Access the Rest of the Fundamentals Course

Financial Modeling Fundamentals, Module 14: Equity Capital Markets (ECM)

Table of Contents:

Key Rule #3: Analysis of Initial Public Offerings (IPOs) 2
Key Rule #4: Analysis of Follow-On Offerings (FOs) 12
Interview Questions 20
IPOs and Follow-On Offerings 20

Key Rule #3: Analysis of Initial Public Offerings (IPOs)

If a company issues Equity and it is not already **public** (you cannot buy and sell its shares on the stock market), then it will "go public" in an **Initial Public Offering (IPO).**

We receive many questions about "IPO valuation" and "IPO modeling," but the truth is, **there's no such thing as "IPO valuation."**

You can build a model for an IPO, but this model simply calculates the funds raised, shares created, and fees paid.

You use *the output* of valuation methodologies in this IPO model, and you present some valuation information at the end, but that's about it.

Here are the steps required to build an "IPO model":

Step 1: Determine the Basic Assumptions

You need a few basic assumptions to set up an IPO model:

1. **Amount of Capital** – Raising $1 billion of capital creates a different number of new shares than $2 billion.

   Most companies aim to sell 20-40% of their total Equity in an IPO, but that varies by industry and maturity stage.

2. **Valuation Multiples** – You focus on *forward multiples* (e.g., if the current year is 20X1, the 20X2 or 20X3 multiples from the comps), and you tend to use P / E in IPO scenarios.

   The idea is to say: "If the Public Comps trade at 20-25x forward P / E, then our company should also trade at multiples in that range when it goes public. So, if its projected Net Income is $100 million, then it should be worth an Equity Value of $2.0 – $2.5 billion."

3. **Pricing Discount** – To incentivize new investors to buy the company's shares, the company typically sells shares at a **discount** to their expected value at trading.

   For example, if the company's expected share price at trading is $15.00 – $20.00, it might offer new investors a 10% discount and sell its shares for $13.50 – $18.00 instead.

4. **Primary vs. Secondary Split** – A company won't necessarily sell all *new* shares in an IPO. Existing investors, such as venture capital and private equity firms, might sell a portion of their *existing shares* to *new investors*.

   "New shares" sold in an IPO are called **Primary Shares**, and "existing shares" sold are called **Secondary Shares**; you assume a percentage for each category.

   This split is important because the company receives Cash only for **Primary Shares**, and only Primary Shares dilute existing investors. If a venture capitalist sells 1 million existing shares, the VC receives money, but the company does not.

5. **Greenshoe Provision** – Also called the "Overallotment Provision," this term allows the banks advising the company to sell extra shares if there's sufficient demand.

   For example, if the company is planning to sell 10 million shares in an IPO, a 15% Greenshoe Provision would allow it to sell an extra 1.5 million shares if there's enough demand from investors.

6. **Fees** – The company going public has to pay the bank(s) advising it, the lawyers, the SEC or other regulatory organization, and other parties. You can find fee estimates by looking at recent, similar deals.

   The numbers change all the time, but *on average*, a company raising a few hundred million to a few billion USD might pay a fee of 3-7% of capital raised to banks and fees of $5 – 15 million to other parties.

Here are the assumptions in our sample model:

Only 75% of the shares issued will be "new"; 25% will be from existing investors.

IPO Valuation & Financing Model

($ USD in Millions Except Per Share Values in $ as Stated)

Company will pay banks a 5% fee on the deal.

IPO Transaction Assumptions:

Funds Raised in IPO:	$ 1,000.0
Underwriting Discount:	5.0%
IPO Pricing Discount:	15.0%
Primary Share %:	75.0%
Secondary Share %:	25.0%
Greenshoe Provision %:	15.0%
Primary Allocation %:	75.0%
Issuer - Existing Shares:	66.914

Expense Assumptions:	$ in Millions
(+) SEC Filing & Registration Fees:	$ 1.5
(+) Printing Fees:	1.0
(+) Accounting & Legal Fees:	6.0
(+) Miscellaneous / Other Fees:	1.5
Total Fees:	**$ 10.0**
Forward Year 1 Revenue:	$ 484.0
Forward Year 1 EBITDA:	249.7
Forward Year 1 Net Income:	175.9

If there's enough demand, the banks can sell up to 15% more shares in the offering; 75% of those will be new.

Company will sell shares at a 15% discount to their "true value" to incentivize investors.

Step 2: Calculate the Post-Money Equity Value at Trading and Pricing

It's easier to explain this step with an Excel screenshot and annotations:

		Filing Range - 1-Year Forward P / E Multiples			
Forward Year 1 P / E Multiple at Trading:	*Units*	17.5 x	20.0 x	22.5 x	25.0 x
Forward Year 1 Net Income:	*$ M*	$ 175.9	$ 175.9	$ 175.9	$ 175.9
Implied Post-Money Equity Value @ Trading:	*$ M*	3,079.1	3,518.9	3,958.8	4,398.7
Pricing Discount %:	*%*	15.0%	15.0%	15.0%	15.0%
Pricing Discount Amount:	*$ M*	401.6	459.0	516.4	573.7
Implied Post-Money Equity Value @ Pricing:	*$ M*	2,677.4	3,059.9	3,442.4	=+J24/(1+J26)
Issuer - Existing Shares Outstanding:	*M Shares*	66.914	66.914	66.914	66.914
Implied Offering Price per Share:	*$ as Stated*	$ 25.07	$ 30.78	$ 36.50	$ 42.22

Range of multiples comes from the public comps; multiply each one by the company's projected Net Income to determine what the Equity Value *should be* after the IPO.

You back into the Equity Value at "Pricing" - i.e., the value at which the company sells shares to investors - by dividing by (1 + Pricing Discount %).

You calculate the Implied Offering Price per Share with (Post-Money Equity Value @ Pricing - IPO Offering Size) / Existing Shares Outstanding.

We're saying, "This $1 billion of additional funds will INCREASE the company's Equity Value since Equity Value reflects *all* Assets but only to common shareholders.

Let's see what the company's Equity Value was *before* this issuance, and then divide by the share count to get the Offering Price per Share."

We now know the company's Equity Value at Pricing and Trading and the price at which it is selling shares to new investors.

Step 3: Determine the Primary and Secondary Shares and Greenshoe Shares

Primary Shares are new shares that represent capital raised in the deal – this capital then goes to the company in the form of Cash.

Secondary Shares represent existing investors selling their stakes to new investors. No capital is raised, and the company doesn't get anything.

We already have the assumptions for these items from Step 1.

The calculations are not complicated, but they are a bit "tricky" because you have to back into so many numbers.

