

Achieving a successful Value Transformation: What makes a high-performing IPO

By: Parag Vaidya

The Wharton Research Scholars Program
Professor Raffi Amit
Spring 2004

Introduction

America has always been fascinated by the concept of the strong “bull” market. One of the biggest proponents of this fervor is the anticipation of the next “hot” IPO hitting Wall Street. Ultimately, successful IPO’s bring capital and growth, but they also have their drawbacks. Specifically, numerous studies have shown the rapid decline of companies who achieved a satisfactory initial public offering. This semester, however, I have chosen to focus more on the pre-IPO stage, in order to examine and profile the factors necessary for a company to even reach a successful offering. In particular, what are the key ingredients that we can compare across industries in hypothesizing why those companies were able to raise a targeted amount of capital? This research will hopefully aid Professor Raffi Amit in writing his book “Getting to Nasdaq,” which will profile various companies across industries in addressing the issue discussed above.

Given the intense research portion to this project and, there are many questions that will still be left to be answered in the future. Nonetheless, one of the main goals of this research was to gain a better understanding for the following concerns:

- 1) Where were each of the selected companies in their growth phase before they went IPO?
- 2) What are some pitfalls to avoid in order to raise our target capital?
- 3) What are the challenges needed to overcome in the evolution of the company?
(Start-up → Public Offering)
- 4) As an entrepreneur, what issues should we constantly be thinking about?

In evaluating each company’s growth phase, it was interesting to determine where in the lifecycle their developed product/service was, how many years the company had been in existence, and how this correlates with the degree of success their public offering achieved. Both the pitfalls and challenges could be seen in analyzing the key strategic decisions companies made leading up to and directly after their public offering.

The goal of this study is to decipher which strategic, operational, and financial initiatives and revamping were undertaken to achieve essentially a “value transformation.” As the issues can be studied endlessly, this research is simply a starting point in the long and somewhat arbitrary process of determining the key ingredients for success across a spectrum of industries and companies. Eventually, the next step will be to interview the companies that leap to the top of our “balanced scorecard” and begin to delineate more specific similarities amongst these highly successful companies. To reach that point, this study focused on determining and interpreting the common, stylized facts that we could extract from our data about various firms that went public and how they differed across industries?

Formulation of Research Area (Process)

There were a few challenges in initiating the research portion of this project. The greatest challenge remains to decipher a list of companies deemed worthy of extensive analysis

for this study. Essentially, we devised “some rules of thumb” based upon the following initial criteria:

- 1) Industry (i.e. Technology, Service, Telecom, Healthcare)
- 2) Amount of capital raised (\$60mm plus)
- 3) Time Period (1994-mid 1998 & post June 2001)

Using the above metrics, a working company list was devised, with the elimination of companies who were not being listed on an exchange for the first time. For example, if a company has had an offering previously on an international exchange (i.e. Japan), then it was not considered in this analysis. Next, each company’s overall IPO process was placed into the following categories:

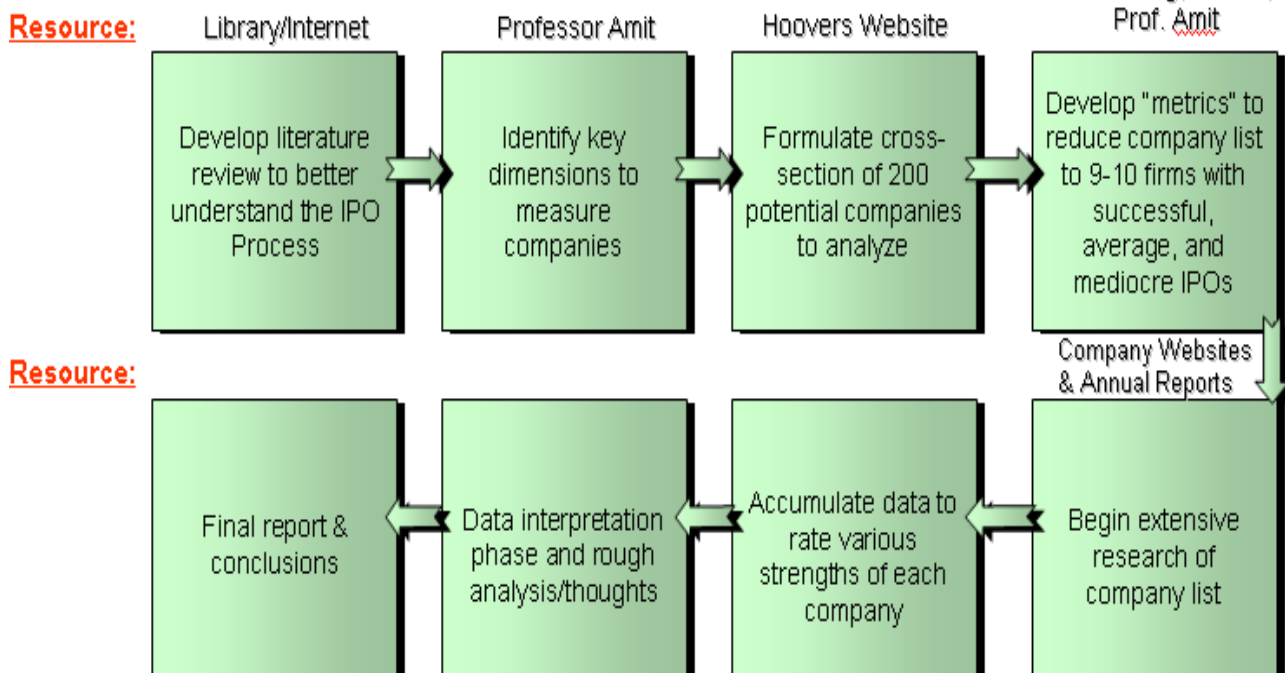
- 1) Strong IPO: indicated by >50% increase in a company’s market cap in the three years following its closing day IPO market cap
- 2) Stable IPO: indicated by a relatively stable market cap during the three years following the firm’s closing day IPO market cap
- 3) Weak IPO: indicated by >50% decrease in a company’s market cap in the three years following its closing day IPO market cap
- 4) IPO Withdrawn: indicated by a company taking the proper actions (i.e S-1 filings) for a potential public offering, but choosing to later retract.

