**FIN 440 LECTURE 10 & 11**

**CAPITAL BUDGETING**

**CHAPTER REFERENCE – CHP 9 & 10**

**Q. WHAT IS CAPITAL BUDGETING**

**KEYWORDS**

1. **CAPITAL EXPENSES vs. FIXED ASSET OUTLAYS**
2. **THE STEPS IN THE CAPITAL BUDGETING PROCESS**
3. **MUTUALLY EXCLUSIVE vs INDEPENDENT PROJECTS**
4. **CAPITAL RATIONING vs. UNLIMITED FUNDS**
5. **ACCEPT-REJECT vs. RANKING APPROACH**

**THE CAPITAL BUDGETING CASHFLOWS**

**OPERATING CASH FLOWS**

INITIAL INVESTMENT TERMINAL CASH FLOW

1. **CONVENTIONAL vs. NON-CONVENTIONAL CASH FLOWS**
2. **MARGINAL ANALSIS**

**AFTER TAX TREATMENT OF SALE OF ASSETS**

**CAPITAL GAIN TAX**

**MARKET**

**PRICE**

**RECAP. DEPR. TAX**

**BOOK PRICE**

**TAX LOSS**

***(ALL OF THESE TOPICS WILL BE DISCUSSED IN DETAIL DURING CLASS – PLEASE REMEMBER TO CONSULT YOUR LECTURE NOTES WHEN REVIEWING – THIS LECTURE SHEET IS A SUMMARY OF IMPORTANT POINTS)***

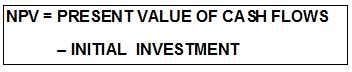
**CAPITAL BUDGETING TECHNIQUES**

1. **NET PRESENT VALUE (NPV)**

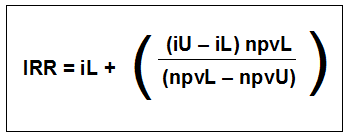
**DECISION CRITERIA**

IF NPV IS POSITIVE – ACCEPT

IF NPV IS NEGATIVE - REJECT

****

1. **INTERNAL RATE OF RETURN (IRR)**

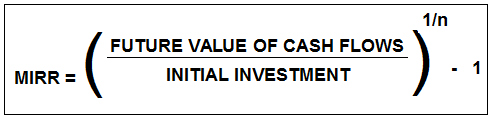
****

**DECISION CRITERIA**

IF IRR > cost of capital – ACCEPT

IF IRR < cost of capital - REJECT

1. **MODIFIED INTERNAL RATE OF RETURN (MIRR)**

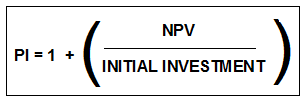
****

**DECISION CRITERIA**

SAME AS IRR

1. **PROFITIBILITY INDEX (PI)**

***(also known as PIR & VIR)***

****

**DECISION CRITERIA**

IF PI > 1 – ACCEPT

IF PI < 1 - REJECT

**DECISION CRITERIA**

IF NPV IS POSITIVE – ACCEPT

IF NPV IS NEGATIVE - REJECT