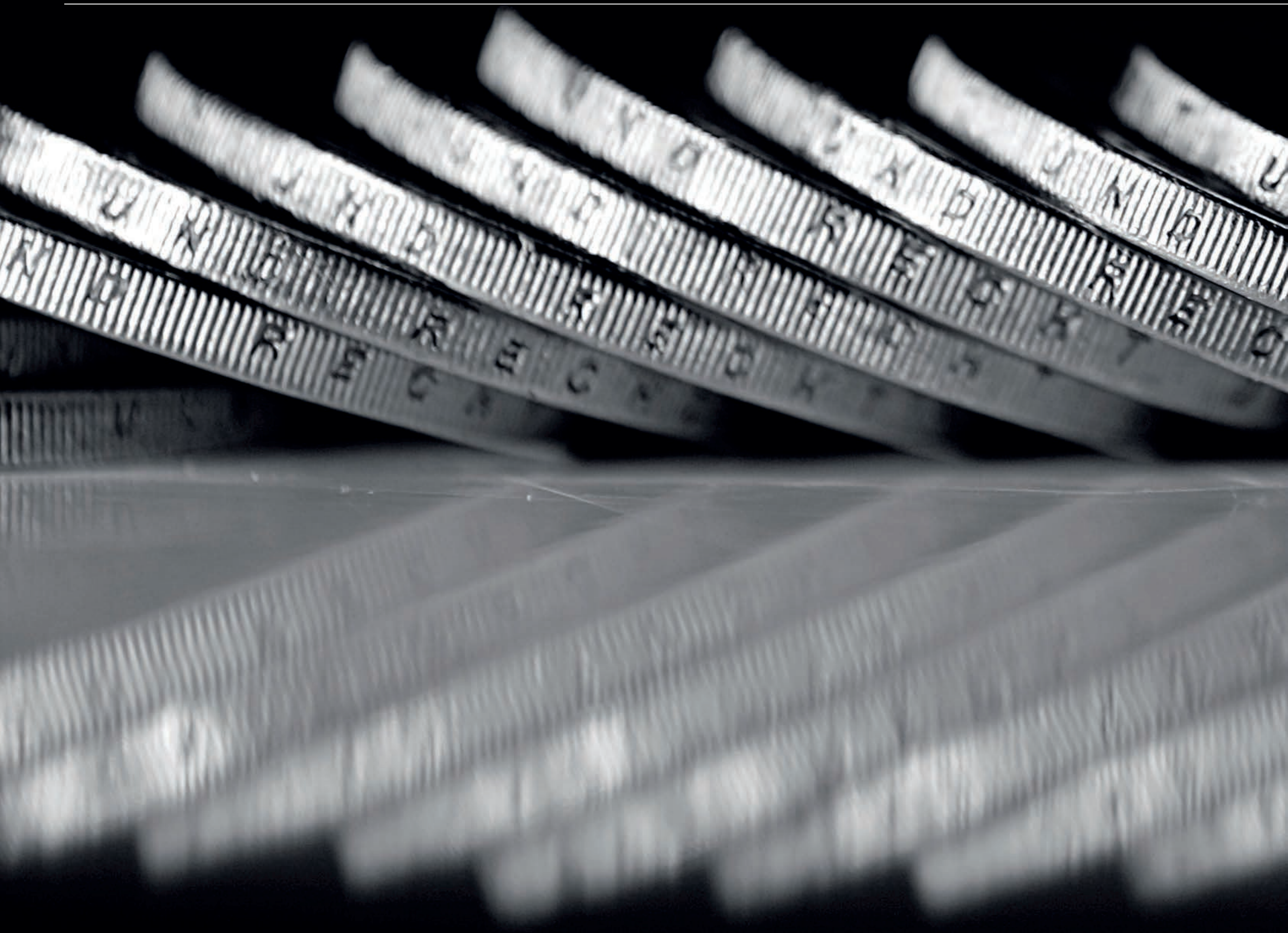

DOUBLE TROUBLE?

With choppiness returning to public markets this year, initiating a dual track process when considering an IPO exit route may seem like the perfect insurance policy. But is it worth the hassle and risk?

By *Vicky Meek*

After a relatively calm 2017, this year has seen volatility return in spades to the public markets. While the VIX index of market volatility averaged just 11 per cent last year, in February 2018, it jumped to as high as 37 per cent and has been yo-yoing ever since as geopolitics take ever more unpredictable turns and the shifttowards a more normalised monetary policy gives rise to market fears (especially in relation to the US) of the economic effect of either over or under-cooking interest rate rises.

Small wonder, then, that a number of IPOs have been pulled over the last nine to 12 months. UK wireless tower business Arqiva and food group Bakkavor scrapped their IPO plans in early November 2017, while publisher Springer Nature also pulled the plug on its €3.2bn German listing in May.

