

*CA Final*

# Advanced Financial Management (AFM)

## MCQS & Case Scenario

CA Divyesh Vaghela

- Chapterwise ICAI BOS MCQs
- Included RTP May 24 MCQs
- All MCQs categorized by difficulty



# PREFACE

Dear student,

This book covers all Chapterwise MCQs & Case Scenarios from ICAI BOS and Latest RTP May 24. All MCQs are categorized by difficulty level, using the same format as on the BOS portal.

Here: S for Simple, M for Medium, and D for Difficult.

**Important:** ICAI may add more MCQs on the BOS portal. If there are any additions, I'll update them on my Telegram channel.

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All the Best!!

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## AFM MCQS

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Important questions will also be uploaded for may 24.  
(78 marks same sfm questions were from imp in nov 23)



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## Financial Policy and Corporate Strategy

- S** 1. The strategic financial management is \_\_\_\_\_
- (a) backward looking
  - (b) report-focused discipline
  - (c) forward-looking subject of financial management
  - (d) All of the above
- M** 2. .... is the springboard for wealth creation.
- (a) Investment in highly risky securities.
  - (b) Capital investment
  - (c) Foreign Exchange Risk Management
  - (d) None of the above
- D** 3. The primary objective of investors in a world of economic uncertainty is.....
- (a) to select investment and financial opportunities that will give them maximum expected returns at minimum risks.
  - (b) to select investment and financial opportunities that will give them maximum expected returns at maximum risks.
  - (c) to select investment and financial opportunities that will give them minimum expected returns at maximum risks.
  - (d) None of the above

Q.	Ans.	Description
1	D	Strategic financial management combines the backward-looking, report-focused discipline of (financial) accounting with the more dynamic, forward-looking subject of financial management.
2	B	Remaining two activities are later activities.
3	A	Basis of wise investment decisions.

## Risk Management

- S** 1. ....is associated with diffusion of economic crisis throughout a market, asset class or geographic region.
- (a) Systematic Risk
  - (b) Unsystematic Risk
  - (c) Contagion Risk
  - (d) Credit Risk
- M** 2. Which type of risk occurs when a counter party fails to honour their obligations?
- (a) Interest Rate Risk
  - (b) Currency Risk
  - (c) Credit Risk
  - (d) Political Risk
- M** 3. Which type of risk is primarily faced by a company when it ventures into a new industry or geographical area with completely different laws and regulations?
- (a) Operational Risk
  - (b) Compliance Risk
  - (c) Currency Risk
  - (d) Financial Risk
- D** 4. ....is associated with diffusion of economic crisis throughout a market, asset class or geographic region.
- (a) Systematic Risk
  - (b) Unsystematic Risk
  - (c) Contagion Risk
  - (d) Credit Risk
- D** 5. One year VaR [Value at risk] of a portfolio is Rs. 10 crores with a confidence level of 95%. This means.....
- (a) There is a 5% probability that the loss will be Rs. 10 crores at the end of the year
  - (b) The loss will not exceed Rs. 9.5 crores during valuation anytime during the year
  - (c) The worst expected portfolio loss over one year will not exceed Rs. 10 crore with 95% confidence

(d) The investor can presume that there is a 95% chance of loss over one trading year will exceed Rs. 10 crore

Q.	Ans.	Description
1	C	Contagion Risk
2	C	Other risks are related to external factors.
3	B	Lesser knowledge of the Rules and Regulations of different country.
4	C	Contagion Risk
5	C	Basis of VAR.

## Advanced Capital Budgeting Decisions

- S 1. Variance measures....
- (a) How far each number in the set is from the mean.
  - (b) The mean of a given data set.
  - (c) Return on Investment
  - (d) Level of risk borne for every percent of expected return.
- S 2. Expected cash flows are calculated as:
- (a) Sum of likely cash flow of the project.
  - (b) Sum of likely cash flow of project multiplied by probability of respective cash flows.
  - (c) Sum of likely cash flow of project divided by probability of cash flow.
  - (d) none of these
- S 3. Which of the following critical factor is generally overlooked by capital budgeting decision makers.
- (a) Quantitative factors
  - (b) Qualitative factors
  - (c) Time factor
  - (d) Discounting factor
- M 4. When the risk is high, the cash flow under certainty equivalent coefficient is:
- (a) Higher
  - (b) Lower
  - (c) No impact
  - (d) None of the above
- M 5. Scenario Analysis is considered under scenarios such as:
- (a) Worst Case Scenario
  - (b) Base Case Scenario
  - (c) Best Case Scenario
  - (d) All of the above
- M 6. Certainty Equivalent approach is:
- (a) Guaranteed return from an investment after adjusting for certainty equivalent coefficient.
  - (b) Return that is expected over the lifetime of a project.
  - (c) Equivalent to Net Present Value.

(d) An important component in Decision Tree Analysis.

