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Question Paper	
Strategic Financial Management	**Duration**: 65
Details: Test - 9 (CH - 9)	**Marks**:35

Instructions:

- All the questions are compulsory
- Properly mention test number and page number on your answer sheet, Try to upload sheets in arranged manner.
- In case of multiple choice questions, mention option number only Working notes are compulsory wherever required in support of your solution
- Do not copy any solution from any material. Attempt as much as you know to fairly judge your performance.

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Q-1 At the end of July, a UK company expects the following receipts and payments in euros at the end of the month in three months' time (at the end of October):

Receipts = €540,000

Payments = €2,650,000

The company is concerned about the exposure to a risk of a movement in the sterling/euro exchange rate, and it has decided to hedge the exposure.

It is considering three methods of hedging the exposure:

(a) With a forward exchange contract

(b) Using a money market hedge

(c) Using currency futures

Relevant data is as follows:

FX rates, €/£1		
Spot	1.4537 – 1.4542	
3 months forward	1.4443 – 1.4448	
3-month interest rates	**Borrow**	**Invest**
Sterling (UK)	6.2%	5.6%
Euro	3.8%	3.4%

Currency futures

Currency futures for sterling/euro are each for €100,000 and are priced in sterling.

Assume that the futures contracts mature at the end of the month.

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Assume for the purpose of this question that when the futures position is closed atthe end of October, the basis is 0.

Futures prices as at end of July

September futures	0.6890
December futures	0.6929

Required

Calculate the net cost in sterling of hedging the currency risk:

(a) With a forward exchange contract

(b) Using a money market hedge

(c) Using currency futures.

(6 Marks)

Q-2(a)A UK company expects to pay $750,000 to a supplier in three months' time.The following exchange rates are available for the dollar against sterling (GBP/USD):

Spot	1.8570 – 1.8580
3 months forward	1.8535 – 1.8543

The company is concerned about a possible increase in the value of the dollar during the next three months, and would like to hedge its FX risk.

Required

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Explain how the exposure to currency risk might be hedged, and the amount that the UK Company will have to pay in sterling in three months' time to settle its liability.

(b) A German company expects to receive US$450,000 from a customer in two months' time. It is concerned about the risk of a fall in the value of the dollar in the next two months, and would like to hedge the currency risk using a forward contract.

The following rates are available for the dollar against the euro (EUR/USD):

Spot	1.3015 – 1.3025
2 months forward	25c – 18c premium

Required

Calculate the company's income in euros from settlement of the forward contract in two months' time.

(5 Marks)

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Q-3 A UK company will receive US$2 million in six months' time. It is now 20th March.The company is not sure whether the US dollar will rise or fall in value against sterling over the next few months, and it has decided to hedge its exposure to currency risk using traded currency options.

On the Philadelphia Stock Exchange, traded currency options are available in a contract size of £31,250. Options are priced in cents per £1. Assume that option contracts expire on 20th of each month.

The following option prices are currently available:

Exercise price	**Calls**	**Puts**

	June	September	June	September
1.8500	1.4	1.9	4.0	5.1

The current spot exchange rate (US$/£1) is 1.8325 – 1.8375.

Required

(a) Explain how the company's currency exposure could be hedged using traded currency options.

(b) Show what would happen if the options are still held by the company at expiry and the spot exchange rate is $1.9150 – 1.9200.

(6 Marks)

Q-4 X Ltd., an Indian Exporter has an ongoing order from USA for 2000 pieces per month at a price of $100 per piece. To execute the order, the exporter has to import Yen 6000 worth of material per piece. Labour costs are Rs.350 per piece while other variable overheads add upto Rs. 700 per piece. The exchange rates are currently Rs.35/$ and Yen 120/$. Assuming that the order will be executed after 3 months and payment is obtained immediately on shipment of goods, calculate the loss/gain due to transaction exposure if the exchange rates change to Rs.36/$ and Yen 110/$.

(6 Marks)

Q-5 Ford India Private Limited is a wholly owned subsidiary of the Ford Motor Company in India. The vehicles and engines use as an integral parts import from Ford Motor Company of Canada Ltd. And the Ford Motor Company of Canada Ltd. invoiced the sales to the Indian company, the

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payment being due three months from the date of invoice. The invoice amount is $ 11,250 and at todays spot rate of $0.015 per Rs .1, is equivalent to Rs 7,50,000.

