



Top 10 IPO readiness challenges

*A Measures that matterSM global study
executive summary*



Dear friends

Challenging markets may come and go, but companies that outperform the overall market prepare early for their initial public offering (IPO). Businesses need to undergo many months of advanced planning, organization and teamwork before they are ready to go public. When the market timing is right, it's the companies that are fully prepared which are best able to leverage the windows of IPO opportunity.

Market outperformers treat the IPO as a long-term transformational process which brings change to every aspect of the business, organization and corporate culture. We call the process of going public, the IPO value journey. The journey to public company status must prepare an organization not only for the defining moment of the IPO event, but also for a whole new phase of corporate life.

This executive summary analyzes the top 10 IPO readiness challenges from the perspective of C-level executives worldwide who have already experienced success in their value journey. It also contains insights from our survey of global institutional investors, as well as the cumulative experience of Ernst & Young's global network of IPO advisors.

The surveyed CEOs (who led the companies that outperformed the market) highlighted four key themes as their advice for those who wish to go public:

- ▶ Be well prepared and have a strategy
- ▶ Understand the process
- ▶ Have the right experienced team
- ▶ Be a good and transparent communicator

Even in the midst of market turbulence, the list of companies preparing for an offering continues to lengthen. We look forward to working with these companies, as they prepare for their transformation from a private entity to a public enterprise.

Ernst + Young

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Key findings

- ▶ Even in a challenging economy, companies which outperform the overall market prepare early for their transformational IPO journey, so that they are ready to launch when markets recover
- ▶ Especially in an uncertain market, outperforming companies explore alternative exit strategies to an IPO, although public offerings are generally seen as providing better valuations, access to capital, visibility and credibility
- ▶ Outperforming companies usually go public to finance their growth strategy and use their proceeds to fund acquisitions or market growth
- ▶ Market outperformers start acting like public companies at least 12 months prior to the IPO by implementing critical changes to their strategic and corporate tax planning, management team, financial accounting, reporting and internal control systems
- ▶ Almost three-quarters of outperforming companies in our survey undertook pre-IPO transactions (e.g., debt financing, corporate reorganization and equity financing) to enhance the offering's value
- ▶ Although only a quarter of surveyed companies conducted acquisitions, alliances or joint ventures prior to IPO, in hindsight, many executives believe that such a pre-IPO transaction would have added shareholder value
- ▶ Institutional investors base an average of 60% of their IPO investment decisions on financial performance measures - in particular, growth in EPS, EBITDA and profitability
- ▶ Institutional investors attribute an average of 40% of their IPO investment decisions to nonfinancial measures, placing the most weight to management credibility, corporate strategy and brand strength
- ▶ The executive's choice of stock exchange depends largely on which offers access to suitable institutional investors who understand their business model, greater stock liquidity and deeper institutional pools
- ▶ A strong management team and a highly experienced group of advisors is critical to IPO readiness execution
- ▶ A strong infrastructure of people, systems, policies and procedures which enables accurate financial forecasting and regulatory compliance needs to be in place before the IPO launch
- ▶ According to surveyed executives, the two major accounting issues are adjusting historical financial statements to comply with local and foreign reporting requirements and dealing with consolidated subsidiary financial statements
- ▶ Two key corporate governance challenges for surveyed executives are recruitment of qualified independent board members and enhancement of internal controls
- ▶ High-performing companies delegate key communication responsibilities to their investor relations team, focus on creating a high-quality road show and keep investors informed through regular communications before, during and after the IPO
- ▶ Market outperformers deliver shareholder value by demonstrating effective investor relations and finance function and, most importantly, operational excellence

Top 10 IPO readiness challenges

Market outperformers¹ prepare far in advance for their transformational IPO value journey

Executing a company strategy requires access to capital. One of the primary ways to access capital is to go public. Companies that have completed a successful initial public offering (IPO) know the process involves the complete transformation of the people, processes and culture of the organization from a private enterprise to a public one. So how does a company begin the all-consuming task of preparing to go public, which starts well before the IPO event and continues long after? It is up to the CEO and senior executives to strike the right balance between executing the IPO transaction and managing the day-to-day operations of the company. In the life-changing journey from the private realm to the public markets, senior managers face numerous leadership challenges which test the IPO readiness of their business. Therefore, the key question that a CEO and senior executives need to ask is, "Are we prepared?"

Chart 1 | **The IPO value journey**



1. We define "market outperformer" or a "successful IPO" as one in which the stock price of the newly-listed company outperformed its stock exchange or major regional index in the three years following the IPO

“Start thinking about it as early as possible and speak to people who’ve done it before, not just the advisors.”

CFO, UK

In the past 20 years, the IPOs of companies around the world have soared in number and value, often enjoying stunning initial share price performance. However, many companies significantly underperform the market, in both profits and share price during the first three years after their IPO². At the same time, a significant number of highly successful companies buck this underperformance trend and enjoy stellar performances, outperforming the market in the three years after going public.

What makes some IPOs so successful, while others underperform? Those who treat the IPO as just a short-term financial transaction underestimate its far-reaching impact. Our extensive experience and our 2008 *Measures that matter*SM research study show that successful executives start to plan and make organizational changes at least a year before the IPO. Moreover, they treat the IPO event as just one defining milestone in a larger transformation process which Ernst & Young calls the IPO value journey. The value journey’s structured approach to managing 10 IPO readiness challenges may serve as a guide to a private company in its transformation into a successful public company that continually delivers value to its stakeholders.

Challenging IPO markets come and go – but winning companies are always ready

The lessons learned from successful IPOs are even more crucial in volatile economic conditions. Even when the financial climate is not ideal for raising funding, it could be a good time to be planning for an IPO or any other deal. While waiting for markets to settle, executives may embark upon the IPO value journey and, in the two-three year transformation process, fully prepare their company so that it is ready to go public when markets recover.

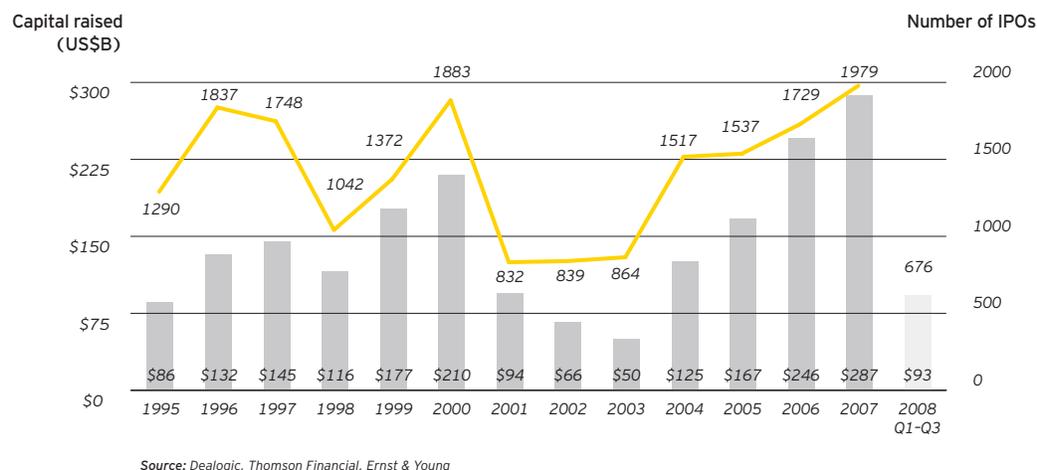
As evidenced by the stock market activity of the last two decades, economic and market trends are cyclical. The global volume of IPOs rose dramatically, from around US\$11 billion in 1990 to US\$210 billion in 2000. In 2000-01 with the bursting of the global technology bubble, IPO market euphoria quickly dissipated, leading to a drastic slowdown in the 2002-03 market. By 2004, however, world-wide IPO market activity had begun to pick up, gaining healthy momentum in 2005.

Accelerated globalization of capital markets and buoyant investor confidence led to a record-setting IPO boom in 2006 and 2007. Global capital inflows and expanding local economies led to stunning growth in the IPO activity of the emerging markets, especially in the BRIC countries (Brazil, Russia, India and China). The world’s largest IPO ever launched in 2006 – China’s largest state-owned bank, the Industrial Commercial Bank of China (ICBC) – raised US\$22 billion. By 2007, global IPO activity reached an all-time high of US\$284 billion raised in 1,979 deals.

