EQUINITI

Your guide to IPOs

Keeping it simple

IPOs

Written in partnership with Shares Magazine

Content

Introduction

In 2013 the London Stock Exchange (LSE) welcomed some very high profile companies to its markets including the Royal Mail and Madame Tussauds-owner Merlin Entertainments. By number, initial public offers (IPOs) recovered to levels not seen since before the financial crisis which culminated in 2008's collapse of Lehman Brothers and prompted a deep recession in its wake.

The LSE interprets this recovery as a 'clear sign that confidence is returning' and the UK Government's plans to sell off its remaining stake in Lloyds Banking Group may be a further signal that the economic outlook has turned a corner. After all, it was the collapse of Lehman which precipitated the crisis which resulted in the state bailing out the banks. Other well-placed observers and advisers confirm the increasing interest of companies to tap the market.

If a sea-change in confidence has occurred, then last year's pick up in IPOs could be just the beginning when you consider that 425 firms 'floated' on the LSE's markets in 2005, at the peak of the last market upswing. And there are already signs that momentum is building nicely with the monthly IPO, or float count, picking up towards the end of 2013 (see charts).

Many firms will have done all the preparation and are just waiting for the conditions to be right to push the button on their IPO, which is why when the market does pick up it is likely to do so rapidly. When business conditions are tough firms draw in their horns, focus on making more of what they've got and getting from one day to the next. But as the economic outlook improves they again look to the future and contemplate growth - this often involves a requirement for fresh funds by selling shares (see chapter 2).

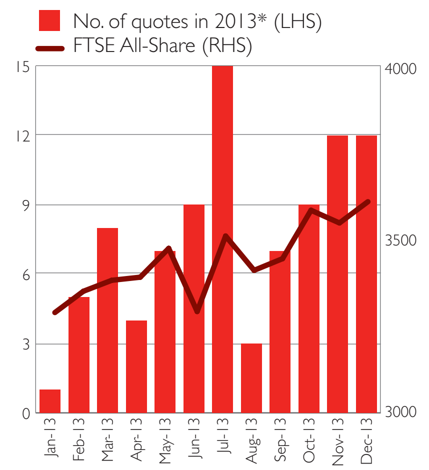
Share prices are back again close to their 2007 all-time highs with the FTSE All-Share benchmark up 17% in 2013 which reflects the fact investors too are feeling more confident about the future. As a result they are willing to meet companies half way by paying a fair price for their shares, setting in motion a virtuous circle which was very clear to see at the start of the last IPO upturn in 2004. Back then the floodgates opened in a matter of months as markets recovered in step with improved business confidence after the dark days that followed the Technology, Media and Telecoms (TMT) bust.

FLOAT NUMBERS SHOWING SLOW BUT UPWARD TREND*

Year	IPOs
2003	86
2004	295
2005	423
2006	367
2007	269
2008	73
2009	22
2010	95
2011	76
2012	67
2013	103

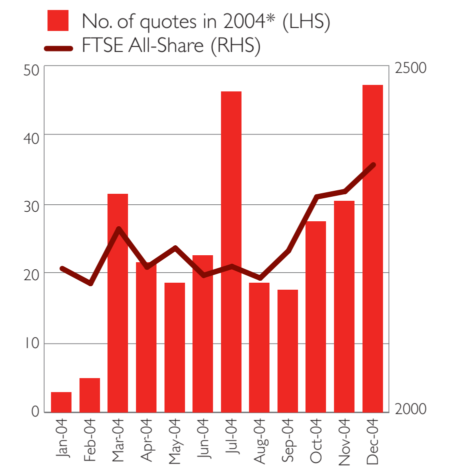
*Includes quotes on the Main Market, International Main Market, Professional Securities Market, AIM and Venture Capital Trusts (VCTs)
Source: Shares Magazine, London Stock Exchange

Monthly IPO count is picking up



*Includes quotes on both the Main Market and Aim, excludes VCTs

...and could precursor a rapid recovery



Source: Shares Magazine, London Stock Exchange

What is an IPO?

An IPO is the first sale of stock by a company to the public. A company can fund itself by taking on debt, issuing shares or generating its own cash. Since there is a lot of pressure to ensure the process is a success, shares may often be competitively priced when offered as part of an IPO (see chapter 3).

