

Roll No. ....

Total No. of Questions – 5

Total No. of Printed Pages – 32

Time Allowed – 4 Hours

Maximum Marks – 100

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Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate who has not opted for Hindi Medium, his/her answers in Hindi will not be valued.

**The Question Paper comprises five case study questions.**

**The candidates are required to answer any four case study questions out of five.**

Answer in respect of Multiple-Choice Questions (MCQs) are to be marked on the OMR Answer Sheet as given on the Cover Page of the answer book.

Answers to MCQs, if written inside the descriptive answer book, will not be evaluated.

Candidates should answer the Case Study Questions as selected by them in totality i.e., MCQ as well as descriptive Question of the same Case Study Question.

Candidates are not permitted to answer MCQs of one Case Study Question and the descriptive questions of another Case Study Question and vice-versa.

Candidates may use calculator.

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**CASE STUDY : 1**

You are a dynamic management consultant of thirty years of age. You graduated from a top notch business school in Delhi and subsequently qualified as a Chartered Accountant, securing all India 1<sup>st</sup> Rank. With a keen interest in academic research, you also obtained a Doctorate degree in capital market and financial services from a reputed University. You are known in the corporate arena as a renowned personality for your interactive deliberations in all gamuts of financial services and capital markets. As an avid speaker, you passionately share your deep and incisive knowledge in India at various events organized by various professional institutes and trade organizations.

You started a consultancy firm in Chennai and expanded your network by opening branches at Bengaluru, Hyderabad and Pune. Your firm provides scratch to end business advisory solutions to corporates, especially on innovative ways to finance a start-up, advising on regulatory mechanism of the SEBI for raising funds through Initial Public Offer, Rights Issue, Bonus Issue, Preferential Issue, Qualified Institutional Placement, Buy Back of Shares etc., Your firm also provides advisory services on Treasury Operations, Mutual Funds, Risk Management, Leasing and Factoring Services. Your clients are spread across the country and you have a sizeable team of professionals working under your entire advisory practice.

Recently, you have been approached by Soft Tech Solutions Limited (STSL), which is based out of Chennai to sort out / clarify certain matters concerning The Securities and Exchange Board of India Act, 1992, SEBI (ICDR) Regulations, 2018 and SEBI (Buy Back of Securities) Regulations, 2018 that may have a potential application for STSL and its group companies. The engagement would further require a regular update to STSL on fiscal and monetary policy matters.

(3)

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### **About STSL**

STSL is one of the India's startup companies incorporated at Chennai in the year 2012. The main objects of the Company are to develop a niche, never invented before, customized software packages for two and three wheeler automobile manufacturers in India. It also caters to the various software needs of diverse global audiences. With its wide range of e-Commerce market place products, it assists in establishing a successful e-Commerce business. Its web and mobile app programs develop cutting-edge software solutions that help businesses align with their goals. Along with e-Commerce, web, and mobile software development, STSL also provides digital marketing and branding services. Its IT consultants help businesses in analyzing the value proposition and business model of competitors. The Company became a listed entity in the year 2017 and got its shares listed on the BSE and the NSE. STSL is well recognized for its governance standards and is very keen to implement its zero tolerance non-compliance policy.

### **Initial Interaction**

During your initial interaction with the top management of STSL, you highlighted the current state of affairs, compliance standards and regulatory assessment hygiene affecting the capital market and gave an overview of the capital market regulator and the regulations framed by it. Thereafter, you were ready for detailed discussions with the Management.

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The financial data and other inputs for your consideration as given by the top management of STSL are summarized below :

- (1) As at 31.12.2021, the following information and figures are noticed from the Audited Annual Accounts for the year ended 31.03.2021 of Unique Soft Tech Solutions Limited (USTSL), a listed entity and a group Company of STSL.

|                                  |                                                                                                                                                                                                                                                                                                                                                                                                                           |
|----------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Authorized Share Capital         | ₹ 20 crore comprising of 2 crore equity shares of ₹ 10/- each.                                                                                                                                                                                                                                                                                                                                                            |
| Paid up Share Capital            | ₹ 9 crore comprising of 80 Lakhs equity shares of ₹ 10/- each fully paid-up and 20 Lakhs equity shares of ₹ 10/- each called and paid-up ₹ 5/- each. The total paid-up capital is paid in cash.                                                                                                                                                                                                                           |
| Securities Premium               | ₹ 20 crore                                                                                                                                                                                                                                                                                                                                                                                                                |
| Debentures                       | 5 Lakhs fully convertible debentures of ₹ 100/- each. These debentures are due for conversion on 31.03.2022 in full, into fully paid equity shares of ₹ 10/- each in the ratio of 2 equity shares for 1 debenture.                                                                                                                                                                                                        |
| General Reserves                 | ₹ 30 crore                                                                                                                                                                                                                                                                                                                                                                                                                |
| Fixed Assets Revaluation Reserve | ₹ 10 crore                                                                                                                                                                                                                                                                                                                                                                                                                |
| Additional information           | <p>(i) Outstanding liabilities in respect of interest payable on Public Deposits - ₹ 15 Lakhs.</p> <p>(ii) Outstanding liabilities in respect of Bonus to employees and workers - ₹ 25 Lakhs.</p> <p>(iii) The partly paid shares were made fully paid prior to 30.06.2021.</p> <p>(iv) Bonus to employees and workers were paid on 15.09.2021.</p> <p>(v) Interest on public deposits was outstanding on 31.12.2021.</p> |

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(2) One of the Independent Directors of STSL informed you that an investor Mr. Parth Khokhani has complained that Mr. Ketan Malani, the Chief Financial Officer(CFO) of STSL has provided the Prospective Financial Information (PFI) of STSL to a registered valuer who has been appointed for carrying out valuation as required by the banker of STSL.