By 2008, market turbulence set off by the credit crunch led to a sharp deceleration in most IPO markets around the world. Faced with more scrutinizing investors and stringent valuations, record numbers of businesses withdrew or postponed their IPOs. Nonetheless, some high-quality enterprises, primarily from the emerging markets, continued to be well received by the world’s public markets. In the first half of 2008, 505 companies from around the globe raised US\$79 billion in the public markets. Even so, many more companies still waited on crowded IPO registration lists, ready to go public once market conditions improved. Indeed, companies that undergo an effective IPO readiness transformation during uncertain times will position themselves to be the first to take advantage of improved equity market conditions.

2. This trend was first documented by Professor of Finance Jay R. Ritter from the University of Florida.

Chart 2 | Global IPO activity 1995 - 2008



Our global study shows how today's outperforming companies prepared for their successful IPOs

Since 1996, Ernst & Young has conducted a series of research projects called *Measures that matter*SM to discover the key performance measures for a successful IPO. In 2008, the research project was relaunched and expanded beyond its initial US scope to encompass a global spectrum of company executives and institutional investors not just from the United States, but also from the rest of the Americas, Asia Pacific and Europe³.

In our research, we closely examined the successful global IPO process, from the internal perspective of the CEOs, CFOs and senior management of the world's outperforming companies, as well as the external perspective of global institutional investors. Our worldwide study yielded robust indicators of the IPO readiness practices associated with an outperforming public company.

We also clearly ascertained the global "measures that matter" – the financial and nonfinancial performance measures that matter to executives and institutional investors. Our study has shown that these measures do matter to corporate executives and contribute to the company's post-IPO performance. Moreover, institutional investors take all of these measures into account when making portfolio allocation decisions.

We hope that knowledge of global leading practices and measures that matter, which are largely consistent regardless of geography or industry, will help executives around the world better prepare their company for their new public status. The following executive summary of global research results may serve as a benchmark for CEOs, their senior executives and shareholders who are considering an IPO. How does your company measure up?

3. See Appendix for research details of the executive and institutional investor studies and profiles of respondents.

Part one

IPO transaction readiness/planning, 24-36 months prior to IPO

Our global study clearly shows that companies which exceed overall market returns make thorough planning an important first step in their IPO value journey. Successful companies usually begin to act like a public company at least a full year prior to going public.



1. Preparing for the IPO value journey

2. Keeping your options open

3. Timing the market

4. Building the right team to take you public

5. Building your business processes and infrastructure

6. Establishing corporate governance

7. Managing investor relations and communications

8. Conducting a successful IPO road show

9. Attracting the right investors and analysts

10. Delivering on your promises

Preparing for the IPO value journey

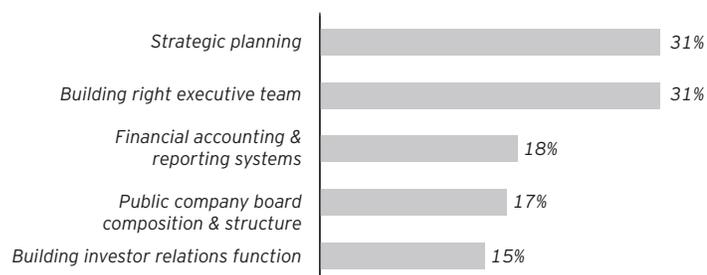
Develop a compelling strategic plan

Planning is critical. The first step in a successful IPO value journey is a careful exercise in defining success. Then, with input from key stakeholders, executives create a comprehensive business plan and detailed timeline regarding the operational, financial and strategic initiatives necessary for the company to go public. The business plan needs to be long term, including the 24 months before and after the IPO. Such a business plan should provide a clear road map for the company of its future direction which may then be communicated to stakeholders. Market outperformers implement critical changes early enough to allow for the changes to season in the organization.

Our experience shows that while a private company can function with an informal planning process, institutional investors expect a public company to have a compelling strategic plan. Investors focus not on a company's past history, but rather on its future direction. Thus, a convincing, well-thought-out and well-documented corporate strategy is crucial.

"We had a road map indicating where we wanted it to go. We would have substantially missed our targets if not for focusing on a well-thought out plan before the IPO."
CFO, Canada

Chart 3 | **Executive survey: which of the pre-IPO changes had the greatest benefit 3 years post-IPO?**



Percentage of executive respondents

Executive point of view

Over half of executives in our study say that developing and executing a compelling business strategy is the biggest pre-IPO readiness challenge. At the same time, 31% of respondents say that strategic planning provided the greatest post-IPO benefit as it allowed their organizations to operate more efficiently.

Institutional investor point of view

Institutional investors rank "corporate strategy execution" and "quality of corporate strategy" as the second and third most significant nonfinancial performance measures in their IPO investment decisions. (Management credibility and experience is considered by most investors to be the most important nonfinancial metric. See Chart 5.) These findings show that investors place great emphasis on the credibility of a company's management team, especially their ability to develop and execute a compelling strategic plan.

“We chose to go public for more liquidity, to grow through acquisitions, and to obtain more clients through improved visibility or reporting.”
CFO, USA

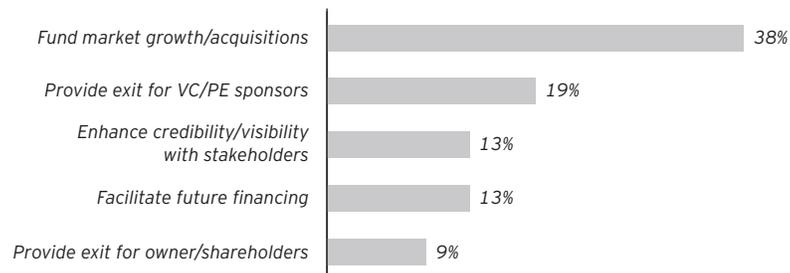
Make sure an IPO is the right strategy

Going public is not for every company. The pitfalls are numerous and the stakes are high. Lack of adequate preparation and poor market timing can jeopardize an IPO. It's important to understand the suitability of the IPO for the business, given a company's business model, growth potential and the stage of the company's life cycle.

Outperforming companies weigh the benefits of going public against the drawbacks, as well as against the company and shareholders' objectives. The possible benefits of going public are numerous, including: improved financial condition, liquid currency, more capital to sustain growth, increased shareholder value and share price, incentives for management and employees through stock options, enhanced corporate image, a path to mergers and acquisitions, better future financing opportunities and the ability to benchmark operations against other public companies from the same industry.

The potential drawbacks of going public can include: loss of control and privacy, limits on management's freedom to act, the demands of periodic reporting, initial and ongoing expenses, the burden of dealing with shareholders' expectations and increased disclosure requirements.

Chart 4 | **Executive survey: what was the most important motive in leading your company to seek an IPO?**



Percentage of executive respondents who consider factor as most important

Executive point of view

Outperforming companies go public to realize growth potential and view the IPO as one of the key enablers to their growth strategies. Specifically, 38% of executives cite the desire to fund acquisitions or market growth. 19% focus on providing an exit for venture capital or private equity sponsors. Indeed, the role of private capital sponsors is expected to grow for many reasons, including the increased availability of private capital around the globe and the lengthening of the median time between the initial investment to IPO during challenging markets.

Almost all executives surveyed are pleased with their IPO experience. However, a small minority (8%) say that they would not advise others to pursue an IPO, and that it might be better to remain private or consider alternative options.

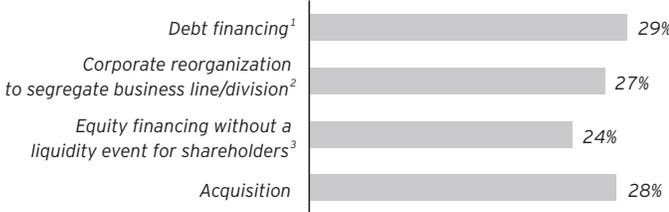
Evaluate which pre-IPO transactions could enhance the offering's value

A company's overall transaction strategy is made up of much more than the IPO itself. Strategic transactions are powerful tools for accelerating development of a business. Therefore, while preparing for an IPO, executives should also evaluate which additional strategic transactions could enhance the value of the IPO for the company before going public (i.e., acquisitions, venture capital, private placements, mezzanine financing, joint ventures, alliances and recapitalizations). Not only should a well-planned and executed transaction add shareholder value, it should also improve the company's credibility with market analysts and investors.

