

# **Pre-IPO Investing: Expert Advice for the Professional Investor**

**By Investment guru, Len McDowall**

This article takes a look at the pros and cons of investing into what is called Pre-IPO capital.

What is Pre-IPO capital? Well it's exactly that, capital that is raised prior to an IPO.

So to make things clear, an IPO, or initial public offering, refers to the time when a company is about to list on the stock exchange, and they have issued a prospectus in order to attract investors funds. The amounts sought vary greatly depending of the size of the company and the need for capital. So if you invest into an IPO, you get the prospectus via a broker or online, fill in the application form and post it in along with a cheque. About 3 to 4 weeks later the company lists and you get your shares which you can immediately sell if you want to.

You are usually limited by the maximum number of shares you can subscribe to. It may be \$10,000 for example. There will also be a minimum subscription. This varies from float to float of course.

The other thing that is common with an IPO offering is that there is a defined time period in which you must respond. - usually about 3 weeks. This allows the company and their broker to coordinate the float with the exchange. It also creates urgency for the investor by giving you a deadline in which to make a decision by.

## **The basics on Pre-IPO...**

Pre-IPO is much different to this, although it sounds similar. Pre-IPO is raised anywhere from 3 months to 18 months prior to the company listing onto the ASX. It is usually done without a prospectus and in most cases is done at a time when there is no stock-broker representing the company or underwriting the float.

At the pre-IPO level, there is no guarantee that the company will make it to the actual IPO, what the share price will be, or even which broker will do it. Also, because it may take up to 2 years before the company floats, your money is pretty much tied up until then.

As you can see, there is higher risk involved. To reflect this, pre-IPOs are usually offered at a considerable discount to the anticipated IPO price. For example, if company X believed that they will list for \$1, they may offer shares in a pre-IPO capital raising at \$0.25. Should they end up listing for \$1, they you make 4 times on your money at the IPO.

Most investors have not even heard of pre-IPO investment opportunities. This is because they are only usually marketed to wholesale investors, high net worth individuals, professional investors and investment funds. So to gain exposure to one, you sort of need to know the right people. Even high net worth individuals do not often get exposed to pre-IPO opportunities simply because they are not connected to the company or the broker/advisor managing the offer.

Most opportunities are restricted to "wholesale" investors however limited opportunities are sometimes available to some "retail" investors.

### **Key strategies for reducing investor risk in Pre-IPO opportunities...**

There is no safe way to invest into pre-IPO opportunities. Simply because there are many factors that may prevent the company from reaching the stock market. So the key is to invest into companies that are fairly close to listing. Some of the indicators for this are:

- Estimated listing timetable stated in Information Memorandum document (ideally within 12 months)
- Board of directors in place
- CEO in place
- Key management and staff in place
- Lead broker in place (or at least short listed)
- Legal team in place (for IPO)
- Accountant in place (for IPO)
- Advisor in place (for IPO)
- Financial projections completed
- Profitable
- Market opportunity clearly defined
- Share capital structure in place
- Value entry level established

It's not necessary to have all the above criteria ticked, but the more the better as each criteria lessens the risk for you, the investor.

How do you know the company is going to list? The short answer is you don't. Even some IPO's have been pulled at the last minute. The bottom line is investing into Pre-IPO is risky, so be sure to only invest what you can afford to lose. And only invest a maximum of say 10% of your investment portfolio.

However when they work, the returns can be quite staggering. I know of a recent float where the pre-IPO investors bought in at \$0.10 per share, less than 4 months before the IPO. The company floated at \$0.20 and within 6 months, the shares rose to over \$0.60. That's 6 times your money within a year. However bear in mind that this was relatively speculative, and the pre-IPO investors could just have easily been left holding the stock for a couple of years.

In terms of Due Diligence, it's wise to spend about 20 minutes on the phone to the CEO or better still, meet with them. Get them to answer any questions you have about the company and its ability to deliver on its promises. If you are investing \$100,000 or more, it's time well spent. If you were to spend a similar amount on a car, I'm sure you would take it around the block a couple of times, so make sure you do some homework when looking at a pre-IPO investment.

So how do you gain access to pre-IPO opportunities? Speak to your broker or get to know an advisory firm who specialises in pre-IPO capital raisings. From time to time, you will also see them advertised in the Financial Review ([www.afr.com.au](http://www.afr.com.au)). It's free to enquire and even if you don't invest, it's good to get a feel for this type of investment prior to writing a cheque.

### **About Len McDowall - Managing Director, Integral Capital Group Pty Ltd**

Len McDowall was previously inaugural Chairman and Managing Partner of Bird Cameron, Chartered Accountants, (now know as RMS Bird Cameron) which employed 1000 people in 50 offices in Australia and Hong Kong. Len established Bird Cameron's mergers and acquisitions division in 1987.

Len has extensive experience in all facets of financial management with a particular emphasis on structuring and negotiating joint ventures and capital raisings. Following his retirement from the accounting profession Len and his partners established the [Integral Capital Group](#). Len specialises in mergers and acquisitions, public floatation's, the creation of financial management strategies and capital management, and has successfully completed hundreds of transactions in these fields.

Len McDowall founded [Integral Capital Group](#) in 1990. Specialising in the Australian capital markets, [Integral Capital Group](#) serve predominantly sophisticated investors, private and public companies delivering a broad range of services including Stock Exchange listings; Mergers, acquisitions and divestments; Capital and debt raising; and pre-IPO offerings.