

MOCK TEST PAPER
FINAL COURSE: GROUP – II
PAPER – 6B: FINANCIAL SERVICES AND CAPITAL MARKETS

CASE STUDY 1

- (a) The National Stock Exchange has decided to withdraw the 'do not exercise' facility for investors trading in the stock options segment from March 30, 2023. Brokers said the move could result in traders incurring unprecedented losses on the expiry day of the futures and options contracts.

In a recent circular, NSE Clearing Ltd said the facility of 'do not exercise' (DNE) available for stock options on the March 2023 expiry of F&O contracts should be discontinued. This facility allows brokers to stop exercising option contracts on behalf of clients.

NSE reintroduced the DNE facility in April 2022 after discontinuing in October 2021 after brokers complained of trading mishaps during the expiry of equity derivatives contracts with traders unable to meet their settlement obligations connected to physical delivery.

Market regulator SEBI introduced physical settlement in derivatives in October 2019. If an investor has an open position in any individual stock option contract, he will be required to take or give delivery of stocks when the options are exercised. The contract gets exercised only if it's 'In The Money' at the time of expiry.

Brokers worry that traders in the options market, who are unable to close their open positions on the expiry day in individual stock option contracts, will have to face a huge risk of settling their trade with shares.

"Now, in the absence of the DNE facility, options traders, whose contract is even 5-10 paise in-the-money (ITM), will be forced to take the physical delivery of the shares and incur large losses," said an expert. "The DNE facility helps the option traders mitigate their losses where they cannot square off their positions before the expiry day."

Currently, derivatives positions are physically settled on the expiry day.

- (b) Adani Enterprises raised ₹ 5,985 crore from anchor investors including global funds, sovereign wealth funds from the Middle East and domestic insurers ahead of the start of its ₹20,000 crore follow-on public offer on January 27, 2023.

The flagship entity of the Adani Group sold about 18.3 million shares at ₹3,276 each to 33 institutional investors in a pre-issue share sale, the company said in an exchange filing. Anchor investors will have to pay ₹2,992 crore now and the remaining amount later in one or more subsequent calls.

Maybank Securities was the largest investor, subscribing to 34% of the anchor book. People in the know said it was representing UAE's International Holding Company (IHC), a strategic partner of the Adani Group, confirming that IHC and Middle East funds were expected to be among the biggest buyers in the follow-on public offer, the largest from an Indian private company. IHC invested \$2 billion in three Adani group companies, including Adani Enterprises, last year. Winro Commercial, ELM Park Fund, Dovetail India Fund and Belgrave Investment Fund bought a little over 5% each, as did Life Insurance Corporation of India.

Other anchor investors include Abu Dhabi Investment Authority, Goldman Sachs, Nomura, Societe Generale, Jupiter, BNP Paribas, Al Mehwar, Citigroup and Morgan Stanley. Besides LIC, the domestic institutions which subscribed to the anchor book include SBI Employee Pension Fund, HDFC Life and SBI Life. Local mutual funds did not participate.

The anchor book closed on a day when short sellers Hindenburg Research released a report targeting the group, leading to a \$10.5 billion shave-off from the market value of the conglomerate with at least 10 listed entities. Adani has called the report malicious.

The company is selling 61.5 million fresh shares at ₹3,112-3,276 a piece in the follow-on offer. It will offer partly paid shares to retail investors at a discount of ₹ 64 a piece to the issue price. Investors must pay 50% of the offer price when placing bids and the remaining on one or more subsequent calls, as decided by the board.

Shares of Adani Enterprises closed 1.54% lower at ₹ 3,389.85 Wednesday on the BSE, where the Sensex ended 1.27% down.

Bids must be placed for at least four shares and in multiples of four.

According to the offer documents, the company proposes to use ₹ 4,165 crore of the issue proceeds to repay debt owed by the company and three subsidiaries: Adani Airport Holdings, Adani Road Transport and Mundra Solar. It intends to spend ₹ 10,869 crore for projects including the green hydrogen ecosystem, airport facilities, and the construction of a greenfield expressway.

Adani Enterprises had ₹ 41,191 crore of consolidated debt as on September 30, 2022.

Half the net offer size is reserved for qualified institutional buyers while 15% is for non-institutional investors. About 35% is for retail investors.

Adani Enterprises has appointed 10 bankers to manage the issue: Jefferies India, ICICI Securities, SBI Capital Markets, BoB Capital Markets, IDBI Capital, JM Financial, IIFL Securities, Monarch Network, Elara Capital and Axis Capital.

