MOCK TEST PAPER 1

FINAL (NEW) COURSE: GROUP II

PAPER 6B: FINANCIAL SERVICES AND CAPITAL MARKETS

I. <u>Case Study Question number One</u>

The following data relates to a Mutual Fund as at 31-3-2018:

	Quantity (Nos.)	Value (Rs.'000)
Unit Capital :		
Outstanding at the beginning of the year	264,31,998.59	2,64,319
Issued during the year	6,85,59,200.117	6,85,592
Redeemed during the year	66,77,620.32	66,776
Outstanding at the end of the year	**883,13,578.387**	**8,83,135**
Reserves and Surplus		
Unit Premium Reserve		
Balance at the beginning of the year		(3,396)
Net Premium/Discount on issue/ redemption of units		98,266
Balance at the end of the year		94,870
Unrealized Appreciation		
Reserve Balance at the beginning of the year		7,870
Change in unrealized appreciation in value of Investments		14,972
Balance at the end of the year		22,842
RETAINED SURPLUS		
Balance at the beginning of the year		6,23,319
Transferred to Revenue account		(1,366)
Surplus transferred from revenue account		19,65,669
Balance at the end of the year		25,87,622
Total Reserves		**27,05,334**
Current Liabilities		
Amount due to AMC for Management Fees		1615
Others		64
Sundry Creditors of units redeemed by investors		
Lateral Shift payable		420
Others		19
Contract for purchase of investments		2,60,840
Inter Scheme Payable		-
Dividend payable on units		-
Dividend Distribution Tax Payable		-

Unclaimed Dividend		-
Unclaimed redemption		
Unit Application pending allotment		70
Investor education expense provision		60
Interest on borrowing		
Other Current Liabilities		2878
Investments		
Listed Debentures and Bonds		14,20,321
Government Securities		20,69,363
Total		34,89,684
Deposit with scheduled banks		-
Other Current Assets		
Balances with Banks in Current Accounts		4851
Sundry debtors for units issued to investors		
-Lateral shift receivable		3
-Others		2
Inter-scheme receivables		689
Margin Deposit with Clearing Corporation of India		-
Outstanding and accrued income		86,336
Amount due from AMC		-
Collateralised Lending		2,72,898
Total		**3,64,779**
Interest		
Money market Instruments		188
Debentures and Bonds		57,425
Deposits		-
Government Securities (including Treasury Bills)		1,17,501
Collateralised Lending		6,950
Less: Interest on Borrowing		-
Total		**1,82,065**

The average expenses ratio (including management fees) amounted to 2.65% which also included GST.

(A) Answer the following questions and reason out your answers:

(i) Under what type of a mutual fund product would you classify the above? Why? **2 Marks**

(ii) Is the scheme open or close ended? Why? **2 Marks**

(iii) Can it be assumed without any contradiction that the product is traded in the stock exchange? **2 Marks**

(iv) Is switching between plans permitted in this mutual fund product ? **2 Marks**

(v) Why is there a nil balance in deposit with scheduled banks ? **2 Marks**

(vi) From the given figures, do you conclude that the scheme has performed well during this year in question ? **2 Marks**

(vii) The fund had invested in Treasury Bills of face value Rs. 1,00,000 each amounting to Rs. 90 crores. If the average annualized yield calculated based on 85 days as on 31st March, 2018 was 8.76%, what was the amount of average purchase price ? **3 Marks**

(B) Answer the following as directed: **(2 Marks x 5 = 10 Marks)**

(i) The type of entity of a mutual fund is:

(A) a private limited company

(B) a public limited company

(C) a partnership firm or LLP

(D) none of the above

(ii) The investments by a mutual fund are controlled by

(A) RBI

(B) SEBI

(C) Registrar of Companies

(D) Both (A) and (B)

(iii) When the holder of units of a mutual fund can sell his units at any time during the year,

(A) the fund is an equity fund

(B) the fund is a bond fund

(C) the fund is a balanced fund

(D) nothing can be said about the classification of the fund from the saleability.

(iv) The following is not true in the context of a mutual fund's payment to its unit- holders :

(A) a scheme that invests in equity pays dividends.

(B) an exchange traded fund pays dividends.

(C) a bond fund pays interest.

(D) a G-sec. fund pays dividends.