(3) The Balance Sheet of M/s. Unique Component Private Limited (UCPL) which is a subsidiary of STSL as on 31<sup>st</sup> March, 2022 is given below :

|                                             |                  |                |                  |
|---------------------------------------------|------------------|----------------|------------------|
| Equity Shares of ₹ 10/- each fully paid –up | 12,50,000        | Fixed Assets   | 46,50,000        |
| Revenue reserves                            | 15,00,000        | Current Assets | 30,00,000        |
| Securities premium                          | 2,50,000         |                |                  |
| Profit and Loss                             | 1,25,000         |                |                  |
| Secured Loans :                             |                  |                |                  |
| 12% Debentures                              | 18,75,000        |                |                  |
| Unsecured Loans                             | 10,00,000        |                |                  |
| Current Liabilities                         | 16,50,000        |                |                  |
| <b>Total</b>                                | <b>76,50,000</b> | <b>Total</b>   | <b>76,50,000</b> |

The Board of Directors of UCPL wants to buy back 25,000 equity shares of ₹ 10/- each on 01<sup>st</sup> April, 2022 at ₹ 20/- per share. Buy-back of shares is duly authorized by its Articles of Association, and necessary resolution has been passed by UCPL towards this. The payment for buy-back of shares will be made by the Company out of sufficient bank balance available which forms part of the current assets.

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- (4) Fiscal and monetary policies affect decision making. In order to improve quality of decision making, inputs on such policy matters would be now required to be submitted by you on a monthly basis rather than quarterly basis. The CEO of STSL is concerned about the volatility in the financial market and has heard that bank-rate is likely to increase and the RBI is likely to increase purchase of government securities (G-Sec). You have been asked to cover this aspect in the next report and submit the same immediately. The CFO of STSL has asked you to provide inputs on the powers of SEBI as he is suspecting some non-compliance by his team.
- (5) Considering the current high level of volatility in the financial market, the Board of STSL has decided to reduce risk of portfolio which has been created out of surplus fund, and the Board has directed the CFO to focus on G-Sec of the government of India. Further, STSL has made investment in a mutual fund which has given average return of 40% during last three years and the mutual fund has a beta of 1.30. This mutual fund is benchmarked against SENSEX which has earned an average return of 35% during the same period. The risk free return is 6% .

**Multiple Choice Questions**

**2×5  
=10**

- 1.1 An economist of a leading bank has informed the CEO of STSL with a supportable data, which suggests that India is experiencing an expansion of real GDP. Which one of the following is correct when the bank-rate increases during expansion of real GDP ?
- (A) The RBI must have been increasing the money supply.
- (B) The RBI must have lowered overnight lending rate.
- (C) The RBI may have changed the money supply in either direction.
- (D) The RBI must have held the money supply constant.

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1.2 The Independent Director of STSL wants to understand from you about the matter of complain against Mr. Malani as discussed in the Case Study before raising the matter in the Board. Which one of the following is the best answer concerning to the liability of Mr. Malani ?

- (A) He will not be liable as such activities are generally allowed.
- (B) He will not be liable when it has been done in terms of the approved policy of the Board.
- (C) He will not be liable when it has been done in terms of the approved policy of the Board and the same has not been shared to bypass the SEBI regulation and the valuer has signed the Non-Disclosure Agreement (NDA).
- (D) He will not be liable when it has been done in terms of the approved policy of the Board and the same has not been shared to bypass the SEBI regulation.

1.3 The CFO of STSL has recently observed that large amount of government securities has been purchased by the RBI. Such action of RBI is likely to:

- (A) Increase loans made by the banks
- (B) Decrease loans made by the banks
- (C) Increase government fiscal deficit
- (D) Be an implementation of effective anti-inflationary policy

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- 1.4 Which one of the following is correct with respect to the power of SEBI ?
- (A) The SEBI can disgorge the amount in a bank account of STSL even if it is found not to be in violation of any provisions of the SEBI Act or Rules or Regulations.
  - (B) The SEBI can disgorge the amount in a bank account of STSL if it is found to be in violation of any provisions of the SEBI Act or Rules or Regulations.
  - (C) The SEBI has to return the disgorged amount to the central government.
  - (D) The SEBI does not have to credit the disgorged amount to the Investor Protection and Education Fund.
- 1.5 The CFO of STSL believes that there is no risk involved in investing G-Sec of the GOI, and has asked you to explain the components of return on G-Sec issued by the RBI. Which one of the following is correct with respect to return and risk of G-Sec ?
- (A) It has only real return and inflation but no risk.
  - (B) It has real return, inflation and reinvestment risk.
  - (C) It has real return, inflation and default risk.
  - (D) It has nominal return and default risk.
- 1.6 Based on the information given in the Case Study, it is proposed by the Board of Directors of USTSL to issue Bonus shares on or after 01.04.2022 in the ratio of 1:1. Advise the Directors on the matter with reference to SEBI guidelines on Bonus Issue. **5**
- 1.7 Based on the information given in the Case Study, determine whether mutual fund has outperformed or underperformed the SENSEX using Treynor's Ratio. **3**

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- 1.8 Based on the information given in the Case Study about buy-back of shares by UCPL, the Management is keen on understanding as to whether buy-back of shares by the Company is within the statutory provisions of SEBI (Buy-Back of Securities) Regulations, 2018 and/or The Companies Act, 2013 assuming that the proposed buy-back is expected to be completed in full within the next three months.

