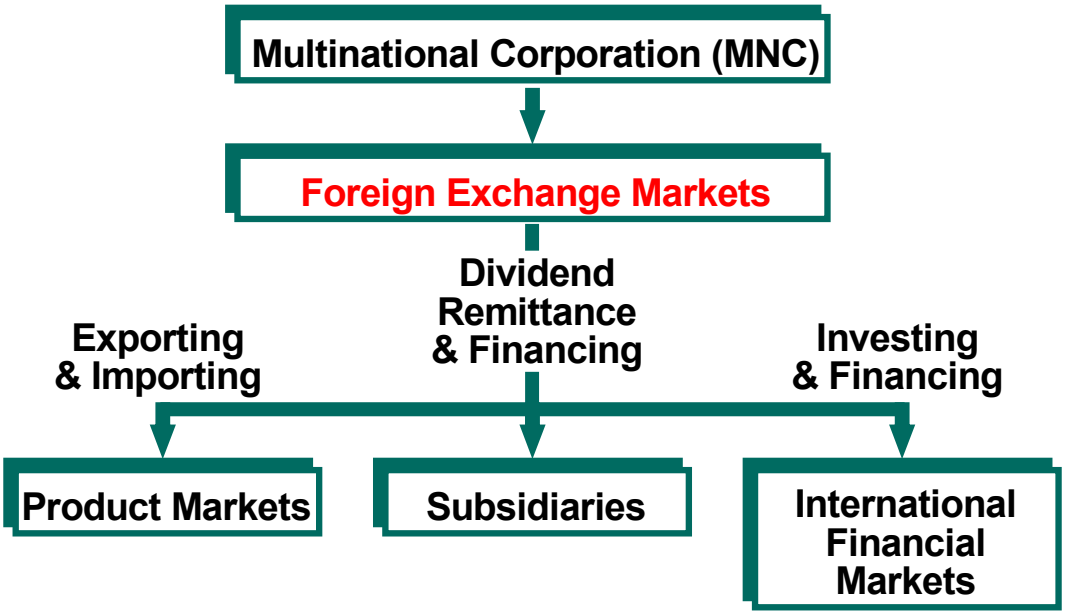
International Financial Environment



Currency Call Options

- A currency call option grants the holder the right to buy a specific currency at a specific price (called the exercise or strike price) within a specific period of time.
- A call option is
  - in the money if spot rate > strike price,
  - at the money if spot rate = strike price,
  - out of the money if spot rate < strike price.

Currency Put Options

- **A currency put option grants the option holder the right to sell a specific currency at a specific price (the strike price) within a specific period of time.**
- **A put option is**
  - in the money if spot rate < strike price,
  - at the money if spot rate = strike price,
  - out of the money if spot rate > strike price.

  - **Speculative outcomes in options contracts can be profitable**

1. Steps in applying NPV analysis
   I. Estimate and identify the size and value of all relevant cash flow
   II. Determine the appropriate discount rate (e.g required rate, cost of capital)
   III. Find the net present value by discounting the cash flows
   IV. Compare the NPV of completing project at the same point in time and make a decision. If NPV >0 accept the project or if the project with highest positive value NPV if the project are mutually exclusive

2. Steps in capital budgeting
   I. Identify and estimate the initial capital investment requirement (or identify initial capital to be put at risk
   II. Estimate the cash flow to be derived from the project over time and the estimate of the terminal and salvage value
   III. Identify the appropriate discount rate for determine the present value of the expected cash flows

Apply tradition capital budgeting decision criteria such as net present value or internal rate of return to determine the acceptability or the priority ranking of the potential project