IPO Readiness: Beat and Raise Model and the IPO Process

For VCs, Board Members, CFOs, and VPs of Finance engaged with IPO readiness, email paul.bieber@compound-ir.com for an illustrative copy of Compound IR's "Beat and Raise" worksheet.

There are many important factors that impact a newly minted IPO in its first several quarters as a public company. One of the most important factors is for a company and its leadership team to establish a track record with investors of exceeding expectations. **Over time, exceeding expectations creates an aura of credibility and execution, which can have a material impact on a company's multiple and valuation.** In addition, exceeding expectations implicitly is the opposite of missing expectations. The cardinal sin for a newly minted IPO is to miss expectations as it *viscerally* alienates investors and will likely take several quarters and perhaps years to regain investor confidence and trust. As the saying goes, "under-promise and over-deliver."

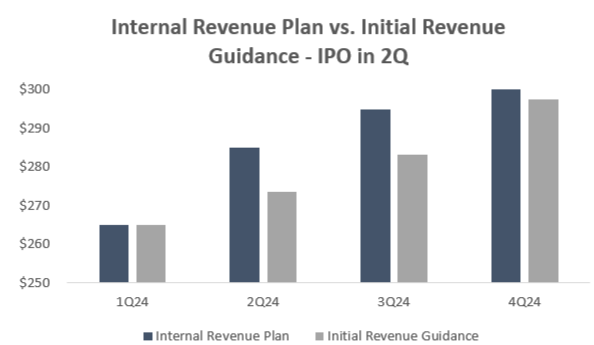
Given the importance of establishing a track record of exceeding expectations, the vast majority of IPOs utilize a "beat and raise" model that takes into account a beat, a raise and a cushion versus the company's internal plan that cascades and compounds over the first several quarters as a public company. It's important for late-stage companies thinking about a potential IPO to understand the "beat and raise" model as they contemplate IPO readiness and/or their capital markets options and the potential impact on valuation.

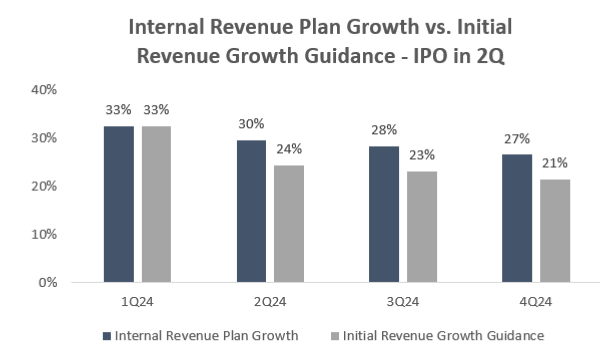
Before delving deeper into the "beat and raise" model, it's essential that late stage companies approach a "beat and raise" model with humility as it requires an honest assessment of a company's forecasting prowess and revenue visibility. So before obsessing over a "beat and raise" model, a first step should be an assessment of a company's forecasting ability, financial forecasting processes and infrastructure. If a company does not have a good track record forecasting its results, finance leaders should understand whether people, process or externalities (ie. competition, consumer headwinds, regulation, etc.) are the primary driver of the inaccuracy. The people and process components can be fixed (relatively easily) while the market externalities component is more challenging to address.

The "beat and raise" model has little value if a company has poor forecasting fidelity to actual results.

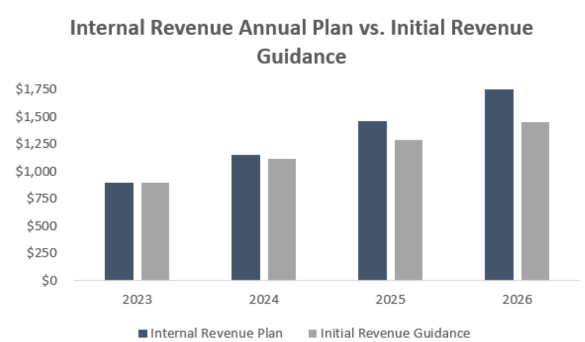
Once we have some confidence in forecasting fidelity, it's crucial for companies to understand the mechanics of a "beat and raise" model and its potential impact on IPO valuation. **Given that a "beat and raise" model compounds over several quarters, it results in an IPO underwritten on lower numbers (ie.revenue, growth, EBITDA, etc.) or more conservative estimates than the company's internal plan. Importantly, this usually impacts a company's potential valuation at IPO.** For example, if a company is expecting 33% Y/Y revenue growth in Q1 2024 and is targeting a Q2 2024 IPO, the company would need to guide to a materially lower growth rate in the back-half of 2024 and for full-year 2025 to account for the “beat and raise” cadence in the in the IPO model assumptions.

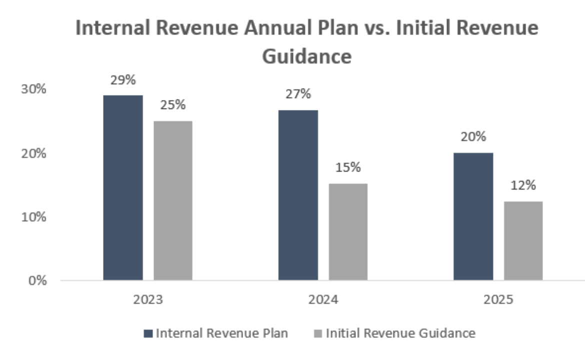
In the example below with **33% Y/Y** revenue growth in Q1 2024, a Q2 2024 IPO and assuming a 1% beat per quarter, a 2% raise per quarter and a 1% cushion per quarter, the company would need to initially guide to **~20% Y/Y** Q4 2024 revenue growth and potentially **15% Y/Y** revenue growth for 2025. In other words, **the beat, the raise and the cushion model assumptions compound quarterly in the back-half of 2024 resulting in materially lower estimates for full-year 2024 and 2025 versus the internal plan.**





Note - Above charts reflect an illustrative “Beat and Raise” model assuming a 1% beat, a 2% raise and a 1% cushion per quarter starting in 2Q24





The bottom line is that the compounding effect of a quarterly beat and raise model could have a material impact on valuation at IPO pricing, and it’s vital for all stakeholders to understand and internalize the potential impact on valuation as stakeholders engage in IPO readiness.

For example, applying constant multiples to the illustrative internal plan estimates for 2025 and the “beat and raise” model yields materially different valuation outputs. Yes, many other factors may impact the valuation (ie. buy side assumes higher estimates to underwrite the IPO, etc.) but we are assuming everything else is constant for illustrative purposes.

Illustrative "Beat and Raise" Impact on Valuation

Revenue Multiple	1.5x	**Revenue Multiple**	1.5x	
2025 Internal Revenue Plan	$1,465	*2025 Initial Revenue Guidance*	$1,290	
Enterprise Value	$2,198	Enterprise Value	$1,935	
Debt	$0	Debt	$0	
Cash	$0	Cash	$0	**Potential Valuation Impact**
Equity Value	$2,198	Equity Value	$1,935	-12%
EBITDA Multiple	12.0x	**EBITDA Multiple**	12.0x	
2025 Internal EBITDA Guidance	$220	*2025 Initial EBITDA Guidance*	$160	
Enterprise Value	$2,640	Enterprise Value	$1,920	
Debt	$0	Debt	$0	
Cash	$0	Cash	$0	**Potential Valuation Impact**
Equity Value	$2,640	Equity Value	$1,920	-27%

Over the long-term, the positive impact on a company's multiple and valuation from exceeding expectations far outweighs the short-term negative impact of the beat and raise model on IPO day pricing.