



Initial Assessment of Competence

Professional Paper 1

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Part (a) Prepare a SWOT analysis in view of the going concern challenges experienced by Inpahla.		Marks
• Do not discuss the turnaround strategies in section 3.		
1	Strengths	
1.1	Inpahla is a primary provider of bulk transport services. Its extensive asset base, operational scale, and strong market position provide a competitive advantage, positioning the company for continued success and sustainable future growth.	1
1.2	The company's core service, freight rail transport, is an essential part of the mining supply chain . Thus, there is a continued demand for its services and its ability to restore financial stability and operate as a going concern.	1
1.3	The company is state owned, which provides it with access to unique resources of the country, and potential synergies with other state-owned entities , leading to an alignment of goals.	1
1.4	The company's adoption of green initiatives , such as rainwater harvesting, LED lighting, and solar power, is a strength because it reduces operating costs, improves environmental sustainability, and enhances the company's reputation.	1
1.5	The company has a long history of operating in the market, having been established in 1860 . This demonstrates the company's ability to operate successfully under a variety of economic and market conditions and reflects its capacity to adapt to changes in its industry over time.	1
1.6	Inpahla could diversify its revenue streams through its various business divisions, reducing its reliance on any single source of income. This diversification could improve financial stability, strengthen resilience against industry-specific downturns, and support the company's turnaround and long-term performance.	1
2	Weaknesses	
2.1	Because the company is owned by the state, it will not have a profit-only motive . State-owned entities usually have social, political and policy-based motives, which can make it more difficult to be globally competitive with companies that have a profit motive, and which can make financial decisions that are more attractive and profitable for both customer and company.	1
2.2	The current financial state of Inphala, with a deteriorated profit situation , places strain on the company's ability to continue as a going concern, as the company has eroded its equity position, which impacts its ability to service its debt obligations .	1
2.3	The company is also experiencing financial distress , which has intensified the challenges within its trading environment. This places additional pressure on its operational performance , limits financial flexibility, and may constrain its ability to respond effectively to changing market conditions.	1
2.4	The significant deterioration in the liquidity position and increase in the obligations, and the resulting impact on the cash interest cover to 1,93 times, will have a significant impact on the ability to raise funding and will place severe strain on the ability of the company to return to profitability.	1
2.5	The resulting risk of going concern issues and the triggering of covenant defaults puts further pressure on the company's operating environment limiting financial flexibility and increasing liquidity risk.	1

2.6	The ageing infrastructure and rail collisions have damaged the income-producing asset base which will make it difficult to generate the needed revenue to return the company to profitability.	1
2.7	The emphasis of matter paragraph on the review report of the entity is a warning signal to all stakeholders, which will make it difficult for the company to raise additional funding.	1
2.8	The company's reliance on continued government financial support represents a significant weakness, as future funding is contingent on the government's own assessment of whether the company can generate sustainable profitability or deliver sufficient economic benefits to justify further investment. This dependence creates uncertainty regarding the company's financial stability and long-term viability.	1
2.9	Damaged locomotives have been standing idle for 6 years already with no progress, this also brings into question the competence and skill of the management team that they have not managed to come up with a solution in such a long period of time (while the company flounders due to so few locomotives in operation)	1
2.10	Irregular tender process and corruption indicate weakness in governance and internal controls. These issues reduce operational efficiency and damage stakeholder confidence.	1
3	Opportunities	
3.1	Having the government as its shareholder does provide the ability to access significant resources to fund future investment.	1
3.2	Securing additional government funding would strengthen the company's financial position by providing the resources needed to support its operations and improve performance. Increased funding could enhance the company's ability to generate higher profitability, improve relationships with its customers, and contribute to broader economic recovery, creating a more favourable operating environment for sustained growth and long-term financial stability.	1
3.3	The company possesses assets that are currently underutilised , indicating operational inefficiencies and an inability to maximise the value of its existing resource base. Improving the utilisation of these assets could enhance operational efficiency, increase revenue generation, and improve overall profitability.	1
3.4	Inpahla's dominant position in the market creates opportunities to establish a public-private partnerships that could improve operational efficiency, enhance service delivery, and increase overall revenue. These partnerships could also provide access to additional investment, expertise, and technology, supporting the company's long-term sustainability and growth.	1
4	Threats	
4.1	The shareholder of the company, the South African government, is also in a financially distressed state with significant global debt commitments, and being impacted by downgrades to its debt ratings makes the acquisition of more funding difficult and expensive. This would negatively impact the company.	1
4.2	Macro-economic variables , including the high oil price, deteriorating value of the rand as a currency and resulting impact on inflation, all make the trading environment particularly difficult in a global context, especially as some assets are obtained in a foreign currency.	1

