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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

TOP CA CASE STUDY EXAMINATION - DECEMBER 2010

Important - This question paper should be answered entirely in the **ENGLISH** Language only.

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

Time allowed : 4 Hours

Marks : 100 marks

Instructions

1. This question paper should be answered entirely in ENGLISH language.
2. Your answer must be submitted in the answer booklets provided at the Examination Hall.
3. Any pre-prepared papers included in your answer WILL NOT be marked.
4. It is advised to spend about 2 hours in drafting the report.
5. After the instruction to stop writing at the end of the paper, you will be given five minutes to assemble your answer.

NF DIVESTS NFC

You are Upul Nawaratna (UN), working as an executive for the Chartered Accountancy practice of Sanath Dayananda, a national firm with offices in Colombo, Galle and Kandy. Your firm is the Sri Lankan member of 'Vision Capital'(VC), a UK based corporate consulting group. Vision Capital UK is headed by a globally recognized author for strategic management. You are located in the Colombo office and are currently working for Sandani Gamage, a senior manager working for Mr. Jon Lloyd- the UK representative and the head of the business advisory department of the firm.

Deshamanya Neel Gunawardana of NF Plc. has sought VC Colombo's assistance in order for him to determine on the new business strategy.

Requirement:

You are to prepare a report to the Chairman of NF Plc., as set out in the letter from Mr. Neel Gunawardana (Exhibit 1), and Ms Sandani Gamage's memo to you (Exhibit 2).

Separate your assumption/s (if any) and limitations from the report.

Explanatory Note

Financial year ending date for all the financial information given in Appendix 1 to the Advance Information, including the accounts of Ranbima Dairies given as 31 December, should be 31 March of every year.

Exhibit 1



NEELAGIRI FOODS PLC

Colombo 02 Sri Lanka.

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enquire@nf.com

www.neelagiri.com

08th December 2010

Sandani Gamage
Vision Capital Colombo

STRICTLY CONFIDENTIAL

Dear Sandani,

This is further to the discussions we had.

I reviewed the spin-off proposal by Mr. Gamini Jayasekara.

You are aware that I had avoided being acquired by FAF in 2004. Similarly, I do not believe in selling NFC. However, NFC would be the largest chain of restaurants if Denny's join with us. Gamini brought me this proposal, to avoid the developing issues at NFC. He is over-confident, and often overestimates. I do not think Denny's would allow us to continue our traditions at NFC. I am prepared to change, but NFC does not have any business issue to sell it fully or partially. Please advise.

All these issues were artificially created by so-called managers. Our HR manager disagrees with my pay policies; employee benefits are too much according to him. Marketing managers' role is criticized by finance managers; I have approved a number of plans rejected by FM. But I rejected FM's dividend proposal last year and this year, as the group did not do well continuously over the recent past; share is not trading in the market. But the demand for the chicken brands is high. Ranbima is performing well, with few but better managers.

Therefore my wish is to change managerial positions and not to divest NFC. Please carryout a study and point out to me the changes required urgently. I wish to have your explanations and suggestions in order to design a better business strategy.

Thank you

Exhibit 2

From: Sandani
Date: 09. 12. 2010
To: UN
Subject: Neelagiri Foods

Dear UN,

Denny's USA has expressed their willingness to invest in shares of NFC (See Exhibit 4, about Denny's). However, the discussions did not proceed far enough to culminate in an offer. Hearing this news, FAF chairman has also approached CEO of NF with an idea again. However FAF is to acquire the entire company, at Rs. 68 per share. Mr. Gamini Jayasekara thinks it is the right time to sell the restaurant division entirely at \$ 3 mn, to Denny's.

The coupon promotion's failure (one rejected by the finance manager of NF) has created room to discuss the divesture of NFC. Now, Chairman of NF needs to decide whether NF should spin-off NFC. He was of the opinion that NFC possesses competitive advantages in the industry. He asked for other alternatives available to avoid the crisis. He also inquired about the method suggested by CEO, that the restaurant division be sold off changing the management. Would it be the best for the group?

I have attached the documents done by CEO of NF (Exhibit 3), the projected data of NFC for next 10 calendar years. (Exhibit 5). The projections were done by CEO of NF, as a part of the proposal, under the assumption that NFC become fully owned subsidiary of NF. The NF share price movements for last 3 months and past six months operating results of the group are also given for your reference (Exhibit 6).

I think we should study the reasons for the conflicts in management functions. My view is that the group is distressed though it is not felt by the chairman, therefore we need to study the entire group and explore solutions. NF has yet to make the final decision as to whether and when the proposed spin-off will be effected. The chairman should be communicated a better strategy if the corporate separation is not suitable.

Rgds



Exhibit 3

Sell / Spin-Off of Restaurant Division

Objectives

The aim of this spin-off is to strengthen the division's autonomy and implement a flexible management system to position NFC's business for a sustainable growth, cope with the challenging environment surrounding the fast foods industry, as well as establishing an independent entity with clear responsibilities required as an enterprise. The spin-off will have no impact on NF's consolidated performance. The group's restaurant division to be separated and a new specialized company incorporated. The new company will conduct its business operations gaining freedom to function independently. The objectives include:

- * avoidance of organisational and co-ordination costs accessing the same resource complementarities as before;
- * expansion of the specialty businesses;
- * addressing growing public concern regarding discriminations and other issues pertaining to management style;
- * restructuring management and changing the traditional culture within NFC;
- * reform of the farming business;
- * improvement in the financial position; and
- * realization autonomous style of management.

