

Overview of Domestic Capital Markets

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. Financial markets are necessary in an economy –
 - a) Because they enable price discovery for public expenditure.
 - b) Because they enable liquidity of investments when required.
 - c) Because they complement the banking system by reducing risk concentration in financial intermediation.
 - d) Because they determine interest rates in the system.
2. Which of the following financial instruments are not a part of Securities Markets –
 - a) Currency derivatives
 - b) Index futures
 - c) Units issued by REITs
 - d) Securitised debt instruments
 - e) Promissory notes
 - f) Repurchase options
 - g) Participatory Notes
3. OTC market enables investors to –
 - a) Trade freely with any potential buyer or seller through the stock exchange mechanism.
 - b) Trade with counterparties in a bilateral negotiation without any risk of default arising from stock exchange regulations.
 - c) Trade with counterparties through the settlement mechanism of the stock exchange.
 - d) Trade freely with counterparties but the default risk has to be assumed by the respective party.
4. In the capital market, securities are traded –
 - a) Only on stock exchanges under the electronic trading system
 - b) In the secondary market only under the surveillance of the stock exchange as per SEBI regulations.
 - c) In the secondary market as per the settlement system of the stock exchange
 - d) In the secondary market after they are issued in the primary market
5. The Corporate Bond Market in India consists of –
 - a) Corporate long term secured debt paper, unsecured long term bonds issued by banks, financial institutions, corporations, local authorities and PSUs.
 - b) Government securities, SLR bonds and Commercial Paper.
 - c) G-Secs, SLR Bonds, Institutional Bonds and Public Deposits.
 - d) PSU Bonds, Bonds issued by banks and financial institutions and corporates.
6. Under the depository system –
 - a) The depository participant keeps the accounts of the shares held by the shareholders and therefore maintains the register of members of each company.
 - b) The list of beneficiaries of the shares is held by the depository participant while the depository keeps the record of shares of each company.
 - c) The depository is recorded in the register of members maintained by the company

- while individual accounts of members are maintained by the depository participants.
- d) The accounts of beneficiaries are maintained by the depository participants while the accounts of the depository participants are kept by the depository.
7. A debenture trustee mechanism works as follows –
- The beneficiary is the representative of the trust.
 - The debenture trust is the representative of the debenture trustee.
 - The trustee is appointed to hold the debentures on behalf of the beneficiaries of the trust.
 - The debenture holders are the beneficiaries of the trust which is managed by the trustee.
8. The following market intermediaries and support service providers are not regulated by SEBI –
- Portfolio Managers
 - Insurance brokers and risk advisors
 - Depository Participants
 - Custodians
9. A credit rating agency provides –
- Market intelligence to an investor on various companies and investment options.
 - Relative strength of a particular debt option with regard to the regular and timely servicing of interest and repayment of principal.
 - Market intelligence on defaulters, potential defaulters and companies staring at bankruptcy.
 - Guidance to investors on the probable outcome of their investment in a particular security or transaction.
10. One of the drawbacks of the corporate bond market in India has been –
- Lack of credit rating on bond issues by companies.
 - Lack of awareness among investors about the merits of investing in corporate bonds vis-a-vis bank deposits.
 - Lack of interest in secondary trades in the non-institutional secondary market.
 - Complicated structure of bonds issued by companies without adequate guidance to investors.
11. One of the pre-requisites for the development of a municipal bond market is –
- Ensuring that municipal bodies have credit limits from banks.
 - Transparency and GAAP compliant accounting system for municipal bodies
 - Government guarantee for all municipal bond issues
 - Budgetary allocations by governments for timely servicing of municipal bonds
12. Identify the category of securities that is not a part of the Corporate Bond Market –
- Corporate long term secured debt paper, unsecured long term bonds issued by banks, financial institutions, corporations, local authorities and PSUs.
 - Government securities, SLR bonds and Commercial Paper.
 - G-Secs, SLR Bonds, Institutional Bonds and Public Deposits.
 - PSU Bonds, Bonds issued by banks and financial institutions and corporates.
13. Which of the following financial instruments are not a part of Capital Markets –
- Index futures
 - Units issued by REITs
 - Securitised debt instruments
 - Promissory notes
 - Repurchase Options
 - Currency Derivatives
14. A large institutional investor is approached by the controlling shareholders of a listed company to purchase upto 2% of the outstanding shares at a negotiated price which is 20% higher than CMP. Under the SCRA, such a transaction constitutes a –
- Block Deal
 - Bulk Deal
 - OTC Deal
 - Spot Transaction
15. The SME Exchange –
- Is an initiative by SEBI to promote a stock exchange exclusively for SME companies in India.

- b) Is a separate exchange floated by BSE and NSE to list SME companies in India.
- c) Is an initiative to help SME companies in India to list in NSE and BSE as a special category of companies.
- d) Is a separate listing and trading platform for SME companies within the existing organisation of NSE and BSE respectively.
- e) Is a separate platform set up jointly by NSE and BSE to promote the listing of SME companies in India.
- 16. The SCRA –**
- a) Is an enactment that provides the regulatory framework for securities to be listed on a stock exchange by way of a public offer.
- b) Is a statute that provides for regulation of listed companies by the Ministry of Corporate Affairs, Government of India.
- c) Is a statute that regulates the working of stock exchanges, listing and trading of securities on stock exchanges and matters incidental thereto.
- d) Is a statute to regulate the derivatives market in India.
- 17. FEMA plays a role in securities law to the extent of –**
- a) Enabling foreign exchange transactions in securities.
- b) Enabling settlement of foreign exchange transactions in securities.
- c) Enabling remittances connected with foreign exchange transactions in securities.
- d) Dealing with foreign investment in securities of Indian companies, participation in Indian securities markets and matters connected therewith.
- e) Prohibiting foreign investment in Indian securities without the prior approval of the RBI.
- 18. The Securities and Exchange Board of India –**
- a) Is a regulator for the securities market in India consisting of long term and short term securities.
- b) Is a regulator for the capital market while the money market is regulated by the respective banks.
- c) Is a regulator only for primary markets which deal with exchange traded securities.
- d) Is a regulator for the capital market while the money market is regulated by the RBI.
- 19. In a securitisation structure, the future receivables of an issuer emerging from aircraft rentals are securitised to provide cash flows for servicing the proposed issue of securities. Such securitised instruments would be classified as –**
- a) Aviation Derivatives
- b) ATF Bonds
- c) Aircraft Futures
- d) MBS
- e) Pay Through Bonds
- f) Pass Through Derivatives
- g) ABS
- 20. The following amounts to insider trading under the appropriate regulations in India –**
- a) A stock broker receives an order of sale of the shares of a company from his client who is a director on the board of the company.
- b) An employee of an investment bank has not disclosed to the management that his brother is also an employee in the bank in the securities trading division.
- c) The managing director of a company has not disclosed to the board that he has an interest in another company that is proposed to be acquired by the first company.
- d) The CEO of a company acquires shares of the company a day prior to the board meeting in which the proposal to pay a handsome interim dividend was considered. The CEO did not participate in the board meeting though he had knowledge of the agenda.
- e) The auditor of a company acquires shares in the company in violation of law.
- 21. Gamma Developers Ltd., is a start-up gaming company that has received financing interest from select marquee investors from China, Netherlands and Japan. Gamma has been started by two founders - a technology expert and a gaming expert. The negotiations are at**

an advanced stage and the terms are being finalised. At this crucial juncture, the gaming expert starts parallel discussions with one of the proposed investors for a new gaming company to be started by him exclusively. He justifies the discussion stating that the entire brain and IP of Gamma belongs to him and he would therefore not like to share the wealth creation with his partner. The investor is excited by this discussion and they both break away from Gamma to start the new venture. The second founder of Gamma and the other investors in the transaction sue the breakaway founder and investor in the court alleging violation of insider trading regulations and use of price sensitive inside information for wrongful gains. From the following analysis, which one seems technically correct?

- a) There is no violation of insider trading regulations since price sensitive information was shared with all investors. So there will be no liability.
 - b) The founder and the investor are not guilty of violation of the insider trading regulations since they have started a separate company. Gamma's stock is not involved.
 - c) Even though insider trading regulations are violated, no liability can be attached.
 - d) Court is not the authority for enforcement of insider trading regulations. SEBI is.
 - e) Insider Trading Regulations are not applicable to the given facts of the case.
22. Harry Plotter is an expert insider trader who has so far avoided prosecution. He now gets reliable information about a company's success in a critical research project. He gets this information from one of the students who worked with a professor who is an expert in that research area. The professor was explaining to the student how he had analysed the company as a general expert and believed that the company was successful in the research project. Harry immediately places a buy order on the company's stock but before the order could be executed, the enforcement department intervenes and arrests Harry and his broker for insider trading. State the exact position from the given alternatives –
- a) Harry cannot be held guilty as the trade was not concluded.
 - b) There is no insider information since no one from the company was involved.
 - c) The news was merely speculative and does not classify as UPSI.
 - d) The professor was an insider since he knew about the research very well but since he did not tell Harry directly, the violation has not been established.
23. Dealing Dragons Pvt Ltd., (DDPL) is corporate broking house engaged in proprietary trading apart from other client services. As part of its trading strategy, it is in talks with large institutional fund houses to pick up a large amount of shares in Vidharba Agro Ltd., a listed company. One of their discussions has been fruitful and a large fund house has agreed to sell 1.5% of the company's stock to DDPL at a premium of 5% over the ruling market price. Accordingly, on the next day the transaction is concluded between the parties on the regular trading platform of the stock exchange. From the given information, identify the type of transaction –
SPOT DEAL/OTC DEAL/BULK DEAL/
BLOCK DEAL/ON-MARKET DEAL
24. wiztrade.com is a fintech start-up set up by three financial engineers. They will provide an app based solution for clients who could devise their own algorithms for their personal securities trading on the web. As a part of this structure, they would invite clients to sign contracts with them, open trading accounts offered by the company and get access to their app based technology. Clients can then log into their own accounts through the app and the app will guide them how to build their own algorithms. The app then interfaces with their trading account and executes high frequency trades. One of the clients complains to SEBI that the algorithm that he used caused significant losses due to faulty execution of trades. The CEO of Wiztrade says it has no control on what algorithms are being written by clients and it is just a technology platform company. He cites the case of Uber and says his company is not responsible for the conduct of their clients. The client says that since they are enrolling customers, they are representing as a broker of the stock exchange

and so either they or the stock exchange is responsible for faulty trades. Who should be held responsible for the faulty trades? –

CLIENT/START-UP COMPANY/STOCK EXCHANGE

25. House Trade Pvt Ltd., (HTPL) is a corporate broking house engaged in proprietary trading apart from other client services. As part of its trading strategy, it is in talks with large mutual fund to pick up a large amount of shares in Brighton House Ltd., a listed company. The

discussions have been fruitful and the mutual fund has agreed to sell 2,00,000 shares of Brighton House to HTPL at a premium of 0.5% over the ruling market price amounting to a transaction size of ₹22 crore. Accordingly, on the next day the transaction is concluded between the parties on the separate window of the stock exchange. From the given information, identify the type of transaction –

SPOT DEAL/OTC DEAL/BULK DEAL/
BLOCK DEAL/ON-MARKET DEAL

PART - B

26. The principal responsibility of a debenture trustee is to provide a safety net to debenture holders that their interests will be protected in all circumstances for the timely debt servicing on their securities –

YES/NO

27. The Derivative segment is also a market of origination of securities of a non-capital raising nature while the ECM and the DCM originate securities of a capital raising nature.

TRUE/FALSE

28. In a securitisation structure, the future receivables of an issuer emerging from a long term supply contract are securitised to provide cash flows for servicing the proposed issue of

securities. Such securitised instruments would be Asset Backed Securities.

TRUE/FALSE

29. In an insider trading prosecution, it is necessary to show that the accused is an insider possessing price sensitive information that was used for enhancing the profits of the company unfairly.

YES/NO

30. In the capital market, any exchange of UPSI is considered a punishable offence under Insider Trading Regulations if it pertains to a listed company.

YES/NO

ANSWERS

- | | | | | | | | | | |
|----------|------------|---------------|------------|----------------|---------|---------|---------|---------|---------|
| 1. (c) | 2. (e) | 3. (d) | 4. (d) | 5. (a) | 6. (b) | 7. (d) | 8. (b) | 9. (d) | 10. (c) |
| 11. (b) | 12. (b) | 13. (d) | 14. (b) | 15. (d) | 16. (c) | 17. (d) | 18. (d) | 19. (g) | 20. (d) |
| 21. (e) | 22. (c) | 23. BULK DEAL | 24. CLIENT | 25. BLOCK DEAL | | | | | |
| 26. (NO) | 27. (TRUE) | 28. (TRUE) | 29. (NO) | 30. (NO) | | | | | |

Introduction to International Capital Markets

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. One of the factors which make international capital markets extremely important for the growth of both the global economy and individual economies of the world is –
 - a) There are several countries with significant part of their populations below the global poverty line.
 - b) International stock markets are required for global speculative activity of hedge funds and high networth investors.
 - c) International capital markets help corporate businesses to raise capital from the most efficient capital sources on globally competitive terms thereby incentivising high standards of business excellence and corporate governance.
 - d) There is a requirement of uniform price discovery of market assets at an international scale.
2. A company based in Helsinki wishes to float a long term bond of 20 years to global investors based all over the world. The bond will be listed on Stockholm stock exchange and will be issued and redeemed in Swedish Currency. This type of bond is known as –
 - a) Domestic bond
 - b) Foreign Bond
 - c) Euro Bond
 - d) Scandinavian Bond
3. A company based in UK wishes to float a GBP designated Bond with returns based on a floating rate. The floating rate is pegged to the US Fed rate. The bond is listed on LSE and is available for investment to both UK investors as well as foreign investors. This type of bond is known as –
 - a) Domestic Bond
 - b) Foreign Bond
 - c) Euro Bond
 - d) Scandinavian Bond
4. A company based in Hong Kong wishes to float a green bond to finance its renewable energy project in Venezuela. The bond will be listed on NYSE and will be designated in US Dollar. The bond is open for subscription to all investors across US, Latin America and Hong Kong. This type of bond is known as –
 - a) Domestic Bond
 - b) Foreign Bond
 - c) Euro Bond
 - d) Scandinavian Bond
5. In an exchangeable bond structure, the bonds issued by an issuer company will be exchangeable into –
 - a) Lower coupon bonds of the same company at a later date
 - b) Into equity shares at a pre-determined price
 - c) Into convertible preference shares of the parent company
 - d) Into equity shares of another company, usually a target or holding company.

6. A non-banking financial company based in Mumbai wishes to issue a masala bond. The bond shall not be priced above the prevalent all-in cost ceiling of 7.00% and shall carry a minimum tenor of 10 years with a call option after 5 years. Which of the following alternatives satisfies the requirements?
 - a) Dollar denominated with a coupon rate of LIBOR+1.5% (within the 7% ceiling)
 - b) 5 year INR denominated with a coupon rate of LIBOR+1.5% (within the 7% ceiling) with bullet repayment
 - c) 12 year Dollar denominated with a coupon rate of LIBOR+1.5% (within the 7% ceiling) with a call option after 5 years
 - d) 12 year Dollar denominated with a coupon rate of LIBOR+1.5% (within the 7% ceiling) with a call option after 5 years
7. An international depository receipt (DR) is different from a global registered share (GRS) in the following way –
 - a) DR represents debt capital while GRS represents equity capital.
 - b) GRS is a share that can be listed in several jurisdictions in multiple currencies while DR is a separate instrument representing the underlying share of the home currency.
 - c) GRS enables cross-listing of the same share in several countries while DR is a derivative instrument that can be listed only in the home jurisdiction.
 - d) DR entails exchange risk to the investor while GRS being a share with cross listing does not carry any exchange risk.
8. Which of the following describes a securitised debt instrument most appropriately?
 - a) A securitised debt instrument is a bond created out of underlying pools of loans with servicing cash flow which can be tranching into different categories.
 - b) A securitised debt instrument is a speculative trade instrument that is issued by an option writer in the derivative market.
 - c) A securitised debt instrument is nothing but a bond with special features such as put and call options.
 - d) A securitised debt instrument is a convertible bond emerging from underlying cash flows that can be used to pay dividends.
9. Which of the following fits the description of an Offshore Financial Centre (OFC)?
 - a) OFC is a special purpose zone that caters to financial services for the purpose of exporting a country's goods and services.
 - b) OFC is a centre for providing foreign exchange remittance facilities for domestic companies and residents.
 - c) OFC is a free trade zone for establishing export oriented companies engaged in manufacturing and services of various kinds.
 - d) OFC is a designated zone that is regarded as a foreign jurisdiction by the government of a country which is set up to provide international financial services.
10. In a OFC based stock exchange, the following is possible –
 - a) An Indian company can list a domestic bond on an OFC stock exchange.
 - b) An Indian company can list on a foreign stock exchange by registering in the OFC
 - c) A foreign company can list in India through the Indian OFC
 - d) An Indian company can do an international listing by listing in an OFC.

