**Economics and Business**

**Department of Economics and Finance**

**TITLE**

# A study on the Italian IPO market. Forward-looking information in the IPO prospectus


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**ACADEMIC YEAR 2016/2017**

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# INTRODUCTION

This work is aimed at analyzing the prospectuses of the six Italian IPO firms, which are OVS, INWIT, Poste Italiane, Technogym, Coima Res and ENAV, between 2015 and 2016 listed on the Milan Stock Exchange Ordinary Market (MTA).

In these prospectuses I will focus on the forward-looking information provided in each prospectus. The extent to which firms provide these information is the core of my analysis.

In Chapter I, I will provide some useful definitions on concept that will be needed to understand the IPO process, specifying all the phases that are needed before a company goes public, how is it made and what lies in the middle up to the Initial Public Offering; afterward I will provide some information about the prospectus, how is it filed and what kind of information are included; finally I will specify what are the forward-looking disclosures in the prospectus and the functions that they have with the respective utility.

Chapter II is the analysis of these elements, I will present my sample and variables, the disclosures together with the concerned tables and finally the result of my analysis.

## CHAPTER I

### 1.1- What is an IPO?

Many successful companies, private and / or characterized by the presence in the capital of institutional investors, find themselves at a certain point in their course to assess the hypothesis of listing on the stock exchange. Companies may have a plan for new investments to finance or may want to grow more incisively through acquisitions; or still, members of the founding family or financial associates may seek an opportunity to diversify the investment or to face a generational replacement more easily. Initial Public Offering (IPO) provides an answer to these needs and represents a key choice for the future of the company. For this reason, companies need to carefully consider all aspects of the listing and the implications that listed company status implies on corporate management. An IPO, or initial public offering, is the very first sale of stock issued by a private company to the public. IPOs are often issued by smaller, younger companies seeking capital to expand, but they can also be done by large, privately owned companies looking to become publicly traded. In an IPO, the issuer obtains the assistance of an underwriting firm, which helps determine what type of security to issue, the best offering price, the number of shares to be issued and the time to bring it to market. Before the IPO the company is considered privately held, that is with a relatively small number of shareholders made up of early investors and professional investors. A privately held company has some benefits that are loosed once it goes

public. For example, its owners do not have to disclose much financial or accounting information about the company.
On the other hand, public companies have sold at least a portion of their shares to the public to be traded on the stock exchange. The public instead consists of everybody else, any individual or institutional investor. Public companies have thousands of shareholders and are subject to strict rules and regulations. They must form a board of directors and they must report auditable financial and accounting information every quarter. In addition, public companies must comply with regulations and requirements set forth by the stock exchanges where their shares are listed.
The Stock Exchange represents for companies an important tool to compete also internationally, offering new opportunities for access to risk capital and stimulating a leap in quality management that allows acceleration of development and value creation for its shareholders. Value creation increases the size of the company's capital as an investment.
The greatest value created, to be perceived and measured by the shareholders, must be correctly expressed by the market value of the company.
Both the creation and the spread of the value that are realized are essential, especially thanks to a proper market communication policy.
In general, the listing brings new responsibilities but above all a number of benefits that result in improved efficiency and transparency of the company, involving all aspects of business management in this project. It is important, however, that the company takes into consideration the potentially critical obligations and aspects that quotation may entail. These aspects, which vary according to the circumstances and peculiarities of the involved company, are generally identified in:

- Need to make organizational and management changes in view of the listing: for example, adaptation of information systems, implementation of a consistent management control system, adoption of corporate governance principles, communication policies;
- Sharing strategic choices: some core decisions for the life of a listed company such as capital increase, the offering of new financial instruments, the definition of new stock option plans may require the consent of a large number of actors whose interests, opinions and reactions are still to be kept present even when their approval is not necessary;
- Management of value maximization for shareholders and shareholder participation in company profits: the listing process significantly increases the number of "interest holders" in the company who have full rights to participate in the company's positive results, both through the distribution of dividends and through the increase in the market value of the shares;
- Disclosure transparency: these procedures derive in part from regulatory obligations, and in part are imposed by the need to maintain and strengthen a trust relationship with shareholders, without the need for commercial or industrial information to be disseminated;
- Attention to insider trading activities: in order to ensure investor information parity and to prevent insider trading, companies are required to regularly disseminate to the public, Borsa Italiana and Consob, news on facts suitable for influence the performance of quotes;

- Susceptibility of the bond to market conditions: the value of the security may be affected by the economic downturn in the market as well as by speculative actions, irrespective of the company's management and strategic policies;
- Management time to devote to the listing process: even before selecting the team of consultants who care for the entire operation, the company's management must prepare to invest a significant amount of time and resources in defining a business in advance plan in which the strengths and weaknesses of your company are highlighted. During the entire process, you will need to work with the team of consultants by taking fundamental decisions for the success of the IPO. During and after the listing will also be available to present the company to potential investors and to dialogue with market participants.

