

Presentation to SEO Interns 2006

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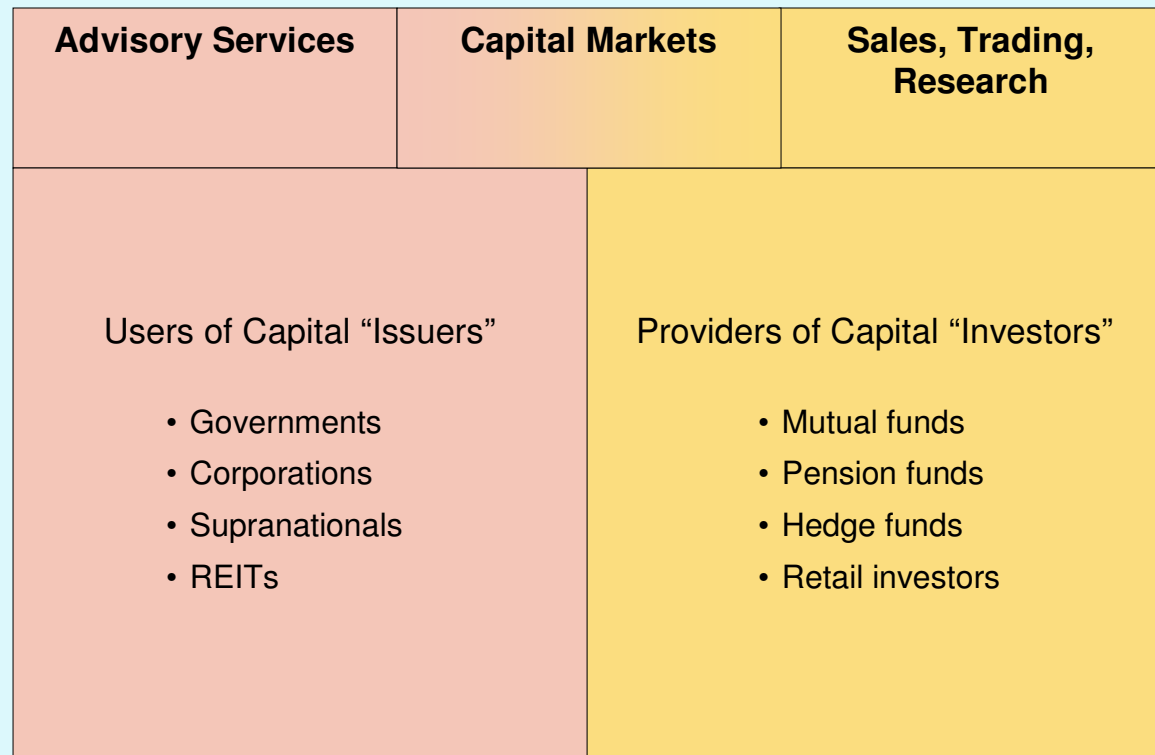
Managing Director

