MODULE 03: FINANCIAL ANALYSIS

Lecture Title 06: LONG-TERM SOURCES OF FINANCE

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Date: 8 February 2023

21 ACADEMY

Undergraduate Diploma in Business Administration

Group Presentations

From the following link https://www.learnstockmarket.in/annual-reports choose a company's Annual Report for 2021.

Each Group must choose a different Annual Report. The chosen report must be shared during Saturday, February 11, 2023's session.

The presentation should highlight the following:

- Analyse and comment on the financial performance of the company using ratio analysis.
- Use between 5 and 7 ratios.
- Give the workings at arriving at each of the chosen ratios, indicating from where the financial information was obtained.
- Compare the ratios of the company for this financial year and last year's ratios.
- Research information about the company that you consider relevant to potential new investors.

Groups

1	2	3	4	5
ANIL	VISHAL	DHEERAJ	ABHILASH	AJAY
ANKIT	JASPREET	GURPREET	MANEESH	LAVISH
JASKARAN	RAJAN	KARANDEEP	RAHUL	LOVISH
PRIYANKA	RAVINDER	SAHIL	ROMI	ROHAN

Presentations

- https://www.learnstockmarket.in/annual-reports

Annual Reports of Indian Companies 2021 – 2022: Full List

Reading annual reports is time consuming and considered to be boring. But what if I told you, annual reports can be a lot of fun and informative too?

Spending 10-15 minutes on the Reliance Industries annual report, can give you a lot of exciting information.

Mukesh Ambani – in the section titled 'Letter to Shareholders' – talks directly to his shareholders about Reliance getting Google and Facebook to invest in Reliance, India's war against the Corona virus and also speaks about his future ambitions for Jio and the retail section of the company.

Presentation

Latest Annual Reports 2022 Report

Annual Report	Link
September 5 2022	
Ethos	Report
Kalyan Jewellers	Report
Rategain Travel	Report
Ugar Sugar Works	Report
Transpek Industry	Report
Medplus Health Services	Report
Tourism Finance Corp	Report
Tiger Logistics	Report
Tasty Bite Eatables	Report
Talbros Automotive	Report
September 3 2022	
Sun Pharma Advanced	Report
Natural Capsules	Report

August 30 2022	
Universal Cables	Report
SP Apparels	Report
Vakrangee	Report
Uttam Sugar Mills	Report
Sequent Scientific	Report
August 26 2022	
TCNS Clothing	Report
Hindustan Aeronautics	Report
Hitachi Energy	Report
Phoenix Mills	Report
REC	Report
Dollar Industries	Report
Rainbow Children Medicare	Report
Ircon International	Report
GTPL Hathway	Report

Group Presentations

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- Use between **5 and 7 ratios**.
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- **Research information** about the company that you consider relevant to potential new investors.

Assignment Questions

- Assignment Deadline: 2 March 2023
- Approx. 20 hours researching and writing
- Word count: 1,200 words
- You are expected to use the Harvard referencing style
- Presentation is VERY important
- Choose any ONE of the questions

Assignment Questions

Question 1:

Outline the following financial ratios, covering in detail how to calculate the ratios, their importance, use and meaning, and the limitations of each of the ratios:

- Acid-Test Ratio
- Asset Turnover Ratio
- Average Inventories Turnover Period
- Average Receivables Settlement Period
- Current Ratio
- Earnings per Share
- Gearing Ratio
- Gross Profit Margin
- Interest cover ratio
- Return on Capital Employed
- Return on Equity

Assignment Questions

Question 2:

Explain the principles and concepts of Financial Accounting, giving details and examples of each; their relevance; and any limitations that the application of such principles and concepts have on businesses in today's world.