(v) Under a Systematic Investment Plan, the following is NOT TRUE:

(A) Unit holders can invest on a monthly basis whatever amount they can save.

(B) Investors can invest only a pre-specified amount every period, say monthly, quarterly or half yearly.

(C) If an investor has subscribed Rs. 3,000 in quarterly payments for a 3 year SIP, he can choose to step up this amount to Rs. 4000 from the second year.

(D) Even where the SIP amount in a financial year does not exceed Rs. 50,000 an investor cannot invest in cash.

II. Case Study Question Number Two

You are practicing in the area of advisory services giving opinions on technical issues relating to the capital markets and financial instruments. The following questions have been raised by different clients for whom you need to explain your answers or give your opinion. Your clients range from well informed CFOs of companies to ordinary individuals.

(A) Answer the following:

(i) What is meant by a recognized stock exchange? Is there any stock exchange which is functional that is not recognized? **3 Marks**

(ii) In case the promoter is an individual, can his holding be counted for the limit applicable for a retail individual investor? State the regulation in support of your answer. **3 Marks**

(iii) X is an individual having a surplus of Rs. 5 lacs. He is interested in investing the amount in shares of a company in an initial public offer. He has a preference for A Ltd. which is to open for subscription on 30th May 2018. The market predictions indicate an oversubscription of that issue. If he does not get any allotment or if he is allotted shares for any lesser value, he would like to invest in Company B Ltd. whose offer is to open on July 1st. He fears that his money will be blocked in the first issue and may not be refunded to him in time for him to apply for B Co. Ltd.'s issue. If he does not want to borrow any money for that purpose, how will he overcome the problem? Discuss. **3 Marks**

(iv) S & P BSE Sensex was 32840.5 on a certain day. On the same day, Nifty 50 was 10,287.70. Explain the vast difference between the numbers and the underlying concept.

3 Marks

(v) Identify suitable investments (indicate broad category rather than specific instruments) that may ideally fit into the investment objectives of the following individuals :

Investment Objective	Instrument	Instrument
Growth and Appreciation in value		
Regular Income		
Liquidity		

3 Marks

(B) Choose the most appropriate answer from the following: **2 Marks x 5 =10 Marks**

(i) The following is true:

(A) An investment Bank needs no licence from RBI

(B) SEBI has to approve the draft prospectus within thirty days of submission to it. If no reply is received within 30 days of submission, it is deemed to have no objection and the company may proceed with public issue,

(C) A Merchant Banker shall not apply for the shares of its client company,

(D) An Asset Management Company is a Banking Company governed by the RBI to deal with a mutual fund's investments in different sections of the financial market.

(ii) The following commodity is not traded in the Indian Commodity Exchange:

(A) Diamonds

(B) Tomatoes

(C) Crude Oil

(D) Pepper

(iii) A company has receivables of Rs.150 crores from four borrowers. It converts these into smaller portions of Rs. 500 each and sells these to smaller investors in the secondary market. This fragmentation of the loan is called

(A) Debt unit scheme

(B) Mutual fund scheme

(C) Debt securitization

(D) Asset Reconstruction

(iv) Margin Trading is the following:

(A) Stock brokers trade on the client's behalf up to the variation margin maintenance.

(B) Stock brokers trade on the clients' behalf even consuming the initial margin.

(C) Investors buy more number of shares than they have money for by paying a lower proportion of the cost and getting the balance funded by their bankers.

(D) A stock broker keeps a margin in his account with the stock exchange for the netting position shortfall among his clients.

(v) Settlement of Stock Market trading happens on:

(A) T + 1

(B) T + 2

(C) T + 3

(D) On the date of trading

III. <u>Case Study Question Number Three</u>

Krishi Vikas Equipment Ltd. (KVE) is an existing unlisted and successful company engaged in manufacturing and marketing agricultural equipment in India. The Company is family-owned and is now headed by a qualified engineer and a member of the family who is the Managing Director (MD). Though family-owned, the Company employs qualified professionals and is soundly managed. Being a player catering to the agri-sector, the Company's products are in good demand and its profitability is sound. The family owners are keen on new products and expansion. In the past, they have been reluctant to borrow except for genuine working capital requirements on short term basis.

