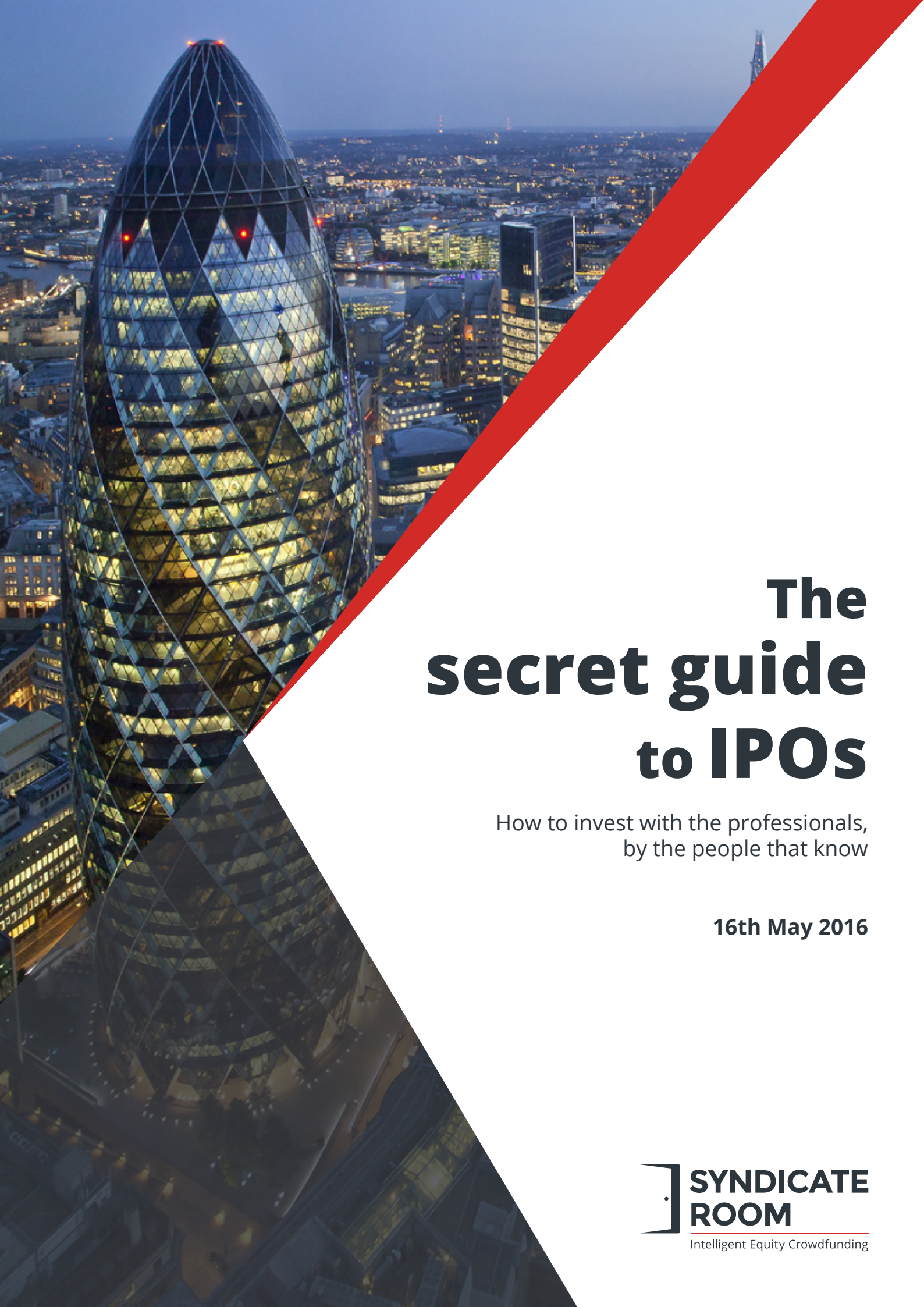

The secret guide to IPOs

How to invest with the professionals,
by the people that know

16th May 2016

SYNDICATE ROOM
Intelligent Equity Crowdfunding

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INTRODUCTION

I'm sure all of you will have noticed the flurry of IPOs this year. I'm also sure you have all heard about the volatility and uncertainty that exists at the moment and which is a feature of the post-crisis market backdrop. No doubt, you will have thought 'I wouldn't mind investing in that IPO'.