Question 3:

Identify the main internal and external users of accounting information of a business, with special emphasis on the type of information each group requires. Give detailed examples of why the users would require such information, and what limitations, if any, exist in providing such data

What we covered in Lecture 05

- Liquidity Ratios
- Gearing Ratios
- Investment Ratios
- Management Accounts

Liquidity Ratios

- Liquidity refers to the availability of cash in the near future after taking account of immediate financial commitments

- Key ratios:

CURRENT RATIO
$\dfrac{\text{CURRENT ASSETS}}{\text{CURRENT LIABILITIES}}$

ACID TEST
$\dfrac{\text{CURRENT ASSETS - INVENTORIES}}{\text{CURRENT LIABILITIES}}$

Gearing Ratios

$$\frac{\text{Non-Current Liabilities}}{\text{Share Capital + Reserves + Non-Current Liabilities}} \times 100$$

$$\frac{\text{Operating Profit before Interest}}{\text{Interest Payable}}$$

Investment Ratios

$$\frac{\text{Total Dividend Paid}}{\text{Number of shares in issue}}$$

$$\frac{\text{Profit after tax}}{\text{Number of shares in issue}}$$

$$\frac{\text{Market value per share}}{\text{Earnings per Share}}$$

Management Accounts: The Story behind the Numbers

- Impossible to read numerical tabulations with any accuracy
- Concentrate on main numbers (profits – net assets – debt- net cash flow movement)
- Major asset movements
- Major changes in group structure
- Major changes in financing
- Prospects for future growth
- Additional information outside accounting statements
- Compare interest paid to loans
- Changes in management

Sources of Finance

- Short-Term Finance
- Long-Term Finance
- Outside Investment at start up phase
- Outside Investment at ongoing phase

- Importance of having adequate finances
- Based on size, type, development phase, scope and purpose of business entity

Short Term Finance Types

- Overdraft facility
- Short-term Loan
- Trade Credit
- Leasing

Today’s Agenda

Long-Term Sources of Finance

Risk

Business Cycle

Long-Term Finance

Long-Term Sources of Finance

- To purchase and finance long-term assets (Fixed Assets)
- Cheaper than short-term finance
- Longer to obtain
- Collateral

- Long-term Debt
- Equity

Long-term Bank Debt

- Long-term Loan – fixed amount for a fixed period
- Advantages
  - Exact amount of interest payments
  - Fixed interest
  - Balance cannot be changed
  - Lower interest rate
- Disadvantages
  - Early payment penalty fee
  - Covenants imposed by Bank
  - Security is higher (related to amounts taken)

Bonds

- Bonds are similar to bank loans
- Sold directly to investors
- Accessible to very good credit rating businesses
- Costly to issue bonds
- Advantages
  - Cheaper than bank debt (in the long run)
  - No need for collateral
  - Trade on capital markets
- Disadvantages
  - High issue costs
  - Increased governance