PART - B

11. What is the eurobond market? What are the other segments of international bond markets? Which is the segment that is most suitable to Indian corporates?
12. What is Rule 144A market? Is it beneficial to issuers?
13. How is a GDR different from an ADR? Can an ADR be issued in the Rule 144A market?
14. How does a Global Registered Share differ from an International Depositary Receipt? Why did the market for a GRS wane over time?
15. Explain the characteristics of an exchangeable bond and how it is distinguishable from a convertible bond.

ANSWERS

1. (c) 2. (b) 3. (a) 4. (c) 5. (d) 6. (d) 7. (b) 8. (a) 9. (b) 10. (d)

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Capital Market Financing and Securities

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. A company introduces an offer that whoever buys its car gets 25 shares free of cost from the promoters of the company. This amounts to –
 - a) Primary market issue
 - b) Secondary sale
 - c) HNI issue
 - d) Tied in sale
 - e) Bonus Issue
 - f) Bogus issue
2. A company issued a Zero Coupon Fully Convertible Note with a face value of ₹1,000. Each note would be converted into 8 equity shares of ₹2 each at a premium of ₹98 per share. Each note also has 2 detachable warrants that can be converted into 2 shares at no extra cost to the investor. Assuming the cost of funds to be 10% p.a., how much of the amount collected can be allocated to interest cost by the company if the total conversion period is six months –
 - a) ₹50
 - b) ₹80
 - c) ₹0
 - d) ₹196
 - e) ₹100
 - f) ₹264
3. Which of the following instruments entails cash flow servicing for interest payments?
 - a) Zero Coupon Fully Convertible Debenture
 - b) Zero Interest Convertible Loan
 - c) Fully Convertible Warrant
 - d) Deep Discount Bond
 - e) Partly Convertible Debenture
 - f) Optionally Convertible Debenture
4. The coupon rate of a pure debt security is 12%. The face value of the instrument is ₹1,000. The instrument has a life of 20 years. At the end of every five years, there is an option to convert it into a zero coupon bond with an implicit rate equal to the existing coupon rate. This conversion makes sense if –
 - a) The prevailing market rate is more than 12%
 - b) The marginal tax rate on interest is reduced
 - c) The marginal tax rate on income is reduced
 - d) Income tax on cash flow is increased
 - e) The prevailing market rate falls below 12%
 - f) The investor seeks to defer taxation
5. An equity warrant has an 'exercise price' of ₹50, CMP is ₹75, warrant is convertible into 2 shares and there is a bonus issue (2 for every 1 held) just prior to the conversion. If ex-bonus price corrects homogenously, the economic value of the warrant is –
 - a) ₹50
 - b) ₹100
 - c) ₹125
 - d) ₹250
 - e) ₹150
 - f) ₹225
6. Which of the following instruments has an impact on the EPS of a Company?
 - a) Zero Coupon Bond
 - b) Floating Rate Bond
 - c) Cumulative Convertible Preference Share

- d) NCD with warrant
e) Optionally convertible Step up Bond
f) FRN with coupon strip
7. A Company makes profit before tax of ₹250 million. The effective tax rate is 22% and the company has deferred tax liability of ₹20 million. The company wishes to write back reserves of ₹50 million and declare dividend of ₹105 million. The Dividend Payout ratio works out to –
a) 42%
b) 55%
c) 10.25%
d) 53.85%
e) 60%
f) 28.57%
g) 25.64%
8. If a Silicon Valley constituted fund wishes to invest in infant unlisted Indian companies with the approval of SEBI, it would classify as –
a) AIF
b) FPI
c) FDI Investor
d) FVCI
e) DII
f) FII
9. Which of the following investors does not qualify as FPI in India –
a) SWFs
b) UNICEF
c) Bank of Seychelles
d) The Boston University Endowment Trust
e) Petroleum Corporation of Riyadh
f) Bill Gates Foundation
g) Richard Gere Buddhist Monastery in Lhasa
10. Sir Donald Bradman Cricket Fund of Australia plans to promote Indian cricket by investing into teams that play in the Indian Premier League. It would classify as –
a) AIF
b) FPI
c) FDI Investor
d) FVCI
e) DII
f) FII
11. If a German Engineering giant acquires controlling interest through purchase of shares of a listed Indian company, it would classify as –
a) AIF
b) FPI
c) FDI Investor
d) FVCI
e) DII
f) FII
12. A private equity fund based in Liechtenstein wishes to invest in a private equity fund constituted in India by the Royal Indian Bank. This amounts to –
a) FPI investment
b) FDI Investment
c) Portfolio Investment
d) Fund of Fund Investment
13. A US based investment bank raises an offshore private equity fund with a mandate to invest in other private equity funds (including Sovereign funds) in emerging markets. This amounts to –
a) FPI investment
b) FDI Investment
c) Portfolio Investment
d) Fund of Fund Investment
14. A French cement company floats a SPV in Bahamas to become a Joint Venture partner in an Indian cement company by acquiring the existing stakes of the promoters through a negotiated purchase. This investment would classify as –
a) FPI investment
b) FDI Investment
c) Secondary Market Purchase
d) Mutual Buyback
e) FVCI investment
f) Foreign VCF investment
g) JV investment.
15. The following market intermediaries and support service providers are not regulated by SEBI –
a) STAs
b) Equity Analysts
c) Financial Planners
d) CRAs
e) Custodians
f) Insurance brokers
g) Issue Bankers
h) Debenture Trustees

- i) Portfolio Managers
- j) Investment Advisors

16. Jaguar Investments Pte Ltd., a stock broking entity, wishes to invest in India in a non-banking financial company so as to apply for a banking licence in future. This classifies as –

- a) Strategic FDI
- b) FVCI
- c) Non-banking FDI
- d) FPI
- e) Investment FDI
- f) Capital market FDI
- g) None of the above

17. Elixor Capital is an established investment bank that has expertise in green bonds, structured instruments and credit derivatives concerning ESG investing. One of their clients, Woodlawn Group is one of its valued clients in B2B office property development sector. Due to the Corona crisis, they have been advised to develop future properties with innovative structuring. Elixor has therefore structured an instrument that enables an investor to get lease rights on its properties such that the lease rentals are charged in favour of servicing bond holders. The bond trustee company is the holder of the charges created in favour of bond holders on the lease rights. Classify the above said debt instrument into the appropriate category mentioned below –

STRUCTURED FINANCE PRODUCT/
CREDIT DERIVATIVE/SECURITISED
DEBT INSTRUMENT

18. Primary Capital Services Ltd. (PCS) is an established investment bank that has expertise in structured bonds for raising debt capital for its clients. Regent Developers Ltd. is one of its valued clients in commercial construction sector. For the long term debt requirements of RDL, the issuance department of PCS intends to structure a bond that is secured by property lease rentals from some of the operational assets of RDL. The debenture trustee appointed for the issue insists that the bonds need to be secured against the property given on lease by RDL as per regulations as these are structured bonds. The legal counsel appointed for the issue states that the formation of a securitisation SPV is necessary to create necessary security on the assets and the lease rentals since these are securitised debt instruments. PCS has now consulted its commercial banking affiliate PCS Bank Ltd. which states that it can act as an escrow banker for the issue and there is no need to create any SPV as this is not a securitisation transaction. From the above facts, identify the category of the instrument from the given alternatives –

CORPORATE BOND/CREDIT
DERIVATIVE/SECURITISED DEBT
INSTRUMENT

PART - B

19. Primary Market consists of securities issuances that are offered by eligible issuers to eligible investors based on public offer mechanism.

TRUE/FALSE

20. If an equity share of a company valued at ₹82 is issued by the company to investors at ₹60, it amounts to an issue of the share at a discount and therefore amounts to capital reduction.

TRUE/FALSE

21. If the share of a company does not have any trading in the secondary market due to lack of

interest from investors, it is called an unlisted share.

TRUE/FALSE

22. A company wishes to issue a step-up bond whereby the investor will be paid higher redemption amounts for increased periods of holding. This can be achieved by increasing the YTM of the bond while keeping the coupon and the terminal cash flow constant.

TRUE/FALSE

23. In balancing the upside return on a fixed income security, the investment banker applies

a wait period after which the investor's return is linked to an index future. This feature does not make it a convertible security.

YES/NO

24. In a convertible structure, the conversion price is inversely related to the dilution in the EPS while the EPS is directly related to the conversion price that is linked to the Price-Earnings Multiple.

TRUE/FALSE

25. In a FCD structure, if the investor refuses to agree to the conversion price to be decided on the date of conversion but agrees to the conversion price, the company has an option to decide the conversion price.

YES/NO

26. In a CPS structure, if the shares are made redeemable, the investor gets to encash the redemption price along with cumulative accrued dividend thereon on redemption.

TRUE/FALSE

27. In a ZOCD structure, if the investor refuses to convert the debt into equity on the appointed date, he neither gets equity nor interest and only the original invested amount is returned.

TRUE/FALSE

28. The shareholding from a ZOCD can be structured identical to that from a share warrant provided their coupon rate remains constant.

YES/NO

29. A pay through securitisation structure ensures that the credit rating of a securitised instrument is different from that of the originator since the cash flows are not mapped one on one.

TRUE/FALSE

30. Credit enhancement on a structured debt product is a way of ensuring that in the event of a default on the underlying cash flow, the SPV may still be able to honour its debt servicing to the investors.

TRUE/FALSE

PART - C

31. What are the advantages to the issuer of equity shares as compared to raising finance through issue of debt instruments? How do offers of convertibles score over those of pure equity?

32. What are the main features of debt instruments? What are the distinguishing features of convertible debentures and zero interest debentures?

33. What are the types of debt instruments that can be issued by a company incorporated under the Companies Act? Are there any limitations to issue unsecured debt instruments?

34. What are the implications of discounted debt instruments vis-à-vis interest bearing debt instruments for issuers and investors? Examine from the financial and regulatory angles.

35. Explain the concept of a structured debt product. Illustrate the process of creating a non-securitised debt product with suitable examples.

36. What are the segments of the primary market?

37. Illustrate the process of creating a securitised debt product in the context of REITs and INVITs with a case and suitable diagrams.

38. Explain the essential differences between a 'pass-through' and a 'pay-through' securitisation structure with the help of suitable diagrams.

39. Explain the concept of a CDO and how its risk-profiling can be structured.

40. Explain the character of a synthetic CDO and how a CDS can be structured along with it.

ANSWERS

1. (b) 2. (c) 3. (e) and (f) 4. (e) 5. (b) 6. (c), (d) and (e) 7. (d) 8. (d)
9. (e) 10. (c) 11. (c) 12. (b) 13. (d) 14. (b) 15. (f) 16. (a) or (c)
17. STRUCTURED FINANCE PRODUCT 18. CORPORATE BOND
19. (FALSE) 20. (FALSE) 21. (FALSE) 22. (FALSE) 23. (YES)
24. (FALSE) 25. (NO) 26. (TRUE) 27. (FALSE) 28. (NO)
29. (TRUE) 30. (TRUE)

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CHAPTER 4

Introduction to Investment Banking

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. The following activity constitutes merchant banking under the Indian regulatory framework –
 - a) Preparation of an Offer Document for fund raising through a public issue of securities.
 - b) Taking a public limited company private.
 - c) Providing advice on capital restructuring that includes reduction of capital.
 - d) De-listing a company as a part of corporate restructuring.
 - e) Demerging a listed company and creating a listed subsidiary.
 - f) Syndication of bank loans for an infrastructure project.
2. Watergate Securities (WGS) is a Wall Street securities firm engaged mainly in on-market securities broking, proprietary trading, securities lending and financing. Its parent company which owns 62% of its shares is a SEC registered investment bank by name McKinley (McK) based in Connecticut. McK has strong client base in Philadelphia, Connecticut, Baltimore and New Jersey. It originates different types of financial securities including derivatives. After these securities are introduced into the secondary markets, WGS operates as a market maker for them. For this purpose, McK and WGS entered into an agreement that allows them to share clients and fees. Some of the employees and databases are also used commonly as shared resources. A whistleblower notifies SEC of wrongdoings by both the companies stating violation of the Volcker's Rule. Which of the following describes the correct position? –
 - a) There is no violation since both the companies have a business agreement
 - b) Volcker's Rule is violated since both companies are connected and clients have no information of any sharing by the companies.
 - c) Though there is violation, there is no combination of investment banking with other businesses since they are separate companies.
 - d) Volcker's Rule does not apply in the given case
3. Mahabharat Group is a financial conglomerate that has its origins in broking and underwriting. It gradually expanded to become a leading investment bank called Dritarashtra Capital Services Ltd. It also floated group entities such as Karna Wealth Management, Duryodhan Derivative Traders, Bhishma Asset Management Company, Drone Forex Services, Kunti Financial and Draupadi Microfinance. This structure can be categorised as –
 - a) Universal Bank
 - b) Bulge Bracket Investment Bank
 - c) Boutique Investment Bank
 - d) Pure Investment Bank
 - e) Securities Bank

4. One of the primary reasons for the maligning of investment banks in the Global Financial Crisis of 2008 is the following –
 - a) The disproportionate compensations paid to investment banking heads and their employees which resulted in moral hazards for the government.
 - b) The complexity of the financial contracts written in the OTC derivative segment meant that investment banks were selling products that were priced inappropriately as they did not have balance sheet exposure to any financial risk.
 - c) The compensation structure of investment bankers provided rent seeking opportunity by issue of toxic derivatives that lacked clarity in risk pricing and depth in secondary market trading.
 - d) The compensation structure of investment bankers incentivised more issuances that led to obfuscation of contractual structures by diluting the organic link between the derivative contract and its underlying asset.
 - e) The complexity of the financial contracts written in the OTC derivative segment meant that investors were unable to correctly interpret their outcome in case of a market fall due to the lack of enforcement mechanisms.
5. The failure of credit rating agencies and insurers in the delivery of their functions was instrumental in the Global Financial Crisis of 2008 due to the following phenomenon –
 - a) The rating agencies relied on the strength of the cash flows of the underlying assets in the CDOs and synthetic CDOs while the insurance company placed reliance on the credit rating.
 - b) The emergence of the synthetic CDO and a CDS on top of it was the result of the rating agencies not being able to comprehend the complexity of the instrument they had to rate and the insurers relying on the rating issued to such derivative contracts.
 - c) The structuring of the CDOs was so complex that the rating agencies could not verify the sub-prime nature of the underlying assets and were relying more on the reputation of the issuing investment banks.
 - d) The rating agencies thought that the underlying cash flows are based on mortgages sanctioned by mortgage lenders which had gone through sufficient due diligence process and were therefore of high quality.
 - e) None of the above
 - f) All of the above

PART - B

6. The Glass-Steagall legislation in the USA provided for the combination of commercial banking and investment banking in the financial sector to prevent collapse of stand-alone investment banks –
TRUE/FALSE
7. One of the main unintended fallouts of the Gramm-Leach-Bliley Act of 1999 was that investment banks could access enormous funds across markets thereby taking excessive risks which caused a systemic collapse in 2008.
TRUE/FALSE
8. Sub-prime mortgages were repackaged as CDOs and sold to Wall Street investors by investment banks with AAA ratings secured through credit enhancements and further protected by CDS obligations.
TRUE/FALSE
9. The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 introduced for the first time a way to regulate OTC derivatives by stipulating that they should be cleared through a central clearing mechanism which shall provide counterparty guarantee.
TRUE/FALSE

10. Financial Engineering by an investment banks includes the structuring of a derivative contract de-linking the obligations of such contract with the underlying cash flows or by innovating on such obligations.

TRUE/FALSE

11. Under the Volcker's Rule, investment banks shall not have any affiliations with hedge fund or private equity fund business if such funds invest in companies that compete with the clients of the banks.

TRUE/FALSE

12. In a financial conglomerate structure, the insolvency of one business entity will result

in the insolvency of the other business entities of the group since they belong to the same ownership structure.

TRUE/FALSE

13. One of the failures of the system that precipitated the financial crisis of 2008 was the mispricing of mortgage loans and the consequent asset bubble in the housing industry.

TRUE/FALSE

14. The CDS mechanism ensured that low quality CDOs were given default protection by insurance companies that resulted in a contagion effect.

TRUE/FALSE

PART - C

15. The emergence of global investment banks was largely driven by the needs to serve an increasingly globalising economy. Examine the statement with illustrations.

16. Was the conglomeratisation of banking and financial services a result of regulatory challenges or due to business imperatives? Explain with suitable illustrations.

