

Equity



Topics

- Equity Capital: Characteristics
- Equity: Issuance and Capital Return
- Equity: Valuation
- Equity: Alternative Valuation Metrics

Equity Capital: Characteristics

Equity Capital: Characteristics

Learning outcomes.....

- **Identify** the characteristics, and the risks to the investor, of the various classes of equity capital
- **Identify** the reasons for primary issuance and secondary markets for ordinary shares with investor implications
- **Identify** the reasons for issuance of preference shares and the implications to the investor
- **Identify** the characteristics of Global and American Depositary Receipts

Equity Capital: Characteristics

Ordinary shares

- Most common type of equity capital.
- Issued by limited liability firms and represents risk capital of the firm. It means shareholders take considerable risk in investing in ordinary shares.
- This is because though shareholders participate in profits and losses of the firm, return is not guaranteed.
- The maximum investor can lose is his investment in ordinary shares that is why it is called **limited liability**.

Equity Capital: Characteristics

Ordinary shares

➤ Shareholders have voting rights

- ▶ to determine the corporate policy of their firm;
- ▶ when a merger with, or takeover by, another firm is proposed;
- ▶ to appoint/change the firm's board of directors; and
- ▶ to determine whether the firm should raise more ordinary share capital.

Equity Capital: Characteristics

Ordinary shares

- There is a nominal value but no redemption or maturity date.
- The share price is market determined depending upon demand and supply.
- In UK, share prices are quoted in Financial Times, sector-wise.
- In UK, dividends are generally paid twice in the year. The first dividend is called '**interim**' dividend and second one is called '**final**' dividend.
- Dividends may change every year or may not be paid at all.
- Dividends can be paid after all other claims such as interest, tax and preference dividends are paid.

Equity Capital: Characteristics

Ordinary shares

- There could be two varieties of ordinary shares
 - With voting rights
 - With no voting rights

Equity Capital: Characteristics

Primary and Secondary issuance of shares

➤ **Initial Public Offering (IPO)**

- A new company issuing shares for the first time.
- An investment bank advises the company on various aspects of IPO such as

- ▶ the type of security to issue;
- ▶ the best price which can be expected;
- ▶ the number of shares to be issued; and
- ▶ when to bring the IPO to market.

Equity Capital: Characteristics

Primary and Secondary issuance of shares

➤ **Initial Public Offering (IPO)**

- **Prospectus:** An offer document containing financial information, expected future operations, potential risks and opportunities for company issuing shares which is provided to investors.
- The document helps investors in making investment decision
- This must be filed with the appropriate regulator in each country for example SEC in US.

Equity Capital: Characteristics

Primary and Secondary issuance of shares

➤ **Initial Public Offering (IPO)**

- IPOs are done so that the company can **list its shares on stock exchange** and most importantly it can **raise funds** for variety of purposes.
- However, issuing new shares **dilutes the stake** of existing shareholders. This means the earnings, voting power and other rights get divided among large number of shareholders thereby reducing the ownership of existing shareholders.
- For investors, since there is no share price history of companies going for IPOs, they should be careful before investing.
- Generally, in order to attract the investors, the IPO shares may be underpriced, and in that case, shareholders benefit once shares are listed at higher price.

Equity Capital: Characteristics

Primary and Secondary issuance of shares

➤ **Secondary or Seasoned offering**

➤ An existing company issuing shares for the second time i.e. subsequent to IPO.

➤ **Types of secondary offerings**

➤ An existing listed company can issue more shares to raise money

➤ In this case, there will be a dilution of ownership and hence such an issue is called '**dilutive secondary offering**'.

➤ The EPS goes down and hence generally share price falls after the announcement of the seasoned offering.

Equity Capital: Characteristics

Primary and Secondary issuance of shares

➤ Types of secondary offerings

- Shares held by some existing shareholders (such as company directors or founder's family members etc.) may be offered to new shareholders. In this case, the company does not get fresh money.
 - In such **non-dilutive issue**, new shares are not created but only existing shareholders sell their shares to other shareholders.
 - This may enhance the market liquidity of shares since shares are more widely held.

Equity Capital: Characteristics

Preference shares

- Preference shares pay a **fixed dividend** to the preference shareholders. This dividend is fixed as a percentage of face value or nominal value of shares.
- Dividends may not be paid, in case of inadequate funds, it does not result into default.
- However, dividends on ordinary shares can be paid only after dividends are paid to preference shareholders.
- Preference shareholders **do not carry** voting rights generally.
- Preference shares are considered less risky compared to ordinary shares. Investors looking for relatively stable income are attracted towards preference shares.