- D 7. Sensitivity analysis is useful in decision making because:
- (a) It shows the probabilities associated with each outcome.
  - (b) It tells the user how much critical each input is for the Output value.
  - (c) It allows to calculate the probable results under different scenarios.
  - (d) The results of Sensitivity Analysis are reliable.
- D 8. The firm expects an NPV of Rs. 10,000 if the economy is exceptionally strong (30% probability), an NPV of Rs. 4,000 if the economy is normal (40% probability), and an NPV of Rs. 2,000 if the economy is exceptionally weak (30% probability). Expected Net present value is \_\_\_\_\_.
- (a) Rs. 5,200
  - (b) Rs. 6,000
  - (c) Rs. 5,000
  - (d) Rs. 6,200

Q.	Ans.	Description
1	A	How far each number in the set is from the mean.
2	B	Sum of likely cash flow of project multiplied by probability of respective cash flows.
3	B	Qualitative factors
4	B	There is inverse relationship
5	D	Consider all factors in one go.
6	A	Consider pessimistic approach
7	B	Give more importance to critical factor.
8	A	$10000 \times 0.30 + 40000 \times 0.40 + 2000 \times 0.30 = 5200$

## Security Analysis

- S 1. Which of the following factor affects industry analysis?  
(a) Product Lifecycle  
(b) Government Attitude  
(c) State of Competition in the Industry  
(d) All of these
- S 2. As per the Dow Jones Theory the Secondary movement of stock prices last from.....  
(a) one year to three years.  
(b) three weeks to three months.  
(c) day to day.  
(d) None of these
- S 3. An efficient capital market is one in which.....  
(a) Taxes are irrelevant.  
(b) Security prices reflect available information.  
(c) Securities always offer a positive rate of return to investors.  
(d) Security prices are guaranteed (by the SEBI) to be fair.
- M 4. Which factor significantly influences the demand in consumer products industries?  
(a) Interest rate  
(b) Discount rate  
(c) Inflation rate  
(d) None of the above
- M 5. Which of the following technique is not used for economic analysis?  
(a) Barometer/Indicator Approach  
(b) Economic Model Building Approach  
(c) Mixed Forecasting  
(d) Economic Model Building Approach
- D 6. Which of the following is a drawback of the Anticipatory Surveys technique used in economic analysis?  
(a) Survey results guarantee that intentions surveyed would materialize.  
(b) They are regarded as forecasts per se, as there can be a consensus approach by the investor for exercising his opinion.

- (c) Both of (a) and (b)
- (d) None of the above

### Q. 7 to 11 - RTP May 24 Case Scenario :

You are a financial analyst at a prominent investment firm and have been tasked with empirically verifying the weak form of Efficient Market Hypothesis (EMH) Theory for the XYZ Stock Index, a collection of diverse stocks. You decided to conduct three different tests to assess whether the stock market follows the principles of the weak form of EMH.

#### Test 1

For the past five years, you collected daily price changes of the stocks in the XYZ Stock Index. You calculated correlation coefficients for different lag periods and analyzed whether past price changes exhibit any significant correlation with future price changes. You considered price changes to be serially independent. The results indicated that most auto correlation coefficients are close to zero and statistically insignificant, suggesting those past price changes do not predict future price changes.

#### Test 2

You further investigated the randomness of price changes in the XYZ Stock Index. Analyzing the sequence of daily price changes, you count the number of runs where price changes are consistently positive or negative. Upon comparing the observed number of runs with the expected number based on randomness, you find that they align closely, supporting the idea that price changes follow a random pattern.

#### Test 3

To examine the efficacy of trading strategies based on historical price trends, you implemented a simple trading rule for the XYZ Stock Index. The rule involves buying when the price crosses a moving average of 5% threshold and selling when it crosses another 7% threshold. Over a period of testing, you computed the returns generated by the trading strategy. The results revealed that the returns are not consistently better than random chance, implying that past price trends do not reliably predict future price movements.

#### Conclusion:

After conducting the three tests the evidence supports the weak form of Efficient Market Theory for the XYZ Stock Index you concluded that past price trends do not reliably predict future price movements.

Based on the above information answer the 7 to 11 Questions:

7. Test 1 is .....
- (a) Serial Correlation test
  - (b) Filter Rules test
  - (c) Run test
  - (d) Variance Ratio test
8. Test 2 is .....
- (a) Serial Correlation test
  - (b) Filter Rules test
  - (c) Run test
  - (d) Variance Ratio test
9. Test 3 is .....
- (a) Serial Correlation test
  - (b) Filter Rules test
  - (c) Run test
  - (d) Variance Ratio test.
10. The Filter Rule Test should not be applied for buy and hold strategy if.....
- (a) the behavior of stock price changes is predictable.
  - (b) the behavior of stock price changes is dependent on past trends.
  - (c) the behavior of stock price changes is correlated.
  - (d) the behavior of stock price changes is random.
11. Results of your studies support the.....
- (a) Semi-strong EMH Theory
  - (b) Strong EMH Theory
  - (c) Random Walk Theory
  - (d) Markowitz Theory

