

**PKF**

Accountants &  
business advisers

# Going public

## A guide to floating your company





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Our clients benefit from an integrated approach based on understanding the key issues facing small and medium sized businesses. This enables us to meet their needs at each stage of development and allows them to focus on building the value of their businesses.

The principal services we provide include assurance and advisory; consultancy; corporate finance; corporate recovery and insolvency; forensic and taxation. We also offer financial services through our FSA authorised company, PKF Financial Planning Limited.

We have particular expertise in the following sectors:

- *Charities*
- *Growing businesses*
- *Hotels*
- *Medical*
- *Professional partnerships*
- *Property and construction*
- *Public sector*
- *Technology.*

We have more than 1,500 partners and staff operating from offices around the country.

Wherever you do business, we can offer you local expertise backed up by the resources of a national firm.

The UK firm is a member of PKF International, a network of independent firms of accountants and business advisers with 380 offices in over 115 countries.

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# Contents

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<b>Introduction</b>		3
<b>Chapter 1</b>	<i>Looking in the mirror</i>	5
<b>Chapter 2</b>	<i>To float or not to float?</i>	7
<b>Chapter 3</b>	<i>Which market?</i>	13
<b>Chapter 4</b>	<i>The sponsor, the broker, the lawyer and the accountant</i>	19
<b>Chapter 5</b>	<i>Preparing your company for flotation</i>	23
<b>Chapter 6</b>	<i>How to float</i>	27
<b>Chapter 7</b>	<i>Preparing your Admission Document</i>	29
<b>Chapter 8</b>	<i>New listing, new obligations</i>	33
<b>Glossary</b>		37
<b>Sources of information</b>		43
<b>Our corporate finance services</b>		44







# Introduction

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Floating your company is perhaps the biggest step your company will ever take. But is it the right step? Float successfully and you'll be able to raise funds and your profile; if it falls through you'll have gone to a great deal of expense for nothing and probably damaged your future standing in the eyes of the City's investors.

To help you make the right decision and to avoid the stumbling blocks that sometimes litter the way, PKF has drawn on its lengthy experience of flotations to produce this no-nonsense, easy-to-digest introductory guide.

It considers flotation from all angles: why you should go public and why you need to think carefully before committing to it; the best place and the best way to float; the advisors you need to appoint and the roles they'll play; the personal toll that flotation makes on the key individuals; and a brief insight into life in the public arena.

Over the past 5 years PKF has assisted in the flotation of many companies. In particular, our significant involvement with companies seeking a listing on AIM and other public markets, and our assistance with subsequent transactions, has established PKF as a leading business advisor and accountant for growing businesses. We have been shortlisted as AIM Accountant of the Year in the Growth Company Investor Awards for a number of years, including winning the award jointly in 2002.

Through our experience PKF is uniquely qualified to comment on the merits of the various markets. This guide has been prepared independently.

I hope you find that this guide is an informative and interesting insight into the markets, the flotation process and life thereafter.

Nick Whitaker  
Head of corporate finance, PKF







# Chapter one

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## *Looking in the mirror*

You've reached a pivotal point in the history of your company. Things have been going well, the company has grown and so the issue of flotation has been raised.


A listing is a good way to raise the profile and prestige of your organisation. You're perceived to be bigger, better, more creditworthy – an altogether safer bet. But perceptions aren't everything. Going public doesn't automatically improve your status. On the contrary, if flotation isn't right for your business, you run the risk of doing it more harm than good. So how do you know if flotation is right for you? And how do you go about making such a major decision?

The first thing is to take a long, hard look at your business. This is no time for flattery or false modesty. You need to make a completely honest appraisal of the company's resources, its stage of development and prospects, and answer some fundamental questions about what you want from the future.

These searching questions must examine not only the strengths and weaknesses of the business, its goals and future strategy, but also the human element, the management's abilities and ambitions. Are you ready for the commitment, time and increased scrutiny that a flotation brings? These questions will include:

- *What are the personal and professional objectives of each of the directors and main shareholders? Where do you each want to be in five years' time?*
- *What is your market strategy and what is your corporate plan? What resources do you need to achieve this plan?*



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- *Are the directors prepared for the added burdens of disclosure, openness and accountability which flotation places, individually and collectively?*

Companies need money to expand and evolve, and a flotation is a good way to get access to much-needed capital. But all this has a price. To gain these rewards you must be prepared to put in a great deal of effort: floating a company is a demanding, painstaking and expensive business. You must expect to have to put in up to several years' commitment before going public and, even then, the demands on your time and energies do not cease.

Going public is a challenging but often rewarding process, although it is not the right choice for everyone. There may well be alternative ways to achieve the goals that you have set (see chapter 2). To make the right decision you need to be fully informed of the issues and potential challenges that lie ahead.

To do that, read on.





# Chapter two

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## *To float or not to float?*

Each company is different. There will be a host of factors – personal, historical and systemic – that make it unique. The reasons for considering a flotation also vary. The most common reason is the need to raise capital. But there are other potential benefits that may justify the time and expense of a listing.


Existing shareholders, especially external investors, may be looking to realise a part of their investment: they also gain a more liquid market on which to realise their remaining shareholding at a later date.

Flotation improves the liquidity of a company through the injection of equity and can improve the long term financial stability. If most of its competitors are listed, a company may find itself at a commercial disadvantage, customers seeing the competitors as being more financially reliable.

A company may have a strategy of acquisitions. Flotation gives it the profile to be seen as a serious contender by the vendors, while also giving the flexibility to use shares and/or cash raised to complete the deals.

The ability to provide share ownership schemes encourages employees' participation in the ownership of the company and increases their long-term commitment. This in turn helps the company recruit and retain good staff.





You need to decide which is your prime motivation. Below is a list of the major advantages and disadvantages of becoming a public company, and also some of the alternative ways you might consider to raise finance.

## The benefits of flotation

### Access to capital

As a public company you will be able to raise finance at the time of flotation and have greater access to new capital in the future. You might use such capital to reduce your debt finance, increase working or investment capital, expand organically, acquire new businesses or undertake research and development. Whatever your reasons, it's important to be clear on your strategy – it will dictate how much you need to adequately finance future expansion.

### Cash out

Flotation may provide an opportunity for existing shareholders to realise part of their investment. However, potential institutional investors will probably restrict this, since they will require existing shareholders to leave equity within the business and to have a continued involvement with its management post-flotation. Indeed, there will normally be lock-in requirements for principal management/shareholders.

