MUTUAL INDUSTRIES LTD.
FOREIGN EXCHANGE RISK MANAGEMENT POLICY

1. PREAMBLE

1.1. Company’s business activities inter-alia includes import of materials for further production, trade and Capital Equipment like Machineries and spares etc. Company exports products manufactured / sourced to various countries which are linked to international prices and major international currencies. As a result, the Company is exposed to exchange rate fluctuations on its imports and exports. The Company also avails Foreign Currency (FC) funding in the form of PCFC/Buyers credit/ECB as the situation warrants. The impact of these fluctuations on the Company’s profitability and finances is considered material.

1.2. It is therefore, important that the Company manages and mitigates its risk and accordingly develop a Currency Risk Management Policy Document which will provide the necessary guiding parameters.

2. OBJECTIVES

2.1. To make certain that the Foreign Exchange Risks are effectively identified, assessed, monitored and managed by the Company in line with the overall objectives of the Company and in compliance with the legal requirements and regulations of Reserve Bank of India.

2.2. To manage Foreign Exchange transactions as a cost-containment exercise only.

2.3. To minimize the impact of Forex rate variations on INR value of the committed receipts and payments in foreign currencies while minimizing the cost of such protection.

2.4. To ensure FC funding, where availed, does not exceed the cost of Rupee funding of a comparable nature, at the time of availing.

2.5. To reduce cash flow uncertainties and improve financial decision making.

2.6. To establish processes to monitor and control the risks as per the process.

2.7. To create an efficient process for reporting the key parameters measuring the risks and the performance of the Risk Management Tools.

2.8. The process also covers the proposed authority and responsibility structure and is meant to cover all activities of the company with regards to management of Foreign exchange as well as interest rate risks.

3. EXPOSURES FACED BY MIL

3.1. **Translation exposure:** The functional currency of MIL is the Indian Rupee (INR). Currently the Company does not have any investments / subsidiaries / associate company or any arrangements of such type in foreign country. Hence, the Company is not exposed to translation exposure.

3.2. **Transaction Exposure:** A foreign currency transaction is one that is denominated or requires settlement in a different currency than INR. The economic effects of an exchange rate change will impact the cash flow directly and are, therefore, included in the net income.

The cash flows of each foreign currency over a period of time (e.g. 12 months) are described as the "currency exposure" of the company for that period of time.

<u>There are four types of transaction exposures:</u>

- **Booked exposure**

  Any outstanding (or not yet settled) foreign currency transaction is defined as a foreign currency exposure in the book of the reporting entity (e.g. an outstanding US-Dollar account receivable in Indian Entities' books). The difference between the exchange rate used when recording this foreign currency transaction and the exchange rate used to re-value it in the balance sheet represents the gain or loss of the foreign currency transaction.

> XYZ Ltd has receivables on account of exports worth USD 50 Mio which @ Rs.45/USD as on 31.03.2020 translates into Rs.225 crs.
> A change of rate to Rs.43/USD would change the receivables Rs.215 crs, a negative cash flow of Rs.10 crs.
> This would represent a Booked Exposure.

- **Economic exposure**

  As business becomes increasingly global, exchange rate changes (volatility) become more important, even for a purely domestic firm operating in a global market. Firms have to pay more attention to exchange rate risk, and devise hedging strategies to manage and control currency risk. Even a purely domestic firm, using only domestic parts (no imports), selling only in the domestic market (no exports), all payables and receivables in local currency, is bound to be affected by changes in exchange rates.

> XYZ Ltd exports some of its plastic finished goods to USA. There is a competitor from China who is also exporting the same product to USA. Even if the rupee-dollar levels remain unchanged, and the Yuan depreciates against the dollar, the company in China would be in a position to offer the same product at more competitive rates to the buyer in the US, thus putting XYZ Ltd at a disadvantage.
>
> This represents Economic Exposure.

