Paper-11 Capital Market Analysis & Corporate Laws

Time Allowed: 3 hours **Full Marks: 100**

Working notes should form part of the answers.
Wherever necessary, suitable assumptions should be made and indicated in answer by the candidates.

Section I
(Capital Market Analysis)

Answer **Question No.1** (carrying 20 marks) which is compulsory and answer **any two** (carrying 20 marks each) from the rest in this section

1. (a) In each of the cases given below, one out of four is correct. Indicate the correct answer (=1 mark) and give workings/ reasons briefly in support of your answer (=1 mark) [7 x 2]

(i) The shares of NALANDA LTD. are trading at ₹ 370. If put options with a strike price of ₹ 380 are priced at ₹ 20, the intrinsic value and time value of the options respectively are :
(A) ₹ 8, ₹ 8
(B) ₹ 10, ₹ 10
(C) ₹ 8, ₹ 10
(D) Incomplete information

(ii) BSE Index is currently quoting at 1620. Each lot is 300. MS ASHA, an investor purchases a July contract at 1710. She has been asked to pay 8% initial margin. What is the amount of initial margin required to be paid by her?
(A) ₹ 31,800
(B) ₹ 41,040
(C) ₹ 44,810
(D) None of the above

(iii) MR. ROHON has purchased a stock of MAX OILS LTD. (MOL). Currently the company pays dividend of ₹ 8.50 per share. Thereafter the dividend is expected to grow at a constant rate of 6.5% p.a. the stock of MOL has beta of 1.40. If the risk free rate of return is 7.5% p.a. and the expected market return is 12% p.a., what would be the stock's expected price four years from now?
(A) ₹ 137.79
(B) ₹ 159.53
(C) ₹ 163.18
(D) None of the above

(iv) The closing prices of the stock of LORRETO LTD on five consecutive trading days are as under:

Days	Closing Prices(₹)
0	274.90
1	275.60
2	268.00
3	270.00
4	272.00

The Relative Strength of the stock of Torrent Ltd. is
(A) 1.0169
(B) 1.0366
(C) 1.0925
(D) None of the above

(v) MS. SADAB holds a portfolio consisting of two stocks-stock A and stock B. Stock A has a standard deviation of returns of 0.6 and stock B has a standard deviation of 0.80. The correlation co-efficient of the two stock returns is 0.50. If MS. Sadab holds equal amount of each stock, what will be risk of the portfolio consisting of two stocks?
(A) 0.40
(B) 0.52
(C) 0.61
(D) Insufficient Information

(vi) MR.AMIT is planning to construct a minimum risk portfolio by investing in the shares of ARIHANT LTD. and SPARK LTD. The risk associated with the returns of Arihant Ltd. and Suzlon Ltd. are 23% and 25% respectively. If the co-efficient of correlation between the returns of shares of both companies is "O" , the proportion of Funds to be invested in the shares of ARIHANT LTD. is
(A) 45.84%
(B) 54.16%
(C) 66.67%
(D) Insufficient Information

(vii) SIDBI came out with an issue of Deep discount Bond. Each bond having a face value of ₹1,00,000 was issued at a deep discounted price of ₹5,000 with a maturity period of 25 years from the date of allotment. The corporate tax rate applicable is 20%. If the Indexed Cost of acquisition is 6%, what will be the Post tax Yield to maturity of the bond?
(A) 14.90%
(B) 11.96%
(C) 10.10%
(D) None of (A), (B), (C)

(b) Choose the most appropriate one from the stated options and write it down: [6×1]

(i) The following Act empowers the government departments to accept filing, creating and retention of official documents in the digital format:

(A) Indian Companies Act, 1956
(B) E commerce Act, 2011
(C) Information Technology Act, 2000
(D) None of the above

(ii) The Board for Financial Supervision (BFS) was constituted in November, 1994 as a Committee of:

(A) The Ministry of Finance
(B) The Central Board of Directors of the RBI
(C) The Ministry of Company Affairs
(D) Incomplete information

(iii) Which of the following statements is/are true?

(A) If market price = face value, then Coupon Rate > YTM > Current Yield
(B) If market price < face value, then Coupon Rate > Current Yield > YTM
(C) If market price > face value, their Coupon Rate > Current Yield > YTM
(D) If market price = face value, then Coupon Rate < Current Yield < YTM

(iv) Which of the following option strategies involve the purchase of call options and writing of put options are exactly the same exercise price?

