1-Financial Management

Meaning Financial Management

Financial Management is a vital activity in any organization. It is the process of planning, organizing, controlling and monitoring financial resources with a view to achieve organizational goals and objectives. It is an ideal practice for controlling the financial activities of an organization such as procurement of funds, utilization of funds, accounting, payments, risk assessment and every other thing related to money.

Goals of Financial Management:

Goals of financial management should be so articulated as to help achieve the objective of wealth maximization and maximisation of profit pool. Financial goals may be stated as maximizing short-term profits and minimizing risks.

Profit maximization refers to the sales level where profits are highest. You might assume that the higher the sales level, the higher the profits - but that is not always true Wealth maximization is the concept of increasing the value of a business in order to increase the value of the shares held by stockholders. The concept requires a company's management team to continually search for the highest possible returns on funds invested in the business, while mitigating any associated risk of loss. This calls for a detailed analysis of the cash flows associated with each prospective investment, as well as constant attention to the strategic direction of the organization.

Scope of Financial Management

- Estimating the Requirement of Funds: Businesses make forecast on funds needed in both short run and long run, hence, they can improve the efficiency of funding. The estimation is based on the budget e.g. sales budget, production budget.
- Determining the Capital Structure: Capital structure is how a firm finances its overall operations and growth by using different sources of funds.[2] Once the requirement of funds has estimated, the financial manager should decide the mix of debt and equity and also types of debt.
- Investment Fund: A good investment plan can bring businesses huge returns.
- To ascertain maximum profit as well as maintain the core value of the organization

Functions of Financial Management

- Estimation of capital requirements: A finance manager has to make estimation with regards to capital requirements of the company. This will depend upon expected costs and profits and future programmes and policies of a concern. Estimations have to be made in an adequate manner which increases earning capacity of enterprise.
- Determination of capital composition: Once the estimation have been made, the capital structure have to be decided. This involves short- term and long- term debt equity analysis. This will depend upon the proportion of equity capital a company is possessing and additional funds which have to be raised from outside parties.
- Choice of sources of funds: For additional funds to be procured, a company has many choices like-
- Issue of shares and debentures
- Loans to be taken from banks and financial institutions
- Public deposits to be drawn like in form of bonds.
- Choice of factor will depend on relative merits and demerits of each source and period of financing.
- Investment of funds: The finance manager has to decide to allocate funds into profitable ventures so that there is safety on investment and regular returns is possible.

- Disposal of surplus: The net profits decision have to be made by the finance manager. This can be done in two ways:
- Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
- Retained profits - The volume has to be decided which will depend upon expansional, innovational, diversification plans of the company.
- Management of cash: Finance manager has to make decisions with regards to cash management. Cash is required for many purposes like payment of wages and salaries, payment of electricity and water bills, payment to creditors, meeting current liabilities, maintainance of enough stock, purchase of raw materials, etc.
- Financial controls: The finance manager has not only to plan, procure and utilize the funds but he also has to exercise control over finances. This can be done through many techniques like ratio analysis, financial forecasting, cost and profit control, etc.
- Financial planning is the task of determining how a business will afford to achieve its strategic goals and objectives. Usually, a company creates a Financial Plan immediately after the vision and objectives have been set. The Financial Plan describes each of the activities, resources, equipment and materials that are needed to achieve these objectives, as well as the timeframes involved.

Sound Financial Planning

(1) Simplicity:
A sound financial structure should provide simple financial structure which could be managed easily and understandable even to a layman. "Simplicity' is an essential sine qua non which helps the promoters and the management in acquiring the required amount of capital. It is also easy to work out a simple financial plan.
(2) Foresight:
Foresight must be used in planning the scope of operation in order that the needs for capital may be estimated as accurately as possible. A plan visualised without foresight spells disaster for the company, if it fails to meet the needs for both fixed and working capital. In simple words, the canon of foresight means that besides the needs of 'today' the requirements of 'tomorrow' should also be kept in view.
(3) Flexibility:
Financial readjustments become necessary often. The financial plan must be easily adaptable to them. There should be a degree of flexibility so that financial plan can be adopted with a minimum of delay to meet changing conditions in the future.
(4) Optimum use of funds:
Capital should not only be adequate but should also be productively employed. Financial plan should prevent wasteful use of capital, avoid idle capacity and ensure proper utilisation of funds to build up earning capacity of the enterprise.
There should be optimum utilisation of available financial resources. If this is not done, the profitability will decline. There should be a proper balance between the fixed capital and the working capital.
(5) Liquidity:
It means that a reasonable percentage of the current assets must be kept in the form of liquid cash. Cash is required to finance purchases, to pay salaries, wages and other incidental expenses. The degree of liquidity to be maintained is determined by the size of the company, its age, its credit status, the nature of its operations, the rate of turnover etc.
(6) Anticipation of contingencies:
The planners should visualise contingencies or emergency situations in designing their financial plan. This may lead to keeping of some surplus capital for meeting the unforeseen events. It would be better if these contingencies are anticipated in advance.
(7) Economy:
Last but not the least, the financial open be made in such a manner that the cost of capital procurement should be minimum. The capital mobilised should not impose disproportionate burden on the company.

