INTRODUCTION TO INVESTMENT BANKING & HEDGE FUNDS

WARRINGTON COLLEGE OF BUSINESS
UNIVERSITY OF FLORIDA

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I. INVESTMENT BANKING
WHAT IS AN INVESTMENT BANK?

*While investment banks perform an array of functions, the most important are to (i) act as intermediaries between providers and users of capital and (ii) serve as advisors to parties engaged in complex corporate transactions.*

- **CORPORATE ADVISORY**
  - Investment banks provide a range of financial advisory services to operating companies, government institutions, pension funds and certain other public entities

- **CAPITAL MARKETS SERVICES**
  - Helping companies access the capital markets is a core function of investment banks
    - Taking a company public, helping it repurchase its shares and issue additional equity are all examples of Equity Capital Markets services
    - Underwriting and syndicating loans for companies, government entities and municipalities would be examples of Debt Capital Markets services

- **SALES & TRADING**
  - Investment banks also engage in the buying and selling of securities (most commonly stocks and bonds) on behalf of their clients
  - A bank’s trading “desk” executes the trading orders submitted by its clients; the orders are often pitched to the clients by the desk’s sales team

- **PROPRIETARY INVESTMENT STRATEGIES**
  - Many investment banks have their own internal alternative investment groups (i.e. private equity, hedge fund, real estate) which make principal investments using the firm’s own capital and the capital of qualified investors
  - Over the course of the last decade, proprietary investing has accounted for an increasing portion of revenue for many investment banks and has even constituted a majority in some cases
THE MAJOR PLAYERS...

<table>
<thead>
<tr>
<th>THE “BULGE BRACKET”</th>
<th>BOUTIQUES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goldman Sachs</td>
<td>Perella Weinberg Partners</td>
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<tr>
<td>Morgan Stanley</td>
<td>Lazard</td>
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<td>JPMorgan</td>
<td>Greenhill</td>
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<tr>
<td>Credit Suisse</td>
<td>Evercore</td>
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<tr>
<td>Deutsche Bank</td>
<td>Moelis &amp; Company</td>
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<tr>
<td>Merrill Lynch</td>
<td>CenterView Partners</td>
</tr>
<tr>
<td>Lehman Brothers</td>
<td>Raymond James</td>
</tr>
<tr>
<td>Citigroup</td>
<td>Bank of America.</td>
</tr>
<tr>
<td>Wachovia</td>
<td>The Blackstone Group*</td>
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</table>
## Traditional Structure of an Investment Bank

### Coverage Groups

<table>
<thead>
<tr>
<th>Financial Institutions</th>
<th>Energy &amp; Power</th>
<th>Consumer &amp; Retail</th>
<th>Real Estate</th>
<th>TMT</th>
<th>Industrials</th>
<th>Financial Sponsors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barclays</td>
<td>Xstrata</td>
<td>PricewaterhouseCoopers</td>
<td>AMB</td>
<td>Nextel</td>
<td>Hertz</td>
<td>Bain Capital</td>
</tr>
<tr>
<td>BlackRock</td>
<td>UnitedHealthcare</td>
<td>Dillard's</td>
<td>The Blackstone Group</td>
<td>Sprint</td>
<td>Ford</td>
<td>CVC Capital Partners</td>
</tr>
<tr>
<td>Nelnet</td>
<td>Hess</td>
<td>Ethan Allen</td>
<td>Clarion</td>
<td>Lamar</td>
<td>Northwest Airlines</td>
<td>The Carlyle Group</td>
</tr>
<tr>
<td>NASDAQ</td>
<td>Statoil</td>
<td>Wal-Mart</td>
<td>ColonyCapital</td>
<td>UPC</td>
<td>Domtar</td>
<td>The Blackstone Group*</td>
</tr>
<tr>
<td>Etrade Financial</td>
<td>Enterprise Products Partners</td>
<td>Whirlpool</td>
<td>R. H. Donnelley</td>
<td>Navistar</td>
<td>Universal Orlando</td>
<td>Apollo</td>
</tr>
<tr>
<td>MetLife</td>
<td>Enterprise Products Partners</td>
<td>Pepsi</td>
<td>Simon Property Group</td>
<td>MITEL</td>
<td>Harley-Davidson Company</td>
<td>KKR</td>
</tr>
<tr>
<td>Conseco</td>
<td>National City</td>
<td>Simon Property Group</td>
<td>American Express</td>
<td>Universal Orlando</td>
<td>Royal Caribbean International</td>
<td>Clayton Dubilier &amp; Rice</td>
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</table>

