



TPE 2020 – Case Study Part 2

W L Fitness

©ICAS 2020



CASE STUDY

It is now early November and Dougie has asked you to come into his office for an update on W L Fitness and details of some additional work that he would like you to complete.

Dougie says, "I had an interesting meeting with Kat and Pascal this morning. They found the business review you prepared really helpful.

"So much so that they are keen to ensure that they follow up on your recommendations even if the corporate status of W L Fitness changes."

"Sorry, what do you mean if the status changes?" you look up, surprised by this comment.

"Thought that might get your attention." Dougie continues, "Well, it turns out that Kat and Pascal are fed up with all the reporting and regulations that they need to adhere to because of their AIM status and they'd like us to help them put a proposal together to take to the board, recommending that the company delists."

"If I remember correctly, I think the institutional investors own about 40% of the company," you say, surprised that you were able to remember this.

"37.5% actually, counters Dougie, "So I need you to do some additional work for me please. They would like an estimate of how much finance they would need if they were to buy back the shares from the institutional investors, so I'll need you to come up with a figure for how much that would be."

"So, you want me to consider a range of appropriate valuation methods and recommend a value for the company in the circumstances?"

"Yes, that's what I said wasn't it? Obviously, we know the current share price, but it has been volatile and the institutional investors may want Kat and Pascal to pay more than the current price. They both have substantial wealth, but they may not wish to commit all of it, so you need to suggest other sources to make up any shortfall.

"You need to prepare a briefing note for them which also covers the impact of delisting and how it might be financed, with any other points you think will be of interest to them. That all make sense to you?"

"Yes, no problem, was there anything else you needed me to do?"

"Most definitely, yes. The main news from my meeting this morning was that Kat and Pascal updated me about the company's investment plans. If you remember, you made some suggestions on sources of finance."

"Yes, it was to finance an investment of around £30 million. What are their plans?" you replied.

"Well, interestingly, they are considering a few options with a view to undertaking one or more. They have asked us to review their initial calculations (Appendix 1) and to include them in a report to the board. Please could you check the reasonableness of the figures and assumptions. There is no need to recalculate if you find any errors. We can assist with this later once they have selected the best combination of options."

Dougie continues, "At this stage it will be useful to highlight any other factors that would be relevant when assessing the options. Please comment on how each option would be treated in the financial statements too? You should add these matters to the report.

"I will email over the workings for you to review but I think it would help if I give you a brief run through of each potential investment. There are four possible options.

“The first is to develop a Zone Ten mobile App for members to use to book fitness classes, personal training sessions, tennis courts and so on. The plan would be to introduce some personal fitness data too.”

You interrupt, “I’ve got something similar for the gym I go to, it’s really good, I’m surprised they don’t have it already.”

“Well, you’d know more about that than me, exercise is not my thing!” Dougie grins.

“Ok, the second is to acquire the trade and assets of a small chain of gyms, around eight I think. Interestingly they are based in northern France. Reading between the lines I think that this is Pascal’s idea, I get the impression he would like to move back to France and if the business expands in this way there is a real possibility of this happening. The club is called Le Bon Club de Santé, but it seems to have been shortened to Le Club. Vive la France eh, might be worth recommending this one just to get a ‘working’ trip to France. I’ll make sure you are on the team, we could get to know each other a little better, a cosy dinner for two maybe?”

“I’m not sure that...”

“I was joking, forget I said anything. So that was option 2. Option 3 is a refurbishment programme for all the Zone Ten clubs. This refurbishment is likely to attract additional members and so boost profits, but the benefits will start to reduce over time as wear and tear takes effect.

“The last project would be for UK expansion by identifying suitable sites and building new gyms, probably a couple of new gyms every three years.”

“That all sounds very interesting, I will start drafting the report straight away. Was there anything else you needed me to do?” you ask.

