



GERALD  
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# A guide to IPOs

Helping you navigate through your  
IPO options and journey



# What is an IPO?

An Initial Public Offering (IPO) refers to the process of offering shares, normally in a private company, to the public (including institutions and fund managers) through the capital markets.

An IPO is defined as a company's first public sale of stock. It is the first-time shares in a private company are offered to outside investors who access such shares through the capital markets. As part of the IPO, the company converts from a private company to a public limited company (often referred to as a PLC).

Many of you would have heard of a "secondary offering", where existing shareholders receive proceeds of a sale of a portion of their shares that are already in issue. This can happen quite often both at the time of the IPO or at a later date.

So, why do companies choose to go public? An IPO or, 'going public', is a transformational event for many private companies that often requires a change in the behaviour and mindset of the company's management team. Accordingly, considering why an IPO is the best course of action for a company is important.

A company usually considers going public when assessing their strategic growth options. In many cases, this can be influenced by changes in their respective industry, motivated by funding or exit strategies and scope for future growth, or where additional funding is required to meet the demands of the business. More on this is covered below.

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# The pros and cons of going public

There are many pros and cons of an IPO, it's important to consider all factors when making this business decision. The possible opportunities and challenges in going public include:

## Pros

- ▶ More attention and branding opportunities including greater visibility and prestige with consumers and potential acquiror's of the company.
- ▶ Efficient access to capital through the markets including secondary equity offerings in the future to institutional and other shareholders/investors
- ▶ The ability to use quoted shares as liquid M&A currency for expansion and possibly consolidation within the relevant sector
- ▶ Increased ability to retain and attract valued employees through incentive plans using quoted shares
- ▶ Flexibility to trade with shares that have, in some cases, high liquidity whilst also having an up to date valuation
- ▶ Diversity of shareholder base

## Cons

- ▶ Going public can be a time-consuming process in both dealing with the IPO itself and investor relations thereafter
- ▶ Lower stake/shareholding held by senior management and others
- ▶ Loss of privacy and a move to generally being publicly accountable
- ▶ Limits on management's freedom to act and trade in shares and transact with the company in other areas
- ▶ The burden of investor relations and managing shareholder expectations
- ▶ Increased disclosure requirements

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# How to prepare for an IPO

Once a company has decided to go public, working out when and how they'll do it takes planning.

So, what are the requirements of a company for an IPO? The process consists of three distinct stages:

## 1) Planning

Fully understanding the objectives and addressing the company's readiness

## 2) Execution

Ensuring there are appropriate workstreams to deliver key requirements

## 3) Completion

Fundraising and the legal process

In order to maximise the value of the company at IPO, it is essential to create and test the "equity story" as this will define how the company and its business is positioned in the market generally.

Following an IPO, and as part of the process itself, there needs to be a very clear focus on the prospects of the business with the historical information only being a guide for the investing community.

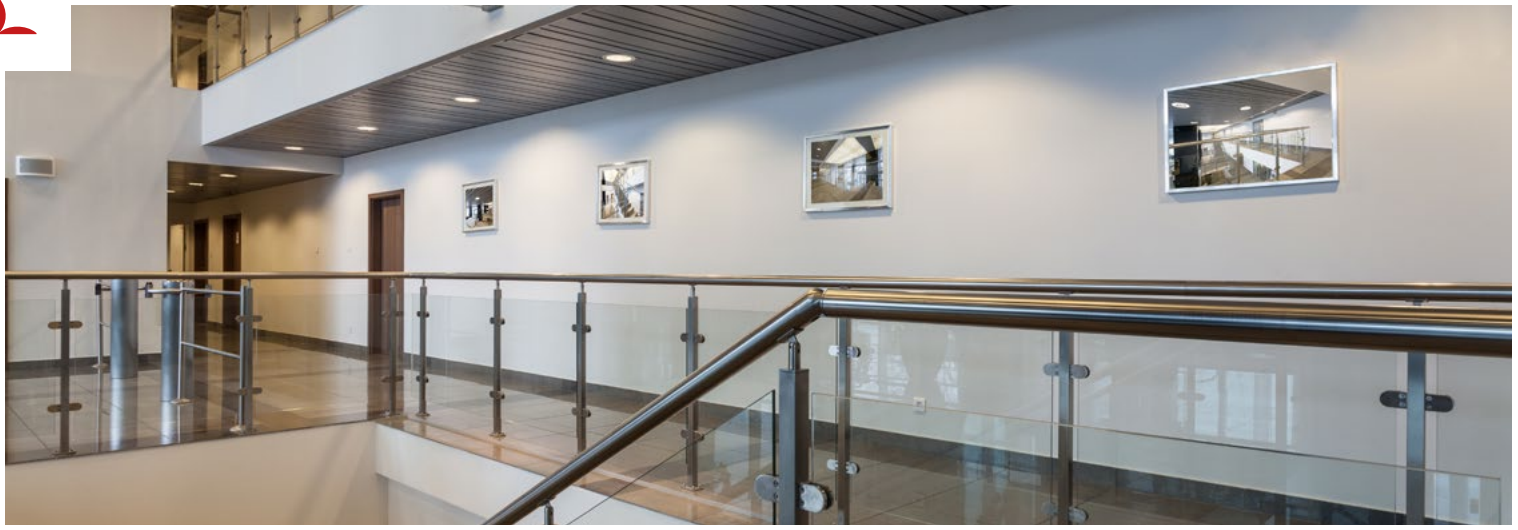
The "equity story" is, in effect, a clear and succinct justification as to why investors should buy shares or equity in the company.