### A market for the company's shares

Floating your company creates a public market in which shares are readily tradeable, enabling shareholders to realise the value of their holdings or to use stock to secure personal loans. Going public will also help to broaden the shareholder base and to provide existing investors with an exit opportunity, subject to lock-in restrictions on disposing of shares agreed with the incoming investors. You can also use shares as consideration for acquisitions instead of borrowings or cash.

### A higher public profile

During and after the float, your company will be very much in the public eye. Your management team will be the source of media attention, your results will be scrutinised and this publicity will help to raise awareness of your company and its products. There is no better time to take advantage of this awareness, to boost your profile, enhance sales and, ultimately, influence share take-up.





## Reassurance for customers and suppliers

A listed company is seen to have a higher financial standing and this, together with the regulatory and due diligence checks necessary to come to market, will reassure both customers and suppliers. It often results in a higher credit rating. As a result it may be possible to negotiate improved commercial terms for doing business as the risk of default is perceived to be lower.

## Incentivised employees

Many companies offer their employees profit-related bonuses or shares in the company as an incentive to participate in its on-going success. For more senior management, share-option schemes can lead to substantial personal wealth once a company comes to market. By the same token, working for a listed company tends to engender pride and, consequently, loyalty among employees.

## The drawbacks of flotation

### Loss of privacy

With the shift from private to public, your company will find itself increasingly in the spotlight. As a public company you will be required to make detailed disclosures. These vary according to the exchange but may include directors' share dealings, appointments and remuneration, price-sensitive information, litigation past or present, related-party transactions and certain employee benefits. This information is in the public domain and is therefore also available to your competitors.

The demands of shareholders to know how – and how well – “their” company is being run can further erode your independence and privacy. Then there is the media. The media takes more interest in quoted companies, which can be a boon in good times, but can be an unwelcome intrusion when things are not going so well.

### Loss of management control

By having public shareholders you inevitably cede a degree of control in your business. Performance will be scrutinised, decisions may have to be ratified by executive and non-executive members of the board, and major acquisitions or disposals may need to be approved by shareholders. Shareholders will also expect the regular payment of dividends and/or appreciation in the price of their shares, and the pressure to achieve this goal can distract from other, long-term strategic targets. Where a majority of a company's shares are in the public domain there is also the risk of being the subject of a hostile takeover or bid.



## The expense

The overall costs of flotation, raising additional capital and the ongoing costs of maintaining a listing may outweigh the benefits, especially if your company is relatively small. It is therefore important to ascertain the scale of costs before beginning the flotation process.

A company can expect to pay up to £500,000 in professional fees for a flotation. This will increase significantly for a sizeable listing, especially when costs such as underwriting fees are taken into account. You may be able to fix some of your costs at the start of the process, such as for accounting and legal advice, helping you to get a clearer idea of the possible total cost in advance. There are also fees payable to the UKLA and the Exchange. These are set out in price lists available from each body.

Once listed, there are annual fees payable to the UKLA in order to maintain your listing and cover the ongoing cost of compliance, such as the fees to your preferred Regulatory Information Service (RIS) for the disclosure of price-sensitive information to the market, and the extra cost of more rigorous financial reporting.

## Difficult to backtrack

Once a company has floated on a market it is difficult to reverse that decision, should things not go as planned. Companies can be left with little or no liquidity in their shares and without access to future capital – yet still bearing the increased cost burdens of being listed.

Taking the company back to private ownership is a possibility: but it is an expensive and not always available alternative.

## Investment of time

Floating a company takes up a substantial amount of senior management time. The process can involve a seemingly endless round of meetings, negotiations and general housekeeping, which can easily become a full-time job. So it's all too easy to neglect the company that you're trying to float. The continuing obligations of being a listed company, especially the need to promote investor relations, can also be time consuming and need to be planned. To cope with this time commitment it is important that responsibilities for the float process are allocated between the key directors, that there is a strong and reliable second tier of management who can cope with your absences and that an experienced team of advisors is selected who can reduce some of this burden.





## **Bull and bear markets**

The state of the economy and the stock market are outside your control and yet may have a significant effect on the price you can achieve at flotation and even its overall success. Timing is everything. Once in the public arena, your company becomes more susceptible to the effects, both positive and negative, of market rumour, sector developments and economic changes on both a national and global level. These conditions are unpredictable and may affect the price and liquidity of your shares.

## **Corporate governance obligations**

For fully listed companies, compliance with corporate governance rules set out in the Combined Code is onerous and requires tougher reporting and disclosure standards. Among the large number of obligations in the Combined Code, for example, is detailed disclosure of individual directors' remuneration, a review of internal financial controls and the publication of an operating and financial review. Also necessary is the appointment of independent, non-executive directors and the formation of audit and remuneration committees.

For companies on AIM or OFEX the Combined Code is not a requirement, but such companies may wish to make disclosures about their corporate governance procedures, and (particularly on AIM), are expected to have a Chairman, independent directors and board sub-committees.

## **Alternatives to flotation**

For a company that requires additional long-term funding but wishes to retain its independence there are alternatives. Each has its own benefits and drawbacks which will depend on the exact circumstances of the company involved.

## **Private equity providers**

By providing equity finance, typically repayable on flotation or sale of the company, private equity providers can help support a business through key stages in its development. Their input can also strengthen the company by bringing to bear new skills and business acumen learnt in similar organisations. However, they will expect a significant return on their investment, so it is likely that you will be giving up a substantial proportion of your equity as well as a degree of control of your company.



## Debt funding

Bank borrowing is also an option provided the company has sufficient positive cashflows to repay the debt and adequate security for the lender to be comfortable with the level of advance required. Repaying a loan can be a drain on financial resources. However, any profits above the cost of debt are not shared with the lender.

The level of gearing of the company will become an issue if debt increases above reasonable levels and as a result financial stability reduces. Also the loan will probably require the company to adhere to strict covenants governing the loan, ranging from the level of results achieved to the provision of information. They will typically also restrict the company's ability to enter into certain transactions without obtaining the bank's permission.

In order to raise finance, many companies also explore options such as debt factoring, invoice discounting, hire purchase, instalment credit or sale and leaseback as an alternative to more conventional bank funding. These methods typically attract higher levels of interest but may allow the company to increase its borrowing compared to commercial bank borrowings.

