

**Global Banking
&
Capital Markets
REVIEW I**

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What is Global Banking and Capital Markets?

The International Financial Markets

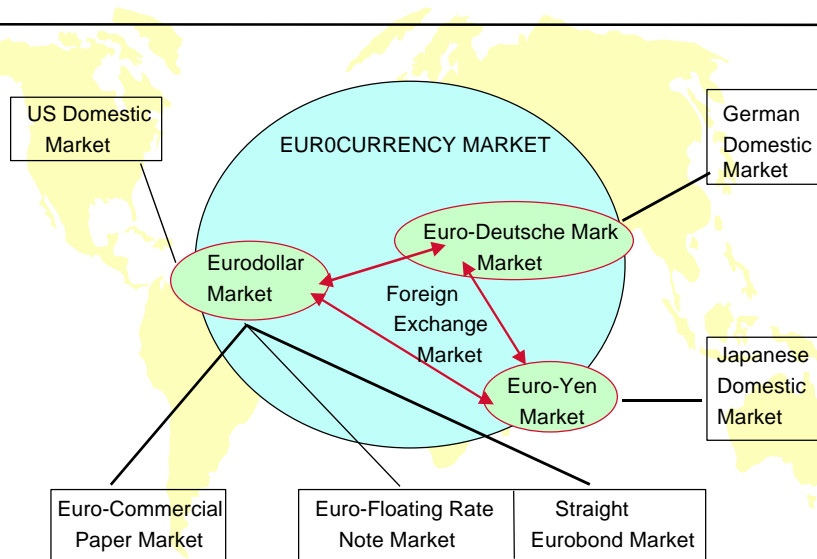
- ◆ Money and foreign exchange; derivatives; international bonds & equities; loan trading
- The Global Banking Business
 - ◆ Lending; trading and transactions; underwriting; M&A; project financing; asset management; advisory services; etc

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What are the Global Financial Markets?

- The Foreign Exchange Market
- Domestic and International Money Markets
- Domestic and International Capital Markets
- The Derivatives
- International Equity and M&A
- Using the Global Capital Markets: Global Banking Strategy and Implementation

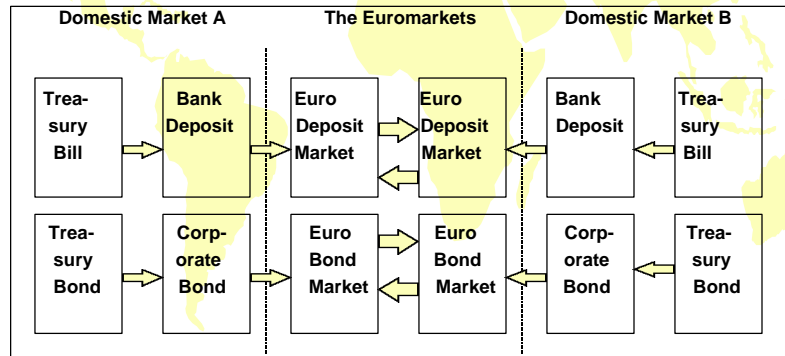
Where the Eurocurrency Market Fits In



Interest Rate Linkages in the International Money Market

Two stories to tell:

- Domestic vs. Euro
- Eurocurrency A vs. Eurocurrency B

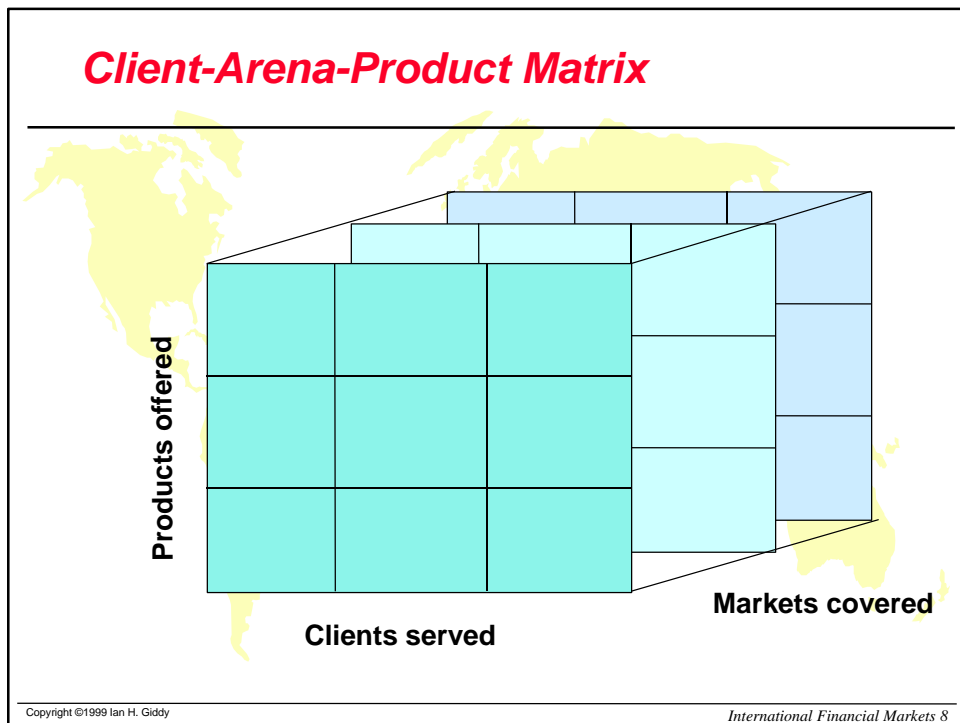
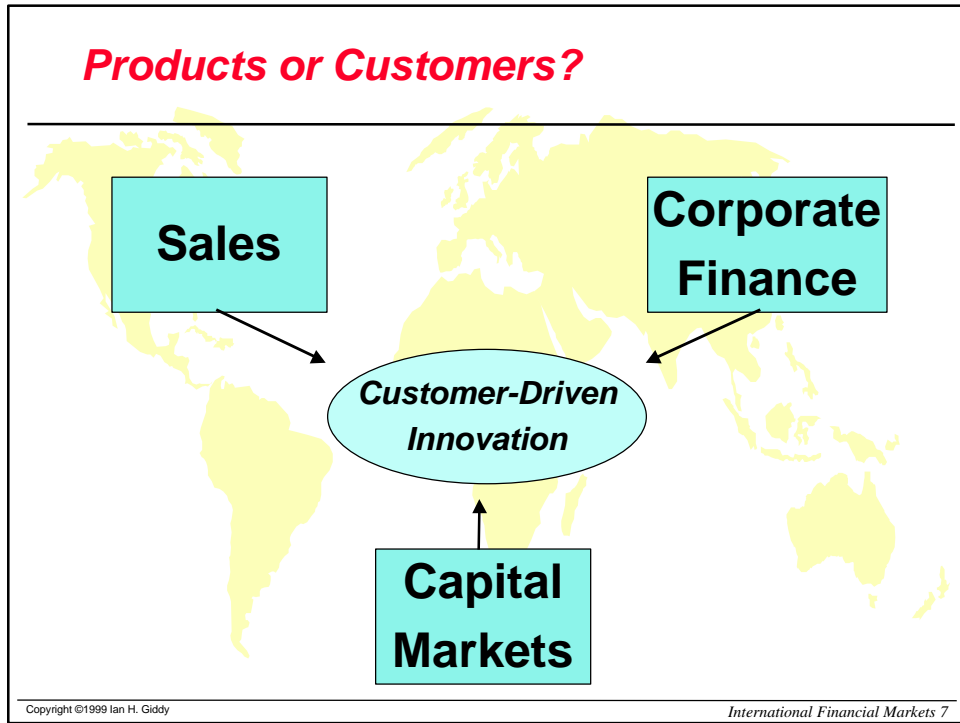


