



Venue \_\_\_\_\_

Seat Number \_\_\_\_\_

Student Number 

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Family Name \_\_\_\_\_

First Name \_\_\_\_\_

## Total

**Question 1: Multiple Choice Questions (20 Marks)**

Select the best answer for each of the following questions, and enter the answer in the answer sheet. Choose only one answer for each question, and note that only the answer sheet will be marked. 2 marks for each question.

1. 'Industry growth is slow' is a factor in which of Porter's Five Forces?
  - A. Threat of New Entrants
  - B. Bargaining Power of Suppliers
  - C. Bargaining Power of Buyers
  - D. Threat of Substitutes
  - E. Rivalry Between Existing Competitors
2. Airlines pilots are difficult and expensive to replace. From the perspective of an airline company (e.g. Qantas), this is an example of which of Porter's Five Forces?
  - A. Threat of New Entrants
  - B. Bargaining Power of Suppliers
  - C. Bargaining Power of Buyers
  - D. Threat of Substitutes
  - E. Rivalry Between Existing Competitors
3. Which of the following is NOT an example of a way that a company might compete on differentiation?
  - A. Offering a higher quality product than competitors
  - B. Exploiting economies of scale
  - C. Investing in advertising to develop brand image
  - D. Developing new products through investment in research and development
  - E. Offering customers customisable products
4. Which of the following is NOT an indicator that an operating revenue/expense might be Unusual Operating Income?
  - A. The amount of the revenue/expense is very volatile
  - B. The amount of the revenue/expense is zero in some years
  - C. The item is described as a 'restructuring charge'
  - D. The item is a recurring part of the company's 'other income'
  - E. The amount of the revenue/expense is unpredictable
5. A chief financial officer wants to inflate earnings using accrual-based earnings management. Which of the following will increase earnings in the current year?
  - A. Overestimate the Provision for Doubtful Debts
  - B. Underestimate the Provision for Warranty Expenses
  - C. Underestimate the useful life of Property, Plant and Equipment
  - D. Write-down Inventory to lower of cost and net realisable value
  - E. All of the above

6. A company called ABC has a small investment in the shares of a private company. ABC cannot observe the market price of the private company's shares, so the management of ABC estimates the fair value of the private company's shares using a discounted free cash flow model, internal estimates of future free cash flow, and internal estimates of weighted average cost of capital.

How would this fair value be described under accounting standards?

- A. Level 1 fair value
- B. Level 2 fair value
- C. Level 3 fair value
- D. Level 1 or 2 fair value
- E. Level 2 or 3 fair value

7. Which of the following is NOT a reason why price-to-book (P/B) ratios are usually greater than 1?

- A. Most assets are measured at fair value
- B. Accounting does not recognise most internally generated intangible assets
- C. Expenditures on R&D and advertising are expensed as incurred, but may generate value for multiple periods
- D. A collection of assets can be worth more when used together than when used separately, but accounting generally records each asset individually
- E. All of the above

8. Which of the following is NOT a typical disadvantage of using comparable company multiples to value a company?

- A. It can be difficult to find genuinely comparable companies
- B. The valuation depends on which multiple is used
- C. It does not require forecasting
- D. It implicitly assumes that market prices of comparable companies are accurate
- E. The denominator can be negative for some multiples, making them not meaningful

9. The weighted average cost of capital (WACC) is the appropriate discount rate for which two valuation models?

- A. Dividend discount model (DDM) and discounted free cash flows (DCF)
- B. Discounted free cash flows (DCF) and residual operating income model (ReOI)
- C. Residual income model (RIM) and residual operating income model (ReOI)
- D. Dividend discount model (DDM) and residual income model (RIM)
- E. Residual income model (RIM) and discounted free cash flows (DCF)

10. Suppose you are using the dividend discount model (DDM) to value a company. You calculate the terminal value by assuming that the company's dividend will be the same forever after the company reaches a steady state. Which valuation Scenario are you assuming?

