

**SINGAPORE CA QUALIFICATION (PROFESSIONAL) EXAMINER'S REPORT**

**MODULE:** Business Value, Governance and Risk (BG)

**EXAMINATION DATE:** 21 June 2023

**General comments**

The June 2023 BG examination consists of a single company case study with financial and industry data covering four questions across the BG syllabus, with each question covering particular syllabus areas, consistent with prior examinations.

Singing Sauces Limited (“Singing Sauces”) is a listed company on the Singapore Exchange (SGX) that manufactures a range of sauces branded as “Singing Sauces” which are very popular in Singapore households and are commonly used by many restaurants and street food establishments in Singapore. Singing Sauces was established over forty years ago and listed on the Singapore Exchange over fifteen years ago as it expanded to become one of Singapore’s best-known food products. During this time, Singing Sauces has diversified into the manufacture of other processed food products. However, its Singing Sauces range remains its most well-known and successful product range. In order to expand, it is considering the acquisition of an instant noodle manufacturer based in Malaysia which provides growth and synergy opportunities from cross selling respective product ranges in Singapore and Malaysia. Singing Sauces is facing increasing external risks and some internal governance issues.

**Business valuation learning outcomes are covered by Questions 1 and 4.**

Question 1 required Candidates to calculate a suitable risk-adjusted discount rate for Singing Sauces for the purpose of valuing Food Express and an estimated equity valuation for Food Express using the free cash flow to the firm valuation method. The valuation should be for 100% of Food Express shares. The question also required Candidates to evaluate valuation sensitivities.

Question 4 required Candidates to explain two types of foreign exchange risk and explain the impact of each risk on the company. The question also required Candidates to evaluate the share for share merger offer from Singing Sauces to acquire Food Express and consider the impact on each group of shareholders. The question also required an evaluation of acquisition synergy and a discussion of further opportunity for synergy which may be gained following the acquisition of Food Express.

**Risk and Governance learning outcomes are covered by Questions 2 and 3.**

Question 2 focused on risk evaluation at Singing Sauces with impact analysis and recommendations for a suitable risk mitigation strategy which will address the potential consequences of each risk discussed.

Question 3 focused on compliance and governance issues at Singing Sauces with the first requiring an explanation of the FOUR issues included in the internal audit report and then recommending TWO actions that will help to improve or resolve each issue. The question also asked Candidates to apply the six capitals to Singing Sauces and how the company can ensure each capital is sustainable to the company in the future.

As with prior BG examinations, it was noted that overall Candidate performance was marginally better on the numerical elements of the examination than on the discussion requirements. Some Candidates are still providing written explanations which are too brief, vague, generic or do not reference the facts or company and its products provided in the question paper. The advice for future Candidates is to use the case facts to provide detailed and specific explanations which directly respond to the nature of the requirement. Candidates are advised to practice their written explanation skills as part of their BG examination preparation.

### Question 1

**Part (a)** required Candidates to calculate a suitable risk-adjusted discount rate for Singing Sauces for the purpose of valuing Food Express. Most Candidates who performed well were able to apply the appropriate formula to determine the WACC with suitable workings. Some Candidates were not able to interpolate an 18-year bond from the information presented.

**Part (b)** required Candidates to calculate an estimated valuation for Food Express using the free cash flow to the firm valuation method. The valuation should be for 100% of Food Express shares. This requirement was generally performed very well, which is in line with the expectation for numerically based calculations. Candidates presented their workings clearly which made it easier for markers to follow. Some Candidates made small errors in cost and revenue growth, the calculation of depreciation and the add back of non-cash flows. Some Candidates failed to deduct the value of debt from the enterprise value to obtain the equity value.

**Part (c)** required Candidates to evaluate the change in valuation of Food Express calculated in **part (b)** if changes to the assumptions made by the Directors of Singing Sauces occur simultaneously and explain the result. This requirement evaluated the Candidate's ability to understand the sensitive nature of valuation assumptions. Most Candidates were able to adjust their valuations for the sensitivities listed in the scenario. However, most Candidates were unable to explain the relationship between additional risk and lower valuation and instead chose to explain the numerical adjustments in words.

## Question 2

**Part (a)** required Candidates to describe each of the eight risks identified in the scenario for the purpose of inclusion in Singing Sauces' risk register. Responses for this part of the question were surprisingly mixed as some Candidates were unable to elaborate upon the information included in the scenario. This part of the question required Candidates to explain the *root cause* of each risk identified and why it was relevant to Singing Sauces, such as increased demand and reduced supply increasing inflationary pressure. Only a minority were able to provide sufficient, scenario-based detail to explain the root cause of each risk and whether they were significant for Singing Sauces.