17. Trace the factors responsible for the stupendous growth of American investment banks into Too-Big-To-Fail institutions.

18. Is universal banking a good business model? Did the US authorities err in their stipulation that pure investment banks should convert themselves into universal banks in the wake of the financial crisis in 2008?

19. Explain the relative strengths and weaknesses of universal banks vis-a-vis pure investment banks.

20. Explain the reasons for conglomeratisation of Indian investment banking and allied services.

ANSWERS

- | | | | | | | |
|------------|------------|------------|-------------|-------------|------------|-----------|
| 1. (a) | 2. (d) | 3. (d) | 4. (d) | 5. (f) | 6. (FALSE) | 7. (TRUE) |
| 8. (TRUE) | 9. (FALSE) | 10. (TRUE) | 11. (FALSE) | 12. (FALSE) | | |
| 13. (TRUE) | 14. (TRUE) | | | | | |

The Business of Investment Banking

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. The following activity does not constitute investment banking –
 - a) Preparation of a Project Report for fund raising for an infrastructure project.
 - b) Advising on a proposed joint venture
 - c) Advising the government on economic policy issues.
 - d) Proprietary trading in derivatives and cash markets.
 - e) Treasury management.
2. Which of the following businesses is regarded as part of investment banking?
 - a) Energy Trading
 - b) Real Estate Investment Trust
 - c) Trading in carbon credits
 - d) Investment advisory and wealth management
 - e) Micro Finance credit
 - f) Financing buyout transactions.
 - g) Money changing
 - h) Currency trading,
 - i) Hedge fund.
3. In investment banking, the following are considered 'core investment banking' –
 - a) Commodity Derivatives
 - b) REITs
 - c) Corporate restructuring
 - d) Microfinance credit
 - e) Financing LBOs
 - f) Weather derivatives,
 - g) Money changing
 - h) Currency trading,
 - i) Fixed Income Trading.
4. Which of the following combinations captures the connotation 'Full Service Investment Banking' better?
 - a) Merchant banking, mortgages, fixed annuities, pension funds and brokerages.
 - b) Merchant banking, superannuation funds, derivatives, letters of credit and guarantees.
 - c) Re-insurance, broking, wealth management and risk advisory.
 - d) Hedge Funds, currency trading, forex advisory, exchange traded real estate fund.
 - e) Asset management, portfolio management, derivatives, equity research, private equity.
 - f) Issue management, corporate advisory, sales and distribution, equity research, asset management.
5. Identify which of the following relationships leads to 'conflict of interest' for an investment bank.
 - a) The securities division enters into a futures contract for a particular stock being covered by the research division.
 - b) A research analyst recommending a particular stock is married to the son of a billionaire champion investor in the stock market.
 - c) A leading investment banker is known to be very close to the managements of

- several leading companies, the public floatations of which, he has handled.
- d) A leading investment bank influences the regulator to bend the rules in its favour.
 - e) The investment bank agrees with a company to sell its stock to investors through the portfolio management scheme run by its wealth management arm.
 - f) The sales and distribution business is primarily run with the commissions earned on marketing of stock issuances by the investment banking business.
6. A limited partner in a private equity fund is promised a return in the following manner – if the fund makes a net appreciation in its stock portfolio as on the last day of the year with reference to the first day by a margin of 20% or more, the limited partner is entitled to 5% thereof subject to deduction of net losses if any, booked during the year. This arrangement can be categorised as –
 - a) Land-mark arrangement
 - b) Preference Share arrangement
 - c) Carry Trade
 - d) Stop Loss Arrangement
 - e) Prime Return Arrangement
 - f) Preferred Return Arrangement
 7. In an asset management structure, if the taxation of incomes and gains is attracted at the investor level and not at the fund level, such mechanism is called a
 - a) Transparent structure
 - b) Tax neutral structure
 - c) Go through structure
 - d) Pass through Structure.
 8. A corporate broker-underwriter shares information about its trades on behalf of clients with another investment bank which handles stock issuances. This amounts to –
 - a) Insider Trading
 - b) Breach of Client Confidentiality
 - c) Conflict of Interest
 9. Which of the following combinations constitutes Core Investment Banking?
 - a) Primary market investing in IPOs, debt market trading and IPO financing
 - b) Stock lending, share financing, sales and distribution of securities
 - c) Securities issuances, corporate advisory, IPO advisory and equity research
 - d) Wealth management through stock and bond investing, hedging and alternative investing, portfolio research
 10. The following transaction is possible for a full service investment bank in Indian capital market –
 - a) Structure a NCD with maturity of 380 days that will be secured against assets of the issuer company, provide risk protection by originating a CDS on the NCD, issue the default free NCD in the primary market through private placement to insurance companies and pension funds.
 - b) Structure a NCD with maturity of 352 days that will be unsecured but rated by an external rating agency, risk protected through a CDS originated through its banking affiliate, make a public issue of the NCD without any market making support in the secondary market.
 - c) Structure an optionally convertible debt instrument (OCDI) that will be secured against future cash flow receivables, provide risk protection by originating a CDS on the OCDI, issuing it in the primary market through private placement and providing market making support in the secondary market.
 - d) Structure a NCD with maturity of 380 days that will be unsecured but rated through an external rating agency, provide risk protection by originating a CDS through its banking affiliate, issue it in the primary market through a public offer without any market making support in the secondary market.
 11. 21st Century Wealth Creators is a start-up company started by two business school graduates upon leaving campus. They will provide wealth management to old people on how to properly bequeath their wealth to their heirs including advising on property matters and wills. As a part of this structure, they would invite their customers to pool their wealth into a corporate entity and take shares

in this entity. Their shares will be transmitted to their heirs according to their wishes after their death. The company will manage the property and estate of its clients in the best interests of

its shareholders to grow their wealth. This type of a structure will classify as –
TRUST FUND/LLP/SPV/PORTFOLIO
MANAGEMENT/NBFC

PART - B

12. Investment Banking and Merchant Banking can be performed on the same balance sheet as that of a NBFC in India.

YES/NO

13. In a mutual fund structure, if the fund generates profits from its investment activity, the general partners are given a top up bonus in addition to their share of dividends.

TRUE/FALSE

14. An AMC structure has been formed by floating the mutual fund in Cayman Islands while the asset management will be done through several AMCs floated across world markets. This is an illegal structure since it does not fall under any particular regulator's purview.

TRUE/FALSE

15. A US underwriter enters into an understanding with its sales and distribution desk to share the underwriting spread with it for promoting the

sale of the securities that it underwrites. This leads to a conflict of interest.

YES/NO

16. Core Investment banking in Indian context is predominantly non-fund based activity while in the US and other developed markets, it is predominantly fund based.

TRUE/FALSE

17. One of the areas in Core Investment Banking is strategic resource planning over a longer period of time for a company's growth and ensuring that fund management is as per corporate governance norms so as to protect the interests of investors.

YES/NO

18. Mr. India Capital, an investment bank wants to merge with Miss India Capital, a commercial bank. The combined entity will be called Mrs India Capital. Will this merger be allowed?

YES/NO

PART - C

19. What are the core services offered by investment banks? How are the different business verticals inter-dependent?

20. Distinguish between merchant banking and investment banking. How are full service investment banks more competent to deliver better value to clients?

21. What is the regulatory framework for investment banking in India? Explain the conglomerate structure permitted in India.

22. Explain the 'conflict of interest' issue in investment banking? Why has it caught the attention of regulators worldwide? What are the measures to address it?

23. Are financial conglomerates a regulatory hazard? Explain the reasons why conglomerate banking has become the order of the day.

ANSWERS

- | | | | | | |
|-----------|-------------|----------------|-----------|----------------|--------|
| 1. (c) | 2. (f) | 3. (c) and (e) | 4. (f) | 5. (a) and (f) | 6. (g) |
| 7. (d) | 8. (b) | 9. (c) | 10. (a) | 11. NBFC | |
| 12. (YES) | 13. (FALSE) | 14. (FALSE) | 15. (YES) | 16. (TRUE) | |
| 17. (NO) | 18. (NO) | | | | |

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CHAPTER 6

Investment Analysis and Valuation

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. Under the DCF method of valuation, the market value of debt is reduced from the PV of the FCFE –
TRUE/FALSE
2. Free Cash flow is the cash flow available to a company in a given period of time that can be used for meeting increased working capital margin requirements for its operations year on year.
TRUE/FALSE
3. Free Cash flow is the cash flow available to a company in a given period of time that can be used for meeting the reinvestment requirements in the business for future growth.
TRUE/FALSE
4. If the IRR of the future free cash flow of a company is equal to its WACC, the valuation of the company is zero.
TRUE/FALSE
5. The tax shelter enjoyed by a company due to interest payments has the effect of increasing the FCFF of the company.
TRUE/FALSE
6. If the marginal rate of tax is used in the estimation of the post-tax cost of debt it has the effect of increasing the valuation of the company.
TRUE/FALSE
7. The CAPM measures the unsystematic risk of a company by taking into account the correlation between the volatility of its stock vis-a-vis the volatility of the market.
TRUE/FALSE
8. The WACC of a company that has a high debt-equity ratio is substantially lower than that of a company with a low debt-equity ratio. Therefore the valuation of the former company would be substantially higher than that of the latter company.
TRUE/FALSE
9. The EBITDA multiple approach to valuation assumes that there are no financial costs to be incurred by the company.
TRUE/FALSE
10. The P/E ratio is a way of analysing the volatility of a company's stock in relation to its earning potential.
TRUE/FALSE
11. In the estimation of value by the DCF method, the surplus cash balances in the company's balance sheet as of the valuation date are added to the DCF value. Only the operating cash balance is deducted.
TRUE/FALSE
12. If a company has no future prospects, DCF valuation cannot be used as the company's going concern concept is not fulfilled. The best method to use in such a situation is the replacement cost method.
TRUE/FALSE

13. In arriving at the Equity Value of a company from the Enterprise Value, the claims of preference shareholders, creditors and employee stock options are deducted.

TRUE/FALSE

14. In a asset heavy company, the book value of assets on the valuation date are added to the DCF estimation in order to arrive at the Enterprise Value.

TRUE/FALSE

PART - B

15. NAV of a company is –

- a) Asset values as reduced by liabilities,
- b) Assets valued at the correct price as reduced by the negotiated values of liabilities
- c) Book Value of assets as reduced by book value of liabilities
- d) Book value of assets as reduced by book value of outside liabilities
- e) Book value of assets

16. In deriving the equity value of a company from its EV, which of the following approaches is used?

- a) The EV is reduced by the outstanding market value of debt, preference capital and reserves and surplus appearing on the balance sheet.
- b) The EV is increased by the NAV of the company.
- c) The equity value is increased by the book value of debt to arrive at the EV.
- d) The EV is reduced by the outstanding market value of debt, preference capital and cash appearing on the balance sheet.

PART - C

17. What are the drivers to value? How should a company strive to maximise value?

18. How is the valuation of a bond different from that of equity? Why are there so many methods of valuing equity?

19. What are the fundamental approaches in the valuation of equity? Do you feel that the free cash DCF models are the most appropriate?

20. What is economic profit? Is it superior to the cash flow approach?

21. How do you differentiate operating cash flow from free cash flow?

22. What are the essential ground rules in financial forecasting? Why is it necessary in valuation?

23. Do you agree with asset based valuation? Does it provide an adequate explanation of value?

24. Explain relative valuation and the main models used therein.

25. What is contingent claim valuation? When it is appropriate to be used?

26. What is the code of ethics that a valuer has to adopt in the process and methodology of valuation?

ANSWERS

- | | | | | | |
|------------|------------|------------|------------|------------|---------|
| 1. (FALSE) | 2. (FALSE) | 3. (FALSE) | 4. (TRUE) | 5. (FALSE) | |
| 6. (FALSE) | 7. (FALSE) | 8. (FALSE) | 9. (FALSE) | 10. (TRUE) | |
| 11. (TRUE) | 12. (TRUE) | 13. (TRUE) | 14. (TRUE) | 15. (d) | 16. (d) |

Domestic Issue Management

OBJECTIVE QUESTIONS WITH ANSWERS

Pick the right answer(s) or the alternative that best fits the given question or situation from the alternatives provided under each question.

PART - A

1. Under the SEBI ICDR Regulations, free pricing of an issue is allowed in the following circumstances –
 - a) The company has net tangible assets of at least ₹3 crore in each of the preceding 3 full years of which not more than 50% is held in monetary assets.
 - b) The company has a minimum average pre-tax profit of ₹15 crore on a consolidated basis during the three most profitable years out of the immediately preceding five years
 - c) The company has a net worth of at least ₹ one crore in each of the preceding 3 full financial years.
 - d) The issue is made through book building route with a minimum of 75% of the NPO allotted to QIBs
 - e) When (a), (b) and (c) are satisfied together or (d) is satisfied
 - f) None of the above from (a) to (d)
 - g) All of the above from (a) to (d)
2. In a book-built issue, the offer document that mentions the cut-off price is known as –
 - a) the Draft Red Herring Prospectus
 - b) the Draft Herring Prospectus
 - c) the Red Herring Prospectus
 - d) the Herring Prospectus
 - e) the Prospectus
3. In a book-built issue, the offer document that mentions the price band is known as –
 - a) the Draft Red Herring Prospectus
 - b) the Draft Herring Prospectus
 - c) the Red Herring Prospectus
 - d) the Herring Prospectus
 - e) the Prospectus
4. In a book-built issue with a price band, the retail investors can bid at –
 - a) the Floor Price
 - b) the Cap
 - c) Any price within the price band
 - d) the Cut-off price
 - e) Higher than Cut-off Price
 - f) Lower than Cut-off Price
5. One of the disclosures supporting Issue Price is –
 - a) The Book Price of the share
 - b) The minimum Networth of the company
 - c) The maximum ROE of the company
 - d) Historical EPS of the share
6. In a Green Shoe Option, the SA receives shares from –
 - a) The promoters
 - b) The Company
 - c) The existing shareholders
 - d) The investors
 - e) Customers
 - f) The Floor Price
 - g) Friends and relatives
 - h) Fan Club
 - i) the demat account

7. In a book built offer, a company receives subscriptions as follows –
- 1.5 times at the Floor Price,
 - 0.3 times at Floor Price + ₹20,
 - 0.2 times at Floor Price + ₹30,
 - 0.2 times at Floor Price + ₹40,
 - 0.1 times at Floor Price + ₹50 and
 - 0.1 times at Floor Price + ₹60.
- The Cut-off Price can be fixed at –
- Floor Price + ₹60
 - Floor Price + ₹50
 - Floor Price + ₹40
 - Floor Price + ₹30
 - Floor Price + ₹20
 - The Floor Price
 - None of the above.
8. A debenture redemption reserve (DRR) is used as follows –
- The cash required for redemption comes out of the DRR
 - The DRR is debited to realise the proceeds for redemption
 - The DRR is built up over the life of the debentures to provide necessary funds
 - The debentures are amortised over the life of the DRR
 - The DRR is co-terminus with the write-off of the debentures
 - The DRR is used to write-off the profits of the company.
9. In a public issue process, the due diligence on the issuer company is performed by –
- The auditor
 - The private equity investors
 - QIBs
 - The Underwriters
 - The Prime Lead Manager
 - The Co-lead manager
 - The BRLM
 - The lead manager responsible for pre-issue process
 - The lead manager responsible for post-issue process
10. A company proposes to issue rights of shares in the ratio of 1:1. Every right share will also have a NCD tagged along at a face value of ₹100. Shareholders have to take the NCD compulsorily if they wish to take the share. This has the following implication –
- The rights issue will be held invalid.
 - The company will be prosecuted for restrictive practice
 - The merchant banker will be held negligent of due diligence
 - Directors of the company will be held liable in personal capacity
 - Investors can demand refund of money.
 - The rights issue is valid.
11. Amazing Ltd. proposes to come out with a right issue at ₹145 per share of ₹10 each. The current market price of its share is ₹190. The ratio of rights announced is 1:2 (i.e. one rights share for every two shares held in the company). A shareholder presently has the following portfolio in the company –
- 500 shares purchased @ ₹86 per share
 - 200 shares purchased @ ₹113 per share.
 - 350 rights shares purchased in an earlier rights issue @ ₹90 per share.
 - 210 bonus shares received in an earlier bonus issue.
 - 400 shares purchased a few days ago from the market @ ₹180 per share cum rights.
- Compute the economic value of the 'right' for the shareholder.
12. The NPO component is defined as –
- The component left after netting out promoters' contribution and reservations from the Offer Document
 - The component left after netting out promoters' contribution and reservations from the Offer in terms of the Offer Document
 - The component left after netting out promoters' contribution, reservations and QIB portions from the Offer to the Public
 - The component left after netting out promoters' contribution, reservations, QIB and HNI components from the Offer in terms of the Offer for Sale
13. In an IPO, the investment banker decides to use a novel pricing methodology based on the following – (1) the valuation based on the present value of the future cash flow from long term supply contracts will be given 30% weightage, (b) the cost-saving from renewable energy usage will be given 20% weightage, (3) gains from forex options in the money

will be given 20% weightage and (4) super-profits arising from brands will be given 30% weightage. The price per share based on normal pricing methodology works out to ₹125 per share. The novel pricing results in a pricing of ₹176 per share. Fair value based on equal application of both the methods results in a valuation of ₹150 per share. Peer valuation in the market is at ₹190 per share. The applicable price for the IPO is –

- a) ₹125 per share
- b) ₹176 per share
- c) ₹150 per share

- d) ₹190 per share
- e) Any of the above
- f) None of the above

14. The NPO in a public offer is calculated as –
- a) 25% of paid-up capital and free reserves
 - b) 25% of the paid-up capital and cash reserves excluding goodwill
 - c) 25% of the post-issue equity capital for an IPO and 25% of the QIP for a FPO
 - d) 25% of the post-issue equity capital for an IPO and 25% of the offer for a FPO
 - e) None of the above

PART - B

15. In an offer for sale, the securities are issued by the issuer company but the selling shareholders receive the proceeds since they have already paid for the securities to the company.

