Q.P. Code: paper 3

[Time: 3.00 Hrs] **[Marks: 75]**

Please check whether you have got the right question paper.

Instructions :

1. Q1 (20 marks) & Q8 (15 marks) are compulsory.
2. Attempt Any Four (40 marks) out of Q2, Q3, Q4, Q5, Q6 and Q7.
3. Students have to attempt any four out of the remaining six questions and within each question; students have to attempt any one out of two sub – questions. Each sub – question would carry 10 Marks.
4. Figures to the right indicate full marks.
5. Draw neat diagrams wherever necessary.

Q.1 Read and attempt the following:

(A) Multiple choice question **10 Marks**

i. Financial leverage refers to:
a. Use of equity capital
b. Use of debt capital
c. Use of both equity and debt capital
d. Use of retained earnings

ii. Operating leverage is primarily concerned with:
a. Fixed costs
b. Variable costs
c. Total costs
d. Marginal costs

iii. The quick ratio is also known as:
a. Current ratio
b. Acid-test ratio
c. Debt ratio
d. Equity ratio

iv. The return on equity (ROE) ratio measures:
a. Profitability of a company relative to shareholders' equity
b. Efficiency in utilizing assets
c. Liquidity of a company
d. Market valuation of a company

v. Which method considers the time value of money in capital budgeting?
a. Payback period
b. Accounting rate of return
c. Net present value (NPV)
d. Average rate of return

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vi. The internal rate of return (IRR) is:
a. The discount rate that makes the NPV of an investment zero
b. The rate of return required by investors
c. The same as the payback period
d. Always higher than the cost of capital

vii. Working capital management involves managing:
a. Long-term assets and liabilities
b. Short-term assets and liabilities
c. Equity and retained earnings
d. Capital structure and dividends

viii. Negative working capital indicates:
a. The company has more current assets than current liabilities
b. The company has more current liabilities than current assets
c. The company is highly liquid
d. The company is highly profitable

ix. The optimal capital structure aims to:
a. Maximize the cost of capital
b. Minimize the cost of capital
c. Maximize the use of debt
d. Minimize the use of equity

x. A company with a high debt-to-equity ratio is considered:
a. Low risk
b. Highly leveraged
c. Underleveraged
d. Liquid

(B) State whether True or false. 10 Marks

i. Higher financial leverage increases the potential return on equity but also increases the financial risk.
ii. Operating leverage is influenced by the proportion of fixed costs in a company's cost structure.
iii. A high current ratio indicates a strong liquidity position.
iv. The price-to-earnings (P/E) ratio measures a company's profitability.
v. The internal rate of return (IRR) is the discount rate that makes the net present value (NPV) of a project zero.
vi. The payback period method accounts for the time value of money.
vii. An increase in current assets generally leads to an increase in working capital.
viii. Efficient working capital management aims to increase the cash conversion cycle.
ix. A company with a high debt ratio is considered to have a conservative capital structure.
x. The cost of equity is typically higher than the cost of debt.

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Q.2 Attempt any one of the following: 10 Marks

(A) On 1st January, the Managing Director of Lala Ltd. wishes to know the amount of working capital that will be required during the year. From the following information, Prepare the working capital requirements forecast.

i. Production during the previous year was 60,000 units. It is planned that this level of activity would be maintained during the present year.
ii. The expected ratios of the cost to selling prices are Raw materials 60%, Direct wages 10% and Overheads 20%.
iii. Raw materials are expected to remain in store for an average of 2 months before issue to production.
iv. Each unit is expected to be in process for one month, the raw materials being fed into the pipeline immediately and the labour and overhead costs accruing evenly during the month.
v. Finished goods will stay in the warehouse awaiting dispatch to customers for approximately 3 months.
vi. Credit allowed by creditors is 1 months from the date of delivery of raw material.Credit allowed to debtors is 3 months from the date of dispatch.
vii. Selling price is Rs 10 per unit.
viii. There is a regular production and sales cycle.
ix. Wages and overheads are paid on the 1st of each month for the previous month.
The company normally keeps cash in hand to the extent of Rs 40,000.

(B) What does negative working capital indicate?

