

Floating your company



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Floating your company can be one of the most exciting experiences in your business life. But it can also be stressful, time-consuming and expensive.

While taking professional advice is essential, it helps if you understand the basics.

This briefing outlines:

- Why you might want to float.
- Which market you should choose.
- How to manage the flotation process.

1 Why float?

1.1 A float can provide an **exit for existing investors** who sell their shares as part of the flotation.

- Venture capitalists may want to realise their investment once the business has become more established.
- A founder may want to realise part or all of the value built up in the business.

1.2 A float can be used to **raise capital** for the company. New shares are often issued as part of the flotation.

- This can be the best form of financing for companies with volatile or low cashflow, or which already have substantial borrowings.

1.3 A float provides a mechanism for investors to **trade shares**.

- Shares which can be traded are more attractive to investors.
- The company's shareholder base can be

widened, increasing the potential for raising future capital.

1.4 A float provides a **market valuation** for the company's shares.

- An initial float, offering a small percentage of the company's equity, may make it easier to sell further shares in the future.
- Key employees can see the value of shares or share options which they have been (or will be) granted.

1.5 A float can allow a company to use its shares as an **acquisition currency**.

- It may be possible to fund future acquisitions entirely or partly in shares.

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1.6 A float helps increase a company's public **profile** and raises its status with customers and suppliers.

2 Why not?

2.1 Most companies cannot offer a **return on investment** sufficient to attract investors.

- You need a strong management team, with a track record of generating profits.
- You must have a viable plan for achieving strong growth in earnings.

2.2 Another exit route — particularly a **trade sale** — may be a better alternative.

- A trade sale is usually faster and cheaper than a flotation.
- Some companies, particularly mature businesses in non-growth industries or those whose value is largely based on their assets, may realise a higher price through a trade sale.

See **Planning your exit from your business** and **Selling a business**.

Costs

A Initial costs can be substantial.

- Advisers' fees vary depending on the level of work and the size of the company. A small firm will typically pay between £150,000 and £350,000.
- The application fee for PLUS is £6,000. For AIM, the fee is dependant on your expected market capitalisation when you float. The minimum fee is £5,125 for those with an expected market capitalisation below £5m.
- You will have to pay commission on any new money raised.

B You will continue to need **advisers** after the float.

- You would have had to pay most of these expenses in any case.
- A corporate adviser will charge about £25,000 a year.

C You will also have to pay an **annual fee** which depends on your market capitalisation.

Call AIM (020 7797 4404) or PLUS (020 7553 2000) for further information.

2.3 You will have a responsibility to **satisfy shareholders'** interests, which may not always be in line with your own.

- Shareholders may want you to focus on short-term profits, rather than your strategic goals.
- Shareholders may want you to become involved in exciting ventures, rather than the opportunities you favour.
- Some shareholders may expect generous, regular dividends, which could undermine cashflow.

2.4 You run the risk of **losing control** of the company altogether.

- Substantial investors may want their own representatives appointed to the board.
- If your (and other directors') shareholdings are diluted, it becomes easier for another business to make a takeover bid.

2.5 There are **hidden costs** as well as significant cash costs (see box).

- Managers can be distracted from running the business during the flotation. There will be a continuing time cost of dealing with investors afterwards.
- If market conditions change, the float may have to be aborted.

2.6 Companies in which shares are traded have to comply with additional **regulatory requirements**.

- You must publish full accounts twice a year, which will allow your competitors to see them.
- You must meet accepted standards of corporate governance. For example, having independent non-executive directors.
- You must ensure that important news is promptly communicated to all investors. For example, changes in your company structure.
- You must invite all shareholders to an Annual General Meeting.

3 Choosing the market

3.1 For companies raising up to £10m **PLUS** (previously known as OFEX) is a possible choice. Floating this way allows shares to be traded 'off-exchange'.

- The requirements for a company to trade on PLUS are less stringent than for AIM (see **3.2**) or the Main Market (see **3.3**).

“The cost of advisers may appear high. But it is the net value of the new funding available to your company that really matters.”
Ken Burgin,
Motion Media

- The costs of flotation, and the ongoing costs, are lower for PLUS than for AIM or the Main Market.
- The pool of investors is relatively limited. Most investors in PLUS shares are private individuals. But more institutions are beginning to invest.
- Share prices, company announcements and other information can be found on the PLUS website at www.plusmarketsgroups.com.

3.2 Larger companies may prefer to float on **AIM** (or the Stock Exchange Main Market).

- The company will get a higher profile within the investment community.
- There are more investors who are willing to buy AIM-traded shares. Venture capital trusts can invest in AIM companies.
- If the company has been in existence for two years or less, existing shareholders must agree not to sell their shares for at least one year after flotation.
- There must be no restrictions on the free transferability of shares.
- There is no minimum percentage of shares that you must make available. However, having fewer shares available could make

Employees

A A float can be an **opportunity** to attract and motivate staff.

- Employees may be more motivated if they have a stake in the business.
- Shares and options can be a tax-efficient part of a remuneration package.
- You may be competing for key employees with other companies which offer shares or share options. A planned flotation at a future date, and the offer of pre-flotation shares or options, can also attract key employees.

