# INVESTMENT BANKING AND VENTURE CAPITAL

INT-328

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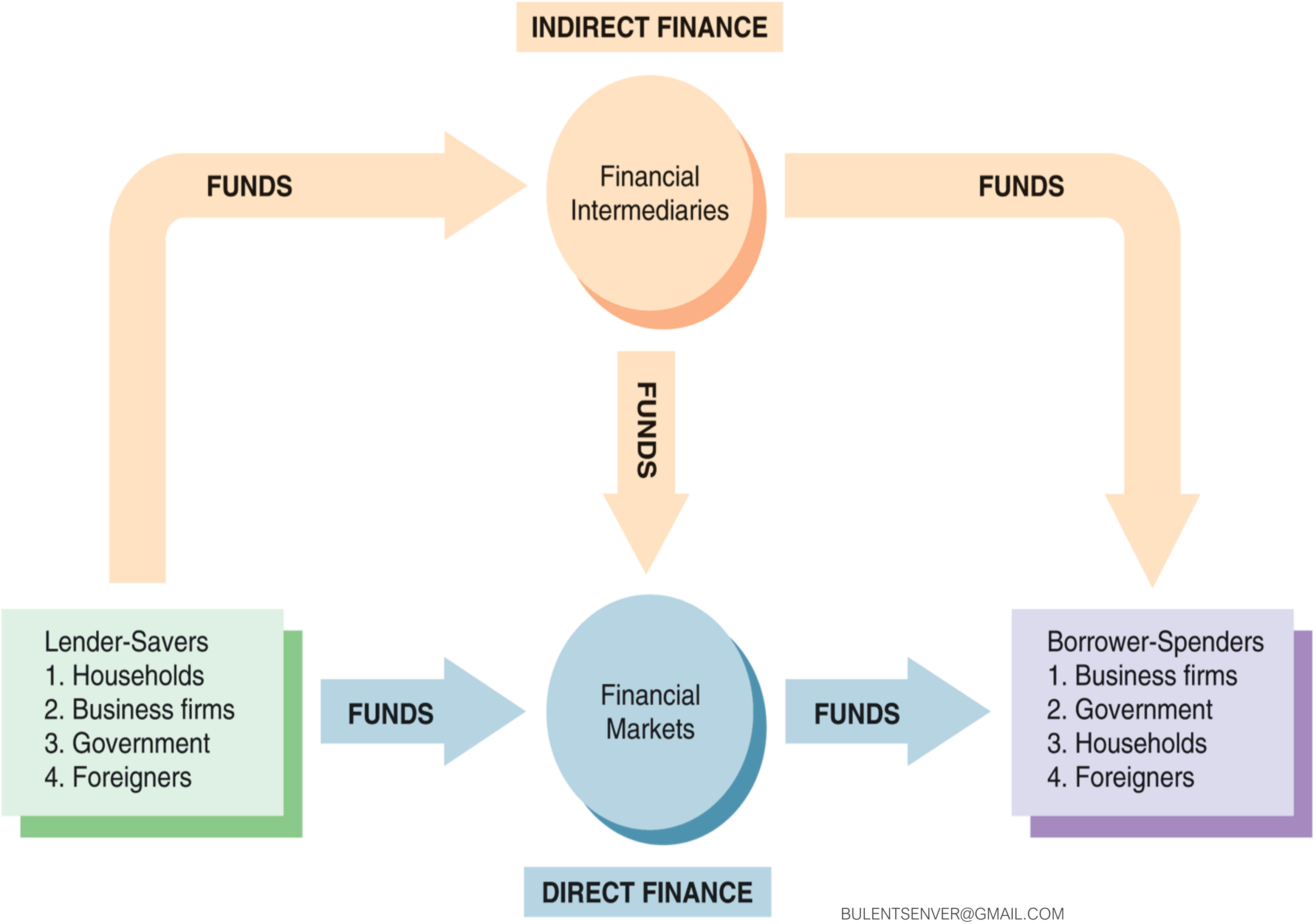
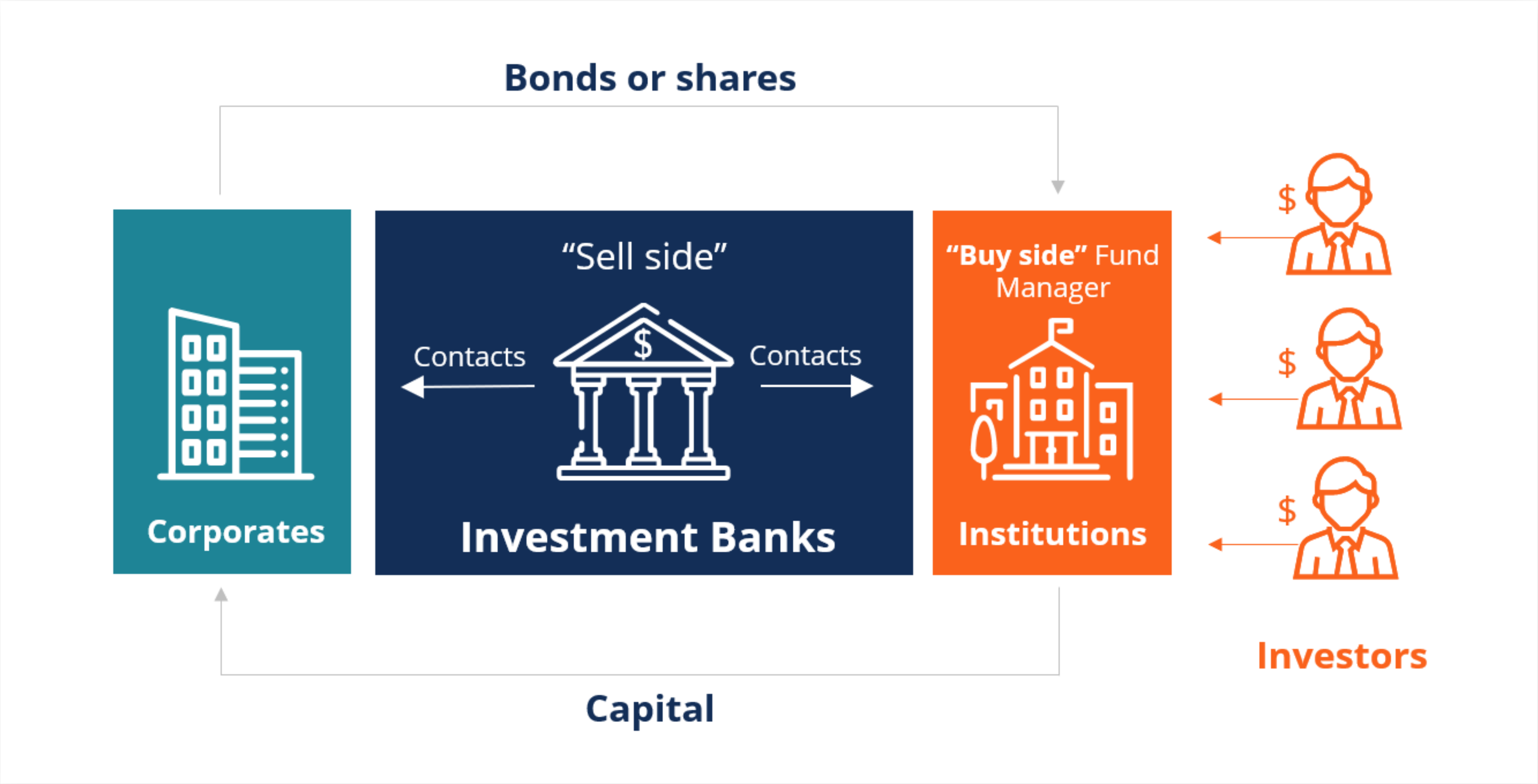
# FUNCTION OF FINANCIAL MARKETS




Bonds or shares
"Sell side"
Contacts
Contacts
"Buy side" Fund Manager
$
$
$
$
Corporates
Investment Banks
Institutions
Investors
Capital

# BANKS TARGET 7 NEEDS OF CUSTOMERS

## NEEDS:

- 1. Savings need
- 2. Borrowing need
- 3. Investment need
- 4. Security need
- 5. Trading need
- 6. Payment need
- 7. Advice & consulting need

## PRODUCTS:

- 1. Term Deposits
- 2. Loans
- 3. Securities, Government Bonds, Treasury Bills, Company Bonds, Mutual Funds, Certificate of Deposits, Commercial Papers, Mortgage Backed Securities, Asset Backed Securities,
- 4. Insurance products, Derivatives, Forwards, Swaps, Options, Hedging
- 5. Buy & sell Foreign Currencies & Capital Market Products
- 6. Cash, Cheques, Promissory Notes, Credit Cards, Debit Cards, ATM, POS, EFT, SWIFT
- 7. Asset management, Wealth Management, Investment Banking

## FINANCIAL INTERMEDIARIES
# TYPES OF BANKS

- Commercial Banks
- Investment Banks
- Merchant Banks
- Islamic Banks (participation banks)
- Development Banks
- Off Shore Banks
- Special Purpose Banks

# COMERCIAL BANKING

*LOANS* ← *DEPOSITS*

Give ← Get


Interest Income

Get

Net Interest Income

Interest Expense

Give

# COMERCIAL BANKING

Interest Earning
Assets

*LOANS*

IEA

Interest Income


Net
Interest
Income

Interest Bearing
Liabilities

*DEPOSITS*

IBL

Interest Expense

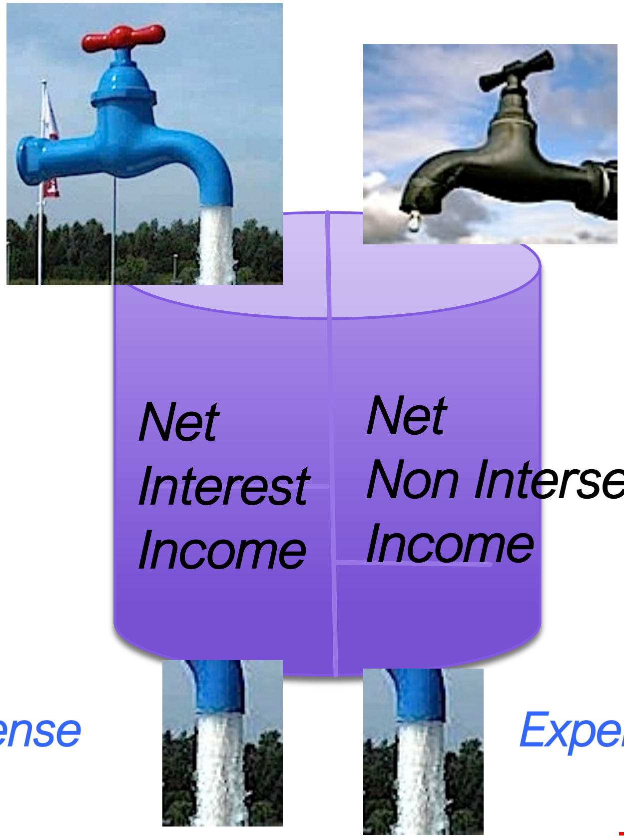
# Revenue Sourses of Commecial Banks

*Revenue 1*

*Revenue 2*

\+ *Interest Income*

\+ *Non Interest Income*




*Expense 1*

*Expense 2*

\- *Interest Expense*

\- *Non Interest Expense*

Net Income Before Tax

FINANCIAL INTERMEDIARIES

# NON BANK FINANCIAL INSTITUTIONS

- Factoring
- Forfeiting
- Leasing
- Insurance
- Pension Funds
- Brokerage Houses
- Consumer Finance
- Angel Capital
- Venture Capital Finds

- Investment Funds
- Mutual Funds
- Mortgage Funds
- Foreign exchange offices
- Money transfer companies
- Real Estate Property Funds

# INVESTMENT VS COMMERCIAL BANK

- Investment vs. Commercial Bank
- Glass-Steagall Act (1933)
- Gramm-Leach-Bliley Act (1999)
- Bail-outs (2008)

The **Glass–Steagall Act**, initially created in the wake of the **Stock Market Crash of 1929**, prohibited banks from both accepting deposits and underwriting securities, and led to segregation **of investment banks from commercial banks**. **Glass–Steagall** was effectively repealed for many large financial institutions by the **Gramm–Leach–Bliley Act** Until 1999, the United States maintained a **separation between investment banking and commercial banks**. Other industrialized countries (including G7 countries) have not maintained this separation historically.

# WHAT IS AN INVESTMENT BANK?

- An *Investment Bank* is a financial institution that raises capital, trades securities and manages corporate mergers and acquisitions.
- Investment banks profit from companies and governments by raising money through issuing and selling securities in capital markets (both equity, debt) and insuring bonds (e.g. selling credit default swaps), and providing advice on transactions such as mergers and acquisitions. A majority of investment banks offer strategic advisory services for mergers, acquisitions, divestiture or other financial services for clients, such as the trading of derivatives, fixed income, foreign exchange, commodity, and equity securities.

# WHAT IS INVESTMENT BANKING?

- Investment banking is the division of a bank or financial institution that serves **governments, corporations**, and **institutions** by **providing underwriting** (capital raising) and **mergers and acquisitions** (M&A) **advisory services**.
- Investment banks act as **intermediaries** between investors (who have money to invest) and corporations (who require capital to grow and run their businesses). This guide will cover what investment banking is and what investment bankers actually do.

# WHAT INVESTMENTS BANKS DO?

| Investment Banking typically covers **two** key areas: | |
|---|---|
| M&A advisory | Underwriting |
| Assisting in the negotiation and structuring of a merger/acquisition | Raising capital through selling stocks or bonds to investors (e.g. IPO) |

# INVESTMENT BANK
Business Areas

# REVENUE-GENERATING ACTIVITIES

- Corporate Finance
- Municipal Finance
- Treasury and Agency Finance
- Dealer Activities
- Brokerage Activities
- Arbitrage
- Proprietary
- Expansion
- Contraction
- Ownership and Control
- Zero Coupon Securities
- Mortgage-Backed-Securities
- Derivative Products
- Investment Management (PWM, PCS and Asset Management))
- Merchant Banking (Private Equity and Venture Capital)
- Consulting
- Transaction Banking (Prime Brokerage)

These are all Front Office Activities

# CORE ACTIVITIES OF AN INVESTMENT BANK

# FULL-SERVICE INVESTMENT BANKS OFFER THE FOLLOWING SERVICES:

- **Underwriting** – Capital raising and underwriting groups work between investors and companies that want to raise money or **go public** via the IPO process. This function serves the primary market or "new capital".
- **Mergers & Acquisitions (M&A)** – Advisory roles for both buyers and sellers of businesses, managing the M&A process start to finish.
- **Sales & Trading** – Matching up buyers and sellers of securities in the secondary market. Sales and trading groups in investment banking act as agents for clients and also can trade the firm's own capital.
- **Equity Research** – The equity research group research, or "coverage", of securities helps investors **make investment decisions** and supports trading of stocks.
- **Asset Management** – Managing investments for a wide range of investors including institutions and individuals, across a wide range of investment styles.

# M&A MERGERS & ACQUISITIONS

# MERGERS & ACQUISITIONS

- Acquisition - When a larger company takes over another (smaller firm) and clearly becomes the new owner. Typically, the target company ceases to exist post-transaction (from a legal corporation point of view) and the acquiring corporation swallows the business. The stock of the acquiring company continues to be traded.
- when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a **"merger of equals"**. Both companies' stocks are surrendered and new company stock is issued in its place.

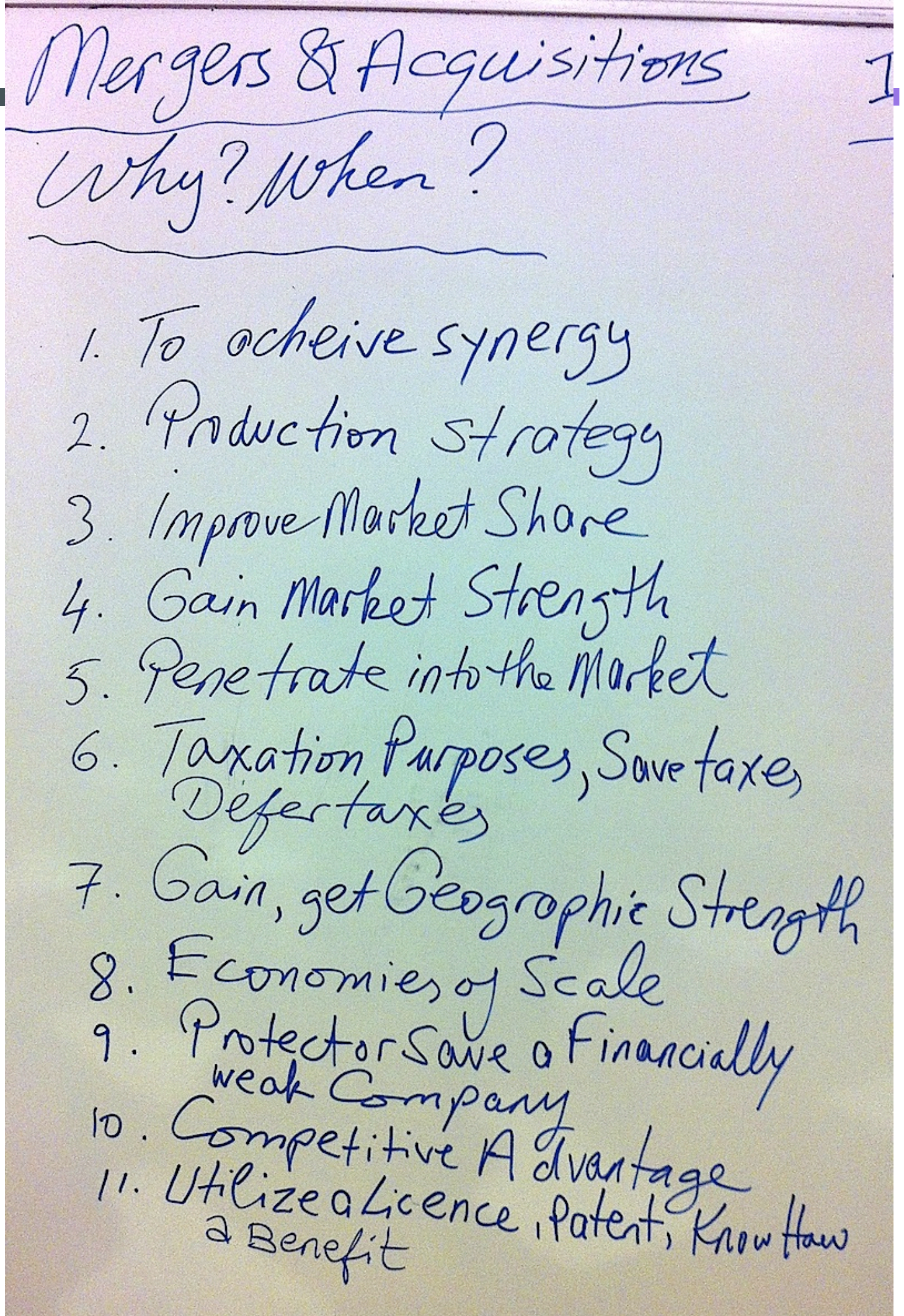
In practice, however, actual mergers of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it is technically an acquisition.

Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is **friendly** or **hostile** and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders. It is quite normal though for M&A deal communications to take place in a so called 'confidentiality bubble' whereby information flows are restricted due to confidentiality agreements

# M&A MERGERS AND ACQUISITIONS

- Mergers and acquisitions (M&A) advisory is the process of helping corporations and institutions **find, evaluate, and complete acquisitions of businesses**.
- This is a key function in i-banking. Banks use their extensive **networks** and **relationships** to **find opportunities** and **help negotiate** on their client's behalf.
- Bankers **advise on both sides** of M&A transactions, representing either the **"buy-side"** or the **"sell-side"** of the deal.

# M&A


Mergers & Acquisitions
Why? When?
1. To acheive synergy
2. Production strategy
3. Improve Market Share
4. Gain Market Strength
5. Penetrate into the Market
6. Taxation Purposes, Save taxes, Defer taxes
7. Gain, get Geographic Strength
8. Economies of Scale
9. Protect or Save a Financially weak Company
10. Competitive Advantage
11. Utilize a Licence, Patent, Know How a Benefit

# WHY?

## ADVANTAGES OF BUYING A BUSINESS

- It may continue to be successful
- It may already have the best location
- Employees and suppliers are established
- Equipment is already installed
- Inventory is in place and trade credit is established

# ADVANTAGES OF BUYING A BUSINESS

**(continued)**

- It's turnkey
- New owners can "hit the ground running"

  (start something and proceed at a fast pace with great enthusiasm.)
- New owners can use the previous owner's experience
- Financing is easier to obtain
- It's a bargain! (kelepir)

# DISADVANTAGES OF BUYING A BUSINESS

- The financial costs are high
- It's a "loser"
- Previous owner may have created ill will (kötü niyet)
- "Inherited" employees may be unsuitable
- The location may have become unsatisfactory
- Equipment and facilities may be obsolete or inefficient

# DISADVANTAGES OF BUYING A BUSINESS

(continued)

- Change and innovation can be difficult to implement
- Inventory may be outdated or obsolete
- Accounts receivable may be worth less than face value
- High bank loans or bad banking relations

# 7 - STEP THE ACQUISITION PROCESS

1. Identify and approach candidate
2. Sign nondisclosure statement
3. Sign letter of intent
4. Buyer's due diligence investigation
5. Draft the purchase agreement
6. Close the final deal
7. Begin the transition

**Negotiations**

**1. Approach the candidate.** If a business is advertised for sale, the proper approach is through the channel defined in the ad. Sometimes buyers will contact business brokers to help them locate potential target companies. If you have targeted a company in the "hidden market," an introduction from a banker, accountant, or lawyer often is the best approach. During this phase, the seller checks out the buyer's qualifications, and the buyer begins to judge the quality of the company.

**2. Sign a nondisclosure document.** If the buyer and the seller are satisfied with the results of their preliminary research, they are ready to begin serious negotiations. Throughout the negotiation process, the seller expects the buyer to maintain strict confidentiality of all of the records, documents, and information he or she receives during the investigation and negotiation process. The nondisclosure document is a legally binding contract that ensures the secrecy of the parties' negotiations.

**3. Sign a letter of intent.** Before a buyer makes a legal offer to buy the company, he or she typically will ask the seller to sign a letter of intent. The letter of intent is a nonbinding document that says that the buyer and the seller have reached a sufficient "meeting of the minds" to justify the time and expense of negotiating a final agreement. The letter should state clearly that it is nonbinding, giving either party the right to walk away from the deal. It should also contain a clause calling for "good faith negotiations" between the parties. A typical letter of intent addresses terms such as price, payment terms, categories of assets to be sold, and a deadline for closing the final deal.

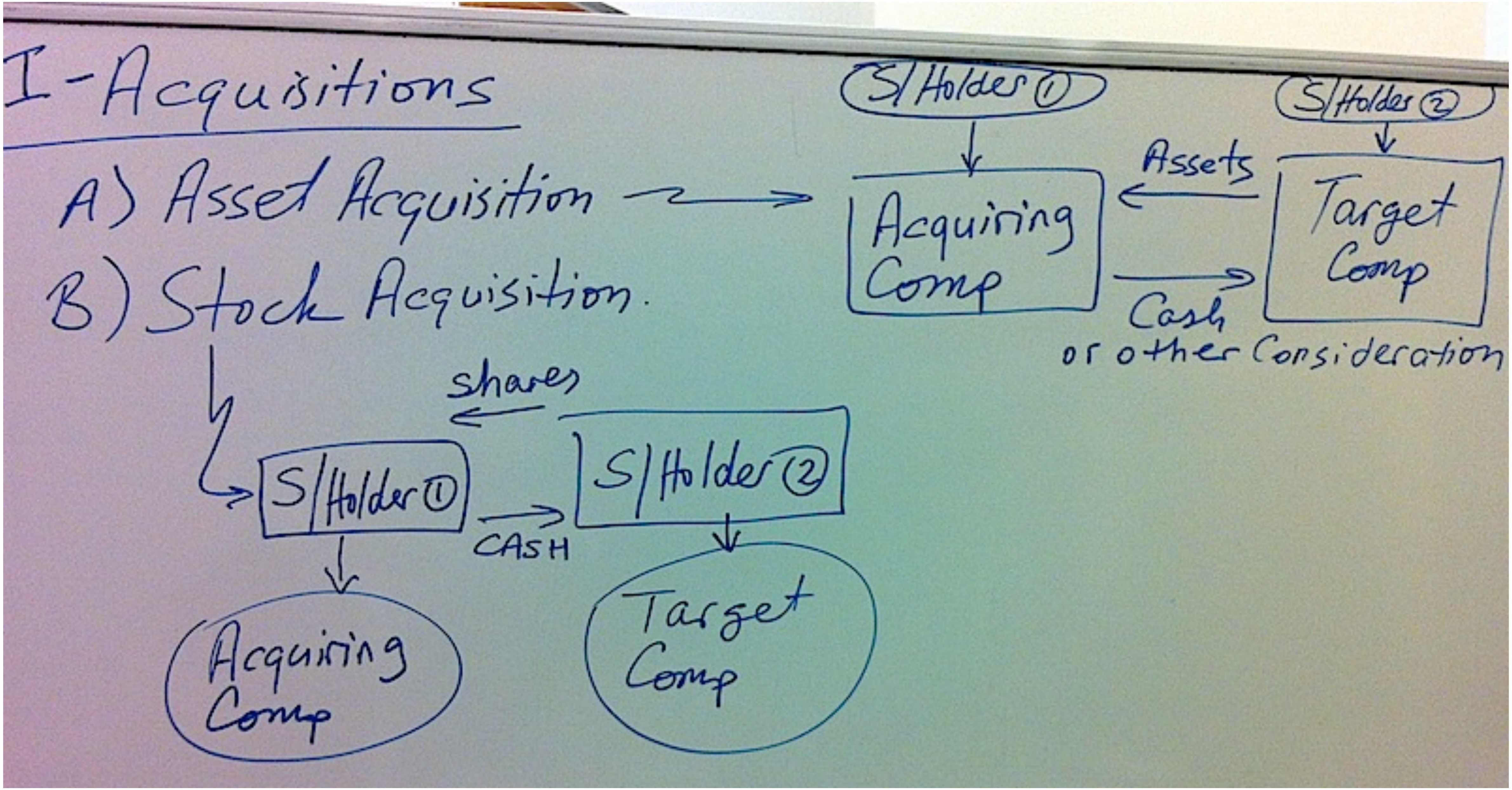
**4. Buyer's due diligence.** While negotiations are continuing, the buyer is busy studying the business and evaluating its strengths and weaknesses. In short, the buyer must "do his or her homework" to make sure that the business is a good value.

**5. Draft the purchase agreement.** The purchase agreement spells out the parties' final deal! It sets forth all of the details of the agreement and is the final product of the negotiation process.

**6. Close the final deal.** Once the parties have drafted the purchase agreement, all that remains to making the deal "official" is the closing. Both buyer and seller sign the necessary documents to make the sale final. The buyer delivers the required money, and the seller turns the company over to the buyer.

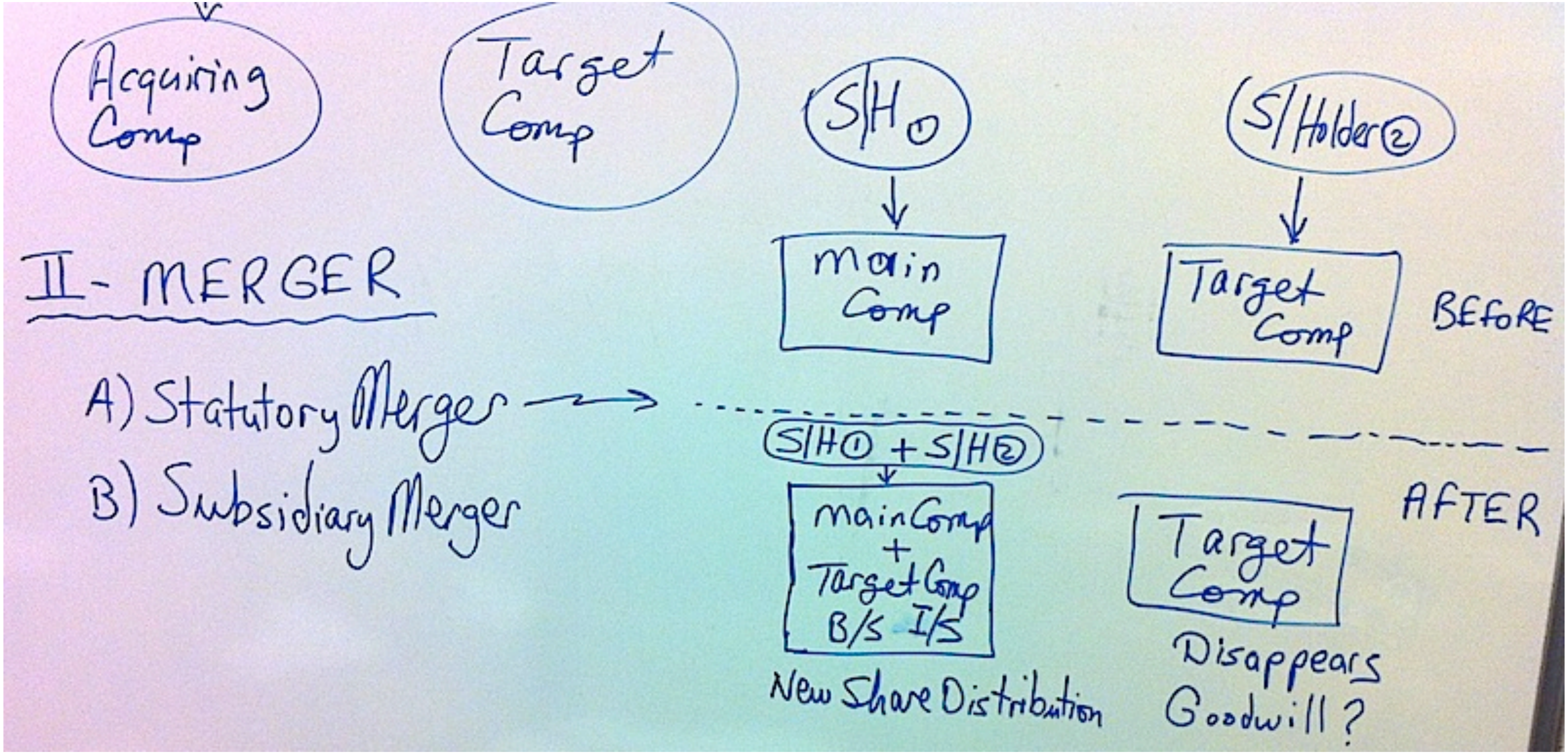
**7. Begin the transition.** For the buyer, the real challenge now begins: making the transition to a successful business owner!

# ACQUISITIONS



# 10-STEP MERGERS AND ACQUISITIONS PROCESS.

## MERGER PRINCIPLE

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# ACQUISITIONS

- *Acquisition*, also known as a
  or a
- In the 1980s, hostile takeovers and LBO acquisitions were all the rage. Companies sought to acquire others through aggressive stock purchases and cared little about the target company's concerns.


When a public company acquires another public company, the target company's stock often shoots through the roof while the acquiring company's stock often declines. **Why?** One must realize that existing shareholders must be convinced to sell their stock. Few shareholders are willing to sell their stock to an acquirer without first being paid a premium on the current stock price. In addition, shareholders must also capture a takeover premium to relinquish control over the stock. The large shareholders of the target company typically demand such an extraction. For example, the management of the selling company may require a substantial premium to give up control of their firm.

# TYPES OF ACQUISITIONS

- ***Friendly:*** the companies cooperate in negotiations
- ***Hostile:*** target is unwilling to be bought or the target's board has no prior knowledge of the offer
- ***Reverse Takeover:*** a smaller firm will acquire management control of a larger company and keep its name for the combined entity.
- ***Reverse Merger:*** a deal that enables a private company to get publicly listed in a short time period. It occurs when a **private company** that has strong prospects and is eager to raise financing buys a publicly listed shell company, usually one with no business and limited assets.

Achieving acquisition success has proven to be very difficult, while various studies have shown that **50% of acquisitions were unsuccessful**. The acquisition process is very complex, with many dimensions influencing its outcome.

# TACTICS AGAINST HOSTILE TAKEOVERS

- *Back-end*
- *Bankmail*
- *Crown Jewel Defense*
- *Flip-in*
- *Flip-over*
- *Golden Parachute*
- *Gray Knight*
- *Greenmail*
- *Jonestown Defense*
- *Killer bees*
- *Leveraged  recapitalization*
- *Lobster trap*
- *Lock-up provision*
- *Macaroni Defense*
- *Nancy Reagan Defense*
- *Non-voting stock*
- *Pac-Man Defense*
- *Pension parachute*
- *People Pill*
- *Poison pill*
- *Poison Put*
- *Safe Harbor*
- *Scorched-earth defense*
- *Shark Repellent*
- *Standstill agreement*
- *Staggered board of directors*
- *Targeted repurchase*
- *Top-ups*
- *Treasury stock*
- *Trigger*
- *Voting plans*
- *White knight*
- *White squire*
- *Whitemail*

# TACTICS AGAINST HOSTILE TAKEOVERS

- 1) Golden Parachute

# TACTICS AGAINST HOSTILE TAKEOVERS

- 1) Golden Parachute (Altın Paraşüt)

Şirket satın alınırsa mevcut CEO’ya yüklü prim, tazminat ödeneceğini Sözleşmesine yazmak

- A. Alım maliyetini arttırır, alım cazibesini azaltır
- B. CEO Şirketi çok cazip yapıp başkasına satıp çok para kazanmak için uğraşır
- 2) Super Majority (Süper Çoğunluk)
- Şirketin satılabilmesi için ortakların %70-%80 onayı gerekir

# TACTICS AGAINST HOSTILE TAKEOVERS

- 3) Staggered Board of Directors (Yönetim Kurulu Üye Değişikliği Sınırlaması)
- Bazı Üyeler 2, bazıları 4 yılda bir değiştirilebilir diyerek alıcıyı zorlamak
- 4) Dual Class Stock (İmtyiazlı Hisseler)
- Eski ortakların Oy Hakları var, Yenilerin Yok veya çok az.
- 5) Poison Pill (Zehirli İlaç)
- Şirketi alıcılar gözünde az değerli az cazip gösterecek her türlü operasyon

# TACTICS AGAINST HOSTILE TAKEOVERS

- 6) People Pill (İnsan İlacı)
- Üst düzey  Yöneticilerin, Şirket alınırsa toplu istifa edeceğini bildirmesi
- 7) Crown Jewels Defense ( Yüzük Taşı Savunması
- Şirketin önemli departmanı satış olursa ayrılırız tehdidi
- 8) Flip in (Eski OrtaklaraUcuz hisse Satışı)
- Herhangi bir ortagın hissesi %20-40 olduğunda eski ortaklara ucuz hisse satışı taahhüdü. Pahalı Alan yanar.

# TACTICS AGAINST HOSTILE TAKEOVERS

- 9) Jonestown Defense (Şirketi Aşırı Borçlanır)
- Alıcıya cazip olmasın diye Şirketi aşırı borçlandırmak
- 10) Lady Macbeth Strategy (Arkadan Vurmak)
- Beyaz Şövalye önce Alıcı tarafında görünür daha sonra Şirketin tarafına geçer
- 11) Pac-Man Defense (Seni almak isteyeni sen al)
- Birisi seni almak mı istedi taş koy alamasın. sonra sen onu satın al

# CATEGORIES OF MERGERS

- ***Congeneric:*** firms in the same general industry, but no mutual buyer/customer or supplier relationship, such as a merger between a bank and a leasing company. (i.e. Prudential's acquisition of Bache & Company)
- ***Conglomerate:*** companies that have no common business areas.
- ***Product-extension merger:*** Two companies selling different but related products in the same market (eg: a cone supplier merging with an ice cream maker).
- ***Consolidation mergers:*** a **brand new company is formed** and both companies are bought and combined under the new entity.
- ***Accretive mergers:*** are those in which an acquiring company's earnings per share (EPS) increase. An alternative way of calculating this is if a company with a high price to earnings ratio (P/E) acquires one with a low P/E.
- ***Dilutive mergers:*** are the opposite of above, whereby a company's EPS decreases. The company will be one with a low P/E acquiring one with a high P/E.

