CHUKA UNIVERSITY

SUPPLEMENTARY/ SPECIAL EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 431: FINANCIAL MANAGEMENT II

STREAMS: BCOM **TIME: 2 HOURS**

DAY/DATE: MONDAY 01/02/2021 **11.30 AM – 1.30 PM**

INSTRUCTIONS:

ANSWER QUESTION ONE AND ANY OTHER TWO

QUESTION ONE

a) Explain the different stock market anomalies. (8 marks)

b) Describe the Assumptions of Efficient Market Hypothesis. (4 marks)

c) Explain the different forms of efficient market hypothesis and the test carried out to support each of the forms. (12 marks)

d) A company has the following information relating to its equity share: current market price per share of kshs. 60, exercise price of kshs. 56, time to maturity of 6 months, variance of 9% and prevailing risk less rate of 14% per annum. **Required:** The value of the call option. [6 marks]

QUESTION TWO

a) Z limited is considering relaxing its credit standard, the firm's current credit terms are 30 but the average collection period is 60 days. Current annual sales amount to sh 5 million, the firm wants to extend the period to net 120, with that, sales will increase by 30% bad debts will increase from 3% to 4% of annual credit sales, collection cost will increase by sh 120,000. The return on Investment to debtors is 10%, selling price per unit is 100 and the variable cost per unit is 70. Assume a year has 360 days.
Required: Should the firm change the credit policy? (8 marks)

b) Describe the difference between forward and futures. (6 marks)

c) Consider a 3 month forward contract on a zero coupon bond with a face value of $1, 000 that is currently quoted at $500, and suppose that the annual risk-free rate is 6%.
Required: The value of the forward contract [3 marks]

d) High the strategies employed by the firm in managing its cash (3 marks)

QUESTION THREE

a) A plain vanilla interest rate swap was recently advertised in an international journal. The advertisement contained the following details

Period	**TB Rate (%)**	**Period**	**TB RATE (%)**
Current	4.0	180 days	5.0
90 days	4.5	270 days	5.5
180 days	5.0	360 days	6.0

An investor A intends to enter into a Euro: 20, 000,000 quarterly pay plain vanilla interest rate SWAP as a fixed rate payer and the fixed rate is 6% per annum. Another investor B, who is a floating rate payer, is willing to pay 90-day Treasury bill rate + percent margin, A year has 360 days. If A enters into a SWAP contract with B, how much will A pay or receive in 90 days, 270 days and 360 days from now. [8 marks]

b) Explain the uses of interest rate SWAPs (4marks)

c) Kena ltd maintains a minimum cash balance of sh. 2, 000,000. The standard deviation of its daily net cash flow at sh. 22,000. The transaction cost of buying and selling of marketable securities is sh. 60 per transaction. The rate of interest for marketable securities is 5% per annum. Assume 360 days in a year

Required:

(i) The upper cash limit [2 marks]

(ii) Target cash balance [2 marks]

(iii) Average cash balance [2 marks]

(iv) Spread [2 marks]

QUESTION FOUR

a) Differentiate between the following (6 marks)

   i) Initial margin

   ii) Maintenance margin

   iii) Variation margin

b) Explain how swaps are terminated (6 marks)

c) An asset is priced at sh 75 with a risk free rate of 5.15% with net storage cost after adjusting for convenience yield as sh3.2 The futures expire in 9 months determine futures contract price.

(3 marks)

d) Mr. William enters into two year 15 Million USD quarterly swap as a fixed payer and will receive the index return on the Nairobi stock exchange (NSE 20 share index). The fixed rate is 10% and Index is currently at 1500. At the end of the next three quarters the index level is 1560, 1170 and 1600. Required; calculate the net payment for each of the next 3 quarters and identify the direction of payment. (5 marks)