(A) Synthetics
(B) Spreads
(C) Conversions
(D) None of the above

(v) If an investor believes that the probability of the price of a stock moving up is higher than the probability of the price plummeting, he/she 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 in-the-money put.
(C) Buy an in-the-money call and buy an out-of the money put.
(D) Sell an out-of-the money call and buy an in- the – money put

(vi) Which among the following increases the NAV of a Mutual Fund Scheme?

(A) Value of investments
(B) Receivables
(C) Accrued Income
(D) All of the above.

2. **(a)** Discuss about the two categories of underwriters in India. **[6]**

(b) Mr. DEBASHIS KAPOOR, analyst at PRUDENTIAL SECURITIES LTD is considering the stocks of SUZLON LTD. and ZOOM LTD. for investment. Expected returns on these stocks depend on the growth rate of the GDP. The conditional Returns of the Stocks and the returns of the market are given below:

Economic Scenario (GDP Growth rate)	Probability	Returns associated with (in %)		
		Suzlon Ltd.	Zoom Ltd.	Market
Less than 1.00%	0.20	-12	15	-15
1.00-2.50%	0.15	30	35	20
2.50-5.00%	0.30	40	20	30
5.00-7.00%	0.10	20	-30	35
More than 7.00%	0.25	-15	-10	-10

The expected risk-free real rate of return and the premium for inflation are 3% and 5% per annum respectively. Assume that CAPM holds good in the market.

You are required to:
(i) Calculate the ex-ante betas for two stocks.
(ii) Find out whether the stocks of Suzlon Ltd. and Zoom Ltd. are under price or over price.
(iii) Determine the proportions of systematic and unsystematic risk in the two stocks.
(iv) Determine which stock the analyst would suggest to invest, if he is required to select only one stock. Justify.

[6+2+4+2=14]

3. **(a)** The Information Technology Act 2000, though appears to be self sufficient, takes mixed stand when it comes to many practical situations.
Outline few places where it looses its certainty. **[5]**

(b) The market received rumour about ASHEEKA PHARMA LTD'S tie up with a multinational company. This has included the market price to move up . If the rumour is false, Asheeka Pharma Ltd.'s stock price will probably fall dramatically. To protect from this Ms. Kritika, an investor has bought the call and put options.

She purchased a 3-month call option for 100 Stocks in Asheeka Pharma Ltd. at a premium of ₹12 per stock with an exercise price of ₹250. She also purchased a 3-month put option for 100 stocks of the said company at a premium of ₹6 per stock with an exercise price of ₹240.
Required:

(i) Determine the Investor's (Kritika) position if the tie up offer bids the price of Asheeka Pharma Ltd's stock up to ₹260. in 3 months.

(ii) Determine the Investor's (Kritika) position if the tie up programme fails and the price of stock falls to ₹215 in 3 months. **[1+3+3=7]**

(c) Bonds of MOUSHIP TECH LTD., an Engineering Company which carries AA rating with 5 years to maturity and 14.50% coupon rate, payable annually, is being traded at ₹1015.50. You as a Fund Manager of the Trust Fund, a 80% Debt fund, want to ascertain the intrinsic Value and take a decision accordingly. Face Value of the bond is ₹1000.

Your Asset Management Company has laid down the guideline that for AA rated Instruments, the discount rate to be applied is 364 day T-Bill rate+4%. (Assume the 364 day T-Bill rate to be 10%).

You are required to

(i) Calculate the Intrinsic value of the Bond

(ii) Calculate the current yield (CY) and the yield to Maturity of the bond (YTM).

Note: (i) Ignore Flotation Costs and transaction costs,

(ii) Extracted from the table of PV.

Interest rate	10%	11%	12%	13%	14%	15%
PVIFA (5 years)	3.791	3.696	3.605	3.517	3.433	3.352
PVIF (5 years)	0.621	0.593	0.567	0.543	0.519	0.497

[3+4=7]

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

(b) ZESLIN TEXTILES LTD. (ZTL) has under consideration refunding of ₹ 3 crore outstanding Bonds at ₹ 1000 per value as a result of recent decline in long term interest rates. The bond refunding plan involves issue of ₹ 3 crore of New Bonds at the lower interest and the proceeds to call and retire the ₹ 3 crore outstanding bonds.

