CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL II EXAMINATION

A2.1: STRATEGY CORPORATE FINANCE

DATE: WEDNEDAY 25, FEBRUARY 2026

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking guide

	Description	Marks
a)	Award 0.5 marks for revenue forecast in each year	1.5
	Award 0.5 marks for cost of sales forecast in each year	1.5
	Award 0.5 marks for gross profit in each year	1.5
	Award 0.5 marks for operating profit or profit before tax in each year	1.5
	Award 0.5 marks for tax forecast in each year	1.5
	Award 0.5 marks for interest forecast in each year	1.5
	Award 0.5 marks for free cash flow forecast in each year	1.5
	Terminal value (Award 0.5 marks for formula and 1.5 marks for calculation)	2
	Award 1 mark for calculation cost of equity	1
	Award 0.5 marks present value for each year	1.5
	Award 0.5 marks for value of the firm	0.5
	Operating cost	
	Award 0.5 marks on calculation of base variable cost 15% of sale	0.5
	Award 0.5 marks on variable cost forecast in each year	1.5
	Award 0.5 marks on fixed cost forecast in each year	1.5
	Depreciation and non-current assets	
	Award 0.5 marks on additional asset in each year	1.5
	Award 0.5 mark on Depreciation in each year	1.5
	Award 0.5 marks on Working capital in each year	1.5
	Working capital	
	Award 0.5 marks for base working capital (Current asset-cash)	0.5
	Award 0.5 marks on Working capital required forecast in each year	1.5
	Award 0.5 marks on Incremental working capital forecast in each year	1.5
	Sub total	**27**
b)	Award 1 mark for each well explained assumption. Max 4 Marks	4
c)	Award 1 mark for each well explained solutions. Max 5 Marks	5
d)	Award 1 marks for each well explained CSR and 1 Marks for metrics on each CSR.	8
e)	Award 1 mark for calculated ratio on profitability and 1 mark for its interpretation Award 1 mark for calculated ratio on cost structure and 1 mark for its interpretation Award 1 mark for calculated ratio on finance costs and 1 mark for its interpretation	6
	Total	**50**

		Base Year (2025)	2026	2027	2028	2029
		Frw Million	**Frw Million**	**Frw Million**	**Frw Million**	**Frw Million**
Revenue	10%	12,000	13,200	14,520	15,972	
Cost of Sales	10%	8,000	8,800	9,680	10,648	
Gross Profit	**10%**	**4,000**	**4,400**	**4,840**	**5,324**	
Variable Costs	15%	1,800	1,980	2,178	2,396	
Fixed Costs	5%	800	840	882	926	
Depreciation		400	420	441	463	
EBIT		**1,000**	**1,160**	**1,339**	**1,539**	
Interest			120	120	120	120
PBT		**1,000**	**1,040**	**1,219**	**1,419**	**-120**
Tax	28%		100	291	341	397
PAT		**1,000**	**940**	**928**	**1,078**	**-517**
Less: Change in NWC			80	88	96.8	
Less: Capex	5%		200	210	220.5	
Add Back Depreciation			420	441	463	
FCFE			**1,080**	**1,071**	**1,223**	**(517)**
Cost of Equity (%)	10%		0.909	0.826	0.751	0.683
Present Value of FCFE			**981.72**	**884.48**	**918.83**	**(353.34)**

Total Present Value of Forecasted Cash flow **2, 432**

Terminal Value [FCFE(1+G) / Ke-g] * Df of 2028

Terminal Value [1,223(1+2%) / 10%-2%] * 0.751= **11,715**

Total Value of Equity **14,147**

Cost of Equity

Equity Beta		0.8	
Risk free rate		6%	
Market Return		11%	
Market Premium		5%	
Expected Return	:Rf + Be*Mp		
		10%	
			Base Year 2025
Operating Cost			3,000
Reveune		12000	
Variable Cost 15% of Revenue		15%	1,800
Cost of Asset		4,000	
Depreciation rate		10%	
Depreciation			400
Fixed Cost			**800**

Account Description In Million		**2025**	**2026**	**2027**	**2028**
Non-current assets (Gross)	5%	4,000	4,200	4,410	4,631
Depreciation 10% of NCA	10%	400	420	441	463

Interest on Loan

Loan FRW	1,000
Interest Rate	12%
Interest Paid	**120**

An existing bank loan secured against general business assets, with no personal guarantees from the directors. Under the forward assumptions agreed with the directors, the level of the loan will be maintained at FRW 1 billion and, based on the forward yield curve

