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PLANNING CAPITAL REQUIREMENTS:
SOUTHEASTERN PLANT (case study)

prepared by

Mobil Oil Corporation, New York

The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the United Nations Industrial Development Organisation.

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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
WORKSHOP ON FINANCIAL PLANNING OF INDUSTRIAL PROJECTS

Case Study: Southeastern Plant

Background

The Packaging Department produces industrial plastic packaging products. Product lines include plastic films and bags for use in dry cleaning, construction, food and agricultural enterprises as well as home consumption.

The Packaging Department has been growing rapidly. In 1965 sales were 16% higher than in 1964. All available estimates of the market indicate the opportunity for further rapid and profitable growth. However, manufacturing capacity is limited. All major facilities operated at full capacity in the latter part of 1965. Some additional capacity can be provided at the existing three plant sites but the additional demand foreseen in the future made it advisable to study the addition of a new plant. This study was made jointly by various operating and staff groups within the Packaging Department and an independent consultant. It concluded that a new plant should be constructed to serve the Southeast. This plant could economically service approximately 20% of the present market in the United States. The financial evaluation indicated a 14% Discounted Cash Flow return on the investment.

The main alternatives considered were expansion of the existing Northeast plant and construction of new Southeast plant.

At the end of 1965, the Northeast Plant capacity was 26.6 million pounds, which is 3.3 million pounds less than the Eastern Region's planned 1966 sales of 29.9 million pounds. It is 7.8 million pounds less than projected 1967 sales of 34.4 million pounds.

The major factors influencing the decision in favor of a new Southeast Plant were the availability of ample land, a more favorable labor market as well as lower freight costs.

Based on 1965 sales distribution, approximately 35% of Eastern Region sales were in a territory consisting of nine states: Alabama, Florida, Georgia, Kentucky, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia. In 1966, sales for this territory are expected to be approximately 10 million pounds. Increased sales growth and market penetration into this area should be strengthened by improving slipping time (1 - 5 days saved over slipping from N.E. Plant) and the intangible benefit of being a company with a producing facility in this area rather than just warehousing facilities.

Project evaluation

The new plant is expected to begin production in the Fall of 1966 with four manufacturing lines.

Assuming a fourth quarter start-up the Southeast Plant is expected to provide production for sales of 1.8 million pounds in 1966 and 5.5 million pounds in 1967. This will provide the majority of the additional capacity required (3.3 million pounds in 1966 and 7.8 million pounds in 1967) to meet the Eastern Region projected sales for 1966 and 1967.

After 1967, it is assumed that this plant will support a 5% annual sales growth. Sales are expected reach 7 million pounds by 1970. An additional production line will be required in 1969 to support this anticipated growth.

Space is available in the proposed plant for four additional production lines in the event that sales increase more rapidly than anticipated.

Some of the basic assumptions governing investment, sales costs and expenses are spelled out in Exhibit A.

Worksheets showing detailed estimates governing the investment in land, buildings, and equipment are also attached in Exhibit B.

Exhibit C is a worksheet which shows the year by year cash flows relating to the Southeast Plant. It is important to note that sales are on an incremental basis, i.e. the sales attributed to this plant are assumed to be unobtainable by expanding the Northeast Plant. The straight line depreciation calculations can be ignored in the economic evaluation, since taxes are based on sum of the years digits (SYD) depreciation.

Exhibit D contains the actual calculations of the economic evaluation. The method of evaluation used is net present value (NPV) at 14%. In other words, the net project cash flow is discounted at the marginal rate of 9%. If the result is a positive total the project yield exceeds the marginal rate and is, therefore acceptable on financial grounds.

Line 5 shows the amount of cash invested each year--line 21 cash income after taxes. Line 23 shows net cash flow each year, which is converted to present value in line 25.

Exhibit E presents a summary of the results of the economic evaluation.

PROJECT EVALUATION: ASSUMPTIONS

COMPANY UNIT: Products Division		PROJECT: Construct Southeastern Plant	EXHIBIT A
PREPARED BY: C. I. Southern	DATE:	CASE: Decision	

I. Investment

- A. Building and Facilities are built and completed with four production lines by the end of 1966.
- B. Projected sales require an additional production line in 1969 and 1973.
- C. Working Capital Requirements are estimated at 25% of sales.
- D. In 1975, the recovery value of the fixed assets is estimated to be the net book value, while all Working Capital is recovered.