Our research has found that successful companies typically undertake transactions in advance of going public to help them achieve the maximum value. These include transactions to acquire a company, to finance/refinance, to reorganize the business and to strengthen competitiveness. Furthermore, successful companies also conduct transactions after the IPO. According to a US Ernst & Young study, 77% of the US companies surveyed that conducted a transaction after the IPO were trading at a premium as of the end of June 2007.⁴

"The pre-IPO transactions gave scale to the listing, provided complementary facilities for ongoing growth and provided a platform for operations, management and financial reporting."
CFO, Australia

Chart 5 | **Executive survey: which transactions did you execute in anticipation of your company's IPO?**



1. 40% of respondents from Americas have undertaken debt financing, compared with 29% from Asia Pacific and 17% from Europe.
2. 35% of respondents from Asia Pacific have undertaken corporate reorganization, compared with 28% from Europe and 21% from Americas.
3. 39% of respondents from Asia Pacific have undertaken equity financing, compared with 28% from Europe and 12% from Americas.

4. Ernst & Young's *IPO Success Factors from the 'Class of '06/07'*, 2008

“The financial transactions pre-IPO provided a clearer story, greater opportunities and a better business.”
CEO, UK

Executive point of view

In our survey, 73% of the outperforming companies conducted transactions prior to the IPO. In all three regions, debt financing was the transaction most frequently taken prior to IPO (for 29% of companies surveyed), followed by a corporate reorganization to segregate business line/division (27%) and equity financing (24%). 19% undertook an acquisition prior to their IPO.

- ▶ **Regional comparison:** 40% of companies in the Americas undertook a debt financing. At least until the credit crunch, US companies tended to take on more debt financing since it was less expensive than equity financing. 39% of companies in Asia-Pacific pursued equity financing without a liquidity event for shareholders. Asia Pacific companies may have pursued equity transactions in part because both long and short term debt financing options were limited in the region. 28% of companies in Europe underwent a corporate reorganization to segregate a business line or division. Among other benefits, such a transaction added shareholder value as it makes the company's business model easier for investors to understand.

Interestingly, while 19% of companies undertook an acquisition, 16% of executives that did not embark on an acquisition wished they had done so, believing it would have added shareholder value. Similarly, while only 8% of companies conducted alliances or joint ventures prior to the IPO, 17% of executives that did not pursue such transactions believe it would have added shareholder value. By contrast, only 4% of those companies that did not undertake debt/equity financing or corporate reorganization prior to their IPO felt that, in hindsight, these transactions would have been beneficial.

Overall, 90% of executives believe that the pre-IPO transactions their companies carried out contributed to shareholder value. Furthermore, investors look favorably upon a company that executes their growth plans. Much of the underlying motivation in pursuing pre-IPO transactions seems to have been “to engineer a business that the market can readily understand”. For instance, a streamlined company structure may allow executives to present a clearer, more focused business model. For other executives, the IPO may help them to make tough business decisions and gave them a clear goal.

- ▶ **Regional comparison:** For a quarter of executives surveyed in the Americas, pre-IPO transactions added to shareholder value by facilitating growth and strengthening the business. The same number of executives in Europe say pre-IPO transactions added shareholder value primarily by increasing company revenues. In Asia Pacific, pre-IPO transactions are often designed to expand the company's business model into new markets.

Understand the main stock price drivers – institutional investors

As the recipients of 70% to 80% of IPO stock allocations, institutional investors drive stock prices. The highly sophisticated institutional investor market includes insurance companies, pension funds, money management funds, larger corporate issuers, investment bankers and other corporate finance intermediaries.

Our research demonstrates that the more institutional investors that invest in a company, the better it is for the business, since these investors tend to work together to make key portfolio allocations. According to a 2007 Ernst & Young study, US companies with at least 80 institutional investors are more likely to outperform the index, offering a 40% premium. Those US businesses with fewer than 40 institutional investors are more likely to underperform the index.⁵

5. Ernst & Young's *Lessons from the leaders, “How to prepare for a successful IPO”*, 2008

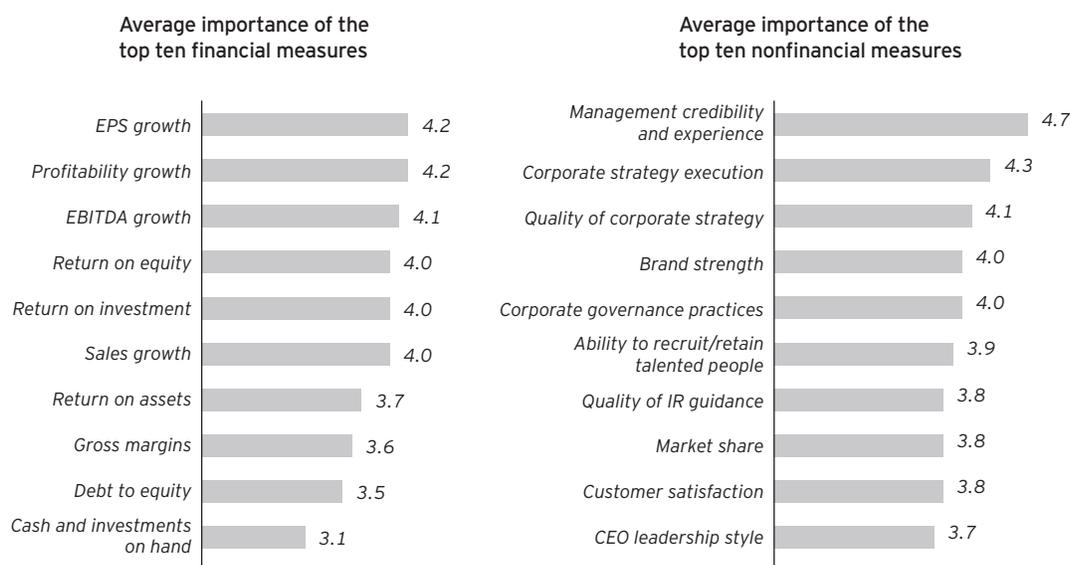
In our 2008 global survey, we find remarkable consistency among institutional investors in their relative weighting of various performance measures during their IPO decision-making. In general, the measures that matter to investors in our survey do not vary significantly between any particular type of investor, investment strategy, geography or industry.

Know which financial and nonfinancial measures matter to investors

Our study clearly shows that investors take both financial and nonfinancial criteria into account when making buy/sell decisions. On the one hand, institutional investors say that vital financial performance measures (such as growth in earnings per share, profitability and EBITDA) are the chief investment criteria and justify on average 60% of their portfolio allocation decisions. These financial metrics help investors determine the attractiveness of the company's valuation and how the IPO is priced (which is typically at a 10% to 15% discount relative to its peer group of comparable companies).

On the other hand, institutional investors say that an average of 40% of their IPO portfolio allocations are based on nonfinancial measures – even in their evaluations of the largest, mature companies. Our research over the past decade has consistently shown that nonfinancial metrics can be seen as leading indicators of future financial performance. We have found that the executives who can skillfully measure, manage and communicate their nonfinancial performance will gain a competitive edge – and may significantly improve their company's operating performance, valuation and ability to attract new investment capital.

Chart 6 | **Institutional investor survey: rate the importance of the following performance measures in your decision-making related to IPO stocks.**



Note: Respondents were asked to rate importance on a scale of one (least important), to five (most important)

Institutional investor point of view

According to surveyed institutional investors, the three most important financial measures in their IPO decision-making are growth in earnings per share, profitability and EBITDA. These results reveal the striking change in profitability and the relevance of various financial measures when a private company goes public. Sales growth, cash and investments on hand are usually the key financial measures for a small private company without shareholders. But in a public company, shareholders focus primarily on continued growth in EPS, cash flow and profitability.

At the same time, the five nonfinancial measures given the most weight by institutional investors in our survey are: management credibility and experience, corporate strategy execution, quality of corporate strategy, corporate governance and brand strength.

Benchmark to ensure competitiveness on key measures

Executives of a public company must become familiar with their peer group of competitive companies and the accepted terms of comparison. A company's performance measurement practices need to be aligned with the demands of the market well in advance. In our survey, executives of highly successful companies report that they were in a leadership position for practically every aspect of financial/nonfinancial performance before the IPO.

