Introduction to Investment Banking

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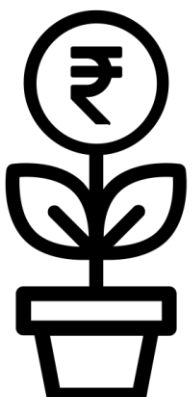
Knowledge Bytes S1-E1

What is an Investment Bank ?

An Investment Bank works with companies that either want to raise capital or want to buy or sell operating assets by offering transaction based services and advisory.

Traditionally associated with Corporate Finance, such a bank might assist in raising capital by underwriting or acting as the client's agent in the issuance of securities.

Financing is arranged by IBs via :

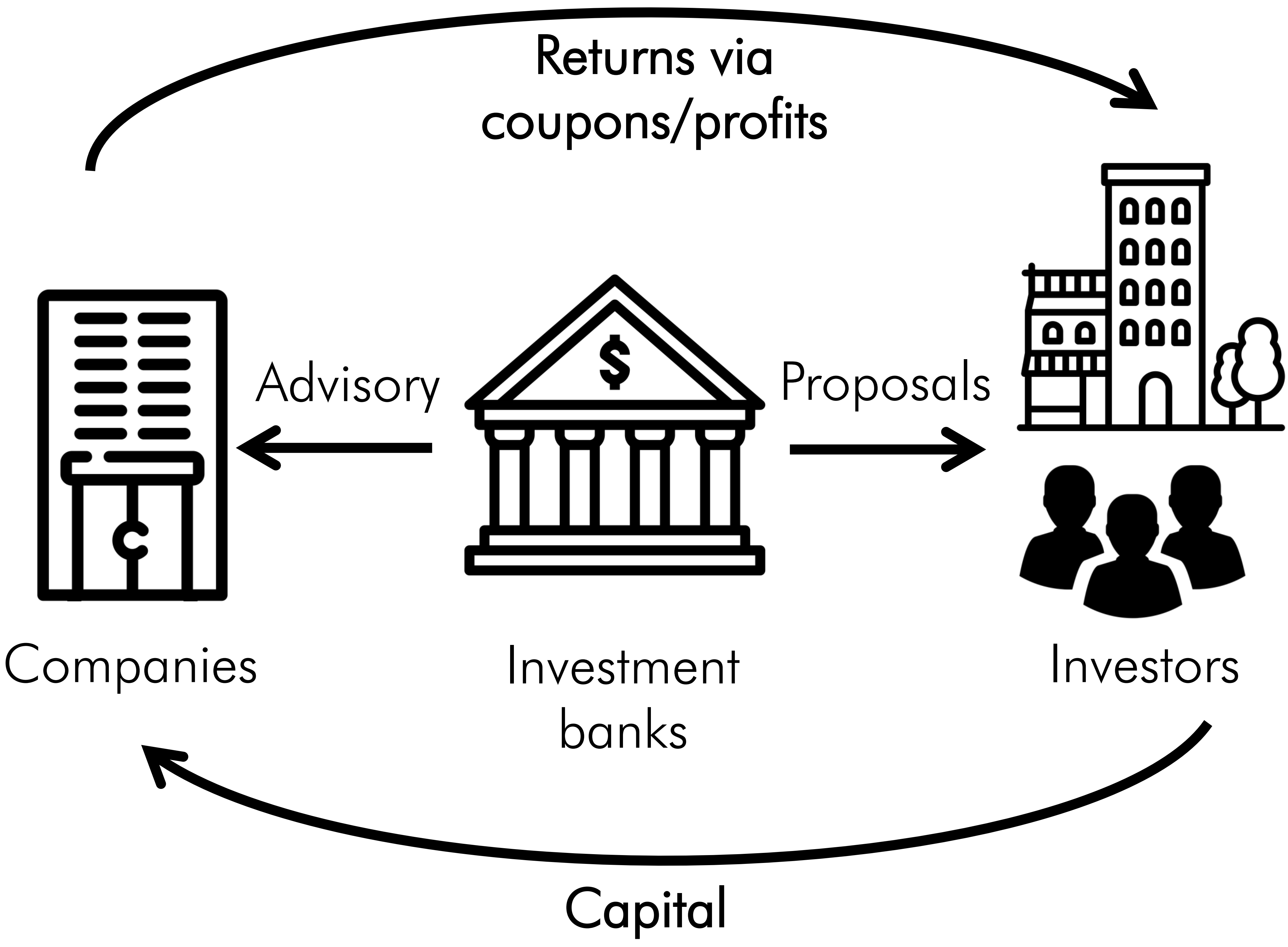


New Funds
IPOs, Equity Offerings, Debt Products

Acquire/Divest Current Business
Mergers & Acquisition (M&A)

Another, prime function of an IB is **Capital Advisory** where clients are advised on a broad range of strategic & tactical issues, including capital structure optimization, capital allocation, equity and debt market positioning and issuance, and investor communication strategies.

