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Facebook’s Faceplant

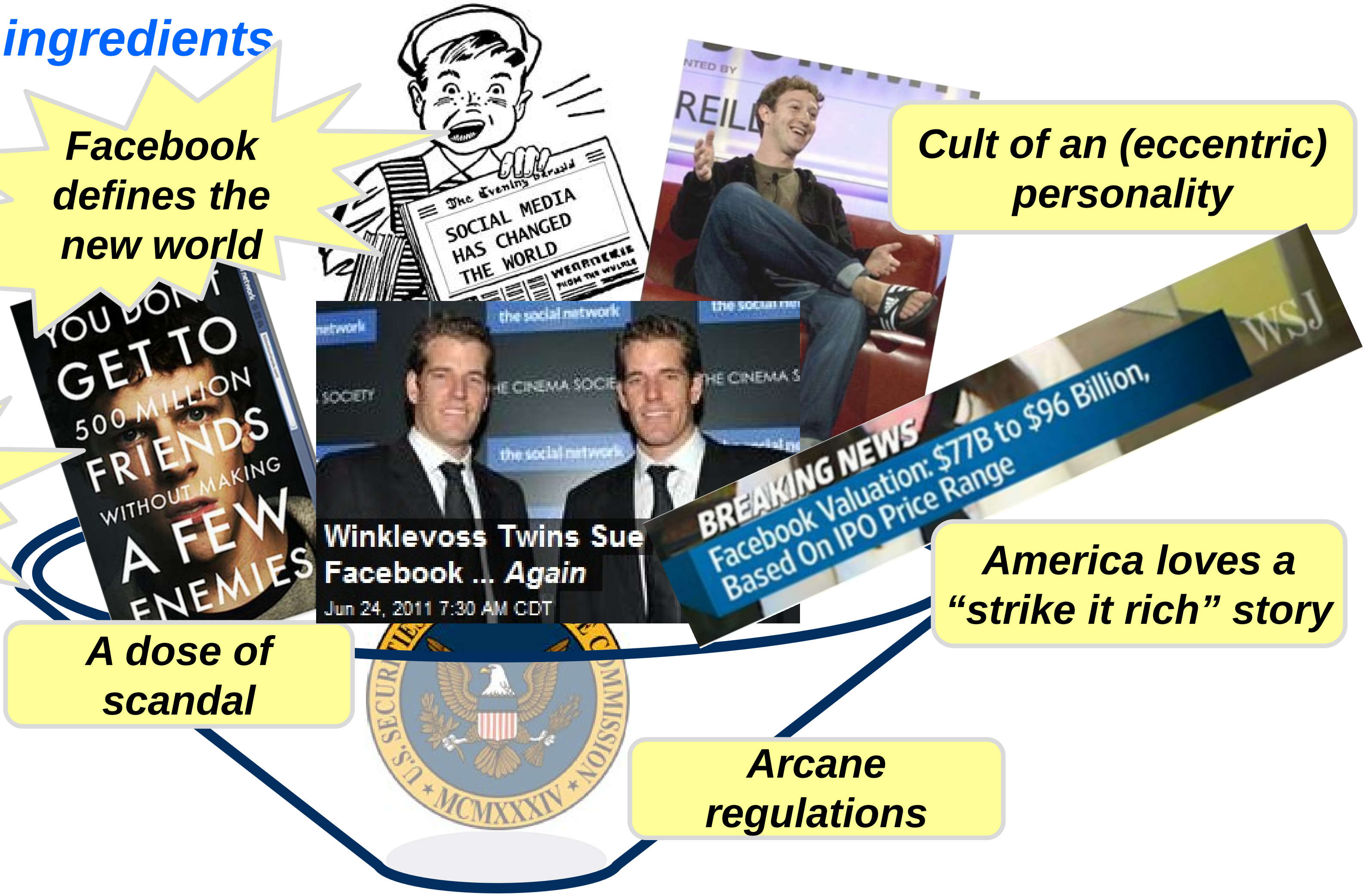
What Went Wrong?
How Do We Fix It?

Ward Greenberg

Frankfurt am Main, July 8, 2013

At its heart, this is a story about *hype*

Put all these ingredients together…



Facebook defines the new world

Cult of an (eccentric) personality

A major motion picture

A dose of scandal

America loves a "strike it rich" story

Arcane regulations

… and something is bound to blow up

Everyone on and off Wall Street wanted a piece of the action…

DealBook ANDREW ROSS SORKIN EDITOR-AT-LARGE

MERGERS & ACQUISITIONS | INVESTMENT BANKING | PRIVATE EQUITY | HEDGE FUNDS | I.

I.P.O./OFFERINGS | MAY 3, 2012, 9:04 PM | 65 Comments

Small Investors May Get to Own a Bit of Facebook

BY SUSANNE CRAIG AND EVELYN M. RUSLI

Steve Ruark for The New York Times

Joseph Quigley, a 32-year-old insurance sales manager, would like to buy Facebook shares.

Facebook, which plans to make a market debut this month that could value it at $86 billion, is the stock that everyone seems to want.

Facebook Gets $500 Million Investment From Goldman

By Antonio Perez
Epoch Times Staff

Created: January 3, 2011
Last Updated: January 3, 2011

Related articles: Business » Economy & Trade

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Facebook received a $500 million investment from Goldman Sachs this week. (Leon Neal/AFP/Getty Images)

NEW YORK—Leading online social networking website Facebook Inc. has received a $500 million investment from investment bank Goldman Sachs Group Inc. and a Russian investor.

The capital infusion assumes a valuation of $50 billion for Facebook, the social networking site with 500 million users worldwide, which last month became the most-visited website in the United States.

Goldman, the New York-based bank, invested $450 million, while Russia's Digital Sky Technologies contributed $50 million in cash,

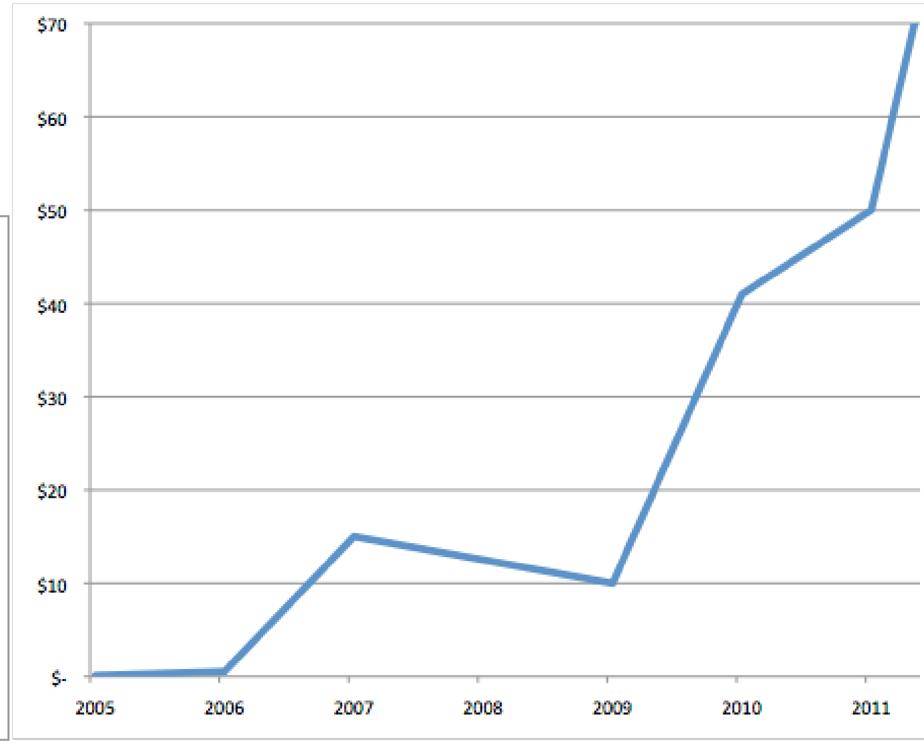
Everyone on and off Wall Street wanted a piece of the action…

the Atlantic **wire**
what matters now

POLITICS | BUSINESS | ENTERTAINMENT | TECHNOLOGY | NATIONAL | GLO

As Facebook Value Soars, Early Investors Seek to Cash Out

"No one questions Facebook's explosive popularity, which boasts over 600 million members and more page views than Google. But will it be able to monetize its traffic as effectively as Google? Up until now valuations of the company have only risen sharply. Here's how far the company has come in the last 6 years. In 2005 Facebook raised $12.7 million from Accel Partners in a valuation rumored at $100 million. In 2006 $27.5 million from Greylock Partners and Meritech Capital gave it a $525 million valuation. In 2007, Microsoft got the ball rolling with a $240 million investment into Facebook valuing it at $15 billion. In 2009 Digital Sky Technologies put a slight dent in the company's valuation, investing $200 million at a valuation of $10 billion. In 2010, Facebook was trading at more than $16 per share on SecondMarket, pegging its estimated value at $41 billion, making it the third biggest web company. In January 2011, a $500 million investment from Goldman Sachs and Digital Sky Technologies valued the company at $50 billion. Not too shabby for a company that hauled $355 million in net income in the last nine months on revenue of $1.2 billion."