Factors Affecting Financial Planning

Financial planning of a business is determined by the following factors:

(i)   Objectives. Objectives of financial planning should be consistent with the overall objectives of the business. The main objectives of financial planning are to raise funds at reasonable cost and utilize them in the best possible manner.

(i**i)   Requirements of the Enterprise.** A good financial plan should take care of the present and future requirements of the business. Provision of or various contingencies, replacement of assets, and growth and diversification of business enterprise must be made.

(iii)   Economy. Case of raising capital should be reasonable. Capital structure should be such as to create an appropriate balance between the cost of funds and the company's ability to pay.

(iv)   Solvency and Liquidity. The funds should be invested in those ventures which are likely to give sufficient return on investment. Moreover, adequate cash should always to available to meet the requirements of the enterprise. The enterprise should be solvent and liquid not only in the short-term but also in the long-term.

(v)   Flexibility. Financial planning should ensure flexibility allow the diversion of funds into more profitable channels. It should also make provision for raising of additional funds at a short notice.

(vi)   Optimum Capital Structure. There should be proper capitallsation of the company. An optimum mix of equity shares, preference shares and debentures should be kept in mid while raising funds form different resources.

FINANCIAL DECISION AND INVESTMENT DECISION

Financial Decision:

Capital structure of a company refers to the composition or makeup of its capitalisation and it includes all longterm capital resources i.e. loans, Reserves, shares, and bonds.

→ **Factors determining the capital structure**

1. Financial leverage
2. Growth & stability of Sales
3. Cost of Sales
4. Nature & size of the firm
5. Flexibility
6. Capital market condition
7. Legal requirement

EPS: Earning per share
EBIT: Earnings before interest and tax

Problems:

1) Determine the EPS [Earning per share] of a company, which has an earning before interest and tax [EBIT] of ₹2,00,000/-. Its capital structure consist of the following securitees.

10% debenture ₹6,00,000/-
12% preference share ₹2,00,000/-
E. share of ₹100/- each 5,00,000/-

The company is in the 50% tax. Determine the percentage change in EPS associated with 25% increase and 25% decrease in EBIT

→ **Given:**

EBIT = 200000
10% debentures : 600000
12% p. shares = 200000
E. share 100 each = 500000 (5000)
Tax = 50%
EBIT : ↑25%...↓25%.

→ Computation of earning per share

Particulars	Existing EBIT	Increase or	Decrease 25/.
Earnings before interest & tax [EBIT]	200000	250000	150000
(-) Interest (debenture)	(-) 60000	(-) 60000	(-) 60000
Earning before tax	140000	190000	90000
(-) Tax (50%)	(-) 70000	(-) 95000	(-) 45000
Earning after tax	70000	95000	45000
(-) Preference shares dividend	(-) 24000	(-) 24000	(-) 24000
Earning available to E.S holders	46000	71000	21000
EPS = $\frac{EAES}{No.\ of\ E.S}$	$\frac{46000}{5000}$ = 9.2	$\frac{71000}{5000}$ = 14.2	$\frac{21000}{5000}$ = 4.2

2) A company ltd has a share capital of ₹100000/- divided into e. share of ₹10/- each. It has major expansion program requiring an investment of another ₹50000/-. the management is considering the following alternative for raising this among.

Issue of 5000 e. share of ₹10/- each

Issue of 5000, 12% p. share of ₹10/- each

Issue of 10% debenture of ₹50000/-

The companies present EBIT is ₹30000/- per annum. You are required to calculate the effect of each of the above methods of financing on earnings per share.

EBIT Continues to be same even after expansion

EBIT increases by 10000

Assume Tax liability is 50%.

