Capital Market Fundamentals

Contents

- How an investment bank helps
- Capital markets teams
- Equity capital markets – IPO
- Equity capital markets – trading venues
- Debt capital markets – products
- Debt capital markets – loans vs bonds

How an Investment Bank Helps

Maximize profits for shareholders

Return on capital > Cost of capital

Returns increase
- Internal efficiency
- External acquisition / disposals

= Financial Advisory / M&A

Lowering cost of capital
- Cheap debt
- Managing equity

= Equity, Debt and Credit

Managing risk
- Commodities
- Foreign exchange

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Capital Market Teams

- Derivative
- Structured Finance
- Municipal Finance
- High Yield

Typically biggest teams:
- Equity Capital Markets (ECM)
- Debt Capital Markets (DCM)
- Leverage Finance

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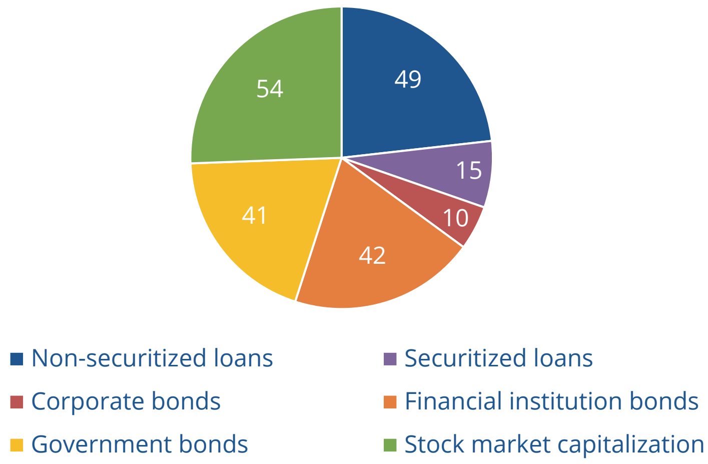
Capital Markets 2010 (Global Value USDtn)



Source:
BIS, S&P, McKinsey

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Equity Vs Debt – Investors

Young executive Long investment horizon		Grandparent Short investment horizon
High risk high return Less need for income	Time horizon →	Low risk Need regular secure income
Mostly invests in equity		Mostly invests in debt

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Equity Vs Debt – Companies

Start up / growth		Mature business
High Risk Cash flow negative Can't support debt	Time horizon →	Low risk Cash flow positive Can support debt Interest tax deductible
Mostly equity financed		Mostly debt financed

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Equity Capital Markets
What is an Initial Public Offering (IPO)?

- Previously privately held shares are sold, for the first time, to the public
- The shares are listed on a securities exchange for the first time
- Existing shareholders may sell some or all of their shares
- Company may or may not raise new capital in the process
- This is referred to as the "primary market"

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Equity Capital Markets
Why Do Companies Go Public?

IPO – pros	IPO - cons
Provides capital for growth	Consumes time and resources
Provides liquidity for existing shareholders	Increases external insight
Easier use of stock options (for compensation)	Need to fulfil requirements made by the stock exchange
Ensures access to further equity funding in future	Higher reporting requirements
Builds corporate brand	Increased liability for directors and officers
Gives company a currency (shares) for acquisitions	Execution exposed to market conditions
And more...	

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Equity Capital Markets
Trading Venues

Stock exchange
Traditionally most common venue
Provides **public** market
Liquidity is displayed

"Dark pools"
Have gained popularity in recent years
Provides **private** market
Liquidity is not displayed – preferred venue for large trades

Other alternative trading systems
Electronic communications networks
Crossing networks
And more...

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Debt Capital Markets
Products

	Borrowing direct from banks / finance companies	**Issuing *securities* into the financial markets**
< 1 year	Revolving credit facility Overdraft	Commercial paper Notes payable
> 1 year	Term loans Capital / finance leases	Investment grade bonds High yield bonds

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Debt Capital Markets
Loans vs Bonds

Loans	**Bonds**
Often floating interest rate	Often fixed interest rate
Flexible terms	Static terms
Simpler to restructure	Harder to restructure
Single counterparty	Broader investor base
Lower administration	High administration and fixed costs (many involved parties)
Higher interest rate	Lower interest rate
More restrictive covenants	Fewer restrictive covenants
	High regulatory requirements

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