TRUE/FALSE

16. In a FPO, the securities issued are listed in the same way as the existing securities and are therefore fungible unless; they are of a different nature in which case, they are listed separately.

TRUE/FALSE

17. NPO is that part of a public offer that has to compulsorily consist of securities that need to be listed.

TRUE/FALSE

18. If a group of HNI individuals float an investment fund by pooling their resources, the fund would be a QIB if it is pooled in India. If it is pooled outside India, it becomes a FPI.

TRUE/FALSE

19. A company makes a private placement of shares in order to save on issuance costs. Thereafter, for the purpose of listing, the company decides to make an IPO of the same shares. Is this possible under the SEBI ICDR Regulations?

TRUE/FALSE

20. In a 100% Book-built offer in the Indian market, the lead manager has to provide underwriting for the Green Shoe component of the offer

YES/NO

21. The green shoe option component in a public issue need not be allotted on the same lines as the NPO component. Since these are secondary shares, they should be allotted based on the under-subscription in each category of applicants.

TRUE/FALSE

22. The green shoe option is provided to the company to oversell its public offer component to the extent of 15%. Since these are secondary shares for which the company does not receive any funds, the question of deployment of those funds does not arise.

YES/NO

23. A company intending to make a public offer has to maintain the minimum RONW on post-issue networth required to maintain the pre-issue EPS.

YES/NO

24. In a book-built IPO, the lead manager discovers the cut-off price at the level wherein complete subscriptions equivalent to one time of the offer have been received. Those bids below and above this price will be rejected.

TRUE/FALSE

25. In a 100% Book Built Offer,
Total Offer Size – Promoters' Quota – Permitted Reservations = NPO

TRUE/FALSE

26. In a Dutch auction method for an IPO, the lead manager decides to arrive at the cut-off price by taking into consideration the single price at which the maximum number of bids have been received and ignore all other bids either above or below such cut-off price. This method is acceptable under the regulations.

YES/NO

27. A company decides to offer 'debentures' on rights basis and provides that each debenture comes with an attached warrant that would be compulsorily converted into a share upon payment of additional consideration. A shareholder contests the issue calling it misleading and illegal. The company defends itself by stating that this does not amount to 'tie-in' sale. The company is right.

YES/NO

28. A company decides to make an IPO in three distinct parts – (a) public issue of shares, (b) offer for sale of shares and (c) issue of fully convertible bonds. The pricing for all the shares is distinct from that fixed for the bonds but the company issues a common offer document explaining all the three components. This kind of issue is not allowed under the regulations.

YES/NO

29. In the offer document of an offer for sale, the number of shares being sold through the offer by the selling shareholders has to be mentioned, though the pricing is determined by a process of book building.

YES/NO

30. In a green shoe option, the stabilising agent has the right to refuse the repurchase of shares from a shareholder if the market price has fallen but has recovered before the repurchase.

YES/NO

31. A company wants to make a public offer of convertible debt securities. The investment banker says that this is not possible since the company is unlisted. The CFO of the company says that though the company is unlisted, an issue of debt securities can be made with an option to be converted into equity later on.

Whose opinion is right in the context of SEBI regulations?

CFO/INVESTMENT BANKER

32. A company wants to create security on its debentures in favour of the debenture trustee. The investment banker says that this is not possible since the company is unlisted. The CFO of the company says that though the company is unlisted, a debenture trustee can be appointed for the debenture issue since listing has no relevance in the given context. Who is right?

CFO/INVESTMENT BANKER

33. Nevada Properties is a company engaged in real estate development and construction. The company decides to make a public issue of a fully convertible debt security that gets converted into a REIT investment within 2 years. The REIT proposes to invest the funds in a portfolio of real estate projects. The REIT has a lock-in of 3 years whence it would be redeemable and its NAV would be published daily.

The regulator pulls up the company on the ground of misleading investors. The charge is that the company will convert a debt instrument into a real estate investment with consequent increase in risk without any choice and proper disclosure to the investor. The company claims that it would be issuing a real estate security on which SEBI has no jurisdiction to regulate. Decide.

- a) The Public Issue is Valid
- b) Misleading and Therefore Legally Invalid
- c) Legally Valid but Morally Invalid.

34. In a green shoe option, the company allots an additional 15% of the issue to the public shareholders. Based on market making thereafter, the market maker did not have the necessity to buy any shares from the market. Therefore the company proceeded to allot the entire 15% shares to the promoters. One of the institutional shareholders alleges that this amounts to a creeping acquisition beyond the limit of 5% permitted under law and complains

to SEBI to take action against the company and the investment banker. Who will SEBI find correct in the given situation?

- a) The Shareholders
- b) The Company and Investment Banker

35. Jumbo Crafts Ltd. is a listed company in the business of high end consumer products aimed at artistic works and home decoration. The company plans a capital raise to the extent of ₹500 crore for its next phase of growth through an IPO. Jumbo has existing investors who wish to exit the company through its

IPO. Looking at the prospects, the investment banker suggests that the company should aim to raise ₹400 crore and the rest should be raised by the investors. The CEO of the company is uncomfortable with the idea and wants the investors to raise ₹100 crore in addition to the company's requirement of ₹500 crore. Accordingly the investment banker makes the plan for a ₹600 crore IPO. From the following alternatives which one describes this type of an issuance?

IPO/SECONDARY IPO/OFS/OFS WITH IPO COMPONENT/SECONDARY OFS

PART - C

36. What is issue management in the Indian context? What are the important aspects thereof?
37. What are the regulations for appointment of issue managers in public offers?
38. Discuss the considerations for deciding the type of offer (book building versus fixed price) including the eligibility criteria to be applied in the context of an IPO.
39. How does one arrive at pricing for an IPO? In what ways is it different from valuation of the share of a company?
40. Discuss the nuances of pricing for IPO, FPO and Rights Issue respectively.
41. What are the key disclosures in an offer document for a public offer?
42. What considerations does a lead manager take into account for determining the capital structure and the issue structure?
43. Issue allocation and basis of allotment connote the same process. Do you agree with this statement?
44. Does an issuer company necessarily make the highest available price as the cut-off price in a book built issue? If not, what are its options and what should be the considerations thereof?
45. How is greenshoe option exercised by a company in its IPO? Illustrate with a numerical example.
46. What are the underlying factors to be considered for taking the listing decision? Elaborate.
47. How does the book building method score over the fixed price method? How is the issue price determined under the book building method?
48. Explain the procedural aspects of a book built issue.
49. Why is the listing decision so important for a company? What are its various dimensions and how does a company consider the various aspects of these dimensions?
50. Public Issues are expensive and issuers take market risk in pricing and capital raising. The compliance cost of maintaining a listed status is also enormous. Under what circumstances does it make financial sense to consider public equity as a viable financing option?

ANSWERS

1. (e) 2. (e) 3. (c) 4. (d) 5. (d) 6. (a) 7. (f)
 8. (c) 9. (h) 10. None of the Given Alternatives
 11. ₹74 (i.e. CMP ₹190 – Average Cost of Holding Post Rights ₹116) 12. (b)
 13. (e) 14. (d) 15. (FALSE) 16. (TRUE) 17. (FALSE) 18. (FALSE)
 19. (YES) 20. (NO) 21. (FALSE) 22. (NO) 23. (NO) 24. (FALSE) 25. (TRUE)
 26. (NO) 27. (YES) 28. (NO) 29. (YES) 30. (YES)
 31. The Investment Banker 32. CFO 33. (b)
 34. The Company and Investment Banker 35. IPO

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Underwriting

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. In the Indian context, underwriting services can be provided by insurance companies if they obtain a separate registration with SEBI even if they are already registered with the IRDA since they form a part of QIBs.
TRUE/FALSE
2. Devolvement is nothing but the subscription to be taken up by an underwriter in a public offer that is in excess of his underwriting obligation.
TRUE/FALSE
3. In computing the devolvement liability of an underwriter, the pro-rata excess procurement of other underwriters is netted out of the under-procurement of the first underwriter.
TRUE/FALSE
4. In a book built offer, the underwriting obligation is only to the extent of the NPO as reduced by the promoters' contribution and reservations.
TRUE/FALSE
5. In a fixed price offer, the underwriting obligation is to the extent of the NPO as reduced by promoters' contribution and reservations.
TRUE/FALSE
6. In a public issue, the issue has underperformed till the last day. The management requests the underwriters to subscribe to their commitments and close the issue successfully, which the underwriters refuse to do.
- Now the company can proceed legally against the underwriters –
YES/NO
7. In a public offer in the US, the underwriters commit the issue price to the issuer company but the actual offer price is different from what is committed to the company.
TRUE/FALSE
8. In the firm underwriting model prevalent in the US, the underwriter's liability is always limited to the difference between the final offer price to be public and the underwritten price promised to the issuer company.
TRUE/FALSE
9. In determining the devolvement of an underwriter, the excess procurement of one underwriter is apportioned to the devolved underwriter.
TRUE/FALSE
10. Devolvement for an underwriter is the excess of his underwriting obligation over the issue subscription.
YES/NO
11. In best efforts underwriting, the underwriter uses his best efforts to fill in the devolvement and the balance if any, has to be written off by the company.
TRUE/FALSE

12. In firm underwriting, the company expects to receive the total issue proceeds at the underwritten price from the underwriters irrespective of whether the public offer price is higher or lower.

YES/NO

13. If the minimum subscription in an IPO has not been subscribed including the devolvments on the underwriters, the promoters can then fill in the gap to meet the requirements.

YES/NO

14. In a public issue under the book-built mechanism in India, the investment banker ties up the underwriting commitments from the syndicate members. When the issue devolves, one of the syndicators who has underwritten 10% of the offer backs out stating financial incapacity. The i-banker informs the company about it and states that since the issue can be closed with 90% subscription, the underwriting

obligation of the defaulting underwriter can be waived by the lead manager. The company insists that according to the underwriting contract, the lead underwriter is liable for the defaulting underwriter. Who is legally right?

1) THE COMPANY

2) THE LEAD UNDERWRITER

15. In a contingent underwriting for a book built IPO, the lead BRLM can stipulate the floor price above which he will not be willing to undertake the responsibility of his 15% mandatory underwriting commitment.

YES/NO

16. In a firm underwriting model, the final offer price to the public is determined by the lead underwriter before the offer opens for public subscription though the price negotiated with the company in the underwriting contract may remain unchanged.

YES/NO

PART - B

17. What is underwriting? Why is it necessary in an issuance of securities by a company?
18. Is underwriting a fee-based service or a fund-based service?
19. Explain the model of fee-based underwriting as is used in India.
20. In a contract of underwriting in the US market, how do the underwriters dispose off the securities that they underwrite?

21. What are the different types of underwriting compensations? How are they computed?
22. In a bought out deal, if the investment banker cannot bring the public offer what is the outcome?
23. Explain the different types of underwriting risks and their mitigation mechanisms.
24. Explain the working of green shoe options in the US capital market.

ANSWERS

- | | | | | |
|-------------|------------|------------|-----------------|------------|
| 1. (FALSE) | 2. (FALSE) | 3. (TRUE) | 4. (TRUE) | 5. (FALSE) |
| 6. (a) | 7. (TRUE) | 8. (FALSE) | 9. (b) | 10. (YES) |
| 11. (FALSE) | 12. (TRUE) | 13. (NO) | 14. THE COMPANY | 15. (YES) |
| 16. (YES) | | | | |

Cross-Border Issuances

OBJECTIVE QUESTIONS WITH ANSWERS

Pick the right answer(s) or the alternative that best fits the given question or situation from the alternatives provided under each question.

PART - A

1. If a number of offshore GDR investors collectively wish to sell their holdings as shares in the domestic market, the option is –
 - a) to seek the company making a reverse sponsored GDR issue
 - b) to sell their GDRs to a FII which can exchange them for shares and sell in the domestic market
 - c) sell their GDRs to a resident domestic investor who can seek conversion into shares
 - d) seek the company to buyback the GDRs and pay for in shares
 - e) become portfolio investors on the domestic market.
2. In a sponsored ADR issue, the shares surrendered in India are offered through depository receipts in overseas markets by way of a
 - a) public offer
 - b) private placement of listed ADRs
 - c) private placement of unlisted ADRs
 - d) 144A placement
 - e) rights offer to existing ADR holders
3. Two-way fungibility of depository receipts shall mean that –
 - a) The DRs can be exchanged for shares in the domestic country
 - b) The shares can be exchanged for DRs in the foreign country
 - c) The foreign country and the domestic country can be interchanged to make the issue
 - d) The company can make the issue in either country
 - e) The investor can apply in either country
 - f) The shares are surrendered for sale in the foreign country.
4. A company proposes to make an ADR issue and a sponsored ADR issue together. This has the following implication –
 - a) Both the issues will be held invalid.
 - b) The company will be prosecuted in both countries
 - c) The promoters will be held liable to imprisonment
 - d) The foreign merchant banker will be asked to punish the Indian merchant banker
 - e) Directors of the company will be held liable
 - f) Foreign investors can demand refund of money from domestic investors.
5. A company proposes to re-issue GDRs, which were surrendered by the foreign investors in exchange for local shares. This has the following implication –
 - a) Such issue is not possible
 - b) The GDRs can be re-issued to domestic investors only
 - c) The reissue would be constituted as a domestic public offer
 - d) SEBI's pricing guideline will apply
 - e) Reissue is possible only to the available headroom
 - f) Reissue should be a public offer.

6. A company proposes to exchange its GDRs with IDRs. This has the following implication –
- The GDRs will be converted into shares and IDRs will be issued against them
 - The IDRs are issued against local shares which are exchanged with the GDRs
 - The IDRs are issued against the GDRs at an agreed ratio
 - SEBI's pricing guideline will apply
 - The IDRs and GDRs are valued independently
 - The IDRs have to be issued at the CMP of the GDR.
7. A listed Indian company proposes to make a simultaneous FPO and private placement of GDRs in overseas market. This has the following implication(s) –
- The entire new shares will be listed in India
 - The shares underlying the GDRs will be listed in India
 - The shares underlying the GDRs will be added to the FPO
 - The GDRs will be listed in the overseas market
 - The proposed scheme is not feasible
 - The shares will be locked in for 3 years
8. A company proposes to make a simultaneous IPO in Indian and overseas capital market through a GDR issue. It can be done in the following way(s) –
- The GDRs have to be issued at the equivalent price as the domestic shares
 - The domestic issue can be made through book-building route but the GDR should be at a fixed price
 - The cut-off price in the domestic issue becomes the fixed price for the GDR issue
 - The cut-off price for the GDR issue becomes the fixed price for the domestic issue
 - The cut-off price has to be common for both the issues
9. The commencement of trading after a public issue happens as follows –
- In USA, within 1 day of the registration statement being declared effective
 - In UK, within 48 hours of the allotments being completed
 - In India within 90 days of SEBI approving the DRHP
 - In USA within 48 hours of the underwriters remitting the funds to the company
 - In UK, within 90 days of the close of underwriting for the issue
 - In India within 7 days of the close of the issue.
10. A company proposes to issue Rupee Denominated Bonds to QIBs in the overseas market. These bonds shall be pegged to the 6 months LIBOR with coupon reset every 6 months. However, the interest and principal will be paid in rupees and the exchange risk is borne by the investor. This kind of a bond is called –
- Paneer Bond
 - Idly Dosa Bond
 - Tandoori Bond
 - Masala Bond
 - Rabdi Jamoon Bond
 - Jalebi Bond

PART - B

11. Foreign Institutional Investors (FIIs) in emerging markets running sub-accounts for investors from other markets can seek fungibility of their DRs into shares so as to sell them in the domestic markets.
YES/NO
12. The Registration Statement submitted to the SEC for an ADR issue shall state the underwritten price of the offer.
TRUE/FALSE
13. The underwriters for a public issue of shares by an US company on the NYSE cannot revise

the price upwards after the effectiveness of the Registration Statement but can always revise it downwards.

