Test - 2		
Time Allowed: 1 hour	**23-Jan-2019**	**Total Marks :34 Marks**

Topic:- Leverage, EBIT - EPS, Indifference, Cost of Capital and Fiscal Policy

Q.1: Explain the major considerations in capital structure planning. **(4 Marks)**

Q.2: Book Value Weights vs. Market Value Weights. **(2 Marks)**

Q.3: The Eastern Limited requires ₹ 50 lakhs for a new Plant. This Plant is expected to yield earnings before interest and Taxes of ₹ 10 lakhs. At the time of deciding the financial plan, the Company considers the objective of maximising earnings per share. It has three alternatives to finance the project: -

(i) Debt of ₹ 5 lakhs and balance through Equity.

(ii) Debt of ₹ 20 lakhs and balance as Equity.

(iii) Debt of ₹ 30 lakhs and balance as Equity.

The funds can be borrowed at the rate of 10% for amount upto ₹ 5 lakhs, at 15% over ₹ 5 lakhs and up to ₹ 20 lakhs and at 20% over ₹ 20 lakhs. The Shares of the Company is currently selling at ₹ 150, but is expected to decline to ₹ 125 in case the Borrowed funds exceed ₹ 20 lakhs. The tax rate applicable to the Company is 50%. Which form of financing should the Company choose? **(5 Marks)**

Q.4: XYZ Ltd. has the following book value capital structure: -

Equity Capital - ₹ 15 crores (in shares of ₹ 10 each fully paid up - at par)	Retained Earnings - ₹ 20 crores
11% Preference Capital - ₹ 1 crore (in shares of ₹ 100 each, fully paid up at par)	13.5% Debentures (of ₹ 100 each) - ₹ 10 crores 15% term Loans - ₹ 12.5 crores

The next expected dividend on equity share per share is ₹ 3.60; the dividend per share is expected to grow at the rate of 7%. The market price per share is ₹ 40. Preference stock, redeemable after ten years, is currently selling at ₹ 75 per share. Debentures, redeemable after six years, are selling at ₹ 80 per debenture. The Income tax rate for the company is 40%.

Required: -

(i) Calculate the WACC using: - **(a)** Book value proportions and **(b)** market value proportions

(ii) Compute the weighted marginal cost of capital of the company, if it raises ₹ 10 crores next year, given the **following information**: -

- **(a)** The amount will be raised by equity and debt in equal proportions.
- **(b)** The company expects to retain ₹ 1.5 crores earnings next year which is to be utilised for financing the new project.
- **(c)** The additional issue of equity shares will result in the net price per share being fixed at ₹ 32.
- **(d)** The debt capital raised by way of term loans will cost 15% for the first ₹ 2.5 crores and 16% for the next ₹ 2.5 crores.

(8 Marks)

Q.5: Explain Negative Consumption Externalities. **(2 Marks)**

Q.6 Explain Free Rider's problem in public goods. **(2 Marks)**

Q.7 What are Quasi-Public goods. **(2 Marks)**

Q.8 Explain Re-distribution of Government for reducing the gap of inequality in income and wealth. **(3 Marks)**

Q.9 Explain Fiscal Policy and its Objectives. **(3 Marks)**

Q.10 Explain Taxes an instrument of Fiscal Policy **(3 Marks)**

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