The MD has had various discussions with the in-house professionals who have zeroed in on a set of new agricultural implements and have all related marketing and technical information ready. The key figures in relation to the expansion they have planned are summarized as below :

	(Rs. In lakhs)
Total project cost	2000
Annual sales (upon full implementation)	3000
Earnings before interest, depreciation & tax	900
Annual depreciation	120

The Chief Financial Officer (CFO) went to discuss with the MD (Project Meeting 1) with the following additional information:

(i) Latest audited Balance Sheet and profitability summary) - Annexure 1

(ii) Estimated Cash Flow Statement for the next 3 financial years - Annexure 2

(iii) Earnings Per Share (EPS) data - KVE vs. Market - Annexure 3

At Project Meeting 1, MD explained to the CFO that the family does not wish to invest 'own money' further; but it is keen about expansion; therefore, company should think of external equity without diluting control. He studied the information brought by the CFO and then said that a senior executive of a Private Equity (PE) enterprise will be coming to meet him in three days' time. Before meeting with the PE, the MD wanted to know from the CFO, among other things, the following:

(a) If the KVE's shares were to be quoted in the secondary capital market, what would be price/share?

(b) How the price per share will be fixed if KVE comes up with a capital issue?

(c) What are the advantages and disadvantages of going with the PE?

(d) Any other suggestions / points relevant to the issue at hand

It was decided then that the MD and the CFO will again meet (Project Meeting 2) the day before the meeting with the PE.

(A) In the above background, kindly deal with the following situations. Your detailed answers may be given to each of the requirements in the question.

(i) Bearing in mind the views of the present ownership / management on the question of ownership and equity dilution, what would be your recommendations for putting through the project? **3 Marks**

(ii) Would you like to examine the debt-equity position of the company and suggest a quantum of debt to be raised by the company additionally? It is gathered that the normal debt equity ratio applicable to the business in which the company is engaged is 2:1. **3 Marks**

(iii) You are required to indicate the possible additional equity issue by the company based on the understanding that the present ownership will relax its stand on dilution. Indicate the alternatives when equity dilution of 40%, 50% or 60% takes place. **3 Marks**

(iv) Kindly indicate the issue price of the additional equity. You may be aware that though this company's shares are not listed in the exchange, shares of similar sized companies are quoted - details of which all given in the schedule - and this company's valuation may not be vastly different from that of the average company in the quoted / listed group. **3 Marks**

(v) Kindly prepare an executive summary of the recommendations to be put up to the Board of Directors of the company. **3 Marks**

(B) Choose the most appropriate answer from the following: **2 Marks x 5 =10 Marks**

1. Which of the following is **not true** for Primary Market conditions?

   (a) In Primary Market, the company directly involved in the transaction for listing

(b) Primary Market involves relationship between company and prospective investors

(c) Primary Market involves relationship between investors who are actively involved in the market

(d) None of the above

2. Nifty Futures expires on……..

   (a) Every Thursday of week

   (b) Last Thursday of the month

   (c) Twice in a month

   (d) Last Friday of the month

3. Which of the following statement is **not true** with respect to exercising call option?

   (a) A call option buyer has limited loss and unlimited profit opportunity

   (b) A call option seller has unlimited loss and limited profit opportunity

   (c) A call option buyer has obligation to exercise the option

   (d) A call option is linked with underlying assets or security

4. Green Shoe Option is used for:

   (a) Under allotment of shares

   (b) Overallotment of shares

   (c) It acts as a price stabilizing mechanism

   (d) Both (b) and (c)

5. Treynor Ratio evaluates the performance of the portfolio on the basis of:

   (a) It evaluates the performance based on total risk of the portfolio

   (b) It considers systematic risk i.e. beta to evaluate the performance

   (c) It calculates performance of portfolio uses standard deviation

   (d) It considers performance of portfolio excess of funds actual return minus expected return

ANNEXURE 1

KRISHI VIKAS EQUIPMENT LTD.

BALANCE SHEET AS AT 31st MARCH (Amounts in Rs. lakhs)

	2018	**2017**	**2016**
ASSETS			
Non-current Assets			
Property, plant and equipment	1080	1025	1000

Financial assets	330	250	
Other Non-current assets	35	40	40
Sub-total	1445	1315	1040
Current Assets	1985	1881	1750
TOTAL ASSETS	**3430**	**3196**	**2790**
EQUITY & LIABILITIES			
Equity			
Equity Share Capital *	500	500	500
Other Equity	1510	1360	980
Sub-total	2010	1860	1480
Non-current Liabilities	583	581	580
Current Liabilities			
Trade payables	680	600	575
Provisions	15	15	15
Other Current Liabilities	142	140	140
Sub-total	837	755	730
TOTAL EQUITY & LIABILITIES	**3430**	**3196**	**2790**

*Shares of Rs. 10 each.