Increase in Working Capital 10%

Year	**NWC (In million)**	**Cash and Cash equivalent**	**NWC (In million)**	**Increase**
2025	**1000**	**200**	**800**	
2026			880	80
2027			968	88
2028			1064.8	96.8

b) Assumptions and uncertainties within the valuation
Whilst the valuation of the business is a useful estimate, it should be treated with caution as it is subject to certain assumption

Rate of return

The rate of return of 10% is assumed to fairly reflect the required market rate of return for a business of this type, which compensates you for the business risk to which you are exposed. Whilst the required return for an investment held in a widely diversified portfolio should only compensate you for market risk, if you hold the same investment individually you may expect a higher return due to your increased exposure to risk.

Growth rates

The growth rate applied to terminal value is assumed to be certain into the indefinite future. In the case of a three-year projection, this is unlikely to be the case, due to unexpected economic conditions and the type of business. In order to reduce the effects of such uncertainties, different growth rates could be applied to the calculations to determine business valuation in a variety of scenarios.

Interest rates and tax rates

Similar to the growth rate, it has been assumed that interest rates and tax rates will remain unchanged during the three-year period. If economic conditions suggest that changes may take place revised calculations could reflect different possible rates to update the estimate of business valuation

Costs, revenues and non-current assets

It has been assumed that the figures used for these factors are certain and that the business is a going concern. It may be worth investigating the potential variability of these factors and the range of values that may result for such variability. Changes in estimates will obviously affect operating profit and projected cash flows, which in turn will affect the estimated value of the business

c) Solutions to address cash flow volatility for Munezero limited

Working-capital excellence programme (cash conversion cycle focus)

Set board-level targets for receivables days, inventory days, and payables days; assign ownership; track weekly. Cash volatility in manufacturing is usually a discipline problem before it is a growth problem.

Customer and contract redesign

Reduce concentration risk by widening the customer base and renegotiating terms: deposits for large orders, milestone billing, and penalties/bonuses tied to delivery schedules that improve cash timing.

Operational resilience to protect cash

Strengthen production planning, preventive maintenance, and supplier reliability to reduce rush orders, stock-outs, rework, and scrap—these are hidden drivers of cash leakage and unpredictable outflows.

Liquidity architecture (buffer + standby funding)

Adopt a minimum cash policy and put in place a revolving working-capital facility/overdraft sized to seasonal swings. This turns "survival volatility" into "managed volatility."

Value-based pricing

Lock in key input pricing where possible, implement lean cost initiatives, and improve product mix/pricing to protect margins. Stable margins reduce the probability of cash shocks.

d) Munezero Limited integrates Corporate Social Responsibility

Employment creation: The company supports local economic development by creating stable jobs across production, administration, and supply chain functions.

Metric: Number of local jobs created and retained.

Skills development and workforce empowerment: Munezero Limited invests in employee training, safety awareness, and technical capacity building to improve productivity and career progression.

Metric: Training hours per employee per year.

Support for local businesses and value chains: The company engages local suppliers and small enterprises to strengthen domestic value chains and reduce dependence on imports.

Metric: Percentage of total procurement sourced from local suppliers.

Environmental responsibility and resource efficiency: Munezero Limited focuses on efficient energy use, responsible raw material consumption, and waste reduction in its operations.

Metric: Energy and raw material usage per unit of output.

Waste management and environmental protection: The company seeks to minimise its environmental footprint through improved waste handling and recycling practices.

Metric: Waste reduction and recycling rates.

e)

1. Profitability ratios

Gross profit Margin

	ICYORO	**Sector**
Gross profit	17,200	24,400
Sales revenue	80,000	107,200
Gross profit margin	**21.50%**	**22.80%**

ICYORO earns a lower gross margin than the sector, indicating weaker control over production and trading costs. This reduces profits available for dividends.

Net profit margin (after tax)

	ICYORO	**Sector**
Profit after tax	5,950	8,890
Sales revenue	80,000	107,200
Net profit margin	**7.40%**	**8.30%**

ICYORO converts a smaller proportion of revenue into profit after tax, directly limiting distributable profits and dividend capacity.

2Cost structure analysis

Cost type	**ICYORO**	**Sector**
Variable cost of sales	70%	100%
Variable operating expenses	30%	70%
Overall cost flexibility	**Low**	**High**

ICYORO has a **high fixed cost base**, resulting in high operating leverage. This makes profits more sensitive to sales fluctuations and encourages management to retain profits rather than pay dividends.

