CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL II EXAMINATION

A2.1: STRATEGY CORPORATE FINANCE

DATE: WEDNESDAY 28, MAY 2025

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking Guide

a) **Calculation of APV**	**Marks**
Calculation of expected revenue (0.5 marks per figure) maximum of 2.5 marks	2.5
Calculation of cost of sales (0.5 marks per figure) maximum of 2.5 marks	2.5
Calculation of tax expense (0.5 marks per figure) maximum of 2.5 marks	2.5
Posting Capital expenditure (0.5 marks per figure) maximum of 0.5 marks	0.5
Calculation of Incremental working Capital (0.5 marks per figure) maximum of 3 marks	3
Add back depreciation or tax shield on depreciation (0.5 marks in each year), maximum 2 marks	2
Calculation of Free cash flow (0.5 marks per figure) maximum of 2.5 marks	2.5
Calculating NPV	1
Calculation of debt tax shield (1 mark per figure) maximum of 1 mark for Method 2	2
Calculation of discounted debt tax shield (0.5 marks per figure) maximum of 2marks for Method 1	2
Calculation of APV (1 mark for each method) maximum 2 marks	2
Calculating Beta for both geared and ungeared 1 mark and Ke 0.5 marks	1.5
Calculation of Discounting factor	1
Maximum marks	**25**
b) Award one mark for describing APV and 2 marks for explain why it is appropriate. Maximum 3 marks	3
c) Ratios Analysis	
(i) Computation of Ratio (award 0.5 marks) maximum 6 marks	6
(ii) Interpretation of Ratio (0.5 marks for each interpretation) maximum 3 marks	3
(ii) Conclusion on financial sustainability (2 marks)	2
d) Award 1 mark for each non – financial information to consider maximum of 5 marks	5
e) • Award 0.5 marks for each point raised and 0.5 for explanation for **Positive impacts** maximum of 3 marks and • Award 0.5 marks for each point raised and 0.5 for explanation for **Negative impacts** maximum of 3 marks	6
Total marks	**50**

Model Answer:

a) Asses Garlic project with APV calculation

		Forecast free cash Flow "000"				
Years	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Sales	440,000,000	514,800,000	602,316,000	704,709,720	810,416,178	931,978,605
Cost of sales		231,660,000	271,042,200	317,119,374	324,166,471	372,791,442
Gross Profit		**283,140,000**	**331,273,800**	**387,590,346**	**486,249,707**	**559,187,163**
Depreciation		0	-93,750	-93,750	-93,750	-93,750
Taxable Income		**283,140,000**	**237,523,800**	**293,840,346**	**392,499,707**	**465,437,163**
Tax (30%)		84,942,000	71,257,140	88,152,104	117,749,912	139,631,149
After tax Income		**198,198,000**	**166,266,660**	**205,688,242**	**274,749,795**	**325,806,014**
Add Back Depreciation		0	93,750	93,750	93,750	93,750
Capital expenditure	(375,000,000)					
Incremental working capital	**(61,776,000)**	**(12,670,258)**	**(15,268,927)**	**(16,549,826)**	**(19,608,019)**	**125,873,030**
Scrap Value						**0**
Net Cash Flow	**(436,776,000)**	**185,527,742**	**244,747,733**	**282,888,416**	**348,891,775**	**545,429,044**
Discounting factor for rate 15% (Rounded)	1.000	0.870	0.756	0.658	0.572	0.497
PV	**(436,776,000)**	**161,409,136**	**185,029,286**	**186,140,578**	**199,566,095**	**271,078,235**
NPV of unleveraged firm	**566,447,330**					

Debt Tax shield Method 1	**8,700**
Debt Tax shield Method 2	**22,500**

Adjusted PV=	NPV of unleveraged firm + Tax Shield	
Method 1	Adjusted PV= **566,447,330 + 8,698,950**	**575,146,280**
Method 2	Adjusted PV= **566,447,330 +22,500,000**	**588,947,330**

1 – 3rd year Sales will grow = $\boldsymbol{Sales} * (\mathbf{1} + \mathbf{17}\%)$
4-5th year sales will grow = $\boldsymbol{Previous\ sales} * (\mathbf{1} + \mathbf{15}\%)$
Cost of sales 1-3rd year = $Sales * (45\%)$
Cost of sales 4-5th year = $Sales * (40\%)$

Working capital in year 1 = $Sales * (12\%)$
Then after you have to inflate
Incremental working capital = current working capital – previous working capital

Year	**2021 (Base Year)**	**2022**	**2023**	**2024**	**2025**	**2026**
12%	**-**	**61,776,000**	**72,277,920**	**84,565,166**	**97,249,941**	**111,837,433**
Inflation of 3%		**1.00**	**1.03**	1.0609	1.0927	1.1255
Adjusted Working Capital	**-**	**61,776,000**	**74,446,258**	**89,715,185**	**106,265,011**	**125,873,030**
Incremental change in Working capital	**(61,776,000)**	**(12,670,258)**	**(15,268,927)**	**(16,549,826)**	**(19,608,019)**	**125,873,030**

Data Given

Tax	30%
Government bond	11%
Inflation 1-3 years	6%
Inflation 4-5 years	4%
Cost of sold 1-3 Years	45%
Cost of sold 4-5 Years	40%
Working capital	12%
Inflation on Working capital	3%

Method 1 Bank Loan				
Debt tax Shield				
Debt amount	75,000			
Interest	13%			
Tax shield	2022	2023	2024	2025
	2,925	2,925	2,925	2,925
Disc factor	0.885	0.783	0.693	0.613
Discounted Tax Shield	2,588	2,291	2,027	1,794
Total Tax Shield	8,700			

Method 2	Irredeemable debt	
Debt amount		75,000
interest rate		6%
Tax shield	75,000*6%*30%	1,350
PV of tax shield	Perpetuality=CFs/disc rate = 1,350/6%	22,500

Comparable company	Ungeared Beta	Geared Beta
UMWETE	1.2	1.6
UBUZIMA	1.3	1.7
SHISHIKARA	1.4	1.9
NDAHIRO	1.1	1.2
Average	1.25	1.6

Cost of Unleveraged	
RF	11%
Beta	1.25
Risk premium	3%
Cost of Equity	14.75% or 15 %

B) Appropriateness of APV

The Adjusted Present Value (APV) method is a valuation approach that separates the value of a company into Base Value and Value of Financing Effect.