PROFIT / LOSS SUMMARY

	(Amount in Rs. Lakhs)		
	2018	**2017**	**2016**
Profit Before Tax	640	970	450
Taxes	190	290	135
Net profit	450	680	315
Dividend	300	300	250
Retained Profit	150	380	65

ANNEXURE 2

KRISHI VIKAS EQUIPMENT LTD.

ESTIMATED CASH FLOW STATEMENT

Year ended 31st March – Amounts in Rs. lakhs

	2019	**2020**	**2021**
Cash flow from Operating activities :			
Profit before tax	1750	2012	2515

Adjustments for Depreciation	180	200	220
Dividend & Interest Income	(100)	(120)	(150)
Change in operating assets & liabilities			
Increase/decrease in current assets	(250)	(300)	(400)
Increase/decrease in current liabilities	120	140	160
Cash generated from operations	1700	1932	2345
Income tax paid	(525)	(605)	(755)
Net cash inflow from operating activities	1175	1327	1590
Cash flow from investing activities:			
Dividends & Interest received	100	120	150
Net cash flow from investing activities	100	120	150
Cash flow from financing activities			
Dividends	(300)	(300)	(300)
Dividend taxes	(32)	(32)	(32)
Net cash outflow from financing activities	(332)	(332)	(332)
Net increase/(decrease) in cash & cash equivalents	943	1115	1408
Cash & cash equivalents at the beginning of the year	525	1468	2583
Cash & cash equivalents at the end of the year	1468	2583	3991

ANNEXURE 3

EARNINGS PER SHARE INFORMATION

S. No.	Name of company	**EPS (Rs.) YE 31/03/2018**	**Market Price (Rs.)**	
			High	**Low**
1	Agri- Imp Ltd.	4.50	45	41
2	Implements (I) Ltd.	3.20	51	42
3	Beta Products Ltd.	6.00	110	80

IV. Case Study Question Number Four

HRS Ltd. is an asset financing company with a proven track record and has been in the business of mainly providing finance to purchase trucks, tractors, farm equipment and commercial vehicles. In the past, it was financing used and new vehicles, but over the recent years, it prefers to concentrate on new vehicles only. Trucks form the major part of the financing business. There is a lot of competition in this field, but due to the increasing norms on pollution control and the decrease in the value of second hand vehicles, the company wants to strategically confine itself only to new vehicles in the coming years. HRS Limited mainly uses debt finance for its operations. The debt-equity ratio is in the range of 5:1 on an average. This is in line with the industry.

The company feels that in addition to truck financing, it can expand its business to finance smaller vehicles such as passenger cars and tempo travellers. The current expansion plan is described in the succeeding paragraphs:

There has been a recent entrant in the country wide market by a mobile application provider who has not only ushered in a revolution in the way cars are being hired by common man, but also in the manner of documentation of bookings, charges, cancellations and in the ownership of vehicles for such hire. This operator has also lured many entrepreneurs to successfully earn money either as drivers or as owners of self-driven cars and be engaged by users of the mobile app. This app has found immense success in the car segment and is also being considered for trucks for transport as well as connections from goods trains to factories so that companies can track the distribution of material and finished goods on an optimal cost.

While discussing with this app provider, HRS Ltd. has discovered a huge potential to finance vehicles to be demanded by virtue of the app users who may be new entrepreneurs, small transport companies, etc. Since the individual entrepreneurs may turn out to be risky and counterproductive for HRS for repossession in the event of failure to repay, the app provider, who has a wide data base and the recovery mechanism for fares realized, has agreed to be the co-borrower for the vehicles. Under such an arrangement, the vehicles financed will be hypothecated to HRS by the entrepreneur who is the principal borrower, fully guaranteed by the app provider. The app provider will also ensure that the used vehicle is also being handed over to another entrepreneur attached to him. Thus, only the repossessed vehicles will form the used vehicle financing segment. Agreements are proposed to be drafted with conditions for repossession within one month of default and redeployment of such vehicles for earning money, by continuing to be hired. GPS system to be installed in the trucks will provide information to the delivery destination and the origin of loading so that better inventory management and production processes are ensured. Thus the whole new business is expected to have a huge success story, going by the success rate in the passenger car booking segment.

