CF1 EDUCATION

Top 100 Most Asked Finance Interview questions and answers

GENERAL FINANCE QUESTIONS

1. What does the inventory turnover ratio show?

The inventory turnover ratio is an efficiency ratio that shows how effectively inventory is managed by comparing the cost of goods sold with the average inventory for a period.

2. What is the return on equity?

Return on equity (ROE) is a ratio that provides investors with insight into how efficiently a company is managing the equity that shareholders have contributed to the company.

Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on Equity = Net Income – Pref. dividend (if, any) / Shareholder's Equity.

3. What is the net worth of a company?

Net worth is the amount by which assets exceed liabilities. Net worth is a concept applicable to individuals and businesses as a key measure of how much an entity is worth. A consistent increase in net worth indicates good financial health

4. What is the operating cycle / Cash Conversion Cycle?

The operating cycle is also known as the cash conversion cycle. In the context of a manufacturer, the operating cycle has been described as the amount of time that it takes for a manufacturer's cash to be converted into products plus the time it takes for those products to be sold and turned back into cash.

5. What is the difference between EBIT and EBITDA? Can EBIT be greater than EBIDTA?

EBIT represents the approximate amount of operating income generated by a business, while EBITDA roughly represents the cash flow generated by the operations of a business.

6. Distinguish between Budgeting and Forecasting?

Budgeting and financial forecasting are financial planning techniques that help a business enterprise to achieve its desired levels of profits.
Budgeting uses estimation to quantify the desired levels of revenues, profits, and cash flows that a business wants to achieve for a future period, whereas financial forecasting is used to estimate the amount of revenues that will likely be achieved. Budgeting essentially is a plan for where a business wants to go, whereas financial forecasting indicates where the business is headed given the scenario.

Budgeting is essentially planning whereas forecasting is estimating based on the given indicators. Hence, forecasting would indicate whether budgets will be achieved or not.

7. What is nifty and Sensex?

SENSEX:
The Sensex also called the BSE 30, is a stock market index of 30 well-established and financially sound companies listed on the Bombay Stock Exchange (BSE).

30 companies are selected based on the free float market capitalization.
These are different companies from different sectors representing a sample of large, liquid, and representative companies.

The base year of Sensex is 1978-79 and the base value is 100.
It is an indicator of market movement. If Sensex go up, it means that most of the stocks in India went up during the given period.

If the Sensex goes down, this tells you that the stock price of most of the major stocks on the BSE has gone down.

NIFTY

The NIFTY 50 index is the National Stock Exchange of India's benchmark stock market
index for the Indian equity market. Nifty is owned and managed by India Index Services and Products (IISL).

The base year is taken as 1995 and the base value is set to 1000.
Nifty is calculated on 50 stocks actively traded in the NSE

8. What are EPS and diluted EPS?

EPS is the portion of a company's profit that is allocated to every individual share of the stock. It is a term that is of much importance to investors and people who trade in the stock market. The higher the earnings per share of a company, the better is its profitability.

EPS - PAT/ TOTAL NO. O/S SHARES

Diluted EPS

Diluted EPS considers what would happen if dilutive securities were exercised. Dilutive securities are securities that are not common stock but can be converted to common stock if the holder exercises that option. If converted, dilutive securities effectively increase the weighted number of shares outstanding, and this, in turn, decreases EPS, because the calculation for EPS uses a weighted number of shares in the denominator.

9. What is derivative

A derivative is a security with a price that is dependent upon or derived from one or more underlying assets. The derivative itself is a contract between two or more parties based upon the asset or assets. Its value is determined by fluctuations in the underlying asset.

The most common underlying assets include stocks, bonds, commodities, currencies, interest rates, and market indexes.

Derivatives can either be traded over the counter (OTC) or on an exchange. OTC derivatives constitute the greater proportion of derivatives in existence and are unregulated, whereas derivatives traded on exchanges are standardized. OTC derivatives generally have a greater risk for the counterparty than standardized derivatives.

10. What is option trading?

Options are a type of derivative security. They are a derivative because the price of an option is intrinsically linked to the price of something else. Specifically, options are contracts that grant the right, but not the obligation to buy or sell an underlying asset at a set price on or before a certain date. The right to buy is called a call option and the right to sell is a put option.

11. Difference between call and put options?

Call options - provide the holder the right (but not the obligation) to purchase an underlying asset at a specified price (the strike price), for a certain period. If the stock fails to meet the strike price before the expiration date, the option expires and becomes worthless. Investors buy calls when they think the share price of the underlying security will rise or sell a call if they think it will fall. Selling an option is also referred to as ''writing'' is an option.