The occurrence of a merger often raises concerns in antitrust circles. Regulatory bodies such may investigate anti-trust cases for monopolies dangers, and have the power to block mergers.

# MOTIVES BEHIND M&A

- *Economy of Scale*
- *Increased Revenue or Market Share*
- *Cross-Selling*
- *Synergy*
- *Taxation*
- *Diversification*
- *Vertical Integration*
- *Managers's Hubris:* manager's overconfidence about expected synergies from M&A which results in overpayment for the target company
- *Empire-building:* Managers have larger companies to manage and hence more power.
- *Manager's compensation:* certain executive management teams had their payout based on the total amount of profit of the company, instead of the profit per share, which would give the team a perverse incentive to buy companies to increase the total profit while decreasing the profit per share

# EFFECTS OF M&A

- ***Reasons for frequent failure of M&A:*** Despite the goal of performance improvement, results from mergers and acquisitions (M&A) are often disappointing. Numerous empirical studies show high failure rates of M&A deals. Studies are mostly focused on individual determinants. The literature therefore lacks a more comprehensive framework that includes different perspectives. M&A performance is a multi-dimensional function. For a successful deal, the following key success factors should be taken into account:
- ***Strategic logic*** which is reflected by six determinants: market similarities, market complementarities, operational similarities, operational complementarities, market power, and purchasing power..
- ***Organizational integration*** which is reflected by three determinants: acquisition experience, relative size, cultural compatibility.
- ***Financial / price perspective*** which is reflected by three determinants: acquisition premium, bidding process, and due diligence.
- ***Post-M&A performance*** is measured by synergy realization, relative performance (compared to competition), and absolute performance.

A study published in the July/August 2008 issue of the Journal of Business Strategy suggests that mergers and acquisitions destroy leadership continuity in target companies' top management teams for at least a decade following a deal. The study found that target companies lose 21 percent of their executives each year for at least 10 years following an acquisition – more than double the turnover experienced in non-merged firms.

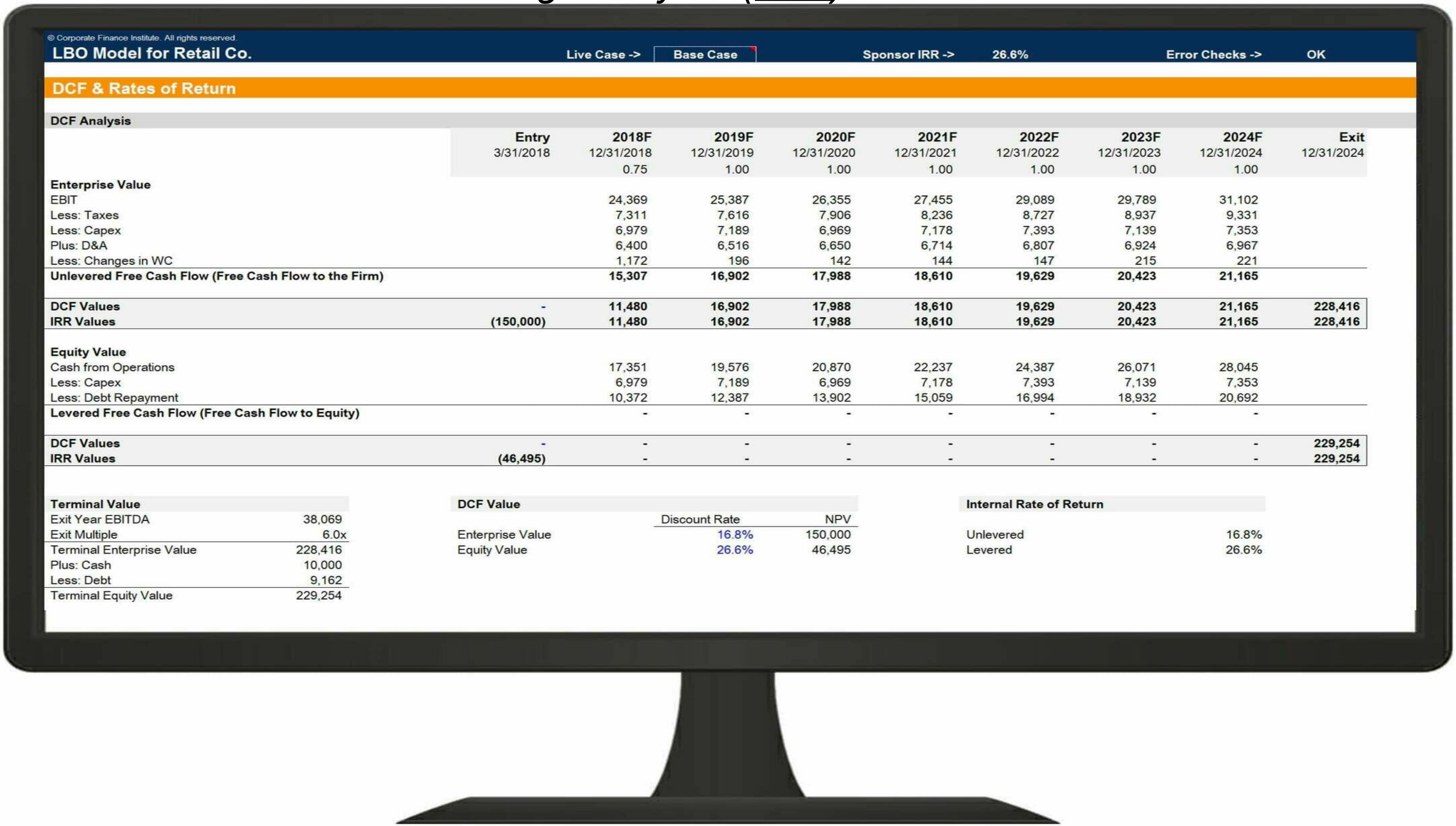
# M&A ADVISORY SERVICES

- M&A advising is highly profitable, and there are many possibilities for types of transactions.
- Perhaps a small private company's owner/manager wishes to sell out for cash and retire.
- Or perhaps a big public firm aims to buy a competitor through a stock swap.
- Whatever the case, M&A advisors come directly from the corporate finance departments of investment banks.
- Unlike public offerings, merger transactions do not directly involve salespeople, traders or research analysts.
- In particular, M&A advisory falls onto the laps of M&A specialists and fits into one of either two buckets: seller representation or buyer representation (also called target representation and acquirer representation).

# THE LEHMAN SCALE

- *The Lehman Scale* is a traditional schedule of advisers' chargeable fees. The scale is based on the transaction size of the deal, and is normally payable by the vendor(s) of the business once the purchaser's funds have cleared.
- 5% on the first $1,000,000, plus
- 4% on the second $1,000,000, plus
- 3% on the third $1,000,000, plus
- 2% on the fourth $1,000,000, plus
- 1% on everything above $4,000,000
- The Lehman Scale was widely used in the 1970s, 1980s and 1990s. Its popularity has waned recently, mainly because there is little incentive for the adviser to "go the extra mile" in achieving a higher sale value.

# *Leveraged Buyout (LBO) model*





**LBO Model for Retail Co.** Live Case -> Base Case | Sponsor IRR -> 26.6% | Error Checks -> OK

**DCF & Rates of Return**

**DCF Analysis**

| | Entry | 2018F | 2019F | 2020F | 2021F | 2022F | 2023F | 2024F | Exit |
|---|---|---|---|---|---|---|---|---|---|
| | 3/31/2018 | 12/31/2018 | 12/31/2019 | 12/31/2020 | 12/31/2021 | 12/31/2022 | 12/31/2023 | 12/31/2024 | 12/31/2024 |
| | | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | |
| **Enterprise Value** | | | | | | | | | |
| EBIT | | 24,369 | 25,387 | 26,355 | 27,455 | 29,089 | 29,789 | 31,102 | |
| Less: Taxes | | 7,311 | 7,616 | 7,906 | 8,236 | 8,727 | 8,937 | 9,331 | |
| Less: Capex | | 6,979 | 7,189 | 6,969 | 7,178 | 7,393 | 7,139 | 7,353 | |
| Plus: D&A | | 6,400 | 6,516 | 6,650 | 6,714 | 6,807 | 6,924 | 6,967 | |
| Less: Changes in WC | | 1,172 | 196 | 142 | 144 | 147 | 215 | 221 | |
| **Unlevered Free Cash Flow (Free Cash Flow to the Firm)** | | **15,307** | **16,902** | **17,988** | **18,610** | **19,629** | **20,423** | **21,165** | |
| **DCF Values** | - | **11,480** | **16,902** | **17,988** | **18,610** | **19,629** | **20,423** | **21,165** | **228,416** |
| **IRR Values** | **(150,000)** | **11,480** | **16,902** | **17,988** | **18,610** | **19,629** | **20,423** | **21,165** | **228,416** |
| **Equity Value** | | | | | | | | | |
| Cash from Operations | | 17,351 | 19,576 | 20,870 | 22,237 | 24,387 | 26,071 | 28,045 | |
| Less: Capex | | 6,979 | 7,189 | 6,969 | 7,178 | 7,393 | 7,139 | 7,353 | |
| Less: Debt Repayment | | 10,372 | 12,387 | 13,902 | 15,059 | 16,994 | 18,932 | 20,692 | |
| **Levered Free Cash Flow (Free Cash Flow to Equity)** | | - | - | - | - | - | - | - | |
| **DCF Values** | - | - | - | - | - | - | - | - | **229,254** |
| **IRR Values** | **(46,495)** | - | - | - | - | - | - | - | **229,254** |

| **Terminal Value** | |
|---|---|
| Exit Year EBITDA | 38,069 |
| Exit Multiple | 6.0x |
| Terminal Enterprise Value | 228,416 |
| Plus: Cash | 10,000 |
| Less: Debt | 9,162 |
| Terminal Equity Value | 229,254 |

| **DCF Value** | Discount Rate | NPV |
|---|---|---|
| Enterprise Value | 16.8% | 150,000 |
| Equity Value | 26.6% | 46,495 |

| **Internal Rate of Return** | |
|---|---|
| Unlevered | 16.8% |
| Levered | 26.6% |

# THE FIVE PS OF NEGOTIATING

***Preparation*** - Examine the needs of both parties and all of the relevant external factors affecting the negotiation before you sit down to talk.

***Poise*** - Remain calm during the negotiation. Never raise your voice or lose your temper, even if the situation gets difficult or emotional. It's better to walk away and calm down than to blow up and blow the deal.

***Patience*** – Don't be in such a hurry to close the deal that you end up giving up much of what you hoped to get. Impatience is a major weakness in a negotiation.

***Persuasiveness*** - Know what your most important positions are, articulate them, and offer support for your position.

***Persistence*** - Don't give in at the first sign of resistance to your position, especially if it is an issue that ranks high in your list of priorities.

# IPO INITIAL PUBLIC OFFERING

# IPO INITIAL PUBLIC OFFERING

- What Is an IPO?
- An initial public offering (IPO) refers to the process of **offering shares** of a private corporation **to the public** in **a new stock issuance**.
- Public share issuance allows a company **to raise capital from public investors.**
- The transition from a **private to a public** company can be an important time for private investors to fully realize gains from their investment as it typically includes **share premiums** for current private investors. Meanwhile, it also **allows public investors to participate** in the offering.

# INITIAL PUBLIC OFFERING

- An *IPO* is the process by which a private company transforms itself into a public company. The company offers, for the first time, shares of its equity (ownership) to the investing public. These shares subsequently trade on a public stock exchange

## Why IPO?

- to raise cash to fund the growth
- cash out partially or entirely by selling ownership
- to diversify net worth or to gain liquidity

## Concerns:

- Going Public is not a slum dunk
- Firms that are too small, too stagnant or have poor growth prospects will - in general - fail to find an investment bank willing to underwrite

# IPO

- **Benefits:**
- Expand access to capital
- Increase employee commitment and recruiting power
- Complements product marketing
- Expand business relationships
- Facilitate mergers and acquisitions
- Provides founders and shareholders with liquidity

# IPO

- **Responsibilities:**
- Sharing corporate control
- Sharing financial gain
- Managing for shareholder value
- Sharing strategic information
- Start-up and ongoing costs of being a public company
- Relinquishing control over personal assets invested in the company

# PROS AND CONS OF AN IPO

- Stronger Capital Base
- Increases Financing prospects
- Better situated for acquisitions
- Owner Diversification
- Executive Compensation
- Increase company prestige

- Short-term growth pressure
- Disclosure and Confidentiality
- Costs – initial and ongoing
- Restrictions on Management
- Loss of personal benefits
- Trading Restrictions

# SELECTING INVESTMENT BANKS

- **1. Experience and Focus.** Given the high stakes of a company's IPO choosing managing underwriters with **substantial experience in the IPO arena** is absolutely necessary. Experience in the company's particular industry or niche, is instrumental to an investment bank's ability to understand the business of the company and its ability to **market the company's story to investors**. Investment banks that **focus on particular industries** tend to have the **greatest access to investors** who are most likely to invest in such sectors.

# SELECTING INVESTMENT BANKS

- **2. Research.** The investment banks will usually **designate a specific research analyst** to cover the company. The **knowledge, focus and credibility of this individual** can influence the success of the IPO and the demand for aftermarket orders. Assessing these determinants can be accomplished through **reference checks** and **examining the research analyst's written reports** and coverage universe. A company should also **request a "positioning" statement from the investment bank** to gauge its understanding of the company's business and industry and ability to create demand for the stock as an investment opportunity.

# SELECTING INVESTMENT BANKS

- **3. Sales and Trading.** A company should try to **assess the sales and trading departments of each investment bank.** Investment banks will have particular **strengths in certain industries** and for certain **types of securities.** In addition, the company's distribution objectives should influence its choices of investment banking partners, as certain investment banks have **a strong international or domestic institutional clientele**, while others are more oriented towards domestic retail investors. It is important to know **how many clients each investment bank has in each area.** Plus, its **annual trading volume** as report by the Istanbul Stock Exchange (ISE) – www.ise.org.

# SELECTING INVESTMENT BANKS.

- 4. Credibility with Investors. An **investment bank's credibility with key investors** and the perceived **ability of the firm to assess and provide good investment opportunities** are critical to a successful offering. As a result, it is to a company's advantage to select and **investment bank with a client base of quality companies and a strong reputation in the domestic and international capital markets**? Investment banks will generally provide their credentials and corporate client list to companies evaluating bankers.

# SELECTING INVESTMENT BANKS.

- **5. Commitment to Long-Term Relationship.** Choose an investment bank that can and **will provide ongoing financial services** as the company grows and is **committed to building a long-term relationship.** Companies that receive quality investment banking services during the IPO and in the aftermarket **will likely utilize the same bankers for general advisory roles, future financing and other types of transactions**, such as mergers and acquisitions. Information concerning an investment bank's **track record and ability to provide a full range of financial services** to its client base will provide a valuable perspective.

# IPO PROCESS

# THE IPO PROCESS

- 1. Present the Proposal to the Board. The IPO process begins with the management making a presentation to the board of directors, complete with business plans and financial projects, proposing that the company enter the public market. The board should consider the proposal carefully.

# THE IPO PROCESS

- **2. Restate Financial Statements and Refocus the Company.** If the board approves the proposal to go public, your **company's books and records should be reviewed for the past three years. Financial statements should be restated to adhere to SPK and ISE standards.** Have the three years **Balance Sheet and Income Statement** Audited by an **Independent External Auditor.** Any intracompany transactions, compensation agreements, and relationships involving management or the board which are customary to private enterprise but improper for a public company must be eliminated and the statements appropriately restated. Also, you should consider whether the market will perceive any exploratory affiliated operations tangential to your company's core business.

# THE IPO PROCESS

- 3. Find an Underwriter and Exchange a “letter of intent”. At this point, your company should select an investment bank as an underwriter for the issue if it has not already engaged one and formalize your relationship with the underwriter through a “letter of intent,” outlining fees, ranges for the stock price and number of shares, research coverage and certain other conditions between the underwriter and the consortium it assembles for the issue.

# UNDERWRITING SERVICES IN INVESTMENT BANKING

- **Underwriting** is the process of **raising capital** through **selling stocks** or **bonds** to investors (e.g., an initial public offering IPO) on behalf of corporations or other entities. Businesses need money to operate and grow their businesses, and the bankers help them get that money by marketing the company to investors.
- There are generally **three types** of **underwriting**:
- Firm Commitment – The underwriter **agrees to buy the entire issue** and assume full financial responsibility **for any unsold shares**.
- Best Efforts – Underwriter **commits to selling as much of the issue as possible** at the agreed-upon offering price but can **return any unsold shares** to the issuer **without financial responsibility**.
- All-or-None – If the **entire issue cannot be sold** at the offering price, **the deal is called off** and the **issuing company receives nothing**.

# THE IPO PROCESS

- 4. Draft the Prospectus and Necessary Documents. After the letter of intent is exchanged, your attorneys and underwriter should being work on the prospectus and necessary filing documents.

# THE IPO PROCESS

- 5. Respond to “Due Diligence.” The next step is to ask your investment banker and accountant to begin an elaborate investigation of your company. This should include a checklist of topics and procedures which serves as an aid in the due diligence process.
- Your underwriter will examine your company’s management, operations, financial condition, performance, competitive position and business plan.
- Other factors open to scrutiny are your labor force, suppliers, customers, creditors, and any other parties that have a bearing on the viability of the company as a public entity and could affect the proper, truthful, adequate disclosure of its condition in the prospectus.
- The accounting firm will examine financial information and such specific documents as contracts, billings, and receipts to ensure the accuracy and adequacy of financial statements.

# THE IPO PROCESS

- **6. Select a Financial Printer and Public Relations Firm.** Your company should select an **experienced financial printer** – one who is familiar with regulations governing the graphic presentation of a prospectus and has facilities to print sufficient quantities under severe time constraints. **A public relations firm** familiar with the IPO process should be retained to help create interest in the offering and get the right message out to the investment community.

# THE IPO PROCESS

- **7. Assemble the Consortium.** After the prospectus and necessary documents have been filed and is approved for circulation among potential investors, your **underwriter should assemble the "consortium,"** consisting of **additional investment bankers** who will place portions of the offering to achieve the desired distribution.
- Your underwriter should also accumulate **"indications of interest"** – solicited through its efforts as well as the consortium's – from institutions and brokers that have approached their clients. These give assurance that the IPO is viable and help to determine the final number of shares to be offered, the price and the allocations to investors.

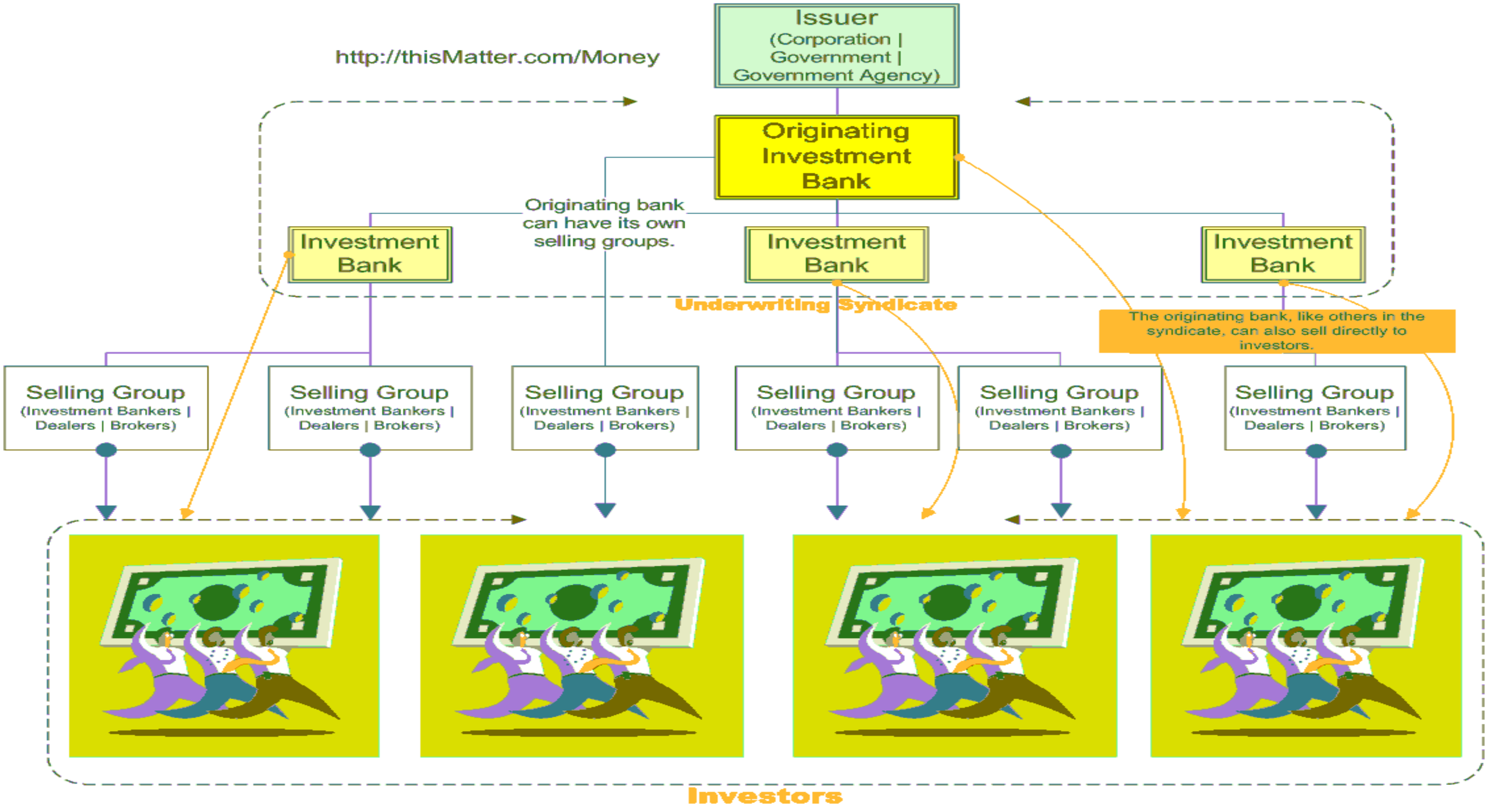
# THE IPO PROCESS

- 8 Perform the Road Show. Next, your company and your investment banker should design and perform the **"road show,"** a series **of meetings held with potential investors** and analysts in key cities across the country and if appropriate, overseas. The "road show" consists of fairly elaborate formal presentation on the company's operations, financial condition, performance, markets, and products and services delivered by the company's top executives, who are then available for questions. The "road show" has become increasingly important not only to communicate key information to investors but also to display the managerial talent and expertise that will be leading the company.

# THE IPO PROCESS

- **9. Price the Offering.** Your investment banker should **recommend for your approval a price per share**, taking into account your company's financial performance and competitive prospects; the stock price of **comparable companies**; general **stock market conditions**; and the **success of the road show** and **ensuing expressions of interest**. While your company will want **as high as price as possible**, an offering that **does not sell or sell completely will not be in your best interest**, or the best interest of investors who may find the share price declining in the market after their initial purchase. In fact, **investors look for at least a modest increase in the market price** to reassure them about their investment decision.

# INITIAL PUBLIC OFFERING PROCESS



- *The Pitch (Pitchbook)*
- *Originating/ Hiring the managers*
- *(“Beauty Contest”)/ Pitching*
- Making a Valuation (mix of art and science)
- Highest Valuation vs. Best-qualified manager
- Determine structuring and distribution


The **Pitchbook** includes:
• the bank's reputation, which can lend the offering an aura of respectability
• the performance of other IPOs managed by the bank
• the prominence of a bank's research analyst in the industry, which can tacitly guarantee that the new public stock will receive favorable coverage by a listened-to stock expert
• the bank's expertise as an underwriter in the industry

# $2^{ND}$ STEP OF AN IPO

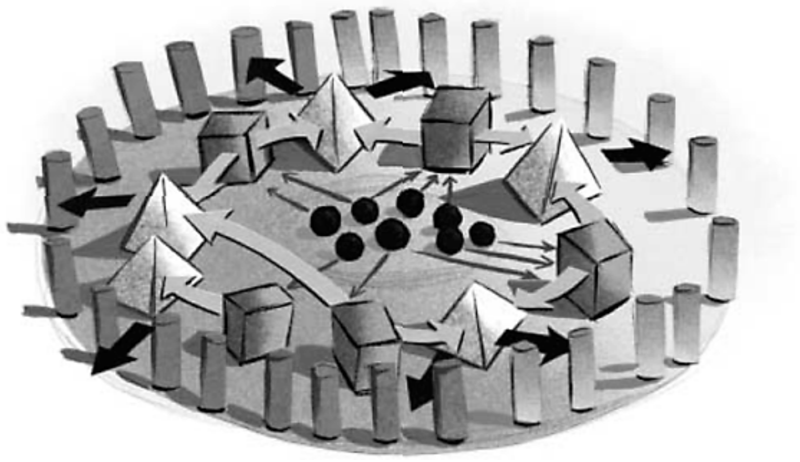
- form the syndicate and selling group for joint distribution of the offering
- Members of the syndicate make a firm commitment to distribute a certain percentage of the entire offering and are held financially responsible for any unsold portions
- Selling groups ("best effort") of chosen brokerages, are formed to assist the syndicate members meet their obligations
- most common type of underwriting, firm commitment, the managing underwriter makes a commitment to the issuing corporation to purchase all shares being offered. If part of the new issue goes unsold, any losses are distributed among the members of the syndicate.

Many underwriters require that your company is generating sales of $10 to $20 million annually with profits of $1 million. That your product is on the "leading edge" and that you have an experienced, proven top management team and can show future growth rates of at least 25% annually for the next five years.

# THE SYNDICATE

Vital link between salespeople and corporate finance. Syndicate exists to facilitate the placing of securities in a public offering, a knock-down drag-out affair between and among buyers of offerings and the investment banks managing the process. In a corporate or municipal debt deal, syndicate also determines the allocation of bonds.

The Structure of Syndication

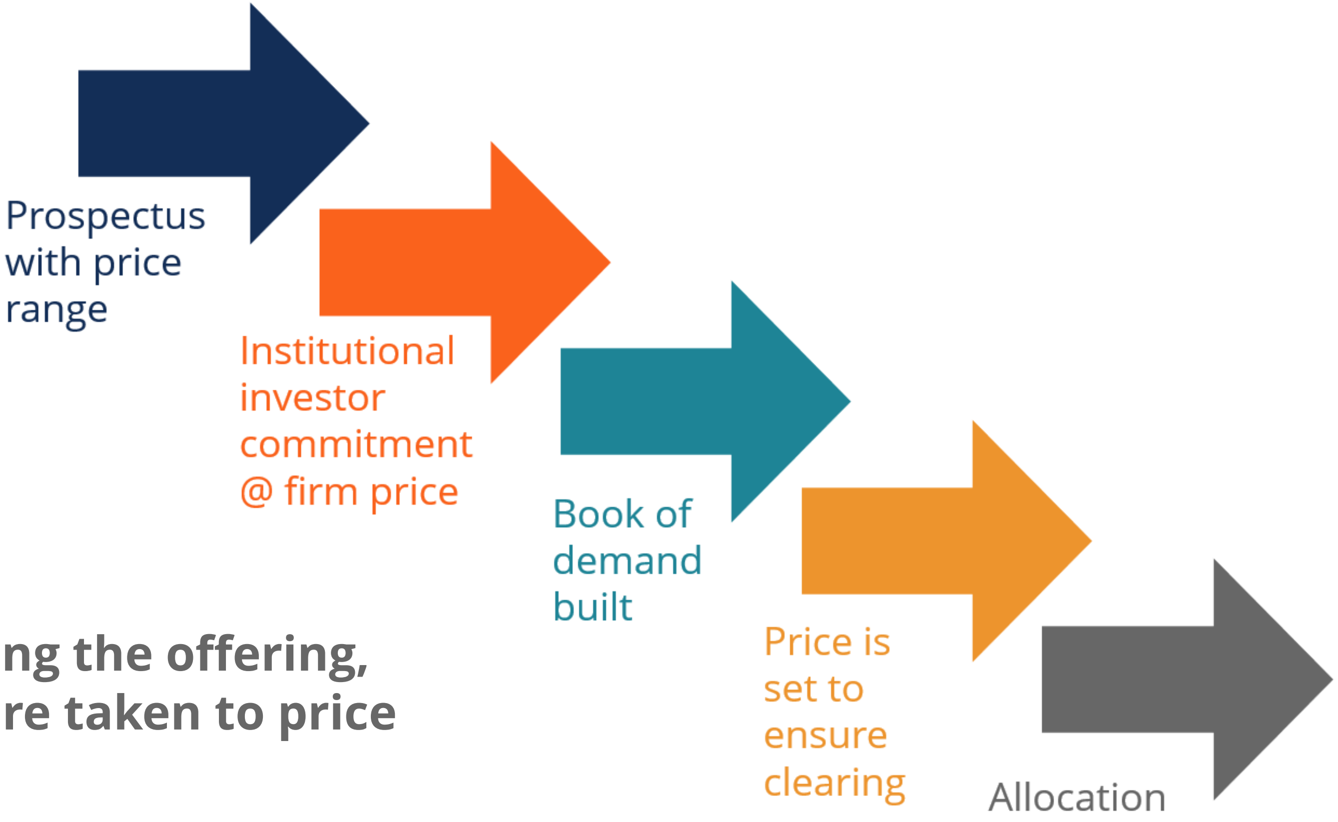


# PRICING OF AN IPO

- Lead managers help to decide on an appropriate price at which the shares should be issued.
- There are two ways in which the price of an IPO can be determined:
- the company, with the help of its lead managers, fixes a price or
- the price is arrived at through the process of ***book building.***

Book Building is a process to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process. In case of oversubscription the *greenshoe (over-allotment) option* is triggered. It can vary in size up to 15% of the original number of shares offered

## ▪ BOOK BUILDING PROCESS



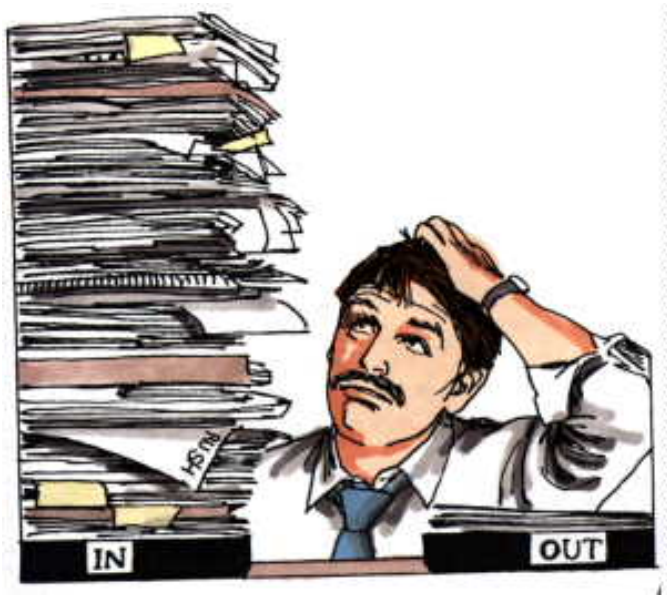

**Once the bank has started marketing the offering, the following book-building steps are taken to price and complete the deal.**

# 3RD STEP OF AN IPO

- ▪

- (Due Diligence) understanding the company's business as well as possible scenarios

- filing the legal Documents as required by the Regulator (Prospectus)
- Registration Statement:
- Business product/service/markets
- Company Information
- Risk Factors
- Proceeds Use
- Officers and Directors
- Related party transactions
- Identification of your principal shareholders
- Audited financials



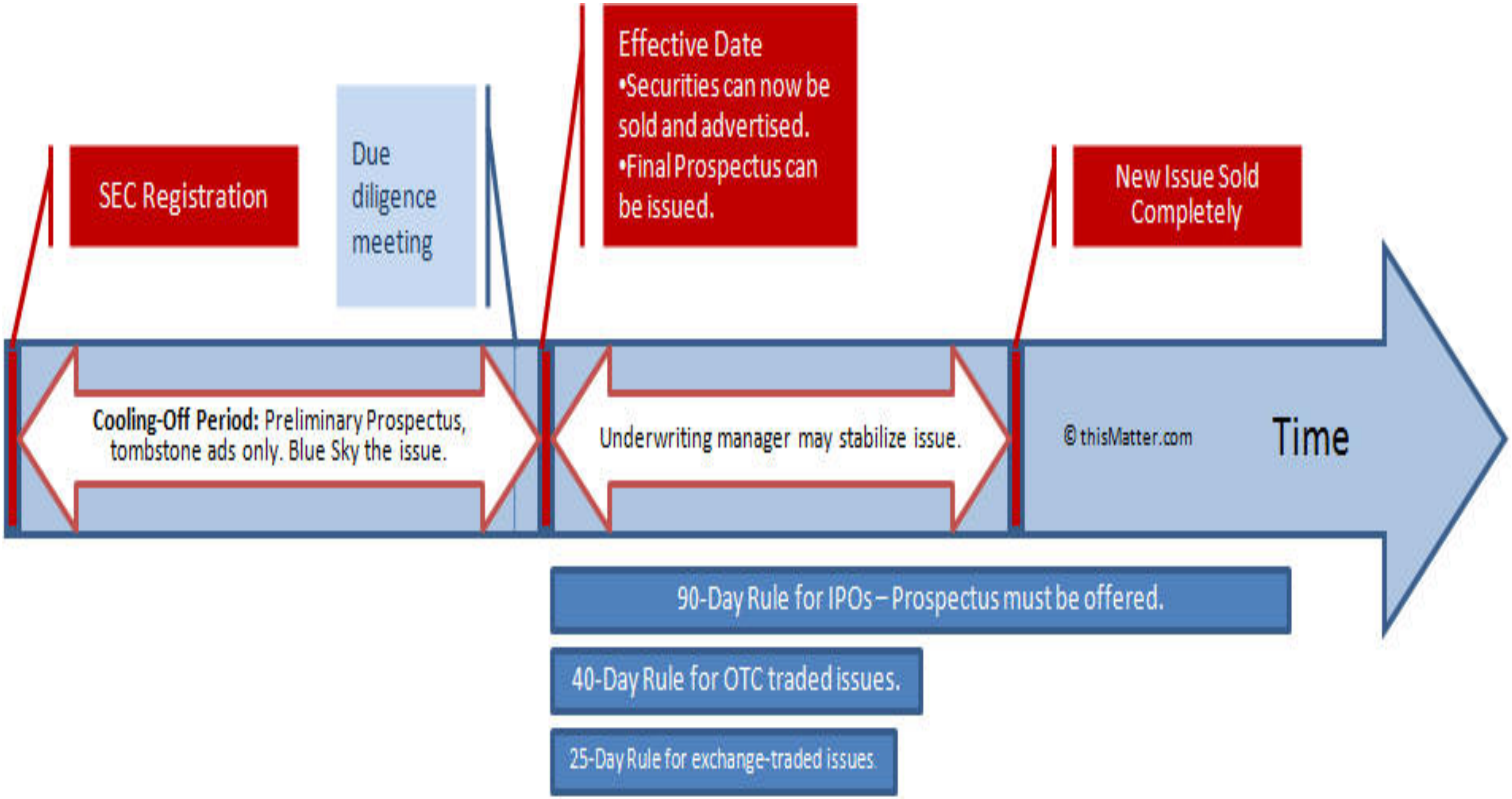
# $4^{TH}$ STEP OF AN IPO

- ***Marketing***
- “*Roadshow*” or “*Baby Sitting*”
- marketing phase ends with the placement of the stock
- gathering "*indications of interest*"
- An indication of interest does not obligate or bind the customer to purchase the issue, since all sales are prohibited until the security has cleared registration.
- final prospectus is issued
- The final prospectus contains all of the information in the preliminary prospectus (plus any amendments), as well as the final price of the issue, and the underwriting spread.

