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SME Exchanges: Big change for Biotech?

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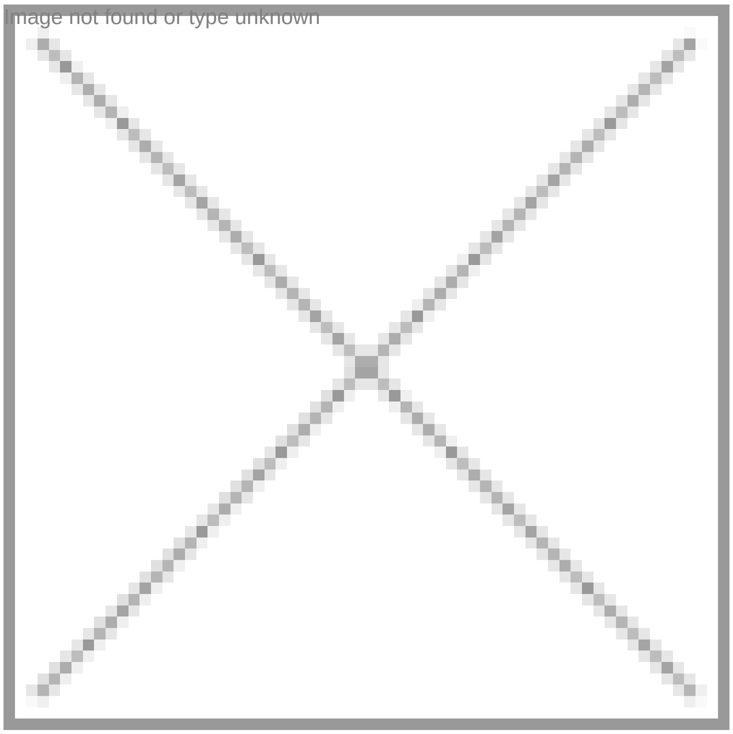

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National Stock Exchange and Bombay Stock Exchange, in March 2012 launched their seperate platforms for SMEs. This step could prove to be a game changer for healthcare and biotech sectors

For an industry that is capital intensive in its initial years of operation, raising the required amount of funds has always beena challenge for India's biotech companies. Getting listed on the stock exchange, considered to be the preferred route to raise capital for most technology and retail companies, has not been an option heavily exercised by the biotech industry. The recent launch of the small and medium enterprises (SME) exchanges by the country's leading stock exchanges, however, could prove to be a game changer for the small and medium sized industries in healthcare and biotech.

India's leading bourses, National Stock Exchange and Bombay Stock Exchange launched their separate platforms forSMEs - Emerge and BSESME respectively on March 13, 2012. This was a long awaited launch considering the fact that the Securities and Exchange Board of India (SEBI) laid down the framework for such a trading platform in 2008 and announced detailed guidelines in May 2011. Both the exchanges are going to run based on these guidelines. Since their start, both Emerge and BSESME have had one company each listed on their platforms. With the launch of such an exchange, India joins the league of other countries such as the UK (Alternate Investment Market or AIM), China (Chinex), Hong Kong (Growth Enterprise Market or GEM) and Japan (Market of the high-growth and emerging stocks or MOTHERS) with similar exchanges.

Termed to be drivers for today's entrepreneur driven economy, SMEs are said to contribute 40 percent of exports employing over 60 million people according to the SME Chamber of India. For a group that contributes over 17 percent of the GDP, adequate support from the government is rightfully warranted. Hence in the latest budget, a corpus o Image not found or type unknown 5,000 crore has been allocated for the Small Industries Development Bank of India (SIDBI). Industry experts hope that a significant portion of this is reserved for the healthcare sector.

The need for the exchange rose primarily from the want of good visibility for smaller companies. A point highlighted by Ravi Tyagi, head, Emerge, NSE Exchange, â€œThe big difference between the main board and a platform like this is that, the former has a large number of companies that are mature with around 1,00,000 investors and here small companies tend to get lost. At such an SME exchange the issues are smaller. Also there is a higher risk and more uncertainty. However the people who invest in such companies are generally those who are well informed and resourceful and who are interested in investing in such fast growing companies.â€?

What it means for biotech...

The growth of the biotech industry though replete with expectations a decade ago, did not translate into a lot of initial public offerings (IPOs) for a number of reasons. In fact barring a few companies such as Biocon, Camson Biotech, Suven Life Sciences, Transgene biotek, and Zydus Cadila are very few biotech companies have gone the IPO way to raise money. â€œBiotech companies in India have failed to scale up and get to a size where they can be potentially listed and attract capital market attention,â€? says Nitin Deshmukh, CEO, private equity, Kotak Investment Advisors. Deshmukh adds, â€œThere was a lot of build up that happened post the Biocon listing in 2004, but that momentum was lost. That is why capital markets and investment bankers have not been very receptive to this industry. There are very few investment banks who are investing in this sector.â€?

