Equity Capital Markets

Interview preparation summary · IB track

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INT.BE.1.a · Going public

Judge whether a company should list and is ready to, weighing the reasons, the costs and the readiness tests an ECM banker applies.

A company lists to raise primary capital, give shareholders an exit through secondary sales, create a currency for acquisitions, build a profile with customers and staff, and set a market price for incentives. The costs are real: underwriting fees of roughly 2% to 4% of proceeds, legal and other costs, ongoing reporting, disclosure of strategy and pay, short-term scrutiny and loss of privacy. An ECM banker tests readiness on five things. An equity story that explains growth and returns in a few lines. A credible audited track record, usually three years. A board and governance structure suited to a public company, with independent directors and committees. A management team able to forecast and guide. Enough free float and trading liquidity to interest institutions. The usual mistake is to answer only with the benefits. A strong answer also says when to wait: weak numbers, a pending restructuring, or a business that does not need outside capital.

WORKED EXAMPLE: IS HARLOW DYNAMICS READY, AND WHAT DOES THE IPO DO TO LEVERAGE?

Harlow Dynamics is an invented engineering group with EBITDA of 80m and net debt of 280m. It plans a primary IPO raising 120m gross, with underwriting fees of 3.0% of gross proceeds and other costs of 2.4m. Post-deal equity value is 500m. Assume all net proceeds repay debt, ignore tax and the interest saved, and compute the net proceeds, the new leverage and the share of the company sold.

Answer: Net proceeds are 114.0m, leverage falls from 3.5x to about 2.1x and new investors would hold 24%. The deal is sensible if the track record, governance and equity story pass the readiness tests.

> **Interview tip:** Give the reason to list, the cost, then the readiness tests, and finish with a view. Quote leverage before and after so the answer shows what the money does for the company.

INT.BE.1.b · Going public

Walk through the IPO process from pre-IPO to allocation, say who does what, and read an order book to set the offer price and its coverage.

An IPO runs in stages. Before launch the banks win the mandate, the company does legal, financial and commercial diligence, and analysts publish early research. At the intention to float the company announces its plan and a price range follows once the prospectus is approved. A roadshow of one to two weeks meets institutional investors, who place orders in a bookbuild at prices within the range. The bookrunners then price, allocate shares, and trading starts. Coverage is total demand at a price divided by shares offered. Banks look at quality as well as quantity: long-only holders with stable positions are preferred to hedge funds who may sell on day one. The usual mistake is to price at the highest level that clears. A strong answer also protects aftermarket trading, because a falling share price harms the issuer and the bank.

WORKED EXAMPLE: READING THE CALDER MARINE BOOK

Calder Marine is an invented shipping services group. It offers 40m shares in a range of 4.00 to 4.80. The bookrunners show cumulative demand at or above each price: 24m shares at 4.80, 38m at 4.60, 62m at 4.40, 90m at 4.20 and 120m at 4.00. Find the highest price at which the deal is fully covered, the coverage there and the gross proceeds, and say what else you would check before recommending it.

Answer: Price at 4.40, where the book is 1.55x covered and raises 176.0m gross. Test the quality of the demand before confirming, because cover alone does not protect the aftermarket.

> **Interview tip:** Quote coverage at each level of the range and name the price where it first drops below 1.0x. Say that you would allocate to long-term holders to support trading.

INT.BE.1.c · Going public

Set an IPO offer price using peers and the IPO discount, and work out the greenshoe, stabilisation and lock-up consequences.

Bankers value the company on trading comparables and a DCF, then set the offer price below fair value by the IPO discount, often 10% to 20%. The discount pays new investors for taking a first-time issuer with limited trading history and leaves room for a first-day gain. The greenshoe, or over-allotment option, lets the banks sell up to about 15% more shares than the base deal and buy them back from the company at the offer price within 30 days. If the share price falls, the stabilising bank buys shares in the market to cover its short position, which supports the price. If it rises, the bank exercises the option and the company raises more. Lock-ups stop insiders selling for typically 90 to 180 days. The usual mistake is to treat the discount as a cost to the bank. It is a cost to the selling shareholders.

WORKED EXAMPLE: PRICING BRINDLE FOODS WITH A GREENSHOE

Brindle Foods is an invented food group. Peer valuation gives a fair value of 5.00 a share. The banks apply an IPO discount of 12%, sell a base deal of 40m new shares and over-allot a further 15%. Find the offer price, the proceeds with and without the greenshoe, and the stabilisation result if the price falls to 4.30 and the banks buy back the over-allotted shares.

Answer: The offer price is 4.40. Proceeds are 176.0m, or 202.4m if the greenshoe is used in full. If the price falls to 4.30, the banks buy back 6m shares for 25.8m and the option lapses.

