Pre-IPO and Late-Stage Investing (Venture Capital)

Interview preparation summary · VC track

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INT.VP.1.a · Going public

Assess a company's IPO readiness (audited accounts, internal controls, governance, reporting and forecasting predictability, equity story) and compare the main listing routes: traditional IPO, direct listing, SPAC merger and dual-track with a sale.

A venture-backed company is ready to list when it can behave like a public company before it becomes one. The usual tests are audited financial statements for the periods and to the accounting standard the chosen venue requires, internal controls over financial reporting that the auditors trust, a board with a real share of independent directors and working audit, remuneration and nomination committees, a finance function that can close the books quickly and report on a regular cadence, and a record of forecasting its own results within a narrow band. The last one matters because a listed company is judged every period against its own guidance. The equity story is the investment case in one account: the market, why the company wins, the path to profit and why it deserves its valuation against listed peers. The main routes are a traditional IPO (an underwritten offering that can raise new money, with a marketed price range and lock-ups), a direct listing (existing shares are listed for trading, usually without a new capital raise and often with fewer lock-ups, so price discovery is left to the market), a SPAC merger (a listed cash shell merges with the company, the price is negotiated, and cash is uncertain because holders can redeem) and a dual-track process, where an IPO and a sale are prepared in parallel so the board has a real alternative. The rules differ by market and are handled by counsel and the underwriters; an investor needs to know what the tests are and where a company falls short. The usual mistake is to treat readiness as a legal formality when it is really a test of management quality.

WORKED EXAMPLE: IS LARKFIELD FREIGHT READY TO LIST?

Larkfield Freight is an invented logistics software company considering an IPO in about nine months. Over the last five quarters it forecast revenue of 10.0m, 11.0m, 12.5m, 14.0m and 15.5m and delivered 10.2m, 10.4m, 12.6m, 12.6m and 15.4m. It has two years of audited accounts to a local standard where the venue wants three years to an international standard, a board of seven with two independent directors and no independent audit committee chair, and a month-end close of 28 days. Judge readiness. Convention: a miss of more than 5% in either direction counts as a miss, which is an illustrative threshold and not a rule.

Answer: Not yet ready: forecast accuracy (two misses in five quarters, mean absolute error about 3.8%), a missing audited period and standard, a slow close and no independent audit committee chair mean the IPO should wait or run alongside a sale process.

> **Interview tip:** Name the tests in a fixed order (accounts, controls, governance, reporting, forecasting, equity story) and then give your own measure, such as the forecast error. Say that the legal detail belongs to counsel and the underwriters; interviewers want to hear that you can judge management quality.

INT.VP.1.b · Going public

Walk through the IPO process (underwriters, price range and book-building, roadshow, pricing, greenshoe, quiet period, lock-ups) and calculate the IPO discount, first-day return, proceeds and the supply of shares around lock-up expiry.

In a traditional IPO the company appoints underwriters, who advise on structure and valuation, prepare the offering document with the company's advisers, test demand with institutional investors, and place the shares. A price range is set from the valuation work (public comparables and growth), the roadshow gathers indications of interest, and the book is built: demand at each price. The offer is priced when demand at the chosen price comfortably covers the shares on offer. Underwriters usually price at a discount to the fair value implied by peers, often put at around 10% to 15% in practice, so that demand is strong and the aftermarket is orderly. The first-day return is the first closing price over the offer price less one, and the money

left on the table is that gain times the shares the company sold. A greenshoe (over-allotment option) lets the underwriters sell up to about 15% more shares than the base offer, usually within about 30 days: if the price rises they exercise it and the company issues the shares, and if it falls they buy shares in the market to cover and support the price. A quiet period limits what the company and the banks can say publicly around the offer. Lock-ups stop existing holders selling for a set time, commonly three to six months, and their expiry can add supply and weigh on the price. Details differ by market and are for counsel and the underwriters. The usual mistake is to read a large first-day gain as success for the company rather than as a price paid for demand.

WORKED EXAMPLE: PRICING THE HAWTHORNE ROBOTICS IPO

Hawthorne Robotics is an invented industrial robotics company. The base offer is 30m shares: 20m new shares from the company and 10m sold by existing holders, in a range of 13.00 to 15.00. Comparable listed companies imply a fair value of 16.00 a share. The offer prices at 14.00 and the underwriters hold a 15% greenshoe on the base offer, which is exercised in full with new shares. The first day closes at 17.50. The underwriters' fee is 5% of gross proceeds. Work out the IPO discount, the company's proceeds and the money left on the table.

Answer: The IPO discount is 12.5%, the company raises 343m gross (about 325.9m after the underwriters' 5% fee), the first-day return is 25% and the money left on the table on the company's shares is 85.75m.

> **Interview tip:** Give the sequence (range, book, roadshow, pricing, greenshoe, lock-up) and then one calculation. Say that a first-day gain is a cost to the company as well as a sign of demand, and that lock-up expiry is the next date to watch.

