CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

Sources of Finance, Capital Investments and Valuations

Effective from 11 July 2024

Objective of the Examination

The aim of the unit is to provide candidates with a thorough understanding of valuations and the use of debt and equity from a corporate finance perspective. This unit will cover:

- Equity Capital Market (ECM)
- Debt Capital Market (DCM)
- Alternative Sources of Finance
- The Cost of Capital
- Capital Budgeting
- Company Valuation
- Derivatives and Risk Management

Assessment Structure

The unit will be assessed by a 1 hour examination of 40 multiple choice questions drawn from across the syllabus.

Candidates sitting the exam by Computer Based Testing may have, in addition, up to 10% additional questions as trial questions that are not separately identified and do not contribute to the result. Candidates will be given proportionately more time to complete the test.

Syllabus Structure

The unit is divided into **elements**. These are broken down into a series of **learning objectives**.

Each learning objective begins with one of the following prefixes: **know**, **understand**, **be able to calculate**, **be able to apply** or **be able to analyse**. These words indicate the different levels of skill to be tested. Learning objectives prefixed:

- **know** requires the candidate to recall information such as facts, rules and principles

- **understand** requires the candidate to demonstrate comprehension of an issue, fact, rule or principle

- **be able to calculate** requires the candidate to be able to use formulae to perform calculations

- **be able to apply** require the candidate to be able to use their knowledge in a given set of circumstances to present a clear and detailed explanation of a situation, rule or principle

- **be able to analyse** requires the candidate to review the information content in detail and draw conclusions

Candidate Update

Candidates are reminded to check the 'Candidate Update' area of the Institute's website (cisi.org/candidateupdate) on a regular basis for updates that could affect their examination as a result of industry changes.

Examination Specification

Each examination paper is constructed from a specification that determines the weightings that will be given to each element. The specification is given below.

It is important to note that the numbers quoted may vary slightly from examination to examination as there is some flexibility to ensure that each examination has a consistent level of difficulty. However, the number of questions tested in each element and / or case study should not change by more than two.

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TOTAL		**40 Questions**

Summary Syllabus

Element 1 Equity Capital Market (ECM)

1.1 Characteristics of Different Types of Equity Securities

1.2 Public Equity

Element 2 Debt Capital Market (DCM)

2.1 Types and characteristics of different sources of debt

2.2 Bond Pricing and Returns

2.3 Risk Assessment

Element 3 Alternative Sources of Finance

3.1 Characteristics and Examples of Alternative Sources of Finance

3.2 Appropriate use of Alternative Sources of Finance

Element 4 The Cost of Capital

4.1 The Cost of Equity

4.2 The Cost of Debt

4.3 Overall Cost of Capital

4.4 Capital Structure Decisions

Element 5 Capital Budgeting

5.1 Investment Appraisal Methods

5.2 Option Pricing Theory in Investment Appraisal

5.3 Project Appraisal and Risk

Element 6 Company Valuation

6.1 Asset-Based Valuation

6.2 Dividend-Based Valuation

6.3 Earnings-Based Valuation

6.4 Cash Flow-Based Valuation

6.5 Enterprise Value versus Equity Value

Element 7 Derivatives and Risk Management

7.1 Types of Risk

7.2 Using Derivatives to Manage Risk

Element 1 Equity Capital Market (ECM)

1.1 Characteristics of Different Types of Equity Securities

On completion, the candidate should:

1.1.1 know the basic characteristics of different types of shares including founder shares, ‘A’ and ‘B’ shares, deferred shares and preference shares including the differences in ownership rights of different types of shares

1.1.2 be able to analyse the relative risk and return characteristics of different types of shares using a range of quantitative measures

1.1.3 know the characteristics of depository receipts and their use for investing in non-domestic equity securities

1.2 Public Equity

On completion the candidate should:

1.2.1 understand the difference between a premium listing, a standard listing and admission to AIM

1.2.2 know the key stages of an initial public offering (IPO)

1.2.3 understand the advantages and disadvantages of bringing securities to listing via:

- Offer for sale
- Placing
- Intermediaries offer
- Introduction

1.2.4 know the various ways in which the offer price for shares in an IPO may be set

1.2.5 understand the use of a ‘greenshoe’ option when issuing shares

1.2.6 know the procedure for a rights issue and the rights of shareholders in relation to rights issues and open offers

1.2.7 understand the meaning of the term pre-emption rights and the circumstances under which these can be disapplied

1.2.8 know the general rules and accounting requirements when a company engages in a share repurchase

Element 2 Debt Capital Market (DCM)

2.1 Types and characteristics of different sources of debt

On completion the candidate should:

2.1.1 know the basic characteristics of short-term unquoted sources of debt finance including overdraft facilities, revolving credit facilities, working capital, debt factoring and invoice discounting

2.1.2 know the basic characteristics of the following types of debt instruments:

- Redeemable bonds
- Irredeemable/perpetual bonds
- Zero-coupon bonds
- Convertible bonds
- Callable and puttable bonds
- Contingent convertible bonds (CoCos)
- Exchangeable bonds
- Medium term notes
- Eurobonds
- Green bonds
- Blue bonds
- Transition bonds
- Commercial paper

2.2 Bond Pricing and Returns

On completion the candidate should:

2.2.1 be able to analyse the price of a bond given a market discount rate

2.2.2 understand what is meant by a bond's yield to maturity and the sources of return from investing in a fixed coupon bond

2.2.3 understand the relationship between bond prices and interest rates

2.2.4 be able to analyse the price of a bond given spot rates

2.2.5 understand the use of matrix pricing for illiquid or infrequently traded bonds

