

Chapter 15

Pricing a Foreign Target Alaska, Inc., would like to acquire Estoya Corp., which is located in Peru. In initial negotiations, Estoya has asked for a purchase price of 1 billion Peruvian new sol. If Alaska completes the purchase, it would keep Estoya's operations for two years and then sell the company. In the recent past, Estoya has generated annual cash flows of 500 million new sol per year, but Alaska believes that it can increase these cash flows 5 percent each year by improving the operations of the plant. Given these improvements, Alaska believes it will be able to resell Estoya in two years for 1.2 billion new sol. The current exchange rate of the new sol is \$.29, and exchange rate forecasts for the next two years indicate values of \$.29 and \$.27, respectively. Given these facts, should Alaska, Inc., pay 1 billion new sol for Estoya Corp. if the required rate of return is 18 percent? What is the maximum price Alaska should be willing to pay?

$$NPV_a = -IO_a + \sum_{t=1}^n \frac{CF_{a,t}}{(1+k)^t} + \frac{SV_a}{(1+k)^n}$$

$$NPV_a = -(IO_f)S + \sum_{t=1}^n \frac{(CF_{a,f})S_t}{(1+k)^t} + \frac{(SV_f)S_n}{(1+k)^n}$$

$$NPV = -1000 * 0.29 + \frac{500 * (1 + 0.05) * 0.29}{(1 + 0.18)} + \frac{(500 * (1 + 0.05)^2 + 1200) * 0.28}{(1 + 0.18)^2} = 191.19 > 0$$

$$S = 0.29, S_1 = 0.29, (1 + f)S_1 = (1 + 0.05) * 0.29 = 0.3045, (1 + 0.29) * (1 + 0.27) = (1 + 0.3713)S_2, S_2 = 0.28$$

Alaska should buy Estoya Corp. with 1 billion and the maximum price Alaska should be willing to pay is 481.19 million dollars (Letting NPV=0)