

Private Equity Goes Public

The return of the private equity-backed IPO



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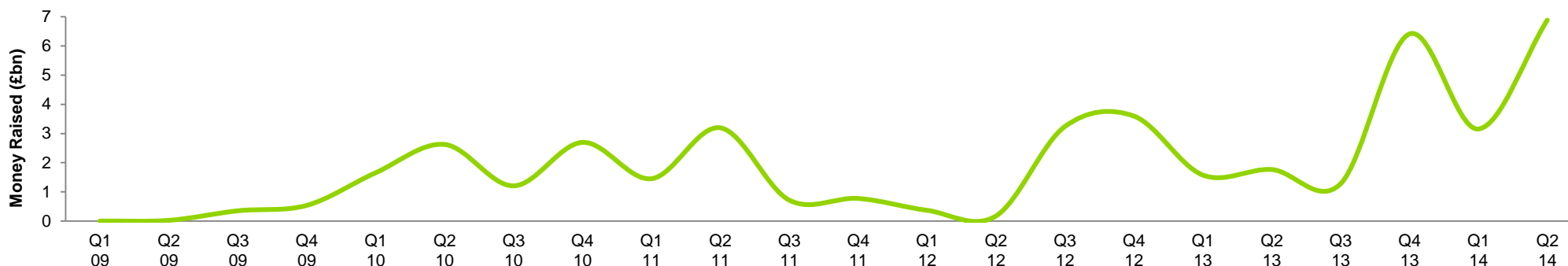
The return of the private equity-backed IPO

IPO market strength

The UK has witnessed a return of IPO activity since the freezing of the equity markets after the financial crisis. With the resurgence beginning in Q4 2013, there has been a focus on retail and online stocks although issuance has been broad across all sectors.

Whilst there has been some recent commentary about institutional investor fatigue from high deal volumes and impact on IPO feasibility, deal flow is still well above averages for the last five. Following the seasonally quieter period of July and August, expectations are for a period of renewed activity over the coming months.

All London IPOs money raised



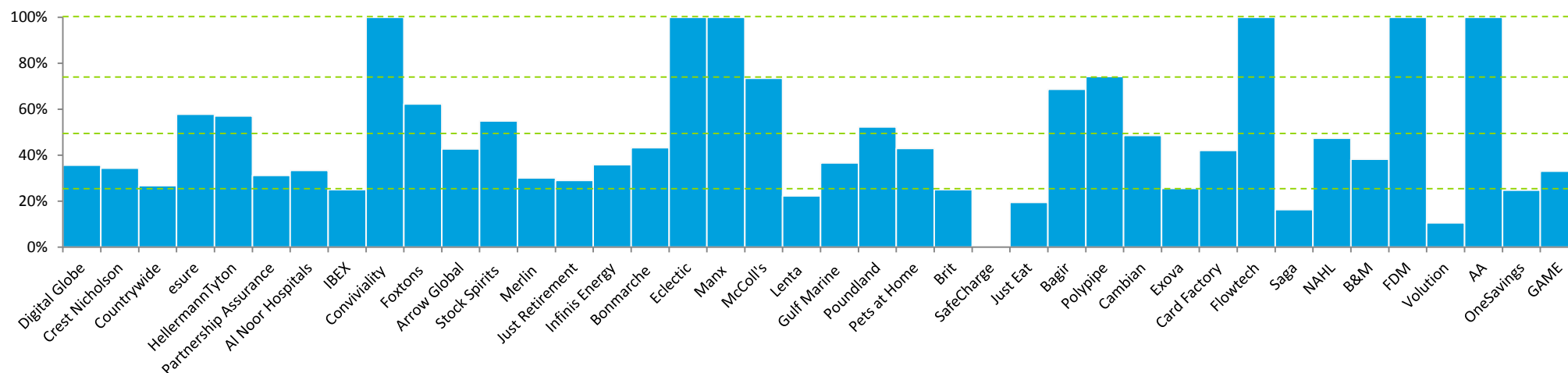
Source: London Stock Exchange, Deloitte analysis¹

Return of the Private Equity-backed IPO

Institutional investors' perceptions of private equity-backed IPOs seem to have changed. Whereas before there was a wariness of over-leveraged companies in which most of the growth had already been delivered, recently private equity sellers have worked hard to address investors' concerns resulting in a raft of successful PE-backed flotations.