→ Equity share = 100000 of 10 (existing) = $\frac{100000}{10}$ = 10000

ES 5000 ₹10/-

$50000 \Big\langle$ PS 12% 5000 10/- EBIT = 30000

Deb 10% deb 50000

Analysis table

	I	II	III
E.S	150000	100000	100000
P.S	-	6000	-
Deb	-	-	5000
	150000	100000	100000
	10	10	10
	[15000]	[10000]	[10000]

Equity share	Preference share	Debenture
5000 @ 10/-	5000 @ 10/- (12%)	50000 (10%)
10000 + 5000 = 15000	= 10000	= 10000

when EBIT is 30000

Particulars	I (E.S)	II (P.S)	III [Deb]
EBIT	30000	30000	30000
(-) Interest (Deb) (50000×10%)	-	-	(-)5000
EBT	30000	30000	25000
(-) Tax (50%)	(-)15000	(-)15000	(-)12500
EAT	15000	15000	12500
(-) P.D (5000 × 10 × 12%)	-	(+)6000	-
Earning available to E.S holders	15000	9000	12500

EPS: $\dfrac{EAES}{No.\ of\ e.s\ holders}$ $\dfrac{15000}{15000}=1$ $\dfrac{9000}{10000}=0.9$ $\dfrac{12500}{10000}=1.2$

→ when EBIT is 40000

Particulars	I (E.S)	II (P.S)	III (Deb)
EBIT	40000	40000	40000
(-) Interest (Deb)	-	-	(-)5000
EBT	40000	40000	35000
(-) Tax (50%)	(-)20000	(-)20000	(-)17500
EAT	20000	20000	17500
(-) P.D (5000 × 10 × 12%)	-	6000	-
Earning available for E-s holders	20000	14000	17500

EPS: $\dfrac{EAES}{No.\ of\ share\ holders}$ $\dfrac{20000}{15000}=1.33$ $\dfrac{14000}{10000}=1.4$ $\dfrac{17500}{10000}=1.75$

③ ABC Co., ltd has currently an all e.share consisting of 15000 e.share of ₹100/- each. The management is planning to raise another 25 lakh rupees to finance a major program of expansion and is considering 3 alternative method of financing.

(i) To issue 25000 e.s of ₹100/- each.

(ii) To issue 25000, 8% debenture of ₹100/- each.

(iii) To issue 25000, 8% p.share of ₹100/- each.

The co...s expected EBIT will be ₹800000/- , assuming tax rate is 50%. Determine the EPS in each alternative and comment which alternative is best and why?

→ [15000 (E.S) ₹100/-] = 15,00,000

2500,000 ⟶ 25000 e.s (₹100/-)
25000 8% deb (₹100/5)
25000 8% p. share (₹100/-)

Analysis Table

	I	II	III
E. share	4000000	1500000	1500000
P. share	—	—	2500000
Debenture	—	2500000	—
	$\frac{4000000}{100}$	$\frac{1500000}{100}$	$\frac{1500000}{100}$
	= 40000	= 15000	= 15000

Calculation of EPS

Particulars	I E.S	II Deb	III P.S
EBIT	800000	800000	800000
(-) Interest (Deb) (25000×100×8%)	—	200000	—
EBT	800000	600000	800000
(-) Tax (50%)	400000	300000	400000
EAT	400000	300000	400000
(-) P.D	—	—	200000
Earnings available to E.S holders	400000	300000	200000
EPS: $\frac{EAES}{No.\ of\ E.S}$	$\frac{400000}{40000}=10$	$\frac{300000}{15000}=20$	$\frac{200000}{15000}=13.33$

Conclusion :

2nd alternative is considered to be the best alternative because EPS is more when compared to the other 2 alternatives.
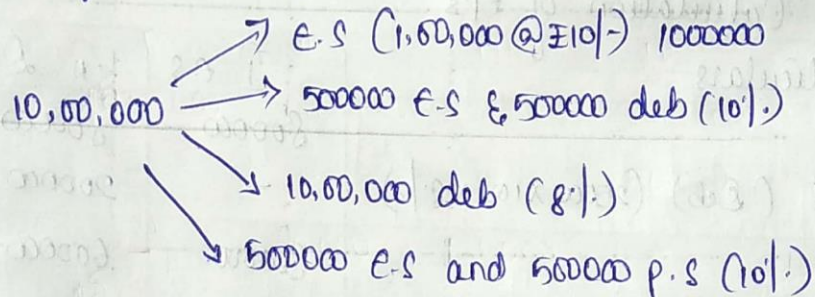
(2) X ltd capitalised with ₹ 10,00,000/- divided into 1,00,0...
e. share of ₹10/- each. The management desire to raise
another 10,00,000 rupees to finance a major expansion prog...
there are 4 possible financing plan.
(i) All e. share
(ii) 500000 of e. share and 500000 in debenture carrying 10%.
interest
(iii) All debenture carrying 8% interest
(iv) 500000 of e. share and 500000 in p. share carrying 10% is divid...

