Answers

The project can be answered in different ways and the suggested solution below should only be regarded as indicative.

1 (a) (i) Projected income statement for the year ended 31 July: assuming promotion at end of 2007/8 season

	Year ended 31 July				
	2007	2008	2009	2010	2011
	£m	£m	£m	£m	£m
Revenue					
League matches	16·3	17·1	27·6	28·0	29·5
Cup matches	5·2	7·5	8·5	13·0	15·0
Sponsorship	11·0	11·4	20·5	21·0	22·4
Merchandising	9·1	9·3	11·9	12·5	12·8
TV Rights	6·2	6·8	22·5	23·5	25·2
Rents and commercial activities			3·8	7·9	12·4
	47·8	52·1	94·8	105·9	117·3
Operating expenses					
Players' wages	(35·8)	(36·8)	(36·8)	(36·8)	(36·8)
Compensation payment	(2·0)				
Amortisation of players' registrations (Note 1)	(13·0)	(19·0)	(16·0)	(16·0)	(16·0)
Loss on transfer of players' registrations (£36m – £25m)	(11·0)				
Depreciation (Note 2)	(4·2)	(4·2)	(4·8)	(5·4)	(5·8)
Administration and other operating expenses	(10·7)	(11·2)	(11·8)	(12·4)	(13·0)
Profit (loss) before interest and taxation	(28·9)	(19·1)	25·4	35·3	45·7
Interest payable	(2·1)	–	–	–	–
Profit (loss) for the year	(31·0)	(19·1)	25·4	35·3	45·7

Notes

(1) Amortisation of players' registrations calculation

	Year ended 31 July				
	2007	2008	2009	2010	2011
	£m	£m	£m	£m	£m
Cost of players' registrations at beginning of year	75·0	65·0			
Less Cost of players' registrations transferred	60·0	–			
	15·0	65·0			
Add New players' registrations	50·0	30·0			
	65·0	95·0			
Amortisation (20%)	13·0	19·0	16·0	16·0	16·0

(2) Depreciation calculation

	Year ended 31 July				
	2007	2008	2009	2010	2011
	£m	£m	£m	£m	£m
Existing depreciation	4·2	4·2	4·2	4·2	4·2
Stage 1 depreciation (£40m – £10m) x 2%			0·6	0·6	0·6
Stage 2 depreciation				0·6	0·6
Stage 3 depreciation					0·4
	4·2	4·2	4·8	5·4	5·8

Incremental cash flows for the year ended 31 July: assuming promotion at end of 2007/8 season

	Year ended 31 July				
	2007	**2008**	**2009**	**2010**	**2011**
	£m	**£m**	**£m**	**£m**	**£m**
Net profit (loss) for the year	(31·0)	(19·1)	25·4	35·3	45·7
Add					
Amortisation of players' registrations	13·0	19·0	16·0	16·0	16·0
Loss on transfer of players' registrations	11·0*				
Depreciation (Note 2)	4·2	4·2	4·8	5·4	5·8
Cash flow from operations	(2·8)	4·1	46·2	56·7	67·5
Add Government grant				10·0	
Sale of players	25·0				
Sale of investment (8·0 x £42·7m)					341·6
	22·2	4·1	46·2	66·7	409·1
Less					
Increase in working capital	(1·1)	(0·9)	(8·5)	(2·2)	(2·3)
Players' registrations	(50·0)	(30·0)			
Loan repayment	(60·0)				
Redevelopment work		(40·0)	(30·0)	(20·0)	
Incremental cash flows	(88·9)	(66·8)	7·7	44·5	406·8

* This is calculated as follows:

	£m
Cost of players' registration	60
Less Amortisation 2004/5 & 2005/6	24
Written down value	36
Cash from sale of players' registration	25
Loss on sale	11

(ii) Projected income statement for the year ended 31 July: assuming promotion at end of 2008/9 season

