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# Class 2: Managing an Investment Banking Process

# Lesson 1: Winning Client Mandates

***Class Script***

**Course 2, Lesson 1: Winning Client Mandates**

1. *Introduction*
   * **Lesson Overview**
     1. During this lesson, The Warren Fox Group will cover topics that deal with:
        1. Business mechanics of an investment bank
        2. Pitching potential clients
        3. Getting staffed on a pitch
        4. Engaging clients
2. *Business Mechanics of an Investment Bank*
   * Background: The Sales Motion of an Investment Bank.
     1. The sales motion of an investment bank is a long process that can take months, even years to complete.
     2. The sales motion is broken up into two main activities: (i) deal origination and (ii) deal execution.
        1. **Deal Origination**
           1. Activities that mainly focus on winning client mandates.
        2. **Deal Execution**
           1. Activities that mainly focused on successfully closing deals.
     3. Roles and responsibilities depending on bank size.
        1. Some investment banks are large multi-faceted institutions that engage a diverse group of clients and provide a wide array of services, while other banks might only employ 5 to 10 practitioners and serve a much narrower mandate.
        2. Larger banks will sometimes decouple the two banker functions, having separate teams dedicated to origination and execution.
           1. Smaller banks are likely to commingle the two activities amongst the bankers. Meaning that practitioners will be utilized on both the pitch and the deal’s execution.

It is important to note that the bankers staffed on the pitch are not necessarily the same bankers placed on the deal team.

* + The Revenue Model of an Investment Bank
    1. **Overview**
       1. Investment banks provide capital markets advisory and receive fees for their services.
       2. There are many types of fees an investment bank can receive, but the largest fee is almost always the Success Fee.
          1. A **success fee** is awarded to the investment bank based upon completion of a client mandate.

For example, when an M&A deal closes or when a client successfully raises capital in the market.

* + - * 1. The **success fee** is usually measured as a percentage of the transaction value, which is the deal quantum expressed in enterprise value.

For example, if an investment bank advised on a sale of a company that traded for $100 million, then the investment bank would be paid a fee based on the $100 million transaction price.

* + 1. **Deal Origination**
       1. The first step of the investment banking revenue model is winning client mandates.
       2. The investment bank needs to successfully pitch clients and win client mandates to obtain deal flow.
          1. Deal flow is an industry term used to denote the number of client mandates the bank has in-market.
       3. Practitioners work diligently to build their brand, increase their network, and develop pitch materials to win as many client mandates as possible.
          1. In some cases, banks receive in-bound interest from businesses who would like to engage with the bank.

For in-bound business that does not require a pitch, the bank needs to carefully vet the client before accepting the mandate, because if the bank underwrites a client that cannot transact in the market, then it is a waste of the bank’s time and resources, because the bank is paid mostly from success fees.

* + 1. **Deal Execution**
       1. The second step of the investment banking revenue model is executing client mandates.
       2. The investment bank needs to successfully close deals to be awarded a success fee.
          1. Closing a deal requires successful execution of the client mandate in the capital markets.
          2. Closing a capital markets deal involves a long process that takes months to complete, requiring an array of different participants all coming to agreement on a very large transaction.

