Emerging
Market Leaders

# Global IPO Survey 2005

# Contents


Introduction 1

2004 Global IPO Activity in Perspective 2

Focus Point: Asia-Pacific 10

Company Profile – Babcock & Brown 13

Focus Point: North America 14

Company Profile – Hutchison Telecom International Ltd 16

Focus Point: Europe 17

Company Profile – Sistema 19

A View From the Bank 20

Cully Davis, Credit Suisse First Boston 20

Sam Dean, Deutsche Bank 22

Mark Pols, Piper Jaffray 24

Zamir Bar-Zion, Piper Jaffray 26

Where to List? – A Global Decision 28

A View from NASDAQ 30

Charlotte Crosswell 30

Stuart Patterson 31

The Venture Capital Perspective 33

Paul Deninger, Broadview, A Division Of Jeffries 33

IFRS Conversion: The Role Of The Board 36

Report Contributors 40

# Introduction

Dear Friends,

2004 was an important turning point for IPO activity. For the first time since 2000, there was a rise in both the number of and total capital raised in IPOs. It was encouraging to see that increases occurred across all global areas. Continuing the trends seen in 2003, the Asia-Pacific region continued to dominate activity, fueled by China's continued economic expansion. Japan, China and Australia all ranked in the top five countries by total capital raised in IPOs in 2004.

The Americas and Europe rebounded in 2004, led by more favorable economic conditions. The United States was the top country by total capital raised in IPOs in 2004, while the United Kingdom was the top country by number of IPOs, largely led by activity on the alternative investment market (AIM).

A key trend in 2004 was an increase in emerging market activity, particularly in China, India, Israel and Russia. The strength of emerging economies, and foreign and local investors seeking out growth opportunities, led to an increase in both local and foreign transactions in these emerging countries. Much of the foreign transaction activity was supported by exchanges actively marketing themselves abroad to attract foreign talent.

Due to the cyclical nature of the IPO markets, it is difficult to tell what will happen in 2005, however, there is a strong pipeline of companies that are ready to come to market. If conditions remain strong, then 2005 should be another good year for IPO activity.

The Ernst & Young global IPO survey presents a review of activity and trends in 2004, an outlook for 2005 from a variety of perspectives, and a look at issues of concern to companies planning an IPO today. This is the second global IPO report produced by Ernst & Young, driven by the needs of companies planning an initial public offering in markets around the world. In 2005 companies will continue to look to the public markets as a source of financing. We look forward to working with these companies and their teams for the transformation from a private entity to a public enterprise.

We hope you find this report useful, and look forward to working together with you on the challenges and opportunities that lie ahead.

**Gregory Ericksen – Global Vice Chair, Ernst & Young, Strategic Growth Markets**

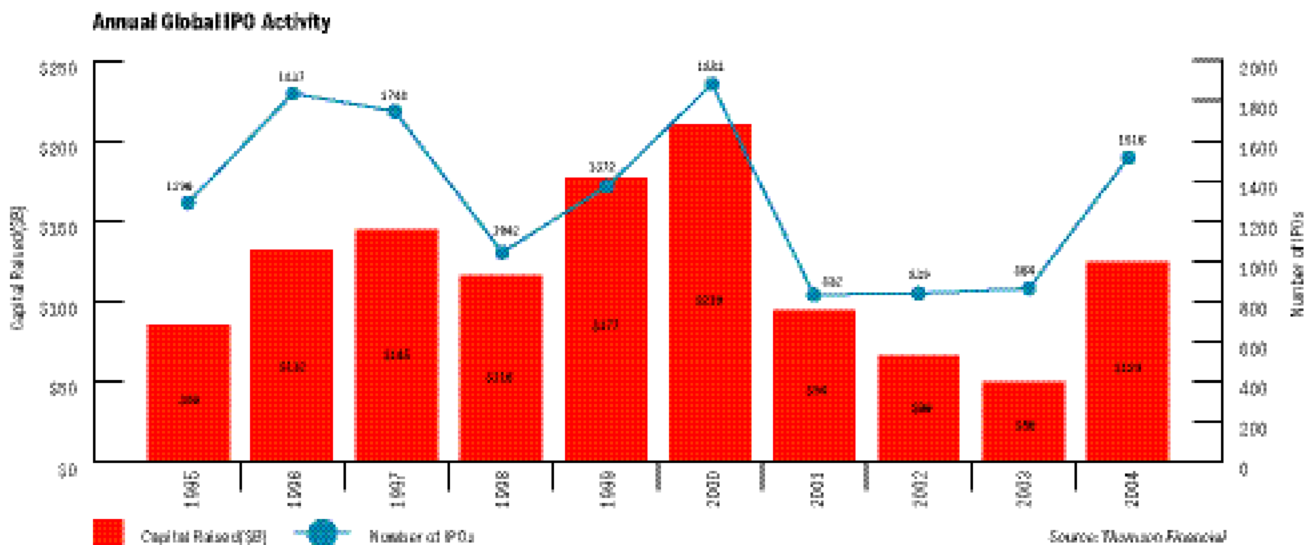
# 2004 Global IPO Activity in Perspective

### Best year for global IPO activity since 2000, guarded optimism for 2005

Building on growing optimism worldwide, global IPO activity jumped sharply in 2004, roughly doubling over 2003 in transaction numbers and even more than that in dollars raised. Leaving aside the bubble years of 1999 and 2000, 2004's 1,516 deals and $124bn of capital raised were last matched in 1997. An encouraging feature of the year was the wide base of activity: all regions shared in the increase for the first time in many years, while the range of companies involved was similarly broad, ranging from Australian biotechs through Greek shippers and Russian miners to European and US technology companies and bricks and mortar.

Could this be a new bubble? Most observers take both the mix and the quality of last year's deals as indicators that current trends represent a return to pre-SARS, pre-Iraq normality rather than irrational exuberance. The recovery of activity in the historic centers of North America and Europe lends support for this view. Although Asia with 48 percent was still the largest single region by numbers of transactions, as it has been since 2000, North America and Europe doubled their joint share from 19 percent to 38 percent, accounting for more than half of total capital raised. Europe's $30bn represented a rise of 445 percent over 2003. Moreover, quarterly deal flow was relatively smooth compared with previous years. Although activity slipped slightly in Q3, it never fell below the levels of 2003's best quarter, and Q4, with 454 deals totalling $38bn, provided a strong rebound, reaching levels last seen in Q4 2000.

'To me, the beauty of '04 was that it was distributed – a nice combination of mid-cap, large-cap and venture capital backed firms that were able to access the IPO market.



**2004 Global IPO Activity by Region**
*By Total Capital Raised*

**North America**

| | | |
|---|---|---|
| USA | 28% | ($35.2b) |
| Canada | 4% | ($4.6b) |

**Central/South America and the Caribbean**

| | | |
|---|---|---|
| Bermuda | 1% | ($1.6b) |
| Brazil | 1% | ($1.2b) |

**Europe**

| | | |
|---|---|---|
| UK | 6% | ($6.8b) |
| France | 5% | ($5.6b) |
| Belgium | 4% | ($4.4b) |
| Italy | 3% | ($3.3b) |
| Germany | 2% | ($2.3b) |
| Ireland | 1% | ($1.5b) |
| Spain | 1% | ($1.1b) |
| Norway | 1% | ($0.9b) |
| Russia | 1% | ($0.9b) |
| Netherlands | 1% | ($0.8b) |
| Sweden | 1% | ($0.8b) |

**Asia**

| | | |
|---|---|---|
| Japan | 10% | ($12.9b) |
| China | 10% | ($12.5b) |
| Hong Kong | 3% | ($3.6b) |
| South Korea | 2% | ($3.1b) |
| India | 2% | ($2.9b) |
| Thailand | 1% | ($1.7b) |
| Malaysia | 1% | ($1.1b) |
| Singapore | 1% | ($0.9b) |

32%

25%

32%

2%

3%

7%

**Middle East & Africa**

| | | |
|---|---|---|
| Morocco | 1% | ($1.1b) |

**Australia/New Zealand**

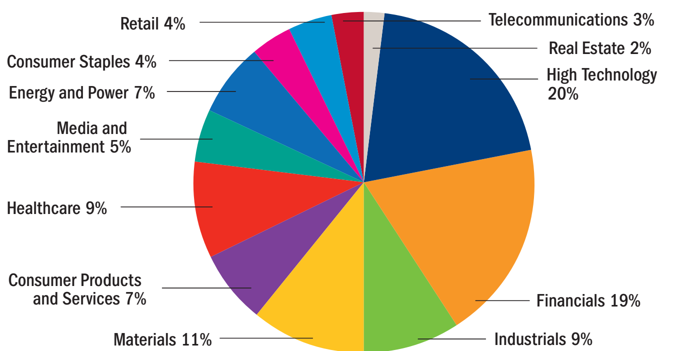
| | | |
|---|---|---|
| Australia | 6% | ($7.8b) |
| New Zealand | 1% | ($0.6b) |

Note: Activity is assigned to the domicile nation of the listing company

*Source: Thomson Financial*

# 2004 Global IPO Activity in Perspective continued

**2004 IPO Activity by Industry**
*Number of Deals*




*Source: Thomson Financial*

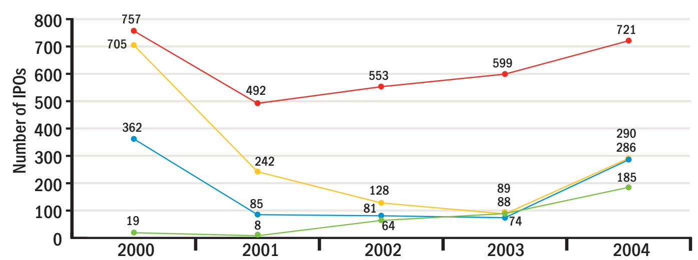
That makes a healthy market to be in, as opposed to a sector-led surge leading to anomalies and a correction down the line.' With a few variations, the judgment of Joe Muscat, Ernst & Young Partner and US IPO Retreat Chairman, on the US IPO market in 2004 could stand for the world as a whole. Continuing the trends of 2003, the bulk of last year's IPOs tell the story of established companies with strong cash flow and growing profits going to market to raise money for expansion. 'The markets have absorbed the bubble at this point,' observes Jackson Day, Ernst & Young Global Director of Capital Markets. 'In addition, there is a lot of pent-up supply from private equity which hasn't been able to sell companies into the market, and on the other side a backlog of demand for good, solid companies that we expect to continue to feed through.' Although 2005 has started more slowly than many expected, the sound fundamentals and healthy pipelines in evidence in many parts of the world suggest that absent exceptional circumstances, IPO activity should remain strong over the medium term.

A caveat is in order, however. 'Normality' is not the same as just 'business as before'. If the global narrative was one of broad-based global recovery, it conceals a number of significant developing strands which together are altering the terms of worldwide IPO investment, bringing both opportunities and dilemmas. Some of the main themes of 2004 were:

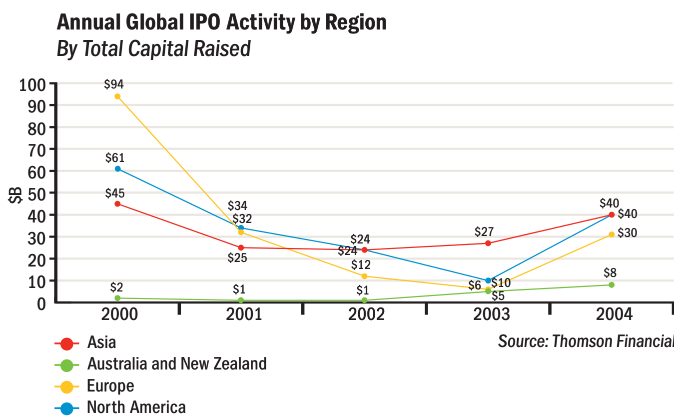
## Emerging markets

While North America and Europe reasserted themselves in IPO terms in 2005, the long-established centres are no longer the only game in town. As the economic centre of gravity continues to shift, much of the capital-market excitement is in non-traditional areas: China, India, Russia and Israel are the most often cited emerging economies with new IPO activity. In addition, Pacific economies such as Australia, Taiwan, Korea and the Philippines are strategically placed to benefit from China's expansion. 'For Australia, the US is becoming a little bit less significant as some of these major emerging Asian economies like China and India are becoming slightly more significant,' says Graeme Browning, Ernst & Young Partner, Transaction Advisory Services, Australia. 2004 saw vigorous continuing growth in Chinese venture capital and M&A activity as well as IPOs – 'as you would expect in an economy this large which has been growing at 8-plus percent annually for the past

**Annual Global IPO Activity by Major Region**
*By Number of Transactions*




*Source: Thomson Financial*



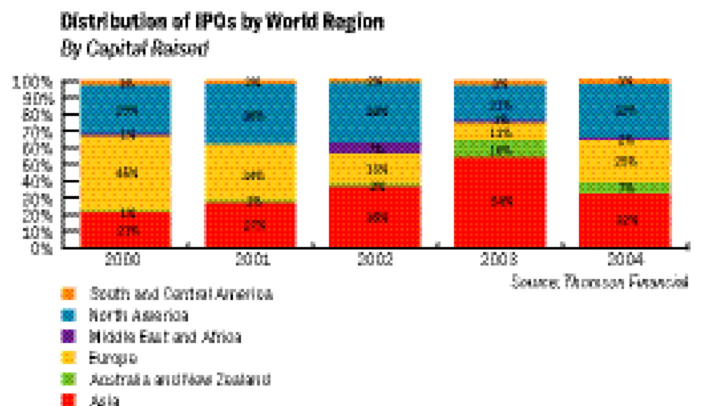

20 years,' notes Sandy Mackintosh, Ernst & Young's International Director of Capital Markets in Asia. Three of the last year's 24 $1bn plus deals were Chinese, including Air China. With 'the whole country industrialising', unless it is derailed by overheating this is likely to continue in the years ahead.