	Year ended 31 July				
	2007	**2008**	**2009**	**2010**	**2011**
	£m	**£m**	**£m**	**£m**	**£m**
Revenue					
League matches	16·3	17·1	18·0	27·6	28·0
Cup matches	5·2	7·5	8·5	9·0	14·3
Sponsorship	11·0	11·4	11·9	20·5	21·0
Merchandising	9·1	9·3	9·6	11·9	12·5
TV Rights	6·2	6·8	7·2	22·5	23·5
Rents and commercial activities			3·8	7·9	12·4
	47·8	52·1	59·0	99·4	111·7
Operating expenses					
Players' wages	(35·8)	(36·8)	(36·8)	(36·8)	(36·8)
Compensation payment	(2·0)				
Amortisation of players' registrations (Note 1)	(13·0)	(19·0)	(16·0)	(16·0)	(16·0)
Loss on transfer of players' registrations (£36m – £25m)	(11·0)				
Depreciation (Note 2)	(4·2)	(4·2)	(4·8)	(5·4)	(5·8)
Administration and other operating expenses	(10·7)	(11·2)	(11·8)	(12·4)	(13·0)
Profit (loss) before interest and taxation	(28·9)	(19·1)	(10·4)	28·8	40·1
Interest payable	(2·1)	–	–	–	–
Profit (loss) for the year	(31·0)	(19·1)	(10·4)	28·8	40·1

Incremental cash flows for the year ended 31 July: assuming promotion at end of 2008/9 season

	Year ended 31 July				
	2007	**2008**	**2009**	**2010**	**2011**
	£m	**£m**	**£m**	**£m**	**£m**
Net profit (loss) for the year	(31·0)	(19·1)	(10·4)	28·8	40·1
Add					
Amortisation of players' registrations	13·0	19·0	16·0	16·0	16·0
Loss on transfer of players' registrations	11·0				
Depreciation (Note 2)	4·2	4·2	4·8	5·4	5·8
Cash flow from operations	(2·8)	4·1	10·4	50·2	61·9
Add Government grant				10·0	
Sale of players	25·0				
Sale of investment (8·0 x £37·1m)					296·8
	22·2	4·1	10·4	60·2	358·7
Less					
Increase in working capital	(1·1)	(0·9)	(1·4)	(8·1)	(2·5)
Players' registrations	(50·0)	(30·0)			
Loan repayment	(60·0)				
Redevelopment work		(40·0)	(30·0)	(20·0)	
Incremental cash flows	(88·9)	(66·8)	(21·0)	32·1	356·2

(iii) Projected income statement for the year ended 31 July: assuming promotion at end of 2009/10 season

	Year ended 31 July				
	2007	**2008**	**2009**	**2010**	**2011**
	£m	**£m**	**£m**	**£m**	**£m**
Revenue					
League matches	16·3	17·1	18·0	19·1	27·6
Cup matches	5·2	7·5	8·5	9·0	10·3
Sponsorship	11·0	11·4	11·9	12·2	20·5
Merchandising	9·1	9·3	9·6	9·8	11·9
TV Rights	6·2	6·8	7·2	8·1	22·5
Rents and commercial activities			3·8	7·9	12·4
	47·8	52·1	59·0	66·1	105·2
Operating expenses					
Players' wages	(35·8)	(36·8)	(36·8)	(36·8)	(36·8)
Compensation payment	(2·0)				
Amortisation of players' registrations (Note 1)	(13·0)	(19·0)	(16·0)	(16·0)	(16·0)
Loss on transfer of players' registrations (£36m – £25m)	(11·0)				
Depreciation (Note 2)	(4·2)	(4·2)	(4·8)	(5·4)	(5·8)
Administration and other operating expenses	(10·7)	(11·2)	(11·8)	(12·4)	(13·0)
Profit (loss) before interest and taxation	(28·9)	(19·1)	(10·4)	(4·5)	33·6
Interest payable	(2·1)	–	–	–	–
Profit (loss) after interest and taxation	(31·0)	(19·1)	(10·4)	(4·5)	33·6

Incremental cash flows for the year ended 31 July: assuming promotion at end of 2009/10 season

	Year ended 31 July				
	2007	2008	2009	2010	2011
	£m	£m	£m	£m	£m
Net profit (loss) after interest and taxation	(31·0)	(19·1)	(10·4)	(4·5)	33·6
Add					
Amortisation of players' registrations	13·0	19·0	16·0	16·0	16·0
Loss on transfer of players' registrations	11·0				
Depreciation (Note 2)	4·2	4·2	4·8	5·4	5·8
Cash flow from operations	(2·8)	4·1	10·4	16·9	55·4
Add Government grant				10·0	
Sale of players	25·0				
Sale of investment (8·0 x £30·6m)					244·8
	22·2	4·1	10·4	26·9	300·2
Less					
Increase in working capital	(1·1)	(0·9)	(1·4)	(1·4)	(7·8)
Players' registrations	(50·0)	(30·0)			
Loan repayment	(60·0)				
Redevelopment work		(40·0)	(30·0)	(20·0)	
Incremental cash flows	(88·9)	(66·8)	(21·0)	5·5	292·4

(b) The maximum price to be paid for each share in the club will be based on the net present value of the future cash flows from the investment.

