

NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
PART IV 2ND SEMESTER FINAL EXAMINATION – MAY 2005
INTERNATIONAL FINANCE II [CFI 4202]
TIME ALLOWED: 3 HOURS

INSTRUCTIONS

1. **ATTEMPT ALL QUESTIONS**

Question One **[15 marks]**

Nestle is updating its weighted average cost of capital. The firm has altered its capital structure in recent years, and wishes to use the revised relative weights of debt and Equity in its capitalisation with current costs of debt and Equity.

Nestle's CFO Dr Mario Corti, has now collected recent values of all alternative portfolios, as well as receiving a new estimate of its beta from one of its major banks, Union Bank of Switzerland [UBS]. The cost of debt is 5%.

<u>Component</u>	<u>Symbol</u>	<u>Domestic ortfolio</u>	<u>Global Portfolio</u>	<u>Revised Portfolio</u>
Riskfree rate	K_{RF}	3,5%	3,5%	3,5%
Market Return	K_M	10,0%	12,5%	12,5%
Beta	β_{NESTLE}	0,950	0,625	0,556

- a. Calculate Nestle's cost of Equity for the three different portfolio data sets. **[9 marks]**
- b. UBS's new Beta estimate was found using a methodology where the beta itself is a moving average of how the individual security's covariance with the global market trends over time. It assumes that the trend will continue and that Nestle's beta will continue to fall in value

What are the implicatins of this for Nestle's cost of capital? **[6 marks]**

Question Two **[25 marks]**

South Korea is home to a large number of Multi-national firms such as Daewoo, Samsung and Lucky Goldstar. Although restrictions may be loosening, foreign investors have not been able to purchase common stock in Korean companies, including these well known Multinationals. On the other hand, foreign investors can purchase shares of the Korea Fund, which is an officially sanctioned mutual fund of Korean shares. The Korea Fund has typically sold at substantial premium over the market value of its underlying shares.

- a. Explain how the restrictions on foreign ownership probably influence the cost of capital of Daewoo, Samsung and Lucky Goldstar. **[5 marks]**
- b. What needs to be done by these firms to lower their cost of capital? **[5 marks]**
- c. What needs to be done by Korea to unsegment the Equity Market? **[5 marks]**
- d. Why do you think South Korea prevented direct foreign ownership in the first place? **[10 marks]**

Question Three [25 marks]

- a. The International Financial System has been experiencing tremendous growth lately.
 - (i) What were the three causes for this growth?
 - (ii) What have been the benefits from this growth?
 - (iii) What have been the costs? **[9 marks]**
- b. The Bretton Woods Accord of 1944 created the International Monetary Fund [IMF] and the World Bank.
 - (i) Discuss the role of IMF during the fixed exchange system. **[4 marks]**
 - (ii) Discuss its current role **[3 marks]**
- c. What type of a Bank is the World Bank? **[3 marks]**
- d. What is the difference between “Hot Money” and “Patient Money”? Give examples. **[6 marks]**

Question Four [25 marks]

- (i) Demonstrate graphically how both the diversifiable and non-diversifiable risks of an investor’s portfolio may be reduced through international diversification. **[5 marks]**
- (ii) Europe, Australia, Far East [EAFE] Index presents the following data on a foreign stock portfolio.
 - Based on monthly data, 1970 - 2000
 $\sigma = 53,2\%$, $\sigma = 58,1\%$ $\sigma = 0,5$:
 - a. Calculate the standard deviation of such an internationally diversified portfolio. **[10 marks]**

- b. Comment on the riskiness of the internationally diversified portfolio vis-à-vis the risk of the US Portfolio. **[2 marks]**
- (iii) What are American Depository Receipts? What are their advantages to United States investors? **[8 marks]**

Question Five **[25 marks]**

The individual subsidiaries' day-to-day cash need and the precautionary cash balances they should hold are as follows [in millions of dollars]:

	Day-to-Day Needs <u>A</u>	One Standard Deviation <u>B</u>	Required Cash Balance [A + 3B]
SPAIN	\$10	\$1	\$13
ITALY	6	2	12
GERMANY	<u>12</u>	<u>3</u>	<u>21</u>
TOTAL	\$28	\$6	\$46

Consider what might occur if the firm decided to maintain all three cash balances at a Centralised Depository in London. **[10 marks]**