Overview of Corporate Separation

A new company to be established with the issue of 3,000,000 equity shares. The alternatives are:

- NFC becomes a fully owned subsidiary of NF. No additional funds will be raised as a result of the subject spin-off.
- NF becomes the major shareholder with 51% stake.
- Sell the entire division

	New company
Trade name	Neel's Food Corner (Pvt) limited. NFC
Main business activities	No change.
Establishment	2011
Chairman	Mr. Ranil Gunawardana
Equity capital	Rs. 150 million.
Shares issued	3,000,000 equity shares at Rs. 50 each.
Total assets	Rs. 323 mn. as at 31.12.2010
Board composition	NF has the power to appoint 3 directors out of five in the board
Major shareholders and ownership percentages	NF 51%
Relationships between parties	All the top level positions become vacant. Other employees in the restaurant division of NF will be temporarily transferred to new company.

Method

At the time of separation, the new company will allocate all the shares it issues to NF. No reduction in capital will result from the corporate separation. The succeeding company will take over all assets, liabilities, and contractual positions related to, and determined to be necessary for conducting the business. NF will accept joint responsibility for the liabilities the new company inherits.

Alternatively, NF could remain the majority shareholder of NFC immediately following the proposed spin-off. This would bring additional capital to NFC. Up to 49% of equity can be offered to the buyer. The offer price to be determined and negotiated.

Business Performance Outlook as a Result of Spin-off

Group will be able to compete against other food and beverage companies in existing and future markets:

- rebuild customer confidence
- attain strong competitive positions in existing markets;
- extensive operational experience;
- strong branding expertise;
- ability to capture operating synergies

A new chief executive would be appointed to NFC. We believe we are positioned to grow our operations and establish ourselves as a market leader. Our management team will now be able to concentrate on their specific levels of expertise in order to grow revenue, expand market presence and increase earnings. This spin off is in line with our strategy of positioning NF for long-term growth, while creating value for our shareholders.

Exhibit 4



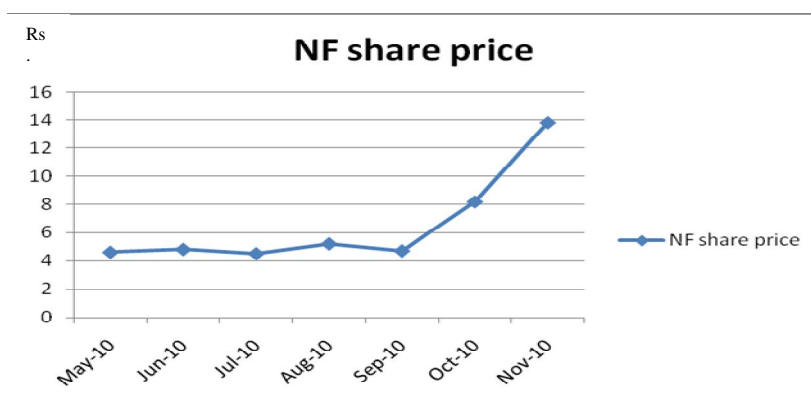
Denny's Corporation, or Denny's, is one of America's largest family-style restaurant chains. Denny's, through its wholly owned subsidiaries, Denny's Holdings, Inc. and Denny's, Inc., owns and operates the Denny's restaurant brand. At December 30, 2009, the Denny's brand consisted of 1,551 restaurants, 1,318 (85%) of which were franchised/licensed restaurants and 233 (15%) of which were company-owned and operated. Denny's restaurants are operated in 49 states, the District of Columbia, two U.S. territories and five foreign countries.

Denny's restaurants generally are open 24 hours a day, 7 days a week; provide high quality menu offerings and generous portions at reasonable prices with friendly and efficient service in a pleasant atmosphere. Denny's expansive menu offers traditional American-style food such as breakfast items, appetizers, sandwiches, dinner entrees and desserts. Denny's restaurants are best known for breakfast items. Sales are broadly distributed across each of the day parts (i.e., breakfast, lunch, dinner and late-night).

Exhibit 5
NFC projected operating statement
Year ended 31st March

Rs. '000	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Restaurant sales	408,395	443,401	477,239	514,812	555,021	598,460	645,275	695,758	750,189	808,878
Franchise Revenue	28,560	29,988	32,558	35,043	37,802	40,755	43,944	47,382	51,089	55,085
Total	436,955	473,389	509,797	549,855	592,823	639,215	689,219	743,140	801,278	863,963
Payroll	118,788	124,728	123,540	123,777	123,730	123,739	123,737	123,738	123,738	123,738
Product & Other costs	292,494	307,118	315,555	325,429	335,593	346,740	358,696	371,606	385,521	400,527
profit from operations	25,673	41,543	70,702	100,649	133,500	168,736	206,786	247,796	292,019	339,698
Interest	23,730	24,917	26,162	26,686	27,219	28,580	30,009	30,309	31,825	32,143
Net	1,943	16,626	44,540	73,963	106,281	140,156	176,777	217,487	260,194	307,555

Exhibit 6



Internal Accounts
Profit and Loss Accounts
for the six month period ended 30th Sept. 2010

Rs. Mn	NF Group	Ranbima Dairies	NFC
Revenue	1,119.1	296.3	166.5
Cost of sales	(633.6)	(183.7)	(124.9)
Gross profit	485.5	112.6	41.6
Other income	2.3	7.5	0.0
Amortisation of Grant	1.0	1.0	0.0
Distribution costs	(127.5)	(36.8)	(3.0)
Administrative cost	(177.1)	(17.0)	(60.2)
Other expense	(10.5)	-	0.0
Profit from operations	173.7	67.3	(21.6)
Finance expense	(56.0)	(9.0)	(11.3)
Profit before tax	117.7	58.3	(32.9)
Income tax	(0.8)	(6.4)	(0.0)
Net income	116.9	51.9	(32.9)