The share sale could result in the stakes of promoters, led by Gautam Adani, falling 3.5%. As of September 2022, the promoters owned 72.63% of Adani Enterprises, while the remaining 27.37% was with public shareholders.

Among the current public shareholders, LIC held 4.03%, while Nomura Singapore, APMS Investment Fund, Elara India Opportunities Fund, and LTS Investment Fund owned 1-2% each.

The Adani offer application was made through the 'fast-track' mechanism.

Listed companies looking to raise money through follow-on offers can speed up the regulatory approval process if they meet certain conditions under Securities and Exchange Board of India regulations. Such companies must apply to one or more stock exchanges to seek in-principal approval for listing their specified shares.

Question

Based on above, answer the following questions:

1. What do you understand by 'Do Not Exercise' (DNE) facility? Discuss the implications of the recent move by SEBI to withdraw the DNE facility. **(4 Marks)**
2. The issue size of ABC Ltd., i.e., net offer to the public is 400 crore equity shares. You are required to give details of allotment to Qualified Institutional Buyers (QIBs) other than anchor investors in accordance with the provision of SEBI (ICDR) Regulations, 2018. **(5 Marks)**
3. Discuss how as an investor you can use options in the following situations:
 - (i) **To hedge a portfolio**
Nifty spot price – 17,850
Strike Price – 18,000
Expiry – 13 July 2023
Price - 630
 - (ii) **To earn arbitrage**
XYZ spot price (₹) – 400
Strike price – 390
Expiry – 4 May 2023

Price (₹) – 8

(iii) **If you expect price of your shares to remain rangebound or even fall.**

XYZ spot price (₹) – 400

Strike price – 390

Expiry – 4 May 2023

Price (₹) – 9

(6 Marks)

4. Multiple Choice Questions

(2 Marks each)

- (1) An investor holds a call option on ABC Ltd. stock with a strike price of ₹ 150. The shares currently trade at ₹155. The contract is
 - (a) In the money
 - (b) Out of the money
 - (c) At the money
 - (d) None of the above
- (2) In continuation of the above question, the investor buys the stock for ₹ 150 and immediately sell it for ₹ 155. Option contract represents 75 shares. The intrinsic value is ₹.....
 - (a) 11250
 - (b) 11625
 - (c) 375
 - (d) 5
- (3) Now, in (2) above, the investor's cost was at a premium of ₹ 7. If the investor decides to exercise the option contract, he would be at a
 - (a) loss of ₹ 2
 - (b) profit of ₹ 2
 - (c) profit of ₹ 5
 - (d) neither profit nor loss
- (4) Which among the following is not true?
 - (a) An investor with a call option that is in the money (ITM) at expiry has a chance to make a profit since the market price is above the strike price.
 - (b) An investor holding an in-the-money put option has a chance to earn a profit since the market price is below the strike price.
 - (c) In-the-money options are less expensive than other options since investors pay for the profit already associated with the contract.
 - (d) Investors must also consider premium and commission expenses to determine profitability of an in-the-money option.
- (5) is the market's forecast of a likely movement in a security's price.
 - (a) Intrinsic value
 - (b) Implied volatility
 - (c) Indicative volatility
 - (d) Extreme volatility

CASE STUDY 2

- (a) ABC Ltd is engaged in the manufacturing of garments. For this purpose, machinery is required. The company is thinking of buying machinery by resorting to borrowing. Another option before the company is to take machinery on lease. The company asks the finance team for its advice. The finance team elaborates the following advantages and disadvantages of leasing to enable the management to make an informed decision.

Advantages

The first and foremost advantage of a lease agreement is its flexibility. The leasing company in most of the cases would be prepared to modify the arrangement to suit the specific requirements of the lessee. The ownership of the leased equipment gives them added confidence to enable them to be more accommodative than the banks and other financial institutions. The other advantages of lease financing are as follows:

