KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2015/2016

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE (FINANCE)

BAC 406: INTERNATIONAL FINANCIAL MANAGEMENT

DATE: Thursday, 31st March 2016 **TIME: 2.00 p.m. - 4.00 p.m.**

INSTRUCTIONS:

ANSWER ALL QUESTIONS

QUESTION ONE

XYZ Ltd. a US firm will need British Pound (BP) 3,000,000 in 180 days. In this connection, the following informationis available:

Spot rate 1 BP = $2.00

180 days forward rate of BP as of today = $1.96

Interest:

	UK	US
180 days deposit rate	4.50%	5.00%
180 days borrowing rate	5.00%	5.50%

A call option on BP that expires 180 days has an exercise price of $1.97 and a premium of $ 0.04.

XYZ has forecast spot rates 180 days hence as follows:

Rate	Probability
$ 1.91	25%
$1.95	60%
$2.05	15%

Which of the following strategies would be most prefereable to XYZ.

a) Forward (b) Money Market hedge (c) no hedging. (15 Marks)

QUESTION TWO

a. Parity conditions are important in International Financial Management. Briefly discuss the THREE parity conditions. (6 Marks)

b. A professional accountancy institute in the U.K is evaluating an investment project overseas in East Asia, a politically stable country. The project involves the establishment of a training school to offer courses on international accounting and management topics. It will cost an initial 2.5 million East Asian Dollars (EA$) and it is expected to earn post tax flows as follows:

Years	1	2	3	4
Cash flow (EA$ 000)	1750	950	1250	1350

The following information is available:

The expected inflation rate in East Asia is 3% a year.

Real interest rates in the two countries are same, and are expected to remain so for the period of project.

The current spot rate is EA $ 2 per £ 1 sterling.

The risk free rate of interest in East Asia is 7% and in the UK 9%

The company requires a sterling return from this project of 16%

Requirement: Calculate the £ sterling net present value of this project using both the following method;

i) By discounting annual cash flows in £ sterling (5 Marks)

ii) By discounting annual cash flows in East Asian $ (5 Marks)

c) Discuss FIVE factors that influence the performance of firms in the international market. (10 Marks)

QUESTION THREE

Ds Inc. is considering a new plan in Netherlands. The plan will cost 26 Million Guilders. Incremental Cash Flows are expected to be 3 Million Guilders per year for the first 3 years. 4 Million Guilders for the next 3.5 Million Guilders in Years 7 to 9, and 6 Million Guilders in years 10 through 19, after which the project will terminate with no residual value.

The present exchange rate is 1.90 Guilders per dollar. The required rate of return on repatriated dollar is 16%.

If the exchange rate states at 1.90, what is the project NPV. (10 Marks)

QUESTION FOUR

1. Briefly indicate **five** rationale for commercial banks to go to the international market. (8 Marks)

2. Briefly indicate three types of arbitrage that exist in the internatiofnal market. (6 Marks)

3. The following information exists in a market, an arbitrageur takes interest in the quotes provided below:

\$/£	1.3670/1.3670/1.3708
S.Fr/DEM	1.0030 /1.0078
\$/S.Fr	0.8790 / 0.8803
And if DEM / £ in the market are 1.5560 / .5576	

Find out if any arbitrage opportunity exists. If so, show how \$10,000 available with you can be used to generate risk - less profit. (5 Marks)