# THE PROCESS OF GOING PUBLIC

- **Hiring the Managers**
- • Pitching/Beauty contests
- • Selecting the managers in the deal
- **Due Diligence & Drafting**
- • Due diligence
- • Drafting the prospectus
- • Meeting at the printer and filing the prospectus
- **Marketing**
- • Designing the roadshow - slides and presentation
- • Amending the prospectus per comments from the SEC
- • Managers set up roadshow meetings
- • Roadshow begins
- • Roadshow ends and stock is priced
- **Stock Begins Trading!**

# TIMELLINE FOR AN IPO (EXAMPLE:US)



# MEASUREMENT OF SUCCESS OF AN INVESTMENT BANK

- 1. Total Shareholders. Is this number increasing or decreasing? What is the rate of increase or decrease per year? While market conditions and corporate events will have an affect on this number, a decrease does have implications for corporate control and future securities sales. Aftermarket performance is crucial in the first few years following the issue.

# MEASUREMENT OF SUCCESS OF AN INVESTMENT BANK

- **2. Number of Analysts Following the Company.** A modest annual **increase in the number of analysts producing reports on your company** is desirable. Just as important, your company should gradually be securing the following of the most **well-known and well-respected analyst** in its industry sector.

## MEASUREMENT OF SUCCESS OF AN INVESTMENT BANK

- 3. Number of Stock Brokers Recommending the Stock. A decrease in this number my call for increasing efforts to reacquaint brokers with the company if the decrease cannot be accounted for by your company's industry being temporarily out of favor or substantial problems at the company.

# MEASUREMENT OF SUCCESS OF AN INVESTMENT BANK

- 5. Price-to-Earnings Ratio. Is your company's price-to-earnings multiple maintaining a position above the industry average? Is it increasing or decreasing over time? In line with the rest of the industry or counter to it? More work focused on increasing the market's valuation of your company's stock may be needed.

## MEASUREMENT OF SUCCESS OF AN INVESTMENT BANK

- 6. Average Trading Volume. Your company needs to **monitor trading volume daily**, particularly block volume, as a barometer of market sentiment and for advance notice of threats to corporate control or market upswings or downswings.

# MEASUREMENT OF SUCCESS OF AN INVESTMENT BANK

- **7. Number and Quality of Inquiries to the Company. The number of inquiries to your company over time** will indicate in itself **the range and intensity of your investor and public relations programs.**
- These inquiries can be **analyzed** further according **to audience** and **geographical region.**
- The **quality of these inquiries**—how much knowledge of your company, its industry, and the stock market is evident—will indicate the degree to which your investor and public relations messages are being understood.
- To a certain extent, **your company must educate its audiences**—observing the appropriate level of sophistication and tact—not only your company's characteristics but also its industry and competitors as well as the general business and economic environment.

# VALUATION OF A BUSINESS

# DETERMINING THE VALUE OF A BUSINESS

- Business valuation is partly an art and partly a science.
- A wide variety of factors influence the price of a business.
- Valuing tangible assets is easy. It’s much harder to value intangible assets.

# DETERMINING THE VALUE OF A BUSINESS

## Goodwill

The difference in the value of an established business and one that has not yet built a solid reputation for itself.

# DETERMINING THE VALUE OF A BUSINESS

- Balance Sheet Technique
  - Variation: Adjusted Balance Sheet Technique
- Earnings Approach
  - Variation 1: Excess Earnings Approach
  - Variation 2: Capitalized Earnings Approach
  - Variation 3: Discounted Future Earnings Approach
- Market Approach

# BALANCE SHEET TECHNIQUES

“Book Value" of Net Worth = Total Assets - Total Liabilities

= $266,091 - $114,325

= $151,766

Variation: Adjusted Balance Sheet Technique:

Adjusted Net Worth = $274,638 - $114,325

= $160,313

# Variation 1: Excess Earnings Method

Step 1: Compute adjusted tangible net worth:

Adjusted Net Worth = \$274,638 - \$114,325 = \$160,313

Step 2: Calculate opportunity costs of investing:

| | | |
|---|---|---|
| Investment | \$160,313 x 22% = | \$35,269 |
| Salary | | \$35,000 |
| | Total | \$70,269 |

Step 3: Project earnings for next year: \$75,000

**(continued)**

# EXCESS EARNINGS METHOD

Step 4: Compute extra earning power (EEP):

EEP = Projected Net Earnings - Total Opportunity Costs

= \$75,000 - 70,269 = \$4,731

Step 5: Estimate the value of the intangibles ("goodwill"):

Intangibles = Extra Earning Power x "Years of Profit" Figure*

= \$4,731 x 4.4 = \$20,896

* *Years of Profit Figure ranges from 1 to 7; for a normal risk business, the range is 3 to 4.*

# EXCESS EARNINGS METHOD (continued)

Step 6: Determine the value of the business:

Value = Tangible Net Worth + Value of Intangibles

= $160,313 + 20,896 = $181,209

Estimated Value of the Business = $181,209

# EARNINGS APPROACHES

## Variation 2:  Capitalized Earnings Method

$$\text{Value} = \frac{\text{Net Earnings (}\textit{After}\text{ Deducting Owner's Salary)}}{\text{Rate of Return*}}$$

$$\text{Value} = \frac{\$75{,}000 - \$35{,}000}{22\%} = \$181{,}818$$

** Rate of return reflects what buyer could earn on a similar-risk  investment.*

# EARNINGS APPROACHES

**(continued)**

## Variation 3: Discounted Future Earnings Method

Step 1: Project earnings five years into the future:

**3 Forecasts:**

- Pessimistic
- Most Likely
- Optimistic

Compute a *weighted average* of the earnings:

$$\frac{\text{Pessimistic} + (4 \times \text{Most Likely}) + \text{Optimistic}}{6}$$

# DISCOUNTED FUTURE EARNINGS METHOD

**(continued)**

Step 1: Project earnings five years into the future:

| Year | Pessimistic | Most Likely | Optimistic | Weighted Average |
|---|---|---|---|---|
| 1 | $62,000 | $74,000 | $82,000 | $73,333 |
| 2 | $68,000 | $80,000 | $88,000 | $79,333 |
| 3 | $75,000 | $88,000 | $95,000 | $87,000 |
| 4 | $82,000 | $96,000 | $102,000 | $94,667 |
| 5 | $90,000 | $105,000 | $110,000 | $103,333 |

# DISCOUNTED FUTURE EARNINGS METHOD

**(continued)**

Step 2: Discount weighted average of future earnings at the appropriate present value rate:

$$\text{Present Value Factor} = \frac{1}{(1+k)^{t}}$$

Where:

k = Rate of return on a similar risk investment.

t = Time period (Year - 1, 2, 3...n).

# DISCOUNTED FUTURE EARNINGS METHOD

**(continued)**

Step 2: Discount weighted average of future earnings at the appropriate present value rate:

| Year | Weighted Average | x PV Factor | = Present Value |
|---|---|---|---|
| 1 | $73,333 | .8197 | $60,109 |
| 2 | $79,333 | .6719 | $53,301 |
| 3 | $87,000 | .5507 | $47,912 |
| 4 | $94,667 | .4514 | $42,732 |
| 5 | $103,333 | .3700 | $38,233 |
| | | Total | $242, 287 |

# DISCOUNTED FUTURE EARNINGS METHOD

**(continued)**

Step 3: Estimate the earnings stream beyond five years:

$$\text{Weighted Average Earnings in Year 5} \times \frac{1}{\text{Rate of Return}}$$

$$= \$103{,}333 \times \frac{1}{25\%}$$

Step 4: Discount this estimate using the present value factor for year 6:

$469,697   x   .3033   =   $142,449

# DISCOUNTED FUTURE EARNINGS METHOD

**(continued)**

Step 5: Compute the value of the business:

| | | | | |
|---|---|---|---|---|
| Value | = | Discounted earnings in years 1 through 5 | + | Discounted earnings in years 6 through ? |

= \$242,287 + \$142, 449 = \$384,736

Estimated Value of Business = \$384, 736

# MARKET APPROACH

Step 1: Compute the average Price-Earnings (P-E) Ratio for as many similar businesses as possible:

| Company | P-E Ratio |
|---|---|
| 1 | 4.5 |
| 2 | 5.3 |
| 3 | 5.0 |
| 4 | 4.8 |

Average P-E Ratio = 4.90

4.90 x 40% (private company discount)

= 2.94

Step 2: Multiply the average P-E Ratio by next year's forecasted earnings:

Estimated Value of Business = 2.94 x $75,000 = $220,500

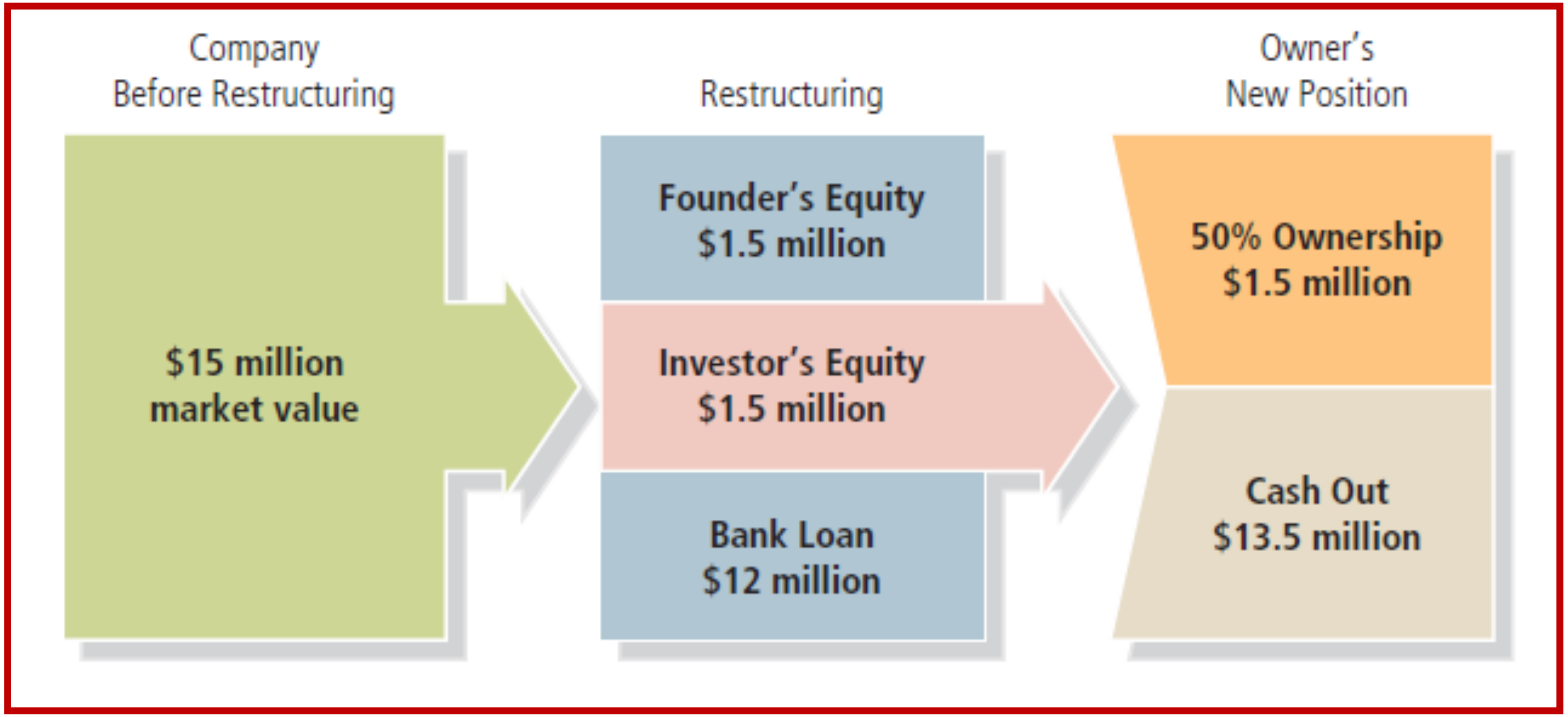
# UNDERSTANDING THE SELLER'S SIDE

For entrepreneurs, few events are more anticipated – and more emotional – than selling their business.

Exit Strategies:

- Straight business sale
- Form a family limited partnership
- Sell a controlling interest
  - Earn-out
- Restructure the company

# RESTRUCTURING A BUSINESS FOR SALE



Duration Analysis

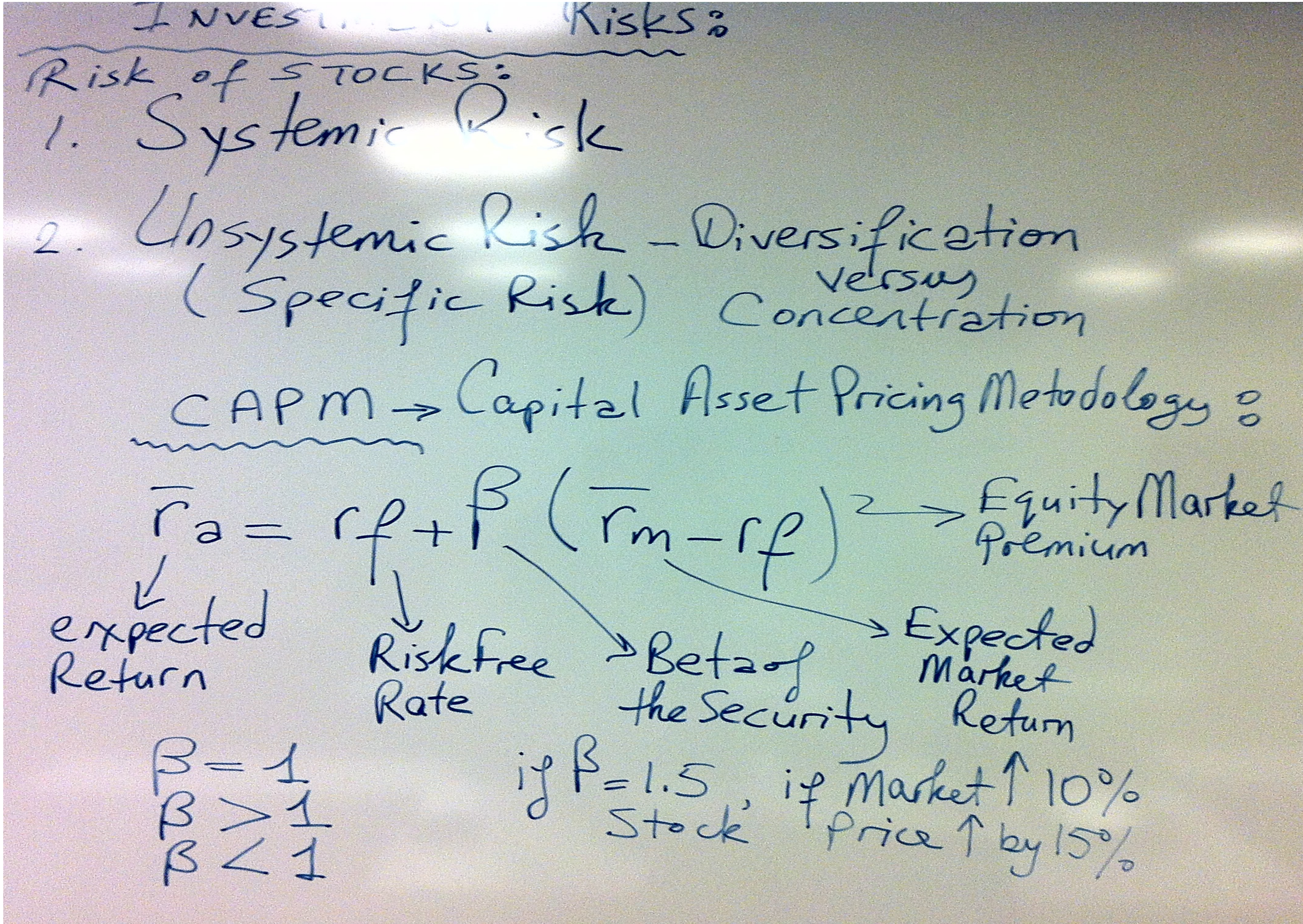
Risk of an Interest Earning Asset:

How to measure?

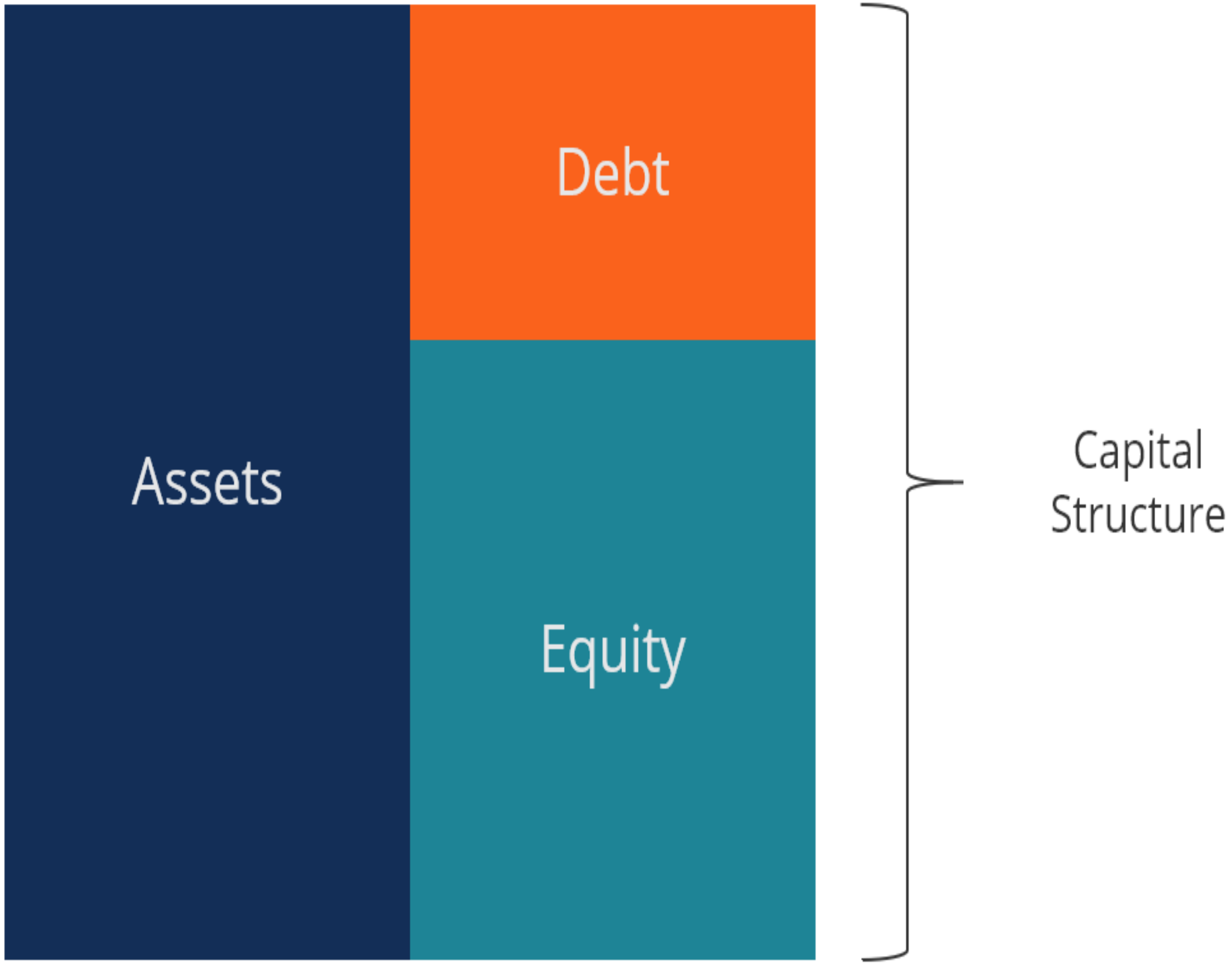
(1) DURATION Analysis

| Year (A) | Cash Inflow | NPV | % of NPV (B) | (A) x (B) |
|---|---|---|---|---|
| 1 | 72.50 | 66.18 | 7.47% | 0.075 |
| 2 | 72.50 | 60.41 | 6.82 | 0.136 |
| 3 | 72.50 | 55.14 | 6.24 | 0.187 |
| 4 | 72.50 | 50.33 | 5.68 | 0.227 |
| 5 | 72.50 | 45.94 | 5.18 | 0.259 |
| 6 | 72.50 | 41.94 | 4.73 | 0.284 |
| 7 | 1.072.50 | 566.31 | 63.90% | 4.473 |
| | $1.507.50 | $886.25 | 100% | 5.641 Years |

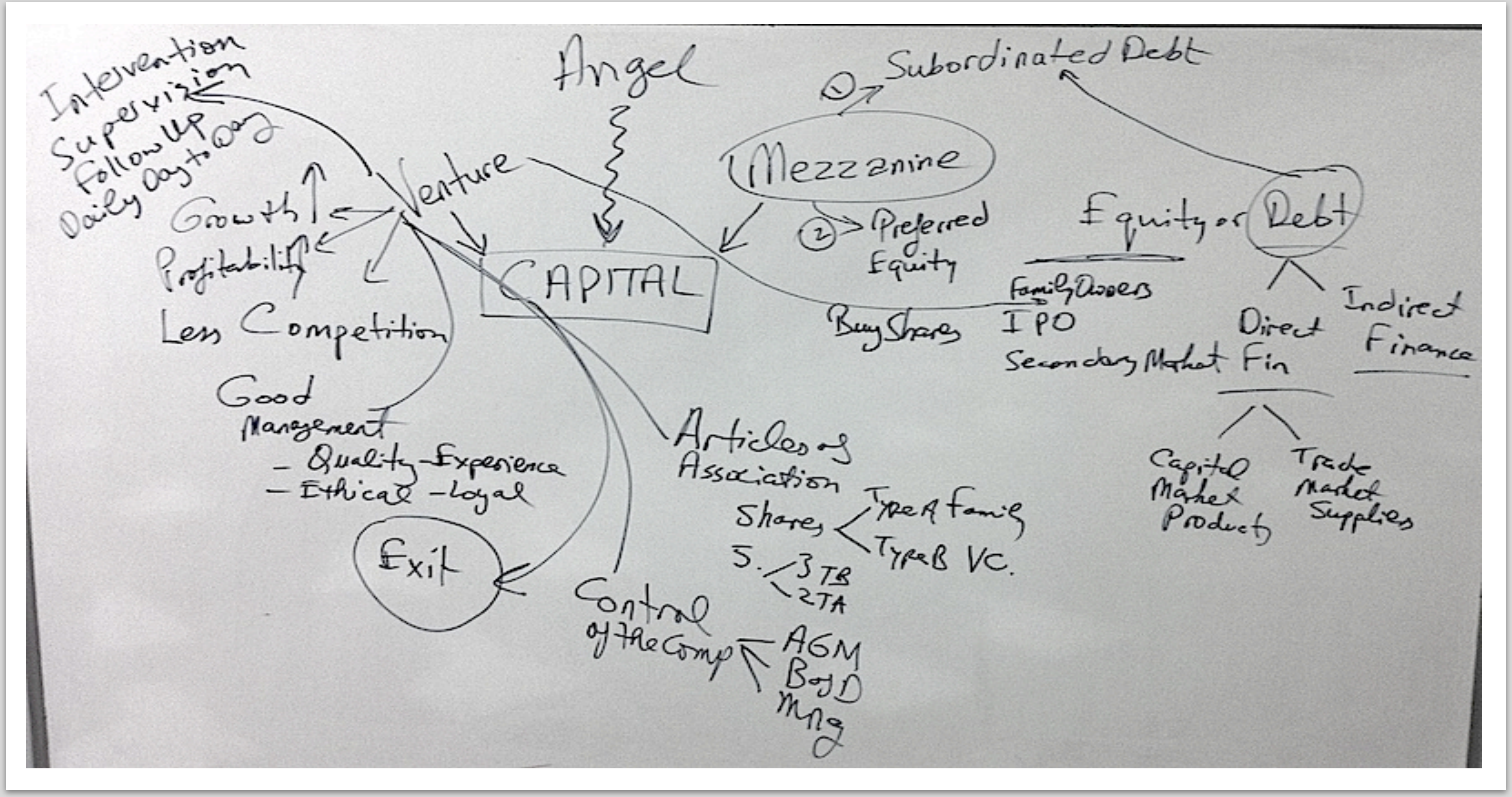
Investment Risks



# CORPORATE FINANCE




# HOW IMPORTANT IS A COMPANY'S CAPITAL STRUCTURE IN CORPORATE FINANCE?


Intervention
Supervision
Follow Up
Daily Day to Day
Angel
Subordinated Debt
1
Mezzanine
2
Preferred Equity
Venture
Growth
Profitability
Less Competition
Good Management
- Quality - Experience
- Ethical - Loyal
CAPITAL
Equity or Debt
Family Owners
Buy Shares
IPO
Secondary Market
Direct Fin
Indirect Finance
Capital Market Products
Trade Market Supplies
Articles of Association
Shares
Type A family
Type B VC.
5.
3 TB
2 TA
Exit
Control of the Comp
AGM
Bo of D
Mng

# WHAT IS CORPORATE FINANCE?

- **What is Corporate Finance?**
- Corporate finance deals with the **capital structure** of a corporation including its **funding** and the actions that management takes **to increase the value of the company**.
- Corporate finance also includes the tools and analysis utilized to **prioritize** and **distribute** financial resources.
- The ultimate purpose of corporate finance is to maximize the value of a business through planning and implementing **management resources** while balancing risk and profitability.

# CORPORATE FINANCE ACTIVITIES

## Corporate Finance Activities

| Capital Investments | Capital Financing | Dividends & Return of Capital |
|---|---|---|
| Decide what projects / acquisitions to invest in<br><br>Earn the highest possible risk-adjusted return | Determine how to fund capital investments<br><br>Optimize the firm's capital structure | Decide how and when to return capital to investors |

# THE 3 IMPORTANT ACTIVITES THAT GOVERN CORPORATE FINANCE

- #1 Investments & Capital Budgeting
- #2 Capital Financing
- #3 Dividends & Return of Capital

# THE 3 IMPORTANT ACTIVITES THAT GOVERN CORPORATE FINANCE

- #1 Investments & Capital Budgeting
- **Investing** and **capital budgeting** includes planning where to place the company's long-term capital assets in order to generate the highest risk-adjusted returns. This mainly consists of deciding whether or not to pursue an investment opportunity through extensive financial analysis.
- By using financial accounting tools, a company identifies capital expenditures, estimates cash flows from the proposed capital projects, compares planned investments with projected income, and decides which projects to include in the capital budget.
- Financial modeling is used to estimate the economic impact of an investment opportunity and compare alternative projects. An analyst will often use **Internal Rate of Return** (IRR) in conjunction with **Net Present Value** (NPV) to compare projects and pick the optimal one.

# THE 3 IMPORTANT ACTIVITES THAT GOVERN CORPORATE FINANCE

- #2 Capital Financing
- This core activity includes decisions on **how to optimally finance the capital investments** (discussed above) through the business' equity, debt, or a mix of both. Long-term funding for major capital expenditures or investments may be obtained from selling company stocks or issuing debt securities in the market through investment banks.
- Balancing the two sources (equity and debt) should be closely managed because having too much debt may increase the risk of default in repayment, while depending too heavily on equity may dilute earnings and value for original investors.
- Ultimately, it's the job of corporate finance professionals to **optimize the company's capital structure** by lowering its **Weighted Average Cost of Capital (WACC)** to be as low as possible.

# THE 3 IMPORTANT ACTIVITES THAT GOVERN CORPORATE FINANCE

- #3 Dividends & Return of Capital
- This activity requires corporate managers to decide whether to retain a business's excess earnings for future investments and operational requirements or to distribute the earnings to shareholders in the form of dividends or share buybacks.
- Retained earnings that are not distributed back to shareholders may be used to fund a business's expansion. This can often be the best source of funds, without incurring additional debts or diluting the value of equity by issuing more shares.
- At the end of the day, if corporate managers believe they can earn a rate of return on a capital investment that's greater than the company's cost of capital, they should pursue it, otherwise, they should return that capital to shareholders via dividends or share buybacks.

# CORPORATE FINANCE TRANSACTIONS

- Initial Public Offering (IPO)
- Secondary Market Offering (SEO)

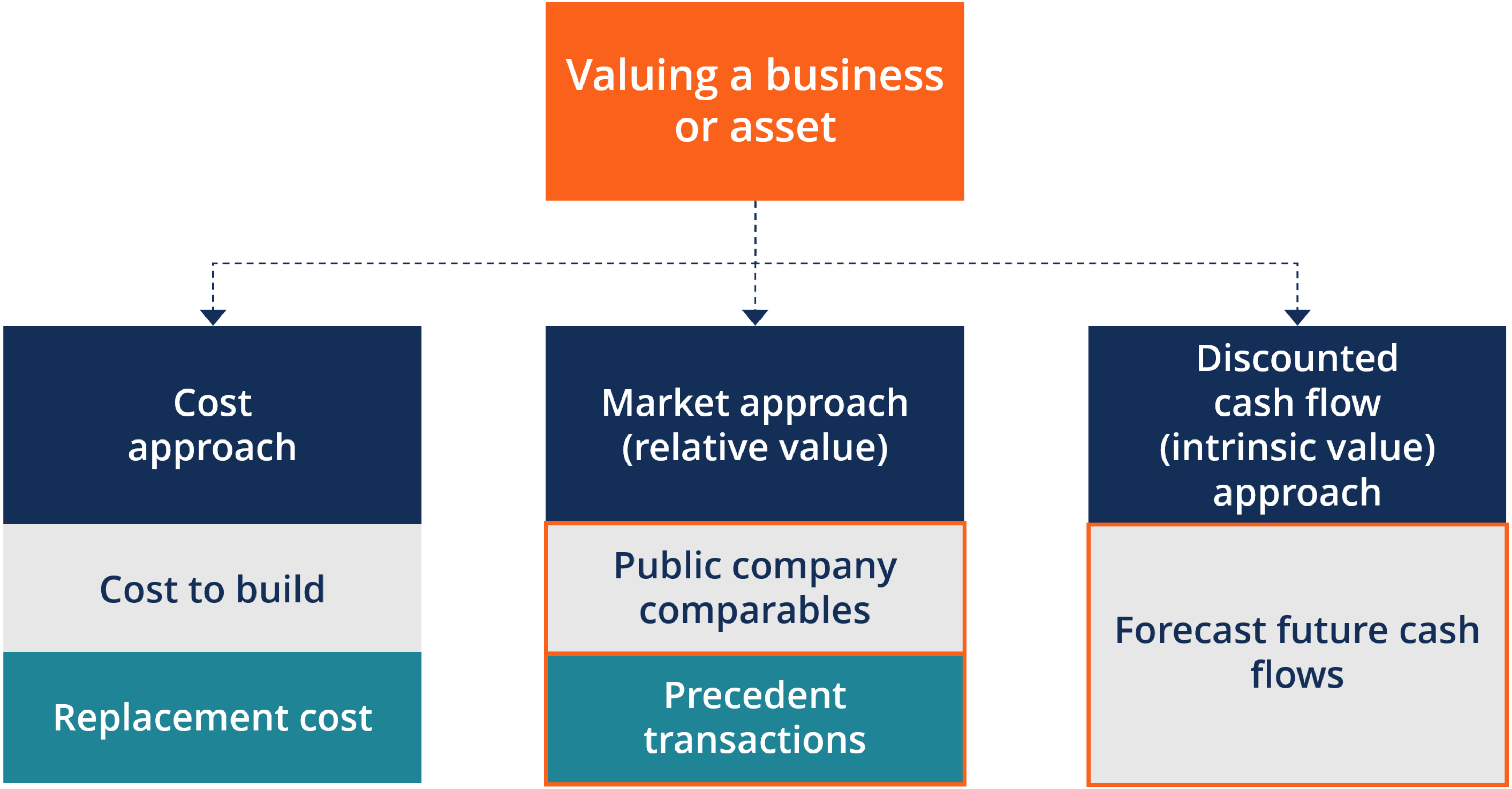
- Takeover

- Leveraged Buyouts
- Bond Offering

# WHAT ARE THE MAIN VALUATION METHODS?

- When valuing a company as a going concern, there are **three main valuation methods** used by industry practitioners:
- (1) DCF analysis,
- (2) comparable company analysis, and
- (3) precedent transactions.
- These are the most common methods of valuation used in investment banking, equity research, private equity, corporate development, mergers & acquisitions (M&A), leveraged buyouts (LBO), and most areas of finance.

# VALUING A BUSINESS or ASSET



# METHOD 1: COMPARABLE ANALYSIS ("COMPS")

- Comparable company analysis (also called "**trading multiples**" or "**peer group analysis**" or "**equity comps**" or "**public market multiples**") is a relative valuation method in which you **compare the current value of a business to other similar businesses** by looking at trading multiples like P/E, EV/EBITDA, or other ratios. Multiples of EBITDA are the most common valuation method.
- The "comps" valuation method provides an observable value for the business, based on what companies are currently worth. Comps are the most widely used approach, as they are easy to calculate and always current. The logic follows that, if company X trades at a 10-times P/E ratio, and company Y has earnings of $2.50 per share, company Y's stock must be worth $25.00 per share (assuming its perfectly comparable).

# Example Comps Table

| Company Name | Price ($/share) | Market Cap ($M) | EV ($M) | Sales ($M) | EBITDA ($M) | Earnings ($M) | EV/Sales x | EV/EBITDA x | P/E x |
|---|---|---|---|---|---|---|---|---|---|
| | Market Data | | | Financial Data (FY+1) | | | Valuation (FY+1) | | |
| Micro Partners | $9.45 | $945 | $1,070 | $268 | $76 | $47 | 2.5x | 14.1x | 22.8x |
| Junior Enterprises | $5.68 | $7,100 | $9,100 | $4,136 | $778 | $412 | 2.2x | 11.7x | 22.1x |
| Minature Company | $18.11 | $906 | $931 | $443 | $96 | $56 | 1.9x | 9.7x | 16.7x |
| Average Limited | $12.27 | $7,730 | $8,080 | $1,949 | $528 | $294 | 2.6x | 12.2x | 22.4x |
| Bohemeth Industires | $9.03 | $13,545 | $13,545 | $6,622 | $795 | $423 | 1.7x | 17.0x | 28.3x |
| | | | | | | | | | |
| Average | | | | | | | 2.2x | 12.9x | 22.5x |
| Median | | | | | | | 2.2x | 12.2x | 22.4x |

## METHOD 2: PRECEDENT TRANSACTIONS

- <u>Precedent transactions analysis</u> is another form of relative valuation where **you compare the company** in question to **other businesses that have recently been sold** or acquired in the same industry. These transaction values include the **take-over premium** included in the price for which they were acquired.
- These values represent the en bloc value of a business. They are **useful for M&A transactions**, but can easily **become stale-dated** and no longer reflective of the current market as time passes. They are less commonly used than Comps or market trading multiples.