Q.	Ans.	Description
1	D	All of these
2	B	three weeks to three months.
3	B	Security prices reflect available information.
4	C	Other factor mainly impact investment decision.
5	C	Mixed Forecasting
6	D	As opposite of first two options are drawbacks of Anticipatory Survey.
7	A	Serial Correlation test
8	C	Run test
9	B	Filter Rules test
10	D	the behaviour of stock price changes is random.
11	C	Random Walk Theory

## Security Valuation

- S 1. The annual interest of a bond divided by its face value is called the bond's.....
- (a) Coupon Rate
  - (b) Face value
  - (c) Maturity
  - (d) Yield to maturity
- S 2. Which of the following is not a money market instrument?
- (a) Commercial paper
  - (b) Participatory certificates
  - (c) Warrant
  - (d) Treasury Bills
- S 3. A debenture of Rs. 10000 carrying 15% coupon rate is quoted in the market at Rs.13500. The current yield on this debenture will be:
- (a) 13.50%
  - (b) 15%
  - (c) 11.11%
  - (d) 10%
- D 4. A Ltd. issued commercial paper worth ₹ 10 crores as per the following details:
- Date of issue: 15th June, 2022  
Maturity period: 73 days  
No. of days in a year: 365 days  
Interest rate: 15% p.a.  
Intermediary charges: 0.1% of Net Receipts  
The net amount received by the company on such issue of CP shall be approximately.....
- (a) ₹ 9,69,90,291
  - (b) ₹ 9,70,87,379
  - (c) ₹ 9,69,77,379
  - (d) ₹ 9,69,00,000
- D 5. The following information is related to two bonds same in other respects:
- |                 |           |
|-----------------|-----------|
| Price of Bond A | = Rs. 10  |
| Price of Bond B | = Rs. 120 |

Coupon Rate of Bond A =14%

Coupon Rate of Bond B = 15%

If both the bonds are redeemable at a Premium of 10% after 2 years and the required yield on this category of Bonds is 16% then best avenue for investment shall be.....

- (a) Bond A
- (b) Bond B
- (c) Any of the two Bonds
- (d) Neither of the two Bonds

- D 6. The value a zero coupon with a maturity of three years and a maturity value of Rs 1,000 discounted at 7% is
- (a) Rs. 816.30
  - (b) Rs. 901.94
  - (c) Rs. 966.18
  - (d) Rs. 1000

**Q. 7 to 10 - Case Scenario :**

The data given below relates to a convertible bond of X Ltd.:

Face value	Rs. 450
Coupon rate	15%
No. of shares per bond	25
Market price of share	Rs. 20
Straight value of bond	Rs. 400
Market price of convertible bond	Rs. 550

Based on the above information answer the following 7 to 10 question:

7. The stock value of bond would be .....
- (a) Rs. 500
  - (b) Rs. 400
  - (c) Rs. 550
  - (d) Rs. 450
8. The percentage of downside risk based on market price of convertible bond is .....
- (a) 10%
  - (b) 27.27%

- (c) 18.18%
- (d) 11.11%

9. The conversion premium is .....

- (a) 10%
- (b) 27.27%
- (c) 18.18%
- (d) 11.11%

10. The conversion parity price of the stock is .....

- (a) Rs. 25
- (b) Rs. 20
- (c) Rs. 22
- (d) Rs. 24

Q.	Ans.	Description
1	A	Coupon Rate
2	C	Warrant
3	C	Interest = Rs. 1500 Yield = $\text{Rs.}1500/13500 = 11.11\%$
4	A	₹ 9,69,90,291
5	A	Bond A
6	A	$\text{Rs. } 1000/(1.07)^3 = \text{Rs. } 816.30$
7	A	Rs. 500
8	B	27.27%
9	A	10%
10	C	Rs. 22

## Portfolio Management

- S** 1. Arbitrage Pricing Theory was developed by.....
- (a) William Sharpe
  - (b) Harry Markowitz
  - (c) Stephan Ross
  - (d) Black Scholes
- M** 2. According to the CAPM, the intercept of Security Market Line (SML) should be equal to.....
- (a) zero.
  - (b) the expected risk premium on the market portfolio.
  - (c) the risk-free rate.
  - (d) the expected return on the market portfolio.
- M** 3. What is the common hypothesis for Traditional and Modern Theories of Portfolio Management.
- (a) Both approaches use statistical methods.
  - (b) Both approaches are based on judgement.
  - (c) Both approaches are based on hypothesis that a portfolio reduces risk by diversification.
  - (d) None of these
- M** 4. Calculation of Coefficient of Variance depends on:
- (a) Standard Deviation
  - (b) Expected Return
  - (c) Expected cash flow
  - (d) All of the above
- M** 5. Risk Premium is:
- (a) Extra rate of return expected by the Investors as a reward for bearing extra risk.
  - (b) Equivalent to the rate of Government Securities.
  - (c) Return provided to equity shareholders.
  - (d) Risk free rate of return.

