0.7695	0.7561
3	0.7312	0.7118	0.6931	0.6750	0.6575
4	0.6587	0.6355	0.6133	0.5921	0.5718
5	0.5935	0.5674	0.5428	0.5194	0.4972
6	0.5346	0.5066	0.4803	0.4556	0.4323
7	0.4817	0.4523	0.4251	0.3996	0.3759
8	0.4339	0.4039	0.3762	0.3506	0.3269
9	0.3909	0.3606	0.3329	0.3075	0.2843
10	0.3522	0.3220	0.2946	0.2697	0.2472

Cumulative present value factors

Year	*11%*	*12%*	*13%*	*14%*	*15%*
1	0.9009	0.8929	0.8850	0.8772	0.8696
2	1.7125	1.6901	1.6681	1.6467	1.6257
3	2.4437	2.4018	2.3612	2.3216	2.2832
4	3.1024	3.0373	2.9745	2.9137	2.8550
5	3.6959	3.6048	3.5172	3.4331	3.3522
6	4.2305	4.1114	3.9975	3.8887	3.7845
7	4.7122	4.5638	4.4226	4.2883	4.1604
8	5.1461	4.9676	4.7988	4.6389	4.4873
9	5.5370	5.3282	5.1317	4.9464	4.7716
10	5.8892	5.6502	5.4262	5.2161	5.0188

THE END