The preparation for listing requires the assistance of a team of specialized consultants to which the company has the highest trust and with which to establish a fruitful cooperation.

The sponsor, provided by the Italian Stock Exchange Rules and nominated by the company, is a financial intermediary that assists the company in the conduct of the entire listing process and for a period subsequent to the IPO. It is also guarantor of the quality and investment opportunity market. In most cases, the sponsor also plays the role of Global Coordinator of the Offer, that is committed to placing on the market the securities of the quoted company. Based on the expected size of the placement, the company may also appoint more than one global coordinator. For the centrality of its role during and after the quotation process, the global sponsor / coordinator must be carefully selected.

### 1.2- Phases of an IPO

Board of Directors resolution and appointment of team of consultants: the management submits to the Board of Directors the quotation project accompanied by the feasibility study. After that the Board of Directors has deliberated on the Company's admission to listing, the Ordinary Shareholders' Meeting or, if a capital increase is planned, the Extraordinary Shareholders' Meeting, is convened. Immediately after the resolution of the Shareholders' Meeting, the sponsor, legal adviser, audit firm and other consultants who will follow the company during the listing are appointed.
Meeting for launch of the operation: is the first meeting where the company's management meets with all incoming consultants. During this meeting, they are assigned their respective responsibilities and plan the times of the quotation procedure, identifying the main steps.
Economic, financial and legal due diligence process: the sponsor and the consultants must carry out an in-depth analysis of the company, identifying its critical success factors and all the elements necessary for an assessment of the feasibility of the rating and the value of the securities to be issued.
At this stage, the drafting of the prospectus and the preparation of the documentation concerning the meetings of the BoD and the Assembly are started.
Drafting of the Prospectus: it is the official document for the solicitation of public savings. It is compiled by the sponsor (according to the schemes required by Consob), together with the company's management and legal

advisers, based on the results of the analyzes carried out during the due diligence process and is intended to provide all information regarding the company and the global supply structure. This document contains data on the company's economic and financial condition and its performance; It also describes its position with regard to competition, its management, objectives and strategies.

Other factors that are being analyzed are: labor force, suppliers, customers, creditors, and all contracts, so as to ensure investors that financial reports are accurate and adequate. In addition, there are sections dedicated to the information regarding the solicitation and the financial instruments of the latter.

The final version of the prospectus is deposited with Consob, which will have to release the null and void from its publication.

<u>Admission to listing by Borsa Italiana:</u> within two months from the submission of the application, drawn up in accordance with the specific template contained in the "Instructions to the Regulations", Borsa Italiana resolves and communicates to the issuer the admission or rejection of the application, communicating it to Consob and making the decision public through its own Notice. The effectiveness of the admission measure is valid for six months and is subordinated to the deposit of the listing prospectus with Consob.

<u>Publication and distribution of the title research report to analysts:</u> research is a very important factor in determining the opinion of investors about the company's positioning and assessment. It has the purpose of communicating the investment case of the title and creating momentum during the pre-marketing phase as it provides the analyst with all the elements needed to express his / her judgment. It contains a detailed

analysis of the company and of the business, a presentation of the offer structure, a description of the valuation methodologies used and is the main source of financial forecasts.

Establishment of collocation consortia: the global coordinator, which generally also has the role of sponsor, constitutes a consortium with other banks with the objective of accumulating "statements of interest" by institutions and brokers to determine successively the number final stock and their allocation among investors.

Pre-marketing: the analysts of the settlement consortium banks' informally meet potential investors to present the company and distribute the research they have done in order to form a judgment on a possible pre-pricing price for the IPO.

Additionally, at this stage, investors have the opportunity to manifest their perceptions of negativity and their doubts and to familiarize with the company whilst banks can identify candidates for one-to-one encounters.

Roadshow: aims to increase interest in the company's investment case. The top management of the listed company participates in a series of meetings in major international financial centers, during which it presents itself and key company information to potential investors. A roadshow needs a lot of energy in terms of time that management must be willing to employ.

If well organized, it gives the opportunity to recruit institutional investors even in one-to-one meetings and to express their skills, demonstrating their commitment to maintaining regular contact with the financial community and thus positively influencing the price of the offer, for the benefit of capital collection.