TRUE/FALSE

14. A company's GDRs are quoting at a premium to the domestic market price of its shares. The company therefore decides to make a GDR FPO. Simultaneously, based on shareholders' demand, the company also decides to float a sponsored GDR issue. The i-banker recommends a composite offer of sponsored and FPO components. The company wishes to have a differential pricing for both the components which the i-banker says is not possible. The i-banker is right.

YES/NO

15. A company's ADR is quoting at a discount of 20% to its domestic share price. In order to rationalise the market, the company proposes a buyback of ADRs. The company's CFO says that it would increase the residual debt equity ratio of the company beyond 2:1. The company's investment banker maintains that this regulation does not apply to buyback of ADRs. Who is right?

Investment Banker/CFO

16. A company that is unlisted in India decides to make an offer for sale of GDRs in London AIM exchange so as to list its GDR. The GDRs will be carved out of the promoters' shares. This amounts to a sponsored GDR issue.

YES/NO

17. In a Rule 144A offer of an Indian company of its ADRs, the underwriters of the issue marketed the instrument to institutional investors only. The ADRs were not proposed to be listed in the US, instead they were to be listed on Luxembourg stock exchange. Some of the US funds require that the company list its ADRs in the US. The investment banker states that this is not possible under Rule 144A. Alternatively, the investment banker proposes a FCCB issue with a conversion option into shares listed in India. The company officials feel the investment banker is misleading the company without being aware of the regulatory requirements. Who is right?

- 1) THE COMPANY
- 2) THE INVESTMENT BANKER

PART - C

18. What is the eurobond market? What are the other segments of international bond markets? Which is the segment that is most suitable to Indian corporates?
19. What is Rule 144A market? Is it beneficial to issuers?
20. How is a GDR different from an ADR? Can an ADR be issued in the Rule 144A market?
21. How does the depository mechanism function? What is fungibility and reverse fungibility and how do these work?
22. What are the operative guidelines in India for fungibility and reverse fungibility of ADRs/GDRs?
23. Outline the procedure of making public offers in USA and UK capital markets. What are the fundamental differences between the these models and the Indian model?
24. How does the US system of public offers mitigate market risk for underwriters?
25. Does the depository system provide an opportunity for arbitrage trading? If so explain the mechanism.

ANSWERS

- | | | | |
|-----------------------------------|-------------|---------------------------|-----------------------------------|
| 1. (b) | 2. (a) | 3. (b) | 4. None of the Given Alternatives |
| 5. (e) | 6. (NONE) | 7. (b) | |
| 8. None of the Given Alternatives | | 9. (a) | 10. (d) |
| 11. (YES) | 12. (FALSE) | 13. (FALSE) | 14. (YES) |
| 15. The Investment Banker | 16. (YES) | 17. The Investment Banker | |

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CHAPTER 10

Private Placements

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. A listed company just completed a buyback due to which the public shareholding stands at 25% and the promoters hold the rest. The Promoters now announce a preferential allotment to themselves increasing their stake to 91%. The following is (are) the implications –
 - a) The proposed allotment is in violation of SEBI Regulations
 - b) The company has to be de-listed after the allotment
 - c) The promoters have to make an open offer
 - d) The Company has to make a de-listing offer
 - e) The promoters have to make a simultaneous de-listing Offer
2. Which of the following classify (ies) as a Preferential Issue (PIPE) under SEBI Regulations?
 - a) An unlisted company seeks creditors' consent to offer shares at a premium in its forthcoming IPO.
 - b) A listed company seeks shareholders' consent to raise equity from select categories of unidentified investors.
 - c) A listed company seeks shareholders' consent to raise equity from two large private equity funds.
 - d) An unlisted company seeks shareholders' consent to raise equity from select categories of identified investors.
3. Which of the following classify (ies) as a Private Placement of Securities?
 - a) An unlisted company seeks creditors' consent to offer shares at a premium in its forthcoming IPO.
 - b) A listed company seeks shareholders' consent to raise equity from select categories of unidentified investors.
 - c) A listed company seeks shareholders' consent to raise equity from two large private equity funds.
 - d) An unlisted company seeks shareholders' consent to raise equity from select categories of identified investors.
 - e) A listed company seeks shareholders' consent to raise equity from select categories of institutional investors.
4. Which of the following classify (ies) as a Qualified Institutional Placement?
 - a) An unlisted company seeks shareholders' consent to raise equity from select categories of institutional investors.
 - b) A listed company seeks shareholders' consent to raise equity from select categories of unidentified investors.

- c) A listed company seeks shareholders' consent to raise equity from select identified institutional investors.
- d) A unlisted company seeks shareholders' consent to raise equity from select categories of identified investors.
- e) A listed company seeks shareholders' consent to raise equity from select categories of unidentified institutional investors.
5. Which among the following would be an acceptable price for a PIPE issue by a listed company?
- CMP of ₹82 per share
 - SEBI price of ₹67 per share
 - Price negotiated with one big investor at ₹65 per share
 - Price negotiated with rest of the investors at ₹80 per share
 - Differential Pricing to investors
 - Minimum of ₹82 per share
 - Promoters' proposed subscription price of ₹75 per share.
6. Which among the following would be an acceptable price for a Private Institutional Placement by an unlisted company?
- Shareholders' consent price of not less than ₹80 per share
 - Promoters' proposed subscription price of ₹75 per share
 - Price negotiated with one big investor at ₹65 per share
 - Price negotiated with rest of the investors at ₹80 per share
 - Differential Pricing to investors
 - All of the above
7. In a QIP, the following are possible:
- A large FPI negotiates to get shares at less than SEBI price but with lock-in.
 - The Company fixes a Reserve Price less than the SEBI price but with a condition that the investor has to take a minimum of 20% of the Offer.
 - The Company proposes a convertible with a conversion price to be fixed at the time of conversion falling 72 months after the allotment.
 - The Company proposes a convertible with a conversion price to be fixed on the conversion date falling 60 months after the allotment.
 - The Company proposes a convertible with a conversion price to be fixed within 12 months from the date of the shareholders' consent.
8. In a private placement the due diligence is performed on behalf of –
- The auditor
 - The private equity investors
 - QIBs
 - The Underwriters
 - The Prime Lead Manager
 - The investors
 - The BRLM
 - The lead manager responsible for pre-issue process
 - The lead manager responsible for post-issue process.
9. An unlisted company issues a Placement Memorandum to all eligible participants to appear in a quiz contest from which select winners would be allotted shares. This amounts to –
- Private Placement
 - Public Issue
 - QIP
 - QIB
 - IPP
 - Rights Issue
10. If promoters increase their stake in a listed company through rights renunciation, it shall be –
- reckoned as preferential allotment
 - held to be in violation of SEBI guidelines
 - shall be valid though the pricing guideline is not followed
 - shall be valid only if pricing regulations are followed.
11. A listed company proposes to make a private placement of FCCBs in the overseas capital market that are convertible into domestic shares within one year of issue. This has the following implication(s) –

- a) The issue will be categorised as preferential allotment
 b) The issue will be categorised as a public issue in India
 c) The issue will be categorised as a private placement in Indian market
 d) The shares will have to be listed in India
12. In a QIP offer, the company provides three options to the investor –
 a) A debt instrument that can be converted into equity at the option of the investor after 84 months from the date of issue at a price to be fixed one month before the conversion date in accordance with SEBI pricing formula
 b) A zero interest debenture that would be redeemed at a premium of 120% of its issue price at a date falling between the end of the sixth and seventh year from the date of issue. The company can exercise a call option anytime after the 6th year.
 c) A NCD with an attached equity warrant that can be converted after a period of 56 months at a conversion price to be derived as per SEBI formula. The NCD will also be repaid on the conversion date. Which of the above complies with the regulations of a QIP issue?
13. Game On Ltd. is a tremendously successful gaming and mobile app company. A QIP is planned for the company for a proposed fund raising of ₹125 million. The investment banker acting as manager to the issue has decided to approach PE funds instead of market investors for the QIP. The idea is to negotiate a significant premium to market price since PE funds are long term investors. The PE funds agree to invest at 50% premium to CMP provided promoters also invest 10% of the transaction size at the same price. The bankers are now confused about the structure of the deal. From the given options, identify which deal structure satisfies the requirements.
- a) A QIP cannot be made unless there are market investors other than PE funds. The proposed pricing of 50% premium to CMP is also against the pricing regulations applicable to a QIP. So the transaction can be made as proposed only if it is made to PE investors along with market investors with a different pricing as permitted.
 b) PE investors are eligible to invest in a QIP though they are not market investors. The proposed pricing is also allowed since it is at a premium to CMP. So the transaction can be made as proposed with PE investors subscribing to 90% and promoters subscribing to 10% of the transaction.
 c) PE investors are eligible to invest in a QIP though they are not market investors. But the proposed pricing is allowed subject to it being at or above the SEBI price. So the transaction can be made as proposed with PE investors subscribing to 90% and promoters subscribing to 10% of the transaction at the appropriate price as permitted.
 d) PE investors are eligible to invest in a QIP though they are not market investors. The proposed pricing is allowed so long as it is at or above the SEBI price. However, promoters cannot invest in a QIP. So the entire transaction can be made only as a preferential allotment with PE investors subscribing to 90% and promoters subscribing to 10%.
 e) PE investors are not eligible to invest in a preferential allotment as they are institutional investors. The proposed pricing is allowed so long as it is at or above the SEBI price. However, promoters cannot invest in a QIP. So the entire transaction can be made in two parts – QIP to PE investors and preferential allotment to promoters at the applicable price as permitted.

PART - B

14. In a PIPE deal, since the shares allotted to the investors are placed privately, these are eligible for trading on the OTC market.
TRUE/FALSE
15. A QIP in the Indian market resembles a Regulation 144A placement in the US since both the varieties of placements deal with unlisted securities.
TRUE/FALSE
16. In a QIP, in order to provide confidence to the investors, the investment banker can decide to have a component for the promoters on a preferential basis at a higher price with a lock-in for one year.
YES/NO
17. In a PIPE, the investment banker decides to have a dual pricing to improve its marketability by which, the promoters will subscribe at 25% higher than the QIB investors. Under the regulations, such higher differential pricing for promoters is allowed.
YES/NO
18. A listed company decides to do a QIP to raise funds. An investment banker is appointed as per the regulatory requirements. While preparing the QIP document, the investment banker realises that a PIPE transaction through a preferential issue makes better sense as the promoters are resourceful and can participate in the offer along with potential investors. Thereby the dilution for the promoters would be minimal. The board of directors dominated by the promoter directors feels that the company should keep its options open and try both the routes simultaneously. The i-banker is therefore asked to be the transaction adviser for both the proposed transactions. The i-banker prepares two different mandates to be appointed by the company for both the transactions. This amounts to violation of regulations and professional misconduct?
TRUE/FALSE
19. A joint venture partner of a listed company decides to take a stake of 40% in a new venture being set up as a SPV of the listed company. This amounts to a private placement.
YES/NO

PART - C

20. What is a QIP? How is it different from private equity in unlisted companies? What are the regulatory requirements for a QIP?
21. What is an information memorandum? How is it different from an offer document for a public offer? What are the requirements for a QIP memorandum?
22. What are the different types of raising capital through the private placement route? What should be the considerations for an issuer to decide on the appropriate route?
23. Explain the characteristics of PIPE investment.
24. What are the advantages of private placements over public offers? Explain in the context of listed companies.
25. Why are debt securities placed pre-dominantly in the institutional private placement market? What types of debt securities are preferred by institutional investors and retail investors respectively?

ANSWERS

- | | | | | | |
|------------------------------------|--------------------------|-----------------|-------------|----------|-------------|
| 1. (b) | 2. (b), (c), (d) and (e) | 3. (b) and (e) | 4. (e) | | |
| 5. (a), (b), (d), (f) and (g), (e) | | 6. (f) | 7. (e) | 8. (f) | |
| 9. (a) | 10. (c) | 11. (a) and (d) | 12. (c) | 13. (d) | 14. (FALSE) |
| 15. (FALSE) | 16. (NO) | 17. (YES) | 18. (FALSE) | 19. (NO) | |

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CHAPTER 11

Private Equity Advisory

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. A company, with an issued capital of ₹1 million (of shares worth ₹10 each), negotiates with a VC for a stake in the company for a consideration of ₹500 million. The VC has to subscribe to a convertible that would entitle it to an equity share for every five convertible instruments issued to it. The face value of each convertible is ₹1,000. The post-money valuation of the Company works out to –
 - a) ₹50 billion
 - b) ₹5 billion
 - c) ₹2 billion
 - d) ₹1 billion
 - e) ₹500 million
 - f) ₹10 million
2. A company, with a post-money valuation of ₹1 billion has come out with an investment plan for ₹500 million involving the following – (1) Financing through promoters' equity ₹50 million, (2) Financing through private equity ₹100 million, (3) Financing through issue of convertibles ₹150 million and (4) internal generation ₹200 million. The pre-money valuation of the Company works out to –
 - a) ₹1.5 billion
 - b) ₹1 billion
 - c) ₹900 million
 - d) ₹800 million
 - e) ₹700 million
 - f) ₹600 million
 - g) ₹500 million
3. An unlisted company prefers to go in for a private equity transaction. One of the following conditions does not apply –
 - a) Promoters can be part of the preferential allotment
 - b) Warrants can be issued to the private equity investors
 - c) Convertibles shall have a maximum currency of 60 months
 - d) All monies due on allotment shall be brought in as per the terms of allotment
4. An unlisted company is raising venture capital through a preferential issue of shares. The following are the implications –
 - a) Promoters cannot be part of the issue
 - b) Promoters can take warrants only if VC is also offered warrants
 - c) The post-money valuation shall not exceed five times the pre-issue valuation
 - d) VC cannot hold more than the promoters
 - e) None of the above
5. An unlisted company has proposed to make a private placement of the anchor investor portion in its upcoming IPO. It can be done in the following way(s) –
 - a) To anchor investors at the issue price
 - b) To promoters at or more than the issue price
 - c) To venture capital funds as part of the offer for sale
 - d) To a strategic investor at a negotiated price
6. In a private equity transaction, the due diligence is performed by –

- a) The private equity investors
b) QIBs
c) The Underwriters
d) The Prime Lead Manager
e) An independent agency
f) The BRLM
g) The lead manager responsible for pre-issue process
h) The lead manager responsible for post-issue process.
7. A company decides to go in for venture capital funding with the following condition – 'whenever the VC feels that its money is unsafe with the company, it can oblige the promoters of the company to buy back the shares from the VC'. This amounts to –
a) Hedging
b) Arbitrage Trading
c) Security dealing
d) Counter Party Risk Mitigation
e) Full Recourse Investing
f) Simultaneous Offer
g) Put option
8. A PE fund (PE 1) enters into a term sheet with a company and simultaneously enters into a back-to-back term sheet with another PE fund (PE 2) to buy it out at the time it wishes to exit the company. This has the following implication(s) –
a) The company can refuse such buy out
b) The Company can compel such buy out
c) PE 1 can proceed against the Company if it refuses to take cognisance of the buy out
d) PE 2 can proceed against the Company if it refuses to take cognisance of the buy out
e) Both PE 1 and PE 2 can proceed against the Company
f) The Company is not obliged in any way unless it is a party to the second term sheet.
9. In a term sheet, a VC negotiates that if the company does not achieve the agreed levels of performance, the VC shall have an option to convert the equity shares into a loan and recover it from the company with interest at the rate of 20% from the date of investment till the date of recovery. This is –
a) against law and therefore illegal contract
b) invalid contract since it is not possible
c) invalid contract since company cannot consent to it
d) Valid only if there is no interest
e) Valid only if sanctioned by the Court/Tribunal
f) Valid only if prior permission is obtained from the Government
g) Valid only for public issue and not for a private placement
10. A VC seeks an investor protection right as follows – 'in the event there is a down round valuation in future, the promoters shall compensate the VC to the extent of the depreciation in their investment by sale of vendor shares from their holdings at an appropriate price'. This may have the following implication(s) –
a) The promoters have no power to enter into such contract on behalf of the company
b) The contract is against law and therefore illegal
c) The sale of vendor shares should be in lieu of the issue of shares by the company and not in addition
d) Vendor shares can be sold only at the same price as the original issue
e) Vendor shares are always subject to lock-in and cannot be sold
f) The contract is valid and legal.
11. In a term sheet, one of the conditions states that if both the VC and the Company find it necessary, the company can buyback the shares from the VC at the issue price and reissue them to the VC at a reduced price so as to compensate for down round valuation. This is –
a) against law and therefore illegal contract
b) possible with the consent of the other shareholders
c) Valid only when the pricing is decided beforehand for the new issue
d) Valid only if the buyback and reissue are at the same price
e) Valid only the buyback is at a lesser price than the new issue
f) Valid only if prior permission is obtained from the RBI.

