



D.R. Dogra
Managing Director & CEO CARE RATINGS



Equity Funding Option Through SME Exchange

Indian SMEs have traditionally been facing a constraint of lack of adequate and timely finance. While sanction and disbursement of a loan from bank itself takes longer time, expecting equity contribution from investors is a complete nightmare. Indian entrepreneurs, therefore, have preferred to rely on own funds or support from relatives & friends for their business capital requirements.

Four already listed, 10 offer documents filed and many more in the pipeline. Though these figures seem to be minuscule in a 3.11 crore population of SME entities in India, a critical analysis of offer documents of these entities filed on newly introduced SME Exchange flashes a ray of hope for many emerging corporate.

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The two SME exchanges set up in March 2012 and modeled on the successful running junior exchanges in developing as well developed countries, are set to provide the right solution. Following the Prime Minister's Task Force recommendation in January 2010 and publication of relaxed regulations by the regulator (SEBI) for the governance of SME Platform, Bombay Stock Exchange launched the 'BSE SME Exchange' and National Stock Exchange termed it as 'NSE Emerge'. Till August 15, more than Rs.30 crore has been mobilized by five emerging corporates through IPOs listed on these SME exchanges. Recent move towards the minimum profitability criteria for listing on the main exchanges is also likely to boost the SME Exchange.

Analysis of IPO profiles

Out of the 10 enterprises which filed offer documents with BSE SME Exchange, most of the entrepreneurs are based out of Mumbai. Two are from non-metro cities viz. Mathura and Udaipur. Apart from northern states, one corporate is from South India having retail business in Chennai. Good point is that the corporates have come forward from diverse sectors which include broking, NBFC, software, cosmetics, crushing, portal services, in addition to retail. These businesses generally find difficulties in raising equity / loans from traditional banking sources due to various reasons viz. lack of availability of assets for mortgage, high risk due to totally new concept, unrelated diversification, etc.

Table 1 enlists the brief profile of entities which have filed offer documents with BSE SME Exchange. Some other eye catching observations are as follows:

- 70% of the corporate are of micro to small size with turnover less than Rs.2 crore
- 80% of the entities earned profit of less than Rs.50 lakh
- Shortest establishment track record is 1 year with the highest upto 17 years
- Except for two, all other entities to raise funds higher than their existing net worth
- The issue size ranges from Rs.4 crore to Rs.8.85 crore
- Most of the entities are expected to be fix issue price at a premium



Table I: Snapshot of offer documents filed for listing on SME exchange

S. No.	Company name	Track record (years)	Industry	State /city	Sales (Rs Lakh)	PAT (Rs Lakh)	Networth (Rs Lakh)	Issue size (Rs Lakh)	Purpose	Status	Latest Trading price
1	RCL Retail Limited	2	Retail Food Industry	Chennai	642.44	7.46	559.91	579.50	Setting up retail outlets and food grain processing unit	Doc filed	N.A.
2	Anshu's Clothing Limited	17	Apparel Retail Industry	Ahmedabad	2771.60	50.31	1244.76	505.44	To make advances or long term supply arrangements	Doc filed	N.A.
3	Comfort Commotrade Ltd	5	Commodity Broking	Mumbai	51.35	17.15	433.18	600.00	Expand operations, enhancement of margin money	oc filed	N.A.
4	Jointeca Education Solution Ltd	15	Education (Educational ERP Solutions)	Mathura	133.66	5.85	962.63	535.30	Cloud computing solutions, Infrastructure for B2B portal	oc filed	N.A.
5	Max Alert Systems Limited	8	Providing solutions for fire fighting	Mumbai	3313.83	172.7	539.06	800.00	Setting up of crushing plant	Listed	At premium
6	Monarch Health Services Limited	1	Cosmetic Industry	Mumbai	0.19	12.48	75.15	720.00	Opening up of 23 new clinics and working capital requirement	Listed	At discount
7	BCB Finance Limited	7	NBFC	Mumbai	146.95	22.61	1095.72	885.00	To augment its capital base for increasing scale	Listed	At discount
8	SRG Housing Finance Ltd	13	Housing Finance Industry	Udaipur	126.60	25.67	491.32	700.80	To augment its capital base for increasing scale	oc filed	N.A.
9	Sangam Advisors Limited	13	Financial Services Industry	Mumbai	66.93	22.05	434.94	506.88	Investment in listed/unlisted securities and financial products	Listed	Near issue price
10	Jupiter Infomedia Ltd	7	Online Advertising and Marketing Industry	Mumbai	63.94	2.01	199.17	408.00	Purchase of offices at two metros, initial operating expenses for the marketing offices	Funds raised	To be listed soon

*Data compiled till August 14, 2012

The figures indicate that size will not be a constraint anymore for fund raising through equity. Investors seem to have recognized upcoming concepts, new business ideas and inherent potential of small entrepreneurs. It seems that business models and certainty of cash flows would prevail over security coverage or balance sheet figures, which can be articulated. The credit should be given to all the stakeholders especially the regulator for its liberal guidelines understanding the nuances of SMEs.

