

Valuation of airtread connections

[Finance](#)



Project Appraisal – Airtread Connections Introduction This particular assignment deals with the financial valuations of Airtread Connection. In order to estimate the valuations of this project, certain assumptions have also been taken such that discount rate to be used in discounting net cash flows is assumed to be 20%. Three scenarios have been considered in such a manner that the valuation of the project can be made on the basis of aggressive, neutral and defensive approaches. The following sections cover all three scenarios and their assumptions as well.

Aggressive Strategy

The first scenario generates a positive Net Present Value of \$257, 065 as the approach of the company behind this project is assumed to be aggressive. The biggest assumption which is taken for this scenario is the steady as well as lower cost pattern especially in terms of recurring cost of people and supervisor which is estimated to be \$20, 000 per year for the next years. On the other hand, the estimated benefits of to be derived from this project in next five years are also another contributing factor in arriving such huge NPV such that increased profits amounts to around \$160, 000 per year over the next five years. In this way, this project would successfully achieve the positive NPV of \$257, 065.

Neutral Strategy

The second scenario is referred to as the neutral strategy such that in this particular scenario, the final figure of NPV would be zero as the cost of capital of the project (discount rate) would be exactly equal to the Internal Rate of Return (IRR). The other assumptions of this strategy are the same however there are few changes as well. The major change in the assumptions of this scenario is that the software cost of the project has been

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reduced from \$175, 000 to around \$118, 128. The other major changes include the increase in the recurring cost of people and supervisor which has been increased from \$20, 000 to \$50, 000 and \$40, 000 in first and second year respectively and kept constant at \$30, 000 each year for the next three years of the project. The other major change is the decrease in the amount of profits such that profits are assumed to be reduced from \$160, 000 to \$40, 000 and \$60, 000 in first and second year respectively whereas it is kept constant at \$80, 000 per year for the rest of the project life. In this way, the cash outflows are exactly equal to the project cash inflows, thereby generating nil NPV for the project which indicates a breakeven position of the project.

Defensive Strategy

The defensive strategy is developed to highlight the negative consequences and effects of cash flows upon the project. All the assumptions are taken quite conservatively such that discount rate is still the same which is 20%. The cost of the software is also the one which was assumed in the aggressive strategy of \$175, 000. Similarly, the increase in the recurring cost of people and supervisor and decrease in the amount of profits are assumed as per the neutral strategy. Therefore, if all these assumptions are applied in the valuation model, it generates the negative NPV of \$ 82, 384.

Conclusion

With the few amendments in the valuation model of Airtread Connection project, it can be observed that if some of the costs and benefits are increased or decreased, it can have a significant impact upon the terminal values of the project which are in turn can fluctuate the values of NPV quite considerably.

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