After this initial phase, we determined the crucial dimensions for which we wished to compare each of the companies across industry. The list of factors includes:

- 1) Management of the company
- 2) Market position
- 3) Product/Technology/Service
- 4) Strategy and business model
- 5) Infrastructure and Organizational
- 6) Financials

Below, please find a chart detailing the steps I took in my research process:

My Process



High Performing Companies: "A Strong IPO"

The most common myth, due to the bubble and its burst, is that most successful IPO's are businesses established overnight, with a management team fresh out of undergrad or grad school. Our company case studies, however, have shown that most successful IPO's have been launched by the bigger, more established firms with extensive track records. The companies we observe have managed the bubble shakeout, and currently trade at nearly three or four times their new issue prices. For our research purposes, we chose to focus on three significant industries: healthcare, telecom, and service. Within these industries, four companies stood out in their market performance following their public offering:

Company	Sector/Type	IPO Date	Closing Day Market Cap (mm)	3 Year Post IPO Market Cap (mm)	Current Market Cap (mm)
Accenture	Business Service (Consulting)	07/19/2001	\$5,964.84	\$8,165.80 (2year)	\$11,787.65
VCA Antech	Consumer Service (Veterinary Care)	11/21/2001	\$300.75	\$1,207.06 (2year)	\$1,327.06

Province HealthCare	HealthCare	02/11/1998	\$246.48	\$929.12	\$781.93
Qwest Communications	Telecom	02/07/1997	\$2,800	\$39,941.72	\$7,603.69

From our analysis, we ascertained a few important findings:

- **Profits matter.** Most companies were making money at the time their IPO's were issued.
- **Management.** The way investors treated these public offerings was largely dependent on the business savvy of the executive in charge and his ability to put together a fundamental business strategy and direction. The above companies' leadership team was not composed of recent Wharton MBA grads; rather, they were executives with an extremely successful track record at previous companies (both public and private). The financial success and ability of these firms to meet earnings targets, debt liabilities, and overall expectations garnered them future credibility in the market. "Accredited" managers are given a chance/break by investors, as they are aware of their "industry." Lastly, the above cases showed that "unrecognized" managers with extensive relevant experience could be a part of a "successful IPO" while empirical evidence has proven that "famous" managers can be a part of the "failed ones."¹
- **Product/Service.** Each of the above companies was not entering the market based upon a newly developed concept/service or product. Their services were already being utilized and the products already on the shelves globally. Thus, these funds first served to expand their existing capabilities and core competencies (i.e. knowledge management) and second to be put to use in new developments. Thus, these offerings were not seen as pure "seed or venture capital" funding to help strengthen a promising business model or technology.
- **Finance.** Many start-ups and dot.coms choose to forecast about future potential for making profits; however, while many of these companies have struggled to simply stay afloat, the above companies had a proven business operations and sales projections. Investors desire to know that a firm will be able to meet (or in the above cases surpass) quarterly financial expectations, and that the business will function according to plan.
- **Company Strategy and Business Model.** The above companies had direct plans/strategies for putting their future equity financing to use years before their actual IPO. These firms established that their proceeds would be used to: 1) continue their acquisition and vertical/horizontal integration strategies 2) pay off

¹ Tsuruoka, Doug. "How top IPO's survived the shakeout? *Investor's Business Daily*. May 29, 2001.

high-interest rate debts 3) expand shareholder base, and increase employee incentives/compensation through stock options 4) increase investment in R&D and other in-housing company functions.

- **Market Position.** Each of the above firms had an established brand name in the marketplace well before their public offering. Indeed, they might not have been the established leader in the industry; however, nonetheless they have been able to leverage the equity raised to expand the “total pie” in the market, while also increasing market share through investments in marketing, R&D and technology, and employee/executive compensation.
- **Organization and Infrastructure:** High performing companies were well established in the marketplace well before IPO. They had the proper logistical functions in place well before offering (accounting, CFO/finance, etc.) and acted like a public company well before they became one. As for the organizational culture, more research and information needs to be gathered through company interviews, chat rooms, etc.

High Performance Example: Province Health Care

Company Overview:

Province Healthcare operates 20 acute-care hospitals (with some 2,260 beds) in about a dozen states. The company seeks to acquire hospitals that are typically the sole providers of acute-care services in their communities and beefs up staff and services. They target up to four per year for acquisition. Their subsidiary Brim Healthcare performs management services for about 35 additional rural hospitals in more than a dozen states with nearly 2,900 licensed beds.²

Leading up to Public Offering in February 1998 (Key Highlights)

- **Firm Strategy:** Growth Through Acquisition. Buy it. Fix it. Grow it. Do it Again. → Heavy Acquisitions (acquire 2-4 hospitals per year at the time)
 - Acquire Hospitals in Attractive Non-urban Markets
 - Expand Breadth of Service Offerings to Increase Local Market Share
 - Improve Hospital Operations
 - Recruit Physicians
 - Develop Healthcare Networks
- **Management:** Province’s management and development team knows what it takes to successfully acquire hospitals in small non-urban communities
 - Founder/CEO Martin Rash worked in numerous community hospital; served as Chairman of Board of Federation of American Hospitals
- **Marketspace:** Substantial consolidation opportunity in the non-urban acute care hospital segment

² Hoovers Website Company Profile (www.hoovers.com).