In the last 18 months² there have been 40 IPOs of PE portfolio companies in London raising £1.7 billion with 41 different PE houses participating.

Percentage cash-out in PE debt & equity investment upon IPO²



Source: Prospectuses, Admission Documents, Deloitte analysis³

IPO as an exit

Recent PE-backed IPOs have provided a meaningful level of cash-out for the selling shareholders, although normally the vendor is not able to exit 100% of its investment. The average percentage cash-out for the PE house³ in our sample was 48%. The average pre-IPO PE equity interest was 76% which reduced to 39% after IPO. Notably however, there have been six complete exits.

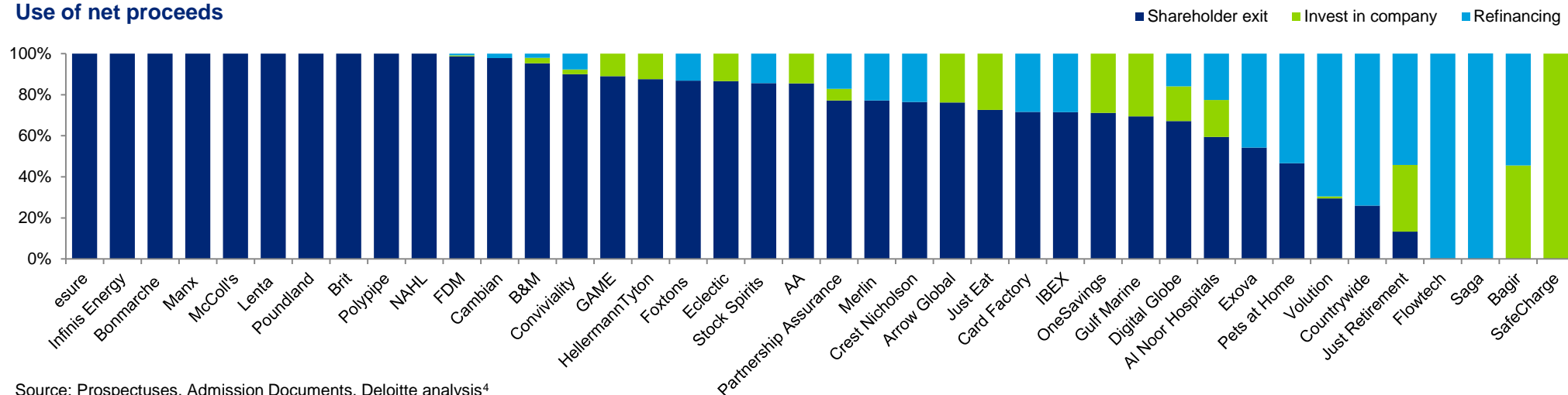
The PE sponsor will typically enter into a lock-in agreement for 180 days as well as a relationship agreement governing its role as a dominant shareholder.

Use of IPO proceeds

It is important to identify the correct balance for use of IPO proceeds as this can influence investors' perceptions of the attractiveness of the opportunity. Cash raised at IPO may be used to fund the sale of shares by existing shareholders, redeem PE loan notes, refinance existing debt or provide new capital to fund growth plans post-IPO. Over the last 18 months², an average of 59% of money raised went to the PE sponsor.

In many cases, a capital re-organisation is carried out several months before the IPO to simplify the capital structure. This sometimes involves the conversion of any private equity loan notes into ordinary shares.

