

Cost of Capital & Capital Structure

Q1. Capital Structure of a company is as follow

Equity (20000 shares , face value 100Rs.)	20 lakh
10% Preference (100Rs.)	8 Lakh
12% Debenture (1000 Rs.)	12 Lakh

Current market price of equity share is Rs. 110 , expected dividend is Rs.10 per share and growth rate is 6%.

- (i) Calculate the Cost of Capital , if tax rate is 30% (4 Marks)
- (ii) Company requires 20 lakh Rs. and wants to borrow at 15% interest. Due to this expected dividend will increase to Rs.12 per share and market price is likely to decrease to Rs.105. Calculate the revised cost of capital after expansion. (4 Marks)

Q2. A company has 30% debt and 70% equity in its capital structure and wants to remain the same. The company is considering various investment proposal which cost less than Rs.30 Lakh.

The cost of raising the debt and equity are as under :

Project cost	Interest Rate	Cost of Equity
Upto 5 Lakh	9%	13%
Above Rs. 5 Lakh & upto Rs. 20 Lakh	10%	14%
Above Rs. 20 Lakh & upto Rs. 30 Lakh	11%	15%

If tax rate is 30% then calculate the cost of capital for each option. (5 Marks)

Q3. Q1. The Capital Employed required for a project is Rs. 80,00,000. There are two option for capital structure

	Option I	Option II
Equity Share Capital	40,00,000	25,00,000
14% Debt	25,00,000	30,00,000
15% Preference	15,00,000	25,00,000

Calculate the Indifference point between option I & II (3 Marks)

Calculate Financial break even point of both the options (4 Marks)

Q4. A company earns a profit of Rs. 3,00,000 per annum after meeting its interest liability of Rs.1,20,000 on 12% Debentures. The tax Rate is 50%. The Number of Equity Shares of Rs.10 each are 80,000 and the Retained earnings amount to Rs. 12,00,000. The Company Proposes to take up an expansion scheme or which a sum of Rs.4,00,000 is required. It is anticipated that after expansion the company will be able to achieve the same return on investment as at present. The Funds required for expansion can be raised either through Debt @ 12% or by issuing Equity Shares at par.

Required :

- (i) Compute the EPS under both the options
- (ii) Advise the company as to which source of finance is preferable (8 Marks)