Investment Banking Division

Introduction to Capital Markets

The Role of the Investment Bank as Intermediary

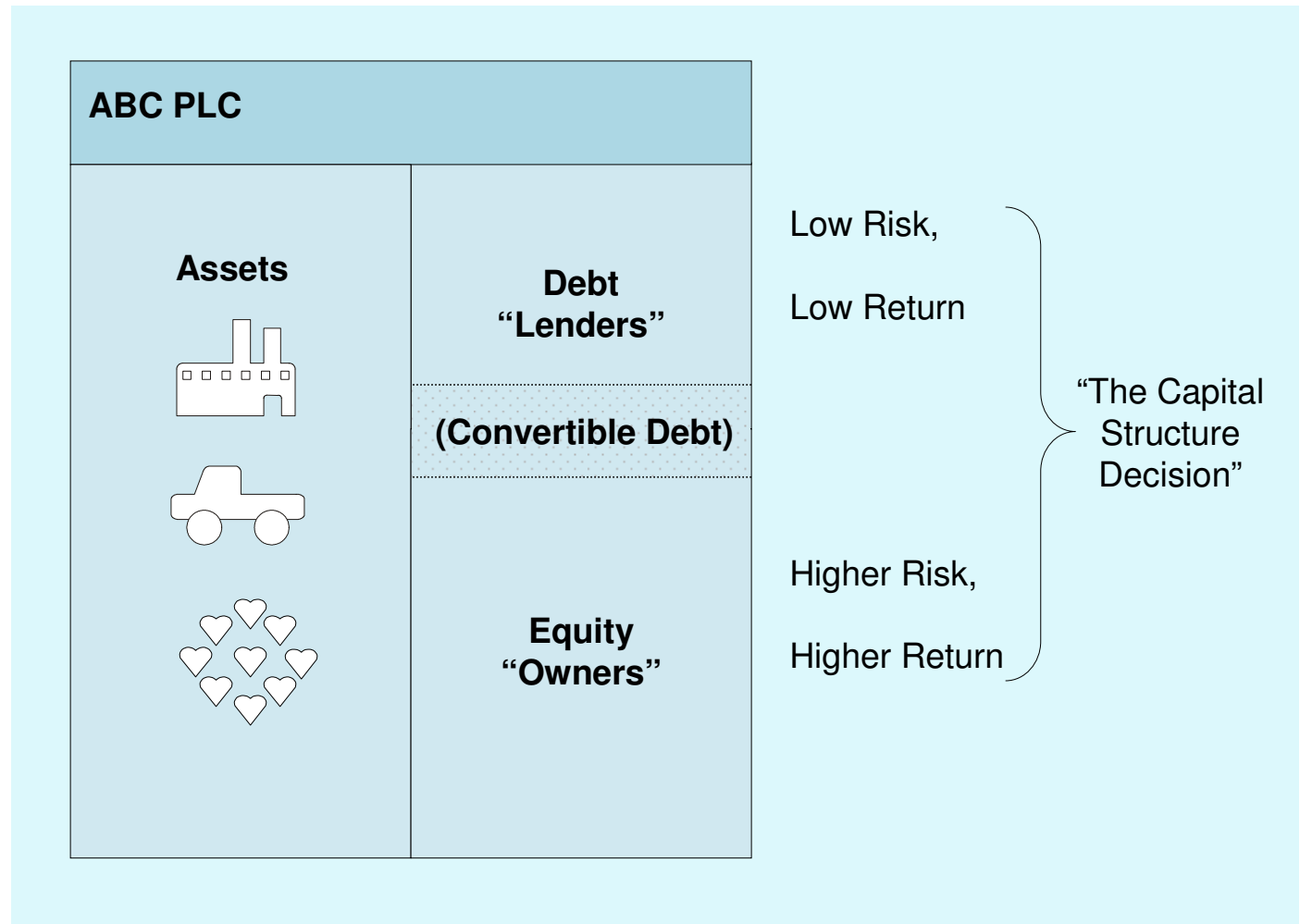
- Investment Banks act as intermediaries between users and providers of capital
- Some services are provided exclusively to one or other category of client
 - e.g. M&A, Equity Research
- Capital Markets is the interface between the issuer-oriented and investor-oriented sides of the bank
 - Provides capital raising and risk management services for issuers



The Nature of Capital

Typical Corporate

- Companies finance their assets through a combination of debt and equity capital
 - “Tangible” assets
 - “Intangible” assets/ “Goodwill”
- Debt investors get:
 - Fixed entitlements
 - Fixed maturity
 - Specific protections
 - No votes
- Equity investors get:
 - Variable returns (depends on profits)
 - No maturity
 - Voting control
- Convertible investors get:
 - Debt security (but with low interest rate)
 - Right to receive equity (but at a higher price)



How is Capital Valued ?