Use of net proceeds



Source: Prospectuses, Admission Documents, Deloitte analysis⁴

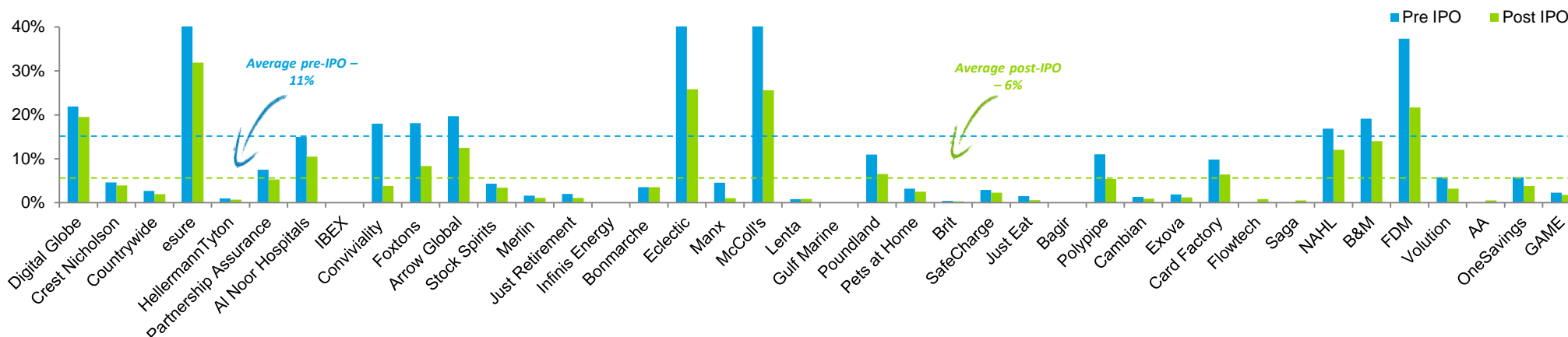
Management cash-out

Management teams are generally able to realise some of their investment at IPO, although the majority of an individual's investment is normally retained in the company. Out of 102 existing management shareholders⁵, 78 sold shares at IPO.

The proportion of stakes disposed of varies, but is usually less than 50% - for those that sold shares, the average percentage of their holding sold was 26%. Only 11 cashed out more than half of their holding.

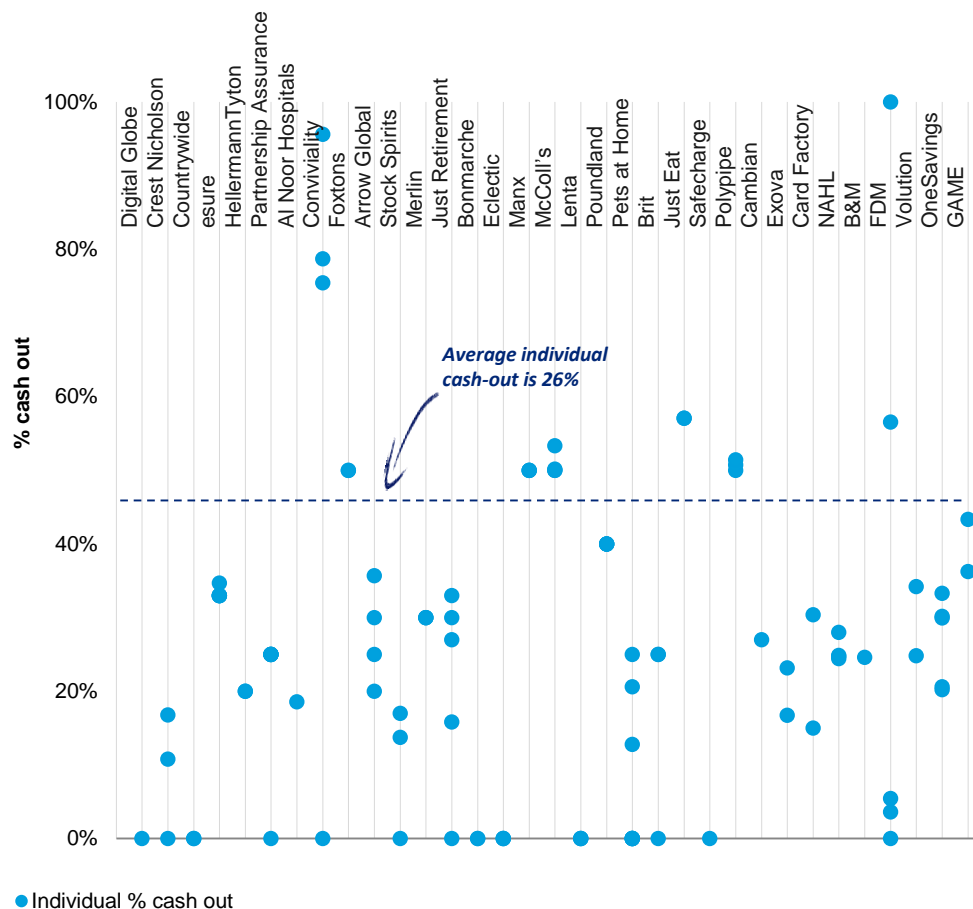
- The average aggregate stake of a management team reduced at IPO from 11% to 6% (due to a combination of cash out and dilution from new shares).

