Viewpoints

What Makes a Great Technology IPO Story and How to Choose the Best Investment Bank for Your Company

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In the life span of any successful technology company, a point is reached when that company wants to go public. To go public, a technology company must choose an investment bank to lead-manage its initial public offering (IPO). However, just because the company starts the process, does not mean that it will successfully bring the process to fruition. In order to successfully go public, a company should have a great story and also choose the right investment bank as a partner in the process. The two are highly interrelated. This article discusses some of the criteria that an investment bank and a company should consider when choosing each other. The first part of the article summarizes what makes a great IPO story. The second discusses some of the factors a company should consider when deciding which investment bank to choose to lead-manage its IPO.

What Makes a Great Technology IPO Story?

What does a company need to offer to distinguish itself from the rest of the crowd? How should a company position itself to guarantee interest from the capital markets and the best institutional investors? In short, what will excite Wall Street and the capital markets to do this financing? The answer is a great story. Broadly speaking, it is a company that started 'once-upon-a-time,' can beat the 'big-bad-wolf' and will live 'happily-ever-after.' From an investment bank's perspective, there are a number of key criteria that create 'the great technology IPO story.'

A straightforward story

First and foremost, Wall Street loves a straightforward story. Good examples include 'The leader in flash-based data storage' (M-Systems), 'The leading provider of Internet traffic management solutions' (RadWare), or 'We secure the Internet' (Check Point). The story must be articulated in straightforward concepts that are easy to understand. Whatever it is, it should be something that easily describes the concept behind the company. This is primarily achieved through good strategic positioning. Wall Street also likes a pure play story, where a company is focused on one particular sector.

A unique and advanced technology

A company must present something unique that provides it with the potential to become the market leader in a specific industry and stay there. This may be the most advanced, the fastest, the smallest, the largest, the least expensive, etc. It could be evolutionary or revolutionary. Whatever it is, it must be something that defines the company, provides a competitive advantage and is sustainable and defensible, whether through persistent research and development, patents or other means.

Ability to take a growing portion of a growing market

Wall Street loves companies that are expanding in explosive markets. There are always hot sectors that are growing at extraordinary rates. Recent examples include

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Internet infrastructure, storage, optical networking, cellular and convergence technologies. When a company can show that it has identified a need in an explosive market, that it has a better solution for that need than any other player in that market, and that it can clearly demonstrate how it intends to dominate that market, then Wall Street takes interest.

Aggressive strategic planning to sustain competitive advantages

Wall Street knows that corporate strategy (what market to be in) and business strategy (how to win in that market) are critical components of any successful company. A company needs to be able to provide a clear definition of what it wants to achieve and how it is going to get there. Clear strategic planning means the company is ready for anything.

Strong visionary management

Wall Street requires good management – not just good, but great management! Better a good company with great management than a great company with passable management. A respected set of VCs as investors is also preferable because of the assistance that can be rendered to management in focusing the business. Management must be able to show that it knows what it is doing and really believes in what it is doing. Additionally, Wall Street requires a complete management team with all positions filled, preferably by managers with experience in running a publicly traded company. Nobody wants a trainee pilot with no navigator at the controls of a 747, especially if they are going to be the passengers.

Strong blue chip customer base

Wall Street likes companies with real customers (think big multinational companies) and backlog. For example, a semiconductor technology company with customers such as Motorola, Siemens or Intel, or a telecom equipment company with customers such as Worldcom, Verizon and British Telecom are likely to impress potential investors. It makes the story easier to sell as it demonstrates that the technology works and the need, and consequently the market, really exists. Long-term contracts excite Wall Street even more. Think backlog, backlog, backlog.

Clear marketing strategy and strategic partnerships with industry leaders

Wall Street likes companies with a clear marketing strategy. These are companies that are focused on building market share within specific targeted market segments and have direct and indirect sales, OEM agreements and global partnerships in place. One of the reasons technology companies sometimes fail is that while they may have great technology, they don't have diversified marketing channels in place. Strategic partnerships with industry leaders provide comfort to potential buyers of the company's stock. It shows the ability to turn great technology into hard revenues.

