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**FIN 203**

**Corporate Finance**

Trimester 2, 2016

Assessment 2 Instructions

1. Assessment 2 is to be completed in groups, consisting of **4-6 members**.

**AEST) Please submit the Assignment Electronically**

- It is due 11 pm Australian Eastern Standard Time (AEST)– if you are in Adelaide you need to make sure you submit at the right time. I.e. in Adelaide it is due 10:30 pm.
- The written part of your assignment will be put through Turnitin and any plagiarism will be traced and penalised.
- All relevant calculations should be included. You may insert **well formatted** Excel spreadsheet calculations.

## Part 1: Group Written Assignment

### Task Description

**Length: 1200 words**

**Due: Sunday, September 11, 2016 11:00PM**

**How to submit:** Under "Assessments" tab on the FIN 203 portal homepage.

- Please submit the Assignment electronically on the portal

**As part of this assessment you are required to conduct your own research of market and financial data online.**

### **1. Evidence of Group Work [10 marks]**

Please see **template for group meeting**. Each group must provide 3 brief records of group meetings as part of the assignment. These briefly list who was present at meetings as well as tasks and contributions.

- Completing this table
- Please note that all group members need to contribute equally to the task.
- If a group member does not contribute to the task, the group's meeting minutes can be used as evidence to demonstrate this. The student's mark can be reduced by the lecturer if they consider that there is sufficient evidence that they did not contribute.

### **2. Written assignment [90 marks]**

Consider the sources below, access other relevant resources and answer the following questions.

Source 1: 2016 Full Year Results were released on August 24, 2016.

<http://www.qantasnewsroom.com.au/media-releases/qantas-group-full-year-result-2016/>

Highlights

- Record underlying profit before tax: \$1.53 billion, up 57%
- Record statutory profit before tax: \$1.42 billion, up 80%
- Record results for Qantas Domestic, Qantas International, Jetstar Group, Qantas Loyalty

- Near-doubling of earnings per share: 49c, up 24c
- Return on invested capital: 23%, up 6.5 points
- Operating cash flow: \$2.8 billion, up 38%
- Net free cash flow: \$1.7 billion
- \$500m shareholder return: fully-franked 7c per share ordinary dividend and on market share buy-back
- Additional cash bonus totalling \$75 million for 25,000 non-executive employees
- Continued investment in aircraft cabins and wi-fi

Source 2: Qantas preliminary annual report 2016.

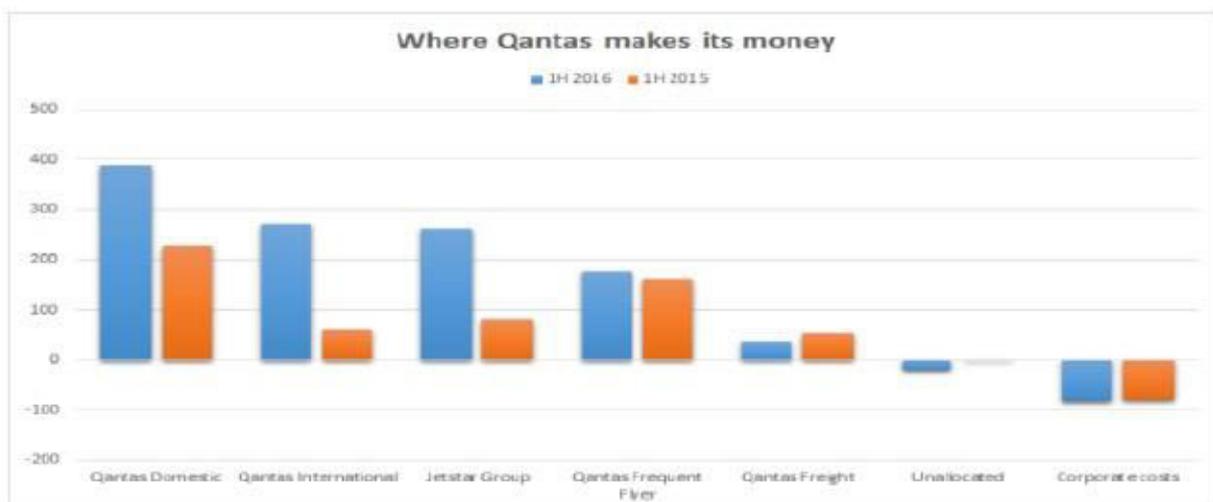
[http://investor.qantas.com/FormBuilder/\\_Resource/\\_module/doLLG5ufYkCyEPjF1tpgyw/file/full-year-results/preliminaryFinalReport16.pdf](http://investor.qantas.com/FormBuilder/_Resource/_module/doLLG5ufYkCyEPjF1tpgyw/file/full-year-results/preliminaryFinalReport16.pdf)

Source 3: Qantas annual report 2015.