Russia also experienced a vibrant 2004, with IPO activity up by 500 percent (albeit from a low base). 'Almost all big Russian companies want to do IPOs,' according to Mark Jarvis, Ernst & Young's Managing Partner of Client Accounts in the CIS. India and Israel are likewise stirring investor interest. India's largest floats, those of Tata Consultancy Services and National Thermal Power Corp, both raised more than $1bn. However, although global investors are keenly aware of the momentum building in these high-growth markets and are reluctant to miss it, they are not plunging in in the way they might have done in the past. 'What is encouraging is that we are not seeing a charge towards the country blindly,' says Stuart Patterson, NASDAQ's Regional Head for the Asia Pacific Region, expressing a widely-felt view. 'People are not buying everything from a country willy-nilly. They are doing their due diligence. Investors are very much business-plan and company focused.'

## Foreign transactions

While investors are being more picky, so are floating companies. This is reflected in foreign transaction activity in 2004. Of the year's 117 IPOs taking place in another country, 39 were Chinese companies taking their first steps to world markets via Hong Kong or Singapore. But the UK, hosting 32 foreign floats, and the US, with 28, were also notable gainers. And these numbers may not reflect the true extent of foreign activity, as some companies will move into the shell company of a local company, or domicile themselves in the host country prior to IPO, and hence will no longer be listed as 'foreign'.

At work here is partly the globalization of capital markets – as investors grow more sophisticated, they are confident enough to accept valuable paper whatever its provenance. Abetting investor sophistication is increasing competition between stock exchanges, which are actively touting for IPO business in emerging economies, where capital-market capacity and options are limited. On the other side is a matching awareness of choice among executives of capital-hungry companies, who are increasingly being encouraged to see an IPO as a viable alternative – in some respects a better one – to venture capital or private equity, particularly in Europe.



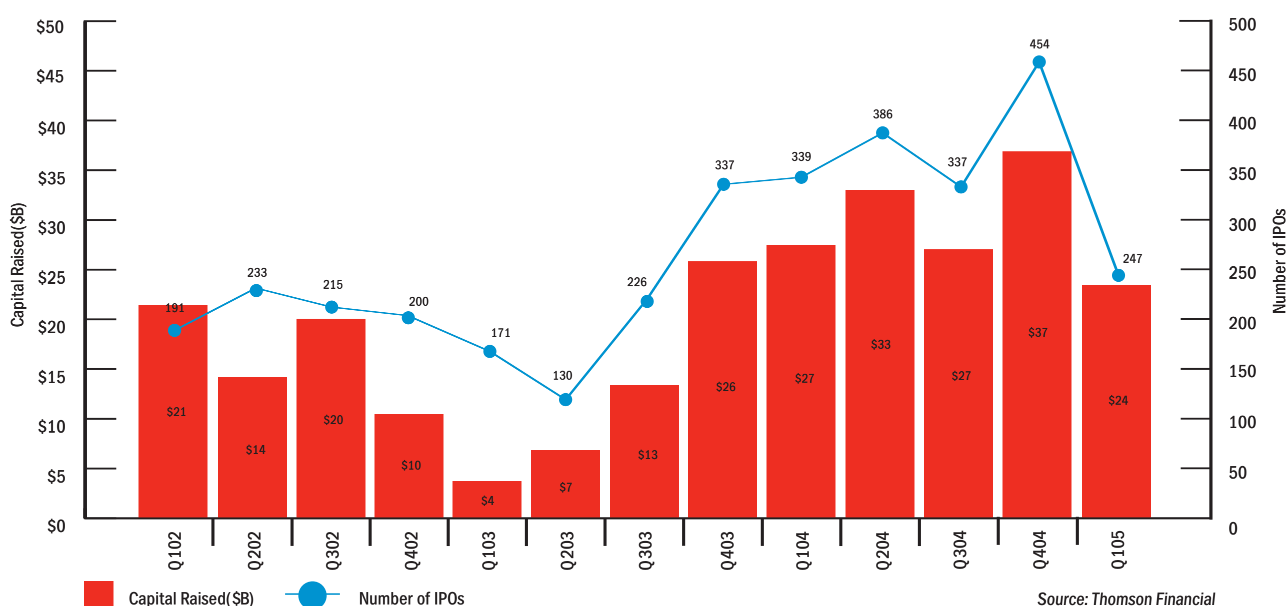
# 2004 Global IPO Activity in Perspective continued

Other trends noted last year last year were reverse mergers – a number of Chinese or Indian companies reversing into a shell company purchased from the bulletin board and then upgrading to the small cap or national market, in this case being technically domiciled in a foreign country – and multiple listings, in which companies piggyback off a local country IPO to launch debt or private tranches elsewhere, often the US. However, such decisions are by no means straightforward, involving sensitive trade-offs between price, visibility, international credibility, compliance costs and the like. Says Day: 'Determining the right exchange is an important decision. People have to weigh up how much capital is needed, how much it costs to access capital, and whether it is in the form of dividends or interest, versus compliance costs and qualitative considerations.'

## Dual tracking

Some of the same considerations apply to the vehicle used for raising capital (or cashing out). In parts of the world blessed with low interest rates, a healthy appetite for new investment and active capital market competition, 2004 saw increasing numbers of companies dual or even triple tracking – simultaneously preparing themselves for an IPO, a trade sale or venture-capital/private-equity round, depending on the balance of advantage. This is another reflection of confidence. 'Every company these days is advised to have a plan A, B and even C,' notes David Wilkinson, Ernst & Young Partner and IPO Leader, UK. 'Very few companies are not dual tracking, with venture capital or private equity as an alternative.' In the UK, he adds, junior market AIM is filling a late-stage investment role, offering

Global IPO Activity by Quarter




Source: Thomson Financial

a slightly wider shareholder base without what some see as the disadvantage of a reliance on venture capital.

A feature of the year in markets such as the US, UK and Australia has been growing activity of private-equity houses, sometimes outbidding public markets for companies with established cash flows, for instance, or themselves backing fledgling companies that they can then take to IPO. In this case, the exit of private equity requires companies that go to IPO to undertake a transaction, to refinance debt. The channel decision can sometimes go right to the wire. In the UK, Saga, a provider of services to people primarily approaching retirement, took dual-tracking a stage beyond keeping its options open, duplicating processes and documentation right through the process. Reportedly, a week before the final decision it still did not know which way it would go. As Wilkinson notes, such a course takes both nerve and skill. ‘Costs will be higher as a result – but if you get it right the price is too.’

## Regulatory developments

Apart from overall activity levels, the most closely watched aspect of the capital markets in 2004 was regulation. Were US IPOs destined to dry up in the wake of Sarbanes-Oxley? Would there be mass desertion of foreign firms to other exchanges? Will we see a race to the bottom in governance? In fact, none of these things have happened. On the contrary, domestic activity in the US, which alone raised one-third of all last year’s capital, continued to rebound. Although some European firms have made noises about delisting from US exchanges, few have done so – not least because in practice it is extremely difficult. As for governance, while most observers accept that some foreign firms in Europe and Australia have been put off from a US listing by the regulatory climate, others have decided that there is an advantage in testing themselves against the toughest regulatory regime in the world.

‘Sarbanes-Oxley is an important piece of legislation that has driven a huge amount of infrastructure build in companies,’ says Muscat. ‘But the US still has the most transparent, low-cost, dynamic capital markets, and their requirements in terms of transparency and compliance are the gold standard. I think the general view is that if you want to be a great international company, you have to measure yourself against the gold standard.’ For some firms, a NASDAQ or NYSE listing is part of the brand. The picture is therefore complex, as companies with international pretensions weigh up a growing number of strategic listing options. Strikingly, of the 117 foreign listings last year, an almost equal number (27, predominantly at the large end) opted for NASDAQ or the NYSE, Sarbanes-Oxley and all, as chose the less stringent conditions of London’s AIM (24, at the smaller end), one of 2004’s success stories.

Adding to the fluidity of the picture are a number of further regulatory changes in the pipeline or already completed: CLERP 9 in Australia, the new European prospectus directive, which comes into force in July, the reorganisation of the French stock exchanges, the prospect of stricter regulation in France, Germany and Japan, and ongoing uncertainty about long-term Europe-wide regulation and exchange consolidation. In short, change is everywhere, and it is not about to stop. Sums up Jackson: ‘Yes, the US was first, but there are also major reforms going on in China, Japan and Europe. I think it’s the general view of the security regulators that if this is a global market, then they need to work together – not just on financial reporting but on oversight of the accounting profession, and that’s going to drive more changes still.’

# 2004 Global IPO Activity in Perspective continued

In the light of these developing strands, what are the prospects for the future? After the advance of 2004, Q1'05 has had a slow start. The main issue seems to be market conditions, particularly in the US. While many companies are better prepared than ever for life in the public eye, they are willing to wait for the right moment to float. Overall, however, the mood might be described as guarded optimism. As Muscat puts it, 'I'm pretty optimistic – but there may be a couple of speed bumps on they way.' Appetite for new-business investment, including technology companies, remains healthy, particularly in emerging markets, if generally conservative: overheating remains a concern in China, but few people see signs of a new bubble. Supply is also in good shape. Pipelines are reasonably stocked, with some larger companies in the US waiting in the wings. As Wilkinson puts it in the UK, 'There's still a backlog of good rather than immature companies waiting in the wings. On the other side, after a gap of several years the market is light on new-business investment, so on the whole it's comfortable with that.'

However, even in notably successful economies such as Australia, observers are cautious beyond the medium term. 'This year started very strongly,' Browning reports. 'But oil is a big black cloud for all of us, and an environment of rising interest rates, even modest ones, does have an impact on confidence. What happens in the US is important too. The window will probably stay open to the end of the year – but there are a couple of warning signs beyond that.'

For different reasons, the outlook in Europe is similar. Underlying confidence remains strong – in the UK, the busiest single IPO country in 2004, the buzz around AIM remains hot, France expects to see more than last year's 24 IPOs, according to Any Antola, Ernst & Young Partner, and IPO Retreat Leader France, and even long-depressed Germany is moving 'from grim to hopeful', in the words of Julie Teigland, Ernst & Young Partner, Strategic Growth Markets. Yet many observers expect a shift to 'wait-and-see' mode around the middle of year as markets digest the implications of the new European directive and await the results of market reorganization in France.

The advice to companies thinking about an IPO is therefore to make sure they have their own processes right rather than try to second-guess the outside world. 'Managers can't control the market – all they can do is control their own business,' observes Muscat. 'So my advice would be, that management teams should fully understand what the market needs in terms of transparency and compliance. They should really take on board how the role of advisers – auditors, investment bankers and analysts, even attorneys – will change when they go public. They must be confident that their core business can withstand these distractions during the IPO process and stand up to scrutiny afterwards. If they can do that, you can be pretty sure that the markets will make themselves available to great companies, almost irrespective of the conditions.'