(i) Net present value: assuming promotion at the end of the 2007/8 season

	Year ended 31 July				
	2007	2008	2009	2010	2011
	£m	£m	£m	£m	£m
Incremental cash flows	(88·9)	(66·8)	7·7	44·5	430·8
Discount rate 16%	0·86	0·74	0·64	0·55	0·48
PV	(76·5)	(49·4)	4·9	24·5	206·8
NPV	110·3				

Price per share = NPV/No. of shares issued
= £110·3m/40m
= £2·76

(ii) Net present value: assuming promotion at the end of the 2008/9 season

	Year ended 31 July				
	2007	2008	2009	2010	2011
	£m	£m	£m	£m	£m
Incremental cash flows	(88·9)	(66·8)	(21·0)	32·1	380·2
Discount rate 16%	0·86	0·74	0·64	0·55	0·48
PV	(76·5)	(49·4)	(13·4)	17·7	182·5
NPV	60·9				

Price per share = NPV/No. of shares issued
= £60·9m/40m
= £1·52

(iii) Net present value: assuming promotion at the end of the 2009/10 season

	Year ended 31 July				
	2007	2008	2009	2010	2011
	£m	£m	£m	£m	£m
Incremental cash flows	(88·9)	(66·8)	(21·0)	5·5	316·4
Discount rate 16%	0·86	0·74	0·64	0·55	0·48
PV	(76·5)	(49·4)	(13·4)	3·0	151·9
NPV	15·6				

Price per share = NPV/No. of shares issued
= £15·6m/40m
= £0·39

(c) Various points could be made in answering this part, including the following:

- under each scenario the club shows a consistent improvement in profitability over time;
- under each scenario it is only when the club is promoted to the Premier League that a profit is made;
- operating expenses are fairly constant and so any increase in revenues has a direct impact on the 'bottom line';
- the dramatic improvement in profitability, once the club is promoted, is largely due to increases in revenues from TV rights, sponsorships and matchday attendances;
- the total financing requirement over the five-year period will be:
  - £155·7m (that is £88·9m + £66·8m) if the club is promoted at the end of the 2007/8 season
  - £176·7m (that is £88·9m + £66·8m + £21·0m) if the club is promoted at the end of the 2008/9 season
  - £176·7m (that is £88·9m + £66·8m + £21·0m) if the club is promoted at the end of the 2009/10 season;
- the total financing requirements are the same for two of the scenarios (promotion at the end of the 2008/9 season and 2009/10 season) and financing requirements for the third scenario (promotion at the end of the 2007/8 season) is not dramatically different from the other two;
- the maximum share prices calculated under each scenario cover a wide range (from £2·76 to £0·39);
- under the most likely scenario, the maximum share price is £1·52 and the current share price is £1·02 (which is close to the net book value of £0·98). It may be reasonable to pitch the share price somewhere between £1·02 and £1·52;
- if a premium of 25% on the current market value is offered to encourage investors to sell their shares, it would mean paying £1·27 per share;
- £1·27 per share is midway between the current share price and the maximum share price and may form the basis for an agreement, however, the margin of error is quite small from the perspective of the consortium;
- the final amount paid will depend on a variety of factors such as the negotiating skills of each side, whether takeover offers are likely to be received from other parties and the perceived probabilities attached to each possible scenario.

(d) To identify potential problems and risks associated with the takeover, information relating to various aspects of the club may be gathered, including:

- financial performance and position including past annual reports, forecasts and budgets, details of major expenses (particularly players' wages), accounting policies and contingent liabilities;
- major assets held including details of ownership rights, fitness for purpose and market values;
- employment contracts of players and key officials to identify possible future commitments such as compensation for loss of office and bonus payments;
- disputes with employees, sponsors, government agencies, or regulatory bodies such as the Football Association and Football League;
- contracts and agreements, including sponsorship and merchandising agreements, television rights agreements, and loan agreements;
- relationships with key stakeholders such as banks, local authorities, sponsors, supporters and the local community;
- regulations governing football clubs and their implications for the club;
- the reputation of the club and the strength of support for the club among supporters, sponsors and the local community;
- the competitive environment including details of main competitors and the critical success factors for effectively competing in the leagues and cup competitions.