The Board has approved to change the capital structure and introduce 20% of the debt, so APV is appropriate because of that introduction of the debt in capital structure.

It helps to access the effects of tax shield that is calculated separately than integrating in cost of capital The introduction of debt financing has improved value of company as shown by improvement in Present value

C) Ratio analysis

i) It assumes that Beta of new projects is directly related to comparable which affects overall calculation of the cost of equity (Ke) It assumes that effects of debts tax shield is evaluated sedately, which is not usually used by investment professionals It fails to incorporate interest tax shield in cost of capital

Profitability Ratio		
	2021	**2020**
ROCE= PBIT / Capital Employed		
PBIT	102,000,000	87,000,000
Capital Employed		
Total Asset - Current Liabilities	747,750,000	765,000,000
ROCE= PBIT / Capital Employed	**14%**	**11%**
Return on Asset		
Net Profit	69,510,000	57,120,000
Total Asset	1,342,500,000	1,215,000,000
ROA= Net Profit / Total Asset	**5.18%**	**4.70%**
Return on Equity		
Net Profit	69,510,000	57,120,000
Total Equity	287,750,000	295,000,000
ROE= Net Profit / EQUITY CAPITAL	**24.16%**	**19.36%**
Net Profit Margin = Net Profit/ Sales		
Net Profit	69,510,000	57,120,000
Sales	440,000,000	390,000,000
Net Profit Margin = Net Profit/ Sales	**15.8%**	**14.6%**
Profitability Ratio is improving from 2020 to 2021 , this signaling efficient Operation		
Gross profit Margin		

Gross Profit	**132,000,000**	**117,000,000**
Sales	440,000,000	390,000,000
Gross Profit Margin = Gross Profit/ Sales	**30.0%**	**30.0%**
Operating profit Margin		
Operating Profit	**102,000,000**	**87,000,000**
Sales	440,000,000	390,000,000
Gross Profit Margin = Gross Profit/ Sales	**23.2%**	**22.3%**

Liquidity Ratio		
	2021	**2020**
Current Ratio (CA/CL)		
Current Asset	425,000,000	280,000,000
Current Liability	594,750,000	450,000,000
Current Ratio (CA/CL)	**0.71**	**0.62**
Quick Ratio [(CA-Inventory)/ CL]		
Current Asset - Inventory	345,000,000	230,000,000
Current Liability	594,750,000	450,000,000
Quick Ratio [(CA-Inventory)/ CL]	**0.58**	**0.51**
Cash Ratio		
Casjh and Cash Equivalent	280,000,000	200,000,000
Current Liability	594,750,000	450,000,000
Quick Ratio [(CA-Inventory)/ CL]	**0.47**	**0.44**

Solvency Ratio		
	2021	**2020**
Debt to Equity Ratio		
Total Debt	1,054,750,000	920,000,000
Total Equity	287,750,000	295,000,000
DEBT/ EQUITY	**367%**	**312%**
AMIZERO have High debt compared to Equity		
Total DEBT to Total Asset Ratio		
Total Debt	1,054,750,000	920,000,000
Total Asset	1,342,500,000	1,215,000,000
DEBT/ Total Asset Ratio	**79%**	**76%**

Long term DEBT to Total Asset Ratio		
Total Debt	460,000,000	470,000,000
Total Asset	1,342,500,000	1,215,000,000
DEBT/ Total Asset Ratio	**34%**	**39%**
Long Term Debt to Equity		
Total Debt	460,000,000	470,000,000
Total Equity	287,750,000	295,000,000
DEBT/Equity	**160%**	**159%**
Long Term Debt to Total Asset		
Total Debt	460,000,000	470,000,000
Total Equity	1,342,500,000	1,215,000,000
Long term DEBT to Total Asset Ratio	**34%**	**39%**
Interest Cover Ratio		
PBIT	102,000,000	87,000,000
Interest Expense	2,700,000	5,400,000
Interest Cover Ratio= Interest / PBIT	**37.78**	**16.11**
Interest Cover Ratio seems to be good due to low interest payment		
EQUITY MULTIPLIER		
Total Asset	1,342,500,000	1,215,000,000
Total Equity	287,750,000	295,000,000
EQUITY MULTIPLIER= TOTAL ASSET/ TOTAL EQUITY	**4.67**	**4.12**

(ii) Interpretation of ratios

1. GP Margin has managed to mention its GP margin at 30%, cost of sales is increasing in the line of sales, so management need so see how to avoid costs that are increasing in line of sales to improve GP Margin
2. Net profit Margin (NPM) has been higher in 2021 comparing to previous years and this is a good sign that company is enjoying economic of scale by increasing income and reducing on operating costs.
3. Current ratio in both years is less than one, which a not good because, current asset cannot finance current liability, but depending on the nature and lifecycle of the industry, the ratio is not good indicator of liquid position, as the company in the industry don't really need to hold more cash, but management need to have other alternative source of ash like Credit line from Bank to finance short term debt when falls due.
4. Acid-test Ratio in both years is less than one, which a not good because, current asset without considering inventory cannot finance current liability, but depending on the nature and lifecycle of the industry, the ratio is not good indicator of liquid position, as the company in the industry don't

really need to hold more cash, but management need to have other alternative source of ash like Credit line from Bank to finance short term debt when falls due.

5. All the debt ratios have been increased significantly; this is not good indicators as company is becoming more leverage, so depend on the nature of the industry, the company is trying to optimize capital structure and this improved margin which good things.

