THE DEALMAKER

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An IPO is an ideal exit route for VC investors. But what does that mean for the management team? Christian Doherty spoke to three FDs who have followed private equity backing with a listing.

WELCOME TO THE MARKET

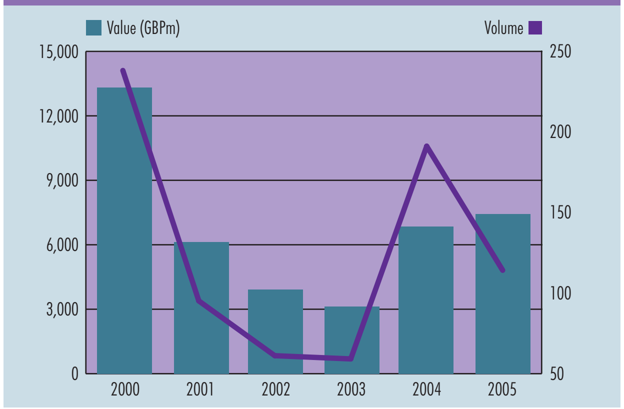
2005 WAS A BUMPER YEAR for IPOs, at least for smaller deals. There were 114 new listings on the main London market, raising US$7.4bn. But the real winner was the Alternative Investment Market (AIM), which admitted 287 IPOs during the year.

Phil Adams of Altium Capital: Several recent IPOs of VC-backed businesses shows AIM is still attractive as an exit.

Whatever deals happened in London were dwarfed by events in France, which saw the state controlled Electricité de France part-privatised. That deal raised a little over €7bn, which underpinned an encouraging total of over €25bn raised on European markets.

But as usual, London saw the bulk of activity. Hot sectors included electronics and the usual high tech suspects, as well as pharmaceuticals and engineering.

IPOs: THE RECOVERY



We're a long way from the heady days of 2000, but 2005 was a year that saw confidence return, at least to IPOs. While the number of new listings on the LSE was down from 191 to 114, cash raised was up by nine per cent. Then there's the AIM effect. There were 287 AIM IPOs to the end of November, which has driven growth in volume. Source: Ernst & Young Global IPO Survey

So why the renewed confidence? Phil Adams at Altium reckons the steady growth of AIM's credibility accounts for a large part of the appetite. "Institutional demand for high-quality companies remains strong and the investing institutions continue to be strong supporters of AIM," he says. "We understand that institutional holdings in AIM now account for over 40 per cent of the market by value at around £20bn, more than double the 2004 figures." Not so "alternative" now, then.

So much for demand. Where's the supply? Enter private equity. While there appears to be more appetite for exiting via trade sales in some sectors (notably technology), some of the leading VC houses appear more amenable now to the IPO as a viable exit strategy than in recent years.

Adams identifies La Tasca's flotation last year (see page 30) as a signal of a new approach that could mean more and more VC-backed floats in the coming year. "The flotation of La Tasca in February was a great example," he says. "The total fundraising on IPO was £37.5m and the placing was in excess of two times over-subscribed – the VC actually increased the level of stock sold on flotation due to institutional demand. We would expect the trend of quality private equity-backed businesses going to market, particularly AIM, to continue into 2006."

The consensus appears to be "more of the same next year, please". Tom Troubridge at PwC says that while 2005 was the best year for floats since the heady days of 2000, there's no sign of a slow-down in 2006. "There's no reason why the IPO markets shouldn't continue to flourish in the coming year – provided, of course, no negative economic factors emerge," he says. "Russia, China and India, for example, need capital and Europe should continue to be a popular destination for international IPOs."

Indeed, a major driver behind AIM's recent stellar success has been non-UK listings. Companies from the Netherlands, Cyprus and even a Dutch-Russian joint venture have all joined the alternative market in recent months.

And what's also interesting is the increasing credibility of AIM as end goal. "It's become apparent that companies are no longer using AIM as a springboard onto the main market," says Andrew Wright, head of the public markets team at law firm Cobbetts. "It has become a serious trading platform in its own right and, as a result, a number of companies have moved on to it from the main market in the last two years – a trend that is certain to continue for the foreseeable future." And the lower administration costs and lighter regulatory burden don't do any harm either...

FROM VC TO PLC

Our FDs said good old-fashioned elbow grease is the key to going public.

Name: Chris Neilson
Company: Synexus
Sector: Medical research
Flotation date: Nov 2005
VC backer: Not disclosed
Amount raised: £3.5m

COMMENT: "Synexus recruits and manages patients for clinical trials. We're in competition with GPs and NHS consultants, who recruit patients on an ad hoc basis. Our niche is that we do it full-time.

