Initial Public Offering
SME Platform

January 18, 2019, Gurugram

Growth Phase of a Corporate

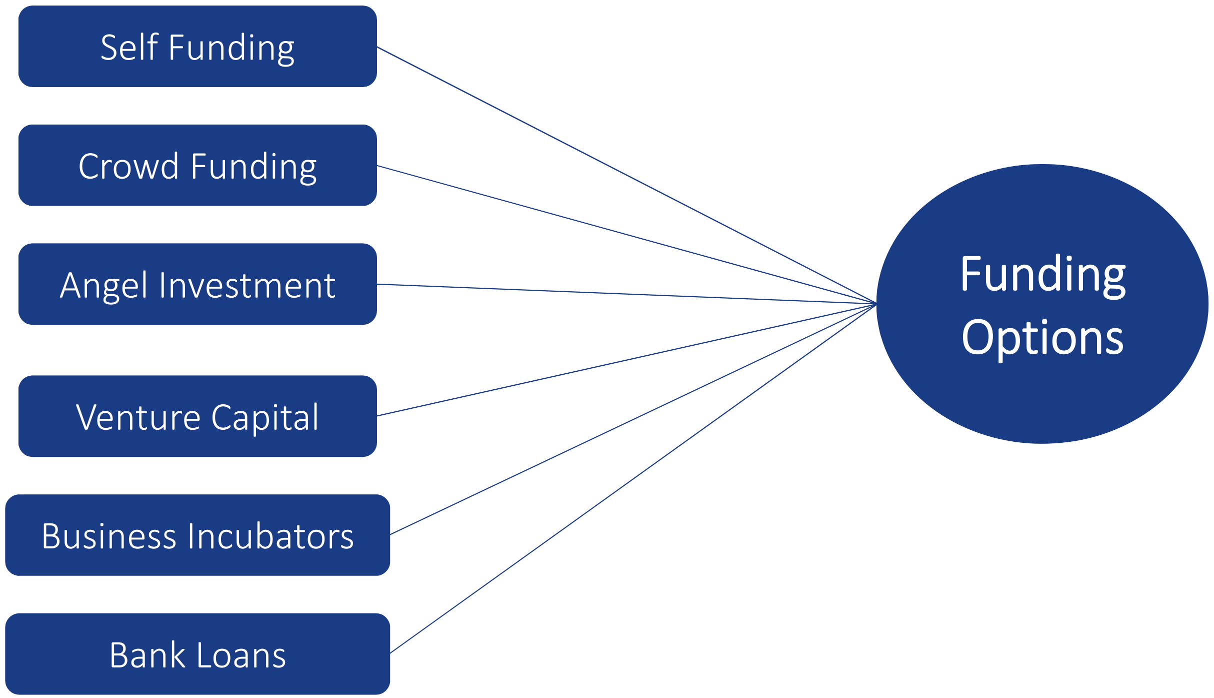
<u>Seed funding</u>:
Promoters and close friends and relatives