… and the valuations went up and up

Everyone on and off Wall Street wanted a piece of the action…

VENTURE CAPITAL | JANUARY 2, 2011, 11:31 PM | 378 Comments

Goldman Offering Clients a Chance to Invest in Facebook

BY SUSANNE CRAIG AND ANDREW ROSS SORKIN

12:42 p.m. | Updated

Tony Avelar/Bloomberg News

The deal could double the personal fortune of Mark Zuckerberg, Facebook's co-founder.

Goldman Sachs has reached out to its wealthy private clients, offering them a chance to invest in Facebook, the hot social networking giant that is considering a possible public offering in 2012, according to people familiar with the matter.

On Sunday night, a number of Goldman clients received an email from their Goldman broker, offering them the opportunity to invest in an unnamed "private company that is considering a transaction to raise additional capital." Another person briefed on the deal said that Goldman clients would have to pony up a minimum of $2 million to invest and would be prohibited from selling their shares until 2013.

… but the initial plan was to keep it private

The SEC disagreed

Goldman Sachs `Blindsided' As Facebook Hype Derails Private U.S. Offering

By Christine Harper - Jan 18, 2011 4:50 AM GMT+0100

0 COMMENTS QUEUE

Goldman Sachs Group Inc.'s decision to scuttle a sale of Facebook Inc. shares to U.S. investors shows the bank miscalculated by trying to privately offer stock in a company with more than 600 million users.

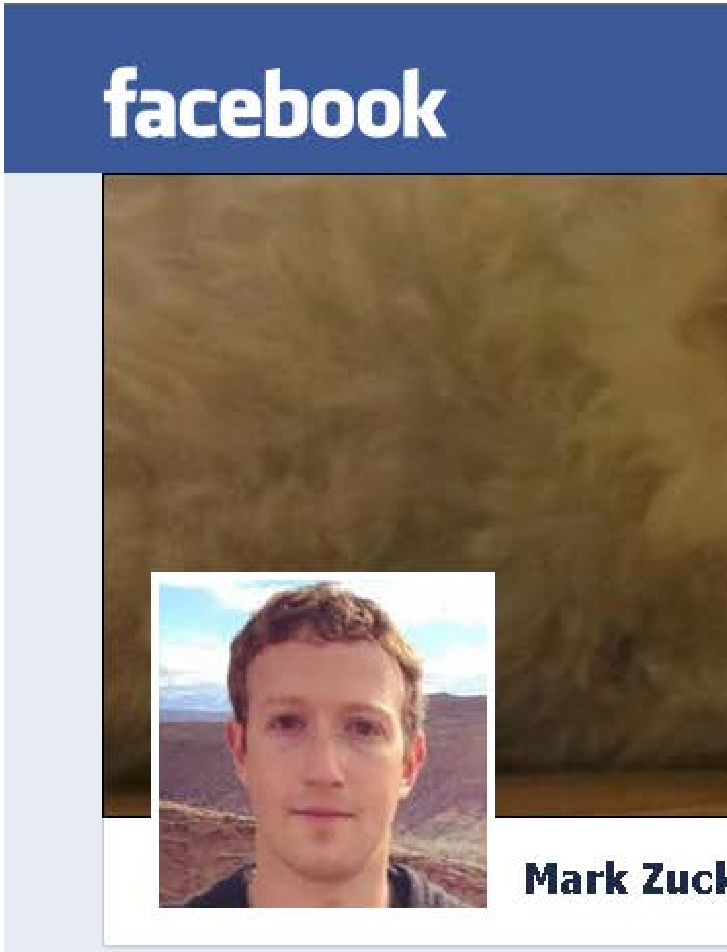
In a statement yesterday, New York-based Goldman Sachs said the sale, first reported Jan. 2, will be restricted to non-U.S. investors because "the level of media attention might not be consistent with the proper completion of a U.S. private placement under U.S. law." The firm planned to sell as much as $1.5 billion of closely held Facebook to clients of its private wealth unit.

Rule 502(c): Limitation on manner of offering. … [N]either the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising….

The SEC disagreed

- Section 12(g) of the Securities Exchange Act of 1934 required a company to register its securities with the SEC if it has assets exceeding $1million and a class of equity held of record by 500 or more persons
- Counting rules: "holders of record", not "beneficial owners"
- But you can't evade the rule – SEC apparently thought Goldman Sachs' $400 million deal via an SPV in January 2011 might be a circumvention
- Facebook agreed to register with the SEC by the time the rule would apply
- The JOBS Act increased the holder limits to 2,000

Against all this hype, Zuckerberg said he didn't want an IPO



"I tend to think that being private is better for us right now because of some of the big risks we want to take in developing new products. For example, products like News Feed, Platform, Connect and so on were all fairly controversial early on but have proven to be valuable services. The experience of managing the company through launching controversial services is tricky, but I can only imagine it would be even more difficult if we had a public stock price bouncing around. There are a lot more new things left to build like the examples I mentioned above, and I'd rather focus on building them than on going public right now."

http://nymag.com/daily/intel/2012/05/mark-zuckerbergs-nightmare-comes-to-life.html

… The SEC made me do it

Were the issues hidden in plain sight?

BUSINESS INSIDER
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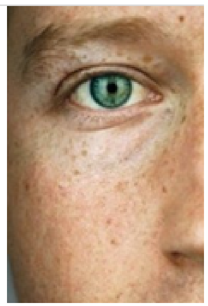
Facebook's Value Blows Through $100 Billion In Last Trade Before IPO

Henry Blodget | March 31, 2012 | 7,527 | 20

Recommend 0 | +1 6 | Email



Facebook was just valued at ~$103 billion in a final private-market trade before the IPO.

The stock sold on SharesPost at a value of $44.10 per share. Using the 2.33 billion fully diluted outstanding share count cited in Facebook's IPO prospectus, that equates to a value of just under $103 billion.

That's a lot.

It's 103X Facebook's earnings last year, which were $1 billion.

It's about 70X this year's estimated earnings of $1.5 billion (my estimate).

It's about 50X next year's estimated earnings of $2.25 billion (my estimate).

To put those multiples in perspective...

Google, another big, hot tech company, trades at about 22X last year's earnings, 18X th earnings, and 15X next year's earnings.

Timeline of a disaster

July 3, 2013
Facebook closes at $24.52 per share
Like · Comment

May 18, 2012
Trading opens at $42; major technical issues at NASDAQ delay trades; share closes at $38.23
Like · Comment

May 17, 2012
Pricing of IPO at $38 per share
Like · Comment

May 15, 2012
Facebook increases the IPO price range to $34 to $38 per share
Like · Comment

May 7 – 15, 2012
During the roadshow, analysts at the three lead underwriters (Morgan Stanley, Goldman Sachs and JP Morgan) as well as Bank of America reduced their internal revenue forecasts
Like · Comment

May 7, 2012
Roadshow starts
Like · Comment

April 23, 2012
Facebook amends S-1 to note fall in Q1 net profits due to higher expenses
Like · Comment

September 4, 2012
Shares close at all-time low of $17.73
Like · Comment

May 22, 2012
Shares close at $31.00
Like · Comment

May 16, 2012
Facebook increases the number of shares being offered by 84 million to more than 421 million
Like · Comment

May 9 – May 11, 2012
Syndicate analysts call selected accounts to advise them of reduction in revenue projections (dates uncertain)
Like · Comment

May 9, 2012
Facebook amends S-1 with expression of caution about revenue growth due to rapid shift to accessing Facebook over mobile devices
Like · Comment

May 3, 2012
Facebook sets price range of $28 to $35
Like · Comment

February 1, 2012
Facebook files for IPO with SEC (Form S-1)
Like · Comment

The underlying issue was easy to understand…

VS.

…and was disclosed in principle

Amendment No. 5 to Registration Statement on Form S-1

Text as of May 3, 2012

would negatively affect our revenue and financial results.

Growth in use of Facebook through our mobile products, where our ability to monetize is unproven, as a substitute for use on personal computers may negatively affect our revenue and financial results.

We had 488 million MAUs who used Facebook mobile products in March 2012. While most of our mobile users also access Facebook through personal computers, we anticipate that the rate of growth in mobile usage will exceed the growth in usage through personal computers for the foreseeable future, in part due to our focus on developing mobile products to encourage mobile usage of Facebook. We have historically not shown ads to users accessing Facebook through mobile apps or our mobile website. In March 2012, we began to include sponsored stories in users' mobile News Feeds. However, we do not currently directly generate any meaningful revenue from the use of Facebook mobile products, and our ability to do so successfully is unproven. Accordingly, if users increasingly access Facebook mobile products as a substitute for access through personal computers, and if we are unable to successfully implement monetization strategies for our mobile users, or if we incur excessive expenses in this effort, our financial performance and ability to grow revenue would be negatively affected.

Amendment No. 6 to Registration Statement on Form S-1

Changed on May 9, 2012

would negatively affect our revenue and financial results.

Growth in use of Facebook through our mobile products, where our ability to monetize is unproven, as a substitute for use on personal computers may negatively affect our revenue and financial results.

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…and was disclosed in principle

Redline

Amendment No. ~~5~~6 to Registration Statement on Form S-1

Growth in use of Facebook through our mobile products, where our ability to monetize is unproven, as a substitute for use on personal computers may negatively affect our revenue and financial results.