## Trade sale

Selling the company may sound like a last resort, but it can maximise a company's inherent value. A trade sale tends to result in a full exit for the existing shareholders and can maximise the selling price as purchasers may be persuaded to pay a premium to gain control of the business. However, where there are no competitive bids for a company, a trade sale may result in a lower price.

Deferred payments, performance related or otherwise, are becoming more prevalent as one of the methods of financing purchases of businesses – meaning that shareholders will not receive the full cash price on sale and may have to wait several years, while still being involved in the business, to realise all their investment.





# Chapter three

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## *Which market?*

An important part of the decision to float your company may be determined by the characteristics of the different markets available. You will therefore need to identify which market best suits your specific business objectives. There are a number of factors which might influence your decision, such as:

- *the quality and size of the company's earning stream and its future earnings potential;*
- *the nature of the market in which the company operates, its susceptibility to recession, sectoral business cycles or seasonal influences; and*
- *the range of products and services you provide;*

In certain circumstances where your company operates in a number of different countries, you may consider a listing abroad.

The three main UK stock markets you might consider are listed below.

### **The London Stock Exchange's markets**

The London Stock Exchange (LSE) comprises two markets, the Official List (main market) and AiM.

The LSE is one of the oldest in the world. Its origins go back to the end of the 17th century when stocks began to be traded in the coffee houses of the City. In 1801 the Stock Exchange was born when the business of buying and selling shares was placed on a formal membership subscription basis.

## The Official List

Size, some say, is everything. It is certainly a vital part of the decision about which market to float on. Thus the Official List (often referred to as the “main market”) is best suited to large companies – those with a capitalisation of over £100 million – or with a specific niche. It is the most expensive market on which to float, but for companies that can satisfy its criteria it has a lot to offer. It is the UK’s largest market, providing ready access to a very wide audience of investors and a deep pool of capital. Because it tends to attract the most publicity, membership of the official list can enhance the profile and status of its listed companies.

However, for smaller companies, although they may meet the criteria for the main market, it may be better to look at another. ‘Small cap’ companies on the official list can often find themselves with limited liquidity in their shares and with little interest shown by investors.

A subsection of the Official List is techMARK, which was launched at the end of 1999. It groups together companies on the main market that are working in innovative technology, thus raising their profile. There is another subsection called techMARK mediscience. Launched at the end of 2001, it groups together companies on the main market that are working in pioneering healthcare. At the end of May 2004, techMARK and techMARK mediscience comprised 177 companies with a combined market capitalisation of over £280bn.

To be admitted to the Official List, a company must meet a detailed set of criteria. These include the requirements that the company must:

- *appoint a sponsor*
- *be incorporated under the relevant laws, which for UK companies means being a public limited company (plc).*
- *have been in operation for at least three years and have audited accounts for that same period.*
- *place at least a quarter of its shares with the public at flotation and prove that it can carry on its business independently of controlling shareholders.*
- *demonstrate that there has not been a significant change in key management prior to flotation.*



- *have a market capitalisation of at least £700,000 – though usually it would be expected to be much larger.*

There are some exceptions, especially for scientific research companies and techMark companies or those undertaking a major capital project, where a three-year financial history and records are not required. However, they will be expected to meet other individually tailored requirements.

### **Alternative Investment Market (AIM)**

AIM, launched in 1995 and run by the London Stock Exchange as a less regulated alternative to the Official List, is designed to meet the needs of smaller, growing companies. AIM also gives investors valuable tax advantages which can be important in attracting shareholders.

Although there is no restriction on the size of company that can seek a listing (market capitalisations range from less than £2m to more than £150m) modest size is the predominant factor for choosing AIM rather than the Official List. There are more flotations on AIM than the Official List: 499 compared to 138 between January 2002 and July 2004.

On the Official List companies need to appoint a sponsor to be admitted. To enter AIM a company must appoint a nominated advisor (commonly known as a “Nomad”) from the approved list published by the LSE.

While AIM has the advantage of being less expensive and with a reduced regulatory burden compared with the main market, on the downside it lacks its larger relative’s high profile and the trading liquidity demanded by the big institutions. Despite this, the majority of recent flotations have been on to AIM, rather than the main list. In practice it is questionable whether being on AIM in itself (rather than the Official List) affects the liquidity of a company’s shares.

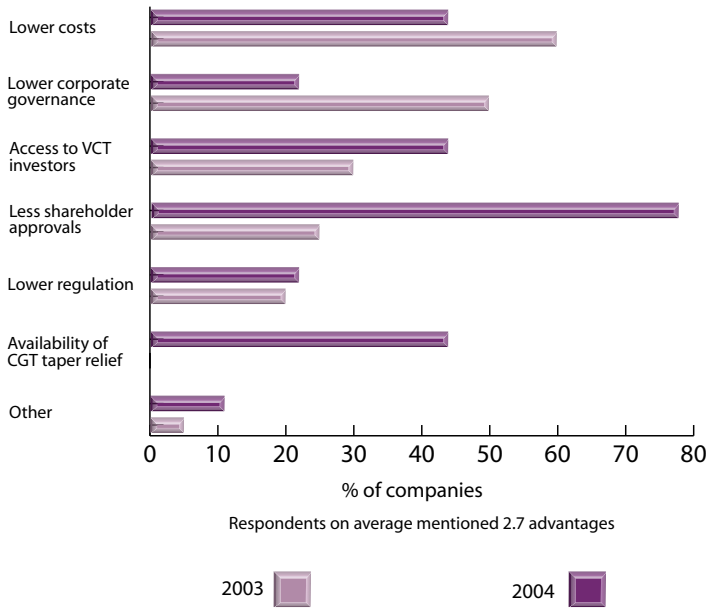
Recent PKF research among AIM companies has shown that one reason for this preference has been, aside from the lighter regulatory touch, the tax reliefs available to investors in AIM companies. AIM has the advantage of significant tax breaks available for potential investors, especially private investors (who can benefit from reliefs on capital gains tax (CGT), the Enterprise Investment Scheme (EIS), inheritance tax (IHT) and relief for losses) and Venture Capital Trusts (VCTs). Corporate investors can also benefit from the Corporate Venturing Scheme (CVS).

