P10 – Test of Professional Competence in Management Accounting

26 May 2005 – Thursday Afternoon Session

Instructions to candidates

You are allowed three hours to answer this question paper.
You are allowed 20 minutes reading time **before the examination begins** during which you should read the question paper and, if you wish, make annotations on the question paper. However, you will **not** be allowed, **under any circumstances**, to open the answer book and start writing or use your calculator during this reading time.
This booklet contains the examination question and both the pre-seen and un-seen elements of the case material.
Answer the question on page 17, which is detachable for ease of reference.
The Assessment Matrix is available on page 18, for your reference.
Maths Tables and Formulae are provided on pages 27 to 29.
Write your full examination number, paper number and the examination subject title in the spaces provided on the front of the examination answer book. Also write your contact ID and name in the space provided in the right hand margin and seal to close.

Contents of this booklet: *Page*

P10 – Test of Professional Competence in Management Accounting

TURN OVER

Background

The marketplace

Recycling has two significant impacts on the global environment. First, the use of recycled materials reduces the consumption of the world's natural resources. Second, recycling waste avoids the over-use of landfill refuse sites, which in turn reduces the level of potential pollution or contamination. Additionally, manufacturing costs can be reduced, as energy savings of around 5% can be achieved when, for example, new cans are manufactured using recycled aluminium. Also, recycled aluminium cans may end up being manufactured into sheet metal for car or aeroplane bodies.

Glass recycling is very efficient because a glass container is 100% recyclable and can be recycled over and over again with no loss in quality or purity. The use of recycled glass is also not restricted to making new glass, as it can also be recycled into construction aggregate and abrasive material for blasting and also into garden paving slabs. Another significant area of recycling is paper. In Western Europeans' household waste, around 40% of it is paper waste, and paper is currently one of the fastest growing recycled products. Aside from waste reduction, paper recycling makes ecological sense as recycling around 17 pounds (which is less than 8kg) of paper can save one tree. Paper is usually recycled into new paper products, such as tissues, printing paper and chipboard.

More and more businesses are also seeing the sense in selling off their waste paper and many new companies are entering into, or expanding their own, recycling business. Additionally, in today's business world, a company's image is one of its most important assets. A company that has a positive environmental profile will attract quality customers, employees and suppliers. It can also command a share price premium, as corporate investors are increasingly aware of the demand for "green" investments. There is also increasing external pressure to demonstrate effective environmental practices and to recycle waste. It is likely that within the next decade there will be a statutory requirement for businesses within the European Union (EU) to adopt processes such as waste recycling. To assist companies to reduce and recycle their waste a large number of service companies have entered this growing market.

Over ten years ago, recycling companies were small and operated only within their home country, but with the freedom to operate across boundaries within the EU, many of the larger recycling companies have made acquisitions to strengthen their position and to expand into new markets. Additionally, many large multi-national organisations have become more aware of waste and "green" issues and have established their own recycling departments, which recycle waste materials from other parts of the company.

Most European governments have established a variety of ways in which both domestic and industrial waste can be minimised and materials recycled. To support the various government initiatives, a wide range of specialist companies has been able to increase the volumes of materials recycled. There are many companies of all sizes in the recycling industry, which is still in its early stages, and the recycled materials market is expanding rapidly.

Details follow on two recycling companies

This material gives details on two fictitious companies operating in the recycling industry, mainly in Europe. The two companies are Reuse Refuse (ReuseR) and No Waste (NOW). Details on both companies and their operational and financial data are shown below.

Reuse Refuse (ReuseR)

Reuse Refuse (which trades as ReuseR) is a quoted company operating in a northern European country, with subsidiary companies across Europe. The company collects waste and recycles a wide range of products, but its single largest recycled product, which is also one of its most profitable, is recycled glass. It currently supplies recycled glass to twelve customers spread over eight countries in Europe. It sources its recycled glass supplies from hundreds of sources, including its many contracts for the collection and recycling of domestic waste. ReuseR also recycles a range of other waste products, including wood, paper, metal, tyres and a number of other materials.

ReuseR has expanded its operations across Europe by the acquisition of many smaller recycling companies. Since 2000, with the pressure on governments and the general population to recycle waste materials, it has introduced several innovative ways in which various types of waste are collected for recycling and sold to a range of manufacturing companies.

Entrepreneur Kurt Finehart, who is the Chairman and Chief Executive, had acquired the company in the 1980's when it was small and operating only in one country. Kurt Finehart always had ambitious plans for the company and was ahead of his time, with his vision of recycling waste. In the late 1980's the company became listed and the current directors and employees collectively own over 53% of the shares. The rest of the shares are spread over a wide range of investors with no large shareholdings.

