

BF-2 Assignment - 1

PAGE No.

DATE

/ /

Q1) (D) IRR is the most reliable means choosing between mutually exclusive projects.

Q2) (A) Market price of share / Earning per share.

Q3) (D) All of the above.

Q4) (c) 9,00,000.

Q5)

$$(i) \text{ Sales} - \text{cost} - \text{tax} = 2500 - 1500 - 400 \\ = \text{£ } 600$$

$$(ii) \text{ NPV} = 1000(1 - 20\%) = \text{£ } 800$$

$$(iii) \text{ NPV} = 2500(1 - 20\%) - 1500(1 - 20\%)^2 \\ = 1040$$

The NPV has increased by £240

Q6) ~~To~~ To measure business efficiency, I would use following ratios:

→ Inventory turnover ratio - To see the usage of the inventory.

→ Asset utilisation ratio - To see the

efficiency of a particular asset.

→ ~~Q~~ Trade Payables turnover - To see that if there any deficit in Trade payable.

Q7) The limitation of ratio analysis are:-

- Inflation effects.
- Historical vs current costs.
- Operational changes.
- Business condition.
- Int^{er}pretation.
- Accounting Policies.
- Company Strategy.

Q8)

i) Beta indicates how volatile a stock's price is in comparison to the overall stock market. The stocks trade at different beta's as each beta signifies the volatility of that specific stock.

→ Negative beta indicates an inverse relation to the market.

→ Beta : 0 indicates the value of stock won't change at all regardless of where market moves.

→ $0 < \beta < 1$ indicates less volatile than market

→ $\beta = 1$ indicates that the stock moves exactly like the market

→ $\beta > 1$ indicates that the stock is more volatile than market.

(88) Gearing $\beta =$ Ungearing $\beta \times [1 + D/E (1 - t)]$

$$1.1 = \beta_{un} [1 + \frac{1}{2} (1 - 0.30)]$$

$$1.1 = \beta_{un} [1 + 0.5 (0.7)]$$

$$1.1 = \beta_{un} [1 + 0.35]$$

$$1.1 = \beta_{un} [1.35]$$

$$\beta_{un} = \frac{1.1}{1.35} = 0.815$$

new $\beta = 0.815 [1 + 1 (1 - 30\%)]$

$$= 0.815 [1 + 0.7]$$

$$= 0.815 [1.7]$$

$$= 1.3855$$

Q9] (b) In general the market value of Investment trust is not correlated to the net present value.

Q10] The Shareholder's wealth are maximised as the stock price rises. The problem with this is that stock price is a variable of many things and its value is affected by the smallest of the news and company has to ~~be~~ keep all the positive news to maximise the shareholder's wealth.

Q11] (i) Beta of a stock is a measure of the stock in comparison of the market as a whole.

$$\beta_i = \frac{\rho(R_i, R_M) \times \sigma_i}{\sigma_{R_M}^2}$$

ρ = ~~covariance~~ correlation

σ^2 = ~~variance~~ Standard Deviation

R_i = Return on an individual stock

R_M = Return on overall market

ii) β could be determined using the above formula.

iii) As an active stock market investor I would invest in a stock with a β of 1, as this ensures that the stock would move exactly as the Index does thus giving great returns in long term.

iv) Cash has a beta of 0, value of cash doesn't ~~depe~~ changed with movement of the market given there is no inflation.

Q12) a

$$i) \text{cost of equity} = R_f + MRF \times \beta$$

$$= 7\% + 5\% \times 1.5$$
$$= 14.5\%$$

$$\begin{aligned} \text{cost of debt} &= \text{gross cost of debt} (1-t) \\ &= 9\% (1 - 25\%) \\ &= 6.75\% \end{aligned}$$

$$\begin{aligned} WACC &= \frac{1}{2} (6.75) + \frac{1}{2} (14.5) \\ &= 10.625\% \end{aligned}$$

$$P^0) \beta_{Lu} = \beta_{Luc} (1 + D/E (1 - b))$$

$$1.5 = \beta_{Luc} (1 + 1(1 - 25\%))$$

$$1.5 = \beta_{Luc} (1.75)$$

$$\beta_{Luc} = \frac{1.5}{1.75} = 0.8571$$

$$\text{New } D/E = 0:1$$

$$\therefore \text{New } \beta_{Lu} = 0.8571 (1 + 0(1 - 25\%))$$

$$= 0.8571 //$$

$$ROE = 7\% + 5\% \times 0.8571$$

$$= 11.2857\% //$$

Q13

$$P^1) NPV = 40000 a_{\overline{n}|i} @ 15\%$$

$$= 114199.1345 //$$

(Q14)

2)

a) Current Ratio :- It is a liquidity ratio which measures company's ability to pay all the short term debts which are due within a year.

b) Debtors turnover period :- It is ^{average} period of time in which company pays back the debt.

Q1) Finance ~~man~~ manager of Xylo Ltd. should track current ratio on a regular basis to ascertain whether the company would be able to meet its short term liabilities. The current ratio must be 2:1 or higher.