The ability to sustain growth throughout has been vital for the success of any company to have a successful fund raising experience at the stock markets. Dhirendra Kumar, founder and CMD, Camson Biotech tells about his experience of getting listed on the main exchanges, â€œFor a company such as ours, we had very few options for private equity funding. Not many wanted to invest in research and development. There was a huge difference in our revenues after getting listed. We opened for trade at Image not found or type unknown 180 per share o Image not found or type unknown 10 in 2008 at BSE. Today raising funds is not a serious issue anymore. Also, since bioagri is not very equipment intensive compared to other sectors, scaling up is not as difficult.â€?

Apart from the access to public equity which is a boon during the growth phase of any company, a popular opinion is that getting listed on a stock exchange offers a sense of visibility along with enhancing the transparency in a company's operations. This would not only attract investors but also build a trust quotient with external government agencies and other private funds, an added advantage to the biotech companies.

The fine print

The most essential criteria for selection of the companies for both Emerge and BSESME is based on the underlying principle that the post issue paid-up capital is to be less tha Image not found or type unknown 25 crore. This differentiates it from the general definition of the MSME industry which states that, an SME is one where the investment in equipment or production plant does not exceed Rs10 crore. This allows for the participation of a large number of companies from all sectors making the option available to many entrepreneurs. Tyagi seconds that by noting, â€œThe number of people who are already listed in NSE and are eligible for getting listed on Emerge is quite high and the current regulations in place allow for the transfer of these firms between the exchanges.â€? Tyagi also added that a lot of companies in the healthcare and pharma industry have already expressed interest in Emerge.

Another salient feature is that the company should be cash positive for two years as opposed to three years on the main board. However, owing to the long research timelines of most biotech companies, a lot of them find it difficult to show such results, proving it to be a major impediment. However, Tyagi says, â€œExceptions can be made in a few cases if the company can show good credibility and have a good ecosystem and that can validate its work.â€?

Contrary to the main exchanges, the SME platforms have different requirements for the merchant bankers. Tanika Singh, associate at Amarchand and Mangaldas and Suresh A Shroff and Company, a legal firm, further explains, â€œA nominated investor (NI) is a qualified institutional investor or private equity fund, who subscribes to the issue in case of under-subscription or assists in the market making process. The role of NIs is especially relevant as other investors could potentially place reliance on NI's participation in making their investment decision. The other is that of market-making which has been made mandatory for a minimum period of three years. The NI concept has been introduced to reinforce the role of the merchant bankers, especially in the context of compulsory market-making.â€?

The relative inexperience of most companies entering into such a platform would require a degree of handholding for sometime. Singh adds, â€œKeeping in mind the success of the AIM framework and that the Indian SME, exchanges are currently in their pilot stage, the SME Listing Framework might significantly benefit from the introduction of a similar roster of advisers registered with the exchanges, who can assist with unknown compliance requirements and standards.â€?

Corporate government requirements	Same as main board	Clause 49
accounts)	Half-yearly	Quarterly
Market making	Mandatory	Not mandatory

the IPO

Apart from this, some other changes have also been incorporated in order to further [illegible] companies, such as the submission of financial results on a half yearly basis instead of quarterly, the choice of making available the results on the website instead of publishing them and sending in only the salient features to the shareholder.

A point strongly favored by investors are the exit options available after the listing in an exchange. Kumar, who said that Camson Biotech would also be interested in moving to an SME platform in future, further reiterated, â€œPeople who put in money as an investment should have an exit route. Getting listed gives us that liberty.â€?

The road ahead

This however would not be the first attempt in India for such an exchange. The Over-the-Counter Exchange of India (OTCEI) in the mid 90s was a similar initiative, which later suffered from the lack of investor interest.

The lessons learned from that experience need to be remembered in order to ensure the success of these new exchanges. Also a new round of discussion is needed after a year of the operations to assess the progress and implement any additional features if need be.

Only time will tell the success of this initiative and the impact it can have, meanwhile the biotech industry has welcomed it. It has definitely set the ball in motion for medium sized companies to access public funds for their growth. Though, surely not a sure shot solution for all problems related to capital, the exchanges do present a promising opportunity to the companies in an environment starved of venture capitalists willing to invest in early and mid stage firms in life sciences industry.

Key differences between Emerge and Main Board

Particulars	Emerge	Main Board
IPO		
Track record	Track record of atleast three years, positive cash accruals (EBDT) from operations for atleast two financial years and positive net-worth*	Three years track record of profitability
IPO grading	Not mandatory	Mandatory

**Exchange requirements*

Courtesy: NSE

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