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QUESTION

1. A company is considering a new investment project. The project requires an initial investment of \$100,000 and is expected to generate cash flows of \$30,000 per year for 5 years. The company's cost of capital is 10%. Calculate the Net Present Value (NPV) of the project.

ANSWER

The NPV of the project is calculated as follows:

$$NPV = -100,000 + \frac{30,000}{1.10} + \frac{30,000}{1.10^2} + \frac{30,000}{1.10^3} + \frac{30,000}{1.10^4} + \frac{30,000}{1.10^5}$$
$$NPV = -100,000 + 27,273 + 24,793 + 22,539 + 20,490 + 18,713$$
$$NPV = -100,000 + 113,808$$
$$NPV = 13,808$$

QUESTION

2. A company is considering a new investment project. The project requires an initial investment of \$100,000 and is expected to generate cash flows of \$30,000 per year for 5 years. The company's cost of capital is 10%. Calculate the Internal Rate of Return (IRR) of the project.

ANSWER

The IRR of the project is calculated as follows:

$$0 = -100,000 + \frac{30,000}{1 + IRR} + \frac{30,000}{(1 + IRR)^2} + \frac{30,000}{(1 + IRR)^3} + \frac{30,000}{(1 + IRR)^4} + \frac{30,000}{(1 + IRR)^5}$$

The IRR is the discount rate that makes the NPV of the project equal to zero. In this case, the IRR is approximately 15.24%.

QUESTION

3. A company is considering a new investment project. The project requires an initial investment of \$100,000 and is expected to generate cash flows of \$30,000 per year for 5 years. The company's cost of capital is 10%. Calculate the Payback Period of the project.

ANSWER