- A. Scenario 1
- B. Scenario 2
- C. Scenario 3
- D. Scenario 1 or 2
- E. None of the above

**Question 2: Balance Sheet Reformulation (20 Marks)**

Suppose you have been given the following Balance Sheet, prepared under Australian Accounting Standards. The company is an ordinary retail company.

	<b>FY18 \$m</b>		<b>FY18 \$m</b>
<b>Current Assets</b>		<b>Current Liabilities</b>	
Cash & cash equivalents	150.0	Accounts payable	30.0
Accounts receivable	125.0	Current tax liability	20.0
Inventories	70.0	Other current liabilities	25.0
Other financial assets	10.0		75.0
	355.0	<b>Non-Current Liabilities</b>	
<b>Non-Current Assets</b>		Interest-bearing liabilities	400.0
Goodwill	200.0	Provision for employee benefits	50.0
PPE (net)	400.0	Deferred tax liabilities	50.0
Equity-accounted investments	40.0		500.0
Deferred tax asset	40.0	<b>Total Liabilities</b>	<b>575.0</b>
	680.0		
		<b>Shareholders' Equity</b>	
		Share capital	300.0
		Retained earnings	110.0
		Preferred equity	50.0
		<b>Total Equity</b>	<b>460.0</b>
<b>Total Assets</b>	<b>1,035.0</b>	<b>Total Equity and Liabilities</b>	<b>1,035.0</b>

Note the following additional information:

- Revenue for FY18 was \$750m
- Assume operating cash is 0.5% of revenue

**Required:** Reformulate the Balance Sheet, following the approach taught in the course.

**Question 3: Cash Flow Statement Reformulation (10 Marks)**

Suppose you have been given the following extract from a Statement of Cash Flows, prepared under Australian Accounting Standards. The company is an ordinary retail company.

	<b>FY18</b>
	<b>\$m</b>
Cash Flow from Operations:	
Cash receipts from customers	200.0
Payments to suppliers and employees	(100.0)
Royalties received	10.0
Interest paid	(40.0)
Interest received	10.0
Income tax paid	(60.0)
Cash Flow from Operations	20.0

Cash Flow Investing:	
Purchases of PPE	(50.0)
Purchases of short-term money market investments	(20.0)
Purchase of business acquisition	(20.0)
Proceeds from sale of PPE	10.0
Cash Flow from Investing	(80.0)

Other information:

- The company had an increase in operating cash of \$10.0m in FY18
- The company's corporate tax rate is 30%

**Required:** Reformulate the Cash Flow from Operations and Cash Flow from Investing sections of the Statement of Cash Flows, following the approach taught in the course.

**Question 4: Accounting and Financial Analysis (30 Marks)**

Below are the reformulated Balance Sheet, Income Statement, and Equity Statement for Blackmores, the Australian vitamin and health supplement manufacturer.

**Reformulated Balance Sheet**

	<b>FY17</b>	<b>FY18</b>
	<b>\$000</b>	<b>\$000</b>
<b>Operating assets</b>		
Operating cash	5,522	6,011
Receivables	132,146	150,788
Inventories	84,794	103,965
Other assets	7,463	10,811
Property, plant and equipment	74,207	76,261
Goodwill and intangible assets	61,754	66,212
Deferred tax assets	9,960	12,590
Amounts advanced to related parties	4,111	3,600
	379,957	430,238
<b>Operating liabilities</b>		
Trade and other payables	124,365	157,868
Current tax liability	1,811	4,846
Provisions	12,921	9,294
Other liabilities	4,581	4,568
Deferred tax liabilities	10,224	9,341
	153,902	185,917
<b>Net operating assets (NOA)</b>	<b>226,055</b>	<b>244,921</b>
<b>Financial assets</b>		
Financial cash	28,729	30,457
Derivative assets	8	475
Investment property	2,160	2,160
Other financial assets	1,320	1,520
	32,217	34,612
<b>Financial obligations</b>		
Derivative liabilities	485	203
Interest-bearing liabilities	78,968	86,000
	79,453	86,203
<b>Net financial obligations (NFO)</b>	<b>47,236</b>	<b>51,591</b>
<b>Common Shareholders' Equity (CSE)</b>	<b>178,819</b>	<b>193,330</b>

