Answers

1 (a) Seventeen Ltd

	Note	Jul £'000	Aug £'000	Sep £'000	Oct £'000	Nov £'000	Dec £'000	Total £'000
Cash inflows								
Ticket sales	1			1,540	2,310	2,310	1,540	7,700
Souvenirs sales	2			1,680				1,680
Total cash inflows				3,220	2,310	2,310	1,540	9,380
Cash outflows								
Purchases: Records Ltd	3		630					630
Purchases: Junk Ltd	3			420				420
Performers	4			60	360			420
Venue costs	5		1,620					1,620
Transport costs	6			69	23			92
Crew costs	7		360	720				1,080
Agency fees	8			36	72			108
Publicity costs	9	500	750			1,250		2,500
Other costs		60	60	60	60			240
Total cash outflows		560	3,420	1,365	515	1,250	0	7,110
Net cash flow		(560)	(3,420)	1,855	1,795	1,060	1,540	2,270
Opening balance		500	(60)	(3,480)	(1,625)	170	1,230	500
Closing balance		(60)	(3,480)	(1,625)	170	1,230	2,770	2,770

Note: The 'Total' column above is not required but does provide a useful arithmetic check for accuracy.

Note 1 Ticket sales

Total votes (180,000,000 + 100,000,000)	280,000,000
Estimated ticket sales (280,000,000/1,000)	280,000
Allocated as follows:	
Premium seats	**£'000**
(280,000 x 10% x £35)	980
Arena floor (280,000 x 30% x £30)	2,520
Stalls (280,000 x 60% x £25)	4,200
Total revenues	7,700
Received in:	
September (£7,700,000 x 20%)	1,540
October (£7,700,000 x 30%)	2,310
November (£7,700,000 x 30%)	2,310
December (£7,700,000 x 20%)	1,540
	7,700

Note 2: Souvenirs sales	**£'000**
Total number of tickets sold	280,000
Average souvenirs sale each	6
Total souvenirs sales	1,680

Note: 3 Souvenirs purchases	**£'000**
Total souvenirs sales	1,680
Split as follows:	
DVDs/CDs – 50%	840
GPM at 25%	(210)
Therefore COS at 75%	630
Payable in August to Records Ltd	
Other souvenirs – 50%	840
GPM at 50%	(420)
Therefore COS at 50%	420
Payable in September to Junk Ltd	

Note 4: Performers	**£'000**
12 performers at £35,000 each	420
Split as follows:	
Due September (12 x £5,000)	60
Due October (12 x 30,000)	360

Note 5: Venue costs	**£'000**
12 venues at £150,000 each	1,800
Less deposits paid (10% x £1,800,000)	(180)
Remainder due in August	1,620

Note 6: Transport costs	**£'000**
2 tour buses (2 x £10,000)	20
6 heavy goods vehicles (6 x £12,000)	72
Total	92
75% due September	69
25% due October	23

Note 7: Crew costs	**£'000**
Total number of crew required (12 x 5)	60
Total cost for August (30 x £12,000)	360
Total cost for September (60 x £12,000)	720

Note 8: Agency fees	**£'000**
August staff	
30 x £12,000 x 10%	36
Due September	
September staff	
60 x £12,000 x 10%	
Due October	72

Note 9: Publicity costs	**£'000**
July: £2,500,000 x 20%	500
Aug: £2,500,000 x 30%	750
Nov: £2,500,000 x 50%	1,250

Note 10: Other costs	**£'000**
July – Oct: £240,000/4	60

(b) **Recommended method of calculation**

Original level of profit per (a)	**£'000**	
Income	9,380	
Less: expenditure per cash budget	(7,110)	
Less: venue deposits pd May	(180)	
Profit	2,090	
Revised level of profit/loss	**£'000**	
Revised income: (£9,380 x 270/280) x 1/2	4,523	
Less original expenses:	(7,110)	
	(180)	
Add: original souvenir expenses (£630 + £420)	1,050	
Less revised souvenir expenses: (£1,050 x 270/280) x 1/2	(506)	
Revised loss	(2,223)	

Alternative method for calculating revised profit/loss

Revised profit/loss	**£'000**	**£'000**
Ticket sales (note 1)	3,713	
Souvenirs sales (note 2)	810	
		4,523
Less expenses		
Per original cash budget	(7,110)	
Less venue deposits paid May	(180)	
Add back original souvenir expenses	1,050	
Less revised souvenir expenses (note 3)	(506)	
		(6,746)
Revised loss		(2,223)

Note 1: Revised ticket sales

Total votes (180,000,000 + 90,000,000)	270,000,000
Estimated ticket sales (270,000,000/2,000)	135,000
Allocated as follows:	
Premium seats	**£'000**
(135,000 x 10% x £35)	473
Arena floor (135,000 x 30% x £30)	1,215
Stalls (135,000 x 60% x £25)	2,025
Total revenues	3,713

