Private Investment in Public Equity - PIPE
Investor’s perspective in PIPE deals
Example of a private investment in public company having market cap of Rs.400cr (a case history)

<table>
<thead>
<tr>
<th>Description</th>
<th>Mkt. cap</th>
<th>Comments</th>
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<tbody>
<tr>
<td>Pre-money market cap of a company (40 mn shares at price of Rs100)</td>
<td>Rs.400 cr</td>
<td>60% (240cr) stake with promoters and 40% (160cr) with public</td>
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<tr>
<td>Private investment of Rs. 100cr comes in the co. @ Rs.133 per share for near 15% stake, i.e., 33% premium to market</td>
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<tr>
<td>Market cap post-money</td>
<td>Rs.500 cr</td>
<td>51% with promoters, 34% with public and 15% with the fund</td>
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For 15% stake in public co. the fund invested 20% money in about 2 months process time

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<th>Description</th>
<th>Amount collected</th>
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<td>If FPO, pricing has to be at least 20% below market price of share for success.</td>
<td>Rs.60 cr (less 10% cost)</td>
<td>Against 100cr from private investors, co. gets Rs.54cr only for the same dilution</td>
</tr>
<tr>
<td>If Rights Issue (RI), pricing has to be at least 30% below market price of share for success (unless there is plan to renounce at higher price)</td>
<td>Rs.52.5cr (less 5% cost)</td>
<td>Against 100 cr from private investors, co. gets Rs.49.9 cr only for the same dilution and promoter has to arrange his own contribution of Rs.31.5cr which he does not have</td>
</tr>
</tbody>
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For 15% stake IPO collection Rs.54 cr and time taken one year and RI collection Rs.52.5 cr in about 4 to 6 months.

The private investment is most beneficial for the co.
An Overview

• PIPE deal - private investors invest in publicly traded corporations.
• In this way Public company gets capital in express mode
• Company has traded shares, issues additional shares under an agreement
• PIPE – Traditional means straight & structured means convertible
• PIPES - a growth capital investment
• Generally a preferred or convertible security that is unregistered
• May involve shares at discount, at premium as far as India is concerned
• PIPE process is fast, simple and inexpensive
PIPE deals dynamics

• Investors in PIPE deals seem short term, in reality they are medium to long term with average holding period exceeding 3 years
• Preference is for convertibles and to lesser degree convertible bonds followed by warrants and registered direct equity to locked in equity
• There is reduced perceived risk to investment
• Maximum opportunities in smaller companies, numbers reduce in bigger
• More growth is seen in small sizes
• Most deals with up to 5% discount to market in US, at par or premium deals in India,
• Premium may go up to 50% above market
• Globally, appetite in Healthcare and life services, BFSI, Energy, Manufacturing, Technology, Consumer, Real Estate, Media, Metals & Mining, Automotives, Telecom
• Despite proper study of the companies and smart investment, gains from the PIPE deals may not be better than investments in open market or PE
Transaction Process and Structure in PIPE deals

- Streamlined process as Due diligence is quick because target company in public domain, time and cost are saved for the investor.
- Security and the transaction documentation is fast due to above and parties can keep the transaction confidential.
- Closing is usually T to T+3 as most transactions are structured.
- Pricing to be as per prescribed formula in India, in US generally there is discount element. More beneficial to investors in USD.
- The issuer may issue warrants to investor as a “sweetener”.
- Most investments structured as convertible shares or convertible debt. These structures provide downside protection to the investor and may also provide some control features.
- In convertibles, underlying shares in many instances can be deemed to be issued at or above the trading price. This allows issuers to sell higher no. of shares without the need for stockholder approval. However the same does not apply to India.
Utilization of funds from PIPE deals

- Investors and co. are better off as money goes into the company.
- Funds mostly used to repay debt, used as growth capital for organic expansion or to restructure operations, enter new markets or to finance a major acquisition.
- Companies need funds as they are able to generate revenue and operating profits but unable to generate sufficient cash to fund major expansions, acquisitions or other investments.
- Promoters may not be willing to take the financial risk alone. By selling part of the company they can take out some value and share the risk of growth with investors.
- Most PIPE investor in order of their activeness are: Private Equity / Hedge funds / Venture funds / High Net worth Accredited Investors / MFs.
Investors choice of PIPE deals vs VC funding

- PIPE deals are follow up offerings in traded cos. and VC largely refers to non-public ownership
- PIPE deals are late stage in relatively matured companies and VC comes in early or mid stage
- PIPE deals can be any term investment which is an advantage for investor while VC is longer term investment
- PIPE deal is generally growth capital having potential to give instant returns, while VC is like business partner, sharing risks and rewards.
- In PIPE deals main objective is capital gains and VC can give advice and assistance to the company based on past experience with other companies which were in similar situations.
- PIPE is straightforward and uncomplicated stake while VC uses his network of contacts in many areas that can add value to the company.
- PIPE deal investor does not look to future participation whereas VC may provide additional rounds of funding should it be required to finance growth.
- For shorter term investment funds, PIPE deals are more suitable.
Selection criteria of PIPE deals

