

P.G.DIPLOMA IN FINANCIAL SERVICES AND LEGISLATIONS
DIRECTORATE OF DISTANCE EDUCATION
NALSAR UNIVERSITY OF LAW, HYDERABAD

Investment Banking

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“Investment banks perform the most critical functions as they cater to the present and future, financial consumption needs across various corporations and firms. This then contributes to the growth of businesses and in turn boosts the progress of the economy.”



COVERAGE

INVESTMENT BANKING DOMAIN – CORPORATE
FINANCE – WEALTH MANAGEMENT –
CORPORATE ADVISORY – KEY CONCEPTS -
SKILL-SET FOR IB



1. INVESTMENT BANKING DOMAIN

Investment Banking

Investment banking is a special segment of banking operation that helps individuals or organisations raise capital and provide financial consultancy services to them.

Investment Banking Services



Corporate Finance

Debt Syndication
PE Syndication
Private Placement
Listing Advisory



Wealth Management

Equity Research
Asset Management
Trading & Brokerage



Corporate Advisory

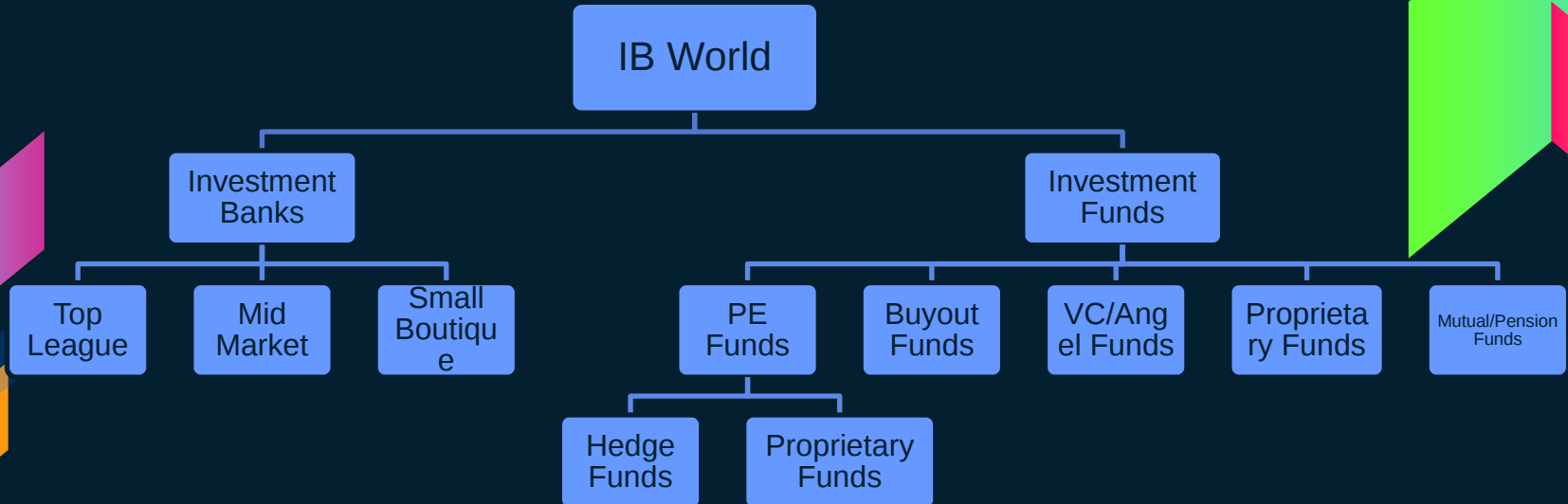
M&A Advisory
Restructuring Advisory



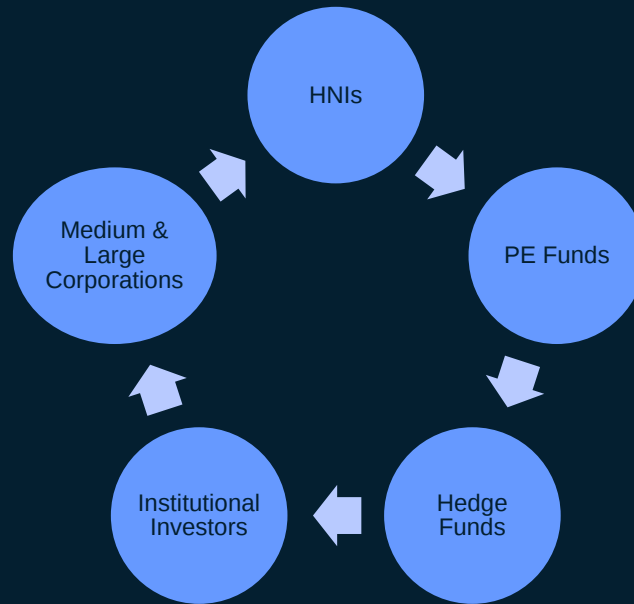
Investment Banker

An Investment Bank/ Investment Banker are a financial intermediary handling large, complex financial transactions for individuals, corporations, institutions and governments. Acts as intermediaries between security issuers and investors and help new firms to go public. Investment Banks advise wide range of clients around the world.

IB – Key Players



Investment Banking Clients



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2. CORPORATE FINANCE

Debt for Businesses

Debt

Is an amount owed to a person/organization for funds borrowed.

Funding Types

- Project Finance
- Working Capital
- Acquisition
- Restructure

How?