*The data presented in this report is from Thomson Financial. For the purposes of the survey, an IPO is defined as follows: An IPO is a company's first offering of equity to the public. Companies with SIC codes 6091, 6371, 6722, 6726, 6732, 6733 and 6798 were excluded from the report in an attempt to exclude trust and fund IPOs. IPOs have been attributed to the domicile nation of the company having an IPO. The primary exchange on which they listed is as defined by Thomson Financial.*

## IPOs raising greater than $1 Billion

**2004**

| Name | Domicile nation | Industry | Proceeds (US $ million) | Primary Exchange |
|---|---|---|---|---|
| Belgacom SA | Belgium | Telecommunications | $4,399 | Euronext |
| Electric Power Development Co Ltd | Japan | Energy and Power | $3,369 | Tokyo |
| Genworth Financial Inc | United States | Financials | $2,856 | NYSE |
| Shinsei Bank Ltd | Japan | Financials | $2,367 | Tokyo |
| Trasmissione Elettricita Rete Nazionale SpA | Italy | Energy and Power | $2,064 | Milan |
| Assurant Inc | United States | Financials | $2,024 | NYSE |
| Google Inc | United States | High Technology | $1,915 | NASDAQ |
| Ping An Insurance Group Co Ltd | China | Financials | $1,839 | Hong Kong |
| Deutsche Postbank AG | Germany | Financials | $1,823 | Frankfurt |
| Semiconductor Manufacturing International Corp | China | High Technology | $1,803 | NYSE |
| Societe des autoroutes Paris Rhin Rhone | France | Industrials | $1,701 | Euronext |
| Freescale Semiconductor Inc | United States | High Technology | $1,690 | NYSE |
| Snecma SA | France | Industrials | $1,627 | Euronext |
| Pages Jaunes SA | France | Media and Entertainment | $1,618 | Euronext |
| INPEX Corp | Japan | Energy and Power | $1,514 | Tokyo |
| Air China International Corp | China | Industrials | $1,238 | Hong Kong |
| Tata Consultancy Services Ltd | India | High Technology | $1,173 | National |
| National Thermal Power Corp {NTPC}(India) | India | Energy and Power | $1,173 | Bombay |
| Itissalat Al-Maghrib{IAM} | Morocco | Telecommunications | $1,075 | Casablanca |
| LG Philips LCD Co Ltd | South Korea | High Technology | $1,060 | NYSE |
| Elpida Memory Inc | Japan | High Technology | $1,049 | Tokyo |
| Gestevision Telecinco SA | Spain | Media and Entertainment | $1,046 | Mercado Cn |
| Navteq Corp | United States | High Technology | $1,012 | NYSE |
| Dex Media Inc | United States | Media and Entertainment | $1,008 | NYSE |

**Q1 2005**

| Name | Domicile nation | Industry | Proceeds (US $ million) | Primary Exchange |
|---|---|---|---|---|
| Huntsman Corp | United States | Chemicals | $1,593 | NYSE |
| Premiere Medien GmbH | Germany | Cable | $1,574 | Frankfurt |
| Sistema JSFC | Russian Fed | Other Financials | $1,557 | London |
| Societe des Autoroutes du Nord et de l'Est de la France {SANEF} | France | Transportation & Infrastructure | $1,104 | Euronext |

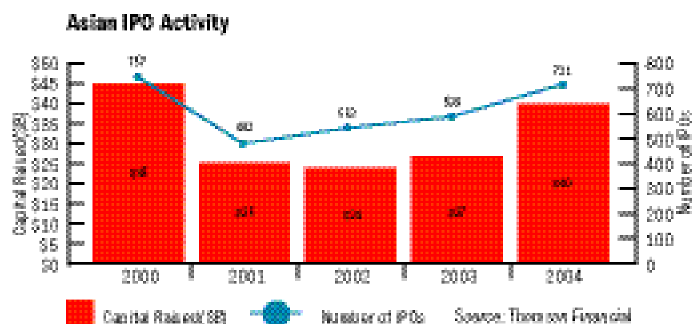
*Source: Thomson Financial*

# Focus Point: Asia-Pacific

Over the last few years Asia has been the mainstay of the global IPO market, by 2003 accounting for two-thirds of transaction volume and half of the capital raised. In 2004 Asia again increased activity levels, hosting 721 IPOs compared with 599 a year earlier, and lifting amounts raised from investors from $27bn to $40bn. In relative terms, however, the continent fell back for the first time since 2000 as other regions began to return to normal levels of activity. Within Asia, most of the major economies shared in the increased IPO activity. Japan and China accounted for the majority of activity in 2004, both raising $13 billion, while India experienced high growth in capital raised in IPOs. Activity also remained lively in Hong Kong ($3.6bn capital raised), South Korea ($3.1bn), Thailand ($1.7bn), Malaysia ($1.1bn) and Singapore ($0.9bn). On the other hand Taiwan was one of the few Asian economies to suffer a downturn. While IPO numbers were relatively stable (93 compared with 98), the $561m of capital raised represented a fall of 37 percent over 2003.

## Japan leads by number and total capital raised in IPOs, Tokyo exchange has first foreign IPO

In Japan, IPO numbers rose by 47 percent to 171, and capital raised by 187 percent to $13 billion. 'IPOs boomed because a number of emerging companies that had been playing wait-and-see were encouraged by an upturn in overall domestic




corporate earnings and stock prices' says Hiroshi Karasawa, a Partner at Shin Nihon Ernst & Young in Japan. A wide range of industries were represented in Japanese IPOs overall, including retail, IT, internet and real estate, and four companies – Electric Power Development Co, Shinsei Bank, INPEX Corp and Elpida Memory – raised more than $1bn. Most IPOs traded higher when they opened, boosting investor confidence. Many subsidiaries and affiliates of established companies went public in 2004, boosting IPO numbers, and on the reverse, some affiliates delisted to become wholly owned subsidiaries.

All three Japanese exchanges for start-up type companies saw increases in IPO numbers in 2004 – the Tokyo Stock Exchange's Mothers, the Jasdaq and the Osaka Securities Exchange's Hercules. In an environment of solid share prices, start-up companies raised more that 2 billion Yen (approximately $19 million) in 2004, and an increasing number of start-ups are showing an interest in listing on one of the three major start-up markets. Trendy industries for entrepreneurial companies include recycling, care services for the aged, and leisure related services. Recently, the Tokyo Stock Exchange has been marketing to foreign companies, particularly to Asian start-ups, and in 2004 a Hong Kong company – Xinhua Financial became the first previously unlisted foreign company to go public on a Japanese stock exchange.

The outlook for 2005 in Japan is positive, with the popularity of IPO stocks rising among individual investors, and online securities brokers encouraging this trend. 'As long as the external environment does not change drastically, the solid IPO trend among the start-up markets is likely to continue for a while,' says Karasawa.

## Chinese growth continues to fuel activity across Asia

Although in 2004 total cash raised by Chinese companies was unchanged at an aggregate $12.5bn, transaction numbers were up by 51 percent. Asserts Sandy Mackintosh: 'The key issue is the continued growth of China.' If anything, he judges that capital activity in 2004 was even more broadly based than in 2003 as increased flows of multinational and venture capital caused knock-on effects in Taiwan, the Philippines and of course Hong Kong and Singapore as well as China itself. 'The breadth of the need for capital and access to capital seems to have increased in the last year,' Mackintosh says. Hong Kong, in particular continued to benefit from the needs of Chinese companies to access foreign investors, with nineteen Chinese companies choosing the Hong Kong Stock Exchange as their primary exchange in 2004. Hong Kong had fewer local IPOs than in 2003 but more than doubled the capital raised. A further 20 Chinese companies went to Singapore, which also showed gains in local IPOs for the year.

Given the larger context, there seems little sign of growth in China slowing up.

This analysis is reinforced by a look at China's IPO pipeline. While 2004 trends were driven by a crop of companies reaching the critical mass needed to go public, 'If you look at the backlog of potential IPOs for both Hong Kong and the US markets, right now it's bigger than ever – probably two or three times what it was a year ago,' says Mark Pols of Piper Jaffray. Companies are reportedly aiming to raise $30bn in Hong Kong alone.

**2004 Australia and New Zealand IPO Activity by Country**

| Country | Total Capital Raised ($M) | Number of IPOs |
|---|---|---|
| Australia | $7,808 | 166 |
| New Zealand | $620 | 19 |
| **TOTAL** | **$8,428** | **185** |

*Source: Thomson Financial*

**2004 Asian IPO Activity by Country**

| Country | Total Capital Raised ($M) | Number of IPOs |
|---|---|---|
| Japan | $12,946 | 171 |
| China | $12,548 | 142 |
| Hong Kong | $3,560 | 40 |
| South Korea | $3,077 | 71 |
| India | $2,857 | 21 |
| Thailand | $1,742 | 45 |
| Malaysia | $1,146 | 80 |
| Singapore | $903 | 45 |
| Taiwan | $561 | 93 |
| Pakistan | $144 | 2 |
| Indonesia | $101 | 8 |
| Sri Lanka | $26 | 1 |
| Philippines | $18 | 1 |
| Macau | $4 | 1 |
| **TOTAL** | **$39,633** | **721** |

*Source: Thomson Financial*

Most venture-backed Chinese companies will wish to list abroad, in order to take money out of the country. This, as with firms in almost any country going public in today's global capital markets, raises important issues of governance and by extension of listing venue. There are some indications that the cost and effort of complying with Sarbanes-Oxley is making some Asian companies think hard about a US IPO. No Japanese firm has listed there since 2002, and although nine Chinese companies went to New York last year, four times as many picked Hong Kong or Singapore. On the other hand, the playing field will become more level in the future as other governance regimes are hoisted – Japan, for instance, will introduce its own version of Sarbanes-Oxley in due course. And the climate is such, that no company would dare to compete on lack of transparency or governance controls. While tactics and timing may vary, there is 'no race to the bottom' in Asia, Mackintosh insists.

# Focus Point: Asia-Pacific continued

## India sees 638% increase in total capital raised compared to 2003

The stellar performer of 2004 in percentage terms was India. While Indian IPO numbers rose from 12 to 21, capital raised soared from $387m to $2.86bn, an increase of 638 percent. As in the rest of the world, a combination of factors accounted for the Indian upswing: strong liquidity, sound economic fundamentals, good performance by Indian corporates and above all brimming confidence in equities as the country's growing number of international firms make their mark in global markets. The quality of the offerings across a range of industries – not just IT, but also banks, airlines, infrastructure and pharma, including nine privatizations – triggered heavy demand from retail investors which was further fuelled by a booming aftermarket.

Foreign investors, too, are determined to get in on the act, with private-equity firms from Europe, the US and the rest of Asia flocking to identify the next high-growth venture. The consultancy A T Kearney named India as the third most attractive investment location in 2004, trailing only the US and China. Although currently only a small percentage, mainly comprising growth companies in IT and the telecom sector consider a foreign listing, the trend is growing and Indian companies are now going to London, Luxembourg and Singapore to list. Indian companies already listed in the US are planning further issues of sponsored American Depository Receipts (ADR) issues to improve liquidity, however, some Indian companies are now more hesitant to go to US exchanges as a result of the compliance procedures prescribed under the Sarbanes-Oxley act.

The encouraging trends have carried over into the first quarter of 2005. 'Going by the first-quarter trend, we can expect more than 40 IPOs and public issues in 2005,' says Rajiv Memani, CEO & Country Managing Partner of Ernst & Young in India. 'With expected aggregate issues of more than $9bn, this year may well create history in terms of both numbers and volume.'

## Australia ranks 4th in world by number of deals in 2004

In 2004, IPO activity increased in both Australia and New Zealand, with the region accounting for 12% of global deals and 5% of the global total capital raised. Australia ranked fourth in the world with $7.8 billion invested in 166 deals, while 19 deals raising $0.6 billion were completed in New Zealand. Deal numbers were up 105% in Australia, and 138% in New Zealand.

The year saw a 'continuation of the trends that started in 2003 which has followed from a very strong economy' says Graeme Browning. In general in 2004, the companies coming to market were cash flow positive, low risk growing companies, rather than the technology IPOs seen during 1999 and 2000. A large and growing superannuation or pension pool of funds with low interest rates has also helped to sustain the equity markets in Australia. Browning expects activity to continue at a similar rate in 2005, 'through to the end of June and maybe a little beyond that'. There are potential risks on the horizon, however, such as the price of oil and rising interest rates, which rose a quarter of a percentage point in March. 'What happens in the US will also be significant for the market in 2005, and to some extent activity in China and India is becoming increasingly important for Australia.' said Browning.

For the first time in 2004 Australia saw a significant of private equity backed IPOs. These were an important demonstration of the maturing of the private equity market in Australia. In the first half of the year there was some nervousness about 'too many' private equity backed IPOs coming to market, but after these companies reported their earnings, and exceeded forecasts, confidence returned. Dual tracking, as in the rest of the world, was a trend in Australia in 2004, with vendors using both the IPO and M&A channel to maximize pricing tension. It was in particular, the private equity backed IPOs that were being price tested against the dual tracking M&A path. According to Browning 'the dual tracking trend is not likely to go away until the markets cool.'

## Company Profile – Babcock & Brown

**Babcock & Brown is a global investment and advisory firm with capabilities in structured finance and the creation, syndication and management of asset and cash flow-based investments. The company is based in Australia, and went public in 2004 on the Australian Stock Exchange. Below is an interview with Robert Topfer who led the IPO team internally at Babcock & Brown.**

### What motivated you to hold an IPO?

There were several reasons. First, we needed more capital. From 2000 to the time of IPO, we had relied on the firm's partners and HBV, its only outside shareholder, for capital. By 2004 we had fully deployed that capital and the lack of capital was limiting our growth. Second, we were looking to move our back office to a location that was cheaper than the US where it was then based. Third, we thought that listed shares would help us with staff issues as the equity in a private firm is difficult to value and finance for new and existing employees. Fourth, the administrative systems required for a capital based business are more stringent than those that are required for a fee based business. As the business was migrating toward a capital based business we were, in any event, going to introduce the systems that would be required in a public company. We needed a major event around which to implement these new systems, and the IPO provided this. A final reason, in hindsight, is that the success and notoriety of the IPO has been a huge catalyst in driving the business forward.

### Were there any key challenges in the IPO process?

There were several key challenges in the IPO process. The first was getting the support of the partnership and all parties involved. We needed to get everyone on board. A second challenge was the fact that we had moved the center of the business from the US to Australia at the time of the float. Babcock & Brown is a very international company, with one third in the US, one third in the Asia-Pacific region, and one third in the UK. The legal and accounting issues of dealing with a truly international business were a challenge.

