

BVCA GROWTH COMPANY IPOs CONFERENCE
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About IPOs Presentation
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Good morning ladies and gentlemen. Normally I try my hardest to avoid making speeches. But when Simon asked me to speak today, I accepted immediately and enthusiastically. IPO's are a topic dear to my heart. As a growth investor I spend my working life looking for the next 'big thing'. I am always keen to look at new companies and new investment themes and the IPO process is the main mechanism by which the stock-market renews itself to reflect technological innovation and economic and social change.

I also feel fairly well qualified to be speaking on the subject. I manage personally over £2bn of pan-European small/mid cap growth funds. My team at Fidelity have probably evaluated more IPO's than any other institution in Europe and the depth of our research, with over 50 research analysts, allows us to have a properly informed view on almost every significant deal. I have a strong focus on technology, with 15-20% of my funds invested in tech hardware, software and service businesses, another 15-20% invested in a wide range of on-line businesses and 5-10% each in medical technology and renewable energy. If I participate in an IPO my target investment size can be anything from £1m to over £20m depending on the risk/reward profile and I will take stakes of up to 10% in companies.

I spent some time mulling over alternative titles for my presentation, thinking perhaps that 'About IPO's' might be a little dull. In the end I came up with this:

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Personally I owe a huge debt of gratitude to Dragon's Den. Until the show became popular I had great difficulty explaining to Mrs Stone and my children what exactly it is that I do for a living.

Now it is perfectly clear. I have management pitch their business to me and then decide 'I'm in, or I'm out'. Simple really!

Madding, according to my dictionary means 'frenzied' and I think is a rather apt description of the way the investment crowd behaves.

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So, let's look at the IPO market.

I have analysed the IPO market over the last 10 years, looking at the supply side; the quantity of deals issued, and the demand side, the funds flow into and out of equity funds.

I have also analysed the performance of all IPO's in the last 10 years, and compared the performance of Venture backed deals.

The conclusions are sobering.

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This chart shows the volume of the Global IPO market over the last 10 years. It is highly cyclical with issuance of \$189bn in 2000 down to \$46bn in 2003, up by 6x to \$295bn in 2007 followed by a collapse of 72% in 2008. There are clear signs of life in 2010, with activity looking like it will recover to levels seen in 2004 and 2005.

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Looking at regional trends, issuance in Europe, Middle East and Africa declined over 90% from 2000 to 2003, recovered to a new high in 2006 and 2007, before declining over 90% again. It has seen some recovery this year, but is still depressed by historical standards. Asian activity on the other hand has already recovered to peak levels with \$55bn in the first 5 months of 2010 alone, indeed, since the start of 2009, Asian issuance represented over 60% of global volume while EMEA issuance was only 14%.

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Now turning to the UK, issuance fell from \$24bn with 108 deals over \$10m in 2006 to \$2bn with just 7 deals last year.

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However The UK has maintained its share of total EMEA issuance fairly stable in the last 6-7 years, although a lot of these deals have been non UK domiciled businesses

NEXT SLIDE 8

Here you can see how the S&P500 is correlated to funds flows. One of the delights of managing unit trusts or other open ended funds is that your investors tend to shower you with inflows when the market is peaking and you have no ideas because everything is overvalued. As day follows night they then pull their money out after the market has fallen and you have loads of ideas because everything is dirt cheap, but no cash to buy them. This is a perfect illustration of the madding crowd at work. A healthy IPO market requires inflows into funds as we saw in most of 2004-2007. If fund managers has inflows, they are far more likely to participate in IPO's because there is little pressure to sell existing holdings to make way for the new. You can also see the severity of the withdrawal of liquidity in 2008 and H1 2009, which coincided with the collapse in the IPO market. Recently we have seen a solid pick up in funds flows, which you might think would be good news for the IPO market....

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Well it's good news in Asia and Emerging markets. The strong cash flows since mid 2009 have all gone to emerging markets and global funds. In fact US and European equity funds have seen substantial outflows. On top of this there is a strong trend to ETF's away from active managers, making the liquidity picture even worse.

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So to summarise on the IPO market

The global IPO market is recovering

The action is all in developing economies

European equity funds being heavily redeemed

This means that European investors will only go for IPO's that offer either really compelling growth - this means companies that offer the prospect of strong revenue and profit growth, whilst also having repeatable or highly visible revenue, OR really compelling value and here we need to think of discounts to peers of more like 20% than the 10% that has been the norm historically.

Now I'd like to discuss the analysis I've done on IPO performance. I looked at the performance of every deal since January 2000 and calculated the Internal Rate of Return either to the end of May 2010 or the date the company delisted.

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Of the 1807 IPO's for which I had returns data, 1378 had a negative IRR, and only 109 or 6% made investors an IRR in excess of 20%. In fact the number of companies with a negative IRR of over 20% outnumbered those with a positive IRR of over 20% by a factor of seven to one. Now I recognise that the year 2000 coincided with the peak of the TMT bubble and that deals from 2000 would have suffered an exceptionally high failure rate, so I re-ran the analysis excluding the 510 deals from that year

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This reduces the % with a negative IRR from 76% to 72% and improves the % with an IRR above 20% from 6% to 11.4%. Still not great odds.

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Looking at shorter term performance. This chart shows Global IPO performance over 1 year by vintage since 2000. Notice how again, it's the Asian deals that generally perform better.

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Looking at EMEA IPO performance over 1 year, I split the performance between developed Western Europe and Emerging Europe, Middle East and Africa. Western European deals lagged Developing economy deals in 9 out of 11 years, and often by a substantial margin.

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Now turning to European Venture Capital backed deals. We were able to identify just 81 VC backed IPO's out of nearly 2000, an incredibly low number. By industry these were roughly half life sciences and half technology, with a few internet and renewable energy companies as well. Performance of the VC backed deals shows 75% with a negative IRR and 6% with an IRR above 20%, which coincidentally is exactly in line with the performance of all IPO's.

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So to sum up on IPO performance, investors have experienced a very high failure rate, although granted this has been in an environment of poor equity market returns overall and there are very few VC backed success stories. This experience is fresh in fund managers' minds and has led them to be cynical about the chances of success. To succeed in current market conditions, an IPO needs to stand out from the crowd. On a positive note, there are many great examples of IPO's that have thrived, where management have delivered on the growth expected at flotation, and where all shareholders have been handsomely rewarded. Let me quickly flick through some examples.

Click quickly through examples Abcam to Telecity

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Before I finish, please allow me to give you a couple of pieces of advice.

Engage with institutions early. The IPO process is highly pressurised and not really conducive to building relationships. You will have a whirlwind of rushed meetings with dozens of institutional investors. I suggest you identify which institutions you want on your shareholder list and build relationships >1year ahead of IPO. The best way to do this is to ask potential sponsors for a list of key fund managers.

Don't over promise. When you float your company, you hand ownership over from a small group of knowledgeable investors to a larger group of knowledgeable investors and a maddening crowd. The crowd rewards companies that deliver consistently, and hates negative surprises. The crowd always over-reacts to bad news. Managing expectations is a major challenge. **To conclude on a positive note; for the right companies, the IPO market is open.** Fund Managers will back companies with a compelling growth story or compelling valuation. Personally I am very keen to back new high growth businesses and I look forward very much to hearing about them in future. Thank you.