A Study on Impact of Capital Structure on EBIT-EPS of KDMPMACU Limited

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Abstract: **This study examines the impact of capital structure on the performance of the company. It is measured using EBIT-EPS analysis. In this paper an attempt is made to analyze the capital structure of KDMPMACU Limited during the period 2011-12 to 2015-2016, so as to understand the factors that influenced the capital structure decisions of the company and to know the impact of capital structure decisions on profitability and performance of the company. The company's performance is measured through BIT-EPS analysis. Increase in the level of debt and net worth increases the debt equity ratio. Capital structure is the crucial decision to be taken by every business, the positives and negatives of these decisions plays an important role in determining the future of every business.**

In this paper, researchers try to quantify the effect of Operating Income or Earning before Income and Taxes (EBIT) & simultaneously the effects of Earning per Share (EPS) on shareholder wealth.

Keywords: **Capital Structure, Earnings before Interest Tax (EBIT), Earnings per Share (EPS), Earning after Tax (EAT).**

I. INTRODUCTION

Capital structure is that part of financial structure which represents combination of long-term sources of funds used to raise the capital required by the company. Normally the sources include Equity, Preference, and Debt Sources. This combination or mix influences the overall cost of capital. Normally capital structure will be the mix of equity and debt. The proportion of this equity and debt to the total capital is decided by the company according to the financial position and ability to raise such capital. The decision regarding the capital structure is very important because it affects the earnings per share or wealth of the shareholders.

Capital structure is the crucial decision to be taken by every business, the positives and negatives of these decisions plays an important role in determining the future of every business. The modern theory of capital structure was established by Modigliani and Miller (1958).

According to Myers (2001, p. 81), 'there is no universal theory of the debt--equity choice, and no reason to expect one'. Many proven theories about capital structure help us to understand about the debt equity mix that the firms choose.

These theories can be divided into two groups – either they predict the existence of the optimal debt-equity ratio for each firm (so-called static trade-off models) or they declare that there is no well-defined target capital structure (pecking-order hypothesis).Static trade-off models understand the optimal capital structure as an optimal solution of a trade-off, for example the trade-off between a tax shield and the costs of financial distress in the case of trade-off theory.

According to this theory the optimal capital structure is achieved when the marginal present value of the tax shield on additional debits equal to the marginal present value of the costs of financial distress on additional debt. On the other hand, the pecking-order theory suggests that there is no optimal capital structure. Firms are supposed to prefer internal financing (retained earnings) to external funds. And when the internal funds are inadequate, the firms may opt for debt instead of equity.

Therefore there is no well-defined optimal leverage, because there are two kinds of equity, internal and external, one at the top of the pecking order and one at the bottom. Thus, several conditional theories of capital structure exist but very little is known about their empirical relevance. Capital structure decision is one of the key decisions to be undertaken by every company at the time of raising their capital. Poor decisions would result in adverse effects. Many firms which are financially healthy have lost because of poor decisions. This paper focuses on the capital structure of the company during 2012 to 2016 and will examine the results of various capital structures.

II. EBIT-EPS ANALYSIS

EBIT-EPS analysis is a very strong and important tool in the hands of the finance manager. This is an alternative technique to measure the impact of financial leverage on the returns available to equity shareholders. Under EBIT-EPS analysis, an attempt is made to analyse the impact of change in the capital structure (Debt) on earnings available to equity shareholders. Thus, EBIT-EPS analysis shows the relationship between *EBIT and EPS of KDMPMACU* Ltd for a period of five years (2012-2016).

III. REVIEW OF LITERATURE

Ramachandra Gowda. (2006) examined the debt equity and EPS trends in the diversified companies. The sample for the study was selected from different industries viz., pharmaceutical, consumer goods, cement and fabric. The analysis suggests that in the diversified companies, debt is not used properly for the purpose of increasing the earnings to shareholders.

The companies are looking 34 forward for employing trading on equity. The regression analysis also suggests that the change in the EPS is not only due to the debt equity factors. There are certain other variables which have an impact on the EPS of the firms.