We had 488 million MAUs who used Facebook mobile products in March 2012. While most of our mobile users also access Facebook through personal computers, we anticipate that the rate of growth in mobile usage will exceed the growth in usage through personal computers for the foreseeable future, in part due to our focus on developing mobile products to encourage mobile usage of Facebook. We have historically not shown ads to users accessing Facebook through mobile apps or our mobile website. In March 2012, we began to include sponsored stories in users' mobile News Feeds. However, we do not currently directly generate any meaningful revenue from the use of Facebook mobile products, and our ability to do so successfully is unproven. ~~Accordingly, if~~We believe this increased usage of Facebook on mobile devices has contributed to the recent trend of our daily active users (DAUs) increasing more rapidly than the increase in the number of ads delivered. If users increasingly access Facebook mobile products as a substitute for access through personal computers, and if we are unable to successfully implement monetization strategies for our mobile users, or if we incur excessive expenses in this effort, our financial performance and ability to grow revenue would be negatively affected.

Let's get behind this change.

Facebook's communications with analysts

CFO – David Ebermann

April 16 – Analyst presentation

Second quarter 2012 revenue estimate

$1.1 to 1.2 billion

Full year revenue estimate for 2012

$5 billion

May 7 – Roadshow began

CFO privately expressed doubt on these estimates due to recent start of mobile ads and limited ads per page

Facebook's communications with analysts

CFO – David Ebermann

May 7 – Revised estimates becoming clear

Second quarter 2012 revenue:

"low end of the $1.1 to $1.2 billion range"

Full year revenues

3% to 3.5% lower than previously forecast $5 billion

May 8 – Roadshow continues

Solution found: "…[U]pdate analyst guidance without creating the appearance of not providing the underlying trend information to all investors and that solution could be filing an amendment to the S-1 with the updated Q2 trend information and after that speaking to analysts to offer them updated guidance based on that public filing"

Facebook's communications with analysts

Treasurer – Cipora Hermann

May 9

Treasurer calls to analysts
Amendment to S-1 filed

May 10 and May 15

Further calls

Treasurer's script for calls:

I wanted to make sure you saw the disclosure we made in our amended filing. The upshot of this is that we believe we are going to come in the lower end of our $1.1 to $1.2 bn range for Q2 based upon the trends we described in the disclosure. A lot of investors have been focused on whether the trend of ad impressions per user declining (primarily as a result of mobile) was a one-time, or continuing, occurrence. As you can see from our disclosure, the trend is continuing. **You can decide what you want to do with your estimates, our long term conviction is unchanged, but in the near term we see these trends continuing, hence our being at the low end of the $1,100 + $1,200 range.**

These calls led to revised estimates

BUSINESS INSIDER
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Analyst Cuts Facebook Estimates – That Company Is NOT Worth $100 Billion

Nicholas Carlson | Apr. 26, 2012, 9:36 AM | 2,921 | 15

Second quarter 2012 revenue estimates

Morgan Stanley	Bank of America	J.P.Morgan	Goldman Sachs
$ 1.175 bln	$ 1.166 bln	$ 1.182 bln	$ 1.207 bln
- 5.44%	- 5.66%	- 7.27%	- 6.79%
$ 1.111 bln	$ 1.100 bln	$ 1.096 bln	$ 1.125 bln

Full year revenue estimates for 2012

Morgan Stanley	Bank of America	J.P.Morgan	Goldman Sachs
$5.036 bln	$ 5.040 bln	$ 5.044 bln	$ 5.169 bln
- 3.61%	- 4.46%	- 4.06%	- 6.13%
$ 4.854 bln	$ 4.815 bln	$ 4.839 bln	$ 4.852 bln

These calls led to revised estimates

2013 EPS Estimates

Morgan Stanley	Bank of America	J.P.Morgan	Goldman Sachs
88 cents	66 cents	70 cents	68 cents
- 5.68%	**- 3.03%**	**- 4.28%**	**- 7.35%**
83 cents	64 cents	66 cents	63 cents

Means of Dissemination

- Phone calls and conference calls with big investors
- Communications within investment banks to sales forces

No reference to guidance or the figures in any public document

Facebook's opening day woes were exacerbated by NASDAQ's mess

- **Delayed start of trading at 11:30 am**
- **Computers kept adjusting order prices**
- **Some orders not executed**
- **Some orders executed at other prices**
- **Confirmations not sent**
- **1:50 pm: Sell order of 11 million shares due not to a mystery seller, but to the order backlog**
- **Nasdaq: We were unprepared for increasing numbers of cancellations in the hours before the start of trading**

Class actions lawsuits were filed in no time flat, and investigations began

- Numerous "copycat" actions filed
- Allege material misstatements and omissions – relating to mobile daily active users (DAUs) increasing – more quickly than anticipated, more quickly than delivery – due to mobile device use
- Argument: Cautionary language and warnings in the prospectus were untrue because Facebook at time of IPO was experiencing a "severe and pronounced reduction in revenue growth" due to increase of users via mobile devices
- Argument: Company told underwriters to materially lower their revenue forecasts for 2012
- Argument: Non-disclosure that some analysts reduced performance estimates during the roadshow (selective disclosure)
- Against Nasdaq: Essentially negligence (few substantiated allegations)

NASDAQ Nasdaq paid $10 million to settle SEC allegations of securities law violations due to "poor systems and decision-making"

The political side heated up as well

The chairman of the Senate Banking Committee, Sen. Tim Johnson, D-S.D., said late Wednesday that his panel wants to learn more about the social network's initial offering

Senator Tim Johnson
1,390 likes · 29 talking about this

Mary Schapiro

"I think there is a lot of reason to have confidence in our markets and in the integrity of how they operate, but there are issues that we need to look at specifically with respect to Facebook" – SEC Chairman Mary Schapiro

Jeff Emerson

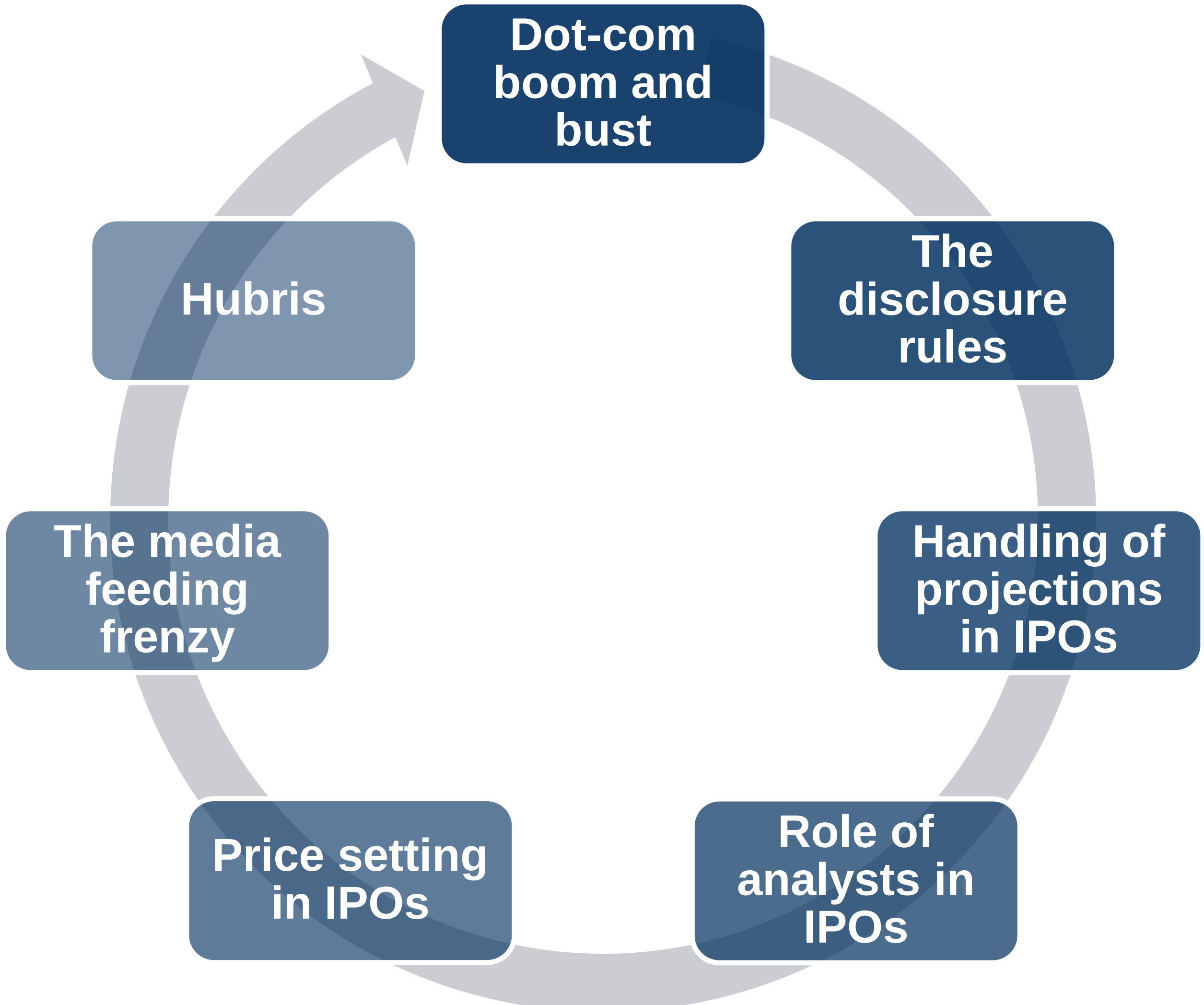
Deputy Chief of Staff - Communications at House Financial Services Committee

House Financial Service Committee spokesman Jeff Emerson said the committee is "gathering information and facts" about the circumstances surrounding the Facebook offering

Sen. Sherrod Brown, D-Ohio, a senior member of the Senate banking panel, said well-functioning securities markets "require transparency and accountability, not one set of rules for insiders and another for the rest of us." "We know that the (Securities and Exchange Commission) must fully investigate and take appropriate action if it discovers any violations," Brown said in a statement

Sherrod Brown
49,807 likes · 7,774 talking about this

That's what happened. Why did it happen?