It is anticipated that the exchange rate will decline by 10% over the three months period and in order to protect the dollar proceeds, the importer proposes to take appropriate action through foreign exchange market. The three months forward rate is quoted as $0.0145 per Rs 1.

You are required to calculate the expected loss and to show, how it can be hedged by forward contract.

(6 Marks)

Q-6 Pacific Leather Goods Ltd. an Indian manufacturer exports leather goods to USA. The company is exporting 5000 units at a price of $60. The company has imported some specialty chemicals from Europe to produce the export items. The cost of chemicals per unit of leather good stands at Euro 10. The fixed overhead costs per unit comes at Rs.250 and other variable overheads, including the freight cost, add upto Rs.1250 per unit. The payments for both exports and imports are due in six months.

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The current exchange rates are as follows:

Rs./$	46.90
Rs./Euro	40.40

After six months (at the time of settlement of payments) the exchange rate turns out as follows:

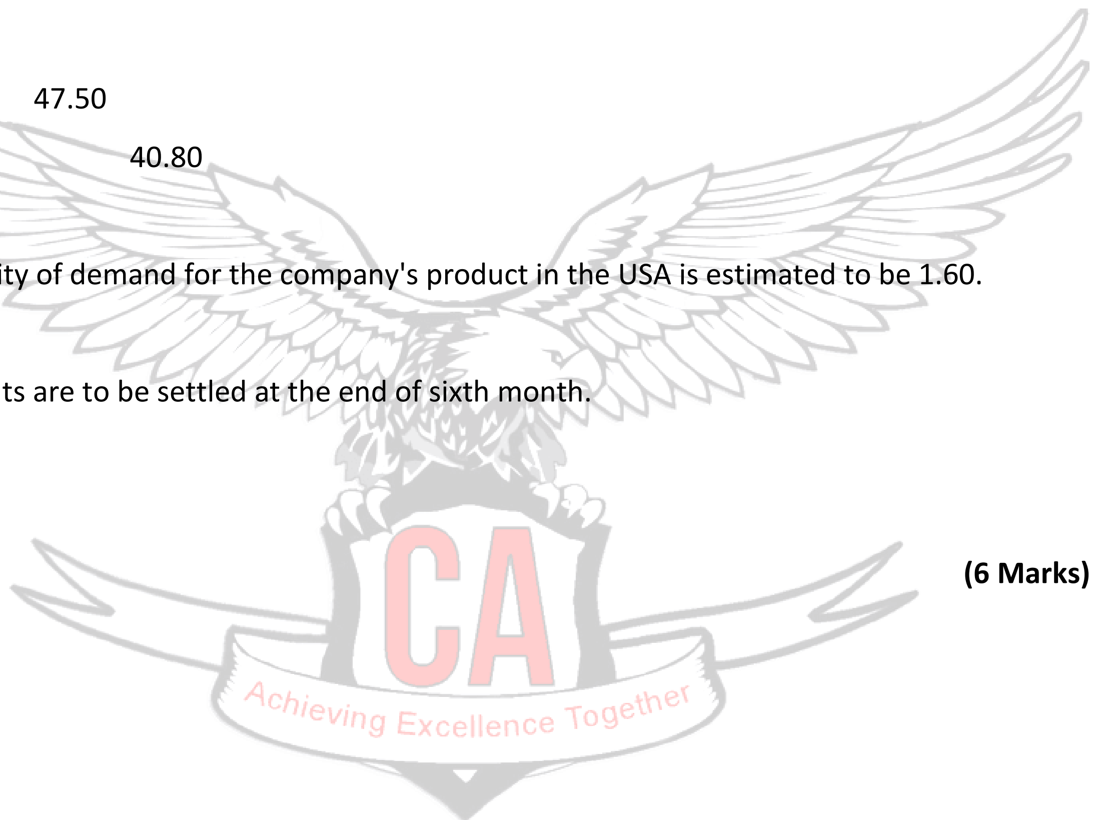
Rs./$	47.90
Rs./Euro	41.25

You are required to:

i. Calculate the loss/gain due to transaction exposure.

ii. Based on the following additional information calculate the losses/gains due to transaction and operating exposure if the contracted export price per unit is Rs.2700:

The current exchange rate changes to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Rs./$: 47.50

Rs./Euro : 40.80

Price elasticity of demand for the company's product in the USA is estimated to be 1.60.

The payments are to be settled at the end of sixth month.

(6 Marks)