Part (a) Discuss, with supporting calculations, the key matters that the Investment Committee of Motsumi Holdings should consider in its decision on whether or not it should participate in the proposed rights issue of Bapong						Marks
Calculations	**2014**	**2015**	**2016**	**2017**	**2018**	
Share price	R96,35	R111,94	R62,77	R47,40	R35,99	
Annual change		16,2%	– 43,9%	– 24,5%	– 24,1%	1
Compound annual 'growth' rate					–21,82%	1
Market capitalisation (Rm)	58 476	67 953	38 106	34 059	25 861	1
Platinum price	USD1 375,20	USD1 210,90	USD891,50	USD905,70	USD886,50	
Annual change		– 11,9%	– 26,4%	1,6%	– 2,1%	1
Compound annual 'growth' rate	(((USD886.50/USD1 375.50)^(1/4))-1) =				-10.4%	
Value of Motsumi Holdings' stake				1 975m	1 499m	
# of shares held				41,67m	41,65m	1
Percentage shareholding				5,8%	5,8%	1
Share price prior to announcement					R35,69	
Rights issue price					R30,34	
Discount					15%	1
Total # of shares in issue prior to rights issue					718,55	
Rights issue shares					143,71	1
Post rights issue					862,26	1C
Estimated share price directly after rights-issue					R35,04	1
Motsumi Holdings' shareholding if it sells rights					4,8%	1
Share value ex-right	R35.69 – ((35.69-30.34)/5) = R34.62 (Alt 34.80)				R34.62	1

Discussion	Marks
Pricing of rights issue	
1 A **15% discount to the share price** prior to rights issue could be enticing, (alt) although could realise this value by selling the right too.	1
2 The stock market reaction of a decrease in the share price from R35,69 to R34,20 indicates that the **market is not supportive of the rights issue** (the share price declined past the ex-rights price of R34.62).	1
3 Motsumi Holdings could potentially **sell its rights for up to R3,86** [R34,20 – R30,34] per right if it decided not to participate in the rights offer. Or… The rights are 5 shares for one right, therefore can be sold for up to (34.20-30.34)/5 = 0.772 per right, 3.86 per share	1
4 **Motsumi Holdings needs to do its own valuation of Bapong** to ascertain whether R34,20 is a fair price per share, and taking into account future performance of the company, **ability to recover, and the potential for the platinum price.**	1 1

Historical share price movements		
5	Why has the **Bapong share price been declining over the past three years**? Consider whether Motsumi Holdings would be interested in maintaining / increasing their shareholding in Bapong when the market value has declined by 24,1% over the past year (or 21% per annum on a compound scale).	1
6	The decline in the share price being **larger than the decline in the platinum price should be questioned, it is either unreasonable** and should be aligned, or alternatively there may be a gearing effect of the platinum price on the value of the firm, indicating business risk. CAGR platinum decline: – 10.4% vs decline in share price of Bapong of -21.82%	1
7	The decline in the Bapong share price has been higher than that of Mot-Plats in 2018 – clearly the **stock market places a lower rating on Bapong** therefore should consider not following their rights to increase their interest.	1
8	Bapong's **beta coefficient** (1,78) is much **higher than that any other Motsumi Holdings investee's, including MotPlats in the same industry** which is **significantly lower at 0.8857** illustrating its **higher risk profile,** and additional investment should be **approached cautiously.** .	1
Platinum industry		
9	What are the **prospects for the platinum industry**? Has any industry research been undertaken in this regard?	1
10	Motsumi Holdings might want to consider to what extent the **decrease in the PGM price is also compensated for by a declining rand value** (especially as the rand is expected to decline further in future). What would the true price decline be without currency fluctuations.	1
11	**What drives the platinum price**? Is it demand versus supply? Is it global GDP growth?	1
Other factors		
12	Bapong has **not had a successful history** with rights issues, with share prices decreasing, perhaps due to **the issues being in times of need**, rather than for attractive expansive reasons.	1
13	With the previous rights issue, an additional 111 470 000 (718,55m – 607,08m) shares were issued for R5,5 billion. This amounts to **R49,34 per share**. What is the **reason for the change in the current year bigger discount** that is being offered?	1 1
14	This seems to be yet another **rights issue in distress,** this time **to reduce debt which is not a great reason to issue more capital, especially so soon after 2017?** Surely Bapong's directors should have planned for the company's capital needs for the next 3–5 years?	1
15	**Bapong has not paid a dividend since 2014 and are being forced to raise more capital in a declining market**, which is not attractive for investors and are indicators of severe distress. (Dividends together with capital growth create value for shareholders.)	1
16	**Motsumi Holdings's stake will dilute from 5,8% to 4,8%** if it does not participate in the rights issue and sells its rights and the rights issue is fully subscribed. Would this matter to Motsumi Holdings, as **5,8% does not give it any particular control over a listed company**?	1 1
17	If **Motsumi Holdings seeks to diversify away from platinum**, this might be a reason for not participating in the rights issue.	1
18	The question is **what other investment opportunities there are for Motsumi Holdings** and whether these are more attractive than the Bapong rights issue?	1
19	The **rights issue will cost Motsumi Holdings about R253m** (41,65m shares / 5 x R30,34). They only have R138m in cash balances – how will the deficit be funded?	1
20	The **money raised with the rights issue will be used to settle debt, and not to increase income** (except through the avoidance of interest payments) and therefore, it will not over the long term increase the value of Bapong (**nothing new is built or generated**).	1
21	**Bapong does lay claim to a significant share of the world market** for PGMs (producing approximately 25%), but the constant decrease in the share price makes it less and less attractive.	1