- Scarcity of High Growth and Quality in Healthcare Segment
- 85% of market still owned by the non-profit sector (rural US hospitals \$50-60bn market/year = 15-20% of total hospital rev.)
- **Finance/Stats:**
 - Surging Revenues/NI & Employee Growth Before 1998 IPO

Year	Revenue	Net Income	Employees
1996	129.9	(2.90)	1647
1997	170.5	4.10	1240
1998	238.9	10.00	2785
1999	346.7	14.50	3324

Key Observations:

In each of the desired dimensions we wished to study prior to its public offering, Provincial Healthcare excelled. The firm had an established brand equity in the market, a management team with an excellent and proven track record, and great financials (Net income and Revenue) leading up to the offering. Six years later, the firm continues to perform at nearly 3 times its initial closing day market cap, and this has been achieved mainly through its focused strategy since 1996 of “growth through acquisition.” At the time of its public offering, Province Healthcare was becoming a leading force in the consolidation of the \$50-billion-plus acute care hospital market. Furthermore, it seasoned management had convinced both equity research analysts and investors that it was capable of leading the company in the proper direction:

In our view, the beauty of the Province Healthcare operating strategy is that it is an iterative process: management only needs to repeat its successful formula time and time again. This is not “rocket science,” but success does demand superior execution capabilities – something that we believe the management team at Province possesses in spades. Province’s management and development team knows what it takes to successfully acquire hospitals in small non-urban communities, in our view, because this team has done it well for the better part of the last decade.³

The company realized in its growth phase that non-urban communities typically have high levels of patient and physician loyalty that results in long-term cooperative relationships with the local hospitals. Thus, while it is a stretch to say Provincial could achieve a “legal” monopoly, it was clear that a company with a proven management team could achieve and leverage a successful consolidation strategy.

High Performance Example: Qwest Communications

³ Equity Research Report: PRV. BancAmerica Robertson Stephens. 4/13/1998.

Company Overview:

Qwest Communications International spans the globe with its high-capacity broadband fiber-optic network. It is the #4 long-distance company in the US (behind AT&T, WorldCom, and Sprint), and the company more than doubled in size and gained 25 million local phone service customers in 14 states in the US with the acquisition in 2000 of Baby Bell U S WEST. Qwest uses its network to provide long-distance, as well as broadband data, voice, and video services outside its local area and around the world. Qwest is expanding its wireless services, offered in affiliation with Sprint PCS, previously only available in its own local area.⁴

Leading up to Public Offering in February 1997 (Key Highlights)

- **Firm Strategy:** Spent years building **low-cost** networks of top of the line technology fiber optics to be able to immediately gain market share (most modern telecom infrastructure at this time)
 - Solid acquisition program to accelerate growth and leverage modern low-cost network (LCI, EUNet)
 - Pivot from being a telecom network construction company to a national telecommunication carrier
 - Sign many deals with international, long-distance, and local carriers and ISPs
 - Strategic alliances with heavy-hitters such as Netscape, USW, AIT
- **Management:** Very strong leadership team. Company founder Philip Anschutz's acquisition strategy dates back to 1988
 - Anschutz hires Joseph Nacchio (former AT&T exec with proven track record) to run company before going public
 - Senior management team has vast telecom experience; several execs also from GTE, AT&T, MCI, etc. (steal from mkt. leader)
- **Marketspace:** Arrived in a crowded marketspace with behemoths (AT&T, Sprint, etc.)
 - Very small player compared to local and long distance telecom giants
 - Aggressive sales/marketing expertise and unlimited capacity allows it to "influence" market (change the game)
 - Strong demand in market for bandwidth capacity
- **Infrastructure:** Investment in various systems and logistics functions, along with impressive management team give the firm "Unlimited Capacity"

Key Observations:

During the years leading up to its public offering, the firm's goal was to become the "preeminent carrier's carrier."⁵ Thus, it made significant strides in the early and mid

⁴ Hoovers Website Company Profile (www.hoovers.com).

⁵ Hambrecht & Quist LLC Equity Research Report. 8/7/1997.

1990's to expand the “most modern” fiber optic network in the U.S., spreading from New York City to Los Angeles. The company positioned itself to capture significant market share, despite its small player status relative to companies such as AT&T and MCI. At the time of its public offerings, the company was widely seen by investors and research analysts as primed for long-term growth opportunities, and enabled with a highly experienced management team to take on high net worth projects. Research analysts had this to say at the time of its public offering:

With a strong blend of new entrant status and seasoned management, we believe QWST is poised to leverage its advanced, low cost network, and expanded and improved distribution channels as it strategically transitions to a broadened customer, and service creation focus QWST has a large addressable market opportunity, significantly expandable as QWST extends vertical and geographical reach into targeted markets.⁶

Qwest was poised at the time of its offering to leverage its low cost network and achieve accelerated growth along the road because the market was expanding for broadband services. Analysts and investors' expectations have clearly been met, as its market cap currently stands at nearly 3 times its closing day IPO market cap. Its new entrant status, broad customer base, solid IT infrastructure, and experienced management team under CEO Nacchio's leadership coupled with a strong global acquisition program allowed the firm to have a “high performance” public offering and achieve positive results in the marketplace 7 years later.

