

**UNIVERSITY OF SWAZILAND**  
**DEPARTMENT OF ACCOUNTING AND FINANCE**  
**EXAMINATION PAPER MAY 2016 ACADEMIC YEAR 2015/2016**

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<b>PROGRAMME OF STUDY</b>	<b>Bachelor of Commerce</b>
<b>YEAR OF STUDY</b>	<b>Year 4 (Full Time)</b>
<b>TITLE OF THE PAPER</b>	<b>Advanced Business Finance</b>
<b>COURSE CODE</b>	<b>AC 428</b>
<b>TIME ALLOWED</b>	<b>Three (3) Hours</b>

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**INSTRUCTIONS**

1. There are Four (4) questions, ANSWER ALL.
2. Begin the solution to each question on a new page.
3. The marks awarded for a question are indicated at the end of each question.
4. Show your workings where necessary.

**NOTE:** You are reminded that in assessing your work, account will be taken of accuracy of the language and the general quality of expression, together with layout and presentation of your answer.

**THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR / SUPERVISOR.**

## QUESTION ONE

- (a) Describe business risk and political risk. (6)
- (b) Explain the meaning of the following foreign exchange market theories
- |                             |         |
|-----------------------------|---------|
| i. Interest rate parity     | 5 Marks |
| ii. Purchasing power parity | 5 Marks |
| iii. Expectation Theory     | 4 Marks |

**(Total Marks 20)**

## QUESTION TWO

- a. Gladys Smith has saved up \$2,000 for investing purposes. She sees that the CD rate in Japan is 6% for the coming year and only 4% in the United States. She also sees that the current indirect exchange rate is 110 yen per dollar. Looking at the forward rates, Gladys sees that the one-year forward indirect rate is 115 yen per dollar. Can she exploit this situation to her gain? Explain. **(8 Marks)**
- a. The beginning-of-the-year prices for sunglasses are \$30 in the United States and ¥5,000 in Japan. We know that prices in the United States and Japan will change over the coming year due to inflation. If we assume that inflation in the United States (our home country,  $inf_h$ ) will be 3% and inflation in Japan will be 2% (our foreign country,  $inf_f$ ), what will the price of the sunglasses be at the end of the year? If one U.S. dollar can be exchanged for ¥166.6667 Japanese yen today and purchasing power parity holds, what can we say about the future exchange rate one year from now? **(6 Marks)**
- b. Let's say that you see that the direct rate for Euro is 1.2922 and the indirect rate for the Yen is 96.16. You check the internet and find that the indirect rate for Yen in Euros is 130 yen. You have \$10,000 and are willing to make quick gains if possible. Is there an arbitrage opportunity here? **(6 marks)**

**(Total Marks 20)**

### QUESTION THREE

Gcinwayinkhosi Corporation is a Swazi firm processing dried fruits. Its export business has risen to the point that it is considering establishing a small processing operation in Zambia.

Suppose Gcinwayinkhosi's Zambian facility is expected to generate the following cash flows in Zambian kwachas (K):

Year:	0	1	2	3	4	5
Cash flows (millions of kwachas)	-15.2	4.0	5.0	6.0	7.0	8.0

The interest rate in Swaziland is 6 percent. Gcinwayinkhosi's financial manager estimates that the company requires an additional expected return of 12 percent to compensate for the risk of the project.

The financial manager looks in the newspaper and finds that the current exchange rate is 0.75 kwacha to the lilangeni ( $S_{K/L} = 0.75$ ), while the interest rate is 6 percent in Swaziland ( $r_L = 0.06$ ) and 4 percent in Zambia ( $r_K = 0.04$ ).

- (i) Calculate the NPV of Gcinwayinkhosi Corporation's project. (18 marks)
- (ii) Should they pursue the project? (1 mark)
- (iii) Would you be able to buy more or less kwachas in the forward market than in the spot market? (1 mark)

**Total Marks : 20**

#### QUESTION FOUR

A. Company A is considering merging with X. The following data has been collected:

	A	X
Earnings after interest and taxes	1,500,000	600,000
Earnings before interest and taxes	2,000,000	1,000,000
Number of shares	3,000,000	2,000,000
Dividends Paid	750,000	300,000
Shares are currently trading at	250cents	150cents

Company A and X have similar growth rate of five percent. After the merger the growth rate is expected to be 10 percent. The payout ratio will be 50%.

