

Business Financing Strategy

National Finance Olympiad 2015

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Pakistan Economic Outlook- Interesting Times Ahead



5 years GDP growth rate : ~4%



Record KSE growth rate 2014-15: 29%



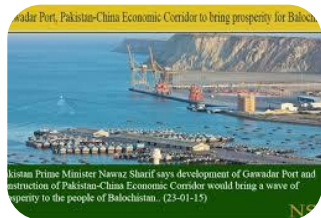
Inflation rate at record low



Interest rates: 6.5%



5 years currency depreciation: 3.6%



Significant progress on China Pakistan Economic Corridor



Target growth rate of 5.5%



Enhanced Credit rating



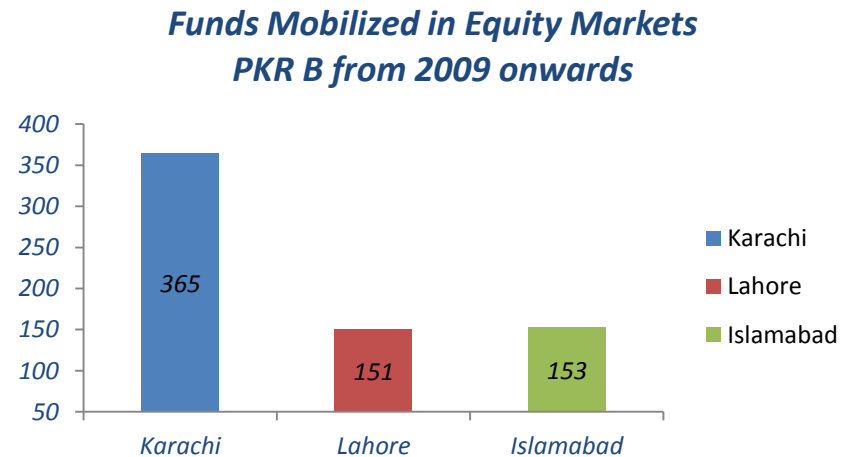
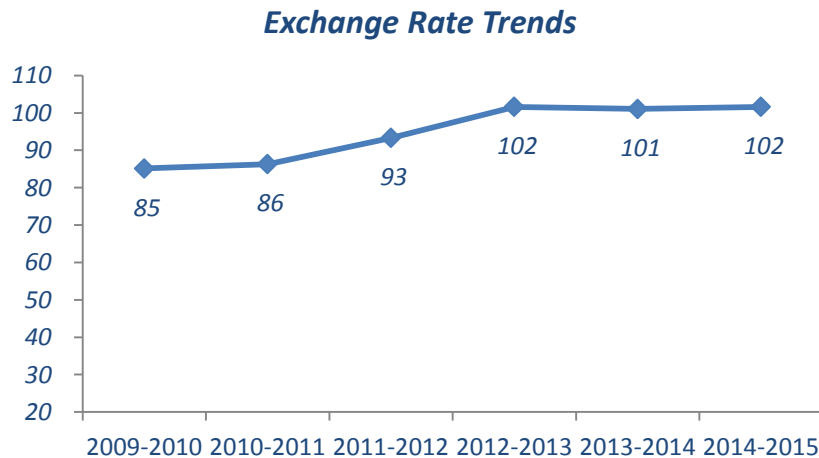
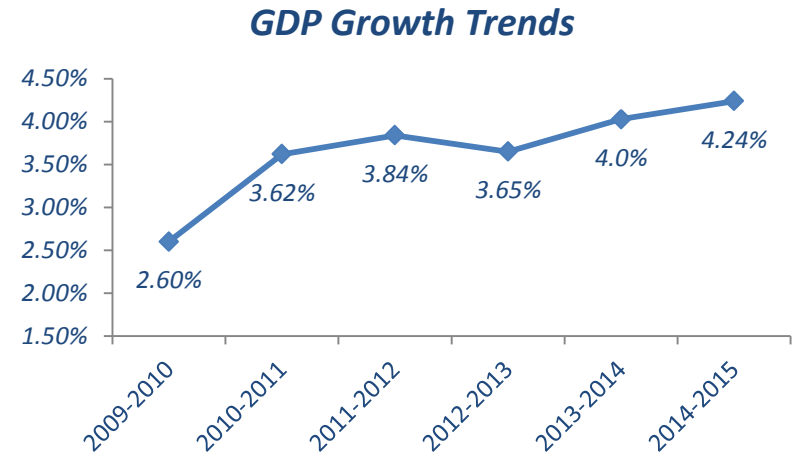
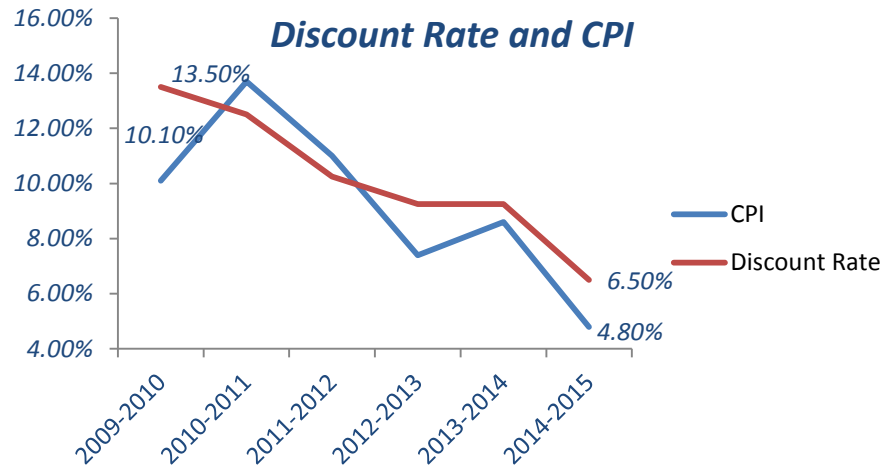
Foreign exchange reserves at a high of USD ~18.5 B



