The water company “Agua Clara” was planning to build a desalination plant to supply drinking water to a large tourist area, and it was considering which of two possible investment projects to choose. The projects were called Marbella and Torremolinos, and they were mutually exclusive.

**MARBELLA PROJECT**

To develop the Marbella project it was necessary to effect the operations described below:

a.- 200,000 € had already been spent on researching the technical possibilities of the project.

b.- At the beginning of the project, the company would have to purchase a plot of land, at a cost of twelve million euros.

c.- The first phase of the project would consist of building the necessary buildings, at a cost of twenty-four million euros. Investment would be made at the end of the first year of the project.

d.- In the second phase of the project, the necessary machinery would be purchased, which would cost eighteen million euros. This investment would be made at the end of the second year.

e.- At the end of the third year it would be necessary to invest three million euros in working capital. It was assumed that working capital would remained constant in the fourth year, and from the fifth year onwards, it would vary according to sales in successive years. Similarly, it was assumed that 50% of the investment would be recovered at the end of the tenth year.

f.- The desalination plant would start operation at the beginning of year 4. It would be operative for seven years. Sales for the first year of operation were estimated at seventy million euros, and associated cash expenses at forty million euros. In successive years, evolution in sales and associated cash expenses would be as follows:

   - Years 5, 6 and 7: annual increments of 5%
   - Years 8, 9 and 10: annual increments of 3%

g.- Due to public interest in the project, the company would be granted government aid. Government aid would be an irrecoverable, tax-free 6% remission of the cost of the building and equipment, and it would be received two years after the corresponding investment.

h.- To compensate, the company would have to use a variable depreciation method for tax purposes. The coefficients to be applied would be:

   - 10% in years 2, 3 and 4
11% in years 5, 6 and 7
12% in years 8 and 9
13% in year 10

i.- Finally, it was considered that the buildings and land could be sold at the end of the project for a sum of eighteen million euros, and machinery for 120,000 €, as scrap.

The corporate tax rate is 30%.