Floating Your Company

Guide

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Disclaimer

This guide has been produced by Sterling Finance (UK) Limited for the benefit of its clients and associate offices worldwide who are interested in doing business in the UK.

Its main purpose is to provide a broad overview of the various issues that should be considered by organisation when considering setting up business in the UK.

The information provided cannot be exhaustive and - as underlying legislation and regulation are subject to frequent changes - we recommend anyone considering doing business in the UK, or looking to the UK as an opportunity for expansion,
should seek professional advice before making any business or investment decisions.

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Floating your company

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.

You need to think carefully about why you want to float, which market to choose and how to manage the process. Professional advice is essential.

1. Why Float?

Existing investors can 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.

The company can raise capital.

- New shares are often issued as part of the flotation.
- This can be the best form of financing for companies with volatile or low cash flow, or which already have substantial borrowings.

Investors will be able to trade the company's 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.

The 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.

The company may be able to use its shares as an acquisition currency.

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

A float helps increase a company's public profile.

- The float raises the company's status with customers and suppliers.

Employees

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 cash flow.

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 employees afterwards.

2. Reasons not to float

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.

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.

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 cash flow.

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

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

There are hidden costs as well as significant cash costs.

- Managers can be distracted from running the business during the flotation.
- If market conditions change, the float may have to be aborted.

You 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.
- Private companies are no longer required to hold an Annual General Meeting (AGM). However, they must hold one if any director or 10% of shareholders (5% if it is more than 12 months since the last AGM) requests one.

3. Choosing the market

AIM is the London Stock Exchange's international market for smaller growing companies.

- The requirements for a company to trade on AIM are less stringent than for the Main Market.
- The costs of flotation, and the ongoing costs, are lower than for the Main Market.
- Private individuals, venture capital trusts and institutions can invest in AIM companies.
- Shares traded on growth markets such as AIM are exempt from Stamp Duty.
- 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 the share price volatile.
- A company may choose initially to float on AIM and move up to the Main Market once the company's needs justify it.

The Stock Exchange Main Market is generally only suitable for the largest companies.

- The Main Market is the most high-profile market.
- Most investors will be prepared to invest in shares quoted on the Main Market (if they appear to be a good investment).
- 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.
- You must have a three-year track record to float on the Main Market.
- Costs are considerably higher than floating on AIM.

Costs

Initial costs can be substantial.

- Advisers' fees vary depending on the level of work and the size of the company.
- The admission fee for AIM is dependent on your expected market capitalisation when you float.
- You will have to pay commission on any new money raised.

You 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.

You pay an annual fee based on your market capitalisation.

4. Advisers

You will need to appoint and retain a corporate adviser.

- 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.

Getting a broker is essential if you are looking to raise money, or float on AIM.

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

Other advisers will need to be involved.

- These include your auditor and your lawyer. See Preparing to float.
- You may want to involve a financial PR company, particularly if you are raising significant amounts of money.
- Choose your advisers carefully. 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.

5. Preparing to Float

Ensure that your annual accounts and reports conform to International Financial Reporting Standards.

- An accountant's report on the company's trading record is normally included in the prospectus.
- Young businesses will need to have a business plan.
- If you have no trading record, check with the applications department before going ahead.

Your company's legal structure needs to be in order.

- If you are a sole trader, or in a partnership, you will need to form a company.

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.

You normally appoint a registrar to register the new shares.

Check the other requirements of the market you choose.

- Before making an application, you should get a copy of the AIM or Main Market rules and ensure you meet their admissions criteria.

6. Pricing your business

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

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).

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.

You may choose to sell for a lower price to ensure a successful flotation.

- Selling for a lower price helps provide good after-market trading in the shares.
- If you plan future share issues it is important to keep investors keen.

7. The float process

Start by choosing your advisers and getting the basics right.

See Advisers and Preparing to float.

Nominate one individual to be responsible for the flotation.

- This is usually the finance director.
- It is useful if that individual has previous experience of a flotation.

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 (or to move from 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.

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.

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

- The process often takes as long as 12 months.

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