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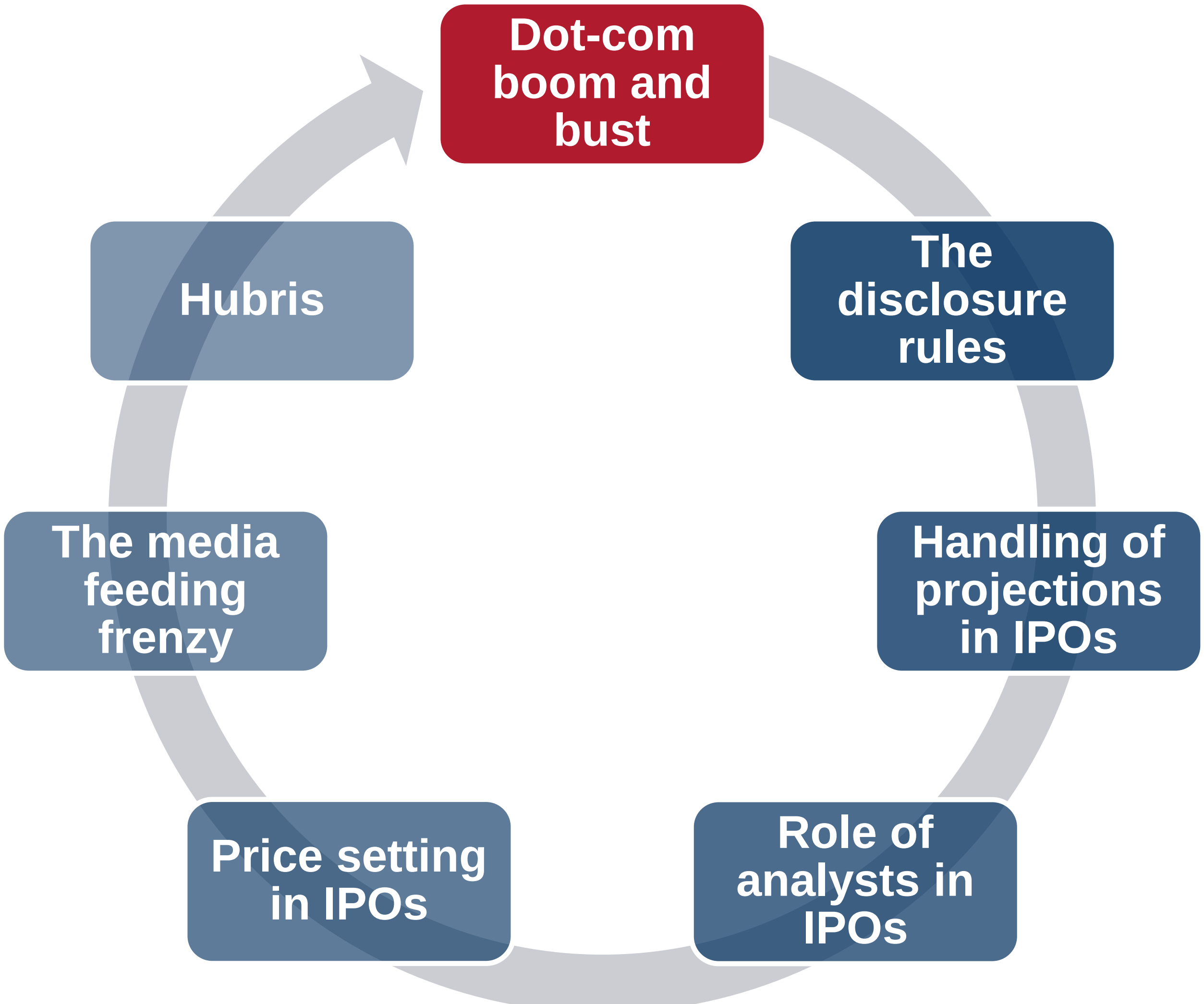
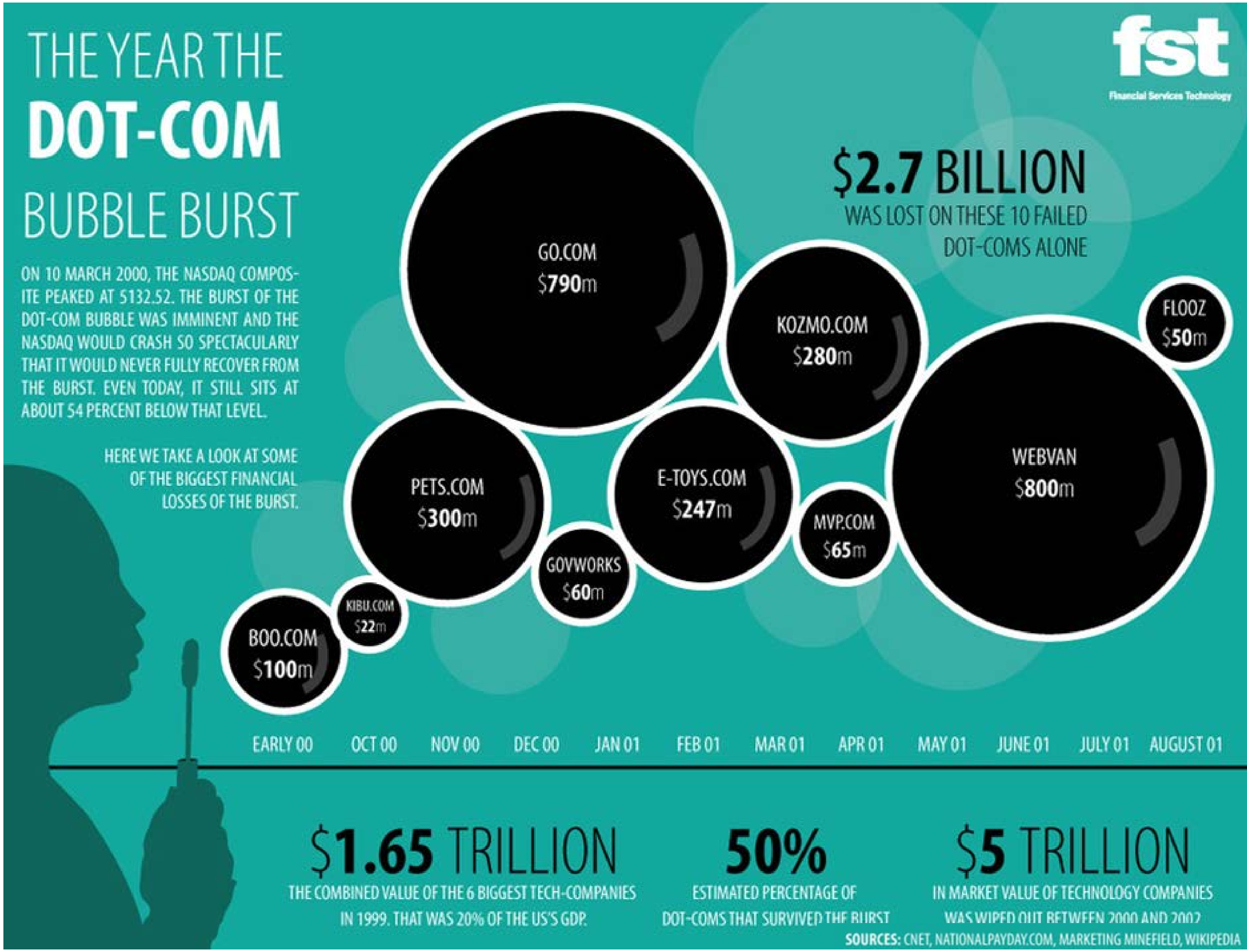


The dot.com boom and bust is all too recent

- Valuations multiplied as soon as you added ".com" – and then vanished in the absence of sustainable business plans
- Scholars, pundits and others are still looking for the culprits
- Blame can be placed on the banks, the regulators, the analysts, the dot.com entrepreneurs – and investors