And with some recently listed businesses failing to perform well since going public (Ceva Logistics, Bawag and Rovio, among others), exits via IPO have become a more risky strategy than in calmer times, deterring some houses from even looking at the public markets.

"We're not seeing many firms looking at the IPO route currently – private equity buyers are able to move fast, providing certainty, and they are paying good multiples for high quality businesses," says Harry Knight, corporate finance director at Corbett Keeling. "An IPO, by contrast, is rather less certain, particularly in a volatile market."

Nevertheless, the value and volume of IPOs across Europe both saw an increase in the first six months of the year compared to the same period last year, according to PwC's H1 2018 European IPO Watch, rising from 161 to 168 and up five per cent, respectively. A public listing clearly remains alluring for sellers.

Not so straightforward

So does this mean dual track processes are a popular choice among some exiting private equity firms at least? After all, running a listing and a private sale process side-by-side sounds like the ultimate in back-covering exercises. It depends who you ask. "We're not really seeing them," says David Silver, managing director at RW Baird. "And I don't think we'll see them return in the near future. IPOs are far from straightforward, they don't offer a full exit and trying to run both processes consumes a lot of time and puts unnecessary pressure on management teams."

EY partner Paul Hammes agrees. "Given the volatility in IPO markets, it can work as an insurance policy to run a private process alongside," he says. "But while dual track processes may be feasible, they are difficult and put a lot of strain on management. We saw a lot before the crisis, but far fewer these days."

Yet some advisers see the market differently. "From the period between the financial crisis and around two years ago, private equity houses dominated the IPO market," says Lucy Tarleton, director in the capital markets group at PwC. "That has reduced over the last couple of years, but private equity remains a key driver of new issues. When markets are more volatile, as they are today, dual track can offer more certainty to sellers."

She points to a recent BVCA/PwC report that shows private equity exits accounting for around 70 per cent by volume and 90 per cent by value of IPO activity in London in 2015, falling to just under 40 per cent and around 45 per cent respectively, in 2017 – still a considerable proportion.

"Many IPOs are, to a greater or lesser extent, dual track processes," adds Chris Nicholls, head of Deloitte's IPO and equity advisory team. "Whether vendors ultimately opt to IPO or choose an alternative way forward very often is driven primarily by valuation. Clearly, when stock markets are toppy, there may be clear blue water between an IPO and a sale."

> **If the public markets get a sniff that a firm is using them as a stalking horse for a valuation, the IPO may quickly lose credibility**

And while he admits that "running two processes is clearly costly, takes more time and can be a lot of hassle if it is not well managed by the advisers", he says the prices fetched at IPO can far outweigh the negatives (providing, of course, that markets are receptive to a business). "Sometimes, it can be pretty obvious which route to choose," says Nicholls. "For example, are you going to go with a sale to a private equity buyer, where you'll get eight to nine times Ebitda? Or are you going to list with a valuation of 14x Ebitda? Other times, it can be more nuanced."

Risky business

Yet while the potential for sky-high valuations and a process with intense competitive tension between two sales tracks can appear attractive and may seem to mitigate against the possibility of one side of the process falling over, it is actually fraught with risk. The major issue is that public investors can perceive they are being taken for a ride. "There can be an element of subterfuge about a dual track process," says Nicholls. "If the public markets get a sniff that a firm is using them as a stalking horse for a valuation, the IPO may quickly lose credibility." And if that happens, competitive tension obviously quickly dissipates.

This is why, in today's dual track processes, advisers suggest that sellers decide relatively early on in the process which route they will follow before private bidders and public markets investors spend too much time on assessing the investment. "You have to make up your mind some time before issuing an intention to float announcement," advises Nicholls. "If you go ahead and put that out and run a parallel private equity/trade sale, that is a significant statement to the market that you may not care whether you waste investors' time."

This is particularly the case in a hot M&A market such as we are seeing today, where private sales can often trump public markets valuations by some margin. Payments business iZettle, backed by a number of investors including Dawn Capital, is a case in point. Earlier this year, the company was less than a fortnight away from its IPO, which was set to value the business at $1.1bn (€950m), when PayPal stepped in and snapped up the business for $2.2bn. It was clearly an offer management couldn't refuse, but the news wasn't particularly well received by those that had worked on assessing the investment. Similarly, Doughty Hanson-backed business services group TMF, having already made its intention to float announcement, abandoned its IPO in October last year in favour of a sale to CVC Capital Partners.

"If you have a track record of running dual track processes and taking the deal off the table at the last minute, investors may not be very receptive to you in the future," says Tarleton. And there are some, according to Nicholls, who already have just such a reputation. "There are a few houses of which stock market investors are somewhat wary, should they be considering an IPO," he explains.

"Maybe investors have had their fingers burned with pulled IPOs in the past or disappointing aftermarket performance - and they don't want to waste any more of their time," he adds.

So, while a dual track process may look enticing as a risk mitigation strategy during a period of volatility at first glance, it seems that it can be anything but. ●