"The VCs came in when two businesses were merged to form Synexus in 2002. But there had been several attempts to revitalise the company before I arrived in 2005 to manage the flotation process. The problem was that it wasn't really making any money. The pharma industry is very conservative and it turned out that the targets the company had set itself were a little too optimistic. When that happens there can be a divergence, and that's what happened with Synexus. We weren't making money in 2003-04 at all.

"It turned out that a float was the best way of strengthening the company's balance sheet. It was the ideal solution for both the business and the VC, who could get cash out of the business as well as retain a decent stake.

"There was also a view within the company that the business was constrained by the demands of being venture capital-backed. The VCs had shares and also loans into the business. We weren't reducing our loan capital either. So the first key thing was for us all to sit down and do some restructuring at the corporate level. That was to make sure we had an attractive proposition to take to the City. Had there not been that fundamental agreement then the deal wouldn't have happened.

"After that it became a joint effort, really. But one thing we did do, which proved to be really useful, was to use our stockbrokers as a third party arbitrator between us and the VCs. They came on board and at times were used as expediters on the deal and to keep it on track. So we used the broker to good effect.

"You've got to appreciate that everyone's looking for *their* best deal – and of course not everyone can be totally happy with what comes out at the end of the process. But we kept on with it and came up with the best arrangement for all concerned.

"You've also got to be very careful not to fall out with the VCs when you're setting the terms for the float – because they are the ones who really can scupper the deal.

"But we weren't in daily contact with the VCs once the deal had been agreed and the IPO kicked off. Once the framework is in place in terms of the organisation of the shares, then it's a relatively straightforward process. You start with presentations to investors. And for myself, as FD, it was all about the numbers – so I had to make sure I had them covered before we started.

"In terms of the presentations, one of the frustrations that you will simply have to get used to is the lack of feedback. You can't ask for instant reactions from investors and analysts – it's just not the done thing, I was told. So you're never really sure how your presentations are going down. It's tough, but you've only really got what your broker tells you to go on – so ask them how *they* think you're doing.

"My key piece of advice is to make sure you start off with good advisers. That doesn't necessarily mean the broker that gives you the highest valuation of the company, but the one that demonstrates a solid understanding and empathy for the business. The time you spend getting the right people on board at the beginning will definitely pay off in the end. And make sure all your advisers are playing the same game from the beginning – accountants, PR and so on.

"You can't start negotiations with the VC house too early, either. Find out what they're looking for from the deal. Once you've got that in mind, you'll know what you need to do. Remember that the VC has the fate of the deal in their hands. So be open, pragmatic and transparent."

Chris Neilson, finance director

"WE USED OUR STOCKBROKERS AS THIRD PARTY ARBITRATORS BETWEEN OURSELVES AND THE VCs. THAT PROVED VERY USEFUL DURING THE DEAL"

“THE HARDEST PART WAS FINDING THE RIGHT STRUCTURE TO TAKE THE COMPANY FORWARD ”

COMMENT: “The company was founded in 1999 by Paul Bateman. The key idea was to develop an over-the-counter fertility testing kit, for men and women, that had previously only been available from your doctor (and only after a 12-month wait). The VCs Schroeders and Permira must have realised the product’s potential, because they got involved right from the off.

“Genosis got all of the correct patents and medical clearances necessary to market the product across Europe, and it was developed over the course of five years. It all went very well, despite the long time-frame, and the first shipment of our product, Fertell, arrived in Boots last month.

“In order to develop the product it was crucial that we had well-informed and patient VCs behind us all the way. That meant both the initial backers and the ones that came in later. Thankfully, they were very supportive and they understood the way these kinds of developments work – they are sector experts. They know it takes years to get a new product to market.

“I arrived in June of last year, after being introduced by a PR firm. The company had clear ambitions to go for a stock market listing. And it certainly helped that I understood the process well, having worked in corporate finance for 13 years.

“We’d already appointed the key advisers, so my main focus was to handle the VC side of the deal. Over the course of the four months before the float, I found that it doesn’t have to be a day-to-day relationship – but you can’t underestimate the importance of communication with the backers. Getting them on-side and fully committed to your plans makes all the difference. Luckily our VCs were very understanding, which wasn’t always the case with some of the earlier investors. Understanding both the medical market and the City proved a real help for us, because we could tap into their knowledge and contacts.

