

GLOSSARY

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Adjusted Present Value (APV) A project or corporate valuation method that separates the components of the project's value into its operational value and the value of its financing side-effects.

American Depository Receipts (ADRs) Certificates issued by a bank stating that a specific number of a company's shares have been deposited with it. These certificates are denominated in dollars and traded on American exchanges as if they were American securities. However, ADRs represent stock in companies outside America.

Allotment letter Allocation of shares from a **New issue** is made by means of an allotment letter. This entitles the recipient to a certain number of shares, subject to payment. When demand for a new issue exceeds the shares available, allotment is made either on a random (*see* **Ballot**) or proportional basis.

Allotment price Price at which stock is allotted to successful applicants in a **New issue** or other offer.

Alternative Investment Market (AIM) AIM was established in 1995 as a market for companies unable to join the **Official List** of the London Stock Exchange. It has less onerous requirements for listing than the Official List.

American option An **Option** which may be exercised any time between its initiation and expiration dates (inclusive).

Annualised return The rate of return for any given period expressed as the equivalent average return per year.

Arbitrage Seeking to exploit price differences between different markets in similar instruments. An early example of arbitrage was between the dollar/sterling market in New York and that in London. Because prices in the two markets sometimes differed,

traders could occasionally buy dollars or pounds in one market and sell them immediately in the other for a profit.

Asset stripping A process by which a controlling shareholder sells the assets of a company and pays the proceeds to the shareholders (often himself). Alternatively, the cash proceeds are retained within the remaining 'shell' of the original company to be used for a variety of purposes.

Authorised capital The amount of share capital that a limited company is authorised to issue. This does not provide any indication of the worth of the company which is related to its **Issued capital** and reserves, its net asset value and its profitability.

Ballot When a **New issue** is over-subscribed some or all of the applications may be 'put into a hat' and applications drawn at random to be granted part or all of the shares applied for. Applications not selected are unsuccessful and are returned.

Basis point One hundredth of 1% (i.e., 0.01%).

Beta A measurement of market sensitivity – i.e., the extent to which a share or portfolio fluctuates with the market. It is a statistical estimate, based on historical data, of the average percentage of change in a fund or a security's rate of return corresponding to a 1% change in the stock market.

Bond A certificate of debt issued by a company, government or other institution. A bondholder is a creditor of the issuer and receives interest at a rate stated at the time of issue.

Bond ratings A system for measuring the relative creditworthiness of bond issues using rating symbols, which range from the highest investment quality (least investment risk) to below investment grade (greatest risk).

Bonus issue When a company issues extra shares free of charge to existing shareholders on a *pro rata* basis. Compare with **Rights issue**.

Call A payment on a specified date on a **Partly paid** stock, to be paid by the holder of the **Allotment letter**.

Call option An **Option** that gives the buyer the right (but not the obligation) to buy a specified quantity of the underlying instrument at a fixed price, on or before a specified date. Compare with **Put option**.

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Capital Asset Pricing Model (CAPM) Sophisticated model of the relationship between expected risk and expected return. Grounded in the theory that investors require higher returns for higher risks.

Capitalisation issue An issue creating additional share capital either by the issue of new shares for old as with a **Scrip** issue or by share rationalisation.

Chinese Walls Controls over communications between corporate financiers, on the one hand, and researchers, traders and salesmen, on the other, in integrated securities houses to avoid potential conflicts of interest.

Comfort letter Letter given by a professional advisor to a company supporting statements that have been made in listing particulars or offering circular.

Convertible stock Stock which gives the holder the right, but not the obligation, to convert all or part of the holding into another stock or stocks on specified dates and on specified terms. Forms include convertible bonds, convertible debentures and convertible preference shares.

Corporate governance Issues relating to the way in which a company ensures that it is attaching maximum importance to the interests of its shareholders and how shareholders can influence management.

Cum dividend **Cum** is the Latin prefix meaning 'with'. A share quoted cum dividend carries the right to a recently declared dividend. Cum scrip and cum rights have similar meanings. Compare with **Ex dividend**.

Dawn raid Term for an investor (corporate raider) buying a substantial number of a company's shares before the market becomes aware of its intentions. The buyer's objective is usually to build a strategic stake in the target company and often leads to a full takeover bid.

Debenture A **Bond** backed by a prior claim on the assets of the issuer or, in some circumstances, by specific assets of the issuer. A debenture holder is entitled to appoint a receiver if necessary.

dividend The part of a company's after-tax earnings which is distributed to the shareholders in the form of cash or shares. The directors of the company decide how much dividend is to be paid and when. A dividend is neither automatic nor guaranteed for ordinary shareholders.