Favorable Demographics

Although the business environment is conducive, challenges remain in the shape of the energy crisis, terrorism, political uncertainty and constantly changing tax policies

Pakistan Economic Outlook- Interesting Times Ahead



Pakistan Economic Outlook- What the world says about us

Rise of Pakistan just a matter of time: Morgan Stanley

Chief strategist says Pakistan is one of nine nations that will add another China in 35 years

Significant economic progress within Pakistan's reach, says IMF



World Bank offers \$2bn 4-year package

The World Bank has announced a \$2 billion, four-year package of financing to support Pakistan's economic growth and poverty reduction efforts. The package includes a \$1 billion credit line and a \$1 billion grant. The credit line will be used to finance infrastructure projects, while the grant will be used for social services and health care. The package is part of the World Bank's broader strategy to support Pakistan's economic development and improve the lives of its people.

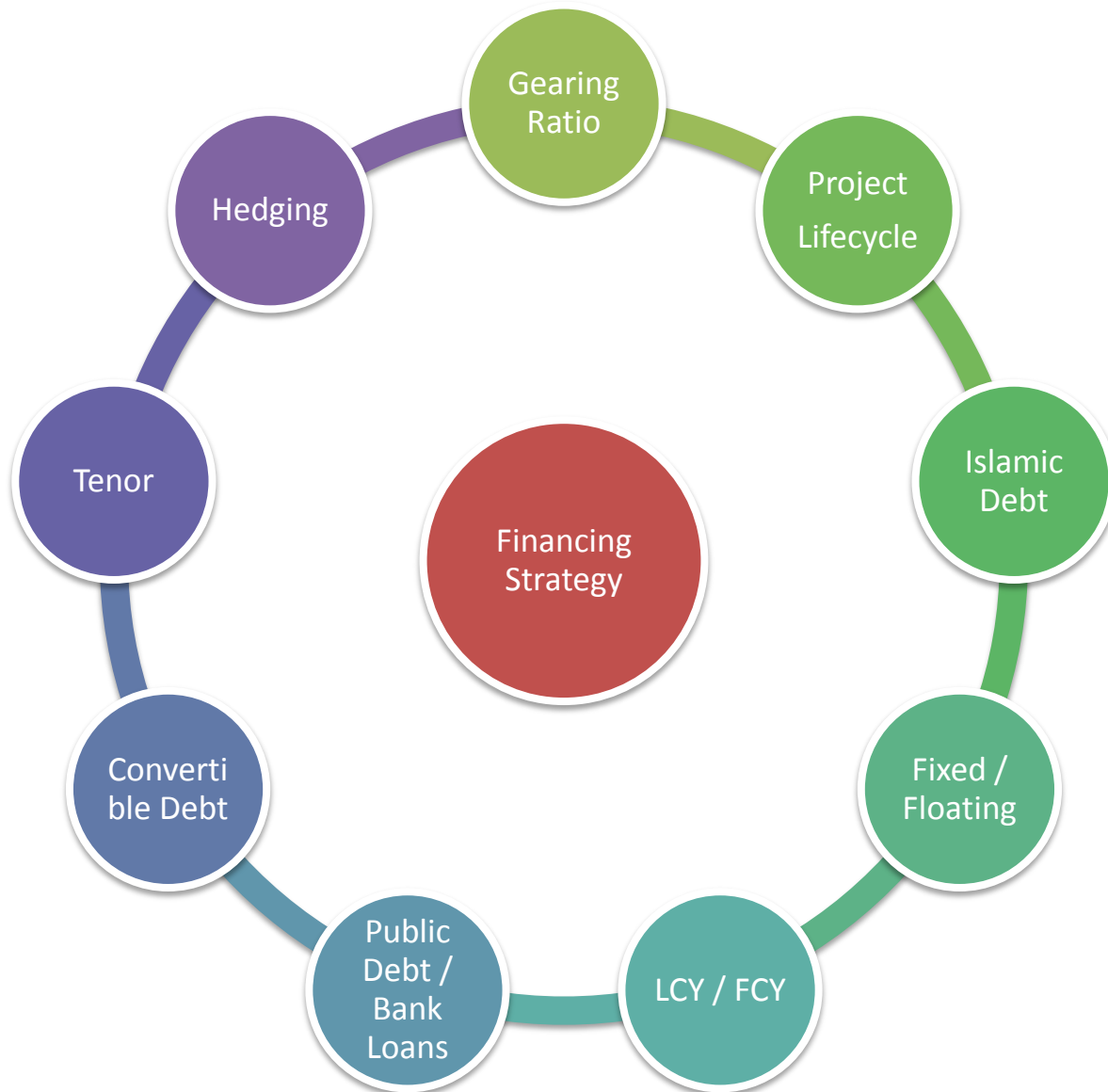
'Iran ready to meet Pakistan's energy needs'
Real interest rate goes up

IMF predicts 5% growth for Pakistan, reduction in inflation Inflation eases to 1.8pc in July
Pakistan's economy to grow 5.1pc in 2015: ESCAP