We'll explain the key points in the screenshot below, but you'll understand it much better if you look at the Excel file:

Implied Post-Money Equity Value @ Pricing:	*$ M*	2,677.4	3,059.9	3,442.4	3,824.9
Issuer - Existing Shares Outstanding:	*M Shares*	66.914	66.914	66.914	66.914
Implied Offering Price per Share:	*$ as Stated*	$ 25.07	$ 30.78	$ 36.50	$ 42.22
Post-Transaction Shares Outstanding Calculations:					
(+) Primary Shares Issued in IPO:	*M Shares*	39.9	32.5	27.4	=+J29/J32-J31
(+) Secondary Shares Sold in IPO:	*M Shares*	13.3	10.8	9.1	7.9
Total Shares Issued or Sold in IPO:	*M Shares*	**53.2**	**43.3**	**36.5**	**31.6**
Total Shares Issued or Sold in Base Deal:	*M Shares*	46.3	37.7	31.8	27.5
Total Overallotment Shares:	*M Shares*	6.9	5.6	4.8	4.1
Pro-Forma Shares Outstanding, Post-IPO:	*M Shares*	106.8	99.4	94.3	90.6
Primary Shares Issued - Basic Offering:	*M Shares*	34.7	28.2	23.8	20.6
Primary Shares Issued - Overallotment:	*M Shares*	5.2	4.2	3.6	3.1
Secondary Shares Sold - Basic Offering:	*M Shares*	11.6	9.4	7.9	6.9
Secondary Shares Sold - Overallotment:	*M Shares*	1.7	1.4	1.2	1.0

Divide the Post-Money Equity Value by the Offering Price to get the total shares, and then subtract the existing shares to get the Primary Shares issued.

Divide the Primary Shares by the Primary Share Percentage (75%) and subtract the Primary Shares.

Equity Value at Pricing / Offering Price per Share.

These are all straightforward - 75% of the Greenshoe Shares are Primary and 25% are Secondary.

There is one less obvious point: **We are backing INTO the number of Greenshoe, or Overallotment, Shares.**

In other words, we **don't** assume that the company will issue a fixed number of shares and then increase that count by 15%.

Instead, we **START** with the **TOTAL** number of Primary + Secondary Shares sold in both the initial deal and the Greenshoe.

THEN, we determine the Greenshoe Shares based on the 15% assumption. We split up the Primary and Secondary Shares according to that.

We could have set up this model in a more straightforward way by using the Primary and Secondary Shares Sold and the Offering Price as key drivers.

But if we had done that, there would not have been a direct link to the range of P / E multiples from the comparable public companies.

Step 4: Calculate the Net Proceeds to Issuer

So far, we've calculated the company's Equity Value and share count after the IPO.

But the point of an IPO is to **raise capital** for the company.

So, in this next step, we calculate the "Total Offering Size," which is based on the total Primary, Secondary, and Overallotment Shares.

To determine the amount that goes to the company, we take **only** the proceeds from the Primary Shares and subtract the Underwriting Discount and the Deal-Related Fees:

		Filing Range - 1-Year Forward P / E Multiples			
Forward Year 1 P / E Multiple at Trading:	*Units*	**17.5 x**	**20.0 x**	**22.5 x**	**25.0 x**
Implied Post-Money Equity Value @ Pricing:	*$ M*	2,677.4	3,059.9	3,442.4	3,824.9
Issuer - Existing Shares Outstanding:	*M Shares*	66.914	66.914	66.914	66.914
Implied Offering Price per Share:	*$ as Stated*	$ 25.07	$ 30.78	$ 36.50	$ 42.22
Deal Size & Gross and Net Proceeds to Issuer:					
Base Deal Size (Primary + Secondary):	*$ M*	$ 1,159.4	$ 1,159.4	$ 1,159.4	$ 1,159.4
(+) Total Overallotment:	*$ M*	173.9	173.9	173.9	173.9
Total Offering Size:	*$ M*	**1,333.3**	**1,333.3**	**1,333.3**	**1,333.3**
Gross Primary Proceeds:	*$ M*	1,000.0	1,000.0	1,000.0	1,000.0
(-) Underwriting Discount:	*$ M*	(50.0)	(50.0)	(50.0)	(50.0)
(-) Deal-Related Fees:	*$ M*	(10.0)	(10.0)	(10.0)	(10.0)
Net IPO Proceeds to Issuer:	*$ M*	**940.0**	**940.0**	**940.0**	**940.0**
Implied Pre-Money Equity Value:	*$ M*	1,677.4	2,059.9	2,442.4	=+J29-J56
% Company Sold in IPO:	*%*	37.3%	32.7%	29.0%	26.1%

(Primary + Secondary Shares in Base Deal) * Offering Price per Share, and Total Greenshoe Shares * Offering Price per Share.

Fixed $1 billion assumption set in the beginning; company pays 5% in fees and $10M in other fees.

% sold is based on the $1 billion in Gross Primary Proceeds / Equity Value at Pricing.

This $1 billion of additional Cash will *increase* the company's Equity Value, which is why there's a $1 billion difference between the "Post-Money Equity Value @ Pricing" and the "Implied Pre-Money Equity Value."

The company sells between 25% and 40% of its Equity in the offering, which is standard in IPOs.

The "Underwriting Discount" is quite high – a higher percentage than the typical fees in M&A deals – because it *used to reflect* the risk that banks *used to assume* when they *used to purchase* the company's shares *before* the IPO (to re-sell to other investors later on).

Banks rarely do this now, but the high fees have persisted. On many large deals, however, companies negotiate the fee percentage down to lower levels.

Step 5: Calculate the Valuation Multiples

As the final step in this process, we calculate the company's Post-Money Equity Value and Enterprise Value at both Pricing and Trading.

The "Pricing" figures reflect the 15% discount for new investors.

"Post-Money" means that we are including the impact of the Equity issuance: The company's Equity Value will be higher, and we subtract the Net Proceeds from the IPO when moving from Equity Value to Enterprise Value.