Veni and Narayana (2002) examined the leverage position of firms to know the impact of fixed charges on EBIT and EPS. They also analysed the capital structure policies and dividend policies and its impact on market price per share. They found that there is no considerable relationship between leverage and EPS. They concluded that fluctuations in the market price of the share influences the capital structure decisions and dividend decisions to some extent.

IV. NEED FOR THE STUDY

EBIT-EPS Analysis It is one of the business objectives of financial management to design an appropriate capital structure which can provide the highest EPS over the firm's expected range of EBIT. EPS is a yard stick to evaluate the firm's performance for the investors. The level of EBIT varies from year to year shows how successful the firm's operation is. EBIT-EPS approach is an important tool for designing the optimal capital structure framework of the firm. EBIT-EPS analysis is widely used by finance manager because it provides a simple picture of the consequences of alternative financing methods. This approach is helpful to analyse the impact of debt on EPS and Shareholders Wealth.

V. OBJECTIVES OF THE STUDY

- To study the capital structure of the firm during the study period
- To study the impact of capital structure on EBIT-EPS of KDMPMACU Ltd
- To study the influence of capital structure on shareholders wealth maximisation.

VI. RESEARCH DESIGN

6.1 Period of Study:

- The study period for the research is considered of 05 years starting from 2011-12to 2015-16.

6.2 Source of Data:

- Secondary data is used for the study. The financial statements of KDMPMACU Limited for the 05 years.

6.3 Tools of Analysis:

- To assess the impact of 'Capital Structure' (Debt-Equity) on earnings and EPS of KDMPMACU Limited Ltd during the study period of 2012 to2016, mainly EBIT-EPS analysis is used to analyze the data.

VII. ANALYSIS & INTERPRETATION

7.1 Debt- Equity capital:

The KDMPMACU Limited has an authorized capital of Rs.10, 00, 00,000/-(50,000 Shares of Rs.2000 each),Paid up capital is Rs.4, 98, 12,000/-(24,906shares of Rs.2000 each)from the year 2011-12 to2015-2016,

The company does not issued any further equity shares during the study period. Thus During 2011-2012 and 2015- 2016 there was no change in the equity capital. But whereas the company raised its long term debt from NDDB Anand and other long term liabilities contentiously from 2012-2013 & 2013-2014 heavily. This results increase of debt burden to the company reduces liquidity position and also long-term solvency position. Higher payment interest reduces EBT but helps to reduces taxes and to increase Earnings available to shareholders & EPS of the company (wealth maximisation also) normally.

When the Debt burden increases that results the net worth of the company also decreased over the years. This shows the company is not getting benefitted through the increased debt capital .In the year 2014-15 & 2015-16 the company reduced its debt but it is also over the equity capital. The debt-equity ratio of the company is not satisfactory from 2012-13 onwards as compared to standard ratio of **0.5:1**.

The Debt- Equity (capital structure) of the company during the study period is presented in the following table.

Table 1 "Table Representing Debt-Equity of KDMPMACU Ltd (2012-2016)''

Year	Debt Capital	Equity Capital	Ratio
2011-2012	Rs. 86,49,313.11/-	Rs.4, 98, 12,000/-	0.17:1
2012-2013	Rs. 22,70,27,102/-	Rs.4, 98, 12,000/-	4.56:1
2013-2014	Rs. 21,74,37,216/-	Rs.4, 98, 12,000/-	4.36:1
2014-2015	Rs. 5,98,61,849/-	Rs.4, 98, 12,000/-	1.20:1
2015-2016	Rs. 7,25,76,556/-	Rs.4, 98, 12,000/-	1.45:1

Source of data: Annual Reports of KDMPMACU Ltd.

