Mangalum Drugs and Organics Ltd

Forex Risk Management Policy

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RISK MANAGEMENT POLICY

Mangalum Drugs & Organics Limited commenced in 1977 its manufacturing of Active Pharmaceutical Ingredients APIs, Intermediates at VAPI - Gujarat. It has a multi-product manufacturing facility on two locations, and an in-house R&D. The company is involved in importing materials to conduct its business operation in India.

Given the complexity and volatility of currency markets in today's world and to establish a control over the forex exchange risk, the company has decided to prepare and document a "Forex Risk Management Policy (RMP)" to ensure that the exposure of forex movements is managed in a professional manner to mitigate the risk.

As part of that process, a sound formal policy for forex risk management is a major step towards satisfying standards for financial controls. The policy lays out clear mandates for action and governance with clearly defined responsibilities.

In view of the above objective, a Risk Management Policy ("RMP") is being prepared to document the same.

1. Objectives of Risk Management Policy

To establish a framework for the policy, we outline the principal business lines where the company is equipped and prepared to take risk. These need to be monitored as risks that can or cannot be hedged in the market.

The objective of the proposed Forex Risk Management Policy is as follows:

- To assess and mitigate the potential exchange rate risk.
- To define roles and responsibilities of personnel in charge of risk management.
- To set benchmarks for treasury to operate within risk limits and prudential controls.
- To ensure reasonable surety of cash flows in terms of base currency.
- To leverage the foreign exchange market to improve margin realizations of the company.

2. Identification and Quantification of Exposures

- Confirmed exposures are foreign exchange transactions to which the company is irrevocably committed. For e.g.: Import payment.
- Documented maturity date. i.e., in the case of imports, it is the expected bill payment date (payment date plus usance period, if any).

E.g. Import: A Day by Day Process of Payment Cycle & Risk Management is illustrated as below:

Day 01 : We contract to import of goods of USD 1,000,000 under letter of credit with usance period up to 90 days.

Day 01 : We use the Forward rates to set the benchmark rate for this exposure (Kindly refer to the section of Hedging Strategy given in latter part of the document)

Day 01 : We open Irrevocable Import Letter of Credit with usance credit period of 90 days

Day 01 : Depending on current market scenario we execute any of the below available hedging strategy. (Kindly refer to the section of Hedging Strategy given in latter part of the document)

Day 15 : Goods are loaded on to the vessel

Day 105: Bill gets paid at the end of the credit period.

Day 105: The effective payment rate is compared with the benchmark rate to evaluate the efficiency of the hedge. (Kindly refer to the section of Hedging Strategy given in latter part of the document)

