Tutorial 7 Expected Return, NPV and Payback Analysis

Entrepreneurs are required to make several investment decisions in the process of managing their firms. Below are the criteria of capital budgeting for Nelson's Enterprise:

- Nelson's Enterprise has two mutually exclusive projects, Project-A and Project-B which requires an outlay of $2,000 and $1,800 respectively.
- Baron can afford only one of the projects.
- First, Nelson's Enterprise needs to determine the expected return on Project-A and Project-B :
  - Expected Life – 2 years
  - Applicable tax rate – 47.50 %
  - Depreciation = Cost/Life
  - Anticipated change in net income for Project-A in Year 1,2 is $1200, $1000
  - Anticipated change in net income for Project-B in Year 1,2 is $820, $950
- Secondly, Nelson's Enterprise needs to buy a server which cost $3,000 for the business, but is unsure which of the two proposals to accept. Using the Payback Method, help Nelson's Enterprise to make decision.
- Thirdly, Nelson's Enterprise would like to seek more information before making his final decision. The company would like to use Net Present Value (NPV) method. The cost of capital is 8.45 percent. Round the discount factor to TWO (2) decimal places.

i) Determine the expected return on Project-A and Project-B.

ii) Compute the payback period for Project-A and Project-B. Give suggestion after the computation.

iii) Calculate the NPV for Project-A and Project-B. Give suggestion on the NPV calculation.