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Business Finance
Assignment

Ans-1 D.

Ans-2 A.

Ans-3 D.

Ans-4 D.

Ans-5 i) There is a positive cash flow of 2500, two negative cashflow of 1500 and $[(2500-1500)\times 0.4]$ 400 on date 1

ii) NPV = $600 \times (1-0.2) = 480$

iii) If the supplier allows to pay them at date 2 then the new NPV = $2500 \times V_1 - 1500 \times V_2 - 400 \times V$

$= 720$

Hence, The NPV will increase

Ans-6

Ans-7 Limitation of ratio analysis:

1. It diverts attention from the figures and statements themselves.

2. Comparisons can be affected by different accounting policies or by other external factors.

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

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

Ans-8 i) • When beta > 1 : The stock has previously amplified the return of the whole market

• When beta < 1 : The stock's performance was counter-cyclical, hence off setting the market experience

• When beta is close to zero : The stock has provided a more stable return as compared to the market as a whole

ii) $\beta(\text{geared}) = \beta(\text{ungeared}) \times (1 + D/E(1-t))$

Geared beta = 1.1

Debt to equity ratio = 1:2

Tax Rate = 30%

∴, for new geared data, we need ungeared data first.

$$1.1 = \beta(\text{ungeared}) \times \left(1 + \frac{1}{2}(1 - 0.3)\right)$$

$$\beta(\text{ungeared}) = 0.815$$

Now,

Geared Beta = $(0.815)(1+1)(1-0.3)$

= 1.385

Ans 9 C

Ans-10

Ans-11 i) Beta = $\frac{\text{Covariance of the Individual Company}}{\text{Variance of the market}}$

Beta is a numeric value that measures the fluctuations of a stock to changes in the overall stock market.

ii) It can be determined using the formula

i.e $\frac{\text{Covariance of the Individual Com.}}{\text{Variance of the market}}$

iii) A stock with a beta of -1 means the stock is inversely correlated to the market. Whereas, A stock with a beta of 1 means that the stock is strongly correlated to the market and hence moves that the same pace of the market.

I would invest in a stock with beta 1.

iv) Treasury Bills

Ans-12 i) $WACC = \frac{(\text{cost of equity}) \times (\%\ \text{equity}) + (\text{cost of debt}) \times (\%\ \text{debt})}{\text{Equity} + \text{Debt}}$

- Cost of equity = $7\% + 1.5(5\%) = 0.145$

$\therefore WACC = 0.145 \times 0.5 + 9\% \times 0.5(1-25\%)$

$= 10.625\%$

ii) Ungeared beta $= \frac{1.5}{(1+1(1-25\%))}$

$= 0.857143$

New cost of equity = Risk-free rate + Ungeared beta x Equity risk premium

$= 7\% + 0.857143 \times 5\%$

$= 11.29\%$

Ans-14 i) a) Current Ratio: One of the liquidity ratios that can measure a company's ability to pay its short-term loans

b) Debtors Turnover Ratio shows how quickly the credit sales are converted into cash. This ratio measures the efficiency of a firm in managing and collecting the credit issued to the customers.

ii)

Ans-15 i)
- To Diversify the portfolio
- To maximize return
- To execute strategies

iii) Underlying Assumptions:
- Debt is risk free
- No taxes
- No agency cost
- No information asymmetry