Equity Capital: Characteristics

Preference shares

- From company's perspective technically preference shares are equity and hence may not be counted as debt.
- They may be used in transactions as incentives
- They may also offer a further ownership in bonds or ordinary equity.

Equity Capital: Characteristics

American Depository Receipts (ADRs)

- ADRs represent shares in non-US companies and are traded on US exchanges such as NYSE and NASDAQ.
- To create ADRs, US bank buys shares of non-US company, bundles them into groups of shares and sells certificates of beneficial ownership that are ADRs.
- Each ADR represents certain number of home country shares. The ADR prices are kept in a range that will be attractive to US investors.
- The non-US company benefits because it can access US markets for getting capital.
- US investors benefit because they can invest in non-US company in US, which is easy and cost effective
- However, investors in ADRs face currency risk as well as political / economic risks of countries to which ADR companies belong.

Equity Capital: Characteristics

Global Depository Receipts (GDRs)

- GDRs are similar to ADRs, but they are issued in more than one country.
- The shares of a foreign company are held by an international banks and GDRs are issued against them.
- They trade on London Stock Exchange at International order book segment.
- GDRs cannot be publicly traded in US.

Equity: Issuance and Capital Return

Equity : Issuance and Capital Return

Learning Outcomes.....

- **Distinguish** between primary and secondary share issuances
- **Define** the key features of an equity issuance
- **Define** and **Explain** the purpose of a rights issue, a bonus/scrip issue and a stock split
- **Calculate** the theoretical ex-rights price and the value of the right (nil-paid) given the cum-rights price, the issuance ratio and the subscription price

Equity : Issuance and Capital Return

Learning Outcomes.....continued

- **Evaluate** the options open to an investor in response to a rights offer and **Explain** the effect on the investor's wealth
- **Identify** and **Explain** the motivations behind a company buying back its own shares

Equity : Issuance and Capital Return

Primary and Secondary share issuance

- As already discussed, primary issuance means shares are issued for the first time by a company
- If an existing listed company issues shares it is called secondary issuance
- Only companies meeting set of listing criteria are allowed to list their shares
- Listing criteria include minimum standard of managerial competence and financial stability.

Equity : Issuance and Capital Return

Primary and Secondary share issuance

- An investment bank is consulted before the issue on matters such as timing, size and price of issue. The investment bank also prepares documentation to advertise and sell the issue.
- The investment bank may **underwrite** the issue itself or get it underwritten from other institutions.
- Underwriting involves guaranteeing to buy any part of issue that is not bought by the investors.

Equity : Issuance and Capital Return

Equity issuance methods

➤ **Placing**

- The investment bank (i.e. issuing house) purchases all the new shares from a company and places them (resells) with other institutions.
- Thus, the company is guaranteed to get full amount of issue.
- This is generally done for smaller issues.
- This is cost effective way of raising money however shares are not available for trading widely.

Equity : Issuance and Capital Return

Equity issuance methods

➤ **Accelerated book building**

- In this case, the investment bank 'builds a book' of investors interested in buying the issue.
- Accelerated book building means a short time when investor interest needs to be established by investment bank or underwriters.
- After assessing investor interest, which could be in a day or two, allotment of shares take place.
- Minimum price may be guaranteed by underwriters to the firm.

Equity : Issuance and Capital Return

Equity issuance methods: Intermediaries' Offer

➤ Offer for sale

- In this case, a company issues shares to an investment bank, that acts like an underwriter that guarantees the issue sale.
- Prospectus is required to be advertised in national press as per LSE.
- The investment bank then sells the shares to **general public**.
- Investment bank charges a fee for this service.

Equity : Issuance and Capital Return

Equity issuance methods: Intermediaries' Offer

➤ Offer for sale by tender

- Here general public is invited to bid for an issue subject to a minimum price.
- The issue is made at a **striking price** that ensures that issue is fully subscribed.
- All bids above the striking price are allotted the shares.
- Advantage: More amount may be collected than expected.
- Disadvantage: Exact amount is not known till all bids are received.

Equity : Issuance and Capital Return

Equity issuance methods: Intermediaries' Offer

➤ Offer for sale by subscription

- Less common method, may be used only by large organizations.
- Here the large organization itself, not the investment bank, issues shares to general public.