- Remuneration in the form of shares or options allows you to reward staff without as great an impact on cashflow.

B A float can also present **problems**.

- Like any change, flotation can face resistance from employees.
- A successful flotation may also have demotivating effects. Key employees may feel there is nothing left to work for, particularly if they are sitting on valuable shares or options. Before you float, plan how you will motivate and retain them afterwards.

the share price volatile.

A company may choose initially to float on PLUS, and move up to AIM (or the Main Market) once the company's needs justify it.

3.3 The full **Stock Exchange Main Market** is generally only suitable for the largest companies with a three-year track record.

- The Main Market is the most high-profile market. Almost all investors will be prepared to invest in shares quoted on the Main Market (if they appear to be a good investment). But many larger investors will only invest in companies whose market capitalisation (the total market value of all the company's shares) is substantial, say several hundred million pounds.
- Costs are considerably higher than floating on PLUS or AIM.

4 Advisers

4.1 You will need to appoint and retain a **corporate adviser**.

- For PLUS, your adviser (referred to as a corporate adviser) will need to be a member of PLUS.
- For AIM, your adviser (referred to as a nominated adviser, or Nomad) will need to be on the register of advisers maintained by the London Stock Exchange.

4.2 Getting a **stockbroker** is a good idea and essential if you are looking to raise money, or float on AIM.

- The stockbroker will help find and interest potential investors.
- The stockbroker will help maintain your profile with investors once the company has floated.

4.3 **Other advisers** will need to be involved.

- These include your auditor (see **5.1**) and your lawyer (see **5.2**).
- You may want to involve a financial PR company, particularly if you are raising significant amounts of money.

Choose your advisers carefully (see **Using a consultant**). Advisers with a better reputation could improve your credibility with investors. And they are likely to be more thorough, as their reputations are at stake.

➤ For more information about AIM and the Main Market, visit www.londonstockexchange.com.

“After flotation, certain transactions proposed by the directors will be subject to shareholder approval. As a result, you will need to send a detailed document to all your shareholders.”
Stephen Toole, Solomon Hare chartered accountants

“Your annual report will become more of a marketing document after flotation. As PR is an important element for a quoted company, you should consider the benefits and costs of hiring a PR consultant.”
Martin Letza, Eversheds

5 Preparation

- 5.1** You must ensure that your **annual accounts and reports** conform to UK generally accepted accounting principles, as accepted by the Stock Exchange.
- Since 1 January 2005 they now have to conform to new International Accounting Standards (IAS).
- Young businesses that are floating will need to have a business plan.
 - An accountant's report on the company's trading record is normally included in the prospectus.
 - Before making an application to PLUS, you should get a copy of their rules and ensure you meet their admissions criteria. If you have no trading record, check with the applications department before going ahead.
- 5.2** Your company's **legal structure** needs to be in order. (See **Forming a business**.)
- If you are a sole trader, or in a partnership, you will need to form a company.
- 5.3** You must make **key information** available.
- Who the directors are and what service contracts they have with the company.
 - Who the major shareholders are and what new or existing shares are for sale.
 - Details of the company's key contracts.
 - The memorandum and articles of association. Check there are no unusual restrictions.
- 5.4** You must appoint a CREST-compliant registrar to **register** the new shares.
- 5.5** Check the other **requirements** of the market you choose.

6 Pricing

Pricing a new flotation is complicated. The price may continue to be a matter for negotiation between you and your corporate adviser or stockbroker right until the last minute.

- 6.1** Most companies are valued on their historical and **expected future earnings**.
- Your advisers will help put together projections of future earnings.
 - You can choose whether or not your prospectus contains an earnings forecast (which you must be confident of meeting or exceeding).

6.2 Investors will pay more for shares in **exciting** businesses.

- Your company will be more valuable if it is a market leader in its sector. Or if it is involved in a growth or fashionable industry.
- 6.3** You may choose to sell for a **lower price** to ensure a successful flotation and provide a good after-market in the shares.
- If you plan future share issues it is important to keep investors keen.

7 The process

7.1 Start by choosing your advisers (see **4**) and getting the **basics** right (see **5**).

7.2 Nominate one **individual responsible** for the flotation (usually the finance director).

- It is useful if that individual has previous experience of a flotation.

7.3 Decide what **type of flotation** you want.

- Choose an introduction if you are not looking to raise capital. It is the cheapest and simplest way to float. An introduction is often used to move from, say, AIM to the Main Market.
- In a private placement, shares are offered to selected investors.
- In an offer for sale, shares are offered to the public and investing institutions. An offer for sale is more expensive than a private placement.

7.4 If you are raising money from new investors, you will need a **prospectus**.

This should set out all the key information about the company and the share offering.

- You are legally responsible for the accuracy of information in your prospectus. Be sure to check it carefully.

7.5 The typical **timescale** from start to successful flotation is at least three months.

But it is not unknown for the process to take 12 months.

Expert contributors

Thanks to **David Abbott** (Solomon Hare chartered accountants, 0117 933 3344); **Nick Roadnight** (Tellus, 0870 9033 007).

Further help

There are other Directors' Briefing titles that can help you. These briefings are referred to in the text by name, such as **Selling a business**.

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