*The Blackstone Group*
What is M&A?

Mergers and acquisitions (M&A) encompasses a broad range of advisory services and processes…

- Buy-side advisory
- Sell-side advisory
- Leveraged buyouts / recapitalizations
- Takeover defense
- Special committee representation
- Fairness opinions
- Divestitures & spin-offs
- Joint ventures
WORKING THROUGH THE M&A PROCESS

- Prepare and distribute the offering memorandum
- Contact potential strategic and/or financial buyers
- Receive non-binding proposals / “indications of interest”
- Determine which buyers will be permitted to conduct due diligence
- Facilitate buyer due diligence and facility visits
- Receive final proposals and mark-up of agreements
- Attempt to extract additional value
- Enter into exclusive negotiations
- Execute transaction agreements and announce the deal
- Close the deal
EXAMPLE OF A SELL–SIDE ADVISORY DEAL

**MARKETING**

- Investment Bank approaches Pernod Ricard with materials proposing the sale of Dunkin Brands, parent company of Dunkin Donuts, Baskin Robbins and Togo’s Great Sandwiches
- The proposition is predicated on Pernod Ricard’s ability to make a good return by selling Dunkin Brands

**MANDATE**

- Based on Investment Bank’s credentials and agreed upon fees, Pernod Ricard selects Investment Bank to represent their financial interest and advise them on the sale of Dunkin Brands
- Investment Bank then legally represents and is obligated to get the best possible deal for Pernod Ricard shareholders
- Investment Bank will ultimately need to determine what is a “fair” value for Dunkin Brands and justify this with multiple valuation methodologies

**SALE PROCESS**

- Investment Bank escorts potential buyers to visit both established and emerging markets for Dunkin Brands
- Facilitates access to top management
- Provides corporate and financial information to potential buyers to aid in the sale process
- Keeps the identity of potential bidders confidential to preserve the integrity of the process, and ensure the best deal for shareholders

**CLOSING THE DEAL**

- Investment Bank advises the client on the best of the available bidders and orchestrates the terms of the deal
- After various stages of negotiation, potential regulatory approvals and attorney review, the deal is announced
- Following final approvals, legal documentation and court authorization, the deal is closed

**Engagement – “Mandate”**

**Sale Process – “Marketing”**

**“Closing the Deal”**
WHO COMPRISES AN M&A DEAL TEAM?

The size and composure of a deal team will vary across firms and often depends on the magnitude and scope of the project.

<table>
<thead>
<tr>
<th>Role</th>
<th>Responsibilities</th>
<th>Experience/Qualifications</th>
</tr>
</thead>
<tbody>
<tr>
<td>MANAGING DIRECTOR</td>
<td>Most senior banker on the team focusing primarily on advising the CEO and Board of Directors</td>
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<tr>
<td></td>
<td>Typically has at least 10-15 years of banking experience and often has an MBA or JD</td>
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<tr>
<td>DIRECTOR / VICE PRESIDENT</td>
<td>Responsible for leading the execution of the deal and managing the internal team</td>
<td></td>
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<tr>
<td></td>
<td>May have 3-10 years of banking experience and often has an MBA or JD</td>
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<tr>
<td>ASSOCIATE</td>
<td>Responsible for overseeing and checking the analytics and production of work product</td>
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<tr>
<td></td>
<td>May have 0-5 years of banking experience and often has an MBA or JD</td>
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<tr>
<td>ANALYST</td>
<td>Responsible for driving the analytics and production of work product on a deal</td>
<td></td>
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<tr>
<td></td>
<td>Typically a 2-3 year track beginning directly after undergraduate studies</td>
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WHAT A SENIOR INVESTMENT BANKER DOES

Senior bankers manage relationships with business leaders all over the world and are primarily responsible for generating business for their firms.