The company can have problem of the defaults if the leverage continues like this

The ratio analysis indicates that AMIZERO Ltd is doing great job in improving net profit margin, liquidity ratios are deteriorating but depend on the nature of the industry is not bad thing and finally leverage is increasing but not bad things, therefore, Company is doing well.

d) **Non-financial information**

1. I would ask management about target expansion in future
2. I would ask about Customers satisfactions (whether they have survey to measure satisfactions)
3. I would ask about supplier relationship with companies
4. I would ask also management about potential increases in inputs prices and measures in place to mitigate that.
5. I would ask the environment measures to protect pollutions

e) **Positive Corporate Social Responsibility (CSR) of AMIZERO L**

1. Good rating from CSR rating agencies, this is a good indicator that company is doing great job in providing beyond to the society
2. Complying with quality control of FDA, this is a good indicator in terms stakeholder's satisfaction and long-term relationship with stakeholders
3. Helping the restructured employees to give training and helping them to start business is good for employees and family of employees in general
4. Investment in renewable energy and climate finance which good initiatives to the society in long term.

Negative Corporate Social Responsibility (CSR) of AMIZERO L

1. Lower consumer satisfactions as shown by survey report, and this will cause in future to be downgrade on CSR rating agencies and incurring more costs related to the potential litigations
2. The futures decision of the reducing budget to the social participation including helping genocide activities
3. The failure to address the issue of wastes destructions which can harm the people around
4. The CEO lobbying for not licensing the competitor from German, this is unfair competitions

SECTION B

QUESTION TWO

Marking Guide **Marks**

a) (i)Rationale for the company engaging in FRA transaction	
Award 2 marks for proper explanation of rational	2
Maximum marks	**2**
a) (ii) Determine fixed rate on new suggested 2 x 5 FRA	
Award 0.5mark for each identified relevant reference rate to be used,	1
Award 1mark for filling properly information in formula	1
Award 2 marks for FRA rate result	2
Maximum marks	**4**
(iii) Based on table 2 above and the three-month BNR reference rate at expiration, Determine the payment amount that the company will receive to settle the 6 × 9 FRA	
Formula of settlement amount	1
Formula of PV for settlement amount	1
Calculate settlement amount	1
Calculate PV of settlement account	1
Determine appropriate rate 1 marks for each maximum is 2 marks	2
Maximum marks	**6**
b) i)	
Amount to be deposited in USD today	1
Convert to FRW at spot rate	1
Future Value of converted amount	1
Calculate 9,800,000/0.0154	1
Calculate 75,000/0.013	1
Total call option	1
Decision 1 mark	1
Maximum marks	**7**
ii) Discussion of potential financial risks.	
Award 0.5 marks for each risk highlighted and 0.5 marks for explanation	**6**
Total marks	**25**

Model Answer

(a)

(i) The rationale for the company engaging in FRA transaction.

Company engage in FRA transaction as hedging mechanism when there is uncertainty about the future interest rate and company perceive it to have adverse movement that will hit the company.

(ii) Determination of fixed rate on new suggested 2 x 5 FRA

The fixed rate on the 2 × 5 FRA is calculated as below:	
The two rates needed to compute the no-arbitrage FRA fixed rate are	
Rate (60)	0.82%
Rate (150)	0.94%

Formula FRA = $\left(\frac{(1+rate\ 150\ days\ (\frac{150}{360})}{(1+rate\ 60\ days\ (\frac{60}{360})} - 1\right) X\ (\frac{360}{90})$

Calculated FRA = $\left(\frac{(1+0.94\%(\frac{150}{360})}{(1+0.82\%(\frac{60}{360})} - 1\right) X\ (\frac{360}{90})$

FRA= 1.019%

FRA≈1.02%

iii) **Based on 1st table above and the three-month BNR reference rate at expiration, Determine the payment amount that the company will receive to settle the 6 × 9 FRA**

Given a three-month BNR Reference rate at expiration	1.10%
Notional amount	200,000,000
FRA rate	0.70%
The settlement amount for the Company as the receive-floating party is calculated as	1.10%
Settlement amount (receive floating) = $(Notional\ amount * (Current\ reference\ rate - FRA\ rate) * (Contract\ \frac{days}{360})$	
Present value of Settlement amount = $\frac{Settlement\ amount}{\left(1+(discount\ rate\ (\frac{90}{360})\right)}$	

Settlement amount = $(200{,}000{,}000 * (1.1\% - 0.7\%) * (\frac{90}{360})$

Settlement amount = 200,0000

Present value of Settlement amount = $\frac{200,000}{\left(1+(1.1\% \left(\frac{90}{360}\right)\right)}$

Present value of Settlement amount that company will be received = FRW 199,452

b) **i)Money market hedge**

The firm has a liability of $9800,000. It needs to create an asset by depositing some money in U.S.A. This hedging would arise as follows:

(a)Deposit some dollars in USA "now" which will, together with interest, equal $9,800,000 in 3 months' time. The amount to deposit today

Amount to be deposited USD today to cover the PV of USD 9,800,000:

$\frac{\$9,800,000}{1.03}$ =$9,514,563.11 Present value

Convert to FRW at spot rate: (To Find the Amount to be Borrowed in Rwanda)

(b)The equivalent FRW. "now" $\frac{\$9,514,563.11}{0.013}$ **=RWF 731,889,469.75**

Find the Future Value of Borrowed Amount to Determine Finance cost to Kigali Electronics Company

FV= PV * (1+R) ^n

FV= **731,889,469.75 (1+3%)**

FV= 753,846,154

Therefore, at the end of 3 months, the deposited $ will mature to $9800,000 and used to pay the USA seller.

ii) Options	**If spot rate > 0.0154 (FRW/USD)**: Exercise option, buy USD at FRW/USD:		
			FRW.
The examiner did not give the strike or exercise price but assuming the forward rate of $0.0154/ FRW. then,			
FRW. payable	9,800,000 0.0154		636,363,636
premium payable now	**$75,000** 0.013	= **5,769,231**	
if this premium was borrowed at 3% in Rwanda, amount in 3 months would be:			
FRW.	**5,769,231**	(1.03)	5,942,308
			642,305,944

- The OPTION is cheaper
- The preferred option is call option with a cost of FRW 642,305,944

ii)

- Exchange Rate Risk: FRW depreciation increases USD costs.
- Interest Rate Risk: Rising USD borrowing rates raise financing costs.
- Liquidity Risk: Tied-up funds may strain cash flow.
- Credit Risk: Supplier may default post-payment.
- Operational Risk: Shipment delays/quality issues.
- Commodity Price Risk: Resale value decline of electronics.