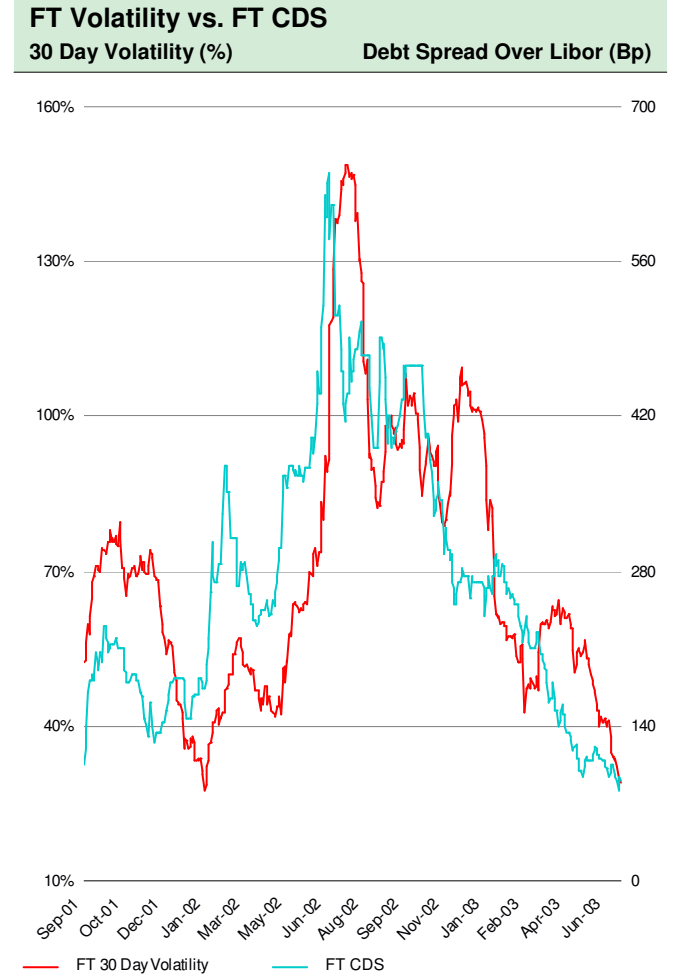
Theory – “Present Value of Future Cashflows”

	Equity	Debt
Future Cash Flows	All future dividends (function of future profits)	Principal plus interest payments
Discounted at	“Risk free” rate plus Equity risk premium (Company specific)	“Risk-free” rate (= Governments) plus “credit spread”
Shorthand	P/E ratio, Dividend Yield, EV/EBITDA	Spread over Libor

Example: France Telecom



Source FactSet, Morgan Stanley Trading, Bloomberg



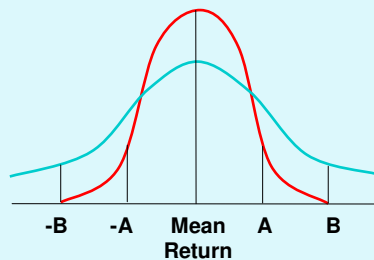
Source FactSet, Morgan Stanley Trading, Bloomberg

What is a Convertible Bond?

Concept

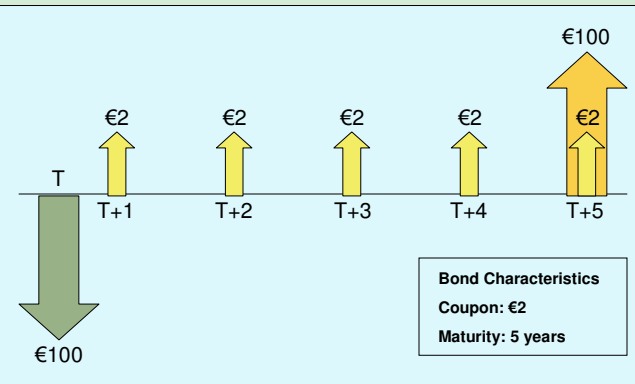
- **Convertible investors have the right but not the obligation to convert their convertible bond into equity**

- Volatility is the (annualised) measure of variance around the mean within one standard deviation

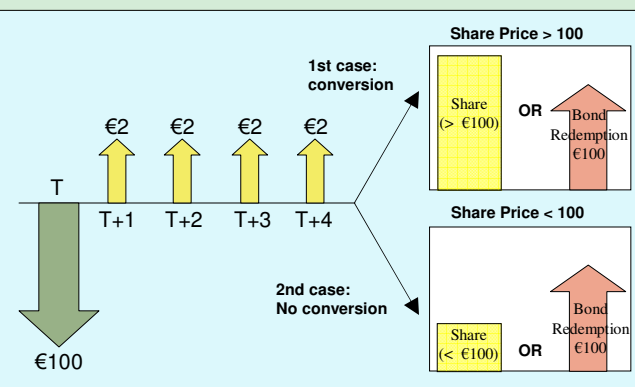


- More volatile stocks (B) have returns more spread out around the mean
- Less volatile stocks (A) have returns more close together

What is a Bond?



What is a Convertible?



