

Chamberton plc

(a)

Ordinary shares

Issue costs	Not too expensive for a rights issue.
Servicing costs	Expensive due to high risk for ordinary shareholders.
Dividend	No obligation to pay dividends.
Redemption	No obligation, nor expectation of redemption.
Tax	Dividends not tax deductible, which increases the effective servicing cost.
Effect on control	Little or none with a rights issue.

Preference shares

Issue costs	Relatively expensive if issue to the public.
Servicing costs	Cheaper than ordinary shares because returns are less risky.
Dividend	No strict obligation to pay dividends, but usually a moral one.

Redemption	Depends on the issue conditions.
Tax	Dividends not tax deductible, which increases the effective servicing cost.
Effect on control	Normally none because preference shares carry no voting rights.

Loan notes

Issue costs	Not too expensive.
Servicing costs	Relatively cheap due to low risk.
Interest	A contractual obligation to pay interest.
Redemption	Normally a contractual obligation to repay the principal on a contracted date.
Tax	Interest is tax deductible, which reduces the effective servicing cost.

Effect on control Little or none, except to the extent of having to meet cash payment obligations.

(b)

Rights issue of equity

Would shareholders or others be willing to take up the shares?

Effect on earning per share:

Currently $60/100$ = £0.60 per share

Would become $[60 + (20 \times 66.67/100)] / [100 + (100/2.5)] =$ £0.52 per share

Preference shares

Would investors be willing to take up the shares? Is the return enough for the risk given a 9% return on the loan notes?

Effect on earning per share:

Currently $60/100$ = £0.60 per share

Would become $[60 + (20 \times 66.67/100) - 10] / 100 =$ £0.63 per share

Loan notes

Would investors be willing to take up the loan notes? Is the return market competitive? Is the business content to have a cash-paying obligation of the type imposed by loan notes?

Effect on earning per share:

Currently $60/100 =$ £0.60 per share

Would become $[60 + (20 \times 66.67/100) - (66.67 \times 8) / 100 =$ £0.68 per share

Other information that would be useful includes:

- Prevailing interest rates and predicted future rates.
- Asset values of the business and their quality as security.
- Predicted cash flows of the business.
- How typical of the business are last year's financial statements?