**Q.1. XYZ Ltd. is listed on NSE & BSE. However the stock price of the Company is**

**languishing for more than a year. As a CFO of the Company you are required to make**

**presentation to the Board of the Company on various anomalies/ events that have impact**

**on stock price movements? Also explain in brief the EMH concept.**

**Ans.**

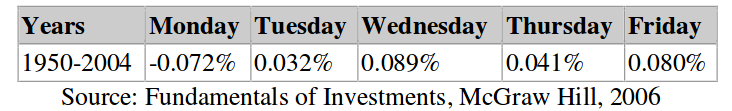
As the efficient market hypothesis defines efficient market is that where all the investors are well

informed about all the relevant information about the stocks and they take action accordingly. Due to their timely actions prices of stocks quickly adjust to the new information, and reflect all the available information. So no investor can beat the market by generating abnormal returns. In the weak form of efficient market technical analysis is useless, while in semi strong form, both the technical and fundamental analysis is of no use. And in strong form of efficient market even the insider trader cannot get abnormal return. But it is found in many stock exchanges of the world that these markets are not following the rules of EMH. The functioning of these stock markets deviate from the rules of EMH. These deviations are called anomalies.

Anomalies that are linked to a particular time are called calendar effects. Some of the most popular calendar effects include the weekend effect, the turn-of-the-month effect, the turn-of-the-year effect and the January effect.

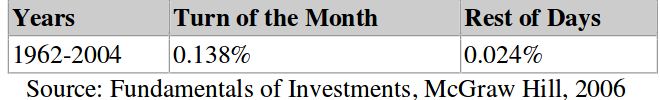
Weekend Effect:

The weekend effect describes the tendency of stock prices to decrease on Mondays, meaning that closing prices on Monday are lower than closing prices on the previous Friday. For some unknown reason, returns on Mondays have been consistently lower than every other day of the week. In fact, Monday is the only weekday with a negative average rate of return.



Turn-of-the-Month Effect:

The turn-of-the-month effect refers to the tendency of stock prices to rise on the last trading day of the month and the first three trading days of the next month.



Turn-of-the-Year Effect:

The turn-of-the-year effect describes a pattern of increased trading volume and higher stock prices in the last week of December and the first two weeks of January.

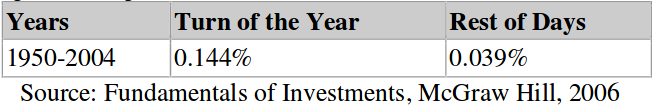


January Effect:

Amid the turn-of-the-year market optimism, there is one class of securities that consistently outperforms the rest. Small-company stocks outperform the market and other asset

classes during the first two to three weeks of January. This phenomenon is referred to as the

January effect.



Occasionally, the turn-of-the-year effect and the January effect may be addressed as the same trend,

because much of the January effect can be attributed to the returns of small company stocks.

Stock Split Effect:

Stock splits increase the number of shares outstanding and decrease the value of each outstanding share, with a net effect of zero on the company's market capitalization. However, before and after a company announces a stock split, the stock price normally rises. The increase in price is known as

the stock split effect.

Small Firms Outperform:

The first stock market anomaly is that smaller firms (that is, smaller capitalization) tend to outperform larger companies. As anomalies go, the small-firm effect makes sense. A company's economic growth is ultimately the driving force behind its stock's performance, and smaller companies have much longer runways for growth than larger companies.

Low Book Value:

Extensive academic research has shown that stocks with below-average price-to-book ratios tend to outperform the market. Numerous test portfolios have shown that buying a collection of stocks with low price/book ratios will deliver market-beating performance. Although this anomaly makes sense to a point (unusually cheap stocks should attract buyers' attention and revert to the mean), this is unfortunately a relatively weak anomaly. Though it is true that low price-to-book stocks outperform as a group, individual performance is idiosyncratic, and it takes very large portfolios of low price-to-book stocks to see the benefits.

Neglected Stocks:

A close cousin of the "small-firm anomaly," so-called neglected stocks are also thought to outperform the broad market averages. The neglected-firm effect occurs on stocks that are less liquid (lower trading volume) and tend to have minimal analyst support. The idea here is that as these companies are "discovered" by investors, the stocks will outperform.

EMH Concept:

Efficient market hypothesis (EMH) is an idea partly developed in the 1960s by Eugene Fama. It states that it is impossible to beat the market because prices already incorporate and reflect all relevant information. This is also a highly controversial and often disputed theory. Supporters of this model believe it is pointless to search for undervalued stocks or try to predict trends in the market through fundamental analysis or technical analysis.

Under the efficient market hypothesis, any time you buy and sell securities, you're engaging in a game of chance, not skill. If markets are efficient and current, it means that prices always reflect all information, so there's no way you'll ever be able to buy a stock at a bargain price.

Proponents of the EMH conclude that, because of the randomness of the market, investors could do better by investing in a low-cost, passive portfolio.

