Model Question

TRIBHUVAN UNIVERSITY

FACULTY OF MANAGEMENT

Office of the Dean

2015

Full Marks: 60

Time: 3 Hrs.

BBM / Third Semester / FIN 311: Business Finance

Candidates are required to answer all the questions in their own words as far as practicable.

Group "A"

Brief Answer Questions: ***[6 × 1 = 6]***

1. What is investment decision?
2. List important instruments traded in money markets.
3. Why do we calculate free cash flows?
4. Represent in the time line – you buy a 2-year maturity bond at Rs 1,000; the bond pays 10 percent coupon interest semiannually.
5. How do we compute percentage return on investment?
6. Draw the security market line.

Group "B"

Descriptive Answer Questions: ***[6 ×3 = 18]***

7. Describe the role of financial manager in a firm.
8. Makalu Transport Ltd. earned Rs 10 million taxable income in the fiscal year 2013/14. What is its tax liability if the corporate tax rate applicable to this company is 25 percent? What is marginal tax rate? **[2+1]**
9. Miss Shanta can save Rs 5,000 annually for five years and invest at 8 percent. How much she will receive at the end of 5th year?
10. Nepal Bank Ltd. pays 8 percent interest, compounded quarterly, on its money market account. The manager of Rastriya Banijya Bank wants its money market account to equal Nepal Bank's effective annual rate, but interest is compounded on a monthly basis. What quoted rate must Rastriya Banijya Bank set?
11. Bond issued by Himalayan Finance Company was selling at a price of Rs 1,500 on July 16, 2013. Coupon amount of this bond is Rs100 payable annually. Neeta purchased this bond on July 16 and sold it for Rs 1,480 on July 15, 2014. What was total yield on her investment?
12. Jyoti Spinning Mills is planning to issue 10 percent preferred stock with a par value of Rs100. Company is confident that it will sell new preferred stock at par value. It will incur 2.5 percent floatation cost. Average corporate tax of Jyoti Mills is 25 percent. What will be the cost of preferred stock? Why we do not adjust corporate tax while calculating cost of preferred stock?**[2+1]**

Group "C"

Analytical Answer Questions: (Any Four) ***[4 ×6 = 24]***

13. "Financial institutions have key role in fund transfer." Critically explain this statement.
14. Suppose a loan of Rs 10,000 is to be repaid in four equal installments including principal and 10 percent interest per annum.
    a. What is the annual amount of installment to be paid off that includes both principal and interest?

b. Set up the loan immortalization table. **[2+4]**

15. Stock X and Stock Y have the following historical returns:

Year	Stock X's Return	Stock Y's Return
2009	(18%)	(24%)
2010	44	24
2011	(22)	(4)
2012	22	8
2013	34	56

a. What is the average rate of return for each stock during the five year period?

b. What is the standard deviation of the return of each stock?

c. If you held the portfolio consisting of 50 percent of Stock X and 50 percent of Stock Y, what would have been the realized rate of return on the portfolio in 2009 and 2013? **[2+2+2]**

16. Assume that the average firm in your company's industry is expected to grow at a constant rate of 6 percent and its dividend yield is 7 percent. Your company is about as risky as the average firm in the industry, but it has just successfully completed some R&D work that leads you to expect that its earnings and dividends will grow at a rate of 50 percent this year and 25 percent the following year, after which growth should match the 6percent industry average. The last dividend paid was Rs10.

a. What is the stock's terminal value?

b. What is the value per share of your firm's stock? **[3+3]**

17. On January 1, the total market value of the Kanchenjunga Company was Rs 60 million. During the year, the company plans to raise and invest Rs 30 million in new projects. The company's present market value capital structure, given below is considered optimum. Assume that there is no short-term debt.

Debt	Rs 30,000,000
Common equity	30,000,000
Total capital	Rs 60,000,000

New bonds will have an 8percent coupon rate, and they will be sold at par. Common stock is currently selling at Rs 30 a share. Stockholders' required rate of return is estimated to be 12 percent, consisting of a dividend yield of 4 percent and an expected constant growth rate of 8 percent. The marginal corporate tax rate is 40 percent.

a. What is the cost of debt?

b. Assume that there is sufficient cash flow such that Kanchenjunga can maintain its present capital structure without issuing additional shares of equity. What is WACC? **[2+4]**

Group "D"

Comprehensive Answer Questions: ***[4 × 3 = 12]***

18. Unilever Nepal Ltd. manufactures international quality home and personal care products, both for domestic and international markets. It is one of the leading manufacturers of fast moving consumer goods in Nepal. It is a public listed company and its shares are traded in the Nepal Stock Exchange. Company management wants to check its financial health of the current fiscal year relative to previous years. Suppose the company appoints you as a financial consultant to check its financial health especially its liquidity position, utilization of its assets, debt management, profitability and reflection of its performance in the capital markets. For the purpose of checking the financial health, company secretary has provided you the following financial information:

Balance Sheet as of July 15, 2014 (Rs in millions)

Capital and Liabilities	Current Year	Previous Year
Shareholders' fund		
Share capital	92.070	92.070
Reserve and retained earnings	303.944	266.359
Total	396.014	358.429
Liabilities		
Trade and other payables	335.716	247.008
Long-term debt	207.990	179.442
Total	543.706	426.450
Total capital and liabilities	939.720	784.879
Assets		
Cash and bank balance	391.532	317.404
Receivables	97.063	64.775
Inventories	184.216	126.107
Prepaid and advances	51.435	81.598
Total current assets	724.245	589.885
Investment	79.764	48.836
Net fixed assets	135.711	146.158
Total assets	939.720	784.879

Income Statement (Rs in millions)

Sales	1,524.901	1,244.727
Less: cost of goods sold	969.109	843.142
Gross profits	555.792	401.585
Less: Operating expenses		
Housing funds	25.474	17.874
Distribution cost	46.322	44.111
Administrative overhead	43.587	41.725
Advertisement and promotional expenses	250.088	164.325
Total operating expenses	365.471	268.035
Operating profit	190.321	133.550
Add: Non-operating income	27.552	7.131
Total income	217.873	140.681
Less: Interest expenses	1.787	2.602
Loss in sales of other assets	0.772	0.253
Provision for staff bonus	21.531	13.783
Profit before tax	193.783	124.043
Less: Income tax	53.000	30.876
Net profit	140.783	93.167

Statement of retained earnings and reserve (Rs in millions)

Balance of previous year	255.231	256.055

Add: Net profit of this year	140.783	93.167
Available for appropriation	396.014	349.222
Less: Proposed dividend	92.070	82.863
Transferred to balance sheet	303.944	266.359

Additional information:

Number of outstanding shares: 920,700 ordinary shares

Share price Rs 1,600 on July 15 of current year and Rs 1,500 on July 15 of previous year.

Depreciation for current year and previous year are Rs 16.874 million and Rs 20.256 million respectively.

Questions:

a. Calculate current ratio and acid test ratio.

b. Calculate debt ratio and debt service ratio.

c. Calculate the inventory turnover ratio, and total assets turnover ratio.

d. Calculate profit margin ratio and return on total assets.

e. Calculate price earnings ratio and market to book value ratio.

f. On the basis of your calculation in (a), (b), (c), (d) and (e), write whether financial health of the company has been improved in current year.