FINAL EXAMINATION- GROUP III

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE -2011

PAPER 11 : CAPITAL MARKET ANALYSIS & CORPORATE LAWS

SECTION - 1 (60 Marks)

Capital Market Analysis

Answer Question No. 1 which is compulsory and any two from the rest in this Section.

Question:

1 (a) In each of the cases given bellow, one out of four is correct. Indicate the correct answer (= 1 mark) and give workings/reasons briefly in support of your answer (=1 mark):

(i) VENTEX LTD. issued right shares which increased the market value of the company by Rs. 150 crore. The existing Base year average is Rs. 952.83 crore. If the new Base year average is Rs. 1010 crore, the aggregate (old) market value of all the shares included in the Index before right issue made will be

A. ₹ 2500 Crore

B. ₹ 1070.60 Crore

C. ₹ 1005.50 Crore

D. None of the above

(ii) Historically, when the market return charged by 10%, the return on the stock of ARIHANT LTD, changed by 16%. If the variance of market is 257.81, what would be the systematic risk for Arihant Ltd.?

A. 320%

B. 480%

C. 660%

D. Insufficient information

(iii) The characteristics of two securities A and B are as follows:

Particulars	Security A	Security B
Expected Return (%)	12	13
Standard deviation of return (%)	21	29
Beta (β)	1.10	1.20

The correlation co-efficient between the returns on Securities A and B is 0.94.

If variance of returns on the market Index is 400%, the systematic risk of a portfolio consisting of two securities in equal proportion will be

A. 460%

B. 529%

C. 606.5%

D. None of the above

(iv) Mr. SAURAV GANGULY can earn a return of 20% by investing in equity shares on his own. Now he is contemplating recently announced new equity-oriented mutual fund scheme in which initial expenses and annual recurring expenses are 5 per cent and 1.5 per cent respectively. How much should the mutual fund earn to provide Mr. SOURAV GANGULY, a return of 20%?

A. 26.5%

B. 21.55%

C. 22.55%

D. None of the above

(v) The beta co-efficient of equity stock of ARISTO LTD. is 1.6. the risk free rate of return is 12% and the required rate of return is 15% on the market portfolio. If the dividend expected during the coming year ₹ 2.50 and the growth rate of dividend and earnings is 8%, at what price the stock of ARISTO LTD. can be sold (based on CAPM)?

A. ₹ 12.50

B. ₹ 16.80

C. ₹ 28.41

D. Insufficient Information

$2 \times 5 = 10$

(b) Choose the most appropriate answer from the stated option and write it down (only indicate A, B, C or D as you think correct):

(i) Which of the following statement is TRUE regarding mutual funds?

A. The shares of close-ended funds are redeemable at their NAV

B. Open-ended funds can sell unlimited number of units

C. The fund units are sold to the public at the NAV

D. Real estate fund is an open-ended fund

(ii) If an investor believes that probability of the price of a stock moving up is higher than the probability of price plummeting, he should

A. Buy an in the money put and sell an in the money call

B. Buy an in the money call and sell an out of the money put

C. Buy an in the money call and buy an out of the money put

D. Sell an in the money call and buy an out of the money put

(iii) Even though SEBI has been given wide power under the SEBI Act 1992, the Central Government continues to exercise which of the following powers under the securities Contracts (Regulation) Act.

A. Power to amend bye-laws of Stock Exchange

B. Licensing dealers in securities in certain areas

C. Power to suspend business of a recognized Stock Exchange

D. Power to call for periodical returns from Stock Exchange

(iv) In capital Market Analysis the external factor influencing the Industry as a whole is called

A. Industrial Risk

B. Market Risk

C. Systematic Risk

D. None of the above

(v) In efficient market, the market price is an 'unbiased estimate' of the true value of the stocks (shares). This implies that

A. The market price always equals the true value

B. The market value has no relation to the true value

C. Market prices contain errors, but these being random can not be exploited by investors

D. Markets make mistakes about true value, which can be exploited by investors

1 x 5 = 5

(c) Fill in the blanks in the following sentences by using appropriate words/phrases:

(i) In BSE for most stocks the rolling settlement period is _______.

(ii) Insurance companies are regulated by the _______ Act which was passed in the year 1999.

(iii) In the Context of investment risk, International risk includes Country Risk and ______ Risk.

(iv) The orders of SEBI under the Securities Laws are appealable before the _______.

(v) An ______ shows how a specified portfolio of share prices are moving in order to give an indication of market trends.

1 x 5 = 5

Answer to Question No 1 (a):

(i) → A : ₹ 2500 Crore

New Base Year Average = Old base year average × $\frac{\text{New market value}}{\text{Old market value}}$

[Where, old market value/aggregate market value be x.]