Put options - give the holder the right to sell an underlying asset at a specified price (the strike price). The seller (or writer) of the put option is obligated to buy the stock at the strike price. Put options can be exercised at any time before the option expires. Investors buy puts if they think the share price of the underlying stock will fall or sell one if they think it will rise. Put buyers - those who hold a "long" - put are either speculative buyers looking for leverage or "insurance" buyers who want to protect their long positions in a stock for the period covered by the option. Put sellers hold a "short" expecting the market to move upward (or at least stay stable) A worst-case scenario for a put seller is a downward market turn.

The maximum profit is limited to the put premium received and is achieved when the price of the underlying is at or above the option's strike price at expiration. The maximum loss is unlimited for an uncovered put writer.

12. Explain Future and Forward Contract?

A forward contract is a customized contractual agreement where two private parties agree to trade a particular asset with each other at an agreed specific price and time in the future. Forward contracts are traded privately over the counter, not on an exchange.

A futures contract — often referred to as futures — is a standardized version of a forward contract that is publicly traded on a futures exchange. Like a forward contract, a futures contract includes an agreed-upon price and time in the future to buy or sell an asset — usually stocks, bonds, or commodities, like gold.

13. What are Swaps

A swap is an agreement between two parties to exchange sequences of cash flows for a set period. Usually, at the time the contract is initiated, at least one of these series of cash flows is determined by a random or uncertain variable, such as an interest rate, foreign exchange rate, equity price, or commodity price. Conceptually, one may view a swap as either a portfolio of forward contracts or as a long position in one bond coupled with a short position in another bond. This article will discuss the two most common and most basic types of swaps: the plain vanilla interest rate and currency swaps.

14. Explain valuation and techniques

Valuation is the process of determining the current worth of an asset or a company; there are many techniques used to determine value. An analyst placing a value on a company looks at the company's management, the composition of its capital structure, the prospect of future earnings, and the market value of assets.

Techniques

1. Discounted cash flow (DCF) analysis.
2. Comparable transactions method.
3. Market valuation.
4. Book value

15. What is financial risk management

Financial risk management is the practice of economic value in a firm by using financial instruments to manage exposure to risk: Operational risk, credit risk, market risk, foreign exchange risk, Shape risk, Volatility risk, Liquidity risk, Inflation risk, Business risk, Legal risk, Reputational risk, Sector risk, etc. Like general risk management, financial risk management requires identifying its sources, measuring it, and planning to address them.

16. What are SLR, CRR, REPO, Reverse Repo, and rates

Repo rate also known as the benchmark interest rate is the rate at which the RBI lends money to the banks for a short term. When the repo rate increases, borrowing from RBI becomes more expensive. If RBI wants to make it more expensive for the banks to borrow money, it increases the repo rate similarly, if it wants to make it cheaper for banks to borrow money it reduces the repo rate. The current repo rate is 5.40%.

The reverse Repo rate is the short-term borrowing rate at which RBI borrows money from banks. The Reserve Bank uses this tool when it feels there is too much money floating in the banking system. An increase in the reverse repo rate means that the banks will get a higher rate of interest from RBI. As a result, banks prefer to lend their money to RBI which is always safe instead of lending it to others (people, companies etc) which is always risky. Rate – 3.35%

CRR - Cash Reserve Ratio - Banks in India are required to hold a certain proportion of their deposits in the form of cash. However, Banks don't hold these as cash with
themselves, they deposit such cash (aka currency chests) with the Reserve Bank of India, which is considered as equivalent to holding cash with themselves. This minimum ratio (that is the part of the total deposits to be held as cash) is stipulated by the RBI and is known as the CRR or Cash Reserve Ratio. Rate – 4.50%

SLR - Statutory Liquidity Ratio - Every bank is required to maintain at the close of
business every day, a minimum proportion of their Net Demand and Time Liabilities as liquid assets in the form of cash, gold, and unencumbered approved securities. The ratio of liquid assets to demand and time liabilities is known as Statutory Liquidity Ratio (SLR). Rate –18%

17. Difference between broad money and narrow money

Narrow money is a category of money supply that includes all physical money like coins and currency along with demand deposits and other liquid assets held by the central bank. In the United States, narrow money is classified as M1 (M0 + demand accounts).

Broad money is the most inclusive method of calculating a given country's money supply. The money supply is the totality of assets that households and businesses can use to make payments or to hold as short-term investments, such as currency, funds in bank accounts, and anything of value resembling money.

18. Explain dividend models?

The Gordon growth model is used to determine the intrinsic value of a stock based on a future series of dividends that grow at a constant rate. Given a dividend per share that is payable in one year and the assumption the dividend grows at a constant rate in perpetuity, the model solves for the present value of the infinite series of future dividends.

Dividend Growth Model

Value of Stock = Dividend pay-out next year / Required rate of return + Expected growth rate

Dividend Discount Model

Value of Stock = Dividend pay-out next year / Discount rate – Expected growth rate

The dividend discount model (DDM) is a procedure for valuing the price of a stock by using the predicted dividends and discounting them back to the present value. If the value obtained from the DDM is higher than what the shares are currently trading at, then the stock is undervalued.