**Q. 6 to 8 - Case Scenario :**

Mr. A is interested in investing Rs. 1,00,000 for which he is considering following three alternatives:

- (i) Invest Rs. 1,00,000 in Mutual Fund X (MFX)
- (ii) Invest Rs. 1,00,000 in Mutual Fund Y (MFY)
- (iii) Portfolio - Invest Rs. 60,000 in Mutual Fund X (MFX) and Rs. 40,000 in Mutual Fund Y (MFY)

Average annual return earned by MFX and MFY is 12% and 11% respectively. Risk free rate of return is 8% and market rate of return is 10%.

Covariance of returns of MFX, MFY and market portfolio Mix are as follow:

Particulars	MFX	MFY	Portfolio
MFX	4.400	4.300	3.370
MFY	4.300	4.200	2.800
Portfolio	3.370	2.800	4.200

Based on the above information answer the following 6 to 8 questions:

6. Standard Deviation of MFX is .....

- (a) 2.0736
- (b) 2.0976
- (c) 1.8358
- (d) 2.0494

7. Portfolio return would be .....

- (a) 11.00%
- (b) 12.00%
- (c) 11.50%
- (d) 11.60%

8. Based on Standard Deviation, the optimum investment for Mr. A would be .....

- (a) Portfolio
- (b) All investment in MFX
- (c) All investment in MFY
- (d) Both MFY and mix are indifferent

Q.	Ans.	Description
1	C	Stephan Ross
2	A	zero.
3	C	Both approaches are based on hypothesis that a portfolio reduces risk by diversification.
4	D	$CV = SD/Expected\ Return$
5	A	There is Risk-Return Trade off relationship.
6	B	2.0976
7	D	11.60%
8	B	All investment in MFX



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## Securitization

- S** 1. ....is the process of repackaging or rebundling of illiquid assets into marketable securities.
- (a) Diversification
  - (b) Securitization
  - (c) Structured finance
  - (d) Tokenization
- M** 2. The main objective of creating a Special Purpose Vehicle (SPV) in the securitization process is.....
- (a) to acquire legal and beneficial interest in the assets.
  - (b) to issue securities to the investors.
  - (c) to remove the asset from the balance sheet of the originator.
  - (d) to write off the asset as bad debt from the balance sheet of the originator.

### Q. 3 to 7 - RTP May 24 Case Scenario :

Grow More Ltd. an NBFC is in the need of funds and hence it sold its receivables to MAC Financial Corporation (MFC) for ₹ 100 million. MFC created a trust for this purpose called General Investment Trust (GIT) through which it issued securities carrying a different level of risk and return to the investors. Further, this structure also permits the GIT to reinvest surplus funds for short term as per their requirement.

MFC also appointed a third party, Safeguard Pvt. Ltd. (SPL) to collect the payment due from obligor(s) and passes it to GIT. It will also follow up with defaulting obligor and if required initiate appropriate legal action against them.

**Based on above scenario, answer the following 3 to 7 questions:**

3. The securitized instrument issued for ₹ 100 million by the GIT falls under category of .....
- (a) Pass Through certificate (PTCs)
  - (b) Pay Through Security (PTS)
  - (c) Stripped Security
  - (d) Debt Fund.

4. In the above scenario, the Originator is.....
  - (a) Grow More Ltd.
  - (b) MAC Financial Corporation (MFC)
  - (c) General Investment Trust (GIT)
  - (d) Safeguard Pvt. Ltd. III.
  
5. In the above scenario, the General Investment Trust (GIT) is a/an.....
  - (a) Obligor
  - (b) Originator
  - (c) Special Purpose Vehicle (SPV)
  - (d) Receiving and Paying Agent (RPA)
  
6. In the above scenario, the Safeguard Pvt. Ltd. (SPL) is a/an.....
  - (a) Obligor
  - (b) Originator
  - (c) Special Purpose Vehicle (SPV)
  - (d) Receiving and Paying Agent (RPA)
  
7. Which of the following statement holds true?
  - (a) When Yield to Maturity in market rises, prices of Principle Only (PO) Securities tend to rise.
  - (b) When Yield to Maturity in market rises, prices of Principle Only (PO) Securities tend to fall.
  - (c) When Yield to Maturity in market falls, prices of Principle Only (PO) Securities tend to fall.
  - (d) When Yield to Maturity in market falls, prices of Principle Only (PO) Securities remain the same.

Q.	Ans.	Description
1	B	The term diversification is used in context of Portfolio Management. Securitization is one of the form of Structured Finance. Tokenization can be one form of issuing units after Securitization.
2	C	While the first two options follow the third option the fourth option is wrong option.
3	B	Pay Through Security (PTS)
4	B	MAC Financial Corporation (MFC)
5	C	Special Purpose Vehicle (SPV)
6	D	Receiving and Paying Agent (RPA)
7	B	When Yield to Maturity in market rises, prices of Principle Only (PO) Securities tend to fall.