Whilst there is no set template or formula as to how this should be laid out, in every case the key is to take the core facts and philosophies about the business and translate them into a well-reasoned story and rationale. The "equity story" should demonstrate the clear attractive financial characteristics and present a desirable corporate image for stakeholder groups.

Appreciation of the typical investor is essential as various fund managers will be evaluating each IPO in a comparative way and your company's story will be measured against other stories and IPO opportunities for individual fund managers.

To create an impactful "equity story", a company should bear in mind the 'three Cs' and make sure their story is:

- ▶ Crisp
- ▶ Comprehensible
- ▶ Compelling



# How to know you're ready for an IPO

There are many facets to review when assessing readiness to embark on an IPO process, including:

## Financial track record

It is not only true that the financial track record should reflect the characteristics of a positive "equity story" i.e. growing profits, but also whether the financial information is in an acceptable form for the rigorous disclosure requirements necessary for the IPO process.

Most public companies are required to account under International Financial Reporting Standards (IFRS) and therefore adjustments may need to be made to previous annual accounts. In addition, if a company is relatively small it may not, in the past, have required an audit and this will need to be addressed in terms of the latest annual figures.

## Management team

The management team needs to be appropriate not only for the business but also from an investor standpoint. Key management should have the appropriate credentials and experience and the depth of knowledge around the sector in which the company operates. As part of the IPO process, independent directors will also need to be appointed if this has not yet been actioned in the past. Such independent directors are non-executive in functionality and will be essential in guiding the company not only through the IPO process but the expectations of a public company following the IPO.

## Executive compensation

Investors are always interested in executive compensation therefore there needs to be a well thought out plan that makes the compensation attractive for key management but also aligns their interests with those of shareholders. It goes without saying that such executive compensation plans need to be commensurate with the industry norm and consider all related tax consequences for each individual team member of management.

## Governance

This is an area that is normally not in place in any robust way for a private company but one which must be fully embraced as a public company. Comparing the protocols that are present or are to be put in place against the applicable corporate governance code is relatively straightforward but deciding on how to fill in whatever gaps are required to be filled in can sometimes be more challenging.

## Related party transactions

As a public company, related party transactions must be reported publicly and therefore details of such arrangements will need to be captured and reported on as appropriate.



## Tax and structuring

This area is one that will be important for not only the company but also the individual director/shareholders especially if there is a secondary offering at the same time as the IPO. Assessing the capital structure that will be required for the IPO is also critical to ensure that any tax losses that may be available within the corporate group are not allowed to lapse and that individual shareholders and directors are not compromised from a fiscal perspective.

## Investor relations

This area is one that many companies will not have had to address prior to the IPO, and it is important that this function is embraced as early as possible. Having a healthy and excellent working relationship with the company's financial adviser/nomad is essential to ensure good investor relations.

In assessing readiness, a successful IPO will require the company and its management to plan to be ready, ensure that any gaps are remedied as quickly as possible and then assess readiness again.

**The management team needs to be appropriate not only for the business but also from an investor standpoint**





# Accounting and financial considerations

A company that wants to go public needs to have audited accounts and sometimes, interim financial information. It is easier and cost effective to perform audits of financial statements and accounting in the normal course of business rather than doing so shortly before going public.

