

13. The Leventhal Baking Company is thinking of expanding its operations into a new line of pastries. The firm expects to sell \$350,000 of the new product in the first year and \$500,000 each year thereafter. Direct costs including labor and materials will be 60% of sales. Indirect incremental costs are estimated at \$40,000 a year. The project will require several new ovens that will cost a total of \$500,000 and be depreciated straight-line over five years. The current plant is underutilized, so space is available that cannot be otherwise sold or rented. The firm's marginal tax rate is 35% and its cost of capital is 12%. Assume revenue is collected immediately and inventory is bought and paid for every day, so no additional working capital is required.

a. Prepare a statement showing the incremental cash flows for this project over an eight-year period. (Structure as a new venture.)

b. Calculate the payback period, NPV, and PI.

c. Recommend either acceptance or rejection.

d. If the space to be used could otherwise be rented out for \$30,000 a year, how would you put that fact into the calculation? Would the project be acceptable in that case? That is, treat the \$30,000 as a real cash outflow.