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Dividend discount model A model for determining the price of a security based on the discounted value of its projected future dividend payments.

Dividend cover The extent to which the **Dividends** distributed by a company are backed by the distributable earnings of the company (net profit after tax divided by total dividends).

Dividend yield The return that the annual **Dividend** of a share represents in relation to the current share price. Calculated by dividing the annual dividend per share by the current market price.

Earnings per share A common way of expressing company profits – dividing the profit after tax by the number of shares in issue.

Equity The capital of a company belonging to the **Ordinary shareholders** who have voting rights allowing them to influence the management of the company.

Equity risk premium The difference between the rate of return available from the risk-free asset (government bonds) and that available from ordinary shares, which are a more volatile investment.

Ex dividend To clarify who receives the **Dividend** on a share that is sold around the time the dividend is due, a date is fixed when a share goes ex dividend. Anyone buying after this date will not receive the dividend. A share price will normally fall by the amount of the dividend on the day that it goes ex dividend. Compare with **Cum dividend**.

Exercise price The price at which an option holder has the right to buy or sell the underlying asset. Also referred to as 'strike price'.

Expiry date The last date on which an option can be exercised. Also referred to as **Maturity date**.

Face value The value of a bond that appears on the bond certificate, unless the value is otherwise specified by the issuer. Face value is ordinarily the amount the issuer promises to pay at maturity and is not an indication of the current market value. Also called **Par value**.

Financial Services Authority (FSA) The leading financial regulatory agency in the UK. Sets out policy and governs the content of **New issue prospectuses**. Similar functions to the **SEC**.

Fixed interest An income stream which remains constant during the life of the asset, such as income derived from **Bonds**, annuities and **Preference shares**.

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Flotation The first issue of shares to the public in a company new to the stock market. *See* **Initial public offering**.

FT All-Share Index An arithmetically weighted index of leading UK shares (by market capitalisation) listed on the London Stock Exchange. The FTSE 100 Index (or 'Footsie') covers only the largest 100 companies.

Fully paid Shares on which the full nominal value has been subscribed. Compare with **Nil paid** and **Partly paid**.

Fundamental analysis Analysis of share values based on factors such as sales, earnings and assets that are 'fundamental' to the enterprise of the company in question. These factors are considered in light of current share prices to ascertain any mispricing of the shares.

GAAP Generally Accepted Accounting Principles, as set by national (e.g., UK, US) or international (e.g., IAS) regulators.

Gearing A measure of how much a company has borrowed.

Gilts, gilt-edged securities Sterling-denominated **Bonds** issued by the British government.

Greenmail A term that describes the situation when a hostile bidder threatens a company with takeover by purchasing a large number of its shares, forcing the management of the company to repurchase those shares at an above-market price. (Occurred mainly in the 1980s in the US.)

Grey market The familiar name given to the unofficial market for a new security before its formal offering. Also known as 'when issued trading'.

Impact day The date on which the FSA approves the entry of the issue to the **Official List** and when the underwriting of the issue takes place.

Initial Public Offering (IPO) The first sale of shares of a company to the public. Also referred to as **Flotation**.

Interest cover A measure of a company's ability to meet its interest obligations, calculated by dividing EBIT by interest payments. The higher the ratio the better.

Interest rate risk The risk borne by fixed interest securities, and by borrowers with floating rate loans, when interest rates fluctuate. When interest rates rise, the market value of fixed interest securities declines and *vice versa*.

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- Introduction** An application for a listing on the stock exchange when the shares to be listed are already widely held by the public.
- Issued capital** The portion of a company's **Authorised capital** that has been issued by the company.
- Issuing house** An infrequently used term given to financial institutions, often merchant banks, that act as intermediaries between companies seeking capital and the investors prepared to supply it.
- Junk bond** A high-risk, high-yield debt security rated below triple B.
- Listing** For shares (or **Bonds**) to be traded officially on a stock market they need to be listed. Essentially, this is an endorsement from the market authorities that the securities and their issuer meet certain criteria.
- Listing particulars** Detailed information that must be published by a company applying to be listed. The content is guided by the **Purple Book**.
- Listing rules** Rule book for listed companies. Was commonly referred to as the **Yellow Book**, but since the change in regulatory responsibility in 2000 from the London Stock Exchange to the Financial Services Authority, known as the **Purple Book** after the colour of its cover.
- Loan stock** Another name for a **Bond**, normally used in connection with those issued by non-government bodies such as companies.
- Long-form report** Detailed report on the company and its business prepared by the reporting accountants for the company's directors and the **Sponsor** of a **New issue**.
- Market capitalisation** The result of the number of ordinary shares issued by a corporation, multiplied by the current market price of a share.
- Maturity** End of the life of a fixed interest security at which point it is repaid. Also known as redemption. Maturity can also mean the end of the life of a future or option.
- Model code** Rules issued by the Stock Exchange to be followed by the directors of a company when dealing in the company's shares.
- Money market** The market for trade in short-term securities (maturity of less than 1 year) such as bills of exchange, promissory notes and Government **Treasury bills (T-bills)**.
- Net present value** The current value of a stream of income discounted by a factor over the period of an investment.

