<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>16.67%</th>
<th>-7.14%</th>
<th>28.57%</th>
<th>40.00%</th>
<th>6.25%</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>15</td>
<td>-5</td>
<td>30</td>
<td>50</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>18</td>
<td>14</td>
<td>21</td>
<td>25</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>E</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td></td>
</tr>
</tbody>
</table>

**Number of ordinary shares**

<table>
<thead>
<tr>
<th></th>
<th>3,750,000</th>
<th>3,750,000</th>
<th>3,750,000</th>
<th>3,750,000</th>
<th>3,750,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current number of shares in issue</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of shares to be issue to BEE</td>
<td>750,000</td>
<td>-250,000</td>
<td>1,500,000</td>
<td>2,500,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Final BEE shareholding</td>
<td>16.67%</td>
<td>-7.14%</td>
<td>28.57%</td>
<td>40.00%</td>
<td>6.25%</td>
</tr>
<tr>
<td># of preference shares</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Conversion ratio</td>
<td>0.75</td>
<td>-0.25</td>
<td>1.50</td>
<td>2.50</td>
<td>0.25</td>
</tr>
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</table>

**Taxation**

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>PBT</td>
<td>20,571</td>
<td>23,214</td>
</tr>
<tr>
<td>Deferred</td>
<td>-50</td>
<td>-75</td>
</tr>
<tr>
<td>STC</td>
<td>-1,200</td>
<td>-1,250</td>
</tr>
<tr>
<td>Normal tax</td>
<td>-6,121</td>
<td>-6,889</td>
</tr>
<tr>
<td>PAT</td>
<td>13,200</td>
<td>15,000</td>
</tr>
</tbody>
</table>
**QUESTION 2: SUGGESTED SOLUTION**

<table>
<thead>
<tr>
<th>Part (a)</th>
<th>2003</th>
<th>2004</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit after tax</td>
<td>13,200</td>
<td>15,000</td>
<td>13.6%</td>
</tr>
</tbody>
</table>

STC be excluded from determination of PAT [similar listed companies do not pay dividends]

| | 2 |

PBT | 23,214 |

Tax (30%) | -6,964 |

Sustainable earnings | 16,250 |

### PE multiples of comparable listed companies

<table>
<thead>
<tr>
<th>PE</th>
<th>Nature of business</th>
<th>Profitability relative to StaffX</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.0</td>
<td>Personnel recruitment</td>
<td>1.0</td>
</tr>
<tr>
<td>8.0</td>
<td>Market research</td>
<td>1.7</td>
</tr>
<tr>
<td>7.0</td>
<td>Training</td>
<td>1.2</td>
</tr>
<tr>
<td>6.5</td>
<td>Recruitment &amp; training</td>
<td>4.0</td>
</tr>
</tbody>
</table>

PE calc's | 2 |

Size differentials | 1 |

It is evident from above that:
- recruitment companies are rated at lower PE multiples | 1 |
- Market research company has higher PE than training company, probably due to higher margins achieved in research | 1 |

### Appropriate PE ratio for StaffX?

<table>
<thead>
<tr>
<th></th>
<th>PE Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Xcutive</td>
<td>4.0 43.0% 1.7</td>
</tr>
<tr>
<td>Xsearch</td>
<td>8.0 26.9% 2.2</td>
</tr>
<tr>
<td>Xtrain</td>
<td>7.0 30.1% 2.1</td>
</tr>
</tbody>
</table>

Unlisted discount 25% | -1.5 |

| | 3 |

Insufficient information to apply specific risk factors

Discount for difference in size between StaffX and listed entities?

Alternatively, use Able Ltd as a benchmark given that there is a blend between recruitment and training?

| Listed PE | 6.5 |
| Unlisted discount (20%) | -1.3 |
| Size difference | -0.5 |

| | 4.7 |

### Conclusions:

| Sustainable earnings | 16,250 |
| Fair multiple | 5.0 |
| Earnings valuation | 81,250 |

Available | 14 |

Maximum | 12 |

### Further information required to finalise valuation:

- updated financial information post June 2004 and forecasts to June 2005 | 1 |
- comparison of operating margins between StaffX and comparable listed companies | 1 |
- cash flow information (historical & forecast) and cost of capital to perform FCF valuation for reasonability check | 2 |
- allocation of head office costs to operating divisions | 1 |
- profit history to ascertain whether R16.2m is sustainable | 1 |

Available | 6 |

Maximum | 5 |
Conclusion
- sustainable earnings higher than FD's due to excluding STC 1
- PE multiples exactly the same and FD's assumption appears reasonable 1
- FD's valuation reasonable, however could be higher 1

Available 3
Maximum 2

Part (b)
- does not take into account future potential of companies 2
- accounting earnings subject to manipulation/ may be inconsistent from company to company 2
- PE valuations assume that multiples never change 1
- far too simplistic a method 1
- difficult to incorporate risk analysis into PE multiple 1

Available 7
Maximum 5

Part (c)
A = 26%
C = R75m
Therefore, B > 26.35
0.26 = x/(x+75)
x = 19.50 + 0.26x
0.74x = 19.50
x = 26.35

B = (D-E) * 5
E = R15m
Therefore, E should be > R20.27m
Average profit for 10% shareholding R16.67m
Average profit for 15% shareholding R17.65m

