

MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1**Total Marks: 35**

General comments					
This was a five-part question, which tested the candidates' understanding of the investment decisions element of the syllabus. The scenario of the question was that a company is launching a new product onto the market and also considering how often it should replace its fleet of delivery vans.					
1.1 (a)					Marks
Units pa	30,000				
		0	1	2	3
Units 000's (x 1.06)			30.00	31.80	33.71
Selling price £ (x 1.03)			399.00	410.97	423.30
Contribution per unit £ (see skilled)			159.6	164.39	169.32
		£000's	£000's	£000's	£000's
Contribution			4788.00	5227.6	5707.78
Contribution lost			-1500.00	-1637.7	-1788.15
Fixed overhead			-500.00	-525.00	-551.25
Taxable	0		2788.00	3064.90	3368.38
Tax @ 17%	0		-473.96	-521.03	-572.62
Sale proceeds					9759.88
Working capital	-2000.00		-183.60	-200.45	2384.05
Machinery and equipment	-8000.00				2000.00
Tax saved on CAs	244.80		200.74	164.60	409.86
Cash flows	-9755.2		2331.18	2508.02	17349.55
PV @ 10%	-9755.2		2119.25	2072.74	13034.97
		NPV	7471.76		
The Defender project has a positive NPV, which will increase shareholder wealth. The project should therefore be accepted.					1
<u>Working capital</u>					
Year	cumulative	Increment			
0	-2000	-2000			
1	-2183.6	-183.6			
2	-2384.05	-200.45			
3	2384.05				

<u>Capital allowances and the tax saved thereon</u>			
Year	Cost/WDV	CA	Tax
0	8000.00	1440.00	244.80
1	6560.00	1180.80	200.74
2	5379.20	968.26	164.60
3	4410.94		
Sale	-2000.00	2410.94	409.86
 <u>Contribution Lost</u>			
The contribution of the other product is:			
			£
Selling price			175
Materials and skilled Labour			-150
Contribution			<u>25</u>
Contribution lost per unit of the defender			-50
Year 1 = -50 x 30 = -1500.00			
Year 2 = -50 x 1.03 x 31.80 = 1637.70			
Year 3 = -50 x 1.03 ² x 33.71 = 1788.15			
NB the skilled labour cost of £15 per hour is common to both alternatives so may be ignored by students. In year 1 the contribution on the Defender is £189.6 ignoring labour. The contribution lost is £40x2=£80 ignoring labour. The net gain is £189.6-80=£109.60 per Defender. If labour costs are included in the figures as above the net gain is the same ie £159.6-50=£109.60.			
If the gross figures are used in the NPV then they are as follows;			
Defender	5688	6210	6781
Lost contrn	2400	2620	2861
Which nets to the same as shown in the NPV calc above			
Sale proceeds			£000's
Contribution			5707.78
Contribution lost			-1788.15
Net Contribution			<u>3919.63</u>
Net contribution x 3 x (1-0.17)			9759.88
Well answered by many candidates, however the following were common errors: incorrect calculation of contribution; timing errors for cash flows; incorrect calculations of the contribution lost; incorrect calculations of the value of the rights at the end of the project and in some cases ignoring it altogether; not explaining why the project should be accepted; not providing workings so no marks could be awarded when the figure presented was incorrect.			
Total possible marks			16
Maximum full marks			16