Traditionally, AIM has perhaps been seen as a stepping stone to bigger things, but this is now less

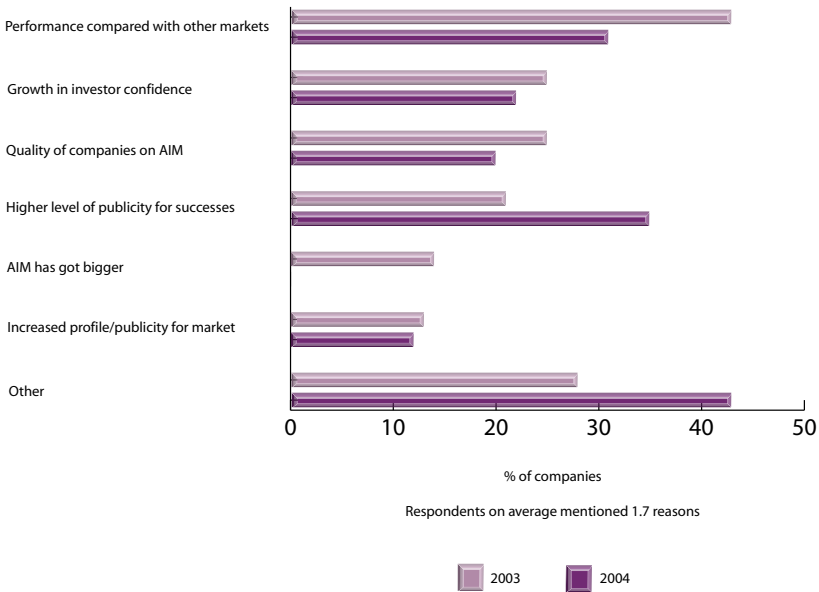


common. PKF research among AIM companies shows that in 2004 75% regarded AIM as their public market of choice. If anything, the trend has reversed: between 1997 and 2003, while 76 companies moved to the full list from AIM, 174 moved in the other direction. It looks very much as though AIM is now the 'preferred' market rather than the 'alternative' market.

### What are the advantages of AIM compared with the Official List?



## Why has AIM improved?




## OFEX

OFEX was established in 1995 as a market for the trading of unlisted and unquoted securities in the UK. OFEX is not part of the London Stock Exchange, nor is it a Recognised Investment Exchange, but it is regulated by the Financial Services Authority. OFEX originally had a low regulatory and fee burden, making it easier and cheaper for companies to list, but this may change with the growing need to comply with government and EU regulations. There are now about 140 companies on OFEX. Most companies on OFEX are smaller than those on AIM.

An approved corporate advisor is required to submit applications for shares to be traded and this advisor may need to be retained for a subsequent period. However, their responsibilities and costs are much lower than for a sponsor/Nomad on the main or AIM markets. In addition, an OFEX traded company requires an identified market maker to trade in the shares of the company.





OFEX is used by companies for a variety of reasons. In the current climate the average fundraising is around the £1m mark. Others seek a listing on OFEX as a way to provide an independent valuation of their shares and to create a dealing facility for them.

Some companies choose to remain on OFEX, while others use it as a springboard to AIM and the Official List. For the latter, OFEX provides a useful forum in which to learn many of the disciplines required on the more senior markets.

During summer 2004 OFEX sought to reinforce its position as an entry market for small companies to raise finance by introducing competing market maker quotes, so that companies can have more than one market maker, with the aim of improving its overall liquidity.

The potential drawback with an OFEX flotation is a lack of liquidity in the shares, along with the fact that companies on the OFEX market do not generally have the same level of prestige or profile as they might on the main market or AIM. In addition, few institutions invest in companies listed on OFEX – severely restricting the ability of companies to raise money.

OFEX as an organisation is itself listed on the AIM market, and is authorised and regulated by the Financial Services Authority.

### **Overseas**

You may decide in certain circumstances that your business is better suited to listing abroad. There are exchanges in all the major business capitals, but one of the most popular with UK companies is the US-based NASDAQ.

Originally an acronym for National Association of Securities Dealers Automated Quotation system, NASDAQ began trading in 1971. It is now the world's largest electronic stock market, with over 3,000 companies listed. Though it lists stock of companies from all industry sectors, its particular niche is high-tech businesses. It is favoured by UK companies that do most of their trading in the US or that intend to raise capital there. NASDAQ has restrictions on the size of companies that join and the number of shareholders.

Anyone considering listing on an overseas market would be wise to seek early advice from a suitably experienced advisor.





# Chapter four

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## ***The sponsor, the banker, the lawyer and the accountant***

If, after a thorough consideration of all the issues, you decide that flotation is the best option for your company, the first step is to appoint a team of outside experts to help you with the process.

The choice of advisors is crucial. Although the level of fees charged is an important criterion, you will be spending a great deal of time with them and so it is vital that you get on with them and that areas of responsibility are clearly defined. Although you will rely heavily on these advisors to guide you through the flotation process, at the same time it is essential that you remain in control of the process and understand what is going on.


The advisors must be experienced and able to understand the issues, pre-empt potential hiccups and handle situations competently. They must be commercially aware and willing to come forward with viable solutions for your problems. Look for those who can offer a sound track record in successful flotations, who communicate effectively and enjoy a good reputation in the City.

The list of people whom you need to hire may seem unnecessarily long but, although some firms can potentially combine areas of responsibility, it should be remembered that each advisor covers a specialist area.

The list below gives the core functions that you will need to bring on board.

If all this sounds daunting, PKF experts can introduce you to potential advisors across a range of disciplines. We have wide experience of assisting in flotations and even in the areas that we don't cover, we will know firms that do have the necessary expertise.





The comments below apply to listing on the Official List and AIM, while the requirements will be less onerous if entering OFEX.

### **The sponsor or Nomad**

A company floating on the Official List requires a sponsor (or, in the case of AIM, a Nomad). The sponsor has a responsibility to the UK Listing Authority/Stock Exchange for the flotation. Unlike its Official List counterpart, the Nomad has full responsibility for the contents of the Admission Document when the amount to be raised is less than €2.5 million. Below, we use the term “sponsor” to cover the work of both a sponsor and a Nomad.

The sponsor, often an investment bank or stockbroker, is also the flotation’s project manager. Co-ordinating the work of the various advisors, the sponsor ensures that all the members of the flotation team fully understand their responsibilities and the deadlines that must be met.

