

Spectra Systems Raises \$23 Million in AIM IPO

Overview

Providence, Rhode Island-based Spectra Systems raised \$23 million in its recent IPO on the London Stock Exchange's Alternative Investment Market (AIM).

Spectra Systems' invents, develops, manufactures and markets advanced, technology-based products used to mark, track and authenticate high value goods. The Company's security materials include proprietary and patented consumables and hardware and software systems which authenticate bank notes, documents, passports and products such as pharmaceuticals, software, optical disks and branded luxury goods. The Company's consumables, hardware and software often work together as a public and/or covert 'lock-and-key' system in the authentication process.

Spectra Systems was founded in 1996 to commercialize technology licensed from Brown University. The Company's corporate office is in Providence, Rhode Island and its laboratory facilities are across the river in East Providence. Spectra Systems has 20 employees; 11 in engineering, service and application support, four in research and development, three in finance, management and administration and two in sales and marketing. Future growth opportunities are focused on the United Kingdom, India and China.

Key Listing Metrics

- \$22.8m gross was raised, \$20.8m net of offering costs, intended to be used for:
 - \$2.0m - Marketing a new generation security feature to the central banks of India and China
 - \$1.5m - Plant and equipment to manufacture consumable materials in-house
 - \$1.0m - Completion of the development of banknote fitness sensing technology
 - An unspecified amount for strategic acquisitions
 - An unspecified balance for general working capital
- Offering costs amounted to 8.6% of the gross capital raised
 - Undertaken on a 'best efforts' basis, as opposed to being underwritten
 - Broking commission of 5.0%
 - Plus three-year warrants over 1.0% of the enlarged share capital at the IPO price
 - Corporate finance fee of £125k (\$204k)
- Opening market capitalization of \$55.5m
- Dilution to existing shareholders of 41.1%
- Free float of 81%
- Trailing pre-money and post-money revenue multiples of 4.5 and 7.6, respectively
- Trailing pre-money P/E ratio of 81.8¹
- Trailing pre-money EBITDA and Adjusted EBITDA multiples of 54.5 and 40.1, respectively¹

¹ Not particularly meaningful given the relatively small denominators.

Key Financial Metrics

(in USD millions)	Y/E 12/31/08	Y/E 12/31/09	Y/E 12/31/10	Δ from 2008	Δ from 2009
Revenue	\$7.0	\$7.4	\$7.3	+4%	-1%
Cost of Goods Sold	2.8	3.5	2.9	+4%	-17%
Operating Expenses	3.5	3.6	4.0	+14%	+11%
Income Before Tax	0.7	0.3	0.4	-43%	+33%
EBITDA	0.9	0.4	0.6	-33%	+50%
Adjusted EBITDA ²	1.2	0.8	0.8	-33%	0%
Accumulated Deficit	31.4	29.8	29.5	N/A	N/A
Cash and Cash Equivalents	2.4	3.4	3.4	N/A	N/A

The Company's revenues are highly concentrated with a very small number of governmental entities; with 95%, 94% and 82% of 2008, 2009 and 2010 revenues, respectively, earned from three, three and two customers, however, these types of customers pose very low non-collection risk. Since the IPO completed within nine months of the latest audited financial statements, unaudited, comparative stub period financials were not required and the Company chose not provided updated management accounts.

Shareholder Base

The Company had 9.5m common shares outstanding prior to the IPO, 17.2m common shares were issued in connection with the IPO via the conversion of preferred shares and 18.6m common shares were issued for cash in the IPO, leaving the Company with 45.3m common shares outstanding. The table below details those who owned 3% or more of the Company prior to and after the IPO, taking retrospective account of the preferred share conversions, along with the collective ownership of the Other Historic Investors, the Directors and the Other New London Investors.

Shareholder	Pre-IPO %	Post-IPO %
U.S. Strategic Investor (Papermaking Technology), NYSE-listed	11.86	6.98 ³
Asian/U.S. Special Situations' Investor	6.80	4.01
Panamanian-domiciled Investment Fund	4.13	2.43
U.S. Strategic Investor (Banknote and Passport Paper Manufacturing)	4.01	2.36
U.S. Strategic Investor (Book Printing and Publishing)	3.92	2.31
Isle of Man-domiciled Company	3.73	2.20
Other Historic Investors	44.44	26.18
Directors	21.11	12.46 ⁴
London Institutional Investor (Fund Manager)	-	9.83
London Institutional Investor (Fund Manager)	-	7.34
London Institutional Investor (Fund Manager)	-	5.87
London Institutional Investor (Insurance)	-	5.87
London Private Client Broker	-	3.86
Other New London Investors	-	8.30
Totals	100.00	100.00

The Company was backed by several Strategic Investors, several Financial Investors and a range of Other Historic Investors. All of the pre-IPO investors retained their shareholdings and were simply diluted as a result of the new shares issued in the IPO. The London Institutional Investors, the London Private Client Broker and the Other New London Investors took up the entire IPO.

