Investec
Corporate & Investment Banking

# ‘Plan for the marriage, not just the wedding’

Prepare well in advance, choose your advisers carefully, and don’t get greedy. So what were the other key messages from Investec’s IPO conference?

Floating a company is, superficially, a technical project. Get your accounts in order, appoint advisers, write and verify a prospectus, pitch to investors, fill out the paperwork… and your company is public.

It's rarely that straightforward – as two CEOs who have both been through the process, and a fund manager, explained to delegates at Investec's recent IPO Conference. Equally important are having a strong rationale for floating, summoning the energy for the process, building relationships, and preparing for the scrutiny of plc status.

## State of the market

One factor shaping a company's appetite for an IPO is the state of the market. "And 2019 has definitely been slow," explained Andrew Pinder, Head of Investment Banking at Investec. External events have shifted risk appetite among investors.

"It doesn't mean IPOs can't be done, you just have to think about how you bring them to market," he stressed. The four Ms – Market, Model, Management team and Metrics – remain the acid test for investors and those companies who tick each of these boxes are still able to achieve successful IPOs. And, according to Investec economist Victoria Clarke, the resolution of national and global uncertainties over the next 12 to 15 months could start to shift risk appetites and widen the pool for potential IPOs.

"Fund managers have got plenty of cash, too," added Pinder. "Public to private takeovers are at a 10-year high, which has led to lots of cash being returned to investors; that needs to find a new home."

## Get your rationale right

There are two primary rationales for an IPO: raise new money for expansion, and to provide liquidity to existing shareholder to enable them to realise value from their investment over time. That might be company founders, but often means private equity (PE) backers at the end of their investment period.

PE firm Electra owned Hollywood Bowl until it floated in 2016. As CEO Steve Burns explained, Electra was keen to realise the value of a range of different investments in its funds. IPO made perfect sense for Hollywood Bowl's ambitious growth plans while enabling Electra to exit.

But there are more nuanced rationales, too. Brendan Mooney is CEO of Kainos Group plc, a university spin-out that's been through several different ownership structures. Doing an IPO was a way to provide liquidity for his long-term shareholders who, unlike a PE backer, hadn't got a fixed investment window.

## But there are several other reasons to list:

- Spreading ownership to employees, creating meaningful share schemes and long-term incentive plans (LTIPs). A point echoed by both Brendan Mooney and Steve Burns.
- Higher profile: being a plc helped Kainos compete against blue-chip rivals such as IBM and Accenture, and it means Hollywood Bowl can attract talent.
- Neater capital structure, with lower leverage than is typical in PE. Cash can be redirected from debt servicing to investment. Lower debt means lighter covenants and possibly better rent deals.
- Customer confidence: at Kainos, government contracts more than doubled, helped by the reassurance that the business would likely remain independent.

## Initial preparations: never too early

Mooney said a conversation with an investment bank is the ideal way to test your rationale. Their fee is contingent on success – so if they say you can float, you probably can. But smart execs lay groundwork years in advance. Dan Nickols, Fund Manager at Merian Global Investors (formerly Old Mutual), advised taking any opportunity to talk with potential IPO investors at an early stage to help them build an appreciation for the company's narrative.

Burns, Mooney and Nickols also agreed setting up a plc board early on in the process was vital. PE backers are often non-executive directors (NEDs), offering valuable insight. But a plc will need a more substantive board with NEDs which bring a broader experience. Mooney advised having the board in place at least 12 months before an IPO to help filter out "the noise in the process".

## Get into the process, but don't drop the ball

"You need to prepare for a process lasting at least a four months – six if you don't want to kill your FD," said Andrew Peck, Head of Listed Companies at Investec. "Time it right: avoid holidays, for example, but accept there are always events that you can't predict."
Mooney stressed you shouldn't gear your business exclusively around delivering the IPO. "As one adviser told me, 'plan for the marriage, not just for the wedding'," he recalled. Messing up your long-term business performance because you've over-focused on an IPO is a cardinal sin for investors, too.