Management team – combined shareholding pre- and post-IPO



Source: Prospectuses, Admission Documents, Deloitte analysis

Management cash-out by individual

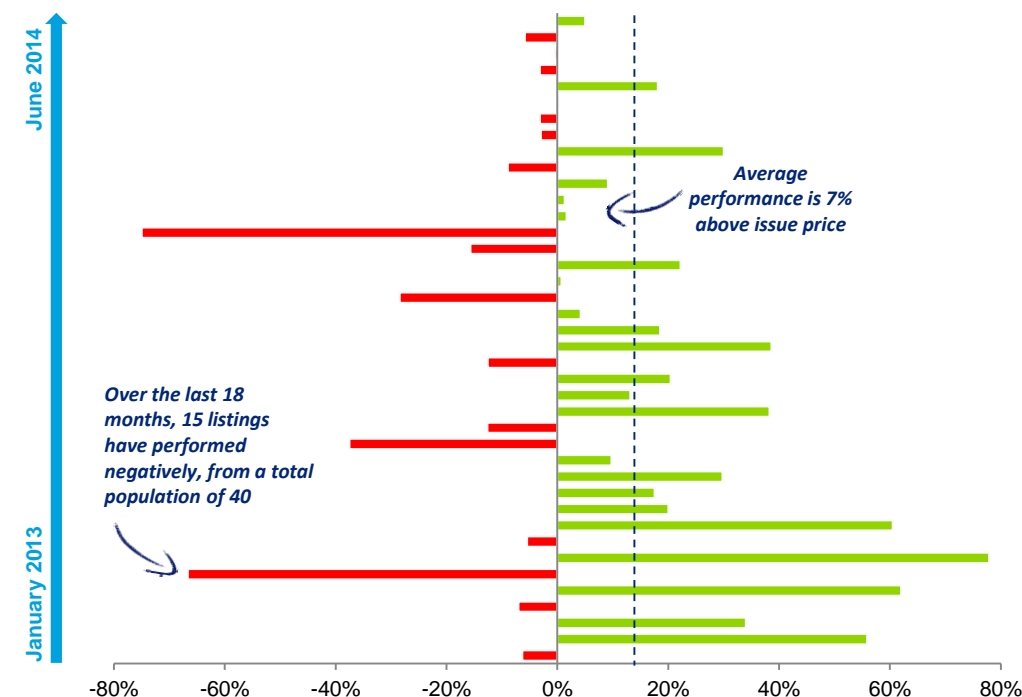


Source: Prospectuses, Admission Documents, Deloitte analysis

Aftermarket performance

PE backed IPOs from the last 18 months have generally positively in the aftermarket, currently up by an average of 7% over their issue prices.