The sponsor reviews the company’s overall suitability for a listing and will advise on the best method of flotation and the flotation timetable. Sponsors are a valuable source of advice when it comes to selecting other key advisors. The sponsor will advise on the pricing and underwriting of the company’s shares. They will support your company in its discussions and negotiations with the broker and ensure that your company is fairly portrayed in the listing document.


### **The broker**

The broker too must have his finger on the pulse of the marketplace and, as such, is there to provide your main link to the stock market and potential investors. Brokers provide essential insight into whether prevailing market conditions are favourable and assess likely investor reaction to your flotation.

Using their knowledge of the market, brokers assist management and the sponsor in setting the share price. They provide the vital link you will need with the investment community and they arrange your presentations to investing institutions.

The sponsor can advise on the selection of a broker. Sometimes separate firms are appointed, but often (particularly on AIM) the sponsor will tend to double up as the broker. As well as judging it on fees and personality, it is important when making your choice of broker to look at the other companies it has acted for. It is best to choose a firm with a strong track record in the sector in which you operate.





It is common for the broker to be retained after flotation to help maintain your shares' liquidity and profile.

### **The lawyers**

There are normally two principal sets of legal advisors in the flotation process: the company's solicitors and the solicitors to the issue. The latter are appointed by the sponsor.

### **Company's solicitors**

The company's solicitors deal with the legal implications of floating your business. This may include:

- *changing the company's articles of association*
- *setting out the contractual terms of directors' new service contracts*
- *carrying out legal due diligence*
- *establishing share option schemes to incentivise employees*
- *handling the valuation and title of properties.*


They also help prepare the listing document, particularly the "back end" which contains the statutory and general information. This includes the rigorous verification procedure that is used to confirm that all the statements in the listing document are factually correct. Your solicitors will also work in tandem with the sponsor's solicitors to draw up the required agreements between your company, the existing shareholders and the sponsor on areas such as underwriting.

### **Solicitors to the issue (sponsors' solicitors)**

The sponsors' solicitors' role includes ensuring that all the documentation supporting the issue is compliant and reviewing the legal due diligence. The company's solicitors are likely to undertake the due diligence and pass it to the sponsor's solicitors for review. This involves reviewing the business to ensure there is no legal reason why the company should not go public and identifying any adverse issues that could seriously affect the company, and subsequently its share price, at flotation.

As with all due diligence, you can save time and money with advance preparation. Ensure that all





necessary paperwork is easy to locate, declare any potential problems at the outset and verify that all outstanding legal compliance matters have been resolved.

These lawyers also provide advice to sponsors on the Admission Document, verification and other matters. They will act for the sponsor on other matters such as the placing agreement.

### **The accountants**

The reporting accountants provide information to the sponsor, documented in the “long form” report, to help it decide whether the company is suitable for flotation. The long form report is based on financial due diligence and contains detailed financial and business analysis of the company, its financial controls, forecasts, financing arrangements, and its track record. Again, sound preparation will make the due diligence process less painful.

The reporting accountant expresses an opinion on the historical financial information included in the admission document and gives comfort to the directors and sponsors on the financial statements, the sufficiency of working capital and other matters included in the prospectus. This role is separate from that of the company’s existing auditors, although it is common practice for the same firm to be retained to fulfil both roles.

PKF is well placed to take on the role of reporting accountant, whether to support the needs of existing clients, or for new clients wishing to float their company, having a long experience helping companies in this way. PKF is especially suitable because, while we have expertise in acting for AIM companies and those wishing to float on AIM, we are not constrained by also being a Nomad.

### **Other advisors**

You will also need to appoint other advisors, including a financial public relations advisor who can assist in raising the company’s profile among the general public and the investment community. This is important because continued publicity helps to ensure awareness and liquidity after the flotation. Other advisors you may need include a registrar to manage your company’s share register, actuaries to help assess your company’s pension scheme, insurance brokers and property surveyors.





# Chapter five

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## *Preparing your company for flotation*

The more time you spend at the planning stage, the smoother your flotation is likely to be. Sharing your ambitions with your advisors as early as possible helps to get the process off to the best possible start.

It is impossible to put an exact duration on the flotation process. This will depend on variables such as the size of the company, its structure and the sector in which it operates, and the flotation method chosen. The preliminary work may take anything up to a couple of years, although the flotation process itself is far shorter, usually somewhere between three and six months.

Below are some of the key areas to be tackled in order to ready your business for the countdown to flotation.

### **Corporate structure**

Management has to decide at the outset the exact shape of the entity to be floated. You may decide to change the structure or reorganise the business prior to flotation.

This is particularly true where owners want to float only part of a group. Typically ownership of relevant subsidiaries is transferred to a new holding company before going ahead with the flotation. Remember, however, that such actions require advance clearance from H M Revenue & Customs, and this can take time.

To raise more capital, companies typically need to increase their amount of authorised share capital. Changes may also be needed to the rights of existing shares and the company's articles of association to make it suitable for flotation.



## Commercial issues

It will also be necessary to tidy up any commercial issues, such as existing contracts for commercial services, sales or supplier contracts, and any legal disputes, which may otherwise impede the progress of the float or require disclosure.

## Pre-float dividend

Where a company has surplus cash, the current shareholders may want to strip this from the company by way of a pre-float dividend. This, of course, will reduce the value of the company and therefore the price of its shares on flotation. You also need to consider the tax implications of pre-float dividends.

Remember to consider tax planning for existing shareholders to ensure that any capital gains on future sales of shares will minimise any tax payable.

## The accounts

Reporting accountants are required to express an opinion on the company's accounts for the three years prior to flotation, on a consistent basis. As such, they will need to consider accounting policies for items such as revenue recognition, and to ensure that the flotation accounts comply with best accounting practices.

Often accounting policies deemed appropriate for private companies are not looked upon favourably by the market. The reporting accountants will seek to ensure that these are brought into line with accepted industry and public-company norms and ensure that they accurately reflect the position and performance of the company.

With the assistance of the reporting accountants you will need to allow sufficient time to tidy up your accounts and to understand any adjustments that need to be made to match financial reporting procedures. In addition, the reporting accountants are required to report on the adequacy of the company's financial reporting procedures. It is therefore advisable to undertake such a review at an early stage, so that any weaknesses can be addressed prior to flotation.

## International Financial Reporting Standards

Companies whose securities are traded on a regulated market of any member state in the European Union have to adopt International Financial Reporting Standards (IFRSs), with effect from accounting periods beginning on or after 1 January 2005, in their consolidated accounts.





