

Passed Solution Review

a. A project costs \$10 up front and has net benefits of \$15 with probability 0.8 at the end of the second year and otherwise returns nothing. The discount rate is 0.035. What is the NPV?

$$-10 + \left(\frac{0}{1.035^1} \right) + \left(\frac{15}{1.035^2} \cdot .8 \right) = -10 + 0 + 11.202 = 1.202$$

b. At what probability of returning \$15 after year 2 would the ENPV be 0?

$$-10 + \left(\frac{15}{1.035^2} \cdot P \right) = 0$$

$$\frac{15}{1.035^2} \cdot P = 10$$

$$14.002P = 10$$

$$P = .71415$$