• **These are distinct from the PE funding**

• Examine Business plan document
  • 1. Background on the company
  • 2. The product or service
  • 3. Market analysis
  • 4. Marketing
  • 5. The management team
  • 6. Financial projections and prospective earnings
  • 7. Amount and use of finance required

• Price negotiation based on market price and quantum of shares
• Turnover on the exchange and market cap, beta of the stock
• Size of investment and nature of offering (preferential or QIP)
• Outcome of DD and legal DD can change the negotiated price
• Lock-in period, board seat (not so important), monitoring,
• Future view on the markets
• Earliest exit possibilities at > than expected ROI
PIPE deal – A win – win situation

- PIPE deal saves a company from the complexity of a fresh public issue and investor gets a large block of shares or convertibles (a structured PIPE)
- A certain deal for the investor and no fear of under-subscription for issuer company
- No complex compliance issue formalities and the process is much faster which benefits both equally
- Low cost, even relatively small amounts of capital can be raised
- Pricing is certain for both once the deal has been negotiated (no uncertainty of book build process)
- Advantage over competitors, since the information of raising capital can be kept confidential
- Less equity dilution for issuer co. since the issue is made to private investors
But there are concerns of investors

• **Control**
  
  Unlike private equity investments, PIPE investors will generally not control the board or the business strategy of the company.

• **Liquidity**
  
  In most instances, PIPE investments offer short-term liquidity through the resale registration process. However, in some Sponsored PIPE transactions the investors are be restricted from selling for a specified period of time.

• **Pricing**
  
  According to rules set by SEBI in India, the deal price in a preferential becomes a concern. With such rules, the price that the investors have to shell out for stakes in companies is relatively high, particularly when we compare to US market where it is unregulated and normally discount to market
  
  In case of QIPs it is slightly easy

• **Transaction Fee**
  
  Infrequently, transaction fees are paid to the investor from the proceeds of the financing. This may be around 1% of the gross proceeds, if at all
Some of the recent Indian deals

- JSW Steel issued 9.7 lakh equity shares on preferential basis in Dec’10 to Japanese steelco. JFE Steel taking its holding to 14.99% at Rs.4,800 crore. This will help JSW reduce its debt.
- ING Vysya Bank issued 28 mn shares in May’11 to Rs crore promoters (13mn) and QIPs (15mn) at Rs. 977 crore to shore up is equity base
- Leela Hotel Group issued 14.5% equity in April on preferential basis for Rs.600 crore to be utilized towards retiring part of its debt
- Filatex India issued 28,58,603 equity shares of Rs. 10 each, in June on preferential basis
A mixed bag of success for investors

- An analysis of 2006 and 2007 deals shows that, of the 91 PIPE deals in India, 40 have appreciated and the rest have lost money. That’s 45% transactions in money.
- Baring India’s stake in JRG Securities was the worst hit, having eroded 71%. Others give erosion of over 50% were Vaibhav Gems, Almondz Global Securities, BAG Films and Media, India Infoline, Rama Pulp & Papers and Sical Logistics.
- Some more names of loss are, McLeod Russel India, Allsec Technologies, Maxwell Industries, Spentex Industries, JB Chemicals and Unichem Laboratories, Kopran, Geometric Software, Gateway Distriparks, Hexaware Technologies.
- The funds which were adversely affected in the above PIPE deal investments were; Nalanda Capital, Al Anwar Holdings, Fidelity, Orient Global, ADM Capital, Macquarie and Credit Suisse.
- Last year PIPE deals halved to 43 worth $858 million. In contrast, investment in private firms picked up from 260 deals worth $3.3 billion in 2009 to 300 deals worth $6.7 billion in 2010. Overall, PE investment also increased to $8.3 billion across 376 deals in 2010 from $4.7 billion across 331 deals in 2009.
- Some PE funds just don’t invest in PIPE deals.
- Trend of investing in PIPE deals may turn favourable now due to fall in values.
Conclusion

• As PIPE market continues to grow, there are increasing opportunities for private equity investors to invest in a broad range of companies
• SEBI likely to raise threshold for public offer from 15 to 25% making PIPE deals more popular
• PIPE investments offer many advantages to investors they get block of shares in one go
• Pricing is a major risk at entry and gains at exit
About India Plus advisors

- SEBI registered Venture Fund, yet to bring in outside investors, but uses captive funds
- Follows top down and unconventional approach and like to nurture SME deals from tier II and III cities
- Invests at very early stage at discount to fair valuation as they get a friend and mentor in us
- Enhances value through handholding, policy formulation, corporate governance, HR strategy, professionalism, new referrals, second round of pre-IPO funding by bigger funds
- Take companies to the next orbit
- Exit with high gains