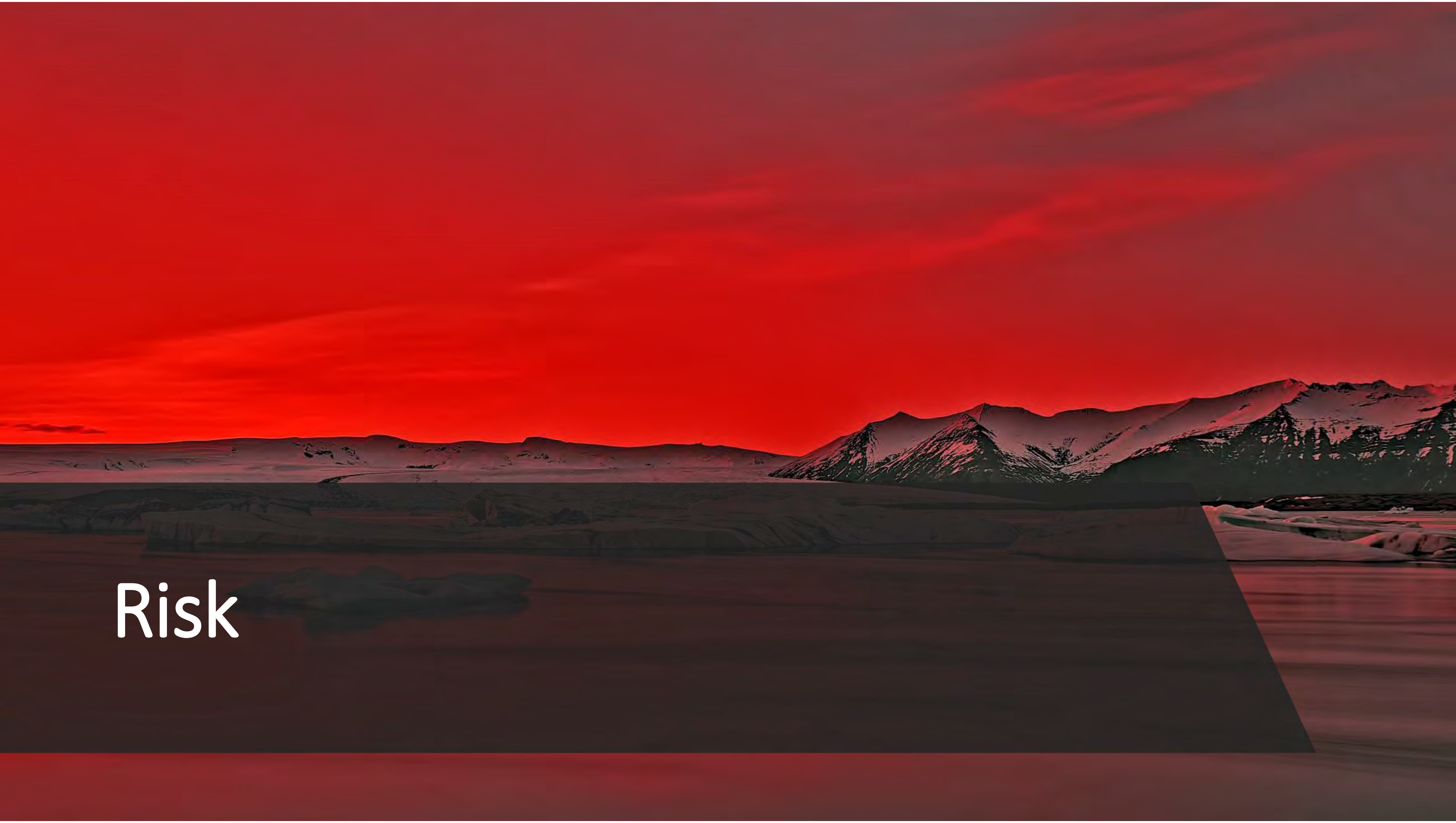
Equity

- Sale of ordinary shares to investors
- Initial Public Offering (IPO)
- Advantages
  - Permanent capital
  - No fixed repayment of returns – no Dividends policy
  - Investment pool is larger
  - Owners can divest parts of their company
- Disadvantages
  - Costliest form – issue costs
  - Losing control
  - Only attractive when business is healthy

Hybrid instruments

- Convertible Bonds
  - Established date to convert to equity
  - Debt → Equity
  - Interest due when debt; Dividends when Equity

- Preference Dividends
  - Equity, with fixed dividend
  - Only when profits are registered
  - Higher priority than Ordinary Shares - Liquidations



Risk

Risk

- Risk appetite of Business
- Lowest: Debt vs. Equity
- Lowest: Short-term vs. Long-term
- Flexible terms vs. Fixed term
- Collateral vs. Provisions
- Dividends vs. Interest