Aftermarket performance of PE floats – list price compared to current



Source: Pricing announcements, Factset, Deloitte analysis

Positioning the asset

- Correct positioning of the asset well in advance of IPO is critical to achieving a successful listing and appropriate valuation.
- Presenting a compelling equity story in terms of sector focus and growth opportunities is important. Niche or unique products and services, companies that have the ability to disrupt their marketplace and barriers to entry are important.
- Is it a growth play, an income play, or does it have aspects of both? Different pools of institutional investors and types of funds focus on each. For a growth company, the strategy requires careful articulation with specific use of proceeds earmarked for expansionary projects. For an income stock, a sustainable dividend policy must be established.
- There will be a different focus for institutional investors compared to financial sponsors. Emphasis is likely to be more on profits rather than cash flow and there will be no requirement to demonstrate an exit plan.
- The public markets are likely to have a lower debt appetite. Capital structure needs careful planning in advance of the IPO to ensure that leverage can be brought to an acceptable level. There is often a debt refinancing before IPO.
- A restructuring pre-IPO to remove or simplify loan note structures is seen on some deals.

Debt

The public markets generally have a lower debt tolerance than leveraged finance structures. A financial sponsor considering an IPO as a potential exit may want to plan to achieve more modest gearing near to the time of IPO, as funds raised being used to pay down debt not only reduces funds available for cash-out but can be perceived negatively. In our sample, post-IPO net debt was an average of 1.9x historical EBITDA. This varied considerably by sector however, ranging⁶ from 7.0x historical EBITDA to companies with a net cash position.

Costs

Across the 40 recent PE IPOs, total costs averaged 5.6% of money raised, or 2.6% of the new listed company's market capitalisation. The biggest cost at IPO is in most cases the brokerage commission, usually calculated as a fixed percentage of proceeds raised. IPO expenses are usually split between the company and the selling shareholders in the relative proportions of money raised for each, with the company usually retaining the advisory and process expenses.

The recent strength of the London IPO market coupled with a resurgence in PE-backed flotations means that an IPO could be a viable exit option for PE assets.

Many PE house have used an IPO as an alternative to a trade sale or secondary buy-out over the last 18 months. Whilst significant levels of cash-out for both private equity and management are achievable, usually a private equity backer must be comfortable with retaining a significant stake going forward.

If an IPO is considered, there are a number of aspects around positioning the asset and running the correct process which should be considered well in advance in order to achieve the best outcome.

How Deloitte can help

Deloitte Corporate Finance Advisory can help to deliver a successful IPO. Our PLC Advisory business is a dedicated team of equity capital markets and M&A professionals that acts as an independent financial adviser to shareholders and management teams considering an IPO.

The value of an independent adviser on IPOs is increasingly being recognised by the market. We provide truly impartial advice and are able to offer a second opinion on any issues that arise in the capital raising and pricing process. We have no institutional shareholder allegiances and sit on the same side as the board.

An IPO is an intensive process for management and we can help lessen the load and achieve the best outcome through our considerable experience of such processes. We can assist companies with the heavy lifting and project management, allowing management teams to focus on the key IPO actions whilst remaining free to run the business so that the company comes to market in best shape.

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¹Main Market and AIM IPOs. Excludes Glencore IPO

²To end of June 2014

³Calculated as total economic value of PE investment (equity plus loan notes) after IPO divided by value before IPO

⁴Calculated based on use of proceeds as stated in the offering circular, divided by total net proceeds. Shareholder exit defined as sale of shares plus repayment of loan notes

⁵Only includes directors who held shares pre-IPO

⁶Excluding marginally profitable outliers

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