Paper - Advance Corporate Finance.

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Q No1 Long term investment is very much important for any business while considering strategic decision making. Bond is one of the debt financing tools avialable to any business - Explain the basic characteristic of bond financing?

Ans; Bonds:

In finance a bond is an instrument of indebtness of the bond issuer to the holders. The bond is a debt security under which the issuer owes the holders a debt and (depending on the term of bond) is obliged to pay them interest (the coupon)

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or repay the principal at a later date, termed the maturity date.

Characteristic of Bonds:

There are many types of bonds but nearly all bonds share three characteristics in the following-

(1) Face value:

The principal portion of the loan usually either $1000 or 5000. its the amount you get back from the issuer on the day the bond matures. A bond price which is in constant flux, can be more or less than the face value.

(2) Maturity:

The day the bonds comes due. A thirty (30) years ~~bond~~ from the day it is issued. Most bonds mature in with in 30 years, but maturities can be as short as a year or even shorter.
Short term bonds are usually called notes.

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(3) Coupon:

Because bonds used to Come with attached coupons That investors had to clip and redeem for Their Interest payments. (Now its all done Electronically) The size of The Interest payment is still called The coupon.

A Bond with an 8% Coupon pays 8% of The face value of The bond year, In two Installments. Assuming a face value of $1000, That's two $40 payments.

(4) Yield: Another commonly characteristic among bonds is That yield the measure of Their value. Think of yield as you would interest rate on a loan. If you are borrower You want The lowest possible interest rate.

Your lender wants to charge to The highest possible rate. When you buy a bond, you are The lender, and you want the high interest rate or yield. Generally The higher a bond yield The more credit or interest rate

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risk it carries just a borrowers pay more if their credit is bad or to borrow for a long term. you can get a higher yeild from risker issuer, or if you are willing to lend your money long term, like their prices bonds yields are also in constant flux when a bond prices rises its yield drops and vice versa. The actuall formula for the yield is more complicated mathematically but the upshot is the same. As bond prices drop, the investors who buys that bond for less end up with a better deal, reflected in a higher yield.

Q.No2 Bond financing can be done in different formation. Explain few most commonly used Bond financing investment in different financing market?

Ans. The bond market are very liquid and active but can take second seat to stocks for many retail or part time investors. it is

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often for professional investors. pension and hedge funds and financial advisor but that does not means that part time investor should steer clear of bonds. In fact bonds play an increasingly important part in your portfolio as you age and because of that learning about them now make good financial sense.

Now there are many types of bonds financing in different market. but I explain in bonds.

1) Treasury bonds.
2) other US government bonds
3) Investment grade corporate bond.
4) High yield corporate bonds (low quality) also known as junk bonds.
5) Foreign bonds
6) mortgage backed bonds
7) Municipale bonds.

① Treasury Bonds:

Treasuries are issued by the fedral government to finance its budget deficits.

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because They are backed by uncle Same and same taxing authority, They are considering credit risk free. Their yield are always going to be lowest (except for tax free munis). But in economic downturns They perform better than higher yield bonds and The interest is exempt from state income.

(2) Federal Home Loan Mortgage Corp:

Agen yield are high Then treasury yield because They are not full faith and credit obligation of The U.S government but The credit risk is considered minimal interest on The bonds is taxable at both The federal and state levels, however

(3) Investment grade corporate bonds:

Investment grade corporate are issued by companies or financing vhicles with relatively strong balance sheets. They carry ratings of at least triple-B from Standard and poor.

(i) Moody Investors Services:

The scale is triple A as the higest followed by

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double-A Single-A Then triple B and so on) for investment grade bonds The risk of default is consider pretty remote-

Still Their yields are higher Than either treasury or agency bonds Though like most agencies They are fully taxable. In economic downturns These bonds tend to underperform treasuries and agencies-

(4) High yield bonds:

These bonds are issued by companies or financing vehicle with the relatively weak balance sheets. They carring rating below triple-B. Defluet is a distinct possibility. As a result high ~~rate~~ yield bond prices are more closely tied to the health of corporate balance sheets. They track stock prices more closely than investment grade bond prices - High yield does not provide the same asset allocation benefits you get by mixing high grade bonds and stock,

(5) Foreign Bonds:

These securities are something else altogether - Some are dollar denominated but the average foreign bonds.

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fund has about Third of its asset in foreign currency denominated debt according to Lipper.
With foreign currency denominated bonds The issuer promises to make fixed Interest payments and to return the principal in another Currency The size of Those payments when They are Converted into dollar on exchange rates.

(6) Mortage backed bonds:

which have face value of $25000 compared to $1000 or $500 for other types of bonds involve prepayment risk. Because Their value drops when They rate of mortgage Prepayment rises. They dont benefits from declining Interest rates like most other bonds do.

(7) Municipal Bonds:

Often Called "munis" are issued by U.S. States and local govt or Their agencies and They Come in both The investment grade and high yield Varieties. The Interest is tax free but That does not mean every one can benefits from Them.

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Q3 Explain one of the basic formations of equity financing as Common Stock financing. Explain the characteristic of Common Stock in details?

Ans: Equity financing:

Equity finance is a method of raising fresh capital by selling shares of the company to public institutional investors, or financial institutions. The people who buys share are reffered to as share-holder of the company because they have recieved ownership interest in the company.

Description:

Equity financing is a method of raising funds to meet liquidity needs of an organization by selling companies stock in exchange for cash. The portion of the stock will depend on the promoter ownership in the company.

