**Strategic Financial Management**

**December 2021 Examination**

**Q1. ABC Limited is looking at expanding its business and wants to invest in a new plant to boost its production capacity. The plant has a life of three years. The details are as follows.**

**The plant would depreciate in three years from the acquiring cost of Rs. 4, 20,000 to zero in three years. There would be no salvage value at the end of three years. The depreciation would be on a straight-line basis.**

**s. 6, 00,000 in year 1, Rs. 7,00,000 in years 2 and 3.**

**· The input cost (raw material) is expected to be ~ Rs. 3, 00,000 for years 1 and 2 and Rs. 4, 00,000 in year 3.**

**Assuming a tax rate of 30% and a discount rate of 20%, you are required to**

**1. Arrive at the expected annual cash flows (after-tax)**

**2. Compute the net present value of the investment and determine if the investment is financially viable? (10 Marks)**

**Ans 2.**

**Introduction**

That is the amount of cash that comes in and leaves a firm. For each dollar obtained, there's the same amount of money spent. On a fundamental stage, the ability of a company to generate adequate cash flows or, more significantly mainly, optimize long-term loose cash flow is what determines its potential to create cost for shareholders (FCF). In different words, it's miles the coins that are generated through a company's common business sports, much less any money spent on capital prices (CapEx). It is the motion of cash into a business and the movement of Its Half solved only

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**Q2. As an investor in the equity market, you become aware of investment opportunities in 3 corporate. Assuming that the cost of equity is 8%, compute the fair value of X Limited, Y Limited, and Z Limited using the Dividend discount model.**

**a. Given the history of the company, X Limited is expected to pay a consistent dividend of Rs. 5.00 per share.**

**b. Being in the IT Industry, Y Limited is expected to pay a dividend of Rs. 4.00 per share and an increase of 5% year on year thereafter.**

**c. A pharmaceutical company, Z Limited, has been paying a dividend of Rs. 2.00 over for the last 3 years. The company is expected to do exceptionally well and increase the dividend payout by 7% year on year. This year the dividend expected is Rs. 8.00.**

**Additionally, what is the biggest lacuna in the Dividend Discount Model in valuing stocks? Give an example to explain. (10 Marks)**

**Ans 2.**

**Introduction:**

It is predicated on the notion that a company's current stock price is worth the overall of all future dividend bills discounted lower back to their present value. To do that, it takes under consideration dividend charge variables and marketplace projected returns, as well as the current market conditions. In different phrases, if the value of the DDM is extra than the contemporary trading charge of stocks, then the inventory is undervalued and must be bought. Businesses

**3. As an Investment Banker, your client, LMN Limited, is looking at restructuring its business. You extract the following data from the financials of the company.**

|  |  |
| --- | --- |
| **Particulars**  | **Rs. Crs.**  |
| **Equity capital (Face value Rs. 10)**  | **1,000.00**  |
| **Debentures (@ 12%)**  | **400.00**  |
| **Long Term unsecured loan (@15%)**  | **200.00**  |
| **Total**  | **1,600.00**  |

**The company has been paying a dividend of 20% per annum (historically). The stock of LMN Limited is listed at Rs. 20 on the NSE.**

**You are required to**

**a. Compute the cost of equity capital. (5 Marks)**

**Ans 3a.**

**Introduction:**

On the one hand, it counts how much money a firm spends on capital, even as on the other hand, it measures how much money it can pay out in dividends to shareholders. Capital costs include both lenders' and owners' interest rates and are calculated as a percentage return requested via an

**b. Weighted Average cost of capital of LMN Limited. (5 Marks)**

**Ans 3b .**

**Introduction:**

WACC (Weighted average value of Capital) measures an organization's overall fee of capital, which includes commonplace inventory, favored stock (favored inventory), and debt (debt). They're weighted via their respective chances within the typical capital and then mixed collectively. Using WACC as a reduced rate in economic modelling, internet gift price is