$\therefore \quad 1010 = 952.83 \times \frac{(150+x)}{x} = \frac{142924.50 + 952.83x}{x}$

Or, $\quad x = \frac{142924.50}{57.17} = ₹\,2500$

(ii)→ C : 660%

10% increase in Market return resulted in 16% increase in Arihant Ltd stock. Thus the Beta (â) for the Arihant ltd stock is 1.60 (i.e. 16% ÷ 10%).

Now Systematic Risk is $\beta^2 \sigma m^2 = (1.60)^2 (257.81) = 660\%$

(iii)→ B : 529%

The Beta of portfolio consisting of two securities given that money is allotted equally between two assets :

$$1.10 \times 0.5 + 1.20 \times 0.5 = 1.15$$

The Systematic Risk of a portfolio = $\beta^2 \sigma m^2$

$$(1.15)^2 \times 400 = 529\%$$

(iv)→ C : 22.55%

R2 = [1/1 – Initial Expenses (%) R1] + Recurring Expenses (%)

Where R2 = Mutual Fund earnings

R1 = Personal earning of SAURAV GANGULY

∴ R2 = [(1/1-0.05) × 20%] + 1.5%

= 0.2105 + 0.015

= 22.55%

(v)→ C : ₹ 28.41

Expected rate of return : (By applying CAPM)

$R_e = R_f + \beta\,(R_m - R_f)$

$= 12\% + 1.6\,(15\% - 12\%) = 12\% + 4.8\% = 16.85$

Price of Stock : (With the use of dividend growth model formula)

$R_e = D_1 \div P_0 + g$

$0.168 = 2.50 \div P_0 + 0.08$ or, $0.168 - 0.08 = 2.50 \div P_0$

or, $P_0 = 2.50 \div 0.088 =$ ₹ 28.41

<u>Answer to Question No 1 (b) :</u>

(i) →B (ii) →C (iii) →C (iv) →C (v) →C

<u>Answer to Question No 1 (c) :</u>

(i) <u>T+2</u>
(ii) <u>Insurance Regulatory and Development Authority</u>
(iii) → <u>Exchange rate</u>
(iv) <u>Securities Appellate Tribunal</u>
(v) <u>Index</u>

Question:

2. (a) Define the term financial market. Briefly sketch the four broad sub-divisions of financial market. 5

(b) Ms MITRIKA an analyst at ASHIKA SECURITIES LTD. is considering the stocks of Spark Ltd. and Global Ltd for investment. Expected returns on these stocks depend on the growth rate GDP. The conditional returns of the market and the stocks are given below:

Economic Scenario GDP Growth rate	Probability	Return on (%)		Return on Market %
		Spark Ltd.	Global Ltd.	
1.00-3.0%	0.18	15	9	7
3.00-6.00%	0.24	25	14	11
6.00-8.00%	0.26	38	27	18
More than 8.00%	0.32	46	33	25

The expected risk-free return is 6.5%

Assume that CAPM holds good in the market

You are required to

(i) Calculate the ex-ante-betas for the two stocks.

(ii) Find out whether the stocks of spark Ltd. and Global Ltd. are underpriced or overpriced.

(iii) Calculate the proportion of systematic risk and unsystematic risk for both the companies.

(iv) Determine which stock the analyst would suggest to invest. 6+3+4+2 = 15

<u>Answer to Question No 2 (a) :</u>

FINANCIAL MARKETS

A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. Financial assets or Financial Instruments represents a claim to the payment of a sum of money sometime in the future and / or periodic payment in the form of interest or dividend.

Money Market: The money market as a wholesale debt market for low risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.

Capital market: The capital market is designed to finance the long-term investments. The transactions taking place in this market will be a period over a year.

Forex Market: The forex market deals with the multicurrency requirements, which are met by the exchange of currencies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated market across the globe.

Credit Market: Credit market is a place where bank, FIs and NBFCs purvey short, medium and long-term loans to corporate and individuals.

Answer to Question No 2 (b) :

(i) Expected return on stock and variance of spark ltd.

$E(Rs) = 0.18\times15 + 0.24\times25 + 0.26\times38 + 0.32\times46$

$= 33.3\ \%$

$\sigma^2 s$ (Variance): $0.18 \times (15\text{-}33.3)^2 + 0.24 \times (25\text{-}33.3)^2$

$0.26 \times (38\text{-}33.3)^2 + 0.32\times (46\text{-}33.3)^2$

$= 60.28+16.53+5.74+51.62=134.17\%$

Expected return on stock and Variance of Global Ltd:

$E(RG) = 0.18 \times 9+0.24 \times 14+0.26 \times 27+0.32 \times 33$

$= 22.56\%$

σ^2G (Variance): $0.18 \times (9\text{-}22.56)^2 + 0.24 \times (14\text{-}22.56)^2+0.26 \times(27\text{-}22.56)^2+0.32 \times (33\text{-}22.56)^2$

$= 33.10+17.58+5.13+34.88=90.69\%$

Expected return and variance on Market:

$E(RM) = 0.18 \times 7+0.24 \times 11+0.26 \times 18+0.32 \times 25$

$= 16.58\%$

$\sigma^2 m$ (Variance): $0.18 \times (7\text{-}16.58)^2+0.24 \times (11\text{-}16.58)^2+0.26(18\text{-}16.58)^2+0.32 \times (25\text{-}16.58)^2$

$= 47.20\%$

$COVSM = 0.18\ (15\text{-}33.3)\ (7\text{-}16.58) +0.24 \times (25 - 33.3)\ (11 - 16.58) + 0.26\ (38 - 33.3)\ (18 - 16.58) + 0.32\ (46 - 33.3)\ (25\text{-}16.58)$

$= 78.63\%$

$CovGM = 0.18(9\text{-}22.56)(7\text{-}16.58) + 0.24(14\text{-}22.5)(11\text{-}16.58) + 0.26(27\text{-}22.56)(18\text{-}16.58)$

$+ 0.32(33 - 22.56)\ (25 - 16.58) = 64.61\%$

Betas :

$\beta\ S = COVSM / \sigma^2M = 78.63/47.20 = 1.67$

$\beta\ G = COVGM / \sigma^2M = 64.61/47.20 = 1.37$

(ii) Normal return = $Rf + \beta\ (Rm - Rf)$

Spark Ltd: $6.5+1.67(16.58\text{-}6.5) = 23.33\%$

Alpha/Excess return = $33.3\text{-}23.33 = 9.97\%$

Global Ltd: $6.5+1.37\ (16.58\text{-}6.50) = 20.31\%$

Excess return/Alpha = $22.56\text{-}20.31 = 2.25\%$

The alpha i.e. excess return of both the companies is positive. Hence the stock of Spark Ltd and Global Ltd is under priced.

(iii) Systematic Risk = $\beta^2 \times \sigma^2 M$
Unsystematic Risk = Total Risk – Systematic Risk
Spark Ltd:
Systematic Risk = $(1.67)^2 \times 47.20 = 131.64\%$
Unsystematic Risk = 134.17-131.64 = 2.53%
Proportion of Systematic Risk = (131.64/134.17) x 100 = 98.11%
Proportion of Unsystematic Risk = (2.53/134.17) = 1.89%
Global Ltd:
Systematic Risk = $(1.37)^2 \times 47.20 = 88.59\%$
Unsystematic Risk = 90.69-88.59 = 2.10%
Proportion of Systematic Risk = 88.59/ 90.69 = 97.68%
Proportion of Unsystematic Risk = 2.10/90.69 = 2.32%

(iv) Spark Ltd:
Excess return/ stander deviation:
$= 9.97/\sqrt{134.17} = 9.97/11.58 = 0.86$
Global Ltd:
Excess return/ stander deviation:
$= 2.25/\sqrt{90.69} = 2.25/9.52 = 0.24$

As the excess return/Alpha to Standard deviation is higher for the stock of Spark Ltd, the analyst should suggest to invest on the stock of Spark Ltd.

Question:

3. (a) What do you mean by ETF (Exchange Traded Funds)? State in brief the applications of it. 2+4 =6

(b) The stock of APSHARA LTD. (AL) is currently trading at ₹ 597.12 and calll option exerciseable in three months time has an exercise rate of ₹600. The standard deviation of the continuously compounded stock price change for Apshara Ltd. is estimated to be 22 per cent per year. The annualized treasury Bill rate corresponding to this option life is 5%.

Required:

(i) What is the value of a three month CALL OPTION on the stoke of APSHARA LTD. (Using Black and Scholes Model)?

(ii) What would be the value of PUT option?

(iii) If this CALL ₹ 26 what investment strategy would you adopt?

(iv) If this PUT option is available in the market at ₹ 25what investment strategy would you adopt?

Note:

Extracted from the Tables:

1. Natural Logarithms:

ln (0.9952)= -0.00481, ln (1.0048) = 0.00479

2. value of $e^{-x}, e^{-0.01} = 0.99005$, $e^{-0.0125} = 0.98758$
3. Cumulative standardized normal probability distribution: NCX
   When $X < 0$: $N(0.125) = 0.5498$, $N(0.015) = 0.5060$
   When $X > 0$: $N(-0.125) = 0.4502$, $N(-0.015) = 0.4940$ 6+2+1+1= 10

(c) The IT Act 2000, the Cyber Law of India, gives the legal framework so that information is not denied legal effect, validity or enforceability – Comment. 4

Answer to Question No 3 (a) :

Exchange Traded Funds (ETF) are just what their name implies: baskes of securities that are traded, like individual stocks on an exchange, Unlike regular open-end Mutual Funds, ETFs Can be bought and sold throughout the trading days like any stock.

