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HOME LENDERS

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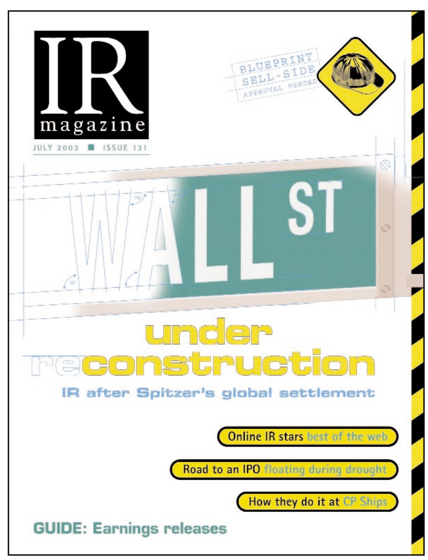
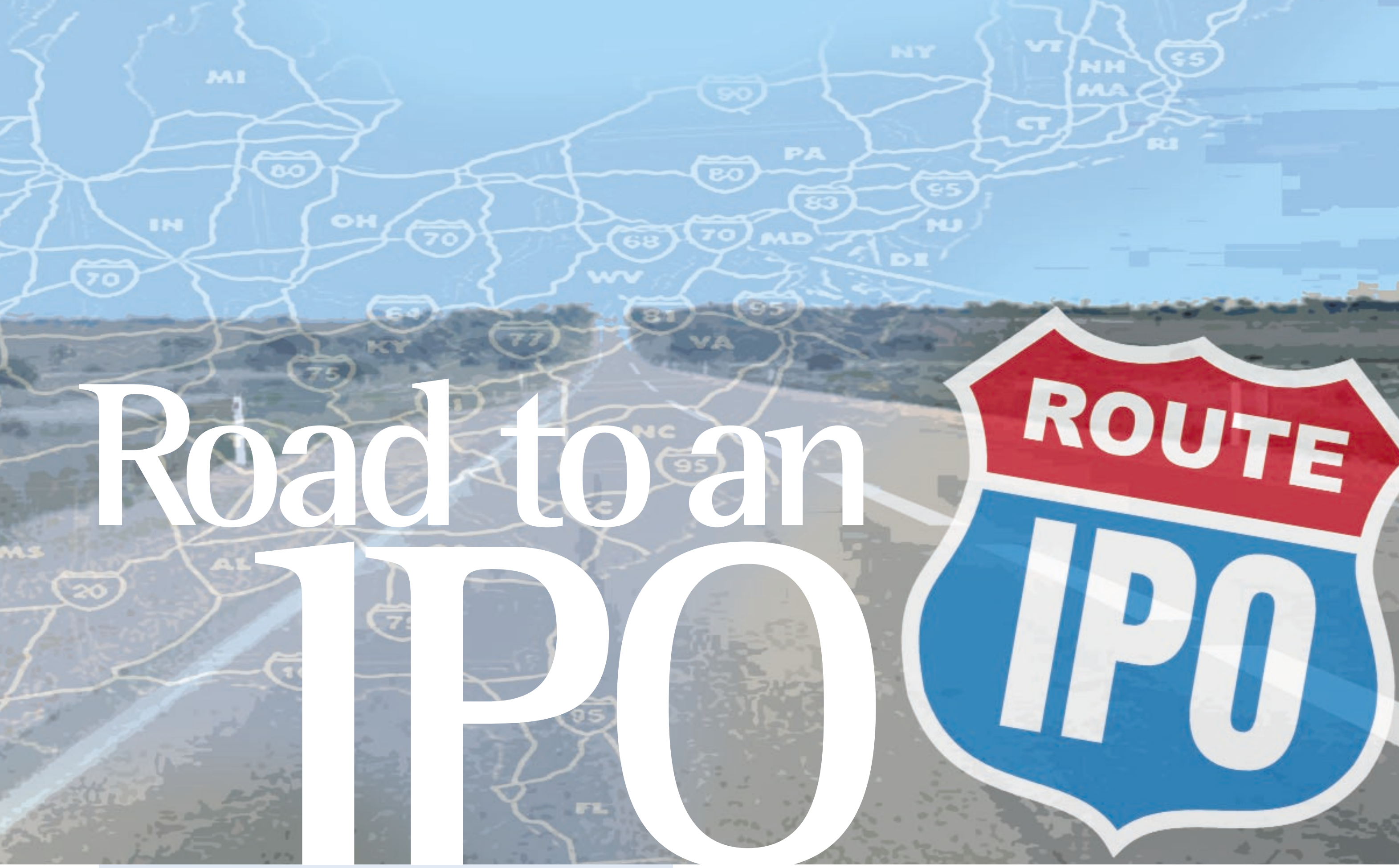