Chart 7 | **Executive survey: how did your organization compare to your key competitors before launching the IPO?**



Percentage of executive respondents who felt their companies were stronger on this measure than their key competitors

Executive point of view

Our executive study demonstrates that successful companies significantly surpass their peers in four key performance measures. Across all regions, market outperformers reveal a predominance of strong growth rates prior to the launch of the IPO. 70% of successful executives state that their pre-IPO growth rate was stronger than that of competitors. 51% say their sales performance was better and 47% claim that their profitability was greater.

- **Regional comparison:** In our survey, companies in Asia Pacific performed more strongly than their peers in the areas of sales performance and profitability prior to the launch of their IPO. By contrast, European companies performed better in terms of market share and global operations.

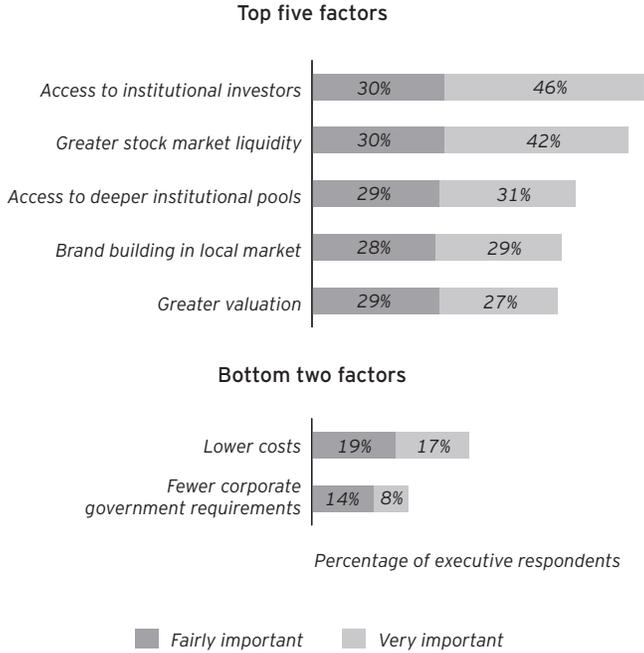
Choose the right stock exchange

For most companies, the domestic stock exchange is the straightforward listing choice. Indeed, over 90% of companies list on their home stock exchanges (and sometimes sell shares internationally). The primary choice that needs to be made is between the domestic markets' main board or junior market. Smaller, younger companies tend to list on their home country's junior stock exchange.

However, some companies may seek a foreign listing. Usually, these are larger companies with a small domestic market which seek a higher profile and more than US\$500 million in funding. A foreign listing may help to maximize IPO proceeds, broaden its investor base or achieve a higher valuation. A growing trend among companies that have already gone public is to consider whether a foreign listing might help them to raise their profile, access different institutional investor pools or achieve other long-range goals.

The best stock exchange will be the one which most effectively enhances the attractiveness of the company's stock to investors. After a company goes public, the exchange should also continue to meet a business's needs.

Chart 8 | **Executive survey: how important were the following factors in helping you to select the stock exchange to list on?**



Executive point of view

Both executives and institutional investors focus on a similar set of drivers in choosing the right stock exchange. For both groups, the choice of exchange is most likely to be determined by access to suitable institutional investors who understand their business model (76%) and a quest for better stock market liquidity (72%), rather than intrinsic qualities of a particular exchange (e.g., reputation and corporate governance standards).

Although the valuation likely to be achieved does matter, companies are not necessarily striving to achieve the highest possible valuation. Furthermore, given the high overall costs of going public, the costs of an exchange appear to be relatively negligible for most executives. The corporate governance/reporting consequences of listing on a particular exchange are also given relatively little weight in the choice of exchange.

Institutional investor point of view

However, investors value high corporate governance standards in foreign listings. 70% of investors say they are more likely to invest in a company that lists on a foreign exchange with higher corporate governance standards than those of its home market. Likewise, 73% of investors observe that they would be less likely to invest in a company that lists in a country with lower corporate governance standards than those of their home market.

- **Regional comparison:** For institutional investors who make investments in BRIC countries, access to suitable institutional investors is an even more important factor since such investor pools are not necessarily available in their home markets. For instance, in China, finding the investor community that understand the company's business model is paramount. By contrast, in the UK, finding the best corporate tax treatment tends to be the key to choosing the right stock exchange.



Keeping your options open

Evaluate alternative exit strategies

Successful executives explore potentially attractive alternatives to a public listing, before settling on the traditional IPO as the chosen route to monetization. The goal is to achieve the optimal value for a company's current situation and future objectives. Compared with the public markets, the private capital markets may be a more realistic, feasible, lucrative and less costly vehicle for raising capital.

Increasingly, businesses keep their options open by grooming for more than one source of funding. Alongside IPO preparation, a company's transaction options may include investment by a private equity firm, strategic sale through the M&A market, joint ventures, alliances, Rule 144A placements, private exchange and international listings or a dual/multi-track approach (concurrent pursuit of any combination of the various capital raising strategies).

It's important to understand the pros and cons of each exit route and its suitability for the company. Executives need to have a clear idea of what's involved, how long the process will take, what it's likely to cost and whether two or more routes need to be run in parallel. A multi-track approach should reduce risk substantially without adding a great deal to the cost or time requirement because many of the same preparations are necessary whichever route is chosen.

By diversifying its approach, a company can significantly expand its strategic options and negotiating leverage. Thus, successful companies keep options open during the long preparation process, especially in an uncertain financial environment.

"Consider carefully the cost-benefit of additional liquidity in a public market versus the availability of substantial private equity funds."

CFO, USA

Executive point of view

For executives in our study, the two primary alternatives to an IPO are to approach a private equity investor (56%) or negotiate a trade sale to a corporate buyer (39%). However, only 29% of the executives considered transactions other than IPO prior to going public. Ultimately, many executives opt for an IPO because they provide better valuation, access to capital, visibility and credibility.

Timing the market

Start early and take time to prepare

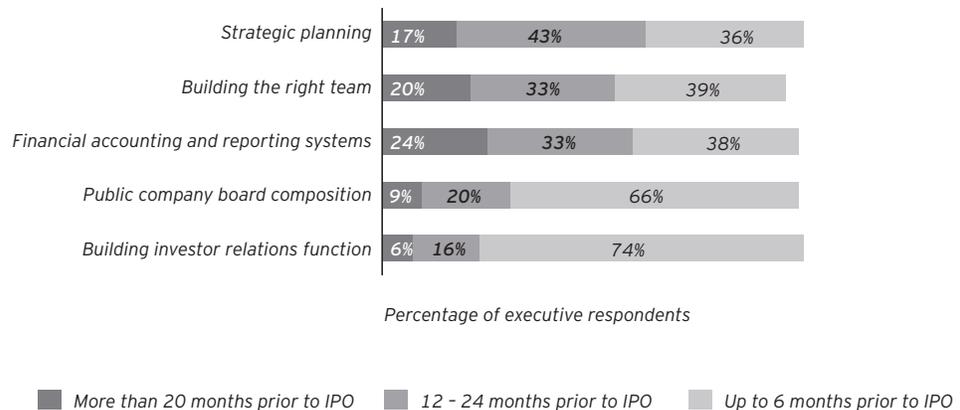
“Be patient and do not go public if you are not well prepared. The preparation phase is crucial.”
CFO, Canada

While it's best to go public in the most opportune market conditions possible, it is just as important to be fully prepared to operate as a public company. Rather than simply timing the market, outperforming companies take the full time needed for preparations, so that they are ready to launch when market conditions are optimal. Our research indicates that the most common mistake of newly public companies is to hurry into their IPO value journey just months before the IPO, and before their company is ready. Typically, the frequent rush to go public could be attributed to a pre-listed company's imminent need for capital, pressure from the advisors or board or the desire to capitalize on a limited window of opportunity in the midst of changing market conditions. Unfortunately, these are frequently the same companies whose results decline soon after the IPO.

Often, the more successful IPOs are launched by the more established and mature firms with proven track records and an established brand name. It can also be a fairly good predictor of the after-market value. For example, in an Ernst & Young study of US companies that went public in 2006-2007 and qualified for listing on the high-performing Russell 2000 Index, the average age of companies was eight or nine years old, regardless of industry.⁶ Only 11% of the companies went public in their first two years of operations. Our experience has shown that the growth stage of a company can be an indicator of a company's stability and ability to consistently generate earnings.

