

SAMPLE PAGE OF FNCE30002 NOTES

TAKEN FROM TOPIC 4: PAYOUT POLICY

1. TAXATION

Tax may have an effect where tax payable on dividend income is different to tax payable on capital gains

Since Sep 1985: **Capital Gains Tax**
 Until June 1987: **Classical** system
 Since July 1987: **Imputation** system
 Since Sep 1999: CGT on **50% of gain**

- From shareholder's perspective, payout policy is really just a question of whether you receive returns via increases in share price (capital gains) or via dividends (or share repurchases)
- Incentive for firms to distribute franking credits to shareholders as quickly as possible

If no capital gains tax CGT=0	$t_p < t_c$	Prefer dividends	Paying tax at personal rate
	$t_p > t_c$	Prefer capital gains	Paying tax at company rate
If capital gains tax CGT > 0	$t_p < t_c$	Prefer dividends	Paying tax at personal rate
	$t_p > t_c$	May prefer dividends	As capital gains get double-taxed
		OR May prefer capital gains	If able to defer realisation to when tax ↓

Non-residents: can't use franking credits, get double-taxed → prefer capital gains/unfranked dividends (corporate tax has not been paid) e.g. foreign source income

Special dividends



Dividend Reinvestment Plan – allow high dividend without loss of cash, distribute franking credits

- Must hold for 45 days – can't receive tax credit by buying the share on day prior to ex-div date then selling on ex-div day

SHARE BUYBACKS

When a company purchases its own shares on the stock market and then proceeds to either cancel them (Aus) or retain them as treasury stock (US)

- Legal requirements – can't buy more than 10% in 12 months unless 75% of shareholders approve

Types of share buyback	
Equal access buy-back	Pro-rata to all shareholders
Selective buyback	Repurchase from specific, limited number of shareholders (requires approval by >75% of non-selling shareholders) – like a reverse placement
On-market buyback	Repurchase through normal stock exchange trading
Employee share scheme buy-back	
Minimum holding	Buy back small unmarketable parcels of shares

SHARE BUYBACKS AND TAXES

Taxes depend on if on-market or off-market buy-back:

- On-market buybacks** – subject to CGT only
- Off-market buyback** – part of proceeds can be a dividend, have franking credits attached

Low-tax individuals benefit more from share buybacks

TAKEN FROM TOPIC 7: REAL OPTIONS ANALYSIS

EVIDENCE ON REAL OPTIONS

Anecdotal evidence that shows management understanding importance of real options analysis: keeping options to trade alive, that conditions might change, purchasing valuable follow-on options

EMPIRICAL EVIDENCE

Discount rate resulting from survey was far greater than WACC estimated from financial data → Report that firms ration capital in the face of operational constraints – may not have the managers to do projects

Why managers don't use real options:

1. Lack of top management support – complexity
2. Discounted cash flow is a proven method - justifiable
3. Requires too much sophistication – modelling risk
4. Encourages too much risk-taking – option value is a positive function of risk

WHEN IT MIGHT BE IMPORTANT TO ACCOUNT FOR THE VALUE OF REAL OPTIONS

When real options analysis would give a different investment decision than standard NPV analysis

<p>Real options can't help Real options are important</p>		→ Likelihood of receiving new information →	
		Uncertainty	
↑ Ability to respond to new information	Flexibility	Moderate flexibility value	High flexibility value
		Low flexibility value	Moderate flexibility value

