CHARTA LEARNING · INTERVIEW PREPARATION

# Investment Banking Fundamentals and the Deal Process

Interview preparation summary · IB track

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INT.BK.1.a · How a bank works

**Describe how an investment bank is organised into coverage, product, middle and back office, and explain how coverage and product bankers work together on a client.**

An investment bank is organised on two axes. Coverage bankers are grouped by industry or region and own the client relationship: they know the chief financial officer, track the client's strategy and bring ideas. Product bankers specialise in a type of transaction, such as mergers and acquisitions (M&A), equity capital markets (ECM), debt capital markets (DCM) and leveraged finance, and they execute. Sales and trading serves investors rather than corporate clients. Behind the front office, the middle office (risk, compliance, finance control) checks what the front office does, and the back office (operations, settlement, technology) records and settles it. A good answer shows how the axes combine: coverage decides which idea fits the client and when to raise it, product sizes and prices it, and the middle office decides whether the bank may do it. The common mistake is to describe divisions as separate businesses, when most large mandates need coverage and two or three product teams working together.

WORKED EXAMPLE: WHICH PRODUCT GROUPS JOIN THE CONVERSATION?

Marlowe Packaging, an invented client, has EBITDA of 140m and net debt of 280m. Its chief financial officer tells her coverage banker that Marlowe wants to buy Tessing Films, an invented target with EBITDA of 60m, for an enterprise value of 640m. Marlowe would fund it with debt and cash on hand. Work out the pro forma leverage, and say which product groups the coverage banker should bring in. Convention: the target is bought cash-free and debt-free, ignore synergies, fees and tax, and treat cash used as an increase in net debt.

**Answer:** Pro forma net debt to EBITDA is 4.6x, up from 2.0x. The coverage banker brings in M&A for the acquisition, DCM and leveraged finance for the debt, ECM for a possible equity component, and clears conflicts and credit limits first.

> **Interview tip:** Say who owns the client (coverage), who executes (product) and who must approve (middle office), and let a number such as 4.6x explain why each team is in the room.

INT.BK.1.b · How a bank works

**Explain how an investment bank makes money from advisory fees, underwriting, trading and lending, and how the risk and capital use of each differs.**

A bank earns money in four main ways, and each carries a different risk. Advisory fees on mergers and acquisitions (M&A) are earned for advice and execution, usually a retainer plus a success fee paid on completion. Advisory work uses little capital but falls sharply when deal volume drops. Underwriting earns a gross spread, the gap between the price paid to the issuer and the price at which securities are sold to investors, and the bank risks its capital between buying and selling. Trading earns the bid-offer spread and gains on inventory, and carries market risk. Lending earns interest and fees, uses the balance sheet and needs regulatory capital. Fee income is cyclical and capital-light, while trading and lending are steadier but capital-hungry. Pay is the largest cost and flexes with revenue. Interviewers want the mix and the line that suffers in a downturn. The common mistake is to say banks make money by doing deals, without separating advice from risk-taking.

**WORKED EXAMPLE: ONE DEAL, THREE FEE STREAMS**

Marlowe Packaging (invented) buys Tessing Films for an enterprise value of 640m. Its bank charges an advisory fee of 0.75% of enterprise value, underwrites a 400m bond for a gross spread of 0.60%, and arranges a 150m bridge loan with a 0.50% arrangement fee. Work out the bank's fees from each stream, the total, and the share that comes from advice rather than from taking risk. Convention: fees are earned in full, ignore the interest on the bridge loan, and treat underwriting and lending as the risk-taking streams.

**Answer:** Fees are 4.8m for advice, 2.4m for underwriting and 0.75m for the bridge, a total of 7.95m. Advice is 60.4% of the total, and the remaining 39.6% comes from fees linked to risk-taking.

> **Interview tip:** Give each stream its fee, then say which streams use capital. Saying 60% of the fee came from capital-light advice shows you understand why banks value advisory income.

INT.BK.1.c · How a bank works

**Read a league table, say what it does and does not measure, and describe what each level of a deal team from analyst to managing director is accountable for.**

A league table ranks banks by the value or number of transactions they worked on in a period, by product, for example announced M&A or bond underwriting. Providers publish them and differ on three rules: whether each adviser gets the full deal value or a split, whether the date is announced or completed, and which deals count. So a bank can be first on one measure and third on another. Banks use rankings in pitches as evidence of experience, but a table measures volume, not fees, profit or quality. A deal team is a pyramid. The analyst builds models and pages and must be accurate, and the associate manages the workstream and checks the analyst. The vice president runs the process day to day, the director holds the client link, and the managing director owns the relationship and the judgement. A good answer says what each level is accountable for and where an analyst adds most value: accuracy, speed and attention to detail. The mistake is to treat a ranking as proof of quality.

**WORKED EXAMPLE: WHY THE RANKING CHANGES WITH THE RULE**

Four invented deals are advised by three invented banks. Deal 1, 800m, is advised by Bank X and Bank Y. Deal 2, 300m, by Bank X alone. Deal 3, 500m, by Bank Y and Bank Z. Deal 4, 200m, by Bank Z alone. Rank the banks when each adviser receives the full deal value, and again when the value is split equally between advisers. Give each bank's share of total deal value under the split method. Convention: all deals are announced in the same period.

**Answer:** Under full credit the ranking is Y (1,300m), X (1,100m), Z (700m). Under split credit it is X (700m), Y (650m), Z (450m), with shares of 38.9%, 36.1% and 25.0%. The method decides who is first.