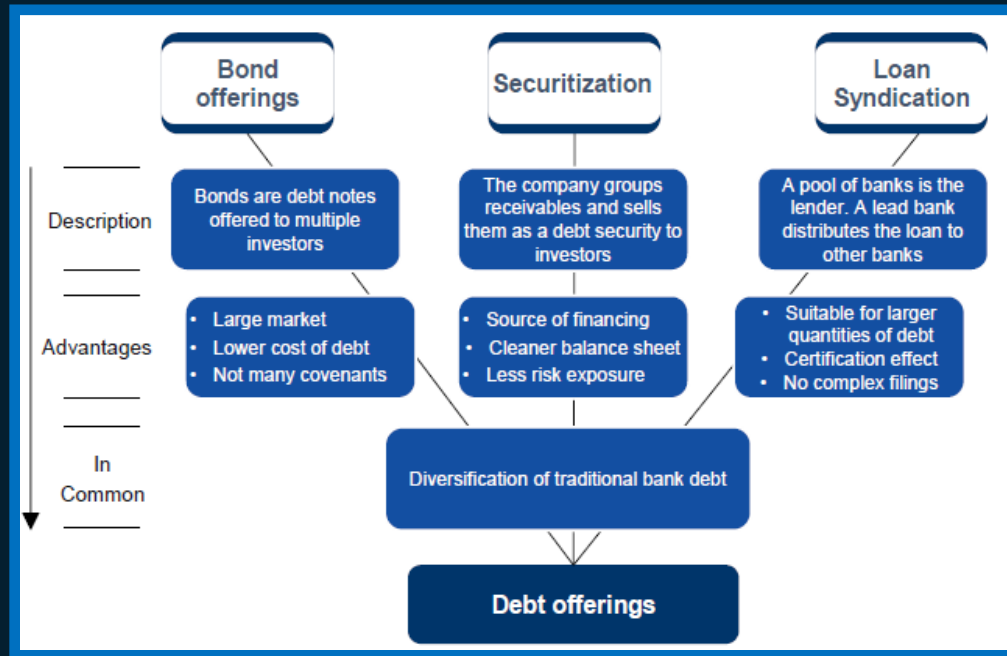
Fund Based

- Term Loan
- Working Capital

Non-Fund Based

- Letter of Credit
- Bank Guarantee

Debt Offerings



Debt Syndication Process/ Scope



Private Equity (PE)

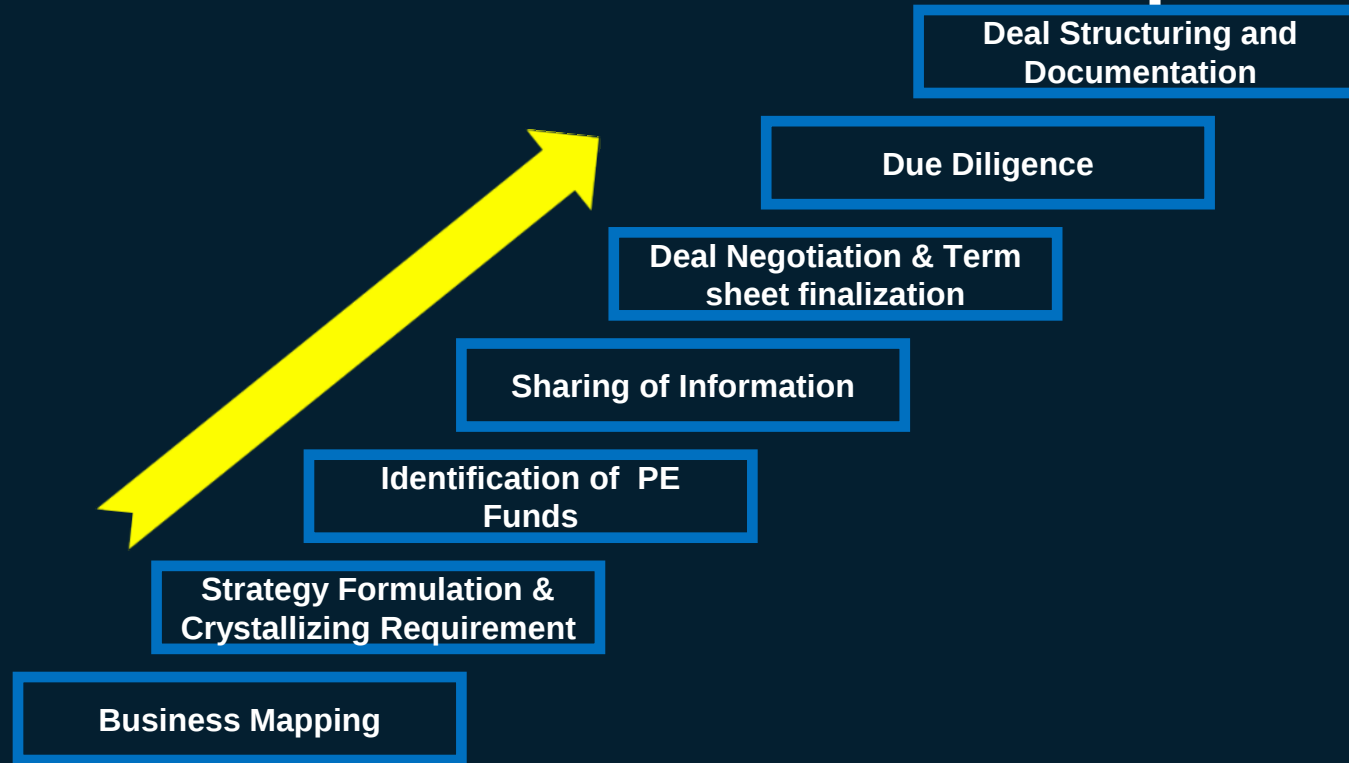
Why PE?

- Growth catalysts
- Facilitating organizational evolution
- Strategic inputs/market intelligence
- Helping build process /systems to ensure longevity and robustness
- Improving Corporate governance
- Adding to the organizational financial acumen.

