**Case 34.1 – Forex Management**

**Premier Computers, Inc.**

Premier Computers, Inc., of USA is considering a project for manufacturing computers in India. It plans to sell 20,000 units of desktop computers in the first year and the company expects volume growth at 10% per annum. If Premier USA makes the investment in India, it will operate the plant for five years and then sell the plant to Indian investors at the depreciated value at the time of sale plus *working* capital. The Indian government will allow

*Premier* to repatriate all net cash flows to the USA each year.

Premier will have to invest *$10* million in plant and $5 million for the initial working capital. Working capital is expected to remain constant through the life of the project. Plant will be depreciated over five years on a straight-line basis for tax purpose. Over the next five years, the selling price of computers will remain at $500 per computer converted into Indian

rupees at the prevailing exchange rate each year. Similarly, operating expenses in India are expected to be rupees equivalent of $250 per computer. Premier USA will finance the project with a debt-equity ratio of 0.50. The debt will be raised in rupees and the company will pay interest at a market borrowing rate of 10% for five years; principal is repayable in four equal instalments starting from year two. Premier USA uses the CAPM to calculate the cost of capital. The market risk premium is 8% and the asset beta for computer manufacturers is 1.25. The corporate tax rate is 35% in India and because of a double taxation treaty no further taxes will be payable in the US. Assume that investment is made now, and cash flows occur from year one through five. The current exchange rate is Rs.45/$1. The risk-free rates of interest in the USA and India, respectively, are 6% and 9%.

**Discussion Questions**

**1.** Calculate the rupees cash flows of the project.

2. Calculate the Indian rupee cost of capital and US dollar cost of capital. State your assumptions.

3. What is its NPV in rupees? (Round the discount rate to nearest percentage to calculate NPV)