> **Interview tip:** Say that the greenshoe works in both directions: a weak market means the banks buy shares and support the price, a strong market means the company raises more.

INT.BE.2.a · After the IPO and other products

Choose between a follow-on, rights issue, accelerated bookbuild and block trade for a listed issuer, and compute the theoretical ex-rights price.

A listed company can raise equity in several ways, and the choice depends on size, speed, discount and who bears the risk. A marketed follow-on takes days or weeks and gives wide investor reach. An accelerated bookbuild (ABB) runs overnight, usually at a discount of about 2% to 5% to the last close, and suits sizes up to roughly 10% to 15% of the company. A block trade sells an existing holder's shares quickly and raises nothing for the company. A rights issue offers new shares to existing holders in proportion to their holdings at a deeper discount and is underwritten, so it suits large raises and keeps pre-emption rights intact. The theoretical ex-rights price (TERP) is the weighted average of the old share price and the issue price. The usual mistake is to think the rights discount is a loss: it is offset by the value of the right.

WORKED EXAMPLE: RIGHTS ISSUE AT FENWICK COMPONENTS

Fenwick Components is an invented listed company with 100m shares at 5.00. It raises 120m through a rights issue at 4.00 a share. Find the number of new shares, the terms, the TERP, the value of one right per new share and the issue price discount to TERP. Ignore costs.

Answer: There are 30m new shares on a 3 for 10 basis. The TERP is 4.77, each right is worth 0.77 per new share, and the issue price is 16.1% below the TERP.

> **Interview tip:** Show the weighted-average arithmetic aloud, then say why the product fits the size and who bears the market risk.

INT.BE.2.b · After the IPO and other products

Explain how a convertible bond works, price its conversion terms and compare its cost and dilution with straight debt and a share sale.

A convertible bond is a bond that holders can exchange for shares at a fixed conversion price, usually set 25% to 40% above the share price at launch. The investor accepts a low coupon for the right to share in upside. The issuer pays less interest, pushes dilution into the future, and raises funds with less pressure on the share price than a direct share sale. Parity is the value of the shares received on conversion, and the bond usually trades above parity while there is time to run. The costs are a bond that may be repaid in cash if shares do not rise, and dilution if they do. Hedge funds buy convertibles and short the shares, so issuance can depress the stock on launch day. The usual mistake is to call the coupon saving free. The saving is paid for with dilution.

WORKED EXAMPLE: A CONVERTIBLE FOR ASHGROVE POWER

Ashgrove Power is an invented company with 200m shares at 10.00. It issues a 200m five-year convertible with a 1.5% coupon and a 30% conversion premium. A straight bond would cost 5.5%. Find the conversion price, the new shares on full conversion, the dilution, the annual interest saving and the parity if the share price reaches 14.00.

Answer: The conversion price is 13.00. Full conversion issues 15.4m shares, which is 7.1% dilution, in return for 8.0m a year lower interest. Parity at 14.00 is 107.7.

> **Interview tip:** Link the coupon saving to the option the issuer sells. Say that the cost shows up either as cash repayment or as dilution, never as nothing.

INT.BE.2.c · After the IPO and other products

Judge the dilution and use of proceeds of an equity raise and read market conditions, investor mix and the window the way an ECM desk does.

Investors judge an equity raise by what the money does. Dilution is the new shares as a share of the enlarged company. Earnings per share (EPS) usually falls when the proceeds repay cheap debt, because the issuer sells shares at its earnings yield, which is earnings per share divided by price, and saves only the after-tax interest rate. The raise is accretive if the use of proceeds earns more than the earnings yield, for example a well-priced acquisition. The ECM desk reads the window through volatility, recent deal performance, index levels, sector flows and the calendar around results and holidays. It also tracks investor mix: long-only funds anchor a deal, hedge funds add speed and price sensitivity. The usual mistake is to chase the window and issue at any price. A strong answer weighs delay against the discount.

WORKED EXAMPLE: THE EPS EFFECT OF A FOLLOW-ON AT MARLOW SYSTEMS

Marlow Systems is an invented company with 250m shares at 8.00 and earnings of 150m. It sells 50m new shares at 8.00 for 400m gross, pays fees of 2.5%, and repays debt costing 6.0% before tax. The tax rate is 25%. Find the dilution, the EPS before and after, and say why EPS falls.

Answer: Dilution is 16.7% and EPS falls from 0.60 to 0.559, or 6.9%, because the 7.5% earnings yield on new shares exceeds the 4.5% after-tax cost of the debt repaid.

> **Interview tip:** Compare the earnings yield of the shares sold with the return on the use of proceeds. That one comparison shows whether the raise helps or hurts EPS.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.