Process


Returns via
coupons/profits
Advisory
Proposals
Companies
Investment
banks
Investors
Capital

Industry

Investment Banks can be classified into:

Bulge Bracket	Middle Market	Boutique Banks
Involved in transactions like IPOs, M&A deals worth billions.	Middle markets are usually more specialized than bulge brackets, but less specialized than boutiques.	Similar to the size of Bulge Brackets transactions, these specialize in one or two industry sector deals. Eg. Retail, Real Estate etc.
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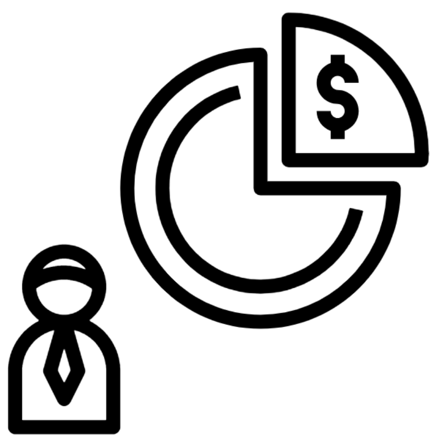
What is Capital?

Capital is anything that increases one's ability to generate value.

In business, the most important form of capital is financial capital. It enables the business to reach its goal in time.

Types of Financial Capital



Equity

Company Shares, Preference Shares, IPO, Venture Capital, Business Angels, Mezzanine Finance

Debt (Long + Short)

<u>Long term :</u>
NCDs, Term Loans, Unsecured Loans

<u>Short Term :</u>
A) Fund Based : OD/CC*
B) Non-Fund Based : LC/BG**

*Overdraft/Cash Credit **Letter of Credit/Bank Guarantee

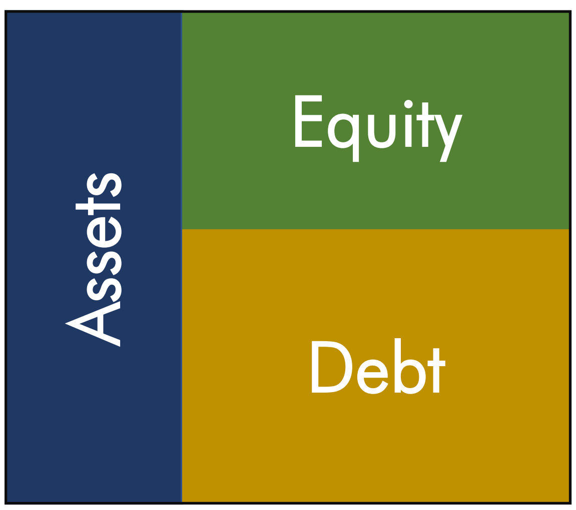
Capital Structure

Capital Structure is simply the proportion of Debt & Equity used by a company to finance its operations and growth.

