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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

TOP CA CASE STUDY EXAMINATION - DECEMBER 2012

**THE EXAMINATION QUESTION, INSTRUCTIONS AND ADDITIONAL
(IMPACT) INFORMATION**

Instructions to candidates:

- (1) **Time allowed :** 4 hours
- (2) **Marks :** 100 marks
- (3) This question paper should be answered entirely in the **ENGLISH** language.
- (4) Your answer must be submitted in the answer booklets provided at the Examination Hall.
- (5) Any pre-prepared papers included in your answer **WILL NOT** be marked.
- (6) After the instruction to stop writing at the end of the paper, you will be given five minutes to assemble your answer.

Background

Skyfly Airlines is one of the corporate finance and advisory clients of TDI Consulting Group. Consequent to a decision made by the cabinet of Serendib government, loss making Flyingair was also to come under the management of Skyfly. The decision was to merge the two airlines and go as one carrier. However, various reasons specially union actions and pressure from other sources have resulted in delaying the implementation of the decision.

Treasury of Serendib government recently appointed a Special Executive Committee (SECo) comprising six members (including TDI as consultant to SECo) to find a sustainable solution to Skyfly Airlines. In the absence of a board which resulted from the recent resigning of entire board of directors after strikes by unions last week, SECo has a major role to play in making decisions on both short term and long term measures to turnaround the loss making two airlines companies. Treasury of Serendib wanted SECo to come up with a viable restructuring plan for the next five years to make the local carriers competitive.

Mr.Travin Ambani is the representative from TDI to deal with SECo.

Requirement

You (Vinod Sriprakash) are a senior consultant at the firm of TDI Consulting Group, working directly for Travin Ambani, a director of the firm. You have been working with Mr. Travin for almost four years and have gained experience in diversified fields as a member of the consulting team.

You are required to prepare an internal memorandum as set out in the e-mail from Mr. Travin (Exhibit 1) of your firm to you.

Your reply should include an executive summary with required appendices. State clearly any assumptions that you make. All workings should be attached to your answer.

The following time allocation is suggested to candidates:

Reading	1 hour
Planning, calculations and preparation of appendices	45 minutes
Drafting memorandum	2 hours and 15 minutes

Marks Allocation

All of the marks in the Case Study are awarded for professional skills, allocated broadly as follows:

Applied to the four elements of your report

- | | |
|--|------------|
| ▪ Assimilating and using information | 20% |
| ▪ Structuring problems and solutions | 30% |
| ▪ Applying judgment | 25% |
| ▪ Drawing conclusions and making recommendations | <u>20%</u> |
| | 95% |

Applied to your report as a whole

- | | |
|--|------------|
| ▪ Demonstrating integrative and multidisciplinary skills | <u>05%</u> |
| | 100% |

Approximately 15% of the marks are awarded for the executive summary.

In planning your report, you should be aware that not submitting an executive summary will have a significantly detrimental effect on your chances of success. Accordingly, not demonstrating your judgment and/or failing to include appropriate conclusions and recommendations in each element of your report will affect your chances of success.

Exhibit 1. - E-mail from Mr. Travin to you;

From : travin@TDI.com
To : vinod@TDI.com
Date : December 6, 2012
Subject: Skyfly group

There have been major changes in relation to the Skyfly work, which require careful consideration in order to present a clear picture to the SECo members, ahead of their meeting with banks and Asianfly, in the next couple of weeks.

In addition to the information I have provided to you earlier, I have been given new information. This is attached and comprises:

- I. Exhibit 2. Extract of minutes of Special meeting held by recently appointed SECo members
- II. Exhibit 3. E-mail from Chairman SECo to Mr.Travin
- III. Exhibit 4. Letter from CEO – Asianfly to Chairman – SECo
- IV. Exhibit 5. News Paper Article – Union issue and resigning of key pilots
- V. Exhibit 6. Extract of budget proposal 2013- Government Policy on tourism
- VI. Exhibit 7. Current Financial Commitments of Skyfly Airlines Ltd (note from audited financial statements)
- VII. Exhibit 8. Additional financial information of Skyfly Catering (Pvt) Ltd.