3Finance cost ratios (interest absorbs profits)

(a) Interest cover ratio

	ICYORO	**Sector**
PBIT	11,000	14,200
Interest payable	2,500	1,500
Interest cover	**4.4 times**	**9.5 times**

ICYORO has a **much weaker interest cover**, meaning a significant portion of operating profit is used to service debt. This reduces profits available for dividends and increases financial risk.

4Profit attributable to Non-Controlling Interests

NCI ownership: 40%

ICYORO profit after tax: 5,950

Profit attributable to NCI=5,950×40%=2,380

Lower profits mean lower dividends payable to NCI, despite their lack of control over operational and financing decisions.

SECTION B

QUESTION TWO

Marking guide

	Description	Marks
Q2(a)	**Statement of Financial Position**	
	Award 0.5 marks for each component in adjusted SOFP except totals	6
	Retained Earning	
	Award 1 mark on increase in interest (pre-tax) for proposal 1	1
	Award 1 mark on revised earnings for proposal 1	1
	Award 1 mark on Gain (after-tax) of retained earnings on proposal 2	1
	Award 1 mark on revised earnings for proposal 2	1
	Gearing and EPS	
	Calculation of Gearing, award 1 mark for each proposal and base year	3
	Calculation of EPS, award 1 mark for each proposal and base year	3
	Others	
	Award 1 mark for calculating interest saving (after tax)	1
	Award 0.5 marks for calculating net increase in current assets = +11,264	0.5
	Award 1 mark for each well explanation on each proposal	2
	Award 0.5 for correct choice	0.5
	Maximum	**20**
b)	Award 1 mark for each well explained ethical issue	5
	Total	

Marking Guide

a)

Diamond Limited
From: Chief Financial Officer (CFO)
Subject: Impact of Proposed Financing Strategies and Ethical Considerations
Date:
This report evaluates the financial and strategic implications of two proposed financing options in response to recent public statements and increased investor scrutiny. It analyzes their impact on:

PROPOSAL 1

Adjusted SoFP

Item	Before (FRW '000)	Change	After (FRW '000)
Non-current assets	742,200	–	742,200
Current assets (cash impact from extra interest paid)	179,400	-20,580	158,820
Total assets	**921,600**	**-20,580**	**901,020**
Share capital	245,000	-20,000	225,000

Retained earnings *(buyback + lower earnings)*	144,000	**(60,000)** **(20,580)**	**63,420**
Total equity	**389,000**	**-100,580**	**288,420**
Non-current liabilities (loan)	420,000	80,000	500,000
Current liabilities	112,600	–	112,600
Total equity & liabilities	**921,600**	**-20,580**	**901,020**

Earnings impact

	FRW '000
Existing interest: 18% × 420,000	75,600
New interest: 21% × 500,000	105,000
Increase in interest (pre-tax)	29,400
Tax saving @30%	-8,820
Decrease in earnings (after-tax)	**-20,580**
Revised earnings: 3,800 - 20,580	**-16,780**

EPS and gearing

Measure	**Result**
EPS = -16,780/ 2,250	**FRW (7.46)**
Gearing = 500,000 / 288,420	**1.73**

W1. Shares repurchased

Item	**Value**
Buyback funds	80,000 ('000)
Share price	400
Shares repurchased	**200 ('000 shares)**
Shares before	2,450 ('000 shares)
Shares after	**2,250 ('000 shares)**

Par value = 100, share capital reduction = 200×100 = 20,000; balance of 60,000 reduces retained earnings.

PROPOSAL 2

Adjusted SoFP

Item	**Before**	**Change**	**After**
Non-current assets	742,200	-85,000	657,200
Current assets *(+11,264 net cash)*	179,400	11,264	190,664
Total assets	**921,600**	**-73,736**	**847,864**
Share capital	245,000	–	245,000
Retained earnings *(+ gain + interest saving)*	144,000	**33,264**	**177,264**
Total equity	**389,000**	**33,264**	**422,264**
Medium-term loan	420,000	-107,000	313,000
Current liabilities	112,600	–	112,600
Total E + L	**921,600**	**-73,736**	**847,864**

Earnings impact

	FRW '000
Proceeds	107,000
Carrying value	-85,000
Gain (pre-tax)	**22,000**
Tax @30%	-6,600
Gain (after-tax)	**15,400**