<p>1.1 (b)</p> <p>The disadvantages of sensitivity analysis are:</p> <ul style="list-style-type: none"> • It assumes that changes to variables can be made independently. • It ignores probability. It only identifies how far a variable needs to change to result in a zero NPV, it does not look at the probability of such a change. • It is not an optimising technique and does not point directly to a correct decision. <p>Simulation goes some way to address the weaknesses of sensitivity analysis. The main advantage is that it allows the effect of more than one variable changing at the same time to be assessed. This gives more information about the possible outcomes and their relative probabilities and it is useful for problems that can not be solved analytically. However it should be noted that simulation is also not an optimising technique and does not point directly to a correct decision.</p>	<p>2</p> <p>3</p>
<p>Responses to this part of the question were mixed with many candidates not able to adequately explain the disadvantages of sensitivity analysis. The question only asked for disadvantages but many candidates wasted time by stating advantages. The explanations of simulation as an alternative to sensitivity analysis were poor.</p>	
<p>Total possible marks Maximum full marks</p>	<p>5 4</p>
<p>1.1 (c)</p> <p>Abandonment option: If the defender project is not successful it is unlikely the team will buy the rights to manufacture the new alarm system. Therefore Innovative has the option to abandon and sell the assets.</p> <p>Follow on option: Rather than sell the rights to manufacture the new alarm system there might be the opportunity to launch a second (and third and so on) version, which could be highly profitable, or could lose money, for Innovative.</p> <p>(Note: Students might mention growth options rather than follow on options. If so award marks)</p>	<p>2</p> <p>2</p>
<p>Responses to this part of the question were good. However some candidates did not read the question and stated real options which did not apply at the end of the project.</p>	
<p>Total possible marks Maximum full marks</p>	<p>4 4</p>
<p>1.1 (d)</p> <p>There is a clear conflict of interest regarding the computation of the sale proceeds of the rights to manufacture the Defender after the time horizon of three years.</p> <p>Since the finance director will be a member of the team he should act with integrity and have the interests of shareholders in mind. In these circumstances he should not be involved in negotiating the price that the team will buy the rights for. He should be objective and demonstrate professional behaviour.</p>	<p>1</p> <p>2</p>
<p>Responses to this part of the question were generally good.</p>	
<p>Total possible marks Maximum full marks</p>	<p>3 3</p>

1.2	Marks
<p>Replacement after one year (£):</p> $(30,000) + (22,500 - 500)/1.15 = \mathbf{(10,870)}$ <p>Annual equivalent cost (AEC) = $(10,870)/0.870 = \mathbf{(12,494)}$</p>	0.5+0.5
<p>Replacement after two years (£):</p> $(30,000) + (500)/1.15 + (17,000 - 2,500)/(1.15)^2 = \mathbf{(19,471)}$ <p>AEC = $(19.471)/1.626 = \mathbf{(11,975)}$</p>	1.5+0.5
<p>Replacement after three years (£)</p> $(30,000) + (500)/1.15 + (2,500)/(1.15)^2 + (12,000 - 3,500)/(1.15)^3 = \mathbf{(26,736)}$ <p>AEC = $(26,736)/2.283 = \mathbf{(11,710)}$</p>	2+0.5 0.5
<p>The optimal replacement period is that which gives the lowest AEC, in this case replacing the vans after three years is preferable.</p> <p>Limitations include:</p> <ul style="list-style-type: none"> Changing technology, leading to obsolescence, changes in design Inflation – affecting estimates and the replacement cycles How far ahead can estimates be made and with what certainty Ignoring taxation. <p>Note: Students were instructed to ignore inflation in 1.2.</p>	2
<p>Responses to this part of the question were mixed, it was apparent that some candidates had not revised this area of the syllabus. However we did see some very good attempts.</p>	
<p>Total possible marks</p> <p>Maximum full marks</p>	<p>8</p> <p>8</p>

Question 2**Total Marks: 35**

General comments					
This was a five-part question that tested the candidates' understanding of the financing options element of the syllabus. The scenario of the question was that a company is diversifying its operations and raising finance by either debt or equity. Also candidates were asked to discuss the company's dividend policy.					
2.1					Marks
(a) Growth can be estimated by past ordinary dividend growth for the past four years excluding special dividend as it's a one-off:					0.5 for ord div
Growth = $(25.2/19.80)^{(1/4)} - 1 = 0.0621$ or 6.21%					1
Shares in issue = 180m (90 x 2)					
2017 dividends per share = 14p (25.20/180)					0.5
Ex div share price = 278p (292-14)					0.5
Ke = $(14(1.0621)/278) + 0.0621 = 0.1156$ or 11.56%					0.5
Kd is calculated as the YTM of the 7% debentures x (1-t):					
The ex interest debenture price is £104 (111 – 7)					
Years	Cash Flow	Factors	PV	Factors	PV
	£	5%		10%	
0	-104.00	1	-104.00	1	-104.00
1 to 5	7.00	4.329	30.30	3.791	26.54
5	100.00	0.784	78.40	0.621	62.10
			<u>4.70</u>		<u>-15.36</u>
The YTM = $5 + (4.7/(4.7 + 15.36) \times 5) = 6.17\%$					2
Kd = 5.12 (6.17 x (1-0.17))					1
The market value of debt and equity =					
Debt £495.04 (476 x 1.04). Equity £500.40 (278p x 180m) Total debt and equity = £995.44m					2
WACC = $(11.56 \times 500.40 + 5.12 \times 495.04)/995.44 = 8.35\%$					
(b) Using the CAPM					
Ke = $3 + 1.3 \times 6 = 10.80\%$					0.5
WACC = $(10.80 \times 500.40 + 5.12 \times 495.04)/995.44 = 7.98\%$					0.5
Responses to this part of the question were mixed. Many candidates did not consider whether their answers were reasonable, for example using a cost of equity of 50% in their WACC computations. Also many candidates made some very basic errors as follows:					
When calculating the cost of equity using the dividend valuation model: when calculating the growth rate from past dividends including the special dividend, also calculating to the 5 th root and not the 4 th root; incorrect calculations of the ex-div share price; incorrect calculations of the number of shares in issue. When calculating the cost of debt: using the cum-interest price for the debentures; incorrect number of years; using the total amount of debentures in issue for the capital flows and for the annual interest flows					

