ICAP

Certified Finance and Accounting Professional Stage Examination

12 June 2025
3 hours and 30 minutes – 100 marks

Business Finance Decisions

CRN: | | | | | | |

Name: ____________________

INSTRUCTIONS

Please carefully read the following instructions:

1. You are required to access your answer working area by using your Student ID and Password as mentioned on your Admit Card.
2. The overall duration of the exam is 3 hours and 30 minutes, which includes the 15-minute reading time and an extra 15 minutes of time that has been allocated due to the introduction of computer-based examinations.
3. All questions are compulsory.
4. Questions can be attempted in any sequence.
5. There is no specific time allocated for individual questions.
6. An auto-save function runs every minute. Further, your answers are saved automatically when you navigate between questions or click on the > **(NEXT)** or < **(BACK)** symbols.
7. Each question provides an answer area with a Rich Text Format (RTF) editor for writing your answers. Additionally, below the RTF editor, a spreadsheet is provided, where necessary, to facilitate examinees in doing rough calculations or other workings. **However, please note that any work performed in the spreadsheet will not be considered for marking. To ensure your work is considered, you must copy and paste it from the spreadsheet to the RTF editor.**
8. Work done in the spreadsheet of one question can also be copied into the RTF editor of the same or another question.
9. You may use Microsoft Office applications such as MS Word or MS Excel for rough working. However, please remember that any work performed in these applications cannot be copied into the examination software, and vice versa. Furthermore, any such work will not be uploaded with your exam for marking.
10. You may use pen and paper for rough work, but please note that pen and paper work should only be done on the last two pages of the question paper that are specifically allocated for this purpose. Remember that any rough work done on these pages will not be uploaded with your exam for marking.
11. In accordance with the open book policy of this paper, you are allowed to use only digital copy of the formula sheet. Keeping a hard copy of any book or notes is not permissible and will be considered a violation under the policy on the use of unfair means.
12. An external calculator can be used, provided it is included in the list of permissible calculators issued by ICAP.
13. During the exam, access to any website other than exam software website and the digital copy of the formula sheet is strictly prohibited. Engaging in such activities will be considered a violation under the policy on the use of unfair means.

Q.1 Innovators Limited (Innovators) is a company that provides business consultancy services to a broad range of commercial and private clients in the Punjab province. The board has recently agreed that the strategic focus of the company should be to serve the commercial clients and consequently the company plans to sell the private clients part of the business.

Innovators created a new 100% subsidiary company called Newco Limited (Newco) on 1 June 2025, the assets and liabilities of the private client business have been transferred to the new company and the board has announced that the business is for sale. The expectation is that the buyer of Newco will relocate the current team of forty employees and so the assets transferred comprise office equipment and receivables, no liabilities will be transferred, and the net asset value is approximately Rs. 36 million.

There have been two expressions of interest in Newco. The first interested party is Soft Solutions Limited, a competitor of Innovators. Initial talks have commenced, and Innovators has shared financial information to assist Soft Solutions with their due diligence. The second potential buyer is the existing management team who are currently in discussion with a venture capital provider to establish if they are able to raise finance for a management buyout.

The following financial information is available for your calculations:

Profit: Private clients division

	Rs. in million
12 months to 31 May 2025	
Revenue	4,450
Cost of revenue	(2,508)
Gross profit	**1,942**
Operating expenses	(835)
Operating profit	**1,107**

Cost of revenue includes an allocation of property lease costs and overheads of Rs. 850 million.

Projected cash flows
The current management team had previously forecast that operating profit growth would be around 5% per year over the next 5 years.

It is difficult to predict growth beyond year 5 though it is expected that after tax profits will either be flat or increase by a maximum of 3% per year.

Dividends
Historically Innovators have distributed 40% of after-tax profit as dividend.

Market information

Market return	21%
Risk free return	12%
Industry average equity beta	0.52
Industry average gearing	Debt: Equity = 25%: 75%
Industry average PE ratio	12
Corporate tax	29%

Required:
(a) Apply appropriate valuation techniques to recommend a price for the sale of Newco. You should include an explanation of your approach as part of your answer. **(13)**
(b) Advise on any **two** risks that will arise with each of the prospective buyers and recommend an action that Innovators might take to mitigate these risks. **(06)**

Q.2 InvestPak Limited is an investment company based in Pakistan. The board would like to add to the current portfolio of investments which is currently worth Rs. 8,000 million. A recent disposal of underperforming UK investments from the portfolio has resulted in Rs. 2,000 millions of surplus cash (not included in the Rs. 8,000 million) which the board is seeking to reinvest, the board has shortlisted two possible investment opportunities.

The first is to invest Rs. 2,000 million in Aaron Limited (Aaron). Aaron is a company listed on an American Stock Exchange. The company is an established Fin Tech company that has performed well in recent years.

The second opportunity is to invest Rs. 2,000 million in Zyal Limited (Zyal). Zyal is a property investment company, and is not quoted on a stock exchange. Zyal is seeking new finance to fund a new property development in Lahore.

