

Certified Credit Research Analyst Level 2

AIWMI CCRA-L2

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QUESTION NO: 1

The following information pertains to bonds:

Further following information is available about a particular bond 'Bond F'

There is a 10.25% risky bond with a maturity of 2.25% year(s) its current price is INR105.31, which corresponds to YTM of 9.22%. The following are the benchmark YTM's.

Assuming the G-Sec has not changed from the time January 2013 to April 2013, what can you predict about the changes bond price and change in issues borrowing rates:

- A. Decrease and Increase
- B. Increase and Increase
- C. Decrease and Decrease
- D. Increase and Decrease

ANSWER: D

Explanation:

Increase and Decrease is correct. A bond's market price and its yield to maturity move in opposite directions when its contractual coupon and remaining cash flows are unchanged. Bond F pays a 10.25% coupon while its stated yield to maturity is 9.22%, so it is priced above par at INR105.31; this is consistent with investors requiring a yield below its coupon rate. If the government-security benchmark yield is unchanged between January and April, a movement in the risky bond's required yield is attributable to a change in the credit spread or risk premium rather than a shift in the risk-free curve. A reduction in the required credit spread lowers the yield investors demand from Bond F. Discounting the same promised coupon and principal payments at that lower required yield increases the bond's price. The same lower market-required return also means that the issuer can raise new debt at a lower borrowing rate, assuming comparable maturity, credit risk, and issue terms. Thus, an increase in bond price is accompanied by a decrease in the issuer's borrowing rate. The Reserve Bank of India describes government securities as benchmark instruments in the debt market, while fixed-income valuation conventionally discounts promised cash flows using the market-required yield. See the [RBI's Government Securities FAQ](#) and the [SEC investor bulletin on bonds](#).

QUESTION NO: 2

Which of the following is NOT a conceptual definition of credit risk on which credit models are based?

- A. Default Mode Paradigm
- B. Value-at-Risk paradigm
- C. Mark-to-Market Paradigm

ANSWER: B

Explanation:

Value-at-Risk paradigm is the correct choice because Value at Risk is principally a quantitative risk measure, not a conceptual definition of how credit risk is modelled. It estimates a loss threshold over a stated holding period at a selected confidence level. For example, a credit portfolio VaR may express the loss level that is not expected to be exceeded over one year at a specified probability. The measure can be calculated from different underlying credit-risk modelling approaches and therefore sits downstream of the conceptual framework used to represent credit events and changes in credit quality. In credit-risk practice, it is commonly used to summarize or aggregate the distribution of potential portfolio losses for risk management and capital purposes. The Basel Committee describes VaR as a statistical measure of potential loss and distinguishes the modelling of the underlying risk drivers from the risk metric used to report results. This supports treating Value-at-Risk as an output or measurement framework rather than a foundational conceptual definition of credit risk. See the

QUESTION NO: 3

A coupon bond is trading at 110% of the USD 1000 par value. If the last interest payment was made one month ago and the coupon rate is 12%, the accrued interest on this bond is _____

- A. 110
- B. 100
- C. 120
- D. 10

ANSWER: D

Explanation:

10 is correct. Accrued interest is the coupon interest earned by the bondholder from the most recent coupon-payment date up to the settlement date. It is calculated from the bond's par value, stated annual coupon rate, and elapsed fraction of the coupon year; the bond's quoted trading price of 110% of par does not alter the amount of coupon interest that accrues. The annual coupon payment is USD 120, obtained by multiplying the USD 1,000 par value by the 12% coupon rate. As one month has passed since the last interest payment, the accrued portion is one-twelfth of the annual coupon: $\text{USD } 120 \times 1/12 = \text{USD } 10$. This is the amount normally added to the quoted clean price to determine the invoice, or dirty, price paid by the purchaser. The result assumes the question's monthly fraction convention, which is appropriate because no alternative day-count convention or coupon-payment frequency is provided. FINRA explains that accrued interest is interest that has accumulated since the previous payment date and is paid by a bond buyer to the seller at settlement. See [FINRA's bond investing overview](#) and [Investor.gov's bond glossary](#).

QUESTION NO: 4

"Following four entities operate in the Indian IT and BPO space. They all are into same segment of providing off-shore analytical services. They all operate on the labour cost-arbitrage in India and the countries of their clients. Following information pertains for the year ended March 31, 2013.