2.2.6 understand the relationship between bond prices and other bond characteristics such as time to maturity and coupon

2.2.7 understand the valuation of convertible bonds

2.3 Risk Assessment

On completion the candidate should:

2.3.1 be able to analyse Macaulay duration and modified duration

2.3.2 understand what is meant by convexity in terms of the relationship between bond prices and interest rates

2.3.3 be able to analyse a bond's price given the bond's duration and convexity

2.3.4 know the benefits and limitations of duration including the impact of convexity

Element 3 Alternative Sources of Finance

3.1 Characteristics and Examples of Alternative Sources of Finance

On completion the candidate should:

3.1.1 know the characteristics, special features, pros and cons of the following sources of finance:

- Private equity and venture capital (including venture capital trusts (VCTs)), angel finance and crowd funding
- Private placings
- Enterprise Investment Schemes (EISs)
- Banks

- Leases
- Project finance
- Senior, mezzanine and other debt
- Sovereign wealth funds
- Family offices

3.2 Appropriate use of Alternative Sources of Finance

On completion the candidate should:

3.2.1 understand the circumstances under which the following sources of finance will be deemed appropriate for:

- A new start up
- An early stage project
- Developmental capital
- A management buy-out or management buy-in
- A re-organisation or turnaround
- A public company

Element 4 The Cost of Capital

4.1 The Cost of Equity

On completion the candidate should:

4.1.1 understand the assumptions, pros and cons of the dividend growth model

4.1.2 be able to analyse the cost of equity using the dividend growth model

4.1.3 understand systematic risk, unsystematic risk and beta as a measure of relative risk

4.1.4 understand the capital asset pricing model (CAPM), its assumptions, pros and cons

4.1.5 be able to analyse the cost of equity using CAPM

4.2 The Cost of Debt

On completion the candidate should:

4.2.1 be able to calculate the cost of irredeemable and redeemable bonds

4.2.2 understand the impact of taxation on the cost of debt

4.3 Overall Cost of Capital

On completion the candidate should:

4.3.1 be able to analyse an entity's weighted average cost of capital (WACC)

4.3.2 know the difference between book value and market value weightings when calculating WACC

4.4 Capital Structure Decisions

On completion the candidate should:

4.4.1 be able to analyse how gearing affects the cost of equity, debt and overall WACC

4.4.2 be able to analyse project-specific discount rates with specific focus on equity and asset betas

4.4.3 know Modigliani and Miller's theory on capital structure and the assumptions behind the theory both with and without taxation

4.4.4 be able to analyse the effect of taxes on capital structure decisions

Element 5 Capital Budgeting

5.1 Investment Appraisal Methods

On completion the candidate should:

5.1.1 be able to analyse the payback and discounted payback period of an investment

5.1.2 be able to analyse the return on capital employed (ROCE) of an investment

5.1.3 be able to analyse the net present value (NPV) of an investment

5.1.4 be able to analyse the internal rate of return (IRR) and modified internal rate of return (MIRR) of an investment

5.1.5 understand the usefulness of adjusted present value (APV) as an investment appraisal method

5.1.6 know the relative pros and cons of the various investment appraisal methods

5.2 Option Pricing Theory in Investment Appraisal

On completion the candidate should:

5.2.1 be able to analyse the following drivers of option value:

- Value of the underlying
- Exercise price
- Time to expiry
- Volatility
- The risk-free rate

5.2.2 know the application of the Black-Scholes Option Pricing (BSOP) model to investment appraisal in evaluating embedded real options within a project to delay, expand or withdraw

5.2.3 know the underlying assumptions and limitations of the BSOP model

5.3 Project Appraisal and Risk

On completion the candidate should:

5.3.1 be able to apply the use of sensitivity analysis in evaluating investment projects

5.3.2 understand the use of Monte Carlo simulation in evaluating investment projects

5.3.3 understand how environmental, social and governance (ESG) issues can affect capital investment decisions

Element 6 Company Valuation

6.1 Asset-Based Valuation

On completion the candidate should:

6.1.1 know the difference between:

- market value
- transaction value
- book value

6.1.2 understand the uses, assumptions and limitations of asset-based valuations

6.1.3 be able to analyse equity value using an asset-based valuation approach

6.2 Dividend-Based Valuation

On completion the candidate should:

6.2.1 understand the uses, assumptions and limitations of dividend-based valuations

6.2.2 be able to analyse equity value using the dividend-based valuation approach

6.3 Earnings-Based Valuation

On completion the candidate should:

6.3.1 know the difference between intrinsic value and relative value

6.3.2 understand the uses, assumptions and limitations of earnings-based valuations

6.3.3 be able to analyse equity value using P/E multiples

6.3.4 be able to analyse enterprise value using EBIT/EDITDA multiples

6.4 Cash Flow-Based Valuation

On completion the candidate should:

6.4.1 understand the uses, assumptions and limitations of cash flow-based valuations

6.4.2 be able to calculate equity value using a cash flow-based valuation model (including growth)

6.5 Enterprise Value versus Equity Value

On completion the candidate should:

6.5.1 know what is meant by enterprise value, its uses and how it differs from equity value

6.5.2 be able to analyse enterprise value using a cash flow-based approach incorporating free cash flows and a terminal value under alternative horizon and growth assumptions

Element 7 Derivatives and Risk Management

7.1 Types of Risk

On completion the candidate should:

7.1.1 understand what is meant by interest rate risk

7.1.2 understand what is meant by foreign exchange risk

7.2 Using Derivatives to Manage Risk

On completion the candidate should:

7.2.1 be able to analyse the use of the following in hedging interest rate and foreign currency risk:

- Forward contracts
- Futures contracts
- Options

- Swaps