QUESTION THREE

Marking scheme

Q3	CRITERIA	MARKS
Q3 a)	**Due diligence report**	
	Award of 0.5 mark for giving at least 8 highlights of the due diligence process	4
	Award of 0.5 marks for the discussed for 8 elements highlighted during the due diligence process	4
	Final Recommendation	1
Q3 b i)	Valuation for mergers and acquisitions	
	Determine the current number of shares in both companies	
	Kigali Industries Limited:	
	Total shares of Nyungwe to be acquired	1
	Number shares of Kigali Industries in shares Exchange to be issued	1
	Total shares after merger of Kigali industry after Merger	1
	Total profit available to shareholders to shareholders after takeover	1
	new earnings per share (EPS) after takeover	1
	Old EPS for Kigali Industries	2
	Increase in EPS	1
	Percentage increase in EPS	1
	comment	1
Q3 b ii)		
	Determine the pre-merger market value of Kigali Industries Limited and Nyungwe Limited (1 mark each, max 2)	2
	Combined market value after takerover	1
	Post-merger price per share	1
	Advise	2
	Total marks	**25**

MODEL ANSWER
QN 3 a)
Due Diligence Report: Acquisition of XYZ Retail Ltd. by ABC Holdings

Date: [Insert Date]
Prepared by: [Your Name], Due Diligence Examiner
For: ABC Holdings

1. Earnings Quality

The audited financial statements for XYZ Retail Ltd. over the past three years show consistent profitability, with a steady revenue stream and positive net profits. However, several issues need to be addressed in assessing the true quality of earnings:

- **One-off Gains:** The company reported a **FRW2 million gain** from the sale of a distribution center in 2022. This gain, while legitimate, is a non-recurring event and must be adjusted when evaluating the true performance of the business. Without this gain, the net profit for 2022 would be reduced significantly.
- **Declining Revenue and Lost Customers:** XYZ Retail has experienced a **10% decline in revenue** in 2023 due to the loss of key customers. This raises a concern about the sustainability of revenue streams going forward. Further details should be obtained regarding the reasons for these customer losses and whether they are temporary or indicate deeper market challenges.
- **Discontinued Products:** The company has discontinued certain underperforming product lines. While this will help improve margins in the short term, the long-term impact on customer loyalty and brand value needs further investigation.
- **Management and Risk Governance:** The management team has been in place for 5 years, but concerns have been raised regarding the company's **risk management practices,** particularly in areas such as customer data security and market volatility. A deeper review of corporate governance policies is recommended to assess whether management is capable of handling future challenges.

2. Forecasts
The financial forecasts for XYZ Retail Ltd. are overly optimistic and based on simplified assumptions, including the **8-10% annual revenue growth** driven by expansion into new markets and the **improved gross margins** from 30% to 35% in the next two years due to cost-cutting and more efficient supply chain management. Upon review, the **assumptions underlying the forecasts** seem difficult to reconcile with historical performance. For example, the projected growth rate exceeds the historical growth rate of approximately 5% per year, and there is no clear rationale for the forecasted margin improvement. Further, no comprehensive market analysis or competitor benchmarking has been provided to support the anticipated expansion. The forecasts need adjustment and should be treated with caution. Re-evaluating the assumptions behind these forecasts is critical before relying on them for strategic decisions.

3. Asset Valuation

XYZ Retail Ltd.**'s Inventory** valued at FRW8 million, with FRW1 million of it identified as obsolete. There has been no write-off for aged or obsolete inventory in the last three years, which suggests that the financial statements may be overstating asset values.

The fixed assets worth FRW10 million of which a significant portion is **underutilized or in need of repairs**. Additionally, the company has **capitalized FRW 500,000** in costs related to a failed technology project, which has not yet resulted in any tangible return.

Further, there is **no clarity** regarding intangible assets such as trademarks, customer lists, or brand value, which are typically important in the retail sector. A detailed **write-off** of obsolete inventory should be conducted, and the valuation of fixed assets should be reassessed by an independent appraiser. The **capitalized costs** related to the failed project need to be reviewed to determine whether they should be expensed rather than capitalized. Additionally, intangible assets should be identified and properly valued.

The current asset valuation is inflated due to unaddressed inventory write-offs and underperforming assets. A more thorough evaluation and adjustment are necessary.

4. Trading Performance

XYZ Retail has been engaging in **related party transactions** with its parent company, XYZ Holdings, which may not reflect normal commercial terms. **Business support services** (IT, logistics) have been provided by the parent company at no charge. Goods and services have been purchased at **discounted prices**, without the application of normal market markups.

Given that these arrangements may change post-acquisition, it's essential to assess their impact on profitability and determine the **fair market value** of these services. ABC Holdings should **re-negotiate** the terms of these related party transactions to reflect normal commercial terms. Additionally, post-acquisition, the company should **benchmark pricing** against industry standards to ensure that future costs are aligned with market expectations. The related party transactions distort financial performance, and it is important to reset these arrangements to market standards post-acquisition.

5. Undisclosed Liabilities

XYZ Retail Ltd. has not disclosed any **specific tax liabilities** or legal penalties, but potential hidden liabilities. The company is involved in a **tax dispute** with local authorities over the classification of certain expenses in 2021 and 2022. This could result in penalties or additional tax assessments. XYZ Retail operates internationally, and there may be **tax exposure** due to transfer pricing issues or the treatment of cross-border payments between subsidiaries. There is a risk of future tax reassessments or penalties related to these issues.

ABC Holdings should require **warranties and indemnities** from XYZ Retail to cover any potential **tax liabilities**. Additionally, an independent **tax due diligence** should be conducted to assess the full scope of potential tax risks, especially concerning international transactions and transfer pricing. There are potential tax liabilities and legal exposures that must be addressed. Protective clauses in the acquisition agreement, such as warranties and indemnities, should be negotiated.