19. What is a sin tax?

A sin tax is an excise tax specifically levied on certain goods deemed harmful to society, for example, alcohol and tobacco, candies, drugs, soft drinks, fast foods, coffee, sugar, gambling, and pornography. Two claimed purposes are usually used to argue for such taxes.

20. What is STT?

STT is levied on every purchase or sale of securities that are listed on the Indian stock exchanges. This would include shares, derivatives, or equity-oriented mutual funds units.

21. What is deferred tax liability and asset?

Deferred tax asset is an accounting term that refers to a situation where a business has overpaid taxes or taxes paid in advance on its balance sheet. These taxes are eventually returned to the business in the form of tax relief, and the overpayment is, therefore, an asset for the company. Deferred tax liability is an account on a company's balance sheet that is a result of temporary differences between the company's accounting and tax carrying values, the anticipated and enacted income tax rate, and estimated taxes payable for the current year. This liability may be realized during any given year, which makes the deferred status appropriate.

22. Explain cash equivalents?

Cash and cash equivalents refer to the line item on the balance sheet that reports the value of a company's assets that are cash or can be converted into cash immediately. These include bank accounts, marketable securities, commercial paper, Treasury bills, and short-term government bonds with a maturity date of three months or less. Marketable securities and money market holdings are considered cash equivalents because they are liquid and not subject to material fluctuations in value.

23. Difference between Depreciation, Depletion, and Amortization

Depletion refers to the allocation of the cost of natural resources over time. For example, an oil well has a finite life before all the oil is pumped out. Therefore, the oil well's setup costs are spread out over the predicted life of the oil well.

Depreciation is an accounting method of allocating the cost of a tangible asset over its useful life. Businesses depreciate long-term assets for both tax and accounting purposes.

Amortization is an accounting term that refers to the process of allocating the cost of an intangible asset over a period. It also refers to the repayment of loan principal over time.

24. What is accumulated depreciation?

Accumulated depreciation is the total depreciation for a fixed asset that has been charged to expense since that asset was acquired and made available for use.

25. What are free cash flows?

FCF is an assessment of the amount of cash a company generates after accounting for all capital expenditures, such as buildings or property, plant, and equipment. The excess cash is used to expand production, develop new products, make acquisitions, pay dividends, and reduce debt.

FCF - EBIT (1-tax rate) + (depreciation) + (amortization) - (change in networking capital) - (capital expenditure).

26. Profitability and valuation ratios

Profitability Ratio

1. Gross Profit
2. Net profit
3. Return on equity
4. Return on assets

Valuation Ratios

1. P/E ratios
2. EPS
3. Price / Book value

27. Difference between solvency and liquidity?

Solvency is defined as the firm's potential to carry on business activities in the foreseeable future, to expand and grow. It is the measure of the company's capability to fulfill its long-term financial obligations when they fall due for payment.

28. Difference between an operating lease and a financial lease?

A finance lease is often used to buy equipment for a major part of its useful life. The goods are financed ex GST and have a balloon at the end of the term. Here, at the end of the lease term, the lessee will obtain ownership of the equipment upon a successful 'offer to buy' the equipment. Traditionally this 'offer' is the balloon amount.

An operating lease agreement to finance equipment for less than its useful life and the lessee can return equipment to the lessor at the end of the lease period without any further obligation.

29. What is asset acquisition?

An asset acquisition strategy is the purchase of a company by buying its assets instead of its stock. An asset acquisition strategy may be used for a takeover or buyout if the target is bankrupt. Liquidity is the firm's ability to fulfill its obligations in the short run, normally one year. It is the near-term solvency of the firm, i.e., to pay its current liabilities.

30. Explain the leverage ratio and solvency ratio

A leverage ratio is any one of several financial measurements that look at how much capital comes in the form of debt (loans) or assesses the ability of a company to meet financial obligations.

The solvency ratio indicates whether a company's cash flow is sufficient to meet its short-term and long-term liabilities. The lower a company's solvency ratio, the greater the probability that it will default on its debt obligations.

31. Difference between the current ratio and the quick ratio?

The current ratio is a financial ratio that investors and analysts use to examine the liquidity of a company and its ability to pay short-term liabilities (debt and payables) with Its short-term assets (cash, inventory, receivables). The current ratio is calculated by dividing current assets by current liabilities.

The quick ratio, on the other hand, is a liquidity indicator that filters the current ratio by measuring the amount of the most liquid current assets there are to cover current liabilities (you can think of the "quick" part as meaning assets that can be liquidated fast). The quick ratio also called the "acid-test ratio," is calculated by adding cash & equivalents, marketable investments, and accounts receivables, and dividing that sum by current liabilities.