You will need to prepare an internal memorandum on the following;

1. Brief evaluation of recapitalizing options suggested by SECo

Your proposal, with justification, for the future financing options to re-capitalize the company, taking into consideration the matters raised by Chairman- SECo in the attached correspondence and your evaluation of each proposal (Please remember, if you reject any proposal, you need to give reason for the same).

2. Analyze and evaluate other issues faced by Skyfly

A discussion of the relevant financial management, operational and strategic issues which may be of concern to SECo when finalizing the restructuring plan to turnaround both loss making airlines and to ensure the sustainability of the same and how the incoming board of directors could address these concerns.

(Please do not forget that Government policy is that Skyfly is to be the national flag carrier and the country needs to be the aviation hub of Asia in promoting tourism. Please remember to consider government policies etc.).

Although I will not be giving your report to the SECo members, it will form the basis for our discussion with them tomorrow. Can we meet to discuss your work tomorrow morning before the meeting.

Regards,

Travin

Exhibit 2. - Extract of minutes of Special meeting held by recently appointed SECo Members

1. Discussion on recent union actions and resulting financial losses and need to take immediate measures for a permanent solution to the same.

The committee discussed the strikes organized by the labour unions of Skyfly group. It was estimated financial loss due to this was SR. 20 million Skyfly now has a tarnished reputation and corporate image owing to Company's un-cooperative work force that resorted to frequent strikes and halting of Company's operations. As reported, the labour unions have a strong political backing, enabling them to successfully oppose any move by the management to privatize the Company or to reduce the workforce. In this context, it was decided that a detailed analysis is required to find out reasons in this regard and to come up with a reasonable solution on a permanent basis.

2. Requirement of immediate measures to make sure of the continuation of operations.

The committee discussed the requirement of immediate measures to address liquidity issues to ensure the going concern of the business. Also action on an urgent basis is required to ensure the continuation of business operations by resolving working capital issues, managing fuel costs and currency risk due to depreciating local currency, high staff cost and other overheads.

3. Managing Flyingair.

The committee noted that continuous loss making Flyingair is also in the picture consequent to the government decision. The committee stressed that Flyingair has been a burden to the treasury and government wanted the committee to suggest a sustainable turnaround plan regarding this. One committee member mentioned that even though the bottom line is not good, Flyingair has captured a considerable market as a low cost carrier in Asia and shows growth potential. Therefore, proper management with infusion of adequate capital is also required for Flyingair.

4. Re-capitalization options discussed.

It has been estimated that, at least, additional capital infusion of SR. 50 billion is required for Skyfly group over the next five year period and following options were proposed in that regard:

- a. Long Term Borrowing from a Local/Foreign Bank.
- b. Ask the Government Treasury to issue long term bonds privately and Skyfly to issue shares to government for the funds they receive.
- c. Go for an IPO by listing Skyfly Catering to raise the expected capital – the committee was very keen on this and all were of the view that this would be an attractive option.

- d. Private placement (part of shares to private investors locally) to sell part or whole of government stake.
- e. To find a foreign institutional investor to join Skyfly and it was decided that Chairman will deal with a few foreign institutional investors and will have initial discussions in this regard.

However, the SECo decided **against options (b) and (d)** above.

Committee requested Chairman to communicate with TDI consultants and come up with recommendations on the **three** selected re-capitalization options considered above.

5. Ongoing financial management, operational and strategic issues of Skyfly group

The committee discussed the ongoing issues of Skyfly and requested TDI consultants to conduct further analysis in this regard and to come up with recommendations for the same which will be considered in drafting the restructuring plan, in the near future.

Exhibit 3 - E-mail from Chairman SECo to Mr.Travin

Date : December 5, 2012
From : chairman@seco.skyflyairlines.com
To : travin@TDI.com
Subject: **Consultation – Capital infusion options and other issues**

Dear Travin,

Further to the telephone conversation I had with you this morning on the above captioned matter, I would like to bring to your notice the following.