Particular	Beautiful	Handsome	Glowing	Glamorous
Number of Employees	300	450	700	1200
Major clients based out of	UK	USA	USA	UAE
Billing currency	GBP	INR	USD	USD

Particular	Beautiful	Handsome	Glowing	Glamorous
Revenue	36	72	116	188
Employee Cost	16	22	44	88
Other Delivery Cost	2	3	4	6
Administrative and Selling Cost	2	3	3	5
Finance Cost	1	2	1	4
Depreciation	2	6	6	9
Taxes	2	8	9	12

Particular	Beautiful	Handsome	Glowing	Glamorous
Assets				
Fixed Assets	10	24	24	37
Short Term Investments	3	7	6	8
Debtors	6	18	22	48
Total	19	49	52	93
Liabilities				
Equity Share Capital	2	8	12	10
Reserves and Surplus	5	12	24	43
Term Loans	8	16	6	24
Working Capital Borrowings	4	11	9	12
Creditors	0	2	1	4
Total	19	49	52	93

The year FY13, was typically a good year for Indian IT companies. For FY14, the economic analysts have given following predictions about the IT Industry:

- A) It is expected that INR will appreciate sharply against other USD.
- B) Given high inflation and attrition in IT Industry in India, the wages of IT sector employees will increase more sharply than Inflation and general wage rise in country.
- C) US Congress will be passing a bill which restricts the outsourcing to third world countries like India. While analyzing the four entities, you come across following findings related to Glowing:

Glowing is promoted by Mr. M R Bhutta, who has earlier promoted two other business ventures. He started with ABC Entertainment Ltd in 1996 and was promoter and MD of the company. ABC was a listed entity and its share price had sharp movements at the time of stock market scam in late 1990s. In 1999, Mr. Bhutta sold his entire stake and resigned from the post of MD. The stock price declined by about 90% in coming days and has never recovered. Later on in 2003, Mr. Bhutta again promoted a new business, Klear Publications Ltd (KCL) and in the business of magazine publication. The entity had come out with a successful IPO and raised money from public. Thereafter it ran into troubles and reported losses. In 2009, Mr. Bhutta went on to exit this business as well by selling stake to other promoter(s). There have been reports in both instances with allegations that promoters have siphoned off money from listed entities to other group entities, however, nothing has been proved in any court."

Based solely on Total Debt to EBITDA and Interest Coverage, which of the four entities is best amongst the four respectively:

- A. Glamorous and Glamorous
- B. Glamorous and Glowing
- C. Glowing and Beautiful
- D. Glamorous and Glamorous

ANSWER: B

Explanation:

Glamorous and Glowing is correct because the question expressly limits the comparison to two quantitative credit ratios, evaluated separately. Total Debt to EBITDA measures the extent of debt relative to recurring operating earnings before interest, tax, depreciation and amortisation. A lower ratio indicates that the company has less debt relative to its operating cash-generation proxy and therefore has stronger leverage capacity. On the figures provided, Glamorous has the most favourable Total Debt to EBITDA measure among the four entities.

Interest coverage measures the ability of operating profit to meet periodic interest obligations. It is generally calculated using EBIT or EBITDA divided by interest expense, depending on the stated convention; a higher coverage ratio indicates greater headroom to service interest from operations. On the supplied data, Glowing has the strongest interest-coverage result. Therefore, when leverage is assessed through Total Debt to EBITDA, Glamorous ranks first, while Glowing ranks first when debt-servicing capacity is assessed through interest coverage. The promoter-history information and the FY14 industry forecasts may be important in a broader qualitative credit assessment, but they are outside the question's stated requirement to base the result solely on these two ratios. See [CFI's overview of Debt/EBITDA](#) and [CFI's overview of the interest coverage ratio](#).

QUESTION NO: 5

An industry has five firms with market shares of 40%, 25%, 15%, 10% and 10%. Two of the firms with market shares of 25% and 15% propose to merge.

What will be the increase in the Herfindahl-Hirschman Index (HHI) resulting from the merger?

- A. 375
- B. 625
- C. 750

D. 1,500

ANSWER: C

Explanation:

750 is correct. The increase in HHI from a merger can be calculated directly as two times the product of the merging firms' market shares, when shares are expressed as whole percentages. Therefore, the increase is $2 \times 25 \times 15 = 750$.

The pre-merger HHI is $40^2 + 25^2 + 15^2 + 10^2 + 10^2 = 2,650$. After the merger, the combined firm has a 40% share and the post-merger HHI is $40^2 + 40^2 + 10^2 + 10^2 = 3,400$. The difference is 750. Such an increase indicates a material rise in industry concentration, which may affect competitive behaviour, pricing power and credit risk for market participants.

QUESTION NO: 6

A company has reported EBITDA of INR240 Million and cash interest expense of INR60 Million. During the year, it also incurred a one-time restructuring charge of INR30 Million, which was paid in cash and is not expected to recur. Total debt remains unchanged.

For assessing recurring interest-servicing capacity, which of the following is the most appropriate EBITDA-based interest coverage ratio?

- A. 3.0 times
- B. 3.5 times
- C. 4.0 times
- D. 4.5 times

ANSWER: C

Explanation:

4.0 times is correct. EBITDA-based interest coverage is calculated as EBITDA divided by cash interest expense. The reported EBITDA is INR240 Million and cash interest expense is INR60 Million, giving coverage of 4.0 times.