The main difference between the current ratio and the quick ratio is that the latter offers the more conservative view of the company’s ability to meet its short-term liabilities with its short-term assets because it does not include inventory and other current assets that are more difficult to liquidate (i.e., turn into cash). By excluding inventory (and other less liquid assets) the quick ratio focuses on the company’s more liquid assets.

32. What is working capital and what is net working capital?

Working capital is the amount of a company's current assets minus the amount of its current liabilities. The adequacy of a company's working capital depends on the industry in which it competes, its relationship with its customers and suppliers, and more.

33. Components of cash flows Statement

- Cash flow resulting from operating activities.
- Cash flow resulting from investing activities.
- Cash flow resulting from financing activities.
- It also may include disclosure of non-cash financing activities.

34. What is goodwill?

Goodwill is an intangible asset that arises because of the acquisition of one company by another for a premium value. The value of a company’s brand name, solid customer base, good customer relations, good employee relations, and any patents or proprietary technology represent goodwill. Goodwill is considered an intangible asset because it is not a physical asset like buildings or equipment. The goodwill account can be found in the assets portion of a company's balance sheet.

35. How to calculate goodwill?

1. Calculating Goodwill Using Average Profits – Avg profits * no of years.
2. Goodwill using super profits (Actual profit – normal profit)
3. Goodwill by capitalization of profits

36. What is contingent liability?

A contingent liability is a potential liability that may occur, depending on the outcome of an uncertain future event. A contingent liability is recorded in the accounting records if the contingency is probable, and the amount of the liability can be reasonably estimated.

37. What is NPA?

A nonperforming asset (NPA) refers to a classification for loans on the books of financial institutions that are in default or are in arrears on scheduled payments of principal or interest. In most cases, debt is classified as nonperforming when loan payments have not been made for a period of 90 days.

Around 7.7 Lakh cr of NPA in India in the year 2017.

38. What are REITs?

REIT, or Real Estate Investment Trust, is a company that owns or finances income-producing real estate. Modeled after mutual funds, REITs provide investors with all types of regular income streams, diversification, and long-term capital appreciation. ... In turn, shareholders pay income taxes on those dividends.

39. What is the book value of a business?
Equity shares holdings + Reserves and surplus + Net profit

40. What is financial modeling?

It is the goal of the analyst to accurately forecast the price or future earnings performance of a company. Numerous valuation and forecast theories exist, and financial analysts can test these theories by recreating business events in an interactive calculator referred to as a financial model. A financial model tries to capture all the variables in a particular event.

41. What is the difference between private equity and venture capital?

Private equity firms mostly buy mature companies that are already established. The companies may be deteriorating or not making the profits they should be due to inefficiency. Private equity firms buy these companies and streamline operations to increase revenues. Venture capital firms, on the other hand, mostly invest in start-ups with high growth potential.

42. Which is cheaper debt or equity?

A company should always optimize its capital structure. If it has taxable income it can benefit from the tax shield of issuing debt. If the firm has immediately steady cash flows and is able to make their interest payments it may make sense to issue debt if it lowers the WACC.

43. What is accretion and dilution?

Accretion is asset growth through addition or expansion. Accretion can occur through a company's internal development or by way of mergers and acquisitions.

Dilution is a reduction in earnings per share of common stock that occurs through the issuance of additional shares or the conversion of convertible securities. Adding to the number of shares outstanding reduces the value of the holdings of existing shareholders.

44. What is the difference between commercial and investment banking?

Commercial bank: accepts deposits from customers and makes consumer and commercial loans using these deposits.

Investment bank: acts as an intermediary between companies and investors. Does not accept deposits, but rather sells investments, advises on M&A, etc...loans and
debt/equity issues originated by the bank are not typically held by the bank but rather sold to third parties on the buy side through their sales and trading arms.

WACC – Weighted Average cost of capital - (ME/E+D Re) + (MD/E+D*Rd)*(1-t)
ME – Market Value of Equity
E – Equity
D – Debt
Re – Cost of equity
Rd – Cost of Debt
T – Tax rate

A company is typically financed using a combination of debt (bonds) and equity (stocks). Because a company may receive more funding from one source than another, we calculate a weighted average to find out how expensive it is for a company to raise the funds needed to buy buildings, equipment, and inventory.

It's important for a company to know its weighted average cost of capital to gauge the expense of funding future projects. The lower a company's WACC, the cheaper it is for a company to fund new projects.

45. Implications of (1 – T) in the WACC formula?

There are tax deductions available on interest paid, which is often to companies' benefit. Because of this, the net cost of companies' debt is the amount of interest
they are paying, minus the amount they have saved in taxes as a result of their tax-deductible interest payments. This is why the after-tax cost of debt is considered.