Considering a Business



Components of Financing Strategy



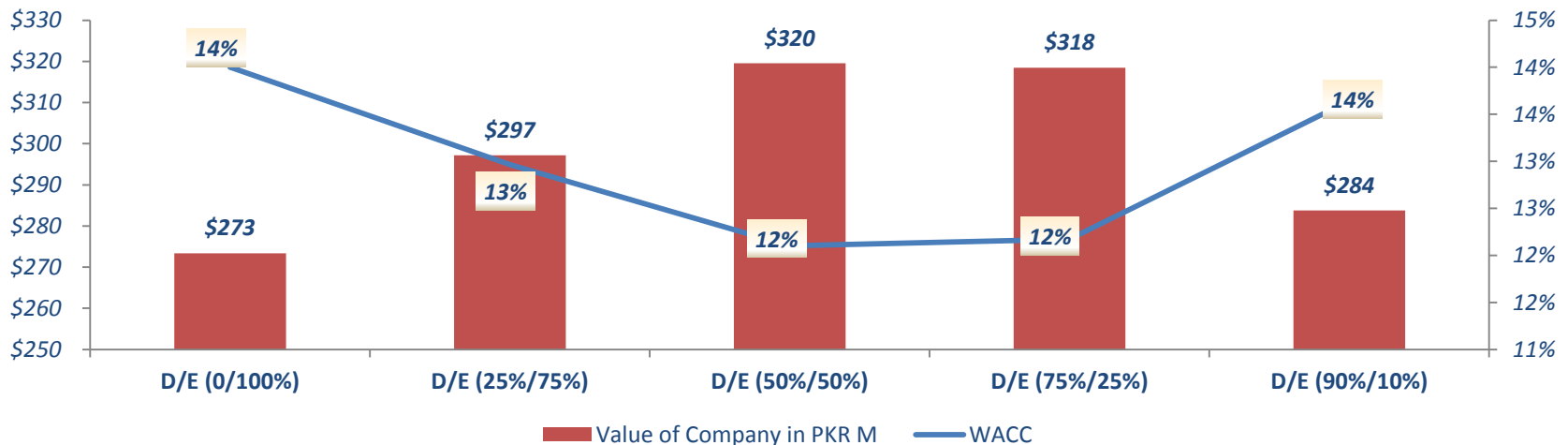
Other Considerations

- *Statutory requirement*
- *State Bank regulation*
- *Financial flexibility*
- *Risk appetite*