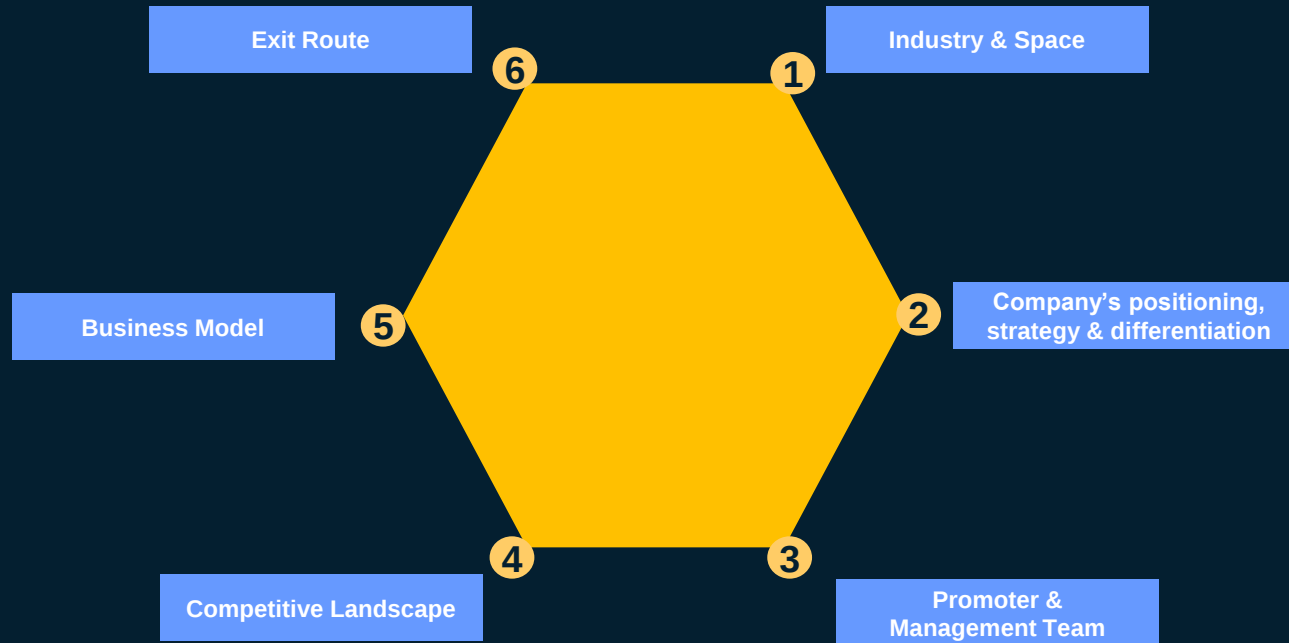
Funding Types

- Angel Funding
- Early Stage Funding
- Growth Equity
- Late Stage Funding
- PIPE Deals
- Buyout Equity

PE Transaction Process/ Scope



PE Evaluation Framework



Private Placement

- **A private placement is an agreement for equity investment in a business made directly between the business and the investor.**
- PRIVATE PLACEMENTS are, in the simplest terms, a way for businesses to **raise capital by selling securities to private investors**. Rather than making shares in a company available to the general public (as with an initial public offering).
- A private placement makes **shares available to only a limited number of suitable individuals**.
- **doesn't require underwriters or registration** with the Securities Exchange Board of India.
- While often used by small companies, private placement is equally beneficial to companies of all sizes because they require less time and expense than a public offering.

Listing Advisory

Fund Raising in Capital Markets

Debt

Issue of Debentures
Issue of Corporate Bonds
Issue of Money Market Bonds
Issue of Government Bonds

Equity

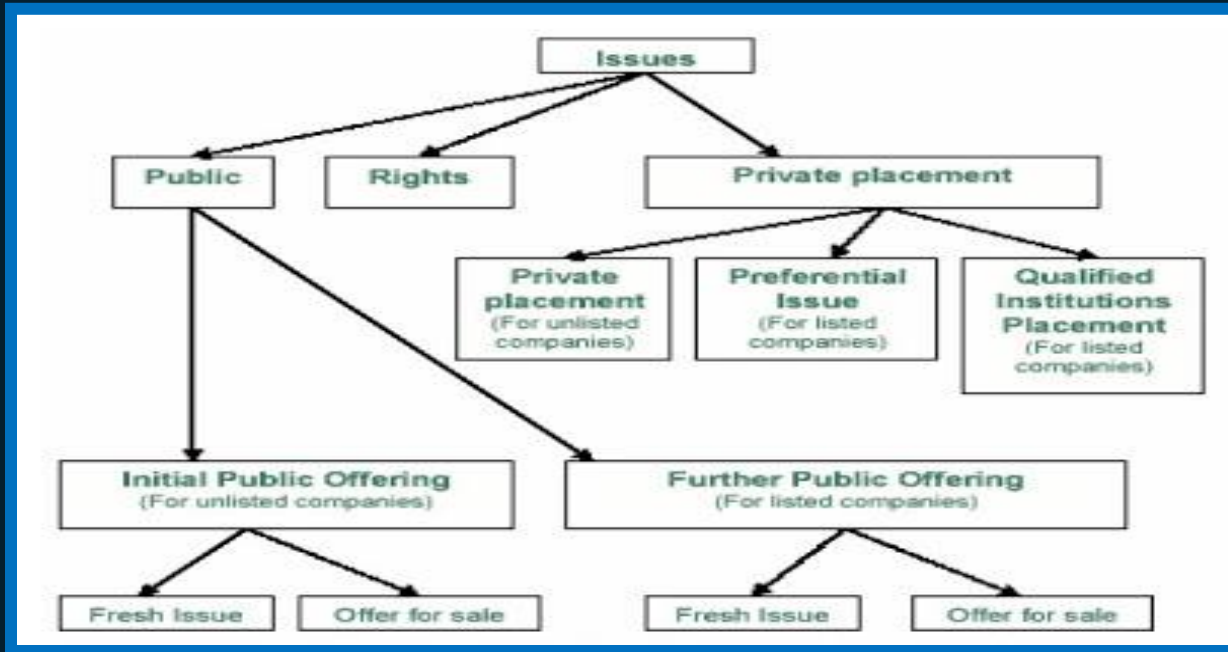
Initial Public Offering (IPO)
Follow on Public Offering (FPO)
Private Placements
Preferential Allotments
Rights Issue

Hybrid

Convertible Preference Shares
Convertible Debentures
Convertible Bonds

- Fund raising in capital markets can be through any of the above modes
- Issue of each of the instruments require separate and elaborate procedure to be followed
- Investment Banker has the requisite skill set and infrastructure to mobilize and complete the transactions

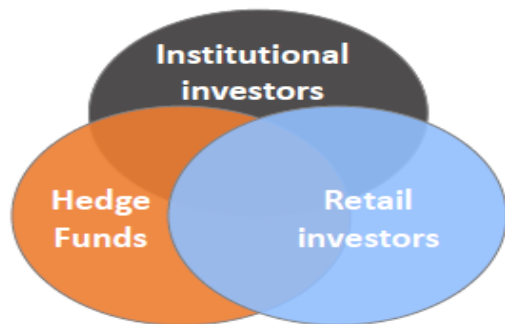
Types of Capital Issues



Listing Objective

Company	Founders/ Promoters	Investors
• Growth Finance • Market Standing (Reputation & Visibility) • ESOPs • M&A • Tool for Management Compensation	• Exit opportunity • Liquidity Assurance	• Exit Opportunity • Liquidity Assurance