1. *Pitching Potential Clients*
   * **Background**
     1. Clients who need capital markets advisory will search for an investment banking partner.
     2. Investment banks will compete for the privilege to represent the client in the capital markets.
        1. The process of competing for the client’s mandate is typically known as a Bake off or a Beauty Contest.
   * **Initiating the Search Process for an Investment Bank:** 
     1. Demanding capital markets advisory.
        1. A business identifies a need to enter the capital markets to maximize business operations and shareholder value.
        2. At this time, senior management, large shareholders, and board members all recognize the need to engage an investment bank.
     2. Listening to pitches
        1. The management team will reach out to a number of investment banks who they believe have the proper capital markets expertise.
        2. The management team will invite the bank to compete in a bake-off.
        3. The banks will have an opportunity to prepare pitch materials and compete for the client mandate.
     3. Banker Selection
        1. Once all options have been weighed, the business will select an investment banking partner to engage.
        2. The business and the investment bank will negotiate the terms of the engagement letter.
        3. Once the terms have been negotiated, the business’s board will vote to approve the engagement.
   * **Elements of Consideration when Selecting an Investment Banking Partner**
     1. **Element 1:** Bank Reputation
        1. The bank’s reputation is a key deciding factor when selecting an investment banking partner.
        2. The bank’s reputation typically needs to be inline with client’s reputation, meaning that is uncommon for large public companies to engage small, unknown investment banks.
           1. The underwriting process is vote of confidence in the client, therefore when the client is represented by a large and prestigious investment bank it is a strong positive signal to the marketplace.
           2. Also, the board takes less risk when engaging a larger and more prestigious investment bank.

For example, it is typically viewed that engaging a larger investment bank with more resources and more experience is less risky that engaging a smaller no-name bank because larger banks have a higher chance of successfully executing the mandate.

* + - 1. Given that reputation is important, practitioners will highlight their most recent deal count and quantum in the pitch materials to communicate the bank’s prestigious and long-tenured reputation in the capital markets.
         1. For example, bank [X] has completed more than [X] number of transactions, for nearly [$XX.X] billions.
    1. **Element 2:** Sector Expertise
       1. The bank’s sector expertise is another key deciding factor when selecting an investment banking partner.
       2. The investment bank needs to prove that it has direct experience in serving similar clients, with similar needs.
       3. Given that sector expertise is important, practitioners will highlight their most relevant previous deals in the pitch materials to communicate the bank’s past experiences in a particular vertical.
          1. For example, bankers will include a Tombstone Slide in the pitch materials that highlights 4 to 6 highly comparable transactions. The deal tombstones will contain background information on the deals, such as deal type, buyer logo, seller logo, closing dates, and deal quantum.
    2. **Element 3:** Existing relationships
       1. The bank’s existing relationships with potential buyers and investors is another key deciding factor when selecting an investment banking partner.
       2. The client wants to leverage the bank’s connections during the capital markets process.
       3. The client wants an investment banking partner that has prior experience in dealing with specific financial and strategic buyers.
       4. Given that the bank’s existing network is important, practitioners will highlight their relationships throughout the pitch materials to communicate the bank’s strong and relevant presence in the capital markets.
          1. For example, bankers will include splash pages of potential buyers. A splash page is simply just a page of company logos that, in this case, highlight strategic or financial investors that could finance the deal.
          2. Following a splash page, the bankers might add a page for “buyer strips” which is an additional page that identifies the specific relationships that the bank has in each of the institutions highlighted on the splash page.
    3. **Element 4:** Valuation
       1. The bank’s perception of the client’s value in the marketplace is another key deciding factor when selecting an investment banking partner.
       2. The client will likely have pre-existing valuation expectations that are necessary to close the deal, and if the investment bank does not believe it can fetch this value in the capital markets, then it would be senseless to engage.
          1. The bank needs to put forth a realistic, fact-based valuation or at least guidance on valuation.
          2. If the bank suggests an unreasonable valuation that is way above market rate, then it will set client expectations too high and create immediate variations in the bid-ask spread and ensure a pricing delta that will be too large to negotiate.
          3. Setting unreasonable client expectations introduces unnecessary deal risk because a client likely will not accept valuation terms below what they are expecting, which will increase the chances of deal failure.
       3. Given that valuation is important, practitioners will highlight their thoughts on valuation by providing some level of intrinsic and relative valuation analysis in the pitch materials.
    4. **Element 5:** Fee Structure
       1. The client will also weigh the bank’s fee structure when selecting an investment bank partner.
       2. The fee structure can vary depending on deal and depending on bank, but typical market terms are lower-single digit percents for M&A deals, and mid-single digit percents for capital market deals.
       3. Sometimes there are special fee structures that banks utilize to attract certain clients.
          1. For example, the bank might decide to forgo fees, or remove an engagement tail, or take warrants in leu of a cash fee.
       4. It is not uncommon for a smaller bank reduce fees to increase its chances of winning a prestigious client mandate, for the purpose of future utilization of the tombstone as a marketing tool to enhance the bank’s reputation.

