**Johnnie & Sons Paints Inc.**

**Capital Budgeting Decision**

**SAMPLE PROJECT**

The production department has been investigating possible ways to trim total production costs. One possibility currently being examined is to make the paint cans instead of purchasing them. The equipment needed would cost $200,000, with a disposal value of $40,000, and would be able to produce 5,000,000 cans over the life of the machinery. The production department estimates that approximately 1,000,000 cans would be needed for each of the next 5 years.

These three individuals would be full-time employees working 2,300 hours per year and earning $8.50 per hour. They would also receive the same benefits as other production employees, 18% of wages in addition to $1,500 of health benefits.

It is estimated that the raw materials will cost 20¢ per can and that other variable costs would be 10¢ per can. Because there is currently unused space in the factory, no additional fixed costs would be incurred if this proposal is accepted.

It is expected that cans would cost 50¢ each if purchased from the current supplier. The company's minimum rate of return (hurdle rate) has been determined to be 10% for all new projects, and the current tax rate of 35% is anticipated to remain unchanged. The pricing for a gallon of paint as well as number of units sold will not be affected by this decision. The unit-of-production depreciation method would be used if the new equipment is purchased.

* Based on the above information and using Excel, calculate the following items for this proposed equipment purchase:

1. Annual cash flows over the expected life of the equipment

2. Payback period

3. Simple rate of return

4. Net present value

5. Internal rate of return

* Would you recommend the acceptance of this proposal? Why or why not?