Investor Segment through IPO



The above categories of investors differ from each other in their:

- Investment horizon
- Return expectations
- Risk profile
- Sophistication

Nevertheless, investors are interested in similar type of stories:

Success stories

Strong leadership

Growth potential

Modest valuation (Lower Price Range)

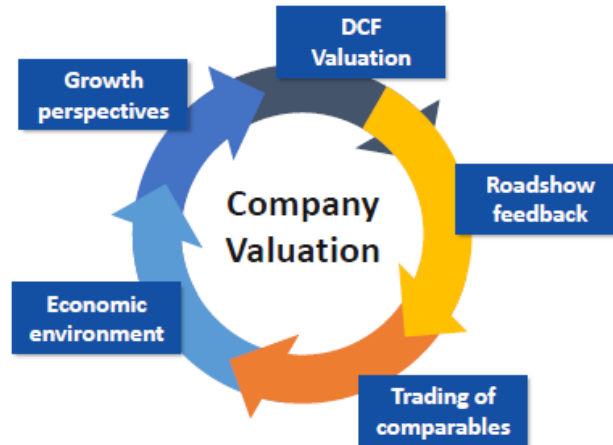
Companies with positive Cash flows

Solid market position

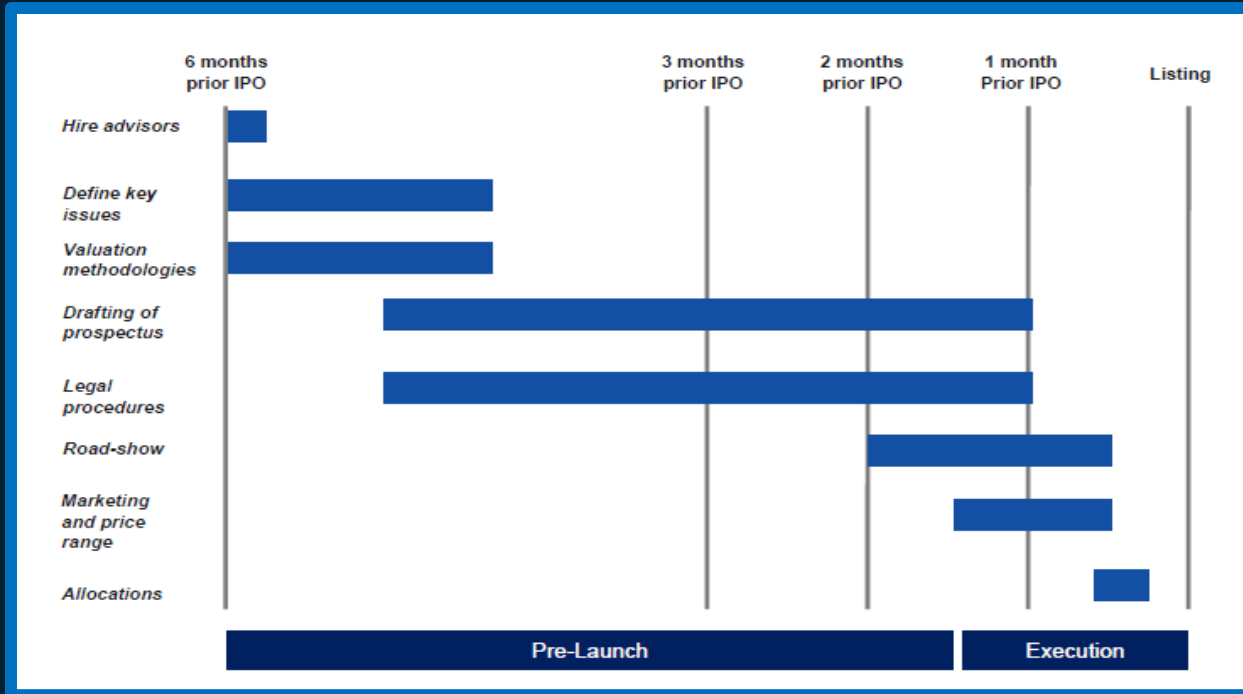
High demand for the IPO

Pricing an IPO

The price range which is set for an IPO depends on multiple factors. Its key goal is to provide a slight discount to the trading value of the company. This will keep investors happy and facilitate the post-launch trading of the shares



Process of IPO



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3. WEALTH MANAGEMENT

Equity Research

What is Equity Research?

1



Performing Valuation of Listed Companies

2



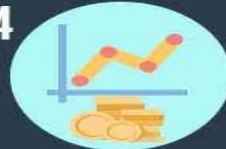
Research the economic & industry parameters

