Elara Capital Plc

2nd Research Meeting of the NIPFP-DEA Program

Foreign Capital for SME’s

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March 28th 2008-DELHI

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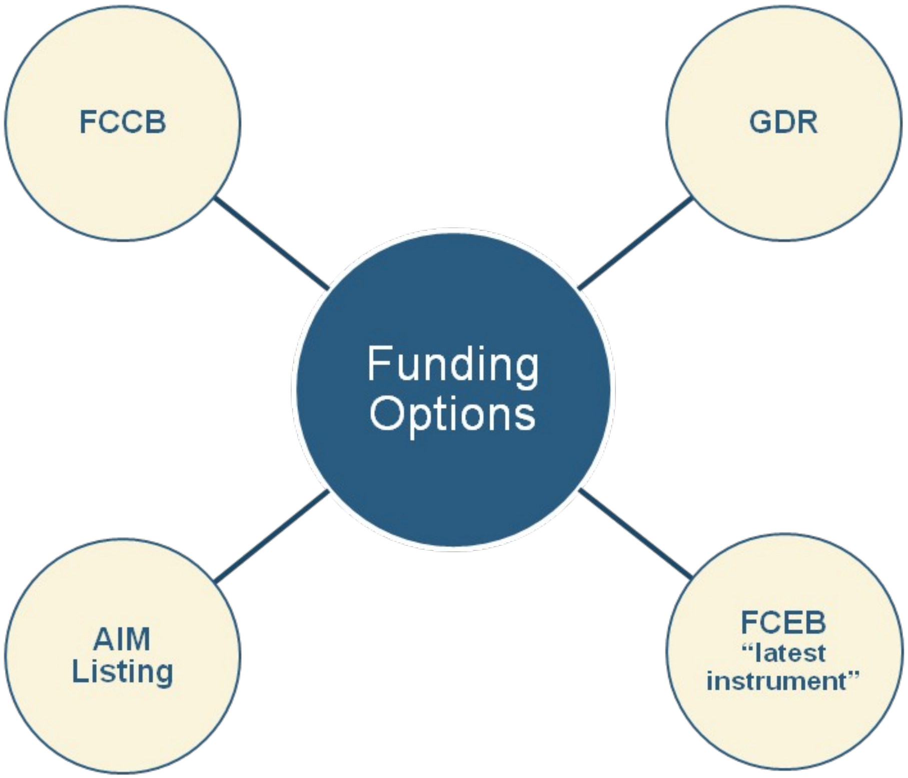
Funding options



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Foreign Capital for SME’s

Reasons for companies to raise funds (Growth Capital)

For cross border acquisitions

Implementation of new projects

Expansion / Modernization of existing projects

For Overseas direct investment in Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS)

Foreign Capital for SME's

Why these instruments are popular?

Benefits to the Issuing Company

- Cost differential -typically 100 to 250bps lower than domestic
- Access to global capital markets – large pools of capital
- Increases the visibility of the company's products & services
- Expands shareholder base, increases liquidity, stable share price
- Better market capitalization

Benefits to an Investor

- Provides an opportunity to invest in fast growing Indian companies
- Diversified / derisked investment portfolio
- Eliminates custody charges
- Ease of comparisons of similar companies – market values / capitalization

FCCB (Foreign Currency Convertible Bonds)

An Introduction

- A type of convertible bond issued in a currency different than the issuer's domestic currency
- A convertible bond is a mix between a debt and equity instrument
- It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholder the option to convert the bond into stock
- FCCBs represent a Debt obligation for the Corporate
- Investors have the option to convert them into GDRs or underlying shares
- If investors prefer to hold the Bonds till maturity date, the Corporate has to redeem the Bonds on that date
- The Coupon rate on the FCCB would be nominal

FCCBs are very effective instruments for raising funds overseas

100 Indian companies raised: $ 7.96 billion through FCCBs in 2007

Total amount raised in 2006 in $ 5.20 billion

Total amount raised in 2005 in $ 3.59 billion

The favourable factors are

- Low interest rate
- Equity up side
- Investor confidence in India growth story
- Increasing profile of mid cap corporates