Stable Performing Companies

Our most interesting challenge in drawing conclusions in this study was to decipher why each of the companies below was unable to achieve high performance benchmarks relative to the ones listed above. Interestingly, when studying these companies along each dimension, it appeared that firms such as Petco and Weight Watchers seemingly had all the proper strengths in place to achieve a successful IPO. In fact, these firms were much more well established in the market in terms of its life cycle and growth stage than even firms such as Provincial Healthcare. Unfortunately, its long establishment in the marketplace seems to have accounted for its stability, as investors seem to have viewed these firms as limited in their potential growth and abilities, given their market leader status leading up to the public offering.

Company	Sector/Type	IPO Date	Closing Day Market Cap (mm)	3 Year Post IPO Market Cap (mm)	Current Market Cap (mm)
AmeriPath, Inc.	HealthCare	10/22/1997	\$374.5	\$386.25	Delisted

⁶ Meltzer, Linda B. Warburg Dillon Read LLC Equity Research Report. 10/21/1998.

Ciena Corporation	Telecom	2/7/1997	\$3,441	\$11,260.33	\$2,726.21
PETCO Animal Supplies, Inc.	Service	2/22/2002	\$1,115	\$1,838.4 (2year)	\$1,878.04
Weight Watchers International, Inc.	Educational Service	11/15/2001	\$3,109.3	\$4,052.71 (2year)	\$4,023.834

The firms listed above had a history of good financials, very experienced management, and services well-known to the marketplace. Weight Watchers, for example, had the most recognized brand equity out of any firm we studied, as it was established in 1965. The firm had a relatively low fixed-cost model and a service that was easy to replicate and expand globally. Similarly, Petco, while perhaps not the market leader in its industry, was seemingly grabbing market share rapidly leading up to its public offering, and was in a non-cyclical industry. Ultimately, America loves pets and thus will always save enough of their personal consumption to feed their animal just as any other family member. The only drawback in a down economy is that a premium food store such as Petco might suffer at the hands of a discount one such as Wal-Mart. Below are a more in-depth look at two of the above studied firms preceding their public offerings.

Stable Performance Example: PETCO Animal Supplies

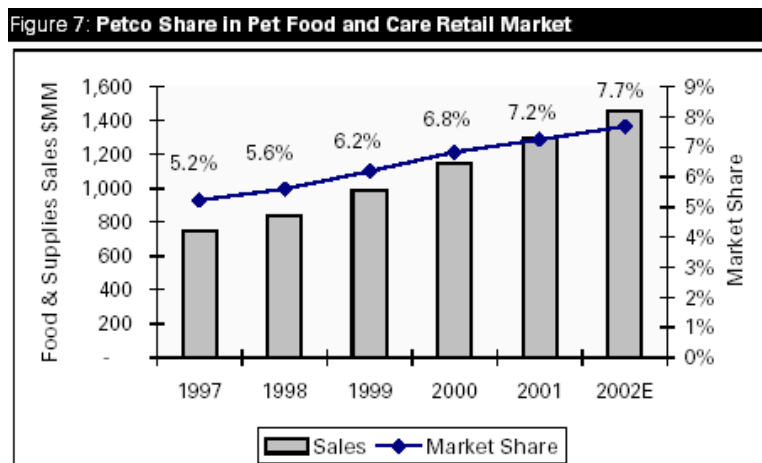
Company Overview:

Petco Animal Supplies, the nation's #2 pet supply specialty retailer, is hounding PETsMART for top dog status. Petco operates about 630 stores in more than 40 states and Washington, DC. The company's 15,000-sq.-ft. superstores carry some 10,000 pet-related items, including premium cat and dog foods (Iams, Nutro, Science Diet), collars, leashes, grooming products, toys, and animal habitats; the stores also offer grooming, obedience training, and veterinary services.⁷

Before February 2002 IPO (Key Highlights)

- **Marketspace:** Extremely fragmented. \$17bn pet food and supplies industry (grew 4.3% in 2001)
 - Pet grooming services could expand market to \$23bn
 - Intense competition from PetsMart and Wal-Mart
 - Premium pet food market is fast-growing segment

⁷ Hoovers Website Company Profile (www.hoovers.com).



Source: Deutsche Banc Alex. Brown estimates and company information

- **Management:** Senior managers have avg. of 10 years with Petco, and 28 years of retail experience
- **Firm Strategy:** Growth through rapid but costly acquisitions
 - Constantly reinvesting in its business (though could constrain EBIT growth)
- **Finance:** Same store sales increased 5% for 36 consecutive quarters
 - De-leveraged balance sheet at time of the IPO (Very strong Cash flow)
- **Target Market:** America loves pets (non-cyclical industry)
 - Large, LOYAL customer base

Why Stable Then?

- Competitive challenges exist; more premium brands migrate to the market
- Very high financial expectations
- Economic factors: slowing of consumer spending

Key Observations

When you walk into a Petco store, you notice their new “millennium-format” store that provides an extremely customer-friendly experience. Its long-term strategy preceding and post-IPO continues to be to focus on the increased sales of supplies and services while de-emphasizing food. During the early decade, Petco has experienced tremendous same-store sales growth, and has had 36 consecutive quarters of increased earnings subsequently. During its offering, analysts and investors were able to see Petco’s focused niche on the premium food market, which has shown tremendous growth in the past couple years. Furthermore, for year its has been the favorable victim of a loyal customer base that accounts for high repeat purchases. 70% of Petco’s sales come from customers enrolled in its PALS loyal programs, and these customers before the offering were already spending 50% more than the average customer.⁸ Most interestingly, Petco’s

⁸ CIBC World Markets Equity Research. 8/12/2002.

product mix consists mainly of consumables, which “by their nature provides consistency to sales.”⁹ Perhaps these stable sales provide an overall explanation for the company’s stable stock price and market cap; the market views the firm as low in volatility and risk, but yet also a consistent performer that perhaps offer less in return from a risk/return standpoint.