Bond Description

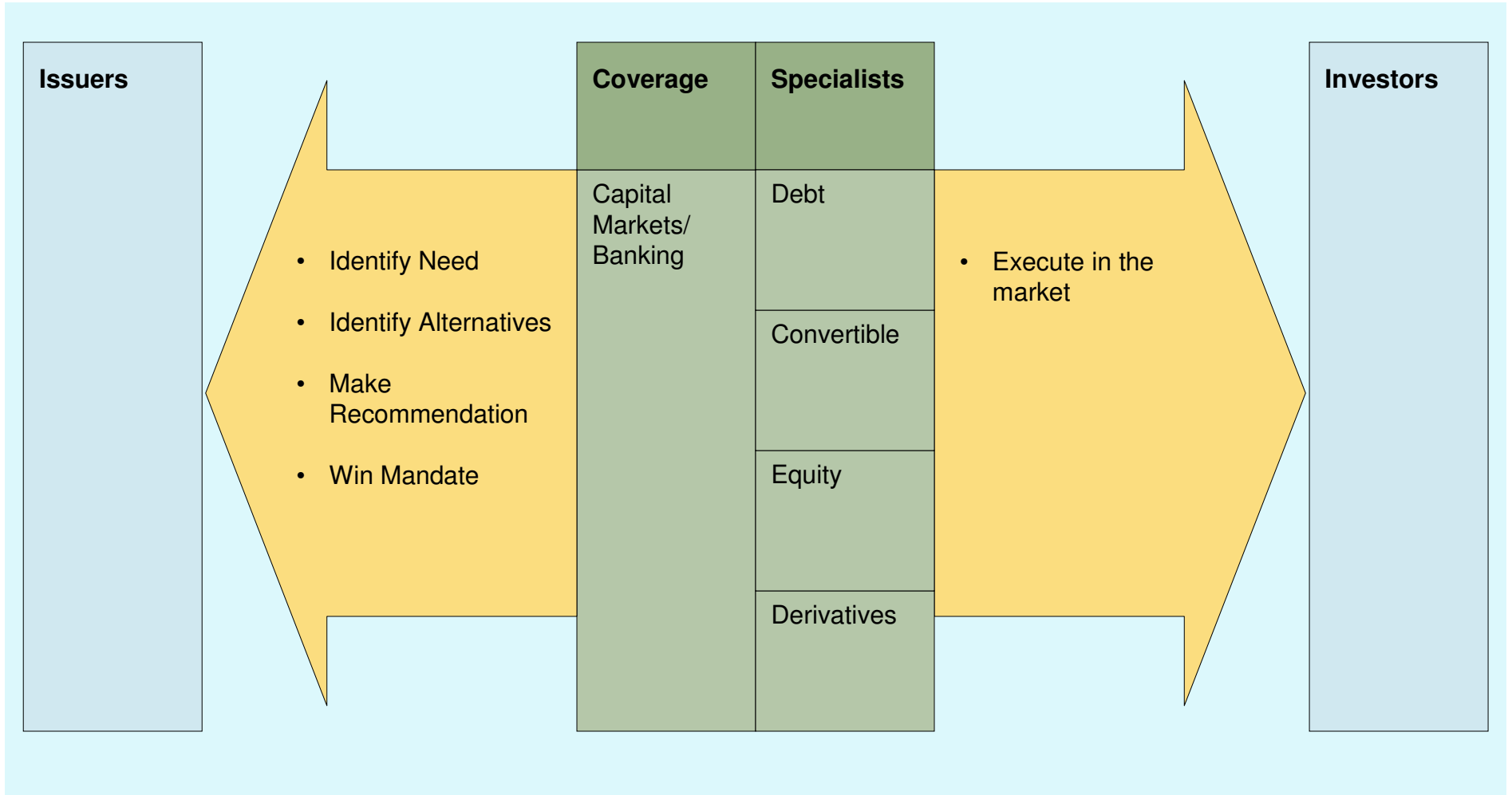
- A bond comprises a series of cash flows paid in discrete intervals over time
- At maturity, the bond repays the principal amount plus the final coupon

Convertible Description

- The investor has the option to convert the bond into a fixed number of shares
- Investors will choose to convert the bonds only if Value of Equity > Bond Principal Amount

The Role of Capital Markets

Overview of Morgan Stanley Global Capital Markets



France Télécom €3,492 MM Convertible

- France Telecom successfully completed a €3,492 MM exchangeable offering into existing shares on an overnight basis on November 21. Morgan Stanley acted as Joint Bookrunner on the transaction