Road to an IPO

Carolyn Iglesias finds out how Accredited Home Lenders managed to go public in an IPO drought

Launching an initial public offering in today's parched capital markets is like searching for an elusive watering hole in the desert. You could die of thirst without seeing even a mirage of investor capital. Or you could *almost* quench your thirst at the shrinking IPO oasis.

Only a few would-be public companies ventured to refresh their capital needs at the drought-stricken IPO waters in early 2003. Among them was San Diego-based Accredited Home Lenders Holding Co, a mortgage banking company that originates, finances, sells, securitizes and services non-prime mortgage loans secured by single-family residences across the US. (Non-prime mortgage loans are those that do not generally conform to the credit criteria or other requirements established by Fannie Mae and Freddie Mac.)

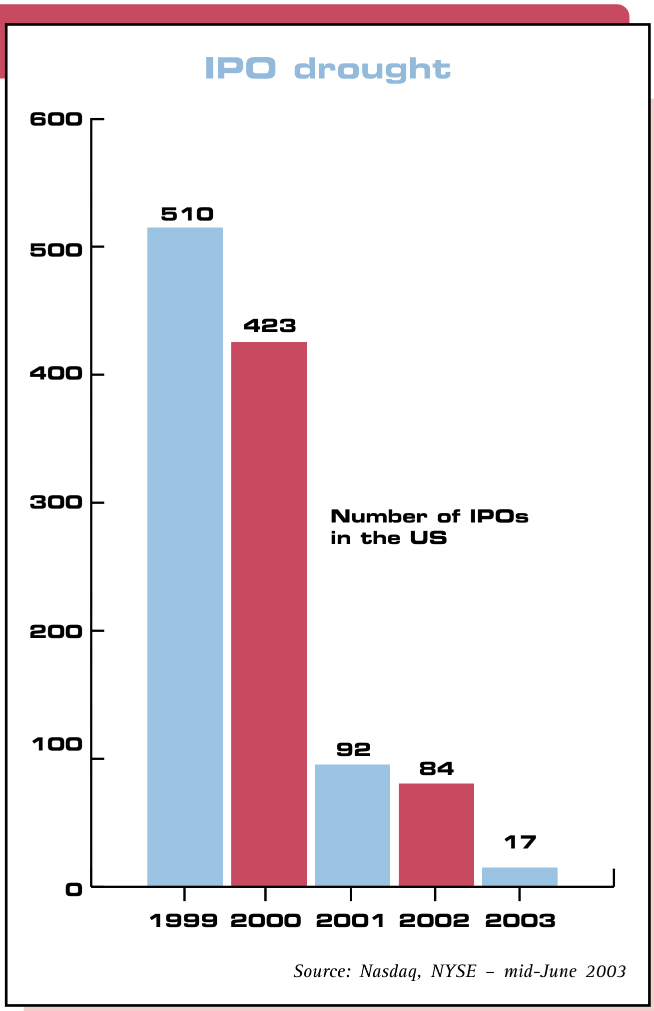
Accredited took the plunge on February 14, 2003, raising $77.2 mn in a 9.65 mn Valentine's Day share offering on the Nasdaq Stock Market. With a target pricing range of $9-11, the $8 per share issue price left the company a little bit thirstier than anticipated. In fact, a special board meeting was called on February 13 to weigh up whether to forge ahead or hold out for a better price. 'We got the best price available in the market at that point in time,' says Jim Konrath, chairman and CEO of Accredited. 'A bird in the hand is worth two in the bush – that's the analogy that comes to mind. We were happy to be there.'

These days very few IPO candidates make it to market. Many abandon the quest along the way, realizing the market is not biting at the chance to invest in new offerings. Following the dot-com geysers of 1990s, IPOs slowed to a trickle by 2002 and virtually evaporated at the start of 2003 (see chart, page 44). Market watchers call the current dry spell one of the worst IPO droughts in recent memory.