Available	**36**
Maximum	**23**
Communication skills – logical argument	**1**
Total for part (a)	**24**

Part (b) **Calculate the weighted average cost of capital of Motsumi Holdings as at 31 December 2018.** Hamada formula: $ß_L = ß_U [1 + (1 - t)(D/E)]$	**Marks**
Fair value of the debentures	
FV: R1 000 000	
N: 6	1
Pmt: R1 000 000 x 9,5% x ½ = R47,500	1
i/yr: (1+i)^n -1 = (1+9%)^1/2-1 = 4.4031% *Mark only awarded if pmt nominal and interest effective*	1
Fair value: R1 017 950 x 5 000 = R5 089,8m	1C
Fair value of the loan facilities	
R8 370m – R5 089.8m = R3 280,25m	1C
After-tax cost of the debentures and loan facilities	
Pre-tax cost of debentures = 9%	1
Pre-tax cost of loan facilities = 9,25%	
Given that the fund's revenue is **dividend based**, no tax benefit will be deductible in respect of its finance charges and as result **the pre- and post-tax cost of debt will be the same**.	1 1
Beta coefficients Geared beta-factor of MoG: 0,7833 x (1 + [0,72 x (50%/50%)]) = 1,3472 *Using Hamada* 50/50 *Correct debt / equity*	 1 1
Weighted average beta of the portfolio	
(1,7803 x 4,45%) + (0,8857 x 8,4%) + (0,885 x 49,8%) + (0,9143 x 30%) + (0,3197 x 2,4%) + (1,3472 x 4,6%) = 0,9410 *Principle of weighting the beta factors* *Weighting based on the **gross value of the investment excl. cash (R33 693)***	 1 1C
Cost of equity of the Motsumi Holdings portfolio	
Ke: 8,93% + 0,9410 (6%) = 14,58% *Uses **longest dated bond yield*** *Uses calculated portfolio beta factor* *Uses correct market premium*	 1 1C
WACC	
[Cost of equity x weighting] + [Cost of debt x weighting]	
Enterprise value = 33,693, therefore equity value = 25,323 [33,693 – debt + excess cash*] * *Excess cash assumed zero given its an investment holding company, or included.*	1
Weighting equity to EV = 25,323/33,693 = 75,2%	1C
Debt weighting therefore 24,8%	
WACC calc +(75.2%*14.58%)+(((5089.8/8370)*9%)+(3280.2/8370*9.25%))*24.8%=13,22% Or: (25 323/33 693x14.58%)+(5 089.8/33 693x9%)+(3 280.2/33 693x9.25%)=13.22%	1C
The above weighting assumes consistent debt/EV ratio, which is unrealistic	
Available marks	**17**
Maximum marks	**17**
Total for part (b)	**17**

