Questions on Capital Structure Decision

Que. 1: A company's present capital structure consists of 3,000,000 equity shares and 1,00,000 preference shares. The firm's current PBIT is Rs.14.4 million. Preference shares carry a dividend of Rs.12 per share. The earnings per share is Rs.2. The firm is planning to raise Rs.20 million of external financing. Two financing alternatives are being considered: (i) issuing 2,000,000 equity shares for Rs.10 each, (ii) issuing debentures for Rs.20 million carrying 15 percent interest.
Required (a) Compute the EPS-PBIT indifference point.
(b) Define the alternative which maximises EPS for various levels of PBIT.

Que 2: PQR company's present capital structure consists of 2,000,000 shares of equity stock. It requires Rs.20 million of external financing for which it is considering three alternatives. Alternative A calls for issuing 2,000,000 equity shares (Rs.10 par); alternative B calls for issuing 1,20,0000 equity shares (Rs.10 par) and 8,00,000 preference shares (Rs.10 par) carrying 11 percent dividend; alternative C calls for issuing 4,00,000 equity shares (Rs.10 par) and Rs.16 million of debentures carrying 15 percent interest. The company's tax rate is 50 percent.
Required:
a. What is the EPS-EBIT equation for alternative A,B and C?
b. Rank the alternative according to EPS over varying levels of EBIT i.e. Rs.30,00,000 and 50,00,000

Que 3: The following information is available about Shivangi Crafts Company:
Depreciation Rs.6 million
PBIT Rs.30 million
Interest on debt Rs.8 million
Tax rate 50 percent
Loan repayment instalment Rs.5 million
Required: (a) Calculate the interest coverage ratio.
(b) Calculate the cash flow coverage ratio.

Que 4: The following projections are available for IFL Limited:

Rs. in million

	Year 1	Year 2	Year 3	Year 4	Year 5
Profit after Tax	-8	44	50	80	100
Depreciation	24	21.6	19.5	17.5	15.74
Interest on term loan	42.2	42.2	41	35.6	30.4
Term Loan repayment Instalment			48	48	48

Required: Calculate the debt service coverage ratio.

Practice Questions:

Que. 5: Multiwal Company Ltd. present capital structure consists of 15,00,000 equity shares and 50,000 preference shares. The firm's current PBIT is Rs.7.2 million. Preference shares carry a dividend of Rs.12 per share. The earnings per share is Rs.2. The firm is planning to raise Rs.10 million of external financing. Two financing alternatives are being considered: (i) issuing 1,000,000 equity shares for Rs.10 each, (ii) issuing debentures for Rs.10 million carrying 15 percent interest.
Required (a) Compute the EPS-PBIT indifference point.
(b) Define the alternative which maximises EPS for various levels of PBIT.

Que 6: PQR company's present capital structure consists of 1,000,000 shares of equity stock. It requires Rs.30 million of external financing for which it is considering three alternatives. Alternative A calls for issuing 3,000,000

equity shares (Rs.10 par); alternative B calls for issuing 7,00,000 equity shares (Rs.10 par) and 23,00,000 preference shares (Rs.10 par) carrying 10 percent dividend; alternative C calls for issuing 10,00,000 equity shares (Rs.10 par) and Rs. 2,00,00,000 of debentures carrying 11 percent interest. The company's tax rate is 25 percent. Calculate the EPS EBIT equation for different alternatives.
Which alternatives maximises the EPS when EBIT is 5 Crore, 7 crores and 10 Crores

Que 7: The following information is available about SP Company:
Depreciation Rs.8 million
EBIT Rs.65 million
Interest on debt Rs.18 million
Tax rate 27 percent
Loan repayment instalment Rs.7 million
Required: (a) Calculate the interest coverage ratio.
(b) Calculate the cash flow coverage ratio.

Que 8: The following projections are available for D Limited:

Rs. in million

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Profit after Tax	-4	15	20	30	35	40	50	75
Depreciation	12	10.6	9.54	9.3	9.2	8.9	8.7	87.6
Interest on term loan	15.2	15.2	17.5	16.8	15.6	11.2	9.8	7.4
Term Loan repayment Instalment			21	21	21	21	21	21

Required: Calculate the debt service coverage ratio.