In the UK, regulated markets include the Official List but not AIM.

AIM companies will be required to adopt IFRSs for accounting periods commencing on or after 1 January 2007, although earlier adoption (from accounting periods beginning on or after 1 January 2005) will be permitted.

IFRSs are standards issued by the International Accounting Standards Board, an independent body which is responsible for setting global accounting standards.

Soon all listed companies in the 25 member states of the European Union (EU) will adopt a common financial reporting language which will assist in transparency and comparability of financial reporting. This in turn should improve the efficiency of capital markets and reduce barriers to both trade and the flow of capital within the EU. The IASB and the US standard setter, the Financial Accounting Standards Board, are now working together to eliminate differences between IFRSs and US GAAP.

### **Taxation issues**


The due diligence process will undoubtedly highlight anomalies and could delay the timing of flotation. All outstanding tax issues should be dealt with in advance and the tax implications of every action considered. As part of the tax-planning process, it's worth checking that all tax-compliance issues have been resolved and required submissions made – for instance, check that VAT, PAYE and corporation tax returns have been filed and that any outstanding fines or penalties are paid. Make sure also that there are no tax problems in any of the jurisdictions in which the company operates.

Before proceeding with flotation, the company is frequently obliged to seek clearances from H M Revenue & Customs. This might occur where a holding company is formed to bring several companies together under single ownership. It is critical that a long lead time is built into the flotation planning process as obtaining clearances can be a lengthy process.

### **Employee incentive schemes**

Management will need to monitor the levels of employee morale. When shareholders and management are perceived to make huge profits and bonuses on flotation, employees may become demotivated if they are not rewarded in some way. Employee incentive schemes are therefore critical to post-flotation employee morale.





You may consider:

- *allowing employees to buy shares in the company before flotation; or*
- *granting employees share options which are exercisable on flotation.*

Any employee incentive scheme takes careful planning to ensure that it is executed in the most cost-effective manner. Don't forget a contingency strategy just in case your flotation does not go ahead.





# Chapter six

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## *How to float*

There are a number of methods by which a company's shares can become quoted. The choice typically comes down to the amount of capital required, the number of existing shares issued, the prevailing market conditions and the appetites of interested investors.

### **Types of flotation**


There are different ways in which to come to market.

**Public offer:** Here, your sponsor will offer shares in your company to private or institutional investors. The offer will usually be underwritten by institutions who agree to buy any shares not taken up. It is the favoured method for companies looking to raise substantial amounts of capital. It also is the most expensive route to market.

**Placing:** Now the most common method, especially on AIM. This usually involves offering shares to selected institutional investors. This method reduces the costs of raising capital and allows more latitude in how it is done. The potential drawbacks are that this method can result in a narrower shareholder base than from making a public offer, which can lead to less liquidity in the shares.

**Introduction:** This is where a company joins the market without raising capital and is therefore the most straightforward way of joining the market. It is also the least expensive in that no broking commission is paid. It does presume that there is already a fair spread of share ownership, i.e. if more than 25% are in public hands already for a company wishing to join the Official List. While the process involves little need to promote the flotation, by the same token, it limits the potential for raising the company's profile. It also means that the costs of the float have to be met from existing funds.





**Reverse takeover:** An alternative option is for a private company to acquire a listed company. The private company will typically identify a defunct public company where the main value resides in its listing and possibly also in its available resources (in which case it is referred to as a “cash shell”).

The advantages of a reversal are potentially twofold. Firstly, with an existing shareholder base, the enlarged group’s shares will tend to have an existing liquidity, not necessarily available through a placing. Secondly, in the case of a cash shell, costs can be saved because of a reduced need for external funds. There are however other cost implications to consider, such as additional advisors who may “double up” due diligence costs and stamp duty costs. The key risk of this route is that, unless the public company is a true “shell”, you may also inherit problems (contingent liabilities and so forth) which affect the whole group.

### **Changes to board structure**

You will also need to consider whom you wish to appoint as non-executive directors to the board.





# Chapter seven

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## *Preparing your Admission Document*

Whatever method of flotation you opt for, you will need to prepare an Admission Document or similar document. Preparing this document is one of the most important and most time-consuming tasks. Its style and content can have an important bearing on the success of the flotation. The directors of your company must assume overall responsibility for its preparation and declare as such, although much of the input comes from the advisors.


The prospectus has two principal functions. First and foremost it includes all the information the government and the relevant exchange require to be made public to investors to enable them to make informed investment decisions. Second, in order to raise potential investor interest in the shares, it provides information about the company, what it does, when it was established, who runs it and its future prospects.

### **Attracting investors**

Assuming your company is able to comply with all the necessary technical requirements and measures up to the demands of your preferred stock exchange, it still faces the hardest test: satisfying the commercial expectations of the marketplace. Understanding exactly what the market wants from you is one of the greatest difficulties facing small and medium-sized businesses.

Perception is everything. By floating your company you are giving it a long-term value which needs to be in line with that placed on it by potential shareholders. The perceived quality of your business and its prospects, as well as the calibre of its management in the eyes of the investment community, are all key to a successful flotation.

Investors, both individuals and institutions, can be fickle creatures. Whim, fashion, economic cycles and market sentiment can all play their part. Personalities are also frequently a factor. It



may even get personal: perhaps your financial director doesn't have the presence to make the City sit up and take notice, or it is felt that your management team needs strengthening. This is where it pays to use your advisors well.

However, there are a number of fundamental, often inter-related attributes that your business should possess to make it attractive to investors. These include:

- *a track record as a sound and well-managed business, preferably with a broad product and customer base;*
- *experienced and capable board members and senior management, who share a common vision for the company's future;*
- *a realistic and workable business plan, based on justifiable cost and sales projections, with enough working capital to meet projected requirements;*
- *transparency of ownership, preferably unencumbered by the presence of a controlling shareholder;*
- *a high standard of accounting systems and financial controls;*
- *the development of appropriate corporate and management structures to reduce the reliance on individuals; and*
- *a good story and opportunities for the future*

## The Admission document

This is made up of three main sections.

### The “front end”

This includes all relevant information about the business. It is produced by the company, assisted by the sponsor, and typically includes details such as the nature of the business, its marketplace, its current performance and its future prospects, together with details of the management team. While it is designed to sell the company's securities, this section is not purely promotional in content. It is heavily regulated, so there has to be clear evidence backing up every statement. Much of it is based on the “long form” report and specialist market reports prepared for the flotation.





