Part (a)	Criticise the free cash flow valuation performed by the financial manager. • **Do not re-perform the valuation.**	Marks
1	**General**	
1.1	The expected synergies are not included in the valuation, the valuation would represent a minimum price. As the purpose of this valuation is to determine the price that Build should offer for the acquisition of the equity of NBS, the expected synergies should be considered in the evaluation in determining the maximum/ price to be paid.	1
1.2	• Forecasts need to be made until we achieve stability to calculate a terminal value which is a perpetuity. The planning period in determining the forecasts should be adjusted due to: • The uncertainties surrounding COVID and additional tax in the future (potentially shorten the planning period as there is increased uncertainty); and • The fact that expansion is planned over the next four years (the planning period should be extended to take this into account). • Insurance recoveries included in FY2023 (and the related tax effects) should be excluded from the terminal value calculation as this will not be incurred every year in the future. • How was the final year cash flow value used in the terminal value of R155 843 derived? Should we not be using the total cash flow of R79 559 for FY2023? The number of years appears to be insufficient to have stable cash flows in order to do the perpetuity, and that the forecast period should be amended	1 1 1 1 1
1.3	• Using the average WACC for listed companies in the construction sector is incorrect because you should be getting to the cost of equity and not the WACC and the industry is an average and not representative of the individual risk of the company in its adjusted form. • A similar listed company's cost of equity (a wholesaler of building material) should be considered OR use Build's WACC (adjusted for differences in risk and capital structure). • The beta of the similar company will have to be unlevered and re-levered in order to calculate the cost of equity. • The marginal cost of debt for NBS should be used in the calculation of the WACC.	1 1 1 1
1.4	The increased growth was as a result of the renewed interest in home improvements as a result of the lockdown. It is questionable whether a growth rate of 10% going forward is realistic (in the context of SA's long-term growth).	1
1.5	No reasonability check was performed (e.g., implied EBITDA multiple, versus NAV).	1
1.6	Inappropriate to use an internal person to perform the valuation, it would be unlikely to be accepted by the buyer, who would require an objective and independent valuation (Own advisors).	1
2	**Technical errors**	
2.1	Amortisation should be added back as this is a non-cash-flow item.	1
2.2	• The tax saving on the wear-and-tear allowance is a cash flow, but the allowance is not necessarily based on depreciation,	1 1

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	• Further, the tax on the wear-and-tear allowance is already incorporated into the tax on the statement of profit or loss, therefore adding it back will be double-counting.	
2.3	The delivery cost that is deemed to be non-recurring should not be added back as this is an actual cash flow.	1
2.4	Non-cash movements in the deferred tax balances should not have been considered in the calculation of free cash flows.	1
2.5	The profit on the sale of the asset should be deducted and the cash proceeds of the sale should be added.	1
2.6	No adjustments for the taxation on interest income or finance cost have been made because the amount is included in the WACC (tax shield on interest) and would be double counting not to remove benefit from the tax balance.	1
2.7	• The expected investment income was included in the calculation of the free cash flows and the value of the investment was added to the enterprise value. This is double-counting the value of the investment. • The income should be removed from the cash flows as the investment is also not part of the normal operations of NBS (different risks and growth expectations, and thus a different discount rate). • Remove the tax impact of this income from the tax amount to avoid double counting.	1 1 1
2.8	Investment property should be valued by discounting the expected income at the market-related return (or at market value). It is incorrect to add it at cost.	1
2.9	• Cash and bank balances have been added to the enterprise value and the movement in cash has been included in the free cash-flow calculation. This is incorrect and double-counting. • If cash is seen as surplus cash, the movement should be excluded from the free cash-flow calculation, including the interests, and the surplus cash balance should be added to the enterprise value. • the cash could also be operational, in which cash the interest should be left in the cash flows, and no cash should be added to the valuation result.	1 1 1
2.10	Movement in provisions should have been added back in the FCF calculation as the related non-cash expense is included in the operating profit.	1
2.11	The movement in tax payable was double-counted by including it in the tax calculation and also including the movement with the working capital changes.	1
2.12	The long-term loan was deducted at book value. The market value of the loan should be deducted.	1
2.13	Purchase of PPE should be an outflow, not an inflow (with only proceeds from the sale of PPE added).	1
2.14	Non-controlling interest should not be added back. NCI is a portion of a subsidiary that is not owned by shareholders of Build. Therefore if 100% of the income from the subsidiary is included in profits then this needs to be adjusted by either excluding the NCI income or deducting the market value of the NCI interest in the subsidiary from the enterprise value.	1
2.15	Consideration needs to be made to determine whether the short term loan is correctly classified as short term or is used for long term purposes in which it will need to be included as part of long-term debt.	1
2.16	Terminal value has not been present valued back to 2021.	1

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2.17	Projections should be tested for reasonability – e.g. compare GP% from year to year.	1
2.18	Given that the valuation is undertaken in June 2022, there should be an adjustment to the FY2022 figures.	1
2.19	Intangible asset should not be added separately because the cash flows include the benefits derived from the intangible asset and this is double counting.	1
	Available	**37**
	Maximum	**19**
	Communication skills – appropriate style	*1*
	Total for part (a)	**20**