6. Internal Controls

XYZ Retail Ltd. has weak **internal controls.** The company uses an **outdated accounting system** that lacks real-time reporting and visibility into financial performance. There are **no formal risk management procedures** in place, particularly concerning inventory management, customer data security, and compliance. The company does not have a **dedicated audit committee**, and there is insufficient documentation of internal control processes.

Post-acquisition, ABC Holdings should invest in a **modern accounting system** and ensure that appropriate **internal control structures** are implemented, including risk management procedures and an audit committee. Additionally, training and hiring of key staff in these areas should be prioritized. Significant improvements to internal controls and reporting systems are needed to ensure effective monitoring and compliance post-acquisition.

7. Balanced View

Integrating XYZ Retail into ABC Holdings' broader retail network could lead to cost savings in procurement, distribution, and logistics. The company's plans for expansion into new regional markets present an opportunity for growth. A new management team could help address operational inefficiencies and implement more effective strategies.

There are weak internal controls, potential tax liabilities, and challenges related to customer retention and product performance. The overly optimistic forecasts do not fully account for the potential risks. ABC Holdings should proceed with the acquisition, but with **caution**. A clear post-acquisition integration plan should be developed, with a focus on improving internal controls and addressing financial and operational weaknesses. While there is significant upside potential, careful consideration of risks and strategic planning post-acquisition is essential to ensure the long-term success of the investment

8. Tax Structure

The company's **tax structure** is somewhat opaque, particularly with regard to the use of **offshore subsidiaries** in tax-efficient jurisdictions, which may not be fully optimized; and the lack of clarity on **transfer pricing policies** and the risk of international tax exposure. ABC Holdings should conduct a comprehensive **tax review** to assess the efficiency of XYZ Retail's tax structure and ensure that it is compliant with all applicable tax laws. This review should address any potential risks related to cross-border transactions and transfer pricing.

Final Recommendation:

After reviewing the due diligence findings, it is clear that XYZ Retail Ltd. presents both significant opportunities and risks. While there are attractive synergies and growth potential, there are also numerous concerns regarding earnings quality, asset valuation, tax exposure, internal controls, and forecasting assumptions. ABC Holdings should proceed with the acquisition, but only after seeking the **warranties and indemnities** to cover potential liabilities, investing in modern reporting systems and internal controls and revisiting and adjusting the financial forecasts based on more realistic assumptions.

Report Prepared By:
[Your Name]
[Your Title]
[Your Contact Information]

This report provides a comprehensive analysis of the due diligence findings and makes detailed recommendations for mitigating risks and optimizing the acquisition

QN 3 b)

Is the takeover worthwhile?

Step 1: Determine the current number of shares in both companies

Kigali Industries Limited:

Issued ordinary shares = 25.0 million

Par value per share = RWF 1.0

Nyungwe Limited:

Issued ordinary shares = 18.0 million

Par value per share = RWF 0.10

Step 2: Number of shares Kigali Industries Limited can acquire

Kigali Industries Limited already owns 5% of Nyungwe Limited, so it can acquire the remaining 95% of Nyungwe's shares.

Total shares of Nyungwe to be acquired	**= 95% x 18.0 million = 17.1 million shares**
The exchange ratio is one Kigali Industries share for every seven shares of Nyungwe.	
Number of Kigali Industries shares to be issued	= 17.1 million / 7 = 2.43 million shares

Step 3: Total number of Kigali Industries shares after the merger

Total current shares of Kigali Industries = 25.0 million

New shares issued = 2.43 million

Total shares after merger	= 25.0 million + 2.43 million = 27.43 million shares

Step 4: Determine the combined profit

Profit of Kigali Industries available to shareholders: RWF 9.5 million

Profit of Nyungwe Limited available to shareholders: RWF 8.0 million

Total profit available to shareholders	= 9.5 million + 8.0 million = RWF

	17.5 million
Step 5: Calculate the new earnings per share (EPS)	
New EPS = Total profit available to shareholders / Total shares after the merger	
New EPS	= RWF 17.5 million / 27.43 million = RWF 0.638 per share
Step 6: Compare new EPS with old EPS	
Old EPS for Kigali Industries	= 9.5 million / 25.0 million = RWF 0.38 per share
Increase in EPS	= 0.638 - 0.38 = 0.258
Percentage increase in EPS =	(0.258 / 0.38) * 100 = 67.89%
Since the merger results in a substantial increase in EPS (67.89%), this indicates that the takeover is worthwhile.	
QN 3 c)	
Calculate the likely post-acquisition price of a share of Kigali Industries Limited if the bid is successful.	
Step 1: Determine the pre-merger market value of Kigali Industries Limited and Nyungwe Limited	
Market value of Kigali Industries	= 25.0 million shares x RWF 4.0 = RWF 100.0 million
Market value of Nyungwe Limited	= 18.0 million shares x RWF 0.60 = RWF 10.8 million
Step 2: Total combined market value after the merger	
Combined market value	= RWF 100.0 million + RWF 10.8 million = RWF 110.8 million
Step 3: Calculate the post-merger market price per share	
Post-merger price per share = Combined market value / Total number of shares after the merger	
Post-merger price per share	= RWF 110.8 million / 27.43 million = RWF 4.04 per share

Advise:

- The takeover is worthwhile because the post-merger earnings per share (EPS) increases significantly by 67.89%, which represents a strong potential benefit to shareholders.
- The likely post-acquisition price of a Kigali Industries share after the bid is successful will be approximately RWF 4.04.

QUESTION FOUR

Marking scheme

Q2	CRITERIA	MARKS
	Award of 0.5 marks for stating for each element of the business plan given	5
	Award 1 mark for clear explanation of executive summary	1
	Award 1 mark for clear explanation of company overview	1
	Award 0.5 marks for each component of Implementation Plan (4 components)	2
	Award 0.5 marks for each component of Risk Analysis (at least 4)	2
	Award of 0.5 marks for each explanation of other element of the business plan discussed except the financial projection (at least 2 points)	5
	Financial project	
	Award of 0.5 marks for each annual Total Sales revenues Award of 0.5 marks for each annual Total Operational Costs Award of 0.5 marks for each annual Net Profit Award of 0.5 marks for breakdown of the funding required by Investors Award of 0.5 marks for breakdown of the funding required by the Government Grant Award of 0.5 marks for breakdown of the funding required for the Bank Loan	2.5 2.5 2.5 0.5 0.5 0.5
	Total marks	25

Model Answer

BUSINESS PLAN FOR KIGALI HOSPITALITY LTD (KHL)

1. Executive Summary

Kigali Hospitality Ltd (KHL) is a luxury hotel company set to be located in downtown Kigali, Rwanda. The flagship property, "Luxe Kigali," will offer world-class accommodation, fine dining, and unique cultural experiences, targeting high-income individuals, corporate clients, and international tourists. KHL plans to emphasize sustainability and environmental responsibility by integrating green practices into operations. The company is seeking funding to establish the hotel and expand its services over the next five years.