- **GENERATES IDEAS**
  - Strategic and financial solutions to help clients meet their objectives and enhance shareholder value
  - Help clients execute on their corporate strategy either through M&A activity, recapitalizations or operational and financial restructuring

- **SERVES AS A SOUNDING BOARD FOR EXECUTIVES AND BOARDS OF DIRECTORS**
  - Assist CEOs and other corporate leaders in the planning and exploration of their strategic initiatives
  - Make introductions between various executives and business leaders
  - Evaluate the fairness of corporate actions and transactions

- **EXECUTES TRANSACTIONS / DEALS**
  - Mobilize resources internally and externally to help clients consummate mergers, acquisitions, divestitures, joint ventures, recapitalizations and other corporate actions
  - Manages confidentiality and integrity of processes

- **MARKETING / BUSINESS DEVELOPMENT**
  - Pitches ideas to new clients
  - Develops network and relationships
  - Represents firm in global leadership forums
WHAT AN INVESTMENT BANKING ANALYST DOES

*While Analysts are primarily tasked with constructing and presenting financial analysis, the responsibility set of an Analyst is essentially boundless.*

- **FINANCIAL ANALYSIS**
  - Building financial models
    - Works with the client to develop projections for a business
    - Examine the merits of a transaction by assessing potential impact on the acquiror’s earnings (“Accretion / (Dilution)”)) or forecasting potential returns (Internal Rate of Return (“IRR”))
    - Examine the impact on a company’s stock price resulting from a variety of initiatives
  - Valuation
    - “Ability to pay” analysis
    - Intrinsic valuation of the cash flows of a company or an asset
    - Implied value based on current market trading multiples
    - Implied value based on precedent comparable transactions

- **PRESENTATIONS / MARKETING / BUSINESS DEVELOPMENT**
  - Board materials
  - Pitch books

- **WORK...A LOT OF IT**
HELPFUL RESOURCES ON THE INVESTMENT BANKING INDUSTRY

▪ BOOKS
  – Barbarians at the Gate (Bryan Burrough)
  – Den of Thieves (James B. Stewart)
  – Monkey Business (Peter Troob & John Rolfe)
  – The Accidental Investment Banker (Jonathan Knee)
  – Blue Blood & Mutiny (Patricia Beard)
  – Liar’s Poker (Michael Lewis)

▪ WEBSITES
  – FierceFinance (www.fiercefinance.com)
  – Dealbreaker (www.dealbreaker.com)

▪ OTHER PUBLICATIONS
  – The Wall Street Journal
  – Financial Times
  – The Economist
  – DealMaker Monthly
  – The Deal
II. HEDGE FUNDS
BACKGROUND ON THE DEVELOPMENT OF HEDGE FUNDS

- A hedge fund is a private, unregulated pool of capital with few restrictions on how it can manage its funds
  - Structured as a limited partnership and available only to “qualified investors”
  - Charges both a management and performance fee on capital which is typically subject to a lockup period of several years
- The original hedge fund niche was merger arbitrage in the 1990s
  - Hedge funds really built their names (good and bad) between 1999 and 2002 through distressed debt investing
- Since that time, hedge funds have increased dramatically in terms of size and numbers while broadening their remit
  - Today there are more than 1,000 hedge funds with more than $100 million under management
  - The largest hedge funds each have more than $15 billion under management
- These funds are interesting and powerful in that there is no expiry on the funds (such as the 5-10 year limit private equity firms have) and the mandate for investing is virtually unlimited (debt/equity, public/private, US/global, long/short)
EVOLUTION OF HEDGE FUNDS

