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Further, in the Elective Papers which are Case Study based, the solutions have been worked out on the basis of certain assumptions/views derived from the facts given in the question or language used in the question. It may be possible to work out the solution to the case studies in a different manner based on the assumptions made or views taken.

PAPER 6B: FINANCIAL SERVICES AND CAPITAL MARKETS - ELECTIVE PAPER

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

While answering the multiple choice question, candidates are required to indicate the alphabet of their choice in capital letters.

In case, any candidate answers extra question(s)/ sub-question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question (s) answered shall be ignored.

CASE STUDY : 1

PQR Ltd is a well-known listed company in the real estate sector in India. It has a large pool of real estate assets across India at strategic locations. In the coming years it expects that India's GDP will grow around 6%. This growth rate will lead to more demand for office spaces hotel rooms, shopping centres and so on. At the recently held board meeting, the Managing Director of PQR LLC Mr. Anup Singh made a suggestion in the board meeting about launching a ReIT as SEBI has recently notified regulations for launching new ReITs. He explained to the Board that investing in ReITs offers various benefits to the investors like liquidity, minimum investment, active professional management etc. So raising funds for ReIT will not be a difficult task. The Board, approved the plan for setting up a ReIT and subsequently PQR ReIT was established with the objective of investing in office buildings. PQR ReIT is now planning to come up with a ₹ 1,000 crores IPO. Alpha capital is contemplating investing in this IPO. You have been appointed as a financial Analyst of Alpha capital and have been given the assignment to value ReIT of PQR. You have been provided with the following data regarding PQR ReIT.

Projected annual operating income	*₹ 150 crore*
Debt	*₹ 400 crore*
Cash and cash equivalent	*₹ 50 crore*
Expected annual dividend next year (2020)	*₹ 10 crore*
Expected growth rate in annual dividend (2021, 2022 and 2023)	*10%*
Dividend growth rate from 2024 into perpetuity	*4%*
Estimated project level capitalisation rate	*12%*
Estimated cost of equity of PQR	*13%*
Risk Free Rate	*6%*
Number of shares	*₹ 10 crores*
Estimated cost of equity of Alpha Capital	*14%*

PQR Ltd. also has a modern treasury department. It parks surplus cash of PQR Ltd. in mutual fund schemes. Over the last few years it has become very sophisticated in the use of credit derivatives. As per approved plan of the board the treasury functions as a profit centre. The board members are, however, not conversant with credit derivatives.

PQR Ltd. has one division which successfully runs restaurant business in the Chinese food only segment. The board has observed that the restaurant business has been showing negative working capital and they are not happy about the same. They did not like the explanation given by the CFO of the company that in restaurant business working capital is generally negative. As· a practice, only cash sales are allowed in the restaurant and inventory is not kept for more than 5 days. Average payable period is not more than 35 days.

The board has also recently created a Special Purpose Vehicle (SPV) for a large size infrastructure project and is in the process of finalising lenders for project financing. In the meantime, PQR Ltd's company secretary has highlighted a few items which could be potential non-compliance. The board has decided to focus first on these issues before going for project financing. One of the very first things that have been highlighted is about related party transactions and post approvals for the same from the Audit committee. However, the Board believes that PQR Ltd. is in full compliance as they get an omnivorous approval in the last board meeting of every year, which covers all transactions that the company has entered into for the year. When it has been further pointed out by the company secretary that it is not in compliance as even omnivorous approvals also did not have the name of the related party, nature, period, maximum amount etc., the board explained that omnivorous as the name suggests was overall and need not be specific at all.

Questions:

1.1 Which one of the following is true about the credit derivatives?

(A) Credit derivative permit the trading of credit risk but with actual ownership of loan.

(B) The key risk driver of the credit derivative is credit risk rather than market risk.

(C) Credit derivatives do not allow investors to create synthetic loan portfolio without bearing the costs of loan origination and administration.

(D) Credit derivatives are over-the-counter (OTC) derivatives the value of which is fully derived from the credit performance of the reference assets. ***(2 Marks)***

1.2 Which of the following can be appropriate for credit derivatives?

It allows investors to isolate and manage various risk including

(A) Specific risks (such as the default and credit spread associated with the issuer)

(B) Interest risk

(C) Currency and /or convertibility risk

(D) All of the above ***(2 Marks)***

1.3 The financial covenants in project financing describe how the loan will be repaid under normal circumstances or may be prepaid under special circumstances. Which one of the following is NOT an example of affirmative covenants?

(A) Covenants to secure note equally with other lender

(B) Financial Statement and information

(C) Right to inspect properties and books

(D) Limitation on guarantees and contingent liabilities ***(2 Marks)***

1.4 In spite of general denial of risk taking by lenders in project financing there are certain transaction risks which lenders in some instances may feel comfortable in assuming. This exposure may be in the form providing additional financing and or charging a higher cost to the borrower. Considering this, which one of the following is correct about the risk which a lender may assume in a project financing?

(A) Country risk and political risk

(B) Availability of permits and licences

(C) Completion risk

(D) All of the above ***(2 Marks)***

1.5 The board member has a negative view about negative working capital and they believe that working capital is not being efficiently managed. Which one of the following is correct about negative working capital?

(A) Negative working capital is always bad.

(B) Negative working capital is always good.

(C) Negative working capital for the restaurant business of PQR indicates efficient management of working capital with value enhancing characteristics.