2. Company Overview

- Business Name: Kigali Hospitality Ltd (KHL)
- Founder and Leadership: The company is led by Ms. Kayitesi, an entrepreneur with an MBA in Hospitality Management and vast experience in tourism and hospitality. The leadership team will include a Managing Director, Finance Director, Operations Director, and Marketing Director.
- Mission: KHL's mission is to provide luxury hospitality services while offering culturally immersive experiences that highlight Rwanda's rich heritage.

- Location: Luxe Kigali will be located in downtown Kigali, Rwanda, strategically positioned to cater to both business and leisure travelers.
- Market Capitalization: The Company anticipates a strong market presence with projected annual sales revenue growing from FRW 180 million in Year 1 to FRW 340 million by Year 5.
- Total Initial Funding Requirement: KHL needs a total initial funding of FRW 987 billion, with the funding structure as follows:
    - 35% from investors
    - 40% from government grants
    - 25% as a bank loan

3. Market Analysis

- Target Market: KHL's primary market segments include high-income individuals, corporate clients, and international tourists. The hotel will focus on attracting eco-conscious travelers, offering an immersive experience through sustainable tourism practices and local cultural integration.
- Competition: KHL faces competition from established hotels such as Kigali Marriott Hotel, Radisson Blu, and Serena Hotel. However, KHL's competitive edge lies in its focus on luxury services, local cultural immersion, and its commitment to eco-friendly practices.
- Local Economy and Tourism: Tourism is a critical sector in Rwanda's economy, with the government promoting eco-tourism and cultural experiences. KHL will leverage Rwanda's growing tourism sector, particularly eco-tourism initiatives like Gorilla Trekking, to attract guests.
- Regulatory Environment: KHL will operate in accordance with Rwanda's strong commitment to sustainable development. This includes adhering to local regulations regarding waste management, water conservation, and renewable energy usage.

4. ESG (Environmental, Social, and Governance) Strategy

- Environmental Impact: KHL will incorporate green practices, such as energy-efficient technologies, water conservation efforts, waste reduction, and eco-friendly materials. The company will seek certifications like Green Key or Earth Check to appeal to eco-conscious travelers.
- Social Responsibility: KHL will create job opportunities for local communities, provide competitive wages, and offer training programs to employees. By sourcing products locally, the hotel will contribute to the economic growth of the region.
- Governance: KHL will maintain transparency and strong ethical standards in all dealings with customers, suppliers, and employees. Regular audits will ensure compliance with local and international regulations.

5. Marketing and Sales Strategy

- ***Target Market Segmentation***

KHL will focus on three primary segments:

- **High-income individuals**: These include both international and local travelers looking for luxury accommodations with exceptional service, fine dining, and personalized experiences.
- **Corporate clients**: Business professionals traveling to Kigali for conferences, meetings, and corporate events. KHL will target this group by offering state-of-the-art meeting and conference facilities, tailored services, and premium accommodations.
- **Eco-conscious international tourists**: With Rwanda's focus on eco-tourism, KHL will target international tourists seeking sustainable, culturally immersive, and eco-friendly travel options.

  - ***Unique Selling Proposition (USP)***

KHL's USP is based on three key pillars:

- **Luxury with local cultural immersion:** Guests will experience a luxurious stay while being immersed in Rwanda's rich cultural heritage, offering local arts, crafts, cuisine, and cultural performances as part of their experience.
- **Personalized guest experiences**: The hotel will offer highly customized services, ensuring each guest's preferences are catered to through tailored amenities, concierge services, and unique packages.
- **Sustainability focus:** By integrating green practices such as energy-efficient systems, responsible sourcing, and eco-friendly facilities, KHL will appeal to eco-conscious travelers and businesses interested in sustainable practices.

  - ***Marketing Channels***

To effectively reach the target audience, the KHL will employ a multi-channel marketing approach as follows:

- **Digital Marketing**:
  - **Website:** The hotel will invest in a user-friendly, visually appealing website that showcases its luxury offerings, booking options, local experiences, and sustainability efforts. It will also feature an easy-to-navigate booking engine.
  - **Search engine optimization:** Optimizing the website for search engines will help KHL attract organic traffic from people searching for luxury hotels in Kigali, Rwanda, or eco-friendly travel options.
  - **Social media:** Social platforms such as Instagram, Facebook, X(Twitter), and LinkedIn will be used to showcase the hotel's luxury services, cultural events, sustainability initiatives, and customer experiences. Influencer collaborations, live tours, and social media ads will be leveraged to drive engagement.
  - **Email Marketing**: Regular email newsletters to past guests, potential customers, and business clients with special offers, updates on events, and promotional packages.
- **Traditional Marketing**:

- **Print Media**: Advertisements in luxury lifestyle magazines, travel publications, and local newspapers to attract both international tourists and local high-income individuals.
- **Brochures and flyers:** High-quality, visually appealing brochures highlighting KHL's offerings, sustainability practices, and unique cultural experiences will be distributed in tourist hotspots, airports, and corporate offices.
- **Events & Sponsorships**: KHL will sponsor local events, conferences, and cultural festivals in Kigali to build brand awareness and connect directly with the target market.