4.3	The impact of electricity constraints cannot be addressed directly by the company, as the impact is on its operations, its clients' operations and on the South African economy in general, which makes the trading environment for the particularly challenging.	1
4.4	Any increases in interest rates by the Reserve Bank will have a material impact on the company's interest burden, and a deteriorating interest cover measure will make raising future finance more expensive.	1
4.5	The community unrest threatens the reputation of the company and confidence that the company will be able to provide services and also introduces an additional risk of damage and disruption to its services, which makes the company's ability to continue to operate profitable at risk.	1
4.6	The restrictive procurement requirements that local rather than global suppliers should be used, will potentially lead to a higher cost of spares, making the company, and in turn its clients, less globally competitive, ultimately negatively affecting the demand for its services.	1
4.7	In addition to this, it appears that the local suppliers are not able to provide the necessary spares and repairs , resulting in an even worse disruption to the company services due to the shortages of spares, and therefore the inability to service its customers and generate revenues.	1
4.8	Ageing infrastructure increases the risk of collisions and train derailments , threatening to disrupt operations, raise costs, and further reduce profitability.	1
4.9	The threat of continued theft of railway infrastructure, crime, and vandalism disrupts operations, increases repair and security costs, compromises safety and service reliability, and reduces revenue and profitability.	1
4.10	Furthermore, adverse weather conditions threaten to disrupt operations, increase costs, reduce operational efficiency, and adversely affect the company's revenue, profitability, and long-term financial performance.	1
4.11	The continued decline in mining operations in South Africa could reduce demand for Inpahla's freight transport services, limiting future revenue growth and reducing opportunities for expansion. As the mining sector is one of the company's key customers, a sustained downturn in mining activity could have a significant negative impact on its long-term profitability and growth prospects.	1
4.12	The volatility of commodity exports will impact on the company customers, who may therefore use less freight services if they are transporting less goods in times of low prices. This could result in lower freight revenue, lower asset utilisation and declining profitability, negatively impacting Inpahla's financial performance and long-term sustainability.	1
4.13	The proposed German supplier presents several risks for the company. Firstly, the supplier's reputation , reliability, and ability to successfully deliver and guarantee the required repairs are unproven, creating uncertainty regarding the quality and timeliness of service delivery.	1
4.14	Secondly, procuring goods and services in euros exposes the company to foreign exchange risk, as fluctuations in the exchange rate could increase procurement costs and adversely affect profitability.	1
4.15	The corruption allegations relating to the train supplier expose the company to significant legal and financial risks, including potential litigation , regulatory penalties, and financial sanctions if wrongdoing is established.	1

4.16	Furthermore, the possibility that the dispute could continue for an additional five years presents a substantial operational risk , as the prolonged unavailability of critical spare parts could disrupt operations, reduce service capacity, and result in significant financial losses.	1
4.17	Significant pressure from government may influence the entity to report favourable financial results or misrepresent information, potentially compromising governance, ethical standards, regulatory compliance, and operational integrity.	1
Available		37
Maximum		20
<i>Z1: Business internal environment</i>		1
<i>Demonstrating an awareness of the strengths and weaknesses arising from the internal environment and distinguishing that from the external environment.</i>		1
<i>Z2: Business external environment</i>		
<i>Incorporating the external threats and opportunities from the scenario into the SWOT analysis</i>		
Total for part (a)		22