On AIM this year there have been several high-profile IPOs, including Hotel Chocolat, yet there has been no retail tranche in any of them. Retail is an essential part of aftermarket liquidity, yet it continues to be locked out of primary capital raises on the public markets, which is simply not good enough.

In addition to retail being largely locked out of IPOs for no good reason, we have found (in our report, **Bridging the Equity Divide**) that there is significant appetite amongst the public to invest in equities and, more specifically, IPOs. However, most wouldn't know where to find an IPO or indeed how to invest. We have also learned that the vast majority of potential investors want to make their own investment decisions.

Good investment decisions come from being armed with the right information. This is why we have pulled together this guide for our members. In it we try to demystify IPOs and also debunk some of the myths around them. We are passionate about providing our members with the best possible opportunities as well as clear guidance on matters that concern investing both in the public and the private markets.

We hope you find this guide useful.

Tom Hinton
Head of Capital Markets, SyndicateRoom

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We can make excellent investment decisions on the basis of present observations, with no need to make guesses about the future.

Howard Marks
Co-chairman of Oaktree Capital Management

History of the stock market

1460
The world's oldest stock market set up in Belgium

1773
Jonathan's Coffee House in London sets up as a new and more formal 'stock exchange' in Sweeting's Alley

1790
First US stock exchange founded in Philadelphia, US

1801
London Stock Exchange (LSE) is officially founded out of Jonathan's Coffee House

1817
New York Stock Exchange (NYSE) founded

1867
The first stock tickers are used

1929
NYSE's Black Thursday crash (24 October) and the sell-off panic starting on Black Tuesday, often blamed for kicking off the US Great Depression

1995
LSE's Alternative Investment Market (AIM) founded

2011
London's biggest ever IPO: Glencore, valued at $10 billion

2012
Facebook lists on the NYSE, valued at $16 billion. Today its market cap exceeds $275 billion

2014
China's Alibaba Group, the biggest-ever IPO, is valued at $25 billion

History of the stock market

Dan Matthews
Journalist and Founding Editor of Minutehack

People have been investing money for a return since time immemorial. Clay tablets dug up in Iran and dating back to the Mesopotamian era (around 1750 BC to be specific) show evidence of people handing out interest-bearing loans.

Since then the mechanisms through which people invest in the hopes of increasing their existing wealth have diversified greatly. One such mechanism, tracing its origins back to the 12th century, is the stock market.

Humble beginnings

Back in the 1100s, French government agents traded debts from farms they were responsible for managing. In Antwerp the following century, a group of investors started trading commodities in the house of a man called Van der Beurze and soon the concept spread across Flanders.

By the mid-13th century Venetian bankers were trading government securities and being copied by moneymen across present-day Italy. It wasn't until the 17th century, however, that a continuous trading set-up was inaugurated by the Dutch East India Company.

East India Companies sprouted in Britain and France and their shares began being traded through brokers. Because physical stock exchanges didn't yet exist, trading generally took place in coffee houses and shares for sale were advertised in shop windows.

Since then, markets trading business stocks have sprung up all over the world; famous stock markets include the FTSE 100, the Nasdaq, Dow Jones, Dax and the Nikkei 225; but hundreds of others exist, trading different shares in different jurisdictions.

Why is the stock market so popular?

Today, the stock exchange is a major channel for businesses to raise capital. Stock markets are highly regulated and listing on one – otherwise known as undergoing an Initial Public Offering (IPO) – has several non-monetary benefits, including increased media attention and the prestige of being attached to an established exchange. Before IPO, companies undergo a strenuous programme of due diligence and are priced according to their value in the context of the market.

