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Assignment - 1

- 1) D - IRR is the most reliable means of choosing between mutually exclusive projects.
- 2) A - Market price of a share / Earning per share
- 3) D - All of the above
- 4) C - 900000
- 5) i) $\text{cashflow} = \text{sales} - \text{tax} - \text{cost} = 2500 - 1500 - 400 = 600$
ii) $\text{NPV} = 1000 - 800$
iii) $\text{NPV} = 1040$

The NPV of Project change by 240 than previous question.

- 6) Some Ratios are used to measure Business Efficiency which are:
 - i) Inventory Turnover Ratio is used to check on the stocks availability and sales of the inventory.
 - ii) Asset utilization Ratio is used to check how good the Asset is ^{used}.
 - iii) Trade payables Turnover Ratio helps to check number of days taken to pay the creditors.

7) Ratio analysis is helpful to check company's performance.

However, there are some limitations of Ratio analysis like :

- i) Operational cost changes
- ii) Business performances
- iii) Different interpretations
- iv) * Accounting policy
- v) Inflation Effect
- vi) Historical costs
- vii) ~~st~~ changes in ~~strategy~~ financial strategy of a company

8)i) Stocks trade at different betas due to various reasons in the stock market. Beta represents how volatile a stock's price is in comparison to overall price of a stock market. Each Beta indicates volatility of a stock and so stock trades have different beta's.

there are different types of beta's :

- a) ~~For~~ Negative Beta
- b) Beta equals to zero
- c) Beta lies between 0 and 1
- d) Beta equals to one
- e) Beta Greater than 1



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$$8) ii) \beta_{\text{levered}} = \beta_{\text{unlevered}} \times \left[1 + \frac{\text{Debt}}{\text{Equity}} (1 - \text{tax}) \right]$$

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

$$1.1 = \beta_{\text{ug}} \times \left[1 + \frac{1}{2} (0.7) \right]$$

$$1.1 = \beta_{\text{ug}} \times [1.35]$$

$$\beta_{\text{ug}} = 0.815$$

After the changes in Debt Equity Ratio

$$(i) \beta_{\text{levered}} = \beta_{\text{unlevered}} \times \left[1 + \frac{\text{Debt}}{\text{Equity}} (1 - \text{tax}) \right]$$

$$\beta_{\text{g}} = 0.815 \times \left[1 + \frac{2}{2} (1 - 0.30) \right]$$

$$= 0.815 \times [1.7]$$

$$\beta_{\text{g}} = 1.3852$$

9) 0 - In general the market value of investment trust is not correlated to the Net present value.

10) i) Companies do exist to maximize the wealth of their owners. However, there are some problems associated with it.

(i) Shareholder's are the owners of the companies and their wealth maximises when the prices of the stock rises. This is also a problem as stock market is volatile and its price of the stock changes due to various factors which could be geographical factors, news, stock past performances as well as optimism of investors. If this is in company's favour then price of the stock will increase which helps to maximise the shareholder's wealth otherwise if everything is against then the prices could go down ~~and~~ leading to diminish the wealth of their owners.

10) ii) Share price = $\frac{10}{(6\% + 5\% (80\%)) - 8\%}$
 $= 500$

This is the Effect on the share price.

11) i) Beta is a measure of systematic risk of an entire market.

The Formula for beta of a stock is:-

$$\beta = \frac{\text{Cov}(r_i, r_m)}{\text{Variance}(r_m)}$$

r_i = Return on an individual stock

r_m = Return on an overall market

cov = covariance

ii) $P_{\text{geared}} = P_{\text{ungeared}} \left(1 + \frac{\text{Debt}}{\text{Equity}} (1 - \text{tax}) \right)$

iii) As an active stock market investor, I would prefer investing in a stock with a Beta of 1. This will help stock market move as ~~Index~~ stock market's Index goes, which will help to understand market and leading to greater returns.

11) iv) The Financial instrument that is likely to have a Beta of 0 is ~~Government Bonds~~ cash as cash is a current asset.

11) iii)

$$\begin{aligned} 12) i) \text{ Cost of Equity} &= 7\% + 5\% \times 1.5 \\ &= 0.145 \\ &= 14.5\% \end{aligned}$$

$$\begin{aligned} \text{Cost of Debt} &= \text{Gross cost of Debt} (1 - \text{tax}) \\ &= 9\% (1 - 25\%) \\ &= 0.0675 \\ &= 6.75\% \end{aligned}$$

$$\begin{aligned} \text{Weighted Average cost of capital} &= \frac{1}{2} (6.75\%) + \frac{1}{2} (14.5\%) \\ &= 3.375 + 7.25 \\ &= 10.625\% \end{aligned}$$

$$\begin{aligned} 12) ii) \beta_E &= \beta_{UG} \left(1 + \frac{\text{Debt}}{\text{Equity}} (1 - \text{tax}) \right) \\ 1.5 &= \beta_{UG} \left(1 + \frac{1}{1} (1 - 25\%) \right) \\ 1.5 &= \beta_{UG} (1.75) \\ \beta_{UG} &= 0.8571 \end{aligned}$$

$$\begin{aligned} \text{New } \beta_{UG} &= 0.8571 (1 + 0 (1 - 25\%)) \\ &= 0.8571 \end{aligned}$$

$$\begin{aligned} \text{Required Return to Equity} &= 7\% + 5\% (0.8571) \\ &= 0.112855 \\ &= 11.2855\% \end{aligned}$$

13) #

~~NA~~

14) i) a)

Current Ratio is also called as Liquidity Ratio.

It helps to measure current assets with current liabilities. Current Ratio helps to know if company is in a position to cover all the short term dues.

b)

Debtors turnover period is a period of time ~~in~~ which ~~it~~ can be number of days ~~and~~ taken to pay back all the ^x debtors. (

ii)

Xylo Ltd deals in goods with a high inventory turnover period.

The company's ~~aim~~ is finance manager's aim is to meet its short term liabilities. • Xylo Ltd can use

Inventory turnover ratio ~~is~~ to check usage of its inventory but it will not be useful in this case to

constantly check on it as ~~it deals~~ its main business includes high inventory turnover ratio. ~~However~~ Thus,

I feel he should track current ratio on regular basis. This will help to maintain its high inventory

turnover and able to manage finances for its use well enough. Along with it, current ratio will be able to

meet ~~the~~ ^{the} goal and help to have good cash flow as well as better management of finance resources. Therefore,

I feel he should track current ratio. The Equation for this ratio ~~is~~ should be 2:1. However, it should

not go below 1 like 0.5:1 or 0.95:1. ~~and~~ In current

Ratio, Current Assets should be greater than current liabilities.