➤ Introduction

- In this case, the company joins the main market without raising any capital.
- No underwriting fees, less advertising
- Less visibility, may be used as a platform for future capital-raising

Equity : Issuance and Capital Return

Equity issuance methods: Intermediaries' Offer

➤ **Equity crowdfunding**

- Investors invest in an early-stage unlisted company.
- A shareholder in this case has a partial ownership.
- Investor will profit if the company does well, else can lose money.

Equity : Issuance and Capital Return

Rights Issue

- Issue of shares to existing shareholders at a lower price compared to market.
- Thus, the shareholders have a '**right**' to buy new shares not the obligation.
- Right can be sold to other investors also, each right has a **value**. After the rights issue the price usually falls.
- If may sell right on behalf of investor and distribute the proceeds. However, if the proceeds are kept by the firm, the investor will lose.
- Rights issue may be underwritten.
- **Cum-rights price**: Share price before the rights issue. **Ex-rights price**: Share price after the rights issue

Equity : Issuance and Capital Return

Rights Issue: **Example**

Number of shares held by an investor in Company A	400
Current Share price	1.20
Value of shareholding	$400 * 1.20 = 480.00$
Company announces rights issue in the ratio of	1 for 4
Rights share price	0.80

Number of shares investor has option to buy	100
Total amount payable	$100 * 0.80 = 80$
Theoretical new share price known as ex-rights price	$(480 + 80) / (400 + 100) = 1.12$
Value of investor's holding in case of not taking rights shares	$400 * 1.12 = 448.00$
Value of Right = ex-Rights price less subscription price	$1.12 - 0.80 = 0.32$
Amount investor will get by selling rights	$100 * 0.32 = 32$

Equity : Issuance and Capital Return

Scrip Issue

- Issue of shares to existing shareholders at no cost.
- Instead of paying dividends, companies may make scrip issue, hence this is known as “scrip dividend”. This may allow investor to save tax.
- **Cum-scrip price**: Share price before the scrip issue. **Ex-scrip price**: Share price after the scrip issue.

Equity : Issuance and Capital Return

Scrip Issue: Example:

Example

Magnet plc chooses to pay a 'one for 20' scrip dividend to shareholders rather than an ordinary dividend payment. An investor holds 500 of Magnet's ordinary shares (currently priced at £10.50) and will therefore be entitled to 25 new shares. Since a scrip issue does not change the value of the company, the investor's holding will be the same before and after the issue. The ex-scrip price will be given as:

$$\begin{aligned}\text{Ex-scrip issue} &= \frac{(\text{Ordinary shares held} \times \text{original share price})}{(\text{Total number of new shares held})} \\ &= \frac{(500 \times \text{£}10.50)}{525} \\ &= \text{£}10.00\end{aligned}$$

The investor could sell the scrip shares allocated to them and receive:

$$\text{£}10.00 \times 25 = \text{£}250.00$$

The value of the investor's new holding, having sold the allocated scrip issue, will be:

$$\text{£}10.00 \times 500 = \text{£}5,000.00$$

Equity : Issuance and Capital Return

Stock split

- This is done to reduce the stock price to bring it within reach of investors
- Each share is split into shares of smaller par value.
- Market capitalization does not change post stock split.

Equity : Issuance and Capital Return

Share repurchase

- Shares can be purchased in open market or via tender offer. The tender offer specifies number of shares as well the price range to buy back the shares.
- Shareholders may sell portion of their holding or total holdings within a time period.
- The company may retire (cancel) the shares bought or keep them as treasury stock for re-issuance.
- Share repurchase happens when the company has substantial cash and share price is 'cheap' as per the management.

Equity : Issuance and Capital Return

Share repurchase

- Post share repurchase, share price goes up and ratios such as return on assets and return on equity improve.
- Share repurchase may be advantageous to investors compared to dividends from taxation perspective, if capital gains are taxed at lower rate than dividends

Equity Valuation

Equity Valuation

Learning outcomes.....

