Growth during economic uncertainty
Global IPO trends report 2008
Foreword

Emerging markets continue to fuel global initial public offerings (IPOs) despite financial volatility triggered by the credit crunch. In 2007, with global IPO fund-raising at an all-time high, Brazil, Russia, India and China (BRIC countries) raised US$119 billion, over 40% of total global IPO proceeds. By contrast, a decade earlier, the US and Europe dominated IPO markets, and all the BRIC countries together produced US$6 billion or just 5% of total IPO proceeds. In the first quarter of 2008, financial turmoil sparked a deceleration in IPO markets around the world, especially in developed economies. However, high-quality enterprises, primarily from the emerging markets, continue to be well received by the world’s public markets.

Today, capital follows a good investment story, wherever it’s listed. Global liquidity and thriving local economies have ignited rapid growth in the emerging markets. In their hunt for higher returns, investors with a risk appetite have been shifting assets to the fast-growth BRIC countries. It’s also getting easier to value and finance ideas outside the public markets, thanks to an expanding array of capital sources, including private equity, venture capital, hedge funds, private placements and sovereign wealth funds.

After extensive interviews with the world’s top investment bankers and stock exchange leaders, Ernst & Young’s Global IPO Trends Report 2008 reviews the major developments in the worldwide IPO markets in 2007 and the first quarter of 2008. As the fifth global IPO report produced by Ernst & Young, this review offers an in-depth examination of the key trends for companies planning an IPO today.

Trends in IPO activity can be difficult to predict, especially in times of market volatility. However, companies around the world continue to ready themselves to go public while waiting for market conditions to improve. We look forward to working with these companies and their teams in their transformation from a private entity to a public enterprise.

Ernst & Young
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Emerging markets drive global IPOs despite financial crisis

Key trends

- Despite financial volatility in 2007, emerging markets fueled global IPOs, with BRIC countries raising over 40% of total proceeds.
- With global IPO fund-raising at an all-time high, China raised the most capital, followed by the US and then Brazil, the world's latest IPO market success story.
- 2007 was a global IPO market of two halves: a robust first half, followed by a volatile yet resilient second half, in the face of the credit turmoil and IPO postponements.
- Global IPO markets exhibited a rich diversity of geographies, industries and types of companies.
- As global liquidity and booming local economies foster emerging markets growth, global investors shift assets to the BRIC countries in their search for higher returns.
- Since capital follows a good investment story wherever it’s listed, almost all companies list on their increasingly liquid home exchanges.
- The world’s stock exchanges continue to consolidate through transatlantic mergers.
- Companies can choose from many alternative capital sources, including private equity, venture capital, hedge funds, private placements and sovereign wealth funds.
- In 2008, despite the market turbulence, companies with strong business models continue to be well received by the world’s public markets.
- The global IPO slowdown in the first quarter of 2008 suggests how interconnected and globalized the world’s capital markets have become.

Emerging markets continue to drive the global IPO markets in 2007-08 despite financial volatility. In early 2008, market turmoil triggered by the credit crunch led to a sharp deceleration in most IPO markets around the world. Faced with more scrutinizing investors and stringent valuations, record numbers of businesses withdrew or postponed their IPO plans. Even so, many companies await in packed IPO pipelines, ready to go public once market conditions improve. High-quality enterprises, primarily from emerging markets, continue to be well received by the world’s public markets.

In the first quarter of 2008, almost all global IPO markets lost their momentum as 236 IPOs generated US$40.9 billion, representing a 38% drop in volume and a 15% decline in capital raised from the first quarter of 2007 (see figure 4, page 7).*

The top 3 IPOs by value were the US$19.6 billion offering of Visa Inc. in the largest US IPO ever, the US$5.8 billion IPO of China Railway Construction Corp. Ltd., and the US$2.9 billion listing of Reliance Power in India (see page 15). Notably, 8 out of the top 10 IPOs represented companies from the emerging markets. Thus, bolstered by robust economic growth, many emerging markets continue to prosper and produce IPOs while developed markets endure a slowdown.

In 2007, global IPO activity soared to an all-time high of US$284 billion raised in 1,979 deals (see figure 1, page 4). Greater China raised the most capital and launched the most IPOs, drawing in US$66 billion in 259 deals. The US generated US$34.2 billion in 172 issuances, while Brazil’s IPO markets gained the global IPO spotlight for the first time, producing US$27.3 billion in 64 IPOs.

With a modest average IPO size of US$144 million in 2007, the headline-grabbing mega IPOs of the past few years were conspicuously absent, primarily because most of the world’s largest state-owned enterprises have already gone public. The

* Unless otherwise specified, all IPO data in the report is based on annual and quarterly data provided by Dealogic, Thomson Financial, and Ernst & Young.
A decade ago, BRIC countries raised US$6 billion or just 5% of global IPO proceeds, and the US, UK and France dominated the world’s public markets.

The financial sector made up 10 of the top 20 IPOs, including Russia’s VTB Bank issuance, the US$5.9 billion IPO of China’s CITIC Bank Corp. Ltd. and the US$4.1 billion offering of US alternative assets manager, the Blackstone Group (see page 14). However, the financial sector was hardest hit by the credit crunch, as heavy losses were sustained by financial institutions exposed to subprime debt.

The industrial, metals & mining and energy sectors were also highly active in 2007 (see figure 3, page 6). Industrial firms, especially those involved with transportation and infrastructure, raised US$48 billion, with such heavyweight deals as the US$5 billion IPO of container port company, Dubai Ports World in the United Arab Emirates. The metals and mining sector generated US$33 billion including the listing of Eurasian Natural Resources Corporation (ENRC), a Kazakh mining company in London. Energy and power companies produced US$32 billion, most notably the IPO of Spain’s Iberdrola Renovables.

Thriving economies and liquidity foster emerging markets growth
Soaring global liquidity and flourishing local economies have kindled emerging markets growth. Furthermore, trade diversification and growing cross-border capital flows have led to multiplying links between the capital markets of emerging and developed countries, as well as among the emerging markets themselves. Why are emerging markets growing so swiftly right now? “It’s a combination of the economic, fiscal and currency strength within these local markets, combined with massive global liquidity,” says Lisa Carnoy, Managing Director and Co-Head of Equity Capital Markets, Merrill Lynch in New York. “The flows of global capital are very robust and fluid. We’re all going after the same pools of capital and that makes a big difference.”

“As these emerging economies develop so rapidly, there is both a need and an opportunity for new entrepreneurial businesses,” says Noreen Culhane, Executive Vice President, Global Corporate Client Group, NYSE Euronext. “These businesses need capital to fund organic growth and to gain a currency for acquisitions.” Since 2007 was a market of two halves with broad sector diversity
In the first half of 2007, global issuers continued to tap public markets at the record-breaking momentum of the previous year, with numerous multi-billion dollar deals. In the second half of 2007, the credit turmoil diminished global investors’ risk appetite and constrained financial sponsor activity. This led many companies, particularly in the US and Europe, to withdraw or postpone their IPOs in record numbers not seen since the dotcom collapse. Smaller companies struggled to draw in capital. Even so, high-quality companies continued to attract capital in the fourth quarter, including the second largest global IPO of the year, the US$6.5 billion offering of Spanish renewable energy company Iberdrola Renovables in Madrid as well as the US$4.1 billion IPO of China Pacific Insurance in Shanghai.

In 2007, financial institutions were the largest and most volatile issuers, attracting 24% of total IPO proceeds or US$67 billion. The largest IPO of 2007 was the US$8 billion offering of Russia’s VTB Bank, which was considerably smaller than the groundbreaking US$22 billion Chinese ICBC bank offering in 2006. Nonetheless, hefty IPOs were still in abundance, with 52 deals priced above US$1 billion in 2007. Remarkably, 20 of these IPOs went public during the market instability of the fourth quarter.

BRIC countries raise over 40% of capital, led by China
Among the emerging markets, the BRIC countries (Brazil, Russia, India, China) were particularly dynamic. In 2007, the BRIC countries generated US$119 billion in 430 deals or 41% of total global IPO proceeds, compared with just 14% in 2004 (see pages 16-17). A decade earlier, IPOs in BRIC countries totalled a meager US$6 billion or just 5% of global IPO proceeds. By contrast, IPOs in non-BRIC countries together generated US$111 billion, and the US, France and the UK dominated global IPO markets. In 2007, half of the top 20 IPOs came from BRIC countries. Furthermore, out of the BRIC countries, China/Hong Kong secured 22% of total IPO funds raised, far more than the other three countries combined (Brazil raised 10%, Russia 7% and India 3% of total global IPO proceeds).

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companies not only based on their individual promise but also as a proxy to participate in China’s stunning economic growth.

Global investors have grown comfortable investing in emerging markets. “The risk premium associated with the emerging markets has come off,” says Gokul Laroia, Managing Director and Head of Capital Markets Asia, Morgan Stanley in Hong Kong. “Because investors have much more confidence in the fundamental demand in these economies and the ability of companies’ management teams to deliver on promises, investors are paying for the growth, putting a lot more capital into these emerging markets.”

Capital follows a good investment story, wherever it’s listed

These days, it’s no longer so necessary for a company to list on a major exchange. “The two-week road show to America is going to be less and less relevant, since companies will be able to raise money in their local markets,” says Ian Hannam, Chairman of Equity Capital Markets EMEA, JP Morgan Chase in London. In 2007, the 12 major exchanges raised just 55% of global proceeds compared with 72% in 2006. The Hong Kong Stock Exchange (HKEx) was the leading exchange in funds raised, attracting US$34.5 billion, the London Stock Exchange (LSE) generated US$30.3 billion, while the New York Stock Exchange (NYSE) drew in US$29.3 billion (see figure 2, page 5). Cross-border IPOs, especially from emerging markets, played a key role in the US and Europe exchanges, with 49 IPOs raising around US$10.8 billion.

Nowadays, about 90% of the world’s companies list on domestic exchanges. Many local stock exchanges have already proven their ability to accommodate substantial offerings and enable local companies to tap large domestic capital pools. 2007 witnessed a huge rise in the number and value of companies listing outside the

### Perspectives on global IPO markets

Figure 1: Global IPO activity by year

![Figure 1: Global IPO activity by year](source: Dealogic, Thomson Financial, Ernst & Young)

bank loans are no longer enough to meet their capital needs, many fast-growing companies in the emerging markets are looking to the local equity markets.

Although the credit crunch triggered a slowdown in the US and Europe in the second half of 2007, many emerging markets, such as China and India, maintained their momentum. This led some analysts to conclude that the emerging market economies had become somewhat “decoupled” or independent from developed market economies, and therefore insulated against the effects of the credit squeeze. However, in the first quarter of 2008, the stock and IPO markets of BRIC countries have often declined in tandem with developed equity markets which suggests that the world’s capital markets remain highly integrated.

**Global investors shift assets towards emerging markets**

Global investors with an appetite for risk have been shifting assets to fast-growing emerging markets where higher returns can be achieved. “It’s a little easier to achieve the alpha or high growth that investors seek in the emerging markets, given their generally greater underlying economic strength,” says Jonathan Grussing, Managing Director and Head of Equity Corporate Finance, Credit Suisse in London. No longer just the province of specialists, emerging markets issues are also being sourced by mainstream global investors with an appetite for risk.

So many more emerging market companies are in a growth industry, or their industries are at an earlier growth stage compared with those in more developed markets. “Emerging market companies offer global investors an opportunity to invest, not just in the company, but in the country and its growth,” says Culhane. For instance, many investors have targeted Chinese
12 major exchanges that dominated listings in the past. Almost all of the global top 20 IPOs in 2007 listed on their own domestic exchanges, including such far-flung locales as Madrid, Dubai, Sao Paulo, Tokyo, Bogota, Frankfurt, Brussels, Dublin, Shanghai and Mumbai (see page 14). In contrast, a decade earlier these local stock markets weren’t considered viable listing locations and most large international companies would be compelled to list either in the US or London.

Rapid growth of emerging markets has led to the establishment of new world-class financial centers. With the adoption of international corporate governance standards and new trading technology, local stock markets continue to become better regulated, more liquid and transparent. Local exchanges are quickly catching up with the established top league exchanges in terms of know-how and infrastructure. For example, the Sao Paolo Stock Exchange (BOVESPA) revealed itself to be a global IPO player, with liquidity ample enough to accommodate the 64 Brazilian IPOs which listed on BOVESPA in 2007.

The world’s stock exchanges continue to consolidate

Whereas over 80 exchanges existed a decade ago, consolidation has diminished their numbers to 50 bourses worldwide today. In 2007-08, intense competition led major US exchanges to seek mergers with bourses in Europe, as the consolidation trend continues.

In 2007, NYSE merged with Paris-based Euronext for US$14.3 billion, creating the world’s first transatlantic stock exchange. “NYSE Euronext is the world’s largest and most liquid exchange group, with 4,000 listed issuers representing over US$29 trillion in market value,” says Culhane. Through the merger, the NYSE is linked with exchanges run by Euronext NV in Paris, Brussels, Amsterdam and Lisbon, as well as London’s Liffe derivatives market. This merger provides the NYSE Euronext greater geographic and production diversification. The exchange seeks to maintain its brand image as the “gold standard” in terms of both listing standards and the blue-chip companies it hosts.

In the first quarter of 2008, NASDAQ, the world’s first and largest electronic stock market, closed a US$4.4 billion merger with OMX, the Nordic stock market operator and state-of-the-art technology provider. In one stroke, NASDAQ doubled its size and created another transatlantic exchange which operates stock markets in eight countries within the Baltics, the Nordic countries and the US. The merger created the first exchange group to operate on 6 continents, 29 countries, and 4,000 listed issuers with an aggregate market capitalization of US$5.5 trillion. The merger also supports NASDAQ’s goal to gain greater efficiency as an electronic data network through expanded scale and scope. More mergers and acquisitions among exchanges can be anticipated as the world capital markets continue to globalize and grow even more interconnected.

Companies can choose from many alternative capital sources

These days, it’s easier to get ideas valued and financed. Companies have many more alternative capital sources from which to choose, including private equity (PE), venture capital (VC), hedge funds, private placements and sovereign wealth funds (SWFs).

“We’re seeing companies taking more time to decide on the best shareholder mix and investor base to support their business,” says John Jacobs, Executive Vice President, Worldwide Marketing and Financial Products, NASDAQ OMX. “Companies have a choice. We can’t generically talk about the flavor of the month for
sourcing companies seeking to go public. Compared with a decade earlier, VC-backed companies going public are more mature at the time of their IPOs. As venture capitalists exercise more patience about their exit strategy, the average deal size continues to grow. “The IPO market now wants companies that have revenues, cash flow and earnings, and if companies don’t yet have them, then they’ll wait until they do,” says Carnoy. She cites the US$130 million offering of Athenahealth, a US healthcare IT company, founded a decade ago as an example of a mature VC-backed IPO that went public in 2007. As a result of the greater maturity of the VC-backed companies, the quality has been much higher. “Venture capitalists are putting more money into these companies and are waiting longer, letting them build larger, more established businesses before going public,” says Cully Davis, Managing Director and Head of West Coast Equity Capital Markets at Credit Suisse in San Francisco.

“Dual track” deals help keep options open

Many businesses keep their options open by grooming for more than one funding source such as a trade sale, an IPO, private equity or other transaction. “Such IPOs are known as ‘dual track deals,’” says Carnoy. “They may be on file with the SEC, but they may also be sold or disposed of in an M&A deal, depending on where there is greater value.” Says Robin Weiss, Senior Vice President, Investment Banking Services, NYSE Euronext, “PE firms have extensive portfolios of companies in various stages of readiness for exits – whether via an IPO, strategic acquisition, or PE secondary offering.”

Indeed, most financial sponsors maintain a dual-tracking process, and keep both the IPO and M&A exit routes open. Although there might be another sponsor or a strategic player that wishes to buy the company, “in 9 out of 10 cases where there is true growth, an IPO will create higher value,” says Carnoy. An IPO remains the
Rule 144A placements have grown in popularity as they allow foreign companies to access US-qualified institutional buyers without the burdens and costs of US registration and Sarbanes-Oxley compliance. According to the Wall Street Journal in December 2007, 80% of foreign companies that raised US capital did so through a Rule 144A offering. Many large IPOs from the emerging markets include a Rule 144A tranche, along with local listing. For most companies, private placements are viewed as a stepping stone to the public markets. “Many companies that do a private placement are businesses that cannot go public yet, since the cost of capital is much higher in the private market than in the public markets,” says Laroia.

Another rapidly growing capital source from many emerging markets has been cash-rich SWFs, defined as assets held by governments in another country’s currency. The International Monetary Fund estimates that the assets of SWFs have swelled from about US$500 billion in 1990 to US$2.5 trillion today. “The use of SWFs will strengthen the equities market,” says Hannam. In 2007–08, SWFs have helped to ease equity market fall out from the credit crunch, by making numerous high-profile equity investments in large financial institutions. Some analysts anticipate SWFs will start to “effectively replace Wall Street” as they contribute capital to financial sponsors and pre-listed companies. “The ability to do pre-IPO fund-raising is much stronger now, as there are SWFs, hedge funds and even mutual funds, all with large amounts of money, willing to take bigger risks,” says Hannam. He notes that, three months before an IPO, these funds are providing capital and working closely together with pre-listed companies to ensure a successful listing. “In the future, pre-IPO financing will be seen as an integral step in the run-up to an IPO,” he says. Thus,
SWFs are also injecting sorely-needed liquidity into the tight credit environment of today’s global financial markets.

**In 2008, high-quality growth companies continue to go public**

Despite market volatility, there is still a healthy global pipeline of IPO-ready companies, especially from emerging markets. “Between 2004 and 2007, global IPOs have more than doubled the amount of funds raised,” says David Erickson, Head of Global Equity Capital Markets, Lehman Brothers in New York. Although such a growth rate would be difficult to sustain, “global IPO markets will continue to grow at about 20%, with a high percentage of that growth coming from the emerging countries,” says Erickson. “On a worldwide basis, I would expect IPO markets to continue to expand relative to global growth rates.”

In 2008, emerging market economies are expected to grow by 6% to 7% per year compared with approximately 2% to 3% for the developed world. Many developed economies are still reeling from the financial crisis. “However, global economic growth is still strong, driven primarily by booming economies in China and India,” says Laroia. “China and India will likely continue to account for 50% to 60% of the total capital raised in Asia, in the form of IPOs and follow-on financing.” He says, “There is a clear prioritization of where investors focus their energies and capital: it is China and India, due to the unambiguous growth.” At the same time, while so much global attention has been focused on the BRIC markets, the Middle East, Latin America and Africa hold great potential for IPO growth as well.

Although emerging market economies seemed less affected by developed market turmoil in 2007, “decoupling is a bit of an overplayed concept, and investors are moving away from this theme,” says Davis. The global slowdown of IPO activity in the first quarter of 2008, even among the BRIC countries, suggests that the world’s capital markets remain highly interconnected. A slowdown in the US and other developed nations could diminish emerging market momentum since many of their exports depend on western consumers. Rising inflation could also lessen BRIC country growth rates. Huge trade and investment inflows, rising commodity and energy prices are among the many factors that could increase the inflationary threat in BRIC countries.

Most global IPO analysts remain upbeat. “What makes me very positive for 2008 is the breadth of countries, regions and industries in the global IPO pipeline,” says Carnoy. “It reflects a very healthy economy both in the US and globally.” Indeed, the global IPO pipeline is filled with a broad array of companies, with those in technology, infrastructure, real estate, retail, commodities and financial services sectors forecast to be especially active.

The full fallout from the credit crunch and market volatility remains to be seen. However, with tighter credit conditions in 2008, more PE-backed IPO exits are likely, since IPOs may become an easier monetization route than buyouts. More carve-out IPOs are also anticipated as large corporations continue to streamline their businesses. As the first quarter of 2008 demonstrated, even in a volatile environment, quality companies with true growth and profitability will continue to tap the global capital public markets.

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**Gil Forer**, Global Director, IPO Initiatives, Strategic Growth Markets, Ernst & Young

**Jennifer Lee-Sims**, Global Associate Director, IPO Initiatives, Strategic Growth Markets, Ernst & Young
Global IPO activity will expand by about 20%

Ernst & Young: What have been the key trends in the global and US IPO landscapes in 2007 and 2008?

David Erickson: I’ll start with the US market backdrop, since that drives the IPO market. We expect the economy will slow in the first half of 2008. The Federal Reserve System (the Fed) will continue to ease interest rates, and financial institutions are recapitalizing in the first quarter, which should help re-energize the market somewhat. Large corporations will continue to benefit internationally from the weaker dollar helping to drive earnings. The US market is going to be relatively sluggish until the Fed eases interest rates and financial restructuring helps loosen up the credit environment. This should help the markets move in a more positive direction towards the end of 2008.

So, what does that mean for the IPO market? We expect the US markets to remain strong in 2008 for two reasons. Firstly, we will continue to see some large corporate strategic restructurings which are a significant part of the IPO market in 2007. Examples include EMC’s carve-out of VMware and MAN Group’s carve-out of MF Global. All of these factors will continue to be a driving force for the IPO market in 2008.

A second driver of continued strength in the US IPO market is the monetization of the leveraged buyout (LBO) since 2004. IPOs of recent LBOs will continue and may accelerate, especially if the leveraged credit markets don’t improve. We’re forecasting that the US IPO market will continue to remain strong and that the 2008 IPO market will probably be up by about 20% year-on-year, based on these two drivers.

From a global perspective, it’s interesting to note that in 2004 there were about $130 billion worth of IPOs on the global front. In 2007, there will probably be about $280 billion, so the amount of IPOs has more than doubled in three years. The US has been a minor participant in that growth. Most of the growth has come out of Europe, Middle East, and Africa (EMEA), largely Eastern Europe, and the Middle East, and to a significant degree Asia. These markets are going to continue to be strong, while some of the developed markets are going to remain challenging.

The big issue is to understand what stage we are at in the credit crisis, and how it’s going to impact the US economy. Since we have the US presidential elections in 2008, the regulatory environments and certain industries will be clearly impacted by which political party is in control in 2008. Despite all that, IPO activity will probably be up by 20% or more in the US.

Global IPO activity will continue to be significant and will probably continue relative to growth rates. The IPO global markets have more than doubled between 2004 and 2007. It would be difficult for that rate to continue, but it’s clearly going to continue at about 20% year-on-year. A higher percentage of that growth will be from the emerging market countries.

Ernst & Young: What’s the impact of the credit crunch and volatility in 2007 – 08?

David Erickson: First and foremost, the credit crunch clearly has impacted investors. Volatility has increased, because investors are not sure whether they want to buy or sell in these markets. Investors are seeking to benefit from a weakening dollar. In June and July of 2007, investors took money out of financial institutions and put it into the large corporate sector, where a high percentage of the sales revenue comes from outside the US (such as GE and Coca-Cola). Investors were also putting money into companies that don’t have a lot of credit exposure, such as technology companies.

Until we start to see some correction in the financial institutions, investors are going to stay away from the financial services sector. As more recapitalizations occur in the financial industry, we will see more investors looking to come back into the sector. In 1991 and 1992, when we had the last real estate crisis, the industry had to be re-capitalized. Back then, once the financial institutions were re-capitalized,
they became tremendous investments. The dynamics are similar now.

**Ernst & Young: What kind of fallout from the credit crunch do you anticipate that we have not yet seen?**

**David Erickson:** Could the housing crisis that’s impacted the US and large US institutions potentially have a ripple effect and affect the UK as well? We’ll have to wait and see, but that’s a possibility. Could it have the same ripple effect in some of the emerging markets? Probably to a lesser extent. In Japan, the real estate market continues to be strong, and funding for commercial real estate projects continues today.

The credit crunch is not just a US phenomena – it’s also impacting on global financial institutions. When you talk to investors in the financial markets, you find they continue to suffer from the credit crisis. The major owners of all of the investment banks, commercial banks and mortgage companies have been impacted. The appetite of these financial institutions to buy new products has lessened because of what they have experienced in the secondary market.

**Ernst & Young: What’s the role of emerging markets on the global IPO markets?**

**David Erickson:** The emerging markets are currently driving and will probably continue to drive the global IPO market for the foreseeable future. In 2007, about $280 billion of global IPOs were completed. Of that, about 40% (or $110 billion) is from EMEA, while Asia (excluding Japan) accounts for 25% and the US 20%.

While there’s been a lot of focus on some of the BRIC markets globally, what’s been interesting is how much IPO activity has come out of Eastern Europe, including Russia, and the Middle East and Africa. If you look at the top 10 IPOs in EMEA this year, are from Russia, 1 is from Kazakhstan and 1 is from United Arab Emirates. So that’s 4 out of 10. Two years ago, none of these countries would have been in the top 10.

**Ernst & Young: What’s the effect of higher levels of PE, M&A and VC activity on global IPO markets?**

**David Erickson:** Private equity is about 40% to 50% of the equity issuance market in the US and it’s becoming a bigger part of other markets. Private equity investors will look to continue to monetize some of the LBOs that they bought in 2004, 2005, 2006 and probably even 2007. The leveraged buyout (LBO) markets remain challenging, so the buying and leveraging of more assets will likely be constrained. Because of that, we expect to continue to see monetizations of the recent LBO “classes.”

Venture capitalists tend to follow trends very actively. For example, VC dominated sectors like telecommunications equipment and medical devices have performed well in the last 18 months in the US. Since it was pretty quiet in the previous two to four years for venture capitalists, there’s currently a significant amount of VC money being put to work in those sectors. As long as the venture capitalists invest in the technology, industrial, healthcare and consumer retail sectors, and those sectors continue to perform, I expect VC-backed companies will continue to come to the IPO market.
Emerging market companies offer an opportunity to invest in the country’s growth

Ernst & Young: What have been the key trends for the US IPO market and NYSE Euronext in 2007?