Here's the full layout in Excel:

Forward Year 1 P / E Multiple at Trading:	Units	Filing Range - 1-Year Forward P / E Multiples 17.5 x	20.0 x	22.5 x	25.0 x
Forward Year 1 Net Income:	$ M	$ 175.9	$ 175.9	$ 175.9	$ 175.9
Implied Post-Money Equity Value @ Trading:	$ M	3,079.1	3,518.9	3,958.8	4,398.7
Pricing Discount %:	%	15.0%	15.0%	15.0%	15.0%
Pricing Discount Amount:	$ M	401.6	459.0	516.4	573.7
Implied Post-Money Equity Value @ Pricing:	$ M	2,677.4	3,059.9	3,442.4	3,824.9
Valuation Multiples @ Pricing and Trading:					
Implied Post-Money Equity Value @ Trading:	$ M	$ 3,079.1	$ 3,518.9	$ 3,958.8	$ 4,398.7
(-) Net IPO Proceeds:	$ M	(940.0)	(940.0)	(940.0)	(940.0)
(-) Cash & Cash-Equivalents:	$ M	(158.1)	(158.1)	(158.1)	(158.1)
(-) Equity Investments:	$ M	-	-	-	-
(-) Other Non-Core Assets, Net:	$ M	-	-	-	-
(-) Net Operating Losses:	$ M	-	-	-	-
(+) Total Debt:	$ M	29.4	29.4	29.4	29.4
(+) Noncontrolling Interests:	$ M	-	-	-	-
Implied Post-Money Enterprise Value @ Trading	$ M	**2,010.4**	**2,450.3**	**2,890.1**	**3,330.0**
Implied Post-Money Equity Value @ Pricing:	$ M	2,677.4	3,059.9	3,442.4	3,824.9
Implied Post-Money Enterprise Value @ Pricing:	$ M	**1,608.8**	**1,991.3**	**2,373.8**	=+J76+SUM(J67:J73)
Implied Forward P / E Multiple at Pricing:	x	15.2 x	17.4 x	19.6 x	21.7 x
Implied Forward P / E Multiple at Trading:	x	17.5 x	20.0 x	22.5 x	25.0 x
Implied Forward EV / EBITDA Multiple at Pricing:	x	6.4 x	8.0 x	9.5 x	11.0 x
Implied Forward EV / EBITDA Multiple at Trading:	x	8.0 x	9.8 x	11.6 x	13.3 x
Implied Forward EV / Revenue Multiple at Pricing:	x	3.3 x	4.1 x	4.9 x	5.7 x
Implied Forward EV / Revenue Multiple at Trading:	x	4.2 x	5.1 x	6.0 x	6.9 x

Post-Money Equity Value increases by $1 billion, but the company only gets $940 million of extra Cash, so the Post-Money Enterprise Value ends up being slightly higher instead of staying the same.

We would compare these multiples to those of the Public Comps to assess how reasonable the company's value is and whether or not the investors are getting a "good deal."

You might *think* that the Pre-Money and Post-Money Enterprise Value are the same because the higher Equity Value and higher Cash balance offset each other, but that's not quite true.

Since the company pays **fees** to the bankers and lawyers, the Net IPO Proceeds are only $940 million rather than $1 billion.

As a result, the Post-Money Enterprise Value is slightly higher than the Pre-Money Enterprise Value.

How to Use This Analysis in Real Life

We might show this analysis to a client or potential client in a pitch book or other presentation.

We would focus on the company's **expected valuation** after going public, the **percentage it sells** in the offering, and the **multiples at pricing and trading**.

This model is simple, so we would spend most of our time explaining the different assumptions. For example:

- **Potential Client Question:** "Why should we offer investors a 15% discount when they buy our shares in an IPO?"

- **Banker Response:** "Because recent, similar deals in this market have all offered investors a 10-20% discount, and we think it's a reasonable level for you as well. The market hasn't responded well to offerings done at lower discounts; they've all traded down in the weeks after the offering."

- **Potential Client Question:** "Why have you assumed forward P / E multiples of 17.5x to 25.0x for our company?"

- **Banker Response:** "Because peer companies in this industry trade at multiples of 15.0x to 22.0x, but you should be valued at a premium to that range since your company is growing more quickly and is less capital-intensive."

- **Potential Client Question:** "Why do you recommend a 75% Primary and 25% Secondary Share allocation? Isn't it better to issue all new shares and raise more capital?"

- **Banker Response:** "Because those figures are standard for recent IPOs, and your venture capital investors want to sell portions of their stakes. Selling 100% of their stakes would send a negative signal to the market, so it's best for them to sell smaller portions in this initial offering.

  Your existing investors would not be pleased if you limited this offering to Primary Shares because they would have to wait longer to sell their shares, which creates more risk for them."

The Alternate IPO Model

You can set up the IPO model above differently and make **the number of Primary and Secondary Shares sold and the Offering Price per Share** the key drivers.

This model is more straightforward and doesn't require you to "back into" quite as many numbers.

But it may also be disconnected from reality because you're not linking the valuation to the multiples from the Public Comps.

An Offering Price of $20.00 or $25.00 or $30.00 doesn't tell you anything – what matters is how the *valuation multiples implied by that price* compare to those of peer companies.

Here's each step in this alternate model, starting with the assumptions:

IPO Valuation & Financing Model - Alternate Version Based on Shares Issued and Offering Price

($ USD in Millions Except Per Share Values in $ as Stated)

Shares issued instead of capital raised.

IPO Transaction Assumptions:

Underwriting Discount:	5.0%
IPO Pricing Discount:	15.0%
Primary Shares Issued:	30.000
Secondary Shares Sold:	10.000
Greenshoe Provision %:	15.0%
Primary Allocation %:	75.0%
Issuer - Existing Shares:	66.914

Expense Assumptions:	**$ in Millions**
(+) SEC Filing & Registration Fees:	$ 1.5
(+) Printing Fees:	1.0
(+) Accounting & Legal Fees:	6.0
(+) Miscellaneous / Other Fees:	1.5
Total Fees:	**$ 10.0**
Forward Year 1 Revenue:	$ 484.0
Forward Year 1 EBITDA:	249.7
Forward Year 1 Net Income:	175.9

We still calculate the Post-Money Equity Value at Pricing and Trading, but we do so based on the Offering Prices and Total Shares Outstanding following the IPO:

		Filing Range - Offering Prices:			
Offering Price per Share:	*Units*	$ 25.00	$ 30.00	$ 35.00	$ 40.00
(+) Primary Shares Issued:	*M Shares*	30.000	30.000	30.000	30.000
(+) Secondary Shares Sold:	*M Shares*	10.000	10.000	10.000	10.000
Total Shares Issued or Sold in Base Deal:	*M Shares*	**40.000**	**40.000**	**40.000**	**40.000**
(+) Overallotment - Primary Shares Issued:	*M Shares*	4.500	4.500	4.500	4.500
(+) Overallotment - Secondary Shares Sold:	*M Shares*	1.500	1.500	1.500	1.500
Total Overallotment:	*M Shares*	**6.000**	**6.000**	**6.000**	**6.000**
Issuer - Existing Shares Outstanding:	*M Shares*	66.914	66.914	66.914	66.914
(+) Total Primary Shares Issued:	*M Shares*	34.500	34.500	34.500	34.500
Pro-Forma Shares Outstanding, Post-IPO:	*M Shares*	**101.414**	**101.414**	**101.414**	**101.414**
Post-Money Equity Value @ Trading and @ Pricing:					
Implied Post-Money Equity Value @ Pricing:	*$ M*	$ 2,535.4	$ 3,042.4	$ 3,549.5	=+J19*J31
Pricing Discount %:	*%*	15.0%	15.0%	15.0%	15.0%
Pricing Discount Amount:	*$ M*	380.3	456.4	532.4	608.5
Implied Post-Money Equity Value @ Trading:	*$ M*	2,915.7	3,498.8	4,081.9	4,665.1

The Post-Money Equity Value still varies in each column, but it's linked to the Offering Price range at the top * the Post-IPO Shares Outstanding rather than the company's P/E multiple * projected Net Income.

