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PERSPECTIVE

Implementing the underwriter perspective can improve IPO success

The fundamental purpose of the underwriter in an IPO process is to tell a story about a company that will generate the most possible interest from investors.

By Sara L. Terheggen

As a company contemplating an IPO, there is an endless list of things that must be done before you are ready to go public. Companies typically start thinking about going public 12-24 months before they actually become a public company. This IPO preparation process involves assessing and, in many instances, making changes to many layers of the company, including business, structure, financial, leadership, governance, communication, operations and infrastructure. But, which of these layers, and what changes within each layer, is going to be most impactful to ensuring a successful IPO?

There is certainly no right answer but one perspective which is critical and is often overlooked until the time comes to actually execute on becoming a public company is that of an underwriter. This is particularly the case because underwriters are often not chosen until after the IPO preparation process is mostly complete and their views become primarily relevant during the IPO execution stage, which is the few months leading up to the time a company goes public. The fundamental purpose of the underwriter in an IPO process is to tell a story about a company that will generate the most possible interest from investors. This will drive demand and allow the underwriter the best opportunity to optimally price the IPO on behalf of the company.

The IPO execution process typically begins with writing the company's story in the S-1 registration statement. Before and after the S-1 is filed, diligence and valuation become the primary focus and the story must be substantiated with financials and facts. Finally, during the roadshow, the company has the opportunity to verbally tell their story to investors. Exploring each of these stages from the underwriter's perspective will allow management to refine and focus strategy, identify risks and prepare a business plan that will lead to better results and a more successful IPO.

The Underwriter Perspective: Focusing on the Story and the Substance

Stage One: Building the Story

Once the organizational meeting happens at the beginning of an IPO execution process, the focus of the parties involved will be on preparing the S-1 registration statement. A huge component of the S-1 is the business section which tells the company's story. The most difficult aspect of this process is that a company will often just rely on the underwriters to show up to the organizational meeting with a draft of the box (which is a summary of the business section). Through several drafting sessions, the business section is revised and revised and, ultimately, may not end up resembling the company story at all.

From an underwriter's perspective, the story is key so it is critical that it comes out right. It is the building block for everything else they do. If a company wants to consider this stage from an underwriter's perspective, they should come into the organizational meeting with two critical items: (1) a business section that the management team wrote themselves and (2) a business plan identifying both a timeline and milestones met. For the written business section, management should undertake to do the following when building their story:

- Gather up similar business sections from peer companies and spend the time to analyze how their company stands apart and craft their own written story.
- Explicitly tie out and support the company's story with the business plan whenever possible.
- Include management's analysis of why and how the company is different from its competitors, including identifying strengths, competitive advantages and weaknesses.

For the business plan component, this is a process oriented document that should ideally encompass 24- 36 months pre and post IPO. The business plan is key to tie the narrative story to the financials. It, along with the written business section, can be critical as tools to come back to throughout the preparation of the S-1 to ensure nothing is lost. The business plan will also provide a company and its team with a helpful roadmap during the IPO process when attention is limited.

While a good underwriter will be prepared to provide input and suggestions, it is always better to start from where the company is to build and refine the story from there. A company who puts time, energy and effort into this aspect of their preparation will establish a strong foundation for a successful IPO.

Stage Two: Supporting the Story

Underwriters play two key functions in the IPO process when it comes to supporting the story: diligence and valuation.

Just like companies, underwriters take liability under Sections 11 and 12(a)(2) of the Securities Act of 1933 for any material misrepresentations or omissions contained in the S-1 registration statement or prospectus. The one key difference is underwriters (unlike companies) can assert a due diligence defense to avoid liability claims. Diligence from underwriters often focuses first on the business and operations more broadly, followed by more specific verification of statements in the S-1. Underwriter diligence will involve the following:

• Counsel to the underwriters will review board minutes, material contracts and many other documents the company is asked to produce for review.

• Underwriters will set up diligence calls with management, customers, vendors and company auditors.

• Background checks on management and the board directors is conducted.

• Underwriters will request fact back-up on certain statements in the S-1, in addition to getting a comfort letter from auditors.

Considering how important this diligence process is to an underwriter, a company can take obvious and easy steps to prepare for the diligence process such as compiling and collecting documents necessary for review in a data room. But, more importantly, companies should go through a standard list of business and legal diligence questions and spend time to prepare responses and consider how their story does or does not address issues and concerns. By taking this thoughtful approach to preparing for diligence from an underwriter's perspective, they can identify holes in their own stories. This analysis will also factor into the company's IPO preparation of their other strategic layers. Finally, this exercise will help a company flesh out pertinent risk factors, as well as relevant priority of such risks, which is another important section of the S-1.

Arguably, valuation can be viewed as the most important factor in determining how well a company's IPO is going to be received by the market. With ever-inflating valuations in the market, it is becoming more and more difficult for investors to tell what stocks are worth it and which are not. Underwriters assist with valuation through building a model and working with management to refine. Some of the key factors underpinning valuation that have been shown to have a positive impact on the overall success of an IPO includes quality of anchor investors and strong financials. Anchor investors, especially large venture capital firms with strong track records, tend to provide validation for a company's story and stronger assurance growth expectations are achievable. Revenue growth and strong EBITDA margins in the 12 months leading up to an IPO are often two of the most important factors investors focus on when considering investing in an IPO. These two financial metrics are also good story supporters. When one or both are weak or have experienced tumultuous results, particularly in the 12-18 months leading up to an IPO, this can put pressure on the company and underwriter to tell the story "around" these issues.

Thinking about valuation from a realistic grounded perspective and developing a business plan to focus on important investor indicators, such as revenue growth and EBITDA margins, gives companies a more targeted approach to their IPO preparation.

Diligence and valuation are key contributions made by underwriters and if companies consider these factors early in their preparation process through the lens of an underwriter, they will help ensure a more successful IPO and smoother process but they will also be building the foundation of a better company which will make "being" a public company that much easier.

Stage Three: Telling the Story

Telling the story is logically the last stage of the IPO execution process and is manifested in the roadshow. The company and the underwriters will go on the road from anywhere between 7 and 14 days to market the offering to potential investors. At the end of the roadshow, pricing will occur so this last opportunity to meet with potential investors and tell the company story is critical to maintaining momentum and contributing to the underwriter's ability to build the book. Companies often forget their CEOs or CFOs or other members of the management team are not the best public speakers. This can result in disastrous roadshow presentations that leave investors feeling underwhelmed. Underwriters are often forced to scramble at the end of the process to shore up management team skills through practice runs of the roadshow presentation. Given this, considering the roadshow from the underwriter's perspective early on can be very beneficial to a company's ability to tell their story. To do this, management should be realistic and assess their own personal abilities and that of their team members early in the IPO preparation process. If deficiencies exist, those individuals should be encouraged to seek presentation training, coaching and executive presence consultation in order to increase their ability to communicate more effectively verbally. This will not only help their underwriters on the road with investors in connection with the IPO but will prepare the management team for the more public communication presence necessary when the company is public.

The Underwriter Perspective is Critical

The fundamental purpose of the underwriter in an IPO process is to tell a good, honest story about a great company to generate the most possible interest from investors. This perspective sounds very straight forward but as discussed herein, the level of work, diligence and effort required by a company to ensure an underwriter can fulfill their purpose is quite extensive. The earlier a company can build this perspective into their IPO preparation process, the better prepared they will be at the time of the IPO execution phase. This will not only ensure the company can build, support and tell a great story, but it will lay the foundation for the company to be a great story.

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