Noreen Culhane: The IPO market was quite strong in 2007. While there were some deals that were delayed or even withdrawn in the second half of the year, we still had an excellent listing year on all four of our platforms – the New York Stock Exchange (NYSE), NYSE Arca, Euronext and Alternext. Despite the high price of oil, the subprime loan issue and its effect on the credit derivatives market and general concerns about a weakening economy, the IPOs remained resilient throughout the year-end.

Technology was strong, as was the energy sector, but we had IPOs across other industries as well. Financial services offerings were prominent in the first half of the year, but weakened later for reasons just discussed. In 2007 as in 2006, private equity (PE) and venture capital (VC) firms were proficient users of IPOs in their exit strategies; over 50% of the proceeds raised on the NYSE were sponsor backed. In 2007, more proceeds were raised on NYSE Euronext than any other exchange group in the world.

Ernst & Young: What would a US economic slowdown mean for the IPO markets in 2008?

Robin Weiss: There is no doubt the economy slowed through 2007, impacting deal flow. Nevertheless, the core pipeline remained solid with some shifting of focus. Consistent with history, leading companies with strong franchises came to market – Virgin Mobile USA, Orbitz, VMware, Blackstone and MSCI, and on the international side, MS Global, Gafisa, E-House and Wuxi Pharma. Global market leaders with strong business models and management teams will continue to be well received by the market, even in the event of a modest downturn in 2008.

We went through a period several years ago when the IPO market was so heavily single industry (technology) focused that when the cycle ended, it was detrimental to the whole market, and the deal pipeline dissipated. Now, though sectors are more prominent at times, they do not dominate the market solely. There is greater diversification, which is a hallmark of our market.

In fact, if you look at the 2,700 companies that are listed on the NYSE, there is a very healthy balance across industry, size and geographies. This results in our ability to withstand the cycles that are inevitable in any market. All of this said, if there is a significant US economic slowdown, it will have ramifications for the global economy and it will result in a dissipation of the IPO pipeline.

Ernst & Young: Can you describe the type of cross-border IPO activity on the NYSE Euronext?

Noreen Culhane: In 2007, we had our strongest year since 1999 for international IPOs on the NYSE platform, with 42 new listings. Our offerings are coming largely from the emerging markets – for example, China, India, Brazil, Mexico and Chile. Those from Western Europe are industry specific, such as shipping and aircraft leasing. The overwhelming majority of these international IPOs (over 30) raised capital in the US. Proud of meeting the highest standards in the world and of differentiating themselves from hundreds of other companies which probably listed solely in their home markets, these companies were seeking global visibility.

By contrast, in the past, the majority of cross-border listings were large multinationals from developed markets – Western Europe being the most significant. They were quotations or listings not involving any capital raising. At the height, there would have been about 60 in a year.

Ernst & Young: What’s behind the surge in US IPO activity from the emerging markets?

Noreen Culhane: First, as these economies are growing so quickly, there is both a need and an opportunity for new entrepreneurial businesses. These businesses need capital to fund organic growth and a currency for acquisition.
US investors have a very big appetite for companies listing from the emerging markets, because they offer an opportunity to invest, not just in the company, but in growth of the country itself. This appetite, plus a broad US institutional investor base, creates an opportunity for deep liquidity, with 30% to 60% of the global trading in these companies occurring here on the NYSE. Just as important, the volume of trading in the home market also increases, so there is tremendous global liquidity, a key benefit for these companies and their home markets.

Ernst & Young: What has been the actual impact of the NYSE Euronext merger on pre-listed companies?

Noreen Culhane: NYSE’s merger with Euronext created the first transatlantic exchange group. Our European markets, Euronext and Alternext, are becoming increasingly international and we expect 2008 to be a year of growth in international listings there as well. From the listings perspective, the merger with Euronext increases our relevance to issuers. We enable them to raise capital in the US or in Europe on one of our four listing platforms. In doing so, we provide access to additional investor pools. We also better serve companies that have global employee bases and the need for acquisition currencies in indigenous markets.

For companies which are not raising capital, we have developed the opportunity to cross-list on Euronext through a “fast path” listing, which makes it easier and far less costly for companies to tap into the European investor pool.

In the much longer term, we are working very closely with the clearance and settlement entities here and abroad, to create the opportunity for full fungibility between and among the markets, to enable ordinary shares to be traded, cleared and settled easily in multiple markets. This would have the effect of fully opening up investor pools and increasing liquidity beyond home markets.

Ernst & Young: Have the recent reforms to Section 404 of Sarbanes-Oxley had much of an impact yet?

Noreen Culhane: The NYSE was very active in Washington with both regulators and legislators, advocating for a better balance between the costs and benefits of Sarbanes-Oxley, in particular Section 404. The costs of regulation and the potential for litigation are two of the reasons international companies have avoided the US capital markets, and some small US companies have remained private or sought listings overseas. Many international companies conducted a public offering in their home market and a private placement in the US, avoiding the need to register here.

The SEC and the Public Company Accounting Oversight Board (PCAOB) have taken steps to amend section 404 of Sarbanes-Oxley to reduce the cost without denigrating the benefits. Their guidance to the audit community calls for a more risk- and principles-based approach. We have yet to observe the true effect of such initiatives, as 2008 is the first year that the audit community will operate under the new language of section 404.

Ernst & Young: How will the credit crisis affect the monetization of PE firms’ investments?

Robin Weiss: The credit crisis impacts PE firms’ investment in companies more than it affects their exits. PE firms are still investing, but the financing structures are more conservative than they were during the height of the credit boom. Further, deal sizes have been more limited in scale; the era of the mega leveraged buyout is over for now.

PE firms have extensive portfolios of companies in various stages of readiness for exits — whether via a strategic acquisition by another company, a PE secondary offering, or via an IPO. Nevertheless, the likelihood is that we will continue to see sponsors providing a significant percentage of the IPOs coming to market — assuming valuations are reasonable.
markets. In addition to the home market listing, they raise capital privately in the US, to avoid the requirement to comply with our regulations and to limit exposure to litigation – specifically class action lawsuits. Domestically, speed to market may drive these offerings. If the US registration process is perceived to be too onerous and long, companies will typically opt for a private placement.

Globally, Rule 144A offerings have a big impact on the capital markets, as the amount of capital raised in private markets is significantly greater than that in public markets. Rule 144A offerings are not available to retail investors – only qualified institutions can participate. This restricts the investor pool and makes it difficult for the US retail investor to participate in some great offerings.

Ernst & Young: What’s behind the recent resurgence in VC-backed IPOs in the US?

Robin Weiss: The resurgence in VC-backed IPOs is driven by both supply and demand. On the supply side, there has been maturation in the portfolios of these firms. Because of the burst in the technology bubble in 2001, these companies have not had a mechanism for liquefying themselves until 2007. Many of these portfolios had matured to the point at which companies were sizeable and well established enough to come to market. Valuations in 2007 were attractive and thus VC firms sought to access the window of opportunity. This supply matched well with demand, as more discriminating investors sought more substantial, seasoned technology IPOs.

Ernst & Young: What’s behind the growth of the private placement market and Rule 144A offerings?

Noreen Culhane: The Rule 144A market has been steadily building over time, and not just in the last year or two. We have seen the number and the dollar value of Rule 144A private placements increasing year-on-year since the late 1990s, driven by several factors.

A key driver is the maturation and development of home markets around the world, where companies can now raise significant amounts of money without necessarily tapping the US public capital markets. In addition to the home market listing, they raise capital privately in the US, to avoid the requirement to comply with our regulations and to limit exposure to litigation – specifically class action lawsuits. Domestically, speed to market may drive these offerings. If the US registration process is perceived to be too onerous and long, companies will typically opt for a private placement.

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We also know that when companies are listed in their home market and in the US capital markets, they enjoy a valuation premium. US investors are increasingly looking to diversify their portfolios and to invest in products outside the US. In 2007, they had over US$3 trillion invested internationally – over 25% of their portfolios. So making it more difficult for retail investors to get access to these investment opportunities is neither good for them, nor the wider markets.
### Top 20 largest IPOs

#### Top 20 IPOs by capital raised, 2007

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Issue Date</th>
<th>Issuer Name</th>
<th>Domicile Nation</th>
<th>Industry Description</th>
<th>Proceeds (US$m)</th>
<th>Primary Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>8/5/07</td>
<td>VTB Bank</td>
<td>Russian Fed</td>
<td>Financials</td>
<td>7,989</td>
<td>London; Moscow</td>
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<td>11/12/07</td>
<td>Iberdrola Renovables</td>
<td>Spain</td>
<td>Energy and power</td>
<td>6,561</td>
<td>Madrid</td>
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<td>3</td>
<td>19/4/07</td>
<td>China CITIC Bank Corporation</td>
<td>China</td>
<td>Financials</td>
<td>5,942</td>
<td>Hong Kong; Shanghai</td>
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<td>Industrials</td>
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<td>21/11/07</td>
<td>Dubai Ports World</td>
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<td>Dubai</td>
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<td>NYSE</td>
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<td>Financials</td>
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<td>Materials</td>
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<td>Dublin; London</td>
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<td>India</td>
<td>Industrials</td>
<td>1,933</td>
<td>Bombay; National</td>
</tr>
</tbody>
</table>

*Source: Dealogic, Thomson Research, Ernst & Young*

- In 2007, the top 20 IPOs raised about US$73 billion, representing 25% of the total capital raised by IPOs.
- Membership in the top 20 IPOs club required a minimum of US$1.9 billion in capital raised.
- In keeping with the historical norm of companies listing at home, 17 of the top 20 IPOs went public on domestic exchanges, (except for one Russian IPO that listed on both LSE and Moscow exchanges, one Kazakh IPO that listed on LSE and one Bermuda deal that listed on NYSE).
### Top 10 IPOs by capital raised, January – March 2008

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Issue Date</th>
<th>Issuer Name</th>
<th>Domicile Nation</th>
<th>Industry Description</th>
<th>Proceeds (US$m)</th>
<th>Primary Exchange</th>
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<tbody>
<tr>
<td>1</td>
<td>18/3/08</td>
<td>Visa Inc</td>
<td>United States</td>
<td>Financials</td>
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<td>NYSE</td>
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<td>Industrials</td>
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<td>3</td>
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<td>Telecommunications</td>
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<td>5</td>
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<td>Rabigh Refining &amp; Petrochemical Company</td>
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<td>Materials</td>
<td>1228</td>
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<td>Want Want China Holdings</td>
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<td>Consumer staples</td>
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<td>10</td>
<td>7/3/08</td>
<td>Honghua Group Ltd</td>
<td>China</td>
<td>Energy and power</td>
<td>409</td>
<td>Hong Kong</td>
</tr>
</tbody>
</table>

Source: Dealogic, Thomson Research, Ernst & Young

### Top 20 IPOs by number of deals, 2007

- **Region**
  - Asia-Pacific: 35%
  - Europe, Middle East and Africa: 35%
  - North America: 5%
  - Central and South America: 25%

- **Exchange**
  - Tokyo: 5%
  - Shanghai: 20%
  - Madrid: 5%
  - Hong Kong: 5%
  - Deutsche Borse: 5%
  - Dublin: 5%
  - Dubai: 5%
  - Brussels: 5%
  - Bombay: 5%
  - Bogota: 5%
  - NYSE: 10%
  - Sao Paulo: 15%
  - London: 10%

Source: Dealogic, Thomson Research, Ernst & Young
The rise of emerging markets

BRIC IPO activity, 2007

Brazil

Total deals: 64 (US$27b)
Cross-border listings:
- NYSE, dual listings: 1 deal (US$1b)
- Luxembourg, dual listings: 3 deals (US$1b)
- AIM: 1 deal (US$76m)
- Other exchange: 1 deal (US$3m)

Source: Dealogic, Thomson Research, Ernst & Young
Total funds raised by BRIC IPOs, US$b

Greater China
Total deals: 259 (US$66b)
Cross-border listings:
- AIM: 11 deals (US$1.1b)
- NASDAQ/NYSE: 29 deals (US$6.8b)
- Singapore: 28 deals (US$1.8b)
- Other exchanges: 10 deals (US$303m)

Russia
Total deals: 20 (US$19b)
Cross-border listings:
- AIM/London, dual listings: 11 deals (US$16b)
- AIM/London, cross-border: 4 deals (US$2b)
- Other exchange: 1 deal (US$258m)

India
Total deals: 106 (US$9b)
Cross-border listings:
- AIM: 3 deals (US$390m)
- NYSE: 1 deal (US$968m)

Singapore

Total percentage of funds raised by BRIC IPOs

Russia
India
China
Brazil

2002 2003 2004 2005 2006 2007

$9 $13 $17 $29 $86 $119

Percentage of the total global market


14% 24% 14% 17% 35% 41%
The US: financial, technology and foreign issuers invigorate IPOs

Despite the swelling subprime crisis and weakening economy, 2007 was one of the strongest US IPO markets in recent years. Companies in the financial, technology and energy sectors, Chinese firms and corporate carve-outs were key drivers of US IPO markets. In the second half of the year, the credit crunch slowed down the IPO momentum, especially in the financial services sector. Even so, the fourth quarter of the year maintained its traditional position as the busiest quarter for IPOs.

In 2007, the US stock exchanges generated US$34 billion with 172 deals (see figure 8, page 21). Reflecting a rise in mid-sized listings, the average IPO deal size on US exchanges was US$227 million. The top three industries in the US IPO markets by funds raised were financial services (US$12.2 billion), technology (US$9.5 billion) and energy (US$6.6 billion). Financial institutions were the most dominant issuers in 2007. The financial sector raised 25% of the funds raised by IPOs on US exchanges including the two largest US IPOs of 2007; the US$4.1 billion offering of US alternative assets manager, the Blackstone Group, and the US$2.9 billion issuance of MF Global, a Bermuda-based brokerage.

In the first quarter of 2008, the credit crunch made it a more challenging environment for going public. In the US, 12 US-based IPOs raised a total of US$20.8 billion largely due to the milestone offering of Visa Inc., the world’s largest credit card network. The largest IPO in US history, Visa raised US$17.9 billion, far eclipsing the previous US IPO record-holder, AT&T Wireless Group’s US$10.6 billion offering in 2000. The Visa IPO suggests that whatever the market conditions, ample liquidity will be available for such well-established and high-profile companies. However, most US companies have adopted a “wait-and-see” approach to the public markets, seeking greater clarity about the direction of interest rates, the stock market and the economy.

US IPO markets remain resilient in the face of subprime turmoil

The US liquidity crunch started in the second quarter of 2007 when the Dow Jones Industrial Average and the Standard & Poor 500 index were at record highs. Although subprime jitters slowed IPO momentum, a third quarter interest rate cut put the markets back on track towards record issuance levels in the fourth quarter. “There is a kind of self-selection, a quality screen, and the companies that have gone on to file have actually been very strong,” says Lisa Carnoy, Managing Director and Co-Head of Equity Capital Markets, Merrill Lynch in New York.

The financial and industrial sectors were most affected by tighter credit since “they often require both debt and equity financing in order to grow, to refinance existing debt or to pursue strategic acquisitions,” says Cully Davis, Managing Director and Head of West Coast Equity Capital Markets, Credit Suisse in San Francisco. “US investors are more discriminating, with a distinct preference for companies with compelling track records, sound financial numbers, and management, in conjunction with solid business

Key trends

- Growth companies in finance, technology and energy invigorated US IPO markets in 2007
- Chinese firms seeking US capital, exit-seeking PE firms and corporate carve-outs were also key US IPO drivers
- US exchanges raised the second highest amount of global IPO capital and merged with European exchanges
- PE and VC firms backed more than 60% of the US-domiciled IPOs
- The Rule 144A offering continue to be as robust a source for raising capital as the US public markets
- In the first quarter of 2008, Visa launched its US$18 billion IPO, the largest in US history, suggesting that the market is always ripe for such well-established companies
Most US companies have adopted a “wait-and-see” approach to the public markets

models, sales growth and profitability," says Maria Pinelli, Americas Strategic Growth Markets Leader, Ernst & Young US.

Growth stories prevail, especially in technology and energy
Despite the volatility, growth stories flourished, in particular technology and energy IPOs. Other sectors less dependent on debt financing, such as business services, retail and media, also withstood the volatility better than most. “Typically, such companies are cash-flow positive. They generate enough cash to sustain their growth and don’t rely on access to the debt markets to finance any future growth,” says Davis.

Technology IPOs raised the second highest amount of capital (US$9.5 billion). The year’s largest US technology IPO and Silicon Valley’s high point was the US$1.1 billion listing of US software maker, VMware. Energy company offerings were also highly coveted by investors. Venture capital (VC) firms invested US$2.6 billion into cleantech companies, especially in the energy generation and energy efficiency areas. Chinese solar cell companies listed in the US including JA Solar and Yingli Green Energy and raised ample capital on NASDAQ.

US exchanges continue to attract foreign issuers
Representing about 30% of total IPO proceeds raised in US exchanges, 53 foreign issuers, primarily from China (31 issuers) and Israel (5), listed on US exchanges. As the leading foreign issuer in the US, Chinese companies listing in the US quadrupled in number since 2006. Thirty-one IPOs of companies based in China raised US$6.8 billion or about 14% of capital raised through IPOs on US exchanges. “The US markets have maintained very aggressive views on valuation for many of these Chinese technology companies,” said Davis. “As long as the US markets maintain this valuation arbitrage, there will be interest by Chinese companies to list in the US.” Chinese listings in the US represented a wide variety of sectors, including technology, media and entertainment and healthcare. “Most Chinese IPOs sold at the top or above their expected price range,” says Carnoy. “Out of the top 20 US IPOs last year based on aftermarket performance, 6 were Chinese companies.”

US exchanges maintain their competitive edge through mergers
In 2007, the US exchanges together raised US$48.2 billion, second only to the US$54 billion raised on the Hong Kong Stock Exchange (HKEx) and mainland Chinese exchanges. In 2007, in the global competition to attract IPOs, the New York Stock Exchange (NYSE) secured the third highest amount of funds raised, behind the HKEx and slightly less than the London Stock Exchange in 2007.

In an effort to extend their global reach, in 2007 and 2008, the two major US stock exchanges combined with European partners. In 2007, the NYSE US$25 billion merger with Euronext, based in Paris, created the world’s first intercontinental stock exchange, with a combined value of listed companies over US$29 trillion. In the first quarter of 2008, NASDAQ closed its US$4.4 billion merger with OMX, the Nordic stock exchange and leading technology provider with a combined value of listed companies of US$5.5 trillion.

“Notwithstanding the number of markets that are doing their deals locally, the US is here to stay as one of the world’s leading capital market centers,” says Carnoy. “We are still going to see many of the leading global firms choose to list in the US because they’ll get the best valuation, the best investors, the biggest profile and that’s where businesses want to file.”

VC and PE players back more than 60% of US-based IPOs*
Alternative capital providers continued to play a key role in the US economy in 2007. “If you look at the largest 20 US-registered IPOs in 2007, seven were from private equity (PE) exits, five were corporate carve-outs, three were financial sponsor IPOs and the remainder were true private companies,” says Carnoy. PE and VC firms sponsored more than 60% of all US-domiciled IPOs in 2007.

* Fourteen percent of US IPOs were both VC- and PE-backed, with VCs providing earlier-stage capital, and PE firms coming in at later stages.
Taking a dual-track approach expands a company’s strategic options, improves negotiating leverage and reduces execution risk

In 2007, the 74 VC-backed IPOs, made up 44% of the total number of offerings by US-based companies. What’s behind the recent surge in IPOs backed by VCs? “Since the technology bubble burst in 2001, these VC-backed companies haven’t had the full array of exit options,” says Noreen Culhane, Executive Vice President, Global Corporate Client Group, NYSE Euronext. “Many of these portfolios have now matured to the point where the companies are sizeable, well established and capable of coming to the public market.” In the US, the largest VC-backed IPO was the US$1.1 billion listing of VMware on the NYSE.

For the past two years, PE firms have been busily buying up potentially public companies, adding shareholder value, and then seeking an exit either by means of a trade sale or an IPO. In 2007, 55 PE-backed IPOs made up 33% of US-based public offerings. With the evaporation of cheap credit, “the ‘era of the mega LBO’ has drawn to a close,” says Robin Weiss, Senior Vice President, Investment Banking Services, NYSE Euronext. “However, the IPO market will remain a key exit route for the portfolio companies of PE players.” The US’s largest PE-backed IPO was the US$1.3 billion offering of Metro PCS Communications, a wireless communications company.

Dual tracking of the M&A and IPO markets continued to be common practice among many of the IPO-bound companies. “For a pre-listed company, taking a dual-track or multi-track approach (which can include an IPO, a PE offering, a strategic sale or another transaction) expands a company’s strategic options, improves negotiating leverage and reduces execution risk,” says Jackie Brya, Americas IPO Leader, Strategic Growth Markets, Ernst & Young US.

Corporate restructuring leads to numerous carve-out IPOs
In 2007, the US saw numerous IPOs of public companies created through a corporate restructuring or a carve-out. A carve-out IPO is created when a large diversified public corporation divests a division that becomes an independent company. For instance, VMware was a carve-out from its parent company, the information infrastructure solutions firm EMC. “That’s the type of carve-out we’ll see more of, where a very large company, has a division that’s faster growing or significantly different from a benchmarking or comparable point of view,” says Carnoy. Another notable US carve-out in 2007 was the IPO of brokerage firm MF Global carved out from its parent company, the alternative investments provider, the Man Group.

Rule 144A offerings remain a robust alternative capital source
Many companies use the Rule 144A offering as another stage to the funding cycle, a way to tap the institutional market before transitioning to the retail market. Rule 144A was implemented to induce foreign companies to sell securities in US capital markets. Companies using a Rule 144A private placement can only sell shares to qualified institutional buyers with over US$100 million of investable assets. “In 2007, more capital continues to be raised in the US through Rule 144A offerings than through IPOs on all major US stock exchanges combined,” says John Jacobs, Executive Vice President, Worldwide Marketing and Financial Products, NASDAQ OMX Group.

“In 2007, companies that used a Rule 144A tranche as part of their global offering raised US$224 billion, while all IPOs and secondary offerings on the major US exchanges raised US$208 billion,” says Jacobs. “Although Rule 144A offerings and IPO listings on stock exchanges are not strictly comparable, they are pretty close. The Rule 144A market has become as robust as the public markets in the US for capital formation.”

In 2008, many mid-sized companies wait in the IPO pipeline
The outlook in 2008 for US IPOs appears to be highly sector- and company-specific. Companies with exposure to the credit markets, the housing cycle or consumer discretionary spending are staying out of the IPO markets. Furthermore, “the aggressive nature of PE and hedge fund managers and all others involved in the capital markets will be moderated, as they assess the market,” says Davis.
Nonetheless, most analysts remain optimistic about US IPO prospects. “The second half of 2008 is going to mirror 2007—it will be extremely robust,” says Carnoy. Key drivers of the US IPO markets will continue to be the carve-outs from large cap companies and monetizations of the leveraged buyouts. “The 2008 IPO market will probably be up by 20% based on these two trends,” says Erickson. 2008 will also continue to be a strong IPO market for high-quality growth companies in the technology, energy and healthcare sectors, many of which currently await in registration. Indeed, the US IPO pipeline is filled with some very high-quality sizeable private companies. Says Brya, “The strength of the Visa IPO and its strong aftermarket performance has paved the way for many mid-market companies in the pipeline to go public in 2008.”

Jackie Brya, Americas IPO Leader, Strategic Growth Markets, Ernst & Young US

Maria Pinelli, Americas Strategic Growth Markets Leader, Ernst & Young US

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**Figure 8: US IPO activity by year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital raised (US$b)</th>
<th>Number of deals</th>
</tr>
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</tr>
<tr>
<td>2007</td>
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<td>172</td>
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Source: Dealogic, Thomson Research, Ernst & Young

**Figure 9: North, Central and South American IPO activity, by year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital raised (US$b)</th>
<th>Number of deals</th>
</tr>
</thead>
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</tr>
<tr>
<td>2007</td>
<td>$77</td>
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</tbody>
</table>

Source: Dealogic, Thomson Research, Ernst & Young
Lisa Carnoy
Managing Director
Co-Head of
Capital Markets Americas
Merrill Lynch
New York

Ernst & Young interview

Growth still works

Ernst & Young: What’s your perspective on the key trends in the US IPO markets?

Lisa Carnoy: There were several themes in 2007:

1) Growth still works.

2) US IPO listings reflected an increasingly global economy with listings of China-based companies particularly prevalent.

3) IPOs for private equity firms and hedge funds were among the largest and most volatile IPOs in the US in 2007.

4) IPO sources were balanced between monetizations from sponsors/VC firms, private companies and corporate carve-outs.

A new trend in 2007 was the IPOs of financial sponsors or hedge funds. Three of the largest US deals were the IPOs of Blackstone, Och-Ziff and Fortress. The financial services sector overall accounted for nearly 30% of issuance last year. With the US$19.6 billion Visa IPO, the financial services sector should be big in 2008 as well.

IPOs still had a lot of success, particularly in technology and other growth sectors. Companies that showed visible, predictable and very consistent growth were particularly well received in the market. The majority of the best-performing deals were in the technology sector. There were also good deals in the retail, healthcare, media, education and real estate sectors, and in the new sector of alternative energy.

There was a lot of activity from China, including many of the best deals across the technology, alternative energy, real estate and media sectors. Six of the 20 largest US deals were actually Chinese deals that listed in the US.

Ernst & Young: What’s behind this sudden influx of Chinese companies coming to the US markets?