<p>using an individual debenture’s interest; not taking tax into account; incorrect interpolation.</p> <p>When calculating the cost of equity using the CAPM many candidates deducted the risk free rate from the market risk premium.</p> <p>When calculating the WACC: using book values rather than market values.</p> <p>In all calculations: not providing workings</p>	
Total possible marks	10
Maximum full marks	10

<p>2.2</p> <p>Ungear existing activities $1.3 = Ba(1+50(1-0.17)/50)$ $Ba = 0.71$ New activity ungeared $1.1 = Ba(1+40(1-0.17)/60)$ $Ba=0.71$</p> <p>So systematic business risk doesn’t change which may mean existing WACC calculated in 2.1 applies.</p> <p>However, the use of WACC/NPV assumes that, over the life of the project the gearing ratio of Peel will remain constant and that the project is marginal. Peel is considering financing a diversification that represents 20% (200/995) of the company’s total market value of debt and equity, which can hardly be considered to be marginal, by either debt or equity. As gearing is likely to change existing WACC cannot be used. Finance is not project specific (eg cheap government loan) so that condition for using the existing WACC is met.</p>	<p>2.5</p> <p>2.5</p>
<p>Generally responses to this part of the question were disappointing with many candidates demonstrating that they do not know the basic assumptions regarding the use of WACC. Hardly any candidates mentioned that since the company is raising a large amount of capital by either debt or equity the gearing might not remain constant and that, because of its size, the project cannot be considered to be marginal. Most candidates centred their discussion of systematic risk, which they assumed would change. However if some very basic calculations were carried out it could be seen that the systematic risk of the new project was the same as existing projects.</p>	
Total possible marks	5
Maximum full marks	5

<p>2.3</p> <p>Gearing (D/E by market values):</p> <p>The current gearing ratio is 99% (495,04/500.40)</p> <p>Gearing if the finance is raised with debt = 139% ((200+495.04)/500.40)</p> <p>Gearing if the finance is raised with equity = 71% (495.04/(200+500.40))</p> <p>(Note: Assuming no change in the share price as a result of the diversification. In the longer term a positive NPV would affect the ratios calculated.)</p> <p>Interest cover: best and worst case as PBIT varies.</p> <p>Current:</p> <table border="1"> <thead> <tr> <th></th> <th>2014</th> <th>2017</th> </tr> <tr> <th></th> <th>£m</th> <th>£m</th> </tr> </thead> <tbody> <tr> <td>EBIT</td> <td>78.86</td> <td>94.04</td> </tr> <tr> <td>Interest</td> <td>33.32</td> <td>33.32</td> </tr> <tr> <td>Int cover</td> <td>2.37</td> <td>2.82</td> </tr> </tbody> </table>		2014	2017		£m	£m	EBIT	78.86	94.04	Interest	33.32	33.32	Int cover	2.37	2.82	<p>6 for calculations. Max of 3 if there is no attempt to look across time and only focus on 2017</p>
	2014	2017														
	£m	£m														
EBIT	78.86	94.04														
Interest	33.32	33.32														
Int cover	2.37	2.82														

