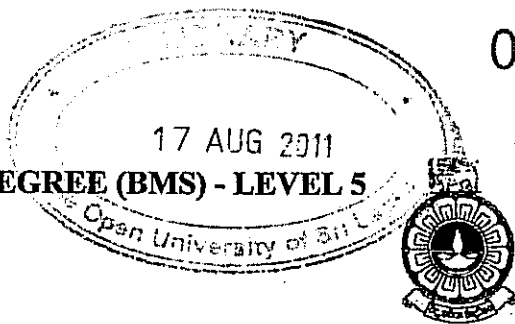


THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES DEGREE (BMS) - LEVEL 5
FINAL EXAMINATION 2011
PROJECT APPRAISAL - MCU 3204



DURATION: THREE (03) HOURS

DATE : 23rd February, 2011

TIME : 1.30 pm – 4.30 pm

- Instructions:** (I) Answer Question 1 (compulsory) and any THREE (03) from others.
 (II) Use of non-programmable calculators is allowed.
 (III) A PV table is attached herewith.

1. A project requires a capital outlay of Rs. 9,000,000 and earns the following cash inflows over the following seven years:

Year	1	2	3	4	5	6	7
Inflows in Rs'000	2000	2500	3000	4500	4000	2000	1500

The project will be completed at the end of seventh year and all fixed assets are expected to be sold for Rs. 1,500,000. The project will incur operating costs of Rs. 1,750,000 in the first year, including depreciation of Rs. 600,000. This is expected to be increased annually by additional Rs. 100,000. (Depreciation value remains unchanged.)

The project's expected rate of return is 12%.

- (i) Calculate the project's payback period. Comment. (04 marks)
- (ii) What is the Accounting Rate of Return (ARR) for the project? How do you feel about the practical applicability of ARR as a decision tool? (07 marks)
- (iii) Calculate NPV of the project. (07 marks)
- (iv) What is the Internal Rate of Return (IRR) of the project? (07 marks)
- (v) How do you make the investment decision using NPV and IRR? (04 marks)
- (vi) Calculate the Net Benefit Investment Ratio (NBIR) of the project and decide on the viability of the project? (05 marks)

- (vii), What will be the risk of making the investment decision when you consider only the above two methods in appraising this project? Discuss. (06 marks)
(Total 40 Marks)
2. Write an essay on "Project Management and why it is needed in an organization?" (not more than 750 words) (20 marks)
3. (i) How do choosing and understanding of the market segments and targets help in carrying out a proper market analysis? Explain.
(ii) What are the factors that should be considered in forecasting demand of a commercial project? (20 marks)
4. (i) Explain the main approaches that can be used to evaluate the capital structure decision of a project.
(ii) Total capital requirement for a project is estimated as Rs. 350 Mn. The project expects Rs. 110 Mn of EBIT. Company has two alternative financing plans. Alternative 1 is to fully finance with ordinary shares and Alternative 2 is to issue 18% Debentures worth 100Mn and rest with ordinary shares. The owners expect 22% dividend for the investment. Evaluate the two alternatives if the corporate tax rate is 35%. (20 marks)
5. (i) What are the practical problems that can be seen in implementing non-commercial projects? Explain.
(ii) "Incomplete financial appraisal is the major reason for failures of most projects". Comment. (20 marks)

Table of Present Values

$PVIF = 1/(1+i)^n$

Period (n)	Discount rates														
	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	22%	24%
1	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8547	0.8475	0.8403	0.8333	0.8197	0.8066
2	0.8573	0.8417	0.8264	0.8116	0.7972	0.7831	0.7695	0.7561	0.7432	0.7305	0.7182	0.7062	0.6944	0.6719	0.6504
3	0.7938	0.7722	0.7513	0.7312	0.7118	0.6931	0.6750	0.6575	0.6407	0.6244	0.6086	0.5934	0.5787	0.5507	0.5245
4	0.7350	0.7084	0.6830	0.6587	0.6355	0.6133	0.5921	0.5718	0.5523	0.5337	0.5158	0.4987	0.4823	0.4514	0.4230
5	0.6806	0.6499	0.6209	0.5935	0.5674	0.5428	0.5194	0.4972	0.4761	0.4561	0.4371	0.4180	0.4019	0.3700	0.3411
6	0.6302	0.5963	0.5646	0.5346	0.5066	0.4803	0.4556	0.4323	0.4104	0.3898	0.3704	0.3521	0.3349	0.3033	0.2751
7	0.5835	0.5470	0.5132	0.4817	0.4523	0.4251	0.3996	0.3759	0.3538	0.3332	0.3139	0.2959	0.2791	0.2486	0.2218
8	0.5403	0.5019	0.4665	0.4339	0.4039	0.3762	0.3506	0.3269	0.3050	0.2848	0.2660	0.2487	0.2326	0.2038	0.1789
9	0.5002	0.4604	0.4241	0.3909	0.3606	0.3329	0.3075	0.2843	0.2630	0.2434	0.2255	0.2090	0.1938	0.1670	0.1443
10	0.4632	0.4224	0.3855	0.3522	0.3220	0.2946	0.2697	0.2472	0.2267	0.2080	0.1911	0.1756	0.1615	0.1369	0.1164

Period (n)	Discount rates														
	25%	26%	27%	28%	30%	32%	34%	36%	38%	40%	42%	44%	46%	48%	50%
1	0.8000	0.7937	0.7874	0.7813	0.7692	0.7576	0.7463	0.7353	0.7246	0.7143	0.7042	0.6944	0.6849	0.6757	0.6667
2	0.6400	0.6299	0.6200	0.6104	0.5917	0.5739	0.5569	0.5407	0.5251	0.5102	0.4959	0.4823	0.4691	0.4565	0.4444
3	0.5120	0.4999	0.4882	0.4768	0.4552	0.4348	0.4156	0.3975	0.3805	0.3644	0.3492	0.3349	0.3213	0.3085	0.2963
4	0.4096	0.3968	0.3844	0.3725	0.3501	0.3294	0.3102	0.2923	0.2757	0.2603	0.2459	0.2326	0.2201	0.2084	0.1975
5	0.3277	0.3149	0.3027	0.2910	0.2693	0.2495	0.2315	0.2149	0.1998	0.1859	0.1732	0.1615	0.1507	0.1408	0.1317
6	0.2621	0.2499	0.2383	0.2274	0.2072	0.1890	0.1727	0.1580	0.1448	0.1328	0.1220	0.1122	0.1032	0.0952	0.0878
7	0.2097	0.1983	0.1877	0.1776	0.1594	0.1432	0.1289	0.1162	0.1049	0.0949	0.0859	0.0779	0.0707	0.0643	0.0585
8	0.1678	0.1574	0.1478	0.1388	0.1226	0.1085	0.0962	0.0854	0.0760	0.0678	0.0605	0.0541	0.0484	0.0434	0.0390
9	0.1342	0.1249	0.1164	0.1084	0.0943	0.0822	0.0718	0.0628	0.0551	0.0484	0.0426	0.0376	0.0332	0.0294	0.0260
10	0.1074	0.0992	0.0916	0.0847	0.0725	0.0623	0.0536	0.0462	0.0399	0.0346	0.0300	0.0261	0.0227	0.0198	0.0173