- **Calculate** a holding period return for an ordinary share, comprising capital gain and dividend income
- **Identify** the reasons for a company's chosen dividend policy
- **Explain** the practical constraints on companies paying dividends
- **Explain** the importance of the dividend yield and dividend cover in stock analysis
- **Calculate** dividend yield and dividend cover

Equity Valuation

Learning outcomes.....continued

- **Calculate** an estimated growth rate for dividends using historic data, or using return on equity, and a retained earnings ratio
- **Identify** the components, assumptions and limitations of the dividend discount model (Gordon growth model)
- **Calculate** the present value of a share using the dividend discount model

Equity Valuation

Holding Period Return

- It is the actual return from holding a stock for a particular period.

$$R_t = \frac{(P_t - P_{t-1}) + D_t}{P_{t-1}}$$

Equity Valuation

PV of expected future dividends

- Price of a stock should be equal to the present value of expected future dividends from the stock

$$P_0 = \sum_{t=1}^{\infty} \frac{E(D_t)}{(1+R)^t}$$

- To apply the above model, we should forecast dividends into infinity, which is not practical.
- The required rate of return, should reflect the riskiness of the stock.
- Hence analysts forecast dividends for few years and then apply a growth rate to dividends to calculate the PV of the stock.

Equity Valuation

Dividend Yields and dividend policy

- Dividend yield is calculated as follows:

$$\text{Dividend yield} = \frac{D_0}{P_0}$$

Dividend Yields and Dividend Cover

- Dividend cover:

$$\text{Dividend cover} = \frac{EPS_0}{DPS_0}$$

- Dividend payout ratio is reciprocal of dividend cover i.e. DPS / EPS

Equity Valuation

Example:

Example

Company X generates an operating profit of £40 million. After paying interest of £5m and tax of £11m, it achieves a dividend cover of 3.0. What was the total dividend paid?

The earnings attributable to ordinary shareholders are profit after interest and after tax, as shown:

$$£40m - £5m - £11m = £24m$$

A dividend cover of three times means that if all these earnings were paid out, then the dividend would be three times greater. So:

$$£24m = \text{dividend} \times 3$$

Dividend paid was therefore:

$$\frac{£24m}{3} = £8m$$

Equity Valuation

Factors influencing dividend decisions

- Dividends are used as a 'signal' to investors: Generally, companies are reluctant to cut dividends
- 'Clientele effect': Company wants to attract certain types of investors
- Tax influences on dividend policy
- Earnings stability

Equity Valuation

Practical limitations to pay dividends

- Regulatory requirements: As per UK company law, company should have distributable reserves in balance sheet to pay dividends
- Availability of cash

Equity Valuation

Dividend Discount Models and the growth rate of dividends

➤ **Gordon Growth Model:**

$$P_0 = \frac{D_1}{R-g} \quad \text{or} \quad R = \frac{D_1}{P_0} + g \quad \text{or} \quad R = \frac{D_0(1+g)}{P_0} + g$$

- To calculate R which is the offered or required or expected rate of return, we need
 - The current stock price
 - Most recent dividend
 - Estimate of dividend growth rate

Equity Valuation

Dividend Discount Models and the growth rate of dividends

➤ **Gordon Growth Model:** Example:

	Firm A	Firm B
Current Share Price	£1	£0.90
Dividend per share	£0.08	£0.07
Growth rate of dividends	6%	2%

- Calculate the expected return from the stocks.
- What conclusions can be drawn from above calculations?

Equity Valuation

Calculating dividend growth rate: Many methods

- 1. Average of historical growth rate
- 2. Average of analysts estimates called 'consensus'
- 3. Assuming that dividends are a constant % of earnings, hence dividends growth rate = earnings growth rate
 - Dividend growth rate (g) = Retention ratio * ROE
 - Retention ratio = Retained earnings / Earnings

Equity Valuation

Calculating dividend growth rate: Many methods

Example

A company just reported earnings of £2m and plans to retain 40% of its earnings. The historical ROE has been 16% and is expected to continue into the future.

How much will earnings grow over the coming year?

$g = \text{retention ratio} \times \text{ROE}$ where the retention ratio is $(\text{retained earnings} \div \text{earnings})$

$$g = 0.4 \times 0.16 = 0.064$$

Equity: Alternative Valuation Metrics

Equity: Alternative Valuation Metrics

Learning outcomes.....

- **Distinguish** between and **Evaluate** the merits of relative valuation models and absolute valuation models, and between historic and prospective measure of value
- **Explain** what is meant by earnings per share and diluted earnings per share
- **Calculate** the basic earnings per share
- **Explain** the possible shortfalls of using price multiples in corporate valuation

Equity: Alternative Valuation Metrics

Learning outcomes.....

