

STUDY GUIDELINE FIN3701 - STUDY UNIT 1

1 GENERAL

This study unit is covered in chapter 8 of the prescribed textbook. The study unit covers mainly the introduction to study units 2 and 3 (Topic 1: Investment decisions) and the terminology that will be used throughout the semester for FIN3701. It is VERY important that students go through the terminology since it will be difficult for them to answer any question in the exam if they do not know for example, that “capital rationing” means “limited funds”. Since FIN3701 is not an English module, you will never come across a question phrased like this “only one project must be chosen from the two” instead, the question will be phrased like this “the two projects are mutually exclusive”.

2 FORMAT OF ASSESSMENT

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

3 IMPORTANT AREAS IN THE STUDY UNIT

Pay attention to the following:

- The basic terminology.
- The most important formulae:
 - The initial investment formula (textbook page 350, Table 8.2).
 - The operating cash inflow formula (textbook page 356, Table 8.6).
 - The terminal cash flow formula (textbook page 359 Table 8.9).
- Please note the following: Initial investment represents cash outflows, whereas the operating and terminal cash flows are cash inflows.
- The book value calculation.
- The tax calculation.

4 Text Book Errata

Areas to correct:

Page 354-Powell Corporation Example

Old machine

Accumulated depreciation = $(800\,000/5) \times 3 = 480\,000$

Book value = $(800\,000 - 480\,000) = 320\,000$

Gain = $(600\,000 - 320\,000) = 280\,000$

Tax liability = $(280\,000 \times 0.30) = 84\,000$

After-tax proceeds = $(600\,000 - 84\,000) = 516\,000$

Initial investment = $(2\,200\,000 - 516\,000 - 30\,000) = 1\,654\,000$