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## **CASE STUDY : 2**

### **1. Background of Best Steel Limited (BSL)**

BSL is an Indian Steel-making Company based in Pune and is headquartered in Mumbai, India. It is among the top steel producing Companies (measured by domestic production) in India with an annual crude steel capacity of 6 MTPA. It produces automation related products, bearings, pipes, precision tubes, car related materials, locomotive parts, agricultural equipment, machinery, tinplate, cable and building structures.

BSL is one of the India's most geographically-diversified steel manufacturers, with operations and commercial presence across the country. Its largest plant is located in Jajuri Village, Pune, and was included in the list of the World Economic Forum's (WEF's) Global Lighthouse Network in 2021.

BSL has been recognised amongst India's best workplaces in manufacturing in 2022 by 'Great Place to Work' and it has received this recognition for the fifth time. This highlights Company's sustained focus on fostering a culture of high-trust, integrity, growth, and care for the employees. A strong, customer-focused approach and the constant quest for top-class quality have enabled BSL to attain and sustain leadership in its major lines of business for over four decades. The Company's integrated capabilities span the entire spectrum of 'design to delivery' and every aspect of the Company's businesses is characterised by professionalism and high standards of corporate governance. Sustainability is embedded into the Company as its long-term strategy for growth.

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**2. Growth of BSL**

The BSL has grown within a short span of time. As it started performing, lenders lined up to provide support in the growth, and BSL did well this way. To cater the funding requirements of the Company and its subsidiaries for large scale projects, besides equity, BSL sourced funds through debt instruments like Non-Convertible Debentures (NCDs) and Commercial Papers (CPs) with best coupon rates at relevant point of time. Several Indian financial institutions had participated in the NCDs and CPs of BSL amounting to ₹ One Lakh crore. BSL could even garner best of the credit ratings from various credit-rating agencies, which in turn happened to be a blessing in disguise for the financial institutions to make investments in the Company. Though the operations of the Company as a whole looked very promising, year-after-year, yet, there were some bottlenecks foreseen by some of the subsidiaries which had financial issues like defaults in repaying loans, interest payments and inter-corporate deposits to banks and other lenders. This came as a jolt from the blue and caused severe frustration with lenders, turmoil and successive resignations of senior management executives in such subsidiaries. Further, the short-term borrowings increased by 20% in one year but this has not awakened any alarming bells. In view of the above-sudden set back, one of the credit rating agency which had reaffirmed a highest rating of A1+, had, within a short span of 30 days, made two successive rating actions and downgraded the rating to D for specific CPs citing irregularities in debt servicing, driven by weakening Company's liquidity profile. The downgrading by a credit agency caused tremors in the financial markets.

The matter got so worse that the Government moved to take control of the Company, and replaced the entire Board. Though there were no fraudulent motives alleged, the issue had even caught the eyes of the Ministry of Corporate Affairs in view of the fact that the Company had multiple layers of subsidiaries and a complicated web of inter-corporate relationships and a possibility of mismanagement of funds. The unfortunate fallout made the market value of quoted mutual funds to fall drastically resulting in erosion of invested values for ordinary investors as several mutual funds and financial institutions who had invested in CPs and debt instruments started to classify their investments as NPA due to strict NPA norms that they are subjected to. This prompted for an intense discussion among the financial market players on the role of the credit-rating agencies. The new Board of BSL has raised number of questions related to credit-ratings and wants to ensure that the same mistake is not repeated in the future.

3. The Company has a small treasury team and it has made investments in 15 listed equity shares and few mutual funds. BSL's treasury has also made investment in REITs. The credit default event also reduced the investment value of BSL in REITs and mutual funds. In fact now, the new Board has discovered that the Company in the past made investment in mutual funds having high expense ratio and hence they were hammered more when market started falling as a result of default by BSL. Although the treasury used risk assessment tools like Value-at-Risk (VaR) but its prediction failed as market started behaving abnormally after the default by BSL. Some of the Directors of BSL have first time heard about VaR and wanted to understand what exactly it means in a simple manner. Two subsidiaries of BSL have real properties at very prominent locations and hence the management is looking at the possibility of raising fund through REITs.

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## 4. New Start-up

After seeing the debt related problems of BSL, the younger son of the Managing Director of BSL has set up a new company named Doc Ltd (DL) which has developed a web portal that helps in document management. DL has been registered as a start-up company and is looking for a suitable venture capitalist (VC) that can make investment in DL. It has roped in a VC named 'Whitestone Inc' for this purpose. The promoters of DL know that VC takes risk and they only can make investment at this stage.

Although market potential is high, the current visibility of future is not clear. From now, DL is likely to generate positive cash flow from the third year. The consultant of DL has given a valuation report which appears unreasonable because it has been prepared as if DL is a matured company. There are number of concepts in the valuation report with which promoters of DL are not comfortable especially beta, standard deviation, total beta, alpha etc. They have approached you for your advice on these terms. Considering unproven market, the VC has rejected the valuation report and has asked for expected cash flow for the three years only that would be used for the purpose of deciding investment. After a brain storming session, DL communicated to the VC that they need INR 100 Lakhs initial funding. The VC is willing to make investment and is looking to attain a 30% return. The probability of low cash flows is 60% and high cash flow is 40%.

