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IMPACT ON EARNING PER SHARE (EPS)-A study with special reference to Ucal Polymer Industries Limited

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Abstract

Financing decision refers to the selection of appropriate financing-mix and so it relates to the capital structure or leverage. Capital structure refers to the proportion of long- term debt capital and equity capital required to finance investment proposal. There should be an optimum capital structure, which can be attained by the judicious exercise of financial leverage. This study mainly concentrates on the exercise of leverage in the context understanding its impact on earnings per share.

The purpose behind this study is to bridge the gap between theoretical and practical aspects. **UCAL** could not enjoy the benefit of accepted leverage theorem. Rather it accrued the benefit of EPS through the reverse operation of leverage. So leverage theorem is not a general rule. The dividend policy of the company is conservative. The company has been maintaining a decrease trend in the dividend payout. The company was enabling to maximize the EPS by reverse operation of financial leverage. The company successfully pulled down the degree of financial leverage to reap the EPS advantage.

Introduction

Liberalization, globalization and privatization are the important issues to the entrepreneur and corporate threatening the existence of a firm. In such a complex corporate environment, it is the challenge to the finance manager to survive the firm in long- run perspective with the objective of maximizing the owner's wealth. With a view to achieve this objective, finance manager is required to pay his due attention on investment decision, financing decision and dividend decision. Assuming that sound investment policy and opportunity are there, it is my intention in this paper to optimize the financing decision and dividend decision in the context of achieving the stated objective.

Financing decision refers to the selection of appropriate financing-mix and so it relates to the capital structure or leverage. Capital structure refers to the proportion of long- term debt capital and equity capital required to finance investment proposal. There should be an optimum capital structure, which can be attained by the judicious exercise of financial leverage. This study mainly concentrates on the exercise of leverage in the context understanding its impact on earnings per share.

Need for the Study

In physics, leverage denotes the use of a lever and a small amount of force to lift a heavy object. Likewise in business, leverage refers to the use of a relatively small investment or a small amount of debt to achieve greater profits. That is, leverage is the use of assets and liabilities to boost profits while balancing the risks involved. It can be classified in to three types of leverage, there are operating, financial, Combined leverage. Operating leverage refers to the use of fixed costs in a company's earnings stream to magnify operating profits. Financial leverage, on the other hand, results from the use of debt and preferred stock to increase stockholder earnings. Although both types of leverage involve a certain amount of risk**,** they can bring about significant benefits with little investment when successfully implemented. This study mainly concentrates on the existed of leverage in the context understanding its impact on earnings.

Objectives of the Study

The specific objectives of this study are as follows:

- To study the overall function of the Company.
- To analyze the EBIT-EPS analysis.

Methodology

The Methodology adopted for this study is based on the secondary data. The company forms, returns, and documents were collected by referring the books of accounts like annual reports.

Review of Literature

Raj S Dhankar and Ajit S Boora (1996) examine whether there exists an optimal capital structure in Indian companies, both at the micro and the macro level and whether financing decisions affect the value of firm. It could be concluded that like perfect capital markets of the west, in India, too, whether the capital market are imperfect, companies have no definite way of determining their optimal capital structure.

According toPandey (1999), the financial leverage employed by a company is intended to earn more on the fixed charges funds than their costs. The surplus (deficit) will increase (or decrease) the return of the owners equity, referred to

as a double-edged sword, financial leverage provides the potentials of increasing the shareholders' wealth as well as creating the risks of loss to them.

SantimoyPatra (2002) made an analytical study of theoretical approaches and practical application of financial leverage, earnings per share and dividend per share. He has found out that the company successfully pulled down the degree of financial leverage to reap the EPS advantage. Thus the objective of this paper to maximize the EPS through judicious operation of financial leverage has been fulfilled.

RashmiBanga and UdayBhanuSinha (2003) examine the impact of total debts, short-term debts and long-term debts on the output, gross investments and technology-upgrading strategies of the firms in certain oligopolistic industries in India. We first develop a simple theoretical model to motivate the analysis. The empirical analysis shows that debt as a whole may have a negative impact on the choice of output and investment levels of the firms. However, the short-term debts make firms behave in a conservative fashion while the long-term debts make firms behave more aggressively in this respect. Debt, irrespective of its structure, forces the firms to upgrade their technology. Total debt has a negative impact on profitability; however, firms with higher long-term debts have higher profitability.

NikolaosEriotis (2004) examined the association between dividend policy and capital structure in the Greek market. Given that companies are interested in their dividend policy we test a dividend policy model with the debt ratio of the firm, the previous year's dividend yield and the changes in earnings of it as depended variables. he has justified Is hypothesis that the level of corporate debt and the, already, established dividend policy affect the dividend policy of the Greek companies. Another useful result is that the firms that face an increase in their earnings have a distinct dividend policy compare to those who do not face an increase.

Analysis and Interpretation

This chapter deals with the data analysis and interpretation relating to impact of leverage and earnings.