Bookbuilding: Potential institutional investors inform the book runner of the amount of securities they intend to purchase and the price they intend to offer and, based on the orders collected, the price and quantity of the offer of the placement is fixed.

The mechanism of bookbuilding allows to determine the highest price at which securities can be placed on institutional investors.

<u>Price fixing</u> usually takes place in two phases:

1. The Shareholders' Meeting approving the capital increase sets a sufficiently wide preliminary pricing gap to take into account any changes in market conditions.

   This preliminary interval may be restricted by the Board of Directors in close proximity to the launch of the operation.
2. According to the results of the bookbuilding, the placement price is determined for the launch of the OPV(S), in case of fixed price public offer, or the maximum price is found in case of the public offer at a price open.

OPV(S) Public Sale Offer (and / or Subscription): shares are assigned to the members of the placement consortium who will handle the offer to the indistinct public whose duration is at least two days. Within 5 days of the end of the public offer, payment and delivery of the shares must be made through the deposit at Monte Titoli.

<u>Start of negotiations and stabilization:</u> during the first day of official trading, the market price of the stock is determined, which is an important signal of the operators’ interest in the company.

After the first quotation day, there is often a period of stabilization of the stock price, usually 30 days, during which the consortium reserves the right to intervene in the financial market to support its performance.

## 1.3- The prospectus

Specifically, as also stated above, a prospectus is a formal legal document that is required by and filed with the Securities and Exchange Commission that provides details about an investment offering for sale to the public. The preliminary prospectus is the first offering document provide by a security issuer and includes most of the details of the business and transaction in question; the final prospectus, containing finalized background information including such details as the exact number of shares/certificates issued at the precise offering price, is printed after the deal has been made effective. In case of mutual funds, a fund prospectus contains details on its objectives, investment strategies, risk, performance, distribution policy, fees and expenses, and fund management.

A prospectus includes the name of the company issuing the sock or the mutual fund manager, the amount and type of securities being sold and, for stock offerings, the number of available shares. The prospectus also details whether an offering is public or private, how much the underwriters are earning per sale and names of the company's principals. A brief summary of the company's financial information, whether the SEC approved the prospectus and other pertinent information is included as well.

A prospectus is issued as a way of informing investors about the risks involved with investing in a stock or mutual fund. Risk are typically disclosed early in the prospectus and described in more detail later.

The information also guards the issuing company against claims that pertinent information was not fully detailed before the investor put money into a security.
The content of the prospectus is specified in the regulations, which state that it must provide information on the offering itself, a brief history of the firm's business, information and a discussion on its past financial performance, a description of the actual and expected ownership structure and the risks associated with the investment. Finally, it must present the actual and future business model with its strengths and weaknesses, the intended use of newly raised funds and detailed information on the firm's subsidiaries and controlling shareholders.
One figure that attracts special attention is the management earnings forecast. Investors assess the accuracy of the earnings forecasts, as they can serve as a performance indicator of the newly-listed firm. Accuracy in future earnings forecasts is difficult to achieve, as there are many unpredictable events that can take place between the forecast day and the day of the official announcement of actual earnings.

## 1.4- Forward-looking information in the prospectus

Forward looking disclosure (narrative forward-looking information and managerial forecast) represent one of the most direct ways for managers to communicate their private information on the firm's outlook and future prospects. Such a disclosure has the potential to help investors value the company, decide whether or not to subscribe the new issue, contain information asymmetries and reduce the amount of "money left on the table". The Consob, (Italian security market Commission) allows issuers to include forward-looking disclosure in their prospectuses, on a voluntary basis, making the prospectus a potential useful tool for mitigating the ex-ante uncertainty. Forward-looking disclosure has been found to mitigate the information asymmetry problem in that it provides investors with narrative forward-looking information, the firm's strategies, plans activities and operations, as well as assumptions on which managerial forecasts are based, together with managerial forecasts, based on the managers' expectations concerning the firm's operational activities, investment and growth options. Forward-looking statements are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not guarantees of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Although forward-looking statements contained in this sample of prospectuses are based upon what management of the companies believes are reasonable assumptions, there can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements.

A forward-looking statement is defined as:

A. A statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;

B. A statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;

C. A statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;

D. Any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

E. Any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

F. A statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

# CHAPTER II

## 2.1- Sample and variables

My sample comprises 6 IPO firms listed on the Milan Stock Exchange Ordinary Market (MTA) between January 2015 and December 2016. The firms I considered are OVS, INWIT, Poste Italiane, Technogym, Coima Res and ENAV.  MTA is the market that welcomes quotations of listed companies consolidated in their respective markets and with good profitability. Generally, they are companies operating in traditional sectors, that have a consolidated market share, a long track record of positive economic and financial results.