Companies that exceed overall market returns have usually implemented the more time-consuming critical changes a full 12 to 24 months prior to going public (e.g., strategic planning, building the team and establishing the internal control, financial and accounting systems). Less time-consuming changes tend to be implemented later on in the process, usually in the last six months (e.g., public company board composition, the investor relations function and employee/executive compensation issues).

Chart 9 | **Executive survey: when did you start implementing the following changes in preparation for the IPO?**



6. Ernst & Young's "IPO success factors from the Class of '06/'07", 2008

Executive point of view

For two-thirds of companies in our survey, strategic and corporate tax planning, internal control systems, financial accounting and reporting issues were implemented at least 12 months prior to the IPO. These findings make sense, since a private company's systems are usually of a much lower standard and it takes time to establish systems which meet public company requirements.

On the other hand, public company board composition, the investor relations function and employee compensation issues are generally left until later on in the IPO process, since they require less time to establish. At the same time, executives say that finding independent board members was more difficult than anticipated and, therefore, more time should have been allocated to their recruitment.

Finally, owners/managers were deemed the most influential in determining IPO timing by 58% of executives. Business advisors carried the most weight in 26% of the companies, while venture capital/private equity sponsors prevailed in 11%.

- ▶ **Regional comparison:** The strong impact of owners/managers on timing was especially true in Europe. In the Americas, 15% of executives claim that their venture capital/private equity sponsors exerted significantly more influence than their peers in other regions. One simple explanation is that private capital sponsors are more involved in the earlier stages in the Americas and, therefore, are more influential. In Asia Pacific, 71% of executives observe that owners/managers held more authority than any other shareholder.



Part two

IPO execution, 24 months prior to IPO

IPO readiness involves the acceptance and implementation of change – not just by executive management, but throughout every aspect of the business, organization and corporate culture. Market outperformers show flexibility and willingness to implement change (e.g., in the composition of the board of directors, employee incentive compensation plans, financial and internal control systems and investor relations strategy).



1. Preparing for the IPO value journey
2. Keeping your options open
3. Timing the market

4. Building the right team to take you public
5. Building your business processes and infrastructure
6. Establishing corporate governance

7. Managing investor relations and communications
8. Conducting a successful IPO road show

9. Attracting the right investors and analysts
10. Delivering on your promises



Building the right team to take you public

Recruit and retain an experienced team

On the journey of transformation into a public company, success depends to a great extent on a coordinated effort by internal management and the advisory team. In the case of market outperformers, the internal team is in place and functioning well in advance of the IPO. The top managers already have the experience and expertise to undertake the IPO and operate a public company during the road show and long after its over. The outperforming companies develop the compensation structures which will help to retain and motivate key talent within the organization.

Market outperformers also select experienced advisors, including underwriter, auditor, attorney and investor relations executives with whom they will work in close collaboration. These advisors help to prepare the business carefully, introduce the right investors, sell the company's story and, most significantly, put a value on the business that reflects its position and potential.

"Make sure you have the right executive team with experience in IPOs and diverse backgrounds. Choose first class advisors and get everything very thoroughly planned."
CEO, USA

Executive point of view

Over half of the executives say that building the right management team is an important factor in building and realizing shareholder value.

Institutional investor point of view

For the vast majority of investors in our survey (95%), the single most important nonfinancial performance measure in their decision-making is the quality of management credibility and experience. Over half of investors surveyed believe that the effectiveness of performance-based compensation policies is a key metric since it greatly affects the ability of the firm to recruit and retain highly talented senior management. As for building an effective advisory team, 65% believe that the strength of the underwriter is a decisive factor, while 39% consider the quality of the accounting firm to be significant.

Building your business processes and infrastructure

Construct a strong infrastructure for accurate financial forecasting

“Changing our financial processes and infrastructure had a positive impact on investors’ market perception of our company and that was reflected in a significant increase in our share price.”

CEO, Australia

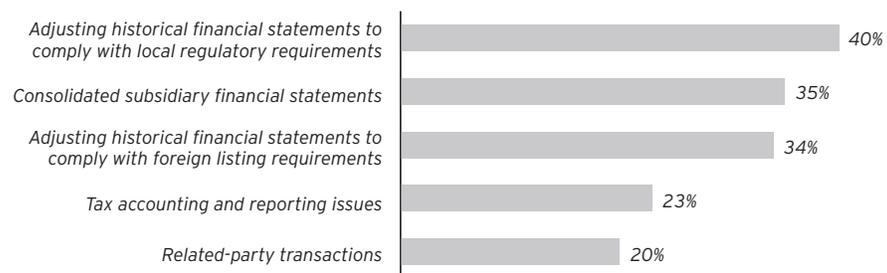
The infrastructure and systems of a publicly traded company are very different from a typical private company structure. Before listing, an organization’s financial, accounting, tax, operational and IT processes, systems and controls must be able to withstand the rigors and scrutiny of public company status. Before going public, executives should have in place, the infrastructure (of people, systems, policies, and procedures) which will enable the production of quarterly and annual reports in compliance with regulations. Currently, compliance of the infrastructure with local and foreign regulations is a major undertaking. As more countries around the world require IFRS for listed companies, differences between local and foreign regulations will diminish. However, it’s still a significant endeavor for a company to change its local accounting standard to meet IFRS standards.

Our experience shows that a strong infrastructure should facilitate regulatory compliance, protect against risk exposure and provide guidance to meet or beat market expectations. Furthermore, such an infrastructure will ensure business execution continues apace despite the focus on the IPO transaction.

Pre-listed companies need to improve their budgeting and forecasting capabilities, enhance external financial reporting, put financial statements in order, prepare to comply with local securities law and consider potential IPO accounting and reporting issues.

Companies may also require some corporate housekeeping. For instance, they need to consider whether the existing corporate, capital and management structures are appropriate for a public company and whether the transactions with owners and management have been properly documented.

Chart 10 | **Executive survey: what were the most challenging accounting and financial reporting issues that you faced during the listing process?**



Percentage of executive respondents

Executive point of view

Senior executives cite the importance of building financial and accounting systems early, as the third most beneficial change for post-IPO value. At the same time, building the financial and accounting systems can be challenging, especially adjusting historical financial statements to comply with local requirements, dealing with consolidated subsidiary financial statements and adjusting historical financial statements to comply with foreign listing requirements. These three challenges are driven primarily by the existence of relatively weak accounting standards in many countries. Even though IFRS is becoming the global financial reporting language, this is only true of listed companies. Therefore, these daunting accounting issues are likely to continue for pre-listed businesses which have not yet gone public.

Institutional investor point of view

Quality of guidance is considered by investors to be one of the key nonfinancial metrics, which underscores the importance of having an appropriate financial infrastructure in order to forecast finances accurately.

“Changing our internal control systems helped us meet the accounting, tax, legal and procedural requirements and was the single pre-IPO change with the greatest beneficial impact to our operations.”

CFO, Singapore



Establishing corporate governance

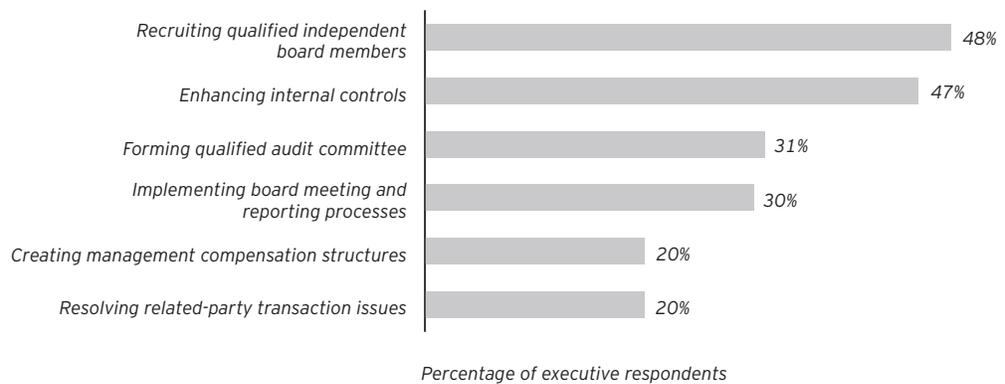
Create the corporate governance policies that inspire shareholder confidence

“You must be well prepared, as the requirements for a public company for corporate governance and internal controls are much higher than for a private company.”
CFO, Hong Kong

Executives of the outperforming companies adopt the best practice corporate governance principles and reporting policies that protect shareholder interests. They take the time to build a public company board with a substantively disparate mix of compensation, compliance and governance specialists, corporate strategists and experienced business and financial executives.