## Mutual Funds

- M** 1. The major difference between open-ended and close-ended mutual fund schemes is that.....
- (a) in Open Ended Schemes, investors can only make entry and exit during pre-specified intervals.
  - (b) Close-ended schemes allow investors to redeem their investments at any time.
  - (c) Open-ended schemes have a limited life, while close-ended schemes have an indefinite redemption period.
  - (d) Open-ended schemes have an indefinite redemption period, while close-ended schemes have a limited life.
- M** 2. Which of the following Business Parks has launched India's first Real Estate Investment Trust (ReIT)?
- (a) Galaxy Business Parks
  - (b) DLF Cyber City
  - (c) Patni Knowledge Parks
  - (d) Embassy Office Parks
- M** 3. The lower the..... of the Index Fund, higher the accuracy the more predictable return is.
- (a) Alpha
  - (b) Beta
  - (c) Tracking Error
  - (d) Exist Load

Q.	Ans.	Description
1	D	Close Ended schemes are for short duration and Open Ended Scheme are meant for indefinite period.
2	D	Embassy Office Parks
3	C	Tracking Error

## Derivatives Analysis and Valuation

- S 1. Which of the following is a traditional method for an Indian farmer to sell wheat?
- (a) Forward Contract
  - (b) Future Contract
  - (c) Spot Market
  - (d) Capital Market
- S 2. In a future contract the term Basis is.....
- (a) The difference between the prevailing spot price and the futures price.
  - (b) The difference between the current market price and the strike price.
  - (c) The difference between the long position and the short position.
  - (d) The difference between the initial margin and the maintenance margin.
- S 3. Which of the following position provides protection from a decrease in prices of a share?
- (a) Buying of Future Contracts in the share.
  - (b) Buying Call Option in the share.
  - (c) Selling of Future Contracts in the share.
  - (d) Selling Put Option in the share.
- S 4. When an investor buys back the same amount of futures contracts that he sold earlier is called.....
- (a) closing out the position.
  - (b) going long of the futures.
  - (c) opening a new position.
  - (d) None of these
- M 5. Which of the following is true regarding a forward contract?
- (a) It is standardized.
  - (b) The contracting parties negotiate only on the price.
  - (c) The contracting parties negotiate only on quantity and quality.
  - (d) Both parties negotiate on quality, quantity, place, and price.
- M 6. Which among the following derivative product is not traded in an exchange at all?
- (a) Futures

- (b) Options
- (c) Forwards
- (d) None of these

- M 7. What is the purpose of trading in futures?
- (a) Only for speculation.
  - (b) Only for hedging.
  - (c) Both for speculation and hedging.
  - (d) Only for arbitraging.
- D 8. ABC Masala Co. purchase jeera to make its products. The company is concerned that prices may rise prior to building inventory for festivals sales. Analysts project that price per quintal could vary from Rs. 52,000 to Rs. 70,000. A September futures contract can be obtained with a Rs. 65,000 purchase prices. What is ABC's risk in this situation?
- (a) Coca prices will rise above Rs. 65,000 and Tingley will purchase its coca at a price of Rs. 65,000.
  - (b) Coca prices will decline below Rs. 65,000 and Tingley will have to purchase coca at Rs. 65,000.
  - (c) Coca prices will hit Rs. 65,000 and the contract was a waste of time.
  - (d) ABC Co. has no risk in this situation.
- D 9. The spot price of an investment is Rs. 3,000 and the risk-free rate for all maturities (with continuous compounding) is 10% p.a.. Suppose the asset provides an income of Rs. 200 at the end of the first year and at the end of the second year, then three-year forward price shall be .....
- ( $e^{0.10} = 1.1052$ ,  $e^{0.20} = 1.2214$  and  $e^{0.30} = 1.3499$ )
- (a) Rs. 1,967
  - (b) Rs. 3,584
  - (c) Rs. 4,515
  - (d) Rs. 4,050
- D 10. A short forward contract on share of A Ltd. that was negotiated some time ago will expire in 3 months and has a delivery price of Rs. 4,000. The current forward price for three-month forward contract is Rs. 4,200 and the 3-month risk-free interest rate (with monthly compounding) is 6%. The value of the same short forward contract will be.....
- (a) Rs. 200
  - (b) - Rs. 200
  - (c) Rs. 197.03
  - (d) - Rs. 197.03

- D 11. A put option on a company's stock has an exercise price of Rs. 200. On the delivery date, the stock is trading at Rs. 240 per share. What should the investor who has paid Rs. 20 for the option do?
- (a) Not exercise the option and lose Rs. 20.
  - (b) Not exercise the option and lose Rs. 60.
  - (c) Exercise the option and gain Rs. 20.
  - (d) Exercise the option and gain Rs. 40.
- D 12. Mr. A a speculator shorts 1000 shares of X Ltd. when the share price was Rs. 50 and closes out the position after 3 months when the share price was Rs. 43. The company pays a dividend of Rs. 3 per share during the 3 months. The gain of Mr. A will be ....
- (a) Rs. 1,000
  - (b) Rs. 4,000
  - (c) Rs. 7,000
  - (d) Rs. 3,000
- D 13. Which amongst the following is not a Greek for Options Pricing
- (a) Delta
  - (b) Gamma
  - (c) Theta
  - (d) Kho
- D 14. The maximum possible loss for a covered call writer is.....
- (a) Option premium.
  - (b) Current price of the underlying asset.
  - (c) Strike price.
  - (d) Initial investment Net of Premium.
- D 15. The spot price of an investment asset that provides no income is Rs. 3000 and the risk-free rate for all maturities (with yearly compounding) is 10%. The three- year forward price of same investment shall be.....
- (a) Rs. 3,993
  - (b) Rs. 4,050
  - (c) Rs. 4,020
  - (d) Rs. 4,034
- D 16. As per Real Option in Capital Budgeting any commitment to disinvest upon the action of another party is called \_\_\_\_\_.