- The deal was launched at 6PM GMT on November 20, 2001 and priced before the market open on November 21, 2001

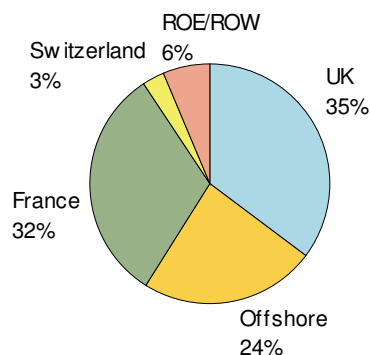
- The exchangeable bond offering represents the fourth capital market transaction lead managed by Morgan Stanley for France Telecom in 2001, following:

- €6.1Bn IPO of Orange
- €3.1 Bn FT/Orange Exchangeable
- €17.6 Bn International bond issue

- Transaction allows FT to monetise its treasury stock at a 47% premium to the current share price

FT Convertible Terms		
	Final	Indicative Range
Pricing Date	Nov 21, 2001	
Core Issue Size	€ 3,040 MM	€ 3,000 MM
Greenshoe	€ 452 MM (exercised)	
Ranking / Issuer credit rating	Senior / BBB+	
Maturity	4 years	
Coupon/Yield	4.00%	3.75 - 4.25%
Exchange Price	€ 72.0	€ 70.0 - € 72.5
Exchange Premium	46.9%	42.9 - 48.0%
Call Structure	NC 2 years. Callable in year 3 subject to a 110% hurdle, and callable unconditionally in year 4.	
Soft Mandatory	Option to deliver shares plus cash top up on final or early redemption. Included mechanism to deliver shares before averaging period	
Joint Bookrunners	Morgan Stanley, BNP	

Investor Allocation Split by Geography



Transaction Highlights

Landmark Capital Markets Transaction

- Largest ever European convertible or exchangeable (next largest was € 3,080 MM FT/Orange - also MS led transaction)
- Unprecedented combination of large size, high conversion premium (3rd highest conversion premium ever) and short-fuse overnight execution
- Highlights opportunity for high quality issuers to tap the convertible market for attractive financing in large size

Aggressive Execution

- Launched and priced on an overnight basis in order to ensure a minimum conversion price of €70 (publicly stated objective)
- Executed on the same day as the MS-led €115 MM convertible convertible for SOITec and only 5 days after Morgan Stanley priced a US\$ 3.3 Bn combined equity and convertible offering for Swiss Re
- Launched in a competitive new issue market on the back of four transactions already launched on the same day

Strong Market Reception

- Books were over 4X oversubscribed
- Priced close to the high end of the premium range and middle of the coupon range with full exercise of greenshoe

