

ECONOMIC VALUE ADDED (EVA)

1. Delta Ltd.'s current financial year's income statement reports its net income as Rs. 15, 00,000. The marginal Tax Rate is 40% and its interest expense for the year was Rs. 15, 00,000. The company has Rs. 1, 00, 00,000 of invested capital, of which 60% is debt. In addition, Delta Ltd tries to maintain a WACC of 12.6%.
 - (i) Compute the operating income or EBIT earned by Delta Ltd. in the current year.
 - (ii) What is the company's EVA for the current year?
 - (iii) The company has 2, 50,000 equity shares outstanding. According to the EVA you computed in (ii), how much can the company pay in dividend per share before the value of the company start to decrease? If the company does not pay dividends, what would you expect to happen to the value of the company?

(NOV 2010)

2. Tender has earned a net profit of Rs. 15 lakhs after Tax at 30%. Interest cost charged by the financial institutions was Rs. 10 Lakhs. The Invested capital is Rs. 95 Lakhs of which 55% is debt. The company maintains a weighted average cost of capital of 13%.
 - (i) Compute the operating Income.
 - (ii) Compute the Economic Value Added.
 - (iii) The company has 6 lakhs equity shares outstanding. How much dividend can the company pay before the value of the entity starts declining?

(MAY 2011)

3. Rahul Ltd has surplus cash of Rs. 100 lakhs and wants to distribute 27% of it to the shareholders. The company decides to buy back shares. The finance manager of the company estimates that its share price after re-purchase is likely to be 10% above the buyback price, if the buyback route is taken. The number of shares outstanding at present is 10 lakhs and the current Earnings per share are Rs. 3. Determine:

- (i) The price at which the shares can be re-purchased, if the market capitalization of the company should be Rs. 210 lakhs after buyback.
- (ii) The number of shares that can be re-purchased.
- (iii) The impact of share re-purchase on the EPS, assuming that net income is the same.

(NOV 2010)

4. Calculate EVA with the help of following data:

Financial Leverage	:	1.4 times
Capital Structure	:	Equity Capital Rs 170 Lakhs Reserves and Surplus Rs 130 Lakhs 10% Debentures Rs. 400 Lakhs
Cost of Equity	:	17.5%
Income Tax Rate	:	30%

(NOV 2004)

5. The following data is available for a concern. *Compute EVA.*

Debt Capital 12%	:	Rs. 2000 crores
Equity Capital	:	Rs. 500 crores
Reserves and Surplus	:	Rs. 7500 crores
Capital Employed	:	Rs. 10000 crores
Operating Profit after Tax	:	Rs. 2100 crores
Risk Free Rate	;	9%
Beta Factor	:	1.05
Market Rate of Return	:	19%
Market Risk premium	:	10%
Tax Rate	:	30%

(NOV 2006 / JAN 2009)

6. Raj and Co. has existing assets in which it has capital invested of Rs. 100 crores. The after tax operating Income of assets in place is Rs. 15 crores. The return on capital employed of 15% is expected to be sustained in perpetuity and company has a cost of capital of 10%. Estimate the present value of EVA to the firm from its assets in place.

(NOV 2004)

7. Compute the EVA from the following data:

Share capital	:	1600 crores
Long term Debt	:	320 crores
Interest		32 Crores
Reserve and surplus	:	3200 crores
PBIT	:	1432 crores
Tax Rate	:	30%
Beta Factor	:	1.05
Market Rate of Return	:	14%
Risk free rate	:	10%

8. The following data is available for a concern. Compute EVA.

Long Term Debt	:	400 Lakhs
Equity Capital	:	2000 lakhs
Reserves and Surplus	:	4000 lakhs
Risk Free Rate	;	9%
Beta Factor	:	1.05
Market Rate of Return	:	16%
Tax Rate	:	30%
Interest	:	40 Lakhs
Profit before interest and Tax	:	2000 lakhs

9. Prosperous bank has a criterion that it will give loans to companies that have an "Economic Value Added" greater than zero for the past three years on an average. The bank considers lending money to a small company that has the economic value characteristics shown below. The data relating to the company are as follows:

- (i) Average operating income after tax equals Rs. 25 Lakhs per year for the last 3 years.
- (ii) Average total assets over the last three years equals Rs. 75 Lakhs.
- (iii) WACC for the company is 10% applicable for all the 3 years.
- (iv) The company's average current liabilities over the last three years are Rs. 15 Lakhs.

Does the company meet the criteria of the bank to have a positive economic value added?

10. Compute the EVA from the following data:

Equity Share capital (Rs. 10 each)	:	400 Lakhs
15% Preference share capital	:	200 Lakhs
15% Debentures	:	1600 Lakhs
Reserve and surplus	:	220 Lakhs
10% Non-Trade Investments (Nominal Value Rs. 100 Lacs)	:	140 Lakhs
Land and Building held as investment	:	20 Lakhs
Advance given for purchase of plant	:	10 Lakhs
Capital WIP	:	30 Lakhs
Underwriting Commission (not written off)	:	20 Lakhs
EPS	:	Rs. 16
Tax Rate	:	30%
Beta Factor	:	1.65
Market Rate of Return	:	16.25%
Risk free rate	:	9.85%

ANSWERS

1. (i) Rs. 40 lacs (ii) Rs. 11.40 lacs (iii) Rs. 4.56
2. (i) Rs. 3.43 Lacs (ii) 9.65 lacs (iii) Rs. 1.608 per share
3. (i) Rs. 21.79 per share (ii) 1.24 lakhs approx. (iii) Rs. 3.43
4. EVA – Rs. 17.5 Lakhs
5. WACC – 17.28% and EVA – Rs. 372 crores
6. EVA – 150 Crores
7. EVA – 298.40 crores
8. EVA – 390.72 Lakhs
9. EVA – 19 LAKHS & qualify for bank loan. Cost of Capital employed – 60 lakhs and cost of capital - 6 Lakhs.
10. EVA – 537.30