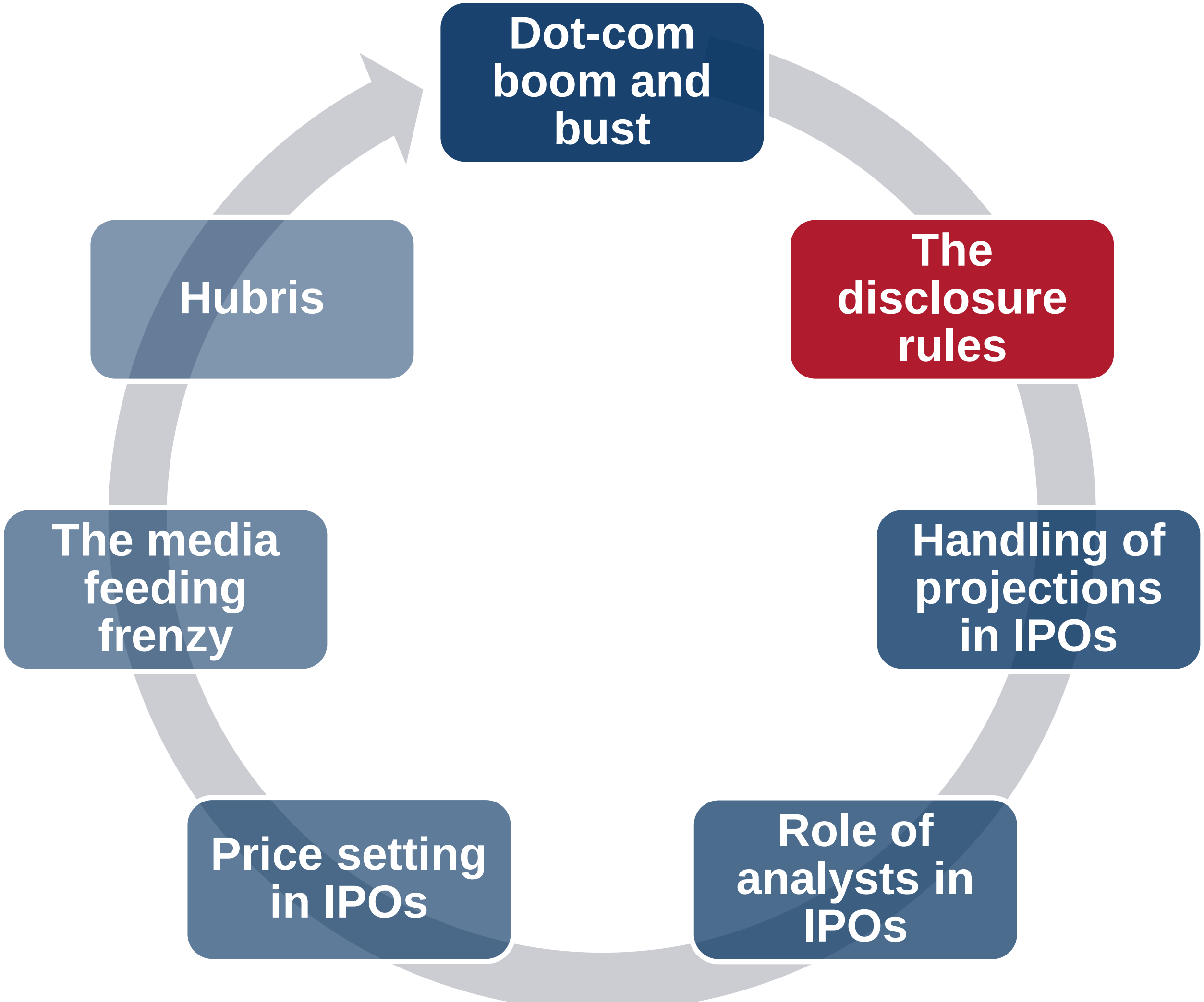
The dot.com boom and bust is all too recent

- Investors always want to find the next sure thing
- Maybe Facebook, Groupon and other recent deals would be “it”
- But maybe capitalism works:
  - There were untold numbers of startups in a rapidly developing field
  - Economic Darwinism says, only the strongest survive: Amazon, Google, E-bay, Apple and yes, Facebook

The dot.com boom and bust is all too recent

Maybe Facebook is just fine.

That's what happened. Why did it happen?



IPO disclosure: Multiple purposes, multiple masters

- In US public offerings, disclosure must be made in a prospectus containing all information material to an investment decision
- If it contains material misstatements or omissions, and investors lose money, the issuer is “strictly liable” and the other offering participants share liability unless they undertook a reasonable investigation
- In the US, the class action device makes litigation a disaster and a costly settlement rather likely unless the claim is obviously meritless
- Elsewhere prospectus liability claims can also be expensive, and reputations can suffer
- Result: Cautionary statements, and lengthy discussions of the risks
- **But** the prospectus is supposed to be a marketing document too
- Leads to: Risk language tries to stay general, avoid getting too specific

The IPO Prospectus

Disclosure Rules

Investment Case

Factual Introduction

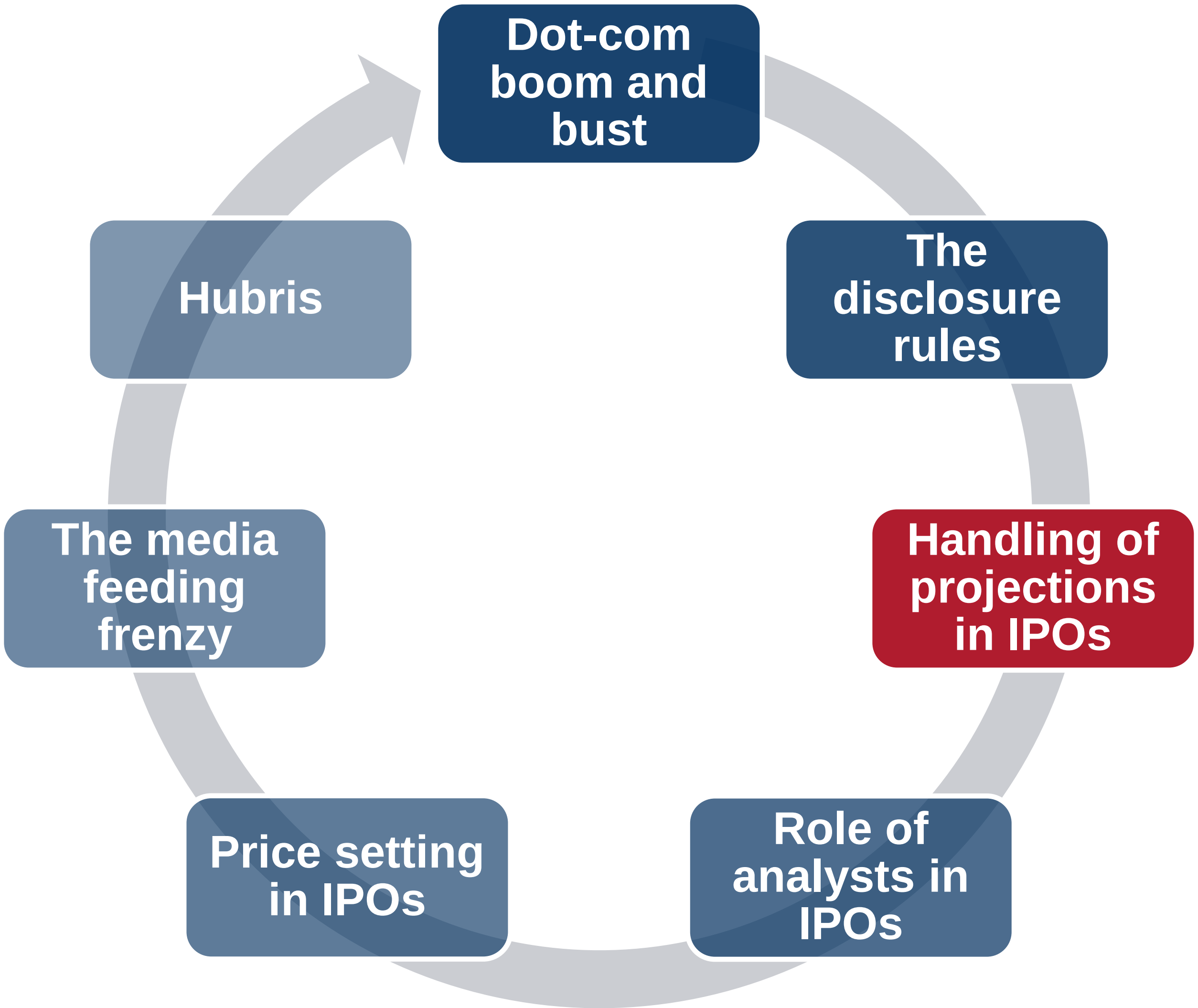
Growth Story

Customer Information

Liability Avoidance

Marketing

That's <u>what</u> happened. <u>Why</u> did it happen?



Why don't IPO prospectuses include projections?

Clear Rule: IPO prospectuses need not include projections, estimates or forecasts. Why not?

