



The Interview

*Following on from the highly successful
“So you think VCs are different...” seminar we have interviewed Tim
Davis of Charles Stanley Securities about the whole flotation issue*

We have had a large number of enquiries and questions as a result of Tim Davis’s talk on what institutional investors look for when investing in AIM companies and the current stock market conditions for fund raisings.

Tim, by the way, is Marketing Director of Charles Stanley Securities, an *Angel News* preferred provider and a specialist in AIM IPOs and fund raisings and in helping companies decide whether AIM is the right route for them.

So to top-up her own knowledge and to share with subscribers the salient points of Tim’s talk, *Angel News* editor-in-chief Modwenna Rees-Mogg interviewed Tim:

Q. *So just how ‘open’ is the stock market at present for IPOs?*

A. It’s always open – it’s just a bit harder at the moment. We have had several years of bull market conditions, a bi-product of which has been an increasing flow of both primary and secondary fund raisings. Investors have been spoilt for choice.

Things came to a head in May of this year when the market had one of its occasional wobbles – perhaps a sign that things were becoming a tad overheated.

Our institutional clients – the pension funds, insurance companies and inheritance tax funds that are the main investors in AIM – understandably paused for breath and have remained cautious throughout the summer and into the autumn.

You have to bear in mind that fund managers do not have bottomless money pits. Some funds may be fully invested which means that they would have to sell one holding in order to buy another. Others will take the view that in a buyers’ market, they can afford to be especially choosy.

Where we are now is that issues are being supported, but selectively: a good quality story that is sensibly priced should always find a willing audience. It is the not-quite-right, too small, me-too or just plain too expensive issues which are finding it harder.

Sentiment has also been impacted by some unexpected bad news emerging from companies, in some cases quite recently floated ones, too.

There is also a degree of cynicism in the market surrounding overseas companies. I think people prefer businesses where management are closer at hand.

Q. So if the good companies are getting through, what about the less good?

A. Some are re-thinking IPO itself (in terms of what other options may be available), or how much they really need to raise now versus how much they would like to raise i.e. settle for a lesser initial amount with a view to revisiting the market at a later date.

We are also aware of companies with fund raisings underway which then stalled in the face of changing market conditions. This highlights another issue – what we call indigestion. There is a backlog of companies waiting to have another run, or that have put their fund raisings on hold pending more clement conditions. And then you have the ones coming at it fresh, or planning now for Q1 or Q2 of next year.

Q. Surely for the right companies, this means pressure on valuations?

A. To an extent, yes. But I can assure you that if a company is right for the market and is sensibly valued, any initial discount – if indeed there is one – should be recovered reasonably quickly if that company delivers the goods.

Q. How important is size?

A. It is becoming increasingly important. In recent months, we have been getting a clear message from institutional clients that, at the start, a company ideally needs to have a market capitalisation of £20 million and above.

Q. Why is this important?

A. At IPO, it is desirable to achieve a mix of cornerstone institutional investors. Institutions tend to be supportive and take a medium to long term view – assuming, that is, everything goes well. So a rough rule of thumb says that the bigger the company, the wider the range of institutions it should attract. Conversely, the smaller the company, the less they will attract.

Q. What about liquidity?

A. It's equally important, both from the point of view of existing and potential investors. Illiquid stocks by their nature are of appeal to a narrower range of potential investors and also tend to experience greater levels of share price volatility. Also, if things don't go as well as planned, institutions will want to know there is a reasonably liquid market, should they wish to reduce their exposure.

Q. Where do the VCTs stand in all of this?

A. If a company is VCT qualifying, then it is potentially of interest to an even wider range of investors. It is also quite common at the time of IPO for VCTs to roll their investment in the unquoted company into the listed vehicle.

Q. So if a company is considering IPO say, in the next year, when should it start the process off?

A. You can complete an IPO from start to receipt of funds in three months. But that can be a bit tight, so the more time allowed, the better. We tend to get to know companies a year or two before they start the actual process, not least of all to help them review the other options and to ensure they prepare themselves thoroughly.

