1. Geoff’s Golf Clubs is considering purchasing a small firm in the same line of business. The purchase would be financed by the sale of common stock or a bond issue. The financial manager needs to evaluate how the two alternative financing plans will affect the earnings potential of the firm. Total financing required is $4.5 million. The firm currently has $20,000,000 of 12 percent bonds and 600,000 common shares outstanding. The firm can arrange financing of the $4.5 million through a 14 percent bond issue or the sale of 100,000 shares of common stock. The firm has a 40 percent tax rate.
2. What is the degree of financial leverage for each plan at $7,000,000 of EBIT?

(b) What is the financial breakeven point for each plan?

1. Kiarra Doll Factory is considering two capital structures. Assume a 40 percent tax rate and expected EBIT of $50,000.

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| **Source of Capital** | **Structure 1** | **Structure 2** |
| Long-term debt | $500,000 @ 8% | $350,000 @ 7% |
| Common Stock | 10,000 shares | 20,000 shares |

1. Calculate two EBIT-EPS coordinates for each of the structures, using $50,000 as one of your choices.
2. Plot the two capital structures on a set of EBIT-EPS axes.
3. Indicate over what EBIT range, if any, each structure is preferred.
4. Discuss the leverage and risk aspects of each structure.