Some experts say it takes a different kind of company to navigate the course to publicly-traded waters today. Eric Chiappinelli, a professor of law at Seattle University who practiced corporate law in the IPO heyday, believes companies with a 'strong story to tell, a longer track record of existence and a very strong management team who have been with public companies before' can still float stock in the current market.

Today's IPO

Accredited may well exemplify the seasoned profile a company should have before it enters today's capital markets. You could say the Accredited team began training to take the company public as far back as 1990. That's when co-founders Jim Konrath and Ray McKewon, the latter now Accredited's executive vice president, secretary and director, started the business with $30,000 of their



Source: Nasdaq, NYSE – mid-June 2003

own personal savings. Their first headquarters was an 800 square foot space above an auto repair shop.

When they joined forces, Konrath and McKewon had plenty of experience heading their own businesses. Konrath spent over a decade in the mortgage lending and consumer finance business, having served as president and CEO of Security Pacific Financial Services and Security Pacific Housing Services. McKewon, originally a stockbroker, co-founded and was managing partner of Enterprise Management Company, a venture capital firm that provided seed financing to growing companies and took several of them public.

From the start they charted a 'no nonsense' course to bring Accredited public. According to Konrath and McKewon, when you begin a business you've got to steer it on one of two paths: 'the lifestyle path' or 'the shareholder value path'. On the lifestyle path, the principals intend to keep the company private so they focus on 'maximizing personal income and current enjoyment of life,' explains McKewon. 'They take the profits out of the company whenever they can, leaving only enough liquidity for the company to run.' You can usually spot such a company through signs like 'the wine cellar beneath the office.'

By contrast, Accredited's founders took the shareholder value path, a more austere route focused on building a publicly-traded company. 'There are no company airplanes, there are no country club memberships, there are no company cars or any of that sort of thing,' says Konrath.

'When you embark on the shareholder value path, 'you take a monk's oath and you leave the profits on the table,' says McKewon. 'You don't maximize salaries because you're trying to build something for the long term.' Along with 'controlled salaries' came 'minimal or no perquisites' and 'sharing equity with employees'. The founders even established criteria for testing when Accredited would be ready to go public (see sidebar, Tests to launch an IPO).

Konrath and McKewon decided to be self-financed while they tested their business plan and put the moving parts of the company together. They initially used their own credit to finance loans. 'It's okay to lose your own money when you try to do something,' states McKewon. 'But it's less okay to lose other people's money; we wanted to be more confident of the business proposition by proving it on our own dime before using anybody else's.'

Laying the foundation

By 1994 Accredited's founders believed they had ironed out all the kinks and were worthy of other people's money. 'We thought we could accelerate our business plan by putting more gasoline into the tank,' recalls McKewon.

So, in two rounds (December 1994 and February 1995) Accredited raised $5 mn in venture capital. 'Now we had outside institutional shareholders whose investment in the company deserved a return,' McKewon recounts. 'And it was our job to produce one for them and ourselves.'

Around the same time the company also established a board of directors and set about introducing board governance procedures.

In 1996 and 1997 the IPO market looked tempting and investment bankers called on the company to explore going public. 'Temptation is always a dangerous thing,' says McKewon, recalling that when the founders looked at the investment bank's business proposition, they didn't agree with the money men. They both believed certain popular accounting practices used 'faulty assumptions' to calculate the present value of a predicted earnings stream.

'We disagreed with the accounting assumptions our competitors were using,' says McKewon. 'We believed the wildly attractive earnings these companies were posting to be air. And we said if we've got to compete with that at a time when we'd be unwilling to use that accounting theory, we're going to look like we have little, tiny, puny earnings compared to their great, big, extravagantly, beautiful earnings and the market won't like us.'

Over the next several years Accredited focused on becoming a 'better and better' private company. 'We put cash in the bank and we improved our systems and our technology,' McKewon says. And as competitors failed, the company recruited talented people who would not otherwise have been available.