# Market Trading Multiples

| Date | Target | Transaction Value ($M) | Buyers | Valuation EV/Sales | EV/EBITDA | EV/EBIT |
|---|---|---|---|---|---|---|
| 01/24/2017 | Current Ltd | 2,350 | Average Limited | 1.9x | 9.4x | 11.2x |
| 04/19/2016 | Recent Inc | 6,500 | Bohemeth Industires | 1.4x | 8.0x | 12.6x |
| 04/19/2014 | Past Co | 2,150 | Other Group | 1.3x | 8.7x | 12.1x |
| 11/07/2014 | Historical LLP | 450 | Junior Enterprises | 2.3x | 11.1x | 13.6x |
| 11/01/2012 | Old Group | 325 | Minature Company | 5.1x | 18.8x | 21.5x |
| 10/07/2011 | Dated Enterprises | 150 | Micro Partners | 2.1x | 9.3x | 13.2x |
| **Average** | | | | **2.3x** | **10.9x** | **14.0x** |
| **Median** | | | | **2.0x** | **9.4x** | **12.9x** |

# METHOD 3: DCF ANALYSIS

- Discounted Cash Flow (DCF) analysis is an intrinsic value approach where an analyst **forecasts the business**' unlevered free cash flow into the **future** and **discounts it back to today** at the firm's Weighted Average Cost of Captial (WACC).
- **A DCF analysis is** performed by building a financial model in **Excel** and requires an extensive amount of detail and analysis. It is the most detailed of the three approaches, requires the most **assumptions**, and often **produces the highest value.** However, the effort required for preparing a DCF model will also often result in the **most accurate valuation.** A DCF model allows the analyst to **forecast value based on different scenarios**, and even **perform a sensitivity analysis.**
- For larger businesses, the DCF value is commonly a **sum-of-the-parts analysis**, where **different business units are modeled individually and added together**. To learn more, see CFI's DCF model infographic.

# DCF Discounted Cash Flow Model



| Online Company Inc Model | Historical Results | | | | Forecast Period | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |

## DCF Model

**Assumptions**

| | |
|---|---|
| Tax Rate | 25% |
| Discount Rate | 12% |
| Perpetual Growth Rate | 4% |
| EV/EBITDA Multiple | 8.0x |
| Current Price | $11.75 |
| Shares Outstanding | 50,000 |

| **Discounted Cash Flow** | **Entry** | **2019** | **2020** | **2021** | **2022** | **2023** | **Exit** |
|---|---|---|---|---|---|---|---|
| *Date* | *9/30/2017* | *12/31/2019* | *12/31/2020* | *12/31/2021* | *12/31/2022* | *12/31/2023* | *12/31/2023* |
| *Year Fraction* | | *1.00* | *1.00* | *1.00* | *1.00* | *1.00* | *1.00* |
| EBIT | | 48,970 | 53,062 | 56,958 | 60,478 | 65,983 | |
| Less: Cash Taxes | | 12,243 | 13,265 | 14,240 | 15,120 | 16,496 | |
| NOPAT | | 36,728 | 39,796 | 42,719 | 45,359 | 49,487 | |
| Plus: D&A | | 9,003 | 10,203 | 11,162 | 11,930 | 12,544 | |
| EBITDA | | 57,974 | 63,264 | 68,121 | 72,408 | 78,526 | |
| Less: Capex | | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 | |
| Less: Changes in NWC | | 4,003 | 4,749 | 2,564 | 2,706 | 2,128 | |
| **Unlevered FCF** | | **26,728** | **30,250** | **36,317** | **39,583** | **44,902** | **579,263** |

| **Terminal Value** | |
|---|---|
| EV/EBITDA | 579,263 |

| **DCF Value** | |
|---|---|
| Enterprise Value | 418,525 |
| Plus: Cash | 139,550 |
| Less: Debt | 30,000 |
| Equity Value | 528,075 |
| **Equity Value/Share** | **10.56** |

| **Market Value** | |
|---|---|
| Market Cap | 587,500 |
| Plus: Debt | 30,000 |
| Less: Cash | 153,654 |
| Enterprise Value | 463,846 |
| **Equity Value/Share** | **11.75** |

| **Rate of Return** | |
|---|---|
| IRR | 10% |

# FINANCIAL STATEMENTS

# 4 FINANCIAL STATEMENTS

- 1. BALANCE SHEET
- 2. INCOME STATEMENT
- 3. CAHF FLOW STATEMENT
- 4. RETAINED EARNIGNS STATEMENT

# FINANCIAL STATEMENTS SHOW?

- 1. BALANCE SHEET
- 2. INCOME STATEMENT
- 3. CAHF FLOW STATEMENT
- 4. RETAINED EARNIGNS STATEMENT

- 1. Financial position
- 2. Results of operations
- 3. Cash inflows & outflows
- 4. Movement in Retained Earnings accounts

| FINANCIAL STATEMENTS | Historical Results 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | |
| **Revenue** | 102,007 | 118,086 | 131,345 | 142,341 | 150,772 | 158,311 |
| Cost of Goods Sold (COGS) | 39,023 | 48,004 | 49,123 | 52,654 | 56,710 | 58,575 |
| **Gross Profit** | 62,984 | 70,082 | 82,222 | 89,687 | 94,062 | 99,736 |
| **Expenses** | | | | | | |
| Salaries and Benefits | 26,427 | 22,658 | 23,872 | 23,002 | 25,245 | 26,913 |
| Rent and Overhead | 10,963 | 10,125 | 10,087 | 11,020 | 11,412 | 10,000 |
| Depreciation & Amortization | 19,500 | 18,150 | 17,205 | 16,544 | 16,080 | 15,008 |
| Interest | 2,500 | 2,500 | 1,500 | 1,500 | 1,500 | 1,500 |
| **Total Expenses** | 59,390 | 53,433 | 52,664 | 52,066 | 54,237 | 53,421 |
| **Earnings Before Tax** | 3,594 | 16,649 | 29,558 | 37,622 | 39,825 | 46,314 |
| Taxes | 1,120 | 4,858 | 8,483 | 10,908 | 11,598 | 12,968 |
| **Net Earnings** | 2,474 | 11,791 | 21,075 | 26,713 | 28,227 | 33,346 |
| **Balance Sheet** | | | | | | |
| **Assets** | | | | | | |
| Cash | 167,971 | 181,210 | 183,715 | 211,069 | 239,550 | 272,530 |
| Accounts Receivable | 5,100 | 5,904 | 6,567 | 7,117 | 7,539 | 7,807 |
| Inventory | 7,805 | 9,601 | 9,825 | 10,531 | 11,342 | 11,715 |
| Property & Equipment | 45,500 | 42,350 | 40,145 | 38,602 | 37,521 | 37,513 |
| **Total Assets** | 226,376 | 239,065 | 240,252 | 267,319 | 295,951 | 329,564 |
| **Liabilities** | | | | | | |
| Accounts Payable | 3,902 | 4,800 | 4,912 | 5,265 | 5,671 | 5,938 |
| Debt | 50,000 | 50,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| **Total Liabilities** | 53,902 | 54,800 | 34,912 | 35,265 | 35,671 | 35,938 |
| **Shareholder's Equity** | | | | | | |
| Equity Capital | 170,000 | 170,000 | 170,000 | 170,000 | 170,000 | 170,000 |
| Retained Earnings | 2,474 | 14,265 | 35,340 | 62,053 | 90,280 | 123,627 |
| **Shareholder's Equity** | 172,474 | 184,265 | 205,340 | 232,053 | 260,280 | 293,627 |
| **Total Liabilities & Shareholder'** | 226,376 | 239,065 | 240,252 | 267,319 | 295,951 | 329,564 |
| **Cash Flow Statement** | | | | | | |
| **Operating Cash Flow** | | | | | | |
| Net Earnings | 2,474 | 11,791 | 21,075 | 26,713 | 28,227 | 33,346 |
| Plus: Depreciation & Amortization | 19,500 | 18,150 | 17,205 | 16,544 | 16,080 | 15,008 |
| Less: Changes in Working Capital | 9,003 | 1,702 | 775 | 903 | 827 | 375 |
| **Cash from Operations** | 12,971 | 28,239 | 37,505 | 42,354 | 43,480 | 47,980 |
| **Investing Cash Flow** | | | | | | |
| Investments in Property & Equipment | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 |
| **Cash from Investing** | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 |
| **Financing Cash Flow** | | | | | | |
| Issuance (repayment) of debt | – | – | (20,000) | – | – | – |
| Issuance (repayment) of equity | 170,000 | – | – | – | – | – |
| **Cash from Financing** | 170,000 | – | (20,000) | – | – | – |
| Net Increase (decrease) in Cash | 167,971 | 13,239 | 2,505 | 27,354 | 28,480 | 32,980 |
| Opening Cash Balance | – | 167,971 | 181,210 | 183,715 | 211,069 | 239,550 |
| **Closing Cash Balance** | 167,971 | 181,210 | 183,715 | 211,069 | 239,550 | 272,530 |

| FINANCIAL STATEMENTS | Historical Results 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
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| **Gross Profit** | 62,984 | 70,082 | 82,222 | 89,687 | 94,062 | 99,736 |
| **Expenses** | | | | | | |
| Salaries and Benefits | 26,427 | 22,658 | 23,872 | 23,002 | 25,245 | 26,913 |
| Rent and Overhead | 10,963 | 10,125 | 10,087 | 11,020 | 11,412 | 10,000 |
| Depreciation & Amortization | 19,500 | 18,150 | 17,205 | 16,544 | 16,080 | 15,008 |
| Interest | 2,500 | 2,500 | 1,500 | 1,500 | 1,500 | 1,500 |
| **Total Expenses** | 59,390 | 53,433 | 52,664 | 52,066 | 54,237 | 53,421 |
| **Earnings Before Tax** | 3,594 | 16,649 | 29,558 | 37,622 | 39,825 | 46,314 |
| Taxes | 1,120 | 4,858 | 8,483 | 10,908 | 11,598 | 12,968 |
| **Net Earnings** | 2,474 | 11,791 | 21,075 | 26,713 | 28,227 | 33,346 |
| **Balance Sheet** | | | | | | |
| **Assets** | | | | | | |
| Cash | 167,971 | 181,210 | 183,715 | 211,069 | 239,550 | 272,530 |
| Accounts Receivable | 5,100 | 5,904 | 6,567 | 7,117 | 7,539 | 7,807 |
| Inventory | 7,805 | 9,601 | 9,825 | 10,531 | 11,342 | 11,715 |
| Property & Equipment | 45,500 | 42,350 | 40,145 | 38,602 | 37,521 | 37,513 |
| **Total Assets** | 226,376 | 239,065 | 240,252 | 267,319 | 295,951 | 329,564 |
| **Liabilities** | | | | | | |
| Accounts Payable | 3,902 | 4,800 | 4,912 | 5,265 | 5,671 | 5,938 |
| Debt | 50,000 | 50,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| **Total Liabilities** | 53,902 | 54,800 | 34,912 | 35,265 | 35,671 | 35,938 |
| **Shareholder's Equity** | | | | | | |
| Equity Capital | 170,000 | 170,000 | 170,000 | 170,000 | 170,000 | 170,000 |
| Retained Earnings | 2,474 | 14,265 | 35,340 | 62,053 | 90,280 | 123,627 |
| **Shareholder's Equity** | 172,474 | 184,265 | 205,340 | 232,053 | 260,280 | 293,627 |
| **Total Liabilities & Shareholder'** | 226,376 | 239,065 | 240,252 | 267,319 | 295,951 | 329,564 |
| **Cash Flow Statement** | | | | | | |
| **Operating Cash Flow** | | | | | | |
| Net Earnings | 2,474 | 11,791 | 21,075 | 26,713 | 28,227 | 33,346 |
| Plus: Depreciation & Amortization | 19,500 | 18,150 | 17,205 | 16,544 | 16,080 | 15,008 |
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| Investments in Property & Equipment | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 |
| **Cash from Investing** | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 |
| **Financing Cash Flow** | | | | | | |
| Issuance (repayment) of debt | – | – | (20,000) | – | – | – |
| Issuance (repayment) of equity | 170,000 | – | – | – | – | – |
| **Cash from Financing** | 170,000 | – | (20,000) | – | – | – |
| Net Increase (decrease) in Cash | 167,971 | 13,239 | 2,505 | 27,354 | 28,480 | 32,980 |
| Opening Cash Balance | – | 167,971 | 181,210 | 183,715 | 211,069 | 239,550 |
| **Closing Cash Balance** | 167,971 | 181,210 | 183,715 | 211,069 | 239,550 | 272,530 |

# RATIO ANALYSIS

# WHAT DOES RATIO ANALYSIS TELL YOU?

- When investors and analysts talk about fundamental or quantitative analysis, they are usually referring to ratio analysis. Ratio analysis involves **evaluating the performance** and **financial health** of a company **by using data** from the **current** and **historical financial statements.**

# Ratio Analysis is used:

- to establish **a trend line** for one company's results over a large number of **financial reporting periods**.
- to **compare** a company to its **peers,** to one or more other companies operating in its sector
- to **compare** a company's **performance over time**
- to **assess** whether the company is **improving** or **deteriorating,**
- to **compare** a company's **financial standing** with the **industry average**

# Liquidity Ratios

- 1. Liquidity Ratios
- Liquidity ratios measure a company's **ability to pay off** its **short-term debts** as they **come due** using the company's **current or quick assets**.
- Liquidity ratios include:
  current ratio,
  quick ratio, and
  working capital ratio.

**Current Ratio = Current Assets / Current Liabilities.**

**Quick ratio = *C+MS+AR / CL***

*C*=cash & cash equivalents
*MS*=marketable securities
*AR*=accounts receivable
*CL*=current liabilities

**Current assets ÷ Current liabilities = Working capital ratio**

# Solvency Leverage Ratios

- 2. Solvency Ratios
- Also called **financial leverage ratios**, solvency ratios compare a company's **debt levels** with **its assets**, **equity**, and **earnings** to evaluate whether a company can stay afloat in the long-term by **paying its long-term debt and interest on the debt**.
- Examples of solvency ratios include:
- debt-equity ratio,
  debt-assets ratio, and
  interest coverage ratio.

# Solvency Leverage Ratios

Solvency Ratio =
**(Net After Tax Income + Non-Cash Expenses) / Short-Term Liabilities + Long-Term Liabilities**

**Debt to Equity ratio = Debt / Equity**

**Debt to Assets ratio = Debt / Total Assets**

**Interest Coverage Ratio = EBIT / Interest Expense**

**where:**EBIT = Earnings before interest and taxes

# Profitability Ratios

- 3. Profitability Ratios
- These ratios show how well a company can **generate profits from its operations.**
- Profit margin,
  return on assets, ROA
  return on equity, ROE
  return on capital employed, and
  gross margin ratio
  are all examples of profitability ratios.

# Profitability Ratios

**Return On Assets, ROA = Net Income / Average Total Assets**

**Return On Equity,  ROE = Net Income / Average Total Share Holders Equity**

**Return On Capital Employed ROCE = EBIT / Capital Employed**

where:EBIT=Earnings before interest and tax
Capital Employed=Total assets – Current liabilities

**Gross Profit Margin Ratio = Gross Margin / Net Sales**

Where **Gross Margin = Net Sales -  Cost of Goods Sold**

**Net Profit Margin = Net Income / Revenues**

# . Efficiency, Activity Ratios

- 4. Efficiency Ratios
- Also called **activity ratios**, efficiency ratios evaluate **how well a company uses its assets and liabilities** to **generate sales** and **maximize profits**.
- Key efficiency ratios are the:
  asset turnover ratio,
  inventory turnover, and
  days' sales in inventory.

Asset Turnover =Total Sales / Average Assets

Inventory Turnover = Cost of Goods sold / Yers-End Inventory

Days' Sales in inventory DSI = (1 – Invetory Turnover) X 365.

# . Coverage Ratios

- 5. Coverage Ratios
- These ratios measure a company's **ability to make the interest payments** and other obligations associated with its debts.
- The times interest earned ratio and the debt-service coverage ratio are both examples of coverage ratios.

# Coverage Ratios

**Times Interest Earned ratio = EBIT / Interest Expense**

**Where EBIT=Earnings before Interest & Tax**

Debt-Service Coverage Ratio  DSCR = Net Operating Income / Total Debt Service

where: Net Operating Income = Revenue – COE
COE=Certain operating expenses
Total Debt Service=Current debt obligations

# . Market Prospect Ratios

- 6. Market Prospect Ratios
- These are the most commonly used ratios in fundamental analysis and include:
- dividend yield,
  P/E ratio,
  earnings per share, and
  dividend payout ratio.
- Investors use these ratios to determine what they may receive in earnings from their investments and to predict what the trend of a stock will be in the future.

# Market Prospect Ratios

**Dividend Yield Ratio = Cash Dividends per share / Market Value per share**

**Earnings Per Share EPS =**
**= (Net Income – Preffered Dividend) / Avr. Number os Shares Outstanding**

**Price Earnings Ratio P/E Ratio = Market value per share / Earnings per share**

**Dividend Payout Ratio = Dividends Paid / Net Income**

**Retention Ratio = Dividends Per Share / EPS**

**where:**EPS=Earnings per share

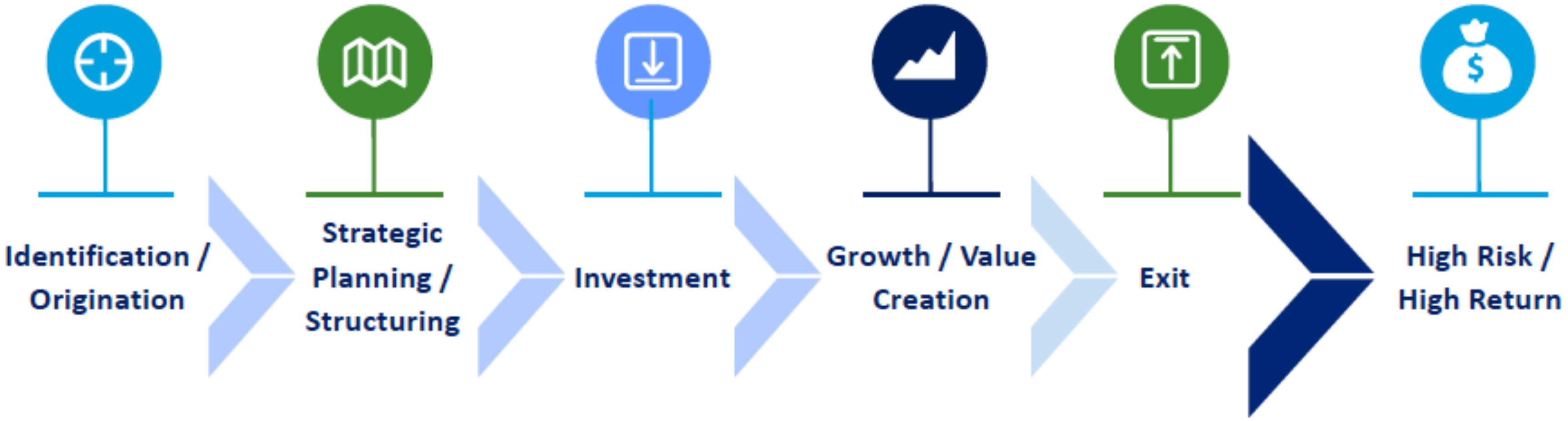
# PRIVATE EQUITY

# PRIVATE EQUITY

- What is Private Equity?
- Private equity is an alternative investment class and consists of capital that is not listed on a public exchange.
- Private equity is composed of **funds and investors** that **directly invest** in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity.
- Institutional and retail investors **provide the capital** for private equity, and the **capital can be utilized to fund** new **technology**, make acquisitions, expand **working capital**, and to bolster and solidify **a balance sheet**.

# What is Private Equity?

- **Private Equity (PE)** refers to equity that is not registered with the relevant securities regulator (e.g. Capital Markets Board in Turkey)
- PE investment comes primarily from institutional investors and accredited investors, who can dedicate substantial sums of money for extended time periods.
- PE investors invest into companies, add value to these companies in terms of growth and corporate development, and exit within the planned period of time by aiming to make profit out of the investment

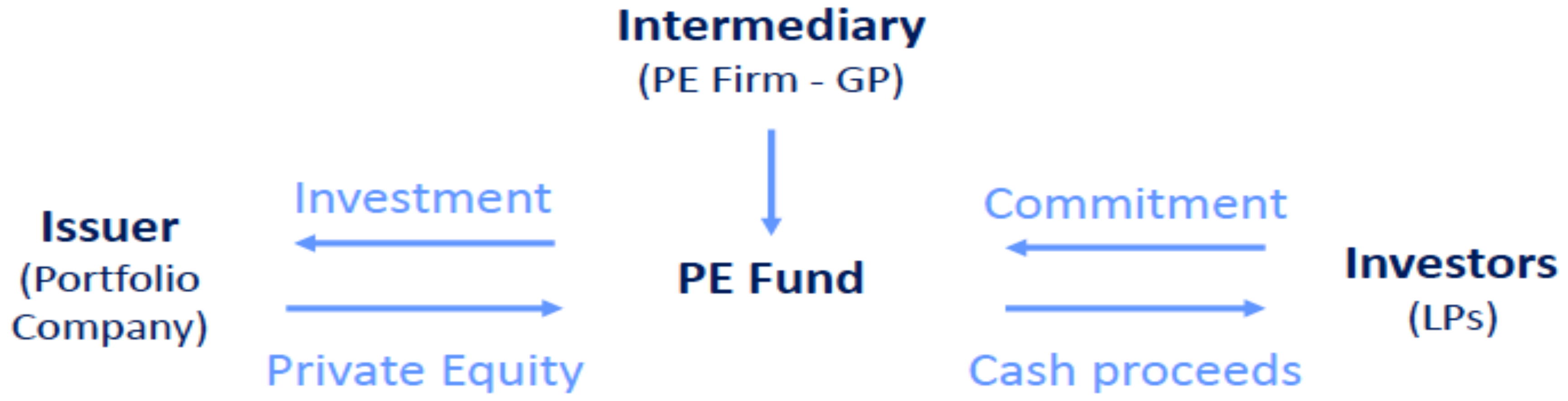


# Private Equity Market Structure – Intermediaries

» Extensive knowledge is needed to analyze huge numbers of potential investment candidates, to assess value, and to monitor/manage the investments (portfolio companies)

» Specialized **"intermediaries" – PE Firms** are at the core of the PE market providing their expertise

» Even the largest and most sophisticated institutional investors generally invest through such intermediaries, not on their own



# Private Equity Market Structure – Complexity

» A PE fund is organized as a partnership, in which a PE management firm serves as the **general partner (GP)**

- These firms are quite small, with very little "overhead"
- The GP might provide a small percentage of the total capital of the fund

» Institutional and individual investors will be **limited partners (LPs)** in the fund

- Silent partner, liability is limited to the amount of their investment in the fund

» A fund might typically have a life of 10 years

- As much as two years might be spent raising the fund
- An investment portfolio will be assembled, with each investment requiring its own structuring
- The GPs will monitor/manage the investments with an eye to eventually "exiting" them via an M&A deal or IPO
- While one fund is still in existence, another one might be raised

» The GPs will receive both a management fee and a "carried interest"

- Annual management fees run 1%-to-2% in most cases (of funds invested)
- GPs typically receive 20% of the profits of the fund

# Private Equity Market Structure – PE vs. Public Equity

**Private Equity vs. Public Equity: It depends on whose perspective**

From the point of view of the **investors**

- Much less liquid—effectively no liquidity
- Costlier in terms of investment expenses
- A blind trust – picking an intermediary who will then pick investments
- Higher risk and higher reward

From the point of view of the **intermediary**

- The due diligence process is much more challenging
- The investment requires a “hands-on” approach
- As in the case of the ultimate investor, there is less liquidity
- The fees are very attractive

From the point of view of the **issuer**

- The cost of equity is higher
- There are only a few outside investors, not thousands of them
- You get to choose who will invest in your company
- You gain the value of the expertise of your investors

# Private Equity Value Creation Levers

## Financial Engineering (β)

**Impact of Leverage**

**Multiple Expansion**

**Contractual Rights**

- Leverage needs to be handled with care during times of economic volatility in order to maintain a robust balance sheet
- Multiple expansion is usually unpredictable
- Enforcement of contractual rights is difficult

**Beta opportunities are very limited on competitive and volatile markets like Turkey**

## Real Value-Add (α)

**Hands-on Management**

**Top-Line Growth**

**EBITDA Improvement**

- Understand sector and the company
- Identify potential and risks comprehensively
- Deal structuring
- Multiple expansion through value creation

**Different forms of Value Creation is available throughout all stages of the investment life cycle**

# Turkish Private Equity Market

# Sources of Private Sector Financing

## Internal Sources

### Shareholders' Equity

- Companies usually established with limited equity
- Capital accumulation is low

**TRY 316k**

The average paid-in capital of newly established companies in 2018

### Internal Cash Generation

- EBITDA / Cash conversion ratios in most sectors are poor mainly due to low margin business and working capital need
- Lack of operationally sound business models and strategies to sustain profitable growth
- Carrying forex risk on their balance sheets in terms of loans, trade payables, etc.

- **Internal and external sources are inadequate to finance the desired growth for private companies in Turkey - Private Equity is a viable financing alternative**

## External Sources

### Loans

Turkish banks are reluctant to provide long-term loans with favorable conditions to finance investments for growth, although short term working capital loans are available

→Tangible collateral requirement

→Non-recourse loans not available

**TRY 472bn**

Total SME Loans as of 2018

**20%**

The ratio of SME Loans to total loans as of 2018

### Capital Markets

- BIST has high quotation standards for most SMEs. In addition, 17 SMEs trade on the newly established BIST Emerging Companies Market platform
- IPO market has lost its appetite for mid market listings

**414 Companies**

# of listed companies in BIST National Market (397) and Emerging Companies Platform (17) as of Dec 2018

**74 Companies**

The number of publicly traded companies among the top 1,000 Turkish companies according to ICI

### Corporate Bonds

- Limited but growing corporate bond market is emerging
- Short-term structure
- Costly than T-bill

**252 Issuances (TL 18.1bn)**

# of non-financial corporate bond issuances between 2012-2016

### Mezzanine

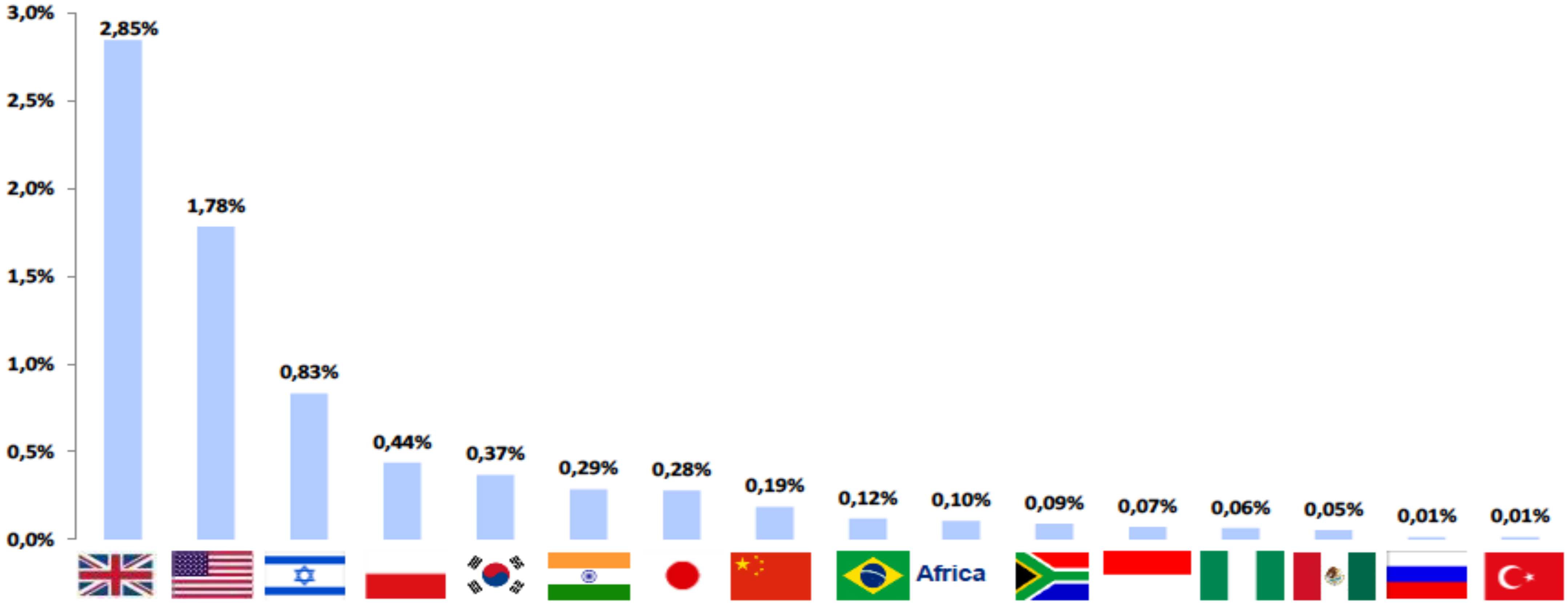
- Similar to senior loan with collateral
- Distressed companies
- Bridge financing
- Growth financing for companies which are not eligible for (further) senior loans >>>> the growth should be high enough to absorb the cost of mezzanine

**25+ Deals**

# of Mezzanine deals completed in Turkey

# PE/VC Activity in Turkey

## Share of PE Investments in GDP (2017) - Comparison Across Countries




**PE penetration in Turkey remains relatively very low**

# Challenges for PE Funds in Turkey

# Local Challenges for PE Funds in Turkey

» **Accessing Proprietary Deal Flow**

- Foreign funds' need to utilize intermediaries to generate deal flow → creates an "auction" environment, high competition resulting in increase in entry prices and less proper due diligence process

» **Completion / Execution Risk**

- Lack of local know-how and presence → Lack of understanding of market dynamics, target companies' value propositions and shareholder expectations

» **Determining Past Performance of Companies – Due Diligence / Industry Information**

- Macroeconomic history of high inflation, fluctuating FX rates and volatility
- Lack of accounting and IT infrastructure
- Inadequate or inconsistent industry data; immature market research and intelligence industry

- » **Business Culture / Corporate Governance and Transparency**
  - Family owned companies reluctant to have an outside shareholder – Has been changing since 2001 crisis
  - Minority/Majority issues
  - Complicated shareholding structures, hard to identify "related-parties"
- » **Human Capital / Management Recruiting and Retaining**
  - Scarcity of result-oriented management talent that can deliver PE expectations
  - Management backgrounds relatively difficult to reference
  - Difficult to find qualified mid-level managers
- » **Legal Environment / Market Regulation**
  - Restructuring the companies (recently updated regulation)
  - Competition Authority Issues
  - ➔ Necessity for complicated shareholding agreements
- » **Availability of Multiple Exit Options**
  - Volatility of ISE
  - Access to the right buyer
  - Acquisition financing has only been available recently

# VENTURE CAPITAL

# VENTURE CAPITAL

- What is Venture Capital?
- Venture capital is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential.
- Venture capital generally comes from well-off investors, investment banks and any other financial institutions.
- However, it does not always take a monetary form; it can also be provided in the form of technical or managerial expertise.
- Venture capital is typically allocated to small companies with exceptional growth potential, or to companies that have grown quickly and appear poised to continue to expand.

# VENTURE CAPITAL INVESTMENT DECISION CRITERIA

- ☑ **Attractive returns**
- ☑ An aggressive but realistic business plan for **high growth** – organic & inorganic, domestic & international
- ☑ **Operational profitability**
  - In current situation
  - Room for development by identifying opportunities to add value through operational improvements
- ☑ Strong, experienced, innovative and dedicated **management team** with a sense of urgency, driven by high energy and high integrity
- ☑ Sustainable **competitive edge**, differentiation
  - A leading and defensible market share
  - Well recognized brand name
  - Scalable and hard to replicate business model with defensible margins
  - Strong, dominant and defensible distribution channel
  - Propriety concept / products with competitive advantages
  - Patents
- ☑ **Clear exit opportunities**
  - Exit to financial / strategic buyer
  - IPO prospects
  - Exit to founding shareholders

# Valuation

## Valuing a Business

### Asset Based Approach

- The most rudimentary method for valuation
- It may not adequately take into consideration the intangibles, especially in asset light businesses

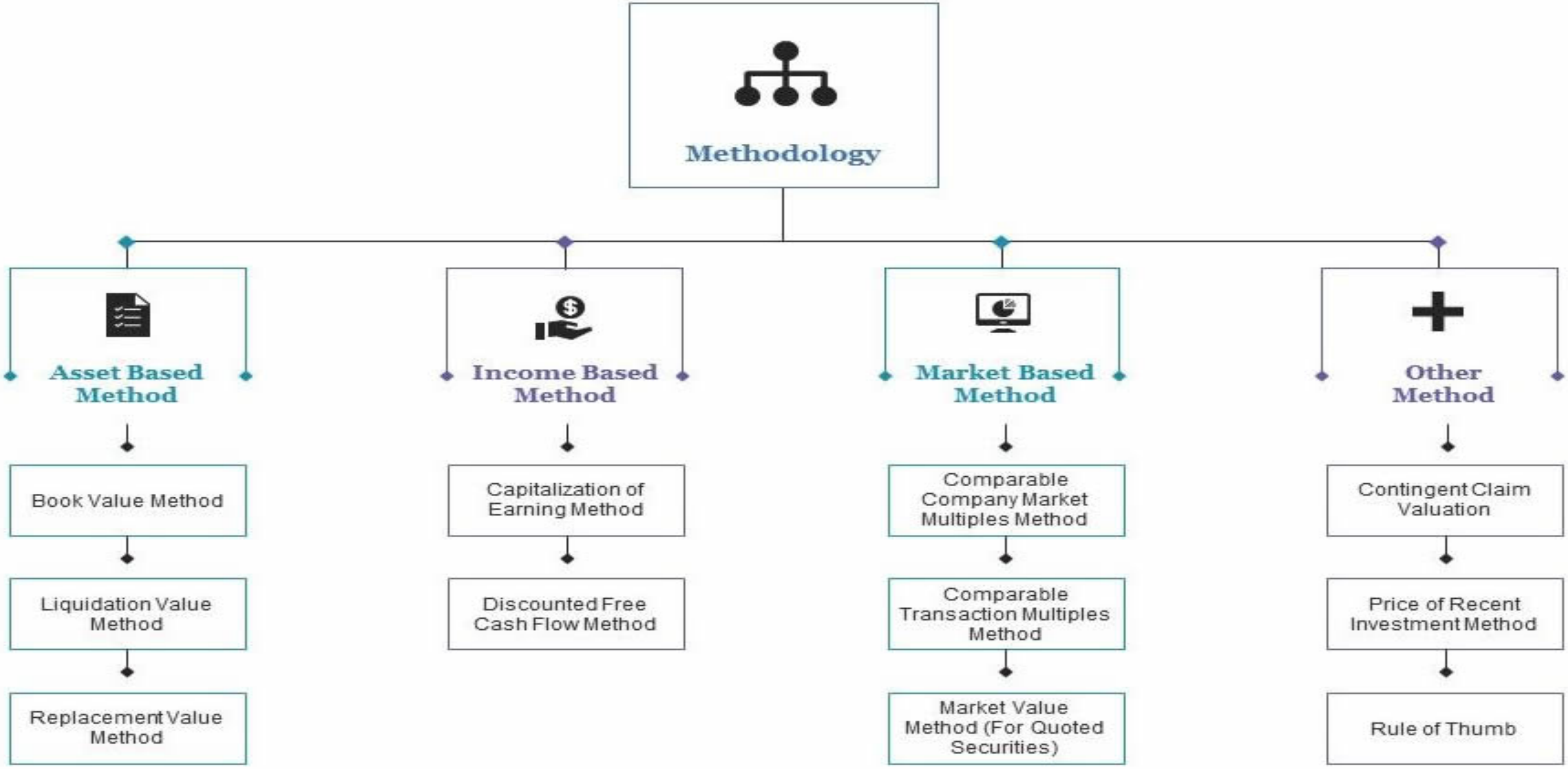
### Market Based Approach

- Public Company Comparables
  - based on the market trading multiples of comparable companies
- Precedent Transactions
  - Based on earnings multiples paid for comparable companies in recent transactions

### Earning Based Approach

- Present value of forecasted future free cash flows
- Captures the intrinsic value of the business

# Valuation Methodology



# Business Due-Diligence Process

## STEP 1

### Terms of Engagement

In this stage, the terms of the business due diligence are decided between the parties and a non – disclosure agreement is signed.