Stable Performance Example: Weight Watchers International

Company Overview:

The company hosts weekly meetings consisting of exercise tips, nutrition advice, and success stories to help its more than 1.5 million members lose weight. The company now has classes in about 30 countries.¹⁰

Before November 2001 IPO

- **Strategically well-positioned:** number of overweight people steadily increasing (increased from 47% to 61% of all adults)
- **Financial Model:** Low fixed costs and rapid earnings growth (high gross margins)
- **Market Position:** Commands unique position in the market (strong brand recognition)
 - Tremendous untapped market potential internationally
 - \$40bn market in 2002
 - High barriers to entry (very few group-education competitors (Jenny Craig))
- **Infrastructure:** Simple business operations allowed for US expansion (human capital training)
- **Management:** Current CEO with the company for 17 years before IPO

Why Stable Performance Then?:

- Limited room for Expansion: company is already worldwide leader in every comparable measure (thus, the stock has been neutral and stable)
- Macroeconomic: U.S. economy slowdown of consumer, “discretionary” spending
- Highly competitive weight-loss market (South-beach, Atkins Diet, etc.)
- Significantly leveraged capital structure due to Heinz buyout

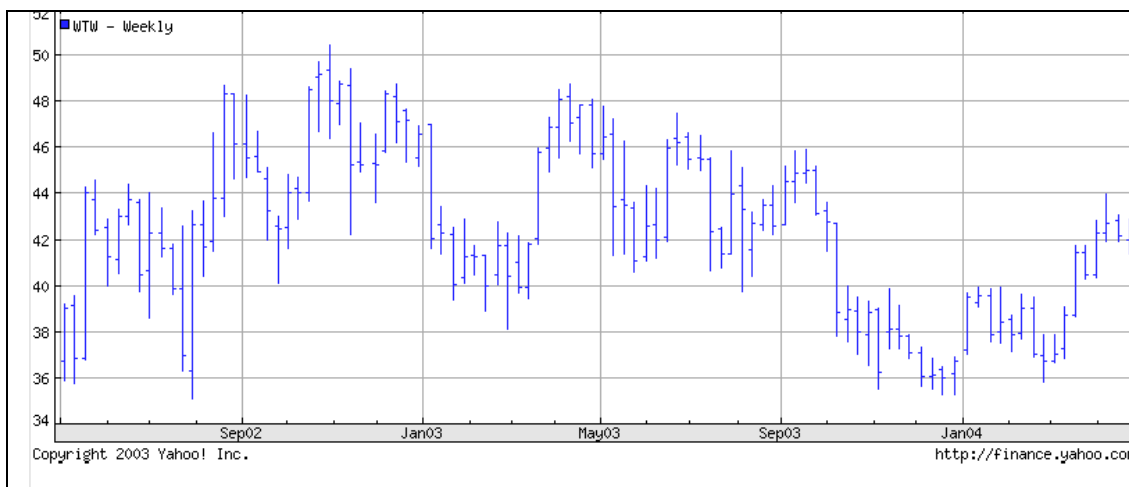
Key Observations

⁹ CIBC World Markets Equity Research. 8/12/2002.

¹⁰ Hoovers Website Company Profile (www.hoovers.com).

Clearly at the time of its public offering and even now, Weight Watchers had a number of factors in its favor: 1) the increasing number of overweight people in the world (and an increasing percentage seeking weight loss help) (2) WTW's leading global position in the marketplace, (3) the company's seasoned management, and (4) its strong recent operating performance and compelling financial model.¹¹ More importantly, however, is the lack of direct competition the company faces when it comes to mass educational testing for weight loss. This has accounted as well for their steady revenues and operating performance, and smooth expansion into global markets. Investors have responded to the low-risk and volatility associated with the company in the firm's stock price, which has been steady since its 2001 IPO.

Stock Performance from September 2002 to January 2004



Overall, despite its high-growth financial model and high market share, investors seemed to have believed that the firm has limited room for multiple expansion. Essentially, the firm is still highly leveraged due to its Heinz buyout transaction. Nonetheless, the company operates in an attractive macro environment, commands a unique position in the market, and has ample room to penetrate global markets (though this will require significant effort in teacher training). Thus, it appears at the time before its IPO, investors viewed the firm as a solid, yet stable firm, with limited overall growth potential, as seen in its stock price stability.

Low Performing Companies

In examining these low-performing companies, one key fact became obvious: these firms mistimed the market. In our three more in-depth studies of Teligent, CoSine Communications, and Alliance Imaging, these companies portrayed some or all of the above characteristics

- Poor financial projections and management (they did not have a proper and successful operating performance leading up to the public offering). Their pro-

¹¹ Nicholson, Wendy. Salomon Smith Barney Equity Research Report. 12/10/2001.

forma projections for the ensuing years were mistargeted, and enabled investors to lose confidence in their abilities.

- They had good, yet inexperienced management with unproven track records. The firms above (high performing, stable) had management that had decades of experience in their industry well before taking their respective companies public. Missing an earnings projection right after a public offering is the safest way to signal trouble to the marketplace.
- Did not accurately value the potential marketplace and their potential for capturing market share. The old theory that its “good to have a strong private company as well,” seemed to have been lost to many CEO’s, as they chose to great and impress Wall Street Analysts rather than focus on improving and expanding their core businesses and competencies.