Interest cover if debt is raised:			
Total interest will equal £45.32m (33.32 + 200 x 6%)			
	2014	2017	
	£m	£m	
EBIT	78.86	94.04	
Interest	45.32	45.32	
Int cover	1.74	2.08	
[EPS (although not explicitly required students may also calculate and comment on EPS)]			
Current:	2014	37.8/180=21p	
	2017	50.4/180=28p	
Equity:	2014	37.8/280=13.5p	
	2017	50.4/280=18p	
Debt:	2014	(78.86-45.32)0.83/180=15.5p	
	2017	(94.04-45.32)0.83/180=22.5p]	
The decision to raise the finance wholly by debt or equity will radically change Peel's gearing ratio and interest cover.			
Interest Cover: Since 2013 Peel has been operating with an interest cover between the average of 2.4 and maximum of 3 for the industry sector that it operates in. Currently Peel has an interest cover of 2.82, which is near the maximum. Interest cover will be unchanged if Peel raises equity, however if debt is raised the interest cover would have been 2.08, which is near to the minimum of 2 for the industry sector, also in previous years interest cover would have been below the minimum.			max 6 for discussion incl advice, looking for a range of issues
Gearing ratio: Peel is currently operating with a gearing ratio of 99%, which is around the average for the industry of 100%. If the company raises debt finance the gearing ratio will rise to 139%, which is above the industry maximum of 135%, and if equity is raised the gearing ratio will fall to 71%, which is below the industry minimum of 80%.			
Given the above the likely reaction of the financial markets is likely to be unfavourable if Peel raises the finance by an issue of debentures. The share price could fall and also the cost of debt increase. Shareholders are also likely to be concerned if the finance is raised by debt and it is unlikely that they would approve the diversification if it were financed in such a way.			
On the other hand raising the finance by equity would make the company much safer in terms of financial risk. However shareholders might be concerned about potential control issues unless the funds are raised by way of a rights issue. Also the financial markets might consider that the company is not using spare debt capacity.			
Advice. Given the potential financial risks involved it would be prudent for Peel to raise the finance by an issue of shares or a combination of debt and equity to keep gearing ratio and interest cover more in line with the 2017 figures.			
Responses to this part of the question were extremely disappointing despite an almost identical question being asked in a recent past paper. The question gave industry gearing and interest cover figures so that the candidates could perform analysis looking at current gearing and interest cover, and then gearing and interest cover after raising the new finance by either debt or equity. Also five years' historic information was given to calculate interest cover figures. It was very disappointing that a large number of candidates did not use this information or calculated the gearing in a different way to that specified or used book values despite the question stating market values had been used. In addition many candidates did not consider the likely reaction of the shareholders and markets to the finance being raised by either debt or equity. Finally, a large number of candidates wasted time explaining the theories of M & M, theory was not asked for in the question.			

Total possible marks	12
Maximum full marks	12

<p>2.4</p> <p>If the finance is raised by either debt or equity the gearing of Peel will radically change. In these circumstances WACC/NPV is not a suitable investment appraisal technique to use. An alternative technique would be Adjusted Present Value (APV), which assumes in the first that the project is financed purely by equity. The resultant NPV of cash flows is then adjusted for the actual benefits and costs of the actual finance used. A suitable all equity discount rate, which reflects the systematic risk of the project would be:</p> <p>Taking the beta equity of a company in the domestic appliance sector we calculate the asset beta and use it in the CAPM (2.2 above)</p> <p>The all equity discount rate using CAPM = 7.26% (3 + 0.71 x 6)</p>	2
Responses to this part of the question were mixed, with many candidates identifying APV as an alternative to WACC/NPV. However few candidates calculated the discount rate that should be used in APV. Again this has been examined many times before.	
Total possible marks	3
Maximum full marks	3

