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(Knowledge for Development)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER

MAIN EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE : BCF 323

COURSE TITLE : FINANCIAL RISK MANAGEMENT

DATE:5TH SEPTEMBER 2022 **TIME:9.00AM – 11.00AM**

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 HOURS

KIBU observes ZERO tolerance to examination cheating

This Paper Consists of 2 Printed Pages. Please Turn Over.

SECTION A

QUESTION ONE (Compulsory).

(a) Colgate-Palmolive is a Multinational Consumer Product Manufacturer with branches in at least 30 countries across the world. Manufacturing and distribution of its products are done in these host countries and at its headquarters, New York, USA.However the entire final accounts and financial reports are prepared at its head office, New York, USA.

Required.

(i) Identify and discuss major financial risks that this Multinational Corporate would be exposed to on account of its operations. **(10 Marks).**

(ii) How can Colgate-Palmolive surmount the effect of these financial risks? **(6 Marks).**

(b) (i) Distinguish between Locational and Triangular arbitrage. **(2 Marks).**

(ii).Consider the following actual exchange rates spotted in NCBA Bank in Nairobi.

1 Ksh	=	0.012 dollars.
1 Tsh	=	0.0006 dollars.
1 Ksh	=	Tshs 22.

Required.

Compute the gain/loss from triangular arbitrage to an investor with 180,000 dollars to invest. **(6 Marks).**

(c) Consider XY Stock which is priced at Kshs 72 and pays a dividend of Shs 8 per share in two months. The risk free rate is 12%.

Required.

Calculate the forward rate for a 10 month contract. **(4 Marks).**

(d) Highlight two risks associated with Swaps. **(2 Marks).**

SECTION B.

QUESTION TWO

(a). Market Risk is one of the major sources of financial risk in most business entities. What are these market risks and how do they arise in an organization? **(14 Marks).**

(b) State and explain three reasons why most corporates invest in financial risk management within their entities. **(6 Marks).**

QUESTION THREE

(a) Distinguish between Capital Market Line and the Security Market Line. **(2 Marks).**

(b) ABC Ltd. Has a risk free rate of interest of 14 percent. The Market Portfolio is expected to yield a return of 24 percent with a standard deviation of 10 percent. If an investor desires to earn an expected rate of return of 18 percent, in what combination should he hold the Market portfolio and that of the risk free security? **(4 Marks).**

(c) You are an Investment and Portfolio Manager in Mutual Fund. Based on the following details, determine the securities that are overpriced and underpriced in terms of the Security Market Line (SML). **(12 Marks).**

Security	Actual Return	Beta(β)	Standard Deviation(σ)
A	0.60	1.50	0.70
B	0.30	1.10	0.30
C	0.55	0.90	0.60
D	0.16	1.30	0.20
E	0.35	0.95	0.30
F	0.20	0.95	0.12
Market Index	0.16	1.00	0.20
Treasury Bills	0.12	0	0.00

(d) Arising from your findings in (a) above, what would be your next course of action for both overpriced and underpriced securities. **(2 Marks).**

QUESTION FOUR.

(a) Consider the value of a put option with the following characteristics.

- Exercise price Kshs 120.
- Premium per put option Shs 14.
- Time to expiry for the option – 6 Months.

Required.

Calculate the value of put option and the Profit or loss based on the spot prices of the underlying security after six months below.
Shs 80, Shs 95, Shs 110, Shs 120, Shs 135. **(6 Marks).**

(b) Assume that the Tsh exhibits a 6 month interest rate of 16 % per annum while the Kshs exhibits a 6 month interest of 12 percent per annum.

Required.

(i) Compute the forward rate premium of the TSh with respect to the Kshs according to interest rate parity. **(3 Marks).**

(ii) If the current spot rate of the Tsh is 0.05 compute the six month forward rate of the TSh with respect to the Ksh. **(3 Marks).**

(iii) Compute the gain from covered interest arbitrage to a Kenyan investor with Kshs 9 Million for a six month period. **(4 Marks).**

(c) The Capital Asset Pricing Model is without a doubt one of the most popular asset pricing models. It however suffers from certain shortcomings. State and explain two such shortcomings of CAPM. **(4 Marks).**

QUESTION FIVE.

(a) Delta Ltd. has a beta of 1.20.The Treasury bill rate is 14 percent and the expected return on the market portfolio is 20 percent.
Delta Ltd currently pays a dividend of shs 18 a share and this dividend is expected to grow at the rate of 9 percent per annum for the foreseeable future.

Required.

(i) Calculate the rate of return according to CAPM. **(2 Marks).**

(ii) Calculate the Stock's present market price per share, based on the required return in (i) above. **(4 Marks).**

(iii) What would be the required return and Market Price per share assuming the beta is 0.90. (Everything else remains the same). **(4 Marks).**

(b) Mr James Kamau, an investor is evaluating five portfolios with the following characteristics.

Portfolio	Portfolio Expected Return (%)	Standard Deviation (%)
M	24	12
N	28	18
O	16	10
P	32	9
Q	22	6

The expected return on the market portfolio is 16% with an accompanied standard deviation of 8%.The Risk free rate of interest is 9%.

Required.

Using the Capital Market Line, advise Mr James Kamau on which of the above portfolios are efficient and inefficient. **(10 Marks).**