

Part (a) Calculate and conclude on which alternative for settling the Competition Commission fine is cheaper for SuperMega								Marks
ZAR million		30 June 2017	30 June 2018	30 June 2019	30 June 2020	30 June 2021	30 June 2022	
Good faith payment								
<i>Sunk cost, would not be recoverable under any alternative</i>								1
Immediate cash payment*		(50)						1
Recurring annual payments*			(45)	(45)	(45)	(45)	(45)	1
Final settlement amount*							(50)	1
Payment to business development charity [(6500x0,36+6850x0,35+7400x0,37+7450x0,36+7280x0,345)/5] x 0,5%		(12,7)						2
Tax saving on payment to business development charity			3,5					1C
<i>Timing one year later as tax saving occurs at end of tax period</i>								1
<b>Cash outflows</b>		<b>(62,7)</b>	<b>(41,5)</b>	<b>(45)</b>	<b>(45)</b>	<b>(45)</b>	<b>(95)</b>	
<b>Net present cost (discounted at 14%)</b>		<b>(240)</b>						1C
<b>Immediate cash payment – alternative settlement scenario</b>		<b>(250)</b>						
Since the net present cost of payment alternative 1 is lower than payment alternative 2, the company should select payment alternative 1.								1
<b>Available</b>								<b>10</b>
<b>Maximum</b>								<b>10</b>
<b>Total for part (a)</b>								<b>10</b>

Part (b) Identify and discuss the factors SuperMega should have considered in determining whether it should have selected alternative 1 or 2 to settle the Competition Commission fine. Calculations are not required.	Marks
1. SuperMega needs to consider if it can fund the R250 million payment immediately,	1
This may not be possible given the proposed funding options reveal that cash and debt facilities may be limited.	1
2. Given that SuperMega's net present cost of the fine is R10 million lower for payment alternative 1 compared to payment alternative 2, it would be value enhancing to take payment alternative 1.	1
3. Furthermore, with payments being payable in the future, by having the predictability of knowing when payments are due,	1
the group can undertake a fundraising exercise that matches the debt term to the fine payable	1
4. By paying ZAR250 million the company manages to close out the liability immediately which makes future reporting operational results simpler (once-off impact on balance sheet and ratios),	1
and prevents prolonged reputational damage.	1

5. However, the <b>payment to the business development trust</b> (which is only available in the longer term repayment profile) is <b>likely to restore corporate social responsibility goodwill</b> for SuperMega, <b>in addition to providing tax relief.</b>	1 1
6. The effect of a change in risk profile after the ruling may result in the <b>cost of debt increasing</b> , which may change the net present cost comparison.	1
<b>Available</b>	10
<b>Maximum</b>	8
<i>Communication skills – logical argument</i>	1
<b>Total for part (b)</b>	<b>9</b>

Part (c) Identify and discuss the disadvantages of each of the proposed funding options that Honey identified for settling the Competition Commission fine	Marks
<b><i>SuperMega could utilise operating cash flows to settle the liability</i></b>	
• 7. The disadvantage of this approach is it <b>may lead to a liquidity strain.</b>	1
• <b>8. This will limit the company's ability</b> to undertake capital expenditure or operating expenditure.	1
• 9. This strategy could mean that there will not be any funds available with which to <b>pay dividends to shareholders</b> for approximately five years, which might affect the share price.	1
• 10. There is the risk that, for instance because of <b>adverse economic conditions</b> , operating cash flows do not grow as expected –	1
• What would be the <b>consequences to the company of missing / being short payment on the fine?</b>	1
<b><i>Selling of non-core assets or alternatively a sale and leaseback of the property</i></b>	
• 11. The disadvantage of this approach is it may lead to the <b>loss of key assets</b>	1
• which <b>may be used as a pledge to raise debt</b> or provide other operational benefits (e.g. no rent payments on owner-occupied property).	1
• 12. The <b>key asset may not be lost if a sale and leaseback is used</b> , as the company will retain the use of the asset (probably over the long term):	1
• however, the <b>capital appreciation that could have been gained by holding the asset would be lost</b> (what is the opportunity costs?).	1
• 13. Furthermore, a sale and leaseback or outright sale of non-core assets is <b>likely to trigger capital gains tax</b> and <b>other normal tax</b> (recoupments, etc.) on the disposed assets	1
• However, it may provide <b>relief through deductibility of lease payments</b> which <b>need to be factored into the analysis.</b>	1
• 14. The cost of <b>moving premises</b> , and cost of <b>renting a new premises</b> should be considered.	1
• 15. The state of the commercial property market, and whether a <b>good price will be received on a forced sale.</b>	1
• 16. The <b>R450 mn &gt; R250 mn needed</b> , this will leave the company with <b>excess unproductive cash</b> , or alternatively, will <b>provide added liquidity.</b>	1
<b><i>SuperMega could utilise short-term debt facilities (e.g. bank overdrafts)</i></b>	
• 17. The disadvantage with this approach is that the <b>cost of the funding is likely to be high.</b>	1
• 18. Furthermore, this reduces the company's flexibility as the <b>repayment terms are likely to be short.</b>	1

