The Institute of Chartered Accountants of Pakistan

Multi Subject Assessment Stage

10 December 2024
4 hours and 15 minutes – 100 marks

Management Professional Competence

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 4 hours and 15 minutes, which includes the reading time and an extra 30 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 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 have a maximum of **FIVE** original books duly bound. Please ensure that the books or notes you bring are permissible under the open book policy. Keeping a book or notes that are not permissible 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 Assessment Master is strictly prohibited. Engaging in such activities will be considered a violation under the policy on the use of unfair means.

QUESTION 1

You are working as part of the PakConnect Telecom Ltd (PCTL) finance team.

PCTL and GreenSignal Communications Ltd (GSC) are both listed on the Pakistan Stock Exchange and operate in Pakistan, with a specific focus on providing telecommunication services such as mobile telephony, broadband services, and other internet technologies.

PCTL is renowned for its widespread network coverage, traditional communication services, and the quality of its network infrastructure, while GSC is recognised for its innovative internet technologies and value-added services.

The telecommunications industry in Pakistan has witnessed significant growth in the last decade. However, intense competition, technological advancements, and shifting customer preferences continually shape and reshape the market dynamics. Faced with evolving challenges such as the need for massive investments in network upgrades and sustaining growth, companies are seeking strategic partnerships and collaborations.

The board of PCTL is proposing a merger with GSC due to the potential synergistic benefits resulting from combining PCTL's robust network infrastructure with GSC's innovative technology solutions. This merger aims to generate strategic growth from a joint customer base, delivering a significant competitive advantage in the telecom sector by offering comprehensive and advanced telecom solutions. The merger will also streamline operations, reduce costs, and enhance service delivery by combining resources and expertise. Research and development capabilities will play a crucial role in innovating in areas like 5G technology and integrated communication solutions.

If successfully executed, the merger of PCTL and GSC would establish one of the largest telecommunication entities in Pakistan, influencing both urban and rural connectivity and digital transformation in the country. The merged entity could significantly impact the industry by driving technological innovation, improving service delivery, and reshaping market competition. Moreover, it could also play a pivotal role in supporting the government's initiatives towards digitalisation and providing digital services to under-connected regions of Pakistan.

The board of PCTL is hopeful that the merger can be completed within the next three to six months, subject to successful negotiations with the board of GSC, due diligence, and approval from both PCTL and GSC shareholders.

Proposed merger deal
The directors of PCTL aim to provide the board with sufficient information before proceeding with a merger offer to the board of GSC. The chief executive officer (CEO) of PCTL, Ali Khan, currently believes that an offer of three PCTL shares for every two existing GSC shares will be sufficient to win over the board and shareholders of GSC.

Ali Khan has also requested a summary of the key Pakistan Code of Corporate Governance (2019) regulations, which the newly merged listed company would be expected to follow. This summary will be included in the proposed merger plan for PCTL shareholders to reassure them of PCTL's continuing commitment to effective governance.

Available information
The following information has been provided to assist you in evaluating a potential merger between PCTL and GSC:

- **Appendix 1:** Competitor benchmarking analysis
- **Appendix 2:** Financial and operational performance data for the year ended 30 September 2024
- **Appendix 3:** Assumptions made by the board of directors of PCTL for the purpose of an equity valuation of GSC

Requirements

(a) Analyse the financial performance of PCTL with GSC for the year ended 30 September 2024. **(10 marks)**

(b) Determine an estimated equity valuation for the new PCTL/GSC group as at 30 September 2024 using the discounted cashflow valuation method by applying the assumptions provided by the directors of PCTL. **(12 marks)**

(c) Advise the board on the business case for a merger between PCTL and GSC, including if the merger should proceed on the proposed share-for-share terms. **(08 marks)**

(d) Discuss the main tax considerations for PCTL as it prepares to merge with GSC. Also discuss the tax impact of the share for share exchange on the shareholders of GSC. **(05 marks)**

(e) Discuss the main governance considerations necessary for the successful merger between PCTL and GSC.

