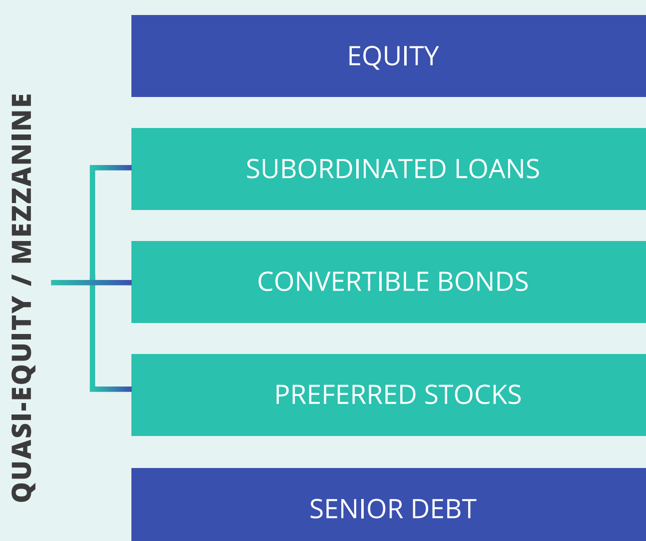
QUASI-EQUITY

"A type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity. Quasi-equity investments can be structured as debt, typically unsecured and subordinated and in some cases convertible into equity, or as preferred equity*".

How does it work?



NOTES

1. **Subordinated loans** have a lower repayment priority than normal (senior) loans. In the event of default, all other lenders are repaid before the holders of subordinated loans. Since the interest payments as well as the capital repayments are subordinated, the risk of loss in the event of default is substantially higher than for senior loans. In addition, generally, there is no collateral (security) required so interest rates are higher to cover the higher risks.

2. **Convertible bonds** are debt where the initial investment is structured as a debt claim, earning interest. At the discretion of the investor, the debt can be converted into equity at a predetermined conversion rate. A convertible bond is essentially a bond combined with a share option where the holder may exchange the bond for a predetermined number of shares at a predetermined price. Because convertibles can be changed into shares they have lower interest rates.

3. **Preferred stocks** are stocks that entitle the holder to a fixed-rate dividend, paid before any dividend is distributed to holders of ordinary shares. Holders of preferred stock also rank higher than ordinary shareholders in receiving proceeds from the liquidation of assets if a company is wound up.

TECHNICAL FEATURES

The different forms of quasi-equity (also known as mezzanine capital or mezzanine finance) are classified as closer to equity or debt capital according to the level of ownership acquired and the exposure to loss in the event of insolvency. The risk profile will also change with the duration of capital commitment and the remuneration conditions.
In general, quasi-equity investments are more difficult to administer than classic debt instruments (loans and guarantees).

PROS

1. For co-investors, there are higher returns compared to pure debt instruments.
2. Addresses specific risk capacity constraints in a particular market segment.
3. Stimulates investment by local private equity industry, also in riskier areas not previously serviced.
4. Might prompt changes in the regulatory framework to encourage a private equity market.

CONS

1. These investments are more difficult to administer than normal loans (high set-up and operational costs), more time-consuming and cost more.
2. Short-term financing is not possible, since returns are feasible only in the long term.
3. Any ancillary services such as management expertise would be an expense for the company.
4. There are typically a low number of investors and FRs, while the investment amounts are high.
5. Compared to debt instruments they may be less attractive to FRs as they may involve loss of control when bonds are converted into equity.