The first step is to choose an investment bank and lawyers. These will be confidantes through the process – so a good personal relationship is as essential as excellent technical skills, experience and contacts.

Internal resources are also crucial. An IPO is distracting, so the CEO and CFO need to know the business is running smoothly in the background.

Becoming a plc often requires companies to change how they prepare their financials. On top of this there will be a vigorous diligence exercise undertaken on the historical numbers, so having a finance team who can talk to the three-year track record is important.

## The fishing trip: testing the market

Investec puts a lot of work into building a high-quality shareholder register, said Peck, aiming for "diversity in depth." "You want different types of investor: long- and short-term money; large and small; different mandates," he explained. "That helps liquidity post-IPO."

At Hollywood Bowl, Burns was guided through a 'pilot fishing' roadshow by the Investec team right at the start of the process. Presentations to around 20 hand-picked investors will reveal a lot about market appetite. And, he said, it was also useful to get fresh perspectives on the company's strategy.

This process also helps management get used to a key concept in the public markets: 'under-promise and over-deliver'. This initial roadshow should also yield some cornerstone investors who want to take up a good chunk of the fundraise.

## Hitting the road: it's all about energy

Things will be tough for three or four months – especially for the finance function, the point-team for due diligence. The finance director will also be responsible for leading the discussion with the investment bank's research analyst who will challenge each assumption that underpins their model before they publish their research note to the investors. Remember, it is the research analyst who provides forecast numbers to the market, not the management team.

The research analyst publishes their research note and undertakes a two-week analyst roadshow. This gets investors briefed on fundamentals and helps test valuations. Following this, a two-week management roadshow will put the top management team in front of 60 to 100 institutions to solicit demand and investment.

"You're presenting to very bright individuals who have poured over every detail of your company," said Burns. "I was staggered by how well informed they were. So understanding your own business is critical." Keeping up energy levels, so the last pitch is as good as the first, is a universal challenge.

That all results in the book-building exercise as the investment bank takes commitments for shares from various investors and at what prices they will buy. In the final week, the board meets to firm up the offer price – and then you list.

## The money question

"Valuation is the thing most people are interested in," said Peck. "When you take on an adviser, they'll give an estimate – but it's like estate agents, there's a risk that they'll pitch high to win the mandate, then chisel down over the process."

The aim is achieving a target valuation – not necessarily the maximum. Mooney warned that taking incoming plc investors to the very edge of their appetite creates a burden that a business could be carrying for years: a need for flawless execution.

"Investors will look at earnings multiples, free cash flow– and revenue multiples if you're loss-making," said Peck. "The research analyst will publish a valuation range that sets expectations. Growth, cash flow and revenue resilience are all important to help drive this valuation."

Getting the right level of free float is critical and requires a good deal of thought. Some investors will push for 50%, but in practice, there is no hard and fast level. However, you do need to offer sufficient stock to enable investors to get meaningful positions. And you need enough investors to generate the liquidity that will allow your shares to trade frequently and your share price to reflect the value of the business properly.


## The day of the float is just the start

Even if you live the 'under-promise, over-deliver' mantra, it will take time for the market to trust your story. Burns said despite great numbers for Hollywood Bowl as a plc, it was a year before his share price started to reflect positive news fully.

Life as a listed company is different and must be planned for – extra heads in the finance function, for example, and investment in PR and media training.

Importantly, said Mooney, being listed mustn't distract from running the business. He remains focused on hiring talent, growth and setting strategy. Those are all things in a CEO's control; the share price isn't.

But the payoffs are worth it. "I love being a listed CEO," Burns admitted. "It's provided us with so much more flexibility and avenues for growth than we had in PE, which is focused on the four- or five-year horizon."

Mooney finished on a reassuring note: "Remember: building a great business is really hard work. In comparison, doing an IPO is relatively simple. So don't worry."