

BF - Assignment

Date: _____

P. No: _____

① D)

② A)

③ D)

④

⑤

⑦ Limitations

- ① There could be peculiarities of the trade which make it difficult to interpret certain ratios.

A property company might appear to have a very low return on capital employed one season for this is that the value of the properties shown in the statement of financial position will be updated on a regular basis, thus 'increasing capital employed'.

- ② It draws attention from the figures and statements themselves: It is important to look at aspects such as the sheer size of the company under consideration. A larger company will have more bargaining power and may be able to enjoy economies of scale.

③ Comparisons can be affected accounting policies or by other external factors;

If, for example, two haulage companies use different methods for the calculation of depreciation then any ratios based on their financial statements might not be comparable.

④ The statements could have been deliberately distorted by so called creative accounting;

This involves the deliberate abuse of the subjectivity inherent in accounting to select policies or make assumptions which tend to bias the figures in the direction chosen by management.

8) i) Stock trade at different Betas as all the companies do not face the same risk.

All companies have different amount of risk as compared to market risk.

$$\text{Levered Beta} = \text{Unlevered Beta} \times [1 + D/E \text{ Ratio} (1 - t_c)]$$

$$1.1 = U_{\text{un}} \times [1 + 1/2 (1 - 0.3)]$$

$$1.1 = U_{\text{un}} \times [1.35]$$

ii)

$$U_{\text{un}} = 0.815$$

$$\Rightarrow \text{Levered Beta} = 0.815 \times [1 + 2/2 (1 - 0.3)]$$

$$= 1.3855$$

9) B)

12)

i) WACC =

Cost of equity =

$$= R_f + \beta (R_m - R_f)$$

$$= 7\% + 1.5 (5\%)$$

$$= 14.5\%$$

$$\text{Cost of Debt} = 9\% \times (1 - 25\%)$$

$$= 6.75\%$$

$$= \left(\frac{1}{2} \times 14.5\% \right) + \left(\frac{1}{2} \times 6.75\% \right) =$$

$$7.25 + 3.375 = 10.625\%$$

ii)

15)

a)

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

This ratio is used to assess whether the company will be able to pay its bills over next few months.

$$b) \text{ Debtor turnover period} = \frac{\text{Debtors (Trade receivables)}}{\text{Credit Sales} \times 365}$$

This is a measure of the average length of time taken for debtors (Trade receivables) to settle their balance.

ii) Stock (inventory) turnover ratio

- ii) i) All companies are exposed to systematic risk because they are all exposed to the market.

We can compare individual stocks with the overall market by assessing the beta of the stock.

$$\beta = \frac{\sigma_{im}}{\sigma^2_m}$$

σ^2_m = Variance of market index

σ_{im} = Covariance b/w individual stock return & that of the market

- ii) Beta is a measure of the systematic risk associated with a particular stock. It can be determined by variance of market index upon covariance between individual stock return and that of market.

- iii) Beta of 1 as it implies it is return same as of market.

- iv) Government Bonds, as they are risk free.

13) i) NPV

$$= 40000 + 40000V + 40000V^2 + 40000V^3$$

$$= 40000 + 40000 \times \frac{1}{(1+0.15)} + 40000 \times \frac{1}{(1+0.15)^2} + 40000 \times \frac{1}{(1+0.15)^3}$$

$$= 40000 + 34782.608 + 30245.74669 + 26300.648$$

$$= \underline{\underline{131329.004}}$$

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v) a)
$$P_i = P_f + \beta(P_m - P_f)$$

2
$$P_i = 6\% + 1.4(5\%)$$

2
$$13\%$$