<ul style="list-style-type: none"> <li>19. The group can undertake a fundraising exercise that provides flexibility in <b>matching the payments to the debt facility.</b></li> </ul>	1
<b>Potentially undertaking an equity raise from existing shareholders or introducing new external shareholders</b>	
<ul style="list-style-type: none"> <li>20. <b>Existing shareholders</b> are likely to view this unfavourably, as it <b>could potentially dilute their voting rights/value.</b></li> </ul>	1
<ul style="list-style-type: none"> <li>21. Furthermore, the company is not listed, which means that the <b>process may be less cumbersome with existing private shareholders,</b></li> <li>But existing shareholders may have <b>limited funds available to support the equity raise.</b></li> <li>New shareholders will potentially also be <b>harder to find.</b></li> </ul>	1 1
<ul style="list-style-type: none"> <li>22. The disadvantage is that the <b>valuation placed on SuperMega equity by new investors is unlikely to be favourable,</b> as the fine may reduce the equity value raised significantly and <b>sentiment is likely to be poor,</b></li> <li><b>resulting in excessive dilution</b> for existing shareholders.</li> </ul>	1 1
<ul style="list-style-type: none"> <li>23. The <b>equity raised will not be used to stimulate growth,</b></li> <li>and therefore the future earnings per share / dividends per share will not be increased by the issuing of the shares – <b>this could be unacceptable to shareholders.</b></li> </ul>	1 1
<ul style="list-style-type: none"> <li>24. The <b>effect</b> of each of the proposals on the <b>capital structure</b> of the company, and the resulting WACC should be considered.</li> </ul>	1
<ul style="list-style-type: none"> <li>The cost of equity will be higher than the cost of debt, including not being tax deductible.</li> </ul>	1
<b>Available</b>	<b>27</b>
<b>Maximum</b>	<b>12</b>
<i>Communication skills – logical argument</i>	1
<b>Total for part (c)</b>	<b>13</b>

Part (d) Based on the updated information in point 3.3 of the initial feasibility study – (i) estimate whether the BPL broadcasting deal would have been financially feasible and lucrative Round your answers to the nearest R million where applicable							Marks
	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	
	R million	R million	R million	R million	R million	R million	
Cost of broadcasting rights	(3 500)						1
Revised forecasts – incremental revenues		(174)	420	1 111	1 557	1 683	1
Cost of initial feasibility study – sunk	-						1
Additional marketing expense		(75)	(75)	(75)	(75)	(75)	1
Net cash flow before tax		(249)	345	1 036	1 482	1 608	
Tax (28%)		70	(97)	(290)	(415)	(450)	1C

**QUESTION 1 SuperMega  
PAPER 1 PART I**

**ITC JUNE 2018  
SUGGESTED SOLUTION**

Tax on broadcasting rights (3500/3)*28%		327	327	327			1
<b>Net cash flow</b>	(3500)	148	575	1 073	1067	1158	
WACC	14%						
NPV	(971)						1C
Consequently, the initial investment was not financially feasible as the NPV is negative.							1
<b>Available</b>							<b>8</b>
<b>Maximum</b>							<b>8</b>
<b>Total for part (d)(i)</b>							<b>8</b>