(D) Negative working capital of the restaurant business of PQR Ltd is an indicator of financial distress. ***(2 Marks)***

1.6 Find the value of a PQR ReIT share using earnings capitalisation method. ***(4 Marks)***

1.7 Find the value of a PQR ReIT share using dividend discount model. ***(4 Marks)***

1.8 The board of PQR is very much concerned about the bank they are going to select for project financing. They have hired you to identify and explain factors that would be relevant for the board to consider before selecting a bank ? ***(4 Marks)***

1.9 Is the view of the board regarding approval of related party transactions correct? What are the non-compliances as per your understanding? ***(3 Marks)***

Answer CASE STUDY 1

1.1 (B)

1.2 (D)

1.3 (D)

1.4 (D)

1.5 (C)

1.6 Value of ReIT using earnings capitalization method

	₹in Crores
Projected annual operating Income	150
Capitalization Rate	12%
Estimated value of operating real estate (150/12%)	1250
Add: Cash and Cash Equivalent	50
Less: Debi	400
Net Asset Value	900
Shares outstanding	10
NAV/share	90

1.7 Value of ReIT using dividend discount model

Year	Dividend per share	PVF @13 %	PV
2020	10.00	0.885	8.85
2021	11.00	0.783	8.61
2022	12.10	0.693	8.39
2023	13.31	0.613	8.16
			34.01

PV in 2023 of dividend beginning in 2024 $\frac{13.31\times(1+.04)}{(13-.04)}$ $\frac{13.84}{0.09}$ =153.78

PV of the above dividend $\frac{153.78}{(1+13)x4}$ $=\frac{153.78}{1.63}$ =94.34219

Value of a share of the Rel T=PV of Dividend (from 2020 to 2023) +PV of Terminal Value

Value of share: ₹ 34.01 + ₹ 94.34= ₹ 128.35

1.8 Factors to be considered in selecting a bank for project financing.

(a) Pricing is one of the main criteria for selection of a bank. However as a result of competition the gaps in pricing are very small.

(b) Size- for large size project large bank is needed

(c) **Experience-** banks have experience in particular type of project is preferable as they would be familiars with any potential problem.

(d) **Support -** borrower would be happy with a bank that can help in crunch situation

(e) **Documentation-** borrower would be happy with covenants that would not restrict the ability of borrower to manage the project.

(f) Working relationships.

(g) Non-interference in the managerial decision

(h) Country exposure

1.9 As per SEBI (LODR Regulations, 2015:- Regulation 23(1) states that 23(1). The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions: Explanation.- A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

(2) All related patty transactions shall require prior approval of the audit committee.

(3) Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions, namely-(a) the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the listed entity and such approval shall be applicable in respect of transactions which are repetitive in nature;(bl the audit committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity; (c) the omnibus approval shall specify: (i) the name(s) of the related party, nature of transaction period of transaction, maximum amount of transactions that shall be entered into. (ii) the indicative base price / current contracted price and the formula for variation in the price if any; and (iii) such other conditions as the audit committee may deem fit. Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available audit committee may grant omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

Case Study: 2

Rahul heads the compliance department of Aggressive Enterprises Limited (AEL) and holds the key responsibility of ensuring obedience to the dynamic policies of financial markets. AEL is a leading Pharma company and has supplies to more Than 20 countries. Raw material used in manufacturing the approved drugs is a standard API sourced from China and other parts of Asia.

In the process of routine business operation AEL has to deal with various countries and their regulators specially related to money markets as their major trades are on the basis of international trade practices. These imports and exports are carried out in more than 8 currencies majorly being USO and EURO. After the COVID-19 pandemic·Outbreak and research on the vaccination, the overall international trade on the research and development has significantly increased for the AEL. They have collaborated with countries like Russia, Israel and Unites states to align their facilities to develop the vaccines. They have also hired volunteers across the globe for the trials of their dosages.

For the international coordination and assessing the impact of international policies on the financial markets, Rahul has on boarded Ms. Tina Harris, certified compliance professional, based. out of Singapore. Ms. Harris has direct responsibility to track any changes in the international policies and major movements in global financials markets which may impact the overall Indian financial market scenario as well. Immediately upon hiring, Rahul has asked Tina to present a detailed note on the current situation and multiple factors comprising of global financial markets. In return, Rahul also appraised her of the credit policy of India and its key instruments. Following were the major inputs provided by Rahul:

Analytics of Credit Policy.

(i) Interest Rate Channel

(ii) Exchange Rate Channel

(iii) Quantum Channel

(iv) Asset Price Channel

Instruments of Credit Policy

(i) Cash Reserve Ratio

(ii) Statutory Liquidity Ratio

(iii) Liquidity Adjustment Facility

(iv) Margin Standing Facility

(v) Market Stabilization Scheme

(vi) Open Market Operations

Tina also presented her detailed views about the presence of major regulators in global markets such as Securities Exchange Commission (SEC), Federal Reserve (Fed), Office of the Superintendent of Financial Institutions in Canada (OSFI), Employees Retirement Income Security Act (ERISA), Mutual Fund Dealers Association of Canada (MFDA) International Swaps and Derivatives Association (ISDA), International Association of Investment Bankers (IAIB). During her presentation, she kept a larger focus on the Fedeal Reserve system in the Central bank of United States as Fed is directly responsible for the US Monetary policy as well in fostering payment and settlement system safety and efficiency.

Tina presented various tools used by the Fed policy including Open market operations, Discount rate, reserve requirements, overnight reserve repurchase agreement facility etc. as all these techniques used by US Federal reserve as a part of Fed Policy have been employed by Reserve Bank of India which are reflected in the credit policy by RBI. Rahul and Tina agreed on the symmetrical approach and corresponding impact on the Global and Indian markets. It was clearly established that US interest rates matter to the foreign stock investors in India also. The reason is Zero or near zero returns on safe investments in the USA. But if the Fed rates go up, it may lead to mass exodus of foreign investors from the Indian Stock markets because higher returns in the form of interest is available there.

During this entire conversation, General Manager Compliance and key team member of Rahul's team, Mr. Prem, highlighted the importance of Cost Inflation Index as well as the Consumer Price Index. As the discussion proceeded, there was a touch point on the headline inflation rate. It was explained in detail by Prem that In India Wholesale Price Index is also known as the headline inflation rate. There were further deliberation on the main uses of Wholesale Price Index and difference between Wholesale Price Index and Consumer Price Index.

The entire discussion on Global financial markets and impact of various policies of financial markets was well summarized by the trio and submitted to the office of Managing Director for their reference. In order to have a better understanding and have a strategic decision making, office of Managing Director raised the following questions. Please submit the answers with detailed explanation.