The concept of ETF first came into existence in the USA in 1993. It took several years to attract public interest. But once it was done, the volumes took off with a retaliation. Most ETFs change lower annual expenses than Index Mutual funds. However, as with Stocks, one must pay brokerage to buy and sell ETF units, which can be a significant drawback for those who trade frequently or invest regular sums of money. The funds rely on an arbitrage mechanism to keep the prices at which they trade roughly in line with the net asset values of their underlying portfolio.

Application of Exchange Traded Funds (ETF) are:

(i). **Managing Cash Flows:** Investment and Fund Managers who see regular inflows and outflows, may use ETFs because of their liquidity and their capability to represent the market.

(ii) **Diversifying Exposure:** If an investor is not aware about the market mechanism and does not know which particular stock to buy but likes the overall sector, investing in shares tied to an index or basket of stocks, provides diversified exposure and reduce risk.

(iii) **Efficient Trading:** ETFs provide investors a convenient way to gain market exposure viz. an index that trades like a stock,

(iv) **Shorting or Hedging:** ETFs may be sold short against long stock holdings as a hedge against a decline in the market or specific sector.

(v) **Filling gap:** ETFs tied to a sector or industry may be used to gain exposure to new and important sectors.

(vi) **Equitising Cash:** Investors having idle cash in their portfolios, may want to invest in a product tied to a market bench mark. An ETF is a temporary investment before deciding which stocks to buy or waiting for the right price.

Answer to Question No 3(b):

(i) Since d1 and d2 are required inputs for Black-Scholes option pricing model.

$d_1 = \ln(VS/E) + (r + 0.5\,\sigma^2) \times t / \sigma\sqrt{t}$

[where t=3/12 =0.25, r =0.05, σ =0.22, VS =597.12, E = 600]

$= \ln(597.12/600) + [0.05 + 0.5 \times (0.22)^2] \times 0.25 / 0.22\sqrt{0.25}$

$= \ln(0.9952) + 0.742 \times 0.25/0.11$

$= (-0.00481 + 0.01855)/0.11 = 0.125,$

$d_2 = d_1 - \sigma\sqrt{t} = 0.125 - 0.22\sqrt{0.25} = 0.015$

$N(d_1) = N(0.125) = 0.5498,\ N(d_2) = (0.015) = 0.5060$

We can use those to solve the equation in Black-Scholes option Pricing model.

Value of CALL Option (Vco) : $V_s N(d_1) - Ee^{-rt} N(d_2)$

[where, $e^{-rt} = e^{-0.05 \times 0.25}$

$= e^{-0.0125}$

= 0.98758 (given)]

Vco = 597.12 x 0.5498 – 600 x 0.98758 x 0.5060

= 328.30-299.83= ₹ 28.47

Hence Value of 3 month CALL OPTION on the stock of Apshara Ltd is ₹ 28.47.

(ii) Value of PUT OPTION (Vpo) :

C + PV of E - So
= 28.47+600x0.98758-597.12
= 28.47+592.55-597.12
= 28.47-4.57
= ₹ 23.90

[where, So = Current price of stock
C = value of call
E = Exercise Price]

Hence, Value of Put option (Vpo) is ₹ 23.90

STRATEGY : (iii) & (iv)

Option	Actual Option Price ₹	Fair Option Price ₹	Valuation	Decision
(iii) CALL (iv) PUT	26 25	28.47 23.90	Under Over	Bye Call Option Sell Put Option

Answer to Question No 3 (c) :

The IT Act 2000 empowers the Government departments to accept filing, creating and retention of official documents in the digital format. The Act also put forward the proposal for setting up the legal framework essential for the authentication and origin of electronics record / Communication through digital signature.

The Act legalizes the email and gives it the status of being valid form of carrying out communication in India.

Digital signatures and digital records have also been awarded the status of being legal and valid means.

The Act now allows government to issue notification on the web thus heralding e- Governance.

The Act also provides statutory remedy to the corporates in case the crime against the accused for breaking into their computer systems or network and damaging and copying the data is proven. The remedy provided by the Act is in the form of monetary damages, not exceeding 1 Crore ($ 200000).

The law sets up the Territorial Jurisdiction of the Adjudicating officers for Cyber Crimes and Cyber Regulation Appellate Tribunal.

The law has laid guidelines for providing Internet Services on a license on a non exclusive basis.

Question:

4(a) Describe briefly the main features of Venture Capital Financing. 5

(b) Ms TANIA an investor has invested in three Mutual Fund Schemes as per detailed below:

	MF-A	MF-B	MF-D
Date of Investment	01.12.2010	01.01.2011	01.03.2011
Amount of Investment	₹ 75000	₹ 150000	₹ 75000
Net Asset Value (NAV) at entry date	₹ 10.50	₹ 10.00	₹ 10.10
Dividend received up to 31.3.2011	₹ 1425	₹ 22.50	NIL
NAV at 31.3.2011	₹ 10.40	₹ 10.10	₹ 9.80

Required:

What is the effective yield on per annum basis in respect of each of the three schemes to Ms Tania up to 31.3.2011? (Ignore time value of Money) 4

(c) The financial data of ROYAL FABRICS LTD. is as follows:

Paid-up Capital (4 lakh Shares)	₹ 40 lakh
Reserve and Surplus	₹180 lakh
Profit after Tax	₹ 32 lakh

The P/E multiple of the shares of Royal Fabrics Ltd is 7.

