Should You Buy Initial Public Offerings (IPOS)?

A CSS INVESTMENTS GUIDE TO INVESTING

INTRODUCING

A SHORT GUIDE TO IPOS

The rebound in equity markets since the global financial crisis has encouraged a number of companies to come to the market looking to raise equity via an initial public offering (IPOs). It offers investors the chance to be amongst the first to buy shares in company, though it is not without some unique risks to your capital.

In this short guide, I will explain what an IPO is with the aim to help you understand the benefits and drawbacks of buying these kinds of investments. Please note from the beginning that IPOs carry a higher level of risk.

Anyone considering buying into an IPO should **always read the company Prospectus** first and consider seeking professional advice to determine whether it is the right option for your circumstances.

COLLINS SARRI STATHAM
INVESTMENTS

WHAT IS AN INITIAL PUBLIC OFFERING?

An IPO is the first sale of shares by a private company to the public. IPOs are often issued by companies seeking the capital to expand, repay debt, or make acquisitions, but can also be done by large privately owned companies looking to become publicly traded.

In an IPO, the issuer obtains the assistance of an underwriting firm who carries the risk of the IPO, which helps it determine what type of security to issue (common or preferred), the best offering price and the time to bring it to market. *

Companies go public for a number of reasons. Companies may require capital to fund investments in projects, infrastructure or to make external acquisitions. Issuing shares to public markets is often a cheaper alternative to obtaining capital compared to private routes, such as venture capital, but is usually more expensive than debt.

Famous examples of IPOs include British Telecom (BT) and British Gas over a couple of decades ago, or more recently Royal Mail and TSB.

There is also usually a lot of publicity around an IPO, which helps with creating awareness for the company, both with investors but also the customers that it serves, it's suppliers and other stakeholders.

*(Source: www.investopedia.com/terms/i/ipo.asp#ixzz3bQC9VL00).

There are of course **risks** when investing in an IPO. We'll cover some of the most common below:

RISK FACTORS WHEN INVESTING IN AN IPO

NEW TO MARKET

It is difficult to predict what will happen to a new IPO over the first few trading sessions, and longer term it is even more difficult. This is due to there being very little or no historical data related to the company in question.
In the short term the IPO performance will depend on whether IPO demand for shares exceeded the allotment of shares, i.e. if there is demand to top up holdings

VALUATION DIFFICULTIES

There may be differences between the way the IPO manager has valued the company and investors valuations. This means that new IPOs can be difficult to value. There can be limited operating and financial history for the company, so getting hold of a copy of the Prospectus and looking for the main risks and company results is an important step, as the Prospectus will identify risk factors under material contracts/risk factors sections.
It's not uncommon for a company going through the IPO processes to be going through a transition, which can mean that past fundamentals may be a poor indicator of future expectations for growth and income.

FAIR PRICING

When buying in an IPO you are getting the price the Board have decided is a good selling price, which may be above the market view.
The process of going public is designed to minimize these information problems, but it is not perfect. It is hard to know as an investor if you are getting a fair price when buying shares in an IPO, and it is rare that you know the share price before you buy. This is especially difficult for the private investor, who is at a further disadvantage due to the news sources that they have available to them not being the most up-to-date or quick to adjust.

LEVEL OF DEMAND

The level of demand in the market is important for any successful IPO, both for you as the investor and for the issuing company. High demand means you may not get the full allocation that you wanted, or even nothing at all. If there is low demand, you'll likely get your full allocation, but the price is more likely to fall once the company is listed on the stock market.

LOSS OF CAPITAL INVESTED

This means it is very possible that you could get back less than you invest. Of course this is true for any investments, though with the added uncertainty around historical data and information if you're questioning whether an IPO is right for you or your current investment goals, you would be wise to seek advice from a professional.

UNDERSTANDING THE IPO PROCESS

There are a series of steps that a pre-public firm needs to complete before going public.

1 INTENTION TO FLOAT

A company makes an announcement that it will be floating on the market.