INT.VP.2.a · Pre-IPO rounds

Explain who joins pre-IPO and crossover rounds and why, how IPO ratchets, minimum-price protection and qualified-IPO conversion work, and carry a round through an IPO to the pro forma cap table, dilution and free float.

A pre-IPO or crossover round is a late private round, often within a year of listing, led or joined by investors that also hold listed shares: mutual funds, hedge funds, sovereign and long-only funds. They get early access, a price below the expected IPO value and a view of the company before they decide how much to buy in the IPO. The company gets a price signal, a bigger and steadier book for the IPO, and cash. To win the round the company may offer structured protection. An IPO ratchet gives the investor extra shares if the IPO prices below a set level, for example enough shares to be worth 1.2 times the amount invested at the IPO price. A minimum-price or guaranteed-return term works in a similar way, and other forms are a conversion discount to the IPO price, a senior preference until a listing, or a right to redeem if there is no IPO by a date. The cost falls on the other holders, who are diluted most when the IPO prices low. Preferred shares normally convert to ordinary shares automatically on a qualified IPO, one that meets a minimum price and size; if the IPO is below the test, conversion needs the preferred holders' agreement, which gives them leverage. When converted, liquidation preferences fall away. The cap table after the IPO is the pre-IPO fully diluted share count plus any ratchet shares plus new primary shares; shares sold by existing holders do not change the total. Free float is the part of the shares freely tradable. Terms vary and the documents are for counsel. The usual mistake is to treat the ratchet as free protection when it can lower the IPO price.

WORKED EXAMPLE: RATCHET AND PRO FORMA OWNERSHIP AT DUNMOOR GRID

Dunmoor Grid is an invented grid software company. A crossover fund invests 40m at 16.00 a share, so 2.5m shares. The round carries an IPO ratchet: at the IPO price the fund's shares must be worth at least 1.2 times the 40m invested, with any top-up issued by the company. The pre-IPO fully diluted count is 100m shares including the fund's. The IPO sells 20m new shares and 5m existing shares at 17.60. A qualified IPO needs a price of at least 16.00 and gross primary proceeds of at least 100m. Convention: the ratchet shares are issued at the IPO without changing the offer price, and the greenshoe is ignored.

Answer: The IPO is qualified so the preferred converts; the ratchet adds 0.2273m shares (taking the fund to 48m of value), the fund owns about 2.27% and the free float is about 20.8%.

> **Interview tip:** Say who is in the round and why, then show that a ratchet is a transfer from other holders that bites exactly when the IPO is weak. Mention conversion and the end of liquidation preferences, and leave the document detail to counsel.

INT.VP.2.b · Pre-IPO rounds

Value a pre-IPO company from listed peers using an enterprise value multiple, a growth-adjusted cross-check, an IPO or illiquidity discount and the equity bridge, and say how a change in market conditions moves the price.

A pre-IPO company is valued by asking what the public market would pay for it on the day it lists, and then deciding what to pay now. Start with a set of listed peers and their enterprise value to forward revenue (or another metric that suits the sector, such as earnings or gross profit). Use the median and look at the spread. Multiples rise with growth, so a growth-adjusted multiple, the multiple divided by expected growth in percentage points, is a cross-check, but extending it to a company that grows faster than every peer overstates value because growth fades and carries more risk. Apply the multiple to the company's forward revenue to get enterprise value, add net cash (including any new money to be raised) to reach equity value, and then apply a discount, because a newly listed company is priced to attract buyers and a pre-IPO holder faces illiquidity and the risk that the IPO does not happen. The discount is judgement and is often put in the range of 10% to 20%. The price per share is equity value over the fully diluted share count before new shares. Market conditions feed straight through: the window is open when peers' multiples are high and listings are being absorbed, and a fall of 20% in the peer multiple takes about that much off enterprise value and rather less off equity value if the company holds a good deal of net cash. A price set at a market peak should be tested at a lower, mid-cycle multiple. The usual mistake is to use the last private round as the anchor when the listed market has moved.

WORKED EXAMPLE: VALUING TALLOWMERE CLOUD FROM ITS PEERS

Tallowmere Cloud is an invented software company with forward revenue of 150m growing at 40%, and 90m of net cash. Four listed peers trade at enterprise value to forward revenue multiples of 6.0, 8.0, 9.0 and 10.0 times, with expected growth of 20%, 25%, 30% and 32% respectively. Apply a 15% discount to equity value. Value the company, and say what happens if peer multiples fall by 20%. Convention: use medians, and take the midpoint of the plain and growth-adjusted multiples as the working multiple.

Answer: About 1,399m of pre-money equity value (a range of roughly 1,160m on the plain median to 1,638m on the growth-adjusted view), falling about 19% if peer multiples fall 20%.

> **Interview tip:** State the method in order (peers, multiple, enterprise value, net cash, discount, per share) and give a range, not a point. Say what you would do if the window moved: re-run at a lower peer multiple before agreeing a price.