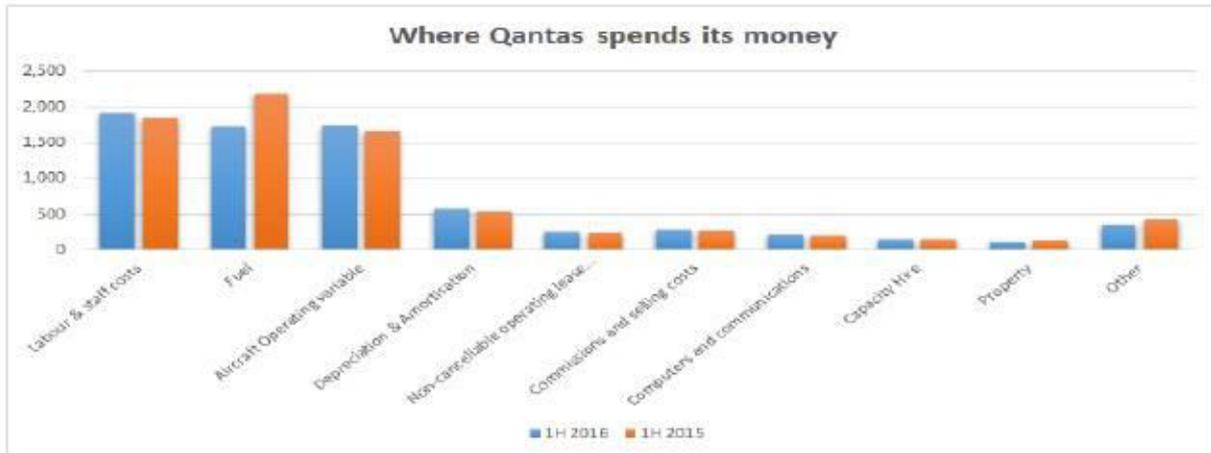
<https://www.qantas.com.au/infodetail/about/investors/2015AnnualReport.pdf>

Source 4: Miscellaneous charts.

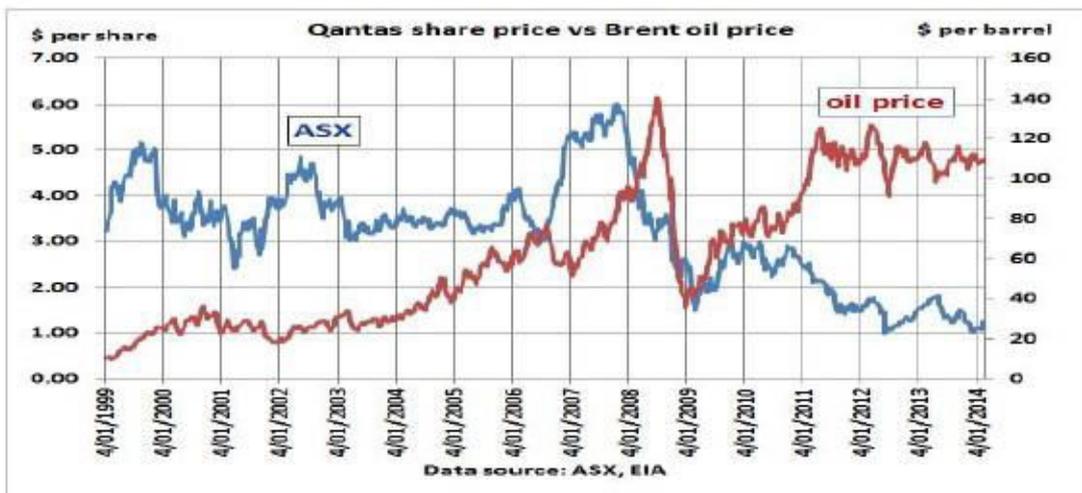
The following chart shows how Qantas has turned around the earnings before interest and tax (EBIT) of its 3 big divisions: Domestic, International and Jetstar over the past 18 months