- Projections are based on many assumptions, uncertainties and predictions about facts, some outside the company's control
  - Distinguish from hard facts known to the company
  - Distinguish from obligation to disclose trends

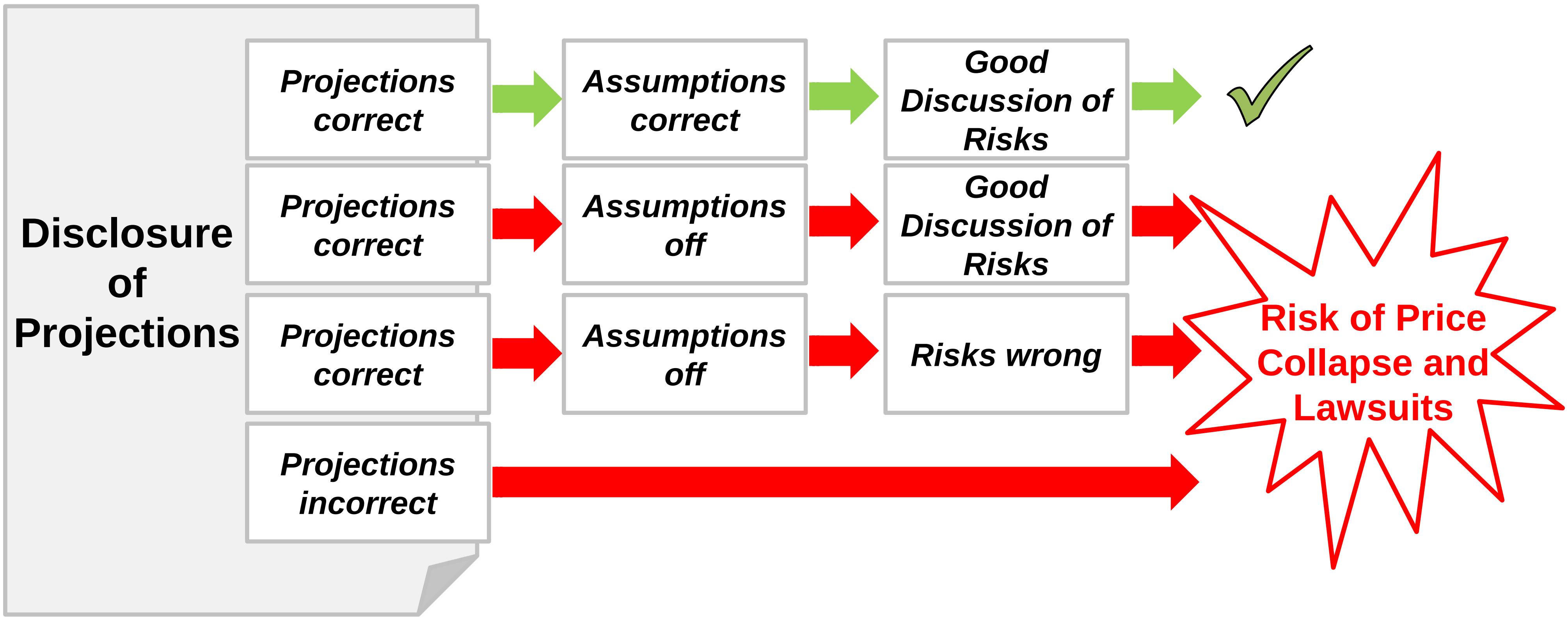
What if the projections are wrong?

- There's a risk of liability if projections etc. turn out to be incorrect
- Not to mention a share price decline, disappointed investors and loss of face
- Prospectus directive: Auditor attestation requirement for projections

"Projections are inherently speculative and unreliable"

Why aren't projections deemed "material"?

- Tension exists between disclosure of projections with the accompanying assumptions and discussion of the risks vs. a fear the assumptions are off and the risks identified turn out to be the wrong ones



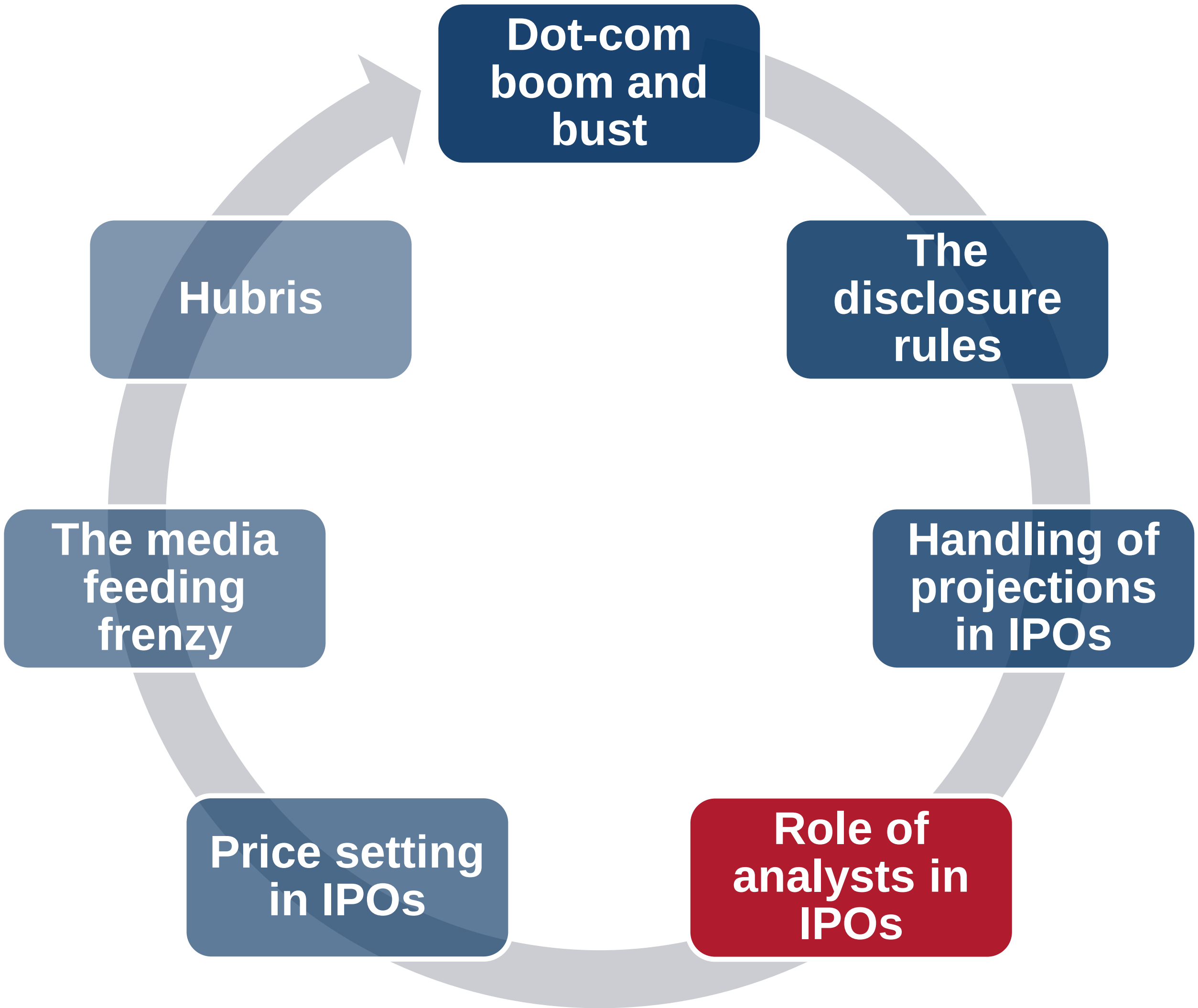
Why aren't projections deemed "material"?

As a result: It's very rare to put projections in IPO prospectuses

But: Institutional investors want to get projections from somewhere!

This is where the research analysts come in!

That's <u>what</u> happened. <u>Why</u> did it happen?



Role of Research Analysts in IPOs

- Any IPO company has (should have?) a business plan and financial expectations
- Investors want to know what's in the business plan, what the business plan means and whether the financial expectations are achievable
- But to disclose all this in the prospectus would expose management to liability risk if things turn out differently
- And it's hard to get fully comfortable with management's expectations without some more experienced (external) check

Research analysts talk to management, review management's business plan and projections, look at comparable companies and other factors and "build their own models" for the company's results going forward (and target share price)

But things changed after the dot.com crash, and are changing again

- Before that bubble burst, the research analysts worked directly with the deal teams
- Their research reports were integral parts of the selling effort and published pre-deal
- Underwriters for IPOs were chosen based on their analysts, and the analysts were pressured (and compensated) for bullishness
- An entertaining body of evidence came to light suggesting that junk companies were hyped up

The Research Industry Settlement

- Chinese walls between analysts and deal teams
- Syndicate analysts may not publish research until 40 days post IPO
- Other steps to consider to avoid or mitigate conflicts of interest

The U.S. JOBS Act of 2012

- For “emerging growth companies” (EGCs), immediate publication of research is again permitted
- Chinese walls now have some tunnels where ECGs are involved