- *Tax holidays and subsidies*
- *Incremental cost of debt at high leverage ratios*

Components of Financing Strategy - Gearing Ratio

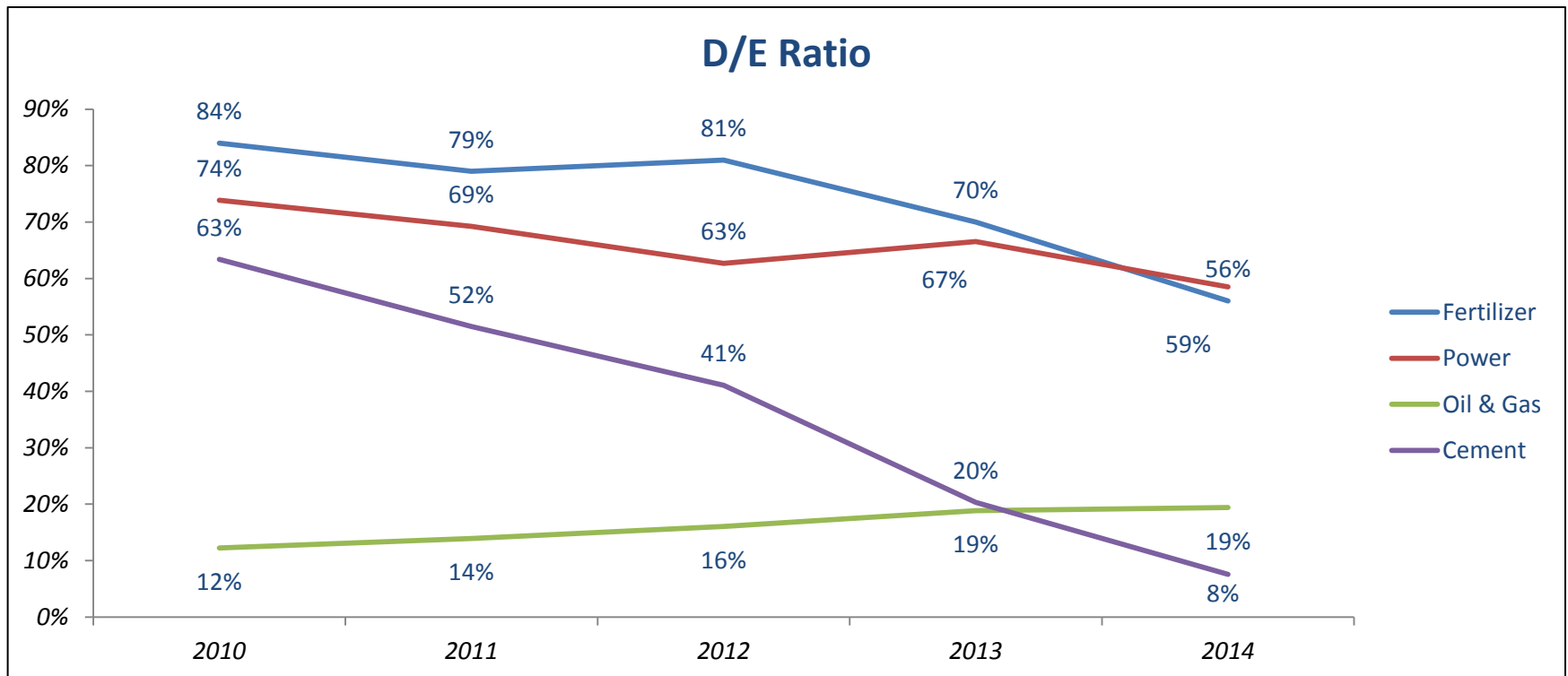
Optimum gearing is at the level where WACC is the lowest