Part (c)	Discuss the key matters Motsumi Holdings's Investment Committee should consider in evaluating whether it should invest in Ezempilo, based on Nonni's proposed transaction structuring	Marks
Loan funding terms		
1	What is the likely **interest rate that will be offered**? Is it attractive enough given the risk?	1
2	What is the likely **security that will be pledged** for the loan? For instance, the potential pledge of Ezempilo and Newco shares held by Nonni.	1
3	What are the proposed **loan repayment terms**? Will these be commercial?	1
4	**Will the loan have covenants** to protect MH? For instance, will it prohibit the payment of dividends to the shareholders until (a percentage of) the loan has been repaid?	1
5	Will the Newco be able to make loan repayments (i.e. are the forecasts **financially feasible**)? Is the **debt : equity balance** reasonable?	1
6	The **interest expense will be deductible by Newco in terms of section 24J because of 24O** provided it retains a 70% shareholding in Ezempilo.	1
7	Is **Nonni likely to offer any profit guarantees**, and what would happen if these guarantees are not met? Alternatively **restrictions on selling** her shares.	1
Migos		
8	Are there any **hidden reasons why Migos is selling**, especially considering they only bought into Ezempilo in 2014?	1
9	The **sale seems very sudden and linked to Ezempilo's entry into Mozambique**	1
10	Who has the **right to decide whether Nonni is going to stay** on at the company – the scenario says 'with the option of renewing', but who holds the option?	1
11	Migos acquired the interest in Ezempilo in 2014, which means **Nonni's contract is approaching the end of its term –** is the renewal (by her) a reason for their exit?	1
12	**What price is Migos seeking?** Is Nonni's assumption of R45m correct?	1
13	What is the fair value of 100% of Ezempilo? Motsumi Holdings needs to do its **own valuation**	1
Attractiveness of investment opportunity		
14	Motsumi Holdings should consider the fact that the investment is required for a further expansion into Mozambique. The **Mozambique venture is exposed to different risks** than the SA venture (e.g. exchange rate risk, political risk, economy less diversified).	1
15	Ezempilo has operations mainly in tourist cities, which are **impacted by seasonality** (i.e. holidays are generally at specific times during the year), which needs to be considered when assessing the predictability of revenues and cash flows.	1
16	Is the **Mozambique investment/opportunity adding or destroying value**? It may be necessary to use a different hurdle/discount rate to assess the Mozambican business.	1
17	It is also **difficult to operationally manage an investment when one is not close to the business** (it is in a different country).	1
18	Historical and forecast financial information needs to be reviewed and **key trends analysed.**	1
19	MH should consider whether the current **increase in revenue** is due to an **increase in gym memberships**/membership **fees**, or just as a result of **additional gyms** being open? The latter is not sustainable infinitely.	1
20	Is there a **risk with regard to fictitious revenue** at Ezempilo?	1
21	What **funding is required to further roll out the Mozambique opportunity?**	1
22	**Can local Mozambican banks be approached** to fund future investments or will Ezempilo have to rely on South African sources of finance?	1
23	**Can funds be repatriated from Mozambique?** What impact could forex restrictions have on for example repatriation of dividends?	1
24	What is **Motsumi Holdings's potential IRR on investing in Ezempilo?** Does it meet the company's minimum hurdle rates?	1
25	A **sensitivity analysis and a scenario analysis** need to be undertaken	1
26	What **other investment opportunities are available for Motsumi Holdings**? These should be ranked against the Ezempilo opportunity. The investment in a gym does	1

	not necessarily make sense in the investment portfolio, it may be diversification, but did not seem to fit even a broader view of their key competencies as a fund.	
27	The investment in a **gym does not necessarily make sense** in the investment portfolio, it may be **diversification,** but did **not seem to fit even a broader view** of their key competencies as a fund.	1
28	Motsumi Holdings is to **'invest' R36m yet only obtains a 40% shareholding** whereas Nonni invests R9m for 60%? This awards Nonni the majority voting and veto power, **whereas MH is taking on the majority of the risk** (its investment in the company [loan + shares] is far greater than that of Nonni).	1 1
29	There appears to be some **governance issues at Ezempilo –** Motsumi Holdings should consider how material these are, and whether it wants to expose itself to the potential reputation risk.	1
30	MH should consider whether Ezempilo makes **sufficient provision for the cost of lawsuits** that may arise from injury suffered at the gyms, especially if children are still allowed to participate. Are there any other potential hidden liabilities?	1
31	The ability to perform a **proper due diligence must be considered** (particularly given Mozambican operations of Ezempilo and related risks).	1
32	Does a company investing in **gyms fit with MH's investment strategy?** Especially as the focus of the company has changed from community service (charity) to a profit-driven motive.	1
	Available marks	**33**
	Maximum marks	**16**
	Communication skills – appropriate style	*1*
	Total for part (c)	**17**
TOTAL FOR PART I		**58**