- (i) The leasing company may finance 100% cost of the equipment without insisting on any initial disbursement by the lessee, whereas 100% finance is generally never allowed by banks/financial institutions.
- (ii) Banks/financial institutions may involve lengthy appraisal and impose stringent terms and conditions to the sanctioned loan. The process is time-consuming. In contrast, leasing companies may arrange for immediate purchase of equipment on mutually agreeable terms.
- (iii) Lengthy and time-consuming documentation procedure is involved for term loans by banks/institutions. The lease agreement is very simple in comparison.
- (iv) In short-term lease (operating lease) the lessee is safeguarded against the risk of obsolescence. It is also an ideal method to acquire use of an asset required for a temporary period.
- (v) The use of leased assets does not affect the borrowing capacity of the lessee as lease payments may not require normal lines of credit and are payable from income during the operating period. This neither affects the debt-equity ratio or the current ratio of the lessee.
- (vi) Leased equipment is an 'off the balance sheet' asset being economically used by the lessee and does not affect the debt position of the lessee.
- (vii) By employing 'sale and lease back' arrangement, the lessee may overcome a financial crisis by immediately arranging cash resources for some emergent application or for working capital requirements.
- (viii) Piecemeal financing of small equipment is conveniently possible through lease arrangement only as debt financing for such items is impracticable.
- (ix) Tax benefits may also sometimes accrue to the lessee depending upon his tax status-

Disadvantages

The lease financing has certain disadvantages also which are discussed as follows:

- (i) The lease rentals become payable soon after the acquisition of assets and no moratorium period is permissible as in the case of term loans from financial institutions. The lease arrangement may, therefore, not be suitable for setting up the new projects as it would entail cash outflows even before the project comes into operation.
- (ii) The leased assets are purchased by the lessor who is the owner of the equipment. The seller's warranties for satisfactory operation of the leased assets may sometimes not be available to the lessee.

- (iii) Lessor generally obtains credit facilities from banks etc. to purchase the leased equipment which is subject to hypothecation charge in favour of the bank. Default in payment by the lessor may sometimes result in seizure of assets by banks causing loss to the lessee.
- (iv) Lease financing has a very high cost of the interest as compared to interest charged on term loans by financial institutions/banks.

Despite all these disadvantages, the flexibility and simplicity offered by lease finance have made it popular.

- (b) ABC Ltd is also listed on BSE and NSE. Its management is concerned about the recent insider trading in the mid-cap and small-cap companies and consequently the SEBI's latest very sophisticated tracking mechanism to detect insider trading. And because of the stock market reaching new highs selling by insiders has increased a lot.

In July 2021, insiders have sold shares worth more than ₹ 10,000 crores. And in May and June 2021 about ₹ 7,000 each. But selling was slow during April 2021 following a correction in the market because of the dangerous second wave of the pandemic. And because of regulatory requirements, companies must disclose to the stock exchanges any buying or selling by promoters or key managerial personnel.

Recently, several top executives of banks and other financial institutions are witnessed to have sold their holdings. Further, promoters of several mid and small-cap companies have reduced their holdings.

However, the liquidation of holdings by insiders doesn't always imply that these persons are trying to take advantage of the bullish scenario. While some of them have sold their holdings to accumulate funds to purchase shares in the fresh employees' stock option scheme, others had been selling at regular intervals to meet other requirements.

But some insiders are being clever, which is evident in their increased activity when the markets have reached record highs, and valuations are also high in comparison to historical levels. A lot of stocks are currently overvalued. Therefore, insiders are taking benefit from these opportunities from the stock market.

The market regulator, SEBI is therefore refurbishing its surveillance mechanism as insider trading is getting savvier. Previously, company insiders or their proxies would buy and sell shares based on insider information. But now they are using complex derivative strategies to make some quick profit.

This has urged the market regulator to develop an internal mechanism to scan all derivative trades and mark suspicious transactions. Experts who are abreast of the system pointed out that the new system will scan about 20 million trades every day.

The experts have also opined that the system scans derivative trading in listed companies based on overall delta positions. In simple words, the system tries to find out large unhedged positions taken by individuals in each stock and analyses them. It is rather strange for a normal trader to take such large unhedged positions unless he knows about some information about the company.

Alerts generated by the new systems are significantly more vibrant than the existing insider trading alerts, and they have given a boost to SEBI's surveillance in the complex derivatives market consisting of futures and options contracts. The performance of the system doesn't finish there. It also creates a database of suspected transactions along with traders who have undertaken the transaction.

This platform will help the market regulator to build patterns. If some trader frequently undertakes such transactions, the platform will catch those and caution the market regulator. Then more details can be dug out to see if the trader is connected to any of the brokers.

