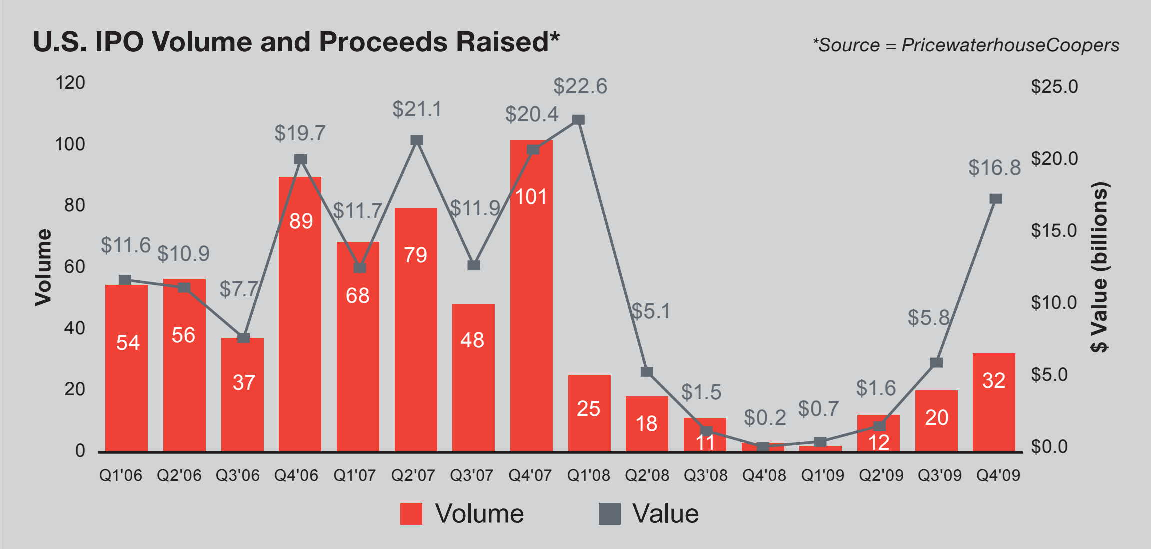
IPO Communications: New Issuances in a Fragile Market

While the significant uptick in initial public offerings in the fourth quarter of 2009 appears to signal better days ahead, it remains to be seen whether the current IPO pipeline will sustain itself in 2010. Certainly, the recent trend is encouraging. In the first three quarters of 2009, a combined 43 companies submitted IPO registration statements to the Securities and Exchange Commission, according to Dealogic; the fourth quarter alone exceeded that, with 53 filings. A closer look at the 66 IPO listings in 2009 reveals that while investors were eager to put their cash back to work, they have become more discriminating in the risks they are willing to take.

Nevertheless, the predominant view among IPO experts remains "optimistic but cautious." A closer look at the 66 IPO listings in 2009 reveals that, while investors were eager to put their cash back to work, they have become more discriminating in the risks they are willing to take. Investors in today's market have the luxury to consider each offering more carefully, given the relatively slow pipeline. Business models and success stories that seemed attractive in thriving markets (e.g., growth potential, brand, technology and innovation) may still carry important currency; however, there also are other factors that are increasingly driving investment decisions among longer-term investors.

According to the Ernst & Young 2009 Global IPO trends report, companies looking to go public will need to demonstrate strong fundamentals, good corporate governance, stable cash flows, a favorable earnings outlook, proven management teams and a solid asset base. In short, they will need to go beyond merely telling a compelling investor story to actually demonstrating robust operational performance on a quarterly basis. This is particularly true given the capital markets turbulence of the past 18-24 months. Recent evidence has suggested a shift in the types of investors that are most likely to purchase IPO shares from the shorter-term hedge funds of the past to the more traditional, long only fundamentals-based investors. Communications must rise to the challenge of persuading these investors to invest in an untested – and thus, inherently more risky – newly-public company, especially with many well-established companies still trading at reasonably discounted evaluations.

The still-challenging and unsure market, combined with investors' increased focus on longer-term performance, calls for a holistic approach to IPO communications that begins during the pre-filing period and continues through the filing with the SEC, listing day and beyond. Companies need to develop a comprehensive and compelling communications strategy to address the new market realities, support the business strategy and maintain investor support for the longer term.



Preparing for the IPO Filing

Companies looking to access the public markets often view communications through the narrow prism of the listing day itself. In reality, potential investors, key media and other stakeholders start to pay attention to a potential listing well before the stock begins trading. A seasoned management team learns to leverage thought leadership, product innovation and business wins during the company's private life to raise awareness among key stakeholders well in advance of an eventual IPO.