I. Re-Capitalization Options

A. Long Term Borrowing: two banks have provided proposals as follows:

	Bank A (Foreign Bank)	Bank B (Local Bank)
Loan Amount	SR. 50 billion	SR. 50 billion
Disbursement	Year 1 - 20 billion Year 2 - 15 billion Year 3 - 10 billion Year 4 - Balance	Year 1 - 25 billion Year 2 - 20 billion Year 3 - 5 billion
Security	Mortgage Bond	Mortgage Bond
Rate	4% +AWPLR *	18% per annum

* AWPLR - Average Weighted Prime Lending Rate

B. Foreign Institutional Investor -Asianfly

Please refer the mail from Mr.Jamal of Asianfly (which I have forwarded to you this morning); please briefly comment on the proposal from Asianfly on the following concerns.

- I. Possibility of selling more than 50% of the stake by government or negotiate to sell less than that and have other alternative arrangements
- II. Transferring management control to Asianfly – totally or partly
- III. What are the strategic advantages of joining Asianfly group
- IV. Whether to sell catering arm to Asianfly or not (if it is proposed to sell, what should be the minimum offer price) and what are the disadvantages/advantages in selling catering arm to Asianfly

C. IPO –Skyfly Catering (Pvt) Ltd.

Can you please comment on the proposal? Special concerns would include but are not limited to the following:

- I. Possibility of going for IPO by the catering arm to raise funds for the parent
- II. Legal, ethical and other concerns (insight would be adequate)

II. Financial Management/Strategic and Operational Issues and Reasonable Suggestions

It is better to discuss all ongoing issues and suggest both short term and long term measures to overcome such issues and turnaround the business.

As we discussed, the committee is ready to suggest a major restructuring exercise as a permanent solution to concurrent issues at Skyfly Airlines including the new wing Flyingair. Areas of concerns would include but are not limited to the following:

- Day to day financial management and financial risk management
- People/culture (need a change and additional investment)
- Physical resources to increase capacity including fleet modification
- Marketing and branding/ increasing revenue
- Enhancing competitiveness and overall strategy/ies – (whether to concentrate on core sector or diversify) / new business /re-launching existing business
- Capital structure
- Operational cost and how to manage operational cost at a reasonable level to compete in the market (better to consider macro environment aspect as well)

I hope you will be able to come up with attractive proposals which would be beneficial to the committee in finalizing the restructuring plan as they want to develop it as a "comprehensive, 360-degree plan" that reinvents Skyfly.

If you need further information and assistance in this regard, please contact me at any time.

Best regards,

The Chairman - SECo

Exhibit 4 - Letter from CEO –Asianfly to Chairman –SECo Committee

3 December 2012

The Chairman,
SECo Committee,
Skyfly Airlines Ltd.,
No.53, Harban Road,
Combilo, Serendib.

Proposal to Invest in Skyfly Airlines

With reference to the telephone conversations had with you and your e-mail correspondence with other supporting information in this regard, I'm pleased to inform you that our board is in favour of your invitation and would like to proceed with further negotiations to have a strategic business relationship with your company.

The board had a few meetings to discuss your invitation for proposals. Accordingly I would like to forward the board proposals which are as follows:

“Considering the strategic advantages, the board agreed to have a strategic relationship in the future with Skyfly Group. The board proposes the following options to the SECo of Skyfly Airlines:

Option I. Agreed to purchase more than 50% of the shareholding of Skyfly subject to the conditions that Asianfly would retain management control and freedom in decision making.

OR

Option II. If the existing shareholders do not want to dilute the ownership below 50% and lose the management control of Skyfly Airlines, we would invest for a non-controlling interest, subject to the condition that, Skyfly Catering (Pvt) Ltd. is carved out from Skyfly group and Asianfly to be the controlling shareholder. Asianfly is ready to purchase even 100% of shares of Skyfly Catering (Pvt) Ltd.