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Global Banking: Products and Customers

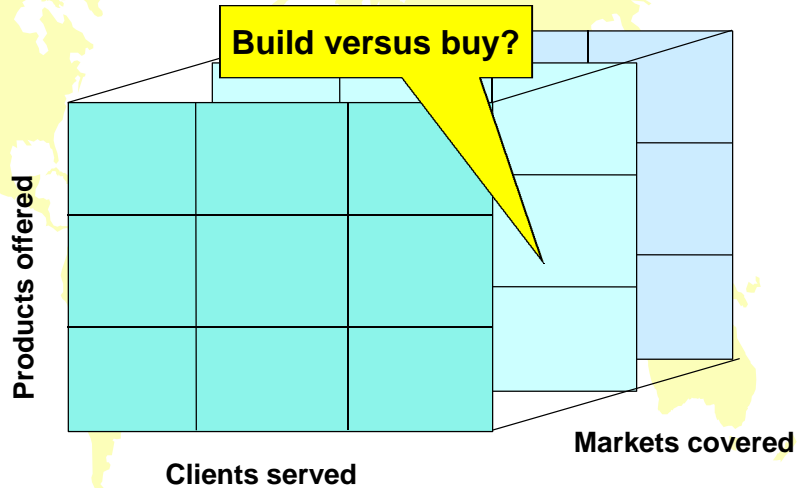
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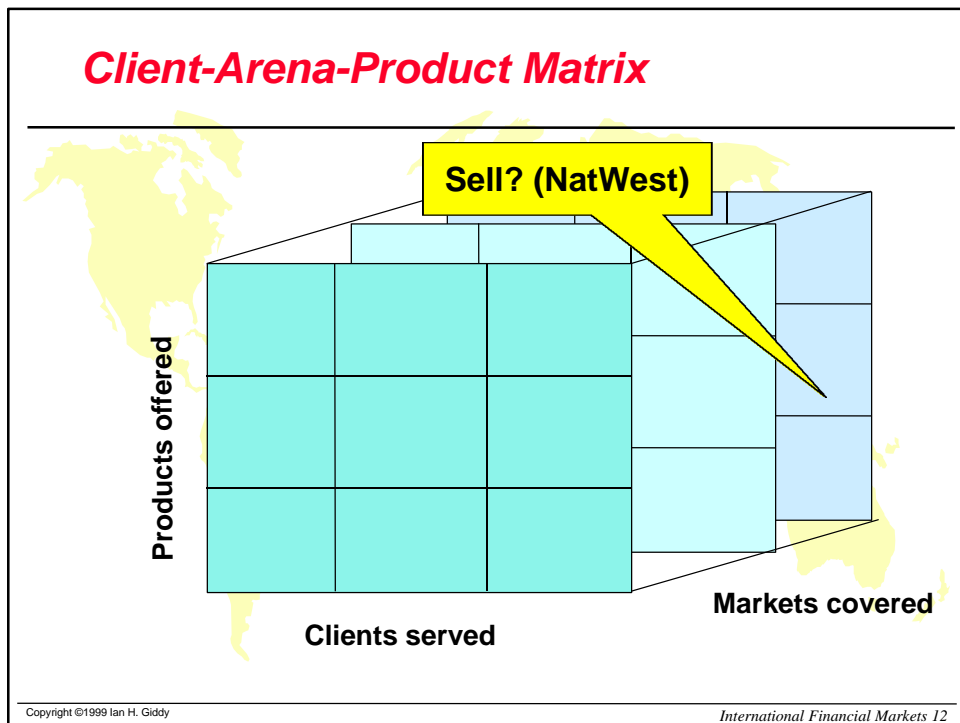
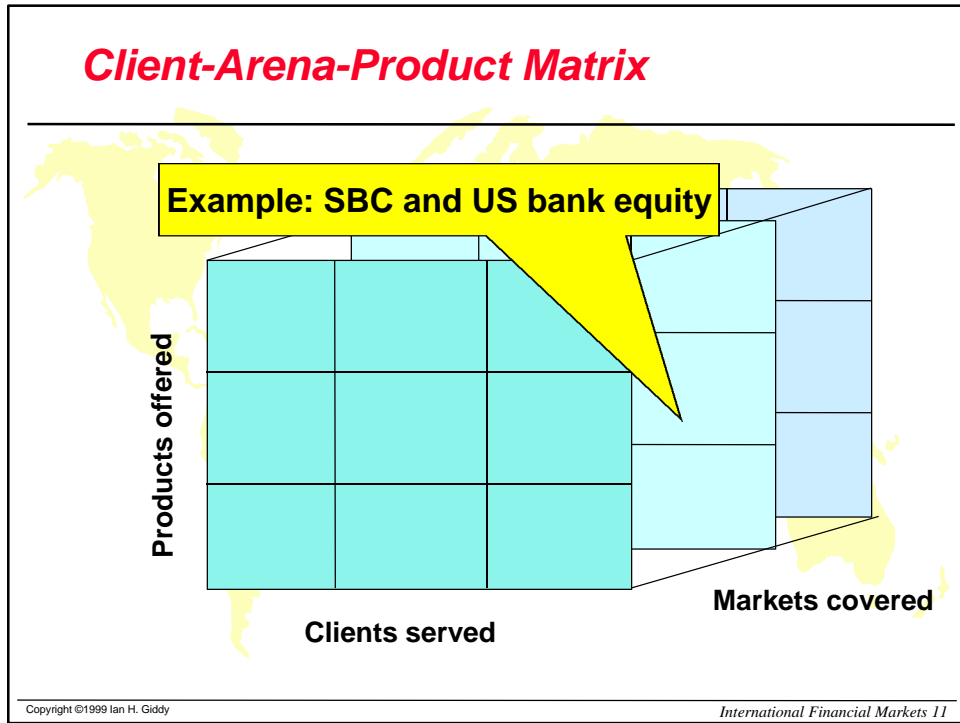


