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Answer ALL questions

MFI share price crash January 2006

MFI is a company with two main parts: builders merchants and flat pack units of furniture.

In January 2006, it became the stock market's most 'shorted' stock with traders expecting further share price falls. Traders sold more than 160 million shares in the company that they did not own in the belief that they could buy them back later at a lower price.

A 25% fall in sales was the main cause of MFI's problems. Intense competition between furniture retailers and crisis talks with the banks had contributed to MFI's plight.

The Chief Executive considered the following three options:

- close 20 stores and sell the assets to other retailers
- close 2 of their 8 regional distribution centres
- sell off the loss-making flat pack part as a separate business to a private equity company.

More than 30% of the equity in MFI was held by three investment banks (Goldman Sachs, Deutsche Bank, Merrill Lynch). However, there are increasingly more private equity groups, such as 3i, buying shares in large companies with the intention of a takeover.

Sources of information

At the end of this examination paper, there are various sources of information relevant to this case. You should study all of them and use the information, together with your own knowledge and understanding of commerce, to prepare a report advising MFI. The report has been divided into a series of tasks on the following pages.

You should use commercial concepts and terms you have learnt during the course, not just the information in the sources which you have studied.

MFI is a large furniture retailer whose share price and sales have fallen. Your task is to decide which of the chief executive's options will ensure the firm's survival.



1. My task is to advise MFI about

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Q1

(Total 2 marks)

2. (a) State **two** main functions of the Stock Market.

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(2)

(b) What would a speculator owning MFI shares do if the MFI share price continued to fall?

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(4)

Q2

(Total 6 marks)

3. Discuss the advantages and disadvantages of the three options considered by the Chief Executive of MFI.

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4. Evaluate which of the three options that you considered in Question 3 would be the best for MFI.

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(Total 8 marks)

Q4

TOTAL FOR PAPER: 40 MARKS

END



SOURCE A

MFI

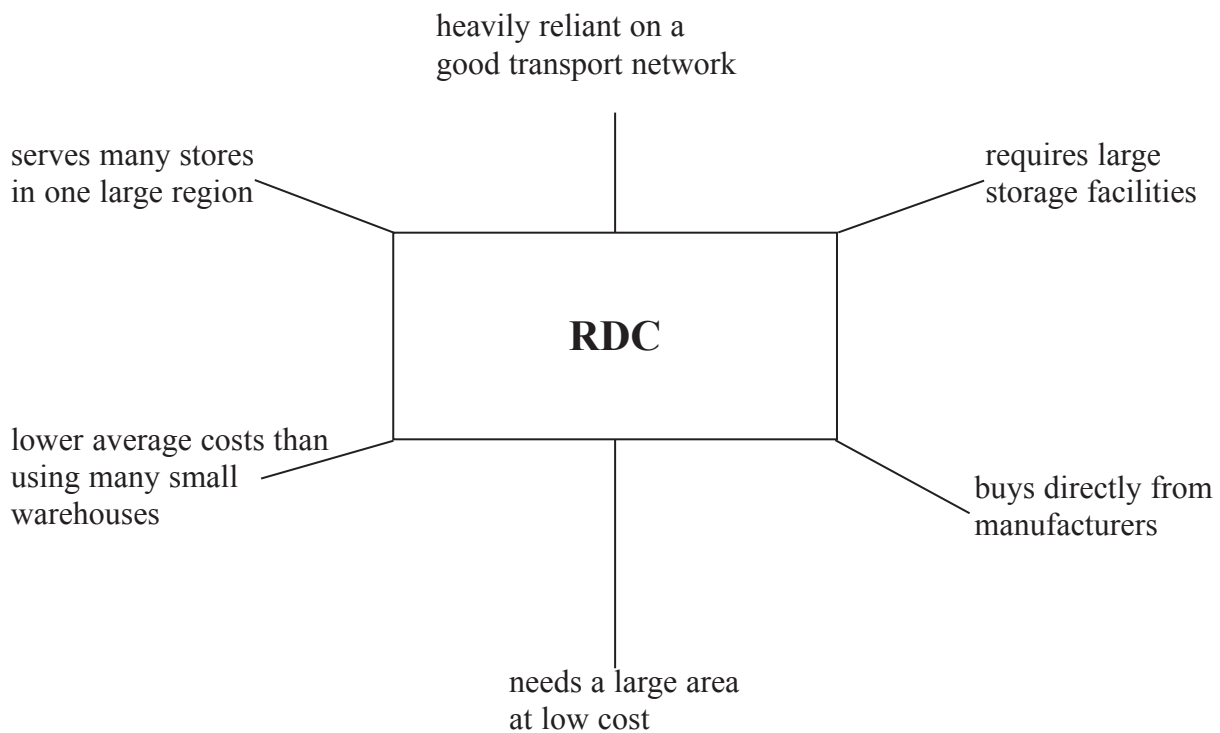
In 1964, Donald Searle and Noel Lister started Mullard Furniture Industries (MFI) from whom customers bought units and then assembled their own furniture. MFI originally sold goods by mail order and later opened stores to sell flat pack furniture, e.g. for kitchens and bathrooms.

The acquisition of builders merchants (Howden) and the development of a wholesale business sustained MFI's growth and profits. Ironically the Howden side of the business, which specialises in ready-built units for builders and the selling of goods from its wholesale business, became the most successful part of MFI.

However, in the last few years, the interest in Do-It-Yourself (DIY) has declined and a rival, IKEA, selling modern and often already assembled units, emerged. This made such retail selling even more competitive.

SOURCE B

Regional Distribution Centre (RDC)



SOURCE C

The Stock Market

The Stock Exchange is a market where stocks, shares, debentures and other bonds are bought and sold. Traders buy and sell stocks and shares on behalf of investors who wish to make a profit. This can be achieved in two ways:

- The capital gain when a plc's share increases in value, having been bought at a lower price
- The income from dividends which is often linked to a company's profitability

Speculators can either buy shares in anticipation of their price rising (bulls) or sell shares in companies which they think are over-priced (bears). This commitment to buying or selling is usually done up to two weeks in advance of settling the accounts. A trader will be 'short' when selling shares they do not have at a certain price. This is done in the expectation of buying back the shares at a lower price later, thereby making a profit.

SOURCE D

Investment Banks

Investment banks provide finance and hold shares in many companies quoted on the stock exchange. Recently, private equity groups have performed a similar role but more with a view to making takeovers.

One private equity group, 3i, said it would return £500 million to shareholders after a bumper year (2007) in which it sold out of 376 businesses. The return will be through a special dividend and a share buyback scheme.

3i made a capital profit of £260 million from asset sales totalling £1.3 billion.



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