Data on the offering and shares allocation are hand-collected from each prospectus and from Borsa Italiana, the management body of the Italian Stock Exchange. After a specific analysis made by reading all the prospectuses in question, collecting  all the forward looking information, I do insert my data on Excel to find out my values for the estimations and then I construct the tables that I insert at the end of my work. I will provide some examples of forward-looking information on which I rely on in making my research.

## 2.2- Disclosure

I examine the extent of narrative forward-looking information and the precision of managerial forecasts in the prospectus. I consider narrative forward-looking information as defined by the Accounting Standard Board (ASB, 2005) and the Canadian Institute of Chartered Accountants (CICA, 2001), and the managerial forecasts as defined by the Institute of Chartered Accountants in England and Wales (ICAEW, 2003). The ASB defines narrative forward-looking information as trends and factors relevant to the assessment of the current and future performance of the business and the progress towards the achievement of long-term business objectives (ASB, 2005). Forward-looking performance disclosure refers to information on current plans and forecasts that enable shareholders, investors and financial analysts to assess a company's future financial performance. This information regards: (1) future events, decisions, opportunities and risks that are likely to affect future results; (2) vision, strategies and objectives expressed by the management; (3) explanation of past events, decisions, facts and results that can have a significant impact on future results (CICA, 2001). ICAEW defines prospective financial information as information that comprises primary financial statements and elements, extracts and summaries of such statements and related disclosures drawn up to a date, or for a period, in the future. This definition includes the forward-looking equivalent of any information that might subsequently be prepared as historical financial information. I consider these prospective financial details as managerial forecasts (ICAEW, 2002).

Each sentence in the prospectus is coded as *no information* when it is not forward-looking according to the ASB and CICA criteria. When the sentence contains forward-looking information, it is classified in one of the following categories: strategy (STRATEGY), industry (INDUSTRY), new products (PRODUCTS), and research and development activities (R&D). Each sentence is then attributed a score of 0 when it provides no forward-looking information, or 1 when it contains forward-looking information. Each firm is awarded an overall score for its narrative forward-looking information, which measures the number of forward-looking sentences in its prospectus.

In addition to narrative forward-looking information, an IPO firm can provide managerial forecasts (financial forward-looking information). Following Baginski and Hassel (1997), we use a coding scheme that awards the highest value to the most precise forecasts; we score point forecasts, closed-range forecasts, open-range forecasts, and general impressions as 4, 3, 2 and 1 respectively. I calculate the precision of managerial forecasts in relation to sales (SALES), EBIT (EBIT), and EPS (EPS). We also investigate whether an IPO firm can mitigate the cost of information asymmetry by providing disaggregate forecasts. Following Hirst et al. (2007), we consider cases in which an IPO firm provides forecasts of the bottom-line net income numbers (EPS equals 3 or 4) together with forecasts with multiple income statement lines (SALES equals 3 or 4; EBIT equals 3 or 4) as disaggregate earnings forecasts (DISAGGREGATE), as opposed to aggregate earnings forecasts (AGGREGATE) when the firm only provides a forecast of the bottom-line net income number (EPS equals 3 or 4). To summarize, the dummy variable DISAGGREGATE assumes the value of 1 when EPS, SALES, and EBIT are all 3 or 4, while the dummy variable AGGREGATE assumes the value of 1 when only EPS is 3 or 4.

INSERT TABLE 1

**2.3- Results**

Descriptive statistics on narrative forward-looking disclosures and managerial forecasts are given in table 2. The mean quantity of forward-looking information disclosed (NARR_FLI) is 3,83.

The narrative forward-looking variable is obtained by summing the extent of disclosure on strategy (STRATEGY), industry (INDUSTRY), new products (NEW_PRODUCT) and R&D activities (R&D). I should say that, on average, prospectuses contain sentences describing the firm's future prospects, and merger and acquisition plans (STRATEGY). Information is also provided on industry trends and expectations (INDUSTRY: 1), the development of new products (NEW_PRODUCT 1), and research and development activities (R&D: 0.83).

To have a better idea of what these statements are and how they look like, I will list here some statements taken from the prospectuses.

Let's see a statement concerning STRATEGY. In the prospectus of Poste italiane we can read a statement like this:

"The Group's strategy is based on (i) transforming and improving the traditional correspondence and parcels industry, (ii) on innovation and expanding the range of financial and insurance services that are characterized by greater profitability, but also by a higher risk component and (iii) on human capital investments and sales channels". This allows me to assign a score of 1 for the strategy forward-looking information of this prospectus, and I had to search that kind of statement in each and every prospectus I decide to analyze.