The details of the new bonds are:

(i) Sale at per value of ₹ 1000 each

(ii) 11 per cent coupon rate

(iii) 20 years maturity

(iv) Floatation costs ₹ 4,00,000 and

(v) A 3 month period of overlapping interest

ZTL's outstanding Bonds were initially issued 10 years ago with a 30 year maturity and 13 per cent coupon rate of interest.

They were sold at ₹ 12 per bond discount from per value with floatation costs amounting to ₹ 1,50,000 and their call at ₹ 1,130.

ZESLIN's Marginal tax rate is 35 per cent.

Required:

(i) Analyse the Bond refunding proposal.
(ii) Would you recommend it? Why?

Note:
Extracted from the Table of PV

Interest rate	7%	7.15%	8.45%	11%	13%
PVIF (20 years)	0.25842	0.25128	0.19743	0.12403	0.08678
PVIFA (20 years)	10.59401	10.47161	9.49787	7.96336	7.02477

[3+3+2+1=9]

(c) Identify the hedging strategies that would be required using the Index Futures under the following circumstances:

Stock	Position	Beta	No. of shares	Price (₹)	Hedge needed
TCS	Long	1.30	1000	1900	Full
WIPRO	Long	1.20	1000	800	Full
CMC	Short	1.10	1000	300	90%
TSL	Short	0.80	1000	400	80%
INFOSYS	Long	1.00	1000	1800	120%

Therefore, higher the Beta higher will be the hedge ratio i.e., the value or futures position would be proportionately be higher and vice-versa. Also the need for full or partial hedging would also have a bearing on the amount of Future exposure.

Futures position = Beta × No. of Shares × Price × % Hedging Required
For the first Case = 1.30 × 1000 × 1900 × 1.00 = ₹ 24.70 Lakh.

Stock	Original Position	Beta	No. of Shares	Price (₹)	Hedge Needed	Hedge Position	Future Strategy (₹) in Lakh	
TCS	Long	1.30	1000	1900	Full	Short	Short	24.70
WIPRO	Long	1.20	1000	800	Full	Short	Short	9.60
CMC	Short	1.10	1000	300	90%	Long	Long	2.97
TSL	Short	0.80	1000	400	80%	Long	Long	2.56
INFOSYSs	Long	1.00	1000	1700	120%	Short	Short	20.40

[2+3=5]

Section II

(Corporate Laws)

Answer **Question 5** (carrying 10 marks) which is compulsory and answer **any two** (carrying 15 marks each) from the rest in this section.

5. (a) Choose the most appropriate alternative from the stated options and write it down: [5×1]

(i) Under the Companies Act, 1956, the first directors shall hold office up to -
(A) The end of the statutory meeting
(B) The end of the period as prescribed by the articles of the company
(C) The end of three years from the date of appointment
(D) Till the first Annual General Meeting

(ii) Buy back of equity shares in a financial year shall not exceed:
(A) 25% of authorized capital;
(B) 25% of called-up capital;
(C) 25% of paid up capital;
(D) 25% of subscribed capital.

(iii) Which of the following items requires special resolution in a general meeting under the Companies Act, 1956?
(A) Issue of shares at discount;
(B) Adoption of Statutory Report;
(C) Appointment of Managing/ Whole-time Director;
(D) Reduction of Share Capital.

(iv) In the context of classification of risk, tax risks will fall under _______.
(A) Credit Risks
(B) Liquidity Risk
(C) Disaster Risks
(D) Legal Risks

(v) In a Public Limited Company there are 10 directors including Managing Director and a nominee of ICICI. How many directors are liable to retire by rotation?
(A) 4
(B) 5
(C) 6
(D) 7

(b) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/ number(s): [5×1]

(i) _______ is not a linear process; it is the balancing of a number of interwoven elements.

(ii) As per Section 205(1A) of the Companies Act, 1956 the amount of interim dividend shall have to be deposited from the date of declaration of such dividend in a separate bank account within ________ days.

(iii) The provisions relating to dissolution of a company and revival of a dissolved company are contained in __________ respectively.

(iv) Shareholders are empowered to transfer their shares by section _____ of the Companies Act, 1956.

(v) As per section 58AA, a small depositor' means a depositor who has deposited in a financial year a sum not exceeding _________ in a company and includes his successors, nominees and legal representatives.