FCCB - Regulatory Mechanism

- ECB guidelines governs FCCBs
- The bonds are required to be issued in accordance with the scheme viz., "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme 1993”.
- ECB can be accessed under two routes:

    (i) Automatic Route

    (ii) Approval Route

Circular No. 04 dated August 7, 2007 relating to External Commercial Borrowings (ECB)- Some salient features

- ECB more than USD 20 million per borrower company per financial year would be permitted only for foreign currency expenditure for permissible end-uses of ECB

- Up to USD 20 million for Rupee expenditure for permissible end-uses would require prior approval of the Reserve Bank under the Approval Route. Such funds shall be continued to be parked overseas until actual requirement in India

- All other aspects of ECB policy such as eligible borrower, USD 500 million limit per borrower company per financial year under the Automatic route and the Approval route

FCCB - Regulatory Mechanism

Permitted End Uses

- For investment (e.g. import of capital goods)
- Implementation of new projects
- Modernization/expansion of existing production units in:
  - real sector
  - industrial sector including SME
  - infrastructure sector

- For Overseas direct investment in Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS)

- For the first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares

Non-Permitted End Uses

- On-lending or investment in capital market
- Acquiring a company (or a part thereof) in India by a corporate
- In real estate
- For working capital
- For general corporate purpose
- For repayment of existing Rupee loans

FCCB - Valuation

- The FCCB has two components, namely a bond component and an equity component
- The Present Value of the bond component is arrived at by discounting the future cash flows at LIBOR + credit premium
- The value of call option on equity is arrived at as per various evaluation models – e.g. Black Scholes model
- The values so arrived are mutually exclusive – at any point of time value of the bond would be higher of the two + accrued interest in addition to
  1. Credit risk, in terms of credit spread included in the YTM, and,
  2. Earnings risk on the equity
- For the issuer, the cost of capital would be: post-tax coupon of the bond and cost of equity

FCCB - Some Salient Features

Pricing	FCCBs are denominated typically at US$ thousand each
Redemption Premium	Based on Yield to Maturity (which is LIBOR plus Basis points as specified by RBI) and Coupon
Transferability	FCCBs can be freely transferred between non-residents outside India
Conversion	FCCBs can be converted at the pre-determined conversion price, at any time by the investor, into GDRs or underlying shares Such converted shares can be sold in the Indian stock market, without RBI approval
Cost ceilings	All inclusive cost including the rate of interest, other fees, expenses in foreign currency except commitment fee, pre-payment fee and any fee payable in Indian Rupees Up to 3 years Tenure: 150 bps over 6 months LIBOR Between 3 to 5 years: 250 bps over 6 months LIBOR
FCCB process	After Issuer gets Board resolution, it takes 10-12 weeks to complete the entire process of FCCB

FCCB - Participants

- Issuer – (e.g. Company)
- Local legal advisor – (e.g. Law firms)
- Local accountants - (e.g. Company's auditors)
- Local custodian – (typically Banks)
- Lead Manager – (e.g. Investment Banks)
- Depository bank – (e.g. Bank of New York / State Street / Global)
- Overseas legal advisor – (e.g. UK Law firms)
- Escrow bank – (typically Overseas Banks)

FCCB Process flow

ISSUER

Decide on FCCB issue,
Seek board approval,
Appoint all participants

Prepare:
Offer Memorandum,
Listing Circular-in line with overseas stock exchange regulations

Apply to:
Stock exchange for in-principle approval,
To RBI for obtaining loan number

Co-ordinate with all participants

LEAD MANAGER

Liaise with potential investors,
Offer Memorandum,
Investor Conference Calls,
Obtain FCCB Term Sheet

Vet listing Particulars,
Ensures it complies with disclosure requirements of overseas stock exchange

FCCB Process flow - Vetting & approval

ISSUER

All participants

LEAD MANAGER

Make changes as required by stock exchange,
Obtain approval

Send draft listing particulars to overseas stock exchange for comments and approval