1990
Merger
Arbitrage/
Public Debt
and Equity

1995
Block
Equity
Trades

2000
Distressed
Debt

2005
Highly
Levered
Capital
Structures

Results

- More liquidity in the markets
- More efficient markets
- Ability for banks to deliver larger more complex transactions
- Solution for troubled companies
- More companies saved
- Negative reputational issues
- Sponsors begin to see value of hedge funds
- Parity between risk and return
- Further move away from “normal” institutional investors
- New alternative for private equity solutions
- Sponsors fearful of their development
HEDGE FUND STRATEGIES

Alternative Investments

Private Equity  Hedge Funds  Venture Capital  Real Estate

Relative Value  Event Driven  Equity Long/Short  Tactical Trading

Convertible Arbitrage  High Yield/ Distressed Debt  Diversified  Global Macro

Equity Arbitrage  Special Situations  Geography  Managed Futures

Capital Structure Arbitrage  Merger Arbitrage  Industry/ Sector  Fund-of-Funds

Multi-Strategy

Strategies
HEDGE FUND INVESTMENT STRATEGIES

MULTI-STRATEGY

- Dynamically allocate capital among several strategies across the entire capital structure in an effort to achieve non-correlated/market-neutral returns
  - Perry Capital
  - Citadel
  - Och-Ziff
  - Highbridge
  - DE Shaw
  - Eton Park

MACRO

- Involves investing by making leveraged bets on anticipated price movements of stock markets, interest rates, foreign exchange, and commodities
  - Moore
  - Duquesne
  - Caxton
  - Soros

EQUITY LONG / SHORT

- Equity oriented investing on both the long and short sides of the market. Overall objective is not to be market neutral
  - SAC Capital
  - Lone Pine
  - Viking
  - Maverick
  - Greenlight
  - Glenview

DISTRESSED / CREDIT

- Invest in debt, equity or trade claims of companies in financial distress or already in default. These securities often trade at substantial discounts to par value
  - Appaloosa
  - Cerberus
  - Fortress
  - Oaktree
HELPFUL RESOURCES ON THE HEDGE FUND INDUSTRY

- **BOOKS**
  - When Genius Failed (Roger Lowenstein)
  - Hedge Hogging (Barton Biggs)
  - The Black Swan (Nassim Taleb)
  - Hedge Hunters (Katherine Burton)

- **WEBSITES**
  - New York Times’ Dealbook (dealbook.blogs.nytimes.com)
  - FierceFinance (www.fiercefinance.com)
  - TheStreet.com (www.thestreet.com)

- **OTHER PUBLICATIONS**
  - The Wall Street Journal
  - Financial Times
  - The Economist
  - Trader Monthly
APPENDIX: THE WARRINGTON YOUNG ALUMNI COUNCIL
The Warrington Young Alumni Council was founded to (i) inform and expose Warrington undergraduates to the full spectrum of careers available to top students every year (ii) promote the virtues of the Warrington College of Business to leading companies around the world and (iii) facilitate the transfer of knowledge and professional experience from Warrington young alumni back to the students, faculty and administration at the College.

- The Warrington Young Alumni Council is comprised of young professionals that graduated from the College within the last ten years who, in their professional capacity, span an array of careers, industries and geographies
  - The Warrington Young Alumni Council is committed to helping undergraduates expand their professional opportunity sets by exposing them to a wide breadth of careers and opportunities

- Through on-campus presentations and panel discussions as well as online resources, the Warrington Young Alumni Council intends to promote the sharing of knowledge, resources and personal experiences with the students, faculty and administration at Warrington
  - The Council’s website contains a variety of useful links, reference materials and other resources to help undergraduates assess their career options and make informed decisions about what they would like to pursue professionally

- The members of the Council firmly believe that Warrington undergraduates are capable of being professionally successful at the highest levels of business and should be given every opportunity possible to achieve their professional goals directly out of school