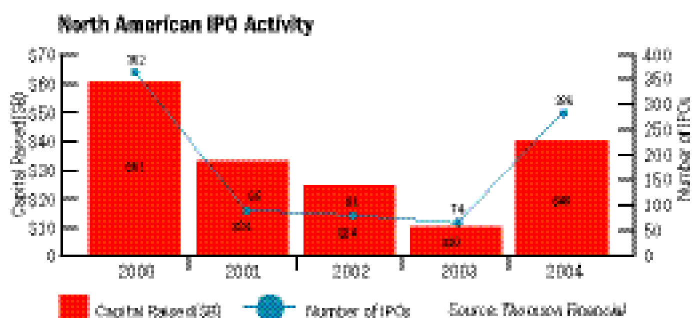
### Do you have any advice for companies about to enter the IPO planning process?

A first piece of advice is to treat the process as separate from the business. We are a transaction based business rather than a widget manufacturer, and it was important for us to keep our staff focused on the business, which is difficult when an IPO is in process around them. You need to set up a separate team from the business to manage the IPO, so that the business can continue to focus on making money. Second, you really need the right people to drive the process. Third, you need to set a date which is relatively short for the IPO, you can't simply say we'll do it 'sometime'. You then need to drive relentlessly toward the IPO. The process can be destructive if you don't do this. Fourth, the greatest benefit we got from the IPO is the public recognition of the business. You should be sensible enough to allow people to participate in the value creation with you. We listed at A$5, and shares now hover around the A$10 mark. Finally, leave something on the table. We raised close to A$6 billion on the back of the IPO.

# Focus Point: North America

The rebound in IPO activity that started at the end of 2003, continued through 2004 in North America, resulting in the most active year for IPOs since 2000. In 2004 $39.7 billion was raised in 286 IPOs, representing an increase of 285% in the number of deals, and 286% in the total capital raised compared to 2003. The majority of the activity was in the United States, with $35.2 billion raised, and the remainder in Canada, with $4.6 billion raised. North America gained a larger portion of the global IPO share in 2004, compared to 2003, with 19% of global deals and 32% of global capital raised.

2004 was a well diversified IPO market in North America. Both mid-cap and large-cap companies were able to access the IPO markets, and they came from a diverse range of industries. According to Joe Muscat, ‘IPOs came from a variety of companies, and a variety of industries, and that makes for a very healthy market environment, compared to one in which there is a tremendous amount of capital flowing in to a very narrow sector, which usually result in a correction downstream.’ Despite a well mixed group of companies coming to market, there were some industry trends. For example, the financials and healthcare segments in the US, particularly biotechnology and some medical device companies saw increases in IPO activity. In Canada there were a noticeable number of mining IPOs on the Toronto Stock Exchange that actively targets companies in this sector, while income trust IPOs which have traditionally accounted for a large amount of IPO activity, declined in number.




There were a number of factors driving activity in the US, such as the economy getting better and the improved ability of US companies to do exports overseas resulting in increased financial results. There was also the intangible element of improved sentiment amongst investors, determining that initial public offerings were an area of their portfolio in which they needed to increase their asset allocation. Finally, there was simply a lot of the demand from companies that had been waiting for the right time to list.

### Three of the top ten 2004 IPOs in the US

Genworth Financial, raising $2.9 billion, Assurant, raising $2.0 billion and Google, raising $1.9 billion all featured in the top ten IPOs of 2004. Google, in particular, attracted attention as a result of the dutch auction model used for the offering, in which each bidding investor had the chance to name their own price for Google shares. Since then, the dutch auction approach has gained a lot of attention, and other companies in the US, such as MorningStar are now considering this approach. Whether or not this method will prove to be a popular model of choice in the future is unclear. ‘From a practical, rather than academic standpoint the approach is much more difficult to execute than the traditional IPO process’, says Cully Davis of CSFB, ‘Investors don’t really mind the old process. There is a lot of debate about the applicability of an auction process and I think the Google IPO was a very unique situation. They were a very strong company that had the ability to raise their story around how they wanted to go public. I don’t think investors would afford that kind of flexibility to companies that were smaller or less exciting.’

**2004 North America IPO Activity by Country**

| Country | Total Capital Raised ($M) | Number of IPOs |
|---|---|---|
| United States of America | $35,187 | 185 |
| Canada | $4,552 | 101 |
| **TOTAL** | **$39,739** | **286** |

*Source: Thomson Financial*

## Investors sought solid companies that were organizationally prepared, prior to IPO

Investor tastes in 2004 determined that companies exiting in North America were solid, well prepared companies. Investors were looking for proven companies with revenue, consistent quarter to quarter growth, and profitability. The days of using the IPO proceeds after the IPO to implement IT systems and resources to support being a public company are over. In 2004, the expectation from investors was that a company about to go public, should have the ability to operate successfully as a public company, should be compliant with Sarbanes-Oxley (if listing in the US) and should have the infrastructure in place to be able to operate successfully as a public company.

In addition to preparedness prior to IPO, investors sought growth in 2004. This growth often came from companies in the emerging markets, in particular from populous and fast growing China. Investors are very interested in tapping into this growth and this has resulted in a lot of interest in the emerging markets. Recently there have been a fair number of Chinese companies that have listed in the US, particularly in the technology space. Interestingly, US companies such as Amazon.com are also looking to China for growth, as US growth has started to slow.

## Outlook for 2005 is cautiously optimistic

In the first quarter of 2005, North America accounted for 23% of global deals and 42% of global deal volume, however, activity on the whole was down with $10 billion invested in 57 deals in the US and Canada. Along with a decline in deal numbers, more of the initial public offerings that made it to market priced below their estimates, rather than above. The slight downturn has been attributed by many to companies coming out of the holiday period and getting their first quarter earnings organized, which has held back IPO activity. Companies have been put off listing, until they see investors reactions to the first quarter results. On the positive, the backlog of companies in the pipeline remains strong, and there is no shortage of interest from the issuer's side. As Muscat says, 'The backlog remains reasonably strong, and if backlogs are indicative, then I would tell you that things are good. But there are a lot of wild cards, and it is not certain what will happen in the second quarter.' To mid-April of 2005, the second quarter in the US had a slow start with just 5 deals raising $480 million. Although the markets are down at the moment, activity in not yet down in the doldrums, and given the number of companies in the pipeline, cautious optimism remains.

# Focus Point: North America continued

## Company Profile – Hutchison Telecom International Ltd

**Hutchison Telecom International is a global provider of telecommunications services. The company's initial public offering was a dual listing on the New York Stock Exchange and the Hong Kong Stock Exchange in 2004. Below is an interview with Tim Pennington, Hutchison Telecom International's CFO.**

### What motivated you to hold an IPO?

The business had been running as a division of Hutchison Whampoa for a while, and we reached a critical mass. In order to continue to develop, we needed more access to capital, a greater profile, and more of a strategic focus than we could gain as a division of a large conglomerate.

### What were the key decision variables in deciding where to list?

Hong Kong was an easy decision for us, as Hutchison Whampoa is one of the largest companies here, and so it is our natural home. We are an international company operating in eight markets around the world, and as a result have substantial capital needs and international focus. We decided to do a dual listing with New York as a result of the liquidity and the diverse investor base in the US. Initially, we needed to make the decision whether to go to London or to New York, and we decided to go to New York, as a result of the US investor profile, and the depth of the liquidity in the market. The capital markets in the US are becoming the most important in the world. We then needed to make the decision whether to list on NASDAQ or the NYSE. Hutchison Whampoa has a couple of operating businesses listed on the NASDAQ so we had experience with the exchange. This was the first time that Hutchison Whampoa had listed a management division abroad however, and this was a very high profile listing so we decided that the main board suited us better. Also, there are lots of Chinese companies listed on the main board, so again, this was a sort of natural home for us.

### Did any recent regulatory changes affect your IPO planning process?

At the end of the day, we consider ourselves to be an international company operating to the highest of standards and we felt that compliance should not be a decision driver for us. You need to operate by the rules of the market on which you list. Living under Sarbanes-Oxley regulations for the past 12 months has made us a better company, and there is a trophy at the end of it which is greater investor interest. Companies that say they don't want to list in the US because of Sarbanes-Oxley are short sighted. You should adhere to the highest standards, and it will only be a matter of time before Sarbanes-Oxley type controls are implemented in Europe.

### Do you have any advice for companies about to enter the IPO planning process?

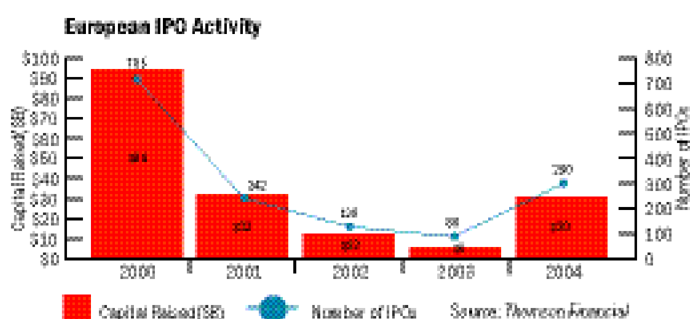
The advice I would offer relates to dual listings. Don't underestimate the process of marrying the listing rules of two exchanges. The biggest challenge we had in the IPO process was marrying the listing requirements of the Hong Kong Stock Exchange with the New York Stock Exchange. The US SEC was easier to deal with than Hong Kong – the response was 'if it's material disclose it,' while the Hong Kong system is very rule based. It is relatively unusual for a company to be listed on both the NYSE and in Hong Kong, and the SEC and the Hong Kong Stock Exchange are not used to dealing with each other. In listing you need to be prepared for an enormous level of disclosure.
A final piece of advice – estimate your fees, then double them and you will be close to the true amount it will cost you to list.

# Focus Point: Europe

## Benign conditions and improving confidence favored a return to growth in 2004

Taking the year as a whole, as in the rest of the world, IPO activity in Europe increased sharply in 2004, the result of fading dotcom hangovers, generally favorable economic conditions and returning investor confidence. The improvement was broadly based, including mature economies such as the UK, France and Germany as well as developing ones in Russia and Greece. Although the major economies laid the foundations for Europe's IPO recovery, 2004 also saw the emergence of several new and smaller markets. Among the advanced nations, IPO markets in the Netherlands, Sweden, Switzerland and Finland all emerged from hibernation last year. However, activity was not consistent over the year, with substantially more money raised in the first half than the second, and observers are cautious about 2005. While they agree that there are probably more companies than ever before waiting to go public, market conditions make it uncertain if and when the starting-gun will actually be fired.

In 2003, the main centre of European IPO activity had been the UK. In 2004, IPOs were considerably more widely distributed. While the UK did far more deals than any other country in Europe (or the world for that matter), raising $6.8bn across 191 transactions, there were also welcome upturns in France ($5.6bn raised), Italy ($3.3bn) and Germany ($2.3bn), all substantial




improvements on 2003's totals. In addition, both Ireland and Spain too did more than $1bn of IPO business.

In France and Germany, in particular, the outlook was better than for many years. 'It's going from grim to hopeful,' sums up Julie Teigland. 'There's potentially a lot more activity this year, and a good mix of companies including some entrepreneurial newer tech firms that might not have been expected from the past as well as some privatizations. I wouldn't say it's sunny, but at least the clouds are moving.'

France is also on the move, recovery being fueled by some large privatizations and the pent-up demand of mid-sized companies for capital to grow. 'It's more bricks-and-mortar, real estate and telecoms than internet related,' says Any Antola, who expects the trend to continue in 2005.

A feature of 2004 has been the number of companies preparing themselves for a possible IPO, even if it hasn't yet taken place. 'Despite the rush last year, there's still a backlog of good rather than immature companies waiting to come to market,' says David Wilkinson in the UK. 'They're businesses the market can be comfortable with, having proper business plans and most of them profits. There's a sort of flight to quality. And the market's ready, being light on new-business investment.'

In one respect, the UK differs sharply from the rest of Europe. While activity in France, Germany, Italy and Belgium has centred on a small number of relatively substantial transactions, in the UK the opposite is the case.

## AIM market popular for both UK and foreign companies

The UK's success story is the junior London market, AIM, which is winning a following among small cap firms not just in

# Focus Point: Europe continued

the UK but a number of other countries. Its combination of speed, market regulation and international outlook make an AIM IPO an attractive alternative to venture-capital or private-equity funding for domestic firms, while for ambitious foreign companies it is a stepping-stone to the international stage. Conscious of its assets, AIM is actively marketing itself in emerging markets such as Russia, Greece and Israel. As Wilkinson has pointed out, these attractions have won it a steady stream of corporate recruits even when the senior market is stagnant – and they may become even stronger when France and Germany follow the Sarbanes-Oxley reporting route in the future.

So far, Wilkinson adds, AIM has done a conspicuously good job of running a less stringent regulatory regime without compromising its reputation – so good, in fact, that the exchanges in France are being reconfigured to offer a similar choice of regime. Whether Paris will be able to handle the necessary trade-offs so well, or catch up with London's long lead, is however moot.