One of the most sought after method of raising cash, apart from public issue, is via venture capital. Venture capital (VC) financing is a method of raising money via high networth

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individual who are looking at diverse investment opportunities. They provide the company with much needed capital to sustain business in exchange of shares or ownership in the company. A start up might need various rounds of equity financing to meet liquidity needs. They venture capital may like to go for convertible preference shares as form of equity financing and as the firms grows and reports profits consistently, it may consider going public. If the company decide to go public these investors (venture capitalist) can use the opportunity to sell their stake to institutional or retail investors ~~(venture capitalist~~ at premium. If the company needs more cash, it can got for right offer or follow on public offerings.

When a company goes for equity financing to meets it's liquidity needs for diversification or expansion purposes it has to propose a prospectus where financial detail of the company are mentioned. The company has to also specify as to what it plans to do with the funds raised.

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Equity financing is slightly different from debt financing, where funds are borrowed by the business to meet liquidity requirement. ideally to meet liquidity needs an organization can raise funds via both equity as well as debt financing.

Common Stock financing:

Common Stock financing represents the sale of owner ship stakes with in corporation in exchange for cash or capital consideration. Investors and management must become familiar with the role of the corporation and the basic means with which to finance the business in order to appreciate share holders rights and privileges. Common Stock Equity finance does carry distinct risks that are applicable to owner and management.

The main advantages of common stock financing is one of the biggest advantages of common stock from the issuing company perspective is the absence of required payments.

Debts financing requires a business to make interest and principal payments on a specified schedule. Common

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Stock has no such requirements-

=> Characteristic of Common Stock:

The following are the main characteristics of common Stock discussed below-

Stock represent the basic form of ownership of a Corporation - it can be broadly classified as Common and preferred Stock-

Common Stock are the most common form of equity investment-

All corporation issue Common Stock and are Controlled or owned by Share-holder or Owners.

Following are some of the most important featuries and Characteristic of Common Stock-

(1) Common Stock provide a Share of Ownership in the Company, while other types of Securities like bonds, which do not,

(2) Common Stockholders have the right to vote at annual meeting, with each Share entitling the holder to one vote- They will also recieve audited financial Statements of The Company-

(3) Common Shareholder are Entitled to recieve dividend payment- if They are authorized by corporation boards of director.

Dividend can be paid in the form of Cash or Stock- However dividend payments are not guaranteed but are normally

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based on the financial success of corporation

(04) When a company issues new shares existing common share holders have the preemptive rights to buy additional shares directly from the company, often below the market price before they are offered to other potential investors.

(05) In the event of dissolution or liquidation common share holder have last claim on the company's assets. they are the last to claim any amount remaining from the liquidation of corporate assets after the creditors, bond-holders and preference share holders are paid.

Q4:- Time value of money is very important element while considering any strategic financial investment. Explain the basic concept of time value of money and introduce the concept of capital budget technique known as the net present value.

Ans:- First of all I will explain time value of money.

Time value of money is a concept that recognize the relevant worth of future cash flow arising as a result of financial decision by considering the opportunity cost of fund

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Concept:

Money loses its value over time which makes its more desirable to have it now rather than later. There are several reasons why money loses value over time. Most obviously there is inflation which reducing the buying power of money.

But quit often the cost of recieving money in the future rather now will greater than just the lost in its real value on account of inflation. The opportunity costs of not have the money right now also include the loss of additional income that you could have earned simply by having recieved the cash earlier. More over recieving money in the future rather than now may involve some risk and uncertainty regarding its recovery.

For these reasons, future cash flows are worth less than the present cash flows.

Time value of money concept attempts to incorporate the above consideration into financial decision by facilitating an objective evaluation of cash flow

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from different time period by converting them into present value or future value equivalents.
This ensure the comparison of like with like.
The present or future value of cash flow are calculated using discount rate (also known as cost of capital, WACC and required rate of return) that is determined on the basis of several factors such as—

1) Rate of Inflation:
Higher the rate of inflation higher the return that investors would require on their investment.

2) Interest Rate:
Higher the interest rates on deposits and debt securities, greater loss of interest income on future cash inflows causing investors to demand a higher return on investment.

3) Risk Premium:
Greater the risk associated with future cash flows of an investment higher the rate of return required by an investors to compensate for the additional risk.

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⇒ Here we will discuss of Capital budgeting known as a present value Capital budgeting techniques-
Net present value method is (also known a discounted cash flow method) is a popular capital budgeting technique that takes in to account the time value of money - it's uses net present value of the investment project as the base to ~~Concept~~ accept or reject a proposed investment in projects like purchase of new equipment, purchase of inventory, Expansion or addition of existing plant assets and the installation of new plants etc.
First I would explain what is net present value and then how it use to analyze investment projects-

i) ⇒ Net present value.

Net present value is the difference between the present value of cash inflow and the present value of cash out flow that accure as a result of undertaking an investment project, it may be positive zero or negative, these three possibility of net present value are brefly explained below -

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Positive NPV:

If present value of cash inflow is greater than the present value of the cash flow out flow, the net present value is said to be positive and the investment proposal is consider to be acceptable.

Zero NPV:

If present value of cash inflow is equal to present value of cash out flow, the net present value is said to be zero and the investment proposal is consider to be acceptable.

Negative NPV:

If present value of cash inflow is less than present value of cash out flow, the net present value is said to be negative and the investment proposal is rejected.

The summary of concept explained so far is given below;

1) present value of cash flow > present value cash outflow NPV is positive and the project is acceptable.
2) present value of cash flow = present value of cash out flow NPV is zero and the project is acceptable.
3) present value of cash flow < present value of cash out flow NPV is negative and the project is not accepted.

(End)

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