Prepare final listing particulars

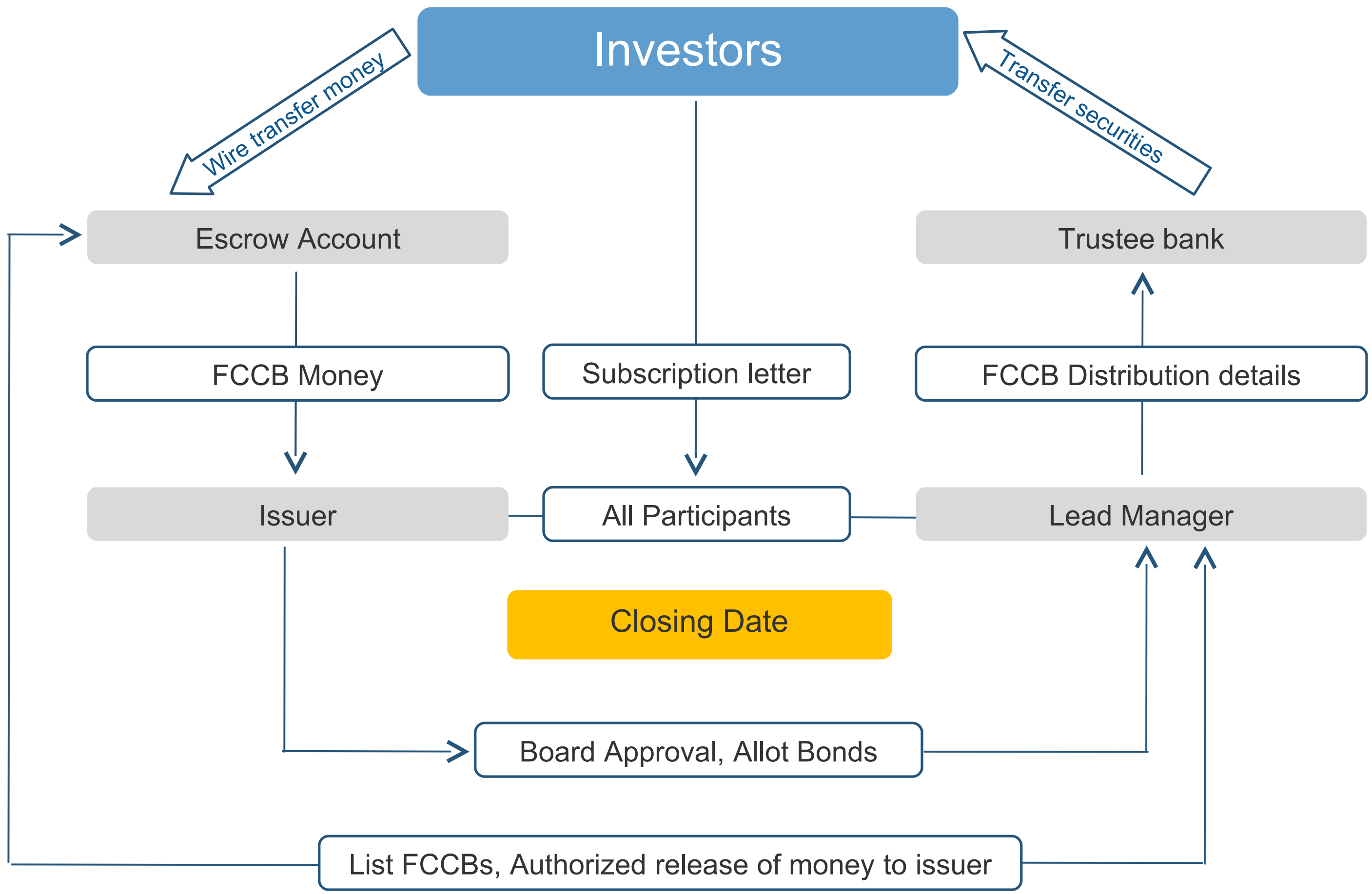
Feedback from overseas stock exchange

Open escrow account with overseas bank to collect FCCB proceeds

Circulate final listing particulars,
Subscription letter to all investors

Consult issuer, all participations and fix FCCB opening & closing dates

FCCB Process flow - Collection of Application Money Distribution of FCCBs



FCCB - Pros and Cons

Advantages

1. The company gains higher leverage, as debt is reduced and equity capital is enhanced upon conversion, subject to favorable stock price

