Issuing Equity - IPO Process

In the course of an Initial Public Offering (IPO), a previously unlisted company offers new or existing securities to the public for the first time.

Typically 5-8 months long, the process starts with the IPO-fit corporate selecting an investment bank to provide advisory and underwriting services. Selection criteria are, among others: Reputation, quality of research, industry expertise, distribution capabilities (reaching institutional and / or private investors), and prior relationship.

In the kick-off meeting appointed advisors and service providers agree on responsibilities and time table, whereby due diligence stands at the forefront in the early weeks of the process: This comprises a full examination of the IPO candidate’s financial, tax, legal, commercial, IT, operational, environmental and human resource status and track record. Due diligence will deliver insights into the sustainability of the issuer´s business model and assess potential risks.

Most IPOs are structured via an underwriting process: An investment bank (the underwriter) acts as a broker between the issuer and the investor community. Usually, the process is based on a firm commitment (i.e. the underwriter purchases the whole offer at a set price and resells the shares). Frequently, this is not just agreed to by a sole manager only, but by a syndicate (with – in most cases - one investment bank appointed as lead or book-running manager).

For their services provided, investment banks will be compensated with a gross spread (underwriting discount): This is the difference between the price at which the underwriter purchases the issue and that at which the issue is sold. Depending on the size of the issue, the gross spread may amount to anywhere of around 3-7 per cent of the proceeds (underwriter spread). If there is a syndicate, the lead manager is usually paid 20 per cent of the spread (manager´s fee), further 20 per cent is split among the underwriters of the consortium (underwriting fee) and the remaining 60 per cent given to syndicate members in proportion to the number of shares sold (selling concession).

The registration statement (prospectus), drafted by the issuer´s counsel is at the heart of the process: It includes all relevant information regarding the IPO, such as the issuer´s financial statements, its management, any insider holdings, legal challenges faced and risk factors. The registration statement gets filed with the SEC which carries out its own due diligence to ensure that all required details have been disclosed correctly in the prospectus.

Based on that, an initial prospectus consisting of the details of the issuing company, save the effective date and offer price (red herring) is printed, distributed and the issue marketed to investors during a roadshow: In the course of this, presentations are given and questions addressed. Meanwhile, a book is opened, a sort of digital archive where (non-binding) orders from investors are registered (book building process).

After approval by the SEC, the IPO´s effective date is agreed. The day before, the issuer and the underwriter decide the offer price and number of shares to be sold. IPOs are typically slightly under-priced to ensure the issue is fully/over-subscribed, with investors anticipating a rise in the share price on offer day, further increasing demand for the issue.

Immediately following, the underwriter creates a market for the stock and, in case of order imbalances, undertakes after-market stabilization for a short period of time: During this period, the underwriter has the freedom to trade and influence the price of the issue as prohibitions against price manipulation are suspended. – On day 25 after pricing, the “quiet period” ends: From that moment on, investors will have to rely on the market and its forces for information regarding the issuer´s shares as well as price finding. Also, as of that moment, underwriters may initiate research coverage.

Over the last years, alternative IPO structures have been tested, such as straight, simple listings, different formats of auctions as well as going public via Special Purpose Acquisition Companies (SPACs). Latter is a publicly traded company registered with the SEC which pools funds in order to finance an acquisition opportunity within a set timeframe. Whilst this process has advantages in regards to speed as well as costs compared to traditional IPOs, less stringent information and disclosure rules (e.g. disclosure of forecasts permitted) pose issues for regulators yet to be resolved.

PREPARATION →	MARKETING →	FINALIZATION
DECISION TO GO	PRE-MARKETING	PRICING & ALLOCATION
↓	↓	↓
APPOINTMENT INVESTMENT BANK, COUNSEL	SEC CLEARANCE	FILING FINAL PROSPECTUS
↓	↓	↓
DUE DILIGENCE	RED HERRING	LISTING
↓	↓	↓
PROSPECTUS DRAFTING	ROAD SHOWS	CLOSING
↓	↓	
FILING SEC	BOOK BUILDING	

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