<p>2.5</p> <p>Since dividends are rising and falling with profits it would appear that Peel has a policy of maintaining a constant dividend payout ratio. The dividend payout ratios have been:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th>2013</th> <th>2014</th> <th>2015</th> <th>2016</th> <th>2017</th> </tr> <tr> <th></th> <th>£m</th> <th>£m</th> <th>£m</th> <th>£m</th> <th>£m</th> </tr> </thead> <tbody> <tr> <td>Profits after tax</td> <td>39.60</td> <td>37.80</td> <td>45.00</td> <td>43.20</td> <td>50.40</td> </tr> <tr> <td>Ordinary dividend</td> <td>19.80</td> <td>18.90</td> <td>22.50</td> <td>21.60</td> <td>25.20</td> </tr> <tr> <td>Payout ratio</td> <td>50%</td> <td>50%</td> <td>50%</td> <td>50%</td> <td>50%</td> </tr> </tbody> </table> <p>(Note: Candidates are not required to calculate the payout ratio for all years. However a clear identification of 50% payout across the period given is required.)</p> <p>A listed company seeks to give ordinary shareholders a constant dividend with some growth. This cannot be achieved by have in a policy of maintaining a constant payout ratio since dividends rise and fall with profits. Peels current dividend policy is not usually considered appropriate for a listed company and may lead to a fluctuating share price (signalling effect).</p>		2013	2014	2015	2016	2017		£m	£m	£m	£m	£m	Profits after tax	39.60	37.80	45.00	43.20	50.40	Ordinary dividend	19.80	18.90	22.50	21.60	25.20	Payout ratio	50%	50%	50%	50%	50%	2 (only 1 if no trend)
	2013	2014	2015	2016	2017																										
	£m	£m	£m	£m	£m																										
Profits after tax	39.60	37.80	45.00	43.20	50.40																										
Ordinary dividend	19.80	18.90	22.50	21.60	25.20																										
Payout ratio	50%	50%	50%	50%	50%																										
Responses to this part of the question were mixed with many candidates not able to demonstrate a good understanding of dividend policy. Few candidates used the historic information to establish the company's current dividend policy. Many repeated theory, despite this not been required.																															
Total possible marks	5																														
Maximum full marks	5																														

Question 3**Total Marks:**

General comments	
This was an eight-part question that tested the candidates' understanding of the risk management element of the syllabus. The scenario of the question was that you work for an investment company and you are working on three specific tasks.	
3.1 (a)	Marks
The forward rate is: \$/£ 1.2526 (1.2492+0.0034) This is result in a sterling receipt of £6,386,716 ($\$8,000,000/\1.2526)	1 + 0.5 0.5
Over the counter option: The option premium is $\$8,000,000 \times 2p = \text{£}160,000$. The premium with interest lost is $\text{£}160,000 \times (1+0.03 \times 4/12) = \text{£}161,600$ If the spot price on 31 March is \$/£1.2700 Orion will exercise the options. The sterling receipt will be $(\$8,000,000/\$1.2400) - \text{£}161,600 = \text{£}6,290,013$	1 1 1 1
Well answered by most candidates. However some of the errors demonstrated by weaker candidates included: using the incorrect spot rate; deducting the forward discount; not including interest on the option premium, or including interest but taking a whole year; treating the OTC option as a traded option.	
Total possible marks	6
Maximum full marks	6

3.1 (b)	
The forward contract locks Jewel into an exchange rate and does not allow for upside potential.	
Forwards: Tailored specifically for Jewel However there is no secondary market	2
OTC currency options: The options are expensive There is no secondary market However the options allow Jewel to exploit upside potential and protect downside risk.	
Advice: Without hedging the sterling receipt would have been £6,299,213 ($\$8,000,000/\1.2700) The currency option results in a sterling receipt of £6,290,013, which is marginally worse than the spot rate on 31 March 2018. However the forward contract results in a higher sterling receipt of £6,386,716.	0.5 2
It is recommended that a forward contract is used to hedge any unanticipated fall in the value of the \$.	0.5
Average answers from a lot of candidates, some without any reference to the numbers calculated in part 3.1. Many candidates did not give a firm conclusion. However there were some excellent answers.	
Total possible marks	5
Maximum full marks	4

3.1 (c)	
Futures are possibly not appropriate since they have the following disadvantages: Not tailored so one has to round the number of contracts Basis risk exists Requires a margin to be deposited at the exchange Need for liquidity if margin calls are made	0.5 per point

However there is a secondary market and if the client decides not to invest it would be possible to close out the position, which could result in a gain or loss on the futures trade.	
Responses to this part of the question were good.	
Total possible marks	2
Maximum full marks	2

3.2 (a)	
The value of one contract = $7,195 \times £10 = £71,950$	1
March contracts will be sold.	1
The number of contracts = $£100,000,000 / £71,950 = 1,389.85$. Round to 1390.	1
On 31 March the portfolio value will fall to: $£100,000,000 (7,010/7,261) = £96,543,176$. A fall of $£3,456,824$.	1.5
Since there is a loss on the portfolio there will be a gain on the futures contracts.	
The futures position will be closed out and the gain will = $(7,195-7,010) \times £10 \times 1390 = £2,571,500$.	1.5
Responses to this part of the question were good however some candidates made some basic errors as follows: incorrect calculation of the number of contracts and the value of one contract by using the current index price and not the current futures price; incorrect computation of the loss on the portfolio; stating that contracts should be initially bought not sold; incorrect computation of the gain on futures by using the current index price and not the futures price	
Total possible marks	6
Maximum full marks	6