Eg: Your Text Here

Mention key points/strategies, if any, in each step

## STEP 2

### Operational Due Diligence

The operational data and information about the business are measured, gathered and documented.

Eg: Cost Structures, Customer Base, etc.

Mention key points/strategies, if any, in each step

## STEP 3

### Financial Due Diligence

The financial statement, data and information of the business are gathered, validated and documented.

Eg: Revenue, Expenses, Profitability, Cash flow, Assets and Libalities

Mention key points/strategies, if any, in each step

## STEP 4

### Legal Due Diligence

The legal and regulatory data and information of the business are gathered, validated and documented.

Eg: Tax payments, Litigations, Registrations, Intellectual Property

Mention key points/strategies, if any, in each step

## STEP 5

### Reporting of Information

The result of the business due – diligence process is shared to the Buyer and/ or Seller.

Eg: Further queries if any about the business may be raised by the Buyer

Mention key points/strategies, if any, in each step

# Strategic Due-Diligence Methodology

**Assess Market Segment & Growth Trends**

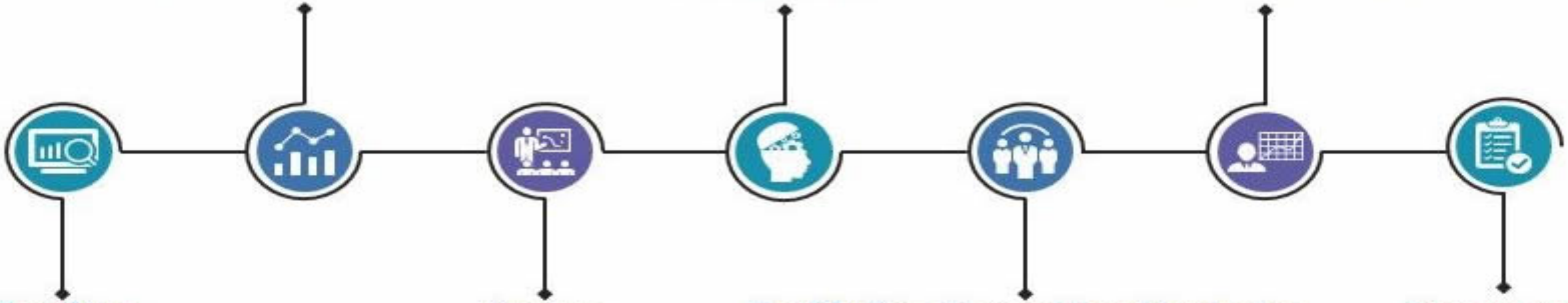
Conduct external interviews Understand customer behavior Validation of market size & trend Understanding the Industry business model

**Assess Skills & Capabilities**

Internal Company Analysis Internal Company analysis to support current strategy

**Stress Test Corporate Strategy**

Understand the business strategy in detail Assess the employee & Organizational fit within the strategy Check whether the marketing, finance and other financial strategies are in line with the vision & mission of the company



**Baseline Starting Situation**

Collection of data & review Market research Business studies Latest Technology

**Review Business Plan**

Analysis of income statement Industry Benchmarking Synergy Analysis

**Profile Key Competitor Strategies & Technology Trends**

Focused group discussions and interviews of customers, top employee from competitive firms Identify the major trends in technology & competitor responses

**Summary & Recommendations**

Perception on technological & competitive landscape Consensus on business plan Identification of Risk & Risk mitigation strategies

# Exit Strategies for Venture Capital Funds

# Subprime Mortgage Crises in USA 2008
# Amerika Mortgage Kırizi

The Subprime Primer

# EXIT STRATEGIES FOR VENTURE CAPITAL FUNDS

- An important aspect of venture capital investing is the exit strategies. Venture capital funds primarily **invest with an exit in mind** after a few years.
- After successfully **funding at seed**, **pre-production**, **production** and **expansion** stages, a venture capitalist will **start assessing exit strategies**.
- The exit in the form of **disinvestment** or **liquidation** is the last and final stage of the venture capital funding. The **key types of liquidation/disinvestment** are:
- **trade sales**,
  **sale of quoted equity post**
  **initial public offering (IPO)**, and
  **write-offs**.

# EXIT STRATEGIES FOR VENTURE CAPITAL FUNDS

- **Trade Sales**: In this type of strategy the **private company is sold** or **merged with an acquirer** for **stocks**, **cash**, or a **combination of both**.
- **IPO**: If the company has done well, the venture capital investors will take the IPO route, by **issuing shares registered for public offering**. An example is the upcoming Facebook IPO, which is expecting to raise about $15 billion through IPO and is valued at approx. 100 billion. The venture capital investors and other private investors will get their portion of shares who can put them in the open marketplace for trading after an initial lock-in period.

# EXIT STRATEGIES FOR VENTURE CAPITAL FUNDS

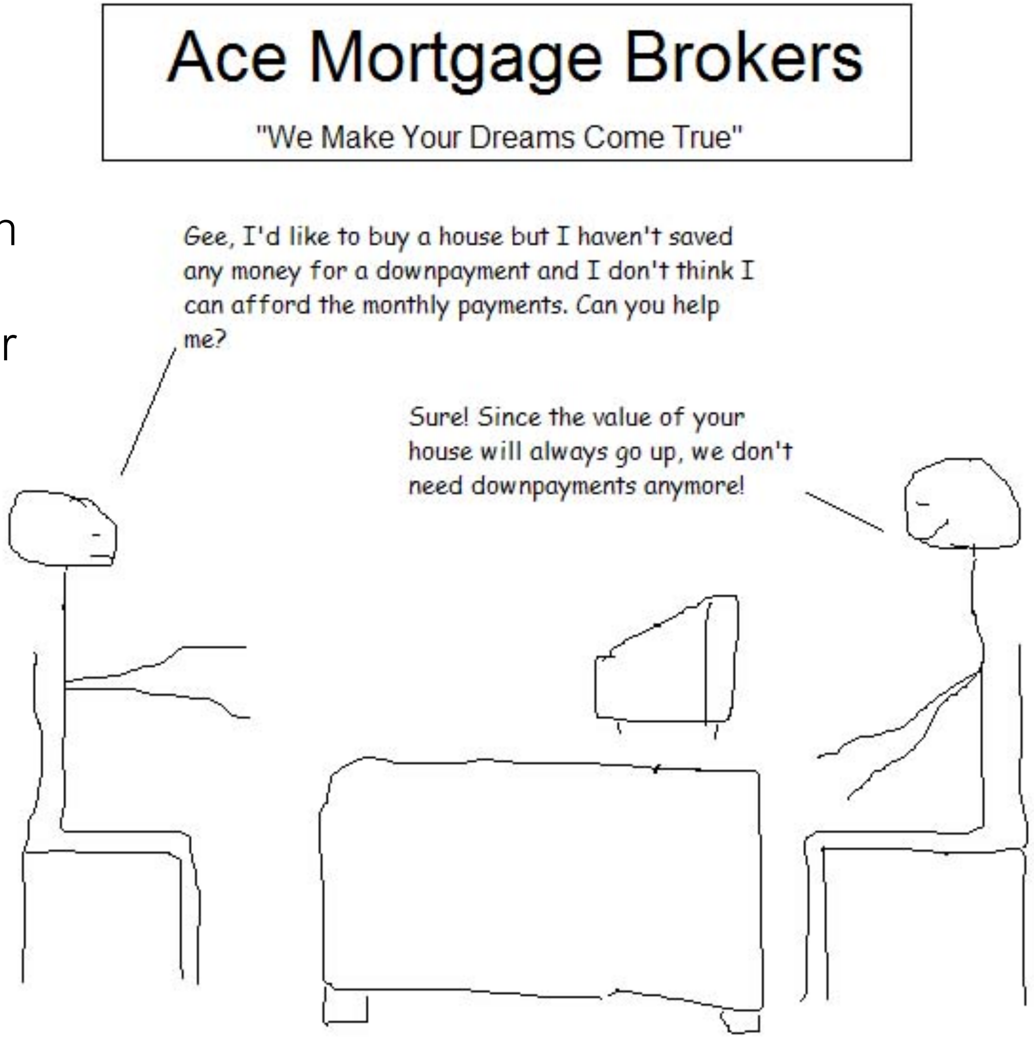
- **Write-offs**: These are **voluntary liquidations** that may or may not result in any proceeds.
- **Bankruptcy:** The company may just **go bankrupt**.
- **Buy-back:** In this method **the entrepreneur buys-back the investment share from the venture capitalists** and takes it back to being a privately held company.

# Mortgage Broker Ofisinde

At the Mortgage Broker's .....

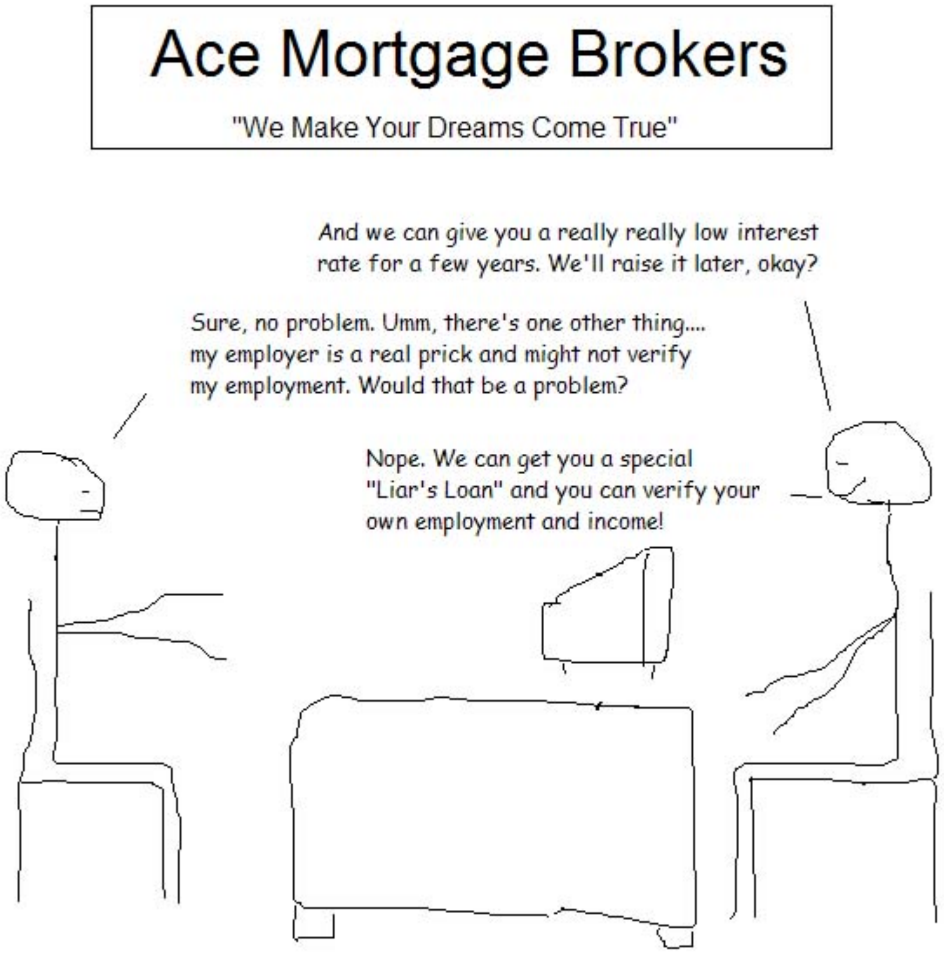
# Mortgage Broker Ofisinde – Hayallerinizi Gerçek Yaparız.

Ev almak istiyorum ama ön ödeme yapacak birikimim yok. Bir de aylık taksik ödemelerini yapcak gücüm yok. Bana yardımcı olabilir misiniz?




Tabiki. Alacağınız evin değeri her zaman artacaktır. Ön ödeme yapmanıza artık gerek yok.

# Mortgage Broker Ofisinde – Hayallerinizi Gerçek Yaparız.




Önden birkaç yıl size düşük faiz uygularız. Faiz oranını daha sonraki yıllarda arttırırız. Olur mu?

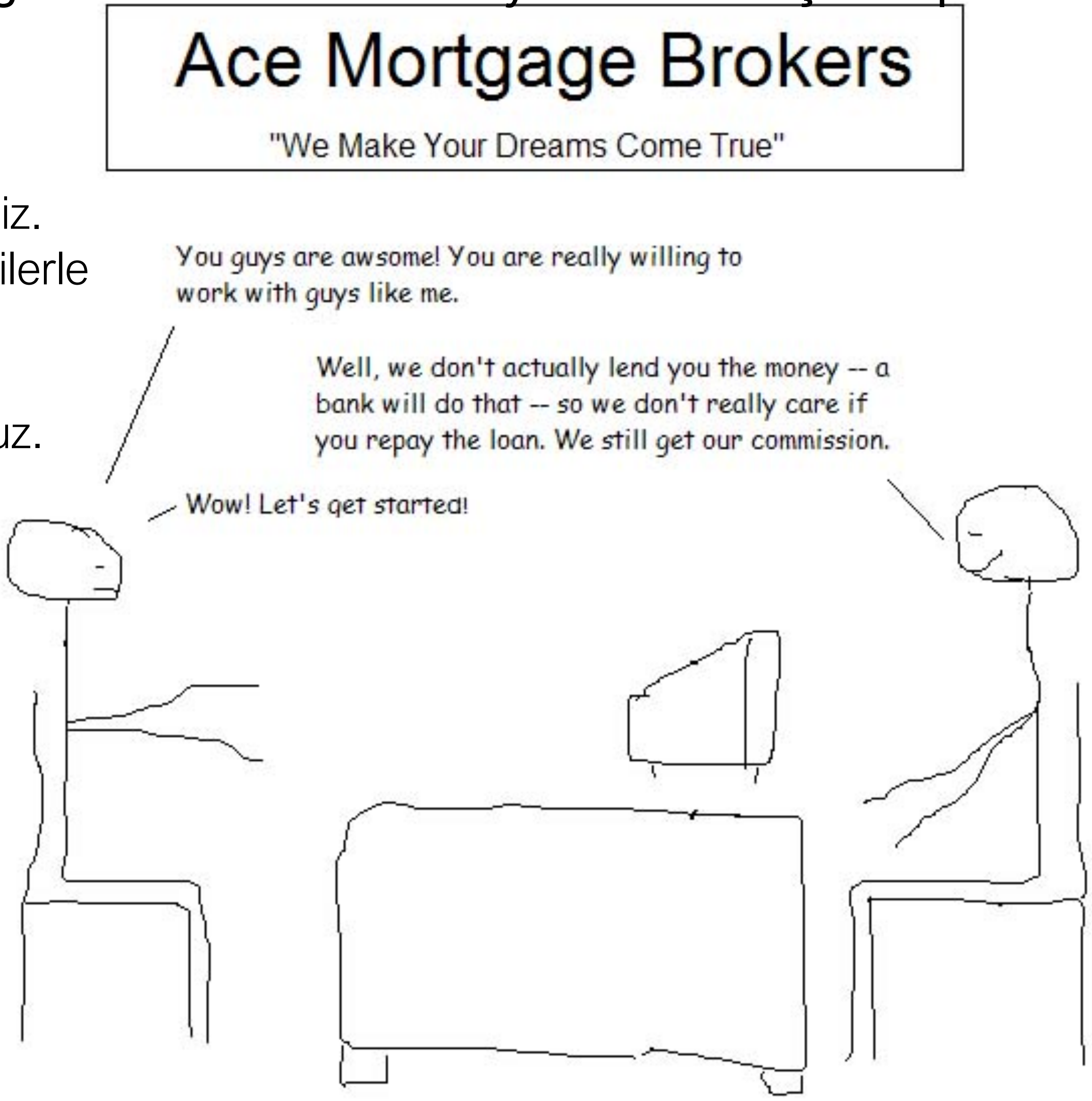
Olur. Sorun yok. Ancak bir şey daha var. Patronum biraz aksidir. Çalıştıığımı size belgeleyemem. Bu bir problem olur mu?

Sorun yok. Sizi özel "Beyana Dayalı Kredi" kategorisine sokarız. Kendi işinizi ve gelirinizi kendiniz beyan edersiniz.

# Mortgage Broker Ofisinde – Hayallerinizi Gerçek Yaparız.

Şiz şahanesiniz. Benim gibilerle hakikaten çalışmak istiyorsunuz.

Hadi başlayalım o zaman.




Parayı size biz vermiyoruz ki. Banka verecek. O nedenle krediyi geri ödemişsiniz ödememişsiniz bizi ilgilendirmiyor. Biz her halukarda komisyonumuzu Bankadan alıyoruz.

Birkaç hafta sonra Bankada . . . . .

A Few Weeks Later, at the Bank .......

# First BANK'da – Yılbaşı Hesabınızı Bugün Açtırın

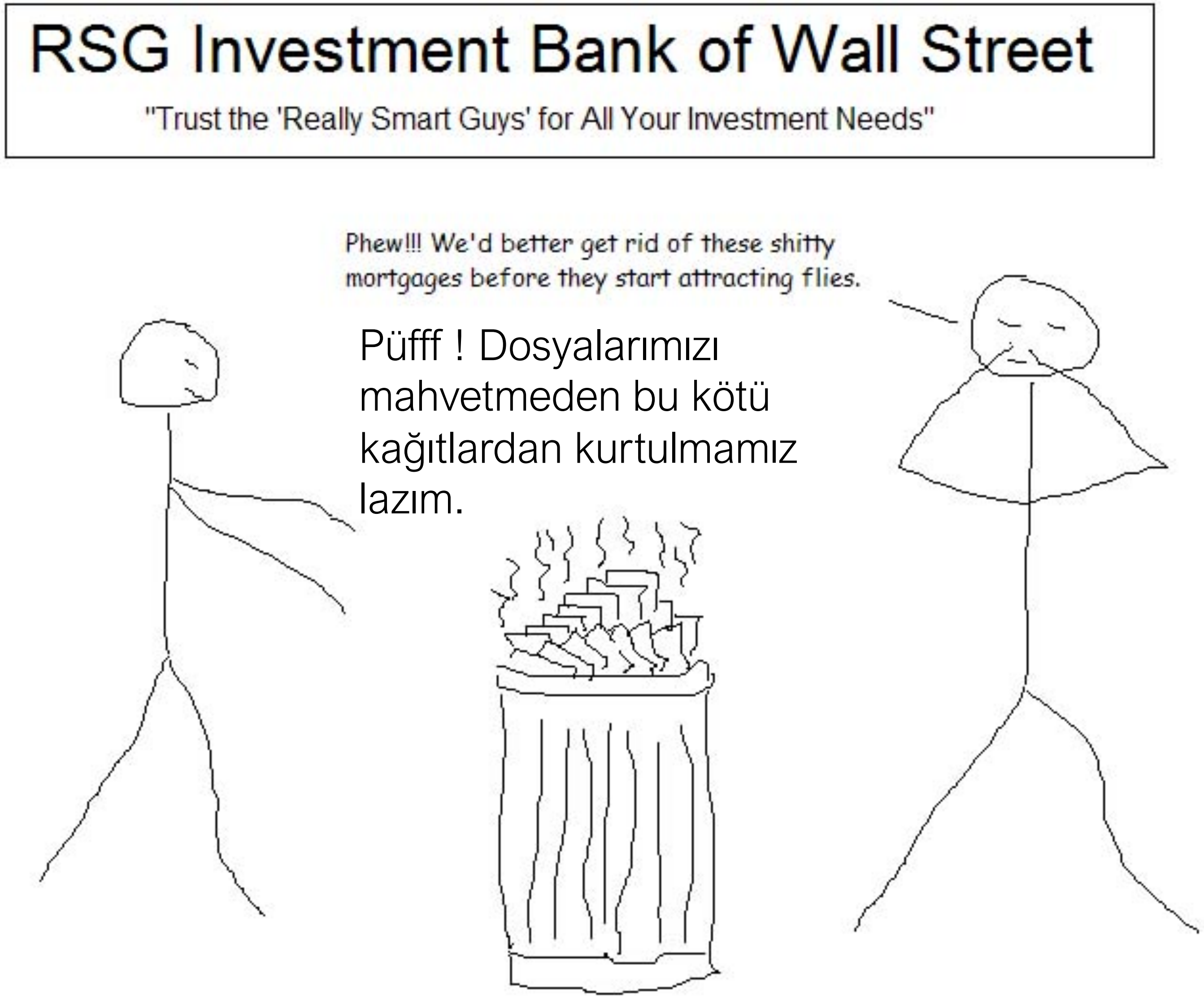
Bu kötü kredilerden kurtulmam lazım. Bilançomu bozacak. New York'taki Yatırım Bankasındaki dahi arkadaşlar sağ olsun, bunları satın alacaklar. Sihirbaz bunlar. Hemen arıyayım.


Mortgage Kredi Dosyaları

## Şimdi New York Yatırım Bankasındaki Zeki Çocuklar Ne Yapıyor Bakalım

Let's See What the Smart Guys Are Doing...

## RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin



# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin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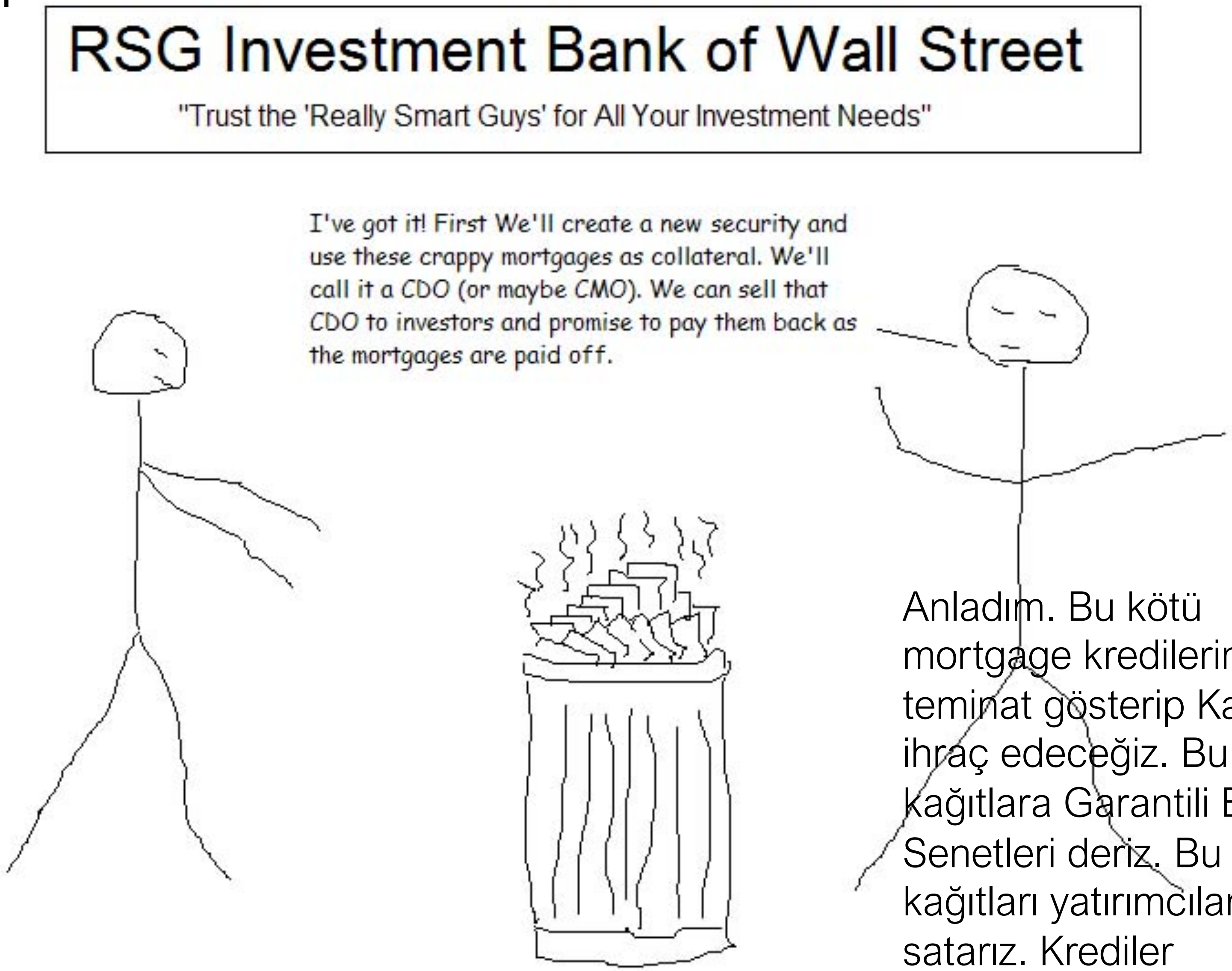
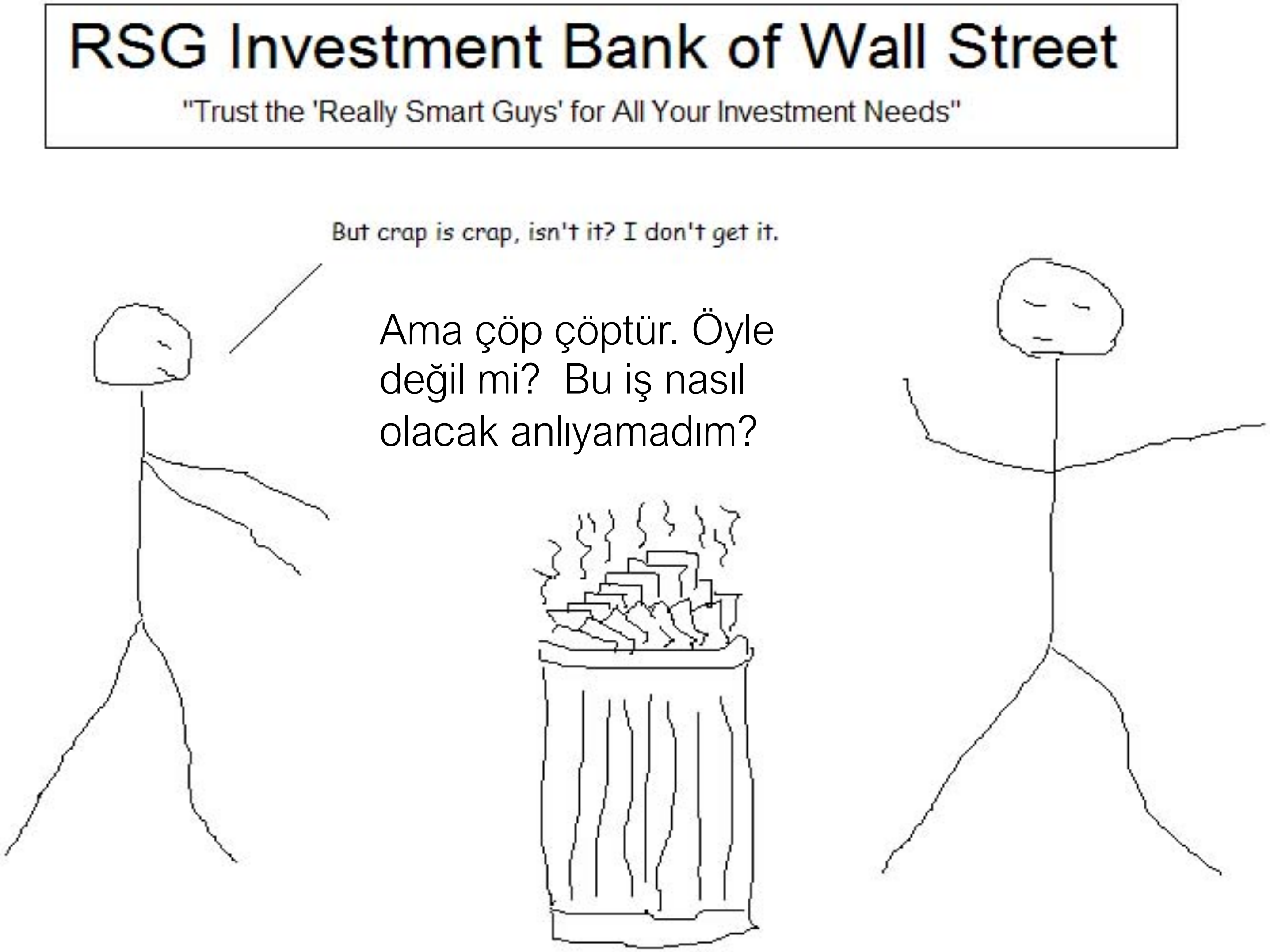



Anladım. Bu kötü mortgage kredilerini teminat gösterip Kağıt ihraç edeceğiz. Bu kağıtlara Garantili Borç Senetleri deriz. Bu kağıtları yatırımcılara satarız. Krediler ödendikçe paralarını alırlar.

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin



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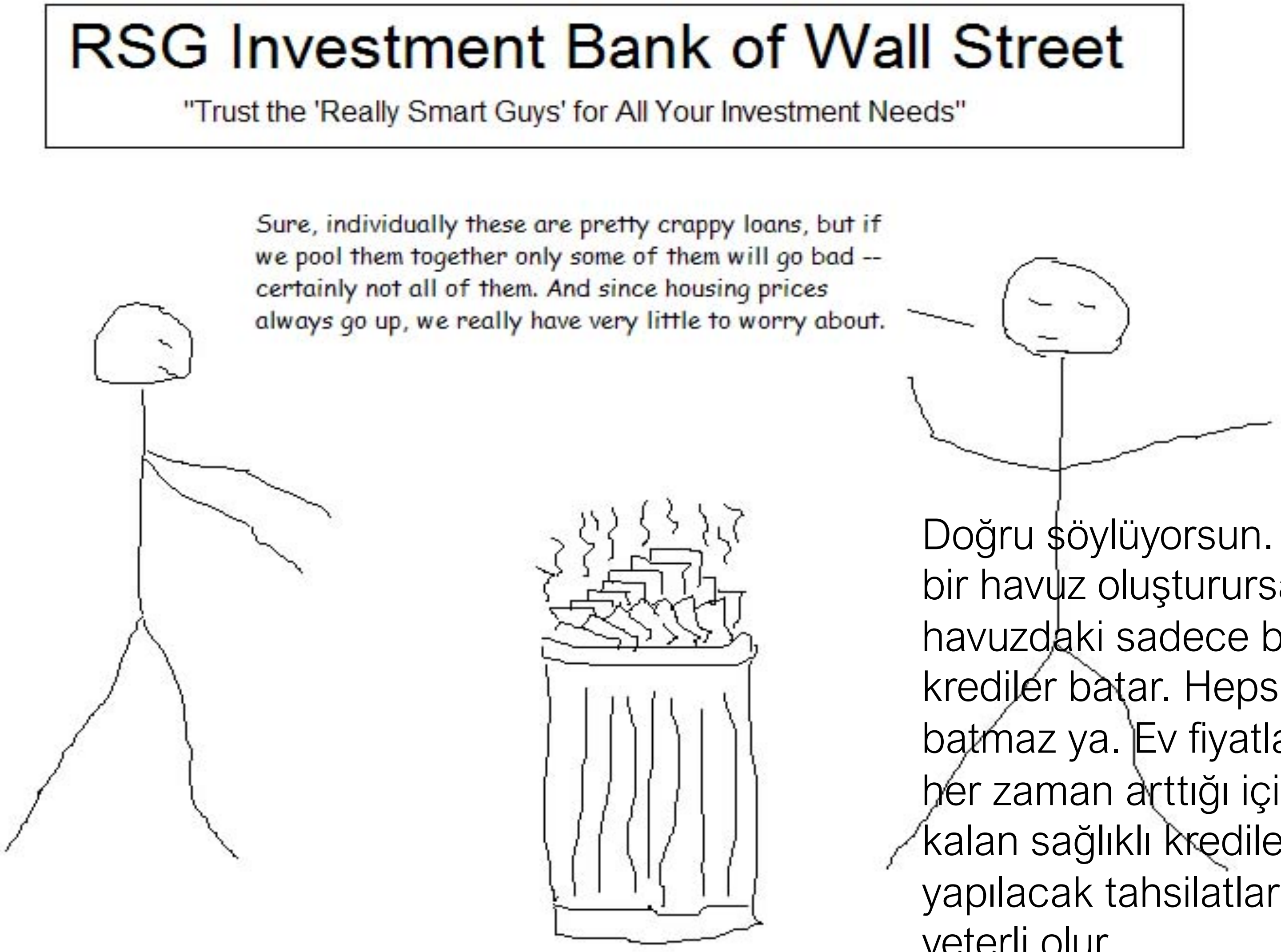
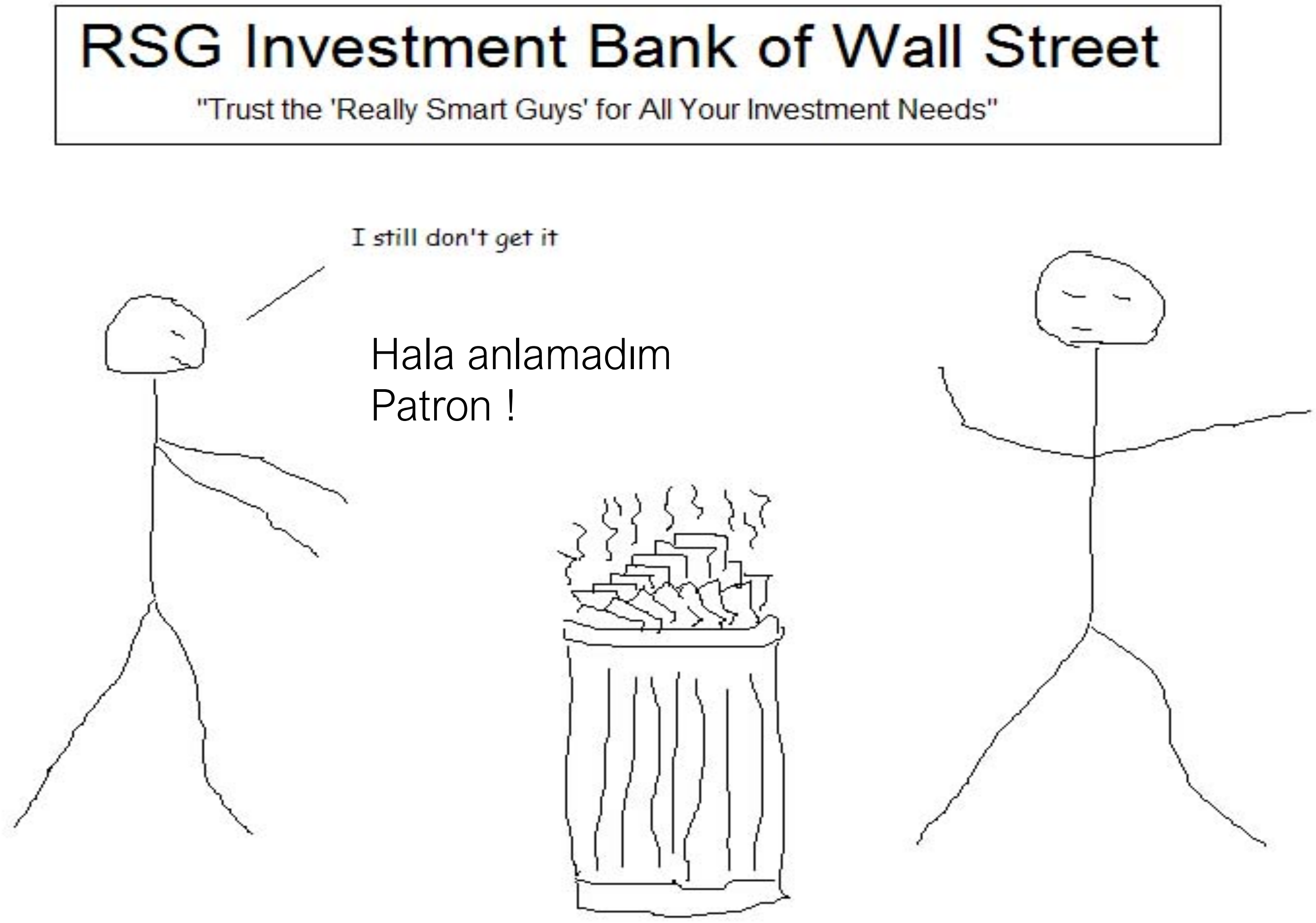
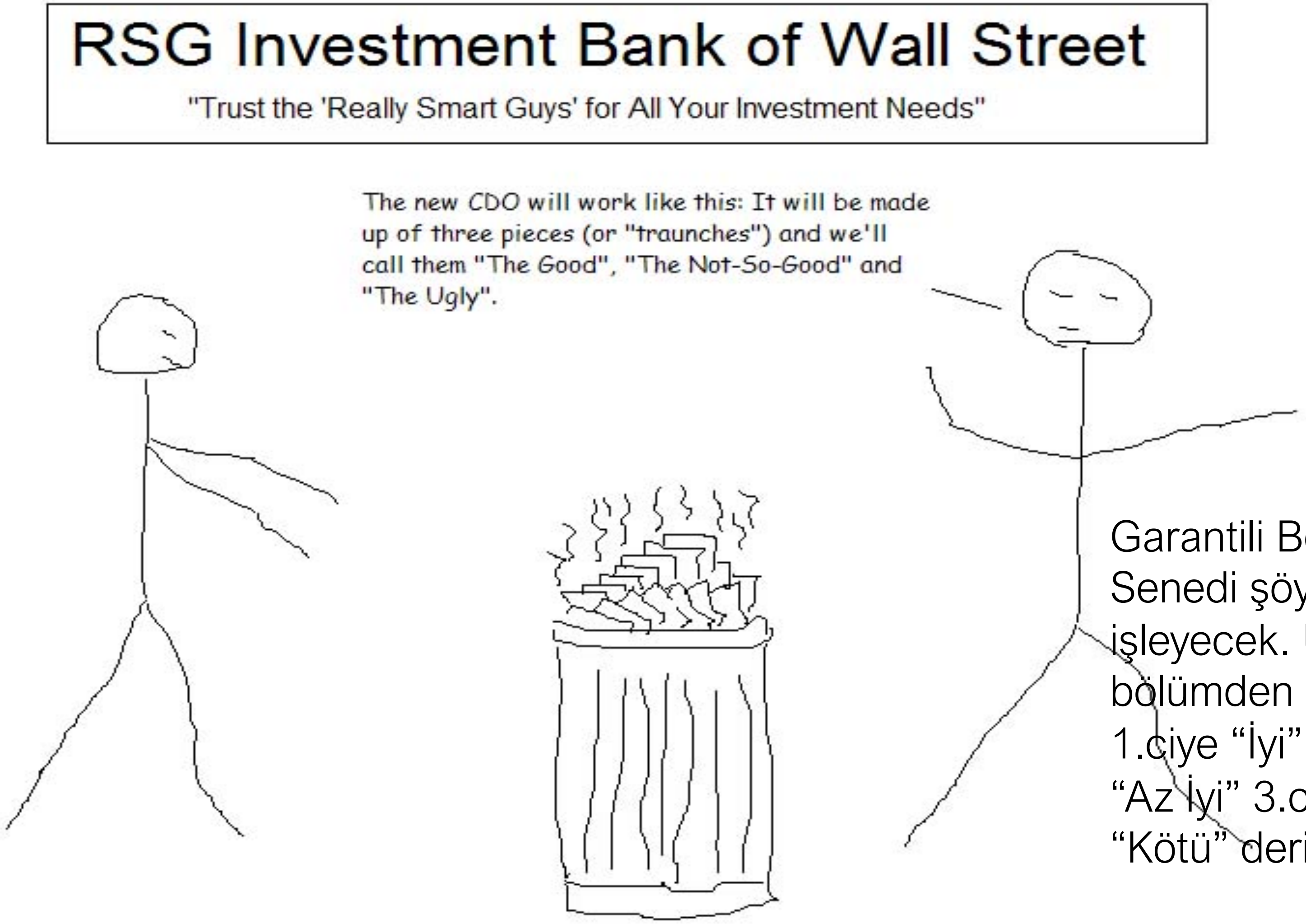



Doğru söylüyorsun. Ama bir havuz oluşturursak bu havuzdaki sadece bazı krediler batar. Hepsi batmaz ya. Ev fiyatları her zaman arttığı için de kalan sağlıklı kredilerden yapılacak tahsilatlar yeterli olur.