Questions

Based on above, answer the following questions:

1. ABC Ltd. requires a machinery costing ₹ 20,00,000. It will be utilized over a period of 5 years. It has two financing options in this regard:

- (i) Arrangement of a loan of ₹ 20,00,000 at an interest rate of 12 percent per annum; the loan being repayable in 5 equal year end installments; the equipment can be sold at the end of fifth year for ₹ 2,00,000.
- (ii) Leasing the equipment for a period of five years at an early rental of ₹ 6,60,000 payable at the year end.

The rate of depreciation is 15 percent on Written Down Value (WDV) basis, income tax rate is 30 percent and discount rate is 10 percent.

Show by way of detailed calculations which of the financing options should ABC Ltd. avail and why?

(7 Marks)

2. Mr. Amit, an insider of the company wants to sell 1000 shares to his colleague Sumit who is also an insider. Will selling these shares by Amit be considered to be an insider trading? If not, then what precautions are to be taken? **(5 Marks)**
3. Discuss briefly the regulations relating to maintenance of code of conduct which is required to be complied with by ABC Ltd. **(3 Marks)**
4. Multiple Choice Questions: **(2 Marks each)**
 - (i) among the following is not a connected person as per the insider trading regulations
 - (a) A member of the board of directors
 - (b) A banker of the company
 - (c) An official of a stock exchange
 - (d) A broker of the insider
 - (ii) The trading plan shall not entail commencement of trading on behalf of the insider earlier than from the public disclosure of the plan
 - (a) six months
 - (b) three months
 - (c) one month
 - (d) one week
 - (iii) Every person on appointment as a shall disclose his holding of securities of the company within seven days of such appointment.
 - (a) Key Managerial Personnel
 - (b) Director
 - (c) Promoter
 - (d) any one of the above
 - (iv) Under method, lessor enters into an arrangement with the seller, to market the latter's product through its own leasing operations.
 - (a) Operating Lease
 - (b) Financial Lease
 - (c) Sales and Lease Back
 - (d) Sales-Aid-Lease
 - (v) From lessee's perspective..... method of evaluating a leasing proposal segregates the financial and tax aspects of lease financing.
 - (a) Present Value Analysis

- (b) Internal rate of return analysis
- (c) Bower-Herringer-Williamson Method
- (d) None of the above

CASE STUDY 3

- (a) Duvvuri Subbarao, as the Governor of the Reserve Bank of India (RBI), once joked that the job of the central banker is probably the easiest one, because all that he does is change interest rates.

All eyes are on what Governor Shaktikant Das does to interest rates at the Monetary Policy Committee (MPC) meeting this week. He has his plate full-inflation is not only stubbornly high but is showing little signs of easing. Growth is faltering. And to cap it all, in a connected world, some banks with operations even in India are blowing up, leaving even the relatively insulated banking system exposed to tremors from far beyond the shores.

Since the last MPC meeting in February, global financial markets have come full circle. Traders' bets have swung like a pendulum-from monetary easing to overcome an economic recession, to tightening to fight against inflation, and finally to easing for the sake of financial stability. All of that occurred in a matter of four months.

What does the RBI do in these circumstances? The consensus is a quarter-point increase in repo rate, the rate at which it lends to banks, to 6.75% and a likely shift in monetary stance to neutral that would give it room to move any which way-or a surprising pause.

How are things stacking up? Inflation above the mandated target of 4% dominates the theme on the hiking side, while the lagged but powerful transmission of 250 basis points increase after the mandated linking of loans to external benchmarks, slowing growth, a positive real interest rate of 100 basis points, and the possibility of easing of price pressures due to the global slowdown are weighing on the other.

"Between these two-way forces, inflation will hold sway," said Radhika Rao, economist at DBS.

But the twist in the tale is the split in the MPC where external members are for a pause with two of the six breaking ranks with the MPC in the February meeting.

"Excessive front-loading of the rate hikes carries the risk of over-shooting that is best avoided," said Ashima Goyal, an external member at the MPC. She argues that raising real policy rates has a stronger effect on growth than on inflation, that monetary policy works with a lag and that the macroeconomic stability improves if real interest rates are kept smoothly below growth rates.

Governor Das, who brought in the 'public good' concept for the sovereign yield curve, is for tailoring policy for Indian needs where growth is essential, especially when the country is headed to elections in a year.

Assessment of growth hints at whether the governor and the MPC, in general, may be differing. When the MPC said the risk to growth was 'broadly balanced' signalling it's not such a worry, the Governor's statement said it is 'evenly balanced'-by growth concerns shortening the odds on a pause. The policy for the full fiscal year could also be a launch pad for the RBI to complete an unfinished agenda of a sophisticated monetary policy envisaged in 2014.

