Giuliano Iannotta

Investment Banking

A Guide to Underwriting and Advisory Services



Contents

1	Introduction to Investment Banking	1
	1.1 Introduction	1
	1.2 Definitions	2
	1.2.1 Commercial Banking	. 2
	1.2.2 Investment Banking	. 3
	1.2.3 Universal Banking and Conflict of Interests	. 6
	1.3 League Tables (2007–2008)	8
	1.3.1 IPOs	. 9
	1.3.2 Debt: Bond Offerings and Loan Syndication	. 9
	1.3.3 M&As Advisory	12
	1.4 Conclusions	14
	References	17
	,	
2		19
	2.1 Introduction	19
	2.2 Definitions	20
	2.3 The Agreement	21
	2.3.1 Management Fee	21
	2.3.2 Carried Interest (Carry)	22
	2.4 Fund Returns	24
	2.5 The Term Sheet	25
	2.5.1 Preferred Stock	26
	2.5.2 Anti-Dilution Protection	29
	2.5.3 Vesting and Shareholders' Agreement	31
	2.6 The Venture Capital Method	32
	2.6.1 The Basic VC Method (No Dilution)	32
	2.6.2 The VC Method Assuming Dilution	34
	2.7 Leveraged Buy-Out (LBO)	36
	2.7.1 The Financing Structure	36

xii Contents

	2.7.2 Candidates and Motives	37
	2.7.3 Valuation	38
	2.7.4 Debt Capacity	40
	2.8 Conclusion	41
	References	43
3	Equity Offerings: Structure and Process	45
	3.1 Introduction	45
	3.2 Why Do Companies Go Public?	46
	3.3 The Offering Structure	47
	3.3.1 Which Shares?	47
	3.3.2 To Whom?	48
	3.3.3 Where?	48
	3.3.4 Which Market?	49
	3.3.5 American Depository Receipts (ADRs)	50
		51
	3.4 Price-Setting Mechanisms 3.5 The Key Steps of the IPO Process	53
	3.6 Seasoned Equity Offerings (SEOs) and Rights Offerings	55 55
		55 55
	3.6.1 SEOs	56 56
	3.7 Conclusion	58
	References	58
	References	50
4	Equity Offerings: Syndicate Structure and Functions	61
	4.1 Introduction	61
	4.2 The Syndicate	61
	4.2.1 Structure	61
	4.2.2 Functions	62
	4.2.3 What Does it Take to Participate in a Syndicate?	64
	4.3 Stabilization	65
	4.3.1 Overallotment and the Green Shoe Option	65
	4.3.2 An Example	66
	4.3.3 Two Other IPO Features: Lock Up and Bonus Share	68
	4.4 Fees	69
	4.4.1 Distribution	69
	4.4.2 Designation	70
	4.4.3 Naked Short and Fee Distribution	73
	4.5 Conclusion	76
	References	76
5	Price Setting Mechanisms	79
	•	
	5.1 Introduction	79
	5.1 Introduction	79 80

Contents xiii

	5.2.2 A Simple Model	83
	5.2.3 The Empirical Evidence	
	5.3 Auctions	
	5.3.1 The Winner's Curse	88
	5.3.2 The Free Rider Problem	90
	5.3.3 The Empirical Evidence	91
	5.4 The Dark Side of Book-Building	
	5.4.1 Other Explanations of Underpricing	
	5.5 Conclusion	
	References	98
6	Debt Offerings	99
	6.1 Introduction	99
	6.2 Bond Offerings	100
	6.2.1 Definitions	100
	6.2.2 Process	100
	6.3 Credit Ratings	102
	6.3.1 Definitions	102
	6.3.2 Split Ratings	103
	6.3.3 Solicited and Unsolicited Ratings	105
	6.3.4 Are Ratings Important to Bond Pricing?	105
	6.4 Securitization	107
	6.5 Hybrids	108
	6.6 Syndicated Loans	109
	6.6.1 Definitions	109
	6.6.2 Syndication Strategies	110
	6.6.3 A Numerical Example	112
	6.7 Conclusion	116
	References	116
7	Mergers and Acquisitions: Definitions, Process, and Analysis	117
	7.1 Introduction	117
	7.2 Definitions	118
	7.3 A Little Bit of Accounting	119
	7.4 The Process	121
	7.4.1 Hiring the Investment Bank	121
	7.4.2 Looking for the Potential Counterparty	122
	7.4.3 Choosing the Type of Sale Process	122
	7.4.4 Bidder Confidentiality Agreement (BCA) and Confidential	
	Information Memorandum (CIM)	123
	7.4.5 First Round Bids	123
	7.4.6 Data Room	124
	7.4.7 The Definitive Merger Agreement (DMA) or Definitive Sale	
	Agramant (DSA)	125

xiv Contents

	7.4.8 Fairness Opinion and Closing	126
	7.5 Do M&As Pay?	126
	7.5.1 Abnormal Returns	126
	7.5.2 The Role of Investment Banks	127
	7.6 Synergies	129
	7.7 Consideration	131
	7.7.1 Control	131
	7.7.2 EPS Accretion/Dilution	132
	7.7.3 Wealth Distribution	134
	7.8 Conclusion	139
	References	139
8	Risk Management in Mergers and Acquisitions	141
O		
	8.1 Introduction	141
	8.2 Differences of Opinion: Earnout	142
	8.2.1 Pros and Cons	142
	8.2.2 Earnout Valuation	143
	8.3 Contingent Value Rights	146
	8.4 Collar	147
	8.4.1 Fixed-Exchange Collar	147
	8.4.2 Fixed-Payment Collar	148
	8.4.3 The Economic Rationale of Collars	150
	8.5 Merger Arbitrage	151
	8.5.1 The Arbitrage Spread	151
	· 8.5.2 The Interpretation of the Arbitrage Spread	152
	8.6 Conclusion	153
	Reference	153
9	Hostile Takeovers and Takeover Regulation	155
	9.1 Introduction	155
	9.2 Hostile Takeovers	155
	9.2.1 Preemptive Defense	156
	9.2.2 Reactive Defense	160
	9.3 Defense Tactics and Bargaining Power	161
	9.3.1 The "Pill Premium"	161
	9.3.2 Competition	162
	9.3.3 The Cost of Hostile Takeovers	163
	9.3.4 Information Asymmetry	164
	9.3.5 Agency Costs	164
	9.4 Takeover Regulation	164
	9.4.1 The Failure of the Value-Increasing Takeover	165
	9.4.2 The Success of the Value-Decreasing Takeover	168

Contents xv

	9.5 Controlling Shareholders	169
	9.5.1 No Mandatory Bid Rule	170
	9.5.2 Mandatory Bid Rule	171
	9.6 Conclusion	173
	References	173
	icolonics	1.0
10	Corporate Restructuring	175
	10.1 Introduction	175
	10.2 Financial Distress	176
	10.2.1 A Road Map	176
	10.2.2 Workout Versus Bankruptcy	177
	10.3 Debt Restructuring	178
	10.3.1 The Holdout Problem	178
	10.3.2 Private and Public Debt	179
	10.3.3 The Role of Investment Banks	183
	10.3.4 Over-Investment and Private Benefits	185
	10.4 Stock Break-Ups	187
	10.4.1 Definitions	187
	10.4.2 Economic Rationale	189
	10.4.3 Diversification Discount	191
	10.5 Conclusion	192
	References	192
	NCICICIDES	174