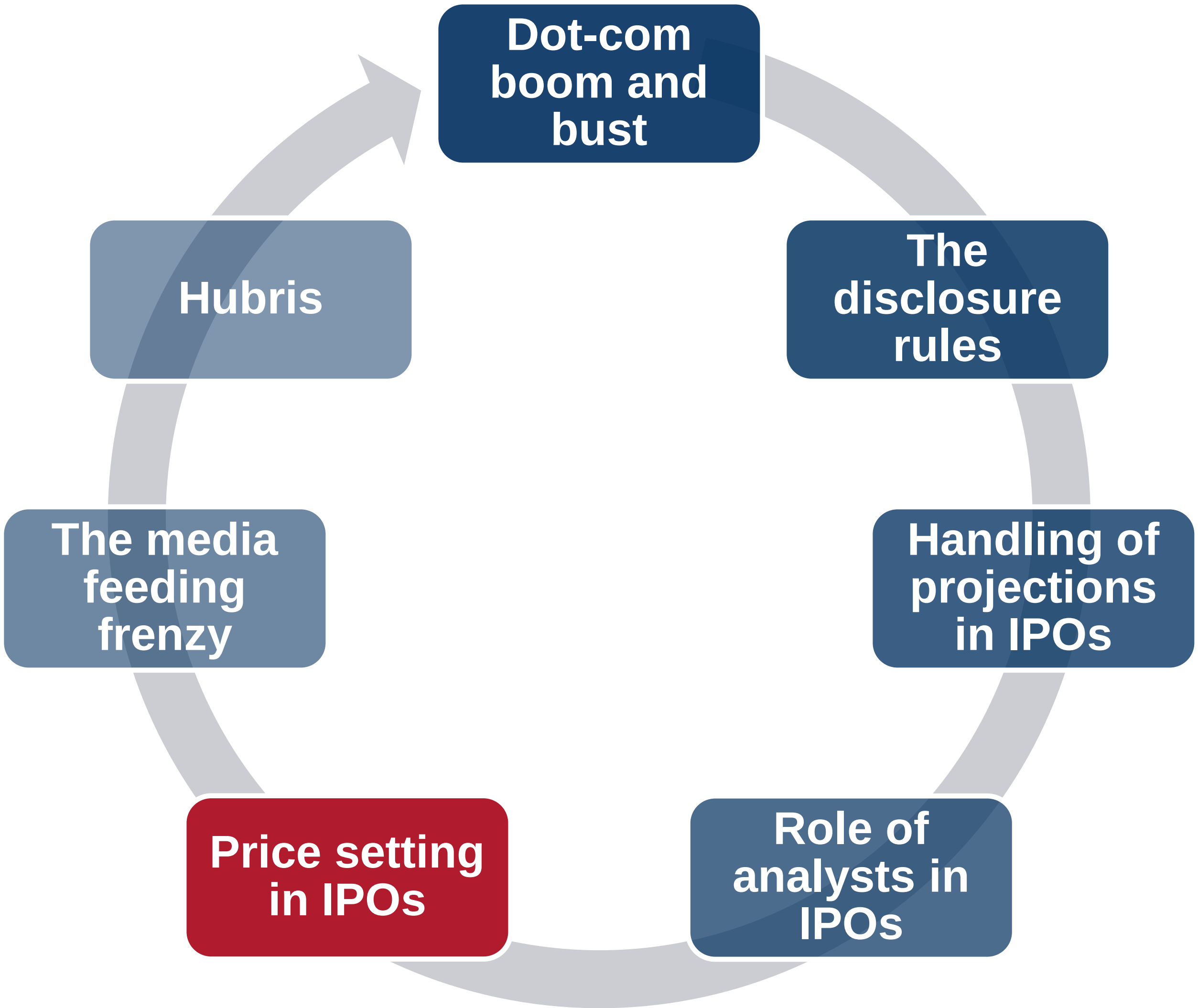
Now analysts communicate with institutional investors, not retail

- What research analysts are currently permitted to do during IPOs:
  - Meet with company management
  - Review the business plan and the company's own estimates/projections
  - Generate their "own" models with some help from management
  - Discuss their estimates confidentially with their customers (essentially, big institutions)

- This means that the big institutions <u>are</u> getting the projections
- In Europe, pre-deal research can be published but research goes to the analyst's customers, not the public, and the biggest investors will get the most attention
- In no case are retail investors getting the projections directly (possible their funds are, though)

> This is an application of the Law of Unintended Consequences:
>
> The research analyst settlement addressed over-hyping of IPOs. But no one anticipated that analysts would selectively communicate <u>bad</u> news pre-IPO!

That's what happened. Why did it happen?



Price-Setting in IPOs is not a fully transparent process

- Companies don't want just any old shareholders – so the process is to a great extent one-on-one

Retail vs. Institutional

Retail	Institutional
• Wider distribution • Liquidity • More likely to buy and hold?	• Sophisticated; badge of quality • Larger blocks of shares • Support in secondary market

Institutions v. Institutions

Pension funds, insurance companies	Hedge funds
• Buy and hold • Badge of quality • Maybe less activist	• Huge pots of cash to invest • May be quick to flip • Often more activist

Ideal is that the banks work hard to achieve the right mix of investors

The dynamics of the order book

Prices ranges and limits

Regional split

Institut-ional/ retail mix

Corner-stone investors

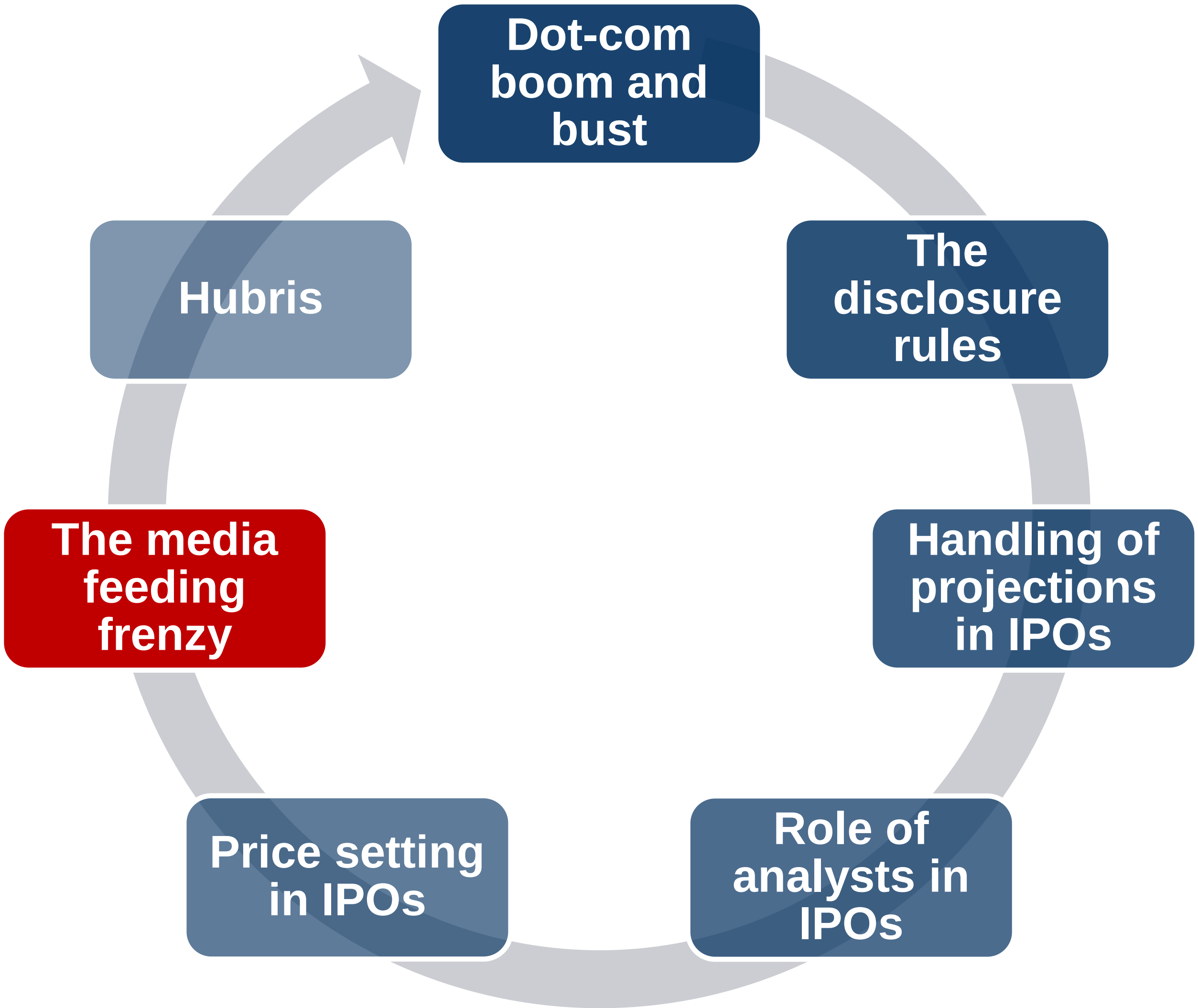
Pricing strategies

Address the ready cash

X-times over-sub-scription

- Desire for the right IPO "Pop"
  - Immediate profit for the banks' key accounts
  - Press attention
  - Management satisfaction, *i.e.* not <u>too</u> much cash left on the table
  - Ease of secondary market management: Price stability, no significant price decline

That's what happened. Why did it happen?



The Facebook frenzy made rationality impossible when bad news broke

- Faced with bad news late in the marketing process, many deals would have been delayed
- The frenzy made it very difficult to manage the overall valuation down
  - Would have been seen as a disaster for all participants
  - Careers to make or break at the investment banks
  - Rare to adjust downward due to company-internal factors: Delay would have been more likely; and delay can lead to abandonment

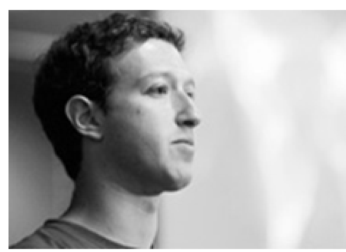
Then the frenetic trading took down Nasdaq

Why Everyone Wants a Piece of Facebook's IPO: Insights From Behavioral Economics

Posted by: Alexander Chernev on May 01, 2012 | 1 Comment

behavioral economics | Facebook | Facebook IPO | investors | IPO | Public Offering | Social Media | stocks