It isn't usually easy to buy shares in a private company. Public companies, on the other hand, have sold at least a portion of themselves to the public and trade on a market. The two key markets in the UK are the Main Market, which is usually where mature companies trade, and AIM (Alternative Investment Market), being the preferred venue for early-stage companies. Early-stage companies tend to focus on activities such as research and development, market research or construction of manufacturing facilities in an effort to establish their business. Mature companies by contrast tend to be well-established in their respective industry, with a well-known product or loyal customer base. These types of firms have passed the stage of rapid growth.

Both the Main Market and AIM are operated by the LSE. Companies on AIM face lower costs and less regulation which is why it has generally attracted early-stage companies which would struggle to meet the expense and conditions associated with a Main Market listing.

When it joins a market a company has to follow a set of rules which are designed to protect investors, whereas investing in private companies can be fraught with difficulties and it may not be easy to get up to date information on them. Although, having said this, there are no guarantees, and share prices can go down as well as up, but investors will have some comfort in knowing public companies have to treat them by the book.

The 'book' for companies quoted on the Main Market is the Financial Conduct Authority's (FCA) Handbook. Among other things, it stipulates what and when companies should publish key financial information such as preliminary and interim reports. It is enforced by the UK Listing Authority (UKLA), which is an arm of the FCA. A firm first has to attain entry to the UKLA's Official List before trading can begin.

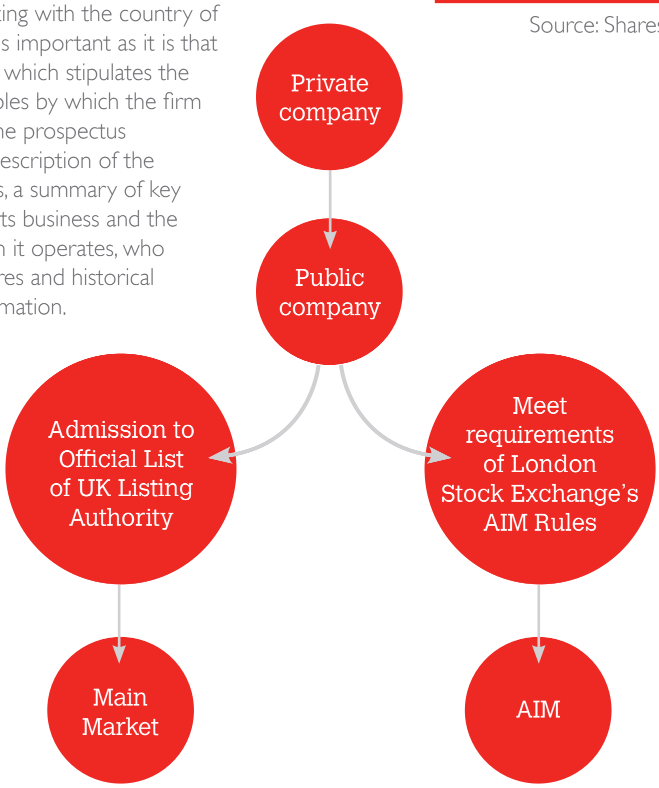
For AIM companies the market's operator, the LSE, also publishes a rulebook, or the AIM Rules, although as discussed above the requirements are not as stringent. Everything that you need to know about an IPO can be found out from its so-called offering prospectus, starting with the country of domicile, which is important as it is that jurisdiction's law which stipulates the high-level principles by which the firm must operate. The prospectus also includes a description of the firm's operations, a summary of key trends affecting its business and the markets in which it operates, who is selling the shares and historical accounting information.

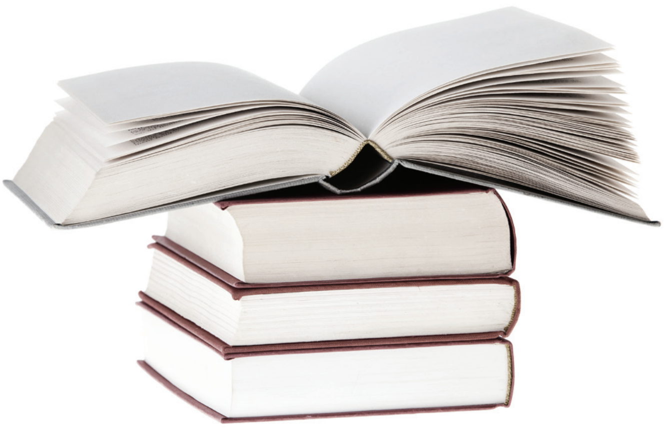
You will be able to use the prospectus to see if the company has generated revenues or profits in the past (see chapter 6) and also assess the key risks faced by the business, which have to be set out in full.