INT.VP.3.a · Returns and liquidity

Calculate the return on a pre-IPO entry (entry price against the expected IPO price, money multiple and IRR over the hold including the lock-up), test the downside if the IPO prices low or the window closes, and show what a ratchet does and does not protect.

The money multiple (MOIC) on a pre-IPO purchase is the price at which the investor can sell divided by the entry price per share, so compare prices per share, not valuations, because new shares at the IPO dilute the valuation comparison. Convert the multiple to an annual rate (IRR) with the multiple raised to one over the years held, less one, and count the whole hold: the time to the IPO plus the lock-up, usually three to six months more. The same multiple earned over a longer hold gives a much lower IRR, which is why a delayed IPO hurts even if the price is eventually reached. The downside has three parts. The IPO can price below the entry price. The shares can fall after the IPO and before the lock-up ends, and the two falls compound, so a 15% fall followed by a 10% fall is a 23.5% loss and not 25%. And the window can close, delaying the IPO or cancelling it, which leaves the investor in an illiquid private holding with its preference rights and any redemption term as the only protection. A ratchet or minimum-price term changes the multiple at the IPO price, since the investor gets extra shares to reach the guaranteed value, but it does not protect against a fall after the IPO, it does not shorten the hold, and it depends on the company being able to issue the shares. The usual mistake is to quote a multiple without the years or to assume protection that stops at the IPO price lasts through the lock-up.

WORKED EXAMPLE: PRE-IPO RETURNS AT KELVANE SYSTEMS

A fund buys 2.0m shares of Kelvane Systems, an invented company, at 12.00 (24m invested) in a pre-IPO round that carries a ratchet: at the IPO price the shares must be worth at least 1.15 times the cost. The fund expects to sell at the IPO price at lock-up expiry, 1.0 year after entry plus 0.5 year of lock-up, so 1.5 years in all. Compare three cases: the IPO prices at 16.80; the IPO prices at 13.00; and the window closes and the IPO at 13.00 happens only 2.5 years after entry, so the hold is 3.0 years. Assume the price at lock-up expiry equals the IPO price.

Answer: Strong case 1.40 times and an IRR of about 25%; base case with the ratchet 1.15 times and about 9.8% (about 5.5% without it); delayed IPO 1.15 times and about 4.8%.

> **Interview tip:** Always give the multiple and the years together. Show the ratchet as a floor on the multiple at the IPO price and then name what it leaves exposed: the aftermarket, the lock-up and the delay.

INT.VP.3.b · Returns and liquidity

Explain secondary sales, tender offers and employee liquidity, decide how to exit a newly listed holding (hold through the lock-up, sell down against trading volume, or distribute in kind), and answer the behavioural questions on late-stage investing, including a down-round IPO.

Late-stage companies stay private longer, so liquidity has moved into the private market. A tender offer is an offer by the company or an outside buyer to purchase shares from employees and early holders at a stated price during a window, and if it is oversubscribed each seller is scaled back pro rata. A secondary sale transfers existing shares between holders; it normally needs company consent and usually meets transfer restrictions and rights of first refusal, and common shares often trade at a discount to the last preferred round because they rank behind preferred and lack its protections. Employee liquidity retains staff and lowers the pressure to list at any price. The rules, including tax and securities rules, are for counsel. After the IPO the investor decides what to do at lock-up expiry. Holding keeps exposure to the company but adds concentration, and selling is limited by liquidity: days to sell equal the position divided by the daily volume the investor is willing to be, usually a fraction of average daily volume. A fund can also distribute shares in kind to its limited partners (LPs) in proportion to their interests, which returns the asset and leaves each LP to decide. Selling in stages and distributing part is a common compromise. The behavioural questions test judgement: why late-stage (shorter hold, lower risk of failure, larger cheques, and skills in public valuation), one company you would back and one you would pass on, with reasons, and how you handle an IPO that prices below the last round, by separating the price from the business and re-underwriting the return. The usual mistake is to hold on until the price recovers to cost.

WORKED EXAMPLE: LOCK-UP EXPIRY AT OSTRANDER DEVICES

A fund holds 1.5m shares in Ostrander Devices, an invented company, bought at 9.00 and now trading at 14.00 as the lock-up expires. Average daily volume is 600,000 shares and the fund limits its selling to 20% of daily volume. The fund wants to sell 60% of the holding (0.9m shares) and distribute the other 40% (0.6m shares) in kind. One LP owns 5% of the fund. Work out the value and multiple, the days needed to sell and the LP's distribution.

Answer: The position is worth 21.0m (1.56 times cost); selling 0.9m shares takes 8 trading days at 20% of volume (12.6m), and an LP with 5% of the fund receives 30,000 shares from the 0.6m distributed.

> **Interview tip:** Anchor on liquidity: how many days does it take, and what does the plan do to the price? Then give the choice (hold, sell down, distribute) and the reason, and say what you would tell the LPs.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.