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin

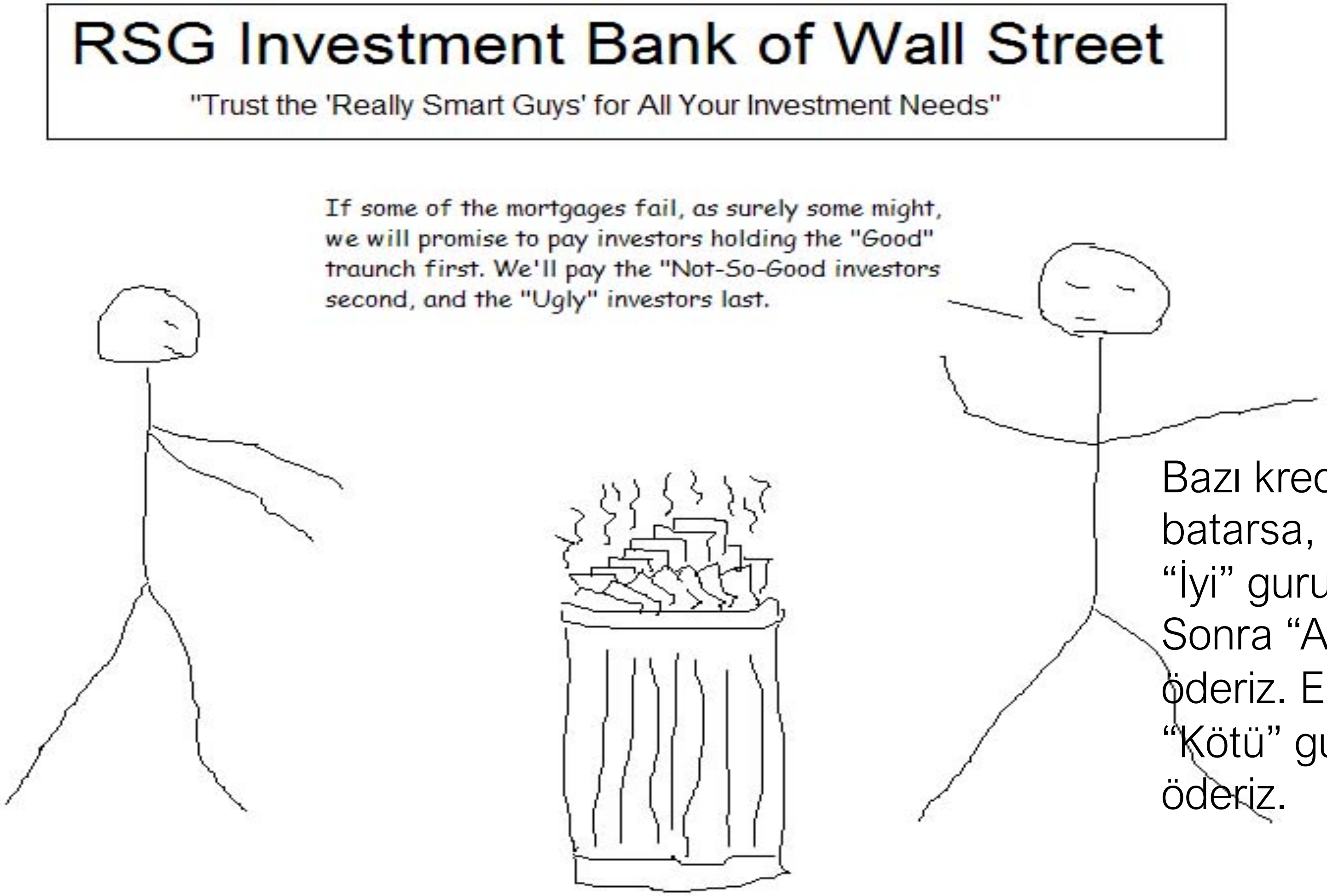


# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin



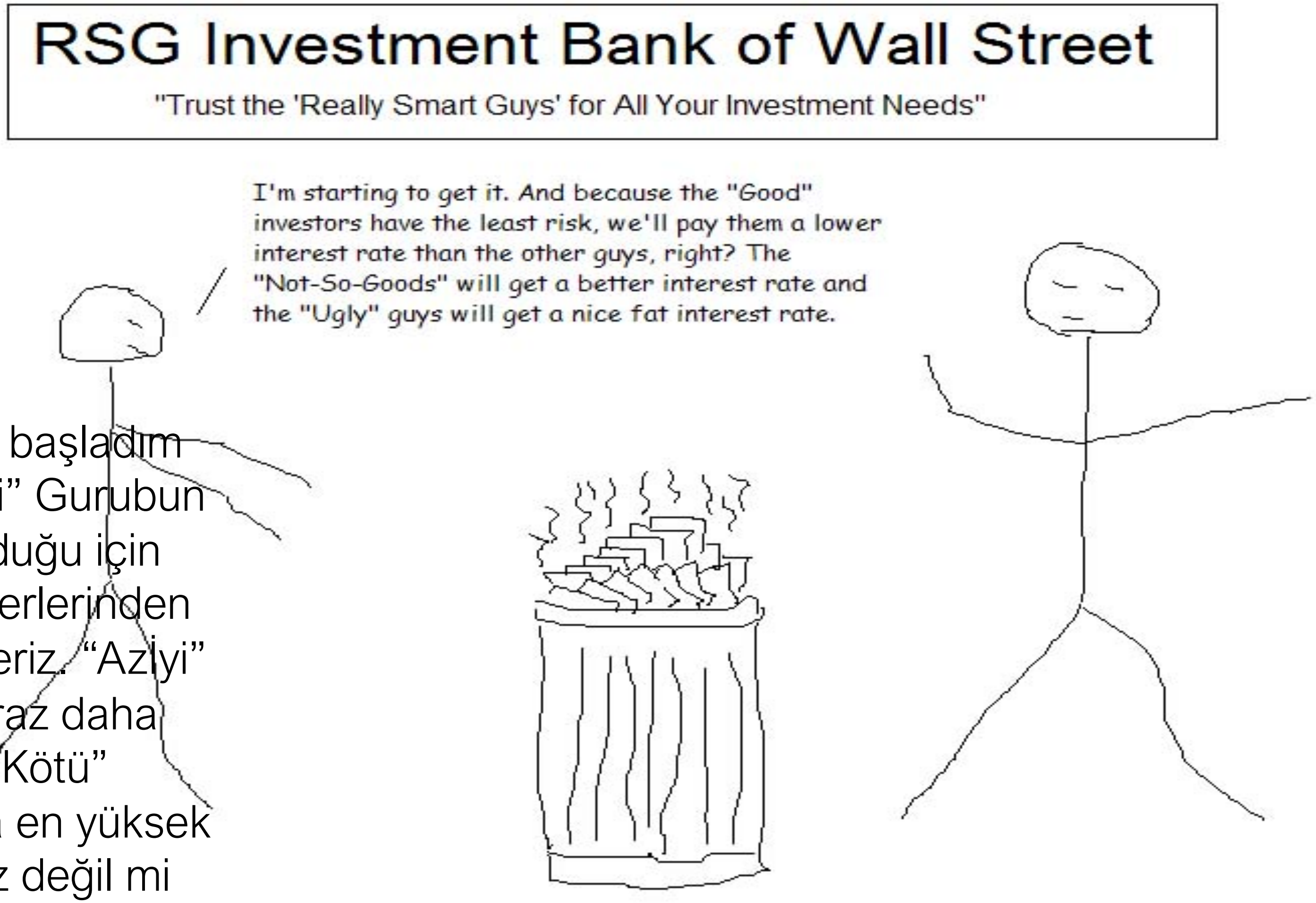

Garantili Borç Senedi şöyle işleyecek. Üç bölümden oluşacak. 1.ciye “İyi” 2.ciye “Az İyi” 3.cüye de “Kötü” deriz.

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin



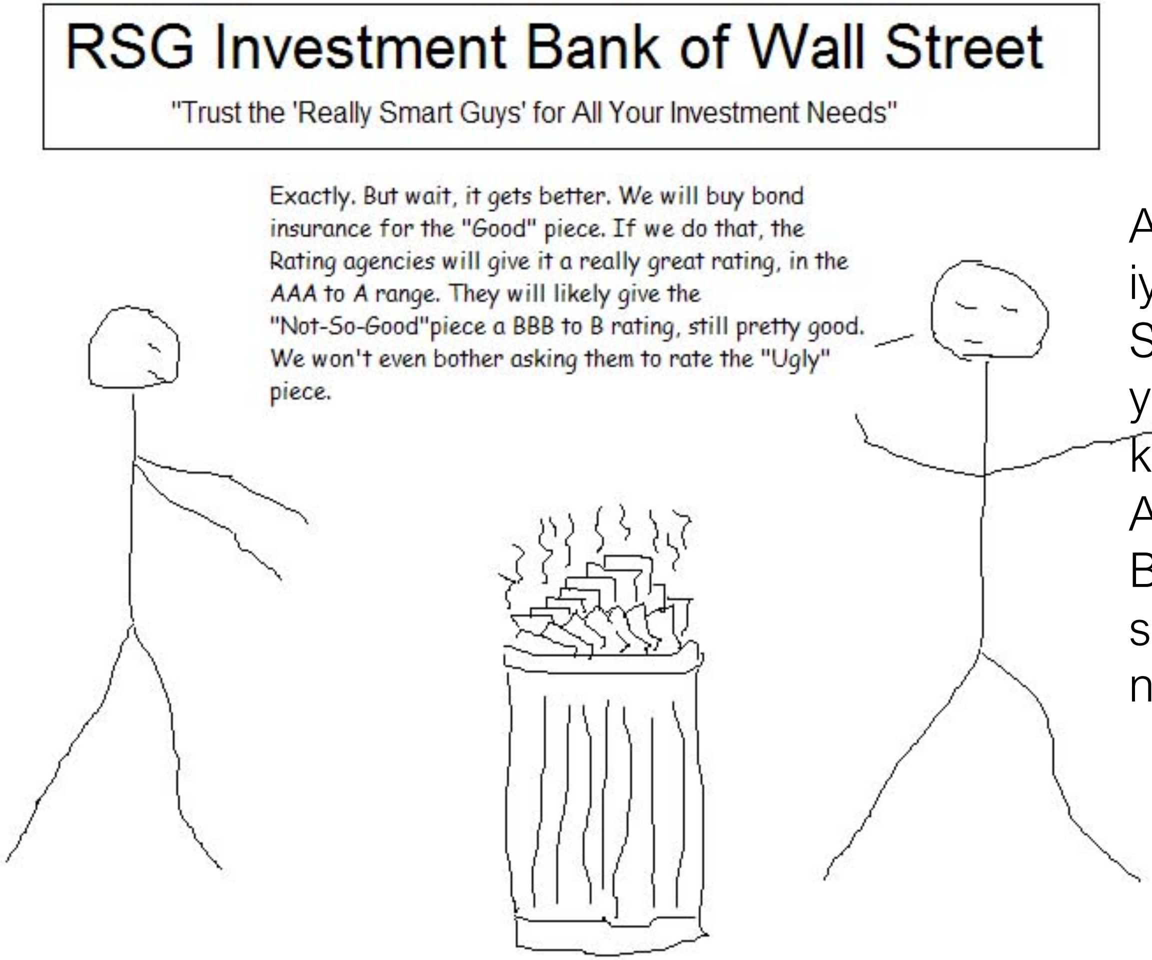

Bazı krediler batarsa, biz önce "İyi" gurubu öderiz. Sonra "Az İyileri" öderiz. En son da "Kötü" gurubu öderiz.

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin



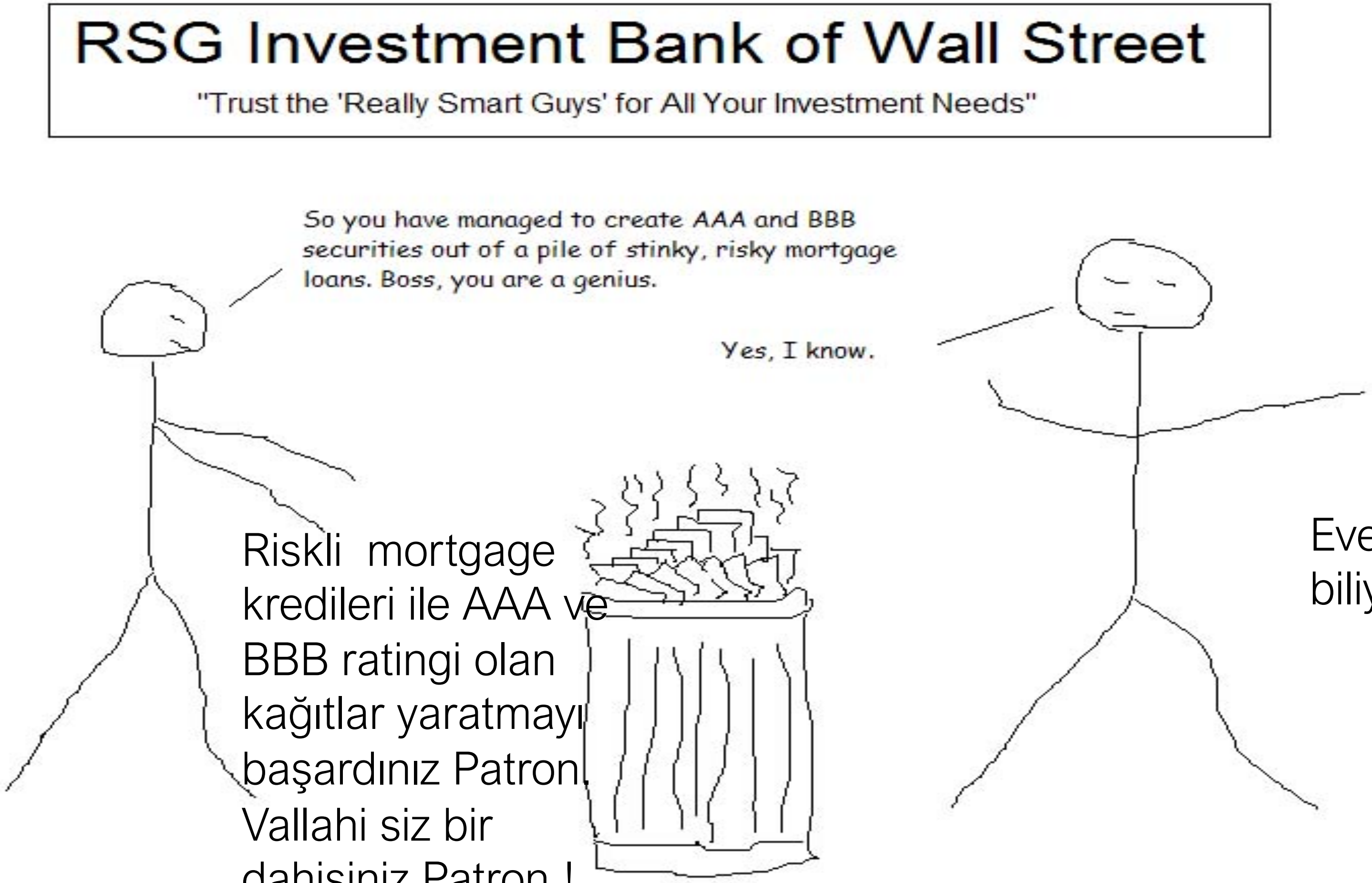

Anlamaya başladım galiba. “İyi” Gurubun riski az olduğu için onlara diğerlerinden az faiz öderiz. “Azİyi” guruba biraz daha fazla faiz “Kötü” guruba da en yüksek faizi öderiz değil mi Patron?

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin




Aynen öyle. Ama dur daha iyisi var. "İyi" guruba bir de Sigorta Policesi alırız. Bunu yaparsak Rating Şirketi bu kağıtlara yüksek Not verir AAA veya A. "Az İyilere" BBB veya B verir. Fena sayılmaz. "Kötü" portföye not almaya gerek yok.

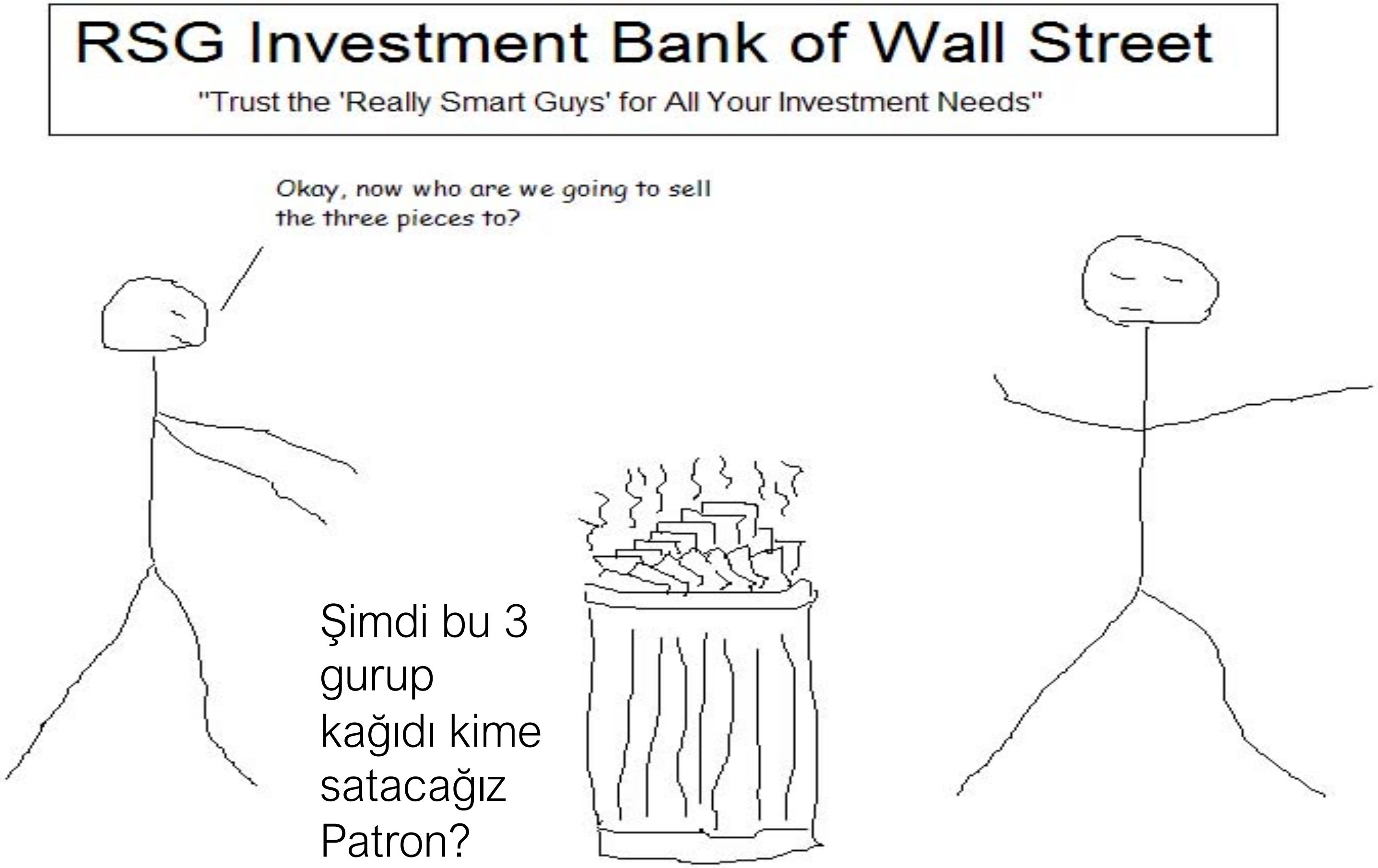
# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin




Riskli mortgage kredileri ile AAA ve BBB ratingi olan kağıtlar yaratmayı başardınız Patron. Vallahi siz bir dahisiniz Patron !

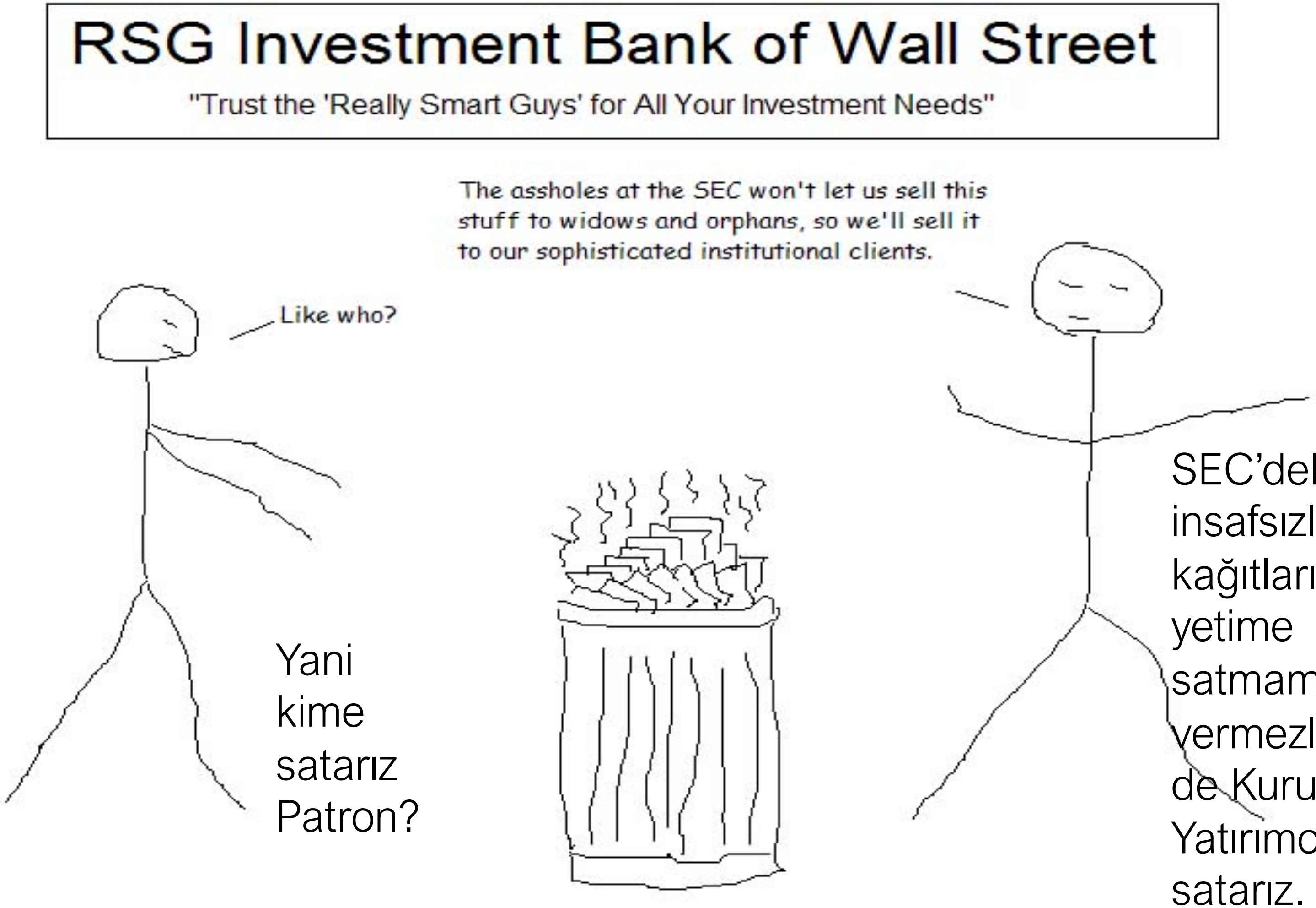
Evet biliyorum

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin




Şimdi bu 3 gurup kağıdı kime satacağız Patron?

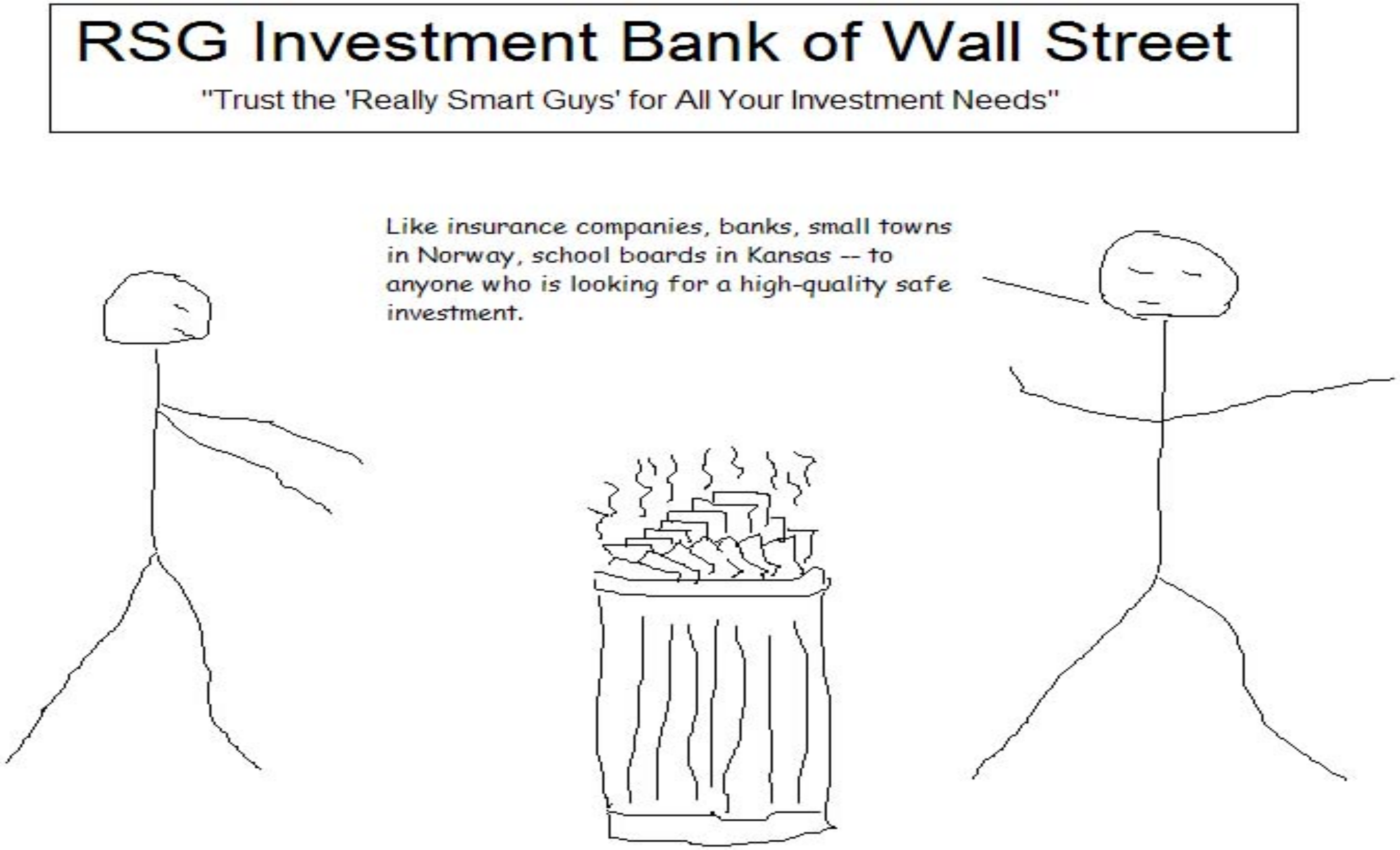
# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin




Yani kime satarız Patron?

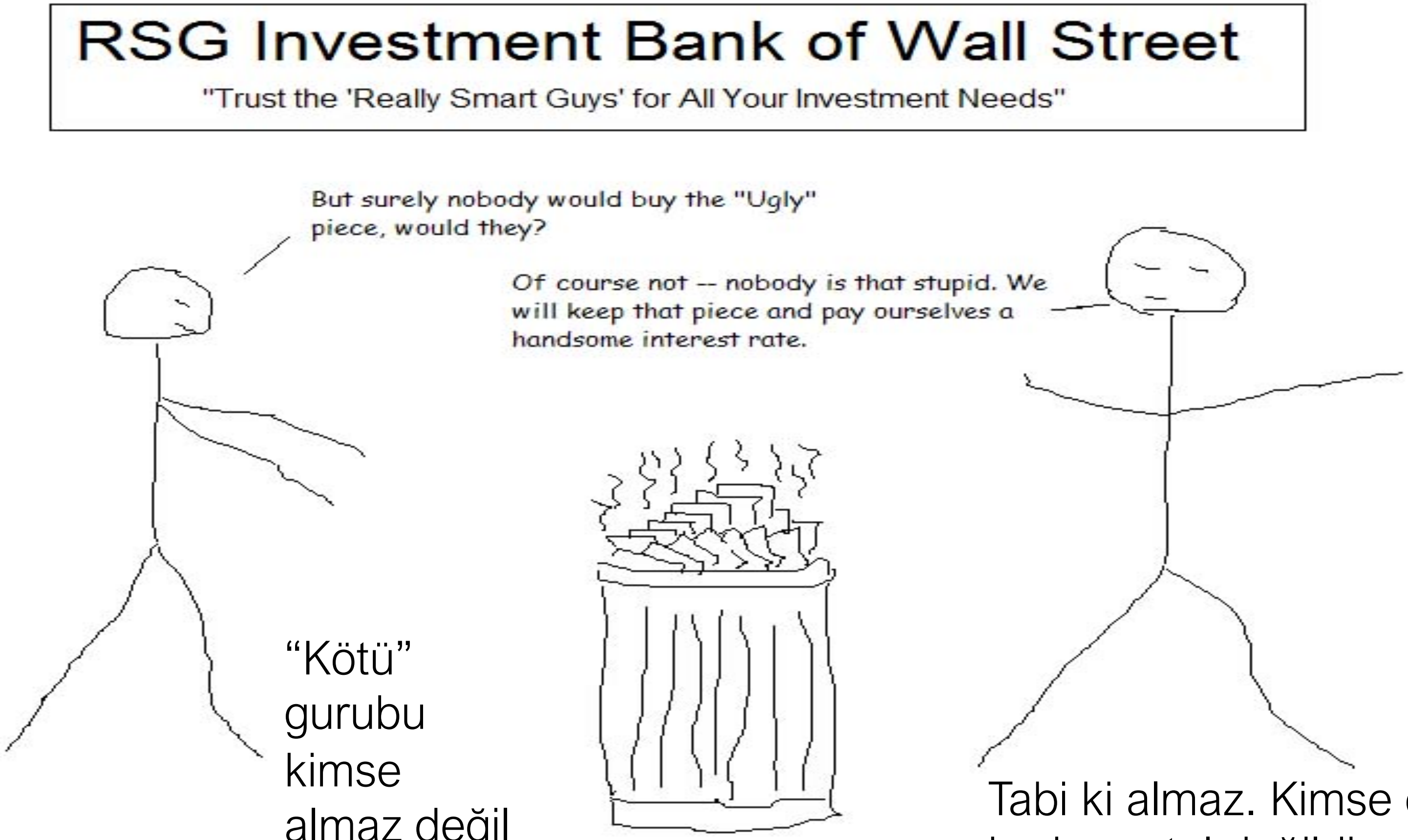
SEC'deki insafsızlar bu kağıtları dula yetime satmamıza izin vermezler. Biz de Kurumsal Yatırımcılara satarız.