Because the company is selling part of its equity and not borrowing money, it does not have to back a debt or interest on a loan, meaning it can invest in growth without any negative impact on its future cashflow.

When a business lists it can 'sell' a slice of its total value to investors in return for a cash injection. The theory holds that as the business grows and becomes more valuable, so too does the invested stake.

Determining which businesses to invest in, and when to buy and sell shares is a closely watched science; the best investors make millions on good bets.

Information everywhere

A major draw for investors in equity markets is the free flow of information that fuels decision-making. Markets work because people trust them to provide high levels of accurate data about listed companies. This information is open and updated regularly, giving investors a high level of insight.

Investors use the information to assess whether shares are undervalued and therefore a good bet. They will take into consideration the senior management team, recent performance, economic conditions and each organisation's growth plans, as well as any problems or challenges associated with the business.

Who invests?

Investors include individuals as well as institutions, such as pension funds and insurance companies. People can trade on their own or through a fund manager – an expert with a track record who is entrusted with other people's money to make it grow.

There are plenty of alternatives to investing in publicly traded stocks. For example, crowdfunding follows the same basic principles as the stock market with a few subtle differences.

The AIM effect

London Stock Exchange's AIM – formerly the 'Alternative Investment Market' – is becoming increasingly popular with people who want to invest in small high-growth businesses. The market fills the gap between small businesses looking for early funding through mechanisms such as crowdfunding and the giant businesses being traded on the FTSE 350.

AIM companies must meet strict criteria before they list and are essentially considered established, growing businesses. The level of risk to investors is therefore thought to be lower than that of backing untested startups, but higher than backing large businesses with long trading histories on the FTSE main market.

The rewards of trading on AIM can be substantial. Take the example of Abcam, which listed in November 2005 with a Placing of around £15 million; at the start of 2016 the company's market cap was more than £1.3 billion. A pound invested in the company at IPO would return more than £8,600 today.

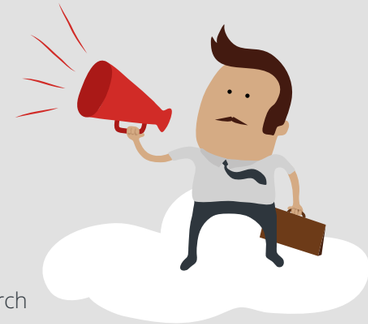
But a word of warning: AIM is volatile and listing on the market is not a guarantee of success – and it pays to know when to get in and when to get out.

The stages of an IPO

1

Intention to float announcement ('ITF')

- Issuer publishes an ITF
- Transaction becomes public
- Each investment analyst publishes their research



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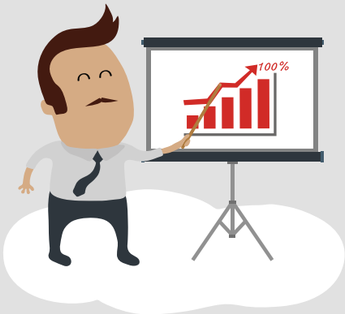
Investor Education

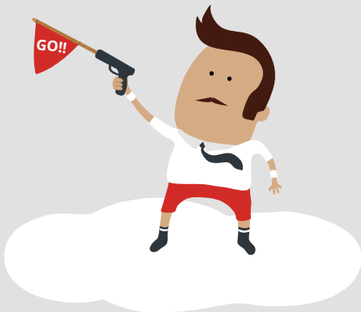


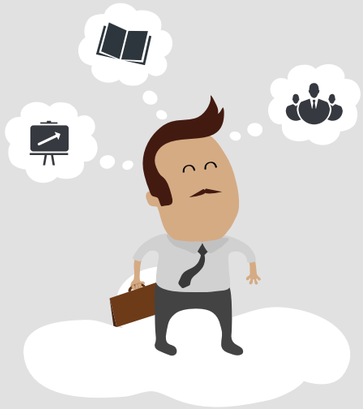
- Research analyst meets with key investors and educates them on the company and the investment thesis
- The investment bank gets feedback from investors, as well as indications of interest at a certain valuation (and price per share)
- From this feedback, the investment bank comes up with a price range per share
- Investors can put in orders within this range when the Offer Period opens

