

Roll No. ....

Final New Syllabus

MAY 2016

Paper - 6 B

Total No. of case study Questions

Financial Services & Capital Markets

Total No. of Printed Pages – 16

Time Allowed – 4 Hours

Maximum Marks – 100

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12/05/18

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

The Question Paper comprises three case study questions. The candidates are required to answer any two case study questions out of three.

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.

**Marks**

**I. Case Study number One :**

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

	Quantity (nos)	Value (₹ '000)
<b>Unit Capital :</b>		
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	<b>883,13,578.387</b>	<b>8,83,135</b>

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<b>Reserves and Surplus</b>		
<b>Unit Premium Reserve</b>		
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
<b>Unrealized Appreciation Reserve</b>		
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
<b>RETAINED SURPLUS</b>		
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
<b>Total Reserves</b>		<b>27,05,334</b>
<b>Current Liabilities</b>		
Amount due to AMC for Management Fees		1615
<b>Others</b>		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	
<b>Other Current Liabilities</b>	<b>2878</b>
<b>Investments</b>	
Listed Debentures and Bonds	14,20,321
Government Securities	20,69,363
<b>Total</b>	<b>34,89,684</b>
Deposit with scheduled banks	-
<b>Other Current Assets</b>	
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
<b>Total</b>	<b>3,64,779</b>
Interest	
Money market Instruments	188
Debentures and Bonds	57,425
Deposits	-
Government Securities (including Treasury Bills)	1,17,501
Collateralised Lending	6,951
Less : Interest on Borrowing	-
<b>Total</b>	<b>1,82,065</b>

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 |
| (ii) Is the scheme open or close ended ? Why ?   | 2 |
| (iii) Can it be assumed without any contradiction that the product is traded in the stock exchange ?   | 2 |
| (iv) Is switching between plans permitted in this mutual fund product ?  | 2 |
| (v) Why is there a nil balance in deposit with scheduled banks ?   | 2 |
| (vi) Do you think that this scheme is a safe investment with negligible risk ? Would you expect high returns from this product on an annualized basis ?  | 3 |
| (vii) What is your comment on the expense ratio given above ?  | 3 |
| (viii) Can you find out the NAV per unit of the scheme from the given data as on the closing date ? Substantiate with appropriate calculations and explain how you can or why you cannot find the NAV. | 3 |
| (ix) What is the role of unrealized reserves ? Is it not contrary to the fundamental accounting principles of prudence ?   | 3 |
| (x) From the given figures, do you conclude that the scheme has performed well during this year in question ?  | 2 |
| (xi) Can this fund borrow from the money market to meet the investors' income expectations or redemption obligations ?   | 2 |
| (xii) What can you say about the entry and exit loads of this fund ?   | 3 |

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- (xiii) The fund had invested in Treasury Bills of face value ₹ 1,00,000 each amounting to ₹ 90 crores. If the average annualized yield calculated based on 85 days as on 31<sup>st</sup> March, 2018 was 8.76%, what was the amount of average purchase price ? 3
- (xiv) What will be the risk appetite of an investor in this type of product ?  
What would be the preferences of the investor in such a product ? 3
- (xv) Why is there a fractional amount in the number of units column in mutual fund product ? 2
- (B) Answer the following as directed along with reasons :
- (i) The type of entity of a mutual fund is : 1  
(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 1  
(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, 1  
(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 : 1  
(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.

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- (v) Under a Systematic Investment Plan, the following is NOT TRUE : 1
- (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 ₹ 3,000 in quarterly payments for a 3 year SIP, he can choose to step up this amount to ₹ 4000 from the second year.
- (D) Even where the SIP amount in a financial year does not exceed ₹ 50,000 an investor cannot invest in cash.
- (vi) An investor in a mutual fund who wants liquidity within a period shorter than the closure date should invest in \_\_\_\_\_. 4×1  
=4
- (vii) Gilt funds have \_\_\_\_\_ risk.
- (viii) An investor who does not want to incur a high expense ratio can opt for \_\_\_\_\_.
- (ix) \_\_\_\_\_ is the standard measure of performance for investors in mutual funds for one year or more time periods.
- (x) Is there any difference between a mutual fund and a scheme ? 4×1  
=4
- (xi) How is a benchmark chosen for effective comparison of the performance of each type of mutual fund product ?
- (xii) Can a mutual fund invest in another mutual fund ? Explain the underlying concepts and laws.
- (xiii) Can a Real Estate Investment Mutual Fund invest in residential house property ?