Company	Sector/Type	IPO Date	Closing Day Market Cap (mm)	3 Year Post IPO Market Cap (mm)	Current Market Cap (mm)
Centennial Healthcare Corporation	Healthcare	7/2/1997	\$219.07	\$63.67 (2year)	Delisted
Alliance Imaging, Inc.	Healthcare	7/27/2001	\$616.2	\$193.82 (2years)	\$185.13
Corvis Corporation	Telecom	7/28/2000	\$27,855.94	\$607.23	\$974.16
CoSine Communications, Inc.	Telecom	9/26/2000	\$6,318.61	\$62.83	\$73.02
Teligent, Inc.	Telecom	11/21/1997	\$1,326.61	\$168.42	Delisted
Aramark Corporation	Service	12/11/2001	\$5,011.42	\$2,519.39 (2year)	\$2,892.70

Interestingly, some of these companies might simply be the victim of poor luck and the overall macro-economic shocks to the market. Obviously, this issue goes back to market timing, but nonetheless, the below case studies provide a little more insight in to the differences in stylized facts between the high-performing and low-performing companies.

Overall, there are a few takeaways that we also deciphered from the above companies¹²:

¹² Hopkins, Michael S. “Paradise Lost.” *Inc. Magazine*. November 1999.

- Bad Forecasting (revenues, earnings, hitting proper growth targets and sales volumes, etc.)
- Pressure to move the stock can change the way executives and companies act. Demands to meet Wall Street expectations can turn normal growing pains of a company into a crisis. Equity Research Analysts are not kind to companies when they miss potential earnings targets.
- Classic problem of trying to grow too fast. Management at time can become so focused on building volume and production side of the business that it comes at the expense of the marketing operation.
- Entrepreneurs can be poor in running a large company. Sometimes they can become too involved and close to the company that they founded; when they need to make changes, they lack the courage and confidence to make them, given their personal attachment. Sometimes the stock price keeps falling as a result, with entrepreneurs going into depression given that their friends and families have invested heavily in the business.

Low Performing Company Example: Teligent Corporation

Company Overview:

The company – a competitive local-exchange carrier or CLEC -- provides fixed wireless broadband services nationwide using digital microwave signals rather than copper wires. Its service offerings include facilities-based business private lines, long-distance, dedicated Internet access, and wholesale transport. But the company faces an uphill fight against incumbent carriers, and Teligent in 2002 completed reorganization under Chapter 11 bankruptcy protection and reemerged as a private firm.¹³

Leading up to Public Offering in November 1997...

- **Management:** Teligent has superb, incentivized management team (experience in building networks and owns 15% of company)
 - CEO Alex Mandl was president and COO of AT&T
- **Marketspace:** Local markets set to open up (\$100bn market; \$55bn from business customers)

Year	Revenue	Net Income	Employees
1996	1.4	(12.6)	108
1997	3.3	(138.1)	474
1998	1.0	(281.5)	1821

¹³ Hoovers Website Company Profile (www.hoovers.com).

What Happened: Emblematic of what went wrong with the explosive growth of the telephony market

- Beneficiary of financing tossed around (few requirements in regards to controls put on the money)
- Raced to get big fast and spent millions building its fixed wireless network of antennas in 43 markets
- Investors simply lose appetite for broadband networks & the \$\$\$ runs out
- Trying to “chase and impress Wall Street;” now private firm and more concerned about simply making money.
- May 2001 company files for bankruptcy with \$1.65bn in debts
- Bankruptcy negates plans of becoming a telecom giant and providing end user service to large enterprises; today, Teligent simply an “enabler” (the CD-Rom of the industry; just an add-on” according CEO Continenza)

Implications...

- Poor Financial Management: The firm simply did not know how to manage its initial seed and venture funding, and thus was forced to go bankrupt after their acquisition strategy failed
- Futile Expansion Strategy: The firm should have used more prudence when trying to take advantage of the potential in the telephony market. Thus, when investors’ enthusiasm for broadband ran out, this company was stuck in trying to salvage “potential synergies.
- Untested Product in Market: Indeed, while some companies did manage to go public quickly after launching their firm, this specific product, with its heavy technology bias, proved to lose favor in investors’ eyes quickly. Unlike an establish “service” such as Weight Watchers or a solid management team to lead the hospital growth strategy of Provincial, Teligent simply had a product in the market that had yet to contribute positive net income.
- Overall, the firm went public TOO EARLY

Observations

From a positive standpoint, it appeared that the firm before its IPO had a very entrepreneurial management team and a small business focus. It had goals of developing a critical mass in terms of network deployment and customer base.¹⁴ Nonetheless it has not been able to overcome investors’ perceived risks of its high debt to capital ratio and

¹⁴ Legg Mason Equity Research. 9/25/2000.

its reliance on an unproven emerging technology which is dependent on market enthusiasm and shifts affected largely by macroeconomic factors. Given that they lack the ability to attract funding due to their high leverage, the company is unable to continually invest in enough marketing and R&D to increase the attractiveness of its product.

Low Performing Company Example: Alliance Imaging

Company Overview:

The company operates about 430 magnetic resonance imaging (MRI) systems for hospitals and other health care providers in nearly 45 states.¹⁵

AT IPO in July 2001

- Highly leveraged balance sheet
- EBITDA constantly on the decline
- Poor operations (its core business continues to deteriorate)
- Industry/sector in imaging doing well, while Alliance market share decreasing
- Poor customer retention (contract renewal on the rapid decline)

Observations

Essentially, Alliance Imaging sought to take advantage of strong diagnostic imaging industry fundamentals and a potential dominant market position within the industry. However, while the industry pie grew, Alliance's market share went on the decline, as it suffered from poor customer retention and a decline in its core operations. The company had a number of things going in its favor: 1) state-of-the-art technology 2) economies of scale due to a large market presence 3) positive market trends for the diagnostic imaging industry.¹⁶ Unfortunately, while the company had a very established market presence with hospitals and a potential high-volume market to take advantage of, it appears its high debt levels limited its financial and operational flexibility (preventing it from reinvesting in its core business and competencies). Their high debt levels incurred as result of a LBO by the firm KKR in November 1999. Next, its clients leading up its public offering were not keen on renewing their contracts, as in-housing MRI scans became increasingly popular. Alliance believed that its customers were too financially constrained to invest in their own MRI systems, and thus took for granted a customer loyalty concept that ended up hurting them in the long run. Next, the market for diagnostic imaging services was extremely competitive leading up to the public offering, while the company's ability to adapt to technology changes was challenged due to its leveraged financial resources and debts.