A robust financial model

Finally, it all comes down to the numbers. Although varying from industry to industry, a technology company is usually ready to go public when it has annual sales in excess of $15 million, at least two quarters' visibility and sales that are expected to at least double every year for the foreseeable future. A good IPO story should present a 'hockey stick' P&L. The financial model must be robust from two perspectives, top-down and bottom-up. The top-down perspective requires that a company's forecasts are realistic and in line with the growth of its given market. The bottom-up perspective breaks the model down to its constituents, such as individual product line or individual customer forecasts or contracts. The robustness is derived from attaching very conservative probabilities against each future potential revenue stream.

What did you say? Profitability? I've heard of that word.

At the height of the recent bull market, profitability was not a prerequisite for going public, but it is becoming a word that is being spoken again. While a company is not generally required to be profitable when going public, it needs to be able to show that it will become profitable within a reasonable period after its IPO. Otherwise, with engines at full throttle, it is going to be hard to keep flying just on fumes. Gravity will win in the end.

In summary, a great IPO story involves a combination of all of the above. Look at Israel's, or for that matter any of Wall Street's, most successful companies. They still provide a combination of all of the above factors. Wall Street likes a company with great management, great technology, a growing market opportunity, growing market share and visibility due to great customers and strategic partners. The factors that are important to an investor in the long-term are the same that make a great IPO in the short-term. It proves one important point: the IPO process doesn't end on the day you price. It just begins.

But How Should I Choose My Bankers?

When a company goes public, it generally chooses one lead manager and two to three co-managers. There are several factors to consider in choosing an investment bank as lead manager. These are broadly divided into (a) the strength of the firm itself, (b) terms proposed and (c) the team that will work with you. The IPO process is long, complex and stressful. It involves a number of stages, including the organizational meeting, drafting, filing, marketing, the roadshow and pricing. Generally you will work with three teams at any investment bank: the Investment Bankers, Equity Capital Markets (ECM) and Research. Some of the main decision-making criteria are listed below.

About The Bank

How well known is the investment bank?

The first contact that financial investors will have with your company is through your investment bank. For better or for worse, institutions presume that larger investment banks underwrite better companies with more exciting stories. Although there are many exceptions to the rule, the reality of the market is that the name of a large investment bank on your prospectus adds credibility to the transaction. However, just choosing any of the big firms isn't enough. It is also important to choose a firm that has a strong track record in marketing and selling deals that are of a similar nature and size to your transaction.

How well do they know my sector?

In order to ascertain whether an investment bank has expertise in your company's given sector, check on how many deals it has done in the sector, which companies it is banker to and how often those companies work with the same investment bank on additional transactions. Go for the banks with the strongest technology and sector groups. A global technology group with local presence that covers your sector may also provide added value during and after the IPO process.

What kind of equity capital market strengths do they have?

Choose an investment bank that can use a powerful capital base to smooth any share price fluctuations which may occur after the IPO due to short-term changes in supply and demand for your company's stock. Also, choose an investment bank that is a lead trader in stocks within your sector and on the exchange on which your company will go public.

What kind of marketing and distribution capacity does the firm have?

Marketing and distribution are key factors to the success of any IPO. Choose an investment bank that has the ability to provide consistent liquidity in a broad range of investor markets. The two broad categories of investors are institutional and retail. While most banks have a base of institutional investors, only certain banks have a significant base of retail investors. The ability to place a substantial portion of your stock with retail investors will generally improve your IPO pricing prospects. In addition, selling into the retail system creates a large block of ownership which is geographically dispersed, has a diverse investment profile and provides consistent, stable, long-term ownership. In a volatile market, this can make a difference to the success of your transaction. Also important is the investment bank's ability to market your company globally across the three main regions of North America, Europe and Asia Pacific. Why is broad distribution important? A broad and balanced distribution of shares will enable the company to achieve an optimal valuation at the offering and provide stability to the stock in the aftermarket.