Lisa Carnoy: Many Chinese issuers share a view that the US IPO market provides better valuations and a higher-quality, deeper pool of investors. The US is a great market to enter, if you want to benchmark against the very best companies in your sector, if you want to do a small or large deal and have access to some of the sector-specific funds.

We have also seen a transition from basic infrastructure deals in China to more consumer-oriented companies in sectors including retail, healthcare, entertainment, and education. The entrepreneurs behind many of these companies are willing to go overseas for a US listing to position their company as a major global player.

The branding and status associated with a US listing remains a key factor, particularly for consumer-oriented companies.

Interestingly, for smaller cap stories, we have actually seen greater investor focus and perhaps higher valuations from US-based global investors. So the bigger deals may stay local where they are assured to get a captive audience, while small caps with a global story will continue to come to the US and the deepest pool of investors.

Ernst & Young: In general, how was the share price performance of US IPOs in 2007?

Lisa Carnoy: The S&P 500 was up 3.7% in 2007, while the average US IPO was up by 12% to 13% after a month. So, participating in IPOs is a source both of outperformance relative to the broader market, as well as good absolute performance. In other words, if you told most investors at the beginning of any year that they could have a 12% return, they’d say, “That’s great, where do I sign up?” So that’s one reason why investors continue to look at IPOs.

We analyzed the top 20 US IPOs in 2007 based on aftermarket performance, and 6 of them were Chinese companies. On average, the top 20 were up by over 100%. So we had some extremely successful deals in 2007, including VMware, Lululemon and Dolan Media. If you bought a portfolio of those companies you would have done very well indeed. And even if you bought all 221 or so US-listed IPOs in 2007, you still got...
returns that were four times higher than the S&P 500 return.

**Ernst & Young: What are the most common sources for IPOs?**

**Lisa Carnoy:** Of the top 40 global IPOs, only three were from the US. That is a staggering statistic. Nearly half of the deals – 17 – were from the BRIC countries with China leading at 9. Fortunately for us, Merrill Lynch was a book runner on all three of the jumbo US IPOs on the list: Blackstone was an IPO of the leading private equity firm; MF Global was a carve-out of a brokerage/exchange business from Man Group; MetroPCS was a financial sponsor-backed deal in the wireless telecommunications sector. So it’s interesting that there were three deals from three sources.

If you look at the largest 20 US-registered IPOs in 2007, 7 were from private equity, 5 were corporate carve-outs, 3 were financial sponsor IPOs and the remainder were true private companies.

In 2008, although we won’t see much activity in permanent capital deals, there’ll be sponsor deals, as private equity firms have monetized investments made over the last two or three years. There’ll still be some good carve-outs and we’ll find more quality private companies that haven’t yet come to market.

Sometimes it surprises me that, in such a long bull market, there are still quality companies that haven’t tapped the public markets. We are working on a handful of extremely large, high-quality private company mandates that people might assume had already publicly listed, due to their size and quality. Most of these companies are profitable and have sufficient cash flow to fund operations and growth. They may pursue an IPO for additional capital for growth, to have shares for acquisition currency, to repay some debt, to have shares for compensation to employees and also for the branding event around the IPO process.

**Ernst & Young: Could you elaborate on the major IPOs that arose from corporate restructuring, i.e., carve-outs?**

**Lisa Carnoy:** VMware was a carve-out of EMC. It was one of the most successful deals of the year in terms of aftermarket performance – up nearly 200%, and one of the top five performing IPOs. That’s the type of carve-out we’ll see more of, where a very large company has a division that’s significantly faster growing or different from a benchmarking point of view. There’s the potential for real financial arbitrage in a carve-out. There’s a benefit in terms of highlighting that business and allowing the management team to have its own profile and its own independence as a separate public company.

Another example of a carve-out IPO was Genpact in the business process outsourcing area, carved out of General Electric (GE). GE has done a number of carve-outs over recent years, such as with Genworth (Insurance) and Genesis (Aircraft Leasing). To offer another potential example, the pharmaceutical industry has some big problems and is not enjoying robust growth overall. But within very large pharmaceutical companies, there are some very fast-growing, exciting businesses that could bring value in a carve-out.

**Ernst & Young: What’s been the impact of the credit crisis on equity markets?**

**Lisa Carnoy:** Clearly these credit issues have now impacted the equity markets. While many mutual fund managers view the equity markets as undervalued, they are more focused on what the credit markets are telling us about corporate balance sheets and the overall strength of various businesses. And investors have a lower risk tolerance – they want more mature companies with highly predictable business models.

More than 20 IPOs have already been pulled in 2008, primarily from smaller, early-stage companies without current revenues or cash flow/earnings. And companies that have exposure to the credit markets, the housing cycle or consumer discretionary spending won’t have access at all. It’s companies that have true growth, a high degree of visibility and
Global IPO trends report 2008

Lisa Carnoy

We’ll continue to see financial sponsors behind at least a third of deals, and we’ll continue to see some Special Purpose Acquisition Corporation (SPAC) or “blank check” companies activity. At some point, the SPAC market will become a very small part of what we do, but for 2008 it will remain a significant part of issuance.

I do think investors want ever more international exposure, so whether it’s a US-based international company like General Electric that has exposure to other markets, or it’s taking stakes in international companies, we’re now competing with investor dollars for opportunities across the globe.

Sectors that are currently strong are in the consumer area, providing things that you need every day, whether you’re in a recession or not. Healthcare, education, energy, power and certain mining companies have been doing very well, but they can be very company-specific.

And finally, if investors see themselves lagging the broader equity market and have cash on the sidelines, they will come back into IPOs in a big way. The new issue market serves as a great tool for investors seeking outperformance. Get ready for a big second half...

Ernst & Young: How much will PE-backed IPO activity slow down in 2008?

Lisa Carnoy: PE-backed IPOs were 40% of issuance in 2006, remained at that level in 2007, and it’s too early to tell for 2008. I think it will still be at least a third of activity. The effect of the slowdown from the second half of 2007 won’t hit us in the first half of 2008. It will hit us maybe in two or three years, but it would be very early to take all the acquisitions public from 2007 or even 2006. The quickest turnaround would typically be one year.

Ernst & Young: Why is VC activity finally coming back now?

Lisa Carnoy: The IPO market now wants companies that have revenues, cash flow and earnings, and if companies don’t yet have revenues, then they’ll wait until they do. So companies that are becoming public are more mature at the time of their IPOs than certainly would have been the case, in the late 1990s. And the VCs are waiting to have bigger companies and bigger IPOs before going through the effort and expense of the IPO process. The typical IPO size is $100 million+ vs. US$40 million to US$50 million a decade ago. And the quality of the companies that are coming to market is much higher.

VCs are looking at maximizing their returns and positioning the company for the greatest long-term success. VCs are going to be fairly agnostic and evaluate options including an IPO, a sale or a dual-track process. Even where a VC thinks a company might be a great IPO, they may go down the dual track process. The VC might find there’s another sponsor or a strategic player that wants to buy the company, or the VC may find that the IPO is the right route. In nine out of ten cases where there is strong and sustainable growth, an IPO will create higher value.

Ernst & Young: What is your 2008 outlook for IPOs?

Lisa Carnoy: I think that the second half of 2008 is going to mirror 2007 – it will be extremely robust – it may not match what we saw for the full year in 2007, but we will be very busy in the second half of the year. We will also continue to see very broad sector representation, although financial services will be down dramatically because there are certain areas of the sector that simply can’t tap the equity markets now, or where it wouldn’t be appropriate given credit, subprime or valuation concerns.

We’ll continue to see financial sponsors behind at least a third of deals, and we’ll continue to see some Special Purpose Acquisition Corporation (SPAC) or “blank check” companies activity. At some point, the SPAC market will become a very small part of what we do, but for 2008 it will remain a significant part of issuance.

The healthcare, data analytics, financial processing, education and energy sectors are all tremendous growth opportunities and/or counter cyclical, and we think these sectors will be active in 2008.
The credit crisis had a sector-specific impact on IPOs

Ernst & Young: What were the key trends in the 2007 US IPO markets and your outlook for 2008?

Cully Davis: US IPO activity was very strong during the first half of 2007, but has since slowed down. As 2007 drew to a close and 2008 has begun, we have seen a marked increase in US equity market volatility, which has caused portfolio managers to become very defensive.

With the credit crisis in the US, the aggressive nature of PE and hedge fund managers, and all others involved in the capital markets, will be moderated. Everyone is stepping back to try to make sense of how the Fed’s actions, the interest rate environment and the looming fear of a recession will affect US markets.

Whenever we see fear or confusion in the equity markets, we inevitably see weakness in IPO activity. US IPOs will probably be of secondary interest compared with the focus on the speed with which confidence can be restored and new investments can be rewarded.

Once we are back on track, we will likely see continued interest in SPACs, PE exits, and even large carve-outs, IPOs from large cap companies that choose to streamline their respective businesses.

The investment community feels generally positive about the market opportunities in 2008. There are concerns about slowing economic growth in the US and the effects that will have on businesses, growth rates, profit targets and capital expenditure spending. But investors are paid to put dollars to work, and there are plenty of good investment opportunities available right now.

Ernst & Young: What’s been the impact of the credit crisis on US IPOs?

Cully Davis: The credit crisis has definitely had an impact on US IPOs, but the severity of the impact is sector-specific. Certain sectors, such as financial services and industrial services, have been hit quite hard, since they often require debt financing in addition to equity financing to grow, to refinance existing debt or to pursue strategic acquisitions. Sub-sectors such as home building have struggled in the current economic environment and have noticeably sold off as a result. Companies in these sectors will continue to have difficulty, whether in the IPO market or in follow-on financing, until the economic climate improves.

Other sectors, such as technology and business services, have fared better, since they are less dependent upon debt financing or economic cycles, and are therefore more immune to credit issues. Such companies are typically cash-flow positive. They generate enough cash to sustain their growth and don’t usually rely on access to the debt markets to finance any future growth. We are seeing many equity investors increasing their holdings in these sectors until there is greater clarity about the direction of interest rates and the general economic climate. It is my belief that IPOs for strong companies in these sectors will continue to find an audience in 2008, despite the negative headlines surrounding the US’s credit problems.

Ernst & Young: What do you make of the recent surge in listings of Chinese companies?

Cully Davis: The US markets have maintained very aggressive views on valuation for many of these technology companies, so that valuation arbitrage will always prove attractive. Chinese IPOs also continue to do reasonably well in the US, generally outperforming the broader markets, so I think that will help sustain the interest Chinese companies have in the technology sector.

However, there is currently less promotion in China regarding the advantages of a US listing than there was one or two years ago. The HKEx has grown in popularity, and regulations in China in particular have sometimes made it more challenging to pursue capital outside its borders. I think the demand from Chinese companies to list in the US has moderated or abated, rather than increased dramatically.

Ernst & Young: What are technology investors in the US focusing on?
Once we are back on track, we will likely see continued interest in SPACs, PE exits and even large carve-outs from large companies.

**Cully Davis:** Technology investors have been very focused on three things: growth, market opportunity and disruptive technologies. Growth has always been a hallmark of most good technology stocks and, in tough markets, a technology investor will be attracted to any new investment opportunity that offers higher growth relative to the S&P 500.

We have seen heightened interest in stories that are attacking large and/or multiple market opportunities coupled with attractive growth. Investors clearly are seeking comfort in a company that can continue to grow and compete effectively in new markets, long after successfully cultivating its initial market opportunity.

**Ernst & Young:** In 2007, about a third of all US-domiciled IPOs were venture-backed. Do you see that trend continuing to grow?

**Cully Davis:** The VC community has always been, and will continue to be, important. As we have seen in the PE and financial sponsor world, venture capitalists have raised a great deal of capital over the last few years. They have been aggressively seeking ways to put that money to work, even as the public markets have weakened a bit. The access to capital that VC firms provide is critical to the health of the next generation of IPO candidates, so we all benefit from strong VC activity.

One approach that has changed over the past decade is that VCs appear more disciplined about the speed with which they push their portfolio companies to go public. They recognize there’s a real cost in going public too quickly, with the reality of Sarbanes-Oxley and the risks associated with disappointing investors by missing quarterly expectations. Many believe that returns can be greater if they wait another six months or a year to confirm that a company is prepared to forecast its earnings and afford all the extra Sarbanes-Oxley costs associated with going public.

I have also seen VC funds become more willing to accept higher valuations than they might have otherwise accepted 5 or 10 years ago. So the return thresholds have probably come down a bit over the last couple of years as the market has been more competitive and more dollars have become available.

**Ernst & Young:** Why are VC funds seeking more established later-stage companies, and waiting longer before taking them public?

**Cully Davis:** VC funds are getting large and, as a result, are investing in more established companies. They have more capital to put to work, so they have to take larger positions in their portfolio companies. By definition, you often have to look at more mature companies to be able to put more dollars to work.

The number of VC-backed IPOs may grow simply because a lot of the companies they invest in, especially in the technology sector, are a bit larger or more mature than they might have been 5 or 10 years ago. These companies can typically go public in almost any market environment, instead of waiting for attractive windows where earlier-stage companies may be able to sneak into the public market arena.

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**Cully Davis:** It’s inevitable that the pace of PE deals will slow in the face of the current credit crisis, because so much of the PE activity is driven by access to cheap financing. There is a huge backlog of PE deals and financial sponsor buyout deals that have yet to be financed. For financial sponsors, the debt financing terms are now much less attractive. I don’t believe we will see any return to the PE boom we saw 12 months ago, until we see a significant improvement in financing terms and a meaningful reduction in the backlog.

My view is that some PE firms may decide to wait for a better equity market before considering an IPO in the short term. The PE firms that are willing to delay their exit plans, let the companies grow and continue to invest significantly, will be
rewarded with stronger companies that will be even better received in the public markets. Obviously, M&A opportunities often become more viable and attractive exits when the equity markets struggle, so I believe we will likely see more merger activity over the next few quarters.

**Ernst & Young: Do you expect M&A activity to slow down and what does that mean for IPOs?**

**Cully Davis:** The M&A market will be slower, but still quite active. In the US we are coming out of a quite remarkable 12 to 18 month run for M&A activity, and it may be hard to keep up that pace over the next 12 to 18 months. As I mentioned earlier, VC exits are more focused on M&A, so I believe merger activity will continue at a steady rate.

IPO activity will be influenced by M&A as long as the M&A option provides a more attractive (i.e., valuable and immediately liquid) alternative to the public markets. We have often seen merger interest and prices paid affected by the level of credibility of the IPO alternative.

A weaker IPO market may heighten the attractiveness of mergers versus IPOs. Recent private company merger announcements such as the open source database company MySQL being pursued by Sun, and the communications storage company Equalogic being pursued by Dell Computer, demonstrate the prevalence of mergers. As long as strategic suitors continue to offer private companies a more attractive and immediate exit, I think we will see more IPO candidates taken off the market before they even begin their road show.

**Ernst & Young: How do you advise your clients on the relative merits of doing a private placement versus going public?**

**Cully Davis:** The advantages are pretty clear. Being able to get to market quicker than through the normal Securities and Exchange Commission (SEC) review process is a huge advantage to the private offerings. There’s no doubt that the Rule 144A market provides real time and cost advantages.

But my advice may differ in line with specific companies’ objectives. Many companies that are going public via the Rule 144A private market are funded by PE or financial sponsor shops. If the financial sponsors’ ultimate goal is to sell down their positions and move onto the next investment, the liquidity challenges of a Rule 144A IPO would make that recommendation difficult.

By definition, once you’re a publicly traded entity, one of the biggest advantages is that there’s a public liquid market that helps support further sell-downs by employees or large shareholders.

However, a company looking to pursue Rule 144A has to be very wary of its ability to continue supporting further sell-downs if there’s not enough liquidity to trade the stock in the aftermarket.
John Jacobs
Executive Vice President, Worldwide Marketing and Financial Products
NASDAQ OMX
New York

Ernst & Young: What were the key trends in the US IPO market in 2007 and your outlook for 2008?

John Jacobs: 2007 was very successful overall, particularly in IPOs. The middle part of the year was more difficult due to the subprime market and credit issues, but generally, companies still looked to access the US institutional and retail marketplace by doing a public or private offering.

I think the chilliness on the IPO market will continue through the first half of 2008. The investment banks have indicated that they anticipate a slower first half in both the private and public markets, due to more macroeconomic and market structural issues. Valuations may be lower than expected and there may not be as much demand by investors, but the macro trends of 2007 are currently showing signs that they will to continue into 2008.

The primary source of international IPOs will likely be China. In 2007, NASDAQ saw 22 Chinese listings on its market and we hope that trend will continue.

US investors are focusing on quality of earnings, the slowdown, and what may be hidden within portfolios or balance sheets. The main concern is whether all of the risky loans, mortgages, debt and credit instruments have been exposed, or whether there is more to be exposed. I don’t think the US investors are leaving the market. They are waiting to see what happens and they are not willing to jump in and make major changes in the interim.

Ernst & Young: With New York no longer the epicenter of global capital raising, what does it mean for the US and global capital markets?

John Jacobs: We are seeing companies taking more time to decide on the best shareholder mix and investor base to support their businesses. That is determining how and where they are raising capital. There are alternative capital centers to the US, such as London and Asia.

Companies can access different types of investors through different means, sometimes with the same offering. In the past, a private company would go public on NASDAQ, or on the London Stock Exchange (LSE), and that was it. That’s not the case anymore. Companies are realizing they can raise capital in stages and start with institutional offerings first. Also, companies don’t have to pick a single platform on which to list their securities.

I think we’re seeing the early stages of transformation in capital markets globally. The US is not the only place to raise capital anymore but it is still one of the primary capital formation markets.

Ernst & Young: Can you clarify the distinction between the “private placement” and the “Rule 144A offering”?

John Jacobs: Rule 144A offerings are a very specific and probably the largest subset of private placements. They are restricted to offering securities, defined under securities laws as a qualified institutional buyer (QIB), which by definition has discretionary assets of US$100 million or more. Whenever someone places securities with an investor without using an exchange such as NASDAQ, it’s considered a private placement. There are a range of categories, including Regulation D, Regulation S and Rule 144A. Regulation Ds and Regulation Ss are sold to accredited investors while...
Regulation Ds are sold to small offerings of less than 35 investors.

The companies in 2006 that used a Rule 144A tranche as part of their global offering raised US$162 billion. All the IPOs and secondary offerings on NASDAQ and the NYSE together raised US$154 billion. Although Rule 144A offerings and IPO listings on stock exchanges are not strictly comparable, they are quite close. The Rule 144A market has become as robust as the public markets in the US for capital formation. It’s a fast, effective way to reach institutional investors.

It takes about 10 weeks from the day you start a Rule 144A offering to close the deal. It takes at least three or four times as long to get through the Securities and Exchange Commission (SEC) today because of the comments, the filings, and the road show. So the Rule 144A is a quicker, shorter, less expensive process.

Ernst & Young: What’s behind the recent surge in capital raised through private placements?

John Jacobs: The Rule 144A market is designed to provide very fast, direct access to institutional investors in the United States. There are only two ways to get to the institutions directly in the US: through a Rule 144A offering, or a public offering – such as an IPO on NASDAQ. IPOs tend to be a much longer and more costly process. It involves tailoring the offering to include retail investors, including the Sarbanes-Oxley Act and shareholder litigation issues. So if your goal is to raise capital among US institutional investors because you want a US valuation, the Rule 144A is the most effective way. That’s why it’s exploded in growth.

Ernst & Young: What are the ultimate monetization plans for companies considering the private placement?

John Jacobs: We consider the Rule 144A market to be a stepping stone, a transitional market on the way to the US public markets. Many of these securities will eventually list and go public on NASDAQ, so we’re keen to work with them. Investors are looking for access to an earlier-stage company. These companies may not be ready in many cases to go public yet. Or they’re non-US companies that may not go public in the US for quite a while.

What companies are looking for through a private placement is a liquidity event, without necessarily having to become a full-blown public company. A private company that goes through the Rule 144A offering has the opportunity to raise capital among the US institutions, to hopefully gain liquidity and a higher valuation, so it can start acting like a public company.

The company has to go out and reach shareholders; but it can have shareholder discussions without having to be in the glare of Sarbanes-Oxley, full disclosure, and other regulations. A Rule 144A offering buys a company time. For example, a company can choose to do Rule 144A for a year, and then do a full public listing on NASDAQ – it can be transitional.

We have seen companies use the Rule 144A market as a 180-day stepping stone. Most US companies that did a Rule 144A offering, and then registered and listed fully on NASDAQ did so within six or seven months. If we develop a robust institutional market, some of these companies may stay longer, but I don’t think it’s their end goal.

Most companies still consider private placements as a transition to the public market. Only a public offering gives access to the retail investor market. And it’s not until then, that you reach the full liquidity and value of your company. Besides, institutional investors also need a partial exit and their exit will be through selling to retail investors.
In 2007, 64 companies worth US$27.3 billion tapped the Brazilian public markets, a 251% rise from 2006. Almost all Brazilian companies going public listed on the Sao Paolo stock exchange, (popularly known as BOVESPA). Most deals were quite large, with an average deal size of US$427 million. Showcasing the depth of its liquidity, BOVESPA hosted four offerings worth over US$1 billion each. Following the global trend of world stock exchange demutualizations, BOVESPA itself went public, and raised US$3.2 billion in the country's largest IPO ever.

After two to three decades of rampant inflation, and several boom-and-bust cycles, Brazil's economy finally stabilized in 2004. The country's GDP has been expanding steadily ever since at 4–5%. Brazil's capital markets now make up about 70% of the capital raised in South America's IPO markets. Other countries in the region, such as Argentina, Peru, Chile and Columbia, are also beginning to raise funds on their local stock exchanges. In 2007, the Bogota exchange hosted its largest IPO ever, the US$2.8 billion offering of Ecopetrol SA, a Colombian energy and power company.

In the first quarter of 2008, however, Brazil's bustling IPO markets ground to a halt, largely in response to global market volatility. All Brazilian companies postponed or withdrew their issuances except for one small US$12 million deal which completed its IPO.

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In the first quarter of 2008, however, Brazil's bustling IPO markets ground to a halt, largely in response to global market volatility. All Brazilian companies postponed or withdrew their issuances except for one small US$12 million deal which completed its IPO.

**BOVESPA hosts four IPOs worth over US$1 billion each**

In 2007, Brazil's two primary exchanges went public in two of the country's largest IPOs ever. Brazil's largest IPO of the year was the BOVESPA offering. As the fastest-growing and largest stock market in South America, BOVESPA boasts a total market capitalization of listed companies of about US$1.4 trillion. Its trading volume has expanded sixfold since 2000. "If it's a capital-raising exercise to fund a growth project up to a certain amount, BOVESPA has proven itself to be sufficiently liquid," says Hans Lin, Managing Director, Global Markets & Investment Banking Group, Merrill Lynch in Brazil.

The US$2.9 billion offering of Bolsa de Mercadorias & Futuros (BMF), Brazil's futures and commodities exchange, was the
Foreign institutional investors have been the chief sponsors behind Brazil’s stock market boom.

Second largest Brazilian IPO ever. BMF is also Latin America’s largest derivatives market and the world’s fourth largest futures exchange. There has been talk of a merger between BOVESPA and BMF, which would secure Sao Paulo’s position as Latin America’s financial hub.

**Issuers in finance, real estate, consumer staples and export commodities drive IPOs**

Lower interest and inflation rates, rising disposable incomes and the sharp appreciation of the Brazilian currency have boosted consumer purchasing power and domestic consumption levels. As a result, Brazil’s consumer-oriented companies dominated the public markets. In 2007, financial services made up almost half (46%) of the US$12.5 billion funds raised. In addition to the high-profile BOVESPA and BMF offerings, a Brazilian credit card network services provider, Redecard, raised US$2.15 billion in its IPO. The real estate sector generated US$5.4 billion while consumer staples accounted for US$3.4 billion in funds raised.

Global demand and soaring prices for Brazil’s export commodities have also contributed to the country’s rapid capital market development. Brazil is full of commodities-based companies, in areas such as mining, agribusiness/foods and alternative energy. Such companies are capitalizing on Brazil’s competitive advantage in commodities and expanding their businesses through a public offering. For example, catering to the growing international demand for alternative energy resources in 2007, Cosan Ltd., the Brazilian sugarcane and ethanol producer, went public on BOVESPA and NYSE in a US$1 billion offering. Moreover, “rapid Chinese growth and urbanization have generated great demand for Brazilian mining and basic materials commodities such as copper, steel and aluminium,” says Lin.

**Regulatory reforms raise comfort levels for foreign investors**

BOVESPA’s new listing system, the Novo Mercado, has drawn a record influx of foreign capital ever since it was created in 2000. Investor confidence has been boosted by the Novo Mercado’s US-style corporate governance standards, one-share/one-vote rules, greater transparency, minority shareholder protection and enhanced quality of disclosed information.

Having purchased over two-thirds of all local Brazilian share offerings, foreign institutional investors have been the chief sponsors behind Brazil’s stock market boom. Retail investors now make up only about one-third of the market for Brazilian IPOs. However, mutual funds and banks are actively promoting equities to their retail customers, encouraging them to switch over from fixed income where most Brazilians still invest their money.

**PE firms, hedge funds and M&A prompt companies to go public**

Traditionally, Brazilian industries were fragmented, comprised mostly of family-run businesses. In 2007, Brazilian companies turned to the public markets primarily to grow their businesses. “The typical business plan is that a private equity firm invests in 25% - 30% of the company, acquires two or three small to medium-sized companies in the same sector to grow bigger, consolidates the sector and then does an IPO,” says Paolo Sergio Dortas, IPO Leader, Strategic Growth Markets, Ernst & Young in South America.

