Chapter 14

Venture Capital, IPOs, and Seasoned Offerings

Topics Covered

- Venture Capital
- The Initial Public Offering (IPO)
- The Underwriters
- Seasoned Offering

Venture Capital

Venture Capital

Equity capital in young businesses is known as venture capital

Since success of a new firm is highly dependent on the effort of the managers, restrictions are placed on management by the venture capital company and funds, after a certain level of success is achieved.

Venture Capital

Zero Stage: $100,000 is raised and invested to build a new company with 1 million shares (At this zero-stage investment, your company's assets are $100,000 plus the idea for your new product)

First Stage Market Value Balance Sheet ($mil)

Assets		Liabilities and Equity	
Cash from new equity	0.5	New equity from venture capital	0.5
Other assets	0.5	Your original equity	0.5
Value	1.0	Value	1.0

Venture Capital

Second Stage Market Value Balance Sheet ($mil)

Assets		Liabilities and Equity	
Cash from new equity	1.0	New equity from 2nd stage	1.0
Other assets	2.0	Equity from 1st stage	1.0
		Your original equity	1.0
Value	3.0	Value	3.0

Venture Capital

- Since the successful rate of venture capital investments is low (for every 10 first-stage venture capital investments, only 2 or 3 may survive as self-sufficient businesses, and only 1 may pay off big), two rules of success in venture capital investment
  - Don't buy into a business unless you can see the chance of a big, public company in a profitable market
  - Cut your losses; identify losers early, and if you can't fix the problem of the firm invested, don't throw any money again

Initial Offering

<u>Initial Public Offering (IPO)</u> - First offering of stock to the general public

- ➔ It is called a primary offering when new shares are sold to raise additional cash for the company
- ➔ It is called a secondary offering when the company's founders and the venture capitalist cash in on some of their gains by selling shares

<u>Underwriter</u> - Investment banking firm that buys an issue of securities from a company and resells it to the public

- ➔ Firm commitment vs. Best efforts (包銷 vs. 代銷)
- ➔ Providing advice, buying a new issue from the company, and resell it to investors

Initial Offering

Spread - Difference between public offer price and price paid by underwriter

Prospectus - Formal summary that provides information on an issue of securities. This document is one of the registration statement for the Securities and Exchange Commission (SEC) and the general public

Underpricing - Issuing securities at an offering price set below the true value of the security (Underwriters argue that underpricing is needed to tempt investors to buy stock and to reduce the cost of marketing the issue to customers)