Available 9
Maximum 9

Part (d)
Current PE multiples very low hence, makes sense to delay "selling" equity. However, BEE deal critical 2

Deal structuring comments
- BEE partner showing commitment by investing R1m upfront 1
- Upon conversion of R1m into ordinary shares, BEE partner will be obtaining a discount 2
- Conversion formula ignores the time value of money! 2
- Earnings target does not escalate by CPI or some rate annually 1
- If earnings levels are lumpy eg R20m, R10m and R25m then BEE partner still benefits 2
- Structure assumes a constant fair value for StaffX 1
- No attempt is made in structure to allocate value add between BEE partner and current shareholders/management 1
- If earnings levels increase dramatically then BEE shareholding capped at 26% 1
- For BEE partner to achieve 26% shareholding average PAT needs to increase by 35.1% 2
- no dividends paid to BEE partner 1
- if PAT targets not met then StaffX will need to restructure deal or find another BEE partner 1
- StaffX could land up with a 2% BEE shareholder, which is nuisance value. Need 26% BEE shareholder? 1

Post deal implications
- Current shareholders can pay dividends over next 3 years! 2
- BEE partner can stop special resolutions etc with 26% shareholding 1
- BEE partner should be prevented from selling to non-BEE shareholder in future 2

Overall conclusions:
- StaffX needs a BEE shareholder given procurement policies of major clients 1
- PAT targets aggressive therefore value preservation to some extent 1
- If earnings do not increase then structure can be unwound 1

Available 26
Maximum 15
Part (e)
Certain decisions should require consent of BEE shareholder prior to enacting:
- payment of dividends 1
- loans to shareholders 1
- sale of major division or business as going concern 1
- incurring borrowings 1
- changing nature of business 1
- change in accounting policies 1
Pre-emptive rights re sale of shares 1
Tag along provisions if current shareholders sell their shares 1

Available 8
Maximum 5

Part (f)
- Xcutive division margins have been declining 2
- Without BEE shareholder, company could face declining revenue 2
- Changing nature of recruitment (internet portals etc) a threat to Xcutive division 1
- Xtrain division is heavily reliant on 2 clients for 40% of it turnover 2
- Head office costs appears significant in relation to profit before tax 1
- Business is very people intensive therefore, significant cost base. Vulnerable to declining turnover 2
- Changing training environment (more e-learning based) could affect business model. More competition? 1
- Market research industry is highly cyclical 2

Available 13
Maximum 9

Part (g)
Weakness
Bonuses based on exceeding budgets
Ignores return on capital
EBITDA targets ignore interest and tax
Bonus scheme only applies to select few
No bonus bank
Bonuses based on accounting targets
Directors are shareholders yet participate in bonus scheme

Behaviour encouraged
Management tempted to understate budgets
Management ignore return on capital and focus on profits
Management ignore tax planning and gearing. Encourages short term decision making eg. Buy building instead of leasing
Other employees not incentivised to perform “us vs them” mentality
Managers may be tempted to over-achieve in one year and leave after receiving massive bonus
Management may be tempted to manipulate accounting
Conflicts between directors and private equity fund

Available 12
Maximum 9

Part (h)
- MD has conflict of interest in BEE partner selection process and may influence StaffX to choose inappropriate partner 2
- MD stands to gain up 2.6% of shares in StaffX without paying fair value 1
- MD may become distracted in driving Circle’s investment strategy as opposed to focusing on his current role as MD 1
- Non-disclosure of actions is a major breach of faith, what else has he not disclosed? 1
- Other StaffX shareholders would be livid to discover MD’s actions 1
- MD has a duty to disclose interest in contracts per Co’s Act! 2
- Discovery of MD’s actions and reporting in press will seriously tarnish StaffX’s reputation! 2
- Circle should re-consider its interest in StaffX given MD’s ethics 1

Available 11
Maximum 7
### Part (i)
- Value that division could be sold for (listed co trading at 4PE!)
- Divisional contribution to group overheads
- Potential release of working capital
- Improved value of group following sale of low margin business
- Head office may need to be downsized following sale
- Potential buyers of Xcutive
- Critical mass that division provides (banking facilities, risk ratings etc)
- Impact that sale could have on impending BEE deal
- Historical cross-selling by divisions?

<table>
<thead>
<tr>
<th>Available</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>8</td>
</tr>
</tbody>
</table>

### Part (ii)
#### Income tax consequences?
- If assets and liabilities transferred at tax values then minimal income tax
- Deferred tax relates to leave pay provisions
- If fixed assets transferred at tax values, no issue

**CGT**
- Gain arising on sale of business will be subject to CGT at an effective 15% of gain
- Was the value of the Xcutive division established at 1/10/2001? If not, can the company value be split?
- CGT valuation was required to be submitted by 30/9/2004
- Any CGT paid will reduce reserves available for distribution

**STC**
- Dividends (capital or revenue profits) subject to STC at 12.5% of dividend declared

<table>
<thead>
<tr>
<th>Available</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>7</td>
</tr>
</tbody>
</table>

| Part a | 19 |
| b      | 5  |
| c      | 9  |
| d      | 15 |
| e      | 5  |
| f      | 9  |
| g      | 9  |
| h      | 7  |
| i      | 8  |
| j      | 7  |
| Presentation | 7 |

<table>
<thead>
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<th>Available</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>7</td>
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</tbody>
</table>