

SIPPs | ISAs | Funds | Shares



A guide to IPOs



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| What is an IPO?

An IPO stands for Initial Public Offering. It represents a private company's first offer to sell its shares to the general public. This event is also called a 'stock market flotation'. It represents the point at which the company becomes publicly listed on a recognised stock exchange, such as London Stock Exchange's Main Market or Alternative Investment Market which is also known as AIM.

IPOs typically involve private companies offering their shares for sale to new investors and for those shares to be freely tradable on a stock exchange. The offer can either be to the general public and/or institutional investors such as pension funds. A company can issue new shares to raise new money or existing investors in the privately-owned business offer their shares for sale.

When the general public participate in IPOs they are essentially buying shares before they hit the stock market. Retail investors accounted for a large proportion of new shareholders when Royal Mail and Saga floated on the stock market. Both these well-known brands invited retail investors to take part in the IPO and buy shares at the same price as the big funds and banks.



I Why do companies float

Companies join the stock market for lots of different reasons, such as:

- Accessing the capital markets to raise money for acquisitions, organic growth or pay off debt.
- The private owners of the business want to reduce or exit completely, so they use an IPO as a way of finding buyers for their shares. Directors or senior management often accumulate shares as part of their remuneration, so they can be among the selling shareholders as it is a chance to crystallise value in their holdings.
- Improve their reputation in the market. Suppliers and customers often like to deal with companies who are listed on the stock market because their accounts and trading activity has to be reported on a regular basis, so there is a sense of transparency.

I Why are IPOs popular?

Many investors are interested in IPOs as they provide a chance to back a company which is likely to be going through a new stage in its life.

This might be a small pharmaceutical business that floats on AIM and issues new shares to raise cash to fund drug development work. You might see an engineering firm use a stock market listing so that it can pay in shares to buy a rival business. Or, for example, it could be a natural resources firm which needs one final slug of cash in order to complete exploration work and start to build a mine.

There can sometimes be an expectation that IPOs are priced at 10% below the true value of the business, so buying an IPO could see you make a quick return on investment once normal trading begins in the shares and their price adjusts to the 'proper' value.

The power is often in the fund managers' hands when it comes to agreeing upon the starting price for the IPO as they are the ones who will inevitably be investing the most amount of money at flotation. These institutional investors will fight hard to get a discount on the proper valuation.

However, you must never assume that all IPOs will jump by 10% immediately upon listing. Investors must always consider the merits of a company before parting with any cash to buy shares. There is no guarantee the shares will rise and there's a risk they could fall if existing shareholders use the stock market listing to feed their stock onto the market and gradually exit.

| Where do I get information on IPOs?

Nearly all companies, whether they are on the Main Market or AIM, make an announcement to the stock market about their plans to list. This will either be an 'Intention to float' statement or 'AIM Schedule 1' announcement. The amount of detail varies considerably, but you will normally be told how much money they want to raise and the names of the biggest existing shareholders. The announcements are published on websites that carry the London Stock Exchange's Regulatory News Service.

Once the company has determined the price range for the float, they will make another announcement to the stock market, although it must be noted that this tends to only be done by those headed to the Main Market. Those going to AIM usually just issue a 'Schedule 1 – Update' that includes the latest on fund raising and the date targeted for the float.

When the IPO pricing has been agreed and stock allocated, Main Market companies usually reveal the final IPO price at 7am and their shares will start conditional trading at 8am on the same day. Conditional dealing tends to run for a few days and has deferred settlement, so you aren't guaranteed that the trades are going to go through. For this reason, you cannot buy shares in an ISA or SIPP under current HMRC tax rules during this period.

Unconditional dealing, which is when the shares are freely available to trade on the market, usually follows a few days later.

AIM-quoted shares are not subject to conditional or unconditional dealing. Normal buying and selling is available immediately upon the company joining the stock market.

Where do I get detailed information on companies before I invest?

Companies either have to produce a prospectus or admission document. These give information on a company's strategy, its financial history, risks and legal issues, for starters. You should see an in-depth analysis of the business, market trends, accounting policies and tax.

Audited historic financial accounts must be present; and lawyers must examine all material contracts, leases, intellectual property and outstanding litigation in order to determine suitability for being a listed company.

Before applying for shares in an IPO you should make sure you have read the prospectus, factsheet and other supporting documentation in order to gauge the risks and rewards, and not rush to place an order.

THE ADMISSION DOCUMENT AND PROSPECTUS

These documents summarise everything you need to know about a company. The prospectus requires more detail and is mandatory for any company going onto the Main Market. For AIM stocks, admission documents are produced which contain lots of detail. You can expect the following content:

- A significant amount of information on the company's trading history, financial status, risks and board structure.
- An in-depth analysis of the business, market trends, accounting policies and tax among many other areas.
- Audited historic financial accounts and lawyers must examine all material contracts, leases, intellectual property and outstanding litigation in order to determine suitability for being a listed company.

| What you should look for – before investing

IPO Checklist

- Are the owners selling all, part of their stake or not at all?
- Is there a strong, long-term strategy for commercial growth that can be easily explained?
- Will new capital be used for growth funding or simply to pay-off existing debt?

