Accessing Capital -- IPOs and Private Equity

2014

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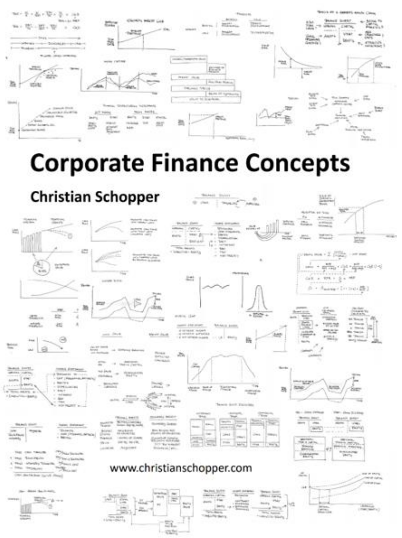

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Why do We Need External Capital?

- To **raise** money for the growth and expansion of operations.
- To **acquire** existing business / companies.
- To **diversify** and reduce investor holdings.
- To provide **liquidity** for shareholders.
- To discover and enhance the Company's enterprise **valuation**.
- To attract and retain talented **employees**.

Accessing Capital through external parties in the form of "Private Equity" or "Going Public" would bring about a major **change** and considered a major **milestone** for any Company

- It would also enable third parties to own the Company (limited to their Equity Shares) and …
- … thus provide them a dual right of:
  - **Sharing** the market potential of the Company's Business; and
  - **Demand** good **results**; information / reports regarding the operations and the conduct of the Company thereby resulting in greater accountability

Modes of Accessing Capital - General

- Traditionally, a private or public limited company would **approach existing shareholders**, associates of promoters for **equity** / quasi equity funding and …
- … to **banks** / financial institutions for their **debt** funding requirements

- Once companies carefully assess their capital requirements, they should analyze the various **funding options available** and …
- … then short list / finalize zero in on the most optimum option which enables achievement of the organizational objectives and also ensure maximizing of **shareholder value**

- This is of utmost importance as **the right source of capital at the right time and right terms** can bring about a significant change in the performance of the company

Modes of Accessing Capital – Sources of Capital

- Senior Debt / Secured Debt
- Mezzanine Funds
- Asset-Based Lending
- Institutional Investors
- Export-Import banks
- Vendor and Customer Financing
- Spin-Offs
- Private Equity
- Going Public

Modes of Accessing Capital – Private Equity Funding

Private Equity is an investment by a financial investor in an – usually - **unlisted enterprise** by way of “risk capital”

- **Funding** based on the business plan, promoters’ background and track record, sector outlook, growth prospects …
- …rather than the security and collaterals
- **Exit** through IPO or sell out …
- … rather than repayment

Enterprise perspective:

- Ability to assume greater risks and **growth potential** without the prospect of financial distress
- Increases the enterprise’s **ability to raise debt**
- Supplement the promoters in **improved management practices**, financial controls and reporting

- PE Investor can in principle come from three routes:
  - Angel Investment
  - Venture Capital Investment
  - Private Equity Investment.

- Private Equity comes once a **company is well established** and …
- … is looking for large value funds for rapid **expansion**

- PE investors generally take lesser stake in companies than venture funds

Modes of Accessing Capital – Initial Public Offering

Initial Public Offering (IPO) is considered to be one of the key goals for several; entrepreneurial ventures

- IPO raises Cash with almost no interest cost (in case of Equity)
- Public Companies may get better rates when they issue debt on account of increased public scrutiny and disclosures
- Trading in the Open Markets means **liquidity**
  - Access to more, and often deeper, sources of capital than a private company
- **Price discovery** for the shares of the Company is established
  - Helps in ascertaining the market capitalization of the company and opens up other opportunities to the Company management to work on improving / optimizing of the market capitalization

- The actual **preparation** and process of going public can be **time-consuming,** expensive, challenging as well as **distracting** to the business
  - The company has to deal with a **broader stakeholder group** than before, …
  - … as well as comply with additional **regulations** and **reporting** requirements
  - A company must be ready to meet shareholder, regulatory, and **market expectations** from day one
  - The company will also be under far greater **public scrutiny**.