<u>Angel funding / Pre Series A</u>:
Capital for kick off with mentoring

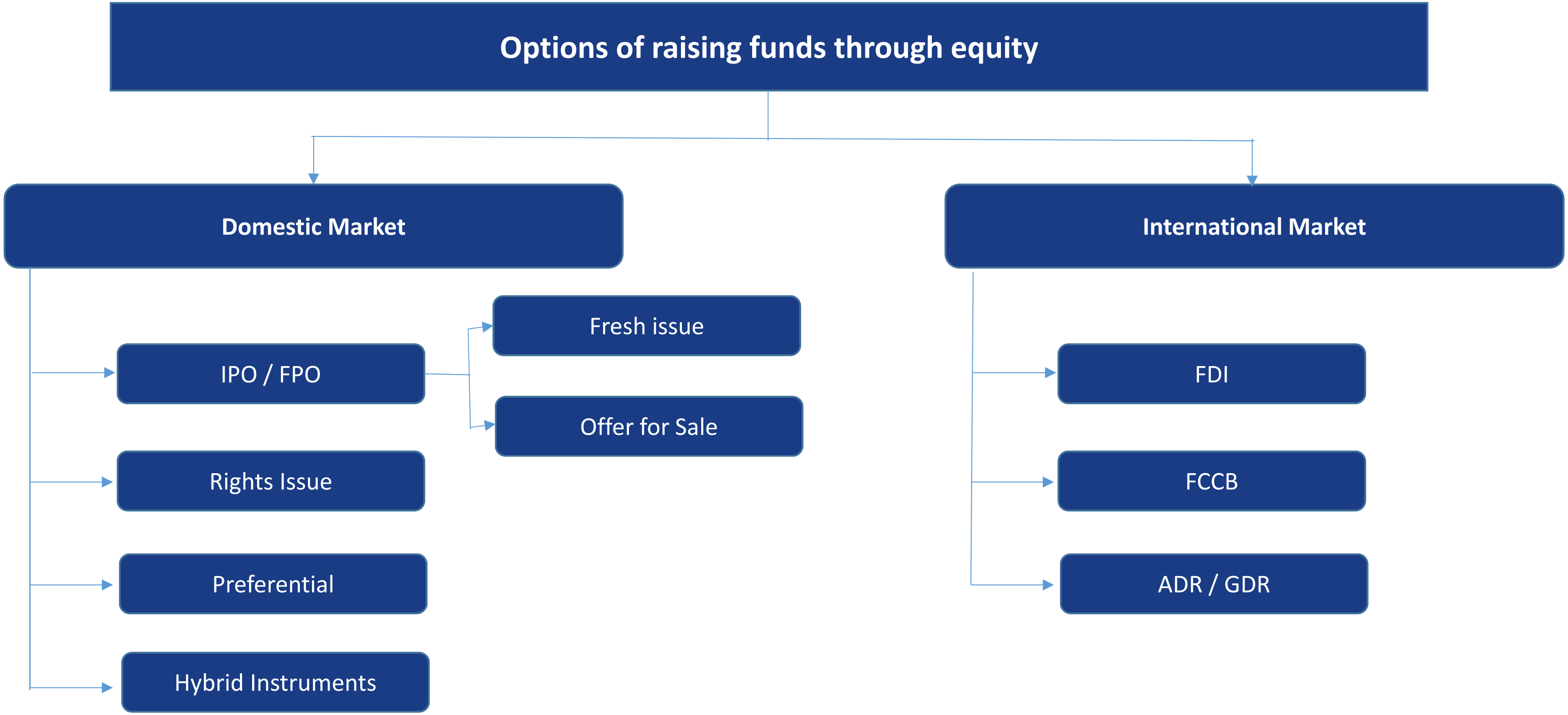
<u>VC funding</u>:
Capital for growth (Series A)

<u>PE funding</u>:
Capital for expansion (Series B / C / D)

Fund raising options: Initial phase



Fund raising options: Matured stage



How to get ready

Complete review of the Company:

- Business of the Company and its USP
- Value chain assessment
- Position of the Company in its peer group and comparative performance
- Infrastructure available with the Company, i.e. office, information technology, business information systems, assets, plant and machinery
- Develop internal controls with soundness in reporting methodologies and solidify accounting controls
- Alignment of books of accounts with the accounting policies
- Revenue projections and monitoring the targets
- Building a strong internal and external advisors team to guide you though the process
- Identifying the best team for managing the IPO

How to get ready

The key to successful IPO and listing is to ASSESS, PLAN, EXECUTE and SUSTAIN

8-12 months before IPO

- Have a clear rationale for going to public
- Meeting with management, KMP and internal team of advisors
- Setting of business plan and reach targets
- Improvisation in the internal controls, reporting practices & business information systems
- Compliance with all applicable laws & obtaining registrations
- Alternative options, timelines & cost
- Developing processes from listing prospective
- Corporate & capital re-structuring
- Group re-structuring
- Consideration of ownership issues, succession planning and taxation issues