12. Malamaal Bharat Ltd. is a fintech company specialised in payment solutions for many banks and NBFCs. The pre-money value of the company at Series B round has been determined based on DCF and other methodologies at a fair value of ₹376 per share amounting to an equity value of ₹345 million. The potential PE investors at Series B have shown interest but have serious valuation concerns. The first of them offers to give ₹87 million for a 33% stake. The second offers ₹91 million for a 35% stake. The existing investors who put in ₹75 million in Series A are willing to fund another ₹50 million for an additional 15% stake. They

presently hold 28%. The company requires a financing of ₹125 million in Series B. The company decides to accept the offer of Series A investors in full and only for the remainder, they accept the offer of the second Series B investor. The post-money valuation at Series B now works out to –

- More than ₹345 million
- More than ₹250 million but less than ₹275 million
- More than ₹275 million but less than ₹345 million
- More than ₹300 million but less than ₹345 million

PART - B

13. Private Equity investors investing in PIPE deals have to be given pre-issue placements preceding the FPO.

YES/NO

14. The term sheet in a private equity deal inter alia talks about the commitment of the investor to finance the investee company in future rounds of financing.

YES/NO

15. The valuation in a private equity deal depends inter alia on the ability of the company to develop technologies that can shape future product trends.

YES/NO

16. In an earn out structure, the private equity investor identifies certain milestones for the company, which if reached will result in the top management team being given an increase in their salaries coupled with handsome bonus payouts.

YES/NO

17. A company's pre-money value is determined by the number of outstanding shares (pre-issue) while the post-money value is determined by the number of shares outstanding (post-issue).

TRUE/FALSE

18. A PE fund wishes to buy a significant stake of 24% in a listed company and has been discussing with the company about the transaction as a combination of funding the company and acquiring secondary shares from a big institutional investor. The promoters already hold 62% of the company. The CFO of the company feels that post the proposed PE deal, the public shareholding in the company will fall below the minimum mandatory requirement of 25% and the company needs to apply for de-listing. The investment banker advising on the deal states that the company would have the minimum required 25% as the PE investor is reckoned as part of public investors. Who is right?

- THE CFO
- THE INVESTMENT BANKER

19. An investment banker negotiates a term sheet for his client with a PE investor based on post-money valuation for a 20% stake. Thereafter, based on due diligence, the pre-money valuation is re-negotiated to a lower level. In order to retain the PE investor's stake at 20%, the i-banker offers that the existing shareholders will bring in additional investment into the company so as to bring up the pre-money valuation to the pre-due diligence levels.

The PE investor insists that such additional investment should be brought in at the same offer price per share as applicable to him since it is happening simultaneously. The i-banker says that such an argument is incorrect. Who is right?

PE INVESTOR/INVESTMENT BANKER

20. A term sheet is negotiated with a particular PE fund by a company whereafter the due diligence is conducted. Post due diligence, the PE investor expresses inability to be able to go ahead with the transaction due to unexpected fund constraints. The company therefore approaches another investor and successfully

completes term sheet and due diligence. When the company is about to execute definitive agreements with the second PE fund, the first PE fund comes back to do the deal stating that they now have the necessary funds and since their term sheet was signed prior to the second term sheet, they have precedence under law to do the transaction. The second PE investor states that the first transaction did not get consummated and is therefore not recognised under law. The company is prepared to do the transaction with whichever investor offers a higher valuation. Will the company succeed in its objective?

YES/NO

PART - C

21. How does one arrive at a transaction structure for a VC/PE deal?
22. What are the valuation techniques used in venture capital and private equity transactions? How does valuation affect pre-money valuation?
23. What are the principal clauses in a term sheet? Explain with suitable illustrations.
24. What are the key issues in business and financial structuring of companies intending to raise venture capital?
25. What are the important stages in private equity investment? How would you say that venture capital is a subset in the universe of private equity?

ANSWERS

1. (d) 2. (e) 3. (c) 4. NONE OF THE GIVEN ALTERNATIVES 5. (a) 6. (e)
 7. (g) 8. (f) 9. NONE OF THE GIVEN ALTERNATIVES 10. (g) 11. (a) 12. (c)
 13. (NO) 14. (NO) 15. (YES) 16. (NO) 17. (FALSE) 18. THE INVESTMENT BANKER
 19. THE INVESTMENT BANKER 20. (YES)

CHAPTER 12

Buybacks and De-Listing

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. One of the reasons why a company would resort to equity repurchase is that its assets are overvalued and to that extent the capital is unrepresented by assets.
TRUE/FALSE
2. A share repurchase programme does not amount to capital reduction if the company is able to buy back the shares at less than their issue price.
TRUE/FALSE
3. A share buyback programme amounts to capital restructuring even when the buyback is financed through internal accruals.
TRUE/FALSE
4. An unlisted company may use the share buyback route to provide exit to venture capitalists.
TRUE/FALSE
5. In a share buyback, the shareholders are given an option to surrender their shares either in part or in full depending upon the price discovery that is done prior to the opening of the offer.
YES/NO
6. In a de-listing offer, if the public have not responded in full, the left out shares can be acquired through a negotiated price after one year.
YES/NO
7. A company has a debt-equity ratio of 1.8:1. It is now considering an equity buyback such that the residual debt-equity ratio is not more than 2:1. For this purpose, the company considers repayment of an existing debt using its debenture redemption reserve so as to conserve cash for the buyback. The company is therefore compliant with the regulations.
YES/NO
8. In a de-listing offer, the company fixes a floor price which is subsequently increased after some of the shareholders have tendered their shares. The revised price has to be mandatorily made applicable even to such shareholders.
YES/NO
9. In a share buyback, the shareholders are given an option to surrender their shares either in part or in full at their option but the pricing will depend upon how much they offer.
YES/NO
10. In a de-listing offer, if the public have not responded in full, the left out shares need not be acquired at all if the promoters' holding has already reached 90%.
YES/NO
11. In a share buyback, the company cannot be de-listed if the public shareholding falls below the statutory minimum even if the share buyback regulations have been complied with.
YES/NO

12. A company has a debt-equity ratio of 1.5 : 1. It is now considering an equity buyback such that the residual debt-equity ratio is not more than 2:1. For this purpose, the company considers transfer of a long term liability to the current liability category in consultation with the auditors. The auditors object to this step stating that it is not in compliance with accounting principles. The company maintains that compliance with statutory provisions takes precedence over accounting principles. Who is right?

COMPANY/AUDITORS

13. A company proposes a buyback of its shares in exchange for 3 year inflation-indexed bonds that would carry a convertible option. The conversion option entitles a bond holder to accept the buyback in terms of repayment proceeds of the bond or in terms of two equity shares for every bond held. The investment banker is hailed by the market as a brilliant banker and the offer is over-subscribed. The CFO is unhappy and cites a huge regulatory liability on the company but is not sure about it. Is the offer valid?

YES/NO

14. In a buyback of shares, a company wants to buyback 25% of its issued capital at a price per share by which the total value of the transaction will be less than 25% of its paid-up capital and free reserves. The CFO says that the buyback is invalid. The investment banker says the buyback is valid. Who is right?

CFO/INVESTMENT BANKER

15. In a share buyback scheme, the residual DER of a company is 2:1 if outstanding FCDs are not considered as debt. If the FCDs are included, the DER amounts to 2.8 : 1. The company's

CFO and the i-banker are confused as to which is the right approach. How do you determine?

- 1) FCDs TO BE INCLUDED
- 2) FCDs TO BE EXCLUDED

16. A company that was incorporated two years ago and taken public wishes to de-list since its shares are not traded at all in the market and the price has remained stagnant below the offer price. The promoters propose to offer a handsome exit price. The offer is valid.

YES/NO

17. In a compulsory delisting, the stock exchange has stipulated that the promoters of a company shall offer to buy the public shareholders at a P/E multiple of 25 when the current trading multiple is 18. The stock exchange is going by the opinion of the valuer. The promoters feel the valuation is unjustified and wish to go in for arbitration. The promoters will succeed.

YES/NO

18. In a share buyback, a company offers a fixed price tender offer to shareholders that is 12% below the CMP. A shareholder questions the validity of the proposal and files a case stating that the controlling shareholders are trying to squeeze out the minority in the pretext of a share buyback at an unfair price. The shareholder's contention is tenable.

YES/NO

19. In a de-listing offer concluded a month ago, the company has obtained 92% stake. 3% of the shareholders are willing to exit at a higher price of 2x. The balance 5% shareholders are willing to exit at 2.5x. The company can insist on paying the same price as in the de-listing offer.

YES/NO

PART - B

20. A listed Indian company that is also listed in Casablanca proposes to de-list its GDRs. It has the following implication(s) –
- a) The de-listing of the GDRs is not possible without de-listing the domestic shares

- b) The Indian de-listing should precede the overseas de-listing
- c) There has to be simultaneous reverse book-built offer at both places

- d) The cut-off price in the de-listing offer in India has to be applied to the overseas de-listing offer
- e) The overseas de-listing offer can be independent of the domestic listing
21. A company decides to make a share buyback through reverse book building since it is of the view that it can return more capital to shareholders than through a fixed price tender offer. The following is (are) the implications –
- The proposed buyback is illegal
 - The has to make a de-listing offer since it is a reverse book built offer
 - Shares bought back have to be sold back through book building
 - The Company has to provide a floor price for the reverse book building
 - The company has to make a simultaneous de-listing Offer.
22. A share buyback is different from de-listing a company in the following way –
- Buyback increases RONW while de-listing decreases floating stock
 - De-listing privatises the company while buyback promotes the Company
 - Buyback increases RONW while de-listing decreases issued capital
 - Buyback increases RONW and decreases issued capital while de-listing decreases RONW and increases the EPS
 - Both RONW and EPS are increased in a buyback while in de-listing both remain unchanged.
 - RONW and EPS are increased and issued capital is decreased in a buyback while in de-listing it is the opposite.
23. Which of the following amount(s) to capital reduction?
- The company decides to cancel unissued capital
 - The company buys back shares and re-issues them
 - The company sub-divides ₹10/- share into five shares of ₹2/- each
 - The company consolidates a ₹1 share into a ₹5 share
 - The company decides to reduce the face value of existing shares from ₹10 to ₹5
 - Makes a buyback of ₹10 share at ₹25 per share
 - Makes a buyback of ₹10 share at ₹5 per share
24. In a share buyback, a company decides to buyback 30% of the issued capital at a price that would be within 25% of the share capital and free reserves of the company. The board and shareholders have approved the proposal. However, since the company proposes to buy more than the allowable 25% of issued capital, the Company Secretary decides to approach SEBI for a special permission in this case. The CFO is of the view that since the company is within the permissible value of the buyback, no approval is required from any authority. Resolve the issue from the following alternatives –
- The Company Secretary is right
 - The CFO is right
 - The Company Secretary is right but SEBI is not the authority to approach
 - Both are wrong since there is no approval mechanism.
25. In a de-listing offer, the company has offered a floor price of ₹275 per share. The CMP is ₹282. The 6 month weighted average price is ₹273. The last two weeks weighted average is ₹287. The price at which the controlling shareholders bought shares from the open market in the past 15 days averages on volume weighted basis at ₹286. The minority shareholders representing 12.20% of the voting capital petition the court against the offer stating that the offer is below the SEBI price. Analyse the situation from the given alternatives.
- The SEBI price has been followed correctly in this case
 - The minority has no right to invoke any action
 - The minority have misunderstood the applicability of the pricing formula
 - The Company should have applied only the last acquisition price and nothing else.
26. In a de-listing offer of a company, the principal shareholders succeed in procuring 98% of the shares. The residual 2% is in the hands of some public shareholders who have not responded to the offer. The principal shareholders now have the following alternatives for a squeeze out –

- a) They can compel the residual shareholders to sell at the discovered price.
 - b) They can offer to buy them out upto one year from the close of the offer at the discovered price.
 - c) They can buy them out through a negotiated price.
 - d) They can compel them to sell through a court proceeding.
 - e) They can de-register them as shareholders by striking off their name from the register of members.
 - f) They can make another de-listing offer for them.
 - g) They can cancel the offer and go for a new offer.
 - h) They can increase the price of the offer and wait for them to surrender their shares.
27. Johnson & Jonathan Ltd. has 42% free float in which small shareholdings constitute only 14%. The rest is held by institutions and other large investors. A HNI shareholder holds about 6%, two mutual funds and an insurance company together hold about 12% in the company. An FII holds 5% and an NRI holds another 5%. The board of directors call for consultation with investment bankers and a law firm on the proposal to take the company private. The law firm recommends direct negotiation with the large shareholders for possible off-market or block deals so that promoters can buy them at an agreed price. It feels that by doing so, the de-listing becomes cheaper and certain even if small shareholders do not respond to the offer fully. The investment banker called to manage the delisting offer says that a delisting offer may not be necessary if they can manage the big shareholders since promoters would have reached 86%. If another 4% can be managed from the secondary market through creeping acquisition, the promoters can apply for delisting by reaching 90%. They offer to provide their services to do the direct negotiations and creeping acquisition. Resolve the issue from the following given alternatives –
- a) If off-market negotiations are unsuccessful, the promoters will have to announce a de-listing offer for 32% so as to reach 90%.
 - b) If off-market negotiations are partly successful, the promoters should aim to reach 90% for the balance shortfall through a delisting offer.
 - c) If off-market negotiations are fully successful as planned, the promoters will have to complete secondary market purchases to reach 75% and then announce a de-listing offer for 25% so as to reach 100%.
 - d) The off-market deals and the de-listing offer cannot be combined. So the delisting offer can be made first only for the retail public so as to reach 72%. Thereafter, the large investors can be bought through off-market deals and company can apply for de-listing.
28. Timeless Travel Ltd. is a travel and tourism company specialising in domestic tourism for foreigners. After the COVID hammering, the company is expected to perform below its potential. In order to boost its stock price and financials, the company proposes a share buyback along with issue of NCDs in the market. The buyback is proposed at a value within the limit of 25% of the share capital and free reserves of the company. At the proposed buyback price, the company will be able to buy 28% of its public shareholding of 46%. The proposed NCD issue will replenish the entire funds used in the buyback through new debt capital. The board and shareholders have approved the proposal. Which of the following choice of considerations applies in the given situation? –
- a) The company has to satisfy only the statutory requirement for quantity of shares purchased since the entire capital used for the buyback is proposed to be replenished through the ncd issue.
 - b) The company has to satisfy the statutory requirements for quantity of shares purchased and value of the transaction and since the ncd issue is also proposed, the residual debt-equity ratio requirement should be calculated after the ncd issue.
 - c) The company has to satisfy the statutory requirements both for quantity of shares purchased and value of the transaction

at the minimum sebi price but since the ncd issue is proposed after the buyback, residual debt-equity ratio requirement need not be complied with.

- d) The company has to satisfy the statutory requirements for quantity of shares

purchased and value of the transaction and since the ncd issue is also proposed, the residual debt-equity ratio requirement should be calculated before the ncd issue.

PART - C

29. What is a share buyback? How is it different from de-listing?
30. How does a company decide between a buyback and a de-listing offer to the shareholders? How do they compare?
31. How is the pricing determined under a buyback and a de-listing offer? From the purchaser's point of view, what are the implications?
32. What are the requirements as regards the quantum of a buyback offer? What is the rationale for such quantitative restriction?
33. What are the methods of making a buy back and a de-listing offer? Are the procedural requirements different and if so, in what respect?
34. What is a squeeze out mechanism? How does it work in the context of a de-listing and a share repurchase programme?
35. Explain the balance sheet impact on a company under a share repurchase programme as compared to a delisting proposal. Illustrate with numerical examples.

