Exercise 14-12 (15 minutes)

1. Computation of the annual cash inflow associated with the new pinball machines:

Net operating income	$40,000
Add noncash deduction for depreciation	35,000
Annual net cash inflow	$75,000

The payback computation would be:

$$\text{Payback period} = \frac{\text{Investment required}}{\text{Annual net cash inflow}}$$

$$= \frac{\$300,000}{\$75,000 \text{ per year}} = 4.0 \text{ years}$$

Yes, the pinball machines would be purchased. The payback period is less than the maximum 5 years required by the company.

2. The simple rate of return would be:

$$\text{Simple rate of return} = \frac{\text{Annual incremental net income}}{\text{Initial investment}}$$

$$= \frac{\$40,000}{\$300,000} = 13.3\%$$

Yes, the pinball machines would be purchased. The 13.3% return exceeds 12%.