Problems

Obj | 2, 3

P15-1 Average rate of return method, net present value method, and analysis

The capital investment committee of Overnight Express Inc. is considering two investment projects. The estimated income from operations and net cash flows from each investment are as follows:

✔ 1. a. 16.5%

	Distribution Center Expansion		Internet Tracking Technology	
Year	Income from Operations	Net Cash Flows	Income from Operations	Net Cash Flows
1	$ 66,000	$ 226,000	$200,000	$ 360,000
2	66,000	226,000	90,000	250,000
3	66,000	226,000	30,000	190,000
4	66,000	226,000	10,000	170,000
5	66,000	226,000	0	160,000
Total	$330,000	$1,130,000	$330,000	$1,130,000

Each project requires an investment of $800,000. Straight-line depreciation will be used, and no residual value is expected. The committee has selected a rate of 15% for purposes of the net present value analysis.

Instructions

1. Compute the following:
   a. The average rate of return for each investment.
   b. The net present value for each investment. Use the present value of $1 table appearing in this chapter.
2. Prepare a brief report for the capital investment committee, advising it on the relative merits of the two projects.