6. (a) Poly Ltd., (hereinafter referred to as 'Seller'), manufacturer of footwears entered into an agreement with City Traders (hereinafter referred to as 'Purchaser'), for the sale of its products. The agreement includes, among others, the following clauses:

(i) That the Purchaser shall not deal with goods, products, and articles by whatever name called, manufactured by any person other than the Seller.
(ii) That the Purchaser shall not sell the goods manufactured by the Seller outside the municipal limits of the city of Secunderabad.
(iii) That the Purchaser shall sell the goods manufactured by the Seller at the price as embossed on the price label of the footwear. However, the purchaser is allowed to sale the footwear at prices lower than those embossed on the price label.

You are required to examine with relevant provisions of the Competition Act 2002, the validity of the above clauses. Section 3(1) prohibits entering into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. Any such agreement, if made, shall be void. **[5]**

(b) Ganga Ltd. and Jamuna Ltd. entered into a scheme of amalgamation by which former would transfer its entire undertaking to the later. However, the Central Govt. raised an objection that unless the objects clause of the companies are similar and the Memorandum empowers to do so, the scheme of amalgamation cannot be permitted. Is the objection of the Central Govt. tenable? **[3]**

(c) State with reference to the relevant provisions of the Companies Act, 1956 whether the following persons can be appointed as a director of a public company:

(i) Mr. P, who has huge personal liabilities far in excess of his assets and properties, has applied to the court for adjudicating him as an insolvent and such application is pending.
(ii) Mr. Q, who was caught red-handed in a shop lifting case two years ago, was convicted by a Court and sentenced to imprisonment for a period of eight weeks.
(iii) Mr. R, a former bank executive, was convicted by a Court eight years ago for embezzlement of funds and sentenced to imprisonment for a period of one year.
(iv) Mr. S is a director of XYZ Limited, which has not filed its annual returns pertaining to the annual general meetings held in the calendar years 2011, 2012 and 2013. **[4]**

(d) The Audit Committee of DULAL PHARMA LTD constituted u/s 292A of the Companies Act, 1956 submitted to the Board of Directors a report containing its recommendations. These recommendations were however not accepted by the Board. In this scenario state your views on the following:

(i) Can the Board adopt the stand of not accepting the Audit Committee's recommendations?
(ii) If yes, that the Board does not accept the recommendations what should the Board do?
(iii) How should the Chairman of the Audit Committee respond? **[1+1+1=3]**

7. (a) In the context of management audit, what is meant by "control risk" vis-a-vis detection of material misstatements in the financial statements? In this regard, what is "Control Risk at the maximum" and "Control Risk at less than the maximum"? **[1+3=4]**

(b) SHIKSHA TELECOM LTD., a private mobile operator had furnished confidential information relating to customer complaints lodged with the company during the quarter ended 31.3.2012 to a public authority. On an application under the Right to Information Act, 2005, the public authority wants to furnish the said information. The authority seeks the objections of SHIKSHA TELECOM LTD.

Can SHIKSHA TELECOM LTD. ask the public authority not to furnish the same on the grounds that the said information is confidential and that it may endanger its image in the market? **[3]**

(c) Can it be said that management audit incorporates in itself, an efficiency audit? What are the main objects of efficiency audit? **[1+2=3]**

(d) ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than $1/10^{th}$ of the share capital of the company apply to the Company Law

Board for the relief against oppression and mismanagement? It is alleged by the said member that the directors of the company have misused their position in making certain inter-corporate deposits which are against the interests of the company. Will the Company Law Board entertain application containing such allegation in the case of private company? **[2]**

(e) What is Abridged Form of Prospectus? Under what circumstances such Abridged Prospectus is not required to be accompanied with the Share Application Form? **[3]**

8. (a) "Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfillment of the requirements of law, but in ensuring commitment of the Board of directors in managing the company in a transparent manner for maximizing stakeholders' value."

In the light of this statement, discuss the various factors which add greater value through good governance. **[8]**

(b) A Managing Director of a Company borrowed a sum of money by executing a document in which he forged the signature of two other Directors who are required to sign as per the requirements of Articles. Can the Company deny liability to Creditors? **[2]**

(c) Six out of seven signatures to the MOA were forged. The Company was registered and the Certificate of Incorporation was issued. Can the registration of the Company be challenged subsequently on the ground of forgery? **[3]**

(d) The Articles of Association of a Private Limited Company contain provisions restricting the right to transfer shares and limiting the number of member to 50. What restrictions are generally incorporated in the AOA in restricting the right to transfer shares? **[2]**