

Following is the discussion based on the pros and cons of issuing an ipo essays e...

[Business](#), [Company](#)



Analysis: Galaxy Skis

Answer 1)

Pros:

a) Cushion of additional capital:

The primary advantage offered by IPO is that it provides assistance to the companies in raising additional capital for their future projects without any obligation to repay back to the shareholders. This helps the company to leverage the acquired capital in more R&D arena, intense marketing strategies and also make them capable to invest in some risky yet profitable projects which can increase the market share of the company and also the probable future returns to the shareholders.

b) Enhanced Corporate Image and increased customer base:

Moreover, a successful IPO issue also enhances the corporate image of an entity, which helps it to raise more capital in the future, either through debt or equity. Another associated advantage of IPO issue is that with the related publicity at the time of issue, the products of the company are known to the new customers and this also helps in increasing the customer base.

Cons:

A)High cost of issue:

A major disadvantage of issuing an IPO is that it is time consuming and involves high amount of legal as well as underwriting costs. The IPO issue process can take up to two years and during this time, the management is required to focus all their time and skills on the issuance of IPO and this

might lead to negligence of some other important ongoing projects.

b) Risk of non-subscription:

Although, all the companies go through the IPO issue process with the help of renowned underwriters as Goldman Sachs, Morgan Stanley, etc., still, there is risk involved that the company might not be able to achieve the minimum subscription requirement as per SEC rules and regulations. Any such activity can tarnish the corporate image of the entity and it might lose the entire legal and underwriting fee paid without attaining any benefit.

Recommendation:

Since Jeremy is running his company since 20 years now and has achieved recognizable sales figures, it is advisable that he should go ahead with his IPO issue as the pros of additional capital that could help him in international expansion, outweighs the cons related to high cost of issue and risk of non-subscription.

Answer 2)

The company has the following sources through which they can raise the required amount of funds:

- Debt
- Equity
- Debt+ Equity

However, since both debt and equity carry their own pros and cons, the most appropriate decision for the company will be to adopt a combination of each of them. Important to note, that, the company must very carefully select the proportion of both debt and equity in their capital structure.

Answer 3)

Following are the advantages of debt over equity:

a) No Dilution of Ownership:

Lending institutions are entitled to claim only the interest payments and principal payments. Thus, the borrower enjoys full entitlement of profits along with no dilution of ownership. (Wolf, 2012)

b) Tax Benefits:

As per rules of IFRS and GAAP accounting standard, any interest paid on debt funds borrowed by the company is entitled to claim the same as expensed under Profit and Loss Statement. This reduces the Profit after Tax and also the tax liability of the company.

c) Low Cost of Financing:

Lenders of debt funds enjoy double layer of protection as they issue debt funds only on the basis of collateral assets hypothecated to them and in case of bankruptcy, they have senior claim to assets and hence with low risk involved, they charge low rate of interest from the borrower as compared to equity. Thus this lowers the cost of capital of the company.

ii) Cost of Debt : 8%

Tax rate: 25%

Cost of Debt after tax: $.08(1-.25) = 6\%$

iii) Cost of Equity: $RFR + \text{Beta}(R_{\text{market}} - RFR)$

$= 2 + 1.8(14-2)$

$= 23.6\%$

* Since, equity do not offer tax deductibility, the cost of equity will remain at

23. 6%

iv) Weighted Average Cost of Capital:

= Weight of Debt* Cost of Debt(1-tax rate)+ Weight of Equity* Cost of Equity

$= (50/110) * .06 + (60/110) * .236$

$= .0272 + .128$

$= .1552 = 15.52\%$

Answer 4)

In order to ensure that he gets regular supply of oil, Jeremy can enter into oil futures that will not only ensure that he gets regular supply as per his needs, but will also fix the price at which he will get the oil at a future date.

Furthermore, in order to mitigate the currency translation losses, he can use the currency futures which are also traded in the future markets just as oil futures.

Answer 5)

Since Jeremy will be outsourcing some of his work in China, at the time of payment of his due accounts he might suffer losses if Chinese Yuan appreciates in relation to USD. Thus, in order to mitigate the currency translation and transaction exposure in Yuan, Jeremy can use currency Forward Contracts as instruments to hedge the currency risks of the company. Under forward contracts, Jeremy who is liable to pay the outsourcing accounts due can enter into forward contracts of purchasing \$100000 Yuan every month at different rates offered by brokers . For

Instance, during the month of August, Jeremy entered into forward contracts

of \$100000 for 6. 23 Yuan/USD to be settled during the month of August. If at the time of settlement of the contract, the exchange rate is 6. 19 Yuan/USD, in such situation, Jeremy will be in a better position as he had already hedged his currency position.

Answer 6)

Following real method to account for inflation:

Real Cost of Capital: $(\text{Cost of Capital} - \text{Inflation}) / (1 + \text{inflation})$

$= (15.59\% - 6\%) / (1 + 6\%)$

$= 9.59 / 1.06$

$= 9.047\%$

If the company should buy or leases the asset:

Now in order to compare the 5 year and 15 year NPV, we have to use suitable discounting factor.

Answer 7)

The decision to invest or not to invest in IPO of Galaxy Skies will depend upon number of factors and only after careful analysis of each factor; any such decision can be taken. As for Galaxy Skies, the success of IPO will depend primarily as how the product of the company is perceived in international markets. All such and related factors are analyzed hereunder:

a) Past Performance of the company:

Important to note that, the company has been growing at the rate of 15% annually and with 20 years of expertise and mentorship of an ex-Olympian will be an added advantage for the company even in the off-shore markets.

Furthermore, a \$50 million sales figure is indeed an optimistic sign for the

pool investors to look for the IPO of the company.

b) Product Quality:

The company is lead by an ex-Olympian who developed the proprietary technology and bonding polymers that give Galaxy skis their unique flexibility, durability, and propensity to need low maintenance. Thus, with such advanced production techniques, the product of the company is likely to be successful in the international market.

c) Controlled Cost Measures:

Major costs involved in the manufacturing of skis are oil polymers, carbon fiber, and labor. However, the technicians of the company are highly skilled machinists and are able to manufacture the finished product in a cost controlled and effective manner. Furthermore, the decision of the company to expand their Ski-Line worldwide by setting up a plant in low cost labor country, China, indicate that the company will be able to continue to control its cost and with anticipated sustained growth rate, will be able to share future profits with the shareholders.

Final Decision: Invest in company's IPO

After analyzing all the concerned factors that will determine the success of the company in the international market, it seems profitable to invest in IPO of the company and the expectations are highly optimistic that Galaxy Ski will be successful in the international markets courtesy above discussed factors.

ii) Expected Return using CAPM Model:

Cost of Equity: $RFR + \text{Beta}(R_{\text{market}} - RFR)$

$$= 2 + 1.8(14 - 2)$$

$$= 23.6\%$$

Answer 8)

*Assuming the client is referring to Chinese Project and assuming that he purchases the plant:

Since, IRR of the project is greater than WACC, the international expected returns will be higher than WACC.

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