2.1 Who are the Primary stakeholders in financial market?

(A) Brokers

(B) Reserve Bank of India

(C) Custodians

(D) None of the above ***(2 Marks)***

2.2 What does SEC stands for a regulator in United States of America? ·

(A) Shares Exchange control

(B) Securities Exchange Commission

(C) Shares Exchange Commission

(D) Securities Exchange Control ***(2 Marks)***

2.3 Reserve Bank of India is established under which Act ?

(A) Reserve Bank of India Act, 1934

(B) Reserve Bank of India Act, 1935

(C) Reserve Bank of India Act, 1932

(D) Reserve Bank of India Act, 1936 ***(2 Marks)***

2.4 Which Index is known as headline inflation rate?

(A) Consumer Price Index

(B) Cost Inflation Index

(C) Wholesale Price Index

(D) None of the above ***(2 Marks)***

2.5 Purchase and Sale of securities in open market by a central bank is called:

(A) Open Market operations

(B) Discount Rate Operations

(C) Overnight Reverse Repurchase

(D) All of the above ***(2 Marks)***

2.6 Explain the difference between Wholesale Price Index and Consumer Price Index. ***(5 Marks)***

2.7 Please elaborate the functions of financial markets. ***(3 Marks)***

2.8 What is Certificate of Deposit? ***(2 Marks)***

2.9 Illustrate the difference between Exchange rate channel and Quantum Channel. ***(3 Marks)***

2.10 What is Liquidity Adjustment Facility (LAF)? ***(2 Marks)***

Answer CASE STUDY 2

2.1 (D)

2.2 (B)

2.3 (A)

2.4 (C)

2.5 (D)

2.6 Difference between Wholesale Price Index and Consumer Price Index

Wholesale Price Index: -Wholesale Price Index (WPI) measures the average change in the prices of commodities for bulk sale at the level of early stage of transactions. The index basket of the WPI covers commodities falling under the three major groups namely Primary Articles Fuel and Power and Manufactured products. (The index basket of the present 2011-12 series has a total of 697 items including 117 items for Primary Articles 16 items for Fuel & Power and 564 items for Manufactured Products). The prices tracked are ex-factory price for manufactured products, mandi price for agricultural commodities and ex-mines prices for minerals. Weights given to each commodity covered in the WPI basket is based on the value of production adjusted for net imports. WPI basket does not cover services.

Consumer Price Index:- A Consumer Price Index (CPI) is designed to measure the changes over time in general level of retail prices of selected goods and services that households purchase for the purpose of consumption. Such changes affect the real purchasing power of consumers income and their welfare. The CPI measures price changes by comparing, through time, the cost of a fixed basket of commodities. The basket is based on the expenditures of a target population in a certain reference period. Since the basket contains commodities of unchanging or equivalent quantity and quality, the index reflects only pure price. Traditionally, CPI numbers were originally introduced to provide a measure of changes in the living costs of workers. so that their wages could be compensated to the changing level of prices. However, over the years, CPIs have been widely used as a macroeconomic indicator of Inflation and also as a tool by Government and Central Bank for targeting inflation and monitoring price stability. CPI Is also used as deflators in the National Accounts. Therefore, CPI is considered as one of the most important economic indicators.

Given the many uses of CPIs, it is unlikely that one index can perform equally satisfactory in all applications. Therefore, there is a practice of compiling several CPI variants for specific purpose. Each index should be property defined and named to avoid confusion. The purpose of CPI should influence all aspects of its construction.

Difference between Wholesale Price Index (WPI) and Consumer Price Index (CPI)

WPI reflects the change in average prices for bulk sale of commodities al the first stage of transaction while CPI reflects the average change in prices at retail level paid by the consumer.

The prices used for compilation of WPI are collected at ex-factory level for manufactured products, at ex-mine level for mineral products and mandi level for agricultural products. In contrast, retail prices applicable to consumers and collected from various markets are used to compile CPI.

The reasons for the divergence between the two indices can also be partly attributed to the difference in the weight of food group in the two baskets. CPI Food group has a weight of 39.1 per cent as compared to the combined weight of 24.4 per cent (food articles and Manufactured food products) in WPI basket.

The CPI basket consists of services like housing, education, medical care, recreation etc. which are not part of WPI basket. A significant proportion of WPI item basket represents manufacturing inputs and intermediate goods like minerals, basic metals, machinery etc. whose prices are influenced by global factors but these are not directly consumed by the households and are not part or the CPI Item basket.

Thus even significant price movements in items included in WPI basket need no! necessarily translate into movements in CPI in the short run. The rise or fall in prices at wholesale level spill over to the retail level after a lag.

Similarly. the movement in prices of non-tradable items included in the CPI basket widens the gap between WPI and CPI movements. The relative price trends of tradable vis a vis non-tradable is an important explanatory factor for divergence in the two indices in the short term.

2.7 Functions of Financial Markets

The role of financial markets in the success end strength of an economy is immense. Some important functions of financial markets are:

- ✓ **Puts savings into more productive use**

  Money in savings account should be put to productive use. Financial institutions like banks loan it out to Individuals and companies that need it for say home loan, study loan. business purposes big projects, etc. Further. savings as such does not have any meaning. It is investment that puts it to productive use.

- ✓ **Determiners the price of securities**

  Once a security is listed, buyers and sellers trade in it, and the traded price reflects the prospects of the company whose instruments are being traded. This is called price discovery. Prices of securities are determined in financial markets, which is an important function.

- ✓ **Makes financial assets liquid**

  Buyers and sellers can decide to trade their securities anytime, provided there is a counterparty. Financial markets provide this avenue, and that creates liquidity in the security. This imparts liquidity to investors and incentivize them to invest.

- ✓ **Lowers the cost of transactions**

  In financial markets, various types or Information regarding securities can be acquired without the need to spend. The Exchanges and market participant associations disseminate relevant information. The companies also can disseminate information, but they would put forth only what they want to propagate, not what is useful for investors.

2.8 Certificate of Deposits are issued by the banks for short term funding needs. Usually banks issue CDs when credit pickup is higher than the bank deposit growth. CDs save on operational costs or the bank as these take place in bulk.

2.9 Exchange rate channel is appreciation of domestic currency which makes domestically produced goods more expensive compared to foreign produced goods. This will cause the next export to fall resulting in decline of domestic output and employment.

