Corporate finance essay sample

Finance

Investment in Assets and required returns

·Cash flow determination

·Non-DCF and DCF techniques

Case: Investment analysis and Lockheed Tri Star

Assignment Questions

1. Compute the payback, net present value (NPV), and internal rate of return (IRR) for this machine. Should Rainbow purchase it? Assume that all cash flows (except the initial purchase) occur at the end of the year, and do not consider taxes. 2. For a $500 per year additional expenditure, Rainbow can get a " Good As New" service contract that essentially keeps the machine in new condition forever. Net of the cost of the service contract, the machine would then produce cash flows of $4, 500 per year in perpetuity. Should Rainbow Products purchase the machine with the service contract? 3. Instead of the service contract, Rainbow engineers have devised a different option to preserve and actually enhance the capability of the machine over time. By reinvesting 20% of the annual cost savings back into new machine parts, the engineers can increase the cost savings at a 4% annual rate.

For example, at the end of year one, 20% of the $5, 000 cost savings ($1, 000) is reinvested in the machine; the net cash flow is thus $4, 000. Next year, the cash flow from cost savings grows by 4% to $5, 200 gross, or $4, 160 net, of the 20% reinvestment. As long as the 20% reinvestment continues, the cash flows continue to grow at 4% in perpetuity What should Rainbow Products do? 4. Using the internal rate of return (IRR), which proposal(S) do you recommend? 5. Using the net present value rule (NPV), which proposal(s) do you recommend? 6. How do you explain any difference

between the IRR and NPV rankings? Which rule is better? 7. Which of the four subsidy plans would you recommend to the city if the appropriate discount rate is 20%? 8. What is the net Present Value of this project?

9. How many shares of common stock must be issued (at what price) to raise the required capital? 10. What is the effect of this new project on the value of the stock of the existing shareholders, if any?