When the time for listing comes, the first real focal point for these stakeholders is the filing of the S-1 (or F-1, in the case of a foreign entity) registration statement with the SEC. In reading this filing, the public gains a new level of insight into the company's business model, risk factors, compensation and governance practices, and financials. Many will make judgements before the company ever has an opportunity to begin its IPO roadshow – much less test its strategy in open trading.

Developing Effective Messages to Drive Communications Throughout the IPO Process

In this challenging market environment – one in which investors are just beginning to regain their footing – credibility is king. Companies must develop and articulate a strong story that clearly explains why investors should believe in the company, its management and its future prospects. To this end, companies must be prepared to address any potential concerns openly and honestly, establishing a reputation for transparency and candor at the onset of their relationships with new investors and other financially-minded stakeholders.

Once completed, the IPO story that takes shape in the registration statement will form the foundation for all written and verbal communications throughout the IPO and during the quiet period, which for those companies taking the most conservative approach, extends approximately 40 days following the listing. In developing language for their registration statements, companies should be sure to consider the following risks and opportunities so they can best showcase their strengths and effectively address investors' anxieties later in the IPO cycle:

- **Focus on Track Record:** Today's investors have placed a renewed emphasis on a company's proven ability to deliver solid performance – in good times and in bad. In the current climate where investors are being cautious about where to make their investments, companies can differentiate themselves by demonstrating consistent revenue generation and profitability, as well as balance sheet strength and liquidity. They must be thoughtful about how they explain their long-term investment proposition and their proven ability to execute against their business strategies to achieve strong results over the long term.
- **Address Risks Head-On:** As a rule, companies should assume that investors will hone in on any potential risk factors and should therefore be prepared to alleviate these concerns as definitively as possible. Key risks could include over-dependencies on certain managers or products, exposure to industries and markets particularly hard-hit in the downturn, or corporate governance concerns such as Board composition or perceived independence. Highlighting the diverse experience of key managers and Board members – and particularly any prior public company experience – can be particularly effective in gaining investors' confidence. Companies also should be prepared to demonstrate not only how they're adapting to changes in the financial markets, but also how they're leveraging new technologies, competing within an increasingly global economy, and otherwise ensuring they remain relevant within the context of broader global and industry trends.
- **Highlight What's Unique:** Pre-IPO companies should tell a unique story – one that focuses on their specific value proposition. In developing the S-1, companies too often focus on cookie cutter messages that mimic the general characteristics of prototypical growth companies. Again, this was acceptable in an era of easy money, but investors are more cautious today.

Companies must delve into the complexities of what makes their businesses successful and what differentiates them from their peers. As one analyst recently asserted: “This story sounds like every other company that has come down the pike. Come on, how can every company have recurring revenue and a great management team?” Lesson learned: make sure the unique aspects of your story are easily identified and understood.

- **Be Aware of Go-Forward Implications for Financial Disclosures:** Prior to listing, a company must create a well-considered guidance strategy that allows investors to assess ongoing performance of the publicly traded entity. Any inconsistencies between the information provided during the roadshow and given during the first earnings announcement will call into question both the company’s actual performance and the management team’s ability to project its operating performance. Furthermore, pulling guidance promised during the roadshow can have a lasting impact on a company’s credibility.
- **Be Sensitive to Use of Proceeds Implications:** Use of proceeds emerged as a key point of contention near the end of the last up cycle, as founders (particularly those of the big investment firms) took home hefty profits rather than reinvesting in their companies. The rich got richer in investors’ minds, and as markets deteriorated, investors were left holding shares worth a mere fraction of what founders made when they took their companies public. The scrutiny continues in today’s environment, where skittish investors prefer to see profits reinvested in the newly-public company to bolster its go-forward potential. When profits are instead going to a founder or a private equity firm, communicators should be prepared with strong messages about these parties’ prior contributions to the company’s success and how exposed their personal holdings remain to the company’s future performance.

Establishing a Solid – and Consistent – Communications Baseline

From the time the IPO is filed through the post-IPO quiet period, companies are prevented from disclosing information beyond what is customary and usual, including changes in the way information is presented or in the frequency of communications. It is important for communicators to ensure they are executing effectively on all programs before this period begins.