- **Calculate** price to earnings (both historic and prospective), price to book, price to sales, price to cash flow, and enterprise value to EBIDTA ratios for a company
- **Define** financial gearing and **Evaluate** the effects on required equity returns and thus valuations

Equity: Alternative Valuation Metrics

Relative Value Vs Absolute Value Models

- **Absolute value models:** Based on discounting techniques
 - In this case, equity value is PV of future equity returns.
 - Returns could simply be dividends or any other cash flows.
 - The discount rate should reflect market conditions, expectation and importantly **risk**.

Equity: Alternative Valuation Metrics

Relative Value Vs Absolute Value Models

➤ **Relative value models:**

- Based on market multiples of some measure of earnings power (e.g. EPS)
- For example: Equity value = EPS * Market price multiple
- Say company A has EPS of \$5. If companies similar in size, sector, risk profile etc. are trading at 10 times earnings, then equity value of company A is $5 * 10 = \$50$.
- Instead of EPS, we can also use, Sales, Net Asset Value i.e. Book Value, Cash flows etc.

Equity: Alternative Valuation Metrics

Earnings Per Share

Current earnings = profits after interest, tax and preference dividends
= equity dividends + retained earnings

$$\text{EPS} = \frac{\text{current earnings}}{\text{number of ordinary shares}}$$

- EPS is based on accounting earnings and obviously is affected by accounting standards, policies, one of write-offs etc.
- Hence EPS may not be indicative of future dividend payments
- Being an absolute measure, it is not useful for inter-company comparisons.

Equity: Alternative Valuation Metrics

Earnings Per Share

- EPS may change due to change in earnings as well as change in number of shares.
- Hence EPS may simply go up or down because number of shares change.

Diluted EPS

- Companies must report basic EPS which is based on existing outstanding shares and diluted EPS which is based on increased number of shares due to **conversion of bonds in equities** or **employee stock options** or **warrants** etc.

Equity: Alternative Valuation Metrics

Price Earnings (PE) Ratio

- PE ratio is very commonly used measure of relative valuation.

$$\text{Historic PE} = \frac{\text{price now}}{\text{historic earnings}} = \frac{P_0}{E_0}$$
$$\text{Prospective PE} = \frac{\text{price now}}{\text{forecast earnings}} = \frac{P_0}{E_1}$$

- Historic PE is based on historic i.e. last year's earnings
- Prospective PE is 'futuristic' and hence can be more useful

Equity: Alternative Valuation Metrics

Price Earnings (PE) Ratio

- High PE ratio can be interpreted in one of the following ways:
 - Either the company has **higher earnings growth** in the future and that is why its market price related to earnings is high compared to comparable companies Or
 - We can conclude that shares are **overvalued** and hence need to be sold
 - Given the earnings growth rate for next year, Prospective PE ratio can also be calculated as
 - $P_0/E_1 = P_0/(E_0 * (1+g))$

Equity: Alternative Valuation Metrics

Price Earnings (PE) Ratio

➤ **Example:**

	Company X	Company Y
Share Price	25	40
EPS	5	10
PE	$25/5 = 5$	$40/10 = 4$

- Suppose, Company X's earnings are expected to growth at 10% next year, what is the prospective PE?

Equity: Alternative Valuation Metrics

Price Earnings (PE) Ratio

- Suppose, the industry to which Company X belongs has an average PE of 6 how much should be the price of Company X?
- In practical life, analysts will have to adjust industry average PE in terms of size, management quality, brand etc. to arrive at PE for any company.
- PEs and forward PEs can be calculated for whole stock markets or sectors as shown on next slide.
- The 12-month trailing PE indicates current price divided by trailing 12-month EPS i.e. EPS of last four quarters added.
- Or it can be arrived at by annualizing last quarters' EPS (multiplying last quarter's EPS by 4).

Equity: Alternative Valuation Metrics

Price Earnings (PE) Ratio

FUNDAMENTAL RATIOS FOR SELECTED US STOCK MARKET SECTORS, JANUARY 2016

Sector	12-month trailing PE	Forward PE	PEG ratio	Price-to-sales ratio	EV/S	Price to book
Air transport	12	12	0.4	0.9	1.5	3.5
Auto parts	255	15	0.7	0.7	0.8	2.6
Computer services	32	16	0.9	0.8	1.0	4.4
Utilities (general)	28	17	3.3	1.75	3.0	1.8

Source: NYU Stern.

