

# [Financial management](https://assignbuster.com/financial-management-essay-samples-2/)

[Business](https://assignbuster.com/essay-subjects/business/)

Year 0 Year Year 2 Year 3 Year 4 Year 5 Year 6 Year 7 Year 8 Operating Activities                   Revenue 0 950000 1500000 1500000 1500000 1500000
1500000
1500000
1500000
Direct Cost
0
522500
825000
825000
825000
825000
825000
825000
825000
Incremental cost
0
80000
80000
80000
80000
80000
80000
80000
80000
Depreciation
0
200000
200000
200000
200000
200000

EBT
0
147500
395000
395000
395000
395000
595000
595000
595000
Tax (35%)
0
51625
138250
138250
138250
138250
208250
208250
208250
Net Income
0
95875
256750
256750
256750
256750
386750
386750
386750
Add: Depreciation
0
200000
200000
200000
200000
200000

Cash flow from operating activities
0
295875
456750
456750
456750
456750
386750
386750
386750
Investing activities

Initial investment
-1000000
0
0
0
0
0
0
0
0
Additional net investment
-200000
0
0
0
0
0
0
0
200000
Cash flow from investing activities
-1200000
0
0
0
0
0
0
0
200000
Cash flow from O and I activities
-1200000
295875
456750
456750
456750
456750
386750
386750
586750
Note: Because we have no additional info about the WC we assume that it will not change over the projects life. Then Working Capital Change for each year Yi is:
Change in Working Capital = Previous Year WC - Current WC = 0 (i= 1 to 7) and ChWC0 = -$100, 000 at year 8 and this amount will be recovered during year 8.( (McLaney, 2009)
NPV:
The discounted value of all ‘ Cash inflows’ is $2275689. 26.
NPV= Initial investment – discounted cash inflows which is:
NPV= (1, 200, 000)+ 2275689. 26
NPV= $1, 075, 689. 26
(Shim & Siegel, 2008)
Payback period:
At the end of two years the initial investment recovered would be equal to:
295, 875+ 456, 750= 752625
Therefore, the payback period is 2 years and
Payback period: 2 years and 353 days (Warren, Reeve, & Duchac, 2011)
a)
The project would be accepted on the basis of NPV and payback period. This project answers to both the queries in positivity. The NPV of this project is $1, 075, 689. 26 which is substantial relative to the project. Moreover, the project would be accepted on the basis of payback method because of its initial investment recovery within 3 years. The company has a policy of not accepting projects with a payback period of over 3 years and this project will recover its initial investment in less than 3 years. (Puxty, Dodds, & Wilson, 1988)
b)
Company’s analysis of the project is based on NPV and payback period. Initial investment has large weight age in both of these analyses therefore; our analysis would change if addition investment in land building is required. Our NPV would decline and payback period will increase substantially. If the additional investment is more than $1, 075, 689. 26 then the project would not be accepted on the basis of NPV. Moreover, its payback period would drastically increase leading to refusal of the project’s proposal.
Works Cited
McLaney, E. (2009). Business finance: theory and practice. Pearson Education Canada.
Puxty, A. G., Dodds, J. C., & Wilson, R. M. (1988). Financial management: method and meaning. Taylor & Francis.
Shim, J. K., & Siegel, J. G. (2008). Financial Management. Barrons Educational Series.
Warren, C. S., Reeve, J. M., & Duchac, J. (2011). Managerial Accounting. Cengage Learning.