As the company refines its story for the IPO registration statement, it also should review existing communications – and train key communicators – to ensure the company is conveying a consistent message across all communications channels. Investors and journalists often check a number of sources when conducting due diligence and can get put off by a company that seems to be sending conflicting messages. A careful review of press releases, websites, newsletters, executive biographies, fact sheets, blogs, and any other media or marketing materials may reveal that additional enhancements and more consistent disclosure are needed before the IPO is filed. With social media sites such as Twitter, You Tube and Facebook increasingly being used as search engines, management also needs to monitor employee activity during the communications review process.

To mitigate the risk of unplanned disclosures, IPO prospects must build proper investor and media relations infrastructures before emerging as public companies. From the creation of an IR website and investor FAQs, to the development of a system routing incoming investor and media inquiries and managing these relationships, companies should not be reacting to changes, but instead have a well-developed program in place to appropriately manage a wide variety of situations.

Engaging Employees in the IPO Process

IPO preparations must recognize that while a public listing can provide many new opportunities for employees (e.g., new career opportunities, employee stock purchase plans), it can also be disruptive from a cultural standpoint. To manage this transition, companies must realign their people around their go-forward strategies and growth prospects, while simultaneously preparing them for new communications constraints. Employees should be educated about the rationale for a public listing, how the listing will benefit them, and – perhaps most critical – what new responsibilities the company must assume as a publicly traded entity. This is often most effectively handled through an employee roadshow in which senior managers speak with staff at each location as they travel for investor roadshow meetings.

Compliance with SEC and Exchange rules needs to be a company-wide effort, and employees must understand that even casual comments (e.g., “I made a big sale today” or “business has been picking up lately”) made to outside parties or on emerging media sites can take on additional meaning for the company’s new financially-minded stakeholders. Under the watchful eye of investors, financial analysts, regulators, and financial and business media, employee actions have the potential to affect the company’s corporate reputation, brand and stock price, but also subject the company and themselves to risk and legal liability resulting from inappropriate disclosures.

All communicators – media relations, employee relations and investor relations teams alike – must be intimately familiar with the S-1 messages and receive additional message training to avoid an inadvertent mistakes through the IPO period. Moreover, the communicators must be familiar with the new regulations that will govern their lives as part of a newly-public company, understanding the implications of disclosing non-public information under Reg FD (Fair Disclosure).

Management should also put in place an employee disclosure policy and train all employees on requirements and implications of Reg FD to help avoid violations. The SEC has signalled that it will take into consideration whether a company conducted Reg FD training and instituted a policy when they evaluate wrongdoing in situations where a violation has occurred.

The IPO Process

Preparation & Filing

- Assess strengths and weaknesses
- Determine peer group
- Develop key messages
- Create collateral materials
- Engage employees

Roadshow & Listing

- Identify investors
- Allocate shares
- Issue press release
- Participate in stock exchange activities
- Take control of media story

Life as a Public Company

- Establish IR/PR infrastructure
- Prepare for earnings
- Conduct perception study
- Initiate sell-side outreach to expand coverage
- Meet with investors and analysts

Roadshow and Listing

Persuading long-term investors to believe in an untested – and thus, inherently more risky – newly-public company requires not only a strong investment story, but also sustained, consistent communications. Portfolio companies and fund managers need to meet with management earlier in the process so investors can gain a better understanding of the company and ultimately show a willingness to invest.

While management teams choose banking leads based, in part, on their ability to identify the right institutions and contacts for their investment story, it also is important for companies to play an active role in determining which investors should own the stock and how much should be allocated to each (the pot allocation process). While involving some higher-turnover funds helps drive reasonable trading volume, smaller hedge funds (those with less than a few hundred million in equity assets under management) are most likely short-term investors. The impact of this group should be counterbalanced with longer-term players with a track record of holding stock – and potentially buying more.

Prior to the pot allocation process, however, a long-term focused management team works with its banking leads to prioritize meetings with long-term investors, ensuring that high-profit hedge funds do not dominate the roadshow's participation mix. Ensuring that many of the top long-term investors in each city are included on the bankers' roadshow outreach list can dramatically enhance the quality of the firms requesting shares of the IPO, enhancing the initial shareholder base and reducing volatility post-IPO.

From a media perspective, companies should assume that, given the slow pace of public filings, any listing in the current market environment will be viewed as a barometer for IPO markets. The Wall Street Journal quoted bankers saying that companies that "have the chops" to go public in the months ahead may fetch lower valuations than they could have two years ago; however, the relative scarcity of deals could allow them to grab more of the limelight. Similarly, the lack of deals means that companies that venture into the IPO market are going to get a more serious look from a large group of investors and, accordingly, have the opportunity to be broadly supported if their stories play well.

