

Saman Herath, the chairman of CAPL had a series of discussions with the directors and shareholders of the company, regarding the automation of the factory, and increasing its capacity, in order to improve the profitability of the company. Saman mentioned that his friend Ravi and Ravi's wife own 30% and 70% of Juizie (Pvt) Ltd (Juizie) respectively, and that Juizie uses new machineries in its business operations which are similar to CAPL. They have decided to sell the shares of Ravi's wife in Juizie, or to sell its machineries. Now CAPL has the option of either buying 70% of Juizie, or buying its machineries without any of the processes. CAPL will first opt for an IPO and generate new equity capital of Rs. 500 million for this new investment.

The statement of financial position of Juizie as at 31 March 2019 is as follows.

	Rs.'000
Non-current assets	
Machineries	450,800
Equipment	332,100
Motor vehicles	350,250
	1,133,150
Current assets	
Inventories	11,540
Receivables	9,120
Cash and cash equivalents	2,100
	22,760
Total assets	1,155,910
Equity and liabilities	
Equity	
Stated capital	700,000
Retained earnings	(209,290)
	490,710
Non-current liabilities	
Borrowings	500,200
Current liabilities	
Borrowings	142,000
Payables	23,000
	165,000
Total equity and liabilities	1,155,910

Additional information has been given assuming the purchase under either option would be taking place on 1 April 2022.

1. The fair value of machineries has been estimated as Rs. 630 million as at 31 March 2022. The cash price of machineries is equivalent to the fair value.
2. CAPL has to pay the fair value of machineries of Juizie, if the machineries are purchased. CAPL has agreed with the following payment plan.

- Rs. 500 million should be paid immediately

- Rs. 150 million on 31 March 2023

3. If 70% shares of Juizie are purchased, CAPL has to pay a total consideration of Rs. 540 million, out of which Rs. 500 million should be paid immediately.

The balance will be paid one year from the acquisition date, if Juizie achieves 10% revenue growth. It is highly likely that this growth will be achieved.

4. Acquisition related costs include professional fees for machineries amounting to Rs. 1.2 million, which would have to be incurred by CAPL. Professional fees should be paid to a technician to certify the proper functioning of machineries. CAPL has to incur Rs. 3.1 million as expenses in addition to the above fee to facilitate the acquisition.

5. On 1 April 2022, Ravi's shareholding in Juizie will be recognised, at proportionate share of net assets.

6. Juizie has a 'brand name' and CAPL seeks an independent valuation for it. The valuation could not be completed before authorisation of financial statements for the year ended 1 April 2022 for issue. The brand has a provisional fair value of Rs. 28 million. CAPL will receive the results of independent valuation before the financial year end.

7. Juizie had appointed a CEO under a 10 year contract. The contract requires Juizie to pay Rs. 5 million to the CEO, if Juizie is acquired before the contract expires. The contract has another 2 years to expire from 1 April 2022.

The management of CAPL wants to know whether this would have any impact, if CAPL acquires 70% shares of Juizie.

8. Use 15% as the discount rate and 28% as income tax rate, for any calculations required.

Required:

(a) Compile a briefing note to the board of directors of CAPL to include the impact on the financial statements of CAPL as at 1 April 2022:

(i) if CAPL acquires machineries of Juizie

(ii) if CAPL acquires 70% shares of Juizie (20 marks)

(b) Assuming that CAPL selects the option (ii) above, advise the board of directors of CAPL on how the results of the independent valuation of the brand name, should be considered, in the consolidated financial statements of CAPL, as at 1 April 2022. (5 marks)