EBIT / EPS Analysis

The EBIT-EPS approach is a method of structuring the firm's capital structure by determining the combination of finding sources that maximizes earnings per share (EPS) over the firm's expected range of earnings before interest and taxes (EBIT). It examine the effects of various financing alternatives through an EBIT-EPS analysis, which involves determining the point of indifference EBIT at which the EPS is the same between two financing alternatives like equity financing or mixed debt and equity financing.

EPS - Earnings PerShare

This is the amount of income that the common stockholders are entitled to receive (per share of stock owned). This income may be paid out in the form of dividends, retained and reinvested by the company, or a combination of both. (It is pronounced EPS).

Table – showing EBIT-EPS Analysis

(₹. in corer)

Particulars	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Sales (A)	**574**	**664**	**596**	**488**	**502**	**607**	**686**	**660**
Less: Variable Cost								
Raw material	283	377	339	285	264	315	363	352
Power and fuel cost	10	14	12	12	13	19	21	27
Employee Cost	133	166	135	115	91	94	110	111
Other manufacturing Cost	19	18	8	9	7	9	8	0
Total Variable cost (B)	**445**	**575**	**494**	**421**	**375**	**437**	**502**	**490**
Contribution(A-B)=C	**129**	**89**	**102**	**67**	**127**	**170**	**184**	**170**
Less: Fixed cost								
Selling and Distribution Expenses	60	69	58	50	44	80	87	98
Total Fixed cost (D)	**60**	**69**	**58**	**50**	**44**	**80**	**87**	**98**
EBIT/ Operating Profit (C-D)=E	**69**	**20**	**44**	**17**	**83**	**90**	**97**	**72**
Less: Finance cost								
Interest	12	21	27	37	35	32	36	38
Total (F)	**12**	**21**	**27**	**37**	**35**	**32**	**36**	**38**
EBIDBT (E-F)=G	**57**	**-1**	**17**	**-20**	**48**	**58**	**61**	**34**
Less: Tax								
Total Tax	**12**	**-13**	**21**	**1**	**-2**	**7**	**8**	**4**
Earning After Tax (G-H)=I	**45**	**12**	**-4**	**-21**	**50**	**51**	**53**	**30**
Earnings Per Share	**1**	**-17.60**	**-31.82**	**-55.07**	**-10.72**	**10.91**	**10.82**	**2.7**

Interpretation

The table clearly indicated the financial performance of UCAL Polymer industry limited for eight from 2006-2007 to 2012-2013 with respect to Sales, Contribution, EBIT, EAT and EPS. Again, it can be clearly visualized from the table that the contribution showed a fluctuating trend for the eight years. The EBIT, EBT and EAT showed fluctuating trend for the years taken for study. The EPS for the year 2006-2007 is ₹1 and ₹ -1, for the year 2007-2008 is -₹32, for the year 2008-2009 ₹-55, for the year 2009-2010 ₹-10.72, for the year 2010-2011 ₹10.91, for the year 2011-2012 ₹10.82, for the year 2012-2013 ₹2.71.

Finding, Suggestion and Conclusion

UCAL do solemnly resolve to strive to meet the requirements and exceed the expectations of all our customers by providing quality products and services. This level of quality is achieved through stringent quality controls, quality assurance procedures and total employee involvement at each stage. It has in turn engendered a work culture where every one of us believes in outside the box thinking, total dedication and a no-compromise attitude towards quality.

Findings

The study has found the following observations relating to Leverage onEarnings PerShare.

- It clearly indicates the financial performance of UCAL for Eight years from 2005-06 to 2012-13 with respect to Sales, contribution, EBIT, EAT, EBT, and EPS.
- From the table 4.8 shows that It is seen that correlation co-efficient between DTL and EPS indicating a high degree of positive association. The value of correlation is found to be significant at 5% level of significance, hence, the null hypothesis are rejected, that there is a positive association between DTL and EPS.However, the degree of financial leverage depicts a better picture of the firm.

Suggestions

The operating leverage can be favourable when increase in sales volume has a positive magnifying effect on operating profits and it is unfavourable when a decrease in sales volume has a negative magnifying effect on operating profits. Therefore, high operating leverage is good when sales revenues are rising and bad when they are falling. The degree of operating leverage has implications for the business risk of the firm. Use of debt fund is cheaper than the equity as the cost of debt is generally lower than that of equity and tax advantage is attached with its use. During the period of study, when the company is not in a position to earn greater rate of return than the cost of debt and preference share, its return on equity and EPS, instead of increasing will actually decrease the financial leverage. Thus the use of debt fund, i.e., uses of financial leverage increases the earnings per share and thus dividend per share.

Conclusion

The purpose behind this study is to bridge the gap between theoretical and practical aspects. **UCAL**could not enjoy the benefit of accepted leverage theorem. Rather it accrued the benefit of EPS through the reverse operation of leverage. So leverage theorem is not a general rule. The dividend policy of the company is conservative. The company has been maintaining a decrease trend in the dividend payout. The company was enabling to maximize the EPS by reverse operation of financial leverage. The company successfully pulled down the degree of financial leverage to reap the EPS advantage.

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