Quantum channel comprise to bank lending channel and the balance sheet channel. Credit channel operates by altering the access or firms and households to bank credit. Balance sheet channel works on the direct effect or monetary policy that is will show the interest cost and increase in payments through loan repayments.

2.10 Liquidity adjustment Facility -Under this facility the commercial banks can borrow from RBI through the discount window against the collateral of securities like commercial bills, treasury bills or other eligible papers. Currently the RBI provides financial accommodation to the commercial banks through repos reverse repos under the LAF.

Case Study : 3

Mr. Lister is the Managing Director of Lister Limited, an entity listed on the stock exchange in India. He is an experienced industrialist. He has recently visited African countries and has identified some business opportunities. For this purpose, he is evaluating various options to raise funds 'including through public offerings. In addition to this, Mr. Lister is also one of the promoters of a start-up named ABC Pvt. Ltd. which is in the business of online food order and delivery.

Recently, an experienced chartered accountant has been appointed as a Chief Finance Officer (CFO) of Lister Ltd. Even though the newly appointed CFO is not a company secretary, he has been asked to look after compliance functions also. The new CFO has informed Mr. Lister that he has observed a few items that could be potential non-compliance issues and he would like to focus on these issues first before going for fund raising activities for the business opportunities in Africa. Mr. Lister also informed the new CFO about two independent directors on the board of Lister Ltd, who are named Mr. Xerox and Mr. Copy. Both are also on the board of a listed entity named Photocopy Limited. Mr. Lister is also a member of the Board of Photocopy Limited and is an independent Director in that company. Mr. Xerox is an independent director in Photocopy Limited and Mr. Copy is a non-independent Director in Photocopy Limited. Further, Mr. Lister has disclosed that he is a director in 11 companies in total. Out of this, he is an independent director in 10 companies. Out of 10 companies two entities are unlisted and two entities have listed their debentures.

The promoters of ABC Pvt. Ltd. have no prior experience in dealing with venture capitalists. Considering expertise of the new CFO, they thought it would be appropriate to take inputs of the new CFO about the dilution in their stake to the venture capitalists and the number of shares· to be issued to them. In this connection the promoters of ABC Pvt. Ltd. have provided the following information.

The start-up is doing well and is currently offering service in three cities in India. Since the response for the start-up has been good especially amongst the youngsters, the promoters of ABC Pvt. Ltd. plan to expand the business to five more cities in a gradual manner. For expansion of the business of ABC Pvt. Ltd. promoters are exploring the option of raising money from venture capitalists in three rounds. However they are concerned about the dilution *in their holding to venture capitalist. They have provided you the following information in this respect.*

Expected Net Income (Earnings After Tax) at the end of 10th year	*₹10 crores*
Expected PE Ratio of comparable companies at the end of the years	*30 times*
Current number of equity shares	*10,00,000*
Fund required now in the First Round from VC 1	*₹ 60 crores*
Investment horizon of VC 1	*10 years*
Required Rate of Return of VC 1	*40%*
Fund required in the Second Round from VC 2 at the end of 3 years from now	*₹ 50 crores*
Investment horizon of VC 2	*7 years*
Required Rate of Return of VC 2	*30%*
Fund required in the Third Round from VC 3 at the end of 6 years from now	*₹ 40 crores*
Investment horizon of VC 3	*4 years*
Required Rate of Return of VC 3	*20%*

Questions:

3.1 Which one should be the compliance officer for Lister Limited as per SEBI (LODR) Regulations:

(A) A Chartered Accountant

(B) A CFO, who is a Chartered Accountant by qualification

(C) A CFO, who is also a Company Secretary by Qualification

(D) The Legal Head who is an Advocate by Qualification ***(2 Marks)***

3.2 The following is an extract from the draft term-sheet given by VC2: "In the event that company issues additional securities at a price less than the current series A preferred conversion price, such conversion price shall be reduced to the price at which the new shares are issued." What, in your opinion, does the above language of the term-sheet indicate?

(A) Broad-based weighted average anti-dilution protection

(B) Narrow-based weighted average anti-dilution protection

(C) No anti-dilution protection

(D) Full-ratchet anti-dilution protection ***(2 Marks)***

3.3 As per draft term-sheet of VC 1 the holder of a 7 5% majority series A 2 share may require a sale of the entire issued share capital of ABC Pvt. Ltd. Which one of the following is correct to describe the above right?

(A) Co-sale Right

(B) Consent Right

(C) Drag-along right

(D) Pre-emptive right ***(2 Marks)***

3.4 Which of the following is included in a Term Sheet?

(A) Down Round

(B) Fee Structure

(C) Exclusivity Agreement

(D) All of the above ***(2 Marks)***

3.5 One of the audit committee members of Lister Ltd has requested for a meeting only amongst the audit committee members without the presence of any of the Company's executives. The newly appointed CFO has strongly objected to this request on the ground that this would not' be in compliance with the spirit of the provisions under SEBI Regulations and at least CFO should be present as the matters being discussed in the Audit Committee are all related to finance and audit matters. In respect of this, which one of the following is correct in view of SEBI (LODR) Regulations?

(A) Request by the audit committee member

(B) Position taken by the CFO

(C) Both (A) & (B)

(D) None of the above ***(2 Marks)***

3.6 Would Mr. Xerox and Mr. Copy qualify as independent directors of Lister Limited, as per the SEBI (LODR) Regulations? Provide your response with explanations. ***(3 Marks)***

3.7 Is Mr. Lister complying with the requirements of SEBI (LODR) Regulations, 2015 for the number of directorships held by him and the number of companies in which he is an independent director ? Provide your response with specific explanations. ***(4 Marks)***

3.8 What percentage ownership should the start-up give to the VC1, VC2 and VC3 to persuade the VC to invest in the start-up? ***(5 Marks)***

3.9 How many shares should VC 1, VC 2 and VC 3 purchase? ***(3 Marks)***

Answer CASE STUDY 3

3.1 (C)

3.2 (D)

3.3 **(C)**

3.4 **(D)**

3.5 **(A)**

3.6. As per Regulation 16(b)(viii) of SEBI (LODR) Regulations, 2015, an independent director is a non-executive director and who is not a non-independent director of another company on the board of which any non-independent director of the listed entity is an independent director. In this case, Mr. Xerox is an independent director in both Lister Ltd. and Photocopy Limited. Considering him as an independent director in Lister Ltd. is appropriate.