3



Perform Fundamental Analysis

4



Project Revenues and Profits of the Company

5



Valuation using DCF, Relative Valuation

6



Compare the fair value with Market Price

7



If Fair Value < Market Price, then SELL

8

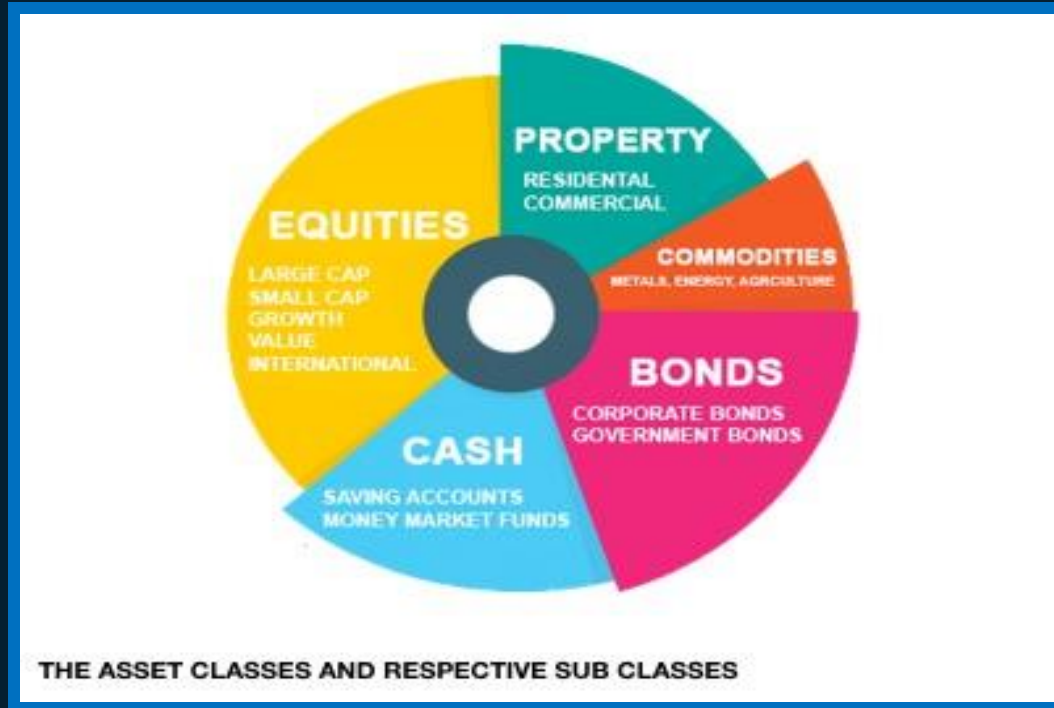


If Fair Value > Market Price, then BUY

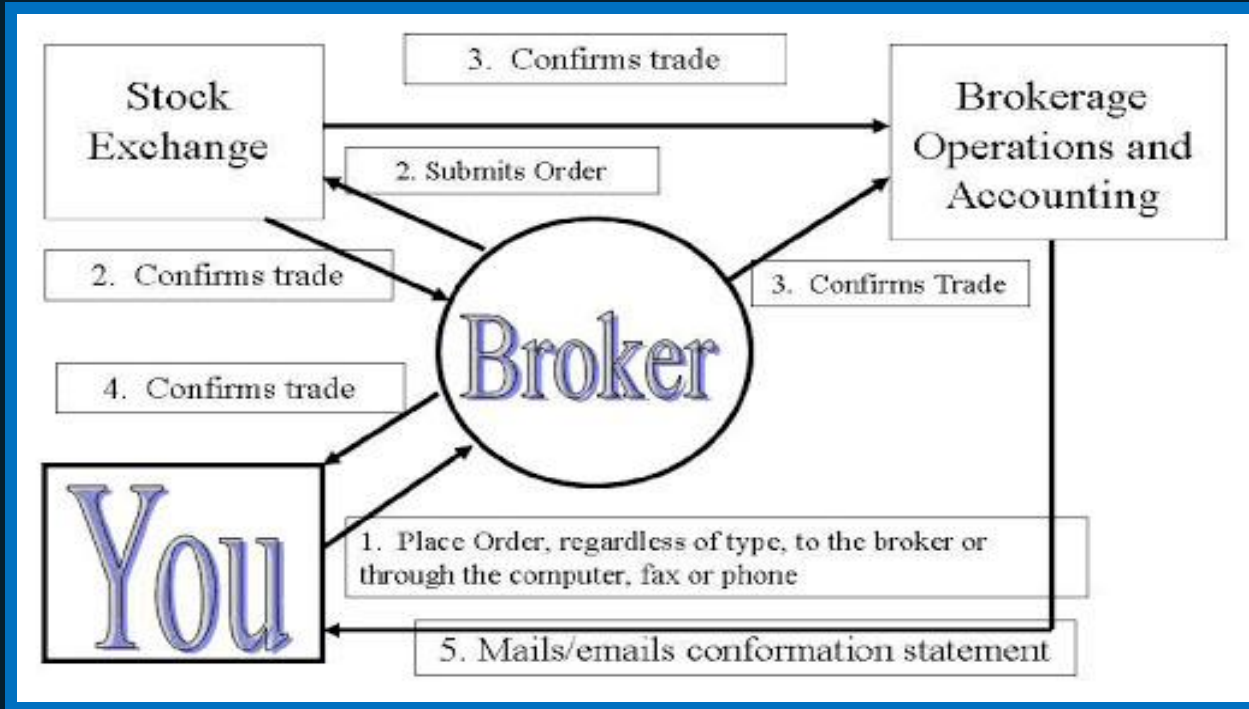
Asset Management



Asset Classes



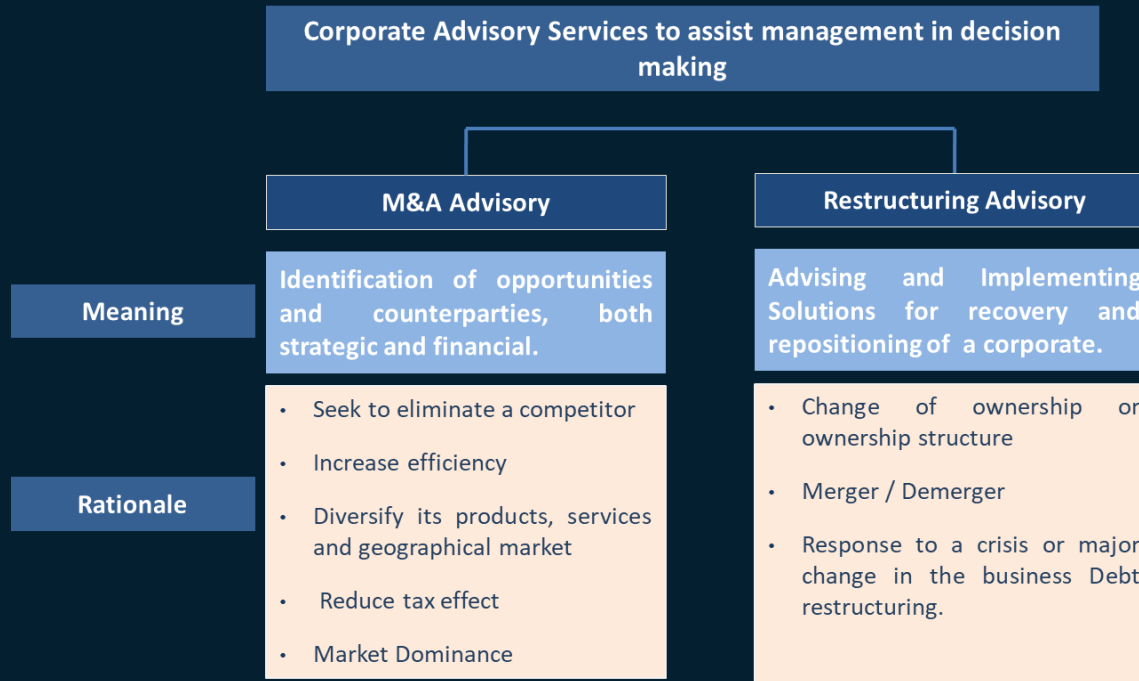
Trading & Brokerage



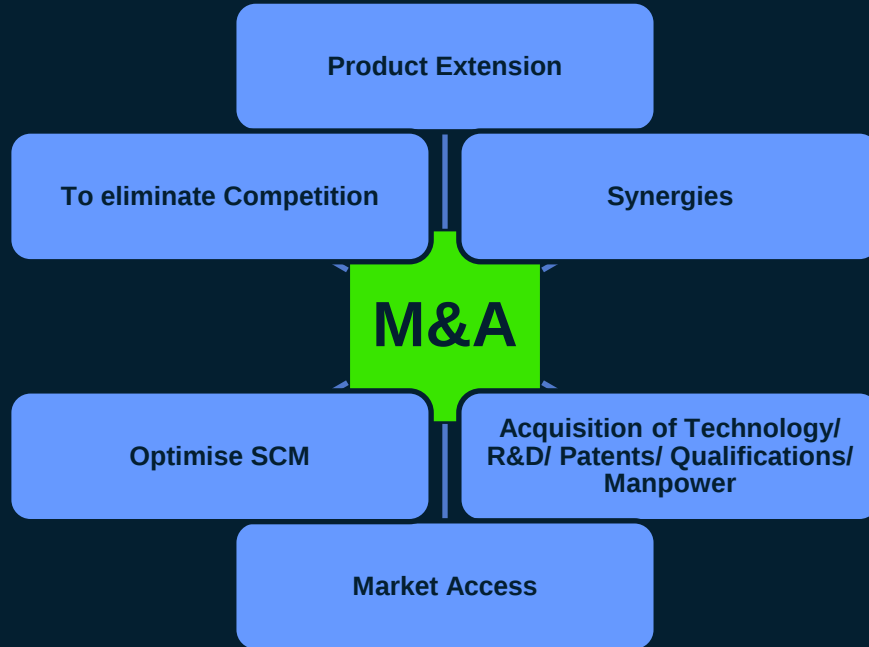
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4. CORPORATE ADVISORY

Corporate Advisory



Rationale behind M&A



M&A Advisory – Process/ Scope



Need for Restructuring

Which are the typical reasons for corporate distress?