“Actually yes, following on from the business review they have asked for some additional consultancy work on suggestions for how to improve the membership numbers of Zone Ten. Would you be able to include this in the draft report for the board? I’m thinking it should cover ways to retain existing members and how to attract new members.

Dougie concludes, “Would you be able to let me have a first draft later today? I’m seeing Kat and Pascal tomorrow for a lunch meeting and I would like to run through the report with them when I see them. Any questions?”

“No, I don’t think so. Actually yes, do you want me to include a section on funding the investment options within the report?”

“No, that won’t be necessary. I’ve already talked this through with Kat and Dominique and they are looking into the points we raised.”

“OK, great then, I’ll get the first draft of the briefing note and report over to you by this evening.”

“I look forward to it. I’m out at clients for the rest of the day so just email it over and I’ll pick it up when I get home tonight.”

Required:

- Submit, without amendment, the work undertaken this morning
- Prepare the briefing note requested by Kat and Pascal
- Prepare the draft report to the board covering the following:
 - A review of the strategic investment options available to W L Fitness
 - Suggestions of strategies for membership retention and growth
- Prepare an email for the ethics partner, if required

Appendix 1

Strategic investment opportunities Development and launch of Zone Ten App

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
£'000						
Operating profit		300	275	250	200	150
Development and launch costs	(1,000)					
Maintenance		(20)	(20)	(20)	(20)	(20)
	(1,000)	280	255	230	180	130
Cost of capital 5%	1.000	0.952	0.907	0.864	0.823	0.784
Present value	(1,000)	267	231	199	148	102
NPV £'000		-53				

Acquisition of Le Bon Club de Santé

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6 - 10
€'000							
Operating profit		3,000	3,359	3,762	4,213	4,717	5,282
Goodwill	(7,000)						
Property	(18,000)						
Equipment	(7,000)						
	(32,000)	3,000	3,359	3,762	4,213	4,717	5,282
Cost of capital 5%	1.000	0.952	0.907	0.864	0.823	0.784	3.392
Present value	(32,000)	2,856	3,047	3,250	3,467	3,698	17,917
NPV €'000		2,235					

Exchange rate on 1 November 2019
1 GBP: 1.2 EUR

Club upgrade programme	Year	Year	Year	Year	Year	Year	Year	Year	Year	Year	Year
£'000	0	1	2	3	4	5	6	7	8	9	10
Incremental operating profit		11,200	8,960	7,168	5,734	4,588	3,670	2,936	2,349	1,879	1,503
Equipment	(30,000)										
	(30,000)	11,200	8,960	7,168	5,734	4,588	3,670	2,936	2,349	1,879	1,503
Cost of capital 5%	1.000	0.952	0.907	0.864	0.823	0.784	0.746	0.711	0.677	0.645	0.614
Present value	(30,000)	10,662	8,127	6,193	4,719	3,597	2,739	2,087	1,590	1,212	923
NPV £'000	11,849										

Organic growth	Year	Year	Year	Year	Year	Year	Year	Year	Year	Year	Year
£'000	0	1	2	3	4	5	6	7	8	9	10
Phase 1		800	896	1,003	1,123	1,258	1,409	1,577	1,766	1,978	2,215
Phase 2				800	896	1,003	1,123	1,258	1,409	1,577	1,766
Phase 3							800	896	1,003	1,123	1,258
Incremental operating profit		800	896	1,803	2,019	2,261	3,332	3,731	4,178	4,678	5,239
Property	(2,000)			(2,000)			(2,000)			(2,000)	
Equipment	(500)			(500)			(500)			(500)	
	(2,500)	800	896	(697)	2,019	2,261	832	3,731	4,178	2,178	5,239
Cost of capital 5%	1.000	0.952	0.907	0.864	0.823	0.784	0.746	0.711	0.677	0.645	0.614
Present value	(2,500)	762	813	(602)	1,662	1,773	621	2,653	2,829	1,405	3,217
NPV £'000	12,633										

END OF PAPER