Revised earnings

	FRW '000
Base post-tax profit	3,800
Add: after-tax disposal gain	15,400
Add: after-tax interest saving	17,864
Revised earnings	**37,064**

EPS and gearing

Measure	Result
EPS = 71,264 / 2,450	**FRW 29.09**
Gearing = 313,000 / 422,264	**0.74**

W2 Interest saving (rate falls by 2% to 16% after debt reduction)

	FRW '000
Existing interest: 18% × 420,000	75,600
New interest: 16% × 313,000	50,080
Saving (pre-tax)	25,520
Tax @30%	-7,656
Saving (after-tax)	**17,864**

W3. Cash/current assets effect (because interest and tax are paid):
Disposal proceeds +107,000 and debt repayment -107,000
Tax on gain paid: -6,600
After-tax interest saving: +17,864
Net increase in current assets = +11,264

Conclusion

Measure	Base	Proposal 1	Proposal 2
Earnings (FRW '000)	3,800	-16,780	37,064
EPS (FRW)	1.55	(7.46)	1.51
Equity (FRW '000)	389,000	288,420	422,264
Debt (FRW '000)	420,000	500,000	313,000
Gearing (Debt/Equity)	1.08	1.73	0.74

Proposal 1: Borrow FRW 80 million and repurchase shares

This proposal significantly weakens the company's financial position. The increase in borrowing causes the interest rate on the entire loan balance to rise from 18% to 21%, leading to a substantial increase in finance costs. As a result, earnings fall sharply, and although the number of shares in issue is reduced, earnings per share decline. In addition, equity is reduced due to the share repurchase, while debt increases, causing gearing to rise markedly. Overall, this proposal increases financial risk and reduces shareholder value.

Proposal 2: Dispose of surplus assets and reduce debt
This proposal strengthens RUBAVU Co's financial position. The disposal generates a taxable gain and allows the company to reduce its outstanding loan balance. The reduction in borrowing lowers the interest rate from 18% to 16%, resulting in significant interest savings. Consequently, earnings and earnings per share increase substantially. Equity rises, debt falls, and gearing improves considerably, indicating a lower level of financial risk.

Proposal 2 is recommended

b) Ethical issue

1. Misleading Public Statements (Lack of Honesty & Transparency): The CEO made exaggerated claims about the software's capabilities and readiness for international markets despite unresolved bugs and performance gaps, violating ethical principles of honesty and transparency.
2. Potential Market Manipulation: The unverified claims led to rise in stock price, misleading investors and raising ethical concerns about market manipulation.
3. Risk to Investors and Stakeholders: Investors and customers developed unrealistic expectations, exposing them to financial loss and eroding trust when the company may fail to deliver.
4. Corporate Governance Failure: Major public statements were made without alignment with internal reports, reflecting weak oversight and accountability within the organization.
5. Legal and Reputational Risk: Failure to meet advertised claims could result in lawsuits, regulatory action, and long-term reputational damage, which leadership has an ethical duty to avoid.

QUESTION THREE
Marking guide

Q4	CRITERIA	Marks
a)	**For leasing**	
	Award 0.5 marks to each leasing cost every year. Max 2 marks	2
	Award 0.5 marks to each Leasing costs – After Tax (1-28%) every year. Max 2 marks	2
	Award 0.5 marks to each PV – FRW '000 in every year. Max 2 marks	2
	Total PV - Cost of leasing-FRW 000'	0.5
	For borrowing	
	Correct purchase price at Year 0	0.5
	W1: PV of after-tax maintenance	
	After-tax maintenance correctly computed	1
	PV of after-tax maintenance (annuity due)	1
	W2: PV of depreciation tax shields	
	Residual value correctly computed	0.5
	Depreciable amount correctly computed	0.5
	Annual depreciation correctly computed	0.5
	Tax shield correctly computed	0.5
	PV of depreciation tax shields	0.5
	W3: PV of after-tax residual value	
	After-tax residual value	0.5
	PV of residual value	0.5
	Total PV cost (BUY)	0.5
	Decision	1
	Maximum	**14**
b)		
	Issue price	
	Calculation of PV for each bond @0.5 maximum of 3	3
	Calculation of PVIF for each bond @0.5 maximum of 3	3
	Issue price for each bond @0.5	1
	Yield to maturity	
	IRR for each bond @2	4
	Maximum	**11**
Total Marks		**25**