46. What is the cost of debt and the cost of equity?

Cost of Debt - Total interest payable / Total Debt * 100
The cost of Debt is the total Cost(interest) that a company is required to pay on the borrowed money. The cost of debt refers to the effective rate a company pays on its current debt.

Cost of Equity = CAPM AND DIVIDEND GROWTH MODEL
Cost of equity refers to a shareholder's required rate of return on an equity investment. It is the rate of return that could have been earned by putting the same money into a different investment with equal risk.

47. Explain CAPM?

CAPM = Rf + B (Rm-Rf)
Rf = Risk Free rate
B = Beta
Rm = Market risk

The capital asset pricing model (CAPM) is a model that describes the relationship between systematic risk and expected return for assets, particularly stocks. CAPM is widely used throughout finance for the pricing of risky securities, generating expected returns for assets given the risk of those assets, and calculating costs of capital.

The CAPM model says that the expected return of a security or a portfolio equals the rate on a risk-free security plus a risk premium. If this expected return does not meet or beat the required return, then the investment should not be undertaken. The security market line plots the results of the CAPM for all different risks (betas).

48. Meaning of BETA and can it be negative?

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market.

A security's beta is calculated by dividing the covariance between the security's returns and the benchmark's returns by the variance of the benchmark's returns over a specified period.
A beta of 1 indicates that the security's price moves with the market. A beta of less than 1 means that the security is theoretically less volatile than the market. A beta of greater than 1 indicates that the security's price is theoretically more volatile than the market. For example, if a stock's beta is 1.2, it's theoretically 20% more volatile than the market.

Conversely, if an ETF's beta is 0.65, it is theoretically 35% less volatile than the market. beta less than 0, which would indicate an inverse relation to the market - is possible but highly unlikely. However, some investors believe that gold and gold stocks should have negative betas because they tended to do better when the stock market declines.

49. What is the required rate of return?

The required rate of return (RRR) is the minimum annual percentage earned by an investment that will induce individuals or companies to put money into a particular security or project. The RRR is used in both equity valuation and in corporate finance.

Investors use the RRR to decide where to put their money, and corporations use the RRR to decide if they should pursue a new project or business expansion.

50. What is the risk-free return

Risk-free return is the theoretical rate of return attributed to an investment with zero risk.
The risk-free rate represents the interest on an investor's money that he or she would expect from a risk-free investment over a specified period.

51. What is a hedge fund?

Hedge funds are alternative investments using pooled funds that employ numerous different strategies to earn active return, or alpha, for their investors. Hedge funds may be aggressively managed or make use of derivatives and leverage in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). One aspect that has set the hedge fund industry apart is the fact that hedge funds face less regulation than mutual funds and other investment vehicles.

52. What is hedging?

Most people have, whether they know it or not, engaged in hedging. For example, when you take out insurance to minimize the risk that an injury will erase your income or you buy life insurance to support your family in the case of your death, this is a hedge.

53. How will you calculate enterprise value?

Enterprise Value, or EV for short, is a measure of a company's total value, often used as a more comprehensive alternative to equity market capitalization. The market capitalization of a company is simply its share price multiplied by the number of shares a company has outstanding. Enterprise value is calculated as the market capitalization plus debt, minority interest, and preferred shares, minus total cash and cash equivalents.
EV = market value of common stock + market value of preferred equity + market

value of debt + minority interest - cash and investments.

54. What is minority interest?

Minority Interest also referred to as non-controlling interest (NCI), is the share of ownership in a subsidiary's equity that is not owned or controlled by the parent corporation. The parent company has a controlling interest of 50 to less than 100 percent in the subsidiary and reports the financial results of the subsidiary consolidated with its own financial statements

For example, suppose that Company A acquires a controlling interest of 75 percent in Company B. In this case, the minority interest in Company B will be 25%. On its financial statements, Company A cannot claim the entire value of Company B without accounting for the 25 percent that belongs to the minority shareholders of Company B. Thus, company A must incorporate the impact of Company B's minority interest on its balance sheet and income statements.

55. IPO AND BOOK BUILDING PROCESS

An initial public offering (IPO) is the first time that the stock of a private company is offered to the public. (HDFC Standard Life Insurance) (Biggest IPO – COAL INDIA –15200cr) Book building is the process by which an underwriter attempts to determine at what price to offer an initial public offering (IPO) based on demand from institutional investors. An underwriter builds a book by accepting orders from fund managers, indicating the number of shares they desire and the price they are willing to pay.

56. Requirement for bringing IPO

The company has net tangible assets of at least Rs. 3 crores in each of the preceding 3 full years (of 12 months each), of which not more than 50% is held in monetary assets: The company has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least three (3) out of immediately preceding five (5) years.

The company has a net worth of at least Rs. 1 crore in each of the preceding 3 full years (of 12 months each).

In case the company has changed its name within the last year at least 50% of the revenue for the preceding 1 full year is earned by the company from the activity suggested by the new name.