## Eastern European emerging markets see increased activity

Among the newcomers, the most attention has undoubtedly centred on Russia, which potentially has an enormous appetite for capital. It carried out six IPOs raising $859mn in 2004, compared with just one the year before. For large Russian companies, the big IPO question is not 'if' but 'when,' says Mark Jarvis. Domestic capital markets being underdeveloped and governance regimes rudimentary, most of these transactions will take place abroad, a prospect which has not escaped exchanges such as AIM, whose representatives are now regular visitors to Moscow. In the pipeline are a number of mining and other industrial companies, all with respectable prospects.

**2004 European IPO Activity by Country**

| Country | Total Capital Raised ($M) | Number of IPOs |
|---|---|---|
| United Kingdom | $6,847 | 191 |
| France | $5,617 | 24 |
| Belgium | $4,401 | 2 |
| Italy | $3,254 | 10 |
| Germany | $2,331 | 5 |
| Republic of Ireland | $1,456 | 5 |
| Spain | $1,130 | 2 |
| Norway | $924 | 8 |
| Russian Federation | $859 | 6 |
| Netherlands | $849 | 3 |
| Sweden | $773 | 4 |
| Switzerland | $447 | 4 |
| Portugal | $265 | 1 |
| Greece | $226 | 10 |
| Poland | $212 | 3 |
| Isle of Man | $190 | 3 |
| Finland | $170 | 2 |
| Luxembourg | $156 | 1 |
| Turkey | $139 | 1 |
| Austria | $102 | 1 |
| Guernsey | $97 | 1 |
| Latvia | $31 | 1 |
| Falkland Islands | $22 | 1 |
| Jersey | <$1 | 1 |
| **TOTAL** | **$30,496** | **290** |

*Source: Thomson Financial*

With shipping in high demand as world trade burgeons, Greek shipping companies have also aroused interest. Looking further ahead, two 2004 IPOs in Poland, one in Latvia and one in Turkey may be a portent of things to come in what used to be thought of as the fringes of Europe. Watch this space.

# Company Profile – Sistema

**Sistema is a holding company active in telecommunications, microelectronics, the oil industry, construction and regional development, insurance, retail trade, tourism and mass media. The company is based in Russia, and went public earlier in 2005 on the London Stock Exchange. Below is an interview with Veniamin Kofman, who was in charge of their internal processes for the IPO.**

### What motivated you to hold an IPO?

As a holding company, Sistema owns a majority stake in various businesses, the majority of which are in the fast growth stage. This means that they require extensive investments to facilitate such growth. At the same time Sistema wished to strengthen its position in telecoms, by participating in upcoming privatizations. Due to the limitations of the debt markets for Russian issuers, such as shorter maturities and high coupon rates, the decision was made in favor of an IPO. The management of Sistema already had experience with another two major Russian IPOs – Vimpelcom and MobileTelesystems.

### What were the key decision variables in deciding which exchange to list on?

Sistema considered the NYSE versus the LSE. The decision was made upon a detailed investigation of disclosure requirements. Sistema as a Russian holding company would not be able to satisfy NYSE requirements.

### Were there any key challenges you experienced in the IPO process?

The key challenge was to meet the financial statement deadline of 135 days. Sistema prepares US GAAP consolidated financial statements with financial data from almost 300 subsidiaries.

### How long prior to IPO did you start the planning process? To what extent did you 'act like a public company' or put in place new measures before becoming a public?

Sistema started the final stages of the IPO process in May 2004. However, prior to that there were two issues of Eurobonds. So, the IPO was an evolutionary process for the company. Management had experience with international investors, roadshows etc. In addition Sistema already had two years of experience with public announcements of US GAAP financial results, which had been prepared since 1997. Sistema also has a well established investor relations department. All necessary internal committees such as the strategic and financial committees had been in place for a few years.

### Do you have any advice for companies about to enter the IPO planning process?

The major advice that Sistema would offer is to start the process well in advance, presumably 3 years, and have a clear view as to why you need IPO funds. You need to convince your investors that you are a good buy.

# A View from the Bank

## Cully Davis – Director, West Coast Technology and Healthcare Equity Capital Markets, Credit Suisse First Boston

### What were the key trends in IPOs in the US in 2004?

2004 was clearly a volatile market. The beginning of the year was reasonably active, but in the summer months, the markets sold off aggressively through to mid August (at the same time that Google went public). It was the time when earnings expectations were at their lowest and concerns about the pace of the US economic recovery were at their dimmest. These elements, combined with the broader poor equity market performance, caused investors to retreat. Then, in the third, and more so the fourth quarter, there was a dramatic increase in the amount of IPO activity. If you look at the performance of IPOs, and to some extent follow-ons during the end of the year, the aggressive position that investors took regarding multiples paid and dollars invested reflected increased optimism about the overall economy.

### And what has been happening in the first quarter of 2005?

The first quarter of this year began with the overall equity markets, and the NASDAQ in particular, performing fairly poorly. We had a very strong run right at the end of 2004, and so there was some profit taking that occurred at the beginning of the year. There was also heightened concern around some of the economic issues I spoke about earlier. Investors really took a step back and thought about what they were investing in, and also the sectors they were involved in. To a certain extent there was some sector rotation from high growth investment opportunities like technology and biotech. The IPO market we've seen so far in 2005, although active in terms of dollars raised, has not been as impressive in terms of performance. That is somewhat the result of poor performance in the broader market, which reflected less aggressive estimates and multiples placed on some IPOs. A related point, which I don't think anyone really anticipated, was that Q1 was the first time a lot of the fourth quarter IPOs announced their earnings as a public company, and a lot of these companies didn't quite meet with the portfolio manager's heightened expectations. Because investors were aggressive in the fourth quarter, they expected greater growth rates and stronger quarterly earnings calls in the new year than these new IPOs delivered. As a result, we saw a lot of those Q4 IPOs trade down in what was perceived to be a somewhat disappointing first quarter out of the box for a lot of these new issues.

### What is the outlook for IPO activity for the rest of the year?

Right now we're in the middle of earnings season, with companies announcing their first quarter of '05 results. Many companies have had disappointing results, and the NASDAQ traded down over four percent just last week alone.The outlook will be somewhat driven by just how much pain we go through in this quarter, and this week is actually a much better week. We need to get past this earnings season and we need a stable market before investors will become active again buying new issues. One positive note in the near term outlook, is that investors still have a lot of cash on hand and there is a need to put that money to work, so they will be forced to search for investment opportunities again. Another element that's unique to the US markets right now is that there are a lot of private equity and venture capital firms that have raised money recently. These funds, like Carlyle and Goldman Sachs, have raised nearly

$10 billion each. We're going to see a lot of activity from these players taking public companies private again.

So, we've got public investors with cash on hand and an environment in which I believe there will be more public companies being taken private. This will help renew interest in finding new public investment opportunities and put more cash into the hands of investors. I'm cautiously optimistic.

### Do you see other companies using less common methods for their IPOs, like the Google dutch auction approach?

There was a lot of talk right after Google's IPO about the auction method as a new way to go public, although we really haven't seen many companies consider it seriously since then. There is a lot of debate about the applicability of an auction to the IPO process. I think Google was a very unique situation, in that they were a very good company that had the ability to write their own script about how they wanted to go public. I don't think investors would afford that kind of flexibility and remain interested in companies that were smaller or were less exciting. And investors don't necessarily mind the traditional method of investing in public companies. I think from a practical standpoint, the Google situation proved that it's much more difficult to actually execute this kind of process than it is to think about it from an academic standpoint.

### What are investors currently looking for in a company about to go public?

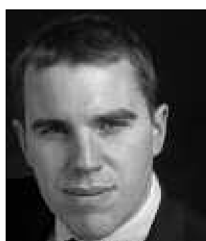
The mindset has certainly changed from five years ago. Clearly, investors are looking for a company that has delivered on growth, earnings, and has validated their business strategy. A strong revenue base is important, and it is important that the revenue stream delivers cash and profitability. And it's not just a promise of cash or profitability, but some demonstrated level of historical cash flows. I think another important element apart from just the financial model that people are focused on now is the sensibility of the business model. Companies that go public these days often operate in a more competitive and crowded market. Investors like to know that the business model can generate cash and earnings, but they also want to make sure that if it is being attacked by competitors, that the company has the ability and the uniqueness to weather this, and to continue to gain market share and drive earnings. And, as always, a good management team is important. For certain industries, a good patent portfolio or some interesting technology that is protected or unique is obviously important as well.

### Any advice for companies about to go public?

I would make sure that first and foremost they are prepared for everything that being a public company has to offer. There are many benefits to being public, such as access to capital, increased legitimacy with clients and the ability to motivate employees with options, but companies need to be very mindful of the expectations of the market, and be able to accurately forecast revenues and earnings. In a tightly regulated, full disclosure world with a lot of rules and regulations around how you interact with Wall Street and any investor, companies need to have a business model that can provide consistent results. Companies also need to be ready and willing to be under the public eye of not only investors, but of the government. As a result of the recent scandals, particularly here in the US, there is a heightened sensitivity and focus on public companies that demands a lot of attention, time, money and effort. And it goes without saying that the companies must be ready to go from a strategic and business model perspective, that is, that they have proven themselves capable of generating revenue and earnings, and are able to operate in a very competitive world.

# A View from the Bank continued

## Sam Dean, Co-head of European Equity Capital Markets, Deutsche Bank



### What were the key trends in IPOs in the UK and Europe in 2004?

First point to note is that market conditions for much of 2004 were not conducive to IPOs. In the summer in particular, market weakness led to a number of deals having to be down-sized, or down-priced, or pulled completely. Market conditions were strongest in the final quarter of the year, but the US election date fell at an awkward time and many deals were postponed until 2005 when the election outcome would be known. So IPO volumes were low as a result.

This also meant that for issuers with various "exit routes", an IPO did not represent the best option from a valuation perspective and many deals were run on dual-track bases where sponsors or trade buyers ended up winning, with the IPO option falling by the way-side.

There were a number of very successful deals though. In some cases, very long-term investors, prepared to see beyond short-term market weakness, were able to buy deals at good prices because the lack of interest of the market in deals generally gave buyers the pricing power. Some of these deals, like Wincor Nixdorf and Axalto, have been very strong aftermarket performers.

### What is your outlook for 2005?

All of the signs are encouraging. The deals that have been done recently in Europe have largely been well-received. Investor interest in deals has been restored. Levels of oversubscription this year are the strongest for some time. Perhaps most importantly, the deal pipeline is the best we have had for about 3 years. But everything depends on market conditions. If they remain positive or at least neutral then we should continue to see IPO activity flourish. A severe downturn in sentiment would have the opposite effect.

### What are investors currently looking for in a company that's about to list?

Investors are looking for "alpha" opportunities – outperformance. We have seen very strong interest therefore in markets and sectors which provide growth opportunities. The Emerging European markets are extremely busy at the moment with several Russian IPOs already pricing this year. We have done deals for Severstal-Auto and Lebedyansky. Our most successful IPO so far this year was for a solar-power company called Conergy which was many times oversubscribed and traded at a significant premium in the aftermarket.

More defensive stories were in vogue last year but that seems to be changing.

## Outside of the emerging markets, what will be the hot areas in Europe in 2005?

Germany and France are going to be key in the coming year. France has a huge privatization program which will see several very large deals including Gaz de France and Electricité De France. Germany has already had a very positive start to the year with deals like Premiere TV and Conergy and the pipeline there looks good. There is a lot of activity in the UK too.

## Do you have any advice for companies currently planning an IPO in the UK or Europe?

We strongly recommend companies consider an IPO methodology which we call the de-coupled approach and which we believe dramatically improves the final outcome of each deal. Essentially the de-coupled approach aims to provide more flexibility to the IPO process, helping to minimize market risk.

For example, setting the price range later in the process rather than at the beginning of the roadshow means that (1) the price range decision is based on more reliable feedback from the market, particularly from management meetings with investors and (2) the price range is exposed to market conditions for a shorter period of time.

We think many deals last year were forced to cut pricing or postpone completely because they failed to incorporate this type of flexibility into the process.

# A View from the Bank continued

## Mark Pols, China Office, Piper Jaffray

### What were the key IPO trends in Asia in 2004?

We focused our efforts in greater China in 2004, so I can comment on this market in particular. There were two key themes of note. First, there was a significant acceleration in the number of venture backed companies, primarily within the technology sector, looking to list on the NASDAQ in the US. Second, there were a good number of reverse takeovers into NASDAQ shell companies by Chinese companies, although, that's obviously not really an IPO. There were also a large number of state owned enterprises that listed in Hong Kong or on the New York Stock Exchange.

There has been a significant pick-up in the volume of IPOs. And, most of this is due to venture backed companies in the internet, wireless or value added services industries, and state owned enterprises from a range of industries, from financial institutions, to consumer companies, to energy companies coming to market.

### What were the key factors that were driving the increases in activity in 2004 in China?

There were a good number of companies that were able to get to the kind of critical mass that you need to go public. A lot of those companies were backed by professional venture money looking to achieve liquidity. And the US equity markets were very favorable, particularly in the first half, and then again towards the end of the fourth quarter of last year. Because of that, overall IPO activity in the US shot up quite significantly. And there were a good number of issuers out of China that accessed the markets there.

