BUSINESS FINANCE ASSIGNMENT

Q1] d) IRR is the most reliable means of choosing between mutually exclusive projects

Q2] A)

$$\frac{\text{Market Price of Share}}{\text{Earning per share}}.$$

Q3] D) All of the above.

Q6] Efficiency ratios include the inventory turnover ratio, asset turnover ratio and recievable turnover ratio. They measure a company's ~~liabilities~~ ability to use its assets & manage its liabilities effectively.

① Inventory Turnover Ratio :-

$$\frac{\text{Cost of Goods}}{\text{Average inventory}}.$$

② Asset Turnover Ratio :-

$$\frac{\text{Company's Revenue}}{\text{Total Assets}}$$

③ Receivables Turnover Ratio :-

$$\frac{\text{Company's Net credit sales}}{\text{Avg. accounts recievable}}.$$

Q7] Limitations of Ratio Analysis are:-

→ Ratio Analysis is based on past data which means it isn't & current data.

→ Ratio Analysis does not ~~mean~~ measure the human element of a firm. [Human Element refers to the holistic & comprehensive methodology for improving the way people work together, leading to better individual performance.]

→ Ratio Analysis can only be used for comparison with other firms of same size and type.

→ It may be difficult to compare with other businesses as they may not be willing to share the information.

Q8] → Beta indicates how volatile a stock's price is in comparison to overall stock market.

→ A beta greater than 1 indicates a stock's price swings more wildly than the overall market.

→ Beta is the number that tells the investor how the stock acts compared to all other stocks.

→ In simpler words, ~~volt~~ volatility is the degree to which the stock's price fluctuates in relation to overall stock market.

Q9] B] In general the market value of investment trust is higher than the net present value.

Q10] When business managers try to maximise the wealth of their firm, they are actually trying to increase company's stock price. As the stock price increase, value of firm increases.

Some of the problems associated with demonstrating that companies actually do operate in such way as to maximise the shareholder's wealth.

① Conflicts between owners and managers

Since the managers of a firm are directed and guided by a board of directors and because they don't profit directly from the firm's goal to maximise shareholder wealth. This conflict is called Agency Problem.

② Long Term sustainable goals.

Profit ~~goals~~ maximisation is one of the top goals of financial management but this type of practice doesn't imply that short-term profit will help produce a long term goal.

③ Product Quality.

While maximising wealth, it is very important for the shareholders to make sure that the quality of product isn't ruined.

Q11] i) Beta of stock refers to how volatile a stock's price is in comparison to overall stock market.

$$\text{Beta coefficent } (\beta) = \frac{\text{Covariance } (Re, Rm)}{\text{Variance } (Rm)}$$

Re → Return of individual stock.
Rm → Return on the overall market

ii] Beta is the systematic risk of a security compared to market as a whole. It is mostly used in the Capital Asset Pricing Model [CAPM]

iii] A beta of (-1) indicates that stock is exactly the mirror image of the benchmark.
A beta of (+1) indicates that the security's price is more volatile than the market.
As an active investor, I would invest in HIGH BETA STOCKS as it is a great investment

iv] A zero beta portfolio is a portfolio constructed to have a zero systematic risk.

Q14] → Current Ratio is used to evaluate a company's ability to pay its short term obligations, such as accounts payable and wages.
→ A current ratio less than 1 is an indicator the company will be unable to pay its current liabilities.

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b) Debtor's turnover period :-
It measures the efficiency with which a company is able to collect on its recievables or the credit it extends to customers
→ A high debtors turnover ratio indicates that the company is able to collect the amount recievable on time, has better liquidity.

14 (ii) Xylo Ltd will use the current ratio to meet its short term liabilities.
Current Ratio is a liquidity ratio that measures a company's ability to pay short term obligations.

Q15] Q10]
Part 2 :- DPS = 10
Growth = 8%
MPS = 70

a) $\beta = 1$
Cost of equity = Exp DY + growth

$$RE = \frac{10}{70} + 8\% = 22.2857\%$$

$RE = 6\% + 5\% \times \beta_1$

$$\beta_1 = \frac{16.2856}{5}$$

$\beta = 3.25714$

New β = old + 80% of old.
= 5.86285

New RE = 6% + (5% of 5.86285)
= 35.31426%.

$RE = 35.31426 = \left(\frac{10}{MPS} \times 100\right) + 8\%$

$\frac{10}{MPS} \times 100 = 27.31426$

$MPS = \frac{1000}{27.31426} = 36.6109$

New MPS → 36.6109

Q8] ii) $\beta_{geared} - \beta_{ungeared}\left[1 + D/E(1-t)\right]$

$1.1 = \beta_{ungeared}\left\{1 + 1/2(1 - 30\%)\right\} = \beta_{ungeared} \times 1.35$

$\therefore \beta_{ungeared} = 0.81481$

when DE = 2:2 = 1:1

$\beta_{geared} = \beta_{ungeared} = \left\{1 + \frac{2}{2}(1 - 30\%)\right)$

$= 0.81481 \times 1.70$

$= 1.385185 = \beta_{geared}$.

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Q15] ii) The traditional theory of capital structure states that when the WACC (weight average cost of capital) is minimised & market value of assets is maximised, an optimal structure of capital exists.

→ As the more expensive equity finance is replaced by cheaper debt finance, the WACC decreases.

→ However, as gearing increases further, both debt holders and equity shareholders will perceive more risk & their required returns both increase.

iii). Modigliani & Miller's first irrelevance proposition theorem states that financial leverage does not affect a company's value if it does not have ~~a~~ to encounter income tax & distress costs.