- (a) Long Call
- (b) Long Put
- (c) Short Call
- (d) Short Put

### Q. 17 to 19 - Case Scenario :

X and Y are two friends. Since Y has earned a lot of profit from trading in financial derivative market, X is also considering speculating on Gamma Corporation's shares which is currently trading at ₹ 700 per share through taking positions in options in stocks of same company. Accordingly, X took following contract positions in the options on Gama Corporation's stock:

- i) Purchasing one contract of 2-month call option with a premium of ₹ 35 and an exercise price of ₹ 750.
- ii) Purchasing one contract of 2-month put option with a premium of ₹ 25 and an exercise price of ₹ 600.

After some time, trading in Option Market and understanding the nitty-gritties of same, X being CEO in an organization advised his team to implement the concept of Financial Options in the Capital Budgeting decisions called 'Real Option'.

Based on the above information answer the following 17 to 19 questions:

17. Assuming that the contract size of each option contract is 100 and the price of Gama Corporation's share after two months falls to ₹ 550, the net pay-off of X will be.....

- (a) ₹ 1,000 loss
- (b) ₹ 1,000 profit
- (c) ₹ 3,000 profit
- (d) ₹ 3,000 loss

18. The per share price of Gama Corporation's stock after 2 months at which X shall be at Break Even is.....

- (a) ₹ 540
- (b) ₹ 600
- (c) ₹ 625
- (d) ₹ 785

19. Which of the following statement is false regarding Real Options?

- (a) Real Options methodology is an approach to capital budgeting that relies on Option Pricing theory to evaluate projects.
- (b) Real options approach is intended to supplement, and not replace, capital budgeting analyses based on standard Discounted Cash Flow (DCF) methodologies.
- (c) Real options are different from financial options as their periods start from the end of 1st year and are higher than financial options.
- (d) Real options are normally traded in the market and are priced.

Q.	Ans.	Description
1	C	In Indian context first two options are modern method and last option is more related to financial instruments.
2	A	As such no particular terms are used for remaining options.
3	C	Selling of Future Contracts in the share.
4	A	closing out the position.
5	D	First three elements are mutually negotiated by the parties among themselves.
6	C	Forwards
7	C	Depends on the purpose of the person taking position in Future Market. Moreover, there are low possibility of arbitrage opportunities in Future market.
8	B	Contrary to Option, in Forward and Future, a commitment is involved.
9	B	Rs. 3,584
10	D	Rs. 197.03
11	A	Rs. 20 is sunk cost. By exercising option Rs.40 be more lost.
12	B	Rs. 4,000
13	D	Kho
14	D	Initial investment Net of Premium.
15	A	Rs. 3,993
16	C	Short Call
17	A	₹ 1,000 loss
18	A	₹ 540
19	D	Real options are normally traded in the market and are priced.

## Foreign Exchange Exposure and Risk Management

- S** 1. Suppose Hari approaches a forex dealer who loads INR 1.00 margin on the interbank rate for travel related remittances. If in the interbank market the USD is quoted at INR 85.46 - 85.50 then Mr. Hari
- (a) can buy travel card at INR 84.46.
  - (b) can buy travel card at INR 84.50.
  - (c) can buy travel card at INR 86.46.
  - (d) can buy travel card at INR 86.50.
- S** 2. On October 10, 2022, the Spot exchange rate is INR / USD = INR 66.2525- INR 67.5945 and the two months swap points are 125 and 195. What would be the foreign exchange rate after 2 months?
- (a) INR / USD = INR 66.2620 - INR 67.6070
  - (b) INR / USD = INR 66.2400 - INR 67.5750
  - (c) INR / USD = INR 66.2330 - INR 67.5820
  - (d) INR / USD = INR 66.2650 - INR 67.6140
- S** 3. US dollar is quoted today as: spot \$ 1 = INR 80 and six months forward \$1 = INR 83.
- (a) This means \$ is at discount
  - (b) This means future of rupee is uncertain
  - (c) This means future of rupee is unclear
  - (d) This means \$ is at premium
- M** 4. If USD/INR spot is trading at 83.2000 and one year Swap annualized premium is trading at 6.8% then what would be the net outright rate
- (a) 77.4500
  - (b) 77.5524
  - (c) 88.4500
  - (d) 88.8576
- M** 5. US dollar is quoted today as: spot \$ 1 = Rs. 80 and six months forward \$1 = Rs. 84. The annualized forward margin is.....
- (a) 10%
  - (b) 5%
  - (c) 3%

