STUDYGUIDELINE FIN3701 – STUDY UNIT 3

1   GENERAL

This study unit is covered in chapter 10 of the prescribed textbook. The study unit creates problems for students who do not know how to use their calculator. It is important to know how to use your calculator in order to minimize the time you spend on each question in study unit 2 and 3. However, interest factor tables (textbook, pages 758-765) will be provided in the exam.

Please note: Students do not need to know both methods (calculator use and interest factor tables), calculator use is sufficient. This study unit is a continuation of study unit 2. The NPV technique discussed in study unit 2 will now be refined by taking into account an element of risk.

2   FORMAT OF ASSESSMENT

The content of this study unit will be assessed by means of long questions. There are no formulae and graphs for this study unit.

3   IMPORTANT AREAS IN THE STUDY UNIT

Pay attention to the following:
*   Adjustment of the operating cash inflows using certainty equivalents (CEs).
*   Adjusting for risk using the risk-adjusted discount rate (RADR).
*   Comparing unequal lived projects/investments.

4   Study Guide Errata

Areas to correct:

Page 30: Example of scenario analysis

	PROJECT X			PROJECT Y		
	Cash inflow estimates			Cash inflow estimates		
	Pessimistic	Most likely	Optimistic	Pessimistic	Most likely	Optimistic
d.Net investment	R30 000	R30 000	R30 000	R30 000	R30 000	R30 000

Page 31: The equivalent annual annuity (EAA) / Annualised NPV (ANPV) approach
Students do not need to memorise the equation given on page 31, calculator use is recommended.

ANPV_A: ANPV_B:

$ANPV_A$:

537.28 ± PV   598.60 ± PV
10 N   5 N
14 I/YR   14 I/YR
PMT (DISPLAY: 103.00)   PMT (DISPLAY: 174.36)

Page 32: Example of capital rationing
Include project G in the data table.

Project	Initial Investment	IRR	PV of Inflows @ 15%
G	R1 200 000.00	20%	R1 300 000

Page 36: Feedback on self assessment questions
Question 3
The correct option is 2.

Question 4
Total investment = 990 000

Areas to skip:

Page 28: Certainty equivalent equation
Certainty equivalents will be given, students do not need to memorise this equation.

Page 32: Infinite replacement equation
Skip the equation: EAA of each project / Cost of capital

5   Textbook Errata

Areas to correct:

Page 426: Annualised NPV (ANPV) equation
Students do not need to memorise equation 10.6, calculator use is recommended.