**EFB240 Workshop 5 Questions**

**Madura Chapter 15 Questions**

**5. Impact of Exchange Rates on NPV.**

a. Describe in general terms how future appreciation of the Chinese yuan will likely affect the value (from the parent’s perspective) of a project established in China today by an Australian-based MNC. Will the sensitivity of the project value be affected by the percentage of earnings remitted to the parent each year?

b. Repeat this question, but assume the future depreciation of the yuan.

**7. Change in Required Return on Projects.** Woodsen Inc. of Pittsburgh, Pennsylvania considered the development of a large subsidiary in Greece. In response to a crisis in Greece, its expected cash flows and earnings from this acquisition were reduced only slightly. Yet, the company decided to retract its offer because of an increase in its required rate of return on the project, which caused the NPV to be negative. Explain why the required rate of return on its project may have increased.

**8. Assessing a Foreign Project.** Huskie Industries, an Australian-based MNC, considers purchasing a small manufacturing company in Japan that sells products only within Japan. Huskie has no other existing business in Japan and no cash flows in Japanese yen. Would the proposed acquisition likely be more feasible if the Japanese yen is expected to appreciate or depreciate over the long run? Explain.

**12.** **Impact of Reinvested Foreign Earnings on NPV.** Flagstaff Corp. is an Australian‑based firm with a subsidiary in China.  It plans to reinvest its earnings in Chinese government securities for the next 10 years since the inter­est rate earned on these securities is so high.  Then, after 10 years, it will remit all accumulated earnings to Australia.  What is a drawback of using this approach?  (Assume the securities have no default or interest rate risk.)

**13. Capital Budgeting Example.** Brower, Pty Ltd just constructed a manufacturing plant in China. The construction cost 9 billion Chinese yuan. Brower intends to leave the plant open for three years. During the three years of operation, yuan cash flows are expected to be 3 billion yuan, 3 billion yuan, and 2 billion yuan, respectively. Operating cash flows will begin one year from today and are remitted back to the parent at the end of each year. At the end of the third year, Brower expects to sell the plant for 5 billion yuan. Brower has a required rate of return of 17 per cent. It currently takes 5.0763 yuan to buy one Australian dollar, and the yuan is expected to depreciate by 5 per cent per year.

a. Determine the NPV for this project. Should Brower build the plant?

b. How would your answer change if the value of the yuan was expected to remain unchanged from

its current value of 5.0763 yuan per Australian dollar over the course of the three years? Should Brower construct the plant then?

**15. Accounting for Changes in Risk.** Rip curl, an Australia-based MNC, was considering establishing a consumer products division in New Zealand, which would be financed by the ANZ banks. Rip curl completed its capital budgeting analysis in August. Then, in November, the government leadership stabilised and political conditions improved in New Zealand. In response, Rip curl increased its expected cash flows by 20 per cent but did not adjust the discount rate applied to the project. Should the discount rate be affected by the change in political conditions?

**19. Tax Effects on NPV.** When considering the implementation of a project in one of various possible countries, what types of tax characteristics should be assessed among the countries? (See the chapter appendix)

**Additional Questions**

**1. Capital Structure of MNCs.** Present an argument in support of an MNC’s favouring a debt‑intensive capital structure.

 Present an argument in support of an MNC’s favouring an equity­‑intensive capital structure.

**2. Cost of Capital.** Explain how characteristics of MNCs can affect the cost of capital.

**3. Cost of Capital.** An MNC has total assets of $100 million and debt of $20 million. The firm’s before-tax cost of debt is 12 percent, and its cost of financing with equity is 15 percent. The MNC has a corporate tax rate of 30 percent. What is this firm’s cost of capital?

**4. Cost of Equity.** Wiley Ltd., a MNC, has a beta of 1.3. The Australian stock market is expected to generate an annual return of 11 percent. Currently, Commonwealth Bonds yield 2 percent. Based on this information, what is Wiley’s estimated cost of equity?

**5. Cost of Capital.** Blues Ltd. is a MNC located in Australia. Blues would like to estimate its weighted average cost of capital (WACC). On average, bonds issued by Blues yield 9 percent. Currently, Commonwealth Bond rates are 3 percent. Furthermore, Blues’ stock has a beta of 1.5, and the return on the ASX200 stock index is expected to be 10 percent. Blues’ target capital structure is 30 percent debt and 70 percent equity. If Blues is in the 30 percent tax bracket, what is its weighted average cost of capital?