

10 Do's & Don'ts of an IPO

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Issuers' Ten Do's & Don'ts For A Successful Initial Public Offering (IPO)

Did you know that there were over 150 IPOs in the last 12 months just across two main exchanges in the U.S. alone? Interesting statistics: almost half of the companies that went public last year have a negative return from the time of listing to the date of this article: at least 85% have return below 10% and 60% of the companies are experiencing returns south of -20%. About 25% of all debutants started their first day with the average negative return of about - 8%. The rate of IPO performance hardship then usually expands throughout the weeks following the listing, when support from the banks leaves the building.

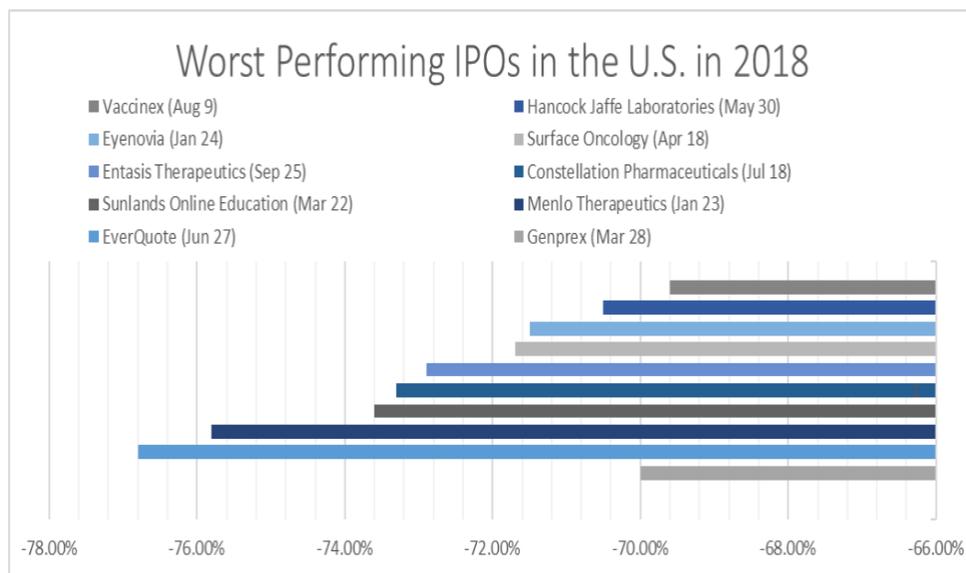


Figure 1: Worst IPOs in the U.S. - Renaissance Capital. (n.d.). IPOs with lowest return in the United States in 2018. In Statista - The Statistics Portal. Retrieved March 14, 2019.

We can debate (and appreciate) the possible reasons for such impressive underperformance since companies do not go public in a vacuum - a difficult macro, trade tensions, China impact, rate hikes, Brexit, possible

border walls, dogs eating homework, etc. Life is always happening, the conditions are always fluid and almost never perfect, though, of course, some years are more favorable than others.

The question is are companies perfecting EVERY SINGLE condition that is actually within THEIR control to ensure a successful IPO? And an even more important question is: are companies aware of WHAT aspects of the IPO and the prep process they actually MUST control? It is imperative (and a duty of management to the company and its

shareholders) to be best-positioned for the most successful debut vs. others, with all other uncontrollable acts of Capital Markets Gods being equal.

There is not a lot of information out there on pre-IPO preparation and the required mindset before the companies run to the external legal counsel and the bankers. Most companies with whom we discuss the pre-IPO process prep are surprised at what we have to say.

I personally was not able to find a single article out there describing all the “Must”s and “Don’t-Even-Think-About-It”(s) on the road to a successful initial public offering. Spoiler alert - hiring investment bankers is NOT THE FIRST step. What most of the articles are addressing as the “manuals on the beginning of the process” is, in fact, the manuals of how “the end of the road” looks like – the last 120-180 days to the limelight. One of the most useful publications on that, in our view, is by [Latham & Watkins](#). There is a vast amount of intelligence that must be obtained by the company to preserve its independent thinking and its leverage, as well as to be aware of all the underwater rocks and potential conflicts of interests - way before the syndicate members are engaged. Further intelligence must be obtained on how to create the best syndicate, who should run the IPO process and what rights and duties the issuers should claim in that.