The existing EBIT amled to rupees 190000/annum. You are
required to calculate EPS under each of the above 4 financi...
plan. assuming tax rate of 50%.

Calculate the EPS if on amount of expansion the level of
EBIT is doubled.

→ (1,00,000 of ₹10/- e.s) = 1000,000

10,00,000 →
- E.S (1,00,000 @ ₹10/-) 1000000
- 500000 E.S & 500000 deb (10%)
- 10,00,000 deb (8%)
- 500000 e.s and 500000 p.s (10%)

Analysis Table

	(i)	(ii)	(iii)	(iv)
E. share	2000000	1500000	1000000	1500000
P. share	—	—	—	500000 (10%)
Debenture	—	500000 (10%)	1000000 (8%)	—
	2000000	1500000	1000000	1500000
	10	10	10	10
	= 200000	= 150000	= 100000	= 150000

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→ Calculation of EPS in

Particulars	I	II	III	IV
EBIT	120000	120000	120000	120000
(-) Interest (deb)	-	(-)50000	(-) 80000	-
EBT	120000	70000	40000	120000
(-) Tax (50%)	(-) 60000	(-) 35000	(-) 20000	(-) 60000
EAT	60000	35000	20000	60000
(-) P.D	-	-	-	(-) 50000
EAES	60000	35000	20000	10000
EPS = $\frac{EAES}{No.\ of\ E.S}$	$\frac{60000}{200000}$	$\frac{35000}{150000}$	$\frac{20000}{100000}$	$\frac{10000}{150000}$
	= 0.3	= 0.233	= 0.2	= 0.067

→ Calculation of EPS when EBIT is doubled

120000 + 120000 = 240000

Particulars	I	II	III	IV
EBIT	240000	240000	240000	240000
(-) Interest (deb)	-	(-)50000	(-) 80000	-
EBT	240000	190000	160000	240000
(-) Tax (50%)	(-) 20000	(-) 95000	(-) 80000	(-) 120000
EAT	120000	95000	80000	120000
(-) P.D	-	-	-	(-) 50000
EAES	120000	95000	80000	70000
EPS = $\frac{EAES}{No.\ of\ E.S}$	$\frac{120000}{200000}$	$\frac{95000}{150000}$	$\frac{80000}{100000}$	$\frac{70000}{150000}$
	= 0.6	= 0.63	= 0.8	= 0.47

⑤ Excellent ltd has currently e-share capital of ₹2500000/- consisting of 25000 shares of 100 each. The management is planning to raise another 20,00,000 rupees to finance a major program of expansion through one after 4 possible financial plan. the options are

i) All through e-share

ii) ₹10,00,000/- through e.s & ₹1000000 through debenture a 8% interest / annum.

(iii) ₹500000/- through e·s and ₹1500000/- through longterm borrowing (debenture) at 9% int /annum.

(iv) ₹10,00,000/- through o·s and ₹10,00,000/- through p·s with 5% dividend.

The co.'s expected earnings before int & tax will be EBIT= 800000/- assuming a tax rate of 50%, determine EPS in each alternative & comment which alternative is best & why.

→ 25,00,000 E·S. (25000 at ₹100/-) = 25,00,000

20,00,000
 ├ 2000000
 ├ 10,00,000 ES & 10,00,000 deb (8%)
 ├ 500000 E·S & 1500000 deb (9%)
 └ 10,00,000 E·S & 10,00,000 P·S (5%)

Analysis table

	I	II	III	IV
E. S	45,00,000	35,00,000	30,00,000	35,00,000
P. S	—	—	—	50,000
Debenture	—	80,000	135000	—
	45,00,000	35,00,000	30,00,000	35,00,000
	100	100	100	100
	= 45,000	= 35000	= 30000	= 35000

Calculation of EPS

Particulars	I	II	III	IV
EBIT	800000	800000	800000	800000
(−) Interest (deb)	—	(−)80000	(−)135000	—
EBT	800000	720000	665000	800000
(−) Tax (50%)	400000	360000	332500	400000
EAT	400000	360000	332500	400000
(−) P.D	—	—	—	50000
EAES	400000	360000	332500	350000
EPS = $\frac{EAES}{No. \, of \, e·s}$	$\frac{400000}{45000}$	$\frac{360000}{35000}$	$\frac{332500}{30000}$	$\frac{350000}{35000}$
	= 8.89	10.29	11.083	10

Conclusion:

3rd alternative is considered to be best alternative because EPS is more when compared to the other three alternatives.