**Product
obsolescence**

Industry decline

**Bad investments in
non-core assets**

Lack of innovation

Inefficiency

Bad Management

Bad M&A deals

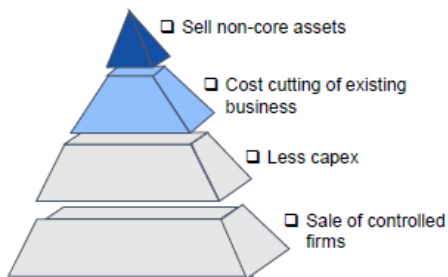
Excessive leverage

**Insufficient cash for operating
activities**

Types of Restructuring

Asset side restructuring

		Cash Flow generation	
		Low	High
Strategic importance	High	Optimization/ Cost cutting	Keep
	Low	Divest	Consider divesting



Liability side restructuring

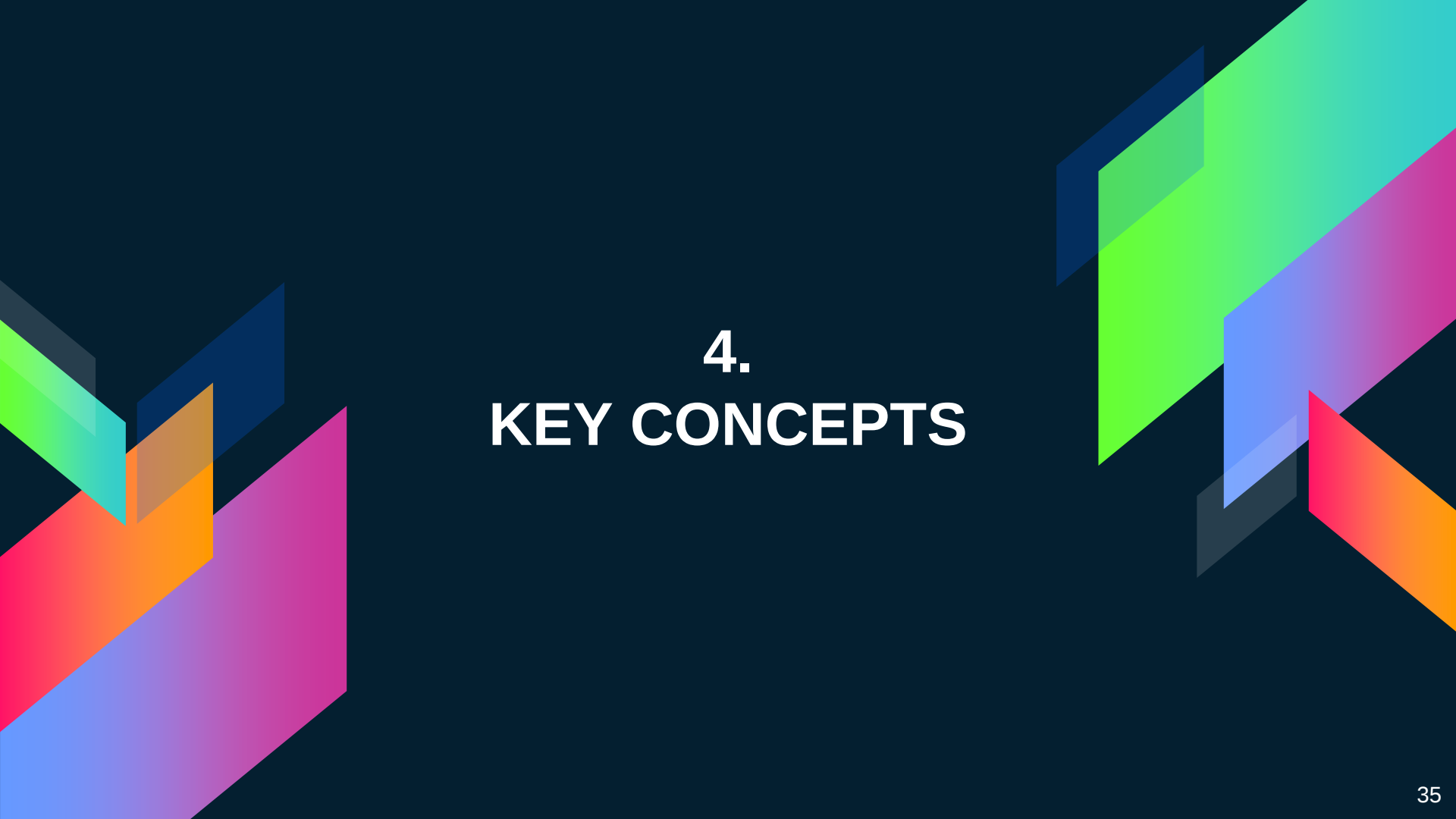
An agreement between creditors to alter the conditions under which liabilities of the company will be restructured, as it will be unable to repay them in their entirety