Model answer

a)

Lease Decision

Details		**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Annual Lease Rentals	5%	(130,000,000)	(136,500,000)	(143,325,000)	(150,491,250)	
Tax saving at 28% on lease rental	28%		36,400,000	38,220,000	40,131,000	42,137,550
Cash flow		**(130,000,000)**	**(100,100,000)**	**(105,105,000)**	**(110,360,250)**	**42,137,550**
Borrowing Rate afetr Tax	**13.0%**	1	0.885	0.783	0.693	0.613
PV of Cashflow		(130,000,000)	(88,588,500)	(82,297,215)	(76,479,653)	25,830,318
TOTAL PV Cost Cash flow		**(351,535,050)**				

Buy decision

Details		**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Maintenance Cost		(5,000,000)	(5,000,000)	(5,000,000)	(5,000,000)	
Tax at 28%	28%		1,400,000	1,400,000	1,400,000	1,400,000
Tax saving on TAD			26,250,000	26,250,000	26,250,000	26,250,000
Initial investment		(500,000,000)				
Scrap Value						125,000,000
Cashflow		**(505,000,000)**	**22,650,000**	**22,650,000**	**22,650,000**	**152,650,000**
Borrowing Rate afetr Tax	**13%**	1	0.885	0.783	0.693	0.613
PV of Cashflow		(505,000,000)	20,045,250	17,734,950	15,696,450	93,574,450
TOTAL PV Cost Cash flow		**(357,948,900)**				

Under Buy or Lease we ASSUME THAT Project are going to be Financed By loan, that why we use After Tax Cost of Borrowing to discount both Cashflow from BUY DECISION or LEASE DECISION then **we Choose Option with the lowest Cost, which is Lease Option.**

b)

The expected price at which the bonds can be issued

Issue price			Cash flow Interest	5 years bond	Cash flow Interest	7 year bond
Year	Interest rate	PVIF		Present value		Present value
Bond 1	13.3	0.8826	18	15.89	16	14.12
Bond 2	13.8	0.7722	18	13.90	16	12.35
Bond 3	14.2	0.6714	18	12.09	16	10.74
Bond 4	14.8	0.5757	18	10.36	16	9.21
Bond 5	15.5	0.4865	118	57.41	16	7.78
Bond 6	16.1	0.4083			16	6.53
Bond 7	16.7	0.3392			126	42.74
Issue price				109.64		103.49

For 5 Year Bond

Interest received= Par Value x Interest rate

This is the cost of debt, we use IRR if debt is redeemable						
yield to maturity 5 year bond						
Year	**Details**	**Cash flow**	**at 20%**	**PV**	**at 15%**	**PV**
1	issue price	(110)	1	(110)	1	(110)
1 to 5	Interest	18	2.991	54	3.352	60
5	Redemption value	100	0.402	40	0.497	50
				(15.61)		0.39

IRR=LDF +(HDF-LDF) x ($\frac{NPV\ @LDF}{NPV\ @\ LDF - NPV\ @HDF}$)

IRR=15% +(20%-15%)($\frac{0.39}{0.39-15.61}$) = 15.12%

This is the cost of debt, we use IRR if debt is redeemable						
Yield to maturity 7 year bond						
		discount factor 20%			**discount factor 15%**	
Year	Detail	Cash flow	DF	PV	DF	PV
1	Issue price	(103)	1	(103)	1	(103)
1 to 5	Interest	16	2.991	48	3.352	54
5	Redemption value	110	0.402	44	0.497	55
				(11.42)		4.81

IRR=15% +(20%-15%)($\frac{4.81}{4.81-11.42}$) = 16.48%

QUESTION FOUR

Marking guide

Q4	CRITERIA	Marks
a)	Award 0.5 Marks for format	0.5
	Award 1.5 Marks for well explained risk. Max 3 marks	4.5
	Maximum	**4**
b)	Consumer Electronics (Smartphones) cost	0.5
	Laptops cost	0.5
	Tablets cost	0.5
	Total purchases	0.5
	Cost of purchase/importation 1st March	1
	Cost of purchase of futures	1
	No of contact purchased	1
	FRW notional hedged	1
	USD hedged	1
	Futures gain per USD	1
	Total futures gain	1
	Transaction fees	1
	Net FRW cost with futures hedge	1
	Net gain from using futures	1
	Maximum marks	**12**
c)	Choosing correct rate to use	1
	Finding USD to invest	2
	Convert that USD now using spot	1
	Repayment of the FRW loan	2
	Maximum marks	**6**
d)	Comparison of all alternatives and Conclusion	2
	Maximum marks	
	Total marks	**25**

