Mezzanine Financing

- It is a capital resource that sits between (less risky) senior debt and (higher risk) equity that has both debt and equity features.
- Companies use mezzanine financing to achieve goals that require capital beyond what senior lenders will extend.
- When companies have maximized their senior debt borrowing capacity or seek to preserve future senior debt capacity and need additional capital to pursue growth opportunities or for shareholder activity they are typically left with two options:
  1. Raise outside equity
  2. Use Mezzanine Financing
- Mezzanine Financing can be viewed as either expensive (higher coupon) debt or cheap (less dilutive) equity.
- Mezzanine carries a higher interest rate than senior debt that companies would obtain through banks but is substantially less expensive than equity in terms of cost of capital.
- Mezzanine financing is less dilutive than raising additional equity to satisfy a capital need and ultimately allows existing owners to maintain control.
- Mezzanine financing is the last option to raise substantial capital without selling a large stake in their company.
- Mezzanine funding should be preferred when it is used for acquisition, shareholder's buyouts, refinancing, expansion.

Benefits of Mezzanine Financing

1. To Borrowers
   - Cheaper, No dilution of , lower equity requirement, lower tax liability, Boost capital structure.
2. To lender
   - Regular revenue, enhance the return, investors gets regular returns

Private Equity

- It is an asset class consisting of equity and debt investments in companies, infrastructure, real estate, and many other assets
- Capital invested in this asset class is typically raised from a range of investors privately, rather than public.
- Private equity firms typically seek to invest in quality assets at attractive valuations and use strategic, operational and financial expertise to add value.
- After a suitable holding period, a private equity firm seeks to monetize its investment at a premium to its acquisition cost, generating positive returns for its investors.
- Private equity investment primarily comes from High Networth Individuals, (HNI), Institutional investors and accredited investors, who can dedicate substantial amount of money for a long period of time to ensure a positive return.

Hedge Funds

- Actively managed fund focuses on high risk high return investment.
- Aggressive investment method.
- Lightly regulated and risky compared to mutual funds.
- It pools money from investors and invests them into all type of complicated financial instruments.
- Their goal is to outperform the market and attain maximum returns.
- They are very smart to create high returns regardless of how the market does.
- Hedge funds cater to high networth individuals, institutional investors.
- Hedge fund investors are usually required to have at least one million dollars in net worth.

Hedge Funds role

- Greater efficiency to financial market.
- Widening the use of investment strategy
- Increasing number of investors.
- Provides liquidity and helps investors to manage risk.
- Freedom to invest anywhere & everywhere

Parties involved in hedge funds.

① Fund Manager / Investment manager

- Person / organisation that has the responsibility for investment decisions and day to day running of the fund.

② Investors

- High Net-worth individuals (HNI)

③ Prime broker/bank

- Usually a firm that charges commission for executing trading instructions submitted by another firm.

④ Counterparty

⑤ Legal and Auditor

⑥ Hedge Fund Administrator

- 3rd party administrator for accounting, pricing, valuation and more.

7 common hedge fund terms

① Absolute Return

- Return that an asset achieves over a certain period of time.

② Accredited Investors

- High Networth Individuals (HNI), banks, insurance companies, Employee benefit plans & trusts.

③ Hurdle Rate

- Minimum Rate of return on investment

④ Alpha

- Return to a portfolio over and above that of an appropriate benchmark portfolio.

⑤ Leverage

- This is when someone borrows money to increase their position in a security

⑥ Run on Funds

- This is when hedge fund faces a growing amount of redemption request.

⑦ Value at Risk

- It is used by risk manager to measure and control the level of risk which the firm undertakes.

Asset

- An asset is a resource with economic value that an individual, corporation or country owns or controls with the expectation that it will provide a future benefit.
- Assets are reported on right side of a company's balance sheet and are bought or created to increase a firm's value.
- An asset is anything that can generate cashflow in future.

Types of assets

1. Current assets
   - Short term economic resources that are expected to be converted into cash with one year.
   - It includes cash, cash equivalents, account receivables, inventory and various prepaid expenses.
2. Fixed assets.
   - Long term economic resources.
   - It includes manufacturing plants, buildings, equipments
3. Financial assets
   - Investment in assets and securities of other institutions.
   - It includes stock, sovereign and corporate bonds, preferred equity, hybrid securities.
4. Intangible Assets
   - Economic resources that have no physical presence.
   - It includes patents, trademarks, copyrights etc.

Liability

- A liability is something that is owed to somebody else.
- It can also mean legal or regulatory risk.
- It's the opposite of assets.
- It is an obligation that company / individual need to pay in the future.
- Liabilities results into outflow of cash and decreases cash balance
- Liabilities comes on the left side of the balance sheet.

Types of liabilities

1. Current liability
   - Company's short term financial obligation that are due within an year or a normal operating cycle.
   - Eg. Account payable, payroll expenses, monthly utilities
2. Non-current liability
   - Any liability that is expected to be paid after a year or so.
   - Eg. long term borrowing, secured / unsecured loan, derivative liability.