Low Performing Company Example: CoSine Communications

*****This company went IPO during the bubble period (2000), but it was interesting to still look at given its dramatic decline in market cap*****

¹⁵ Hoovers Website Company Profile (www.hoovers.com).

¹⁶ Lawson, Deborah J. SalomonSmithBarney Equity Research. December 10, 2001.

Company Overview:

The company manufactures and markets switches and software used by telecom service providers to manage their Internet protocol-based voice and data communications networks. Carriers use CoSine's IPSX switches to incorporate virtual private networks, firewalls, virtual routing, secure broadband connections, and similar services into their service offerings. The company's software (InGage, InVision) helps customers manage the functions of their equipment. CoSine's customers include Sprint and NEC.¹⁷

AT IPO in September 2000

- Promising but undeveloped market
- No previous financials
- Was timing the market extremely wrong
- Was trying to gain first-mover status in an unestablished market!
- IP services industry in EXTREMELY early stages, forecasted to grow over the next few years.
- Single product line
- Very limited customer base...solid clients, but was later hurt by their clients' decline as well
- Later suffers from widespread implementation failure...

Observations

CoSine Communications was hoping to target an increasingly significant market that was estimated to grow to nearly \$7 billion by 2004.¹⁸ Unfortunately, CoSine was the **true Internet stock**, subject to a volatile and overvalued industry. Its potential sales cycle to service providers was long, while orders tended to be large and sporadic. CoSine's biggest problems have come in its inability to reduce costs and overall large-scale deployment problems.

IPO's Withdrawn:

Sector	Company	Potential Ticker	Company Established	Date Withdrawn
Healthcare	Alliance Medical Corporation	ALMC	1987	Mar 12, 2002
Healthcare	AmeriChoice Corporation	AMCH	1988	Sep 24, 2002
Healthcare	Digirad Corporation	DRAD	2000	Nov 9, 2001
Healthcare	IASIS Healthcare Corporation	IAS	1999	Dec 10, 2001
Healthcare	LipoScience, Inc.	LIPO	1997	Oct 21, 2002
Healthcare	Masimo Corporation	MSMO	1989	Apr 26, 2001
Healthcare	Medco Health Solutions, Inc.	MHS	1998	Jul 31, 2002

¹⁷ Hoovers Website Company Profile (www.hoovers.com).

¹⁸ Sue, Mark. Lehman Brothers Equity Research. February 1, 2001.

Healthcare	R2 Technology, Inc.	RTWU	1993	Jan 15, 2003
Healthcare	Universal Hospital Services, Inc.	UHOS	1939	Dec 3, 2001
Service	AMR Research, Inc.	–	1986	Jan 11, 2002
Service	DoveBid, Inc.	–	1937	Oct 25, 2002
Service	Idea Integration Corp.	–	1988	Jul 24, 2001
Service	LynuxWorks, Inc.	–	1986	Jun 21, 2001
Service	YellowBrix, Inc.	–	1997	Feb 21, 2001

Key Findings

- **Most companies withdraw due to:**
 - Poor Market Conditions (Lynux Market Works, Alliance Medical Corp, R2 Technologies, etc.)
 - Face increased public pressure and scrutiny as they are about to file S-1. Do not have proper infrastructure
 - Realize need to stay focused on “business”, rather than spend precious management time on potential deal
 - Penalty for not going public is that you still have a great private company.

- **Alternative to going Public: Sell the Company!**
 - Example: from 1998 to 1999 alone, more than 20 companies sold out to Cisco systems
 - Provides liquidity: if sale is for cash. Even if sale is for stock, the shares of a more established company proves less volatile than those of a newer company
 - Tradeoffs: Market may value a company more than the buyer’s investment bankers. Surrender upside potential

- **IPO failures can practically kill a company**

Literature Discussion (Past Studies)

Much of the discussion surrounding the nature of public offerings has centered on the benefits of an IPO and the rise and ruin of many companies afterwards. Market performance data, EPS, and other statistical measures have shown overwhelming evidence for companies that have outperformed and significantly under-performed the market index in the first three years after going public. A study by the Ernst & Young Center for Business Innovation,¹⁹ however, performed an extensive study on identifying the keys to a successful IPO. The study identified the practices entrepreneurs take and the reasons behind these decisions in transforming their companies from private to public enterprises.¹⁹ Senior executives were asked to rank the success of their public offerings

¹⁹ “Managing the Success of the IPO Transformation Process.” Ernst and Young Study. July 1998. From universe of some 2500 companies that went public between 1/1/1986 and 08/31/1996, 1996 senior

on a 7-point scale from highly successful to highly unsuccessful. Based on these responses, E&Y “identified statistically significant differences in such areas as financial controls, employee incentives, corporate strategy, and major decisions made among the highly successful, successful, and the unsuccessful groups throughout the entire transformation process.”

Beyond statistical measures, the survey aimed to explore the timing of major strategic initiatives, the company’s position in the marketplace before/after the IPO transaction, the process for selecting the key players in the IPO process, and the senior executives’ overall perception of the success of their company’s offering.

