HW - Chapter 5 - Capital Structure - Q2

The capital investment can be financed in two ways i.e.

(i) By issuing equity shares only worth Rs. 9 crore or

(ii) By raising capital through taking a term loan of Rs. 6 crores and Rs. 3 crores through issuing equity shares (as the company has to comply with the 2 : 1 Debt Equity ratio insisted by financing agencies).

Indifference point is that level of EBIT where EPS is the same between the two options.

[{(EBIT - Interest) ×(1- t)} ÷ preference dividend] ÷ No.of equity shares

EBIT (1- 0.30) ÷ 90,00,000 = EBIT -Rs. 72,00,000)x (1- 0.30) ÷ 30,00,000

On solving, (please show the working of solving fully)

EBIT = Rs. 1,08,00,000

EBIT at point of Indifference will be Rs. 1.08 crore.

(The face value of the equity shares is assumed as Rs. 10 per share. However, indifference point will be the same irrespective of face value per share).