With heightened corporate governance standards for public companies, the process of attracting qualified independent board members is more complicated and critical for IPO candidates these days than it was in the past. Public company boards require a different skill set compared to private company boards. With intense individual scrutiny and liability for today’s public company directors, substantial time and effort is required to identify, appoint and groom a qualified board of independent directors.

Chart 11 | **Executive survey: what were the top three most challenging corporate governance issues that you addressed in the IPO process?**



Executive point of view

Executives cite the change in composition and structure of the company board as one of the most beneficial changes for shareholder value. The three most challenging corporate governance issues are recruiting qualified independent board members, enhancing internal controls and forming a qualified audit committee.

- **Regional comparison:** Difficulty in recruiting qualified independent board members is cited by 57% of companies in Europe, especially for companies listed on the AIM exchange (71%). This recruitment challenge could be a reflection of the wide variability in corporate governance standards among various European countries. Furthermore, enhancing internal controls is cited by 53% of organizations in the Americas, especially those listed on the NYSE (74%). The internal controls difficulty for US executives could be attributed to the demanding nature of internal control reporting requirements in the US. Furthermore, 58% of companies listed on the NYSE cite the problems forming a qualified audit committee.

Managing investor relations and communications

Keep investors informed by regular communications

The investor relations function involves educating the public about the company's position in the industry, providing a regular update of forecasts and identifying any key business issues that could impact the company. Specifically, when a public company acquires a group of shareholders, it needs to keep them informed of corporate developments in a variety of disclosure vehicles, including annual and quarterly reports, proxy statements, press releases, direct mailings and shareholders' meetings. Shareholders, analysts and the financial press will critically evaluate management's performance and focus attention on the company's share price.

Private companies often underestimate the need to court public investors, as well as the amount of time it takes. While a private company does not require investor relations, the function becomes a major priority for the public company. High-performing companies not only appoint the right investor relations team, but also listen to it and give it some authority. Together, the company and the investor relations specialists work to sustain the market's interest in the company, communicate with shareholders and the public, attract a pipeline of new investors and sell-side research coverage while managing regulatory and liability risk. Overall, the company's investment messaging needs to define the core value proposition for investors and answer the question, "Why invest now?"

"We need to communicate with investors regularly. They need to know, not to guess, our business and operations. We must be transparent and honest."
CEO, Singapore

Executive point of view

Overall, half of the executives say they felt well prepared for the disclosure and investor relations responsibilities. 58% state that managing investor relations and communications are key to building and realizing shareholder value.

- ▶ **Regional comparison:** Nonetheless, the confidence of the executives in their levels of preparation for disclosure and investor relations responsibilities varies considerably across regions. For instance, 22% of companies in the Americas felt "very well prepared" while 25% of European respondents felt "unprepared" for investor relations responsibilities.

Institutional investor point of view

In our survey, two-thirds of institutional investors agree that the quality of investor relations guidance and the road show presentation are key measures in their portfolio allocations.

Conducting a successful IPO road show

Convey a compelling equity story in the road show

“Ensure that you’re prepared to meet the expectations that you propose during the initial road shows.”

CFO, USA

Completion of the road show is one of the most challenging steps in the period between the publication of a company’s IPO prospectus and final closing. It is a vital step, since the road show will likely be the only time a company’s senior management meets the investor. Institutional investors rarely visit the companies they invest in, preferring instead to rely on information presented at the road show meetings and other sources.

On the road show, underwriters take senior management on a whirlwind tour and introduce the company to key investment audiences, including the underwriting sales forces and prospective institutional investors. Senior management tells the company’s story and sells its investment merits to these various stakeholders. They also address skeptics who pose challenges to the investment thesis. Typically, the road show consists of intensive meetings in many locations over a two-week period.

High-performing company executives aim to understand their stakeholder audience and learn how to convey the company’s performance to the investor community. They strive for a business plan and messages that are realistic, consistent, clearly communicated, sustainable and supportable over the long term. Executives need to be able to describe the company’s specific lifecycle, infrastructure, talent, board, partners and customer considerations. Furthermore, the road show’s presentation should be given in the investor’s language.

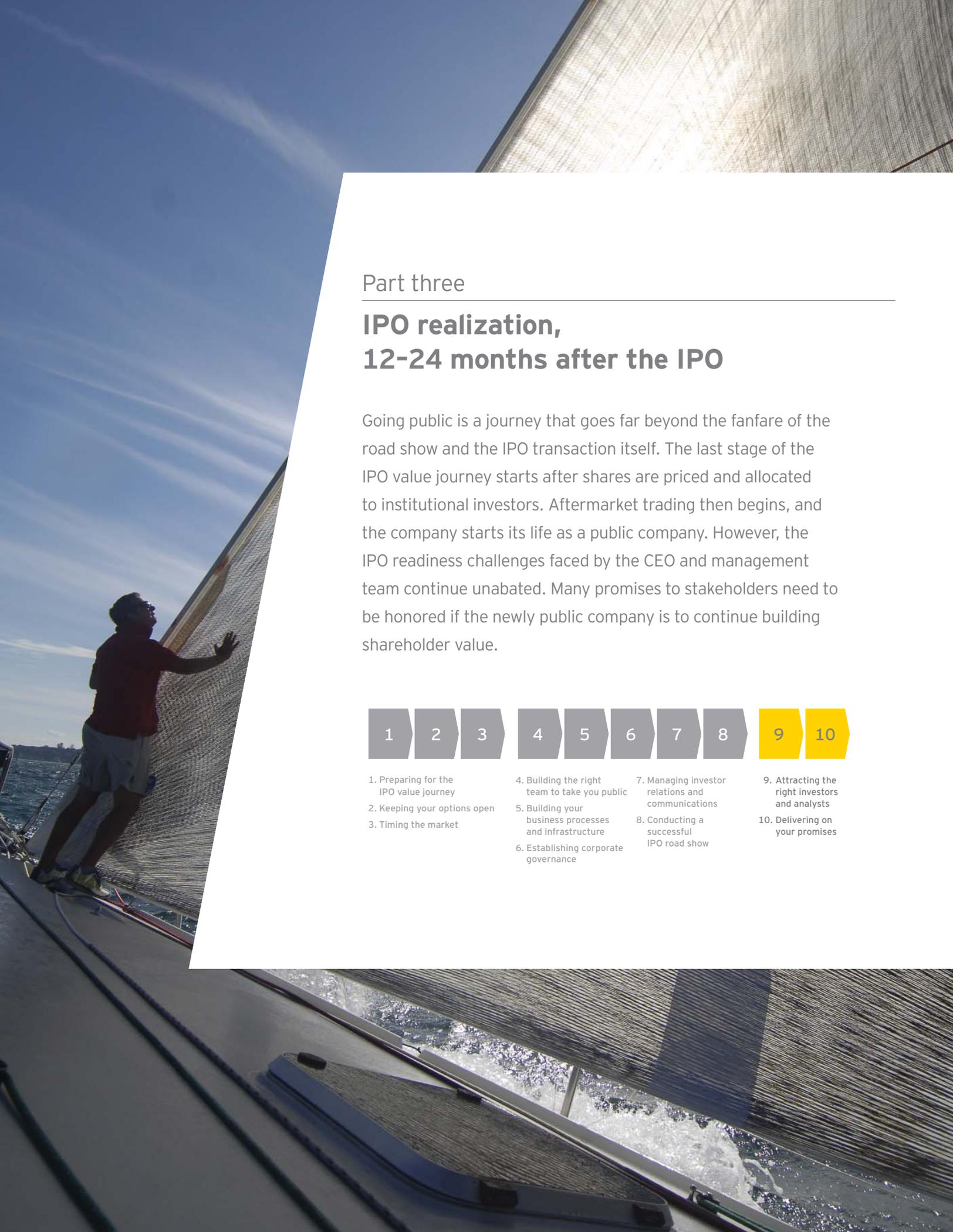
Executive point of view

An effective road show is rated as the third most significant factor in realizing shareholder value by almost three-quarters of executives around the world, especially in the US (83%). There seems to be a correlation between the number of institutional investors and the performance of the IPO. Therefore, during roadshows, US executives should focus on trying to secure as many institutional investors as possible.

- ▶ **Regional comparison:** Over 60% of European and Asian executives agree that an effective road show was important in building and realizing shareholder value.