“The hardest part of the deal was finding the right corporate structure to take the company forward from the IPO, and it’s clear the VC will want their say in how that happens. From the time I arrived I >

Name: Ann Simon
Company: Genosis
Sector: Medical
Flotation date: October 2005
VC backer: Sitka VCT
Amount raised: £8m

STOP, LOOK, LISTEN

Alex Tamlyn of DLA Piper lays out the key areas of concerns for VC-backed FDs embarking on an IPO – and uncovers the common mistakes.

1 Opinion shopping. If you’re told by three or four advisers that your business isn’t ready to float, it’s not. Don’t shop around until you find an adviser who will tell you what you want to hear. You might find someone who will say they can get you listed, but it won’t be at the right price, at the right time or with the right structure. So don’t go for a NOMAD just because they tell you they can do what you want.

2 Don’t rush it! Timing is everything on this type of deal.

3 Listen to the advice you’re given. These guys know what they’re doing.

4 Understand the **management time** needed to get the float away. As FD, I’d be thinking about keeping the business running well. You want to float on an upward curve, so hitting the numbers and getting some good growth going over the course of the float can make all the difference. That certainly strengthens your story to investors.

5 Remember the **public face** of the management team is important. If you need presentation coaching, then get it.

6 Don’t stint on the **prospectus.** It’s an important document that needs to be prepared properly – it’s the main sales document.

7 I find that the **lawyers are usually called in too late** in the process. I can understand it in a way – people are worried that the fees involved will inflate the costs for the process. But these days most decent law firms will offer you a fixed-fee arrangement for the entire listing process. If you leave it too late, the timescale is reduced and people’s expectations not met. And remember, the process will take longer than you expected.

knew this would be of utmost importance.

"We tried to keep right on top of the numbers on the way to floating in order to simplify the process. Doing it that way means you don't end up with a huge wodge of work to do on the eve of the float.

"It was very useful to have an entire 'soft copy' data room set up for the due diligence process. Having that in place meant we could respond to any requests very quickly and easily. That definitely smoothed the way for me as FD and I'd recommend it as a way of making the due diligence process less onerous. The VCs certainly appreciated it. Any decent-sized transaction will involve a lot of due diligence so having the ability to source any documents that are needed quickly is really important.

"I would say that doing a float without any corporate finance background is difficult for any FD. If it's the first IPO you've done then it's easy to become distracted by all the different advisers telling you what your priorities should be. The FD needs to be clear in their own mind what they think are the key priorities, and stick to that."

Ann Simon, finance director

"I'D ADVISE FDs TO TAKE AS MUCH HELP FROM THE VCs AS THEY CAN"

Name: Martin Evans
Company: La Tasca
Sector: Restaurants
Flotation date: Feb 2005
VC backer: Penta Capital
Amount raised: £37.5m

COMMENT: "The business has gone through several phases – 3i was the original VC, and they were replaced by Penta Capital in 2001. Once we'd decided we were going to float, the first call was to Penta. They hadn't been looking to sell – they were very close to the business. So we needed to see if they were happy for any deal to go forward. Once we'd established they wanted to retain a reduced stake (22 per cent), we could get on with the IPO.

"The first thing was appointing a NOMAD. We chose Altium because they knew the market well and, being a smaller broking house, they seemed like a good fit for us. There was good chemistry and we felt we could work with them – which is important. They also had good contacts, which made a difference.

"It's definitely important to get your lawyer involved at an early stage. The verification process is very arduous and intense. If they're on board, they can steer you through it. Cost was an issue, of course. At the start we agreed a fixed fee with the lawyers and other advisers. That took a lot of the stress out of it and worked well.

"The other people we immediately got on board were the PR advisers. They have the right contacts and have done this sort of thing many times in the past. We brought them in nearly a year before the flotation date to co-ordinate meetings, sound out the market and get analysts interested.

"You need to be aware that the process can be a long one, so make sure you're prepared. We spent a lot of time familiarising ourselves with the City and how it worked – as a business not based in London, that was useful. When we were presenting, I felt a great deal of confidence because I knew the business inside out. Presenting was new to me, but I got used to it pretty quickly.

"All the way through the process, we were in semi-regular touch with the VCs. That might be once a week or three times a week, depending on how much we needed from them. I certainly made a point of keeping them up-to-date with all the important issues. They needed to be consulted on the share structure of the newly floated company, for instance.

"They did offer advice, and I would recommend FDs take advantage of any help the VCs offer – they can be a great help, at the very least as a sounding board. So, for example, we decided to re-negotiate our banking terms after we had reduced our debt and the VCs advised us on that.

