#1-174A

EASY INTERMEDIATE HARD

CFA® SAMPLE QUESTION – LEVEL I

Corporate Finance

Q: An analyst has gathered the following information about two projects, each with a 12% required rate of return:

	Project A	**Project B**
Initial Cost	$15,000	$20,000
Life	5 Years	4 Years
Cash Inflows	$5,000 per Year	$7,500 per Year

If the projects are mutually exclusive, the company should:

CORRECT ANSWER:

ⓑ **accept Project A and reject Project B.**

To answer this question, we need to find out the NPV for both Project A and Project B first.
NPV computation is easy if you have a financial calculator (or Excel worksheet…). Treat the cash flows as annuity

Project A: N = 5, I = 12, PMT = 5,000, FV = 0, CPT ==> PV = -18,024
Thus NPV of project A = 18,024 - 15,000 ==> $ 3,024

Project B: N = 4, I = 12, PMT = 7,500, FV = 0, CPT ==> PV = -22,780
Thus NPV of project A = 22,780 - 20,000 ==> $2,780

If the projects are mutually exclusive, then you should choose the project with the Highest NPV. That is choose Project A and reject Project B accordingly.

CFA Society Hong Kong
Candidate Services

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