

# **FNCE20005 CORPORATE FINANCIAL DECISION MAKING**

## **TUTORIAL 3: RAISING CAPITAL – DEBT AND LEASES**

Answers to Section B questions to be submitted on Canvas by **10am on Monday, August 16<sup>th</sup>**

### **SECTION A**

#### **QUESTION 1**

Leasing increases a company's access to debt. Discuss critically.

#### **QUESTION 2**

It is common for airlines to own some aircraft while leasing others under operating leases. What are the advantages and disadvantages of this approach?

### **SECTION B – PRIORITY QUESTION**

**REMEMBER ALSO THAT ALL ANSWERS MUST BE HANDWRITTEN AND YOUR NAME CLEARLY WRITTEN AT THE TOP OF EACH SUBMITTED PAGE.**

You are a consultant who has been employed by a transport company, Arbed Ltd. The company is bidding for a license to transport silicate from mines located in the south-east of the Northern Territory to the wharves of Darwin. If the company succeeds in obtaining a license, then they must acquire a custom-made silicate transport vehicle (STV). The management of Arbed Ltd. has sought your guidance as to whether they should purchase such a vehicle by borrowing money or lease it. They have supplied you with the following information.

STV Purchase Price	\$85,000
Effective Life of STV	5 years
Effective tax rate	30.00%
Before-tax cost of an equivalent loan	15.00% p.a.
Annual lease payment required in advance	\$16,150
Salvage value of STV at conclusion of effective life	\$12,750

The management team also tells you that if they purchase the STV they will fully depreciate it, for taxation purposes, using the straight-line method, and that all cash flows have been quoted on a before-tax basis.

Assuming that Arbed Ltd. was going to acquire the STV, would you recommend that they purchase by borrowing or lease it? What is the incremental wealth associated with your decision?