But Mr. Copy is a non-independent director in Photocopy Limited in which Mr. Lister is an independent director. Accordingly, Mr. Copy cannot be an independent director in Listed Limited.

3.7 As per Regulation 17A, The directors of listed entities shall comply with the following conditions with respect to the maximum number of directorships, including any alternate directorships that can be held by them at any point of time

(1) A person shall not be a director in more than eight listed entities with effect from April 1, 2019 and in not more than seven listed entities with effect from April 1, 2020:

Provided that a person shall not serve as an independent director in more than seven listed entities.

(2) Notwithstanding the above. any person who is serving as a whole time director/managing director in any listed entity shall serve as an Independent director in not more than three listed entities.

For the purpose of this sub-regulation, the count for the number of listed entities on which a person is a director I independent director shall be only those whose equity shares are listed on a stock exchange.

Accordingly, Mr. lister is a Director in 11 entities out of which two are unlisted and two are debt listed. So, he is a director only in 7, which is ok.

A director cannot be an independent director in more than seven listed entities Mr. Lister is in compliance with this condition as well.

However, where a person is service as MD, he cannot be an independent director in more than 3 entities. Accordingly, Mr. Lister is not eligible to continue as an independent director beyond 3 entities as he is the MD of Lister Umi9ted.

3.8 Value of the company at the end of 10 year Net Income x PE Ratio

100 crores x 30 times

₹ 3000 crores

Future value of VC 1 Investment $60*(1+.4)^{10}$ = ₹1,735.53 crores

Future Value of VC 2 Investment $50*(1+3)^{7}$ = ₹313.74 crores

Future Value of VC 3 Investment $40*(1+2)^4$ = ₹ 82.94 crores

VC 1 ownership % at the end of year 10 = ₹ 1735.52/₹ 3000 Cr = 57.85%

VC 2 ownership % at the end of year 10 = ₹ 313.74/₹ 3000 Cr = 10.46%

VC 3 ownership % at the end of year 10=₹82.94/₹ 3000 Cr = 2.76%

Alternate solution: If a student attempts and considers ₹ 10 Crores as

3.9 Number of shares VC 1, VC 2 and VC 3 should purchase

	Founders	VC1	VC2	VC3
% Shareholding	28.93	57.85	10.46	2.76
No. of shares	1000000	?	?	?
		19,99,654	3,61,562	95,403

Alternate solution: - If a student attempts and considers ₹ 10 Crores as Net Income and considers value of the company as ₹ 300 Crores then weighted mark to be given for that answer along with other calculations. The examiner should Judge the concept or the student.

Case Study: 4

You are a very renowned financial analyst and of late have been appearing constantly on television on issues related to financial policy making, economic slowdown and expected recovery of the economy. You have received an e-mail from the· Economic Advisory Group, a committee of members constituted by certain governments and industry bodies in India to look into the various aspects that are of key relevance to the economy and the equity markets. As a Pre-read, you have been provided with certain background information, which is given below:

- *The Central banks (like FED in USA) in every country plays a significant role in the policy making for the financial markets. Whilst each of the central banks have their own mechanisms in performing their roles, there are certain fundamental roles being played by these banks.*
- *There is a session that has been scheduled on the history of global financial markets and how these have evolved over a period. In particular, the expectation is that the importance of various types of financial markets, the key stakeholders, the regulatory environment etc., are the key focus. One specific aspect that is being looked at is the impact of the technological changes and how aspects such as block chain technology and the various online platforms could impact the financial markets where there is a likelihood of extensive discussions.*
- *An analysis of the market capitalisation of various listed corporates has been carried out by a group of students from the Indian Institute of Financial Studies and they will be making a presentation. This presentation is expected to provide an insight on the link between*

market capitalisation and economic measures such as the gross domestic product (GDP) etc.

- *Amongst the various areas which a central bank would focus on are topics like inflation, employment generation, stability of the economy etc. and the overall monetary policy. An analysis of the link between these different aspects and the role the central banks would be discussed extensively.*
- *Capital markets are expected to occupy a considerable time during the discussions. In particular views on the various instruments within the capital market and their current features would be covered. Given the various advancements in technology and new items such as crypto currencies that are coming into play, the group would be keen to understand the current instruments and the likelihood of these changing.*
- *Bonds and preference shares, as an instrument, would be a topic for detailed discussions, It is expected that the participants could pose questions on the relevance of preference shares as an instrument, the attractiveness of the bonds in the debt market, the methods to determine the returns and factors to consider in determining yields etc.*
- *A top focus amongst the industrial community (primarily from start• ups) which will be at the gathering is 'on fresh IPOs and issues. They believe the current regulations relating to such issues are quite cumbersome and are not easy for the business community to understand. They would be eagerly looking for someone to provide them an overview of the IPO process and provide answers to some specific questions they would be having.*
- *Use of Collateralised Debt Obligations (CDO) by, companies is now quite common. CDOs would be the key subject of discussion. The press coverage about headline inflation and core inflation is intensive while analysing inflation and hence some discussion on the same can also take place.*
- *Money market institutions such as·RBI, SCB, FII etc. are using multiple type of money market instruments which range on a span of Short, medium and long term whereby yield curve is derived on the basis of discount offered and overall tenure. Moreover there is a vast range available in front ended and back ended product to counter the money market volatilities.*
- *There has to be clear emphasis on the Institutions and intermediaries of the market and their role in navigating the markets towards positive momentum. These parties closely work with their global counter parts and assist smooth flow of money.*
- *Influence of commodity markets is significant on the overall market operations especially when they collaborate with foreign commodity exchanges. These platforms enable for both demand and supply factors to determine the prices for a particular commodity:*

Questions:

4.1 All of the following statements about CDO are true, EXCEPT:

(A) CDO is a form securitized debt.

(B) Synthetic CDO does not require actual transfer of assets.

(C) Arbitrage CDOs are also known as balance sheet CDO.