3. Risk Management Policies and Responsibilities

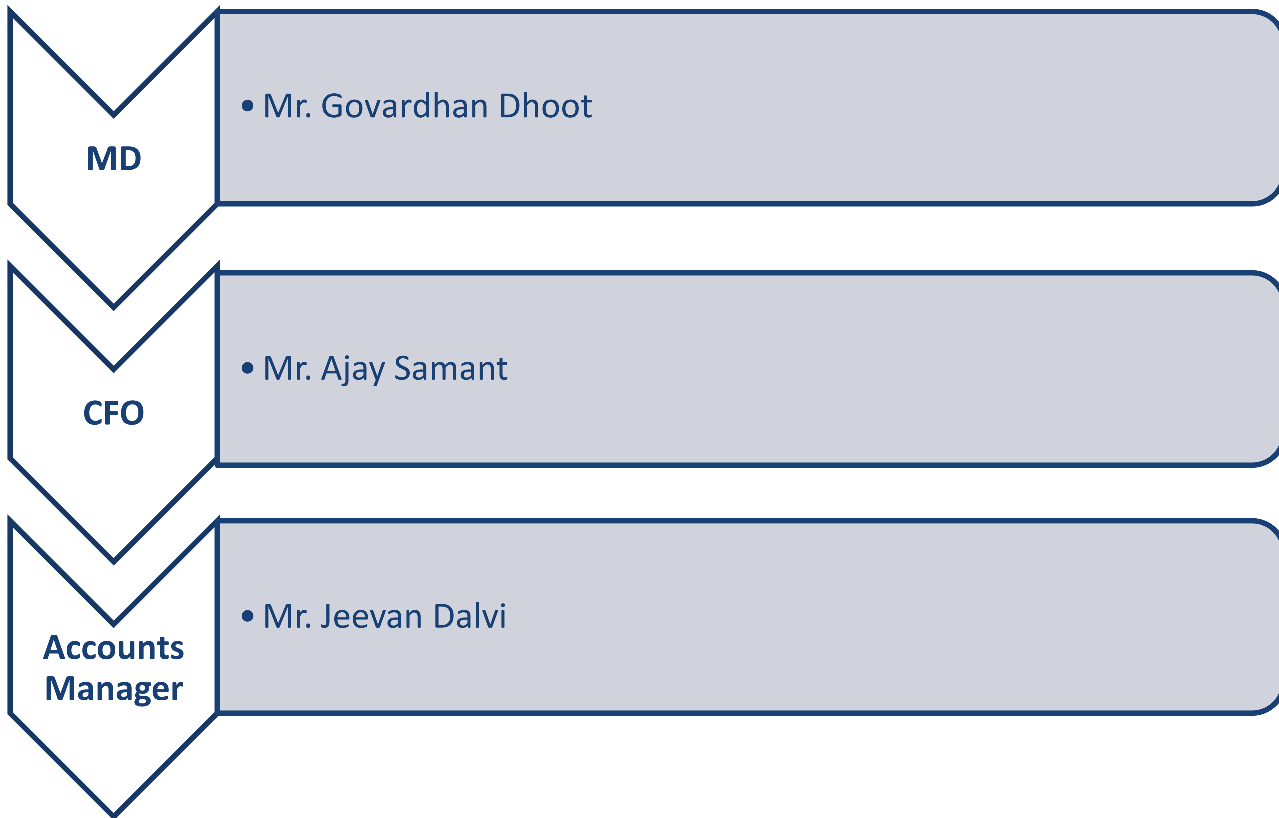
The chain of responsibility for making decisions and executing them is to be formally established. Basic guidelines and ranges of acceptable hedging activity should also be established.

Basic Risk Management Guidelines:

- The Company will not participate in speculative transactions. Speculative activities would include any action that would add to, rather than reduce, the financial risks of the company.
- Full statutory compliance of the FEMA, Rules, and guidelines issued by RBI/SEBI & any other government agency.
- An exposure shall be recognized as per the Guidelines prescribed by the Reserve Bank of India.

Risk Management Roles and Responsibilities:

Hierarchy



MD:

- Actively taking hedging decisions for exposures of the company.
- Maintain and overall vigilance on hedged and open positions.
- Monthly review of hedged and open positions of company.
- To ensure that risk management practices are in compliance with the policy framework.
- To review changes in FEMA, if any.

CFO/ Accounts Manager

- To execute the approved hedging strategies.
- To ensure effective and efficient functioning of the day to day activities pertaining to forex risk management.
- To be responsible for administrative activities related to the forex operations. To review and approve reports generated by the back office.

4. Hedging Strategy

In this section, hedging strategies to manage risk are explicitly identified. In order to provide additional flexibility, a range of approved products, including forward contracts, options, and other permitted derivatives are recommended.

The specific hedging technique selected will depend on the circumstances of each exposure.

For example, if certainty of an outcome is the main objective, forwards are likely to be the required product.

Alternatively, for competitive reasons, the company may need upside potential from currency movements. In this case, options and derivatives strategies will provide the desired trade-off of protection against adverse market moves while preserving upside potential from the underlying exposure.