The Company has taken up an expansion project at Noida. The cost of the project is ₹ 200 lakh. It proposes to fund it with a term loan of ₹ 100 lakh from IDBI and balance by a right issue.

The rights will be priced at ₹ 25 per Share (₹ 15 premium).

Requirements:

(i) Calculate the value of the rights and the market Capitalization of Royal Fabrics Ltd. after the rights Issue, and

(ii) Calculate the Net Asset Value (NAV) of the Shares after the rights issue. 2+2+2=6

(d) On May 28th, the June, July and August contracts of LMN LTD. are open for trading on the stock exchange. All three contracts have exercise prices of ₹ 50. The current market price of the stock is ₹ 48. All of the LMN call options are trading at premiums. In addition, the premium for August is more than that of July and for July more than that of June. How? Explain. 5

Answer to Question No 4 (a) :

Venture Capital Financing

Venture capital is long term risk capital to finance high technology project which involves risk but at the same time has strong potential for growth.

Some of the features of venture capital financing are:

(i) Venture capital is usually used in the form of equity participation. It may also take the form of convertible debt or long term loan.
(ii) Investment is made only in high risk but growth potential projects.
(iii) Venture capital is available only in high risk but high growth potential projects.
(iv) Venture capital joins the entrepreneurs as a co-promoter in project and shares the risk and rewards of the enterprise.
(v) There is continuous involvement in business after making an investment by the investor.
(vi) Once the venture has reached the full potential the venture capitalist disinvests his holdings either to the promoters or in the market.
(vii) Venture capital; is not just injection of money but also an input needed to set to the firm design its marketing strategy and organize and manage it.
(viii) Investment is usually made in small and medium scale enterprises.

Answer to Question No 4 (b) :

CALCULATION OF EFFECTIVE YEILD ON PER ANNUM BASIS IN RESPECT OF THEIR MUTUAL FUND SCHEMES TO MS TANIA UPTO 31.3.2011

		MF-A	MF-B	MF-D
1. Investment	₹	7500	150000	75000
2. No of Units (W_1)Particulars	₹	7142.86	15000	7500
3. Unit NAV on 31.3.2011	₹	10.46	10.10	9.80
4. Total NAV on 31.3.2011 (2 x 3)	₹	74285.74	151500.00	73500.00
5. Increase/Decrease of NAV (1-4)	₹	(714.26)	1500.00	(1500.00)
6. Dividend Recieved	₹	1425.00	2250.00	NIL
7. Total yield (5+6)	₹	01.12.2010	01.01.2011	01.03.2011
8. Number of Months		4	3	1
9. Effective Yield P.A. (W2)	(%)	2.84%	10.00%	(24%)
Working Notes : (W_1) Investment ÷ NAV on entry date (W_2) [Yield = (Total yield Investment) x 12/ No of month]		75000 ÷ 10.50	150000÷ 10	75000÷ 10

Alternative Solution to Question No 4 (b) :

CALCULATION OF EFFECTIVE YEILD ON PER ANNUM BASIS IN RESPECT OF THEIR MUTUAL FUND SCHEMES TO MS TANIA UPTO 31.3.2011

Particulars			MF-A	MF-B	MF-D
1.	Investment	₹	7500	150000	75000
2.	No of Units (W_1)	(1÷3)	7142.86	15000	7500
3.	NAV on entry date	₹	10.50	10.00	10.00
4.	Unit NAV on 31.03.2011	₹	10.40	10.00	9.80
5.	Total NAV on 31.3.2011	₹	74285.74	151500.00	73500.00
6.	Increase/Decrease of NAV (1-5)	₹	(714.26)	1500.00	(1500.00)
7.	Dividend Recieved	₹	1425.00	2250.00	NIL
8.	Total yield (6+7)	₹	710.74	3750.00	(1500.00)
9.	Date of Investment		01.12.2010	01.01.2011	01.03.2011
10	Number of Days		121	90	31
11.	Effective Yield P.A. (%) [8÷1) x 365/No. of days]		2.86%	10.13%	(23.55%)

Answer to Question No 4 (c) :

ROYAL FABRICS LTD

Total loan to be raised	:	₹ 100 Lakh
Amount to be raised through rights issue	:	₹ 100 Lakh
Total amount required for expansion project	:	₹ 200 Lakh
Right Price (Including Premium)	:	₹ 25 Lakh
Number of rights shares to be offered	:	100 lakh ÷ 25 = 4 Lakh

