**Part II:**

Suppose you have been provided the following data on proposed KFC project in Africa:

Initial cost/outflow: R12,000,000 (South African Rand – Code: ZAR; Symbol: R)

**Note:** Please note that company has R12,000,000 on the bank account in Africa to recover the initial cost.

Current exchange rate: 1USD = 8 ZAR; 1 ZAR = .125 USD

The company has provided the following cash flow figures to you:

|  |  |
| --- | --- |
| **Year** | **Cash Flow (In South African Rand – Symbol: R)** |
| 0 | -R12,000,000 |
| 1 | 3,350,000 |
| 2 | 3,899,000 |
| 3 | 1,122,000 |
| 4 | 4,200,000 |

The above cash flow is based on the current food items that KFC sells and the company will sell the restaurant after 4 years for approximately R10,000,000 (expected salvage value). It is also expected that African government will impose 10% withholding tax on the transfer of cash to USA. The KFC will transfer the above cash to USA each year.

The discount rate is 17% to the above project.

To complete Module 4 Case Assignment, please read the information in the background material, look for more information, and then write a 5 to 6 pages report for your professor and the financial managers of KFC by answering the following questions:

*1) How big the risk is it for KFC to enter the African market? What can go wrong?*

*2) What would be your major concerns if you were the Chief Financial Officer of KFC and you were asked to find financing in the African market?*

*3) What is the project's net present value?*

*To answer question 3, you need to calculate cash flow to parent company (KFC) and then, calculate net present value (NPV) of the project.*

Step 1: Calculate Cash Flow to Parent Company

**R** = African Rand

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|   | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|   |   |   |   |   |   | (Salvage Value) |
| Initial Cost (R) |  (12,000,000) |   |   |   |   |   |
| Cash Flow (R) |   | 3,350,000 |   |   |   |   |
| Withholding Tax (10%) |   |         0.10                     |   |   |   |   |
| Withholding Tax (R) |   | 335,000 |   |   |   |   |
| Cash Flow after tax (R) |   | 3,015,000         |   |   |   |   |
| Exchange Rate | 0.125 | 0.125 |   |   |   |   |
| Cash Flow to KFC | (1,500,000) |  376,875 |   |   |   |   |

**Initial Cost in US Dollars =** Initial Cost in Rand (R) x Exchange Rate (e.g., .125)

= R12,000,000 x .125 = $1,500,000

**Withholding Tax** = Cash Flow x Withholding tax bracket (e.g., 10%)

= 3,350,000 x .10 = R335,000

**Cash Flow after tax in Rand (R)** = Cash Flow – Withholding Tax

= 3,350,000 – 335,000 = R3,015,000

**Cash Flow to Parent Company (KFC)** = Cash Flow After Tax x Exchange Rate

= 3,015,000 x .125 = $375,875

**Step 2: Calculate NPV (In US Dollars)**

You may use the following steps to calculate NPV:

1) Calculate present value (PV) of cash inflow (CF)

**PV of CF =** CF1 / (1+r)1 + CF2 / (1+r)2 + CF3 / (1+r)3 + CF4 / (1+r)4 + CF5 / (1+r)5

r = Discount rate (17%)

If you do not know how to use calculator to calculate present value, please use Table 1 (Present value of $1 to be received after t years) of the following source:

Brealey, R.A., Myers, S.C., & Allen, F. (2005). Principles of corporate finance, 8th Edition. The McGraw-Hill Companies. Retrieved May, 2011, from <http://jcooney.ba.ttu.edu/fin3322/Brealey%20Files/Appendix%20A%20-%20Present%20Value%20Tables.pdf>

2) Calculate NPV

**NPV** = Total PV of CF – Initial Cost

or

-Initial Cost + Total PV of CF

*4) Based on your analysis and findings, what would you recommend to KFC? Should KFC move into African market? Are there any advantages of moving into African market for KFC?*

*5) What do you perceive you have learnt in Module 4 Case Assignment? Which of the following learning objectives do you feel you have mastered?*

*☼Discuss the relative advantages and disadvantages of foreign direct investment*