Equity Markets - Company Perspective

- Equity vs. Debt
- Reasons for issuing stocks
- Public vs. private equity
- Private equity
- IPO process
- Stock market investors
- Efficiency
- Diversification

Corporate perspective Debt vs Equity

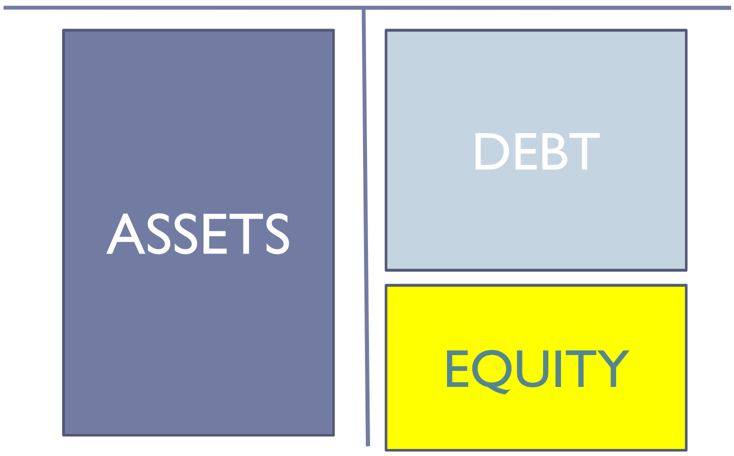
- Company is being started

or

- New project is being considered
- Original owner wants to take some cash out

- So, when the Company needs financing

Company's Balance Sheet



Equity vs. Debt

- Equity – financing (in form of money or in-kind contribution) that Company's owners invest into the venture.
  - Equity investors become the Company's (co-) owners. Ownership unit is called 'share'. The equity investors are entitled to share in profits.
- Debt – financing that creditors are willing to give the Company, and the Company is obliged to return in the future.

Equity vs. Debt

If you are Company's owner and need more resources for new venture, you can:

- Take debt and repay it with interest, but each Company has limited DEBT CAPACITY
- Issue shares (to increase Company's capital)

Benefits and risks of share issue

- Company can usually raise more capital by issuing shares than it can borrow
- Additional capital increased debt capacity of the Company
- Share issue does not require the Company to pay periodic interest or make repayments

- Necessity to share ownership with new investors
- New investors may have influence on the Company's operations

Private equity or public equity?

- Know the co-investor
- Choose the co-investors
- Pre-agreed shareholders agreement
- Better protection of sensitive information
- Lower costs
- Typically lower price

- Access to broad investor base
- Publicity/ Prestige
- Stock exchange rules apply
- Access to capital in the future
- Limited influence on the choice of investors
- High costs but higher proceeds
- Motivation for employees
- Market Valuation

Private equity

Each transaction can be unique

Private equity

- **Shareholders Agreement** – legal agreement between the shateholders that rules the co-operation between the Shareholders
- **Corporate and Civil Codes** – legal acts that set some limits to what can be agreed and rules in case sth is unregulated in the Shareholders Agreement

- Everything that is not strictly enforced by the Law can be agreed in the Shareholders Agreement

Shareholders Agreement – main areas of decisions

- Core business / Strategy of the Company and majority needed to change it
- Management and its appointment
- Supervisory Board composition
- Scope of decisions made at Shareholders and Supervisory Board Meetings (and majority needed)
- Anti dilution – decisions on capital increases
- EXIT (especially for the minority investors)

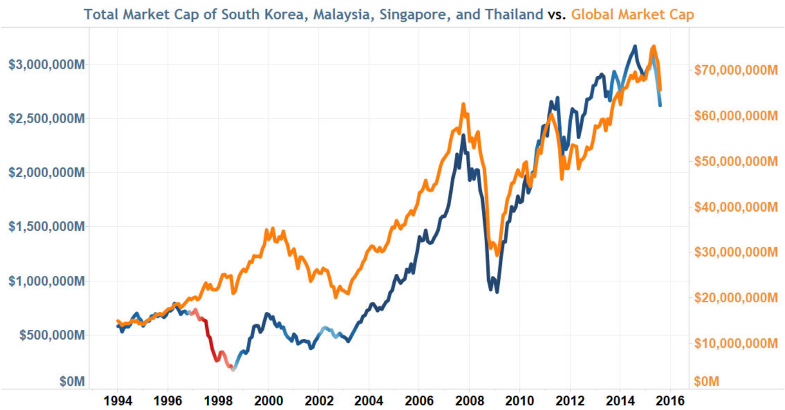
Exit
– special provisions

- Put option
- Call option
- Right of First Refusal
- Drag-along rights
- Tag-along rights