Not all companies which join the stock market will be generating revenues. Companies in the small cap oil and gas and biotechnology sectors, for example, are often at the pre-revenue stage. The prospectus will give details of the offer, including the price range the shares will be sold at (although this can change), how many shares will be offered, who is selling them and what proportion of the outstanding shares the main sellers will have once the company has joined the market.

A company can issue shares on either one of the UK's two principal markets

Source: Shares Magazine





Why invest in IPOs?

If the LSE is correct that confidence is returning to the UK IPO market (see chapter 1) then any boost to float numbers in 2014 could herald a great opportunity for retail investors to get involved in companies when valuations are compelling. The experience of the Royal Mail is a great example of the value opportunity IPOs might offer. Investors were able to apply for shares in the company at 330p last October. In the 90 days following its 15 October, 2013, admission to trading the shares advanced 78%.

When buying shares you can either buy them in the secondary market, in companies which are already quoted, or new shares when the company conducts an IPO, in what is known as the primary market. It is possible to buy cheap shares in the secondary market, but more often than not the primary market can offer good value as firms are keen to make sure their IPO gets off the ground without any hiccoughs (see chapter 2).

With any quoted company an investor always needs to begin by analysing the firm's prospectus, which involves an in-depth analysis of the business model and the market or markets it operates in (see chapter 6), but the price you pay is crucial. A company might have a great business model and operate in a very favourable market, generate plentiful sales and plump profits, but if you pay too much for its shares it will be very hard to make a decent return.

If you pay too much for shares it will be very hard to make a decent return

The experience of the Royal Mail IPO is not an isolated one as the primary market's past performance during the early stages of the IPO boom between 2004 and 2007 demonstrates. Had investors blindly bought all 180 companies that joined AIM and the Main Market between March 2004 and September 2004, and immediately sold at the end of the first day of trading they will have generated an indicative 6% return (see table). Had they held for 30 days the average gain would have been 9%, it was 11% after 90 days and 20% after 180 days.

All these numbers are based on the share price at admission to trading and the commencement of unconditional dealings (see chapter 5) and if investors had been able to purchase at the issue or offer price the returns may have been even greater. By the time unconditional dealings began in Royal Mail shares at the point of the firm's admission to trading on 15 October they were already trading at 478p, up 45% on the issue price.

It is important to note that not all IPOs will necessarily be as successful as that of Royal Mail. Thorough investigation is necessary to assess the quality, opportunity and risk of any IPO before making a decision to invest. Should there be a couple which seriously underperform then there could be a shift in investors' sentiment towards this investment opportunity. This in turn may impact the number and type of IPOs going ahead.

IPOs PRICED TO GO*

	Sell next day**	Sell after 30 days**	Sell after 90 days**	Sell after 180 days**
Average return (%)	**6**	**9**	**11**	**20**
Gainers	82	82	92	99
Losers	64	76	70	66
No move	26	14	10	7
Average gainer (%)	15	26	32	49
Average loser (%)	-5	-9	-15	-21

*Based on buying all the 180 floats between March and the end of September 2013 at first open mid price, where price data available (unavailable for eight companies)
**Based on closing mid price. Where 'sale' date a non trading day used price on last trading day, except for next day where next trading day mid close used.
Source: Shares Magazine, Thomson Reuters Datastream.

Choosing how to apply for and hold shares

Some IPOs will limit the Offer to institutional investors while some will allow retail investors to participate either directly, or through a stockbroker.

Where there is a retail component, investors will need to decide how they apply and pay for their shares, and how to hold their shares. **There are two main ways of holding shares: either directly with the company, or through a stockbroker of their choice.**

Keeping your shares with a stockbroker means the stockbroker will hold the shares in paperless or electronic form. Most stockbrokers will require you to apply online.

If you apply for shares directly with the company, you can choose between receiving a share certificate or, if the company makes one available, holding your shares electronically in the corporate sponsored nominee (CSN). Until recently only paper applications were accepted, accompanied by a cheque for the full amount of the application. Today, some of the larger Offers may allow investors to apply online with payment by debit card.

Investors who choose to hold their stock in electronic form, will need to decide whether they want a share dealing account with a stockbroker or hold the shares in the company's CSN (though these are not offered by all companies and the shareholder rights of a CSN holding may differ from that of a certificated holding).