The key senior management team in ReuseR is as follows:

Kurt Finehart – Chairman and Chief Executive

Kurt Finehart is a very flamboyant 48 year old, who has strong Government connections in his home country. He is from a wealthy family, which helped him to acquire the company initially. He has proved himself to be a serious businessman, with close links with several of his key customers. He is a non-executive director of two other companies, one of which is a glass manufacturing and printing company, to which ReuseR sells some of its recycled glass and paper. Kurt Finehart is also actively involved in many global environmental groups and is highly respected in the recycling industry. His catch phrase, which the press repeats often, is "re-use, not refuse".

Jean-Paul Gamell – Finance Director

Jean-Paul Gamell joined ReuseR over ten years ago and has improved the company's financial strength and its ability to manage its increasingly complex business covering eight EU countries. He has a small, strong head office team and has established finance teams in each country where ReuseR operates. In each country in which ReuseR operates, a separate subsidiary company manages its operations and acts as an autonomous business unit. Communication between some of the finance teams in the subsidiaries and head office needs to be improved and it is a problem area that Jean-Paul Gamell is aware of and he has planned to concentrate on, but he has continually been under pressure with the many recent acquisitions that ReuseR has made.

TURN OVER

Clement Weiss – Business Development Director

Clement Weiss joined ReuseR five years ago and has been the driving force behind many of the company's recent acquisitions. The recycling industry is very fragmented and many small, privately owned, local companies operate successfully and profitably. Clement Weiss believes that economies of scale can be achieved by building upon ReuseR's existing collection and distribution network that it operates in eight EU countries. Some of the small companies that ReuseR has acquired in the last two years handle a range of recycled products that ReuseR had not dealt with previously. ReuseR is currently recycling these additional materials, including electronic waste, old vehicles and plastics and is considering which of these recycled materials should be continued with a view to future expansion of its recycling business.

Allain Chambers – Operations Director

Allain Chambers, now 53 years old, had worked in the transportation business for over 20 years before joining ReuseR in 1994. He had previously managed his own small fleet of lorries, but when a large European logistics company had acquired his company, he felt that he wanted to stay in the industry, and personally felt strongly about recycling. The opportunity to manage the European operations and logistics at ReuseR was a challenge, but he felt he had a lot of experience to help ReuseR achieve its goals of cost reduction and improved operational safety and performance. He has been key in the selection and implementation of a €12 million IT project using satellite navigation technology that enables the company to track and monitor its large fleet of specialised vehicles.

During the early 1990's the company had experienced a few minor safety incidents, prior to his joining the company. The safety problems arose where employees had been involved with hazardous materials, which had resulted in personal injury claims. Allain Chambers feels strongly that the assets of the company are its staff, who should always be looked after as its first priority, and that a 100% safety record should be aimed for, despite the company's complex, and sometimes difficult, business.

Ellouise Matin – Human Resource Director

Ellouise Matin had joined ReuseR eight years ago after the unfortunate health and safety problems had occurred. She agreed with Allain Chambers that the staff should be better managed and safety procedures improved. These two directors have both put pressure on the Board to improve pay and conditions and to reduce working hours. In the past some staff had worked excessively long hours with large payments for overtime. Ellouise Matin considered that staff could not work effectively for long hours on a regular basis. She had initiated a recruitment drive to replace overtime with full and part-time employees. She is well respected by the ReuseR workforce for many of the Human Resources (HR) changes that have occurred.

The company has experienced problems with recruiting, and also retaining, employees, despite providing training, good rates of pay and allocation of free shares for staff after two years of employment. The company is still experiencing a high staff turnover in some countries and in certain sectors of the business. HR and operational management are looking at ways in which team building and more flexible working could improve staff retention and commitment to the company.

Cost control and international logistics in ReuseR

The ReuseR Board has asked Jean-Paul Gamell to investigate why the increased volumes and increased turnover has not resulted in corresponding increases in margins. At the December 2004 Board meeting Jean-Paul Gamell tabled an analysis of costs. This demonstrated that the current level of spend on improved IT facilities was one of the contributing causes of the lower than expected margins, together with training and recruitment costs of new staff, which he explained was an ongoing high cost as the company was continuing to expand.

The Board approved a new IT project in December 2004, which has been outsourced, following on from the successful implementation of the satellite navigation tracking system in 2003. This minor additional software solution will improve the reporting of waste materials collected and the location, and status, of recycled materials. The system will additionally incorporate the automatic production of legal paperwork for cross border deliveries. This IT project is forecast to cost a total of €1·5 million and to be operational before the end of 2005. The project is justified financially on the basis that it will eliminate delays due to incorrect or missing paperwork, and it will also speed up deliveries of recycled waste to ReuseR's customers.