- **Partnerships and Collaborations**:
  - **Travel agencies and tour operators**: Collaborating with international and local travel agencies and tour operators to offer packaged deals that include accommodation, cultural tours (such as Gorilla Trekking), and eco-tourism activities.
  - **Corporate partnerships**: Building relationships with corporate clients to offer business travel packages, corporate retreats, and event hosting services.
  - **Local businesses**: Partnering with local artisans, restaurants, and cultural institutions to incorporate Rwanda's local culture into the guest experience. This partnership will help enhance authenticity and generate goodwill among the local community.

- ***Sales Strategy***

KHL's sales strategy will focus on driving direct bookings, offering special packages, and building long-term relationships with both individual and corporate clients.

- **Direct booking incentives**: KHL will encourage guests to book directly through its website by offering incentives such as discounted rates, complimentary services (e.g., spa treatment, meals), or exclusive upgrades for those who book directly rather than through third-party sites.
- **Corporate sales team**: A dedicated sales team will be tasked with reaching out to corporate clients to offer tailored solutions for business travelers, conferences, and corporate events. This team will also manage relationships with companies that are likely to host regular business trips to Kigali.
- **Loyalty programs**: To encourage repeat customers, KHL will implement a loyalty program that rewards guests for repeat bookings, referrals, and feedback. Guests will earn points for each stay, which can be redeemed for discounts, room upgrades, or complimentary services.
- **Group sales**: A specialized team will target group bookings for conferences, seminars, and social events such as weddings, anniversaries, and family gatherings. By offering tailored packages, personalized event coordination, and competitive pricing, KHL will position itself as the ideal venue for both business and leisure events.
- **International sales channels**: To target international guests, KHL will list its property on global travel platforms like Booking.com, Expedia, and Airbnb. Partnerships with online travel agents will help broaden the hotel's reach, especially for guests from outside Rwanda.

- *Pricing Strategy*

KHL will adopt a **value-based pricing** strategy, focusing on the unique luxury and cultural experiences offered while remaining competitive in the market.

- **Tiered pricing**: Different room categories (e.g., standard, deluxe, suite) will have distinct pricing tiers to cater to different customer budgets. Special seasonal rates, corporate discounts, and promotional packages will help increase bookings during off-peak periods.
- **Premium add-ons**: In addition to room rates, KHL will offer premium services such as spa treatments, exclusive tours, fine dining experiences, and private events that can be added to bookings as upsells.
- **Special offers and discounts**: KHL will provide limited-time offers, discounts for longer stays, and early booking discounts to drive sales during low-demand periods.

- ***Brand Positioning***

KHL will position itself as a **luxury, eco-friendly hotel that blends Rwanda's rich cultural heritage with exceptional service**. This will be communicated through all marketing channels, from its website to social media and print media. By emphasizing local culture, sustainability, and personalized experiences, KHL will differentiate itself from competitors in the Kigali hotel market.

- ***Marketing Metrics and KPIs***

To evaluate the effectiveness of the marketing and sales strategy, KHL will track the following key performance indicators (KPIs):

- **Revenue per Available Room**: Measuring the efficiency of room sales and pricing strategies.
- **Customer Acquisition Cost**: The cost incurred to acquire a new customer through marketing efforts.
- **Booking Conversion Rate**: The percentage of website visitors who make a booking.
- **Social Media Engagement**: Number of followers, likes, shares, and comments to gauge brand visibility and customer engagement.
- **Customer Satisfaction & Net Promoter Score**: Measuring guest satisfaction and loyalty, and tracking the likelihood of guests recommending KHL to other

6. Operational Plan

- **Facility and infrastructure**: Luxe Kigali will feature energy-efficient systems, including solar power, water-saving technologies, and sustainable building materials. The property will be designed with climate resilience in mind, capable of withstanding extreme weather conditions such as flooding and heavy rainfall.
- **Technology integration**: KHL will utilize smart hotel technology, including online booking platforms, keyless entry, and energy-saving systems, to improve operational efficiency and enhance guest satisfaction.

- **Health and safety**: In response to post-pandemic concerns, KHL will implement stringent health and safety protocols, including frequent sanitization, temperature checks, and training employees on health procedures.

7. Management and Organization

- **Leadership team**: The leadership team includes Ms. Kayitesi (Managing Director), who will guide the company's strategic vision, along with a Finance Director, Operations Director, and Marketing Director.
- **Board of Directors**: The board will consist of 12 experienced individuals in hospitality, marketing, and finance.
- **Staffing**: KHL will hire 35 employees in its first year, with a strong focus on local employment and skills development. The company will collaborate with vocational training centers to bridge the skills gap in Rwanda's hospitality sector.

8. Financial projection for the five years (2026 -2030)

Year	2026	2027	2028	2029	2030
	Amount in FRW"000"	**Amount in FRW"000"**	**Amount in FRW"000"**	**Amount in FRW"000"**	**Amount in FRW"000"**
Sales revenues:					
Room Revenue	120,000,000	138,000,000	165,000,000	195,000,000	225,000,000
Food & Beverage Revenue	35,000,000	40,000,000	45,000,000	50,000,000	55,000,000
Conference & Event Revenue	20,000,000	23,000,000	27,000,000	30,000,000	35,000,000
Other Services Revenue	10,000,000	11,500,000	13,000,000	15,000,000	17,000,000
Retail & Merchandise Revenue	5,000,000	5,500,000	6,000,000	7,000,000	8,000,000
Total Sales revenues	**190,000,000**	**218,000,000**	**256,000,000**	**297,000,000**	**340,000,000**
Operational Costs:					
Labor Costs	25,000,000	28,000,000	32,000,000	36,000,000	40,000,000
Utilities	7,000,000	8,000,000	9,000,000	10,000,000	11,000,000
Maintenance & Repairs	5,000,000	5,500,000	6,000,000	7,000,000	8,000,000
Food & Beverage Costs	4,000,000	5,000,000	6,000,000	7,000,000	8,000,000
Marketing & Advertising	3,000,000	3,500,000	4,000,000	5,000,000	6,000,000
Admin & General Costs	2,000,000	2,500,000	3,000,000	3,500,000	4,000,000
Technology & Software	1,500,000	1,700,000	2,000,000	2,500,000	3,000,000