**Part (b)** required Candidates to discuss the potential consequences of each risk described in **part (a)** which will aid the evaluation of risk at the next Board meeting. Candidates generally were more successful with this part of the question as they were able to link the risk to the impact on production, to customers, to product prices, to capacity and to profit. Some Candidates made generic statements which failed to bring in Singing Sauces, or its products, or use the facts in the scenario which is a learning point for future Candidates.

**Part (c)** required Candidates to determine a suitable risk mitigation strategy which will address the potential consequences of each risk discussed in **part (b)**. Whilst Candidates generally performed well, some Candidates failed to articulate practical and scenario specific solutions such as the use of inventory management, hedging techniques and disaster planning. Candidates who provided muddled or generic responses scored partly or not at all.

## Question 3

**Part (a)** required Candidates to explain why each of the four issues included in the internal audit report may impact on the effectiveness of Singing Sauces strategic or sustainability performance. Candidates' responses were mixed with some only restating what had happened rather than assess the impact of those issues on the firm's strategic performance and sustainability performance and how this may lead to poor overall decision making. Some Candidates re-stated the case scenario, discussed the present problem and current processes.

**Part (b)** required Candidates to recommend two actions for each issue explained in **part (a)**, that will help to improve or resolve the issue. This part was not as well answered generally as compared to **parts (a) and (c)** as many elaborated on the issue instead of recommending how to improve or resolve the issue.

Some Candidates failed to recognise that the problems sat with behaviours of the Chair and CEO and chose instead to punish the non-executive directors (NEDs), where guidance by the Chair and NED training could have been a more positive approach.

**Part (c)** required Candidates to identify one example of each form of capital at Singing Sauces and for each example, explain how Singing Sauces can apply corporate governance mechanisms to ensure its continual and sustainable supply.

Most Candidates were able to identify each of the six forms of capital at Singing Sauces by applying specific examples. However, some Candidates struggled to articulate precisely how each source of capital could be proactively sustained at Singing Sauces by its Board, with some Candidates failing to address this part of the question.

#### Question 4

Overall, question 4 was the weakest performing question of the paper.

**Part (a)** required Candidates to explain two impacts of foreign exchange risk which Singing Sauces will be exposed to as a result of acquiring Food Express. Generally, Candidates were able to distinguish between transaction, translation and economic risks and link this to the operating activities of Singing Sauces and Food Express.

**Part (b)** required Candidates to explain the impact following the implementation of exchange controls by the Malaysian Government and recommend one measure which the Board of Singing Sauces could implement to counter the impact. Some Candidates were unable to provide specific details of how foreign exchange control impact could be mitigated against. Many Candidates did not make the link between delayed foreign exchange and the risk that the currency could reduce in value during this time due to the movement in exchange rates and limit Singing Sauces' ability to immediately maximise the benefit from the cash profits generated in Malaysia.

**Part (c)** required Candidates to explain ways of how the regulatory framework for mergers and acquisitions for listed companies in Singapore aims to protect the shareholders of Singing Sauces and the shareholders of Food Express. Candidates mostly performed satisfactorily and were able to articulate different protections provided by merger and acquisition regulations to shareholders. Few Candidates viewed this separately from the acquiring shareholder perspective and the target shareholder perspective, although this was not a barrier to gaining full marks, but it may in future requirements.

**Part (d)** required Candidates to calculate the number of new Singing Sauces shares which will be awarded in exchange for existing Food Express shares under a share-for-share exchange offer proposed by Singing Sauces to acquire Food Express, and determine the percentage holding in the new group by Singing Sauces shareholders and by Food Express shareholders, respectively. This question part was fairly well performed.

**Part (e)** required Candidates to calculate the estimated value synergy arising from the acquisition of Food Express and explain the result using discounting techniques

and the assumptions made by the Directors of Singing Sauces. Candidates were able to provide a suitable valuation for synergy. However, a common error was to include the whole company cashflows, and not the cashflow increment which was due to synergy, which significantly overvalued the overall valuation synergy. It was evident that some Candidates ran out of time during the examination as they did not answer this part. This is also the worst performing part of Question 4.

**Part (f)** required Candidates to discuss one other potential source of revenue and cost synergy which could be realised if Singing Sauces proceeds with the acquisition of Food Express. Whilst some Candidates repeated the revenue synergy already included in the scenario, other Candidates were able to suggest other revenue and costs synergies well. Some Candidates did not answer this part which indicated they were short on time, or offered very brief, generic answers which failed to gain marks.