FM - Module 5 - Chapter 7

Sources of Finance & Capital Structure

Sources of Finances

- Short term	- Long term
→ trade credit	→ equity (public)
→ bank finance	→ equity (private)
→ commercial paper	→ debt
→ project finance	→ hybrid → conv. debt, → warrants
→ Certificate of Deposit	→ mezzanine

Features of equity shares

- Ownership & voting rights
- control over management
- claim on assets
- limited liability
- dividend
- freely transferable

Means of raising equity

- public issue (IPO, FPO).
- right issue
- private placement
- offer for sale

Debt

- Non convertible debentures (NCDs)
  - → long term debt instruments & are repayable after maturity.
  - → interest on debt is paid by issuing company on monthly, quaterly, semi-annually or annually at fixed or variable rate.
- either secured by assets of company or insecured.

Hybrid Financing

1) Preferences share
2) Convertible debentures
   - → Compulsorily convertible debentures (CCD)
   - → Optionally convertible debentures (OCD)
   - → Partly Convertible debentures (PCD)
3) Warrants

Mezzanine Finance

- hybrid between debt & equity which provides the financier right to convert mezzanine debt to equity in case of default.

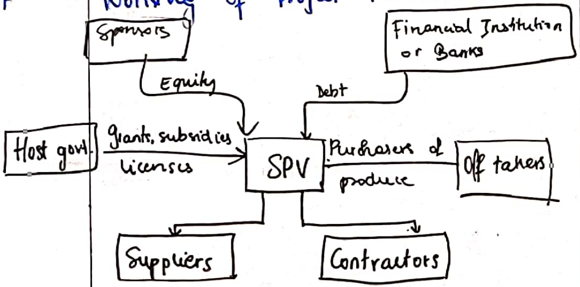
Project Finance

Parties involved in Project Finance.

- Sponsors
- special purpose vehicles (SPVs)
- contractors
- offtakers
- banks or financial institutions
- Specialist advisors

Risks
- foreign exchange
- completion risk
- cost over run
- market risk
- enviromental or govermental risks

Working of Project Finance.



Capital Structure

$$\text{Debt Ratio} = \frac{\text{Debt}}{\text{Total capital}} = \frac{D}{D+E}$$

$$\text{Debt to Equity Ratio} = \frac{D}{E}$$

Factors affecting capital structure

1) Stability of Business
2) Cost
3) Flotation Cost
4) Control Consideration
5) Tax Rate
6) Capital Market Conditions
7) Competition

Capital Structure Theories

1) Net Income Approach
2) Net Operating Income Approach
3) Traditional Approach
4) Modigliani - Miller Approach

Elements of capital structure

1) Capital mix
2) Maturity & priority
3) Terms & Conditions
4) Currency
5) Financial Market segments

Optimum Capital Structure

1) EBIT - EPS Analysis
2) Financial Break Even
3) Financial in different point
4) Cashflow analysis

Commercial Paper (CPs)

- It has fixed maturity period (from 1 to 270 days)
- higher returns than treasury bills
- CPs are traded actively in secondary market

Certificate of Deposits (CDs)

- functions as deposit receipt for money which deposited with a financial organization or bank
- CDs is different from fixed deposit receipt in 2 ways.
  - → CDs are issued only if sum of issue is huge
  - → CDs is freely negotiable
- CDs are also issued at discounted price like T-Bills
- lifespan (7 days to 1 year)
- CDs issued by bank range from 3 m, 6 m, 12 m.

Note: CDs can be issued to individuals, Companies, corporations, NRI...

Trade Credit

- B2B agreement in which customer can purchase goods on account without paying cash upfront, paying the supplier at later scheduled date
- Business that operate with trade credits will give buyers 30, 60 or 90 days to pay.
- It can act like 0% loan on balance sheet.

Private equity

- asset class consisting of equity & debt investment in companies, infrastructures, real estate, other assets