In case the app provider or the app itself fails due to technical faults or user- unfriendly situation or in the event of fierce competition that this app provider may face, the large number of vehicles financed would have to be managed by another app provider or alternatives set up in-house. These could take some time.

In the near future, HRS Ltd. would like to cater to vehicle financing as in the earlier line of business, but mainly to the customers targeted through the app provider, who would be entrepreneurs in the categories of first time vehicle owners, repeat vehicle owners, small transport operators, etc. Thus, HRS is not deviating essentially from its vehicle financing activity.

HRS Ltd. has also accepted deposits from the public in the past through its country wide branches.

The financial information relating to HRS Ltd. is given in Tables 1 and 2. HRS Ltd. was promoted by HS Holdings Ltd. which has subscribed to 63% of the equity capital of HRS Ltd. There have been no negative pointers under any law on the company or its directors or management.

The company is professionally managed and has had qualified persons of repute heading the respective operations and the middle level managers are also carefully chosen to be able to manage the country wide operations and to take decisions quickly and efficiently. The managers who have retired have done so only due to age reasons and there have been no adverse publicity in any media about any internal mismanagement or controversy.

The company proposes to issue Rs. 500 crores worth debentures comprising 50,00,000 debentures of Rs. 1,000 each face value, for a period of five years, the full value being payable on application. Most of this issue is to be used for redeeming an earlier issue which is due to mature during the next twelve months.

The company intends to patronize active trading and hence prefers to have tradability of even one debenture. There will be no option for the company to redeem earlier than the committed period nor does it allow the holder to claim redemption earlier than stipulated. Land and buildings worth Rs. 950 crores are the intended security for this offer. The debentures are proposed to be issued and redeemed at par. The rate of interest is fixed at 9.5% p.a. throughout the tenor and interest will be paid on the 30th day of June and December every year.

The company has fulfilled all the conditions under the various regulations and plans for the issue to open on 15th January, 2019 and remain open for only the minimum period required under law.

(A) Choose the correct answers to the following questions: **2 Marks x 5 = 10 Marks**

1. Which of the following is **not true** of Circuit Breaker?
   (a) It helps in controlling panic during high volatility in market
   (b) It prevents true price discovery of price during Circuit Breaker imposed
   (c) It also helps investors to take a rational approach towards the security being imposed
   (d) It gives an opportunity to assesses the market volatility situation and take appropriate decision
2. Which of the following is not one of the advantages of investing in Mutual fund?
   (a) Mutual Fund investment is managed by professional fund manager and it helps to create pool of investment
   (b) It provides guaranteed return over investment
   (c) It provides benefits of economies of scale
   (d) Mutual Funds are regulated by SEBI regulation and publish NAV on daily basis
3. Which of the following is the correct definition of Private Equity (PE) firms?
   (a) PE firms provides initial funding to startups and other enterprises who generates new business idea
   (b) PE firms are institutional investor to provide capital funding to newly setup enterprises
   (c) PE firms are investment fund companies who take strategic stake in the enterprises
   (d) None of the above
4. Which among the following is not a Credit Rating Agency?
   (a) FITCH
   (b) ICRA
   (c) CRISIL
   (d) CIBIL
5. What an active fund manager expecting the market index to decline will do?
   (a) Shift to low-beta defensive stocks
   (b) Shift to high-beta aggressive stocks
   (c) Shift to high P/E stocks
   (d) Shift to specified category of stock

(B) Attempt the following questions:

1. You are an analyst at a credit rating agency and are part of the team involved in the rating process of the company. Prepare a report to your director indicating:
   (a) Assessment of risks; **5 Marks**
   (b) Rating that you would consider appropriate along with a short note on CAMEL criteria considered. **5 Marks**
2. Write a short note on the potential benefits of the proposed new unit of business. **5 Marks**

V. Case Study Question Number Five

The expansion project of BON BON Limited which is under finalization is expected to consist of:

	Rs. Lakhs
Capital assets	200
Working capital	300
Total	**500**

The initial scheme of raising project finance is:

11% Long term debt	135
12% Bank borrowings for working capital.	225
Internal accruals	140
Total	**500**

Extracts from the Balance Sheet of the Company as at the end of the last financial year are given in Annexure 1.