- Although IPOs are among the most rewarding decisions for organizations, they **can also be most daunting**
  - Companies considering an IPO should carefully assess their organizational and market **readiness** for going public, …
  - … as well as determine whether leaving the private sphere is indeed the right move for them

IPO vs Private Equity

- The **determination** and **timing** of the mode of accessing capital - other than the traditional mode of Debt - is very essential …
- … as it could make the difference between success and failure

- Considering the implications of "Going Public" are enormous compared to PE Investing
- Therefore **"Are the Market and Organization prepared for Going Public"?**
  – The need for capital does not ideally justify the reason / logic for Going Public …

- **Once an Organization goes public, there is no looking back**
  – The Organization needs to raise and answer a number of questions before deciding to Go Public or for that matter even going for PE Investor
  – Some of the questions to be answered by the Organization before taking any decisions have been discussed hereinafter

Setting Up the Organisation

Preparation strategies can be broadly bifurcated into two aspects:

- Changes required **internally** within the Organization
- Assistance required from **external** agencies.

Changes Required Internally Within The Organization.

- It is important that the Organization starts **thinking; acting and functioning like a Public Company**
  - This requires colossal changes in the **mindset** of the personnel associated with the Organizations specifically the Top Management and Key Executive Team / Head of various Business Units.

Assistance Required From External Agencies

- It is imperative that an organization identifies an **External Agency**, who shall guide and hand hold the Organization throughout the whole **process** (Co-ordinator)
  - The said Co-ordinator shall support the Organization in identifying the key players within the Organization who could be involved in raising "private equity" or "Going Public" and also assist the Organization to hire the services of other external agencies such as Merchant Bankers etc

Financial Aspects

- Capital Structure
  - Companies needs to ensure that appropriate capital structure in terms of **authorized capital**, enabling approvals etc are in place before proceeding for raising "private equity" or an IPO.
- Track Record
  - **Profitability** and **growth** and outdoing the industry averages in terms of profits and growth on a **consistent** basis has better prospects of receiving a favorable response
  - Consistent upbeat **trend** in the financial and operating performance over the past few years
  - Highly respected **management**
- Prospects for High Growth
  - **Potential** for significant **future growth**
  - Products and services accepted in the market over the years duly supported by an attractive **growth plan**
  - Attractive / unique business proposition with a **competitive edge** and appropriate market
- Strong Equity Growth Story
  - Exciting story, as **investors** will **scrutinize** your company and its bottom line performance much more closely than before
  - In uncertain times, investors will demand even greater **details**, **explanation** and **transparency** about the use of funds in the prospectus and during road shows
  - Investors seek companies with business models that have performed well in the downturn, a solid track record, an actionable plan to sustain growth and that are well able to service their interest and debt

Financial Aspects (cont´d)

- Proceeds should Fund Growth
  - **Investors typically prefer** to invest in companies using **funds to grow** the new company, who will put the money back into the business to expand, funding R&D, marketing and capital expenditures
  - The Company should have a clear plan in place regarding the usage of the capital accessed and how far the same would enable the Company to achieve sustained higher growth rate

- Benchmark Performance to Ensure Competitiveness
  - Market leaders have usually been way **ahead of** their **competitors** and comparable companies in practically every aspect of their performance before raising "private equity" or the IPO
  - Companies will need to benchmark performance to demonstrate **competitiveness** with industry peer group/s

Management Aspects

Building an Effective Management Team

- Investors want to be sure that the management running a company is **not a "one-man band"**
  - Adding individuals with public company experience in marketing, operations, development, and finance including a **CFO** who has previously been through the raising "private equity" or IPO process

- The core team in the Company should have **collective experience and understanding** of raising "**private equity**" or the **IPO process**
  - Selecting the right team of external advisors like attorneys, underwriters, auditors, transaction specialists, investor-relations professionals and others is also imperative

- Once the company raises "private equity" or goes public, a **significant amount of executive time** will be devoted to investor / stakeholder relations and **communication**
  - With reduced CEO and CFO oversight, the executive team and managers must be well equipped to oversee the day-to-day operations of the company

Management Aspects (cont´d)

Board of Directors

- The Board of Directors should have an optimum combination of executive and non-executive directors (NEDs)
  - Should have sufficient knowledge of the business specifically in the case of raising “private equity” or an IPO…
  - … with a **good mix of skills**, including industry contacts, technical knowledge, business development, marketing, strategic planning, acquisition integration and financial expertise
- NEDs should be **inducted** six months **in advance** of raising “private equity” or the IPO if possible
  - A NED with experience of raising “private equity” or an IPO, who is able to challenge board debate and provide constructive suggestions to the Board
- Directors can improve board performance by:
  - Having **loyalty to shareholders**, not management
  - **Challenging management** to simplify and explain the business
  - Serving as **ambassadors** and promoters of the business
  - Carefully evaluating **executive remuneration** plans
  - Improving **audit** committee oversight of **risk** management
- One of the best sources of objective advice can come from an independent or outside director