## The financials

These are produced by the directors, and the reporting accountants express a “true and fair” opinion on the numbers, which are based on the company’s accounts. It is comprised of the previous three years’ audited financial statements including balance sheets, profit and loss accounts, cash-flow statements and all supporting notes. It may also include pro-forma information and more rarely, profit forecasts.

## The “back end”

This is principally formed of legal information on the directors and shareholders. In certain circumstances a short term financial forecast may also be included. It includes information such as the company’s share capital, memorandum of association, articles of association, directors’ interests, major contracts and outstanding legal disputes. It also contains the working-capital statement by the directors.

## Pricing shares

One of the most difficult aspects of floating a company is valuing the business and setting a price on its shares. This responsibility falls to the sponsor and broker.

A balance needs to be struck between maximising sales proceeds and making the shares attractive to investors. The price must also be set at a level that would be attractive to underwriters and sub-underwriters when committing to taking up unsold shares.


Other factors influencing the share price include the general state of the market, net assets, historic and forecasted profit, and price-earning ratios for similar companies. It is usual to finalise the price as late as possible so that prevailing market conditions at the time of flotation can be taken into consideration. However, a balance needs to be drawn between maximising the price of the flotation and leaving room for the price to increase once trading begins after flotation (the “aftermarket”).

Whilst no-one can predict the future, a successful float will normally see the company’s share price rise in the aftermarket. A fall, particularly if it is out of step with the market, can reflect badly on the company and its brokers – making future fund raising more difficult.

## Timing of flotation

The timing of flotation can obviously make or break the transaction. Some factors are within your





control. Flotation should fit in with the cycle of your business, both in terms of presenting your financial results and the time commitment in running the business. Therefore it is usually best to float after your peak season. This ensures that you can afford to dedicate more time to running the business when it is most needed. In addition, the London Stock Exchange requires that the most recently audited financial statements must be dated no more than six months old (nine months in the case of AIM) at the date of the prospectus issued prior to flotation.

Other factors are beyond your control. These include changes in the economic environment or market sentiment. If these change adversely, it may be necessary to postpone or even call off the flotation. It is also advisable to fit your float in with the accepted flotation “seasons” of spring and autumn.





# Chapter eight

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## ***New listing, new obligation***

Congratulations! You have successfully floated your company. But if you thought that the hard work was over, think again.

Your company is now in the public arena and you have new responsibilities and duties, not all of which will be welcome.

Family-owned businesses may find that salaries and other benefits are fixed by non-executive directors. For major acquisitions or disposals, it is often necessary to seek approval from shareholders via a circular and to obtain an accountants' report on working capital to support the transaction.

And ensuring that the flotation remains a success is a time-consuming task. You must be prepared, for instance, to put time and effort into investor relations.

A list of some of the key changes you are likely to experience as a public company are listed below.

### **Directors' responsibilities**

As directors of the company, it is crucial that you fully understand the legal implications of the flotation. Directors of a public company are subject to significant liabilities and, because they declare responsibility for the content of the Admission Document, they may be subject to claims from investors who act on its content.



Directors are obliged to sign warranties and indemnities issued by sponsors and brokers, under which they may be personally liable if things go wrong with the flotation.

### Accountability

The transition from a private to a public environment means the directors have to become a great deal more accountable to shareholders for their actions. Where directors may previously have let company and personal affairs overlap, this is not permitted by public company directors.

The directors of a public company act as stewards, running it for the benefit of shareholders. They are also required to issue statements if, for example, there have been market rumours or big movements in the price of the shares, or in the event of a profit warning.

There are three essential differences in the directors' roles that need to be understood:

- *The directors are now more accountable to shareholders, albeit that one or more of the directors may also be a shareholder.*
- *The regime is much more restrictive. Directors need to ensure that they do not let personal and company matters overlap.*
- *Directors are required to make shareholder statements and request shareholder approval if they are considering transactions such as disposals (depending on their size).*

### Reporting

A public company faces more rigorous reporting requirements than a private company. On flotation it immediately becomes subject to public scrutiny due to the significant increase in its stakeholders. To ensure that it is fully accountable, a quoted company must divulge certain information to the public:

- *A half-yearly financial report (interim report) must be published as soon as possible, and in any case within 90 days after the period-end for AIM and main market companies. The report summarises the results for the period.*
- *It is best practice to make a preliminary year-end announcement, agreed by the auditors, within 120 days (for main market companies) or 6 months (for AIM companies) of the year-end.*



- *For companies on the main market, a directors' statement in the report and accounts must state whether they have applied corporate governance principles and complied with the Combined Code or, where they have not, explain why not.*

## Disclosures

A listed company is subject to on-going obligations under the Official List, AIM and OFEX rules, especially relating to detailed disclosures. Directors are obliged to disclose any information, not otherwise available to the general public, of major developments, such as product launches or acquisitions, which could lead to a substantial movement in share price. Disclosures of the salaries of directors of public companies are much more onerous. This is to ensure transparency and accountability as regards levels of remuneration.

The disclosures include any share options issued, gains on exercising those options, benefits, bonuses, etc. Other disclosures from an expansive set, include:

- *changes in directors' (or connected parties') interests in the shares of the company;*
- *changes to the capital structure of the company or the rights attached to the shares;*
- *the effect, if any, of any further share issues on the terms of the exercise of rights under options, warrants and convertible securities;*
- *any potentially damaging information such as past prosecutions or convictions.*

## Share dealings

It is usual at the time of flotation to agree that restrictions will be placed on share dealings by existing share holders and directors for a period after the float. There are also restrictions on the timing of directors' share dealings contained in the Combined Code.

## Dividends

Though not legally required, regular dividend payments are expected by the shareholders of public companies (especially fully listed companies) and by the market in general. The dividend policy of a company is often seen as a reflection of its state of health. Failure to make dividend payments or to reduce the dividend without an acceptable explanation may lead to a significant fall in share price.







# Glossary

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## **Admission Document**

The published document detailing the offer for sale or placing of the company's shares. Its content is determined by the rules of the UKLA, AIM rules and the Prospectus Rules and must be produced by all companies issuing shares to the public.

## **AIM**

AIM (the Alternative Investment Market) is the London Stock Exchange's global market for smaller and growing companies.