Two of ReuseR's main costs are staff costs, in respect of the collection of waste, and secondly distribution costs associated with recycled materials. As the volume of waste collected has increased, the collection costs have reduced as a proportion of the volume of waste collected, due to economies of scale. However, ReuseR has identified that its distribution costs of recycled materials have increased significantly more than changes in volumes of materials handled would justify in recent years. Allain Chambers has led a project team to identify what costs are currently incurred and to benchmark the costs against other European recycling companies, as well as other European distribution companies.

It is planned that the investigation and report will be completed in March 2005 and that a report recommending changes will go to the ReuseR Board in April. Early findings are that transportation costs have increased significantly, while waste sorting and handling costs have fallen, mainly due to the introduction of new recycling plants in some countries. Allain Chambers has stated that the bulk of some types of recycled products, some of which have a low resale value, have contributed to the reduced margins that ReuseR has experienced in the last few years. He wants his team to identify which materials are not cost effective to transport and recycle, so that the company can take a strategic decision not to handle these products.

However, Clement Weiss has pointed out that ReuseR has won a number of long-term waste collection and recycling contracts (many with local government departments for the recycling of domestic waste) on the basis that over 80% of all materials collected will be recycled. He therefore argues that the company cannot renege on its contracts, some of which are 10 and 15 year contract periods, and that the company cannot change its strategy by selecting which materials it will, or will not, handle.

Allain Chambers is therefore under pressure to identify which costs within the distribution and waste handling operations could be reduced. In some of the countries in which the company has only been operating recycling plants for a short period of time, ReuseR has not yet reached a critical mass, which would enable it to enjoy economies of scale. One additional factor is that recycled glass is currently sold to only twelve customers in Europe, whereas only three years before, ReuseR sold glass to over thirty companies. The company changed its customer profile to generate higher revenues. However, it now has higher transportation costs to move this bulky product to fewer customers over greater distances. Allain Chambers pointed out that ReuseR was able to secure longer-term contracts for the supply of recycled glass to its twelve main customers and that the contracts secured higher prices per tonne. However, the contracts stated that ReuseR would bear the transportation costs to customers' factories. Allain Chambers agreed to provide a detailed analysis of margins by recycled product for the next Board meeting.

TURN OVER

ReuseR shareholdings, share price and earnings per share (EPS)

At the end of November 2004 there were 200 million authorised shares, with a nominal value of €0·20 per share, and 90 million shares were issued and fully paid up. The main shareholdings were as follows:

	Number of shares (000) at 30 November 2004	*% shareholding*
Kurt Finehart	20,500	22·8%
Jean-Paul Gamell	7,300	8·1%
Clement Weiss	5,900	6·6%
Allain Chambers	4,100	4·6%
Ellouise Matin	1,000	1·1%
Institutional and other investors	41,800	46·4%
Employee shares*	9,400	10·4%
Total number of shares issued	90,000	100·0%

* *Note:* Employee shares are purchased by ReuseR and issued to employees free of charge.

The share price of ReuseR had risen slowly during the 1980's and 1990's, and during 2004 ranged from €1·91 to €2·61. ReuseR has a current P/E ratio of 10. The industry average P/E ratio is 9. The company achieved EPS of €0·24 in 2004. The company plans to increase its EPS, in accordance with its five year plan, to €0·39 per share by 2009.

Appendix 2 shows an extract from the accounts for ReuseR.

Establishment of ReuseR's first recycling operations in the Middle East

ReuseR opened a recycling plant in October 2004 in a country in the Middle East. The move is to a stable country in the region, which has a very high record of recycling. This country is keen to establish itself as an example of high recycling levels to the rest of the world. ReuseR had wanted to establish a base in this country before the market for waste became too competitive and this would enable ReuseR to establish its name as a leading waste recycling company. However, it is forecast that this will result in operational losses for the first two years. The company has had many meetings with the large companies operating in this country and to date has signed two contracts for the recycling of waste.

Potential acquisitions by ReuseR

ReuseR has expanded its operations in the past mainly by acquisition, both by expanding into recycling different products and also into other countries. ReuseR is planning to make a number of further acquisitions to grow the business and also to give it access to new markets in other EU countries, and elsewhere, in which the company does not currently operate. The management of ReuseR believes that it has the business skills to recycle a range of materials, and that the company has existing customers who want these recycled materials. However, if recycled materials are transported back to existing customers in the EU, it is forecast that transportation costs could increase in the short term. However, within two years of ReuseR expanding its operations into a new country, it is forecast that ReuseR will have located new customers to which it could sell the recycled materials produced within that country.