The scarce amount of publicity addressed to the issuers on these important matters is quite puzzling to us - this subject seems to join the category of the best kept secrets. It is not something that is being widely discussed in public forums. I could not find any educational materials addressed to management teams and selling shareholders of issuing companies to help assess IPO readiness, viability, and their role in the early process BEFORE 120-day clock starts ticking.

So... whatever the reason might be, there seems to be no experts publicly sharing the knowledge and publishing IPO manuals or just simple list of pitfalls to avoid. One can say: “Well, surgeons are not publishing articles on “Do’s and Don’ts Of Your Very Own Quadruple Bypass Surgery”... Or lawyers don’t publish “Do’s and Don’ts of Defending Yourself In A Class Action Case”. Nobody will ever think of doing it on their own!

Thorough planning of IPO process INTERNALLY is basically as critical for a company as a quadruple bypass surgery is for a person in need, just please remember that not every player in the IPO process has the same standard of fiduciary duty to the issuer as doctors have to their patients.

Therefore, it is not recommended to be under general anesthesia on any matters related to this complex and (let's face it) opaque for the non-investment banking eye process. Catching up on how to navigate the markets and investor psychology at a later day, when the bankers no longer support your shares and the quiet period is over, is really not a good idea. That would be an equivalent of waking up post-surgery, still on the operating table, with the lights off and nobody around. Yet, many issuers seem to do exactly that. Or worse, while there are knowledgeable and capital markets-savvy management teams out there, there are many newbies who are 100% certain that they know exactly how the markets work and what are the rules of the sandbox... until they realize they don't have a tight handle on the process at all.

There is such a massive disparity of IPO performance for individual companies and for the sectors! Thus, we can't help but wonder whether this gap can be contracted by a better prep process and the degree of awareness of the companies themselves. We literally have an IPO factory in this country alone: just in the past six months we had over 3

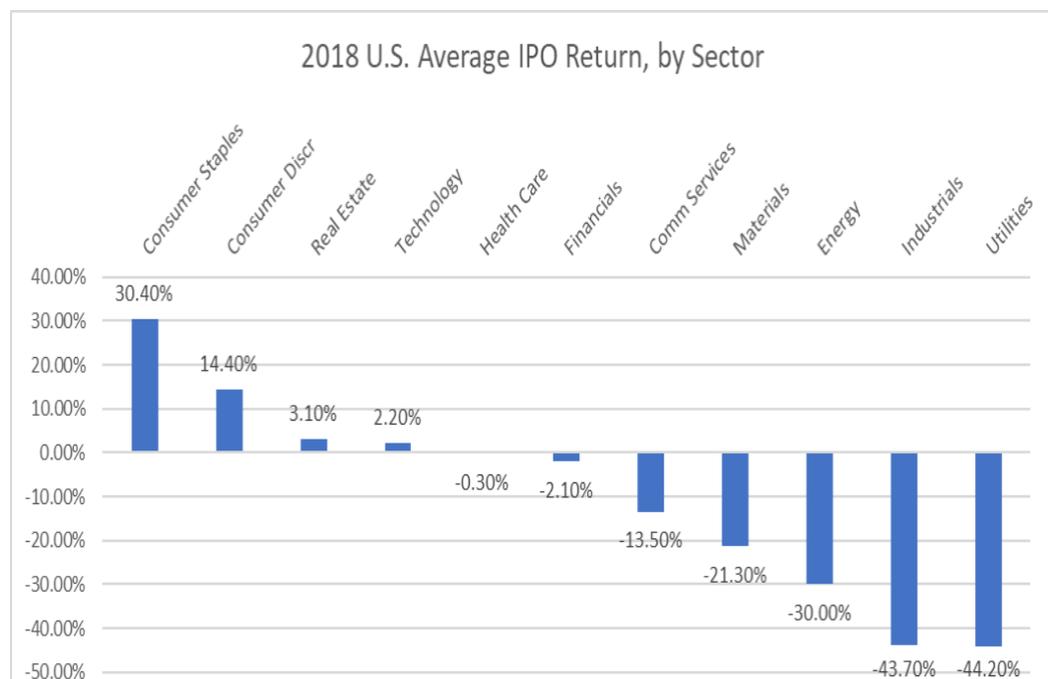


Figure 2: Renaissance Capital. (n.d.). Average IPO return in the United States in 2018, by sector. In Statista - The Statistics Portal. Retrieved March 14, 2019, from <https://www.statista.com/statistics/429879/average-ipo-returns-usa-by-sector/>

IPOs per week on NYSE and NASDAQ on average. The individual issuers performed anywhere from +324% to -74% since their first day of trading, to date. We will examine possible reasons for such extreme outcomes in the future analytical undertakings.

