## Review Classmates: Module 2 Mini-Project

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| **Reviews** | 8 complete |

**Well done!**

You've sent 8 classmates valuable feedback that will help them improve. You can review another submission below or you can continue the course.

Cut Here, Inc. Options Analysis



by Julie Arnold

Submitted on July 1, 2016

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### Part 1

Cut Here, Inc. is considering a new video rendering system for their in-house studio. Currently, there are two options. Each option involves a significant investment in an asset that has a multi-year useful life. The key benefits of each option are cash savings, which Cut Here equates to cash inflows (i.e., compared to the status quo scenario, in which it incurs significant costs in terms of labor, time, etc.).

Use the cash flow information provided in the Assignment Details section of the **Instructions** tab.

Then, use the following measures to assess the two options from a financial perspective. That is, compute the following measures for each option.

* Payback
* Accounting rate of return
* Net present value
* Internal rate of return

**Payback Period :** Option A Payback = 4 years and Option B Payback = 6 years   
(Assuming cost inflows for each year are received at the end of the year)

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| **Accounting Rate of Return**: | Option A | Option B |
| Avg. Annual Cash savings | $40,000.00 | $69,500.00 |
| Annual Depreciation | $16,666.67 | $41,666.67 |
| Difference | $23,333.33 | $27,833.33 |
| Rate of Return | 23.33% | 11.13% |

Please note that for the NPV calculation no discount or hurdle rate is given in the problem so I calculated NPV using two scenarios for comparison, one scenario at 10% discount rate and the other at 16%.

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| **NPV** | Option A | Option B |
| 10% discount rate | $68,568.91 | ($11,937.80) |
| 16% discount rate | $35,341.41 | ($75,582.60) |

(As a first step, I calculated the present value of cash flows for each of the 6 years for both Options A and B using formula (i.e. year "X" cash savings x 1/ (1+.10)^YearX), then added up total of all 6 years of discounted cash flows. From there, I took the difference between total discounted cash flows and the cash outflow amount in year 0.)

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|  | Option A | Option B |
| **Internal Rate of Return (IRR)** | 27.81% | 9.09% |

(Can use a trial and error method and calculate NPV at different rates until you arrive at the rate where NPV is 0. I calculated using the formula in an Excel spreadsheet. IRR is the discount rate at which NPV becomes 0.

Read the response to Part 1 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 points: No answer, completely irrelevant answer.
* 5 pts - 5 points: Insufficient, incomplete, lacks supporting evidence.
* 7 pts - 7 points: Passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
* **10 pts - 10 points: Superior performance, excellent.**

### Part 2

Based on what you calculated in Part 1, which option would you recommend to Cut Here management?

I would recommend that Cut Here go with Option A. The NPV is positive and coupled with the fact that the Internal Rate of Return is quite high, Option A appears to be a good investment. Waiting for the big in flow of cash in year 6 for Option B is not worth it given the time value of money. The large in flow in year 6 has more risk associated with it, and you could likely invest the original amount of $250,000 in a better investment as NPV for option B is negative.

Read the response to Part 2 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 points: No answer, completely irrelevant answer.
* 5 pts - 5 points: Insufficient answer, incomplete, lacks supporting evidence.
* 7 pts - 7 points: Passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
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### Part 3

Describe some of the strengths and weaknesses of your analysis (i.e., specific measures, etc.). Also, what other considerations might influence your recommendation?

Although payback period and accounting rate of return are simple calculations, they can be misleading because they do not take into account the time value of money or show the feasibility of the options based on cost inflows and outflows.  
  
Strengths of using NPV as an indicator of investment viability and value is that NPV accounts both for cash flows and time value of money. Additionally, it allows you to compare other investments on an equal playing field by discounting money into today's terms. However, NPV requires that an investor or company make some assumptions, and there is some uncertainty about what inappropriate rate of return should be.  
  
Some potential weaknesses in IRR and NPV is that impact of inflation over life of the investment must be considered and there may be other factors in the decision to move ahead (or not) with an investment. If an investment option has a negative NPV or does not meet the company's required rate of return, there may be other reasons to pursue the investment that are of a strategic nature. These could be a company's desire to maintain brand image, be first to market, or form a strategic partnership or alliance. The investment may serve as a loss leader and drive growth and profitability in another product line or company sector.  
  
Quantitative measures are very helpful in analyzing investment options, but they must consider the bigger picture.

Read the response to Part 3 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 points: No answer, completely irrelevant answer.
* 5 pts - 5 points: Insufficient answer, incomplete, lacks supporting evidence.
* 7 pts - 7 points: Passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
* **10 pts - 10 points: Superior performance, excellent.**

Please provide any overall feedback that you have for the author of this assignment. What is one strength of the submission? What is one area of improvement that you would like to suggest?

Submit Review

Excellent !!!

<https://www.coursera.org/learn/managerial-accounting-tools/peer/crAeu/module-2-mini-project/discussions/threads/jBqzpFyDEeaCxw4CtnLVoQ>

Visible to classmates