**Required:**

(a) Calculate

i. Value of A

**5 Marks**

ii. Value of X

**5 Marks**

iii. The total value of the two firms.

**5 Marks**

iv. The value of the merged firm, assuming that company A made a cash payment **(3 Marks**

**(b)** Should company A merge with company X? why or why not?

**(2 Marks**

**(Total Marks 20)**

## QUESTION FIVE

1. In the United States, we can buy a pair of shoes for \$36. These shoes are identical in all aspects to a pair of shoes from Japan that be purchased for ¥6,000 including shipping costs. What dollar amount can we save by buying the shoes in the United States if the exchange rate is \$1 for ¥150?
  - A) \$5.00
  - B) \$4.00
  - C) \$3.00
  - D) \$2.00
  
2. \_\_\_\_\_ is a financial term for "free money," that is, the opportunity to make a profit without risk.
  - A) Free rider
  - B) Arbitrage
  - C) Trading in perfect markets
  - D) Trading in imperfect markets
  
3. In terms of exchange rates, you can think of the denominator as what you want to buy and the numerator as \_\_\_\_\_.
  - A) the price in the foreign currency
  - B) the price in your currency
  - C) what you want to receive
  - D) None of these
  
4. Which of the statements below is FALSE?
  - A) The opportunity to make a profit without risk by exchanging three currencies is known as triple arbitrage.
  - B) When cross rates are out of line, there can be an arbitrage opportunity.
  - C) Exchange rates vary from one day to the next.
  - D) Even if you could not do a direct exchange between pounds and yen, you could convert pounds to dollars and then dollars to yen and ultimately end up changing pounds into yen.
  
5. Which of the statements below is TRUE?
  - A) The foreign rate is derived by pricing two currencies against a third.
  - B) All domestic rates can be computed using a setup with American rates and European rates with the U.S. dollar as the home currency.
  - C) The opportunity to make a profit without risk by exchanging three currencies is known as triple arbitrage.
  - D) When cross rates are out of line, there can be an arbitrage opportunity.
  
6. Which of the statements below is TRUE?

- A) Spot rates are based upon the interest rates for two countries.
- B) Forward Indirect Rate<sub>t</sub> = Current Indirect Rate  $\times \left( \frac{1 + \text{interest}_f}{1 + \text{interest}_h} \right)^t$
- C) There is no way to lock in future currency exchange rates.
- D) What the International Fisher Effect really tells us is that inflation rates the world round are the same and that one cannot exploit different inflation rates across different countries.
7. Anticipated cash inflows may fall in value if unexpected movements in the exchange rate hurt your ability to convert the foreign currency into domestic currency. This reduction in the conversion of future payments is called \_\_\_\_\_.
- A) translation exposure  
 B) transaction exposure  
 C) conversion exposure  
 D) operating exposure
8. Assume you manage a firm that faces transaction exposure. Your company manufactures and sells automobile parts around the world. You have just completed a large sale of parts to an auto manufacturer in France and received a promised payment of €172 per part. You have already sold 17,000 parts and are now awaiting payment. The exchange rate today is \$1.25/€. Over the next ninety days, the direct exchange rate unexpectedly moves from \$1.25/€ to \$1.30/€. What is the gain in domestic revenue due to this unexpected move in the exchange rate?
- A) \$106,000  
 B) \$114,900  
 C) \$118,500  
 D) \$146,200
9. Transaction exposure deals with converting financial statements from foreign operations into consolidated reports of both foreign and domestic operations. TRUE or FALSE
10. A UK exporter sells goods to a firm in the USA and sends an invoice for US\$9m payable in 3 months.  
 The current rate of exchange is US\$1.50/£. The exporter considers the deal to be barely profitable at the current exchange rate. What gain or loss will occur due to currency changes in the following circumstances?
- US\$1.70/£ US\$1.20/£**
- A £0.706m gain; £1.5m loss.  
 B £1.8m loss; £1.5m gain.  
 C £1.8m gain; £2.7m gain.

D £0.706m loss; £1.5m gain.

Total (20 marks)

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