Yaslike Ltd is a holding company listed on the JSE Securities Exchange SA, and has four operating subsidiaries. Wolfgang Engineering GmbH, a German based conglomerate, owns 49.5% of the issued share capital of Yaslike Ltd, while institutions and the general public own the balance. The non-executive directors of Yaslike Ltd, particularly those appointed by Wolfgang Engineering GmbH, have expressed concerns regarding the head office treasury functions and the limited controls over operating subsidiaries in this regard.

Twelve months ago the group auditors strongly recommended that, in view of the diversity and materiality of transactions entered into by group companies, a centralised treasury function be established. According to the auditors, a specialised skill set is required at head office to address the financial and operational risks flowing from group operations. In response to the auditors’ recommendations, Yaslike Ltd appointed a treasury controller, Mr Sparks, six months ago. Unfortunately, Mr Sparks has made little progress in formalising group treasury functions and addressing the key treasury risks to which Yaslike Ltd is exposed.

The nature of business of each operating subsidiary and other relevant information are summarised below.

**AutoM (Pty) Ltd (AutoM)**

AutoM manufactures radiators and exhaust systems for supply to the automotive industry. Approximately 75% of revenue is derived from supplying automotive manufacturers and the balance from distributing products in the after-sales market. The vast majority of raw materials is sourced locally.

Automotive manufacturing customers have 180-day payment terms with AutoM. While this places significant pressure on the company’s cash flows, the strong negotiating power of the automotive manufacturers has ensured that 180-day trade terms are the norm for the industry. After-sales market customers are generally required to pay between 60 and 90 days after delivery of products by AutoM.

AutoM funds its investment in working capital by means of banking facilities provided by ABC Bank, mainly in the form of an overdraft facility. The facility is secured by a cession of receivables and a general notarial bond over inventory and other assets.

**DGE Agricultural (Pty) Ltd (DGE)**

DGE imports and assembles agricultural equipment. Products include seed and fertilizer spreaders, rotary tillers, ploughs, front-end loaders, crop sprayers and cultivators. The company supplies co-operatives and commercial farmers in South Africa, as well as a few in neighbouring countries.

DGE imports equipment from suppliers in the United States, South America and the United Kingdom. The average lead time from placing orders to receiving equipment is four months. The purchasing manager of DGE has been employed by the group for over 25 years and uses her judgement in whether to take out forward cover on equipment purchases. She will for example take out forward cover in excess of the company’s requirements when she believes the rand is going to depreciate against major currencies.

The local agricultural industry has experienced lean times over the past two years because of adverse weather conditions and lower commodity prices. Farmers have reacted by deferring purchases of agricultural equipment until market conditions improve. DGE is increasingly selling equipment on an instalment sale basis to major customers to generate sales. Repayments are fixed in amount per instalment sale agreements and repayment terms vary between three and five years. DGE is funding its credit extension to customers by loans from group subsidiaries.
**Crushtec (Pty) Ltd (Crushtec)**

Crushtec imports and distributes rock-crushing equipment to customers in the mining and construction industries. The company invests significantly in research and development, and provides custom designed solutions for use in open pit and ocean diamond mining operations. Highly experienced technicians provide assembly and product support facilities to customers.

Equipment is imported from suppliers in the United States and Japan. Foreign supplier credit terms range from 90 to 120 days from shipment date. These favourable trade terms are the result of annual order volumes and Crushtec’s long-standing track record with key suppliers. Crushtec does not take out forward cover on equipment imports as the company is generally able to pass on price increases to customers.

Crushtec generates significant profits and cash flow for the Yaslike Ltd group. Customers generally pay promptly within 30 days of delivery. Crushtec has significant cash resources on deposit with its bankers. The buoyant market conditions in the mining and construction industries bode well for Crushtec over the next three years.

**Malvern Stainless (Pty) Ltd (Malvern)**

Malvern manufactures a range of bathroom and kitchen products from stainless steel. Raw materials are locally sourced. The company commenced operations three years ago and has created an impressive array of products. A major retailer in the United States has approached Malvern to obtain exclusive agency rights to sell and distribute their stainless steel products in the United States. The initial projections are promising and Malvern expects to generate significant revenue from supplying this retailer.

