IPO CAPITAL PLC

Approach to Investment and Main Criteria

IPOC's Overall Approach

There are various different approaches to researching and assessing investment propositions. Some investors take a top-down 'macro' approach to research – they look at what is going on in the world, and they try to find companies that will benefit from certain trends. Others take a bottoms-up approach, focusing initially on the internal attributes of the company, not the business context in which it operates. We combine these two approaches by identifying certain preferred sectors and focus attention on the companies within those areas which exhibit strong fundamentals.

However, while we may share a taste for fundamentals, as investors have different preferences and tolerance levels for factors like debt levels and margin of safety – these are things we can be guided on, but in the end, we have to establish our own level of comfort with risk. This is best determined, on a case-by-case basis, by the overall balance of attributes and opportunity and by counterbalancing the upside and the downside risks.

Our Principle Philosophy of investing

1. Buy into a **business**, not 'tickers' – the concept, the market, the management, the growth potential
2. Long term – where the founders/management are driven by medium/long term growth opportunity not a quick exit
3. Diversity – spread the risk, whilst remaining in areas where we have knowledge and understanding
4. Avoid emotion – stick to the criteria, and not be attracted just because a business might look exciting or fun

An attractive investment candidate for IPOC meets the following criteria

- A good asset base with short to medium term execution plans (2-3 year horizon)
- A realistic business plan with a global outlook
- Sound financial base and plan for future growth
- Solid, experienced management team capable of delivering the companies' objectives
- Revenue generating and in profit (preferably) or showing strong forward contracts – Typically, revenue: $1-5 million+ in trailing 12-month period
- Listing/IPO Timing: Within 6-18 months (from our investment date)
- Return Potential: Expectation of 3x return over an anticipated 2-year maximum holding period

Industries of Specific Interest

- Cleantech
- Internet & Software
- Technology
- Fast moving consumer goods

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Finding the fundamentals

In order to start researching a company, we need information. We generally start with the company's annual reports, corporate presentation, product fact sheet and/or executive summary which are usually available on its website or via the introducing advisors of the proposed investee companies.

The fundamental information we look at when researching a company starts with the following;

Management

We want to know who's running the business and why. What industry experience does the Board have? How long have the CEO and the executive team been together, with the company, and in the industry? If the CEO has the extensive, relevant technical experience, we think that is usually a good sign.

We like to see some ownership stake of the management. A founder and/or management team that has meaningful amounts of their wealth, reputation, or legacy tied to the company's success will usually look out for shareholder well-being. We are not interested in companies whose management are looking for an immediate exit, but those who want to continue to work, with their interests aligned to those of the new investors, for at least 2-3 more years.

In a similar vein, we are interested to know how management is compensated. For example, are salaries and bonuses commensurate with the company's stage of development, its competition? Is compensation appropriately incentivising management to look to the long-term value of the company, rather than short-term, superficial targets like quarterly numbers or the share price?

Financial strength

Here we're looking for evidence of a strong, sustainable business model, which usually translates into strong profit margins, cash flow, and return on capital – which tells us how good management is at deploying the company's cash into profitable ventures.

We also look for a strong balance sheet. This doesn't necessarily mean zero debt – especially these days when companies can fund growth through debt at historically low interest rates – but it does mean debt should be manageable. Can the cash flow easily cover interest payments? When does the debt mature? Debt maturing in the next couple years is more threatening than debt due 5 or 10 years down the line. We would also look at stress tests on the company's ability to service debt in the event of significant (and inevitable at some future point) increases in interest rates.

A less obvious financial item is the investment in the future. How much does a company spend on R&D, marketing and distribution in order to ensure it maintains its advantage and continues growing? We like companies like Rapid Nutrition Plc that is continually investing in the next thing – this type of company tends to be innovative enough to adapt to changes in their industries.

Industry

It is important to find out what its competitive environment looks like. Who are the largest competitors and how many are there? Is this company one of the leaders? Is it a fragmented market or a consolidated one?

What is our target company's USP? What are the key differentiators – how much are these an opportunity or could they be usurped?

Then we'll take a closer look at the main competitors. We like to see what they are saying in their results and press releases. Does this match what this company is saying or are some faring better or worse? What is causing any differences?

On an even broader view, what is the state of the industry? Is it growing rapidly or is it more mature? What threats face the industry and the company? Can new technology displace the company or is this company doing the displacing?

Valuation

Finally, and possibly most importantly, we try to figure out if what the market wants us to pay for a company makes sense. How much growth is priced into the shares? Does it appear that any downside has been priced in (or even better excessively priced in)?

If a company meets our expectations in the management, financials, and industry categories, but doesn't make the grade on valuation it doesn't mean the end of the story. Shares of high-quality companies are hard to come by, so we put the ones that look overpriced on a watch list and monitor their performance on a periodic basis.

Additional resources

In addition to a company's website, we can find information for research in several locations. A few examples include Companies House, RNS filings, Google (we use both the regular search and Google News to track down headlines and developments), and any industry and business publications we can find.

Crucially, we also have the benefit of using the advisors resources to satisfy our research requirements, and it must of course be remembered that in the vast majority of cases these investment opportunities come to us via our advisors and other partners, to a large extent 'pre-qualified' - with all their own rigorous investment criteria applied and internal Due Diligence already carried out.

Conclusion

By starting simply and getting to know the company through its own reports, we can start to form an idea of the company's competitive advantages and an understanding of the company's business model. While this is still just the beginning, it provides a strong base from which to identify companies that we would like to have in your portfolio and to continue dialogue with concerning our proposed investment.

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