For the first time since the Covid breakout, on March 24, the RBI did not conduct the 14-day variable repo auction on a reporting Friday when banks' data are taken for reserves computation. This probably is a precursor to facilitating the movement of liquidity management to 14-day repo from overnight.

The Revised Liquidity Management Framework the RBI put forth in February 2020 but kept in abeyance due to the Covid crisis may be dusted off as the surplus liquidity due to Targeted Long Term Repo Operations wind down this month.

- (b) Amid a substantial reduction in surplus liquidity, Indian banks significantly increased their reliance on certificates of deposits (CDs) to mobilise funds, with issuances of such short-term debt instruments surging more than three times in the previous financial year.

"Banks continued to rely on CDs for funding with issuances of '3.8 lakh crore in H2 (up to March 24, 2023) on top of ₹ 3 lakh crore in H1," the Reserve Bank of India (RBI) said in its April 2023 Monetary Policy Report, released on Thursday.

The RBI's March bulletin had said that banks' fund mobilisation through CD issuances was ₹ 6.3 lakh crore in 2022-23 up to March 10, as against ₹ 2 lakh crore a year ago.

The sharp increase in issuance of CDs came amid tighter liquidity conditions as the RBI moved to withdrawal of policy accommodation in the previous financial year and booming demand for credit.

As the economy progressively reopened in 2022 following Covid-19-induced restrictions, demand for bank loans firmed up, with credit growth beginning to outpace growth in deposits from April 2022. Along with the shrinking surplus liquidity, the strong demand for credit exerted pressure on banks to raise funds.

Latest RBI data showed that as on March 10, bank credit growth was 15.7% year-on-year, far higher than the 10.3% deposit growth during the period.

According to the Monetary Policy Report, resource mobilisation by companies through commercial papers tapered to ₹ 6.4 lakh crore in October 2022-March 2023 from ₹ 7.3 lakh crore in April-September, reflecting a preference for bank credit amid firms.

The weighted average discount rate on issuance of commercial papers hardened to 7.21% in October-March from 5.53% in the previous six months, according to RBI. While corporate entities continued to be the largest issuers of commercial papers, their share declined to 42% in October-March from 52% in April-September, the central bank said.

"The rise in CD issuances was backed by two factors - demand for credit gained an enormous amount of traction in FY23 and concomitantly because of the balance of payments shortage, deposit growth did not keep pace with credit growth," said an expert of a leading credit rating agency.

Rate transmission in the money markets started before May because of tightening liquidity, he said, whereas transmission in the banking system started around August-September and gained traction in the third quarter of the fiscal. "So, in the first half, the rates between the banking system and the CP market were favourable towards banks for borrowers and that's why borrowers were tapping banks rather than looking for CPs for short-term capital financing," he said.

As tighter liquidity conditions drove up market rates, short-term fundraising became increasingly expensive for both banks and corporates. According to the RBI's report, the spreads of CDs and commercial papers over the policy repo rate widened to 85 basis points (bps) and 99 bps, respectively, in October-March from 46 bps and 63 bps, respectively, in the previous six months. A basis point is a hundredth of a percentage point.

It is also recommended by various experts to issue certificate of deposits for upto three years to bank depositors (known as retail CDs) and alluded to benefits that can accrue from doing so. Furthermore, retail CDs can aid build an ecosystem that serves every stakeholder's interests.

Questions

Based on above, answer the following questions:

- (1) Do retail CDs improve monetary transmission and whether they provide additional information on banks? Is the retail CD market good for development of corporate bond markets? **(5 Marks)**
- (2) PQR Ltd. has a ₹ 76.04 crore market value position in deep discount bonds of 6 years maturity with a face value of ₹ 100 crores. The current market yield is 8% p.a. and potential adverse move in yield is 0.00165 [5% chances of (1 bad day in 20 days) of yield change at 90% level of confidence following normal distribution with standard deviation of 10 basis point]. You are required to calculate the daily earnings at risk on above bond due to an adverse move in interest rate next day. **(6 marks)**
- (3) Explain the analytics of credit policy. Also discuss how various credit policies of RBI helps in inflation control. **(4 Marks)**

(4) Multiple Choice Questions

(2 Marks each)