The Pricing Discount still works the same way, i.e. we're assuming a 15% discount for new IPO investors.

The 30 million of Primary Shares here represent 29% of the 101 million post-IPO total.

With the Greenshoe factored in, the Primary Shares represent about 34% of the total:

Offering Price per Share:	Units	Filing Range - Offering Prices: $ 25.00	$ 30.00	$ 35.00	$ 40.00
Deal Size & Gross and Net Proceeds to Issuer:					
Base Deal Size (Primary + Secondary):	$ M	$ 1,000.0	$ 1,200.0	$ 1,400.0	$ 1,600.0
(+) Total Overallotment:	$ M	150.0	180.0	210.0	240.0
Total Offering Size:	$ M	**1,150.0**	**1,380.0**	**1,610.0**	**1,840.0**
Gross Primary Proceeds:	$ M	862.5	1,035.0	1,207.5	1,380.0
(-) Underwriting Discount:	$ M	(43.1)	(51.8)	(60.4)	(69.0)
(-) Deal-Related Fees:	$ M	(10.0)	(10.0)	(10.0)	(10.0)
Net IPO Proceeds to Issuer:	$ M	**809.4**	**973.3**	**1,137.1**	**1,301.0**
Implied Pre-Money Equity Value:	$ M	1,672.9	2,007.4	2,342.0	2,676.6
% Company Sold in IPO:	%	34.0%	34.0%	34.0%	34.0%
Valuation Multiples @ Pricing and Trading:					
Implied Post-Money Equity Value @ Trading:	$ M	$ 2,915.7	$ 3,498.8	$ 4,081.9	$ 4,665.1
(-) Net IPO Proceeds:	$ M	(809.4)	(973.3)	(1,137.1)	(1,301.0)
(-) Cash & Cash-Equivalents:	$ M	(158.1)	(158.1)	(158.1)	(158.1)
(-) Equity Investments:	$ M	-	-	-	-
(-) Other Non-Core Assets, Net:	$ M	-	-	-	-
(-) Net Operating Losses:	$ M	-	-	-	-
(+) Total Debt:	$ M	29.4	29.4	29.4	29.4
(+) Noncontrolling Interests:	$ M	-	-	-	-
Implied Post-Money Enterprise Value @ Trading	$ M	**1,977.6**	**2,396.9**	**2,816.1**	**3,235.4**
Implied Post-Money Equity Value @ Pricing:	$ M	2,535.4	3,042.4	3,549.5	4,056.6
Implied Post-Money Enterprise Value @ Pricing:	$ M	**1,597.3**	**1,940.5**	**2,283.7**	**2,626.9**
Implied Forward P / E Multiple at Pricing:	x	14.4 x	17.3 x	20.2 x	23.1 x
Implied Forward P / E Multiple at Trading:	x	16.6 x	19.9 x	23.2 x	26.5 x
Implied Forward EV / EBITDA Multiple at Pricing:	x	6.4 x	7.8 x	9.1 x	10.5 x
Implied Forward EV / EBITDA Multiple at Trading:	x	7.9 x	9.6 x	11.3 x	13.0 x
Implied Forward EV / Revenue Multiple at Pricing:	x	3.3 x	4.0 x	4.7 x	5.4 x
Implied Forward EV / Revenue Multiple at Trading:	x	4.1 x	5.0 x	5.8 x	6.7 x

With this setup, the Deal Size, Primary Proceeds, and Underwriting Discount change in each column because the Offering Price changes.

But the % sold stays the same because the shares sold stay the same.

Everything at the bottom is the same in this version. The only difference is that the Net IPO Proceeds now differ in each column because the deal size is no longer fixed.

Anything Else?

The analyses above are the most important ones for IPOs, but here are a few others:

- **Analysis of Comparable IPO Offerings** – You could look at recent offerings and find the median percentage sold, the median pricing and trading multiples, the median pricing discount, and the median Primary / Secondary split.

  However, this analysis is not *that* useful because **each deal is different.** A recently public airline company will trade at very different multiples than a biotech company.

- **Shareholder Analysis** – You could analyze institutional investors with holdings in this sector and make recommendations for the investors to target based on that.

  For example, let's say your bank is taking a transportation and logistics company public. You look at major institutional investors in the U.S. and find several firms with major holdings in similar companies. These investors do **not** yet own stakes in your client.

  Based on that, you might recommend that the company meet with these investors since they have a demonstrated interest in the sector.

  This analysis is more relevant for **Follow-On Offerings** because companies rarely have wide institutional investor bases before going public.

Return to Top.

Key Rule #4: Analysis of Follow-On Offerings (FOs)

Follow-On Offerings (FOs) are *very* similar to Initial Public Offerings, but the process and model drivers are a bit different.

The process is simpler and faster to complete because **the company is already public** – regulatory organizations don't need to "sign off" in the same way.

It's also more important to look at **comparable issuances** because they include more details that apply to all industries and deals.

Here are the steps you complete when analyzing a **Follow-On Offering** for a company:

Step 1: Review Comparable Follow-On Issuances

As in IPOs, companies that issue Equity in FOs typically do so at a **discount**.

Since the company is already public, though, this is a discount to the company's *current share price* (or 30-day average, 1-year average, etc.) rather than its estimated share price.

For example, if the company's current share price is $50.00, it might issue new shares to investors at $45.00, representing a 10% discount.

The company offers this discount to **incentivize investors to sign up** – if it did *not* offer such a bargain, investors would have little reason to buy the company's shares in the offering.

The company is **already public**, so these investors could just buy shares on the open market for $50.00.

This **Offering Price Discount** is one of the key figures in Comparable Follow-On Issuances. Others include:

- **Deal Size % Market Cap:** Did companies sell a median of 20%? 10%? 5%?

- **Primary / Secondary Split:** Companies sell both types of shares in FOs, and the terms mean the same thing as in IPOs: Primary Shares are **new shares** issued by the company, and Secondary Shares are existing shares sold by existing investors.

- **Price Performance:** How did the company's stock price perform in the months or years following the deal? Did companies' stock prices increase by a median of 10%? Decline by 5%? Stay the same?

You could look at other stats, such as the percentages of new vs. existing investors who buy shares and the *types* of investors, but this information is hard to summarize in Excel.

You **screen** for comparable FO issuances the same way you screen for Precedent Transactions: Industry, geography, size, and time.

"Size" refers to *the size of the offering*. You shouldn't be comparing a $10 million offering from a small-cap biotech company to a $10 billion offering from a multinational conglomerate.