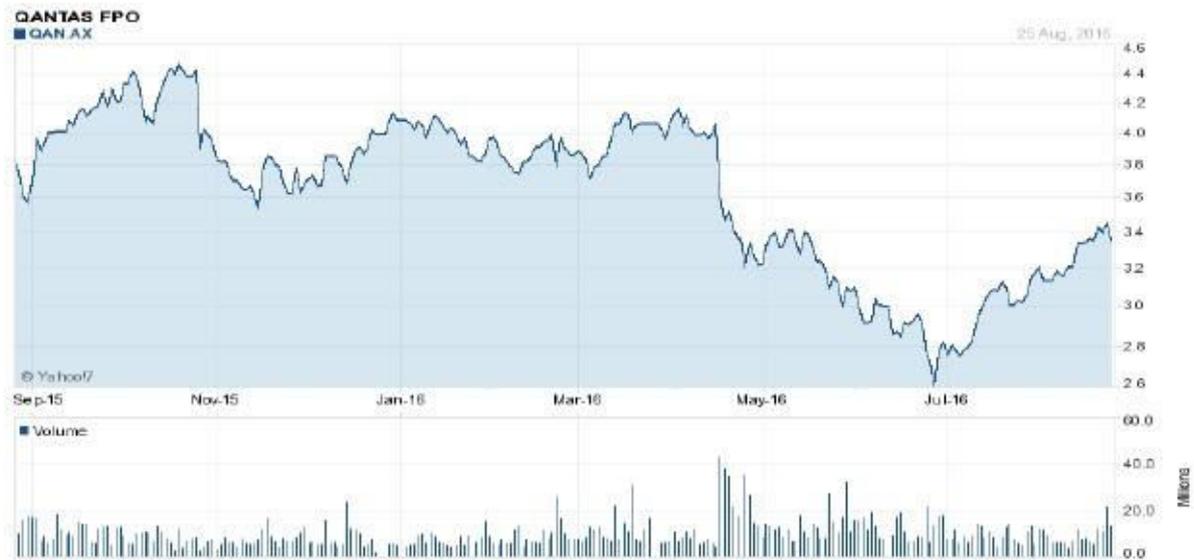
This following chart shows where Qantas spends its revenues and how the falling oil price has translated into big savings



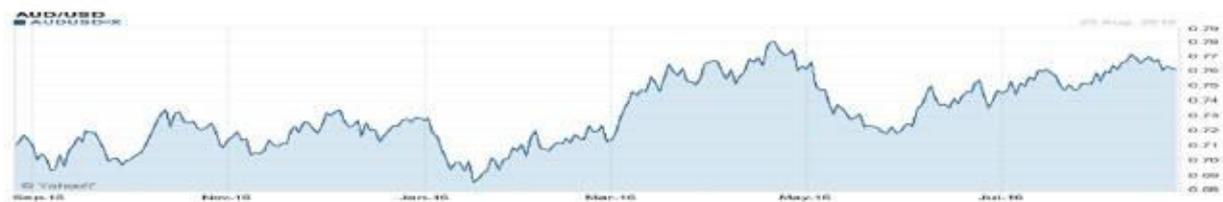
**Qantas share prices vs Brent oil price**



**Qantas share price movements Sept 2015 – to date**



**A\$ currency exchange rates 2015 – 2016**



Source 5: Venezuela’s oil economy. \_\_\_\_\_

<https://www.washingtonpost.com/news/worldviews/wp/2016/01/15/venezuelas-oil-based-economy-is-about-to-flatline-then-what/> \_\_\_\_\_

**Other Resources** \_\_\_\_\_

[http://investor.qantas.com/FormBuilder/\\_Resource/\\_module/doLLG5ufYkCyEPjF1tpgyw/file/full-year-results/investorPresentation16.pdf](http://investor.qantas.com/FormBuilder/_Resource/_module/doLLG5ufYkCyEPjF1tpgyw/file/full-year-results/investorPresentation16.pdf) \_\_\_\_\_

<http://www.iata.org/publications/economics/fuel-monitor/Pages/price-analysis.aspx> \_\_\_\_\_

## Questions

### **Part 1: Company financials [45 marks]**

Through 2014-2016 financial performance of Qantas has seen a major turnaround (refer to Source 1, 2 and 3).

