

[This question paper contains 4 printed pages.]

4233

Your Roll No.

MBA (FT)

A

Paper F – 3104 – INTERNATIONAL FINANCIAL MANAGEMENT

Time : 3 Hours

Maximum Marks : 70

(Write your Roll No. on the top immediately on receipt of this question paper.)

Attempt any Four questions. All questions carry equal marks.

1. a) The one-year interest rate in New Zealand is 6 percent. The one-year U.S. interest rate is 10 percent. The spot rate of the New Zealand dollar (NZ\$) is \$.55. The forward rate of the New Zealand dollar is \$.58. Is covered interest arbitrage feasible for U.S. investors? Is it feasible for New Zealand investors? In each case, explain why covered interest arbitrage is or is not feasible with the help of an example.
 - b) Explain the changing International Monetary System. What lessons can economists draw from the current International Monetary System?
2. The Balance Sheet of a manufacturer based in Canada, at the current exchange rate of C\$1.60/\$ is shown as follows.

	Value In C\$	Value at C\$1.50/\$
Assets		
Cash & marketable securities	C\$300,000	\$200,000
Accounts receivable	C\$150,000	\$100,000
Inventory	C\$600,000	\$400,000
Plant & equipment	C\$450,000	\$300,000
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Total liabilities & Net Worth	C\$1,500,000	\$1,000,000
Liabilities		
Accounts payable	C\$300,000	\$200,000
Wages payable	C\$150,000	\$100,000
Net worth	C\$1,050,000	\$700,000
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Total liabilities & Net Worth	C\$1,500,000	\$1,000,000

Answer each of the following questions under the current/noncurrent rate method, the temporal method of FAS #8, and the current rate method of

P.T.O.

FAS #52. (Use current exchange rates for inventory in the temporal method.)

- a. Identify the exposed assets, exposed liabilities, and net exposed assets under the current /non current rate method, the temporal method, and the all current rate method. (Use historical exchange rates for inventory in the temporal method.)
 - b. Identify the impact of a depreciation of the U.S. dollar from C\$1.50/\$ to C\$1.40/\$ on the consolidated balance sheets under the all current method.
3. a) Assume that ABC company has net receivables of 1,00,000 Swiss francs in 90 days. The spot rate of the Swiss franc is \$50 and the Swiss interest rate is 3% over 90 days. Explain briefly how a US firm can implement a money market hedge?
- b) When would a firm consider hedging net payables or net receivables with currency options rather than forward contracts? What are the disadvantages of hedging with currency options as opposed to forward contracts?
- c) How does the forward market differ from the futures and options markets?
4. INA Corporation presently has no existing business in Germany but is considering the establishment of a subsidiary there. The following information has been gathered to assess this project:
- The initial investment required is DM50 million. Given the existing spot rate of \$.50 per mark, the initial investment in dollars is \$25 million. In addition to the DM50 million initial investment on plant and equipment, DM20 million is needed for working capital and will be borrowed by the subsidiary from a German bank. The German subsidiary of INA Corporation will pay interest only on the loan each year, at an interest rate of 14 per cent. The loan principal is to be paid in 10 years.

- The project will be terminated at the end of year 3, when the subsidiary will be sold.
- The price, demand and variable cost of the product in West Germany are as follows:

Year	Price	Demand	Variable Cost
1	DM500	40,000 units	DM30
2	DM511	50,000 units	DM35
3	DM530	60,000 units	DM40

- The fixed costs, such as overhead expenses, are estimated to be DM6 million per year.
- The exchange rate of the mark is expected to be \$.52 at the end of year 1, \$.54 at the end of year 2, and \$.56 at the end of Year 3.
- The German government will impose an income tax of 30 per cent on income. In-addition, it will impose a withholding tax of 10 per cent on earnings remitted by the subsidiary. The US government will allow a tax credit on remitted earnings and will not impose any additional taxes.
- All cash flows received by the subsidiary are to be sent to the parent at the end of each year. The subsidiary will use its working capital to support ongoing operations.
- The plant and equipment are depreciated over 10 years using the straight-line depreciation method. Since the plant and equipment are initially valued at DM50 million, the annual depreciation expense is DM5 million.
- In three years, the subsidiary is to be sold. INA plans to let the acquiring firm assume the existing German loan. The working capital will not be liquidated, but will be used by the

acquiring firm. INA Corporation expects to receive DM52 million after subtracting capital gains taxes when it sells the subsidiary.

- INA Corporation requires a 20 per cent rate of return on this project.

Determine the net present value of this project. Should INA Corporation accept this project?

5. a) What are the key factors contributing to an effective cash management system within a firm? Is the cash management process more difficult in a MNC? Why?
- b) 'Country risk and credit worthiness have become important over the years and despite analytical difficulties there has been a growth in interest in recent years as well as a growth in various agencies in the systematic valuation of country risk, infact country risk analysis is a difficult task and it may also change over time.' Discuss.