To see what does it mean NEW PRODUCT concerning forward-looking information I choose the prospectus od INWIT. It discloses:

“The Management of the Company intends to further enhance its sites by expanding its portfolio of services through the implementation of the latest generation infrastructure, and in particular: i) Infrastructures and services to provide adequate radio coverage in areas with increased access density and traffic, the so-called small cells; (ii) hospitality services of technologies related to the development of smart cities and, in particular, the Internet of Things; (iii) "turnkey" implementation of radio systems for smaller operators requiring advanced design and implementation capabilities.
Management, among other things, believes that it can seize the opportunities associated with the demand for new Sites expected during the years covered by the Plan due to multiple factors of various kinds, such as: i) completion of network covers 4G by the operators, in accordance with the commitments imposed on frequency assignment contracts and demand growth; (ii) the process of deconstruction of the infrastructure that is involved with the main network operators; iii) the development objectives of the so-called. "Ultra-wideband" recently defined by the Italian Government, which play a major role in radio-cell technology in areas with lower housing density”.

Some IPO firms should give point or range forecasts of the bottom-line net income number together with multiple income statement lines forecasts (DISAGGREGATE) while others IPO firms should have provided point or range forecasts of net earnings alone (AGGREGATE). The scarcely litigious Italian environment might be expected to encourage the voluntary disclosure of managerial forecasts, but this is not the case of my sample, because I didn’t find out managerial forecasts in my prospectuses sample.

This is true for all the types of forecasts considered (SALES, EBIT, and EPS), meaning that IPO firms do not disclose their performance targets.

# CONCLUSIONS

The main purpose of this thesis is to investigate on forward-looking disclosures (narrative forward-looking information and managerial forecasts) in the prospectus. From my analysis, I can say that Italian IPO firms tend to disclose, in a very precise manner, narrative forward-looking information, and this is common for every prospectus I do analyze. They very well explain their investment plans, their strategy is very clear and their research and development activities are very well explained and described. Unfortunately, I can't say the same for what concerns the managerial forecasts that are completely not disclosed in all the prospectus. I can only base my idea on actual results, ex post, without having the possibility to rely on and compare them to forward-looking information.

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| Variable | Definition |
|---|---|
| | |
| STRATEGY | Extent of narrative forward-looking disclosure on firm's strategy |
| INDUSTRY | Extent of narrative forward-looking disclosure on industry trends and regulations |
| NEW_PRODUCT | Extent of narrative forward-lookig disclosure on firm's new products |
| R&D | Extent of narrative forward-llоking disclosure on firm's research and development activities |
| | |
| NARR_FLI | Extent of forward-looking disclosure on: strategy, industry, new products, R&D activities |
| LN_NARR | Logarithm (NARR_FLI) |
| | |
| SALES | Precision of SALES: the score is 4 if SALES is disclosed as a point estimate; 3 if it is a closed-range estimate; 2 if it is an open-range estimate; 1 if it is a qualitative estimate. |
| EBIT | Precision of EBIT: the score is 4 if EBIT is disclosed as a point estimate; 3 if it is a closed-range estimate; 2 if it is an open-range estimate; 1 if it is a qualitative estimate. |
| EPS | Precision of EPS: the score is 4 if EPS is disclosed as a point estimate; 3 if it is a closed-range estimate; 2 if it is an open-range estimate; 1 if it is a qualitative estimate. |
| DISAGGREGATE | Dummy = 1 if EPS, SALES, and EBIT are disclosed as point or closed-range estimates, 0 otherwise. |
| AGGREGATE | Dummy = 1 if only EPS is disclosed as point or closed-range estimate, 0 otherwise. |

**Table 1. Variable definition**

Table 2. Descriptive statistics on narrative forward-looking disclosures

| Variable | Obs | Mean | St. Dev. | 1% | 25% | 50% | 75% | 99% |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |
| *Narrative forward-looking information* | | | | | | | | |
| NARR_FLI | 6 | 3,83333333 | 0,40824829 | 3,05 | 4 | 4 | 4 | 4 |
| STRATEGY | 6 | 1 | 0 | 1 | 1 | 0,60205999 | 0,60205999 | 0,60205999 |
| INDUSTRY | 6 | 1 | 0 | 1 | 1 | 1 | 1 | 1 |
| NEW_PRODUCT | 6 | 1 | 0 | 1 | 1 | 1 | 1 | 1 |
| R&D | 6 | 0,83333333 | 0,40824829 | 0,05 | 1 | 1 | 1 | 1 |