² Only adds back stock-based compensation expense.

³ Subject to a six-month lock-in.

⁴ Subject to a 12-month lock-in and customary orderly market provisions for a further 12 months.

Beyond the obvious benefit of raising capital for organic and acquisitive growth, the Company now has a more diversified shareholder base from which to create post-IPO liquidity and new London-based investors to diversify the risk of any future financings. As a public company, Spectra Systems' corporate standing and profile will be raised, particularly in the United Kingdom, its share option plan will be more attractive to existing and prospective employees and Board members and its common shares will be more attractive to potential acquisition targets.

Board of Directors and Corporate Governance

The Board of Directors consists of one Executive Director (the Founder, President and CEO) and six Non-Executive Directors, all with solid resumes and a good blend of complementary experiences and skill sets. Given the sensitivity of the Company's technologies and products, one unique requirement is that the Board be comprised of a majority of U.S. citizens, as mandated by the U.S. Department of Security Services, the regulatory body of suppliers to the U.S. Government. As such, four of the seven Directors are U.S. citizens.

Companies listed on AIM are not required to comply with the U.K. Corporate Governance Code, which is mandatory for companies listed on the Main Market; however, the Company intends to comply with the Corporate Governance Guidelines for Smaller Quoted Companies which are published by the Quoted Companies Alliance. The Board intends to meet at least six times per year and as deemed necessary.

The Company has established an Audit Committee, a Compensation Committee and a Government Security Committee. Each committee consists of between two and four members with the Executive Director only being represented on the Government Security Committee.

Accounting Considerations

Since the Company remained incorporated under the laws of the State of Delaware and did not re-domicile into a European Economic Area country, which includes the U.K., they chose to report using U.S. GAAP. While, not required, a summary of the relevant differences between U.S. GAAP and IFRS was provided.

The U.K. Member Firm of an international accountancy network acted as Reporting Accountant while the U.S. Member Firm of another international accountancy network audited the 2008 - 2010 financials. Since the 2010 financials were less than nine months old, unaudited, comparative stub periods were not required.

An unaudited pro forma statement of net assets is never required in connection with an AIM IPO and was not provided in this instance since the Company does not have any debt; therefore, the effect of the net proceeds from the IPO on the net assets of the Company is obvious.

Legal Considerations

While the Company remained incorporated under the laws of the State of Delaware, its constitutional documents were amended to incorporate the most important elements of English corporate law as follows:

1. Pre-emption Rights (i.e. anti-dilution) – Shareholders may participate in, or the Company has to obtain approval from at least 75% of them for, the issuance of shares for cash of more than 10% of the then outstanding shares during any 12-month period. These pre-emption rights will cease to apply if the Company becomes a reporting company under the U.S. Exchange Act, the most common reason being a dual listing on a U.S. securities exchange such as NASDAQ.
2. Notifiable Interests – Shareholders are required to notify the Company of, and the Company is required to publicly announce, holdings at or above the 3% level and whenever a full percentage point is breached in either direction.
3. Takeovers (i.e. mandatory offer) – If any party, or parties acting in concert, accumulates a holding of 30% or more, they must make a cash offer to the other shareholders at the highest price they paid for the Company's shares during the last 12 months.

The Company relied on the safe harbor afforded by Regulation S of the U.S. Securities Act of 1933 so as to not have to file a registration statement with the U.S. SEC. Shares subject to Reg. S (generally, those issued in the IPO, issued one year before the IPO and/or held by affiliates) are not eligible for dematerialization and, as such, are always held and traded in certificated form.

Since the Company did not re-domicile into the U.K. or one of its Crown Dependencies, the Channel Islands and Isle of Man, its shares that are not subject to Reg. S are not eligible for trading within CREST; the most common electronic system for the holding and transfer of shares in the U.K., however, a Depository could be appointed and Depository Interests (DIs) could be created which would be eligible for trading within CREST.

Due to the sensitivity of the Company's technologies and products, they chose to not create DIs for their shares that are not subject to Reg. S so as to mitigate the risk of non-compliance with certain U.S. federal laws and trading and economic sanctions enforced by the U.S. Office of Foreign Assets Control and the U.S. Department of Defense regarding 'unauthorized parties' holding shares in the Company and 'non-U.S. persons' holding a stake of 5% or more given the potential for access to classified information and the potential for exercising control over, or influencing, the business or management of the Company.

The Company has two share trading lines, Reg. S and Unrestricted, and both represent securities with identical rights.

Other

Given the nature of the Company's business, advanced, technology-based products used to mark, track and authenticate high value goods; Experts' Reports on the technology and intellectual property were prepared, however, they were kept confidential given the sensitivity of the Company's technologies and products.