ANSWERS

- | | | | | | |
|------------------------|------------|-----------|---------------------------|-----------|------------|
| 1. (FALSE) | 2. (FALSE) | 3. (TRUE) | 4. (TRUE) | 5. (NO) | 6. (YES) |
| 7. (NO) | 8. (YES) | 9. (NO) | 10. (YES) | 11. (YES) | |
| 12. AUDITORS | | 13. (NO) | 14. THE INVESTMENT BANKER | | |
| 15. FCD TO BE EXCLUDED | 16. (NO) | 17. (NO) | 18. (NO) | 19. (YES) | |
| 20. (e) | 21. (d) | 22. (e) | 23. (e) | 24. (c) | 25. (NONE) |
| 26. (b) | 27. (c) | 28. (b) | | | |

CHAPTER 13

Corporate Restructuring

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. The following falls under the category of internal restructuring –
 - a) Capital Reduction by the company.
 - b) Creation of a new SBU.
 - c) Reducing the face value of the equity shares of the company.
 - d) Consolidation of share capital.
 - e) Stock-split.
 - f) Issue of sweat equity.
 - g) Issue of ESOP.
2. The following falls under the category of External Restructuring –
 - a) Capital Reduction by the company.
 - b) Creation of a new SBU.
 - c) Reducing the face value of the equity shares of the company.
 - d) Consolidation of share capital.
 - e) Stock-split.
 - f) Issue of sweat equity.
 - g) Issue of ESOP.
3. The following is an essential pre-requisite for a transaction to constitute a demerger under Indian law –
 - a) The entire assets and property of the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger.
 - b) All the liabilities of the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger.
 - c) The transfer of assets and liabilities is at values appearing in its books of account immediately before the demerger.
 - d) The resultant company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis.
 - e) The shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger.
4. A company decides to give up a sea-face guest house valued at \$ 2 million to the bank for the settlement of a loan which was overdue. This amounts to –
 - a) Internal restructuring
 - b) External Restructuring.
 - c) Demerger
 - d) Hive-off
 - e) Spin-off
 - f) Asset Sale
 - g) Asset Carve Out
5. A company decides to suspend operations in a loss making manufacturing division and transfer all the assets of that division to another profit-making division. This amounts to –
 - a) Internal restructuring
 - b) External Restructuring.

- c) Demerger
 - d) Hive-off
 - e) Spin-off
 - f) Asset Sale
 - g) Asset Carve Out
6. A company proposes to start a new business activity with bankruptcy remoteness in a separate 100% subsidiary and grow it. This process would amount to –
- a) Formation of a subsidiary
 - b) Subsidiarisation through hive-off
 - c) Spin-off of a subsidiary
 - d) Subsidiarisation through split-off
 - e) Demerger of business
 - f) Demerger through subsidiarisation
 - g) Restructuring through subsidiarisation.
7. A company proposes to separate one of its existing business activities with bankruptcy remoteness and grow it. This can be achieved through –
- a) Sale of business to a newly formed 100% subsidiary
 - b) Hive-off of the business to another existing company
 - c) Demerger into another existing company
 - d) Demerger into a new company
 - e) Converting the existing company into a joint venture
 - f) Bringing in a strategic investor.
8. A company decides to suspend operations in a loss making manufacturing division and transfer all the assets of that division to its group company at the values appearing in the balance sheet as of the date of transfer at a share issuanceratio of 2.5:1. The group company issues its own shares as purchase consideration to the transferring company. This amounts to –
- a) Demerger
 - b) Hive-off not amounting to demerger
 - c) Asset sale
 - d) Spin-off
 - e) Purchase in the nature of demerger
 - f) Spin-off in the nature of hive-off
 - g) Asset Carve out in the nature of demerger
 - h) Spin-off in the nature of a demerger
9. A listed company proposes to invest into a new business, grow it and then look to unlock the value. This can be achieved through –
- a) Investing in a subsidiary and spinning it off at a later date
 - b) Growing the business as a division and demerging it
 - c) Investing in a subsidiary and rolling it back at a later date
 - d) Growing the business as a division and invite private equity investment
 - e) Growing the business as a division and convert itself into a JV
 - f) Investing in a subsidiary and go for equity carve out.
10. If a holding company spins off its subsidiary and then merges it with itself, the share swap is made between –
- a) The holding and the subsidiary companies.
 - b) The shareholders of the holding company and the subsidiary company.
 - c) The holding company and the shareholders of the subsidiary company.
 - d) The shares held in the subsidiary with additional shares in the holding company.
 - e) The shares in the holding company are exchanged for shares in the subsidiary company.
11. A listed company has two subsidiaries, one that is also listed and the other unlisted. It wishes to do a spin-off of the unlisted subsidiary and subsequently a merger between the two subsidiaries. The merger has to be accomplished through –
- a) Exchange of parent company's share with that of the listed subsidiary.
 - b) Exchange of shares between shareholders of the parent company and that of the listed subsidiary.
 - c) Exchange of shares between shareholders of the parent company and that of the unlisted subsidiary.
 - d) Issue of shares by listed subsidiary in exchange for shares held in unlisted subsidiary.

- e) Issue of shares by listed subsidiary in exchange for shares held in parent company.
- f) Issue of shares by listed subsidiary in exchange for shares held by shareholders of parent company in the unlisted subsidiary.
12. In a demerger scheme, a division of Company A is proposed to be demerged into Company B and another division of Company B is proposed to be demerged into Company A. The mutual consideration is proposed to be set-off against each other such that both the companies do not propose any share issue. For the scheme to be fair and reasonable, it needs to be shown that –
- The number of shares to be issued by Company A is identical to that of Company B
 - The book value of assets and liabilities to be transferred by Company B to Company A is identical to those of Company B to be transferred to Company A.
 - There is approval by 75% of the shareholders of both companies to the scheme.
 - The valuation of Company A and B are almost identical.

PART - B

13. In a spin-off, if the purchase consideration has to be settled in cash, it is paid to the shareholders of the company that has been spun off.
TRUE/FALSE
14. The difference between a demerger and a spin-off is that the former entails an asset transfer along with an equity transfer while the latter is just an equity transfer.
YES/NO
15. A company wishes to relinquish control of its 100% subsidiary in favour of its own promoters. This is possible through a spin-off.
YES/NO
16. In a three way split of a company, it is decided that at the first stage, a demerger would be done to create the second company. At the second stage, the resultant company will do a second demerger so as to create a third company. In this case, the share-swap can be done on a combined basis for both the demergers.
YES/NO
17. If a division of an existing company has to be spun-off into a subsidiary, it is necessary to pay a purchase consideration to the transferor company either by way of securities or cash or both.
TRUE/FALSE
18. In the spin-off of a subsidiary, the shareholders of the spun-off company are the shareholders of the parent.
YES/NO
19. A listed company has two unlisted subsidiaries. In one of the subsidiaries a carve out is proposed while in the other it's a divestiture. Will this be the right strategy if in the former subsidiary, the parent wishes to monetise its holding while in the latter, it proposes to cut losses.
YES/NO
20. A listed parent company has two subsidiaries, one of which is also listed. It wishes to do a demerger of a business from the listed subsidiary into the unlisted subsidiary. The investment banker advises that under the scheme, the unlisted subsidiary would be subject to backdoor listing. In order to prevent such a situation, the parent company proposes to issue its own shares in exchange for the shares of the unlisted subsidiary. Such a scheme would be invalid as the parent company has no *locus standi* under the demerger.
YES/NO
21. A company proposes to hive-off its loss making division into a wholly owned subsidiary through a BTA at an agreed value. This could

lead to tax liability for the holding company even though its an internal reorganisation.

TRUE/FALSE

22. In a demerger, a loss making division is separated from a listed company into a newly formed resultant company. The resultant company proposes to issue shares to the shareholders of the demerged company. This will amount to a backdoor listing for the loss making resultant company. The investment banker states that this is not possible since a loss making company cannot get backdoor listing. The banker is right –

YES/NO

23. American Auto Ltd. has two divisions – auto manufacture and auto ancillaries. It decides to hive off the auto ancillary division to its OEM supplier Indian Auto Ltd. Indian Auto wishes to pay the purchase consideration in the form of 10% royalty to the American company over the next 20 years. The purchase agreement also provides for a guaranteed 20 year lock-in for payment of royalties by the Indian company. A shareholder of the Indian company alleges that this is a fraud on the company as the value of the assets being acquired is far less than the royalty agreed to be paid. The I-banker advising on the deal states that independent valuation has been conducted and the royalty to be paid is justified by the valuation. Are shareholders within their right to reject the scheme or are they bound by the conclusions of the independent valuation?

- a) SHAREHOLDERS CAN VETO THE SCHEME
- b) SHAREHOLDERS ARE BOUND BY THE SCHEME

24. Saina Sindhu Corporation Ltd. manufactures Diwali fire crackers and gym equipment. Since both businesses are unrelated and both

the promoters are not on friendly terms, they decide to split the company and part ways to pursue respective business independently. The tax consultants (PWCKPMGEYDT Associates) advising the company recommend a demerger route to keep the restructuring tax neutral. The independent director feels that the gym equipment business should be sold through slump sale to Sindhu for a consideration of ₹150 crore so that it gets appropriate valuation. Which of the following statements is true with regard to the proposal? –

- a) Demerger will create two companies with Saina and Sindhu as shareholders of the original holding company and both the new companies become its subsidiaries.
- b) The consideration of ₹150 crore from the slump sale should be paid by Sindhu to Saina which will result in capital gain tax to Saina.
- c) Since both Saina and Sindhu were shareholders of the combined business, the best way to separate them permanently is to do a demerger first and later, Saina's shares in Sindhu's company should be purchased by Sindhu for an agreed price. Alternatively, Saina can purchase Sindhu's shares in her company. However, there will be a capital gain tax implication for the seller of the shares.
- d) The demerger can be done in such a way that both businesses go into two resultant companies and each of them becomes the 100% shareholder of her business.
- e) The existing company can demerge one of the divisions into the resultant company. Shares will be issued by the resultant company to both the shareholders. Thereafter, the shares can be swapped with each other so that each one gets to keep the respective company. This way the entire transaction is tax neutral.

PART - C

- | | |
|---|---|
| <p>25. What corporate reorganisations? Why do they happen? What are the types of corporate reorganisations?</p> <p>26. What are the methods for splitting up a company? What are the strategic and other considerations that go to decide the method adopted in a given situation?</p> <p>27. How is a demerger tax efficient? What are the disadvantages of a demerger in comparison with a subsidiarisation through a hive-off?</p> | <p>28. How does a de-subsidiarisation through a spin-off compare with that through an equity carve-out?</p> <p>29. What are the considerations to be kept in mind while determining the appropriate transaction structure for a corporate split-up strategy?</p> <p>30. In a split-up strategy involving transfer of shares, is it possible to create tax neutrality and if so how?</p> |
|---|---|

ANSWERS

- | | | | | | |
|--------------------------|-----------|--------------------------|---------|-----------|---------|
| 1. (d) | 2. NONE | 3. (a), (c), (d) and (e) | 4. (f) | 5. (a) | 6. (a) |
| 7. (a), (b), (c) and (d) | 8. (a) | 9. (a), (b) and (f) | 10. (b) | 11. (f) | 12. (c) |
| 13. FALSE | 14. YES | 15. NO | 16. NO | 17. FALSE | 18. YES |
| 20. NO | 21. FALSE | 22. NO | 23. (a) | 24. (c) | 19. YES |

CHAPTER 14

Mergers and Amalgamations

OBJECTIVE QUESTIONS WITH ANSWERS

Identify the right answer(s) or the alternative that best fits the description from the alternatives provided under each question.

PART - A

1. In a three-way unification of companies, a holding company and its subsidiary propose to get absorbed by another loss-making associate company. This transaction is termed as –
 - a) Reverse Demerger
 - b) Merger in the nature of absorption
 - c) Fantastic Merger
 - d) Triangular Merger
 - e) Three-way Merger
 - f) Amalgamation
2. If a profit-making company gets absorbed by a loss-making company, the transaction is termed as –
 - a) Amalgamation
 - b) Merger
 - c) Reverse Merger
 - d) Hive-off in the nature of merger
 - e) Reverse Demerger
 - f) Unhappy Merger
 - g) Sloping Merger
3. In an amalgamation in the nature of a purchase –
 - a) The entire assets and property of the merging company are transferred to the merged company and based on the valuation of both the companies, the purchase consideration is fixed.
 - b) The assets and liabilities of the merging company to be transferred are finalised and valued to arrive at the purchase consideration which is paid in the form of shares of the transferee company based on the share swap ratio.
- c) The purchase consideration is paid by the transferee company in the form of shares or cash or both and the transferor company is dissolved.
- d) The assets and liabilities may or may not be transferred in full by the transferee company based on the valuation of the transferor company.
- e) Based on the mutual valuation of the two companies, the share swap ratio is fixed to pay the purchase consideration.
4. In a true merger with 'pooling of interests' –
 - a) The entire assets and property of the merging company are transferred to the merged company and based on the valuation of both the companies, the share swap ratio is fixed.
 - b) The assets and liabilities of the merging company to be transferred are finalized and valued to arrive at the purchase consideration which is paid in the form of shares of the transferee company based on the share swap ratio.
 - c) The purchase consideration is paid by the transferee company in the form of shares or cash or both and the transferor company is dissolved.
 - d) The assets and liabilities may or may not be transferred in full by the transferee company based on the valuation of the transferor company.

- e) Based on the mutual valuation of the assets of both the companies, the share swap ratio is fixed.
5. If a holding company spins off its subsidiary and then merges it with itself, the share swap is made between –
- The holding and the subsidiary companies.
 - The shareholders of the holding company and the subsidiary company.
 - The holding company and the shareholders of the subsidiary company.
 - The shares held in the subsidiary with additional shares in the holding company.
 - The shares in the holding company are exchanged for shares in the subsidiary company.
6. In an amalgamation, the share swap ratio is fixed on the basis of –
- Book value of assets and liabilities on the date of merger.
 - DCF valuation of both the companies.
 - Earnings capitalization method.
 - Market Value of the shares of both the companies.
 - A fair value based on different approaches of valuation.
7. A listed company has two subsidiaries, one that is also listed and the other unlisted. It wishes to do a spin-off of the unlisted subsidiary and a merger between the two subsidiaries. This would result in –
- An open offer in the listed subsidiary.
 - An IPO for the unlisted subsidiary.
 - A de-listing offer for the listed subsidiary.
 - One unlisted subsidiary.
 - One listed subsidiary.
8. A listed company has two subsidiaries, both listed. It wishes to do a spin-off of one subsidiary and a merger between the two subsidiaries. This would result in –
- An open offer in the listed parent.
 - An IPO for the spun-off subsidiary.
 - A backdoor listing for the other subsidiary.
 - Two listed group companies.
 - One listed subsidiary.
9. A promoter group has two companies – both listed. In the bigger company they have 38% stake and in the smaller company they have a 62% stake. They now propose a merger between the two companies and the share swap ratio is fixed in such a way that their stake in the combined company goes upto 51%. This has the following implication(s) –
- The Takeover Code will be triggered off in the bigger company.
 - The Takeover Code will be triggered off in the smaller company.
 - The promoters will be compelled to make a de-listing offer for the merged entity.
 - The scheme will be held valid with an open offer requirement
 - The company will be prosecuted for violation of corporate governance norms.
 - The scheme will be held valid without any further requirements.
10. In accounting for a merger under the purchase consideration method, a company is faced with a situation wherein it does not know how to transfer a capital reserve in the transferor's books to the transferee's books. This can be achieved in the following way –
- The transferee can reduce the capital reserve from the purchase consideration.
 - The transferee can allot shares to the extent of the capital reserve.
 - The transferee can settle the capital reserve in cash.
 - The transferee can allot shares to the shareholders of the transferor company to the extent of the capital reserve.
 - The transferee can net off the capital reserve from other reserves appearing in its books.
 - The transferee can reduce the book value of the assets taken over to the extent of the capital reserve.
11. In financing the merger of two companies through purchase consideration method, the transferee comes up with a scheme of issuing deep discount bonds to the shareholders of the transferor company. This has the following implication –
- The scheme is not compliant with an amalgamation in the nature of purchase.

- b) The transferee is not permitted to do so since the shareholders of the transferor have to be settled in cash.
 - c) Since this is a buyback of shares, it has to be financed only in cash.
 - d) The deep discount bonds have to be valued at not less than the original issue price of the shares.
 - e) The swap ratio of bonds to shares shall not be less than the issued capital of the transferor company.
 - f) The issue price of the bonds shall be equal to the purchase consideration.
12. Company A is an unlisted holding company and is in need of capital. Company B which is its listed subsidiary, has a problem of excess free cash flow. The CFO of Company A proposes a preferential offer to Company B. The CFO of Company B proposes a high dividend distribution. The financial adviser of the group suggests that there should be a share repurchase by Company B. The tax advisor to the group says that Company B should be merged with Company A. The Chairman of Company A fears that this would lead to a back door listing of Company A. Since they could not agree on the offer formulation, they engage an investment banker who advises that a separate SPV should be floated in which both the companies are equal shareholders. Which of the following alternatives is the most tax efficient and also meets the strategic requirement?
- a) Advice of CFO of Company A
 - b) Advice of CFO of Company B
 - c) Advice of Group Financial Adviser
 - d) Advice of Group Tax Adviser
 - e) Advice of Investment Banker
13. An investment bank announces the merger of its banking associate with itself. This amounts to –
- a) Insider Trading
 - b) Core Investment Banking
 - c) Universal banking
 - d) Non-Banking Financing
 - e) Conglomerate Banking
14. In financing the merger of two companies through purchase consideration method, the transferee comes up with a scheme of issuing deep discount bonds to the shareholders of the transferor company. This has the following implication –
- a) The scheme is not compliant with an amalgamation in the nature of purchase.
 - b) The transferee is not permitted to do so since the shareholders of the transferor have to be settled in cash.
 - c) Since this is a buyback of shares, it has to be financed only in cash.
 - d) The deep discount bonds have to be valued at not less than the original issue price of the shares.
 - e) The swap ratio of bonds to shares shall not be less than the issued capital of the transferor company.
 - f) The issue price of the bonds shall be equal to the purchase consideration.