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New issue New shares issued by companies to raise additional cash. Can refer to an **Initial public offering** or a **Rights issue** (secondary offering).

Nil paid Shares whose nominal value has not been paid up and where there is therefore a **Call** due on the balance. Government stocks (bonds) are sometimes issued in this way, with one or more calls at specified dates.

Nominal rate of return A rate of return expressed only in monetary terms. Compare with **Real rate** of return.

Nominal value Sometimes known as par value, this is the face value of a security as opposed to its market value. In the case of a **Bond** it represents the principal sum due on redemption.

Off balance sheet Referring to financial commitments or liabilities that do not generally appear in a company's balance sheet.

Offer for sale One of the means by which a company can be floated, where the **Sponsor** offers shares to the public.

Official List The main portion of the London Stock Exchange with approximately 2,000 companies quoted. Complemented by the **Alternative Investment Market** for smaller companies and OFEX which offers a trading service for companies whose shares trade very infrequently.

Options The right to buy (**Call option**) or sell (**Put option**) a specific security at a specified price, at or within a specified time, whatever happens to its market price. This right can usually only be obtained by payment of an amount (known as the premium) to the writer of the option.

Ordinary shares Securities which represent an ownership interest in a company. If the company has also issued **Preference shares**, both have ownership rights.

Over-subscription A new issue is said to be over-subscribed when more applications are received than there are shares for offer. In this event, applications are scaled down *pro rata* or offered by a ballot. See **Allotment letter** and **Ballot**.

Over the counter (OTC) A financial contract that is not traded on an exchange but is 'tailor-made' for a client by a financial institution.

Par value See **Nominal value**.

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- Partly paid** Shares or bonds may be issued partly paid, meaning that the full value of the investment will be paid in two or more instalments or **Calls**. Only the first instalment is paid on issue.
- Pathfinder prospectus** Draft prospectus (preliminary) published in advance of pricing of the offering to aid in marketing the **New issue**.
- PE ratio** Price-earnings ratio. A ratio used to value a company's shares. It is calculated by dividing the current market price by the earnings per share.
- Placing** The placing of a company's securities made by a **Sponsor** or stockbroker with its own clients and with the market.
- Placing agreement** Terms under which the **Sponsor** agrees to underwrite the placing of the company's shares to its clients. *See Underwriting agreement.*
- POS regulations** Public Offers of Securities regulations (1995) are the regulations governing all offers of securities other than those to be listed on the **Official List**.
- Preference share** Preference shares rank before **Ordinary shares** in respect of **Dividend** payments and, usually, capital repayment. Dividends on preference shares are at a fixed rate and the shares do not normally carry voting rights unless the dividend is in arrears.
- Present value** The current value of an investment which matures in the future, after discounting the maturity at an assumed rate of interest and adjusting for the probability of its payment or receipt.
- Primary market** The market in which securities are sold at the time they are first issued.
- Promissory note** A debt security issued by a borrower, showing the amount that the borrower is prepared to pay the noteholder on its maturity. The note is issued at a discount to its face value, representing the yield on the funds for the noteholder.
- Prospectus** A legal document setting out the terms of issue of a new stock. The published document containing all the details of offer for sale or placing, which can also be called the **Listing particulars**. *See New issue.*
- Put option** An **Option** that gives the buyer the right (but not the obligation) to sell a specified quantity of the underlying instrument at a fixed price, on or before a specified date. The writer (seller) of the option has the obligation to take delivery of the

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underlying instrument if the option is exercised by the buyer. Compare with **Call option**.

Real rate of return Nominal rate of return adjusted for inflation.

Red herring A US term for a preliminary prospectus issued in advance of the offer. *See* **Pathfinder prospectus**.

Rights issue When existing shareholders are given rights to purchase new shares in proportion to their existing holding. Compare with **Bonus issue**.

Risk premium The extra **Yield** over the **Risk-free rate** demanded by investors to compensate them for the possibility of default.

Risk-free asset/rate An investment with no chance of default, and a known or certain rate of return. Either **Treasury bills** or **Gilts** in the UK.