An assessment also needs to be made of the adequacy of the company's financial infrastructure and resources for public company reporting. Finance directors or other leaders of finance departments need to evaluate the company to ensure the structure is in place to meet the demands of a public company. This will include back office roles but, as importantly, HR and systems must be robust and substantiated, where required, in order to meet the needs and requirements of new external shareholders. Higher expectations of transparency and data reliability may include increased scrutiny of budgets, projections and filings.

Effective reporting requires much more than just looking at past performance. Investors will expect companies to know how the performance matched up against projections, forecasts and the key drivers impacting any variants in order to improve future predictions.

Throughout the IPO process, brokers and their analysts will be looking for the company to prepare financial forecasts and comparisons against historical performance. This will mean the company will need to establish a financial planning and analysis infrastructure to put such a process in place and, furthermore, the company will need to adopt the habit of preparing realistic budgets and updated forecasts

with the ability to articulate an explanation as to any variances.

As part of the readiness for an IPO, the company's board will be required to prepare detailed reports covering the working capital requirements of the company including detailed cashflow and profit forecasts for at least a two-year period following an IPO. In addition, there will be a report entitled Financial Protocols and Processes which will look at every aspect of the company's business and ensure there are adequate controls and systems appropriate for a public company.



The other area that will need to be looked at within accounting and finance is to ensure that any issues around taxation have been addressed especially if, prior to the IPO, there is a re-organisation and movements of assets within the corporate group.

Any public company will need a full quota of board-approved risk management and control policies. Increasingly, investors are scrutinizing risk and the valuation of a company will often be at a premium where there is strong risk management and a focus on risk assessment.

Prior to an IPO, a company must fully understand the risk management's impact on new shareholders including, where appropriate, compliance with regulatory and other legal matters. Risk assessments should be an ongoing, systematic process to identify and evaluate any possible future events whether within the organisation or in its external environment that has the potential to have an impact on the company's ability to meet its objectives included within its "equity story".

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# A guide to the IPO Process

The IPO process is one in which the company and its key advisors will have separate areas of responsibility. It goes without saying that a company's external advisers should be highly skilled professionals with extensive credentials and experience in dealing with an IPO process.

As mentioned previously in this eBook, a great deal of management time is required to complete an IPO process and it is important that management have support staff to assist them with day to day operational issues especially when they are focusing on the IPO process itself.

The IPO process, once initiated, can last up to 12+ weeks. Normally the company will agree on an approximate timeline for the IPO event to take place which will, of course, take into consideration the financial reporting requirements of the company but, as importantly, the timing from a capital markets perspective. In this regard, IPOs tend not to happen from mid-December until mid-January or over the summer months mainly as a result of the fund managers not being around to properly consider the opportunity due to vacations.

The sponsor of the IPO, normally the house broker and its nomad (in the case of an IPO on AIM), will conduct discussions with selected potential investors and organise the interface between the company and such investors through a series of "roadshows".

Following the roadshow, the house broker will then prepare the Order Book which will set down the provisional investors with the amounts that each will be investing. It is also at this time that the valuation will finally be agreed upon and which will depend on a number of factors including the status of the

capital markets generally as well as valuations for comparable companies and, of course, the expectation of management and shareholders.

The success or failure of an IPO can be greatly determined by fair pricing, valuation and delivering on your promises, which are clearly important parts of the IPO process. It is not surprising that many investors will expect some form of a discount on the fair value of the company's shares. The higher the perceived risk in an investment then the greater the discount and therefore the lower the share price an investor is prepared to pay.

A convincing "equity story" told by a management team that communicates effectively with their investors will generate a degree of confidence and will inevitably raise the level of the valuation itself.



# How Gerald Edelman can help

Gerald Edelman can assist at every stage of going public, including considerations and implementation of an IPO for any business.

We would be happy to help with any of the stages in an IPO process, including:

- ▶ Strategic planning
- ▶ Assessing financials
- ▶ Financial due diligence
- ▶ Regulatory compliance
- ▶ Preparation of financial statements
- ▶ Tax optimisation
- ▶ Undertaking the role of Reporting Accountants including reviewing the Short Form report, Working Capital report and other related issues that have to be dealt with through the IPO process

In addition to the areas above, Gerald Edelman can also assist with:

- ▶ Functions
- ▶ Leadership
- ▶ Timing

## Functions

- ▶ Assisting with new investor relations function
- ▶ The appropriateness of the compliance function to meet regulations in areas such as disclosure/insider trading, etc.

