Tutorial 2:

Accounting & Finance Tutorial 1: How does Cameron Balloons assess its opportunities?

The financial figures used are entirely contrived and are made up to be most useful only for instruction.

Cameron Balloons has noticed that the materials it uses also have medical applications. A brief investigation has shown that the company could readily produce these goods with its existing staff and processes, though a “clean room” would need to be built to ensure a sterile environment. In addition clean storage facilities and materials handling processes would be needed. These would require an investment of £100,000. The MD believes that the additional sales in the first five years would be approximately £35,000 annually with operating costs of roughly £10,000. In addition the directors believe that they could dispose of the specialist equipment required for this project at the end of production for approximately £40,000 (£50,000 proceeds less £10,000 building reinstatement and sales costs). In the past, Cameron has used both a payback period of 3 years and a discount rate of 10% to assess such projects and typically achieves an ROI of about 17%.

Assess how attractive a development is this for Cameron?

You are expected to calculate appropriate measures, consider the sensitivity of those measures to misestimates of the key figures and consider other factors. Misestimates could include, for example:

1. Discount rate & risk premium

2. Residual value of equipment, unlikely to be higher than estimate but could be as little as zero net benefit.

3. Estimates of operational cash flows could easily be wrong by up to 20% either way. And these errors could escalate in later years.