- (i) Amount of face value of Certificate of Deposits (CDs) is ₹ 3000. Period of maturity is 3 months. Discount rate is 12%. The issue price of CDs is
- (a) 2640
 - (b) 3090
 - (c) 2910
 - (d) 3360
- (ii) On the basis of the facts of the above question, the effective rate of interest is
- (a) 12%
 - (b) 31.2%
 - (c) 15%
 - (d) 18%
- (iii) refers to the market for extremely short period loans i.e., 1 day to 14 days
- (a) Treasury Bill
 - (b) Call or notice money
 - (c) Repos
 - (d) Commercial papers
- (iv) Which among the following is an unsecured promissory note?
- (a) Treasury Bill
 - (b) Commercial Paper
 - (c) Commercial Bill
 - (d) Repos
- (v) Which among the following is not true?
- (a) WPI reflects the change in average prices for bulk sale of commodities at the first stage of transaction while CPI reflects the average change in prices at retail level paid by the consumer.
 - (b) 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.
 - (c) The WPI basket consists of services like housing, education, medical care, recreation etc. which are not part of CPI basket.
 - (d) The Federal Reserve System conducts the nation's monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy.

CASE STUDY 4

Rihansh Food Truck Private Limited (RFTPL) was incorporated on July 1, 2015, by Sachin Mewal, Sonu Mewal and Ashok Mewal. On April 1, 2017, it was converted into a public limited company and a fresh certificate of incorporation was issued on July 1, 2017, under the name of RFTL. RFTL manufactures and exports processed and preserved food products like dry fruits, pickles, and jams and sells its products under the brand names, 'Rihansh' and 'Pop's Recipe' in India. In the Middle East, it sells pickles and tamarind through its premium brand 'family' and a popular segment brand 'Mast', and in the UK under the brand name 'Krish'. It has an installed capacity of 22,900 tonnes per annum (tpa) for canned and bottled processed vegetables/foods/fruits. RFTL completed the expansion and modernization of its existing plant at

Gandhinagar, Gujarat, in the financial year 2019, thus increasing its capacity from 12,600 tpa to 19,900 tpa. A new project for manufacturing spices in Mumbai was also commissioned in FY20.

The Indian food industry is the second largest in the world after the Chinese. At present, the size of the Indian food industry is around US\$ 181 billion. It contributes to around two-third of the total Indian retail market. According to some experts, the industry will touch US\$ 258 billion by the end of FY22 and US\$ 318 billion by the end of FY25.

At a recent board meeting of RFTL, Sachin Mewal, Chairman of the company, apprised Ashok Mewal, Chief Executive Officer, and Sonu Mewal, Chief Financial Officer, for the dramatic change in return on equity, which increased substantially in FY20. However, Sonu Mewal, CFO of RFTL is disturbed about financial position of company.

To grow business, company has to acquire new clients and build their cash reserve. This reserve is required to meet variable cost as customer payment will take 90 days (Normal credit allowed to clients). Current financial position is not well to grow business and take on new clients.

After being denied a bank loan, RFTL is looking for finance company who are providing service of factoring. With factors help, RFTL will quickly gain access to cash equaling and will be able to fund its operations; without having to wait for the customers to pay and without incurring any debt.

RFTL has invited proposals from various factors and also provided them extract of financial and operational data to evaluate and submit the proposal to company. The details are as follows:

Sr. No.	Particulars	₹ in crore
1	Annual Turnover	3600
2	Variable Cost (60%) *	2160
3	Fixed Cost (Rent, Administrative expenses etc.)	450
4	Profit	990

*Also includes bad debts –Company experience indicates that bad debt losses are 2% of turnover)

Sonu Mewal has got a proposal from a factor that will provide factoring services on recourse basis. The proposal is as below:

- Factor will keep reserve equal to 20% of amount after adjusting commission and 10% of receivable
- Commission charges 1.80%
- Interest rate is 18% p.a.
- The factor will provide advance after adjusting reserve, commission charges and interest amount

The factoring is expected to save ₹ 75 crore as administrative cost (Fixed Cost).

During this time, Mr. Sachin Mewal informed the management that they have received an order of ₹ 720 crore which is big enough in terms of contribution to the profits.

Note:

Year represents 360 days

Questions:

Based on above, answer the following:

1. Compute amount paid as advance by factor considering RFTL has accepted the proposal of factor. (4 Marks)
2. Compute Net Factoring cost (%). (4 Marks)

3. RFTL has opportunity to accept new orders of ₹720 crore. Company has to accept current proposal from factor if they wish to grab this opportunity. Suggest RFTL whether they should accept new orders.