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Part (b) Calculate and conclude which of the two financing alternatives would be the most cost effective way for Build to raise the required financing to acquire NBS. • Round your answer to two decimal points. *[Marker note: NPV method to assess different financing alternatives will also be marked appropriately]*							Marks
Tselane ventures							
	0	**1**	**2**	**3**	**4**	**5**	
	R'million	**R'million**	**R'million**	**R'million**	**R'million**	**R'million**	
Initial advance	2 000						0.5
Transaction costs	(60)						0.5
Tax - issue cost		16,80					1
Tax – interest		50,4	54,9	59,9	65,3	71,1	1C 1
Final payment						(3 077,2)	1C
	1 940	67,2	54.9	59,9	65,3	(3 006,1)	
Comp IRR	6,94%						1C
Interest							
Opening		2 000,0	2 180,0	2 376,2	2 590,1	2 823,2	
Interest		180,0	196,2	213,9	233,1	254,1	1
Closing		2 180,0	2 376,2	2 590,1	2 823,2	3 077,2	1
Ace Bank							
	0	**1**	**2**	**3**	**4**	**5**	
	R'million	**R'million**	**R'million**	**R'million**	**R'million**	**R'million**	
Initial advance	2 000						0.5
Arrangement fee	(20)						0.5
Tax – arrangement fee		5,60					1
Interest		(180)	(144)	(108)	(72)	(36)	1
Tax – interest		50,40	40,32	30,24	20,16	10,08	1
Loan payments		(400)	(400)	(400)	(400)	(400)	1
	1 980	(524)	(503,68)	(477,76)	(451,84)	(425,92)	
Comp IRR	6,77%						1C
Alternatively							
Initial advance	2 000						0.5
Arrangement fee	(20)						0.5
Interest		(180)	(144)	(108)	(72)	(36)	1
Loan payments		(400)	(400)	(400)	(400)	(400)	1
	1 980	(580)	(544)	(508)	(472)	(436)	
Comp IRR	9,41%						1C
IRR after tax	6,77%						1C

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Note, consideration needs to be made that the tax effect on the arrangement fee must be in year 1. The alternative method ignores that, however that should be considered when making the decision.	1
Consequently, based on the above, the loan from Ace Bank would be the most cost-effective form of finance.	2C
Available	**16**
Maximum	**15**
Total for part (b)	**15**

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Part (c) In relation to the incentive scheme proposed by Mukuru – (i) calculate the amounts due in cash to Mukuru at the end of each financial year from FY2022 to FY2024; and • Ignore taxation for the purposes of the calculation.					Marks
Calculate the amounts due in cash					
	2021	**2022**	**2023**	**2024**	
	R'000	**R'000**	**R'000**	**R'000**	
Market capitalisation	6 305 664	7 299 161	6 995 030	7 585 000	
Increase from the base date		993 497	689 366	1 279 336	1.5
		R	**R**	**R**	
2.5% of the above amount		24 837 425	17 234 150	31 983 400	1.5C
Vesting:					
60%		14 902 455			0.5C
80%			13 787 320		0.5C
100%				31 983 400	0.5C
Difference due to Mukuru		14 902 455	(1 115 135)	18 196 080	1.5C
				Available	**6**
				Maximum	**6**
				Total for part (c)(i)	**6**

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Part (c) In relation to the incentive scheme proposed by Mukuru – (ii) discuss the advantages and disadvantages of the proposed incentive scheme from Build's perspective. • Ignore taxation for the purposes of the calculation.		**Marks**
Advantages:		1
1.	Shareholders rely on CEOs to adopt policies that maximise the value of their shares and therefore an incentive scheme partially based on share price performance could help achieve this goal (goal congruence).	
2.	This bonus scheme may motivate him to stay for at least 3 years as at this date he will be due 100% of the growth. Which may be good for continuity for the company.	1
3.	The fact that the scheme is spread over a three- year period, this might be advantageous for the company because the cash outflow will be spread across the years (this might alleviate a cash flow burden).	1
Disadvantages:		
4.	The market capitalisation does not necessarily reflect Mukuru's individual contribution to the company.	1
5.	An increase in the price per share (rather than total market capitalisation) could be a better performance measure given that the company could potentially increase its market capitalisation by simply issuing more shares (provided that the share price does not decrease proportionately).	1
6.	The above point is illustrated by the expected increase in the number of shares in FY2024. Although the price per share does also increase, Mukuru will benefit substantially from the increase in the number of shares (which is not necessarily an indicator of good performance).	1
7.	The scheme does not follow a balanced score-card approach because it does not focus on long-term wealth and sustainability measures which include:	1
o	Successful integration of NBS's business into Build's operations / the success of the negotiations with NBS's shareholders and management.	1
o	Other financial measures, such as ROCE, EVA and growth in market share could also be incorporated.	1
o	Non-financial measures such as leadership (as determined by employees), competitiveness, motivation, innovation, etc., should also be included in his KPIs.	1
8.	Basing incentives on an increase in market capitalisation over a three-year period – especially where payments are made annually – could incentivise Mukuru to manipulate results to increase the share price (with dividends and/or share-buyback) in the short term to the detriment of shareholder value in the longer term.	1
9.	The liability could be significantly understated as the predicted share prices could be much higher: although some comfort is taken from the independent research analyst's predictions, circumstances may change and the risk is significant.	1
10.	The scheme does not seem to be broad-based in nature but only tailor-made for the CEO, this might have a negative of other executives/employees in the company.	1
11.	In FY2023, the decrease in the share price would mean that the CEO was 'overpaid' at the end of FY2022.	1
12.	There is no indication if the vesting or reduction will be capped at zero or if the CEO will have to be repay the bonus.	1
13.	Vesting amount of 60% seem too high leading to a significant cash outflow of cash from the company's perspective in 2022. Will Build annually have the cash available to meet these payments.	1

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14. There seem to be no clawback provisions for potential issues that are identified post the scheme period (e.g., issues in controls or fraud that could drive an increase in the share price over a short period of time through overstating profits).	1
15. There seem to be no governance structures like a Remuneration Committee at Build to undertake setting performance incentive scheme duties.	1
Available	**18**
Maximum	**8**
Total for part (c)(ii)	**8**
Communication skills – layout and structure	*1*
Total for part (c)	**15**

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