1. *Getting Staffed on a Pitch*
   * **Background**
     1. Below is a detailed process outline describing what junior bankers should expect when being staffed on a pitch:
        1. **Step1:** Receiving a staffing email:
           1. The bank’s staffer alerts a practitioner of his or her obligations on a pitch with an email that will include a few main items:

The team members on the pitch

The name of the potential client

An action item for the junior banker to set up an Introductory Call to discuss the opportunity, the client, and any additional next-step action items.

* + - 1. **Step 2:** Introductory Call:
         1. On the Introductory Call, the senior bankers are going to explain the situation in further detail and set timeline expectations.

The origination of the relationship with the client.

The client’s goals and expectations within the capital markets.

The date of the bake-off and the potential go-to-market timing.

* + - 1. **Step 3:** Creating and gathering pitch materials:
         1. Following the Introductory Call, the junior team members will begin creating pitch materials for the bake-off.

Ensure that there is a mutual NDA executed between the potential client and the bank.

Set up an internal email distribution list for team communications.

Set up a folder on the internal drive to organize pitch materials.

* + - * 1. The junior bankers will than begin leveraging all internal and third-party resources to shell-out a deck, which will collection of certain preliminary information:

General industry analysis

Client-specific research and financials

Valuation analysis that includes comparable companies and precedent truncations

* + - 1. **Step 4:** Creating the pitch deck:
         1. Once junior bankers review and collect the preliminary materials, they will begin shelling out a Pitch Deck

*Note 1*

Never recreate the wheel; junior bankers should leverage templates from past relevant pitch decks.

*Note 2*

Break down the Pitch Deck into at least three sections:

Section 1: Intro to Bank [x]

Section 2: General Industry Analysis

Section 3: Bank [X]’s Strategic Advisory

* + - * 1. Pitch Deck Composition

**Section 1: Intro to Bank [X]** will be mainly comprised of the below slides:

**Summary of Bank [X]** – this slide includes an executive summary of the bank describing (i) who they are, (ii) what they stand for, (iii) types of industry / deal specialization, (iv) how many professionals work at the bank, (v) how many deals the bank has done, and (vi) for how much in enterprise value.

**Key Officers of the Bank** – this slide introduces the founders, partners, and officers of the bank, with special priority given to the senior managers who will likely be participating on the deal.

**Tombstones** – this slide represents recent deal flow to qualify the bank’s experience in the field. It is not uncommon for there to be multiple tombstone slides in the deck. The first slide being with the most relevant and recent deals that apply to this particular client and then additional slides to highlight the banks last 12 or 24 months of deal activity.

* + - * 1. **Section 2: General Industry Analysis** will be mainly comprised of the below slides:

**Status of Industry [X]** – this slide includes an executive summary of Industry [X] describing (i) what the industry does, (ii) the key players in the industry (iii) how the industry makes money (iv) and the key risks in the industry.

**Market Opportunities in Industry [X]** – this slide describes (i) a TAM of the Industry (ii) the future of the industry and how the industry grows into its future state and (iii) current market trends, regulatory trends, and geo-political trends that could affect the industry.

**Current Market Multiples** – this slide introduces the public company benchmarks that will support relative valuation, while also introducing potential strategic acquirers.

**Recent Transaction in Industry [X]** – this slide introduces the market’s recent trading activity of public and private transactions in Industry [X] providing the client with a strong indication of a potential valuation range.

* + - * 1. **Section 3: Bank [X]’s Strategic Advisory** will be mainly comprised of the below slides:

**Executive Advisory Plan** – this slide outlines the services and the strategic plan that the bank will likely follow, typically highlighting the wide range of possibilities that will could occur in parallel with the capital markets transaction.

