**Strategic Financial Management**

**September 2021 Examination**

**1. Calculate Economic Value Added (EVA) if the Earnings before Interest and tax is Rs 20, 00,000. The capital structure of the firm consists of Debt-Equity ratio of 2: 3, pretax cost of debt is 14% and the tax rate is 35%. The equity beta is 1.5. The risk free rate of return is 9% and risk premium is 5%. Total borrowed capital of the firm is Rs 45, 00,000. Comment on the value of EVA. (10 Marks)**

**Ans 1.**

**Introduction:**

Economic value added (EVA) is a financial management concept used to assess an enterprise's economic performance based on variables such as net income produced, cost of capital, working capital generated, and taxes. EVA is calculated by multiplying the net income made by the cost of capital, working capital generated, and taxes. For the first time, a Stern Value Management consulting firm introduced the concept of economic value added to quantify financial

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**2. A company is considering a project whose machine cost will be ₹ 72,000. It has a life expectancy of four years and the tax rate is 30%. Estimated profits before depreciation and tax is as follows: (10 Marks)**

**Year PBDT (₹)**

**1 20,000**

**2 25,000**

**3 27,000**

**4 30,000**

**The cost of capital is 10% and the company follows straight line depreciation method. Compute Net Present Value and Discounted Payback Period and comment on the values.**

**Ans 2.**

**Introduction:**

The net present value, often known as the net current value of capital investment, can be defined as the present value of cumulative cash inflows from a capital investment less the present value of cumulative cash outflows from investing. Whenever inflows occur in the future period, the current value of those inflows is calculated.

The discounted payback period is used to assess the length of time it will take for an investment

**3. A Company expects an operating income of ₹ 1, 50,000. The equality capitalization rate of the company is 12%.**

**a) Calculate the value of the firm and overall capitalization rate according to the net**

**Income approach if it has ₹ 3, 00,000, 8% debentures. Comment on the value of the cost of capital in the case of Net Income Approach when the proportion of debt is changed in the capital structure. (5 Marks)**

**Ans 3a.**

**Introduction:**

The capital structure comprises many components such as equity share capital, reserves preference shares, borrowings, and so on. The company uses these monies to support its operations and growth.

Various factors such as risk, control, pay, tax consequences and flexibility all contribute to

**b) If the debentures are increased to ₹ 4, 00,000, 8% debentures. What shall be the value of the firm and the overall capitalization rate? Interpret the result. (5 Marks)**

**Ans 3b.**

**Introduction:**

Some ideas advocate the 'optimal' capital mix or capital structure for a company. The most prominent is that a proper capital structure is critical in identifying the underlying worth of the company. According to the net income approach, the value of a company can be increased by increasing the share of debt in the overall capital mix. An increase in debt is followed by a fall in