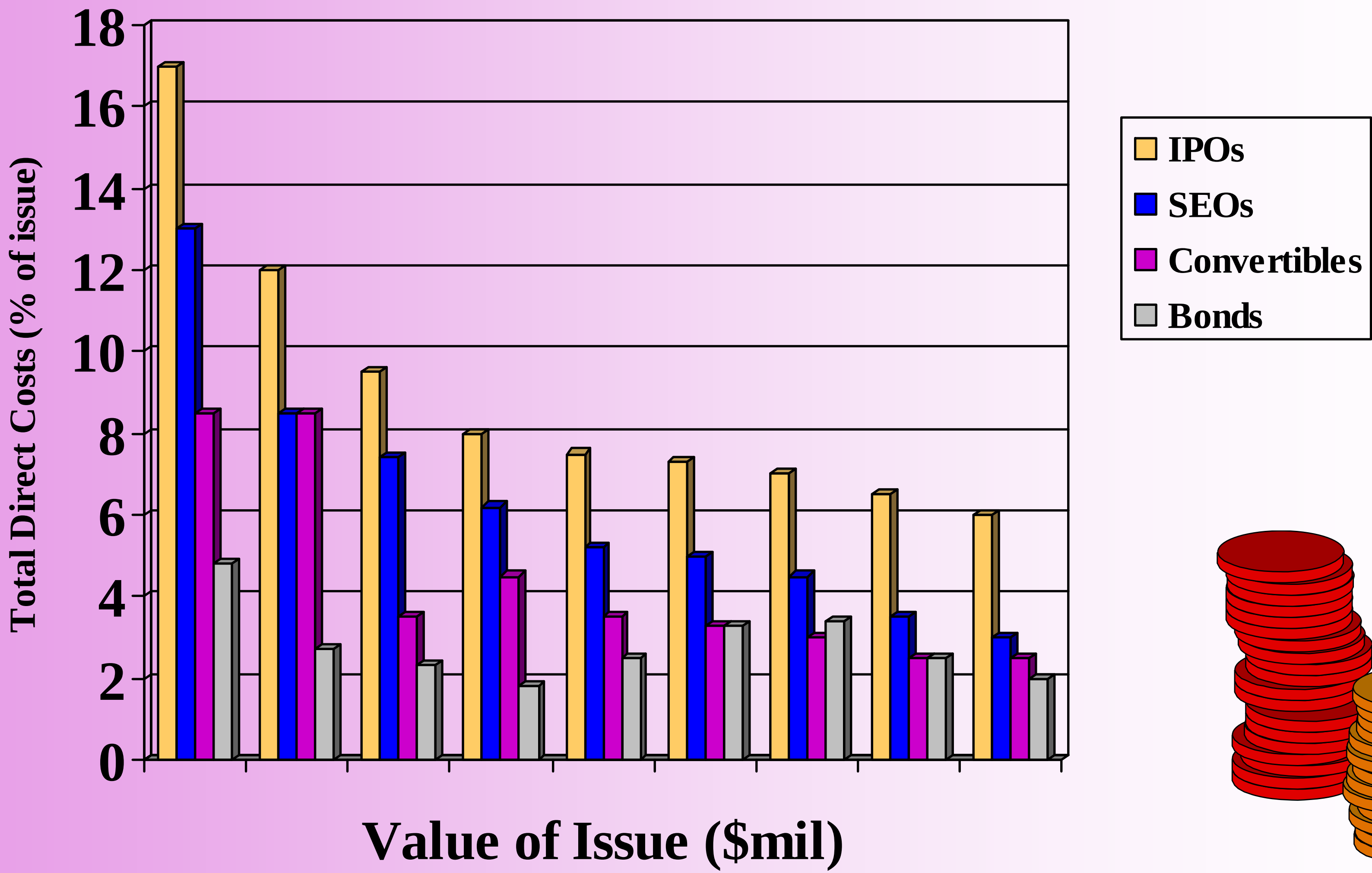
Initial Offering

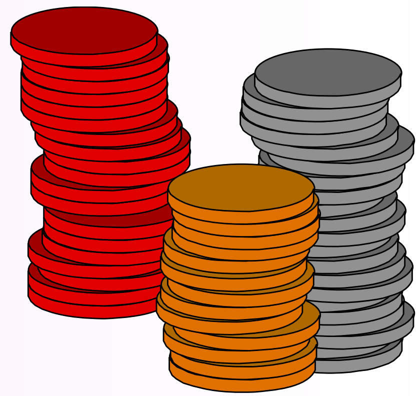
<u>Winner's Curse</u> - Unless the investors can know which issues are underpriced or overpriced, they will receive a small proportion of the underpriced issues (因申購的人多) and a large proportion of the overpriced issues (因申購的人少). Therefore, not anyone can become wealthy by buying stock in IPOs.

<u>Flotation Costs</u> - The costs incurred when a firm issues new securities to the public (see the next slide)

Initial Public Offering

Expenses





The Underwriters

Top U.S. Underwriters in 2001

($bil of total issues)

Citigroup	$487
Merrill Lynch	433
CS/First Boston	347
JPMorgan	315
Goldman Sachs	302
Morgan Stanley	278
Lehman Brothers	261
UBSWarburg	253
Deutsche Bank	224
Bank of America	163
All Underwriters	$3,062

Top U.S. Underwrite rs in 2004

($bil of total issues)

Citigroup	$534
Morgan Stanley	414
JPMorgan	386
Lehman Brothers	370
Lerrill Lynch	370
CS/First Boston	362
Deutsche Bank	335
UBS	300
Goldman Sachs	286
Bank of America	204
All Underwrit ers	$3,564

Seasoned Offering

<u>Seasoned Offering</u> - Sale of securities by a firm that is already publicly traded.

