UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING

MAIN EXAMINATION PAPER 2012

COURSE TITLE   :   FINANCIAL INSTITUTIONS AND MARKETS

COURSE CODE   :   AC 310

DEGREE/DIPLOMA   :   DEGREE

TIME ALLOWED   :   THREE (3) HOURS

INSTRUCTIONS   :   1.   TOTAL NUMBER OF QUESTIONS ON
                                     THE PAPER: FOUR (4)

                              2.   ATTEMPT ALL FOUR (4) QUESTIONS

                              3.   THE MARKS AWARDED FOR A QUESTION ARE INDICATED
                                     AT THE END OF EACH QUESTION

                              4.   WHERE APPLICABLE, ALL WORKINGS ARE TO BE SHOWN

                              5.   CALCULATIONS ARE TO BE MADE TO TWO DECIMAL
                                     PLACES OF ACCURACY, UNLESS OTHERWISE INSTRUCTED.

SPECIAL REQUIREMENTS   :   NONE

NOTE   :   YOU ARE REMINDED THAT IN ASSESSING YOUR WORK,
                              ACCOUNT WILL BE TAKEN OF THE ACCURACY OF
                              LANGUAGE, THE GENERAL QUALITY OF EPRESSION,
                              TOGETHER WITH THE LAYOUT AND PRESENTATION OF
                              YOUR FINAL ANSWER.

THIS QUESITON PAPER SHOULD NOT BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY
THE INVIGILATOR.

QUESTION 1

a) Discuss how interest rate swaps and currency swaps might be of value to the corporate financial manager.

(15 MARKS)

b) Yende Ltd has taken a 3 month E1,000,000 deposit with interest payable of 8%, the loan being due for rollover on 31 March. At 1 January, the company treasurer considers that interest rates are likely to rise in the near future. The futures price is 91 representing a yield of 9%. Given a standard contract size of E1,000,000 the company sells a Lilangeni three month contract to hedge against interest on the three month loan required at 31 March (to sell a contract is to commit the seller to take a deposit). At 31 March the spot interest rate is 11%.

   i. What is the cost saving to Yende Ltd.
   ii. Calculate the hedge efficiency

(10 MARKS)

TOTAL (25 MARKS)

QUESTION 2

Mancoba Ltd arranges on 1 January with a US supplier for the delivery of a consignment of goods costing US$192,000. Mancoba Ltd will have to pay for the goods in six months' time, on 1 July. The company therefore arranges a forward exchange contract for its bank to sell it US$192,000 six months hence.

In the event, the size of the consignment is reduced, and on 1 July, Mancoba Ltd only needs US$100,000 to pay its supplier. The bank will therefore arrange to close out the forward exchange contract for the US$92000 which Mancoba Ltd does not need.

Exchange rates between the US dollar and sterling are as follows:-

    1 January
        Spot $1.5145 – 1.5155
        6 months forward   0.95 -0.85c pm
    1 July
        Spot $1.5100 – 1.5110
Compute the cost to Mancoba Ltd of the whole transaction, ignoring commission

(10 MARKS)

(b)   Explain the main financial instruments which a company can use to reduce risks associated with interest movements

(15 MARKS)

TOTAL (25 MARKS)

QUESTION 3

a) Write explanatory notes on the following:-

i. Put option
ii. Call option
iii. American option
iv. European option

(10 MARKS)

b) An investor thinks that the price of shares in Mavuso Ltd which are currently quoted at E2.00, are likely to increase. She therefore buys call options on 5000 shares with an exercise price of E2.10 and a premium of E600 (equivalent to 600/5,000 = 12 cents per share).

Required:
Calculate the profit or loss and percentage return the above investor will make assuming the price of the shares on the maturity date is:

i) E2.40
ii) E2.04

And calculate the profit or loss that would have arisen if the investor had, instead of buying the call option, purchased the underlying shares.

(15 MARKS)

TOTAL (25 MARKS)

QUESTION 4

a) Explain how bonds are rated **(7 MARKS)**

b) i. Assume an investor buys a 10 percent coupon bond for E1075, holds it for one year, collects E100 in interest, and sells the bond for E1050.

   Required: Calcuate the total return for this one year period.

   (3 MARKS)

   ii. On the other hand, assume the investor had held the bond only for six months, collected one E50 coupon, and sold the bond for E1110. Calculate the total return for six month period.

   (3 MARKS)

c) Is the call feature an advantage or a disadvantage to an investor? In what interest environment would you expect issues to call in bonds, other things being equal?

   (7 MARKS)

d) Explain what you understand by zero – coupon bond

   (5 MARKS)