POKHARA UNIVERSITY
Faculty of Management

FIN 131: ESSENTIALS OF FINANCE

Time: 3 hours **Full Marks 100**

Section A
Very Short Answer Questions

Attempt all the questions. Give your answer in few lines. (10 X 2 = 20)

1. What are the major areas in finance?
2. What are the types of financial markets?
3. What is the amount of shareholders' equity if total assets are Rs 10,000 and total liabilities are Rs 4,000?
4. Calculate nominal rate of return if the real rate of return is 3 percent and inflation rate is 5 percent?
5. You need Rs 10,000 to buy textbooks next year. If you can earn 7 percent interest on your money, how much money do you need to invest today so that you will have Rs 10,000 next year?
6. Kumari Bank Ltd. issues Rs 1,000 face value, five-year zero coupon bond. The initial price of bond is set at Rs 640. What is the total interest paid over the life of the bond?
7. Find cash flow to stockholders if cash flow from assets is Rs 10,000 and cash flow to creditors is Rs 6,000.
8. Define marginal cost of capital.
9. Calculate the cost of preferred stock if the dividend on it is 5 percent and market price is Rs. 50.
10. What is opportunity cost?

Section B
Descriptive Answer Questions

Attempt any six questions. [6 X 10 = 60]

11. What is agency relation? Discuss the types of agency relation. [5+5]

12. Explain how fund is transferred from saving units to deficit units in an economy? What role do financial institutions play in this process?

13. The possible returns of Stock X and Stock Y in the three possible states of economy with the given probability of occurrence of each state are as follows:

State of Economy	Probability of State of Economy	Stock X Rate of Return if State Occurs	Stock Y Rate of Return if State Occurs
Recession	.10	-.20	.30
Normal	.60	.10	.20
Boom	.30	.70	.50

a. Calculate the expected returns for these two stocks?
b. Calculate the standard deviations for these two stocks?
c. Which stock is riskier? And why? [3+5+2]

14. Nilakshi is looking into an investment that will pay her Rs 12,000 per year for the next 10 years. If she requires a 15 percent return, what is the most she would pay for this investment? [10]

15. Himalayan Company Ltd. is a quickly growing company. Dividends are expected to grow at a 30 percent rate for the next 3 years, with the growth rate falling off to a constant 6 percent thereafter. If the required return is 13 percent and the company just paid a Rs 2.75 dividend, what is the current share price? [10]

16. Annapurna Finance Ltd. recently paid Rs.10 dividend per share. The dividend is expected to grow at 5 percent indefinitely. The stock currently sells for Rs.120. What is Annapurna's cost of equity capital?

    In addition to the information given above, suppose Annapurna has target debt-equity ratio of 50 percent. Its , before tax cost of debt is 8 percent. If the tax rate is 25 percent, what is the weighted average cost of capital? [4+6]

17. Write note on any two of the followings: [5+5]

    a. Preferred Stock
    b. Free Cash Flow
    c. Sunk Cost

Section C
Comprehensive Answer Question

18. Ready the following situation and answer the questions that follow. (20)

Kanchanjunga Ltd. is planning to establish a new factory to meet the growing demand for its products. It will use the land already purchased for Rs 500,000. The company can sell this land for Rs 1,000,000 now. The price of required plant and machines is Rs 2,500,000. Construction of factory building will cost Rs 1,500,000. The company will invest Rs 100,000 in inventory and Rs 50,000 in receivables and Rs 40,000 in miscellaneous current assets. It will have Rs 90,000 trade credit and Rs 30,000 miscellaneous current liabilities.

The new factory capacity will be to produce 1,000 tons annually. Variable cost per ton is Rs 400 and annual fixed overhead exclusive to depreciation will be Rs 200,000. The expected selling price per quintal (100 kg) is Rs 800. The company will utilize at least 80 percent of the plant capacity. Factory building will be depreciated at 5 percent, and plant and machines by 10 percent each year on straight-line method.

Kanchanjunga will run the new factory for next 7 years. At the end of this period, land is expected to sell for Rs 1,000,000, and equipments and machines for Rs 50,000. Factory building will be useless. Moreover, it will cost Rs 50,000 to dismantle the building. The buyer of the land will bear dismantling cost. Corporate tax rate applicable to this company is 20 percent.

Questions

a) What will be the net cash outlay of the project?
b) What will be the annual depreciation on building and plant and machines?
c) What will be the annual net cash flows of the project?
d) What will be the net terminal cash flows of the project?
e) Should Kanchanjunga establish new factory if its required return is 10 percent and it uses NPV criterion to make its investment decision? [4x3+8]

THE END OF THE QUESTIONS

NOTE: THESE QUESTIONS ARE PROVIDED JUST AS A MODEL OF QUESTIONS THAT MAY BE ASKED IN THE EXAMINATION. IN NO WAY THEY INDICATE THE UNIT REFERENCE AND PROPORTION BETWEEN NUMERICAL AND THEORETICAL QUESTIONS.