II. Sales

- A. Prices exclude freight.
- B. By 1968, sales equal the capacity of four production lines.
- C. Starting in 1969, sales increase 5% per year.
- D. Prices per pound are assumed to decrease approximately 0.5¢ per pound per year.

III. Costs and Expenses

- A. Total material costs are expected to decline on a per pound basis from 1968 on due to reduced reclaim generation and packaging costs improvements.
- B. Labor rates per hour increases are anticipated to be approximately offset by improved efficiency and have little or no effect on a labor cost per pound over the projected period.
- C. Salaries and wages of indirect labor are assumed to increase slightly from year to year.
- D. Depreciation is computed on a S.Y.D. basis.
- E. Fixed Costs are anticipated to increase slightly over the projected life.
- F. Variable overhead is estimated at 2.0¢ per pound.

IV. Start-Up Expenses are estimated to be \$15,000 per line

V. Operating Expenses are estimated to be 5% of net sales.

DETAIL OF ESTIMATES

1	<u>Land</u>		
	A. 25 Acres at \$1,000/acre		\$25,000
	B. Title Insurance and Deed		2,000
	C. Offsites		
	Finish grade 8 acres	26,000	
	Road and parking	7,600	
	Railroad siding		
	700' @ \$8.00	5,600	
	Sewer	2,000	
	Fire Protection serv.		
	and Hydrants	5,500	
	Landscaping	2,500	
	Natural Gas Service	<u>600</u>	
			<u>49,800</u>
			\$76,800
2	<u>Building</u>		
	A. Warehouse		
	33.6M ft ² at \$6.70		225,000
	B. Production, Reprocessing		
	Maint., Washrooms, Cafe.		
	33.6M ft ² at \$7.15		240,000
	C. Plant Offices		
	5.36M ft ² at \$15.00		<u>80,000</u>
			545,000
3	<u>Equipment</u>		
	A. Whse. Racks		
	25M ft ² at \$1.20		30,000
	B. Utilities		
	1. Air		
	150 HP Compressor	16,000	
	Distribution	<u>4,000</u>	
			20,000
	2. Power		
	200 KVA/480 v.		
	3-phase	20,000	
	Distribution	<u>4,000</u>	
			24,000
	3. Water-Recirc. System with Tower		
	Tower	13,000	
	Distribution	<u>2,000</u>	
			22,000
	4. Refrigeration		
	105 tons at \$398		<u>41,850</u>
			97,850

3 Equipment (continued)

C. Office Equipment

1. 15 desks at \$200	3,000	
2. 5 tables at \$100	500	
3. 30 chairs at \$50	1,500	
4. 5 Add. Mach. at \$140	700	
5. 3 Calculators at \$500	1,500	
6. 4 Typewriters at \$200	800	
7. Misc.	<u>5,000</u>	

\$13,000

D. Shop Equipment

Drill press, grinder, band saw, hack saw, welding equip., benches, etc.

25,000

E. Lift Trucks

1. Gas-Counter Bal. One (1) at \$8,000	8,000	
2. Elect-Hi Lift Two (2) at \$8,000	16,000	
3. Hand Jack Truck Two (2) at \$400	<u>800</u>	

24,800

F. Dock Boards

Four (4) at \$1,150

4,600

G. Pallets

2M at \$3.50

7,000

H. Q.C. Equipment

Production and Inspection
Testing Equipment

9,000

I. Resin Handling

1. Silo System Four (4) silos w/dist. @ \$21.25M	85,000	
2. Resin Tanks Twenty (20) @ \$200	4,000	
3. Reclaim Tanks Twenty (20) @ \$130	2,600	

3	<u>Equipment (continued)</u>			
	1. Resin Handling			
	4. Reprocessing System Extruder, pelletizer, Granulator and etc.	<u>80,000</u>	171,600	
	J. Print Services		<u>20,000</u>	402,850
4	<u>Hi Speed Garment Roll Line</u>			
	A. Extruder, drive, resin feed	32,500		
	B. Dies, Carts, adapter, internal cooler	4,500		
	C. Air rings, refrigerated air system	15,000		
	D. Nip frame	5,500		
	E. 1/C press, dryer, treater, drives	12,100		
	F. Post print gusseter	5,500		
	G. Winder	13,000		
	H. Misc. Steel work and utilities	6,200		
	I. Contingency	<u>6,500</u>		100,800
5	<u>Bulk Roll Line and Two Side Seal Bag Machines</u>			
	A. Extruder, drive, resin feed	32,500		
	B. Dies (2), rotator, adapter	7,000		
	C. Air rings: Lower with inserts (2)	900		
	Upper (3)	750		
	Inserts (12)	3,000		
	D. Refrigeration System	9,500		
	E. Nip Frame	5,500		
	F. Treater	4,500		
	G. 3/C press with drive	30,000		
	H. Dryer system	3,000		