### Do you expect that these trends will continue?

The backlog of potential IPOs for both the Hong Kong exchange as well as the US markets is probably bigger now than it's ever been. I read a statistic the other day that companies were looking to raise $30 billion in the Hong Kong market alone this year. And in terms of venture backed companies looking to go public in the US, the backlog of companies right now is probably two or three times what it was a year ago. The big difference between these companies, and US venture backed companies that had an IPO during the boom years, is that all of the Chinese companies are making money and are very profitable.

A trend we are now seeing, is that younger companies are starting to look at the market again here, as some banks are pitching more aggressively. So there are definitely a number of smaller companies looking to list, but all of them are still very profitable. That said, it's not necessarily a good trend. Some of the more aggressive deals that have happened have had a pro forma market cap of $200 million or less. In this case, there is almost no real point in listing on the US markets because no institutional investors are going to care about you. In order to succeed in the US, reasonable earnings multiples are required. You would want to get to a valuation of at least $200 million, and to list at least $50 million worth of stock. In March 2005, we saw seven IPOs, versus twenty three in February. This downward trend will likely continue in April here, as the trend has been that the offerings that have gone out so far this year have performed very poorly.

## Do you see a lot of competition from various exchanges for Chinese companies?

I know NASDAQ opened up an office here in Shanghai a while ago. I've heard that the London Stock Exchange is also spending a lot of time here. Sarbanes-Oxley and the potential for lawsuits from shareholders put some Chinese companies off listing in the US. And the European and Hong Kong exchanges are using the lesser regulatory constraints as a public relations tool, in an effort to make the US exchanges look more difficult to list on. If you're in the technology space, you want to go to NASDAQ regardless. At the end of the day, companies would still prefer a US listing, but they are a little bit scared of all the Sarbanes-Oxley regulation and even more so of the potential for shareholder litigation. I know at least five companies that are thinking about an IPO and have said that the potential for shareholder litigation is a serious concern to them. But I also know that every single one of those will still end up listing in the US.

Chinese companies may consider foreign listings outside the US at some stage in the future, but that said, the valuation differences for high technology growth companies listing in Hong Kong, and particularly Singapore compared to the US, are very significant. The higher valuations in the US make it very compelling to list there. In addition, for a lot of these companies valuations are only part of the reason for listing in the US. The global branding is also important. Branding themselves as a NASDAQ quoted company appeals to a company's customers, both domestically in China and internationally. For example, there is an online travel company that listed on the NASDAQ, and their television advertisements in China specifically mention that they are listed on NASDAQ. It is very much a branding issue for them.

And the other element, is that a decent number of the investors in these companies have been US investors, and for this group, particularly venture capital investors, it's easier to get liquidity in the US. We have also read a lot of comments that the Hong Kong market can't absorb much more in terms of new issue volume.

## Have there been any local regulatory issues of relevance?

The local Shanghai and Shenzhen exchanges are very tightly regulated. The valuation of a company, how much you actually float on the exchange and then subsequently if you want to make any additional offerings, is completely covered in red tape. Recently the government has been cracking down on local companies that have been set up as offshore entities – whether it's the US, the Caymans or the British Virgin Islands. The government is taking a much more aggressive stand, as in the longer term they would prefer for companies to be domiciled in China. However, the vast majority of quality companies here right now are all domiciled outside of China - typically, in a sunny Caribbean location.

Foreign venture investors are not going to put a single dollar into a domestic Chinese company, because they can't get the money back out. Most of the management teams prefer to set up their businesses that way, because if they were ever to sell the company, or try to get some of their shares liquid, they are already offshore. There are very significant capital and currency flow restrictions that exist in China. China is working on easing the regulations.

# A View from the Bank continued

## Zamir Bar-Zion, Managing Director, Piper Jaffray Israel

### What were the key trends in IPOs by Israeli companies in 2004 and 2005 year to date?

Israeli IPOs in 2004 were often done by those companies that had waited in line since 2000. For example, shopping.com and Ness Technologies were Israeli companies that were actually in our pipeline in 2000, but didn't make it out in time. After the bubble burst, listings stopped. The window opened again in 2004, and as a result, companies that couldn't list in 2000 had another opportunity. There was also some follow on activity in 2004 by the strongest companies that could execute.

The lesser market performance in the first quarter of 2005 in the US has stopped some Israeli companies from listing. We also have some very interesting companies that wanted to go to the NASDAQ, but all of them are now on hold for a while, as they want to ensure that they have strong visibility. I think that 2005 will only see chip companies, and communication companies from Israel going to market in the US. I don't think we'll see any software companies listing.

The local market is Israel is also performing well at the moment. In 2004 there was IPO activity on the local exchange, and the market was quite open. In the last 16 months, the market raised more than 6 billion in Israeli Shekels which is a huge amount of money. This activity has replaced a lot of other financing processes.

### Have Sarbanes-Oxley regulations decreased the desire of Israeli companies to list in the US?

The requirements have definitely been raised, and the costs increased to close to $1 million per year. As a result of this, you need to be a very solid and strong company in order to go to NASDAQ. You can't do this with just a few million per quarter, you need to be a company with $8-$10 million per quarter in order to reach $200 million in market cap. This means that there is a big difference in the companies going to NASDAQ vs. Europe. The strongest companies go to the NASDAQ, because the NASDAQ is the most competitive market. These companies want research, they want investment banking, and they want to do a follow on.

Companies in the earlier stages may go to the UK, because there are fewer requirements, and venture capitalists may be pushing the company to an exit, because they want to raise money. You could potentially look at the UK as a stepping stone to getting to the US, although, historically, there have only been two examples of companies that moved from the UK to NASDAQ. Most of the companies that have listed in the UK have not perform as well as those on the NASDAQ. Maybe the UK market is one step before NASDAQ, but in London you definitely cannot raise the same amount of money as in the US. There are only a few companies that are good examples of those that raised a lot of money in the UK.

That said, the UK market provides good opportunities for smaller Israeli companies. For them, it's a great exit. The AIM market is an interesting market for Israeli companies. In the AIM pipeline at the moment, there are 10 Israeli companies. Definitely later on in the year, we will see more companies

going the AIM, than to the NASDAQ. Israel is a great place for technology, but the pipeline for the NASDAQ is smaller – just five or six companies this year.

There are also some Israeli companies going to Singapore. Small to medium sized companies that can't go to the US are looking for markets that will accept them, otherwise they will not be profitable enough to pay for required R&D and to be as aggressive in the markets as they need to be. Sometimes they have no other choice but to list on a foreign non-US market. As more markets open up, it's better for Israeli companies. There are four major exchanges that are marketing themselves heavily in Israel – the New York Stock Exchange, NASDAQ, AIM and the London Stock Exchange. All of the CEO's from these exchanges have visited Israel, and they are also holding conferences for Israeli companies that are looking to IPO, to convince them to list on their exchange. Historically, aside from Canada, Israel has been the country with the most foreign listed companies on the NASDAQ. The exchanges see big opportunity in Israel, and that's the reason that they're visiting.

### What are investors looking for in Israeli companies?

I think we should begin to answer this question by asking why US venture capitalists invest in Israeli companies. The main answer to this, is usually to bring a new chip to market. In the US, this costs approximately $40 million. In Israel, however, the average price to bring a chip to market is approximately $20 million. An IPO can be much more successful, with less investment.

Israeli companies also have a very high quality of management and it is necessary to have this strong management to go public. In Israel, many good management teams are grown, and often a year or so after executing an M&A, good managers will leave an acquired company and start a new company. Venture capitalists are eager to invest in these new companies with experienced managers, because the management knows the market, they have strong relationships, excellent execution, a good network, they know the clients, they know their needs and they can exit very quickly. Looking at the last six months, we've had an amazing number of M&As in Israel. 12 months from today, those managers will be back trying to raise money from venture capitalists again. Israeli companies have a lot of knowledge and are very tight with expenses. The management needs to be very strong today, because, the trends in technology are shifting so quickly. For managers, if you don't know how to ride the wave, and follow the market and the customers, you'll fall behind the market.

Israeli companies also have a discount advantage when going to NASDAQ, and this gives them a good competitive advantage. Every foreign company that goes to the NASDAQ has a 16 percent discount, compared to their comparables in the US market. So, they have an additional 16 percent in order to be equal to their comparables in the market.

### Has dual tracking of the IPO and M&A process been a trend in Israel?

It's tricky to push the M&A route when the company is in the IPO process. In Israel we don't see dual tracking of IPO and M&A very often, although there have been some cases. In the US market, however, we are increasingly seeing companies that don't want their competitors to be listed, actually acquiring their competitors before they go public. Acquiring companies are paying the same price as the IPO range in order to eliminate the possibility that their competitor will go public.

# Where to List? – A Global Decision

**The choice of an exchange to list on is key for companies planning an IPO, and not all markets are the same, nor is one stock market appropriate for all types of companies. Exchanges vary by listing requirements, maintenance standards, rules and regulations, reporting and settlement. Companies should chose a stock market that matches their goals in going public, and which will most effectively enhance the attractiveness of their stock to investors.**

There are several key considerations to take into account when considering the exchange that is right for you as a company. Quantitative considerations include liquidity, the cost of capital and compliance costs. Qualitative considerations include the location of major investors, the ability for customers and employees to invest, and several other intangible considerations such as being branded as listed on a particular exchange or in a particular country. Increasingly companies are looking beyond their own borders, and intial public offering activity is becoming much more global. In 2004, the top 20 IPOs were completed on 10 separate exchanges, 14 out of 20 largest IPOs listed outside the US, and 16 out of 20 largest IPOs were domiciled outside the US.

In general, around the world, there has recently been significant regulatory attention by the EU, the SEC, and others, and this is important to take into account when deciding where to list. The US markets are the deepest and most liquid in the world, and have a major emphasis on transparency. Along with this come high costs of compliance, as a result of Sarbanes-Oxley Act requirements and internal control reporting – Section 404/PCAOB 2. The landscape in the US has changed dramatically in the last few years, as a result of corporate scandals, driving the implementation of stricter reporting standards as set out by the Sarbanes-Oxley Act. This has put some companies off listing in the US, while others see the stricter regulations as an advantage in selling themselves to investors. In Europe, the EU requirement for use of International Financial Reporting Standards (IFRS) in 2005 was a defining moment in globalization, and many non EU countries are also adopting the standard. The use of IFRS is on the rise now – especially in developing markets.

## Decision Criteria for Selecting an Exchange

**Quantitative considerations**

- Liquidity
- Cost of capital
- Compliance costs

**Qualitative considerations**

- Location of major investors
- Ability for customers and employees to invest
- Intangible considerations.

In 2004 there was a lot of competition among the world's stock exchanges, and it was a buyer's market as exchanges competed like never before. Charlotte Croswell, NASDAQ's Regional Head for Europe, the Middle East and Africa recently ran into the New York Stock Exchange representative on the same flight to Russia, while at a Shenzhen conference in October 2004, Stuart Patterson, NASDAQ's regional head for the Asia Pacific Region, also found he had company. Alongside NASDAQ, representatives from no less than seven other stock exchanges – Korea, Tokyo, Hong Kong, Singapore, London, Toronto and Amex – were jostling fiercely to capture the next round of new IPO business from China.

This competition, says Patterson, represents 'a massive paradigm shift' for the world's stock exchanges. In the past, the order was relatively settled. A large company would list in its home

base, and possibly also in London, New York or Tokyo, depending on the spread of its international business. The US was a must for the biggest firms. Smaller companies would choose the domestic junior market, if there was one. Mobility was low. Says Patterson: 'The old assumption was that new business would naturally flow to the US exchanges without a significant and ongoing marketing and sales effort in place.'

Not any more. Globalization, regulatory change and growth in demand from vigorous new markets have spawned a host of innovative new products and services. As the choice of platform grows, traditional allegiances are breaking down. In a buyer's market – 'good for companies,' says Patterson – exchanges have to become sharper, more specialized, and sell themselves harder.

Even New York has to make its case. Partly because of compliance costs, but also because of the existence of eager alternatives, a US listing is no longer a foregone conclusion for even the largest foreign company unless there is a strong business need for American visibility. So US exchanges are underlining instead, that in the right circumstances they offer higher valuations – partly because investors better understand tech businesses, but also because of the 'confidence premium' resulting from demonstrating compliance with the world's most stringent regulatory regime.

The governance card touches a chord even in emerging markets, where transparency levels and governance standards are much lower. 'There is no race to the bottom,' insists Ernst & Young's Alexander Mackintosh in Hong Kong. 'That is not a winning argument in Asia.'

This is certainly NASDAQ's view. Encouraged by the fact that nine Chinese companies listed in the US last year, it aims to recruit 170 foreign companies, chiefly Chinese, Indian, Russian and Israeli, in the next few years, expanding its international portfolio by half.

At the other end of the scale, one of the success stories of 2004 was London's second market, AIM. AIM accounted for the vast bulk of the UK's 192 listings last year, the largest number of transactions for any country. AIM's advantages are small size, less stringent regulations and speed. Where an accelerated IPO can be done in a matter of weeks, as in several cases last year, an AIM listing becomes a viable alternative to late-stage venture capital or private equity. 'It's a fine line between tightening regulation to the point where there's no differentiation from the main market and relaxing entry requirements so that companies fall over and the market loses its reputation,' says Wilkinson. 'So far it has managed the balancing act rather well.' Like NASDAQ, AIM is successfully marketing the formula abroad, in 2004 picking up IPOs from Russian, Israeli and South African companies, among others.