2 PRICE RANGE AND PROSPECTUS ANNOUNCED

This is where the price of the share is set in a range eg. 330-360 and as you get closer to the IPO the range starts to narrow.

3 APPLICATIONS OPEN – OFFER PERIOD

This is where you send in a application form to the company expressing your interest to receive shares and how much you want. They will they reply telling you if you have been successful or not.

4 FINAL PRICING AND ALLOCATION

The price of the share is now set and the amount of shares in issue is to be announced and allocated to investors.

5 TRADING

Firstly, the shares will trade in the grey (conditional) market before it will then go onto the open market. You will find that in the first month of the trading the shares will be less volatile than the month after and that would be due the lead manager supporting the share issue and not allowing the share price to fluctuate wildly.

SHOULD YOU INVEST INTO AN IPO?

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Conclusion: You should only invest into an IPO if you feel that you understand the risks of doing so or receive suitable advice that is in-line with your investment objectives. Please do make contact with our broking team to discuss IPO's in full.

Enquire

*(Source: www.investopedia.com/terms/i/ipo.asp#ixzz3bQC9VL00).

FAQS

WHAT ARE THE COSTS?
As the Issuer in an IPO pays broker charges, there aren't usually commissions to pay on the initial IPO purchase and there is no stamp duty to pay.

HOW MANY SHARES CAN I APPLY FOR?
You can apply for as much as you like however that doesn't mean you will get that much (look back on Royal mail which if you applied for £10k or more you didn't get any and anything under than you only for a £1k or so). The application process is usually handled by a third party, such as a bank or broker, not the company itself. You can usually find a list of nominated third parties in the Prospectus.

WHAT PRICE WILL I PAY FOR THE SHARES?
You will pay the price set prior to the release which will be announced only a day or two before the shares go onto the grey market

CAN I APPLY FOR AN IPO IN AN ISA OR SIPP?
That depends on your platform, but usually a SIPP Manager/trustee can apply for shares in an IPO. Speak to your provider for full information.

WHEN WILL THE OFFER OPEN AND CLOSE?
That will be set in the prospectus for the company issuing the IPO

WILL I ALWAYS GET SHARES IN AN IPO?
You will in most cases but it's not unheard of not to. Again like the royal mail IPO, some who applied for too much (because there was such a high demand for them) you won't get anything

WHO DECIDES THE ALLOCATION POLICY?
The lead manager of the IPO which is generally a bank

WHEN AND HOW WILL I FIND OUT IF I RECEIVE ANY SHARES?
The company will release its allocation to investors either on its website or to the market. Once the shares start trading they will appear on your account

WHAT HAPPENS TO MONEY NOT ALLOCATED TO SHARES?
They will only take money for the shares in your account. You apply for the shares and leave the money in your account to then be taken by the issuing company.

DO IPOS ALWAYS GO UP?
Not every time. Facebook for example fell right after the IPO and it took a year to return to the initial offer price. Supply and demand rules. An IPO will rise if demand exceeds supply due to under allocation.

WHAT IS CONDITIONAL DEALING?
That is where there are conditions on trading that share i.e. you will not be allowed to short the stock in conditional trading. The IPO manager often has an option post IPO to manage the stock. It can supply more shares to market, it can buy stock post IPO and use its underwriting option. It can exercise a greenshoe option to smooth out sharp price swings.

General Risk Warning

Trading in the products and services offered by Collins Sarri Statham Investments Ltd (CSS) may, result in losses as well as profits as the value of investments may go down as well as up. You may not get back the full amount you have invested. Any reference to past performance should not be viewed as an indication of any future performance. Investments held in overseas markets are subject to the effects of changes in exchange rates which will impact on the value of the underlying investment. Investments made in AIM and penny shares carry an increased risk due to the difficulty in creating a market in these shares. There may be a substantial difference in the buy and sell price. Leveraged products such as Contracts for Difference (CFDs), derivatives, commodities & Foreign Exchange (FX), carry a higher risk to your capital. They can lose their value rapidly and you may lose substantially more than your initial investment.

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