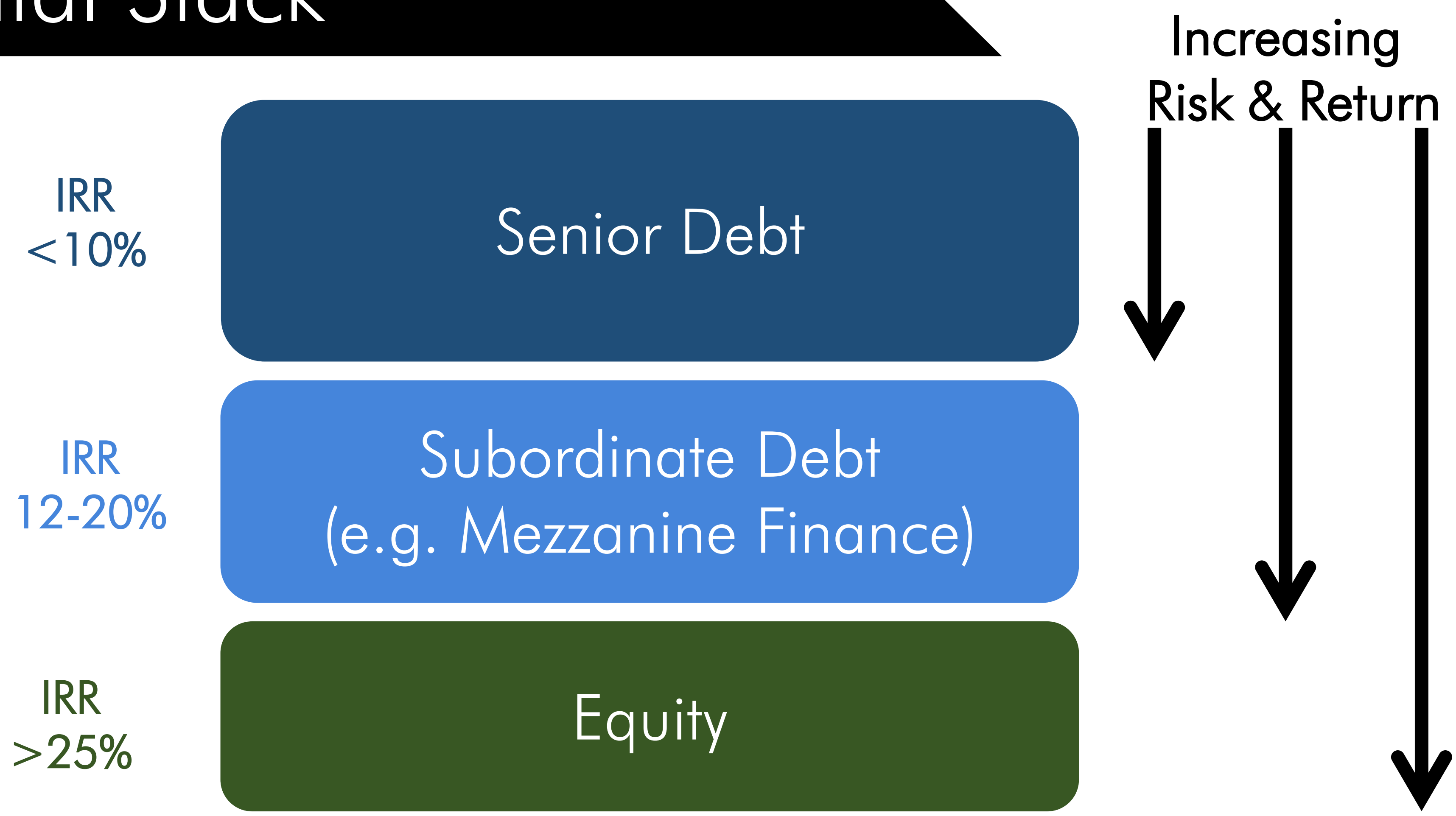
Firms can issue either more debt or equity to fund its operations. A company's debt-to-equity ratio (D/E) is a measure of risk for investors (capital providers).

More the debt, lower are the profits available for shareholders after paying interest expenses. More the equity, slower can be the growth compared to industry competitors and survival can be at stake.

Based on predefined specifications, evaluations (business plan, shareholders' constraints, prevailing interest rates), financial advisors put forward adjustments (via products) to alter this financial structure in order to achieve more flexibility and continuity, which in turn contributes to better company growth.



Understanding the Capital Stack



Senior debt is a loan from a bank. Most senior loans are collateralized with assets and hence 'Secured'.

Subordinated debt, or Junior debt, is repaid after senior debt. It is not secured and hence is more of a risk.
(**Mezzanine debt** is a hybrid form of debt that is part loan and part investment. It can be seamlessly converted into equity if the borrower chooses to default. Mezzanine loans are mostly structured around the cash flows with less focus on assets of the business.)

Equity finance is a method of raising fresh capital by selling shares of the company to public, institutional investors, or financial institutions. Buyers are referred to as shareholders of the company because they have received ownership interest in the company and entitled to a share in profits.

Stay tuned for More Knowledge

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