BGCC

BITS GOA CONSULTING CLUB

ConsultFin’24

Round -2

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Current Capital Analysis

Annual Revenue : $500 million

Current Weight % of Debt: 70%

Moderately Higher

Current Weight % of Equity: 30%

Moderately Lower

Interest expense : $30 millions

Pre-tax Cost of Debt: 8.57%
Tax Rate: 30%
Post-tax Cost of Debt: 6%

Cost of Equity: 12.67%

Moderately Higher

Current credit rating : BBB

Moderately safe , Depend upon the factors it some one can invests on it.

Interest coverage ratio : 2.0

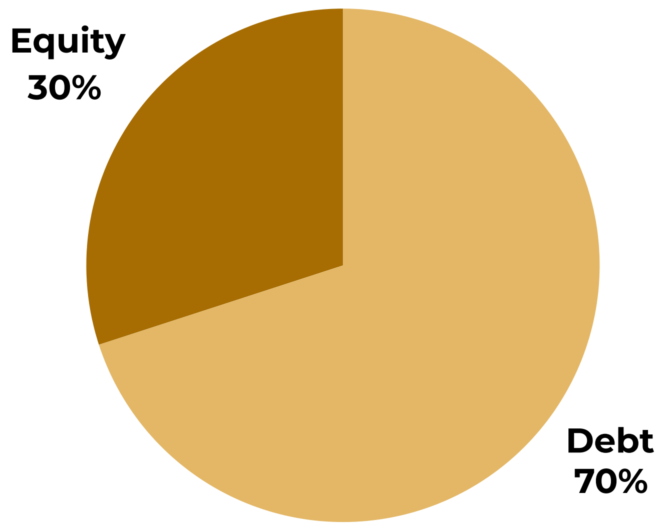
Relatively low than other company .High Financial risk . Ideal rage is above 3 %