Bulk Roll Line and Two Side Seal Bag Machines (continued)

I. Post Gusseter w/trim assembly	6,000	
J. Winder with spreader assembly	15,000	
K. Power Hips (2)	2,500	
L. Catwalks, web handling, utilities	6,200	
Contingency 5%	<u>6,300</u>	133,350
M. Two (2) side seal bag machines	51,600	
N. (2) Folding Boards	1,200	
O. (3) Spare Seal Bars	1,000	
P. (1) Windbag punch assembly	5,000	
Q. Packaging Equipment	4,000	
Contingency 5%	<u>3,100</u>	<u>65,900</u>
		199,250
<u>Can Liner Line</u>		
A. Extruder, drive resin feed	35,000	
B. Die, cart, adapter, internal cooler	7,000	
C. Air rings	15,000	
D. Hip frames and Treater	12,000	
E. 1/C press, drive, slit seal 1-up	12,000	
F. Post print gusseter and winder	25,100	
G. Bag Mach., stacker	22,000	
H. Misc. Steel work and utilities	10,000	
Contingency	<u>12,000</u>	
		150,100

EXHIBIT B (cont.)

7	<u>One L & DC Line</u>		
	A. (1) Extruder, drive, resin feed	32,500	
	B. (1) Die, cart, adapter, internal cooler	4,500	
	C. (1) Air ring system	15,000	
	D. (1) Hip frame	5,500	
	E. (1) L/C press, dryer, treater, drive	12,100	
	F. (1) Post print gusseter	5,500	
	G. (1) Winder	13,000	
	H. Misc. Steel work and utilities	6,200	
	I. Contingency	<u>6,500</u>	100,300
8	<u>Engineering</u>		
	A. Plant	30,000	
	B. Equipment		
	1. L & DC Line	7,500	
	2. Liner Line	8,500	
	3. Bulk Roll Line	5,750	
	4. Bag Machines	<u>1,800</u>	
		<u>23,550</u>	53,550
			<u>53,700</u>
9	<u>Contingency</u>		<u>1,637,550</u>

**SOUTHEAST FLAKE
ECONOMIC ANALYSIS
INVESTMENT & DEPRECIATION**

	1966	1966	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1975
	Life	STD Depreciation	Life	STD Depreciation	Life	STD Depreciation	Life	STD Depreciation	Life	STD Depreciation	Life	STD Depreciation	Life
	Years	1966	Years	1967	Years	1968	Years	1969	Years	1970	Years	1971	Years
													Recovery
<u>1966</u>													
Investments													
Land	27												
Buildings (including contingency)	642												
Machinery & Equipment	411												
Plant Equipment	208												
2 Garment Roll Lines	190												
1 Cap Liner Line	195												
1 Bulk Roll Line	51												
Engineering	1,019												
Total M & E	1,688												
Total 1966		85	154	139	124	108	93	77	62	46	31	100	
1969 - Add one Average Line	150				13	23	20	18	16	14	11	35	
1973 - Add one Average Line	150												
Equipment Improvements - 1967	30		3	5	4	4	3	3	2	2	2	3	
1968	30			3	5	4	4	3	3	3	2	4	
1969	30				3	3	3	4	4	4	3	6	
1970	30					3	3	4	4	4	3	6	
1971	30						3	5	5	4	3	6	
1972	30							3	4	4	3	6	
1973	30								3	5	4	11	
1974	30									3	4	14	
1975	30										3	18	
Total		105	195	184	185	181	165	150	146	139	118	711	
<u>S/L Depreciation</u>													
Buildings 1965	642												
M & E 1965	1,019												
1 Line 1969	150												
1 Line 1973	150												
Equipment Improvements	327/77.												
Total	2,230	10	20	40	20	20	20	20	20	20	20	20	152
S/L vs. STD Profit Impact		47	93	93	93	93	93	93	93	93	93	93	135
					7	7	7	7	7	7	7	7	59
					8	8	8	8	8	8	8	8	115
		57	115	118	128	138	141	144	154	164	164	164	144
		48	80	66	57	43	24	6	(8)	(25)	(43)	(43)	305

EXHIBIT C (cont.)