The aggregate of the proposed issue and all previous issues made in the same financial year in terms of size (i.e., offer through offer document + firm allotment + promoters' contribution through the offer document), does not exceed five (5) times its pre-issue net worth as per the audited balance sheet of the last financial year.)

57. Sources of Raising Funds

- Issue of Shares.
- Issue of Debentures.
- Loans from Financial Institutions.
- Loans from Commercial Banks.
- Public Deposits.
- Reinvestment of Profits

58. Explain NPV and IRR and how you calculate the same

Net Present Value (NPV) is the difference between the present value of cash inflows and the present value of cash outflows. NPV is used in capital budgeting to analyze the profitability of a projected investment or project.

NPV = Cash inflows / (1+r) ^n – Cash outflows

Internal rate of return (IRR) is a metric used in capital budgeting to measure the profitability of potential investments. The internal rate of return is a discount rate that makes the net present value (NPV) of all cash flows from a particular project equal to zero. the higher a project's internal rate of return, the more desirable it is to undertake the project.

IRR is uniform for investments of varying types and, as such, IRR can be used to rank multiple prospective projects a firm is considering on a relatively even basis.

59. Can the IRR be negative?

Negative IRR indicates that the sum total of the post-investment cash flows is less than the initial investment, i.e. the non-discounted cash flows add up to a value that is less than the investment. Yes, both in theory and practice negative IRR exists, and it means that an investment loses money at the rate of the negative IRR.

In such cases, the net present value (NPV) will always be negative unless the cost of capital is also negative, which may not be practically possible.

However, a negative NPV doesn't always mean a negative IRR. Negative NPV simply means that the cost of capital or discount rate is more than the project IRR. IRR is often defined as the theoretical discount rate at which the NPV of a cash flow stream becomes zero.

60. What is typically higher – the cost of debt or the cost of equity?

The cost of equity is higher than the cost of debt because the cost associated with borrowing debt (interest expense) is tax deductible, creating a tax shield. Additionally, the cost of equity is typically higher because, unlike lenders, equity investors are not guaranteed fixed payments, and are last in line at liquidation.

61. What is loan syndication?

Loan syndication is the process of involving several different lenders in providing various portions of a loan. Loan syndication most often occurs in situations where a borrower requires a large sum of capital that may be too much for a single lender to provide or outside the scope of a lender's risk exposure levels. Thus, multiple lenders work together to provide the borrower with the capital needed.

Loan syndication is used in corporate borrowing. Companies seek corporate loans for a wide variety of reasons. Loan syndication is commonly needed when companies are borrowing for mergers, acquisitions, buyouts, and other capital projects. These types of
capital projects often require large loans; thus, loan syndication is mainly used in extremely large loan situations.

62. What is securitization?
Securitization is the process of taking an illiquid asset, or group of assets, and through financial engineering, transforming it (or them) into security. Securitization is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans, or credit card debt obligations (or other non-debt assets which generate receivables) and selling their related cash flows to third-party investors as securities, which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs).

63. What major factors affect the yield on a corporate bond?

The economic factors that influence corporate bond yields are interest rates, inflation, and economic growth. All these factors affect corporate bond yields and exert an influence on each other. The pricing of corporate bond yields is a multivariable, dynamic process in which there are always competing pressures.

For example, economic growth is bullish for corporations as it leads to increased revenues and profits for companies, making it easier for them to borrow money and service debt, which leads to readuced risk of default and lower yields. However, extended periods of economic growth led to inflation risk and upward pressure on wages. Economic growth leads to increased competition for labor and diminished excess capacity.

64. What is financial modeling?

Financial modeling is a quantitative analysis that is used to decide or forecast a project generally in asset pricing models or corporate finance. Different hypothetical variables are used in a formula to ascertain what the future holds for a particular industry or for a particular project. In simple terms, financial modeling means forecasting companies' financial statements like Balance Sheets, Cash Flows, and Income Statement. These forecasts are in turn used for company valuations and financial analysis.

Financial modeling is useful because it helps companies and individuals make better decisions.

Financial modeling is not confined to only a company's financial affairs. It can be used in any area of any department and even in individual cases.

65. Explain valuation.

Valuation is the process of determining the current worth of an asset or a company; there are many techniques used to determine value. An analyst placing a value on a company looks at the company's management, the composition of its capital structure, the prospect of future earnings, and the market value of assets.

66. Techniques of capital budgeting?

- Payback Period.
- Discounted Payback Period.
- Net Present Value
- Internal Rate of Return.

67. What is the payback period and discounted payback period?

The payback period is the length of time required to recover the cost of an investment. The payback period of a given investment or project is an important determinant of whether to undertake the position or project, as longer payback periods are typically not desirable for investment positions.