Note: Debt includes loan from NDDB anand & other long term Borrowings

Table 2 CALCALATION OF **EPS** OF "KDMPMACU" LTD (2012-2016)

Particulars	2011-12	2012-13	2013-14	2014-15	2015-16
EBIT(Rs.)	4,10,57,993.70	4,26,32,704.26	9,38,05,781	16,98,75,273	17,49,02,199
LESS: Interest	65,62,135.00	1,011,6983.94	84,48,292.0	74,42,764.00	1,47,72,275
EBT	3,44,95,858.70	3,25,15,720.30	8,53,57,489	16,24,32,509	16,01,29,924
LESS: Tax	39,42,888.59	1,60,6026.00	3,06,68,943	5,44,54,202	4,83,66,827
EAT	3,055,2970.10	3,090,9694.30	5,46,88,546	10,79,78,307	11,17,63,097
LESS: Dividend	Nil	Nil	6,22,650.00	24,90,600.00	24,90,600.00
Earnings Available to Shareholders	30,55,2970.10	3,090,9694.30	5,40,65,896	10,54,87,707	10,92,72,497
No of shares	**24,906**	**24,906**	**24,906**	**24,906**	**24,906**
EPS (Rs.)	**1,226.7313**	**1,241.054**	**2,170.798**	**4,235.26**	**4,387.396**

Source of data: Computed from balance sheet and Profit and Loss A/C Statements of KDMPMACU Ltd (2012-2016).

$$\textit{EPS} = \frac{\textit{Earnings Available to Shareholders}}{\textit{No of Shares Outstanding}}$$

Table 3 ***Table Showing "EBIT-EPS''***

Years	EBIT(Rs.)	EPS(Rs.)
2011-12	**4,10,57,993.70**	**1,226.73**
2012-13	**4,26,32,704.26**	**1,241.05**
2013-14	**9,38,05,781.00**	**2,170.79**
2014-15	**16,98,75,273.0**	**4,235.26**
2015-16	**17,49,02,199.0**	**4,387.39**

VIII. FACTORS RESPONSIBLE FOR INCREASE OF EPS OF KDMPMACU LTD

- The major factor for increase of EPS during the years 2014 & 2015 is huge increase of sales revenue and that results increase of earnings before interest and tax (EBIT).
- EPS of the company increased majorly due to payment of interest and taxes but debt burden is very high.
- The company improved its sales revenue through sale of bye products and overcoming the competition and by introducing new products.

IX. MAJOR FINDINGS

- Debt capital of the company increased heavily in the years 2012-13 & 2013-14 it is not good for the company liquidity position.
- Increase of debt also results high interest payment and also interest rate risk.
- The company paid high tax amount during the years 2013-14,2014-15 & 2015-2016
- EPS is increased throughout the study period as result of increase in the earnings of the company only.
- Comparatively in the recent years company has reduced its debt burden but where as it is also very high as compared to equity capital.
- In the year 2013-14 onwards company is paying dividend to its shareholders.

X. SUGGESTIONS

The Company has the following good opportunities to utilise its sources to overcome its debt burden and to form the optimum capital structure for their shareholders wealth maximization.

- The company can use its dividends either fully or partially for payment of short-term loans by the issue of bonus shares to its shareholders instead of payment of dividend.
- The company is getting higher EPS in the recent years. If the company can use its EPS either fully or partially to raise the capital by Right Issue that can balance Debt and Equity (for optimum capital structure) and also reduce debt burden.

- The company has also try to reduce tax obligations in the future.
- The company should also maintain sufficient reserves and surpluses for future business events and uncertain outcomes.

XI. CONCLUSION

The debt equity ratio of the company is very high suggesting that high amount of debt in the capital structure indicates debt burden, which is not good for the owners wealth and also results low liquidity position. And it had reduced the owner's fund and confidence as the risk of the equity holder's increase with an increase in loans, also results the value of the company can decreases. Thus is suggested to company to issue partially or fully right Equity shares to raise owner's funds, to reduce debt proportion and to maintain optimum capital structure for shareholders wealth and it will have positive effect in its future business.

The EPS of the company is increasing from the beginning onwards due to increase in EBIT only but the capital structure is not good even though the company reduced its debt from Rs.22crores to Rs.7crores.It is suggested that the company has to maintain a standard Debt-Equity Ratio of **0.5:1** for balancing of its liquidity and solvency.

The debt burden results and heavily impact on the management future decisions and Capital Structure position, net worth and also shareholders wealth in future. If the company sales revenue may falls that results decrease in EBIT- EPS of the company. Because at present EPS majorly resulted from only earnings of the company.

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