**Reformulated Income Statement**

	<b>FY18</b>
	<b>\$000</b>
<b>Core Operating Income from Sales (before tax):</b>	
Sales	601,136
Raw materials and consumables used	(232,374)
Gross profit	368,762
Other core operating expenses (total)	(266,727)
Core Operating Income from Sales (before tax)	102,035
<b>Core Other Operating Income (before tax):</b>	
Government grant	602
Core Other Operating Income (before tax)	602
<b>Unusual Operating Income (before tax):</b>	
Proceeds from the disposal of fixed assets	29
Unusual Operating Income (before tax)	29
<b>Net Financial Expense (before tax):</b>	
Interest revenue	416
Interest expense	(4,346)
Dividends received	87
Bank charges	(1,141)
Net Financial Expense (before tax)	(4,984)
<b>Tax Allocation:</b>	
Income tax expense	28,459
Tax shield from NFE	1,495
Tax allocation to Unusual OI	9
Tax allocation to Core Other OI	181
Tax Allocation to Core OI from Sales	29,765
<b>After Tax Amounts:</b>	
Core OI from Sales (after tax)	72,270
Core Other OI (after tax)	421
Unusual OI (after tax)	20
NFE (after tax)	(3,489)
<b>Operating OCI (after tax):</b>	
Exchange differences arising on translation of foreign subsidiaries	2,625

**Financing OCI (after tax):**

Net gain/(loss) on hedging instruments entered into for cash flow hedges (net of tax)	603
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<b>Total Operating income (OI) after-tax</b>	<b>75,337</b>
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<b>Total Net financial expense (NFE) after-tax</b>	<b>(2,886)</b>
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<b>Comprehensive income (CI)</b>	<b>72,451</b>
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**Reformulated Equity Statement**

	<b>FY18</b>
	<b>\$000</b>
Beginning balance	178,819
Comprehensive income (CI)	
Net profit after tax (NPAT)	69,223
Other comprehensive Income (OCI)	3,228
	72,451
Transactions with shareholders (d)	
Dividends declared/paid	49,957
Share-based payments	(1,259)
Issue of shares under employee long-term incentive plans	9,242
	57,940
Ending balance	193,330

**Required:**

- Briefly explain why 'Proceeds from the disposal of fixed assets' is classified as Unusual Operating Income. (2 marks)
- Briefly explain why 'Exchange differences arising on translation of foreign subsidiaries' is classified as Operating OCI, rather than Financing OCI. (2 marks)
- Blackmore's 'Investment property' is carried at historical cost. What other measurement method is permitted for investment properties under accounting standards? (2 marks)
- Show that the clean surplus relation holds for FY18. Show workings. (2 marks)
- Calculate free cash flow (FCF) for FY18. Show workings. (2 marks)
- Sales in FY17 was \$552,160,000. Calculate normal change in net operating assets (NOA) for FY18. Assume that normal asset turnover (ATO) is 2.62. Show workings. (3 marks)



- g. Compare normal change in net operating assets (NOA) to the actual change for FY18. Briefly state what the difference between the normal change in NOA and the actual change in NOA suggests about Blackmore's accounting quality.

**Note:** You do not need to discuss why the two numbers are different. Simply comment on what the difference suggests about Blackmore's accounting quality.  
(2 marks)

- h. Calculate ROCE, and show that  $ROCE = RNOA + FLEV \times SPREAD$  holds for FY18. Show all workings. (6 marks)
- i. Show that  $RNOA = ROOA + OLLEV \times OLSPREAD$  holds for FY18. Assume a short-term borrowing rate after tax of 3%. Show all workings. (6 marks)
- j. Calculate profit before tax (PBT). Show all workings. (3 marks)

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**Question 5: Valuation (20 Marks)**

Suppose you have been given the following information about an Australian company called Acme. Acme operates entirely within Australia.