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**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
- (ii) Does SEBI (ICDR) Regulations 2009 (amended in 2017) apply to preference shares ? If so, under which regulation ? Explain in detail. 4
- (iii) Point out the flaws or the irregularities of the following proposal and state how rectification may be done, quoting relevant rules or sections or procedures and the authority : 8
- IJK Ltd. wants to publicly issue for the first time, 10,00,000 equity shares of a face value of ₹ 10 by book building process. It wants to keep the bid open from the 14<sup>th</sup> of May 2018 up to 5<sup>th</sup> June 2018. The price band offered is to be fixed between ₹ 30 to ₹ 40 per share. The promoter intends to contribute to 15% of the shares proposed to be offered at ₹ 30 per share and hold the investment up to two years. To what extent can anchor investors provide the support necessary ?
- (iv) 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
- (v) A soap manufacturing company has requested SEBI's prior approval to use a popular actor to advertise for the proposed equity issue to public. The same actor has been employed by the company to promote the sales of its soaps. Is it alright to grant approval ? 2

- (vi) X is an individual having a surplus of ₹ 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 30<sup>th</sup> 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 1<sup>st</sup>. 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
- (vii) What do you mean by large cap, mid cap and small cap stocks ? 4
- (viii) 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
- (ix) Will the equity share prices of a company be the same in both BSE and NSE at the same point in time ? If so, explain the concept. If not, explain why they could differ ? If they differ, will an investor not be able to profit by buying at a lower price and simultaneously selling it at a higher price ? 3
- (x) Identify suitable investments (indicate broad category rather than specific instruments) that may ideally fit into the investment objectives of the following individuals : 4

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



- (B) Choose the most appropriate answer from the following and give your reason :

2×5  
=10

(You are required to only state the Roman numeral and the alphabet of choice in capital letters rather than copy the entire question into the answer books) :

- (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 ₹ 150 crores from four borrowers. It converts these into smaller portions of ₹ 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) AM Inc., an American company wants to set up its marketing company in India. The following process does not violate Indian Regulations :

- (A) AM has identified 205 entities / individuals in India who are willing to subscribe to the shares of the new company. AM would like to raise money from these persons and not invoke the provisions relating to public issue.
- (B) AM will restrict the issue to about 150 persons and raise the capital without having to comply with SEBI regulations.
- (C) AM will set up a Mutual Fund and offer its units to either the 150 or the 205 persons and use the proceeds to set up its new company and will comply with the SEBI (Mutual Fund) Regulations.
- (D) AM will get a banking licence in India and set up the new company as the subsidiary of the banking company.

(C) Fill in the blanks : (The blank is not restricted to one word. There could be one to four words to fill the blanks. The question Roman numeral and the content filling the blank will be sufficient for presentation in the answer books)

- (i) \_\_\_\_\_ is an arrangement between parties A and B, where A has given a loan to C and is afraid that C may not pay it back and in that case, B will make good A's loss. In return for this, B will charge a periodic premium from A. 1
- (ii) When shares are traded in the \_\_\_\_\_, the company's share capital account is not affected. 1
- (iii) A group of engineers has designed an air conditioning machine which is a revolutionary product that efficiently admits fresh air circulation. This will replace the wide air conditioning market within the country. The new product has been successfully tested and is being patented. The group has had a start-up venture as a private limited company. A big company that enjoys over 50% of the air conditioning market, which is threatened by this product should attempt a \_\_\_\_\_ to retain its market leadership. 1

### III. Case Study Number 3 :

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 :

	(₹ 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.

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 ? 8  
 Would you prefer equity dilution in the primary or the secondary market or through private placement of shares ?  
 What are the requirements of SEBI for entities making a public issue of shares ? Discuss.
- (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. 7
- (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. 10
- (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.
- (v) What is private equity and what are its attributes ? Discuss. 15  
 One P.E. firms is prepared to invest in this company and take a 45% interest in the equity. It has made its working and is prepared to project the company's future workings and offer now a rate based on EPS of ₹ 10. The multiplier is expected to be the same as established by the details in the schedule of listed companies functioning.

- (vi) What will be the recommendations of the CFO to the Managing Director ? 3
- (vii) Kindly prepare an executive summary of the recommendations to be put up to the Board of Directors of the company. 7

## ANNEXURE 1

## KRISHI VIKAS EQUIPMENT LTD.

BALANCE SHEET AS AT 31<sup>ST</sup> MARCH (Amounts in ₹ lakhs)

	2018	2017	2016
<b>ASSETS</b>			
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
<b>TOTAL ASSETS</b>	<b>3430</b>	<b>3196</b>	<b>2790</b>
<b>EQUITY &amp; LIABILITIES</b>			
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
<b>TOTAL EQUITY &amp; LIABILITIES</b>	<b>3430</b>	<b>3196</b>	<b>2790</b>

\*Shares of ₹ 10 each.

**PROFIT / LOSS SUMMARY**

(Amount in ₹ 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 31<sup>st</sup> March – Amounts in ₹ 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

(16)

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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 (₹) YE 31/03/2018	Market Price (₹)	
			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

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