Debt-to-equity ratio - 2.5:1

Highly depend upon of loans ,Highly leaverage

Weighted Average Cost of Capital (WACC) : 8 %

Moderrately good

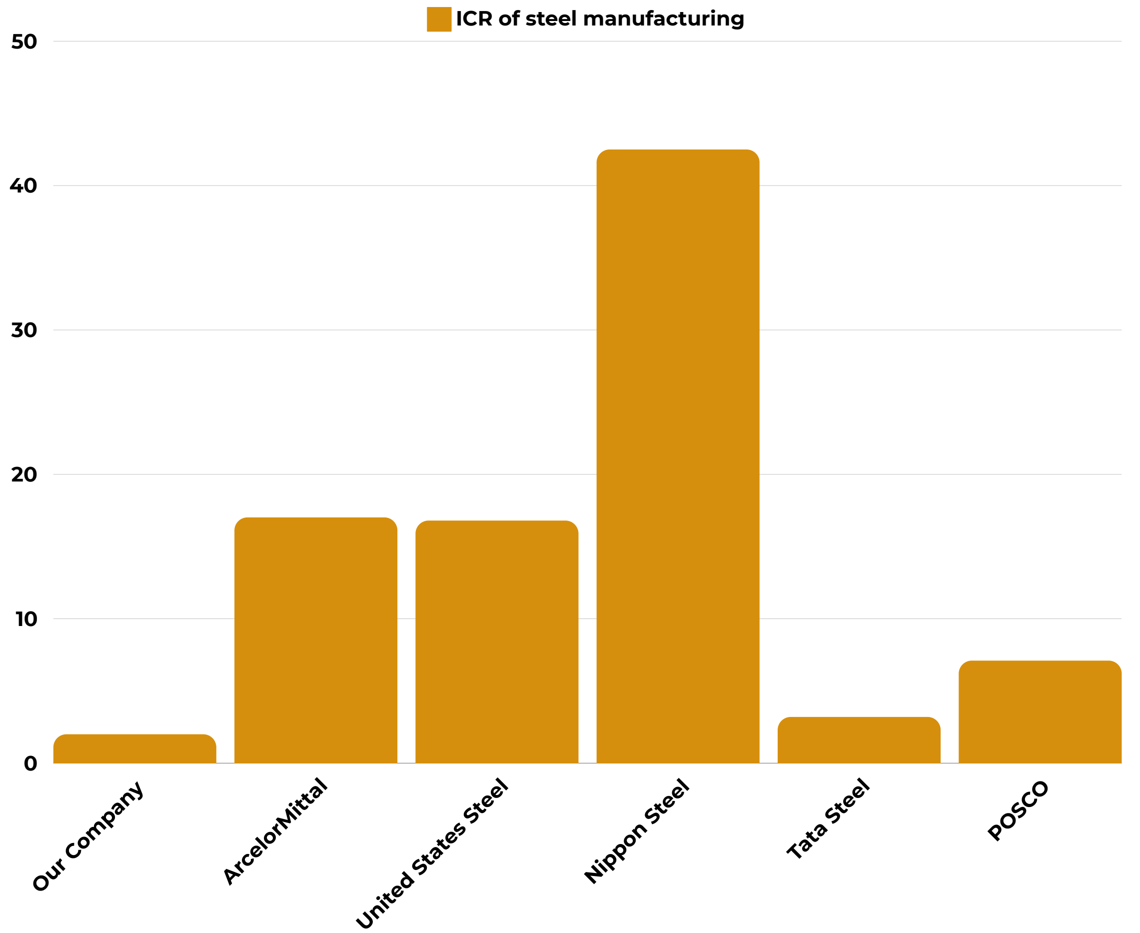


Keys Risk

- **Credit Risk:** In a non Perfroming economy credit rating of BBB will get in trouble.
- **Interest rate risk:** Company highly depend on debt rather equity
- **Stock volatility:** Due to high D/E there may be higher volatility in the stock price relative to the market.

Analysis of Current Capital Structure

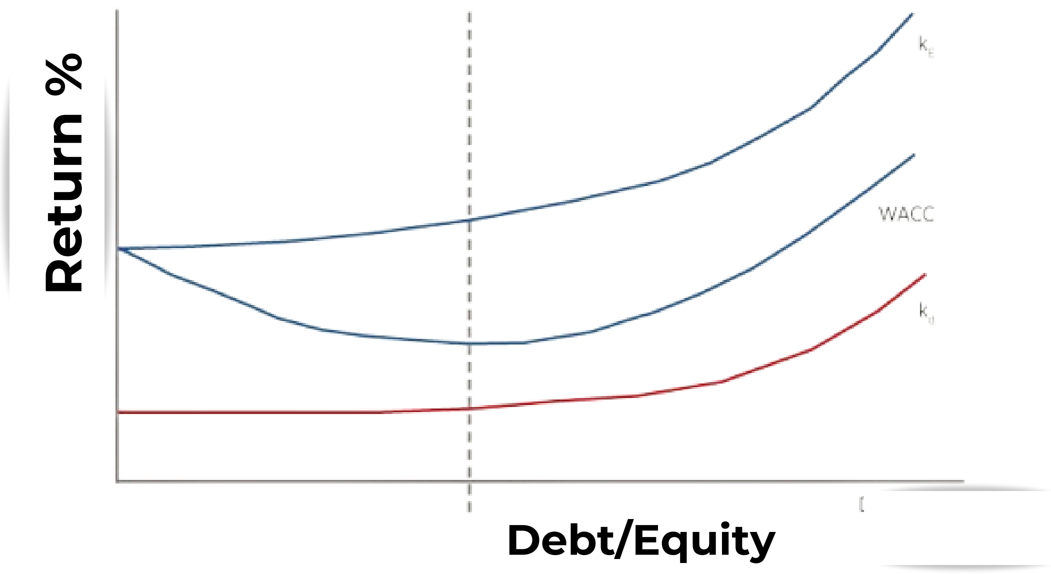
- **Highly Leveraged :** Company has a relatively higher D/E ratio .
- **Low Interest Coverage Ratio:** a lower ratio than 3 is considered to be risky.
- **Higher WACC:** 8% WACC is relatively higher because of elevated Cost of Debt.



