

Chapter 06: Section 2

Practice Question 153:

As a Management Accountant for Mango Holdings, you are reviewing a major capital investment proposal. The Renewable Energy division has proposed a new 30 MW solar expansion project. The initial financial analysis includes an annual Rs. 10 million charge for corporate head office overhead. It also lists the Rs. 50 million original purchase price of the proposed land, which the company acquired five years ago and has remained idle since. Your review must address a key question for the project's approval: How should Mango Holdings differentiate between relevant and irrelevant cash flows when evaluating a major solar power expansion to ensure the project's true profitability is assessed? The Chief Financial Officer, Ravindra Jayawardena, has tasked you with preparing a revised cash flow projection for the investment committee.

To provide an accurate project appraisal, your revised analysis must correctly classify all cash flows based on their relevance to the investment decision. This involves applying the principles of cash flow identification and classification from this subsection.

Practice Question 154:

As a Credit Analyst at Taprobane Finance Ltd, you are reviewing a recent portfolio acquisition. The company has purchased 100 SME loans from a smaller competitor. Each loan requires a fixed monthly repayment of Rs. 50,000 for the next 36 months. The finance department has confirmed that the company's required rate of return for this type of asset is 1.5% per month.

Your manager needs to validate the acquisition price and has asked you to answer the question: **How can Taprobane Finance Ltd accurately determine the present value of a newly acquired portfolio of SME loans with fixed monthly repayments to ensure it paid a fair price?**

Your task is to calculate the total present value of these future cash flows to validate the purchase.

Practice Question 155:

An investment of Rs. 10 million generates average annual profits of Rs. 1.5 million.

Calculate the Accounting rate of return.

Method Appropriateness Matrix				
Criterion	Payback	ARR	NPV	IRR
Project Scale	Low	Low	High	High
Data Requirements	Low	Medium	High	High
Resource Intensity	Low	Low	High	High
Communication Ease	High	High	Low	Medium

Practice Question 156:

As the Group CFO at Mango Holdings, you are presenting a critical capital allocation decision to the board. The Renewable Energy division has proposed a Rs. 1.5 billion investment in a new wind farm with a projected ten-year operational life.

Financial projections show the project will generate significant positive cash flows from year three onwards, ultimately delivering strong returns over its full life. However, high depreciation charges on the new turbine infrastructure will result in accounting losses during the first two years of operation.

A board member, focusing on these near-term accounting metrics, has expressed serious concerns about approving the investment.

How can the CFO of Mango Holdings use DCF methods to convince the board that a 10-year wind farm project with a negative accounting profit in its first two years is actually a value-creating investment?

Your task is to prepare a compelling financial argument that demonstrates the project's true economic value.

Practice Question 157:

As Finance Manager at Zenith Logistics, you are reviewing two capital proposals from the operations team. The first is a Rs. 500 million investment in an automated warehouse facility with a projected operational life of 15 years.

This warehouse will support the company's expansion into pharmaceutical logistics and requires careful evaluation given its scale and long-term nature. The second proposal requests Rs. 50 million for a fleet of electric delivery motorcycles to expand last-mile delivery services in Colombo, with an expected operational life of 3 years.

The board requires your recommendation on evaluation approaches for these distinct investments.

How should the finance team at Zenith Logistics decide which capital budgeting method to use for two very different proposals: a Rs. 500 million automated warehouse and a Rs. 50 million fleet of last-mile delivery bikes?

Your task is to prepare a formal recommendation that justifies the selection of the most appropriate appraisal method for each project.

Practice Question 158:

Trident Logic Ltd is evaluating a new technology solutions project with the following annual estimates: Sales Revenue of Rs. 25,000,000, Operating Costs (excluding depreciation) of Rs. 15,000,000, and Depreciation of Rs. 2,000,000. The company's tax rate is 30%. Calculate the annual operating cash flow (OCF).

Practice Question 159:

What is the impact of the riskiness of the project on the discount rate and the net present value of a project?

Practice Question 160:

What are the DCF and Non-DCF based project evaluation methods?

Practice Question 161:

Compare the use of Payback, ARR, NPV and IRR in evaluating projects on project scale, data requirements, resource intensity and ease of communication.

Practice Question 162:

As a Treasury Analyst at Taprobane Finance Ltd., you are evaluating a repayment proposal from a corporate client who owes the company Rs. 1 million. The client has presented two settlement options for your analysis. Option one consists of a single payment of Rs. 1,050,000 at the end of one year. Option two involves five annual payments of Rs. 220,000 each, totaling Rs. 1,100,000 over the five-year period. The Head of Treasury requires your analysis to address a fundamental question: Why is a Rs. 1 million lump-sum repayment in one year financially superior to receiving five annual payments of Rs. 220,000, even though the total cash received is higher in the second option? Your task is to calculate the present value of both repayment proposals using Taprobane Finance's 8% opportunity cost of capital and provide a clear recommendation supported by financial analysis.

Practice Question 163:

As a Junior Financial Analyst at Lotus Construction Ltd., you are reviewing two mutually exclusive investment proposals for the company's next major development project.

Project A is the "Lotus Smart City" pilot, requiring a Rs. 2 billion investment that will generate cash flows over 20 years with a payback period of 8 years.

Project B is a small commercial tower, requiring Rs. 500 million with quick returns and a payback period of 3 years.

A senior manager, focused on maintaining post-development liquidity, strongly argues for Project B based on its shorter payback period.

During the investment committee meeting, he poses the question: **Why might relying on the Payback Period lead Lotus Construction to reject a highly profitable, long-term "Smart City" project in favour of a less valuable, short-term commercial project?**

Your task is to prepare a comprehensive memo that explains the limitations of this approach and provides a more complete analysis.

Practice Question 164:

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Practice Question 165:

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This warehouse will support the company's expansion into pharmaceutical logistics and requires careful evaluation given its scale and long-term nature. The second proposal requests Rs. 50 million for a fleet of electric delivery motorcycles to expand last-mile delivery services in Colombo, with an expected operational life of 3 years.

The board requires your recommendation on evaluation approaches for these distinct investments.

How should the finance team at Zenith Logistics decide which capital budgeting method to use for two very different proposals: a Rs. 500 million automated warehouse and a Rs. 50 million fleet of last-mile delivery bikes?

Your task is to prepare a formal recommendation that justifies the selection of the most appropriate appraisal method for each project.

Practice Question 166:

BlueGem Textiles is evaluating a new automated dyeing system that requires an initial investment of Rs. 10,000,000. The expected net cash inflows are: Year 1: Rs. 2,000,000; Year 2: Rs. 3,000,000; Year 3: Rs. 4,000,000; Year 4: Rs. 5,000,000. Calculate the payback period.

Practice Question 167:

Trident Logic Ltd invests Rs. 20,000,000 in new server infrastructure with a 5-year life and no salvage value. The project is expected to generate the following accounting profits (after depreciation): Year 1: Rs. 1,500,000; Year 2: Rs. 2,000,000; Year 3: Rs. 2,500,000; Year 4: Rs. 2,200,000; Year 5: Rs. 1,800,000. Calculate the ARR based on the initial investment

Practice Question 168:

Serendib Hospitality is considering a hotel refurbishment project with an initial investment of Rs. 15,000,000. The project is expected to generate the following cash inflows over four years from increased room rates and occupancy: Year 1: Rs. 5M, Year 2: Rs. 6M, Year 3: Rs. 7M, Year 4: Rs. 4M. The company's required rate of return (discount rate) is 10%. Calculate the NPV and decide if the project should be accepted.

Practice Question 169:

With the data from question 168, explain whether the project is viable based on IRR.