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin




Sigorta Şirketlerine, Bankalara, Norveç'teki Kasaba Belediyelerine veya Fonlarına, Kansas'taki Okul Yönetimlerine, yüksek verim peşinde olan ve Güvenli yatırım isteyenlere satarız.

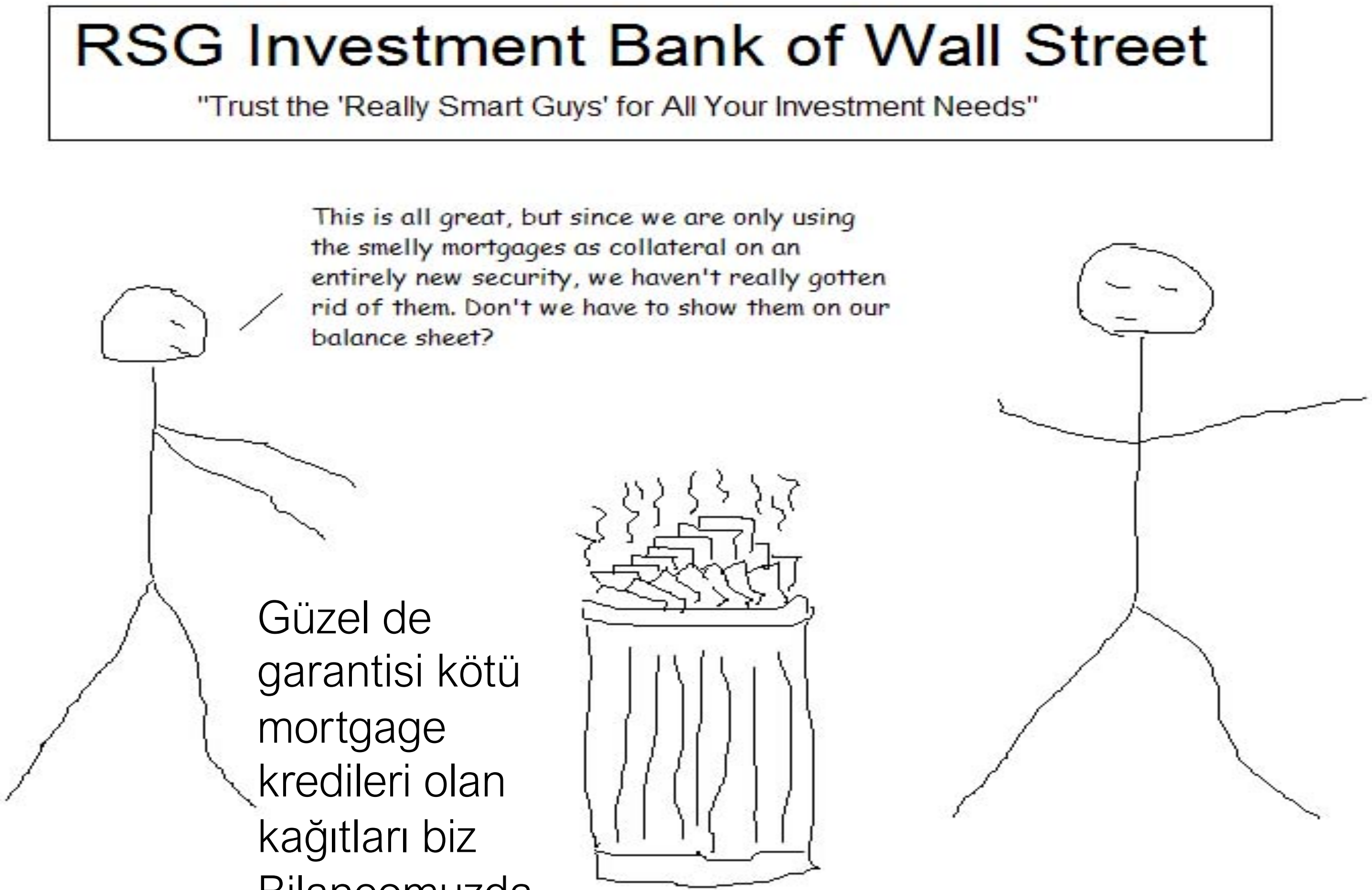
# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin




"Kötü" gurubu kimse almaz değil mi Patron?

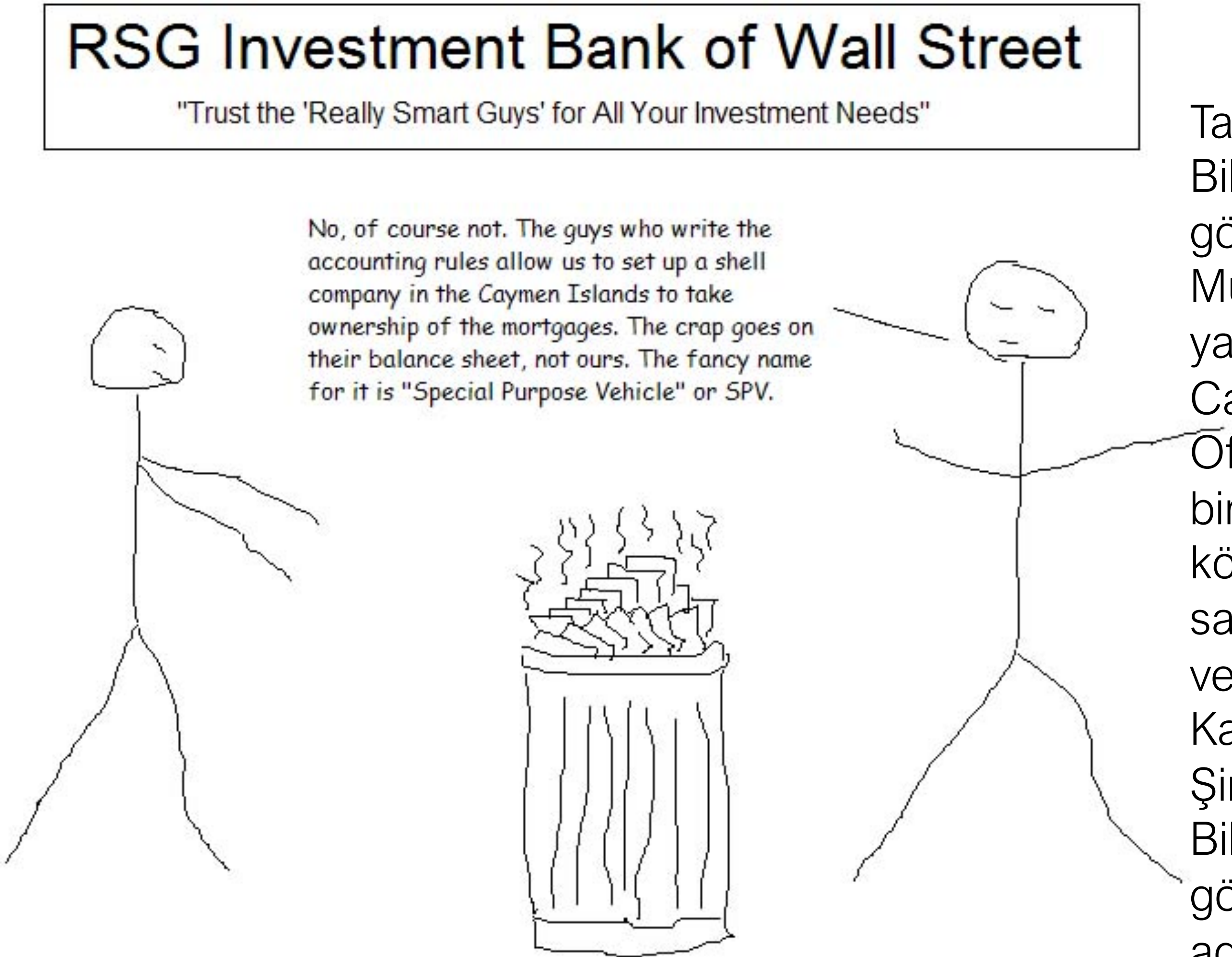
Tabi ki almaz. Kimse o kadar aptal değildir. Onları kendi portföyümüzde tutarız ve kendimize çok yüksek faiz öderiz.

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin



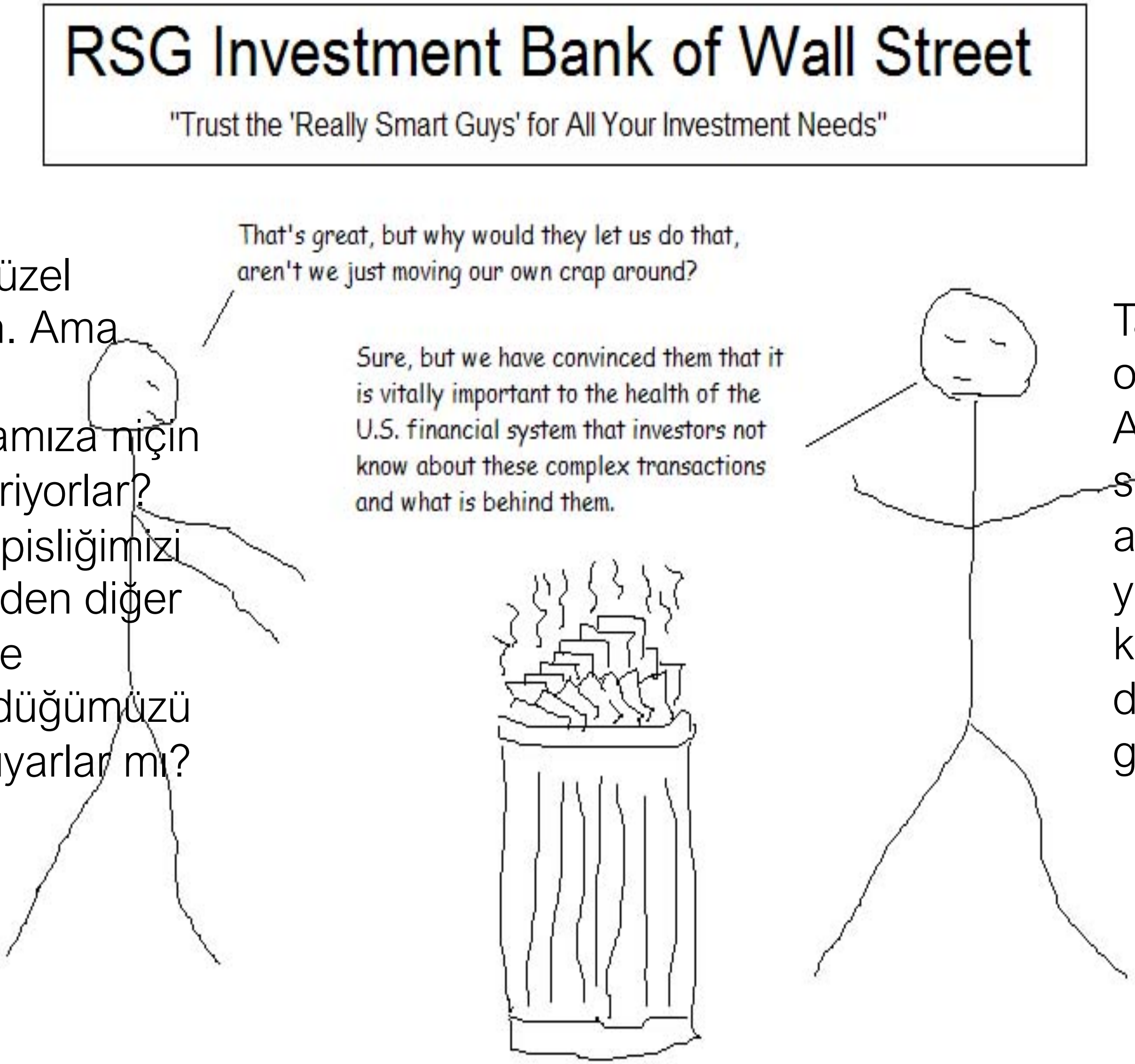

Güzel de garantisi kötü mortgage kredileri olan kağıtları biz Bilançomuzda gösterecek miyiz?

# RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin




Tabi ki biz Bilançomuzda göstermiyeceğiz. Muhasebe kuralları yazanlar bize Caymen Island’da Off Shore Paravan bir Şirket kurup kötü kağıtları ona satmamıza izin veriyor. Kötü Kağıtlar Paravan Şirketin Bilançosunda görünecek. Bunun adı “Özel Maksatlı Araç” olacak.

## RGS Yatırım Bankası – Tüm Yatırım İhtiyaçlarınız için Zeki Arkadaşlarımıza Güvenin



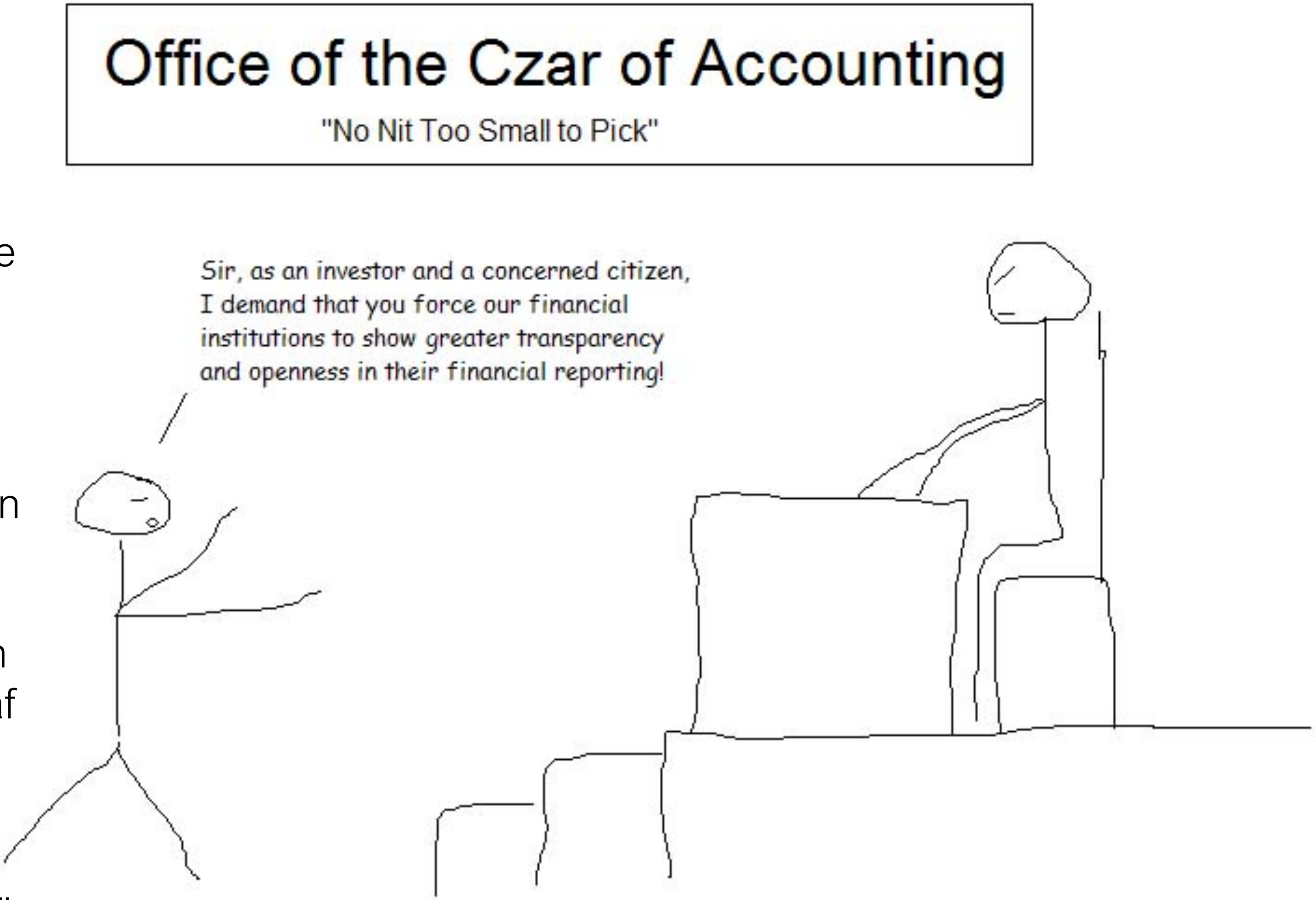

Çok güzel Patron. Ama bunu yapmamıza niçin izin veriyorlar? Kendi pisliğimizi bir yerden diğer bir yere süpürdüğümüzü görmuyarlar mı?

Tabiki görüyorlar. Biz onları inandırdık. Amerikan mali sisteminin sağlığı açısından yatırımcıların kompleks işlemlerin deyatını bilmesi gerekmiyor dedik.

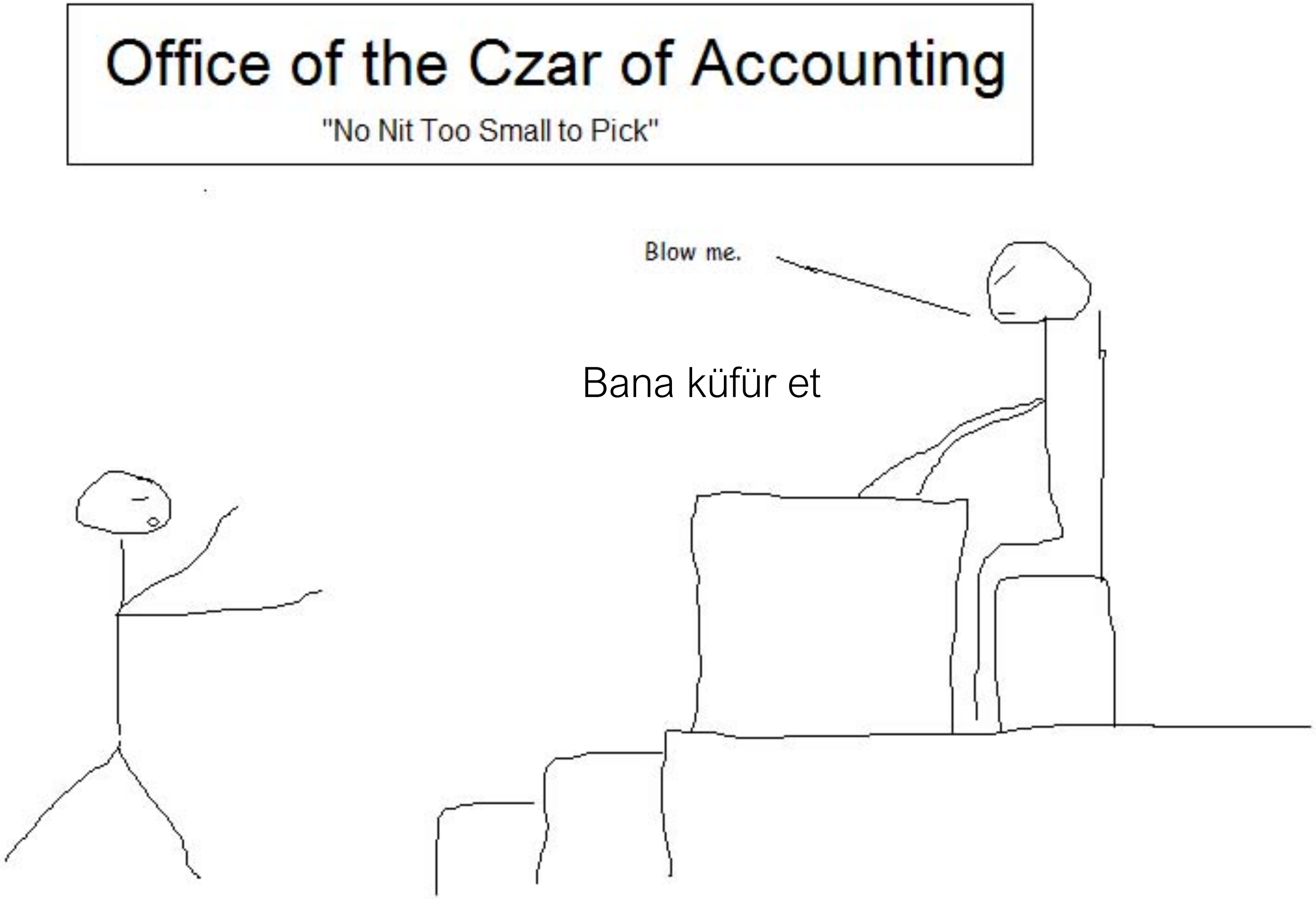
Şimdi de Muhasebecilerin Bağamsız Dış Denetim Şirketlerinin ne yaptıklarına Bakalım.

Let's drop in to see the Accountants.....

# CZAR BAĞIMSIZ DENETİM ŞİRKETİ




Yatırımcı ve sorumlu vatandaş olarak Finasman Şirketlerinin Mali Tablolarını hazırlarken daha Şeffaf Açık ve Dürüst olmalarını zorlamanızı istiyorum.



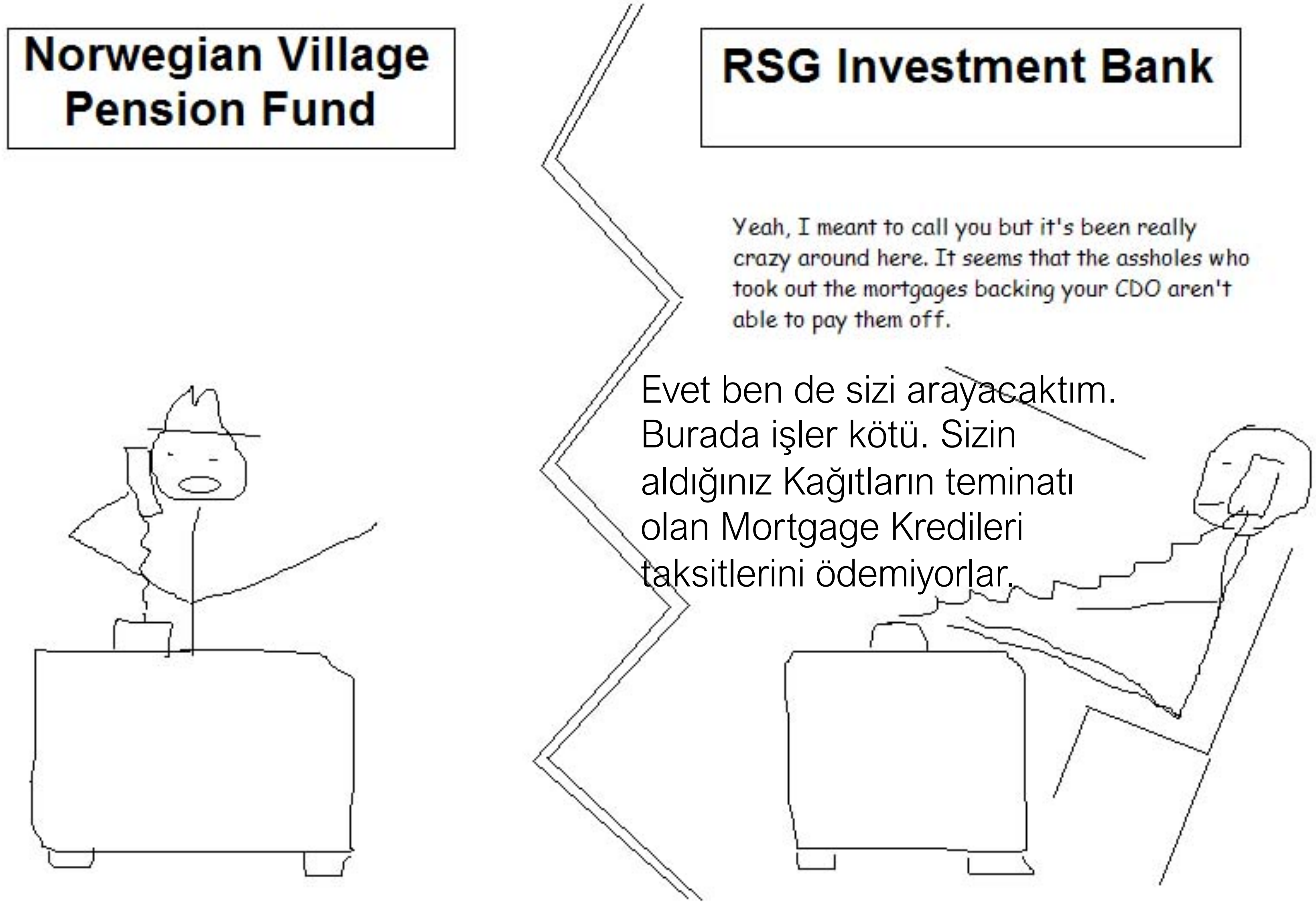

Bana küfür et

Felaketin geldiğini göremedik

Gee, We Never Saw it Coming......

Norveç’te Kasaba Emekli Fonu

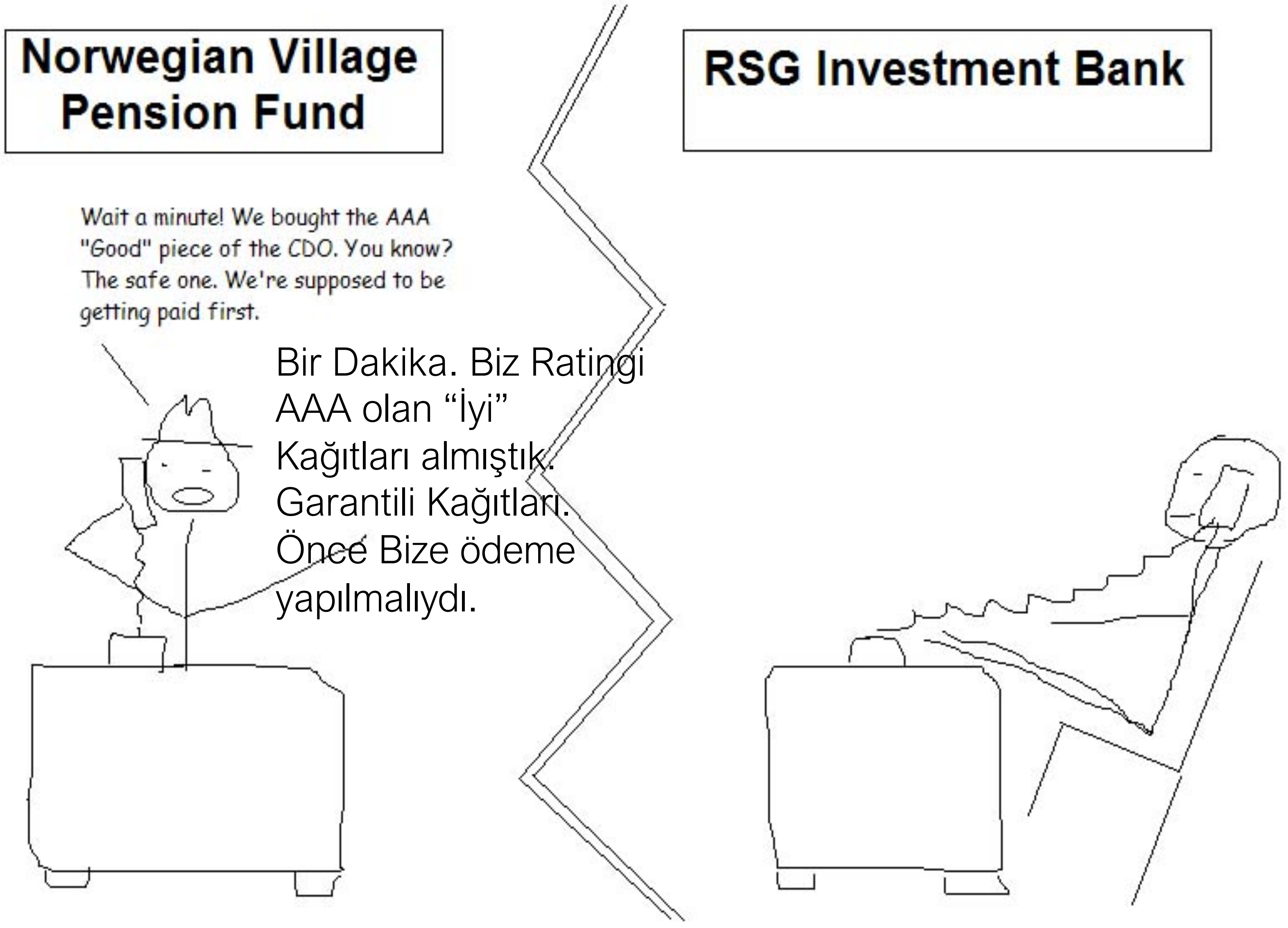
RSG Yatırım Bankası




Evet ben de sizi arayacaktım. Burada işler kötü. Sizin aldığınız Kağıtların teminatı olan Mortgage Kredileri taksitlerini ödemiyorlar.

Norveç'te Kasaba Emekli Fonu

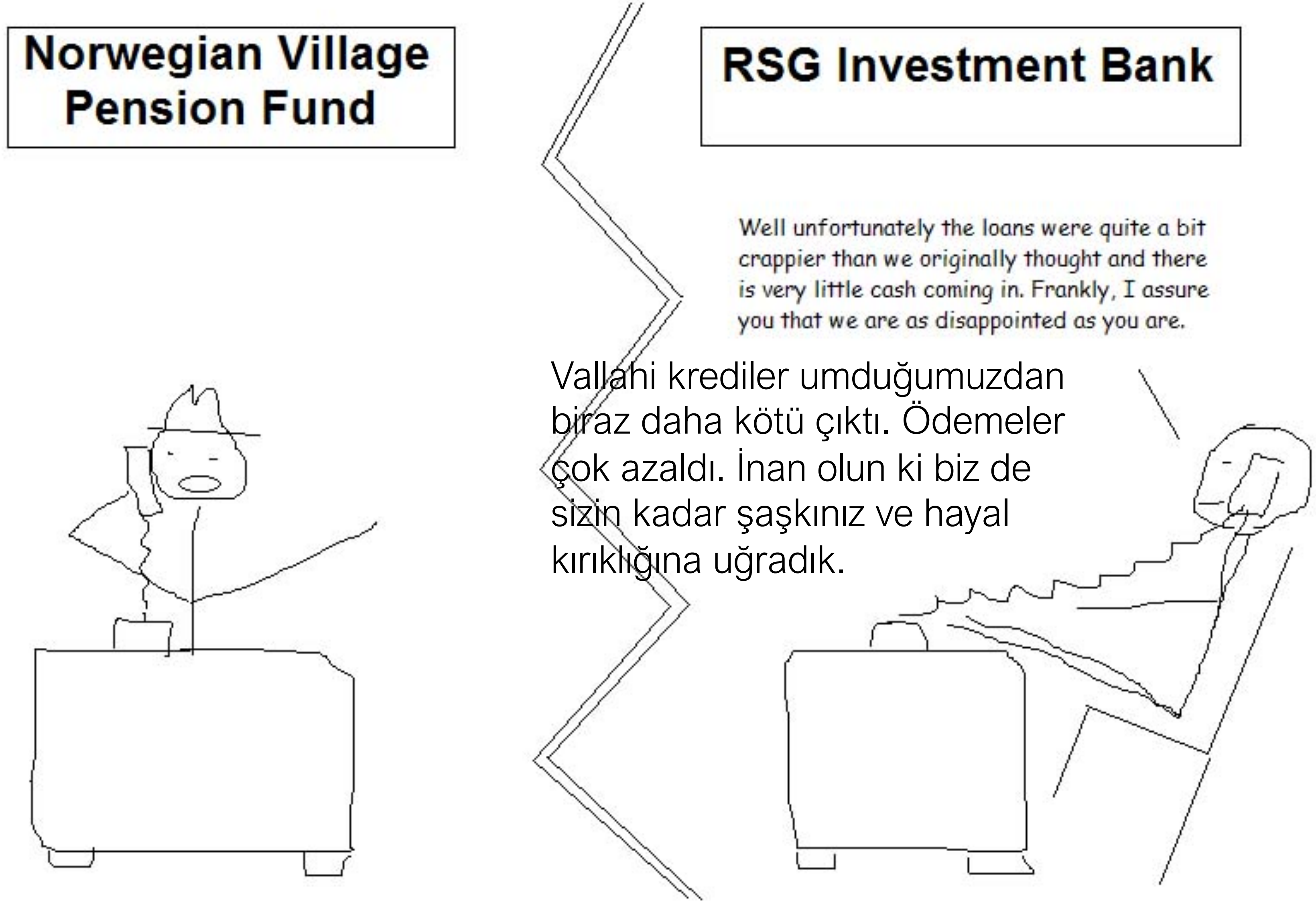
RSG Yatırım Bankası




Bir Dakika. Biz Ratingi AAA olan "İyi" Kağıtları almıştık. Garantili Kağıtları. Önce Bize ödeme yapılmalıydı.

Norveç’te Kasaba Emekli Fonu

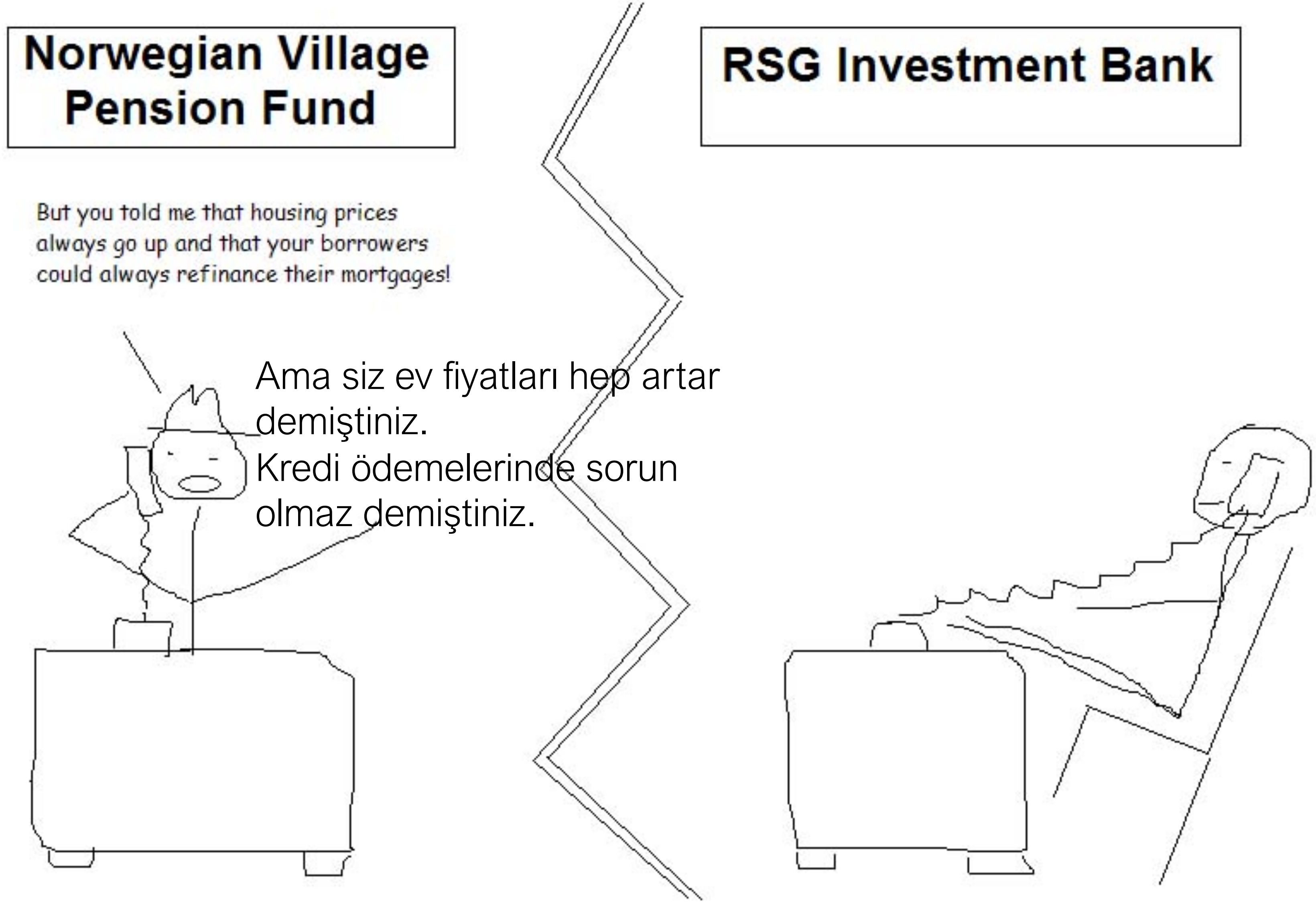
RSG Yatırım Bankası




Vallahi krediler umduğumuzdan biraz daha kötü çıktı. Ödemeler çok azaldı. İnan olun ki biz de sizin kadar şaşkınız ve hayal kırıklığına uğradık.