The desire for acquisition currency is another reason why Brazilian companies are seeking to raise funds through an IPO. “Many Brazilian companies are going public in order to prepare for making acquisitions,” says Dortas. “This is provoking very intense acquisitions activity in Brazil and in the region.”

At the same time, hedge funds are filling in the pre-IPO financing gap for Brazilian companies. “Instead of buying at the IPO stage, hedge funds buy a stake and finance the company at an earlier stage,” says Lin. “The company then uses the hedge fund’s capital to strengthen its business, accelerate growth and improve preparations for going public.”

**In 2008, despite a barren first quarter, IPO prospects remain strong**

“While many of Brazil’s biggest names have already gone public, many ‘second-tier’ companies are still looking to finance growth
projects through the public markets,” says Dortas. Forecasting a strong pipeline for 2008, Lin says, “Many big companies are still preparing feasibility studies, changing their internal controls, improving their corporate governance and just doing their homework to prepare for going public.” Consumer goods, mining and financials companies are expected to be especially active in the Brazilian public markets in 2008.

In 2008, the international credit rating agency Standard & Poor upgraded Brazil’s credit rating one notch to BBB-, investment grade status. Such an upgrade is a great boon to Brazil’s markets, as it becomes open to a new breed of investors such as pension funds and institutional investors, (which are restricted from putting money into non investment-grade securities).

Brazil’s current macroeconomic stability greatly reduces the internal risk. As long as external risk factors, such as international liquidity levels and commodity prices, do not drop dramatically, Brazil’s IPO prospects look strong. “The greatest fear is that foreign investors, who often have less patience than local investors, would exit Brazilian markets at the first signs of serious trouble from global credit issues,” says Lin. Although the Brazilian IPO markets were inactive in the first quarter, it’s likely that the pace will pick up later in the year, since the Brazilian economic fundamentals remain solid.

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**Figure 10: Brazil IPO activity by year**

<table>
<thead>
<tr>
<th>Capital raised (US$b)</th>
<th>Number of deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>2003</td>
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<tr>
<td>$0</td>
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<td>1</td>
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Source: Dealogic, Thomson Financial

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*Paolo Sergio Dortas, IPO Leader, Strategic Growth Markets, Ernst & Young South America*
Equity offerings have become a popular means of financing in Brazil

Ernst & Young: What are the key trends behind the 2007 surge in Brazil’s IPO markets?

Hans Lin: To understand the current development of Brazilian capital markets, we should note that in the past, Brazilian privatizations (unlike those in Europe and Asia), were executed through the sale of state-owned utilities and banks to foreign multinationals from Europe and the US (e.g., Telefonica, Telecom Italia, MCI, Iberdrola, Suez, EdF and Santander) rather than through the sale of equity though public offerings to investors (e.g. British Telecom, NTT, and BP).

Consequently, in the late 1990s and early 2000s, most of the deals in Brazil were private transactions undertaken by multinationals. These companies were aiming to streamline the shareholder structure of their subsidiaries and, therefore, were taking liquidity out of the Brazilian stock exchange (BOVESPA). People were even questioning whether the BOVESPA would continue to exist in 20 years’ time.

But a dramatic change followed the 2002 election of President Lula. This was a very volatile year because people didn’t know what to expect from the new government after eight years of the Real plan under former President Fernando Henrique. For instance, there were rumours about Lula defaulting on Brazil’s debt, which would create an unstable environment for investment.

However, over time, investors began to feel confident that Lula was committed to creating financial stability through the continuity of economic policy. With greater financial stability, the emergence of the BRIC countries and higher returns on investments, more investors started to put money to work in Brazil. With interest rates coming down and an appreciating currency, people started looking closely at Brazilian equities. At the same time, Brazil showed an annual growth rate of 3% to 5%, and there were some very strong, sizeable companies with attractive projects looking for financing.

This trend started in 2004, but really picked up in 2006 when investors bought into 39 IPOs that accounted for over $8 billion, a more than fivefold increase compared with 2004. In 2007, IPO volumes were almost 4 times those of 2006 at around $32 billion with 64 offerings, which is huge by Brazilian standards. Today, Brazil represents over 10% of IPOs globally, and equity offerings have become a popular means of financing in Brazil, especially in the current high interest rate environment.

Many of the most obvious names have already gone public in Brazil. But we are still in the process of bringing in pent-up demand for companies looking to finance growth projects through the public markets. That doesn’t put off the good smaller projects. Soon, the smaller growing companies will be seeking to tap the public markets to finance themselves, once they reach a certain larger market capitalization size.

Ernst & Young: Which sectors have been driving Brazilian IPO activity?

Hans Lin: I would separate the sectors into two types: the more domestically focused sectors, and the internationally focused or export-oriented sectors. The domestically focused companies include the real estate sector, consumer goods and the banking sector. Brazil has been very strong in the whole commodity cycle, with prices being driven by China. There are many projects in mining, agribusiness and energy looking for financing and seeking to capitalize on Brazil’s competitive advantage in these exports.

The export-oriented companies are the second type of industry. They reflect global growth, and include mining, alternative energy and food commodities. Brazil has been very strong in the whole commodity cycle, with prices being driven by China. There are many projects in mining, agribusiness and energy looking for financing and seeking to capitalize on Brazil’s competitive advantage in these exports.
sectors. Brazilian companies associated with the commodity cycle, especially mining, are clearly benefiting from the Chinese growth triggered by the urbanization wave that brings 20 million people every year from the countryside to the cities. This Chinese growth is creating high demand for Brazilian commodities such as copper, steel and aluminium, in mining and basic materials. Agribusiness is a promising sector as well. Brazil has good weather and available land. Given the rise in oil prices, the current focus on alternative energy – ethanol, for instance – will bring additional demand for food commodities like sugarcane from Brazil, corn from the US and wheat from Australia, which translates to opportunities for the Brazilian companies.

Ernst & Young: How do developed country investors view the risk-reward equation of investing in Brazil?

Hans Lin: Currently in Brazil, the key concerns are not internal. The internal risk factor used to be higher. There was a time when Brazil had almost 100% inflation a month, but the risk/return equation today is much better because of the stability of the economy. Now, people are quite comfortable investing in Brazil. The Brazilian economy has been quite solid. The 3-5% growth levels are still a healthy growth path. With increased consumption, the emergence of a larger middle class and growing disposable incomes, the Brazilian fundamentals are good. The key domestic risk in Brazil these days is related to energy supply and its potential to cap the possible returns and growth.

Therefore, the key risks are really external factors. One-half to two-thirds of the allocation in recent IPOs still come from international investors. Currently, foreign investors are realizing that the emerging markets have given better returns over the last few years than investments in the US, Europe or Japan. But if there is a big downturn in the US over subprime mortgages or leveraged buyouts, it would affect investor confidence anywhere in the world. So that’s the key concern here: external factors that might stop investors from investing in emerging markets and in the BRIC countries.

Ernst & Young: Apart from IPOs, what other forms of financing are Brazilian companies entering into?

Hans Lin: Private equity and pre-IPO financing is an area that has been quite active recently, and will continue to be very active. Private equity investors are seeking and investing in smaller companies with growth potential, as well as taking companies private. With decreasing interest rates, leveraged buyouts are becoming possible, especially as the domestic corporate debt market evolves and gains depth.

There are increasingly more hedge funds seeking exposure to the pre-IPO financing of Brazilian companies. Instead of buying at the IPO stage, hedge funds buy a stake and finance the company at an earlier stage. The company could use the capital to strengthen its business, accelerate growth and better prepare to go public.
In 2007, robust IPO activity in Greater China (mainland China and Hong Kong) was largely driven by privately owned companies seeking to benefit from the deep liquidity, rich valuations and 10% GDP growth. Thanks to the government’s new policy to promote Shanghai’s exchange, about two-thirds of funds raised on Shanghai’s exchange were H-share returns – first-time domestic IPOs by China’s biggest companies, which had previously listed in Hong Kong. In 2007, Greater China led the world in both IPO funds raised, US$66 billion, and in number of deals, 259 (see figure 11, page 38). Since most of the country’s largest state-owned enterprises have already gone public, China launched many mid-sized IPOs with an average deal size of US$255 million. The largest Chinese IPO in 2007 was the US$5.9 billion offering of China’s CITIC Bank Corp., which was much smaller than China’s groundbreaking US$22 billion ICBC offering in 2006.

Chinese IPO markets reflected a broad cross-section of industries in 2007. “There was investor interest in every sector, even the worst ones,” says Henry Cai, Managing Director and Chairman of Investment Banking, China, at UBS in Shanghai. The top four Chinese industries by funds raised were financial services, (US$15.8 billion), industrials (US$9 billion), real estate (US$8.8 billion) and metals & mining (US$8.2 billion).

As investors grew more cautious in early 2008, many analysts believed that buoyant Chinese markets peaked in 2007. Nonetheless, in the first quarter of 2008, China was still a global front runner with 30 deals, the highest number of IPOs globally, worth US$8.6 billion, the second highest amount of capital raised after the US. The largest first quarter IPO was the US$5.4 billion listing of China Railway Construction Corporation which dual listed in Shanghai and Hong Kong.

Overheated markets decline in a “systematic adjustment”
In the first three quarters of 2007, the Shanghai and Hong Kong stock exchanges regularly hit record heights. Most China-related IPOs grew at least 50% in share value. A “first day pop” for China’s IPOs was virtually guaranteed, with domestic funds trapped on the mainland.

“With claims of relatively limited exposure to subprime debt, the Chinese do not seem particularly concerned about the global slowdown,” says Matthew Sutton from the Capital Markets Group, Ernst & Young China. He notes that, “The majority of China’s companies going public have sustainable business models with strong earnings and profits.”
The private mainland Chinese companies that have great stories tend to receive significant PE and VC backing to go to the US or Hong Kong

In the fourth quarter of 2007, the Chinese markets took a sudden dip, with some IPO share prices slumping far below their first day close. Nonetheless, the Chinese market decline “has given many investors some degree of comfort, since it happened systematically, and without panic,” says Philip Leung, Far East Strategic Growth Markets Leader, Ernst & Young China. “When there were high private equity (PE) multiples, at 60 or 70 times earnings, people thought the market was heading towards a bubble, but instead, there’s been a systematic adjustment,” he says. “At the end of 2007, the Chinese stock markets were a bit overheated but I don’t think it was a bubble,” says Cai.

**Strict capital controls contribute to inflated Chinese valuations**

Some analysts believe that mainland Chinese companies listed on the Shanghai Stock Exchange (A-shares) trade at about a 50% premium to mainland Chinese companies listed on the Hong Kong Stock Exchange (H-shares). “The shares in China are trading at much higher multiples than those trading in Hong Kong for the same entity, for the same company,” says Leung. Strict capital controls and a flood of retail money have inflated China’s stock valuations. Although the wealth of individuals in China has grown rapidly, capital controls prevent the average Chinese investor, who has a very limited range of companies in which to invest on the mainland, from moving money offshore.

Huge slumps in the share prices of some newly listed stocks suggest critical flaws in the current pricing system on the mainland. “China’s inflated valuations are neither sustainable nor are they comparable to any other markets globally,” says Gokul Laroia, Head of Capital Markets, Asia, at Morgan Stanley in Hong Kong, “The mainland Chinese market is not one in which global institutional investors often participate. It is dominated by local Chinese institutions and, much more significantly, the local Chinese retail sector.”

Cai agrees that Chinese price-earnings ratios are inflated. “However, high price-earnings multiples do enable a Chinese company to gain better financing, to seek suitable acquisition targets and to issue bonds,” says Cai. “I think after the central government introduces the trading of stock futures, price-earnings multiples will be adjusted down to a more natural level.” In the meantime, investors have begun to scrutinize more closely Chinese valuations and deals are becoming more realistically priced.

**Many of Shanghai’s newest listings are H-share returns**

The government has been encouraging H-shares, that is, Chinese companies already listed in Hong Kong (before 2006 when Shanghai first became a developed exchange) to list in Shanghai as well. In 2007, these H-shares returns included state-owned enterprises already listed in Hong Kong, such as the secondary offerings of PetroChina, China Shenhua Coal and the Chinese Construction Bank.

The Chinese government now makes it very difficult for Chinese companies to list anywhere outside the mainland. Chinese-registered companies now need regulatory approval to list overseas, and these approvals of offshore IPOs are hard to obtain. “The Chinese authorities determine which companies should be dual listed, listed locally or offshore, and that process is not entirely transparent,” says Laroia.

By keeping Chinese IPOs on the mainland exchanges, the Chinese government is attempting to “prevent the export of the Chinese capital market,” says Laroia. “There is the view that Shanghai should become the national exchange, and that top Chinese companies should list on this exchange,” he observes. “The government also hopes to end fears of an equity bubble,” says Sutton. “The aim is to absorb the excessive investor liquidity which has dramatically elevated stock market values, and to offer investors a broader, more diversified portfolio of investment opportunities,” he says.

**Hong Kong remains a key international fund-raising hub**

The dominance of the Hong Kong Stock Exchange (HKEx) in Greater China’s IPO markets has been diminished by the rapid growth of the Shanghai and Shenzhen exchanges in 2007.
Many highly visible Chinese companies continue to list on the HKEx. In 2007, the Chinese e-commerce trading company Alibaba was the first major Asian technology company not to list on NASDAQ, (which has typically received the majority of listings from overseas technology companies). Alibaba achieved a very high price-earnings multiple and raised US$1.7 billion in Hong Kong.

In 2007, a record-breaking total of 29 Chinese companies listed in the US. Representing a wide variety of sectors, including technology and real estate, these IPOs were highly sought after by US investors. Many of the share prices of these Chinese IPOs rose dramatically on their debut, selling far above the expected price range and became top performers in the US markets.

Smaller Chinese companies are still listing in Singapore or London's junior market AIM. “But those tend to be companies that have a nice story but not a great story,” says Sutton. “The ones that have truly great stories tend to get significant private equity and venture capital backing to go to the United States or Hong Kong.”

In 2008, mid-size private companies fill the IPO pipeline

In the first quarter of 2008, despite the credit crisis, China's rapid IPO momentum continues relatively unabated. “Mid-sized private Chinese enterprises listing in Shanghai account for about 80% of the pipeline,” says Cai. Although there are some local government state-owned enterprises (SOEs) in the pipeline, “privately owned companies will continue their strong IPO momentum and lead Chinese economic development over the next two years,” he says.

In 2008, vigorous Chinese IPO activity is expected across all sectors, although financial services, natural resources and infrastructural sectors such as railroads and power will be particularly active. Private consumer products and retail enterprises will also be tapping the Chinese public markets, particularly in the real estate, media and technology sectors.

In 2007, the Chinese government suggested it would allow mainland Chinese individuals in Shanghai to buy and sell shares. Nonetheless, compared with mainland exchanges, the HKEx still offers the advantages of better access to global capital, greater brand recognition, higher corporate governance standards and less volatility. While the HKEx caters to China's foreign investors and is settled in Hong Kong dollars, the Shanghai and Shenzhen exchanges focus on local retail investors, operate under an exchange control regime and use the local Chinese renminbi currency. “In Shanghai, there are still restrictions on the free flow of foreign capital and central government has to approve inflows,” says Cai. “As a result, the Hong Kong and mainland exchanges are not fully comparable and neither is in a dominant position.”

In 2007, the HKEx remained the key international fund-raising hub for private Chinese companies. “In past years, Hong Kong's market infrastructure and quality have improved significantly,” says Paul Chow, Chief Executive of Hong Kong Exchanges and Clearing Limited. As a result, Hong Kong's credit rating has been upgraded by the international investment community, he says.

The IPO of Chinese bank ICBC, which raised US$16 million in Hong Kong, and US$6 billion in mainland China, dispelled the myth that you can only raise large funds in the US,” says Chow. “Now, funds flow freely across the border. Investors from almost anywhere in the world can easily participate in the Hong Kong market.”

Private mainland companies still can choose to list overseas

Private Chinese companies registered offshore still have a choice of where to list their shares. “Private Chinese companies usually have a PE firm as a majority shareholder,” says Cai. “With a foreign PE firm as the host, an overseas listing is set up with little difficulty. In such cases, companies do not need to receive local government approval.”

Private companies usually prefer to list in Hong Kong to access the global institutional market, then use Regulation S or Rule 144A offering to tap the European or US institutional markets,” says Alexander Mackintosh, Capital Markets, Ernst & Young China.

In 2007, the Chinese government suggested it would allow mainland Chinese individuals in Shanghai to buy and sell shares.
in Hong Kong-listed Chinese companies called “red-chips” for the first time ever. “Whether and how the Chinese government relaxes restrictions on the ability of mainland investors to purchase shares listed in Hong Kong will be a critical trend to track,” says Mackintosh. “Any relaxation of controls over capital flows in and out of China could have a dramatic impact on company valuations on the HKEx relative to mainland exchanges.” At the same time, since the largest H-share companies have already listed in Shanghai in 2007, the number of H-share returns will likely drop off in 2008.

As investors grow more discriminating, Chinese valuations are expected to become more rational, with price-earnings ratios returning to more normal levels. “While before, all Chinese IPOs were ‘a buy’, now an IPO needs to be a good value or brand name,” says one analyst. “Many Chinese companies preparing to have an IPO would like to have it done before the Olympics,” says Leung. “With valuations at a high level, companies want to have their IPO done before there is any more correction.”

The troubled global credit backdrop and a tougher pricing environment has created a mood of uncertainty. “Although the fundamentals for China are strong, market watchers are closely monitoring inflation and what the government does to control it,” says Leung. Surging exports have flooded China with foreign currency, and the investment of cash surpluses in China may be fostering further inflation. Says Sutton, “The outlook for China is going to depend a great deal on the Chinese government’s skill and flexibility in managing its reforms.”

Philip Leung, Far East Strategic Growth Markets Leader, Ernst & Young China
Alexander Mackintosh, Capital Markets, Ernst & Young China
Matthew Sutton, Capital Markets, Ernst & Young China

Figure 11: Greater China IPO activity by year

Capital raised (US$b) | Number of deals
--- | ---
177 | 144 | 182 | 114 | 175 | 259
$12 | $14 | $16 | $24 | $57 | $66
2002 | 2003 | 2004 | 2005 | 2006 | 2007

Source: Dealogic, Thomson Research, Ernst & Young

Figure 12: Asia-Pacific IPO activity by year

Capital raised (US$b) | Number of deals
--- | ---
606 | 618 | 906 | 803 | 772 | 919
$25 | $32 | $48 | $52 | $91 | $97
2002 | 2003 | 2004 | 2005 | 2006 | 2007

Source: Dealogic, Thomson Research, Ernst & Young
Private mainland companies will continue their strong IPO momentum

**Ernst & Young: What were the key trends in the Chinese IPO markets in 2007 and your outlook for 2008?**

**Henry Cai:** At the end of 2007, the Chinese stock markets were a little bit overheated but I don’t think it was a bubble. The average PE multiple on the Hong Kong exchange for a Chinese company was 30 to 40 times earnings. The credit crisis hadn’t had much of an impact on Chinese markets, except in the financial services sector.

In 2008, Chinese IPO markets are expected to maintain strength because Chinese economic growth is strong. In the immediate future, the central government has a new policy to control microeconomic development particularly in the oil resources and rural areas.

Over the next two years, the Chinese economy is expected to continue growing at a rate of over 10% per year. The IPO market is still dominated by the private sector, which accounts for about 80% of deals, with many deals in the pipeline.

We have some state-owned enterprises (SOEs) in the pipeline, such as Bank of China. But it is privately owned companies that will continue their strong IPO momentum and lead Chinese economic development in the next two years.

**Ernst & Young: Who are the key investors in China’s IPO markets, and on what sectors are they focused?**

**Henry Cai:** At UBS, we are still focusing on pre-IPO investors which have created a very strong momentum in China – there is investor interest in every sector, even the worst ones.

I don’t think that any distinct sector is driving IPO activity in 2007. In 2006, the SOEs, the financial services sector and the largest Chinese banks were driving IPO activity. However, in 2007, Chinese IPO activity was strong in a variety of sectors including consumer, retail, natural resources, power, financial services and property. In 2007, privately owned companies, rather than SOEs, were driving Chinese IPO activity, and I see this continuing in 2008.

**Ernst & Young: What are the chief concerns of mainland Chinese pre-listed companies seeking to go public?**

**Henry Cai:** Since 2006, investors have been concerned about the difficulty of gaining approval from the mainland’s local and central governments to list in Hong Kong. The Chinese central government is encouraging local companies to list in the A-share market in Shanghai and Shenzhen. Another concern is that application for an A-share listing requires a very lengthy approval process.

Privately owned companies that did not obtain approval to list on HKEx before September 2006, will not be able to receive approval from central government. Nonetheless, even in these circumstances, pre-listed companies still want to list in Hong Kong, the US or Singapore.

**Ernst & Young: What’s the impact of the Chinese government’s recent policies on the A-share and H-share markets?**

**Henry Cai:** Currently, the central government rarely approves any Chinese SOE application to list in Hong Kong. As a result, the A-share market will remain overvalued compared with the H-share market. Due to new government policy, companies that are already listed in Hong Kong will be encouraged to come back to list in mainland China exchanges.

**Ernst & Young: Can a foreign private equity firm help a mainland Chinese company gain an overseas listing?**

**Henry Cai:** If a company has direct investment from a PE firm that is a majority shareholder in the company, the foreign PE firm will be the host, and will be able to set up an overseas listing with little difficulty. In cases such as this, companies do not need to get approval from local government.
Ernst & Young: Why are some mainland Chinese companies still eager to list overseas?

Henry Cai: Of the privately owned Chinese companies, perhaps 10% still list overseas.

There are three advantages to an international listing. Firstly, the international valuation is higher and more reasonable than the local Shanghai price. Some A-share companies seem to be trading at high multiples. However, those were based on historical earnings. The Chinese central government requires that the price-earnings ratio of each local Shanghai listing not trade at multiples greater than 30 times earnings. There is no such restriction in overseas markets.

In A-share market listings, companies provide a one-year forecast. For a Hong Kong listing, investment bank research analysts would normally be able to provide forecasts for two years, which can lead to a more optimistic valuation.

The second advantage of a red-chip company with an international listing is that post-IPO fund-raising or follow-on fund-raising is very easy in Hong Kong and the US, and does not require government approval. The third advantage of an international listing is the international recognition gained for the listed company and the creation of an acquisition currency (i.e., their shares) for international acquisitions.

Ernst & Young: Why have many private Chinese companies been listing in the US recently?

Henry Cai: Generally, the Chinese companies listing on NASDAQ have a foreign PE firm as the major shareholder. So why go to the US? First, the US has been the traditional base for the IT sector, although that changed in 2007. For instance, the online company Alibaba is listed in Hong Kong with a very high price-earnings multiple, so now companies can achieve higher valuations than in the past.

Second, in the US, the disclosure standards and profitability track record requirements are less demanding and simpler than in Hong Kong. The Hong Kong Main Board requires a continuous three-year track record of profitability. During those three years, the management team and board of directors could not change. By contrast, in the US, even a short track record is acceptable.

Ernst & Young: Do you think the Shanghai Stock Exchange (SSE) will come to dominate the HKEx as a result of mainland government policies?

Henry Cai: Essentially, the Hong Kong and Shanghai exchanges cover the Chinese capital markets, but with different styles and different foundations. It is very difficult to determine which market is in a dominant position. The HKEx caters to China’s foreign international investors, and is paid in Hong Kong dollars, whereas the SSE caters to China’s local domestic retail investors, and is paid in renminbi, the local Chinese currency.

The Hong Kong market and its market capitalization are increasing. Even in the IT sector, companies such as Alibaba can be listed in Hong Kong and still achieve fantastic results. The successful Alibaba listing illustrates that Hong Kong is becoming a global player in the capital markets. In Shanghai, there are still restrictions on the free flow of foreign capital and central government has to approve inflows. So the two exchanges are not fully comparable and neither is in a dominant position.

In a few years, if the central government allows the free flow of foreign capital, perhaps the Shanghai and Hong Kong exchanges could merge and become a one-stop Chinese marketplace.
Investors prefer China and India because of their unambiguous growth

Ernst & Young: What are the key trends for IPO activity in China and India for 2007-08?

Gokul Laroia: From an issuer’s perspective, China and India are the two most important markets in the Asian region. No other market in the region even remotely compares in terms of the size of the two economies, their growth and their need for capital. The relative maturity and penetration in these economies are still incredibly low.

From a volume perspective, I expect China and India to continue to account for anywhere between 50% and 60% of the total capital raised in Asia. Much of this will be in the form of IPOs and follow-on financings, particularly from the banks as they raise capital to fund the economy.

From the investor side, there is a clear prioritization in terms of where people want to focus their energies and their capital – investors prefer China and India, because of their unambiguous growth – these markets grow 8% to 12% a year. Companies operating in these markets across sectors are experiencing earnings growth of 20% to 40%, depending on the sector and the country.

You find that kind of growth occurs in some emerging markets. However, the difference that we’ve seen over the past three or four years in India and China is that their management teams have consistently delivered on this growth.

There are a broad-based variety of sectors driving IPOs in Asia, especially real estate, domestic consumption (i.e., retail and consumer), financial institutions, and commodities. These are the four areas where we have seen a lot of capital raised, and they will continue to be fairly active.

Ernst & Young: What are your clients’ key concerns about the Asian markets?

Gokul Laroia: Investors are concerned about how quickly the markets have run up company valuations. Are these valuations sustainable? What would be the impact of a US recession, a US slowdown and a breakdown in credit markets? Is the decoupling that everyone talks about real?

Investors are very comfortable investing in Asian exchanges. The reduction of the risk premium applies broadly. Most people believe there is some political volatility. But in major markets like Thailand and India that volatility does not concern anyone anymore. In markets like Singapore, Hong Kong, Mumbai, even some of the smaller markets like Thailand or Malaysia, investors are very comfortable with the regulatory framework.