Management Aspects (cont´d)

Appointments To The Board

- Companies should issue formal letters of appointment to Non-Executive Directors (NEDs) and Independent Directors
  - The **term** of the appointment;
  - The **expectation** of the Board from the appointed director;
  - The Board-level **committee(s**) in which the director is expected to serve and its tasks;
  - The fiduciary duties that come with such an appointment along with accompanying liabilities;
  - Provision for Directors and Officers (D&O) **insurance**, if any;
  - The Code of Business **Ethics** that the company expects its directors and employees to follow;
  - The list of **actions** that a director **should not do** while functioning as such in the company; and
  - The **remuneration**, including sitting fees and stock options etc, if any.

Complementary Skills

- **Disparate mix** of audit, governance, compensation and compliance specialists, corporate strategists and experienced executives in business development via organic and M&A growth, capital markets involvement, industry experience and basic financial literacy
- The Board members must have the **individual capacity** to meet the substantial annual time commitment that may be required

Management Aspects (cont´d)

Nomination Committee

- Comprising of majority of **Independent Directors**, including its Chairman
  - Proposals for **searching, evaluating, and recommending appropriate Independent Directors and Non-Executive Directors** [NEDs], based on an objective and transparent set of guidelines which should be disclosed and should, inter-alia, include the criteria for determining qualifications, positive attributes, independence of a director and availability of time with him or her to devote to the job;
  - **Determining processes** for evaluating the skill, knowledge, experience and effectiveness of individual directors as well as the Board as a whole.

- Also evaluate and recommend the appointment of **Executive Directors**

- A separate section in the Annual Report should outline the guidelines being followed by the Nomination Committee and the role and work done by it during the year under consideration

Management Aspects (cont´d)

Remuneration Committee

- The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific **remuneration packages** for executive directors including **pension** rights and any compensation payment

- To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, **all** of whom should be **non-executive directors**, the Chairman of committee being an independent director

- All the members of the remuneration committee could be present at the meeting
  - The Chairman of the remuneration committee could be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries

Remuneration Of Independent Directors (IDs)

- Adequate sitting fees which may depend upon the twin criteria of Net Worth and Turnover of companies
- May not be allowed to be paid stock options or profit based commissions, so that their independence is not compromised

Build a Positive Public Image

Public Relations Firms

- Experienced in investor relations, working with the business **press** and financial **analysts**, can be valuable advisers and facilitators
  - Develop lists of analysts and business press editors who follow an industry and regularly provide them with **news releases** and information
  - Identify the most respected analysts in an industry and target them for either special focus or **interviews** with members of senior management
  - Obtain invitations to trade association and technical **conferences** where companies can present themselves to both the press and analysts who frequently attend to keep current in their field
  - Ensure presence in all the key happenings / forums relating to your industry / markets etc

- PR as an effective tool is to be used much before a Company decides to go public or approach for PE funding
  - This is required to create the right messaging to the target audiences about the strengths of the Company, its prospects, industry prospects, leadership abilities of its senior management etc

Auditors

Statory And Internal Auditors

- Investors per se are concerned about the stature and credibility of the Statutory Auditors and Internal Auditors of the Company

Audit Committee

- The Audit Committee of the Board should be the first point of reference regarding the **appointment of auditors**
- A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following
  - The audit committee shall have minimum three directors as members. Two-thirds of the members shall be independent directors
  - All members of the audit committee shall be **financially literate** and at least one member shall have accounting or related financial management expertise
  - The chairman of the Audit Committee shall be an independent director
  - The chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries
  - The audit-committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee

Auditors (cont´d)