"The biggest headache was the time we had to take out of the business. Everything comes to the FD – the lawyers, auditors, advisers and so on. It can get manic. We had an audit around the same time as the IPO. That meant the financial controller really had to step up and take control, and ours certainly did. So having a good team behind you is essential in all this.

"You do need to give up about three or four months of your life. And what shocked me most was the extent of the verification process. It was certainly arduous. It's very wide-ranging and you soon realise that everything you communicate to the market has to be verified by the lawyers. That takes some getting used to.

"My final tip is be organised and plan it properly. And make sure that you've got good records in place: otherwise it'll be a real struggle."

Martin Evans, finance director

IPO LESSONS

What we learned from VCs and FDs on going public.

1 Use the VCs. "Don't underestimate the help your backers can give," says Tim Jackson-Smith at Halliwells. "They can put in you in touch with good people – they also probably use venture capital trusts (VCTs) so they might be able to put you in touch with them for the post-IPO period. Your backers can give you all kinds of support like that."

2 Get corporate structure in place early. Alex Tamlyn at DLA Piper says getting the share structure working is a critical task for the FD. "The first thing you must do is sort out the basic layout of the ownership of assets," he says. "Of course in a VC-backed business this won't be such a pressing issue as the due diligence will already have been undertaken, but it's still an issue that needs to be got straight." Be clear on what the VCs want from the deal. Getting them on board with a post-IPO structure they're happy with will save a lot of time and heartache later on.

3 Get governance controls in place. Remember you're going into a new arena by going public, and the demands on the FD when it comes to corporate governance will be much greater. "This will be a major issue and the FD needs to be on top of it, even in a VC-backed business," says Tamlyn. "Indeed, the chances are the governance structures in place in a VC business will not be anywhere near adequate for a publicly listed company. So straight off, the FD needs to get his or her head round the need for non-execs, board committees and so on. And then there are the IR aspects as well, so preparing for that and putting proper structures in place before the float arrives can be vital."

Craig Armour, Penta Capital: The FD needs to get the business's corporate governance up to scratch for the float.

4 Start the preparation early. Don't forget the three Ps: preparation, preparation, preparation. "The FD needs to be aware that in every one of these deals, there is an enormous amount of due diligence involved, and the VCs will expect him to take the lead on that," says Craig Armour at VC firm Penta Capital. "So while he has help, from lawyers, accountants, NOMADs and so on, he will need to drive the due diligence process.

"What that means is that without a strong and organised finance director, the process can end up in a bottleneck, and that slows everyone down. That's tough because he still has the day job of running the business and that does place demands on him. So starting off by being thorough and making sure everyone knows what they're doing is key."

5 Use the process. There will be areas of your business that will need tweaking when you're a public company, so you might be wise to use the float as a way of refining some of the business's operational areas. Penta's Armour says you "need to be aware of all kinds of different issues that you wouldn't immediately associate with going public. There's insurance, the environment, banking covenants and so on. You needs to take the lead in assessing these risks. And try not to make it a box-ticking exercise – see it as a way of improving your business processes."

> "THE FD HAS TO BE READY. IF HE'S REACTING TO EVENTS, HE'LL BE PLAYING CATCH-UP"

6 Be your own toughest critic: Ask yourself, your board colleagues and your backers the tough questions: is the timing right? Are you floating for the right reasons? And then think about the questions analysts, shareholders and the authorities might ask. "Before you start, any FD should sit down and ask himself the difficult questions that will be asked throughout the process," says Penta's Armour. "That preparation is crucial and is by far the most important element in the float."

7 Resource your team properly. Just as you need to make sure the business is running along nicely while you're going for the deal, staffing up and resourcing the float team properly is a prerequisite. "It's easy to talk about floating and not be fully aware of the rigours of the process," says Armour. "From our point of view, we want to see the FD getting his team fully resourced and ready. If he's not then he will struggle. What happens if he's not on top of it? He'll start reacting to events and chasing to catch up. It can get away from him, and that's when it really starts to get difficult."

8 Listen to all the advice you get. Your advisers are there to do just that – advise. Colleagues' opinion might be to go for the float no matter what. But if the advisers you sound out aren't convinced, there's probably a good reason why you should think again.

"Looking for the adviser who tells you 'it's possible' is a common mistake, and it can prove disastrous," says Alex Tamlyn at DLA Piper. Try listening to a "disinterested party" for the best advice of all.

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