The ReuseR Board has set the following criteria as a guideline for possible acquisitions:

- Gross margins (defined as sales less all direct costs, variable and fixed) must be similar or higher than achieved by ReuseR (ReuseR gross margin is over 50%);
- Sales revenue of between €10 – €30 million per annum;

- Must be a stand alone company, rather than a recycling division of a larger company. ReuseR has historically found it quite difficult to manage the merger of operations post acquisition, when it has acquired the recycling division only of a larger company;
- Must be willing to be acquired (for cash or share exchange), as ReuseR's management do not want to pursue a hostile take-over.

The business development department of ReuseR, headed by Clement Weiss, had identified a list of thirty possible targets for acquisition, of which most are operating in EU countries. However, some potential acquisitions are operating in countries in which ReuseR does not currently operate, as well as some countries outside of Europe. From this initial list, Clement Weiss has eliminated fifteen companies as unsuitable for acquisition and he has selected three companies that he considers would be particularly suitable for ReuseR to acquire.

Clement Weiss has requested his managers in the business development department to prepare further detailed reports on a few of the other potential acquisitions from the original thirty that had been identified, and to continue to identify new companies that are emerging in this growing marketplace. Depending on the size of the company and the price required, and whether shares or cash are used, ReuseR, is planning to acquire as many as eight companies over the next eighteen months.

Jean-Paul Gamell has been in negotiations with a leading European bank to secure loan financing of €40 million in order to fund ReuseR's aggressive acquisition plans. **Appendix 1** shows an extract of the news report about the announcement of ReuseR's new financing plans agreed with this European bank.

ReuseR Board meeting in February 2005

Following on from strategic planning meetings attended by ReuseR senior managers during January 2005, a proposal was put to the Board meeting in February 2005 to agree to three proposed acquisitions. All three companies are privately owned companies.

Jean-Paul Gamell announced to the Board that financing plans had been finalised for the loan of €40 million over eight years, at a variable interest rate of 2·15% above European lending rate, repayable in 2013. ReuseR will now have loans totalling €60 million.

The Board agreed in principle to the three acquisitions, of RED, KLL and MER. Details of these companies are shown in **Appendix 4**. The basis for ReuseR's proposed acquisitions is as follows:

1. Acquisition of RED on the basis that ReuseR does not have any recycling operations in this Eastern European country (now in the EU) and wishes to expand its geographical coverage. All investigations have shown that RED's operations are efficient and the company is operating profitably. However, it has not invested in advanced recycling plants and much capital expenditure on equipment, plant and vehicles will be necessary post acquisition.

2. Acquisition of KLL on the basis that this will help consolidate operations in a northern European country where ReuseR already has established recycling operations and has a growing customer base. This will enable it to acquire a larger customer base and better utilise the new recycling facilities that it has opened in two regions of this country to achieve operating synergies.

3. Acquisition of MER, which was one of the first recycling companies operating in the same Middle East country in which ReuseR set up a recycling plant in October 2004. The country has seen recycling rates increase rapidly and the ReuseR Board agreed that there is huge potential in this country. Additionally, ReuseR considers that this privately owned company would benefit from ReuseR's experience and expertise.

TURN OVER

No Waste Recycling Services Ltd (NOW)

No Waste Recycling Services Ltd (which trades as NOW) recycles a range of products and has established long-term relationships with a number of its larger customers from whom it collects waste materials. Some of these customers are local government departments and divisions of multi-national companies. NOW is highly regarded as a leader in waste management and it provides its customers a high level of customer service.

NOW is a privately owned company whose shares were originally owned by two families, who ran a transportation company. However, after over 20 years in the transportation business, and increasing wage costs and competition, the company changed its trading name to NOW in 1996 and decided to enter the growing business of recycling waste. NOW handles a number of recycled products, but its two dominant business areas, which together account for almost 50% of its sales revenue are the recycling of waste paper and wooden pallets. The next most profitable sector of its recycling business is recycled glass, which accounts for almost 20% of the company's sales revenue.

When NOW first started in the recycling industry, it was able to establish very good links with a number of companies, and commenced with recycling these companies' waste paper. It soon established a high reputation as a recycling company and it has been able to forge strong links with several European wide manufacturers, to whom it sells recycled products.

The shareholders and management team of NOW at the end of 2004 are detailed below.

Imran Patel – Chairman

When his parents, who started the family's transportation business, retired, Imran Patel took over as Chairman, in 1996. As a shrewd businessman, Imran Patel, then 38 years old, saw the gap in the market for companies requiring recycled products and for their need for a specialised waste disposal and recycling service. He had worked in the transportation business all of his career and understood logistics and the need to provide customers with a quality service. Imran Patel strongly believed that the company could rapidly gain a good reputation in the growing recycling industry by exceeding customers' expectations, both in service quality and price. He is a perfectionist and very hard working, which has helped NOW maintain a high growth in turnover.

