FE2118 Corporate Finance 1

Semester 1 2003/04

Coursework Presentation by:

Rajesh Patel

K0201098

Introduction:

A city council has asked me to analyse and evaluate their financial proposal to host a pop music festival next summer that would take place on the sport field owned by the local university. The projected figures for hosting the event have been provided by the local council and they would like me to advise them, if the project is worth while pursing from a financial prospective.

To establish whether the project is worth while pursing, I will use a number of financial analysising techniques and calculations to work this out, they will include using standard investment appraisal techniques.

I propose to do the following to establish whether the project is worth while pursuing:

(1) I will construct a cash flow and cash outflow statement for each year of the potential project. The cost statement will also show the net cash flow for each year, which is simply derived from taking inflows away from the outflows.

(2) Decide a suitable discount rate that takes into consideration the nature of the business, how the council is funding this funding this project and analysing the current economic climate.

(3) With the aid of the discount rate, I will calculate the net present value of this proposed project. The present value will help to determine weather the project is worth while pursuing.

(4) The written report of the project will consist of the following concepts:

- All relevant assumptions stated
- Full explanation of my findings from my analysing and evaluation of the project
- Conclusion with results whether to accept or reject the project

(5) A full appendix will be given at the end.

MAIN REPORT FOR THE PROJECT:

For this investment appraisal I will attempt to use the current prices as pose to constant prices. Constant prices are the prices, that the council projected the figures to host the event the inflation at that time. I am going to adjust the net revenue by the current prices, which are the prices that I will predicate for each year. The Current price takes into consideration that inflation is changing every year., therefore this needs to be accounted for. I will predicate my inflation rate (price levels) based upon the current inflation rate and economic climate for the year 2003.

The current inflation rate for November 2003 is about 2.5% and the current economic climate is that most people think that we are entering recession due to the slow down of the global economy. If this is the case then my prediction that inflation over the coming years will be increasing, after about the year 2005 the inflation rate may start to decrease slightly and then on carry on declining. It must be stressed that these are anticipated inflation rates. I predicate the following inflation rate for the following years:

Year 2004	Inflation rate: 2.7%	(increase)
Year 2005	Inflation rate: 2.8%	(increase)
Year 2006	Inflation rate: 2.8%	(constant)
Year 2007	Inflation rate: 2.8%	(constant)

Justification for this assumption

The UK has not joined the Euro and simplest will not in the future. The UK is under great pressure within joining the Euro. So it is anticipated that the UK will join the Euro in the near future, this will change the inflation and interest rate for this project completely. The Euro interest rate is lower than the UK interest rate and their inflation rate is greater than the UK's. For this appraisal I will make an assumption that they will not join the Euro in the near future years to come.

The following spreadsheet shows the cash statement for the project, which show the in and out flows of the project, the net cash flow and the net cash flow adjusted to the anticipated inflation rate.

YEAR	2004	2005	2006	2007
CASH INFLOW:				
Cola Company Sponcer	£100,000.00			
Ticket Sales Revenue	£1,593,750.00	£281,250.00		
Food and Drink Sales Revenue	£12,500.00	£12,500.00	£12,500.00	£12,500.00
Other Suppliers	£87,500.00	£87,500.00		
BBC Radio 1 Broadcast	£75,000.00			
BBC TV Broadcast		£250,000.00	£50,000.00	£50,000.00
5% Profits from CD/Cassettes releases	£3,000.00	£1,500.00	£500.00	£500.00
TOTAL CASH IN FLOW	£1,871,750.00	£632,750.00	£63,000.00	£63,000.00
CASH OUT FLOW:				
10% of Total Sales Payable to Selling Agent		£187,500.00		
Fees Payable to Bands	£320,833.33	£160,416.67	£160,416.67	
Fees for PA and Lighting	£200,000.00	£200,000.00		
Policing & Over time Payments	£50,000.00			
Payment for Security			£150,000.00	
Advertising cost	£50,000.00			
Estimated Medical Cost	£75,000.00			
Ground Maintenance & Refuse Collection		£50,000.00		
Interest Payment on Uni Loan	£75,000.00	£75,000.00	£75,000.00	£75,000.00
General Admin. Cost	£25,000.00	£25,000.00	£25,000.00	
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]		[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Evaluation of Cash Statement