Publicly traded equity

Initial Public Offering

Public Equity (Overview)

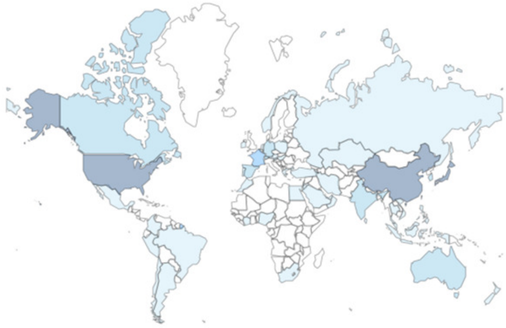


Source: Oxstones Investment Club

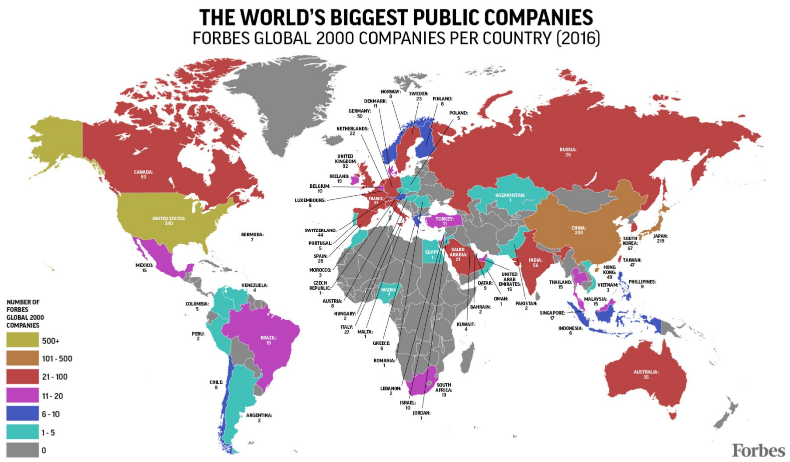
Public Equity (as % of Global GDP)

Source: WorldBank data

Public Equity (by country)



Source: WorldBank data



Source: Forbes Magasine

IPO (initial public offering)

1. Appoint an IPO advisor/ brockerage house
2. Appoint an auditor
3. Appoint legal advisor and PR agency
4. Register with securities commission
5. Publish preliminary prospectus ('red herring')
6. 'Road Show'
7. Final Prospectus (with price range)
8. Book-building
9. Share issue

IPO Advisor / Brockerage House

1. Analyses the impact of the IPO and its costs
2. Prospectus preparation
3. SEC filing documents
4. Represents the Company in front of Capital Markets institutions
5. Assists in meeting with the investors
6. Assists in setting the price range
7. Active role in the issue process
8. Ensures share registration
9. Often underwriter or underwriting consortium leader

Remaining Actors

1. • **Auditor -** verifies the financial statements of the capital group for at least 3 years. Has to be independent.
2. • **Legal Advisor** – prepares legal section of the Prospectus, introduces necessary changes in the corporate documents and bylaws, prepares decissions of the Shareholder's meeting
3. • **PR/IR agency** – ensures appropriate information flow to the potential investors, arranges investors meeting and appropriate publicity /marketing for the issue

Prospectus

- Document that presents the Company seeking capital market investors. The core binding legal document describing the share issue
- Contains information on:
  - The Company: its operations, permissions, management, past and forecasted results, company by-laws
  - The Offer: incl. issue size, instrument issued, use of proceeds, targeted secondary market, costs, planned timetable
  - Risk Summary

Type of share offerings

- Initial Public Offer
- Secondary Public Offer

- Capital Increase
- Sale of Securities

- Public Offer
- Dedicated Issue
- Private Placement

Stock Market Players

1.
- Brocker
  - Acts on behalf of another investor. Does not take risk in the transaction. Charges a commission.