For now, we have compiled a list of IPO-related imperatives for the issuers, and we plan on expanding on each subject in the articles to follow.

10 Do's and Don'ts of The IPO Process For The Issuers

1. DO NOT Rush, DO Independently Assess The Option of Staying Private.

Form your opinions before your company starts speaking to possible IPO-related services providers, who have clear vested interests in hefty payments associated with you joining the IPO crowd. As part of this effort, please DO meet with institutional investors that would be your potential shareholders. Even if you contemplate a possible IPO in 2-3 years from today, it makes sense to meet with those for whom you desire to become a steward of capital. If you are approaching a solid small cap size, they will take meetings with you and without the intermediaries! In addition to understanding the mentality of each fund and each investment mandate, you will get invaluable feedback about your company through the eyes of buy side, potential improvements needed, and important thresholds you will have to meet once you are on 120-180-day clock. You will also assess whether you can handle expectations and demands of these passengers, some of which can be quite heavy (as they also have to answer to their demanding shareholders or LPs!). Importantly – you will start building a track record and credibility with the buy side early on – so if you do eventually decide on a listing, your deal roadshow meeting with your key investors ideally should not be your first!

2. DO Understand – Bankers ARE NOT Your Fiduciaries

Bankers are there to take you public. It is possible but NOT advisable to go public without them for a slew of reasons. However, what many companies miss is that the bankers do not have to always “have their backs”! As a matter of fact, most deals have at least several stages during the IPO process where a

company's interests will not 100% align with those of the bankers. And they don't have to! Business is business and the bankers have to make money for them and their buy-side investors who are their ongoing trading clients. A subject of fiduciary duty between the underwriters and the issuers has been a subject of much controversy. Even the United States Securities and Exchange Commission refuses to clearly delineate the definitions. The cases from Supreme Courts and the Courts of Appeal pointed out that bankers and issuers only have a mere contractual relationship. Thus, it is imperative for companies to form their own understanding of all intricacies.

3. DO Build The Company With The Highest Degree of Transparency and Corporate Governance.

Investors (public and private) would rather fund an "OK" business with an impeccable management and clean corporate governance, than a uniquely brilliant business with questionable structure, governance, and an "OK" or questionable management practices. Markets are completely unforgiving to credibility flaws and potential governance-related red flags. Moving headquarters, reorganizing, and de-offshorization in the 11th hour before the IPO does not look like dynamite moves to picky investors' eyes. If you have your heart set on going public one day – do it right from the start!

4. DO Run Your Own Numbers

A company must be ready to be under the magnifying glass of the public markets at all times. Six months or less is nearly not enough to get everything buttoned up: not only structurally and operationally. The company also must develop an acute financial maturity across reporting standards, disclosure standards, and precision in forecasts. Take an objective look at your prior projections vs. actuals – your ability to come out with viable expectations, correctly manage them, and most importantly, fulfill them with a consistent positive surprise will play into a huge success of your stock vs. your peers, macro factors aside. If your history of short- and mid-term forecasts is less than stellar, that is something to clean up WAY before you engage any IPO-related experts. Build your own valuation models, build your own investment case, use the

feedback from your investor assessment from “DO” #1 above, do your own research and come up with your own valuation range.

5. DO Appoint Your Corporate Chaperone

So, if the bankers are not your fiduciary then who is? The management must start with appointing its very own corporate chaperone, as we like to call it. This person should have the knowledge of the investment banking process, live, breathe and speak the language of investment bankers, be able to put forth a proactive consistent Investor Relations strategy, know the buy-side and the sell-side research crowd, and EXCLUSIVELY represent the interests of YOUR company. It can be someone internally or it can be someone on a long-term consulting basis.

6. DO NOT Try to Get By With Your Own Resources

IPO preparation process can be very distracting to senior management. During a sensitive time when you have to run your company and meet and beat the numbers expectations, the last thing you should do, on the ongoing daily basis for 6 months or more, is to be pulled into endless amounts of meetings, drafting sessions, coordination, status calls, etc. You must keep an eye on the process but allow your IPO Chaperone to oversee the daily minutia.

