BANKING AT MICHIGAN

Investment Banking Products & Roles

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Agenda

- Overview of Structure of an Investment Bank
- Differences in Structure for Bulge vs. Boutique
- M&A
- Restructuring
- Leveraged Finance
- Capital Markets
- What falls into product vs. industry groups
- Public side of investment banks

What is an Investment Bank

“ An investment bank is a financial institution that offers a range of services from financial advisory, underwriting, trading, research, raising capital, issuance of shares and bonds, to advisory on mergers and acquisitions. They are usually involved where large amount of money moving happens.”

Structure of an Investment Bank

Users of Capital	**PRIVATE**: INVESTMENT BANKING DIVISION	CHINESE WALL	**PUBLIC**	Providers of Capital
	INDUSTRY GROUPS		SALES	
	PRODUCT GROUPS		TRADING	
	DEBT CAPITAL MARKETS		RESEARCH	
	EQUITY CAPITAL MARKETS		ASSET MANAGEMENT	

Industry (Coverage) Groups

- Differentiated by what industries they serve
- Common coverage groups include
  - Technology, Media, & Telecommunication (TMT)
  - Healthcare
  - Consumer & Retail
  - Financial Institutions Group (FIG)
  - Natural Resources
  - Industrials
  - Real Estate
  - Gaming & Lodging
  - Financial Sponsors

Product Groups

- Product groups will always work on a specific deal type across industries such as:
    - Mergers & Acquisitions
    - Equity Capital Markets
    - Debt Capital Markets
    - Leveraged Finance
    - Restructuring / Special Situations / Distressed Debt
    - Corporate Derivatives
    - Structured Finance

Equity Capital Markets (ECM)

- Group responsible for advising clients on equity related products such as swaps, options, futures, and shares - common services include:
  - IPOs
  - Equity Private Placements
  - Roadshows
- Sometimes referred to as a “cross between investment banking and sales and trading”
- **Recruiting:** expect similar interviews to any other IBD group but with more of a focus on accounting, DCF, equity, and enterprise value rather than merger models and LBOs
  - Demonstrate interest in markets (know equity trends, recent IPOs, and how indices are performing)

Debt Capital Markets (DCM)

- Group that helps companies and governments raise money via debt instruments such as corporate bonds, government bonds, credit default swaps (usually investment grade) - Bankers help:
  - Raise debt for acquisition or other project
  - Refinance/restructure existing debt
  - Connect clients with global pool of debt investors
- **Recruiting:** follow the bond markets and know debt related information such as bond valuation, yield curves, etc

Leveraged Finance (LevFin)

- LevFin departments work on acquisitions (leveraged buyouts), recapitalisations, and asset purchases, M&A, and refinancing by raising **high yield debt**
    - Leveraged buyouts: Financial sponsors need to raise debt to fund a leveraged buyout.
    - Recapitalizations: Acquirers often borrow to pay acquisitions. When a lot of debt is needed, it falls under the leveraged finance umbrella.
- "The Leveraged Finance Capital Markets team originates, structures and executes bank loans and high yield bond financings for corporate clients and financial sponsors."
- Companies use debt because it is typically cheaper to use than equity or cash

Restructuring

- When a company can no longer meet its payment liabilities it will elect or be forced into bankruptcy and will hire a restructuring banker to help with the process
  - Chapter 7 Bankruptcy: “Liquidation” - the company is past a state of reorganization and needs to sell off its assets to pay back creditors
  - Chapter 11 Bankruptcy: “Rehabilitation” - company tries to reorganize its debt by contacting creditors to renegotiate loan terms in an attempt to reemerge as a healthy organization
- Bankers help
  - Sell assets to pay creditors
  - Negotiate loan obligations
  - Advise management on reorganization strategy

Corporate Derivatives

- What is a derivative?
  - Financial contract whose value is based on an underlying security (e.g. currencies, interest rates)
  - Futures contracts, forward contracts, options and swaps are commonly used derivatives
  - Derivatives can be used to either
    - **Mitigate risk** (**hedging**), or
    - **Assume risk** with the expectation of commensurate reward (**speculation**)

Corporate Derivatives

- Helps corporations and financial sponsors address macro market exposures – e.g. interest rates (IR), foreign exchange (FX) and commodities
  - Risk management related to M&A, debt financings, other strategic initiatives as well as day-to-day exposures
  - Take away worry of what companies can’t control (e.g. rates, currencies) so they can focus on what they can control / what really matters (e.g. normal biz operations)
  - Transfer risk from corporation / financial sponsor to bank
- Works closely with LevFin, IGCM and M&A teams + industry groups