The key benefit of holding shares in paper form is that you maintain 'name-on-register' rights without being tied to a corporate-sponsored nominee. The key negative is that it generally costs more to sell and takes longer to settle a trade. If you sell your stock it is likely you'll have to wait ten working days until the cash is paid to you. The industry standard for electronic shareholdings is three, known as 'T+3' settlement. Another point worth noting is that if you lose a share certificate you may go through a long and expensive process to obtain a replacement.

A corporate-sponsored nominee can allow the best of both worlds, whereby you have T+3 settlement and name-on-register rights, but each CSN can differ and unless you transfer your shares out of the account and into that of a stockbroker's, you may be tied to using it to sell your shares. Although, the charges and terms can still be competitive.

By contrast, share certificates can be presented to any stockbroker to sell on your behalf, so you may be able to take advantage of the most competitive dealing commission in the market. Stockbrokers will generally apply an additional charge for dealing with a share certificate and increasingly insist that the share certificates are deposited with them before agreeing to sell.

Name-on-register rights can be important. They ensure you get sent all company information, including results announcements and notices of meetings, in addition to which you are guaranteed a vote at key meetings.

Stockbrokers tend to pool investors' individual holdings in one nominee account. This appears under the stockbroker's name on the company's share register and the company is only obliged to send one set of notices to the name on the register. Stockbrokers may arrange for copies of annual reports to be made available, but investors can readily obtain company information and announcements from online sources or on request to the company, even if they do not appear on the company share register in their own right. The stockbroker has the right to vote using your shares, however, most stockbrokers will only vote if directed to do so by their customer.

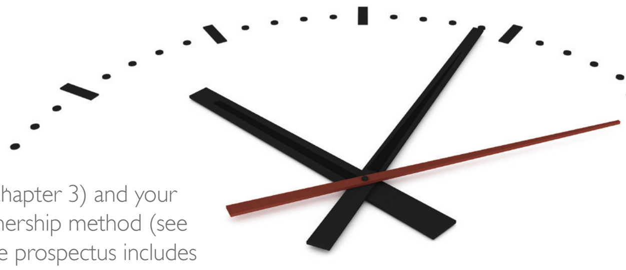
Choosing to use a corporate-sponsored nominee will probably depend on whether you are new to shares, if you already have a broking account with lots of holdings in it you may wish to keep your new shares in the same place too.

THE PROS AND CONS OF DIFFERENT OWNERSHIP METHODS

	Stockbroker account	Corporate-sponsored nominee	Share certificates
Name-on-register rights	N	Offer dependant	Y
Company dividend reinvestment plan	N	Y	Y
Various shareholdings in one account	Y	N	N/A
T+3 settlement	Y	Y	N
Execute trade with any broker	N	N	Y
Low-cost dealing	Y	Y	N

Source: Shares Magazine

The timeline



From the moment a company announces its intention to float prospective investors should glean as much information as they can from any source possible to help them make a decision as to whether it is likely to be a winning IPO (see chapter 6). The clock really starts ticking loudly from the point the prospectus is published, by which time you should have already decided whether the IPO is likely to be of interest (see chapter 3) and your preferred ownership method (see chapter 4). The prospectus includes details of the valuation and with a little under two weeks between its publication and the deadline for applications, you'll need to move quickly. There is plenty to think about as the indicative timeline below illustrates.

WEEKS 1-2

Late in week 1
- Company announces intention to float. This announcement will typically contain a summary of the business, historic financial performance and the details and timing of the IPO.

End of week 1
- First details of valuation start appearing in the press, including speculation as to whether the firm will be big enough to make the FTSE 100/250.

Over course of week 2
- Further details begin to seep into press.

CHECKLIST
- Read intention to float.
- Visit company's website for further details.
- Scour press for details of proposed valuation.

WEEKS 3-4

Late in week 3
- Company publishes its prospectus, including application deadline.

End of week 3
- More press comment, including detailed analysis of valuation.

Over course of week 4
- Press comment about investor appetite, if high then offer price range may be raised.

Early in week 4
- If you are applying via a stockbroker ensure you have cleared funds in your account ahead of submitting your application.

CHECKLIST
- Establish closing date for application – how much time do I have to make a final decision? Bear in mind it might be earlier through a stockbroker.
- Study prospectus for details of firm's finances – does the company generate revenues and profits? (see chapter 6).
- Ascertain whether valuation sufficiently appealing, assuming top of offer price range, or revised range.
- Decide on value of your application and get funds in place.

WEEK 5

Early in week 5
- Latest date for receipt of completed applications – it may be possible to make applications on the day using a debit card online or by post or hand delivering an application form and cheque to the receiving agent, application deadline usually late afternoon.