Scrip issue A share issue which raises no new money for a company, but simply gives extra shares to existing holders. Also known as a bonus issue. Compare with **Rights issue**.

Securities Exchange Commission (SEC) An independent regulatory agency in the US with responsibility for administering the federal securities laws. The SEC also regulates firms involved in the purchase or sale of securities, people who provide investment advice and investment companies. Similar functions to those of the **FSA**.

Secondary market Any market in which existing securities are traded (as distinct from the primary market, in which securities are first issued). The Stock Exchange is the secondary market for share trading.

Share buy-back Corporate self-purchase of its own shares in the market to reduce its issued share capital. Changes the proportion of debt to equity that it holds on its balance sheet.

Share certificate A piece of paper representing legal evidence of ownership of a stipulated number of shares in a company. Also known as a **Scrip**.

Short form report A report prepared by the reporting accountants for a **New issue**, which is included in the listing particulars, setting out the results for the last 3 years, the cash flow statements and the balance sheets.

Small-cap Term used to describe the smallest listed companies on the stock exchange.

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Sponsor All activities and matters connected to a new issue are co-ordinated by a sponsor, which may be a merchant bank, investment bank, stockbroker or accounting firm. The sponsor is responsible for arranging the timing and underwriting of the issue and ensuring that the company is fairly portrayed in the **Prospectus**.

Stag An investor in the stock market who aims for quick gains by subscribing to new share issues and then selling once the shares commence trading on the exchange.

Subscription An agreement to purchase a certain offering.

Sub-underwriting The sponsor (or **Underwriter**) of a **New issue** will usually spread its financial risk by sub-underwriting a proportion of its total commitment with other financial institutions.

Takeover bid An offer made to the shareholders of a company by an individual or organisation intending to gain control of that company.

Technical analysis An approach to the analysis of stock and futures and their future trends which examines the technical factors of market activity, often represented by charting patterns, as contrasted with **Fundamental analysis**.

Tender An infrequently used method of issuing securities whereby investors are invited to bid, subject to a minimum price. The allocation of the securities is made according to the prices bid. This method can be used when comparable companies are hard to find, or when the demand for shares is anticipated to be overwhelming.

Tender offer A public offer to buy some or all of the existing stock of a company within a specified period.

Treasury bill (T-bill) Treasury bills are short-term debt instruments issued by the UK and other governments. Their return is derived from being issued at a discount to their final redemption value.

Underwriter The underwriter (or **Sponsor**) 'insures' a **New issue** (or **Rights issue**) by agreeing to buy all shares which are not sold. The underwriter typically earns a fee of 0.5% of the funds it guarantees to underwrite.

Underwriting agreement Agreement which sets out the arrangement made between the company and the **Sponsor** that the sponsor will, for a fee, purchase all shares not taken up by the

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public. The sponsor will usually spread its financial risk by arranging to **Sub-underwrite** the issue with major financial institutions, the sub-underwriters taking up any unsold shares.

Unquoted securities Shares which are dealt in the market but which are not subject to any listing requirements and are given no official status.

Venture capital Capital which is subject to more than a normal degree of risk, usually associated with a new business or venture and particularly in relation to new-technology projects.

Verification Procedures undertaken to confirm the accuracy and fairness of statements made in the prospectus. Solicitors to the issue conduct detailed verification of all statements of fact and opinion in the prospectus.

Voting rights **Ordinary shares** usually have associated voting rights that enable the holder to influence the management of the company. *See also* **Corporate governance**.

Warrant A certificate giving the holder the right to purchase shares at a stipulated price within a specified timespan. The money paid upon exercise is received by the company issuing the warrant, unlike options, which raise no new capital.

Working capital statement Statement provided by the directors of any company going public confirming that the company's working capital is adequate for the following year. Usually the reporting accountants will write a letter of comfort to the directors and **Sponsors** having reviewed the statement and its supporting evidence.

Yield A **Measure** of the income return earned on an investment. In the case of a share the yield expresses the annual **Dividend** payment as a percentage of the market price of the share. In the case of a **Bond** the running yield (or **Flat yield**) is the annual interest payable as a percentage of the current market price. The redemption yield (or yield to maturity) allows for any gain or loss of capital which will be realised at the **Maturity** date.

Yield curve A graphical representation of the relationship between the **Yields of bonds** with the same credit quality, but of different maturities. The Government yield curve is the basis of the pricing of new bond issues.

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Yield to maturity The yield provided by a bond which is held to its maturity date, taking account of both interest payments and capital gains or losses.

Yellow Book Document formerly used to govern the listing requirements for the London Stock Exchange.