Example screens might include:

- Follow-On Equity Offerings Worth Between €100 Million and €1 Billion from European Transportation and Logistics Companies Over the Past 3 Years

- Follow-On Equity Offerings Worth Between ¥1 Billion and ¥10 Billion from Chinese Internet Companies Over the Past 2 Years

- Follow-On Equity Offerings Worth Between $10 Million and $100 Million USD from Latin American Food Processing Companies Over the Past 5 Years

Here's our screen in an example Follow-On Offering analysis for Netflix:

Comparable Follow-On Equity Offerings Worth Between $100 Million and $5 Billion USD from U.S.-Based Internet and Software Companies Over the Past Two Years
($ USD in Millions Except Per Share Values in $ as Stated)

Standard industry, geography, size, and time screen.

Equity Issuances - Financial Statistics							Price Performance			
	Offering	Deal Size	Market Cap Just	Offering Price Premium / (Discount) to:			From Offering	Deal Size	% Primary	% Secondary
Company Name	Date	($ Millions)	Before Offering	Last Trade	30-Day Average	1-Year Average	to Present	% Market Cap	Shares	Shares
TrueCar Inc.	20X4-11-11	$ 125.2	$ 1,343.5	(2.8%)	(4.4%)	5.8%	2.5%	9.3%	26.6%	73.4%
GrubHub Inc.	20X4-09-03	421.3	3,219.5	(1.4%)	1.3%	15.1%	(15.5%)	13.1%	10.8%	89.2%
salesforce.com, Inc.	20X4-08-25	394.1	37,025.7	(8.3%)	1.1%	(0.1%)	(5.8%)	1.1%	0.0%	100.0%
Dealertrack Technologies, Inc.	20X4-08-11	220.2	2,056.0	(2.6%)	(4.4%)	(15.1%)	11.7%	10.7%	0.0%	100.0%
Orbitz Worldwide, Inc.	20X4-07-17	272.0	965.8	(9.6%)	(8.9%)	(4.1%)	8.5%	28.2%	0.0%	100.0%
Verint Systems Inc.	20X4-06-12	274.6	2,610.1	(1.1%)	3.4%	17.1%	12.8%	10.5%	100.0%	0.0%
Activision Blizzard, Inc.	20X4-05-21	852.4	14,937.2	(1.6%)	2.0%	16.9%	(1.0%)	5.7%	0.0%	100.0%
Bankrate, Inc.	20X4-03-04	293.8	1,949.2	(3.7%)	(1.7%)	10.4%	(32.2%)	15.1%	0.0%	100.0%
Workday, Inc.	20X4-01-14	614.1	15,961.4	(2.5%)	6.6%	29.1%	(13.8%)	3.8%	100.0%	0.0%
Groupon, Inc.	20X4-01-07	163.1	8,071.0	(0.7%)	6.2%	43.0%	(41.5%)	2.0%	0.0%	100.0%
Facebook, Inc.	20X3-12-20	3,853.5	138,477.8	(0.1%)	12.0%	58.8%	38.4%	2.8%	38.6%	61.4%
HomeAway, Inc.	20X3-12-12	256.1	3,211.4	(1.1%)	(0.5%)	24.6%	(28.8%)	8.0%	7.5%	92.5%
RetailMeNot, Inc.	20X3-12-11	187.4	1,361.6	(3.5%)	(12.3%)	(18.8%)	(44.1%)	13.8%	40.8%	59.2%
Yelp Inc.	20X3-10-30	288.9	3,592.1	(0.1%)	(2.5%)	92.9%	(21.0%)	8.0%	100.0%	0.0%
Shutterstock, Inc.	20X3-09-19	317.4	2,032.3	(0.5%)	11.1%	52.3%	(5.1%)	15.6%	31.9%	68.1%
Pandora Media, Inc.	20X3-09-18	523.3	4,516.7	(2.5%)	20.3%	83.3%	(34.6%)	11.6%	75.2%	24.8%
LinkedIn Corporation	20X3-09-04	1,200.0	26,737.1	(6.7%)	(5.4%)	42.8%	(7.7%)	4.5%	100.0%	0.0%
Zillow Group, Inc.	20X3-08-20	473.7	2,565.9	(10.1%)	(0.7%)	73.9%	7.7%	18.5%	56.3%	43.7%
Trulia, Inc.	20X3-03-14	212.5	841.0	(2.2%)	4.2%	36.8%	42.1%	25.3%	56.4%	43.6%
Maximum		$ 3,853.5	$ 138,477.8	(0.1%)	20.3%	92.9%	42.1%	28.2%	100.0%	100.0%
75th Percentile		498.5	11,504.1	(1.1%)	5.2%	47.7%	8.1%	14.4%	65.8%	100.0%
Median		**293.8**	**3,211.4**	**(2.5%)**	**1.1%**	**24.6%**	**(5.8%)**	**10.5%**	**31.9%**	**68.1%**
25th Percentile		238.2	1,990.7	(3.6%)	(3.4%)	8.1%	(24.9%)	5.1%	0.0%	34.2%
Minimum		125.2	841.0	(10.1%)	(12.3%)	(18.8%)	(44.1%)	1.1%	0.0%	0.0%

If the assumptions in our Follow-On Offering model are very different from these, we may need to re-think them.

These numbers indicate that companies rarely offer huge discounts; could be a sign of high demand for equity in this sector.

Companies that have issued Follow-On Equity have not had great stock-price performances.

Step 2: Make Assumptions for the Funds Raised, Discount, Greenshoe, and Fees

The **funds raised** in a Follow-On Offering are tied to the company's plans.

Companies tend to sell lower percentages in FOs than they do in IPOs because they're more mature, don't need as much capital, and don't want to dilute existing shareholders as much.

Also, there may not be as many existing investors – such as VC and PE firms – that are looking to realize gains in FOs.

These investors tend to sell their stakes gradually over time, so they don't necessarily "need" a Follow-On Offering in the same way they "need" an Initial Public Offering.

We might do a quick check to make sure the Deal Size as a % of Market Cap is a reasonable figure – e.g., it's not 35% when the median is 10%.

Other than that, **the fees** tend to be significantly lower in FOs because far less work is required; the company is already public and has institutional investors.

The Primary/Secondary split depends on why the company is issuing Equity, but if the company needs money for expansions, acquisitions, or Debt repayment, the offering will be mostly Primary Shares.

Finally, the Greenshoe Option still exists for FOs, and the Greenshoe Shares are still split into Primary and Secondary, just like the ones in the base offering:

Follow-On Equity Financing Model
($ USD in Millions Except Per Share Values in $ as Stated)

Only 5% of Equity Value.

Much lower fees than in an IPO.