## Lakhs

| Time               | 0     | 1 | 2 | 3    |
|--------------------|-------|---|---|------|
| Cash flow          | (100) | 0 | 0 |      |
| 60% probability    |       | 0 | 0 | 90   |
| 40% probability    |       | 0 | 0 | 1000 |
| Expected Cash flow | (100) | 0 | 0 | 454  |

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**Multiple Choice Questions**

**2×5**

**=10**

**2.1 Why Venture capital is considered risky in nature ?**

- (1) The business plan in which venture capitalists invests is non-conventional in nature.
- (2) Venture capitalists contribute to the debt of the product.
- (3) Venture capitalists contribute money for a longer time period.
- (4) Venture capitalists, by investing in startups at an earlier stage, exhibits raw potential.

Choose the correct from the options given below :

- (A) (3) and (4) only
- (B) (1), (3) and (4) only
- (C) (1) and (2) only
- (D) (1), (2) and (3) only

**2.2 Suppose the management of BSL has approached you for raising funds through REITs using real properties of two subsidiaries. Which one of the following is not the major way that a REIT can be structured ?**

- (A) As a single property REIT
- (B) As a fixed life REIT
- (C) As a dedicated REIT
- (D) As an indexed REIT

**2.3 Assume that the returns of one of the mutual fund investment made by BSL are normally distributed and that one month VAR is 10000, what would the four month VAR be ?**

- (A) 10000
- (B) 40000
- (C) 80000
- (D) 20000

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(14)

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- 2.4 As discussed in the Case Study about the problems in the valuation report of DL, the promoters of DL want to know about the dispersion of return in order to understand risk. In your opinion which of the following is the measure of dispersion of return ?
- (A) Beta
  - (B) Total Beta
  - (C) Standard Deviation
  - (D) Alpha
- 2.5 The Board of BSL wants to understand which type of mutual fund has lower expenses so that appropriate changes are made in the investment policy. In your opinion which one of the following mutual fund is likely to have lower expenses than other type of mutual fund ?
- (A) Index Fund
  - (B) Equity Fund
  - (C) Debt Fund
  - (D) Balance Fund

The new Board of BSL has appointed you as a Consultant to answer Questions 2.6 to 2.9.

- 2.6. What are the areas that credit ratings do not take into account and measure ? 2
- 2.7 What kind of responsibility or accountability will attach to a rating agency if an investor, who makes his investment decision on the basis of its rating, incurs a loss on the investment ? 2
- 2.8 How reliable and consistent is the rating process ? How do rating agencies eliminate the subjective element in rating ? 2
- 2.9 What could be the significant factors for the role and failure of the credit rating agency based on the inputs given in the Case Study ? 3

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- 2.10 Based on the information given in the Case Study, what percentage of equity share of DL, the VC would demand in order to finance 100 Lakhs ? **2**
- 2.11 Assume that the VC is ready to invest in DL with preference share having no dividend rights but with a liquidation preference of INR 100 Lakhs and which is convertible at any time into equity share at 1:1 ratio. If this is agreed by the VC instead of equity shares, what the VC receives in DL ? **1**
- 2.12 What fraction of equity share of DL, the VC would receive upon conversion of the preference share in order to get 30% IRR from the investment ? **2**
- 2.13 In your opinion, based on the results of Questions 2.10 and 2.12, which alternative would be less risky to the VC ? Give the reasoned answer. **1**

### **CASE STUDY : 3**

#### **Background**

Wellington Limited (WL) is engaged in the business of manufacturing products like moulds, dies and machinery. They have a wide customer base in the automobile, infrastructure, construction and other sectors both within India and abroad. The business model of WL involves entering into a contract for sale of each product and consideration is received on the event of delivery of goods at the customer place. Issues related to the business of WL are described below.

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**(1) Loan in Foreign Currency**

On 1<sup>st</sup> April, 2020, WL raised a long-term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par at a coupon rate of 10%. WL incurred incremental issue costs of FCY 2,00,000. Interest of FCY loan is repayable in FCY on 31<sup>st</sup> March, 2021. The FCY loan is redeemable at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortized costs. Relevant exchange rates are given below :

01.04.2020: FCY 1 = ₹ 2.50; 31<sup>st</sup> March, 2021: FCY 1 = ₹ 2.75. Average rate for the year ended 31<sup>st</sup> March, 2021: FCY 1 = ₹ 2.42. The functional currency of the Company is Indian Rupee.

- (2) For meeting the day-to-day working capital needs, WL has been banking with Amir Bank Limited for the last five years and has become an important client of the bank. The Company has been borrowing heavily in order to finance its growth. The track record of servicing debt is very good. In addition to interest income, the Company provides a significant amount of fee income. The following financial summary has been presented to the Bank.

|                                                 |               |
|-------------------------------------------------|---------------|
| Total Sales                                     | ₹ 1,40,00,000 |
| Total Assets                                    | ₹ 35,00,000   |
| EBIT                                            | ₹ 4,00,000    |
| Debt as a Percentage of Total Assets            | 70%           |
| Capital Turnover                                | 10 Times      |
| Inventory Days                                  | 30            |
| Receivable Days                                 | 1             |
| Payable Days                                    | 13            |
| Annual Sales Growth (Average, Last Three Years) | 120%          |
| Dividend Payout Ratio                           | 20%           |

The Management of the Company believes that next year Sales will grow by 100%. Currently, the Company is using its Cash Credit limit of ₹ 5,00,000 and expecting an increase in the cash credit limit. Term lending is no longer an option as the Company has reached the bank's limit of total gearing.