Income

- The term income generally refers to the amount of money, property and other transfer of value received over a set period of time by individual or entities as compensation for services, returns on investment, pension distribution, gifts.
- Amount of Income is determined as per context as there is no proper definition of Income.

Taxable income

- It is a total of all income from all sources and in any form.
- Taxable income is annual total income of an individual/entity and reducing that amount by the exclusions, exemptions and deductions allowed under the tax law.

Capital Grain

- It is ~~the~~ increase in a capital asset's value and is realized when the asset is sold.

Expence

- Expense is a cost of operation that a company incurs to generate a revenue
- Common expenses includes payment to suppliers, employee wages, factory leases, maintenance
- Businesses are allowed to write-off tax deductible expenses on their Income Tax Returns to lower their taxable income., provided that they meet IRS guideline.
- Accounts record expenses through one of two accounting methods.
  1. Cash basis
  2. Accrual basis.

Types of business expenses.

1. Operating expense
   - Expenses related to company's main activities, such as cost of goods sold, rent, administrative fees.
2. Non-operating expense
   - Expenses that are not directly related to businesses core operation.
   - Eg. Interest charge borrowing money.

Capital Expense

- Also known as Cap Ex
- Funds used by companies to acquire, upgrade and maintain physical assets such as property, building, equipments.

Bonds

- Debt security
- An instrument which gives,
  1. Possibility of earning more than FD
  2. With some risk exposure
- It is a fixed income security which allows a lender to lend a predetermined amount of funds and be eligible for interest on those funds.

Features of bonds

1. Coupon Rate
   - Rate of interest
2. Tenure
   - Time span
3. Maturity
   - Coupon payment date
   - Date declared by issuer of the bond
4. Date of redemption
   - Date of repayment the funds.
   - Scheduled maturity date
5. Redemption value
   - Par value of a debt security
   - Par value means face value
     → Redemption @ par
     → Redemption @ discount
     → Redemption @ premium

Risk of investing in bonds

1. Interest rate risk
2. Default risk
3. Reinvestment risk
4. Call risk
5. Inflation risk
6. Liquidity risk
7. Market risk
8. Event risk

Types of bonds

1. Convertible bonds
2. Municipal bonds
3. Corporate bonds
4. Mortgage Backed securities (MBS)
5. Asset Backed securities (ABS)

Owners of Bonds

1. Debt holders
2. Creditors
3. The issuer

Dividend

- Share of profits that is distributed to shareholders
- Return / reward that shareholders receive for their investment in Compy

Types of dividends.

1. Cash dividend
   - Paid out in cash and reduces the cash reserves of a company
2. Stock dividend
   - Shares of a company are distributed to shareholders at no cost.
   - Usually done in addition of a cash dividend, not in place of it.

Important dates

1. Declaration date
   - Board of directors announces dividend
   - Board also announces date of record and payment date
2. Date of record
   - Ex-dividend rate
   - Day when the stock holders are entitled to the dividend payment.
   - Only the owners of shares on or before that day will receive dividend
3. Payment Date
   - Dividends are distributed to shareholders

Dividend Policy

- Policy dictates the amount of dividend paid out by the company to its shareholders and the frequency with which dividends are paid out
- When company makes profit
  1. They can keep the profit to themselves
  2. They can distribute the money to shareholders in form of dividends

Types of dividend policies

1. Stable dividend
2. No dividend
3. Regular dividend
4. Irregular dividend

Forward Contract	Future Contract
① It is an agreement between parties to buy and sell the underlying asset at a specified date and agreed rate in future	① A contract in which the parties agree to exchange the asset for cash at a fixed price and at a future specified date.
② It is a tailor made contract	② It is a standardized contract.
③ Traded on OTC (Over The Counter) i.e. There is no secondary market	③ Traded on stock exchange
④ Settlement on maturity date	④ Settlement on a daily basis
⑤ High risk	⑤ Low risk
⑥ As they are private agreements, the chances of default are high.	⑥ No probability of default.
⑦ Size of contract depends on the contract terms.	⑦ Size of contract is fixed.
⑧ Collateral is not required	⑧ Initial margin is required.
⑨ Mature as per the term of contract	⑨ Predetermined date of maturity
⑩ Low liquidity	⑩ High liquidity

Derivatives

- Derivatives are financial contracts set between two or more parties, that derive their value from an underlying asset, group of assets or benchmark.
- A derivative can trade on an exchange or over the counter.
- Prices for derivatives derive from fluctuations in the underlying asset.
- Derivatives are usually leverage instruments., which increases their potential risk and reward.
- Common derivatives includes future contracts, forwards, options and swaps.

Options:

- An option contract is similar to future contract.
- It is agreement between two parties to buy or sell an asset at a predetermined future date for a specific value.
- key difference between option and future is that in option, buyer is not obliged to exercise their agreement to buy or sell. It is only an opportunity and not an obligation like future contract.

Pros:

① Lock in prices
② Hedge against risk
③ Can be leveraged
④ Diversify portfolio.

Cons:

① Difficult to value
② Subject to counterparty default (if OTC)
③ Complex to understand