Quiz A for 4:00 Class: 11/26/12 Name ____________________________

Bowl Bound 3 Inc. is considering whether to build a new plant today at a cost of $100 million. There is a 30% chance that the plant will generate net cash flows of $20 million per year for 25 years and a 70% chance that the factory will generate net cash flows of $15 million per year for 7 years. In both cases, net cash flows would begin a year from today. However, rather than building today, Bowl Bound could wait a year to determine the size of the market for its product and thus will know whether net cash flows from the plant will equal $20 million per year or $15 million per year. Assume the cost of capital for the project equals 10%.

a. Sketch a decision tree of this capital budgeting decision.
b. Set up the calculations needed to determine the expected net present value of building today. How would you make a decision?

Wall Street Journal Questions are on the back of this page.