Contents

Preface xi

1 Overview of Engineering Economics
  1.1 Why Study Engineering Economics 1
  1.2 Text Objectives 2

2 Foundation of Engineering Economics
  2.1 Loan Elements
    2.1.1 Monies Transferred 3
    2.1.2 Balances, Interest Rate & Total Interest 4
    2.1.3 Interest Rate Specifications 5
    2.1.4 Analogy Between Loans & Rentals 6
  2.2 Cash Flows
    2.2.1 Definitions 7
    2.2.2 Cash Flow Diagram 7
  2.3 Fundamental Repayment Equation
    2.3.1 Definitions 8
    2.3.2 Derivation 9
    2.3.3 Total & Normalized Total Interests 10
    2.3.4 Using the Fundamental Repayment Equation 10
  2.4 Worth, Factors & Equivalence
    2.4.1 Worths of a Cash Flow 14
    2.4.2 Factors for a Cash Flow 16
    2.4.3 12-FACTOR Calculator 18
    2.4.4 Present & Future Worths of a Series 19
    2.4.5 Equivalence 20
  2.5 General Repayment Equation (GRE)
    2.5.1 Balance Equation 21
    2.5.2 Derivation of the GRE 22
    2.5.3 Total Interest Equation 23
    2.5.4 Applications of the GRE 24
  2.6 Uniform Series Factors & Uniform Worth Factors of a Cash Flow
    2.6.1 Present Worth Factor 26
    2.6.2 Future Worth Factor 29
    2.6.3 Uniform Worth of a Present Cash Flow 30
    2.6.4 Uniform Worth of a Future Cash Flow 33
    2.6.5 Shifted Basic Series 36
  2.7 Gradient Series Factors
    2.7.1 Present Worth Factor 39
    2.7.2 Future Worth Factor 43
    2.7.3 Uniform Worth of a Gradient Series 43
  2.8 Geometric Gradient Series Factors
    2.8.1 Present Worth Factor 46
    2.8.2 Net Present Worth Factor 48
VI Contents

2.8.3 Future Worth Factor 50
2.8.4 Uniform Worth of a Geometric Gradient Series 51

2.9 Rate of Return of a Simple Investment
2.9.1 Comparison of Loans & Investments 53
2.9.2 Rate of Return of an Investment 54
2.9.3 Simple Investments 56

2.10 Calculating the IRR% with Excel
2.10.1 IRR Function 57
2.10.2 Spreadsheet Cells 59
2.10.3 Goal Seek Command 59

2.11 Classification of the Examples 60

2.12 Developing the 12-FACTOR Calculator
2.12.1 Creating the 12-Factor Functions in Excel 61
2.12.2 12-FACTOR Calculator 62
2.12.3 Excel’s Three Factor Functions 63

2.13 Summary 64

2.14 Problems 65

3 Intermediate Balances and Other Interest Rates & Series

3.1 Intermediate Balances
3.1.1 Intermediate Balance Equations 69
3.1.2 Annual Interests of a Home Mortgage 71
3.1.3 Recursive Calculation of Intermediate Balances 74

3.2 Other Interest Rates
3.2.1 Annual Percentage Yield 76
3.2.2 Simple Interest 78
3.2.3 Continuous Compounding 79

3.3 Composite Series
3.3.1 Introduction 81
3.3.2 Decreasing Linear Series 83
3.3.3 Composite Series Transformation Procedure 84

3.4 Summary 86

3.5 Problems 86

4 Annual Worth Comparisons

4.1 Introduction
4.1.1 Definitions 89
4.1.2 Rationale & Consistency of Annual Worth Comparisons 90

4.2 Specified Service Time
4.2.1 Introduction 91
4.2.2 ANNUAL WORTH COMPARISON Calculator 92
4.2.3 Using the ANNUAL WORTH COMPARISON Calculator 93
4.2.4 Component Replacement Costs 94
4.2.5 Adding Component Replacement Costs to the ANNUAL WORTH COMPARISON Calculator 95
4.2.6 Effect of the MARR on a Least-Cost Study 96

4.3 Indefinite Service Time
4.3.1 Least Common Multiple 97
4.3.2 Repeatability Assumption 98
4.3.3 Comparison of Specified & LCM Service Times 99
4.3.4 Disadvantages of the LCM Service Time 101

4.4 Other Cost Alternatives
4.4.1 Extra Capacity Versus Staged Construction 101
4.4.2 Dissimilar Alternatives 104
4.4.3 Irregular Alternatives 105

4.5 Perpetual Service Time
4.5.1 Definition 107
4.5.2 Three Annual Worth Limits 107

4.6 Annual Worth Investment Calculations 109

4.7 Problems 112

5 Present Worth Comparisons

5.1 Specified Service Time
5.1.1 Present Worths Without Replacement Costs 115
5.1.2 PRESENT WORTH COMPARISON Calculator 117
5.1.3 Using the PRESENT WORTH COMPARISON Calculator 117
5.1.4 Component Replacement Costs 118
5.1.5 Adding Component Replacement Costs to the
      PRESENT WORTH COMPARISON Calculator 120

5.2 Other Capacity Alternatives
5.2.1 Extra Capacity & Staged Construction Alternatives 121
5.2.2 Dissimilar & Irregular Alternatives 122