## **Back end**

The part of the flotation prospectus dealing with statutory and general information prepared by the company's solicitor.

## **Combined Code**

The current benchmark for best practice corporate governance. The code is part of the UKLA's Listing Rules.

## **Comfort letter**

A letter provided by a professional advisor, e.g. the accountants, to the company and its sponsor to support statements made in the Admission Document or a circular. These are required to be published in certain instances (e.g. pro-forma historical financial information) or just made available privately to the company and sponsor.

## **Crest**

Was introduced in 1996 and is a paperless share settlement system through which trades on markets can be executed.



## Due diligence

Detailed investigations – both financial, legal and human – into a company's suitability for flotation, takeover, merger or sale.

## Financial section

The part of the Admission Document produced by the directors and upon which the reporting accountant expresses a "true and fair" opinion based on the company's accounts. It comprises the financial information from the three years' audited financial statements, including balance sheets, profit and loss accounts, cash-flow statements, etc. It can also include historical pro-forma financial information and, less frequently, forecasts or projections.

## Flotation

The process whereby a company's shares are offered or issued to the public for the first time.

## Front end

The promotional part of the company's flotation Admission Document which includes all relevant information about the business. It is produced by the company, assisted by the sponsor.

## Insider share dealing

Using inside knowledge about the company and its business activities in order to make a profit on the sale or purchase of its shares.

## IPO

An Initial Public Offering (IPO) is also described as a flotation.

## Liquidity

The ease and frequency with which a security can be traded on a market

## UK Listing Authority (UKLA)

The Financial Services Authority (FSA) acts as the UKLA and maintains the official list showing all securities admitted to and restored to the Official List. To comply with its responsibilities the UKLA has created a set of 'Listing rules' for use by all entrants to the Official List and to those AIM companies seeking to raise in excess of €2.5 million.





## Listing particulars

A document, typically the Admission Document, that gives full details of the company and its shares, and which must be published when seeking a listing. Its content is determined by the relevant regulatory rules.

## Listing rules

Also known as the Purple Book, these rules, laid down by the UK Listing Authority, govern the admission of securities for listing on the Official List and for AIM companies raising in excess of €2.5 million. They also set out the on-going responsibilities of listed companies.

## Long form report

The report, produced by the reporting accountants, giving the sponsor and directors information to help them decide whether the company is suitable for flotation. It represents financial due diligence and contains detailed financial and business analysis of the company, its financial controls, forecasts, financing arrangements and its track record.

## NASDAQ

A US-based international stock market open to all industries but specialising in high-tech business. Favoured by UK companies that trade in the US or intend to do business there. NASDAQ has restrictions on company size and the number of shareholders.

## Nominated Advisor (Nomad)

A Stock Exchange-approved advisor for AIM companies. AIM companies must appoint a Nomad for a listing on AIM and retain them at all times thereafter.

## Official List

The list of all securities officially maintained by the UKLA.

## Placing

The method by which a broker places or markets the company's securities.

## Placing agreement

Terms by which the broker agrees to place the company's shares.

## PE ratio (price/earnings)

The price of a share, divided by the company's earnings per share. A higher PE ratio generally suggests investors favour the company's prospects.



### **Public limited company**

A company whose shares can be bought by the public, and whose share capital exceeds the statutory minimum. Not all plcs are listed companies.

### **Purple Book**

Formally known as the Listing Rules, this book lays down the regulations governing the admission of securities to the London Stock Exchange and on-going obligations of listed companies.

### **Reporting accountants**

Any company seeking a listing will use the services of reporting accountants. The accountants produce a long form report (financial due diligence) and express an opinion on the financial information (the short form report) contained in the Admission Document. They also review the adequacy of the company's working capital.

### **Short form report**

A report, prepared by the directors, summarising the company's previous three years' financial results, cash-flow statements and balance sheets and upon which the reporting accountants express a "true and fair" opinion. This is included in the listing particulars.

### **Sponsor (see also Nomad)**

A company's advisor who is approved by the UKLA. The role of a sponsor is to ensure that the company is suitable for listing on the Official List. The sponsor is responsible for co-ordinating the work of the advisors as well as pricing and arranging the underwriting of the company's shares. The sponsor also ensures that the company is fairly represented in the Admission Document and that the UKLA's requirements are understood and met.

### **Underwriting**

This is an arrangement, made between the company and the sponsor, whereby the sponsor will, for a fee, acquire all the shares not purchased by the public. The sponsor will often arrange to sub-underwrite the issue with other financial institutions, thereby reducing its own exposure.





### **Working capital**

Before undergoing flotation, the directors must make a statement declaring that there is sufficient working capital in the business. The reporting accountants review the basis for this statement and typically issue a letter of comfort to the directors and the sponsors that the statement has been made after 'due and careful enquiry'.





# Sources of information

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The following organisations and links can provide further information on floating your company.

UK Listing Authority (UKLA) – [www.fsa.gov.uk/ukla](http://www.fsa.gov.uk/ukla)

London Stock Exchange (LSE) – [www.londonstockexchange.com](http://www.londonstockexchange.com)

Alternative Investment Market (AIM) – [www.londonstockexchange.com/aim](http://www.londonstockexchange.com/aim)

OFEX – [www.ofex.com](http://www.ofex.com)

NASDAQ – [www.nasdaq.com](http://www.nasdaq.com)



# Our corporate finance services

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We have a well-established corporate finance team, providing expertise in a wide variety of business sectors and covering all major geographical locations.

Our dedicated UK corporate finance team includes 25 partners, supported by more than 50 staff, who are internally licensed to undertake or supervise corporate finance work. The partners' experience is derived from within the accounting profession, through holding senior executive positions with listed acquisitive companies, or with the venture capital industry.

Our proven experience covers a wide range of corporate finance activities from advisory to reporting aspects. Advisory assignments can consist of strategic planning, business disposals and acquisitions, management buy-outs, fund raising and pre-flotation planning.

Reporting assignments typically consists of financial due diligence investigations and acting as reporting accountants in connection with company flotations or other listed company transactions. We also specialise in high-profile valuation assignments.

Vital to any assignment is ensuring that we fully understand the aims and aspirations of the stakeholders in the business so that we can apply our experience and tailor our approach to help in achieving your desired goals. This flexibility enables us to work alongside clients, from discussing the initial business concept, assisting with fund-raising, through to the ultimate sale or flotation.



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## **Associated firms**

### **Guernsey**

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