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PAPER: FINANCIAL MANAGEMENT
PAPER CODE: C 305
TOPIC: LEVERAGE ANALYSIS
PRACTICE SET (I)

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1. **A firm has a DOL of 3.5 at Q units. What does this tell us about the firm?**
   A. If sales rise by 3.5% at the firm, then EBIT will rise by 1%.
   B. If EBIT rises by 3.5% at the firm, then EPS will rise by 1%.
   C. If EBIT rises by 1% at the firm, then EPS will rise by 3.5%.
   D. If sales rise by 1% at the firm, then EBIT will rise by 3.5%.
2. **A firm has a DFL of 3.5 at X dollars. What does this tell us about the firm?**
   A. If sales rise by 3.5% at the firm, then EBIT will rise by 1%.
   B. If EBIT rises by 3.5% at the firm, then EPS will rise by 1%.
   C. If EBIT rises by 1% at the firm, then EPS will rise by 3.5%.
   D. If sales rise by 1% at the firm, then EBIT will rise by 3.5%.
3. **Higher operating leverage is related to the use of additional __________.**
   A. Fixed costs
   B. Variable costs
   C. Debt financing
   D. Common equity financing
4. **Lower financial leverage is related to the use of additional __________.**
   A. Fixed costs
   B. Variable costs
   C. Debt financing
   D. Common equity financing

5. **Calculate the degree of operating leverage (DOL) at 400,000 units of quantity sold. The firm has Rs. 1,000,000 in fixed costs. The firm anticipates selling each unit for Rs. 25 with variable costs of Rs. 5 per unit.**

   A. 3.33

   B. 1.25

   C. 1.14

   D. There is not sufficient information provided to calculate the degree of operating leverage (DOL).

6. **Calculate the degree of financial leverage (DFL) for a firm when its EBIT is Rs. 2,000,000. The firm has Rs. 3,000,000 in debt that costs 10% annually. The firm also has a 9%, Rs. 1,000,000 preferred stock issue outstanding. The firm pays 40% in taxes.**

   A. 0.78

   B. 0.80

   C. 1.24

   D. 1.29

7. **A firm is considering three different financing alternatives -- debt, preferred stock, and common equity. The firm has created an EBIT-EPS chart that shows several indifference points. What does each indifference point show the firm?**

   A. He level of EBIT that generates identical EPS under two alternative financing plans.

   B. The level of sales that generates identical EBIT and EPS figures.

   C. It shows the level of EBIT and EPS at which DFL is identical under two alternative financing Plans.

   D. None of the above.

8. **The maximum amount of debt (and other fixed-charge financing) that a firm can adequately service is referred to as the __________.**

   A. Debt capacity

   B. Debt-service burden

   C. Adequacy capacity

   D. Fixed-charge burden

9. **The cash required during a specific period to meet interest expenses and principal payments is referred to as the:**

   A. Debt capacity

   B. Debt-service burden

   C. Adequacy capacity

   D. Fixed-charge burden

10. **Which of the following costs would be considered a fixed cost?**

   A. Raw materials.

   B. Depreciation.

C. Bad-debt losses.

D. Production labor

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