White Paper
Structure of Offer to Investors
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This paper aims at highlighting major issues pertaining to the structuring of an Offer to Investors of part of equity/equity-linked instruments of an unlisted company. The following definitions apply to the present paper:

- (1) Investors: Investors investing in private equity transactions, whose purpose is non strategic, namely "Financial Investors". Investment decision criteria are strictly in terms of investment opportunity and risk/return ratio. As a consequence:
  - Unlike strategic investors, they prevent themselves from being involved in the business of the company, be it at commercial, managerial, technical or other levels.
  - Their only objective is to maximize the value of their investment, and as such, they may be interested in being involved actively within the Board of Directors, hence in contributing to decisions implying major investments/disinvestments and/or further transactions involving equity/shareholding structure. However they do not aim at becoming majority shareholders.

  Typical Financial Investors are Venture Capitalists.

- (2) (Private) Equity Transaction: any transaction involving a transfer of equity or equity-linked instruments (ordinary or preferred shares, convertible bonds, options, etc.) leading to a change in the shareholding structure of a company.

- (3) Offer to Investors: Terms of a proposal to Investors in a view of a Private Equity Transaction.

<u>Major issues faced by Investors in their Investment Decision</u>

Each Investment decision depends of two sets of criteria:

- Fund management criteria, such as:
  - Preferred sectors & location of investment (e.g. IT in Europe, etc.)
  - Portfolio diversification (e.g. 50% IT, 40% Telecoms, 10% misc.)
  - Benchmarks linked to fund structure (duration of the fund, etc.)

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- Investment/Disinvestment policy criteria
    - Size of each investment (e.g. USD 1 to 5 mn)
    - Stage of growth of the company (e.g. seed, early stage, 1st growth, 2nd growth, IPO, etc.)
    - Level of involvement (active, passive)
    - Expected return for each investment (e.g. IRR of 30%)
    - Duration of investment (e.g. 3-5 years)

These criteria pertain to the objective of maximizing the value of investment. They deal with:

- Minimizing risk
    - Investing in an expected high-growth and "safe" sub-sector/niche of activity
    - Selecting a company which is likely to become a leader of this sub-sector/niche of activity
    - Carefully assessing the managers : professionalism and quality of management
- Maximizing return: Return is calculated in terms of IRR for the expected duration of the investment, i.e. taking into account all "cash in – cash out" flows: amount invested, dividends, proceeds of the sale of the participation, etc.
- Securing the disinvestment process (exit scenarios).

<u>Structuring an Offer</u>

The Offer has to address the Investors' concerns as described in the paragraph above. An example of an Offer is given below:

- "There is an opportunity of investment in this company [sector, position of the company in its sector, competitive edge, etc.]
- Based on current assumptions of our base case scenario where… [identification/major features of scenario]…
- …the value of our company pre-money is… [valuation]
- We offer the Investors to participate to a right issue of …shares with … premium [description of the Transaction]
- Post investment the Investors will own …% of the company [% of participation]
- Exit would be realized through … on Year ….[description of Exit: how and when]
- Under the current scenario this would ensure an expected return to Investors superior to… [IRR estimates]
- We believe that this investment is interesting for Investors because… [rationale

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for investing, including the quality of the team]
- The risk is limited to …[description of the risk for the investor]"

Before the negotiations the company has to be ready to discuss and justify each item of the offer:

- Selection of a base case scenario: description of revenues, cash-flows, etc. and underlying assumptions. A base case scenario:
    - is a scenario which is 1/ conservative AND 2/the most likely to take place (not necessarily the worst case scenario)
    - highlights the value drivers (value drivers: a selection of business variables and parameters, which, when sensitivity analyses were performed, highlighted a high sensitivity correlation with the company valuation)
- Valuation methodology and parameters (for example DCF and WACC, etc.)
- Parameters of the Transaction: premium, etc.
- Exit for Investors: it must be anticipated and discussed in terms of : which type of exit is likely to take place and when ? In most cases the exit consists of:
    - Either an IPO
    - Or a majority sale to a strategic investor (for example a competitor)
    - Or another transaction allowing more liquidity: for example an exchange of shares of the unlisted company against shares of its listed holding.
- Quality of the team…which is also demonstrated while – precisely - performing the "exercise" of the negotiations with the Investors, as described in this paper.

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