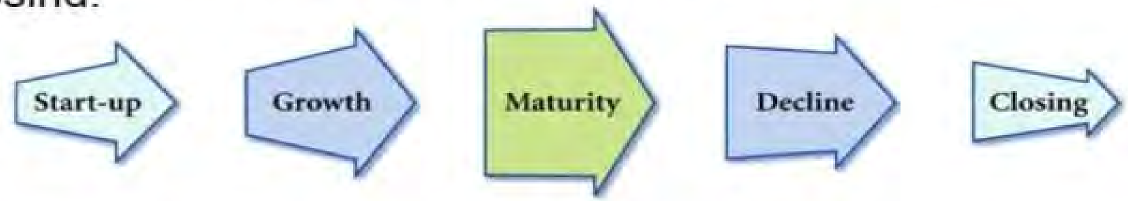
Timing of Finance requirements

- At what stage is the business ?
- Small business less risky than large ones.
- Large businesses to be more established
- Stable earnings vs. Forecast profits
- Type of project to be financed
- Private investors get involved if business is large and established – public call

Business Lifecycle

A firm typically goes through ***5*** stages in its life cycle: start-up, growth, maturity, decline, and closing.

The business life cycle.



- Each stage presents unique problems, opportunities, and funding requirements.
- Business life cycles vary considerably. Some firms go through the early stages fairly rapidly and then settle into maturity for a long time, while others skip to the closing stage in a few years.
- Some estimates predict that roughly 60% of businesses that employ others besides the owners will close within their first 6 years.
- The life cycle approach is a useful way to discuss financing opportunities and sources for businesses.

Start-Up and Growth

6 sources of Capital

1. *Personal funds*
2. *Borrowed funds from family and friends*
3. *Commercial bank loans*
4. *Borrowed funds through business start-up programs*
5. *Angel financing or venture capital*
6. *Enterprise Investment Schemes*

Angel Financing & Venture Capital

- usually businesses that would not qualify for commercial bank loan
- ***Angel investors*** - wealthy individuals and groups providing initial funding for high-risk ideas. They typically have very short loan investment horizons (less than 10 years) and upside limits of about $2 million.
- ***Venture capitalist firms or funds*** - fund high-risk projects, but have longer time horizons and higher funding limits. They generally provide the funding in stages.

Differences between Angel Investors and Venture Capitalists

Angel Investors	Venture Capitalists
Individual or group of individuals	Corporate entities
Invest own money	Invest pooled money from range of investors
Focus on early stages of business	All stages
Investment may be tied to individual or group expertise	Investment may be tied to high-growth opportunities, with focus on technology and innovation

Source: Adapted from LBO Advisers, "Essential Differences between Angel Investors and Venture Capital," www.lbo-advisors.com.

Credit Ratings

A comparison of Moody's and Standard & Poor's rating scales

Standard & Poor's	Moody's	Grades	
AAA	Aaa	Prime, maximum safety	Investment grade bonds
AA+	Aa1	High grade, high quality	
AA	Aa2		
AA–	Aa3		
A+	A1	Upper medium	
A	A2		
A–	A3		
BBB+	Baa1	Lower medium	
BBB	Baa2		
BBB–	Baa3		
BB+	Ba1	Speculative	Non-investment grade, high-yield or 'junk' bonds
BB	Ba2		
BB–	Ba3		
B+	B1	Highly speculative	
B	B2		
B–	B3		
CCC+	Caa1	Substantial risk	
CCC	Caa2	In poor standing	
CCC–	Caa3		
CC	Ca	Extremely speculative	
C	C	May be in default	
D		Default	

What is equity capital?

- Ordinary shares
  - Ordinary shares represent the equity share capital of the firm
  - Share in the rising prosperity of a company
  - Owners of the firm
  - The right to exercise control over the company
  - Vote at shareholder meetings
  - A right to receive a share of dividends distributed
  - Each shareholder entitled to a copy of the annual report
  - No agreement between ordinary shareholders and the company that the investor will receive back the original capital invested
  - What ordinary shareholders receive depends on how well the company is managed

Preference shares

- Preference shares usually offer their owners a fixed rate of dividend each year
- However if the firm has insufficient profits the amount paid would be reduced, sometimes to zero
- The dividend on preference shares is paid before anything is paid out to ordinary shareholders
- Preference shares are part of shareholders' funds but are not equity share capital

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