Norveç’te Kasaba Emekli Fonu

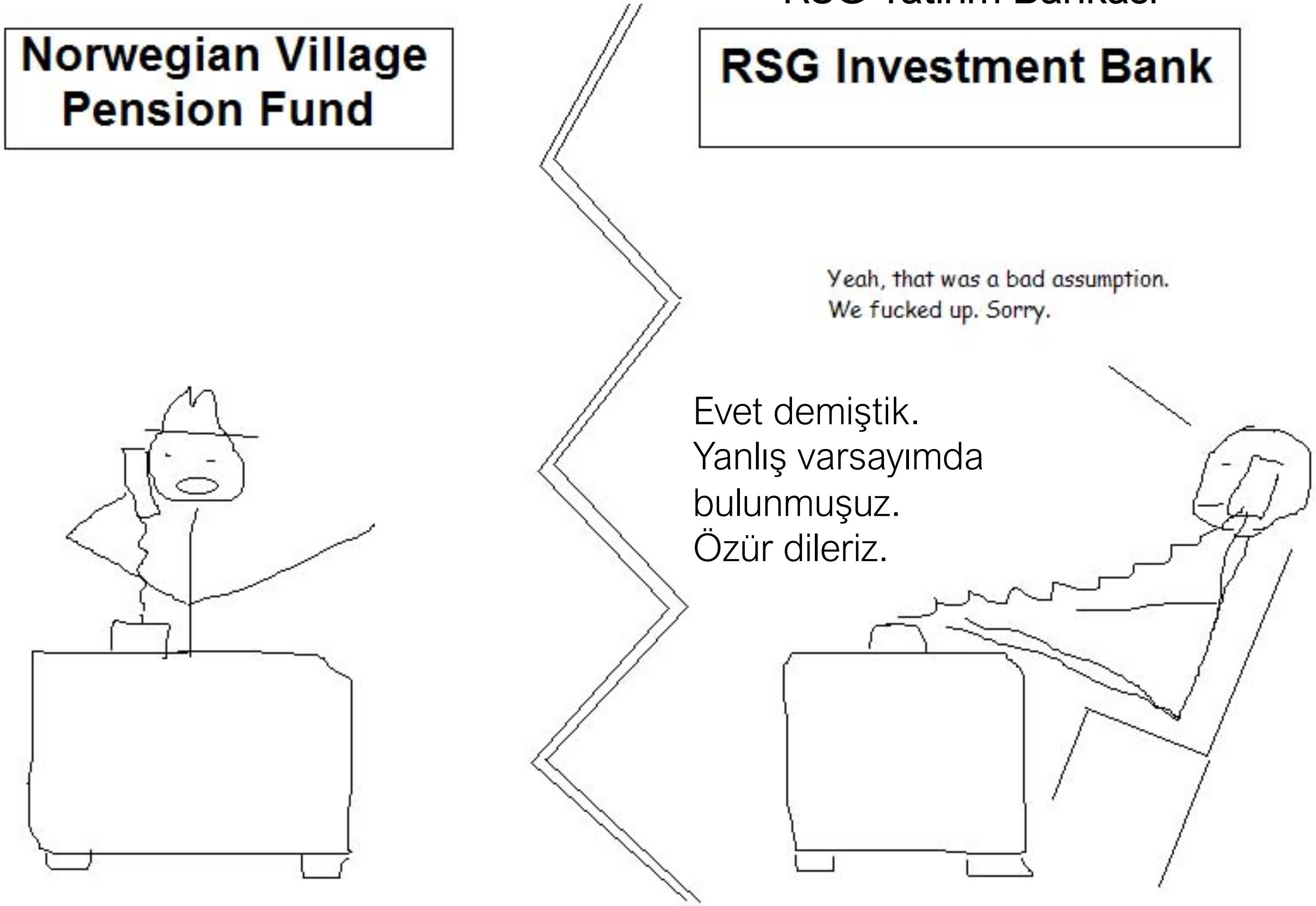
RSG Yatırım Bankası




Ama siz ev fiyatları hep artar demiştiniz.
Kredi ödemelerinde sorun olmaz demiştiniz.

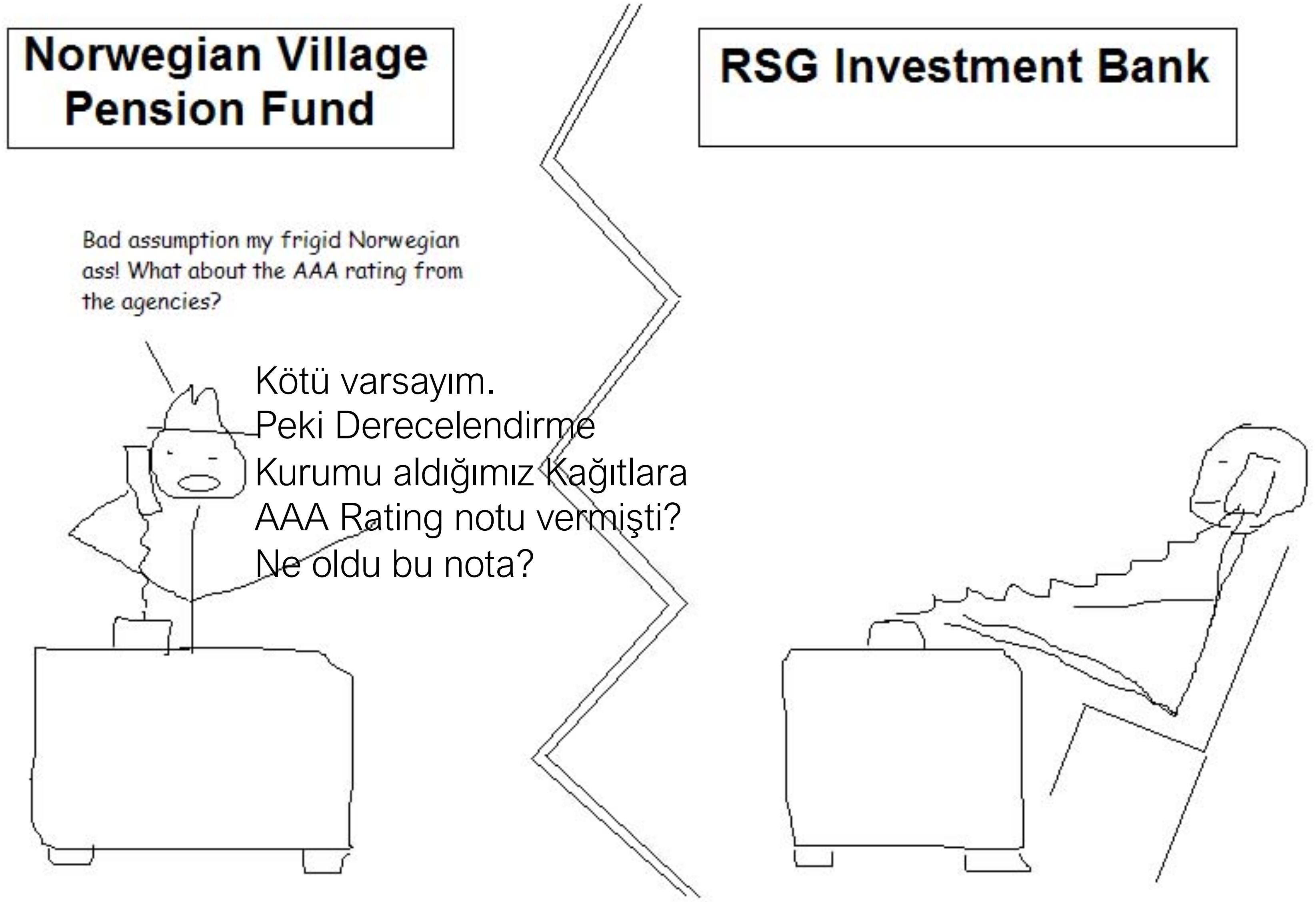
Norveç'te Kasaba Emekli Fonu

RSG Yatırım Bankası



Norveç’te Kasaba Emekli Fonu

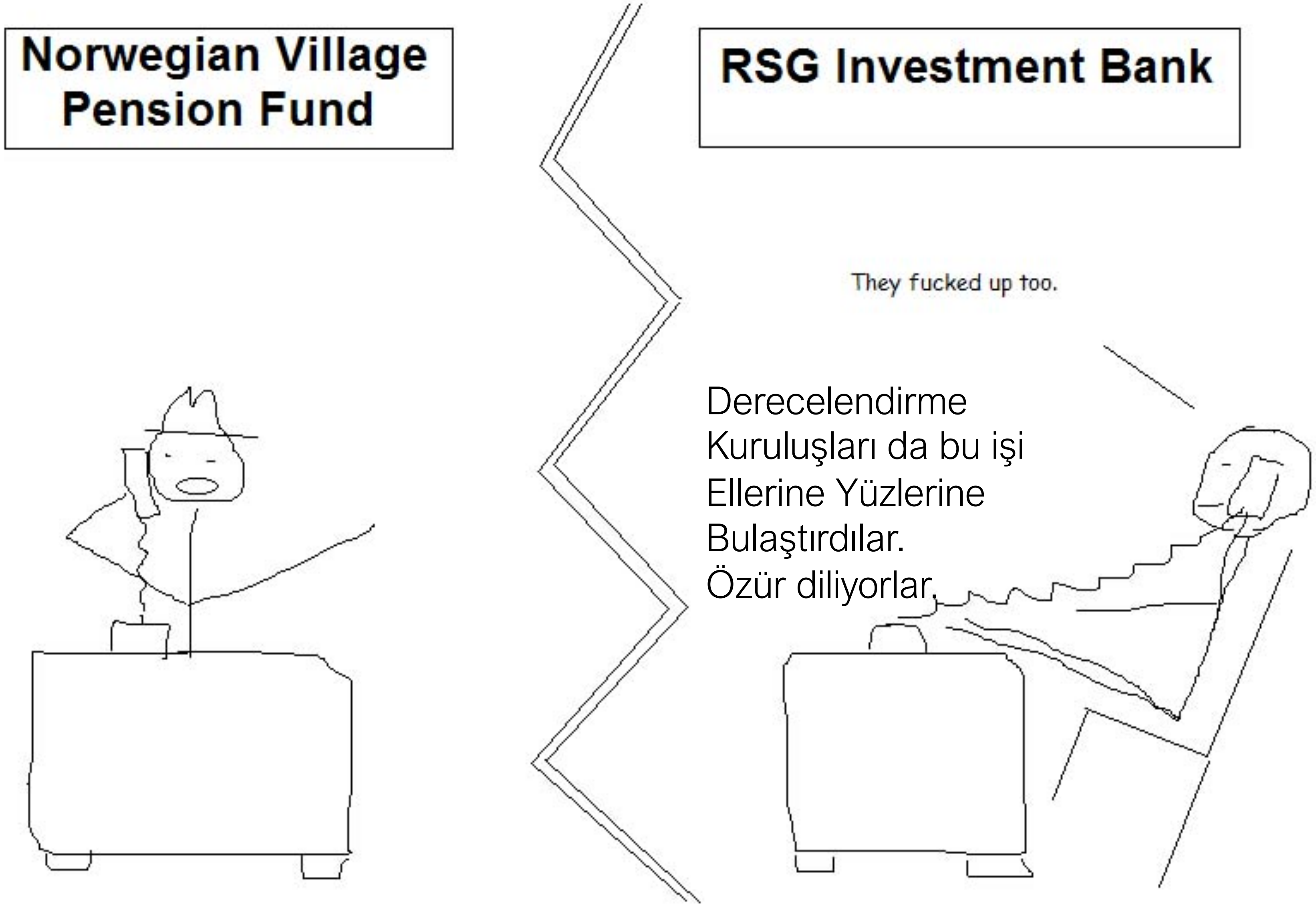
RSG Yatırım Bankası




Kötü varsayım.
Peki Derecelendirme
Kurumu aldığımız Kağıtlara
AAA Rating notu vermişti?
Ne oldu bu nota?

Norveç’te Kasaba Emekli Fonu

RSG Yatırım Bankası




Derecelendirme
Kuruluşları da bu işi
Ellerine Yüzlerine
Bulaştırdılar.
Özür diliyorlar.

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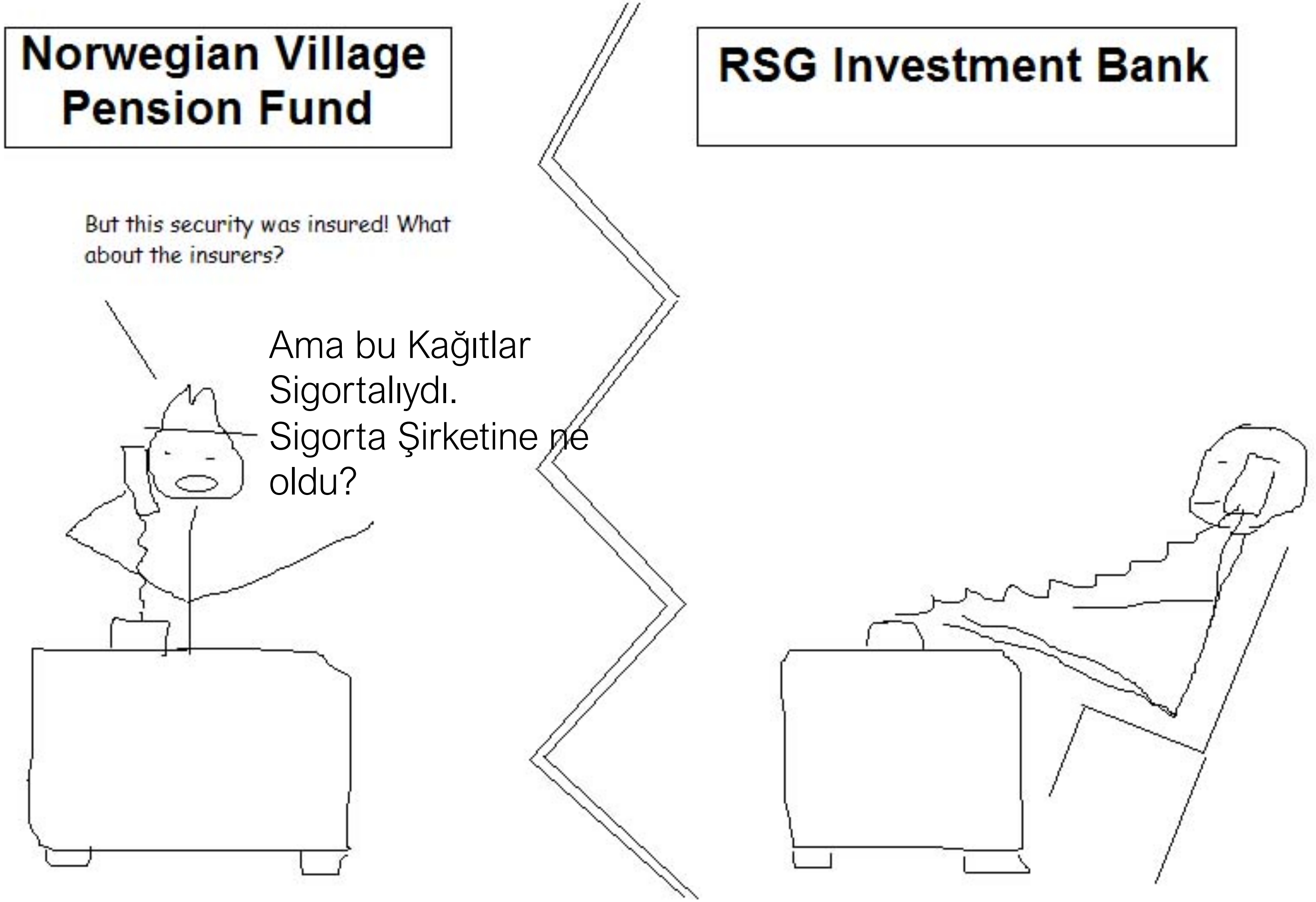


Ama bu Kağıtlar Sigortalıydı. Sigorta Şirketine ne oldu?

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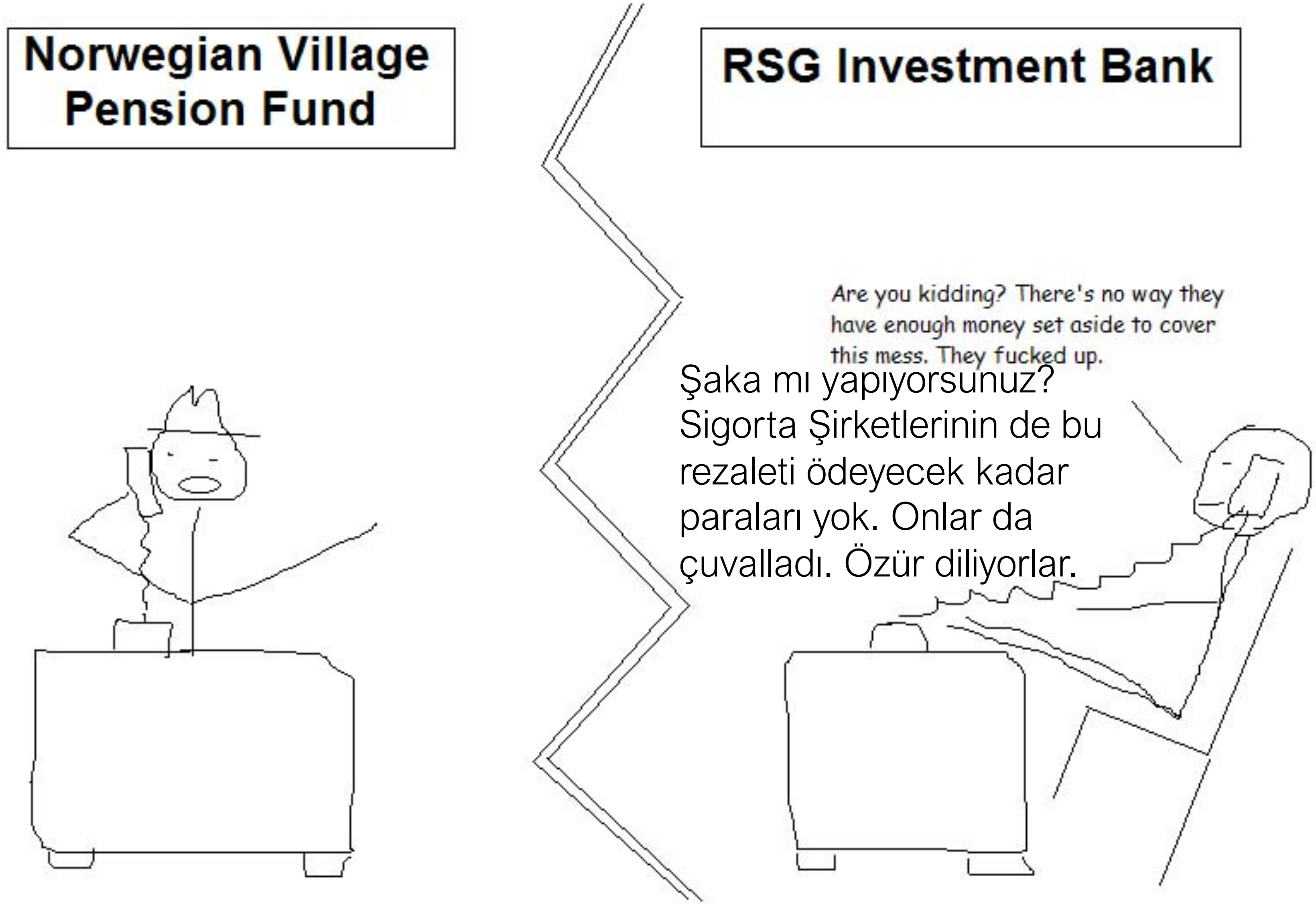


Şaka mı yapıyorsunuz? Sigorta Şirketlerinin de bu rezaleti ödeyecek kadar paraları yok. Onlar da çuvalladı. Özür diliyorlar.

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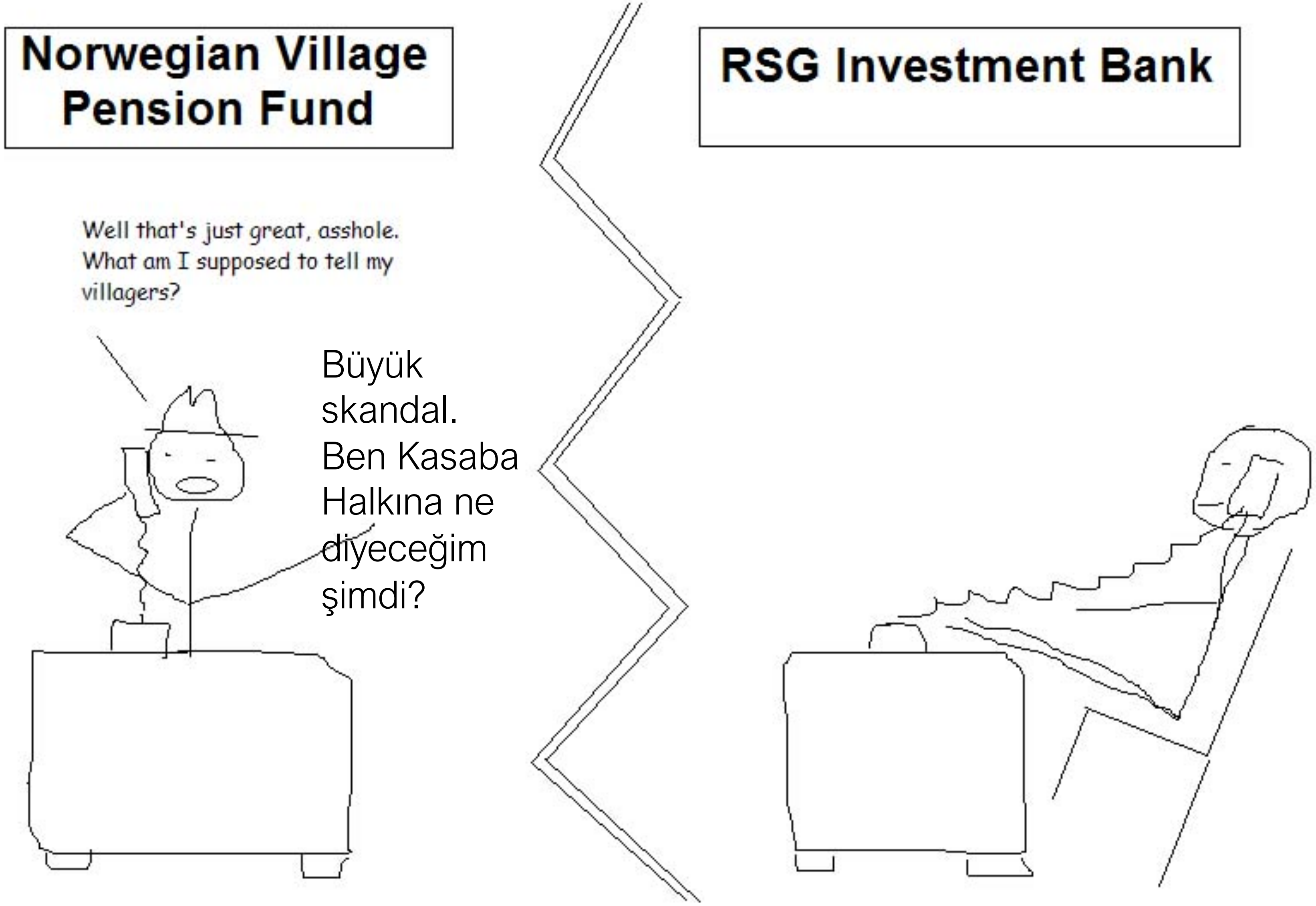


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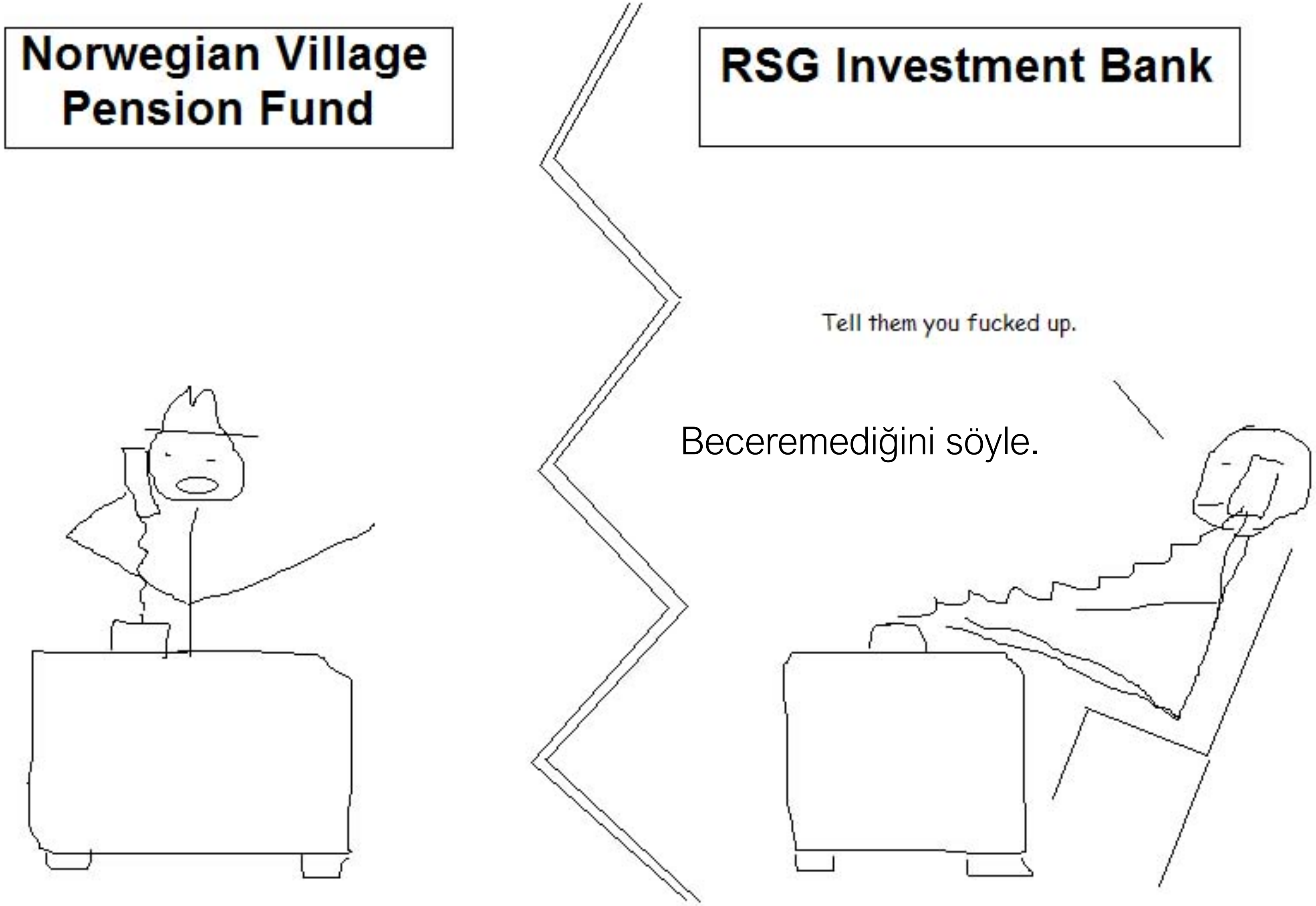


Beceremediğini söyle.

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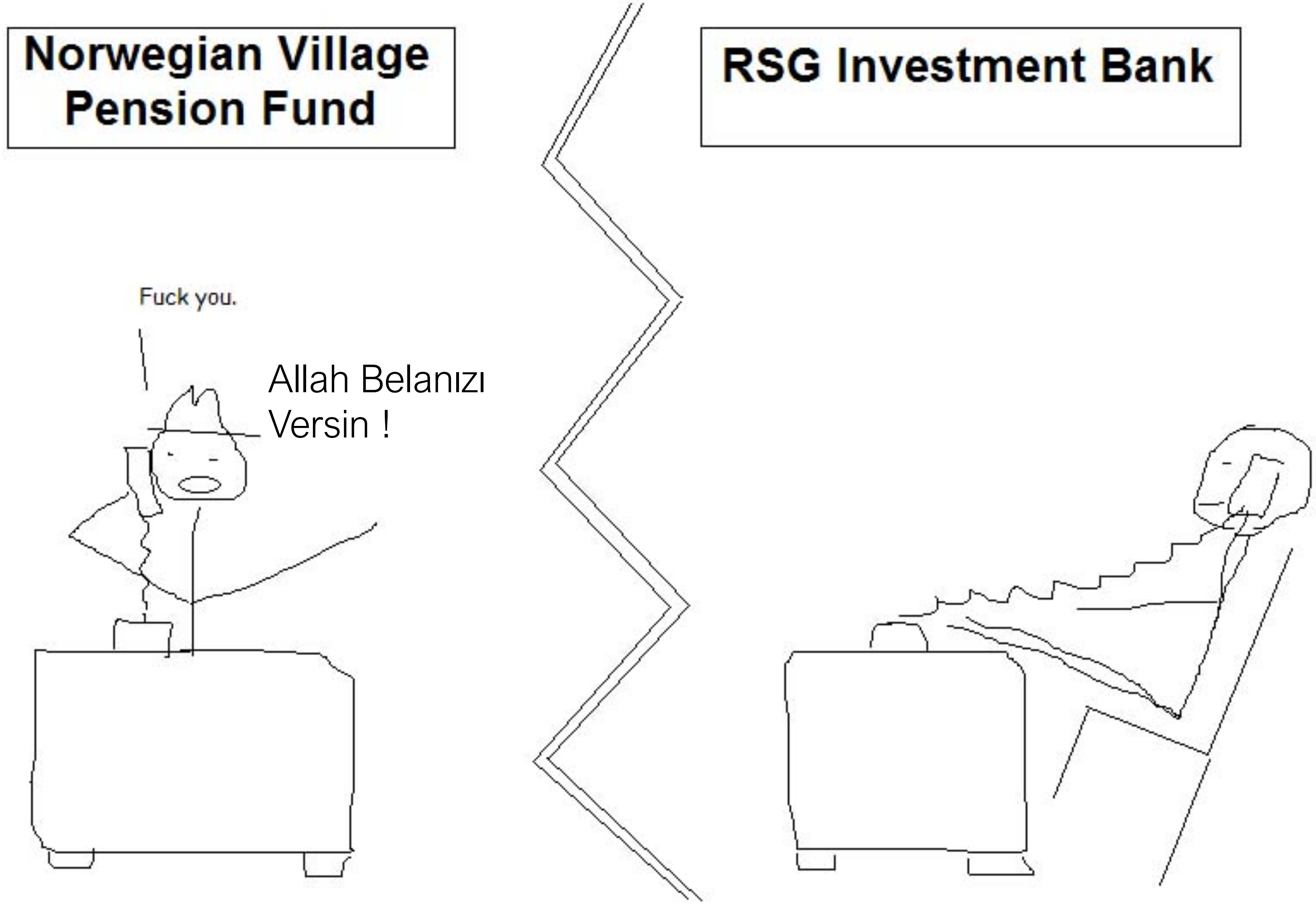
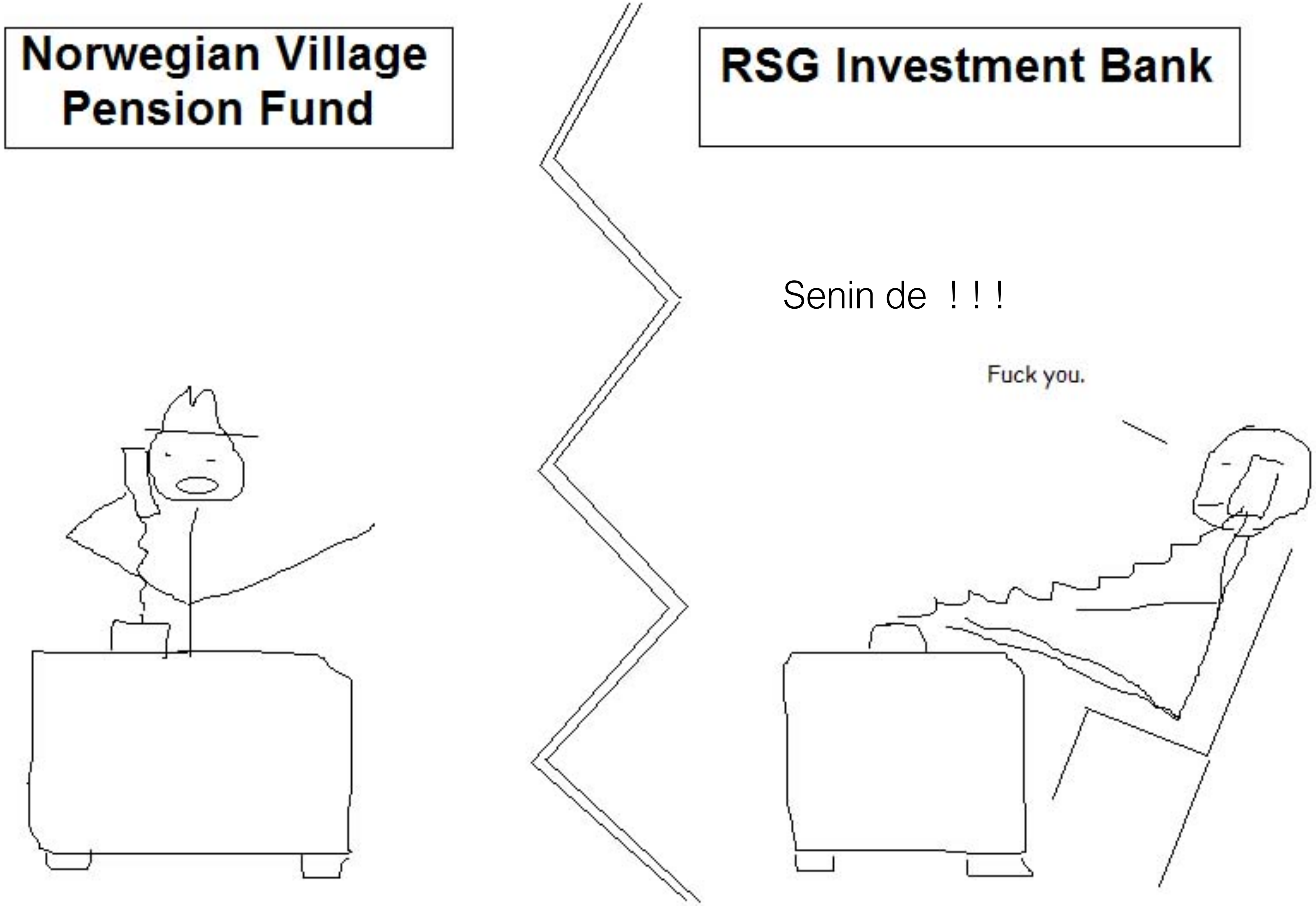


Norveç’te Kasaba Emekli Fonu

RSG Yatırım Bankası




Senin de ! ! !

# Mutlu Son

The End