FNCE 100 A. Craig MacKinlay

Practice Capital Budgeting Problem

JPC is considering the purchase of a machine to produce a new product line. The cost of the machine is $4 million. This machine falls into the 5-year asset class and thus would have to be capitalized and depreciated over 6 years at rates 20.00%, 32.00%, 19.20%, 11.52%,11.52%, and 5.76%. JPC's expects to run the machine for four years and then sell it. After the four years, the salvage value is estimated to be $2 million. For the four years of operation the equipment will generate revenues of $1.5 million per year and will have operating costs of $200,000 per year. If the required rate of return for JPC is 11%, should it purchase this equipment? The tax rate of JPC is 35%.