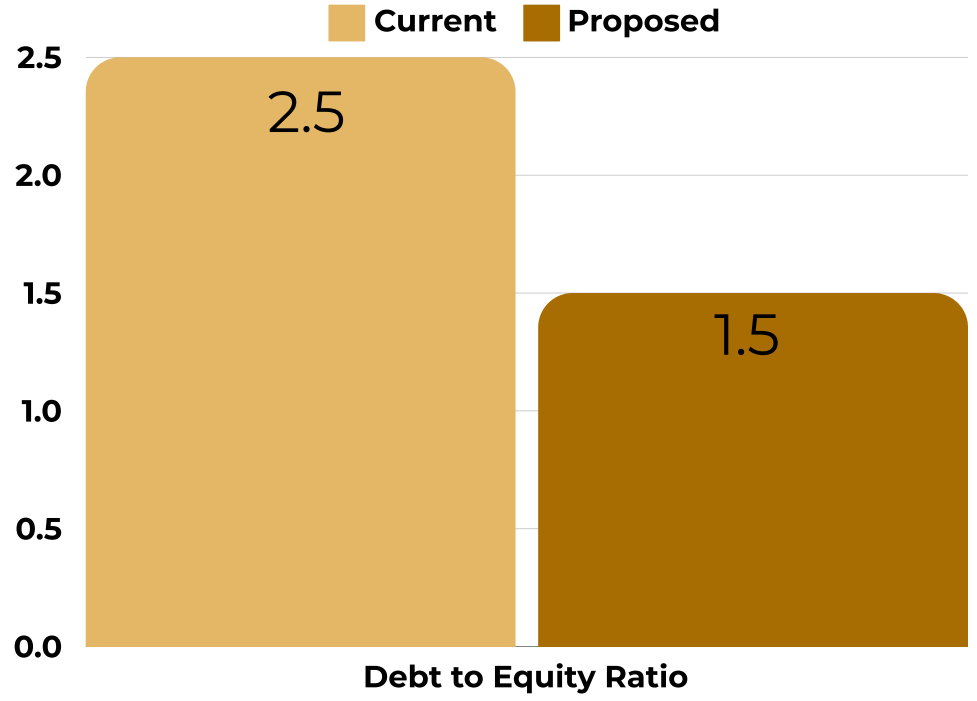
Recommendations

- **Lowering D/E Ratio:** For Steel manufacturing industry, D/E Ratio between 1 to 1.5 is considered to be on more balanced side, lowering D/E Ratio from 2.5 to 1.5, will reduce the cost of debt and cost of equity and hence the overall WACC will be reduced and it will get closer to its optimal value.
- **Increasing Credit Score:** Company should try to increase its credit score from BBB, as it will reduce the cost of debt because it will give investors a good signal and they will demand lower interest as risk will seem to be lower.
- **Increasing Interest Coverage Ratio:** Currently its 2:1 but in this industry an ICR less than 3:1 is not considered to be good.
- **Issuing Convertible bonds:** Company should issue Convertible Bonds, which will fulfill its short term needs and reduce its leverage.
- **Joint Ventures or Strategic Partnerships:** By doing this, Company can attract equity investors and partners who can share capital and risks, therefore, reducing the need of debt financing.

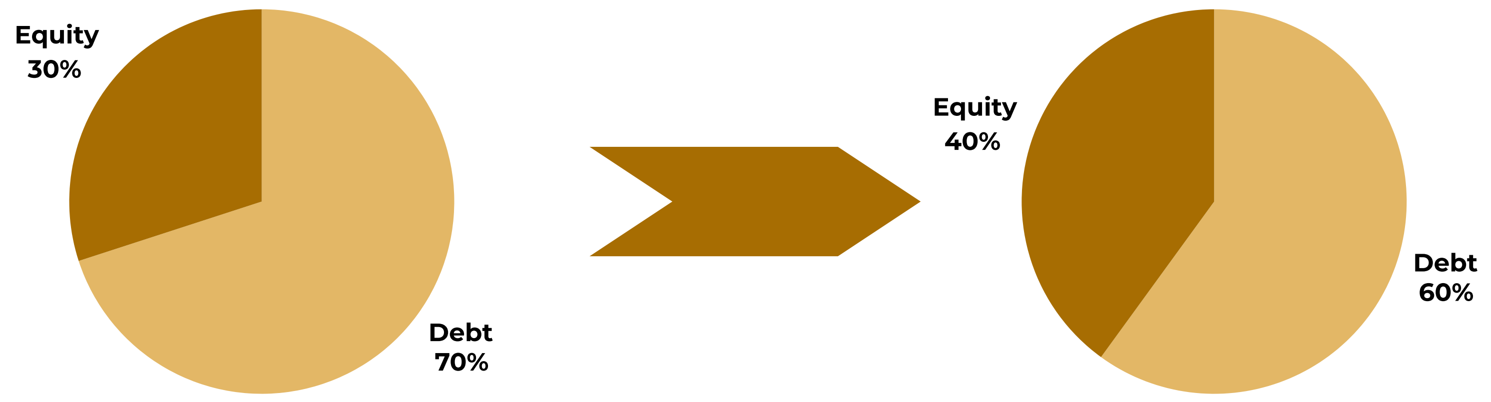
The Cost of Capital and the Value of the Corporaation



