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THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES – LEVEL 5
FINAL EXAMINATION- 2007
PROJECT APPRAISAL – MCU 3204
DURATION : THREE (03) HOURS

This paper contains ***six Questions*** and has ***TWO PAGES***.

Date : 25th February 2007	Time : 9.30 a.m. – 12.30 p.m.

Answer Question 1 (compulsory) and any THREE (03) from others.

(1) A business man considers two independent projects for investment. The projects, 'Hitek' and 'Midtek', have the following expected cash flows.

Expected annual cash flows (Rs. Thousands)

	Year			
Project	**2007**	**2008**	**2009**	**2010**
Hitek	-800	400	400	300
Midtek	-800	200	300	625

Cost of capital for the businessman is 10%.

a) Which of the two projects gives the highest return on investment? (06 marks)

b) If the investor expects to recover the investment in the shortest possible time, assist him to identify the most suitable project. (06 marks)

c) For each project calculate;
   (i) Net Present Value
   (ii) Internal Rate of Return and
   (iii) Net Benefit Investment Ratio (16 marks)

d) Identify the best project based on the results of (c) above. Explain the reasons for your decision. (06 marks)

e) Assume both projects are divisible. If the businessman has Rs.1.2 millions for investment, what should be his investment plan? (08 marks)

f) If the project Hitek bears a 3% risk higher than the project Midtek, does your answer to (d) above will remain as same? Explain. (05 marks)

g) If the rate of inflation is expected to increase in the next few years, explain its impact on these projects. (05 marks)

(2) Explain the stages of project life cycle a successful project may go through. What are the stages a project idea may be dropped or redefined? Explain with suitable examples. (16 marks)

(3) (a) Explain why project feasibility has to be examined at the beginning of a project? (06 marks)

(b) Explain (i) Marketing (ii) Technical and (iii) Financial feasibility of projects. (10 marks)

(4) (a) With suitable examples, explain the;
(i) independent projects and (ii) mutually beneficial projects. (10 marks)

(b) When selecting such projects what financial analysis tools do you use? Explain. (06 marks)

(5) A project with an annual expected return of Rs. 2.5 million requires an investment of Rs. 10 million. A businessman has the following financing options for this project.

Investment options (Rs. Millions)

	Option 1	**Option 2**
Equity capital (15% dividends)	10	5
Long term loans (20% interest)	-	5

(a) What is the cost of capital under each option? What is the best option? (05 marks)

(b) If the income tax is 35%, what is the most profitable financing option? Explain why. (05 marks)

(c) Explain the merits and demerits of using higher levels of loan capital. (06 marks)

(6) Explain any four of the following. Use suitable examples where necessary. (04 marks each)

(a) Impact of subsidies and taxes on projects.
(b) Inflation and its impact on long term and short term projects.
(c) Externalities of a project.
(d) Different sources of financing for a project.
(e) Performa profit and loss account and balance sheet and their uses.

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