**SOUTHEAST PLANT
ECONOMIC EVALUATION
NET SALES**

(M lbs. & \$)

Production Lines	Less Study Annual Capacity	Start-up Date	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Pounds (Assume 1967 - 90% capacity; 1968 100% capacity; 1968 improvement thereafter)												
Hi-speed Garment Roll Line	1,420	7-1-66	710	1,278	1,420	1,437	1,448	1,462	1,477	1,492	1,507	1,522
Hi-speed Garment Roll Line	1,420	8-15-66	533	1,278	1,420	1,434	1,448	1,462	1,477	1,492	1,507	1,522
Total	2,840		1,243	2,556	2,840	2,868	2,896	2,924	2,954	2,984	3,014	3,044
Can Liner	1,180	10-1-66	295	1,062	1,180	1,192	1,204	1,216	1,228	1,240	1,252	1,265
Bulk Roll & 2 Schjeldahls	2,144	11-15-66	268	1,930	2,144	2,165	2,187	2,209	2,231	2,253	2,276	2,299
Sub-total 4 lines	6,164		1,806	5,548	6,164	6,225	6,349	6,413	6,477	6,542	6,608	6,674
New Line @ Average	1,541		-	-	-	329	677	1,054	1,459	1,614	1,635	1,652
New Line @ Average	1,541		-	-	-	-	-	-	-	277	722	1,210
Total Pounds	9,246		1,806	5,548	6,164	6,554	7,026	7,467	7,926	8,373	8,899	9,470
Price - \$/lb.												
L. & DC												
Can Liners	38.5		38.0	37.5	37.0	36.5	36.0	35.5	35.0	34.5	34.0	33.5
Side Seal Bags	36.0		34.0	33.5	33.0	32.5	32.0	31.5	31.0	30.5	30.0	29.5
New Lines - Average	61.5		60.0	60.0	59.5	59.0	58.5	58.0	57.5	57.0	56.5	56.0
Sales Dollars (Before freight)												
L. & DC												
Can Liners	472		999	1,051	1,047	1,047	1,043	1,038	1,034	1,029	1,025	1,020
Side Seal Bags	100		356	389	387	387	385	383	381	378	375	373
New Lines - Average	162		1,158	1,276	1,276	1,277	1,279	1,281	1,283	1,284	1,286	1,287
Total Sales before freight	734		2,473	2,716	2,716	2,716	2,716	2,716	2,716	2,716	2,716	2,716
Freight @ 2.14%/lb.	38		117	129	129	138	146	152	166	176	186	199
Net Sales	696		2,356	2,587	2,587	2,578	2,570	2,564	2,550	2,540	2,530	2,517
Net Price \$/lb.	38.6		42.5	42.0	42.0	41.3	41.0	40.3	40.0	39.5	39.0	38.4

SOUTHEAST PLANT
ECONOMIC ANALYSIS
DIRECT LABOR AND OVERHEAD
(\$'000)

	1966		1967		1968		Packers	Total \$M	1965 Annual Capacity M lbs.		Cost \$/lb.	1974	1975
	Operations	Helper	1966	1967	1968	1970			1971	1972			
<u>Direct Labor Cost</u>													
L & DC-2 lines	53	8				61		2,840	2.1				
Can Liners	26	8				34		1,180	2.9				
Side Seal Bags	53	-	67			120		2,144	5.6				
Total						215		6,164	3.5				
<u>Direct Labor Cost \$/lb.</u>													
L & DC	1966	1967	1968	1970	1971	1972	1973	1974	1975				
Can Liners	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1				
Side Seal Bags	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9				
New Lines - Average	5.6	5.6	5.7	5.8	5.8	5.9	6.0	6.0	6.0				
	3.5	3.5	3.5	3.6	3.6	3.7	3.7	3.7	3.8				
<u>Direct Labor Costs - Total</u>													
L & DC	26	54	60	61	61	62	63	64	64				
Can Liners	9	31	35	35	35	36	36	37	37				
Side Seal Bags	15	108	123	127	128	132	137	138	138				
New Lines	20*	-	12	24	38	54	87	109	109				
Total	70	193	230	247	262	284	323	348	348				
<u>Variable Overhead</u>													
Variable Power	20.0												
Maint. Supplies & Mat'ls.	76.2												
Production Supplies	3.5												
Shipping-Receiving Whse.	32.0												
Total Variable	131.7	36	123	131	139	148	167	178	178				
Total \$/lb.	6600	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0				
	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0				
<u>Fixed Overhead</u>													
Total per Legee Study	565												
Less: Depreciation	(124)												
Variable Overhead	(132)												
Fixed Overhead	309	200	309	340	355	370	400	430	430				
Total Overhead		236	420	471	494	518	567	593	593				
Training													