- ▶ Review of investor reporting with regard to meeting the demands of institutional investors
- ▶ Training for finance departments on external reporting processes and the catch of data for IFRS

## Leadership

- ▶ Consideration of preparing incentive schemes for key personnel, including arrangements involving deferred benefits and complex securities
- ▶ Recruitment of new hires especially in connection with board composition
- ▶ Implementation of long-term employee incentive plans including stock options and related plans
- ▶ Assisting with the implementation of functions to manage corporate governance

## Timing

- ▶ Preparation of IPO timeline including monitoring of milestones
- ▶ Preparation of data room for due diligence purposes
- ▶ Preparation of financial, legal and fiscal due diligence
- ▶ Preparation and implementation of corporate communication and finance calendar to be appropriate for a public company

## FREQUENTLY ASKED QUESTIONS ('FAQS')

### What is an initial public offering?

An Initial Public Offering (IPO), refers to the process of offering shares, normally in a private company, to the public (including institutions and fund managers) through the capital markets. An IPO is a company's first public sale of stock, often the first-time shares or other securities are offered to outside investors who themselves access such shares through the capital markets.

### What is a pre-IPO stock?

A pre-IPO stock is defined as a pre-initial public offering where a late-stage private company offers to sell a large stock of shares to raise funds in advance of the company going public on the stock exchange. Pre-IPO investing was once limited to venture funds, global investors and other specialised organisations, however in recent years they are much more accessible with many specialist brokers entering the market.

Investing in pre-IPO stocks can carry high risk and an investor needs to do their research prior to investing in pre-IPO stocks. A private company is not obliged to disclose company information or financials, that is normally required when going public, this results in pre-IPO shares being cheaper than IPO shares and having the potential to yield substantial returns.

Selling pre-IPO stocks can also be a huge advantage for a private company, giving them the opportunity to raise funds and their valuations as well as their public profile prior to going public, maturing and becoming better prepared for IPO.

### How is an IPO priced?

There are several factors that need to be considered when evaluating an IPO price, which is normally determined by the lead investment bank or financial intermediaries underwriting it.

The two main components of IPO pricing are a strong demand from investors and the company financials, in many cases, these are complex to determine. IPO readiness is crucial to the success of an IPO and the allocation of a fair price when launching the IPO.

This requires the creation of a compelling corporate narrative or "equity story", comparable company valuations, industry experience, and accounting and financial considerations by trusted advisors and compliance experts that will determine an IPO's success and profitability. Taking the right approach to IPO readiness will result in strong demand and a higher stock price and be a catalyst for a successful IPO.

It is not surprising that many investors will expect some form of a discount on the fair value of the company's shares. The higher the perceived risk in an investment then the greater the discount and therefore the lower the share price an investor is prepared to pay.





## How does an accountant help during the IPO process?

The private company preparing for IPO will need to establish a financial planning and analysis infrastructure to put such a process in place, furthermore, the company will need to adopt the habit of preparing realistic budgets and updated forecasts with the ability to articulate an explanation as to any variances.

As part of the readiness for an IPO, the company's board will be required to prepare detailed long-form reports covering the working capital requirements of the company including detailed cash flow and profit forecasts for at least a two-year period following an IPO. In addition, there will be a report entitled Financial Protocols and Processes which will look at every aspect of the company's business and financial due diligence and ensure there are adequate controls and systems appropriate for a public company.

With the exception of the matters that need to be covered as part of the Reporting Accountants role, the other area that will need to be looked at within accounting and finance is to ensure that any issues around taxation have been addressed especially if, prior to the IPO, there is a re-organisation and movements of assets within the corporate group.

Any public company will need a full quota of board-approved risk management and control policies. Increasingly, investors are scrutinizing risk and the valuation of a company will often be at a premium where there is strong risk management and a focus on risk assessment.

Prior to an IPO, a company must fully understand the risk management's impact on new shareholders including, where appropriate, compliance with regulatory and other legal matters. Risk assessments should be an ongoing, systematic process to identify and evaluate any possible future events whether within the organisation or in its external environment that has the potential to have an impact on the company's ability to meet its objectives included within its "equity story".

In all the above instances the private company will need to rely on the expertise of their accountant and trusted advisors to help collate the information required, and assist with reporting, due diligence, accounting, valuations and compliance and tax-related matters.

Prior to an IPO,  
a company must  
fully understand  
the risk  
management's  
impact on new  
shareholders



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