A summary of the recent financial performance of Aaron and Zyal is shown below, each year carries an equal weighting.

Year	**Return %**	
	Aaron Limited	**Zyal Limited**
2015	22	16
2016	23	17
2017	28	17
2018	27	18
2019	26	18
2020	27	18
2021	26	19
2022	23	19
2023	24	19
2024	24	19

The board would like you to evaluate two potential portfolios:

(i) The current portfolio and Aaron, and
(ii) The current portfolio and Zyal.

The board require a sizable stake in the new company and so investing a smaller amount in both companies is not an option. The board would like to understand the return and risk trade of both options before deciding whether to add Aaron or Zyal to the portfolio.

The following additional information can be used in your analysis:

Correlation coefficient	
Existing portfolio + Aaron	– 0.19
Existing portfolio + Zyal	– 0.72
Market information	
Aaron equity beta	1.44
Property industry equity beta	0.62
Existing portfolio weighted equity beta	0.78
Existing portfolio average return	19.0%
Existing portfolio standard deviation	3.1%
Market premium	9.0%
Risk free return	12.0%

Required:

(a) Evaluate the risk and expected return of each of the two potential portfolios using the Capital Asset Pricing Model and Portfolio Theory. **(12)**

(b) Advise, with supporting explanations, which portfolio the Board of InvestPak should choose. Your answer should also address additional financial risks. **(04)**

Q.3 You should assume that today's date is 30 June 2025.

Global Treasure Limited, a large importer and exporter of rare antiques, is based in Multan. The company is exposed to significant exchange rate risks due to its international sales and purchases. An extract from the latest cash flow forecast shows that the following receipts and payments are due in three months' time.

	EUR	USD
Payments	1,000,000	2,000,000
Receipts	500,000	2,600,000

The board is concerned regarding foreign currency fluctuations and has decided to hedge the value of the EUR against the USD.

The board would therefore like to fix the cost of net EUR payment due in 3 months' time (i.e. at the end of September) in terms of USD, and then to use the net USD receipt due in three months' time to settle this payment. Any surplus USD in three months' time will then be converted into PKR.

You have been asked to calculate the net PKR receipt at 30 September 2025, assuming the company hedges the exchange rate risk using the following three methods to fix the USD value of the net EUR payment:

(i) Forward rate agreement
(ii) Futures
(iii) Money market hedge

Relevant information:

Spot rate at 30 June 2025	
PKR/EUR	300
PKR/USD	278
Assumed spot rate at 30 September 2025	
PKR/EUR	312
PKR/USD	285
3-month forward rates at 30 June 2025	
USD/EUR	1.0903 – 1.0964
PKR/USD	297 – 330
September dated futures at 30 June 2025	
USD/EUR	1.0810
Contract size	EUR 125,000
Tick size	0.0001 USD/EUR
Three-month interest rates	
EUR	5.0% – 6.2% per annum
USD	4.8% – 6.0% per annum

Required:
Advise the board of Global Treasure Limited on the expected net PKR receipt in 3 months' time after using the recommended hedging techniques. **(16)**

Q.4 AgriGrow Ltd., a listed company, manufactures agricultural products and is based in Faisalabad. The company acquired a new subsidiary Banklight Ltd. in March 2025 and consequently the level of cash held in the business is lower than normal, such that only Rs. 8,000 million is currently available for investment.

The board have recently met to consider the capital expenditure budget for the year ending 30 September 2026. Several potential investments were considered however the available funds are not sufficient to invest in all of the four proposed projects. You have been asked to recommend which projects should be included in next year's budget.

Further information on the possible projects is shown below:

(i) Management Information System

Banklight Ltd. uses a different management information system to AgriGrow Ltd. This lack of compatibility is causing significant additional administration costs and increased risk of error when consolidating information. The cost of the replacement would be Rs. 7,000 million.

It is difficult to quantify the financial benefits of the new system but the annual savings in staff costs as a result are expected to be Rs. 2,500 million before tax.

The investment would be eligible for tax allowable depreciation of 30% in the first year and 15% reducing balance in subsequent years. The benefit of the new system is expected to continue for five years. It is likely that further upgrade costs will be incurred after this time. The salvage value of the new system is estimated to be Rs. 2,000 million after 5 years.

(ii) Delivery fleet

The current fleet of delivery vehicles is old and there have been problems with breakdowns, this has led to increased running costs and disputes with customers as some deliveries have been late as a consequence. The fleet comprises 5 delivery vehicles, the replacement presents an opportunity to upgrade to electric vehicles rather than a replacement with petrol vehicles. The cost of the electric fleet would be Rs. 450 million, the existing fleet could be sold at its written down value of Rs. 100 million.

The maintenance costs for the new vehicles will be much lower than the current fleet and annual savings are expected to be Rs. 95 million pre-tax. The vehicles would be eligible for tax allowable depreciation at 15% on a reducing balance basis. The vehicles are expected to have a scrap value of Rs. 125 million after five years.

