

Gargi Tendulkar.

Business Finance - 2 Assignment.

Roll No. 77.

Q1 (D)

Q2 (A)

Q3 (C)

Q4 (C)

Q5
Sales (outflow) = 2500
cost (inflow) = 1500.
tax rate = 40%.
discount rate = 20%.

(i) Cashflow = 1000

(ii) $\frac{1000 \times 40}{100} = 400$ = NPV

(iii) Since NPV also takes into consideration the time value of money.

So, if the date of repayment changes, the NPV changes.

Q6 Efficiency ratio how well a company uses its assets and liabilities internally.

An efficiency ratio can calculate the turnover of the receivables, the repayment of liability, the quantity and usage of equity, and the general use of inventory and machinery.

This ratio can track and analyse the performance of commercial and investment banks.

Shareholders look at efficiency ratios to see how effectively their investments in the company are used

$$\text{Efficiency Ratio} = \frac{\text{Expense}}{\text{Revenue}}$$

Q7 Limitation of Ratio Analysis:

1) Historical Information is used:

The information used in the analysis is based on real past results that are released by the company. Therefore, ratio analysis metrics do not represent future company performance.

2) Inflation:

Financial statements are released periodically and, therefore, there are time difference between each release. If inflation has occurred in between periods, then real price are not reflected in the financial statements. Thus, the number across different periods are not ~~can~~ comparable until they are adjusted for inflation.

3) Change in Accounting Policies:

If company has changed the accounting policies and procedures, this may significantly affect the financial reporting.

In this case, the key financial metrics utilized in ratio analysis are altered, and the results recorded after change are not comparable to those before changes.

4) Operational Changes:

With significant operational changes (eg: supply chain strategy) the comparison of financial metrics before and after the operational changes may lead to misleading conclusions about the company's performance and future prospects.

5) Seasonal Effects:

An analyst should be aware of seasonal factors that should potentially result in limitations of ratio analysis.

88 All companies are exposed to systematic risk because they are exposed to the market.

However, there are some companies that are more exposed to the market than the others and therefore, are more ~~ex~~ exposed to a greater proportion of the systematic risk in the market.

A value of β in excess of 1 indicates that a stock that has, historically, amplified the return of the whole market (the $\pm$ ve)

A β close to 0 would indicate more stable stock that provide a more stable return than the market as whole.

A $\pm$ ve β would signify a stock whose performance was counter cyclical, offsetting the overall market experience.

89 (c)

810

Q10 (i) When business managers try to maximize their wealth, they are actually trying to increase the company's stock price.

As the stock price increases, the value of firm increases, as well as the shareholder's wealth.

Asides from their salaries and benefits, the only profit from the business if they own shares of stock in the company.

When employees are also shareholders, they tend to have a greater sense of responsibility to the firm. Consequently, many companies encourage employees to become shareholders.

In fact, some businesses offer shares of stock to their employees at discount through ESOPs.

There can be conflict between shareholders and the Board of Directors — called Agency Problem.

Managers serve as agents of the shareholders. If there is an agency problem, it is imperative to find a resolution as soon as possible to prevent problems within the business that can impede performance.

Q10(ii)

XYZ Ltd.

Presently trading @ 70 Rs.

Dividend p. share is 10 Rs.

Growth Rate @ 8%.

risk free rate @ 6%.

Market risk premium @ 5%.

Systematic Risk increase by 80%.

find: Effect on share price.

811 (i) All companies are exposed to systematic risk because they are exposed to the market.

However, some companies are more exposed to the market than others and therefore are exposed to a greater proportion of the systematic risk in the market.

$$B_i = \frac{\sigma_{im}}{\sigma_m^2} \quad \text{OR} \quad B_i = \rho_{im} \frac{\sigma_i}{\sigma_m}$$

Where σ_m^2 = Variance of market index.

σ_{im} = covariance between the individual stocks

(ii) Beta can be calculated by first dividing the security's standard deviation of returns by the benchmark's standard deviation of returns.

The resulting value is multiplied by the correlation of the security's returns and the benchmark's returns.

(iii) A value of B in excess of 1 indicates a stock that has, historically, amplified the return of the whole market (true or -ve).

A beta close to zero would indicate a stock that provided a more stable ~~the~~ return than the market as whole.

A negative beta would signify a stock whose performance was counter cyclical, offsetting the overall market experience.

(iv) 'D' Beta portfolio is created in such way that has no systematic risk.

eg: Government Bonds,
Fixed Deposits.

Q 12]

Debt

Equity

1:1

B = 1.5

(i)

risk free ROR = 7%

tax = 25%

Equity risk premium = 5%

Gross cost of Debt = 9%

$$WACC = (\% \text{ debt}) (\text{After tax cost of Debt}) + (\% \text{ preferred stock}) (\text{cost of preferred stock}) + (\% \text{ common equity}) (\text{cost of common equity})$$

$$WACC = W_d r_d (1 - T) + W_p r_p + W_e r_e$$

$$= 1 \times 9\% + 0 + 0$$

$$= 1 \times 9\% (1 - 25\%) + 1 \times 5\% + 0$$

Q 12 ii]

If all the debts are repayed.

$$\frac{\text{Debt}}{\text{Equity}} = \frac{0}{\text{Au.}}$$

then,

$$WACC = 0 + 0 + 1 \times 9\% (1 - 25\%)$$

$$WACC = 0 + 0 + 1 \times 5\%$$

$$WACC = \underline{\underline{5\%}}$$

Q14 (i) Current Ratio

Current Ratio is a liquidity ratio that measures a company's ability to pay short-term obligations or those due within one year.

It tells investors and analysts how a company can maximize the current assets on its balance sheet to satisfy its current debts and other payables.

Debtors Turnover Period

Debtors Turnover Period Ratio shows how quickly the credit sales are converted into the cash.

This ratio measures the efficiency of a firm in managing and collecting the credit issued to the customers.

$$\text{Debtors Turnover Ratio} = \frac{\text{Net Credit Sale}}{\text{Average Account Receivables}}$$

Where average account receivables include trade debtors and bill receivables.

Higher the Debtors turnover, better is the credit management of the firm.

Q14 ii

Since the finance minister of XYLO LTD is interested in finding the short term liability he should keep a track of the current ratio of the company.

The current ratio is a liquidity ratio which measures a company's ability to pay short-term obligations or those due to within a year or so.

It can tell the investors and analysts how a company can maximize the current assets on its balance sheet to satisfy the current debts and payables.