**Q.2. PSL Ltd. is a textile manufacturing Company with annual turnover of Rs. 1,200**

**Crores. The Company has decided to go public to fund the future CAPEX plan. The**

**Company is looking to raise about Rs. 500 Crores. As a CFO, discuss the process and**

**method of listing of the shares in the stock market.**

**Ans.**

Initial Public Offer (IPO) is a process through which an unlisted Company can be listed on the stock exchange by offering its securities to the public in the primary market. The object of an IPO may be relating to expansion of existing activities of the Company or setting up of new projects or any other object as may be specified by the Company in its offer document or just to get its existing equity shares listed by diluting the stake of existing equity shareholders through offer for sale.

Listing provides an exclusive privilege to securities in the stock exchange. Only listed shares are quoted on the stock exchange. Stock exchange facilitates transparency in transactions of listed securities in perfect equality and competitive conditions. Listing is beneficial to the company, to the investor, and to the public at large.

Few important advantages of listing are listed below:

* Fund Raising and exit route to investors:

Listing provides an opportunity to the corporates / entrepreneurs to raise capital to fund new projects/undertake expansions/diversifications and for acquisitions. Listing also provides an exit route to private equity investors as well as liquidity to the ESOP-holding employees.

* Ability to raise further capital:

An initial listing increases a company's ability to raise further capital through various routes like preferential issue, rights issue, Qualified Institutional Placements and ADRs/GDRs/FCCBs, and in the process attract a wide and varied body of institutional and professional investors.

* Collateral Value of Securities:

Listed securities are acceptable to lenders as collateral for credit facilities. A listed company can also borrow from financial institutions easily as it is rated favorably by lenders of capital; the company can also raise additional funds from the public through the new issue market with a greater degree of assurance.

Qualifications for listing Initial Public Offerings (IPO) are as below:

1. Paid up Capital:

The paid up equity capital of PSL Ltd shall not be less than  10 crores \* and the capitalisation of PSL Ltd equity shall not be less than  25 crores\*\*.

\* Explanation 1

For this purpose, the post issue paid up equity capital for which listing is sought shall be taken into account.

\*\* Explanation 2

For this purpose, capitalisation will be the product of the issue price and the post issue number of equity shares. In respect of the requirement of paid-up capital and market capitalisation, the issuers shall be required to include, in the disclaimer clause of the Exchange required to put in the offer document, that in the event of the market capitalisation (Product of issue price and the post issue number of shares) requirement of the Exchange not being met, the securities would not be listed on the Exchange.

1. Conditions Precedent to Listing:

PSL Ltd, shall have adhered to conditions precedent to listing as emerging from inter-alia from Securities Contracts (Regulations) Act 1956, Companies Act 1956, Securities and Exchange Board of India Act 1992, any rules and/or regulations framed under foregoing statutes, as also any circular, clarifications, guidelines issued by the appropriate authority under foregoing statutes.

1. Atleast three years track record of either:
2. PSL Ltd.
3. The promoters of PSL Ltd., incorporated in or outside India or
4. Partnership firm and subsequently converted into a Company (not in existence as a Company for three years) and approaches the Exchange for listing. The Company subsequently formed would be considered for listing only on fulfillment of conditions stipulated by SEBI in this regard.

For this purpose, PSL Ltd shall submit annual reports of three preceding financial years to NSE and also provide a certificate to the Exchange in respect of the following:

* PSL Ltd has not been referred to the Board for Industrial and Financial Reconstruction (BIFR).
* The networth of the PSL Ltd has not been wiped out by the accumulated losses resulting in a negative networth
* PSL Ltd has not received any winding up petition admitted by a court.

\*\*\*\*Promoters mean one or more persons with minimum 3 years of experience of each of them in the same line of business and shall be holding at least 20% of the post issue equity share capital individually or severally.

1. PSL Ltd listing its securities should satisfy the exchange on the following:

There shall be no material regulatory or disciplinary action by a stock exchange or regulatory authority in the past three years against the PSL Ltd.

* Redressal Mechanism of Investor grievance

The points of consideration are:

1. PSL Ltd track record in redressal of investor grievances
2. PSL Ltd arrangements envisaged are in place for servicing its investor.
3. PSL Ltd general approach and philosophy to the issue of investor service and protection
4. Defaults in respect of payment of interest and/or principal to the debenture/bond/fixed deposit holders by the PSL Ltd shall also be considered while evaluating application for listing. The auditor's certificate shall also be obtained in this regard. In case of defaults in such payments the securities of the PSL Ltd may not be listed till such time it has cleared all pending obligations relating to the payment of interest and/or principal.

* Distribution of shareholding:

The PSL Ltd shareholding pattern on March 31 of last three calendar years separately showing promoters and other groups' shareholding pattern should be as per the regulatory requirements.

* Details of Litigation:

The PSL Ltd litigation record, the nature of litigation, status of litigation during the preceding three years period need to be clarified to the exchange.

* Track Record of Director(s) of the Company:

In respect of the track record of the director's, relevant disclosures may be insisted upon in the offer document regarding the status of criminal cases filed or nature of the investigation being undertaken with regard to alleged commission of any offence by any of its directors and its effect on the business of the PSL Ltd, where all or any of the directors of issuer have or has been charge-sheeted with serious crimes like murder, rape, forgery, economic offences etc.

