Short case (due 4/26/2024)

The controller of the Front Range Airways is considering the addition of a new on-site maintenance facility at its main airport of Centennial Airport. The addition will has two primary benefits: to eliminate its reliance on the maintenance of its fleet by outside contractors and create the opportunity to sell its maintenance program to other commuter airlines. The new maintenance facility will allow the Front Range Airways not only to reduce its operating costs but also to increase its revenue. The new on-site maintenance program is expected to reduce the fleet's downtime by 1 day which allows the Front Range Airlines to schedule more flights. The question for the controller is whether these expected benefits were enough to justify the $24 million capital outlay plus the incremental investment in working capital over the six-year life of the project.

Construction will start in January 2024. $22 million of the capital outlay will be spent in 2024 and the remaining $2 million will be used in 2025. When the new on-sire maintenance facility begins operating in 2025, it is expected to significantly reduce the operating costs of the airline. These operating savings will come mainly from the difference between the cost of self-maintenance and the cost of buying maintenance contract from the open market. The controller's estimate shows that the operating savings will be $2 million for 2025 and $2.5 million per year for the following five years.

The controller also plans to take advantage of reduced fleet downtime to schedule more flights to create additional revenue. For 2025, she expects to show additional $4 million revenue from its increased utilization of the airline's fleet. She expects the additional revenue to top at $10 million in 2026 and continue to stay at that level through 2030. It is estimated that the cost of goods sold (mainly fuel) will be 68% of revenue, and SG&A will be 5% of revenue.

In addition to the capital outlay of $24 million, this project will require the Front Range Airways to invest in increased level of inventories and accounts receivable. No changes in current liabilities are expected from this project. The total net working capital is expected to average 10% of annual revenue. This means that the amount of net working capital investment each year will equal 10% of incremental revenue for the year. At the end of the life of the project in 2030, all the net working capital on the books will be recoverable at cost. The salvage value of the capital outlay is expected to be zero. Tax rate would be 21%, and the capital outlay of $24 million will be depreciated under straight-line schedule, starting 2025.

The firm's long-term bond is rated as Baa as of today. The firm's stock beta is 1.25. Other financial information is provided in the Exhibits below.

Should this company accept this project?

Instruction:

- Please show works where they are appropriate
- Please state your assumptions if you make any
- Only one report is accepted in with word document or pdf file. If you use Excel for your calculation/analysis, please copy and paste the portion of the work that needs to be shown. If you submit your report and Excel separately, the Excel will not be reviewed for grading.
- There is no page limit. However, please keep in mind that there is no positive correlation between your grade and the page number in your report.
- Please make sure to put your name on your report. To save your time, no fancy cover page is necessary as long as the name is shown at the top of the first page of the report.
- Any other question, please feel free to ask me.

Exhibit 1: Interest rates information (December 2023)

Bank loan rate (LIBOR)		*Market risk premium*	
1-year	2.17%	Historical average over T-bill	6.5%
		Historical average over T-bond	5.25%
Treasury Bonds		*Corporate Bonds (10-year maturities)*	
1-year	1.83%	Aaa	3.51%
5-year	2.25%	Aa	3.71%
10-year	2.46%	A	3.96%
30-year	2.81%	Baa	4.23%

Exhibit 2: Front Range Airways Financial Information (December 2023)

Balance sheet information ($ millions)	
Current portion of long-term debt	$ 300
Long-term debt	2,000
Common stock	450
Retained earnings	1,850
Share information (per-share)	
Shares outstanding (millions)	400
Book value per share	$ 5.75
Share price as of December 2023	$25.00
Other information	
Bond rating of the firm	Baa
Beta	1.25