**Question 2: Capital Budgeting Techniques**

Sea Cable Industries is a company involved in the manufacture of marine cables. The company is planning a move into land lines to exploit new telecommunications opportunities. This will involve the acquisition of new equipment. Two machines have been identified and the returns involved in purchasing each, are as follow:

**Machine 1 Machine 2**

**Rand Rand**

Cost (Immediate outlay) 200 000 120 000

Expected annual net Profit/Loss

Year 1 60 000 33 000

Year 2 (2000) (12 000)

Year 3 8 000 12 000

Year 3 Estimated residual value 14 000 12 000

The company has an estimated cost of capital of 10% and utilizes the straight line method of depreciation. Sea Cable Industries minimum accounting rate of return is 18% and the maximum payback period is 2 years and 4 months. You should assume that the two machines are mutually exclusive.

**Required:**

2.1 Calculate the accounting rate of return for each machine, assess its acceptability and indicate which machine is better using the accounting rate of return.

2.2 Calculate the payback period for each machine, assess its acceptability and indicate which machine is better using the payback period.

2.3 Calculate the net present value (NPV) of each machine, assess its acceptability and indicate which machine is better using NPV.

2.4 Calculate the internal rate of return (IRR) of each machine, assess its acceptability and indicate which machine is better using IRR.

2.5 Which method of investment appraisal is most appropriate and give reasons.