- (3) WL has also diversified into organic agro-based business and has taken on lease 1000 acres of land for producing coriander. As this is a new line of business, there is less focus on risk management of price risk related to this commodity. After the success in this commodity, WL has a plan to add more commodities which can improve growth in the future. However, before expanding further, it wants an appropriate risk management system is put in place.
- (4) WL's treasury is interested in trading future contract and in this respect has identified future contract on ZIP Ltd. The stock ZIP pays an annual dividend of ₹ 4 and is currently priced at ₹ 125. Each future contract calls for delivery of 1,000 ZIP shares in one year. The corporate Treasury-bill rate is 8%.
- (5) WL is also considering diversifying into lending business. As taking a banking license is difficult it would be a great idea to start with a NBFC. The management of WL wants your inputs on the compliance issues of NBFCs and also on what are the operational freedom and restrictions available to NBFCs.
- (6) One of the subsidiaries of WL named HT wants to enter securitization market. However, they are concerned with a lower rating-grade. They also know that, with a rating below an investment-grade rating, it is difficult to market a securitized transaction to institutional investors who are not allowed to invest below investment grade. WL's team is very clear that in order to attract institutional investor, a securitized transaction require some form of credit enhancement to achieve investment grade rating for one or several classes. Now, WL has decided to take your help in this regard. Further, a brief note on collateralized debt obligation (CDO) and other credit derivatives are also required before they can be put in operation as WL's team is not in a position to understand related terms like collateralized bond obligation (CBO), collateralized debt obligations (CDO) and collateralized loan obligations (CLO).

## Multiple Choice Questions

2×5  
=10

3.1 You have been informed that the working capital of HT is showing indicators such as (i) reliance on long-term debts, (ii) offering longer credit period, (iii) higher level of inventory, (iv) rapid decreasing sales and (v) deteriorating current ratio. Which of these indicators are reflections of “overtrading” in the context of working capital management ?

- (A) (ii) and (v) only
- (B) (i), (iii) and (v) only
- (C) (i), (ii) and (iii) only
- (D) (i), (iii) and (iv) only

3.2 There are number of issues that would require consideration before WL decides to operate in NBFC segment. Given below are few such issues.

1. All NBFC's should be registered with RBI.
2. NBFCs cannot accept demand deposits.
3. NBFCs do not form part of the payment and settlement system and cannot issue cheque drawn on it.
4. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs.

Which one of the following is correct with respect to NBFCs in India ?

- (A) 1, 2 and 3 only
- (B) 1, 2, 3 and 4
- (C) 1, 2 and 4 only
- (D) 1 and 2 only

3.3 For hedging commodity prices of WL, number of hedging products are available in the market. Which one of the following risk management technique is correct to hedge the financial risk arising from the prices of coriander that it sells ?

- I. Short coriander future contract
- II. Long Put option on coriander
- III. Long Call option on coriander

- (A) I only
- (B) II only
- (C) III only
- (D) I and II only

3.4 In your opinion which one of the following accurately describes the relationship between CBO, CDO and CLO ?

- (A) Any CBO can be considered a CDO.
- (B) Any CDO can be considered as a CLO.
- (C) Any CLO can be considered as a CBO.
- (D) Any CBO cannot be considered as CDO.

3.5 Which one of the following is incorrect with respect to credit enhancement in case of securitized transaction ?

- (A) Over collateralization is an example of internal credit enhancement.
- (B) Subordination is an example of external credit enhancement.
- (C) Letter of Credit is an example of external credit enhancement.
- (D) Surety bond is an example of external credit enhancement.

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- 3.6 How much increase in the cash-credit is required in order to fund increased working capital requirements of WL ? Provide your answers through step-wise calculation taking into consideration 365 days in a year ? **4**
- 3.7 In respect of the foreign currency loan taken by WL, calculate the initial measurement amount for the FCY loan, the finance cost for the year 2020-21, and the closing balance of the loan at March 31, 2021. **5**
- 3.8 Based on the information given in the Case Study **6**
- (A) What should be the price of one ZIP future contract ?
  - (B) If the ZIP price decreases by 6%, what will be the price of one ZIP future contract ?
  - (C) If price of ZIP decreases, will WL make profit with their long position in one ZIP future contract, and what will be the amount of gain or loss ? (Ignore margin and taxation, if any).

#### **CASE STUDY : 4**

XYZ Limited is a large manufacturing Company having its registered and Corporate Office at Financial District, Visakapatnam. The Company was formed by the chief Promoters namely Mr. R.T. Raghavan and R.T. Shanmugam respectively being twin brothers and in collaboration with Carl Lewis Inc., U.K. The combined shareholding of the two brothers is 51% and that of Carl Lewis Inc., U.K. is 49%. Whilst the day-to-day activities are monitored by both the brothers, the technical know-how is provided by Carl Lewis Inc., U.K. The Board of Directors of the Company comprises of eminent directors drawn from various fields including a nominee foreign director from Carl Lewis Inc., U.K., and with an appropriate mix of executive and non-executive independent directors and a women director as well. Ms. Preeti Garg is the CFO of the Company since incorporation and she advises the top management on all finance

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related matters. She is highly extrovert and goes an extra mile in knowing the emerging trends in the financial services and capital markets and deploys the best practices in the Company.