Accredited posted record earnings in 1999, 2000 and 2001. By late 2001, the founders believed that the company was able to meet

Tests to launch an IPO

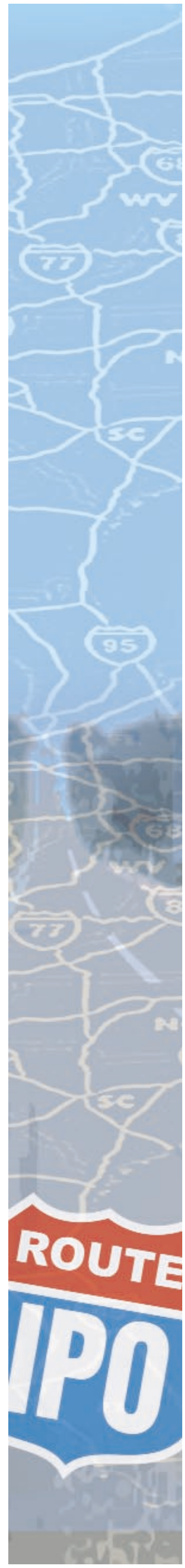
Accredited Home Lenders' co-founders, Jim Konrath and Ray McKewon, set their own ground rules for when their company would be ready to go public. They established three 'tests' and focused on achieving them. This disciplined approach, as described by Ray McKewon, helped Accredited tap into the capital markets during a drought.

Test 1: **The company must be ready with a solid team, solid earnings, and confidence that we would be able to deliver appropriate growth following an IPO**

Test 2: **The company must have a public market that would allow us to do an IPO**

Test 3: **The company must receive terms that would be satisfactory to the current shareholders at the time of the IPO and must have enough proceeds to carry out its objectives**

'You know you're ready when you can look ahead to the next two or three quarters and you can be pretty sure you know what is going to be happening. Furthermore, you know that what's happening is good and has a reasonable certainty to it such that you can predict and deliver growth,' McKewon concludes.



the tests they had established, so long as the market improved. In October 2001, they began meeting with investment bankers. Then, at an April 2002 board meeting, they made the decision to go public and selected an investment banker. On July 1 last year the prospectus was finally filed.

Even without major changes, the amendment process took months and months. 'The Securities and Exchange Commission probably took longer, and was more cautious in its response, because we were living in the middle of WorldCom and all the rest of the things that were going on,' comments Konrath.

Taking the plunge

By October Accredited had SEC clearance and could have printed a red herring prospectus and begun the roadshow. But then the market took a nosedive and institutions took short positions in one of Accredited's publicly-traded peers, so management opted to wait. 'There's a market perception that if you cut a red herring and don't do anything with it or start a roadshow that gets aborted, that somehow marks you as a failed offering,' McKewon surmises. 'We did not need, or desire to have, that blemish.'

Eventually the market began to recover but multiples had shrunk considerably. 'They went from eight to twelve times forward earnings to six to eight times forward earnings, and then to four to five times forward earnings,' McKewon recalls. With year-end approaching and not enough market improvement in sight, these patient executives bided their time once again until they finally spotted a window of opportunity in early 2003.

Accredited printed its red herring in January 2003 and set off on the road. In two and a half weeks, the management team did a whirlwind tour of 19 cities and held 75 meetings.

There was good news – Accredited was practically the only show on the road and got to present before a who's who list of investors. 'We got connected with some people we might not otherwise have gotten to meet because of the time they had available,' Konrath comments.

And there was bad news – another downturn. 'There would be days while we were on the road when the market would go down 150 points ,' McKewon says. 'It was like you didn't want to look at what happened that day, or listen to it on the radio or TV,' Konrath says. 'It was kind of ugly.'

'It is a far more challenging market today than we've seen in many, many years,' confirms Jim Kleeblatt, senior managing partner of capital markets for Friedman Billings Ramsey & Co, the investment bank that served as lead placement agent for Accredited's IPO. 'The market seems to be very, very selective.' So what led to the company's successful offering? According to Kleeblatt there were many factors including 'the compelling earnings, a modest P/E and a disciplined management team.'

Fulfilling a dream

Accredited's IPO is the story of one company's voyage to the public markets. It's about drawing up a plan, laying the foundation and building a solid business before opening up to the public. It's about fulfilling an obligation to provide liquidity to venture capitalists who fueled the company's growth by putting 'more gasoline' in the tank. And it's about helping customers fulfill the American dream of home ownership along the way.

But for Konrath and McKewon it's about fulfilling their own dream (on Valentine's Day, no less) of building a publicly-traded company. From humble beginnings they grew Accredited to a business of 1,400 employees with an office that is 73,500 square feet big. Accredited's quaff at the IPO waters provided capital to expand operations, invest in technology, improve infrastructure, open additional offices and hire additional sales staff.

As Accredited continues its journey as a public company after entering a shaky market, CEO Konrath shares his guiding philosophy: 'Take good care of your employees, take good care of your customers, and your stock price will take care of itself.' IR