

# Capital Structure: What To Understand

(Welch, Chapter 16)

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Did you bring your calculator? Did you read these notes and the chapter ahead of time?

# Plan

- ▶ Confuse with many choices.
- ▶ In future sessions, learn how to think about them.

What's a cash flow right?

What are the cash flow rights of debt and equity?

Why do *any* owners and managers *ever* return any money to funders?

What's the diff between Straight and Convertible Debt?  
Is a Convertible more like Debt or more like Equity?

What's the diff between Secured or Senior Debt and Unsecured or Subordinated Debt?

# Bond Features

Covenants. Seniority. Collateral. Convertibility. Puttability. Callability. Sinking Fund. Maturity. Duration. Coupon bonds. Fixed-rate vs. floating-rate Bonds. Diffuse vs. Concentrated. Financial vs. Non-Financial.

How is a bank loan different from a bond?

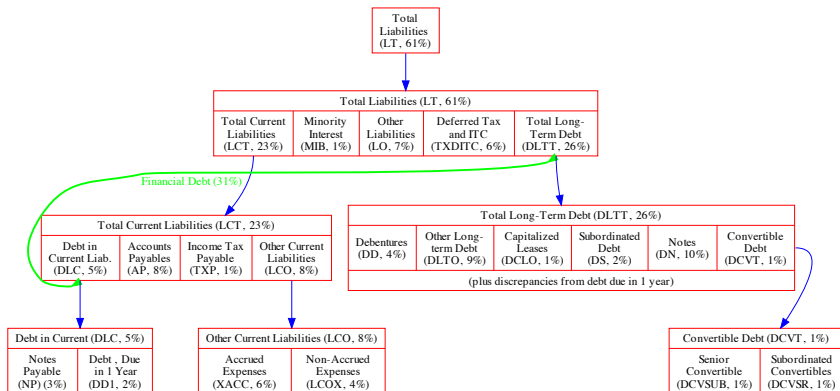


What's a non-financial liability (NFL)?

Do NFLs provide resources to help fund the firm?

How big are NFLs usually compared to FD (Fin'l Debt)?

# In Book Values, as Fraction of Firm Assets



These are averages over all non-tiny firms on Compustat. For details, see Ivo Welch, *Two Common Problems in Capital Structure Research: The Financial-Debt-To-Asset Ratio and Issuing Activity Versus Leverage Changes*, International Review of Finance 11:1, 2011, p 1-17. Watch out: the denominator are assets, measured in book value.

What's the diff between Common and Preferred Equity?

# Equity Features?

Warrants vs. Options.

Units.

Class A and Class B shares.