**SOURCING PLANT
ECONOMIC EVALUATION
MATERIAL COSTS**

(M lbs. & ¢)

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Sales Revenue										
L. & DC	1,243	2,556	2,840	2,868	2,896	2,924	2,954	2,984	3,014	3,044
Can Liners	295	1,062	1,180	1,192	1,204	1,216	1,228	1,240	1,252	1,265
Side Seal Bags	268	2,930	2,144	2,165	2,187	2,209	2,231	2,276	2,299	2,329
Sub-total	1,806	5,548	6,164	6,225	6,287	6,349	6,413	6,477	6,542	6,608
New Lines - Average	-	-	-	329	677	1,054	1,429	1,806	2,187	2,562
Total	1,806	5,548	6,164	6,554	6,964	7,403	7,842	8,283	8,729	9,170

Poly Material Cost - ¢/lb.

L. & DC	14.5	14.5	14.4	14.4	14.3	14.3	14.2	14.2	14.1	14.1
Can Liners	12.7	12.7	12.6	12.6	12.5	12.5	12.4	12.4	12.3	12.3
Side Seal Bags	15.3	15.3	15.2	15.2	15.1	15.1	15.0	15.0	14.9	14.9
New Lines - Average	14.3	14.4	14.3	14.3	14.2	14.2	14.1	14.1	14.0	14.0
Total Poly Material Cost										
L. & DC	180	371	409	413	414	418	419	424	425	429
Can Liners	37	135	149	150	151	152	152	154	154	156
Side Seal Bags	41	292	326	329	330	334	332	338	332	343
Sub-total	258	801	884	892	895	904	906	916	918	928
New Lines - Average	-	-	-	47	96	150	206	267	330	401
Total	258	801	884	939	991	1,054	1,112	1,183	1,248	1,329

Non-Poly Material Costs - ¢/lb.

L. & DC	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.1	3.1
Can Liners	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Side Seal Bags	4.5	4.4	4.3	4.2	4.1	4.0	4.0	4.0	4.0	4.0
New Lines - Average	-	-	-	3.3	3.2	3.2	3.1	3.1	3.1	3.1
Total Non-Poly Material Costs										
L. & DC	44	87	94	95	93	94	92	93	93	94
Can Liners	4	16	18	18	16	18	18	19	19	19
Side Seal Bags	12	85	92	91	90	88	89	90	91	92
Sub-total	60	188	204	204	201	200	200	202	203	205
New Lines - Average	-	-	-	11	22	34	45	56	73	86
Total	60	188	204	215	223	234	244	261	270	294

