

## CASE STUDY: CAPITAL STRUCTURE ANALYSIS

- Suppose you are hired by the Board of Directors of the company you choose to perform analyses of the company's capital structure and to provide advice on whether the current capital structure is optimal.
- Since, you will report directly to the Board of Directors, you can assume Financial Management level knowledge of finance, i.e., you can assume that your readers would be familiar with Modigliani and Miller (MM) theorem with corporate taxes. The report should therefore cover material more advanced than MM with corporate taxes.
- You should read the relevant textbook chapters, and the survey, "The Theory and Practice of Capital Structure", by Henri Servaes and Peter Tufano (available on Chaoxing) to gain the background necessary to undertake the project.
- You can choose **one** company for the case study such as Alibaba, Bytedance, Xiaomi, Tencent, and so on.
- This case study is an individual task and represents 50% of your final grade. Each student should do this case study and produce a report by yourself. Your assigned task is to produce a report on the capital structure of the company. In the report, you should analyse the capital structure of the firm following the guidelines provided below, and determine whether the firm is under, over or correctly leveraged.
- **The report is due on Thursday, Week 10. A soft copy must be submitted to Chaoxing and the lecturer's email address: xieyamin@shu.edu.cn by this deadline. A hard copy must be submitted to the lecturer before the class of Week 10.**

### GUIDELINES FOR THE REPORT

- In your report, **you must apply the theories and concepts discussed in class to the facts of the firm.** The report should **demonstrate your understanding of the theories and their practical implications.**
- **The report should be no longer than 12.5 pages.** including the executive summary, tables and graphs but excluding references and appendices. You can include one page of references and up to 4 pages of appendices.
- The report will be marked on both its content (discussions/analyses/arguments) and the quality of its write-up (organization, conciseness, clarity, grammar and punctuation).
  - When the information reported in a table can be easily and more effectively presented in a graphical form, a graph representing the relevant information should accompany the table.
  - You must discuss the relevance and the significance of the information provided in tables and graphs included in the report. You should not include redundant information in tables.
  - Tables and graphs that are marginally relevant should be included in the appendices
  - You should use line graphs to show trends in variables.
  - All graphs and tables included in the report must be produced by you. **You may not copy**

figures, graphs or tables from other sources such as company annual reports or financial databases.

- You may obtain raw financial data from financial databases.
- 3D effects are often distracting and should be generally avoided.
- **In order to receive high marks on the report, the report must successfully apply the theories and concepts discussed in class to the firm.**
- The report will be marked out of a total of 50 marks.
- A case study cover sheet is available on Chaoxing. The report should be submitted with a completed and signed cover sheet attached.

The following is a summary of the areas you need to work on. Please note that it is not comprehensive but it gives you a sense of what is expected in your submission.

## **1. EXECUTIVE SUMMARY and COMPANY AND INDUSTRY OVERVIEW (10 marks)**

### **1.1 EXECUTIVE SUMMARY (max ½ page)**

Include a brief (half page) summary of the report highlighting its major conclusions and recommendations and how you arrived at those conclusions and recommendations.

- Half of the executive summary page should be left blank.
- Executive summary should not be a list of the content of your report.

### **1.2 COMPANY AND INDUSTRY OVERVIEW (max. 2 pages)**

Provide a brief summary of the firm's business activities and business segments and recent developments in the company and its industry.

- This overview of up to 2 pages should also identify two comparable firms, which you will use in your analyses in the next section. You should fully justify your choice of the comparable firms.

## **2. CAPITAL STRUCTURE ANALYSIS (35 MARKS)**

In this section you will analyse the company's capital structure and leverage policy.

Your discussion in this section should include but not be restricted to the following:

### **2.1 Historical Company Leverage/Financing Analysis and Peer/Industry Leverage Analysis (max. 5 pages, 15 marks)**

- You should document the financing and leverage history of the company and characterise the company's historical (and current) leverage policy using:
  - recent trends in the use of debt and equity and recent financing activities of the firm (debt and equity issues, placements and share buybacks); current and recent history of leverage and interest coverage ratios; management discussions about the firm's leverage policy.
    - Does the company have a target leverage ratio?
    - Does the past pattern of the company's leverage support

- the managerial inertia theory?
  - the security mispricing theory?
- recent capital expenditures (including mergers) and their financing
  - Is the financing behaviour of the company consistent with the pecking order theory?
- You should document and discuss the firm's leverage policy relative to the leverage policies of comparable firms.

## 2.2 Optimal Leverage Analysis (max. 5 pages, 20 marks)

- You should discuss the implications of the various capital structure theories for optimal capital structure as they apply to your company including:
  - Trade-off theory
    - The trade-off between tax benefits of debt (including personal taxes and dividend imputation credits) and the financial distress costs.
      - **Analysis of tax benefits should be detailed.**
    - The implications of the trade-off theory determinants of optimal leverage for the optimal leverage of the firm.
      - **Analyses of the determinants should be both qualitative and quantitative.**
    - You may incorporate stakeholder theory, agency theory along the trade-off theory determinants mentioned above in a broader trade-off theory framework.
    - **The analyses of the broader trade-off theory determinants should be detailed and should form the bulk of your analyses of optimal leverage.**
      - **You should have a separate sub-section for each determinant.**
  - Agency theory
  - Stakeholder theory
- You should determine the optimal leverage or optimal leverage range of the firm and whether the firm should increase, decrease or maintain its current leverage.
- You should also suggest how and when any recommended leverage change should be implemented.

## GRAMMAR, PUNCTUATION AND CLARITY (2 MARKS)

- The write-up should be grammatically correct and properly punctuated.
- The write-up should be clear, concise and to-the-point.

## FORMAT AND PRESENTATION OF THE REPORT (3 MARKS)

- The report should satisfy the basic formatting requirements suggested in the Writing Guides that are available online (Chaoxing)  
These requirements include, but are not limited to the following:

- MARGINS: The left-hand margins should be approximately 3cm. The top, bottom and right-hand margins of each page should be about 2.5cm.
- LINE SPACING: Line spacing should be 1.5 as a default. Between paragraphs, increase the spacing so that the paragraphs are visually distinct.
- TABLES and GRAPHS: Tables and graphs must be properly formatted and labelled. The labels of the graph should clearly identify the x (horizontal) axis and the y (vertical) axis.
- GRAPHS: When a graph contains multiple variables, the variables should be represented in a way so that they can be easily identified. If the original graph is in colour, it should not be printed in black and white.
- FONT & POINT SIZE: The type-face should be 11-point or 12-point in a standard font such as Times New Roman.
- PAGE NUMBERING: Page numbering should be included at the bottom of every page, except the title page.

#### References

- The report should appropriately reference all sources used following the latest APA referencing style (7th ed. which was published in late 2019) that is available online (Chaoxing).
- Students should use the textbook, the lecture notes, company annual reports, industry reports and news about the company and the industry as the primary references in writing the report.
- Other acceptable sources include published academic journal articles.
  - **You may not use Wikipedia, Investopedia, Baidu Baike or other similar internet sources as references.**

#### Appendices

- Up to four pages of appendices are allowed. You may include tables showing historical financial statements and ratios in the appendices.

#### **PLAGIARISM**

- If there is evidence of plagiarism in any section of the report, you will be accordingly penalized based on the relevant university policies.

#### **RESOURCES**

- You should acquire the financial and other information necessary to complete the case study yourself from company annual reports and databases available through SHU library (e.g., CSMAR, WIND)
- The SHU library subscribe to many databases that provide information relevant for the case study such as company financials, industry reports, newspapers and journal articles.
  - You can access these databases on and off campus.