3

Start of Offer Period

- The price range/share is announced
- The Prospectus is published and circulated to all investors
- Offer is opened to retail investors (if there is a retail element) and institutional investors
- Investors put in orders to the investment bank within the published price range





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During the Offer Period

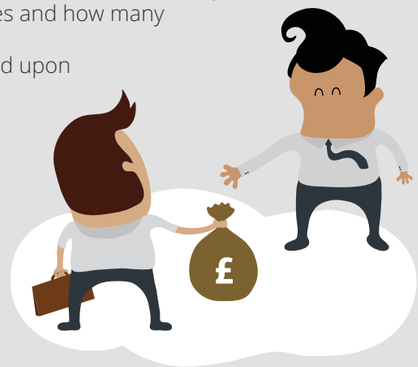
- Management presents to investors at 1-on-1 and group meetings
- The investment bank takes orders from institutional investors within the price range and builds a 'book of demand'
- The investment bank tries to ensure that the company achieves the highest possible valuation by getting as many investors as possible to invest towards the top of the range

5

Pricing

- The marketing period closes
- The final price per share is decided upon depending on demand at various points in the range
- The IPO prices at the top of the range if there is sufficient demand

  The company with advice from the investment bank) decides upon which investors should be allocated shares and how many
- If applicable, the retail allocation is decided upon



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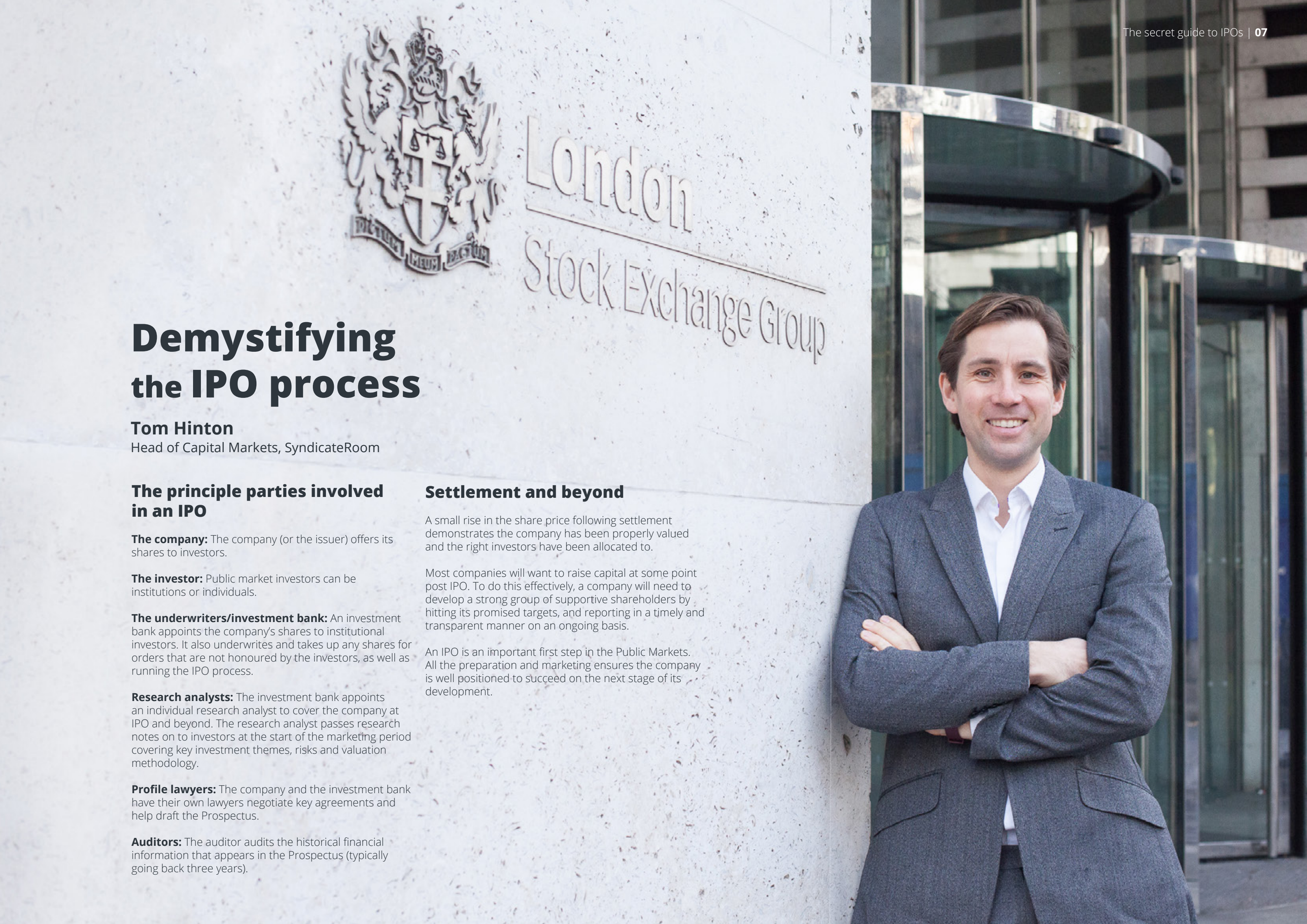
Settlement