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⑥ A newly established company wishes to determine an appropriate capital structure. It can issue 12% deb and 10% preference capital and the existing tax rate is 35%. The co. requires 50,00,000/-. The possible capital structure -

Plan	debenture	P. share	E. capital	
1	0	0	100%.	50,00,000/100 = 50000
2	30%.	0	70%.	35,00,000/100 = 35000
3	30%.	20%.	50%.	25,00,000/100 = 25000
4	50%.	0	50%.	25,00,000/100 = 25000
5	50%.	20%.	30%.	15,00,000/100 = 15000

Deb = 12%.
P S = 10%.
Tax = 35%.

The EBIT is 12%. Calculate EPS assuming that the face value per E. share is 100/-.

→ Calculation of EPS

Particulars	I	II	III	IV	V
EBIT	600000	600000	600000	600000	600000
(−) Interest (deb)	—	1,80,000	1,80,000	300000	300000
EBT	600000	420000	420000	300000	300000
(−) Tax (35%)	210000	2,14,4000 2144000	2,144000	105000	105000
EAT	390000	273000	273000	195000	195000
(−) P.D	—	—	100000	—	100000
EAES	390000	273000	173000	195000	95000
EPS = EAES/No. of E.S	390000/50000	273000/35000	173000/25000	195000/25000	95000/15000
	3900 7.8	2730 7.8	1730 6.92	1950 7.8	850 6.33

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④ Firm X and Y are the idential except that firm is not levered by. firm Y is levered. the following data relating to them

Particulars	Firm X	Firm Y
Assets	500000	500000
Debt Capital	—	250000 (9% int)
E.S. capital	500000	250000
No. of shares	500000	25000
Rate of written on Asset [EBIT]	20%	20%

Calculate EPS for both the firm assuming tax rate is 50%. will it be advantageous to firm Y to raise the level of debt by 75%.

→ Calculation of EPS   Extra adjustment

Particulars	'Y' debenture increase by 75%	X	Y
EBIT	100000	100000	100000
(-) Interest (deb)	(600000×75%×9%) (-) 33750	(-) —	(-)22500
EBT	66250	100000	77500
(-) Tax (50%)	(-) 33125	(-) 50000	(-)38750
EAT	33125	50000	38750
(-) P.D	—	—	—
EAES	33125	50000	38750
EPS = EAES / No. of shares	$\frac{33125}{12500}$ = 2.65	$\frac{50000}{50000}$ = 1	$\frac{38750}{25000}$ = 1.55

