Cash flow estimation m3c

Finance

Cash Flow Estimation for Pinehill Medical Associates (PMA) Cash Flow Estimation forPinehill Medical Associates (PMA)Pinehill Medical Associate (PMA) needs to prepare cash flow estimation for evaluating the investment decision of opening former medical facility and building new medical facility. Cash flow estimation assists in analyzing the movement of cash in these two options of medical facility (Principles of Cash Flow Estimation, n. d.). This forecasting provides the financial tool for selecting the profitable project from available options (Cash Flow Forecasting, n. d.). The present document reflects on the analysis of medical facility on the basis of selected decision making criteria for choosing the profitable medical facility for Cash Flow Estimation for Pinehill Medical Associates (PMA). Analysis of PMA's Medical Facilities PMA analyzes worth of medical facilities of option 1 and option 2 with the discount rate defined as 10% and the cost of capital as 15%. Cash flow estimation for option 1 is included in the following table: Formula for payback period is as follows: Payback Period = Year before Cumulative Cash Flow becomes positive + (-Cumulative cash flow in the year before it becomes positive i. e. Total amount to be paid)/ (Incremental Cash flow in the year when it becomes positive i. e. Total amount to be paid) (Fabozzi, 2003). Payback period of Option 1: Payback Period = 3 + 47, 800/137, 400 = 3. 35 yearsNet Present Value (NPV) for Option 1Excel calculation for NPV provides the value of $13, 263. 03 for option 1. Internal Rate of Return (IRR) for Option 1Excel calculation for IRR provides the value of 12. 25% for option 1. Cash flow estimation for option 2 is included in the following table: Payback period of Option 2: Payback Period = 3 + 99, 600/136, 800 = 3. 73 yearsNet Present Value (NPV) for Option 2Excel calculation for NPV provides the value of -$38, 638. 89 for option 2. Internal Rate of Return (IRR) for

Option 1Excel calculation for IRR provides the value of 4. 38% for option 2. Attached excel sheet contains step of calculation: Rationale behind Selection of Preferable Medical FacilitiesEmery, Finnerty, Stowe (2007) define the internal rate of return (IRR) as the discount rate estimated for the project that provides the point at which cash inflow and cash outflow of the organization becomes equal. If IRR is taken as the discount rate of the project, then net present value becomes equal to zero. Most of the companies chooses IRR for the rate of re-investment. The comparison between IRR and the cost of capital provides the criteria for selecting or rejecting the project. If IRR is greater than the cost of capital, then investors benefit from surplus return from the project (Emery, Finnerty, Stowe, 2007). If IRR is lesser than the cost of capital, then investors need to invest further capital for operating the project (Emery, Finnerty, Stowe, 2007). Valuation techniques applying the decision making criteria of IRR and the cost of capital for assessment of option 1 and option 2 does not satisfy acceptance criteria in both cases as IRR of 4. 38% is significantly lower than the cost of capital in option 2 whereas IRR of 12. 25% for the option 1 is also lower than the cost of capital, but it is comparable. Risk classification of both options should also be taken into account before accepting or rejecting the decision. Net Present Value (NPV) and Payback is another criterion for selecting the profitable options. NPV sensitivity analysis provides the net cash flows across the year accommodating the amount of initial investment (Fabozzi, 2003). Payback period includes the time to retrieve initial investment from future cash flows (. As NPV and payback criteria is the preferable option for maximizing the wealth of its shareholders, option 1 provides better facilities for achieving the objective of maximizing the wealth of shareholders because

of NPV of option 1 is greater than NPV of option 2, but payback period of option 1 is lesser than option 2. ReferencesCash Flow Forecasting (n. d.). Retrieved from http://www. mindtools. com/pages/article/newTMC_06. htmEmery, D. R, Finnerty, J. D & Stowe, J. D (2007). Corporate Financial Management (3rd ed.). Prentice Hall, Inc: A Pearson Education Company. Fabozzi, F. J. (2003). Financial Management and Analysis. New Jersey: John Willy and sons. Principles of Cash Flow Estimation. (n. d). Retrieved from http://finance. mapsofworld. com/corporate-finance/cash-flows/principles-estimation. html