Products

- Credit products
- Trading and positioning
- Risk management products
- Financial engineering and structured finance
- Underwriting and distribution
- Asset management
- Retail and private client services
- Transactions services

Client-Arena-Product Matrix





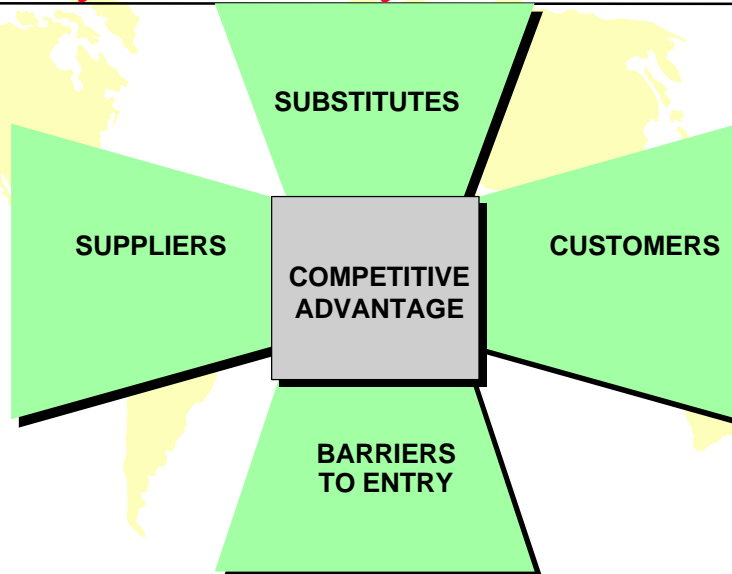
NatWest Bank?

NatWest Bank	Clients				
	Corporations	Government	Institutions	High net worth	Retail
Products					
Securities custody	x		x		
Asset Management	x		x		x
Private Equity	x				
Insurance	x				x
Lending	x		x	x	x
Deposits	x		x	x	x
Securitization/Structured and Project Finance	x		x		
Equity underwriting					
Bond underwriting					
Mergers and Acquisitions					
Credit cards	x			x	x
Trading					
- Money market	x		x		
- FX and derivatives	x		x		
- Interest rate derivatives	x		x		
- Bonds	x		x		
- Securitized products	x		x		
- Futures	x		x		
Mortgages					x
Stock brokerage	x				x
Corporate Advisory	x				
Private Banking				x	

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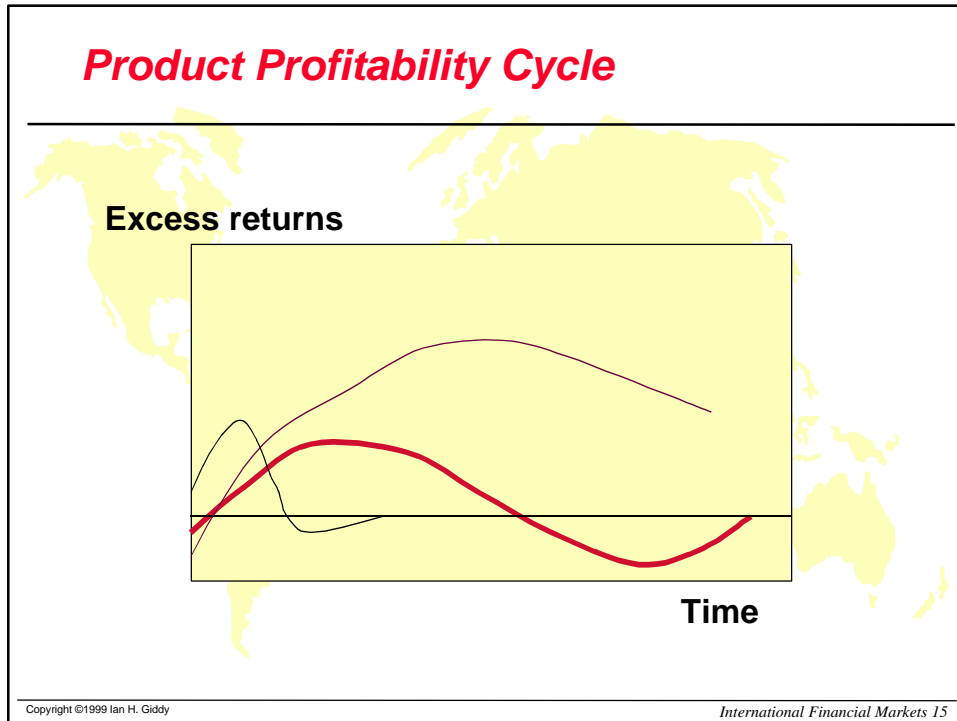
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To Succeed, Analyse the Industry Structure