Key Findings from the Study

From the survey, senior executives felt that their IPO:

Senior Executives Response	(7 point scale)
IPO Highly Successful	28.0%
IPO Successful	31.0%
IPO Unsuccessful	41.0%

Overall, the E&Y study revealed three important characteristics for those companies that benefit the most from IPOs:

- 1) **Preparation:** They systematically implemented new programs, policies, and systems common to a public company, in short, acting like a public company before they became one
- 2) **Sufficient lead time:** They instituted these improvement initiatives months, if not years, before the offering
- 3) **Competitive Position:** They were far stronger than their competitors- financially and non-financially – at the time of their offering.²⁰ These leadership factors included: sales, cash flow, strategic planning, and quality of management.

Other Notable Statistics from the Study

- **47%** of executives considered themselves ill-prepared for the IPO
- **62%** of self-reported unsuccessful companies felt they had not been adequately prepared for going public
- **>90%** of respondents made changes to company’s policies, processes, and systems in advance of IPO (operating, strategic, financial improvements) and investor relations programs
 - **62%** revised financial account/reporting systems

executives from more than 500 companies completed an in-depth survey, representing a substantial 20% response.

²⁰ E&Y Study.

- **65%** revised executive compensation systems
- **68%** revised board structures
- **66%** of executives reporting successful offerings had transaction strategies (acquisitions, recap, etc.) in place before after going to market
- **57%** of all respondents made improvements to employee incentive programs, believed to have had a greater impact on company's subsequent performance than all other policies/practices cited.

Overall, the study provides statistical evidence that the competitive positioning gap widens between highly successful companies and the rest after the public offering. From an investor's standpoint, the study manifests their large dependence on non-financial factors when evaluating large-cap companies. Thus, it adds credibility to the need for CEO's to constantly identify, respond to, and implement key non-financial factors in order to maximize the return on their strategies.

Furthermore, it appears that investors attribute their investment decisions to: 1) management credibility 2) innovativeness 3) quality and execution of corporate strategy 4) ability to attract and retain talented people. Furthermore, a vast majority of the public offerings during the largest period of wealth creation in the U.S. history were spinoffs older private companies.²¹

Going Public Checklist²²

- Is the timing right in your company's history?
- Do we have enough \$\$\$ to make a successful IPO?
- Can the company "afford" the distraction of an IPO?
- Are we ready for greater public scrutiny?
- Are our company records in good shape?
- Do we have correct management/administrative personnel in place (& selection of outside team)?
- How would the company's structure, key contracts, and relationships be affected by an IPO?

Conclusion

Overall, from this study, we can also see that there are many pros and cons in general to going public. Going public allows a firm to be able to go back to the public markets for funds and follow-on offerings. It allows a firm to further incentivize its employees through stock options; it allows the market to evaluate the firm for potential M&A options. The list of pros for going public goes is endless, yet many companies fail to think of the market scrutiny that accompanies the initial public offering. Once the company has consecutive poor quarters and fails to live up to earnings expectations, the company can be made cheaper for possible takeovers, and management can easily lose its

²¹ E&Y Study.

²² "Taking Your Company Public." <http://www.wienerboerse.at/cms/2/43/14>.

jobs. Next, a young company can seemingly lack a solid investor relations department that is needed to make the company transparent to the market. The firm is no longer in the hands of its “entrepreneur” and founder;” rather, the company faces constant pressure to meet numbers expectations, and cannot pursue far-reaching ideas without regards to the “bottom line.”

In our study, the companies that succeeded seemed to have an obvious and identifiable theme in the market well before its public offering. The companies had a growth plan and strategy in place for the next 3-5 years well aligned with the funds it so desired to raise. It could easily highlight past wins, investments, solid management teams, and milestones preceding its public offering, which was a sign that the company could function as a successful private company as well (wasn't in dire need of access to public funds). The firms' financials (Revenues, R&D goals, Future EPS, and bottom-line ROE and NOI) had been solid in the years preceding and post public offering.

Finally, there is an extensive amount of research still yet to be done in order to study the organizational culture and structure of the above companies. Investigating the level of happiness of each of the employees in the company could have an interesting correlation with the overall performance of the company in the market. Ultimately, it seems that it is very difficult to derive hard and cold facts about why some companies succeed in their IPO performance and others fail. Some of the companies that failed did excel in some of the key dimensions we studied and were simply victim to either poor market timing and or macroeconomic shocks.

Bibliography

Cited Sources:

CIBC World Markets Equity Research. 8/12/2002.

BancAmerica Robertson Stephens Equity Research Report: PRV. 4/13/1998.

Hambrecht & Quist LLC Equity Research Report. 8/7/1997.

Hopkins, Michael S. "Paradise Lost." *Inc. Magazine*. November 1999.

Lawson, Deborah J. SalomonSmithBarney Equity Research. December 10, 2001.

Legg Mason Equity Research. 9/25/2000.

"Managing the Success of the IPO Transformation Process." Ernst and Young Study. July 1998.

Meltzer, Linda B. Warburg Dillon Read LLC Equity Research Report. 10/21/1998.

Nicholson, Wendy. Salomon Smith Barney Equity Research Report. 12/10/2001.

Sue, Mark. Lehman Brothers Equity Research. February 1, 2001.

Tsuruoka, Doug. "How top IPO's survived the shakeout?" *Investor's Business Daily*. May 29, 2001.

"Taking Your Company Public." <http://www.wienerboerse.at/cms/2/43/14>.

Uncited Sources

Lipman, Frederick D. "The complete Going Public Handbook. California: Prima Publishing, 2000.