Late in week 5
- Announcement of the offer price and offer size, before market opens and conditional dealings begin.
- Confirmation whether investors are scaled back and individual allocation levels.
- If the demand for shares has been exceptionally high the company and its advisers decide to increase the share price above the price range initially announced in a supplementary prospectus will have to be issued, giving applicants 48 hours to give notice to withdraw their applications should they so wish.
- Commencement of conditional dealings (see chapter 7). If admission to trading (see chapter 7) does not occur, conditional trades will be cancelled.

CHECKLIST
- Complete application form.
- Decide whether to sell into any short-term share price rally.

WEEK 6

Early in week 6
- Admission to trading, and unconditional dealing begins on the Main Market or AIM.
- Share register gets loaded up and investors informed of their stock allocation. Those who applied via corporate-sponsored nominee (see chapter 4) get first opportunity to sell at this point. Share certificates and corporate sponsored nominee statements posted.

Late in week 6
- Those who applied via corporate sponsored nominee and who paid by debit card may get excess funds cleared into their bank account, as might those who applied via a stockbroker and who asked for excess funds to be returned immediately. Those who applied for shares by way of a cheque through the post may have to wait up to another week to have excess funds returned by post.

CHECKLIST
- Decide whether to sell into short-term share price rally
- If applied via a stockbroker account decide what to do with excess funds.

Spot the winners

Of the three best-performing IPOs since 2010 all generated revenues in the year prior to their quotation: one, Smart Metering Systems, turned in a pre-tax profit and WANdisco, might have been loss making but was cash generative and on the cusp of a move into the black. The Sheffield-based server replication specialist produced US$0.2 million at the earnings before interest, tax, depreciation and amortisation level in the 12 months to 31 December 2011 prior to joining AIM.

WANdisco

When it floated WANdisco made a point of highlighting in its prospectus how it had grown 'organically without any venture capital, angel investors or private equity funding'. Co-founders chief executive officer (CEO) David Richards, chief marketing officer and chief operating officer James Campigli and chief scientist Yeturu Aahlad owned close to 100% of the company before float and retained significant holdings immediately after the IPO.

Smart Metering Systems

The continuing strong presence of founders was also apparent at Smart Metering Systems established by Steve Timoney in 1995. Timoney, like the WANdisco founders, has resisted raising money from private equity and controlled 75% of the gas metering expert prior to float with the balance of 25% held by CEO Alan Foy. Immediately after IPO both men retained sizeable stakes.

blur

Professional services exchange specialist blur did have backing from angel investors but deliberately avoided venture capitalists for fear of being pushed into a quick sale. Founder Philip Letts owned 76% of the share base prior to float and 61.1% immediately after. He still retains 47.6% to this day.

Much of the above information is there to be found in the company's admission prospectus, a document you simply must study. In addition to giving you the required details to make a meaningful analysis of its prospects, the prospectus will also supply all the basics about the firm, such as where it is domiciled (and therefore what country's company law it must obey) and an overview of its operations.

You will be able to tell whether the company intends to join the Official List of the UKLA and be listed on the Main Market, or is seeking a quotation on the AIM market. Those looking for the highest standards of corporate governance will tend to gravitate to Main Market companies, which also have a shot at entering the FTSE All-Share, and any one of its three sub-indices of the FTSE 100, FTSE 250 and FTSE SmallCap, where firms have to meeting further exacting standards to gain entry, particularly around the liquidity of their shares.

Those willing to accept higher risks for the potential of more exciting growth may opt for AIM-quoted companies, but irrespective of the quotation venue all investors will wish to pay careful attention to the key risks set out in the prospectus.

WINNING CHARACTERISTICS*

Company	Sector	Gain (%)**	Revenues***	Profits^
blur	Software & Computer Services	546.7	Y	N
WANdisco	Software & Computer Services	525.3	Y	N
Smart Metering Systems	Support Services	375.8	Y	Y

*Best performing floats since 2010 with market caps of more than £100 million. **Pecentage change between open mid price on admission day and closing mid price on 30/12/13. ***Revenues in the last full financial year prior to float. ^Pre-tax profits in the last full financial year prior to float.
Source: Shares Magazine, ShareScope, London Stock Exchange, company reports.

Glossary

AIM
...or the Alternative Investment Market, is the London Stock Exchange's quotation venue for early-stage companies.

Admission to trading
When shares begin unconditional dealing on either the Main Market or AIM.