Therefore, one rights share to be offered for every one existing share.
Existing EPS : ₹ 32 lakh ÷ 4 Lakh share = ₹ 8
Price - earning ration : 7, Market Price per share (7 x 8) : ₹ 56

Value of right (R) = $\frac{P_0 - S}{N+1}$

Where, P_0 = Cum rights market share price
S = Subscription price of rights share
N = Number of existing shares required for a rights issue

Value of right (R) = $\frac{56-25}{1+1}$ = ₹ 15.50

Market Value after right issue = $\frac{NP_0+S}{N+1} = \frac{1\times56+25}{1+1}$
$= \frac{81}{2}$ = ₹ 40.50

Number of shares outstanding after rights issue : 800000 Shares

MARKET CAPITALISATION : Ex-rights price × No of shares outstanding
= Rs. 40.50 × 800000 = Rs. 32400000

CALCULATION OF NET ASSET VALUE PER SHARE AFTER RIGHTS ISSUE :

Paid up Capital	:	8000000
Reserves and Surplus :	₹	
Existing	18000000	
Premium on Rights issue	6000000	24000000
Network of Royal Febrics	₹	32000000

Net asset Value per share : 32000000 ÷ 800000 = ₹ 40 per share

Answer to Question No 4 (d) :

We know that premium is comprised of two parts viz intrinsic value and Time Value. Intrinsic value will be greater than zero only if by exercising we get gains. In this case since the option is not exercised, these premiums reflect the "time value" of the contract. The fact that there is still time left to expiration for the price to move in a favourable direction means that the buyers are willing to pay a premium for the contract. We would expect that the premium for the August contract would be higher than the premium for July contract and the premium for the July contract would be higher than the premium for the June contract. Obviously the fact that the August contract expires one month after the July contract and that the August contract expires two months after the June contract means that a purchaser would be willing to pay correspondingly higher prices for later expirations as there is more time available for the buyer to exercise the contract.

The premium for the June contract might be say 3, the premium for the July Contract might be 4.5, and the premium for the August contract might be 5.75.

SECTION-II (40 Marks)
(Corporate Laws)

Answer Question No. 5 *which is compulsory and any two from the rest in this Section.*

Question:

5 (a) Match the items in part A with the most appropriate one in Part B: 1x 5 =5

Part A	Part B
(i) Appeal against refusal for registration	i) Section 13 of the Companies Act, 1956
(ii) First directors of the company	(ii) Are to appointed and not elected
(iii) Memorandum of Association to contain certain particulars	(iii) Code of best practices
(iv) Cadbury Committee	(iv) Governance Standards
(v) Clause 49 of the listing Agreement	(v) Section 111 of the Companies Act, 1956
	(vi) Are to be elected and not appointed
	(vii) Code of risk management

(b) Fill in the blanks in the following sentences by using appropriate words/Phrases:

(i) For all listed companies as well as public limited companies whose paid-up capital and free reserves exceed rupees _______ crore or turnover exceeds rupees ________ crore there should be a certification by the CEO and CFO.

(ii) The minimum number of member in a Nomination Committee is _________.

(iii) Any person aggrieved by any decision or order of the Competition Commission may file an appeal to the _________.

(iv) In the context of classification of risks, Elections will fall under _______.

(v) The recommended minimum size of Independent directors in all listed Companies by SEBI is _______.

1 x 5 =5

Answer to Question No 5(a):

	Matching
Part A	**Part B**
(i)	(v)
(ii)	(ii)
(iii)	(i)
(iv)	(iii)
(v)	(iv)

Answer to Question No 5 (b) :

(i) → 10 50

(ii) → Two

(iii) → Supreme Court

(iv) → Political Risks

(v) → One-half of the board

Question:

6 (a) What is meant by "Sweat Equity Share"? When can the same be issued by a company as per the provisions of the Companies Act, 1956? 2+4 =6

(a) Mr. ANUP KUMAR was a member of the Competition Commission of India. He ceased to be such member on 31st March, 2011. Thereafter, he was offered the post of Executive Director with appropriate remuneration and perquisites in the following organizations to join his duties on from 1st June, 2011:

(i) ASHLEEN LTD., a privet sector public Limited company, whose case was disposed off by the Competition Commission under the provisions of the Competition Act, 2002 in the month of February, 2011

(ii) Life Insurance Corporate of India.

You are required to state with relevant provisions of the Competition Act, 2002, the option available to Mr. Anup Kumar in respect of accepting the above offers. 2+2+2 =6

(c) DHONI SYNTHETICS LTD. has sent two different notices for holding two separate Annual General Meetings (AGM), one relating to adjourned AGM of earlier year and another relating to AGM of current year. Both AGMs are scheduled to be held on 30th June, 2011 one in the forenoon and another in the afternoon. A shareholder raises an objection that two AGMs cannot be held on the same day. Is his Contention Correct? 3

Answer to Question No 6 (a) :

Sweat equity shares

For the purposes of sec. 79-A, the expression **'Sweat equity shares'** means equity shares issued at a discount or for consideration other than cash providing know-how or making available rights in the nature of intellectual property rights or value addition by whatever name called [Explanation II to Sec. 79-A(1)].