500000 { 75% deb
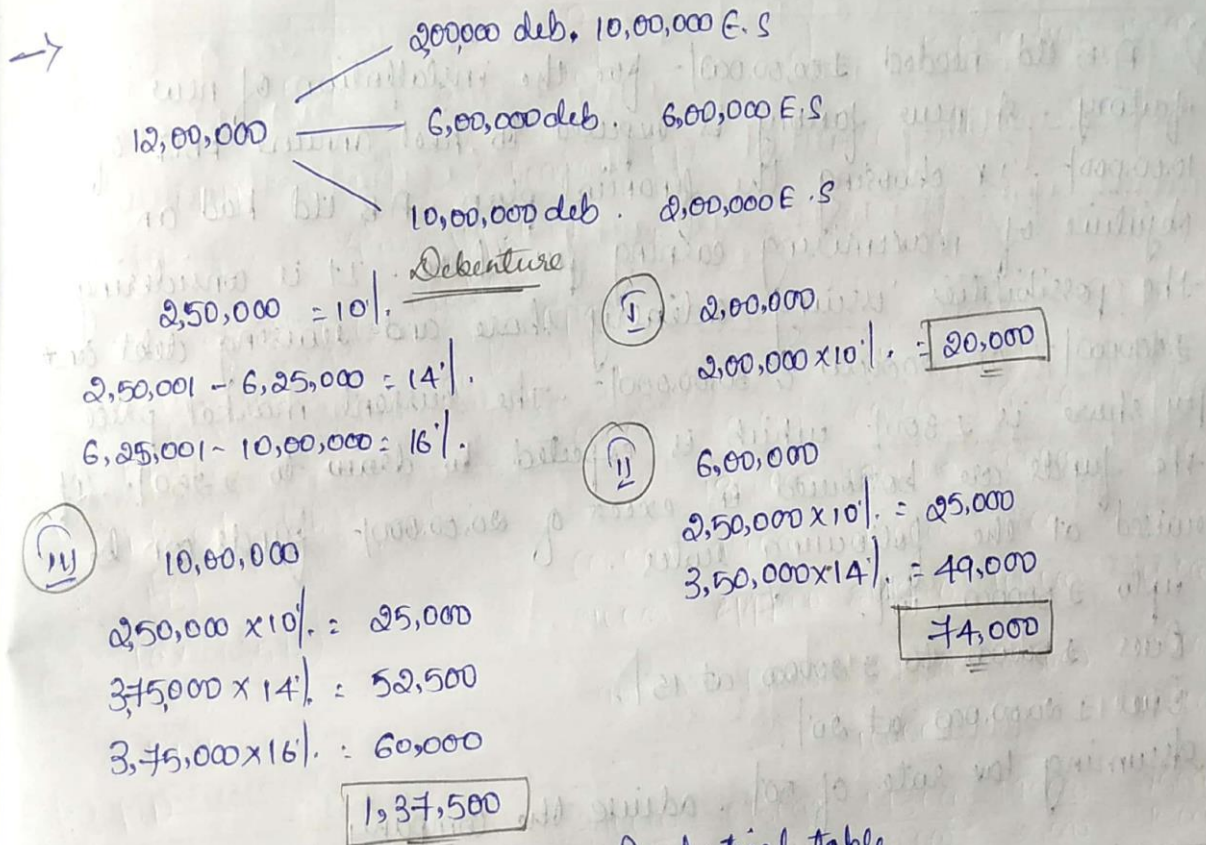   25% ES = 125000 ÷ 12500
                    10

→ Conclusion: It is advantageous to firm Y to raise the debt financing to 75%. because it increases the EPS from ₹1.55/- to ₹2.65/-.

⑧ A company needs ₹12,00,000/- for installation of new factory, which would yield an annual EBIT of ₹8,00,000/-. The company has a objective of maximizing the EPS. It is considering the possibility of issuing e-shares **plus** raising debt of ₹2,00,000/- or ₹6,00,000/- or ₹10,00,000. The current market price p. share is ₹40/-, which is expected to draw to ₹25/- p. share. If the market borrowing where to exceed ₹7,50,000/-. Cost of borrowing is indicated as under.

Upto ₹2,50,000/- @ 10% p.a
₹2,50,001/- - ₹6,25,000/- @ 14% p.a
₹6,25,001/- - ₹10,00,000/- @ 16% p.a

Assuming a tax rate of 50%, workout the EPS and scheme which could meet the objective of the management.

→

12,00,000
- 2,00,000 deb. 10,00,000 E.S
- 6,00,000 deb. 6,00,000 E.S
- 10,00,000 deb. 2,00,000 E.S

Debenture

2,50,000 = 10%
2,50,001 - 6,25,000 = 14%
6,25,001 - 10,00,000 = 16%

Ⓘ 2,00,000
2,00,000 × 10% = 20,000

Ⓘ 6,00,000
2,50,000 × 10% = 25,000
3,50,000 × 14% = 49,000
74,000

Ⓘ 10,00,000
2,50,000 × 10% = 25,000
3,75,000 × 14% = 52,500
3,75,000 × 16% = 60,000
1,37,500

Calculation of EBIT Analytical table

Particulars	Ⓘ	Ⓘ	Ⓘ
E.S.	10,00,000	6,00,000	2,00,000
Deb	2,00,000	6,00,000	10,00,000
No. of ES.	$\dfrac{10,00,000}{40}$	$\dfrac{6,00,000}{40}$	$\dfrac{2,00,000}{25}$
	= 25000	= 15000	= 8000