PROJECT EVALUATION CASH FLOW ANALYSIS

EXHIBIT I

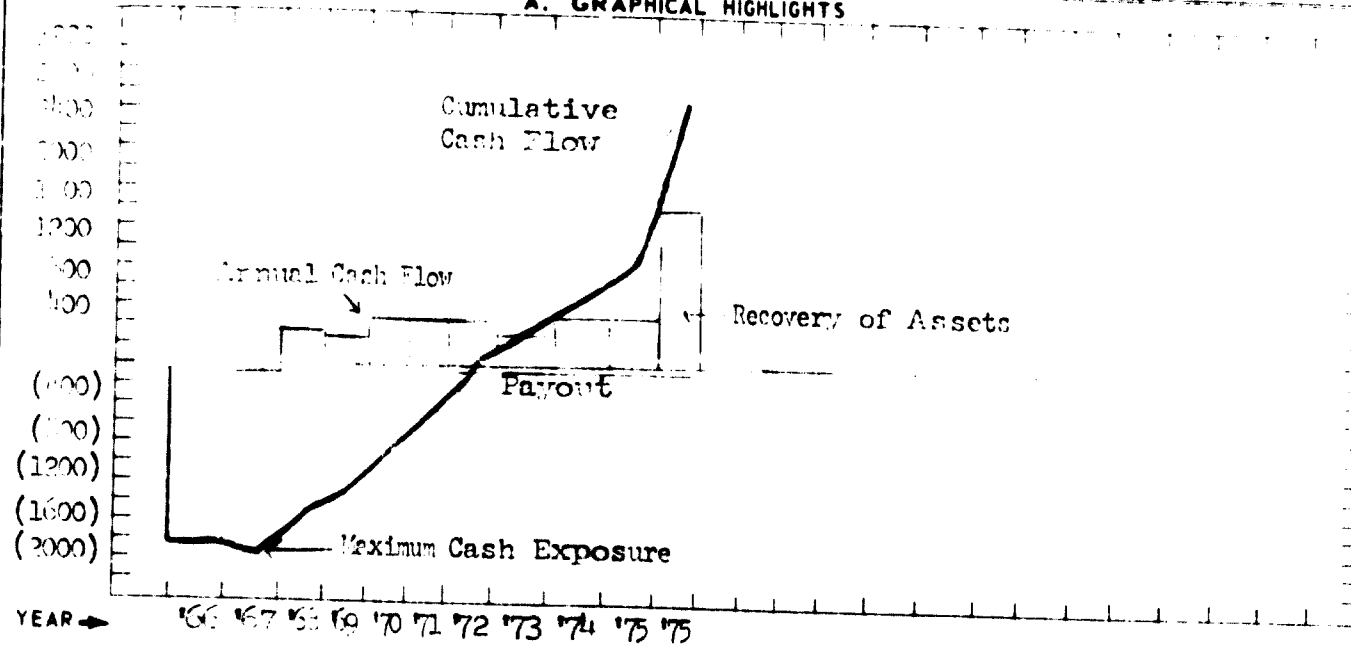
ITEM	ANNUAL CASH FLOW IS THOUSAND									
	1	2	3	4	5	6	7	8	9	10
TOTAL	1,566	(1,274)	(89)	(30)	(50)	(20)	(20)	(20)	(20)	(20)
SALES AND OTHER INCOME										
- Sales	1,566									
- Other										
TOTAL	1,566									
EXPENSES										
- Depreciation										
- Interest										
- Taxes										
- Other										
TOTAL										
NET CASH FLOW	1,566	(1,274)	(89)	(30)	(50)	(20)	(20)	(20)	(20)	(20)
INITIAL INVESTMENT	(1,000)									
ACCUMULATED CASH FLOW	566	(274)	(363)	(393)	(443)	(463)	(483)	(503)	(523)	(543)
PRESENT VALUE	500	(200)	(250)	(280)	(300)	(310)	(320)	(330)	(340)	(350)
NET PRESENT VALUE	566	(274)	(363)	(393)	(443)	(463)	(483)	(503)	(523)	(543)
- Initial Investment	(1,000)									
- Present Value of Cash Flows	434	(274)	(363)	(393)	(443)	(463)	(483)	(503)	(523)	(543)
TOTAL	(566)	(274)	(363)	(393)	(443)	(463)	(483)	(503)	(523)	(543)

NOTE: Values may not agree due to rounding.

