Capital structure changes

- **Altering the D/E ratio of a company**
  - Increase debt – new loan (Wrigley)
  - Decrease debt – repay loan
  - Increase equity – issue shares publicly (IPO - Facebook, SEO), issue shares privately
  - Decrease equity – repurchase shares, pay dividends (Wrigley)

IPO

1. Terminology
2. Why go public?
3. Drawback of listing
4. IPO &potential investors
5. Good IPO candidate
6. Stock Exchange selection
7. Process
8. Documents
9. Roles in IPO process
10. Underwriter selection issues
11. Share offer pricing
12. IPO share issue clauses for underwriter

1. Terminology

- **IPO** (initial public offering) – shares offered for the first time to third-party investors.
  - **Primary offering** (offer of subscription in UK) – raising new money in equity markets.
  - **Secondary offering** (offer for sale in UK) – existing shareholders of privately owned firm sell their shares. May refer also to follow-on transaction seasoned equity offering or secondary equity offering (SEO).
- **Lock-up period** - a time period during which a shareholder cannot sell his/her shares.
- **Listing**
  - **Primary** – main exchange where share is listed.
  - **Secondary** - share is listed on another exchange in addition to primary exchange.

2. Why go public?

- **Pros for existing shareholders**
  - Possible to sell existing shares.
  - Possible to raise capital for financing investments, acquisitions or re-financing loans.
  - Improving access to funding from financial markets and improving bargaining power at credit negotiations.
  - Improving possibilities to use stock options or stock-based bonuses in employee remuneration.
  - Improve company prestige and visibility.
  - Increase liquidity of shares (easier to trade).
  - Possible to carry out equity carve-out.
  - Improved protection of minority shareholder's rights – obligation to disclose information, more consistent dividend policy.

3. Drawbacks of listing (1)

- **Listing is costly.**
  - At the time of listing - direct IPO costs 1.5 to 10% of capital raised.
  - Thereafter
    - Additional disclosure requirements required for maintaining the listing (financials, executive compensation, insider transactions)
    - Additional regulative requirements - internal controls, committees, stock exchange fees
    - Investor relations have to be transparent – can give competitors, suppliers or customers a competitive edge over the company
    - Time and resources needed for meeting the expectations of the market

3. Drawbacks of listing (2)

- **Pressure to deliver short-term growth**
- **Longer decision process** – approval from the Board are needed.
- **Attracting unwanted shareholders/losing control** – potential loss of control over the company in the long run through takeover or due to financial difficulties of the firm.

4. IPO &potential investors

- **Pros**
  - Possibility to acquire significant shareholding quickly.
  - IPO discount makes company cheaper compared to already listed ones.
  - IPO under-pricing – on average the share price immediately following the IPO increases 19%.
    - Big information asymmetries, IPO price is set lower to attract uninformed investors.
    - Agency conflict (underwriter vs issuer).
    - Managers may leave after lock-up period.
    - Potential litigation related to misstatements.
- **Cons**
  - Possibility of bidding too high price.

5. Good IPO candidate:

- **Attractive business** – new sector, sector leader, fast growing sector, possibility to turn cash flow into dividends.
- **Sustainable performance**.
- **Good possibilities to predict the future**.
- Possibility to use **strategic investor** who already has a stake in the company going public.
- **Stand-alone business**.
- **Managers** amongst existing shareholders – smaller agency problems.
- Possibility to achieve **reasonable liquidity and transaction size**.

6. Stock exchange selection

- **Primary**
  - Location
  - Profile and prestige
  - Index considerations
  - Corresponding to revenue location of the firm
  - Existence of peers on the same exchange
  - Possibilities for analyst coverage
  - Listing requirements
- **Secondary**
  - Closeness to shareholders (M&A, global focus) or main activities of the company
  - Better access to financing
  - Improving image

7. Process (1)

1. **Firm's decision to go public.**
2. **Preparations.**
   - Underwriter selection.
   - „All hands" meeting – IPO timetable and key issues.
   - Business due diligence (feasability of the business plan) and legal due diligence (contracts, liabilities, patents, legal facts).
   - Company and underwriter sign letter of intent – range of offering price, amount raised, underwriter fees etc.
   - Registration statement drafted and filed, response to comments.
   - „Pilot fishing" - underwriter approaches some trusted institutional investors informally to get their views about the coming issue.

7. Process (2)

3. **Approaching the market.**
   - Public announcement of IPO and issuing Prospectus.
   - Quiet period (black-out period) – underwriter issues no further information on the company till end of IPO.
   - Underwriter approaches potential investors and determines price range (10-20% from the mid price).
   - Firm's management goes on a road show for 10-15 days to explain firm's activities to potential investors.
   - Institutional investors make non-binding bids and the book is built and closed.
4. **Going public.**
   - Price meeting – issuer and underwriter set offer price.
   - Announcing actual offer price.
   - Allocation of shares.
   - Trading begins (6 to 12 months from decision).

