Leverage Analysis

1. An analytical statement of AB Co. is shown below. It is based on output level of 80,000 units.

Sales	9, 60,000
- V.C.	5, 60,000
Contribution	4, 00,000
Fixed Costs	2, 40,000
EBIT	1, 60,000
- Interest	60,000
EBT	1, 00,000
- Tax	50,000
EAT	50,000

   Calculate (1) DOL (2) DFL and (3) Combined Leverage.

2. A firm has sales of Rs. 10, 00,000, variable cost of Rs. 7, 00,000 and fixed costs of Rs. 2, 00,000 and debt of Rs. 5, 00,000 at 10% of interest. What are the operating, financial and combined leverages? If the firm wants to double up its EBIT, how much of a rise in sales would be needed on a percentage basis?

3. A company intends to start a new manufacturing unit for which it needs Rs. 15, 00,000. The new factory is expected to yield an annual EBIT of Rs. 2, 50,000. In choosing a financial plan, the company has an objective of maximizing EPS. It has three alternatives of issuing debentures Rs. 1, 50,000, 6, 00,000 or Rs. 9, 00,000. The rate of interest in each case would be (1) up to Rs. 2, 00,000 at 10% (2) over Rs. 2, 00,000 up to Rs. 8, 00,000 at 11% and (3) over Rs. 8, 00,000 at 18%. The current market price per share is Rs. 30 and it is expected to drop to Rs. 24 if the funds are borrowed in excess of Rs. 7, 00,000. Assume tax rate at 50%. Give your opinion on the basis of EPS.

4. A company intends to establish a new factory for which an investment of Rs. 20, 00,000 is required. The company is considering two alternatives.
   a) Proportion of equity and debentures is to be maintained at 70:30.
   b) Proportion of equity and debentures is to be kept at 50:50.

   If the first alternative is selected, then equity shares are sold at Rs. 40 per share and debentures can be issued at the interest of 10% p.a. If the second alternative is selected, equity shares are sold at Rs. 25 per share and debentures are to be issued at 12% interest p.a. The factory is expected to earn 3, 20,000 before interest and taxes. Tax rate is 50%. Which alternative is to be selected on the basis of EPS? Compute financial leverage for both options.