

Chapter: Capitalisation and Capital Structure

1. Excellent Ltd. Is considering three financial plans. The key information is as follows.
- Total investment to be raised ₹ 2,00,000
 - Plan of financing proportion:

Plan	Equity	Debt	Preference Share
A	100%	----	---
B	50%	50%	---
C	50%	----	50%

- Cost of Debt 8%. Cost of preference Shares 8%.
- Tax rate 50%
- Equity shares of the face value of ₹ 10 each will be issued at a premium of ₹ 10 per share.
- Expected EBIT is ₹ 80,000

Determine for each plan:

- Earnings per share (EPS) and
- The Financial break-even point.

2. A Company's capital structure consists of the following:

Particulars	₹ (lacs)
Equity Shares of Rs. 100 each	20
Retained earnings	10
9% preference Share	12
7% Debenture	8
Total	50

The company earns 12% on capital. The income tax rate is 50%. The company requires a sum of ₹ 25 lacs to finance expansion programme for which following alternatives are available to it.

- Issue of 20,000 Equity Shares at a premium of ₹ 25 per share.
- Issue of 10% Preference Shares.
- Issue of 8% Debentures.

It is estimated that the P/E Ratio in the cases of equity, preference and debenture financing would 21.4, 17 and 17 and 15.7 respectively.

Which of the three-financing alternative would you recommended and why?

3. A company needs Rs 12 lakhs for the installation of a new factory which would yield an annual EBIT of Rs 2,00,000. The company has the objective of maximizing the earnings per share. It is considering the possibility of issuing equity shares plus raising a debt of ₹ 2,00,000 ₹ 6,00,000 or ₹ 10,00,000. The current market price share is ₹ 40 which is expected to drop to ₹ 25 per share if the market borrowing were to exceed ₹ 7,50,000.

Cost of borrowing are indicated as under:

Upto Rs 2,50,000	10% p.a.
Between Rs 2,50,001 and Rs. 6,25,000	14% p.a.
Between Rs 6,25,001 and Rs 10,00,000	16% p.a.

Assuming a tax rate of 50% workout the EPS and the scheme which would meet the objective of the management

4. M. C. Ltd. Planning an expansion programme which will require ₹ 30 crore and can in the funded through one of the three following options:
- 1) Issue further equity shares of Rs. 100 each at par.
 - 2) Raised loans at 15% Interest
 - 3) Issue preference shares at 12%
- Present paid up capital is ₹ 60 crores and average EBIT is Rs 12 crores. Assume Income tax rate at 50%. After the expansion EBIT is expected to be ₹ 15 crores per annum. Calculate EPS under the three financing options to indicating the alternative giving the highest return to the equity shareholders.
5. The Zed Ltd. needs ₹ 5,00,000 for commissioning of a new plat. The following three financial plans are feasible.
- 1) The company may issue 50,000 equity shares of ₹ 10 per share.
 - 2) The company may issue 25,000 equity shares of ₹ 10 per share and 2,500 debentures of ₹ 100 denomination bearing 8% rate of interest.
 - 3) The company may issue 25,000 equity share of ₹ 10 per share and 2,500 preference shares at ₹ 100 per share bearing 8% rate of Dividend.

If the company's earnings before interest and taxes is ₹ 60,000 and ₹ 1,00,000 what is the EPS under – each of the three financial plans for both EBITs? Which alternative would you recommend? Assume corporate tax rate to be 50 %