Institutional investor point of view

A strong majority (88%) of institutional investors cite the quality of the road show as a key nonfinancial measure in their buying decisions, with little variation across geographic regions.



Part three

IPO realization, 12-24 months after the IPO

Going public is a journey that goes far beyond the fanfare of the road show and the IPO transaction itself. The last stage of the IPO value journey starts after shares are priced and allocated to institutional investors. Aftermarket trading then begins, and the company starts its life as a public company. However, the IPO readiness challenges faced by the CEO and management team continue unabated. Many promises to stakeholders need to be honored if the newly public company is to continue building shareholder value.



1. Preparing for the IPO value journey
2. Keeping your options open
3. Timing the market

4. Building the right team to take you public
5. Building your business processes and infrastructure
6. Establishing corporate governance

7. Managing investor relations and communications
8. Conducting a successful IPO road show

9. Attracting the right investors and analysts
10. Delivering on your promises

Attracting the right investors and analysts

Cultivate long-term relationships with investors

“Be ready to dedicate all the necessary time and energy to the dialogue with the investors, to consider them as partners as well as investors.”

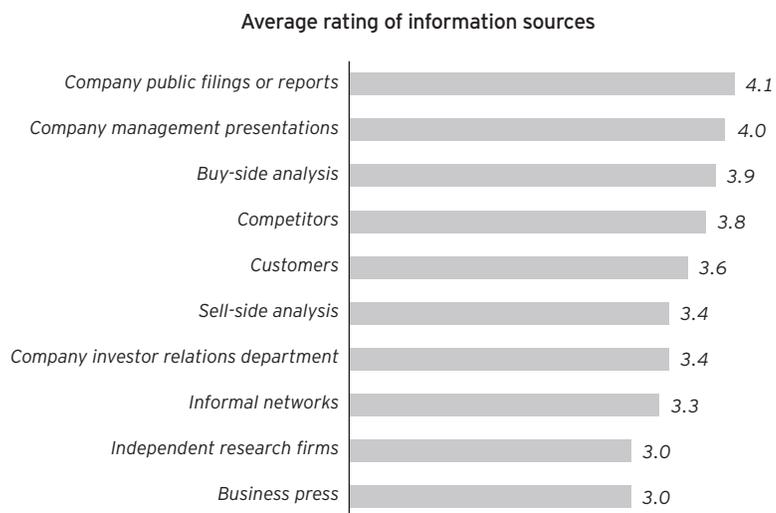
CEO, France

Once the IPO is over, the process of retelling and fine-tuning the company’s investment story begins. At first, many newly public companies enjoy high share prices fuelled, in part, by investors’ interest in IPOs and by the press coverage for such companies. However, unless the market’s interest in the company is carefully maintained after the IPO, the initial euphoria will quickly fade away. The trading volume and value of the company’s shares will also decline. Thus, after the IPO event, senior executives need to continually communicate the intangible business drivers of the company.

Successful executives target the type of investor that will maximize liquidity and valuation. They strive to develop a proactive investor relations strategy that will attract the optimal ownership mix and a long-term pipeline in the aftermarket. They aim to attract equity research analyst coverage and to establish an ongoing dialogue with the investment community and financial media. Senior management then needs to convey the company’s value proposition through carefully crafted messages to the targeted investors and analysts.

Outperforming executives determine which information to convey to the investment community and effectively monitor and react to news about the company. Thus, knowing which information sources institutional investors pay attention to is a keystone for formulating a successful investor relations strategy.

Chart 12 | **Institutional investor survey: please rate the following sources of non-financial information used in your decision making related to IPO stocks.**



Note: Respondents were asked to rate importance on a scale of one (least important), to five (most important)

Executive point of view

In our study, 83% of executives say that “attracting the right investors” is an essential factor in building and realizing shareholder value. When executives were asked to describe the key lessons learned about communicating with institutional investors: “Keep investors informed and communicate regularly” topped the list of responses (with almost half of executives mentioning this theme). “Keep promises, overdeliver” and “Strive for clarity and transparency” were the responses from one-quarter of executives interviewed.

Institutional investor point of view

According to our survey, institutional investors pay the most attention to company filings and management presentations, buy-side analysis, as well as what the competitors say about the company. Contrary to the common view that blogs and online communities wield significant influence on investors, our respondents rate blogs as the least important of information sources.

“We must keep institutional investors well informed about important management decisions and communicate the information to them at the right point in time.”

CFO, India



Delivering on your promises

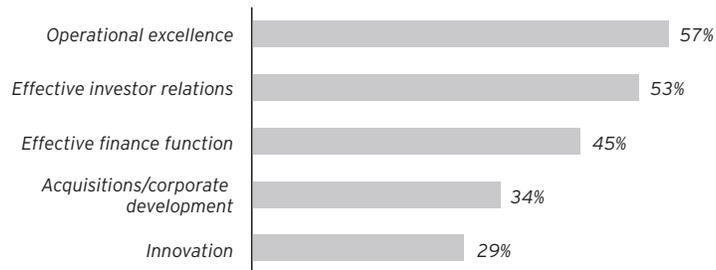
Provide shareholder value by keeping promises

“My most important advice to a CEO considering an IPO? Underpromising and overdelivering, transparency, early communication, growth distribution, managing risk sensibly and carrying out acquisitions to create value.”
CEO, Australia

Once a company goes public, the real work begins. A company must meet or beat the expectations that it has set. After the IPO, the executive challenge is to deliver the shareholder value (and, ultimately, share price appreciation) promised to stakeholders by the business plan, offering prospectus and other communications. Promises will also have been made during the IPO and road show to many different stakeholders, including investors, analysts, employees, customers and the board, as well as the regulatory body, financial community and the press.

Being a public company means having to keep the promises made. Management must strive for accuracy in projections and forecasts so that targets are hit – quarter after quarter. Many newly public companies seriously underestimate the level of market scrutiny that accompanies an IPO. The public markets are an unforgiving place. A private company may endure negative publicity without major repercussions. However, for a public company, a single negative news item that is not well-managed by the investor relations function can have a significant impact on a stock price. In some countries, missteps by newly-public companies are frequently used as the basis of shareholder class action lawsuits. Thus, failure to deliver on promises will hurt a company’s stock price.

Chart 13 | **Executive survey: which factor is the most vital in helping you build post IPO shareholder value?**



Percentage of executive respondents who consider factor to be very important

Executive point of view

- ▶ Over half (57%) of executives cite operational excellence as the most highly valued characteristic for creating post-IPO shareholder value. (Operational excellence can be defined as running the company well, successfully executing the business plan, meeting financial targets, etc.) Nonetheless, as global competition grows, it is critical for public companies to also focus on acquisitions, corporate development and innovation as key drivers of shareholder value.
- ▶ **Regional comparison:** According to our survey, companies in the Americas and Europe emphasize operational excellence as the most vital factor in building post-IPO shareholder value. Businesses in Asia Pacific are more likely to cite the growth factors of acquisitions/corporate development as the most significant factors.

Use IPO proceeds to fund growth

From the perspective of both investors and executives, the best reason for a company to pursue an IPO is to raise capital to grow the business, i.e., the expansion of business operations. Our experience shows that investors are wary of investing in companies which use proceeds to pay off debt or where management is "cashing out" by selling more than 30% of their shares. Clearly, investors seek out companies with a persuasive growth plan.

Chart 14 | **Executive survey: what were the most important uses of IPO proceeds?**



Percentage of executive respondents

Executive point of view

For many outperforming companies in our survey, growth is the key driver. In keeping with this trend, market outperformers are most likely to use IPO proceeds to fund growth and acquisitions, whether through expansion of operations (51%), moving into new geographic markets (39%) and acquisitions of other companies (37%).

The ongoing challenge: renewing and recreating

Be ready to re-evaluate company strategy

“Do not be blinded by the euphoria of the IPO. Companies are well supported until the IPO but, once they are public, things get complicated. You need to be well prepared for the events that follow.”
CEO, France

The IPO value journey is a recurring series of challenges for executives. In a constantly changing world, executives need to maintain a clear picture of the opportunities and risks. They may need to periodically return to the beginning of the cycle and recreate strategies and processes. Market outperformers aim to continue accelerating their business, all the while building the infrastructure and management practices that a mature public company requires.