> **Interview tip:** Say which rule you are using before quoting a rank, and add that a ranking measures volume and not fees or quality. That shows you will not overstate a credential in front of a client.

INT.BK.2.a · A deal from pitch to close

**Explain what a pitch is for, what an engagement letter fixes, and how a sell-side fee with a retainer, a tiered success fee and a tail works.**

A pitch is a bank's case for being hired. The pitch book is a short deck that shows the bank's understanding of the client's situation, a view on strategy or value, relevant experience, a proposed process and team, and the fee. If the client chooses the bank, the two sign an engagement letter. It sets the scope, the exclusivity, the fee, expenses, a tail period and an indemnity. The fee is often a monthly retainer, credited against a success fee paid only on completion, and the success fee may be tiered so the percentage rises with price. The tail lets the bank still earn its fee if the client later completes a deal with a party the bank introduced. Interviewers ask about this to test whether you see that fees are contingent, that most pitches are lost, and that unpaid work is part of the model. The usual mistake is to treat the pitch as a brochure and not as a point of view backed by numbers.

**WORKED EXAMPLE: PRICING A SELL-SIDE ENGAGEMENT**

Aldern Components (invented) hires a bank to sell its business. The engagement letter has a retainer of 50k a month for six months, credited against the success fee, and a success fee of 1.0% of enterprise value up to 200m and 1.5% on any value above 200m. The sale completes at an enterprise value of 340m. Work out the success fee, the total fee, the amount due at completion and the effective fee rate, and say what the bank earns if the sale fails. Convention: retainers are paid for six full months and ignore expenses, tax and VAT.

**Answer:** The success fee is 4.1m, of which 0.3m has already been paid as retainer, so 3.8m is due at completion. The effective rate is 1.21%. If the sale fails, the bank earns only the 0.3m retainer.

> **Interview tip:** Say that the fee is contingent, that the tiers reward a higher price, and that the retainer only covers part of the work. Naming the tail shows you know the bank protects itself against a client who ends the mandate and then does a deal with a buyer the bank found.

**INT.BK.2.b · A deal from pitch to close**

### Describe a two-round sale process from teaser to final bids, and compare bids on price, certainty, conditions and timing, not on headline price alone.

After the mandate, the sell-side team prepares a teaser, an information memorandum, a buyer list and a timetable. Buyers sign a non-disclosure agreement before they receive the memorandum. The process letter tells bidders what to submit and when. In round one, buyers submit non-binding indicative bids. A shortlist then gets the data room, a management presentation and time for due diligence, and submits final binding bids with a marked-up sale agreement. The bank compares bids on much more than headline price: certainty of funding, conditions such as regulatory approval, the form of consideration, deferred or contingent payments, timing, and the treatment of employees and customers. Competition is the seller's main protection, so a good process keeps at least two bidders alive until signing. The bank also controls disclosure so that the data room is complete and consistent. The usual mistake is to rank bids on headline price and to forget how likely each is to close.

**WORKED EXAMPLE: SIZING THE BUYER LIST**

A bank is selling Brindle Labs (invented) in a two-round auction. From experience, 50% of the parties contacted sign a non-disclosure agreement, 50% of those submit a first-round bid, one third of first-round bidders are shortlisted, and two thirds of the shortlist submit a final bid. The team wants three final bids so that competitive tension survives if one drops out. How many parties must it contact, and what does it get from a list of 36? Convention: use these rates as expected values and round up to whole parties.

**Answer:** The team should contact about 60 parties to expect three final bids. A list of 36 would give only about two.

> **Interview tip:** Work back from the number of final bids you want, and then say that you would add credible buyers, not volume. This shows you see a process as a funnel with competition as the goal.

**INT.BK.2.c · A deal from pitch to close**

### Explain the steps from signing to closing, build a funds flow, and describe how information barriers and conflict checks protect clients and the bank.

Signing is when the parties sign the sale and purchase agreement and fix the terms. Closing, or completion, is when ownership and cash change hands, often weeks or months later because conditions must be met first, such as regulatory approval, financing or shareholder votes. Between the two, the seller usually must run the business in the ordinary course. At closing a funds flow memorandum lists every payment: the equity price to the sellers, the repayment of the target's debt, and fees. Throughout, the bank must protect confidential information. Information barriers separate teams that hold inside information from those that trade or advise others, and a person is brought across only on a need-to-know basis with compliance approval. A conflict arises when the bank's duties to two clients, or its own interests, pull apart, and it must be cleared before work begins. Interviewers want you to say that these checks come early and not at the end. This is general education, and rules differ by jurisdiction.

### WORKED EXAMPLE: A FUNDS FLOW AT CLOSING

Harrow Mills (invented) is bought for an enterprise value of 420m on a cash-free, debt-free basis. It has net debt of 90m, which is repaid at closing. The buyer's advisory fee is 1.0% of enterprise value and its legal and other costs are 2.5m. The buyer funds the deal with a new term loan of 280m and the rest from its own cash. Work out what the sellers receive, the total uses and the buyer's own cash needed.

**Answer:** Sellers receive 330m, lenders are repaid 90m and fees are 6.7m, so total uses are 426.7m. With a 280m term loan, the buyer needs 146.7m of its own cash.

**Interview tip:** Say that sources equal uses, and that a funds flow is checked line by line by several people. This shows the accuracy a deal team needs.

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