THE IMPORTANCE OF THE EQUITY STORY IN IPOs.

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When preparing for an IPO, one of the earliest workstreams will be the company's equity story. Simply put, it is the company's own rationale on why it should be bought by investors.

The bankers will rely on it to advise the issuer on its public market valuation, and positioning versus peers. And the lawyers use it for the structure and content of the business description in the prospectus.

No surprise this is a vital part of the IPO process. It's a core part of our work with issuers who are preparing for their IPO. Yet too often, this can go wrong. A poorly prepared equity story, whether without management buy-in, or lacking due consideration for the company's track record, will not go down well with investors. I'll discuss later some of the ways this can be mishandled, and how to avoid them.

Who owns it?

This is simple. It belongs to the management of the issuer. Not the private shareholders, and certainly not the bankers. After all, once the company is listed, management will be the ones answerable for this equity story and its embedded strategy. It's therefore crucial that the management team bring a conscious self-awareness to the process of writing the equity story. It's often helpful to think about how the description today might look in three to five years' time. Not least as many of the investors hearing the equity story will themselves have a three- to five-year investment horizon.

We often say the optimal balance is to combine an element of humility about their business "*We focus on what we're good at*", with confidence in their goals "*We know where we're headed*". Personally, I think the proverb "Truth will always triumph over the imitation" still holds in today's markets. Introducing an element which stretches belief, risks diluting the overall impact on investors.

Key documents relying on the equity story

In most countries, it appears in three main documents: the analyst presentation (not in the US which does not have connected research), the prospectus, and the roadshow presentation. It's important that all three documents match in every detail. Despite which, there will be several judgments on what can or should be included, not least when summarising the longer form versions into a short form roadshow presentation. For this reason, we recommend preparing the short form first, to tie down the key concepts. Don't underestimate how long this could take. Writing a short presentation is harder than writing a long one.

In the UK, the equity story description should also underpin the Long Form report, which prepared by the auditor for the benefit of the bank(s) acting as Sponsor.

Foundations

In our work with companies executing an IPO, we advise that the equity story should:

i) Derive from the financial and operating track record. The company history underpins and explains the current financial results and its strategy. The equity story should describe the business in the same segments as it is currently managed, which then tie into the segments used in the financial reporting.

ii) Fairly reflect the current operating and competitive environment. Investors will expect the issuer to be aware of the track record of its listed peers. This quickly becomes complex if the closest peers are in different geographies. Investors will tend to compare the issuer to companies they are familiar with. Asking a UK-based investor to consider e.g. a single Indonesian peer purely on business profile match, instead of emphasising the differences with the broader range of more familiar Eastern European peers, is unlikely to meet with much enthusiasm. There are exceptions, which I discuss in the following section.

iii) Describe achievable strategic and operating goals. It's naturally tempting to err on the positive side, to maximise the IPO price. This is risky. An equity story that asks investors to believe in a post-IPO J-curve uptick, or a significant change in strategy, will be received with great scepticism. An IPO is generally not the time to make major strategic changes to the business. Management teams (and their private shareholders) should recognise that falling short of targets creates long term concern over management credibility. Instead, beating targets consistently will create an enthusiastic shareholder following.

Where the bankers add value

An important factor for choosing the lead banks, is the industry knowledge of the sector bankers. This will give valuable insight into how the listed peers are viewed by investors, which is useful to adjust the positioning of the company, and the relative importance of elements of the equity story.

An example: an airline IPO I worked on. The main competition for this low-cost airline (in terms of routes and bums on seats) was the national flag carrier. The sector banker involved insisted they avoid referring to this other airline as their competition, since the operating model was very different. Bluntly, knowing the national carrier was no help at all to understand the future operating performance of the low-cost airline. Instead, the issuer should consciously refer to the business strategy and operating multiples of the other European low cost airlines, at the time being Ryanair and EasyJet, which traded at a significant premium to the legacy carriers. Net result was, the IPO priced at a premium multiple to the national carrier, despite the issuer being many times smaller.

Additionally, the due diligence examination of the equity story provides an objective view on the management's approach to business. Good bankers should be asking "so explain to us why you took those decisions/margins changed/new markets entered into". This process is helpful, as you can be sure investors will ask the same questions. Perhaps not so politely!