5-8 months before IPO

- Consolidation of all information related to company, creation of data room & internal due diligence
- Preparation of the draft offer document for statutory filing
- Broad base the Board & create committees
- Appointment of KMPs & compensation
- Assessment of peer set and competition
- Brand building and creating visibility
- Creating the re-stated financial statements
- Introduction with intermediaries for the IPO

2-5 months before IPO

- Appoint the intermediaries for the IPO
- Due Diligence
- Pre IPO initial meetings with institutional investors
- Initial road shows
- Brand building and creating visibility
- Hold internal organizational meeting and provide education to employees & directors regarding IPO and associated regulations, e.g. research reports, business projections, insider trading, etc

Final 2 months before IPO

- Filing of Draft offer document with stock exchange
- Seeking approval from stock exchanges
- Finalisation of the offer document, in compliance with the comments received from the regulatory authorities
- Road shows, press and broker meet
- Meetings with institutional investors and analysts
- Newspaper advertisements
- Marketing of the issue with institutions, brokers and public
- Registration of the offer document with ROC
- Deciding on the issue schedule and offer pricing

Why SME IPO

- ❖ Small and Medium Enterprises, which act as support functions to the large industries require capital and have limited resources with high growth potential
- ❖ Micro, Small and Medium Enterprises (MSMEs) contributes 8% of the country's GDP, 45% of the manufactured output and 40% of our exports
- ❖ Going public would provide the MSME's with equity financing opportunities to grow their business, both organic and inorganic
- ❖ Fund raising is difficult for SMEs because of their relatively smaller size of operations
- ❖ Long term strategic objectives
- ❖ Increased visibility and prestige
- ❖ Liquidity for shareholders, which is a major challenge in Private Equity funding
- ❖ Being listed, create employee incentive mechanisms

+ / - ives of IPO

+ives of an IPO

- ✓ Flexibility for capital raising opportunities for business expansion
- ✓ Independent valuation of company & Wealth creation
- ✓ Exit strategy for PE / VC investors and liquidity to shareholders
- ✓ Enhanced ability to attract, retain & reward employees with stock incentive plans
- ✓ Brand visibility and enhanced customer recognition

-ives of an IPO

- ✕ Time consuming exercise
- ✕ High cost of funding vis-à-vis debt
- ✕ Loss of entrepreneurial control, influence and power of business decisions as a result of diversified investor base
- ✕ Enhanced transparency into system and processes
- ✕ Peer pressure on performance
- ✕ Cost of maintaining listing

Is the Company ready

- Evaluate the business plan of the Company
- Growth opportunities for the Company and Industry
- Implement best practices and business processes
- Dependable and robust management and execution team
- Financial reporting and budgeting tool
- Re-alignment of accounting policies and standards
- Investment rationale and potential for future investors to create wealth for long term
- Competitors and how they stand in the capital markets
- Consolidation of businesses in different structures or companies
- Promoter estate planning or holding structure with the best taxation advantage

Key Requirements for Listing

- Chapter XB of SEBI ICDR Regulations provide for issue of specified securities by small and medium enterprises
- Approval from stock exchange/s only
- Post issue face value capital should not exceed 25 crore
- Minimum Application Size shall not be less than one lakh per application
- Number of prospective allottees should not be less than 50.
- 100% underwritten (Merchant Banker is required to underwrite minimum 15% of the issue size)
- Market Making for minimum 3 years
- Mandatory facilitation of trading in Demat securities
- Company to have a website
- Lower initial and annual listing fees compared to main board

Advantages of SME Listing

Company advantages

- ✓ Fund availability from investors
- ✓ Create better leveraging capabilities
- ✓ Visibility and creating track record with customers, suppliers, institutions, media, investors, etc
- ✓ Better liquidity - entry & exit platform

Regulatory Benefits

- ✓ Concessional rate of 10% on LTCG
- ✓ Lower tax rate of 15% on STCG
- ✓ No tax on equity infusion in the company (Section 56(2)(viib))
- ✓ Simplified disclosure norms (half yearly)

Others

- ✓ Enhancing worth for all stakeholders
- ✓ ESOPs - with marketable securities
- ✓ Setting up of internal risk management and governance systems

