

HW - Chapter 5 - Capital Structure - Q1

Capital Structure After issue.

Particulars	Option I	Option I	Option III
Number of Equity Shares			
- Existing	10,00,000	10,00,000	10,00,000
- Newly issued	2,00,000 (50,00,000 ÷ 25)	---	50,000 25,00,000 ÷ 50
Total	12,00,000	10,00,000	10,50,000
16% Debentures (Rs.)	---	50,00,000	25,00,000

Calculation of Earnings per share under the three options:

	Rs.	Rs.	Rs.
Profit Before Interest and Tax:			
Existing pre-tax profit	60,00,000	60,00,000	60,00,000
(+) From new projects	40,00,000	40,00,000	40,00,000
EBIT	1,00,00,000	1,00,00,000	1,00,00,000
(-) Int on 16% Debentures	---	8,00,000 (16% × 50 lakhs)	4,00,000 (16% × 25 lakhs)
Profit Before Tax	1,00,00,000	92,00,000	96,00,000
Less: Tax at 50%	50,00,000	46,00,000	48,00,000
Profit After Tax	50,00,000	46,00,000	48,00,000
÷ Number of equity Shares	12,00,000	10,00,000	10,50,000
EPS	4.17	4.60	4.57

Advise: Option II i.e., issue of 16% Debentures is most suitable to maximize the earnings per share.