3. The impact on cash flow is positive, as most companies issue FCCB with a redemption premium, which is payable on maturity, only if the stock price is less than the conversion price

5. FCCB do not dilute ownership immediately, as the holders of ADR / GDR do not have voting rights

7. Conversion premium adds to the capital reserves

9. FCCB carries fewer covenants a compared to a syndicated loan or debenture, hence more convenient to raise funds for Mergers and Acquisitions

Disadvantages

1. In a falling stock market, there is no demand for FCCB. In globally listed companies, prices in other stock exchanges also impact the issue of FCCB

3. FCCB, when converted into equity, bring down the earnings per share, and eventually, dilute the ownership

5. In the long run, equity is costlier than debt, and hence, when interest rates are falling, FCCB are not preferred

7. Book value of converted shares depends on prevailing exchange rate

GDR (Global Depositary Receipts)

An Introduction

- A negotiable certificate held by a Depositary of one country representing a specific number of shares of a stock traded on an exchange of another country.
- When any GDR is traded, the broker will aim to find the best price of the share in question. He or she will therefore compare the U.S. dollar price of the GDR with the U.S. dollar equivalent price of the local share on the domestic market
- For example
  - The GDR of the Indian oil and gas company is trading at US$12 per share and the share trading on the Indian market is trading at $11 per share (converted from rupees to dollars), a broker would aim to buy more local shares from India and issue GDRs on the U.S. market.
  - A U.K. broker may also sell GDRs back into the local Indian market. This is known as cross-border trading. When this happens, the depository cancels an amount of GDRs and the local shares are released from the custodian bank and delivered back to the Indian broker who bought them.

GDR - Regulatory Mechanism

An Indian corporate can raise foreign currency resources abroad through the issue of Global Depository Receipts (GDRs).

- the GDRs are issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government thereunder from time to time
- Approval from the Ministry of Finance, Government of India a must
- No end-use restrictions except investment in real estate and stock markets
- No limit except otherwise eligible to raise foreign equity under the extant FDI policy
- FIPB clearance necessary if likely to exceed percentage limits under the automatic route

GDR - Salient Features

Particulars	GDR
Applicable Guidelines	The issue of GDR is governed by Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government thereunder from time to time and various notifications and regulations issued by Reserve Bank of India under the Foreign Exchange Management Act 1999
Type of Issuer	Listed Companies can issue GDR. Unlisted Companies accessing global markets vide GDR route would require prior or simultaneous listing in the domestic market
Track Record	The Company should have a consistent track record (both financial and otherwise) for a period of at least three years. However for infrastructure projects financial track record is not a prerequisite.
Issue Size	There is no restriction on the amount which the issuer company can raise through GDR however it should be eligible to raise foreign equity under the FDI policy in force
No. of Allottees	There is no restriction on no. of allottees in case of GDR

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GDR - Pros and Cons

Advantages

1. Access to capital markets outside the home market to provide a mechanism for raising capital or as a vehicle for an acquisition

3. Expanded shareholder base which may increase or stabilize the share price

5. Increase potential liquidity by enlarging the market for the company's shares

7. GDR facilitate diversification into foreign securities

9. Trade, clear and settle in accordance with requirements of the market in which investors trade

11. Eliminate custody charges

13. Can be easily compared to securities of similar companies

Disadvantages

1. Less liquidity

3. Tracking error

5. Trading on a premium or discount to underlying share price creates issues

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AIM Listing - Alternate Investment Market - LSE

An Introduction

- AIM is the world’s leading market for smaller, growing companies – key to its success is
  - A balanced regulatory environment, specifically designed to make the process of going public as smooth as possible for smaller companies
  - An increasing network of advisers, investors and market practitioners supporting smaller companies
  - An integral part of the portfolio of markets offered by the London Stock Exchange

- Over 2,800 companies have joined AIM since the market’s launch in 1995, raising more than £49 billion
- More than 400 international companies have chosen AIM

Why AIM?