Executive point of view

A company will always be surrounded with issues outside of its control, including the stock market, economy and fluctuations within the industry. In our mid-2008 survey, executives were asked about the current impact of key issues on their businesses. 84% of executives state that recruiting talented individuals has had a significant impact on their business. 67% cite uncertain economic conditions, regulatory and compliance risk (66%), industry consolidation/transition (58%) and capitalizing on energy markets (43%).

When communicating with investors, the executive focus should be on factors within the company's control – managing the business, producing the numbers and creating value. Credible communicators speak with transparency about both opportunities and challenges in the business. In today's challenging business climate, meeting or beating expectations and delivering on promises remains as crucial as ever.

Throughout the IPO value journey, senior management's focus should not only be on going public but also on being public. After positioning themselves as public entities long before going public, market outperformers demonstrate superior financial performance and effectively communicate non-financial attributes. Although IPO readiness can lead to a successful IPO outcome, all of the best financial engineering will not create business prosperity - only strong operational execution will forge the path to long-term success. The IPO may be the most important transaction in a company's history to date, but it's often just one more milestone along the road to market leadership for an exceptional enterprise.⁷

7. Ernst & Young's "Exceptional Enterprise Model" highlights the six key business challenges companies should address and the actions they should take to become a market leader

Appendix

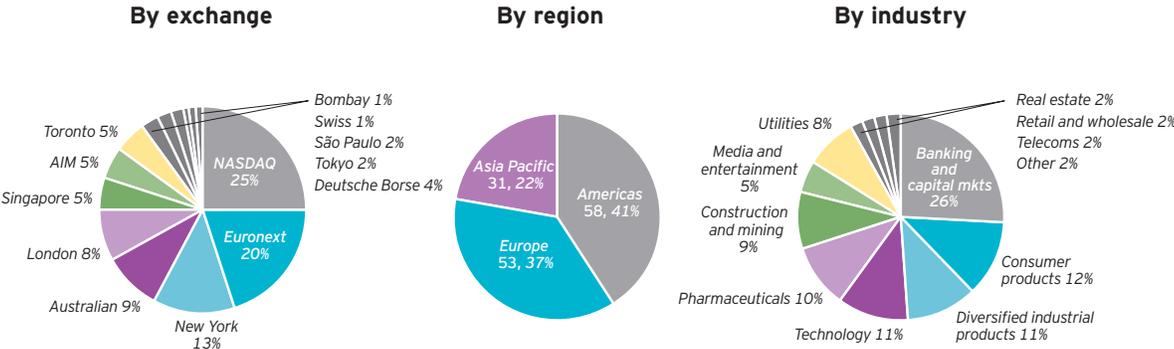
Executive study: measures that matter to outperforming companies

In the Ernst & Young 2008 *Measures that matter*SM study, we undertook an independent survey of companies that had recently launched and completed a successful IPO in order to identify the key factors that contribute to post-IPO success. We defined a successful IPO as one in which the newly-listed company's stock price outperformed its stock exchange or major regional index in the three years following the IPO.

Specifically, the survey population was made up of 750 publicly traded companies that launched an IPO between 2001 and mid-2005, on one of the major stock markets in North America, Europe and Asia.⁸ Representing a wide cross-section of industries and geographies, 142 qualifying companies participated in and completed the study. The current average market capitalization of the companies surveyed was US\$1.85 billion.

Senior executives, predominantly CEOs and CFOs, participated in 30 minute phone interviews consisting of a mixture of structured and open-ended questions and completed in-depth semi-quantitative questionnaires. To qualify, these interviewees must have held a senior role at the company during the preparation and launching stages of the IPO. 65% of respondents were holding the same senior position as at the time of the IPO.

Chart 15 | Profile of executive respondents

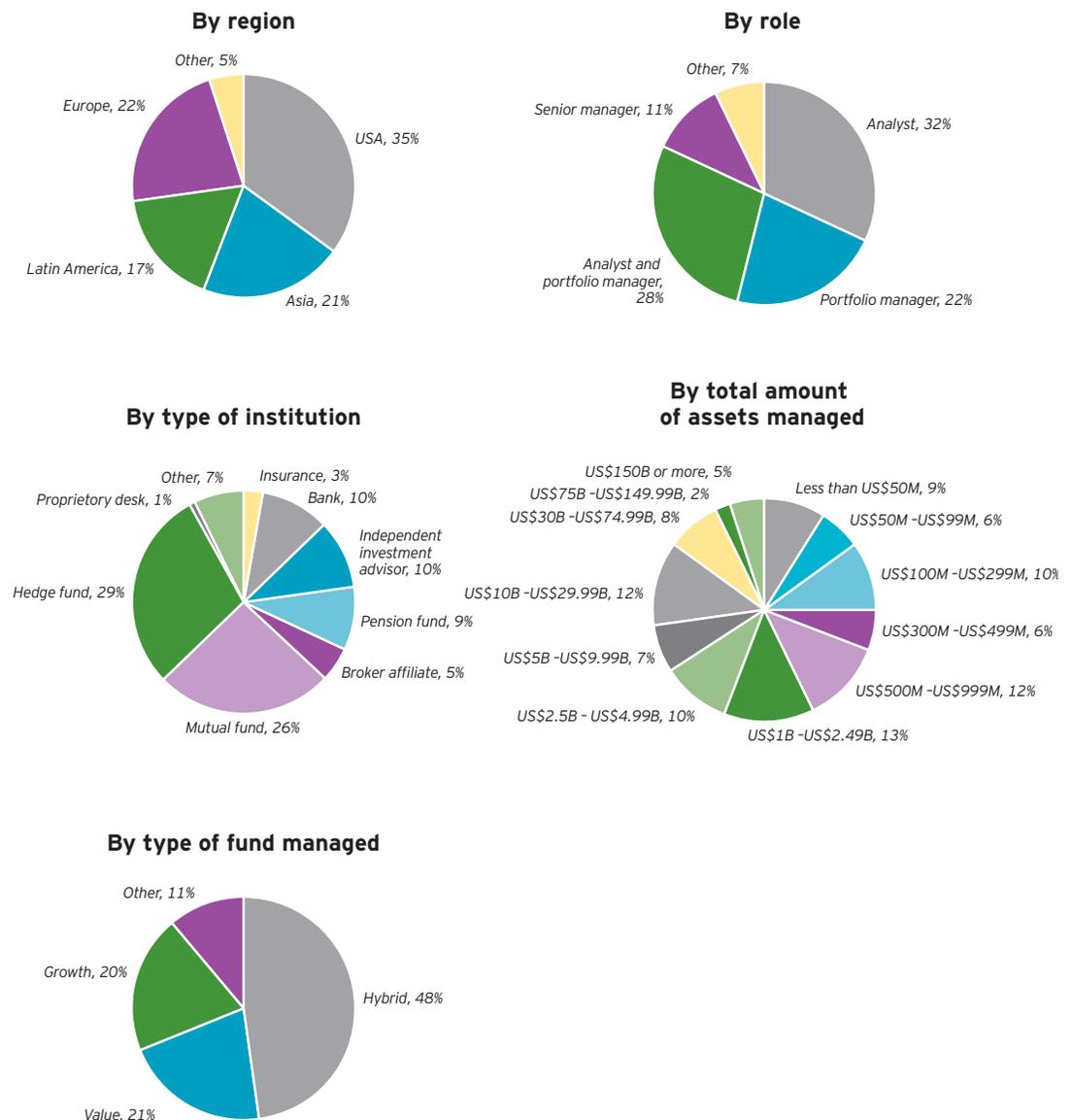


8. Companies from the following exchanges were included in the study: the New York Stock Exchange, NASDAQ, London Stock Exchange, Alternative Investment Market, Euronext, Deutsche Börse, Swiss Exchange, Singapore Stock Exchange, Hong Kong Stock Exchange, Australian Securities Exchange, Tokyo Stock Exchange and São Paulo Stock Exchange.

Institutional investor survey: measures that matter in assessing new issues

In the 2008 *Measures that matter*SM study, Ernst & Young asked institutional investors through an independent online survey about how they evaluate new equity offerings. The goal was to determine what information institutional investors need or use most often, how they make buy and sell decisions and to which criteria they give the most weight. A total of 361 institutional investors from around the world rated the importance of various financial and nonfinancial performance measures in their decision-making related to IPO stock investment in the survey.

Chart 16 | Profile of institutional investor respondents





Ernst & Young's global *Measures that matter*SM study acknowledgements

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