Note for examinees: Consider impact on shareholders, the main board, risk management, sustainability and other board committees required for compliance with the Listed Companies (Code of Corporate Governance) Regulations, 2019. **(05 marks)**

(f) Prepare a high-level merger integration plan for PCTL and GSC that will manage post-merger matters and address emerging challenges. Your response should focus on business continuity planning, employee and HR integration, systems and data integration, legal and compliance integration, marketing and branding integration, and leadership and governance planning. **(10 marks)**

Total: 50 marks

APPENDIX 1 – COMPETITOR BENCHMARKING ANALYSIS

To: Ayesha Malik, chief finance officer (CFO), PCTL
From: Ali Khan, CEO, PCTL
Subject: Request for competitor analysis with GSC for merger consideration
Date: 1 December 2024

Dear Ayesha,

I am writing to request your assistance in conducting a comprehensive competitor analysis with GreenSignal Communications Ltd (GSC), a key player in the telecom industry in Pakistan. This analysis is crucial as we explore potential strategic opportunities, including a merger with GSC.

As you are aware, the board of PCTL is keen to understand the competitive landscape better and identify areas where we can learn from our competitors. GSC has recently exhibited impressive performance indicators in terms of market growth, profitability, operational efficiency, and returns to investors. Given these factors, we believe there may be valuable lessons to be learned from their success.

To ensure a thorough evaluation, we would like to benchmark GSC's performance against our own using the same criteria that we used to assess PCTL's financial performance. The key performance indicators we would like to focus on are as follows:

- Revenue growth (%)
- Revenue per customer (Rs.)
- Revenue per employee (Rs. in million)
- Employee costs/revenue (%)
- Employee cost per employee (Rs. in million)
- Telecoms customer turnover rate (%)
- Telecoms customer satisfaction rating (out of 5)
- Telecoms customer network availability (%)
- Operating profit margin (%)
- Interest cover (%)
- Return on capital employed (%)

We have taken a significant step in this regard by obtaining access to GSC's performance results for the year ended 30 September 2024. This data will serve as the foundation for our analysis and discussions concerning a potential merger between our companies.

Your expertise in financial analysis and strategic evaluation will be invaluable in helping us draw meaningful insights from this data. I request that you lead this analysis, working closely with our financial and strategy teams to ensure a comprehensive assessment.

The objective of this analysis is twofold: firstly, to gain a deeper understanding of GSC's performance relative to PCTL; and secondly, to assess whether GSC could be a suitable strategic fit for a potential merger. Your recommendations based on this analysis will be crucial in guiding our discussions with GSC and the board's decision-making process.

Ali

APPENDIX 2 – FINANCIAL AND OPERATIONAL PERFORMANCE DATA FOR THE YEAR ENDED 30 SEPTEMBER 2024

Statement of profit or loss for the year ended 30 September

	PCTL	GSC
	2024	2024
	----- Rs. in million -----	
Revenue	3,385.2	2,864.4
Costs		
Employee and related costs	(1,299.6)	(1,102.8)
Material costs	(339.6)	(325.2)
Depreciation, amortisation, and impairment	(75.6)	(63.6)
Marketing and other selling expenses	(496.8)	(572.4)
Overheads and administrative expenses	(360.0)	(194.4)
Other operating expenses	(363.6)	(259.2)
Operating profit	**450.0**	**346.8**
Finance costs	(99.0)	(66.0)
Profit before tax	**351.0**	**280.8**
Tax	(101.8)	(81.4)
Profit after tax	**249.2**	**199.4**

Extract from statement of financial position as at 30 September 2024

	PCTL	GSC
	2024	2024
Net book value non-current assets (Rs. in million)	2,001	1,473
Outstanding 5% loans (Rs. in million)	2,000	2,000

Other operating information

	PCTL	GSC
	2024	2024
2024 revenue growth versus 2023 (%)	6.8%	9.7%
Number of telecom customers (millions)	25.96	20.54
Telecoms customer turnover rate (%)	3.1%	1.8%
Telecoms customer satisfaction rating (out of 5)	4.38	4.71
Telecoms customer network availability (%)	96.8%	98.1%
Number of employees	8,140	6,932

APPENDIX 3 – ASSUMPTIONS MADE BY THE BOARD OF DIRECTORS OF PCTL FOR THE PURPOSE OF AN EQUITY VALUATION OF GSC

To assist with the valuation, the following information and assumptions have been gathered:

(i) **Revenue and cost synergy**
Key departments, such as production, sales, finance, and human resources, will undergo integration.