- **Local Foreign Currency exposure**
  This represents the liquidity or cash holdings (net of overdraft) held in a currency other than INR. This would typically mean foreign currency accounts being maintained in banks within India. As in the case for the "booked exposure", the movement in the exchange rate of cash holdings and equivalents held in a foreign currency will represent a gain or loss of the foreign currency asset and to that extent would also affect the liquidity position of the company.

> XYZ Ltd has an EEFC (Exchange Earner's Foreign Currency) Account with State Bank of India, Ahmedabad. The balance of the account is USD 1.0 Mio, which as at 31.12.2005 is valued at Rs. 4.5 crs (@ Rs.45/USD). A change in the rate to Rs.43/USD would result in a loss of Rs.0.20 crs in the value of the amount held in the account.
>
> This represents Local Foreign Currency Exposure.

- **Anticipated or Expected Exposure**
  The anticipated or expected currency exposure represents highly probable future foreign currency settlements of the Indian Entities which are not yet reflected in the book and, therefore, do not generate any exchange gains or losses in the financial statements. However, we can anticipate them and their direct impact on the profitability in case of a movement in the exchange rates.

> The forecasted currency exposure arising from future sales and their corresponding collection of the account receivables of XYZ Ltd would represent Anticipated or Expected Exposure.

4. VARIOUS TYPES OF FOREX RISK

Risk has two components - exposure and uncertainty. This uncertainty would be on account of unpredictability of future events. Based on the exposures faced by MIL, the various risks facing it are:

Exchange Rate Risk

The risk arising on account of movement in the exchange rates of all relevant currencies where the company has exposure in terms of

- Foreign currency denominated cash flows; and/or
- Foreign currency denominated assets/liabilities

Analyzing the financial impact arising from potential positive or negative exchange rate movements on the currency exposure can help assess this risk. The outcome of this analysis can then determine which foreign currencies should be tracked and monitored on an ongoing basis.

The financial impact due to potential changes of exchange rates has to be quantified for each foreign currency exposure separately. The risk has to be quantified based on the shift of the spot exchange rates at the time of the analysis according to the volatility of the currency pair.

The evaluation shall be done based on the total booked and anticipated transaction exposures (no netting of outstanding hedge deals) for the next 12 months (rolling).

Interest rate risk

Interest rate movement in India and the dollar market can pose a risk when the company has an exposure to

- Long-term foreign currency assets/liabilities; and/or
- Long-term rupee assets/liabilities

There is always a possibility of a reduction in the value of a security, especially a bond, resulting from a rise in interest rates. This risk can be reduced by diversifying the duration of the fixed income investments that are held at a given time. This is often referred to as Risk Diversification.

5. POLICY

5.1. A **hedge is defined** as an action taken in order to reduce the risk of adverse price movements in a security, by taking an offsetting position in a related security, such as an option or a short sale. These would include measures, such as deployment of financial Instruments, for the purpose of safeguarding the value of a foreign currency exposure.

5.2. The **purpose** of hedging is to reduce the unpredictability arising on account of exchange rate movements and currency movements on cash flows, earnings and equity.

5.3. The **objective** of hedging is to:
- Minimize transaction and translation losses on balance sheet items; and to
- Protect the anticipated exposures and risks, in the process mitigating the impact on profits

5.4. Decisions regarding borrowing in Foreign Currency and hedging thereof, (both interest and exchange rate risk) and the quantum of coverage shall be driven by the need to keep the cost comparable.

5.5. Foreign Currency loans shall be hedged after taking into consideration the anticipated Foreign exchange inflows / outflows in the form of Exports / Imports.

5.6. The tenure of the forward contract shall be decided considering the tenure of the underlying Foreign Currency transaction, generally not exceeding five years.

5.7. The decisions regarding Foreign Exchange transactions shall be made in the Corporate Office only.

5.8. Derivatives if found required to hedge positions, could be entered only with the prior approval of CFO / Dpty CFO and two executive directors / Board of Directors.

5.9. Foreign Currency Transactions shall be recorded in accordance with the guidelines laid down in Accounting Standards.