Calculation of EBIT

Particulars	I	II	III
EBIT	2,00,000	2,00,000	2,00,000
(−) Interest (deb)	(−)20000	(−)74000	(−)137500
EBT	1,80,000	1,26,000	62,500
(−) Tax (50%)	(−) 90,000	(−) 63000	(−) 31250
EAT	90,000	63,000	31,250
(−) P.D	—	—	—
EAES	90,000	63,000	31,250
EPS = $\dfrac{EAES}{No.\ of\ shares}$	$\dfrac{90,000}{25000} = 3.6$	$\dfrac{63000}{15000} = 4.2$	$\dfrac{31250}{8000} = 3.9$

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(9) A.B ltd needed ₹50,00,000/- for the installation of new factory, A new factory is expected to heel annual EBIT of 10,00,000/-. In choosing the financial plan. AB ltd had an objective of maximising earning per share. It is considering the possibilities using ordinary share and raising debt and ₹500000/- on 20,00,000 & 30,00,000/-. The current market price per share is ₹300/- which is expected to draw to ₹250/-. If the funds are borrowed in excess of 20,00,000/- funds can be raised at the following rates.

upto ₹500000 . 10%.
Over ₹500000 to ₹200000 at 15%.
Over ₹20,00,000 at 20%.

Assuming tax rate of 50%. advise the company.

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                      ┌─── 500000 (deb), 4500000 (ES)
                      │
5,00,000 ─────────────┼─── 20,00,000 (deb), 30,00,000 (ES)
                      │
                      └─── 30,00,000 (deb), 20,00,000 (ES)
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500000 × 10%
500000 − 200000 → 15%.
200000 → 20%.

10,00,000 x 10%.

Ⅰ 500000 x 10% : 50000

Ⅱ 20,00,000

500000 x 10%. : 50000
15,00,000 x 15% = 225000
———————
245000

Ⅲ 30,00,000

500000 x 10%. : 50000
1500000 x 15%. : 225000
1,00,000 x 20%. : 200000
———————
475000

Analysis Table.

Particulars	Ⅰ	Ⅱ	Ⅲ
Equity share	45,00,000	30,00,000	20,00,000
Debenture	5,00,000	20,00,000	30,00,000
No. of equity share	$\dfrac{45,00,000}{300}$	$\dfrac{30,00,000}{300}$	$\dfrac{20,00,000}{250}$
	= 15,000	= 10,000	3000

Calculation of EPS

Particulars	Ⅰ	Ⅱ	Ⅲ
EBIT	10,00,000	10,00,000	10,00,000
(−) Interest (deb)	50,000	2,75,000	4,75,000
EBT	950000	725000	525000
(−) Tax (50%)	475000	362500	262500
EAT	475000	362500	262500
P.D	—	—	—
EPS = $\dfrac{EABS}{No. \ of \ shares}$	$\dfrac{475000}{15000}$	$\dfrac{362500}{10000}$	$\dfrac{262500}{8000}$
	= 31.67	36.25	32.81

(10) A companies capital structure consists of the following.
equity share of ₹100/- each . ₹20,00,000/- retained earnings₹10l
9%. preference share ₹12,00,000/-
7%. debentures ₹8 lakh
Total 50,00,000/-.

The company earns 12%. on its capital. The income tax rate is 50%
You are require to a sum of 25,00,000/- to finance its expansion
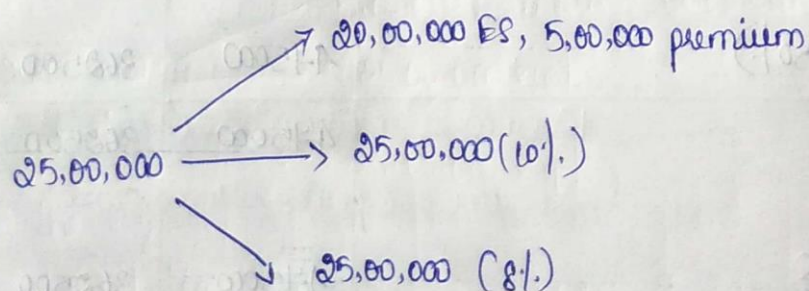Program for which The following alternative are able to it

a) Issue of 20000 e.s at a premium of ₹25/- per share.
b) Issue of 10%. preference share.
c) Issue of 8%. debentures.

It is estimated that P.E ratio in the cases of equity,
Preference and debenture financing would be 21.4, 17 and
15.7 respectively. which of the 3 financial alternative
would you recommend and why?

→ ES : 20,00,000
   RE : 10,00,000
9%. P.S : 12,00,000
7%. deb : 8,00,000
Extra : 25,00,000
_____
   75,00,000 × 12%.