5.3 Perpetual Service Time
5.3.1 Definitions 122
5.3.2 Capitalized Costs of the Basic Series 123
5.3.3 Comparison of Annual Worth Limits & Capitalized Costs 123

5.4 Present Worth Investment Calculations 127

5.5 Choosing a Worth Calculation Method
5.5.1 Least-Cost Studies 127
5.5.2 Other Calculations 127

5.6 Summary 127

5.7 Problems 128

6 Simple and Quasi-Simple Investments

6.1 Simple Investments: A Quick Review
6.1.1 Definition 129
6.1.2 Properties 130

6.2 IRR% of a Manufacturing Plant Investment & End-of-Year
      Convention
6.2.1 Disbursement Classes 131
6.2.2 Cash Flow Timing 132
6.2.3 End-of-Year Convention 132
6.2.4 Pretax IRR% of a Chemical Plant Investment (SI-Class) 134

6.3 Simple Cost Reduction Investments
6.3.1 Definition 137
6.3.2 Calculating the IRR% (SI-Class) 137

6.4 Multi-Simple Investments
6.4.1 Definitions, Properties & Occurrences 138
VIII Contents

6.4.2 IRR of a Quasi-Simple Investment (QSI-Class) 139
6.5 Creating a Polynomial Root Finder in Mathematica
6.5.1 Creating the polyRoots Function 142
6.5.2 Using the polyRoots Function 143
6.6 Incremental Investment Criterion 144
6.7 Summary 145
6.8 Problems 145

7 Non-Simple Investments
7.1 Five Fundamental Properties of Simple & Quasi-Simple Investments
7.1.1 Negative First Cash Flow 147
7.1.2 Positive Last Cash Flow 147
7.1.3 Odd Number of Cash Flow Sign Changes 148
7.1.4 Unique Rate of Rate of Return 148
7.1.5 Positive Balances 148
7.1.6 Fundamental Properties of the Four Basic Non-Simple Investments 148
7.2 Down Payment Investments
7.2.1 Definition, Properties & Occurrence 148
7.2.2 Finding the ROEs of a Down Payment Investment 149
7.2.3 Meaning of Negative Balances 151
7.2.4 Mixed Down Payment Investment 151
7.2.5 Properties of a Mixed Down Payment Investment 153
7.3 Termination Investments
7.3.1 Definition, Properties & Occurrence 155
7.3.2 Mixed Termination Investment 156
7.4 Down Payment & Termination Investments
7.4.1 Definition, Properties & Occurrence 158
7.4.2 Mixed Down Payment & Termination Investment 159
7.5 Bi-Simple & Tri-Simple Investments
7.5.1 Definitions, Properties & Occurrences 161
7.5.2 Mixed Bi-Simple Investment 161
7.5.3 Mixed Tri-Simple Investments: Two Simple Internal Investments 164
7.6 Summary 165
7.7 Problems 166

8 Mutually Exclusive Investments
8.1 Comparing Two Simple Mutually Exclusive Investments
8.1.1 Definitions 167
8.1.2 Basic MEI Selection Model 168
8.1.3 Relationships Between the Three IRRs 170
8.2 Comparing Three or More Mutually Exclusive Investments
8.2.1 General MEI Selection Procedure 172
8.2.2 Relative Values of the Challenger-Defender IRRs 174
8.2.3 Effect of the MARR on an MEI Study 174
8.3 Equal Initial Cash Flows 175
8.4 Summary 176
8.5 Problems 176
9 Aftertax IRR%

9.1 Income Taxes & Depreciation
   9.1.1 Combined Income Tax Rate 177
   9.1.2 Taxable Income, Income Tax & Aftertax Cash Flow 178
   9.1.3 Depreciation Expenses 178

9.2 MACRS Depreciation
   9.2.1 Percentage Depreciations 181
   9.2.2 Net Recovered Capital 181
   9.2.3 Calculating an Aftertax IRR% 182

9.3 Start-Up Cost & Time
   9.3.1 Definitions 182
   9.3.2 Percentage Depreciations 182
   9.3.3 Calculating the Aftertax IRR% with a Start-Up Time 184

9.4 Straight Line Depreciation 184

9.5 Book Depreciation Methods
   9.5.1 Straight Line Depreciation 187
   9.5.2 Double Declining Balance Depreciation 188
   9.5.3 Sum-of-Years-Digits Depreciation 190

9.6 Brief History of U.S. Tax Laws 193

9.7 Summary 193

9.8 Problems 193

Chapter 10 Sensitivity Analysis

10.1 Creating an IRR% Sensitivity Table 198

10.2 Staged Construction & Break-Even Point 201

10.3 Summary 202

10.4 Problems 203

Chapter 11 Other Profitability Measures

11.1 Net Present Value
   11.1.1 A 15-Second Review of Calculating an IRR 205
   11.1.2 Screening the IRR with a Net Present Value Calculation 206
   11.1.3 Calculating a Net Present Value with Excel 206
   11.1.4 Comparing Two or More Mutually Exclusive Investments 207

11.2 Accounting Rate of Return 209

11.3 Benefit Cost Ratio 210

11.4 Payback Period
   11.4.1 Definition & Calculation 211
   11.4.2 Rationale for the Payback Period 212

11.5 Investment Information Package 214

11.6 Summary 214

11.7 Problems 215

Index 217