(D) Arbitrage CDOs can be broken down into cash flow and market value CDO.

(2 Marks)

4.2 The extent to which the financial markets assign a value to the listed corporates against the gross domestic product of the economy is also known as:

(A) Market capitalization

(B) Returns from equity

(C) Buffet indicator

(D) Hurdle rate ***(2 Marks)***

4.3 Which one of the following is money market instrument?

(A) Call Money

(B) Treasury Bill

(C) Commercial Bills

(D) All of the above ***(2 Marks)***

4.4 The yield curve is inverted. A creditworthy company considering alternative debt maturity would most likely:

(A) Enter into a short-term floating rate agreement

(B) Obtain a long-term fixed interest rate

(C) Roll-over short-term debt at each maturity

(D) Obtain a long-term floating rate agreement ***(2 Marks)***

4.5 Innovators growth platform means the trading platform for listing and trading of specified securities of issuers that comply with the :

(A) Eligibility criteria specified in regulation 283 of the SEBI (ICDR) Regulations, 2018

(B) Eligibility criteria specified in regulation 283 of the SEBI (LODR) Regulations, 2018

(C) Eligibility criteria specified in regulation 283 of the Securities and Exchange Board of India Act, 1992.

(D) Eligibility criteria specified in Section 283 of the Companies Act,2013. ***(2 Marks)***

4.6 Certificate of Deposit is a front ended negotiable instrument and if a bank offers an amount of ₹ 1,000 for a period of 3 months at a discount of 3 0% then what will be the yield on that certificate of deposit. ***(3 Marks)***

4.7 One of the participants in the session wanted to know the following questions:

(i) *Who are Foreign Portfolio Investors and what are their broad categories?* ***(2 Marks)***

(ii) *Who is the regulator of Commodity markets in India?* ***(1 Marks)***

(iii) *What is order matching mechanism?* ***(1 Marks)***

(iv) *Which is the most popular international commodity exchange active for trading 24 hours day?* ***(1 Marks)***

4.8 *Mr. Innovator had some questions for you and provide specific responses with reference to relevant regulations and definitions in the SEBI (ICDR) Regulations, 2018 :*

(a) *For many terms used in the eligibility conditions, there is no definition. For example, he said the term operating profit, monetary asset has not been defined under the SEBI (ICDR) Regulations, 2018. In such a case, he would like to make his. own computation but is willing to make the disclosures in the notes to the filing documents or should he write to SEBI and seek their opinion on the actual definition to be used?*

(1 Marks)

(b) *His company made a loss during the last financial year in the standalone financial statements, though it was a profit at the consolidated level. One of his friends has informed him that since the Company has made a loss in the last financial year, it would not be eligible to proceed with an IPO. He needs your two specific inputs:*

(i) *Why can't he take average as that is a profit for last three years?* ***(1 Marks)***

(ii) *Why can't he take the consolidated profit instead of considering the standalone profit, though his friend does not agree with him?* ***(1 Marks)***

(c) *The latest financial statements had some prior period errors observed, but Mr. Innovator is not keen in restating the financial statements. Is it permissible since the average profit for the last three years does not undergo a change?* ***(1 Marks)***

(d) *His Company has ₹ 60 Crores in fixed deposits with banks.*

(i) *He wants to understand is there any way an unrestricted fixed deposit can be treated·as a monetary asset as this is not defined in the regulations?* ***(1 Marks)***

(ii) *One of his friends Company also had fixed asset which was under lien and earmarked for a-specific purpose with a bank for a specific bank guarantee provided to them for a· non- cancellable contract for investment in plant and machinery. In that case, the fixed deposit was considered as eligible and he wanted to know why?* ***(1 Marks)***

(iii) *Is there any other way, his company can still be eligible for an IPO even if it is not able to meet the condition relating to monetary assets.* ***(1 Marks)***

Answer CASE STUDY 4

4.1 (C)

4.2 (C)

4.3 (D)

4.4 (B)

4.5 (A)

4.6 Yield on Certificate of Deposit

Amount of Issue-1000

Period -3 Months

Discount -30%

Discount Value =1000x30/100x3/12 = 75

CD Issue Price = 1000 - 75 = 925

Effective Yield = (Face Value - Sale Value)/Sale Value x Months in year / Months x 100

(1000-925)/925 x 12/3 x 100 = 32.43%

4.7 (i) Foreign Portfolio Investor (FPIs) are basically registered foreign funds which put their money in stock markets in India. They participate in debt and equity segment both under 3 categories.

(a) Category 1 includes Government & Government related Investors.

(b) Category 2 Includes regulated funds, regulated parties and pension funds

(c) Category 3 Includes endowments, trusts and foundations etc.

(ii) SEBI

(iii) Other Matching Mechanism -Firstly a trader places his/her order with any registered broker who in term enters the same into online terminal. In case order matches with opposite order the trade is said to be completed.

(iv) London Metal Exchange (LME)

4.8 (a) As per Regulation 2 of the SEBI (ICDR) Regulations, 2018, words or expressions used but not defined in these regulations but defined in the Act or the Companies Act, 2013, the Securities Contracts (Regulation) Act. 1956 etc., and/or the rules and regulations made thereunder shall have the same meaning as respectively assigned to them in such statutes. Hence. Where definitions is not there in the ICDR Regulations, the Company would need to look for the definitions as per Companies Act, etc., Which has defined the terms operating profit, monetary asset etc.

(b) (i) Average profits - is not allowed and profit has to be there in each of the three financial years as per regulation.

(ii) Consolidated profits only; should be considered and not the standalone profits.

(c) Prior period errors -the requirement is that the financial information should be restated and the profits/turnover/net worth for each of the years has to be observed.

(i) Fixed deposit cannot be a non-monetary asset as per the definitions under the Companies Act and accounting standards. Hence, it is not correct to treat it as a non-monetary asset.

(ii) Where the Company has made firm commitments to use such monetary assets (fixed deposits) in business or project, it is permissible under the Proviso to Regulation 6(1)(a), and therefore in that case it is eligible.

(iii) As per Proviso 2 to Regulation 6(1)(a), if the IPO is entirely made through an offer for sale this requirement or 50% of monetary asset would not be applicable.