The various options for debt restructuring are:

- Debt refinancing
- Suspending interest payments
- Debt write-off
- Debt-equity swap
- Introduce convertible bonds

Creditors need to assess 3 key parameters:

- Loss given default – Liquidation
- Loss given default – Restructuring
- Probability of successful restructuring

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4. KEY CONCEPTS

Business Valuation

Discounted Cash Flows (DCF)

Inputs:

- Top line forecast for 5-10 years,
- Estimated cost of capital
- Growth rate after the forecast period

Trading Multiples

Inputs:

- Comparable firms which are listed
- A measure indicating operating profitability (e.g. EBITDA)

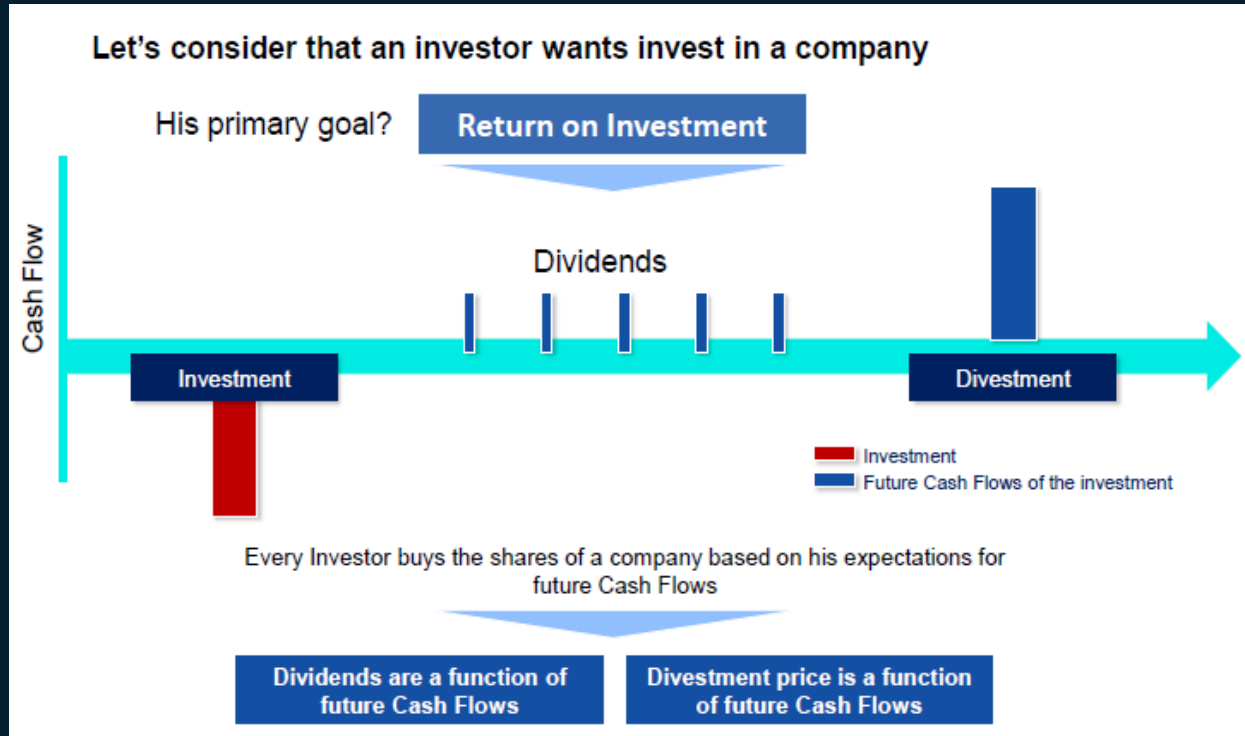
Transaction Multiples

Inputs:

- Comparable firms, which have been subject to a transaction
- A measure indicating operating profitability (e.g. EBITDA)

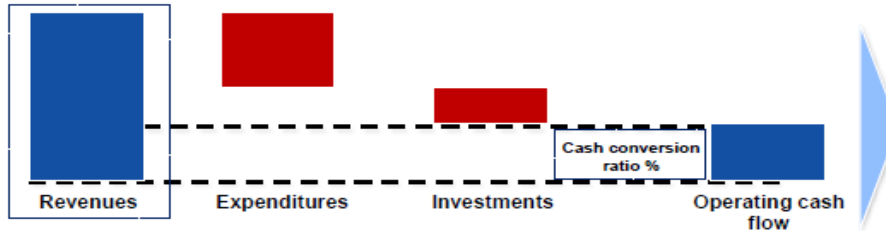
Use a combination in order to triangulate results

Discounting Future Cashflows



Drivers of Company's Valuation

Given that a company's value is a function of its future cash flows, we need to determine what drives future cash flows



Two functions drive a firm's value in the future:

Growth

Profitability

Why growth?



- Bigger size
- Same conversion ratio

Why profitability?



- Same size
- Stronger conversion ratio

Higher future cash flows, higher valuation

NOPAT Calculation

1 NOPAT (Net Operating Profit After Taxes) :

\$ in million	Year 1	Year 2	Year 3
Net Sales	17,022	18,341	18,549
Cost of goods sold	(9,483)	(9,822)	(9,857)
Gross Margin	7,539	8,519	8,692
Operating expenses	(3,492)	(4,394)	(4,123)
D&A	(487)	(511)	(693)
EBIT	3,560	3,614	3,876
Tax rate	35%	35%	35%
Operating taxes	(1,246)	(1,265)	(1,356)
NOPAT 1	2,314	2,349	2,520

NOPAT is a measure of operating profitability. It does not take into consideration financial structure. Interest expense is not included in the calculation above.