**Universe of Buyers / Investors** – this slide describes all the potential buyers and investors, and calls out all the personal relationships of the bank.

**Valuation** – this slide outlines a specific valuation range based on the available public information of company-specific information that has been provided to the bank.

* + - 1. **Step 5:** Delivering the Pitch:
         1. The pitch will either be in-person or electronically over a video call
         2. If the pitch is delivered electronically, the junior banker’s responsibility will be to flip the pages and take notes.
         3. The bank’s goal on the pitch is to win the mandate by convincing the client that the bank has a stellar reputation in the industry and has the capacity to execute the deal in a timely and efficient manner.

1. *Engaging the Client*
   * Following a successful bake-off the investment bank will need to execute an engagement letter with the client to be officially engaged.
   * Below is an overview of next steps following a successful bake-off.
     1. **Step 1:** Negotiating and Executing an Engagement Letter
        1. The bankers will provide the client with the bank’s engagement letter, specified directly to the needs of the mandate at hand.
           1. The engagement letter is the document that officially outlines the relationship between the bank and the client.
           2. At a high-level, the engagement letter defines the parties involved, the services offered, the associated fees and pricing, and other terms of the arrangement such as engagement tails and potential carve-outs.

**Note 1:** Engagement Tail

The engagement tail is a function of the engagement letter that commits a client to a specific investment banking partner over a given-period of time.

This function of the engagement letter protects the bank against a client benefitting from the bank’s initial work and relationship building, without properly being compensated.

For example, if there was no tail then a client could cancel the engagement nearing the end of a process and close a deal shortly after, without compensating the bank for its underwriting and brokering services. The engagement tail protects the banks against this type of behavior.

**Note 2:** Carve-Outs

A carve-out list is a group of investors who the client already has an existing relationship with, that will not yield a success fee for the bank.

Carve-outs are typically only allowed in special situations because the bank does not want to run a process and find an investor to price the deal, only to have the client take capital from an existing investor on those same terms.

The above scenario is called a “stalking-horse event”.

* + 1. **Step 2:** Ensuring a Mutual NDA is in-place
       1. If not already in place, the junior bankers will prepare and execute a mutual Non-Disclosure Agreement between the bank and its client.
          1. A mutual NDA is a document that allows the bank and the client to freely exchange information.
          2. The document is a two-way non-disclosure agreement that protects both the client and the bank from outside sharing of internal company information, ideas, financials, or near-term strategy objectives.
          3. At a high-level, the MNDA will define an effective date, the participating parties, what is and what is not confidential information, what can be done and what cannot be done with confidential information, what happens if there is a breech in confidential information, how long the agreement lasts for, and the state in which the contract is governed.
    2. **Step 3:** Initial Due Diligence List
       1. Following the successful execution of the Engagement Letter and the Mutual NDA, the bankers will work with the client to obtain the initial due diligence information to begin underwriting the deal and will schedule a kick-off meeting to officially begin the process.

1. *Summary*
   * Throughout the first lesson of Managing an Investment Banking Process, The Warren Fox Group has covered a multitude of topics:
     1. Business Mechanics of an Investment Bank
     2. Pitching Potential Clients
     3. Getting Staffed on a Pitch
     4. Engaging Clients
   * After the first lesson, viewers have a clear grasp on the how investment banks operate, how to pitch a client, what is expected of a banker during a bake-off, and what is necessary to officially engage a client
     1. The important take-aways of Lesson 1 include:
        1. The sales motion within the Investment Banking industry is a very long process
        2. Deal origination is a crucial part of investment banking operations
        3. The main pieces and responsibilities on a pitch largely relate to client-banker trust
     2. The goal of Lesson 1 is:
        1. Help junior bankers understand the importance of deal origination
        2. Educate junior bankers on their roles and responsibilities during a pitch
        3. Educate junior bankers on best practices when creating pitch materials

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*It is an honor and privilege to join you in your journey throughout Investment Banking!*

*The Warren Fox Group*