3 Five years ago the Patel family invested in a new business, Flufftort Co, which manufactures furniture. Some family members became directors of Flufftort Co, others have not been actively involved in management. A venture capital firm, Gupte VC, also made a 20% investment in Flufftort Co. A representative of Gupte VC was appointed to Flufftort Co's board. Flufftort Co also took out a long-term 8·5% bank loan.

Sales have generally been disappointing. As a result, members of the Patel family have been reluctant to invest further in Flufftort Co. Over the last year Gupte VC has taken a tougher attitude towards Flufftort Co. Gupte VC pressurised Flufftort Co to pay a dividend of $2 million for the year ended 30 June 2015. Gupte VC has also said that if Flufftort Co's financial results do not improve, Gupte VC may exercise its right to compel Flufftort Co to buy back its shares at par on 30 June 2016.

However, Flufftort Co's most recent product, the Easicushion chair, has been a much bigger success than expected. In order to produce enough Easicushion chairs to affect its results substantially, Flufftort Co will need to make significant expenditure on manufacturing facilities and additional working capital.

Extracts from statement of profit or loss for year ended 30 June 2015 and forecast statement of profit or loss for year ended 30 June 2016

	2015	2016 Forecast
	$m	$m
Operating profit	8·0	6·0
Finance cost	(3·0)	(3·0)
Profit before tax	5·0	3·0
Tax on profits (20%)	(1·0)	(0·6)
Profit for the period	4·0	2·4
Dividends	(2·0)	–
Retained earnings	2·0	2·4

Note
The forecast statement of profit or loss for the year ended 30 June 2016 is not affected by the proposed investment. This can be assumed only to affect results after 30 June 2016. The figure shown for retained earnings in the 2016 forecast can be assumed to be the net increase in cash for the year ended 30 June 2016.

Summarised statement of financial position as at 30 June 2015

	$m
Assets	
Non-current assets	69·0
Current assets excluding cash	18·0
Cash	7·6
Total assets	94·6
Equity and liabilities	
Share capital ($1 shares)	50·0
Retained earnings	2·6
Total equity	52·6
Long-term liabilities	
8·5% Bank loan	30·0
9% Loan note	5·0
Total long-term liabilities	35·0
Current liabilities	7·0
Total liabilities	42·0
Total equity and liabilities	94·6

Notes

1. 55% of shares are owned by the members of the Patel family who are directors, 25% by other members of the Patel family and 20% by Gupte VC.
2. The bank loan is secured on the non-current assets of Flufftort and is due for repayment on 31 December 2019. The loan is subject to a covenant that the ratio of equity to non-current liabilities should be greater than 1·3 on a book value basis. Flufftort has also been granted an overdraft facility of up to $5 million by its bank.
3. The loan note is held by Rajiv Patel, a member of the Patel family who is not a director. The loan note is unsecured, is subordinated to the bank loan and has no fixed date for repayment.
4. If no finance is available for investment in manufacturing facilities, non-current assets, current assets excluding cash, the bank loan, loan note and current liabilities can be assumed to be the same at 30 June 2016 as at 30 June 2015.

However, the chief executive and finance director of Flufftort Co intend to propose that the company should be refinanced to fund the expanded production of the Easicushion chair. They have not yet consulted anyone else about their proposals.

Details of the proposed refinancing are as follows:

1. The members of the Patel family who are directors would subscribe to an additional 15 million $1 shares at par.
2. Gupte VC would subscribe to an additional 20 million $1 shares at par.
3. The 8·5% bank loan would be renegotiated with the bank and the borrowing increased to $65 million, to be repaid on 30 June 2022. The expected finance cost of the loan would be 10% per annum.
4. Rajiv Patel's loan note would be replaced by 5 million $1 shares.
5. The refinancing would mean non-current assets would increase to $125 million, current assets other than cash would increase to $42 million and current liabilities would increase to $12 million.
6. Operating profits would be expected to increase to $20 million in the first full year after the facilities are constructed (year ended 30 June 2017) and $25 million in the second year (year ended 30 June 2018). No dividends would be paid for these two years, as cash surpluses would be used for further investment as required. Tax on company profits can be assumed to remain at 20%.

Required:

(a) (i) Prepare a projected statement of financial position as at 30 June 2016, on the assumption that Gupte VC exercises its rights and Gupte VC's shares are repurchased and cancelled by Flufftort Co. (4 marks)

(ii) Prepare a projected statement of financial position as at 30 June 2016 on the assumption that the proposed refinancing and investment take place. (4 marks)

(iii) Prepare projected statements of profit or loss for the years ended 30 June 2017 and 30 June 2018 on the basis that the profit forecasts are correct. (4 marks)

(b) Evaluate whether the suggested refinancing scheme is likely to be agreed by all finance providers. State clearly any assumptions which you make. (13 marks)

(25 marks)