The risk premium associated with these Asian markets has diminished. Investors have much more confidence in the fundamental demand in these economies, and in the ability of management teams to deliver. As a result, they’re paying for this growth and they’re putting a lot more capital into these markets.

Over the last three or four years, these markets have been meaningfully upgraded by credit rating agencies to an extent that many analysts say that they are over-valued. But if you think about earnings growth and equity in these markets, on a forward basis, you could very easily make the argument that they are not over-valued.

Ernst & Young: Do you believe that Indian and Chinese markets are overvalued?

Gokul Laroia: I don’t think India is inexpensive, but I do not think it is heavily overvalued either. It is trading at about 19 or 20 times forward earnings, which is not inexpensive. But if you factor in earnings growth, return on equity, and the likelihood that this kind of growth will continue for the next three to five years, it is not overvalued.

There is some concern about the A-share valuations and the impact on Chinese markets should the A-share market collapse. The Chinese A-share market is an isolated market, so its impact on other parts of the world is unclear and outsiders tend not to understand what the impact will be. The impact of a sell-off in the
Asian market on the Chinese economy will obviously be negative.

But an A-market correction won’t slow down the Chinese economy dramatically, nor will it create a crisis in the banking system. Because the macroeconomy in China is so strong, a slowdown could be managed. But if this market falls 40% to 50% in the next three months, it will certainly translate into a fall in Hong Kong. Such a fall will have a psychological impact and as a result will affect Asia because China is such a large part of the region and the world.

Ernst & Young: What’s your take on the Chinese government’s new policy to keep Chinese IPOs on the mainland?

Gokul Laroia: There is a view that Shanghai should become the national exchange, and that top Chinese companies should list on this exchange. All the state-owned enterprises that sought a listing in Hong Kong, before 2006 when Shanghai became a developed exchange, are being asked to return to list in Shanghai. Thus, state-owned enterprises like PetroChina, Shenhua Coal, and the Chinese Construction Bank are all being asked to add a Shanghai listing.

Chinese companies registered in China must list in Shanghai, while Chinese companies not registered in China, will continue to list in Hong Kong. (In China, there is a big difference between onshore or offshore incorporation.) For Chinese companies registered in China seeking to list in Hong Kong, approval from the Chinese Securities Commission is required. Those approvals are less forthcoming now and are given on a case-by-case basis. The Chinese authorities determine which companies should list locally, which companies should list offshore, and where there should be a dual listing.

Ernst & Young: How do investors compare and contrast China and India as investment opportunities?

Gokul Laroia: From a macroeconomic perspective, China and India are similar, with their increased urbanization, demand for property and wealth levels. However, China and India’s microeconomic numbers are very different, and as a result, investors view China and India as very separate opportunities. Right now, if an investor had US$100 of capital, the investor would probably allocate US$50 to China, US$20 to US$25 to India and US$25 to US$30 elsewhere. Basically, investors evaluate investment opportunities in China and India, sector by sector.

There is some commonality between China and India. For instance, financial institutions in China and India both need a significant amount of capital. Because neither country has a domestic bond market, so much of the financing is done by banks, which means that banks actually experience asset growth of 30% to 50% a year. As a result, investors have been very willing to finance banks both in China and in India. Indians have been huge consumers of capital. And that trend is set to continue over the next five years.

But there are a differences between the two countries. As far as financial institutions are concerned, there is a view that India is ahead in terms of how these banks are managed, their risk management control systems and their fee-based income. However in the real estate sector, China is far ahead, with capitalization of Chinese real estate companies listed in Hong Kong nearly US$200 billion. On the other hand, India is an emerging player in the public market for real estate. So in evaluating the two countries, while the macroeconomic background is broadly similar, the microeconomic details are different.
Ernst & Young: What are the key trends for the HKEx?

Paul Chow: One reason for the success of the HKEx over the past few years is our focus on core businesses that generate genuine returns. We shall continue to improve the quality of the Hong Kong market by improving our regulatory and risk management regimes, adopting international standards and best practices, and ensuring that there is a robust infrastructure and information technology platform to support our core businesses. We want to run an exchange which delivers real value to our shareholders and market participants.

Our strategic mission for 2007-09 is “to be a leading international marketplace for securities and derivatives products focused on Hong Kong, mainland China and the rest of Asia.” While we are actively attracting listings from foreign companies, especially those with a mainland connection, we will always focus on Hong Kong and mainland China because this is our home market.

While mainland China runs essentially a closed capital regime, the Hong Kong market has the advantage of being a free and open market. We will continue to leverage our position as the gateway for international investors to access mainland enterprises, and for mainland investors to access overseas markets via channels such as the Qualified Domestic Institutional Investor (QDII) scheme.

Ernst & Young: What do you make of the dual-listing trend in Shanghai and Hong Kong which began with the ICBC IPO in 2006?

Paul Chow: Ultimately, any company has the right to make a decision on where and how to list. Many want a sole listing, some may want a primary listing in Hong Kong, some may seek a secondary listing here – it’s not something for us as an exchange to decide.

What an exchange needs to do, however, is to provide a level playing field and the best infrastructure for listing and trading. A quality market increases investor confidence, which in turn generates order flow, hence improving the depth and liquidity of the market. Liquidity, in turn, attracts more quality enterprises to list and more investors from around the world to invest in the market, and the virtuous cycle continues.

Ernst & Young: Why have large Chinese technology companies such as Alibaba, started listing on HKEx rather than NASDAQ?

Paul Chow: In the past when technology companies considered the IPO venue, they preferred NASDAQ because it is renowned for its technology constituency. Companies could argue that they could raise funds in NASDAQ more easily because of the high PE multiples.

Over the last few years, the market infrastructure and quality of the HKEx has improved significantly. The market has been re-rated upwards by the international investment community. We have proven that we are capable of raising funds of any size. A prime example is ICBC, which raised US$16 billion on the HKEx and US$6 billion in mainland China in 2006 in the largest IPO of the world to date. We also command valuations that are on a par with our peers in the US or Europe.

In addition, with improved telecommunications networks and increased global coverage by intermediaries, funds flow freely across borders. Investors in the US, Europe or the rest of the world can easily invest in any companies listed in Hong Kong. For example, a company does not need to list in the US to attract US investors. Therefore, when Alibaba wanted to raise funds from international investors, the natural IPO venue was Hong Kong since it is Alibaba’s home market as well as an international fund-raising platform.

Increasingly, Alibaba's more technology companies from mainland China are expected to seek a listing in Hong Kong and, perhaps in the longer term, in the mainland when the renminbi becomes freely convertible. At that point, choosing between Hong Kong and Shanghai as a listing venue would be similar to choosing
between NYSE and NASDAQ in the US or Tokyo and Osaka in Japan.

**Ernst & Young: Why is the HKEx not as interested in creating mergers with other world bourses, as the European and American exchanges?**

**Paul Chow:** An exchange is not in the business of investing, including investing in other exchanges. Rather, an exchange’s business is to provide a platform for trading and capital raising. Our view is that if we have excess cash, we should distribute it to our shareholders and let them decide whether to invest in other exchanges or in other means.

I do not believe that in the next few years you will see considerable amount of synergies resulting from the recent cross-border M&A activities of exchanges. It is very difficult to successfully merge exchanges across countries. The exception may be the European Union, which can essentially be treated as one country since all the rules and regulations have been harmonized and the Euro is the single trading currency in the region.

Having said that, I am in favor of M&A within a single country. When two exchanges involved in an M&A are within the same country or even in the same city, they are subject to the same regulatory regime, rules and labor laws. It is much easier to merge and harmonize the operations, IT systems and trading platform, and hence, create synergies.

In-country M&As make sense, but many Asian countries such as Singapore, Australia, Taiwan, Japan and Malaysia have already done this. For a cross-border M&A in Asia, factors such as currency, politics and nationalism come into play. For instance, it would be hard to imagine Taiwan merging with Hong Kong or Tokyo merging with Korea.

**Ernst & Young: What do you make of rumors that the Hong Kong and Shanghai exchanges might merge – are these rumors completely unfounded?**

**Paul Chow:** Mainland China operates essentially a closed capital account and the renminbi currency is not freely convertible. Mainland China and Hong Kong have their own regulators and two different sets of regulatory framework. With the exception of qualified institutional investors, no one from one market may participate in the other market. So we are doubtful how synergies could be created and how the two exchanges could be merged.

When the renminbi becomes freely convertible, the Hong Kong and Shanghai exchanges may still coexist just like NYSE with NASDAQ in the US or Tokyo with Osaka in Japan. In such a scenario, Shanghai will be a competitor in the global arena, similar to other major world exchanges.

**Ernst & Young: So you probably don’t agree with the notion that, in the future, there will be just a few mega-exchanges?**

**Paul Chow:** I don’t agree that in the future, the world will only have a few mega-exchanges. I think the number of exchanges will roughly be equivalent to the number of countries, at the very least. You can see fast development of exchanges around the world – in the Middle East, in South Africa, in Brazil, in India, in mainland China and in Russia. Many countries belonging to the former Soviet Union, for example, are developing their own exchanges. Why is that? It’s because every country needs to have an exchange to attract local and overseas investment and support its economy. So I actually expect to see more exchanges in the future, not fewer.
India: soaring liquidity and corporate profits propel IPO markets

Key trends

- In 2007 buoyant Indian IPO markets were propelled by foreign capital inflows, robust corporate profits and a soaring stock market.
- Foreign institutional investors eager to invest in a high-growth emerging market provided three-quarters of capital flowing into India’s IPO markets.
- Indian IPOs are growing in size and quality thanks to greater institutional depth, a supportive VC and PE ecosystem and stringent regulatory standards.
- The increasingly liquid Indian stock exchanges keep companies listing at home, although most larger listings add a Rule 144A tranche to access institutional buyers.
- In 2008 when markets stabilize, the key drivers of Indian IPO markets will be exit-seeking PE firms and companies in the infrastructure, real estate and financial services.
- In the first quarter of 2008, the Indian IPO market slowdown demonstrated its susceptibility to global market volatility.

In 2007, India’s booming IPO markets maintained their rapid momentum, boosted by 9% economic growth, unprecedented foreign inflows and a five-year stock market bull run. Against the healthy economic backdrop, India’s expansion-oriented businesses flourished with an average corporate profitability rate of 18-20%. In 2007, India’s dynamic IPO markets generated US$8.8 billion in 106 deals, the highest amount ever raised in India (see figure 13, page 47). The average deal size was US$83 million. The largest Indian IPO in 2007 was real estate developer DLF’s US$1.9 billion offering. The most active industries in India were in the industrial (US$3.4 billion), energy and power (US$0.9 billion), financial (US$0.9 billion) and real estate sectors (US$0.8 billion).

In the first quarter of 2008, investors began to fear that India might not be as “decoupled” from global troubles as previously hoped. Global market volatility and a massive liquidity drain due to the Reliance Power offering helped trigger downturns in the Bombay Stock Exchange. Indian IPO markets saw 16 deals worth US$4.0 billion, thanks primarily to India’s largest IPO ever, the US$3 billion Reliance Power offering. The IPO raised around US$3 billion in less than one minute of the subscription’s opening, only to suffer disappointing aftermarket performance.

Indian IPOs grow in size and quality due to institutional depth

Due to strict regulatory limits, foreign investors made up only 10% of the Indian stock market. Yet, foreigners contributed three-quarters of the capital coming into the IPO markets. “When companies do an IPO, about 50% of the issue is reserved for qualified institutional buyers,” says R. Balachander, IPO Leader, Strategic Growth Markets, Ernst & Young India. The value of foreign institutional investment in India was approximately US$10 billion in 2007. Many analysts believe that such keen investor enthusiasm is justified, since with strong economic fundamentals, and some of the world’s best-managed companies, India is still considered relatively inexpensive for a high-growth emerging market. “With so many foreign players, mutual funds and asset management companies coming in and educating people about the stock markets, equities have a bright future in India,” says Balachander.

“Many medium-sized companies are growing fast, and will have to raise resources,” he says. “An IPO would probably be the best way to go about that.”

Indian IPOs are growing in size and improving in quality. Reflecting a market appetite for quality and safety, most Indian IPOs have been established businesses with strong track records. “Larger deals can now be done within India because of the greater depth in the institutional markets, both domestic and foreign,” says Dr.
Many medium-sized companies are growing fast and will have to raise resources – an IPO would probably be the best way to do that.

S. Subramanian, Head of Investment Banking, Enam Securities Private Ltd. in Mumbai. “The venture capital/private equity (VC/PE) ecosystem that is slowly developing has aided the growth of many small companies. They are now of reasonable size when they are ready to list.” The more stringent entry standards of the Indian securities regulator, SEBI, have also boosted the quality of deals.

Soaring stock markets and positive sentiment for equities have also encouraged many companies to tap the public markets. “It’s just a good feeling amongst all investors that equity investments provide strong returns, which has then boiled down to a very strong IPO market as well,” observes Subramanian. Indeed, families across India have begun to shift money in their banks from non-equity accounts into equities. “Whereas in 2005, the total amount of Indian savings in equities was under 2%, in 2007 the overall Indian retail savings rate was over 5%,” he says.

**Infrastructure, real estate and energy sectors dominate IPOs**

As India builds up its roads, power and ports, India’s strongest IPO sector was the industrials (which includes real estate, construction and infrastructure companies) with 39% or US$3.4 billion in funds raised. As India’s commercial and residential construction market grows, the real estate sector, which only began listing in 2006, has also become very active. Indeed, about US$25 billion of market capitalization has been added to the real estate sector in 2007. Property companies attained very high valuations, not just in India, but also abroad.

In a country with chronic energy shortfalls, energy companies are a strong long-term prospect, representing 11% (US$0.9 billion) of capital raised in India in 2007. The US$3 billion Reliance Power offering in the first quarter of 2008 generated the greatest investor enthusiasm for any Indian IPO ever. “The power sector needs to grow extremely fast to provide the energy for the manufacturing sector which is growing at a double-digit rate,” says Balachander.

**Indian exchanges keep companies listing at home**

“It is now the norm for a large Indian company to list at home, since local markets are able to raise up to US$5 billion,” says Subramanian, “The only reason for most Indian companies to go abroad to list is for regulatory arbitrage or because the domestic markets don’t fully value a particular sector.” Moreover, Indian law mandates that only Indian companies with a local listing can also list abroad.

“If you have a story and if you can sell it in India, then why go abroad, unless there’s a strong reason,” says Balachander. He notes that there are two primary types of Indian companies that would seek an overseas listing. An IT company will list in the US for higher valuation, since most of their customers are based in America where their value proposition is better understood. Similarly, mining and metals companies would list on London’s AIM market since the exchange typically attracts these types of companies, and its mature investors understand the long gestation of such companies’ business models.

In 2007, both the Bombay Exchange and the National Stock Exchange became 20% owned by global investors including the NYSE, Deutsche Borse and the Singapore Exchange. “This had led to another phase of globalization, sharing of management practices and a more sophisticated way of regulating markets,” says Balachander. “The Indian stock exchanges are now almost in the league of the large western exchanges.” Although most stocks are listed in India, “broadly speaking, any Indian IPO of US$100 million to US$125 million or more has a Rule 144A component and raises capital from qualified institutional buyers in the US,” says Subramanian.

**Financial sponsor pre-IPO and IPO financing grows**

A key driver of Indian IPOs has been PE firms selling off equity stakes for cash, and exiting from earlier investments. “2007 is probably the beginning of a PE trend, not the culmination,” says Subramanian. “PE in 2008 is expected to be even more active,
Nonetheless, “the Indian corporates are still very bullish and the overall mood is expected to turn positive,” Subramanian says. “Since businesses will continue to require capital to fuel their growth plans, IPO activity is unlikely to slow down for a prolonged period,” says Balachander. “Indian IPO activity is likely pick up in the second half of 2008 and, despite the global crisis, may attain or even surpass 2007 levels.” Although capital will be raised across all sectors, infrastructure, real estate and financial services are expected to drive public markets for the next couple of years.

Moreover, Indian investor liquidity is at a peak. “India’s high 35% savings rate and growing GDP have made a huge pool of investible funds available, while awareness of equity products continues to grow,” notes Balachander. Indian mutual funds have a lot of cash to deploy once the markets settle. “Once some stability is perceived, investments are likely to flow back into the capital markets,” he says.

Hedge funds are also providing capital to the Indian small or middle-sized companies that seek money in the two years prior to an IPO. “Since the Indian government recently announced that any fund which is regulated in its home country is welcome to invest in India, the registration of very large foreign hedge funds in India is expected to grow,” says Subramanian. As a result of the growth in hedge fund activity, the number of private placements is also rapidly increasing. “In the past, companies thought that bank financing or PE financing was preferable,” says Laroia. “But now it is somewhat cheaper, more flexible and faster to complete private placements through hedge funds – all of which probably meets the needs of both the issuer and investors, and is likely to continue.”

Figure 13: India IPO activity by year

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital raised (US$b)</th>
<th>Number of deals</th>
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<tr>
<td>2002</td>
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<td>$9</td>
<td>$9</td>
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<tr>
<td>2007</td>
<td>$106</td>
<td>$106</td>
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</tbody>
</table>

Source: Dealogic, Thomson Research, Ernst & Young

In 2008, Indian IPO activity will pick up when markets stabilize

In 2007 some analysts claimed that India has a uniquely insulated position from the global credit crisis. However, the falling stock market and stagnant IPO market in the first quarter of 2008 suggests that India may not be immune to the global slowdown. “The recent turmoil in the US financial markets has had a negative impact on global liquidity – the effect of which is being felt in India,” says Subramanian.

Other possible challenges to India’s markets include a possible slowdown of economic reforms due to impending elections, the impact of high oil prices on domestic inflation, and the rapidly appreciating Indian currency and its effect on export industries.
Ernst & Young: What have been the key trends and drivers in India’s IPO markets?

Dr. Subramanian: The key global trend that has impacted India has been the liquidity in the global system, with a significant inflow to India. The recent turmoil in the US financial markets has had a negative impact on global liquidity – the effect of which is being felt in India and across the globe. Secondly, the world economy is in a benign growth stage across most countries and this has had a positive impact from a global macro level.

In India, we have seen two macro-level trends which are very important. One is that the domestic economy continues to expand at a faster pace than in the previous two or three years, so domestic companies are doing very well. The second macro-level trend for domestic markets is a slow increase in domestic savings, moving from non-equities to equities. Until 2005, India’s total savings in equities was slightly under 2%, while in 2007, savings in equities were above 5%. So the domestic boom in savings, particularly from bank deposits to equities, has been quite strong.

We have seen global and domestic liquidity and domestic growth in the economy has been very beneficial to corporate performance. India’s stock markets have gone up nearly 100%, and corporate profit growth has been between 30% and 40%. PE investments, at least in listed stocks, have not been significant compared with those in previous years.

There is a third trend at the sector level: we’ve seen a completely new sector opening up for listings and absorbing investor money – real estate. The total amount of money coming into the real estate sector, including private equity money into unlisted ventures, could be close to US$10 billion.

The fourth trend in India is the significant amount of capital raised in 2007 through convertible bonds issued overseas. To stabilize the liquidity flows which are coming into India, the Reserve Bank of India put severe restrictions on convertible bonds. Therefore, capital raising has increased as equities gained momentum in 2007.

The fifth trend in 2007 was the significant number of new investors coming to the Indian market. Our regulators have registered an additional 100 to 120 institutions in the last 12 months, giving them access to direct investment in the Indian equity markets. Many of those which used to come through derivative instruments and participatory notes issued by other registered entities will now register and enter the markets directly. In the next 12 months, we should continue to see a significant and increasing number of direct participants.

Going forward, the risk to the market will be global liquidity and a slowdown of reforms in India, with political issues taking precedence over economic ones as we come closer to impending elections.

Ernst & Young: Which sectors drove IPO activity in 2007 and will that change in 2008?

Dr. Subramanian: Real estate will continue to drive IPO activity in India. There will also be significant large IPOs from infrastructure companies over the next three to five years; for example, the power sub-sector will continue to raise funds from the IPO market. In a growing economy and under-banked country, banks will be perennial visitors to the capital markets, and the insurance sector will come to the markets at the beginning of 2007. However, most capital raising won’t be sector-specific. We will continue to see capital raising across the sectors, but infrastructure, real estate, banking and resources will remain amongst the large capital-raising sectors in the next two or three years.

Ernst & Young: What are the current levels of PE and private placement activity in India and what do they mean for the IPO market?

Dr. Subramanian: PE in India will probably double from 2006 levels, if not more. One reason is that large ticket transactions are becoming available. The other reason is
that, in India, most PE firms are still going after growth capital, rather than buyout and financial engineering/LBO-based capital flows.

Therefore, what we saw in 2006 is probably the beginning of a trend, rather than the culmination. In 2007, we saw PE flow doubled that of 2006. In 2008, we believe the total PE deals will reach US$20 billion and may get close to US$25 billion, with real estate representing a significant proportion of this increase.

One of the things that the government has done in terms of hedge funds is relaxation of product switching guidelines by the market regulator in India. The regulator has announced that any fund which is regulated in its home country is welcome to invest in India. Given this investment opportunity, we believe a significant number of hedge funds will register here and, indeed, some very large funds have already done so.

What does that mean for IPO markets? I think we will continue to see good levels of flow into IPO offerings. PE in India also needs to be correlated with the IPO market, because quite a lot of companies that raise funds are listed companies. We are seeing more PIPE (Private Investment in Public Equity) deals than in other parts of the globe. Some could be through an IPO or pre-IPO transaction – so there would also be some private equity money involved.

Broadly speaking, any Indian IPO which has an offering size of US$100 million to US$125 million or more has a Rule 144A component and goes to qualified institutional buyers (QIBs) in the US to raise capital. A significant number of domestic listings have moved away from the global depositary receipts (GDRs) route, and now use Rule 144A to raise money. We believe that this trend will continue: stocks will still be listed in India, but will tap the US institutional market using Rule 144A.

Secondly, the current VC/PE ecosystem that is slowly developing has aided the growth of many small companies and they are now of reasonable size when they are ready to list. Thirdly, in the last four or five years, new unlisted sectors such as green energy, real estate and large technology companies have emerged and grown very quickly.

**Ernst & Young: What are the current key concerns of domestic and foreign investors in India?**

**Dr. Subramanian:** The major concern are the elections and the uncertainties around that. The second concern is the regulated prices of oil at the gas pumps, because much of the impact of oil price hikes has not yet been passed to the Indian consumer, but has been absorbed by the oil marketing companies and by the government. However, every 10% rise in the price of gasoline in India would lead to around 0.8% increase in inflation.

The third concern is the Indian currency. If it continues to appreciate as quickly and as dramatically as it has in the last six months, it will cause significant anxiety to most export or dollar-denominated industries. The fourth concern is that imports have moderated. At this level of economic growth, imports need to go up, and our worry is whether moderating growth in imports is an indication of future slowdown. However, having raised all the key concerns, Indian corporates are still...
very bullish and I think the overall mood remains very positive.

**Ernst & Young:** What’s your view of the localization trend in India, where companies are looking to list domestically, rather than overseas?

**Dr. Subramanian:** In the past, Indian companies were looking to list overseas for two reasons. The primary reason was that they could access investors whom they could not otherwise access, but that generally is no longer the case. Most global investors are now willing to invest directly into the domestic market, including the use of Rule 144A by Indian companies to access US institutional investors.

The other reason was regulatory arbitrage; at that time, the domestic regulator didn’t allow placement of stock exclusively to institutional investors, and Indian offerings always had to be open to retail participation, making them extremely expensive and requiring a lengthy process.

The only other reason to go to an international market is the inability of domestic market investors to understand a particular sector. Companies in the IT sector, specifically in the business process outsourcing and the internet sectors, have found that global investors, particularly US investors, seem to value the sector much more than investors in the Indian markets. Initially, when the Indian investors did not understand real estate and media, a lot of money was raised in the London AIM market, but we are now seeing both of those sectors slowly being listed directly in India, and investors are coming here directly.

In the next five years or so, Indian markets will need to raise a significant amount of capital if we are to see the kind of economic growth that most of us are expecting. Much of the money will be raised through domestic capital markets with significant foreign participation, as Indian rather than overseas listings. The latter will continue, but will raise less than in the domestic markets.
Australia: numerous small mining companies continue to tap public markets

The key drivers of Australia’s 2007 IPO markets included the accelerating Chinese demand for commodities, the ongoing mining and resources boom, a continuing surge of capital into pension funds and brisk private equity (PE) deal flow. Against an expanding economic backdrop of 3% GDP growth and healthy corporate earnings, Australia’s public markets raised US$6.6 billion in 228 IPOs, the second-highest number of deals in the world. However, with an average IPO deal size of US$29 million, the vast majority of Australian IPOs were worth less than US$20 million. Many of these small companies (121) were in the metals and mining exploration sector. In the largest Australian IPO of the year, drilling contractor Boart Longyear Ltd. raised US$1.85 billion.

In 2007, the largest share of fund-raising came from the industrial sector which raised US$2.2 billion largely resulting from the Boart Longyear deal. The finance sector generated US$1.7 billion the second highest amount of funds including the IPO of loan provider RAMS Home Loan Group, which raised US$590 million. Although the metals and mining sector evinced an impressive 135 IPOs, these small companies raised a total of just US$1.4 billion. Australian miners continue to benefit from the commodities boom fuelled by Chinese demand. “The Australia story is all about China and its demand for iron ore, coal and other raw materials as it undergoes urban development,” says Garry Wayling, IPO Committee Chair, Ernst & Young in Australia.