PROJECT EVALUATION: HIGHLIGHTS

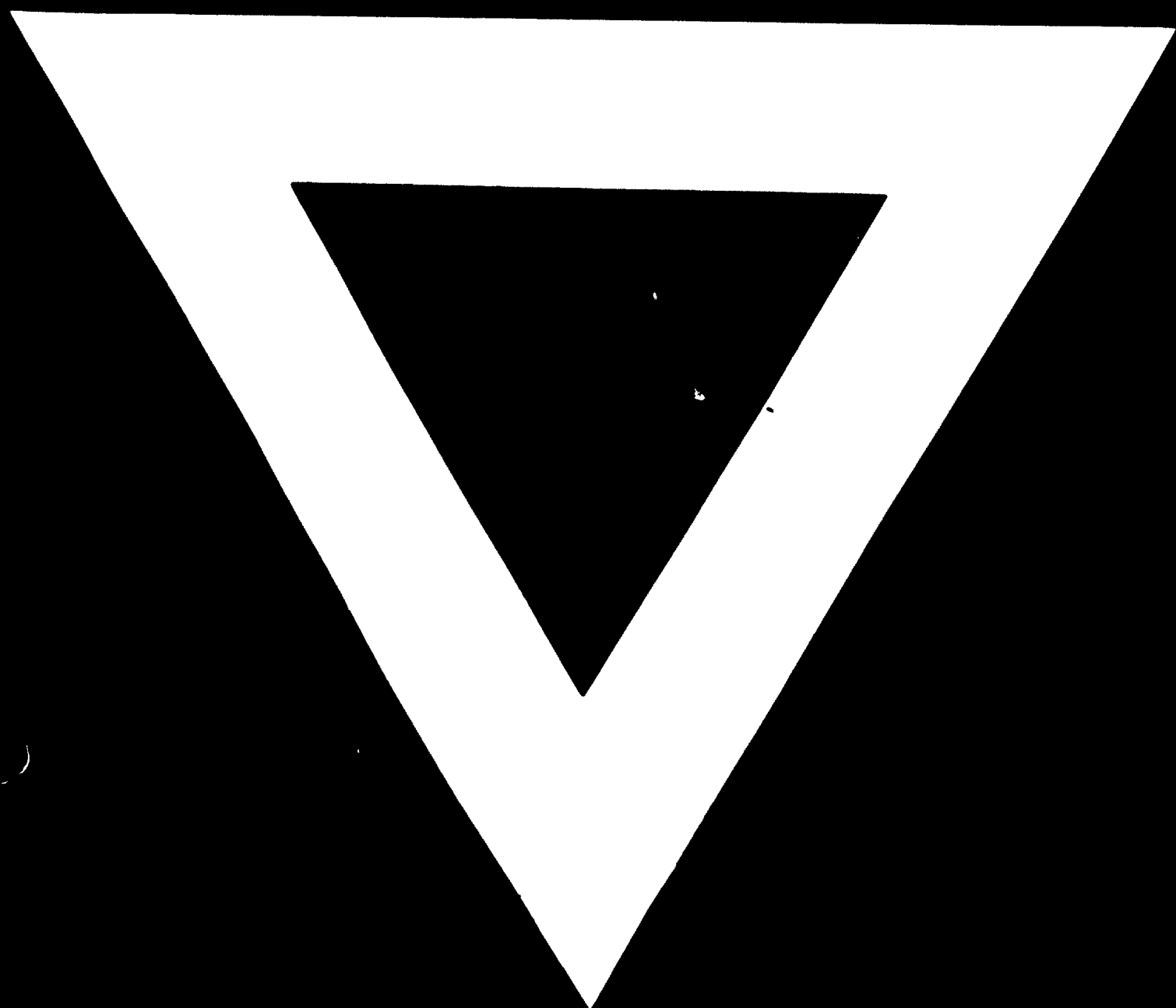
COMPANY PROJECT: Institute Decision PROJECT BY: G. W. Conther	PROJECT: Construct Weather Station DATE: 13/17/81 CASE: Decision
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A. GRAPHICAL HIGHLIGHTS



B. STATISTICAL HIGHLIGHTS

ITEM		AMOUNT (\$ THOUSAND)		
				DECISION CASE
1	FINANCIAL INDICATORS	DCF RATE OF RETURN (%)		14
2		NET PRESENT VALUE *	147	(27)
3		PAYOUT PERIOD (YEARS)		7
4		PROJECT LIFE (YEARS)		10
5		MAXIMUM CASH EXPOSURE		1800
6				
7				
8	INVESTMENT (Project total, gross basis.)	NEW PROPERTY, PLANT, AND EQUIPMENT		2270
9		TRANSFER PROPERTY, PLANT, AND EQUIPMENT		-
10		LEASED ASSETS (PRESENT VALUE @ 3%)		-
11		WORKING CAPITAL		210
12	TOTAL		3170	
13	OPERATIONS (Annual Average for 10 years 1966 to 1975.)	VOLUME (UNITS:)		6000
14		SALES AND OTHER INCOME		2770
15		COSTS AND EXPENSES		2243
16		INCOME TAXES		25
17		NET INCOME		277
18		CASH FLOW		277
19	OTHER HIGHLIGHTS	DATE OF FIRST EXPENDITURE		1966
20		DATE OF INITIAL OPERATIONS		1967
21		PAYOUT DATE		1972
22		TERMINAL DATE		1975
23				
24				
25				
26				
27				
28				
29				
30				



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