INSTITUTE OF ACTUARIAL & QUANTITATIVE STUDIES

Subject: Business Finance - 2

Chapter: Unit 3 & 4

Category: Assignment Questions

1. Which of the following statements is NOT true about Internal Rate of Return (IRR) method of project appraisal

A. IRR may give multiple solutions.
B. IRR is less popular than Net Present Value as a measure of project worth.
C. IRR has the benefit of highlighting the return achieved by the project.
D. IRR is the most reliable means of choosing between mutually exclusive projects.

2. Which one of the following is the correct formula for the price earnings ratio?
A. Market price of share/ Earning per share
B. Issue price of share/ Earning per share
C. Market price of share* Earning per share
D. Issue price of share* Earning per share

3. While calculating Inventory turnover period, Inventories include
A. Finished goods
B. Work-in-progress
C. Raw material
D. All of the above

4. The following figures were taken from a company's accounts:

	2018	2019
Operating Profit	10,00,000	8,00,000
Depreciation	1,00,000	1,20,000
Working Capital (inventory + trade receivables – trade payables)	3,50,000	2,50,000

What is the company's cash inflow from operating activities for the year ended 2019?

A. 12,00,000
B. 11,00,000
C. 9,00,000
D. 10,00,000

5. The project generates 2500 in sales and 1500 in costs (excluding depreciation) at date 1. The tax rate is 40%.

The discount rate for the project is 20%.

i. What is the cash flow from the project at date 1?
ii. What is the NPV of the project?

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iii. Now assume (for this question only) that your suppliers allow you to pay them with a one-year delay, that is, at date 2. How does the NPV of the project change compared to the previous question?

6. If you want to measure any business efficiency, what ratios will you analyze and why?

7. Briefly list down the limitation of ratio analysis.

8. i. State possible reasons why stocks trade at different betas in the stock market.
ii. A company has a geared beta of 1.1 on a debt equity ratio of 1:2 and corporate tax rate of 30%. Calculate the geared beta if the debt equity ratio is 2:2.

9. Which of the following statements is true?
A) In general the market value of investment trust is lower than the net present value
B) In general the market value of investment trust is higher than the net present value
C) In general the market value of investment trust is equal to the net present value
D) In general the market value of investment trust is not correlated to the net present value.

10. i) In theory, companies exist to maximize the wealth of their owners. Explain the problems associated with demonstrating that companies actually do operate in such a way as to maximise their shareholders wealth.

ii) The stock of XYZ Ltd is presently trading at Rs 70. The current dividend per share is Rs 10. The company is assumed to grow sustainably at the rate of 8%. Currently the risk free rate is 6% and market risk premium is 5%. If systematic risk is increased by 80% calculate the effect on the share price

11. i. Explain the beta of a stock along with formula
ii. How can beta be determined?
iii. As an active stock market investor, would you invest in a stock with a beta of 1 or -1?
iv. Name a financial instrument that is likely to have a beta of 0.

12. ABC Pvt. Ltd. has a debt: equity ratio of 1:1. The risk-free rate of return is 7%, the equity risk premium derived from the market is 5% and the gross cost of debt is 9%. Its beta is 1.5 and assume any profit is taxed at 25%.
i) Calculate its weighted average cost of capital.
ii) ABC is concerned about its high debt: equity ratio. If ABC were to repay all debt, what

would be the required return to equity?

13. The following data relates to a capital project being evaluated by the Management of X Ltd.

	Project M
Annual Cost saving	Rupees 40,000
Useful life	4 years
I.R.R.	15%
Profitability Index (PI)	1.064
Salvage Value	0

Calculate for project M:

i. NPV
ii. Cost of Capital
iii. Cost of Project
iv. Payback

14. i) Define the following ratios and state its use:
a) Current ratio
b) Debtors turnover period

ii) Xylo Ltd deals in goods with a high inventory turnover period. Its finance manager wishes to ascertain whether the company would be able to meet its short term liabilities. Explain which ratio he should track on a regular basis and state the equation for the ratio suggested.

15.
i. A company has a debt to equity ratio of 1:1, the gross redemption yield on debt is 8% and the dividend yield is 4%. Explain why an investor might buy shares in this company, and suggest a suitable cost of capital for the investor, assuming the debt is held till maturity.

ii. Explain the traditional view of the effect of gearing on the cost of capital, including why the cost of equity increases with an increase in gearing. You should include an appropriate diagram to illustrate your answer.

iii. Identify Modigliani and Miller's first irrelevance proposition, and describe its underlying assumptions.

iv. Draw a diagram showing the effect of gearing on the cost of capital using Modigliani and Miller's first proposition.

v. Beta is a measure of the risk of investing in a security.
a. If the risk-free rate of return is 6% and the equity risk premium is 5%, what is the cost of equity for a company with Beta (ungeared) of 1.4?

b. The total market capitalization of a company is 100m, whose debt has a book value of 40% and a market value of 50%. The tax rate is 30%. Determine the geared beta of the company.

c. Determine the cost of equity of the company