In the first quarter of 2008, Australia’s IPO markets were subdued with 30 deals worth a total of just US$171 million. “Equity and IPO markets are expected to be sluggish for a while,” says Wayling, “due to the uncertainty as a result of the credit crunch and less PE activity. When a degree of normality returns to the equity markets, a renewal in IPO activity can be expected,” he says. Nonetheless, a steady stream of small companies continue to go public, especially resource exploration companies. “Unless China collapses, the resource IPO boom is likely to continue,” says Wayling. An area to watch in Australia is the renewable energy sector following a resurgence in governmental and corporate focus on environmentally responsible governance. Furthermore, the potential float of privatized power assets in New South Wales will likely be worth about US$13–14 billion.

Garry Wayling, IPO Committee Chair, Ernst & Young Australia
EMEA/Europe

Europe: IPO markets remained resilient, sustained by Russian/CIS companies and private equity

Key trends

- In 2007, European IPO markets remained resilient, sustained by emerging markets companies and PE-backed IPOs, despite numerous postponements and withdrawals.
- The European IPO market was dominated by the industrials, metals and mining, financial and energy sectors, each composing 16 to 17% of new issuances.
- London remains the key destination in Europe for international IPOs, especially from Russia and the CIS.
- Rather than a full LSE listing, most emerging markets issuers take the less demanding path of a local listing together with a London GDR issuance.
- European private placement activity thrives on volatility.
- In the UK, Germany and France, local issuers were restrained, although junior markets were active.
- In the first quarter of 2008, the sluggish European IPO markets underscored the global slowdown, although emerging market issuers will continue to drive IPOs.

In 2007, in the midst of mounting global uncertainty, rising interest rates and a strong Euro, European IPO markets remained resilient. Sustained by fast-growth companies from the emerging markets and exit-seeking private equity (PE) players, Europe hosted 508 IPOs worth US$93 billion (see figure 14, page 54). For the first half of 2007, Europe outpaced any other region by funds raised. The London Stock Exchange (LSE) generated almost 16% of worldwide total IPO proceeds. All of the major IPOs in London came from the emerging markets. These London listings were primarily Global Depositary Receipts (GDRs) from Russia, including the largest global IPO of 2007, Russian VTB Bank’s US$8 billion issuance, which included a US$6.4 billion GDR in London.

Prompted largely by US subprime turmoil, the second half of 2007 saw a sharp increase in European market volatility. A record 46 European IPOs were postponed or withdrawn due to the instability. The deferrals included many larger issuances, such as the US$9 billion IPO of Russia’s top aluminum producer, Rusal, which was supposed to have listed in London.

Nonetheless, the fourth quarter’s European IPO volume was surprisingly strong. Two large offerings listed in December including the world’s second largest IPO of the year, the US$6.6 billion listing of Spanish renewable energy company, Iberdrola Renovables in Madrid, as well as Europe’s third-largest offering, the US$3 billion IPO of Eurasian Natural Resources Corporation’s (ENRC), a mining company from Kazakhstan. The ENRC offering was atypical in that it completed a full LSE listing rather than just a GDR offering like most CIS companies.

In the first quarter of 2008, a subdued European IPO market underscored the global slowdown with 46 deals raising a mere US$1.4 billion. Non-European issuers generated most of the capital. In the face of turbulent broader markets, wary European IPO investors grew more discriminating, preferring higher-quality, more liquid deals with rationally priced valuations.

Metals and mining, financial, industrial and energy issuers dominate markets

The European IPO markets in 2007 were dominated by the metals and mining, financial, industrials and energy companies. Each sector raised 16 to 17% of total IPO proceeds or about US$15-16 billion. The European metals and mining sector had particularly large deals, including three global top 20 offerings: the US$3 billion Kazakh mining IPO of ENRC in London, Belgium’s US$2.4 billion listing of zinc and lead producer Nyrstar SA/NV in Brussels, and the US$1.9 billion offering of Irish paper-based packaging company Smurfit Kappa Group in Dublin and London.
Typically, emerging market issuers complete a local listing, then gain access to international institutional investors through a London GDR.

In the European financial sector, most of the capital raised came from the Russian VTB Bank IPO. Damaged the most by the credit squeeze, some European financial institutions suffered heavy losses due to their holdings of securities backed by US subprime mortgages. The European energy sector attracted strong investor demand, most notably the Iberdrola Renovables listing in Madrid. The European industrials sector was similarly active, including the US$2.7 billion offering of the German automotive engine components firm Tognum AG, which listed on the Deutsche Borse.

**Many emerging market investors go for London GDRs**

Many emerging market issuers complement listings on their local market with GDRs in London. These certificates allow investors to hold shares of public companies in foreign countries through global offerings issued simultaneously in two or more markets in 2007. Overseas companies listing on the London markets for the first time raised around US$17.7 billion through GDRs. Requiring European Union (EU) standards of transparency and disclosure, GDRs tend to suit companies targeting specialist investors. Issuing GDRs in London is a far less rigorous and time-consuming route than undertaking a full listing on the LSE’s main market. Typically, these emerging market issuers first complete a local listing to access domestic capital. Then, through a GDR issued in London, companies raise their global profile and gain access to international institutional investors.

“Investors active in emerging markets are happy to buy into the GDR format so a main market listing is not required for a successful global offering,” says Jonathan Grussing, Managing Director and Head of Equity Corporate Finance at Credit Suisse in London. Investors do not seem to mind giving up the advantages of a full LSE listing, such as inclusion on the main indexes and greater aftermarket liquidity. “GDRs do have certain disadvantages compared with a full listing, as many GDRs only meet local governance standards, and the level of financial reporting and due diligence is not the same,” says Grussing. “Many GDRs have very limited due diligence and less investor protection” says Michael Lynch-Bell, Head of Inbound IPOs at Ernst & Young UK.

**London remains the key destination for international issuers**

London remains the top choice in Europe for international IPOs. “In 2007, the LSE attracted 95 international IPOs by companies from over 20 countries, and raised over GB£15 billion,” says Tracy Pierce, Head of Primary Markets, LSE. “The significant increase in LSE listings has really come from the emerging markets – countries that have less developed home capital markets but high-growth economies with companies that need capital to grow.” The LSE’s appeal includes its proven liquidity, large sophisticated investor following, with its hands-off regulatory framework post-IPO, and relatively low listing costs.

In 2007, LSE began a new policy encouraging larger companies (over US$300 million market capitalization) to move from AIM on to its LSE main market. “The bigger boys are no longer on AIM anymore,” says Lynch-Bell. Nonetheless, smaller companies are still listing on AIM, including many foreign companies. “If you’re a US$100 million market cap, early-stage technology company and you come to London’s AIM, you will get attention from market makers and you have all the infrastructure,” says David Wilkinson, IPO Leader, Strategic Growth Markets, Ernst & Young UK.

**Almost all European companies list on domestic exchanges**

In 2007, the LSE remained Europe's leading exchange, raising US$30.2 billion in 41 IPO deals. London’s AIM raised US$7.4 billion in 143 listings. Almost all UK firms listed at home, on London’s main market or AIM. Furthermore, “the few continental European companies that come to the LSE or AIM will do so because of their involvement in the emerging markets,” says Lynch-Bell, “or because they have a global reach outside of continental Europe.”

Most continental European companies also listed on their own domestic exchanges. In 2007, almost all of the 46 deals valued at US$10.4 billion that listed on Frankfurt’s Deutsche Borse were German. The Paris-based Euronext NV and its junior market, Alternext, which was formed through a merger of stock exchanges in Amsterdam, Brussels, Paris and Lisbon, attracted 64 IPOs worth US$9.6 billion – almost all of which
European companies seeking the US institutional market are no longer thinking about a dual listing, but rather prefer to use a Rule 144A offering to access these investors.

**Figure 14: European IPO activity by year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital raised (US$b)</th>
<th>Number of deals</th>
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</thead>
<tbody>
<tr>
<td>2002</td>
<td>132</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>97</td>
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<td>2006</td>
<td>528</td>
<td></td>
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<tr>
<td>2007</td>
<td>508</td>
<td></td>
</tr>
</tbody>
</table>

Source: Dealogic, Thomson Research, Ernst & Young

**Figure 15: Europe, Middle East and African IPO activity by year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital raised (US$b)</th>
<th>Number of deals</th>
</tr>
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<tbody>
<tr>
<td>2002</td>
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<tr>
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<tr>
<td>2007</td>
<td>699</td>
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</tbody>
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Source: Dealogic, Thomson Research, Ernst & Young

were companies based in those four countries. More than half of these IPO deals were listed on Alternext, which has become the leading exchange for smaller European companies. It was also an unusually active year for the Spanish exchange, BME, with nine deals worth US$10.1 billion, including Iberdrola Renovables which was the largest Madrid listing ever.

**IPO activity among UK, German and French issuers was restrained**

In the three major European markets of the UK, Germany and France, 2007 IPO activity was restrained. However, a steady flow of smaller deals kept the junior markets of AIM, the Entry Standard and Alternext busy.

UK-based issuers initiated just 95 IPO deals worth US$9.4 billion with 74 of these new issuances listed on the AIM market. Although London hosted large international IPOs from Russia and Kazakhstan, the largest UK-based issuer that listed in London was retailer Sports Direct International, which raised US$1.8 billion.

German issuers launched 42 deals worth US$10.2 billion, all on the Deutsche Borse. The largest German IPO was the US$2.7 billion Tognum AG IPO. Germany still boasts a healthy corporate landscape and a rising DAX index. Deutsche Borse’s junior market, the Entry Standard, hosted around half of German IPOs and is now firmly established as an alternative access to the EU capital market. The Entry Standard has evolved into the financing source for very small companies worth an average of US$5 million. “Despite shrinking German valuation multiples, the outlook for Germany is positive, with a large backlog of German companies waiting to go public,” says Julie Teigland, Central European Strategic Growth Markets Leader, Ernst & Young Germany. “A large majority of German IPOs are backed by private equity.”

French issuers launched 46 IPO deals worth US$4.2 billion in 2007. More than half of the French IPOs were small to middle-sized companies, from a range of different industries, including consumer products and services and technology industries. Almost
all of the 46 French issuers chose to list locally on the main market Euronext (12 deals) or on the junior market Alternext (33 deals). The two biggest French IPOs were both PE-backed and listed on Euronext: the US$1.5 billion offering of consumer certification services firm Bureau Veritas SA and the US$1.4 billion offering of electrical equipment distributor Rexel SA. Both of those IPOs were heavily over-subscribed, demonstrating that “despite market volatility, strong investor interest persists for PE-backed companies with strong assets,” says Any Antola, Continental Western Europe IPO Leader, Ernst & Young France.

European private placements thrive on market volatility
Given market volatility, many European companies that are not quite ready for an IPO are choosing to do private placements as a stepping stone in their capital-raising efforts. “There are quite a lot of IPO deferrals, but the private placement pipeline has never been stronger,” says Lynch-Bell. Indeed, a high proportion of international companies that list in London also raise capital from US institutional investors through Rule 144A. “European companies seeking the US institutional market are no longer thinking about a dual listing, but rather prefer to use a Rule 144A offering to access these investors,” says Teigland. “It’s not about having a material US shareholder base, but rather the additional publicity, potentially higher valuations and the overall business recognition. Often, especially for technology companies, a Rule 144A offering is an absolute necessity.”

Although a few European issuers may prefer to stay private, most companies will go on to the public markets to access deeper liquidity indefinitely and maximize their international profile. “The IPOs will come,” says Lynch-Bell, “because the institutional investors will only invest if they think an IPO is coming eventually.”

In 2008, emerging markets will continue to drive IPOs
Global volatility has diminished European investor appetite, and forced companies to be flexible on valuations. European issuers have been obliged to slash their growth stock multiples. “Nowadays, either you accept a lower valuation, or you postpone,” says David Wilkinson, IPO Leader at Ernst & Young UK. “The money is there, it’s just the valuations that people are accepting are going to be lower because of the uncertainty.”

In the meantime, secondary offerings are playing an important role in European capital markets, since investors feel more confident about already established listed companies with a track record. “If market sentiment deteriorates, companies that are already public, and are doing a follow-on offering or a rights issue, will more likely find receptive investors,” says Grussing. “After a few quarters of new issue activity concentrated on listings by existing companies, IPO activity usually returns.”

In 2008, companies from the emerging markets are expected to be driving European IPOs. Russian issuers will be active, as some companies have waited for the presidential elections before coming to the market, while Latin American and Middle Eastern companies are starting to trickle into the London market. As governments in formerly socialist states such as Poland continue to sell large portions of former state-owned businesses, more IPOs based on privatizations can also be anticipated. With investors eager to capitalize on high commodities prices, energy companies, particularly in exploration and development, and natural resource companies, especially in agricultural commodities, are also expected to be continuing sources of many European listings.

Any Antola, Continental Western Europe IPO Leader, Strategic Growth Markets, Ernst & Young France
Michael D. Lynch-Bell, Head of Inbound IPOs, Ernst & Young UK
Julie Teigland, Central European Strategic Growth Markets Leader Ernst & Young Germany
David Wilkinson, IPO Leader, Strategic Growth Markets Ernst & Young UK
Global IPO trends report 2008

Jonathan Grussing
Managing Director and Head of Equity Corporate
Finance, Credit Suisse
London

Ernst & Young interview

Investors continue to look for alpha and growth

Jonah Grussing
Managing Director and Head of Equity Corporate
Finance, Credit Suisse
London

Ernst & Young: What’s your view on the key trends in the 2007–08 IPO markets in Europe?

Jonathan Grussing: We were pleasantly surprised by the level of new issue activity in the second half of 2007. When people got back to their desks in September, the prevailing expectation was, “This is going to be a quiet second half.” But in the fourth quarter in 2007, issuance activity remained pretty strong, even though volatility increased considerably. The VIX, which is the index used as the barometer of market volatility, was over 30 (and it had been below 15 earlier in 2007), so it was a fairly big change in market sentiment.

Volatility has required vendors to adjust some of their expectations. In tough markets, investors hold issuers to higher standards of readiness. Growth stock multiples are also going to be a little bit lower. Management needs to get every step right as they go on the road show. But for the right stories – especially larger and therefore more liquid names – with appropriate pricing, the market remains open.

The IPO pipeline of activity suggests that the next 12 to 18 months may be as busy as the last few months, in terms of volume if not number of deals. If the turmoil in the markets broadens out though, new issue activity will slow down, except for those companies that genuinely need the money.

Ernst & Young: What are other IPO developments to look for in 2008?

Jonathan Grussing: Other things to watch for will be the continuing rise of issuance from new markets. The Brazilian stock exchange BOVESPA went public in 2007. Brazil has been a very active market for IPOs and we have seen a number of companies from Latin America starting to come to the London market. There will continue to be a lot of activity out of the Middle East and Russia will also be strong, particularly as some issuers have waited for the elections before coming to market. We saw relatively less privatization activity in 2007 but a number of issues are scheduled for 2008, if politics and markets be willing.

Particularly with markets being more volatile, rights offerings and other acquisition financing are expected to be an important part of capital market activity in 2008. If sentiment deteriorates, companies that are already public, and are doing a follow-on offering or a rights issue, will more likely find receptive investors. After a few quarters of new issue activity concentrated on listings by existing companies, IPO activity usually returns.

Ernst & Young: Do you believe there was a decoupling of the developed and emerging markets in 2007?

Jonathan Grussing: There has been a decoupling – emerging markets have remained open longer and stayed stronger, while western markets have been more impacted by the volatility. The decoupling suggests that investors continue to be looking for alpha and growth. It is perhaps a little easier to achieve the alpha or high growth that investors seek in the emerging markets given generally greater underlying economic strength.

Emerging markets have been and continue to be an important part of the overall issuance activity. Over the last couple of years, IPO activity has been picking up, and Russia and China have featured in top issuer lists. We expect there will be a continued rise in the level of GDR offerings, generally from Russia, but we may also see more GDRs from India and other countries that will look to come to London.

Ernst & Young: What are the primary differences between a main market listing and a local country listing through a GDR?

Jonathan Grussing: There is certainly more work involved with a main market listing. Because such a listing requires adherence to UK as well as local market governance standards so it is seen as more aspirational. Additional financial preparations and analysis are required. Once achieved, a main market listing brings a number of benefits. The potential for FTSE indexation is a benefit as is the ability to position the company more closely to comparable companies already listed in London. You
are also more likely to reach domestic UK investors if you have a main market listing.

Emerging market investors are happy to buy into the GDR format so a main market listing is not required for a successful global offering. In Russia, for example, politically it is very difficult to do anything other than a GDR, because the Russian government is trying to develop the local capital market and requires a local listing for Russian issuers. That said, given the market volatility we’ve seen, some of the GDR listings have seen quite a big trail off in liquidity levels in the aftermarket.

A company must do more pre-planning to do a full listing. If you were well prepared, you could think about doing a GDR IPO in London with a three- to five-month lead time. For a main market listing, you would want to have at least four to six months’ lead time, for the board to gel, for financial reporting and other procedures to be in place, and to have the necessary systems to meet EU transparency directive obligations.

Ernst & Young: What’s your view on private equity and hedge fund activity and its impact on IPOs?

Jonathan Grussing: There were a number of private equity and permanent capital deals earlier in the year that worked well. Some of these issuers have even been able to come back to market with follow-on offerings to raise more money. If issuers have the kind of investment returns that are sustainable and probably benefit from raising permanent capital, they can put the capital to work immediately, but in a slightly different fashion. Companies can be less concerned about redemptions, maybe take slightly larger or less liquid positions, which yield more returns, thus creating a virtuous circle.

In the US, we have seen a rise in issues by SPACs, or Special Purpose Acquisition Corporations. It will be interesting to see if more SPACs are attempted in Europe as another way to offer investors a chance for potential private equity-like returns.

We may see more hedge fund and other alternative asset managers look to go public. That trend will continue because more investing institutions are placing money with alternative asset managers in their quest for returns. Ultimately, an IPO is a branding tool for an alternative asset manager. This can be a double-edged sword and a wider audience will then be paying attention to investment returns in the aftermarket. But a number of issuers have found that the profile-raising activity of an IPO can be quite good for their underlying business, provided it comes at the right point in their development cycle.

Ernst & Young: What’s your take on the growth in private placement activity?

Jonathan Grussing: We see private placements as an important part of our business. We’ve recently hired a managing director to lead a dedicated private placement team. When volatility might make an IPO difficult, this team is able to work with issuers who say, “My growth plans need capital, but I’m not prepared to go public now.” That will actually be an important part of our toolkit – not necessarily to do a quick financing round prior to the IPO, but more to use as a stepping stone in the overall capital-raising plans of an issuer. Sometimes issuers may not ever seek to go public. We’ve seen this in the US, in some of these private exchange markets, where you can access a finite number of holders and avoid having to become an SEC-registered company, yet still benefit from a degree of liquidity without a full public quotation.

Ernst & Young: Do you see any major differences between exchanges within Europe?

Jonathan Grussing: We have seen some healthy competition across the exchanges. Euronext was quick to spot some of the limitations within the old Chapter 15 listing rules in the UK which meant that certain types of investment companies in London were not permitted to list (i.e., the exchange and the UK Listing Authority) responded by allowing Chapter 14 listings to happen and then launching a consultation to change the
Chapter 15 rules. It is actually healthy that there is competition between markets; it allows issuers to pick and choose, within the overall Prospectus Directive region within Europe.

We are working with one of the listing markets right now. We’re finding them to be quicker in their turnaround of comments than they were earlier in the year. If this is in response to competition between markets, this can only be good for issuers. Once you have chosen your listing market and are in the approval queue, you need to stay the course. But at the outset, issuers often have the luxury of choosing among more than one potential listing market.

AIM rules are probably the most flexible and issuers in theory can go public sooner, even if they only have a one- or two-year financial track record. But with the flexibility comes a need to wait for a three-year record. If the issuer then wants, it can move to the main market and a slightly different investor profile. For a company with big aspirations, we will often debate the trade-off between moving quickly and waiting for the financial track record for another market. Lastly, I don’t think we’ve yet seen much in the way of tangible benefit to issuer clients from the various exchange link-ups, although this may come.

**Ernst & Young: What are your clients’ key concerns for the future?**

**Jonathan Grussing:** Issuers will be worried about spillover from the financial sector into the real economy and whether that shows up in consumer confidence. The degree to which housing will no longer be seen as a safe investment bet and whether housing prices move downwards can impact both consumer and investor sentiment. However, the role of the retail investor in the IPO process is not as important as it was the last time we had a prolonged downturn in new issuance activity, at least in the US and the UK. In 2000-01, retail investors were a bigger part of the IPO market, but sentiment clearly matters when choosing the time for your IPO.

Another concern is the dislocation in the credit market. It’s tough out there for high-yield and leveraged finance issuance as spreads have widened. This has implications for issuers in the financial sector as well as those with a need to refinance their debt. On the one hand, banks need to repair their balance sheets through rights issues or other measures. On the other hand, this cooling in leveraged finance borrowing may actually lead to increased IPO activity over time. Private equity firms that in the past might have sold an acquired business to another private equity firm in a so-called secondary buyout might now need to consider an IPO exit.

It’s probably too early now to say whether the US presidential race will impact European markets directly, but it may start to concern issuers, particularly if there is a political gridlock during the last year of President Bush’s term.

Corporate governance will remain a key investor focus, particularly with issuers from the emerging markets. Issuers need to be doing the groundwork to build the right board and systems.
**Ernst & Young interview**

**Investors are emphasizing sector and management**

**Ian Hannam**

Chairman

Equity Capital Markets EMEA

JP Morgan Chase

London

**Ernst & Young: What have been the key trends in the European IPO markets and your outlook for 2008?**

**Ian Hannam:** 2007 ended up being essentially a record year in IPO issuance for the UK. It was a market of two halves. A key trend was the IPO issuance of recycled goods, (i.e. the private equity houses taking their portfolio companies public). However, the prospects for private equity firms weren’t good during the second half of 2007 and for 2008. The portfolio companies of private equity firms will have debt and probably won’t be able to refinance on better terms.

In their attitudes towards IPOs, institutional investors are emphasizing sector first and then management. There is more emphasis on management than ever before, and people intrinsically are willing to pay a fee for good management.

2008 is expected to be a very different market from previous years. New companies will be raising capital for new ideas, such as energy companies in India or other emerging markets. If you could serve a new bank today, emerging out of the financial crises, you would be very well placed. The top sectors in Europe will be different in 2008 – there will be more natural resources, but less mining.

As we’ve seen in the crisis of 2007, the equity market will probably continue to outperform any other asset class, especially compared with the lower liquidity of the corporate bond market. The equity market went through record volumes in 2007, and provided the hedging and the liquidity that people needed. Many of the hedge funds had to sell their equities because it was the only thing they could sell.

The next trend will be the rise of sovereign wealth funds (SWFs) that have historically bought only US bonds but are now considering other asset classes – particularly equities. The rise of SWFs will strengthen the equities market.

**Ernst & Young: Will the emerging markets continue to drive global IPO activity?**

**Ian Hannam:** My basic belief is that the further you get away from the US, the more the growth is happening. The liquidity of stock markets will be healthier outside North America. Although the risk-adjusted price might be slightly lower, the underlying credit risks and the borrowing of debt may be higher in real terms. There needs to be a healthy trade-off in some of these markets, to adjust to the increased cost of debt. We’re due for a healthy correction in China, but the cash coming into emerging economies will continue, due to the high demand for metal, raw materials and food.

**Ernst & Young: What do you see as the dominant sectors in Europe IPO markets?**

**Ian Hannam:** The strength in mining will be replicated in other natural resources. We’ve seen it happen in uranium and in power, and we will see it again in basic agricultural commodities. Countries with a lot of land and good sources of agriculture, such as Brazil, certain parts of Africa, Kazakhstan and the Ukraine, will also be interesting. Initially, PE will emerge in those countries, then there will be public companies which start to produce a revenue source.

Sector activity should increase, in any areas that are impacted by the growth of the developing markets. Where we will really see increased growth is where the economy has grown from nothing and is now thriving. IPO and M&A activity in the natural resources sector will also increase.

We are going to see a lot of IPO activity from the Middle East. Increasingly, the demand and drivers for those IPOs will be from local money, for example Middle Eastern deals driven by Middle Eastern money. The two-week road show to America is going to be less and less relevant, since companies will be able to raise money in their local markets.

**Ernst & Young: SWFs are contributing to pre-IPO fund-raising. Do you think that the emergence of SWFs will actually defer IPO activities?**

**Ian Hannam:** The ability to do pre-IPO fund-raising is much stronger now, in that...
there are SWFs, hedge funds and even mutual funds, all with large amounts of money and willing to take bigger risks. For example, the Russian power plant OGK-6 was able to raise 10% on a valuation of US$1.5 billion in a pre-IPO financing because of these SWFs. That enabled them to do their IPO, which otherwise may not have been accomplished.

So pre-IPO fund-raising as part of the IPO process is going to be at the margins. The private placement organizations which have traditionally treated pre-IPO financing as a separate, discreet entity will be at a disadvantage. In the future, pre-IPO financing will be seen as an integral step in the run-up to an IPO, as a means of validating value. SWFs, mutual funds and hedge funds are suggesting that they will provide funds three months before the IPO, and work closely with the institutions to ensure a successful idea. In volatile markets, it’s preferable to have the financial flexibility of being able to choose the best time and window of opportunity to go public, rather than going public at a pre-specified time.

**Ernst & Young: What are private equity firms doing with their funds in 2008?**

**Ian Hannam:** We’re seeing a move by the private equity funds to precondition the market through the media. They are telling their investors that returns in general are going to be lower, due to the lack of ability to leverage deals. They will then do deals with less leverage in order to deploy their funds. Private equity funds have the money to deploy and they have the individuals. They’ll be trying to raise money in different vehicles so they can essentially provide debt to their own deals or other firm’s deals.