Follow-On Equity Transaction Assumptions:

Current Share Price:	$ 442.47
Diluted Shares Outstanding:	62.644
Diluted Equity Value:	$ 27,718.1
Base Funds Raised in Follow-On Offering:	$ 1,500.0
Underwriting Discount:	2.25%
Primary Share %:	90.0%
Secondary Share %:	10.0%
Greenshoe Provision %:	15.0%
Primary Allocation %:	90.0%

Expense Assumptions:	$ in Millions
SEC Filing & Registration Fees:	$ 0.2
Printing Fees:	0.1
Accounting & Legal Fees:	0.1
Miscellaneous / Other Fees:	0.1
Total Fees:	**$ 0.5**
Pre-Transaction Forward 1 Year EPS:	$ 5.31
Forward Year 1 Revenue:	$ 6,829.1
Forward Year 1 EBITDA:	678.3
Forward Year 1 Net Income:	327.7

Clearly, this company is completing a Follow-On because it needs to raise capital.

Step 3: Calculate the Post-Money Shares Outstanding and Equity Value

Similar to the "Alternate IPO Model" in the previous section, the key driver in a Follow-On Model is the **Offering Price**.

Unlike the Alternate IPO Model, however, we assume a range of Offering Prices at **different discounts** to the company's current share price.

Then, we determine the Shares Issued based on the Funds Raised and these Offering Prices (e.g., $1 billion raised at a $20.00 Offering Price is 50 million Shares Issued).

Here's the first part of our model:

Shares Issued in Follow-On Offering:	Units:	Follow-On Equity Filing Range - Discount to Current Share Price (25.0%)	(20.0%)	(15.0%)	(10.0%)	(5.0%)	0.0%
Follow-On Offering Price:	*$ as Stated*	**$ 331.85**	**$ 353.98**	**$ 376.10**	**$ 398.22**	**$ 420.35**	**$ 442.47**
Base Shares Issued or Sold in Offering:	*M Shares*	**4.520**	**4.238**	**3.988**	**3.767**	**3.568**	=+FO_Offering_Size/L24
Primary Shares Issued:	*M Shares*	4.068	3.814	3.589	3.390	3.212	3.051
Secondary Shares Sold:	*M Shares*	0.452	0.424	0.399	0.377	0.357	0.339
Overallotment Shares Issued or Sold:	*M Shares*	**0.678**	**0.636**	**0.598**	**0.565**	**0.535**	**0.509**
Primary Shares Issued:	*M Shares*	0.610	0.572	0.538	0.509	0.482	0.458
Secondary Shares Sold:	*M Shares*	0.068	0.064	0.060	0.057	0.054	0.051
Pre-Transaction Diluted Shares Outstanding:	*M Shares*	62.644	62.644	62.644	62.644	62.644	62.644
(+) Total Primary Shares Issued:	*M Shares*	4.678	4.386	4.128	3.899	3.693	3.509
Pro-Forma Diluted Shares Outstanding:	*M Shares*	**67.322**	**67.030**	**66.772**	**66.543**	**66.337**	**66.153**
Post-Money Equity Value @ Trading and @ Pricing:							
Implied Post-Money Equity Value @ Pricing:	*$ M*	$ 22,341.1	$ 23,727.0	$ 25,112.9	$ 26,498.8	$ 27,884.7	$ 29,270.6
Pricing Discount %:	*%*	25.0%	20.0%	15.0%	10.0%	5.0%	0.0%
Pricing Discount Amount:	*$ M*	7,447.0	5,931.7	4,431.7	2,944.3	1,467.6	-
Implied Post-Money Equity Value @ Trading:	*$ M*	29,788.1	29,658.7	29,544.6	29,443.1	29,352.3	29,270.6

Discount to current price is the key driver.

Fewer new shares are issued when the discount is lower; more shares are issued when the discount is higher.

Reflects the discounts of 0% up to 25% above.

We use the company's CURRENT share price, so these figures differ only because of slightly different share counts in each case.

Step 4: Calculate the Net Proceeds, % Company Sold, and Valuation Multiples

Similar to the first IPO model in the previous section, **the deal size** does *not* change based on the Offering Price here.

Instead, the company simply issues more shares at higher discounts and fewer shares at lower discounts so that it always raises the same amount of capital.

The proceeds the company receives are linked to the **Primary Shares** it sells in this offering.

These Gross Primary Proceeds and the Net Proceeds also stay the same regardless of the pricing discount.

We can calculate the Post-Money Equity Value and Enterprise Value at both Pricing and Trading the same way we did in the IPO Model:

Shares Issued in Follow-On Offering:	Units:	Follow-On Equity Filing Range - Discount to Current Share Price (25.0%)	(20.0%)	(15.0%)	(10.0%)	(5.0%)	0.0%
Follow-On Offering Price:	*$ as Stated*	**$ 331.85**	**$ 353.98**	**$ 376.10**	**$ 398.22**	**$ 420.35**	**$ 442.47**
Deal Size & Gross and Net Proceeds to Issuer:							
Base Deal Size (Primary + Secondary):	*$ M*	$ 1,500.0	$ 1,500.0	$ 1,500.0	$ 1,500.0	$ 1,500.0	$ 1,500.0
(+) Total Overallotment:	*$ M*	225.0	225.0	225.0	225.0	225.0	225.0
Total Offering Size:	*$ M*	**1,725.0**	**1,725.0**	**1,725.0**	**1,725.0**	**1,725.0**	**1,725.0**
Gross Primary Proceeds:	*$ M*	1,552.5	1,552.5	1,552.5	1,552.5	1,552.5	1,552.5
(-) Underwriting Discount:	*$ M*	(34.9)	(34.9)	(34.9)	(34.9)	(34.9)	(34.9)
(-) Deal-Related Fees:	*$ M*	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Net Proceeds to Issuer:	*$ M*	**1,517.1**	**1,517.1**	**1,517.1**	**1,517.1**	**1,517.1**	**1,517.1**
% Company Sold in Follow-On Offering:	*%*	**6.9%**	**6.5%**	**6.2%**	**5.9%**	**5.6%**	**5.3%**
Valuation Multiples @ Pricing and Trading:							
Implied Post-Money Equity Value @ Trading:	*$ M*	$ 29,788.1	$ 29,658.7	$ 29,544.6	$ 29,443.1	$ 29,352.3	$ 29,270.6
(-) Net FO Proceeds:	*$ M*	(1,517.1)	(1,517.1)	(1,517.1)	(1,517.1)	(1,517.1)	(1,517.1)
(-) Cash & Cash-Equivalents:	*$ M*	(1,608.5)	(1,608.5)	(1,608.5)	(1,608.5)	(1,608.5)	(1,608.5)
(-) Equity Investments:	*$ M*	-	-	-	-	-	-
(-) Other Non-Core Assets, Net:	*$ M*	-	-	-	-	-	-
(-) Net Operating Losses:	*$ M*	-	-	-	-	-	-
(+) Total Debt:	*$ M*	928.4	928.4	928.4	928.4	928.4	928.4
(+) Noncontrolling Interests:	*$ M*	-	-	-	-	-	-
Post-Money Enterprise Value @ Trading:	*$ M*	**27,590.9**	**27,461.6**	**27,347.4**	**27,245.9**	**27,155.2**	**27,073.4**
Post-Money Equity Value @ Pricing:	*$ M*	22,341.1	23,727.0	25,112.9	26,498.8	27,884.7	29,270.6
Post-Money Enterprise Value @ Pricing:	*$ M*	**20,143.9**	**21,529.8**	**22,915.7**	**24,301.6**	**25,687.5**	**27,073.4**
Forward Year 1 P / E Multiple at Pricing:	*x*	68.2 x	72.4 x	76.6 x	80.9 x	85.1 x	89.3 x
Forward Year 1 P / E Multiple at Trading:	*x*	90.9 x	90.5 x	90.2 x	89.8 x	89.6 x	89.3 x
Forward Year 1 EV / EBITDA Multiple at Pricing:	*x*	29.7 x	31.7 x	33.8 x	35.8 x	37.9 x	39.9 x
Forward Year 1 EV / EBITDA Multiple at Trading:	*x*	40.7 x	40.5 x	40.3 x	40.2 x	40.0 x	39.9 x
Forward Year 1 EV / Revenue Multiple at Pricing:	*x*	2.9 x	3.2 x	3.4 x	3.6 x	3.8 x	4.0 x
Forward Year 1 EV / Revenue Multiple at Trading:	*x*	4.0 x	4.0 x	4.0 x	4.0 x	4.0 x	4.0 x