5.10. Day-to-day decisions regarding booking/cancelling forward contracts or booking/unwinding option contracts shall be made with the approval of the CFO/Dpty CFO and the documents in respect of the foreign exchange transactions shall be executed as per the authority given by the Board of Directors.

5.11. The officer-in-charge of Treasury Operations at the Corporate Office will maintain a detailed database of all hedges obtained bank-wise and arrange for utilization/ cancellation of the same as in tune with the above said Objectives and Policy decisions.

6. **RULES FOR HEDGING**

6.1. Hedging should not be done permanently and automatically as in most circumstances the associated hedging costs would be expensive. Hedging should be carried only after the following things have been taken care of:

- There has been an assessment of the key currencies to track and exposures to hedge
- There is a mechanism in place, which allows real-time monitoring of market conditions so as to allow the company to take advantage of favourable market development while minimizing the costs of hedging.

6.2. The company approves the following hedging instruments for the purpose of hedging currency and interest rate risks:

- Spot Transactions
- FX Forward Contracts
- Options contracts
- Principal Only Swaps
- Interest Rate Swaps

6.3. All import & export transactions should be hedged. Amounts below USD 50000 or its equivalent should be hedged with simple forward of the cross-currency exposure as the value is small to get buyers credit quote and its handling cost could be more.

6.4. Payments due in a month to various suppliers should be clubbed to consolidate the amounts and reduce handling costs

6.5. For imports above USD 50000 and its equivalent, the company should try and take buyers credit to reduce its working capital cost. The time period will be of maximum of 6 months in case of non-capex imports. For capex imports, the buyers credit loans could be for maximum tenor of 3 years or as allowed by RBI.

6.6. Illustration for calculation of decision-making thresholds for entering into hedge by way of Options / forwards / futures contract instruments:

Reference	**Remarks**	**Value**
A	Import Purchase Buyers Credit (EURO)	30,92,900
B	Drawdown Date	31-Jul-19
C	Maturity	01-Jul-22
d=c-b	**Buyers Credit tenor days**	**1,066**
E	Effective interest rate (EURO)	2.50%
f	Effective interest rate (INR)	9.00%
g=f-e	**Net benefit in EURO facility**	**6.50%**
H	INR/EURO on Drawdown Date	78.3
I	Aggregate threshold benefit (INR)	4,59,73,264
j=i/a	**Maximum tolerance in exchange rate INR/ EURO**	**14.86**
k=h+j	Stop loss for closing the facility / enter full hedge	93.16

Basis above analysis, Company should decide the maximum tolerance level for the variation in exchange rate and suitably select the hedge instrument which is most beneficial considering the then market scenario.
While selecting the hedging instrument, Company should have the priority of locking the downside and keep the upside open.

6.7. The powers to enter contract will be delegated to the CFO/Dpty CFO for entering all kinds of contracts / derivative transactions with banks arising out of import / export transactions of the Company up to amt of USD 2 Mio

6.8. Contracts / Derivative transactions with banks arising out of import / export transactions of the Company in excess of USD 2 Mio but up to USD 5 Mio will be approved by Managing Director / Wholetime director of the Company. All other transactions will require approval of the Board.

6.9. The Company shall not enter any speculative transactions and shall use its underlines to genuine derivatives to hedge the forex risk arising out of business transactions.

6.10. All / any derivative transactions entered by the company should be foreclosed, moment the loss arising out of the transaction reach 10 % of the transaction value. This stop loss value could be changed only with approval of the board on a case to case basis.

7. **REPORTING & REVIEW**

7.1. The details of foreign currency transactions and loans / Foreign Exchange Derivative Contracts done in the immediately preceding quarter shall be submitted to the Board at the meeting to be held in the succeeding quarter.

7.2. The MTM position of all such contracts / derivatives should be reported to the board at its meeting each quarter, with nature of transaction & value.

7.3. Any unhedged exposure should be reported to the Board for necessary guidance with reasons of not being hedged.