Model Answers

Report to the Board of Directors

Kigali International Trade Co (KIT Co)

Subject: Foreign Exchange Risk Assessment and Evaluation of Hedging Strategies for the USD Import Payable Due on 30 April 2024

Kigali International Trade Co (KIT Co) entered into an international procurement transaction involving the importation of electronic goods denominated in United States dollars (USD), with settlement due on 30 April 2024. As a result, the company is exposed to foreign exchange risk

arising from movements in the USD/RWF exchange rate. This report evaluates the key risks associated with the transaction, assesses the effectiveness of the currency futures hedge previously employed, considers an alternative money market hedge, and provides a recommendation on the most appropriate hedging strategy for future transactions.

a) Risk affecting KIT

Foreign exchange (transaction) risk

KIT Co has a USD-denominated payable due on 30 April 2024. Any depreciation of the Rwandan franc (FRW) against the U.S. dollar increases the FRW amount required to settle the obligation, reducing profit margins.

Liquidity / cash-flow risk

The large size of the import payable creates pressure on short-term liquidity. Hedging instruments also involve fees and settlement cash flows which may strain working capital if not properly planned.

Operational / Commercial risk

The goods are intended for resale in the local market. Changes in demand, selling prices, competition, logistics delays, or regulatory costs may reduce revenues and impair the company's ability to recover costs.

Evaluation of the Currency Futures Hedge

b) Futures Hedge evaluation

Kigali International Trade Co

Item Description	**Quantity**	**Unit Price**
Spot rate (March 1, 2024)	1,269.72	
Futures settlement rate(used for hedge)	1,273.575	
Forward rate on April 30,2024	1,277.43	

STEP 1: **The total cost of the goods in USD**

Consumer Electronics	57,500	278	15,985,000
Laptops	97,350	480	46,728,000
Tablets	235,100	140	32,914,000
Accessories			3,458,900
			99,085,900

Cost Without Hedging (Un hedged)	
Total Cost in $	99,085,900
Using forward/spot rate at payment date: FRW 1,277.43	1,277.43
Settlement amount required in RWF using Forward rate	**126,575,301,237**
Cost Using Futures Contract	
Total Cost in $	99,085,900
Future spot rate RWF 1,273.575 / $	1,273.58
Settlement amount required in RWF using Future Contract rate	**126,193,325,093**
Exposure at spot (1 March 2024)	
Total Cost in $	99,085,900
Spot rate at 01 March 2024	**1,269.72**
Total COST @ 01 March 2024 to hedge	**125,811,348,948**
Contract Size	45,000,000
Number of Contract Required	**2,795.81**
Contract Fess	3,500
Total Contract Fees	**9,785,327**
Total Hedged Cost (under Futures Contract)	**126,203,110,420**
Net Gain from Futures Hedge	**372,190,817**

c) Money Market Hedge Evaluation

Given Data to use:

USD lending rate = 4% p.a.

FRW borrowing rate = 10% p.a.

Spot rate on 1 March 2024 = FRW 1,269.72

Time = 2 months

The USD lending rate (4% p.a.) is used because USD is invested to accumulate to the amount payable at settlement, while the FRW borrowing rate (10% p.a.) is used because francs are borrowed to buy the USD immediately.

Step 1: Find USD to invest on 1 March to grow to the payable

$PV\ USD = \frac{99{,}085{,}900}{1+0.04*2/12}$ = 98,429,701.987

Step 2: Convert that USD now using spot, funded by borrowing FRW

FRW borrowed on 1 March

= 98,429,701.987 × 1,269.72

≈ FRW 124,963,394,000

Step 3: Repay the FRW loan after 2 months

FRW repay = 124,963,394,000*(1+0.10*2/12)

Money market hedge total FRW cost ≈ FRW 127,061,130,560

d) Conclusion

Based on quantitative analysis, currency futures are recommended as they resulted in the lowest settlement cost of FRW 126,203,046,715, compared with FRW 127,061,130,560 under the money market hedge and FRW 126,575,301,237 if unhedged and clearly demonstrating that, under prevailing interest and exchange rate conditions, the money market hedge is not cost-effective and is more expensive than even remaining unhedged.

End of Model Answers and Marking Guide.