A cross-company sales team is expected to create revenue synergy which will increase current 2024 sales levels of GSC by 10%. Also, a cross-functional integration team has been formed to oversee the entire integration process and is expected to yield cost savings. This is expected to create cost synergy which reduces all current 2024 costs of GSC, except depreciation, amortisation, and impairment, by 10%.

(ii) In addition to synergy gain, additional growth in both companies for each year from 2025 to 2027 inclusive is expected as follows:

	Annual growth (% per annum)
Revenue	3.0%
Expenditure: All operating costs (except for depreciation, amortisation, and impairment)	2.0%

Other valuation assumptions provided by the directors of PCTL

- Assume capital expenditure for each year (2025 to 2027 inclusively) is expected to be Rs. 500 million.
- The average depreciation rate on all existing and newly acquired non-current assets is 20% per annum on a reducing balance basis.
- Assume annual depreciation is a reasonable approximation to all available capital allowances on non-current assets for each year.
- For 2028 and beyond, assume growth in the forecast free cash flow to the firm is 2% per annum from 2027 levels.
- PCTL's cost of capital is estimated by the board of PCTL to be 9% per annum. This can also be assumed to be the cost of capital of the merged entity post-merger.
- The tax rate is expected to be 29% for the foreseeable future.

Market information

- PCTL is currently listed on the Pakistan Stock Exchange with 500 million shares, which are trading at Rs. 10 per share at the last close of business.
- GSC is also listed on the Pakistan Stock Exchange with 250 million shares trading at Rs. 15 per share at the last close of business.
- PCTL has Rs. 2,000 million of outstanding debt in issue in the form of 5% corporate bonds.
- GSC also has Rs. 2,000 million of outstanding debt in issue in the form of 5% corporate bonds.

QUESTION 2

Punjab Light Commercial Vehicles (PLCV) is a dealership branch network that sells vans and pick-up trucks. It is a family-owned business and is based in Lahore where it has four large sites, but it has a total of 40 dealership branches spread throughout the Punjab.

PLCV sells both new and used vehicles. Finance is offered on new vehicle sales, but used vehicle sales are for cash only. Due to global supply chain issues with sourcing new vehicles in recent years, margins on used vehicles (even old and poorly maintained vehicles) have increased significantly, hence this has increasingly been PLCV's focus.

The marketplace for light commercial vehicles in Punjab is competitive and becoming increasingly dynamic, and difficult to negotiate. A news article published in the *Lahore Bugle* – a popular local newspaper – recently highlighted some of the issues being faced (**Appendix 1**).

Each dealership branch is managed by a local dealership managing director (MD). Each dealership MD receives a monthly performance report from head office, and they meet monthly with the group operations director (Nabeel Barsar) to discuss branch performance. The annual bonus for dealership MD is based on Nabeel's reviews over the year and is awarded at his discretion. The bonus is between 0% and 100% of base salary for the year, with many MDs historically being close to one extreme or the other. An example of a monthly performance report is provided in **Appendix 2**.

The rest of the local dealership management teams (below MD) and local dealership sales teams are paid a low base salary, but there is a generous monthly bonus scheme in place based on volume of sales. There is a monthly dealership branch target that, if the dealership branch as a whole hits, all managers of that dealership branch below MD are paid. Sales staff have their own personal targets, and they are awarded their bonuses if they hit their individual monthly targets. Bonuses typically double the income of the employee for the month when they are awarded.

Hashim Kahloon, the head of HR, is increasingly concerned that some dysfunctional behaviour is occurring at the dealership branch level and has written to the head of sales (Mahbeer Rajput) voicing his concerns (**Appendix 3**).

Requirements

(a) Identify risks in the macro and competitive environment using PESTEL and Porter's Five Forces. **(08 marks)**

(b) Recommend a plan to respond to the risks identified in part (a). **(06 marks)**

(c) Evaluate the pros and cons of the performance report used by PLCV to assess a dealership branch and recommend improvements. **(06 marks)**

(d) Analyse, with **examples**, the impact of the current sales team incentive plan, and recommend improvements to the plan. **(05 marks)**

Total: 25 marks

APPENDIX 1 – NEWS ARTICLE

The future of business transportation in the Punjab is... dark and smoggy

It is an increasingly difficult dilemma – businesses need transportation to thrive, but the only affordable form of transport available is an ageing fleet of vans and trucks that belch out toxic fumes, clothing Lahore in a blanket of pollution, poisoning our families and children.