Eligibility Criteria

S. No.	Parameters	NSE Emerge	BSE SME
1.	**Incorporation**	The Issuer should be a company incorporated under the Companies Act 1956 / 2013 in India.	The Issuer should be a company incorporated under the Companies Act 1956 / 2013 in India.
2.	**Post Issue Capital**	Face Value of the post issue paid up capital of the company shall not be more than Rs. 25 Crore.	The post-issue paid up capital shall be at least Rs. 3 Crore and shall not be more than Rs. 25 Crore.
3.	**Networth**	Net-worth should be positive	Net-worth should be positive (earlier Requirement of Rs. 3 crores)
4.	**Net Tangible Assets**	No such Criteria	At least Rs.3 Crore as per the latest audited financial results.
5.	**Track record**	The company/entity should have positive cash accruals (earnings before depreciation and tax) from operations for at least 2 financial years preceding the application. Track record of at least three years of either (a) the applicant seeking listing; or (b) the promoters*/promoting company, incorporated in or outside India or (c) Proprietary / Partnership firm and subsequently converted into a Company (not in existence as a Company for three years) and approaches the Exchange for listing. *Promoters mean one or more persons with minimum 3 years of experience in the same line of business and shall be holding at least 20% of the post issue equity share capital.	The company/entity should have positive cash accruals (earnings before depreciation and tax) from operations for at least 2 financial years preceding the application. Earlier, a newly incorporated company was also getting listed on BSE SME platform it they could not meet the profit requirement but were having a net worth of Rs. 5 crore. However the same is not possible now.

Eligibility Criteria

S. No.	Parameters	NSE Emerge	BSE SME
6.	**Securities in Demat form and Agreement with Depositories, i.e. NSDL & CDSL**	100% of Promoter holding shall be held in dematerialized form post listing of equity shares of the company.	It is mandatory for the company to facilitate trading in demat securities and enter into an agreement with both the depositories.
7.	**Min. Allottees required**	50 The minimum application and trading lot size shall not be less than Rs. 1,00,000/-	50 The minimum application and trading lot size shall not be less than Rs. 1,00,000/-
8.	**Underwriting of Issue**	100% underwriting of the issue and 15% of the underwriting should be by the merchant banker	100% underwriting of the issue and 15% of the underwriting should be by the merchant banker
9.	**Migration from SME Platform to the Main Board**	It is mandatory for the company to be listed and traded on the NSE Emerge Platform for a minimum period of two years and then they can migrate to the Main Board	It is mandatory for the company to be listed and traded on the BSE SME Platform for a minimum period of two years and then they can migrate to the Main Board
10.	**Other Listing conditions**	A certificate from the applicant company / promoting companies stating the following: (a) The applicant Company has not been referred to Board for Industrial and Financial Reconstruction (BIFR). (b) No petition for winding up is admitted by a Court of competent jurisdiction against the applicant Company. (c) No material regulatory or disciplinary action by a stock exchange or regulatory authority in the past three years against the applicant company.	Similar conditions & There should not be any change in the promoters of the company in preceding one year from date of filing the application to BSE for listing under SME segment. It is mandatory for a company to have a website.

Comparative: Main Board vis-à-vis SME

S. No.	Parameters	Main Board	SME Platform
1.	**Compliance norms**	Quarterly compliance	Simplified Half Yearly compliance
2.	**Annual report to shareholders**	Complete	Abridged
3.	**Minimum Allottees**	1000	50
4.	**Issue Expense**	High	Minimal, however, the issue will be charged for underwriting, sub-underwriting and responsibility of three years market making.
5.	**Market Making**	Not required	Compulsory for 3 years
6.	**Listing Fees**	High	Minimal
7.	**Underwriting**	Soft underwriting	100% underwritten
8.	**Approval**	SEBI & Exchange (other business regulators, if required)	Exchange (other business regulators, if required)

Issue Type: Fixed Price

- The Issuer determines the price while registering of the Prospectus with the ROC
- Atleast 5% of the Issue Size shall be reserved for the market maker
- Of the balance issue, 50% shall be reserved for applicants applying for shares exceeding the value of Rs. 200,000
- Balance 50% shall be reserved for the applicants applying for shares for value upto Rs. 100,000