Part (b) Evaluate the two turnaround strategy financing proposals, based on the current situation of Inpahla.		Marks
Proposal 1: Government funding and an increase in debt		
1.1	The current situation of the company is dire, with declining profitability, a deterioration of revenues, a poor debt position with a high debt-to-equity ratio, and a declining cash interest cover ratio (from 4 times to 1,93 times). Therefore, any turnaround strategy should improve the company's long-term financial sustainability without further compromising its financial position.	1
1.2	In addition to the financial state of the company, the government as the sole shareholder is also in a problematic state with reducing tax revenues and increasing debt. The ability of government to provide further equity would be in question (i.e. it may need to raise tax revenue or divert resources from other departments/functions).	1
1.3	Proposal one requires a guarantee from a shareholder who is in a difficult financial space itself, which is unlikely to be attractive to the providers of debt capital .	1
1.4	In addition, the guarantee will be used to raise further debt in Inpahla, which would exacerbate the debt and interest positions , and potentially place the company in breach of covenants.	1
1.5	The existing debt covenants would potentially prohibit this action , and the company may need to engage with debt providers to relax their covenants in order to follow this course of action, which would be a difficult sell.	1
1.6	The cost of the additional debt financing may be significantly higher than anticipated given Inpahla's weakened financial position and increased credit risk, reducing the attractiveness of Proposal 1	1
1.7	The concerns regarding the deteriorating domestic inflation outlook could lead to the SA Reserve Bank raising interest rates to counteract inflationary increases. This would lead to increased interest payments for Inpahla, as well	1

	as reduced profit and cash, which would further harm its ability to service debt payments when due.	
1.8	The proposed funding option should be aligned with Inpahla's historic strategic objectives and capital structure strategy which seemed adequate, rather than addressing only the immediate funding shortfall.	1
1.9	Although the government may not receive an attractive financial return on the additional equity investment, it may still consider the investment appropriate given its broader service delivery and socio-economic objectives .	1
1.10	Additional government funding may be politically difficult to justify , given the historical performance of state-owned entities and increasing public scrutiny over the use of public resources.	1
1.11	The relaxing of regulations for procurement could have a significant impact on the company costs and revenues, with no need for further investment. It should be pursued irrespective of the funding option chosen.	1
1.12	Relaxing the procurement requirements may improve operational efficiency; however, it could also weaken governance controls and increase the risk of fraud, corruption and procurement irregularities	1
1.13	The proposal allows government to retain full ownership and control of nationally important transport infrastructure while providing the financial support needed to implement the recovery strategy. This would enable Inpahla to continue pursuing both its commercial and developmental objectives.	1
1.14	The government guarantee would enable Inpahla to raise funding that is currently unavailable, providing immediate cash to meet short-term obligations and finance its turnaround strategy. This would reduce the pressure created by the company's deteriorating liquidity position.	1
Proposal 2: Privatisation		
2.1	The second proposal to privatise assets is a good option as it would not lead to a deterioration in the financial position of either the government or the company.	1
2.2	Government will likely need to share control of Inpahla, and decision making will need to incorporate the preferences of the private investors that might lead to conflict of interest for Inpahla	1
2.3	The privatisation option could also bring in new capital and skills which could provide critical assistance with turning the company around and improving the financial performance and position.	1
2.4	Private investors are likely to prioritise profitability over broader social and policy objectives . Consequently, the government may need to compromise some of these objectives to attract private sector participation.	1
2.5	The partnership with private sector participants with other assets might unlock opportunities and synergistic benefits for Inpahla.	1
2.6	The government would not need to inject additional capital, but could have the benefit of increased tax collections from the partnership profits and the clients' improved profits, as well as from a general increased tax collection from the broader economic impact it would have in all tax areas.	1
2.7	Private sector participation may improve stakeholder confidence through stronger commercial expertise, improved governance, greater operational discipline and enhanced accountability.	1

2.8	Privatisation of state-owned assets is often politically sensitive. Government, political parties and the public may oppose transferring part ownership of strategic national infrastructure to private investors, particularly where transport infrastructure is regarded as a national asset. Such opposition could delay or prevent implementation. Social goals might be compromised in favour of profit.	1
2.9	Inpahla has significant going concern issues and questions surrounding the recent management of the company which would bring into question whether companies would be interested in partnering with them.	1
2.10	If assets are transferred into subsidiaries, tax implications need to be considered - recoupments and CGT might arise.	1
2.11	The proposal involves establishing new subsidiary companies, transferring assets into those entities, negotiating partnership agreements and obtaining the necessary regulatory approvals. These processes may take considerable time, delaying the operational improvements that are urgently needed to address Inpahla's going concern challenges.	1
Available		25
Maximum		10
<i>Y4: Judgement and decision making - Demonstrable ability to apply judgement and make sound decisions based on the facts Mark awarded for evaluation of the two proposals rather than providing a list of advantages and disadvantages</i>		1
Total for part (b)		11

