

Quiz A: 4/23/12

Name & Time _____

Quiz: Draw a decision tree for the following project. Be sure to clearly label anything you want me to grade.

Assume that Sweep the Aggies Inc. is considering whether or not to build a factory today at a total cost today of \$100,000. There is a 40% chance that the factory will produce annual cash flows of \$6000 per year and a 60% chance that the project will produce annual cash flows of \$12,000 per year. Either way, cash flows would continue through 20 years from today. If sales are high (\$12,000 per year), the factory could be expanded two years from today at a cost of \$60,000. This expansion will allow the factory to generate additional annual cash flows of \$8,000 per year starting three years from today that would continue through 20 years from today. If the factory is not expanded, annual cash flows would continue at \$12,000 per year (through 20 years from today). If sales are low (\$6000 per year), the factor can be sold one year from today for \$75,000.

Note: Bonus WSJ Questions on back of page