Only those financial instruments permitted by RBI/SEBI and authorized by this policy shall be used for hedging.

Exposure management shall be conducted in line with the prudential controls as laid down under this policy.

Definitions:

- ***Benchmark rate:*** It is the rate based on which a viability of a particular transaction has been evaluated. This benchmark rate should be plus/minus 10 paise from the Forward Reference Rate for all the outflows.
  E.g.: Import transaction
    - Import Date: 2nd April, 2016
    - Payment Date: 31st May, 2016
    - RBI Reference rate on 2nd April, 2016: 66.25
    - Premium upto 31st May, 2016: 55 paisa
    - Benchmark rate: 66.25 + 0.55 + 0.10 = 66.90 paise.

- ***Efficiency measurement:*** The final rate of a transaction will be compared with the Benchmark rate to calculate profitability of the hedging strategy.
  E.g.: Import transaction
    - Benchmark rate: 66.90
    - Actual hedge/payment rate: 66.25
    - Profit/ (Loss): 65 paisa (66.90-66.25)

Authorized Instruments:

- **Cash, Tom and Spot deals**

  E.g. Closing Spot as of 03rd April, 2016, Settlement date 05th April, 2016, is 66.25 (i.e. Trade+2 days)
  E.g. Relevant Tom as of 03rd April, 2016, Settlement date 04th April, 2016, is 66.24 (i.e. Trade+1 day)

E.g. Relevant Cash value as of 03rd April, 2016, Settlement date 03rd April, 2016, is 66.23 (i.e. Trade day) The spot rate (T+2) is the rate which we can see on a live Reuters / Ticker plant terminal or the one that is flashing on business channels.

- **Forward Contracts**

In simple terms means fixing of conversion rate for future fx transaction whether inward/outward.
E.g. Forward Price can be fixed on 3rd April for 30th April, 2016 maturity at 66.60 (Spot 66.30 + Premium 0.30)

- **Currency Options**

E.g. A Buy Call option of 66.75 for April expiry or various option strategies e.g. Import Seagull. Explained in detail below.

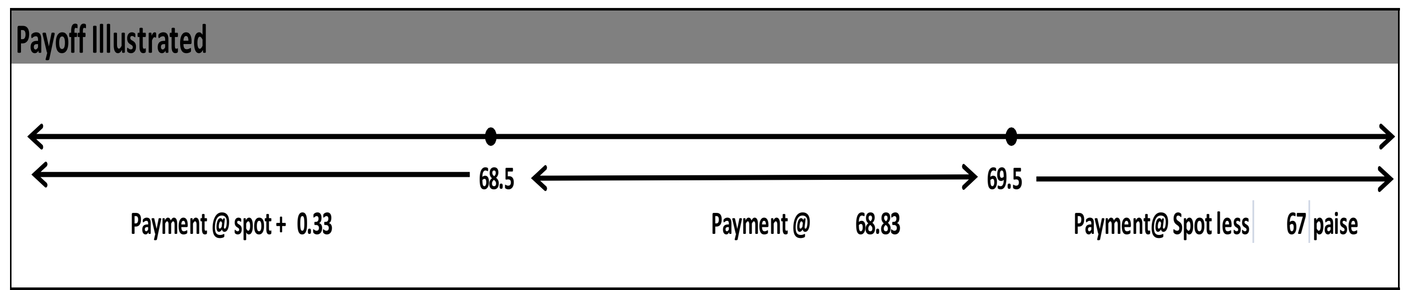
Hedging Strategy:

- **Import exposure**

1. **Forward contracts:** It is locking a particular rate of exchange for a date in future.