Despite this, the number of light commercial vehicle dealerships has doubled in the last five years in Punjab. Many are 'internet only' without a traditional showroom, and the average age of second-hand vehicles sold has increased from two to five years over the same timescale.

Average prices have increased by 50% over that period, but that hides an increase in dealership margins, as the average price of sales to dealerships has only increased by 20% over the same period.

Electric vehicles are coming into the market from China now and their prices are falling as technology improves, but it will be a few years before they become a reasonable alternative, cost-wise, to fossil fuel vehicles. This is being addressed by the government, as taxes on fossil fuel cars are set to triple over the next ten years and, conversely, 100% first-year allowances are now available on the purchase of electric vehicles, but it will take time to filter through. In the meantime, schools are closed due to smog, and the incidence of respiratory illness continues to climb in Lahore.

Public opinion in Lahore is difficult to read. No one likes the smog, and there have even been public protests about the poor controls over polluting vehicles, but most citizens also appreciate there is no realistic alternative at the moment. Outside the city, although smog is less of an issue, the low incomes of business owners needing transportation is such that they cannot see any realistic alternative but to buy affordable, polluting vans and trucks for their businesses.

The courts are inundated with cases of owners of dangerous vehicles being prosecuted for their polluting transportation.

APPENDIX 2 – BRANCH PERFORMANCE REPORT

Branch 07 performance report: September 2024

	Actual	Target	Variance	
	--------- Rs. in million ---------			
Sales	134.2	165.0	(30.8)	✗
Cost of sales	(94.5)	(99.0)	4.5	✓
Gross profit	**39.7**	**66.0**	**(26.3)**	✗
GP %	29.6%	40.0%	(10.4%)	✗
Rent	(10.0)	(10.0)	0.0	✓
Wages and salaries (including bonus)	(20.0)	(12.0)	(8.0)	✗
Administration cost	(5.0)	(7.0)	2.0	✓
Marketing and promotion	(8.0)	(2.0)	(6.0)	✗
Distribution cost	(2.0)	(2.0)	0.0	✓
Other costs	(0.5)	(0.1)	(0.4)	✗
Branch profits	**(5.8)**	**32.9**	**(38.7)**	✗
Volume of vehicles sold (in number)	38	38	0	✓

Assessment	Achieved volume of sales targets
	Beat cost of sales and administration cost targets
	Met rent and distribution cost targets
	Missed other targets
	Overall assessment: Mixed

APPENDIX 3 – EMAIL FROM HUMAN RESOURCES (HR) TO SALES

To: Mahbeer Rajput, head of sales
From: Hashim Kahloon, head of HR
Subject: Branch incentivisation
Date: 15 November 2024

Dear Mahbeer,

I hope you are well. Further to the board meeting, I have conducted some additional research into some of the issues I raised. Whereas I appreciate the importance of dealership branches hitting sales targets, my research has shown the following:

- Next to no aftersales care once the vehicle has been sold, despite escalating formal complaints being made by customers.
- Heavy discounting. I can't understand why this should be needed given the global supply chain issues with vehicle supplies.
- An increase in the sale of older vehicles that have on average five times the carbon-based pollution of their new equivalents.
- Marketing events at the branch which, although attractive in a competitive market, are wildly extravagant. For example, one of the Lahore dealership branches recently had a prize draw of selling an almost-new pickup truck for Re. 1 for those who attended. This was recorded as a sale!
- In some of the better performing branches, on average, an increase of 200% in complaints in the last week of each month, citing slow service – e.g. phone calls not being returned, or most sales staff on holiday.

Given our ultimate objective is to maximise the wealth of our owners, in my view, the current volume related bonus scheme is not fit for purpose and needs to be amended as soon as possible. We are paying significant bonuses in loss-making branches! Can we please meet with a view to replacing the current scheme. I look forward to hearing from you.

Many thanks and kindest regards,

Hashim Kahloon

QUESTION 3

Today is 1 December 2024.

Lahore Consumer Electronics (LCE) is a large international business that assembles components into finished consumer electronic goods to sell business-to-business. It has three divisions: Kitchen Appliances (KA), Home Entertainment (HE), and Personal Technology (PT). Each division has a high degree of autonomy, each having its own stand-alone functional structure, including: operations; sales and marketing; finance and treasury; human resources; and information technology. Each divisional manager is largely responsible for all major decisions in that division.