The Company's risk-free rate is 9%, market return 14% and relevant company assets beta is estimated at 1.5.

The Company has approached you, a financial and management consultant, to review the above numbers. They have also given you additional information about the project which is given in the Annexure 2.

Upon an initial study of the given information, the first thought that strikes you is that Adjusted Present Value (APV) should be calculated to test whether the project is worth undertaking; also, that the plan of financing should be re-cast.

Choose the correct answers to the following questions: 2 Marks x 5 = 10 Marks

(1) Determine which of the following not part of bank financing is:
   (a) Term loans
   (b) Packing credit
   (c) Overdraft
   (d) Commercial paper

(2) Which one of the following does not fall within the scope of credit rating?
   (a) Opinion in regard to a debt instrument
   (b) Opinion based on an evaluation of business risks
   (c) Opinion on the probability of meeting the interest and principal obligations of a business

(d) Opinion on a holding company, its subsidiaries and associates

(3) Which of the following is incorrect as regards the functioning of an investment banker?

(a) They help in raising capital for the client

(b) They take deposits from their customers

(c) They act as an intermediary for their customers in relation to their dealings

(d) They earn an underwriting commission as part of business.

(4) Which one of the following does not form part of treasury management?

(a) Cash management

(b) Management of interest, currency and commodity risks

(c) inventory control

(d) Liquidity planning and control

(5) Factoring concerns itself with the management of

(a) fixed assets

(b) accounts receivable

(c) stock in trade

(d) accounts payable

In the light of the information supplied above, answer the following:

(6) Explain briefly Adjusted Present Value (APV). Calculate the APV for the above project and state your view on acceptability. **7 Marks**

(7) Is the debt option as proposed viable for the company? Would you suggest any other alternative? **4 Marks**

(8) State what changes you would like to recommend to the project financing plans, briefly explaining each change. **4 Marks**

ANNEXURE 1
BON BON LIMITED

BALANCE SHEET SUMMARY· ACTUALS FOR THE LAST TWO YEARS
Year ended 31st March (In Rs Lakhs)

	2018	**2017**
Share Capital :		
Shares of Rs.10 each	50	50
Reserves	200	140
11% Long Term Debt	250	300
12% Bank borrowings	120	125
Total	**620**	**615**
Fixed assets	140	150
Net Current assets	480	465
Total	**620**	**615**

ANNEXURE 2
PROJECT CASH FLOWS & OTHER DETAILS

Amounts in Rs. Lakhs

	Year 1	Year 2	Year 3	Year 4	Year 5
Sales:					
Domestic	540	780	1320	1500	1350
Exports	360	520	880	1000	900
Total	**900**	**1300**	**2200**	**2500**	**2250**
Profit before depreciation	180	350	400	500	450
Less:					
Depreciation	38	38	38	38	38
Interest:					
LT Debt	8	14	12	9	6
Short term debt	7	27	27	27	27
Profit before Tax	127	271	323	426	379
Less: tax	44	95	113	149	133
Profit after Tax	83	176	210	277	246
Cash in-flow:					
PAT + Dep+ Int	136	255	287	351	317
Terminal in flow:					
Capital assets					10
Working capital assets					**300**
Total	**136**	**255**	**287**	**351**	**627**

PROJECT- INTEREST WORKINGS

Amounts in Rs. Lakhs

	Year 1	Year 2	Year 3	Year 4	Year 5
LT Debt:					
Amount outstanding at the start of the year	-	135.00	121.50	94.50	67.50
Additions during the year	135.00				
Repayment during the year	-	13.50	27.00	27.00	27.00
Amount outstanding end of the year	135.00	121.50	94.50	67.50	40.50
Interest at 11% on average outstanding	7.43	14.11	11.88	8.91	5.94
Rounded off	8.00	14.00	12.00	9.00	6.00
WC borrowing:					
Amount outstanding at the start of the year	112.50	225.00	225.00	225.00	225.00
Interest at 12%	6.75	27.00	27.00	27.00	27.00