(7 Marks)

4. Multiple Choice Questions (MCQs)

(2 Marks each)

- (i) Which form of factoring is known as “Old Line Factoring”?
- (a) Recourse Factoring
 - (b) Non-Recourse Factoring
 - (c) Full Factoring
 - (d) Cross Border Factoring
- (ii) Identify the incorrect statement.
- (a) A forfaiter discounts the entire value of the note/bill. In a factoring arrangement, the extent of financing available is 75%-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 standard 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.
- (iii) Which form of factoring is known as “Two Factor System”?
- (a) Recourse Factoring
 - (b) Non-Recourse Factoring
 - (c) Full Factoring
 - (d) Cross Border Factoring
- (iv) In a factoring transaction, who purchases the goods and services on credit?
- (a) Factor
 - (b) Client
 - (c) Customer
 - (d) Both (b) and (c)
- (v) Every company seeking registration as NBFC-factor shall have a minimum NOF of ₹ ____.
- (a) 1 crore
 - (b) 2 crores
 - (c) 5 crores
 - (d) 10 crores

CASE STUDY 5

- (a) Axis Mutual Fund's former chief dealer Viresh Joshi ran an elaborate scheme to front run the trades of his employer; avoid regulatory glare and move the ill-gotten money to safety, according to the Securities Exchange Board of India. In one of its most comprehensive investigations, the regulator showed how Joshi and his aides operated through a complex arrangement for almost two years, allegedly circumventing the regulations and making wrongful gains to the tune of ₹ 30.56 crore.

The story

SEBI alleged that Joshi passed on information of impending large trades by his employer Axis Mutual to his aides who took positions before the fund house executed the transactions. SEBI said Joshi, who was privy to the trade information of the fund house including size and timing of orders that were not in public domain, would pass on the confidential information regarding the impending trade order to his connected individuals.

Key Aides

Viresh's key aides in this arrangement were Sumit Desai, a market operator, and Prijesh Kurani. Joshi approached Desai to arrange trading accounts through which the trades could be undertaken. Desai through his network also arranged trading accounts through Pranav Vora. Joshi used to interact and deal only with Desai and one of his close accomplices Prijesh Kurani, who has access to terminals of brokers: Marfatia Stock Broking and Woodstock Broking. Desai installed a trading terminal software in Kurani's computer system, which executed the trades, alleged SEBI.

Trading Accounts on Rent

Joshi's key aides Desai and Vora managed to get various trading accounts on rent that allowed him to front run the trades of Axis Mutual Fund.

The Dubai Connection

The SEBI order said Prijesh Kurani is based in Dubai and the trades were done through his terminal installed there. The regulator also alleged Joshi incorporated a company in Dubai for transferring the wrongful gains using clandestine channels in the bank accounts of the company. The information relating front running orders was passed by Joshi to Kurani using BOTIM and Apple Facetime, Prijesh Kurani's brother Bindesh, who was also allegedly part of the front-running scheme, is already on the radar of various other agencies and a Look Out Notice was issued in his name, because of which he has made Dubai his home.

Angadias

Joshi and his aides used Angadias, a highly reliable unofficial courier service to transfer cash and diamonds from one city to another, to send the profits from the alleged front running scheme. This is probably the first time the role of Angadias has popped up in a SEBI investigation report.

Fake SIMs

Joshi used various fake SIMs registered in the name of a carpenter situated in Rajkot to avoid regulatory detection. He communicated with arrangers and operators using fake SIMs.

The Jadugar

The SEBI order has repeated references of the word Jadugar, meaning magician in Hindi, that was used frequently by some of Joshi's aides including Kurani and Desai. The regulator said it can be sufficiently ascertained that Jadugar is none other than Joshi.

Whistleblower Complaint

SEBI said Axis Mutual during its internal investigation has unearthed an email dated January 19, 2022 from the inbox of Joshi's official email address where in the allegation of executing illegal trades was levelled against him. The email sent from ibhavings-hah@gmail.com, which SEBI suspects belongs to Bhavin Shah, who alleged Joshi 'misused' his demat account at Marfatia Stock Broking. "Viresh Joshi is the only one responsible for all illegal trades in my trading account. They used to login to my account through a Dubai IP address to execute all the aforesaid illegal trades. "Subsequently, a letter from Shah Clarified to Marfatia Stock Broking's compliance department that he only was operating his trading account and the complaint email was not addressed by him. The letter also requested Marfatia Stock Broking to also forward the letter/email to six email ids of different regulatory agencies.