PART - B

15. In a merger of two companies, the first company requests the second company to revalue its assets before fixing the share swap ratio. This is not possible since it is a merger of two companies.
- YES/NO
16. In a merger of two companies A and B, the share swap ratio has been fixed taking into account an impending acquisition by A of another company C. The shareholders of B wish to have two ratios – one assuming that the acquisition will go through and the other assuming it will not. The investment banker of A holds that there cannot be multiple share swap ratios for one merger transaction. Who is right?
- SHAREHOLDERS OF B/INVESTMENT BANKER OF A
17. In an amalgamation in the nature of a merger of two companies, the absorbing company

demands that the merging company should be valued on the basis of its assets before fixing the share swap ratio. This is not possible since the merger has to be at book values.

YES/NO

18. In a scheme of merger, Doctor Ltd. decides to keep its intellectual property out of the merger scheme by transferring it to a third company prior to the merger. This is proposed so as to retain the IP advantage for the future. The other company in the scheme, Gambler Ltd.

opposes the move and objects to the scheme for being fraudulent. Can the Court overrule either party and decide the case? –

YES/NO

19. Madaari Securities Ltd., a broking and underwriting firm wishes to merge with Kabaali Capital Ltd., an investment bank to become Kamaali Capital Securities Ltd. Will this merger be allowed?

YES/NO

PART - C

19. How do you distinguish a merger from an amalgamation? What are the legal connotations of both the words?
20. What is the process flow of a merger and the role of an investment banker therein?
21. Explain the process of financial evaluation of a merger and the inferences to be drawn therein with the help of a numerical illustration.
22. Enumerate the main strategic objectives in inorganic growth strategy and how an M&A transaction may accomplish them with examples.
23. How does one ensure fairness in a scheme of amalgamation so as to pass judicial scrutiny?
24. Explain the principal terms of a merger agreement and how an investment banker helps in the process of concluding it.
25. Explain the context of valuation in M&A and how it can be applied with relevant examples.

ANSWERS

1. (f) 2. (c) 3. (a) 4. (a) 5. (b) 6. (e) 7. (e) 8. (d) 9. (g) 10. (b)
11. (f) 12. (d) 13. (c) 14. (NO) 15. (NO) 16. INVESTMENT BANKER OF A 17. (NO)
18. (YES) 19. (f)

CHAPTER 15

Acquisitions and Takeovers

OBJECTIVE QUESTIONS WITH ANSWERS

Pick the right answer(s) or the alternative that best fits the given question or situation from the alternatives provided under each question.

PART - A

1. The promoter group of a company decides to take the assistance of a large private equity fund in making a counter-offer in response to an open offer made by an acquirer. The private equity fund is then called –
 - a) Black Dog
 - b) Blue Label
 - c) Hungarian Opening
 - d) White Knight
 - e) Red Herring
 - f) Dark Horse
 - g) Poisson Curve
 - h) Check and Mate
 - i) Windsor Castle
 - j) White Stallion
 - k) Her Royal Highness
2. If promoters increase their stake in a listed company through rights renunciation beyond 5% of the total issued capital, it amount to –
 - a) good strategic planning
 - b) substantial acquisition under the Takeover Code
 - c) substantial acquisition that will not trigger off takeover code
 - d) invalid acquisition
 - e) hostile takeover
 - f) shall be valid only if pricing guideline is followed.
3. In a Bought Out Deal (also known as a Bought Deal), the investment bank that makes the BOD –
 - a) Takes the company public through a public offer
 - b) De-lists the company
 - c) Holds its stake till maturity
 - d) Buys off the promoters through an open offer
 - e) Makes an Open Offer to the public
 - f) Exits through an Offer for Sale of secondary shares
 - g) Makes a preferential allotment
 - h) Makes the company buyback the equity.
4. The promoters of a company provide for affirmative rights and shares with differential voting rights to themselves to ward off potential takeover attempts. These arrangements are called –
 - a) Begees
 - b) Scorpions
 - c) Hungarian Openings
 - d) Red Herrings
 - e) Dark Horses
 - f) Poisson Curves
 - g) Check and Mate
 - h) Poison Pills
 - i) Windsor Castles
 - j) White Stallions
 - k) His Royal Highnesses
5. In a LBO, the acquirers aim at the following –
 - a) Acquire the target company's assets so as to make asset sale

- b) Acquire the target company's shares so as to do a share buyback and get 100% control
 - c) Acquire the target company's brands and intellectual property so as to make a brand sale
 - d) Acquire the rights to manage the company by a contract with the existing shareholders
 - e) Replace existing management with shareholders
 - f) Take the company private so as to make a SIPO through a preferential allotment
 - g) Take the company private so as to make a SIPO at a later date.
6. In a LBO, the acquirer has created a SPV to finance the transaction. The SPV is capitalised with assets transferred by the acquirer company through a hive-off against which the SPV has allotted shares to the acquirer. The debt has been raised through bank loans which are secured against those assets. The SPV now proposes to sell the assets to pay the shareholders of the target company to which the lenders object. This has the following consequence –
- a) The lenders have a right to object since the assets are a security given to them.
 - b) The lenders have a right to enforce the security against the SPV.
 - c) The lenders may agree to the sale provided the assets of the target are substituted as security.
 - d) The lenders may foreclose the debt and demand repayment prior to the sale of assets.
 - e) The lenders can bring an attachment order on the assets to prevent their sale by the SPV.
 - f) The lenders can insist that the SPV pay the proceeds of the assets to them to set off their debt.
7. In a LBO structure, the acquirer has created a 100% subsidiary SPV to finance the transaction. The SPV issues bonds to the shareholders of the target company to acquire 100% stake of the target. The bonds are secured against the assets of the target company. The bonds are proposed to be listed so that they provide liquidity to the bondholders. If at a later date, the SPV is merged with the target company,
- a) The bondholders become shareholders in the merged entity
 - b) The bonds will rank as sub-ordinate debt in the merged entity
 - c) The bondholders will receive shares from the acquirer in lieu of the bonds.
 - d) The acquirer can redeem the bonds by issue of its own shares
 - e) The merged entity will become the subsidiary of the acquirer.
 - f) The bonds will be delisted from the market
 - g) The merged entity will cancel the bonds against shares held by the acquirer
8. In an Open Offer under the Takeover Code, an acquirer makes an Open Offer for the entire non-promoter shareholding of the company. Which of the following scenarios is valid under the Takeover Code?
- a) The public response is for the entire offer whereby the acquirer becomes 100% shareholder of the company
 - b) The Open Offer is rejected by the public in full and the acquirer gets to keep only the shares already acquired before the open offer.
 - c) The public accepts 25% of the offer whereby the acquirer's post-offer stake settles at 56%.
 - d) The public accepts 75% of the offer whereby the acquirer's post-offer stake settles at 76%.
9. Planet Shipping and Maritime Ltd., has 22% with the present promoters. The non-promoter shareholding consists of a total of 18% held by many NRIs from Andhra Pradesh settled in USA. The rest is held by institutional investors and foreign investors. The promoters approach a business associate to request for a voluntary open offer under the Takeover Code to acquire a minimum of 26% of the company so that together with the promoters they can have a combined stake of 48%. From the following alternatives, select the most probable answer that can be possible under the Takeover Code. –

- a) If the open offer is successful, the business associate can creep up to 75% slowly and eventually takeover the company as the business associate will have 51% control.
- b) If the business associate wants to takeover the company, another offer for takeover has to be given under the Takeover Code after the present offer is concluded.
- c) The business associate has to be appointed on the board of the company before any takeover is possible.
- d) If the acquirer succeeds in procuring the required 26%, he will still need to acquire the 22% held by the current promoters in order to takeover the control of the company.

PART - B

10. A PE fund takes a 26% stake in a company through a PIPE transaction and argues with the investment banker that they are not in a controlling position because they are an institutional fund. Therefore they do not require to make an open offer under the Takeover Code. The i-banker disagrees. Who is right?
PE FUND/INVESTMENT BANKER
11. A hostile bidder offers to buy 100% of a company with a simultaneous FPO through an OFS for 25% so as to retain the minimum public shareholding. This is valid since the company will continue to be listed and the acquirer's stake is capped at 75%.
YES/NO
12. Robert DeCosta Ltd., (RDL) announces a hostile bid for 53% of Michael Gonsalves Ltd., (MGL). RDL does not own any shares in MGL but RDL's subsidiary holds 26% in MGL from a previous amalgamation scheme. This is therefore not a voluntary offer but a mandatory offer.
YES/NO
13. A squeeze out is a mechanism by which the controlling shareholders of a company vote to transfer the shares of the minority to themselves at a price that is agreed to by the majority through a special resolution of 75% favourable votes.
YES/NO
14. A PE fund wishes to buy a significant stake of 24% in a listed company and has been discussing with the company about the transaction as a combination of funding the company and acquiring secondary shares from a big institutional investor. In the meantime, a buyout fund makes a hostile bid by announcing an open offer to acquire 51% of the company. In a bid to save the company, the promoter group with a shareholding of 32% requests the assistance of the PE fund as a white knight to make a counter offer. The financial advisor of the PE fund advises the fund that such a step would amount to acting in concert with the promoters, and its own position will become that of an acquirer leading to an obligatory open offer. The i-banker advising the company states that the advisor is clearly wrong and the PE fund's support to the promoters will form part of the same on-going PE transaction. Who is right?
THE FINANCIAL ADVISOR/THE INVESTMENT BANKER
15. In an open offer following a hostile bid, the acquirer increases the offer price suo moto before there is a counter-offer by the existing promoters. Such an increase is invalid under the Code. –
TRUE/FALSE
16. In an Open Offer, if the acquirer makes a conditional voluntary offer to acquire a 30%. If the response to the offer is to the extent of 14%, the offer is deemed to have failed and all the money collected is to be refunded.
YES/NO
17. A management buyout is proposed in a company in which the management already

has ESOPs amounting to 12%. They now propose to acquire the promoters' stake of 24%. The investment banker states that this would trigger the Takeover Code. The management maintains that the buyout is only for 24% and the rest are ESOPs. Who is right?

THE MANAGEMENT/THE
INVESTMENT BANKER

18. In a negotiated acquisition, the Takeover Code of SEBI does not apply as it is applicable only to hostile takeovers.

YES/NO

19. A listed company decides to spin-off its wholly owned subsidiary and thereby get it listed. Immediately thereafter, the subsidiary proposes to go in for a substantial acquisition by a strategic investor. The investor proposes to make an open offer and retain the maximum permissible under law. The shareholders object to this scheme stating that the strategic investor could have acquired a stake in the subsidiary directly from the parent without listing it. By listing it and making an open offer, the public shareholders are being deprived of future growth potential of the subsidiary. The investment banker claims that the scheme is perfectly valid under law and the investor was not obligated to buy shares in an unlisted subsidiary. Who holds the correct position under law?

THE SHAREHOLDERS/
THE INVESTMENT BANKER

20. In a buyout deal, the existing promoters with 34% stake wish to exit the company selling their entire stake to the acquirer. The rest of the shareholding is with the public. The acquirer is open to the option of the company being listed or not. CMP = ₹110 per share, Average market price under SEBI formula = ₹93 per share, negotiated price with promoters = ₹125 per share.

- Does the open offer get triggered? YES/NO
- What would be the applicable price for the Open Offer ? ₹----- per share.
- What is the minimum and maximum size of the Open Offer ?
Minimum% ----- Maximum% -----

21. Angela Kernel GmbH, a German Company intends to acquire 22% of Namo Smrithi Ltd., a listed Indian company which already has 16% stake by another German Company Boris Graf GmbH. Therefore the acquisition by Angela will trigger the Takeover Code.

YES/NO

22. A company wishes to do cash less acquisition. However, it does not wish to do a stock swap for the acquisition. Therefore it decides to do an amalgamation through purchase method wherein the consideration (in stock) will be issued to the acquired company. This is possible.

YES/NO

23. A company is interested in the assets and business of a target company rather than in its legal entity. The best way to accomplish its acquisition objective would be to settle the purchase consideration to the target company.

YES/NO

24. A company is interested in an acquisition wherein the continuance of the legal entity of the target is necessary. The best way to accomplish its objective would be to pay the purchase consideration to the shareholders of the target company without effecting an amalgamation.

YES/NO

25. A buyout fund wishes to acquire 100% of a target company through a tender offer and merge it with another portfolio company which was acquired in the previous year. In the proposed merger, the stock swap will be made between the shareholders of the target company and the PE investor.

YES/NO

26. A buyout fund decides to do a LBO through a SPV floated for this purpose. The leverage in this case, is reflected on the balance sheet of the SPV, the equity in the target is owned by the SPV, the equity in the SPV is owned by the buyout fund, the debt servicing is done by the SPV, while the mortgage is reflected in the balance sheet of the target.

TRUE/FALSE

27. The founders of a company holding 26% presently wish to make a counter offer for only 30% of the public holding while the acquirer has made an open offer for the entire 62% of the public shareholding. The i-banker maintains that the open offer is invalid since it is for more than 20% and the counter offer is also invalid since it is less than the minimum quantity required. The i-banker is right.

YES/NO

28. In an Open Offer, if the acquirer makes an offer to acquire a minimum of 30% and the response to the offer is to the extent of 14%, the offer is deemed to have failed and all the money collected is refunded.

YES/NO

29. Mid-way in an open offer, if the acquirer decides to increase the quantity of the offer,

he has to make another public announcement before there can be a counter-offer.

YES/NO

30. In an Open Offer, the escrow account is opened in order to protect the acquirer company from bankruptcy such that the persons tendering their shares in the open offer need not have any recourse to the company in which they own shares.

YES/NO

31. A company makes a PIPE placement to a PE fund amounting to a 26% acquisition. This triggers the Takeover Code and under the regulations of SEBI, an open offer to the extent of an additional 25% is required so as to make it a 51% acquisition.

YES/NO

PART - C

32. What are the triggers for the Takeover Code? What are its main requirements?

33. Are hostile takeovers possible under the Takeover Code? How does one ensure success in a hostile takeover within the framework of law?

34. What are the strategic issues in M&A that investment bankers have to take into account in determining transaction structure?

35. What are the valuation approaches and techniques adopted in M&A?

36. What are the financing options in M&A? How does one choose from them?

37. What is a buyout? How is different from a substantial acquisition or a takeover? Explain

in your own words with an illustrated example, the rationale of taking a company private for the purpose of a SIPO.

38. What is a divestiture? What are the different methods available for a divestiture? Explain the methodology of a divestiture through a BTA (Slump Sale) and how it is different from a divestiture through share sale.

39. Is a hostile acquisition a preferred method of acquiring control of a target company? How does it compare with other available alternatives? When does it become the first preferred strategy?

40. What is the transaction structure of a classical LBO? Is it possible in the Indian scenario?

ANSWERS

- | | | | | | |
|--|--------------------------|----------------|-----------|-----------|--------|
| 1. (d) | 2. (c) | 3. (a) and (f) | 4. (h) | 5. (g) | 6. ALL |
| 7. (e) | 8. The Investment Banker | | | 9. (a) | |
| 10. Investment Banker | | 11. (NO) | 12. (NO) | 13. (NO) | |
| 14. Financial Advisor | | 15. (TRUE) | 16. (NO) | | |
| 17. The Investment Banker | | 18. (NO) | 19. (b) | | |
| 20. a) - YES , b) - ₹125 PER SHARE, c) – MIN 26%, MAX 41% (Without De-Listing) and 66% (With De-Listing) | | | | | |
| 21. (NO) | 22. (YES) | 23. (YES) | 24. (YES) | 25. (YES) | |
| 26. (TRUE) | 27. (YES) | 28. (NO) | 29. (YES) | 30. (NO) | |
| 31. (YES) | | | | | |

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