Beta ( $\beta$ ) = 1.2

Market risk premium = 6.5%

Risk-free rate = 3.2%

Acme currently has Common Shareholders' Equity (CSE) per share of 200 cents/share.

Analysts have issued the following forecasts:

	2018A	2019E	2020E	2021E	2022E
Dividends per share	15.00	17.00	23.00	28.00	30.00
Earnings per share	35.00	30.00	35.00	37.00	39.00

Assume that Acme will reach a steady state in 2022. Analysts forecast Acme's terminal growth rate to be 6.0% after 2022.

**Required:**

- Calculate Acme's cost of equity using the CAPM. (2 marks)
- Using the analysts' forecasts and the analysts' terminal growth rate assumption, calculate the value per share of Acme's shares using the Dividend Discount Model. Show all workings. (5 marks)
- Using the analysts' forecasts and the analysts' terminal growth rate assumption, calculate Acme's residual income for 2019, 2020, 2021, and 2022. Calculate the value per share of Acme's shares using the Residual Income Model. Show all workings. (8 marks)
- Why might the analysts' terminal growth rate assumption be too high? (3 marks)
- Compare your Residual Income Model valuation to Acme's current Common Shareholders' Equity (CSE). What explains the difference between your valuation and Acme's current CSE? (2 marks)

**END OF EXAMINATION**

## Formula Sheet

$$\Delta CSE = CI - d$$

$$C - I = d + F$$

$$C - I = OI(\text{after tax}) - \Delta NOA$$

$$C - I = NFE(\text{after tax}) - \Delta NFO + d$$

$$C - I = -NFI(\text{after tax}) + \Delta NFA + d$$

$$\text{Normal } \Delta NOA = \frac{\Delta \text{Sales}}{\text{Normal } ATO}$$

$$\text{Normal } OI = C - I + \text{Normal } \Delta NOA$$

$$ROCE = RNOA + FLEV \times SPREAD$$

$$RNOA = ROOA + OLLEV \times OLSREAD$$

$$ROOA = \frac{OI(\text{after tax}) + \text{Implicit Interest}(\text{after tax})}{\text{AvgOA}}$$

$$RI_t = CI_t - r_E CSE_t$$

$$ReOI_t = OI(\text{after tax})_t - r_F NOA_{t-1}$$

$$V_E = \frac{E[d_1]}{(1+r_E)^1} + \frac{E[d_2]}{(1+r_E)^2} + \dots + \frac{E[d_T]}{(1+r_E)^T} + \frac{E[d_{T+1}]}{r_E - g} \times \frac{1}{(1+r_E)^T}$$

$$V_E = CSE_0 + \frac{E[RI_1]}{(1+r_E)^1} + \frac{E[RI_2]}{(1+r_E)^2} + \dots + \frac{E[RI_T]}{(1+r_E)^T} + \frac{E[RI_{T+1}]}{r_E - g} \times \frac{1}{(1+r_E)^T}$$

$$V_F = \frac{E[FCF_1]}{(1+r_F)^1} + \frac{E[FCF_2]}{(1+r_F)^2} + \dots + \frac{E[FCF_T]}{(1+r_F)^T} + \frac{E[FCF_{T+1}]}{r_F - g} \times \frac{1}{(1+r_F)^T}$$

$$V_F = NOA_0 + \frac{E[ReOI_1]}{(1+r_F)^1} + \frac{E[ReOI_2]}{(1+r_F)^2} + \dots + \frac{E[ReOI_T]}{(1+r_F)^T} + \frac{E[ReOI_{T+1}]}{r_F - g} \times \frac{1}{(1+r_F)^T}$$

$$r_E = r_f + \beta(E[r_M] - r_f)$$

$$r_F = \frac{NFO}{V_E + NFO} r_D + \frac{V_E}{V_E + NFO} r_E$$