- a) On Page 24 of the 2016 Preliminary Final Report shows a Return on Invested Capital (ROIC) of 16.2% in FY15 and 22.7% for FY16 (calculations showing how these figures have been derived is detailed in subsequent pages). What are the main contributing factors to this improved operating result? Explain in detail. You may want to do some research of your own, present and cite your own findings where applicable. (15 marks)
- b) Based on the 2016 Preliminary Final Report (Source 2) consolidated financial statements, calculate average interest bearing debt levels, average total equity and cost of debt for the financial year 2015-2016. Clearly state any assumptions. (10 marks)
- c) Use Yahoo Finance and other sources, find beta and market premium. Based on your knowledge of either the Capital Asset Pricing Model (CAPM) and derive an appropriate cost of equity. Clearly state any assumptions. (10 marks)
- d) Calculate the weighted average cost of capital (WACC) for Qantas. (5 marks)
- e) For the year ended June 2016 Qantas paid more than \$500m to buy back shares. Explain possible reasons for Qantas to follow such a course of action? (5 marks)

### **Part 2: Raising capitals [15 marks]**

Assume that Qantas is evaluating financing options for the investment in aircraft cabins and Wi-Fi through the issue of corporate bonds. Qantas is exploring issuing \$100m bonds of face value \$1000, a coupon rate of 5.5% paid semi-annually, with a maturity period of 10 years. If yield to maturity is 6%:

- a) Calculate the value of the bond (5 marks)
- b) Assume that the cost of existing debt and equity from part 1 b) and c) are unchanged, calculate the new WACC (5 marks)
- c) If Qantas issues convertible bonds instead, how would the yield change from the current 6%? Why? (no calculations required, 5 marks)

### **Part 3: Capital budgeting [25 marks]**

Assume that Qantas wishes to make further capital investments and the management is exploring two options, all dollar figures are in Australian Dollar:

Option 1: Expanding their jet services to regional Australia. The new jet services require an initial investment of \$ 1.8m and further investments at the end of years 1, 3 and 5 of \$ 1.2 m each. In addition, it will also incur working capital expenses at the beginning of the project of \$0.4 m and recover these at the end of year 8. The Golf course will generate cash inflows of \$ 0.8 m at the end of year 1, \$1.6m each in years 2, 3 and 4 and \$ 1.8m each through years 5 to 8. At the end of year 8 the service will be sold for \$ 0.6m. Qantas is able to claim an annual depreciation of \$0.15m from years 1 to 5 and pays Australian company tax at 30%.

Option 2: Given the recent economic trouble in Venezuela (See Source 5), its government is looking to privatise portions of the country's oil industry. One of the oil fields in Venezuela requires one-off initial investment of \$ 5m now and will generate cash inflows of \$0.6m at the end of year 1, \$1.8m each in years 2, 3 and 4 increasing to \$2m every year for the next 4 years. The oil field will be sold at the end of this for \$ 0.4m. Qantas will not qualify for any depreciation on this project and will pay Australian company tax at 30%. Venezuelan government promises to charge no tax for this project.

- a) Calculate the Net Present Value for each of the two investment options, assume that the WACC is 10%. (10 marks)
- b) Which investment will you recommend for Qantas? (5 marks)
- c) Considering the choice of WACC as the discount rate for both projects, what could be the potential dangers? What adjustments in terms of discount rate would you recommend? (answer qualitatively, no calculations needed, 10 marks)

**Part 4: Market perspectives [5 marks]**

- a) Qantas announced the full year result 2016 (See Source 1) at 8:42am on 24<sup>th</sup> August 2016. Considering the share price movements from 23<sup>rd</sup>-25<sup>th</sup> August 2016, what would be the implications to the efficient market hypothesis? Which version of the efficient market hypothesis does this event imply? (5 marks)





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