**Ernst & Young: What’s your perspective on the growing competition amongst the world’s exchanges?**

**Ian Hannam:** Stock exchanges are in the competition business. We have seen that the New York Stock Exchange (NYSE) has reacted very flexibly in terms of its rules, to become more competitive with other world exchanges. The NYSE has tackled three key issues: it has allowed non-voting shares on different share classes, 10% free floats, and boards with no independent directors. These are significant moves. Hedge funds have been able to list in New York because of these three factors. These changes have more than offset the disadvantages of Sarbanes-Oxley.

**Ian Hannam:** The challenge to the GDR process is that the London Stock Exchange (LSE), in its quest to stay independent, is including all the GDR listings under its main listings. The problem is that it’s not comparable with other listings. The UK market is made up of three different markets: the main board and full listings, a huge GDR market which is something very different, and the AIM market. Consequently, there is a problem that could develop with the regulator. There could be a collapse in the GDR market, as the GDR market is just a settlement system and the liquidity depends entirely on the investment banks.

The listing committee does not look favorably on companies with foreign shareholders. It wanted to change the rules so that only British companies, British management and British assets could be listed on the LSE. The committee doesn’t accept the argument that HSBC would not be here today if it had operated that system. It’s an ongoing issue that is resulting in bad publicity for the LSE.

**Ernst & Young: What about the current challenges to the London Global Depositary Receipt (GDR) process?**

**Ian Hannam:** The challenge to the GDR process is that the London Stock Exchange (LSE), in its quest to stay independent, is including all the GDR listings under its main listings. The problem is that it’s not comparable with other listings. The UK market is made up of three different markets: the main board and full listings, a huge GDR market which is something very different, and the AIM market. Consequently, there is a problem that could develop with the regulator. There could be a collapse in the GDR market, as the GDR market is just a settlement system and the liquidity depends entirely on the investment banks.

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The significant increase in LSE listings comes from high-growth emerging markets

Ernst & Young: What have been the key trends in the European IPO markets in 2007?

Tracy Pierce: The second half of 2007 was not without its challenges for companies considering an IPO, but overall fund-raising on the LSE remained strong for the year as a whole.

Money raised by international IPOs on our markets during 2007 reconfirmed our position as the world’s most international equity market. In 2007, we attracted 95 international IPOs by companies from over 20 different countries. Between them they raised over GB£15 billion, more than double the GB£6.7 billion worth of offerings by the 34 non-US companies which conducted IPOs on NYSE, and more than the GB£10.7 billion worth of international IPOs on NYSE and NASDAQ combined.

Overall, companies on the LSE raised over GB£45 billion in new and further issues during the year. This included 269 IPOs on the Main Market, Professional Securities Market and AIM, which raised over GB£26 billion, with an additional GB£18.9 billion which was raised through further issues.

For the Main Market, we continued to attract significant numbers of companies from Russia and the CIS, but we were also encouraged by the potential of new regions where we have started to market more actively, with companies joining the market from Argentina, Vietnam and Bahrain.

AIM also had another excellent year. The ability of existing AIM companies to raise record amounts in further issues (GB£9.6 billion) together with the growth in average money raised at IPO, reflected the long-term institutional investment available and the market’s growing maturity. We also saw a record 12 companies transfer from AIM to the Main Market; more than in the previous four years combined. During the year, 183 companies completed IPOs on AIM, including 59 international companies, raising over GB£6 billion in total.

We continued to see strong interest from the developed markets of North America and Continental Europe, but also increasing interest from emerging markets such as China, India and Latin America. By the end of 2007, a total of 347 international companies were quoted on AIM.

Ernst & Young: What is the LSE’s competitive position amongst the world exchanges?

Tracy Pierce: One of London’s greatest strengths in recent years has been its ability to attract companies and investors from high-growth markets overseas. We currently have around 700 international companies from over 70 countries listed and traded on the LSE. The main reason for this success is that London has a number of unique advantages compared with our international competitors.

The LSE provides access to the largest pool of international capital in the world, with US$1.9 trillion in international equity assets under management; this is 30% more than New York, and far more than any other major financial center. London is the most cost-effective place for companies to raise capital. The equity cost of capital at both IPO stage and beyond is lower in London than in any other major financial center, particularly compared with New York.

We have world-class standards of regulation and corporate governance. We offer the widest choice of routes to market – London has been designed as a home for companies of all sizes and at different stages of development. And we facilitate the strategic objectives of companies that want to access Europe as part of fulfilling their global ambitions. London is the gateway to Europe for international companies which want to access the population of 490 million people, and a market which now accounts for 20% of world trade, one of the most economically significant markets in the world.

Ernst & Young: Most companies from emerging markets take the less rigorous route of issuing GDRs – why would any company bother to list on the LSE Main Market?
Tracy Pierce: We offer a choice of listing routes for different types of companies, dependent upon their size, stage of development and the investor base that they want to access. This includes the Main Market (for primary listings and GDRs), the Professional Securities Market, the Specialist Fund Market and AIM. The larger, more established companies from emerging markets either choose a primary listing (e.g., Hochschild Mining from Peru) or a listing of GDRs (e.g., TMK from Russia).

Companies that join the market via a primary listing are complying with London’s gold standard, that is EU-regulatory standards, additional UK super-equivalent requirements and the UK combined code of corporate governance. This provides companies with access to institutional and retail investors, and usually, inclusion in the FTSE UK series of indices.

Those companies that require additional flexibility and are targeting specialist, professional investors have, the option of a GDR listing, which requires compliance with EU standards of transparency and disclosure. These securities are generally very liquid and trade on our International Order Book, the most successful electronic trading platform for international securities in the world. The trading of GDRs on the IOB continues to grow and reached record levels in 2007, with the value of bargains exceeding $446 billion, up 54% compared with 2006.

Ernst & Young: What might be the pros and cons be for a public market listing compared with some of these alternative offerings?

Tracy Pierce: For Rule 144A tranches, it can be quicker and cheaper for companies to raise capital from US qualified institutional buyers. However, Rule 144A tranches do not provide the significant additional advantages that a listing on a public market can provide.

For instance, companies listing on a regulated public market have to comply with higher standards of corporate governance, transparency and disclosure. As a result, they gain higher profile and access to a much deeper pool of capital and a broader range of investors both at IPO and through further issues. In addition, these securities are traded on highly transparent platforms facilitating efficient price formation, which supports greater secondary market liquidity.

Ernst & Young: Do you see this recent private placement growth as a temporary phenomenon or do you think we’re headed toward more lightly regulated markets?

Tracy Pierce: To some extent, the increase in private placements can be seen as a reaction to the onerous level of US regulation, particularly as a result of Sarbanes-Oxley, which has significantly increased the costs and risks associated with maintaining a public listing in the US markets. However, in specific cases, I think these private routes can offer additional choice to companies, particularly those specialist entities looking to target professional investors.

It is interesting to note that a high proportion of the international companies that list in London, whether via the Main Market or AIM, have raised a percentage of capital from US institutional investors through Rule 144A. So, in some cases, private placements can be seen as complementary to a listing on a public market, either before or in parallel to the IPO process.

However, for those companies looking to maximize their international visibility and profile and to access a deeper pool of capital and liquidity, the public markets remain the most viable option. We will continue to offer a choice of routes to market to suit the needs of a wide range of domestic and international companies.
Russia/CIS: record IPO markets decelerate due to rising domestic challenges

Key trends

- 2007 was another record year for IPO markets in Russia and the CIS, although market uncertainty sparked an abrupt deceleration in the second half
- For Russia’s larger companies, London remains the favorite listing destination through a GDR issuance combined with the legally-required 30% local listing
- The quality and depth of Russian IPO markets continue to improve, since large Russian IPOs are complemented by a strong pipeline of mid-sized offerings
- Among the CIS, Ukrainian and Kazakhstan markets are the most active, with larger companies listing in London due to the lack of local liquidity
- PE and hedge funds are filling the pre-IPO financing gap in Russia
- Corporate governance, transparency, public relations and regulatory issues are key challenges facing Russian issuers
- Despite an inactive first quarter of 2008, a steady stream of diverse, mid-sized IPOs is expected

The capital markets in Russia and the CIS have developed rapidly over the last seven years. Since 2000, the Russian stock market grew tenfold while its IPO markets expanded to make up 7% of global funds raised in 2007. The first half of 2007 maintained the rapid Russian IPO momentum of the last four years. Driving the demand, international investors sought out Russian IPOs, heartened by the country’s economic growth prospects, political stability, natural resources and consumer purchasing boom.

2007 broke new IPO fund-raising records as Russian-based companies launched 20 IPOs worth US$19 billion. With an average deal size of US$948 million, investors focused on Russia’s hefty deals, primarily in financial services (US$8.4 billion), but also in real estate (US$2.8 billion) and energy and power (US$2.6 billion). The US$8 billion IPO of Russia’s second largest state-owned bank, Vneshtorgbank (VTB) was the world’s largest IPO of the year. The VTB IPO raised US$8 billion through a dual listing on a local Moscow exchange and the issuance of a London GDR. The second largest new issuance in Russia and the CIS was that of Kazakh mining company, Eurasian Natural Resource Corp (ENRC), which raised US$3 billion in a full listing on the LSE.

Credit crunch and domestic challenges prompt IPO slowdown

In the second half of 2007, the Russian IPO markets suddenly decelerated. Numerous IPOs were postponed and withdrawn, including the highly anticipated US$9 billion London listing of Russian aluminum producer on Rusal. The Russian IPO slowdown could be blamed not just on the credit crunch, but also on rising domestic concerns about accelerating inflation, corporate governance standards and disappointing share price performances. In 2007, many Russian IPOs sold at high valuations, with some failing to deliver on promises of growth. Deals sold at aggressive forward multiples often fared poorly in post-IPO trading. Some uneven post-IPO share price performances dampened investor enthusiasm for Russian IPO markets and raised suspicions of inadequate due diligence performed on companies.

“Russian IPO markets went through a dramatic change in the second half of 2007. Investors have become much more company-specific and demanding in terms of quality, pricing and due diligence of companies,” says Natasha Tsukanova, Managing Director and Head of Investment Banking of JP Morgan in Moscow.

Indeed, in the first quarter of 2008, Russian and CIS IPO markets were quiescent, with only one Russian IPO which generated US$464 million locally and one Kazakh deal which raised US$100 million in London.
Global IPO trends report 2008

Private equity players fill in the pre-IPO financing gap
Private equity (PE) is developing in Russia and the CIS, although only smaller PE deal sizes of about US$100 million to US$200 million have gone through so far. "Ever since the credit crisis, it has become very difficult to obtain cheap loans from Russian banks, and so PE is starting to play a key role in financing the growth of newly established high-growth companies," says Tsukanova. She observes that one huge benefit of western PE investment into Russian companies has been the introduction of international corporate governance standards to these firms. "Furthermore, international hedge funds will also be a very important source of funding for creative pre-IPO financing or for growing a company through M&A transactions," she says.

The desire for acquisition currency drives some IPOs
Robust Russian M&A activity continues to be another driver for IPOs, as many strategic transactions not relying on leverage are underway. The desire for acquisition currency has become a key motivation for Russian companies to go public. "It's a new realization among Russian company owners that by going public, they can get a completely new currency of shares to use as payment for an acquisition," says Tsukanova. An increasingly common scenario is that an ambitious Russian company will grow by merging with its peers, and then, when the merged companies reach a critical mass, will seek to go public.

Ukrainian and Kazakh issuers also seek capital in London
Among the CIS, companies in the Ukraine and Kazakhstan were most active in readying themselves for IPOs. In 2007, Kazakh companies launched six deals worth US$3.8 billion, including the Kazakh mining company, ENRC. Currently, Kazakh companies tend to list in London because of its deeper liquidity. "However, a shift to listing in Hong Kong is highly likely in the future," says Gellashvilli.

Most Ukrainian companies also listed in London due to lack of local liquidity to support mid-sized to large offerings and strict regulatory limits on domestic IPOs. In 2007, eight Ukrainian companies went public and raised US$1.2 billion, including the

Larger Russian companies prefer London GDRs
Currently, Russian companies are legally required to list locally at least 30% of their equity. However, the local Russian market retains only enough liquidity to support small or mid-cap IPOs up to the value of US$500 million. "Moreover, Russian issuers are not always eager to list on the Moscow Exchange, primarily because of its shallow liquidity and opaque pricing system," says Marchello Gelashvilli, IPO Leader, Strategic Growth Markets at Ernst & Young in Moscow. He adds, "Many improvements are underway to enhance the Russian listing process, market infrastructure and trading system."

London remains the preferred destination for larger capital-seeking Russian companies. In 2007, 37% of all CIS IPOs listed on the LSE or AIM only, 31% conducted dual listings on their local exchange and the LSE, while 17% chose to list only on their local exchanges. Six out of the 35 Russian CIS issuers pursued a full London main board listing.

The most popular form of listing for larger Russian companies was a GDR issued in London, combined with a local Moscow listing. In 2007, 11 out of the 20 Russian IPOs conducted such a dual listing, which gives a Russian company exposure to both local and international investors. "Politically, in Russia, it is very difficult to do anything other than a GDR," says Jim Klein, Capital Markets Group, Ernst & Young in Moscow. "So once you have listed locally, the GDR is a simpler route."

London GDRs are available only to institutional investors, and are not eligible for inclusion in major indices (except for a specially designed Russian GDR index). "Nonetheless, for most Russian companies, the advantages of a full LSE listing, such as index inclusion and greater liquidity, do not outweigh the full listing’s disadvantages of higher cost, stricter corporate governance and other more demanding requirements," says Gelashvilli.

Figure 16: Russian IPO activity by year

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital raised (US$b)</th>
<th>Number of deals</th>
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</tbody>
</table>

Source: Dealogic, Thomson Research, Ernst & Young
As Russian markets, companies and investors grow in sophistication, the range of pre-IPO financing and other financial products will also increase. “What we will see in the next 18 to 24 months, is a broadening of the financial products which companies will be using while in the pre-IPO phase,” says Tsukanova. “We will see more hybrid structures, types of convertible bonds and warrants which allow investors to share upside returns with the companies and perhaps get some downside protection against loss.”

In 2008, the Russian IPO markets are expected to continue to diversify. More IPOs from financial services, real estate and retail companies are anticipated. In addition, as a result of the Russian government’s policy initiatives, there will also likely be a rise in public offerings from companies in the technology, agriculture, infrastructure and engineering sectors.

Marchello Gelashvilli, IPO Leader, Strategic Growth Markets, Ernst & Young Russia

In 2008, a steady stream of diverse, mid-sized IPOs is expected
Despite global volatility and the lack of deal flow in the first quarter of 2008, a steady stream of diverse, mid-sized transactions in the range of US$200 million to US$1 billion is expected later in the year. Many Russian IPOs originally scheduled for the second half of 2007 are expected to go public in 2008. At the same time, at least two Russian mega-deals announced plans to list in Hong Kong, including aluminum producer Rusal’s $9 billion offering, and full service bank Gazprombank’s US$8 billion deal.

Corporate governance, public relations and regulatory issues pose key challenges
“Since Russian companies are no longer an ‘automatic buy’, new issuers must be prepared to face a very tough competitive environment in which the qualitative value drivers are important,” says Gelashvilli. Smaller private companies preparing for an IPO must first improve their corporate governance, investor communications, financial statements and management disclosures. “Nowadays, nothing will attract investors more than transparency and the ability to see the true results of the operations of the company,” he says.

Public relations is also a key concern for Russian issuers that have already listed GDRs or local shares. “Our clients need to learn how to communicate with investors, the government and the regulators,” says Gelashvilli, who claims that public relations, articulate management and open communications to investors were never a major issue in Russia, until now.

“Other key challenges for Russian companies relate to implementing new financial reporting standards, internal control procedures, and managing the IPO process,” says Gelashvilli. “Investors are also apprehensive about the ambiguity of many Russian regulations, especially with regard to tax, financial statements and legal restructuring,” he says. “It leaves a lot of potential issues to be raised by tax authorities when they come and do their inspections.”

James Klein, Capital Markets Group, Ernst & Young Russia

US$419 million IPO of Ferrexpo, an iron ore mining company, which listed on the LSE. “The Ukrainian IPO market is expected to take off in 2009-10, with many Ukrainian companies currently preparing themselves for an IPO,” says Klein.
Ernst & Young: What have been the key trends in the Russian IPO markets in 2007–08?

Natasha Tsukanova: Russia went through a honeymoon period with international capital markets in 2007, so it was a very important year. Investors were ready to look at virtually any company coming from Russia. At the beginning of 2007, it was very easy for Russian companies to raise large amounts of capital. This was based on a very positive outlook for Russia in terms of economic growth and political stability.

But Russian markets went through a dramatic change around the middle of 2007 and, although investors are still open to investment in Russian companies, they are now much more thorough and demanding in terms of due diligence in valuing companies.

Russian company valuations aren’t necessarily coming down, but investors will scrutinize the pricing and the company’s businesses based on the reliability of their financials and their forecasts. If you are a good business with reliable prospects, then you still get a very good response from the international capital markets. However, investors are much more selective and company specific than before.

Ernst & Young: What are the reasons for the sudden increase in investor selectivity?

Natasha Tsukanova: It’s a combination of factors, of which one is the credit market. Typically, whenever there is volatility, investors are more aware of what’s going on and more cautious. Another factor is that, over time, investors become more sophisticated – they learn, and instead of just throwing money at Russian companies in general, they become more selective.

Also, in 2007, some investors lost money in a number of Russian IPOs, and even though they made good profits on other IPOs, it made them very aware of the need to scrutinize every issue. VTB had a very successful IPO – it was massively oversubscribed. But those who invested in the IPO a year ago would now have lost money because the share price went down.

Ernst & Young: Currently, who are the primary investors in Russian IPOs and what are they focusing on?

Natasha Tsukanova: If we look at major IPOs, the demand is still driven by international investors. Russian investors have indeed become more active and are progressively playing a more important role in IPOs but, in terms of volume, that’s still not comparable to the international investors.

Ernst & Young: What are the major Russian risk factors right now?

Natasha Tsukanova: Investors are always interested in elections, but the uncertainty that was linked to elections is pretty much gone now. So even though the specifics regarding the future leadership may not be clear, the market regards the political situation as very stable and predictable. The risk factors which will be very important for investors in the next 12 to 24 months are the corporate governance and legal system.
Ernst & Young: What’s the current role of PE firms and hedge funds in Russia and their impact on the IPO market?

Natasha Tsukanova: Before the credit crisis, many companies had very good and fairly easy access to funds from Russian banks. It’s not necessarily going to be that easy to get cheap loans in 2008. So there is definitely an increasingly important role for banks to bridge the gap, assisting high-growth companies to finance their growth. These high-growth companies are well suited to gaining financing from the private equity market.

Many hedge funds have set up special situation funds with Russian companies that are very active and very sophisticated. International investors know that hedge funds are a very important source of funding, especially in situations where companies need to be creative in pre-IPO activity, or need to grow and do M&A transactions.

Ernst & Young: What are the non-monetary advantages that PE firms provide to Russian companies in which they invest?

Natasha Tsukanova: An advantage of the Western PE sector is the expertise it provides in improving the corporate governance of the high-growth Russian companies it invests in, for example, how to participate in board meetings or how to structure the company. They will want the Russian company to start reporting according to international standards, which is very good preparation for an IPO. A western PE firm investing in a company for one or two years gives investors an additional level of comfort and confidence.

Ernst & Young: How is the high level of M&A activity influencing the IPO markets in Russia?

Natasha Tsukanova: M&A activity is high. Companies are emerging as consolidators, acquiring other smaller companies, reaching critical mass, and then going public. There’s a new realization among company owners in Russia that, if they go public, they get a completely new currency for their M&A activity, in the form of shares.

Thus, one of the main reasons for companies to go public is to gain acquisition currency. In order to acquire another company, an acquirer doesn’t have to borrow cash, an acquirer can also offer equity in its own company as payment to companies it is buying or integrating.

Ernst & Young: What’s your outlook for Russian IPO markets in 2008?

Natasha Tsukanova: In the next two to three years there will be a continuous stream of smaller Russian companies going public from a broader range of sectors than we’ve seen previously. In 2008 and 2009, we expect large transactions to come from sectors such as power, mining, financial services, insurance, retail, consumer and, more recently, real estate.

We saw a number of very large transactions in the power sector in 2007 and expect to see more large IPO issues in 2008-09 in this sector. The power industry was undergoing a complete transformation in 2007, a broad restructuring process, geared towards raising new capital.

What we will see in the next 18 to 24 months is a broadening of the financial products which companies will be using while in the pre-IPO phase. That is partially driven by the fact that companies, investors and markets are getting more sophisticated.

Markets are becoming more complex, both internationally and in Russia. We see more hybrid structures, types of convertible bonds and warrants which again broadly you would call, in many cases, pre-IPO financing. These products allow investors to share upside returns with the companies and perhaps get some downside protection against loss.
The number of Middle East IPOs just about doubled in the past two years. During 2007, 53 new issuances in these 10 Middle East countries raised US$13.7 billion (see figure 17, page 70), with an average IPO size of US$165 million. As the region’s largest IPO ever, the US$5 billion offering of container port operator Dubai Ports World listed in the UAE and made up over one-third of the funds raised in the Middle East. In 2007, the industrials sector raised US$7 billion, or about half of the region’s total IPO proceeds, followed by real estate (US$2.5 billion), financial services (US$2.1 billion) and metals and mining (US$1.9 billion).

In the first quarter of 2008, the Middle East IPO markets were off to a strong start, in stark contrast to sluggish public markets in much of the rest of the world. Thirteen Middle East companies worth US$3.8 billion went public, including two large deals from Saudi Arabia; the US$1.9 billion IPO of Mobile Telecommunications Co. and the US$1.2 billion offering of Rabigh Refining & Petrochemical Co.

Surging petrodollar liquidity, robust 8% GDP growth and economic liberalization fueled the Middle East IPO markets in 2007. Middle East countries are wealthier than ever, boasting two-thirds of the world’s oil reserves as well as around US$1.5 trillion in sovereign wealth fund reserves from the UAE, Saudi Arabia, Kuwait and Qatar. The recycling of soaring oil revenues into local economies and equity markets has bolstered the Middle East capital base and investor confidence. Under political pressure to liberalize and reform the capital markets, Middle East regulators have begun to relax restrictions on foreign investment and promote IPOs.

The Middle East:* surging petrodollar liquidity and economic reforms fuel IPO markets

**Key trends**

- Soaring oil prices, robust 8% GDP growth and economic liberalization fuel an expanding Middle East IPO market
- Apparently recovered from the 2006 stock market crash, the Middle East IPO markets have stabilized, although they still remain “prone to a stock market bubble”
- Local and regional investors fund most Middle East IPOs due to restrictions on foreigners, although the international institutional investor base is growing
- The two largest Middle East economies, Saudi Arabia and the UAE, have the most active IPO markets in the region
- The Middle East has a strong and sustainable IPO pipeline bolstered by market liquidity, privatization initiatives, high IPO oversubscription rates and economic prosperity
- In the first quarter of 2008, the IPO markets were off to a strong start including two large Saudi deals

* In this article, the “Middle East” refers to the six GCC states: Saudi Arabia, Bahrain, Qatar, UAE, Oman, and Kuwait, plus Jordan, Egypt, Syria and Yemen.
good infrastructure and low or no taxes, Dubai aims to attract investment from abroad and become the Middle East financial hub. In 2007, Dubai purchased a 20% stake in the NASDAQ and Nordic exchange OMX, underscoring its growing global ambitions.

Local investors fund most IPOs
Most Middle East countries restrict foreign investment in local shares. For instance, foreign institutions and individuals can only invest in Saudi Arabia through mutual funds. “Nonresidents cannot invest in the secondary markets and even resident expatriates are not allowed to participate in IPOs,” says Gandier. “Because of such constraints, foreign inflows to the Middle East are mostly in the form of foreign direct investment into very large projects,” says Bourland. These are primarily ventures in hydrocarbons, petrochemicals and refining, funded by major global corporations from the US, Europe and Asia.

However, as exchanges and regulators are becoming more open to the idea of overseas investors, restraints on foreign investment are gradually easing. The growing maturity of the Middle East capital market can be seen in the rapid expansion of its institutional investor base, especially mutual funds, which gave the secondary markets a boost in 2007. Nonetheless, since few Middle East IPOs are open to foreigners thus far, local and regional investors have provided almost all the funds for new issuances. “Domestic investors did get burned in the secondary markets by the crashes of 2006, and they are much more wary,” says Gandier. “But they are coming back to IPOs.”

In 2008, a strong pipeline of high quality blue-chip companies
Middle East analysts expect robust IPO markets in 2008, far surpassing the previous year. Increased economic prosperity, market liquidity, privatization initiatives and the popularity of recent large IPOs all bode well for Middle East IPO markets, despite the chronic possibility of further geopolitical conflicts.

The difficulty in predicting changes to the regulatory framework poses a major concern for pre-listed companies. “The question

There will probably be less volatility, strong economic and capital markets growth and more IPOs in the next two years

The valuations and earnings multiples of Middle East companies are rising, strengthened by the robust economy, business climate and investor confidence. Nonetheless, “the Middle East markets remain somewhat prone to a stock market bubble. We had our emerging market period of excessive optimism, resulting in an overpriced stock market,” says Brad Bourland, Chief Economist of Jadwa Investments in Saudi Arabia. “Then the markets corrected substantially in 2006. Now markets should be in a consolidation phase for a few years, where they rise gently but do not reflect the robust economic activity.”