**Catalytic converter tender**

AutoM tendered for and was awarded an exclusive five-year contract to manufacture and supply catalytic converters to the wholly owned South African subsidiary of a European automotive conglomerate. This is a fixed-price contract except for annual inflation-related price adjustments. The European conglomerate, through its local subsidiary, owns two manufacturing plants in South Africa, which export significant volumes of vehicle models to Europe and the rest of the world. The European group has established centers of excellence in different geographical locations to focus on the production of specific vehicle models, which are then exported globally.

Catalytic converters are fitted to vehicles to reduce the pollution from exhaust emissions in line with legislative standards set by major Western countries. Converters comprise a ceramic structure coated with metal catalysts (platinum, rhodium and palladium). These metal catalysts make up 55% of the cost of the finished product.

AutoM needs to import new plant and equipment from the United States to enable it to produce catalytic converters in accordance with the contract specifications. The estimated cost of the plant and equipment is US$8,5 million. The equipment will be delivered and supplied nine months after the order is placed. AutoM has approached local banks to finance the acquisition of plant and equipment, but they have been declined because of the perceived high risk of the project.

Wolfgang Engineering GmbH has offered to advance Yaslike Ltd a loan to fund the acquisition of the plant and equipment by AutoM. Their proposed loan terms are as follows:

<table>
<thead>
<tr>
<th>Amount</th>
<th>€7,0 million (€ = Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term</td>
<td>5 years</td>
</tr>
<tr>
<td>Interest rate</td>
<td>4,25% per annum, fixed in Euro</td>
</tr>
<tr>
<td>Repayments</td>
<td>Quarterly in arrear</td>
</tr>
</tbody>
</table>
Mr Sparks asked various investment banks for advice on hedging the foreign currency exposure of Yaslike Ltd with regard to the loan from Wolfgang Engineering GmbH. The advice received was that Yaslike Ltd should either enter into rolling three month forward exchange contracts or into upfront currency swaps. The current exchange rate is 1€ = R8,00.

**BEE deal**

Indigenous (Pty) Ltd (Indigenous), a diversified BEE holding company, has approached Yaslike Ltd to acquire a 20% shareholding in Yaslike Ltd. The shareholders in Indigenous are four prominent black individuals (60%), with the balance owned by broad based community and women's organisations. The corporate finance advisors to Indigenous have proposed the following transaction terms:

- **Valuation of 20% shareholding**: Based on the ruling share price on the date on which Indigenous initially approached Yaslike Ltd, namely R75 million for a 20% shareholders interest.
- **Special purpose vehicle**: Indigenous will form a wholly-owned subsidiary (SPV) to acquire the 20% interest in Yaslike Ltd.
- **Funding of acquisition**: Indigenous will subscribe for ordinary shares in SPV for a total consideration of R7,5 million. The balance of the purchase price is to be funded by a subscription by Crushtec for cumulative redeemable preference shares in SPV to the value of R67,5 million.
- **Acquisition structuring**: Arrangement whereby Indigenous will acquire one share from existing shareholders of Yaslike Ltd for every five shares held.
- **SPV preference share terms**: Dividends will be equivalent to 70% of prevailing prime overdraft lending rate multiplied by the preference share capital and premium amount. Preference shares will be redeemable at par at the latest in eight years’ time. In the event that SPV has insufficient cash resources to redeem the preference shares, Crushtec will be entitled to acquire the ordinary shares in SPV for a nominal consideration.

**REQUIRED**

(a) Identify and discuss the general and specific risks facing the Yaslike Ltd group from a treasury perspective. Your discussion should include the potential treasury risks associated with obtaining a loan from Wolfgang Engineering GmbH.  

(b) Outline the key attributes of a forward exchange contract and a currency swap. Make a recommendation, with reasons, as to which is the more suitable instrument for Yaslike Ltd to hedge its foreign currency exposure on the proposed loan from Wolfgang Engineering GmbH.

(c) Recommend general risk management procedures and policies that the treasury division of Yaslike Ltd should implement to minimise foreign currency and interest rate risks and improve the cash management of the group.

(d) Critically review and discuss the transaction proposed by the advisors to Indigenous (Pty) Ltd regarding the acquisition of a 20% shareholding in Yaslike Ltd from the perspective of the shareholders of Yaslike Ltd.

(e) Assuming the proposed BEE deal is implemented, discuss how Yaslike Ltd should account for its investment in SPV in its consolidated annual financial statements.