In order to further strengthen the finance functions of the Company, she has sought your assistance and shared the following details with you :

- (1) The CFO wanted you to provide an overview of 'money market' as a whole and accordingly, you gave a short presentation on the basics of money market. But the CFO asked you to explain functioning of Repo and Reverse Repo transactions by way of an example.
- (2) The CFO shared with you that the Company exports its products to North America. All the exports are invoiced in US\$. The firm is considering the use of money market or forward market to cover the receivables of US\$ 50,000 expected to be realized in 3 months' time and has the following information from its bankers :

|             | Exchange Rates    |
|-------------|-------------------|
| Spot        | USD/ INR 72.65/73 |
| 3-m Forward | USD/INR 72.95/40  |

The borrowing rates in US and India are 6% and 12% p.a. respectively and the deposit rates are 4% and 9% p.a. respectively.

- (3) The CFO further informed that receivables form a major part of the current assets of a Company and management of such receivables is the most important concern for the Company. In this regard, she suggested factoring would be a best financial option for the management of receivables as it is a tool to obtain quick access to short-term financing and mitigate risks related to payment delays and defaults by buyers. She further informed that in the process of factoring, the seller sells its receivables to a financial institution ("Factor") at a discount. After the sale, there is an immediate transfer of ownership of the receivables to the factor. In the due course of time, either

the Factor or the Company, depending upon the type of factoring, collects payments from the debtors. She explained the above significance of factoring as she was very much concerned about one of her Subsidiary which was in the brim of becoming a sick company because of delay / non-realization of their dues from large units to whom they were supplying. She is of the opinion that introduction of factoring services will, therefore, prove to be very beneficial for such units as it will be free from hassles of collecting receivables to enable them to concentrate on product development and marketing.

In numeric terms, she tabled the following information about the subsidiary of the Company :

|                           |                   |
|---------------------------|-------------------|
| Credit Sales              | ₹ 2,10,00,000     |
| Average Receivables       | ₹ 35,00,000       |
| Estimated Bad Debt Losses | 0.9% on the sales |

With an eye to save time on collection of receivables, the CFO suggested a proposal to appoint a Factor.

**Further Information :**

| Particulars                                                              | Recourse | Non-Recourse |
|--------------------------------------------------------------------------|----------|--------------|
| Average reduction in collection of receivables (Days)                    | 30       | 30           |
| Reduction in Bad debts                                                   | 0.3%     | 0.9%         |
| Savings in administrative costs                                          | 40,000   | 40,000       |
| Advance                                                                  | 80%      | 80%          |
| Interest on Advance-<br>2% p.a. higher than current OD<br>interest of 7% |          |              |
| Factor fee                                                               | 0.60%    | 1.25%        |

Number of days in a year has been assumed to be 360 days.

(23)

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(4) XYZ has 100 Lakhs rolling over on a 3m-MIBOR based deposit for a period between June and September 2022. Anticipating that 3m-MIBOR will fall further than anticipated, the Company wants to hedge the same using June 2022 interest future contract. Notional size of interest future contract is INR 10 Lakhs. The June interest future contract is quoted at 98.5.

(5) The CFO of XYZ Ltd. has asked a quote for generic interest rate swap (IRS) as she wants to use this for hedging interest risk of its subsidiary. The bank's quote on a 3-year generic IRS is: All-in-Cost of "55-58" flat. The benchmark for float rate is 6m-MIBOR and the fixed rate benchmark is MCLR. Further, interest rate data of two subsidiaries of XYZ named DP and MQ are given. The CFO is interested in knowing whether an IRS can be structured between them assuming there is no regulatory issue.

|                      | DP              | MQ              |
|----------------------|-----------------|-----------------|
| Credit Rating        | BBB             | A               |
| Objective            | Fixed rate loan | Float Rate Loan |
| Fixed Rate borrowing | 13%             | 11%             |
| Float Rate borrowing | MIBOR + 150 bp  | MIBOR + 50 bp   |

(6) XYZ has bought substantial number of 7-year 7.5% INR 1000 bond with 4 % premium on maturity at a required Yield to Maturity (YTM) of 8.5 %. However, for a project it is looking to sell these bonds and has got a proposal from another investor who is willing to purchase these bonds by shelling out a maximum amount of 895 per bond. Investors value bonds on intrinsic value basis.

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**Multiple Choice Questions**

- 4.1 Based on the information given in the Case Study about MIBOR based deposit, what action and how many interest future contract would be needed by XYZ to hedge its position ?
- (A) Buy 10 interest Future contracts
  - (B) Sell 10 interest Future contracts
  - (C) Buy 1 interest Future contract
  - (D) Sell 1 interest Future contract
- 4.2 The CFO and her team have never used IRS and hence they are not aware about the market convention of IRS quote. Which one of the following is not correct with respect to the quote for IRS as mentioned in the Case Study ?
- (A) The dealer is ready to buy IRS at 55 basis point over MCLR.
  - (B) The dealer is ready to buy at 55 basis point over MIBOR.
  - (C) The dealer is ready to sell at 55 basis point over MCLR.
  - (D) The dealer is ready to sell at 58 basis point over MIBOR.
- 4.3 Which form of factoring is known as “Old Line Factoring” ?
- (A) Recourse Factoring
  - (B) Non-Recourse Factoring
  - (C) Full Factoring
  - (D) Cross Border Factoring