The discounted payback period is a capital budgeting procedure used to determine the profitability of a project. A discounted payback period gives the number of years it takes to break even from undertaking the initial expenditure, by discounting future cash flows and recognizing the time value of money. The net present value aspect of the discounted payback period does not exist in a payback period in which the gross inflow of future cash flows is not discounted.

68. For whom free cash flows are prepared

Free cash flows for equity (FCFE)
Free cash flows for Firm (FCFF)

69. How to calculate FCFE?

Net Income + D&A + Net Borrowings
- Net Capital Expenditure
- Net Change in working capital

70. How to calculate FCFF

Net Income + D&A + Interest (1-T)
- Capital Expenditure
- Change in working capital

71. How to calculate Free cash flows

EBIT (1-tax rate) + (depreciation) + (amortization) - (change in net working capital) (capital expenditure).

72. What is the principle of cash flow estimation?

Consistency Principle Incremental Principle Separation Principle Post Tax Principle

73. What is DCF and why do we calculate DCF?

A discounted cash flow (DCF) is a valuation method used to estimate the attractiveness of an investment opportunity. DCF analysis uses future free cash flow projections and discounts them to arrive at a present value estimate, which is used to evaluate the potential for investment. If the value arrived at through DCF analysis is higher than the current cost of the investment, the opportunity may be a good one.

74. When would you not use a DCF in a Valuation?

We do not use a DCF if the company has unstable or unpredictable cash flows (tech or bio-tech start-up) or when debt and working capital serve a fundamentally different role. For example, banks and financial institutions do not re-invest debt and working capital is a huge part of their Balance Sheets - so you wouldn't use a DCF for such companies.

75. How to calculate DCF

We take cash flows for each year and discount them with either cost of equity or WACC depending upon which cash we are using.

76. How do you calculate the discount rate?

There are several methods that can be used to determine discount rates. A good approach and the one we'll use in this tutorial – is to use the weighted average cost of capital (WACC) – a blend of the cost of equity and the after-tax cost of debt

77. What is terminal value and how do you calculate the same?

Terminal value (TV) represents all future cash flows in an asset valuation model. This allows models to reflect returns that will occur so far in the future that they are nearly impossible to forecast. The Gordon growth model discounted cash flow and residual earnings all use terminal values that can be calculated with perpetuity growth, while an alternative exit valuation approach employs relative valuation methods.

78. What is a risk-free rate? The current rate in India.

In theory, the risk-free rate is the minimum return an investor expects for any investment because he or she will not accept additional risk unless the potential rate of return is greater than the risk-free rate. W
Current risk-free rate – 6.25%

79. How to calculate beta?

The formula for calculating beta is the covariance of the return of an asset with the return of the Market, divided by the variance of the return of the benchmark over a certain period.

80. What are levered and unlevered beta?

Unlevered beta compares the risk of an unleveled company to the risk of the market. The unleveled beta is the beta of a company without any debt. Unlevering a beta removes the financial effects of leverage. This number provides a measure of how much systematic risk a firm's equity has when compared to the market. Unlevering is also done to compare companies that are in competition so we can use the peer method to calculate WACC.

81. What are systematic risk and unsystematic risk?

Unsystematic risk, also known as "specific risk," "diversifiable risk" or "residual risk," is the type of uncertainty that comes with the company or industry you invest in. Unsystematic risk can be reduced through diversification. For example, news that is specific to a small number of stocks, such as a sudden strike by the employees of a company you have shares in, is an unsystematic risk.

Systematic risk, also known as "market risk" or "un-diversifiable risk", is the uncertainty inherent to the entire market or entire market segment.

82. What is LBO?

leveraged buyout (LBO) is the acquisition of another company using a significant amount of borrowed money to meet the cost of acquisition. The assets of the company being acquired are often used as collateral for the loans, along with the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital.

83. What is a management buyout?

A transaction where a company's management team purchases the assets and operations of the business they manage. A management buyout (MBO) is appealing to professional managers because of the greater potential rewards of being owners of the business rather than employees.

An MBO is different from a management buy-in (MBI), in which an external management team acquires a company and replaces the existing management team. It also differs from a leveraged management buyout (LMBO), where the buyers use the company assets as collateral to obtain debt financing.

84. What do you do in Restructuring?

Restructuring bankers advised distressed companies – businesses going bankrupt, in the midst of bankruptcy, or getting out of bankruptcy – and help them change their capital structure to get out of bankruptcy, avoid it in the first place, or assist with a sale of the company depending on the scenario.

85. Why would a company go bankrupt in the first place?

▪ A company cannot meet its debt obligations/interest payments.
▪ Creditors can accelerate debt payments and force the company into bankruptcy.
▪ An acquisition has gone poorly, or a company has just written down the value of its
assets steeply and needs extra capital to stay afloat (see investment banking industry).