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- ### **New Financial Products: Economics of Financial Innovation**
- Certain kinds of *market imperfections* allow hybrids to flourish
 - But innovation are readily copied; so only certain kinds of *firms* can profit from innovations.
 - There is a product cycle and profitability cycle of innovations.
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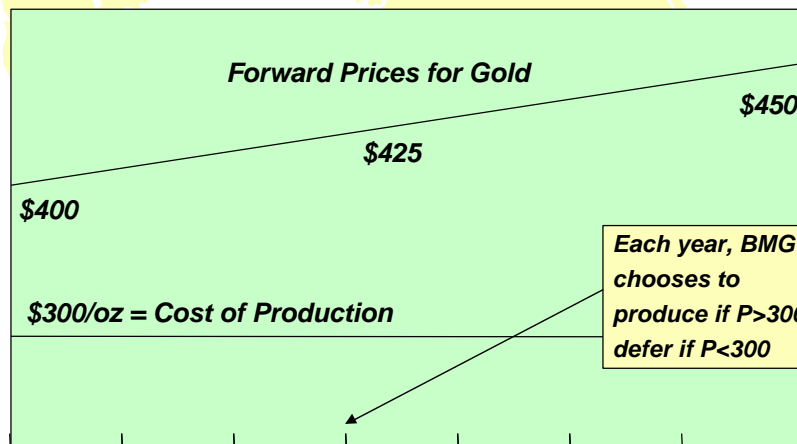
Financial Innovations: What to Look For

- Reallocating risk
- Increasing liquidity
- Reducing “agency costs”
- Reducing transactions costs
- Reducing issuers’ or investors’ taxes
- Circumventing regulations
- Circumventing internal constraints

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Battle Mountain Gold



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Principles of Innovation Through Financial Engineering

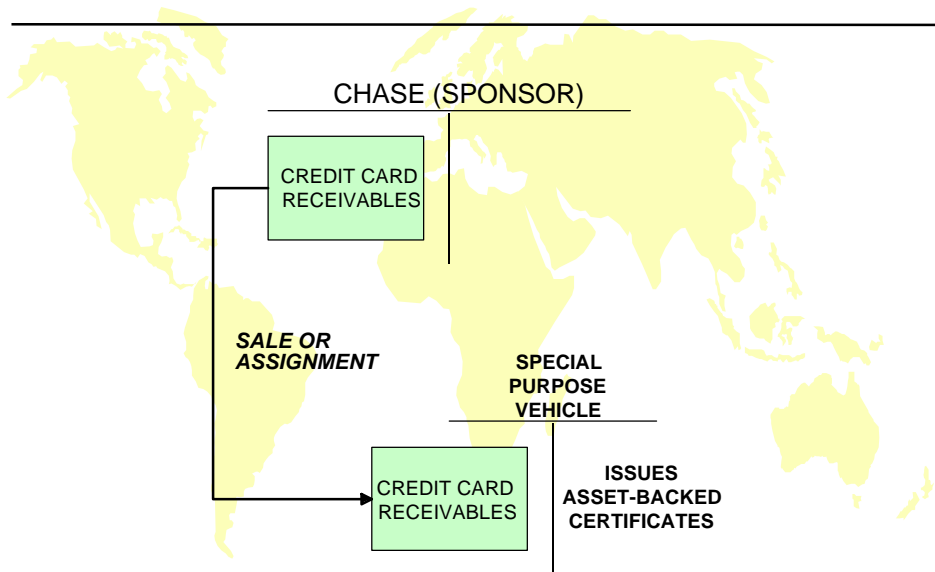
- Bundling and unbundling basic instruments
- Exploiting market imperfections (sometimes temporary)
- Creating value added for investor and issuer by tailoring securities to their particular needs

Key: For the innovation to work, it must provide **value added** to both issuer and investor.

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Asset Securitization



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Example

Dayton Hudson Credit Card Master Trust, Series 1995-1

Issue Date: 9/13/95

Expected Maturity: 2/25/2002

Structure: Senior/Subordinated, sequential pay

Seller: Dayton Hudson Receivables Corporation

Cards: Private label cards for Mervyn's, Target and Dayton's Department Store

Servicer: Retailers National Bank

Underwriter: First Boston Corporation

Tranche	Face Value	Coupon	Ave. Life	Rating	Description	Placement
A	\$400 million	6.10%	3 Years	AAA	Senior	Public
B	\$123 million	0.00%	3 Years	AAA	Subordinated	Private

Collateral Information

Yield on portfolio	22.52%
Historical yield after delinquencies	18.90%
Number of accounts	22,796,667
Overcollateralization of A Tranche	23.50%
Largest geographic concentration	California (24.9%)