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- 4.4 Identify the incorrect statement.
- (A) A forfaiter discounts the entire value of the note/bill. In a factoring arrangement, the extent of finance available is 75% to 80%.
  - (B) The forfaiter's decision to provide financing depends upon the financing standing of the availing bank. On the other hand, in factoring deal, the export factor bases his credit decision on the credit standing of the exporter.
  - (C) Factoring is a pure financial arrangement while forfaiting includes ledger administration as well as collections.
  - (D) Factoring is a short term financial deal. Forfaiting spreads over 3-5 years.
- 4.5 Bank A enters into a Repo for 14 days with Bank B in 10% GoI Bonds, 2021 at a rate of 5.00 % for ₹ 6 crore. Assuming that the clean price is 98.40, initial margin be 3% and days of accrued interest be 295, the 'dirty price' would be (based on the number of days in a year at 360) :
- (A) 106.60
  - (B) 109.15
  - (C) 107.50
  - (D) 110.00
- 4.6. The CFO shared with you data about the Company's export. On the basis of further information provided in this regard, answer the following questions : 4
- (i) Which option is better for the Company ?
  - (ii) Assume that the Company anticipates the spot exchange rate in 3 months' time to be equal to the current 3 months forward rate. After 3 months, the spot exchange rate turns out to be USD/INR 73.20/22. In such a scenario, what will be the foreign exchange exposure and risk of the Company ?

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- 4.7 Based on the data given in the Case Study answer the following questions :
- (A) Compute the Market price. 3
  - (B) Duration and Volatility of the bond ? 2
  - (C) Compute required Yield to Maturity (YTM) of the new investor. 4
- 4.8 Assuming an IRS can be structured between DP and MQ, what is the maximum saving possible ? If the saving is split equally, what is the cost of two subsidiaries with the IRS ? 2

### CASE STUDY : 5

#### 1. Background

Zedd Ltd. (ZL) is a technology platform that connects customers, restaurant partners and delivery partners, serving their multiple needs. Customers use its platform to search and discover restaurants, read and write customer generated reviews and upload photos, order food delivery, book a table and make payments while dining-out at restaurants. On the other hand, it provides restaurant partners with industry-specific marketing tools which enable them to engage and acquire customers to grow its business while also providing a reliable and efficient last mile delivery service.

Business of the Company is built around the core idea that over time, people in India are going out to eat at restaurants more than they cook at home. To capture value out of this shift in customer behaviour, it has two core business-to-customer (B2C) offerings food delivery and dining-out and it also has business-to business (B2B) offerings. Another important part of its business is Zedd Pro, its customer loyalty program which encompasses both food delivery and dining-out. Each of B2C as well as B2B offerings helps increase the value of its platform for its customers, enabling it to further attract new customers and to deepen engagement with existing customers. Each of its offerings also helps improve assortment, affordability, accessibility and quality ("AAAQ") of restaurant food for its customers thereby helping grow the restaurant industry.

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**2. ZL's IPO**

ZL has come out with an Initial Public offer (IPO) and the issue open dates are: July 14 to July 16, 2021. The price band is: INR 72-76, and the issue type is 100% Book-Building. The offer comprises a fresh issue by ZL and an 'Offer for Sale' by the Selling Shareholder (Y-Tech Ltd or YL). YL will be entitled to its respective portion of the proceeds of the 'Offer for Sale' after deducting its proportion of Offer expenses and relevant taxes thereon.

ZL needs to continue to invest in two core areas for the growth of its business which include customer and user acquisition and food delivery and technology infrastructure. It has made these investments in the past, and expects these to continue to be critical for the growth of the business in the future. The size of fresh issue is INR 9000 cr and Offer for Sale is INR 375 cr. ZL proposes to use INR 6750 cr of the net proceeds of the IPO for funding organic and inorganic growth initiatives.

Past financial performance of ZL is given below:

**Profit & Loss**

| <b>Particulars (₹ in million)</b>                 | <b>FY21</b>    | <b>FY20</b>     | <b>FY19</b>     |
|---------------------------------------------------|----------------|-----------------|-----------------|
| Revenue from Operations                           | 19937.9        | 26047.4         | 13125.9         |
| Other Income                                      | 1246.4         | 1380.0          | 851.3           |
| <b>Total Income</b>                               | <b>21184.3</b> | <b>27427.4</b>  | <b>13977.2</b>  |
| <b>Total Expenditure</b>                          | <b>24609.6</b> | <b>49094.4</b>  | <b>35563.7</b>  |
| Purchase of stock in trade                        | 2028.7         | 1105.2          | 187.2           |
| Changes in inventories of traded goods            | -110.0         | -16.0           | -21.3           |
| Employee benefits expense                         | 7407.7         | 7988.8          | 6007.9          |
| Other expenses                                    | 15283.2        | 40016.4         | 29389.9         |
| <b>PBIDT</b>                                      | <b>-3425.3</b> | <b>-21667.0</b> | <b>-21586.5</b> |
| Interest                                          | 100.8          | 126.4           | 86.5            |
| <b>PBDT</b>                                       | <b>-3526.1</b> | <b>-21793.4</b> | <b>-21673.0</b> |
| Depreciation, amortization and impairment expense | 1377.4         | 842.4           | 431.4           |
| <b>PBT</b>                                        | <b>-4903.6</b> | <b>-22635.7</b> | <b>-22104.3</b> |
| Exceptional items                                 | -3247.7        | -1220.3         | 11999.2         |
| <b>Tax(incl. DT &amp; FBT)</b>                    | <b>13.0</b>    | <b>0.0</b>      | <b>0.0</b>      |
| Net Current Tax                                   | 13.0           | 0.0             | 0.0             |
| <b>PAT</b>                                        | <b>-8164.3</b> | <b>-23856.0</b> | <b>-10105.1</b> |
| OPM (%)                                           | -23.4          | -88.5           | -170.9          |
| PATM (%)                                          | -40.9          | -91.6           | -77.0           |