86. What options are available to a distressed company that can't meet debt obligations?

▪ There is a liquidity crunch, and the company cannot afford to pay its vendors or
suppliers.

- Refinance and obtain fresh debt/equity.
- Sell the company (either as a whole or in pieces in an asset sale).
- Restructure its financial obligations to lower interest payments/debt repayments, or
- issue debt with PIK interest to reduce the cash interest expense.
- File for bankruptcy and use that opportunity to obtain additional financing, restructure
- its obligations, and be freed of onerous contracts.

87. What is the end goal of a given financial restructuring?

Restructuring does not change the amount of debt outstanding in and of itself – instead, it changes the terms of the debt, such as interest payments, monthly/quarterly principal repayment requirements, and covenants.

88. Distinguish between merger and acquisition?

A merger occurs when two separate entities combine forces to create a new, joint organization. An acquisition refers to the takeover of one entity by another. A new company does not emerge from an acquisition; rather, the smaller company is often consumed and ceases to exist, and its assets become part of the larger company. Acquisitions – sometimes called takeovers – generally carry a more negative connotation than mergers.

89. What are the reasons for mergers and acquisitions?

- Synergy
- Diversification
- Growth
- Eliminating competition

90. What are horizontal mergers and vertical mergers?

A horizontal merger is when two companies that belong to the same industry merge – for example, if Airtel and Jio merge! They belong to the same industry = telecommunications.

A vertical merger is a merger between two companies that operate at separate stages of the production process for a specific finished product. A vertical merger occurs when two or more firms, operating at different levels within an industry's supply chain, merge operations. Most often, the logic behind the merger is to
increase synergies created by merging firms that would be more efficient operating as one.

91. What is a reverse merger?

A reverse merger (also known as a reverse takeover or reverse IPO) is a way for private companies to go public, typically through a simpler, shorter, and less expensive process.

A conventional initial public offering (IPO) is more complicated and expensive, as private companies hire an investment bank to underwrite and issue shares of the soon-to-be public company.

When acquiring company is weaker or smaller than the one being gobbled up, this is termed a reverse merger. Typically, reverse mergers take place through a parent company merging into a subsidiary, or a profit-making firm merging into a loss-making one.

92. What is a conglomerate merger?

A conglomerate merger is a merger between firms that are involved in totally unrelated business activities. There are two types of conglomerate mergers: pure and mixed. Pure conglomerate mergers involve firms with nothing in common, while mixed conglomerate mergers involve firms that are looking for product extensions or market extensions.

93. Regulators involved in the process of mergers and amalgamation?

- Competition Commission of India
- Reserve Bank of India
- Depositories
- Stock exchanges
- Registrar of Companies
- Regional Director
- Official liquidator
- NCLT – replaced High Courts

94. Benefits and drawbacks of merger

Advantages of mergers

- Economies of scale – bigger firms are more efficient
- More profit enables more research and development.
- Struggling firms can benefit from new management.

Disadvantages of mergers

- Increased market share can lead to monopoly power and higher prices for consumers
- A larger firm may experience diseconomies of scale – e.g., harder to communicate and coordinate.

95. What is the swap ratio?

The ratio in which an acquiring company will offer its own shares in exchange for the target company's shares during a merger or acquisition. To calculate the swap ratio, companies analyze financial ratios such as book value, earnings per share, and profits after tax and dividends paid, as well as other factors, such as the reasons for the merger or acquisition.

96. What is divestiture?

A divestiture is the partial or full disposal of a business unit through sale, exchange, closure, or bankruptcy. A divestiture most commonly results from management the decision to cease operating a business unit because it is not part of a core competency

97. What is the difference between accounts payable and accounts receivable?

Accounts payable are amounts a company owes because it purchased goods or services on credit from a supplier or vendor. Accounts receivables are amounts a company has a right to
collect because it sold goods or services on credit to a customer. Accounts payable are liabilities. Accounts receivable are assets.

98. What are accruals?

Accruals are adjustments for 1) revenues that have been earned but are not yet recorded in the accounts, and 2) expenses that have been incurred but are not yet recorded in the accounts. The accruals need to be added via adjusting entries so that the financial statements report these amounts.

99. What are prepaid expenses?

Prepaid expenses are future expenses that have been paid in advance. You can think of prepaid expenses as costs that have been paid but have not yet been used up or have not yet expired.

The amount of prepaid expenses that have not yet expired are reported on a company's balance sheet as an asset. As the amount expires, the asset is reduced, and an expense is recorded for the reduction. Hence, the balance sheet reports the unexpired costs and the income statement reports the expired costs.

100. What is deferred revenue?

Deferred revenue is not yet revenue. It is an amount that was received by a company in advance of earning it. The amount unearned (and therefore deferred) as of the date of the financial statements should be reported as a liability. The title of the liability account might be Unearned Revenues or Deferred Revenues.

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