Som-Lalit Institute of Management Studies (SLIMS)

Subject Code: 4529202, Subject Name: Corporate Finance

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Topic: Capital Budgeting

Rainbow Colours Ltd. is a leading manufacturing of Paints. Its projects ideally have a short period of life as it introduces new shades of paints on regular intervals depending upon the demand of the market. The company have a separate segment of colours which are mainly targeted at the various interior designing firms who have a niche cliental. They like to experiment in their projects. Since last one year the designers are demanding certain offbeats colours which they can use for the accent walls in their projects.

Mr. Harsh Patel, who is a CFA by qualification having a work experience of 15 years with various big organisations of repute has been appointed as the financial expert by the company. He has been asked to study the current market scenario of the paint industry. Based on that he has to analyse the two projects that the company is considering to introduce in the market.

Both the projects have the initial cash outlay of Rs. 10,00,000. The cost of capital of both the projects is 12%.

The expected cash flows of the projects are as follows:

Year	Project Mauve (Rs.)	Project Teal (Rs.)
1	1,00,000	1,00,000
2	2,00,000	2,00,000
3	2,00,000	3,00,000
4	4,00,000	6,00,000
5	5,00,000	3,00,000

Based on the above information, Mr. Patel has been asked to calculate, analyse and suggest to Rainbow Colours Ltd. which project to accept and why considering the following:

1. What is NPV? Calculate the NPV of projects “Mauve” and “Teal”.

2. Find out the payback period and discounted payback period for both the projects.

3. If both the projects are mutually exclusive and the cost of capital is 15% then the company should select which project?