Audit Committee: Role and Responsibilities

- Oversight of the company's **financial reporting process** and the **disclosure** of its financial information to ensure that the financial statement is correct, sufficient and credible
- Recommending to the Board, the **appointment**, re-appointment and, if required, the replacement or removal of the statutory **auditor** and the fixation of audit fees
- Approval of **payment** to statutory auditors for any other services rendered by the statutory auditors.
- **Reviewing**, with the management, the quarterly and annual **financial statements** before submission to the board for approval
- **Reviewing** statement of **uses** / application **of funds** raised through an **issue** (public issue, rights issue, preferential issue, etc.)
- Reviewing **performance of auditors**, and adequacy of the internal control systems
- **Reviewing** the adequacy of **internal audit function**, if any, including the structure of the internal audit department, staffing and seniority
- **Discussion** with internal auditors any **significant findings**
- **Reviewing** the findings of **suspected fraud**, irregularity or failure of internal control
- To look into the **reasons for substantial defaults** in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors
- To review the functioning of the **Whistle Blower mechanism**

Corporate Governance

- Companies adopt the appropriate corporate governance practices that will protect shareholder interests
  - Working with legal counsel on all corporate governance matters, including efficient pre- and post-IPO legal structures and compliance with exchange-listing and other regulatory requirements

- Key success factors in **managing risk include**:
  - Assignment of risk **ownership**
  - Internal risk **communications**
  - Understanding of **enterprise-wide risk**

- Larger public companies are looking beyond internal controls around financial reporting to address the broader, enterprise and external risks

Managing Risks

- Questions the board and audit committee should consider include:
  - Does the board clearly delineate the risks that fall within the oversight of the **audit committee**?
  - What are the company's **risk priorities**?
  - What are the most **important areas of risk** for the company?
  - How are risk **resources** currently being **allocated** relative to the management of these areas of risk?
  - What are the major business initiatives being considered and the significant risks associated with it?
  - How does the risk management program consider **new business strategies**, initiatives, and transactions, and those that relate to external factors (e.g., new regulatory interpretations, focus areas)?
  - Does management provide **frequent updates** to the board and/or the Risk Management Committees ?
  - Are the risk updates prioritized, clear and concise (e.g., management uses a risk dashboard)?
  - **How does the company assure that its risk management programs do not cause it to become risk averse**?

- Corporate Communications Plan

- Institution of Mechanisms for Whistle Blowing

Some Key Steps in Going Public

- Ascertain opportunities for raising funds through access to Capital market
- Determine the appropriate Capital structure, promoters holding, broad business plan and application of funds raised
- Finalize the fund raising plan with the target amount, pre and post issue shareholding of promoters and public, costs involved, principal compliances and other related aspects
- Brainstorming the various fund raising options and deciding the final option to be chosen
- Finalizing Merchant Bankers, Banker to the Issue, Registrars and other related agencies in finalizing the related terms / documentation etc with them
- Provide interactive support between the Merchant Banker / Other related agencies and CDBL on a reasonable and best effort basis
- Participating in meetings with Merchant bankers, institutional investors, financial analysts and financial intermediaries (to be appointed by IT Source)
- Compile / provide financial reporting for IPO (recasting of financial statements for last 5 years). However this does not include attestation work
- Coordinate with the Auditors for getting the said financial statements audited
- Obtain the report on tax implications for inclusion in prospectus

Some Key Steps in Going Public (cont´d)

- Accounting compilation for recasting of financial statements for the IPO or any related attestation thereon
- Media plan
- Investor communications
- Preparation of Business Plan
- Finalization of placement plan
- Finalizing the capital structure keeping in view the Promoter’s interest
- Finalization of Means and Application of Funds
- Appropriate profiling of the Board of Directors
- Advising regarding SEBI and Company Law aspects based on specific requests Finalization of appropriate Dividend and Bonus policy
- Finalization of sizing of the issue (either private placement or IPO)
- Obtaining of the Tax Benefit report required
- Finalization of Prospectus and other legal / commercial documentation
- Preparation of presentations to be given to the Indian Institutional investors / FIIs etc
- Finalizing

Contact

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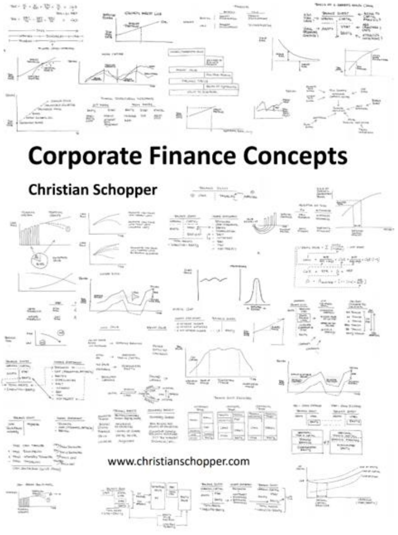

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