Ernst Heist – Chief Executive

Ernst Heist, now aged 48, had identified a gap in the market for recycling domestic waste and he had established quite a reputation for himself and the media dubbed him the "the man who made gold out of rubbish". Fifteen years ago he had worked as an adviser to Government departments and had close political links with central government in his home country in northern Europe. Then he founded his own recycling company and was its Managing Director, until NOW acquired it in 1999. This acquisition enabled NOW to expand geographically in Europe and also to almost double its turnover. For the past five years Ernst Heist has held the role of Chief Executive of NOW.

NOW's acquisition of Ernst Heist's previous company had given NOW the opportunity to expand its operations into neighbouring countries, which are all operating profitably. By 2001 the company decided to expand its recycling facilities and to commence handling certain waste materials from local industries. With the help of a government grant and bank loans the recycling facilities were quickly operating at almost maximum capacity.

Peri Patel – Operations Director

Peri Patel, who is Imran Patel's younger brother by 3 years, had not previously worked in the family's transportation company. He was the first member of the family that had graduated from university (with a degree in marketing management), and he then joined an international shipping company. Later he moved to an electrical manufacturing company. When his brother took over the family business in 1996, Peri agreed to join the company and to head up marketing and operations. Since the company has grown, a new marketing director has been recruited and Peri Patel has concentrated on operations. Peri Patel has sound management knowledge and experience and he has been the driving force behind the professionalism that NOW has established within the company. Together with his brother's demand for high quality service, they make a formidable team.

Val Rines – Sales and Marketing Director

Val Rines, then 33 years old, joined NOW in 2000 as Sales and Marketing Director. Initially she had no equity interest, but has since invested €0·9 million (financed by a personal loan secured on her family property) in the company. Val Rines had previously worked in a local government department responsible for refuse and recycling and then as the sales director for a small competitor in the recycling industry. She has much knowledge of recycling and had graduated with a degree in environmental studies.

Rik Mal – Finance Director

Rik Mal, then 45, joined NOW in 1997 shortly after the company started in the recycling business and he bought shares in NOW during 2001. He is a steady, reserved character and has a close bond with the Patel brothers who respect his conservative attitude to business. They fully appreciate that Rik Mal has managed to keep the company's finances under control, given the company's rapid expansion over the last nine years.

NOW shareholdings

NOW has 20 million authorised shares, at a nominal value of €0·50 each, of which 10,620,000 shares have been issued and are fully paid up. The main shareholdings are as follows:

	Number of shares (000) at 31 December 2004	*% shareholding*
Imran Patel	4,000	37·7%
Ernst Heist	2,500	23·5%
Peri Patel	1,700	16·0%
Val Rines	320	3·0%
Rik Mal	300	2·8%
Employee shares*	1,800	17·0%
Total number of shares issued	10,620	100·0%

* *Note:* The employee shares have been given to employees free of charge.

Appendix 3 shows an extract from the accounts for NOW.

Growth of NOW since 1996

NOW had grown the recycling business rapidly since 1996 and has expanded its operations into six European countries. The business has always been a strong cash generator and the company has reinvested much of the cash generated from operations into expansion. It has also invested in a number of recycling plants, many of them small plants, which are located close to the main cities in which it operates waste collection services. This gives the company flexibility and reduces transportation costs.

The company has also embraced the use of IT in the business, which enables its customers that it collects waste from, to monitor volumes collected as well as collection dates and times. Its IT systems also enable customers who purchase recycled materials to place their orders and get immediate confirmation of delivery dates and volumes.

TURN OVER

During early 2004, one of Ernst Heist's innovative plans came to fruition with the introduction of new recycling containers at over 800 large shopping centres in several countries. Previously most of the domestic waste that was recycled relied on the continued social pressure to recycle goods and the increased publicity of environmental problems caused by landfill sites. Ernst Heist's new plan was to pay cash to the members of the public for each and every item recycled. The new recycling containers that NOW had designed paid cash for each item of waste that was recycled, based on weight or type of waste, for example per glass bottle. Therefore, the public could now recycle paper, clothes, glass, batteries and certain other items and the new recycling containers weighed or measured the input and reimbursed coins. These newly-designed recycling containers had the added advantage that waste collected was also pre-sorted, which reduces labour costs at recycling depots.