Source	100% Equity	25% Debt & 75% Equity	50% Debt & 50% Equity	75% Debt & 25% Equity	90% Debt
Cost of Debt	8%	8.5%	9%	11%	14%
COE	14%	15.4%	18.1%	26.2%	50.7%
WACC	14%	13%	12.1%	12.2%	13.6%
Enterprise Value	PKR 273 M	PKR 297 M	PKR 320 M	PKR 318 M	PKR 284 M



Project Financing Lifecycle of Various Sectors in Pakistan

- Initial / Expansion phase with the highest D/E ratio (~60%-~80%)
- Deleveraging is observed as project matures
- Stable D/E ratio for companies with recurring annual projects



Components of Financing Strategy - Debt Characteristics

- *Exchange Rate Risk*
- *Country Risk*
- *Limited Local market depth*
- *Hedging*
- *Matching revenue stream*

LCY / FCY

- *Currently cheaper*
- *Administrative hassle*
- *Positive attitude due to sharia compliance*
- *Only available for companies with assets backing*

Islamic Debt

- *Floating rates - volatile market*
- *Option to hedge through interest rate swaps available*
- *High premium on fixed rate due to higher volatility*

Fixed / Floating

Components of Financing Strategy - Debt Characteristics

- *More expensive than bank loans in Pakistan*
- *Can be used to adjust banks group exposure*

Public Debt

- *Allows for dilution in exchange for lower interest rates*

Convertible Debt

- *Can be used to change debt characteristics already locked in*

Hedging

- *Should match expected life of project*
- *Local market for loans beyond 5-10 years is very limited*

Tenor

Financing Strategy for Different Pakistani Industries

		Capital Intensive Industries	Consumer goods industries	Service Industry
Typical Industry Characteristics	Capital	<ul style="list-style-type: none"> Huge upfront capital 	<ul style="list-style-type: none"> Modest Capital Requirement 	<ul style="list-style-type: none"> Low Capital Requirement
	Fixed Assets	<ul style="list-style-type: none"> High 	<ul style="list-style-type: none"> Mid Size 	<ul style="list-style-type: none"> Low
	Margins	<ul style="list-style-type: none"> Consistent margins to justify the capital cost 	<ul style="list-style-type: none"> Fluctuating margins 	<ul style="list-style-type: none"> Consistent margins
Financing Strategy		<ul style="list-style-type: none"> High Gearing Floating Rates Mix of LCY / FCY Bank Loans 5-10 Year Tenor Hedging to reduce FCY exposure 	<ul style="list-style-type: none"> Modest - Low Gearing Floating Rates LCY Debt Bank Loans Relatively lower Tenor 	<ul style="list-style-type: none"> Modest - Low Gearing Floating Rates Bank Loans Relatively lower Tenor

Conclusion



*“The shoe that fits one person pinches another;
there is no recipe for living that suits all cases”*

Carl Gustav