To identify potential problems and risks associated with the plans outlined by Chris Ambridge, information relating to the following should be gathered:

- the reliability and validity of revenue and expense forecasts, including the likelihood of occurrence and key assumptions employed;
- details of the agreement reached with Brian Framlington and any impediments to his re-employment at the club;
- the reaction of key stakeholders such as investors, supporters, sponsors and local authorities to the proposed takeover;
- the adequacy of the proposed players' budgets to achieve promotion to the Premier League;
- the likelihood of obtaining planning permission for the proposed redevelopment of the stadium;
- the reliability of the cost estimates provided for redevelopment of the stadium and the likelihood of cost escalation;
- the feasibility of the proposed exit strategy including the likelihood that the P/E ratio mentioned can be achieved;
- the ability of the consortium to raise the total financing requirements that have been identified.

In addition, the timing of the flotation may be re-considered. The best exit strategy may be to delay the flotation until the team has enjoyed several years in the Premier League. It would seem more sensible to exploit the higher profits (valued at a price/earnings ratio of 8) that arise after becoming established in the Premier League rather than selling the shares before the impact of the team's new status has been fully felt.

(e) The proposal to make the existing chief executive of Barchester Rovers the chairman of the reconstituted board runs a number of risks. One such risk is that he will find it difficult to relinquish his former role and will interfere with the plans and decisions of the new chief executive, Chris Ambridge. It is difficult to demarcate clearly the authority and responsibilities of the chairman and chief executive and so the risk of interference always exists, however, this risk is heightened where the chairman was formerly the chief executive.

A further risk is that both the new chairman and new chief executive may engage in defensive behaviour. The chairman may seek to justify decisions that were taken in the past when he was still chief executive and may resist attempts by the new chief executive to overturn these decisions. The new chief executive, on the other hand, may seek to criticise the decisions made by his predecessor. As Chris Ambridge is new to the club, he may employ criticism as a means of imposing his authority and, given the financial predicament of the club, there is likely to be no shortage of opportunities for such behaviour.

The new chairman and chief executive must recognise these risks and strive to maintain a good working relationship. This should involve an agreement at the outset of their respective roles and responsibilities and a willingness to discuss these roles where events conspire to blur the previously agreed lines of demarcation. There must be a mutual respect for individual abilities for the authority and powers awarded to each role. Past decisions should not be criticised and the focus must be firmly on the future.

(f) The main advantages of a football club obtaining a listing include:

– the opportunity to raise finance easily and at a lower cost;
– strengthening corporate governance procedures, through adherence to the Combined Code;
– raising the club's profile, which may be helpful in its dealings with sponsors and suppliers;
– strengthening links with supporters by providing them with an opportunity to acquire shares in the club through the open market;
– greater management and financial discipline through greater accountability and transparency of operations.

The main disadvantages of a listing arise from the fact that a football club has sporting, as well as commercial, objectives. When a club is listed on the London Stock Exchange, it is the commercial objectives that are likely to dominate. The board of directors of a listed company must give priority to the needs of shareholders and should be committed to maximising shareholder value. (The 'market for corporate control' ensures that failure to do so will run the risk of takeover.) This priority, however, can lead to a conflict with other stakeholders, which include the Football Association, Football League, local communities, local authorities, sponsors, and supporters' clubs. These other stakeholders are likely to view the financial performance of the club as being of secondary importance to sporting performance. They may also expect any profits to be re-invested in the club rather than distributed in the form of dividends to shareholders.

In addition to the problems mentioned, there are other, more general, problems such as the:

– greater regulatory burdens;
– difficulties of conducting sensitive negotiations when subjected to intense scrutiny by analysts, the media and others;
– increased vulnerability to takeover.

(g) Other exit strategies may include:

– obtaining a listing on secondary markets such as AIM and Ofex. These secondary markets impose less regulatory burdens (and cost) than a full listing and avoid the requirement to have a minimum number of shares in public hands;
– selling the shares to a wealthy individual or another consortium of wealthy individuals;
– selling the shares to a private equity firm or venture capitalist;
– selling the shares to major stakeholders such as supporters, sponsors and the local authority;
– selling the shares to a group of managers (a buy-in or buy-out).

1	**(a)**	5 marks expected profit, 5 marks incremental cash flows for each of the three scenarios	30
	(b)	4 marks maximum share price for each scenario	12
	(c)	5 marks financial performance, 5 marks financing needs, 5 marks share price	15
	(d)	10 marks problems and risks of club, 10 marks problems and risks of business plans	20
	(e)	5 marks problems, 3 marks remedies	8
	(f)	5 marks advantages, 5 marks disadvantages	10
	(g)	1 mark per option (Max. 5 marks)	5
			100