Following a month's trial at 30 sites during 2003, the level of recycled goods had increased dramatically. The financial justification of these new "recycle for cash" containers was that if the level of recycled goods increased by more than 70%, then this would cover the increased costs, primarily the cash payments, and the higher costs for logistics for emptying the recycling containers and filling up the cash payment machines. At one site during the trial, one of the containers filled up within one day and the cash payment machine was empty, whereas the old containers were usually less than half full when they were emptied weekly. Therefore daily emptying of the 30 trial sites proved necessary to maintain public confidence in the scheme.

At the end of the one-month trial, the overall level of recycling had increased much more than the required 70%, with some sites achieving 300+% higher recycling rates. This proved that cash payments do appeal to the public. NOW decided to invest in these new "recycle for cash" recycling containers for over 800 sites. This involved an investment of over €3 million. However, it was decided that the company would move the existing, old style, recycling containers (which had no payment mechanism) from these sites, when the new "recycle for cash" containers were installed, to other sites.

After monitoring the ongoing volumes of recycled goods, which generate increased turnover for NOW, most sites showed a substantial increase over previously experienced recycling levels. Overall the level of recycled goods at "recycle for cash" sites was increased by over 180% (that is the recycled goods volume had almost trebled).

However, it has since been established that collection of domestic waste (by NOW's regular weekly collection that NOW operates on behalf of local government departments) has seen a decline in volumes recycled. Therefore NOW's management has reached the conclusion that some of the waste that it used to collect as part of the local government contract for domestic waste recycling, NOW is collecting via the "recycle for cash" containers, and is having to pay for. Therefore the increased volume is not entirely due to customers recycling more goods, or even new customers recycling goods for the first time, but is due to astute customers who are now recycling their waste using a different method and getting paid for recycling it.

During 2003 and the start of 2004, the company consolidated its position after a period of three years during which several acquisitions had been made. Peri Patel, the Operations Director, ensured that all of the sites that had been acquired were rationalised, and some waste storage sites were closed. Additionally, in some of the businesses that NOW had acquired, it was decided to cease handling some waste materials. NOW had no plans to be involved with liquid waste treatment and this had formed a small part of one of its recent acquisitions. NOW has been able to sell some areas of recycled waste that it did not wish to be involved with, to other waste recycling companies. NOW decided that it wanted to concentrate on its core strengths, which are the collection and processing of paper waste and reselling of the pulp to manufacturers of paper products; the recycling of wood products and glass recycling.

NOW's secure collection and pulping of waste paper for recycling

Another new development during 2003 was that NOW opened three new waste paper pulping plants which handle all of the waste paper collections in two of the Northern European countries in which it operates. By supplying paper pulp to several newspaper printers, rather than the waste paper itself, the transportation costs were reduced as the bulk being transported was reduced. Additionally, the revenue rate per tonne of pulped recycled paper was significantly more than the price achieved for waste paper that needed treatment and pulping. The company considered that this new change to the way in which it handled the paper side of its business could generate an additional 12% gross margin, on top of the 40% gross margin currently achieved in this recycled product sector, even after taking into account the direct incremental fixed costs of treatment and pulping.

NOW has also been innovative in the collection of waste paper and has been building up the number of companies to which it supplies a secure collection and destruction of waste paper service. It operates a fleet of purpose-designed vehicles that collect confidential waste paper and then pulps the paper on customers' premises. NOW then removes the pulped paper from customers' premises, which it then sells onto its customers who require recycled paper pulp. This service gives many companies the reassurance that all confidential material is being securely disposed of.

By the end of 2004, NOW had contracts with eight large international companies to dispose of their office waste paper securely on their premises, as well as a number of smaller customers. NOW has a contracted schedule to collect and pulp customers' waste paper. Generally it has met the agreed schedule. However, it has experienced a high staff turnover in this area of the business. To maintain the company standards, new recruits have undergone on-site training, which has slowed up the collection and pulping service even more. Recently there have been repeated instances where customers have been left without a collection. Customers are disappointed but so far have only complained. No contracts have been cancelled as NOW has been able to reassure customers and it is putting in place plans to ensure that agreed customer collections are met.

During January 2005, NOW secured two major new contracts; the first was from a local government department in a northern European country. This will generate turnover of €1·5 million per year and is for 6 years. Also, NOW is hopeful that securing this contract could lead to other contracts within that country. The other major contract was from a large international IT company to collect, pulp and recycle, in a secure manner, all of its waste paper. The IT company has appointed NOW for a trial period of two years in two European countries. If it is satisfied that NOW can meet its collection requirements within the contract terms, it may lead to a European-wide contract for waste paper collection and pulping, which could generate an additional turnover for NOW of over €5 million per year. NOW currently operates waste recycling plants in all of the European countries in which the IT company has offices, but it does not operate the specialised waste paper pulping vehicles in all countries. However, these could be purchased if NOW were to be awarded the European-wide contract in two years time.