**Q.3. (a) You have joined LMH Ltd. as CFO. The company has annual export turnover of**

**Rs. 700 Crores. The Company is expecting inflow of US$ 5 million in the month of April**

**2017. As a CFO you have to guide the management to hedge the financial exchange risk.**

**Explain various hedging techniques.**

**Ans.**

Hedging is a process by which risk is reduced however, I'll emphasize that unless we liquidate a position, all risk cannot be eliminated. Hedging can reduce most risk, but sometimes we wind up trading one risk for another. Hedging is typically a short-term strategy to protect long-term positions. It may also be utilized to complete an arbitrage transaction. However, you never want to apply a long-term hedging strategy to a short-term position, as that would be costly and add more risk in the long run.

Five essential hedging techniques:

* Pairing:

Pairing seeks to offset a position with a similar but not identical security . For example, let's say we are seeking to hedge a stock position, LMH Ltd. The first step is to identify many characteristics of LMH Ltd. that are relevant to its risk profile.

These include (but are not limited to):

* Industry/sector categorization ("Industries or. Sectors: What's the Difference?")
* Market capitalization
* Beta
* Dividend yield
* Historic volatility
* ("Understanding the Four Measures of Volatility") P/E Ratio
* Price/Book Ratio

The next step is to match up target stocks with similar characteristics. Once we ascertain which stock (or group of stocks) best replicate LMH Ltd.'s risk metrics, we can then perform a correlation of the historic prices of LMH Ltd and the target hedges. If there is a high correlation between LMH Ltd and the potential hedge, we have found the right match.

The final step is to short-sell the hedge and thereby pair up LMH Ltd with the hedge. While the match between LMH Ltd and the hedge is not identical, it might provide some short-term risk protection.

* Short against the box

Selling "short against the box" (SATB) is a unique hedging technique whereby a stock is hedged by short-selling the same exact stock ( "What Do I Need to Know About Shorting Stocks?" ).

This was once a very popular strategy employed by many high- net-worth individuals and hedge funds to avoid capital gains taxes on low-cost- basis holdings.

However, after the abuse of the SATB transaction by the Lauder family when taking Estee Lauder( EL) public (see IPO ) nearly a decade ago ( "Why a Blackstone IPO Makes Sense" ) , Congress placed many restrictions on the use of SATB by eliminating many of its long-term tax benefits. In essence, SATB is now a short-term hedging strategy rather than a long-term hedging and tax-avoidance tactic.

* Exchange-traded funds (ETFs)

Exchange-traded funds ( ETFs ) open up a whole range of hedging possibilities.

Three alternatives:

1. The Spyders
2. Sector-specific ETFs:
3. Inverse and leveraged inverse ETFs:

As with the use of futures, ETFs will provide imperfect hedges and could result in adding more risk rather than reducing risk to our portfolio.

* Futures

Financial futures in foreign exchange rates are contracts to buy or sell an amount of foreign currency at a future date, and are traded on futures exchanges. Example:

The total beta adjusted risk relative to the S&P 500( SPX) ( SPY) for that portfolio was $2,619,000. Each SPX futures contract is for 250 times that index. Let's say the SPX is selling at $1,525. At that price, the market value of each SPX future would be 250 x $1,525 = $381,250. Thus, each SPX future would provide $381,250 of equivalent SPX exposure. With $2,619,000 of portfolio risk, you would have to sell 6.8 contracts ($2,619,000 / $381,250) to fully hedge the position. Since we have to sell whole contracts, our choices would be to sell seven SPX contracts, which would slightly over-hedge the position, or less than seven contracts and slightly under-hedge the portfolio.

* Options

Options are the most complex tool available for hedging. Options require an intimate knowledge of the non-linear aspects of options pricing in order to effectively execute hedge and manage risk.

Three strategies:

* **Selling covered calls**: Selling a call against the position you desire to hedge.
* **Buying puts**: Buying put protection or insurance against your holding(s).
* **Collaring**: Simultaneously selling a covered call and buying a put to lock in a minimum and maximum potential sales price.

**(b) Indian financial system and financial market are witnessing a fast paced liberalization**

**over past few decades. In light of these changes, as a CEO of a new E- commerce Start**

**up, briefly explain various financial services/ payment options that you can offer to all**

**your customers?**

**Ans.**

With a growth rate of 8.5% every year, there are many ways in which Internet has affected Financial Services sector in India, following are the services offered to customers that can be provided by an E-commerce startup:

1. Collateral free loans from Rs. 1 lakh to Rs. 1 crore.
2. Interest rates between x% and y%. Provided that x<y.
3. Instant loan facility and quick online submission of documents, Pre-approved loan for small sellers with limited documentation.
4. While all sellers can apply for loans, but the final call is taken by company after analysing the seller’s quality of business.
5. Loan duration is three to six months.
6. The loan facility is available on invite-only basis.