Part (c) Prepare a capital budget, based on a single locomotive, to assess the viability of the proposal by Zug AG for the damaged locomotives and conclude whether Inpahla should go ahead with the proposal.								Marks
• Include nil effects, where relevant.								
	0	1	2	3	4	5	6	
Mark for including contribution and fixed costs in correct period								1
Contribution earned			4 300 000					1
Fixed costs			(250 000)					1
Additional tax revenues			–					
Mining royalties			–					
Additional tax collected by SARS and mining royalties – excluded since not earned by Inpahla directly								1
Total			4 050 000					
Inflation at 5%			4 252 500	4 465 125	4 688 381	4 922 800	5 168 940	1C
Original cost of locomotive – irrelevant, not incremental								1
Opportunity cost of not selling locomotive	(12 000 000)							1
Redesign cost	(1 900 000)							1
Repair component	(1 840 000)	(1 876 800)						2
Market value of train							11 000 000	1
Working capital	(120 000)	(6 000)	(6 300)	(6 615)	(6 946)	(7 293)	153 154	3
Interest on debt – not included as included in discount rate								1
Taxation @ 27%	–	513 000	(317 439)	(583 504)	(743 143)	(1 005 156)	(2 421 614)	1
Processing mark	(15 860 000)	(1 369 800)	3 928 761	3 875 006	3 983 293	3 910 351	13 900 480	1C
Net present value @ 13%	(95 374)							1P
The company should not go ahead with the repairs since the NPV is negative, when calculated using the target rate of return.								1

	0	1	2	3	4	5	6	Marks
Taxation								
<i>No CGT saved – the proceeds (R12m) are less than the original cost (R19m)</i>								
Redesign cost		(1 900 000)						1
Repair component wear and tear			(1 840 000)	(1 104 000)	(736 000)			2
Exchange loss on repair component			(36 800)					2
Wear and tear on train (R12m – R6m)/5			(1 200 000)	(1 200 000)	(1 200 000)	(1 200 000)	(1 200 000)	2
Recoupment on train sale							5 000 000	1
Operating cash flows			4 252 500	4 465 125	4 688 381	4 922 800	5 168 940	1C
Taxable cash flows	–	(1 900 000)	1 175 000	2 161 125	2 752 381	3 722 800	8 968 940	
Tax @ 27%		(513 000)	317 439	583 504	743 143	1 005 156	2 421 614	1C
Available								29
Maximum								27
Total for part (c)								27

Part (d) Discuss how Inpahla's green initiatives align with the United Nations Sustainable Development Goals 6 and 7.		Marks
1	Goal 6 is about ensuring access to water and contributing to water security .	
1.1	Water scarcity is projected to increase with the rise of global temperatures as a result of climate change threatening access to water and water security. The use of alternative water sources, such as rain water harvesting, can mitigate this threat and support more sustainable water management.	1 1
1.2	Rainwater is not drinkable, and therefore not clean, therefore it does not address the need for clean water through its harvesting. However, it does address the sanitation aspect through being able to use for washing and toilets.	1
2	Goal 7 is about ensuring access to clean and affordable energy.	
2.1	Inpahla's installation of solar panels on rooftops increases the proportion of Inpahla's energy that is obtained from renewable sources, contributing to the broader transition towards clean and sustainable energy, thereby reducing the entity's carbon footprint.	1 1
2.2	The use of LED lighting and climate control systems reduces electricity consumption, contributing to improved energy efficiency	1
2.3	The insulation improves the energy efficiency of the warehouses by reducing the energy required for climate control, thereby supporting the efficient use of energy resources.	1
2.5	The use of the sun's energy (which cannot be depleted) as opposed to coal (which is a limited resource used by Eskom), provides Inpahla with a sustainable energy source .	1
2.6	Whilst solar power is generally considered to be a more environmentally friendly practice, the resources and raw materials needed to produce solar panels and batteries and the renewability of those should be taken into consideration as well as environmentally friendly ways of disposing of lithium batteries at the end of its lifetime.	1
Available		9
Maximum		6
Total for part (d)		6
Total for part I		66