7. DO Understand Objective Strengths & Weaknesses Of Investment Bankers.

Investment banking is an art that combines razor-sharp financial savvy, the art of building relationships, and the art of making a sale. As you select your syndicate, you're likely to face bankers' pitch decks that are over 100 slides long. Every bank is also usually “Rated #1” in your domain. Paying attention to the fine print explaining how such calculations are derived is important, and sometimes can be entertaining and enlightening! While we all know that the companies usually pick the bankers based on their relationships and logos, it is important to understand the strengths and the weaknesses of each candidate regardless of the brands you are selecting (and regardless of the vintages of champagne served at dinners together). You must compile a SYNERGISTIC syndicate, which also has checks and balances covering every aspect of your IPO in the best way possible. Weaknesses of one bank must be reinforced by an absolute strength

of the other. Make sure you've got key success aspects covered across the syndicate: at least one strong (preferably highly ranked) analyst to launch research coverage post quiet period; a solid capital markets distribution team for whom short - AND long-term success of your deal will be a priority; a committed senior banker to draft prospectus and your analyst deck; steel-strong relationships with a complimentary investor base, etc.

8. DO Own Your Offering Memorandum!

The company's management must weigh and assess every word in the prospectus. OWN every page of it! Let's face it, if there were stats on how many management teams do not read their own offering documents from A-Z, and yet, they sign it, I bet the numbers would raise eyebrows. Yes, there, I said it! I can hear people shushing at me already... but we all know it is true. The phrase "nobody reads this thing anyway" is way too common and one body that reads it for sure is your SEC examiner.

Related to the above there are two sub-do and do-not recommendations:

a. DO NOT Overstate Your Risks.

The notion of throwing everything and a kitchen sink into the Risk section of your prospectus may please your attorneys but it may not be all that constructive to you. Put only those risks that do pertain to your business. We had some instances where certain factors that if transpire would contribute ONLY to the upside of the business across the board were written down as risks under the "kitchen sink" methodology. The Risk section is probably the most read section by the investors. So get all of the skeleton's out of the closet to avoid any unpleasant surprises later and kick the ones that are imposters out!

b. DO Talk Up Your Business Model

A Prospectus is a marketing document that conveys beliefs of management that are propped by historical performance. Don't be shy to express why you're better than the competition and why are you going to knock it out of the park in the long-term. Keep in mind that any near-term projections are forward-looking statements for which you will be held accountable. Also, make sure to absolutely NAIL your first few quarterly reports vs. the forecasts you're providing during the IPO process.

9. DO Test The Waters

If you know that you will qualify for Emergent Growth Company (under \$1.07 Bn top line) under the JOBS Act, take advantage of this opportunity. Once you hire your legal counsel and even before you hire the bankers you're already in a "grey" period, so meeting investors during this time if you're not EGC is not desirable as it may look like you're "jumping the gun". That is why we included meeting potential investors under "Do" 1 during your "pre-IPO pondering stage". If you're EGC and you already have your institutional following, meet with them during this pre-IPO time again, it will cement your credibility, help connect the dots on earlier meetings and make you sleep well during the deal roadshow vs. other teams on the road who have zero idea on how their book of orders is REALLY shaping up and why.

10. DO NOT Be Shy To Ask Questions

The company has a right to and should be standing in a position of 100% internal NON-SUPERFICIAL understanding of what happens at every step and why. The management can challenge and ultimately override any suggestions (at your own risk) as you're the boss of your IPO and others are at your service. That is why it is important to have people who are 100% comfortable driving the process, know your target investors, and speak the same language with the bankers. Go ahead and ask "why this way?", "what are the alternatives?", "why this particular target shareholder list suggested", "why this valuation?", "why this target price range?", "why this book allocation?", etc.

We hope this article will launch an interesting educational series for corporate issuers, shedding more light on the IPO process and urging companies to educate themselves meticulously on the IPO process and all possible consequent scenarios. We also hope this series will raise awareness of the importance to OWN this process and the ongoing responsibility of companies to adhere to the best standards in corporate reporting and communication to operate well regardless of changes prompted by macro or regulations, such as MiFID II.

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