Price is negotiable subject to a minimum offer price after an independent valuation and due diligence have been carried out.

I hope you will give us a favourable response in this regard. Also we welcome any other options from your-end and we can negotiate further if necessary.

Should you have any concerns over what we have proposed and need further clarification, please do not hesitate to revert to the undersigned as soon as possible.

We look forward to a positive response in this regard.

Yours faithfully,

Jamal Rajudeen
CEO - Asianfly

Exhibit 5 - News Paper Article – Union issue and resigning of key pilots

“Instead of subsidizing Skyfly, the Serendib government should promote competition and efficiency in Skyfly. That way, everyone, especially the consumer, wins”

In the second week of November 2012, the board of directors of Skyfly, met in Combilo to discuss the deteriorating situation of the Company. This followed strikes organized by labour unions on November 07, 2012, in which a majority of Skyfly employees took part. These strikes caused major financial damages to the already loss-making Company, bringing it a step closer to bankruptcy. The stormy meeting led to the resignation of the entire board of directors, over their “failure” to work out an amicable solution with agitating labour unions. Amidst this turmoil, many pilots and key technical staff have quitted and joined other airlines.

Exhibit 6 - Extract of budget proposal 2013- Government Policy on tourism

- The government strategy to develop the tourism industry to attract 2.5 million high spending foreign tourists and an equally large number of domestic tourists has produced encouraging results. It attracted one million foreign tourists and a dollar billion foreign earnings this year. The Hotel industry has expanded with new room capacity, refurbishment of existing facilities, and building of more than 38 new hotels. Existing coastal tourist resorts are in places positioned well for high spending tourists. Investments by internationally reputed hotel companies have increased with at least 7 global brands taking position in this industry.
- In order to assist domestic entrepreneurs to create greater value in the tourism economy, it is proposed to offer a 25 percent discount on the lease rental determined by the Government Chief Valuer for the entire term, to all local investors.
- The bio diversity and the wide range of tourism resources available have enabled local enterprises to brand diverse tourism products.
- In order to assist domestic entrepreneurs to create greater value if any foreign investor forms an equity partnership of at least 30 percent with local investors, it is proposed to offer concessions on land leasing. The sale of state land to foreigners will be prohibited. Lease of state land to foreigners will be permitted subject to the payment of a 100 percent tax on the lease value determined by the Government Chief Valuer for the entire lease period, that is payable upfront unless the prescribed investment requirement by way of a foreign remittance is exceeded.
- It is proposed to invite and sponsor media personalities, TV crews, journalists and promoters from key up market global travel publications to promote Serendib as an up market tourist destination. It is proposed to allocate SR. 100 million for this from the Tourism Development Authority Fund, to meet the cost of their air tickets and related international transport. It is expected all up market tourist hoteliers to provide free accommodation and other facilities to such visitors to make this venture a success.

Exhibit 7 - Current Financial Commitments of Skyfly Airlines Ltd. (notes from audited financial statements)

- a) Company's total minimum lease commitment under non-cancellable operating leases as at 31st March

	2012	2011
	SR. million	SR. million
Within one year	13,270.28	7,411.28
After one year but not more than five years	55,150.99	24,187.00
Later than five years	9,575.19	1,894.18
	<u>77,996.46</u>	<u>33,492.46</u>

- b) The remaining lease rental commitments for lands, leased by the Company for a period of 16 years, as at 31st March

	2012	2011
	SR. million	SR. million
Within one year	336.73	310.72
After one year but not more than five years	1,412.78	1,377.06
Later than five years	3,461.75	3,787.36
	<u>5,211.26</u>	<u>5,475.14</u>

Exhibit 8. - Additional Financial Information of Skyfly Catering (Pvt) Ltd

As at/for the year ending 31st March	2012	2011
	SR million	SR million
Assets	7,898.49	5,490.86
Liabilities	2,965.32	3,362.99
Acquisition of Property, Plant & Equipment	87.32	65.34
Depreciation and Amortization	255.84	344.24
Operating Expenses	2,337.97	1,816.35