8. Documents

- **Prospectus** – targeted at retail investors, contains all information regarding:
  - the issuer – risk factors affecting company performance, strategy, competitive advantage, management quality.
  - the issue – use of IPO proceeds.
- **Red Herring** (prospectus) - first or preliminary prospectus that has a standard legal disclaimer written in red colour stating that the securities are not yet offered.
- **Offering circular** – simplified version of the prospectus addressed to institutional investors.

9. Roles in IPO process

- **Lead manager** – leads the IPO process (due diligence, preparing prospectus, marketing, selecting underwriters, co-ordinating non-institutional allocation, finalising trading etc.)
- **Underwriter** – manages, advises, prices, markets and sells the IPO. Usually reputed investment bank.
- **Deal sponsor** (nominated adviser in UK)– one or more banks helping to draft prospectus and negotiating with the regulator or stock exchange.
- **Global coordinator** – brings together parties involved in the transaction.
- **Bookrunner** - maintains the list of orders placed by institutional investors and makes allocations of stock.
- **Receiving bank** – commercial banks with retail investor clients.

10. Underwriter selection issues

- Track record of successful past IPOs.
- Solid reputation.
- Thorough industry-specific expertise.
- Type of contract - possibilities to get a „firm commitment“.
- Underwriter fees – 1 to 7% of amount raised.
- Relationships with potential investors – strength of network.

11. Share offer pricing

- **Bookbuilding –** underwriter certifies the quality of the issue, gathers bids and has discretion in the allocation of shares after final offer price is determined with the issuer.
- **„Dutch Auction“ (uniform price auction)** – price of offering is set after taking all bids (all investors bid quantity and price) and determining the highest price at which the total offering can be sold. Often up-bounded (max bid price set).
- **Direct sale to public (fixed offer price)** - investors make actual bids to buy shares at offer price (in prospectus). Pro-rata allocation amongst investors.

	Bookbuilding	Dutch Auction	Fixed offer
Target	Institutions	All investors	All investors
Costs	High direct		High Indirect
Main risk		Undersubscription & underpricing	Underpricing
Risk borne by	Underwriter	Issuer	Undewriter bears undersubscription risk

12. IPO share issue clauses for underwriter

- **„Best effort“** - price and amount raised are not guaranteed by the underwriter. IPO geared mainly towards private investors.
- **„Firm commitment“** - underwriter commits to purchase all offered shares, regardless of their ability to resell them to the public at a specific price. IPO geared primarily towards institutional investors.
- **Greenshoe option (overallotment option)** –underwriting contract includes an option for the underwriter to increase the issue size (number of shares sold) in case of high demand and to decrease it in case of low demand.
  - High demand – option realised, underwriter pays strike price = IPO price
  - Low demand - underwriter pays market price < IPO price

Introduction (1)

- Facebook history (history see Exh. 1)
  - Established in 2004 by Mark Zuckerberg.
  - 2006 free access.
  - Numerous acquisitions (see Exh. 7), biggest Instagram (photo sharing).
- Activity – social network relying on ad revenues (85% of sales).
  - Mid 2012 901 million registered users.
  - July 2013 1.15 bio users logging in each month.
- Market position – global leader.
- Rivals – vKontakte, Orkut, Google, Twitter. Now more Twitter, Printerest, LinkedIn.

Introduction (2)

- Strategy
  - Expand global user community.
  - Build great social products to increase engagement.
  - Provide users with the most compelling experience.
  - Build engaging mobile experiences.
  - Enable developers to build great social products using the Facebook platform.
  - Improve ad products for advertisers and users.

Introduction (3)

- Financing:
  - Angel funding.
  - Convertible preferred stock series A to E.
- Several takeover attempts had been rejected - Viacom, Yahoo, Google.
- Ownership prior to IPO (after IPO see Exh. 21)
  - Zukerberg
    - 28.1% of Class B
    - 30.4% of Class B voting proxy
    - 36.1% of Class A voting proxy
    - Total voting control 56.6%

Introduction (4)

- Company financials – see exh. 5 &6 + Excel file.
- IPO
  - Announced 1st Feb 2012 (SEC filing in Moodle)– value 50-140 bio USD.
  - Final prospectus available in Moodle (Exh. 8 is not the final version).
    - 180 mio new class A shares + 241 mio class A shares from existing shareholders.
    - Price estimate initially 28 to 35 USD per share, final 38 USD per share (par value 0.000006 USD).
    - Total amount paid for shares is 16 bio USD.
    - After IPO Class B voting power 96%, Zukerberg's 57.5%.
    - Trading begins 18 May 2012.

After Facebook IPO

- First interview of Zuckerberg following the IPO
- http://www.cbsnews.com/news/mark-zuckerberg-talks-ipo-regrets-at-techcrunch-disrupt/
- Facebook's 10th birthday – interview with Zuckerberg (4 Feb 2014)
- https://www.youtube.com/watch?v=lcS-TtSqXqI

Facebook share now