- Shares received by investors and cash transferred to the company
- Shares admitted to trading on the London Stock Exchange (or other exchange as applicable)



Demystifying the IPO process

Tom Hinton
Head of Capital Markets, SyndicateRoom

The principle parties involved in an IPO

The company: The company (or the issuer) offers its shares to investors.

The investor: Public market investors can be institutions or individuals.

The underwriters/investment bank: An investment bank appoints the company's shares to institutional investors. It also underwrites and takes up any shares for orders that are not honoured by the investors, as well as running the IPO process.

Research analysts: The investment bank appoints an individual research analyst to cover the company at IPO and beyond. The research analyst passes research notes on to investors at the start of the marketing period covering key investment themes, risks and valuation methodology.

Profile lawyers: The company and the investment bank have their own lawyers negotiate key agreements and help draft the Prospectus.

Auditors: The auditor audits the historical financial information that appears in the Prospectus (typically going back three years).

Settlement and beyond

A small rise in the share price following settlement demonstrates the company has been properly valued and the right investors have been allocated to.

Most companies will want to raise capital at some point post IPO. To do this effectively, a company will need to develop a strong group of supportive shareholders by hitting its promised targets, and reporting in a timely and transparent manner on an ongoing basis.

An IPO is an important first step in the Public Markets. All the preparation and marketing ensures the company is well positioned to succeed on the next stage of its development.

Prospectuses and Admission Documents

Ross McNaughton
Corporate Partner, Penningtons Manches LLP

If you have invested in a public company offering before, you may well have already come across the terms 'Prospectus' or (in the case of AIM companies) 'Admission Document'. This article explains the concepts behind each, and gives a bit of guidance as to why they are important and what you should be looking out for in them.

What is a Prospectus?

A Prospectus is essentially a marketing document issuers publish in the context of an IPO. It sets out details of the issuer and the securities being issued.

It is heavily regulated with strict content requirements, which are ultimately derived from European law. For a UK issuer, before being published the Prospectus will have been vetted and approved by the Financial Conduct Authority (FCA).

The ultimate aim behind the extensive legislation governing each Prospectus is to promote investor protection and market efficiency, based on the premise of full disclosure. The Prospectus must contain all information necessary to enable potential buyers to make an informed assessment of the issuer and shares.

When is a Prospectus needed?

A Prospectus is required when there is either 1) an offering of 'transferable securities' (which would include shares) to the public or 2) an admission to trading on a 'regulated market'. It is worth noting that AIM is not a 'regulated market' for the purpose of the second point.

However, producing a Prospectus is time consuming and costly. There are some key exemptions that issuers rely on to avoid drawing up a Prospectus on an IPO, such as where the consideration of the public offer across the EEA is less than €5 million or if an offer is made to fewer than 150 people per EEA state.