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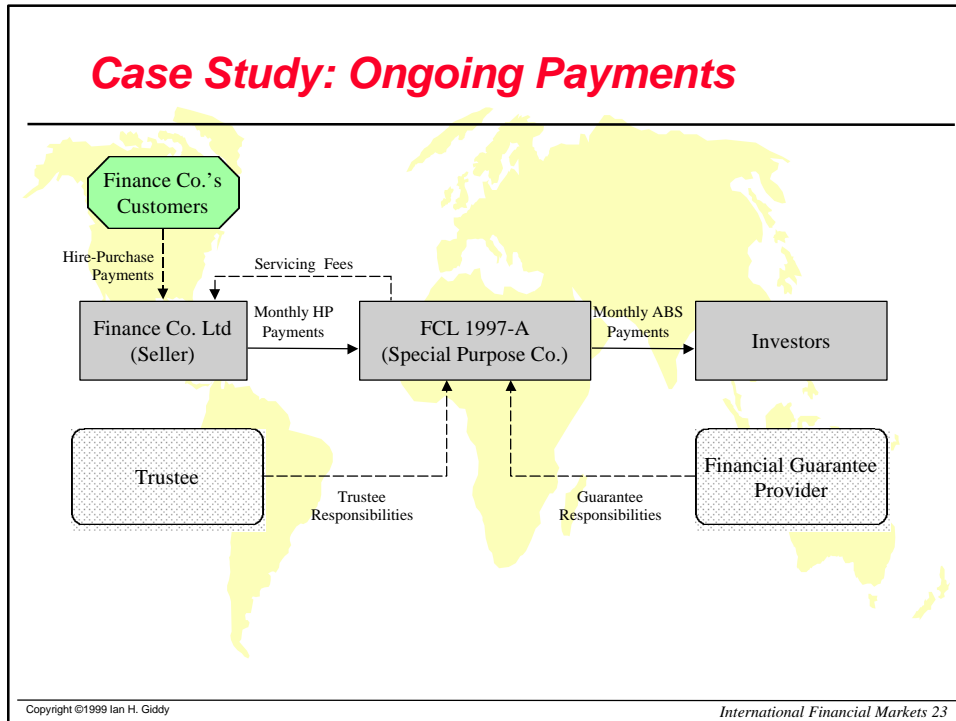
Is the Company Ready for ABS?

- Does the originator currently face a **high cost of funding** assets that would be recognized as sound, cash-generating assets if taken in isolation?
- Does it have a regulatory or **capital constraint** that makes freeing up the balance sheet important?
- Does it have **data** about the assets (required by rating agencies and financial guarantors)?
- Does it have the **servicing** process and systems that can meet the more demanding standards of the asset-backed market?
- Is the originator **willing** to undertake a complex, time-consuming transaction to obtain a broader, potentially cheaper, ongoing source of funding?

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Case Study: Ongoing Payments



Project Financing

Definition

- **Lending** to a single purpose entity for the acquisition and /or construction of a revenue-generating asset with limited or no recourse to the sponsor
- **Repayment** of the loan is solely from the revenues generated from operation of the asset owned by the entity
- **Security** for the loan
 - ◆ the revenue generating asset
 - ◆ all shares and interests in the entity
 - ◆ real property
 - ◆ all contacts, permits, authorizations, etc.; and,
 - ◆ all other instruments necessary for continuing project operations