- Entry criteria tailored to smaller/growing companies, giving a wide range of companies access to a public market at an earlier stage of their development
- Appropriate regulatory regime, allowing businesses to learn to deal with life as a public company
- Straightforward acquisition rules, facilitating growth through acquisition
- Unquoted status for tax purposes, which may be an advantage for some companies
- Companies listing on AIM also gain access to a unique, globally-respected market and deep pool of capital; enhanced profile and heightened interest in their company; and increased status and credibility

Unique Self - Regulatory Concept

NOMAD (Nominated Advisor) has the responsibility to

- Ensure that prospective AIM client (& its directors) are suitable for listing (AIM candidates cannot list without a NOMAD)

- Advise the client on listing, undertake due diligence, act as preparer of & project manager in relation to Admission Document/Prospectus

- Ensure that clients are properly advised on the LSE AIM Rules for Companies

- Act as the interface between AIM Regulators and the client (in essence act as the referee)

- Provide advice to clients on continuing obligations post Admission

- Monitor company post IPO & ensure that the market is properly informed

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Admission Criteria for AIM and The Main Market

- A comparison

AIM	Main Market
1. No prescribed level of shares to be in public hands	1. Minimum 25 per cent shares in public hands
2. No trading record requirement	2. Normally 3-year trading record required
3. No prior shareholder approval for most transactions	3. Prior shareholder approval required for substantial acquisitions and disposals
4. Admission documents not pre-vetted by Exchange nor by the UKLA in most circumstances, as NOMAD regulates the quality of the document	4. Iterative pre-vetting of prospectus by the UKLA
5. Nominated adviser required at all times	5. Sponsors needed for certain transactions
6. No minimum market capitalization	6. Minimum market capitalization

AIM - Admission Document of Prospectus

- Choice between following Prospectus route or Admission Document driven by fundraising size and expected number & spread of shareholders

- Target market can be ‘professional’ investors (often limited to no more than 100 investors per EA state) or may include a high proportion of, or an offering to retail investors

- Admission Document route rather than Prospectus (dependent on the above) is the most common route followed

Target shareholder for a typical AIM float

Institutional investors

Larger financial fund managers

Companies specializing in AIM investment

High net worth individuals & retail investors

Considerations for AIM Listing

- Board members and other employees must accept the disciplines of having shares traded publicly and be prepared for closer scrutiny of the company and its performance
- The directors will face increased accountability for key management decisions and actions and must ensure that they run the company in the interests of shareholders
- Quotation on a public market brings with it the uncertainty of market conditions and other factors which may affect your share price, such as general market sentiment or developments in the same sector
- The board must be prepared for greater openness, in terms of disclosing the company's financial position and details of other developments such as corporate activity
- In most cases, admission to AIM will mark the start of the company's relationship with new investors and it will be important to maintain an active programme of activities to keep investors aware of the company's development and plans for the future

Key Steps Involved in AIM Listing

- Appoint a Nominated Adviser (NOMAD) and broker
- Bring on board other advisers such as accountants and lawyers
- Decide on the Public Relations or Investor Relations Company, who can help by raising awareness of the company and its business
- With Nomad and other advisers, prepare the necessary documentation for admission to AIM
- Talk to potential investors by embarking on a series of roadshows

Admission Timetable

Week before admission

24 weeks	12 weeks	6 weeks	1 weeks
▪ Appoint and instruct advisors. Agree timetable	▪ Review problem area ▪ Produce draft prospectus ▪ Produce other documents in first draft ▪ Initial review of pricing issue ▪ Review PR presentations ▪ Host analyst presentations	▪ Continue drafting meetings ▪ Carry out due diligence ▪ Hold PR meetings and roadshows ▪ Submit 10 day announcement to exchange of intention to join AIM	▪ All documents completed and approved ▪ Pricing and allocation of the offer ▪ Register admission document

FCEB (Foreign Currency Exchangeable Bond)

An Introduction

A bond expressed in foreign currency, the principal and interest in respect of which is payable in foreign currency, issued by an Issuing Company and subscribed to by a person who is a resident outside India in foreign currency and exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments

2.The Issuing Company shall be part of the promoter group of the Offered Company and shall hold the equity share/s Bond

3.The Offered Company shall be a listed company which is engaged in a sector eligible to receive Foreign Direct Investment and eligible to issue or avail of Foreign Currency Convertible Bond or External Commercial Borrowings