(d) 6%

- M 6. Combination of two fixed floating currency swaps to fixed to fixed currency swap is called?  
(a) Vanilla Swap  
(b) Circus Swap  
(c) Extendible Swap  
(d) Roller-Coaster Swaps
- M 7. ....Theory substantiates that the expected disparity between the exchange rate of two currencies is approximately equal to the difference between their countries' nominal interest rates.  
(a) Interest Rate Parity  
(b) Purchasing Power Parity  
(c) International Fisher Effect (IFE)  
(d) None of these
- M 8. How does a deficit in current account affect the exchange rate of a country?  
(a) Appreciation of home currency  
(b) Depreciation of home currency  
(c) No impact on the exchange rate  
(d) It depends on the size of the deficit
- D 9. T & L Ltd has submitted its bid along with bid bond guarantee of its bank for Green-house gas construction project in Australia with expected cash flows spread over next 3 years. Though its pricing is very competitive, it is not sure of securing it due to other factors. But if secured, it has a huge exchange risk in the invoicing currency viz.: AUD. It can opt for the following derivative product to protect itself.  
(a) Forward contract  
(b) Futures contract  
(c) Option contract  
(d) Swaps
- D 10. An Indian exporter expecting a remittance of USD 5 Million, planning to hedge his position by option contracts should.....  
(a) buy Call Option in USD.  
(b) buy Put Option in USD.  
(c) buy Call Option in INR.  
(d) buy Put Option in INR.

- D** 11. How can expectations affect the exchange rate of a currency?  
 (a) Speculators can have a substantial impact on exchange rate through speculations.  
 (b) The current spot/forward rates are often used to develop forecasts.  
 (c) A combination of forecasting techniques is used to develop forecasts.  
 (d) Historical data is used to predict future values.
- D** 12. A Trader sold 20 lots of USD/INR in an exchange (1 lot = \$ 1000) via currency futures. He dealt at a future price of INR 78/\$ for 3 months. Currently future price is trading at INR 82/\$. The M2M (Mark to Market) of trader in the exchange shall be.....  
 (a) INR 4000  
 (b) INR 8000  
 (c) INR 80000  
 (d) INR 40000

Q.	Ans.	Description
1	D	Margin is added in selling rate by bank.
2	D	Swaps points shall be added to the respective rates.
3	D	As more INR need to be surrendered to acquire same amount of US \$.
4	D	Rs. 83.200 (1.068) = Rs. 88.8576
5	A	$[(84-80)/80] \times 12/6 \times 100 = 10\%$
6	B	Acronym stands for Combined Interest Rate and Currency Swap.
7	C	International Fisher Effect (IFE)
8	B	More foreign exchange is required to settle trade bills.
9	C	In case if contract is not secured even then will not be bound by the contract in AUD.
10	B	buy Put Option in USD.
11	A	A lot of speculation activities results in unanticipated demand and supply of foreign currencies.
12	C	$(\text{INR } 82 - \text{INR } 78) \times \$ 1000 \times 20 = \text{INR } 8000$

## International Financial Management

- M** 1. Which of the following factors are crucial in multinational capital budgeting?
- (a) Cash flows from domestic projects.
  - (b) Profits remitted to the host country.
  - (c) Effect of foreign exchange risk on the parent firm's cash flow.
  - (d) Changes in rates of inflation in the parent country.
- D** 2. What is the difference between evaluating a project-based cash flows and parent firms cash flows?
- (a) Evaluation based on parent firms cash flows requires competition with existing local firms.
  - (b) Evaluation based on parent firms cash flows involves financial cash flows only.
  - (c) Evaluation based on parent firms cash flows eliminates problems associated with fluctuating exchange rate changes.
  - (d) Evaluation based on parent firms cash flows involves operating and financial cash flows.

Q.	Ans.	Description
1	C	More or less first two options are based on third option. Changes in rates in inflation in parent country indirectly impacts the capital budgeting decision.
2	D	In case of evaluation of foreign projects the actual cash remitted plays a big role.

## Interest Rate Risk Management

- M** 1. The primary difference between an interest rate swap contract and a forward contract can be on account of.....
- underlying
  - time of payment
  - daily marking to the market
  - number of exchanges
- D** 2. Which of the following contract involves the notional principal for the purpose of exchange of liabilities.
- Currency Swap
  - Plain Vanilla Swap
  - Forward Contract
  - None of these
- D** 3. Suppose A Ltd. is entering into an interest rate swap with a notional principal of Rs. 10,00,00,000. At the beginning of the swap the initial amount of money the counterparties must exchange.....
- Rs. 0
  - Rs. 5,000,000
  - The future value of Rs.10,00,00,000
  - Rs. 10,00,00,000 discounted

Q.	Ans.	Description
1	D	number of exchanges
2	B	Plain Vanilla Swap
3	A	Settlement shall be made as per prevailing interest rates on forthcoming reset dates.