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Steps

Project Identification & Resource Allocation

Risk Allocation & Project Structuring

Bidding & Mandating Contracts

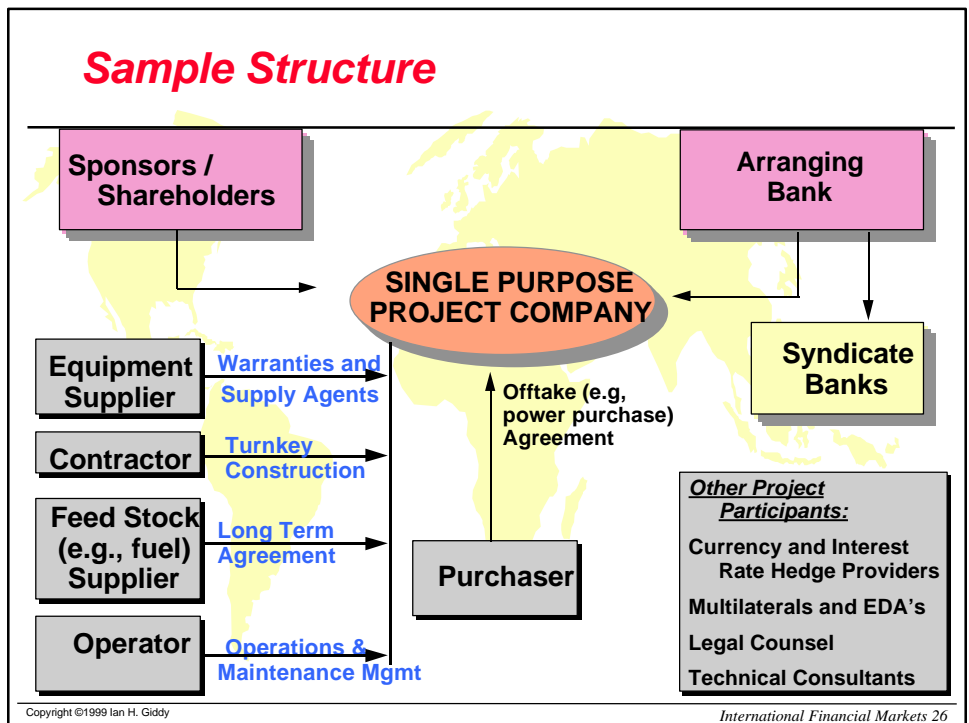
Due Diligence & Documentation

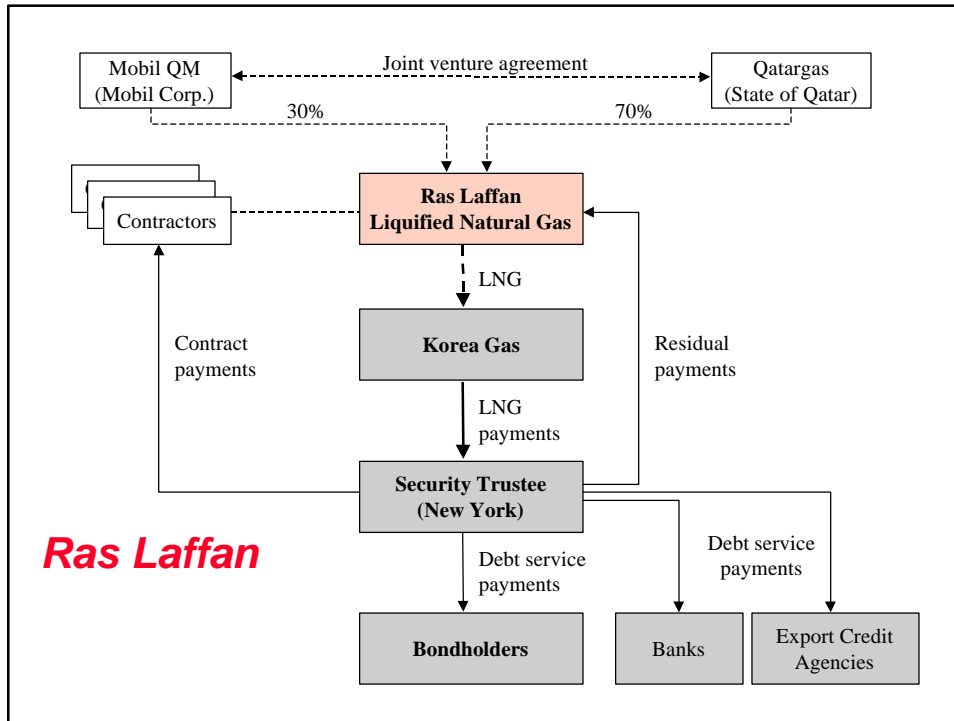
Execution & Monitoring

Construction Monitoring

Term Loan Conversion & Ongoing Monitoring

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Martell

- Martell
 - ◆ family
 - ◆ other shareholders
- Seagrams
- Grand Met

Concept: What are the goals and tactics of each in this ownership transfer?

Goals of Acquisitions

Rationale: Firm A should merge with Firm B if

[Value of AB > Value of A + Value of B + Cost of transaction]

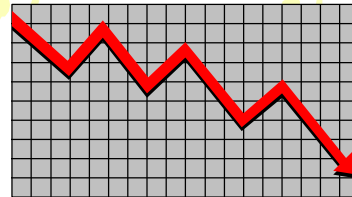
- Synergy
 - ◆ Eg Martell takeover by Seagrams to match name and inventory with marketing capabilities
- Gain market power
 - ◆ Eg Atlas merger with Varsity. (Less important with open borders)
- Discipline
 - ◆ Eg Telmex takeover by France Telecom & Southwestern Bell (Privatization)
 - ◆ Eg RJR/Nabisco takeover by KKR (Hostile LBO)
- Taxes
 - ◆ Eg income smoothing, use accumulated tax losses, amortize goodwill
- Financing
 - ◆ Eg Korean groups acquire firms to give them better access to within-group financing than they might get in Korea's undeveloped capital market

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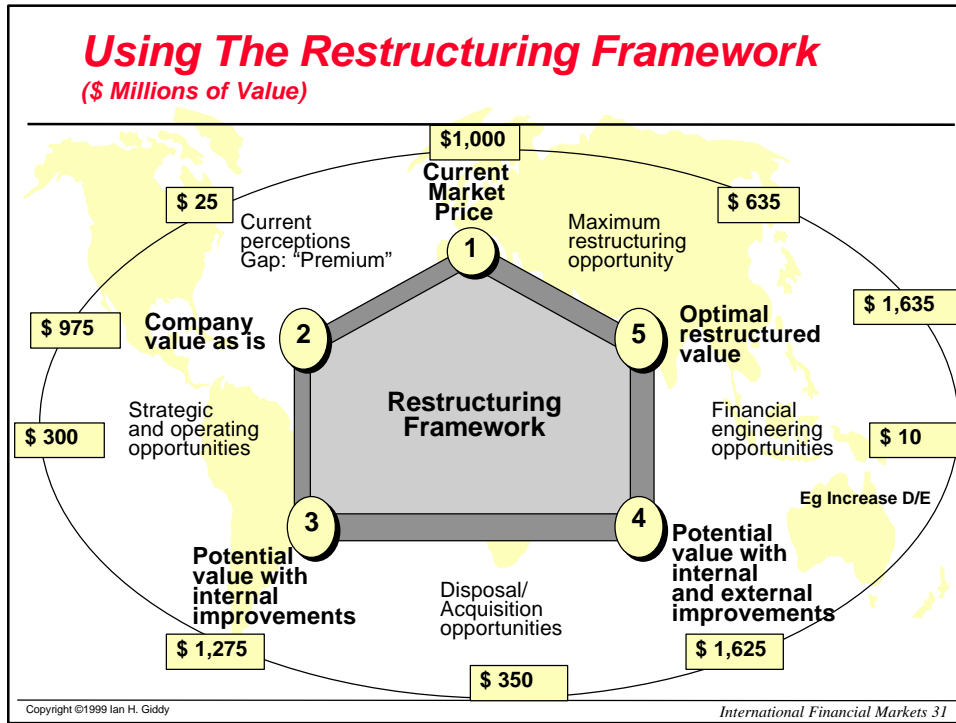
Fallacies of Acquisitions

- Size (shareholders would rather have their money back, eg Credit Lyonnais)
- Downstream/upstream integration (internal transfer at nonmarket prices, eg Du Pont/Conoco, Pru/Bache)
- Diversification into unrelated industries (Kodak/Sterling Drug)