The percentage sold changes because the shares sold change, but the offering size stays the same at different discounts.

Slightly different Equity Value figures because of slightly different share counts post-IPO.

These multiples all reflect the pricing discount. The Pricing vs. Trading differences go to 0 as the Discount goes to 0%.

This company (Netflix) has *exceptionally high multiples* – especially its P / E and EV / EBITDA multiples.

We might use this data to show the management team the appeal of the offering at different discounts.

We might also explain how these multiples compare to those of the comparable public companies.

Step 5: Compare the After-Tax Cost of Equity via a Follow-On to Other Financing Options

When a company completes a Follow-On Offering, and it's doing so to **raise new capital**, it has many fundraising options available: Equity, Debt, and Convertible Bonds.

In this example for Netflix, we assumed that the company had the following options:

- **Option #1:** Equity.
- **Option #2:** Senior Notes at 5.5% – 6.0% coupon rates.
- **Option #3:** Convertible Bonds at a 1.5% coupon rate and 45% conversion premium.

The Convertible Bonds are clearly cheaper than the Senior Notes.

But if the company has an extremely high P / E multiple, as Netflix does, there's a chance that **Equity could result in less dilution than Debt, making Equity *cheaper* than Debt.**

It's worth running the numbers to see what happens:

		Follow-On Equity Filing Range - Discount to Current Share Price					
Shares Issued in Follow-On Offering:	*Units:*	(25.0%)	(20.0%)	(15.0%)	(10.0%)	(5.0%)	0.0%
Follow-On Offering Price:	*$ as Stated*	$ 331.85	$ 353.98	$ 376.10	$ 398.22	$ 420.35	$ 442.47
Forward Year 1 Post-Transaction EPS:	*$ as Stated*	$ 4.87	$ 4.89	$ 4.91	$ 4.92	$ 4.94	$ 4.95
Forward Year 1 EPS Accretion / (Dilution) - $:	*$ as Stated*	(0.44)	(0.42)	(0.40)	(0.39)	(0.37)	(0.36)
Forward Year 1 EPS Accretion / (Dilution) - %:	*%*	(8.4%)	(8.0%)	(7.6%)	(7.3%)	(7.0%)	(6.7%)
After-Tax Cost of Equity:	*%*	1.47%	1.38%	1.30%	1.24%	1.18%	1.12%
After-Tax Cost of Debt:	*%*	3.73%	3.73%	3.73%	3.73%	3.73%	3.73%
After-Tax Cost of Convertible Bonds:	*%*	0.99%	0.99%	0.99%	0.99%	0.99%	0.99%

Because of the company's extremely high P / E multiple, Equity is *cheaper* than standard Debt in this case, and it's almost as cheap as Convertible Bonds.

In most cases, the After-Tax Cost of Equity, defined as Projected Net Income / Post-Money Equity Value at Pricing, will be higher than the After-Tax Cost of Debt and Convertible Bonds.

If we measure the Cost of Equity with CAPM instead, it will probably exceed the Cost of Debt, given the risk/potential return profile of this industry.

Based on these results, we might tell the client:

- Given your high P / E multiple, now would be an ideal time to issue Equity; even at a 25% discount, a Follow-On Offering would create less dilution than traditional Debt.

- Traditional Debt makes the *least* sense because of the covenants and higher costs.

- A Convertible Bond makes the most sense because it has the lowest After-Tax Cost. Even if your share price increases, and the investors convert their bonds into shares, the cost will be relatively low because of your P / E multiples.

Return to Top.

Interview Questions

These questions are primarily for **investment banking interviews** in groups such as Equity Capital Markets (ECM), Debt Capital Markets (DCM), and Leveraged Finance (LevFin).

We covered many Debt-related questions in the technical guide(s) to Leveraged Buyouts and LBO modeling, so we will **not** repeat all of those questions here.

You are unlikely to receive questions on these topics in private equity interviews, but they could come up if you interview at a **credit fund** rather than a traditional PE fund.

You could also get questions on these topics if you interview at a hedge fund that uses strategies such as Convertible Bond Arbitrage or otherwise invests in companies' credit.

You are **not** likely to receive questions on these topics in interviews for corporate finance, corporate development, or equity research roles.

IPOs and Follow-On Offerings

You're more likely to get questions on **the process** behind IPOs and FOs than the analysis, but we've covered the process in the qualitative guides and various articles on M&I.

So, these questions cover the *models* for Equity offerings – even though there isn't much to them.

1. How do you value a company in an IPO?

The same way you value a company in any other transaction: With comparable public companies, precedent transactions, and a DCF analysis.

The main *difference* is that you focus on the **forward multiples of the Public Comps** because investors pay so much attention to them when a company goes public. A company's pricing in an IPO is based on these metrics as well.

So, if the median 1-year forward P / E multiple for similar public companies is 20x, you might suggest a range of 1-year forward P / E multiples around 20x for your company as well.

2. How do you build an IPO model for a company?

You start by assuming a range of forward multiples (often P / E multiples) and then applying them to the company's projected financial metrics.

If you're using P / E multiples, that gets you the company's implied post-money Equity Value when it starts trading.