NOW Board meeting to discuss future strategy

In January 2005, the quarterly NOW Board meeting had an item on its agenda concerning future growth strategies. During 2003 and part of 2004, NOW had not acquired any other smaller recycling companies, and Imran Patel considered that the time was right for further expansion, following a small acquisition in December 2004. He also felt that the company had a strong balance sheet and was generating cash from operations and that NOW should speed up its acquisition and expansion plans, so that economies of scale and synergies can be achieved. NOW had recently announced that it would be paying a final dividend of €0·245 per share to its shareholders.

Imran Patel stated at the meeting that NOW could not just sit back and continue to see cash being generated, as the company cannot control its destiny. In order to survive and grow it will have to continually balance its performance with its suppliers, customers, competitors and the community in which it operates. He stated that this would not be an easy task as NOW is operating in several European countries.

As NOW has grown it has reviewed and changed its business structure. Only five years ago, each country operated as a stand-alone strategic business unit. Following a review of operating activities and a reassessment of the European market, the company changed its organisation structure to enable it to deliver better customer solutions. This also involved out-sourcing of some activities, which Ernst Heist felt the company did not have the correct skill mix to retain within the company. The treasury function was outsourced to its bankers and IT development and implementation work to a global IT company. The company now has one centralised finance department in its Europe-wide HQ building with small teams operating in a few offices around Europe. IT operations were also centralised in the HQ building following the review. NOW has established business units by type of recycled product, such as paper, wood or glass. This enabled line managers within each business to better serve its European customers.

After much discussion on alternative expansion plans, some of which are included in NOW's current five year plan, Imran Patel has requested Ernst Heist and Rik Mal to prepare an updated plan of future expansion for the next Board meeting in April 2005.

Pricing

NOW used to set its prices for recycled products based on the customers' ability to pay. However, with the increasing number of companies and governments involved in collecting and recycling a wide range of products, NOW has identified, in the last two years, a decline in the prices it can command for some recycled products, particularly with some of its major customers, who buy large quantities of recycled paper, wood, glass and metal.

Ernst Heist has requested Val Rines review prices and customer mix, and consider whether NOW should change its customer mix. He considers that if the company were to sell a lower quantity of recycled products to its few large customers, and more to smaller companies, it could achieve at least 15% more in sales revenue. Val Rines stated that NOW's larger customers had continued demand for its recycled materials and NOW should not put at risk its customers' loyalty, to achieve higher margins in the short term. Val Rines wants to set up long-term supply contracts so that its long-term waste collection contracts can be matched by region and by product type. Val Rines does not feel that the company should be looking to make short-term profits by selecting higher revenue generating customers, at the expense of long-term customer stability.

Appendix 1

European News

25th February 2005

Finehart secures loans of €40 million today with a leading European bank

Entrepreneur, Kurt Finehart, Chairman and Chief Executive of leading recycling company, ReuseR, today announced that loan financing had been secured to fund further European acquisitions of recycling companies, as well as expansion into the rapidly growing recycling industry in some of the Middle East countries.

Finance Director, Jean-Paul Gamell stated, "this loan will enable ReuseR to expand its operations to other European Union countries which will enable the company to benefit from further economies of scale. I am confident that ReuseR's planned growth strategy will have a long term positive effect on the company's share price".

Finehart stated "the financing package agreed is good for the company, good for the EU and good for the environment." He added, "With ReuseR handling higher volumes of waste for recycling throughout Europe, this will result in more materials being recycled and less waste and pollution".

The news was received positively in the market and ReuseR's share price rose 5·8% to €2·68 per share at the close of trading today.

It is believed that negotiations with possible companies that ReuseR is planning to acquire are well underway. The market expects that bid announcements will be made over the next few weeks.

TURN OVER

Appendix 2

Note: All data in the Appendices are presented in International Financial Reporting format.