From looking at the cash statement it is clear that in the first year that there is positive net cash flow. This is because in the first year the council receives the bulk of the revenue from the event as they get sponsors from companies such as Coca-Cola, also from its advance selling of tickets. However the net cash flows for the following three years is negative as they are paying out. The payouts for the event are spread out over the 4 years, with the bulk of the money going out in the first 3 years that's why in year 2005 and 2006 the net cash flow is largely negative as outflows are grater than inflows.

Determination of Discount Factor

From the cash flow we are able to conclude that the organisers are in the public sector as pose to the private sector, because if the organiser were in the private sector then their cash flow would look different. Their net cash flow for the first year would be negative flowed by positive cash flow, as they would have initial outlay, grater than the revenue received in the first year. In this cash flow we have the opposite we have the positive cash flow followed by negative cash flow as they have an initial receipt, which is grater than expenditures for the first year.

Knowing that the organisers are in the public sector and have negative net cash flows after the first year due to their large payouts they have, the net cash flow has to be discounted at a higher factor. This is because by discounting the cash flow at a higher factor means the council can avoid the risk of not being able to pay out large sums they have in 2005 - 2007. To achieve a higher discount factor the discount rate has to be low, lower than the prevailing interest rate in the market. The higher discount factor will ensure that the council is able to pay out large sum , if they have too. The present Interest Rate value is 3.75%.

The following spreadsheet shows the net cash flow at current prices:

Year	Net Cash Flow	Discount Factor	Present Value
2004	1075916.67	1	1075916.67
2005	-65166.67	0.95	-61908
2006	-347416.67	0.90	-347583
2007	-12000	0.85	-10200
			656225.67

NET PRESENT VALUE:

= Initial Receipts - Sum of Present Value of future payments
=1075916.67 - 656225.67
= 419690.33

Conclusion

As a consultant to the council, it is my duty to recommend whether or not the project is viable financially. It is apparent through standard investment appraisal techniques that the project makes has a positive Net Present Value. The project makes a positive contribution of £419690.33 at current prices; this makes the project look very attractive. More often than not if a project makes a positive contribution. But in this dues to vast sizes of the project other factors must be considered, such as the whether conditions. The council must consider the potential environmental consequences such as

pollution and congestion. The event will create environmental damages and the council needs to evaluate if the revenue they earn will cover for the social costs of pollution. However, the greater the amount the amount of people who come to the event will make it beneficial for the local economy. Local shops and businesses should benefit from visitors of this event because they should earn more revenue due to people spending in the community. This project may create short-term jobs for the local community. I have made many assumptions for this project that I feel are fairly accurate but the reality in the future can be very different, as we know that economies can be very volatile.
I would recommend that this project as it is financially viable and makes a positive contribution, which is a very attractive proposition.

References

Accounting J R Dyson (Forth Edition) Financial Times

Begg, D Economics, 7th edition, Mcgraw-Hill

Appendix

COMPANY	INTEREST RATE
CAPITAL ONE 4 YEAR FIXED RATE BOND	5.50%
JULIAN HODGE BACK MILLENNIUM BOND	5.30%
HALIFAX BANK PLC WEB SAVER	5.20%

The average rate is 5.33% but a discount factor of 5.50%, because it is the greatest opportunity cost to invest in the festival project. The rate of Interest is based on a four year term. Therefore the discount factor can remain constant.

Sources:

www.halifax.co.uk

www.capitalone.co.uk

www.bankofengland.co.uk

HM Treasury