Note 2: Revised souvenirs sales	**£'000**
Total number of tickets sold	135,000
Average souvenirs sale each	6
Total souvenirs sales	810

Note 3: Revised souvenirs purchases	£'000
Total souvenirs sales	810
Split as follows:	
DVDs/CDs – 50%	405
GPM at 25%	101
Therefore COS @ 75%	304
Other souvenirs – 50%	405
GPM at 50%	203
Therefore COS at 50%	202
Total souv. expenses (£304,000 + £202,000)	506

2 Silly Filly Ltd

(a) NPV

	0	1	2	3	4	5
	£'000	£'000	£'000	£'000	£'000	£'000
Revenues			1,200	2,200	1,600	
Market research – sunk cost						
Animation company costs	(260)	(260)				
Producers' salaries		(240)				
Other production costs		(650)				
Director's salary		(160)				
Royalties (note 1)				(60)	(110)	(80)
Specialist equipment	(2,300)	1,700				
Loan interest – irrelevant						
Net relevant cash flows	(2,560)	390	1,200	2,140	1,490	(80)
Discount factor	1	0·909	0·826	0·751	0·683	0·621
Discounted cash flow	(2,560)	355	991	1,607	1,018	(50)

The project should be undertaken as it has a positive NPV of £1·361 million.

Note 1: Royalties	Years					
	0	1	2	3	4	5
Revenues			1,200	2,200	1,600	
Royalties: (2 x 1·5% + 2% = 5%)				60	110	80

(b) **Four costs of new equity issues**

- Underwriting costs
- Stock exchange listing fees
- Costs of printing and distributing the prospectus
- Advertising costs
- Issuing house fees
- Solicitors' fees
- Public relations consultancy fees
- Accountants' fees

(Note: Only four were required.)

(c) Reasons for a stock exchange listing

Access to wider pool of finance

The level of finance available to a private unlisted company is limited. Therefore, if a company needs more finance than is currently available to it, it may seek a stock exchange listing. A stock exchange listing may also improve the company's credit rating, meaning that more investors are willing to invest in it.

Enhancement of the company image

A company's image is generally improved anyway when it becomes listed, as it is perceived as being more financially stable. This may result in increased custom and increased buying power.

Increased marketability of shares

It is not very easy for a shareholder in a private company to sell his/her shares, and this in itself makes the investment more risky. Once a company is listed on the stock exchange, its shares become far more marketable, thus making them far more attractive.

Facilitation of growth by acquisition

Should a listed company wish to make an offer to takeover another company, they are in a much better position to do so than an equivalent unlisted company. This is because the terms of the offer will probably include an exchange of the shares in the acquiring company for those of the target company.

Transfer of capital by founder owners

A stock exchange listing gives founder members more opportunity to sell their shareholding, or part of it, leaving them free to invest in other projects.

Note: Only three reasons were required.

3 Duel Fuel Ltd

(a) Whether to factor

Existing finance cost at 9%

New level of debtors = £4,300,000 x 120%	£5,160,000
Overdraft cost per annum = £5,160,000 x 9%	£464,400

Cost of factoring

New sales level = £8,500,000 x 120%	£10,200,000
Debtors reduced to 60 days:	
£10,200,000 x 60/365	£1,676,712
70% advanced by factor at 12%:	**£**
£1,676,712 x 70% x 12%	140,844
30% still financed by overdraft:	
£1,676,712 x 30% x 9%	45,271
Admin Fee:	
£10,200,000 x 1·5%	153,000
Saved salaries	
(2 x £14,000) – (2 x £3,000)	(22,000)
	317,115
Saving = £464,400 – £317,115	147,285

Conclusion

It is financially viable for Duel Fuel Ltd to factor its debts as a total saving of £147,285 will be made.

(b) Advantages of factoring

(i) Managers can concentrate on running the business rather than spending time dealing with problems relating to slow paying debtors.

(ii) The factor will run the company's sales ledger department, hence cutting running costs in this area.

(iii) The company's cash flow position is improved, such that the company can pay its suppliers promptly and benefit from early payment discounts.

(iv) The finance costs of the business are linked to its sales levels and will therefore only increase as sales levels increase.

(v) Expansion can be financed through sales, rather than through increased debt or any injection of capital.

(vi) Optimum stock levels can be maintained, since the cash is readily available for injection.

(vii) Insurance against the company's bad debts is provided, since the factor takes over the risk of these losses if the agreement is a 'without recourse' agreement.

Note: Only five advantages were required:

(c) Roles of credit control department

– Keeping the sales ledger up-to-date
– Pursuing overdue debts
– Investigating customers' creditworthiness
– Dealing with customer queries about their account
– Advising customers on payment terms
– Giving references to third parties

Note: Only five roles were required.