ReuseR

Balance Sheet	As at 30 November 2004 € million	€ million	As at 30 November 2003 € million	€ million
Non-current assets (net)		**131·9**		**123·3**
Current assets				
Inventory	20·8		19·9	
Trade receivables	46·5		39·1	
Cash and short term investments	6·4		4·1	
		73·7		**63·1**
Total assets		**205·6**		**186·4**
Equity and liabilities				
Equity				
Paid in share capital	18·0		18·0	
Share premium reserve	21·6		21·6	
Profit and loss reserve	109·8		95·1	
		149·4		**134·7**
Non-current liabilities				
7% Loan notes (redeemable in 2011)		**20·0**		**20·0**
Current liabilities				
Trade payables	22·5		19·6	
Tax	6·1		5·9	
Accruals	7·6		6·2	
		36·2		**31·7**
Total equity and liabilities		**205·6**		**186·4**

Note: Paid in share capital represents 90 million shares at €0·20 each

Income Statement	*Year ended 30 November 2004 € million*	*Year ended 30 November 2003 € million*
Revenue	214·2	184·0
Total operating costs	185·0	155·9
Operating profit	29·2	28·1
Finance costs	-1·4	-1·4
Tax expense (effective tax rate at 22% after allowances)	-6·1	-5·9
Profit for the period	**21·7**	**20·8**

Statement of changes in equity year ended 30 November 2004

	Share capital € million	*Share premium € million*	*Retained earnings € million*	*Total € million*
Balance at 30 November 2003	18·0	21·6	95·1	134·7
Profit for the period	-	-	21·7	21·7
Dividends paid	-	-	-7·0	-7·0
Balance at 30 November 2004	**18·0**	**21·6**	**109·8**	**149·4**

Appendix 3

Note: All data in the Appendices are presented in International Financial Reporting format.

NOW

Balance Sheet	As at 31 December 2004 € million	€ million	As at 31 December 2003 € million	€ million
Non-current assets (net)		**53·8**		**44·8**
Current assets				
Inventory	5·9		7·1	
Trade receivables	12·9		12·1	
Cash and short-term investments	2·3		0·4	
		21.1		**19·6**
Total assets		**74·9**		**64·4**
Equity and liabilities				
Equity				
Paid in share capital	5·3		5·2	
Share premium reserve	4.0		3·6	
Profit and loss reserve	44·4		34·7	
		53·7		**43·5**
Non-current liabilities				
Bank loan (repayable in 2005) at 10% interest per year		**0·0**		**2·5**
Bank loan (repayable in 2009) at 10% interest per year		**11·9**		**11·9**
Current liabilities				
Bank loan (repayable in 2005)	2·5		0·0	
Trade payables	3·3		3·2	
Tax	2·9		2·2	
Accruals	0·6		1·1	
		9·3		**6·5**
Total equity and liabilities		**74·9**		**64·4**

Note: Paid in share capital represents 10·62 million shares at €0·50 each at 31 December 2004

Income Statement	Year ended 31 December 2004 € million	Year ended 31 December 2003 € million
Revenue	55·8	48·3
Total operating costs	39·2	35·1
Operating profit	16·6	13·2
Finance costs	-1·4	-1·4
Tax expense (effective tax rate at 19% after allowances)	-2·9	-2·2
Profit for the period	**12·3**	**9·6**

Statement of changes in equity year ended 31 December 2004

	Share capital € million	Share premium € million	Retained earnings € million	Total € million
Balance at 31 December 2003	5·2	3·6	34·7	43·5
Shares issued during the period (to employees)	0·1	0·4	-	0·5
Profit for the period	-	-	12·3	12·3
Dividends paid	-	-	-2·6	-2·6
Balance at 31 December 2004	**5·3**	**4·0**	**44·4**	**53·7**

Appendix 4

Data on ReuseR proposed acquisitions

All figures have been restated in € million for latest financial year	*RED*	*KLL*	*MER*
Geographic location	Eastern European EU	Northern European	Middle East
Turnover	12·0	18·0	28·0
Gross margin	6·1	10·1	18·2
Net profit (after tax)	1·0	2·0	7·6
Gross margin %	51%	56%	65%
Net margin %	8%	11%	27%
No of shares	10,000	6,000	38,800
Company status	Privately owned	One operating division of a privately owned company	Privately owned
Form of acquisition: cash or shares	Cash	Cash or ReuseR shares	Cash or ReuseR shares
No of employees:	96	220	292
Recycled products	Glass, tyres, industrial waste	Domestic recycled waste only	Glass, chemicals, paper and some other industrial waste
Other relevant data:	Local press reports state that company is struggling with a cash shortage and that it has been unable to secure further loans	This is a small competitor of ReuseR that has secured a number of government domestic waste recycling contracts by under-cutting ReuseR on price. ReuseR would like to eliminate this competitor before it grows larger and becomes more of a threat. It would also help ReuseR to achieve greater economies of scale in this country.	This would be ReuseR's first acquisition of a company operating outside of Europe. MER is operating in the same Middle East country in which ReuseR opened a recycling plant in October 2004. ReuseR's five-year plan had identified a number of regions globally that have an increasing recycling industry. The Middle East is achieving high levels of recycling and this company could provide ReuseR with a customer base in this country from which to increase trade.

End of Pre-Seen Material