classmate

Date

Page

Assignment - 1 (Unit 3 & 4)

Ans 1) D. IRR is the most reliable means of choosing between mutually exclusive event

Ans 2) A. Market price of share / Earning per share

Ans 3) D. All of the above

Ans 4) C. 9,00,000

Ans 5) i) Cash flow = Inflow - outflow
= 2500 - 1500
= 1000

Tax rate @ 40% = 40% × 1000
= 400

Net cash flow = 1000 - 400
= Rs 600

ii) NPV = 2500 (1 - 20%)^1 - 1500 (1 - 20%)^1
= 2000 - 1200
= Rs 800

iii) NPV = 2500 (1 - 20)^1 - 1500 (1 - 20%)^2
= 2000 - 960
= Rs 1040

Thus, the NPV of the project increases.

Ans 6) • The ~~the~~ three ratio used to measure business efficiency are :- inventory turnover ratio, asset turnover ratio & trade receivables turnover ratio along with the trade payables ratio.

• Efficiency ratio measure & analyze the management of assets & liabilities in a company.

- The ~~inventory~~ asset turnover ratio measures the magnitude of sales generated from each unit of asset owned by the company.

- The trade receivables turnover ratio measures the efficiency with regard to collecting accounts receivable & paying accounts payable.

- The inventory turnover ratio measures the ability to efficiently manage inventory and generate sales to utilize the inventory.

Ans 7) Limitations of ratio analysis:-

(1) It ignores the qualitative aspect of business. It only accounts for the accounting or monetary aspect of the business.

(2) Accounting ratios are prepared based on accounting information. Thus if the accounts are subjected to window dressing, personal bias and judgement, it will paint a false picture

(3) It ignores price-level changes owing to the historical cost principle

(4) The variations in accountancy practices, eg:- straight line depreciation & written down method could affect the numbers and hence the ratios.

Ans 3) The possible reasons why stocks trade at different betas in the stock ~~ma~~ market :-

1) It assess the stock's volatility in relation to market. Thus every stock ~~is~~ has a different beta based on their deviation from market.

2) It assesses the risk component of the business which is subjective as it depends on nature & scale of business operations.

3) Beta can also vary based on the market index used and the time period analysed.

ii) Geared beta = ~~1.0~~ 1.1
Debt : Equity = 1:2
Corporate tax = 30%

$$\text{Geared} = \text{Ungeared} \times \left[1 + (1 - \text{tax rate}) \times \frac{D}{E}\right]$$

$$1.1 = UG \times \left[1 + (1 - 0.30) \times \frac{1}{2}\right]$$

$$1.1 = UG \times [1 + (0.7 \times 0.5)]$$

$$\text{Ungeared} = 0.8148$$

$$\text{Geared} = 0.8148 \times \left[1 + (1 - 0.3) \times \frac{2}{2}\right]$$

$$= 0.8148 \times \cancel{1.07}\,[1.7]$$

$$= 1.38516$$

Ans) b) In general the market value of investment trust is not correlated to the net present value.

Ans 10) i) The problems associated with demonstrating that companies ~~do~~ operate for maximisation of shareholder's wealth :-

1) A company has many stakeholders i.e customers, public, government, financial institution etc. Thus the conflict of interest arises amongst the various shareholders.

2) There is a ~~confli~~ diversion of interest as managers ~~als~~ always do not act in interest of shareholders.

ii) ~~Risk~~ RF ~~7~~

Ans 11) i) Beta is a measure of a stock's variability.

ii) A beta of less than 1 indicates less volatility and vice versa. Thus I would choose less than 1.

iii) Beta can be determined by risk level of the business, debt-equity ratio & corporate tax rate.

classmate
Date
Page

iv) Cash has a beta of 0 due to low volotality.

Ans 12) i) $WACC = \left(\frac{5}{14} \times 1\right) + \left(\frac{9}{14} \times 1\right)$

$= \frac{5}{14} + \frac{9}{14} = 1$

ii)

Ans 13) ~~NPV =~~

Ans 14) a) Current ratio = $\frac{\text{Current asset}}{\text{Current liabilities}}$

It determines the short term solvency of the business.

b) Debtors turnover = $\frac{\text{Net credit sales}}{\text{a/c receivable}}$

It shows the credit management of the firm.

ii) They should assess the current ratio & liquidity ratio to assess short term solvency.

Ans 15)