4 Gym Jam Ltd

(a) Operating lease

– This is a rental agreement between two parties, whereby the lessor supplies equipment to the lessee.
– The lessor usually retains the responsibility for servicing and maintaining the leased equipment.
– The period of the lease is usually shorter than the asset's expected useful economic life.

(b) Finance lease

– This is an agreement between the lessor, who provides finance for the asset, and the lessee.
– The person supplying the equipment is usually a third party; the lessor just finances the asset.
– The lessee is responsible for the service and maintenance of the asset.
– The lease has a primary period which covers all/most of the expected useful economic life of the asset.
– The lease usually has an indefinite secondary period whereby the lessee continues to lease the asset for a nominal rent.

(c) Weaknesses and rectifications

– Invoices are only raised quarterly, and using an inefficient manual system. A computerised invoicing system should be introduced that automatically raises invoices every month.
– Cheques are a slow method of payment, and rely on the customer sending them by post. Direct debits should be set up for customer payments instead.
– There are insufficient sales ledger staff to cope with the workload and this is causing a backlog. Additional sales ledger staff should be recruited to assist with the increased workload.
– Customers are not penalised for late payment and are therefore paying late. An interest penalty should be imposed on all late payments. Customers should be notified of this on their invoices.

(d) Factors affecting interest rate on loan

– Level of risk
– Interest rates in the economy
– Status of the borrower
– Security offered by the borrower
– Amount of the loan
– Purpose of the loan
– Duration of the loan

(e) Increase in interest charges

Interest charges persisted in increasing because the loan was linked to the Bank's base rate. A bank's base rate is based on LIBOR – the London Inter-Bank Offered Rate. LIBOR is the rate at which a bank can borrow money on the Inter-bank market. This LIBOR rate must have gone up, leading to an increase in Gym Jam Ltd's bank's base rate, and hence the rate of interest on the loan.

			Marks
1	(a)	**Cash budget**	
		Total votes cast	1
		Total tickets bought	1
		Premium sales	1
		Arena sales	1
		Stalls sales	1
		Total sales	1
		Ticket sales – Sept	1
		Ticket sales – Oct	1
		Ticket sales – Nov	1
		Ticket sales – Dec	1
		Souvenirs Sales	1
		Souvenirs Purchases – CDs	2
		Souvenirs Purchases – Other	2
		Performer costs – Sept	1
		Performer costs – Oct	1
		Venue costs	1
		Transport costs – Sept	1
		Transport costs – Oct	1
		Crew costs – Aug	1
		Crew costs – Sept	1
		Agency costs – Sept	1
		Agency costs – Oct	1
		Publicity costs	1
		Other costs	1
		Net cash flows	1
		Opening bank balances	1
		Closing balances	1
		Presentation	1
		Total	30
	(b)	**Profits – recommended method**	
		Current profit figure	3
		Revised income	2
		Original expenses	1
		Add back souvenir expenses	1
		Revised souvenir expenses	2
		Loss figure	1
		Total	10
		Total marks	40

			Marks
2	(a)	**NPV**	
		Revenues	1
		Market research – sunk cost	1
		Animation company costs	1
		Producers' salaries	0·5
		Director's salary	0·5
		Other production costs	0·5
		Royalties	1
		Special equipment	1
		Loan interest – irrelevant	1
		Discounted cash flow	1·5
		Conclusion	1
		Total	**10**
	(b)	**Costs of new equity issue**	
		For each cost	1
		Max marks	**4**
	(c)	**Stock exchange listing**	
		For each reason explained	2
		Max marks	**6**
		Total marks	**20**

3	(a)	**Whether to factor**	
		New sales level	1
		Current cost	1
		New debtors level	1
		Debtors at 60 days	1
		Cost of 70% advanced	1
		Cost of 30% not advanced	1
		Admin fee	1
		Saved salaries	1
		Factor saving	1
		Conclusion	1
		Total	**10**
	(b)	Advantages	
		For each advantage	1
		Max marks	**5**
	(c)	**Roles**	
		For each role	1
		Max marks	**5**
		Total marks	**20**

			Marks
4	(a)	**Operating lease**	
		For each characteristic	1
		Max marks	**3**
	(b)	**Finance lease**	
		For each characteristic	1
		Max marks	**5**
	(c)	**Weaknesses/rectifications**	
		Computerised invoicing	1
		Changing payment method	1
		More staff	1
		Interest penalty	1
			4
	(d)	**Interest rate factors**	
		Each factor	1
		Max marks	**6**
	(e)	**Increasing interest**	
		Base rate must have increased	$^1/_2$
		Base rate based on LIBOR	$^1/_2$
		LIBOR explained	$^1/_2$
		LIBOR must have increased	$^1/_2$
			2
		Total marks	**20**