Saudi Arabia and UAE are the region’s most active IPO markets
The Middle East countries most focused on developing their IPO markets are Saudi Arabia, the UAE, Bahrain and Qatar. In 2007, all Middle East companies going public listed on their domestic exchanges. Indeed, most Middle East businesses remain quite insular in their operations, and deal only within their own country’s boundaries. Recently, cross-border activity has begun to grow, albeit only within the six Gulf states.

In 2007, the IPO markets of Saudi Arabia, the Middle East’s largest economy, and the world’s largest oil exporter, were the liveliest in the region with 26 deals raising US$4.8 billion. “Saudi government policy on licensing is behind this surge in Saudi IPOs,” says Bourland. “When the Saudi government gives away a license and rights to national treasures such as a quarry, gas or even the telecommunications network, it often requires a 30% equity offering through an IPO to share that development with the people of the country,” he says.

The IPO markets of the second-largest Arab economy, the UAE, generated the most funds. US$6.5 billion was raised through only three deals, thanks to the massive US$5 billion Dubai Ports World IPO which listed at the Dubai International Financial Center (DIFX), and was 15 times oversubscribed. Opened in 2005, the DIFX adopted a regulatory framework similar to that of the London Stock Exchange, with no restrictions on share ownership by foreigners. By offering a blend of transparent regulation,
always is, ‘What new rules could come up in the middle of my IPO that could change the timing, pricing or other factors critical to its success?’” says Gandier. “The regulations governing the previous IPO process may not necessarily be the regulations applied to the next IPO.” However, as the financial regulatory framework improves, more family businesses and private equity funds are likely to pursue IPOs in the near future.

Swelling capital inflows reflect investor enthusiasm for the infrastructural assets in the Middle East pipeline, estimated to be worth about US$1 trillion. Although financial services are expected to account for more than half of the IPOs forecast for 2008, analysts also anticipate a wave of privatizations in state-dominated sectors such as transport, construction, oil and gas, power, telecoms and utilities.

For the next two years, Middle East governments will continue to urge local companies down the IPO route. “There will probably be strong economic and capital market growth, a rise in stock market pricing, less volatility and more IPOs,” says Gandier. “The Middle East has a strong IPO pipeline of high-quality blue-chip companies, such as big family conglomerates,” says Bourland, who anticipates a continuous flow of new IPOs coming primarily from Saudi Arabia, UAE, Bahrain and Qatar for the next four or five years. “We have a good sustainable IPO growth story here.”

**Figure 17: Middle East IPO activity by year**

Capital raised (US$b)  
Number of deals

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<th>Year</th>
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Source: Dealogic, Thomson Research, Ernst & Young

Phillip Gandier, IPO Leader, Strategic Growth Markets,  
Ernst & Young Middle East
Ernst & Young interview

We have a good sustainable IPO growth story

Ernst & Young: What are the key trends in the Middle East for IPO activity in 2007–08?

Brad Bourland: The number of stock market listings in the Middle East has essentially doubled over the last couple of years. The acceleration of capital market activity is the result of economic reform. Consequently, the big trends in the region are high capital flows because of oil revenues, economic liberalization and reforms.

Sustained high oil revenues have generated tremendous capital flows into the region, especially into the Gulf Cooperation Council countries that are the main oil producers. Official Middle East government foreign assets are growing to about the size of China’s at around US$1.3 trillion.

Economic liberalization and reform are rapidly developing Middle East capital markets with new products and new listings. In 2003 we had 1 listing in 2004 we had 2, in 2005 we had 4, in 2006 we had 8, in 2007 we had over 20 and now there are over 100 companies in the IPO pipeline. So in 2008, we’ll be up to 40 to 50 plus.

Ernst & Young: What’s in the Middle East IPO pipeline for the next two years or so?

Brad Bourland: In the bigger countries such as Saudi Arabia, there’s a good pipeline of high-quality blue-chip companies, such as the big family conglomerates, that could list on the market and sustain the pipeline of IPOs for four or five years. The market in Saudi Arabia now has about 110 listings, and could grow to somewhere between 200 and 300 listings in the next few years, so I think we have a good, sustainable IPO growth story here.

I think there will be a constant flow of new IPOs over the next several years. The areas in the region that have a focus on developing the stock market and IPOs are the Dubai International Financial Centre and the markets in Bahrain, Qatar and Saudi Arabia.

Ernst & Young: The Middle East experienced quite a bit of volatility in 2006, while 2007 looked more stable. What’s your expectation for 2008?

Brad Bourland: I think the Middle East stock markets will remain somewhat prone to a stock market bubble. We had our emerging market period of excessive optimism, resulting in an overpriced stock market. Then the markets corrected substantially in 2006. Now it should be in a consolidation phase for a few years, where the markets rise gently but do not reflect the robust economic activity.

The crash in 2006 has worked its way through the system because of the strength of the economy, and we may be susceptible to another bit of a bubble in the markets here. Oil prices are high and people think they’ll stay high forever, and the market gets carried away with optimism.

Ernst & Young: Which sectors are driving Middle East IPO activity?

Brad Bourland: Well, there are several sectors. Real estate development is a big one in the UAE. Saudi Arabia has quite a diversified pipeline with a lot of financial sector companies, including all the new insurance companies. There are 42 companies applying for licenses, and they must have an IPO on the stock market, so financial sector listings will grow. Major refining and petrochemical mega-projects are also listing.

Ernst & Young: Who are the primary foreign investors and in what are they investing?

Brad Bourland: The foreign investors are mainly big global corporates from the US, Europe and Asia. There’s limited ability for foreigners to invest in the stock market. Most foreign investment inflows are not portfolio investments but foreign direct investments in some very large projects, primarily in the fields of hydrocarbons, petrochemicals and refining, etc. There’s also some inflow related to real estate, in Dubai in particular, but portfolio investors in the stock market have limited access to the local markets.
Foreigners would like more access and it’s gradually opening up. For example, in Saudi Arabia, foreigners – whether individuals or institutions – can only invest through mutual funds. Foreign investors can’t buy shares of individual stocks directly so it’s a bit hard to get access.

**Ernst & Young: What’s the impact of the PE activity on IPO markets in the Middle East?**

**Brad Bourland:** PE is very active here, but there’s a lot of capital and not too many real deals. In the Middle East, we have massive oil revenues coming in, and that money is looking for economic activity to be directed towards.

Most of the deals tend to be early-stage start-ups. Also, there’s not much buyout activity, given the magnitude of capital flowing into the region. As I look at PE in Saudi Arabia, the firms that will differentiate themselves and be the winners are those that can demonstrate access to high-quality deal flow in the region.

**Ernst & Young: What are pre-listed companies in the Middle East most concerned about?**

**Brad Bourland:** The first consideration, if it is a start-up, is that they must list their IPO at par value with no premium. As a result, they are available to the public at a very good price, even though they are early-stage companies. Companies don’t want to list at par value, because they’re giving away equity participation at their own cost, and they’ve done a lot of work to prepare the company to start up. They have incurred a lot of expense and then they have to essentially give away par value shares for participation by potentially millions of local citizens.

The second major consideration is pricing, because there is a wealth distribution aspect to the IPO market pricing in the Middle East. Prices are designed to be attractive to the investing public, which means the company going public may have concerns that they’re selling assets at too low a price.

**Ernst & Young: How are foreign investors balancing the risk-reward equation in the Middle East?**

**Brad Bourland:** As an emerging market area, the Middle East compares quite favorably with the robust growth in IPO activity in even more developed emerging markets such as Brazil, Russia and China. There are also some pretty good IPO stories in the Middle East on a par with those in the BRIC countries.

It’s always a difficult balancing act in the Middle East because this region tends to have more geopolitical risk than other parts of the world. While Middle Eastern investors themselves are more accustomed to the threat, the farther you move away from the region, the greater is the hazard perceived. European and US investors are much more concerned about the geopolitical risk.

Many people think that a major obstacle is bringing their accounting up to modern standards. But if a company is ready for an IPO, it is probably already in pretty good shape in terms of accounting standards.
Companies have a choice in structuring an IPO

Critical lessons learned

1. Maximize capital raising with careful analysis of available options
2. Cross-border offerings may be the most attractive option
3. Consider quantitative and qualitative factors
4. Important considerations include cost-benefit analysis, industry preferences, investor base and analyst coverage

In the evolution of the global capital market over the past few years, fundamental changes have occurred. Specifically, there has been continued emphasis on cross-border activity, an increase in activity outside of the US market, a shift within the US market from public to private offerings, more activity from private funding sources (such as Rule 144A offerings and private equity [PE] funds), and an increase in the number of individual investors within the US.

In the last year alone, we have witnessed first hand how intertwined the global economy has become. A deterioration of credit quality in the subprime mortgage sector in the US has caused markets around the world to suffer as a result of the ongoing credit crisis. What started as a narrow issue within the financial sector has now impacted nonfinancial companies that have written down asset balances relating to illiquid securities exposed to subprime mortgages. Consequently, regulators around the world have implemented measures for greater transparency in financial disclosures, especially those involving liquidity and capital resources. These events illustrate the continued development of a single, highly linked global economy.

Market changes offer companies and investors a wider range of options

The ongoing changes in the market offer a company that is currently considering an IPO a variety of options and alternatives. Accordingly, a company must evaluate the type of offering that is needed or desired, including appropriate consideration of a primary, secondary and/or private offering, as well as the amount of capital that should be raised. For example, in 2007, one company initially sold 91 million shares in a public transaction in its local market and simultaneously sold an additional 822 million shares in the global markets, through the use of a Rule 144A offering in the US and equivalent offerings in other markets. Therefore, over 90% of the total capital raised by this company originated outside its local market, through the use of private offerings in foreign markets.

Such changes have been magnified by ongoing changes in the US, which have primarily resulted from the mature nature of this market. Specifically, many of the domestic IPO transactions within the US in recent years have originated from start-up companies and resulted in relatively small offerings, both in terms of volume and capital raised. In contrast, transactions originating in emerging markets have included large IPOs, many of which originated from former state-owned entities (SOEs).

Given the changes in the US and around the world, investors have been provided with more investment opportunities. Such new opportunities include investments in PE funds and/or Rule 144A offerings, primarily by qualified institutional buyers (QIBs), both of which allow individual or smaller investors to contribute capital to be invested on a “pooled” basis, as well as investments in the equity of individual companies through securities such as GDRs, including American Depository Receipts (ADR). These opportunities have generated a significant amount of capital from investors seeking to maximize the earnings potential from their investments. Such investment activity also demonstrates that investors are no longer limited to primarily investing in their domestic market. Instead, the continued evolution of the global market has provided different...
companies have a choice in the IPO’s location, accounting and auditing standards and complementary financing tranches

opportunities for investors to consider when searching for the best return on their capital.

The rise of emerging economies has an impact on the global market

Recently, several major US and UK financial publications have all published articles outlining changes in the global market relating to the increasing use of Rule 144A offerings, the globalization of capital markets and the emergence of IPO activity in markets around the globe, especially from Brazil, Russia, India and China (BRIC countries). For the year ended 31 December 2007, a total of US$284 billion was raised globally through IPOs, with 39% of the total originating from companies located in BRIC countries compared with 12% and 3% raised by companies located in the US and the UK, respectively.

As mentioned above, the decision to raise capital is no longer limited to exchanges in a company’s local market – companies now have a choice. Not only do companies have a choice in the location of an IPO, they also have choices in accounting standards, auditing standards and complementary financing tranches. With each of these choices, many other influencing factors have to be appropriately considered before initiating a transaction, including the available market options, industry preferences and the costs of registration.

Companies face a wide range of available market options and transaction types

A company today faces a wide range of options for registering in markets in addition to, or possibly, instead of, the company’s local exchange. The NASDAQ, NYSE, LSE, AIM and Singapore stock exchanges are just a few of the markets where a significant amount of the capital raised in the 18 months ended 31 December 2007 was generated from foreign IPOs. However, when evaluating the potential attractiveness of a foreign offering, companies should consider the regulatory requirements of each exchange. Companies should also consider whether a dual listing would be beneficial and/or whether they should take advantage of private capital such as a Rule 144A offering.

Knowledge of the filing rules in each of the markets being considered is necessary to evaluate the best exchange on which to register a primary listing. Some markets, such as Singapore, require a company to have at least one independent director who is a resident of Singapore. Other markets impose requirements such as internal control reporting, management certifications, periodic disclosures and/or other ongoing registration obligations. As such, companies should enlist the aid of qualified advisors to fully understand and thoroughly evaluate the filing rules associated with each market.

In addition to the regulatory requirements, it is also important to determine what accounting rules and auditing standards are accepted in each market. The market is moving towards accepting International Financial Reporting Standards (IFRS) as the global accounting standard. Europe already requires IFRS while Canada, South Korea, India and Brazil have agreed to adopt IFRS within the next four years. In addition, the regulator in the US recently decided to accept foreign private issuer financial statements prepared using IFRS as issued by the International Accounting Standards Board (IASB) without reconciliation to US generally accepted accounting principles (GAAP). Many believe that the continued acceptance of IFRS will improve an investor’s ability to evaluate companies operating in similar industries and, as a result, will provide more transparency in the global market. It is also believed that a single, globally accepted accounting standard may decrease the costs incurred by companies for accumulating, preparing and reporting financial information.

Finally, when considering available markets, a company should also determine whether a dual offering or ADR would be a beneficial addition to an IPO. As noted above, it is common for companies today to maximize the capital raised by including foreign tranches in connection with an IPO (such as a private Rule 144A offering in the US). These tranches may be sold via an
In addition, analysts often look for comparability in reporting within an industry, while investors look for growth opportunities. Both analysts and investors need comparable financial information across industry sectors to make informed decisions regarding the potential investment in a company's securities. By understanding what markets and accounting standards are utilized by competitors, a company can make an informed decision on whether it wishes to enter a market that will provide comparable financial information for both the analyst and investment communities.

The cost of registration must be evaluated

Once markets have been assessed and industry preferences considered, a company also has to evaluate its ability to finance a registration. Large markets, while appealing because of their liquidity, often have more stringent compliance regulations and higher costs associated with registration. All offerings incur professional fees, given that lawyers, bankers and/or accountants have to be involved in their completion. Additional costs could be incurred by a company having to convert to different accounting and auditing standards if the chosen market does not recognize the standards being utilized by the company. There are also different filing fees associated with the registration of securities with different exchanges. Such discrepancies in exchange fees further demonstrate the options that a company should consider in properly planning for a public offering. A company should carefully evaluate the costs of offering securities in relation to the expected capital to be raised. Frequently, companies with limited resources will elect a local offering with tranches sold throughout the world to maximize their returns.

In this global environment, companies have a plethora of options to consider and choices to make when it comes to structuring the right IPO.

Jackson Day, Global Director, Global Capital Markets, Ernst & Young
Craig West, Global Capital Markets, Ernst & Young
In 2002, the European Union agreed that all listed companies within Europe should report using one financial reporting framework - International Financial Reporting Standards (IFRS) - as from 2005. Little did anyone realize that this was effectively the launch of IFRS as the key contender to be the global financial reporting language. In this article, we look at how extensively IFRS is used around the world, and the challenges that using IFRS brings.

**Adoption of IFRS around the world**

Since European-listed entities successfully adopted IFRS in 2005, its adoption elsewhere in the world has been far more widespread and far quicker than anyone had expected. Adoption of IFRS has been in one of two ways — either as the direct application of IFRS, or as an amendment to national standards in order that they “converge” with IFRS. Figure 19 shows the extent to which IFRS is, or will be, applied as at the end of December 2007. Once major countries such as Canada, India, Brazil, China, Korea and Japan either adopt or converge to IFRS, approximately 65% of the Fortune 500 companies will be reporting their financial results under IFRS.

A further positive step for IFRS came from the US, with the US Securities and Exchange Commission (SEC) announcing that foreign private issuers preparing their financial statements in accordance with IFRS will no longer have to include a reconciliation to US GAAP. This has also meant increasing pressure in the US to adopt IFRS and we expect to see a date set by the US SEC in 2008.

One global financial reporting language means that the cost of doing business across jurisdictions becomes lower, comparability is increased and new investment opportunities are likely to emerge. It also helps regulators reach their ultimate goal to increase the efficiency of financial marketplaces; lower the costs of capital with an improved allocation of capital worldwide; and enhance shareholder value.

This success of IFRS for listed companies prompted questions as to whether unlisted companies were disadvantaged by not having a common language for fund-raising. In 2007, the IASB issued proposals to provide a simplified, self-contained set of accounting principles appropriate for nonlisted companies. These principles, called IFRS for small and medium-sized entities (IFRS for SMEs), are based on full IFRS, but contain simplified application guidance and less disclosure requirements.

Many believe the proposals do not meet users’ needs. Large and growing nonpublic companies will be more likely to prefer to apply full IFRS, as the burden of preparation will not be significantly greater for them. Upon listing, in most instances, these companies would still need to convert to full IFRS and, prior to listing, they are more likely to compare themselves with companies that are required to apply full IFRS. On the other hand, smaller companies will find the proposed IFRS for SMEs too complicated and too costly to apply. A final standard is expected towards the end of 2008. It will then be up to each jurisdiction to determine whether they will allow this “simplified” set of principles to be applied.

**Implications for companies going public**

The consequences of IFRS for companies wishing to go public are therefore dependent on:

- whether or not IFRS is only required for listed companies; and
- the extent to which the national standards converge with IFRS and they achieve this.

**Jurisdictions where IFRS is only required for listed companies**

In those countries where IFRS is only required for listed companies, nonlisted companies must apply their national standards when preparing their financial statements. For example, in Germany, listed companies prepare their consolidated financial statements in accordance with IFRS, while most nonlisted companies prepare their financial statements in accordance with German GAAP. Therefore, when pursuing an IPO, the company may have to undertake an exercise to convert its financial information from national GAAP to IFRS. IFRS requires that any set of financial statements include one year of...
Jurisdictions where national standards are identical to IFRS
Many countries have decided to converge their national standards with IFRS by amending national standards/law to such an extent that they become identical. This means that all companies in that country will apply the same accounting requirements as those required in IFRS. However, their financial statements will still be described as being in accordance with the national standards rather than IFRS. This means that, if the company is to apply IFRS after going public, it will still need to convert to IFRS. IFRS provides some first-time adoption exemptions and exceptions, which can result in the financial statements being different to those prepared under national standards. While the conversion exercise should be easier, early planning and identification of these effects will still be a key part of the IPO process.

In some countries, national standards are being replaced by IFRS in their entirety, including the first-time adoption requirements. For example, Australia replaced Australian Standards with IFRS in its entirety, calling it Australian International Financial Reporting Standards (AIFRS). This allows companies to also claim compliance with IFRS (otherwise known as dual reporting), thereby eliminating the need for another IFRS conversion.

The challenges ahead
With one global financial reporting language, the future holds many challenges; for those companies yet to adopt IFRS; for those companies that already have adopted IFRS; and for the standard-setters themselves.

Embedding IFRS into the business
A key objective is to embed IFRS into the business. Experiences throughout Europe and Australia confirm that conversion has
Broader business impacts

Areas for consideration include:

**Market communication:** financial communications need to address changes in presentation of financial information, and the fundamental change towards fair value accounting and its impact on traditional ratios and key performance indicators.

**Legal:** in-house legal staff will need to support accounting staff in interpreting contractual terms and conditions; companies may need to revise processes and systems for entering into, drafting, approving and monitoring contracts.

**Treasury:** detailed hedge documentation and ongoing effectiveness testing is required to achieve hedge accounting.

**Human resources:** the volatility caused by IFRS may require adjustment of the calculation base for compensation (profit sharing, bonuses, share option awards).

**Taxation:** the tax department will have to work closely with accounting staff to examine the IFRS impact of any new financing structures implemented within the group.

**Marketing and sales:** IFRS will impact a number of areas, including managing the portfolio of brands and trademarks now recognized on the balance sheet, determining the net realizable value of inventories, reviewing sales contracts for revenue recognition issues, conditions of sale and embedded derivatives.

**Production/R&D:** information from production/R&D personnel will drive accounting on a broad range of topics, including defining normal capacity and measurement of inventories, identifying embedded derivatives, determining components of property, plant and equipment, and distinguishing between research and development phases, etc.

**Structured financial products:** these are often entered into on the basis of a specific accounting treatment, and changes in that framework (including future changes) often result in liabilities that previously were not recognized (including embedded derivatives). All such products need to be constantly re-evaluated. The revised framework and future changes may also impact debt covenants.

Impacted many aspects of a company and its environment: financial accounting, internal management reporting, external financial reporting, communications with internal and external stakeholders, performance measurement, information systems, contract and transaction structures and human resources. A new financial language has also required an enterprise-wide awareness and training of many nonfinancial personnel, as the box above demonstrates. Organizations that have embedded IFRS into their business successfully have:

- Redefined their overall communications strategy to make information, both financial and nonfinancial, a competitive advantage
- Reviewed the key performance measures used for managing the entity
- Harmonized internal and external financial reporting systems in order to avoid confusion and to identify and report on important issues more quickly, more frequently and in more detail
- Adapted information systems to accelerate account closing processes, while ensuring the completeness of information produced
- Improved communication and enhanced teamwork across different group functions
- Educated all stakeholders, in particular shareholders and analysts, to ensure they are not confused by new and more complex financial information

Wider usage of IFRS will provide a big opportunity for all multinationals. Information systems and resources can be better utilized and processes can be streamlined. Internal communication will also improve, as everyone is speaking the same language.

**Market communication**

A key issue for all entities applying IFRS is how they communicate with the markets and investors. For companies converting to IFRS, this means ensuring that the markets understand the underlying performance. Shareholders and other market players will need management to develop appropriate expectations of what IFRS will bring, so that investors have confidence in their understanding of the figures as they are announced.

For entities that have been applying IFRS for some time, it is important to communicate the future developments in IFRS and their impact on financial performance.
Complexity of IFRS
Many view IFRS as too complex and the disclosure requirements as becoming increasingly onerous. There is a danger that the preparation of financial statements will become a technical compliance exercise, merely for the benefit of regulators. This will be important for the IASB to consider in their future developments.

Jurisdictional IFRS
The rapid adoption of IFRS around the world, its increased complexity and the traditional links between tax and accounting, will pose a major challenge for the board in holding IFRS together. It is all too easy in these instances for local variations to develop. However, it is important that local regulators and other national bodies avoid providing interpretations. It is inevitable that regulators, preparers and others, take views on how to apply the standards, if only to ensure that IFRS is applied consistently. But the regulators must be aware of the consequences of its decisions – other regulators may not have the same view, hence local jurisdictional views can quickly emerge. The International Financial Reporting Interpretations Committee (IFRIC) works with the IASB to issue interpretative statements about IFRS. Regulators and national standard-setting bodies must be mindful of this and refer matters to the IFRIC, rather than issue statements themselves.

The Future of IFRS
The process of converting to IFRS was itself a significant change for many companies, as new recognition, measurement and disclosure requirements were adopted. However, there appear to be even more extensive changes afoot. In many ways this is to be expected, as there are some fundamental conceptual issues that need to be resolved in relation to IFRS before it can be an effective principles-based system. However, the IASB seems to be going further than just sorting out existing issues. It has an enormous and ambitious agenda, which seems to be breaking into new frontiers in financial reporting.

There appears to be a desire by the IASB to move balance sheet valuations generally away from historical cost-based measurements toward what is termed fair value. However, the increasing focus on fair value is a cause for concern, not least of which is that for many assets and liabilities there is no active market, hence market value can only be expressed as a range rather than a number.” However, financial reporting demands that one number is used, bringing into question the reliability of the reported performance and financial position. Fortunately, the IASB has started addressing the entire measurement debate, rather than limiting it to just fair values. It remains to be seen whether fair value continues to expand its role in financial reporting.

Concluding comments
IFRS as a global financial reporting language has become a reality – far ahead of expectations. This will likely be the impetus for further changes to integrate the world’s capital markets – such as harmonized international regulations. For investors, this will certainly improve the ability to make informed decisions. For companies accessing financial resources will become easier, improving the growth potential.

Companies, regulators and investors all have different backgrounds, and converting to one financial reporting language has its challenges. Many issues arise from the relative ‘newness’ of IFRS. However, as IFRS becomes more widely spread, industry practices and trends are emerging, turning it into a real GAAP.

Lynda Tomkins, Global IFRS Services, Ernst & Young
Valerie Quint, Global IFRS Services, Ernst & Young
**IPO definition:** In this report, only IPOs of operating companies are considered. An IPO is defined as: *a company's first offering of equity to the public.*

**Comment:** This report includes only those IPOs for which the data providers Dealogic, Thomson Financial and Ernst & Young offer data regarding the issue date (the day the offer is priced and allocations are subsequently made), the trading date (the date on which the security first trades) and proceeds (funds raised including any over allotment sold). Postponed IPOs or those that have not yet been priced are therefore excluded.

In an attempt to exclude nonoperating company IPOs such as trusts, funds, and companies with the following SIC codes are excluded:

- 6091: Financial companies that conduct trust, fiduciary and custody activities
- 6371: Asset management companies such as health and welfare funds, pension funds and their third-party administration as well as other financial vehicles
- 6722: Companies that are open-end investment funds
- 6726: Companies that are other financial vehicles (e.g., investment offices)
- 6732: Companies that are grant-making foundations
- 6733: Asset management companies that deal with trusts, estates and agency accounts
- 6798: Companies that are REITs
- 6799: Special Purpose Acquisition Companies (SPACs)

All charts are created based on the domicile nation of the issuers except for the chart titled *Global IPO activity by stock exchange, 2007* on page 5, which depicts market activity by exchanges as a percentage of global deal numbers and capital raised.
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EYG No. CY0031

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