The expression "a company" means the company incorporated, formed and registered under the Companies Act, 1956 and includes its subsidiary company incorporated in a country outside India [Explanation I to Sec. 79-A(1)].

Issue of sweat equity shares – Notwithstanding anything contained in Sec. 79 (which deals with the power of a company to issue shares at a discount), a company may issue sweat equity shares of a class of shares already issued if the following conditions are fulfilled, namely –

(a) the issue of sweat equity shares is authorised by a resolution passed by the company in the general meeting.

(b) the resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity are to be issued.

(c) not less than one year has at the date of the issue elapsed since the date on which the company was entitled to commence business;

(d) the sweat equity shares of the listed company are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf [Sec 79-A (1)].

Answer to Question No. 6 (b)

The Chairperson and other Members shall not, for a period of one year from the date on which they cease to hold office, accept any employment in or connected with the management or administration of, any enterprise which has been a party to a proceeding before the commission under this Act (Section 12 of the Competition Act 2002).

Provided that nothing contained in this Section shall apply to any employment under the Central Government or a State Government, or local authority or in any statutory authority or any Corporation established by or under any Central, State or Provincial Act or Government Company as defined in section - 617 of the Companies Act, 1956 (1 of 1956).

Based on the above provisions of the Competition Act 2002, Mr. Arup Kumar will not be able to accept the offer of ASHLEEN LTD for one year from the date of the cessation as a member of the Competition Commission since the said company was a party to the proceedings before the Commission.

However, since Life Insurance Corporation of India is a Corporation established under the Central Act, the above restriction does not apply and Mr. Arup Kumar can accept the offer to join as the Executive Director of the said Corporation with effect from 1st June, 2011.

Answer to Question No 6 (c) :

Holding two AGMs on the same day 3

There is no provision in the Companies Act prohibiting the holding of two AGMs on the same day.

If the Articles do not contain any provision to the contrary, AGM for the current year as also for the previous year can be held on the same day.

There should, however, be separate notices for each meeting and they should be held at different timings. This has been complied with. Hence the shareholder's contention is incorrect, assuming that the Articles do not have any restriction for holding two AGMs on the same day.

Question:

7.(a) The Public Information Officer of Delhi Municipal Corporation has turned down the request for information lodged by Mr. Kamal Hassan on the grounds that the request was sent through an e-mail and on the ground that the same was in Hindi and not in English. Are his contentions correct in law as per the RTI Act, 2004? 4

(b) In the Context of Risk Management considerations, what are the key factors to be included in the Check List prepared on assignment of risk ownership? 4

(c) Can it be said that Management Audit incorporates in itself, an efficiency Audit? What are the main objects of efficiency Audit? 7

Answer to Question No 7 (a) :

Request for information under RTI Act through email

Section 6(1) of the RTI Act enjoins that a person desirous of obtaining information shall make a request in writing or through electronic means in English or in the official language of the area in which the application is being submitted, to the Public Information Officer.

The section makes two things clear:

(a) The request can be through electronic media. Email is an accepted form of electronic communication;

(b) The request can be in English or in the official language of the area in which the application is being submitted. In Delhi, Hindi is the official language of the area.

Therefore the refusal on the grounds that the request was not in English and that the same was sent through email is not justified.

Answer to Question No 7 (b) :

Checklist on assignment of risk ownership:

- Have owners been allocated to all the various parts of the complete risk process and the full scope of the risks being created for? For example, suppliers may be tasked with ownership of assessing and evaluating risk as part of their contracts.
- Are the various roles and responsibilities associated with ownership well defined?
- Do the individuals who have been allocated ownership actually have the authority in practice to fulfill their responsibilities?
- Have the various roles and responsibilities been communicated and understood?
- Are the nominated owners appropriate?
- In the event of a change, can ownership be quickly and effectively reallocated?
- Are the differences between benefit and delivery risks clearly understood and, if required, do they have different owners?

Answer to Question No 7 (c) :

Management Audit incorporates in itself an efficiently audit. Efficiently audit ensures "application of the basic economic principle so that resources flow into the most remunerative channels".

The main object of efficiency audit is to ensure that

1. Every rupee invested in capital or in other fields give the optimum returns and
2. The planning of investment between the different functions and aspects is designed to give optimum result.

The parameters for measuring efficiency with its concomitant details are

1. Overall rate of return on capital employed
2. Better capacity utilization
3. Better utilization of raw material, power, labour, equipments and finance
4. Effective incentive system
5. Better export performance and import substitution
6. Cost Control

It is necessary to make study activity wise so as to identify areas of deficiency in particular activity.