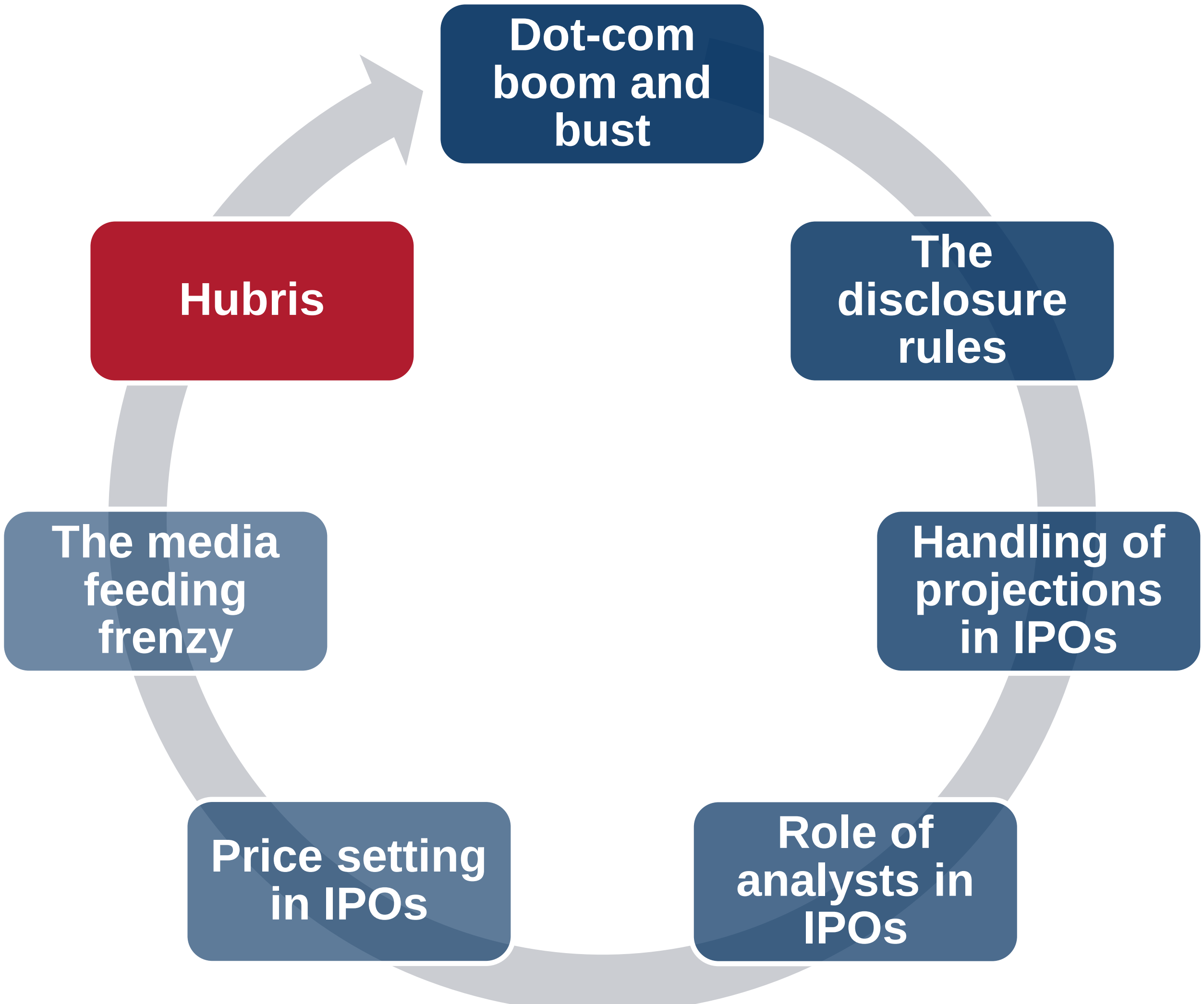
Related



What If Facebook Isn't So Special

Facebook's IPO is one of the most anticipated stock offerings of the year—maybe the decade. Everyone, from the novice to professional investor, seems to want to own a piece of the company. Of course, some of this is driven by the desire to turn a quick profit—not unusual for a high-tech IPO. What makes this offering stand out is the unprecedented interest among individual investors, many of whom lack the expertise to evaluate Facebook's true profit potential.

That's what happened. Why did it happen?



Hubris

Where do we go from here?

- Publish research pre-deal?
- Prohibit all research analyst involvement?
- Disclose all communication with analysts?
- Require projections in the prospectus?
- Curb liability risk for projections?
- Set prices only by auction?
- Force delay for new information?
- Make all syndicate research public (SEC file?)

Adopt a new approach to research?

Encourage more active engagement of research analysts in IPOs?

+ The analysts are professionals who can provide useful insights that can help price the deal "properly"
+ This was the case prior to the dot.com meltdown, until the industry settlement required Chinese walls between the analysts and the deal teams
+ The U.S. JOBS Act is an attempt to turn this back, if only for "emerging growth companies" (revenues to $1 billion), which excludes Facebook
+ Not every statement by an analyst is hype, as the Facebook case demonstrates

– The JOBS Act cannot change the terms of the settlement agreements or liability risk, so it is unclear how much will really change in practice
– There was a good reason for the settlement: The hype machine was in overdrive
– The analysts' reports still go only to those who pay for them (institutions – their and the banks' clients) and are not published to a retail investor who is using a discount brokerage

Publish research pre-deal?

Adopt a new approach to research?

Or: Take research analysts out of the IPO process altogether?

+ Truer to the US securities law ideal that the prospectus is the sole source of all material information about the IPO
+ There is no realistic possibility of resolving the conflicts of interests inherent in the analysts' role
+ Would foster equality of information among all participants in the IPO
+ Management needs to give trend analysis, forward-looking to some extent, in its disclosures in any event

– The information analysts provide must be important to investors – people are willing to pay for it and they clearly react to it
– Mandating a lesser quantum of useful information about IPOs hardly seems to promote market efficiency
– The efficiency of IPO pricing may suffer as a result of the suppressed information

Prohibit all research analyst involvement?

Adopt a new approach to research?

Or: Require companies to publish exactly what they provide orally or in writing to analysts?

+ This would leave it up to companies and their advisors how much, if anything, to provide to analysts and when in the process to provide it
+ Would represent a clear leveling of the playing field among all investors
+ Would preserve the role of the analyst in "vetting" management's plans and expectations

Make all syndicate research public (SEC file?)

Disclose all communication with analysts?

– Highly unlikely to work without meaningful litigation reform or other protection for the projections, in particular for underwriters
– Very difficult to draw the lines between information consistent with previously disclosed information and new information, potentially leading to more rather than less litigation
– Giving the projections more protection from liability may substantially dilute investor protection given the importance of this information to investment decisions

Adopt a new approach to issuers publishing their projections?

Require issuers to include information (including quantifications) on their business plans and expectations in the IPO prospectus?

- + Would ensure equality of information flow to all potential investors
- + Would make it easier to limit the role of research analysts
- + This information would then be covered by the securities law disclosure standards and the liability regime's protections for investors
- + Would lead to a useful balancing of the "hype" projections can contain with carefully considered and contextual disclosure on how future results could differ

- – Getting this information to a quality on which management is willing to assume prospectus liability is difficult – there are so many assumptions and variables
- – The necessary risk language and waffling may well eviscerate any real benefit
- – Management is often too optimistic – and the analysts (with their experience of many issuers) can be more realistic

Require projections in the prospectus?

Make some changes to the liability regime?

- + As long as the risk of liability for companies publishing their projections is as high as it is, managements are unlikely to step up to the inclusion of projections in prospectuses
- + The current liability regime values caution above all else, including to the exclusion of meaningful and contextual information on a company's own beliefs as to its prospects
- + If promotion of growth businesses and capital formation are goals, management needs to have less fear of a lawsuit just because it is optimistic

- – This is the core of the US Depression-era securities laws: Investors need protection from overoptimistic (recklessly or fraudulently so) companies and their promoters
- – The risk of liability may limit at least some unprepared businesses from coming to market on pure hype
- – The liability regime assists in leveling the playing field among retail investors, institutional investors and insiders

Curb liability risk for projections?

Change the way IPO prices are set?

Require an auction without regard to investor type?

- **+** Some IPOs are done this way already
- **+** Can be more transparent, but perhaps only if the current state of bids is available in real time
- **+** Possibly cheaper for issues as some of the "art" for which the investment banks charge is removed


NEW YORK POST
Page Six
LATE CITY FINAL
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20 BILLION
UNITED STATES OF AMERICA
20B
Facebook boss soaks Main St. for $20B in IPO
PAGES 4-5

- **–** Would not necessarily have prevented the Facebook debacle
- **–** There may be advantages in being able to select the investor base: greater stability
- **–** May actually increase the risk that hype leads to overpricing, followed by immediate flipping

Change the way IPO prices are set?

Slow down the pricing process if any new information develops?

- + Require leveling of playing field via equality of information for institutional and retail investors
- + Ensure information can be digested by the media before orders are made final

- – This is actually current law: You have to make a judgment call whether to delay while new information is digested
- – How to extend this to information that the company would not have published anyway? In Facebook, the disclosure was to some extent in the prospectus already
- – Delay may lead to the amplification of minor negative news and the abandonment of otherwise "good" deals

Force delay for new information?

What is likely to change?

Not much!

Here's my bet:

- While there will be some development on greater inclusion of analysts for emerging growth companies, the uncertainty concerning the continuing existence of the settlement and the litigation surrounding Facebook will dampen changes
- Throwing out the analysts is not realistic – they provide a service throughout the capital markets that is valued and paid for. Legislating them away would be hard
- Requiring companies to publish projections is highly unlikely to succeed because the risks of liability are simply too high
- Requiring publication of whatever is given to analysts could be an attractive middle ground – but this would be hard to implement given the interests of the analyst community and the banks, and the liability risks
- Meaningful changes to the liability regime are not likely – this has been a Holy Grail for decades

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