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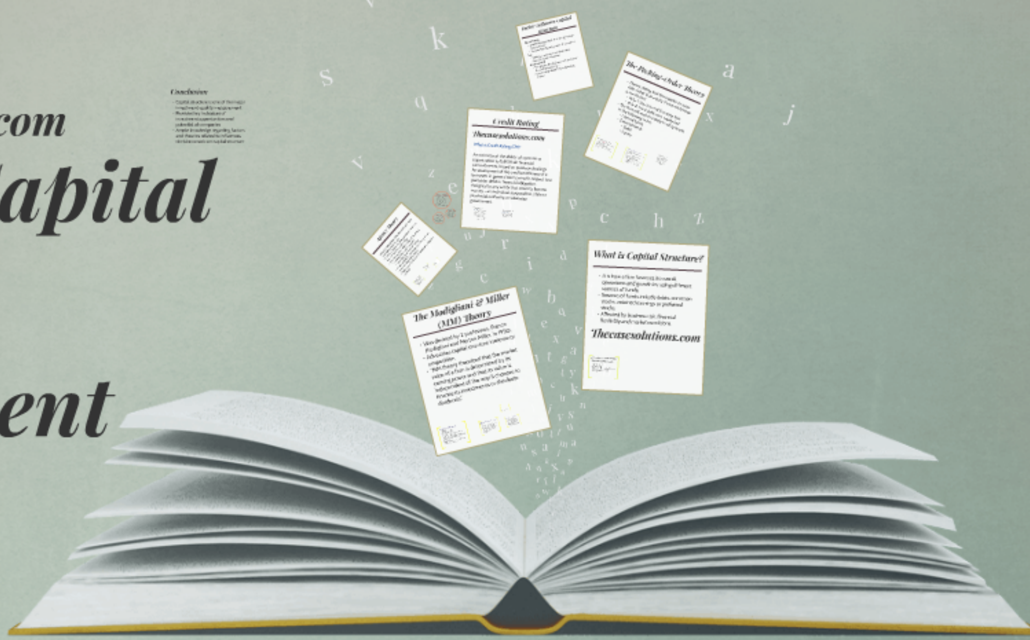
TELUS: Capital Structure Management



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Conclusion

- Capital structure is one of the major investment-quality measurement
- Provides key indicators of investment opportunities and potential of companies
- Ample knowledge regarding factors and theories related to influences decisions made on capital structure

What is Capital Structure?

- It is how a firm finances its overall operations and growth by using different sources of funds.
- Sources of funds include debts, common stocks, retained earnings or preferred stocks.
- Affected by business risk, financial flexibility and market conditions.

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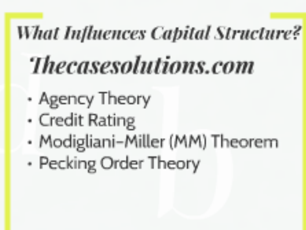

What Influences Capital Structure?

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- Agency Theory
- Credit Rating
- Modigliani–Miller (MM) Theorem
- Pecking Order Theory

Credit Rating

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What is Credit Rating (CR)?

An estimate of the ability of a person or organization to fulfill their financial commitments, based on previous dealings
An assessment of the creditworthiness of a borrower in general terms or with respect to a particular debt or financial obligation.
Assigned to any entity that seeks to borrow money – an individual, corporation, state or provincial authority, or sovereign government.

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Why Use CR?

- determines the likelihood that the borrower will pay back a loan within the confines of the loan agreement, without defaulting.
- affects the entity's chances of being approved for a given loan, or receiving favorable terms for said loan
- High credit rating
  - High possibility of paying back loans
- Low
  - Trouble paying back loans in the past

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Factors affecting CR

- Entity's past history of borrowing and paying off debts
- Entity's future economic potential
- Payment history, amounts owed, length of credit history, new credit, and types of credit

The Effects of Credit Rating Grades' Changes on Capital Structure: S&P 500

- Discrete Cost
  - relevant and associated with decision on capital structure
- Trade-Off Theory
  - Costs and benefits relating to financing with debt will affect decisions for capital structure of companies
- Pecking Theory
  - increases in asymmetric information with the increase in financing costs

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The Influence of Credit Ratings on Capital Structure

Credit Rating-Capital Structure (CR-SR) Hypothesis

- if a company is near a potential downgrade/(upgrade) in its credit rating is more likely to adjust their capital structure to avoid/(achieve) that downgrade/(upgrade)

Violation of Debt covenant

- increase in collateral, interest rate, future covenant restrictions, demand for prompt repayment of the amount of cash owed or termination of the lending agreement by the creditors.