Forecasts and non-financial information

Forecast guidance is one of the trickier judgments for any listed company. Companies shouldn't give profit forecasts as they're inherently uncertain, and open the company to liability issues. Instead, companies need to think through what guidance they are comfortable giving on, for example, the underlying business trends, or profit margin evolution, over the medium term. Typically, this guidance will be in the form of only one page, with between two and five bullets on the specific points of guidance. Knowing what is published by the listed peers is useful. However, the management team's own financial reporting metrics are perhaps the best starting point. After all, the market will expect the issuer to keep them updated on progress towards these points of guidance.

iv) It's also important to think carefully about the non-financial information to be given to the market. Again, knowing what peers do is important, as are the management's operating metrics. One further wrinkle however; while these numbers don't have to be audited, they must derive from the management reporting system or another reliable source. And these will also need to be regularly updated to the market

Using the equity story well before the IPO

In my experience, the IPO execution process is often the first opportunity that the equity story is thought through in a public market context. We believe strongly this leaves it too late. In the heat of a live execution, with multiple demands on their time, is not the best environment for management to decide carefully how they wish to present the business to investors for the next five years.

We recommend that the equity story exercise takes place as part of the decision-making process on IPO versus other alternatives, even before banks are on board. Issuers who have a deep understanding of their own story, are best equipped to communicate their passion and conviction on the strengths of their business in a concise and powerful format. This then gives them the firmest possible platform to engage with banker pitches, research analysts, and investors.

What's more, the issuer can then start using this equity story to frame their own corporate profile, reporting, website, etc. well ahead of the IPO. An issuer that has transparently acted as though it was listed, before any IPO, will have done valuable work in establishing its credibility with investors. Arguably, this could even go as far as publishing an annual report and holding capital markets days for buyside and sellside analysts. Although this is relatively rare and private shareholders can be understandably reluctant to give detailed information on businesses that may still be transforming.

Where it can go wrong – and what to do

Ignoring the broader market context. The equity story is a living piece of work that should reflect the current market and operating reality. It's seductive to believe one's company is the best positioned in the sector, particularly once bankers start pitching! Investors will however challenge this unless there is a compelling, well thought out argument. Where there are strong founder shareholders, this can be doubly challenging. The current investor debates on the Snap Inc IPO are, in my view, a good example of insufficiently thought through messages going down badly.

Leaving it to the lawyers. Too often, the first drafts of the concise equity story are left to the legal team drafting the prospectus. It will be accurate; however, it's pretty unlikely that the optimised marketing message will be embedded in the factual information. The lawyers benefit from – and appreciate – being given detailed guidance on the structure and key points of the equity story before they start drafting. This also saves time and cost of redrafting and re-diligencing.

Taking a sudden turn at a late stage. The syndicate bankers you hire for your IPO are there to provide insight into the equity story positioning, research, and distribution. So, it's surprising to me that the prospectus drafting process often takes place in a bubble between issuer, lawyers and junior sector bankers. The risk is the senior sector input (i.e. the Managing Director) disappears after the pitch, and reappears only when the analyst presentation is being drafted, some three months into the execution process. This causes real cost and delay as he rips into the positioning, segmental reporting, or operating metrics. Prompting a prospectus redraft and refiling. Management who are on the roadshow a few short weeks later, are less confident in their own story, as quite simply they haven't managed the business on that basis up until now. Issuers should identify early on who these key bankers are, and hold them accountable for prompt input.

Recommendations

Our top recommendations for the equity story preparation.

1. **Invest in self-reflection on the equity story early on, as part of the internal IPO planning**

2. **Use the company's equity story to challenge the banker pitches rather than accepting unquestioned their views on positioning.** Better still, give it to them beforehand and ask them to critique it in their pitch, instead of making them reinvent it from imperfect information.

3. **Hold an equity story focus session with the key management, selected senior bankers, and lawyers 1-2 weeks after the kick-off meeting.** At this meeting, task the senior sector bankers to attend and present

a short memo with their recommendations for the structure and key points of equity story, including the rationale for any changes to the company's internally prepared version.

4. **Use the "early look" meetings with potential IPO investors to get feedback on the equity story.** The temptation is to focus on valuation feedback – however investors at this stage have no detailed information (and cannot even keep the presentation!). Far more useful, will be their views on the story and relative peer positioning. At this point it's still early enough to make major changes if required. This will also be a useful backcheck on what the sector bankers are telling you, particularly if these bankers are do not regularly work close to the public market side of their organisations.

We believe passionately that a coherent equity story which is fully integrated with the strategy and business plan allows i) educated debate with and challenges to the syndicate banks' own ideas ii) confident discussions with research analysts and iii) creates a fully empowered management team on the roadshow. Hitting these points will put the issuer and its management in the best possible position to engage with the market at IPO, and through the first crucial months and years as a listed company.

We're here to help.