<b>Part (d) Based on the updated information in paragraph 3.3 of the initial feasibility study – (ii) identify any other factors that should be considered in evaluating the broadcasting deal.</b>	<b>Marks</b>
<b>Additional factors that should be considered in evaluating the broadcasting deal:</b>	
• 25.How realistic is it to expect that the <b>proportion of advertising revenue/total revenue</b> will remain constant, considering there may be both fixed and variable elements to the revenue?	1
• 26.SuperMega plans to <b>charge a premium</b> for subscribers who select packages that broadcast the British Soccer League, • reasonability of the assumptions regarding <b>what proportion of customers are expected to pay the premium.</b>	1 1
• 27.Will SuperMega <b>need to hire any additional staff</b> to manage the increase in customers going forward?	1
• 28.Are there <b>any other incremental costs that have not been included</b> that may be incurred, such as administration or systems costs to handle the increased subscriber numbers?	1
• 29.Consider whether it is <b>feasible and realistic that the company will be able to maintain an 81% market share</b> for five years.	1
• 30.The impact of the increasing <b>popularity of online streaming services</b> should be considered.	1
• 31.Have any additional <b>scenario analyses</b> been performed to assess the reasonability of the revised feasibility study?	1
• 32.Is the <b>discount rate of 14% appropriate</b> for the subscription rights or • <b>should it be adjusted given the forecasting risk</b> on potential customers and economic conditions?	1 1
<b>Available</b>	<b>10</b>
<b>Maximum</b>	<b>7</b>
<b>Total for part (d)(ii)</b>	<b>7</b>
<b>Total for part (d)</b>	<b>15</b>

Part (e) Identify and describe potential mitigating actions SuperMega could undertake to respond to the risks and issues raised under the market dominance action plan.	Marks
<ul style="list-style-type: none"> <li>33. SuperMega could <b>revise its bundled service offering</b> by introducing an offering that enables consumers to <b>purchase content on demand</b></li> <li><b>without paying for channels or events in which they are not interested.</b></li> </ul>	1 1
<ul style="list-style-type: none"> <li>34. Furthermore, SuperMega should consider <b>selling access to some of its content</b> to competitors <b>at a cost-recovery rate</b> to ensure they can also <b>broadcast national sporting events</b> or</li> <li>alternatively <b>sell the rights to the national broadcaster.</b></li> </ul>	1 1
<ul style="list-style-type: none"> <li>35. In addition, SuperMega should consider <b>sub-licencing its broadcasting rights,</b></li> <li>so that even though it initially has control over the rights it can ensure that <b>competitors have a mechanism to potentially access elements of the content</b> based on a reasonable price.</li> </ul>	1 1
<ul style="list-style-type: none"> <li>36. SuperMega should consider <b>expanding into new segments</b> or areas, such as gaming and mobile content,</li> <li>where <b>dominance issues are likely to be limited</b> and the potential for growth is high.</li> </ul>	1 1
<ul style="list-style-type: none"> <li>37. SuperMega should also consider <b>diversifying away from pay TV and the entertainment industry,</b> or</li> <li>consider new markets where it does not currently have a presence and which will allow it to <b>diversify its revenue base and cash flows within entertainment.</b></li> </ul>	1 1
<ul style="list-style-type: none"> <li>38. SuperMega should consider undertaking a <b>public relations campaign to raise awareness of its offerings</b> and</li> <li><b>address some of the concerns raised by the article in the local newspaper.</b></li> </ul>	1 1
<ul style="list-style-type: none"> <li>39. Consider <b>showing certain content for free</b> – SuperMega can advertise their other products during the free shows,</li> <li>and to generate interest and to <b>grow the number of subscribers.</b></li> </ul>	1 1
<ul style="list-style-type: none"> <li>40. Employ a <b>compliance officer</b> to ensure that the legal requirements for this industry and the bidding processes are managed and met.</li> </ul>	1
<ul style="list-style-type: none"> <li>41. Make <b>voluntary disclosures to the Competition Commission</b> to prevent further investigations.</li> </ul>	1
	Available <b>16</b>
	Maximum <b>10</b>
<i>Communication skills – clarity of expression</i>	1
<b>Total for part (e)</b>	<b>11</b>