Corporate Derivatives

https://www.nomuraconnects.com/focused-thinking-posts/deal-contingent-hedging-a-flexible-way-to-mitigate-risk/

- Cross-border M&A Example: European PE Fund acquiring US asset for $2bn
  - Such a deal would usually be denominated in US dollars
  - A lot can change during 3-12m+ an M&A takes to complete…
    - FX Risk: If dollar appreciates 20% against euro, deal becomes more expensive and IRR is lower (would take more euros to equal the same $2bn)
    - IR Risk: If interest rates rise during period, cost of financing (debt) increases and IRR of deal falls
- Solution: deal-contingent hedge to mitigate FX / IR risk

Corporate Derivatives

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- Vanilla FX Forward
  - Could use an FX forward to lock in currency costs (e.g. EUR/USD)
  - If the M&A fails, the hedge must be unwound (which costs money)
  - If the FX market has moved against the hedge, you could incur costs
- Deal-Contingent FX Hedge
  - No payment upfront + can lock in a forward rate
  - Small spread is added to pay for the hedge, only if the M&A is successful and the hedge is used
  - If it fails, the hedge disappears and there's no fee

Corporate Derivatives

- At GS, was broken into the following “pods”
  - Interest Rate Derivatives: larger, M&A deals
  - Foreign Exchange Derivatives: lots of day-to-day exposure, higher volume
  - FIG Derivatives: banks are driven by their Balance Sheet and have high sensitivities to interest rate changes (Net Interest Income could be equivalent to Operating Income of a normal corporation)

M&A

- Will either be working on “sell side” or “buy side” M&A
  - Sell Side Mandate: Client wants to sell their company and make money
  - Buy Side Mandate: Client wants to buy a company, and the bankers help them sell it or finance it
- Provide advice on valuation, transaction structures and deal tactics/negotiations
- Bulge Brackets may also tap into balance sheet to finance through debt and equity issuances (help from ECM / DCM / other product groups)
- Some banks (i.e. Goldman Sachs bake M&A into their coverage groups vs. JPM where coverage bankers do not do any M&A work)

Are you confused yet?!

- **Leveraged Finance "LevFin" (Product Group)**
  - Focus on high yield bonds and leveraged loans
- **Debt Capital Markets "DCM" (Product Group)**
  - Markets based group that focuses on investment grade debt
- **Financial Sponsors (Coverage Group)**
  - Industry group that works with private equity firms to pitch new ideas, help with their LBOs, and work with their portfolio companies
- **Financial Institutions Group (Coverage Group)**
  - Industry group that works with "financial institutions" such as commercial banks, insurance companies, asset management firms, and sometimes "FinTech" companies

Analyst Experience at Boutique vs Bulge

Boutique	Bulge
• Typically offers generalist program • Typically only advisory focused • Small deal teams with 1-2 analysts, an associate, VP, director, and MD • Get exposure through entire deal process and often get to run the model with associate	• Placed in a group right away • Offer a wide variety of services including access to balance sheet • Deal teams vary in size, usually larger • Get exposure to large, complex deals and will sometimes work with analysts from other industry/product groups

How to network to find the right group

- Each bank will structure their groups slightly different - here are some questions to ask to figure out what group is best for you:
    - How much time do you spend working in models vs pitch decks?
    - How many deals have you worked on as an analyst?
    - How big are deal teams? How many analysts per team?
    - Where do analysts in your group exit to? (be careful asking this)
    - How do your hours compare to other groups?
    - Why did you pick this group? How is it different than others?

Examples of Public Side of Investment Banking

- PLEASE DO NOT FEEL LIKE IB IS THE ONLY OPTION
- Securities / Sales and Trading
  - Provide clients leading market insight, risk management and execution, helping them raise money, invest, and transfer risk across different asset classes
  - Clients: Asset managers, hedge funds, banks, pensions, corporations, etc.
- Research
  - Equity research analysts closely analyze small groups of stocks in order to provide insightful investment ideas
  - Give reports to firm's salesforce / traders, institutional investors and the general investing public. They communicate formally via research reports that place "Buy," "Sell," or "Hold" ratings on the companies they cover.

BANKING AT MICHIGAN: Investment Banking

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