Relaxation in SEBI guidelines

Entities willing to list on SME Exchanges are required to file offer documents at the Exchange & SEBI. However, the process would be similar to fast track issues and no comments / observations would be issued by SEBI. This certainly helps smoothening the fund raising process. Even annual reports are not required to be circulated to the shareholders however should be made available on the company's website. Entities may submit the half-yearly

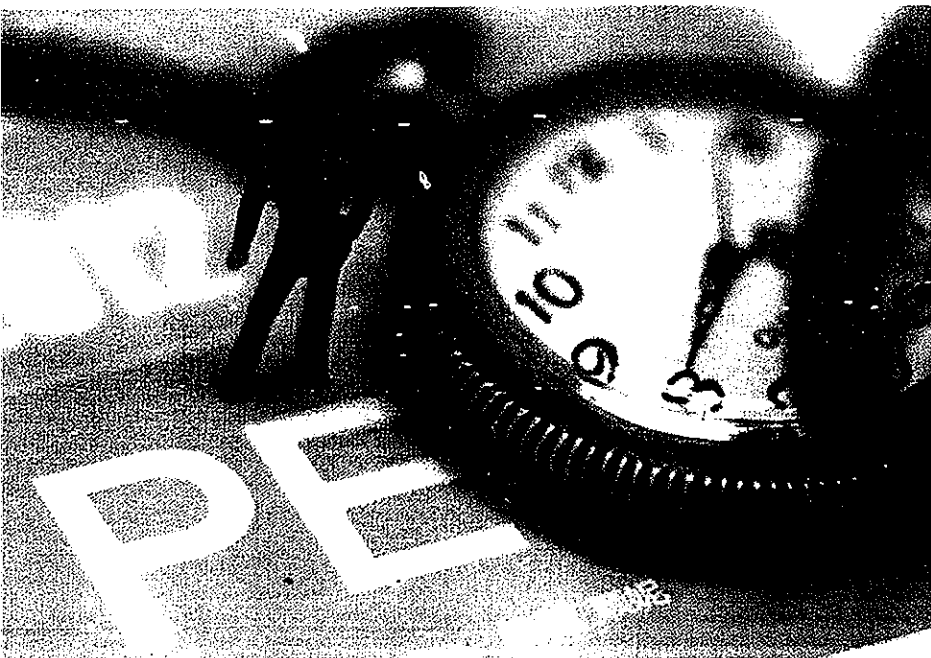
results instead of quarterly results, that too not in newspapers. Market making activities would be mandatorily done by the Merchant Bankers with some

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flexibility of underwriting related clauses. These flexibilities are available to issues proposing to list on SME Exchange, which has certain eligibility norms.

Eligibility criteria to list in SME Exchange

1. Net Tangible assets of at least Rs. 1 crore as per the latest audited financial results
2. Net worth (excluding revaluation reserves) of at least Rs. 1 crore as per the latest audited financial results
3. Track record of distributable profits in terms of Sec. 205 of Companies Act, 1956 for at least two years out of immediately preceding three financial years and each financial year has to be a period of at least 12 months. Extraordinary income will not be considered for the purpose of calculating distributable profits. Otherwise, the networth shall be at least Rs 3 Crore.



CRA's like CARE Ratings would assess the overall fundamentals of an IPO on a five-point scale. Highest score to be assigned to any IPO would be 5 (indicating 'Strong Fundamentals') and the lowest score would be 1 (indicating 'Poor Fundamentals'). IPO grading would involve an in-depth assessment of the various quantitative and qualitative parameters of the issuer.

About CARE

Credit Analysis & REsearch Ltd. (CARE) is a full service rating company that offers a wide range of rating and grading services across sectors. CARE has an unparalleled depth of expertise. CARE Ratings methodologies are in line with the best international practices.

'Poor Fundamentals'). IPO grading would involve an in-depth assessment of the various quantitative and qualitative parameters of the issuer. Quantitative parameters include growth prospects of the industry, financial strength & operating performance of the issuer whereas, qualitative parameters primarily include management capability, promoters' evaluation, accounting policies and corporate governance practices. Grading based on such a detailed analysis is expected to provide inputs for investment decision. Issuer would also be benefited as it would help them in benchmarking themselves in the market place. With this service already in place since more than five years, CRA's can further boost this mechanism of resource mobilization for SMEs.

Conclusion

Government has set a target of achieving one third of total funds requirement for SMEs, of about Rs.7 lakh crore, through equity. BSE management expects 100 listing in first 15 months of launch. While the time would tell on the achievement of that, the initiatives have indeed been resourceful.

4. The post-issue paid up capital of the company shall be at least Rs. 1 crore
5. The company shall mandatorily facilitate trading in demat securities and enter into an agreement with both the depositories.
6. Companies shall mandatorily have a website
7. Certificate from the applicant company / promoting companies stating the following –
 - a. The Company has not been referred to the Board for Industrial and Financial Reconstruction (BIFR).
 - b. There is no winding up petition against the company that has been accepted by a court.

NSE / BSE can also consider relaxation in these conditions with the approval of

proper authority.

Role of Credit Rating Agencies (CRA's)

Though the IPO grading has been made optional for these entities, it is recommended due to its benefits. IPO grading given by CRA's like Credit Analysis & Research Ltd. (CARE Ratings), etc., is a service aimed at facilitating the assessment of equity issues offered to public. It is an independent and professional opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the 'fundamentals' of that issuer.

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