Our feeling is that if a company is looking at floating now, it will probably be better off waiting until Q1 of next year – by which time, hopefully, the indigestion will have abated. But there is nothing to stop them kicking-off the process now.

Q. Can you outline what institutions look for when considering investment in IPOs?

A. I think there are three broad areas, the first being the company itself. Is it right for the market – or could it become so if in the near term, it reaches certain milestones?

People often ask what makes a business ‘right’. My answer is to consider if you were making an acquisition of a top quality, growing business, what boxes would you and your advisers be looking to tick? In the event of IPO, you need to be able to tick the same boxes.

Q. Which particular boxes?

A. In no particular order:

The nature of the business – is the service or product addressing a growth market, or does it address an emerging market? Either way, management need to be able to demonstrate that its has ‘legs’ i.e. that it is scalable and can look forward to growth in both sales and profits; and what it will cost in terms of funding and when in order to get there.

Strategy is obviously vital. Does it make sense? How robust are the company’s financial procedures, reporting and controls? Cash flow is also very important, especially if the company is carrying debt.

Management must also be able to demonstrate a commanding knowledge of the company’s markets; reasonably high barriers to entry (or an understanding as to how it keeps the competition at bay); a well spread customer base or mix of revenue streams; and among others, a mature attitude towards, and appreciation of, the risks attached to the business.

Timing of the proposed IPO is also important, not just in terms of prevailing stock market climate, but from the point of view of the optimum time for the business itself. For example, rather than float the business on breakeven, might it achieve a higher valuation off the back of delivering its first year’s profit?

It is also important to have a clear view on what shareholders want out of it as they will more than likely have different time horizons and the normal post-IPO lock in may not suit all.

Finally, why does the company want to float? There are a range of reasons why companies do it, but the principal ones we look for are for the company to use equity to help fund growth, be it organic or via acquisition; and to help facilitate employee participation and staff retention, be it via direct equity, or share options.

Q. You mentioned three broad areas. What's the second?

A. Management. What is their motivation for floating the business and have they looked – hard – at all the other options? Is there management in breadth and depth and are there any gaps to fill around the boardroom table? How ambitious and able are they and does a critical external audience feel they have what it takes?

Track record in terms of achievement is important, even if it is with private companies. Successful private company management should not feel that because they have no public company experience, the market is not for them. AIM is all about entrepreneurial companies and you have to start somewhere.

Equally, that is where non-executive directors come in: typically, as it prepares for IPO, a company will recruit two non-executive directors, with probably one having stock market and / or IPO experience. It is also part of the advisers' role to educate promising management teams on what is expected of them both at the time of IPO and thereafter.

Q. And the third?

A. It's the future. It's all about using the listing effectively and goes back to what the company can deliver and – in equity terms – what it will take to enable it to do this. Institutions want to back winners and implicit in investing at IPO is that as the company grows, so it may need further equity financing.

There are additional expenses associated with being listed, the main ones being the costs of non-executive directors and additional professional fees.

There are also demands placed on management in terms of time spent maintaining relationships with existing institutional investors; and importantly, cultivating potential investors. Properly managed (by the company's broker), this can however be contained.

Last but not least, transparency. A public listing brings automatic prestige, but it also means that a lot of financial information is available, electronically, worldwide – which cuts both ways, especially if things are not going well.

Q. So what is your message to would-be IPO aspirants?

A. AIM is a great place for entrepreneurial, growth companies. If you can tick most or all of those metaphorical boxes on your business, you should consider IPO as but one option for the future, even if you subsequently discount it.

Irrespective of stock market conditions, good quality stories, with 'legs', will usually find willing supporters, but they will have an eye on value and liquidity.

For further information on floating your business, please contact Tim Davies, Marketing Director, Charles Stanley Securities on 020 7149 6412 or via email: tim.davis@csysecurities.com