Q.3 Attempt any one of the following: 10 Marks

(A) XYZ ltd financial statement contain the following information:

Particulars	Year 1 (Rs.)	Year 2 (Rs.)
Cash	2,00,000	1,60,000
Sundry Debtors	3,20,000	4,00,000
Temporary Investments	2,00,000	3,20,000
Stock	18,40,000	21,60,000
Prepaid Exp	28,000	12,000
Total Current Assets	25,88,000	30,52,000
Total Assets	56,00,000	64,00,000
Current Liabilities	6,40,000	8,00,000
Loan	16,00,000	16,00,000
Capital	20,00,000	20,00,000
Retained Earning	4,68,000	8,12,000

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Statement Of Profit For Current Year

Particulars	Rs.
Sales	40,00,000
Less: COGS	28,00,000
Less: interest	1.60.000
EBT	10,40,000
Less: Tax @ 30%	3,12,000
EAT	7,28,000
Profit Distributed	2,20,000

Calculate:

a) Current Ratio b) Quick ratio c) Debt Equity Ratio d) ROCE e) Working capital ratio

(B) What does the debt-to-equity ratio indicate about a company?

Q.4 Attempt any one of the following: **10 Marks**

A) Calculate operating leverage, financial leverage and combined leverage of Anna Ltd under situation 1 and 2 in financial plans A & B from the following information relating to the operation and capital structure of a company.
Installed capacity – 2,000 units
Actual production and sales – 50% of the capacity
Selling price ₹20 per unit Variable Cost ₹10 per unit
Fixed Cost:
Under Situation I ₹ 4,000
Under Situation II ₹ 5,000

	Financial plan	
Particulars	**Plan A**	**Plan B**
Equity	5,000	15,000
10% Debt	15,000	5,000
total	20,000	20,000

B) Discuss the factors influencing the choice of capital structure for a company.

Q.5 Attempt any one of the following: **10 Marks**

(A) The following key information pertains to PQR Ltd. for the year 2022-23.

Particulars	Rs. In lakhs
Sales	100
Variable Cost	52
Fixed Cost	8

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9% Debentures	50
Equity Shares	60
Corporate Tax	30%

You are required to work out :

i. What is the Company's ROI?
ii. Does it have favorable financial leverage?
iii. If the firm belongs to an industry whose asset turnover is 1.5, does it have high or low asset leverage?
iv. What is the operating, financial and combined leverage of the firm?
v. What is the Company's EPS? 6. What will be the expected EPS if the Sales of Thakurain Ltd. increase by 10% in the next year and cost structure as well as financial structure remains same?

(B) Explain how operating leverage affects a company's cost structure and profitability.

Q.6 Attempt any one of the following: 10 Marks

(A) If two Machines details are given, which one would you choose on the basis of NPV.

Capital Outlay: A B
1,90,000 1,90,000

Annual estimated Income After depreciation & Income-tax

Year	Machine A	Machine B
	PAT	PAT
	13375	21375
	15375	19375
	17375	17375
	19375	15375
	21375	13375
Total	86875	86875

i. Estimated life for both the machines is five years.
ii. Estimated salvage value for both the machines are 13000 each. Depreciation has been
iii. charged on straight line basis solution.
iv. Assume discounting factor 10%

(B) What is the purpose of the Net Present Value (NPV) method in capital budgeting?

Q.7 Attempt any one of the following: 10 Marks

(A) Tom Ltd. has currently an ordinary share capital of Rs. 50 lakhs, Consisting of 50,000 equity shares of Rs. 100 each. The management is planning to rise another Rs. 20 lakhs to finance major programmed of expansion through one of four possible financing plans. The options are:

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i. Entirely through equity / ordinary shares.
ii. Rs. 20 lakhs through equity shares & Rs. 30 lakhs through Long term borrowings at 8% interest p.a.
iii. Rs. 10 lakhs through equity shares & Rs. 40 lakhs through Long term borrowings at 9% interest p.a.
iv. Rs. 25 lakhs through equity shares & Rs. 25 lakhs through preference shares with 5% dividend.
v. The Company's expected EBIT will be Rs. 8 Lakhs. Assuming a corporate tax rate of 50%, determining the EPS in each alternative.

(B) What is the goal of an optimal capital structure?

Q.8 Write short notes on Any three from the following: 15Marks

(A) Combined leverage
(B) Price to earning ratio
(C) Financial leverage leverages
(D) Net working capital
(E) Quick Ratio

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