- (b) Deepening the funding crisis that startups have been witnessing for some time, the October inflows plunged 75 percent on-year to USD 3.3 billion across 75 deals, including six large deals worth USD 2.2 billion. Exits touched half of the inflows at USD 1.6 billion across 15 deals in the reporting months, a significant rise over the previous month which saw just USD 653 million worth of exits across 24 deals, but 69 percent lower on-year basis, *PTI* reported quoting data collated by EY for the Indian Private Equity & Venture Capital Association, the umbrella body of the PEs and VCs.

The report said, on a MoM basis, the inflows continued to grow, clipping at 60 percent over the September numbers. In volume terms, the deals saw a 43 percent decline to 75 last month from 132 deals in October 2021.

The report added that Vivek Soni, a partner at EY, blamed inflation woes, global recession fears, the rising cost of capital and elevated levels of uncertainty driven by geopolitical tension for the funding crisis.

October had six USD 100 million-plus deals aggregating to USD 2.2 billion, a sharp drop from 24 large deals worth USD 11.3 billion in October 2021. By deal type, growth investments were the highest in terms of value at USD 2 billion across 13 deals including the USD 1 billion investment in Citiustech by Bain Capital for a 40 percent stake, the report said.

The month saw 15 exits worth USD 1.6 billion compared to USD 5.2 billion in October 2021 across 25 deals and USD 653 million across 24 deals in September 2022. October 2021 had recorded two large secondary exits worth USD 5 billion—the USD 3 billion Hexaware deal between Carlyle and Baring Asia and the USD 1.9 billion VFS Global deal between EQT and Blackstone.

Exits via secondary sale were the highest with four exits worth USD 1.4 billion, the report noted, propped up by the large deal which saw Bain Capital purchase a 40 percent stake in Citiustech for USD 960 million from BPEA EQT, making it the largest exit in the month and the fourth largest this year.

From a sector point of view, healthcare topped with USD 977 million inflows across three deals, followed by financial services, with USD 216 million across 13 deals.

Questions

Based on above, answer the following questions:

- (1) A VC firm is looking at an investment of ₹ 20 crores in a start-up company today. Exit will be in 5 years at a revenue multiple of 10000 and Year 5 revenue of ₹ 150 crores.

No debt is required. No additional equity to be raised.

Cash flow profile:

YEAR	0	1	2	3	4	5
CF	(2)	0	0	0	0	120

IRR is 70%. You are required to calculate the post money valuation and the equity % of the company the VC may ask for. **(6 Marks)**

- (2) How Mutual Fund executes transactions? Explain by correlating it to front running. Do SEBI regulations for Insider Trading works for front running also? **(5 Marks)**

- (3) What is the Style of execution of front-running trades? **(4 marks)**

- (4) Multiple Choice Questions: **(2 Marks each)**

- (i) While doing a financial due diligence which among the following a private equity may not consider before investing?
- (a) Off-balance sheet financial instruments
 - (b) Weakening working capital trends
 - (c) Dependence on powerful suppliers or a concentrated customer base

- (d) Accounting adjustments to obscure actual performance
- (ii) Which among the following is not a disadvantage of IPO in the exit strategy of private equity?
 - (a) Risks of going to market
 - (b) Strategies require a majority stake
 - (c) Lock-up
 - (d) Uncertainty of returns
- (iii) Which among the following is not true with regard to a trading plan?
 - (a) Not entail commencement of trading on behalf of the insider earlier than three months from the public disclosure of the plan.
 - (b) entail trading for a period of not less than twelve months.
 - (c) not entail overlap of any period for which another trading plan is already in existence.
 - (d) not entail trading in securities for market abuse.
- (iv) The shall review the trading plan to assess whether the plan would have any potential for violation of the insider trading regulations.
 - (a) managing director
 - (b) both managing director and whole-time director
 - (c) compliance officer
 - (d) managing director, whole time director and compliance officer
- (v) The, of a listed company, shall put in place adequate and effective system of internal controls to ensure compliance with the requirements given in these regulations to prevent insider trading.
 - (a) Compliance Officer
 - (b) Company Secretary
 - (c) Internal Auditor
 - (d) Chief Executive Officer