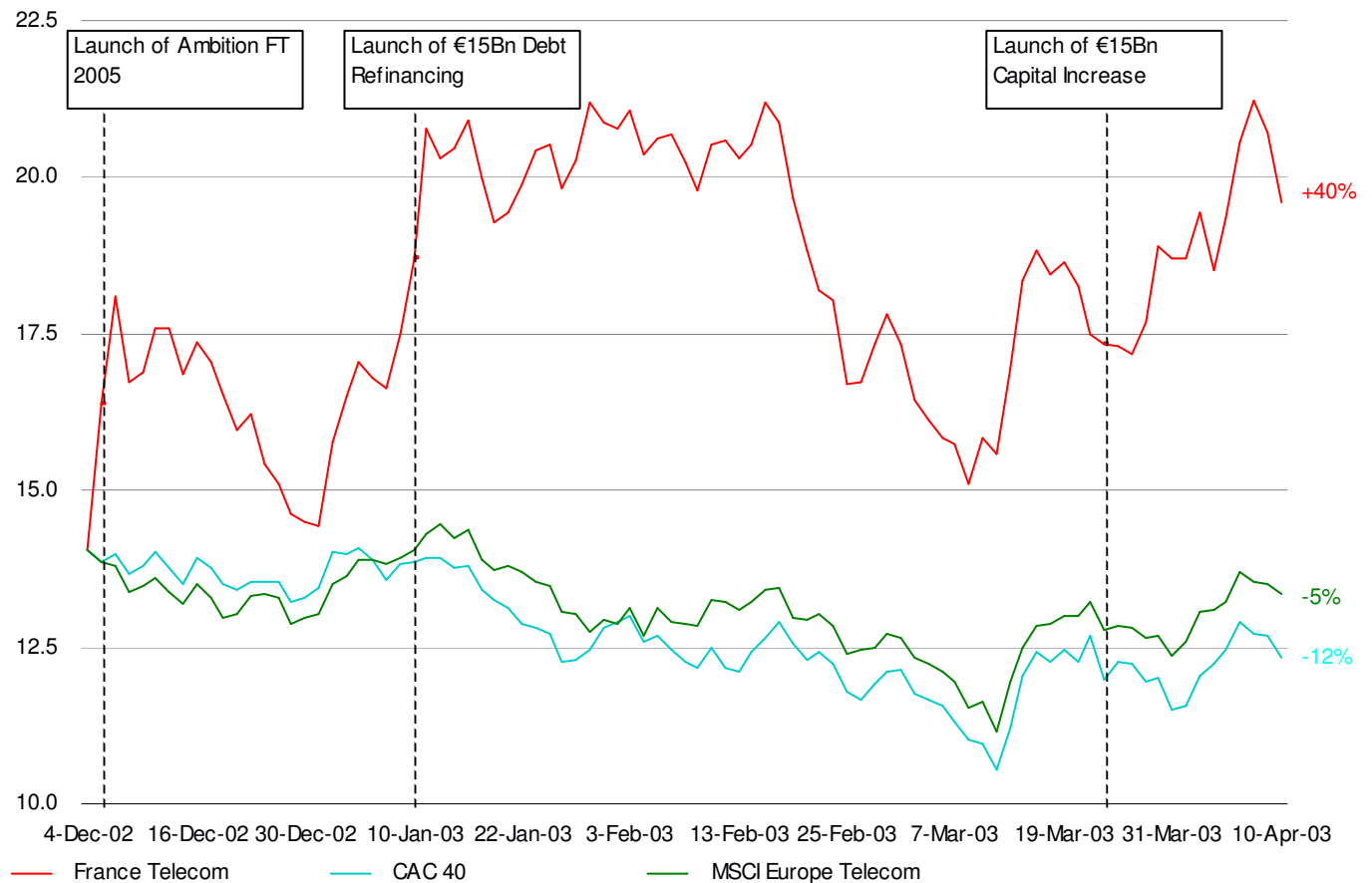
France Télécom Financial Rebalancing

Ambition FT 2005

Morgan Stanley has acted as an advisor to France Telecom since the beginning of the financial rebalancing effort:

- Appointed to assist FT in developing and presenting FT2005 recovery plan to the market (analysts, shareholders, credit rating agencies, press...)
- Bookrunner on €5.9Bn jumbo bond issue in January including €1bn 30 year bond (the largest 30 year corporate issue ever in Europe) and sole bookrunner on €500MM tap issue of same 30 year bond
- Advised company on structure, timing and approach to capital increase
- Underwrote €500MM of the capital increase and was appointed a Joint Global Coordinator

France Telecom Share Price Performance since announcement of Ambition FT 2005
 € (Rebased to FT on December 4, 2002 - Last price before announcement of Ambition FT 2005) Price Variation



Source Factset

France Télécom €15Bn Capital Increase

Key Highlights

- The structure implemented for the offer replicated the economics of a rights issue but reduced the period between announcement and closing to only 14 trading days (compared to 26 trading days minimum in a traditional French rights issue)
- Morgan Stanley acted as an underwriter and Joint Global Coordinator of the €15Bn capital increase (9.2Bn to the State, and €5.8Bn to the market)
- The capital increase was completed in a very uncertain environment, and has been successfully completed:
 - Positive share price performance, outperforming the benchmarks
 - High take-up rate

The Largest Capital Increase Ever... in a Very Difficult Environment

- The largest ever worldwide primary equity offering
- The largest ever worldwide non-IPO equity offering
- The largest ever worldwide Rights Issue (and underwritten Rights Issue)
- The 2nd largest ever European equity offering
- The 3rd largest ever worldwide equity offering

In addition to the sheer size of the capital increase, the execution was further complicated by a very uncertain environment: war in Iraq, SARS, poor worldwide economic prospects

Finally, the stock had been extremely volatile over the previous months, reflecting the “turning around” status of FT