## Business Valuation

- S** 1. ....approach attempts to identify multi-industry companies that are undervalued and would have more value if separated from each other.
- (a) Economic Value Added Method
  - (b) Market Value Added Method
  - (c) Chop-Shop Method
  - (d) None of the above
- M** 2. ....method involves valuation as per determination of the cost of group of assets and liabilities of equivalent company in the open market.
- (a) Net Asset Value
  - (b) Net Realizable Value
  - (c) Replaceable Value
  - (d) None of the above
- D** 3. X Ltd. made a net profit of Rs. 50,00,000 and incurred expenses of Rs. 15,00,000. The number of issued Equity shares is 10,00,000. The company has a debt of Rs. 5,00,000. The market related details are as follows:  $R_f = 10%$  Market Rate of Return = 15%  $\beta = 1.2$  The per share Earning Value of the company shall be.....
- (a) Rs. 31.25
  - (b) Rs. 21.88
  - (c) Rs. 312.50
  - (d) Rs. 218.75

Q.	Ans.	Description
1	C	Other two methods mainly concerned with Cost of Capital.
2	C	Net Asset Value method is based on Balance Sheet. Net Realizable Value can be defined as realizable value of all assets after deduction of liquidation expenses and paying off liabilities.
3	A	$[(5000000/016)/1000000] = 31.25$

# Mergers, Acquisitions and Corporate Restructuring

- S 1. Which type of merger happens when two companies that have buyer-seller relationship (or potential buyer-seller relationship) come together?
  - (a) Horizontal Merger
  - (b) Vertical Merger
  - (c) Conglomerate Merger
  - (d) Congeneric Merger
  
- M 2. The general reason for a divestiture, such as a sell-off or spin-off may be.....
  - (a) Synergy
  - (b) Economics of scale
  - (c) Reverse synergy
  - (d) None of these
  
- D 3. A merger that combines companies deal with the same product but in separate markets is called a.....
  - (a) market extension merger.
  - (b) pure conglomerate merger.
  - (c) vertical merger.
  - (d) reverse merger.

## Q. 4 to 7 - Case Scenario :

P Ltd. is studying the possible acquisition of Q Ltd. by way of merger. The following data are available:

Firm	After-tax earnings	No. of equity shares	Market price per share	Book Value Per share
P Ltd.	Rs. 10,00,000	2,00,000	Rs. 75	Rs. 210
Q Ltd.	Rs. 3,00,000	50,000	Rs. 60	Rs. 105

The merger shall be gone through by exchange of equity shares and the exchange ratio is set according to different weights assigned to different basis as mentioned below :-

EPS	50%
Market Price	25%
Book Value	25%

Based on above information Answer the following 4 to 7 Questions.

4. The swap ratio based on assigned weights shall be.....
  - (a) 0.825
  - (b) 0.925
  - (c) 0.952
  - (d) 0.752
  
5. Based on swap ratio as per assigned weights the total number of shares issued by P Ltd to Q Ltd. shall be.....
  - (a) 46250
  - (b) 41250
  - (c) 47600
  - (d) 37600
  
6. Post merger the EPS of the P Ltd. shall be.....
  - (a) 5.39
  - (b) 5.25
  - (c) 5.28
  - (d) 5.47
  
7. In case Q Ltd. wants to be sure that its EPS is not diminished by the merger, the relevant exchange ratio to achieve the same objective should be.....
  - (a) 0.83
  - (b) 1.20
  - (c) 1.30
  - (d) 1.10

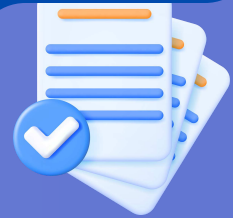
Q.	Ans.	Description
1	B	In horizontal merger two companies merged are in the same industry. Conglomerate mergers involve firms engaged in unrelated type of business operations. In congeneric mergers, the acquirer and the target companies are related through basic technologies, production processes or markets.
2	C	Reverse synergy
3	A	market extension merger.
4	B	0.925
5	A	46250
6	C	5.28
7	B	1.20

## Startup Finance

- M 1. Which of the following can not be considered as a potential source of startup financing?  
 (a) Bank loans  
 (b) Personal financing  
 (c) Crowdfunding  
 (d) Government grants
- M 2. In corporate restructuring when a company sells shares of the new company in market by making a public offer is called\_\_\_\_\_.  
 (a) Sell off  
 (b) Spin Off  
 (c) Split up  
 (d) Equity Carve Outs
- D 3. Which among the following is not a method to approach a pitch presentation?  
 (a) Introduction of the team  
 (b) The market size of the product  
 (c) Explaining the approach to be followed to solve a problem  
 (d) Method to be followed by the firm to bootstrap
- D 4. The vendor financing in startup involves.....  
 (a) borrowing funds from customer to lend funds to the company.  
 (b) borrowing funds from customer to purchase products from the company.  
 (c) lending funds to customer so that he can purchase products from different vendor.  
 (d) lending funds to customer so that he can purchase products from the company itself.

Q.	Ans.	Description
1	D	Government grants are generally provided for some specific purposes.
2	D	Equity Carve Outs
3	D	Method to be followed by the firm to bootstrap
4	D	lending funds to customer so that he can purchase products from the company itself.

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