4.An Indian Company, restrained from accessing the securities market by the Securities and Exchange Board of India shall not be eligible to issue Foreign Currency Exchangeable Bond

5.The subscriber to the Foreign Currency Exchangeable Bond shall comply with the Foreign Direct Investment policy and adhere to the sectoral caps at the time of issuance of Foreign Currency Exchangeable Bond. Entities prohibited to buy, sell or deal in securities by Securities and Exchange Board of India will not be eligible to subscribe

6.Prior approval of Foreign Investment Promotion Board, wherever required under the Foreign Direct Investment policy, should be obtained.

FCEB - Regulatory Mechanism

1. The Issuing Company shall comply with the provisions of the Companies Act, 1956 (1 of 1956) and obtain necessary approvals of its Board of Directors and shareholders if applicable. The Offered Company shall also obtain the approval of its Board of Directors in favor of the Foreign Currency Exchangeable Bond proposal of the issuing company

3. The Issuing Company intending to offer shares of the offered company under Foreign Currency Exchangeable Bond shall comply with all the applicable provisions of the Securities and Exchange Board of India Act, Rules, Regulations or Guidelines with respect to disclosures of their shareholding in the Offered Company

5. The Issuing Company shall not transfer, mortgage or offer as collateral or trade in the offered shares under Foreign Currency Exchangeable Bond from the date of issuance of the Foreign Currency Exchangeable Bond till the date of exchange or redemption. Further, the Issuing Company shall keep the offered shares under Foreign Currency Exchangeable Bond free from all encumbrances from the date of issuance of the Foreign Currency Exchangeable Bond till the date of exchange or redemption

FCEB - Valuation

1. The rate of interest payable on Foreign Currency Exchangeable Bond and the issue expenses incurred in foreign currency shall be within the all in cost ceiling as specified by Reserve Bank of India under the External Commercial Borrowings policy

3. At the time of issuance of Foreign Currency Exchangeable Bond the exchange price of the offered listed equity shares shall not be less than the higher of the following two

   i. The average of the weekly high and low of the closing prices of the shares of the offered company quoted on the stock exchange during the six months preceding the relevant date; and

   iii. The average of the weekly high and low of the closing prices of the shares of the offered company quoted on a stock exchange during the two week preceding the relevant date

6. The minimum maturity of the Foreign Currency Exchangeable Bond shall be five years for purposes of redemption. The exchange option can be exercised at any time before redemption. While exercising the exchange option, the holder of the Foreign Currency Exchangeable Bond shall take delivery of the offered shares. Cash (Net) settlement of Foreign Currency Exchangeable Bonds shall not be permissible

FCEB - Pros and Cons

Advantages

1. It provides an additional avenue for Indian companies raising funds from overseas

3. It helps companies unlock the value of their holdings in other companies. Simply stated, it allows companies that hold shares in other group companies (which are listed on the stock exchange) to leverage on the value of their investments by borrowing on their strength

5. It helps companies raise financing without further dilution. For instance, instead of a listed company issuing further shares to raise capital, one of its promoter entities may issue FCEBs on the strength of its holding in the listed company and fund the listed company with the proceeds of the FCEB offering. This way, the promoter entity' shareholding in the listed company would not be diluted at all

7. There seem to be no perceive disadvantages from a taxation standpoint

Disadvantages

1. It is permissible only in certain areas and to the extent that ECBs and FCCBs are permitted

3. Changes effected to the ECB/FCCB policy last year (that are perceptibly linked to capital controls and the need to stem the rising Rupee) have restricted such borrowings only to very limited types of activities

5. This has resulted virtually in a demise of these routes, unless and until they are resuscitated by further policy change

7. Proceeds of FCEBs cannot be used for investment in the real estate sector or in capital markets

Key Challenges

For Issuers

- To understand the legal and compliance process
- Corporate Governance issues
- No exposure to Investments outside
- Restrictions on total amount to remit to India – USD 20 million
- Proceeds of such instruments cannot be used for investment in the real estate sector or in capital markets
- Pricing

For Investors

- To understand small & mid cap companies
- Size
- Liquidity