3.2 (b)	
The hedge is not 100% efficient due to: Basis risk i.e. the futures price at 30 November is not the same as the FTSE 100. The rounding of the number of contracts.	1 1
Responses to this part of the question were good.	
Total possible marks	2
Maximum full marks	2

3.3 (a)																					
First it is necessary to calculate the interest rate differentials:																					
<table border="0"> <thead> <tr> <th></th> <th>Jewel</th> <th>Nevis</th> <th>Differentials</th> </tr> </thead> <tbody> <tr> <td>Fixed rates</td> <td>6.5%</td> <td>5.0%</td> <td>1.5%</td> </tr> <tr> <td>Floating rates</td> <td>LIBOR + 4%</td> <td>LIBOR + 3.5%</td> <td>0.5%</td> </tr> <tr> <td></td> <td>Net differential</td> <td></td> <td>1.0%</td> </tr> <tr> <td></td> <td colspan="2">This net differential will be shared</td> <td>0.50% each</td> </tr> </tbody> </table>		Jewel	Nevis	Differentials	Fixed rates	6.5%	5.0%	1.5%	Floating rates	LIBOR + 4%	LIBOR + 3.5%	0.5%		Net differential		1.0%		This net differential will be shared		0.50% each	1
	Jewel	Nevis	Differentials																		
Fixed rates	6.5%	5.0%	1.5%																		
Floating rates	LIBOR + 4%	LIBOR + 3.5%	0.5%																		
	Net differential		1.0%																		
	This net differential will be shared		0.50% each																		
The interest rates that can be achieved through the swap are:																					
<table border="0"> <thead> <tr> <th></th> <th>Jewel</th> <th>Nevis</th> </tr> </thead> <tbody> <tr> <td>Fixed market rate</td> <td>6.5%</td> <td>----</td> </tr> <tr> <td>Floating market rate</td> <td>----</td> <td>LIBOR + 3.5%</td> </tr> <tr> <td>Less the differential</td> <td>0.5%</td> <td>0.5%</td> </tr> </tbody> </table>		Jewel	Nevis	Fixed market rate	6.5%	----	Floating market rate	----	LIBOR + 3.5%	Less the differential	0.5%	0.5%									
	Jewel	Nevis																			
Fixed market rate	6.5%	----																			
Floating market rate	----	LIBOR + 3.5%																			
Less the differential	0.5%	0.5%																			

Rates achieved through the swap	6.0%	LIBOR + 3.0%	1+1
Cash flows would typically be: LIBOR from Nevis to Jewel and fixed of 2.0% from Jewel to Nevis.			1
Responses to this part of the question were good however many candidates did not read the question when they demonstrated the cash flows that would typically occur when the swap was implemented.			
Total possible marks			4
Maximum full marks			4

3.3 (b)			
Jewel is paying 4.36% (0.36 + 4) on its floating rate borrowings and would be paying a fixed rate of 6% through the swap. The initial difference in interest rates is = 1.64% (6.00 – 4.36)			1
For the floating rate to equal the fixed rate of 6% achieved through the swap LIBOR would have to rise to 2% (1.64 + 0.36).			1
Responses to this part of the question were generally good.			
Total possible marks			2
Maximum full marks			2

3.3 (c)			
The advantages to Jewel of an interest rate swap include:			
<ul style="list-style-type: none"> • The arrangement costs are significantly less than terminating an existing loan and taking out a new one. • Interest rate savings are possible either out of the counterparty or out of the loan markets by using the principle of comparative advantage. • They are available for longer periods than the short-term methods of hedging such as FRAs, futures and options. • They are flexible since they can be arranged for tailor-made amounts and periods. Also they are reversible. • Obtaining the type of interest rate, fixed or floating, that the company wants. • Swapping to a fixed interest rate for Jewel will assist in cash flow planning. 			1 mark for each -max 4
Responses to this part of the question were good.			
Total possible marks			6
Maximum full marks			4