HOMEWORK SECTION - Capital Structure

Q1. Best of Luck Ltd., a profit making company, has a paid-up capital of Rs. 100 lakhs consisting of 10 lakhs ordinary shares of Rs. 10 each. Currently, it is earning an annual pre-tax profit of Rs. 60 lakhs. The company's shares are listed and are quoted in the range of Rs. 50 to Rs. 80. The management wants to diversify production and has approved a project which will cost Rs. 50 lakhs and which is expected to yield a pre-tax income of Rs. 40 lakhs per annum. To raise this additional capital, the following options are under consideration of the management:

(a) To issue equity share capital for the entire additional amount. It is expected that the new shares (face value of Rs. 10) can be sold at a premium of Rs. 15.

(b) To issue 16% non-convertible debentures of Rs. 100 each for the entire amount.

(c) To issue equity capital for Rs. 25 lakhs (face value of Rs. 10) and 16% non- convertible debentures for the balance amount. In this case, the company can issue shares at a premium of Rs. 40 each.

ADVISE which option is the most suitable to raise the additional capital, keeping in mind that the management wants to maximize the earnings per share to maintain its goodwill. The company is paying income tax at 50%.

Q2. Aaina Ltd. is considering a new project which requires a capital investment of Rs. 9 crores. Interest on term loan is 12% and Corporate Tax rate is 30%. CALCULATE the point of indifference for the project considering the Debt Equity ratio insisted by the financing agencies being 2 : 1.

Q3. Xylo Ltd. is considering two alternative financing plans as follows:

Particulars	Plan – A (Rs.)	Plan – B (Rs.)
Equity shares of Rs. 10 each	8,00,000	8,00,000
Preference Shares of Rs. 100 each	-	4,00,000
12% Debentures	4,00,000	-
	12,00,000	12,00,000

The indifference point between the plans is Rs. 4,80,000. Corporate tax rate is 30%. CALCULATE the rate of dividend on preference shares.

Q4. Ganesha Limited is setting up a project with a capital outlay of Rs. 60,00,000. It has two alternatives in financing the project cost.

Alternative-I: 100% equity finance by issuing equity shares of Rs. 10 each Alternative-II: Debt-equity ratio 2:1 (issuing equity shares of Rs. 10 each)

The rate of interest payable on the debts is 18% p.a. The corporate tax rate is 40%. CALCULATE the indifference point between the two alternative methods of financing.