⟨EBIT = 900000⟩

                    ↗ 20,00,000 ES, 5,00,000 premium
   25,00,000 ——→ 25,00,000 (10%.)
                    ↘ 25,00,000 (8%.)

P.E Ratio : 21.4 , 17 , 15.7

Analytical table

Particulars	I	II	III
E.S	40,00,000	20,00,000	20,00,000
Premium	5,00,000	—	—
P.S (9%)	12,00,000	12,00,000	12,00,000
Raised P.S (10%)	—	25,00,000	—
RE	10,00,000	10,00,000	10,00,000
Deb (7%)	8,00,000	8,00,000	8,00,000
Raised	—	—	25,00,000

Calculation of EPS

Particulars	I	II	III
EBIT	9,00,000	9,00,000	9,00,000
(−) Interest (deb)	(−)56,000	(−)56,000	(−)2,56,
EBT	8,44,000	8,44,000	6,44,0
(−) Tax	(−)4,22,000	(−)4,22,000	(−)3,22,
EAT	4,22,000	4,22,000	3,22,0
(−) P.D	(−)1,08,000	(−)3,58,000	(−)1,08
EAES	$\dfrac{3,14,000}{40,000}$	$\dfrac{64,000}{20,000}$	$\dfrac{2,14,}{20,00}$
EPS: $\dfrac{EAES}{No.\ of\ shares}$ EPS	=7.84	=3.2	=10.
PE ratio	21.4	17	15.
market price per share (EPS×PE)	168	54	168

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⑪ The existing capital structure of ABC Ltd is as follows.
ⓘ E. share of ₹100/- each ₹40,00,000/- ⓘⓘ Retained earnings ₹10,00,000/-.
ⓘⓘⓘ9%. p. share ₹25,00,000/- ⓘⱽ7% debenture ₹25,00,000/-.
The co. earns 12% of its capitals. The income tax rate is 50%.
The co. requires a sum of ₹25,00,000/- to finance its expansion
project for which the following alternatives are available
to it.

(i) Issue of 20000 e-share at a premium of ₹25/- p/share.
(ii) Issue of 10% p. share.
(iii) Issue of 9% deb

→ (profit earning)
Projected that the PE ratio in the case of equity, preference
and deb. financing would be 20, 17, 16 resp...
which of the 3 financing alternative would you recommend and
why?

→ ₹100. E. share   —   40,00,000
        R.E   —   10,00,000
     9%. p. share   —   25,00,000   EBIT — 12%.
     7%. debenture   —   25,00,000   Income tax — 50%.
        Required   —   25,00,000
                          _____
                          1,25,00,000 × 12%.

       EBIT = 1500,000

                          ┌ 5,00,000 premium, 60,00,000 e share
        25,00,000 ─────< (25,00,000 × 10%.)
                          └ (25,00,000 × 9%.)

       Profit earning ratio = 20, 17, 16

Analytical table

Particulars	I	II	IV
E. share	60,00,000	40,00,000	40,00,000
Premium	5,00,000	—	—
R.E	10,00,000	10,00,000	10,00,000
P.S (9%)	25,00,000	25,00,000	25,00,000
New P.S (10%)	—	25,00,000	—
Deb (7%)	25,00,000	25,00,000	25,00,000
New Deb (9%)	—	—	25,00,000
	$\frac{60,00,000}{100}$	$\frac{40,00,000}{100}$	$\frac{40,00,000}{100}$
No. of shares	60000	40000	40000

deb = 25,00,000 × 7% = 175000
25,00,000 × 9% = 225000

(i) Calculation of EPS

Particulars	I	II	IV
EBIT	1500000	1500000	1500000
(−) Interest (deb)	(−)175000	(−)175000	(−)400000
EBT	1325000	1325000	1100000
(−) Tax (50%)	(−)662500	(−)662500	(−)550000
EAT	662500	662500	550000
(−) P.D	(−) 225000	(−) 475000	(−) 225000
EAES	437500	1875000	325000
EPS = $\frac{EAES}{No. \ of \ shares}$	$\frac{437500}{60000}$	$\frac{1875000}{40000}$	$\frac{325000}{40000}$
	7.29	4.69	8.13
PE ratio	20	17	16
market price shares (EPS × PE ratio)	145.8	79.73	130.08
	146	80	130

Conclusion: If the objective is to maximize eps 3rd alternative is best. If the objective is to increase the m.p/share then 1st alternative is the best.

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