

CHAPTER 10

⊙ PAYBACK PERIOD

- LESS THAN the maximum acceptable payback period ACCEPT
- GREATER THAN maximum acceptable payback period REJECT

$$\triangleright \text{initial investment} \div \text{annual cash inflow} = \text{Payback Period}$$

$$\triangleright (1 - \text{tax rate}) \times \text{Pre-tax cash flow} = \text{After tax cash flow}$$

⊙ NET PRESENT VALUE (NPV)

- GREATER THAN \$0, ACCEPT the project.
- LESS THAN \$0, REJECT the project.

$$\triangleright \text{PV of cash inflows} - \text{initial investment} = \text{NPV}$$

$$\triangleright \sum_{t=1}^n \frac{CF_t}{(1+r)^t} - CF_0 = \text{NPV}$$

CF_0 = initial investment

CF_t = PV of its cash inflows

r = cost of capital

$$\triangleright \frac{\sum_{t=1}^n \frac{CF_t}{(1+r)^t}}{CF_0} = \text{PROFITABILITY INDEX (PI)}$$

$$\triangleright \text{PV of cash inflow} \div \text{initial cash outflow} = \text{PI}$$

$$\triangleright \text{Project cash flow} - [(\text{cost of capital}) \times (\text{invested capital})] = \text{EVA}$$

⊙ INTERNAL RATE OF RETURN (IRR)

- GREATER THAN the cost of capital, ACCEPT the project.
- LESS THAN the cost of capital, REJECT the project.

$$\sum_{t=1}^n \frac{CF_t}{(1+IRR)^t} - CF_0 = \$0$$

$$\sum_{t=1}^n \frac{CF_t}{(1+IRR)^t} = CF_0$$

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$$\begin{aligned} A &= AR/AR \\ A &= AR/AR \\ S &= SR/ST \end{aligned}$$

$$\begin{aligned} A &= A \times 0.1 \\ B &= B \times 0.1 \end{aligned}$$