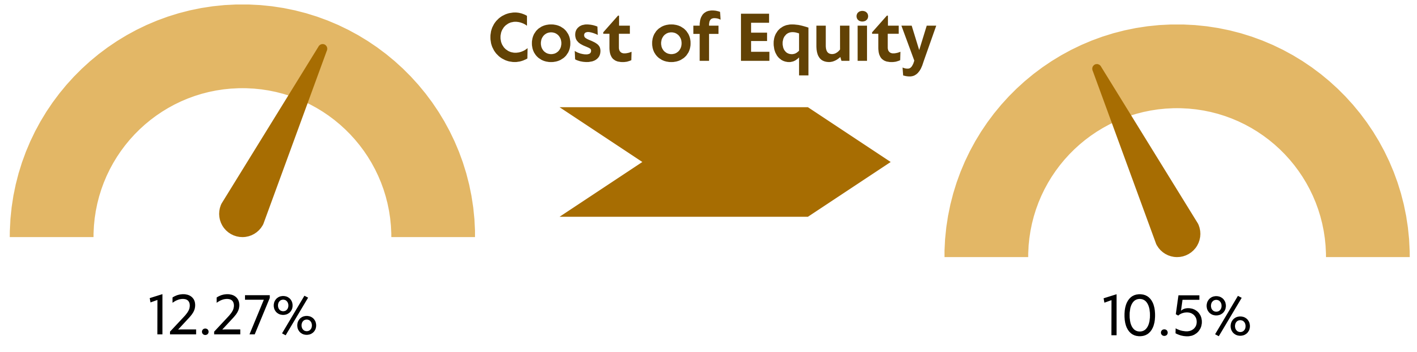
D/E Ratio



Capital Structure



Cost of Equity



Pre-tax Cost of Debt

WACC

Implications & Implementation

Refinancing Debt
(0-3 Months)

- Try to refinance existing debt at lower interest rates.
- Negotiate with lenders to achieve our goal.
- Can issue new lower cost debts if available.

Raising Equity
(3-6 Months)

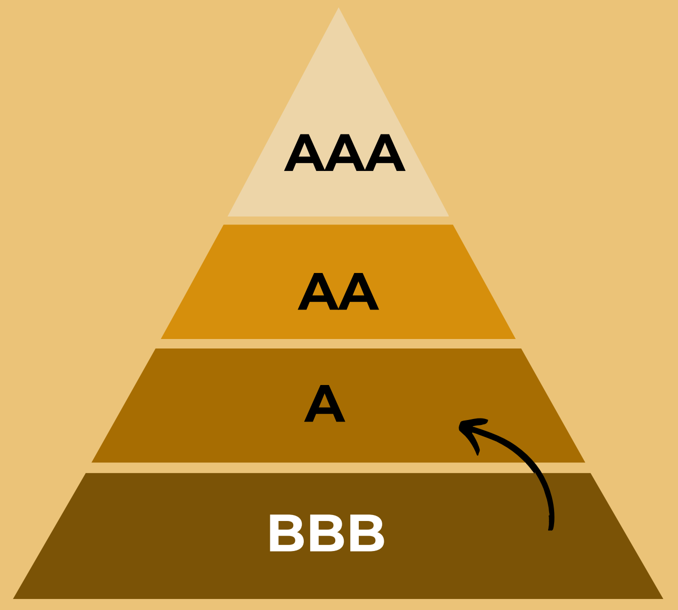
- Attract Private equity investors or issue new shares
- Use the raised money to finance high-cost debt.
- Effectively monitor D/E Ratio as our target is 1.5

Credit Rating improvement
(6-12 Months)

- Engage with Credit Rating Agencies like CRISIL to review our rating and upgrade it if possible.
- Monitor Financial performance, Interest Coverage Ratio and WACC.

Regular Optimization
(12+ Months)

- Annually monitor capital structure to make sure it is optimized according to the market conditions.
- Change Financial strategies such that it improve Balance sheet that help in expansion, acquisitions and other strategic initiatives.



Credit Rating Ugrade

Conclusion

Current D/E Ratio was on higher side as compared to the industry, so reducing it will make the WACC move towards optimality as cost of debt will reduce along with cost of equity but overreducing it will result in neglance of tax shield benefits and after a certain point, cost of equity will start increasing even on reducing D/E because as company will become under-leveraged, investors will perceive it to be conservative management or missed growth oppportunity, therefore, will demand higher equity returns. Therefore, There is an optimal D/E here in our case its about 1.5. In a nutshell, **By reducing D/E Ratio to 1.5, We can reduce the overall Cost of Capital and Optimize our Capital Structure.**

THANK YOU

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Our Team