For Main Market IPOs, a Prospectus will likely be required.

What is an Admission Document?

AIM Admission Documents are also a form of marketing document but, unlike Prospectuses, they do not need to be approved by the regulator. Instead, the London Stock Exchange delegates responsibility to the issuer's nominated advisor ('NOMAD') to confirm that the Admission Document conforms with the content requirements in the AIM rules (and indeed the appropriateness of an applicant for the AIM market more generally).

Admission Documents have similar content requirements as Prospectuses, but in practice tend to be shorter. It will be apparent from the face of the document whether it is an approved Prospectus or not.

What is in a Prospectus?

The FCA imposes a general requirement that a Prospectus must contain all such information as is necessary to enable investors to make an informed assessment of:

1. The assets and liabilities, financial position, profits and losses, and prospects of the issuer and of any guarantor
2. The rights attached to the shares to be issued

With the above general requirement in mind, a Prospectus must be drawn up using one or a combination of the schedules and building blocks prescribed by the Prospectus Regulation. Different specific requirements apply for different types of the proposed activity, but broadly the following specific contents are generally included:

- A summary, including key information that allows investors to understand the securities and decide whether to consider the offer further
- Information about the issuer's directors and auditors, including a declaration by the directors accepting responsibility for the Prospectus
- Technical information about the shares being issued
- Details of the issuer's management, including their remuneration, service contracts and directors' interests
- General information about the trends in the issuer's business and prospects for at least the current financial year and, where a profit forecast is included, the principal assumptions on which it is based and a report by the accountant

Both Prospectuses and Admission Documents should provide all you need to know about the company and the rights attached to the shares being offered.

Your ultimate decision to invest will be made on the basis of the Prospectus/Admission Document. It is therefore important you take care to review this in detail and ensure the story being presented is the same as the one you are expecting to see.

The Prospectus must contain all information necessary to enable potential buyers to make an informed assessment of the issuer and shares.

Retail investors
and their role in an IPO

Jeremy Wiseman
Director, Scott Harris

Private investors have traditionally been bit-part players in the broader IPO landscape. Consistently excluded from new issues, often regarded as too short-term, unpredictable and complicated to include in the process, the perception was that (outside of government privatisations) the city didn't really like private (also known as retail) investors.

However, attitudes are changing. It is no longer complicated to add a retail component to a share offer, and the significant levels of demand generated for new issues that have been offered to (increasingly sophisticated) private investors have highlighted the potential of this part of the market.

Retail myths...

1. 'Retail investors will sell immediately after the IPO'

A common perception that is fundamentally inaccurate. Clearly any set of investors will contain groups that have different time horizons. Just as some institutional investors will sell out of a security within the first days or weeks of trading, so will some retail investors. However, in the private-investor sphere, these are a minority; retail investors are generally long-term, supportive shareholders.

2. 'Yes, but are they long-term investors?'

Part of our business runs investor meetings with already-listed companies for private client wealth managers – an opportunity for them to speak to investor relations and management teams on behalf of their retail clients. All the evidence we see is that this part of the market buys and holds equity investments on a long-term basis.

According to Capita Asset Services: 'On average, retail shareholders hang on to a share for five years, much longer than the two-year holding period of institutional and foreign investors.'

3. 'Involving retail investors in the IPO process is complicated'

In days gone by, perhaps, yes. But this certainly doesn't apply today. An IPO can be marketed to retail investors through a number of channels, and all coordinated alongside the institutional offer. The typical route – the intermediaries offer – is managed by an advisor who works alongside the syndicate banks, who are selling shares to their institutional clients. Retail investors apply for shares through their stockbroker or platform, and these are aggregated and placed into the Order Book. Shares are then allocated according to the level of overall demand for the offer.

What next?

Private investors should be a consideration for any company listing on the UK market. Indeed, Xavier Rolet, the CEO of the London Stock Exchange Group, has stated that he believes up to 20 per cent of floats should be made available to the public: 'Doing so would create some excitement around new issues and give retail investors the chance to make some money ... At the moment, many initial public offerings end up in the hands of a few of the same institutions.'