To conclude we can infer saying that investor in order to protect his investment in any company expects proper exhibition of corporate governance which is taken care by Management Audit as Management

Audit would encompass compliance audit, efficiency audit, propriety audit and systems audits as well as management audit is concerned with the overall objectives of an organization.

Question:

8. (a) Mr. BHUSHAN is holding the post of Director in five companies out of which SAMAROH LTD. is one. For the financial year ended on 31st March, 2010, Samaroh Ltd. failed to pay interest on loans taken from a financial Institution and also failed to repay the matured deposits. On 1st July, 2010 Mr. Bhushan accepting the post of additional director in Fedex Ltd, submitted a declaration that the disqualification specified in Section 274 of the Companies Act, 1956 is not applicable in his case.

Decide whether the declaration submitted by Mr. Bhushan to Fedex Ltd. is in order. 6

(b)"A good Corporate Governance should have certain basic principles"- Enumerate them. 6

(c) State the additional requirements stipulated in Section 292A of the Companies Act, 1956, which are silent in clause 49 of the Listing Agreement. 3

Answer to Question No 8 (a) :

As per section 274(1)(g), a director of a public company shall be disqualified from being appointed as a director in any other public company, if the public company in which he is already a director-

(a) Does not file the annual accounts and annual returns for any continuous 3 financial years commencing on and after 1.4.1999; or

(b) Fails to repay its deposit or interest thereon due date or redeem its debentures on due date on pay dividend and such failure continues for one year or more.

In this present case, Samaroh Ltd. has committed the following defaults:

(a) Failure to pay interest on loans taken from a financial institution for the financial year ended on 31st March, 2010. However, such failure does not attract the disqualification under section 274(1)(g), since the disqualification is incurred only if the default relates to payment of 'public deposits', and not on non-payment of interest on 'loans' obtained from a financial institution.

(b) Failure to repay the matured deposits on due date for financial year ended on 31st March, 2010.

Default in payment of matured deposits or interest thereon would result in applicability of section 274(1)(g), only if such default continues for 1year or more. In the absence of any information, it may be assumed that such default has not continued for 1year, as on 1st July, 2010. Accordingly none of the directors of Samaroh Ltd. are disqualified under section 274(1)(g). Hence Mr. Bhushan can be appointed as an additional director of Fexed Ltd. on 1st July 2010, and so the declaration given by Mr. Bhushan is in order.

Answer to Question No 8 (b) :

Principles of corporate governance: A good governance should include the following principles :

(i) **Review of operation-** There should be review of operations of the company at a regular interval. It may include comparison of monthly/quarterly production and sales targets with actual, cash flow analysis, etc.

(ii) **Compliance with Statutory and Regulatory Requirements –** The Board Should ensure compliance with various statutory and regulatory requirements. It may include clearance of statutory dues, compliance with FERA regulations, following suitable accounting policies and standard, etc.

(iii) **Appointment of various committees-** There should be appointment of various committee to look after different matters. There can be following committees-(a) Audit Committee, (b) Grievance Committees, (c) Remuneration Committee and (d) Investment Committee, etc.

(a) Audit committee- It should meet periodically to review the effectiveness of the system of internal controls and reports to shareholders.

(b) Grievance committee- It should look after the grievances from customers, suppliers, creditors in respect of price, quality, discount, etc. It should also look after the problems of executives/employees of the organization.

(c) Remuneration committee- Its role should be to fix remuneration of non-executive directors. It may be fixed in relation to company performance.

(d) Investment committee- It should look after the investment decisions. It should be in accordance with the guidelines approved by the Board. Shareholders expect that investment decisions are judicious and do not incur any losses, which affect shareholder's interest.

(iv) **Contribution of employees' Union-** Employees or worker's union should also contribute significantly to good corporate behaviour by promoting work culture. In this case, inclusion of employees or worker's representative on the board may be thought of.

(v) **Contribution to Community Development-** A good corporate governance should help community development programme by active participation. It should adopt measures for pollution control, and follow fair and ethical business practices.

Good corporate governance calls for accountability for all concerned. The Shareholders, Directors, auditors, executives, advisersand other staff who are associated with the working of the corporate should combined their efforts to improve the system and ensure good management practices.

Answer to Question No 8(c):

Additional Requirements Stipulated as per Section 292 A:

The following additional requirements are stipulated as per section 292A of the companies Act, 1956 which are silent in clause 49 of the Listing Agreement:

(i) The audit Committee Constituted shall act in accordance with terms of reference to be specified in writing by the board.

(ii) The recommendation of the audit Committee on any matter relating to financial management, including the audit report, shall be binding on the board.

(iii) If the board does not accept the recommendations of the audit committee, it shall record the reasons therefore and Communicate such reasons to the Share holders.