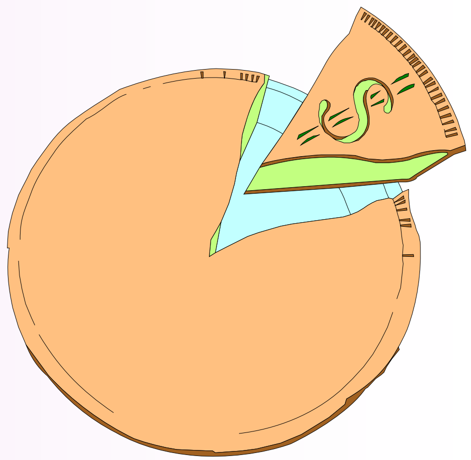
<u>General Cash Offer</u> - Sale of securities open to all investors by an already public company.

<u>Rights Issue</u> - Issue of securities offered only to current stockholders (often with attractive price)

- ➔ In some countries the rights issue is the most common or only method for issuing stock, but in the United States rights issues are now very rare

Seasoned Offering

Example for Rights Issue - YRU Corp currently has 9 million shares outstanding. The market price is $15/sh. YRU decides to raise additional funds via a 1 for 3 rights offer at $12 per share. If we assume 100% subscription, what is the value of each right?



Seasoned Offering

Example for Rights Issue - YRU Corp currently has 9 million shares outstanding. The market price is \$15/sh. YRU decides to raise additional funds via a 1 for 3 rights offer at \$12 per share. If we assume 100% subscription, what is the value of each right?

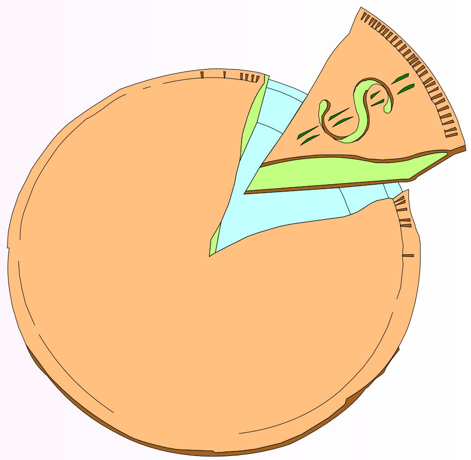
⇒ Current Market Value = 9 mil x \$15 = \$135 mil

⇒ Total Shares = 9 mil + 3 mil = 12 mil

⇒ Amount of new funds = 3 mil x \$12 = \$36 mil

⇒ New Share Price = (135 + 36) / 12 = \$14.25/sh

⇒ Value of a Right = 15 - 14.25 = \$0.75



Seasoned Offering

<u>Shelf Registration</u> - A procedure that allows firms to file one registration statement for several issues of the same security. (The actual issues happen whenever the firm needs cash or thinks it can issue securities at an attractive price)

- ➔ The shelf registration is less often used for issues of common stock than for various-feature corporate bonds (因複雜且有不常見條件的合約，可能需要投資銀行的顧問與幫忙行銷，甚至需要與當時公司的需要與經濟情況相連結，所以沒法先註冊，之後再發行)

Seasoned Offering

<u>Private Placement</u> - Sale of securities to a limited number of investors without a public offering. (SEC insists that the security should be sold to no more than a dozen or so knowledgeable investors)

- ➔ Advantage
  - Avoiding registration costs and incurring less arrangement costs
  - Custom-tailored contracts
- ➔ Disadvantage
  - Lack liquidation (not easy to resell)