This doesn't mean that absolutely every deal in the future will be offered to private investors, but there's no reason why the majority of new issues shouldn't have a retail component at IPO, as part of building a balanced share register.

Investor communications

Neil Doyle
Senior Managing Director,
FTI Strategic Communications

The admission in September 2015 that Volkswagen was cheating pollution tests wiped €25 billion euros off the company's stock market value and prompted some investors to campaign for the launch of a full-scale legal attack against management. While the Volkswagen case is at the extreme end of the spectrum, it serves as a reminder that a company's relationship with its shareholders is rooted in communication. For most companies, dealing with issues on such a scale is unlikely; instead, the main day-to-day focus is on ensuring good communications with investors and other stakeholders.

'Best-practice communications'

While private companies have to make certain submissions to regulatory and government organisations, these are nowhere near the scale of the legally binding reporting and disclosure requirements a company has to comply with once listed.

The duty of transparency that a public company has to all of its shareholders – however large or small – means that all its corporate governance procedures, executive remuneration, and operational and financial performance need to be publicly and widely available in the market. This means maintaining an up-to-date website with all relevant information – such as past results statements, stock exchange announcements and other press releases – easily accessible.

It also means investors need to be provided with price-sensitive information on a synchronised and timely basis – usually via a regulatory announcement distributed to the relevant stock exchange (or exchanges) – so there is no prejudice or advantage for some investors over others. 'Price-sensitive' or 'material' information encompasses that which may lead to a substantial movement in the price of a company's listed securities. This includes financial performance, acquisitions, and changes to the company's CEO or CFO, amongst others.

Over-sharing

The proliferation of social media as a tool for communication means companies need to be even more careful in what information they post on Twitter, Facebook and other platforms.

In 2012 Netflix and its Chief Executive, Reed Hastings, faced the threat of civil action from regulators after he posted a revealing status on Facebook: 'Netflix monthly viewing exceeded one billion hours for the first time ever in June.' Although the post was accessible to Netflix's 244,000 Facebook followers, the US Securities and Exchange Commission considered it material information that should have been disclosed to the market via a press release or regulatory filing.

Costly accidents

While complying with best practice communications is something most listed companies take very seriously, on occasion things don't go to plan – often with significant and wide-reaching consequences.

In 2012 Google was left red-faced after it announced its results a few hours early. Its shares immediately slumped and were subsequently suspended by NASDAQ. Once they resumed, 40 minutes before the end of the day, the stock was trading 8% down.

The heart of compliance

Ultimately, while best practice reporting is something to which all companies aspire, it means much more than just complying with regulatory rules. It's about ensuring investors have a clear understanding of the business – its strategy, opportunities and risks – so they can make informed investment decisions on the value of the company and its future prospects.

8 things to consider (before you invest)

Tom Beevers
CEO & Co-founder, StockViews

IPOs have always held a particular fascination for investors, and to many they represent the chance to invest in the next generation of exciting growth opportunities. But as experienced investors know, there is a dark side to these investments – not least a reputation for underperformance over time. When it comes to IPOs, being selective is crucial to achieving a good result. As Warren Buffett said: 'You don't have to swing at everything – you can wait for your pitch.'

1 Understand the business

An IPO is like a shotgun wedding – the investor only has a limited time to get to know the business before making a commitment. This is a very different situation to a quoted company, where the investor enjoys a long period of courtship before deciding to invest. An IPO requires a much more intensive research effort over a short period of time, often with less information than is available for a listed company. However, the information is there for those who are prepared to put in the work.

A detailed study of the Prospectus will provide most of the information needed – in particular the MD&A (Management Discussion and Analysis) and the financials. Beyond that, a study of listed competitors will yield valuable insights into the industry as a whole.