What the Investment Bank Offers

Valuation - Myth: The investment bank sets the value. Fact: The market sets the value

Don't choose your bank because of the valuation they propose. While the range they propose needs to be realistic, the bank doesn't set your value at pricing, the market does. However, the market sets your value on how well it understands your story, which is a product of how well your investment bank prepares you for the IPO process. An unfocused story may result in a misunderstood company, which may in turn lead to low demand for your company's shares and consequently a lower value or, possibly, a failed offering. A good company with a well-understood story should be able to raise money in almost any market. Therefore, choose the bank that will help you to achieve the highest valuation possible through great preparation and focused marketing, not the one that sets the highest valuation expectations and doesn't deliver.

Research - Will the bank provide you with an analyst who knows your space?

Choose an investment bank that provides you with a research analyst who understands your technology and markets, is well known and is respected by the institutional investor base. This last point is important because a respected analyst can rally the institutional investor community around your stock irrespective of regional political events. Your company may fundamentally be in great shape, but if the analyst or investors confuse your business prospects with the local political situation then it may hurt your stock.

When should I go public? Like a good wine, the longer you wait, the better the result... but don't wait too long!

Don't choose an investment bank just because it encourages you to go public as soon as possible. The right bank should be one that is interested in helping you build your company and taking you public when you are ready, not when they are ready. That is because the longer you wait, the more mature your company will be, the greater your revenue base will be and the greater your visibility will be in terms of projected near term revenues. Public companies on Wall Street are expected to give quarterly and annual guidance as to revenue expectations. Once articulated, companies are strictly held to those expectations because their stock prices will be based on them. If you disappoint when you are private, then the only people you have to face are your Board and your spouse. If you disappoint as a public company then shareholders will lose confidence in management and dump your stock. Think of going public as filling a rocket with fuel. The longer you wait, the more fuel you can add. The more fuel you have, the faster you can go and the higher you can climb. And if you are lucky you may get into orbit.

Fees: Pay peanuts, get monkeys

Don't choose your bank on the basis of how negotiable they will be with their fees. In any case, most banks charge a similar fee scale.

The Actual Team

Who are the bankers that are actually going to work on the deal? Does my company really matter to these bankers?

Regardless of whether you choose a super-bulge bracket bank or a small boutique bank, at the end of the day it's the actual individuals that you work with from the investment bank that will determine the success of the deal. Every deal needs a champion, someone who is going to commit totally to your company and ensure that the deal is well executed. Meet the team that is going to work for you and make sure that this deal matters to them.

Dedication and preparation: that's what you need!

As discussed earlier, one of the key differences between a great IPO and a poor IPO is how well Wall Street understands the story. Wall Street is sometimes said to be 80% perception and 20% reality. If they don't get it, they don't buy it. If your company's IPO was not successful, yet it met all the criteria discussed earlier, and the market was good, then the main reason that Wall Street didn't get it is because you weren't properly prepared by your investment bank for the process. For all the work you do on the IPO, only twice does your company actually interact directly with potential investors: through the prospectus and the roadshow presentation. If your prospectus isn't clear and focused, or your roadshow presentation isn't sharp and to the point, then investors won't understand why they should buy into the deal. These are the 'moments of truth' and each requires a special form of dedication from your investment bank to make sure that these interactions are as close to perfect as possible. Additionally, the more prepared you are for your organizational meeting, the faster you are likely to draft the prospectus and consequently the quicker you may go public. So, do choose a bank that spends as much time as required with you in order to get you and your presentation team ready for the entire process.

Will the bankers continue to help my company grow after the IPO?

A final factor to consider is what other services your investment bank will provide after the offering, aside from research. Will it continue to provide creative ideas on how to grow? Does it have a good M&A group that is familiar with Israeli companies? Can it provide ongoing equity or debt financing? Does it have a local office? Will it stay in touch? These are some of the questions you should ask.

In conclusion, the courtship between a company and its investment bank is complex. The investment bank you select must help your company prepare for the entire IPO process, dedicate itself to continuing to help your company grow after the process and have all the capabilities required to build your firm into a world class corporation. In the same way that the game of golf isn't won with just a driver and a putter, make sure the investment bank you choose to lead your IPO has the full range of clubs. After all, it's a tough course out there!