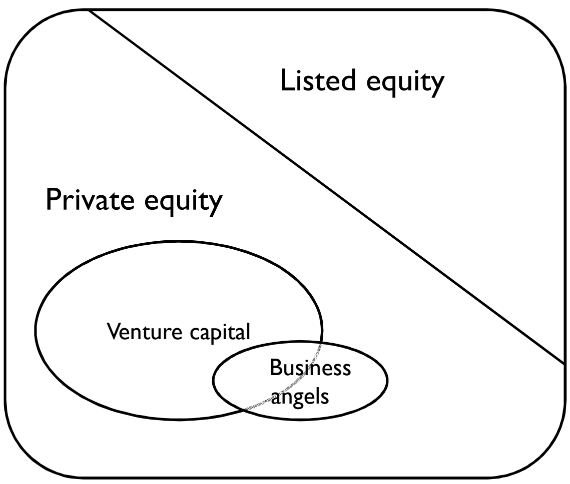
2.
- Dealer
  - Trades on its own risk

3.
- Market Maker
  - Ensures sufficient liquidity and daily quotes for the underlying security

Private Equity

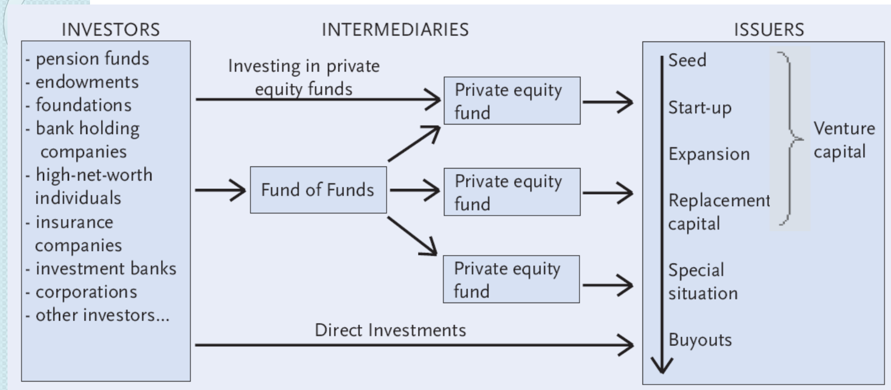
- Invest in Companies that are not listed
- Typically actively involved in management of the Company
  - Prefer to take majority stake
  - Exit withing 5-7 years via: IPO, sell to strategic, recapitalisation
  - Types:
    - Venture Capital
    - Buy Out
    - Special Situation

The universe of equity investment



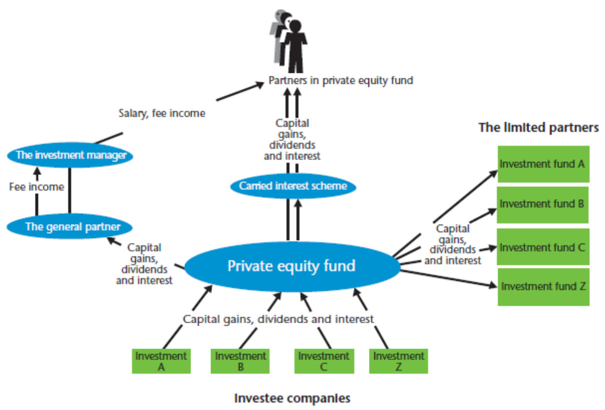
Not to scale

The Private Equity Market



Source: Federal Reserve Bank of Dallas, IFSL, EVCA/Thomson Venture Economics/PricewaterhouseCoopers

Structure of a typical private equity fund

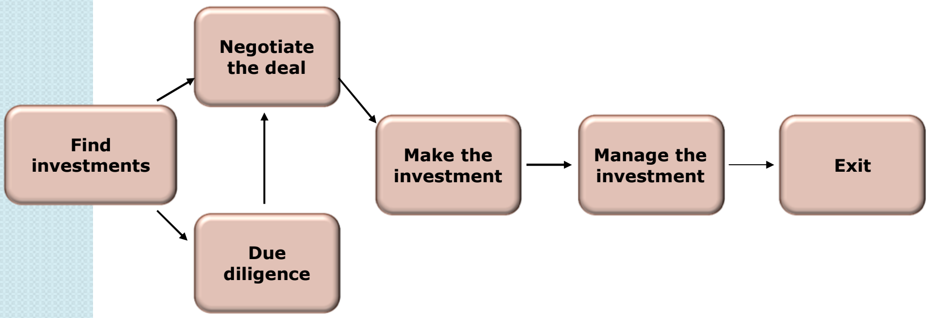


Gilligan, J. and Wright, M. (2010) *Private Equity Demystified*, Corporate Finance Faculty of the ICAEW.