**3. ZL's Machine Acquisition**

ZL, after the IPO, has a plan to install a machine and is considering buying or leasing option. The machine is subjected to straight line method of depreciation. In this regard, ZL can raise a debt at 16% payable in 4 equal annual installments of ₹ 1,68,589 each at the beginning of the year. In case of leasing, the Company would require to pay an annual rent at the end of the year @30% of cost of the machine for 4 years. The Company is in 45% tax bracket. The salvage value is estimated at ₹ 12,412 at the end of 4 years.

**4. ML Ltd.**

One of the associate companies of ZL named ML Ltd is planning to use credit derivatives for hedging credit risks. It will do it after evaluating its impact on its financial statement. It also has plans to convert rupee loan into foreign currency loan in order to reduce its cost of borrowing. The CFO of ZL would support and continuously monitor these as there is no in-house expertise available with ML to manage foreign exchange risk.

**5. PQ Ltd.**

You have also been asked by the CFO of PQ Ltd which is a subsidiary of ZL to help him in certain matters related to the Right issue. PQ has an expansion plan and is proposing to fund its expansion plan of INR 1984.20 crore by making a rights issue. The Board of PQ is proposing a discount of 20 % on the market price per share of PQ for the rights issue. The Board also wants that fall in Ex-Right price of the shares should be restricted to 10 % of the market price per share. The current market price per share is INR 6614.

5.1 Which one of the following is incorrect with respect to conditions that are attached to an 'Offer for Sale' forming part of an initial public offer (IPO)? 2×5  
=10

- (A) Limit on monetary asset of an issuer is not applicable, in case IPO is entirely through an 'Offer for Sale'.
- (B) Limit on monetary asset of an issuer is applicable, in case IPO is entirely through an 'Offer for Sale'.
- (C) Only fully paid up equity shares can be 'Offer for Sale'.
- (D) The full issue price for each specified security shall be payable at the time of application.

5.2 The CFO of Z Ltd wants to know about possible utilisation of the net proceeds of the IPO. Which of the following is incorrect with respect to utilization of the net proceeds of the IPO? The funds collected from the IPO by ZL :

- (A) Can be used for any general corporate purpose.
- (B) Can be fully used only to create food distribution and technology infrastructure of ZL.
- (C) Can be used for funding organic growth and/or in organic growth up to INR 6,750 cr of ZL.
- (D) Cannot be used for investing temporarily in unsecured loans to other companies.

5.3 ZL proposes to acquire another large start-up company and has signed an MOU recently subject to approval of the Board. The Board meeting is scheduled in the next 14 days for which date and agenda are under finalization. The Managing Director of the start-up company wishes to dispose of his 5 % shareholding in ZL. In this respect, which one of the following is correct?

- (A) After signing the MOU.
- (B) After the date of Board Meeting in which the transaction is approved.
- (C) After a public announcement is made of the MOU signed by the company.
- (D) Once the stock exchanges are notified about the proposed Board meeting to consider the proposal.

(30)

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**Marks**

- 5.4 ZL wants to ensure that an anchor investor is attracted towards the IPO. Which one of the following is incorrect with respect to the anchor investor ?
- (A) ZL can reserve up to 60% of the issue to the anchor investor under qualified institutional buyers category.
  - (B) Promoters or promoter group can be an anchor investor.
  - (C) Bidding for anchor investor is opened one day before the IPO opens.
  - (D) Anchor investor has to pay entire application money as margin money on the application.
- 5.5 ML has got a proposal from a reputed bank to convert its INR borrowing into USD liability for a 10-year and promised to hedge the foreign exchange risk. The CEO of ML appears happy with the proposal as it is likely to save 200 basis point of interest cost. However, he does not want any fluctuation in the cash flow on account of this and wants to remain fully covered from interest rate risk and foreign exchange risk. Which one of the following derivative instrument would be the most suitable for this purpose ?
- (A) Forward Contract
  - (B) Currency Swap
  - (C) Interest Rate Swap
  - (D) Currency Future
- 5.6 Do you think the IPO of ZL could have been a fixed-price issue ? Why merchant bankers and the issuer decided to issue shares on the basis of book-building and not fixed-price ? Give reasoned answer for both questions. 2
- 5.7 What is the minimum spreads required in case of price-band ? Do you think that and price-band can be changed after filing the RHP ? 2

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- 5.8 In the light of the information provided in the Case Study for considering buying or leasing a machine, advise which option should be exercised and why ? **5**

| N             | 1     | 2     | 3     | 4     |
|---------------|-------|-------|-------|-------|
| PVIF (8.8, n) | 0.919 | 0.845 | 0.776 | 0.714 |
| PVIF(16, n)   | 0.862 | 0.743 | 0.640 | 0.552 |

- 5.9 Based on the information given in the Case Study for PQ Ltd answer the following questions :

- (A) What will be the number of equity shares for each right share held ? **2**
- (B) What will be the number of fresh equity shares to be issued ? **2**

- 5.10 ML wants to use credit derivatives and wants your suggestion on two sources of market risk that credit derivatives contain. Explain these two risks. **2**
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