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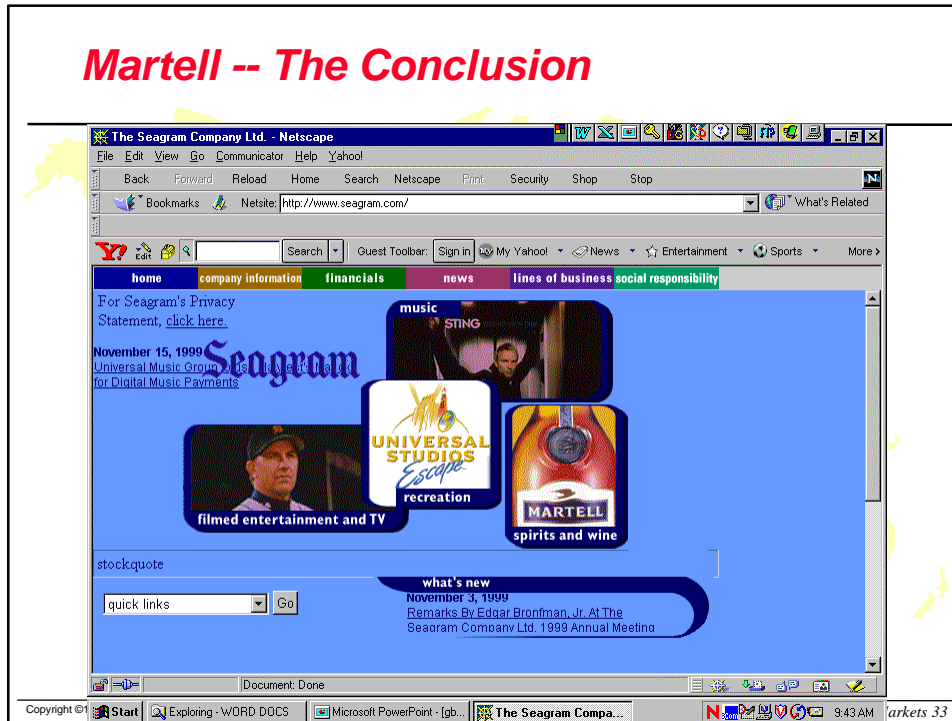
Mergers and Acquisitions: Summary

- Mergers & Acquisitions
- Divestitures
- Strategic Alliances

Concept: Is a business worth more within our company, or outside it?

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Martell -- The Conclusion



M&A Advisory Services: 1. Role of the Seller's Advisor

- Develop list of buyers
- Analyze how different buyers would evaluate company
- Determine value of the company and advise seller on probable selling price range
- Prepare descriptive materials showing strong points
- Contact buyers
- Control information process
- Control bidding process
- Advise on the structure of the transaction to give value to both sides
- Ensure all nonfinancial terms are settled early
- Smooth postagreement documentation

M&A Advisory Services: 2. Role of Buyer's Advisor

- Thoroughly review target & subs
- Advise on probable price range
- Advise on target's receptiveness
- Evaluate target's options and anticipate actions
- Devise tactics
- Consider rival buyers
- Recommend financial structure and plan financing
- Advise on initial approach and follow-up
- Function as liason
- Advise on the changing tactical situation
- Arrange the purchase of shares through a tender offer
- Help arrange long term financing and asset sales

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Alliance Capital

- Trends in the business?
- Global business?
- Continue "active growth" management?
- Competition?
- Fees?

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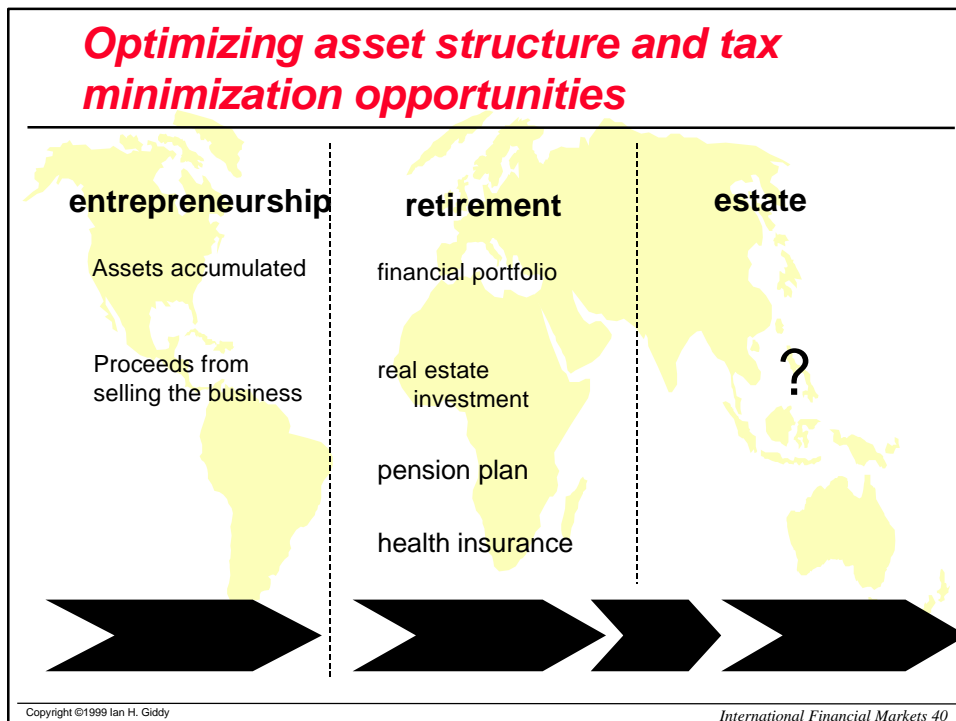
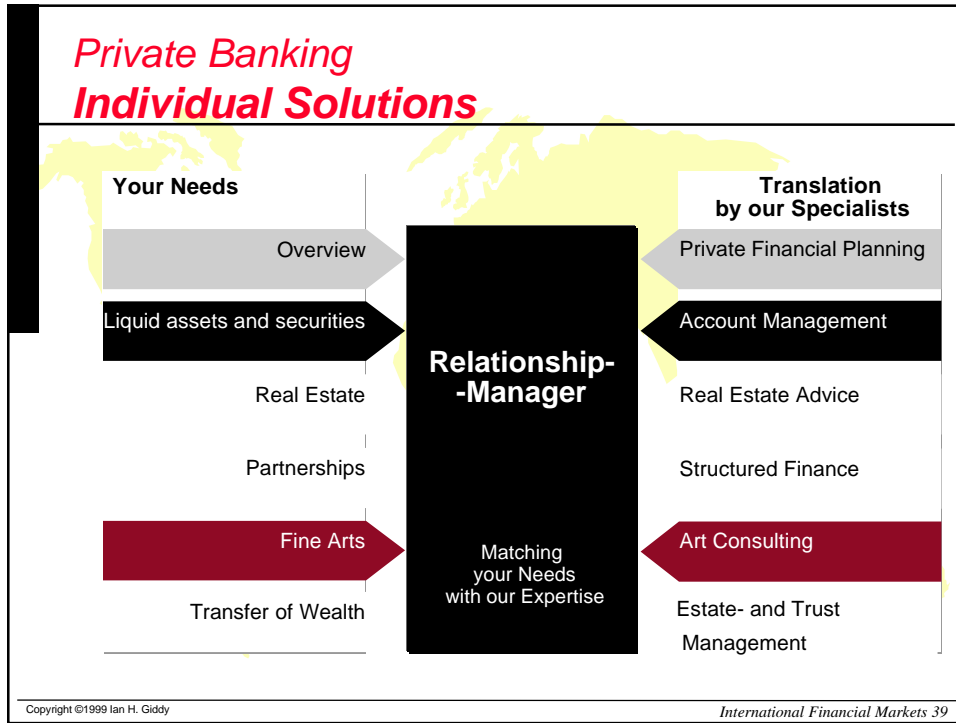
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Portfolio Performance Evaluation