All divisions operate internationally. A consistent trend is that the KA division sells to the US regularly, whilst the PT division purchases a similar value from the US regularly. Both divisions settle in US dollars for these transactions. As each division is exposed to foreign exchange transaction risk, they hedge accordingly through their own finance and treasury function. The divisional manager of KA is celebrating a major sale she has just made to the US to be settled in three months' time. She has written to her head of finance asking him to consider two options for hedging (see **Appendix 1**).

The head of finance of the KA division has suggested to the KA divisional manager that any foreign exchange transactions losses experienced on sales to the US should be posted to a balance sheet account called 'other receivables' until they can be reversed out using future gains. This is to reflect the fluctuating nature of exchange rates and to protect shareholder value.

The HE division at LCE has an overseas assembly plant in a developing country that has caused some bad press as the country is remote with low labour standards and a poor health and safety record. The resulting environmental and social issues have to date gone unchecked as LCE does not measure these aspects. The issues have been highlighted in a newspaper article (**Appendix 2**) that is causing a rise in customer complaints. The CEO of LCE would like to formally measure economic and social performance as a first step to targeting and managing these aspects formally.

Requirements

(a) Evaluate and recommend whether the LCE treasury function should be centralised or not. **(08 marks)**

(b) Recommend which of the suggested hedging strategies should be adopted at LCE. Provide supporting calculations. **(06 marks)**

(c) Evaluate, from an ethical perspective, the suggestion made by the head of finance to keep foreign exchange losses on the balance sheet to protect reported profits. **(05 marks)**

(d) Evaluate the potential impacts of the environmental and social sustainability issues at LCE, noted in the article (**Appendix 2**), and recommend one key performance indicator (KPI) for each that should be measured and reported publicly. **(06 marks)**

Total: 25 marks

APPENDIX 1 – EMAIL CONCERNING US SALES HEDGING

To: Amir Duggal, head of finance, KA division
From: Arfaana Handa, divisional manager, KA division
Subject: US sales hedging
Date: 1 December 2024

Dear Amir,

I hope you're well. As you know, as a business, we are celebrating the closure of the 'Prep and Cook USA' deal. Given the forecast profitability of the deal, we can also celebrate personally given our bonuses are based on our divisional annual return on investment! Our first shipment is due to go out today, for US$ 3.5 million, to be settled in three months' time. I would like to hedge this transaction using either forward contracts or US dollar futures.

Today's spot rate is Rs. 269–281 per $1, and the three-month forward adjustment is Rs. 6.5–2.5 discount per $1.

The price today for April futures is Rs. 231 per $1, with a standard contract size of US$ 125,000.

I would like to use the forecast rates we discussed last week to help make our decision, so please assume the spot rate on 1 March will be Rs. 242–250 per $1, with an April futures price on that date of Rs. 203 per $1.

I would be grateful if you could provide indicative calculations to compare our two alternatives, and a short narrative comparing the two methods, concluding with your recommendation as to which of these two would be preferable.

I look forward to hearing from you.

Regards,

Arfaana
Divisional manager, KA division

APPENDIX 2 – NEWS ARTICLE

The true price of cheap home entertainment…

A great TV picture at an affordable price… What's not to like? Well, plenty it would seem!

It all depends on how you define the word 'price'. For example, consumer electronics giant Lahore Consumer Electronics (LCE) chooses to keep its costs down by manufacturing around 12,000 miles from its target market, in a sweatshop where workers (some of them children) earn less than US$ 0.10 an hour, and serious injury and sickness due to exposure to the dangerous chemicals involved in the manufacturing process are commonplace.

The finished goods are then shipped on old, polluting (and therefore cheap) container ships to give the end consumer a pristine bargain of a TV in their living room.

The company doesn't measure anything but its financial profits, so no one knows the full impact of its operations –a good example of capitalism at its very worst! Not even the company knows (or therefore cares) about the impact it is having on the lives of workers, and our planet.

LCE may not be breaking any laws, but how do they sleep at night? Probably by counting the money in the LCE company bank account…

(THE END)

Rough Sheet

Rough Sheet