(iii) IT management brought in house

Currently the IT support function of the business is outsourced to a third party with an annual fee of Rs. 200 million. If the function is brought back in house, there will be an initial investment of Rs. 150 million followed by additional annual salaries and operating expenses of Rs. 100 million pre-tax.

The initial investment would comprise building renovations, which would not be eligible for any tax relief and an investment in hardware of Rs. 80 million, which would be eligible for tax allowable depreciation at 15% on a reducing balance basis. The board do not expect there to be any residual value after five years.

(iv) Plant and Machinery

The final proposal is to expand production which would require additional investment of Rs. 5,400 million in plant and machinery. It is expected that production volumes would increase, and this would result in additional pre-tax operating profit of Rs. 2,200 million each year. The useful life of the plant and machinery would be five years, with no scrap value expected after this time. The plant and machinery would qualify for tax allowable depreciation of 15% on a reducing balance basis.

During the board meeting it was suggested that all four projects could be financed if the usual Rs. 6,000 million dividend is not paid. You have been asked to advise the board on the relevance of the dividend policy to the level of investment.

You have also been asked to advise the directors of the practical considerations they should take into account when determining the next dividend.

You should assume that all investments will take place in October 2025 and investments should be appraised over a five-year period. Corporate tax of 29% is paid in the year that the profits arise. A balancing allowance or charge arises when assets eligible for capital allowances are disposed of. You should assume that AgriGrow Ltd.'s cost of capital is 15%.

Required:

(a) Recommend, with supporting explanations and calculations, the optimal investment plan for AgriGrow Ltd., considering the restricted capital available for investments. **(16)**

(b) Advise the board, without calculations, how the approach to decision making would change if capital was limited for multiple periods. **(02)**

(c) Advise the board on the relevance of the dividend policy to the level of investments AgriGrow Ltd. can make. **(02)**

(d) Advise the directors on the practical considerations they should take into account when determining the next dividend. **(04)**

Q.5 SteelCo Pakistan Limited (SPL) is a steel manufacturing company based in Karachi. The company produces steel that is used by the ship building industry in the manufacture of ships. The board would like to diversify and produce steel that can be used by building construction industry. The initial financial projections indicate that the new product stream will be profitable, but you have been asked to provide an in-depth analysis of the cashflows, tax, inflation, and discount rate and to recommend if the project should be accepted by the board.

Project cash flows

The project will require an investment of Rs. 6,000 million in September 2025, just before its year-end of 30 September. This investment comprises Rs. 1,000 million, which is not eligible for tax relief, and Rs. 5,000 million which relates to plant and machinery and will be eligible for tax allowable depreciation at 15% on a reducing balance basis. SPL will be able to claim the tax relief against profit from its existing operations and therefore relief will be obtained in the year of expenditure. The plant and machinery will be sold for Rs. 1,000 million (at the price level at that time) after five years and a balancing allowance or charge will arise on sale. SPL calculate depreciation for financial reporting purposes on the same basis as for tax.

The board expect to sell 15,000 tonnes of steel to construction industry customers in the first year with volumes increasing by 5,000 tonnes for each subsequent year. Each tonne would cost, on average, Rs. 120,000 to produce and would be sold for Rs. 215,000. In addition, there would be incremental fixed costs of Rs. 200 million each year. These figures do not include inflation, which is expected to be 5% for sales, 6% for variable manufacturing costs and 2% for fixed costs.

Investment in working capital is required and must be sufficient to cover 10% of the following years' sales.

You should assume that the project lasts for five years.

Capital structure and new finance

The company plans to finance the new project by increasing borrowing, consequently Rs. 6,000 million (net of issue costs) will be raised by an issue of new 15% debentures. The debentures will be secured on the assets of the company. Note that the new debt will be issued at the current market value of the existing debentures (i.e. at 105% of nominal value). The new debt will also need to be sufficient to pay the 1% issue costs. The issue costs are not tax deductible.

The current capital structure is as follows:

Statement of financial position (extract)

	Rs. in million
Equity	
Share capital (Rs. 100)	8,000
Retained profit	43,800
	51,800
Debt	
15% Debentures (2030)	40,000

Additionally, the following market information has been provided by the board to help you with your analysis.

Betas	
SPL equity beta	1.27
SPL debt beta	0
Industry average asset beta for:	
Ship building	1.42
Building construction	1.83
Market values	
SPL share price	Rs. 900
SPL debentures (of nominal value Rs. 1,000)	105%
Other information	
SPL EPS (projected for year ending 30 September 2025)	Rs. 340
Corporate tax	29%
Market return	21%
Risk free return	12%

Note:
Assume that asset betas of steel manufacturing for ship building and building construction are almost the same.

Required:

(a) Using the APV of the proposed investment, recommend whether the board should approve the project. **(17)**

(b) Evaluate the impact of the project on the earnings per share figures over the duration of the project and the gearing ratio. **(08)**

(The End)

Rough Sheet