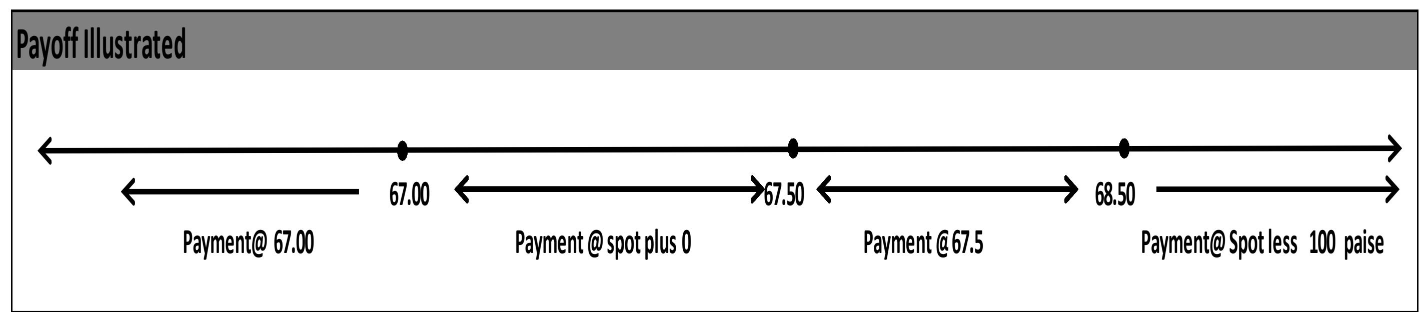
2. **Call Spread:** Using this strategy we can participate in the rupee appreciation and in case the rupee depreciates we are protected for the range of call spread.

E.g.: Assume the range of call spread is 68.50 to 69.50 with 33 paisa cost.



3. **Seagull:** Using this strategy we can participate in the rupee appreciation up to the lower range of the seagull strategy and are protected up to the upper range of the seagull.

E.g.: Assume the strikes of seagull are 67.00 – 67.50 – 68.50 with zero cost.



The decision to hedge all exposures will be taken on the basis of guidelines below:

- **Materiality concept:** We shall not look to hedge any exposures unless the aggregate unhedged position of new exposures is more than **50,000 units of a particular currency.**
- For remaining unhedged position an appropriate time to either hedge it or keep it open shall be taken by the management on an ongoing basis.
- **Stop Loss Policy:** Here we define when an unhedged exposure should be hedged in case the exchange rates go against us. Stop loss shall be 50 paisa.
  E.g.: Import

  - Benchmark rate : 66.90
  - Stop Loss : 66.90 plus 0.50 = 67.40
  - Thus, if the current rate of unhedged exposure goes above 67.40, we should use an appropriate strategy to hedge the complete balance exposure.
- **Target Rate Policy:** Here we define when an unhedged exposure should be hedged in case the exchange rates are moving in our favor. Target should be 100 paisa
  E.g.: Import

  - Benchmark rate: 66.90
  - Stop Loss: 66.90 less 1.00 = 65.90
  - Thus, if the current rate of unhedged exposure goes below 65.90, we should use an appropriate strategy to hedge the complete balance exposure.

- Once risk management actions have been taken, the hedge choices and actions need to be monitored for performance by the management. The underlying exposures must be monitored on an on-going basis to ensure that the position does not become over or under hedged.
- If there is ever any evidence of an erroneous outcome or impropriety, it has to be immediately reported to the immediate higher authority.

5. Monitoring, Reporting and Evaluation of RMP

Risk management should be a process of continuous improvement. The policy itself should be viewed as a living document. Within the policy, there should be an explicit commitment to review the policy on an annual basis to confirm that it is meeting its compliance objectives of risk reduction and enabling the company to reach its financial goals.
This process should be documented, reviewed, approved and signed so that the mandated officers can attest to the integrity of the provisions on an on-going basis.

6. Conclusion

The benefits of comprehensive FX risk management would be realized through a more predictable and stable financial performance.
A well-drafted risk management policy is an essential component of this process. Once goals and responsibilities have been made clear, every person in treasury will benefit from the well- defined mandate. And ultimately, the shareholders will benefit the most from improved financial controls and performance.