WC & Capex Calculation

2 Working Capital

\$ in million	Year 1	Year 2	Year 3	DeltaY1-Y2	Calculate cash effect
Account receivables	3,621	4,174	3,492	(553)	-(Receivables Y2-Receivables Y1)
Inventories	2,311	1,813	2,104	(498)	-(InventoriesY2-InventoriesY1)
Trade payables*	(3,383)	(4,207)	(3,212)	824	-(PayablesY2-PayablesY1)
Working Capital	2,549	1,780	2,384	(227)	

*Please note that Trade Payables are with a negative sign because they are a liability

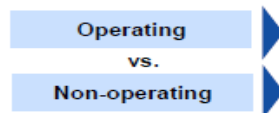
3 Capital Expenditures

Capital expenditure is the cost which the company sustains in order to replace old PP&E or Acquire new PP&E.

A reasonable assumption is that a growing business will need additional PP&E investments.



4 Other assets and liabilities



Used for the generation of Operating Cash Flows;
Could be modeled as a % of revenues

Not used for the generation of Operating Cash Flows; Their value (positive or negative) should be added/(subtracted) to Enterprise Value

Free Cash Flow Calculation

\$ in million

NOPAT

Add-back D&A

△ Working capital

△ Net other assets, liabilities

Capex

Unlevered Free Cash Flow

!Free Cash Flows are available to both debt and equity investors!

NOPAT

Net Operating Profit After Taxes is a measure of operating profitability

Add-back D&A

D&A is added back as it is not a Cash expense

Delta Working Capital

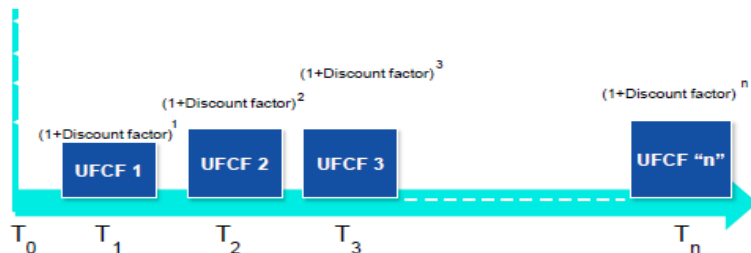
Growing a business requires investments in Receivables and Inventory and generates more Payables

Delta Net Other Operating assets

Similar to Working Capital. As a business grows it needs more other operating assets

Capex

Expenditure for PP&E used to replace old PP&E or acquire new PP&E in order to support the growth of the business



WACC as Discount Factor

There are two types
of financial
investors in a firm

Debt investors

Equity investors

Free cash flow is
available to both
debt and equity
investors

WACC
(Weighted average cost of capital)

Takes into consideration
both debt and equity
investors

WACC (Weighted Average Cost of Capital) represents the opportunity cost that investors sustain for investing their funds in the firm

$$WACC = \left(\frac{D}{D + E} \right) * k_d * (1 - t) + \left(\frac{E}{D + E} \right) * k_e$$

D = Amount of debt financing

E = Amount of equity financing

k_d = Cost of debt

k_e = Cost of equity

t = Tax rate

Cost of Equity & Debt

	Methodology	Needed data	Practical implementation
Cost of debt	▪ Market value of debt	▪ Bond current pricing	Use the bond's Yield to Maturity
	▪ Book value of debt	▪ Book value of Financial debt in BS ▪ Interest expense in P&L	Divide Interest expense to the amount of Financial debt
Cost of equity	▪ CAPM (Capital Asset Pricing Model)	▪ Risk-free rate	Use a 10 year government bond
	$k_e = r_f + \beta * \text{Market risk Premium}$	▪ Market Risk Premium	Studies show it is between 4.5% and 5.5%
		▪ Company beta	A measure of the stock's volatility in relation to the market. Available in financial platforms such as Bloomberg, Thomson Reuters etc.

DCF

$$\text{Present Value of Free Cash Flows} = \text{Cash Flows in the Forecast period (5-10 years)} + \text{Continuing value (After forecast)}$$

	Description	Needed data	Math formula
Forecast period (Stage 1)	The explicit forecast period should be long enough to allow the business to reach a maturity stage	- Free Cash Flow Forecast (5 or 10 years) - WACC	$\frac{FCF_1}{(1+WACC)^1} + \frac{FCF_2}{(1+WACC)^2} + \frac{FCF_3}{(1+WACC)^3} + \frac{FCF_4}{(1+WACC)^4} + \frac{FCF_5}{(1+WACC)^5}$
Continuing Value (Stage 2)	Continuing Value is the period after the explicit forecast period. Often a large portion (>50%) of a company's valuation lies in its Continuing Value	- Free Cash Flow Forecast for 5th year - WACC - Perpetuity growth rate (g)	$\frac{FCF_5 * (1 + g)}{(WACC - g)^1} \div (1 + WACC)^5$

DCF based Equity Value

Present Value of Free Cash Flows
+ Non-operating Assets 1

Enterprise Value

- Financial debt 2
- Debt-like items 3

Equity Value

1

Non-operating Assets: These are assets that are not used in the operating business of the company

Non-operating real estate, personal cars, financial subsidiaries etc.

2

Financial debt: Interest-bearing financial debt

Debt to banks, Bond issues, Leases etc.

3

Debt-like items: Non-interest bearing liabilities that are not considered within Free Cash Flow

Provisions, Unfunded Pension liabilities, Liabilities from litigation, etc.

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5. SKILL_SET FOR INVESTMENT BANKERS

Finance Professionals in IB



Skill-set of Investment Banker

- Strong analytical and mathematical skills
- Good knowledge of the business world and latest market developments
- Ability to keep calm and work under pressure
- Attention to detail
- Project and time management skills
- IT competency
- Good inter-personal skills
- Tolerance for taking risks
- Ability to work in a team environment
- Ability to demonstrate effective leadership
- Ability to take initiative, good networking skills
- Good oral and written communications skills
- Adapt to different situations and cultures of different countries.



THANKS!

Any questions?

You can find me at:

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