IPO Red Flags

- Valuation: Investors do not want to feel that a company's shares are overvalued.
- Management: The quality of management of the company is key and an established track record in a sector is very important.
- Management stakes: Fund managers tend to view management attempting to exit a business very suspiciously.
- Related-party transactions: Deals between two parties with a pre-existing relationship are viewed unfavourably.
- Acquisition history: Any recent acquisitions made by the company will need to be explained very carefully.
- Investment: Merely raising funds to plug underinvestment is frowned upon.
- Competitive position: A company needs to convince of the sustainability of its competitive position.

| How to get involved

Once a company decides to float on the stock market, one of two events happens. They either restrict the IPO offer to institutional investors or they open up the event to the broader public.

Our IPO page details upcoming IPOs which are open to private investors. You can also register to receive emails on upcoming IPOs - visit the IPO page in the 'Our services' area at www.youinvest.co.uk

Offer period

The offer period can last between a few weeks and a month, giving you time to study the documentation and place an order if you like the look of the company.

The company will not have a firm price at this stage, so you will need to state how much money you are prepared to invest. IPOs normally have a minimum investment level, usually between £1,000 and £2,000. All interested investors will be asked to confirm they have read and understood the information contained in the prospectus before investing, particularly the key risks highlighted by the company.

Share allocation

The IPO price tends to be published within two days of the offer closing. There's a chance you won't get the full desired allocation of shares if the offer is oversubscribed.

If the IPO offer is restricted to institutional investors then your first chance to buy the shares will be the point at which the company starts trading on the stock market. You will be able to buy shares on the open market, in the same way that you would buy companies that are already listed on the stock market.

Which accounts to use

You can invest in eligible IPOs through your ISA, SIPP or Dealing account.

| The risks of investing in an IPO

Admission documents and prospectuses are meant to provide a detailed look at a company, yet there have been plenty of examples of companies which have disappointed investors soon after IPO.

Is it important to read documentation so you do not discover bad news that was buried deep in an admission document or prospectus, such as a legal case or lack of patents to protect intellectual property.

There's often elevated expectations of new market entrants so share prices can fall fast upon the smallest bit of bad news. For example, this might happen if sales figures or contract wins are not as strong as implied by management commentary in the intention to float or other IPO-related announcements.

Many companies often have a short track record of trading, so there's little data on which to base your investment decision. Some businesses use the promise of large dividends to lure investors but subsequently fail to deliver suitable cash returns to shareholders, either because the money is needed elsewhere in the business or they haven't been able to generate sufficient cash to pay investors.

Before the company is floated, the expected price of the IPO is set within a range. The price at flotation can be at the lower end of this range. There's a risk you apply for shares in an IPO offer and end up with a shareholding in a business that starts life on the stock market surrounded by negative investor sentiment. People who expected a higher valuation may sell immediately once the shares start trading in disappointment of how the IPO has played out. That selling could push the share price down even further.

Checklist for taking part in an IPO or new issue with AJ Bell Youinvest:

- ✔ Visit our IPO page for full details of upcoming IPOs and new issues
- ✔ Make sure you have first opened an account with us
- ✔ Deposit the money in your account before applying for the shares
- ✔ Read the factsheet, prospectus and other documents carefully
- ✔ Applications are made online
- ✔ No stamp duty or PTM levy is charged for IPOs
- ✔ Dealing charges will not normally apply unless we do not receive intermediary commission, if this happens our standard dealing charges apply
- ✔ A contract note will be issued if your application for shares is successful
- ✔ Standard dealing charges will apply when shares are sold

I IPO Glossary

AIM: The Alternative Investment Market is the London Stock Exchange's quotation venue for early-stage companies.

Admission to trading: When shares begin unconditional dealing on either the Main Market or AIM.

Conditional dealing: Where shares are traded before the admission to trading date, as the name implies these trades are 'conditional' on the company being listed and can only settle once trading has become unconditional; i.e. everyone can buy and sell them.

Factsheet: Key information about the IPO available to investors before flotation

Issue price: The price at which the shares will be sold, also known as the offer price, before general trading begins.

Intention to float: The company's first announcement on its plans to join the stock market.

IPO: Initial public offering.

Main Market: The London Stock Exchange's key quotation venue for mature companies.

Offer: When a company sells shares to the general public it has to make the formal offer in the form of a prospectus.

Offer price: The price at which the shares will be sold, also known as the issue price.

Offer price range: Range at the time of publication of prospectus within which offer price is expected to be set.

Offer size: The number of shares to be sold under the offer.

Official List: Operated by the UKLA, all Main Market companies need to join it before trading can begin.

Primary market: The market for new shares issued and offered as part of an IPO. (An IPO may be made up of a mixture of new and existing shares).

Prospectus: The definitive document outlining the offer in full.

Scaled back: When all investors' applications cannot be satisfied by the amount of stock available they may be scaled back by a proportionate amount.

Secondary market: The market for shares already admitted to trading.

Supplementary Prospectus: A document only issued in the event of a significant change in the terms of the original Prospectus.

UKLA: UK Listing Authority, the arm of the City regulator – the Financial Conduct Authority – which deals with the rules of companies quoted on the Main Market.

Unconditional dealing: When a company is officially listed on the stock exchange and normal exchange trading takes place.



Please remember that investing in IPOs carries a high degree of risk. The value of your investment may fall significantly after the security is quoted on the open market and you may not get back all the money that you invest. We do not offer advice about the suitability of our products or any investments held within them. Should you require financial advice you should consult a suitably qualified financial adviser. Tax rules can change in the future and the tax treatment depends on your personal circumstances. Past performance is not a guide to future performance and some investments need to be held for the long term.

