

## Abandonment Option – Foxconn

Foxconn engineers have developed a prototype touch, and 2-way screen for PCs. The project would require an initial investment of \$320 million and would be worthless after 6 years. This project is new, so demand conditions are very difficult to forecast. The CFO suggests that there are three scenarios--each equally likely.

In the first scenario, demand would be high, and the project would generate a 6-year annuity of \$115 million.

In the middle scenario the project would generate a 6-year annuity of \$78 million.

And in the worst-case scenario, the project would generate a 6-year annuity of \$15 million.

Your engineer S.K. Mohan proposed a modification to the design such that for an additional \$15 million up-front, the project could be scuttled after a year if things don't look good, and the company could recover \$200 million in value from the initial investment. Mohan has developed a component-based framework that allows the facility to convert to other Foxconn applications.

Foxconn's capital structure is 75% equity, 25% debt. Its cost of equity is 9% and its cost of debt, on an after-tax basis is 4%.

The CFO wants your analysis as to whether the company should take on this project, and if it does, whether it should also invest in Mohan's enhancements.