Conditional dealing
Where shares are traded before the admission to trading date, as the name implies these trades are 'conditional' on the company being listed and can only settle once trading has become unconditional i.e. everyone can buy and sell them.

Financial Conduct Authority
The UK's financial regulator.

Issue price
The price at which the shares will be sold, also known as the offer price.

Intention to float
The company first publicly announces its plans to launch an IPO.

IPO
Initial public offer.

Main Market
The London Stock Exchange's key quotation venue for mature companies.

Offer
When a company sells shares to the general public it has to make the formal offer in the form of a prospectus.

Offer price
The price at which the shares will be sold, also known as the issue price.

Offer price range
Range at the time of publication of prospectus within which offer price is expected to be set.

Offer size
The number of shares to be sold under the offer.

Official List
Operated by the UKLA, all Main Market companies need to join it before trading can begin.

Primary market
The market for new shares issued and offered as part of an IPO. (An IPO may be made up of a mixture of new and existing shares).

Prospectus
Is the definitive document outlining the offer in full.

Scaled back
When all investors' applications cannot be satisfied by the amount of stock available they may be scaled back by a proportionate amount.

Secondary market
The market for shares already admitted to trading.

Supplementary Prospectus
A document only issued in the event of a significant change in the terms of the original Prospectus.

UKLA
UK Listing Authority, the arm of the FCA which deals with the rules of companies quoted on the Main Market.

Unconditional dealing
When the wider public and not just participants in the IPO can begin trading shares in a company.

FAQS

Q: Can you please advise which website can provide me information of upcoming IPOs?
A: The London Stock Exchange publishes a list of forthcoming floats, but it is not entirely comprehensive. The list can be found here: http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/new-and-recent-issues/new-recent-issues-home.html.

Reuters also devotes a section of its website to IPOs - http://uk.reuters.com/business/deals/ipos. The UK Listing Authority has details of all the companies on its Official List. http://www.fsa.gov.uk/ukla/officialList.do.

Q: I can't find details of my IPO on the London Stock Exchange's website, can you suggest alternative sources?
A: Companies headed for the Main Market tend to put out an 'intention to float' announcement. This link is handy to spot forthcoming listings: http://www.investegate.co.uk/Index.aspx?searchtype=1&words=intention+to+float. You'll occasionally get AIM stocks putting up these announcements, too, but the AIM Rules say prospective firms must publish a 'Schedule 1' announcement ahead of joining the market and the following link will help you to spot such announcements: http://www.investegate.co.uk/Index.aspx?searchtype=1&words=schedule+1.

Q: If I cannot find any information on where or how to register to receive shares in a new float does this mean I can't participate?
A: Not all IPOs are open to the public and many firms will simply offer shares to institutional investors. Others may make arrangements for the public to apply directly for shares or limit applications from private investors to those applying through their stockbroker as intermediary. Make sure that the offer has a public element to it.

Q: Is it possible to make multiple applications?
A: It is completely against the conditions of such offers for an individual to put in more than one application.

Q: If I want to hold my shares in paper form is this possible?
A: Yes. Generally, if you apply directly you will receive a share certificate unless you choose to hold your shares in a corporate sponsored nominee. If you apply through a stockbroker, your shares will typically be held in electronic form in a stockbroker account unless you request a share certificate. Each IPO is different though and you should read the prospectus carefully to understand the choices available to you.

Q: Is it possible to get an idea of whether an offer might be scaled back?
A: Once the prospectus has been published investors typically have 10 days to apply but during this period stories might appear in the press to suggest that appetite has been strong. When the company increases the offer price range it is a concrete signal that demand is strong in which case scaling back may well occur. However it may also mean that the existing shareholders will simply make more shares available and sell more of the company in order to satisfy demand rather than scale back applications received.

Q: Do I need to fund my account to the full amount of my application, or can I wait to find out what I've been allocated and fund it then?
A: You have to fund your account to the size of the application and only find out later at the point of admission to trading whether you have been scaled back. After that point you will get any excess monies returned to you. Some offers may have rules about the retention of small amounts so check the details of the offer carefully.

Q: Can I leave my application decision right up until the day of the application?
A: You should check the deadline that your stockbroker has set. It may be earlier than the close of the offer and it may depend on how you are funding the application, whether by debit card or bank transfer. If you are applying direct, there may be the opportunity to apply online and fund your application by debit card up to the offer close. Alternatively, and for higher value applications which require payment by cheque, there may be a different deadline for applications received by post.

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