Issue Price: Book Building

- The Issuer determined the price after registration of the RHP with the ROC
- Atleast 5% of the Issue Size shall be reserved for the market maker
- 50% of the offer size shall be reserved for QIB allocation
- Of the QIB allocation, 60% of the same shall be allocated for Anchor Investors
- 5% of the QIB allocation (excluding Anchor Investor portion) shall be available for allocation to Mutual Funds only
- 35% of the offer size shall be reserved for Retail Individual Investors
- 15% of the offer size shall be reserved for Non Institutional Investors

Process for SME Listing

Appoint intermediaries

- Merchant Banker
- Advisors & Professionals
- RTA, Banker, Lawyers, etc

Structuring

- Identify optimal capital structure
- Assessment of Enterprise Valuation
- Offer size estimation

Due Diligence

- Secretarial, legal, financial
- Third party certifications
- Company structure

Documentation

- Obtain legal Due Diligence Report
- Prepare Draft offer document
- In-principle listing application

Regulatory approvals

- Filing of Draft offer document with stock exchange/s
- Obtain their approval

Marketing strategy

- Road shows
- Press and brokers meet
- Meeting with investors

Prior to issue opening

- ROC registration of offer document
- Finalisation of issue price / price band
- Statutory advertisements
- Agreements with intermediaries

Issue closure

- Allotment
- Promoter lock-in / demat credit
- Listing application and approval

Post listing of company

- FIRC & FC-GPR filing
- Market making
- Routine listing compliances

Market Making: Post Issue

- ❖ The market maker shall provide two way quote in the market post listing of the equity shares of the Company
- ❖ Such quote shall be available for atleast 75% of the time
- ❖ Limits on upper side for the market maker during market making process, based on issue size is as under:

Issue Size (in cr)	Buy quote exemption threshold (including 5% initial inventory)	Re-entry threshold for buy quote (including 5% initial inventory)
Upto 20	25%	24%
20-50	20%	19%
50-80	15%	14%
80 above	12%	11%

Post listing compliances

General applicability

- ❖ SEBI LODR Regulations
- ❖ SEBI PIT Regulations
- ❖ SEBI SAST Regulations

Event based

- ❖ SEBI ICDR Regulations
- ❖ SEBI Buyback Regulations
- ❖ SEBI SBEB Regulations

Migration to Main Board

Compulsory Migration to Main Board

Post Issue Face Value Capital increases beyond 25 crores

Shareholders to approve by way of special resolution through postal ballot for allotment of shares & migration

At least Two times votes of public in favor than against the agenda

Issuer shall obtain in-principle approval from the Main Board

Optional Migration to Main Board

Post Issue Face Value Capital more than 10 crore rupees and upto 25 crores

Fulfills the eligibility criteria for listing by Main Board

Shareholders to approve by way of special resolution through postal ballot

At least Two times votes of public in favor than against the agenda

Documentation for IPO

For convenience, divided into

Secretarial related:

- Resolutions and meetings for requisite approvals
- Memorandum and articles of association
- Capital Structure of the Company
- History and other corporate matters
- Management of the Company
- Promoter and Promoter Group
- Group Companies

Financial related :

- Restated Financial statements
- Management Discussion and Analysis of financial condition and results of operations
- Financial indebtedness
- Statement of possible tax benefits

Operations related:

- Business of the Company
- Industry Scenario
- Objects of the Issue
- Details of the employees

Legal related

- Litigations
- Risk factors
- Government and statutory approvals taken / required by the Company
- Agreements with intermediaries, e.g. Market Making, Underwriting, Banker to the Issuer, etc
- Key Industry Regulations

Taxation under Section 56(2)(viib) of the Income Tax Act, 1961

Section 56(2)(viib)

The Section 56(2)(viib) of the Income Tax Act, 1961 reads as under:

where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:

Provided that this clause shall not apply where the consideration for issue of shares is received—
(i) by a venture capital undertaking from a venture capital company or a venture capital fund; or
(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Explanation.—For the purposes of this clause,—
(a) the fair market value of the shares shall be the value—
(i) as may be determined in accordance with such method as may be prescribed; or ***(See: Rule 11UA)***
(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature,
whichever is higher;

(b) "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (a), clause (b) and clause (c) of Explanation to clause (23FB) of section 10; ***(See: Now governed through SEBI AIF Regulations)***

Cases where no tax liability

- If the Company falls in the definition "Company in which public are substantially interested"
- Receipt of money from a person not resident in India (i.e. where the money is repatriable outside India)
- Receipt of money from Venture Capital (or now AIFs)
- If valuation justified in accordance with Rule 11UA
- If valuation can be substantiated to the satisfaction of the Assessing Officer

Methods specified under Rule 11UA(2)

- Simple NAV (i.e. Asset – Liabilities). Does not takes into consideration the circle rate value of properties held and the re-assessment of fair value of the investments made
- DCF based value as determined by a Category I Merchant Banker

Concerns: Angel Tax

What is Angel Tax:

- There is no tax with this name. It is the commonly used terminology to refer to the tax liability under Section 56(2)(viib)
- This is a tax on the unjustified premium collected by the Company during fund raise
- Since startups and new business ideas are on the rise for last few years, it is the startup segment which is badly hurt with the taxability under this Section since a start up always have funding issues and operate on very tight liquidity
- However, it is not just startups, but other well established companies in varied business operations are also facing the fears of tax liability under this section
- Quantum of tax: 30%, on unjustified premium without any deduction

Concerns: Angel Tax

Vide notification no. 24/2018/F.No. 370142/5/2018-TPL (Pt.) dated May 24, 2018, the CBDT had exempted angel investors from the Angel Tax from 11th April, 2018 (Startups registered under Section 80IAC of the Income Tax Act) subject to fulfilment of certain terms and conditions and approval granted by the Inter-Ministerial Board of Certification (IMB).

Under April 11, 2018 notification, an entity shall be considered as startup:

i. **Upto a period of seven years from the date of incorporation / registration**, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India. In the case of Startups in the biotechnology sector, the period shall be upto ten years from the date of its incorporation/ registration.

ii. Turnover of the entity for any of the financial years since incorporation/ registration has **not exceeded Rs. 25 crore**

iii. Entity is **working towards innovation, development or improvement** of products or processes or services, or if it is a **scalable business model with a high potential of employment generation or wealth creation**.

Challenges:

- Investor specific approval
- Aggregate of paid up capital and premium of the start up after proposed fund raise does not exceed Rs. 10 cr
- Investor’s average returned income should be Rs. 25 lakhs+ for last three years OR networth of Rs. 2 cr or more at the end of the last financial year
- Valuation report required from Category I Merchant Banker

Impact on startups

- Squeezing the liquidity for fund raise by startups
- Lack of stable deal pipeline
- If tax levied, 30% tax burden to be borne by the startup. Various angel investors are not asking for indemnity from angel tax under the share subscription agreements to protect their value of investments. It will be a undue hardship on the promoters of startups as they do not have such cash resources available
- Valuation based on intangibles will be difficult to be justified to the revenue authorities as they do not see any real asset creation. New age technology based ventures do no achieve break even for years, but the valuation of the same is based on the reach and usage by the population at large
- Various startups are planning their corporate structure in a way to ring fence the Company from the applicability of the provisions of Section 56(2)(viib)

Present scenario

- Taxation department is raising questions over the basis and assumptions for the valuation and the reasonableness of the projected financial statements
- Evaluation of the projected financial statements is being made with the actual performance of the Company after 2-3 years (since the scrutiny and assessment takes a similar time to complete)
- At various places, questions are also raised on the cost of capital / required rate of return for the investor
- Various litigations are being contested on the matter at various levels by the companies, including the questions like whether taxation department can question on the assumptions taken by an independent expert in the field, questions of valuation v/s evaluation, intent of insertion of the said provisions (to check money laundering), etc

THANK YOU

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Merchant Banking I M&A I Valuations I ESOP I Advisory