Between these two extremes, other exchanges are striving to develop a viable niche. Hong Kong and Singapore are prospering on the back of the Chinese boom. Toronto is making a play for mining. Some of the most intriguing activity is in continental Europe. Germany is adopting stringent Sarbanes-Oxley type rules of its own. So is France, which in addition is simultaneously streamlining its market structures and launching a new, AIM-type junior market. Both these initiatives risk being superceded if long-mooted consolidation of French, German and London exchanges finally takes place. Consolidation raises a number of tricky issues. But a fully fledged Euro bourse could take international IPO competition to a new and higher level.

# A View from NASDAQ

## Charlotte Crosswell – NASDAQ Regional Head for Europe, the Middle East and Africa

### What were the key IPO trends in Europe, the Middle East and Africa in 2004?

Our busiest market is certainly the emerging market. I spend most of my time in Russia, Israel, and South Africa. I also spend time in Western Europe, but there are not a lot of Western European companies going to the US capital markets at the moment – we're talking about one or two listings here and there, and a few in the pipeline. In 2004 we predominantly saw companies coming in from Israel. Israeli companies have been listing in the US for a considerable amount of time, they are well understood in the market, and therefore get higher valuations. What we are not seeing anymore, is the larger companies that used to list in the US as a form of prestige. This can partly be put down to Sarbanes-Oxley, but more so, it's the fact that global markets are opening up, and these companies can come to the US, but wouldn't necessarily be able to attract US capital.

Some of the CIS countries, Russia, Ukraine and Kazakhstan will probably have listings eighteen months to two years out. It's not going to happen overnight, because people are concerned about transparency issues in Russia. We just signed a listing memorandum with the Russian exchanges. It's important for us to work with them as Russian companies have to be listed locally, before they can access international markets.

In South Africa, the Rand is strong at the moment, and the economy is growing. As a result of this there are more companies looking at IPOs. South African companies are less likely to list in London because of exchange controls. These are controls within the country on where a company gets listed and where it re-incorporates. It is necessary to get permission to list, and companies are more likely to get approval for a US listing because the exchange controls to the US are less, and a listing in the US is seen as less of a threat to their market.

### What's running through the minds of CEOs and the board as they decide whether to list on the US or not?

It really depends on the specific company. Companies will list in the US if they see that they're getting a higher valuation as a result, if they have a better chance of raising the capital, or if they've got a lot of business in the US. By being listed in the US, a company may be trying to give more credibility to customers in the US. Otherwise they may list in London. The regulatory environment can also be an issue. Some people will pride themselves on being listed in the most regulated capital market to the world. There are also often other softer factors, such as having US investors in the company that a foreign listing wouldn't give enough comfort to. I'd say the decision to list in the US is more heavily based on the types of investors companies are trying to attract than a regulatory stance. Companies also want to know that they can get back to the market for further capital. You go to market with the future in mind as well, so this will always be a factor.

### What's your outlook for the next year, do you think foreign transaction activity will continue to increase?

We have stated that the international business is very important in our corporate structure. We very much see it as a growth

opportunity for NASDAQ. 10 percent of the companies listed on NASDAQ at the moment are international. We have 10 people in London, and four people in Asia. In 2005, I think activity will predominantly be in the emerging markets. At the moment I'm doing a lot of business in Greece. Shipping is huge at the moment, and the Shipping Community is now getting listed.

Things have changed from 20 years ago when every company had to go and get a US listing, or even get a London listing or a Paris listing, or all of these. You don't find that anymore. We used to have NASDAQ Europe, NASDAQ Japan, NASDAQ Canada and so forth. Now the focus is on the US business. If you take Europe for example, you probably need consolidation, rather than any more stock exchanges there.

### What are investors looking for in emerging markets companies listing in the US?

A good growth story is important. Investors want to know what the future holds for them. A company considering a listing in the US needs to have a reason for wanting to be there. Investors want to know why they are in the US and why they need capital. For example, we've seen a lot of companies in Scandinavia delisting because they are household names in Scandinavia who just didn't need to be listed in the US anymore. Strong management also always comes up time and time again. And how well the company presents themselves is also important. The key though, is the business they're doing, and the growth prospects of it.

## Stuart Patterson – NASDAQ Regional Head for the Asia-Pacific Region

### What were the key IPO trends in the Asia-Pacific region?

Our entire book of business out of the Asia-Pacific region for 2004 was from China, primarily in wireless communications or the IT sector. In 2005 so far, four Asia-Pacific companies have listed on the NASDAQ – from Korea, Australia and China. In 2005, we'll see the evolution of the Chinese portfolio away from this very heavy tech weighting, to include more multi-type companies. The companies that are coming out of China and are looking to list on NASDAQ are often away from that traditional tech space that we tend to dominate. One of the challenges we have at NASDAQ is the 'tech heavy' label that's put on us. Only 30 percent of NASDAQ's pool is from the tech sector and the rest is fairly well balanced among most of the other sectors.

One of the interesting trends out of China at the moment, that will really evolve this year is the reverse merger concept. This is when a Chinese company purchases a shell on the US bulletin board, and then transfers all the company's assets into that shell, and upgrades from the bulletin board to the national market, or the small cap market. The benefit of a reverse merger over an IPO is that it's easier from a legal perspective, but companies still have to meet the compliance standards,

# A View from NASDAQ continued

and they become a US company as opposed to remaining a Chinese company. Reverse mergers are being marketed heavily as a strategy whereby you can get your US listing, get your valuation, and get credibility without having to go through the large investment banks.

A further trend we're seeing is lot of interest in the pharma and biotech sectors coming out of Australia, as Biotech sector valuations are perceived to be much better understood in the US. These Australian biotech companies are choosing to establish ADR programs in the US and use the platform here to raise visibility, but also to drive valuation. We have been charged with increasing NASDAQ's international portfolio by 50 percent in the next three to five years. We see a majority of that new business coming out of four countries – Russia, Israel, India and China.

### What are the key reasons that companies will come to the US to list?

50 percent of the world's invested capital is in the US. It's probably the easiest place to come to raise capital. There is a huge retail investor base here, and there is also the ability to diversify your investor base, which is a strong selling point. Other companies are using the US listing to gain global visibility and credibility. Infosys is a great example, today they are perceived as a global company and brand as opposed to simply an Indian tech company. Another trend coming out of countries such as India, is the establishment of a US ADR program, in order to use the currency for acquisition. Valuations are a further reason to list in the US. This is driven, not only by the US investor understanding the business, but also by the risk premium that is built into a listing in Hong Kong or London or on the AIM market, where the regulatory environment isn't quite as stiff. There is a huge amount of US investor interest in growth areas such as India and China at the moment. The US market has been moving sideways for the last 12 months, and the anticipation is that it will continue to do that for the next 12 months.

### Do you have any advice for companies from the Asia-Pacific region that are considering listing in the US?

In order to decide whether to do a foreign listing or not, you should start by defining what your strategy is, and determine if an international listing fits into that strategy. You need to be committed to certain protocols or expectations when you list in the US. Work begins with the first day of trading. You have to be prepared to maintain an ongoing and continual dialogue with investors, and company senior management should meet with them on a regular basis. Investors want points of contact, and they want answers to their questions pretty quickly. The performance of the company is half of the equation, and the other half is confidence in the management team to execute the strategy. You want the visibility and you want the liquidity, because that will help encourage investors and analyst coverage.

# The Venture Capital Perspective

**In 2004, IPO activity by venture backed companies increased around the world for the first time since 2000, resting at around 1998 levels. Activity increased in both the traditional venture capital hotbeds such as the US and Europe, and also in emerging markets such as China. In the US, VentureSource reports $5.0 billion was raised in 67 IPOs in 2004, up from 22 IPOs in 2003. European IPO activity also increased with €0.7 billion raised in 34 venture backed deals, compared with just 9 deals in 2003. China had 39 IPOs raising $0.6 billion according to Zero2IPO, a Chinese venture capital data provider.**

In the first quarter of 2005, however, following the trend of the overall IPO market, venture capital backed IPO activity dropped off again, to the lowest levels in a year. In the US there were 8 IPOs raising $0.4 billion, while in Europe there were 12 IPOs raising  0.4 billion. There were several challenges for venture backed companies going public in 2004, such as a general demand for larger deals, particularly private equity backed deals, and regulatory compliance particularly as a result of the Sarbanes-Oxley act in the United States. This legislation affects all companies going public in the US, and with the NASDAQ being the traditional market for venture backed companies listing, this affected companies around the world.

Implemented two years ago, the Sarbanes-Oxley act greatly increases the costs of going public, and these have proven too much for some venture backed companies to bear. Mergers and Acquisitions are becoming more common and given the ample availability of M&A activity, it is becoming more difficult for small companies to sell their shares to the public. The abundance of private equity has also boosted the number of companies dual tracking their exit, resulting in a higher appetite for M&A. According to the VentureOne liquidity report, 79 US venture-backed companies were acquired in the first quarter of 2005, for $7.07 billion. This is the highest amount paid for venture-backed M&A in four years. An M&A is less burdensome than an IPO, and still produces a good return. IPOs have traditionally been the exit of choice for growing companies, and their Venture Capital investors, but could this be changing?

Below is a conversation about the challenges venture backed companies face today in going public and an outlook for 2005.

## Paul Deninger – Chairman, Broadview, a Division of Jeffries

### What were the key venture backed IPO trends in 2004?

If you look at the deals that were done in the US in 2004, the companies going public got smaller over the course of the year. In the first half of the year, the trailing 12-month revenue for the companies going public was about $90 million. At year-end, it was less than $50 million, and I worry about that. I think the IPO market has changed forever in the sense that it takes a larger company to be a sustainable public company. I worry when $25 million to $50 million revenue tech companies go public. At that level they may have trouble becoming sustainable public companies because of the quarterly reporting requirements. There is just too little room for error in any quarter.

# The Venture Capital Perspective

## continued

Yes, it's true. In order to be a successful public company you must first IPO. But rather than focusing on the success of the IPO event itself, you should really be focusing on what happens 6 months, 12 months, 24 months, 36 months down the road. The track record here is pretty poor, because often there is pressure to get companies out too early. As a consequence, their business models are not yet fully mature, and if they miss a quarter, they often take a long time to recover.

Historically, about 50 percent of all IPOs trade below their IPO value within 12 months 18 months ago when the tech markets opened, we saw a very high focus on quality. The companies going public had pretty substantial revenues, and they were virtually all profitable. In the second half of '04, 30 percent of companies that listed were below $25 million and over 30 percent were unprofitable. I just think that's a disaster.

### What's the outlook for venture backed IPOs in 2005?

I am reasonably optimistic. There are a handful of companies that meet with my criteria for a really successful IPO - that is to say they have, or are approaching, revenue of $100 million and are profitable and growing. My view for '05 and '06 is that the venture capital community is getting the message that companies need to have that kind of scale and sustainability in order to be successful public companies. Last year there were by our count, 93 tech IPOs in the US and Western Europe, and I don't expect that number to jump dramatically. In the first quarter this year we had 10 IPOs in the U.S. versus 60 for all of last year, so we are actually little behind where we were at that time last year. But the companies that are going out this year are relatively high quality.

### What impact have Sarbanes-Oxley regulations had on venture backed IPOs?

It's substantial, there's no doubt about it. Sarbanes-Oxley has changed many CEO's mindsets. It used to be that a CEO would look forward to an IPO. It was an exciting concept. Nobody I know who is going through Sarbanes-Oxley right now would describe it as exciting, and a lot of people are very concerned about it both in terms of the absolute cost, the amount of time and the potential risk. It's a tax on the P&L and it's a regressive tax that affects small companies more. If a company that is doing $50 million in revenue spends $2 million on Sarbanes-Oxley compliance and a company like IBM spends only $25 million, is that fair? The other impact is the literal financial costs. If you are a $25 million revenue company doing 10 percent pre-tax, your entire pre-tax profit could be consumed in Sarbanes-Oxley compliance in year one. It's going to cost you $2.5 million, and after that between $1-$1.5 in annual costs. For a $100 million revenue company doing $10 million pre-tax, a 10 to 15 percent hit on that pre-tax income is a big number. It's a tax on market cap, because it's a totally non-productive expense that affects shareholder value. If you are a 25 P/E company, a million dollars in cost is $25 million in market cap lost.

Depending on the enterprise that I was running, if I were the CEO and I had a choice between getting 100 percent liquidity at say, a $400 million M&A valuation, versus an IPO valuation of say, $500 million, I am not sure the valuation difference would be enough to suggest an IPO is a great idea in the post-SarbOx world.

While venture capitalists don't often stay on public company boards for long, some stay for a year or two. Sarbanes-Oxley is encouraging venture capitalists to get off sooner. So, I think it's having a substantial impact there as well.

Finally, I believe that Sarbanes-Oxley is discouraging European companies from listing on NASDAQ. We are starting to hear from more European companies that are considering going public that they are thinking less about NASDAQ and more about LSE or one of the other European exchanges. The Asian markets are not as mature as European markets are and so they are not affected in the same way. Asian companies, Chinese companies, in particular, are still seeking the NASDAQ listing. But the LSE and NASDAQ have a similar investor bases in London and the US.