Year	2026	2027	2028	2029	2030
	Amount in FRW"000"	**Amount in FRW"000"**	**Amount in FRW"000"**	**Amount in FRW"000"**	**Amount in FRW"000"**
Depreciation	500,000	600,000	700,000	800,000	1,000,000
CSR Costs	80,000	100,000	120,000	150,000	200,000
Total Operational Costs	48,080,000	54,900,000	62,820,000	71,950,000	81,200,000
Net Profit	**141,920,000**	**163,100,000**	**193,180,000**	**225,050,000**	**258,800,000**

KHL expects to break even by the end of Year 3 as its brand recognition grows and operational efficiencies improve.
The total funding requirement is FRW 987 billion. The breakdown of the funding is:

- Investors: 35% (FRW 345 billion)
- Government Grant: 40% (FRW 395 billion)
- Bank Loan: 25% (FRW 247 billion)

9. Risk Analysis

The risks self-assessment shows the following possible risks to be mitigated:

Risk Category	Risk description	Risk impact	Risk likelihood rating	Mitigation controls
Financial Risks	Inadequate funding or cash flow problems due to delays in revenue generation, especially in the first few years.	High – Can affect operations, development, and scaling efforts.	Medium	- Secure diversified funding sources (bank loans, investor contributions, government grants). - Tight financial management and monitoring. - Regular cash flow forecasts.
Market Risks	Intense competition from established hotels (Kigali Marriott, Radisson Blu, etc.) and potential market saturation.	Medium – May impact revenue generation and customer acquisition.	High	- Focus on niche targeting (luxury, local cultural immersion, and personalized experiences). - Enhance marketing and branding strategies. - Build partnerships with local businesses.

Risk Category	Risk description	Risk impact	Risk likelihood rating	Mitigation controls
Regulatory Risks	Changing government regulations, particularly in environmental standards, tourism laws, or labor laws.	Medium – Compliance issues could lead to fines or business disruptions.	Medium	- Stay updated on local and international regulations. - Work closely with legal advisors. - Engage with government bodies to remain compliant and leverage incentives.
Operational Risks	Issues related to service quality, staff training, or inefficiencies in day-to-day hotel operations.	Medium – Can affect customer satisfaction and brand reputation.	High	- Implement robust operational procedures. - Continuous staff training and quality control. - Regular audits and feedback systems to ensure operational excellence.
Economic Risks	Negative economic conditions, inflation, or currency fluctuations affecting the cost of operations or revenues.	High – Could lead to reduced consumer spending or higher operational costs.	Medium	- Build a flexible pricing strategy to adjust to economic conditions. - Diversify revenue streams to reduce reliance on one segment. - Monitor economic indicators closely.
Environmental Risks	Impact of climate change, such as flooding, droughts, or extreme weather conditions affecting hotel operations.	High – Physical damage to property or service disruptions.	Medium	- Design climate-resilient infrastructure. - Implement energy-efficient systems. - Develop emergency preparedness and contingency plans for adverse weather conditions.

Risk Category	Risk description	Risk impact	Risk likelihood rating	Mitigation controls
Reputational Risks	Negative publicity due to poor employee treatment, waste management practices, or other CSR issues.	High – Can harm brand image and reduce customer loyalty.	High	- Enhance CSR initiatives and transparency. - Implement regular employee satisfaction surveys. - Adopt sustainable practices and communicate them to customers effectively.
Technology Risks	Technology failures, cyber-attacks, or issues with digital platforms impacting operations and customer experience.	Medium – Can lead to operational disruptions and customer dissatisfaction.	Medium	- Invest in robust cybersecurity measures. - Regular IT audits and backups. - Use reliable technology providers and platforms for customer interaction.
Health and Safety Risks	Public health crises or health and safety issues impacting guest experience or leading to regulatory scrutiny.	High – Can result in loss of business and possible legal action.	Medium	- Implement strict health and safety protocols. - Ensure regular cleaning and hygiene procedures. - Train staff on health crisis management. - Stay updated on global health standards.
Supply Chain Risks	Disruptions in the supply of goods, food, or materials due to external factors (e.g., geopolitical issues, natural disasters).	Medium – Can lead to service delays or increased operational costs.	Medium	- Build strong relationships with multiple suppliers. - Diversify sourcing to minimize reliance on single suppliers. - Keep adequate stock of essential items and materials.

10. Implementation Plan

Phase	Objective	Key Activities	Timeline
Pre-Launch Phase (2026)	Establish infrastructure	- Site preparation and construction of the hotel (Luxe Kigali).	20Q1 - Q4

Phase	Objective	Key Activities	Timeline
	and secure funding.	- Implement sustainability certifications (Green Key, EarthCheck).	Q1 - Q4
		- Recruit and train key leadership team and 35 staff members.	Q1 - Q3
		- Develop and launch branding and digital marketing campaigns.	Q2 - Q4
		- Apply for necessary funding (25% bank loan, 40% government grant, 35% investor contribution).	Q1 - Q2
Soft Launch & Initial Operations (2027)	Open the hotel and begin generating revenue.	- Soft launch with limited guests to refine services.	Q1
		- Official grand opening event and media outreach.	Q1
		- Begin offering core services (room, food & beverage, events).	Q1 - Q4
		- Continued digital marketing, PR, and partnerships with local agencies.	Q1 - Q4
		- Focus on financial management, cost monitoring, and cash flow management.	Q1 - Q4
Growth Phase (2028- 2029)	Achieve break-even and expand market presence.	- Scale up operations (expand staff, refine operational processes).	2028
		- Strengthen local and international marketing to attract more guests, particularly eco-tourists.	2028
		- Expand revenue streams (food & beverage, events, retail).	2029-2030
		- Continue building brand recognition and partnerships.	2029-2030
		- Work towards sustainability certifications and eco-friendly initiatives.	2029-2030
Consolidation & Expansion (Year 5)	Achieve full profitability and prepare for growth.	- Achieve profitability through cost optimization and increased revenue generation.	2030
		- Expand services (e.g., wellness programs, eco-tourism).	2030
		- Begin planning for possible expansions (new properties, international partnerships).	2030
		- Review CSR impact and employee welfare programs to ensure sustainable growth.	2030

End of Marking Guide and Model Answers