Case Study: 5

Ms. Placer is the Chairperson of the Placement Group of Companies, which has its presence in various industries with domain expertise in the financial services segment. The discussions about one of the companies of Placement Group are given in sub-paragraph (i) and other information Group is given in sub-paragraph (ii) below.

(i) ABC Ltd. is one of the listed companies of the Placement group and is engaged in the business of manufacturing toys. As a part of expansion plan the board has given approval to purchase a new machine costing ₹ 25 crores which will be used for 5 years. For an appropriate advice ABC Ltd.is planning of approach Growth Securities which is a leading Investment Banker of the country. They offer services in the area of Corporate Finance, Trading, Research, Loan Syndication and other Allied areas. They also advice clients in the area of Leasing and Hire purchase by suggesting whether the client should opt for leasing or hire purchase or outright purchase. The two alternatives considered by ABC Ltd. are :

- *taking the machine on lease or*
- *purchasing the machine outright by taking a loan*

ABC Ltd. has been offered a lease contract with a lease payment of ₹ 5 crores for five years payable in advance. The banker of ABC Ltd. requires the loan to be repaid at 12 % in 5 equal installment each installment being. due at the beginning of each year. Tax relevant depreciation of the machine is 25 % as per WDV method. At the end of 5th year the machine can be sold for ₹ 1 crore. Marginal Tax rate of ABC Ltd. is 25 % and use post tax cost of debt for evaluating leasing vs buy with borrowing decision.

Further, ABC Ltd. has a robust treasury department and it manages working capital efficiently. In addition to cash credit facilities it extensively uses buyer's credit and factoring services for efficient management of its working capital. However, the board is concerned about contractual risk arising out of the seller's obligation when buyer's credit is used. They want a detailed discussion on this issue.

(ii) The Placement Group has more listed entities (other than ABC Ltd.) in which there have been few transactions in the recent past. The cost of having these entities as listed is hitting on the results over a period and hence the chairperson is keen to explore options

for de-listing. She has heard about exit offers through some sources but she wants to know why those are perceived as time consuming and is there any way she can de-list the entities in an easier manner. One of the companies has been admitted in the NCL T by the lender under the Companies Act, 2013 and there is a plan to de-list through specific options provided to public for selling their shares, but she would like to go with an easier mechanism if it exists.

- *For the flagship company in the Group, Ms. Placer is keenly looking at expansion opportunities. Historically, this flagship company has not been listed though some of the domain businesses are a part of this company and there is a view in the Board that this company should get listed, which will enhance the value of the Group considerably. Ms. Placer is not ruling out listing but more importantly wants to explore options to see how she can still raise funds through other possible means too if that is going to be cost efficient.*
- *The audit committee members of some of companies in the Group strongly advocate buy back of securities for some of these entities. One of the reasons why they prefer buy back is that these are highly unregulated and could be an easier route compared to de-listing of shares, particularly in listed companies. However, Ms. Placer believes that this is an area where she needs more advice to understand it better.*
- *Ms. Placer also has some private investors in few major companies in the Group where the promoter stake has come down over a period and Ms. Placer is not too pleased with this. These are entities where there is also a significant amount of cash pool, but due to tax reasons, the Group is unable to use the same expansions planned in other group companies. Is buyback an option in these companies is also a thought that Ms. Placer is exploring including whether this could help here in funding expansions in other companies.*
- *Just to provide data, she said in one of the listed companies, the market price currently is ₹ 380 per share (which in her view is overvalued), but she does not want to do a buy back at such a higher price as these are also companies in which the Group does not have great hopes on future expansion plans and is not a company which she would like to focus on for enhancing shareholder value (though this is not the market perception).*

Questions:

5.1 The CAP Factor is a leading factor in India. It-has sent notice to ABC Ltd. for repaying the amount paid to ABC Ltd. as a part of factoring facility because the buyer has refused to pay the bill on due date. The type of facility under which the factor collects back from the seller the amount paid by him in case of non-payment of the bill on due date is called

(A) Recourse factoring

(B) Non-recourse factoring

(C) *Bill discounting*

(D) *Bill purchase* **(2 Marks)**

5.2 *Which one of the following is correct about buyer's credit arrangement?*

(A) *A long-term credit is extended to the seller*

(B) *A long-term credit is extended to the buyer*

(C) *Buyer's credits are given directly to the buyer but not to the buyer's bank*

(D) *The outstanding contractual risk for due fulfilment of the seller's obligation is normally not covered outside the loan agreement by a separate performance guarantee in favour of the buyer* **(2 Marks)**

5.3 *In addition to the issuer's ability to pay and the strength of the security owners claim on the issue, which other factor is important in the default risk assessment and quality rating assigned to an issue :*

(A) *The economic significance of the industry and the market place of the issues*

(B) *The economic significance of the world*

(C) *The economic significance of the Country*

(D) *None of the above* **(2 Marks)**

5.4 *Which one of the following economic phenomenon can't be determined by just reading inflation rate?*

(A) *hyperinflation*

(B) *deflation*

(C) *stagflation*

(D) *disinflation* **(2 Marks)**

5.5 *All of the following statements about the role of back office of a treasury is correct, EXCEPT:*

(A) *independent risk assessment*

(B) *delivery and deal settlement of the transactions*

(C) *controls on the transaction*

(D) *accounting of the transactions* **(2 Marks)**

5.6 *Determine as an analyst of Growth Securities whether leasing is financially viable for ABC Ltd. What would be the break-even Lease Rental for ABC Ltd.?* **(4 + 1 = 5 Marks)**

5.7 *Advise Ms. Placer on options to de-list? Which regulations would the Group need to comply with for the same? Can these regulations be applied for all companies in the Group?* **(2 Marks)**

5.8 Provide your inputs on share buy back to Ms. Placer on the below specific matters in particular :

(a) If share buyback is done, can she not worry about delisting and compliance surrounding the same? What are the differences between the two? ***(2 Marks)***

(b) Is there any law which bars a company from doing the buy back so as to de-list?

(1 Marks)

(c) Is buyback an option for the entities where the Group has high cash reserves? What advantages would arise that would excite Ms. Placer? ***(2 Marks)***

(d) Should promoters participate in the buyback and what is the advantage in doing that?