### What are investors currently looking for in a Venture backed company that's about to IPO?

The number one thing that they are looking for is growth, and that is really hard to get these days. The IT industry, as an industry segment, is growing in single digits. If you look at the big cap tech companies, such as Cisco, Microsoft, they are no longer high growth stocks. There are a lot of dimensions to growth. Specifically, investors are looking for access to large markets undergoing change or new emerging markets that are going to be large. They are looking for access to key geographic markets like China. There are a lot of dimensions to the growth angle.

The second thing that public investors look for is sustainability and relative predictability in the business. They are really sick and tired of the negative surprises and they really want some level of predictability in earnings.

### Do you have any comments or advice for venture backed companies that are currently planning an IPO?

My number one piece of advice is to be patient. Don't rush to the IPO. A company should not do an IPO when they minimally meet the acceptable standards to go public. Most companies don't use the capital that they raise when they go public anyway. The real reason they go public is to crystallize their value, get currency to do acquisitions, and show their employees and their investors a financial return for their efforts. A better model is to go public when your business is ready to be public, and ready to sustain itself as a public company. More than 50 percent of all the companies on NASDAQ have a market cap of 250 million or less. This is not a good place to be. We call it "Small Cap Hell."

Second, when you are deciding on a banker to take you public, make sure the banker is going to be there for you for the long haul. Don't fall in love with someone who is not really in love with you. Most companies believe they need to have one of the big investment banks as lead to go public successfully. They don't, and here's the dirty secret: The big banks have no interest in banking $500 million market cap companies in the long term. They have two interests in taking a venture backed company public. First, they want the fee for taking the company public and second, they want the option that the company will be the one of the one or two in 10 that gets to $1.5b-$2.0b in market cap over the subsequent two years. You've got to anticipate that the probability is you are going to be a sub $1 billion market cap company for some time, and you need to hire a banker who is going to care about you at that level.

# IFRS Conversion: The Role of the Board

**The biggest governance challenge facing most of the 7,000 listed companies in the European Union this year is the conversion to International Financial Reporting Standards (IFRS). Although the EC Regulation requires IFRS to be applied for the first time in companies' 2005 full year financial statements, most European listed companies will either be required to do so by national securities regulators or will choose to apply IFRS in their quarterly or half year 2005 reports. Although many companies are now well advanced in their preparation for conversion to IFRS, some are not and are still laboring under the illusion that IFRS is not much different from local GAAP.**

**Among the key issues for boards is how to monitor the quality and integrity of companies' internal conversion process, and how to ensure that the communication to investors of the impact of IFRS on reported results does not have an adverse share price impact that is not justified by the underlying facts.**

## Major task

The change to IFRS is fundamental for countries whose national accounting standards are not based on a balance sheet fair value model of accounting. For countries whose national accounting standards are, to an extent, based on this model, the change will nevertheless be far reaching. This is because the new and revised accounting standards issued by the International Accounting Standards Board (IASB) are far more complex and detailed than those they have replaced. Since November 2003, the IASB has issued over 3,000 pages of standards and guidance – three times as long as "War and Peace."

The fact that many of the standards are new, and the interpretations and guidance on them are still evolving, further complicates the matter and increases the implementation risk, while the increased earnings and equity volatility that arises from the IASB's asset/liability fair value approach increases the investor relations risk.

## Who is responsible?

Although no board would deny that it has ultimate responsibility for the quality and integrity of the IFRS conversion and the way in which its impact is communicated to the capital markets, our experience is that there are very different views among boards and audit committees about how this responsibility should be discharged.

At one extreme, there is a strongly expressed view that IFRS conversion is essentially a management challenge, rather than a task for the board. In a recent meeting with audit committee chairs from some major European companies, one chairperson said, "Each business must organize itself appropriately. We are interested in outputs, not the process of getting there."

The more commonly held view, however, is that audit committees must understand the rationale behind management decisions for selecting particular accounting policies, in addition to understanding and monitoring the process. As one chairperson put it, "The accounting change is huge. Significant resource is needed. Internal controls need to stand up to these new standards." Another explained, "As audit committee chair, I have been interested in this as a communication process. There is also a behavioural component about how to manage the company differently."

## IFRS Conversion is far more than a technical accounting exercise

Clearly, it is important for the board to be confident that the finance personnel in the group have an appropriate degree of

IFRS financial competence, that appropriate guidance on the application of the company's IFRS accounting policies is made available, and that the IFRS conversion project is well planned and managed. One useful approach to assess preparedness is to benchmark the organization's current IFRS status with companies of a similar size or in a similar industry. However, the responsibility of board members goes beyond monitoring the IFRS conversion process.

Conversion is not just a technical accounting exercise because it may have significant impacts on the way companies operate and how IFRS may affect transaction structures. For example:

- Sales contract pricing may include embedded derivatives that need to be accounted for separately.
- Information systems must be able to collect data to meet the new accounting recognition and measurement requirements in relation to revenue recognition on long term contracts or components of fixed assets previously regarded as single assets.
- Treasury operations and systems may be affected by the highly prescriptive IFRS hedge accounting rules. Far greater use of valuation models, together with the data required and the assumptions to be employed, will be required in order to apply IFRS.
- Pensions, share-based payments, asset impairment, and financial instruments will all require the use of models and assumptions about future performance and cash flows.
- Capital instruments previously classified as equity may have to be classified as debt under IFRS (or bifurcated with an element being treated as debt and the balance as equity), thereby affecting gearing.

Of great importance for senior management and boards, the accounting recognition and measurement changes brought about by IFRS will affect the measures used by companies and investors to assess the performance of companies and, as a consequence, may lead to a realignment of management's performance targets and performance-related remuneration. Boards will have to assess the impact of the changes resulting from IFRS on dividend policy.

Boards need to understand the significance of these issues in order to assure themselves that management has addressed them properly. For example, boards or their audit committees need to be able to assess the appropriateness of the assumptions used by management to value pension scheme assets or to determine whether assets are impaired, as quite small adjustments to the underlying assumptions may give very different results.

It is therefore essential that those charged with governance should develop a good understanding of the organization's approach to conversion and receive regular progress reports and summaries of key issues.

### Can boards handle it?

Boards need to consider their own competence, including whether they have, not just a degree of financial and accounting expertise, but sufficient awareness of IFRS to play the appropriate role in questioning the choices of management. For example:

- Can the group challenge management's choice of accounting policies and the robustness of the transition process?
- Can they evaluate the impact of IFRS on areas of accounting involving significant levels of judgment?

# IFRS Conversion: The Role of the Board continued

- Can they assess the clarity and compliance of disclosures and explanations relating to IFRS implementation?

There may well be a need for the board to consider additional focused training to address these issues. Audit committees should ensure that the company's auditors are involved throughout the conversion process and request regular reports from them giving their view of the quality, integrity, and timeliness of the process.

## Stakeholder communication is key

One of the major challenges facing boards and management is the effective communication of necessary changes to shareholders. As one audit committee chair commented, "IFRS is an exercise in communication, not technical accounting. …Shareholders have never really understood what goes on in the accounting engine." The fact that most analysts do not appear to be equipped to deal with the changes in accounting makes it particularly important that the changes brought about by IFRS are explained clearly, both in quantitative and qualitative terms. As well as the content of the communication, timing is a particularly crucial question on which the board needs to be clear. Many large groups have published their 2004 results under IFRS either at the same time, or shortly after, publishing their results under their national GAAP, in order to reduce the possibility of negative market reaction and to ensure that discussions focus on the underlying performance, and not the accounting cosmetics.

## Time is running out

Management in every company will be responsible for the operational planning and implementation of the IFRS transition, but ultimate responsibility lies with those charged with governance. Time is fast running out for boards which have not so far played their full role.

## What is the Status of Your Conversion?

**Top Quartile**

- Conversion is at an advanced stage and all IFRS decisions taken
- IFRS processes and procedures are in place
- Systems modifications have been made
- Rewriting of the group reporting manual is complete
- Training is in process on a global basis, including audit committee familiarization
- Restatement of opening 2004 balance sheet is complete and restatement of 2004 results is well progressed
- Auditors have reviewed IFRS accounting policies and issues arising have been resolved
- Detailed plan prepared of timing and content of market communications

**Bottom Quartile**

- Comprehensive IFRS impact study has not been completed or implementation had not yet commenced
- The amount of work involved and the resources needed have been underestimated
- Accounting staff are not being trained
- Little or nor involvement of auditors
- Board or audit committee are not fully engaged or briefed
- No clear plan on market communication

## Questions for Boards and Audit Committee Members

**Questions to Ask Yourself**

- Have you equipped yourself to challenge management on IFRS issues?
- What is your new frame of reference for making those challenges?
- What training do you require to enable you to provide an appropriate degree of input?
- How well do you understand how your company will be affected and to what extent?
- Are you familiar with the nature, content, and timing of the company’s planned IFRS communications with the market?
- How can IFRS financial statements provide information that better enables you to evaluate management performance, forecast value, and make sound investment decisions?
- Does the company’s performance-related remuneration structure need to be redefined?
- Could the change to IFRS require a change in dividend policy?

**Questions to Ask Management**

- What are the plans for training finance staff and the board?
- How is change in processes and systems being managed?
- What should be communicated? When does the market need the information? How could it be interpreted?
- What is the planned approach to educating analysts and major investors?
- How will the analysts understand our underlying performance and maintainable earnings?
- Will IFRS have any impact on our credit rating or debt covenants?
- To what extent will we make greater use of pro forma reporting and non-GAAP measures in explaining the company’s performance?
- To what extent will we need to redefine our business segments and rethink the basis on which we report segment information?

# Report Contributors

**Any Antola**
Audit Partner and IPO Retreat Leader, Ernst & Young France

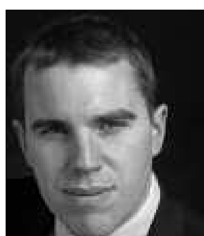
**Graeme Browning**
Partner, Transaction Advisory Services, Ernst & Young Australia

**Nicole Buisson**
Assistant Director and IPO Survey Manager, Strategic Growth Markets, Ernst & Young Global

**Charlotte Crosswell**
Regional Head for Europe, the Middle East and Africa, NASDAQ

**Jackson Day**
Global Director, Capital Markets, Ernst & Young Global

**Cully Davis**
Director, West Coast Technology and Healthcare, Credit Suisse First Boston


**Sam Dean**
Co-head of European Equities, Deutsche Bank

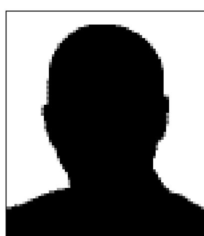
**Paul Deninger**
Chairman, Broadview, a Division of Jeffries

**Gregory K. Ericksen**
Vice Chairman of Strategic Growth Markets, Ernst & Young Global

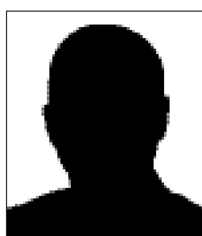
**Gil Forer**
Global Director – Venture Capital Advisory Group, Ernst & Young Global

**Mark Jarvis**
Managing Partner – Client Service and Accounts, Ernst & Young CIS

**Hiroshi Karasawa**
Partner, Ernst & Young Shin Nihon Japan


**Veniamin Kofman**
Internal IPO Process Leader, Sistema

**Alexander Mackintosh**
International Director of Capital Markets, Ernst & Young Asia

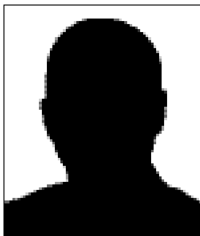

**Owen Mellard**
Senior Researcher, Ernst & Young Center for Business Knowledge, UK

**Rajiv Memani**
CEO and Country Managing Partner, Ernst & Young India

**Joe Muscat**
Partner and US IPO Retreat Chairman, Ernst & Young US

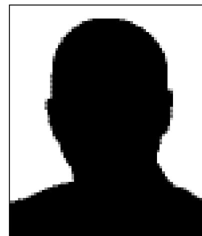
**Stuart Patterson**
Regional Head for the Asia Pacific Region, NASDAQ

**Tim Pennington**
CFO, Hutchison Telecom International



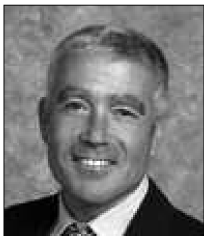
**Mark Pols**
China Office, Piper Jaffray

**Julie Teigland**
Partner Strategic Growth Markets, Ernst & Young Germany



**Robert Topfer**
Internal IPO Team Leader, Babcock & Brown

**David Wilkinson**
Partner and IPO Leader, Ernst & Young United Kingdom



**Zamir Bar-Zion**
Managing Director, Piper Jaffray Israel

This publication has been carefully prepared but it necessarily contains information in summary form and is therefore intended for general guidance only, and is not intended to be a substitute for detailed research or the exercise of professional judgment. Ernst & Young can accept no responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

ERNST & YOUNG

www.ey.com

Copyright © 2005 EYGM Limited.
All Rights Reserved.
EYG No. CY0001

10303 04/05 Designed by Living Designs, London.