Types of PE transactions

LBO	leveraged buyout – can be any of the following
MBO	management buyout – the existing management of the company buy the company
MBI	management buy-in – incoming management buy the company
BIMBO	combination buyout and buy-in
IBO	institutional buyout – a PE company buys the company and then puts in the management of its choice
P to P	public to private (i.e. delisting)
Leveraged build up (Buy & Build)	The PE company makes an investment in order to buy a lot more companies in that sector and put them together to make something big and profitable

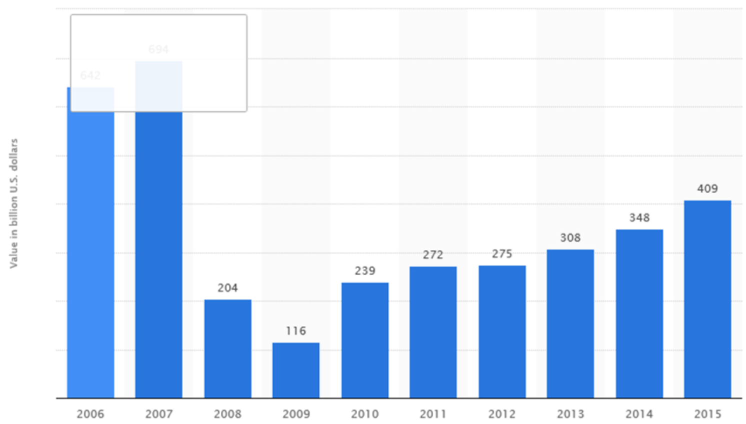
The private equity deal process



Contrasting a buyout with an acquisition

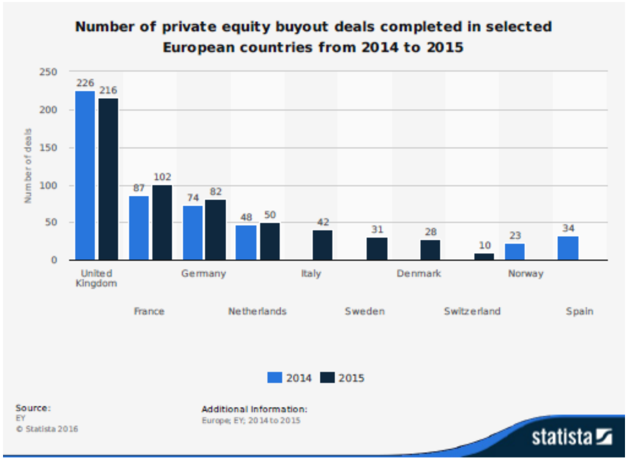
	PE acquirer	Corporate acquirer
Use of a Newco	Newco must be created to hold the shares	Target can be taken as a subsidiary of the acquirer
Impact of debt	Acquisition debt is held in the Newco and does not gear up the PE fund	Debt relating to the acquisition is not ring-fenced and affects the acquirer's capital structure
Conditional payments	Ratchets can be used change shareholdings, dependent on performance	Earn-outs can be used to give the sellers further proceeds, dependent on performance
Changes to target business operations	Part of the acquisition plan agreed with management	Generally plans for synergies to be created
Management incentives	Linked completely to the eventual exit from the investment	Will depend on the corporate objectives
Purpose and timescale of acquisition	The acquisition is made with an ultimate profitable disposal in mind	Probably made for strategic reasons with no expectation of selling on
Funding the acquisition	A relatively high level of debt	To meet the corporate financial structure

PE Market trends (Global)



Source: Statista 2016

European PE market



Source: Statista 2016

Market Characteristics (Poland)

- In 2015 803,5 mln euro - 50% of CEE
- IT, media and industrial sectors dominate with a growing interest into consumption
- Growth capital & Buyouts responsible for ca 98% of volume
- Venture over 60% of deal number
- Growing interest into public to private

Reading list

Based on Jeff Madura: International Financial Management

- International Financial Environment
  - Chapter 1 International Financial Management - Overview
  - Chapter 2 International Flows of funds
- Foreign Exchange and FX Hedging
  - Chapter 3 (section 1) International Financial Market / ForeignExchange Market
  - Chapter 5 Currency Derivatives
  - Chapter 10 Measuring Exposure to Foreign Exchange
  - Chapter 11 Managing Transaction Exposure
- Interest Rate and IR Hedging
- Long term debt financing
  - Chapter 18
- Multinational Capital Structure and Cost of Capital
  - Chapter 17
- Direct Foregn Investment
  - Chapter 13
- Country Risk Analysis
  - Chapter 16