But companies almost always offer new investors a **pricing discount** in IPOs, so you have to apply that discount (10-15%) to determine the post-money Equity Value at pricing.

Then, you can determine the Offering Price per Share by taking the post-money Equity Value at pricing, subtracting the offering size, and dividing by the company's pre-IPO share count.

Based on that, you can calculate the Primary Shares issued in the offering. For example, a post-money Equity Value of $10 billion / $50.00 Offering Price = 200 million shares, and if the company currently has 150 million shares, it must issue 50 million new ones.

You can then determine the Secondary Shares and Overallotment Shares based on separate assumptions for those.

Finally, you calculate the % of the company sold in the IPO and its valuation multiples at pricing and trading, reflecting the Net IPO Proceeds in its Equity Value and Enterprise Value.

3. What are the advantages and disadvantages of driving an IPO model off of valuation multiples vs. # shares issued?

A model driven by valuation multiples – the description above – is closer to reality because companies price based on the multiples of comparable public companies and the capital they want to raise.

However, such a model is also harder to explain to clients because you have to "back into" many of the figures in it.

You could also drive the model based on the Offering Price and # Shares Issued. This one is easier to explain to clients because the deal size changes at different Offering Prices, as you would expect, but the % Company Sold stays the same.

The downside is that it's not linked to peer companies' valuation multiples in the same way, and the capital raised varies at different Offering Prices – which isn't necessarily what companies want.

4. Why do companies offer Pricing Discounts in IPOs?

Even if a company believes its shares are worth $100.00, it usually lets new investors in an IPO purchase them at a discount of ~15% (so, $85.00 here) because those investors assume significant risk by purchasing the shares *before* the company is a publicly traded entity.

Anything could happen between pricing and the first few minutes of trading – the company's share price might plunge by 20%, for example. To compensate investors for that risk, companies offer this discount.

5. How does a company decide on the amount of capital to raise in an IPO?

It depends on the reason why the company is going public: If it *needs* capital for a specific purpose, such as making an acquisition or buying a factory, it will aim to raise that amount of capital.

But if the company is going public to provide existing investors with an exit and liquidity, it often raises capital such that it sells a certain percentage of the company (often between 20% and 40%).

The company wants to offer enough new shares to make investors committed to the company, but not so many that it gives up control.

Some companies can get around these guidelines if they're "hot," and there's a huge amount of demand for their shares – they can often sell much smaller percentages of their Equity, such as 5-10%, in initial public offerings.

6. What's the significance of Primary vs. Secondary Shares in an IPO or FO?

"Primary Shares" are **new ones** issued by the company in an Equity offering. They dilute the company's existing investors by reducing their ownership stake, but they also allow the company to raise capital.

"Secondary Shares" are **existing shares sold to new investors** in the offering. They do *not* dilute existing investors at all, but the company also receives no cash from them.

The percentages of Primary and Secondary Shares should be within reasonable ranges in an Equity offering, or the market may not buy into it. For example, new investors may be skeptical if too many existing investors want to sell their shares.

7. How might the market interpret an IPO with 100% Secondary Shares?

The market would interpret this deal negatively since the company is not issuing any new shares, which implies that growth expectations are low.

Also, if so many existing investors sell their shares in the company, they're sending a signal to the market that they don't believe in the company's long-term prospects.

In most market environments, it would be difficult-to-impossible to conduct an IPO with no Primary Shares.

8. What's the impact of a Greenshoe provision in an IPO or FO, and when might a bank and company offer it?

A "Greenshoe" lets a company sell more shares than originally planned in an Equity offering. A company might use it if there's higher-than-expected demand for its shares, and it believes it can raise additional capital easily, without completing a separate offering.

For example, the company initially planned to offer 10 million shares at $10.00 each, but with a 15% Greenshoe, it can offer 11.5 million shares and raise $115 million instead of $100 million.

In an IPO or FO, a Greenshoe increases the deal size and results in a higher percentage of the company being sold to new investors.

9. How is the Follow-On Offering process different from the Initial Public Offering process?

It's much faster and easier to issue Equity in a Follow-On Offering because the company is already public and doesn't need to go through regulatory approvals once again.

Also, investors already know the company's name and reputation, and it doesn't take as much marketing to sell the offering.

As a result, banks tend to earn lower fees in FOs – often less than 50% of what they earn in IPOs – and the legal and accounting fees are also lower.

Since the company is already public, there's no question over the appropriate valuation – the main issue is how much of a **discount** to offer to new investors.

10. How do you set up a Follow-On Offering model differently from an IPO model?

It's similar to an IPO model driven by Shares Issued and Offering Prices, but the Offering Prices are framed in terms of a discount to the company's share price (such as 5%, 10%, or 15%).

You determine the Shares Issued based on the amount of capital the company wants to raise and the discount it is offering; a higher discount means more shares, and a lower discount means fewer shares.

Then, you factor in the Overallotment (Greenshoe) and the Primary vs. Secondary Share split and determine the Net Proceeds to the Issuer based on the proceeds from Primary Shares minus fees.

You can then calculate the % of the company sold in the offering (based on Primary Shares issued and post-FO shares outstanding), the valuation multiples at pricing and trading, and the cost of issuing Equity based on the pricing discount.

11. What might a Shareholder Analysis tell you about an Equity deal?

For an existing public company, a Shareholder Analysis lets you compare current institutional investors to ones that the company might target in a new Equity offering.

For example, if one of your client's investors has a low percentage of holdings in the transportation industry, and the company is transportation-related, then your team may want to target this investor in the offering since it may want more exposure to the industry.

You could also use this analysis to find institutional investors with similar industry holdings that have *not* yet invested in your client and target them in the offering.

12. How does a bank add value for a client in an IPO or Follow-On Offering?

The bank adds value for the client by guiding it through the entire process, recommending the terms in an offering (such as the appropriate Offering Price and Pricing Discount), and selling the offering to the right set of investors.

Investment bankers focus on getting the company's "story" right, while the sales team uses its relationships with institutional investors to sell the offering.

In ancient times, banks also used to assume risk in IPOs by buying the company's shares before the company went public and then re-selling them to new investors, but this practice is far less common today.

13. How might you use Comparable Follow-On Issuances in an analysis for an Equity deal?

You'll often look at a set of "Follow-On Comps" to get a sense for the appropriate offering size (as a % of the company's current Market Cap), the Primary vs. Secondary split, the typical Pricing Discount, and the stock-price performance of recent offerings.

For example, if the median Follow-On Offering represented 10% of the company's pre-deal Market Cap, Primary Shares were 35% of the total sold, and the median Pricing Discount was 5%, you might use those terms as well.

You might use the stock-price performance (e.g., did the company's stock price increase by 30% after the offering?) to advise the company on whether or not it's a **good time** to issue Equity.

Return to Top.