- How well did the portfolio do?
- How do we adjust for risk, to compare different managers?
- Why?
 - ◆ Risk
 - ◆ Timing
 - ◆ Asset allocation
 - ◆ Security selection

Global Brivate Banking Key Issues to be Addressed

- Personal, family, business and political/economic context
- Personal Investment Portfolio
- Personal Retirement Plans
- Insurance
- Estate Planning
- Businesses

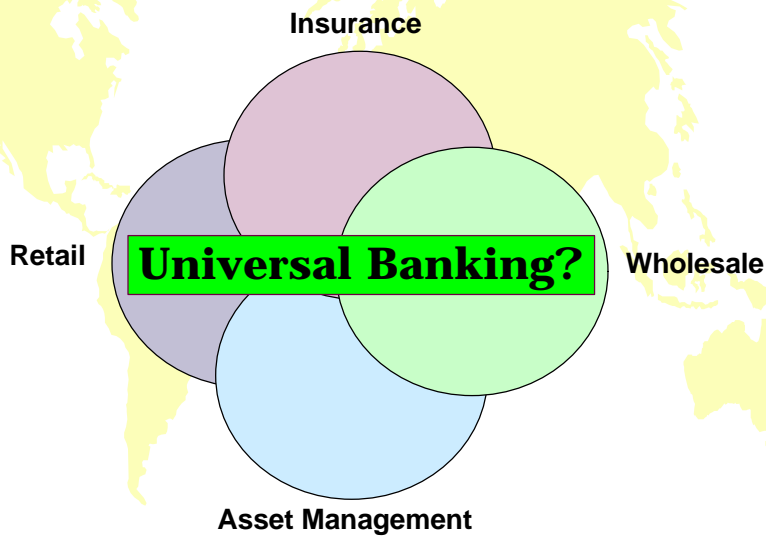


Global Private Banking

- Client needs
- Provision of services to meet needs
- Where does the bank excel?

- *Add value to the relationship by building from asset management to family financial planning and family-owned investment banking services*

After Glass-Steagall



Citigroup

- Buy? Sell? Hold?
- What's unusual about the deal?
- Will the combination produce net positive economic value?
- From where? Who will get it?
- How long before gains realized?
- Risks that the deal will fall through?

Valuation: The Key Inputs

- A publicly traded firm potentially has an infinite life. The value is therefore the present value of cash flows forever.

$$\text{Value} = \sum_{t=1}^{t=\infty} \frac{CF_t}{(1+r)^t}$$

- Since we cannot estimate cash flows forever, we estimate cash flows for a "growth period" and then estimate a terminal value, to capture the value at the end of the period:

$$\text{Value} = \sum_{t=1}^{t=N} \frac{CF_t}{(1+r)^t} + \frac{\text{Terminal Va}}{(1+r)^N}$$

Models of Valuation

Choose a			
Cash Flow	<i>Dividends</i> Expected Dividends to Stockholders	<i>Cashflows to Equity</i> Net Income - $(1 - \delta) \cdot (\text{Capital Exp.} - \text{Deprec.} \cdot n)$ - $(1 - \delta) \cdot \text{Change in Work. Capital}$ = Free Cash flow to Equity (FCFE) [δ = Debt Ratio]	<i>Cashflows to Firm</i> EBIT (1- tax rate) - $(\text{Capital Exp.} - \text{Deprec.} \cdot n)$ - Change in Work. Capital = Free Cash flow to Firm (FCFF)
& A Discount Rate	<i>Cost of Equity</i> <ul style="list-style-type: none"> • Basis: The riskier the investment, the greater is the cost of equity. • Models: <ul style="list-style-type: none"> CAPM Riskfree Rate + Beta (Risk Premium) APM Riskfree Rate + Σ Beta (Risk Premium): <i>n factors</i> 		<i>Cost of Capital</i> $WACC = k_E \cdot (E / (D+E)) + k_D \cdot (D / (D+E))$ k_D = Current Borrowing Rate (1-t) E,D Mkt Val of Equity and Debt
& a growth pattern	<p style="text-align: center;">Stable Growth</p>	<p style="text-align: center;">Two-Stage Growth</p> <p style="text-align: center;">High Growth Stable</p>	<p style="text-align: center;">Three-Stage Growth</p> <p style="text-align: center;">High Growth Transition Stable</p>

Client-Arena-Product Matrix: Citigroup