2 Exercise caution around 'hot issues'

Too many investors will buy into an IPO simply because it seems 'hot' or has a topical 'investment story' attached to it. The problem with hot issues is twofold – one, they tend to get overpriced; and two, they tend to attract fast money that runs for the exit at the first sign of trouble. Sometimes these IPOs will get heavily over-subscribed, leading to a strong rally in the first few days (often led by investors who didn't get their full allocation buying in). But as the initial excitement fades and reality settles in, the initial gain is followed by a long period of underperformance.

In other cases, where the IPO has been priced way too high, and where there is too much fast money in the book, the stock might even see an immediate drop on the first day of trading.

It's not a case of ignoring hot IPOs, but you should certainly understand your own reasons for investing.

3 Study the financials

The Prospectus includes plenty of detailed financial information that will help inform your view of the company. In my experience, investors spend too much time focusing on the earnings forecasts of sell-side analysts (which almost always turn out to be far too bullish anyway) and too little time on the reported numbers.

A thorough study of the financials will help you understand how the business performs over the cycle as well as provide evidence of management's competence (see Point 5). In particular, metrics such as revenue growth, margins and ROIC (and a comparison of these metrics to peers) will help frame your expectations of the company's prospects.

4 Risk awareness

The section of the Prospectus that deals with risk factors usually runs to several pages and is padded with a host of generic risks, often with little apparent relevance to the investment. Nevertheless, it's important to read carefully because hidden within this section will be a number of key weaknesses and threats that actually are highly relevant. You will want to be satisfied that the management understands these risks, and has an adequate strategy for addressing them.

5 Understand the reason for listing

IPOs are often a mix of a 'primary offering' (raising of new capital) and 'secondary offering' (where existing shareholders are selling into the market). Where an offer is mostly primary, what will the additional cash be used for? In the case of a high-growth company the cash may be needed for organic expansion. But where the company has less obvious needs for cash, or where it is being used simply to pay down debt, investors need to understand more. Is a company is simply adding to its war chest so that it can become a bigger company through aggressive acquisition?

Where an offer is mostly secondary, it will typically involve a private equity or venture capital firm selling down their stake. Here you need to understand the reasons for exiting and the extent to which they are reducing their position. Investors usually like to see that the original shareholders are maintaining a significant stake in the company for a reasonable period of time. Study the terms of the 'lock up' to ensure that such an arrangement is in place and is adequate.

6 Look for a great management team

When analysing a listed company, the track record of the management team is often laid out on the table for all to see. When it comes to an IPO that clarity is lacking, so you need to dig deeper by asking questions.

How long has the management team been at the helm of the company and what has it achieved during that time? If a board member came in from elsewhere, what was their role and what did they achieve there? You also need to assess the management as an entire team – do they collectively provide the skill set needed for this next stage of development?

These are all important questions to answer before putting your faith in management.

7 Valuation

In my opinion, a lack of discipline on price is one of the most common traps that investors fall into. Because investors do so much work before the pricing is set, they risk becoming emotionally attached to an investment and don't want to see their work 'go to waste'. This is why it's important to have a firm idea of what you're prepared to pay and not go beyond that. A comparison of multiples to listed peers is a good place to start – you should be looking for the price to reflect an attractive 'IPO discount'. If the multiple is more expensive versus listed peers, then there needs to be a strong reason why this is the case.

8 Embrace volatility

IPOs are naturally volatile beasts. It amazes me how, in the months after an IPO, a stock remains highly volatile despite the release of no new information. If you understand the company well you can use this to your advantage to top up on your position at attractive prices (particularly if you didn't get your full allocation).

“

The individual investor should act consistently as an investor and not as a speculator.

Benjamin Graham
Economist

The secret guide to IPOs was put together by SyndicateRoom.

SyndicateRoom is a UK crowdfunding platform that enables online investors to invest in sophisticated opportunities alongside, and on the same economic terms as, professional investors.

First offering members the chance to 'invest with the angels' in private opportunities, in 2016 SyndicateRoom became the first and only crowdfunding platform to enable members to invest in IPOs and placings on the Public Markets.

For more information on Public Markets and for investment opportunities, click through to the following:

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