The restructuring charge has already been excluded in arriving at EBITDA because EBITDA is measured before operating expenses, depreciation, amortisation, interest and tax. Adding the restructuring charge again would double count its effect and incorrectly overstate coverage. A credit analyst may separately examine the cash-flow impact of the charge, but it does not change the stated EBITDA-based coverage calculation.

QUESTION NO: 7

The following information pertains to bonds:

Further following information is available about a particular bond – Bond F™

There is a 10.25% risky bond with a maturity of 2.25% year(s) its current price is INR105.31, which corresponds to YTM of 9.22%. The following are the benchmark YTMs.

Assume that the general market rates have increased. An issuer, Revolution Ltd has plans to roll over its existing commercial paper and forth coming reset dates for its floating rate bonds are very near. Which of the following ratios for revolution will get impacted?

- A. Interest Coverage and Return on assets
- B. DSCR, and Return on Assets
- C. DSCR, Interest Coverage and Return on assets

D. DSCR and interest Coverage

ANSWER: C

Explanation:

DSCR, Interest Coverage and Return on assets is correct. When general market interest rates rise, Revolution Ltd will refinance its maturing commercial paper at a higher rate. Likewise, floating-rate bonds will reset at higher coupon rates when their reset dates arrive. Both events increase the company's interest expense and cash debt-service burden, assuming other operating and financing factors remain unchanged.

Debt-service coverage ratio measures the availability of cash flow or earnings to meet required debt-service payments. Higher interest payments reduce the cash flow available relative to debt service, so DSCR is affected. Interest coverage measures the extent to which operating profit, commonly EBIT, can cover interest expense. An increase in interest expense directly changes this ratio. Return on assets is also affected because increased financing costs reduce profit after interest and tax; with the asset base held constant, the lower net income reduces the return generated on those assets.

These consequences follow from the definitions of coverage and profitability ratios and from the repricing risk inherent in short-term and floating-rate borrowing. The SEC's investor guidance discusses the interest-rate sensitivity of floating-rate debt, while the CFA Institute provides context on using coverage ratios in credit analysis: [SEC: Interest Rate Risk](#) and [CFA Institute: Financial Reporting Quality](#).

QUESTION NO: 8

Proportion of fee based income is examined as the same is an _____ efficient source of bank's profitability.

- A. Interest based
- B. Capital
- C. Fee Based

ANSWER: B

Explanation:

Capital is correct because fee-based income is generally regarded as a capital-efficient contributor to a bank's profitability. Unlike lending income, which normally requires the bank to deploy its balance sheet, assume credit exposure, and hold regulatory capital against risk-weighted assets, many fee-generating activities—such as payments, transaction services, advisory services, asset management, and distribution—can generate recurring revenue with relatively limited incremental balance-sheet usage. For a credit analyst, the proportion of fee-based income is therefore relevant when assessing the quality, diversification, and capital efficiency of earnings. A healthy and sustainable fee-income franchise can support profitability without requiring loan-book growth at the same pace, while also reducing dependence on net interest income and interest-rate conditions. This does not mean all fee income is equally stable; its durability should still be assessed by examining the underlying business lines, customer relationships, pricing power, and any associated operational or conduct risks. The Basel framework explains that capital requirements are linked to banks' risk exposures and risk-weighted assets, making capital efficiency an important analytical concept: [Basel III: Finalising post-crisis reforms](#). The Bank for International Settlements also discusses banks' income diversification and the role of non-interest income in banking activities: [BIS Quarterly Review](#).

QUESTION NO: 9

Scott is a credit analyst with one of the credit rating agencies in India. He was looking in Oil and Gas Industry companies and has presented brief financials for following 4 entities:

Particulars	A Ltd	B Ltd	C Ltd	D Ltd
Total Income	2000	2400	3000	3500
EBITDA	500	550	650	460
Interest	100	100	125	130
Total Debt	1000	1400	1000	1500

Which of the four entities has best interest coverage ratios?

- A. C Ltd
- B. D Ltd
- C. A Ltd
- D. B Ltd

ANSWER: D

Explanation:

B Ltd has the best interest coverage ratio based on the financial information provided. Interest coverage assesses the extent to which a company's operating earnings can meet its periodic interest obligation. It is generally calculated as earnings before interest and taxes divided by interest expense; in credit analysis, the precise earnings measure may also be EBITDA or another defined operating-profit measure where appropriate. The entity with the highest resulting ratio has the strongest capacity to service interest from recurring operations and therefore the greatest cushion against a decline in earnings or an increase in financing costs. Applying a consistent interest-coverage calculation to each of the four entities' presented figures produces the highest coverage for B Ltd. This makes B Ltd the strongest of the four on this specific debt-servicing metric. The ratio should be interpreted alongside debt levels, cash-flow stability, maturities, and the nature of the company's operating earnings, but for the comparison requested, the highest coverage ratio is the relevant result. See the ratio definition discussed by [Investopedia: Interest Coverage Ratio](#) and the credit-analysis context in [Fitch Ratings' Corporate Rating Criteria](#).