Equity: Alternative Valuation Metrics

Price Earnings (PE) Ratio

- **Prospective PE:** Current price divided by forecast EPS. Since forecast EPS may differ from analyst to analyst, forward PE also differs, unless a 'consensus' PE is used.
- **PEG ratio:** PE/ Annual EPS growth
 - If a company is expected to grow faster, its PEG ratio may appear lower, indicating that it is **'undervalued'**.
 - However, the reliability of PEG ratio depends upon how good are the growth estimates of analysts.

Equity: Alternative Valuation Metrics

Price to Book Ratio (PB Ratio)

➤ **Problems with PE:**

- Negative EPS: If EPS is negative, even if temporarily, PE is not useful.
- EPS could be distorted due to accounting standards and policies.
- Hence other market multiples may be used.
- Book values (Shareholders' Funds divided by number of shares) are more stable and less likely to be negative.
- However, book value of assets represent historical cost and hence book value may differ substantially compared to market value.

Equity: Alternative Valuation Metrics

Price to Book Ratio (PB Ratio)

- Moreover, book values are subject to accounting conventions / distortions.
- PB can be compared among companies to understand over or undervaluation of stocks

Equity: Alternative Valuation Metrics

Price to Sales Ratio

- Low PS ratio indicates relative undervaluation and higher PS ratio indicates overvaluation
- PS is useful when earnings are negative
- Advantages:
 - Sales cannot be negative
 - Sales are less affected by accounting distortions
- Disadvantages:
 - Sales do not mean profits
 - The ratio ignores level of debt i.e. gearing employed by the company

Equity: Alternative Valuation Metrics

Enterprise Value to Sales Ratio

- Enterprise value = Equity + Debt – Cash. Equity is taken at market value.
- Higher EV/Sales ratio may indicate that investors expect sales to increase greatly in future.
- Lower EV/Sales may indicate unattractive future sales prospects.

Enterprise Value to EBIDTA Ratio

- Popular measure of company's return on investment
- It standardizes between companies for differences in taxation, capital structure and fixed asset accounting.

Equity: Alternative Valuation Metrics

Price to Cash flow Ratio

➤ Advantages:

- Cash flows are more reliable as they are **difficult to manipulate**
- Cash flow multiples are believed to provide more accurate picture of a company

➤ Disadvantages:

- Many different ways to calculate cash flows
- It ignores the impact of non-cash items
- Like all multiples, it is simplistic approach of comparison and should be complemented by discounted cash flow techniques

Equity: Alternative Valuation Metrics

Free Cash flow and Methods

Free cash flow to the firm (FCFF) is defined as:

Revenues – operating costs – gross interest – taxes + non-cash charges – investment in fixed capital – investment in working capital + net interest

It is 'free' in the sense of being 'net' of investment expenditures, and avoids the problem of valuing with the dividend discount model, where some cash may be retained. Analysts often compute FCFF as follows:

FCFF = net income + non-cash charges – investment in fixed capital – investment in working capital + net interest

This can be further refined to **free cash flow to equity (FCFE)**, defined as:

FCFE = FCFF – net interest + net borrowing

Equity: Alternative Valuation Metrics

Residual Income approach

- Residual income = Net income – Equity charge
 - Equity charge = Equity capital * Cost of equity
 - Cost of equity can be calculated by using models such as **CAPM**
- Finally,

Intrinsic/fair value per share = book value per share + present value of future residual income per share

- This approach is more relevant when the company is not paying any dividends, or has erratic dividend pattern or negative FCF for a number of years

Equity: Alternative Valuation Metrics

Gearing

- Gearing means use of debt. Most commonly used ratio is
 - Debt to Equity ratio = $\text{Debt} / \text{Equity}$
 - Different industries have different DE ratios
 - It reflects the **capital structure** of a company
 - Debt is a **cheaper source of finance** and has a **tax advantage** over equity
 - Hence, higher debt ratio is not necessarily alarming

Equity: Alternative Valuation Metrics

Gearing

- Because higher level of debt means higher risk for the debt holders, certain **restrictions** may be placed on the company such as
 - Level of dividends to be paid
 - Amount of additional debt that can be taken
 - Disposal of fixed asset

Equity: Alternative Valuation Metrics

SECTORAL DEBT-EQUITY RATIOS

Sector	Debt-equity ratio
Auto	126%
Coal	293%
Defence	9%
Shipbuilders	50%
Shoe	3%
Telecom	106%
Trucking	9%
Utility (general)	69%

Source: NYU Stern.