	↓ Period Ending Dec 26, 2015	Dec 27, 2014	Dec 28, 2013
<b>Assets</b>			
Current Assets			
Cash And Cash Equivalents	15,308,000	2,561,000	5,674,000
Short Term Investments	10,005,000	11,493,000	14,413,000
Net Receivables	6,823,000	6,385,000	6,176,000
Inventory	5,167,000	4,273,000	4,172,000
Other Current Assets	3,053,000	3,018,000	1,649,000
<b>Total Current Assets</b>	<b>40,356,000</b>	<b>27,730,000</b>	<b>32,084,000</b>
Long Term Investment	7,851,000	9,120,000	7,694,000
Property Plant and Equipment	31,858,000	33,238,000	31,428,000
Goodwill	11,332,000	10,861,000	10,513,000
Intangible Assets	3,933,000	4,446,000	5,150,000
Accumulated Amortization	-	-	-
Other Assets	7,735,000	6,505,000	5,489,000
Deferred LngTm Asset Charges	-	-	-
<b>Total Assets</b>	<b>103,065,000</b>	<b>91,900,000</b>	<b>92,358,000</b>
<b>Liabilities</b>			
Current Liabilities			
Accounts Payable	10,845,000	12,210,000	11,191,000
Short/Current Long Term Debt	2,634,000	1,596,000	281,000
Other Current Liabilities	2,188,000	2,205,000	2,096,000
<b>Total Current Liabilities</b>	<b>15,667,000</b>	<b>16,011,000</b>	<b>13,568,000</b>
Long Term Debt	20,036,000	12,059,000	13,165,000
Other Liabilities	2,841,000	3,278,000	2,972,000
Deferred LT Liability Charges	2,539,000	3,775,000	4,397,000
Minority Interest	-	-	-
Negative Goodwill	-	-	-
<b>Total Liabilities</b>	<b>41,083,000</b>	<b>35,123,000</b>	<b>34,102,000</b>
Temporary Equity (Misc Stocks Options Warrants)	897,000	912,000	-
<b>Stockholders' Equity</b>			
Redeemable Preferred Stock	-	-	-
Preferred Stock	-	-	-
Common Stock	23,411,000	21,781,000	21,536,000
Retained Earnings	37,614,000	33,418,000	35,477,000
Treasury Stock	-	-	-
Capital Surplus	-	-	-
Other Stockholder Equity	60,000	666,000	1,243,000
<b>Total Stockholder Equity</b>	<b>61,085,000</b>	<b>55,865,000</b>	<b>58,256,000</b>
<b>Net Tangible Assets</b>	<b>45,820,000</b>	<b>40,558,000</b>	<b>42,593,000</b>

# Pension Liabilities — Defined Benefit or Defined Contribution?

- ▶ Defined-benefit pension liabilities can rank among the most important liabilities for older blue-chip firms, for governments, and for foreign firms or subsidiaries.
- ▶ In the US, corporations have moved to defined contribution plans.

It used to be a good business to buy companies with overfunded defined-benefit pension plans, replace the pension liabilities with the low bidder, take out the difference, and resell the firm. (“First Executive” run by Fred Carr did this in around 1985-1990 with Drexel Junk Bonds.) Obviously, many of these insurers (including FE) later on went bankrupt themselves.



Issued	Nominal	Type	Maturity	Stated	Amount
Q4-2015	\$915	senior	Dec 2045	4.7%	\$908
Q4-2015	A\$800	senior	Dec 2019	3.25%	\$181
		senior	Dec 2022	4.0%	\$397
Q3-2015	\$1,000	senior	Aug 2045	4.90%	\$1,009
Q3-2015	\$7,000	senior	Jul 2022	2.45%	\$1,748
		senior	Jul 2022	3.10%	\$996
		senior	Jul 2025	3.70%	\$2,247
		senior	Jul 2045	4.90%	\$1,998
2012	\$6,200	senior	Dec 2017	1.35%	\$2,999
		senior	Dec 2022	2.70%	\$1,492
		senior	Dec 2032	4.00%	\$744
		senior	Dec 2042	4.25%	\$924
2011	\$5,000	senior	Oct 2016	1.95%	\$1,499
		senior	Oct 2021	3.30%	\$1,997
		senior	Oct 2041	4.80%	\$1,490
2009	\$2,000	jnr conv	Aug 2039	3.25%	\$1,103
2005	\$1,600	jnr conv	Dec 2035	2.95%	\$975
					\$22,707
less current part of long-term debt					(\$2,602)
less issuing costs					(\$69)
Net of issuing costs					\$20,036

Year	2016	2017	2018	2019	2020	2021–
Amount	\$1,500	\$3,000	\$0	\$181	\$1,750	\$17,845

## More INTC Capital Structure

We omitted discussion of more complexity of

- ▶ used and unused credit lines,
- ▶ total interest payments.
- ▶ hedged out aspects.
- ▶ the prevailing interest rates at the time in order to make more sense of capital structure changes. the prevailing yield curve and credit spread.

...and Intel has one of the most vanilla capital structures I know.

What are reasonable measures of firms' leverage / precariousness / debt burden?

How do you calculate the market-value of assets?

What is the biggest determinant of year-to-year changes in most firms' debt ratios?