

Homework: Capital Budgeting—Cash Flow Estimation (1)

The president of Real Time, Inc. is considering the acquisition of a new computer. It costs \$40,000, and falls into the MACRS 3-year class. Its purchase would require an increase in net working capital of \$2,000. It would increase the firm's before-tax revenues by \$20,000 per year but would also increase operating costs by \$5,000 per year. The computer is expected to be used for 3 years and then be sold for \$25,000. The firm's marginal tax rate is 40%, and the project's cost of capital is 14%.

Estimate the project's cash flows and determine whether the firm should undertake the investment.