This heightened media attention, combined with increasing levels of investor scrutiny, eliminates companies' option to fly under the radar on the day their shares begin trading. For better or worse, listing entities have the stage in today's market. In most instances, it is advisable for companies to seize the opportunity to take control of their own messaging. Yet many companies remain hesitant to engage with the media, given the inherent challenges in establishing valuation amid today's volatile market conditions.

The gap between valuations expected by investors and companies is widening (Ernst & Young 2009 Global IPO trends report), and external events have the ability to dramatically alter not only the listing price, but also the stock's performance in day-one trading. This uncertainty – and the erroneous belief that they can avoid negative coverage by avoiding an interview – leads many companies to shy away from media interviews. In reality, select listing-day media interviews, conducted within the boundaries of SEC quiet-period regulations, can help balance potentially negative coverage with messages about the newly listed company's long-term strategy and investment rationale – or embed additional key messages within already positive stories. The key is to be ready for the various outcomes that may result from initial trading by creating a comprehensive Q&A and scenario plan that anticipates and addresses the potential concerns of all key audiences.

Investors understand that a growing company's management will face a number of hurdles. Acknowledging that challenges exist and addressing them with a well thought-out action plan can transform a potentially negative situation into an opportunity to build long-term credibility.

Beginning Life as a Public Company

Even after the listing, a newly-public company remains in a quiet period for several weeks. Nevertheless, its investor relations team must be fully engaged to complete investor targeting; develop strategy for investor marketing; arrange and prepare for upcoming investor conferences and analyst meetings, and get ready for the company's first quarterly earnings announcement. Having a strong infrastructure in place ensures that a newly-public company is talking to the right people at each of the initial milestones and gaining credibility with each interaction.

Earnings

The quarterly earnings announcement presents a particular challenge for many newly-public companies reporting results for the first time while still in a quiet period. Disclosure requirements can be met through a standalone SEC filing, but many companies choose to be more proactive, issuing a press release and/or hosting an analyst call in line with how they expect to communicate earnings going forward.

Guidance

Guidance policies should be clearly established at the time of the IPO filing, but analyst expectations must also be monitored on an ongoing basis. Results or guidance outside the anticipated range – be it on the upside or the downside – can significantly impair management credibility for effectively communicating with Wall Street and potentially lead to a misperception that the company's results will be volatile. While many companies mistakenly believe that earnings that beat expectations will propel their stock price forward, the benefits are often short-lived as the stock hits more momentum-based screens, encouraging shorter-term investors to make big bets on the company's ability to beat Street estimates, rather than focusing on the long-term strategy.

Investor and Analyst Meetings

Even under the best conditions, management can't meet with all the best firms and the best contacts in any one roadshow or conference. As investor relations teams work to establish the meeting schedule for the period immediately after the IPO quiet period is lifted, the priority should be underweighted to current investors and on-the-fence targets who did not buy at the offering. These targets should then be supplemented with appropriate long-term investors that did not participate in the roadshow. Building these relationships creates a new level of potential buyers of the stock when bridge institutions or insiders want to sell their shares.

Corporate Governance

Well-reputed investment firms will only buy into companies that are compliant and have robust corporate governance infrastructures. Initial flashpoints will occur around key disclosures and around any milestones in building an independent, highly qualified Board of Directors (if one does not exist prior to the listing). Management must work with its legal, financial and communications advisors to ensure the company is adapting to regulatory changes.

Benchmarking and Disclosure

Following the first earnings period, a newly-public company should conduct a realistic assessment of its investor base, as well as the new media covering the company from a financial point-of-view, to take a temperature check of the market's understanding and confidence in its value drivers and to identify any misconceptions about the business. Based on this analysis, companies have the opportunity to refine messages for subsequent investor meetings and conferences and consider additional disclosures for subsequent earnings periods.

Conclusion

Even as newly-public companies work to strengthen the investor relations function, media relations programs must expand to include a new universe of reporters and publications that will cover the company's stock, and internal communications programs must adapt to new regulatory issues and employee concerns.

The current market's uncertainty will increase the temptation for a company to focus solely on the end result of a listing – i.e., the market reception to the newly listed shares. However, the proper preparation for a successful listing and a successful start as a newly public company begins well in advance of when the shares start trading. An IPO is a complex process that requires careful planning and consideration. The plan that takes into account the different phases of an IPO, addresses all of the critical audiences and establishes the necessary infrastructure for a fulsome investor relations program, is the right formula for a successful offering – in any market.

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