(1 Marks)

(e) Give factors which she should bear in mind to make the offer of buyback more attractive, with specific reference to facts provided to you? ***(2 Marks)***

Answer CASE STUDY 5

5.1 (A)

5.2 (B)

5.3 (A)

54 (CJ

5.5 (A)

5.6 Debt Option

PV of installments = Installment *(1 +PVFA 12%,4)

250000000 Installment * (1+3.03)

Installments = 6,20,34,739

Year 1	Opening Balance 2	Interest 3=2*12%	Installment 4	Principal paid 5 = 4-3	Cl. Balance 6 = 2-5
0	25,00,00,000		6,2034,739	6,20,34,739	18,79,65,261
1	18,7965,261	2,25,55,831	6,20,34,739	3,94,78,908	14,84,86,352
2	14,84,86,352	1,7818,362	6,20,34,739	4,42,16,377	10,42,69,975
3	10,42,69.975	1,25,12,397	6,20,34,739	4,95,22,342	5,47,47,633
4	5,47,47,633	72,87,107	6,20,34,739	5,47,47,633	0

Depreciation Tax shield

Year	Opening Balance	Deb.	Cl. Balance	Tax Saving
0	25.00,00,000	6,25,00000	18,75,00,000	1,56,25,000
1	18,75,00,000	4,68,75,000	14,06,25,000	1,17,18,750
2	14,00,25,000	3,51,56,250	10,54,68,750	87,89,063
3	10,54,68,750	2,63,67,188	7,91,01,563	65,91,797
4	7,91,01,563	1,97,75,391	5,93,26,172	49,43,848

Tax on Sale

WDV at the time of sale	5,93,26,172
Sale Value	1,00,00,000
Loss on Sale	4,93,26,172
Tax Savings on loss on sale@ 25%	1,23,31,543

Particulars	0	1	2	3	4	5
Principal Repaid	-6,20,34,739	-3,94,78,908	-4,42,16,377	-4,95,22,342	-5,47,47,633	
Post Tax Interest		-1,69,16,873	-1,33,63,772	-93,84,298	-54,65,330	
Deprecation Tax Shield		1,56,25,000	1,17,18,750	87,89,063	65,91,787	49,43,848
Salvage Value						1,00,00,000
Tax Savings on loss						1,23,31,543
	-6,20,34,739	-4,07,70,782	-4,58,61,399	-5,01,17,578	-5,36,21,166	2,72,75,391
	1	0.917	0842	0.772	0.708	0650
PVG 9% (12% x (1-25)	-6,20,34,739	-3,74,04,387	-3,87,00,622	-3,86,99,966	-3,79,66,586	1,77,27,132
	-19,69,99,167					

Net Present Value

Lease Option

NPV: -PV of Lease Rent+ PV of Tax benefit

LR*(1 +PVFA(9%,4)+LR*1*PVF A(9%,5)

-16,33,75,000

Lease option is better and the net advantage is ₹ 3,36,24,167

At break-even lease rent the NPV under lease option will be equal to NPV under debt option ₹ -19,69,99,167

Let Lease Rent be x

PV of Lease Payment=PV of Lease Rent+ PV or Tax benefit

₹ -19,69,99,167 =-x*(1+PVFA(9%,4)+x*PVFA(9%,5)

₹ -19,69,99,167 =·x (1+3.24)+x·.25*3*89

₹ -19,69,99,167 = -3.27 x

X = ₹ -6,02,90,487

5.7 Delisting can be done under two categories. One is a voluntary delisting by the promoters on a voluntary basis. There is no regulatory compulsion under statutory provisions to initiate delisting. The secondary category is mandatory delisting which gets triggered due to some regulatory compulsion under statutory provisions.

Dellsting in Indian capital market is governed by the SEBI (Delisting of Equity Shares) Regulations, 2009. However, these regulations are not applicable to any delisting made pursuant to a scheme sanctioned by the NCLT if such scheme specifies procedure to complete the delisting or provides an exit option to the existing shareholders at a specified rate.

5.8 a. Delisting and buyback are not the same, major differences are:

- In case of delisting, buyback of shares compulsorily happens while buyback offer does not lead to delisting shares.
- Delisting can happen in two circumstances - voluntarily or compulsorily through regulations. However, buyback is at the option of the company.
- In case of delisting entire capital is no extinguished where buy back only some portion is offered to shareholders.
- Delisting can happen only in case of a listed entity.

b. Regulation 4(v) of SEBI (Buy Back of Securities) Regulations, 2018 prohibits a company from doing a buy back so as to delist its shares from the stock exchange.

c. Buy backs are being favored when the Company has cash at its disposal and where it is lying idle without being utilized. Since the group has restrictions to use the case for expansion, these are entities which are ideally placed for carrying out a buy back. Some of the other advantages include.

- A company may reduce Its dividend liability by buying back shares providing more cash in the hands of shareholders. In a group scenario, if the common shareholders get more cash from buy back, they could in turn invest those funds in the entities where cash is required for expansion purpose.
- A company's EPS increases as the number of shares comes down.
- The shareholding of the promoter group may or may not vary depending on the extent to which these promoters participate in the buy back as compared to the need for cash.

- Another reason for buy back is when a company feels that the current market value of its shares is underpriced and is confident of its business and potential future value to investors.

d. If there is promoter participation, the buyback is likely to be positive for the shares in the long run.

e. Factors to make buy attractive for investors: ·

- If the price offered to them is at a premium on the market price. For example, if market price is ₹.380, if buy back is priced at a premium much higher than ₹.380, that would make it attractive for the Investors.
- An important aspect to bear in mind from an investor perspective is the signals the Group is providing on the future of the company. If the general shareholders is of the view that the company is found for future growth, they may opt for not participate in the buy back. Hence, if the real intention is not to focus the company on future growth path, the facts would need to brought to the attention of the investors which would help in investors taking a short term view and premium being low.
- Acceptance ratio is another aspect lo be considered from a Group perspective. If the intention is to reduce non-promoter stake, higher acceptance ratio will help the company in doing this.