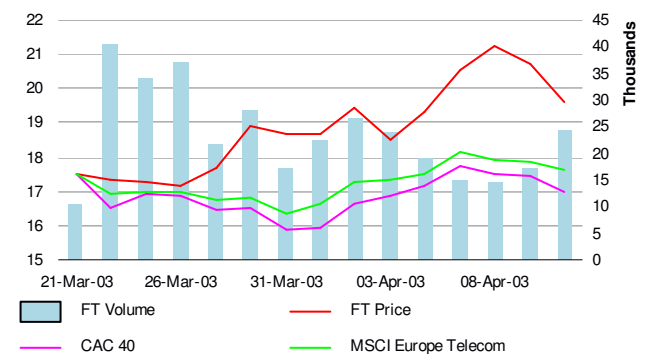
A Strong Equity Story Enabled a Launch at a Moderate Discount

- Ambition FT 2005 programme
 - Implementation of TOP largely on track
 - Refinancing of debt completed
 - Capital increase
- Strong management credibility
- Additional rationalisation of asset portfolio
- Support of the State in the rights issue
- Compelling valuation compared to peers

Equity story was conveyed to the market through intensive communication, including a 3-team, 9-day roadshow

Price Performance During the Offering

Price per share (€) Volume



Source Factset

Outcome for France Telecom

- €15Bn capital increase launched with a moderate discount of 17.3% to ex-rights price (approximately 50% in average for recent telecom rights issue⁽¹⁾)
- Completed with overwhelming success:
 - Over 94% take-up rate
 - Positive price impact: +12% between launch and closing of institutional book
- Success in an uncertain market environment, capitalising on strong equity story and ad hoc warrants (“BSAs”) structure which reduced market exposure
- Strengthening of balance sheet enables management to fully concentrate on operations part of FT 2005 plan

France Télécom €15Bn Capital Increase

Structural Elements

- The structure designed for the capital increase enabled France Telecom to complete:
 - A pre-emptive capital increase...
 - ... at a relatively low discount...
 - ... with reduced market exposure
- Structure reduces market exposure drastically, from 26 trading days in a traditional French rights issue to 14 trading days only
- This enabled France Telecom to meet its objective, and to complete a capital increase in a very uncertain market environment

Key Terms	
Capital Increase with Free Distribution of Warrants (BSAs)	
Issue Size	€15.0Bn
<i>Taken-up by the State</i>	€9.2Bn
<i>Taken-up by the market</i>	€5.8Bn
Underwriting	Full Underwriting
Subscription Price	€ 14.50
Terms	20 BSAs for 19 Shares
Discount to Unaffected Price	28.20%
Discount to Ex-Price	17.30%
Take-up Rate	94%
Pre-Offering Metrics	
Market Cap	€24.0Bn
Float	€8.5Bn
Share Price	€ 20.20
Theoretical Ex-Rights Price	€ 17.54

Syndicate Structure	
Morgan Stanley Role	
Company Advisor	
Joint Global Coordinator	
Syndicate Members	
Joint Global Coordinators	
7 Banks	Underwriting commitment: €500MM each
Joint Global Lead Managers	
7 Banks	Underwriting commitment: €200MM each
Co Lead Managers	
6 Banks	Underwriting commitment: €61-65MM each

Timetable	
Annual Results	Mon 5 March
Announcement Date	Mon 24 March
<i>(Pricing and terms announced on same day)</i>	
Record Date	Mon 24 March
Ex-Rights Date	Tue 25 March
<i>(First day of trading of the rights and of exercise period)</i>	
End of Exercise Period	Fri 4 April
<i>(Last day of trading of the rights)</i>	
Beginning of Bookbuilding to Sell Shares from Unexercised BSAs	
(Rump Placement)	Tue 8 April
Publication of Preliminary Take-Up Rate	Wed 9 April
Publication of Final Take-Up Rate	Thu 10 April
Closing of Institutional Book	Thu 10 April
Closing of Retail Book	Thu 10 April
Allocation	Fri 11 April
Settlement/Delivery	Tue 15 April

Offering Key Points	
Objectives of the structure	
•	Same economics as a rights issue
•	Minimise the length of market risk exposure and execution risks in a high volatility environment
•	Allow existing shareholders to participate (Tresor objective)
Main characteristics of BSAs (warrants)	
•	BSAs distributed to treasury shares kept unexercised by the company
•	Unexercised BSAs transferred to the syndicate, which exercises them and resells shares through a bookbuilt offering